

Target price increase

February 13, 2019

Altynay Ibraimova

a.ibraimova@halykfinance.kz

Ticker	LKOH RM
Recommendation	BUY
Current price, ₸/share	5 420
12M target price, ₸/share	6 792
Upside	25%
Expected dividend, RUB/share	246
Expected dividend yield	5%

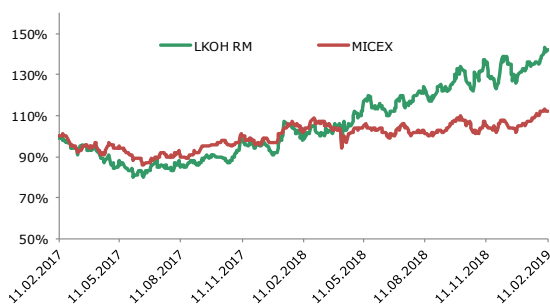
Ticker	LKOD LI
Recommendation	BUY
Current price, \$/share	82.00
12M target price, \$/share	103.46
Upside/Downside	26%
Expected dividend, RUB/GDR	3.7
Expected dividend yield	5%
No. of ordinary shares (mn)	750
Free float (%)	63.4%
3M av. daily turnover (P ths)	845
Market capitalisation (P bn)	4 065

Financials (P bn)	2017A	2018E	2019F
Revenues	5 937	7 990	7 325
EBITDA	832	1 125	926
Net profit	420	614	487
EPS, ₸	631	1 291	1 023
Equity	3 490	3 921	4 213
Net debt	266	218	-5

Valuation	2017A	2018E	2019F
Net Debt/EBITDA (x)	0.32	0.19	-0.01
Debt/Equity	0.18	0.16	0.11
EV/Sales (x)	n/a	0.54	0.55
EV/EBITDA (x)	n/a	3.81	4.38
P/E (x)	n/a	4.20	5.30

LKOH RM price dynamic	Abs.	Relative MICEX
1M	4.2%	n/a
3M	9.3%	n/a
6M	22.4%	11.7%
Max 52 week	5 489	
Min 52 week	3 533	

LKOD LI price dynamic	Abs.	Relative FTSE 100
1M	5.9%	2.9%
3M	12.0%	10.9%
6M	26.7%	31.6%
Max 52 week	83.28	
Min 52 week	58.60	



Source: Company data, Bloomberg, Halyk Finance forecast

Despite the achievement of historic highs by Lukoil shares, justifying our Buy recommendation, we continue to expect further strengthening of LKOH positions. We condition our optimism with the expected strong results for 2018, in response to which it is likely that high dividends will be announced and that shares will continue to be repurchased as part of the buyback in order to increase the shareholder value of the company. In addition to short-term growth drivers, we are positive in terms of the stability of cash flows generated by the company even under adverse conditions for oil companies. Actualizing our calculations for the operational results of 2018, we increase our 12M TP from 5,296rub/share to 6,792rub/share and recommend to Buy Lukoil shares.

Buyback continues – dividends are rising. In addition to 95rub/share, paid to Lukoil as a dividend for 9M2018, we expect that for the rest of 2018 the company will pay 151rub/share. In addition to the growth of net profit, from which, according to our expectations, about 30% will be paid, due to the reduction in the number of shares from 850.6mn units to 750mn units, we expect the total dividend for 2018 to be 246 rub/share. We note dividends as a short-term growth factor for stocks, while maintaining optimism about further dividend growth due to the ongoing buyback program (until 2022).

Sales will increase due to higher export prices. We calculated our forecasts for 2018 based on the average oil price of \$69/bbl, while the actual price for 2018 was slightly higher - \$71.69/bbl (+ 32% yoy), which also gives reason to expect stronger results on the basis of 2018, given the relatively successful operating performance of the company. In the long term, we expect revenues in the range of 7,641bn-8,090bn rubles, which exceeds our previous estimate of 6,531- 7,551bn rubles. A more positive approach to forecasting is based on strengthening our expectations for the Upstream segment, where for 9M2018 we see a rather strong increase in EBITDA by 72% yoy, caused by an increase in profit in Russia by 67% yoy. In addition, we see progress in the export sales of petroleum products, revenues from which in the 9M2018 increased by 29% yoy due to a rise in prices by 38% yoy.

