FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades NC QazaqGaz to 'BB+'/Stable; Revises SCP Lower to 'b'

Thu 08 Feb, 2024 - 14:44 ET

Fitch Ratings - London - 08 Feb 2024: Fitch Ratings has downgraded JSC National Company QazaqGaz (QG)'s Long-Term Foreign- and Local-Currency Issuer Default Ratings to 'BB+' from 'BBB-', and removed the ratings from Under Criteria Observation (UCO). The Outlooks are Stable.

The Long-Term Foreign-Currency IDRs of QG's fully owned subsidiaries, Intergas Central Asia JSC (ICA) and KazTransGas Aimak JSC (KTGA), were also downgraded to 'BB+' from 'BBB-'. The Outlooks are Stable. See below the full list of rating actions.

Fitch has also revised lower QG's Standalone Credit Profile (SCP) to 'b' from 'bbb-'. The downgrade to 'BB+' reflects QG's significantly deteriorated SCP, which in combination with our assessment of QG's linkage with the state (Kazakhstan, BBB/Stable) results in QG being rated two notches below the sovereign's under Fitch's recently updated Government-Related Entities (GRE) Rating Criteria. QG's support score is 32.5, which underlines 'Very Likely' support from the state, based on the Criteria definitions.

Our revision of QG's SCP reflects its drastically weakening consolidated profitability on the back of (i) practically discontinued gas transit from central Asia to Russia, (ii) still loss-making domestic gas tariffs, and (iii) growing domestic natural gas consumption in Kazakhstan that will constrain gas exports to China and result in increased gas imports from Russia. QG's leverage and free cash flow (FCF), however, should remain adequate given significant dividends QG is expected to be receiving from Asia Gas Pipeline LLP (AGP), its joint venture (JV) with China National Petroleum Corporation (A+/Stable).

Lower SCP: QG's SCP revision follows our reassessment of its business profile and the quality of its cash flows. We project QG's EBITDA (before dividends from JVs) to fall sharply in 2024-2026, potentially even turning negative. This compares with QG's average EBITDA of around KZT150 billion per year in 2019-2023.

Its weak projected profitability reflects rising domestic gas consumption in Kazakhstan (which means lower amount of gas available for exports to China, and the need to buy gas from Russia), practically stopped transit of central Asian gas to Russia (which was one of the group's key sources of income in the past), and increasing but still low domestic gas tariffs, which do not necessarily cover input costs. To some extent these are offset by the group's new transit arrangements, such as the transit of Russian gas to Uzbekistan.

Responsibility to Support: We view QG's 'decision-making and oversight' as 'Very Strong', given its full control by the government and its role in implementing the government's energy policies. Although the state is contemplating selling a minority share of QG through an IPO, we believe that the government will maintain strong links with the group. However, we do not give QG any scores for 'precedents of support' as state support has been irregular.

Incentives to Support: We assess QG's 'preservation of government policy role' as 'Strong' given its important role in the government's energy strategy and its status as the main domestic supplier of natural gas. We view its 'contagion risk' as 'Strong' as QG is present in the eurobond market and its default could affect the ability of Kazakhstan and other GREs to borrow on international markets.

High Dividends From AGP: AGP is QG's largest JV, which operates Kazakhstan's largest section of the central Asia-China pipeline. It has repaid its financial debt and should generate around KZT500 billion in annual pre-dividend free cash flow (FCF) in 2024-2026. We assume that QG will receive at least KZT200 billion in dividends from AGP per annum. This should support QG's cash flow generation; we project its EBITDA gross leverage (adjusted for dividend received from JV, as per Fitch's criteria) to remain comfortable at around 2x in 2024-2026. However, high reliance on dividends from AGP suggests that the quality and diversification of the group's cash flow have significantly deteriorated.

Increasing but Low Domestic Tariffs: In 2023 QG's average domestic tariff was around 20% lower than the average price at which QG purchased gas domestically, and significantly lower than the price at which QG will be buying natural gas from Russia from 2024. QG expects domestic tariffs to rise faster than the domestic gas purchase price in 2024-2026, albeit not sufficiently to lift profitability. Increasing domestic gas production is one of the group's strategic objectives, but we expect its production to remain minimal at least in 2024-2026.

Evolving Regulatory Environment: Uncertainties surrounding the domestic pipeline transportation and distribution regulatory environment in Kazakhstan are among the factors negatively affecting QG's SCP. Tariff indexation can be irregular and in the past was sometimes affected by political decisions.

Subsidiaries' Ratings Equalised with Parent's: We view the legal incentives to support under our Parent and Subsidiary Linkage (PSL) Rating Criteria as 'High' since QG guarantees most of ICA's and KTGA's external debt. ICA's debt is subject to a cross-default provision under QG's eurobond.

