# Credit Opinion: Kaztemirtrans, JSC

Global Credit Research - 28 May 2014

*Astana, Kazakhstan*

## Ratings

| Category | Moody's Rating |
|---|---|
| Outlook | Positive |
| Corporate Family Rating | Ba1 |
| **Parent: National Company Kazakhstan Temir Zholy JSC** | |
| Outlook | Positive |
| Issuer Rating | Baa3 |
| Bkd Senior Unsecured | (P)Baa3 |

## Contacts



| Analyst | Phone |
|---|---|
| Artem Frolov/Moscow | 7.495.228.6060 |
| Sergei Grishunin/Moscow | |
| Jean-Michel Carayon/Paris | 33.1.53.30.10.20 |



## Key Indicators

[1]**Kaztemirtrans, JSC**

| | 31/12/2013 | 31/12/2012 | 31/12/2011 | 31/12/2010 | 31/12/2009 |
|---|---|---|---|---|---|
| Revenue ($ million) | $706.8 | $552.0 | $413.7 | $338.6 | $283.2 |
| Operating Margin | 22.5% | 37.9% | 38.2% | 41.8% | 34.4% |
| FFO / Debt | 6.6% | 8.3% | 12.4% | 11.4% | 17.8% |
| EBITA / Avg. Assets | 5.9% | 8.6% | 9.3% | 10.3% | 10.0% |
| Debt / EBITDA | 7.7x | 7.3x | 5.3x | 5.9x | 4.1x |
| EBIT / Interest Expense | 1.2x | 1.9x | 2.2x | 3.0x | 2.6x |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

*Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.*

## Opinion

### Rating Drivers

- Strategic importance for the state and strong government support resulting from status as an integral part of Kazakhstan Temir Zholy

- Ongoing transformation of Kaztemirtrans into national freight carrier

- Market leadership in freight rail transportation in Kazakhstan

- Pressure on credit metrics due to large amount of debt and business model transformation

- Challenges associated with operating in a developing market

### Corporate Profile

Headquartered in Astana, JSC Kaztemirtrans (KTT) is a 100% owned subsidiary of JSC National Company Kazakhstan Temir Zholy (KTZ), which is, in turn, the 100% state-controlled vertically integrated rail group operating the national rail network of the Republic of Kazakhstan. KTZ's sole shareholder is the Kazakh government, represented by JSC National Welfare Fund Samruk-Kazyna (Samruk-Kazyna).

KTT is the owner and operator of the largest freight railcar fleet in Kazakhstan. KTZ intends to complete the transfer of the national freight carrier function to KTT in 2014. As part of the people's IPO initiative, the state, via KTZ, may privatise a 5%-10% stake in KTT in 2015. In the longer term, the state may sell an additional stake in KTT to a strategic investor, retaining a controlling stake in the company.

### SUMMARY RATING RATIONALE

In determining KTT's corporate family rating (CFR), we apply our government-related issuer (GRI) rating methodology. According to this methodology, KTT's Ba1 CFR reflects the following combination of inputs: (1) a Baseline Credit Assessment (BCA) of b1; (2) the Baa2 local currency rating of the government of the Republic of Kazakhstan; (3) the high default dependence between KTT and the government; and (4) the strong probability of state support for the company in the event of financial distress.

KTT's BCA of b1 recognises the company's strength derived from being a part of Kazakhstan's national integrated railway business, KTZ (BCA of ba2). At the same time, and similar to that of KTZ, KTT's BCA reflects (1) its increased leverage and continuing negative free cash flow generation as a result of large debt-financed capex needs associated with renewal and expansion of its railcar fleet; (2) exposure to foreign-currency risk, as more than 85% of KTT's debt is denominated in foreign currency; and (3) KTT's overall exposure to an emerging market operating environment with a less developed regulatory, political and legal framework.

KTT's BCA is underpinned by (1) the company's full integration into KTZ's business and its position as the leading railcar operator in the domestic market; and (2) the fact that the company's debt is managed and largely guaranteed by KTZ.

