

Transportation  
Kazakhstan  
Update

# Kazakhstan Temir Zholy

## Ratings

Security Class	
Foreign Currency	
Long-Term IDR	BBB-
Senior Unsecured	BBB-

## Outlook

Foreign-Currency Long-Term IDR Stable

## Financial Data

Kazakhstan Temir Zholy		
	31 Dec 09	31 Dec 08
Revenue (KZTm)	480,993.2	483,763.4
Operating EBITDAR (KZTm)	110,060.5	96,851.5
Operating EBITDAR margin (%)	22.9	20.0
Cash flow from operations (KZTm)	99,554.9	92,374.0
Free cash flow (KZTm)	-7,482.2	-32,019.4
Net fixed charge cover (x)	8.9	28.6
EBITDA/gross interest expense (x)	11.4	10.9
Gross debt (KZTm)	172,584.0	132,167.7
Cash (KZTm)	70,149.4	64,732.8
Net debt (KZTm)	102,434.6	67,434.9
Gross leverage (x)	1.6	1.4
Net leverage (x)	0.9	0.7

## Analysts

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## Related Research

Applicable Criteria

- *Corporate Rating Methodology (November 2009)*
- *Parent and Subsidiary Rating Linkage, Fitch's Approach to Rating Entities Within a Corporate Group Structure (June 2007)*

Other Research

- *Fitch Affirms 7 Kazakh Corporates; Revises Outlooks to Stable (December 2009)*

## Rating Rationale

- The ratings of Kazakhstan Temir Zholy (KTZ), the national railway company of Kazakhstan, are aligned with those of the sovereign, due to its 100%-state-ownership, operational linkage with government, and the strategic importance of its operations to Kazakhstan's economy. Accordingly, KTZ's ratings were affirmed on 16 December 2009, and the Outlook on the Long-Term Foreign Currency IDR was revised to Stable from Negative.
- Recovering demand (freight volumes were up 12% year-on-year (yoy) for the first five months of 2010, but still 6% down on 2008) and an average increase of 17.6% in freight tariffs from January 2010 (to be followed by a planned 15% tariff increase in 2011 and in 2012), is expected to result in revenue and earnings growth in the freight division, representing 84% of financial year 2009 (FY09, to December) revenue.
- Despite the lower freight revenue in 2009, passenger revenue rose by 9.6% yoy, and related subsidies by 38% to KZT10bn. The passenger subsidies are planned to increase to KZT22bn in 2012, thus ending the cross-subsidisation by the freight division. Fitch Ratings views this development as a credit positive.
- Staff costs increased by 6.6% yoy in FY09, but other major cost items remained broadly stable – a 21.5% fall in fuel costs helped reduce overall operating costs by 3.7%. Fitch notes that overall cost control was not as tight as for KTZ's peers, however this was offset by comparably healthier top-line performance.
- The agency notes that FYE09 gross leverage of 1.6x (1.4x at FYE08) was lower than Fitch had expected, helped by stronger earnings and delays in capex (2009 capex was around 30% lower than planned) that allowed a slower drawdown on borrowings. The agency expects leverage to increase during 2010, but to stay within the 2.5x covenant level.
- KTZ is likely to remain the monopoly provider of rail infrastructure in Kazakhstan, and maintain a dominant market share in the provision of locomotives and rolling-stock upon completion of the rail reforms.

## What Could Trigger a Rating Action?

- A sovereign rating action would be replicated for KTZ, due to ratings alignment.
- Evidence of weakening state support, and a substantial increase in leverage due to debt-funded capex or weaker-than-expected cash flow generation, would be negative for the ratings.

