

**1899**

The first oil spring in Kazakhstan -  
on Karaburgul field

**1911**

Industrial development  
of Dossor field

**2004**

KazMunaiGas Exploration Production  
establishment

**1961**

Uzen field discovery

**2008**

Annual Report  
KazMunaiGas Exploration Production

JSC KazMunaiGas Exploration Production (KMG EP or the Company) is the second largest oil and gas exploration and production company in Kazakhstan.

KMG EP is a subsidiary of the national oil and gas company JSC National Company KazMunayGas (NC KMG). It was created through the merger of JSC Uzenmunaigas (UMG) and JSC Embamunaigas (EMG) in March 2004.

The total volume of proved and probable reserves of UMG and EMG fields is 1,775 million barrels (241.2 million tonnes). Including the acquisitions made in 2007 the total volume of 2P reserves of the Company is over 2.1 billion barrels (292 million tonnes). Today the Company operates on 41 fields (excluding the recent acquisitions).

The Company's shares are listed on the Kazakhstan Stock Exchange and its GDRs are listed on the London Stock Exchange.

KMG EP has years of experience of oil production in Kazakhstan and expert knowledge of the geology of Western Kazakhstan.

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FINANCIAL AND OPERATIONAL  
HIGHLIGHTS

% CHANGE

RESERVES <sup>2P</sup>

Million tonnes (mmbbl)

2007: 240 (1,767)

2008: 241 (1,775)

+0.5%

PRODUCTION <sup>(1)</sup>

Million tonnes (kbopd)

2007: 10.64 (215)

2008: 11.95 (240)

+12%

REVENUE <sup>(2)</sup>

Billions of KZT (billions of US\$)

2007: 487 (3.97)

2008: 605 (5.03)

+24%

NET INCOME <sup>(2)</sup>

Billions of KZT (billions of US\$)

2007: 157 (1.28)

2008: 241 (2.01)

+54%

CAPEX <sup>(2)</sup>

Billions of KZT (millions of US\$)

2007: 40.1 (327.18)

2008: 41.9 (348.26)

+4.5%

CASH, CASH EQUIVALENTS AND OTHER FINANCIAL ASSETS <sup>(3)</sup>

Billions of KZT (billions of US\$)

2007: 369.4 (3.07)

2008: 534.5 (4.43)

+45%

DIVIDEND PER SHARE

KZT

2007: 563

2008: 656 <sup>(4)</sup>

+16.6%

DIVIDEND PER GDR

US\$ <sup>(5)</sup>

2007: 0.78

2008: 0.73 <sup>(4)</sup>

-6.4%

<sup>1</sup> Including shares in Kazgermunai and CCEL (Karazhanbasmunai).

<sup>2</sup> Convenience translation rates - 122.55 and 120.29 KZT/USD for 2007 and 2008, respectively.

<sup>3</sup> Cash, cash equivalents and other financial assets less borrowings. Convenience translation rates are 120.30 and 120.77 KZT/USD for 31.12.2007 and 31.12.2008, respectively.

<sup>4</sup> Recommendation of the Board of Directors held on 31 March 2009, subject to approval by General Meeting of Shareholders' on 28 May 2009.

<sup>5</sup> Convenience translation rates - 120.58 for 2007 (the rate as of 28.05.2008, the date of the 2007 dividend approval by Annual General Shareholders' Meeting) and 130.0 USD/KZT for 2008 (midpoint of the current indicative range established by the National Bank of Kazakhstan).





One of the main factors that influenced the operations of JSC KazMunaiGas Exploration Production in 2008 was oil price volatility. During the year, the difference between the highest and the lowest oil points was almost US\$110.

In spite of this we are pleased to report that in 2008 KMG EP achieved a record net profit of US\$2bn. This success was mainly a result of the approach adopted by the Company's management, who proved capable of navigating through both positive and negative market dynamics.

KMG EP demonstrated the success of its strategy developed five years ago at the inception of the Company. We believe that our strategy will continue to serve us well through 2009.

Firstly, the Company is determined to maintain its production level. At Uzen and Emba as well as at Kazgermunai and Karazhanbasmunai the production plateau has been already reached and in 2009 we intend to stay at approximately the same levels, mainly by using the appropriate oil production technologies.

Secondly, KMG EP will seek to grow its asset portfolio. One of the ways of achieving this is through exploration on the existing licensed blocks, as well as by acquiring new licences in less explored areas of Kazakhstan, for which funds have been allocated.

Another proven way of growing the Company's portfolio is through acquisitions. Ownership of 50% interests in

# Letter to shareholders from the Chairman of the Board of Directors

Kazgermunai and Karazhanbasmunai already played a positive role in 2008. The acquisition policy will continue, especially given that under current market conditions the opportunity exists for acquisitions on beneficial terms.

KMG EP intends to expand internationally and this is in line with the general strategy of the «KazMunaiGas» group of companies. Signing of the three-party upstream co-operation agreement between BG Group, NC KMG and KMG EP in December 2008 was an important step in this direction.

Thirdly, the Company is making consistent cost reductions and continues to improve its management systems. The introduced ISO standards are having a positive impact, in particular, on the quality of management. The effectiveness of production is also increasing. The Company is committed to the optimal use of its resources, and as a result the reserves replacement ratio in 2008 was 113%. However the Company appreciates that there is still much to be done for this trend to continue.

As for 2009, in poor market conditions, we have implemented a radical reduction of all non-production costs, including administrative expenses.

Despite the fact that the development plan for 2009 is conservative, as it is based on the average Brent oil price forecast of US\$40 per barrel, we realise that a worse scenario may occur. Therefore, following the recommendation of the Board of Directors, KMG EP has devised an alternative plan which is based on the assumption that the oil price could fall as low as US\$25 per barrel. In this instance the Company will have to make appropriate adjustments, however, we will ensure that general strategic development continues.

The history of oil production in Kazakhstan is over 110 years old. Several generations of Kazakh oilmen made significant contributions to the development of their country. We are working to continue this valuable contribution for the benefit of the oil and gas sector and

the economy at large. It is rewarding to note the large pool of experience within KazMunaiGas Exploration Production, the Company that continues the operations of its predecessors who have been exploiting the Emba fields for over 100 years.

The five years since the creation of KMG EP is just a fraction of the history of oil production in Kazakhstan, but it has been an important part of the story. The example of KMG EP shows that it is possible to combine over a century of tradition with modern approaches to business.

Making the right choices only brings results when they are properly implemented. 2008 proves this point. We still have a great deal to achieve, but KMG EP has considerable potential. I am convinced that having absorbed the experience of previous generations KMG EP will continue on its way as a modern and competitive company.



Kaigeldy Kabyldin  
Chairman of the Board of Directors

# Letter to shareholders from the Chief Executive Officer



2008 was a year of contrasts for KazMunaiGas Exploration Production. Our net profit reached a five year record of US\$2bn. However, the year also saw a sharp fall in the oil price, the looming global economic downturn and the introduction of the New Tax Code in the Republic of Kazakhstan. These events inevitably had an impact on the Company's operations.

