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**Fitch changed the outlook on the rating of MEDNC to "Negative", confirmed the rating at the level of "B +"**

Ratings Endorsement Policy 25 Nov 2014 3:35 AM (EST)

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Fitch Ratings-Moscow-25 November 2014:

Fitch Ratings-Moscow / London-November 24, 2014. Fitch Ratings changed the outlook for the long-term issuer default rating (IDR) of the Mangistau Power Distribution Company (hereinafter referred to as MPDC), Kazakhstan, from Stable to Negative and confirmed its rating at BB+. A full list of rating actions is provided at the end of this message.

The revision of the outlook reflects the agency’s expected weakening of the company's relations with its ultimate maternal structure, the Republic of Kazakhstan (“BBB +” / forecast “Stable”), in view of the government’s intention to sell 75% in Samruk-Energy JSC (“BBB-” / Stable”, is in 100 percent state ownership) in 2015. Fitch notes that if the parent structure ceases to own a controlling stake, the agency may adopt a bottom-up rating approach (when the agency focuses on the company's independent creditworthiness) instead of the currently applied “top-down” approach (when the company’s rating is calculated from the rating of the parent structure). Fitch regards the independent positions of the company as corresponding to the “BB-“ rating.

KEY RATING FACTORS

Company ratings are three levels below the sovereign rating.

The ratings of the MPDC are three levels lower than the sovereign ratings of Kazakhstan, which reflects the company's moderate connections with its ultimate maternal structure. Direct maternal structure of MPDC, Samruk-Energy JSC (in indirect 100% state ownership) did not provide substantial financial support to MPDC, since the agency increased the difference between the company and state ratings from two to three levels in 2011. Samruk-Energy did not consider MPDC as a strategic asset and, most likely, will sell its stake in the company in 2015.

Privatization may lead to a change in the rating approach.

Weaker ties with the ultimate maternal structure, for example, reducing the share of Samruk-Energy in the MPDC to a non-controlling stake, may lead Fitch to revise its rating approach to a bottom-up approach instead of the current top-down approach. In April 2014, the government of Kazakhstan approved a list of 106 companies for privatization in 2014-2016. The terms of sale and the price of these assets have not yet been disclosed. Nine of these companies, including MPDC, belong to Samruk-Energy.

Currently, Samruk-Energy owns 75% in the MPDC. We expect privatization to be carried out in two stages. At the first stage, 24% + 1 share in Samruk-Energy will be sold during a public offering, and at the second stage, the remaining 51% will be sold to a strategic shareholder during the auction, possibly already in early 2015.

Independent creditworthiness is estimated at the level of "BB-"

We consider the independent solvency of MPDC as corresponding to the lower part of the “BB” rating category, which reflects the balance between the relatively small size of the company, industry and customer concentration, average forecast credit indicators, but at the same time favorable tariff regime and good quality of counterparties.

The creditworthiness of MPDC is supported by its close to monopolistic position in the field of transmission and distribution of electricity in the Mangystau region, one of the strategic oil and gas regions of Kazakhstan. Creditworthiness is also supported by prospects for economic development and expansion in the region in relation to both the oil and gas and transport sectors, and favorable three-year tariffs. In addition, the positive aspects for the MPDC are limited currency risks and the absence of interest risks.

Small scale, concentrated customer base

Ratings of MPDC are constrained by the small scale of the company's activities (which limits its ability to generate cash flow), significant dependence on one industry (oil and gas) and high customer concentration within this industry (for 9 months of 2014, four leading customers accounted for over 67% revenue). The last factor is to some extent smoothed by

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the fact that some customers are state-owned, as well as due to advance payments provided for by agreements on the transmission and distribution of electricity.

Favorable tariffs

The approved increase in tariffs averages about 5% for 2014 and 2015. Since 2013, MPDC tariffs have been approved by the Agency of the Republic of Kazakhstan for the Regulation of Natural Monopolies (“ARNM”) for a three-year period in accordance with the capex program, and not for one year as before. MPDC expects that its tariffs for 2016-2019 will be approved before the end of 2014. Fitch views positively the transition to mid-term approval of tariffs. The tariff system for the transmission and distribution segments, which is now based on increased efficiency, should provide favorable tariffs for the company.

Lower leverage expected

MPDC ratings are held back by a significant program of future investment compared to the small scale of the company's operations. At the end of 2013, according to the statements, adjusted leverage in cash from operating activities (FFO) of the MPDC decreased to 1.3x from 1.5x at the end of 2012. A large-scale investment program of the company in the amount of about KZT 26 billion in 2014-2017 is likely to result in negative free cash flow over the same period and will require substantial debt financing. Based on its conservative assumptions, Fitch expects this to cause an increase in the adjusted FFO leverage to about 3x by the end of 2015, and then to 4x by the end of 2016.

