Fitch Affirms Kazakhstan's Condensate at 'B-'; Outlook Stable

Fitch Ratings, Moscow, 18 November 2014: Fitch Ratings affirmed JSC Condensate's Long-term foreign currency Issuer Default Rating (IDR) at 'B-'. The Outlook is Stable. A full list of rating actions is provided at the end of this release.

Condensate's ratings reflect its small but growing scale of production, credit risks associated with off-taker concentration and expected higher leverage. It currently does not have any debt, but plans to borrow up to USD140m for its ongoing refinery upgrade programme. We expect that after completing this upgrade Condensate's gross funds from operations (FFO)-adjusted leverage will peak at 3.4x in 2015 before falling below 2.5x when the upgrade project is complete.

KEY RATING DRIVERS

- Small Size Caps Ratings
Condensate's ratings are capped in the 'B' category due to its relatively small size and single site operations in north-west Kazakhstan. Its refinery has an annual capacity of 600,000 tons and mainly produces heavy distilled liquid fuel and straight-run gasoil. Its actual refining throughput in 2013 was 478,000 tons, up 51% yoy, due to production recovery after a short-term interruption in outbound logistics at the beginning of 2012. In 2013, Condensate had revenues of nearly KZT46bn (USD302m) and EBITDA of KZT6.9bn (USD45.1m).

- Off-Taker Risks Remain
Condensate's reliance on a single off-taker remains a credit risk. Since February 2013 Occidental Energy Logistics Ltd. (UK) became the main off-taker for Condensate's oil products, instead of Great Eastern Oil Limited (UK). The sales contract with Occidental Energy Logistics Ltd. is valid until 31 December 2014. In 2013 and 9M14, Occidental Energy Logistics Ltd. accounted for 77%-78% of Condensate's total revenues. On 30 September 2014, the accounts receivable balance due from Occidental Energy Logistics Ltd. to Condensate was KZT4.3bn (USD23.4m). We expect that Condensate's customer base will become more diversified once it starts to produce gasoline and other higher value-added oil products in 4Q15.

- Ongoing Upgrade Rating Positive
Condensate is upgrading its refinery to produce Euro-5 quality gasoline, to be sold at the domestic market, which experiences gasoline shortages. The company expects to complete the upgrade in Q315, which will improve its profitability by increasing sales of higher value-added oil products and will also diversify its customer base. Condensate estimates that the project requires capital investments of about USD200m, of which the company has already spent around USD70m of its own money to date.

- Manageable Debt-Funded Capex
To finance the refinery upgrade Condensate plans to raise up to USD140m in loans from local banks and/or on the bond market. We expect that after the planned debt-funded transactions Condensate's gross FFO adjusted leverage will peak at 3.4x in 2015 before falling below 2.5x when the upgrade project is complete. FFO interest coverage will fluctuate around 4x until end-2016. These metrics imply a moderate debt load relative to other Fitch-rated Russian and Kazakh oil and gas peers and are comfortable with the 'B' category ratings.

- Competitive Location, Rising Competition
Condensate's location in north-west Kazakhstan, near the Russian border and more than 500km away by car from the closest Atyrau refinery (over 1,000km by railroad), is an important competitive advantage once the company starts producing gasoline at end-2015. The company has preliminary agreements with local traders and retailers to sell all its gasoline produced after the modernisation. In our view, the main threat is a surplus of motor fuels in Kazakhstan and Russia after a number of refineries complete their modernisation programmes by 2016, which may put downward pressure on gasoline prices.

- Earnings Volatility to Decrease
Condensate's refining margins (EBITDA to barrels refined) ranged between USD11/bbl and USD24/bbl in 2011-2013, illustrating the company's earnings volatility exacerbated by its lack of own raw materials. Refining margins in both Kazakhstan and Russia, where the company may potentially sell its gasoline, are driven by industry-specific taxes and movements of regional supply and demand. Our base case scenario is for Condensate's refining margins to average USD10-USD12/bbl over the medium term.

RATING SENSITIVITIES

Positive: Future developments that could lead to positive rating actions include:

- A successful completion of the refinery upgrade programme currently expected in the second half of 2015. We expect that post-upgrade Condensate will generate additional revenues and margins from sales of higher value-added oil products
- Diversification of the customer base

Negative: Future developments that could lead to negative rating action include:

- Failure to complete or significant delays in completion of the refinery upgrade, leading to an erosion of its financial profile
- FFO gross adjusted leverage above 4x on sustained basis
- Liquidity problems such as Condensate's failure to secure and maintain credit facilities to complete the refinery upgrade programme

LIQUIDITY AND DEBT STRUCTURE

Currently, Condensate does not have any debt outstanding. At 30 September 2014 it had cash balances and short-term deposits of KZT4.3bn, which were mostly kept with the Kazakh subsidiary of Bank Sberbank of Russia OJSC (BBB-/Negative) and Bank Centercredit (B/Stable). At end-2013, Condensate's USD-denominated short-term deposits with Kazakh banks amounted to KZT2.3bn and it had cash and cash equivalents of KZT3.2bn mainly in USD.

For the refinery upgrade, Halyk Bank of Kazakhstan (BB/Stable) agreed to provide Condensate with a long-term USD130m credit line. In July 2014, Condensate registered a KZT5bn bond, which was listed on the Kazakhstan Stock Exchange (KASE). However, the bond has not been sold to investors yet and the company has a right to sell the bond in the future.

The company expects to finance the refinery upgrade either by drawing on a bank loan or by selling the KZT bond. Condensate is also considering a Eurobond issue.

FULL LIST OF RATING ACTIONS

Short-term foreign currency IDR: affirmed at 'B';
Long-term local currency IDR: affirmed at 'B-', Stable Outlook;
National Long-term rating: affirmed at 'B+(kaz)', Stable Outlook;
Local currency senior unsecured rating: affirmed at 'B-';
National senior unsecured rating: affirmed at 'B+(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: Including Short-Term Ratings and Parent and Subsidiary Linkage', dated 28 May 2014, are available at www.fitchratings.com.