

KAZAKHSTAN

PART TWO

Monday, November 27, 2006

Major league energy exporter blazes new economy trails

In July this year, President Nursultan Nazarbayev took part in the G-8 summit in St. Petersburg. In an age of energy uncertainties, he emphasized Kazakhstan's role as a reliable oil supplier. With giant reserves in fields like Kashagan and Tengiz, the oil boom is yet to come. By 2015, the country could be exporting 3.5 million barrels per day. With the opening of the Baku-Tbilisi-Ceyhan (BTC) pipeline, Kazakhstan has ceased to be in the minor league of energy exporters. But the country is also changing in other fundamental ways.

In 2003, the World Bank placed Kazakhstan on its list of 20 countries with the most attractive investment climate. Since independence, U.S. investment has helped the country blaze new trails into market economics. Companies like Chevron-Texaco, ExxonMobil and AES have pumped about \$16.6 billion into the financial system, contributing to average GDP growth of 9 to 10 percent since 2000. Technology inputs are largely behind the expansion in extractive industries, as well as the cascade effects in the financial system. Today, there are 374 American companies operating in Kazakhstan and a total of 91 representative offices. Bilateral trade with the U.S.



President Nursultan Nazarbayev believes further focus on ICT will boost infrastructure and diversify the nation's revenue base.

amounted to almost \$2 billion in 2005.

"American investment encourages the inflow of state-of-the-art technology and know-how. It enhances the opportunities to implement our Industrial Innovation Development Strategy through 2015, which is geared to diversify the economy and produce high value-added goods and services," says President Nazarbayev. As Kaza-

khstan prepares to finalize its entry into the World Trade Organization (WTO), it is also seeking to shield itself from external shocks. After all, a country of 15.1 million people has no choice but to integrate fully with global trade.

"By 2015, we will be producing 180 million tons of oil crude. But this is not the country's primary goal," says Prime Minister Daniyal Akhmetov. If Kazakhstan makes good on its intention to become one of the world's 50 most competitive economies, reforms in the legal framework and business climate should remain on track. In a recent IMF report, the growth in manufacturing, telecoms and machinery was deemed impressive. "This is a society that is evolving very quickly. It's similar to the pace of change taking place in the U.S. a century ago," says Karim Massimov, the Deputy Prime Minister.

With \$24 billion in the National Oil Fund as of August 2006, President Nazarbayev is confident that the economy can expand in several direc-

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Prime Minister Daniyal Akhmetov foresees Kazakhstan as a leader in space technology.

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tions. So far, he has opted for a cluster approach to diversify the government's revenue base. In the first stage, tourism, machinery, food processing, textiles, logistics, metallurgical plants and construction materials will be the industrial priorities. "Expanding the market of information and communications technology will serve as an impetus to the modernization of railways, roads, telecoms and utility networks," says President Nazarbayev.

The shift is already evident in

space travel and satellite communications. Last September, the first private female space tourist, 40-year-old Iranian-American businesswoman Anousheh Ansari, took off on a Soyuz spacecraft from the Baikonur Space Center in Kazakhstan. She landed safely on a TMA-8 capsule after visiting the international space station. Earlier in the year, Kazakhstan launched its first satellite. Three more are scheduled before 2009. Meanwhile, more than 200 Kazakhstani students are enrolled in space programs at universities worldwide. "We have a solid research base that will enable Kazakhstan to proclaim itself not only a major hydrocarbons producer, but also a leader in advanced space technology," says Mr. Akhmetov.

For Kazakhstani policymakers, it is important to give people credit for the painful adjustments since 1991. Showing robust figures is not as important as investing in education and human resources. That is why knowledge-intensive production and innovation are critical to making a seamless switchover. "Essentially, it's our human capital and our brains which are driving the country forward," says Mr. Massimov.

Financial sector reforms pay dividends

When global credit research firm Moody's raised Kazakhstan's rating to investment grade in 2002, it made waves across Central Asia. As the region's largest economy, it was an indicator that a threshold had been passed. Since then, GDP growth has averaged ten percent per year. The current bonanza is mainly due to the structural reforms of the 1990s. Price liberalization and privatization laid the groundwork for financial sector reforms. The number of banks has fallen from 230 in 1993 to 34 today.