## Liquidity and Debt Structure

Cash flow from operations (CFO) remained strong in 2009, and the 22% yoy decrease in capex resulted in a manageable increase in gross debt (31%), despite the Kazakh tenge's 25% devaluation in February 2009 (the company's debt is largely US dollar-denominated). KTZ had a cash position of around KZT62.5bn (USD421m) at end-May 2010, compared with maturities of KZT17.8bn in 2010 and KZT85bn in 2011, including KZT67bn (USD450m) relating to notes due in May 2011. Management plans to refinance the notes to allow an increase in capex, but is also building up a board-approved segregated liquidity fund (KZT32.5bn of the cash position above; increasing monthly by KZT3.3bn). Liquidity (now largely in dollars) is held with various banks – including local banks, which is a concern for Fitch.

**Peer Group**

Issuer	Country
AA	
DB	Germany
BBB	
RZD	Russian Federation
BB+	
TransContainer	Russian Federation
B+	
Georgian Railway LLC	Georgia

**Issuer Rating History**

Date	LT IDR (FC)	Outlook/ Watch
16 Dec 09	BBB-	Stable
5 Jun 09	BBB-	Negative
19 Feb 09	BBB-	RWN
10 Nov 08	BBB-	Negative
4 Nov 08	BBB	Negative
17 Dec 07	BBB	Negative
21 Mar 06	BBB	Stable
7 Feb 06	BBB	Stable
22 Dec 05	BBB	Stable
1 Nov 04	BBB-	Stable
11 Oct 04	BB+	Positive
27 Dec 02	BB+	Stable

"RWN" denotes Rating Watch Negative

**Snapshot Profile: Major Issuer-Specific Rating Factors and Trends**

Rating Factor	Status <sup>a</sup>	Trend
Operations	Average	Neutral
Market Position	Average	Neutral
Finances	Strong	Weakening
Governance	Average	Neutral
Geography	Average	Neutral

<sup>a</sup> Relative to Peer Group

**Immediate Peer Group – Comparative Analysis**

**Sector Characteristics**

*Operating Risks*

National vertically-integrated European railway companies are relatively stable businesses compared with pure transportation service providers and other modes of transport (trucks, shipping and airlines). The transparency, predictability and objectives of regulatory and tariff-setting regimes vary from country to country. Direct or indirect subsidies continue to play a significant role in most countries. The degree of competition (especially in freight rolling-stock provision) also varies greatly, as does the importance of rail transportation for each economy.

*Financial Risks*

The financial profile of integrated railways tends to benefit from solid and stable operating cash flow generation. However, negative FCF will remain common across the sector due to large capex needs – with limited flexibility at times. Railways generally tend to be funded by a mixture of private and public capital.

**Peer Group Analysis**

2008	DB	RZD	KTZ	TransContainer	GR
Revenue (USDm)	49,160.1	40,934.1	4,005.1	683.1	195.8
Total adjusted debt/operating EBITDAR (x)	3.9	2.2	1.4	0.6	0.2
FFO interest coverage (x)	3.7	9.5	12.0	11.7	65.8
EBITDAR margin (%)	14.9	18.2	20.0	34.7	44.7

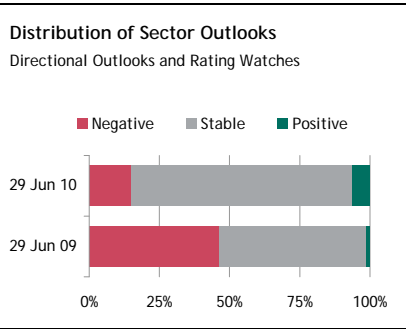
Source: Fitch, companies

**Key Credit Characteristics**

Railway companies with solid business profiles and strong-to-medium financial profiles generally have investment-grade ratings. Key qualitative credit factors include market presence, degree of competition and vertical integration, and freight and passenger diversification. Key financial factors include financial policy, leverage, profit margins and capex plans. Parent (i.e. state) links represent an important rating factor for many railways.

