

# Kazakhstan Temir Zholy

## Update

### Ratings

#### Foreign Currency

Long-Term IDR	BBB-
Senior unsecured	BBB-

### Outlook

Foreign-Currency Long-Term IDR	Positive
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### Financial Data

#### Kazakhstan Temir Zholy

	31 Dec 11	31 Dec 10
Revenue (KZTm)	702,749	582,381
Operating EBITDAR (KZTm)	233,667	172,574
Operating EBITDAR/revenues (%)	33.3	29.6
Cash flow from operations (KZTm)	212,052	168,123
Free cash flow (KZTm)	-140,876	-36,552
Operating EBITDA/gross interest expense (x)	11.8	12.9
Total debt with equity credit (KZTm)	363,109	309,594
Cash and equivalents (unrestricted) (KZTm)	181,434	219,715
Total debt with equity credit/operating EBITDA (x)	1.6	1.8
FFO adjusted leverage (x)	1.6	1.8
FFO interest coverage (x)	11.3	16.7

### Key Rating Drivers

**Strong Links With State:** The ratings of Kazakhstan Temir Zholy (KTZ) reflect its 100% indirect state ownership and strategic importance to Kazakhstan ('BBB'/Positive/'F3'), as it provides about half of freight and passenger transportation in the country. Furthermore, KTZ's tariffs are regulated and its investment plans approved, and directly co-funded, by the state (through equity injections and loans). The government also provides direct subsidies for the loss-making passenger business.

**Outlook Positive With Sovereign:** Although KTZ benefits from strong links with the state, full and timely financial support, which would allow rating alignment with the sovereign is not certain without robust legal ties (for example, explicit guarantees). KTZ's rating is therefore one notch down from the sovereign. Fitch revised KTZ's Outlook to Positive from Stable after the upgrade of Kazakhstan's IDR to 'BBB'/Positive from 'BBB-'/Positive in November 2011. Fitch considers KTZ's standalone credit profile commensurate with the low 'BBB' rating category.

**People's IPO in 2014-2015:** JSC National Welfare Fund Samruk-Kazyna (S-K) plans to offer 5%-15% stakes in a number of Kazakh entities, including KTZ, to the local public in a so-called "People's IPO" over 2012-2015. Fitch believes that following the proposed IPO, S-K would retain a majority stake in KTZ and the government will continue to support KTZ at least within rating horizon.

**Negative Free Cash Flow:** Fitch expects profitability and cash flow from operations (CFO) to remain strong in 2012, but the increase in capex will mean higher gross debt. Fitch expects free cash flow (FCF, before equity contributions) to remain negative for the foreseeable future.

**Increase in Leverage:** KTZ's FFO adjusted leverage of 1.6x at end-December 2011 was slightly below that of 2010 (1.8x) and returned to its 2009 level. Due to its substantial capex for 2012-15, Fitch expects KTZ's gross leverage to increase markedly to around 3x in 2014-15.

### What Could Trigger a Rating Action

**Sovereign Rating Action:** An upgrade of Kazakhstan's IDR would probably be replicated for KTZ (with the current one notch differential), unless its links with the state weaken. Similarly, a change in Outlook for the sovereign IDR to Stable would be replicated, unless KTZ's standalone profile significantly strengthens.

### Liquidity and Debt Structure

**Satisfactory Liquidity Position:** KTZ's end-Q112 cash and deposits stood at KZT125bn which is sufficient to cover short-term maturities of KZT35bn as of end-Q112. However, expected negative FCF continues to add to funding requirements.

**Cash With Local Banks:** Cash (largely in US dollars) is mostly held with domestic banks, including ATF Bank JSC ('BBB'/Negative), Kazkommertsbank ('B'/Stable) and Halyk Bank of Kazakhstan ('BB-'/Stable), whose ratings include the potential for moderate government assistance, and whose credit profiles remain challenged.

**FX Risk Remains:** FX risk remains a concern for KTZ as at end-2011 about one-third of its debt was denominated in dollars. Hedging is limited to monitoring exchange rates changes and maintaining a portion of cash in dollars. Interest on KTZ's debt is mostly fixed (74% of debt) at an average rate of about 6%, reducing its exposure to interest rate fluctuations.

