



Private equity market in Kazakhstan

KPMG in Kazakhstan and Central Asia
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Welcome statement



Ardak Kassymbek

Dear partners, investors and colleagues,

Welcome. It gives me great pleasure to welcome you on pages of this report which analyses the private equity market in Kazakhstan.

The goal of Kazyna Capital Management (KCM) today is to develop the private equity infrastructure in Kazakhstan; therefore, it is highly important for the Company to gain an understanding of the current state of the market and to determine the necessary steps that need to be taken to foster its development.

One factor constraining the development of the private equity industry in Kazakhstan is a lack of information. Extensive work has been undertaken as part of preparing this report to collect and analyse information. For example, for the first time ever private equity market players and businesspersons have been interviewed to ascertain current issues and to elaborate recommendations to develop the market. Moreover, it is the first time that quantitative data on the size of the private equity market and its role in Kazakhstan's economy will be presented to the public.

This report is the first public analytical material of its kind related to the private equity market in Kazakhstan, and we hope that it will provide both domestic and foreign investors with the information they need to understand the industry and to help improve the market ecosystem to facilitate its further growth. We are very proud of this initiative and strongly believe that the report will be useful for professional market players and a wider audience.

I am confident that KCM will continue to foster the further development of the private equity market in Kazakhstan and boost the efficiency of investment projects that are implemented.

I would like to thank KPMG for the contribution that they made in preparing this report, and all market players that also played an active role.

Sincerely yours,

Ardak Kassymbek,

Chairman of the Management Board, Kazyna Capital Management JSC



Saken Zhumashev

Dear colleagues,

We are glad to present you with the first-ever review of the private equity market in Kazakhstan, prepared at the initiative of Kazyna Capital Management JSC.

We have attempted in this research not only to highlight the current state of the private equity industry in Kazakhstan, but also to analyse the development outlook and key issues.

The highly closed nature and poor transparency of the Kazakhstan's private equity market have resulted in a situation where a significant number of transactions go unnoticed by analysts and experts, and this not only hinders an understanding of the industry (and not to mention complicates our research), but also reduces the appeal of the industry for its players, including potential investors and businesspersons.

In such circumstances it was essential for us to rely not only on the available data, but also to get the current opinions of market players. During the research we held interviews with 35 private equity industry representatives and surveyed over 100 members of the business community. We are very grateful to all respondents for their contribution to this research and their valuable professional judgements; without them this report would not have been possible.

We would like to express our sincere gratitude to Kazyna Capital Management JSC for the opportunity to work on this report. My special thanks goes to all colleagues who made a contribution.

We hope this report will fill a gap in the information available about private equity instruments in Kazakhstan, and lead to a great many success stories in the market.

Faithfully yours,

Saken Zhumashev

Managing Partner, KPMG in Kazakhstan and Central Asia

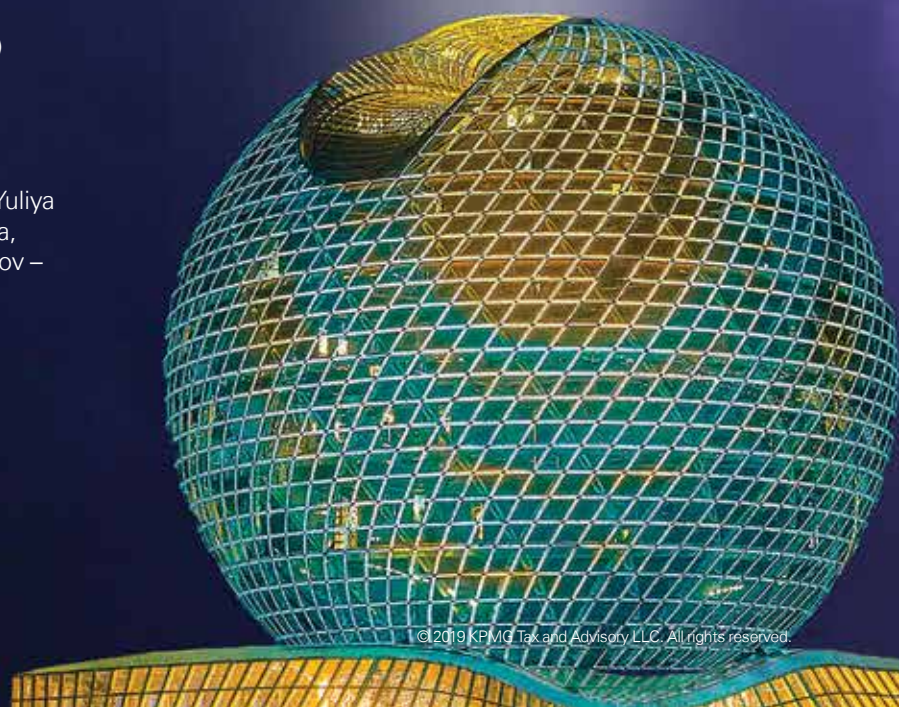
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Special thanks to KPMG team – Madiyar Toleugali, Yuliya Tychinskaya, Zhannat Salimova-Tekai, Daria Privalova, Tatyana Shaposhnikova and Yer Khan Kosmagambetov – for their assistance in preparing this report.



Terms

The terms Private Equity and Mergers & Acquisitions are often interpreted differently, both in the English language and when translated into Russian; therefore, the definition of these terms is an important aspect of the research (for details, see Section 7, Glossary).

The following terms and definitions are used in this report:

Private Equity Funds (PEFs) are financial entities that raise capital from private and institutional investors for subsequent investment in companies' equity. In this research the definition of PEFs is narrowed to cover two categories: classic PEFs and captive PEFs under family offices/business conglomerates. A detailed description of the features of classic PEFs and captive PEFs under family offices/business conglomerates is provided in Section 2.

Private Equity (PE) is a class of private investments in shareholders' equity. In this research, PE means investments made by classic PEFs and captive PEFs under family offices/business conglomerates, i.e. professional investors that have the characteristics described in Section 2.

Mergers & Acquisitions (M&A) is a generic term that covers a number of different transactions, such as mergers, acquisitions, consolidations, and purchases of assets and acquisitions to gain control of an entity. Acquisition means

gaining control over a company or the right of ownership therein. Financial operations involving mergers/acquisitions/consolidations of companies are often performed through a number of transactions and by different legal entities/individuals, while information on the stake in the company to be acquired is unknown. For the purposes of this research, M&A is considered in the broad sense of an acquisition of a stake in the charter capital of a non-public company, i.e. M&A includes private equity (PE).

Thus PE differs from any other private capital transaction by the type of investor (this research deals with classic PEFs and captive PEFs under family offices/business conglomerates).

Quality of information and research methodology

The market of non-public equity transactions, both in Kazakhstan and worldwide, is rather closed in terms of access to information. At the same time, in more developed markets there are certain structures (usually operating in the form of associations) that exercise monitoring, consolidate information, and determine a respective methodology. No such work is performed in Kazakhstan; therefore, in conditions of limited access to information we had to use different data sources and consolidate these for subsequent monitoring and update purposes.

As the data sources were not always reliable, to test hypotheses and to obtain the most accurate information interviews were held with industry experts, international funds, and market players from both the private and public sectors that have extensive work experience in Kazakhstan.



Content

Executive summary

p. 8

The economy of Kazakhstan over the past 10 years

1

- 1.1 Macroeconomic overview **15**
- 1.2 Distribution of wealth **22**
- 1.3 Sources of business funding **25**
- 1.4 Kazakhstan in the ratings **34**

p. 14

Private equity as a source of sustainable economic growth

2

- 2.1 Private equity **38**
- 2.2 Value of PEFs for business **41**
- 2.3 From debt to equity: sustainable growth through diversifying the structure of an economy's financing **42**
- 2.4 Classic PEFs and PE specifics in Kazakhstan **44**

p. 36

Development of the private equity market in Kazakhstan

3

- 3.1 Evolution of the private equity market in Kazakhstan **47**
- 3.2 Overview of key private equity ecosystem players in Kazakhstan **52**
- 3.3 Analysis of M&A market activity over 2008–2018 **66**
- 3.4 Fundraising by PEFs and the application of investors' funds **70**
- 3.5 Dynamics in total volume of private equity investments made in Kazakhstan, 2008–2018 **71**
- 3.6 Industry focus of investments **74**
- 3.7 Types of transactions **75**
- 3.8 Determining the number of completed exits and exit strategies **76**
- 3.9 Overview of the most successful PEF cooperation stories with business in Kazakhstan **82**

p. 46

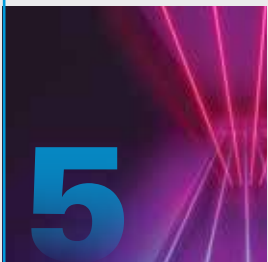
PE market development in Kazakhstan – issues and outlook

4

- 4.1 Identifying development issues in the Kazakhstan's private equity market **87**
- 4.2 PE potential and the outlook for PE market development **95**

p. 86

Opportunities and recommendations for PE market development in Kazakhstan



p. 98

Research methodology



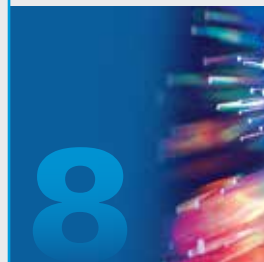
p. 108

Glossary



p. 112

List of abbreviations

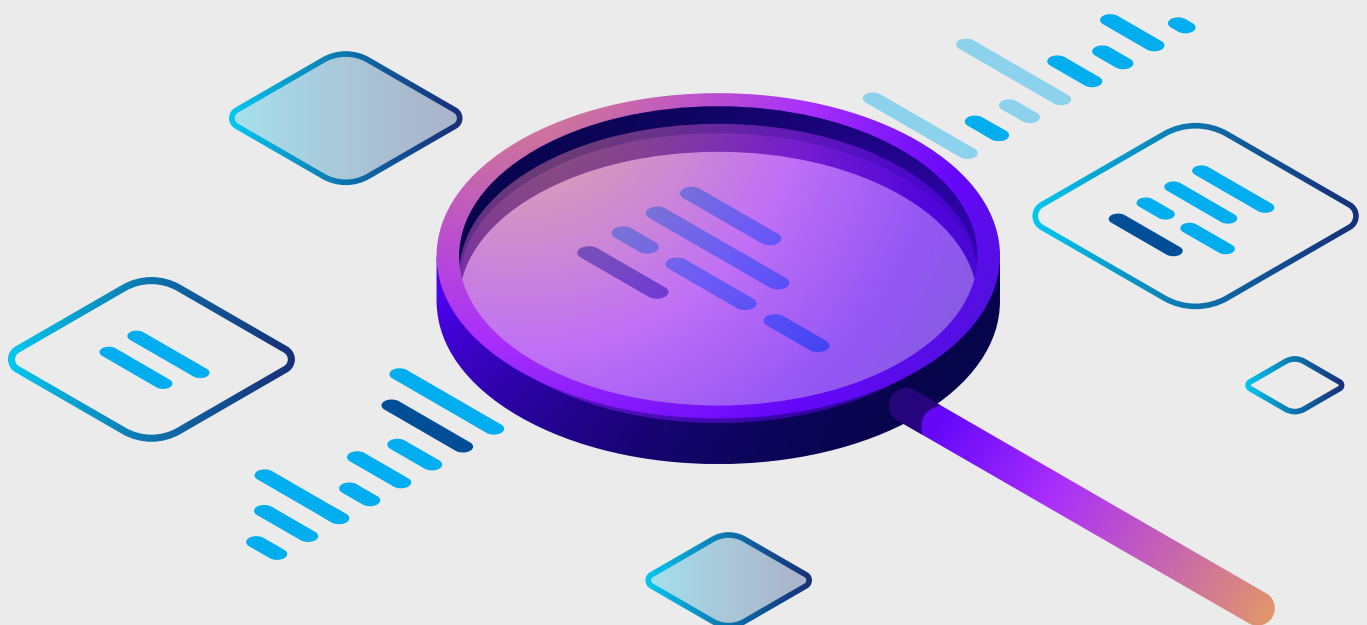


p. 114

Appendices



p. 116



Executive summary



Global experience shows that private equity plays an important role in the economies of both developed and developing markets. Kazakhstan, as a frontier market, needs to diversify the financing structure of its economy in order to ensure sustainable development.

Credit expansion before 2008 and large-scale, favourable state debt financing programmes fostered conditions in which professional investments in equity were uncovered.

Therefore, the Kazakhstan's private equity market sees rather weak activity, which corresponds to a low stage of market maturity, due to the influence of a plethora of both internal and external factors.





Private equity in the context of the evolution of economic development in Kazakhstan

The history of how professional private equity investments developed in Kazakhstan can be divided into the following stages:



This stage comprised a difficult initial transitional period to a market economy that began with the privatisation of property.

During this period, the Brent oil price quadrupled, and Kazakhstan's GDP in US dollar terms was growing by 9% annually. Banks carried out an aggressive credit expansion by attracting foreign investments. Certain Kazakhstani companies owned by prominent entrepreneurs, such as Resmi, Visor, and Centras, began operating according to the principles of classic PEFs, and, in 2007, PE fund of funds, Kazyna Capital Management, was established through an Order from the President of Kazakhstan.

This period began with the global financial crisis, which severely impacted the economies of many countries, Kazakhstan included. Other events that had an adverse influence on the economy of Kazakhstan over the past 10 years include periods of price volatility of natural resources (including oil and metals), sanctions introduced against Russia, and the subsequent devaluation of the Russian rouble in 2014–2015, when real GDP growth reached an all-time low of 1.1-1.2%. These challenges strongly impacted the investment appeal of Kazakhstan's assets for international investors and, thus, the development of the private equity market.



Private equity market specifics in Kazakhstan: fundraising through the quasi-public sector and the important role played by family offices

The market of professional private equity investments was created during a period of macroeconomic instability, under the influence of numerous external factors. As a result of radical transformations during the first two stages of the country's economic development, Kazakhstan has developed private equity characteristics that differ from those typically seen across the globe.

- Family offices/business conglomerates, which account for ~50% of total public wealth, play a key role in the private equity market. Investment structures under family offices focus on the management of available assets; when making investments they have profit generation as their chief goal, and they lack a separate divestiture strategy. However, our analysis showed that nine family offices/business conglomerates had a structure similar to that of PEFs; today, most of these captive PEFs do not actively invest in Kazakhstan.
- Over 10 years a quasi-public fund of funds, Kazyna Capital Management, has been a key driver of PE in Kazakhstan. It jointly established with international investors 15 funds, such as the EBRD, ADB, and IFC, CITIC. The total capitalisation of funds with KCM participation was ~\$2.6 billion as at 1 May 2019, with KCM liabilities equal to ~\$580 million, or 22%. In 2019 KCM has launched a Concessionary Funding Programme to support a wide range of entities.
- Transactions were carried out by 27 classic PEFs, out of which 15 were funded by quasi-public development institutions, four were established by independent local companies¹ and the remaining eight were private international funds with point investments in Kazakhstan's assets.
- Fund managers mostly comprised international general partners (GPs) – only nine funds out of 27 were managed by local GPs.
- The key sources of funding for Kazakhstan PEFs are quasi-public institutions such as KCM and KazAgro, international financial institutions (e.g. the EBRD, IFC, and CDC) and, to a lesser extent, high-net-worth individuals (family offices)/business conglomerates, but not institutional investors (pension funds, insurance companies).
- Currently in Kazakhstan only nine investment companies are actively operating according to the principle of classic PEFs: seven quasi-public and two independent private PEFs. Classic PEFs in Kazakhstan manage investments starting from \$1-5 million. The total capitalisation of nine PEFs is ~\$575.6 million, out of which 91% is attributable to the capitalisation of seven funds financed by quasi-public institutions.



Investment volume dynamics for M&A and private equity²

During the period from 2008, investment volumes in M&A and private equity correlated with economic changes in the country. During the global financial crisis of 2008–2010, the size of the M&A market shrank from \$8 billion to \$2.3 billion (-46% on average per year), and the number of transactions dropped from 75 to 46 (-39%). 2010–2013 was a period of economic recovery – the average annual growth in nominal GDP in USD terms was +17%, and the annual increase in the M&A volume was 63% annually. The volume of M&A transactions quadrupled, while the number doubled. The period 2014–2018 was characterised by a high volatility of natural resource prices, due to transitioning to a floating exchange rate, and a devaluation of the national currency; the compound annual growth rate (CAGR) of the M&A market was -22% per annum

The main observations vis-à-vis the Kazakhstan's private equity market in 2008–2018 are as follows:

- The average annual volume of PE investments over the past 10 years was ~\$160 million, which accounts for ~3.7% of the volume of M&A transactions, or ~0.07% of GDP. Each year there are, on average, nine private equity investments;
- In terms of PE/M&A and PE/GDP ratios, Kazakhstan lags behind Malaysia, Russia, Brazil, Indonesia, and the Asia-Pacific region by 2-2.7 times. Hence the Kazakhstan's private equity market is undersaturated and has certain growth potential up to an annual volume of \$320-430 million;
- When observing the industry-specific priorities of PEFs, one notices a wide range of sectors involved and a fragmentation of investments. From year to year transactions in such sectors as finance, oil and gas, power generation, mining and metals, and production demonstrate stable market shares.



Exits from Kazakhstan's assets and successful investments

61 exits ►► \$6,4 bln

Over the past 10 years, 61 exit transactions from Kazakhstan's assets have been registered, for a total amount of ~\$6.4 billion. The amounts are known for only 70% of these transactions, with the average being \$155.4 million and median value \$4.9 million, which suggests that there is a preponderance of mega-deals.

The most interesting deals during 2012-2015 were made by Verny Capital, TPG Capital and Ordabasy. Activity in the market was also rather high during 2018: KCM funds made six exits and at the end of the year Verny Capital sold a part of its share (35%) in the GR Gold mining company to a US-based PEF Resources Capital Fund (RCF).

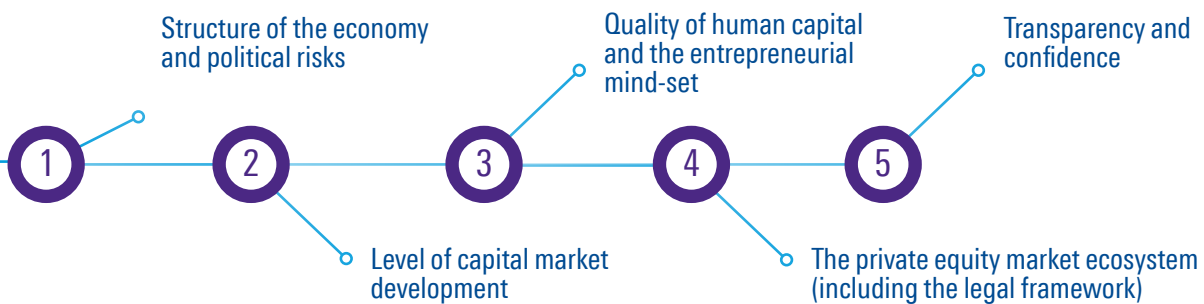
¹ See the Methodology section of the report.

² See the Methodology section hereto. Certain terms are provided on page 2



Five Key market issues

Based on the results of analysis and interviews with experts, PE development issues in Kazakhstan were identified and grouped into five categories:



Thus currently Kazakhstan is witnessing trends that indicate that the Kazakhstan’s PE market is still immature:

- There is **a lack of high-quality projects** that can provide the desired rate of return commensurate to existing risks;
- **Project divestiture opportunities are restricted;**
- Local classic PEFs **are funded** predominantly through quasi-public institutions.



The outlook for private equity: is there light at the end of the tunnel?

According to the survey, most respondents believe that no significant changes will take place in the PE market within the next five years, while 15% of experts predict a contraction in the PE market. The neutral attitude of most respondents leads us to conclude that the development of the PE market requires large-scale reforms and measures to improve the investment climate; however, the interviewees find it difficult to forecast the likelihood and timing of these reforms.

Meanwhile, Kazakhstan looks rather attractive compared with other emerging markets. Subject to proper development of the PE infrastructure, including development of the legal framework, a deepening of the financial markets, and market players increasing their professional competences, Kazakhstan will be able in the coming years to not only ensure a stable inflow of investments, but also create the prerequisites to facilitate the sustainable development of the economy.



Opportunities and recommendations: how to find a needle in a micro-haystack and not to hurt your finger?

The development of private equity and venture capital requires an integrated approach; at the same time, promising opportunities and recommendations to stimulate growth in private equity investments in Kazakhstan can be subdivided into four categories:



Development of the PE market infrastructure:

enhancing measures to safeguard the rights of minority shareholders, amending regulatory legal acts, and improving taxation and court practice;



Stimulating activity in capital markets:

developing trading platforms to attract investors, and transferring pension assets to independent asset managers;



Potential economic growth points:

developing exports, small- and medium-sized businesses, and investments in distressed assets;



Popularising the private equity tool:

promoting the Private Equity Association, which unites professional market players, elaborating an integrated strategy to promote and popularise the equity investment tool.



1 The economy of Kazakhstan over the past 10 years



1.1 Macroeconomic overview



1.2 Distribution of wealth



1.3 Sources of business funding



1.4 Kazakhstan in the ratings

1.1 MACROECONOMIC OVERVIEW



Global challenges in the past decade have changed the structure of the world economy.

Two key events in the global market can be highlighted over the past 10 years, which impacted the economies of many countries, including Kazakhstan: the global financial crisis of 2008 and geopolitical changes, including anti-Russian sanctions imposed since 2014.

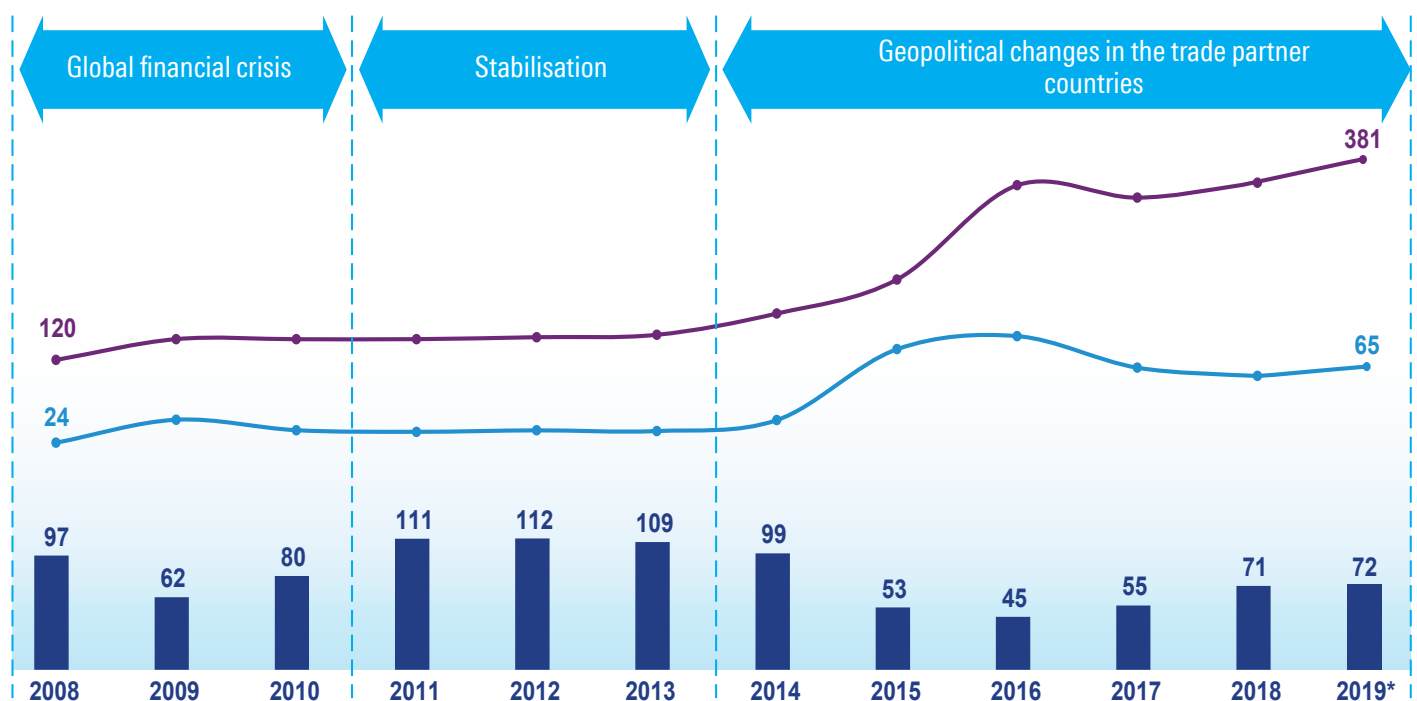
These events were accompanied by commodity price volatility: for example, during 2008 the Brent oil price saw an almost threefold decrease and

metal prices halved; this resulted in adjustments to the values of the national currencies of countries dependent on commodity exports, such as Russia and Kazakhstan.

In addition to the direct impact from global commodity prices, the stability of the tenge exchange rate in Kazakhstan depends, in large part, on the stability of currency exchange rates in its trading partner countries. Hence the weakening of the Russian rouble became one of

the factors that influenced the tenge devaluation over 2014–2015; the NB RK chose to maintain the competitiveness of Kazakhstan's products and preserve gold and foreign exchange reserves.

Figure 1. KZT/USD and RUB/USD exchange rate and oil price dynamics³



Note: * - as at 1 May 2019

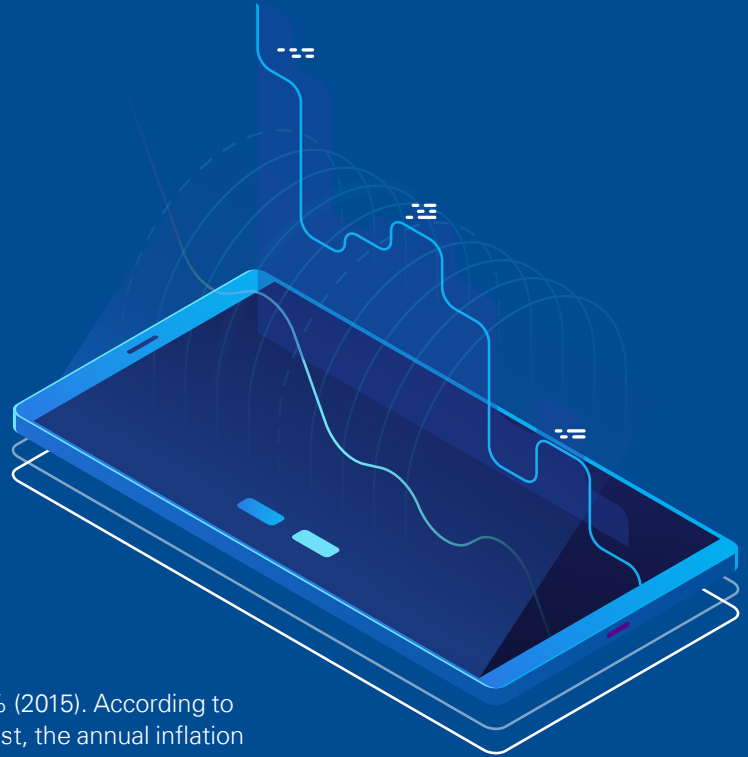
● Brent

—●— RUB/USD exchange rate

—●— KZT/USD exchange rate

³ NB RK, CBR, World Bank

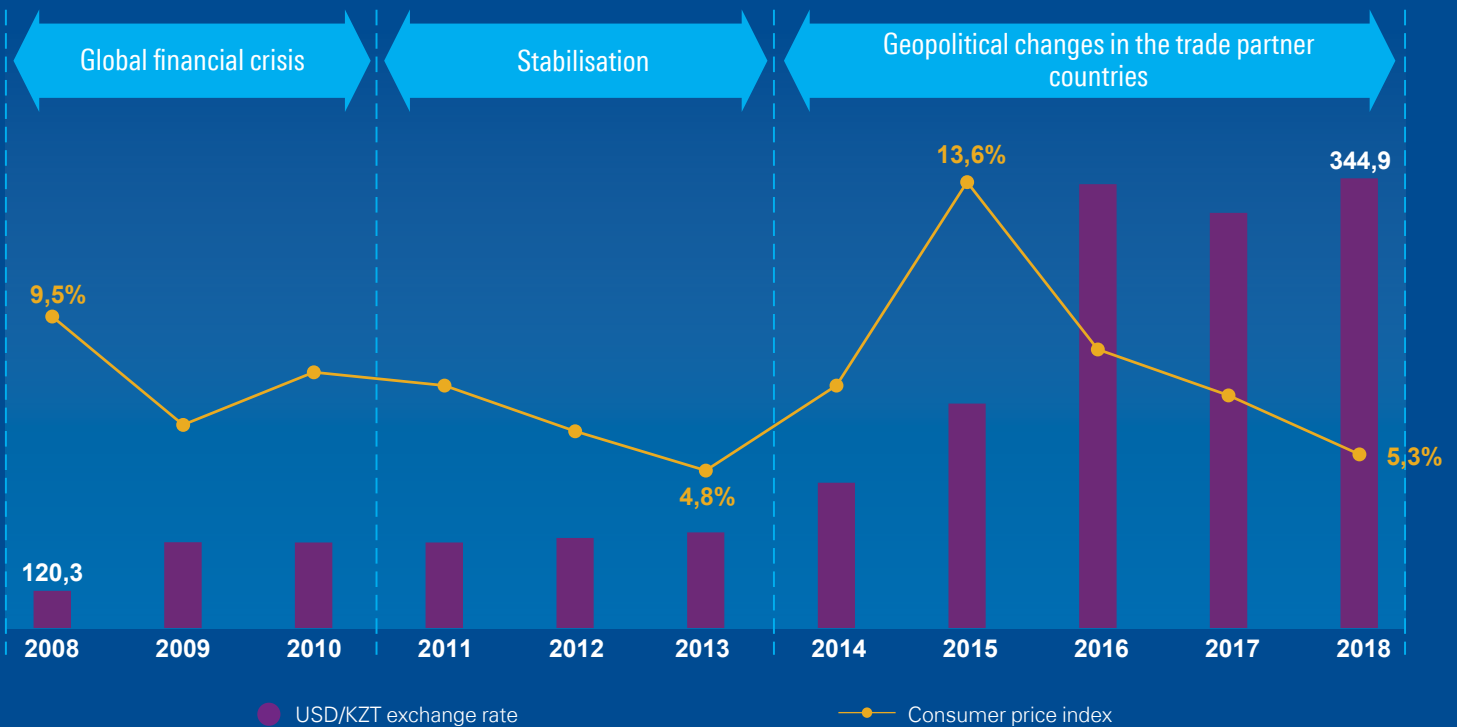
The fall of the tenge and high inflation were due to the volatility of export commodity prices and the devaluation of the Russian rouble.



Movements in the national currency exchange rate resulted in high inflation in Kazakhstan. Over the past 10 years, the annual average inflation rate in Kazakhstan has demonstrated significant fluctuations, from 4.8%

(2013) to 13.6% (2015). According to a NB RK forecast, the annual inflation rate in Kazakhstan in 2019 will begin a smooth entry into a new target corridor of 4-6%, and be at about its upper threshold.

Figure 2. Inflation rate and KZT/USD exchange rate dynamics⁴





The real GDP growth rate remained positive, but fluctuated under the influence of external factors, thereby reflecting commodity dependence.

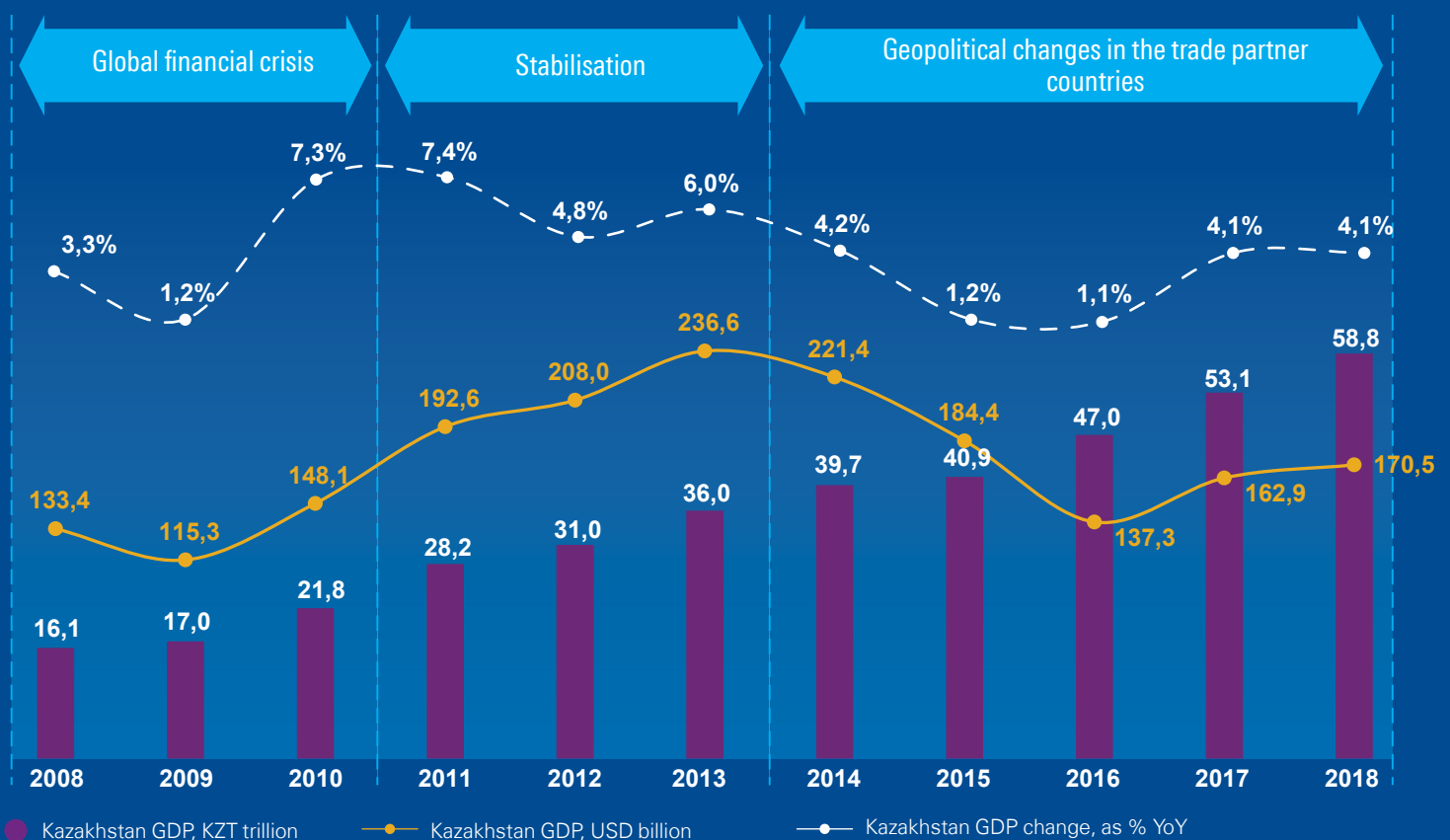
Economic growth in Kazakhstan before 2013, which preceded the economic decline, was due to high oil prices. The development of the mining industry and high commodity prices contributed to an increase in government revenue and expenditure, as well as volumes of domestic consumption. Then, over 2014–2016, the economy of Kazakhstan slowed. The real GDP growth rate dropped from 6% in 2013 to 1.1% in 2016.

Economic growth resumed in 2017, due to a recovery in internal demand, supported by the attraction of new investment, an expansion of production in trading sectors, and well-balanced growth in almost all industries. External factors that

favourably influenced the economy include a recovery in oil and metal prices in global markets and an economic recovery in the main trading partners of Kazakhstan: European Union member states, Russia, and China.

Dynamic economic growth also persisted in 2018: according to World Bank preliminary estimates, GDP in the past year has risen 4.1% in real terms.

Figure 3. GDP dynamics in USD and KZT terms, changes in real GDP in %⁵



Note: Nominal GDP values and changes in real GDP are shown

⁴ NB RK, CBR, World Bank

⁵ Statistics Committee of the MNE RK



The low domestic consumption rate observed in Kazakhstan has been due to its low population density and low purchasing power, i.e. the market is rather small in size terms. Thus the average volume of consumer spending in Kazakhstan over 10 years was \$84 billion, while in Malaysia the indicator was \$152 billion and in South Africa \$209 billion. Average consumer spending in such countries as Turkey, Russia, and Brazil is \$505 billion, 913 billion and 1,304 billion, respectively.

With low absolute consumer spendings, their growth also appeared low.

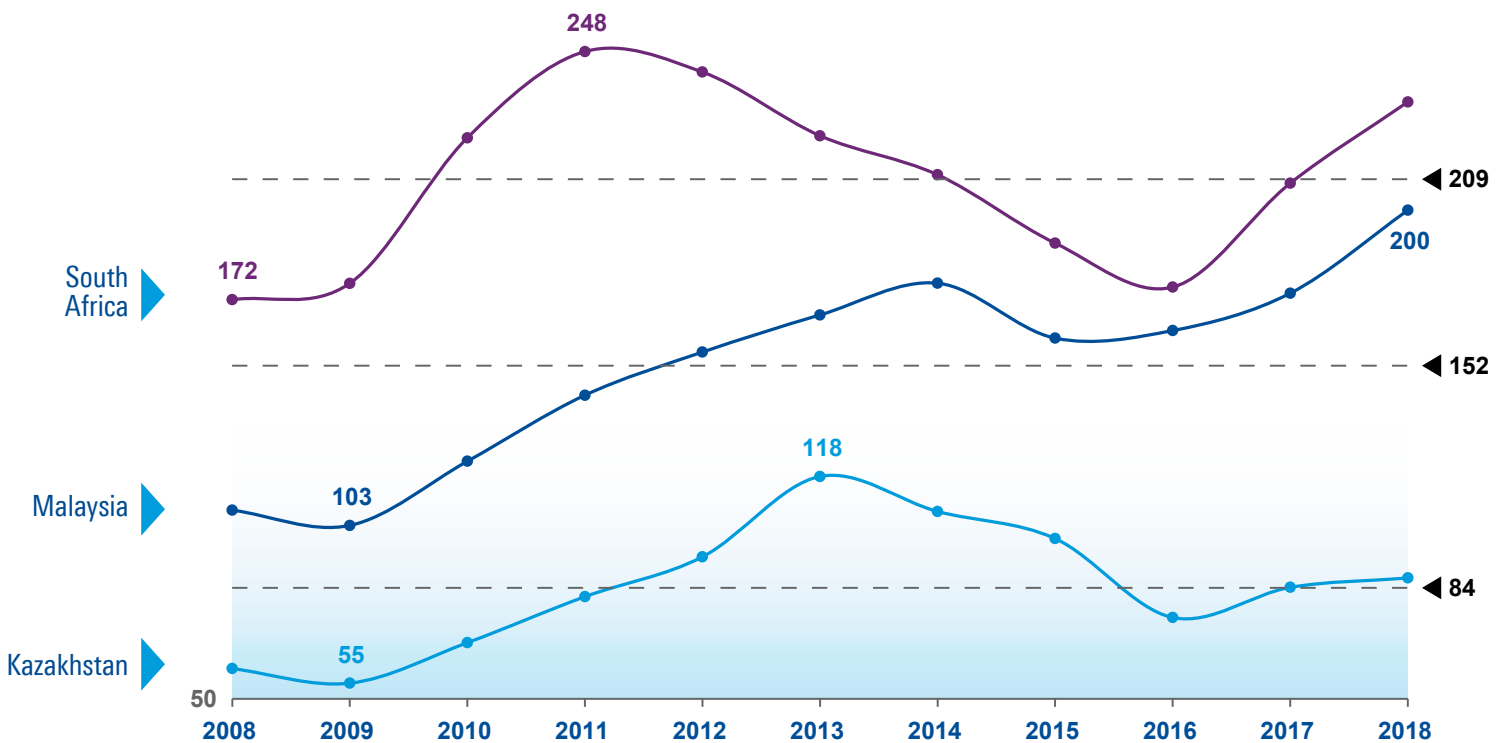
The annual average growth rate of consumer spending in Kazakhstan was 5%, with a forecast growth rate of 4% until 2023⁶.

Thus it can be concluded that the domestic market in Kazakhstan is rather small compared to domestic markets in developing countries.

