



KAZTRANSOIL

Kashagan and increase in tariffs as the main driver of growth

The expected launch of Kashagan project, as well as the growth of tariffs are the potential triggers for KTO shares. At the moment, the growth potential by our forecast is more than 23% and the potential dividend yield of 11% in 2016-20.

Tariffs on oil transportation are determining factor for KazTransOil share price. At the end of October 2015 new tariffs for oil pumping to the domestic market for 2015-2019 were approved. The average annual growth rate of domestic tariffs is 10%. Since 2014 tariffs for exports have not been revised, and by our expectations the probability of tariffs increase in 2016 is not large due to the low oil prices and difficult economic situation. However, in 2017 we expect export tariffs to increase by an average of 6% a year.

Revenues of KazTransOil include crude oil transportation (83%) and oil reloading and railway shipment (7%). We expect revenues to increase from 2018 due to the launch of Kashagan oil field and the increase of oil transportation via the main pipelines of KazTransOil, as well as due to the increase in tariffs for pumping oil for export and the domestic market.

We expect that in 2015 KazTransOil will post net income of KZT 40 139m (-15% YoY). The main reason of the decrease of net income is the devaluation of tenge, as a result of which joint venture incurred a loss (the company's debt is in foreign currency).

Devaluation effect on the results of KTO. Tariffs of the Company are denominated in local currency, while bulk of investment program is in foreign currency. We expect increase in operating costs as well as appreciation of investment program in the forecasted period. There is no direct effect on the balance sheet of the Company, as KazTransOil has no debt. Net foreign exchange loss from joint venture (KCP) negatively affected consolidated net income of "KazTransOil".

Dividend yield will be 11% in 2016-20. We expect KazTransOil to distribute approximately KZT 107/share as dividends for 2015 financial year. In 2017 we expect minimum dividend payout-ratio (40% of net income). However we expect KazTransOil to distribute around 60% of its net income starting from 2018. Average dividend yield from current price will be around 11% in 2016-20.

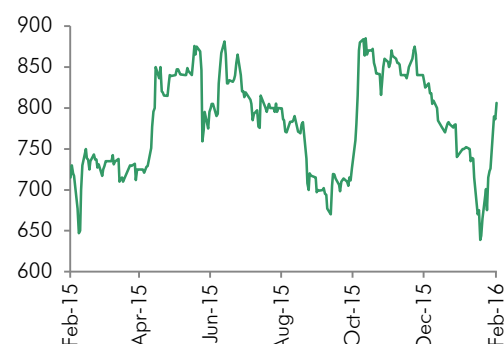
Our target price for KazTransOil shares is **KZT 995/share**, which is **23%** above market price. Our recommendation is **"BUY"**.

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Ticker	KZTO KZ
Capitalization	309 bn. tenge
Last Price	806 tenge
Range, 52 weeks.	620-905 tenge
Avg. daily volume (3 m)	18 m. tenge
Target price	995 tenge
Upside	23%
Recommendation	BUY
Dividend yield 2016	13%

SHARE PERFORMANCE (12-M)



KEY FINANCIAL INDICATORS

KZTbn	2014	2015F	2016F
Revenue	206.6	208.4	221.4
Cost of Sales	121.3	128.2	141.0
Gross Profit	85.3	80.2	80.4
EBITDA	105.4	102.8	104.8
EBIT	58.2	24.3	67.6
EBT	62.1	50.9	68.4
Net Income	46.4	40.1	53.9

KEY RATIOS

	2014	2015F	2016F
EBITDA Margin	44%	28%	47%
EBIT Margin	28%	12%	31%
EBT Margin	30%	24%	31%
NI Margin	22%	19%	24%
ROAE	10%	9%	12%

Operating activities

KazTransOil operates network of main oil pipelines of 5 373 km and water pipelines of 1 975 km. The Company transports oil to the domestic market and for export.

The oil deliveries in the domestic market are made in the direction of Pavlodar refinery, Atyrau refinery and PetroKazakhstan Oil Products.

