Research Update:

Kazakhstan Temir Zholy 'BB' And 'kzA+' Ratings Affirmed Despite Increased Liquidity Pressure; Outlook Remains Stable

December 20, 2024

Primary contact

Valeriia Kuznetsova
London
44-2071760864
valeriia.kuznetsova
@spglobal.com

Secondary contact

Elena Anankina, CFA
London
447785466317
elena.anankina
@spglobal.com

Rating Action Overview

- We expect Kazakhstan Temir Zholy (KTZ)'s financial performance to remain robust, as continuing freight turnover increments (+7% in 2023 compared with 2022, and expected growth of 1.3% in 2024) as well as a significant increase in regulated tariffs (23.7% hike in 2023 compared with 2022, and a forecast increase of about 24% year over year in 2024-2026) should support KTZ's credits metrics with funds from operations (FFO) to debt of above 12% in the next two to three years despite the company's ongoing heavy capital expenditure (capex) program.
- KTZ's liquidity position could be under pressure from its massive capex plans in 2024-2026 aimed at capturing freight growth opportunities, as well from the upcoming $880 million bullet bond maturing in October 2025. We assume that the Kazakhstan government, via its Sovereign Wealth Fund Samruk-Kazyna (SK, 100% owner of KTZ), will support KTZ in a timely manner with its liquidity pressures, given that SK is the sole holder of the $880 million bond and actively monitors KTZ's strategy and financing.
- Our expectation of a very high likelihood of government support (including via SK as the government's key economic policy vehicle) continues to underpin our ratings on KTZ, reflecting KTZ's importance to Kazakhstan's national transport sector as well as the track record of support in recent years (including refinancing, subsidized interest rates, preferential debt terms, equity injections etc.). That said, we continue to monitor KTZ's liquidity situation (including availability of committed long-term sources for capex funding and specific arrangements of about $880 million bond refinancing), as well as the planned initial public offering (IPO) on a minority stake in KTZ and its effect on the company's relationship with the government, strategy, and financial policy. These factors could affect our view on both KTZ's stand-alone credit profile (SACP) and on the degree of government support factored in the rating.
- We therefore affirmed our 'BB' long-term issuer credit rating on KTZ and our 'kzA+' Kazakhstan national scale rating.

- The stable outlook is underpinned by our assumption that KTZ's shareholder, 100% state-controlled SK will support the company with refinancing of its upcoming $880 million bullet maturity in 2025 (with a more specific refinancing approach to be clarified in the first quarter of 2025), that KTZ will be able to maintain manageable liquidity thanks to access to long-term funding and to some flexibility in its capex, and that the planned IPO on a minority stake will not weaken the link between KTZ and the Kazakh government represented by SK.

Rating Action Rationale

We think that KTZ will retain healthy metrics, with FFO to debt of above 12% in the next two to three years, thanks to material tariff increases and continuing robust freight turnover, and despite heavy capex. We expect the company will reach about 266 billion ton-kilometers of freight turnover by year-end 2024, a 1.3% increase compared with record high 2023 levels when KTZ reached its highest volumes since Kazakhstan gained independence in 1991. We forecast minimal growth of 1%-2% for KTZ's freight turnover in 2025-2026. In addition to the higher transit to Russia, China, and Central Asia (an increase of 18% in 2023 compared with 2022), which could be exposed to competition with alternative routes and geopolitical volatility. KTZ's freight turnover increase reflects steady growth of Kazakhstan's commodity exports and imports, including chemicals and fertilizers, oil derivatives, grains, and ferrous metals. To sustain such high freight volumes, KTZ will need to exercise its aggressive capital investments plans for maintaining and renewing its fleet and infrastructure. In addition, KTZ's management has successfully negotiated an additional material increase of the regulated freight tariff (about 24.0% in 2024-2026 annually in addition to the 23.7% increase in 2023), which should help mitigate increases in labor, energy, and fuel costs, and the high inflation and high interest environment. Although about a third of KTZ's debt is denominated in hard currencies, we think that 25%-30% of operating cash flows denominated in foreign currencies provide a natural hedge against the risk of local currency devaluation, and the company's policy to increase the share of debt in local currency provides additional support.