It is my pleasure to note that KMG EP was well prepared to face new challenges and, as a result, we maintained our position as the second largest oil producer in Kazakhstan. In 2008 KMG EP produced approximately 12m tonnes of oil, including our share in the production of Kazgermunai and Karazhanbasmunai, of which we own 50% of both. It is due to those acquisitions that we managed to significantly increase our oil production. In accordance with our strategy, we intend to continue to look for and to acquire new assets. An important step in this direction was the signing of the three-party upstream co-operation agreement between BG Group, NC KMG and KMG EP.

Our Company adopts a highly considered approach to the exploitation of natural resources, the development of which was entrusted to us by the government of Kazakhstan. Due to the use of modern technology and the high professionalism of our staff, KMG EP managed

to maintain stable production levels at its core fields and grow our reserves at the same time. According to the report by Gaffney, Cline & Associates, the total 2P reserves of oil as at 31 December 2008, excluding the share of KMG EP in Kazgermunai and CCEL (Karazhanbasmunai), were 241m tonnes.

Throughout the year the Company demonstrated its resilience to the influences of external factors. This was evidenced by the fact that Standard & Poor's reaffirmed its credit rating of KMG EP at «BB+». Thus, the efforts of the Company's management to adhere to the principles of openness, transparency and the improvement of financial control systems were duly recognised. The financial stability of the Company, largely dependent on consistent profits, sufficient cash flow and balanced strategy of control over finances, has also been noted.

The Company could not fail to react to the sharp fall in oil price. In response to the decision of the Board of Directors, the Company's management prepared the budget for 2009 based on an assumption that the average oil price for Brent would be US\$40 per barrel. The projected production from Uzen and Emba was slightly reduced. All non production expenditure has been minimised while maintaining the funding for capital investment in the areas of exploration and well maintenance. Moreover, the Company managed to avoid redundancies and preserve its valuable staff counting on the eventual improvement of the macroeconomic situation.

KMG EP also had to react to the fall in its share price. Realising that under the influence of external factors the share price ceased to reflect the real value of the Company, the management introduced a share buyback programme. By doing so, we demonstrated our confidence in the Company and also introduced a more effective use of funds in the interests of all shareholders.

Overall, 2008 has confirmed the business acumen of the KMG EP's management. Our team proved that it can deal with emerging challenges. Over time we have created a modern system of corporate governance that is characterised by effectiveness and transparency. We continue to improve our management systems and adhere to the best international standards in this regard. We are pleased to note that this work has received

recognition by the international rating agencies. Thus, in November 2008, Standard & Poor's increased our corporate governance score from CGS5+ to CGS6 on the international scale.

KMG EP is a socially responsible company. We aim to support projects that improve living conditions in the areas where we operate. The Company does everything in its power to provide for its employees a fair system of pay, necessary social guarantees and a safe working environment. These efforts were highly commended by the State of Kazakhstan and KMG EP won the National Competition among socially responsible businesses in the category «The Best Collective Agreement».

It is our people who are at the core of our success and stability. KMG EP enjoys a coherent professional team, and in everyday operation we manage to combine modern approaches with experience of past generations. Kazakhstan boasts 110 years of oil production and we are proud of our traditions in this sector.

I would like to thank the Board of Directors that brings together support from the National Company, international perspective of Independent Non-Executive Directors and extensive individual experience of all Board members. This is a key element of the Company's success.

I am confident that 2008 only made our Company stronger and more resilient. I have no doubt that KMG EP is well positioned to achieve its goals in the interests of all stakeholders.



Askar Balzhanov  
Chief Executive Officer



# Board of Directors



## **Kairgeldy Kabyldin**

Has been the President of NC KMG since August 2008. On 24 September 2008 he was elected to the Board of Directors of KMG EP and became the Chairman of the Board on 8 October 2008. Mr Kabyldin graduated from Kazakh Polytechnic Institute and has over 30 years of experience in the oil and gas sector. Prior to his appointment to NC KMG he was Deputy Chairman of the Management Board of Samruk State Assets Management Holding of Kazakhstan. He has occupied senior executive positions with NC KMG, NC Oil and Gas Transport and KazTransOil.



## **Askar Balzhanov**

Was appointed CEO of the Company on 7 June 2006 and elected to the Board of Directors on 12 June 2006. Prior to this, he was CEO of JSC KazMunayTeniz, a subsidiary of NC KMG specialising in offshore oil and gas operations. After graduating from the Moscow Institute of Petrochemical and Gas Industry, he gained broad experience in the oil and gas field working in various positions in a range of hydrocarbon enterprises including Embaneft PB, KazakhstanNefteGas SE, KazakhstanMunaiGas SE, KazRosGas, and NC KMG.



## **Tolegen Bozzhanov**

Has been a Vice President of NC KMG since 7 June 2008 and was elected as a Director of KMG EP on 24 September 2008. He graduated from Kazakh State University and Kazakh State Construction Academy, holds a Bachelor degree from Warwick University. He has occupied senior executive positions with Kazkommerts Securities, Kar-Tel and NC KMG. Prior to his latest appointment he was CEO of Trade House KazMunaiGas.



## **Kenzhebek Ibrashev**

Is a Vice President of NC KMG, has been a Director of the KMG EP Board of Directors since 30 October 2007. He graduated from Moscow Oil and Gas Institute. He has gained broad experience working in a number of senior positions in the oil and gas industry. Since 2003 he was a Director for business development in Kazakhstan at Agip Kazakhstan North Caspian Operating NV, First Deputy CEO, and CEO of KazMunayTeniz.

*The Company operates with a Board of Directors and a separate Management Board (the executive body). The Chief Executive Officer, who heads the Management Board, is also a Director of the Company, and is the only representative of the Management Board on the Board of Directors. The Company appointed three Independent Non-Executive Directors, being Christopher Mackenzie, Paul Manduca and Edward Walshe, at the time of the IPO in 2006. The other four members of the Board of Directors, including the Chairman, Kairgeldy Kabyldin, are representatives of NC KMG.*

### **Christopher Mackenzie**

Worked for such companies as JP Morgan, GE Capital and Brunswick Capital in the UK, USA, Japan and Russia and he has gained extensive experience in mergers and acquisitions and investment banking. He is the Chairman of Borets International Ltd., a global oil services company and is on the Board of UK and Saudi Arabian companies. He holds a Master's degree from the University of Oxford and an MBA from INSEAD. He was elected as an Independent Non-Executive Director of the Board on 28 August 2006. Mr Mackenzie is the Chairman of the Remuneration Committee and a member of the Audit and Nominations Committees.



### **Paul Manduca**

Has extensive global investment management and business experience having worked as CEO for companies such as Threadneedle Asset Management, Rothschild Asset Management, Deutsche Asset Management in the UK and Europe since 1973. Mr Manduca has served on a number of boards as an independent director in the last 10 years and at various points he has headed audit, remuneration and nomination committees. He holds a Master's degree from the University of Oxford (Modern Languages). He was elected as an Independent Non-Executive Director of the Board on 28 August 2006. Mr Manduca is the Chairman of the Audit Committee and a member of the Remuneration Committee.