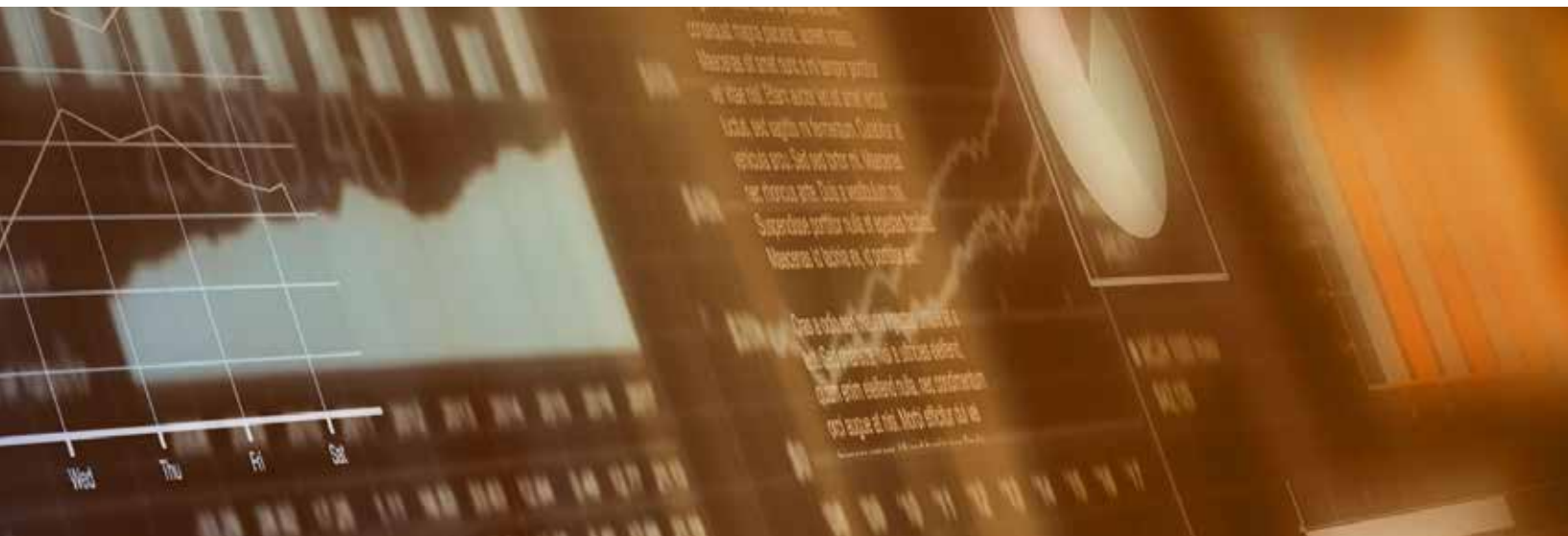
⁶The Economic Intelligence Unit (EIU)

⁷The Economic Intelligence Unit (EIU)

Figure 4. Consumer spending volume dynamics, USD billion⁷



Note: Consumer spending comprises food and non-food goods, paid services, and administrative expenses on life insurance and pension savings



From external debt of banks to intercompany debt.

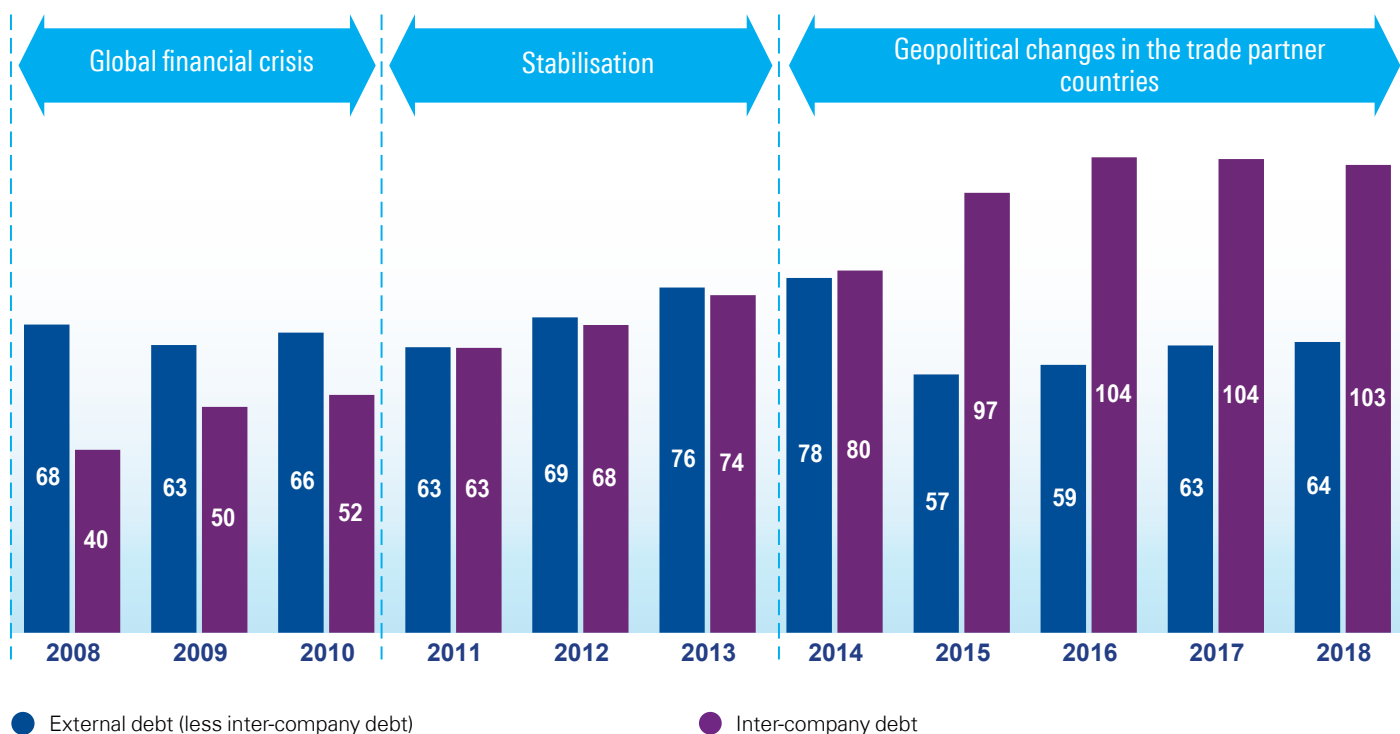


The total external debt volume during 10 years has been growing steadily.

The main cause of this growth has been a rise in intercompany debt (which relates to the implementation of oil and gas projects by the branches of foreign

companies), and increasing levels of debt to direct investors relating to unpaid dividends and interest on loans.

Figure 5. External debt and intercompany debt dynamics, USD billion⁸



⁸NB RK

Note: Intercompany debt comprises all foreign direct investments in the Republic of Kazakhstan, with the exception of share purchases, contributions to the charter capital of non-joint-stock companies, and reinvested profit and the liabilities of Kazakhstan's entities to their overseas branches, subsidiaries, and associates

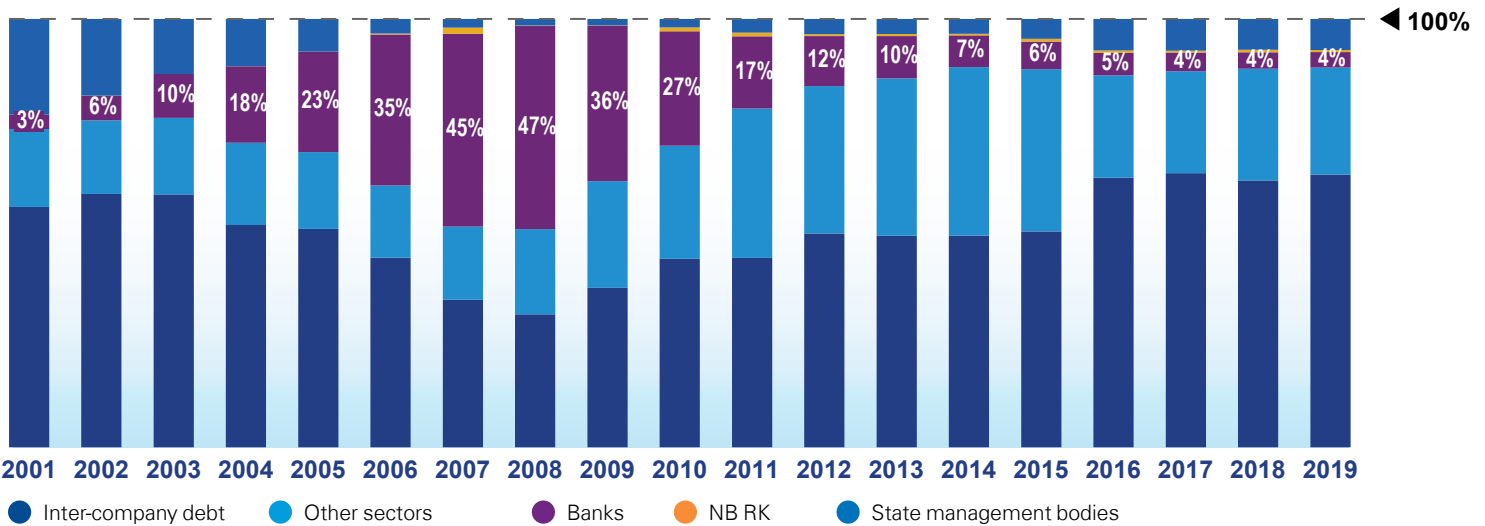
If the external debt structure is looked at in more detail, one sees that since 2008 the indebtedness of second-tier banks began declining gradually, due to the manifestation of the global financial crisis. Thus while in 2008 the total debt of Kazakhstan's banks stood at 47% of external debt, in 2018 this indicator was as low as 4%. A reduction in bank debt was achieved through restructuring measures and debt repayments, with state assistance.

Debt instruments prevailed in the structure of foreign direct investments.

Foreign direct investments (FDIs) are less exposed to sudden outflows than other types of investments. Therefore, FDI inflows are an important component of sustainable economic growth. Observing FDI inflow dynamics in Kazakhstan, one sees that from 2005 their volume has increased by 169%, with the average annual growth rate

being 39%. In general, over the past 10 years the volume of FDIs has been at the level of \$22.5 billion per year, having risen by 14%, from \$21.3 billion in 2008 to \$24.3 billion in 2018. FDIs as a share of GDP stood at 13% annually, while in emerging markets the indicator was 20%¹⁰.

Figure 6. Structure of external debt dynamics⁹



Notwithstanding the 2008 crisis, FDI inflows continued to increase, but at much lower rates: the average annual rate before 2012 was 8%, and in 2012 FDIs achieved a peak of \$28.9 billion for the period 2008–2018. FDI inflows began falling in 2013, and by 2015 the volume of FDIs was at an all-time low for the period, of \$15.4 billion. Such

fluctuations were due to the internal and external factors described above: commodity price volatility, a devaluation of the national currency, and geopolitical changes in the region.

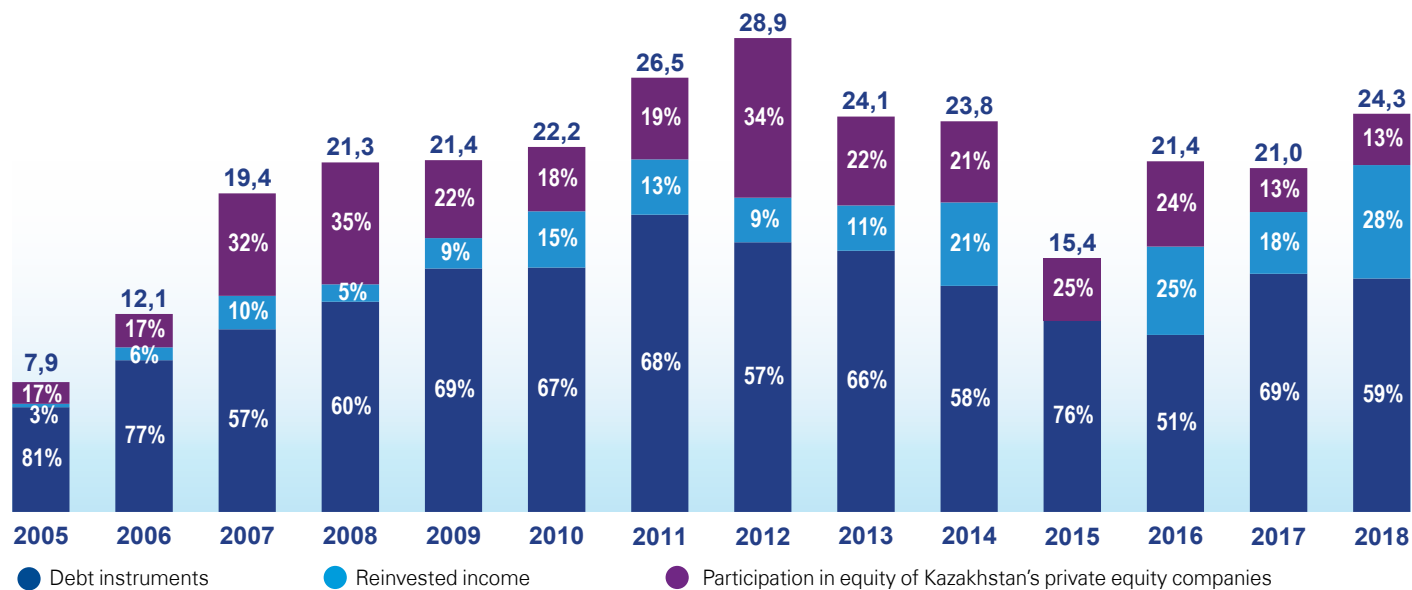
The share of debt instruments in FDIs was at a persistently high level, while the share of investments in the equity

of Kazakhstan's companies almost halved on a year-on-year basis. The main recipients of FDIs in Kazakhstan are service sectors associated with the oil and gas and mining industries.

⁹ NB RK

¹⁰ "Rebalancing finance", EBRD Transition Report 2015–2016

Figure 7. Foreign direct investment dynamics, USD billion¹¹



¹¹ NB RK



1.2 DISTRIBUTION OF WEALTH



The public sector still occupies a high share of the economy of Kazakhstan. It is planned for this share to be brought to the level of OECD states by 2020.

Kazakhstan, like many other post-Soviet states, is still characterised by having an uneven distribution of wealth between the public and private sectors.

All data related to the public sector share in the economy are estimates, as no official statistics are published. As the experts noted, assets owned by public and quasi-public structures account for around 60% of GDP.

The high concentration of the public share in the economy creates numerous issues in many sectors, in particular the finance sector: the largest public companies receive funding from the state and quasi-public sector not on arm's length terms, and this limits the operations of second-tier private banks.

The need to make significant investments in many enterprises has become a driving force behind the government privatisation programme. Under a comprehensive privatisation plan, the share of the public sector in Kazakhstan by 2020 should be reduced by a further 15%¹², to the level seen in OECD states.

¹² Targets. Comprehensive Privatisation Plan for 2016–2020



A small group of high-net-worth Individuals play an important role in the private segment.

While transitioning to the market economy, with its attendant accelerated privatisation processes, public assets were not evenly distributed over 27 years.

The capital distribution shown in Figure 8 shows the structure of the economy of Kazakhstan where **the high-net-worth Individuals** and the companies they own – so-called business conglomerates/family offices – hold a large share. Thus according to Credit Suisse data, the top-50 richest businesspersons in Kazakhstan own 42% of the total wealth of the adult population, or 16% of nominal GDP. As the figure shows, in Kazakhstan 0.001% of the population, or 162 persons, are worth more than \$50 million, which equates to around

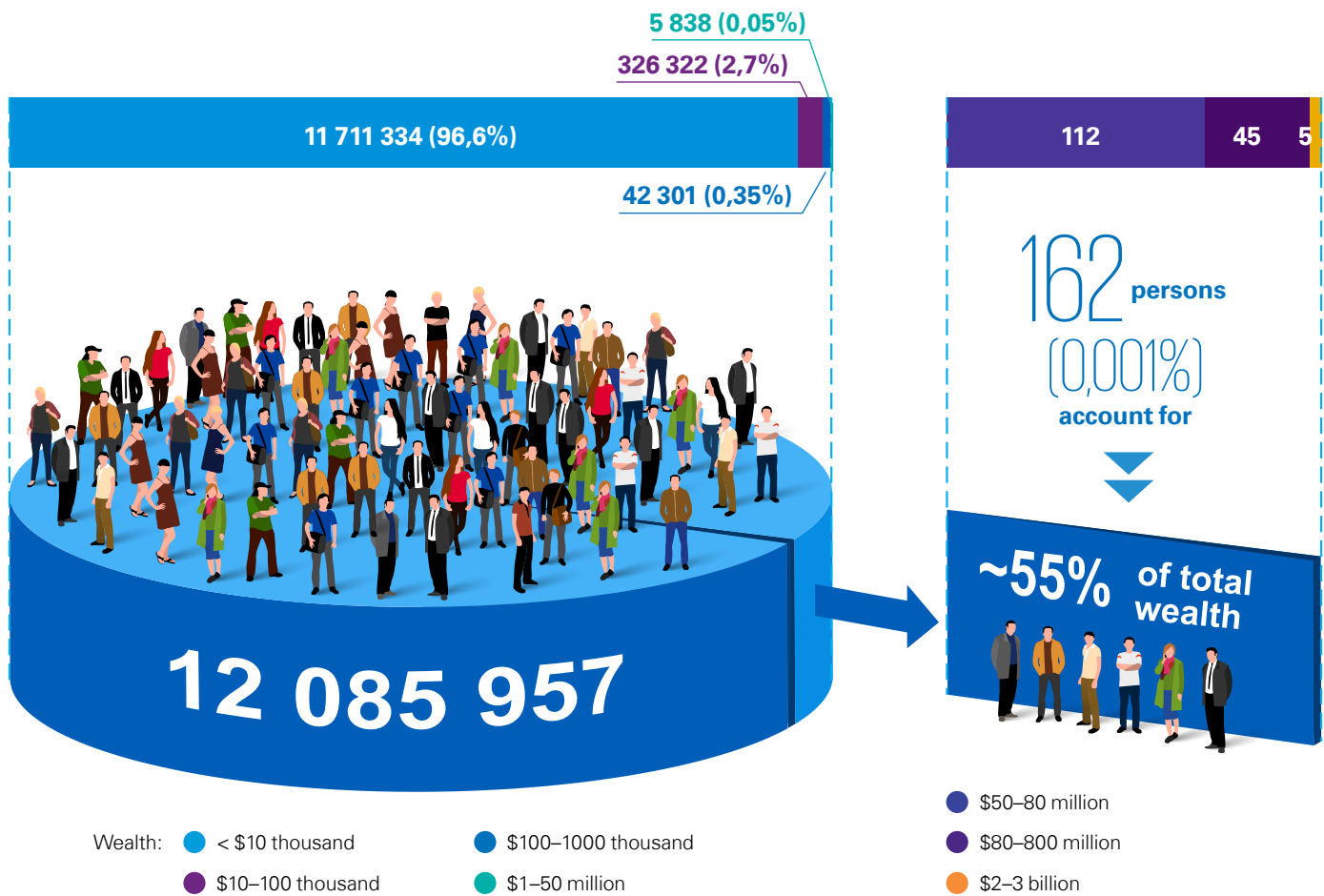
50% of the total wealth of the population¹³.

Adults worth between \$10 thousand and \$1 million account for around 3% of the population, while the average value of this indicator in Ukraine and Belarus is 1%; in Indonesia, Turkey, Russia, and Brazil 20%; the Asia-Pacific Region 26%; worldwide 35%; and in such developed economies as the US and the UK 71%. A non-uniform distribution of wealth can be seen in a number of post-Soviet states, which is due to various factors, including the fact that private property has existed for a relatively short period.

¹³ Data of Credit Suisse Research Institute: Global Wealth Report 2018, Forbes, KPMG analysis



Figure 8. Adult population of Kazakhstan in 2018 broken down by level of wealth (number of persons)¹⁴



¹⁴ Data of Credit Suisse Research Institute: «Global Wealth Report 2018», Forbes, KPMG analysis

Currently Kazakhstan has a small middle class, and this limits the economy in terms of domestic consumption potential, competition, and stock market liquidity. The government is taking measures to change the situation; in particular, through actively supporting the development of small-and medium-sized enterprises (SME) and implementing the People’s IPO programme.

1.3 SOURCES OF BUSINESS FUNDING

Structure of business funding



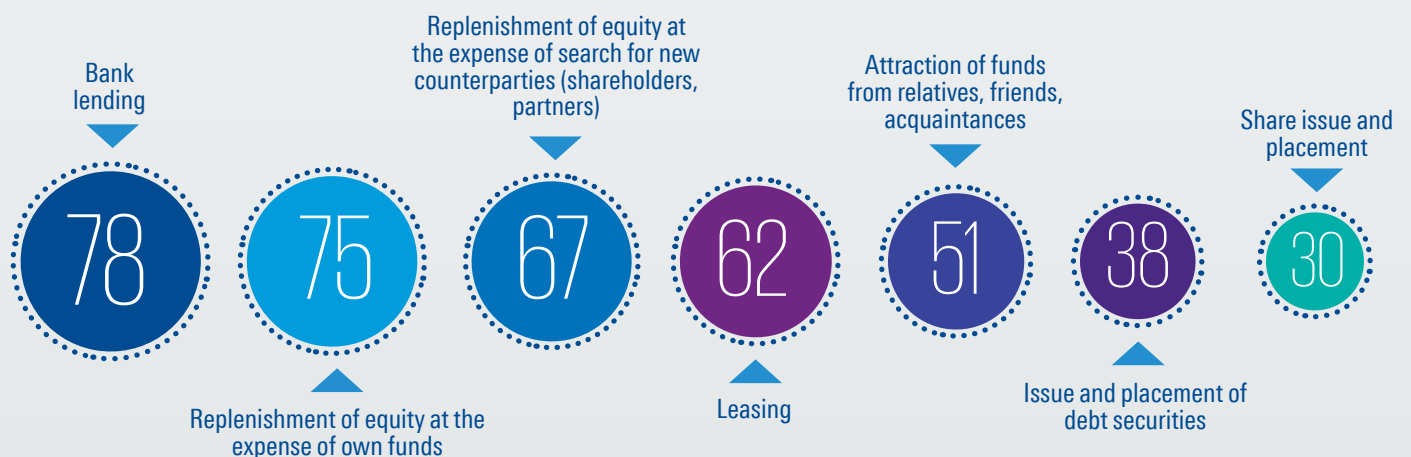
Our survey of the business community¹⁵ demonstrated that bank lending is the most preferable source of funding.



Capital replenishment at the expense of own funds or through searching for new partners (shareholders) in the market are the next most popular methods of business funding in Kazakhstan. Issues

and placements of debt securities and shares on the stock exchange were the least popular source of funding among the respondents.

Figure 9. Business community preference rates by sources of funding¹⁶



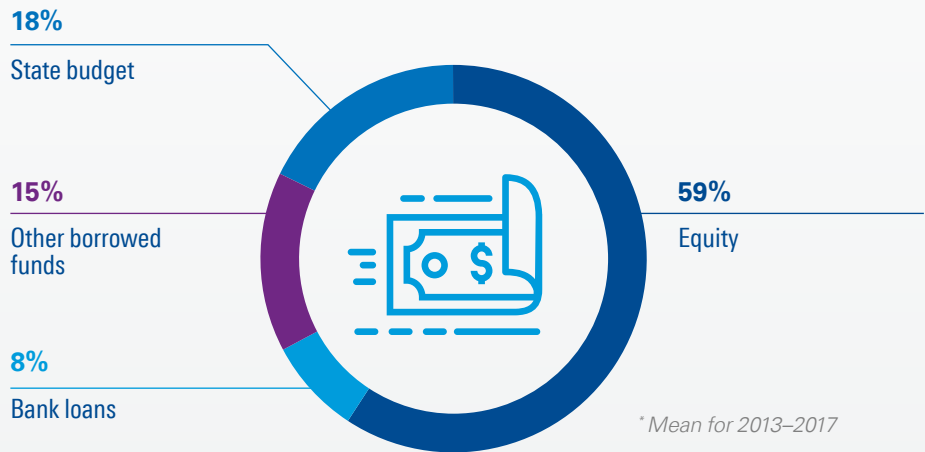
Note: The values are preference rates derived by using the scaling method, where 100 is the maximum value and 1 is the minimum value

¹⁵ Over 100 respondents from the Kazakhstan's business community participated in the PE market survey (see the Methodology section)

¹⁶ Results of the Kazakhstan's business community survey on the PE market

However, as can be seen from Figure 10, bank loans have the smallest share (8%) in the structure of fixed investments as businesses mainly attract borrowings from second-tier banks (STB) to replenish working assets.

Figure 10. Sources of funding of fixed investments*¹⁷



State of the banking sector



A trend is being seen towards a reduction in the role of bank lending in the economy.

Over the past 10 years, the role of the banking sector in funding economic growth in Kazakhstan has been gradually decreasing, as growth in the volume of bank lending was not proportionate to GDP growth during this period. In 2018 bank lending accounted for 21% of GDP, while in 2008 it was as high as 46%. This value is low compared to developed economies; for example, as at the end of 2016 the indicator was 48% in Russia, 150% in Singapore, and 182% in Germany. Worth noting is that at the beginning of 2019 SME loans amounted

to 33.2% of banks' loan portfolios (at the beginning of 2018 the figure was 34.3%), i.e. there was a decline of 2.1 percentage points from the beginning of 2018. Growth in the loan portfolio in recent years has mostly been attributable to the consumer lending segment.

During the post-crisis period a fall in the volume of bank lending was observed in a number of countries, due to a number of factors, including higher credit risks and a deterioration in the loan portfolio.

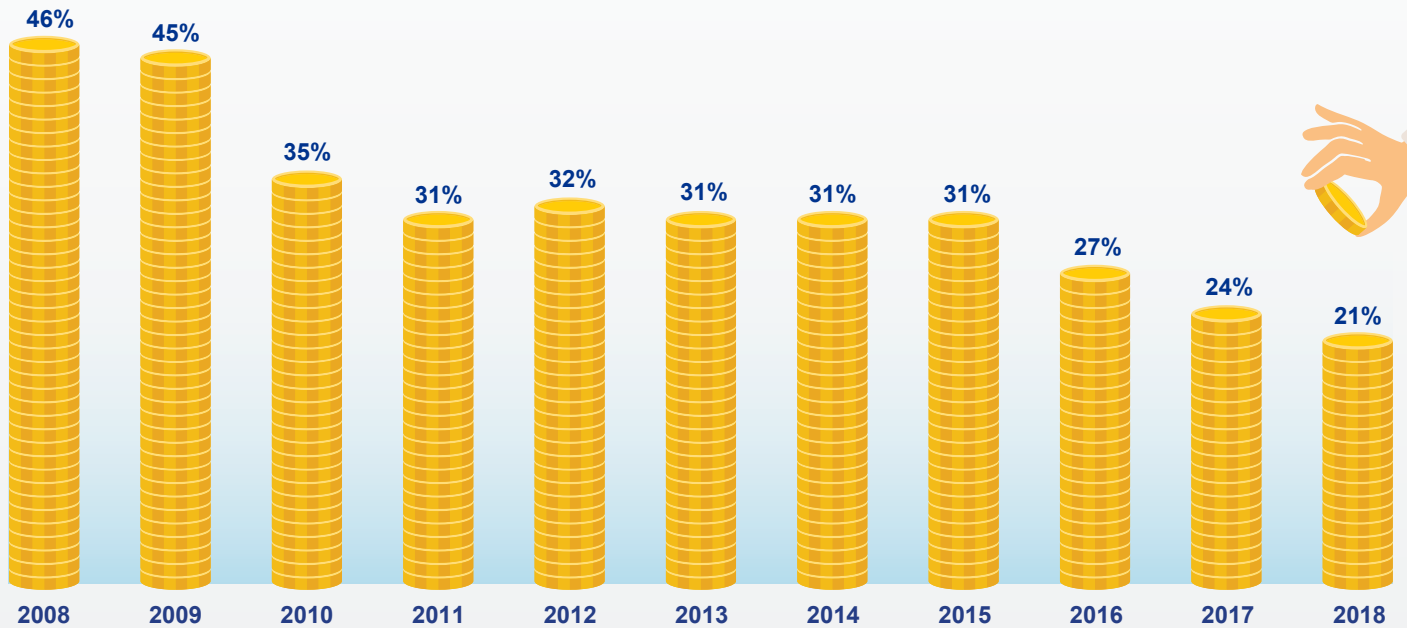
¹⁷ Statistics Committee of the MNE RK

The main reasons behind the sharp fall in bank lending volumes over 2008–2010 are the following:

- 1 restructurings carried out by banks and writing non-performing loans off-balance sheet
- 2 banks experiencing difficulty in refinancing external borrowings
- 3 a conservative lending policy on the part of banks in relation to risk appetite, against a backdrop of uncertainty over economic expectations
- 4 a slowdown of the GDP growth rate in the country
- 5 a decline in personal incomes
- 6 loan insolvencies in the real sector of the economy and among the public
- 7 a high level of substandard loans in banks' portfolios



Figure 11. STB loans as % of GDP at the end of the period¹⁸



Over 10 years there has been a process of banking sector consolidation and rehabilitation.

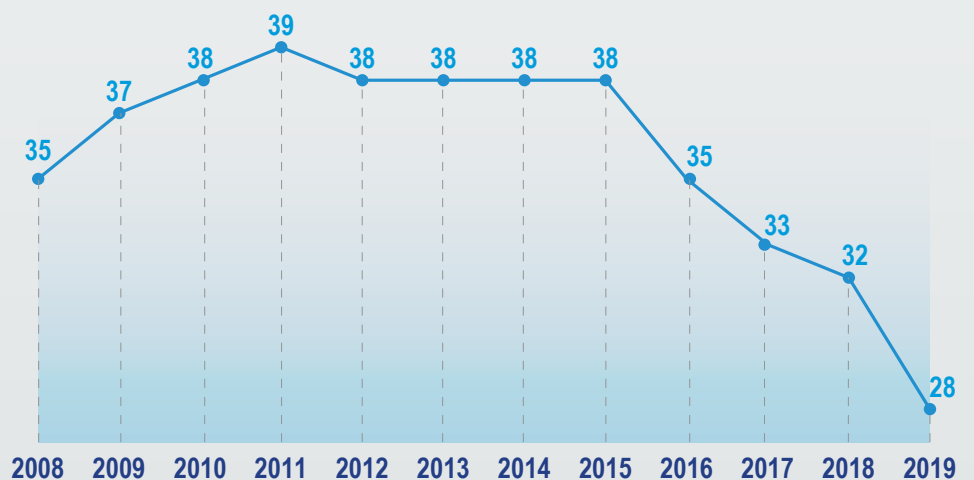
Astana, Eximbank, Qazaq Bank, and Delta Bank. A number of large bank mergers took place; for example, in 2014 Qazkom merged with BTA Bank, and Temirbank merged with Alliance Bank and ForteBank. In 2018 key events in the banking sector included: an additional accrual of provisions and the write-off of previously concealed troubled loans,

the Qazkom merger with Halyk Bank, and support given to Tsesnabank¹⁹. Thus by 1 January 2019, 28 banks had been registered in Kazakhstan, of which 14 had foreign participation, including 12 subsidiary banks. The top-5 largest banks account for 64% of banks' total assets.

With the onset of the global financial crisis, access to external funding for Kazakhstan's banks became limited. Moreover, the low quality of banks' loan portfolios gave rise to a critical situation vis-à-vis paying capacity; a number of Kazakhstan's financial institutions defaulted on their liabilities (including BTA Bank, Temirbank, and Alliance Bank.)

Nevertheless, during 2008–2011 the number of second-tier banks rose from 35 to 39. However, since 2011 the number of banks has been steadily declining. Some banks' licenses were revoked and some banks were liquidated/are in the process of being liquidated: in 2011 Credit Altyn Bank, and in 2018 Kazinvestbank, Bank of

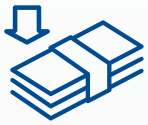
Figure 12. Number of banks in Kazakhstan²⁰



¹⁸ NB RK, Statistics Committee under the MNE RK

¹⁹ In February 2019 Tsesnabank was repurchased by the investment Group First Heartland Securities and subsequently consolidated with First Heartland Bank. The new name of the consolidated bank is Jysan Bank.

²⁰ NB RK



The level of NPLs in the economy fell significantly, due to the implementation of a bank system rehabilitation programme.

Dynamics in the level of non-performing loans²¹ (NPL) in Kazakhstan since 2008 reflect aggressive credit expansion since 2000, when commercial banks had wide access to funding, while standards for assessing borrowers' creditworthiness were rather weak. Based on NB RK data, the historical NPL indicator reached a peak during the period from 2012 to 2015 and stood at around 30%; as at the beginning of 2019, NPLs accounted for 7.4% of the loan portfolio. A decline in the number of overdue loans was due to measures taken by commercial banks as part of the Concept of Kazakhstan Financial Sector Development up until 2030 to reduce the level of problem loans. Also in 2012, the Government of the Republic of Kazakhstan established the Fund of Problem Loans, whose main activity is to repurchase problem loans from second-tier banks and the management of repurchased assets. The principal operations of the Fund are

as follows: taking on Bank of Astana's liabilities of \$257.6 million to Astana LRT; placing special-purpose deposits with STBs under the refinancing programme of residential mortgage loans/mortgage loans, in the amount of KZT126.4 billion; the conditional funding of Qazkom, in the amount of KZT250 billion; the purchase of an agricultural loan portfolio worth KZT604 billion from Tsesnabank; and a buyout of BTA Bank's assets for KZT2.6 trillion.

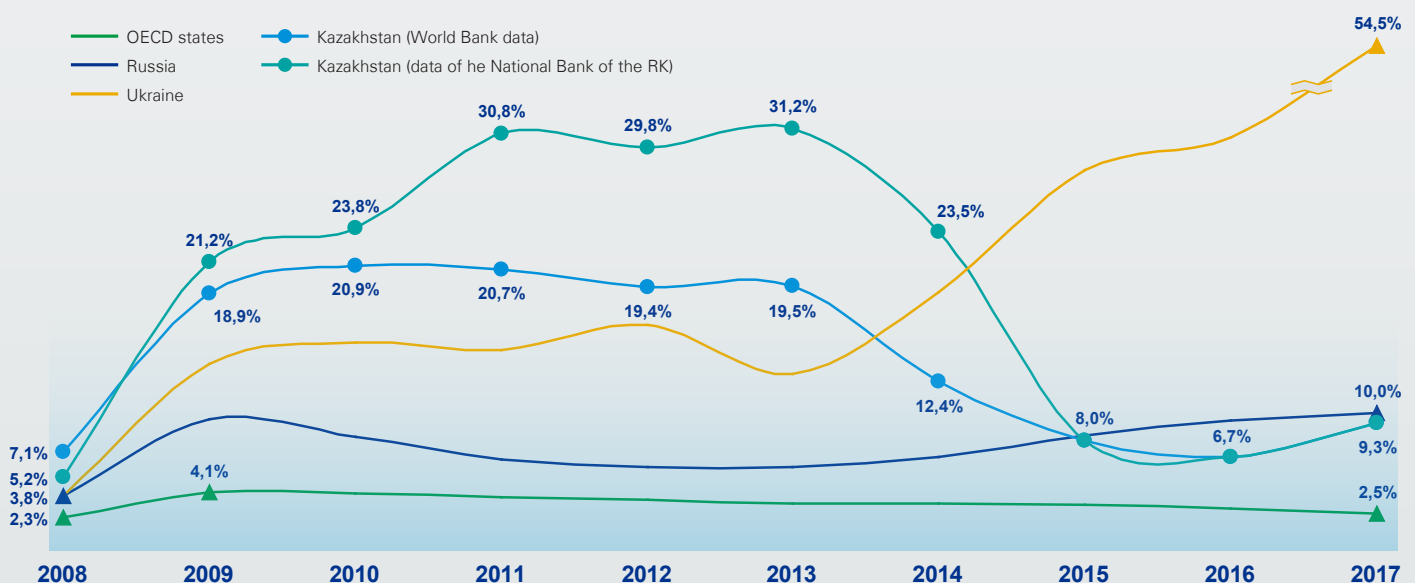
At the same time, compared to developed economies the NPL level in Kazakhstan remains high (see Figure 13). A similar situation is observed in Ukraine, where the share of NPLs accounted, on average, for ~21% of the loan portfolio over the past 10 years, while in 2017 this proportion reached a record of 54.5%. Such high levels of NPLs have not been observed in OECD states, where the maximum was achieved in 2009, after the crisis,

and stood at 4.1%; in this regard, the average level since 2008 has been ~3.3%. In Russia the level of NPLs for the period of analysis did not exceed ~10%.

Supportive measures and restructurings of banks, as well as clearing banks' balance sheets of problem loans, are intended to foster a recovery in lending in the economy and reduce interest rates on corporate loans.

Decreasing the share of distressed assets on the balance sheets of second-tier banks is only a partial solution to the issue – accumulated amounts of distressed assets have moved to other legal structures; however, there is now the issue of effectively managing and restructuring liabilities, which is a promising area for investors, including funds for distressed asset management.

Figure 13. Non-performing loans as % of total gross loans²²



²¹ NPL past due for more than 90 days (% of loan portfolio)

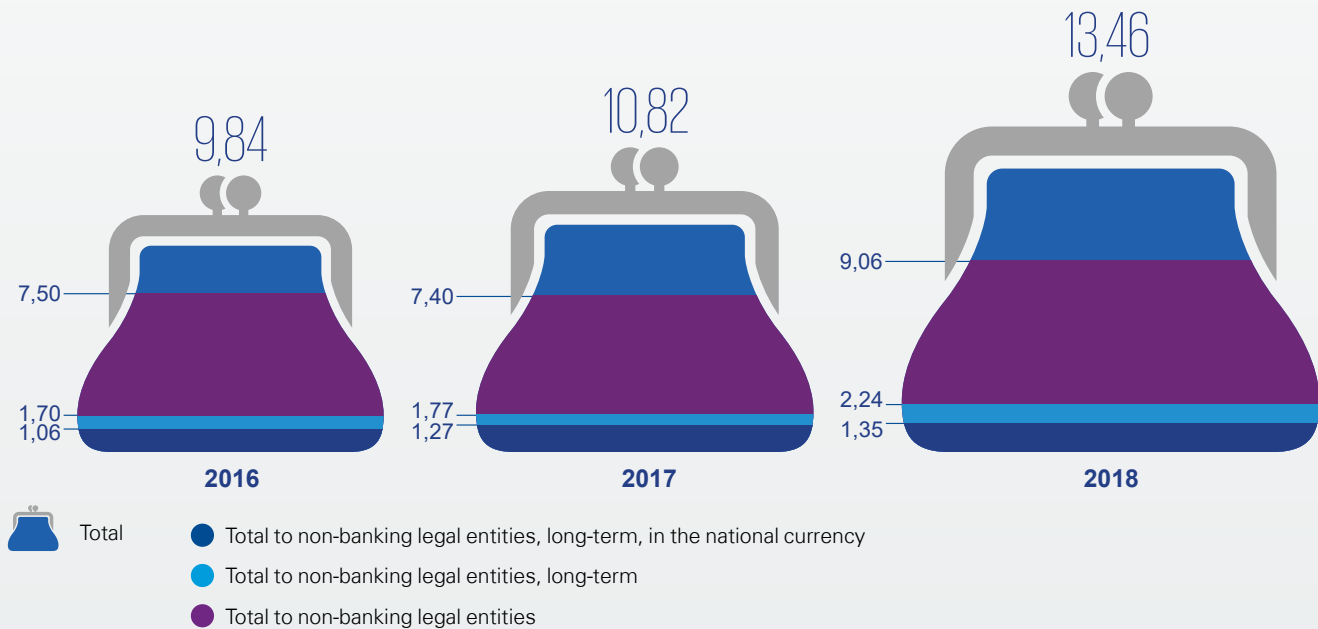
²² World Bank, IMF



A share of newly issued long-term loans²³ to businesses is at a permanently low level relative to the total amount of loans issued. Government programmes are the key driver behind this.

In recent years the proportion of long-term loans out of total newly issued loans has been rather low. In 2018 long-term loans issued accounted for around 25% of the total amount of loans issued to non-banking legal entities (24% on average over three years).

Figure 14. Volume of loans issued by banks, 2016–2018, KZT trillion²⁴



²³ Usually a long-term loan is used as investment capital. According to the NB RK, a long-term loan is a loan issued for a period of more than one year

²⁴ The mean for 2013–2017. Statistics Committee of the MNE RK.





The subsidising of interest rates and other government programmes enable business to raise capital at low interest rates, while market interest rates remain rather high.

The banks' average weighted interest rate on tenge-denominated loans to non-banking legal entities varies from 10% to 16.1%. High interest rates are an economic and market reality. The key reasons for high interest rates are the following:

- Relatively high inflation. When inflation is high, depositors and creditors have no interest in placing money in banks and in bank bonds if the interest rates they are offered do not cover the inflation rate and attendant risks. At the same time, banks may not set interest rates on loans below the cost of their own funding.

- High credit risk vis-à-vis borrowers. The level of non-repaid loans is far higher in Kazakhstan than in developed economies.
- The “Long” funding base of the banks is limited and loans are mostly short term in nature.

When analysing interest rate dynamics over the past 15 years, it can be seen that the indicator has never been much lower than its current level, even during periods when the economic conditions in Kazakhstan were the most favourable and banks' loan portfolios were growing rapidly (2006–2007).

Figure 15. Average weighted interest rates of Kazakhstan's banks on loans to legal entities (%) as at December 2007–2018²⁵



²⁵ NB RK. Data as at year end



The funding base of banks is today predominantly short term in nature.

