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Research Update:

QazaqGaz NC JSC Upgraded To 'BB+' From 'BB' On Stronger Financial Metrics; Outlook Stable

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Rating Action Overview

- We project QazaqGaz NC JSC's (Qazaqgas') financial metrics will remain solid, with funds from operations (FFO) to debt staying well above 60% over 2023-2025, despite extensive investments over the period.
- Moreover, its strong cash position exceeding Kazakhstani tenge (KZT) 500 billion ($1.1 billion) at year-end 2022 provides a significant liquidity buffer.
- In our view, state-owned Qazaqgas' role is expanding in Kazakhstan due to its increasing operations throughout the gas value chain as part of the government's goal to reach 65% gasification by 2030 while maintaining security of supply.
- We therefore raised our long-term issuer credit rating on Qazaqgas to 'BB+' from 'BB', standing one notch below our foreign currency sovereign rating on Kazakhstan.
- The stable outlook mirrors that on the sovereign rating and reflects our expectation for Qazaqgas to operate with lower adjusted leverage (including joint ventures [JVs]) than previously, with FFO to debt above 60% over the next three years, after substantial debt repayments at JVs in late 2022 and first-quarter 2023.

PRIMARY CREDIT ANALYST

Emeline Vinot
Paris
+ 33 014 075 2569
emeline.vinot@spglobal.com

SECONDARY CONTACTS

Sergei Gorin
Dubai
+971 54 5836430
sergei.gorin@spglobal.com

Aarti Sakhuja
London
+ 44 20 7176 3715
aarti.sakhuja@spglobal.com

Pierre Gautier
Paris
+ 0033144206711
pierre.gautier@spglobal.com

Rating Action Rationale

Qazaqgas has shown resilient financial performance and stronger-than-expected credit metrics. We expect 2022 S&P Global Ratings-adjusted EBITDA (including dividends from JVs) to reach KZT290 billion-KZT310 billion and exceed 2021 levels of about KZT300 billion (including a one-off arbitration court gain), driven by dynamic domestic gas transportation and sales and the strong performance of the two gas pipeline JVs. Coupled with the debt repayments at some JVs and the strong cash position, FFO to debt improved to well above 100% in 2022.

In our view, EBITDA generation will moderate in 2023 as the country reduces exports to China and purchases gas from neighboring countries including Russia and Turkmenistan. This will reduce short-term margins to secure significant gas for increasing domestic demand. We expect the volume of gas purchased to increase to 25 billion cubic meters (m3) in 2023 from 22.7 billion m3 in

2022, before reducing once domestic gas processing plants are commissioned. This leads to our forecast adjusted EBITDA of KZT300 billion-KZT320 billion in 2023 and closer to KZT350 billion in 2024. Based on our estimates, we expect FFO to debt will remain amply above 60% in 2023 and 2024 despite the substantial investments we expect this year. As a result, we revised up the standalone credit profile (SACP) to 'bb+' from 'bb'.

Still, Qazaqgas' adjusted EBITDA is heavily reliant on dividends from its JVs. The company co-owns two gas pipelines with Chinese Trans-Asia Gas Pipeline: The Asia Gas Pipeline (AGP) and Beineu-Shymkent Gas Pipeline (BSGP). Both shareholders have equal weight in decision making for the JVs.

- AGP transports gas from Turkmenistan to southern provinces of China. Benefitting from tariffs decided within the contract between Qazaqgas and PetroChina. In first-quarter 2023, AGP fully repaid its remaining $528.5 million loan resulting in the JV being unleveraged. As a result, 100% of net income from AGP will be up streamed to the two shareholders
- BSGP transports gas from western to southern regions of Kazakhstan and China. It benefits from high regulated tariffs set by the Kazakhstani government until the $700 million loan due 2029 ($650 million at end-first-quarter 2023) is fully repaid. BSGP won't pay dividends to the shareholders until the debt is fully repaid.

We forecast annual dividends from AGP will reach KZT80 billion-KZT100 billion in 2023-2024 and expand beyond KZT200 billion from 2025. This represents 25%-30% of consolidated adjusted EBITDA and results in an adjusted EBITDA of KZT300 billion-KZT320 billion in 2023-2024 and KZT350 billion afterward. The high dependence on dividends constrains our assessment of Qazaqgas' financial risk profile, since we view it as volatile and dependent not only on the company's decisions but also those of its Chinese counterparts.