Strategic incentives are 'High' for ICA and 'Medium' for KTGA. ICA is the operator of trunk gas pipelines in Kazakhstan for transporting gas domestically and internationally, and accounts for 34% of the group's estimated EBITDA in 2023-2026, including dividends from JVs. KTGA is a domestic operator of gas distribution networks, but its contribution to the group's EBITDA is smaller at 7%. Operating incentives are 'High' for both subsidiaries, due to a fully integrated management strategy, as well as common planning and budgeting.

DERIVATION SUMMARY

We rate QG two notches below the sovereign, which is based on QG's weak SCP of 'b' and our assessment of strong support from the sovereign. QG has a monopolistic position in domestic gas transmission and distribution in Kazakhstan, but its profitability is very weak, mainly in view of loss-making domestic operations. The group expects its domestic tariffs to increase, but this will not be sufficient to cover all input costs, particularly as it will have to rely more heavily on gas imports from Russia. QG's cash flows, however, will be supported by a sizeable dividend it will be receiving from its JV.

Kazakhstan Electricity Grid Operating Company's (KEGOC, BBB/Stable, SCP: bbb-) IDR is derived from its SCP plus one notch uplift for strong links with the state with the support score of 25. KEGOC's 'bbb-' SCP reflects a stronger financial profile and improvements in the regulatory framework following market reform introduced in June 2023. The SCP benefits from KEGOC's monopoly position, long-term tariff approval that adds visibility to cash flow generation, and its large size compared with local peers'.

KEY ASSUMPTIONS

- Brent crude price at USD80/bbl in 2024, USD70/bbl in 2025 and USD65/bbl in 2026

- Increasing gas imports from Russia; gas exports to China at around 5bcm per annum to 2026

- Increasing gas transit from Russia to Uzbekistan partially offsets practically discontinued gas transit from central Asia to Russia

- Domestic gas tariffs increasing but insufficient to cover all input costs, including of purchased and imported gas

- Capex peaking in 2023 and moderating thereafter

RATING SENSITIVITIES

QG:

Factors That May, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- A sovereign upgrade

- Stronger ties between Kazakhstan and QG

- Significant improvement in QG's SCP, driven by higher domestic tariffs comfortably covering input costs, and/or reduced gas import needs

Factors That May, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Further material deterioration of QG's SCP, driven for example by lower-then-expected dividends from its JVs or materially deteriorating standalone liquidity

ICA and KTGA

Factors That May, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Positive rating action on QG

Factors That May, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Negative rating action on QG

- Weaker ties between QG and ICA (or QG and KTGA), coupled with deterioration of their credit profiles

Kazakhstan sovereign (see Fitch Affirms Kazakhstan at 'BBB'; Outlook Stable published 17 November 2023):

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Public and External Finances: Erosion of the sovereign balance sheet; for example, due to disruption of exports, a prolonged period of looser fiscal policy, a severe commodity price shock, 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.

- Structural: Spillovers from Russia-related sanctions or geopolitical tensions, or domestic social or political instability, which raise risks to macroeconomic performance and stability.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Public and External Finances: A substantial and sustained improvement in fiscal performance that leads to further strengthening of the sovereign balance sheet.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: QG has an adequate liquidity buffer; at end-2023 its Fitch-estimated cash amounted to around KZT160 billion, versus around KZT50 billion of total maturities in 2024 and 2025. Its largest maturity is an USD706 million eurobond maturing in 2027. Similarly to its subsidiaries, QG has a record of good access to Kazakh banks, even though it has no long-term committed facilities.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

QG is rated two notches below Kazakhstan under our GRE Rating Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	RECOVERY ⬍	PRIOR ⬍
Intergas Central Asia JSC	LT IDR		BBB- Rating Outlook

	ST IDR B Downgrade		F3
	LC LT IDR BB+ Rating Outlook Stable Downgrade		BBB- Rating Outlook Stable
	Natl LT AA-(kaz) Rating Outlook Stable Downgrade		AA+ (kaz) Rating Outlook Stable
senior unsecured	LT BB+ Downgrade	RR4	BBB-
senior unsecured	Natl LT AA-(kaz) Downgrade		AA+(kaz)
KazTransGas Aimak JSC	LT IDR BB+ Rating Outlook Stable Downgrade		BBB- Rating Outlook Stable
	ST IDR B Downgrade		F3
	LC LT IDR		BBB- Rating Outlook Stable

Natl LT AA-(kaz) Rating Outlook Stable Downgrade	AA+ (kaz) Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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

APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 23 Dec 2020)

Parent and Subsidiary Linkage Rating Criteria (pub. 17 Jun 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 14 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 04 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 04 Nov 2023)

Government-Related Entities Rating Criteria (pub. 13 Jan 2024)

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	UK Issued, EU Endorsed
JSC National Company QazaqGaz	UK Issued, EU Endorsed
KazTransGas Aimak JSC	UK Issued, EU Endorsed

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