Welcome to the Spring 2012 issue of Russia & CIS Express. This issue focuses on developments taking place in one of the most dynamic economies in the region: Kazakhstan.

Kazakhstan is, of course, well known for the wealth of its mineral reserves. But it is wealth in other forms as well that are beginning to play a more prominent role in the country’s development story.

For example, Kazakhstan’s planned People’s IPO, which we cover in this issue, aims to offer its citizens a chance to participate directly in the success of its economy by organising share sales in a number of state-owned businesses, spanning a broad range of industry sectors.

Preparation for the People’s IPO has required regulatory reviews for the Kazakhstan Stock Exchange and, critically, the development of investor education so that individuals understand how the capital markets work and what they should expect from investing their own money in listed shares. It’s a bold and ambitious programme – and is attracting considerable interest from many local and international observers.

Kazakhstan’s increased confidence and sophistication are also evident in its more nuanced approach to working with foreign investors. With the natural resources it has as its disposal, it’s no surprise that Kazakhstan is a major investment target for many countries. But rather than being satisfied with a straight swap of cash for resources, Kazakhstan’s National Development Strategy is seeking more from foreign investors and what they can bring to the country. It wants to ensure that the infrastructure being put in place today will continue to generate benefits for future generations. That means joint ventures with Kazakh companies to develop production facilities in which both parties have a stake.

Investors will need to ensure that their approaches are framed to meet those requirements. One of those opportunities for sharing technical information and know-how is between national and international
Kazakhstan, and in line with increasing economic diversification, a larger number are from outside the extractive industries. As Kazakhstan begins to expand its horizons, seeking partnership and technical exchange to build and diversify its economy, the UK is well placed to act as a major commercial partner.

Overall, the articles in this issue of Russia & CIS Express highlight the great strides that Kazakhstan has taken over only two decades to develop and grow its economy. PwC’s positive experience in the country is neatly summed up in our profile of Pete Wilkin, recently retired after three years as a senior partner in our Eurasian practice. He praises the enthusiasm, ambition and talent of the young people with whom he worked as one of the country’s greatest ‘natural’ resources. It’s no surprise in this context that a particular focus on education has been a hallmark of President Nazarbayev’s approach. That’s been particularly evident in the Bolashak programme that aims to provide the country’s brightest students with the chance to study at leading higher education institutions overseas.

Other changes to national policy that we highlight in this issue are also likely to shift the requirements on foreign investors. In particular, the aim of ensuring greater social stability – a priority after violence erupted in 2011 in the western city Zhanaozen – is likely to change aspects of employment regulations. Companies may be required to ensure that they employ a higher proportion of Kazakh nationals on the payroll, or in some cases even establish local job creation schemes to address unemployment.

Two of the articles in this issue also highlight the close financial and economic ties that exist between the UK and Kazakhstan. The London Stock Exchange has been the venue for 10 Kazakh companies to list since 2005. In an interview with Jon Edwards, Deputy Head of Primary Markets at the LSE, he relates how the momentum established by those first listings have created a knowledgeable pool of seasoned investors making it an attractive venue for future businesses seeking to access global capital markets via a listing in London. The strength of the relationship with the UK is also highlighted in an article by Alderman David Wooton, Lord Mayor of the City of London. He stresses the mutual opportunities for successful partnership that will be the focus of his visit to Kazakhstan later this year. Many UK companies are significant investors in Kazakhstan, and oil companies. Some analysis carried out by PwC in conjunction with KIMEP University in Kazakhstan highlights a performance gap between the majors and their national counterparts. Closing it will require just the type of collaborative working and sharing of innovation that the Kazakh Development Strategy aims to encourage.

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Mission Possible – energising Kazakhstan’s capital markets

Kazakhstan’s government has initiated a pioneering programme of privatisations – the ‘People’s IPO’ – geared to reinvigorating the country’s capital markets.

The vision behind the ‘People’s IPO’ is to engage Kazakhstan citizens as investor partners to a number of IPO candidates. By buying and holding newly-issued shares in these enterprises, either through their pension funds or using brokerage accounts, individual investors will be able to take an active role in the country’s capital markets. A largely unknown phenomenon until now, the change in national mind-set that this represents could prove to be a very significant development for financial markets in Kazakhstan.

Although similar initiatives have already been launched in countries including Russia, South Korea and China, the ‘People’s IPO’ is unique. Rather than envisaging just one or two IPO opportunities, candidates in the Kazakh programme span a range of industries – from natural resources and utilities to infrastructure – and are expected to come to market over a number of years.

Buoyed by a combination of rising commodity prices and a sustained strategy of debt reduction, Kazakhstan has recently bounced back from the effects of the global recession. As a result, the government, aided by the Sovereign Wealth Fund, Samruk-Kazyna, believes that now is a perfect time to launch this programme.

Planning for a new frontier

The preparation and planning phase of the ‘People’s IPO’ has now been completed. This involved detailed assessments of the readiness of the various candidates, the current capital markets framework and governance, the viability of offering shares and the process of selling shares to Kazakh nationals.

As a member of the steering committee for this landmark process, PwC has been integral to the completion of these various readiness assessments. Led by representatives of Samruk-Kazyna, this committee also included four investment banks (Visor Capital, Citibank, UBS and KazKom Securities), two legal firms (Grata and Cleary Gottlieb Steen & Hamilton LLP) and a PR firm, Merlin.

The next stage is expected to include a series of IPOs, starting later this year and continuing through to 2015. Preparation for two IPOs is already underway – one for the listing of an electricity transmission business, the other for an oil transportation company. Although there is a detailed and publicly available plan for this programme, the timetable remains flexible to allow the government and individual companies the flexibility of listing when the time is right for them.