### Related Research

[Kazakhstan \(November 2011\)](#)

### Analysts

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Peer Group

Issuer	Country
<b>AA</b> Deutsche Bahn AG	Germany
<b>BBB</b> JSC Russian Railways	Russian Federation
<b>BBB-</b> Kazakhstan Temir Zholy	Kazakhstan
<b>BB-</b> Georgian Railway JSC	Georgia

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
21 Nov 11	BBB-	Positive
15 Apr 11	BBB-	Stable
21 Dec 10	BBB-	Stable
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  
Source: Fitch

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

National vertically integrated European railway companies are relatively stable businesses compared with pure transport 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 transport for each economy.

Financial Risks

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

Peer Group Table

2011	DB 'AA'/Stable	RZD <sup>a</sup> 'BBB'/Stable	KTZ 'BBB-'/Positive	GR 'BB-'/Stable
Revenue (USDm)	52,317	43,779	4,736	288
Operating EBITDAR margin (%)	13.8	33.3	33.3	55.3
FFO interest coverage (x)	6.2	13.2	11.3	6.0
FFO adjusted leverage (x)	4.5	0.9	1.6	1.7

<sup>a</sup> Data for 2010  
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 (ie, state) links are an important rating factor for many railways.

Overview of Companies

**Deutsche Bahn AG** (DB, 'AA'/Stable) – wholly 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 and freight forwarding.

**JSC Russian Railways** (RZD, 'BBB'/Stable) —is 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 transport system in the world (after that of the US). Its rail activities include ownership of the infrastructure, and provision of locomotives and rolling stock. The group also provides passenger and freight transport services.

**Kazakhstan Temir Zholy** (KTZ, 'BBB-'/Positive) — is 100% (indirectly) owned by the state, and owns and operates Kazakhstan's rail network infrastructure, operating freight and passenger services, including the provision of rolling stock and locomotives.

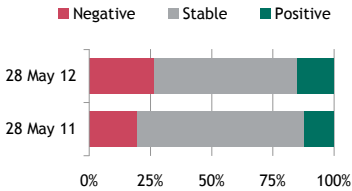
**Georgian Railway JSC** (GR, 'BB-'/Stable) — is the 100%-state-owned vertically integrated monopoly railway of Georgia, operating the key cross-Caucasus link between the Caspian and Black Seas. Its high profitability stems from a high proportion of transit in its operations.

Related Criteria

Corporate Rating Methodology (August 2011)

### Distribution of Sector Outlooks

Directional Outlooks and Rating Watches



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 include:

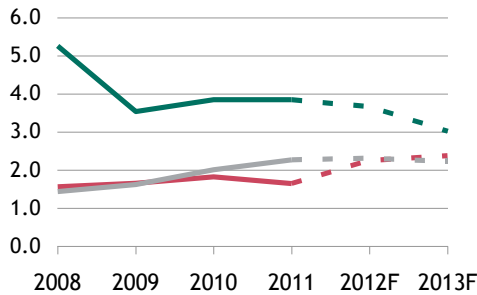
- Revenue increase slightly below nominal GDP growth;
- passenger subsidies increasing to KZT19.9bn in 2012, later flat;
- capex increasing substantially compared with 2011, partially funded through equity and soft shareholder loan.

### Definitions

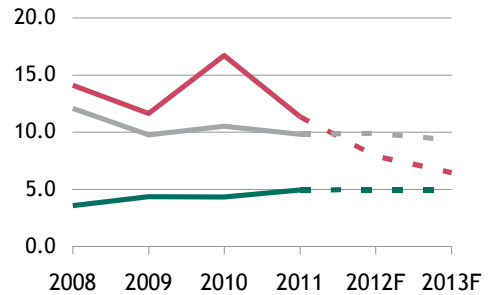
- **Leverage:** Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.
- **Interest cover:** FFO plus gross interest paid plus preferred dividends divided by gross interest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

Kazakhstan Temir Zholy — Transportation Median — Emerging BBB Cat Median —  
Source: Company data; Fitch