KTZ faces a massive hike in capital investments in 2024-2026 to capture higher growth potential. To fully benefit from higher freight volumes, KTZ must substantially increase its capex to maintain its current infrastructure and renovate its locomotives and wagon fleet. The company spent about Kazakhstani tenge (KZT) 785 billion in 2023 (about $1.5 billion), a 234% increase compared with 2022. We understand KTZ's management is committed to a very aggressive capital investment plan in 2024-2026 and that it will be funded by the mix of internal sources, government equity injections, and low-interest loans. In our base case, we forecast a capex outflow of close to KZT650 billion-KZT700 billion in 2024, KZT700 billion-KZT800 billion in 2025, and KZT400 billion-KZT500 billion in 2026, leading to severely negative free operating cash flow.

High capex plans, the upcoming maturities in 2025, and current high interest rates put further pressure on KTZ's liquidity position, which we currently expect to be mitigated by support from SK as the key tool of Kazakhstan's government. The upcoming $880 million (approximately KZT450 billion) bullet bond maturing in October 2025 is a sizable debt amount for the company (about 17%-19% of the total debt in 2024), compared to generated EBITDA of KZT490 billion in 2023. Considering this, together with high capex plans, we now expect liquidity sources to be lower than liquidity uses over the next 12 months. However, because SK is the sole holder of the upcoming $880 million bond, and because of the stable track record of support from SK to KTZ via refinancing, equity injections, and subsidized interest rates, we do not expect a default on this bond.

We understand that KTZ and SK are currently discussing specific plans for refinancing the upcoming $880 million bond due in 2025, the final decision will take place in the first quarter of 2025. It is not clear if any part of the bond could be refinanced with equity or a subordinated instrument (which could provide some upside to our current base case), if KTZ will retain the current favorable interest rate (the existing interest rate for the $880 million bond is 2%, which is well below current interest rates in Kazakhstan), and what the maturity of any new debt could be. Pending the final decision on refinancing, we see liquidity risk as an important credit consideration for KTZ, given the sizable debt amount, relative near-term maturity, and still high interest rates in Kazakhstan, which could affect KTZ financial metrics.

Regarding capex funding, we think that KTZ is well positioned on the domestic capital market, it is in the process of arranging long-term credit lines to fund its capex, and we think that KTZ could enjoy some support from SK to negotiate long-term funding options. We also understand that, although most of the capital works are contracted, there is still some level of flexibility, and KTZ should be able to adjust the timing of its capex depending on funding availability. Considering this, we continue to assess KTZ's liquidity as less than adequate and not weak.

A very high likelihood of extraordinary state support underpins our rating on KTZ and will be tested by liquidity arrangements and the upcoming IPO. The company plays a very important role in Kazakhstan's national transport sector, given the country's land-locked position and strong commodity sectors. We think KTZ has a very strong link with the Kazakh government, which wholly owns KTZ via the Sovereign Wealth Fund Samruk-Kazyna JSC (BBB-/Stable/A-3). We understand that the government is considering an IPO for up to a 25% stake in KTZ in 2025, but there is no clarity yet about the size of the stake to be sold, the use of proceeds (e.g. whether KTZ would get any equity funding to support capex or deleveraging), and any changes to the company's strategy or financial policy related to the IPO. At this stage, we assume there will be no material changes in KTZ's governance or links with the government, and we expect the government to remain the controlling shareholder of KTZ, in line with the prior IPO experience of other government-related entities in Kazakhstan, including KazMunayGas NC JSC and Kazakhstan Electricity Grid Operating Co. (JSC), which have previously sold minority stakes at IPOs. Therefore, we continue to see the likelihood of timely and sufficient extraordinary financial support for KTZ from the Kazakhstan government as very high and incorporate two notches of uplift above our 'b+' assessment of KTZ's stand-alone credit quality in our 'BB' rating on KTZ. Having said that, we continue to monitor the IPO plans and will adjust the KTZ ratings accordingly if, contrary to our current expectations, the IPO weakens the link between the company and the government of Kazakhstan, as represented by 100% state-controlled SK.

Outlook

The stable outlook reflects our expectation of the very high likelihood of state support for KTZ and of sufficient headroom in KTZ's credit metrics, with FFO to debt above 12%. The stable outlook is also underpinned by our assumption that the KTZ's shareholder SK will support the company with refinancing of its upcoming $880 million bullet maturity in 2025 and that specific details of the refinancing will be agreed in the first quarter of 2025. We also anticipate that KTZ will be able to secure new long-term credit lines and to modulate its capex amount and timing depending on availability of long-term funding sources, leading to a manageable liquidity.

