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Research Update:

Kazakh Gas Utility KazTransGas And Gas Pipeline Operator Intergas Central Asia Affirmed At 'BB+'; Outlook Stable

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Overview

- Kazakh gas utility KazTransGas (KTG) continues to have a fair business risk profile and intermediate financial risk profile, in our view, and we think the likelihood that KTG would receive extraordinary support from the Kazakh government is moderately high.
- We equalize our ratings on Intergas Central Asia (ICA) with those on KTG because of ICA's core status and KTG's 100% ownership of ICA.
- We are affirming our 'BB+' long-term corporate credit ratings on KTG and ICA.
- The stable outlook reflects our view that the risks associated with KTG's planned heavy capital expenditures, growing exposure to the volatile gas retail segment, and potential dividend pressure from the parent are balanced by KTG's solid market position, moderate projected debt over the next two years, and adequate liquidity and maturity profiles.

Rating Action

On April 14, 2014, Standard & Poor's Ratings Services affirmed its 'BB+' long-term corporate credit ratings on Kazakh gas utility company KazTransGas (KTG) and its 100% owned gas pipeline operator Intergas Central Asia JSC (ICA). The outlook on both companies is stable.

We also affirmed the 'BB+' rating on the senior unsecured debt issued by Intergas Finance B.V.

Rationale

The affirmation reflects our view that KTG continues to enjoy a "moderately high" likelihood of timely and sufficient extraordinary government support from the government of Kazakhstan. It also reflects our assessment of KTG's stand-alone credit profile (SACP) at 'bb', based on its "fair" business risk profile, "intermediate" financial risk profile, and "negative" financial policy.

In accordance with our criteria for government-related entities (GRES), our view of a moderately high likelihood of extraordinary government support is based on our assessment of KTG's:

- "Important" role for Kazakhstan, given its strategic importance as the

monopoly gas supplier in the service area, and ICA's status as the national trunk gas pipeline operator; and

- "Strong" link with the government via full ownership of KTG by its parent, 100% state-owned oil and gas operator KazMunayGas (KMG; BBB-/Stable/--; Kazakhstan national scale 'kzAA').

We view KTG as a "moderately strategic" part of KMG under our group rating methodology criteria. We assume, however, that in case of financial stress, any extraordinary support to KTG would likely come directly from the government. Therefore, we determine the corporate credit rating on KTG based on its SACP plus uplift for potential government support.

We equalize the ratings on ICA with those on KTG, reflecting the overall creditworthiness of the KTG group. The consolidated approach reflects the companies' close integration, KTG's 100% ownership of ICA and other major subsidiaries, financial guarantees on much of the group's debt issued by ICA and KTG, large intragroup cash flows, and an absence of effective subsidiary ring fencing.

KTG's SACP reflects its "fair" business risk profile, "intermediate" financial risk profile, and a one-notch downward adjustment for our "negative" financial policy modifier.

KTG's "fair" business risk profile is supported by the stable and regulated nature of the gas transportation business and ship-or-pay terms until 2015 in the gas transportation contract with Russian energy major Gazprom. KTG's status as the national gas operator and its solid market position stemming from the favorable location of the group's transit pipelines also bolster the business risk profile. It is constrained by the company's exposure to Kazakhstan country risk, which we assess as "high," and heavy dependence on Gazprom in its gas transportation and sales activities. Furthermore, it has an aged asset base and faces potential competition from alternative gas export pipelines transporting Central Asian gas. Moreover, retail gas tariff regulation in Kazakhstan is not transparent.

KTG's financial risk profile is "intermediate," in our view, supported by moderate debt levels and resulting in debt to EBITDA not higher than 3x and funds from operations (FFO) to debt of at least 30% in our base-case projections for 2014-2015. It is constrained by continued ambitious planned investments in gas transmission and distribution, leading to negative free operating cash flow generation in 2014-2015 in our base case. Moreover, rising cash flow volatility stemming from the increasing share of unregulated gas sales in the group's revenue composition also pressures the financial risk profile. Furthermore, KTG's exposure to foreign currency risk also constrains the financial risk profile, as more than 95% of the company's debt is denominated in U.S. dollars. The foreign currency risk is mitigated to some extent because much of KTG's revenues are U.S. dollar denominated: 57% of its 2013 revenues were U.S. dollar denominated.

We assign a "negative" financial policy modifier because we think that the

financial policy framework allows KTG to take a more leveraged position than we currently expect, primarily on the back of higher investment needs.

In our base case for 2014-2015, we assume:

- Revenue growth of about 15% in 2014 supported by devaluation of the Kazakhstani tenge (KZT) and of about 3% in 2015;
- EBITDA margins of 22%-25%;
- Capital expenditures of about KZT55 billion-KZT70 billion per year; and
- Dividends of about KZT12 billion.

Based on these assumptions, we arrive at the following credit measures for 2014-2015:

- Standard & Poor's-adjusted debt to EBITDA of 2x-3x; and
- FFO to debt of 30%-45%.

Liquidity

We consider KTG's liquidity to be "adequate" under our criteria, and calculate that sources will exceed uses by about 1.2x over the next 12 months as of Jan. 1, 2014.

Principal liquidity sources on Jan. 1, 2014, include:

- Unrestricted cash and equivalents of KZT19 billion (excluding KZT8.8 billion deposited at Alliance Bank);
- KZT30 billion available under long-term committed credit lines; and
- Our projection of cash from operations of about KZT50 billion over the next 12 months.

Principal liquidity uses on Jan. 1, 2014, include:

- Debt maturities of about KZT33 billion;
- Capital spending of at least KZT35 billion; and
- Dividend payments of about KZT12 billion.