### **Edward Walshe**

Has over 35 years experience in the oil and gas sector. Mr Walshe has worked in various roles at British Petroleum and British Gas including the overseas exploration and production operations of these companies in Nigeria, Abu-Dhabi, Central Asia and South-East Asia. Mr Walshe has a PhD in Solid State Chemistry from the University of Dublin. He was elected as an Independent Non-Executive Director of the Board on 28 August 2006. Mr Walshe is the Chairman of the Strategic Planning Committee and a member of the Audit, Remuneration and Nominations Committees.



### **Yerzhan Zhangaurov**

Was appointed a Managing Director of NC KMG on 6 June 2006 and was elected as a Director of KMG EP 12 June 2006. Prior to this appointment he was Executive Director for Legal Matters of NC KMG. He also headed the legal service and HR department in the Administration of the President of Kazakhstan and was the adviser to a Vice President of NC KMG. He obtained a law degree at Karaganda State University.



# 2008 Milestones

*The world economic crisis forms the background against which all the 2008 key events developed. Nevertheless, for KMG EP this year was one of the most successful since the Company's creation. In addition to financial and operational indicators, the success of the decisions taken was confirmed by independent experts. Gaffney, Cline & Associates has acknowledged our commitment to the efficient use of reserves, the corporate governance development efforts were highly evaluated by Standard & Poor's, and our social policy was recognised on the highest state level.*

## 1Q 2008

*22 January*

KMG EP published its operating results for 2007. The crude production volume, including the share in subsidiaries, was 10,639 thousand tonnes (215 kbopd), an increase of 1,118 thousand tonnes, or 11.64%, over 2006. The increase in production was primarily due to the acquisition of 50% stakes in JV Kazgermunai LLP and CITIC Canada Energy Limited (CCEL).

*5 February*

KMG EP announced the increase of proved and probable reserves. According to the report by Gaffney, Cline & Associates, the total Proved and Probable (2P) oil reserves were 240.0m tonnes (1,767m barrels) excluding KMG EP's interests in Kazgermunai and CCEL (Karazhanbasmunai).

Comparing on a like for like basis in early 2007 the 2P oil reserves grew by 18.1%. Given the crude produced during 2007, the growth of oil reserves was 22.8%. The reserves replacement ratio (a reserves growth to annual production ratio) was 490%.

*19 February*

KMG EP entered into an agreement with the Administration (Akimat) of the Mangistau Region on financing the development of the social infrastructure of Karakiya District and Zhanaozen. This agreement is an addendum to the subsoil use contract signed in 1996 for the development of Uzen and Karamandybas oilfields in the Mangistau Region. According to the terms and conditions of the agreement, KMG EP will annually allocate KZT900m under the Social Infrastructure Development Programme for Karakiya District and Zhanaozen.

*17 March*

KMG EP published financial results for 2007. According to the audited financial results, the Company's net profit increased by 28% over 2006, and was KZT157bn (US\$1,282m), of which the additional profit of KZT17.9bn (US\$146m) was generated by the 50% stake in Kazgermunai.



# 1899

**The first oil-spring in Kazakhstan-  
on Karashungul field**

## 2Q 2008

### 17 May

The export customs duty of US\$109.91 per tonne of exported crude (US\$14.9 per barrel) was introduced. From 11 October 2008, the duty was increased to US\$203.8 per tonne (US\$27.7 per barrel).

### 28 May

The Company held an Annual Shareholders' Meeting where shareholders approved the Financial Statements and Annual Report for 2007 and decided on the dividend amount per one share to be KZT563 (US\$0.78 per GDR) including a special dividend.

### 29 May

KMG EP held an Open Day event. The Company provided analysts and media with an update on the Company's activity.

### 30 June

KMG EP and NC KMG management conducted a meeting in Zhanaozen with representatives of some transportation units of Uzenmunaigas to resolve a dispute around proposed restructuring of UMG and compensation system for the employees of these units. Measures taken over the months following this meeting enabled social stability to be maintained and improved labour discipline.

## 3Q 2008

### 1 July

The KMG EP Board of Directors approved the amendments to the exploration programme for 2008. In accordance with the updated programme, the Company performed 3D seismic survey on the territory of 360 sq km to complete a detailed study of the Buiyrgyn subsalt structure on the R-9 block.

### 2-4 July

KMG EP participated in the international conference Kazakhstan Growth Forum (London).

### 3 July

The Brent price peaked at US\$146.08 per barrel.

### 18 July

KMG EP published operational results for the first half year 2008. The consolidated crude production was 5,899 thousand tonnes (238 kbopd). This is an increase of 960 thousand tonnes, or 19.4%, compared with the same period in 2007. The production increase occurred largely due to the acquisition of 50% stakes in JV Kazgermunai LLP and CCEL (Karazhanbasmunai) in April and December 2007, respectively.

### 28 July

The 2007 dividend payments commenced. The total amount of dividends was approximately KZT39.5bn (US\$328.4m).

### 16 September

KMG EP published financial results for the first half of 2008. According to the unaudited interim financial information, the net profit increased 154% year on year to KZT147.5bn (US\$1,224m), which resulted in an increase of the profit per share from KZT780 to KZT1,990 (US\$1.05 per GDR and US\$2.75 per GDR, respectively). Contribution of the 50% stakes in JV Kazgermunai LLP and CCEL to the Company's financial results was KZT28.6bn (US\$238m).

### 24 September

At an Extraordinary General Meeting the new members of the Company's Board of Directors were elected: Kairgeldy Kabyldin, the President of NC KMG and Tolegen Bozzhanov, a Vice President of NC KMG.

## 4Q 2008

### 8 October

The KMG EP Board of Directors approved the Company's share buyback programme. In accordance with this programme, the Company intends to purchase ordinary shares listed on the Kazakhstan Stock Exchange (KASE) and global depository receipts (GDRs) listed on the London Stock Exchange (LSE) for an amount up to US\$350m. The approved share buyback programme start date - 24 November and it is to be completed by 31 October, 2009.

### 8 October

At the Board of Directors meeting Kairgeldy Kabyldin, the President of NC KMG, was elected Chairman of the Board of Directors. In addition, Kairbek Yeleusinov, Director of Uzenmunaigas, was approved as a new member of the KMG EP Management Board.

### 17 November

International rating agency Standard & Poor's (S&P) confirmed KMG EP's credit rating at BB+. S&P noted that the management's efforts are focused on transparency and improvement of the financial control system. The financial sustainability of KMG EP is ensured by adequate profitability, sufficient cash flows, and a well-balanced treasury management strategy.

### 18 November

International rating agency Standard & Poor's increased the corporate governance rating of JSC KazMunaiGas Exploration Production from CGS5+ to CGS6 on the international scale.

#### 5 December

NC KMG, KMG EP and BG Group signed an upstream co-operation agreement. The agreement sets out the principles of a joint study of hydrocarbon reserves potential of specific areas in the Republic of Kazakhstan and other countries. The companies will cooperate to identify opportunities across a range of potential oil and gas exploration and production projects.

#### 24 December

KMG EP won a prize at the national Paryz Awards for social responsibility. The Company became a winner in the Large Enterprise category for The Best Labour Contract. This nomination considered labour contracts that significantly improve and enhance labour and social rights of employees under existing legislation.

