

## Research Update: Kazakh National Rail Co. Kazakhstan Temir Zholy 'BB+/kzAA-' Ratings Affirmed; Outlook Stable

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**Primary Credit Analyst:** Eugene Korovin, Moscow (7) 495-783-4090;  
[evgueni\\_korovin@standardandpoors.com](mailto:evgueni_korovin@standardandpoors.com)  
**Secondary Credit Analyst:** Sergei Gorin, Moscow 7 495 783 4132;  
[sergei\\_gorin@standardandpoors.com](mailto:sergei_gorin@standardandpoors.com)

### Rationale

On April 18, 2008, Standard & Poor's Ratings Services affirmed its 'BB+' long-term corporate credit and 'kzAA-' Kazakhstan national scale ratings on Kazakh national railroad company Kazakhstan Temir Zholy (KTZ). The outlook is stable.

The ratings on KTZ reflect the company's high strategic importance to the state and strong government support. The ratings are based on a top-down approach and are two notches lower than the sovereign local currency rating.

The ratings on KTZ are constrained by an opaque regulatory regime in Kazakhstan and the company's obsolete assets and aggressive investment program. The ongoing rail-sector restructuring, the risk of commodities traffic volatility, and competition from oil pipelines also constrain the ratings.

The company's strong market and competitive position in the national transport sector somewhat mitigate these risks. KTZ's vertically integrated business model, which combines monopoly rail infrastructure and profitable freight transport operations, and the company's intermediate financial profile and moderate financial policy also bolster the ratings.

KTZ is strategically important to Kazakhstan as a national rail company, transporting 58% of national freight and employing 1.7% of the national labor force. This justifies government support to KTZ. KTZ benefits from state support through such means as budget subsidies to the passenger segment and guarantees on some debt, although new borrowings are not guaranteed. The government also shares the burden of rail infrastructure development with KTZ and supports a benign low dividend policy.

We estimate KTZ's stand-alone credit quality, which has improved on the back of recent tariff decisions and changes in financial policy, at 'BB+'.

KTZ holds a strong competitive position as a low-cost commodities transporter, but faces competition in oil transportation from pipelines and is exposed to volume risk in commodities exports, which are influenced by market prices.

Kazakhstan's new rail-sector restructuring plan for 2008-2010 calls for ownership unbundling of KTZ's loss-making passenger segment and some other assets. KTZ should, however, retain a vertically integrated business model that includes infrastructure, locomotives, and freight operations.

KTZ operates under a cost-cover regulatory regime, which lacks transparency, is politicized, and does not ensure timely cost recovery. In January 2008, however, the government approved a tariff policy for 2008-2012 that decrees a substantial increase in KTZ tariffs and increases visibility regarding future tariffs.

The company faces significant operating risks, due to its exposure to electricity and fuel prices; growing maintenance costs, following divestment of its repair operations; and aged rail infrastructure and rolling stock, requiring significant investment.

In January 2008, the government also approved the company's new medium-term investment program for 2008-2012, increasing it substantially to Kazakhstani tenge (KZT) 888 billion (\$7.4 billion).

KTZ has an adequate financial profile for the ratings, with funds from

operations to debt at 68% in 2006. We expect KTZ's financial profile to weaken over 2008-2010, given its large investment program that partially relies on debt financing. We expect, however, that the company will comply with its financial policy targets, including keeping debt to EBITDA below 2.9x and net debt to net capital below 21%.

### Liquidity

KTZ has an adequate liquidity position. According to KTZ management, at Dec. 31, 2007, the company had KZT97.3 billion in cash and bank deposits, which covered its short-term debt of KZT4.5 billion and the financing requirements for the 2008 investment plan.

KTZ has no financial covenants in its outstanding financial obligations.

### Outlook

The stable outlook reflects our expectation that KTZ will continue to benefit from solid state support to the sector, such as higher operating subsidies to the passenger segment, which would allow higher track access locomotive traction charges for the passenger segment after its potential divestment, and financial support for investments in railroad infrastructure. We also expect that KTZ will retain an adequate financial profile within approved financial policy targets, which will underpin KTZ's stand-alone credit quality.

A consistent implementation of the government's tariff policy for KTZ and the sector restructuring plan--including ownership unbundling of the passenger segment from KTZ--together with higher subsidies, could create ratings upside potential in the absence of negative macroeconomic implications.

A positive change in the sovereign rating or outlook would most likely lead to similar movement in the ratings on KTZ, unless there is evidence of a changed relationship with the state, which would likely trigger a revision of our top-down rating approach.

A negative change in the sovereign rating would not automatically result in a similar action on the company, unless the trigger for the sovereign rating change materially impairs KTZ's stand-alone credit quality.

### Ratings List

Corporate credit rating	BB+/Stable/--
Kazakhstan national scale rating	kzAA-

NB: This list does not include all ratings affected.

**Additional Contact:** [Infrastructure Finance Ratings Europe;  
InfrastructureEurope@standardandpoors.com](mailto:InfrastructureFinanceRatingsEurope@standardandpoors.com)

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