Buy recommendation with 12M TP 6792 rub/share. The decrease in capital expenditure projections by an average of 26% and a more optimistic approach to forecasting revenues are reflected in the increase in the target price from the previous 5296rub/share to 6,792rub/share. Increasing the discount rate from 15.4% to 16.5%. It was compensated by a decrease in the number of shares from 850.6mn to 750mn. Despite the historical maximum value of Lukoil's shares of 5467rubles/share, we recommend to "Buy", noting cash flow stability, high probability of improving dividend attractiveness and sufficiency of projects with strong returns.

Fig. 1. Profit for 9M2018

RUB bn	9M2017	9M2018	yoy
Revenue	4 274	5 993	40%
Operating expenses	-339	-345	2%
Cost of purchased oil	-2 227	-3 403	53%
Transportation costs	-204	-205	0.5%
Administrative expenses	-118	-142	20%
Depreciation and amortization	-249	-291	17%
Oil taxes	-435	-649	49%
Excise and export duties	-342	-410	20%
Exploration costs	-2	-2	-
Operating profit	358	546	53%
Financial income	10	13	30%
Financial expenses	-22	-26	18%
The share of profits in JV and assoc.	12	18	50%
Exchange difference	-25	32	-
Other (expenses) income	45	-11	-
Profit before income tax	378	572	51%
Income tax	-78	-111	42%
Net profit	300	461	54%

Source: Company Data

Fig. 2. Operational indicators

	unit	2017	2018	yoy
Production of				
hydrocarbons	ths boepd	2 235	2 319	3.8%
crude oil	ths tons	85 592	85 610	0.0%
gas	mn cube m	28 861	33 543	16.2%
Oil refining	ths tons	67 240	67 316	0.1%

Source: Company Data

Operating results for 2018

In 2018 average daily hydrocarbon production increased by 4% yoy to 2.3mn boepd.

Oil production in 2018 amounted to 85.6mn tons, which almost coincides with the level of 2017 (85.59mn tons). There is a slight increase in oil production in Russia (+ 0.2%) and in subsidiary projects (+ 0.5%), offset by lower production abroad (-4%).

Oil production levels are stable due to the ongoing development of projects. In particular, 15% of production comes from projects at the Filanovskoye deposit, where in 4Q2018 the fifth well was put into operation, and production increased by 32% yoy; in the Yaregskoye field high-viscosity oil production increased by 25% yoy and in the Pyakyakhinskoye field oil and gas condensate production increased by 4% yoy.

Gas production for 2018 showed an increase of 16% yoy to 33.5bn cub. m. Due to the launch of new gas treatment facilities, Kandym and Gissar projects in Uzbekistan continue to be the main catalyst for gas production growth - growth in these projects amounted to 67% yoy.

Refining volumes of crude oil stagnate, not showing for 2018 changes - 67.3mn tons.

At the end of 2018, we observe a stronger increase in gas production compared to our expectations due to the successful launch of capacity at the Kandym and Gissar projects in Uzbekistan, in which Lukoil has been operating since April 2018. under the terms of the PSA. Despite the impressive growth in gas production, we note a slight weight of revenue from gas sales in the amount of 2% in 9M2018.

A significant share in oil production is occupied by Russian projects - 94%. Western Siberia remains the main region of production in Russia, accounting for 44% of the total Russian oil production in 9M2018 (9M2017 - 46.1%). We expect a slight increase in production in Russian projects by an average of 2% annually.

Dividends

Following the 9M2018 results, Lukoil paid an interim dividend in the amount of 95 rub/share.