"Implementing reforms is a very complex issue. But once we carry them out, we should not give up," says Natalya Korzhova, the Minister of Finance. Mrs. Korzhova helped introduce a radical new pension scheme that raised eyebrows in the emerging markets of the last decade. Kazakhstani authorities even upstaged Russia by monetizing social benefits and drawing up an entirely new budget. The country thus set in motion critical banking sector reforms. As a result, Kazakhstan today is a net capital exporter with \$10 billion invested abroad.

In the early days of transition, multilateral institutions used local financial institutions to reach the re-

al economy. When the European Bank for Reconstruction and Development (EBRD) first opened shop in Almaty, they were the only gateway to manufacturing firms and telecom startups. The EBRD helped usher in transparency, but for the EBRD Country Director, André Küüsvek, homegrown changes in the regulatory framework saved the day. "The NBK and the Financial Supervisory Agency deserve most of the credit for the success in banking," he says.

"Banking reforms were quite radical. New requirements were introduced not only in terms of capital adequacy, but also in accounting standards, corporate governance and risk management," says Anvar Saidenov, Governor of the National Bank of Kazakhstan. Mr. Saidenov took part in the first Eurobond issue of 1997 and was on the early road shows organized

by the investment agency. Today, his main task at NBK is inflation targeting. The array of instruments is limited, but NBK controls liquidity by accepting deposits from commercial banks and issuing short-term debt. The minimum reserve requirements for banks were tightened last July.

Now, the buzz is all about windows of opportunity. With more global exposure, the country finds itself at a crossroads. The basic



NATALYA KORZHOVA
Minister of Finance



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Governor of the National
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PHOTO: KAZINVEST

Windows of opportunity are being exposed by the Ministry of Finance in Astana.

products and instruments are lying on the table: oversight mechanisms, loans to SMEs (Small and Medium Enterprises) and a boom in consumer lending. According to Mr. Saidev, there is enough volume and credibility to attract FDI. The litmus test will be a new environment of lower oil prices. If banks play their cards right, they will see an increase in the export of financial services to other CIS markets. From 2007, NBK will do away with its licensing system for capital outflows.

"Of the 34 banks operating in the country, 14 of them are foreign-owned, meaning the number of Kazakhstani-owned banks has actually come down from 230 to 20," says Grigori Marchenko, CEO of Halyk Bank. Not all investment in Kazakhstan is directed at oil and gas. In the last seven to eight years, Mr. Marchenko estimates \$500 million has flowed into the financial sector alone. This has contributed to Kazakhstan's ratio of banking assets to GDP, which is higher than in Poland. Adapting to international standards will pay off long-term.

Analysts at the EBRD think the best is yet to come. "The oil boom has not even started. Big medium-term investments will trigger developments not only in oil and gas, but also in services and logistics," says Mr. Kūusvek.

In January this year the government took steps to further improve the country's competitive edge and role as regional hub through enforcing the principles of efficient corporate governance and management. A new national holding company, Samruk, emerged to improve the performance of the government's asset management and budget transparency of key state-owned enterprises.

Taking the name of the mythical Kazakhstani bird of revival and happiness, Samruk State Holding Company was developed with the help of U.S.-based McKinsey & Company. It serves as an active shareholder on behalf of the state in a number of strategic sectors of the economy, such as KazPost, Kazakhstan Temir Zholy (railways), Kazakhtelekom, KazMunaiGas and KEGOC (Kazakhstan Electricity Grid Operating Company).

Sauat Mynbayev, CEO and Acting Chairman of Samruk, says, "To reach qualitative economic growth, Kazakhstan should have a solid infrastructure to maximize its transit potential and develop high value-added industries. In this respect, the companies that are in Samruk's portfolio play a vital role."

The move to oversee all national companies under one single holding will enhance capital efficiency as well as make the economy of Kazakhstan more transparent and attractive for global investors.

Samruk is fully state-owned but with the legal status of a joint stock company. It aims to strike the right balance between boosting accountability and transparency without in-

terference in the day-to-day operations of national companies. Our overall goal is to maximize the long-term value of companies." Samruk has developed a unique system of indicators for each company's line of business to identify goals and mea-

sure performance. "Samruk is a socially responsible national holding and increasing labor efficiency should be closely linked to the introduction of new technologies for business growth and expansion on the whole," affirms Mr. Mynbayev.

"We are an open country and not only in terms of creating a conducive environment for investment. The people of Kazakhstan are open for communication, new knowledge, and new types of activities," he says. "Kazakhstan combines stability, openness and hospitality. It's an exciting country for everyone to come and discover as a destination for tourism, business, and life in general."



