FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms NC QazaqGaz and Subsidiaries at 'BBB-'; Outlook Stable

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Fitch Ratings - Warsaw - 14 Feb 2023: Fitch Ratings has affirmed JSC National Company QazaqGaz (NC QG, formerly KazTransGas) and its fully owned subsidiaries, Intergas Central Asia JSC (ICA) and KazTransGas Aimak JSC (KTGA), at 'BBB-' Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs). The Outlooks are Stable.

NC QG's 'BBB-' rating is one notch below that of ultimate shareholder Kazakhstan (BBB/Stable), based on our assessment of the linkage under Fitch's Government-Related Entities (GRE) Rating Criteria. This reflects NC QG's fairly strong links with the sovereign. We assess NC QG's Standalone Credit Profile (SCP) at 'bbb-', which considers its strong market position in the domestic market and a fairly diversified business profile with exposure to production, trading and domestic and international transit. However, the group's shrinking earnings due to decreasing exports and a greater focus on the domestic market, where prices are lower, would lead to increasing gross leverage, though its absolute amount of debt should remain broadly stable and net leverage would remain well below 1x due to substantial cash balances.

More Focus on Domestic Operations: NC QG expects that in view of gradually rising domestic gas consumption in Kazakhstan the group may need to stop or dramatically decrease highly profitable exports to China starting from 2024-2025. Moreover, NC QG may even need to start purchasing gas from abroad (potentially Russia) to support growing domestic demand. NC QG will aim to increase domestic gas production, but its ability to do so is yet to be confirmed.

Shrinking Earnings on Domestic Tariffs: The greater focus on domestic operations means that NC QG's earnings are likely to moderate. We conservatively estimate that NC QG's Fitch-defined EBITDA may contract to less than KZT100 billion in 2025 from KZT204 billion in 2021. The group expects its dividends from joint ventures (JVs) with China National Petroleum Corporation (A+/Stable), BSGP and AGP, to increase as AGP repays its debt, and to partly offset contracting EBITDA, leading to EBITDA (including dividends from affiliates) contracting by only around 15% over 2021-2025. NC QG's domestic gas tariffs are below international prices and do not always cover input costs but its transit operations are profitable.

Leverage May Increase: Intensifying capex in 2022-2023 (and potentially beyond), coupled with shrinking EBITDA, could result in NC QG's funds from operations (FFO) gross leverage increasing towards 3x in 2024-2025 - our negative sensitivity for the SCP - from 2021's 1.8x. At the same time, the group's net debt should remain low-to-moderate and net leverage well below 1x. Its earnings and leverage will largely be determined by its domestic gas prices, supply-demand balance (and ability to export some remaining natural gas volumes), capex and potential cash injections from the state.

Strong Links with State: Fitch views status, ownership and control of NC QG by the state as 'Strong', reflecting the latter's indirect full ownership. NC QG is 100% owned by the state though Kazakhstan's Sovereign Wealth Fund Samruk-Kazyna JSC (SK, BBB/Stable). Even though the state is contemplating selling up to 25% of NC QG through an IPO in the next 1-2 years, we believe that the government will continue to maintain strong links with the group. NC QG's strong links with the state are further underpinned by the group's status of national company by the state, making NC QG one of the implementation agents of the government's energy-related policies.

Moderate Track Record of Support: For 2022-2023 the Kazakhstani state has

Incentive to Support: We assess the socio-political implications of default as 'Strong', as NC QG is a large employer with around 12,000 people and a natural monopoly with significant development capex plans. NC QG supplies gas to over 50% of Kazakh citizens. The group is a modest borrower with total debt of USD1.1 billion and less than 5% of the country's foreign debt in 2022, leading to 'Moderate' assessment of financial implication of its default.

Subsidiaries Ratings Equalised with Parent: We view the legal incentives to support under our Parent and Subsidiary Linkage (PSL) Rating Criteria as 'High' since NC QG guarantees around 90% of KTGA's debt and ICA's debt is subject a cross-default provision under NC QG's Eurobond, which makes up most of the parent's debt. Previously NC QG fully guaranteed ICA's debt. However, ICA's main loan was refinanced and currently NC QG only guarantees 2% of ICA's debt. Our assessment for legal incentives remains 'High' in view of the cross-default provision in place.

Strategic incentives are 'High' for ICA and 'Medium' for KTGA. The latter as sole domestic operator of gas distribution networks, based on Fitch's estimates, should contribute 8% of NC QG's consolidated EBITDA (average for 2021-2025F), while ICA, as the operator of trunk gas pipelines in Kazakhstan for transporting gas domestically and internationally, should account for around 40% of NC QG's EBITDA. Operating incentives are 'High' for both subsidiaries, due to a fully integrated management strategy, common planning and budgeting.

