FitchRatings

Fitch Upgrades KazTransGas and Subsidiaries to 'BBB-'; Outlook Stable

Ratings Endorsement Policy
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Fitch Ratings-Moscow/London-17 April 2014: Fitch Ratings has upgraded KazTransGas JSC's (KTG) and its fully-owned subsidiaries, Intergas Central Asia JSC's (ICA) and KazTransGas Aimak JSC's (KTGA), Long-term Issuer Default Ratings (IDRs) to 'BBB-' from 'BB+'. The Outlook is Stable. A full list of rating actions is provided at the end of this commentary.

The upgrade of KTG and its subsidiaries (KTG or the group) reflects Fitch's reassessment of the group's linkage with its state-owned parent JSC National Company KazMunayGas (NC KMG, BBB/Stable). We believe that the 'national operator' status granted to KTG in 2012, the ongoing transfer of trunk gas pipelines from the state to ICA, as well as NC KMG's flexible approach to KTG's dividend payouts underline stronger parent-subsidiary links between KTG and NC KMG than what was reflected in the previous ratings.

The group's ratings are now notched down by one level from that of its parent, reflecting their close linkage, but also limited legal ties between the two. KTG qualifies as a material subsidiary in NC KMG's eurobond documentation and is subject to cross-default provisions, but NC KMG does not guarantee KTG's debt.

KTG is the state-owned monopoly engaged in natural gas transit, transportation and distribution in Kazakhstan (BBB+/Stable). It continues to derive most profits from the transit of central Asian gas to Russia.

KEY RATING DRIVERS

Midstream and Downstream Gas Monopoly
KTG's ratings reflect its position as the operator of the Kazakh gas pipeline network, the only transit route for central Asian gas to Russia and Europe. As the national gas company, it has a pre-emptive right to purchase natural gas from local oil & gas companies and resell it domestically and for export. ICA, the operator of trunk gas pipelines, generated 60% of the group's consolidated EBITDA in 2013.

High Customer Concentration
OAO Gazprom (BBB/Negative) remains the group's principal customer, accounting for 71% of ICA's 2013 revenues, down from 76% in 2012. In January 2011, Gazprom and ICA signed a five-year contract for transit of 28 billion cubic meters (bcm) of central Asian gas, of which 80% are covered by 'ship-or-pay' clauses. In 2012 and 2013 despite significantly lower transportation volumes ICA's profits did not suffer, due to Gazprom honouring its 'ship-or-pay' obligation.

In our rating case, we forecast stable gas revenues until January 2016 when the contract with Gazprom expires, as we believe that Gazprom's purchases of central Asian gas and hence ICA's transit revenues may decline to reflect current purchase volumes.

Fully Regulated Tariffs
The group's profitability is driven by cost-plus domestic tariffs and regulated gas prices set by Kazakhstan's Agency for Regulation of Natural Monopolies (AREM). We view Kazakhstan's tariff environment as developing. Historically, gas prices and transit tariffs have been sufficient for KTG to maintain adequate profits and finance its capex, which we expect to continue under our rating case. However, in an event of a prolonged economic recession AREM may face pressure to limit further tariff increases, which could force KTG to raise its leverage beyond our expectations.

Manageable Capex
We view as manageable the group's KZT140bn investment programme in 2014-2016, which will be partially debt-funded, and expect its credit metrics to remain commensurate with the current ratings. After KTG completes most of its development projects in 2014, annual capex should fall to under KZT40bn per year in 2015 and 2016, from about KZT70bn per year in 2013 and 2014.

We do not foresee any significant impact on KTG's creditworthiness from the construction of the Beineu-Bozoy-Shymkent pipeline and Line C of the Asian Gas Pipeline from Central Asia to China, which are financed by KTG's JVs with China National Petroleum Corporation (CNPC, A+/Stable) and are guaranteed by CNPC and NC KMG with no recourse to KTG.

Moderately Rising Leverage
At end-2013, KTG's funds from operations (FFO) adjusted gross leverage was 1.8x, and we expect it to reach 2.3x in 2016. We forecast that the group's FFO interest coverage will deteriorate to 7.7x in 2017, from 10.5x at end-2013, which remains adequate for the current ratings.

RATING SENSITIVITIES

Positive: Future developments that may, individually or collectively, lead to positive rating action include:

- a positive rating action on NC KMG
- evidence of stronger ties between NC KMG and KTG

Negative: Future developments that may, individually or collectively, lead to negative rating action include:

- a negative rating action on NC KMG
- evidence of weaker ties between NC KMG and KTG, e.g. sustained deterioration of credit profile with FFO adjusted gross leverage rising above 3.0x, or cancellation of the cross default provision

LIQUIDITY AND DEBT STRUCTURE

At end-2013, KTG's short-term debt of KZT33.7bn was fully covered by cash and short-term bank deposits of KZT22bn and undrawn credit lines of KZT38.3bn. There are no major debt repayments in 2014-2016, and nearly 90% of KTG's maturities fall on 2017 when ICA's USD540m eurobond is due. KTG intends to borrow up to KZT50bn in 2014 to finance capex.

In February 2014, Kazakhstan devalued the tenge to USD/KZT185 or by 17% from the end-2013 level, which followed the depreciation of the Russian rouble by 13%. We expect this to have no material impact on the group's leverage, as losses on its USD-denominated debt will largely be offset by gains from ICA's USD-denominated revenues.

LIST OF RATING ACTIONS

KazTransGas JSC
Long-Term foreign currency IDR: upgraded to 'BBB-' from 'BB+', Outlook Stable
Long-Term local currency IDR: upgraded to 'BBB-' from 'BB+', Outlook Stable
Short-Term IDR: upgraded to 'F3' from 'B'
National Long-Term rating: upgraded to 'AA(kaz)' from 'AA-(kaz)', Outlook Stable
Senior unsecured long-term rating: upgraded to 'BBB-' from 'BB+'
Senior unsecured National long-term rating: upgraded to 'AA(kaz)' from 'AA-(kaz)'

Intergas Central Asia JSC
Long-Term foreign currency IDR: upgraded to 'BBB-' from 'BB+', Outlook Stable
Long-Term local currency IDR: upgraded to 'BBB-' from 'BB+', Outlook Stable
Short-Term IDR: upgraded to 'F3' from 'B'
National Long-Term rating: upgraded to 'AA(kaz)' from 'AA-(kaz)', Outlook Stable
Senior unsecured long-term rating: upgraded to 'BBB-' from 'BB+'
Senior unsecured National long-term rating: upgraded to 'AA(kaz)' from 'AA-(kaz)'

KazTransGas Aimak JSC
Long-Term foreign currency IDR: upgraded to 'BBB-' from 'BB+', Outlook Stable
Long-Term local currency IDR: upgraded to 'BBB-' from 'BB+', Outlook Stable
Short-Term IDR: upgraded to 'F3' from 'B'
National Long-Term rating: upgraded to 'AA(kaz)' from 'AA-(kaz)', Outlook Stable
Senior unsecured long-term rating: upgraded to 'BBB-' from 'BB+'
Senior unsecured National long-term rating: upgraded to 'AA(kaz)' from 'AA-(kaz)'

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Additional information is available at www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable criteria, 'Corporate Rating Methodology', dated 5 August 2013, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage

Additional Disclosure
Solicitation Status