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Lower Oil Prices Prompt Revision Of Gazprom, KazMunayGas, And Tengizchevroil Outlooks To Negative

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- We updated our Brent oil price assumptions on March 19, 2020, and we now expect $30 per barrel (/bbl) for the remainder of 2020, $50/bbl in 2021, and $55/bbl thereafter.
- We project most rated oil and gas companies' core debt coverage metrics will be below our rating guidelines, with weaker cash flows in 2020.
- However, the tax systems in Russia and Kazakhstan, along with devaluation of the local currencies, should partly offset the impact of the low prices on oil companies in these countries, versus the effects on their global peers.
- We are therefore taking rating actions on Gazprom in Russia and on KazMunayGas And Tengizchevroil in Kazakhstan.

MOSCOW (S&P Global Ratings) March 27, 2020--S&P Global Ratings today took rating actions on three Russia- and Kazakhstan-based oil and gas companies as part of our global review of the sector following the oil price collapse.

In Russia, we revised the outlook on our 'BBB' local currency rating on Gazprom PJSC to negative from stable. We affirmed the 'BBB-' foreign currency rating. The ratings on all the other Russian hydrocarbon companies we rate are unchanged, because we think the drop in credit metrics will be immaterial and temporary, thanks to the way the Russian tax system works and reflecting the positive impact of a weak ruble. Still, improvement in market conditions in 2021 will be important for the ratings, especially for Gazprom, because we assume meaningful improvement of gas prices.

In Kazakhstan, we revised the outlooks on KazMunayGas NC JSC (KMG) and Tengizchevroil LLP to negative from stable, and affirmed the ratings. This reflects ratings downside pressure if recovery of oil prices takes longer than we currently expect. Although Kazakhstan's tax system also protects against immediate downside, the weaker tenge is less meaningful. This is primarily because of a higher proportion of hard currency-denominated capital expenditure (capex) and operating expenditure (opex) than Russian peers, and a generally less flexible cost base. Still, in our base-case scenarios for KMG and Tengizchevroil, we project that both companies can improve their ratios to rating commensurate levels in 2021.

Gazprom PJSC

Primary analyst: Elena Anankina

We revised the outlook on the 'BBB' local currency rating on Gazprom to negative from stable because we see limited headroom in Gazprom's stand-alone financial metrics owing to the recent drop in oil prices, as well as continuing weakness in European gas prices. We kept the outlook on our 'BBB-' long-term foreign currency rating at stable.

We affirmed our 'BBB' local currency and 'BBB-' foreign currency ratings on Gazprom because of the currently unchanged sovereign rating on Russia and our expectation of an extremely high likelihood that the government of Russia would provide support sufficient to offset potentially weakening stand-alone performance.

The weakening stand-alone financials stem from the company's heavy exposure to currently very difficult European gas markets, lower oil prices, sizable (even if somewhat flexible) capex plans in 2020-2021, and increasing dividend payout. Under our price assumptions of Brent at $30/bbl in the remainder of 2020, $50/bbl in 2021, $55/bbl thereafter, and only gradual recovery in gas prices from current levels of below $3 per million btu on the spot market in late 2020-2021, we expect Gazprom's ratio of funds from operations (FFO) to debt will be below our 30% threshold for a 'bbb-' stand-alone credit profile (SACP) in 2020, with potential recovery in 2021-2022. Gazprom's FFO to debt was 74% in 2018, and we expect it was about 50% in 2019. We think Gazprom's discretionary cash flow (DCF) after capex and dividends will be heavily negative.

Our base-case scenario hinges upon our understanding that much of Gazprom's exports to Europe is under long-term take-or-pay contracts. About 30% of contracts are directly or indirectly linked to the oil price with a six-to-nine month lag and a large part of the remaining gas sales is linked to forward prices, which have been above spot. We expect Gazprom's gas exports to remain profitable, thanks to its low cost position, further strengthened by recent ruble devaluation. We also factor in a degree of capex flexibility in line with Gazprom's policy and track record. We expect Gazprom to stick to its newly adopted dividend policy, which sets the target payout at 30%, 40%, and 50% of adjusted net income, and be able to reduce the absolute amount of dividends when net income is lower.

We believe that Gazprom's ability to restore sufficient financial headroom will depend on the situation in the oil and gas markets, as well as on its ability and willingness to effectively and timely limit leverage increase through capex cuts or asset disposals. Furthermore, we believe that Gazprom will retain adequate liquidity and access to debt funding.

