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Tagging Info

**Fitch Affirms MPDC at 'BB+'; Stable Outlook**

Ratings Endorsement Policy 27 Nov 2013 5:14 AM (EST)

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Fitch Ratings-Moscow-27 November 2013:

Fitch Ratings-Moscow / London - November 25, 2013. Fitch Ratings affirmed the long-term issuer default rating (“IDR”) of Mangistau Power Distribution Company (hereinafter - “MPDC”), Kazakhstan, at the BB + level. The rating outlook is “Stable”. A full list of rating actions is provided at the end of this message.

Affirmation of the ratings reflects the preservation of the level of relations of the company with its ultimate maternal structure, Kazakhstan (“BBB+” / “Stable” outlook).

KEY RATING FACTORS

* Company ratings are three levels below the sovereign rating

The ratings of the MEDNC 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 (indirect 100% state ownership) did not provide substantial financial support to MPDC after the agency increased the difference between the company and state ratings from two to three levels in 2011. Samruk-Energy does not consider MPDC as a strategic asset, but does not take active steps to reduce its stake in the company. The ratings are based on the assumption that Samruk-Energy will retain, at a minimum, a majority share in MPDC over the rating horizon, and Fitch does not expect significant changes in relations between the companies in the short term. The agency regards the independent positions of the company as corresponding to the BB- rating.

* The company's position in the region is close to the monopoly

The creditworthiness of MPDC is supported by its close to monopolistic position in the field of power transmission and distribution 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 and concentration of client base

MPDC ratings are constrained by the small scale of the company's operations (which limits its ability to generate cash flow), significant dependence on one industry (oil and gas) and high customer concentration within this industry (in 2012 four leading customers accounted for over 67% of revenue). The latter factor is somewhat smoothed out due to the fact that some customers are state-owned, as well as due to advance payments provided for under transfer and distribution agreements.

* Favorable rates

In the period from 2012 to 9 months of 2013, the growth in MPDC’s revenue was mainly due to the increase in transmission and distribution tariffs to 3.1 tenge / kWh in 2013 from 2.39 tenge / kWh in 2012 and 1.95 tenge / kWh in 2011. For 2014 and 2015, a further increase in tariffs was approved on average at around 5%. The increase in tariffs in 2012 was partly due to the increase in electricity prices from MAEC-Kazatomprom.

Starting from 2013, MPDC tariffs are 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 its tariffs for 2016 to be approved by the end of November 2013. Fitch views positively the transition to mid-term approval of tariffs. The tariff system for the transmission and distribution segments is aimed at increasing the efficiency of MPDC and should ensure favorable tariffs for the company.

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* Capital investments will increase leverage

MPDN ratings are held back by a significant program of future investment compared to the small scale of the company's operations. As of the end of 2012, according to the statements, adjusted leverage in cash from operating activities (FFO) at MPDN was reduced to 1.5x from 2.2x at the end of 2011. A large-scale investment program of the company in the amount of about 27.8 billion KZT in 2013- 2017 is likely to lead to negative free cash flow over the same period and will require substantial debt financing. Based on its conservative assumptions, Fitch expects this to result in an increase in FFO adjusted leverage to about 3x by the end of 2015, and then to 4x by the end of 2016.

These investments will be directed to the construction of two new power lines worth 13.5 billion KZT, to reconstruct the existing power lines and substations to the amount of 4.6 billion KZT and to some other projects. The currently approved investment program amounts to 12 billion KZT for 2013-2015. At the end of 2012, the security of interest payments on FFO improved slightly to about 4x compared to 3.6x at the end of 2011, and Fitch expects that it will still be expressed in one digit in 2013-2016.

Stable operating cash flow (CFO) and negative free cash flow are expected. Fitch expects MPDC to continue to generate good and stable operating cash flow (CFO) in 2013-2016. However, free cash flow is likely to become negative in 2013 and beyond, which will be mainly due to significant capital investment plans. According to the agency's estimates, in 2013, the CFO of MPDC will amount to 2.2 billion KZT before investment (3.4 billion KZT) and dividends (250 million KZT). The agency expects the company will resort to new borrowing to cover the lack of funds.

* Increased dividend payouts

Fitch notes that the dividend payout ratio from MPDC for 2012 increased to 75% (or 250 million KZT) compared to 50% (or 88 million KZT) in 2011. At the same time, the management expects its decline to about 50% in the medium term. If dividends remain elevated during the 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 (when the company’s rating is calculated from the parent structure) to bottom-up (when the agency focuses on self-solvency of the company).

FACTORS WHICH CAN IMPACT ON RATINGS IN THE FUTURE

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

Positive rating factors:

* Positive change in the ratings of Kazakhstan provided that there is no weakening of ties between MPDC and the state.
* 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 change of ratings of Kazakhstan
* Weaker ties with the ultimate maternal structure, such as 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 approach instead of the top-down approach used today.
* A deterioration in adjusted leverage in FFO at MPDC to 4x or more, and the security of interest payments up to 2.0x or less on a long-term basis would be negative for the company's independent solvency.

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 the 3rd quarter of 2013, cash in the accounts of MPDC in the amount of 2.9 billion KZT was sufficient to cover short-term repayments in the amount of 962 million KZT. The funds are mainly placed in national currency in local banks, including Halyk Bank (“BB-” / Rating Watch “Evolving”) and Nurbank, which is a risk.

At the end of 3rd quarter of 2013, the main part of the debt of MPDC was represented by two issues of unsecured

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bonds with a fixed rate in the amount of 812 million KZT and 1.7 billion KZT maturing in 2014 and 2023 respectively. The rest of the debt is interest-free loans for a period of up to 2036 provided by MPDC clients for co-financing new connections to the network. A large scale investment program of the MPDC is likely to require additional debt financing in the medium term. MPDC has proven access to the domestic bond market in practice. In 2013, the company issued bonds in the amount of 1.7 billion KZT for partial financing of substantial investment needs (3.4 billion KZT) in the said year. It is expected that the rest will be financed at the expense of the MPDC’s own funds.

FULL LIST OF MPDC RATINGS

Long-term foreign currency IDR affirmed at 'BB +', outlook Stable

Long-term IDR in national currency is confirmed at “BBB-", outlook Stable

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

Short-term foreign currency IDR affirmed at 'B'

Priority unsecured foreign currency rating affirmed at 'BB +'

The senior unsecured rating in national currency, including bonds in the amount of 1.7 billion KZT and 800 million KZT, was affirmed at the level of “BBB-”.

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Applicable rating criteria are presented at www.fitchratings.com: see “Corporate Rating Methodology” dated August 5, 2013.

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