MOODY'S
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Credit Opinion: Kaztemirtrans, JSC

Global Credit Research - 25 Dec 2012

Astana, Kazakhstan

Ratings

Category	**Moody's Rating**
Outlook	Stable
Corporate Family Rating	Ba1
Parent: Kazakhstan Temir Zholy (KTZ)	
Outlook	Stable
Issuer Rating	Baa3

Contacts

Analyst	**Phone**
Artem Frolov/Moscow	7.495.228.6060
Marco Vetulli/Milan	39.02.9148.1100
David G. Staples/DIFC - Dubai	971.42.37.9536

Key Indicators

Kaztemirtrans, JSC[1]

	30/06/2012(LTM)	31/12/2011	31/12/2010	31/12/2009
EBIT Margin	**55.3%**	**57.0%**	**59.5%**	**51.2%**
RCF/Net Debt	**11.0%**	**12.8%**	**13.0%**	**14.7%**
FFO Interest Coverage	**3.2x**	**2.9x**	**3.6x**	**3.6x**
Debt/EBITDA	**6.8x**	**5.9x**	**7.3x**	**5.6x**
Debt/Book Capitalization	**78.5%**	**72.0%**	**82.0%**	**76.2%**

[1] All ratios are calculated using Moody's adjustments. 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

- Pending liberalisation of freight tariffs and ongoing transformation of Kaztemirtrans into national freight carrier

- Market leadership in freight rail transportation in Kazakhstan

- Pressure on credit metrics due to high capital expenditure (capex) to fund growth

- Challenges associated with operating in a developing market

Corporate Profile

Headquartered in Astana, JSC Kaztemirtrans (KTT; Ba1 stable) is a 100% owned subsidiary of JSC National Company Kazakhstan Temir Zholy (KTZ; Baa3 stable), 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 owns the largest railcar fleet in Kazakhstan, generating its revenues mainly from leasing out railcars to the KTZ group (92% of KTT's revenue in 2011). KTT is to take over the national freight carrier function from KTZ by 2014. As part of the people's IPO initiative, the state, via KTZ, may privatise a 5%-10% stake in KTT in 2014. However, it expects to retain a controlling stake in the company in the longer term. KTT continues to benefit from state support as the company forms an integral part of the KTZ group.

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 factors in (1) the expected increase in the company's leverage and weakening of its cash flow metrics as a result of the large capex needs associated with its aged railcar fleet, along with its fleet expansion plans, which make it reliant on external funding; (2) exposure to foreign-currency risk, as more than two thirds 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 remains underpinned by (1) the company's full integration into KTZ's business and its position as the leading railcar provider in the domestic market; (2) the generally supportive regulatory environment, which enables KTT to recover its operating costs and links tariff decisions and the company's investment plans; and (3) 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. Railway transportation represents 50% of total freight transportation turnover in Kazakhstan, including pipelines.

KTZ, a parent company of KTT, is the monopoly provider of rail infrastructure services and holds the leading position in the railway market in Kazakhstan in terms of railcar fleet, while KTT is the owner of virtually all freight railcars in the KTZ group. With a fleet of 61,132 freight railcars as of 1 October 2012, representing more than 50% 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 the ownership, leasing and operation of railcars and containers. Private operators have a total market share of around 50% by freight turnover and less than 50% by freight railcar fleet. However, most private operators form parts of industrial groups and largely service their cargo turnover. Through its scale and flexible tariff policy, KTT aims to maintain its leading market position, targeting a share of at least 80% in terms of revenue following the tariff liberalisation that is to take place in the country in 2014.

TARIFF DEREGULATION AND SHIFT IN BUSINESS MODEL ARE TO INCREASE EBITDA...

Current regulation of freight transportation tariffs in Kazakhstan is driven largely by social and political considerations, which frequently overweigh the economic drivers. Limiting tariff growth hampers fleet renewal and limits KTZ's EBITDA and cash flow generation growth. One of the main components of the government's strategy is the liberalisation of freight tariffs by 2014. By that time, only infrastructure services will remain regulated, while locomotive traction, railcar usage, and freight and commercial services will be liberalised.

Tariff liberalisation will be gradual and will start with deregulation of the railcar usage component of the tariff, which directly relates to KTT's current main business of leasing out its railcars to KTZ, generating a dominant 92% portion of the former's revenue in 2011. Deregulation of this component would enable KTZ to charge higher fees related to the railcar usage from customers and transfer that surplus to KTT, which should support KTT's margins attributed to its railcar leasing business.

As part of KTZ's corporate restructuring process, KTT is gradually increasing the portion of its railcar fleet that is under its own operation, aiming to fully take over the freight transportation function from KTZ in 2014. While the freight transportation business has lower margins compared with those for the company's main business of leasing railcars, its revenue generation and EBITDA are set to increase in absolute terms as a result of the transportation business's scale.

... WHILE THE LARGE AMOUNT OF DEBT RAISED TO FINANCE CAPEX WILL CONTINUE EXERTING 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, and was partially channelled by KTT as loans to KTZ and JSC Locomotive.

We note that KTT's BCA incorporates normalised leverage, which factors in KTT's loans to KTZ and JSC Lokomotiv. KTT's normalised debt/EBITDA was 4.1x as of year-end 2011, but is likely to exceed 5.0x as of year-end 2012 as a result of KTZ Finance's issuance of a new 30-year $1.1 billion Eurobond in 2012, largely used for acquiring rolling stock for KTT. However, we expect this increase to be temporary and that leverage will decline below 5.0x in 2013 as the acquired railcars start generating EBITDA. We also take comfort from the long-term nature of KTT's debt portfolio, as most debt matures after 2016, mitigating refinancing risk over the next 18-24 months.

Liquidity

RELIANCE ON EXTERNAL SOURCES TO FUND CAPEX

As of September 2012, KTT had cash balance of KZT34.1 billion ($227 million) and short-term debt maturities of KZT19.5 billion ($130 million). Operating cash flow expected over the following 12 months fell short of KTT's planned expansion capex and the company remained reliant on raising new debt to finance it, which it procured by issuing a $300 million Eurobond in November 2012.

Rating Outlook

The stable outlook on KTT's rating reflects our expectation that the company's financial profile, which is supported by the government via KTZ, will remain commensurate with the current rating.

What Could Change the Rating - Up

Upward pressure on the rating could arise if conditions in the Kazakhstan freight transportation market remain stable, 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 the 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.