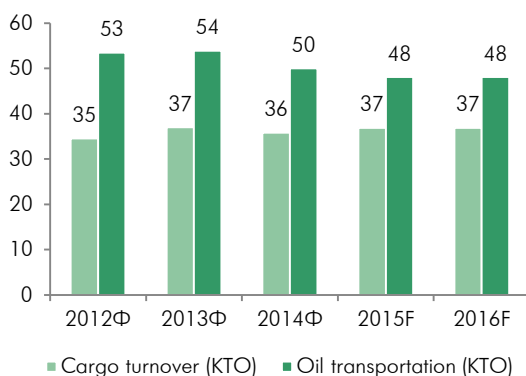
The oil deliveries for export purpose are carried out through Samara for further delivery to the ports of the Black and Baltic Seas and to the European market, through the terminal of the Aktau port for further deliveries to Baku and Makhachkala pipelines, via Atasu-Alashankou pipeline to China, via the CPC pipeline for further export in the direction of Black Sea.



Operating Results

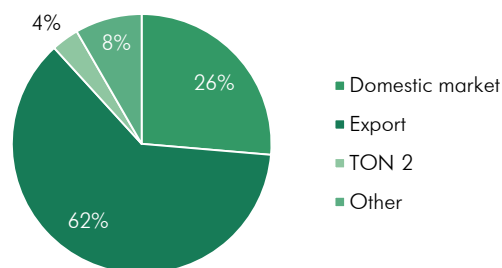
In 2015 KazTransOil exceeded the plan on oil transportation and turnover volumes. Oil turnover volume for “KazTransOil” JSC standalone amounted to 36 866m. ton-kilometers, while the volume of oil transportation and transshipment through the network of main pipelines of “KazTransOil” JSC in 2015 equaled to 47 541k tons. This is 4% higher than the planned amount of turnover volumes and 3% higher than the planned amount for crude oil transportation.

Fig 1 Oil turnover and transportation (m. tons) via MP of KazTransOil (bn. tkm) standalone



Source: Company data

Fig 2 Directions of oil turnover (“KazTransOil” standalone) for 6M 2015



Source: Company data

According to the data on execution of the tariff estimate on transportation of crude oil via main pipeline systems of JSC “KazTransOil”, oil turnover based on the directions can be divided as follows: 62% - exports, 26% - domestic market, 8% - TON 2. Our model is based on these figures; however, we slightly adjusted them starting from 2016, given the assumption that after the reconstruction of oil refineries a larger amount of oil will be supplied to the domestic market.

Kashagan and KazTransOil

«Kashagan» is the largest oil field in Kazakhstan. Geological reserves of Kashagan are estimated at 4.8bn. tons of oil. The oilfield’s reserves are estimated at 38bn. barrels/ 6bn. tons. According to experts, commercial resources are in the range between 9bn and 13bn. barrels. In our model, we incorporated Kashagan oil starting from 2018. According to our forecast, production in 2018 will amount to 9.3m tons, in 2019 to 14.0m tons, and in 2020 to 18.6 m tons. Currently there is no exact information on where the oil from Kashagan field will go to. We made assumption that 50% will be transported through a pipeline Atyrau-Samara, and the remaining 50% will be transported via the CPC.

Tariff policy

KazTransOil’s operations are regulated by the Law of Republic of Kazakhstan “On natural monopolies”. Tariff policy of KazTransOil is based on “the cost-plus pricing” principle. Tariffs are set taking into account the amount of reasonable costs and acceptable level of profit

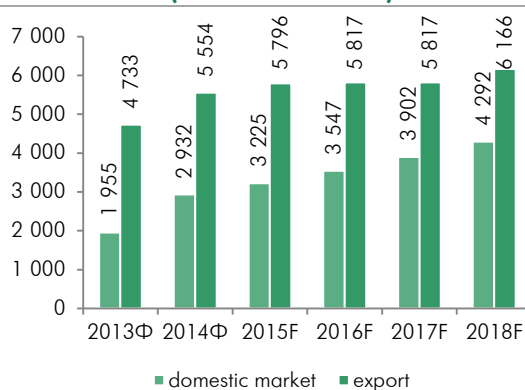
At the end of August 2015, The Antimonopoly Committee on Regulation of Natural Monopolies and Protection of Competition under the Ministry of National Economy of the RK approved the threshold levels of tariffs and tariff estimate for regulated service on oil pumping into domestic market via the main pipeline system of “KazTransOil” for 2015-2019. The average annual growth rate of tariffs accounts for 10%. The increase in tariffs for the domestic market is a positive

development, as the tariffs for domestic transportation of oil have not been revised since 2014. Later on, it is planned to align domestic and export tariffs for transportation.

