Research Update:

Gas Utility QazaqGaz Affirmed At 'BB+' On Cash Flow Volatility Offset By Expected Government Support; Outlook Stable

July 12, 2024

PRIMARY CREDIT ANALYST

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

SECONDARY CONTACTS

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

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

Rating Action Overview

- We expect QazaqGaz NC JSC's (Qazaqgas') loss-making domestic operations in 2024-2026 to increase the gas company's reliance on the timely receipt of dividends from joint ventures, thereby creating volatility in profitability and credit metrics and weakening our business profile assessment. We therefore reassessed the stand-alone credit profile (SACP) to 'bb' from 'bb+'.
- That said, we apply a one-notch uplift to the SACP to capture our view of a high likelihood of government support, via sovereign wealth fund Samruk-Kazyna, if Qazaqgas faced financial distress.
- We therefore affirmed our 'BB+' rating on Qazaqgas and on its core subsidiary Intergas Central Asia (ICA).
- The stable outlook indicates that we expect Qazaqgas' average funds from operations to debt over 2024-2026 will remain above 45%, and that its liquidity will stay adequate thanks to limited maturities and manageable spending plans over the same period.

Rating Action Rationale

Qazaqgas' business risk profile has weakened, in our view, because the company's reported EBITDA will likely be negative over 2024-2026 due to loss-making domestic operations. Kazakhstan's gas demand is increasing fast, jumping to about 20 billion cubic meters (bcm) in 2023 from 15 bcm in 2021, and we anticipate further growth to 25 bcm by 2026 in line with the government's goal to achieve 65% gasification in 2030. To meet demand, and since local gas production is limited, Qazaqgas has increased gas imports from Russia as well as the purchase price of gas from subsoil users to encourage them to ramp up gas production. As a result, the average cost of purchasing gas is about 33 tenge per cubic meter of gas. Domestic gas selling prices are set low by the government, at Kazakh tenge (KZT) 22 per cubic meter (equivalent to about $45 per thousand cubic meter), which is behind the structural losses on the domestic business. We think that any potential efforts by the government toward domestic operations to break-even by 2027, would require at least a 20%-25% annual tariff growth (excluding new projects), that could be difficult to align with the government's affordability considerations. Higher volumes mean that domestic market losses are no longer compensated by profitable, but relatively moderate gas exports (5.6 bcm in 2023), even though export prices could exceed $250 per thousand cubic meter. As a result, we now expect Qazaqgas' reported EBITDA (corresponding to domestic operations, i.e. before dividends from JVs) to be negative over 2024-2026.

We assume Qazaqgas' financial metrics will fluctuate because of high volatility in profitability over 2024-2026. This is because S&P Global Ratings-adjusted EBITDA and funds from operations (FFO) depend heavily on the amount and timely receipt of dividends from AGP (contracted) and BSHP (regulated), the company's 50% gas pipeline joint ventures with Chinese partners. In 2023, protracted negotiations between Chinese and Kazakh counterparts on AGP's tariff delayed the receipt of dividends, sinking FFO to debt to negative territory from the above 60% we had expected. At this time, the dividends from AGP were paid in full for the year 2022 in the amount of KZT255 billion. We expect that, over the second half 2024, Qazaqgas to receive an additional KZT269 billion related to the 2023 dividends. Still, we cannot rule out volatility in payment timings or amounts, because Qazaqgas does not have full control over these joint ventures; we view this lack of EBITDA predictability as a structural weakness of the business.