Qazaqgas' cash buffer is large but its investment program is extensive, in line with the government's objectives. Kazakhstan's gas sector is currently under pressure, with increasing gas demand that is not currently met by supply. Qazaqgas is therefore planning to invest KZT350 billion-KZT400 billion in network expansion and gas processing plants in 2023 and we also expect it to increase investments in the exploration and production (E&P) business (KZT150 billion-KZT170 billion) over the following years to increase domestic production. We expect Qazaqgas to fully finance its investment plan with operating cash flows and its significant cash buffer of KZT500 billion-KZT600 billion at year-end 2022.

Qazaqgas' role in Kazakhstan is expanding in line with the government's goal to gasify and decarbonize the country. In our view, gas is becoming more important for Kazakhstan's energy mix, as demonstrated by the 50% increase in demand since 2018 and 7% rise in 2022, amid the government's goal for 65% gasification of the country by 2030 from 59% in 2022. In November 2021, Qazaqgas officially became the national gas company of Kazakhstan, when it was spun off from KazMunayGas, and became a direct subsidiary of Sovereign Wealth Fund Samruk-Kazyna. Thanks to this status, Qazaqgas now has preemptive rights to purchase the associated gas from oil producers and develop Kazakhstan's gas fields. The company must therefore expand its business throughout the value chain in line with the government's objectives, which includes fulfilling social goals to develop regional gas infrastructure, gasify cities, and replace high-emitting coal with gas. This implies that Qazaqgas now has three specific roles for the country including:

- Owning and operating the entire gas infrastructure including transmission, distribution, transit, storage, and sale.

- Ensuring energy security in line with increasing domestic gas demand by increasing gas production from associated gas and rerouting gas for export to the domestic market despite lower tariffs.
- Contributing to the energy transition in line with the Paris Agreement and considering gas the alternative source, as demonstrated by local banks lending money to gas-using companies rather than coal.

Accordingly, we now assess Qazaqgas' role for the government as very important from important previously.

Outlook

The stable outlook mirrors that on Kazakhstan.

The future rating on Qazaqgas will continue to hinge on both the company's intrinsic credit profile and the sovereign rating on Kazakhstan. The current stable outlook also incorporates our view that Qazaqgas will continue operating with very low leverage, using its significant cash balance to support investments in gas production and network enhancement while maintaining FFO to debt above 60%. It also assumes the persistence of the current role for and link with Kazakhstan.

Downside scenario

We believe there is some rating headroom and do not see downward pressure in the next 12 months. Still, we could lower the rating to 'BB' if we see:

- A two-notch downgrade of the sovereign to 'BB'. In such a case, given the largely domestic nature of Qazaqgas' business and its state-owned status, it is unlikely we would rate Qazaqgas above the sovereign, even if its SACP stays at 'bb+'; or
- A substantial deterioration of Qazaqgas' SACP to 'b+' from 'bb+', which could come from a structural decline in the profitability of the historical business (not the JVs) and a massive increase in leverage caused by much higher capital expenditure (capex) than currently expected, with FFO to debt well below 45%.

Upside scenario

At this stage, we see limited rating upside after the upgrade to 'BB+'. A sovereign upgrade would be a prerequisite for any positive action on Qazaqgas'.

Company Description

Qazaqgas is Kazakhstan's national gas operator, which is 100% owned by Sovereign Wealth Fund Samruk-Kazyna JSC (BBB-/Stable/A#3), itself 100% owned by the Kazakhstani government. Qazaqgas operates more than 21,000 kilometers (km) of gas transmission pipelines, about 63,000 km of gas distribution networks in 12 gasified regions, 56 compressor stations, and three underground gas storage facilities. Since November 2021, Qazaqgas has been granted the official status of national gas operator, which means the company has preemptive rights to gas purchases from local oil producers.

In 2022, Qazaqgas transported 83.7 billion cubic meters (bcm) of gas for both domestic needs and exports (to China, Russia, Turkmenistan, and Uzbekistan) and supplied 22.7 bcm of gas (18.4 bcm domestically and 4.3 bcm to China). At year-end 2022, the country was 59% gasified with a goal to reach 65% by 2030.

Qazaqgas' operations include:

- Gas distribution and supply in Kazakhstan through a major part of the national gas distribution network (via 100% owned Intergas Central Asia [ICA]) and 50% owned Beineu-Bozoy-Shymkent (BSGP);
- International transportation and transit of gas;
- Gas sales on local and external markets;
- Gas-field development and gas production in Kazakhstan; and
- Export of gas through the 50% owned AGP.