Education and investor protection – the cornerstones of a successful ‘People’s IPO’

Samruk-Kazyna has identified a number of pressing challenges that must now be addressed – specifically, these include increasing public awareness of the ‘People’s IPO’ and educating and protecting future investors.
The National Bank has embarked on a programme of education, although this is still in its infancy and will continue to be developed throughout 2012. Along with other legislative and regulatory changes, a revitalised regulatory framework at the Kazakhstan Stock Exchange (the ‘KASE’) will help to assure protection for future investors, as will the more rigorous financial reporting and corporate governance requirements now being applied to companies scheduled for listing.

Based on international best practice in London, Hong Kong and New York, and overseen by Samruk-Kazyna and assisted by PwC, the development of these higher standards for KASE-listed companies is expected to play an important part in attracting and then protecting local (and, in future, international) investors.

What does success look like?

The short-term and longer-term success of the ‘People’s IPO’ programme will be closely monitored by many interested parties.

In the short term, the involvement of the people of Kazakhstan in each of the IPOs will, of course, be fundamental to the viability of the programme. In the longer term, success will be measured by an increase in the number of follow-on IPOs for privately-owned companies, as well as levels of retail participation in these offerings.

With these goals in mind, the government and Samruk-Kazyna are continuing the drive towards increased transparency of corporate reporting and uplift in corporate governance standards for companies pre- and post-listing, alongside broader-based changes to the overall regulatory and legislative environment. These developments will significantly contribute to the development and continuation of an internationally recognised capital market in Kazakhstan.

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Viv recently returned to London following a two year secondment to PwC Russia, where she advised on debt and equity offerings coming into London. More recently she spent time in Kazakhstan supporting PwC’s provision of services to the ‘People’s IPO’.

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Almaz is based in Astana and is focused on serving Samruk Kazyna and Kazakhstan state owned companies participating in the ‘People’s IPO’.

View of the administrative and cultural center of Astana
Kazakhstan: targeting socio-economic modernisation

Kazakhstan’s Ambassador to Great Britain and Northern Ireland, His Excellency Mr. Kairat Abusseitov, outlines the modernisation agenda in his country.

Having reached a certain level of development, the Kazakh economy is no longer looking simply for finance. New technologies and know-how are prerequisites for future growth. This is why, from now on, participation in modernisation-related initiatives will be key to sustaining successful business relations in Kazakhstan.

In the early years of independence, Kazakhstan’s government set a strategic course to build a modern, democratic and secular state with a market economy and a socially oriented society. Twenty years later, a young but ambitious Kazakhstan can now confidently say that it has achieved its goals through wide-scale reforms in the political, economic and social spheres.

As a result, Kazakhstan has proudly entered its third decade of independence with GDP growth at 7.5%, and GDP per capita at US$11,000, (as opposed to US$700 in 1993). The state industrialisation programme has generated US$85 billion of annual industrial output and new jobs. And the list continues, with successful reforms in pensions, education, health care and legal systems.

Creating a favourable business climate

As an increasingly influential member of the world’s economic community, Kazakhstan is subject to the same global pressures. Especially now, with the global economic crisis continuing, we have to ensure that our economy and people are prepared for new challenges. This is why Kazakhstan’s government has chosen socio-economic modernisation as the process through which economic success can be balanced with ongoing public benefit.

In the years since independence, Kazakhstan has attracted over US$126 billion in foreign investment. It is largely because of these investments by foreign companies, particularly in oil, gas and mining, that we have achieved such strong economic growth and development. Now, as we look to the future, it is increasingly clear that these investments provide an invaluable platform for knowledge transfer and capacity building in our domestic market.

For its part, the Kazakhstan government has been taking important measures to create a favourable business climate through the protection and support of both domestic and foreign investors with more predictable legislation and greater transparency. This has been recognised in the World Bank’s ‘Doing Business’ report of 2011, where Kazakhstan moved up 15 places to rank 47th among 183 economies. In what represents a very significant achievement for a post-Soviet country, Kazakhstan was ranked 10th in terms of investor protection.
As they continue to compete with companies from Germany, France and Italy, British businesses are well placed to develop opportunities for cooperation with Kazakhstan and participate in the ongoing modernisation of the country’s economy. Already one of the largest investors in Kazakhstan, the United Kingdom accounts for 8% of total foreign direct investment (with over US$10 billion invested to date). Bilateral trade turnover has grown steadily, reaching US$2.5 billion in 2011 and the number of British companies, or joint ventures with British connections, working in Kazakhstan increased last year from 500 to over 614.

While British business was initially involved mainly in Kazakhstan’s oil and gas industry, today Britain is considered to be one of Kazakhstan’s most important partners in implementing the National Programme for Accelerated Industrial-Innovative Development. From now on, by strengthening the technological component of their long-term cooperation with Kazakhstan, British companies will have an opportunity to play an important part in the modernisation of the Kazakh economy.

Perhaps more importantly, Britain is missing out significantly by not moving to new forms of cooperation. One positive example is Germany, which has already chosen to pursue more innovative and industrial forms of partnership. President Nazarbayev’s February 2012 visit to Germany resulted in the signing of 50 commercial contracts worth €4 billion.

Russia and China, as neighbours, are obviously well placed to meet Kazakhstan’s requirements for imported goods and services. But among developed economies, Germany, France and Italy, are becoming increasingly significant partners. These countries understand Kazakhstan’s current and future needs, and they are using this knowledge to contribute meaningfully to the country’s modernisation. Almost all their ongoing investment projects envisage practical steps towards the creation of dozens of industries using advanced technologies and know-how.

**Kazakhstan – the emerging market opportunity**

It is now clear that the future lies in emerging markets. Goldman Sachs’ Jim O’Neill summed this up with his exhortation to “Go BRICs” and other leading economists and global businesses, including PwC, continue to underline this message. Already well established as an attractive location for foreign investment, Kazakhstan is recognised as a premier emerging market. And as a neighbour and supplier to three out of four BRICs – China, Russia and India – it also stands centre-stage in a high-growth region.

Investors that can contribute to Kazakhstan’s social and economic modernisation (through employment, new enterprises and technologies), will be uniquely positioned to share in the country’s development from now on. As Kazakhstan’s relationship with British business enters this exciting new phase, the priority must be to build on established friendly relations, while broadening the focus from oil and gas sector involvement towards a greater exchange of scientific and engineering expertise and increased technology transfer between Britain and Kazakhstan.