Evolving Regulatory Environment: Uncertainties surrounding the domestic pipeline transportation regulatory environment in Kazakhstan are among the factors constraining NC QG's SCP. A six-month moratorium on tariff increases until end-June 2022 following unrest in Kazakhstan, however, has not affected NC QG's tariff indexation in 2022. This is in contrast to the average 30% year-on-year drop in gas distribution revenue for KTGA and ICA in 2019 when all state monopolies were forced by the government to lower their tariffs for end-users in all regulated sectors.

DERIVATION SUMMARY

The 'BBB-' IDR of NC QG is supported by its monopoly in domestic gas transmission and distribution in Kazakhstan (BBB/Stable), and its dominant position in gas transportation export and sales. Domestic tariffs are exposed to the evolving regulatory environment (revenue and EBITDA) and share of the Kazakh oil transportation market. A strong financial profile and very low leverage underpin KTO's 'bbb' SCP although the company's IDR is constrained by that of parent, JSC National Company KazMunayGas. NC QG's rating is notched down once from the sovereign's.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for NC QG, ICA and KTGA:

- Brent crude price of USD85/bbl in 2023; USD65/bbl in 2024 and USD53/bbl in 2025, down from USD101/bbl in 2022

- Capex peaking in 2023 and moderating thereafter

- Gradually falling gas exports to China

- No dividends paid to the parent in 2022-2025

- Substantial dividends from JVs

RATING SENSITIVITIES

NC QG:

Factors that may, individually or collectively, lead to positive rating action/upgrade:

- A sovereign upgrade

- Stronger ties between Kazakhstan and NC QG

- Improvement in NC QG's SCP, driven by a clearly defined and conservative financial policy, and an improved regulatory environment supporting FFO gross leverage at below 2x on a sustained basis

Factors that may, individually or collectively, lead to negative rating action/downgrade:

Factors that may, individually or collectively, lead to positive rating action/upgrade:

- Positive rating action on NC QG

Factors that may, individually or collectively, lead to negative rating action/downgrade:

- Negative rating action on NC QG

- Weaker ties between NC QG and KTGA

- Weaker ties between NC QG and ICA, coupled with deterioration of ICA's profile

Kazakhstan sovereign:

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Structural: Spillovers from Russia-related sanctions or geopolitical tensions or renewed domestic social and political unrest that increase risks to export performance, domestic macroeconomic and/or financial stability

- Public and External Finances: Erosion of the sovereign balance sheet due to a severe commodity price shock or disruption to exports, a prolonged period of significantly looser fiscal policy or a crystallisation of significant contingent liabilities.

- Macro: A deterioration in the economic policy mix that, for example, undermines the predictability of monetary policy or confidence in the flexibility of the exchange rate to respond to external shocks.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Structural/Macro: Continued strengthening of the economic policy framework, institutional capacity sufficient to enhance policy predictability, effectiveness, domestic competition and economic diversification. This could lead to a removal of the -1 notch on the QO's 'Macro' features.

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: NC QG has ample liquidity, as cash and cash equivalents of KZT453 billion as of 30 June 2022 were more than sufficient to cover short-term maturities of KZT34 billion. We expect its substantial cash buffer to support large investments in 2023. NC QG has a record of good access to Kazakh banks, even though it has no long-term committed facilities.

KTGA has strong liquidity and evenly balanced debt maturities. In June 2022, cash and cash equivalents of around KZT38 billion provided healthy headroom over KZT11 billion of short-term debt. Similarly to NC QG, KTGA has good access to Kazakh banks, even though it has no long-term committed facilities.

ICA's cash and cash equivalents of around KZT59 billions at end-June 2022 were sufficient to cover short-term maturities of KZT11 billion. We expect its liquidity buffer, however, to gradually reduce, due to continued investments. New borrowings or intra-group loans should allow ICA to maintain adequate liquidity. ICA has no long-term committed facilities, but has good access to Kazakh banks.

ISSUER PROFILE

NC QG is a natural monopoly in natural gas transit, transportation and distribution in Kazakhstan. It also exports gas abroad and has small-scale gas upstream operations.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

NC QG is rated top-down minus one from Kazakhstan's rating under our Government Related-Entities (GRE) Rating Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
senior unsecured	LT	BBB-	Affirmed	BBB-
senior unsecured	Natl LT	AA+(kaz)	Affirmed	AA+(kaz)
JSC National Company QazaqGaz	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	ST IDR	F3	Affirmed	F3
	LC LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	Natl LT			AA+ (kaz) Rating Outlook

senior unsecured	LT	BBB-	Affirmed	BBB-
senior unsecured	Natl LT	AA+(kaz)	Affirmed	AA+(kaz)

VIEW ADDITIONAL RATING DETAILS

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Additional information is available on www.fitchratings.com issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

National Scale Rating Criteria (pub. 23 Dec 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

Corporate Rating Criteria (pub. 29 Oct 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Intergas Central Asia JSC	EU Issued, UK Endorsed
JSC National Company QazaqGaz	EU Issued, UK Endorsed
KazTransGas Aimak JSC	EU Issued, UK Endorsed

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