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Kazakhstan Temir Zholy

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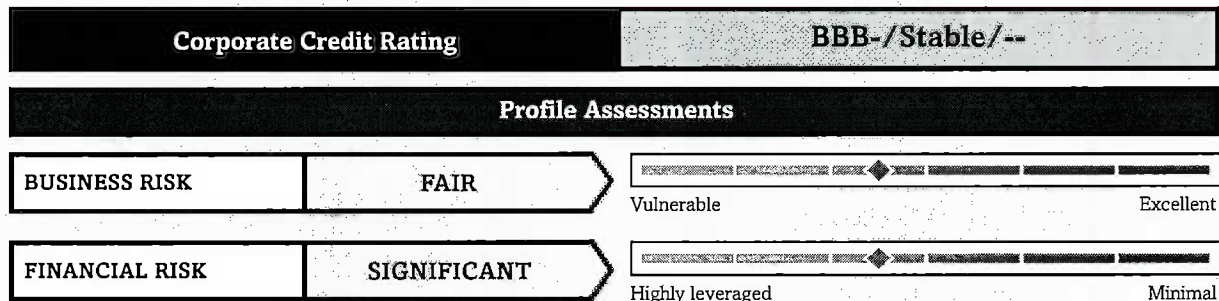
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Kazakhstan Temir Zholy



Initial Analytical Outcome ("Anchor") And Rating Result

Our 'BBB-' rating on Kazakhstan's national railway operator Kazakhstan Temir Zholy (KTZ) is derived from:

- Our anchor of 'bb', based on our "fair" business risk and "significant" financial risk profile assessments for the company.
- Our assessment of KTZ's stand-alone credit profile (SACP) of 'bb-', which is one notch below the anchor due to our unfavorable comparable rating analysis, whereby we review an issuer's credit characteristics in aggregate. The unfavorable comparable rating analysis reflects some additional country risks not captured elsewhere in the rating and the downward trend in KTZ's cash flow ratios.
- Our view of KTZ as a government-related entity (GRE) and the "very high" likelihood of the Kazakh government providing timely and sufficient extraordinary support to KTZ in the event of financial distress. This provides a three-notch uplift from the SACP.

Rationale

Business Risk: Fair	Financial Risk: Significant
<ul style="list-style-type: none"> • Strong market share and competitive position in Kazakhstan's transport sector. • Vertically integrated business model combining monopoly rail infrastructure and profitable freight transport operations. • Relatively favorable tariff regime allowing for the recovery of cost inflation. • Exposure to commodity traffic volatility. • Aged asset base, resulting in high maintenance spending. 	<ul style="list-style-type: none"> • Substantial capital spending requirements due to the need to replace aging and obsolete assets and improve infrastructure. This leads to negative free operating cash flow (FOCF) in the near term. • High exposure to foreign-currency risk. • High exposure to lower-rated local banks. • Strong ongoing financial support from the Kazakh government.

Outlook: Stable

The stable outlook reflects our assessment of the "very high" likelihood of ongoing and extraordinary sovereign support from the government of Kazakhstan.

Downside scenario

We could lower the rating on KTZ if our assessment of extraordinary government support weakens from current levels due to the state's reduced willingness or ability to provide tangible financial aid, subsidies, and equity injections. Weakened government support could also result from the partial privatization of KTZ.

We could also lower the rating on KTZ if we revise our assessment of KTZ's SACP downward. However, we would have to revise the SACP downward by two notches to 'b' for it to trigger a downgrade, under our criteria. This could occur if there were a substantial and prolonged decline in freight traffic, or if KTZ had to debt-finance a greater portion of its capital expenditure (capex) than we currently anticipate. For example as a result of a reduction in the amount of ongoing government financial support causing KTZ's Standard & Poor's-adjusted funds from operations (FFO)-to-debt ratio to fall below the threshold of 12% that would lead to KZT's SACP being revised downward to 'b', all other things being equal.