We note that the Company's tariffs on exports have not been revised since 1st April 2014 and currently stands at 5 817.2 tenge. In 2014, the rate was increased due to the devaluation of the tenge as an emergency regulatory measure. The current economic situation is different from 2014. Tenge halved in value going from 185 to 370 tenge per dollar. Oil prices have updated historical lows of 2004, falling below \$28 per barrel. We expect that this year the tariff for oil transportation for export will remain unchanged, due to the difficult economic situation and low oil prices. However, after 2016, we expect an average growth rate of export tariffs at 6%.

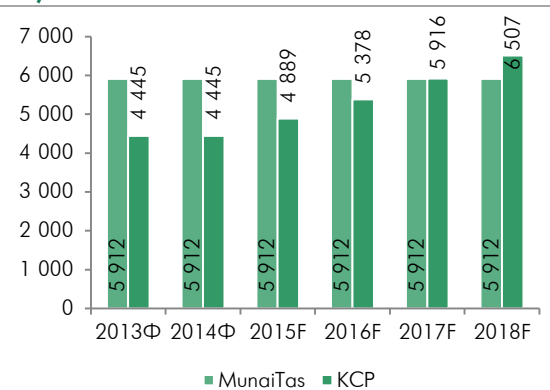
Also, the maximum level of tariffs on the regulated service on oil transportation to the domestic market through the “Kenkiyak-Kumkol” pipeline of “Kazakhstan-China Pipeline LLP” for 2015-2019 was approved. The average annual growth of tariffs accounts for 10%. Tariffs for oil transportation of “Munai Tas” through the “Kenkiyak-Atyrau” pipeline remained unchanged.

Fig 3 Tariffs for regulated services of KazTransOil (KZT for 1 000 km)



Source: Company data

Fig 4 Tariffs of joint ventures (KZT for 1 000 km)



Source: Company data

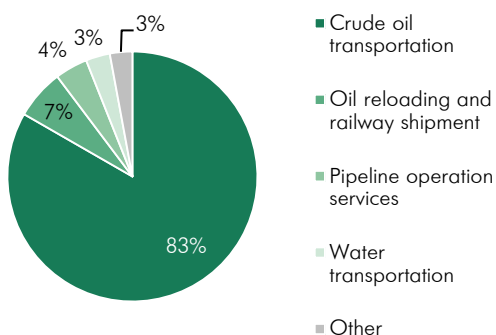
Financial activities

KazTransOil is the national operator of the main oil pipelines that is engaged in transportation of approximately 53% (YE2014) of produced crude oil in Kazakhstan.

Revenues of KazTransOil include crude oil transportation (83%) and oil reloading and railway shipment (7%). In addition, revenues from pipeline operation services (4%) and water transportation (3%) constitute significant proportion of the Company’s revenue.

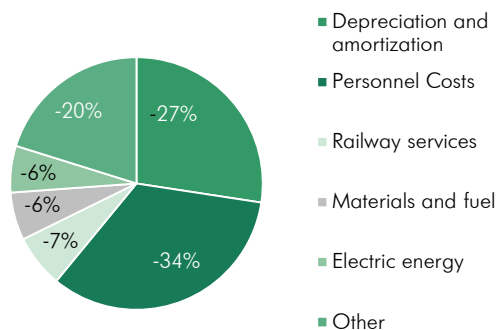
Significant part of cost of sales represents depreciation and amortization costs (27%), and personnel costs (34%). Also, cost of railway services (7%), costs of materials and fuel (6%) and costs of electric energy (6%) are considerable items in cost of sales.