### DETAILED RATING CONSIDERATIONS

Our assessment of there being high default dependence between KTT and the Kazakhstan government mirrors our assumption for KTZ, based on our view that there is a high correlation between the financial profiles of the government and KTZ, including KTT, as (1) KTT's business is focused on the Republic of Kazakhstan; and (2) the company's credit profile is dependent on the operating framework, including tariff regulation, set by the government.

KTT's rating incorporates our assumption that the company would benefit from strong government support in the event of need, which takes into account (1) the fact that KTT is the owner of virtually all freight railcars in the KTZ group and therefore is essential for the group's business; and (2) our assessment of a high probability of state support available for KTZ. At the same time, we note that, because it is part of KTZ, KTT's access to the state support is not direct. This indirectness of the state support has resulted in a lower probability of support being incorporated into KTT's Ba1 CFR compared with that incorporated into KTZ's Baa3 issuer rating.

Key Considerations for the BCA

STRATEGIC IMPORTANCE AND MARKET LEADERSHIP WILL REMAIN IN PLACE

Railway is the key freight transportation industry in Kazakhstan, a country that is characterised by substantial size, a landlocked position and widespread natural resources. In 2013, railway transportation represented 47% of total freight transportation turnover in Kazakhstan, including pipelines.

KTZ, a parent company of KTT, is the monopoly provider of rail infrastructure services in Kazakhstan and holds the leading position in the country's railway market in terms of railcar fleet, while KTT is the owner of virtually all freight railcars in the KTZ group. With a fleet of 65,606 freight railcars as of year-end 2013, representing 51% of the Kazakhstan total, KTT's market position is likely to remain unrivalled for the foreseeable future.

As independent operators do not have access to the national railway network, private participation in the Kazakhstan railway transportation industry is currently limited to ownership, leasing and operation of railcars and containers. Private operators have a total market share of 49% by railcar fleet. Many private operators are part of industrial groups and largely service their cargo turnover.

SHIFT IN BUSINESS MODEL IS LIKELY TO INCREASE EBITDA

Until 2013 KTT's main business was leasing out its railcars to KTZ (92% of its revenue for 2011 and 76% for 2012). As part of KTZ's corporate restructuring process, KTT is to fully take over the freight transportation function from KTZ, including locomotive traction services. In 2013, the company increased the portion of its railcar fleet that is under its own operation. The share of KTT's revenues from the operator business represents a major 67% portion of total revenue for 2013.

The shift in business model should be beneficial for KTT's financial profile, because the freight rail carrier business will generate higher revenue and EBITDA than its previous business of leasing railcars. However, the carrier business is generally less marginal than operating leasing because of higher costs, as reflected in KTT's EBITDA margin decline to 52% as of year-end 2013 from 72% a year earlier.

LARGE AMOUNT OF DEBT AND BUSINESS MODEL TRANSFORMATION EXERT PRESSURE ON CREDIT METRICS

KTT's debt profile has been largely developed as part of KTZ's debt strategy, with a large portion of the company's borrowings procured for the whole KTZ group. In 2006, 2010 and 2012, KTT's wholly owned subsidiary KTZ Finance issued Eurobonds for the KTZ group totalling $2.6 billion (of which $450 million was repaid in May 2011). The bonds are guaranteed by KTT, KTZ and its subsidiary JSC Lokomotiv. This debt, sitting at the level of KTT, represents the major portion of KTZ's consolidated debt as of year-end 2013, and was partially channelled by KTT as loans to KTZ and JSC Locomotive. In April 2014, KTZ substituted KTZ Finance as a borrower under the $1.1 billion Eurobond placed in 2012.

