FitchRatings

Tagging Info

Fitch Affirms KazMunayGaz at 'BBB'; Outlook Stable

Ratings Endorsement Policy

25 Jun 2014 11:18 AM (EDT)

Fitch Ratings-Moscow/London-25 June 2014: Fitch Ratings has affirmed JSC National Company KazMunayGas's (NC KMG or the group) Long-term foreign currency Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook. Fitch has also affirmed KazMunaiGaz Finance Sub B.V.'s foreign currency senior unsecured rating at 'BBB'. A full list of rating actions is at the end of this release.

Wholly state-owned NC KMG is a holding company for Kazakhstan's (BBB+/Stable) interests in the oil & gas sector, and its ratings are notched down from the sovereign's. We view NC KMG's standalone operational and credit profile as commensurate with the 'BB' rating category. Its main upstream subsidiary is facing declining production, and we expect that any output growth would come from the group's joint ventures (JVs) and associates. We do not consider the group's significant cash balance of KZT1,216bn, including short-term deposits at end-2013, as fully offsetting its high leverage and continue to focus our analysis on gross leverage metrics. Our forecast is that NC KMG's funds from operations (FFO) gross adjusted leverage will remain above 4x in 2015-2017.

KEY RATING DRIVERS

Ratings Notched Down From Sovereign

Although NC KMG continues to benefit from strong links with the Kazakh state, we believe that an explicit state guarantee would be needed for a significant portion of NC KMG's debt to ensure full rating alignment. Therefore, we notch the group's ratings down one notch from the sovereign ratings. Fitch views NC KMG's standalone operational and credit profile as commensurate with the 'BB' rating category.

New Projects Drive Output

We consider a successful ramp-up of Kazakhstan's new oil and gas projects operated JVs in which NC KMG has a stake as a pre-requisite for the country's production growth in the medium to long term. This is in contrast to JSC KazMunaiGas Exploration Production, NC KMG's majority-owned subsidiary, whose primary goal is to maintain stable output levels from its oil mature assets. On the other hand, the unsuccessful launch of a multi-billion dollar Kashagan project in which NC KMG has a 16.88% stake has led to an estimated two-year production delay, which highlights the inherent execution risks in the oil and gas industry, in particular when operating in environmentally sensitive areas and working with high pressure, high sulphur reservoirs. Nonetheless, we believe that upstream will remain NC KMG's main segment by EBITDA and cash flow contribution.

Affiliates' Dividends Provide Cash

We expect that cash dividends from NC KMG's JVs and affiliates will remain its principal source of operating cash inflows over the medium term. In 2013, NC KMG received KZT371bn in dividends from its JVs and associates, while it generated KZT344bn in net cash flows from its consolidated operations. In 2013, TengizChevroil LLP (TCO), NC KMG's largest affiliate by dividend contribution, paid KZT254bn in dividends to NC KMG, up from KZT244bn in 2012. We expect a dividend reduction from TCO in 2014-2016 because of its large expansion plans.

On-going Refinery Upgrades

NC KMG's Atyrau refinery upgrade is currently on-going. In 2014, the group expects to start upgrading its Shymkent and Pavlodar refineries to be completed by 2016 to ensure that all its products are compliant with

Euro 4-5 emission standards. It estimates its total investments in downstream projects at USD4.9bn by end-2016.

Focus on Gross Leverage
Although we believe that the accessibility of the group's cash balances held at domestic banks has improved since 2009, the group continues to rely on external debt financing for capex funding. Therefore, we do not consider NC KMG's significant cash balance of KZT407bn plus short-term deposits of KZT809bn at end-2013 as fully offsetting its high indebtedness and continue to focus our analysis on gross, rather than net, leverage metrics.

Expected Gross Leverage Exceeds 4x
NC KMG's KZT2trn (USD11bn) capex programme in 2014-2016 will be partially debt-funded. We forecast that the group will continue generating negative free cash flows and estimate that its gross FFO adjusted leverage will fluctuate between 4x and 4.5x over this period, based on our Brent oil price deck of USD96/bbl in 2014, USD91/bbl in 2015, USD85/bbl in 2016 and USD80/bbl in the long term. Therefore, we forecast gross coverage and leverage ratios for NC KMG that are weaker than those of its similarly-rated Russian oil and gas peers.

RATING SENSITIVITIES
Positive:
NC KMG's ratings would be affected by a sovereign rating action. A sovereign upgrade or downgrade would be replicated for NC KMG with a one-notch differential.

Negative:
- Evidence of weakening state support would be negative for NC KMG's ratings.
- Aggressive acquisitions and/or an investment programme resulting in a further material deterioration of the standalone credit metrics could also be negative for NC KMG's ratings.

LIQUIDITY AND DEBT STRUCTURE
Manageable Upcoming Debt Maturities
At end-2013, NC KMG had gross balance sheet debt of USD17.1bn, about 69% of which was held by the parent company. Its short-term debt of USD3bn was covered by the company's cash of USD2.7bn and short-term investments of USD5.4bn on that date.

We view the group's liquidity as sufficient. We consider its large cash balances and deposits, assuming full accessibility of funds, as positive for its liquidity. According to NC KMG, it has USD5.3bn of unused committed credit facilities, which support its ability to meet short-term debt repayments.

Moderate FX Risks
Around 88% of the company's borrowings were denominated in foreign currencies, primarily US dollars, at 31 December 2013. A 19% Kazakh tenge devaluation against the US dollar in February 2014 will have a positive impact on NC KMG's revenue and earnings over time, as US dollar-denominated sales accounted for 66% of total revenues in 2013. However, it will also increase its gross nominal debt and debt service costs, as the company reports in tenge.

FULL LIST OF RATING ACTIONS

NC KMG
Long-term foreign currency IDR: affirmed at 'BBB'; Outlook Stable
Long-term local currency IDR: affirmed at 'BBB+'; Outlook Stable
Short-term foreign currency IDR: affirmed at 'F3'
Foreign currency senior unsecured rating: affirmed at 'BBB'
Local currency senior unsecured rating: affirmed at 'BBB+'

KazMunaiGaz Finance Sub B.V.
Foreign currency senior unsecured rating: affirmed at 'BBB'

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Additional information is available at www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable criteria, 'Corporate Rating Methodology', dated 28 May 2014, is available at www.fitchratings.com

Applicable Criteria and Related Research:
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage

Additional Disclosure
Solicitation Status