Tear Sheet:

Kazakhstan Temir Zholy

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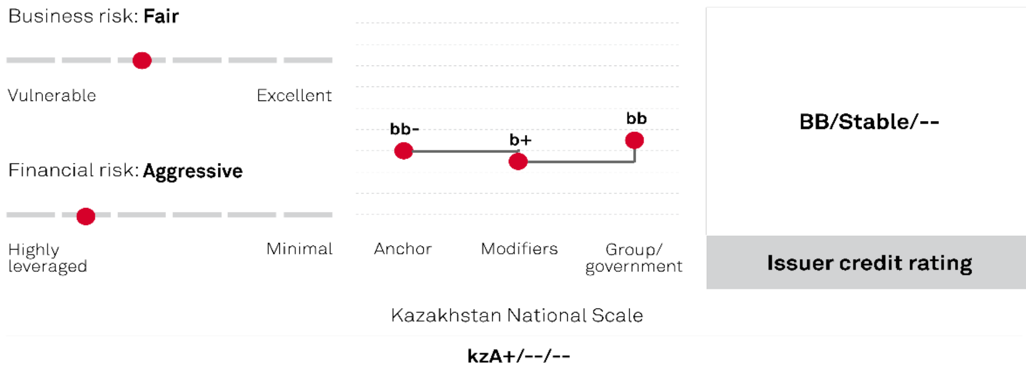
S&P Global Ratings believes Kazakhstan Temir Zholy (KTZ) will retain healthy metrics, with funds from operations (FFO) to debt above 12% in the next two to three years. We expect this will be underpinned by a record high freight turnover and material increase in regulated tariffs. We now predict the company will reach about 265 billion ton-kilometers of freight turnover by year-end 2023, an 8% increase compared with 2022 levels and record high for KTZ since Kazakhstan gained independence in 1991. This is due to steady growth of commodity exports, including coal and petroleum products, and increased transit to Russia, China, and Central Asia. In addition, management has successfully negotiated a material increase of the regulated freight tariff (about 30% by year-end 2023), which will now mitigate the 33% increase in labor costs in 2022. We believe the increased tariff and freight volumes will support a massive increase in KTZ's EBITDA to about Kazakhstani tenge (KZT)540 billion-KZT560 billion (about $1.18 billion-$1.23 billion equivalent), up 60% from 2022, and create a solid cushion against persistent high inflation.

Pressure on KTZ's liquidity will remain for the next two years, with a massive hike in capital investments and an upcoming $880 million bullet bond maturing in 2025. To fully benefit from increased freight volumes, KTZ will have to substantially increase its capital expenditure (capex) to maintain its current infrastructure and renovate its locomotives and wagon fleet. We understand KTZ's management is committed to a very aggressive capital investment plan in 2023-2025. We project a peak capex outflow of close to KZT800 billion-KZT900 billion in 2023 and KZT700 billion-KZT800 billion in 2024-2025, up from KZT335 billion in 2022. We expect KTZ's substantial capex to be funded by internal sources, government support, and low-interest loans, and we will monitor specific liquidity arrangements. We believe that KTZ's exposure to refinancing needs in 2025 and high interest rates could further pressure its liquidity. In addition, the increased capex could reduce headroom in KTZ's financial metrics from 2025 if not offset by further tariff adjustments or volume increases.

A very high likelihood of extraordinary state support underpins our rating on KTZ. The company plays a very important role in Kazakhstan's national transport sector, given the country's land-locked position and strong commodity sectors. We believe there's a very strong link with the Kazakh government, which wholly owns KTZ via sovereign wealth fund Samruk-Kazyna and provides stable ongoing support. We continue to see the likelihood of timely and sufficient extraordinary financial support for KTZ from the Kazakhstan government as very high, and incorporate two notches of uplift in our 'BB' rating on KTZ.

Ratings Score Snapshot



Recent Research

- Kazakhstan, Sept. 4, 2023
- Industry Top Trends Update Europe: Transportation Infrastructure, July 18, 2023
- Ratings Affirmed On Three Kazakhstani Government-Related Entities On Upward Revision Of Support, May 3, 2023
- Samruk-Kazyna, KMG, Kegoc, KTO, And KTZ Outlooks To Stable After Similar Action On Kazakhstan, March 9, 2023

Company Description

KTZ is the 100% state-owned monopoly railroad company in Kazakhstan. It owns and operates Kazakhstan's national railway system and related infrastructure. KTZ enjoys a dominant market position in the railway industry with about half of Kazakh freight (excluding pipeline transportation) and more than 80% of railway passenger transportation revenue. The company employs about 130,000 people and is one of the country's biggest taxpayers.

Outlook

The stable outlook on KTZ reflects our view that a very high likelihood of extraordinary state support, sizable cash balances, and expected credit metric headroom will balance high capex needs, moderate fluctuations in cargo mix and volumes, and potentially rising dividend payouts. Our base case envisages that the company will maintain FFO to debt comfortably above 12% and at least less than adequate liquidity. This view is underpinned by our expectations of modest cargo turnover growth, annual tariff increases, and the company's cautious approach to refinancing maturing debt.

Downside scenario

Given the very high likelihood of extraordinary state support, a one-notch downgrade of Kazakhstan could lead us to lower our rating on KTZ, all else unchanged.

