FitchRatings

FITCH UPGRADES KAZAKHSTAN TEMIR ZHOLY'S TO 'BBB'; OUTLOOK STABLE

Fitch Ratings-London/Moscow-22 November 2012: Fitch Ratings has upgraded JSC National Company Kazakhstan Temir Zholy (KTZ) Long-term Issuer Default Rating (IDR) and Kazakhstan Temir Zholy Finance B.V.'s senior unsecured rating to 'BBB' from 'BBB-'. The Outlook on the Long-term IDR is Stable.

KEY DRIVERS

- Sovereign Rating Upgrade

The upgrade of KTZ's ratings reflects the agency's upgrade of Kazakhstan's long-term foreign and local currency IDRs to 'BBB+' from 'BBB' and to 'A-' from 'BBB+', respectively, with Stable Outlooks (see 'Fitch Upgrades Kazakhstan to 'BBB+'' dated 20 November 2012 at www.fitchratings.com).

- Strong Links With The Sovereign

KTZ's ratings reflect its 100% indirect state ownership and strategic importance to Kazakhstan, as it provides about half of freight and passenger transportation in the country. Furthermore, KTZ's tariffs are regulated and its investment plans are approved, and directly co-funded, by the state (through equity injections and soft loans). The government also provides direct subsidies for the loss-making passenger business. Although KTZ benefits from strong links with the state, full and timely financial support, which would allow rating alignment with the sovereign is not certain without robust legal ties (for example, explicit guarantees). KTZ's rating is therefore one notch down from the sovereign. Fitch considers KTZ's standalone credit profile commensurate with the low 'BBB' rating category.

- State Support Continues

JSC National Welfare Fund Samruk-Kazyna (S-K), the immediate parent company of KTZ, continues to support KTZ and provided about KZT130bn as a direct contribution to fund the construction of railway lines over 2009-2011. In Q212 it received a further KZT4bn to finance the expansion of the railway line network. The company anticipates receiving KZT10bn in Q313. Additionally, S-K has provided about KZT61bn in a way of soft loan to finance the further expansion of the railway line network (at about 2% for 30 years).

- Capex Driven Negative FCF Expected

Fitch expects cash flow from operations (CFO) to remain strong in 2012, but the increase in capex will mean higher gross debt. Fitch expects free cash flow (FCF, before equity contributions) to remain negative for the foreseeable future. KTZ's funds from operations (FFO) adjusted leverage of 1.6x at end-December 2011 was slightly below that of 2010 (1.8x) and returned to its 2009 level. Due to its substantial capex for 2012-15, Fitch expects under its conservative growth scenario KTZ's gross leverage to increase markedly to above 3x in 2014-15. In H112 KTZ reported revenue of KZT385bn, a 16% year-on-year increase, mainly due to the increase of freight transportation revenue that accounted for over 85% of total revenue in H112. KTZ mainly derives revenue from the transportation of oil and oil products (about 25%), coal (about 10%), ferrous metals and ore (about 6% each). The company expects oil transportation volumes to decrease over 2013-2015.

- FX Risk Remains

FX risk remains a concern for KTZ as at end-Q312 about 64% of its debt was denominated in dollars. Hedging is currently limited to monitoring exchange rates changes and maintaining a portion of cash in dollars. Interest on KTZ's debt is mostly fixed (about 87% of debt), reducing its exposure to interest rate fluctuations.

RATING SENSITIVITY ANALYSIS

Positive: Future developments that could lead to positive rating actions include:
- A positive change in Kazakhstan's rating may be replicated for KTZ (with the current one notch differential), unless its links with the state weaken.
- Industrial growth leading to transport volume growth stronger than Fitch anticipates would be positive for KTZ's stand alone credit profile and possibly ratings.

Negative: Future developments that could lead to negative rating action include:
- A negative change in Kazakhstan's rating would be replicated for KTZ unless KTZ's standalone profile significantly strengthens.
- A sustained increase in gross leverage beyond 2.5x would put pressure on KTZ's standalone profile and possibly ratings (should the links with government simultaneously weaken).

LIQUIDITY & DEBT STRUCTURE

- Sufficient Liquidity
KTZ's end-H112 cash and deposits stood at KZT104bn which is sufficient to cover short-term debt maturities of KZT37bn. However, expected negative FCF continues to add to funding requirements. In July and October 2012 Kazakhstan Temir Zholy Finance B.V. issued notes for the total amount of USD1.1bn due 10 July 2042. Proceeds were partially used to repay a bridge facility (approximately USD220m), to refinance a loan from JSC Development Bank of Kazakhstan entered by Kaztemirtrans (about USD100m) and the remainder will be used for acquiring rolling stock, the implementation of the investment programme and other general corporate purposes.

Contact:

Principal Analyst
Oxana Zguralskaya
Associate Director
+7 495 956 7099

Supervisory Analyst
Josef Pospisil
Senior Director
+44 20 3530 1287
Fitch Ratings Limited
30 North Colonnade
London, E14 5GN

Committee Chair
Angelina Valavina
Senior Director
+44 20 3530 1314

Media Relations: Julia Belskaya von Tell, Moscow, Tel: +7 495 956 9908, Email: julia.belskayavontell@fitchratings.com; Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available on www.fitchratings.com.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable criteria, 'Corporate Rating Methodology', dated 8 August 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684460