### Leverage including Fitch expectations



### Interest Cover including Fitch expectations

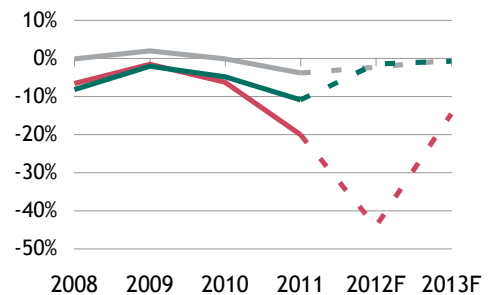


### Debt Maturities and Liquidity at 31 Dec 11

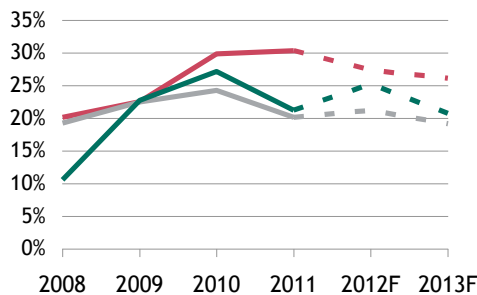
Debt maturities	(KZTm)
2012	33,119
2013	12,256
2014	10,801
2015	10,149
After 2015	134,169
<b>Cash and equivalents</b>	<b>181,434</b>

Source: Fitch

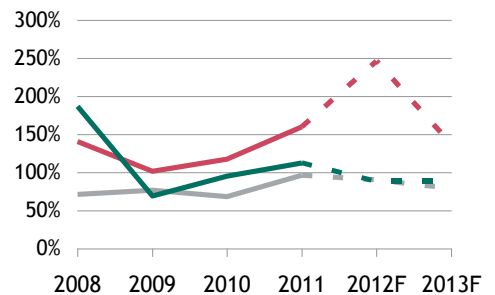
### FCF/Revenues including Fitch expectations



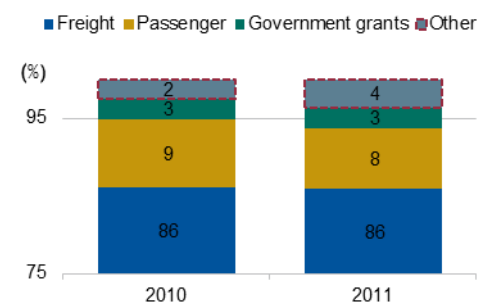
### FFO Profitability including Fitch expectations