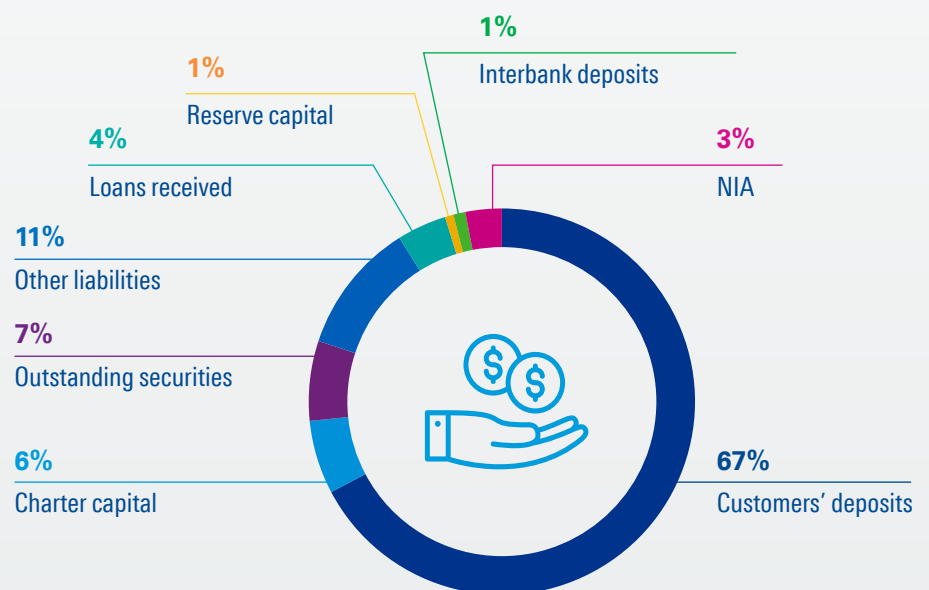
67.5%

Currently, customer deposits account for 67.5% of total liabilities in the funding structure of the Kazakhstan's banking sector, while loans received account only for 4.1%.

In Russia, for example, customer deposits account for 59.7% of total liabilities. The NB RK cites the dependence of banks on large depositors (around half of liabilities undertaken by banks is due to the 25 largest creditors) as being a vulnerability, as well as non-stable funding. Liquidity issues could be created if only a few of these customers withdrew their deposits. The prevalence of the deposit base in the funding structure is explained to some extent by the fact that the population has no better alternative to place free funds, in view of the high interest rates on deposits and due to the fact that bank deposits can be guaranteed. Also, banks today are practically unable to attract long-term financing from foreign creditors at acceptable interest rates.

At present the Kazakhstan banking sector is experiencing difficulties, due to a lack of cheap sources of funding (with the exception of funds allocated as part of implementing state business support programmes), and banks still have a high proportion of overdue loans in their portfolios. Hence loan interest rates remain high if state support is not taken into account.

Figure 16. Structure of total liabilities, Kazakhstan's banking sector, 1 January 2019²⁶



Note: NIA – Net income accrued

The government is taking measures to rehabilitate the banking and corporate sectors, and funds are allocated through banks to implement favourable lending programmes and to subsidise interest rates

According to the experts, the reasons why the financial aid to banks has not resulted in a full credit rehabilitation are as follows:

- The high cost of borrowed funds. As banks have no access to cheap foreign credit, the bulk of liabilities is created in relation to tenge-denominated deposits; moreover, deposits from individuals with

interest rates of 10-11% are playing an increasing role. The basic interest rate was also high, due to persisting expectations over inflation; however, in April 2019 the basic rate was reduced to 9%;

- Government intervention in the lending process through the implementation of state programmes. In a number of cases, funds are allocated to poorly performing companies that would have been unable to raise capital on market terms.

²⁶ NB RK

Stock market



The key liquidity providers in the Kazakhstan's securities market are UAPF and STBs.

1. Unified Accumulative Pension Fund (UAPF)

8.4 trln tenge

Pension assets invested in securities amount to KZT8.4 trillion (14% of GDP). For reference, in 2017 this indicator in Kazakhstan was 11.5%, while it was 2.6% in Turkey, 10.1% in Poland, 10.5% in Norway, 72% in Chile, and 105.3% in the UK²⁷. In this regard, Kazakhstan's Government securities account for ~47% and the non-government securities of Kazakhstan's issuers 33.1%.

2. Banking investment companies

5.4 trln tenge

STB assets invested in securities totalled KZT5.4 trillion. Investments in Kazakhstan's government securities accounted for over 70%, while investments in non-government securities of Kazakhstan's issues accounted for over 13%.

3. Insurance companies

615 bln tenge

The assets of insurance (reinsurance) organisations invested in securities totalled KZT615 billion. In this regard, 31.8% of assets were invested in government securities and 42.8% in Kazakhstan's non-government securities.

4. Investment funds and professional market players

191 bln tenge

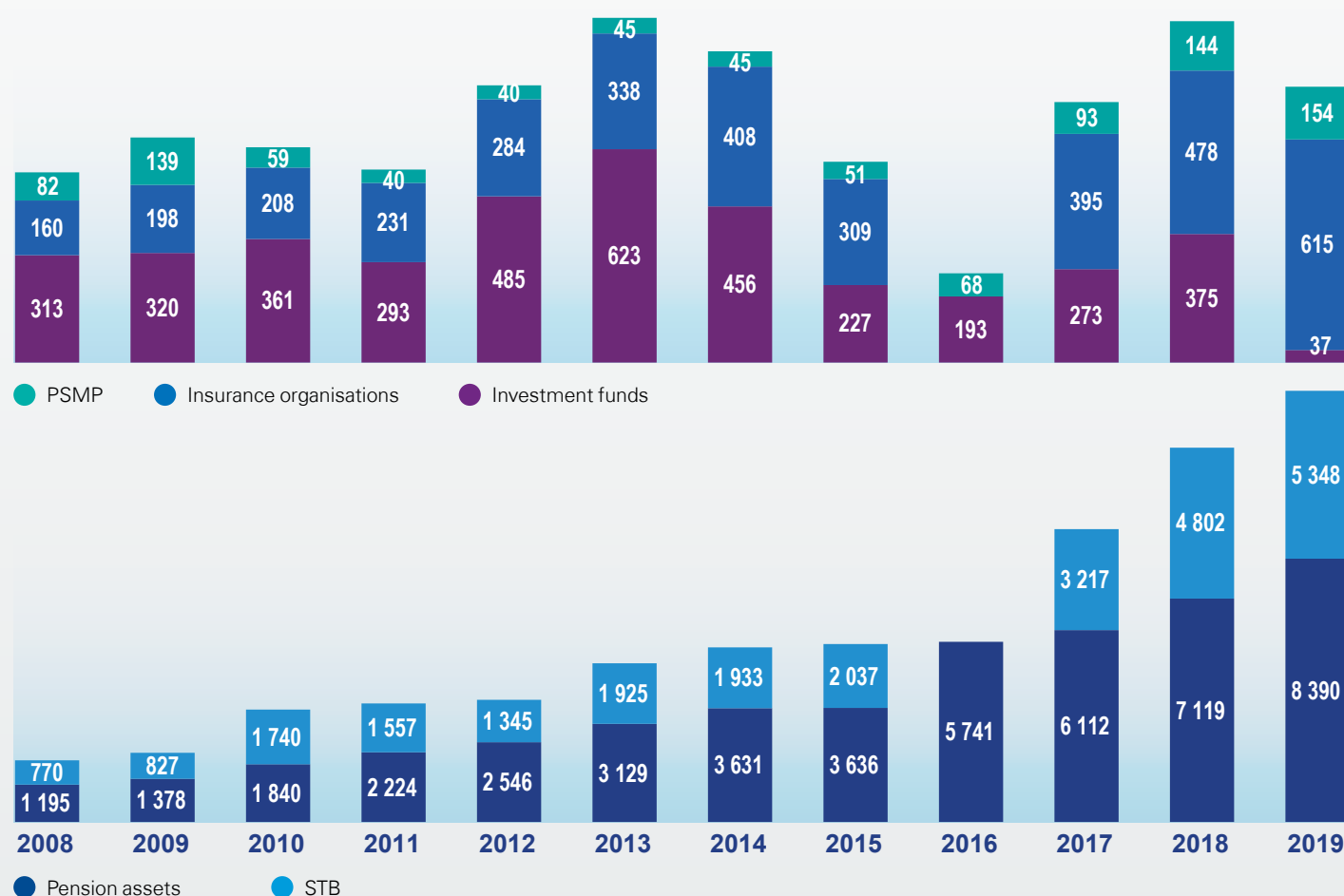
Investment funds and professional market players invested KZT27 billion and KZT154 billion in securities, respectively.

²⁷ Pension Fund Market, 2018. OECD Annual Report



The proportion of individuals involved in the stock market is very low. Only about 0.7% of Kazakhstan’s citizens have broker accounts with the Central Depository, while in Russia the figure is 1.3% and in the US it is 51.9%. The share of the population holding accounts with broker companies is also low.

Figure 17. Assets invested through the stock market (KZT billion), 1 January²⁸



²⁸ NB RK (no data is provided for insurance organisations and STBs for 2016)

Note: PSMP – professional securities market players

 The market is seeing a declining trend in profitability from broker-dealer businesses.

As the experts observed, the unification of all private pension funds into the UAPF has been a key factor behind declining profitability. The consolidation of pension assets in the UAPF has resulted in a sharp fall in liquidity and a reduction in the number of transactions on the Kazakhstan’s stock market. The UAPF adopts a conservative strategy and invests mostly in state securities and securities issued by quasi-public sector companies; it also provides support to the banking sector through purchasing

the bonds of certain large Kazakhstan’s banks.

The profitability of broker firms has also been impacted by a toughening of the NB RK’s requirements related to the investment portfolios of insurance companies, banks that are a key institutional investor in the Kazakhstan’s stock market, and large customers of broker-dealer companies.

1.4 KAZAKHSTAN IN THE RATINGS

Kazakhstan is considered a frontier market among developing economies. Since 1998 the country has attained good results:



**in terms of GDP
per capita**



**in terms of nominal
GDP**

In 20 years Kazakhstan, in terms of GDP per capita at purchasing power parity (PPP), has climbed 20 positions, from 78 to 58 in the rankings, lagging behind Russia by only four places, and only one place behind Turkey. Meanwhile, countries such as Belarus, Azerbaijan, Ukraine, and Uzbekistan are ranked 70, 79, 117 and 126, respectively. Such rapid growth was observed in a small number of countries; for example, Ireland moved up 19 places (from 25 to 6), Hong Kong 18 places (from 29 to 11), Taiwan 21 places (from 38 to 17), and South Korea 15 places (from 47 to 32).

In terms of nominal GDP (in USD) Kazakhstan improved its standing by 12 places: from 68 in 1998 to 56 in 2018. Other countries that managed to grow significantly in GDP volume terms were Indonesia (+20), Saudi Arabia (+12), UAE (+16), Iraq (+39), and Qatar (+36).



In the past year Kazakhstan's ranking in international ratings has fluctuated. In most cases, Kazakhstan occupies above-average positions. In 2017–2018 the country was downgraded slightly in a number of ratings. However, in Doing Business 2019, published in October 2018, Kazakhstan was ranked 28 out of 190 economies, improving its position by eight positions compared to 2018 (when it was ranked 36).

Figure 18. Kazakhstan in international ratings



Kazakhstan is working aggressively to foster a favourable investment climate in the country and to attract foreign investors. To this end Astana Hub, an international technopark of IT start-ups, has been established. To develop the financial market and boost the investment attractiveness of Kazakhstan, the Astana International Financial Centre was launched, which is operating under a special legal system.

Private equity as a source of sustainable economic growth



2.1 Private equity



2.2 Value of PEFs for business



2.3 From debt to equity: sustainable growth through diversifying the structure of an economy's financing



2.4 Classic PEFs and PE specifics in Kazakhstan

Sustainability is a cornerstone of state and business development, and events such as the global financial crisis serve as another reminder of this fact. A key indicator characterising business sustainability is the debt-to-equity ratio. Thus if the debt-to-equity ratio is high, companies usually experience difficulties in securing debt and in taking out additional loans, while a low debt-to-equity ratio indicates that the company is missing opportunities to increase the return on equity through effective financial leveraging²⁹.

Equity investments entail risk sharing between the business owners and the investor, as well as no requirement to provide collateral. However, the main positive factor of certain equity instruments (such as FDI and PE) comprises non-financial benefits.

At individual company level, PE investments afford access to new technologies, the experience and expertise of investors, and increase the likelihood of attracting debt financing, including bank loans and leasing options. In global practice many companies that are leaders in their industries have received funding from PEFs at key development stages; for example, Apple, Starbucks, Versace, Yandex, Tinkoff Bank and many others.

Global experience shows that PE plays an important role in the economies of both developed and developing countries.

At the macro level, PE development in emerging markets promotes improved performance, technological developments, and higher employment rates³⁰.

As it is very important from a financial stability viewpoint to attain an optimal balance between debt and equity at company level, one of the key objectives for the government is to rehabilitate the banking sector, including through recovering distressed assets and stimulating equity investments in Kazakhstan's companies.

The 2008 crisis was the result of an imbalance between debt and equity levels. The intensive growth in lending in Kazakhstan before the crisis resulted subsequently in a 30% level of unpaid loans in 2011, while in OECD states the figure was below 4.1%.

To increase the level of investment in Kazakhstan it is necessary to use a combination of debt and equity funding instruments. Thus while before 2006–2008 Kazakhstan saw a credit expansion, from 2005–2006 the government actively stimulated FDI inflows (since 2005 the amount of FDIs rose by 169%), and alternative funding instruments such as equity investments also received a boost (the Kazyna Capital Management

fund of equity investments was established in 2007). However, over the past 10 years the segment of alternative funding instruments was developing in an environment of economic instability: the financial crisis of 2008, anti-Russian sanctions, commodity price volatility, and, as a result, a devaluation of the national currency. As we demonstrate below in Section 4, the private equity segment in Kazakhstan remains underdeveloped.

²⁹ The essence of the financial leverage effect is as follows: the debt is almost always a less expensive source of funding than equity, as entering into equity implies big risks and, accordingly, these risks are provided for in the cost of equity; in addition, the interest expenses related to the debt are deducted from the tax base of a company, which makes the debt less expensive

³⁰ Rebalancing finance, EBRD Transition Report 2015–2016



2.1 PRIVATE EQUITY

In the diagram showing the communication scheme of investment ecosystem participants (Figure 19), the central link is businesses that have four key instruments³¹ to raise capital:

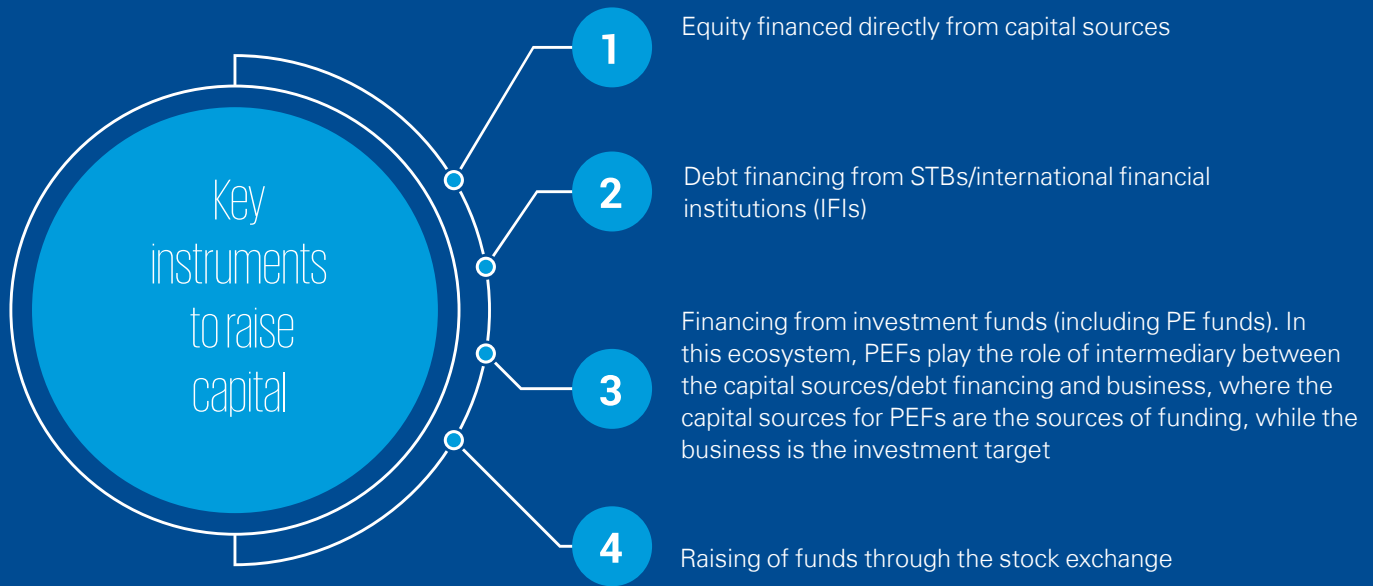
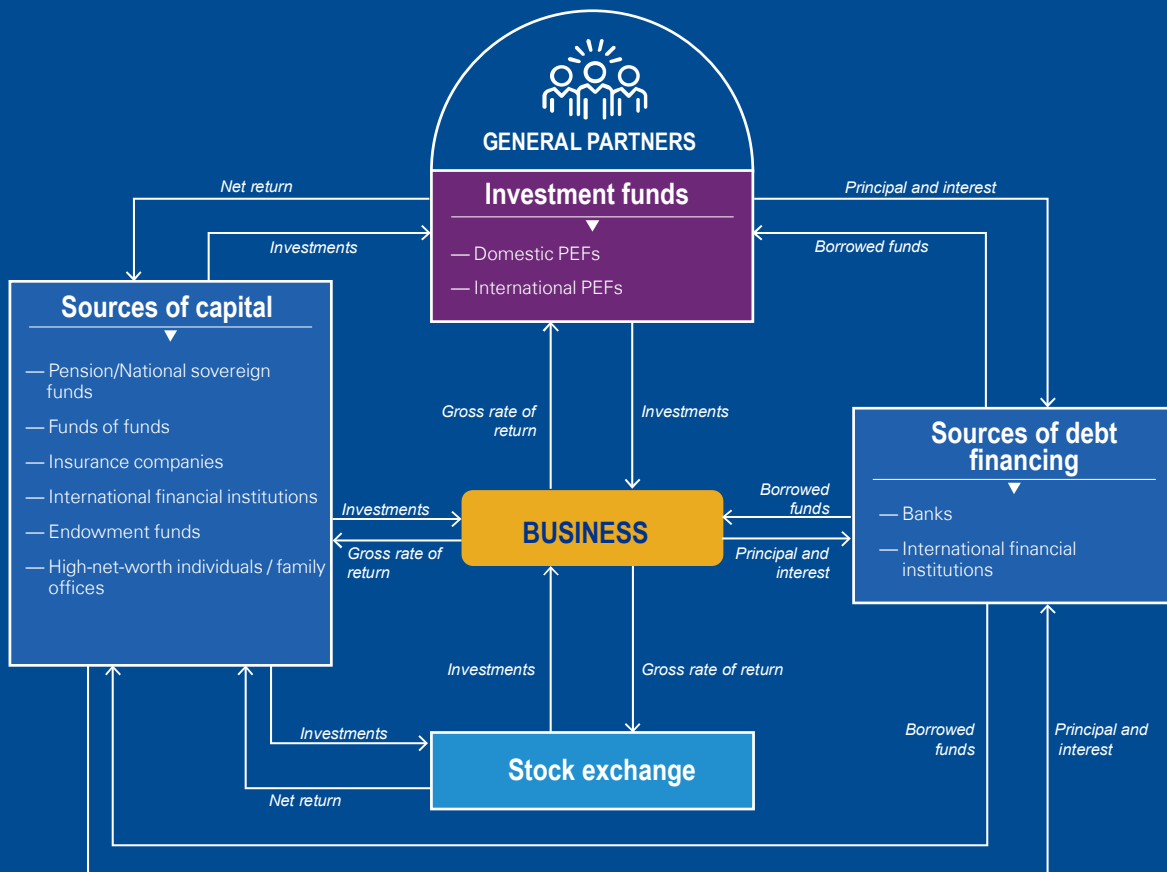


Figure 19. Communication scheme of key investment ecosystem participants, including PEFs³²



The communication scheme of key investment ecosystem participants clearly illustrates the difference between direct investments, where the investor earns a gross return, and classic private equity, where the investor earns a net return, taking into account the compensation of GPs and their share of compensation for management services.

The distinctive feature of private equity from the acquisition of shares in public companies and portfolio investments is a medium-term investment horizon and the degree of corporate control. The target of investors in public companies and direct investors is the same – to buy cheap and sell expensively/earn dividends, and the difference lies in the approach to attaining the final selling cost and its timing. Private equity funds,

as a rule, have certain rights to control a company and, hence, are involved in the management process. Thus a private equity fund is an active shareholder with a clear financial motivation to augment the company's capitalisation in the medium term. It is important to appreciate the value that GPs bring to a business's shareholders.

The value of classic PEFs consists of three key components:



The consolidation of funds of independent investors (usually these are institutional investors) to pursue a specific investment strategy;



GP competences: the ability to positively influence a company's value, with a view to its further sale;



Synergy with the fund's portfolio companies.



The private equity funding of a business is a 'precision-guided weapon' that should play a fundamental role in the sustainable development of a specific sector and finance precisely the 'tectonic shifts' in this sector.

Kairat Mazhibayev

Chairman of the Board of Directors of RESMI group of companies

Thus PEFs are financial structures whose capital is formed at the expense of the funds of private and institutional investors for further investment in the equity (or other equity-related instruments) of other companies, with the aim of building a project pipeline. PEFs as a rule make medium-term investments for a period of up to 10 years.

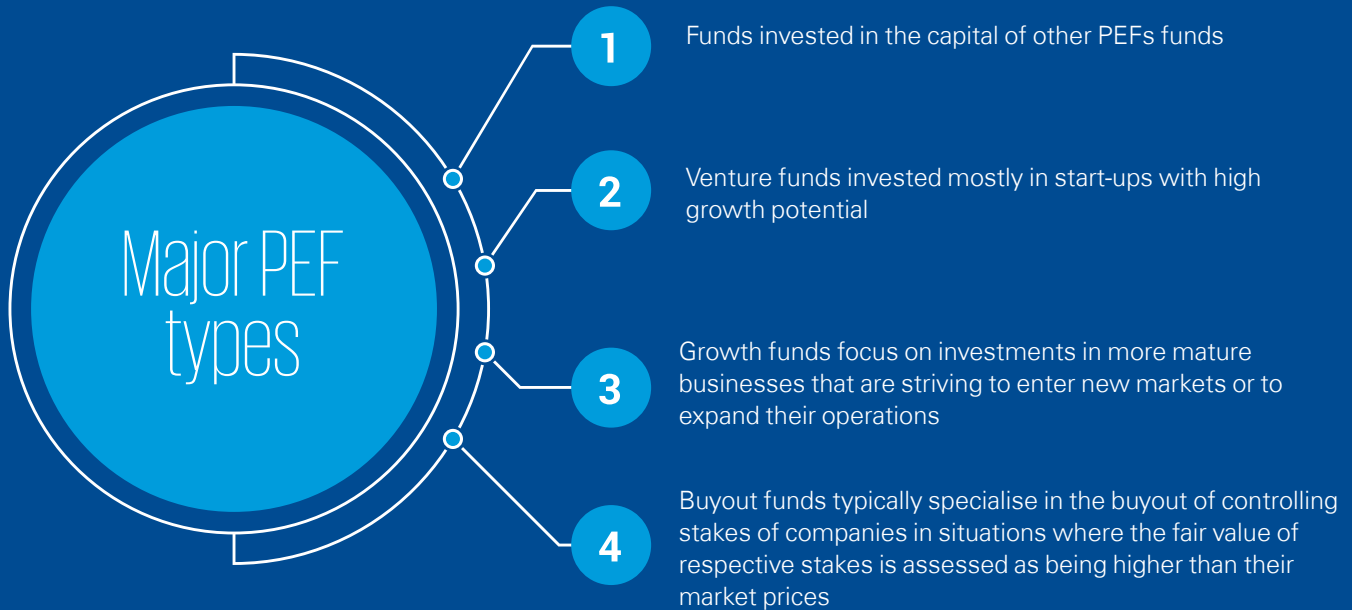
Funds are managed by general partners, or GPs. These shape PEFs strategies, establish the target size, and search for investment targets. To form PEFs, GPs raise capital from LPs, over a period of from one to five years, until the target fund size is reached; then the fund "closes" the fundraising period.

In a classic PEF model, a GP receives a remuneration of 1.5-2% of the total fund size during the investment period, 1.5-2% of the invested capital thereafter, and 20% of excess profit calculated based on the performance of the investment portfolio's management. LPs receive the remaining profit. In practice, many funds these days deviate from this classic pattern.

³¹ The scheme is not exhaustive

³² According to World Economic Forum data

Depending on the selected direction and investment strategy, PEFs are subdivided into a number of main types:



The strategies of many PEFs are aimed at the acquisition of stakes that facilitate the active involvement of management in a limited number of companies with growth potential (e.g. growth funds, buyout funds).

Alternative strategies comprise:

- The acquisition of minority interests in a number of start-ups (venture funds);
- Investments in companies experiencing financial difficulties, but which have a chance to recover their financial position and to increase their business value (buyout funds, including those focused on investments in distressed assets).

Equity investments are quite long term in nature compared to debt financing, and carry a higher risk level, due to the lower priority in capital allocation when a company goes bankrupt. Hence when making an investment decision, investors closely scrutinise the activity of a company and seek to secure certain controls over their operations in one form or another (participation in

management bodies, having veto rights, etc.)

From an investor's perspective, PEs provide an alternative investment option to more traditional financial instruments (e.g. money market instruments, bonds, stocks traded on a stock exchange). When investing in PE, investors aim to achieve a more diversified portfolio of assets and higher yields than those provided by traditional instruments, in absolute terms and in terms of the risk level.

2.2 VALUE OF PEFs FOR BUSINESS

Given their investment specifics, PEFs, unlike credit institutions, are interested in making qualitative improvements and increasing the value of a business. Thus, being involved in the management of companies, they facilitate the implementation and strengthening of corporate governance and ethics standards, and improving the corporate culture and transparency. Many business leaders consider one of the most significant factors in making a decision to raise financing through a PEF to be the option to gain access to the expertise and contacts of a PEF, as well as the synergy provided by other companies in the PEF portfolio.

The EBRD, in its Transition Report 2015–2016, cites Baring Vostok Fund as being an example of a positive influence of a classic PEF on a company's business. Originally, the fund focused on middle-sized companies in Russia and former USSR countries. Its investment strategy entailed the acquisition of controlling stakes or significant minority interests in companies operating in various industries, with the aim of increasing the value of the business. Over the period of its activity, the fund has

made a number of fairly successful investments, including those in:

- Yandex: a leading Internet company in Russia. Baring Vostok invested in Yandex in 2003, three years after its establishment. During the investment period the company underwent a radical transformation and expansion, to such an extent that it was valued \$8 billion when it was listed on the NASDAQ in 2011, and thus earned Baring Vostok \$1 billion³³. Baring Vostok exited the project completely in 2016;
- Europlan: a leading automotive leasing company in Russia, which began operations in 1999. Initial investments from the Baring Vostok Fund were in 2003. During the investment period the company launched new products, diversified sources of financing through bond issues, began providing services to SME businesses, grew significantly, and became a leader in the car and truck leasing market in Russia. The fund exited the project in 2015.

The fund's average internal rate of return (IRR) is 38%. Successful investments by Baring Vostok had a positive impact, not only on the performance of the fund and the companies in its portfolio, but also on the business climate in Russia and PE in general. Examples of positive experiences in the region and the publication of relevant information illustrate to other potential investors the opportunities available for development and increased value as a result of mutually beneficial cooperation with PEFs.

³³ Where Baring Vostok invested in Russia, *Vedomosti*, 2019



2.3 FROM DEBT TO EQUITY: SUSTAINABLE GROWTH THROUGH DIVERSIFYING THE STRUCTURE OF AN ECONOMY'S FINANCING



Attracting direct foreign investments, including those from PEFs, and reducing outflows of internal investors' capital abroad have a positive impact on the balance of payments capital account and help stabilise the national currency rate.

The diversification of funding sources is an important distinguishing feature of private equity compared to other ways of raising capital, which require longer investment periods and lower capital mobility, that is, countries with a higher share of equity financing in their economies are less exposed to capital outflows and financial meltdowns during crisis periods³⁴.

In emerging markets PE has a direct positive influence on the levels of return from businesses and employment in

the country, due to the scale effect, an increase in capital expenditure to improve labour productivity, and the implementation of lean production methods based on more efficient spending related to cash and working assets. In developed countries, no direct rise in the employment rate occurs, as the funds in such countries are typically invested in equity of mature companies so that they increase their profitability through the restructuring of businesses and optimising organisational structures.

PE market expansion also has an indirect influence on the development of associated activities required to support PEF transactions: the business of valuation, legal, and investment companies grows, thereby contributing to a diversification of the economy, an increase in GDP, improvements to the employment rate, and growth in professional competencies on the local market.

³⁴ "Rebalancing finance", EBRD Transition Report 2015–2016



The experience of Brazil serves as a good example of the positive impact PE development can have on the investment attractiveness of a country.

Brazil is currently of interest for private investors across the globe. Investment activity in the region rose significantly due to investors and new participants of global PEFs. For local PEFs already present in the market, this is a time of very high deal flows and new opportunities.

Early market participants in Brazil include GP Investimentos, Patria Investimentos, Banco Bozano (currently Santander), CRP Companhia de Participacoes, and Advent International Brazil. Dealing with many family offices in Brazil, these firms ensured that the business community enjoyed the advantages that PE investors could provide: improved governance, continuity planning tools, and, most important of all, - increased company value. The experiences gained by these companies in the past attracted other participants to try and replicate their success. In the mid-90s the number of active PE investors in Brazil grew significantly.

Issues faced by the first investors that potentially impeded PE market progress included the following:

- legal structure and red-tape barriers from the time of Cardoso's rule (Brazilian President from 1995 to 2003) hindered operations;
- most potential PE recipients were lacking in corporate governance;
- there were several types of shares with various voting rights, which gave tremendous opportunities for insiders to shake investor confidence in capital markets;
- companies' opportunities for holding public offerings were limited.



Potential PE market growth points in Brazil:



The maturing of the capital markets in Brazil is a key factor behind stronger interest in the country on the part of PE investors



More sales opportunities. While sales to foreign companies still represent a safe exit for many investors, other options are available for PE investors. Domestic buyers (high-net-worth individuals) are increasingly making investments through direct acquisitions



IPOs offer an additional exit strategy. Transborder rates in stock exchange quotes are becoming an increasingly viable alternative

The attractiveness of Brazil as an investment region is attributable to the following factors:

- **A new paradigm.** As the business community increased its understanding of Brazil, businesspersons and family office owners, which at one time had exercised caution when dealing with PEFs, became more receptive to engaging with them. In many cases, business owners saw that competitors or vendors derived benefits from PE participation;
- **Tax privileges related to type of investment.** The tax regime of Brazil is complicated, hindering corporate investment; nevertheless, the government endeavours to improve the situation. One related initiative is to provide new tax incentives aimed at encouraging investment in strategic sectors and regions. As an illustration, the government provided Ford Motor Company with significant state and federal incentives to increase the annual amount of investment. As a

result, the company invested \$1.6 billion in modernising its facilities in Baiy;

- **A maturing of Brazilian equity markets.** In the past decade, global investor confidence in the equity market of Brazil has grown, due to increased transparency within the banking sector, achieved through the consistent supervision of the central bank and regulators. The banking clearing system is now real-time, which enables regulators to identify issues as they arise and to take necessary action to prevent an exacerbation of issues. Similarly, financial markets have been transformed in recent years, which has contributed to increased investor confidence. Changes in the regulation of publicly traded companies protect minority shareholders and resulted in improved corporate governance. The most important changes related to the adoption of IFRS by publicly traded companies and financial institutions in Brazil, which helped boost transparency and reliability

and ensure comparability with a growing number of international companies. All these successes will help attract more investment.

During the period from 2006 to 2009, Brazilian firms spent over \$148 billion making more than 900 acquisitions domestically³⁵. PE penetration index (PE/GDP) in Brazil was at a fairly high-level, given the large GDP rate, on average 0,14% annually. A strong economic basis, exceptional corporate growth, and a consolidation trend point to a continued increase in the volume of domestic transactions. Government measures to expand the PE market include introducing rules for investing in certain economic segments and on over-the-counter markets, which will further promote PE market growth in the near future.

³⁵ EMPEA

2.4 CLASSIC PEFs AND PE SPECIFICS IN KAZAKHSTAN

The approach to PE investments in Kazakhstan entails certain specifics – see Table 1.

Table 1. Difference between the classic and local approaches to private equity investments





	 CLASSIC APPROACH (global practice)	 APPROACH IN KAZAKHSTAN
Investors and their role in making decisions	<ul style="list-style-type: none"> — There is an independent GP that manages the money of LP (investors); — The fund's investors are usually institutional players: pension funds, insurance companies, etc. 	<ul style="list-style-type: none"> — LP and GP are most commonly rolled into one: the one that owns the money also manages it; — Widespread in Kazakhstan are captive funds under family offices/business conglomerates. These usually have an investment committee that includes representatives from both the family office and the fund itself; — An anchor investor is always a majority shareholder of a family office/business conglomerate (in some cases these funds engage independent LPs).
Fundraising	<ul style="list-style-type: none"> — GP established new funds at certain intervals and attract investors for these funds, which of one of the major competences of the classic funds. 	<ul style="list-style-type: none"> — Most often the investment team does not set fundraising as its target, as there is one specific investor (a high-net-worth individual/fund of funds/international financial institution); — Local GPs are sometimes looking for co-investors for certain projects; however, establishing funds with a third party is rarely seen.

Table 1. Difference between the classic approach and local approach to private equity investments (continued)

	 CLASSIC APPROACH (global practice)	 APPROACH IN KAZAKHSTAN
Investment strategy	<ul style="list-style-type: none"> — A clear focus on investment stages – VC (seed/early), growth, buyout; — An investment that does not comply with the fund's mandate is not possible; — A focus on different industries is possible, but less popular. 	<ul style="list-style-type: none"> — GPs in captive funds place an emphasis on the shareholder's core business that is generating stable and sufficient revenue (cash cows, IRR (KZT) ~15%); however, the company also considers opportunities to acquire assets for their subsequent resale (rising stars, IRR (KZT) ~30%); — Usually these assets should have a synergistic effect with the group's core business, but it is not always the case. Hence a team is continuously in the process of creating the project pipeline; — Projects are searched for, as a rule, in industries where a business group has experience; — Investments can be made at any stage – the main thing is that a deal should generate the desired rate of return.
Creation of value for shareholders (life cycle and exit strategy)	<ul style="list-style-type: none"> — PEFs have an exact life cycle, upon the expiry of which they cease to exist and pay funds back to investors; — Exits are mandatory – a focus is placed not on collecting dividends, but on realising the full value potential (the resale of an asset at a price that exceeds the entrance price). 	<ul style="list-style-type: none"> — Classic PEFs in Kazakhstan have been established mostly under quasi-public institutions – KCM and KazAgro. Private classic PEFs (from a legal standpoint) practically do not exist in Kazakhstan, while the life cycle of captive funds is not limited; — The resale of an asset is desirable, but not a mandatory component of the investment strategy; — The dividend flow may appear to be so attractive that investors can make a decision to not exit the asset; — For the owners of family offices the size of annual dividends is important.

Many management teams in Kazakhstan work in a format that is similar to GPs. They are involved in raising capital for projects and specifically run a few enterprises with consolidated share capital. There is a large number of inconspicuously efficient entities that deal with additionally raised equity and borrowed capital. These can be established in the form of a JV, LLP, or JSC, however all have one characteristic feature: they have a well-organised management team that represents one investor (or one group of investors) in different projects. Their key advantage is that they know the business and environment from within.

Kairat Mazhibayev
Chairman of the Board of Directors of RESMI group of companies

Thus **classic PEFs** comprise those funds whose operating principle meets, to a greater extent, the features of the classic approach set out in Table 1. At the same time, one observes that in Kazakhstan each high-net-worth individual/family office has a captive asset management team. However, as part of this research, a separate category of **captive PEFs under family offices/business conglomerates** is singled out, which covers family offices/business conglomerates that carry out investment activity, which is the nearest (relative to other business conglomerates) in terms of its structure to classic PEFs.

3 Development of the private equity market in Kazakhstan



3.1 Evolution of the private equity market in Kazakhstan



3.2 Overview of key private equity ecosystem players in Kazakhstan



3.3 Analysis of M&A market activity over 2008–2018



3.4 Fundraising by PEFs and the application of investors' funds



3.5 Dynamics in total volume of private equity investments made in Kazakhstan, 2008–2018



3.6 Industry focus of investments



3.7 Types of transactions



3.8 Determining the number of completed exits and exit strategies



3.9 Overview of the most successful PEF cooperation stories with business in Kazakhstan

3.1 EVOLUTION OF THE PRIVATE EQUITY MARKET IN KAZAKHSTAN

The development of the PE market in Kazakhstan can be divided into three main stages:



The emergence of private equity (1991-1998)



This stage represented a challenging initial transitional period to a market economy, which began with property transformation through denationalisation and further privatisation.

Over 16,000 state-owned entities and enterprises were privatised³⁶. The economy of Kazakhstan was gradually reviving and showed positive signs of growth, thus attracting interest from foreign investors. However, a poorly developed legal framework and tax system made the investment climate unstable, and this impacted the activity of international PEFs.

The emergence of the PE market in Kazakhstan was marked by international financial institutions (IFIs) entering the market. In 1996, a private equity fund focusing on venture capital began operations in Kazakhstan, Eagle Kazakhstan Fund (formerly Kazakhstan

Post Privatisation Fund), which was a regional venture fund (RVF) established in CIS countries and Eastern Europe and was funded by the EBRD. In 2000, following the merger of a number of Russian venture funds, the fund was renamed Eagle Kazakhstan Fund. The fund made nine investments, in total worth around EUR33 million. The market players also included such funds as AIG Silk Road Fund (SRF) and Central Asian-American Enterprise Fund (CAAEF).

At that time, the EBRD and International Finance Corporation (IFC) began issuing their first long-term loans and making investments in the equity of Kazakhstan's companies, e.g.

a convertible loan of \$40 million issued by the EBRD to Qazkom Bank³⁷.



³⁶ Information agency: Strategy2050.kz

³⁷ EBRD: ebrd.com/kazakhstan

A booming banking sector and first steps in the private equity sphere (1998-2007)



During this period, Brent oil prices quadrupled, at an average annual growth rate of 19%³⁸.

Thus, against a backdrop of rapidly-growing exports of goods and domestic consumption, Kazakhstan's GDP showed an average growth of 9% annually in USD terms. Notwithstanding such a favourable environment for equity investments, debt financing was in greater demand due to its affordability from a cost viewpoint, a better understanding of how the instrument functioned, and ease of use for corporations. All large banks issued Eurobonds and attracted foreign investors to participate in capital, anticipating sustainable future economic growth.

M&A activity. According to estimates from Centras Securities, in 2004 the total amount of M&A transactions in Kazakhstan exceeded \$1.1 billion³⁹. According to Resmi data, the value of M&A transactions in Kazakhstan in 2005 totalled \$9 billion, thus by almost 10 times exceeded the figure for 2004; the 2006 figure was \$7.6 billion, and in

2007 the total value of such transactions reached as high as \$10 billion⁴⁰.

PEF activity. M&A transactions in the mining and oil and gas sectors accounted for the lion's share of the M&A market, including also PE deals; for example, in 2006, the PEF Great Circle Fund invested in the Kazakhstan's oil service company Caspian Service Inc. In addition, as the financial sector was on the rise in that period, such large PEFs as Baring Vostok Private Equity III, CVCI Growth Fund I, and East Capital Financial Fund made investments in Kazakhstan's banks. Other players that made substantial investments in the equity of Kazakhstan's banks included the EBRD, Citigroup Alternative Investments, Goldman Sachs, and UniCredit.

Emergence of the first Kazakhstan's asset managers and PEFs. As for Kazakhstan's asset managers, RESMI Finance & Investment House was carrying out transactions in the consumer lending and insurance sectors at this time. And as early as 2007, Centras Private Equity Fund, the first public PEF in Kazakhstan, announced it would commence operations, having a committed capital of \$42.5 million. The management of the Centras financial group succeeded in attracting institutional investors (the EBRD and CDC) as LPs and in acquiring the insurance company Kommesk-Omir⁴¹. In the same year, representatives of the well-known investment group Lancaster also expressed an interest in opening a PEF, of \$100 million⁴².

In addition, a landmark event of the period was appearance in the market of three hybrid funds managed by Compass Management team: Tau Capital PLC, Kazakh Compass, and Compass Kazakhstan Ltd. Their investment focus was not limited to private equity, but also included investments in securities⁴³.

