

Kazakh privatisation drive draws tepid response

Kazakhstan's latest privatisation drive has begun to lose its momentum

KAZAKHSTAN

WHAT:

Kazakhstan's sovereign wealth fund aims to reduce its ownership of the economy from 40% to 15%.

WHY:

The country is eager to improve its bid for membership of the OECD.

WHAT NEXT:

Kazakhstan risks failing to meet its target, amid opposition from factions of the elite, a global shortage of capital and competition for investment from Uzbekistan.

PRIVATISATION in Kazakhstan has taken place in fits and starts since the country broke free from the Soviet Union in 1991. The government embarked on the latest wave of sales in 2016, as part of an anti-crisis plan to lift the economy out of recession. Under this programme, hundreds of state enterprises are to head to market by 2021.

Kazakhstan is using three different methods for selling its assets. Larger national enterprises such as airline Air Astana, oil and gas giant KazMunayGas (KMG) and uranium producer Kazatomprom, are to be sold through a series of initial public offerings (IPOs), beginning this year. Meanwhile mid-sized companies, some of which are already joint ventures with foreign investors, are being sold via direct negotiations. Lastly, hundreds of smaller firms are mostly being divested via electronic auctions.

"It is a very diverse mix, so you can't have a one-size fits all approach," Aset Shyngyssov, an Almaty-based managing partner at Morgan Lewis, told *NewsBase Intelligence (NBI)*. Morgan Lewis worked as a transactional law firm on the behalf of buyers in several privatisation deals.

The sale of state assets is not only aimed at injecting extra funds into the national budget, which was hit by slump in commodity prices that began in 2014. Indeed, following the modest recovery in oil prices this year, replenishing government coffers has been a less pressing concern. Rather, Astana has a broader ambition of

dramatically reducing the state's involvement in the economy. At present, Kazakhstan's sovereign wealth fund Samruk-Kazyna controls around 40% of the economy. This is partly a legacy of the government's bailout of businesses following the 2008 global financial crisis.

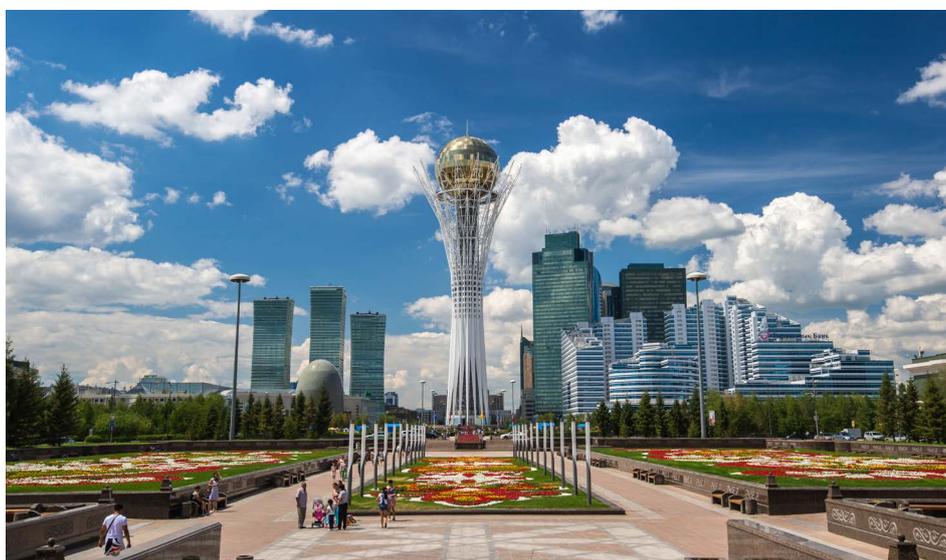
"As government involvement increased after the crisis you saw a lot of non-core businesses, from sports clubs to educational institutions, become state assets," Shyngyssov told *NBI*. "The conventional wisdom is that government is not the best manager of such assets."

According to Kate Mallinson, a partner at London-based Prism Political Risk Management, a personal aspiration of President Nursultan Nazarbayev is to see Kazakhstan join the Organisation for Economic Co-operation and Development (OECD). This would help the country broaden its trade horizons beyond its main partners such as China and Russia. To strengthen to bid for membership of the group, Kazakhstan aims to reduce Samruk-Kazyna's ownership of the economy to 15%.