Upside scenario

A positive rating action is unlikely in our view. It would most likely follow a similar action on the Republic of Kazakhstan, because we consider an upward revision of KTZ's SACP to 'bb' to be remote in the near future. This is because we forecast negative FOCF over the next few years, due to significant capex plans. Potentially, we could take a positive rating action if KTZ were to curtail its capex substantially, all other things being equal, or if it were to finance the capex with direct equity injections from the state rather than with debt, such that KTZ's FFO-to-debt ratio remained sustainably at about 35%-40%.

Standard & Poor's Base-Case Scenario

We anticipate that KTZ will continue to do well operationally and implement its substantial capex program. We note this capex program is partly financed by the government through various instruments including shareholder loans and equity injections.

Assumptions	Key Metrics			
<ul style="list-style-type: none"> • KTZ's freight volumes to grow slightly below our estimated 6% GDP growth for Kazakhstan. • KTZ's tariffs to rise at least to cover the anticipated inflation rate in Kazakhstan (we expect inflation to be about 6% in 2014-2015). • Low-double-digit passenger growth due to new routes in operation. • Significant capex. 		2012A	2013E	2014E
	EBITDA margin* (%)	32	31-33	30-32
	Debt to EBITDA* (x)	2.4	2.5-2.7	3.0-3.3
	FFO to debt* (%)	37	32-35	25-28
A--Actual. E--Estimate.				

Company Description

KTZ is Kazakhstan's national railroad company. It owns and operates the national railroad infrastructure and provides transportation services. KTZ is also a holding company for several subsidiary companies (legally unbundled from KTZ), which operate its locomotives (JSC Locomotiv); rolling stock (JSC Kaztemirtrans); and provide repair and auxiliary services.

Freight transport is the key contributor to revenues and cash flow generation. Other activities, including the sale of inventories and electricity, and wagon repair, generate an insignificant share of total group revenues.

Business Risk: Fair

Our "fair" business risk profile assessment incorporates our view of the infrastructure transportation industry's "low" risk and KTZ's "high" country risk as its assets are located in Kazakhstan.

Key considerations in our assessment of KTZ's "fair" competitive position are its dominant market share in Kazakhstan's transportation industry and its relatively favorable, albeit nontransparent, tariff system, which allows KZT to recover cost inflation, but not cost infrastructure improvements. In addition, KTZ's vertically integrated business model allows for better cost control, and KTZ has average profitability as defined in our criteria. These strengths are partially offset by the susceptibility of KTZ's cash flow generation to volatile commodity traffic in Kazakhstan, and high maintenance costs resulting from an aging rail fleet.

We believe that KTZ will likely continue to play a leading role in the Kazakh freight market in the short term, despite recent improvements in Kazakhstan's pipeline network. This may lead to an increase in the transportation of oil by pipeline instead of by rail, as well as new entrants and alternative transportation options gradually opening the railway freight market to competition.

S&P Base-Case Operating Scenario

- KTZ's freight volumes to grow slightly below our estimate of 6% GDP growth for Kazakhstan.
- KTZ's tariffs to rise at least to cover the anticipated inflation rate in Kazakhstan (we expect inflation to be about 6% in 2014-2015).
- Low-double-digit passenger growth due to new routes in operation.

Financial Risk: Significant

We view KTZ group's risk profile as "significant" because of substantial negative FOCF over the past few years, as a result of what we view as an aggressive, largely debt-financed, capex program. KTZ's financial risk profile is further constrained by the group's high exposure to lower-rated local banks and KTZ's high exposure to foreign-currency risk, as a large part of KTZ's debt is foreign-currency denominated.

S&P Base-Case Cash Flow And Capital Structure Scenario

- Continuing high capex for new rail tracks and new rolling stock.
- Capital spending trending lower in 2014 than in 2012-2013.
- Ongoing dividend payouts of 15% of net income.
- Ongoing, but not substantial, equity contributions from the state to partially finance capex.