The most remarkable event of this period was an Order of the President of the Republic of Kazakhstan to establish a fund of private equity funds⁴⁴. Thus an important development institution, Kazyna Capital Management (KCM), was established. In 2007, the KCM-backed Aureos Central Asia Fund began operations.

Simultaneously, the beginnings of venture capital were seen. In 2003, the National Innovation Fund was established (later renamed the National Agency for Technological Development (NATD)); currently, it is called QazTech Ventures⁴⁵. From 2003 to 2008, the NATD funded 10 venture funds, of which five were foreign: Mayban-Jaic Asean Fund L.P., Wellington Partners Ventures III Technology Fund L.P., Flagship Venture Fund, Vertex III Venture Fund, CASEF, and five were Kazakhstani: Advant, Almaty Venture Capital, Centras, Delta Technology, and Areket.

³⁸ Website of research platform Macrotrends: macrotrends.net

³⁹ A. Zaikov 2007 record results in M&A: 12 trend markers" // *Mergers and Acquisitions*. No. 1-2 (59-60). 2008

⁴⁰ S. Frangulidi, Financial Analyst, RESMI Finance & Investment House JSC.

The Mergers and Acquisitions Market M&A Kazakh Style // investkz.com 2008

⁴¹ Presentation of Centras Capital from Centras Capital website // centrascapital.com. 2009

⁴² Alimbek Seidullayev, «Private equity: Kazakhstan starts to walk the walk» // euromoney.com. 2007

⁴³ Website of Kazakhstan Stock Exchange: kase.kz. Additional information from website of the fund – taucapitalplc.com

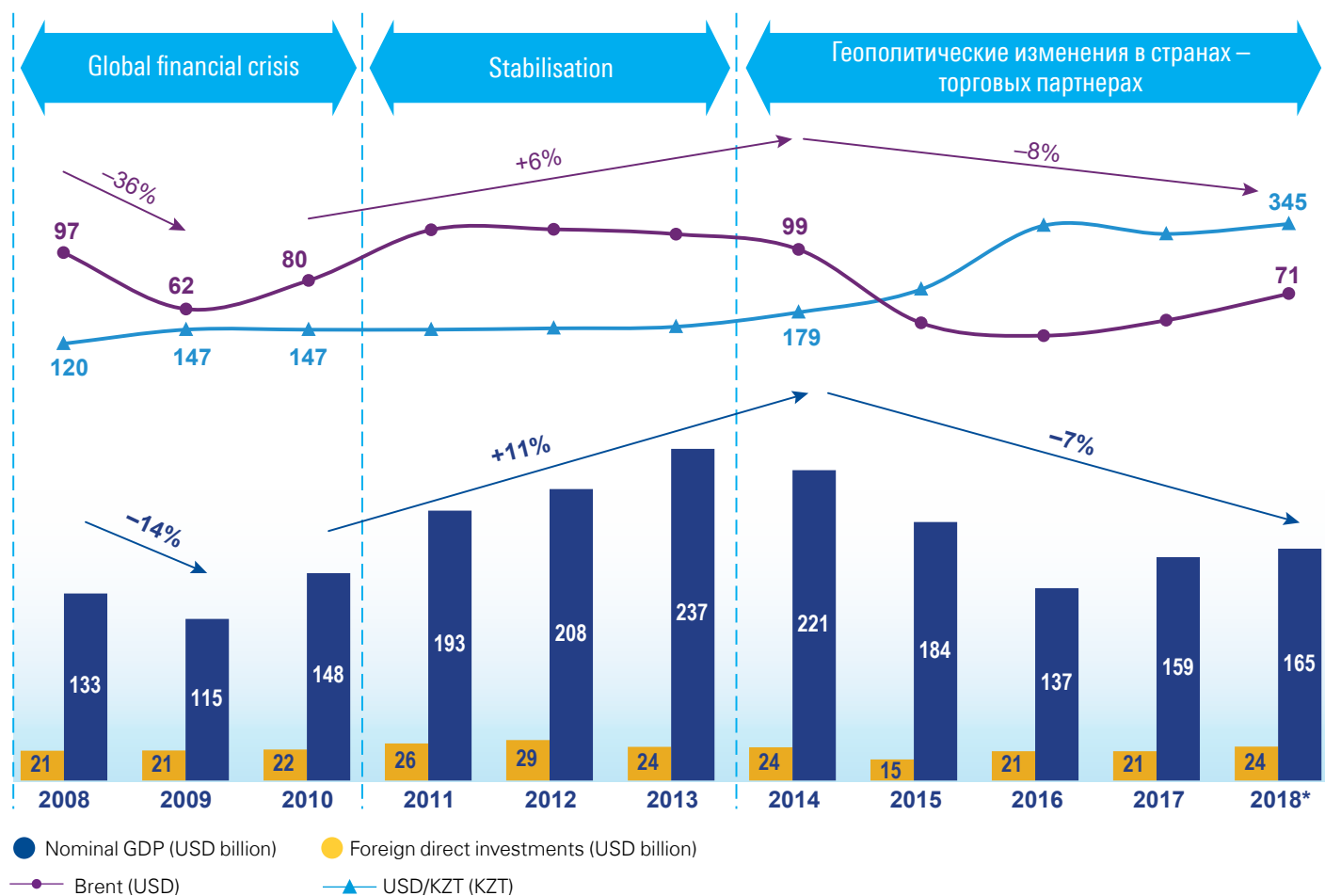
⁴⁴ Address of the President of Kazakhstan to the People of Kazakhstan, 28 February 2007

⁴⁵ In 2019, NATD was transformed to QazTech Ventures JSC with a focus on development of a venture market and technology entrepreneurship

Laying the foundation of the private equity market (2008-2018)

This period can also be subdivided into the enlarged micro-stages shown in Figure 20.

Figure 20. Dynamics of key macroeconomic indicators in Kazakhstan⁴⁶



CAGR

* The GDP volume is indicative (according to World Bank data)

⁴⁶ Macrotrends analytical platform, NB RK, World Bank

1 2008–2010 – a period of global financial crisis

By 2008 Kazakhstan was already well integrated into the global economy. Total foreign debt by this time amounted to around \$100 billion, with the debts of commercial banks accounting for a significant part of that amount⁴⁷, as described in Section 1. Therefore, with the onset of the global financial crisis, which began in 2007–2008, the economy of Kazakhstan underwent significant changes. Access to funding for banks was closed; moreover, as a result of the low quality of the loan portfolios and a lack of liquidity, large banks defaulted on their liabilities. Thus from 2008 access to debt financing for businesses was of an entirely different nature; primarily, in terms of the cost of debt capital. The market needed alternative sources of funding.

Public/quasi-public organisations provided both debt financing and alternative financing: private equity and venture capital; such large-scale government programmes as the State Programme for Accelerated Industrial and Innovative Development continued to be implemented.

2 2011–2014 – a period of stabilisation: a clean-up of banks' assets and a consolidation of pension assets

As Figure 20 demonstrates, the period from 2011 to 2014 was one of post-crisis stabilisation: oil prices remained consistently high, GDP was growing at a rapid pace, and, as will be shown below, it was a period when KCM funds reached a peak of investment activity and the M&A market size was at its maximum.

At the same time, after the shocks of 2008 the Kazakhstan's Government carried out serious reforms to develop a more sustainable economy:

- Large-scale measures were taken to rehabilitate the banking sector: STB assets were cleaned up, and in 2012 the Fund of Problem Loans was established as an additional tool for enhancing the quality of banks' loan portfolios;

- In 2013 organisations providing financial and non-financial support to businesses were consolidated to implement a uniform approach to supporting business, and became a part of the newly established National Managing Holding Baiterek;
- Large-scale pension reforms was implemented. Thus in 2013 pension assets were consolidated into the Unified Accumulative Pension Fund.

3 2014–2018 – the impact of anti-Russian sanctions, commodity price fluctuations: transitioning to a floating exchange rate and a consolidation of banks

The period 2014–2018 in Kazakhstan was characterised by high commodity price volatility (including oil) as well as adverse geopolitical events in the region, including anti-Russian sanctions and political changes in Ukraine; and, as a result of transitioning to a floating exchange rate and an exceptional devaluation of the national currency, the average annual growth rate of nominal GDP (in USD) was negative and amounted to -7%, while the CAGR for the M&A market was -26% per annum. Such features necessitated serious actions related to rehabilitating the financial system, as well as implementing initiatives to create a favourable business ecosystem for investment.

Thus this period saw a process of completing the clean-up and consolidation of the banking sector, as a result of which large amounts of distressed assets were transferred to legal entities that were separate from banks, such as the Fund of Problem Loans and Investment Fund of Kazakhstan.

Very sizeable funds were accumulated by the Unified Accumulative Pension Fund (UAPF) – according to some data, currently an opportunity is being considered to transfer some UAPF assets to private management companies. Offering an opportunity

to invest small portions of pension assets in private PEFs could potentially lend additional momentum to market development⁴⁸. Global experience shows that enabling PEFs to attract money from pension funds should be accompanied by the implementation of additional regulations in this area.

In addition, the Astana International Financial Centre (AIFC) was established in Nur-Sultan. The legal system of the AIFC is based on the principles and rules of English law, and a stock exchange was also set up under its auspices.

⁴⁷ NB RK. *Balance of Payments and Foreign Debt of the Republic of Kazakhstan*

⁴⁸ Interviews with respondents (see the *Methodology* section)

Thus over 10 years Kazakhstan has made a number of significant steps to promote the creation of a favourable investment environment:



Currently, pension assets have been consolidated in Kazakhstan. The banking sector is concentrated, i.e. it comprises relatively large players.



The state has adopted the Yellow Pages Rule and continues to privatise public assets.



By the end of 2018, the lifecycle of the first KCM funds came to an end: currently, six KCM funds perform active investment-related activities. KCM mainly focuses on developing the private equity ecosystem, mainly using non-financial instruments.



In the updated Global Financial Centres Index (GFCI), the AIFC is ranked 61 out of 100 institutions. Furthermore, the shareholders of Astana International Exchange (AIX) include Goldman Sachs, Shanghai Stock Exchange, Silk Road Fund, and NASDAQ, which have significant influence and worldwide expertise. A large Chinese private equity fund has also showed interest in operating through the AIFC trading platform, and announced the establishment of a joint fund with the Government of Kazakhstan.



Under an Order from Nursultan Nazarbayev, a new PEF with a capitalisation of KZT370 billion will be established in Kazakhstan under the auspices of the AIFC, to co-fund breakthrough projects.





3.2 OVERVIEW OF KEY PRIVATE EQUITY ECOSYSTEM PLAYERS IN KAZAKHSTAN


Sources of funding, debt financing, and investment funds comprise the following key categories:

1.  Public/quasi-public development institutions
2.  International financial institutions
3.  High-net-worth individuals (family offices)/business conglomerates
4.  Classic PEFs (with local and international management teams)

The key representatives of these categories in Kazakhstan are listed in Table 2.

Table 2. Main investors and asset managers in the Kazakhstan’s private equity market⁴⁹

	 INTERNATIONAL GPs	 LOCAL GPs
Public/quasi-public development institutions	EBRD, IFC, ADB, CDC, FMO, IDB, and others	Samruk-Kazyna (Samruk-Kazyna Invest), Baiterek (IFK)
International financial institutions	<p>KCM active funds: KIF (Verno Capital), ENIF (Eurasian Nurlu (Bright) Investment Fund)</p> <p>Other KCM funds: ACAF, IIF (CapAsia), KCRF (ADM), KGF (CEECAT), CKIF (CITIC), Macquire Russia and CIS (MIRA), WCP (JDW Partners), FGF (Al Falah), RKFN (VTB Capital I2BF)</p>	<p>KCM active funds: Baiterek Venture Fund, DBK Equity Fund, Almex Baiterek Fund, KCM Sustainable Development Fund I</p> <p>KazAgro funds: Kazakhstan “Silk Road” Agriculture Fund (CEECAT)</p>
Classic PEFs	<p>Baring Vostok Capital Partners, Resources Capital Fund</p> <p>Eagle Kazakhstan Fund, AIG Silk Road Fund, CVCI Growth Fund I, East Capital Financials Fund, Great Circle Fund, SigmaBleyzer, TPG Capital, Spring Capital Asia, PPF Investments, Phoenician Offshore Fund, TRG Growth Partners</p>	<p>Falconry, Almak Capital, Stichting RCG Netherlands</p> <p>Kazakh Compass Fund, Tau Capital PLC, Amun Capital</p>
High-net-worth individuals (family offices)/business conglomerates	<p>FO/PE: Verno Capital, Ordabasy, Kaspi Group, Lancaster, VISOR, Resmi, Centras, Seimar (Asadel)</p> <p>OGC: Chevron, Exxon Mobil, CNPC, Lukoil and others</p> <p>Banks: Sberbank, Alfa-Bank, VTB, Citi, Goldman Sachs, Bank of China and others</p> <p>MMPC: ArcelorMittal, Glencore and others</p> <p>Transport: RZhd, DP World and others</p>	<p>Beneficiaries in banks and/or insurance companies: T. Kulibayev, V. Kim, A. Ibragimov, O. Shodiyev, B. Baiseitov, R. Sarsenov, G. Yessenov, G. Sultan, T. Kuanyshev</p> <p>Beneficiaries in insurance companies: A. Mynbayev, E. Baimuratov</p> <p>Other: S. Zhumashov, N. Smagulov, E. Tatishev, K. Boranbayev, D. Abulgazin, A. Rakhimbayev, A. Belovich, S. Seitzhanov, E. Mukashev, S. Tulbassov, N. Aliyev, E. Kim, A. Balushkin, and others</p>

 Participants falling within two categories of investors at once

⁴⁹ The list provided is not exhaustive. Source: KPMG analysis



Public/quasi-public development institutions

~60%

As mentioned in Section 1.2, public sector assets play a significant role in the economy of Kazakhstan, accounting for around 60% of GDP.

However, under the Integrated Privatisation Plan, the share of public sector assets should be significantly reduced by 2020.

Role of the state in the private equity market

The key role of the state is to create a favourable investment environment, including building a legal framework (including with regard to taxation and safeguarding the rights of shareholders), judicial system, infrastructure, and establishing regulatory norms in the financial sector that meet current market challenges.

In terms of PEFs in Kazakhstan, the state is represented in the following categories:

1. Sources of funding

National sovereign funds/fund of funds (National Fund Samruk-Kazyna, Kazyna Capital Management (KCM), and KazAgro). KCM acts as the state's main investment tool for PEFs. The role of KCM in the PE market is described in more detail below.

2. Investment targets

Assets subject to privatisation and distressed assets on the balance sheets of Ministry of Finance agencies are potential business targets for private PEFs.

In 2008 the KCM fund of funds took on obligations to invest in seven private equity funds. Other private PEFs operating in Kazakhstan had limited

funding capabilities, owing to prevailing market conditions. Since the start of its activity KCM has participated as an LP in a total of 15 classic PEFs, with a total capitalisation of ~\$264 billion⁵⁰.

⁵⁰ KCM funds – KCM Sustainable Development Fund I and Eurasian Nurdy (Bright) Investment Fund – were established in 2019

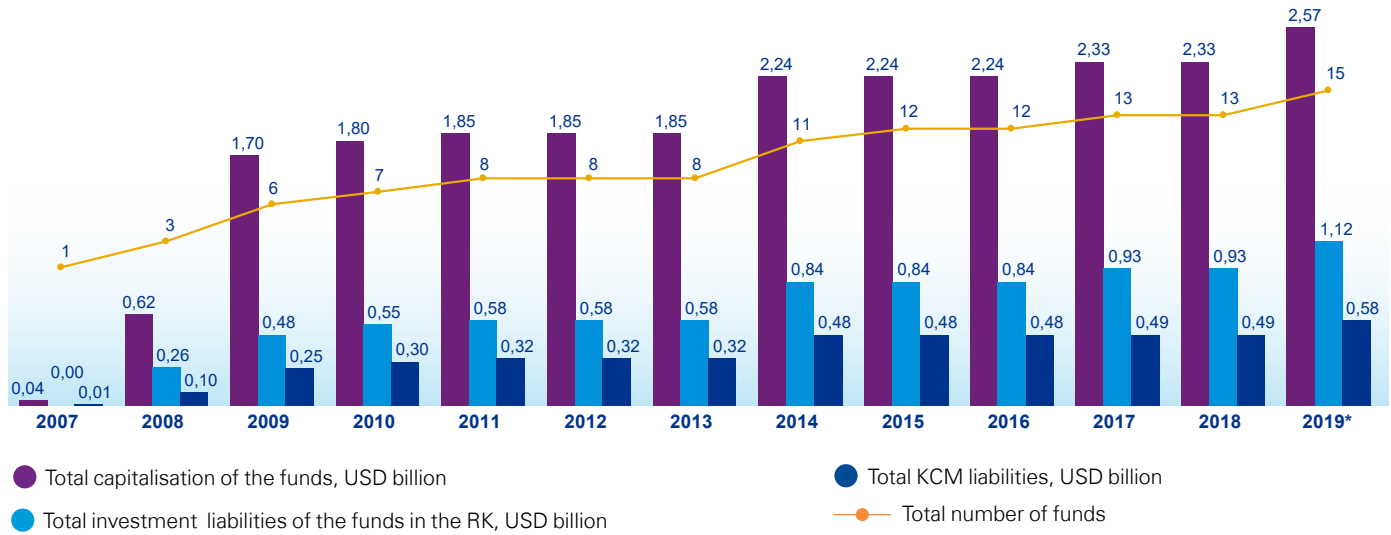
⁵¹ According to data current as at 1 May 2019

Key observations⁵¹:

- the liabilities of foreign and local investors accounted for ~\$2 billion; KCM liabilities accounted for the remaining \$0.6 billion
- 14 out of 15 funds had a mandate to invest in Kazakhstan
- 38 investments totalling \$583 million were made in Kazakhstan
- 86% of investments by KCM were made in Kazakhstan assets, 6% in China, 5% in Russia, and the remaining 3% in other countries

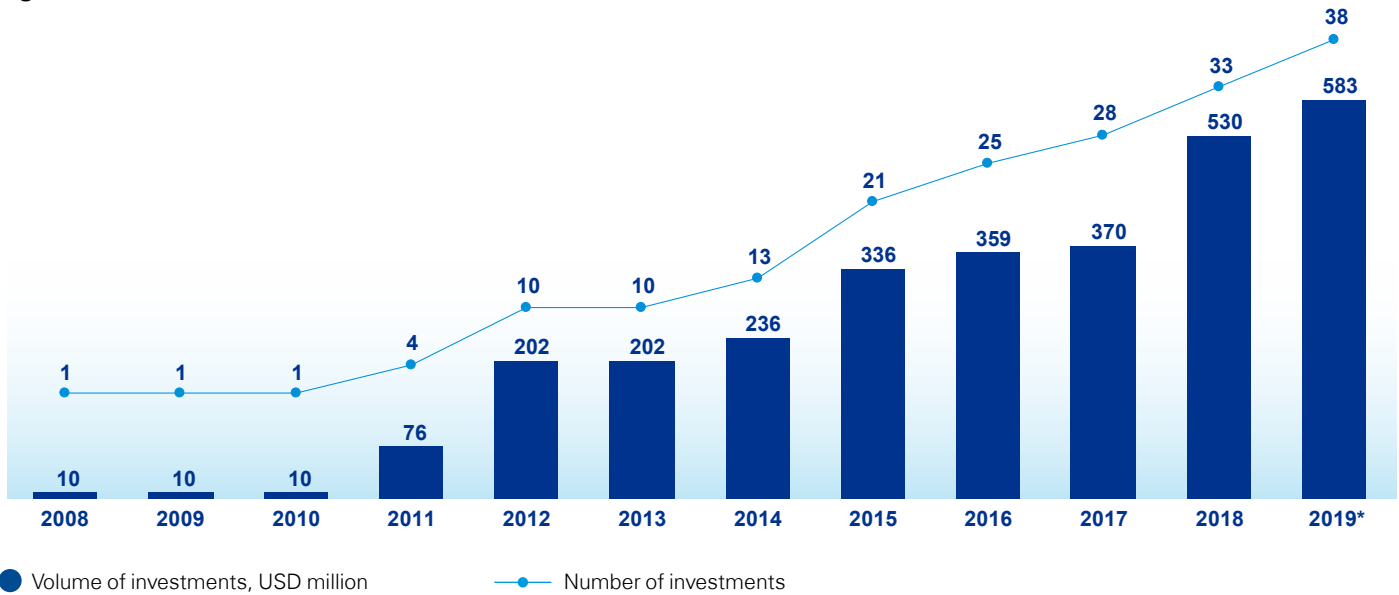


Figure 21. Capitalisation and liabilities of KCM funds⁵²



* The chart shows accumulated indicators based on the exchange rate as at 1 May 2019

Figure 22. Investments of KCM funds in Kazakhstan’s assets, 2008–2019⁵³



* The chart shows the accumulated volume and number of investments based on the exchange rate as at 1 May 2019.

Currently, KCM acts as an LP in 15 funds:

- Nine funds are at a closure/monitoring stage; 100% of these had/have an international management company (GP);
- Six funds are actively engaged in investment activity, of which one has an international management

company (GP), while the rest operate under management of captive teams.

KCM has contributed to developing local competencies vis-à-vis private equity investments in Kazakhstan. Funds had an investment focus on priority sectors under the State Program of Industrial-Innovative Development (SPIID) and on infrastructure and energy projects.

One of the key objectives of KCM in its capacity as an LP is to foster more active investment by portfolio funds, to facilitate the efficient use of allocated funds.

⁵² KCM annual reports (2008–2017), KCM internal data. According to data as at 1 May 2019

⁵³ KCM annual reports (2008–2017), KCM internal data. According to data as at 1 May 2019



International financial institutions (IFIs)

The most active institutions in this category in Kazakhstan have been the EBRD, ADB, IFC, CDC, FMO, and IDB. International financial institutions focus on lending; however, they also act as sources of equity capital

through participating in business as minority shareholders. Such institutions make investment decisions based on criteria such as the social and economic consequences of a project and any potential partner being highly

transparent and independent. The investment focus in Kazakhstan is on infrastructure, the power industry, and finance.

Table 3. Operations of certain IFIs in the PE market in Kazakhstan⁵⁴

NAME AND DESCRIPTION	INDUSTRIES	INVESTMENTS	TRANSACTIONS (YEAR) ⁵⁵
<p>EBRD</p> <p>An investment mechanism created in 1991 by 40 countries and two international organisations to support market economies and democracy in 34 countries. The EBRD invests in private businesses jointly with its commercial partners. It provides project financing to banks, enterprises, and companies by making greenfield and brownfield investments. It works with state-owned companies to support their privatisation and structural reorganisation processes as well as to improve public utilities.</p> <p>Commencement of activity in Kazakhstan: 1997</p>	<p>Power industry, financial institutions, manufacturing, trade and agrobusiness, infrastructure</p>	<p>Number of investments: 254</p> <p>Total amount: 7.7 bln EUR</p>	<p>Exits:</p> <ul style="list-style-type: none"> — KazinvestBank (2014) — Qazkom (2014) — CAEPCO (2019) <p>Investments:</p> <ul style="list-style-type: none"> — CAEPCO (2009) — KazExportAstyk (2011); — Hambleton Mining plc (2012); — Shymkentcement (2014); <p>LP in KCM funds: ACAF, KGF, MRIF, KCRF</p>
<p>IFC</p> <p>IFC is a member of the World Bank Group, the largest global development institution, which is focused solely on the private sectors of emerging economies.</p> <p>Commencement of activity in Kazakhstan: 1993</p>	<p>Financial sector, healthcare, infrastructure, transport, AIC</p>	<p>Number of investments: 57</p> <p>Total amount: 1 bln EUR</p>	<p>Exits:</p> <ul style="list-style-type: none"> — SK-Leasing (2013) — Bank CenterCredit (2013, 2017) <p>Investments:</p> <ul style="list-style-type: none"> Archimedes Health Developments (2011) <p>LP in KCM funds: ACAF, MRIF</p>
<p>ADB</p> <p>The Bank was established in 1966. Its main purpose is to foster economic growth in Asia and the Far East by providing direct loans and technical assistance.</p> <p>Commencement of activity in Kazakhstan: 1994</p>	<p>Agriculture, education, finance</p>	<p>Number of investments: 113</p> <p>Total amount: 5.0 bln EUR</p>	<p>LP in KCM funds:</p> <ul style="list-style-type: none"> IIF (Islamic Infrastructure Fund)

⁵⁴ Official websites / management reports of the EBRD, IFC, and ADB

⁵⁵ KPMG database. Data on transactions are not exhaustive; for more details, see the Methodology section

ROLE OF INTERNATIONAL FINANCIAL INSTITUTIONS IN THE PRIVATE EQUITY MARKET

As mentioned above, the emergence of the private equity market in Kazakhstan was marked by the entrance of international financial institutions. The peak of IFI equity investment activity over the past decade was 2014–2015. A slackening in their investment activity was primarily due to the devaluation of the national currency and a respective higher risk that the rate of return of local companies in foreign currencies would fall. Therefore, IFIs currently have a very conservative equity investments strategy – the minimum investment amount, as a rule, exceeds \$10 million, while the expected IRR should be approximately 15-25% in a foreign currency. In addition to equity investments, IFIs are also one of the main sources of funding of PEFs in Kazakhstan.

- In 2007 the EBRD and CDC became investors (LP) in the first Kazakhstan's private equity fund: Centras Private Equity Fund;
- Out of 15 funds the KCM co-investors were: the EBRD (four funds), IFC (two), and CDC, FMO, ADB, and IDB (one each).



High-net-worth individuals (family offices)/business conglomerates

As mentioned in Section 1, high-net-worth individuals control the majority of assets in Kazakhstan, therefore, their role in the economy is very significant. Research into the category of high-net-worth individuals is carried out by Forbes Kazakhstan magazine, which publishes the annual rating Top-50 Richest People In Kazakhstan (hereinafter, the "Rating").

Top list of the richest people. A special category should be mentioned, which includes the permanent top-five leaders of the Rating, which represent four systemically important holding entities: ALMEX, Verny Capital, ERG and KazMinerals. The share of their assets in the overall wealth of high-net-worth individuals varies, but accounts, on average, for 45% of the total wealth of the Rating.

The growth rate of the overall wealth of the Rating's top-5 entities exceeds the average growth rate of total wealth according to the Rating by 29 percentage points, and has stood at 38% since 2012, with an average annual increase of ~6%. This is due primarily to the assets of these holding

entities being related to export-orientated sectors.

Financial industrial groups/bank conglomerates. Large holding entities can also be classified into a more general category of financial industrial groups – business conglomerates that have captive commercial banks. Some financial industrial groups have insurance companies of their own: the assets of insurance companies associated with banking structures account for over 60% of the total assets of Kazakhstan's insurance companies, where the share of insurance companies belonging to Eurasian Financial Company and ALMEX Holding Group makes up 50% of total assets. Hence these holding entities are the next key providers in Kazakhstan of liquidity, after the state.

Table 4. Activity of financial industrial groups/banking conglomerates⁵⁶

BANK AND KEY BENEFICIARIES	FORBES WEALTH, USD BILLION	SHARE OF WEALTH IN RATING	SHARE IN TOTAL BANK ASSETS	SHARE IN TOTAL INSURANCE ASSETS	SHARE IN TOTAL ASSETS OF INVESTMENT COMPANIES	NON-BANKING ASSETS OF THE REPRESENTATIVES ⁵⁷
Halyk Bank, Altyn Bank Timur and Dinara Kulibayevs	6.2	24%	44.6%	19.6%	29.5%	Kipros, ALMEX Holding Group, Steppe Capital Pte LTD, Mayfair Investments BV (Nostrum Oil & Gas), Precious Oil Products BV (Kaspy Neft), TOEX B.V.(KazAzot)
RBK Vladimir Kim	4.1	16%	3.2%			KAZ Minerals Group: KAZ Minerals PLC, Kazakhmys Group
Forte, Kassa Nova B. Utemuratov	2.6	10%	6.3%		0.9%	Verny Capital Holding: RG Gold, KAR-Tel (Beeline), «Sky Mobile», Global Development, Burger King, Ritz-Carlton (Astana, Moscow, Vienna), Glencore Plc.
Eurasian Bank A. Ibragimov	2.3	9%	4.1%	27.7%	0.8%	ERG (TNC Kazchrome)
Nurbank R. Sarsenov	0.7	2.8%	1.3%	11.2%	0.8%	KSP Steel, Kokshe-Cement, Vita Caspian Riviera, French House, Beautymania, Imperial Home, Dibek, Beauty Planet
BCC B. Baiseitov	0.6	2.2%	5.5%		13.7%	Caspian Services Inc, AIFRI Orient Investments (Turgyn Ui Karasu)

⁵⁶ Data are not exhaustive and are presented as at 1 March 2019. Beneficiaries are the RK citizens, according to Forbes rating

⁵⁷ Kase, National Business, Forbes Kazakhstan, KPMG analysis

THE ROLE OF HIGH-NET-WORTH INDIVIDUALS (FAMILY OFFICES)/BUSINESS CONGLOMERATES IN THE PRIVATE EQUITY MARKET

Business conglomerates that represent high-net-worth individuals are the main strategic investors on the market, performing transactions with assets both between each other and with other market players.

For example in 2016 Kenes Rakishev (No. 7 in the Rating) acquired Grandes Life Insurance Company from Galymzhan Yessenov (No. 19 in the Rating), and sold a 30% stake in Magnum Cash and Carry LLP to Vyacheslav Kim (No. 21 in the Rating). Other large transactions from the period include the sale of a 24.47% stake in Kazakhtelecom by Aigul Nuriyeva (No. 12 in the Rating) to the representative of CAPEC Alexander Klebanov (No. 32 in the Rating). For more information on transactions see the following section.

By 2008 a category of professional private equity market players had been established in Kazakhstan, representing various family office/business conglomerates and having a structure that was most similar to one of the classic PEFs – a category of captive PEFs under family offices/business conglomerates (hereinafter, the “FO/PE”). This category in Kazakhstan included, at different times, the following groups: Verny Capital, Ordabasy, Kaspi Group, Lancaster, Visor, Resmi, Centras, and Seimar (Asadel).



Table 5. Captive FO/PE funds⁵⁸

FO/PE GROUP	INDUSTRIES	PORTFOLIO	TRANSACTIONS (YEAR) ⁵⁹
<p>Verny Capital: Bulat Utemuratov <i>One of the largest groups in Kazakhstan focused on direct investments in private businesses (private equity). The Group was established in 2006. The Group, as a rule, acquires projects only from private owners, not participating in public tenders and other forms of sale of public property.</i></p> <p>Total assets are about \$4 billion.</p>	<ol style="list-style-type: none"> 1) Telecom and media 2) Consumer sector 3) Production of construction materials 4) Real estate 5) Natural resources 6) Transport and infrastructure 7) Financial services 	<ol style="list-style-type: none"> 1) 31th Channel, VI Kazakhstan, Beeline Kyrgyzstan, Beeline Kazakhstan, InformBUREAU Megapolis 2) Burger King 3) South-Kyrgyz Cement 4) Global Development, The Ritz-Carlton Astana, The Ritz-Carlton Moscow, The Ritz-Carlton Vienna, Rixos Borovoe, Astana Property Management 5) RG Gold 6) Sary-Arka Airport 7) Forte Bank, Kassa Nova Bank 	<p>Investments:</p> <ul style="list-style-type: none"> — Altyntau Resources (2006) — Limnotex Developments Ltd (2008) — Metrocombank (2010) — Sky mobile (2010) — Orion Minerals (2013) — Alliance Bank (2014) — Temirbank JSC (2014) <p>Exits:</p> <ul style="list-style-type: none"> — RG Gold, RG Processing (2018) – partial exit — Talan Towers Trade Gallery (2018) — Kazzinc (2012-2013)

⁵⁸ Official websites/management reports of Verny Capital, Ordabasy, Kaspi Group, Lancaster, Visor, Resmi, and Centras, Seimar (Asadel); data from Forbes Kazakhstan, KASE, National Business, and KPMG databases. Data current as at 1 March 2019

⁵⁹ KPMG database. Data on transactions are not exhaustive; for details, see the Methodology section

Table 5. Captive FO/PE funds (continued)

FO/PE GROUP	INDUSTRIES	PORTFOLIO	TRANSACTIONS (YEAR)
<p>Ordabasy Group: Dinmukhamet Idrissov, Bakhariddin Ablazimov, Yerzhan Dostybayev</p> <p><i>Ordabasy Group is an investment holding in Kazakhstan which successfully operates in national and regional markets.</i></p> <p>The market capitalisation of its investment portfolio amounts to over \$1.5 billion.</p>	<ol style="list-style-type: none"> 1) Power industry 2) Oil and gas sector 3) Metals and mining 4) Financial services 5) Processing industry 	<ol style="list-style-type: none"> 1) Kazakhstan utility systems 2) Ansagan Petroleum 3) Ai-Karaaul Mining Company 4) Amanat Insurance, Qazaq Banki JSC 5) Aktobe Oil Equipment Plant, KazAzot Health City 	<p>Investments:</p> <ul style="list-style-type: none"> — Ordabasy-Nokian Tyres JSC (2008) — Alma-TV (2014) — Ai-Karaaul (2014) — AltynEx Company (2017) — AES Ust-Kamenogorsk TPP, Sorginsk TPP (2018), Taraz GrinPower Genko (2018) <p>Exits:</p> <ul style="list-style-type: none"> — Alma-TV (2017) — Maten Petroleum (2014)
<p>Kaspi Group: Viktor Kim, Mikhail Lomtadze</p> <p><i>Kazakhstan's financial banking holding; its strategic partner is Baring Vostok, international PEF GP.</i></p>	<ol style="list-style-type: none"> 1) Financial Services 2) Technologies and Innovations 	<ol style="list-style-type: none"> 1) Kaspi Bank JSC 2) Kolesa, Alseco, Interfinance 	<p>Investments:</p> <ul style="list-style-type: none"> — Kolesa (2013) — Alseco (2015) — Kaspi.kz (2015)
<p>Lancaster Group: Berik Kaniyev, Yuriy Pak</p> <p><i>Lancaster Group — a diversified holding company in Kazakhstan established in the early 2000s. Investing in various economic sectors the Group sets up joint ventures with major global operators.</i></p>	<ol style="list-style-type: none"> 1) Oil and Gas 2) Metals and Mining 3) Transport and Infrastructure 4) Other (Pharmaceuticals, Media) 	<ol style="list-style-type: none"> 1) ER SAI Caspian Contractor, SITEK Caspian, DSL Caspian 2) Tin One Mining (former Syrymbet JSC) 3) Senko-Lancaster Silk Road Logistics 4) Abdi Ibrahim Global Pharm, RTS Deco 	<p>Investments:</p> <ul style="list-style-type: none"> — Kun Renewables (2017) — Asia Teniz Group (2017) <p>Exits:</p> <ul style="list-style-type: none"> — Karpovskiy Severniy (2011) — Kazinvestbank (2016)
<p>Visor: Aidan Karibzhanov</p> <p><i>Investment holding VISOR commenced its commercial operations in the early 2000s. The Group focused on financial sector (investment banking). The company implemented a number of successful deals, investing in foreign assets.</i></p>	<ol style="list-style-type: none"> 1) Technologies and Innovations 2) Power industry 3) Oil and Gas 4) Processing industry 5) Telecom and media 6) Retail 	<ol style="list-style-type: none"> 1) iQ-Solutions and iQS Engineering 2) Wind farms: Shokparskiy, Sofiyevskiy and Arkalykskiy. 3) Tengiz Service 4) Chimpharm, CIS: United Cement Group 5) Nur-Telecom 6) Narodniy 	<p>Investments:</p> <ul style="list-style-type: none"> — Turkcell (2009) — MangystauMunaiGas (2010) <p>Exits:</p> <ul style="list-style-type: none"> — Ncell (2008, 2015) — Visor Holding (2017)

Table 5. Captive FO/PE funds (continued)

FO/PE GROUP	INDUSTRIES	INDUSTRIES	TRANSACTIONS (YEAR)
<p>Resmi: Kairat Mazhibayev, Yerkin Koshkinbayev <i>RESMI investment management company is a diversified investment group; its principal activity focuses on the customer-orientated sectors of Kazakhstan and Central Asia; the group has been operating since 1994.</i></p> <p>Current portfolio earns income of \$300 million; the company employs more than 2,000 employees.</p>	<p>1) Consumer markets (Food and beverages) 2) Financial Services 3) Real estate and construction</p>	<p>1) RG Brands 2) Investment Financial House RESMI 3) Great Wall Joint Stock Investment Real Estate Fund</p>	<p>Investments: — Ekoton + (2016)</p> <p>Exits: — Pension Assets Investment Management Organization “Orleu” (2009) — Korgau Pension Fund (2009) — Respublika Pension Fund (2011) — Innova Investment (2015)</p>
<p>Centras: Eldar Abdrazakov <i>History of Centras Group goes back to 2004. Since 2004, the Group has been managing a venture capital fund, established jointly with NATD. In 2007, the Group established the first public private equity fund in Kazakhstan, which attracted institutional investors (CDC, the EBRD).</i></p> <p>The capital of the Fund amounted to \$42.5 million.</p>	<p>1) Financial services (insurance, asset management, venture investments) 2) Other</p>	<p>1) Kommesk-Omir, Centras Insurance, Centras Securities, Centras Venture Fund, Centras Credit Microfinance organisation 2) iLEX Law Company, Medical Center “SOS Medical Assistance”</p>	<p>Investments: — Kommesk-Omir (2007)</p> <p>Exits: — Kazakhstan-American Rehabilitation Centre (2017)</p>
<p>Seimar Investment Group, Asadel Partners: Margulan Seisembayev <i>The Group has more than 20 years’ experience in the area of investments. Before 2008, the investment group of Margulan Seisembayev entered into large deals in telecommunications and banking sectors in Kazakhstan and abroad (including Alliance Bank’s IPO and sale of VimpelCom).</i></p>	<p>1) Agriculture 2) Other</p>	<p>Bloombees, Pipeline Capital Partners, Tripping, Karmic Labs, Map Jam, Ranker, Game Salad, SkyWard, Lemonade, Inventables, Teneleven Ventures, Ping Identity, Digital Shadows, Countertack, Cylance, Hexadite, Payout, Adnry Advisory</p>	<p>Investments: — Fresh Fruits Kazakhstan, Astana Fruits (2015) — Alel Agro (2016)</p> <p>Exits: — FinanceCreditBank (2009) — Starbank CJSC (2010) — Alel Agro (2017)</p>

High-net-worth individuals (family offices)/business conglomerates for PEFs in Kazakhstan are grouped into the following categories:

1. Sources of funding.

Primarily for captive FO/PE teams. In some cases, business conglomerates participate as investors (LP) in classic PEFs; for example, Ordabasy’s participation in Falah Growth Fund, and ALMEX’s participation in Almex Baiterek Fund.

2. Investment targets.

Certain assets of family offices may constitute investment targets for PEFs; however, when a PEF enters as a minority shareholder, difficulties may arise on account of the PEF’s influence on a company’s management.

3. Exit.

In Kazakhstan, high-net-worth individuals (family offices)/business conglomerates are the main private sources of liquidity (with the exception of IFIs). Thus they may be strategic investors, and in the case of captive FO/PE funds, may offer opportunities for secondary buyouts.



Classic PEFs

The category of classic PEFs in Kazakhstan, which comprises funds managed by local or international GPs, is presented in Table 2. Classic PEFs can be subdivided into two categories: those funded by quasi-public holding companies (Table 6) and independent PEFs (Table 7).

1 PEFs funded by quasi-public holding companies (KazAgro and KCM)

2 Independent PEFs⁶⁰

PEFs funded by quasi-public holding companies⁶¹:

- **Operating:** Kazakhstan “Silk Road” Agriculture Growth Fund (CEECAT), Baiterek Venture Fund, DBK Equity Fund, Almex-Baiterek Fund, KCM Sustainable Development Fund I, Kazakhstan Infrastructure Fund (Verno Capital), Eurasian Nurly (Bright) Investment Fund.
- **Others:** Aureos Central Asia Fund, Islamic Infrastructure Fund (CapAsia), Kazakhstan Capital Restructuring Fund (CEECAT, former ADM), Kazakhstan Growth Fund (CEECAT), CITIC Kazyna Investment Fund I (CITIC Capital), Macquire Russia and CIS Infrastructure Fund (Macquire Infrastructure and Real Assets), Wolfensohn Capital Partners (JDW Partners), Falah Growth Fund (Al Falah Capital Partners), Russian-Kazakhstan Nanotechnology Fund (VTB Capital I2BF Innovation Partners).

In the past 10 years KCM funds with a total capitalisation of ~\$2.6 billion have been the main representatives of classic PEFs in Kazakhstan:

- 10 out of 15 funds were managed by the international GPs;
- 11 out of 15 funds had international financial institutions and/or other external investors as an LP;
- 9 out of 15 KCM funds will complete their life cycle within next 4 years (2019–2022).