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**His Excellency Mr. Kairat Abusseitov**

His Excellency Mr. Kairat Abusseitov has been the Ambassador Extraordinary and Plenipotentiary of the Republic of Kazakhstan to Great Britain and North Ireland (Sweden, Ireland and Iceland) since 2008. Prior to his current appointment, he was Ambassador to Switzerland and Permanent Representative of the Republic of Kazakhstan to the United Nations in Geneva.

Ambassador Abusseitov has a PhD from Moscow State University and a long career in foreign affairs. Prior to his joining the Ministry of Foreign Affairs, he had an academic career which included lecturing appointments at the Kazakh State University, the Almaty Higher Party School and the Almaty Institute of Politology and Management.
Much has been written in recent months about Kazakhstan’s achievements in the twenty years since this young country achieved its independence. There has been impressive headway made towards realisation of its economic and social goals. Britain - as a commercial and political partner, and as one of Kazakhstan’s largest investors – has made a major contribution to this process. Many challenges remain, but the progress is real.

It is clear that Kazakhstan is not satisfied to rest on its laurels. It is a country in a hurry, outward looking and ready to benefit from collaboration with countries from all parts of the world, from its nearest neighbours to other important trade partners in Europe and beyond. For Kazakhstan, the next twenty years start now.

Kazakhstan’s medium term ambitions are clearly set out in President Nazarbayev’s visions for both 2020 and 2030. The three major oil and gas projects – Tengiz, Kashagan and Karachaganak - will drive Kazakhstan’s emergence as one of the world’s larger energy producers. The mining and agricultural sectors are also increasingly important, and Kazakhstan is well placed to become a regional financial and logistics centre.

It is Kazakhstan’s talented and energetic young people who will be the key to delivering all this, as well as addressing other challenges such as developing effective health and social services provision to communities across this enormous country. Kazakhstan has made a sustained investment in education, both abroad through its Bolashak scholarship programme, and increasingly at home in institutions such as Nazarbayev University in Astana and the Kazakh-British Technical University in Almaty. The UK has been involved in this educational investment through the University College of London’s partnership with Nazarbayev University, long established links with KBTU and the establishment of the Haileybury schools in both Almaty and Astana. The aim is to equip the next generation to take full advantage of their future in a competitive economy and a rapidly changing global political and social landscape.

So what might this future look like? An optimistic vision would place Kazakhstan within an open and rules-based international system and working with institutions (including the international financial institutions) which reflect progressive values and are based on free trade and co-ordinated action against protectionism, as well as...
effective strategies for a low carbon economy. For new emerging powers, the next twenty years should be a time of growing stability and prosperity, with evolving political institutions effectively meeting domestic economic, social and political aspirations and contributing to better global governance and more effective co-ordinated action on international security priorities such as counter-proliferation, counter-terrorism, and conflict prevention and resolution.

With its commitment to economic diversification and multivector foreign policy, Kazakhstan should be well placed to play a significant part in this process. Fora, such as the Foreign Investors’ Council, are useful venues for discussing priorities for improving the investment climate and attracting additional FDI. The Kazakh government’s commitment to judicial reforms which will strengthen a rules-based system will find support among the international business community. Accelerating corporate governance co-operation with the OECD, achieving WTO accession and reaching full compliance under the Extractive Industries Transparency Initiative (EITI) would all send a strong signal of commitment to free trade and foster an attractive business climate. The British Embassy in Kazakhstan actively supports this process, whether through facilitating high level political or commercial contacts or working alongside British business and the Kazakh government on issues such as sustainable promotion of local content.

In the political sphere, Britain stands ready to work with Kazakhstan on strengthening the legacy of the 2010 Astana Summit’s recommitment to core OSCE values. The next twenty years will hopefully see these universal values underpin a trend towards democratic political governance across the OSCE area, including Kazakhstan, with the active participation of multiparty parliaments, empowered and effective civil society, and independent media. Kazakhstan is also carving out a niche as a diplomatic interlocutor and influencer within the Islamic world, notably through its chairing role in the Organisation of Islamic Co-operation (OIC). Its constructive positions on pressing foreign policy issues such as Iran and Syria have complemented important UN and multilateral diplomatic initiatives. And Kazakhstan will remain an invaluable partner in managing regional security challenges arising out of changes in the next few years in Afghanistan.

Britain remains a committed partner as Kazakhstan works to shape its external environment and internal future. We have provided about 14% of Kazakhstan’s FDI since independence – more than $15 billion. Our companies - whether small, medium or large - will continue to enable Kazakhstan to realise its ambitions across the economy. Hydrocarbons, renewables, mining, education, financial services, insurance, infrastructure, agriculture, retail: the list where we are working profitably together is long and growing. We are keen to build on this solid foundation and be a major partner of choice. We have been investing in Kazakhstan from the beginning and want to be there beside you to celebrate in 2031.

Her Majesty’s Ambassador Mr David Moran

David Moran was appointed as Her Majesty’s Ambassador to the Republic of Kazakhstan in December 2009. Before his assignment to Kazakhstan Ambassador Moran was Deputy Director at the Cabinet Office and prior to that, Her Majesty’s Ambassador to Uzbekistan. He has a long career in the civil service, having completed overseas assignments in Africa and Russia, as well as working as a UK permanent representative to the OECD in Paris.

Ambassador Moran holds a BA in Soviet Studies from Willamette University, Oregon, and an MA in International Relations from the University of Sussex, Brighton. Early in his career he was a professional blues pianist.
Challenges facing National Oil Companies

In general, International Oil Companies outperform their National Oil Companies counterparts in almost every key economic and operational indicator

At first glance, it might appear to be self-evident that National Oil Companies (NOCs), with ready access to domestic reserves, hold all the cards in the oil and gas industry. The facts appear to add weight to that intuition. Of reserves held by the top 100 NOC and International Oil Companies (IOCs), NOCs hold close to 90% of proven reserves, with IOCs holding the remainder. Conventional wisdom would suggest that this advantage would be reflected in market value (or capitalisation) assigned to NOCs. However, conventional wisdom can be very misleading.