Fig 5 Revenue breakdown – 9M2015



Source: Company data

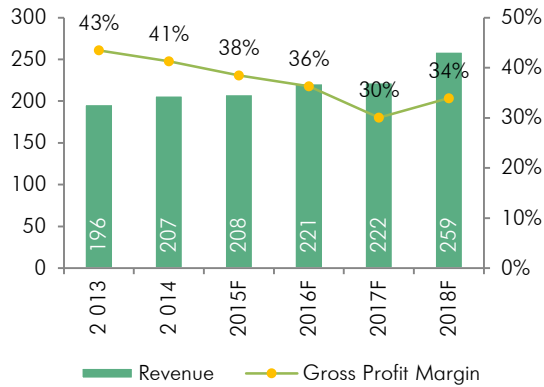
Fig 6 Cost of Sales breakdown – 9M2015



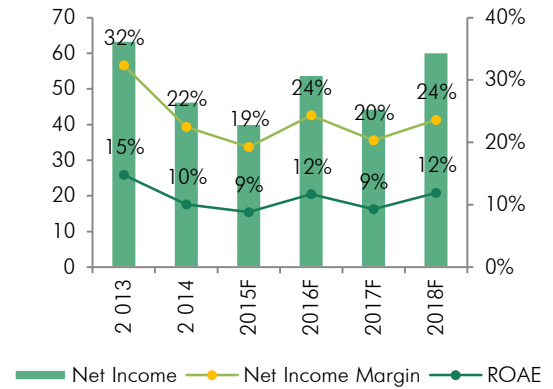
Source: Company data

In 9M2015 the net profit of the Company has increased by 4.1% to KZT 38.79bn. The negative impact on net profit had a devaluation of the tenge, since the debt of joint venture (KCP) is represented in foreign currency.

It should be noted that the financial results of KazTransOil standalone generally look decent. Standalone revenue in FY2015 amounted to KZT193.6bn, which is 3.5% higher (YoY). Net profit amounted to KZT 78bn, which is 23% above the result of the previous year. Earnings per share for 2015 amounted to 203 tenge. The amount of dividend will be determined based on the highest value of either consolidated or standalone net income. It is already obviously that standalone net income will be higher and therefore will be decisive in determining the dividend.

Fig 5 Revenue (KZTbn) and Gross Profit Margin

Source: Company data

Fig 6 Net Income, Net Income Margin (%) and ROAE (%)

Source: Company data

Devaluation Effect on the company's results

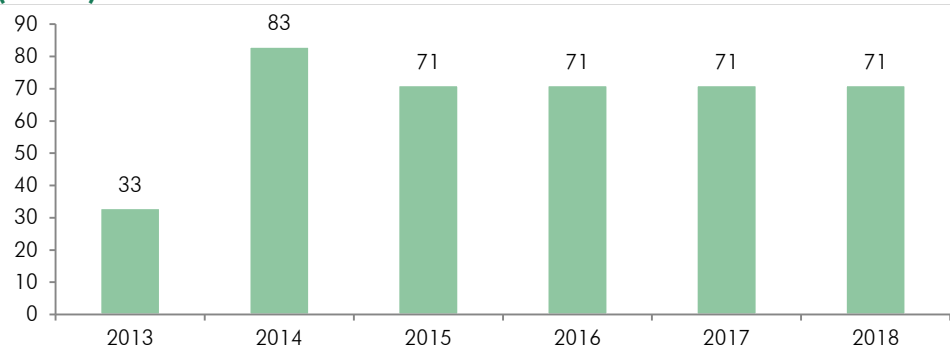
KazTransOil has 2 joint ventures: Kazakhstan China Pipeline (KCP, 50% shareholding) and MunaiTas (51% shareholding).

As a result of KZT devaluation, the Company experienced a loss from joint venture (KCP) on a consolidated basis. KCP has a large foreign currency debt. Weakening KZT led to a foreign exchange loss, increase in the total amount of debt in KZT and increase in the cost of servicing the debt. It is noteworthy that KazTransOil (standalone) has no debt, and from changes in the exchange rate the company receives foreign exchange gain, as significant part of cash and cash equivalents are in a foreign currency. However, the increase in operating costs and appreciation of the investment program as a result of KZT devaluation will negatively affect the financial results of both companies.

Investment program

The investment program of the company is mainly focused on the construction, repair and reconstruction of pipelines.

In 2014, capex have been allocated to the following projects: the second phase of the second stage of "Kazakhstan - China" pipeline construction, reconstruction of the main oil pipelines "Kalamkas - Karajanbas - Aktau" and "Uzen - Zhetybai - Aktau". Also, the overhaul of a 40km-pipeline on the Kazakh section of Tuymazy - Omsk - Novosibirsk-2 has been performed. In 2014, the investment program equaled 75.6bn tenge.

Fig 7 Actual and forecasted capital expenditures in 2013-18F (KZTbn)

Source: Company data (CFS), BCC Invest forecast

We expect increase in the investment program due to devaluation of the tenge. We believe that the Company will keep the investment program under control; however we forecast that total capex will not change significantly in tenge and will remain approximately at the level of KZT 71bn. In addition, the imminent approach of the Kashagan project requires the whole system to be ready, which will require investments in coming years.

