



Fitch Affirms National Company KazMunayGas at 'BBB-'; Outlook Stable

Fitch Ratings - London - 27 March 2020:

Fitch Ratings has affirmed JSC National Company KazMunayGas's (KMG) Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook.

KMG is the national oil and gas company in Kazakhstan (BBB/Stable), with medium-scale hydrocarbon production and refining, and is the owner of trunk oil and gas pipelines. It is rated one notch below the Kazakh sovereign (BBB/Stable).

Key Rating Drivers

Links with State Drive Rating: We rate KMG on a top-down basis, one notch below Kazakhstan, using our Government-Related Entities (GRE) Rating Criteria, under which KMG scores 37.5 points. We assess the status, ownership and control factor for KMG as strong, while we view support track record and expectations as moderate because the government had maintained KMG's gross leverage at an aggressive level in 2014-2017. We view the socio-political implications of a KMG default as strong and financial implications of its default as very strong because we believe KMG is a major Kazakh borrower in the Eurobond market and a proxy issuer for the government.

Stable Standalone Credit Profile: We assess KMG's standalone credit profile (SCP) at 'bb-'. Its business profile is supported by its significant scale in hydrocarbons production (259,000 barrels of oil equivalent per day (kboe/d, 77% liquids) on a consolidated basis in 2019; 638kboe/d including stakes in equity affiliates (76% liquids) and integration into the more stable midstream and downstream segments. Its financial profile constrains SCP at 'bb-', although we project further strengthening in the credit metrics in 2022-2023.

Debt Repayment in 2019: Funds from operations (FFO) adjusted gross leverage decreased to 3.6x in 2019 from 6.1x in 2017, due to repayment of debts in combination with solid operational results. KMG has elected to repay USD2.25 billion (KZT864.4 billion) it owed under the TCO advanced oil sale agreement, which we classified as debt, in 2019. This represents an accelerated repayment of USD1.25 billion compared with its repayment schedule. This has been achieved by a decrease in bank deposits, which we view as credit-positive.

Low Oil Prices Impact Leverage in 2020: We forecast an increase in net leverage to 4.3x in 2020 from 2.4x in 2019, due to the effects of the COVID-19 pandemic and the collapse of the OPEC-Russia alliance. We expect a sharp recovery in prices from 2021 onwards, which we expect will have a positive impact on cash generation and leverage. Fitch projects KMG's FFO leverage to average 4.4x on a gross basis and 3x on a net basis in 2020-2023.

Kashagan Stake Buyback Timing Uncertain: KMG has a call option with JSC Sovereign Wealth Fund Samruk-Kazyna (SK; BBB/Stable) to buy back the former's stake in the giant Kashagan oilfield (KMG Kashagan B.V.) until 2022. However, the stake in Kashagan is currently frozen by a Dutch court under arbitration, which makes the timing uncertain. The 8.44% stake was purchased by SK for USD4.7 billion, of which an USD2.7 billion-equivalent was provided as a local-currency debt, in 2015 to provide KMG headroom under its debt covenants. We view this call extension as an example of state support to KMG and expect flexibility in the future.

Megaprojects Set to Boost Volumes: KMG has stakes in the three internationally developed giant upstream projects in Kazakhstan: TengizChevrOil (TCO; 20% stake; 651kb/d production in 2019), Karachaganak (10%; 218kb/d) and Kashagan (8.44%; 301kb/d). TCO is currently undergoing expansion to increase output by 260kb/d by 2022, while Kashagan has been increasing production volumes since its launch in 4Q16 and reached around 400kb/d liquids production in January 2020. Two additional rounds of future Kashagan development may lead to an increase in the field's output to 500kb/d in the medium term with significantly lower capex requirements than in the initial development stage.

Muted Outlook for Dividend Inflow: We forecast modest dividends from KMG's equity affiliates in 2020-2023, averaging at KZT207 billion p.a. (USD0.5 billion) versus KZT380 billion (USD2.4 billion) p.a. in 2012-2014. The modest dividend, despite large production volumes attributable to affiliates and reasonable oil prices, is due to the expansionary project at TCO. We expect no dividends from Kashagan in 2020-2022 as KMG Kashagan B.V., KMG's 50% associate with 16.88% of the project, will use its free cash flow to repay USD1.5 billion long-term oil prepayment that we view as debt. We estimate that dividends received by KMG should grow significantly around 2022-2023, due to higher payments from TCO unless oil prices remain low.

