

National Company «KazMunayGas» Fixed Income Analysis

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Bond issues					
	Price	YTM		Amount tanding USDm	
KZT KMGZ b2 9.839% 'Oct-19	-	-			
USD KMGZe 10 3.875% 'April-22	101.1	3.5%		500	
USD KMGZe 11 4.750% 'April-27	103.0	4.3%		1 000	
USD KMGZe 12 5.750% 'April-47	103.7	5.5%		1 250	
USD KMGZe 13 4.750% 'April-25	103.4	4.1%		500	
USD KMGZe 14 5.375% 'April-30	105.4	4.7%		1 250	
USD KMGZe 15 6.375% 'Oct-48	109.7	5.7%		1 500	
Major shareholders					
Samruk-Kazyna				90%	
National Bank of Kazakhstan				10%	
Ratings					
	Rating	Outlook		Date	
S&P	ВВ	stable	90	3 Nov 18	
Moody's	Baa3	stable	01	Aug 17	
Fitch	BBB-	stable	29	June 17	
Financial statement items (₹ bn)	2015	2016	2017	2018	
Revenue	1 094	1 857	4 794	6 989	
Operating profit	-484	-25	406	559	
EBITDA	-300	195	645	844	
PBT	53	163	719	969	
Profit for period	495	360	525	694	
Total assets					
Cash and cash equivalents	770	878	1 264	1 539	
Short-term assets incl. cash	2 308	2 868	4 093	3 205	
Long-tern assets	7 335	7 957	9 433	10 748	
Total liabilities					
Short-term liabilities	778	1 128	2 124	1 803	
Long-term liabilities	3 333	3 913	4 640	5 064	
Debt	3 229	3 073	4 301	4 153	
Debt including advance payment	3 229	4 061	5 215	5 018	
Equity	6 090	6 278	6 784	7 143	
Dynamic yoy	2015	2016	2017	2018	
Revenue	4%	70%	158%	46%	
Operating expenses	-39%	-95%	n/a	37%	
EBITDA	-48%	n/a	230%	31%	
PBT	-73%	208%	341%	35%	
Profit for period	-84%	-27%	46%	32%	
Debt	4%	-5%	40%	-3%	
Debt including advance payment	4%	26%	28%	-4%	
Key financial ratios	2015	2016	2017	2018	
Opertaing margin	-44%	-1%	8%	8%	
Net profit margin	45%	19%	11%	10%	
Debt/EBITDA	-10.7	15.7	6.7	4.9	
Net debt/EBITDA (HF calcul-s)	-4.9	10.0	3.5	3.6	
Долг/Equity	0.5	0.5	0.6	0.6	
ROA	5%	3%	4%	5%	
ROE	8%	6%	8%	10%	
Source: Company data, Bloomberg, Halyk Finance (HF) calculations					

We hold "Buy" recommendation of NC KMG bonds, while continuing to point out the significant role of the issuer in the country's oil and gas industry and believe that the incentive for support from the main shareholder will not weaken in the event of deteriorating conditions in the oil market. The impressive amount of assistance provided in 2015 from Samruk-Kazyna and the National Bank, reinforces our assumptions. At the same time, NC KMG bonds are an attractive alternative to foreign currency deposits that can provide a higher guaranteed income.

The results of 2018 - oil continues to "bail out". Strengthening revenue for 2018 by 46%, which was largely the result of favorable oil prices, contributed to an increase in EBITDA by 30% y/y. Thus, the increase in the average price for the Brent brand by 32% y/y (from \$54.2 in 2017 to \$71.3 per barrel in 2018) coupled with high demand from Asian consumers, became the main driver for improving financial performance. Despite the significant increase in the cost of "oil" taxes and the cost of purchased oil and gas, profit for the year strengthened by 32%. Participation in the Tengiz project brings to the company's income the lion's share of profits of 439bn tenge (+51% y/y).

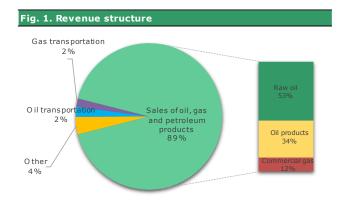
Credit ratings with Stable outlook. According to Fitch forecasts, free cash flow will be substantially positive over the medium run. Moody's retains assumptions about government support if necessary, and expects to maintain adequate indicators of the company's creditworthiness. Moody's considers prepayments for oil as debt.

