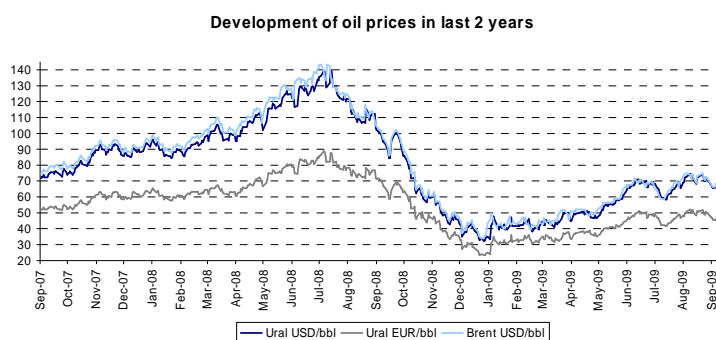


Oil price set to stabilize, refining still to struggle

- Prospects for economic recovery support oil price; long-term price forecast at EUR 65-68/bbl
- Gas transportation and storage immune to recession, but drop in sales expected
- Nabucco - better diversification for sources, but lower dependence on Russia unlikely
- Erste Group analysts recommend cautiousness in buying stocks with strong downstream exposure (refining). OMV remains top pick

Oil sector

Crude oil has made a permanent entry in the history of investment bubbles, given the events seen from fall 2007 to the end of 2008. After an unprecedented bull run that took the oil price to over USD 140 per barrel in July 2008, prices slumped even more quickly than they had risen, shedding roughly 68% from their peak in the event. The price of oil (Brent) has stabilized in the range 40-50 EUR/bbl after a recovery from a steep and prolonged decline.



Outlook for mid-term horizon

"The global economy is clearly on its way up from the deepest post-war recession, which means better prospects for oil consumption," say Erste Group analysts. In particular, Asian economies (including China) are showing renewed growth vigor. OECD economies should remain weak for a much longer time - we expect several years of sub-par growth in the US and EU. The relative weakness of consumption in OECD countries should limit the upside potential for the oil price. However, there are still factors to be taken in account. "Firstly, we may experience another wave of commodity related investments similar to that preceding the recent bubble. Secondly, a significant decline in upstream investment may lead to insufficient growth of production capacity and a tight balance between supply and demand", says Jakub Zidon, oil and gas sector analyst at Erste Group.

Long-term price forecast is EUR 65-68/bbl

Erste Group analysts don't rule out temporary decreases in the crude oil price, but stick with a long-term price expectation of EUR 65-68 per barrel. The demand side, which was under pressure because of the recession, is steadily improving, along with the brighter prospects for the world economy. However, they assume that, in the long run, the supply side will determine the price development. Given that production is becoming increasingly cost-intensive, that the massive amounts of capital expenditures required are only coming through at a fraction of the amount actually needed (according to studies, up to 80% of the infrastructure has to be replaced by 2020) and that numerous oil fields and indeed oil-producing countries are past their peak production, they actually expect higher prices in the long run.

Gas segment

The biggest positive surprise in the sector recently came from the gas segment, as the companies profit from the vertical integration of the gas business – e.g. OMV operates as an exploration and production player (in Austria, Romania, etc.), in gas logistics on both the storage and transmission sides (gas hub in Baumgarten and ownership of pipelines) and via its sales and trading arm (EconGas). The gas sector is still relatively "low-weighted" (8.5% of OMV's 2008 total clean EBIT), but provides significant potential upside – gas pipelines to Europe, storage facilities, etc.

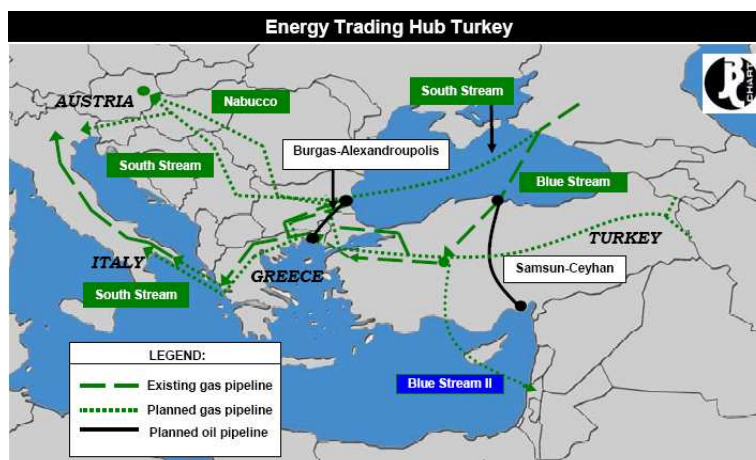
Regarding the whole region, the gas business is the most stable over time and is practically immune to recession (transportation, storage), thus providing a considerable degree of cash flow stability, say Erste Group analysts. On the other hand, driven by the economic downturn, the sales segment expects declining demand, especially from the industrial segment across the region.