As part of the buyback program from September 3, 2018 to December 30, 2022, up to \$3bn today were repurchased 10.4mn registered uncertified shares (1.39%) and 4.4mn ADR (0.59%). Due to the decrease in the number of shares, we recalculated the dividend forecast.

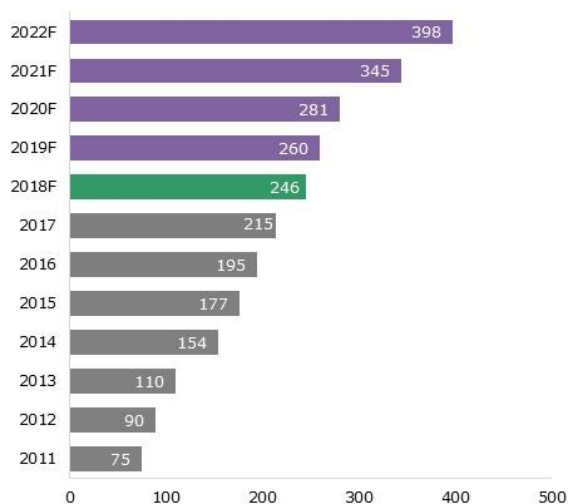
Taking into account the updated estimate of net profit and reducing the payout ratio from 40% to 30% of net profit, we expect a dividend of 246rub/share for the 2018, which is 35% higher than our previous forecasts. Dividend yield to the current price is 5%. In the future, due to the ongoing buyback program, we expect a more substantial increase in the dividend per share.

Capital expenditures

Based on the company's stated plans, we previously laid down more aggressive capital expenditures, focusing on about 550-600bn rubles in the next five years, which will be directed mainly at drilling new wells to maintain production levels at the optimal level. However,

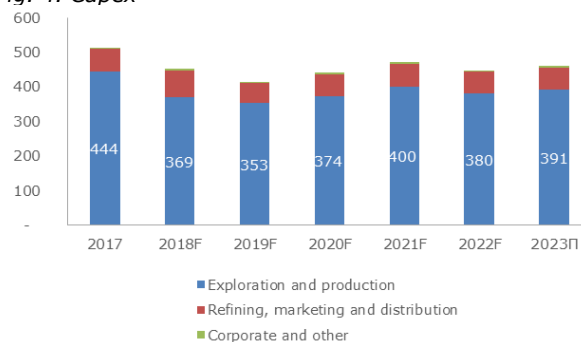
following the 9M2018 results we observe a decrease in capital expenditures by 10% yoy to 338bn rubles, caused by lower capital costs for exploration and production (-17% yoy) and offset

Fig. 3. Dividends, rub/share



Source: Lukoil data, HF forecasts

Fig. 4. Capex



Source: Lukoil data, HF forecasts

by an increase in costs for the downstream segment (+ 53% yoy). Capex's exploration and production decline is associated with lower spending in Uzbekistan after the completion of the main part of the development of the Gissar and Kandym fields.

Capital expenditures in 4Q2018 It is unlikely that it will reach the level of 539bn rubles pledged by us earlier with 338bn rubles already spent in 9M2018. We positively estimate a more modest development of the company's capital compared to our expectations and lower our Capex forecast.

At the end of 2018 we expect capital expenditures in the amount of 451bn rubles. We are building Capex growth to 460bn rubles by 2023, expecting further development of the recently operating fields in the Caspian. In comparison with the previous Capex estimate, our forecasts look more conservative:

RUB bn	2019F	2020F	2021F	2022F	2023П
Capex	415	440	471	447	460
earlier	580	609	627	639	658
Change	-28%	-28%	-25%	-30%	-30%

Oil prices

The average price of Brent crude for 2018 was at the level of \$71.69/bbl (+ 32% yoy), while from September to December the price of oil fell steadily, fixing annual extremes at \$85-50/bbl. The decline in prices at the end of 2018 mainly reflected the growth in oil reserves as a result of record levels of production in the United States, Russia and Saudi Arabia. Prices also fell as a result of uncertainty about global economic performance and future growth in oil demand, ignoring OPEC+ decision to reduce production from January 2019. The market is still unsure of the sufficiency of the announced reductions given the rising levels of production in North America along with with the possibility of weakening growth in global oil demand, which could lead to an increase in world oil reserves.