Drag factors

Reaching this goal may prove difficult, however. Indeed, Kazakhstan's latest privatisation push has already begun to lose momentum, as the price of oil and other commodities has grown more bullish.

According to Shyngyssov, the response so far to the sales has been "tepid".





Kazakhstan's NOC, KazMunayGas, controls shares in highly profitable foreign ventures but also smaller loss-making projects.

► On the macro level, Shyngyssov said that emerging markets such as Kazakhstan were coping with a flight of capital amid global economic uncertainty. Kazakhstan is also competing for direct foreign investment with neighbouring Uzbekistan, another country looking to open up its economy, he said.

Opposition from some factions in the Kazakh elite has also been a drag on the privatisation programme.

"There is this dichotomy in Kazakhstan between quite progressive modernisation objectives coming from the top and underneath this quite neo-feudal patrimonial political economy, whereby the idea of reform threatens the interests of the key elite figures," Mallinson told *NBI*. "Every time a grandiose reform project is announced it is stymied by the informal system."

By and large, Shyngyssov said the government's preparation for privatisation had been "thorough". Though he noted that existing shareholders in limited liability companies had been somewhat taken by surprise by a government decision to deny them a pre-emptive right to buy state shares on offer in these businesses. This right had been stipulated in the original shareholder agreements at these firms. But Shyngyssov argued that the government's decision had been aimed at facilitating the privatisation and did not become a deal breaker.

"Whereas the general framework of the privatisation is good, there are many angles and wrinkles that I think the government has found still need to be addressed," Shyngyssov told *NBI*. "But the government is a quick learner and it listens."

Shyngyssov also dismissed the notion that Kazakhstan had built up a bad reputation among investors amid high-profile disputes over the years. "The image of Kazakhstan is robust actually," he said.

To help improve investor confidence, Kazakhstan is establishing a separate court staffed with UK judges and barristers at a newly opened financial hub in Astana. But Mallinson noted that companies operating at the hub could still have their investments challenged by Kazakhstan's national legal system.

"The laws don't currently work, you have this island of supposed British jurisdiction, but actually the Kazakh courts can still challenge investments and expropriate assets," she told *NBI*.

What next?

According to Mallinson, expectations among Western investors regarding upcoming sales are tempered with caution.

"Investors are already quite weary, there's been a lot of scandals about privatisation in Kazakhstan," she said. "This is a bellwether about whether the country can commit to the reform process."

Among the largest offerings still to come is a stake in KMG. The company has bought back shares in its London-based subsidiary KazMunayGas Exploration Production (KMG EP) and has trimmed its debt pile to prepare for the sale. Sources told Reuters and Bloomberg in early March that Kazakhstan was planning a pre-IPO sale of a 10-20% stake in the company to Royal Dutch Shell to ensure the listing's success. Representatives of the Anglo-Dutch major declined to comment to *NBI* on whether these talks were still ongoing. Kazakh authorities are yet to disclose when the actual IPO will take place.

KMG's performance has improved dramatically since 2015, but the company still suffers from weak cash flow, which could deter investors. It controls stakes in some highly profitable ventures with clear growth prospects, such as the Tengiz oilfield, but it also owns various other loss-making ventures. As an NOC, the company is bound under social obligations and cannot slash costs too deeply at these assets, through fear of causing unemployment.

Another prize asset on offer is a stake in Kazatomprom, the world's leading producer of uranium. Samruk-Kazyna's deputy head Alik Aydarbayev told reporters last week that an IPO at the company would take place in the fourth quarter of this year. Mallinson noted that although Kazatomprom is an attractive and well-managed asset, its strategic status will limit the number of potential buyers. She also pointed to a lack of transparency, particularly at some of the company's joint ventures.

Moving forward, Mallinson cautioned that some of these more ambitious sales could be postponed, with the government likely to cite market conditions.

"Unless we see an IPO this year, it is unlikely that we'll see any IPOs," she told *NBI*. ❖