Merger of KazTransOil and KazTransGas – economically unviable

Umirzak Shukekeyev, the Head of Samruk-Kazyna, at the expanded government meeting, chaired by President Nursultan Nazarbayev, made a proposal on merger of KazTransOil and KazTransGas in one company. He noted that the presence of two pipeline companies in the structure of KazMunaiGas is inappropriate. However, he noted that the issues of gas trade is necessary to focus in separate companies, so that expenses related to other activities were accounted separately without falling into the transportation tariffs.

As a result, in January 2016 on the website of NC KazMunaiGas it was officially declared that the merger of KazTransOil and KazTransGas is economically unviable.

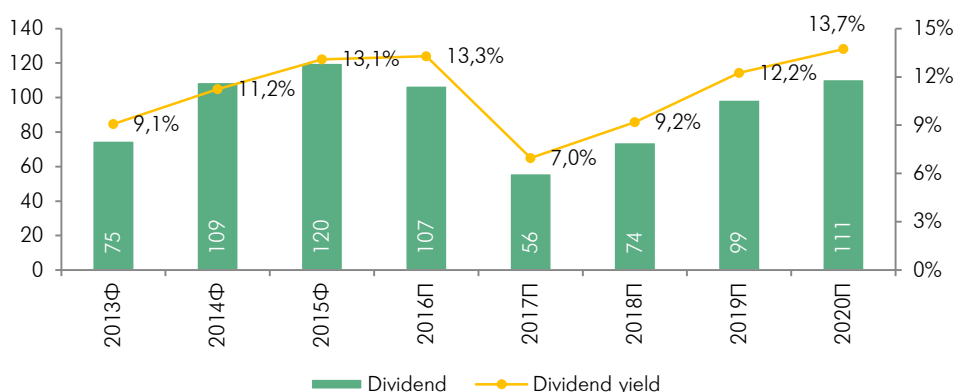
Dividend Story

Minimum guaranteed dividend on shares is 40% of net income; however the amount of dividends may exceed the above mentioned payout ratio if approved by shareholders. The amount of dividends is calculated based on the highest amount of either standalone or consolidated net income.

In 2015, the Company distributed 100% of the FY2014 consolidated net income or 78% of standalone net income, which amounted to 120.71 tenge per share. The dividend yield from IPO price was 16.6% and 13.2% from the average annual price in 2015.

At the end of August 2015, the National Bank of RK allowed the currency to float freely. We expect that standalone net income of KazTransOil will exceed consolidated net income in 2015, as KazTransOil will post a loss from joint ventures. In our view, the dividends will be calculated based on standalone net income of KazTransOil. According to our estimates the minimum guaranteed amount of dividends per share will be KZT 81 (40%). However, in our opinion, the most probable amount of the dividend would be approximately 107 tenge.

Fig 8 Dividend payments 2013-2020F



Source: Company data, BCC Invest forecast

We forecast that the Company will pay dividends in the amount of 40% of its net income in 2017 and 60% in 2018-20. In our view, devaluation of tenge and appreciation of investment program are the main reasons of lower dividend payments in 2017.

The dividend yield from the current price in 2017-20 will increase gradually from 7.0% in 2017 to 13.7% in 2020.

Equity Valuation

For equity valuation we used Discounted Cash Flow method (DCF).

Our valuation comprises of 2 parts:

1. Discounted future free cash flows.
2. Net Debt (Debt less liquid assets).

By our estimates, fair value of all free cash flows of the company, discounted to YE2016 is KZT 368bn.

The company has no debt as of September 30, 2015, while cash and cash equivalent amount is KZT 15.079. As a result, net debt value of the Company as at YE2016 is equal to KZT 15.079bn.

Target price and recommendations

Our target price for ordinary shares of KazTransOil as at YE2016 is KZT 995. Given prices imply 23% upside potential in Kazakhstan. We recommend to **BUY**.