At PwC Kazakhstan, in conjunction with KIMEP University (Kazakhstan Institute of Management, Economics, and Strategic Research), we built a benchmarking tool to assist NOCs and IOCs to assess where they stand relative to their peers. We developed our tool using information from publicly available sources, enhanced with knowledge gleaned from our industry experience.

The results were surprising. Using Operating Cash Flow (OCF) as an indicator of value, our research and analysis has revealed that OCF (a proxy for efficiency and reserve utilization) can be statistically correlated with market capitalisation for those companies where market capitalisation is reported. The correlation is better than the correlation between market capitalisation and proven reserves.

In general, we found that IOCs outperform their NOC counterparts in almost every key economic and operational indicator; intuitively we can attribute this to greater market scrutiny of management. For illustrative purposes, we benchmarked operating cash flow per barrel across the whole top 100 global oil companies - along with two other key performance measures. To facilitate local insights we evaluated IOCs against NOCs and further evaluated oil and gas companies from the CIS in a separate peer group.

Figure 1 illustrates OCF per barrel of oil equivalent (BOE) production (USD/BOE). Here, IOCs generate close to three times OCF when compared to NOCs. Further, CIS companies, some of which are national and some of which are international, generate less than half the OCF of other IOCs. The difference in IOC performance versus NOC is due in no small part to the significantly lower operational efficiency of NOC. Figure 2 illustrates this inefficiency relative to the size of respective work forces.
Fig. 2 compares OCF per employee (USD/person). Here again, the results suggest that NOCs are overstaffed when compared to IOCs. IOCs generate over US$400,000 OCF per employee while NOCs and CIS companies generate roughly US$80,000 per employee. Evaluating production per employee shows similar trends. It is clear that on average, IOCs are producing equivalent quantities of oil and gas with far fewer employees than NOCs.

In addition to operational inefficiencies, NOCs are less efficient in converting their vast reserves into production. This is where IOCs excel and they are rewarded for their performance through higher earnings multiples and market capitalization per BOE produced. For NOCs to close the gap, they will need to tackle many areas of their operations simultaneously, including increasing labour productivity, transforming operations including maintenance and production support, upgrading equipment, and levels of automation, etc. NOCs will also have to separate the impact of government dictated social mandates to quantify the drag on performance resulting from these activities.
Reshuffles and policy changes will challenge Kazakhstan’s investors

January’s parliamentary elections in Kazakhstan saw a few seats ceded to friendly opposition parties, but these will have little impact on Kazakhstan’s political stability in formal terms.

More important for investors in Kazakhstan is the raft of policy changes outlined on January 27th by President Nursultan Nazarbayev in his annual state-of-the-nation speech. Along with major reshuffles at the US$78 billion Samruk-Kazyna state holding company and a trend towards tighter control over its subsidiaries, the new policies will have broader implications for foreign companies operating in Kazakhstan.

President Nazarbayev’s emphasis on social stability will likely put pressure on investors to promote enhanced employer/employee relations, to locate as many staff as possible near the project site rather than in the two main cities of Astana and Almaty, and to increase levels of Kazakh national involvement in both staff and services. Investors – particularly those operating in single-industry towns – may also come under pressure to develop job creation schemes.

These policy directions were outlined by new Samruk-Kazyna head, Umirzak Shukeev, a seasoned politician known for his shrewd ability to manage the regions. Shukeev was appointed to head the fund in December 2011.

Although his remarks are targeted most closely at state-owned enterprises, foreign investors should heed the political atmospherics since the likelihood is that they will be asked to respond in kind.

As their employees become increasingly aware of the government’s new and more conciliatory stance towards workers in industrial disputes, foreign companies could find themselves under increased pressure on wages and/or CSR activities. Personnel reshuffles, both within the government and Samruk-Kazyna, will also impact foreign investors.

Shukeev, having now replaced Kuliabyev as chairman of KMG and Kazatomprom, has reorganized Samruk-Kazyna into four blocks. While retaining direct control over two of the blocks (which include subsidiaries in oil and gas, energy, mining and transport), he has appointed two capable technocrat deputies to manage the two others. Elena Bakhmutova will assume responsibility for financial issues and BTA’s second restructuring, and Kuandyk Bishimbayev will cover investor relations, innovation policy and Kazakh content.

The next few months will likely see further personnel changes following the change of leadership at Samruk-Kazyna. A second trend at Samruk-Kazyna – often referred to as Kazakhstan’s second government – will be tighter and more centralised control over its subsidiaries.

With these developments ongoing, Samruk-Kazyna will devote its efforts to its principal task – implementing the country’s ambitious 2010-2014 industrialisation and economic diversification programme and grooming state-owned enterprises for eventual privatisation. This begins with a domestic IPO programme that should see 5-15% stakes in KEGOC (Kazakh Electricity Grid Operating), KazTransOil and Air Astana being floated before the end of the year. (Further details about the ‘People’s IPO’ can be found on pages 2-3 of this edition of Express).
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Ministry of Communication, Kazakhstan
Since the first listing of a Kazakh business on the London Stock Exchange’s (LSE) Main Market in 2005 (copper mining company Kazakhmys), the LSE has seen nine further Kazakh businesses list on the main market, raising several billion pounds at IPO.

Those ten pioneers have been instrumental in helping the LSE to secure its status as a first port of call for Kazakh businesses investigating the possibilities for raising funds from the international capital markets.

Jon Edwards, Senior Manager, Russia & CIS Equity Primary Markets at the LSE, explains how among CIS countries, Kazakhstan has been particularly prominent, and second only to Russia in seeking listings: “After the Russians started to list, Kazakhstan has been right up there with them. In terms of large IPOs we’ve seen in the London market, companies from Kazakhstan were the first from the CIS to do premium listings.”