At present, only six KCM funds are performing investment activities in Kazakhstan (ABF, BVF, DBK Equity Fund, KIF, KCM SDF I, and ENIF), and one KazAgro fund (the Kazakhstan Silk Road Agriculture Growth Fund):



Total capitalisation of quasi-public funds is

▶ ~\$575.6 mln



>95%



The funds have a significant share of Kazakhstan’s participation as an LP (over 95%) and are managed by captive teams (except for ENIF fund, jointly established at the end of April with Chinese investors).



The industry focus is on serving priority sectors under the



SPIID



AIC



Infrastructure

⁶⁰ Independent PEFs, which made investments in Kazakhstan, comprise funds established as entities not directly affiliated with any family office/business conglomerate or the state

⁶¹ In brackets, the fund’s name is followed by the managing company’s name (if any)

Table 6. Operating classic PEFs financed by quasi-public funds⁶²

FUND	INDUSTRY MANDATE	KCM'S SHARE	AMOUNT, USD MILLION	SOURCE OF CAPITAL	TRANSACTIONS ⁶³ /INFORMATION
1. Kazakhstan Infrastructure Fund GP: Verno Capital	Infrastructure	95.2%	105	KCM	CAEPCO JSC, KIF Warehouses (Korgos)
2. Baiterek Venture Fund (BVF)*	Priority sectors under NPFID	100%	102.5	KCM	CAEPCO, AllurGroup, Mining Chemical Company, Sachiko-Olzha Products, ARP Company, Aitas KZ, CAPEC Green Energy, Astana Gas, Baikonur Solar
3. DBK Equity Fund CV. (DBK EF) GP: BV Management	Projects of Development Bank of Kazakhstan and DBK Leasing	3%	88.4	KCM DBK	TengizTransGroup, CAPEC Green Energy
4. Almex-Baiterek Fund (ABF)*	AIC, food industry and other priority sectors under the SPIID	7%	1.2	KCM ALMEX Project	In January 2018, KCM reduced its participatory interest in the fund to 7%
5. Kazakhstan "Silk Road" Agriculture Growth Fund (KAGF) GP: CEECAT	AIC	-	40	Hungarian EximBank, KazAgro	Greenhouse complex: Green Capital Kazakhstan, apple orchards, dairy farm
6. KCM Sustainable Development Fund (KCMSDF I) GP: BV Management	Priority sectors of the economy	100%	26.4	KCM	The fund has been established on 12 April 2019, at the moment there are no ongoing projects
7. Eurasian Nurly (Bright) Investment Fund (ENIF)	Multiple industries mandate, including infrastructure, processing of natural resourced, logistics, IT, processing industry and AIC	14%	212.1	KKM, CITIC Group, Asia Investment Finance Group Limited, China Bosen, SSOG	On 25 April 2019, at Kazakhstan-China Round Table in Beijing devoted to investment cooperation, there were signed the documents of the first closure of the fund for \$212.1 million. The planned target size of the fund to be established will be \$500 million.

Note: * - the fund is managed by a captive team

⁶² The funds' official websites, KCM annual reports (2008–2017), KCM in-house data, open source data, public sources. Data current as at 1 May 2019 (at the exchange rate as at 1 May 2019)

⁶³ KPMG database. Data on transactions are not exhaustive; for more details, see the Methodology section

Independent PEFs⁶⁴:

— *Independent PEFs managed by local (Kazakhstan) teams*

are: Tau Capital PLC, Kazakh Compass Fund, Stichting RCG Netherlands (CRG fund), Falconry;

— **Other funds include:** Resources Capital Fund, SigmaBleyzer, TPG Capital, Spring Capital Asia, PPF Investments, Phoenician Offshore Fund, TRG Growth Partners, Eagle Kazakhstan Fund, AIG Silk Road Fund, CVCI Growth Fund I, East Capital Financials Fund, Great Circle Fund, funds managed by Baring Vostok Capital Partners.


For the period 2008–2018, **12 out of 23 identified independent PEFs** entered into transactions with Kazakhstan's companies.

THE RESULTS FOR 10 YEARS ARE SHOWN BELOW*:

 20 investments ► 19% of total PE transactions in Kazakhstan

 Total amount of investments in Kazakhstan amounted to ► ~\$400 mln ► (\$170 million - a deal for acquisition of Emir Oil)

 Industry focus of independent PEFs was mainly put on traditional sectors ►  Metals and mining  Oil and gas  Finance

 6 exits for the total amount of ► ~\$1.8 bln ► (\$1.6 billion: an exit of PPF Investments from Oriel Resources Limited; \$155 million: a partial exit of TPG Capital from Emir Oil)

Note: * - Data on transactions are not exhaustive; for more details, see the Methodology section

⁶⁴ PEFs carrying out transactions since 2000

Table 7. Operating independent classic PEFs⁶⁵

FUND	DESCRIPTION	INDUSTRIES	GEOGRAPHY	AMOUNT, USD MLN**	INVESTMENTS
1. Baring Vostok Capital Partners' funds (BVCP)	The largest classic PEF operating in the CIS	Multiple industries focus	Russia and CIS	413	— Caspian Gas Corp (2006) — Bank Kaspiyski – Kaspi (2007) — Zhaikmunai (2009) — Kolesa (2014)
2. Resources Capital Fund (RCF)	US-based private equity fund specialising in extraction of mineral resources	Natural Resources/ Metals and Mining	Across the globe	3600	RG Gold (2018)
3. Stichting RCG Netherlands (CRG Global Resources Fund)	RCG is a specialised firm managing private investments in the sector of natural resources	Natural Resources/ Metals and Mining	Kazakhstan and Central Asia	~30	~8 investment projects BAST (2012) Irtys Polymetal (2014)
4. Falconry	Kazakhstani PEF established by private investors	Multiple industries focus	Kazakhstan, Russia	20	Shoes Republic (2016)

Note: ** Size of Baring Vostok Private Equity III

⁶⁵ Official websites of the funds; CKM annual reports (2008–2017), KCM internal data, public sources, KPMG database. Data are presented as at 1 March 2019



Other observations:

- Independent funds managed by international GPs that made investments in Kazakhstan are characterised by being ‘closed’ in nature and having a point investment approach (they lack regular investments in Kazakhstan’s assets)
- Due to the protracted crisis, since 2008 there have been fewer independent classic funds with local general partners (GP). Mention can be made of the hybrid fund Tau Capital PLC and its management company Compass Management, which made about four investments in 2008–2010
- As far as it is known, currently in Kazakhstan there is a limited number of independent PEFs with local management companies that carry out investment activities. Only two small funds, managed by Falconry and RCG, may fall into this category. These funds are distinguished by having specific investments of up to \$5 million, chiefly in SMEs



Figure 23 shows that classic PEFs in Kazakhstan are today focused on investments of \$1-5 million or more.

~\$625.6 mln

The total capitalisation of nine such funds is ~\$625.6 million, of which \$575.6 million constitutes the capitalisation of seven funds financed by quasi-public holding companies.

Three funds, which invest more than \$5 million in Kazakhstan, have a clear sector-specific focus (with the exception of ENIF fund, which has a multiple industry mandate):



RCG – metals and mining

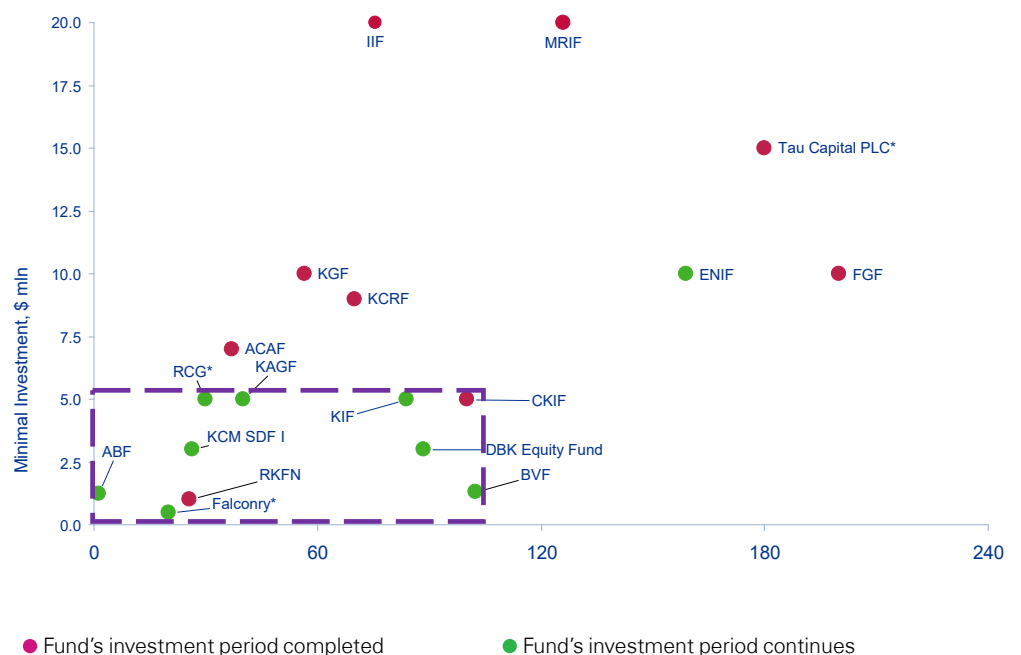


KIF – infrastructure



KAGF – agriculture

Figure 23. Distribution of PEFs with a mandate to invest in Kazakhstan⁶⁶



⁶⁶ Official websites/management reports of the funds, public sources



Over **the past ten years**, around **28 classic PEFs** have been carrying out transactions in Kazakhstan, of which 16 are quasi-public, three are local independent ones, and the remaining nine are private international funds.



The investments of international funds have been of point nature.



The management companies of the funds largely comprised **international GPs**; only seven out of 28 funds were managed by local GPs.



Currently only nine investment companies in Kazakhstan are carrying out investment activities based on the principles of classic PEFs: seven quasi-public funds (ABF, BVF, DBK Equity Fund, KIF, KCM SDF, ENIF, and KAGF) and two independent private PEFs (funds managed by RCG and Falconry).



Nine family offices/business conglomerates had a structure similar to that of a PEF (FO/PE).

There are certain constraints in private equity markets compared to international practices:

- The main **sources of funding** for Kazakhstan's PEFs are the funds of funds (KCM, KazAgro), international financial institutions (the EBRD, IFC, CDC, etc.), and, to a lesser extent, high-net-worth individuals (family offices)/business conglomerates, but not institutional investors, such as pension funds/insurance companies.
- State-owned companies (been put up for sale under privatisation programmes), distressed bank assets, and the assets of family offices may serve as **investment targets** for PEFs. In the wake of the devaluation of the national currency, the assets' value decreased, and, in view of this, transactions in this area can be even more profitable in cases where a company has export potential. At the same time, there is a significant imbalance in how capital is distributed among the state, the limited number of high-net-worth individuals, and the rest of the population of the country, and this is one of the factors that contributes to there

being a lack of a sufficient number of companies with medium capitalisation levels and lower stock market activities.

- **Exit opportunities (key investors in the market)**. The Sovereign Wealth Fund Samruk-Kazyna is an active investor in large projects, mainly with the aim of supporting international investors and major national companies. International financial institutions are also investing in major projects (worth more than \$10 million), which have a positive growth outlook and potentially beneficial social and economic effects. At the same time, currently a number of local strategic investors are established on the market, comprising companies owned by high-net-worth individuals (family offices)/business conglomerates. These entities focus on investing in assets to pursue synergies with portfolio companies. More details about other exit opportunities are provided in the following section.



3.3 ANALYSIS OF M&A MARKET ACTIVITY OVER 2008–2018



On average, 122 M&A transactions are annually executed in Kazakhstan, with a total value of around \$4.8 billion, and accounting for ~2.8% of GDP.

The M&A market lacks transparency, especially when it comes to disclosing the amount of transactions; for 10 years, the share of transactions with undisclosed amounts has accounted for 47% of total deals (see details in Appendix 3).

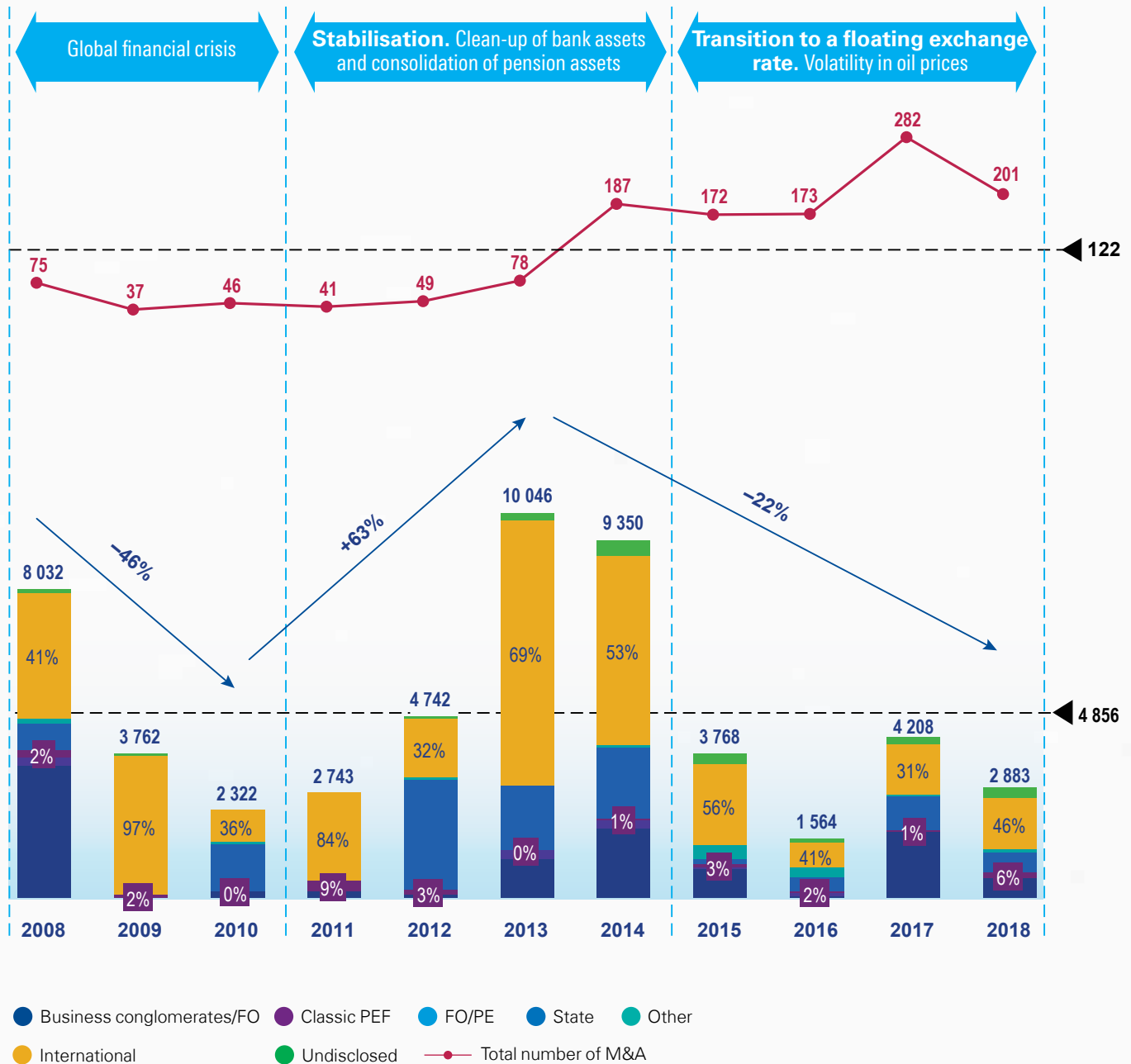
It is clear that there is a correlation between the economic situation in the country and the value of M&A transactions:

- During the global financial crisis (2008–2010) the size of the M&A market shrank significantly, from \$8 billion to \$2.3 billion (on average -46% annually), and the number of transactions declined from 75 to 46 (-39%);
- From 2010 to 2013 the economy was recovering: average annual nominal GDP growth in USD was +17%, and growth in M&A volumes was

+63% annually. The volume of M&A transactions saw a fourfold increase, while the number almost doubled;

- The period between 2014 and 2018 was characterised by high commodity price volatility (including oil prices), and in the context of transitioning to a floating exchange rate and the devaluation of the national currency, average annual nominal GDP growth in USD was -7%, and, for the M&A market, the CAGR stood at -22% per year. At the same time, the average number of transactions for the period was 203 per year, with a trend to rise at a CAGR of +2% per year. A privatisation programme of state-owned assets was one of the key drivers behind the increase in the number of M&A transactions.

Figure 24. Dynamics in the number and volume of M&A transactions in Kazakhstan by types of investors, USD million



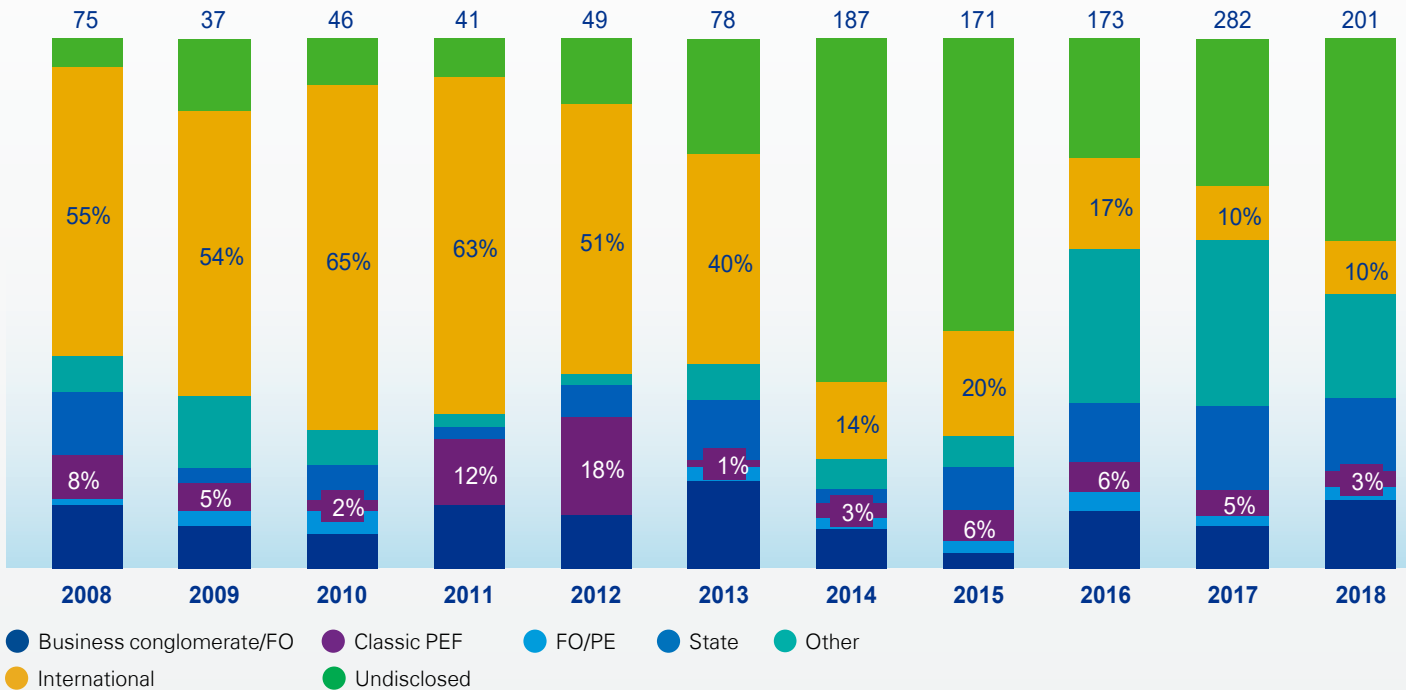
Source: KPMG database

As can be seen from Figure 25, the number of M&A transactions with the participation of foreign investors declined significantly from 2014. While before 2014 its share averaged 55%, in the past four years its average share

fell to 14%, which was mainly due to an increase in the number of transactions of undisclosed investors, whose proportion grew by 43 percentage points for the year (from 2013 to 2014). The change in the volume (in the USD

equivalent) was not so severe, from 60% to 46%, which points to a decline in foreign investor activity during this period.

Figure 25. Dynamics in the number of M&A transactions in Kazakhstan by types of investors



\$53.4 bln

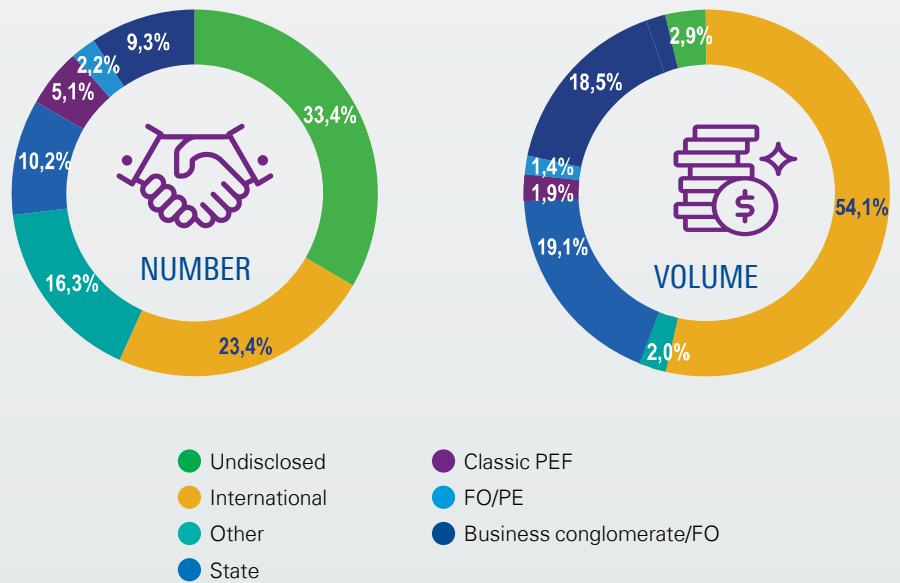
Thus in the past 10 years, 1,340 M&A transactions worth \$53.4 billion, or ~3% of GDP annually, have been executed.

As can be seen from Figure 26, the key players in the M&A market comprised international investors: their share accounted for 23.4% in terms of number and 54.1% in terms of value. Investments featuring the participation of the state constantly accounted for a significant share, contributing 19.1% to the total value of transactions and 10.2% to the total number of transactions.

The percentages of classic PEFs and FO/PE were the smallest, accounting for 3.3% in terms of value and 7.3% in terms of number of transactions.

In terms of a sectoral focus, traditional sectors – oil and gas, metals and mining, and financial services – accounted for a significant share of the volume of M&A transactions. On average, these three sectors annually accounted for 69% of the total transaction volume, with the oil and gas sector contributing 32%, metals and mining 21%, and financial services 15%.

Figure 26. Total number and volume of M&A transactions in Kazakhstan, 2008–2018, by types of investors



Source: KPMG database

Transactions in traditional sectors also account for a significant, but not so substantial, share of all M&A transactions: only 38% of total number of transactions annually, with oil and gas contributing 8%, metals and mining 12%, and financial services 18%. And

while over 2008–2013 the average share of the traditional sectors was 49% annually, since 2014 this indicator has almost halved, to stand at 25% annually, which was largely attributable to volatility in oil and metal prices.

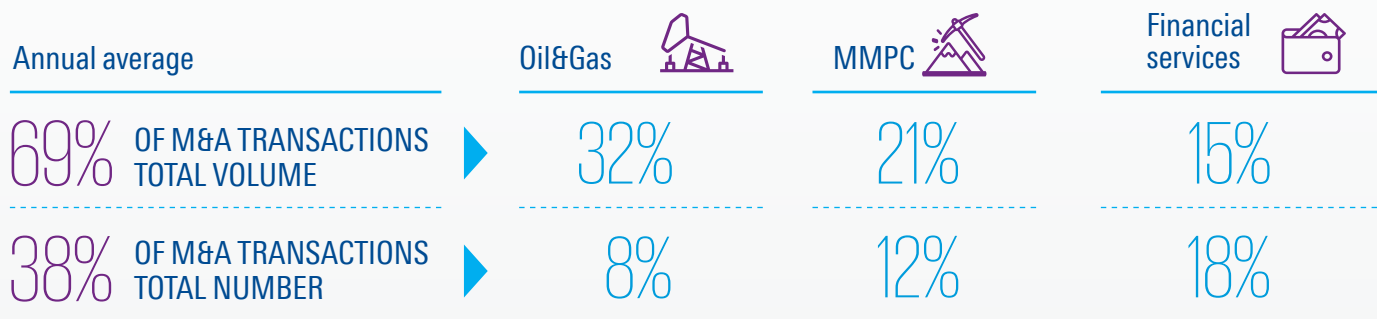
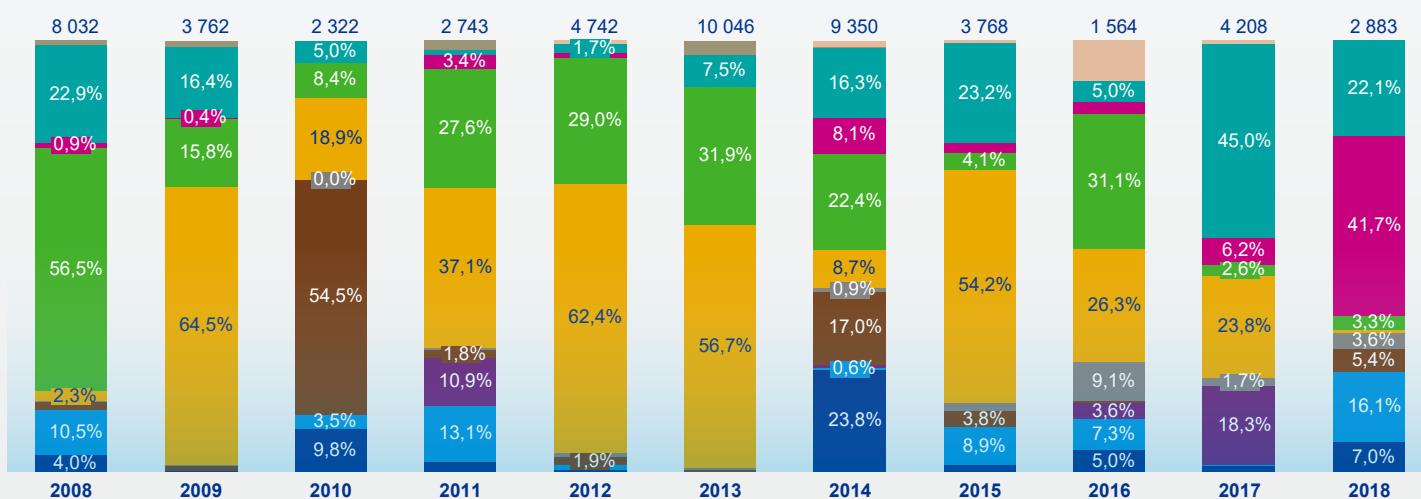
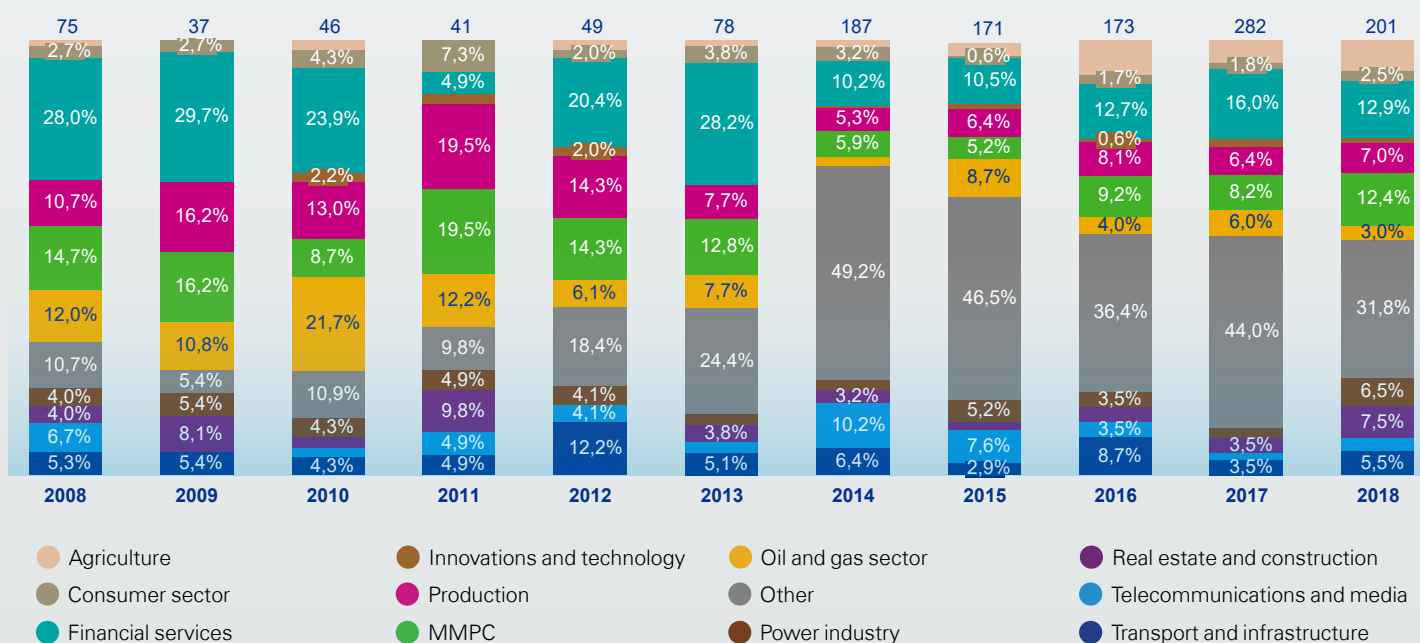


Figure 27. Dynamics in the volume of M&A transactions in Kazakhstan by sectors, USD million



Source: KPMG database

Figure 28. Dynamics in the number of M&A transactions in Kazakhstan by sectors



Source: KPMG database

3.4 FUNDRAISING BY PEFS AND THE APPLICATION OF INVESTORS' FUNDS



As mentioned above, the specific feature of the Kazakhstan's market is that the key players of the private equity market are categorised into two main groups: classic PEFs and captive teams under family offices (FO/PE).

CLASSIC PEFS during the period 2008–2018 mainly comprised quasi-public funds (the funds KCM and KazAgro). For the 10-year period of its existence, KCM has established 15 funds, with a total capitalisation of ~\$2.6 billion; the share of funds allocated by KCM to the funds amounted to around \$0.58 billion or ~21% of the total capitalisation of 15 funds. The bulk of KCM funds were established before 2011 (eight out of 15), which raised a total of \$1.8 billion.

As mentioned above, the key co-investors in quasi-public funds comprise international financial institutions: the EBRD (four funds), IFC (two), and CDC, FMO, ADB, and IDB (one each).

It should be noted that by the end of 2015 the investment phase of the bulk of funds established jointly with other independent LPs was completed; the remaining funds had a high share of Kazakhstan's companies in their capital (with the exception of ENIF). A decline in

activity on the part of external investors was due chiefly to the devaluation of the national currency.

The structure of **private independent funds** is not sufficiently transparent. It is not known how much funding private independent funds have raised by year, however, according to open source data, in the past 10 years only three-to-four funds with a low level of capitalisation (below \$20 million) have appeared on the Kazakhstan's market.

CAPTIVE FUNDS UNDER FAMILY OFFICES (FO/PE). According to open source data, in the past 10 years the funds of this category have not attracted independent co-investors or LPs and have been operating solely at the expense of the internal funds of principal shareholders.



3.5 DYNAMICS IN TOTAL VOLUME OF PRIVATE EQUITY INVESTMENTS MADE IN KAZAKHSTAN, 2008–2018⁶⁷

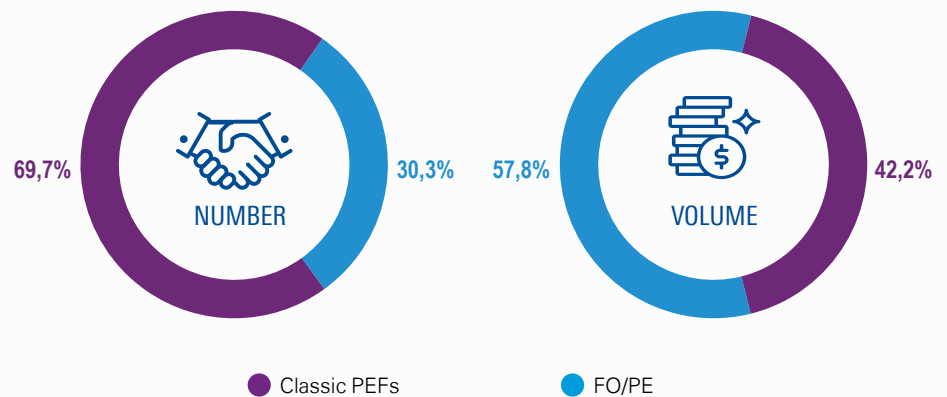
 **\$1.8 bln**

In 10 years around 100 transactions have been executed related to PE investments in Kazakhstan's assets, worth \$1.8 billion.

Thus, on average, nine transactions worth \$160 million were made annually, which accounted, on average, for ~3.7% of the total volume of the M&A market and ~0.07% of GDP⁶⁸.

Classic PEFs accounted for 69.79% of all transactions, while FO/PE transactions accounted for 57.8% of the total volume (Figure 29).

Figure 29. Total volume and number of PE transactions in Kazakhstan for the period of 2008–2018 by types of PEFs



Source: KPMG database

Over the past 10 years there have been a number of standout transactions executed by PEFs (see Table 8). During 2011, for example, the globally known TPG Capital fund invested \$170 million in

an asset in Kazakhstan, Emir Oil, through one of its portfolio companies – the Chinese oil and gas holding company MIE Holdings⁶⁹.

⁶⁷ In assessing market size and dynamics, the funds' investments in Kazakhstan's assets are considered. For details, see the Methodology section

⁶⁸ Nominal GDP in USD

⁶⁹ Bain & Company Global Private Equity Report 2012

Table 8. List of key PE in Kazakhstan's assets, 2008–2018⁷⁰

DEAL TARGET	SECTOR	BUYER	TRANSACTION VALUE (USD MILLION)
2008			
Ordabasy-Nokian Tyres	Transport and infrastructure	Ordabasy	235.0
Asem-Ai	Consumer markets	SigmaBleyzerInvestment Group	77.0
Digital TV	Telecommunications and media	Tau Capital	39.4
Teniz Servis	Oil and gas	Tau Capital	28.5
Zhaikmunai (Nostrum Oil & Gas)	Oil and gas	Baring Vostok Capital Partners	n/a
2009			
CAEPCO	Power industry	EBRD	47.3
2010			
Lucent Petroleum	Oil and gas	Tau Capital	n/a
Metrocombank	Financial services	Verny Capital	n/a
2011			
Emir Oil	Oil and gas	MIE Holdings (TPG Capital)	181.9
CAEPCO	Power industry	Islamic Infrastructure Fund	50.0
2012			
Karaganda Power Center	Power industry	Falah Growth Fund	50.0
Alsad Kazakhstan	Other	Falah Growth Fund	23.0
Caspian Development CS	Other	KCRF	20.7
Olzha	Transport and infrastructure	CITIC Kazyna Investment Fund	17.0
2013			
Orion Minerals	Metals and mining	Kazzinc, Verny Capital	205.9
2014			
Temir bank	Financial services	Verny Capital	195.4
Chaplin cinema	Other	KCRF	19.8
Kolesa	Innovations and technologies	Baring Vostok Capital Partners	14.5
Alma-TV	Telecommunications and media	Ordabasy Group	n/a
2015			
CAEPCO	Power industry	Kazakhstan Infrastructure Fund	30.0
Primejet	Transport and infrastructure	Kazakhstan Infrastructure Fund	25.0
Fresh Fruits Kazakhstan	Agriculture	Asadel Partners PEF	15.2
2016			
Alel Agro	Agriculture	Asadel Partners PEF	50.7
2017			
Apple orchards (Taraz)	Agriculture	KAGF	13.0
Commercial dairy farm	Agriculture	KAGF	10.4
2018			
AstanaGas KMG	Power industry	Baiterek Venture Fund	116.4
Tengiztransgas	Transport and infrastructure	DBK Equity Fund	24.0
CAPEC Green Energy	Power industry	Baiterek Venture Fund	7.7
RG Gold	Metals and mining	Resource Capital Funds	n/a
2019			
Baikonur Solar	Power industry	Baiterek Venture Fund	12.3

The volume dynamics of PE transactions in Kazakhstan (Figure 30) show that general economic trends in Kazakhstan impacted activity on the PE market; however, the Kazakhstan’s private equity market is characterised more by having a point investment approach rather than a systematic approach.

Figure 30. Volume dynamics of PE transactions executed in Kazakhstan by types of PEFs⁷⁰, USD million

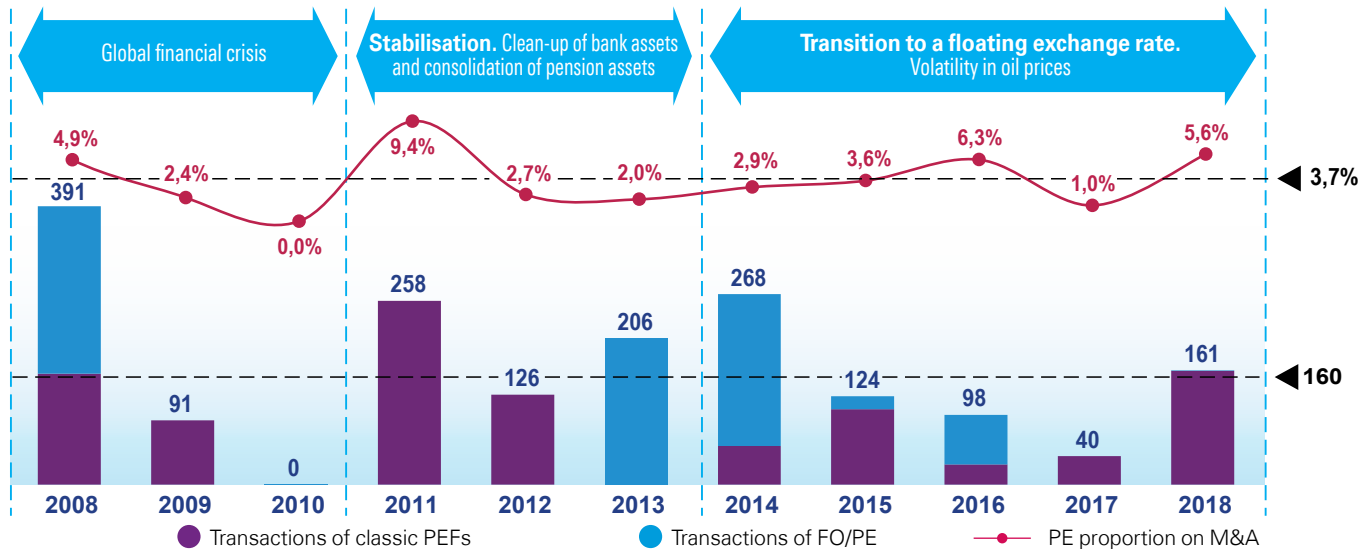
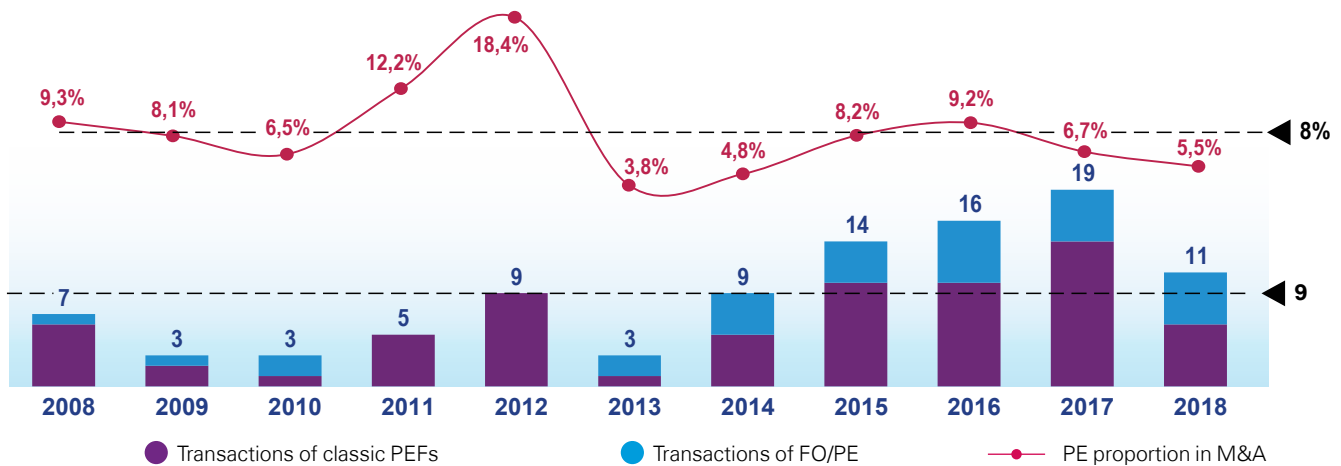
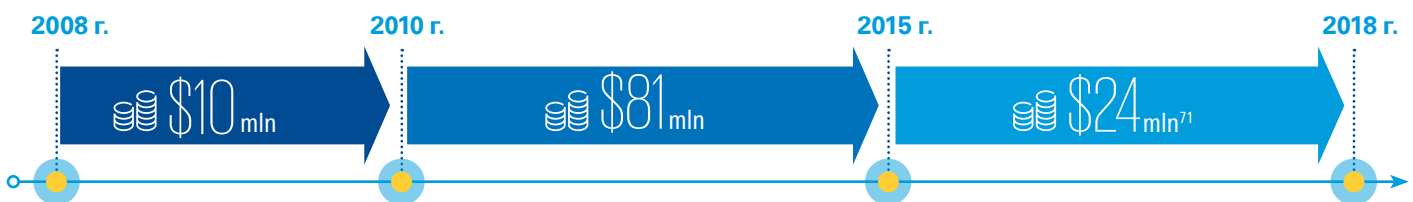


Figure 31. Dynamics in the number of PE transactions executed in Kazakhstan by types of PEFs⁷⁰



FO/PE transactions accounted, on average, for around 33% annually in number terms (Figure 31), and 39% in volume terms (Figure 30). Up to 60% of transactions remained undisclosed (in volume terms), which was due to the specifics of equity investments on the part of family offices.

