



## RATING ACTION COMMENTARY

# Fitch Affirms JSC Kazakhstan Temir Zholy at 'BBB-'; Outlook Stable

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Fitch Ratings - Dubai - 19 Dec 2022: Fitch Ratings has affirmed JSC National Company Kazakhstan Temir Zholy's (KTZ) Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook. A full list of rating actions is below.

The affirmation reflects Fitch's expectations that KTZ's link with Kazakhstan (BBB/Stable) will remain unchanged, while its debt metrics will be commensurate with its Standalone Credit Profile (SCP) of 'b+', leading to a single-notch rating differential between KTZ's and the sovereign's IDRs.

## KEY RATING DRIVERS

### Status, Ownership and Control: 'Very Strong'

This assessment is underpinned by KTZ's 100% indirect ownership by the Kazakh government via Sovereign Wealth Fund Samruk-Kazyna JSC (SK; BBB/Stable) and its status as a strategic enterprise for the state. KTZ's status as a natural monopoly entails tight state regulation and monitoring. The state's control over KTZ is exercised both directly, by setting the company's strategy and tariffs on regulated activities, and indirectly, via SK representatives on the board of directors. The company's long-term development goals follow national strategic policies and programmes.

### Support Track Record: 'Strong'

KTZ benefits from sustainable state support in the form of subsidies, subsidised debt, and equity funding. It receives annual subsidies (KZT39.2 billion, or 3.0% of its 2021 operating revenue), which partially compensate losses on its passenger transport services. Additionally, the state injects equity into KTZ's capital to fund infrastructure projects. This totalled KZT282.4 billion over 2015-2021 (7.8% of KZT total assets in 2021). KTZ's debt is partly funded by its parent and other state-related entities at subsidised rates and long maturities (27% of nominal debt as of end-2021). We expect financial support from the state to continue in the medium term.

### **Socio-Political Implications of Default: 'Strong'**

This assessment is supported by Fitch's view that a KTZ default would lead to strong economic repercussions for the government. KTZ accounted for over 40% of the national transportation, and its default could materially endanger national economic activity. KTZ forms a vital part of the state's development programme by fostering the country's transit and export growth potential and serving as the nation's transport backbone, connecting the geographically dispersed population of Kazakhstan.

### **Financial Implications of Default: 'Strong'**

In our view, a default by KTZ would be damaging to Kazakhstan's reputation. Both KTZ and the state treasury tap international capital markets and source loans from international financial institutions to finance infrastructure investments. KTZ is among the top national issuers in external debt markets and 45% of its outstanding debt as of end-2021 is in foreign currency. In Fitch's view, a default by KTZ could materially impair the credibility of the central government, leading to an increased cost of debt for other Kazakh GREs and the state.

### **Standalone Credit Profile**

Based on Fitch's Public Sector, Revenue-Supported Entities Rating Criteria, KTZ's SCP is assessed at 'b+'. This is based on a 'Weaker' assessment of revenue defensibility and financial profile combined with 'Midrange' assessment of operating risk. The notch-specific SCP assessment also factors in peer comparison, including relatively strong leverage compared to peers.

### **Revenue Defensibility 'Weaker'**

The assessment reflects 'Midrange' demand and 'Weaker' pricing. Demand is supported by the company's position as the monopolistic owner and operator of the rail infrastructure. Its sizeable freight operations are the main revenue driver.

KTZ remains exposed to risks of negative commodity markets dynamics, foreign currency-market fluctuations, and macro-economic and geo-political developments in neighbouring countries, primarily Russia and China, which affects our demand assessment. Further development of more transparent and predictable above-inflation tariff-indexing could underpin KTZ's railway transportation volumes and may prompt a reassessment of revenue defensibility to 'Midrange'.

### **Operating Risk 'Midrange'**

Fitch assesses KTZ's operating costs and resource management as 'Midrange'. The cost structure is fairly stable and dominated by salaries (42% of cash operating expense in 2021), followed by goods and services at 31%. Most of KTZ's operating expenses are well-identified and fixed. During 2022 the company significantly increased salaries following the protests that took place in Kazakhstan in January. As a result, total personnel costs increased by 35% in 3Q22 relative to 3Q21. Fitch views this as one-off event, which does not affect the Operating Risk assessment.

### **Financial Profile 'Weaker'**

KTZ's financial profile remains constrained by sizeable debt, an exposure to commodity market and foreign-exchange risks, and the geopolitical environment in the country's prime trade partners. KTZ is moderately exposed to domestic competition in passenger transportation, while its financial profile is supported by its monopolistic position, sizeable operations in freight, and the long and established history of state support.

In the Fitch rating case, we expect the leverage ratio (Fitch's net adjusted debt to EBITDA) to be in the 6x-7x range in 2024-2026 (2021: 4.4x) as a result of salary increases in 2022 and a significant increase in capital expenditure in the coming years, driven by investments in rolling stock and modernization of Dostyk-Aktogay-Moyynty transit corridor.

### **Derivation Summary**

Under its GRE Criteria, Fitch classifies KTZ as an entity with strong linkage to the Kazakh government and assesses the government's ability and willingness to provide support to the company as high. Based on our assessment of the strength of linkage and incentive to support by the government, KTZ's GRE support score is 35, which, combined with the 'b+' SCP, leads to the IDRs being notched down once from the sovereign's.

### **Debt Ratings**

The ratings of all senior debt instruments are aligned with KTZ's Long-Term IDR.

## KEY ASSUMPTIONS

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on 2017-2021 historical figures and 2022-2026 projected ratios:

- Operating revenue growth of 9.1%, on average;
- Operating expenditure growth of 11.0%, on average;
- Capital expenditure on average of KZT478 billion.

## Liquidity and Debt Structure

KTZ's total nominal debt at end-2021 was KZT1,937.4 billion (2020: KZT1,901.5 billion), 45% of which was foreign-currency-denominated (2020: 44%). The company has a natural hedge of this foreign-currency exposure, as revenue from transit services, which consistently comprises more than 30% of total revenue, is denominated in Swiss francs. KTZ liquidity is satisfactory with accumulated cash and deposits of KZT178.0 billion at end-2021 (end-2020: KZT155.4 billion).

## Issuer Profile

KTZ is a national transportation and logistics holding company. Its core operations are centred on its monopolistic position as an integrated railway group, supplemented by management on behalf of the state's other transport infrastructure.

## RATING SENSITIVITIES

### Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A downgrade of Kazakhstan's sovereign rating
- Dilution of linkage with the sovereign resulting in the ratings being further notched down from the sovereign's

### Factors that could, individually or collectively, lead to positive rating action/upgrade:

- An upgrade of Kazakhstan's sovereign rating
- Improvement of the company's financial profile leading to a reassessment of the SCP to 'bb', which could be justified by strengthening the net adjusted debt/EBITDA toward 2x on a sustained basis

## ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

KTZ's IDRs are directly linked to Kazakhstan's.

## Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

## RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅		PRIOR ⇅
JSC National Company Kazakhstan Temir Zholy	LT IDR	BBB- Rating Outlook Stable	BBB- Rating Outlook Stable
senior unsecured	LT	BBB- Affirmed	BBB-

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**[Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)[Public Sector, Revenue-Supported Entities Rating Criteria \(pub. 01 Sep 2021\) \(including rating assumption sensitivity\)](#)

## ADDITIONAL DISCLOSURES

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JSC National Company Kazakhstan Temir Zholy

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