

## **Moody's upgrades KTZ's rating to Baa2 from Baa3; stable outlook**

### **Rating Action|**

05 Jan 2024 Moody's Investors Service

London, January 05, 2024 -- Moody's Investors Service (Moody's) has today upgraded National Company Kazakhstan Temir Zholy JSC's (KTZ) long term issuer rating to Baa2 from Baa3. The outlook remains stable.

### **RATINGS RATIONALE**

Today's rating upgrade reflects the accumulated sustainable improvements in KTZ's standalone credit profile demonstrated by its track record of robust operating and financial performance and stronger credit metrics amid supportive external conditions. The rating action also incorporates the company's high importance for the state and its efforts to diversify the economy away from hydrocarbon sectors, which translates into sizeable ordinary support, accommodating tariff policy and prudent supervision over KTZ's strategy and financial policy. At the same time, the rating reflects the company's large capital spending programme which is designed to meet strong demand for railway transportation and improve its asset base.

KTZ's cargo turnover increased by 5.1% in 2022 and 7.5% in the first nine months of 2023, and will grow by 7.0%-9.0% a year in 2023-24, mainly driven by transit and export operations. The company benefits from increased transportation activity between Russia and Asia and across the Trans-Caspian International Transport Route – also known as the Middle Corridor. Demand for railway freight transportation is likely to remain at the elevated level due to structural diversion of cargo flow in the region and may be curbed only by infrastructure bottlenecks.

The tariff regulation has been supportive recently. The average cargo tariff increased by 13% in 2021, 6% in 2022 and 18% in 2023 which helps offset relatively high inflation and finance extensive capital spending. However, future tariff increases are likely to be less pronounced.

As a result, KTZ demonstrates strong revenue growth and good profitability. Its revenue increased by 13% in 2021, 16% in 2022 and 26% in the first nine months of 2023, and may grow by 15%-18% in 2024. Moody's-adjusted EBITDA margin is solid at 28%-33% in 2020-23, compared with 25% in 2017-19, and is likely to be sustained at 28%-30% over the next 12-18 months.

The rating action also factors in overarching ongoing financial and organisational support from the state, mainly provided through KTZ's parent company Kazakhstan's Sovereign Wealth Fund Samruk-Kazyna JSC (Samruk-Kazyna, Baa2 positive). Besides tariff indexation and the government subsidies for loss-making

passenger transportation, the company receives ample long-term low-interest debt financing from Samruk-Kazyna to fund its capital spending. KTZ also benefits from Samruk-Kazyna's strong influence over its strategy and operations, including asset composition, management and appointment of board of directors, financing policies and risk management.

KTZ has embarked on a large and aggressive capital spending programme, investing in railway infrastructure and rolling stock over 2022-25. The ambition looks adequate to the company's needs and demand for its service, and supported by the state through long-term debt funding. Capital spending increased by 33% in 2022, will more than triple in 2023 and remain at elevated level in 2024-25.

The rating action also factors in sustainable improvement in credit metrics in 2020-23, compared with 2015-19. Leverage reduced to 4.0x-5.0x in 2020-23 from 5.5x-6.0x in 2016-19 and EBIT/Interest expense increased to around 2.2x from 1.3x over the same period. Leverage will fluctuate around 4.5x and EBIT/Interest expense will be within 2.0x-2.5x in 2023-25 because strong earnings growth will balance negative free cash flow due to capital spending.

Moody's also acknowledges the reduction of foreign currency debt to 37% in the KTZ's total portfolio as of September 2023 from 56% in 2021. This supports the company's credit quality, reducing its susceptibility to currency volatility. The remaining portion of foreign currency debt is covered by natural foreign currency hedge through transit revenue denominated in hard currency.

KTZ's Baa2 rating incorporates a standalone assessment which has the characteristics of a weak Ba profile, and several notches of uplift reflecting KTZ's continued strategic and social importance to Samruk-Kazyna and, therefore, the Government of Kazakhstan (Baa2 positive) as the monopoly owner of rail transportation infrastructure and the largest provider of transportation services in Kazakhstan.

## ESG CONSIDERATIONS

KTZ's CIS-2 indicates that ESG considerations are not material to the rating thanks to the uplift provided by its continued strategic importance to Samruk-Kazyna and the state. The company's G-IPS has been changed to G-3 from G-4 due to improvements in financial strategy and risk management as demonstrated by reduced foreign currency exposure and very long-term debt maturity profile.

## RATIONALE FOR THE STABLE OUTLOOK

The stable outlook on KTZ's rating reflects Moody's view that KTZ's specific credit factors, including its operating and financial performance, credit metrics, market position and liquidity, will remain commensurate with its rating on a sustainable basis, and there will be no weakening in the probability of support from Samruk-Kazyna and the government in the event of financial distress.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward rating pressure could emerge if (1) there is a significant improvement in the company's standalone creditworthiness and (2) Kazakhstan's sovereign rating and Samruk-Kazyna's rating are upgraded. The former would require that the company completes its investment cycle and sustainably reduces its adjusted debt/EBITDA below 4.0x.

Moody's could downgrade KTZ's rating if it was to downgrade Kazakhstan's sovereign rating or Samruk-Kazyna's rating, or if it reassess the likelihood of support from Samruk-Kazyna and the government in the event of financial distress to a weaker level. A material deterioration in the company's standalone credit quality could also lead to a rating downgrade.

## PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Surface Transportation and Logistics published in December 2021 and available at <https://ratings.moodys.com/rmc-documents/360641>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

## CORPORATE PROFILE

Headquartered in Astana, Kazakhstan, National Company Kazakhstan Temir Zholy JSC (KTZ) is the vertically integrated monopoly owner and operator of the national rail network of the Republic of Kazakhstan, and the leading provider of freight and passenger rail transportation services in the country. Beyond its railway operations, KTZ also manages several significant infrastructure assets, including sea ports. The company is wholly owned by JSC National Welfare Fund Samruk-Kazyna. For the 12 months that ended 30 September 2023, KTZ reported revenue of KZT1,832 billion and Moody's-adjusted EBITDA of KZT514 billion.

The local market analyst for this rating is Mikhail Shipilov, +971 (423) 795-61.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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