Over 2013–2017 a growth trend was observed: the number of transactions saw a six-fold increase, which was chiefly due to a rise in the number of public deals involving venture capital. As far as the activity of KCM funds is concerned, the average annual amount of investment in Kazakhstan’s assets, by periods, was as follows:



Therefore, the investment activity of the funds was also in line with general economic trends in the country.

⁷⁰ Data are not exhaustive and are estimated. Source: KPMG database. For details, see the Methodology section

⁷¹ Excluding an AstanaGas transaction worth \$116 million

3.6 INDUSTRY FOCUS OF INVESTMENTS

While observing the industry-specific priorities of PEFs, one notices wide range of sectors involved and a fragmentation of investments. From year to year, the most in-demand sectors for investments have been finance, oil and gas, power, metals and mining, and manufacturing (processing industry). Also, investors have shown

a keen interest in three sectors: telecommunications and media, transport and infrastructure, and oil and gas. Less in-demand deals were made in the consumer markets, real estate, and construction sectors, data on which are not disclosed, as the sectors mainly consist of SMEs, which have a relatively

low capitalisation and a non-public structure.

Regarding the volume of transactions, it is important to note that transactions in the traditional sectors finance, oil and gas, metals and mining, and power, accounted for a significant share of all transactions.

Figure 32. Dynamics in the number of PE transactions in Kazakhstan by sectors

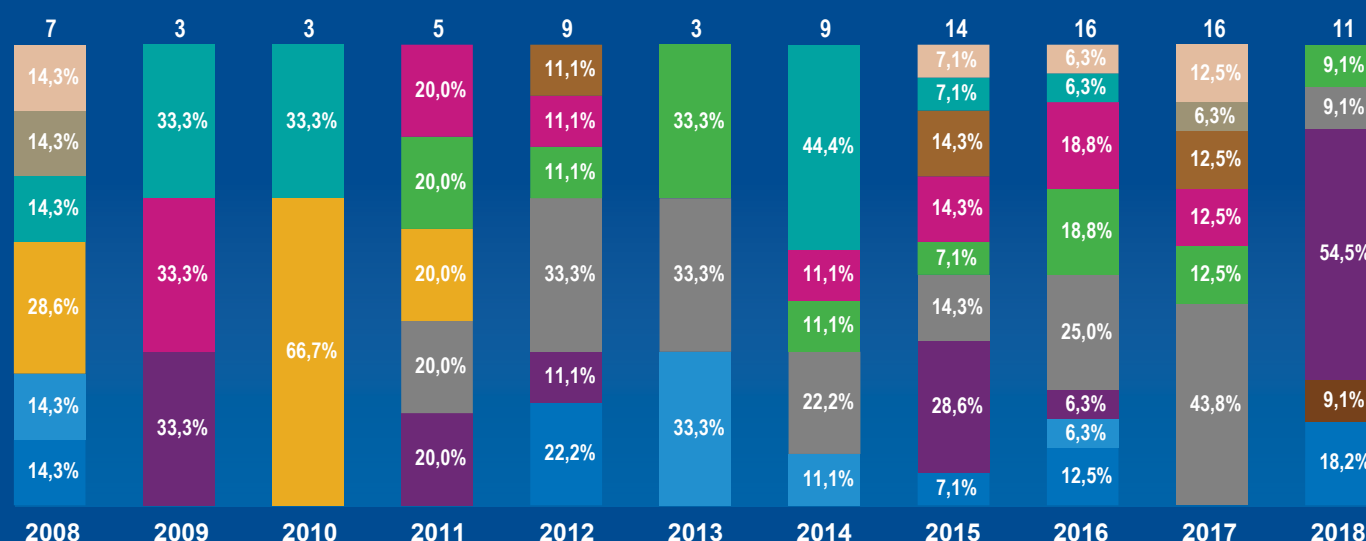
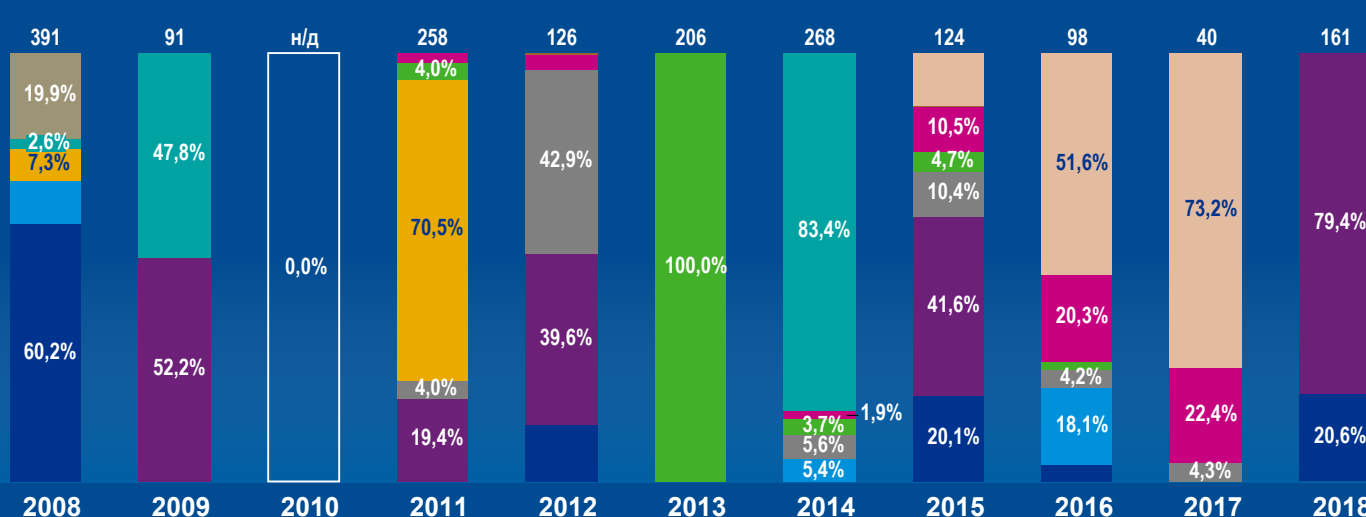


Figure 33. Volume dynamics of PE transactions in Kazakhstan by sectors, USD million



- Agriculture
- Innovation and technology
- Oil and gas sector
- Real estate and construction
- Consumer sector
- Production
- Other
- Telecommunications and media
- Financial services
- MMPC
- Power industry
- Transport and infrastructure

Source: KPMG database

3.7 TYPES OF TRANSACTIONS

Among classic PE transactions known in terms of their structure (Figure 33), the key types of transactions are those with growth and venture capital in the companies at the expansion stage. Such investment specifics are due to the low maturity of the PE market in Kazakhstan, the small number of companies with mid-capitalisation and the limited opportunities for their growth.

As can be seen from Figure 35, the average size of disclosed PE transaction totalled \$28 million. Players from the FO/PE category are characterised by having larger transactions, with an average volume of \$62 million, while for classic PEFs this volume stands at \$20 million. The median value for all PE transactions is \$10 million.

The share of all PE transactions with an undisclosed volume averaged 36% per year, while the number of undisclosed FO/PE transactions amounted to 60% of the total number of FO/PE transactions annually, which is indicative of the low transparency of the private equity market.

Based on data on PE players' "average checks" in Kazakhstan, it can be concluded that, based on global parameters, the average volume of PE transactions in Kazakhstan is at the level of average values of venture capital transactions in more mature markets. The concentration of companies that have passed through a full investment cycle (from creation to exit) is very low.

Due to the current economic situation and the low maturity of the market, there is potential for investing at earlier stages of companies' development, and for investing in specific areas (such as investments in distressed assets).

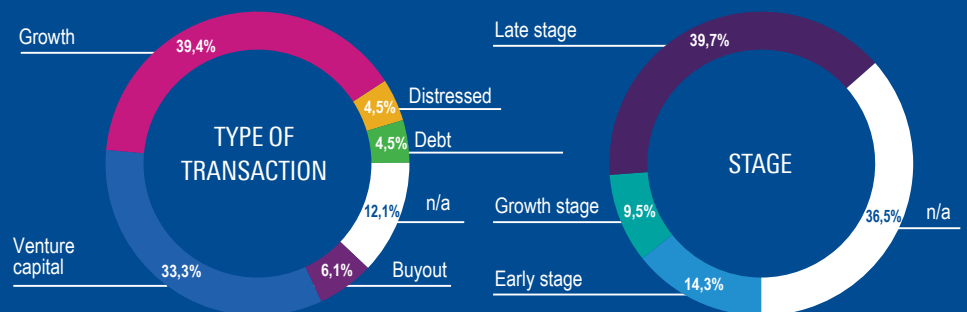
As noted previously, the Kazakhstani market lacks opportunities to invest in equity with a level starting from \$10 million⁷² (previously, five such funds existed). It can be surmised that the supply in this market segment



All potential investment targets in Kazakhstan are at the VC Late Stage.

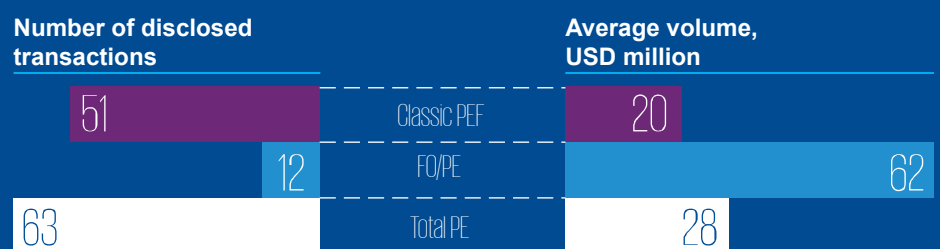
*Eldar Abdrazakov
General Director, Centras Group*

Figure 34. Classification of transactions in Kazakhstan, 2008–2018, by investment types and stages



Source: KPMG database

Figure 35. Number of disclosed deals and average volume of investment in Kazakhstan by types of PEF



Source: KPMG database

matches low demand; in addition, the devaluation of the national currency impacted supply, as the cost of non-commodity assets almost halved in USD terms.

However, investments in projects with a value starting at \$1 million are highly specific and require a more flexible decision-making structure for the fund

– players in this sector so far comprise small private funds.

⁷² Except for KCM fund – EINF, established in April 2019

3.8 DETERMINING THE NUMBER OF COMPLETED EXITS AND EXIT STRATEGIES

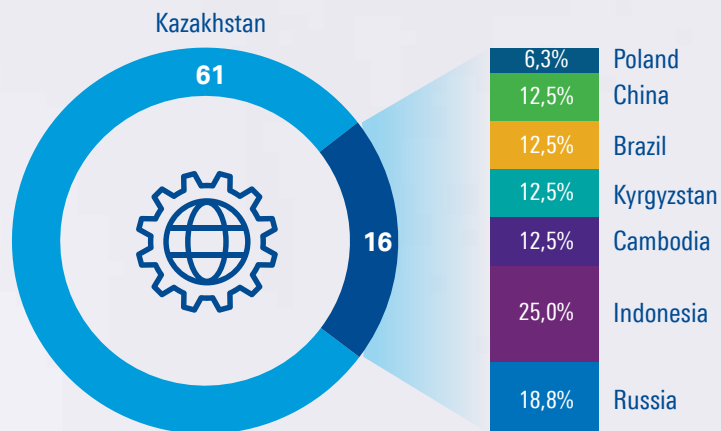


Over the past 10 years, 77 exits have been registered, of which 61 were from Kazakhstan’s assets and the remaining 16 were those of Kazakhstan’s funds from overseas assets.

Available data on the transactions of Kazakhstan’s companies overseas are very limited: only five out of 16 transactions pertain to FO/PE players, while the remaining 11 transactions are executed by KCM funds, which have a mandate to invest globally.

Since 2008 the volume of exits has totalled \$7.7 billion, which is nearly quadruple the value of PE transactions executed during this period. The average value of an exit was \$139 million, while the median exit value was \$14.6 million,

Fig. 36. Number of executed exits by countries for the period of 2008–2018



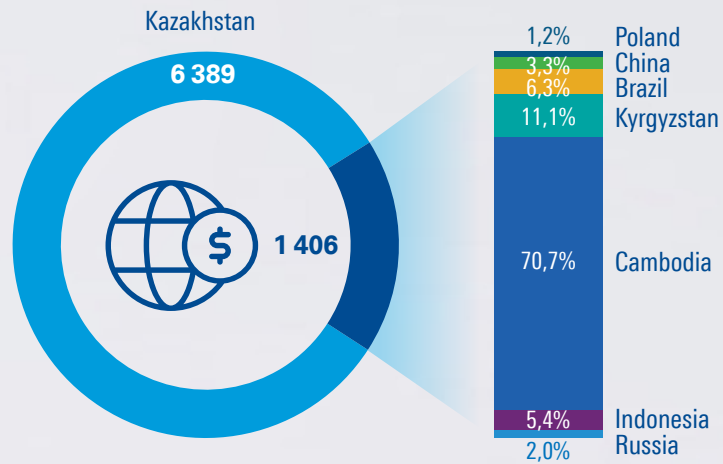
Source: KPMG database

which was primarily attributable to mega transactions. In 10 years, three transactions worth over \$1 billion have been concluded, three worth over \$500 million, and four worth over \$100 million. It should be noted that partial exits were

considered to be separate transactions: thus four of the 10 mega transactions relate to two assets, NCELL and Kazzinc.

Exits in Kazakhstan accounted for 82% of total exits executed over this period. A major part of overseas transactions was accounted for by Cambodia, due to a large transaction of Visor Holding on the sale of the telecommunications operator NCELL to the companies Telia Sonera and Axiata Group: the value of the two transactions amounted to nearly \$1 billion. The remaining deals were distributed more-or-less evenly.

Figure 37. Value of executed exits by countries, 2008–2018, USD million



Source: KPMG database

Exits from Kazakhstan's assets

70%

Of 61 exits executed, the transaction value is known for only 70% of transactions, with the average transaction value being \$155.4 million and the median value \$4.9 million, which is evidence of the existence of targeted mega transactions.

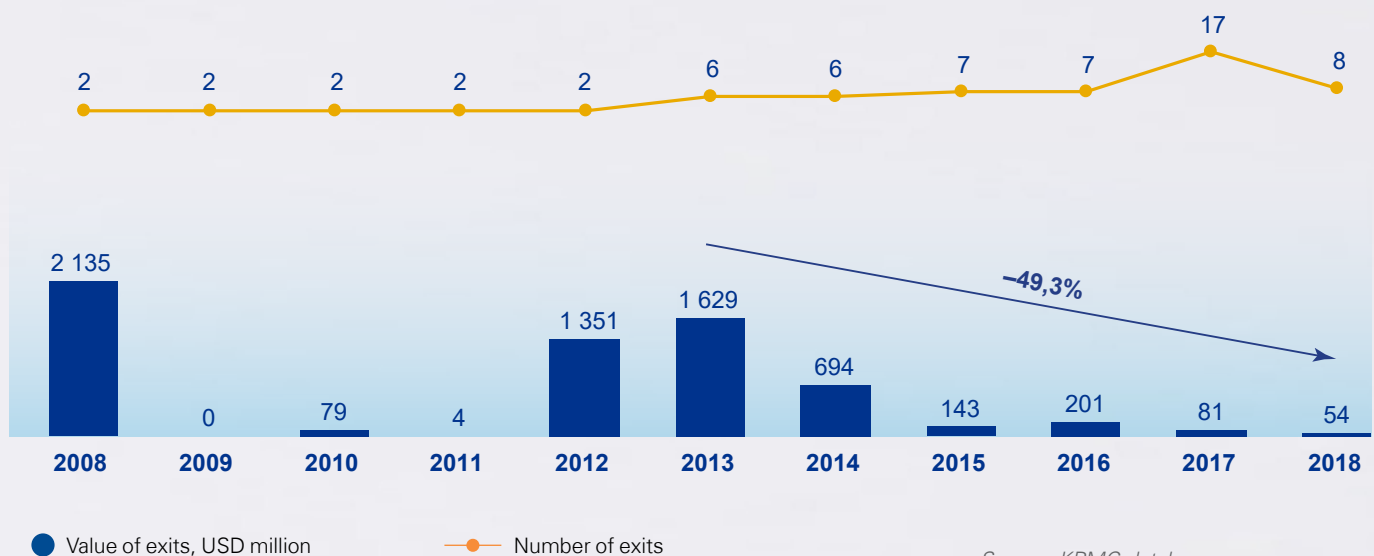
In terms of trends, as can be seen from Figure 38 the number of exits began increasing in 2013, which was chiefly associated with the related investment cycle (a focus on executing an exit) of the majority of KCM funds. At the same time, in 2013 the value of exits began decreasing (on average by 49% per

year). This could have been due to the devaluation of the national currency, which resulted in an impairment of assets, which increased their attractiveness in the local market.

When analysing the total value and number of executed exits (Figure 38), it can be seen that the number

of transactions was distributed comparatively evenly among KCM funds, FO/PE, and international funds, while in terms of the value of transactions, FO/PE and international funds accounted for 91.6%.

Figure 38. Dynamics in the number and value of exits from Kazakhstan's assets



Source: KPMG database



During the period 2012–2015, of special interest were Verny Capital’s sale of Altyntau and TPG Capital’s partial exit from Emir Oil (the sale of a 60% stake in the oil asset to a strategic investor). Particularly active during this period was Ordabasy group, which successfully sold a controlling stake in Maten Petroleum and in ALMA TV. Equally successful was Falah Growth Fund selling its asset Karaganda-EnergoCenter to the company KKS.

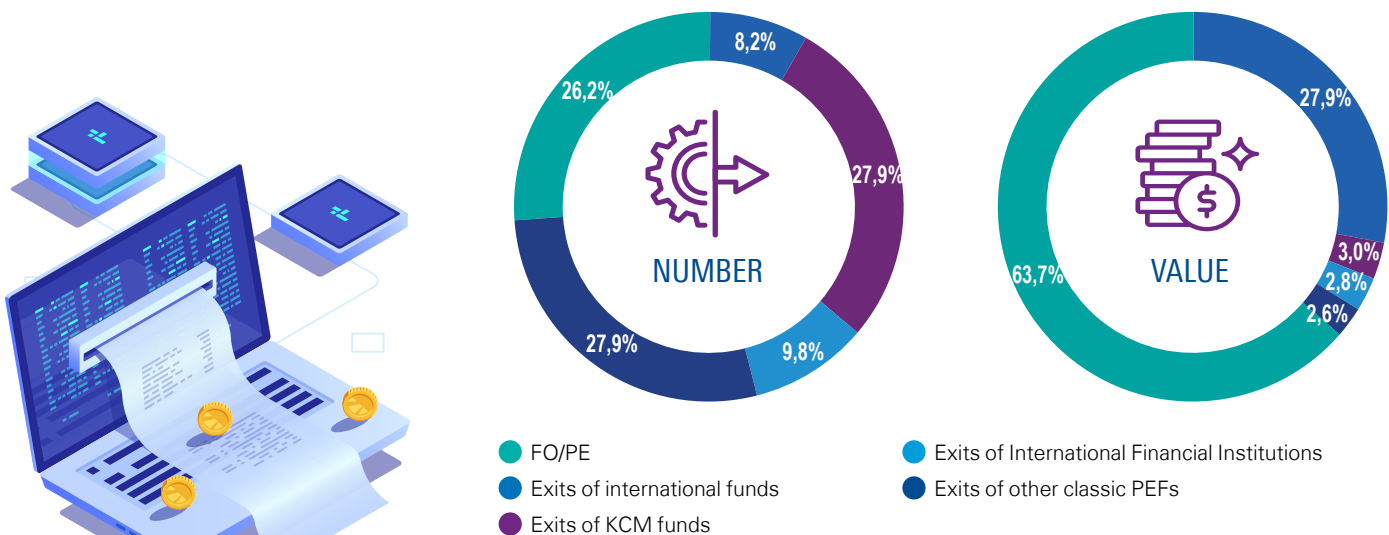
2018 ▶ 6 exits were made by KCM funds

Activity observed in the market in 2018 was fairly good: KCM funds made six exits.

Closer to the year-end, Verny Capital sold a part of its stake (35%) in the gold mining company RG Gold to another PEF that was focused on the mining industry

and geological surveying: Resources Capital Fund (RCF).

Figure 39. Total value and number of exits from Kazakhstan’s assets, 2008–2018, by types of selling parties



Source: KPMG database

Table 9. List of key PE exits from Kazakhstan's assets, 2008–2018⁷³

TRANSACTION TARGET	SECTOR	SELLER	TRANSACTION VALUE (USD MILLION)
2008			
Oriel Resources Limited	Metals and mining	PPF Investments Ltd	1581.7
Limnotex Developments Ltd	Telecommunications and media	Crowell Investments (Verny Capital)	553.3
2009			
Pension Plan Investment Management Organization "Orleu"	Financial Services	Resmi	n/a
APF Korgau	Financial Services	Resmi	n/a
2010			
Almaty Airport	Transport and infrastructure	Meridian Capital, SAT Infosystems	79.3
2011			
Karaganda Pharmaceutical Complex	Production	NATD	42.3
2012			
Kazzinc	Metals and mining	Verny Capital	1349.7
KazGeoKosmos	-	IFK	1.3
2013			
Kazzinc	Metals and mining	Verny Capital	1623.4
SK Leasing	Financial services	International Finance Corporation	2.2
Bank CenterCredit	Financial services	International Finance Corporation	n/a
2014			
Maten Petroleum	Oil and gas	Ordabasy	514.0
Qazkom	Financial services	EBRD	137.5
KazinvestBank	Financial services	EBRD	27.5
Alem Communication Holding	Telecommunications and media	DTV Invest co (Tau Capital)	15.2
Alma-TV	Telecommunications and media	Ordabasy	n/a
2015			
Karaganda Power Center	Power	Falah Growth Fund	86.4
Kremnii Kazakhstana	Production	IFK	46.0
Kazakhstan Kagazy PLC	Production	Phoenician Capital	7.5
Innova Investments	Financial services	Resmi	n/a
2016			
Emir Oil	Oil and gas	MIE Holdings Corp. (TPG Capital)	171.9
Ai Karaaul	Metals and mining	Ordabasy	18.4
Primejet	Transport and infrastructure	Baiterek Venture Fund	4.2
KazInvestBank	Financial services	TRG Growth Partnership LP	n/a
2017			
BioOperations	Production	IFK	23.9
Bank CenterCredit	Financial services	International Finance Corporation	12.5
Mining Chemical Company	Metals and mining	Baiterek Venture Fund	2.9
Korporatsia Derzhava	Production	Aureous Central Asia Fund LLC	1.5
2018			
ARP Company	Production	Baiterek Venture Fund	13.9
Sachiko-Olzha Products	Production	Baiterek Venture Fund	3.8
RG Gold	ГМК	Verny Capital	n/a
2019			
CAEPCO	Power	EBRD	n/a

⁷³ Data are not exhaustive and are estimated. Source: KPMG database. For details, see the Methodology section

Figure 40. Exits from investments in Kazakhstan's assets by types of strategies⁷⁴

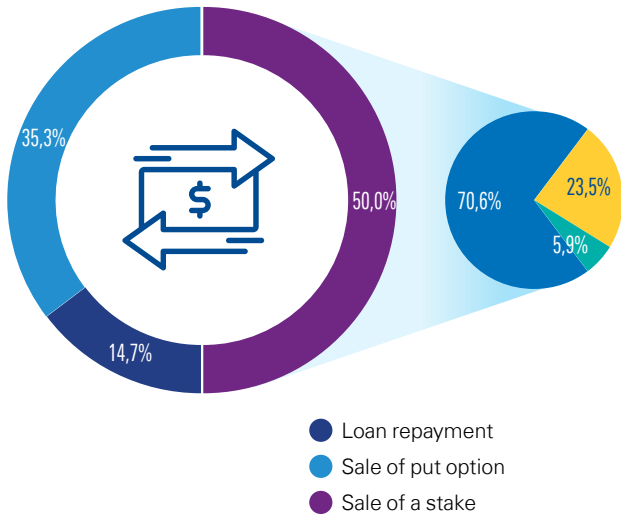
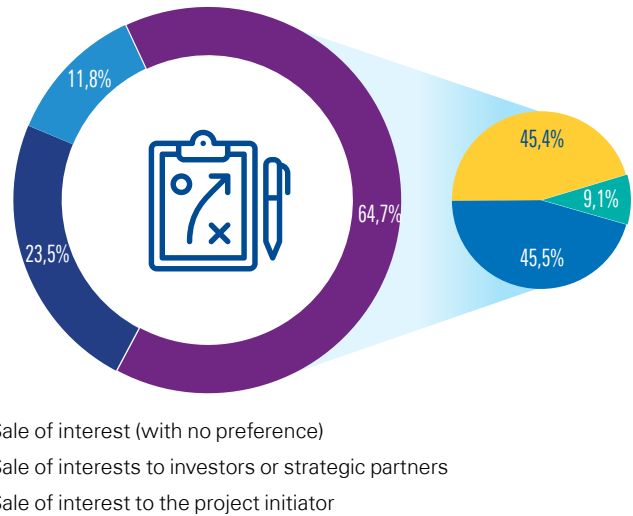


Figure 41. Exits in Kazakhstan by executed exit strategies⁷⁵



Source: KPMG database

A key exit strategy adopted in Kazakhstan is the sale of a stake.



In this regard, 70% of funds are not particularly concerned with whom they sell to – be it a project initiator or an external strategic investor. The second most popular exit method features a more conservative investment strategy, where the exit is made through put option; players preferred this method in 35% of investment exit strategies.

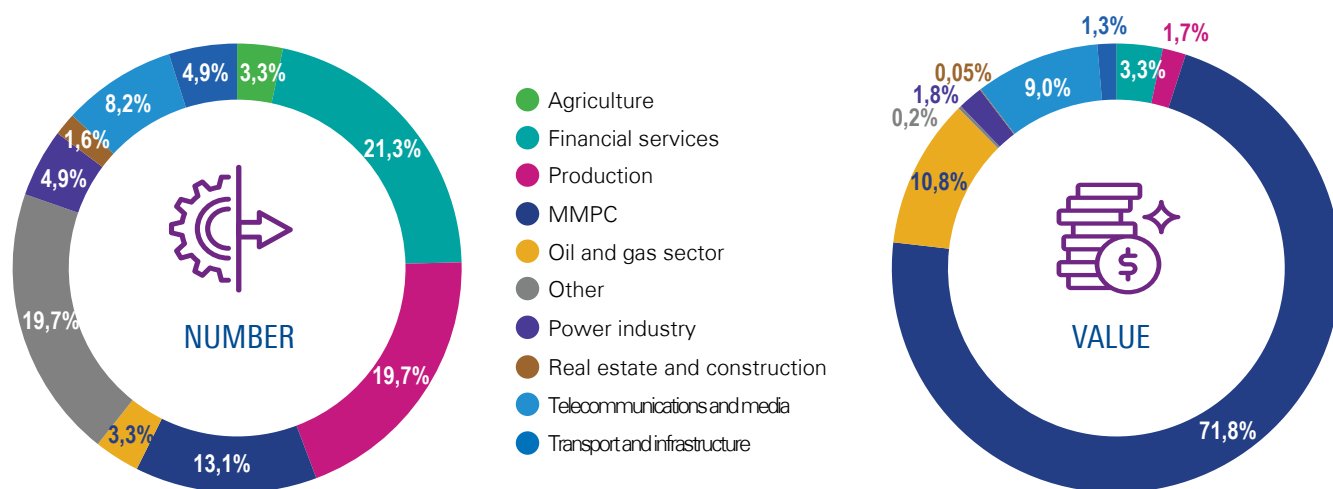
Based on the data available on actually executed transactions, 65% of exits were sales of a stake and, as can be seen in Figure 41, around 50% of exits were via the sale of a stake to strategic investors. Only four out of 17 exits were made through a put option, while two were via loan repayments.

Figure 42 shows that the number of exits was split fairly evenly between different industries – a large number of transactions were made in the financial services and manufacturing (processing industry). However, while the metals and mining industry accounted for only 13.1% of exits in number terms, in value terms this sector accounted for almost 72% of exits, with the remaining large exits, in value terms, being made in another primary sector, oil and gas. The telecommunications sector was in third place in value terms, and accounted for 9% of exits.

⁷⁴ KCM internal data; data on 34 investments

⁷⁵ KCM internal data, public sources, KPMG analysis, data on 17 exits

Figure 42. Total number and value of exits in Kazakhstan by industries, 2008–2018



Source: KPMG database

The investment strategies pursued by PEFs must be tailored to address local market realities: strategic investors remain a key instrument for exits; their investment potential has not been fully realised in Kazakhstan and is at a rather low level in the country.

- 1. The stock market** is underdeveloped, due to a lack of liquidity available for investment. For details, see Section 1.3.
- 2. Secondary buyouts.** There have been targeted sales made between PEFs, however, they are very infrequent. For example, Verny Capital attracted the US-based fund RCF to jointly develop the RG Gold project, which constituted a partial exit. The potential here is very poor, as there are few local PEFs in Kazakhstan.
- 3. Strategic investors.** Kazakhstan has good potential for joint projects – family offices are active strategic investors in various sectors.

Figure 43. PE market in Kazakhstan: existence and potential⁷⁶

EXIT STRATEGY	EXISTENCE	POTENTIAL
Recapitalisation	✓	◐
Strategic investor (trade sale)	✓	◑
Secondary buyout	✗	◐
Initial public offering (IPO)	✗	◐

⁷⁶ The blue colour indicates the extent to which the circle is completed. Secondary buyout, IPO 25%, recapitalisation 50%, strategic investor 75%

3.9 OVERVIEW OF THE MOST SUCCESSFUL PEF COOPERATION STORIES WITH BUSINESS IN KAZAKHSTAN



Kazakhstan has already seen a number of successful transactions, and these have generated significant benefit and value for the business community.

At the same time, the PE market has not so far accrued a critical mass of successful exits: the potential exit of Baring Vostok from Kaspi (through an IPO in 2019) may become one such exit.

Case №1:

Kaspi.kz – Bank’s transformation into the largest ecosystem of innovative services in Kazakhstan

In December 2006 the PEF Baring Vostok Capital Partners acquired a significant stake in Kaspi Bank, thus becoming one of the largest shareholders of the bank. Mr. Mikhail Lomtadze, Partner at Baring Vostok, was appointed Chairman of the Management Board. From 2006 to

2018, under the leadership of Mr. Lomtadze, the bank achieved good performance results, significantly increased its capitalisation, and became a major retail bank, payment system, and marketplace in Kazakhstan, and it had the most popular mobile application. Over 12

years, the Kaspi team succeeded in creating not just the largest retail bank, but in building the Kaspi.kz ecosystem, whose services had been used by five million people at the end of 2018. used by 5 million people at the end of 2018.

Figure 44. Baring Vostok investment: Kaspi.kz

PROFILE

Chairman of the Board of Directors:
Vyacheslav Kim

Chairman of the Management Board: Mikhail Lomtadze

Year of establishment: 1991

Equity: KZT 213 918 000,00 thousand

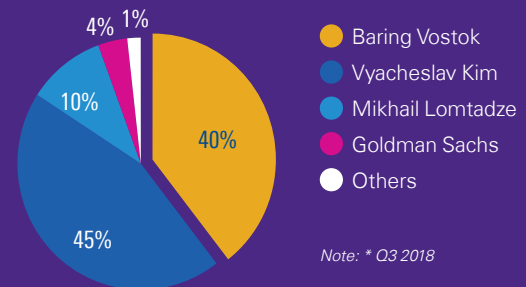
Total assets: KZT 1 699 652 000,00 thousand

Net profit: KZT 111 119 000,00 thousand

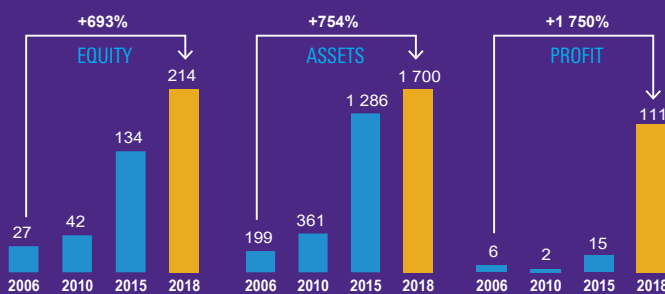
Carrying value per ordinary share: KZT 11 072,00



One of the largest shareholders of Kaspi Bank is the private equity fund – Baring Vostok*



Kaspi’s key performance indicators demonstrated stable growth after investment by Baring Vostok since 2006



Sources: KASE, Forbes Kazakhstan, exclusive.kz, capital.kz

KASPI IN FIGURES

- 2 rank in the banks rating according to Forbes Kazakhstan
- 1 In terms of retail loan portfolio
- 96.6% Is a share of retail loan portfolio
- 5 million customers in Kaspi Ecosystem
- 20% of turnover of non-food goods
- IPO is scheduled for 2019



At the time of making the investment, we did not think that the project would be so long term. However, the development has been so successful that we now believe the project is a landmark one for Baring Vostok. This is true even now, when the region is in a challenging economic situation.

Kaspi had the opportunity to evolve into something more than just a bank. Today, this is one of the most innovative and high-tech businesses in Kazakhstan. We believe that a new line of the business strategy, not connected with the banking sector, is very promising and will ensure rapid business growth. We decided to develop it further⁷⁷.

Michael Calvey
Co-Partner at Baring Vostok

At the end of 2018, Kaspi.kz Chairman Mr. Lomtadze announced that Kaspi was planning to hold in 2019 an IPO on the London Stock Exchange.

⁷⁷ M. Calvey. "Why Baring Vostok is ready to invest in Kazakhstan in time of crisis" // Forbes.kz. 2015

Case №2:

Vassilkovskiy MPP – the most successful transaction of the investment market leader in Kazakhstan

In 2007 Verny Capital acquired VasGold company, which owned subsoil use rights to the Vassilkovskoye gold field (one of the largest gold fields in Kazakhstan in terms of reserves), and one of the top-20 gold fields worldwide. Before Verny Capital entered the project, a number of international mining companies,

including Barrick Gold, Placer Dome, Dominion Mining, and Batman, attempted to do so, but without success. The key issue was low gold content and highly refractory ore; it was necessary to find the technology that would address these issues and to select the appropriate equipment.

At the time of the acquisition, the gold production cost exceeded its final selling cost. The Verny Capital team faced a challenge – to find and launch a new technology to extract the gold and to make the production profitable.



Eventually, two main factors contributed to the success of the project: innovative technology, which was applied in Kazakhstan for the first time, and an appropriately calibrated processing chain in the existing favourable market situation.

Yerlan Ospanov

Director General, Verny Capital group of companies

Figure 45. Verny Capital investment: Vassilkovsky Mining and Processing Plant

PROFILE

The largest gold mining company (ore mining and processing mills)

Location: Akmola Oblast

Gold field: Vassilkovskoye

Gold reserves: about 360 tons

Is a wholly owned subsidiary of Kazzinc LLC - Kazakhstani producer of zinc, lead, copper, gold and silver.



HISTORY OF INVESTMENTS

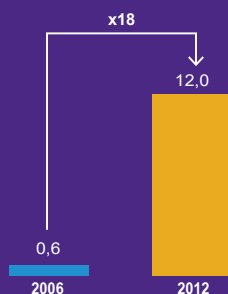
2006 Verny Capital acquired a 100% stake in VasGold, the company which owned the enterprise

2010 Verny Capital sold a 40%-stake in Altyntau Resources JSC to Kazzinc and acquired 29.5% of Kazzinc's shares

2010 Kazzinc acquired a **60%**-stake in Altyntau Resources, Verny Capital acquired **19,2%**-stake in Kazzinc

2013 Verny Capital sold shares of Kazzinc and completed a 5-year direct investment project

GOLD OUTPUT (TON/YEAR)



IN FIGURES

800% IRR (in USD)

x18 the output grew by 18 times during the period from 2006 to 2012

\$700M were invested during the entire period



Sources: Altyntau, exclusive.kz, vlast.kz

From 2007 to 2012, gold production increased by more than 18 times, and 1,679 new jobs were created. During 2009–2010, \$5.2 million was earmarked to build a 95-apartment house for the company's employees, and over 2007–2012, the average wage level rose by 90%.

In 2010 Verny Capital sold 40% of Altyntau Resources shares to Kazzinc, in exchange for 38.7% of Kazzinc shares. In 2013 Verny Capital sold its entire stake in Kazzinc and completed its exit from the investment, which had lasted five years. The investor's IRR in Altyntau was around 800%.

Case №3:

Chaplin – from a minor player to the largest cinema network in Kazakhstan

In 2014 the KCM portfolio funds – Kazakhstan Capital Restructuring Fund and Kazakhstan Growth Fund – made investments through a buyout of the controlling stake in the Chaplin Cinemas cinema network.

Total investments of over \$19 million was allocated to expand the project and to develop the competitive and transparent film-distribution industry in Kazakhstan. CEECAT Capital, a

company managing private equity funds, was engaged to elaborate the strategy and to deal with the development. CEECAT Capital appointed a representative to head the Company.

During this period Chaplin Cinemas became one of the leading cinema networks in the country; it streamlined costs, including through closing loss-making cinemas. As a result, the

number of cinema visitors rose from 1 million in 2014 to 2.5 million in 2018.

On 27 April 2018 the fifth cinema of the network was opened at the MEGA Alma-Ata Shopping and Entertainment Centre; this 15-screen cinema is the largest in Kazakhstan.



Currently the MEGA Alma-Ata Shopping and Entertainment Centre is a place where the largest cinema in Kazakhstan is located, and, thanks to Chaplin Cinemas, it will be ... showing movies with the highest picture and sound quality.

Nurlan Smagulov

President of Astana Group (the holding company owning MEGA Alma-Ata Shopping and Entertainment Centre)

Figure 46. KCRF and KGF investment: Chaplin Cinemas

PROFILE

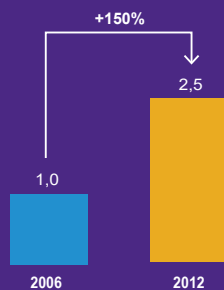
Movie theatre chains in Nur-Sultan and Almaty cities

Year of establishment: 2011

Number of movie theatres: 5



NUMBER OF VISITORS AT MOVIE THEATRES (MILLION PERSONS)



Source: Forbes.kz

INVESTMENTS IN CHAPLIN CINEMAS

- In **2014**, Kazyna Capital Management PEFs – KCRF and KGF invested in business by acquiring a controlling stake in the company for **\$19 million**.
- CEECAT Capital, PEF management company (GP in KCRF and KGF) dealt with the company strategy and development and appointed its representative to the position of the company's CEO.
- As a result, the company performance was improved through an adjustment to business model and refinement of key processes.
- In addition, the costs were optimised, 4 of 6 movie theatres that were loss-making and inefficient, were closed.
- In accordance with world best practices, a set of measures was implemented to maintain customers confidence and increase their loyalty.
- Approaches to pricing, movies schedule planning and cinema quality were completely revised.



It is important to note that funds established with KCM's participation invest in various sectors of the economy, supporting both the real production and service sector. For example, one of the portfolio funds invested in the Chaplin Cinemas project in MEGA Alma-Ata, which has become the most capital-intensive project in the Kazakhstan movie market. This project set a new level of quality for watching movies, concerts, and performances.

Asset Sagimbekov

Deputy Chairman of the Management Board, Kazyna Capital Management JSC

Thus Chaplin Cinemas is a successful network comprising five cinemas in Almaty and Nur-Sultan, and has the capacity to grow further.