However, we expect FFO to debt should remain relatively comfortably above 45% on average over 2024-2026 and liquidity to be adequate thanks to solid cash cushion and limited near-term maturities. Due to business volatility, we now look at Qazaqgas consolidated financial metrics (i.e. domestic business and JVs) on a gross debt basis. Under our base case, we expect Qazaqgas to receive KZT200 billion-KZT300 billion annual dividends from joint venture in a broadly timely manner. Still, dividends inflows could be delayed for reasons that are beyond Qazaqgas' control and this lack of predictability could heighten liquidity issues, in case of short-term debt repayments (which is not currently the case). We also forecast limited capital expenditure (capex) of KZT100 billion-KZT150 billion, annual debt amortization of KZT25 billion-KZT50 billion as well as minimal dividends to Samruk-Kazyna, which should enable Qazaqgas to build a significant cash balance to fully repay its Eurobond maturing in 2027. Also, we understand that AGP is debt-free and BSHP can service its debt from its own cash flow without any support from Qazaqgas. We acknowledge, however, that t uncertainty around the timing of dividends could trigger pronounced fluctuations in the company's credit metrics year on year.

We continue to see it as highly likely that the government of Kazakhstan, via Samruk-Kazyna, will provide support to Qazaqgas if needed, translating into a one-notch of uplift to the SACP. The increasing demand for gas, amid the government's goal for 65% gasification of the country by 2030 from 60% in 2023, makes gas a critical part of Kazakhstan's energy mix and decarbonization, in our view. 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 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. We therefore expect a high likelihood that the government through Samruk-Kazyna will support Qazaqgas in times of distress as demonstrated by the KZT13 billion cash injection in done in 2022 as well as the readily available KZT76 billion equity injection to be finalized should Qazaqgas require funding (for example if Samruk-Kazyna require Qazaqgas to enter a large investment project to fulfill new government objectives). In our view, potential extraordinary government support offsets the weaker profitability of domestic operations and increased volatility in credit metrics.

We align the rating on ICA with that on Qazaqgas based on our view of the former's core status within the group. The consolidated approach reflects the companies' close integration, Qazaqgas' 100% ownership of ICA, financial guarantees on much of the group's debt issued by ICA and Qazaqgas, large intragroup cash flow, and a close management integration in the absence of effective subsidiary ring fencing. We equalize the ratings on ICA with those on Qazaqgas, reflecting the overall creditworthiness of the group.

Outlook

The stable outlook is in line with that of Kazakhstan (BBB-/Stable/A-3).

The stable outlook also incorporates our view that Qazaqgas will receive annual dividends from AGP and BSHP of KZT200 billion-KZT300 billion in a timely manner ensuring FFO to debt remains on average above 45%, albeit with potential volatility year on year. We also expect Qazaqgas to build a significant cash balance to support investments in gas production and network enhancement as well as full repayment of the Eurobond due in 2027.

Downside scenario

A sovereign downgrade would trigger a similar action on Qazaqgas.

On a stand-alone basis, we could revise down Qazaqgas' SACP if we view liquidity constraints from interruptions in dividends from the joint ventures or a materially enlarged investment program squeezes FFO to debt, causes negative free operating cash flow (FOCF), and creates a marked increase in debt.

Upside scenario

A sovereign upgrade would prompt a similar action on Qazaqgas.

On a stand-alone basis, rating upside is limited. Revising the SACP up to 'bb+' could stem from growth in organic EBITDA (excluding dividends from joint ventures) despite re-routing gas flows to domestic consumption leading to less reliance on dividends from its joint ventures.

Company Description

Qazaqgas is the national gas operator which is 100% owned by Samruk-Kazyna (BBB-/Stable/A#3) itself 100% owned by the Kazakh government (BBB-/Stable/A#3). Qazaqgas operates more than 21,000 km of gas transmission pipelines, about63,000 kilometers (km) of gas distribution networks in 12 gasified regions, 56 compressor stations, and three underground gas storage facilities. Since November 2021, Qazaqgas has the official status of national gas operator, which means the company has preemptive rights in gas purchases from local oil producers.