Млн. тенге	2015	2016	2017	2018	2019	2020
EBIT	24 337	67 588	59 350	79 435	89 127	101 180
EBIT*(1-tax rate)	19 469	54 071	47 480	63 548	71 301	80 944
D&A	33 767	36 759	39 511	42 042	44 370	44 801
Changes in WC		-2 399	-2 071	-3 815	-3 605	-3 742
Operating Cash Flow		93 229	89 062	109 405	119 277	129 487
Capital Expenditures		71 058	71 058	71 058	49 740	49 740
Free Cash Flows		22 171	18 004	38 347	69 536	79 746
<i>Discount Factor</i>			1,17	1,38	1,62	1,90
Discounted Free Cash Flow			15 328	27 793	42 905	41 890
Accumulated DFCF			15 328	43 121	86 026	127 916
Terminal value						456 665
Discounted terminal value						239 881
Estimated value of underlying assets (EV)						367 797
Cash and Investments						15 079
Debt						0
Net Debt						15 079
Estimated capitalization						382 876
Number of shares (m)						385
Target price, KZT/share						995

Share performance of KazTransOil

The IPO of KazTransOil was held in December 2013 at the offering price of KZT 725. The shares demonstrated positive performance after a secondary market opened and continued to show steady growth, achieving historical high in February 2014. However, immediately after that, the shares began to decline gradually that is explained by devaluation of tenge (February, 2014) and further devaluation expectations on the back of oil prices decline and devaluation of ruble. Since the IPO the minimum share price of KazTransOil was KZT 615.5 and the maximum price was at the level of KZT 1 280.

At the moment, Company's shares are priced at KZT 806.01, which is higher than the IPO price. It should be noted that KazTransOil has no debt, but the continuing depreciation of tenge will have a negative effect on the company's results in the medium term.

Since the Company's IPO share price increase by 11%, the dividend income was 42.0% (of IPO price), and the total investment income amounted to 53%.

Рис 9 KazTransOil share price dynamics, KZT (12-months)



Source: Bloomberg

Appendix

Results for January-September 2015 – Income Statement

KZTm	3Q14	3Q15	%	9M14	9M15	%
Revenue	49 687	51 167	3%	150 142	157 813	5%
Crude oil transportation	40 591	42 723	5%	120 620	131 463	9%
Oil reloading and railway shipment	3 869	3 050	-21%	11 346	10 148	-11%
Water transportation	1 829	1 728	-6%	5 240	4 932	-6%
Other	3 399	3 667	8%	12 936	11 270	-13%
Cost of sales	-31 251	-31 403	0,5%	-84 084	-87 574	4%
Depreciation and amortization	-8 270	-8 004	-3%	-24 794	-24 010	-3%
Personnel costs	-10 068	-11 299	12%	-26 505	-29 368	11%
Other	-12 913	-12 100	-6%	-32 784	-34 197	4%
Gross profit	18 436	19 764	7%	66 058	70 239	6%
General and administrative expenses	-4 098	-3 057	-25%	-8 847	-8 309	-6%
Other operating income	2 123	179	-92%	2 594	1 410	-46%
Other operating expenses	-28	-729		-136	-1 939	
Operating profit	16 433	16 158	-2%	59 669	61 400	3,0%
Loss from impairment of PPE	-4 947	-5		-5 018	-207	-96%
Share in (loss)/income of joint ventures	1 664	-24 504		-8 179	-21 917	168%
EBIT	13 150	-8 352	-164%	46 471	39 276	-16%
Net foreign exchange gain/(loss)	28	14 132		-13	15 191	
Finance income	1 024	384	-63%	4 086	2 035	-50%
Finance cost	-355	-488	38%	-1 065	-1 411	33%
EBT	13 847	5 676	-59%	49 560	55 091	11%
Net Income	10 835	-642		37 274	38 786	4%