SAUAT MYNBAYEV
CEO and Acting
Chairman of Samruk



For and on behalf of the government of the Republic of Kazakhstan, SAMRUK, a newly created holding company for the management of state assets, serves as an active shareholder in the country's most important corporations with state ownership shares.

SAMRUK is targeting long-term growth in all of these corporations by applying the world's best practice principles of corporate governance and is determined to thus secure the sustainable growth and prosperity of the Republic of Kazakhstan.

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Success story thrives on reading future

Kazakhstani society is evolving fast. It was clear that a favorable geography and resource abundance would turn Kazakhstan into a tiger economy. But management in the 1990s was a challenge. The first priority for the population was housing and nutrition. Integration into world markets took a good 15 years—and radical reform. Banks shifted their focus from cashing in on privatized firms

to the emerging tier of SMEs. This became a specialty for Bank CenterCredit (BCC), and the company has never looked back.

It's such an American happy ending!" says Bakhytbek Baiseitov, Chairman of the Board of Directors. Established in 1988, BCC was the product of a late-Soviet revolution in terms of banking. Thanks to a legal provision that allowed for independent banks, BCC had a head

start. Today, it is Kazakhstan's 5th-largest financial institution. Its clients include 18,000 companies and 420,000 individuals. By 2005, assets had grown 122.5 percent year-on-year to \$2.5 billion. Deposits accounted for \$1 billion and net loans amounted to \$1.5 billion. Net income in 2005 was \$36 million, with return on assets at 2.0 percent. As for market share, it rose from 5.52 percent at end-2005 to 7.32 percent in 2006.

Rated 'Ba1/Positive' by Moody's and 'BB-/Stable' by Fitch, BCC now has its eye on external markets. In December 2005, it obtained a permit to open a branch in Moscow. It also opened a subsidiary in the Netherlands. But the focus of its

strategic expansion will remain in Kazakhstan, where IT is revolutionizing business. At its 111 retail branches, BCC is busy anticipating the demand for imported cars and univer-

sally higher standards of living. "What will consumers want more of and what will they consume less of?" muses Mr. Baiseitov. Part of his job as an economist is to find out. However, he thinks it is crucial to decide where the priorities will be. If the country's goal

is to be included among the 50 most competitive economies, the banking sector needs further integration, including an update of the regulatory framework. "Then everyone will be working in the same direction," says Mr. Baiseitov.



BAKHYTBEK BAISEITOV
Chairman of the Board
of Directors of BCC



BCC's offices in Almaty. The company is Kazakhstan's fifth-largest financial house, posting a net income in 2005 of \$36 million.

Above and beyond the call of duty

When 28 fishermen went adrift on an ice floe last winter near Kostunai, KCell saved their lives. The Kazakhstani mobile operator was the only company with coverage in the far north. In the end, the fishermen were able to dial an emergency number to organize a rescue. In Dzhambul, KCell again was the only mobile operator with services after a major earthquake struck the area. Thanks to its network, the job of relief workers was sped up tenfold.

The importance of cellular communications may seem anecdotal to outsiders. But in Kazakhstan, a vast and sparsely populated country, a mobile handset can save lives. That, at least, is how Serdar Canogullari assesses his company's performance. The CEO of KCell points to highway statistics

showing the impact of a mobile network with broad coverage. "We have severe winters here and people have often frozen to death on the road," says Mr. Canogullari. Today, only 20 percent of highways lie outside KCell's grasp.

In a market where the telecom sector is second only to oil and gas

in terms of government revenue, KCell has managed to capture two-thirds of market share, equivalent to 3.5 million subscribers. In the last 3-4 years, average growth at the company has exceeded 80 percent. The low penetration rate of 30 percent means there are a good five to seven more years of solid growth ahead.

"Currently we operate in the 5 MHz frequency. But our license allows for 7.5 MHz. The extra 2.5 MHz will reduce station maintenance costs—and make our services cheaper for users," says Mr. Canogullari.

"Our users are squeamish about the quality of communications and additional services," he adds. Almaty was the eighth city in Eurasia to implement EDGE technology, for example. KCell was also the first operator to introduce GPRS, WAP and MMS. Four tenets are key for Mr. Canogullari: quality, innovation, technology and a professional cadre. The result is a high-quality communications platform. KCell's current objective is to expand its range of additional services. With new handsets going on the market every day, there is a vast field to operate in.



SERDAR CANOGULLARI
CEO of KCell