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Credit Opinion: National Company Food Contract Corporation JSC

Global Credit Research - 22 Jul 2013

Astana, Kazakhstan

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	Ba3
Senior Unsecured -Dom Curr	Ba3/LGD4

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Key Indicators

National Company Food Contract Corporation JSC[1]	2012	2011	2010	2009	2008
EBIT Margin	23.6%	19.6%	20.9%	26.3%	16.0%
EBIT / Interest Expense	1.2x	1.5x	1.7x	2.5x	2.1x
Debt / EBITDA	10.2x	13.5x	5.8x	10.3x	9.6x
FFO / Debt	3.2%	-0.7%	7.0%	4.4%	4.6%
(Cash from Operations - Dividends) / Net Debt	12.5%	-63.2%	114.7%	-58.5%	-71.0%
Free Cash Flow / Debt	9.5%	-60.6%	68.7%	-53.9%	-70.7%

[1] Annual ratios as adjusted by Moody's

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Inherent volatility of the company's revenues, operating profit and cash flows

- Dependence on government budget programme for agricultural segment

- High leverage

- History of strong government support

Corporate Profile

Headquartered in Astana, Kazakhstan, JSC National Company Food Contract Corporation (FCC) is fully owned by the state of Kazakhstan through JSC National Holding Company KazAgro. By virtue of its current ownership structure, we consider FCC to be a government-related issuer (GRI).

FCC is the largest grain trader in Kazakhstan. Its principal mandate is to maintain state grain reserves at levels required to supply the Kazakh population and to ensure timely grain replenishment. The company is also responsible for keeping accounting records and monitoring the quality, quantity and security of state grain resources. In addition, FCC acts as the main governmental tool in supporting the stability of the country's grain market, and grain prices in particular, through large-scale purchases and sales of grain on the domestic market. In 2005, the company also began providing loans to farmers as another form of support to domestic agricultural producers.

Since 2002, the company has been permitted to perform commercial operations on behalf of the state related to grain sales and other non-oil related activities such as cotton production, bio-diesel and bio-ethanol production, and more recently horticultural production.

FCC has 11 regional offices in Kazakhstan, as well as foreign representations in Russia and China. The company has five subsidiaries specialised in the purchase, storage of grain and logistics, six bread depots countrywide and a grain terminal in the Aktau Port on the Caspian Sea with transshipment capacity of 500,000 metric tonnes (mt) per annum. In addition it holds a 50% stake in the grain terminals in Amirabad (Iran) and Baku (Azerbaidzhan).

At the end of December 2012, FCC reported revenues of KZT71.9 billion (approximately $480 million) and adjusted EBIT of KZT16.9 billion (approximately $114 million).

SUMMARY RATING RATIONALE

FCC's Ba3 corporate family rating is determined in accordance with our rating methodology for GRIs (Government-Related Issuers: Methodology Update, published in July 2010), which comprises the following inputs (1) a baseline credit assessment, or BCA - a measure of the company's underlying fundamental credit strength, excluding any government support - of b3; (2) the Baa2 local currency rating of the government of Kazakhstan; (3) high default dependence between the GRI and the government; and (4) the probability of strong support from the government.

The BCA is constrained by (1) the volatility of FCC's revenues, operating profit and cash flows; (2) the company's high dependence on the state for funding; and (3) the company's history of high leverage, with a substantial proportion of its loans being short term in nature.

However, FCC's ratings benefit from the state support it receives on an ongoing basis, mainly in the form of shareholder loans, loans from the Ministry of Agriculture of Kazakhstan, and, to a lesser extent, equity injections. The ratings also factor in (1) the company's more than 10-year track record of operations in domestic and international grain markets; and (2) its long-term relationships with grain storage companies in Kazakhstan, grain traders and foreign banks.

We also take into account that FCC's weak operating and financial profile, characterised by low profitability and high leverage, is mainly driven by the company's mandate to maintain state grain reserves and act as a government's arm to regulate domestic grain prices, which often implies operating against the market trends, i.e., selling grain at prices below the market price and buying grain at prices above the market.

DETAILED RATING CONSIDERATIONS

STRONG GOVERNMENT SUPPORT EXPECTED TO BE MAINTAINED

As per our GRI rating methodology, FCC's ratings incorporate uplift to the company's standalone credit quality, measured by a BCA of b3. The uplift to the BCA is driven by the credit quality of the state as the sole shareholder, and our assessment of strong support from its ultimate shareholder in the event of financial distress, as well as high default dependence between the company and the state.

The high level of default dependence reflects (1) FCC's full state ownership, and its high reliance on the government for operational support, both directly and indirectly as the company acts as a government agent; (2) the high concentration (more than 90%) of the company's revenues in the domestic market; and (3) the sensitivity of FCC's financials to the same sources of risk as the government, as political events might affect the willingness of the government to support the company (or even willingness to support the continued existence of the company).