Debt load remains high. KMG loans at the end of 2018 amounted to 4.2tn - a decrease of 4% y/y. The company's cash position is T1.5tn (+22% y/y). Net debt in the amount of T2.2tn calculated by the company does not include prepayment under contracts for the supply of oil. The company's Net debt / EBITDA is 1.76x. According to our calculations, net debt exceeds T3 tn and the Net debt/EBITDA ratio is 3.6x. We stand in solidarity with Moody's and classify prepayments for advance deliveries as debt.

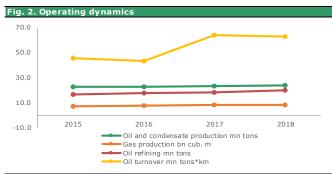
Government support continues to act as a guarantee in the event of a deterioration in oil prices. We remain committed to the opinion of "strong" state support in case of need and maintain our expectations for extraordinary assistance from Samruk-Kazyna in the event of a deterioration in oil prices and overall market conditions. At the same time, the current, relatively favorable levels of oil prices allow the company to generate a sufficient level of cash flows for the gradual optimization of the debt burden. In addition, given the current returns that exceed the interest rate on foreign currency deposits (the maximum recommended rate is 1%), we note the attractiveness of the bonds in comparison with foreign currency deposits and confirm the recommendation to "Buy" NC KMG bonds.



NC KMG April 2019



Source: Company Data



Source: Company Data

Fig. 3. Cost of sales, bn KZT	2017	2018	yoy
Purchase of oil and gas for resale	1 853	2 931	58%
Inventories	876	1 382	58%
Labor costs	312	292	-7%
Depreciation	198	248	26%
MET	94	116	24%
Other	372	384	3%
Total	3 704	5 353	45%

Fig. 4. P&L, bn tenge	2016	2017*	2017	2018	yoy
Revenue	1 857	2 459	4 794	6 989	46%
Cost of sales	-1 562	-2 380	-3 704	-5 353	45%
Gross profit	296	79	1 089	1 635	50%
General and administrative costs	-118	-152	-200	-247	23%
Transportation and marketing costs	-198	-289	-441	-659	50%
Impairment of PP&E	-3	-26	-25	-166	571%
Loss on disposal of the PPE	-6	-4	-4	-4	-8%
Other operating income	19	20	20	23	14%
Other operating expenses	-15	-30	-34	-24	-28%
Operating profit/(loss)	-25	-401	406	559	37%
Exchange difference	-13	67	67	-38	n/a
Financial income	168	122	123	161	31%
Financial expenses	-230	-295	-306	-428	40%
Recovery of impairment of investments in JV	-6	15	15	0	n/a
Disposal of a subsidiary	-	-	-	18	n/a
Impairment of loans issued	-1	-	-	-	n/a
Share of income of JV and associates	270	415	415	697	68%
Profit before taxation	163	-78	719	969	35%
Income tax expense	-164	-192	-190	-279	47%
Profit from continuing operations	-1	-270	529	690	30%
Profit from discontinued operations	361	789	-4	3	n/a
Profit for the year	360	520	525	694	32%

Source: Company data

Results for 2018

Revenue

Revenue NC KMG for 2018 amounted to T6 989 bn, an increase of 46% y/y. In general, the company's revenue growth last year was more favored by "strong" oil.

For 2018, the group sold crude oil in the amount of 3.3 tn tenge, which accounted for 48% of all revenues. In monetary terms, the sale of crude oil in 2018 increased by 44% y/y, while physical sales increased by only 4% y/y to 18mn tons. This is primarily due to an increase in average sales prices by 38% y/y 131ths tenge per ton on average in 2018, which was a result of rising world oil prices — the average price for the Brent brand increased from \$54.2 in 2017 up to \$71.3 per barrel in 2018.

Sales of petroleum products are in second place in terms of revenues received - more than T1.4tn, which corresponds to a 52% growth compared with 2017. In 2018 the company sold slightly higher than 11mn tons of oil products (+28% y/y) at a higher price (the average price is 18% y/y higher), compared to 2017. According to the company reports, high demand was observed in the Asian market.

Significant growth (+112% y/y) shows sales of marketable gas, whose revenues amounted to T364bn, which is also associated with sales growth to China, as well as in the Kyrgyz and Russian markets.

The export part of revenue was 98% against 2% of revenues received in the domestic market.

Revenue from participation in projects

Last year, the share in profits of the joint ventures and associated companies increased by 68% y/y to 697bn. More than 62% was received from participation in the Tengiz project, from which KMG made a profit in the amount of 439 bn tenge (+51% y/y). For 2018 dividends from the joint ventures and associated companies amounted to 160 bn tenge, which is 41% lower than in 2017, due to momentary shifts in dividend payments of KMG.