#### 24 December

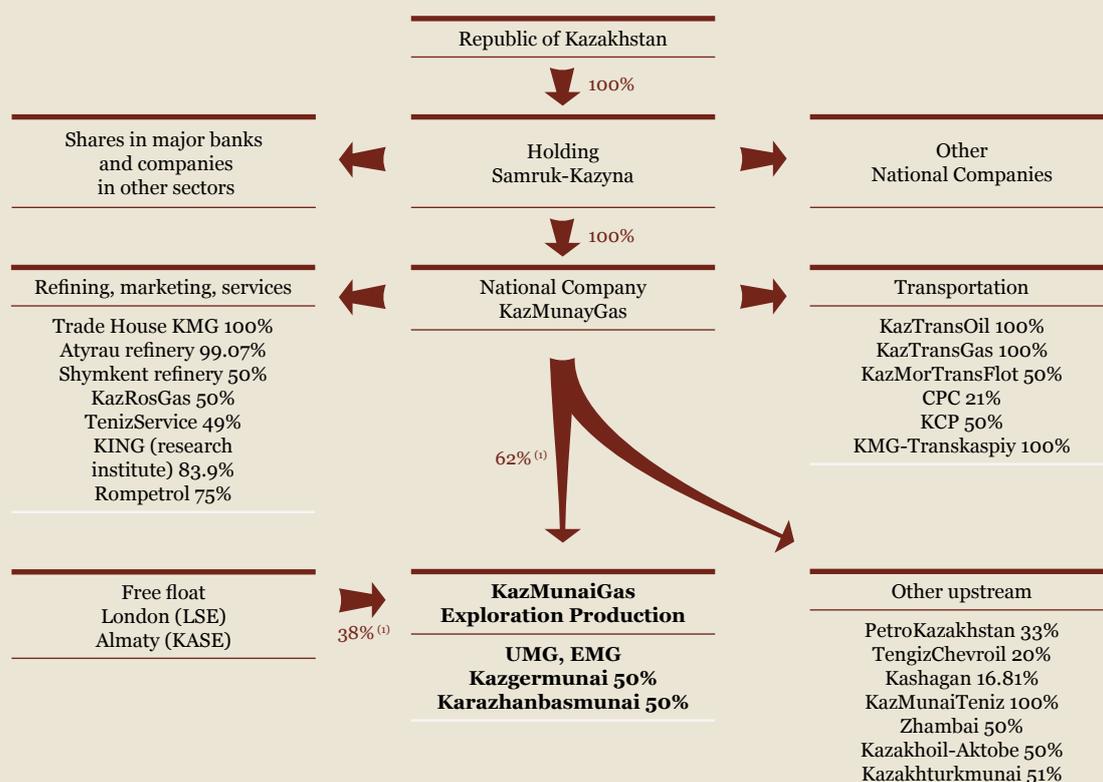
The Brent price dropped to a low of US\$36.61 per barrel.

#### 25 December

The KMG EP Board of Directors approved the Company's 2009 budget based on the annual average Brent price at US\$40 per barrel.

KMG EP plans to make capital investments of KZT40.0bn (US\$266.7m) in 2009. The reduction in capital investment versus the previously planned amount is a prudent response to the worsening world economic situation.

Production volume at the core assets (Uzenmunaigas and Embamunaigas) was planned at 9.141m tonnes (184.32 kbopd), 3.8% less than the previously envisaged level. This reflects the fact that with low oil prices it becomes unprofitable to maintain existing production rates on some low yield wells.



<sup>(1)</sup> Ordinary shares excluding Treasury Shares

# Operational Activity

*The key goals of KMG EP's core operations are to maintain production on a steady level and to ensure cost optimisation. Application of modern technologies and equipment as well as timely optimisation of field development plans not only help to maintain achieved production levels, but also improve efficiency of oil extraction and enhance recoverable reserves of the existing fields.*

## Crude Oil Production

In 2008 KMG EP (including shares in Kazgermunai and CCEL) produced 11,954 thousand tonnes of crude (239.8 kbopd), or by 1,315 thousand tonnes, 12% more than in 2007. The increase is due to the acquisitions made by KMG EP in 2007.

In an effort to intensify crude production and to maximise the full potential of the fields, the Company applies enhanced oil recovery methods such as hydro-fracturing, flow deviating polymer injection, electric formation stimulation, as well as a number of technologies stimulating wellbore zones. These are insulating works, re-perforation, perforation of additional intervals, acid treatment and treatment with other solvents.

Production optimisation includes improvement of the field development plans, more extensive utilisation of electric-centrifugal pumps and electric screw-type pumps, replacement of steel pipes with fibreglass pipes, and more effective well monitoring.

These measures enable the Company to maintain oil production at its fields at an optimal level. At the core assets (Uzenmunaigas and Embamunaigas) 9,470 thousand tonnes of crude were produced (190.4 kbopd), which is slightly less than in 2007.

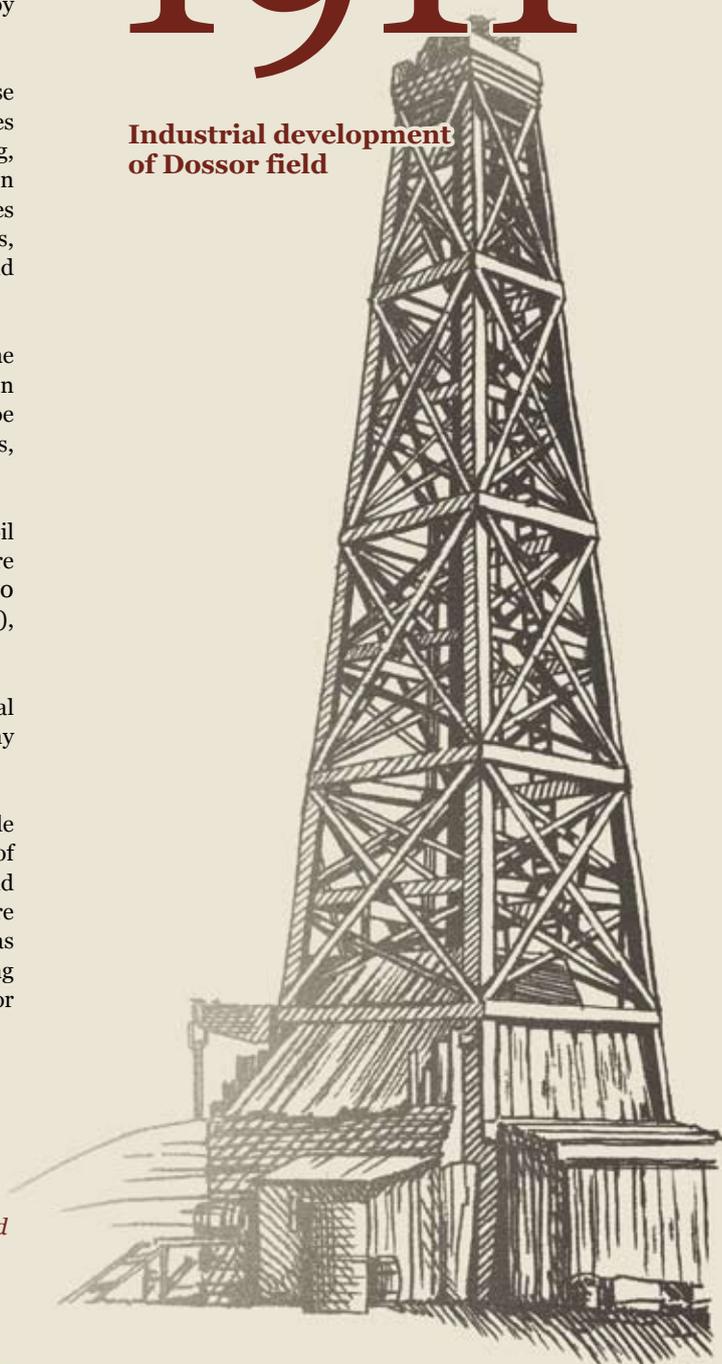
Currently, thanks to the Company efforts, an optimal level of production was reached which the Company seeks to maintain.