Financial summary

Table 2

Kazakhstan Temir Zholy -- Financial Summary

Industry sector: railroads

(Mil. KZT)	--Fiscal year ended Dec. 31--				
	2012	2011	2010	2009	2008
Rating history	BBB-/Stable/--	BBB-/Stable/--	BBB-/Stable/--	BB+/Stable/--	BB+/Stable/--
Revenues	795,788.8	702,740.1	583,900.2	480,993.2	483,763.4
EBITDA	252,230.7	235,585.6	168,108.9	110,207.5	98,787.5
Funds from operations (FFO)	222,456.4	218,831.3	158,544.0	100,135.9	90,967.4
Net income from continuing operations	114,437.5	124,829.0	65,175.4	19,488.8	63,881.7
Cash flow from operations	224,754.1	212,329.4	178,965.1	99,967.5	98,770.2
Capital expenditures	499,041.8	339,256.2	206,033.9	101,821.0	129,844.1
Free operating cash flow	(274,287.7)	(126,926.7)	(27,068.8)	(1,853.6)	(31,073.9)
Discretionary cash flow	(308,507.5)	(137,803.1)	(29,992.1)	(4,741.8)	(33,629.4)
Cash and short-term investments	110,364.1	181,433.6	216,831.0	70,149.4	64,686.0
Debt	602,043.5	379,314.9	312,121.4	184,635.5	147,238.6
Equity	1,031,425.5	950,477.7	752,200.8	661,003.2	643,853.2
Adjusted ratios					
EBITDA margin (%)	31.7	33.5	28.8	22.9	20.4
Return on capital (%)	11.4	13.9	11.8	7.3	7.3

Table 2

Kazakhstan Temir Zholy -- Financial Summary (cont.)					
EBITDA interest coverage (x)	8.7	12.3	13.7	10.5	10.9
FFO cash int. cov. (x)	11.7	11.5	16.8	10.8	13.4
Debt/EBITDA (x)	2.4	1.6	1.9	1.7	1.5
FFO/debt (%)	37.0	57.7	50.8	54.2	61.8
Cash flow from operations/debt (%)	37.3	56.0	57.3	54.1	67.1
Free operating cash flow/debt (%)	(45.6)	(33.5)	(8.7)	(1.0)	(21.1)

N.M.--Not meaningful.

Liquidity: Adequate

We assess KTZ's liquidity as "adequate" under our criteria. Over the next 12 months we anticipate that sources of liquidity will exceed uses by 1.2x or more, the minimum threshold for an "adequate" assessment under our criteria.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> Balance-sheet cash and short-term bank deposits at the end of 2013, and state equity injections budgeted for 2014. Together, these are about Kazakhstani tenge (KZT) 177.1 billion (about \$980 million); and Our base-case estimate of cash from operations of about KZT250 billion in 2014. This includes planned government grants in the passenger segment. 	<ul style="list-style-type: none"> Short-term debt maturities of about KZT34.3 billion in the 12 months to December 2014; Our base-case dividend payments in 2014 in line with the company's dividend policy; and Our base-case estimate of nondiscretionary maintenance capex of about KZT100 billion. This capex is well below the total of KTZ's planned capital spending program for 2014, which we understand is subject to successful fundraising, and/or KTZ receiving state support in the form of direct equity contributions or shareholder loans.

Debt maturities

KTZ Debt Maturities	
Maturities	(Bil. KZT)
2014	34.3
2015	29
2016	33.8
2017	106.8
Thereafter	705.1

Other Modifiers

KTZ's SACP of 'bb-' is one notch below the anchor due to our unfavorable comparable rating analysis, whereby we review an issuer's credit characteristics in aggregate. The unfavorable comparable rating analysis reflects some

additional country risks not captured elsewhere in the rating--including our view of the weak Kazakh banking system in light of past state interventions--and the downward trend in KTZ's cash flow ratios.