In 2023, Qazaqgas transported 78.6 bcm of gas for both domestic needs and exports (China, Russia, Turkmenistan and Uzbekistan) and supplied 24.8 bcm of gas (19.8 bcm domestically and 5 bcm to China). As of end-2023, the country is 60% gasified with a goal to increase to 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 ICA); ICA is designated as the national operator of the main gas pipelines, which manages all Kazakhstan's gas pipelines and gas handling facilitates (47,000 km of gas distribution networks, 19,000 km of main gas pipelines, 56 compressor stations with 348 gas compressor units of 2.2 GW, three underground gas storage).
- 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 50% owned joint ventures BshP and AGP.

Our Base-Case Scenario

Assumptions

- Domestic gas sales volumes increasing towards 25 billion cubic meters (bcm) per year (compared with 20 bcm in 2023) as Qazaqgas' strategy is to focus on domestic market.
- Stable gas export to China at least 5 bcm. We expect Qazaqgas to import more gas from Russia to meet domestic demand in Kazakhstan and to facilitate exports to China using internal reserves.
- Relatively stable international gas transit volumes of about 50 bcm.
- Gas transportation tariffs growing with inflation.
- Increasing dividends from its 50-50 joint ventures to KZT 250 billion-KZT300 billion annually.
- Annual investments of KZT100 billion-KZT200 billion investments annually.
- Minimal dividends to Samruk-Kazyna.

Key metrics

Qazaqgas--Key Metrics*

Mil. KZT	2022a	2023a	2024e	2025f	2026f
EBITDA	244,376	66,429	500,000-550,000	250,000-300,000	250,000-300,000
o/w dividends from joint ventures	80,976	10,954	about 540,000	about 290,000	about 310,000
Funds from operations (FFO)	134,118	(2,036)	500,000-550,000	200,000-250,000	200,000-250,000
Capex	101,774	300,231	100,000-150,000	100,000-150,000	100,000-150,000
Dividends	--	27,065	22,000	0-5,000	5,000-10,000
Debt§	69,439	454,064	500,000-530,000	500,000-530,000	500,000-530,000

Qazaqgas--Key Metrics* (cont.)

Mil. KZT	2022a	2023a	2024e	2025f	2026f
FFO/debt (%)	193.1	(0.4)	90.0-100.0	about 45.0	about 45.0

*All figures adjusted by S&P Global Ratings. §2022 and 2023 on a net basis. 2024 until 2026 on a gross basis a--Actual. e--Estimate. f--Forecast.

Liquidity

We consider Qazaqgas' liquidity to be adequate. This is based on our assumption that liquidity sources will exceed uses by more than 1.5x over the 12 months from July 1, 2024, and that sources will exceed uses, even if EBITDA declines by 15%. Furthermore, the company had KZT67 billion cash reserve at end-2023 and received dividends of about KZT255 billion from AGP in the first half 2024. We highlight there is potential for a higher investment program that prevents us from assessing the company's liquidity in a stronger category.

We think that Qazaqgas has adequate access to financing from local banks. The company keeps cash mostly with the country's largest bank, Halyk Bank, and Kazakh 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 July 1, 2024 include:

- Unrestricted cash and equivalents of about KZT200 billion; and
- Our projection of cash from operations of at least KZT255 billion corresponding to AGP dividends from 2022 and KZT18 billion corresponding to BSHP dividends from 2023 already received.

Principal liquidity uses for the same period include:

- Debt repayments of KZT15 billion-KZT25 billion for the coming 12 months;
- Capex of KZT100 billion-KZT150 billion; and
- Limited dividends to Samruk-Kazyna.

Ratings Score Snapshot

Issuer Credit Rating	BB+/Stable/--
Business risk:	Weak
Country risk	High
Industry risk	Intermediate
Competitive position	Weak
Financial risk:	Intermediate
Cash flow/leverage	Minimal
Anchor	bb

Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Moderately negative (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bb
Related government rating	BBB-
Likelihood of government support	High (+1 notch)

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: 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
- 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

Ratings List

Ratings Affirmed	
QazaqGaz NC JSC	
Intergas Central Asia JSC	
Issuer Credit Rating	BB+/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of