### Capex/CFO including Fitch expectations



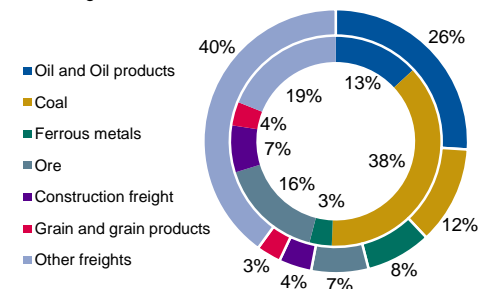
### Revenue Breakdown



Source: 2011 IFRS Financial Statements

### Freight Structure 2011

Outer ring: Revenue  
Inner ring: Volume



Source: Company data

**Kazakhstan Temir Zholy  
FINANCIAL SUMMARY**

	31 Dec 2011 KZTm Original	31 Dec 2010 KZTm Restated	31 Dec 2009 KZTm Original	31 Dec 2008 KZTm Original	31 Dec 2007 KZTm Original
<b>Profitability</b>					
Revenue	702,749	582,381	480,993	483,763	423,639
Revenue Growth (%)	20.67	21.08	(0.57)	14.19	10.73
Operating EBIT	169,537	115,676	62,210	48,705	44,887
Operating EBITDA	230,160	168,191	110,061	96,852	94,679
Operating EBITDA Margin (%)	32.75	28.88	22.88	20.02	22.35
FFO Return on Adjusted Capital (%)	17.68	17.04	14.19	13.46	14.80
Free Cash Flow Margin (%)	(20.05)	(6.28)	(1.56)	(6.62)	3.33
<b>Coverages (x)</b>					
FFO Gross Interest Coverage	11.33	16.69	11.63	14.08	11.93
Operating EBITDA/Gross Interest Expense	11.79	12.94	11.38	10.90	10.41
FFO Fixed Charge Coverage (inc. Rents)	9.83	12.24	8.78	8.83	9.42
FCF Debt-Service Coverage	(2.13)	(0.22)	0.10	(2.01)	1.73
Cash Flow from Operations/Capital Expenditures	0.63	0.85	0.98	0.71	1.17
<b>Debt Leverage of Cash Flow (x)</b>					
Total Debt with Equity Credit/Operating EBITDA	1.58	1.84	1.57	1.36	1.31
Total Debt Less Unrestricted Cash/Operating EBITDA	0.79	0.53	0.93	0.70	0.29
<b>Debt Leverage Including Rentals (x)</b>					
Annual hire lease rent costs for long-term assets (reported and/or estimate)	3,507	4,383	3,744	4,991	2,622
Gross Lease Adjusted Debt/Operating EBITDAR	1.67	2.00	1.78	1.69	1.49
Gross Lease Adjusted Debt /FFO+Int+Rentals	1.65	1.82	1.65	1.57	1.35
FCF/Lease Adjusted Debt (%)	(36.01)	(10.61)	(3.69)	(18.61)	9.69
<b>Debt Leverage Including Leases and Pension Adjustment (x)</b>					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	1.69	2.01	1.79	1.69	1.51
<b>Liquidity</b>					
(Free Cash Flow+Available Cash+Committed Facils)/(ST Debt + Interest) (%)	108.45	169.62	260.50	328.65	906.51
<b>Balance Sheet Summary</b>					
Cash and Equivalents (Unrestricted)	181,434	219,715	70,149	64,733	97,319
Restricted Cash and Equivalents	225	228	234	0	0
Short-Term Debt	35,790	103,438	17,768	4,773	4,452
Long-Term Senior Debt	327,319	206,157	154,816	127,395	119,967
of which subordinated debt	0	0	0	0	0
Equity Credit	0	0	0	0	0
Total Debt with Equity Credit	363,109	309,594	172,584	132,168	124,418
Off-Balance-Sheet Debt	28,058	35,064	29,950	39,930	20,979
Lease-Adjusted Debt	391,167	344,658	202,534	172,098	145,398
Fitch- identified Pension Deficit	4,292	3,721	2,388	1,958	1,948
Pension Adjusted Debt	395,458	348,379	204,921	174,057	147,346
<b>Cash Flow Summary</b>					
Operating EBITDA	230,160	168,191	110,061	96,852	94,679
Gross Cash Interest Expense	(20,621)	(11,069)	(10,207)	(7,447)	(8,811)
Cash Tax	(5,336)	(4,977)	(1,625)	(5,304)	(1,454)
Associate Dividends	0	0	0	0	0
Other Items before FFO (incl. interest receivable)	8,886	21,582	10,318	13,323	11,886
<b>Funds from Operations</b>	<b>213,090</b>	<b>173,726</b>	<b>108,547</b>	<b>97,423</b>	<b>96,300</b>
Change in Working Capital	(1,038)	(5,603)	(8,992)	(5,049)	14,206
<b>Cash Flow from Operations</b>	<b>212,052</b>	<b>168,123</b>	<b>99,555</b>	<b>92,374</b>	<b>110,506</b>
Total Non-Operating/Non-Recurring Cash Flow	(2,795)	(4,230)	(2,864)	8,007	(75)
Capital Expenditures	(339,256)	(197,522)	(101,284)	(129,845)	(94,093)
Dividends Paid	(10,876)	(2,923)	(2,888)	(2,556)	(2,245)
<b>Free Cash Flow</b>	<b>(140,876)</b>	<b>(36,552)</b>	<b>(7,481)</b>	<b>(32,019)</b>	<b>14,094</b>
Net (Acquisitions)/Divestitures	(505)	(1)	0	0	168
Net Equity Proceeds/(Buyback)	90,822	52,459	1,578	0	0
Other Cash Flow Items	(41,237)	(145)	(29,097)	(8,316)	5,623
Total Change in Net Debt	(91,796)	15,760	(35,000)	(40,336)	19,885
<b>Working Capital</b>					
Accounts Receivable Days	3	4	5	4	4
Inventory Days	32	27	25	20	20
Accounts Payable Days	57	54	54	38	33

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