MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes outlook on KTZ and KTT to negative; affirms ratings

Global Credit Research - 08 Sep 2015

London, 08 September 2015 -- Moody's Investors Service has today changed to negative from stable the outlook on the Baa3 issuer and senior unsecured ratings of Kazakhstani state-owned rail transportation company JSC National Company Kazakhstan Temir Zholy (KTZ) and its guaranteed subsidiaries, as well as the Ba1 corporate family rating (CFR) and Ba1-PD probability of default rating (PDR) of KTZ's wholly owned operating subsidiary Kaztemirtrans, JSC (KTT). At the same time, Moody's has affirmed the Baa3 issuer and Ba1 corporate family ratings of the two companies.

Concurrently, Moody's has lowered to ba3 from ba2 for KTZ and to b2 from b1 for KTT the baseline credit assessments (BCA), which measures the underlying fundamental credit strength, for both companies. This follows sustained deterioration of their standalone credit profiles, primarily as a result of the recent tenge devaluation and a weakening macroeconomic environment.

"Our decision to change the outlook to negative primarily reflects our concerns over covenant compliance, operating performance and liquidity of the companies in the next 18 months," says Julia Pribytkova, a Moody's Vice President -- Senior Analyst and lead analyst for the issuers. "On the other hand, today's affirmations reflect our expectation that both companies will continue to receive significant governmental support."

RATINGS RATIONALE

Today's lowering of KTZ's and KTT's BCA's primarily reflect the material weakening of their standalone credit profiles over the past 12 months, as their profitability, leverage and coverage metrics have been negatively affected by (1) an increase in the tenge equivalent of the foreign-currency-denominated debt following the first wave of the devaluation of the local currency in February 2014; (2) an accelerated decrease in the volumes of railway transportation, which amounted to 15% year-on-year in the first six months of 2015; (3) the lack of tariff indexation in 2015; and (4) an increase in the operating expenses driven by cost inflation.

Since 2013, KTT's metrics have continued to be negatively affected by their poorly balanced business model of a railcar fleet operator versus a railcar leasing company for KTZ. Moody's notes that the second wave of tenge devaluation of approximately 25% in August 2015 will exacerbate the deterioration of the credit metrics in 2015-16. The agency also advises that KTZ will likely breach its recently renegotiated financial covenant of debt/EBITDA at 4.5x embedded in the European Bank for Reconstruction and Development (EBRD) loan. Moody's believes that there is a reasonably high probability that the bank will reset the covenant for the company at a more comfortable level within the next few months.

Following lowering of the BCAs, state support becomes a more prominent component in the ratings. Moody's notes that KTZ's business model incorporates ordinary support from the state in the form of subsidies to support its loss-making transportation segments (approximately $88 million in 2015), and equity injections, which Moody's expects to amount to approximately 70% of its operating cash flow in the same year (KZT89 billion, approximately $355 million in 2015). Equity injections do not affect the company's leverage and coverage financial metrics, but provide crucial support to its liquidity.

On the debt side, Moody's notes that more than one-third of KTZ's funding is represented by KZT-denominated long-term financing from the state, more than two thirds of these loans are due beyond 2018 and bear a below-market interest rate. Moody's expects that the government will support the companies' efforts to reduce their foreign currency exposure, including via providing refinancing in the local currency.

Given the weak macroeconomic environment, Moody's does not expect material improvement in the companies' metrics over the course of the next 18 months. Some support to KTZ's cash flow generation should come from a contemplated 4%-5% annual increase in regulated tariffs in 2016-20, currently being negotiated with the state, an increase in the volumes of the Asia-Europe transit which benefits from foreign currency-denominated tariffs, and a material reduction in the investment programme. KTT should demonstrate an improvement in the financial results starting from 2015 as it reverts to its leasing company model, and generate free cash flow from 2016 as it has completed its programme of fleet modernisation and will not invest into new railcar fleet in the next 4-5 years.

Other GRI methodology inputs that Moody's uses to determine the companies' ratings remain unchanged: (1) the rating of the support provider, the Kazakhstan government (Baa2 stable); and (2) assumptions of the probability of government support to the entity in the event of distress: high for KTZ and strong for KTT; and the high default dependence which reflects the joint susceptibility of a GRI and its supporting government to adverse circumstances that simultaneously move them closer to default.

RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook on the ratings indicates Moody's concerns over covenant compliance, operating performance and liquidity of the company in the next 18 months. The agency will stabilize the outlook when it gains reasonable assurance that the execution risks pertaining to the loan covenant amendment and timely provision of envisaged state support extinguish.

WHAT COULD CHANGE THE RATINGS UP/DOWN

There is no upward potential for the ratings in the current operating environment. A material improvement in the standalone creditworthiness, alongside positive developments at the sovereign rating level, would have a positive effect on the ratings. Conversely, continued deterioration of the financial metrics compared with the benchmarks established by the agency for the current BCAs (please refer to credit opinions on respective companies), liquidity, and/or weakening of the sovereign creditworthiness and support assumptions, would put pressure on the ratings and the outlook.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Global Surface Transportation and Logistics Companies published in April 2013. Other methodologies used include the Government-Related Issuers methodology published in October 2014. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

Headquartered in Astana, Kazakhstan, JSC National Company Kazakhstan Temir Zholy (KTZ) is the 100% state-controlled vertically integrated rail group operating the national rail network of the Republic of Kazakhstan. The sole shareholder of KTZ is the state, represented by JSC National Welfare Fund Samruk Kazyna (Samruk Kazyna, not rated). KTZ is the monopoly provider of rail infrastructure services and has the leading position in the railway transportation market in Kazakhstan. In the last 12 months ended 30 June 2015, the group generated revenue of around KZT818.8 billion (approximately $4.5 billion), and EBITDA of KZT219 billion (approximately $1.2 billion).

Headquartered in Astana, Kazakhstan, JSC Kaztemirtrans (KTT) is a 100% owned subsidiary of KTZ. KTT is the owner and operator of the largest freight railcar fleet in Kazakhstan. In the last 12 months ended 30 June 2015, the group generated revenue of around KZT90.1 billion (approximately $491 million), and adjusted EBITDA of approximately KZT35 billion (approximately $191 million).

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Julia Pribytkova
Vice President - Senior Analyst
Corporate Finance Group
Moody's Investors Service Limited, Russian Branch
7th floor, Four Winds Plaza
21 1st Tverskaya-Yamskaya St.
Moscow 125047
Russia
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Victoria Maisuradze
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454