**Overview of Companies**

- **Deutsche Bahn AG (DB, 'AA'/Stable/'F1+')** – 100%-state-owned, DB is the market leader in Germany's national, regional and urban passenger transport segments, and is the operator and owner of the domestic rail infrastructure network. DB also operates rail freight transport, freight-forwarding and contract logistics.
- **JSC Russian Railways (RZD, 'BBB'/Stable/'F3')** – a 100%-state-owned railway company founded in 2003 as a joint-stock company (it previously operated as the Ministry of Railways). RZD operates the second-largest railway transportation system in the world (after that of the US). Its rail activities include ownership of infrastructure, and provision of locomotives and rolling stock. The group also provides passenger and freight transport services.
- **KTZ ('BBB-'/Stable)** – KTZ, which is 100% (indirectly) owned by the state, operates Kazakhstan's rail network, and provides freight and passenger services. Its activities span ownership of rail infrastructure, and the provision of rolling-stock and locomotives. Although the rail reforms in Kazakhstan foresee privatisation in some areas of rail transport (including wagons and, potentially, locomotives), KTZ will remain the monopoly provider of the rail network.
- **OJSC TransContainer (TransContainer, 'BB+ '/Stable/'B')** – the leading container transportation provider in Russia, 85%-owned by RZD.



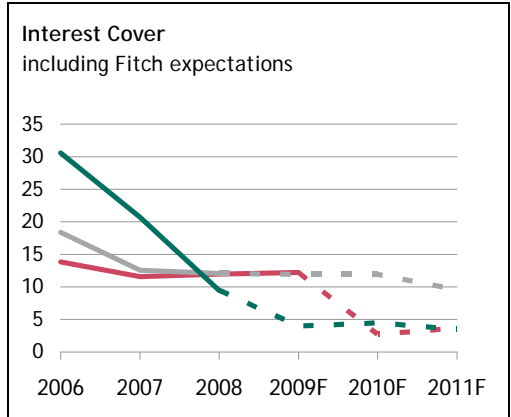
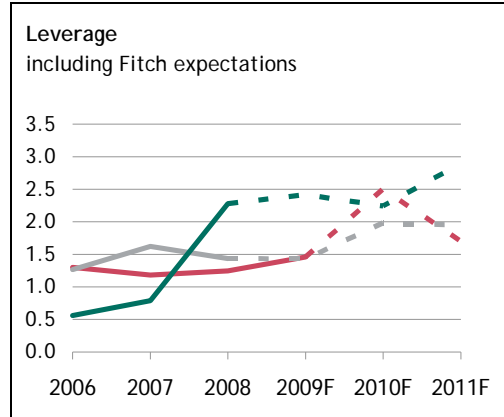
Fitch's expectations are based on the agency's internally-produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions for KTZ include:

- average freight tariff increase of 15% in 2011 and 2012, volumes returning to 2008 levels by 2012;
- passenger subsidies increase to KZT16.7bn in 2012, KZT19.4bn in 2011 and KZT22.2bn in 2010;
- capex increases substantially compared with 2009; dividends remain at 10% of net profit;
- upcoming debt maturities are refinanced only partially.

#### Definitions

- **Leverage:** Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.
- **Interest Cover:** FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.
- **FCF/Revenues:** FCF after dividends divided by revenues.
- **FFO Profitability:** FFO divided by revenues.
- For further discussion of the interpretation of the tables and graphs in this report, see Fitch's "Interpreting the New EMEA and Asia-Pacific Credit Update Format", dated 25 November 2009 and available at [www.fitchratings.com](http://www.fitchratings.com).