Strong support is predicated on (1) the significance of agriculture to the Kazakh economy, as well as the sector's contribution to national exports, albeit secondary to the importance of the oil and gas sector; (2) the threat of reputation risk to the state if it failed to service the company's financial debts (via a fully owned state agency) in a timely manner; (3) the role played by the company in underpinning national economic growth that favours non-oil-related sectors; and (4) the actual state support that FCC has received to date, in the form of interest-free loans, capital injections and subsidies.

The degree of support is constrained by the lack of an explicit guarantee of FCC's financial liabilities by Kazakhstan, although we expect the government will ensure that FCC is in a position to honour its financial obligations in a timely manner.

COMPANY'S REVENUES, OPERATING PROFIT AND CASH FLOWS ARE INHERENTLY VOLATILE

FCC's BCA of b3 reflects the fact that the company's earnings and cash flows remain inherently volatile, as grain prices vary due to imbalances between demand and supply driven by weather conditions, political changes and farmers' incentives to plant specific crops. This volatility is further reinforced by the company's special mandate to maintain state grain reserves and regulate domestic grain prices, which often implies selling grain at prices below the market price and buying grain at prices above the market, as well as significant investments in working capital explained by the nature of the company's mandate and industry seasonality.

In financial year (FY) 2012 (to 31 December), the company's revenues increased by around 16%, mainly due to the increased volume of grain sales in 2012 to 2 million mt, from around 1 million mt in 2011. Around half of these sales were performed at lower-than-market prices. The increase of sales is explained by a weak grain harvest (around 14.5 billion mt in net weight) in Kazakhstan in 2012 (2011: around 29 billion mt in net weight) as a result of droughts in several districts of the country.

We also note that in FY 2012, FCC reduced the amount of grain it purchases from domestic farmers to around 1 million mt (2011: around 5 million mt), which resulted in a decrease in its working capital of around KZT12 billion (2011: minus KZT100 billion). FCC's cash flow from operations turned positive, to around KZT18 billion, from negative KZT100 billion, which mainly reflected the increase in the company's revenue and the decrease in working capital.

In FY 2013, we expect that FCC's purchases of grain from domestic farmers will be around 1-1.5 million mt. We also expect that the company's grain sales will remain around the level of those in FY 2012, given the Kazakh government's expectation of a grain harvest of around 15 million mt.

DEPENDENCE ON FINANCIAL SUPPORT FROM GOVERNMENT AND SHORT-TERM COMMERCIAL BANK LOANS TRANSLATES INTO HIGH LEVERAGE AND ONGOING REFINANCING PRESSURE

FCC is highly dependent on the government's financial support in performing its main functions as a regulator of domestic grain prices and provider of financing to farmers. Although FCC's ratings benefit from the ongoing state support, we note that it mainly comes in the form of short-term reduced-interest shareholder loans and interest-free loans from the Ministry of Agriculture of Kazakhstan, and, to a lesser extent, in the form of equity injections. In 2006-12, the state injected around KZT35.3 billion (approximately $230 million) into the company's share capital, of which around KZT2.5 billion (approximately $16 million) was injected in 2012. At the same time, as of end-FY 2012, FCC's interest-free loans amounted to KZT6.5 billion (approximately $43 million; around 4% of total reported borrowings), and reduced-interest loans from holding company KazAgro amounted to KZT39.5 billion (approximately $260 million; around 22% of total borrowings).

In addition, FCC is reliant on short-term commercial bank loans to fund its high working capital requirements. The company's leverage remains high. As of year-end 2012, the company's adjusted debt stood at KZT178 billion, or approximately $1.2 billion (2011: KZT173 billion), out of which around 75% was short-term debt. The company's adjusted leverage - measured as adjusted debt/EBITDA - decreased to 10.2x at year-end 2012 from 13.5x as of year-end 2011, driven by the increase in the company's EBITDA, which was underpinned by growth in sales. We understand that none of FCC's existing debt facilities have financial covenants.

Liquidity Profile

STATE FUNDING IS CRITICAL TO LIQUIDITY

We expect that the company will be able to maintain a satisfactory liquidity position over the next 12 months from the start of Q2 2013 to end-Q1 2014, based on the assumption of planned support from the Kazakhstan government in the form of interest-free loans from Kazakhstan's Ministry of Agriculture, as well as loans from KazAgro to finance grain purchases and provide financing to the country's farmers.

We note that FCC remains highly reliant on timely state funding as well as on its ability to roll over short-term working capital facilities with banks. However, the history of regular government support, FCC's critical role in the Kazakh agricultural sector and the company's long-established relationships with banks provide some comfort that it will maintain satisfactory liquidity going forward.

Rating Outlook

The outlook on FCC's rating is stable, reflecting our expectation that the banks and the government will remain supportive of the company in meeting its future financial commitments in a timely manner.

What Could Change the Rating - Up

Upward pressure is unlikely to be exerted on the rating over the intermediate term in light of FCC's weak balance-sheet structure, reflected in the company's BCA.

What Could Change the Rating - Down

Downward pressure could be exerted on the rating if support from the Kazakh government fails to materialise in a timely manner when needed. Also, any downgrade of the sovereign rating could have a direct impact on FCC's corporate family rating.

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