For the future, there are several key factors that lead the analysts to believe the importance of the gas segment will rise further:

- diversification of long-term supply will be pursued, including accessing new supply sources
- building of new pipelines (like Nabucco, described in detail in the full report) will contribute to the second pillar
- construction of several LNG terminals – Gate LNG in Rotterdam, Adria LNG in Croatia
- building of gas-fired power plants (new phenomenon in the oil and gas sector, described in our previous sector report)
- extension of existing gas pipelines will continue, aiming to increase transport capacity

Nabucco - better diversification, but lower dependence on Russia unlikely

Erste Group analysts say political support from Turkey (as a crucial transit country) is important for the future development of the project, however the consortium has not yet found guaranteed gas supplies. Azerbaijan and Turkmenistan (which have enough gas and where transportation would exclude problematic countries) have preliminarily committed to other beneficiaries (South Stream, China), while, due to the political climate, Iran could not be a supplier to Nabucco, despite its huge reserves. Among 'second-tier' suppliers, Iraq should be highlighted, as it has huge undeveloped natural gas reserves and both OMV and MOL have announced expansion of their E&P portfolios there.



Source: JBC Energy FSU/CEE Insight

Bearing that in mind, however, the region will not significantly decrease its dependence on Russian natural sources. The main result of these projects (Nabucco, South Stream, Blue Stream, etc.) will be better transport diversification, which should be seen as a half-victory, rule Erste Group analysts.

Outlook and investment case

As the CEE oil & gas sector is characterized by strong exposure to the R&M segment, Erste Group analysts recommend cautiousness in buying stocks with strong downstream exposure, especially highly leveraged stocks. However, stabilization of the crude oil price around USD 70/bbl (EUR 45/bbl) and marginal improvement in refining margins are expected. The drop in demand for both refining and petrochemical products is the main factor behind the expected mid-term "low profitability" in downstream.

In addition, Erste Group analysts expect several transactions in the sector. Targeted acquisitions will primarily be conducted in the SEE region (as it is currently suffering from the credit crisis, while in need of huge investment to meet EU fuel quality requirements) and Turkey. Most CEE refiners are seen to focus on and consolidate their current operations, as only OMV has an acquisition appetite. However, the company is not seen able to compete with Russian giants outside the region.

- Fundamentally, there is no doubt that **OMV** remains top pick, with a **Buy** recommendation and target price of EUR 39/share. However, it would be negative news for the company if it overpays for Petrol Ofisi, a transaction that could be financed via a capital increase.
- **Accumulate** recommendation on **MOL** and increase 12M target price to HUF 18,200. Despite the rather sluggish outlook for the downstream segment, MOL has superior quality at its refineries, which have the highest complexities, enabling above-average refining margins.
- Cautious is recommended in buying Lotos and PKN Orlen. The weak refining outlook and financial vulnerability are the main concerns. **PKN Orlen** is kept on **Hold**, with a slightly higher 12M target price of PLN 30/share, while **Lotos** is now a **Sell**, with a 12M target price of PLN 21.0.
- **Unipetrol** was hit strongly by the collapse in the petchem segment already in 2H08 and the drop in refining margins this year. The environment almost could not be worse, and the recovery will be slow. The lack of a mid-term strategy leads to a **Reduce** recommendation with a target price of CZK 140.
- **Petrom** target price is upgraded from RON 0.18 to RON 0.31, on the back of the increasing crude oil price and lower discount rate for the company. Petrom's heavy upstream exposure is seen positively. However, the still-awaited results from the refining segment restructuring do not allow an upgrade of the **Accumulate** recommendation.
- **INA** will clearly benefit from the fact that MOL has basically taken over the company. Although potential growth drivers (upstream production increase, refinery upgrades at the Rijeka and Sisak plants and cost saving programs) are already mostly priced in, we upgrade the rating to Accumulate with a 12M target price of HRK 1,888.

Group Research:

Jakub Zidon (CEE Oil & Gas sector analyst)

Tel: +420 224 995 340

E-Mail: jzidon@csas.cz

Press department:

Hana Cygonková (Head of External communications)

Tel: +43 50100 - 11675

E-Mail: hana.cygonkova@erstegroup.com

Ionut Stanimir (Group Press Officer)

Tel: +43 50100 - 11676

E-Mail: ionut.stanimir@erstegroup.com

Alina Costache (Group Press Officer)

Tel: +43 50100 - 11681

E-Mail: alina.costache@erstegroup.com

Erste Group, 1010 Wien, Graben 21, Fax: +43 50100 – 19849

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Erste Group is one of the leading financial providers in CEE. More than 51.000 employees serve 17 million clients in 3,000 branches in 8 countries (Austria, Czech Republic, Slovakia, Romania, Hungary, Croatia, Serbia, Ukraine). As of 30 June 2009 Erste Group has reached EUR 204.2 billion in total assets, a net profit of EUR 492.1 million and cost-income-ratio of 52.5%.