Having established a successful core of listings in London, the market will no doubt benefit from future listings as companies look to raise capital and their international profile. And developments within Kazakhstan, particularly the planned privatization programme, the People’s IPO, will certainly add to the momentum, as Jon Edwards says: “I think we certainly will continue to see Kazakhstan companies coming to the market. One of the big drivers in the near term will be the People’s IPO. It’s of paramount importance to the Kazakhs to make sure that this proceeds successfully, and it’s of course very important to the LSE, and the international investor base that we attract.”
With that in mind, the LSE has been a very willing partner to help Kazakh companies stage investor-facing events in London. Jon Edwards suggests that regardless of whether the IPOs take place in Kazakhstan or as a dual listing, London is eager to stress its status as the pre-eminent venue in which Kazakh companies – including the state owned businesses that are part of the People’s IPO process – can find interested parties for investment.

Aside from its deep pool of liquid capital and worldwide reputation, the attraction of London is partly due to the familiarity it offers to companies from Kazakhstan. There is an established peer group, not only of Kazakh companies but, in total, 67 listed businesses from the CIS. And that means that investors are already familiar and comfortable with the context within which Kazakh companies operate, as Jon Edwards relates, “There is an established benchmark which means companies don’t have to start from the very beginning in telling the right investment story to investors. In London they are facing a group of seasoned investors who understand the opportunities and risks of investing in a particular country. Companies don’t have to go over the basics, and don’t have to start from the beginning to answer the question: ‘Why Kazakhstan?’ Many of the answers have already been successfully supplied.”

Kazakhstan’s wealth of natural resources means that many of the listings to date have been by companies from the extractive and resources industries. The strength of the LSE in those industries is also extremely helpful for potential listings, with ready access to investors who understand the economic drivers and appreciate Kazakhstan’s potential. However, as the country develops, it’s likely that there will be greater diversity in the companies coming to market. Three banks – Kazkommertsbank, Halyk Bank and Alliance Bank from Kazakhstan have already completed successful IPOs in London and in time it’s highly probable that businesses from sectors such as infrastructure, property and transport will follow.

One issue that will be critical to any potential listing is operating with appropriate corporate governance. It’s an issue that is attracting increased attention in Kazakhstan, and in response the LSE has run a number of well attended events aimed at providing representatives from both government owned and private companies with advice and information about international investors’ expectations of governance standards. Jon Edwards explains “There has been huge take up of our corporate governance events, and part of that reflects the feedback from the pioneer listed companies in London. It’s become very clear to those companies seeking to raise capital internationally that good corporate governance is essential to the listing process and for life after the IPO.”

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As deputy head of primary markets, Jon helps to oversee the work of London Stock Exchange’s Primary Markets team. He is responsible for developing the London Stock Exchange’s business in Russia and the CIS, spending a majority of his time working with companies, advisors and regulators in the region interested in London Stock Exchange markets.
The Lord Mayor’s travel plans take shape

As Lord Mayor of the City of London, I am an Ambassador for the whole of the UK’s financial, professional and business services industry.

I will travel to twenty-five countries this year, accompanied by a delegation of UK business leaders, looking for opportunities for British businesses in key high-growth markets. These opportunities will, in turn, mean jobs and economic growth at home in the UK. The City and the UK remain committed to the Eurozone, which remains our largest export market, but we must also look to the dynamic emerging economies for new opportunities and new business.

My visit to Kazakhstan in Summer 2012 will be one my most important business missions of the year. In recent years, Kazakhstan has made incredibly impressive progress – often achieving double digit annual growth. This country is a hugely important force in Central Asia, both geopolitically and because of its very great natural resources.

The City of London already enjoys excellent relations with our partners in Kazakhstan. We hosted the President of Kazakhstan in the City in 2000, as part of a State Visit, and many of my predecessors have visited the country as Lord Mayor in recent years. I know that all former Lord Mayors who visited were greatly impressed with what they found, and excited about the potential for our future partnership.
As someone from Bradford, I was particularly pleased to know that, during the Lord Mayor’s visit to Kazakhstan in 2009, a Memorandum of Understanding was signed with TVET UK and Bradford and Loughborough Colleges, to train 1,000 volunteers to assist the 7th Asian Winter Games, which were held in Almaty last year. I am delighted that Bradford could support this important event, and later this year, this Bradford-born Lord Mayor will also strive to support growth and development in Kazakhstan.

My visit will build on the visit in December 2010 by the Deputy Prime Minister, Nick Clegg, and the Chief Executive of UKTI, who met major UK investors in Kazakhstan. Many British companies are already significant investors – Shell alone has invested $40 billion in Kazakhstan. In 2011, UK services export revenues are expected to be worth around £700 million. The UK has invaluable expertise to contribute – not only in the oil and gas sector, but in financial services, and our close working relationship can improve long-term stability and maintain a competitive but cooperative business environment.

The Kazakhstan-British Trade and Industry Council and the Kazakh-British Chamber of Commerce are playing a vital role in strengthening relations, and the London Stock Exchange and the Kazakhstan Stock Exchange have developed a strategic partnership over many years – achieving a number of dual listings. There is also bi-lateral co-operation between lawyers and the Bar in both our countries.

I am committed to ensuring that my own business mission builds on our very productive existing relationship. The track record of our trade and investment, and boundless goodwill between business in both our countries, means the UK is ideally placed to support Kazakhstan’s ambitious plans to diversify its economy away from a reliance on extractive industries. In order to do this, Kazakhstan needs to attract vital investment, state-of-the-art technologies and expertise, all of which are core elements of the City’s competitive offer.

The UK and the City want to be Kazakhstan’s commercial partner of choice. There are considerable opportunities in Kazakhstan, but there remain challenges for business. Kazakhstan ranks 47 out of 183 in the World Bank ease of doing business. The UK can provide invaluable assistance to increase investment flows; to use public private partnerships as a method for planning, delivering and managing major infrastructure projects; to support and encourage IPOs by listing in London; and to make the case for stability, predictability and clarity in the legal and regulatory environment as an essential precondition for attracting further business and further investment.