4 PE market development in Kazakhstan - issues and outlook



4.1 Identifying development issues in the Kazakhstan's private equity market



4.2 PE potential and the outlook for PE market development

4.1 IDENTIFYING DEVELOPMENT ISSUES IN THE KAZAKHSTAN'S PRIVATE EQUITY MARKET

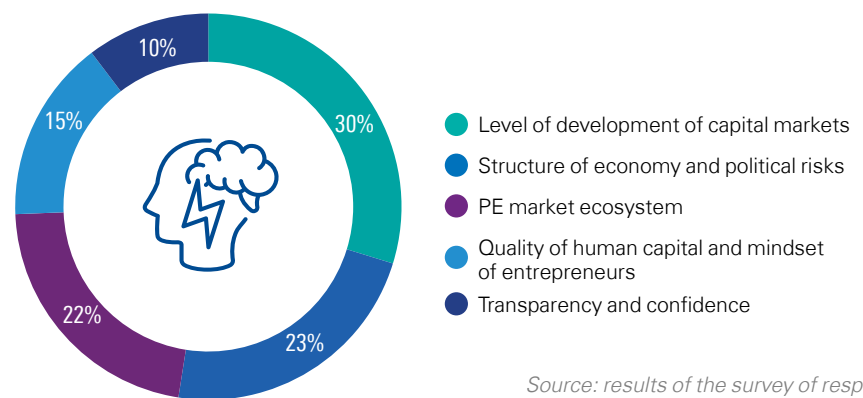
 Over 27 years of independence, Kazakhstan has seen many events that have impacted the financial sector, and many decisions have been made that have contributed to the development of the PE market.

It is necessary to identify the issues that are most relevant today for the PE market. Currently, trends are being observed in Kazakhstan that indicate that the PE market in Kazakhstan still has development potential.

- There is **a dearth of high-quality projects**, which may provide the desired rates of return against the risks involved;
- Project **exit opportunities are limited**;
- Local classic PEFs **are funded** mostly through **quasi-public institutions**.

Such a situation is due to a plethora of external and internal factors.

Figure 47. Categories of issues affecting the development of the PE market in Kazakhstan (based on the results of the survey of respondents)



Source: results of the survey of respondents

Based on the analysis results and the interviews held, issues characteristic of the PE market in Kazakhstan were identified; these issues have been grouped into five categories (Figure 47):

1.  Structure of the economy and political risks
2.  Development level of capital markets
3.  Quality of human capital and the mindset of entrepreneurs
4.  Ecosystem of the private equity market
5.  Transparency and confidence



The outlined issues are not exhaustive; moreover, some may overlap with others. The structure of respective issues, split into **the order of priority**⁷⁸ and based on identified categories, is set out in Table 10. The issues identified are considered in more detail below.

Table 10. Classification of PE market development issues in Kazakhstan

STRUCTURE OF ECONOMY AND POLITICAL RISKS	DEVELOPMENT LEVEL OF CAPITAL MARKETS	QUALITY OF HUMAN CAPITAL AND THE MIND-SET OF ENTREPRENEURS	PE MARKET ECOSYSTEM	TRANSPARENCY AND CONFIDENCE
<p>Heavy reliance of the economy on external factors:</p> <ul style="list-style-type: none"> — commodity prices; — changes in the countries – trade partners, including anti-Russian sanctions. 	<p>The financial sector is sometimes ineffectively regulated.</p>	<p>Low level of professionalism on the part of market players.</p> <p>Lack of competent:</p> <ul style="list-style-type: none"> — management personnel; — experts and specialists. 	<p>Immature standards of corporate governance.</p>	<p>Low transparency of business and investors – ‘an off the radar’ culture.</p>
<p>Unpredictability and historical fluctuations of national currency exchange rates.</p>	<p>Lack of capital recirculation:</p> <ul style="list-style-type: none"> — underdeveloped stock market; — insufficient M&A activity. 	<p>Underdeveloped system of training professional staff.</p>	<p>Shortcomings in the legal framework:</p> <ul style="list-style-type: none"> — tax system still needs to be refined; — frequent changes in regulations. 	<p>Lack of information:</p> <ul style="list-style-type: none"> — investors lack information about Kazakhstan; — business lacks information about the PE tool and the benefits of working with PEF
<p>High share in the economy of:</p> <ul style="list-style-type: none"> — state ownership; — limited number of high-net-worth individuals. <p>As a consequence of this:</p> <ul style="list-style-type: none"> — middle class and SME are not mature enough; — limited domestic consumption. 	<p>Challenges in the banking industry:</p> <ul style="list-style-type: none"> — limited funding structure; — short-term accumulated tenge liquidity; — unfavourable interest rates on long-term debt for business (with the exception of state programmes); — large amounts of accumulated problem assets. 	<p>Mind-set unprepared for PE – “better to borrow than to have business shared”.</p> <p>Most entrepreneurs are still unable to adapt to market relations; many rely solely on state support.</p>	<p>Other infrastructure for investors:</p> <ul style="list-style-type: none"> — red-tape, inefficient decision-making process; — lack of accumulated experience in PE-related judicial practice; — underdeveloped protection of investors’ rights. 	<p>Lack of investor confidence in:</p> <ul style="list-style-type: none"> — official statistics; — the financial statements of companies; — asset valuations.

⁷⁸ The order of priority was determined based on KPMG analysis, supported by the results of interviews held with market participants and experts

Structure of the economy and political risks



The PE market depends largely on the economic and political environments in Kazakhstan. A deterioration in these environments may have significant adverse impacts on the PE market.

Both private equity and debt capital are drivers of economic growth. Paradoxically, under conditions of unstable economic growth rates households often reduce consumption; accordingly, volumes of external investment funding decline. Economic and political stability in the country creates favourable conditions for facilitating an increase investments, including PE, and subsequent economic growth.

High dependence of the economy on external factors: commodity prices, changes in trading partner countries

Kazakhstan is a resource abundant country. However, over the relatively short period of its independence, the economy of Kazakhstan “could not get off the oil train”. Thus there is a dependence on export trade and commodity prices. The government promotes reforms aimed at increasing inflows of foreign investments and economic diversification, so as to reduce reliance on commodity exports; however, the actions taken are not sufficient.

Kazakhstan is situated between two major economies: Russia and China. Historically, Russia has been the main economic and political partner of Kazakhstan. Therefore, according to the respondents, the anti-Russian sanctions could have an indirect negative impact on the economy of Kazakhstan. In the interviews, many respondents noted

that, due to Kazakhstan and Russian being located in the same region, some foreign investors associate Kazakhstan with Russia.

Unpredictability and historical fluctuations of national currency exchange rates

Fluctuations in the national currency exchange rate against foreign currencies could affect the PE market in Kazakhstan. In August 2015, the NB RK announced the introduction of a floating exchange rate system, which resulted in the devaluation of the national currency by 35.5%⁷⁹. This increases risks for foreign investors in terms of earning expected rates of return. Therefore, of interest are predominantly export-orientated projects.

Prominent role of the state and a limited number of high-net-worth individuals in the economy

The role of the state in the economy of Kazakhstan is still high, and this gives rise to numerous issues in many sectors: ongoing privatisation processes allow the role of the state to be reduced in favour of the private sector. However, to date, assets have been allocated unevenly in the private sector – the concentration of the middle class is insufficient, while a limited number of high-net-worth individuals (family offices) play a significant role.

Therefore, Kazakhstan has not yet created a stable middle class, and the economy is characterised by having limited domestic consumption. In 2017 the share of medium-sized business in GDP was 4.6%, and that of small-sized business 22.5%. Today’s government policy is aimed at supporting the SME sector as a potential driver of economic development.

In addition, the level of the shadow economy is still high, and this is one of reasons behind implemented reforms being ineffective. The shadow economy also significantly reduces the tax take.

⁷⁹ A one-time depreciation

⁸⁰ The A.T. Kearney global shadow economy ranking, <https://info.atkearney.com>

12th RANK

According to the A.T. Kearney global ranking, in 2016 the share of the shadow economy in Kazakhstan rose to 33.5% of GDP. Thus Kazakhstan was ranked 12th⁸⁰. In the shadow economy global ranking, Kazakhstan’s position was better than Russia’s (9th rank and 34.3% of the shadow economy), Ukraine (4th and 43.9%), Brazil (6th and 36.5%), Kenya (11th and 33.7%), and Nigeria (1st and 53.4%).

Development level of capital markets

The financial sector is sometimes inefficiently regulated

Emerging challenges, such as the global financial crisis, change the structure of the economy and force the state to be more risk-orientated with regard to regulating the financial sector. A more conservative strategy entails encouraging investment in low-risk instruments which, accordingly, have a low rate of return, which in turn weakens the public market.

Thus in 2013, pension assets were consolidated in the UAPF; currently, these assets are invested primarily in government securities. The NB RK also sets strict requirements for the investment portfolios of insurance companies.

Other players with liquidity issues are second-tier banks. However, given the current level of distressed assets and the consequences of previous crises, when many published revocations of licenses took place, the NB RK closely watches banks' operations, which also results in a more conservative investment strategy for accumulated liquidity.

Such actions on the part of the NB RK appear logical; however, to achieve the maximum economic effect, an optimal balance between risk reduction and enhancement of return is required.

No capital recycling: an underdeveloped stock market and low M&A activity

"A purchase by one investor turns out to be a sale for another". The efficacy of the investment ecosystem depends on its being sufficiently mature at

all stages of the investment cycle. This is particularly important for PEFs and venture funds, where a sale is a necessary step in the profit-making process.

The capital market in Kazakhstan has insufficient capacity. The securities market is not active, due to the small number of players and a lack of promising investment instruments.

Securities dealings are performed on the KASE, as market players are more interested in short-term gains on currency trading and monetary instruments transactions.

Today, the Astana International Exchange (AIX) of the AIFC has been designated the main trading platform for offering public and quasi-public securities. However, being established in July 2018, AIX is at an early stage of development. In January 2019, Her Majesty's Revenue and Customs of the UK (HMRC) granted AIX "recognised stock exchange" status. However, taking into consideration its insufficient practical experience, there can be no guarantee that AIX will be able to attract sufficient market players and issuers to ensure acceptable trading volumes in the foreseeable future.

Insufficient M&A activity is caused to a certain degree by uneven wealth distributions and a weak SME sector. The key players in the M&A market are international investors, whose market activity is decreasing, while internal resources are limited to family offices, many of which have been pursuing conservative investment strategies in recent years.

Challenges in the banking sector

The banking system in Kazakhstan needs improvement. The global financial crisis and a sharp decline in real estate prices in the country caused a number of large banks to default on their obligations. The banking system still has a high proportion of NPLs in its loan portfolio, and no one can guarantee that reform efforts, which are now under way, will be successful and adequate.

The banking sector is still feeling the consequences of the crisis and is undergoing a process of reform.

Key issues include:



a limited funding structure;



accumulated short-term tenge liquidity;



unfavourable interest rates on long-term loans for business (with the exception of state programmes);



large accumulated amounts of problem assets.

Another feature of the banking industry is its heavy concentration: the five-largest banks hold more than half of customer deposits, hence they have the funds to issue loans.

A downgrading of the sovereign credit rating and liquidity issues in the economy could be detrimental to the economic development of Kazakhstan, which, in turn, may negatively affect the PE market in the country.

A lack of long-term debt financing from banks is another critical factor. According to the NB RK, long-term loans are issued, however, their share of total loans has, on average, been only 24% in the past three years.

The low percentage of long-term loans in the economy has largely been due to a lack of access to foreign capital markets, which enable low-cost long-term financing to be received from banks. Customer deposits accounted for 76.7% of the banking sector's

cumulative liabilities as at 1 January 2019. Moreover, 46.8% of customer deposits are in a foreign currency.

An inadequate level of long-term loans may also be attributable to relatively low and unstable economic growth rates. Equity capital used to finance investment projects is a superior method in these circumstances.

Quality of human capital and the mindset of entrepreneurs



A shortage of well-qualified local human resources that can drive business growth impedes PEF development.

A low level of professionalism on the part of market players: a lack of good-quality managers, experts, and specialists

Funds tend to focus on having experienced managerial teams when they create their investment portfolios.

If people have a lack of necessary financial knowledge and skills and make premature decisions the results will often be disastrous. This is particularly true when individuals take on very large debt obligations.

In this regard, some respondents noted an outflow of skilled labour from Kazakhstan. According to KISR research, professionals understand that the situation in Kazakhstan can be altered only by changing the entire system, and targeted measures cannot resolve respective issues. Factors contributing to the migration of young people, such as having access to a quality education, being able to reach their full potential,

and building a successful career, and policies in some countries aimed at supporting education-related migration, will continue to exert an influence on the migration attitudes of young people in Kazakhstan. Particular attention should be paid to the issue of youth migration, as a brain drain of this sort affects the quality of human capital in the country, which in turn influences the development of an entrepreneurial culture.

Education at universities and research institutes plays an important role in promoting Kazakhstan as an investment destination. It is especially important for small- and medium-sized entities to respond rapidly to a changing market environment, as labour market constraints affect private equity market activity.

Education at universities and research institutes plays an important role in promoting Kazakhstan as an investment destination. It is especially important

for small- and medium-sized entities to respond rapidly to a changing market environment, as labour market constraints affect private equity market activity.

Mindsets unprepared for PE

Most people in Kazakhstan have still not been able to adapt to market relations and rely on state support. The mind-set towards PE can best be described as follows: "better to borrow than to have business shared".

Most respondents observe that in the current investment climate entrepreneurs lack sufficient awareness of PE instruments. Many businesspersons do not have the necessary mind-set that will allow external investors to feel comfortable about getting involved; this relates to concerns over illegal practices during takeovers.

The ecosystem of the PE market

Immature standards of corporate governance

Corporate governance issues arise as global stock markets develop and economic processes become global due to transitioning from “the capitalism of private owners” to “the capitalism of employed professional managers”. A delineation of areas of activities and responsibilities, distributions of executive and oversight functions among shareholders and managers, and searching for a balance across the entire entity, are reflected in codes of corporate governance. Currently, most developed economies have in place corporate governance codes that have been developed at the initiative of non-government professional associations and which are widely adopted by business communities on a voluntary basis.

The quality of the corporate governance system in Kazakhstan is not yet sufficient to foster the transparency and effectiveness of the PE market, and it is also not sufficiently governed by legal regulations. The Government of Kazakhstan stated that it had confidence in the ongoing process of corporate governance reforms, and wishes to

encourage discipline and transparency in the corporate sector.

Shortfalls in the legal framework

The tax system still requires refinement. Historically, tax administration in Kazakhstan has not been effective, leading to frequent changes in tax legislation that occurred over a short period and which were applied retrospectively.

Tax norms are subject to varying interpretations, both by different state bodies and within. Such varying interpretations increase levels of uncertainty and, therefore, tax risks, and may potentially lead to inconsistent compliance with these laws and regulations. Official pronouncements and court rulings are often unclear and contradictory and give rise to legal disputes, which can result in significant legal costs to private investors.

Frequent changes to regulations. To improve the quality of the legislative control of the PE market in Kazakhstan, it is required, first of all, to define and adopt terminology that is specific to the market (i.e. introduce into legislation definitions for various derivative financial

instruments, including options and swaps, which may be used when structuring PEF transactions), and from time to time to keep it updated and amended.

Kazakhstan is a civil law jurisdiction, and court rulings, as such, are not required to be used as precedents in future cases. Many laws vest in regulators and officials a considerable degree of latitude over their interpretation and application. Also, the legal and tax authorities may apply arbitrary judgements and challenge previous judgements and tax estimates, hence making it difficult for companies to understand whether they will be liable for additionally assessed taxes, fines, and interest.

Because of ambiguity and a lack of consistent interpretation of legislative acts, tax and legal risks related to doing business in Kazakhstan are more significant than in other countries.

Fiscal regulations in Kazakhstan continue to evolve, which may result in a lower predictability of developments in the legal and regulatory framework and lead to difficulties in their interpretation in the absence of judicial precedents and guidance from regulators, and may unfavourably affect the PE market in Kazakhstan.

The Kazakhstan law on foreign exchange controls may affect foreign currency transactions. Under the Law of the Republic of Kazakhstan “On Currency Regulation and Currency Control” dated 13 June 2005, as amended (hereinafter, the «Currency Law»), the government, under certain exceptional circumstances, has the power to impose restrictions on currency transactions conducted by Kazakhstani and foreign nationals. Such restrictions may be introduced as part of a “special currency system” imposed by the government, upon consultation with the NB RK and other government authorities, if the security of the national economy and the stability of the financial system are threatened. Moreover, the government can impose other requirements and restrictions on

currency transactions, if the economic resilience of Kazakhstan is at risk.

Other infrastructure for investors

Red-tape and inefficient decision-making. Red-tape, which involves excessive rules and procedural requirements, a profusion of agencies that issue necessary permits, and burdensome paperwork requirements, can significantly impact entrepreneurial activity and, subsequently, the development of the PE market.

Insufficient accumulated experience in PE litigation. Insufficient experience on the part of representatives of the Kazakhstan’s judicial system in the financial sector, in particularly the PE sector, and difficulties in implementing judicial decisions, can prevent market participants from receiving effective reparation through the courts.

Following the opening of the Astana International Financial Centre and the setting up of its own court, which is governed by the English law, market participants can choose where to settle judicial disputes. However, the brief history of the court’s existence means that it is difficult to forecast how effective this initiative will be.



Transparency and confidence



An indispensable prerequisite and important driver of successful PE market development in Kazakhstan is the effective interaction of all its participants and the availability of high-quality information on the PE market.

The operations of businesses and investors having low transparency; a “stay-out-of-sight” culture

The PE sector is not sufficiently transparent across the globe. However, there are problems in Kazakhstan that aggravate this issue. The respondents cited major obstacles when it comes to transparency, such as a lack of international reports and publications, private equity market analytics, success stories, a lack of transactional transparency, and insufficient information about PEF activity in Kazakhstan (the closed nature of PEFs, a lack of details about PEFs and their activity in open sources). All these factors can deter foreign investors.

International investors lack information about Kazakhstan, while business lacks information about the PE tool as well as the benefits of working with PEF

References to Kazakhstan in the media are relatively infrequent; participation in various forums and events could secure maximum visibility for Kazakhstan in the

international arena, which in turn would facilitate the development of the PE market and attract international investors to the country.

Lack of investor confidence in official statistics, financial reporting, and business asset valuations

Official statistics and other data published by the Statistics Committee of the Ministry of National Economy of the Republic of Kazakhstan may be not as thorough as in more developed countries.

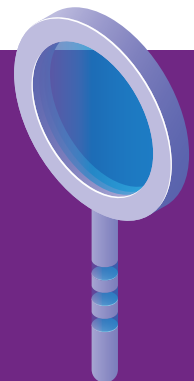
Respondents indicate that businesses lack transparency when it comes to financial reporting; for example, they maintain double-entry bookkeeping, or companies manage a business through a number of small, legally unrelated businesses. There are various reasons for businesses to follow such a strategy – tax optimisation, avoiding forced takeovers, etc.

Therefore, many investors do not rely on independent valuations of assets carried out by local companies, however, at the same time, the services of international valuers are rather expensive.



Many of the issues identified by market participants are complex in nature. Addressing them may take quite a long time, even in conditions of a favourable political and economic environment; hence it is essential that market participants and government bodies coordinate their efforts to solve them.

Recommendations on the main potential courses of action to be considered are set out in Section 5.



4.2 PE POTENTIAL AND THE OUTLOOK FOR PE MARKET DEVELOPMENT

 \$430 mln

Private equity transaction volumes in Kazakhstan could potentially reach \$430 million annually.



If we proceed from a more conservative PE/GDP and PE/M&A benchmark scenario,⁸¹ annual volumes of private equity transactions in Kazakhstan could potentially rise further, by 2 – 2.7 times or by **\$160–270 million**, with the annual volume totalling \$320-430 million.

PE/GDP ratio in Kazakhstan is ~0.066%, due to the low maturity of the market.

Kazakhstan lags behind Russia, Malaysia, Brazil, and Indonesia by two times in this area, behind the average value of the countries listed in Figure 48 by ~5.3 times, and behind the UK and the US by 25 times.

The PE/M&A ratio in Kazakhstan is ~3.7%, which is 2.7 times less than the average value in the Asia-Pacific Region and is 3.6 times lower than the worldwide level.

The M&A/GDP ratio in Kazakhstan is 2.2%, which twice better than Tunis, Turkey, and Indonesia, and is ahead of Belarus and Saudi Arabia by 4.7 times – this is chiefly driven by large transactions in the oil and gas and metals and mining sectors.

Figure 48. PE/GDP⁸²

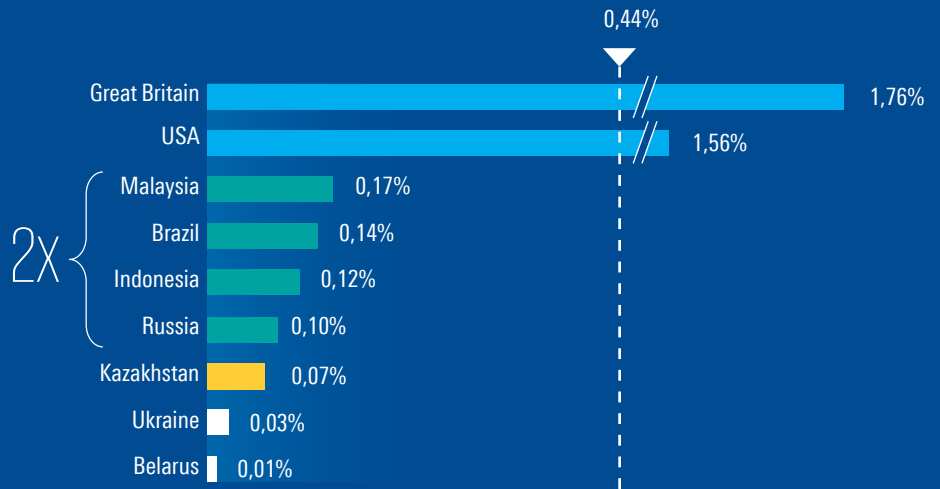
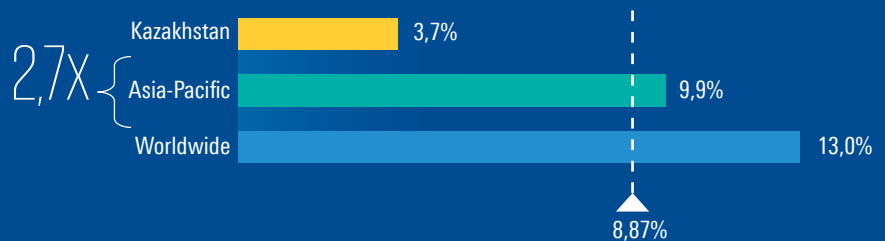
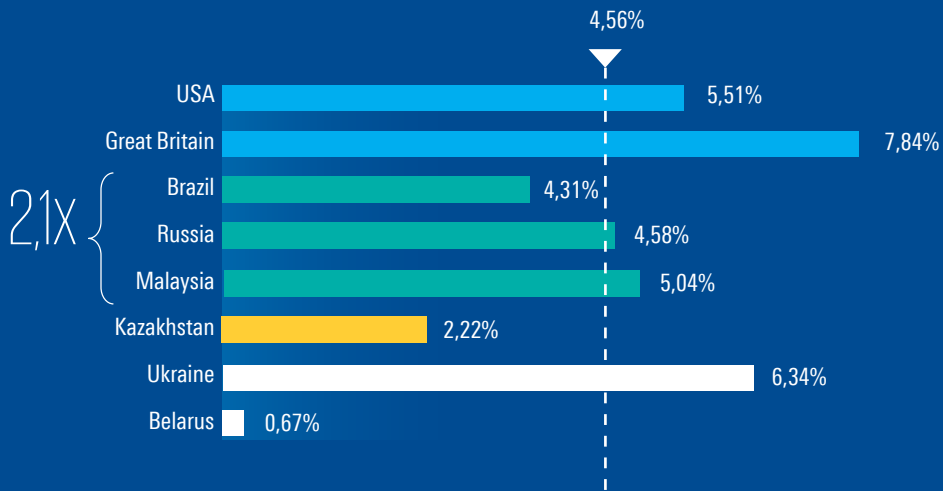


Figure 49. PE/M&A⁸²



⁸¹ PE/GDP benchmark: Russia, Malaysia, Brazil and Indonesia; PE/M&A: Asia-Pacific Region and worldwide

⁸² KPMG internal database, The Economist, EMPEA, Bain & Company, average values for 2009–2018

Figure 50. M&A/GDP⁸³

That said, the M&A/GDP ratio is behind the average values for the countries listed in Figure 48, by ~1.9 times; Russia, Brazil, and Malaysia, by ~2.1 times; and developed markets such as the UK and the US by ~3.1 times. Thus the M&A market has the potential to increase by ~\$3.4 billion per annum.*

⁸³ KPMG internal database, The Economist, EMPEA, Bain & Company, average values for 2009–2018

Note: *From 2.2% to 4.75% of average GDP for 2008–2018, which totalled \$172.9 billion



The development outlook for the Kazakh private equity market

 62%

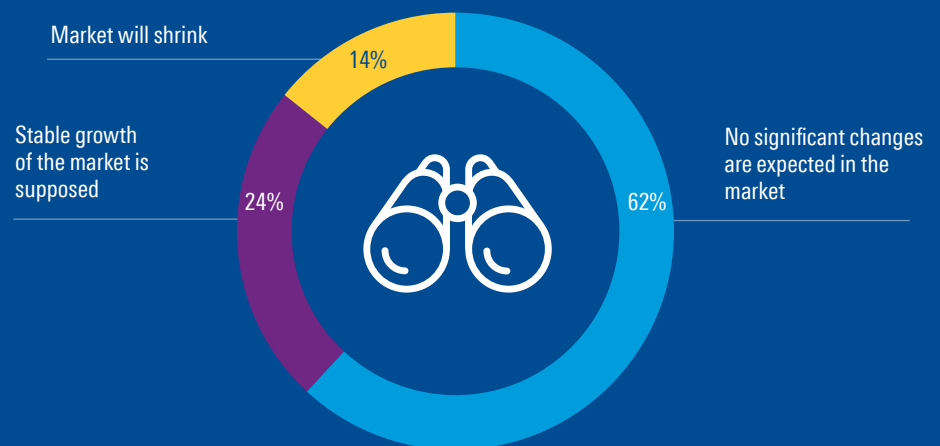
Based on the survey results most respondents believe the private equity market will not change dramatically in the next five years, while 15% of respondents expect the market to shrink.

24% of respondents expect the market to demonstrate stable growth.

The neutral attitude of most respondents reflects the fact that large-scale reforms and upstream activities to improve the investment climate are required for PE market development, and the respondents find it difficult to predict the likelihood and timing of these reforms. However, given global PE market trends, one can expect at least a stable private equity performance in Kazakhstan. If reforms to improve the investment climate, ensure the strong development of the AIFC, and enhance the position of Kazakhstan in the frontier markets rating by 2023 are implemented, the market is likely to grow.

Kazakhstan looks attractive compared to other markets, given the size of the country and the implementation of a multi-faceted foreign policy. Through the adequate development of the private equity infrastructure in the country, including development of the legal framework, an expansion of the

Figure 51. PE market development forecast in Kazakhstan up until 2023 (based on the survey results)



Source: based on the survey results

set of financial instruments for funding and exits, a deepening of financial markets to increase investment liquidity, implementing other initiatives to attract investment into the economy, building professional competencies, and the further development of professional

private equity players, Kazakhstan will be able to ensure not only stable investment inflows, but also create the prerequisites for sustainable private equity market development and economic growth in the coming years.

5 Opportunities and recommendations for PE market development in Kazakhstan

The following recommendations related to furthering PE market development in Kazakhstan are based on the answers of the survey respondents:

Figure 52. Recommendations for PE market development in Kazakhstan⁸⁴



⁸⁴ Based on the answers of survey respondents

Most of the recommendations provided are more like pinpoint initiatives that have been categorised, based on the results of the analysis conducted as part of this research (Figure 53). Opportunities move from general categories to private initiatives and recommendations, which are outlined in detail below.

Figure 53. Opportunities for private equity market development by category





Private equity monitoring and integrated development

As described in Section 4, Identifying private equity market development challenges in Kazakhstan, private equity development is impacted by a multitude of internal and external forces, which need to be developed in an integrated manner.



For example, human capital development is a key driver behind economic development that has both direct and indirect impacts on private equity development.

Kazakhstan is subject to an underdevelopment of professional competences at all levels of company operations – from individual employees to managing directors. The development of respective competencies and professional skills is a separate task that the agency-in-charge faces; however, it cannot be ignored when considering private equity development.

Therefore, it is recommended to monitor a complex indicator of private equity market development, including the optimal number of factors to be quantified to monitor progress in respective parameters, both individually and jointly. One such indicator is the Venture Capital and Private Equity Country Attractiveness Index, where

Kazakhstan is ranked 57 out of 125 countries. This index includes Human capital and social environment as one of five categories of factors influencing the development of the private equity and venture capital markets.

Consideration should be paid to setting appropriate KPIs for the relevant agency, in order to improve Kazakhstan's rating compared to other countries, based on the methodology of the index adopted.





Potential points of growth: exports, SME, and distressed assets

1 Exports are key to sustainable business and country development

There are many untapped niches in Kazakhstan for entrepreneurs, in terms of import substitution or developing new products. However, as mentioned in Section 1, the country has a rather low level of domestic consumption, which constrains business growth, and an unstable national currency threatens its sustainability. The development of export-orientated projects and

businesses generating hard currency revenues should, in our opinion, be a key agenda for the country's economic development.

Kazakhstan is located between the huge markets of Russia and China; in addition, Uzbekistan has also been demonstrating immense potential in recent years. At the same time, the remoteness of Kazakhstan from major international markets with strong currencies entails high logistical costs and lowers the

competitiveness of Kazakhstan's goods on these markets. Therefore, to develop exports, new business models and projects generating revenues in international markets with strong currencies need to emerge. Kazakhstan envisages a specific set of measures, including integrated government programmes, to promote exports.

2 Focus on unleashing SME sector potential

The share of medium-sized businesses in the GDP of Kazakhstan is 4.6%, and small business 22.5%, based on 2017 data⁸⁵. Current government policy is focused on supporting the SME sector as a potential driver of the economy.

Thus in 2019 KCM launched a favourable capital financing programme for a total amount of up to \$50 billion. The programme entails the financing of investment projects under two streams of financing: SME and corporate businesses. KCM fund – Baiterek Venture Fund – acts as an operator under the

first stream: funding of up to \$1 billion is provided against guarantees from partner banks. Under the second stream the operators are Baiterek Venture Fund and KCM Sustainable Development Fund I (established in 2019), under the management of a captive team from KCM – BV Management. Funding will be used to support corporate businesses with investments of KZT1-5 billion. The final interest rate under the two streams is not more than 8%. The proposed terms of the programme are focused on increasing the attractiveness of PE instruments among SMEs, and will potentially contribute to the wider use

of PE instruments in the Republic of Kazakhstan.

In addition, the market is seeing activity on the part of private firms investing in SMEs' share capital, such as Falconry and iKapitalist (SME Growth Fund).

⁸⁵ Based on MNE RK data



3 Distressed asset rehabilitation as a foundation of future growth

As mentioned above, the economy has amassed large amounts of non-performing loans. Banks within the existing legal framework assign their rights to claims on doubtful and bad loans to their subsidiaries, or sell loans at a discount to the Fund of Problem Loans⁸⁶ under the Ministry of Finance of the Republic of Kazakhstan.

According to the respondents, due to imperfections in the tax and legal environment, as well as a lack of transparency in the purchase schemes of problem assets,⁸⁷ there are issues in this area in Kazakhstan.

Distressed asset management is a separate market and a special niche in the private equity segment. The task of asset managers is not only to buy at a good discount and to sell at a mark-up, but also to save enterprises.

Effective distressed asset management will make it possible to put many enterprises back on the track to recovery and create a strong foundation for a new project pipeline in the PEF growth phase.

Problem enterprises can be rehabilitated by engaging independent PEFs that have the necessary expertise. To this end, it is important to initially create a supportive legal framework, and a transparent system of communication

between these PEFs and banks and the Fund of Problem Loans.

An integrated programme has been put forward jointly by the NB RK and the Ministry of Finance of the Republic of Kazakhstan to transfer problem assets to independent management companies, based on best international practices. The aim of the programme is to find the best possible solution for all stakeholders, including business owners, bank representatives, government agencies, investors, PEF managers. In addition, a transparent platform could be created under this programme to ensure effective interaction between the parties.

⁸⁶ The Fund of Problem Loans JSC was established in 2012 to consolidate and manage problem assets; these activities were performed as part of an integrated programme aimed at the recovery of the banking sector. In 2017 the NB RK divested its shares from the Problem Loans Fund and the government, represented by the State Property and Privatisation Committee under the Ministry of Finance of the republic of Kazakhstan, became the sole owner and shareholder. In 2018 Problem Loans Fund JSC was restructured through a merger with Asset Rehabilitation and Management Company, created jointly with the World Bank under the programme, thereby reinforcing its position

⁸⁷ It is assumed that the information about a problem entity is accurate and properly disclosed





Development of the PE infrastructure through developing Kazakhstan's jurisdiction, improving legislation and legal and legal framework

1 Regulatory amendment

Kazakhstani law does not adequately cover the matter of derivative financial instruments (call options, put options, swaps) or hedge funds. Some respondents cite that this creates problems in structuring transactions. In addition, most foreign funds have their ultimate owners registered in offshore jurisdictions. Companies that have

received investments from such funds with offshore structures among their shareholders face issues in obtaining loans from banks in Kazakhstan, as the banks should immediately charge a 100% provision against such loans (as required by the NB RK), which directly impacts the banks' net profit and capital adequacy levels.

Many respondents note insufficient protection vis-à-vis minority

shareholders' rights. Therefore, measures to protect minority shareholders' rights and interests should be enhanced at the legislative level.

2 Improving the tax system

One promising way to increase the investment activity and operations of PEFs is to provide tax advantages for the implementation of "priority investment projects" (PIP). In Kazakhstan, for example, tax relief can be applied to PIP.

However, this mechanism is not adapted sufficiently well to the realities of the local market: uniform, capital requirements have been set for all business entities and industries, which set barriers for less capital-intensive industries and medium-sized businesses. In addition, the Tax Code stipulates that a range of raw materials and consumables are exempt from import VAT, provided that they will be

used as part of an investment contract. However, this exemption does not apply to PIP.

Unequal terms for granting tax privileges in respect of import VAT for entities engaged in implementing various types of investment projects may diminish the attractiveness of PIP for investors.

To stimulate the production of domestic goods, works, and services and to develop medium-sized businesses, it has been proposed to amend current legislation to take account of the implementation of PIPs, in order to boost the efficiency of the mechanism for businesses and the state, in accordance with best global practices, as follows:

- 1) Amending the Entrepreneurial Code of the Republic of Kazakhstan in terms of differentiating capital requirements by industries and business entities.
- 2) Amending the Tax Code in terms of extending when tax privileges are initially granted on corporate income tax until the first profit is generated, and a phased introduction of the tax burden related to CIT in order to mitigate the tax effect.
- 3) Extending tax privileges for import VAT in respect of a range of imported raw materials and consumables for entities implementing PIPs (provided that the raw materials and consumables are used as part of a relevant investment contract).



3 Review of legislation related to currency risk hedging

Hedging is used widely in global practices to reduce the risks of unforeseen losses (index, price, and exchange rate fluctuations). Currently, Kazakhstan's legislation related to hedging covers only general provisions, which may be interpreted differently by entrepreneurs and government agencies, including the tax authorities. This creates potential tax risks for entrepreneurs and limits the number of Kazakhstan's companies that are willing to use this instrument in their activities.

The Civil Code of the Republic of Kazakhstan includes general provisions

for derivative financial instruments that tend to be used to reduce risks for entrepreneurs, i.e. for hedging purposes. The term "hedging" per se does not exist in civil legislation.

The Tax Code of the Republic of Kazakhstan provides for the specifics of hedging tax accounting. However, an absence in legislative acts of both basic hedging concepts and hedging mechanisms prevents entrepreneurs from managing risks related to external factors: currency exchange rate fluctuations, seasonal price fluctuations, etc.

It has been proposed to review the legal framework in order to incentivise the use of hedging instruments in

Kazakhstan, drawing on international experience.

It has also been proposed to introduce the term "hedging" to legislation (the Civil Code, the Commercial Code, the Tax Code, and Rules of Exchange) and to specify the mechanism of its use, as well as its legal regulation and taxation.

4 Increasing the attractiveness of Kazakhstan for PE market players; improving business protection measures

Notwithstanding the significant progress made in recent years in Kazakhstan, the potential for further transparency and predictability of the judicial system (e.g. vis-à-vis legislative shortcomings, a lack of transparency in the work of courts, the unpredictability of court rulings) remains unrealised. This could lead to transactional structuring in the jurisdiction of Kazakhstan being perceived by a significant number of private equity players as an additional risk factor.

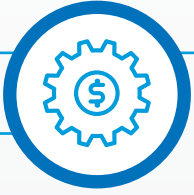
A noteworthy event for the PE market was the setting up of the Court under the Astana International Financial Centre (AIFC), which will work according to English common law principles, i.e. a legal case will be binding for the court when it considers

cases, until the respective ruling is cancelled by a higher tribunal. In cases that involve parties from different countries, the jurisdiction of English courts is possible; however, specific factors determining jurisdiction are rather complicated, hence it is advisable to insert into contracts a provision on jurisdiction.

It is also recommended to perform the following measures to improve PEF activity in the territory of Kazakhstan:

- consider the option of establishing, as a part of the AIFC, a legal organisational form of a non-legal entity (similar to C.V., L.P.), which will facilitate establishing special-purpose vehicles by quasi-public sector entities without authorisation from a competent body, and provide an opportunity for international investment funds to operate on the basis of generally accepted international practices;

- to perform activity relating to PEF structuring in Kazakhstan, it is proposed to make relevant amendments to the Commercial Code of the Republic of Kazakhstan related to not applying a provision to receive authorisation from the competent body for establishing legal entities, where over 50% of the shares (stakes in the share capital) are owned by the state or state-affiliated entities.



Stimulating capital market activity: developing trading platforms and adapting regulatory constraints

1 Building and developing trading platforms to attract investors

The KASE Private Market trading platform was launched in 2018 at the initiative of KCM to organise the trading of LLP shares on the Kazakhstan Stock Exchange, which provided SMEs with access to KASE and an opportunity to have the free trading of LLP shares and a disclosure of information that ensures an appropriate level of company transparency for potential investors.

This stock market component could potentially facilitate the development

of the PE system in Kazakhstan. The benefit of the KASE Private Market floor lies in its simplified requirements for small- and medium-sized enterprises compared to entities that are in the form of a joint-stock company.

The KASE Private Market offers new opportunities for all types of investors to purchase shares in promising projects and to diversify their investment portfolios. PEFs, in turn, will be able to attract investments both during the fundraising and exit phases, which will potentially facilitate investments into SMEs and provide a significant

spur to private equity development in Kazakhstan.

To develop the attractiveness of such trading platforms, an integrated programme is required to develop and popularise the instruments trading on them, successful cases, and companies.



2 Transfer of pension assets to independent management companies and option to invest pension assets in PEFs

Whether pension reforms associated with the transfer of part of UAPF assets under the management of private companies becomes a driver of stock and PEF markets' development will depend on the investment climate that is created for pension asset management companies (PAMCs). If requirements to have ratings from "BB-" and above are applied, the funds will invest in quasi-public companies and there will be no market development. Experts believe that significant diversification requirements related to PAMC portfolios and giving them an opportunity to invest a small portion of assets into a medium-sized entity will foster the development of the stock market.

In accordance with international practice, pension funds in many countries can invest a small portion of their funds into PEFs. However, certain requirements are imposed on PEFs, including licences/registration with an

authorised body, the regular publishing of financial statements, and the quality of investment assets.

During the early phases of PEF development in Kazakhstan it will be advisable, most likely, to not tighten up centralised regulations and to let the market develop independently. The investments of institutional investors (pension funds, insurance companies, etc.) may come more to the fore when the private equity market achieves a certain level of maturity. The authorisation of such investments should be accompanied by the implementation of centralised regulations.



Making popular the private equity instrument and developing a culture of equity investments

1 Improving communications among PE market ecosystem players, determining a player to consolidate information to develop private equity

Effective communication among all market players is a prerequisite for the successful development of the PE market in Kazakhstan. To simplify the search and selection of new projects, it is necessary to increase the level of collaboration between professional participants of the market ecosystem, business community, and other parties.

In international practice industry associations such as the European Private Equity and Venture Capital Association (formerly EVCA, now InvestEurope) in Europe or the Arab Private Equity Association (APEA) handle such tasks and represent the interests of the PE sector as a whole.