The company reflected 3.5bn in profit from discontinued operations through the sale of a 50% stake in KMG Ustyurt in January 2018.

Costs

The cost increased by 45% y/y to T5,353 bn. As a result of the increase in the cost of oil relative to the levels of 2017, the company's expenses for the purchase of finished products (crude oil, gas and gas processing products) increased by 58% and amounted to T2,931bn or 55% of the total cost. In addition to the price component, in 2018. KMG increased purchases for resale.

The increase in expenditure on materials and reserves is also 58% y/y due to an increase in the purchase of petroleum products for resale in the Asian market due to higher demand.

The reduction in employee wage costs (-7% y/y) was due to a decrease in the average number of production personnel by almost 3ths units.

Significant growth is observed in implementation costs - by 50% y/y to T659bn. This reflects the increase in tariffs for railway transportation and high volumes of gas transportation to China via the Beineu-Shymkent gas pipeline. In addition, following the rise in oil prices was followed by an increase in rental tax and duties. Unit costs for MET, rent tax and export duties in 2018 increased 32% y/y to \$ 6.45 / bbl.

Net Income

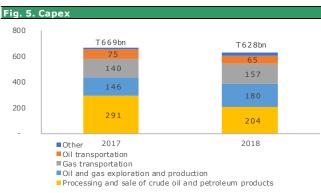
In 2018 the company has depreciated the fixed assets of T166bn, which is 7 times higher than in 2017 .

As a result of this, and also due to a noticeable increase in operating expenses, KMG's operating profit amounted to T559bn,

^{*} before recalculation with discontinued activities



NC KMG April 2019



Source: Company data

Fig. 6. Net debt (KZT bn)	2017	2018	%
Long term loans	3 417	3 823	12%
Current loans	884	331	-63%
Total loans	4 301	4 153	-3%
Cash	1 264	1 539	22%
Current bank deposits	1 639	386	-76%
Net debt - NC KMG calculations	1 398	2 227	59%
Advance payment (crude oil)	914	864	-5%
Net debt - HF calculations	2 312	3 092	34%

Source: Company data, HF calculations

and with a 50% increase in gross profit, it increased only by 37% v/v.

Net income strengthened by 32% y/y, reaching T694bn - supported by increased profits from equity participation.

CAPEX

Capital expenditures in the reporting period amounted to slightly above T625bn, a decrease of 6% y/y.

In 2018, we see a decrease in the Group's capital expenditures on the transportation and processing of oil and oil products by 13% and 30% y/y, respectively. The reduction of capex was influenced by the completion of modernization at the Atyrau Refinery and the Pavlodar Refinery.

Given that "Other" capital investments show an increase of 39%, although they have a low share - 22bn tenge or 4% of the total Capex. The reason for the growth is not given.

Debt and Cash

In July 2018 the company redeemed \$1.6bn Eurobonds. Also during the past year, KMG fully repaid the loan to Sberbank of Russia, amounting to \$400mn (of which \$371mn ahead of schedule).

In March 2019 KMG received the consent of the holders of Eurobonds (maturity in 2022, 2023, 2027 and 2047) for early redemption of bonds in 2044, subsequently, which was carried out a full early redemption of these Eurobonds in the amount of \$14.4mn.

KMG loans at the end of 2018 amounted to 4.2tn - a decrease of 4% y/y. The company's cash position is T1.5 trillion (+22% y/y)

Net debt in the amount of T2.2tn calculated by the company does not include prepayment under contracts for the supply of oil. The company's Net debt/EBITDA is 1.76x. According to our calculations, net debt exceeds T3tn and the Net debt/EBITDA ratio is 3.6x.

The cash outflow for the repurchase of KMG EP shares amounted to T643bn.

NC KMG share in oil production

After a record increase in oil production in 2017 by 10.5% y/y, following the results of 2018. Kazakhstan produced 90.3mn tons of oil, which is higher than the level of 2017 by 4.8% y/y. The contribution of KMG Group was slightly above 26% or 24mn tons. The top three oil producers are Uzen and Emba (8.3mn tons), Tengiz (5.7mn tons) and Mangistaumunaygas field with a production volume of 3mn tons. The share in Kashagan and Karachaganak slightly exceeds 1mn tons each (KMG share). In general, mining at Kashagan has increased significantly compared to 2017 by 60% to 13.2mn tons.