We may revise our assessment of KTZ's stand-alone credit profile (SACP) downward if liquidity reduces substantially or S&P Global Ratings-adjusted FFO to debt deteriorates below 12% due to weaker-than-expected operating performance, a material decrease in ongoing state support, or a significant devaluation of the tenge, inflating the company's debt position.

Upside scenario

We would consider an upgrade if KTZ's SACP strengthens to 'bb-', which could likely result from:

- Stronger liquidity, supported by a manageable maturity profile and no covenant breaches.
- FFO to debt improving sustainably above 20% due to gradual deleveraging, supported by a solid increase in traffic and/or favorable tariffs, material subsidies, or equity injections from the state.

A one-notch upgrade of the sovereign could also lead us to take a positive rating actions on KTZ, all else unchanged.

Key Metrics

Kazakhstan Temir Zholy--Forecast Summary

Period ending	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025
(Bil. KZT)	2021a	2022a	2023e	2024f	2025f
Revenue	1,329	1,481	1,900-1,950	2,000-2,200	2,200-2,400
EBITDA	408	345	540-560	510-530	560-580
Funds from operations (FFO)	278	218	370-380	310-330	330-350
Capital expenditure (capex)	252	335	800-900	700-800	700-800
Free operating cash flow (FOCF)	65	(70)	Negative	Negative	Negative
Dividends	--	--	--	--	--
Debt	1,551	1,560	2,100-2,150	2,550-2650	3,100-3,200
Adjusted ratios					
Debt/EBITDA (x)	3.8	4.5	3.5-4.0	4.5-5.5	5.0-6.0
FFO/debt (%)	17.9	14.0	17.5-18.0	12-14	11-13
EBITDA margin (%)	30.7	23.3	28-29	24-26	24-26

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--

Kazakhstan Temir Zholy--Forecast Summary

Forecast. KZT—Kazakhstani tenge. Source: Company reports.

Financial Summary

Kazakhstan Temir Zholy--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (bil.)	KZT	KZT	KZT	KZT	KZT	KZT
Revenues	913	1,044	1,139	1,173	1,329	1,481
EBITDA	217	256	313	348	408	345
Funds from operations (FFO)	134	155	160	228	278	218
Interest expense	95	95	177	128	133	121
Cash interest paid	79	103	152	117	124	125
Operating cash flow (OCF)	181	156	250	197	318	264
Capital expenditure	231	203	164	202	252	335
Free operating cash flow (FOCF)	(50)	(47)	86	(5)	65	(70)
Discretionary cash flow (DCF)	(51)	(50)	65	(6)	65	(70)
Cash and short-term investments	63	67	152	155	164	253
Gross available cash	63	67	152	155	164	253
Debt	1,258	1,409	1,443	1,544	1,551	1,560
Common equity	1,259	1,141	1,156	1,139	1,272	1,463
Adjusted ratios						
EBITDA margin (%)	23.8	24.5	27.4	29.6	30.7	23.3
Return on capital (%)	4.6	5.5	7.1	8.8	10.4	7.7
EBITDA interest coverage (x)	2.3	2.7	1.8	2.7	3.1	2.9
FFO cash interest coverage (x)	2.7	2.5	2.1	2.9	3.2	2.7
Debt/EBITDA (x)	5.8	5.5	4.6	4.4	3.8	4.5
FFO/debt (%)	10.7	11.0	11.1	14.8	17.9	14.0
OCF/debt (%)	14.4	11.0	17.3	12.7	20.5	16.9
FOCF/debt (%)	(4.0)	(3.3)	6.0	(0.3)	4.2	(4.5)
DCF/debt (%)	(4.1)	(3.5)	4.5	(0.4)	4.2	(4.5)

Peer Comparison

Kazakhstan Temir Zholy--Peer Comparisons

	Kazakhstan Temir Zholy	Georgian Railway JSC
Foreign currency issuer credit rating	BB/Stable/--	BB-/Stable/B
Local currency issuer credit rating	BB/Stable/--	BB-/Stable/B
Period	Annual	Annual
Period ending	2022-12-31	2022-12-31
Bil.	KZT	GEL
Revenue	1,481	115
EBITDA	345	49
Funds from operations (FFO)	218	39
Interest	121	11
Cash interest paid	125	10
Operating cash flow (OCF)	264	44
Capital expenditure	335	23
Free operating cash flow (FOCF)	(70)	21
Discretionary cash flow (DCF)	(70)	16
Cash and short-term investments	253	48
Gross available cash	253	48
Debt	1,560	238
Equity	1,463	133
EBITDA margin (%)	23.3	42.2
Return on capital (%)	7.7	11.9
EBITDA interest coverage (x)	2.9	4.4
FFO cash interest coverage (x)	2.7	4.9
Debt/EBITDA (x)	4.5	4.9
FFO/debt (%)	14.0	16.3
OCF/debt (%)	16.9	18.5
FOCF/debt (%)	(4.5)	8.8
DCF/debt (%)	(4.5)	6.9

Rating Component Scores

Foreign currency issuer credit rating	BB/Stable/--
Local currency issuer credit rating	BB/Stable/--
Business risk	Fair
Country risk	High
Industry risk	Low
Competitive position	Fair
Financial risk	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb-
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Less than Adequate (-1 notch)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	b+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011