Capital investments will drive negative free cash flow Fitch expects MPDC to continue to generate strong and stable operating cash flow (CFO) in 2014-2017. However, free cash flow is likely to become negative from 2014, which will be mainly due to significant capital investment plans. Capital investments will be directed to the construction of two new power lines and the modernization of existing power lines and substations. The currently approved investment program amounts to 9 billion KZT for 2014-2015. At the end of 2013, the security of interest payments on FFO improved to about 10x as compared to 5x at the end of 2012, and Fitch expects that it will continue to be expressed in one digit in 2014-2017.

According to agency estimates, in 2014, the operating cash flow (CFO) of MPDC will amount to 2.6 billion KZT before investment (3.5 billion KZT) and dividends (434 million KZT). Fitch expects the company will resort to new borrowing to cover the shortage of funds.

Increased Dividend Payments

Fitch notes that the dividend payout ratio for 2013 from MPDC has decreased to 38% (or 434 million KZT) compared to 76% (or 255 million KZT) for 2012. At the same time, management expects this ratio to be at 50% in the medium term. If dividends remain elevated during a period of increased capital investment, Fitch may consider this a sign of weakening ties with the ultimate parent structure and change the top-down rating approach to bottom-up, even if there is no change in the company's ownership structure.

FACTORS WHICH CAN IMPACT ON RATINGS IN THE FUTURE

The “negative” outlook reflects the possible sale of MPDC by Samruk-Energy and the likely change in the agency’s rating approach to which it will lead. The main factors that individually or together can lead to a rating action:

Positive rating factors:

* Stronger connections with the ultimate maternal structure
* Improving the business profile, such as diversification and scale, with only a moderate increase in leverage would be positive for the company's independent creditworthiness.

Negative rating factors:

* Negative rating action in Kazakhstan.
* Weaker ties with the ultimate maternal structure, for example, reducing the share of Samruk-Energy in the MPDC to less than 50% or increasing dividend payments, insufficient tariffs and increasing investments, which would contribute to weaker creditworthiness indicators. This may lead to a change in the rating approach to the "bottom-up" instead of the current top-down approach.
* A deterioration in adjusted leverage on FFO of MPDC to 4x or more, and the security of interest payments on FFO to 2.0x or less on a long-term basis would be negative for the company's independent solvency.

In its comments on the sovereign rating of Kazakhstan, the ultimate maternal structure of Samruk-Energy, dated November 7, 2014, Fitch pointed out the following factors that may affect the country's ratings in the future:

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The “stable” outlook reflects Fitch's view that the positive factors and risks for the rating are currently well balanced. The main factors that individually or together can lead to a rating action:

Positive rating factors:

- Steps aimed at reducing the vulnerability of public finances to sharp negative changes in the price of oil, for example, by reducing the non-oil budget deficit

- Effective restructuring of bank balance sheets

- Consolidation of low and stable inflation with a more flexible exchange rate regime;

- Significant improvements in management and institutional environment.

Negative rating factors:

- Implementing policies that would lead to a sustained reduction in sovereign assets or a decrease in economic or financial stability

- A prolonged shock in commodity prices

- Renewal of the weakening of the banking sector and manifestation of contingent liabilities

- The event from the field of political risk.

LIQUIDITY AND STRUCTURE OF THE DEBT

Fitch views the liquidity of MPDC as managed, including only cash, as the company does not have any available credit lines. At the end of 3 quarter of 2014, cash in the accounts of MPDC in the amount of 2.3 billion KZT was sufficient to cover short-term repayments in the amount of 217 million KZT. Cash is mainly placed in national currency in local banks, including Halyk Bank (“BB” / “Stable” outlook) and Nurbank, which is a risk.

At the end of the third quarter of 2014, the main part of the debt of the MPDC was represented by two issues of unsecured bonds with a fixed rate in the amount of 1.7 billion KZT and 2.4 billion KZT and maturing respectively in 2023 and 2024. The rest of the debt is interest-free loans with a term of up to 2036 provided by MPDC clients to co-finance new connections to the network. A large scale investment program of MPDC is likely to require additional debt financing in the medium term. MPDC has proven access to the domestic bond market in practice. In 2014, the company issued bonds in the amount of 2.4 billion KZT for partial financing of substantial investment needs (3.5 billion KZT) in the indicated year. It is expected that the rest will be financed by MPDC’s own funds.

FULL LIST OF RATING ACTIONS

Long-term foreign currency IDR affirmed at “BB +”; outlook changed from “Stable” to “Negative”

The long-term IDR in national currency was confirmed at the level of “BBB-”, the outlook was changed from “Stable to“ Negative ”

National long-term rating affirmed at “AA (kaz)”, outlook changed from “Stable” to “Negative”

Short-term foreign currency IDR affirmed at 'B'

Priority unsecured foreign currency rating affirmed at 'BB+'

The priority unsecured rating in national currency, including bonds in the amount of 1.7 billion KZT and 2.4 billion KZT, was confirmed at the level of “BBB-”.

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Applicable rating criteria are presented at www.fitchratings.com: see “Rating of corporate issuers: including short-term ratings and linking ratings of parent and subsidiary structures” (Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage) dated May 28, 2014

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