In 2008 9,079 thousand tonnes (182.6 kbopd) of crude were sold to customers (excluding the crude oil of Kazgermunai and CCEL), including 7,008 thousand tonnes (140.9 kbopd) of crude sold for export. The share of Kazgermunai<sup>(1)</sup> and CCEL sales owned by KMG EP was 2,474 thousand tonnes (49.5 kbopd) of crude, including 2,125 thousand tonnes (42.5 kbopd) of crude sold for export.

<sup>(1)</sup> Royalty paid in kind by Kazgermunai was accounted for as domestic sales.

# 1911

**Industrial development  
of Dossor field**



|  | Uzenmunaigas | Embamunaigas |
|--|--------------|--------------|
| Fields   | 2            | 39           |
| Production wells                                     | 3,766        | 2,248        |
| Injection wells                                      | 1,233        | 442          |
| 2P oil reserves as of December 31, 2008 (bn barrels) | 1.35         | 0.42         |
| Crude production in 2007 (kbopd)                     | 136          | 57           |
| Crude production in 2008 (kbopd)                     | 134          | 57           |
| Reserves-to-production ratio (years)                 | 27           | 21           |

**Growth of Oil Reserves**

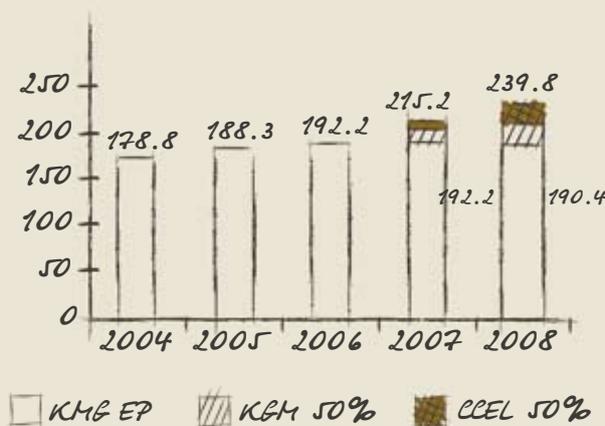
According to the report of Gaffney, Cline & Associates, in 2008 the total Proved and Probable (2P) reserves of KMG EP were 241.2 million tonnes (1,775 million barrels) excluding the Company's share in Kazgermunai and in CCEL (Karazhanbasmunai).

Including the crude produced over 2008, the Company's reserves increased by 10.7 million tonnes (78 million

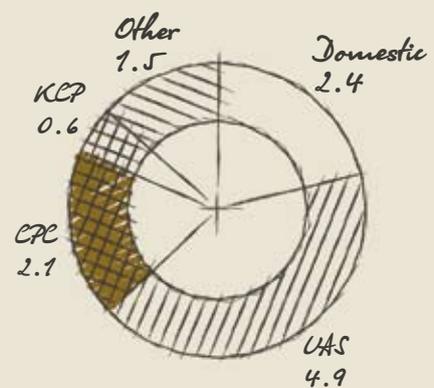
barrels). The reserves replacement ratio (a reserves growth to annual production ratio) was 113%. The reserves-to-production ratio in 2008 is 25 years.

The growth of proved and probable reserves of KMG EP reflects the efficiency of the Company's operations. Thanks to up-to-date technologies and highly qualified specialists working for the Company, KMG EP managed to maintain a stable production level and replenish its reserves at the same time.

*Production, kbopd*



*Sales by routes in 2008 - 11.5 mm tonnes*



# Company Development

*KMG EP is consistently moving forward and expanding its resource and operational base. In 2008, for the first time, the operational and financial results of the Company consolidated the performance indicators of JV Kazgermunai LLP and CCEL (Karazhanbasmunai), where KMG EP has 50% stakes. As a result of the acquisitions made in 2007, the Company's annual average production level increased by 12% in 2008 and reached 11.95m tonnes. KMG EP's share in the net profit of Kazgermunai (50%) was KZT58.8bn (US\$488.6m), and the financial income from CCEL was KZT2.9bn (US\$23.7m).*

## Acquisition of New Assets

In 2008 the Company conducted integrated audits of potential acquisition targets and made preliminary estimation of risks and project profitability. However, the Company made a decision to postpone the transactions due to uncertainty surrounding the development of a new Tax Code of Kazakhstan, changes on the world oil and gas market and the overall economic situation.

For those companies, such as KMG EP, possessing significant financial resources, this is good time to acquire new assets as their value declines in a lower crude price environment.

## Acquisition of Interest in JSC Mangistaumunaigas

KMG EP has expressed interest in acquiring a share in the oil-producing assets of JSC Mangistaumunaigas (MMG). In April 2009 NC KMG and CNPC signed an agreement on the acquisition of 100% of the common shares of MMG from Central Asia Petroleum Ltd.