Downside scenario

We could lower our rating on KTZ in case of material liquidity pressures, which could affect our assessment of KTZ's SACP and of its likelihood of state support. We will monitor KTZ's capex funding and specific refinancing solutions for the upcoming $880 million maturity due in October 2025.

Apart from liquidity, given our expectation of a very high likelihood of extraordinary state support, a one-notch downgrade of Kazakhstan could lead us to lower our rating on KTZ, all else unchanged.

We could also revise down our assessment of KTZ's SACP if S&P Global Ratings-adjusted FFO to debt deteriorates below 12% due to weaker-than-expected operating performance or higher capex.

Upside scenario

We could raise our ratings on KTZ if its SACP strengthens to 'bb-', which could likely result from:

- Stronger liquidity, supported by the ratio of committed sources to uses of sustainably above 1.2x over the next 12 months, a manageable maturity profile and no covenant breaches; and
- FFO to debt improving sustainably above 20% due to gradual deleveraging, supported by a solid increase in traffic and/or favorable tariffs, material subsidies, or equity injections (including refinancing of debt with equity, equity injections from the state, or IPO proceeds), absent material liquidity gaps.

A one-notch upgrade of the sovereign could also lead us to take a positive rating action on KTZ, all else unchanged.

Company Description

KTZ is the 100% state-owned monopoly railroad company in Kazakhstan. It owns and operates Kazakhstan's national railway system and related infrastructure. KTZ enjoys a dominant market position in the railway industry with about half of Kazakh freight (excluding pipeline transportation) and more than 80% of railway passenger transportation revenue. The company employs about 130,000 people and is one of the country's biggest taxpayers.

Liquidity

We assess KTZ's liquidity as less than adequate because the company faces large debt maturities and high capital investments in the next 12 months, which are not yet fully covered by committed long-term sources of funding.

Currently, we do not view KTZ's liquidity as weak as we assume that the upcoming $880 million bullet maturity will be refinanced in 2025 with the support from the company's shareholder, 100% state-controlled SK. We also assume that the company will not have severe liquidity shortages despite its high capital investments because we expect that KTZ's capex needs will be partially addressed through material tariff increases, that KTZ will be able to secure long-term committed credit lines and to exercise cautious capex management, and that it will defer some of the investments in case funding sources are not available.

Principal liquidity sources

For the 12 months from Sept. 30, 2024:

- Cash and cash equivalents of KZT72 billion;
- Committed credit facilities of about KZT188 billion; and
- An estimate of cash FFO of about KZT360 billion-KZT460 billion.

Principal liquidity uses

For the 12 months from Sept. 30, 2024:

- Debt maturities of about KZT320 billion; and
- Maintenance and committed capex of about KZT740 billion.

Covenants

We expect KTZ will comply with covenants as of year-end 2024, including adjusted debt to adjusted EBITDA, adjusted debt to equity, and interest coverage ratios. We think the company will be able to get waivers for potential breaches if needed, as it has done previously.

Environmental, Social, And Governance

Governance factors are a moderately negative consideration in our credit rating analysis of KTZ. In our view, the company is more exposed to governance factors than many European peers due to the high country risk in Kazakhstan. Environmental factors are an overall neutral consideration. About one-fourth of KTZ’s freight turnover is coal, mostly consumed in Kazakhstan and exported to Russia, where we see solid demand despite worldwide initiatives against climate change. Therefore, we think that risk of a structural decline in coal turnover is remote for KTZ.

Rating Component Scores

Rating Component Scores

Component	
Foreign currency issuer credit rating	BB/STABLE/--
Local currency issuer credit rating	BB/STABLE/--
Business risk	Fair
Country risk	High Risk
Industry risk	Low Risk
Competitive position	Fair
Financial risk	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb-
Diversification/portfolio effect	Neutral/Undiversified
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Less than adequate
Management and governance	Moderately Negative
Comparable rating analysis	Neutral
Stand-alone credit profile	b+

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Kazakhstan, Aug. 26, 2024

- Industry Report Card: Global Transportation Infrastructure Demonstrates Strength In 2024, Aug. 7, 2024
- Tear Sheet: Kazakhstan Temir Zholy, Dec. 20, 2023
- Ratings Affirmed On Three Kazakhstani Government-Related Entities On Upward Revision Of Support, May 3, 2023

Ratings List

Ratings list	
Ratings Affirmed	
Kazakhstan Temir Zholy	
Issuer Credit Rating	
Foreign Currency	BB/Stable/--
Local Currency	BB/Stable/--
Kazakhstan National Scale	kzA+/--/--