Group Support

The ratings on KTZ's wholly-owned subsidiary, the group's freight wagon owner, JSC Kaztemirtrans (KTT) are equalized with those on KTZ, reflecting the overall creditworthiness of the KTZ group. This is because we assess KTT as "core," reflecting the companies' close operational integration, KTZ's 100% ownership of KTT, financial guarantees on a major part of the debt issued by KTT and KTZ, and large intragroup cash flows. Furthermore, we believe that as one of the main subsidiaries of the KTZ group, KTT is closely associated with KTZ and we think that its default could negatively affect KTZ's access to the capital markets.

Government Support

In accordance with our criteria for GREs, our view of a "very high" likelihood of government support is based on our assessment of KTZ's:

- "Very important" role in Kazakhstan's economy as the national railroad company responsible for about half of all freight traffic in Kazakhstan. KTZ plays a key role in land-locked Kazakhstan's vital national transport sector, which lacks access to the sea or navigable rivers; and
- "Very strong" link with the Kazakh government, which wholly owns KTZ indirectly via sovereign wealth fund Samruk-Kazyna, and provides ongoing support and monitoring. We foresee no privatization risk in the short-to-medium term.

Ratings Score Snapshot

Corporate credit rating: BBB-/Stable

Business risk: Fair

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

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)

- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bb-

- Sovereign rating: BBB+/Stable/A-2
- Likelihood of government support: Very high (+3 notches from SACP)

Reconciliation

Table 3

Reconciliation Of Kazakhstan Temir Zholy Reported Amounts With Standard & Poor's Adjusted Amounts									
--Fiscal year ended Dec. 31, 2012--									
(Mil. KZT)	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Capital expenditures
Reported	582,385.99	1,023,900.19	795,788.79	246,087.73	169,550.58	27,475.18	246,087.73	221,663.35	499,041.80
Standard & Poor's adjustments	--	--	--	--	--	--	--	--	--
Interest expense (reported)	--	--	--	--	--	--	(27,475.18)	--	--
Interest income (reported)	--	--	--	--	--	--	3,921.76	--	--
Current tax expense (reported)	--	--	--	--	--	--	(4,782.04)	--	--
Operating leases	482.29	--	--	607.54	39.75	39.75	567.79	567.79	--
Postretirement benefit obligations/deferred compensation	19,175.27	--	--	5,535.39	5,535.39	1,500.50	4,136.36	(405.91)	--
Non-operating income (expense)	--	--	--	--	9,454.84	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	2,928.90	--
Non-controlling Interest/Minority interest	--	7,525.29	--	--	--	--	--	--	--
Total adjustments	19,657.56	7,525.29	0.00	6,142.92	15,029.97	1,540.25	(23,631.31)	3,090.78	0.00
Standard & Poor's adjusted amounts									
	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Capital expenditures
Adjusted	602,043.55	1,031,425.48	795,788.79	252,230.65	184,580.55	29,015.43	222,456.42	224,754.13	499,041.80

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings Detail (As Of March 27, 2014)

Kazakhstan Temir Zholy

Corporate Credit Rating	BBB-/Stable/--
<i>Kazakhstan National Scale</i>	kzAA/--/--
Senior Unsecured	BBB-

Corporate Credit Ratings History

24-Dec-2010	BBB-/Stable/--
24-Sep-2010	BB+/Positive/--
16-Sep-2009	BB+/Stable/--
16-Jun-2009	BB+/Watch Neg/--
24-Dec-2010 <i>Kazakhstan National Scale</i>	kzAA/--/--
16-Sep-2009	kzAA/--/--
16-Jun-2009	kzAA-/Watch Neg/--

Related Entities

JSC Kaztemirtrans

Issuer Credit Rating	BBB-/Stable/--
<i>Kazakhstan National Scale</i>	kzAA/--/--
Senior Unsecured	BBB-

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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