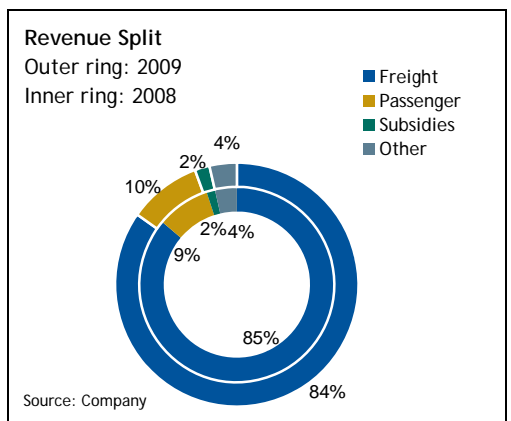
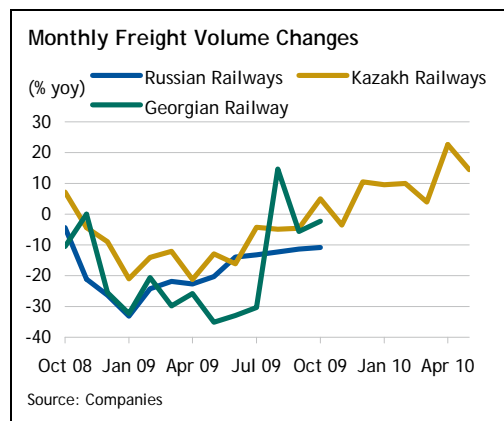
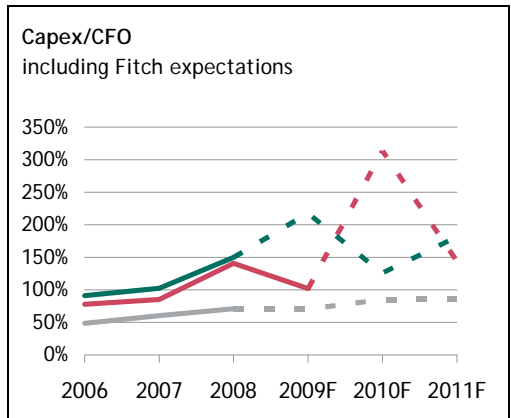
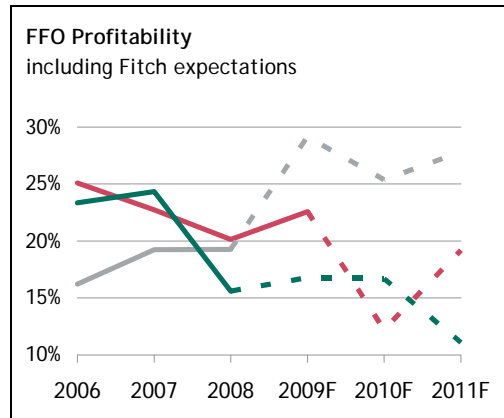
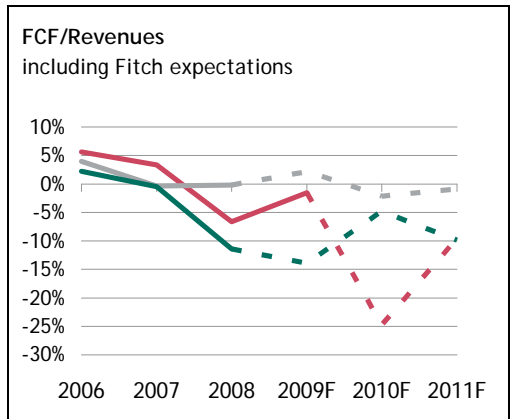
Kazakhstan Temir Zholy — JSC Russian Railways — Emerging BBB Cat Median —  
Source: Company data; Fitch.



### Debt Maturities and Liquidity at 31 December 2009

Debt maturities	KZTm
2010	17,768
2011	84,857
2012-2014	9,454
After 2014	60,504
Cash and equivalents (unrestricted)	70,149