Our calculations for 2018 were based on an average oil price of \$69/bbl. Bloomberg's current consensus outlook for oil prices is higher than the levels we have set:

\$/bbl	2018	2019F	2020F	2021F	2022F	2023П
Before revision	69	68	69	68	65	65
After revision	72	66	69	73	65	65
Change	4%	-3%	0%	7%	0%	0%

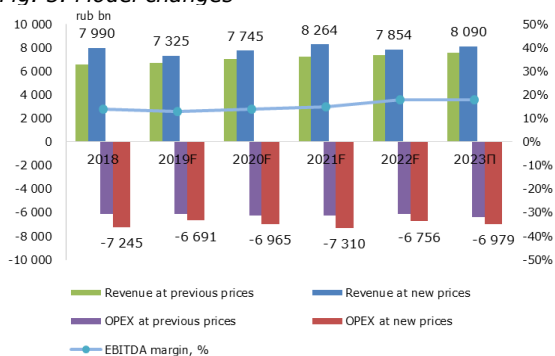
Sales will increase due to higher export prices

Following the 2018 results, we expect oil revenues in the amount of 1,940bn rubles with a further reduction to 1826-1832bn rubles in 2019-2023. We proceed from the sale of 87% of the volume of oil produced and note rather strong support from the increase in physical sales volumes, which, coupled with the stable dynamics of selling prices, shifts expectations for incomes above the previous ones.

According to our forecasts, physical sales of petroleum products will grow on average by 4% per year until 2023, while in monetary terms, growth rates will be higher (on average 7%) due to higher average selling prices in the foreign market.

We are also optimistic about export sales of gas, expecting an increase of 16% on average, which is partially offset by a decrease in domestic sales of 2% and revenues from gas sales in 2019-2023 will increase by an average of 10%. We are laying growth in sales of petrochemical products, comparable to the dynamics of sales of petroleum products.

In general, our income expectations imply that the company's revenue will be in the range of 7641bn-8090bn rubles in 2018-

Fig. 5. Model changes


Source: HF forecasts

2023, which exceeds our previous estimate of 6531-7551bn rubles. A more positive approach to forecasting is based on strengthening our expectations for the Upstream segment, where for 9M2018 we see a rather strong increase in EBITDA by 72% yoy, caused by an increase in profit in Russia by 67% yoy. In addition, we see progress in the export sales of petroleum products, whose revenues in the first 9M2018 increased by 29% yoy due to a rise in prices by 38% yoy.

12M target price calculation

When calculating the target price, taking into account the new oil price forecasts and adjusted sales forecasts, we also updated the WACC calculation parameters. We have updated the risk-free rate (8.3% vs 7.14%), Beta value (1.003 vs 1.076) and market risk premium (9.8% vs 9.0%). The WACC value increased from the previous 15.2% to 16.5%. At the same time, the effect of a high discount rate is leveled by a reduction in the number of shares in connection with the repurchase. Our new 12M target price is 6792 rub/share. Despite the historical achievement of the value of Lukoil's shares at a maximum of 5467 rubles/share, we recommend to Buy Lukoil shares, noting the cash flow stability, the high probability of improving dividend attractiveness and the sufficiency of projects with strong returns.

