

19. March 2008

CEE oil sector: solid USD earnings, but partly due to US currency depreciation

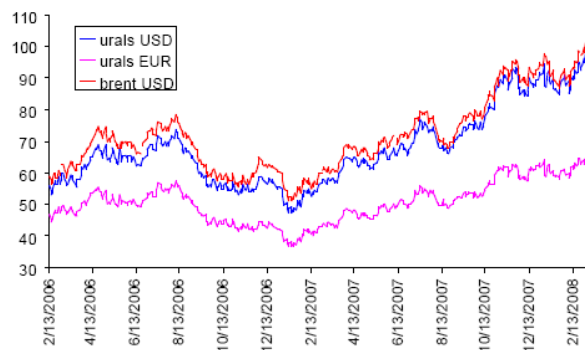
- **OMV:** Nice upstream figures, while refinery suffered due to shutdowns
- **MOL:** Slightly better than expected results at all levels
- **Unipetrol:** Figures negatively affected by long shutdowns, but outlook positive (Buy recommendation with target price of CZK 358)
- **Petrom:** Reports 22% decrease in Q4 07 bottom line
- **INA:** Yet to publish Q4 07 results at the end of March

Earnings & profits

Higher average Brent oil price generated very solid figures in USD but part of the increase in the oil price in USD per barrel is attributed to the US dollar's depreciation, say analysts of Erste Bank. They point out all CEE companies have the same FX exposure - profits in both upstream and downstream are linked to the USD, but inputs are mainly in local currencies.

"Oil prices in Euro terms look much more stable than in USD terms, which is also a traditional OPEC argument for <<why to not raise production>>", says Jakub Zidon, Oil & Gas analyst at Erste Group. "We can also say that the last increase above USD 100 per barrel level could be attributed to the strong depreciation of the USD vs. the EUR. Local currencies also strengthened vs. the EUR in 2007, partly offsetting the negative impact of high oil prices on downstream players", adds Zidon.

Oil price development in last two years



Source: Bloomberg

The analysts of Erste Bank do not see too much room for an increase/decrease of the oil price in EUR terms and expect the price of crude to remain at a similar level of EUR 60/bbl at the beginning of this year. The potential decrease in USD terms would therefore be related to an appreciation of the US currency. The current RON depreciation is seen positive for OMV, as FX expenses added some 70% to the increase in crude oil production costs. For MOL, the bigger issue is still the high middle distillates exposure.

Companies in brief

"Despite the refinery shutdowns and still sub-optimal performance of Petrom, OMV remains our top pick (with a Buy recommendation), due to the almost 70% share in its portfolio held by the exploration and production segment and its presence in the swiftly increasing gas segment. As expected, MOL is enjoying high diesel margins, although we do not see potential growth drivers for the future. Therefore, we maintain our Hold recommendation for the Hungarian title," states Jakub Zidon, the Oil & Gas analyst at Erste Group.

Unipetrol is another story entirely, as the company was strongly hit by the longer than expected shut-down of its Litvinov plant (the cold box will be installed in April/May, prompting us to slightly decrease our 2008 projection). However, we anticipate a recovery for petrochemicals in 2008 (polymer margins already went up in January and February). Unipetrol remains our No. 2 pick, with a Buy recommendation and target price of CZK 358," adds Zidon.

The Erste Group analysts recommend as followed:

Company	Current recommendation	Current target price
OMV	Buy	EUR59.70
Unipetrol	Buy	CZK 358.0
Petrom	Accumulate	RON 0.608
MOL	Hold	HUF 24,125
INA	Hold	HRK 3,030

Valuation

Following the market correction of the last few weeks, the CEE peers' 2008 and 2009 EV/EBITDA ratios are currently traded around the 4.6x mark, which is well below their Western peers' (with 2008 and 2009 EV/EBITDA of 5.8x and 5.7x, respectively). Erste Bank analysts deem this to make sense at the moment, as investors see CEE stocks as having a higher level of risk. Nevertheless, they expect CEE sector still to provide higher profit growth in the coming years and more significant growth potential for CEE stocks in the coming months.

As for the P/E level, CEE stocks are traded with P/Es of 8.1x in terms of 2008 earnings and 7.6x using 2009 estimated earnings, while the sector's European peers are traded at P/Es of 11.6x for 2008 and 11.5x for 2009.

Outlook for 2008 and beyond

Erste Bank analysts expect crude oil price to remain above EUR 50 per barrel, while refinery margins to be further under pressure due to very weak gasoline spreads. *"We would highlight OMV (due to its strong upstream exposure, with a rising gas segment) and MOL (which should enjoy strong middle distillates margins in the short term). Unipetrol should profit from the strong petrochemical segment. However, the first sign of better performance will likely be seen as of the second quarter of this year,"* strengthens Zidon.

Erste Group, Press department
 1010 Vienna, Graben 21, Fax: 0043-50100-19849
 Hana Cygonková, Tel: 0043-50100-11675, e-mail: hana.cygonkova@erstebank.at
 Ionut Stanimir, Tel: 0043-50100-11676, e-mail: ionut.stanimir@erstebank.at

You can also download this text from our homepage at <http://www.erstebank.com/Press>.

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