Outlook

The negative outlook on the 'BBB' local currency rating reflects our view of the reduced headroom in Gazprom's stand-alone credit metrics and continuing uncertainty in the global oil and gas markets. We would lower the local currency rating if the SACP deteriorates from the current 'bbb-' to 'bb+'. We view FFO to debt sustainably above 30% as commensurate with a 'bbb-' SACP, and we expect the company will remain close to this threshold in 2020-2021.

The stable outlook on the 'BBB-' foreign currency rating mirrors that on Russia and reflects our view of the extremely high likelihood the state would support Gazprom and that such support would offset a potential deterioration in the SACP.

Downside scenario. If Gazprom's SACP were to deteriorate by one notch to 'bb+', we would lower our local currency rating to 'BBB-' and affirm our foreign currency rating at 'BBB-'. This could happen due to weakening liquidity or if FFO to debt declined to below about 30% due to persistently low gas prices, larger-than-expected investments or dividends, or potential contingent liabilities on joint ventures (JVs) and ship-or-pay contracts. A major shift in European gas markets might lead us to re-assess Gazprom's business strength, and could therefore also weigh on the local currency rating.

We would lower both local and foreign currency ratings on Gazprom if we downgraded the sovereign.

Assuming the sovereign rating and the likelihood of extraordinary state support remained unchanged, the SACP would have to decline to 'b+' in order to pressure the foreign currency rating, a situation which is still very far from our base case.

Upside scenario. We could revise the outlook on the local currency rating to stable from negative only if market conditions strengthened significantly and Gazprom displayed comfortable headroom in its financial metrics with FFO to debt sustainably above 30%.

We would raise the foreign currency rating if we upgraded the sovereign, but this is not our base-case scenario.

KazMunayGas NC JSC

Primary analyst: Mikhail Davydov

We revised our outlook on KMG to negative because we expect that the lower Brent oil price of $30/bbl until the end of 2020 will temporary push the group's leverage to higher level this year. We think S&P Global Ratings-adjusted debt to EBITDA will increase to 5.0x-5.4x and FFO to debt will fall to 9%-13%, versus 2.54x and 27%, respectively, reported in 2019. At the same time, we expect KMG's credit metrics to recover in 2021, as the oil price rebounds to $50/bbl on average, with debt to EBITDA falling to 3.0x-3.5x and FFO to debt improving to 18%-22%.

We expect KMG's S&P Global Ratings-adjusted EBITDA to fall by at least 40% in 2020 to about Kazakhstani tenge (KZT) 700 billlion-KZT750 billion in 2020, from KZT1.279 trillion in 2019, reflecting primarily the lower oil price, but also much lower dividends from JVs (we use dividends from JVs rather than the share of income in our EBITDA calculation). We forecast the groups' own exploration and production business to post nearly breakeven ratios in 2020 because of the high cost of production, while the more stable pipeline business will prevent a bigger EBITDA contraction. We note that the weaker tenge will somewhat mitigate EBITDA decline in 2020, but the group will not be able to enjoy the full benefit of it; its leverage will also inflate because 93% of its debt is denominated in foreign currency. Nevertheless, on a net basis, the weaker tenge is beneficial for the group's leverage, given that the capex is also primarily tenge-denominated. The 2021 rebound will be supported by higher dividends from JVs, on top of more expensive oil, with EBITDA improving toward KZT1.10 trillion-KZT1.15 trillion.

KMG's liquidity remains adequate, in our view, with sources covering uses by more than 1.2x, thanks to large S&P Global Ratings-adjusted cash reserves of KZT1.3 trillion (about $3.4 billion) at year-end 2019 and manageable maturities of KZT254 billion for 2020. We estimate, that KMG could marginally breach its 3.5x net debt to EBITDA financial covenants (calculated on a different basis than our leverage metrics) on certain loans in 2019. At the same time, we don't expect acceleration on these loans, because they were provided by state-owned and development banks, which don't usually accelerate debt due on covenant breaches. In an emergency case, KMG's cash funds would cover the amount of these loans, although that would represent a sensitive cash burn. Moreover, although not our base case at the moment, liquidity risks could also stem from an increasing share of KMG's cash being located at Kazakh banks. We estimate that as of year-end 2019 about 55% of KMG's cash was located in Kazakhstan's banking system, which has a track record of cash not being readily available to corporate issuers.

We don't expect Kazakhstan's government to exercise its option to sell an 8.44% stake in the

Kashagan project to KMG in the current environment, even if the freeze on the stake were to be released (for which we have no visibility). Therefore, the potentially meaningful increase in leverage after the option's execution that we have already incorporated in our rating provides some headroom at the moment.