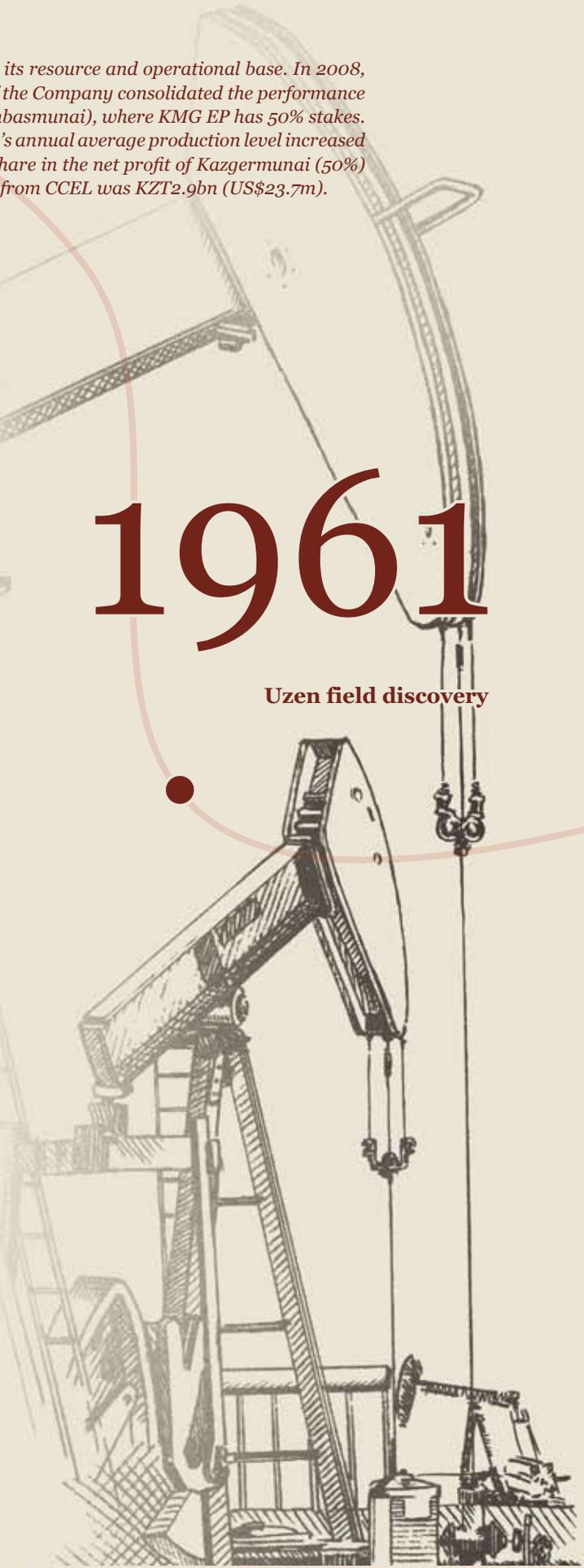
NC KMG expects to complete the deal in 2009, once the final approval are obtained from the regulatory authorities.

It is anticipated that after this transaction is finalised, the negotiations concerning the acquisition of a stake in MMG by KMG EP will commence.

## Agreement between KMG EP, NC KMG and BG Group

In 2008, KMG EP made an important step towards getting access to the international market.

On 5 December 2008 NC KMG, KMG EP and BG Group signed an upstream co-operation agreement.



# 1961

Uzen field discovery

The agreement sets out the principles of a joint study of the hydrocarbon reserves potential in a number of areas in Kazakhstan and other countries. The companies will work in partnership to identify opportunities across a range of potential oil and gas exploration and production projects. A joint team will assess targeted regions and recommend prospective acreage to partners for their consideration.

Cooperation with BG Group will provide KMG EP with an opportunity to join large-scale international projects and achieve a new level of development.

This is the first agreement of such significance in Central Asia and it is strategically important for KMG EP. The benefits for KMG EP from this cooperation are evident. First, it is an entry to the international market in partnership with an experienced oil and gas operator; second, gaining experience in international project management, including offshore projects, and getting access to up-to-date oil and gas exploration and production technologies.

The agreement provides for a long-term, mutually beneficial partnership: BG Group's contribution is sharing its international upstream experience, technologies and training local personnel. KMG EP will bring significant technical and commercial upstream opportunities as well as knowledge of local industry specifics.

## Exploration

Exploration is a key activity of KMG EP in order to grow the Company's reserves. Throughout 2008, the Company focused on searching for hydrocarbons at deeper subsalt horizons.

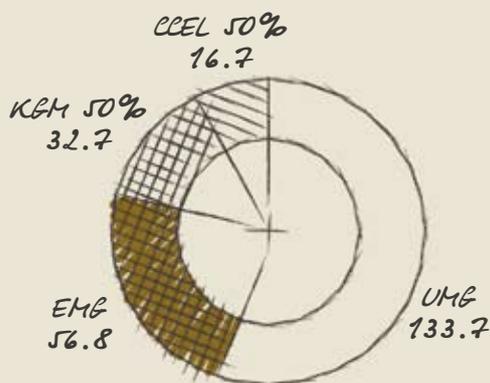
A detailed seismic survey was performed on Liman and R-9 blocks, and its geological and geophysical results were analysed in order to evaluate the resource base of these prospects. In addition, a risk assessment was made in order to select locations for exploration wells.

Although the KMG EP 2009 budget provides for a reduction in expenditure, significant funds are allocated for exploration and are considered by the Company as investments for the future.

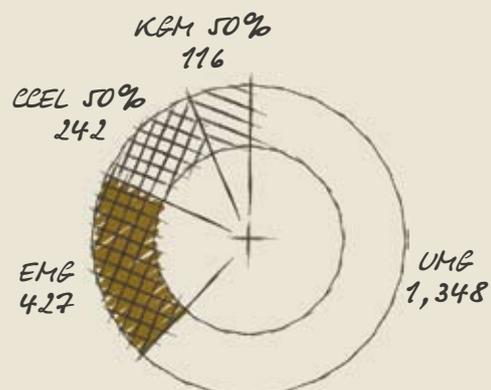
The main focus of the further study will be block R-9. In particular, a seismic survey is expected to be carried out in the northern and north-eastern parts of the block.

A 3D seismic survey was performed earlier on another structure of R-9 block – Buiyrgyn. In 2009, it is scheduled to make data interpretation with pre-stack depth migration.

*Oil production in 2008, kboed*



*2P reserves as of 31/12/2008, mm bbl*



Depending on the results of the aforementioned survey it is expected that a well will be drilled to 2,000 meters to the suprasalt horizons of the priority structure. In addition, with regard to a subsalt structure, it is expected that drilling of a 7,000 meter well will be started, and its construction will continue in 2010.

Additional exploration of the S. Nurzhanov field will also be carried out. As a result of drilling wells No.502 and No.503 it was confirmed that the oil bearing area in the Trias structure on a southern block of the field is larger than previously thought. Moreover, in 2009 it is planned to drill two wells with a projected depth of 3,500 meters.

**Other Opportunities**

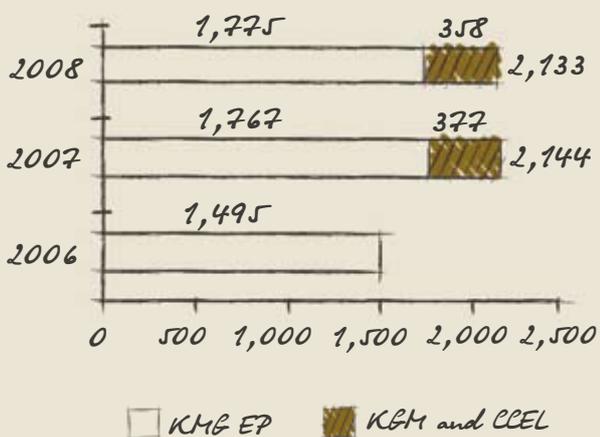
KMG EP, as a subsidiary of NC KMG has the opportunity to participate in oil and gas projects which are supported by NC KMG and the Government.

One such project is the production of Bitumen from the crude oil produced by JSC Karazhanbasmunai (50% owned by the Company), which will thereby upgrade the heavy Karazhanbas crude oils. This project is promoted by NC KMG and by JSC Kazakhstan Petrochemical Industry (JSC KPI - 50% owned by the Company).