Fig. 6. Changes in the model

RUB bn	2019F	2020F	2021F	2022F	2023F
EBIT	634	781	954	1 098	1 111
+ Depreciation, depletion and amortisa	291	302	313	323	332
- Capex	415	440	471	447	460
- Change in working capital	-41	83	35	-21	15
- Income tax expense	129	160	196	227	229
FCF	422	399	565	769	739
DCF	380	279	339	461	444
WACC	16.5%				
First stage DCF	1 903				
Terminal value	5 641				
PV терминальная стоимость	3 385				
Joint ventures' dividends	24				
Enterprise value	5 312				
Net debt	218				
Equity value	5 094				
Number of common shares (mn)	750				
Fair value, RUB/share	6 792				
Current price, RUB/share	5 420				
Potential upside (downside)	25%				
Rating	BUY				

Source: HF Calculations

Appendix 1. Forecast of financial statements

RUB bn	2017	2018F	2019F	2020F	2021F	2022F	2023F
P&L							
Revenues	5 936 705	7 990 229	7 325 036	7 745 295	8 264 052	7 854 472	8 090 303
Operating expenses	-456 765	-443 328	-441 194	-458 843	-479 155	-469 530	-480 907
Cost of purchased crude oil, gas and products	-3 129 864	-4 537 088	-4 219 492	-4 388 272	-4 607 686	-4 146 917	-4 312 794
Transportation expenses	-272 792	-273 181	-286 840	-298 314	-310 247	-322 657	-335 563
Selling, general and administrative expenses	-165 331	-189 239	-198 701	-206 649	-214 915	-223 512	-232 452
Depreciation, depletion and amortisation	-325 054	-380 313	-291 149	-301 557	-313 391	-322 752	-332 394
Taxes other than income taxes	-606 510	-865 568	-804 978	-837 177	-879 036	-791 132	-791 132
Excise and export tariffs	-461 525	-547 144	-439 502	-464 718	-495 843	-471 268	-485 418
Exploration expenses	-12 348	-9 384	-8 727	-9 076	-9 530	-8 577	-8 577
EBIT	506 516	744 984	634 453	780 689	954 249	1 098 127	1 111 066
Finance income	15 151	17 902	19 310	18 733	19 618	19 854	19 782
Finance costs	-27 331	-35 290	-46 842	-44 785	-46 095	-46 749	-49 369
Equity share in income of affiliates	16 864	24 241	24 241	24 241	24 241	24 241	24 241
Foreign exchange gain	-19 948	32 177					
Other expenses	32 932	-15 921	-14 647	-15 526	-16 613	-15 782	-16 255
Profit before income taxes	524 184	768 093	616 515	763 352	935 400	1 079 691	1 089 465
Current income taxes	-99 976	-153 619	-129 468	-160 304	-196 434	-226 735	-228 788
Deferred income taxes	-3 786						
Total income tax expense	-103 762	-153 619	-129 468	-160 304	-196 434	-226 735	-228 788
Profit for the year	420 422	614 474	487 047	603 048	738 966	852 956	860 677
EPS, rub	560.6	819.3	649.4	804.1	985.3	1 137.3	1 147.6

