MOODY'S
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Credit Opinion: Kaztemirtrans, JSC

Global Credit Research - 21 Aug 2013

Astana, Kazakhstan

Ratings

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

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Key Indicators

[1]**Kaztemirtrans, JSC**

	31/12/2012	**31/12/2011**	**31/12/2010**	**31/12/2009**
Revenue ($ million)	**$552.0**	**$413.7**	**$338.6**	**$283.2**
Operating Margin	**37.9%**	**38.2%**	**41.8%**	**34.4%**
FFO / Debt	**7.1%**	**11.3%**	**9.4%**	**13.0%**
EBITA / Avg. Assets	**8.3%**	**9.2%**	**10.1%**	**10.0%**
Debt / EBITDA	**8.8x**	**5.9x**	**7.3x**	**5.6x**
EBIT / Interest Expense	**1.8x**	**2.2x**	**2.9x**	**2.6x**

[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

- 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) 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 railcar fleet in Kazakhstan. KTZ intends to transfer the national freight carrier function to KTT 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.

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 80% 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; (2) our expectation of improvement in the company's financial metrics over the next 12-18 months; 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 nearly 50% 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 65,496 freight railcars as of year-end 2012, representing more than 60% 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 less than 40% 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 in 2014 (including locomotive traction services). In 2012 and the first half of 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 is likely to represent a major portion of total revenue for 2013.

The shift in business model should be beneficial for KTT's operating performance, because the operator business is likely to generate higher EBITDA margin than its previous business of leasing railcars. In addition, the company's revenue generation and EBITDA are likely to increase in absolute terms as a result of the operator business's larger scale.

LARGE AMOUNT OF DEBT RAISED TO FINANCE CAPEX EXERTS 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.

KTT's BCA incorporates normalised leverage, which factors in KTT's loans to KTZ and JSC Lokomotiv. As of year-end 2012, KTT's normalised debt/EBITDA increased significantly to 7.7x from 4.4x as of year-end 2011, while normalised EBIT interest coverage declined to 2.1x from 3.6x. The weakening of financial metrics was a result of the company raising substantial new debt, including a $1.1 billion Eurobond, to finance the purchase of 14,200 new railcars. In 2012, capex peaked at 227% of revenue, compared with 177% in 2011 and 43% in 2010.

We expect normalised leverage to decline below 5.0x by year-end 2013, as a result of both a reduction in debt and increase in EBITDA following business model transformation and railcar fleet expansion. We also take comfort from the long-term nature of KTT's debt portfolio, as most debt matures after 2017, mitigating refinancing risk over the next 18-24 months.

Liquidity Profile

As of June 2013, KTT had KZT12 billion ($82 million) in cash 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 KZT53 billion ($350 million) over the following 12 months.

Rating Outlook

The positive outlook on KTT's rating reflects the potential for an upgrade of KTT's rating, should the sovereign rating be upgraded, and taking into account our expectation of improvement in the company's standalone financial profile.

What Could Change the Rating - Up

The rating is likely to be upgraded in case of an upgrade of the sovereign rating. In addition, upward pressure on the rating could 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 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.

Rating Factors

Kaztemirtrans, JSC

Surface Transportation and Logistics Industry [1][2]	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**	**Caa**	**Ca**
Factor 1 : Business Profile (15%)								
a) Business Profile					x			
Factor 2 : Scale (20%)								
a) Revenue ($ billion)							$0.6	
Factor 3 : Profitability, Cash Flow, and Returns (20%)								
a) Operating Margin		37.9%						
b) FFO / Debt						7.1%		
c) EBITA / Avg. Assets					8.3%			
Factor 4 : Leverage and Coverage (30%)								
a) Debt / EBITDA							8.8x	
b) EBIT / Interest Expense						1.8x		
Factor 5 : Financial Policy (15%)								
a) Financial Policy					x			
Rating:								
a) Indicated Rating from Grid						B1		
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

[1] All ratios are calculated using Moody's adjustments. [2] As of 31/12/2012; Source: Moody's Financial Metrics

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