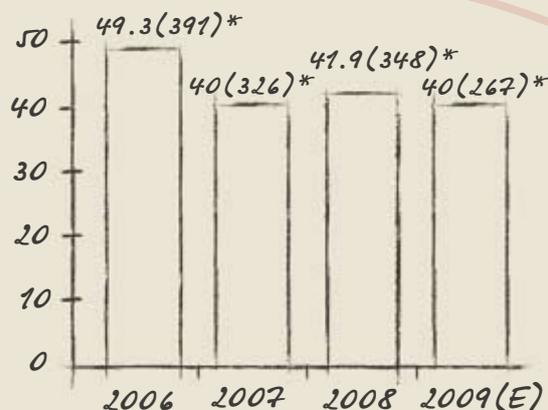
Another project, which the Company approved in 2008, is a facility for sulphur removal from associated petroleum gas (APG) at the Prorva group of oil and gas fields, which will enhance APG utilisation. A pre-design study was done with a view to selecting treatment technology and determining the budgeted cost of the project.

The Company can also be expected to respond to Governmental objectives for related businesses. One such is the construction of an integrated petrochemical complex (IPC) to produce polyethylene and polypropylene in the Atyrau area. The Company's Board of Directors approved a contribution of US\$40m to the authorised capital of a design company in order to finance the development of a Front End Engineering Design (FEED) as a basis for contractors to provide turnkey bids in an international tender. The Company's continued participation in the project is expected to be considered towards the end of 2009 after review of these bids.

*2P reserves of KMG EP as of 31/12/2008, mm bbl*



*KMG EP (UMG, EMG) CAPEX, in Tenge (mm USD)\**



*\* Exchange rates are 126.09, 122.55, 120.30 and 150 Tenge per 1 USD for 2006, 2007, 2008 and 2009 respectively.*

# Social Responsibility

*KMG EP is building an open and effective business that meets the long-term interests of the country and community. The Company is striving to share its success with the regions of its operations by taking an active part in social infrastructure development. KMG EP is consistently providing social support not only for its own staff but it is also contributing to the improvement of the welfare of the community in general. KMG EP is especially focusing on implementing a progressive corporate policy on labour and environmental protection.*

## Social Projects

The core assets of the Company – Uzenmunaigas (UMG) and Embamunaigas (EMG) are vital to local communities. The future of Zhanaozen (Mangistau Region) and of the district centers and settlements of the Atyrau Region directly depends on the development of the Company's production branches. This is why KMG EP views its operating and financial performance as an important element of social responsibility. UMG and EMG are among the largest taxpayers of the Mangistau and Atyrau regions and contribute a significant share of the regional budgets.

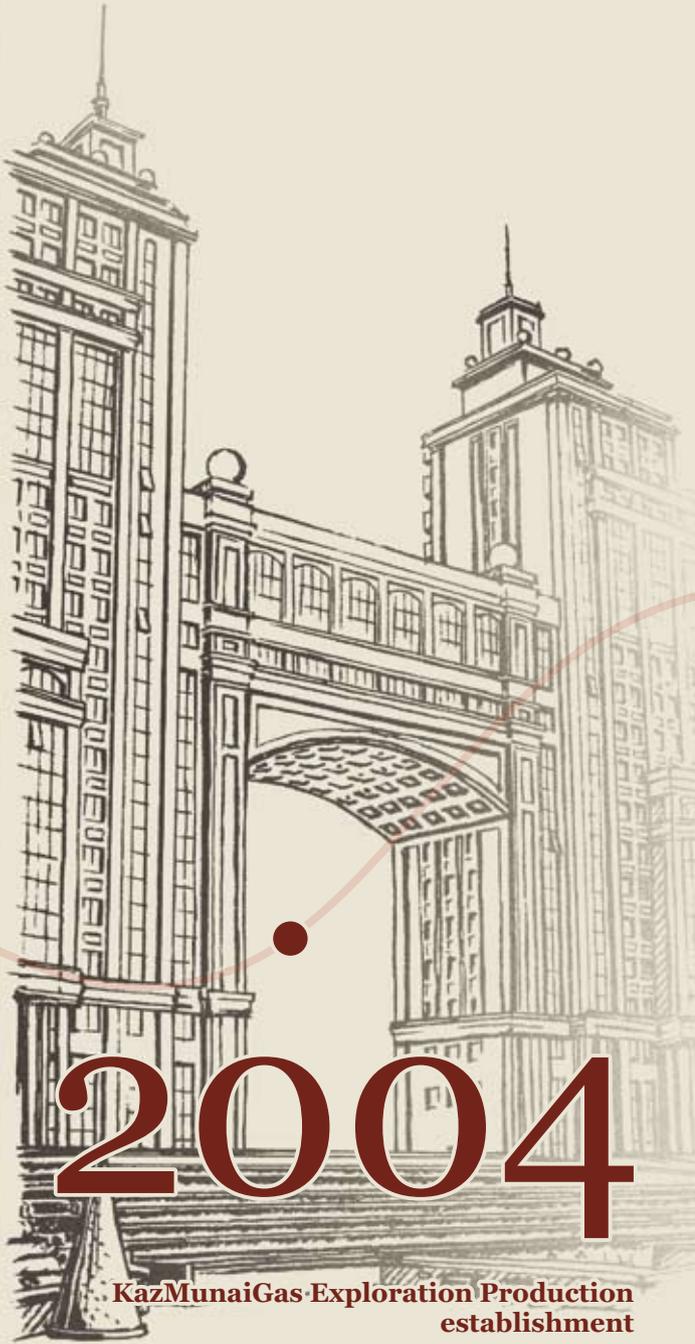
Moreover, as a part of social partnership arrangement and according to the subsoil use contracts, the Company contributes to the development of infrastructure in the regions where it operates in line with the municipal social development programmes.

In 2008, the funding of medical, sport, entertainment, recreation, special charitable and sponsorship programmes, as well as social benefits and social support payments in the regions where KMG EP operates, amounted to approximately KZT2.1bn (US\$17,6m).

Traditionally, one of the elements of the KMG EP's social policy has been providing assistance to low income groups of the local population. Every year the Company provides financial aid and sends gifts to orphans, veterans of war, pensioners, and to people with special needs. During the times of the economic recession these groups are the most vulnerable, and KMG EP intends to continue supporting them.

## Personnel Policy

KMG EP views wellbeing of its employees and their families as an integral part of its business success. By creating good working conditions, providing opportunities for growth and development, the Company strives to build a highly qualified and strong team of specialists who have the ability to move the business forward.



# 2004

**KazMunaiGas Exploration Production establishment**



In 2008, the main objective of KMG EP's personnel policy was to retain high quality personnel and therefore enhance the Company's potential. Despite the challenging business environment in the second half of 2008 KMG EP was among the few companies in Kazakhstan which managed to avoid extensive staff reductions.

KMG EP's Labour Agreement, based on the principles of distribution of rights and responsibilities, is aimed at ensuring the Company's operational effectiveness and providing socio-economic and legal guarantees to the Company employees. At the Paryz Awards competition for social responsibility in 2008, KMG EP's Labour Agreement achieved recognition as the best in Kazakhstan.