RUB bn	2017	2018F	2019F	2020F	2021F	2022F	2023F
Balance Sheet							
ASSETS							
Cash and cash equivalents	330 390	399 511	366 252	387 265	400 000	392 724	400 000
Accounts receivable net	418 272	602 879	552 689	584 398	623 540	592 636	610 430
Other current financial assets	19 561	0	112 696	188 421	452 925	887 232	1 193 527
Inventories	398 186	470 201	438 317	512 781	538 436	495 122	511 534
Other taxes receivable	87 338	135 724	124 425	131 564	140 376	133 418	137 424
Other current assets	54 367	79 902	73 250	77 453	82 641	78 545	80 903
Total current assets	1 308 114	1 688 217	1 667 629	1 881 882	2 237 918	2 579 677	2 933 818
Property plant and equipment	3 575 165	3 744 346	3 868 130	4 006 402	4 163 628	4 287 964	4 416 071
Investments in associates and joint ventures	164 286	164 286	164 286	164 286	164 286	164 286	164 286
Other non-current financial assets	79 717	79 717	79 717	79 717	79 717	79 717	79 717
Deferred income tax assets	25 128	25 128	25 128	25 128	25 128	25 128	25 128
Goodwill and other intangible assets	41 304	41 304	41 304	41 304	41 304	41 304	41 304
Other non-current assets	32 501	32 501	32 501	32 501	32 501	32 501	32 501
Total non-current assets	3 918 101	4 087 282	4 211 066	4 349 338	4 506 564	4 630 900	4 759 007
TOTAL ASSETS	5 226 215	5 775 499	5 878 695	6 231 220	6 744 482	7 210 577	7 692 825
LIABILITIES AND EQUITY							
Current liabilities							
Accounts payable	559 977	678 218	632 229	658 273	691 207	635 604	656 672
Short-term borrowings and current portion of long-term debt	128 713	103 802					
Other taxes payable	118 484	118 484	118 484	118 484	118 484	118 484	118 484
Provisions	58 253	58 253	58 253	58 253	58 253	58 253	58 253
Other current liabilities	93 420	93 420	93 420	93 420	93 420	93 420	93 420
Total current liabilities	958 847	1 052 177	902 386	928 430	961 364	905 761	926 829
Long-term debt	487 647	513 469	474 228	408 728	408 728	376 005	277 744
Deferred income tax liabilities	237 980	237 980	237 980	237 980	237 980	237 980	237 980
Provisions	47 962	47 962	47 962	47 962	47 962	47 962	47 962
Other non-current liabilities	3 380	3 380	3 380	3 380	3 380	3 380	3 380
Total non-current liabilities	776 969	802 791	763 550	698 050	698 050	665 327	567 066
Total liabilities	1 735 816	1 854 968	1 665 936	1 626 480	1 659 414	1 571 088	1 493 895
Equity							
Share capital	1 151	1 151	1 151	1 151	1 151	1 151	1 151
Treasury shares	-251 089	-251 089	-251 089	-251 089	-251 089	-251 089	-251 089
Equity-linked notes							
Additional paid-in capital	129 641	129 641	129 641	129 641	129 641	129 641	129 641
Other reserves	27 090	27 090	27 090	27 090	27 090	27 090	27 090
Retained earnings	3 576 158	4 006 290	4 298 518	4 690 499	5 170 827	5 725 248	6 284 688
Total equity attributable to PJSC LUKOIL shareholders	3 482 951	3 913 083	4 205 311	4 597 292	5 077 620	5 632 041	6 191 482
Non-controlling interests	7 448	7 448	7 448	7 448	7 448	7 448	7 448
Total equity	3 490 399	3 920 531	4 212 759	4 604 740	5 085 068	5 639 489	6 198 930
TOTAL LIABILITIES AND EQUITY	5 226 215	5 775 499	5 878 695	6 231 220	6 744 482	7 210 577	7 692 825

RUB bn	2017	2018F	2019F	2020F	2021F	2022F	2023F
Cash Flow Statement							
Cash flow from operations	758 490	703 566	719 536	737 409	741 990	771 068	867 273
Cash flow from investing activities	-433 286	-451 014	-414 933	-439 829	-470 617	-447 086	-460 499
Cash flow from financing activities	-247 395	-183 431	-337 862	-276 567	-258 638	-331 258	-399 498
Net change in cash	69 023	69 121	-33 259	21 013	12 735	-7 276	7 276
Cash at YE	330 390	399 511	366 252	387 265	400 000	392 724	400 000

Source: Company Data, Halyk Finance Forecasts

© 2019 Halyk Finance, a subsidiary of Halyk Bank.