Outlook

The negative outlook on KMG reflects the possibility we would lower the rating if we didn't believe that the group's FFO to debt would rebound to about 20% in 2021. This scenario could primarily result from the oil price staying meaningfully below our current $50/bbl Brent forecast in 2021, inability to control opex or capital investment, leading to significant cash burn, or the government suddenly exercising the put option on the stake in Kashagan. Pressure on the rating could also materialize if KMG's liquidity weakens owing to unavailability of a significant part of its large cash reserves, notably those held in Kazakhstan's banks. Inability to negotiate a covenant waiver in case of a breach and forcing the group to repay the loans or spending part of its cash cushion could also add pressure on the rating.

We could also lower the rating on KMG if we were to lower our rating on Kazakhstan.

Upside scenario. We could revise the outlook to stable if we have visibility that the 2021 credit metrics will likely stabilize with FFO to debt trending toward 20% as a result of oil price recovery and good control of the group's spending, leading to limited cash burn in 2020 and DCF turning at least neutral in 2021.

Tengizchevroil LLP

Primary analyst: Mikhail Davydov

We revised our outlook on Tengizchevroil to negative because we expect that lower oil prices will cause the project's S&P Global Ratings-adjusted debt to EBITDA to shoot up to 3.1x-3.5x in 2020 from a moderate 0.65x in 2019, before recovering to 2.2x-2.6x in 2021. Such a sharp decrease in forecast leverage stems from a combination of significant decline in EBITDA and, to a greater extent, debt accumulation due to large capex in 2020, which we currently estimate at about $8.8 billion. Lower EBITDA in 2020 means that Tengizchevroil will need to borrow more to complete its inflated expansion program, following a significant upward revision in November 2019 of the cost of its major expansion project, Future Growth Project-Wellhead Pressure Management Project (FGP-WPMP).

Although more than 80% of Tengizchevroil's capex is expansion, at the moment we have limited visibility over how much of it, if any, the company would be ready to postpone to contain leverage growth. However, should the company decide to postpone part of capex, actual leverage ratios could be meaningfully lower. We note that Tengizchevroil has an about $8.5 billion currently available credit facility, which is enough to cover the full cost of capex in 2020. Additionally, a shareholder cash call mechanism is available to Tengizchevroil until FGP-WPMP comes online and can be used to provide additional funds to ensure finalization of the project. We do not expect Tengizchevroil to use a cash call in our current base case scenario.

Outlook

The negative outlook on Tengizchevroil reflects the possibility that we would lower our rating if the project's debt to EBITDA were to stay above 3x after 2020, due to a combination of lower-than-expected oil prices and inability to adjust its capex. A downgrade could materialize if Kazakhstan's government were to impose large fines, change the rules of Tengizchevroil's license, or otherwise penalize Tengizchevroil for meaningful overspend on FGP-WPMP, to compensate for the loss of tax revenue for the state budget and lower dividends received by state-owned shareholder KazMunayGas. We could also lower the rating on Tengizchevroil if we were to lower the rating on Kazakhstan, as our rating on Tengizchevroil can only be higher than that on Kazakhstan by one notch.

Upside scenario. We would revise the outlook to stable if market conditions improve, supporting debt to EBITDA below 3x, and we get sufficient clarity regarding the revised amount of the project cost.

UNAFFECTED COMPANIES

The following companies are not affected by the lower oil price assumptions and we are not taking any rating or outlook actions on them. Below we are explaining for the purposes of ratings transparency why these ratings are unaffected.

LUKOIL PJSC

Primary analyst: Sergei Gorin

The 'BBB' rating reflects the strong financial headroom Lukoil has built in the recent years (on Dec. 31, 2019, the company had minimal S&P Global Ratings-adjusted debt of Russian ruble (RUB) 150 billion EBITDA of RUB1.287 trillion). It also reflects the company's flexibility concerning capex and dividends (pay-out of which is linked to cash flow generation). Historically the company has diverted a sizable part of its free operating cash flow (FOCF) to dividends, buybacks, and mergers and acquisitions, but still managed to generate sizable positive DCF of RUB223 billion in 2019. Since the oil price declined, we understand the company has developed a mitigating $1.5 billion-worth action plan to optimize opex and scale down its expansion investments while keeping production maintenance spending untouched. This should support FFO to debt remaining consistently above 60%, commensurate with rating.