KTT's BCA incorporates normalised leverage, which factors in KTT's loans to KTZ and JSC Lokomotiv. As of year-end 2013, KTT's normalised debt/EBITDA increased to 6.4x from 6.0x as of year-end 2012, while normalised EBIT interest coverage declined to 1.2x from 2.1x. The weakening of financial metrics was a result of KTT's EBITDA decline, mainly because of increased empty run costs resulting from KTT's shift to the operator business model. We note that we do not include in KTT's debt its guarantees provided for other KTZ group companies if the underlying obligations are also guaranteed by KTZ, assuming low probability of KTT's guarantees being called as long as debt is guaranteed by KTZ which is a stronger credit. Nevertheless, KTT's guarantees represent an additional credit negative factor which contributes to KTT's lower BCA and rating compared with KTZ.

KTT's normalised financial metrics should improve after the company starts providing locomotive traction services, as anticipated under the KTZ group reorganisation plan. However, the timing of improvement is uncertain. We note that KTT benefits from the long-term nature of its debt portfolio, as most debt matures after 2015, mitigating refinancing risk over the next 12-18 months.

**Liquidity Profile**

As of December 2013, KTT had KZT19 billion ($123 million) in cash and cash equivalents and expected to generate solid operating cash flow over the following 12 months, which was sufficient to comfortably cover its short-term debt maturities of KZT7 billion ($45 million) and planned capex of around KZT32 billion ($208 million) over the following 12 months.

**Rating Outlook**

The positive rating outlook reflects the potential for an upgrade of KTT's rating, which would be likely in the event of an upgrade of the sovereign rating, provided that KTT is able to restore its financial metrics more comfortably within the guidance for the current BCA in the near term, and maintains solid liquidity on a sustainable basis.

**What Could Change the Rating - Up**

The rating is likely to be upgraded in case of an upgrade of the sovereign rating. Upward pressure on KTT's rating could also arise if conditions in the Kazakhstan freight transportation market remain supportive, coupled with KTT generating positive free cash flow on a sustainable basis and reducing its normalised leverage.

**What Could Change the Rating - Down**

We could downgrade KTT's rating if there were a sustained deterioration in KTT's ability to generate cash flow and in its leverage metrics, or if the company's liquidity position weakened. In addition, KTT's rating would be downgraded if we were to downgrade the rating of the Kazakhstan government, or revise downwards our assessment of the probability of the government providing extraordinary support to the company in the event of financial distress.

## Rating Factors

**Kaztemirtrans, JSC**

| **Surface Transportation and Logistics Industry Grid** [1][2] | **Current FY 31/12/2013** | | [3]**Moody's 12-18 Month Forward ViewAs of 27/05/2014** | |
|---|---|---|---|---|
| **Factor 1 : Business Profile (15%)** | **Measure** | **Score** | **Measure** | **Score** |
| a) Business Profile | Ba | Ba | Ba | Ba |
| **Factor 2 : Scale (20%)** | | | | |
| a) Revenue ($ billion) | $0.7 | Caa | $0.6 - $0.7 | Caa |
| **Factor 3 : Profitability, Cash Flow, and Returns (20%)** | | | | |
| a) Operating Margin | 22.5% | A | 22% - 24% | A |
| b) FFO / Debt | 6.6% | B | 5% - 8% | B |
| c) EBITA / Avg. Assets | 5.9% | Ba | 6% - 7% | Ba |
| **Factor 4 : Leverage and Coverage (30%)** | | | | |
| a) Debt / EBITDA | 7.7x | Caa | 7.0x - 7.5x | Caa |
| b) EBIT / Interest Expense | 1.2x | B | 1.0x - 1.3x | B |
| **Factor 5 : Financial Policy (15%)** | | | | |
| a) Financial Policy | Ba | Ba | Ba | Ba |
| **Rating:** | | | | |
| a) Indicated Rating from Grid | | B2 | | B2 |
| b) Actual BCA Assigned | | | | b1 |

| **Government-Related Issuer** | **Factor** |
|---|---|
| a) Baseline Credit Assessment | b1 |
| b) Government Local Currency Rating | Baa2 |
| c) Default Dependence | High |
| d) Support | Strong |
| e) Final Rating Outcome | Ba1 |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 31/12/2013; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

MOODY'S
INVESTORS SERVICE