The UK, the City of London and Kazakhstan have a strong relationship, which we can build upon to achieve economic growth and prosperity for both our countries. I look forward to contributing to that shared future during my visit to Kazakhstan later this year.

Alderman David Wootton
Lord Mayor of the City of London

Alderman David Wootton took office as the 684th Lord Mayor of the City of London on 11 November 2011. He was educated at Bradford Grammar School, and at Jesus College, Cambridge, where he read Classics and Law.

Alderman Wootton is a partner at Allen & Overy LLP, the international law firm based in the City of London, and a committee member of the City of London Law Society and Chairman of the City of London Branch of the Institute of Directors.
Investing in Kazakhstan as a member of a Customs Union

Kazakhstan’s wealth of natural resources is well known. For example, there are already more than 200 active oil and gas fields in Kazakhstan with the promise of more to follow. A boom in commodities prices has enabled Kazakhstan to enjoy significant economic growth in the last decade.

Last year, GDP growth reached 7.5% and this increase fuelled a rise in domestic consumption making the country an attractive market for consumer goods and service industries. At the same time, owing to its location and recent political developments, Kazakhstan could also serve as an entry point to the vast Russian market as well as operating as a platform from which to do business in the resources rich Central Asia region. Being a member of the Customs Union means that most of the technical regulation for goods will become uniform for union member countries and goods originated in Kazakhstan will face no access restrictions for entry to the Russian market.

The Customs Union

The Customs Union, a trade bloc initiative along the lines of the EU, was established in 2010 between Russia, Belarus and Kazakhstan, and started with a uniform customs tariff. A Uniform Customs Code followed, with the removal of customs borders between the three countries.

Uniform technical regulation and common economic space with no restrictions on accessing internal markets is on the way. There are practical issues to be considered in reaching this goal, but progress is being made.

Why Kazakhstan?

Kazakhstan also has certain tax advantages compared to Russia or Belarus as a production site or hub for the Customs Union market. These advantages include:

- VAT rate of 12 percent (compared with the Russian rate of 18%), which minimizes cash outflows;
- Flat social tax at 11%
- Participation exemption on upward dividends and capital gains for the non-extractive sector (when 3-year holding and other conditions are met)

In addition, Kazakhstan has an extensive international income tax treaty network (44 tax treaties), which could be helpful in structuring investment into the country.

Issues to consider

Kazakhstan’s tax system is relatively sophisticated, both compared to other Custom Union members and within the CIS. It has developed anti-base erosion rules such as transfer pricing, beneficial ownership requirements, thin capitalisation and anti-treaty shopping provisions and so on. It also has such features as extra-territorial taxation of capital gains, service permanent establishment and withholding tax on services provided by non-residents.

At the same time, Kazakhstan has introduced various tax incentives to attract foreign and domestic investments which, if used in the right way, can help to improve effective tax rates. These include:

4. Tax that employer pays on top of the payroll to the budget
5. Different rules that combat tax avoidance like thin capitalization, transfer pricing, anti-treaty shopping, beneficial ownership requirements and etc.
1. No cash-outflow for the import VAT on importation of qualified industrial equipment
2. No withholding tax on qualified cross-border leasing arrangements
3. No withholding tax on bonds financing listed on local stock-exchange
4. 150% R&D credits on qualified activities
5. Free economic zones in certain areas
6. Reduced taxation for qualified agri-business activities

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Over the last decade, Kazakhstan’s multi-vector foreign policy has gradually shifted to reflect the emergence of players from Asia as the region’s most significant investors. Driven by their thirst for natural resources, countries from Asia are seeking relationships that go beyond a traditional cash-for-resources approach. Instead they are now identifying how they can best respond to President Nazarbayev’s vision for the future of Kazakhstan. And that means they increasingly need to answer the question: “What can you offer Kazakhstan?”

China in particular has aligned its interests with those of Kazakhstan. It has invested in creating mutually beneficial infrastructure, entering joint ventures with local companies, offering loans and building the Atyrau-Alashankou pipeline. CNPC (China National Petroleum Corporation), Petro China and Sinopec all have local presence, and are particularly focused on Kazakhstan’s oil-rich western regions.

While Japan initially allied with western interests in order to enter Kazakhstan (with Inpex, for example, holding a 7.56% share in the Kashagan oil project), Japan is now an independent actor, pursuing joint ventures with the Kazakhs to advance its economic aims. Recent examples include Marubeni Corporation which, capitalising on its investment experience, was awarded a contract for the third phase of the Atyrau oil refinery reconstruction project in December 2011 – a US$1.7 billion investment it will undertake with Sinopec. The refinery is a component of Kazakhstan’s National Development Strategy which envisages “prosperity, security and improved living standards for all Kazakhs” by 2030. Japan has pursued policies designed to deliver mutual benefit in the uranium sector too, with Sumitomo and Toshiba signing a joint venture with Kazatomprom – the Kazakh state uranium company.

Aligning with state agencies in the delivery of major projects often confers advantages. However, as India demonstrates, there are no guarantees of success. Despite the award of a 25% stake in the Satpayev block, an oilfield off the Caspian coast in which KazMunaiGas is the principle shareholder, India has consistently lost out to bigger and wealthier investors in the hydrocarbon sector. Its undisguised ambitions for access to Kazakhstan’s oil and gas reserves are yet to be fulfilled and its commercial clout remains, for the time being, relatively weak compared with Japan or South Korea.