For contact details see the information on Halyk Finance website www.halykfinance.kz or contact Halyk Finance office. All rights reserved. This document and/or information has been prepared by and, except as otherwise specified herein, is communicated by Halyk Finance. This document is for information purposes only. Opinions and views expressed in this document do not necessarily represent the opinions and views held by Halyk Finance, or other subsidiaries of Halyk Bank. The differences of opinion stem from different assumptions, sources information, criteria and methodology of valuation. Information and opinions expressed herein are subject to change without notice; and neither Halyk Finance, or Halyk Bank, or any of its subsidiaries or affiliates are under any obligation to keep them current. This document is not an offer or an invitation to engage in investment activity. It cannot be relied upon as a representation that any particular transaction necessarily could have been or can be effected at the stated price. This document does not constitute an advertisement or an offer of securities, or related financial instruments. Descriptions of any company or companies or their securities or the markets or developments mentioned herein are not intended to be complete. Views and opinions expressed in this document cannot substitute for the exercise of own judgment and do not attempt to meet the specific investment objectives, financial situation or particular needs of any specific investor. The information and opinions herein have been arrived at based on information obtained from sources believed to be reliable and in good faith. Such sources have not been independently verified; information is provided on the basis and no representation or warranty, either expressed or implied, is provided in relation to the accuracy, completeness, reliability, merchantability or fitness for a particular purpose of such information and opinions, except with respect to information concerning Halyk Finance and its affiliates.

The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. Options, derivative products and futures are not suitable for all investors and trading in these instruments is considered risky. Past performance is not necessarily indicative of future results. Foreign-currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or the price of, or income derived from, the investment. Halyk Finance and its affiliates, directors, representatives, employees, or clients may have or have had interests in issuers described herein. Halyk Finance may have or have had long or short positions in any of the securities or other financial instruments mentioned herein at any time and may make a purchase and/or sale, or offer to make a purchase and/or sale, of any such securities or other financial instruments at any time, as principal or agent. Halyk Finance and its affiliates may act or may have acted as market maker in the securities or other financial instruments described herein, or in securities underlying or related to such securities. Employees of Halyk Finance or its affiliates may serve or have served as officers or directors of the said companies. Halyk Finance and its affiliates may have or have had a relationship with or have provided investment banking, capital markets, advisory, investment management, and/or other financial services to the relevant companies. Halyk Finance relies on information barriers to avoid the appearance of conflict of interests within Halyk Finance or in its relations with clients, other issuers, and external investors.

The information herein is not intended for distribution to the public and may not be reproduced, redistributed or published, in whole or in part, for any purpose without the written permission of Halyk Finance. Neither Halyk Finance nor any of its affiliates accepts any liability whatsoever for the actions of third parties in this respect. This information may not be used to create any financial instruments or products or any indices. Neither Halyk Finance, nor its affiliates, nor their directors, representatives, or employees accept any liability for any direct or consequential loss or damage arising out of the use of any information herein.

© 2019, All rights reserved

Research Department

Stanislav Chuyev	Deputy Head
Dmitriy Sheikin	Macroeconomics
Asan Kurmanbekov	Macroeconomics
Altynai Ibraimova	Equity
Aliya Assilbekova	Equity
Vladislav Turkin	Fixed income

E-mail

s.chuyev@halykfinance.kz
d.sheikin@halykfinance.kz
a.kurmanbekov@halykfinance.kz
a.ibraimova@halykfinance.kz
a.assilbekova@halykfinance.kz
v.turkin@halykfinance.kz

Sales Department

Mariya Pan	Head
Aizhan Moldakhmetova	Institutional
Shynar Zhakanova	Institutional
Dariya Maneyeva	Retail
Aziza Ordabayeva	Retail
Aliya Abdumazhitova	Retail

E-mail

m.pan@halykfinance.kz
a.moldakhmetova@halykfinance.kz
sh.zhakanova@halykfinance.kz
d.maneyeva@halykfinance.kz
a.ordabayeva@halykfinance.kz
a.abdumazhitova@halykfinance.kz

Address:

Halyk Finance
Abay av, 109 «B», 5th fl.
A05A1B9, Almaty, Kazakhstan
Contact: +7 727 357 31 77
www.halykfinance.kz

Bloomberg

HLFN

Thomson Reuters

Halyk Finance

Factset

Halyk Finance

Capital IQ

Halyk Finance