Derivation Summary

KMG is Kazakhstan's national oil and gas company, with medium-scale hydrocarbon production and refining, and is the owner of trunk oil and gas pipelines. Its 2019 production was nearly 259kboe/d, or 638kboe/d including its share in equity affiliates. It accounts for about 26% of domestic oil production including its share of production in affiliates, and owns most of the refining capacity in the country and key pipeline infrastructure. KMG is broadly comparable to State Oil Company of the Azerbaijan Republic (SOCAR, BB+/Stable) in operational profile, but KMG has significantly higher hydrocarbon production from equity affiliates. KMG's financial profile is stronger than SOCAR's.

KMG's rating is notched down once from the sovereign rating because it scores 37.5 points under our GRE Rating Criteria. The score is comparable to those of Argentina's YPF S.A. (CCC), Petroleos Mexicanos (PEMEX, BB+/Negative), SOCAR and Indian Oil Corporation (BBB-/Stable), which also have strong ties with the sovereign.

No country ceiling constraint or operating environment influence affected KMG's ratings.

Key Assumptions

Fitch's Key Assumptions within our Rating Case for the Issuer

- Brent oil price of USD41/bbl in 2020, USD48/bbl in 2021, USD53/ bbl in 2022 and USD55/bbl thereafter;
- Average exchange rate of KZT424 per USD in 2020, KZT453 in 2021, KZT441 thereafter;
- Flat oil and gas production by subsidiaries;
- No dividends from Kashagan in 2020-2023;
- Improved profitability in the downstream segment in 2020-2021 relative to 2017 due to higher refining fees;
- Capex averaging KZT630 billion per annum in 2020-2023; and
- No significant asset acquisitions or disposals in 2020-2023.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- A sovereign upgrade.
- Stronger ties between Kazakhstan and KMG.
- Improvement in KMG's SCP, including FFO-adjusted gross leverage sustainably below 4x.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- A sovereign downgrade by more than one notch while assuming stable SCP of KMG.
- Weaker ties between Kazakhstan and KMG.
- Substantial weakening of standalone credit profile.

For the sovereign rating of Kazakhstan, Fitch outlined the sensitivities listed below in the Rating Action Commentary dated 21 February 2020.

The following risk factors individually, or collectively, could trigger positive rating action:

- Improved governance indicators and strengthening of the policy framework to enhance its predictability and effectiveness.
- Sustainable improvement in the health of the banking sector, e.g. demonstrated by improved financial intermediation and asset quality.
- Improvement in the economy's and public finances' resilience to commodity price shocks through economic diversification.

The following factors, individually or collectively, could result in negative rating action:

- Policies that widen the fiscal deficit or undermine monetary policy credibility.
- Materialisation of additional significant contingent liabilities from the banking sector on the public sector balance sheet.

Liquidity and Debt Structure

Strong Liquidity, Foreign-Exchange Debt: At 31 December 2019, KMG's short-term debt of roughly KZT253 billion would have been fully covered by unrestricted cash and short-term investments, which amounted to KZT1,426 billion. At end-2019, 77% of KMG's cash and deposits and 93% of the company's debt was denominated in US dollars.

Emphasis on Gross Metrics: We put more emphasis on KMG's gross leverage due to risks associated with the availability of cash held at Kazakh banks. Historically, KMG has relied on external debt to finance capex. It has gradually decreased the share of cash and deposits held at low-rated domestic banks over the past eight years while the percentage of funds at high-rated international banks has significantly increased. Continuation of KMG's policy resulting in a larger part of the company's liquidity being held at strong banks may prompt Fitch to focus on net, rather than gross, leverage metrics.

Summary of Financial Adjustments

- Fitch treats the long-term prepayments for oil deliveries from Vitol as debt. Associated interest payments are added to KMG's interest charge.
- Fitch included the full amount of USD684 million loan guarantee provided to Beineu-Shymkent Pipeline LLP, KMG's JV, in debt at end-2019.
- Fitch adjusted KMG's debt by adding 6x the annual operating lease expense.
- Fitch removed KZT50 billion of cash pledged as loan collateral from KMG's readily available cash.

ESG Considerations

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RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
JSC National Company KazMunayGas	LT IDR BBB- ● Affirmed	BBB- ●
	ST IDR F3 Affirmed	F3
	LC LT IDR BBB- ● Affirmed	BBB- ●
senior unsecured	LT BBB- Affirmed	BBB-

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Applicable Criteria

Sector Navigators (pub. 23 Mar 2018)
Corporate Rating Criteria (pub. 19 Feb 2019)
Government-Related Entities Rating Criteria (pub. 13 Nov 2019)
Short-Term Ratings Criteria (pub. 06 Mar 2020)

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