We note that we project higher overall capital expenditures (maintenance plus investment) for 2014, up to about KZT70 billion. But we consider the portion that we don't include in our above calculations as discretionary and dependent on availability of financing.

Outlook

The stable outlook reflects our view that the risks associated with KTG's planned heavy capital expenditures, growing exposure to the more volatile gas retail segment, and potential dividend pressure from KMG are balanced by KTG's solid market position, moderate projected debt levels over 2014-2015 (which we consider to be commensurate with an "intermediate" financial risk profile), and adequate liquidity and maturity profiles.

To maintain a "fair" business risk profile, we expect KTG to retain its solid position in gas transmission and distribution in Kazakhstan and to demonstrate profitability margins above 20%.

To maintain an "intermediate" financial risk profile according to our criteria, we expect KTG to sustain adjusted FFO to debt of more than 30%, and Standard & Poor's-adjusted debt to EBITDA of less than 3x.

We assume KTG will continue having adequate liquidity and debt maturity profiles and lessen refinancing risk on an ongoing basis. Specifically, we expect the group's liquidity sources to cover its 12-month funding needs by 1.2x.

Upside scenario

Ratings upside might result from a fundamental and sustainable improvement in the group's financial credit measures. This might stem from better cash flow generation and higher earnings derived from profitable gas-trading operations as the volumes of associated gas sales increase. Notably, we would expect to see FFO to debt above 45% and debt to EBITDA below 2x on a constant basis (without any potential stresses to liquidity) to consider an upgrade.

Under our criteria for GREs, a one-notch upward revision of the SACP would lead us to raise the long-term rating on KTG by one notch, all else being equal.

A track record of stronger motivation on the part of the government to provide financial aid to the entity might lead us to reassess upward the likelihood of extraordinary government support for KTG. In accordance with our criteria, such a revision would result in an upgrade of KTG.

Downside scenario

We think pressure on KTG's credit profile could result from a more aggressive financial profile than we currently anticipate. That would include weakened credit ratios due to any unexpected financial underperformance, extensive reliance on short-term funding, or KTG's increased capital expenditures requiring significant external borrowing and leading to leverage above our expectations. For instance, if KTG increased capital expenditures because of a greater need to invest in gas distribution assets or start new large investment projects. The ratings could also come under pressure as a result of any indications of negative interference from KMG, including, but not limited to, inducement to pay excessive dividends.

If we revised down our assessment of KTG's SACP by one notch, it would lead us to lower the long-term rating to 'BB', provided that the sovereign long-term local currency rating and the likelihood of extraordinary financial government support remained the same.

If we saw signs of weakening state support, for instance stemming from increased substantial privatization risk, we might consider revising down the likelihood of extraordinary government support for KTG. Under our criteria for GREs, however, we would have to revise the likelihood of extraordinary

government support down to "limited" from the current "moderately high" to result in a downgrade of KTG. We don't consider this to be likely in the next two years.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/--

Business risk: Fair

- Country risk: High
- Industry risk: Low
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

Modifiers

- Diversification/Portfolio effect: Neutral (No impact)
- Capital structure: Neutral (No impact)
- Financial policy: Negative (-1 notch)
- Liquidity: Adequate (No impact)
- Management and governance: Fair (No impact)
- Comparable rating analysis: Neutral (No impact)

Stand-alone credit profile: bb

- Group credit profile: bbb-
- Entity status within group: Moderately strategic
- Sovereign rating: BBB+/Stable/A-2
- Likelihood of government support: Moderately high (+1 notch)

Recovery Analysis

The 'BB+' issue rating and '4' recovery rating on the US\$540 million senior unsecured notes issued by Intergas Finance B.V. reflect the strategic nature of the group's assets and our valuation of the company as a going concern. They are constrained by the significant pari passu debt and unfavorable insolvency jurisdiction of Kazakhstan.

- In our hypothetical default scenario, we assume default would be triggered by cost overruns in expanding the transmission network and capacity and loss of volume starting in 2015 under contracts with Gazprom, leading to payment default.
- We think the recovery prospects for the notes in a default scenario would be heavily determined by the ability and willingness of Kazakhstan's government to negotiate with noteholders rather than sell the assets.

Simulated default and valuation assumptions

- Year of default: 2017
- EBITDA at emergence: KZT25 billion
- Implied enterprise value multiple: 3x
- Jurisdiction: Kazakhstan

Simplified waterfall

- Gross enterprise value at default: KZT75 billion
- Administrative costs: KZT5 billion
- Net value available to creditors: KZT70 billion
- -----
- Priority claims: KZT1.5 billion
- Unsecured debt claims: KZT142 billion*
- --Recovery expectation 30%-50%

*All debt amounts include six months' prepetition interest.

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Key Credit Factors For The Midstream Energy Industry, Dec. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Group Rating Methodology, Nov. 19, 2013
- Criteria Guidelines For Recovery Ratings On Global Industrial Issuers' Speculative-Grade Debt, Aug. 10, 2009

Related Research

- Country Risk Assessments Update: February, Feb. 11, 2014
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 2013

Ratings List

Ratings Affirmed

Research Update: Kazakh Gas Utility KazTransGas And Gas Pipeline Operator Intergas Central Asia Affirmed At 'BB+'; Outlook Stable

KazTransGas
Intergas Central Asia JSC
Corporate Credit Rating BB+/Stable/--

Intergas Finance B.V.
Senior Unsecured* BB+
Recovery Rating 4

*Guaranteed by KazTransGas.

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