India may have more luck as an importer of Kazakh uranium. In 2009, India and Kazakhstan signed a pact on cooperation in civil nuclear energy, with Kazakhstan looking to India as a market for its uranium exports. The Indian Prime Minister, Manmohan Singh, speaking in January 2012, emphasised that energy security is a priority for India. However, India’s role in Kazakhstan can still be characterised as one of as yet unrealised potential, with Japan and South Korea for the time being enjoying greater success in asserting their influence.
2011 saw perhaps the most obvious manifestation of convergence between Kazakh and South Korean ambitions to date. South Korea’s LG Chem is seeking a petrochemical refining capacity that will rival those found in the Middle East; Kazakhstan has the Atyrau petrochemical complex on its national development agenda. Accordingly, LG Chem will now work together with KPI (Kazakhstan Petrochemical Industries – 51% owned by United Chemical Company LLP, a subsidiary of the national wealth fund, Samruk-Kazyna) Korea will fund this development and the Export-Import Bank of Korea has signed an agreement with LG Chem, KPI and Korea Trade Insurance Corporation to finance the project.

Such projects demonstrate that Asian economies are prepared to make significant capital investments to underpin their drive for resources, and are willing to work within Kazakhstan’s development ambitions to achieve their aims. What remains to be seen is the shape and impacts of the political relationships that Asian economies will have both with one another, and with the Kazakh public. South Korea, Japan and India may together provide foreign direct investment to mitigate the Chinese influence. And that will echo how China offers a balance against Russia, just as Russia does against the West.

In addition, some Kazakhs appear wary of what China offers. The country’s generous loans are often perceived as a mixed blessing that may be given with rather onerous demands for special treatment attached. Wiser after the events in Zhanaozen, and pushing extensive infrastructure development, Kazakhstan is today seeking projects that benefit the population, not merely boost the treasury’s coffers. So while multi-vector Kazakhstan is still very much open for business, investor nations need to be aware that they will now be expected to offer a clear idea of what they can contribute; not simply state what they want.

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Jessica is an analyst at GPW where she focuses primarily on Central Asian political risk issues.
Flying to Almaty, Kazakhstan from London takes seven hours. Half of this time is spent flying above Europe and the other half crossing Kazakhstan to reach its commercial centre. The country’s sheer scale and distance from western Europe leads many to see the country as remote and isolated from the rest of the world. But, as Pete Wilkin – who in 2008 took up the offer to head up PwC’s Eurasian Assurance, Financial Services and Capital Markets – discovered nothing could be further from the truth. Speaking from his study in France with a view of Mont Blanc in the Alps towering above him, Pete Wilkin says he is reminded of the view of the Tian Shan (“heavenly mountains”) that similarly dominate the Almaty skyline. Discovering the beauty of the city was just one of the surprises that met Pete when he took up the offer. He says that, like many others, he had certain preconceptions about what would greet him. Many, if not all, of those were he says confounded by the reality of living and working in Kazakhstan.

As the balance of the global economy shifts eastwards, Kazakhstan’s links with major players in the region, notably China and Russia will continue to grow.

Profile: Pete Wilkin
Part of that dynamism is a reflection of the country’s relative youth. It’s only 20 years since the end of the Soviet Union, and Kazakhstan has come a long way since then. Blessed with an almost unparalleled abundance of natural resources, the country has experienced rapid growth. In fact, the speed of development can be a challenge for a business like PwC operating in Kazakhstan. As Pete explains, the young people that work for the firm are fiercely ambitious and are often approached by businesses looking for qualified professional accountants to take on chief financial officer roles at salaries that can be very hard to match in the short term. One of Pete’s principal roles at PwC in Eurasia was to cultivate careers with the firm, demonstrating to young and ambitious people the development path that PwC can offer, making it a great place to build their career for the longer term.

During the three years that Peter spent in Kazakhstan, he saw the practice continue to develop from a principal focus on assisting the firm’s international clients with their investments in the region to a much more locally driven practice. PwC now works with local enterprises, both government owned and local entrepreneurs, providing them with advice and assistance to grow their businesses and in particular to gain access to international capital markets. Not only has the client base diversified but the nature of the work too has expanded from a focus on assurance work to become a broad-based business advisory firm.

The international capital markets played a major role in the firm’s work from when Peter arrived in 2008, owing to the impact of the financial crisis. During his time in the region Pete worked with both local and international businesses helping them to address issues arising from the crisis. During his last year in Kazakhstan PwC was appointed as advisors to Samruk-Kazyna, the Sovereign Wealth Fund, on their privatisation project, an opportunity he points to as particularly exciting, and further evidence of the rapid pace of change that makes working in the region a stimulating and exciting prospect.

The rapid pace of growth and development by institutions in Kazakhstan and the region is certainly bracing for those used to the more sedate pace in western Europe. And Pete is quick to acknowledge that sometimes aspects of doing business in the region can create additional hurdles for international companies. The government of Kazakhstan is keen to ensure that the country presents itself as welcoming to foreign investment, and as such has been very vocal in its approach to tackling corruption and encouraging all businesses to adopt appropriately high levels of transparency and corporate governance. Here again, PwC’s practice plays a major role in helping businesses to develop in line with the expectations of international markets and investors, and particularly to help Eurasian businesses to tell the right investment stories when it comes to accessing capital markets by, for example, a listing on an international stock exchange.

As the balance of the global economy shifts eastwards, Kazakhstan’s links with major players in the region, notably China and Russia will continue to grow. Pete Wilkin believes that the country’s strength as a resource play means that its future looks very bright and, given the progress made in the last two decades, can only become an increasingly attractive destination for international investment and a fast-growing economic player in its own right.

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Peter retired from PwC Eurasia at the end of 2011 after a three year secondment. Prior to working in Almaty he was a Partner in PwC UK for 22 years.
Astana, Kazakhstan Baiterek
Kazakhstan makes Jubilee Awards to commemorate the 20th anniversary of Independence

The President of the Republic of Kazakhstan has made awards of a Jubilee Medal, for contribution to the country, to commemorate the 20 years of Independence of the Republic of Kazakhstan.