Gazprom Neft PJSC

Primary analyst: Mikhail Davydov

We expect Gazprom Neft's FFO to debt to remain above 60% on average in the coming years, even under our revised oil price forecast of $30/bbl until the end of 2020 with a recovery to $50/bbl in 2021 and $55/bbl in 2022. Our expectation stems from Gazprom Neft's low leverage at year-end 2019 with FFO to debt of 88% and debt to EBITDA of 0.95x as well as our expectation that the weaker ruble and Russia's oil tax system will somewhat mitigate the effect of lower oil prices. Still, we expect that Gazprom Neft's FFO to debt will temporary fall to 45%-50% and debt to EBITDA will increase to 1.5x-2x in 2020, recovering to above 60% and below 1.5x, respectively, in 2021. Should Gazprom Neft's FFO to debt fall to 45%-60% long-term, we could revise our view of Gazprom Neft's SACP to 'bbb-' from 'bbb', but this would not affect the 'BBB-' rating.

We view Gazprom Neft's liquidity as adequate, supported by sizable cash balances at the beginning of 2020, manageable capex, and limited maturities over next 12 months. We note that Gazprom Neft's debt is mostly denominated in rubles, because the company is under U.S. financial sanctions and cannot access the international capital markets.

Transneft PJSC

Primary analyst: Elena Anankina

We expect 100% state-controlled Russian oil pipeline monopoly Transneft to continue to demonstrate low leverage, with FFO to debt comfortably above 60% and positive FOCF after large capex projects have been completed. We believe that Transneft's solid financials help create a solid cushion for dividends at 50% of net income and contingent liabilities related to the Druzhba pipeline accident in the second quarter of 2019.

We expect Transneft's oil transportation volumes to remain largely resilient to the plummeting oil price, in line with its 2014-2015 track record, reflecting the Russian oil industry's low cost position and producers' natural hedge through taxes and foreign exchange. We understand that Transneft does not have any material foreign currency-denominated debt, either. The sovereign rating on Russia remains the key driver of our ratings on Transneft (local currency BBB/Stable/--; foreign currency BBB-/Stable/--), reflecting our expectation of an extremely high likelihood of state support in the event of difficulty and the company's close links with the government.

NOVATEK PJSC

Primary analyst: Elena Anankina

Novatek displays solid financial headroom within the 'BBB' rating, a large contribution from stable gas business, and cash proceeds from the sale of stakes in one of its liquefied natural gas (LNG) projects, Arctic LNG-2. In 2018, Novatek's FFO to debt was well above 100%. Under our base-case scenario of Brent at $30/bbl in 2020, $50/bbl in 2021, and $55/bbl thereafter, we expect Novatek's FFO to debt to remain above 60%.

Novatek has a very low cost position, and its profitable domestic gas business is effectively independent from currently difficult gas markets. Novatek's large liquefied natural gas (LNG) JVs, Yamal LNG (operational) and Arctic LNG-2 (under construction), are non-recourse equity investees. We expect Yamal LNG to generate sufficient cash flow to service its significant debt (RUB2.1 trillion at year-end 2019).

We understand that Novatek plans large capex in its core business in 2020, as well as massive investments in its strategic project Arctic LNG-2. We note, however, that in 2019, Novatek sold stakes in Arctic LNG-2 to several strategic investors, and is set to receive another RUB173 billion installment for it in 2020, which will additionally support Novatek's financials. Our rating on Novatek remains one notch above the sovereign rating on Russia, because of the company's low debt and large exports.

State Oil Company of Azerbaijan Republic (SOCAR)

Primary analyst: Elena Anankina

We believe that Socar's metrics can come under pressure in the $30-$50-$55 Brent oil price scenario, but the impact will depend on potentially material working capital movements at Socar's trading operations, on the resilience of Socar's large downstream businesses, and on equity infusions from the government. Even if Socar's SACP were to deteriorate, with FFO to debt falling below 12%, it would not be sufficient to trigger a downgrade, absent liquidity pressures, a sovereign downgrade by more than one notch, or significant changes in the government's policy, because we expect a very high likelihood of support from the government of Azerbaijan.

RELATED CRITERIA

- General Criteria: Group Rating Methodology, July 1, 2019

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Midstream Energy Industry, Dec. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

RATINGS LIST

Outlook Action; Ratings Affirmed		
Gazprom PJSC		
Issuer Credit Rating (Foreign Currency)	BBB-/Stable/A-3	BBB-/Stable/A-3
Issuer Credit Rating (Local Currency)	BBB/Negative/A-2	BBB/Stable/A-2
KazMunayGas NC JSC		
Issuer Credit Rating	BB/Negative/--	BB/Stable/--
Kazakhstan National Scale	kzA+/--/--	kzA+/--/--
Tengizchevroil LLP		
Issuer Credit Rating	BBB/Negative/--	BBB/Stable/--
Kazakhstan National Scale	kzAAA/--/--	kzAAA/--/--

NB: This list does not include all the ratings affected.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.