

Privatisation of 'Holy Cows' to Start in 2012

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Kazakhstan is planning to initiate a wide-scale privatisation programme (People's IPO) from 2012 - 2015, which will include IPOs of shares in the country's most attractive national companies and monopolies in the infrastructure and energy sectors. The move is considered a major economic reform aimed at increasing the country's profile, liquidity and economic development over the coming decade, and providing a larger stake in the national wealth to Kazakhstan's population. We believe the successful implementation of the programme which will be reflected in the level of involvement of retail investors, could potentially strengthen the social stability of the country and spur economic growth.

Although it's still too early to know exactly how attractive the pricing of these assets will be, some details have been announced.

- The list of likely IPOs includes Air Astana (airline), KazTransOil (oil pipeline company) and KEGOC (power grid operator) in 2012; KazTransGaz (gas pipeline operator), Samruk-Energo (power generation) and KazMorTransFlot (tanker operator) in 2013; Kazakhstan Temir Zholy (the rail monopoly) and Kaztemirtrans (railcar operator) in 2015; and NC KazMunaiGaz (oil producer and the holder of the state's KMG EP stake) and Kazatomprom (nuclear company) after 2015. Subsidiaries of the KazAgro agricultural holding could also be included in the IPO plan at some point. We note the focus seems to be on basic infrastructure companies, which are less volatile and therefore more attractive to investors.
- The plan is to place a 5-15% stake locally to raise c. \$500mn from investors (\$100-200mn) and pension funds (\$200-300mn). There has been no official confirmation regarding the possibility of any discount to market prices, however limitations on the number of shares per person will apply. Retail

sales will be carried out via the Kazpost postal service and public servants will be allowed to buy stakes with no requirement of an income declaration. The necessary legislative amendments, allowing the abovementioned companies to go public, will be made by the end of the year.

We see no reason to expect significant price discounts, as the sale of these quasi-sovereign assets is not due to government necessity (both the state budget and government's international reserves are at record highs). Moreover, the placement of shares is justified by the government as a means to partially finance Samruk-Kazyna's ambitious capex programmes under the country's industrialisation programme. On the other hand placing blue chips on the domestic market should positively influence the development of the Kazakh stock market, in our view (the total market cap of shares traded on the KASE was \$60.7bn in 2010).

Over the long term, we believe the IPOs could positively influence social stability in Kazakhstan, especially if all goes according to the plan of more evenly distributing the country's national wealth. Currently, all large companies operating in Kazakhstan prefer to place their shares on foreign markets in order to benefit from cheaper funding, higher liquidity and the closer proximity to a wide spectrum of investors. The participation of local retail investors remains low and the Kazakh stock market is underdeveloped. Bank deposits remain the only widely accepted means of accumulating savings, although the concentration of retail deposits is highly high (an estimated 2-3% of depositors own two-thirds of total deposits).

Introducing new, attractive instruments to the market could help resolve issues in the Kazakh financial system.

Kazakhstan's post-crisis banking system still faces high levels of non-performing loans (NPL), deleveraging trends and zero growth in lending, with the plunging real estate market no

longer an attractive investment vehicle. Pension funds, caught in the trap of low returns on investment and high domestic inflation, are also seeking investment opportunities within the high requirements set by the regulator. Banks have accumulated around \$11bn in excess liquidity, while pension funds have assets under management of more than \$15bn: both remain the largest holders of government debt, marking negative real return rates on their investments.

We estimate domestic demand pull at \$6.6-10.3bn, of which \$1.3-2.6bn could potentially originate from retail investors. We potentially see five main sectors interested in investing in the placement of new stocks, as these sectors have generated a significant amount of excessive liquidity. Banks have been accumulating excess liquidity for the past three years and, in our view, could invest an estimated \$3.6-4.5bn worth of assets which are currently held in the 'safe haven' of government bonds and central bank accounts. Retail investors have an estimated \$11bn of cash available for investment and increased their retail deposits by \$2bn last year. These investors are currently restricted only by their low investment experience and knowledge, we believe. Pension funds we think could allocate \$1-\$2.5bn, which is currently being held in government bonds and bank deposits, in accordance with regulatory restrictions. Insurance companies and mutual investment funds could contribute \$0.7bn, according to our estimates.

In summary, we expect the privatisation programme to play a positive role in redistributing national wealth and decreasing the size of the public sector, which increased significantly due to the government's anti-crisis measures. The programme was announced immediately before President Nursultan Nazarbayev's re-election in April and we consider it one of the three main pillars of government's economic development plan for the new five-year term, in addition to the industrialisation programme and the Customs Union.