Source: Company



Kazakhstan Temir Zholy  
Financial Summary

	31 Dec 2009 KZTm Original	31 Dec 2008 KZTm Original	31 Dec 2007 KZTm Original	31 Dec 2006 KZTm Original	31 Dec 2005 KZTm Original
<b>INCOME STATEMENT</b>					
Revenues	480,993	483,763	423,639	382,592	285,885
Revenue Growth	(0.6)	14.2	10.7	33.8	16.6
EBIT	61,266	50,580	42,249	45,393	(8,434)
Interest Expense Net of Interest Income	7,012	1,704	2,377	5,122	2,260
Net Income	19,489	63,882	25,555	22,446	(17,233)
<b>BALANCE SHEET</b>					
Cash and Equivalents	70,149	64,733	97,319	85,970	8,456
Total Assets	994,814	927,002	856,340	801,046	671,637
Short-term Debt	17,768	4,773	4,452	4,420	41,995
Senior Long-Term Debt	154,816	127,395	119,967	128,533	23,434
Subordinated Debt	0	0	0	0	0
Total Debt	172,584	132,168	124,418	132,954	65,429
Common Equity	661,002	643,854	582,682	548,818	515,514
Off-Balance Sheet Debt	0	0	0	0	0
Total Adjusted Capitalisation	833,586	776,021	707,101	681,772	580,943
Total Adjusted Debt	172,584	132,168	124,418	132,954	65,429
Preferred Stock + Minority Interests	0	0	0	0	0
<b>CASH FLOW</b>					
Operating EBITDAR (Op. EBITDAR)	110,061	96,852	94,679	91,558	37,970
Cash Interest Paid, Net of Interest Received	7,487	5,117	5,352	5,610	2,594
Cash Tax Paid	1,625	5,304	1,454	4,941	6,148
Associate Dividends	0	0	0	0	0
Other Changes before Funds From Operations**	7,598	10,992	8,428	14,996	12,259
FUNDS FROM OPERATIONS	108,547	97,423	96,300	96,003	41,487
Working Capital	(8,992)	(5,049)	14,206	927	23,672
CASH FLOW FROM OPERATIONS	99,555	92,374	110,506	96,929	65,159
Non-Operational Cash Flow*	(2,864)	8,007	(75)	0	0
Capital Expenditure	101,284	129,845	94,093	75,401	90,608
Dividends Paid	2,888	2,556	2,245	0	1,147
FREE CASH FLOW	(7,481)	(32,019)	14,094	21,529	(26,597)
Receipts from Asset Disposals	0	737	1,246	481	305
Business Acquisitions	0	0	0	73	683
Business Divestments	0	0	168	146	1,112
Exceptional & Other Cash Flow Items	0	(540)	(3,219)	(2,765)	(1,248)
NET CASH IN/OUTFLOW	(7,481)	(31,823)	12,289	19,318	(27,111)
Equity Issuance/(Buyback)	1,578	0	0	0	0
FX movement	(28,973)	0	0	0	0
Other Items Affecting Cash Flow**	(123)	(8,513)	7,596	(9,329)	(9,491)
NET CASH FLOW AVAILABLE FOR FINANCING	(35,000)	(40,336)	19,885	9,989	(36,602)
CLOSING NET DEBT	102,435	67,435	27,099	46,984	56,973
<b>PROFITABILITY</b>					
Op. EBITDAR/Revenues (%)	22.9	20.0	22.3	23.9	13.3
EBIT/Revenues (%)	12.7	10.5	10.0	11.9	(3.0)
FFO Return on Adjusted Capital (%)	14.2	13.7	14.9	15.2	7.6
<b>CREDIT RATIOS</b>					
Funds From Operations/Gross Interest Expense (x)	12.2	12.0	11.6	13.8	17.4
FFO Fixed Charge Cover (x)	12.2	12.0	11.6	13.8	17.4
Op. EBITDAR/Net Fixed Charges (x)	15.7	56.8	39.8	17.9	16.8
Adjusted Leverage/FFO (x)	1.5	1.2	1.2	1.3	1.5
Total Adjusted Debt Net of Cash/Op. EBITDAR (x)	0.9	0.7	0.3	0.5	1.5
Total Adjusted (Recourse) Debt/Total Adjusted Capitalisation (%)	20.7	17.0	17.6	19.5	11.3

Off Balance sheet debt reflects 8 times gross rent expense plus off balance sheet debt with full/limited recourse.

\* Includes Analyst Estimate

\*\* Balancing Item

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