Source: Company data

Results for January-September 2015 – Balance Sheet

KZTm	2014	6m15	9m15	QoQ	QtD
Assets					
PPE & Intangibles	420 870	433 548	458 653	6%	9%
Investments in joint ventures	49 843	50 930	26 802	-47%	-46%
Bank deposits	3 730	3 601	3 940	9%	6%
Other non-current assets	11 324	12 164	10 898	-10%	-4%
Total non-current assets	485 767	500 243	500 293	0%	3%
Bank deposits	32 112	16 030	23 389	46%	-27%
Cash and cash equivalents	42 175	28 704	47 949	67%	14%
Trade and other AR	5 804	7 009	4 261	-39%	-27%
Other current assets	19 548	14 188	14 645	3%	-25%
Total current assets	99 638	65 931	90 244	37%	-9%
Assets classified as held for sale	1	22	22	0%	
Total assets	585 407	566 196	590 559	4%	1%
Equity	457 644	450 794	460 623	2%	1%
Debt	-	-	-	-	-
Deferred tax liabilities	41 168	40 674	40 606	0%	-1%
Other non-current liabilities	36 259	35 591	40 874	15%	13%
Total non-current liabilities	77 427	76 265	81 480	7%	5%
Trade and other accounts payable	15 774	9 654	10 006	4%	-37%
Advances received	16 746	16 010	15 533	-3%	-7%
Other current liabilities	17 816	13 472	22 917	70%	29%
Total current liabilities	50 336	39 137	48 456	24%	-4%
Total equity and liabilities	585 407	566 196	590 559	4%	1%

Source: Company data

Condensed Income Statement

KZTm	2 013	2 014	2015F	2016F	2017F	2018F
Revenue	196 366	206 637	208 390	221 441	222 460	259 250
Cost of sales	110 969	121 309	128 231	141 059	-155 611	-171 342
Gross Profit	85 398	85 328	80 160	80 382	66 849	87 908
General and administrative expenses	11 028	13 593	11 079	12 300	-13 700	-15 300
Operating profit	75 280	72 547	69 021	68 023	53 090	72 549
Share in (loss)/income of joint ventures	11 847	- 6 255	-44 684	-435	6 261	6 887
EBIT	74 463	58 172	23 417	66 672	59 350	79 435
Net foreign exchange gain/loss	104	1 056	25 770			
EBT	77 390	62 130	50 939	68 407	60 169	80 254
Net income	63 543	46 431	40 139	53 907	47 469	63 254

Source: Company data, BCC Invest forecast

Condensed Balance Sheet

KZTm	2013	2014	2015F	2016F	2017F	2018F
Assets						
PPE & Intangibles	406 810	420 870	458 160	492 4759	524 005	553 021
Investments in joint ventures	53 554	49 843	26 802	28 142	29 549	31 027
Bank deposits	577	3 730				
Other non-current assets	5 960	11 324	11 890	12 485	13 109	13 765
Total non-current assets	466 900	485 767	496 853	533 086	566 663	597 812
Bank deposits	83 117	32 112				
Cash and cash equivalents	25 645	42 175	34 017	15 079	11 731	21 536
Trade and other AR	4 549	5 804	6 880	7 311	7 344	8 559
Other current assets	10 284	19 548	15 378	16 147	16 954	17 802
Total current assets	123 595	99 638	56 274	38 537	36 030	47 896
Assets classified as held for sale	32	1	-	-	-	-
Total assets	590 527	585 407	553 127	571 622	602 693	645 708
Equity	467 270	457 644	415 546	428 296	451 172	484 809
Deferred tax liabilities	43 538	41 168	40 606	40 606	40 606	40 606
Other non-current liabilities	30 091	36 259	42 918	45 063	47 317	49 682
Total non-current liabilities	73 629	77 427	83 524	85 670	87 923	90 289
Trade and other accounts payable	11 096	15 774	13 828	15 211	16 780	18 476
Advances received	17 182	16 746	16 167	17 179	17 258	20 113
Other current liabilities	21 351	17 816	24 063	25 266	26 529	27 855
Total current liabilities	49 629	50 336	54 057	57 656	60 567	66 444
Total equity and liabilities	590 527	585 407	553 127	571 622	602 693	645 708

Source: Company data, BCC Invest forecast

Key ratios

Ratios	2 013	2 014	2015F	2016F	2017F	2018F
ROAA	12%	8%	7%	10%	8%	10%
ROAE	15%	10%	9%	12%	10%	12%
Gross margin	43%	41%	38%	36%	30%	34%
EBITDA margin	53%	44%	28%	47%	44%	47%
EBIT margin	38%	28%	12%	31%	27%	31%
EBT margin	39%	30%	24%	31%	27%	31%
NI margin	32%	22%	19%	24%	21%	24%
Assets growth (YoY)	19%	-1%	-6%	3%	5%	7%
Liability growth (YoY)	18%	4%	8%	4%	4%	6%
Equity growth (YoY)	19%	-2%	-1%	3%	6%	7%
Net income growth (YoY)	90%	-27%	-14%	34%	-12%	33%

Source: Company data, BCC Invest forecast

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