Credit ratings and bond valuation

In early April, Fitch affirmed KMG's rating at "BBB-" with a "Stable" outlook. Fitch predicts that the FFO leverage on average will be 3.8x on a gross basis and 2.1x on a net basis in 2019-2021. More moderate capital investments are expected (in dollar terms) due to the completion of the refinery modernization program in 2018. Fitch forecasts that free cash flow will be substantially positive over the medium run. Regarding the stake in the Kashagan project, according to Fitch, KMG can buy out a stake in the Kashagan field from Samruk-Kazyna, using proceeds from a future IPO if the government decides to send the company revenues from a public offering. In the absence of an IPO, Fitch has doubts about whether the company will repurchase a stake in Kashagan until the company substantially reduces the amount of its debt.

Fitch expects moderate dividends from companies in which KMG has equity interests in 2019-2021, at an average of 217 bn tenge (\$537 mn) per year, which is significantly lower compared to 380



bn tenge (\$2.4 bn) in 2012-2014, before the fall in oil prices. One of the reasons for the low dividend income, despite significant shares in the volumes of production of affiliated companies and acceptable oil prices, is the current expansion project for Tengizchevroil, which has already been completed by about 50%. Fitch estimates that dividends received by NC KMG should grow substantially in approximately 2022-2023 due to higher payments from TCO, unless oil prices fall.

The rating at Baa3, according to Moody's, reflects Moody's assumptions of high government support when necessary and the expectation of relatively stable oil and gas production and transportation and increasing refining volumes after refinery upgrades supported by a recovery in oil prices against the background of a rather weak tenge and that the company's credit rating will remain adequate. At the same time, the leverage adjusted by Moody's will be slightly increased due to the fact that the prepayment for oil is considered, as in our case, as debt. Moody's also focuses on the strong influence that the Government, through Samruk-Kazyna, has on KMG's strategy and operations, including the composition and distribution of assets, the appointment of the board of directors, investments, financing policies and risk management.

According to Moody's, the potential implementation in 2020-22. call option for a stake in KMG Kashagan BV may adversely affect the KMG credit profile .

The S&P rating of BB with a Stable Forecast (November, 2018) reflects improvements of expectations in KMG's financial indicators in 2019-2020, exceeding the FFO / Adjusted Debt ratio by 20% and positive cash flow from operating activities (FOCF). S&P's opinion is driven by "favorable oil prices, the company's plans to increase gas exports to China, cost optimization measures, stabilization of capital expenditures, and the centralization of KMG's cash resources due to increased centralization of the group and a weighted policy of its management regarding liquidity management. The baseline S&P scenario assumes that KMG will pay only small dividends and provide only limited amounts of loans to its direct owner Samruk-Kazyna after refinancing the debt at the level of the parent company in 2018 and obtaining debt financing for its largest capital projects - United Chemical and Saryarka gas pipelines. According to S&P, the average performance of the Kashagan oil field allows generating sufficient cash flow to cover its operating and capital expenses. As a result, Samruk-Kazyna does not need new large loans from KMG to cover the costs associated with its share in Kashagan, as it was before.

Due to the repurchase of KMG EP shares from minority shareholders for approximately \$2bn at the beginning of 2018. KMG, according to S&P, can use most of the consolidated funds on its balance sheet to service the debt. Expectations of a "high" likelihood of extraordinary state support in the S&P's opinion are met. Nevertheless, the agency retains its views on the complexity of providing assistance through Samruk-Kazyna and the tolerance of the state to the high debt burden of KMG.

In turn, we are also committed to the opinion of a "strong" state support, if necessary, and we maintain our expectations for extraordinary help from Samruk-Kazyna in the event of a deterioration in oil prices and overall market conditions. At the same time, the current, relatively favorable, levels of oil prices allow the company to generate a sufficient level of cash flows for the gradual optimization of the debt burden.

In addition, given the current returns that exceed the interest rate on foreign currency deposits (the maximum recommended rate is 1%), we note the attractiveness of the bonds compared to foreign currency deposits and confirm the recommendation to "Buy" NC KMG bonds.



The national company KazMunayGaz (NC KMG) is a Kazakhstani operator in the exploration, production, processing and transportation of hydrocarbons, representing the interests of the state in the country's oil and gas industry. 90% of NC KMG shares are owned by Samruk-Kazyna NWF JSC and 10% by NBK. NC KMG occupies more than a quarter of the market of Kazakhstan for the production of oil and gas condensate, as well as a dominant position in oil refining and pipeline transportation of oil and natural gas in the country. The company also has stakes in such major projects as Kashagan, Tengizchevroil, Karachaganak and the Caspian Pipeline Consor.



NC KMG April 2019

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