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Summary:

JSC Kaztemirtrans

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Summary:

JSC Kaztemirtrans

Credit Rating:	BBB-/Stable/--

Rationale

We equalize the rating on Kazakhstan's major freight wagon owner JSC Kaztemirtrans (KTT) with our rating on Kazakhstan's national railway operator Kazakhstan Temir Zholy (KTZ; BBB-/Stable/--; Kazakhstan national scale kzAA/--/--), KTT's 100% parent. The equalization of the rating reflects our view of an almost certain likelihood that KTZ would provide financial support to KTT, if needed. We base our view on the following:

- KTT is 100% owned by KTZ. The KTZ group guarantees almost all of KTT's debt;
- KTZ views KTT as a strategic core subsidiary. KTT is tightly integrated within KTZ's freight operations--one of the group's main activities--and derives the bulk of its revenues from KTZ; and
- As one of the main subsidiaries of the KTZ group, KTT is closely associated with KTZ and we think that its default would negatively affect KTZ's access to the capital markets;
- In addition, most of the KTZ group's debt carries cross guarantees between KTZ and KTT, as well as cross-default provisions.

The stand-alone credit profile of KTT is constrained by what we see as the company's obsolete rolling stock, which results in high investment needs; high debt leverage; high exposure to foreign currency risk; and exposure to rail traffic volatility under existing short-term lease contracts.

We see rail traffic in Kazakhstan as potentially volatile, owing to its concentration on just a few commodities; its sensitivity to commodity prices; and its dependence on railroad tariffs in other transit and destination countries. In our view, KTT's lease contracts with KTZ do not provide adequate protection from this volatility. The contracts are short term and do not guarantee full or even minimum compensation, since KTZ pays only for the actual number of wagon days used while KTT must keep a specified number of wagons available for KTZ at all times.

These constraints are mitigated, in our opinion, by KTT's strong position as the major freight wagon owner in Kazakhstan, whose economy depends highly on rail transport--with significant demand for rail freight transportation--and where rail competes strongly against other means of freight transport.

S&P base-case operating scenario

In April 2012, the Kazakh Agency for the Regulation of Natural Monopolies increased the average tariff for wagon leasing by 15.5% following an 18.2% tariff increase in January 2011. We expect another, albeit less steep, tariff improvement in 2013 to support implementation of KTT's long-term investment program.

Under our base-case scenario, we believe that KTT's revenues will likely increase by about 15% in 2012, in line with the tariff increase. This is further to a 22% increase in revenues in 2011, which was also driven mainly by higher tariffs, as well as growth in demand for freight wagons. We assume a similar rate of revenue growth 2013.

KTT's profitability has been improving over recent years, and we view it as supporting the ratings. In our opinion, the improvement reflects favorable tariff regulations, but also better operating efficiency. KTT's EBITDA margin reached 54% of revenues in 2011, and we believe that it will likely remain stable in the coming years. However, some improvement in the EBITDA margin is possible as the company gradually renews its rolling stock.

S&P base-case cash flow and capital-structure scenario

We link our assessment of KTT's financial risk profile to that of KTZ. KTT raised a large part of its debt (about $1 billion as of Dec. 31, 2011, of total adjusted debt of $1.8 billion) in favor of KTZ or its locomotive fleet operations subsidiary, JSC Locomotiv (not rated). In addition, KTT has provided about $170 million in guarantees for the KTZ group, while the KTZ group guarantees almost all of KTT's consolidated debt. This supports the consolidated approach we take when assessing the credit quality of KTT.

On a consolidated basis, including the recent bond issues that KTT partly onlent to the KTZ group, KTT has what we consider to be very aggressive cash flow and debt protection measures. In 2011, the ratio of funds from operations to debt was about 10% and debt to capital was about 71%. Under our current base-case rating scenario, we believe that the improvement we anticipate in cash flows on the back of increases in traffic volume and tariffs, will most likely be offset by a higher level of debt that KTT has assumed to proceed with its capital spending program. Consequently, we do not forecast an improvement in KTT's financial risk profile in the near term.

Liquidity

We view KTT's liquidity profile as "adequate," under our criteria, in line with KTZ's liquidity profile.

KTT's liquidity and cash flow generation depend on KTZ's timely payment of rolling-stock leases (86% of KTT's 2011 revenues) and the repayment of intragroup loans from KTZ and Locomotiv. We understand that KTZ coordinates treasury and liquidity centrally, and transfers cash to KTT by adjusting receivables.

We anticipate that KTT's cash flow, together with available cash balances, will likely be sufficient to cover debt maturities of about KZT4 billion over the 12 months to Sept. 30, 2013, and capital expenditure (capex) in the 12 months to end-September 2013. However, we believe that implementation of the sizable investment program could put KTT's liquidity under pressure unless the company secures the necessary financing, which we assume will be the case. Since most of its capital spending is discretionary, we believe that KTT will likely match its capex to its available funding sources.

Under its existing debt agreements, KTT is subject to a number of financial covenants that are tested on a semi-annual basis, and under which we understand the company has adequate headroom. We assume adequate headroom under the covenants through 2013.

Outlook

The stable outlook reflects our assumption that KTT will remain a core subsidiary of KTZ and will remain closely integrated into the group's operations. We will likely revise our rating on KTT if we revise that on KTZ.

In addition, a material change in the parent-subsidiary relationship between KTT and KTZ--which we currently do not anticipate--could cause us to change our current rating equalization approach and reassess KTT's credit quality and our corporate credit rating on KTT.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Corporate Criteria--Parent/Subsidiary Links; General Principles; Subsidiaries/Joint Ventures/Nonrecourse Projects; Finance Subsidiaries; Rating Link to Parent, Oct. 28, 2004

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