Our Base-Case Scenario

Assumptions

- Domestic gas sales volumes increasing toward 20 bcm in 2023 and 22 bcm in 2024, compared with 17.6 bcm in 2021, since Qazaqgas' strategy is to focus on the domestic market
- Gas sales to China reduce to 4.3 bcm in 2022 and toward 1.5 bcm from 2024, compared with 5.7 bcm in 2021. We expect domestic gas purchase prices from oil producers to remain at $45 per 1,000 m3 as decided by the government, with increasing volumes pressuring 2023 EBITDA but lower volumes purchased from 2024 improving EBITDA back to 2022 levels.
- Relatively stable international gas transit volumes in 2022-2024 of about 52 bcm.
- Gas transportation tariffs rise with inflation.
- Domestic gas sales prices increase 10%-15% in 2023 and a further 59% in 2024 upon new tariff adoption for industrials.
- Increasing dividends from the 50/50 AGP JV in 2022-2023 and up to KZT100 billion by 2024 following the complete deleveraging of the JV.
- About KZT350 billion-KZT450 billion of investments in 2023 as part of Qazaqgas's extensive program to support Kazakhstan's energy projects.
- Limited dividends to Samruk-Kazyna.

Key metrics

Qazaqgas--Key Metrics*

	--Fiscal year ended Dec. 31--			
Mil. KZT	**2021a**	**2022e**	**2023f**	**2024f**
EBITDA	300,237	300,000-320,000	300,000-320,000	350,000-370,000
Of which dividends from JVs	60,952	80,000-85,000	75,000-80,000	100,000-105,000

Qazaqgas--Key Metrics* (cont.)

	--Fiscal year ended Dec. 31--			
Mil. KZT	2021a	2022e	2023f	2024f
Funds from operations (FFO)	252,978	200,000-220,000	200,000-220,000	280,000-300,000
Capital expenditure	133,940	180,000-200,000	350,000-400,000	100,000-150,000
Debt	356,851	100,000-150,000	300,000-350,000	100,000-150,000
Debt to EBITDA (x)	1.2	0-0.5	0.7-1.2	0-0.5
FFO to debt (%)	71	>100	>60	>60
DCF to debt (%)	35	55-65	(80)-(70)	Positive

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. DCF--Discretionary cash flow. KZT--Kazakhstani tenge. JVs--Joint ventures.

Liquidity

We consider Qazaqgas' liquidity adequate, based on our assumption that liquidity sources will exceed uses more than 1.5x over the 12 months from Jan. 1, 2023, and that sources will exceed uses even if adjusted EBITDA declines 15%. The company accumulated ample cash reserves of about KZT550 billion-KZT570 billion at year-end 2022, which boosted its liquidity position, but sizable capex needs expected in 2023 prevent a stronger assessment of Qazaqgas' liquidity.

We believe that Qazaqgas has adequate access to financing from local banks. The company keeps cash mostly with the country's largest bank, Halyk Bank, and Kazakhstani subsidiaries of international banks. We view the local banking system as relatively weak, even if we believe Qazaqgas keeps most cash with the largest local institutions. In our view, as for other midsize emerging market issuers, the company's access to international capital markets could fluctuate.

Principal liquidity sources for the 12 months started Jan. 1, 2023, include:

- Unrestricted cash and equivalents of about KZT550 billion; and
- Our projection of cash from operations of about KZT200 billion-KZT220 billion including about KZT80 billion of dividends from JVs in 2023.

Principal liquidity uses for the same period include:

- Debt repayments of about KZT145 billion for the coming 12 months;
- Capex of KZT350 billion-KZT400 billion; and
- Limited dividends to Samruk-Kazyna.

Ratings Score Snapshot

Issuer Credit Rating	BB+/Stable
Business risk:	Fair
Country risk	High
Industry risk	Intermediate

Issuer Credit Rating	BB+/Stable
Competitive position	Fair
Financial risk:	Intermediate
Cash flow/leverage	Minimal
Anchor	bb+
Modifiers:	
Diversification/Portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Adequate
Management and governance	Fair
Comparable rating analysis	Neutral
Stand-alone credit profile:	bb+
Related government rating	BBB-
Likelihood of government support	High (no impact)

ESG credit indicators: E-3, S-2, G-4

Related Criteria

- Criteria | Corporates | Industrials: Key Credit Factors For The Midstream Energy Industry , Nov. 15, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019
- 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
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry , Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities , Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating , Oct. 1, 2010

Ratings List

Upgraded; Outlook Action

	To	From
QazaqGaz NC JSC		
Intergas Central Asia JSC		
Issuer Credit Rating	BB+/Stable/--	BB/Positive/--