Setting up the Kazakhstan Private Equity Association will promote addressing the issue of developing the information environment, which enables entities to find each other and stimulates relations between small, medium-sized enterprises and large corporations. In addition, the objectives of the association may include:

- representing the interests of professional market players before state authorities, the

media, and financial and industrial communities in Kazakhstan and abroad;

- the consolidation (collecting, analysis) of information on equity investments, including venture capital and private equity and also the M&A market;
- improving the transparency, availability, and quality of data about the volumes and dynamics of major equity transactions will contribute to enhancing the investment attractiveness of Kazakhstan;
- preparing analytical papers about best international practices related to programmes for private equity and venture capital market support, to be distributed between PE market development institutions.

2 Improving the culture of attracting professional equity investors among Kazakhstan business representatives

To improve a PE culture among SME entrepreneurs that will promote attracting private equity instead of solely using internal funding or borrowings, it is recommended to:

- develop an integrated strategy to facilitate and popularise equity investment instruments, using available public communication channels, including forums, associations, etc.;
- develop publicly available courses for concerned entities for dealing with PEFs (resolve this issue jointly with the NCE), including examples of how to develop the corporate culture, design documents, etc.



6

Research methodology



KPMG database about the Kazakhstan M&A market

This research has been prepared using information from the KPMG database about the Kazakhstan M&A market generated in 2019.

The database covers transactions where Kazakhstan's companies/residents are acquisition targets (when they are purchased by foreign companies) and/or a target and a buyer (in case of internal transactions). All data comprise transactions completed during 2008–2018. Future data may differ from that presented in this research, as the KPMG database of mergers and acquisitions in Kazakhstan is updated retrospectively in terms of cancelled transactions and information subsequently made available to the public, as well as other adjustments.

The data reflect transactions of any value, as well as transactional information which has not been disclosed.

The KPMG database of mergers and acquisitions in Kazakhstan was created using the following databases: Mergermarket, Capital IQ, and other sources and data discussed during the interviews for this research and made publicly available (including companies' press releases).

We may apply our own professional judgements to classifying industry transactions, therefore such classifications may be subjective.

We did not perform a detailed check of all data contained in the KPMG database of mergers and acquisitions in Kazakhstan, and cannot be held liable for its absolute accuracy or completeness. An analysis of alternative sources/databases of transactions may lead to results other than those presented in this research.

The KPMG database has been generated with a view to being further monitored and integrated with other information sources and further improvement.



Estimation of the number of transactions and size of the private equity market

Seven categories⁸⁸ of acquirers and vendors have been introduced: international investors, public/quasi-public companies, Kazakhstan's business conglomerates/family offices, classic PEFs, captive FO/PE funds, and undisclosed investors. The category of an acquirer and vendor for one or another asset/investment target was defined for each of ~1,500 transactions collected for the period 2008–2018, using the KPMG database of mergers and acquisitions in Kazakhstan.

Thus by categorising acquirers into classic PEFs and captive FO/PE funds and by selecting Kazakhstan's assets we estimated the internal private equity size. Data related to the private equity investments of players into foreign assets were of a limited nature and are not covered in this research.

A similar approach was undertaken to determine the number of exit transactions; however, the vendor category was separate. In case of exits, Kazakhstani companies' exits from foreign assets were identified separately. Partial exits were deemed to be full exits.



Benchmarks and assessing the potential of the private equity market

The M&A/GDP ratio reflects the saturation of the market with private equity transactions and illustrates to market players opportunities for both deal sourcing and exit opportunities.

Moreover, in countries with developed M&A markets professional market players such as investment banks, audit/legal firms, M&A boutiques, and consultants necessary for the successful implementation of VC/PE transactions⁸⁹ and the effective operation of the entire investment ecosystem carry out many activities.

The major M&A players in various countries are both external and internal investors, including large transnational companies, business conglomerates, family offices, and the state.

The PE/GDP ratio is also referred to as the PE penetration index, which reflects market depth in relation to the entire economy of the country.

The PE/M&A ratio enables the role and development of the private equity instrument to be assessed in the capital private equity segment.

The potential of the private equity market was assessed in combination, based on PE/M&A and PE/GDP ratios. The PE/GDP ratio was compared against the benchmarks for the following countries: Russia, Brazil, Indonesia, and Malaysia, while the PE/M&A ratio was benchmarked against **the Asia-Pacific Region and the world**. Average M&A volumes and GDP in Kazakhstan for 10 years were used.

⁸⁸ Definitions of business conglomerates/family offices, classic PEFs and captive FO/PE fund categories were introduced as part of market players analysis in this research

⁸⁹ The Venture Capital and Private Equity Country Attractiveness Index 2018





Interviews with private equity market players

Interviews were held with private equity market players in Kazakhstan as part of this research. In total, 35 interviews (in-person and by phone) were held with respondents, who represented:

-  large business conglomerates and family offices
-  local PEF and international managing companies
-  international financial institutions
-  public/quasi-public companies
-  firms providing professional services in capital markets

Respondents comprised individuals holding decision-making positions: shareholders/chairpersons of the board of directors/general directors/managing directors/ chief financial officers/chief investment officers/ investment directors/directors of business units.



Business community interviews

Interviews with the business community, involving 100 respondents representing large, medium, and small businesses operating in the territory of Kazakhstan, were held as part of the survey. The survey focused on business community awareness about PEF instruments, their interest in securing private equity, as well as the practical and potential challenges posed by working with private equity.

RESPONDENT PROFILE

57% of respondents are companies with an annual average number of employees of below 10. 22% of respondents have a workforce of 101-250. Large companies with over 3,000 people account for 4%.

The majority of respondents represent companies with an average annual income of KZT757.5 million to KZT7.5 billion. 8% of respondents represent large businesses with an income of more than KZT30 billion.

Figure 54. Number of employees in companies

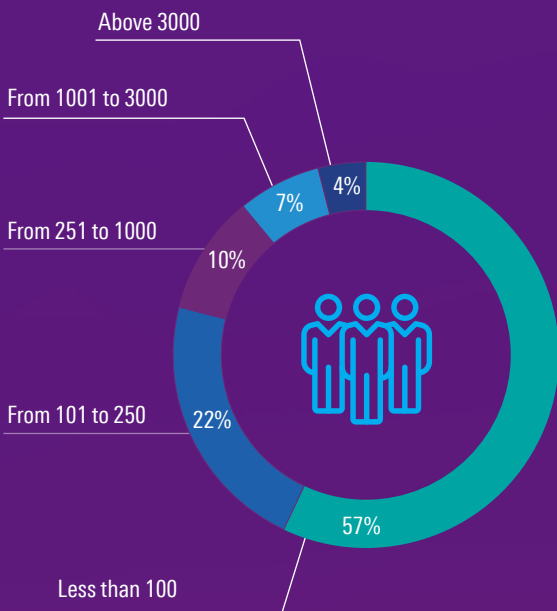
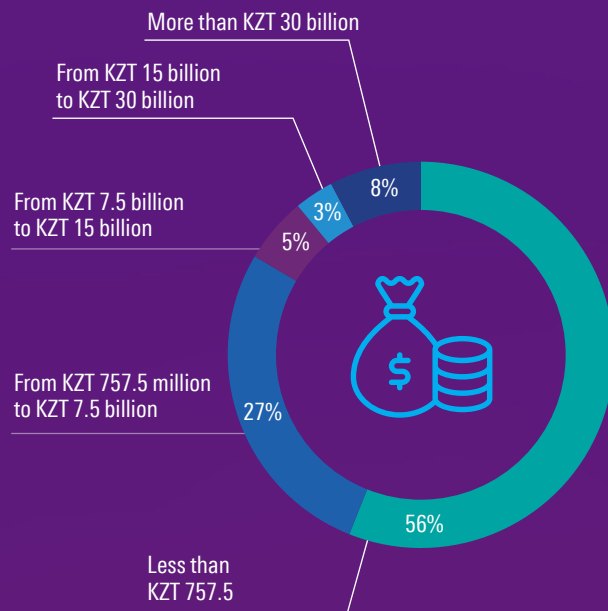
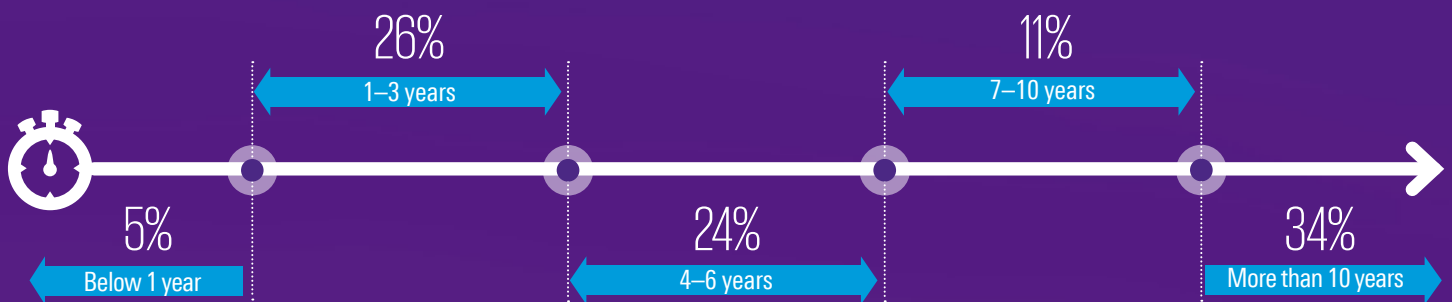


Figure 55. Average annual rates of return of the companies



A third of respondents have more than 10 years' market experience. Only 5% are relatively new companies and have been operating for less than one year.

Figure 56. Period of existence in the market

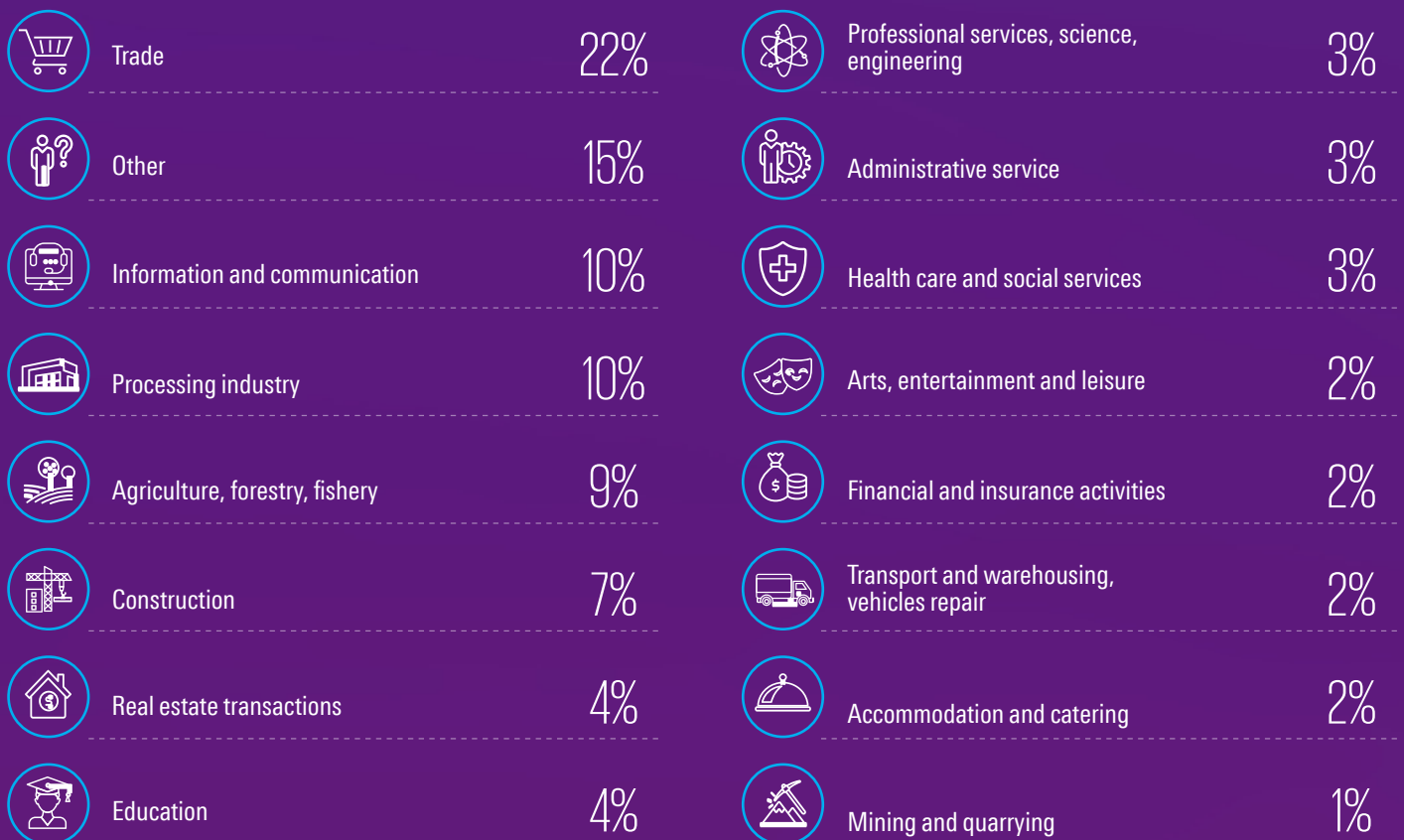


Source: KPMG analysis

4% out of 100 respondents indicated that the state was a major shareholder in their company.

22% of all respondents have trade as their principal activity. Information and telecommunications and manufacturing industries account for around 10%.

Figure 57. Principal activities of respondents



Note: multiple-choice answers were possible

Source: KPMG analysis

Glossary

Buyout means the buyout of a controlling stake in a company. Usually such transactions are financed using a combination of LP funds and borrowed funds – such transactions are called leveraged buyouts (LBO).

Cash cows are a type of assets (business/product) that produces a stable high rate of return, and which is used to fund the company's investments. Cash cows, as a rule, have no significant growth potential, while other type of assets – rising stars – are the company's growth drivers.

Cash-on-Cash (CoC) is the ratio of the amount of sales (exit) to the amount of investment (entry).

Committed capital means the allocated investment funds that LPs commit to provide to a PEF. The sum of all committed capital of all LPs is equal to the fund size.

Exit or Divestment is the last phase in the private investment process: the sale of shares owned by a venture investor and its exit from the company.

Exit Strategy is a plan of a PEF or venture fund or private investor to cease its investments, liquidate its share in the company, and maximise its return. Strategies comprise: direct sales, sales through public offerings (including IPO), write-offs, repayments of preference shares/loans, sales to other PEF, and sales to a financial organisation.

Family office is an office providing services to one or several families. These offer a wide range of services, from investment management and consulting, accounting, tax and finance consulting to educational planning or concierge services.

Frontier Market is a term introduced by the IFC in 1992 to denote a type of developing country which is more developed than the least developing countries (LDCs), but is still not considered an emerging market based on certain parameters.

Fundraising is the process of gathering money by venture capitalists to create an investment fund. These funds are gathered from private, corporate, or institutional investors and transferred to the fund, from which the management company will make investments.

General Partner, GP is a company that has unlimited personal liability for the debts and obligations of a limited liability partnership and the right to participate in the management of the partnership. A GP is usually a firm responsible for managing the funds of a PEF or venture fund.

Growth Capital or Development Capital is a type of PE which is used to acquire a minority stake in sufficiently mature companies that are looking for capital to finance their growth, expand, or restructure operations, and enter new markets.

High-net-worth individuals, HNWI are private individuals who have liquid assets worth in excess of a certain threshold. Usually this is an amount above \$1 million. For the purposes of this report, high-net-worth individuals mean a category of individuals whose wealth is worth above \$50 million (Ultra HNWI).

Internal Rate of Return, IRR is the rate of return on invested capital, calculated as profit for the period divided by the investment amount. IRR is calculated as the annualised average effective compounded rate of return, using monthly cash flows and annual valuations.

Late stage – a company is operating and needs financing to enter new markets and increase the production output/market share.

Limited Partner, LP is an investor in a limited liability partnership that does not participate in the management of the partnership and has limited liability for its debts and liabilities.

Mergers & Acquisitions, M&A - this is a generic term that covers a number of different transactions, such as mergers, acquisitions, consolidations, purchases of assets, and acquisitions to gain control. Acquisition means gaining control over a company or the right of ownership therein. Financial operations related to mergers/acquisitions/consolidations of companies are often performed through a number of transactions and by different legal entities/individuals, while information on the stake in the company to be acquired is unknown. For the purposes of this research, M&A is considered in a broad sense to mean the acquisition of a stake in the charter capital of a non-public company.

Minority Stake is a non-controlling interest in a company in relation to other, larger investors.

Non-performing loans, NPL are loans past due for more than 90 days or other loans, for which no repayment is expected.

People IPO is a state programme aimed at the sale of state interests in entities listed on the stock market to citizens of the Republic of Kazakhstan.

Pipeline is a list of potential transactions/projects, which are at different stages of signing/review.

Portfolio investments are passive investments in the securities of companies (which do not provide for participation in the management of the companies).

Private Equity, PE is a class of private investments in the shareholders' capital. For the purposes of this research, PE means investments made by classic PEFs and captive PEFs under family offices/business conglomerates, i.e. professional investors having the features describe in Section 2.

Private Equity Fund, PEFs are financial entities that raise capital from private and institutional investors for subsequent investment in the companies' equity. In this research the definition of PEF is narrowed to a consideration of two categories: classic PEFs and captive PEFs under family offices/business conglomerates. A detailed description of the features of classic PEFs and captive PEFs under family offices/business conglomerates is given in Section 2.

Public company is a joint-stock company whose shares are traded freely, without limitations, on the stock market.

Put option is an option contract giving the buyer the right, but not the obligation, to sell an asset at a specified price within a specified timeframe.

Quasi-public sector comprises state enterprises, LLPs, JSCs, including national holding companies, and companies in which the state is a partner or shareholder, as well as subsidiaries, associates, and other legal entities affiliated therewith, as provided for by Kazakhstan legislation.

Seed/early stage is the stage in a company's development when it is developing an initial concept. As a rule, companies at an early development stage do not generate sales.

Strategic investor is a company that is/may be interested in acquiring a stake in the PEF portfolio company. Usually a strategic investor carries out business in the industry similar to that of the portfolio company.

Venture capital is a type of PE aimed at high-risk investments in companies that have significant growth potential.

8

List of abbreviations

ABF – Almex-Baiterek Fund	KIF – Kazakhstan Infrastructure Fund
ACAF – Aureos Central Asia Fund	KISS – Kazakhstan Institute for Strategic Studies
ADB – Asian Development Bank	KPI – Key Performance Indicators
AIFC – Astana International Financial Centre	LP – Limited Partner
AIX – Astana International Exchange	M&A – Mergers and Acquisitions
APR – Asia-Pacific Region	MC – Management company
BVCP – Baring Vostok Capital Partners	MIRA – Macquire Infrastructure and Real Assets
BVF – Baiterek Venture Fund	MMPC – Mining and Metallurgy Processing Complex
CAGR – Compound Annual Growth Rate	MNE RK – Ministry of the National Economy of the Republic of Kazakhstan
CDC – Commonwealth Development Company	MRIF – Macquire Russia and CIS Infrastructure Fund
CKIF – CITIC Kazyna Investment Fund	NATD – National Agency for Technological Development JSC
DBK – Development Bank of Kazakhstan JSC	NB RK – National Bank of the Republic of Kazakhstan
DBK EF – DBK Equity Fund	OECD – Organization for Economic Cooperation and Development
EBRD – Eurasian Bank of Reconstruction and Development	OGC – Oil and Gas Complex
EIF – European Investment Fund	PE – Private equity
EMPEA – Emerging Market Private Equity Association	PEF(s) – Private Equity Fund(s)
ENIF – Eurasian Nurly (Bright) Investment Fund	PSMP – Professional securities market players
FDI – Foreign Direct Investment	RCF – Resources Capital Fund
FGF – Falah Growth Fund	RCG – Resources Capital Group
FMO – Голландский банк развития	RKFN – Russian-Kazakhstan Fund of Nanotechnologies
FO – Family office	ROA – Return on Assets
GDP – Gross Domestic Product	ROE – Return on Equity
GDP (PPP) – Gross Domestic Product (Purchasing Power Parity)	SM – Securities market
GP – General Partner	SME – Small and Medium-sized Enterprises
GS – Government securities	SPIID – State Program of Industrial-Innovative Development
HMRC – Her Majesty’s Revenue and Customs	UAPF – Unified Accumulative Pension Fund
IDB – Islamic Development bank	USD – US Dollar
IFC – International Finance Corporation	VC – Venture Capital
IFI – International Financial Institution	WB – World Bank
IFO – International Financial Organisation	WCP – Wolfensohn Capital Partners
IIF – Islamic Infrastructure Fund	
IPO – Initial Public Offering	
IRR – Internal rate of return	
IT – Information technologies	
KAGF – Kazakhstan Silk Road Agriculture Growth Fund	
KCM – Kazyna Capital Management JSC	
KCM SDF – KCM Sustainable Development Fund	
KCRF – Kazakhstan Capital Restructuring Fund	
KGF – Kazakhstan Growth Fund	

9

Appendix

Appendix 1 - List of Private Equity and Venture Capital Associations of the World

AFIC, Association Française des Investisseurs en Capital	IVCA, Irish Venture Capital Association
AIFI, Italian Private Equity and Venture Capital Association	LAVCA, Latin American Venture Capital Association
AMEXCAP, Asociación Mexicana de Capital Privado	LVCA, Latvian Venture Capital Association
AMIC, Association Marocaine des Investisseurs en Capital	NVCA, Norwegian Venture Capital & Private Equity Association
APCRI, Portuguese Private Equity and Venture Capital Association	NVP, Nederlandse Vereniging van Participatiemaatschappijen
ASCRI, Spanish Private Equity and Venture Capital Association	PPEA, Polish Private Equity Association
ATIC, Tunisian Venture Capital Association	Réseau Capital, Québec Venture Capital and Private Equity Association
ILPA, Institutional Limited Partners Association	RVCA, Russian Venture Capital Association
GVCA, Gulf Venture Capital Association	SAVCA, Southern African Venture Capital and Private Equity Association
HKVCA, Hong Kong Venture Capital Association	SECA, Swiss Private Equity and Corporate Finance Association
APEA, Arab Private Equity Association	SLOVCA, Slovak Venture Capital Association
AVCA, African Venture Capital Association	SVCA, Swedish Private Equity and Venture Capital Association
AVCAL, Australian Private Equity and Venture Capital Association	
AVCO, Austrian Private Equity and Venture Capital Organisation	
BVCA, British Venture Capital Association	
BVK, Bundesverband Deutscher Kapitalbeteiligungsgesellschaften	
CVCA, Canada's Venture Capital & Private Equity Association	
CVCA, China Venture Capital Association	
CVCA, Czech Venture Capital and Private Equity Association	
DVCA, Danish Venture Capital Association	
EMPEA, Emerging Markets Private Equity Association	
FVCA, Finnish Venture Capital Association	
HVCA, Hungarian Venture Capital and Private Equity Association	
Invest Europe, formerly – EVCA	

Appendix 2. Overview of international experience in private equity market development: South Africa

The establishment of the PE market in South Africa provides a good example how a PE segment can develop in an emerging economy.

Historically, development institutions have played an important role in the development of the African economy. Until the 1990s, they supported the African economy by issuing loans, mostly to support the implementation of national development agendas; later, their focus expanded to include private equity investments that were separate from the state.

Development institutions had a positive market impact, as they assisted and continue to assist in developing the necessary business infrastructure and PEF associations at the level of individual countries and regions, and in raising awareness among governments of existing legislative constraints and the changes that need to be made. In addition, development institutions

provide useful inputs in terms of rehabilitating the businesses they invest in, rolling out corporate governance and environmental protection standards, and improving businesses' social responsibility.

The first private equity funds appeared in the market in the early 1990s. There were 12 such funds by 1997, and the total amount of funds invested in Africa was around \$1 billion. Their interests were initially focused on South Africa, but they later began making investments in other African countries⁹⁰.

The increased attractiveness of the African private equity market largely related to a slowdown of economic growth and a decline in the rates of return on investment in the US and Europe, which forced investors to tap into emerging markets, including African states. The appeal of Africa as an investment region is due to the following factors:

- Strong macroeconomic performance. Due to a relatively underdeveloped banking sector, Africa was less exposed to the global financial crisis than other countries. GDP growth forecasts outstrip those of developed countries, as well as many other emerging economies.

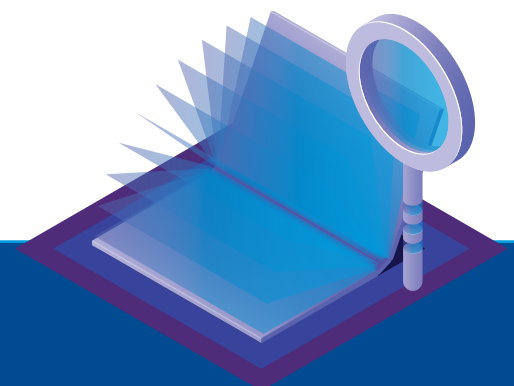
Examples of attracting pension fund assets

South African pension funds have been historically active in investments in private equity funds, together with development institutions, due to an undeveloped stock market and a lack of other investment instruments. The amount of investment in unquoted equity (including PEF) up until 2011 was not to exceed 5% of pension funds investment. In 2011 the limit was increased and pension funds could invest up to 10% in PEFs. The mandate of the largest African pension fund, Government Employees Pension Fund (GEPF), authorises to place up to 5% of assets in instruments, mostly in PEF, in other countries in Africa.

Among other countries in Africa, Nigeria's experience is of interest. There the regulator (National Pension Commission – PENCOM) set a limit of 5% in December 2010 for pension fund investments in PEFs, as a class of assets. Thus based on 2016 estimates, the potential investment of pension funds in PEF could have been \$842 million.

However, PENCOM established further restrictions:

- 1) 75% of PEF funds should be invested in Nigeria;
- 2) PEFs should be registered with the Nigeria Securities Commission;
- 3) GP's minimum investment level in PEF is 3%⁹².



⁹⁰AVCA

⁹¹ London Business School, Coller Institute of Private Equity, ECP – IHS | Private Equity in Africa, July 2013

⁹² Bright Africa 2018

- Good demographic indicators: population growth, urbanisation, and a growing middle class;
- A deficit of other funding sources (bank lending, on-exchange instruments), in particular, for SMEs, contribute to deals terms that are more favourable for investors;
- Positive changes in the regulatory environment – pension funds in some African countries (for example, Kenya and Nigeria) can invest some of their assets in PEFs and the barriers to such investments were eased in the 2000s⁹¹.

By 2016 the number of PEFs operating in the market exceeded 140. Development institutions continue to play a significant

role in the market, by providing support to PEF novice managers and maintaining private investor and business community confidence in the PE market.

Investment activity rose significantly in South Africa in 2017. Total investment stood at ZAR31.1 billion, compared to an annual average of ZAR14.7 billion in the past 10 years. ZAR12.2 billion out of the total investment was invested in 2017 in ongoing projects, while ZAR18.9 billion went on new investments.

This growth was due to an increased number of transactions and their average values. The number of transactions rose to 750 in 2017, vs 574 in 2016. The average value of a

transaction went up from ZAR27 million in 2016 to ZAR41.7 million in 2017.

In 2017 South African PEFs raised ZAR7.5 billion, of which 81.2% was invested in PEFs at a later stage. The amount of funds managed by African PEFs stood at ZAR158.6 billion as of 31 December 2017, with average annual investment growth rates of 9.4% since 1999. Of the funds raised in 2017, 49.9% were from South African sources (2016: 73.5%).

Figure P1. Investment dynamics in PEFs in South Africa

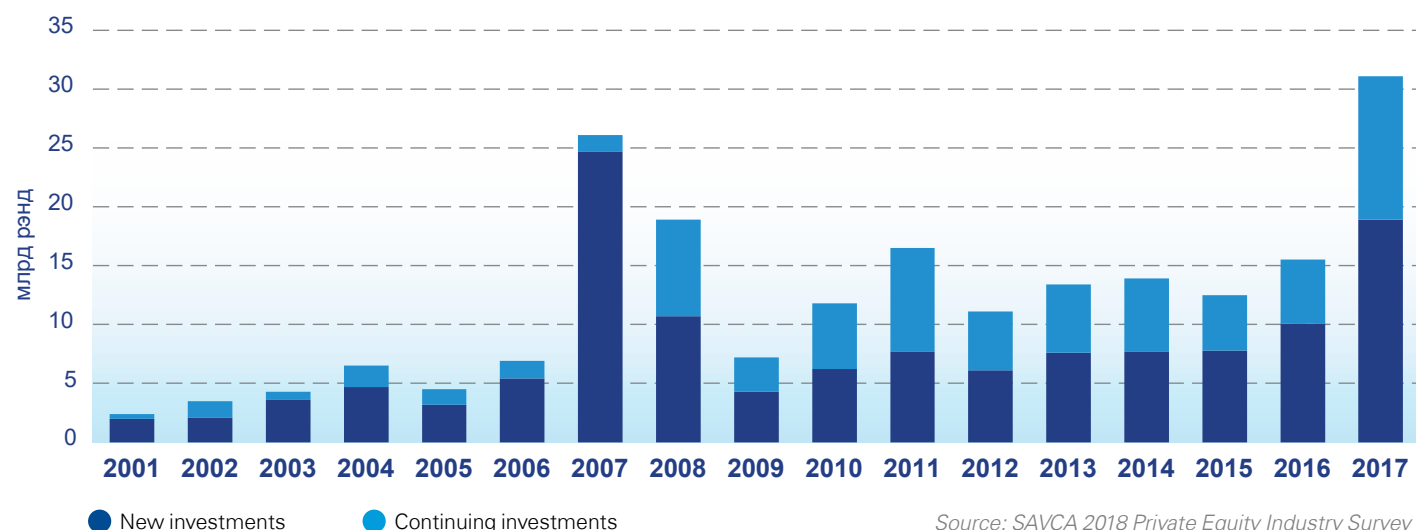
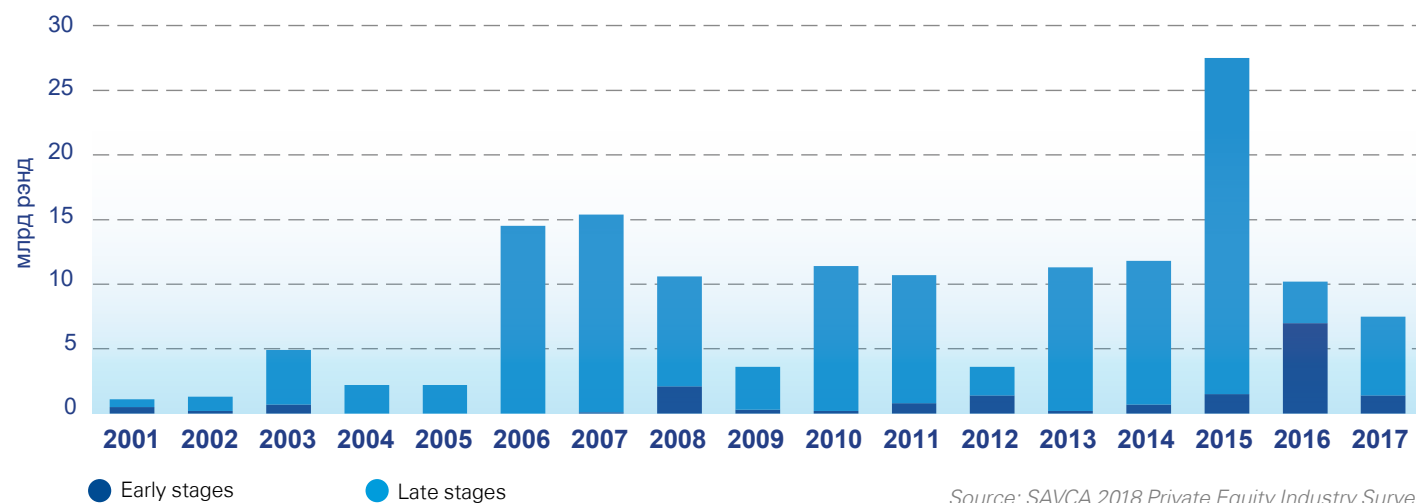


Figure P2. PEF fundraising activity dynamics at early and late stages in South Africa



Of the assets under management as at the end of 2017, ZAR35.9 billion in funds was earmarked for investment, of which ZAR15.5 billion was intended for investment only in South Africa, and ZAR20.4 billion could be invested across Africa. ZAR32.5 billion (or 90.4%) of the amount was earmarked for independent parties, and the remaining amount for captives.

 17,1 bil ZAR

The amount of funds returned to investors amounted to ZAR17.1 billion in 2017.

Thus South Africa's PEF penetration rose to 0.7% of GDP in 2017, compared to 0.4% in 2016.

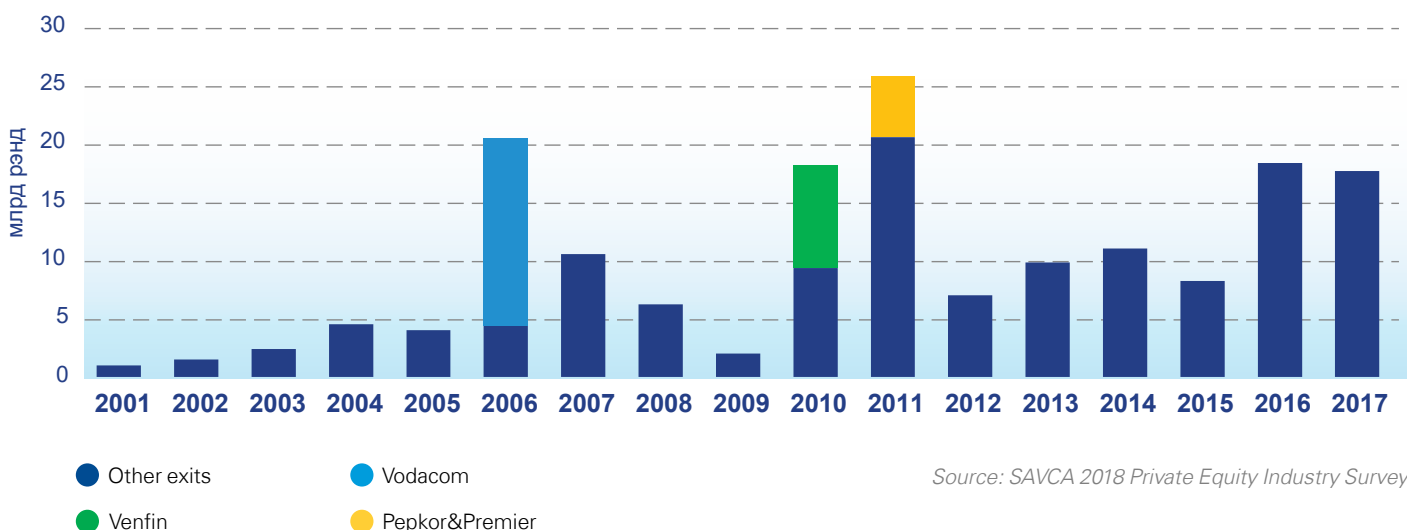
In 2017 and 2016, the information technology sector led the way in fundraising, and accounted for 26% of investment in 2017 (2016: 21%). The vast majority of IT investments are targeted at Nigeria and South Africa. The consumer goods sector historically remains important, due to an increased middle class. Investors' interests lie in the area of online retailing, educational services, advertising; finance and infrastructure (including transport, logistics, construction, engineering, and equipment) have also gained momentum in recent years. Investments in industries relate to economies which focus on import substitution.

The local industry association the South African Venture Capital and Private Equity Association (SAVCA) operates in the market. It has a membership of 170 companies which have assets under management worth around ZAR165 billion. The association contributes to developing venture capital and

private equity investments by fostering information technology, trainings, and interactions among market players.

In terms of the specific market features of Africa, investors highlight the need for due diligence and a PEF presence and networking as critical success factors. Networking is required to facilitate successful PEF exits, as exits are mainly the result of investment sales to other PEF or trading partners.

Figure P3. PEF exits dynamics in South Africa



Source: SAVCA 2018 Private Equity Industry Survey

Appendix 3. Information on M&A and PE transactions in Kazakhstan, 2008-2018

Figure P4. Dynamics in the number of undisclosed M&A transactions and their share in the total number of M&A transactions

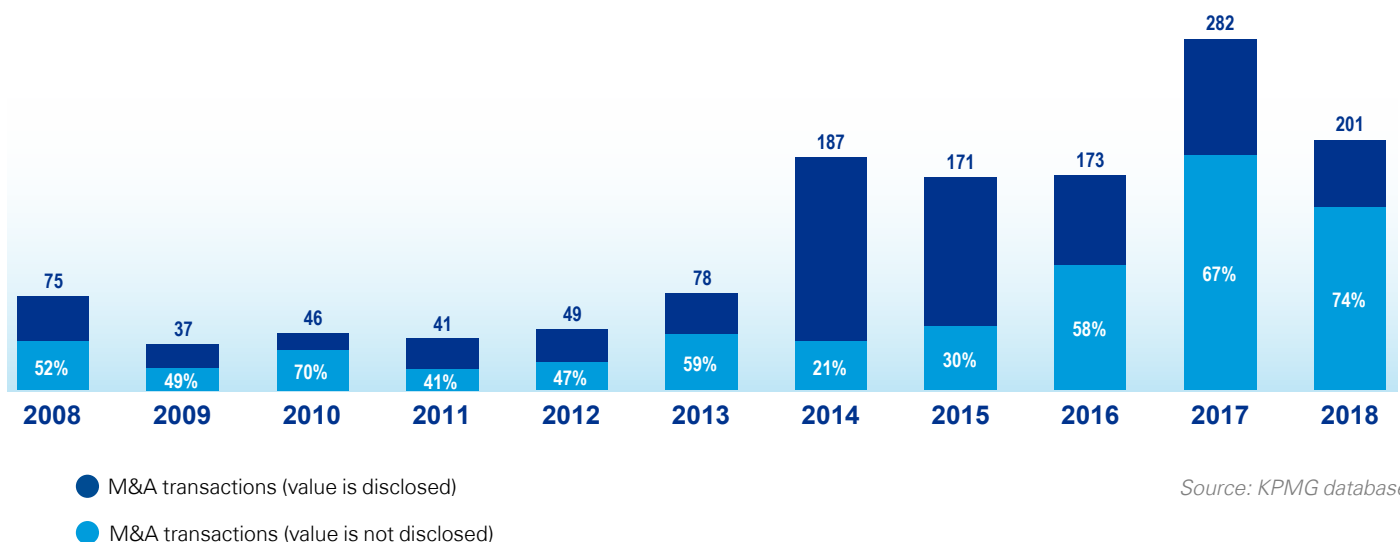
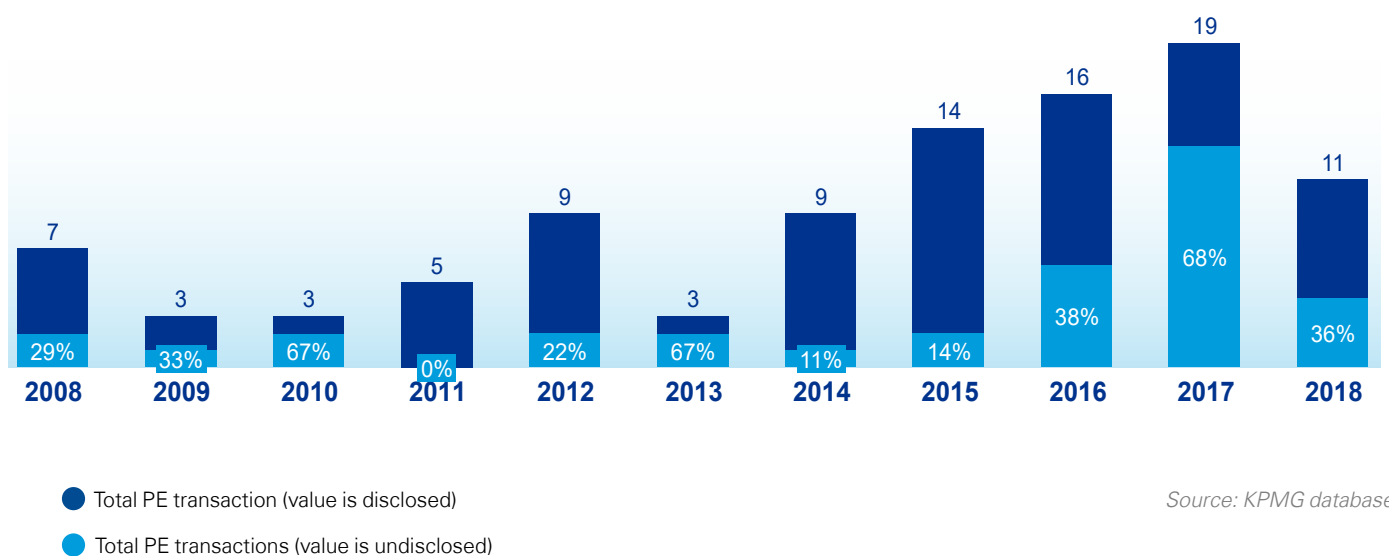


Fig. P5. Dynamics in the number of undisclosed PE transactions and their share in the total number of PE transactions



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