The list of those being honoured in the UK includes:

- Lord (Peter) Fraser, Chairman of the British-Kazakh Society
- Lord Hurd, former Home Secretary and former Foreign Secretary
- Lord Waverley, Chairman of the British All Parliamentary Group on Central Asia
- Sir Frank Chapman, Chief Executive, BG Group
- Sir John Stuttard, Co-Chair of the Kazakh-British Trade & Industry Council and Chairman of PwC Kazakhstan Advisory Board
- Dr Shirin Akiner, Lecturer in Central Asian Studies at London University SOAS and Associate Fellow of the Royal Institute of International Affairs
- Dr Montu Saxena, Fellow of Jesus College and Chairman of the Cambridge Central Asia Forum
- Ismail Kesici, Chairman of the United Kingdom Kazakh Association
- Gauhar Bramley-Fenton, Chief Executive of the British-Kazakh Society
A macroeconomic focus on Russia

Each quarter, PwC’s Macro Consulting team produces an in-depth ‘Economic Views’ report focused on the fast-growing BRIC economies (Brazil, Russia, India and China). These reports can be downloaded at www.pwc.co.uk/economy.

February 2012

Here is a summary of some of the highlights from the latest edition, focusing particularly on our analysis of Russia.

The BRICs (Brazil, Russia, India and China) should continue to provide the engine for world economic growth in 2012, with stable FDI flows into these countries pointing to an optimistic medium to long-term outlook.

Various factors are expected to moderate their positive impact on the fragile global economy, however, at least in the short term. Particular challenges arise from the BRICs’ trade exposure to the Eurozone, as well as a reversal of investor risk appetite, with short-term capital being moved from the BRICs into safe havens. Slowdowns in domestic demand in all four countries are also apparent, following a period of rising inflation and interest rates in 2011.

But unlike developed economies, the authorities in the BRICs have greater capacity to loosen monetary policy and provide fiscal support. Brazil and China have already taken decisive steps in this direction.

Brazil’s central bank has cut its key policy rate by 150 bps since September 2011 and the Chinese monetary authorities reduced the banks’ reserve requirement ratio policy by 50 bps in December 2011. Meanwhile, moderating growth and easing inflation in Russia and India look likely to create room for interest rate cuts in both countries later in 2012.
**Russian growth holding up...**

Alone amongst the BRIC economies, Russia’s economic output continued to accelerate in 2011, with Q3 data showing year-on-year GDP growth of 4.8%, up from 3.4% year-on-year growth in the previous quarter (see Figure 1).

This impressive performance was driven by strong consumer and investor activity, with an accompanying slowdown in import growth – a dynamic that suggests the Russian economy may be experiencing a period of import substitution.

Although Russia remains vulnerable to a downturn in the Eurozone and a possible drop in oil prices, looking ahead, we expect the Russian economy to expand by 3.7% and 4% in 2012 and 2013 respectively.

**WTO membership – a likely boost?**

After 18 years of negotiations, Russia finally became a member of the World Trade Organisation (WTO) in December 2011. According to some estimates, this could give the economy a boost equivalent to 1% of GDP per year.

Russia’s accession to the WTO will certainly create new opportunities for European businesses. Compliance with WTO rules will open Russia to a range of European service industries, including legal, insurance and telecoms. And although foreign participation in the banking system will remain limited to 50%, 100% foreign-owned banks will be allowed in Russia for the first time.

At the same time, tariff reductions on imported equipment will reduce costs and increase profitability in various industries, including telecommunications and manufacturing.

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**Figure 1: The Russian economy, year-on-year growth rates**

![Figure 1: The Russian economy, year-on-year growth rates](image)

Source: Federal State Statistics Office

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**...but challenges ahead**

Assisted by a sharp jump in agricultural output, along with monetary and fiscal measures taken early in 2011, Russia benefited from a drop in inflation last year (from 9.6% in January to 6% in December).

This is likely to change in 2012, with inflation picking up partly as a result of increased government expenditure. Together with possible rate cuts, we expect inflation to average 6.9% in 2012 and 7.5% in 2013.
Kazakhstan country profile

**Capital:** Astana

**Largest city:** Almaty

**Population:** 16,500,000 (April, 2011)

**Climate:** Continental, cold winters and hot summers, arid and semi-arid

**Official languages:** Kazakh and Russian

**Monetary unit:**
- 100 tiyn = 1 Kazakh tenge;
- 145 tenge (KZT) = $US1
[http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm](http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm)

**Area:** 2.7 million sq km (1 million sq miles). Kazakhstan is the ninth largest country in the world, equivalent to the size of Western Europe, which is five times the size of France. It shares its longest borders with Russia (4,251 miles; 6,846 km) and China (951 miles; 1,533 km), as well as with Uzbekistan (1,629 miles; 2,205 km); Kyrgyzstan (653 miles; 1,051 km); and Turkmenistan (235 miles; 379 km). Kazakhstan also borders 1,183 miles (1,894 km) of the Caspian Sea.
[http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm](http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm)

**Major religions:** Islam, Christianity

**Economy:** While the global financial crisis took a significant toll on Kazakhstan’s economy, it has rebounded well. In response to the crisis, Kazakhstan’s government devalued the tenge to stabilize market pressures and injected around US$10 billion in economic stimulus. Rising commodity prices have helped revive Kazakhstan’s economy, which registered roughly 7% growth in 2010-11. Despite solid macroeconomic indicators, the government realizes that its economy suffers from an over-reliance on oil and extractive industries. In response, Kazakhstan has embarked on an ambitious diversification programme, aimed at developing targeted sectors like transport, pharmaceuticals, telecommunications, petrochemicals and food processing. In 2010 Kazakhstan joined the Belarus-Kazakhstan-Russia Customs Union in an effort to boost foreign investment and improve trade relationships. The government expects to join the World Trade Organization in 2012, which should also help to develop the manufacturing and service sectors.

**Main exports:** Oil, uranium, ferrous and nonferrous metals, machinery, chemicals, grain, wool, meat, coal
[http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm](http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm)

**Natural resources:** Oil and gas

**GNI per capita:** US $7,440 (World Bank, 2010)
[http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm](http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm)

**Unemployment rate:** 5.4% (2011 est.)

**Sources:**
- [http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm](http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1298071.stm)
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