KMG EP's Collective Labour Agreement allows for the efficient resolution of labour disputes in accordance with the legislation of the Republic of Kazakhstan. One example is resolution of a labour dispute involving transportation units of UMG that emerged in June 2008.

Since 1 July 2008, monthly salaries for ancillary workers at production branches increased by 40-45%, and of core production workers by 20-25%. This compensated for the impact of inflation and ensured social stability in the regions where KMG EP operates.

The Company regards the health of its staff as one of its key priorities. Medical cover and regular medical examinations and vaccination programmes have been developed for KMG EP's employees, both at the production branches and at the head office of the Company.

In 2008, the Company funded healthcare facilities and medical insurance programmes in the amount of KZT602.7m (US\$5m).

## Health, Safety and Environment

In the area of industrial and environmental safety KMG EP is committed to meeting high international standards and is successfully moving in this direction.

The Company has a corporate labour and environmental protection policy in place that ensures a continual control over the quality of the fields' ecosystem.

In order to ensure the smooth operation of this system and the sustainable preservation of the environment, the Company implements a series of highly advanced environmental projects.

In 2008 the actual expenses for environmental protection activities at the Company amounted to KZT5.2bn (US\$43.2m). In 2007 these expenses totaled KZT3.9bn (US\$31.8m)

Last year, the Company managed to increase utilisation of waste that had accumulated for decades. The area of land re-cultivated by a biological method also increased. Polluted areas were reduced from 70 hectares at the beginning of the year to 58 hectares at the end of 2008.

In 2008, independent auditing organisation Kazecology made an assessment of environmental risks for the Company. The assessment confirmed that potential environmental risks have been identified by the Company, developed corrective measures are adequate, and corresponding financial reserves are sufficient.

Industrial facilities of oil companies are inherently hazardous, and therefore, KMG EP is actively working to reduce risks that pose a threat to personnel's health and safety. Nevertheless, accidents at work do happen and this is the utmost concern for the management.

2008 has seen seven work-related incidents, of which three were fatal. Strict disciplinary actions were undertaken following the incidents, including termination of employment agreements with the certain employees. General controls have been further strengthened.

The Company's permanent commission conducts regular inspections and reviews the state of labour and environmental protection. The commission checks industrial facilities and assesses the knowledge of employees of production branches, inspects the industrial equipment and instruments for compliance with their technical standards.

Labour safety issues are reviewed at the meetings of the Company's Board of Directors on a regular basis.

Accident prevention is given the highest consideration. Ongoing safety training for all personnel has been organised and this is a key element of the current personnel training and professional development system in the Company.

# Corporate Governance Information

## Combined Code compliance

As an overseas company with GDRs admitted to the Official List of United Kingdom Listing Authority, the Company is not required to comply with the provisions of the UK Combined Code on Corporate Governance («Combined Code»). In addition, it is not required to disclose in its Annual Report whether or not it complies with the corporate governance regime of the Republic of Kazakhstan and the significant ways in which its actual governance practices differ from those set out in the Combined Code. However, the Directors view high standards of corporate governance to be very important and consider that such information shall be included in the Annual Report.

### *Differences in Kazakhstan Corporate Governance Code and Combined Code provisions*

Corporate governance best practice in Kazakhstan is set out in the Kazakhstan Corporate Governance Code. The Kazakhstan Corporate Governance Code is based on existing international best practice in the area of corporate governance and sets out recommendations for applying the principles of corporate governance by Kazakhstan joint-stock companies. It was approved by the Expert Council for Securities Market Matters under the National Bank of the Republic of Kazakhstan in September 2002. The Code was also approved by the Association of Financial experts of Kazakhstan in March 2005 and by the Board of Issuers in February 2005.

The Company currently complies with the provisions of the Kazakhstan Corporate Governance Code in all material respects. The Company has adopted the Kazakhstan Corporate Governance Code, modified to include certain provisions from the Combined Code, as its Corporate Governance Code. The modifications adopted by the Company impose additional corporate governance obligations on the Company. The Company believes that these additional modifications significantly strengthen the corporate governance regime adopted by the Company. The Company will also take into consideration other provisions of the Combined Code and will seek to improve its standards of corporate governance in the future.

Below are described the main differences between the Corporate Governance Code and the Combined Code which the Directors believe to be important.

- The Combined Code provides that the Non-Executive Directors should meet without the Chairman of the Board present at least annually to appraise the Chairman's performance and on such other occasions as are deemed appropriate.

Five meetings of the Non-Executive Directors were held in 2008 where the following issues were discussed: management appointments at NC KMG, the amendments to the tax legislation of the Republic of Kazakhstan, the Company's treasury policy, construction project of the first integrated petrochemical complex in the Atyrau region, and drafts of the Company's production programme and 2009 budget. Although no official evaluation of the activity of the Chairman of the Board of Directors was made by the Non-Executive Directors; the Board's activities were evaluated by external independent consultant in December 2008. More detailed information on the Board of Directors evaluation may be found on page 21 of this report.

- In accordance with the provisions of the Combined Code, following his appointment, the Chairman of the Board of Directors shall meet the criteria of independence defined in the Combined Code.

The provision on appointment of the Chairman of the Board of Directors is not included in the Company's Corporate Governance Code, and in the opinion of the Directors, the Chairman of the Board of Directors would not meet the criteria of independence stated in the relevant provision of the Combined Code.

- The Combined Code stipulates that not less than half of the Board of Directors members, except for the Chairman of the Board of Directors, shall be Independent Non-Executive Directors. In contrast to this, the Company's Corporate Governance Code stipulates that not less than one third of the Board of Directors members shall be Independent Non-Executive Directors.

Currently, there are three Independent Non-Executive Directors in the Company: Christopher Mackenzie,

Paul Manduca and Edward Walshe, and thus a number of independent directors comprises more than one third of the Board of Directors. In addition, according to the Company's Charter, key issues are required to be approved by Independent Non-Executive Directors. The issue of the Board of Directors membership and the requirements concerning availability of independent directors will be periodically considered.

- The Combined Code also states that the Board shall appoint one of the independent directors to be a Senior Non-Executive Director.

The Board of Directors did not appoint a Senior Non-Executive Director given the current shareholder structure. The requirement concerning appointment of a Senior Non-Executive Director will be considered from time to time.

### Directors' responsibility statement

In accordance with the Company's Corporate Governance Code, the Board of Directors and the Management Board

shall bear responsibility for credibility of the Company's annual report and financial statements.

In compliance with the UKLA's Disclosure and Transparency Rules each of the Directors, whose names and functions appear on pages 6-7 of this Annual Report, confirms that to the best of his or her knowledge:

- the financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and;
- the management report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

### The Board of Directors structure

As of December 31, 2008 the Board comprised eight members, being:

| Name                  | Position                               |
|-----------------------|--|
| Kairgeldy Kabyldin    | Chairman of the Board of Directors     |
| Askar Balzhanov       | Member of the Board of Directors (CEO) |
| Yerzhan Zhangaurov    | Member of the Board of Directors       |
| Tolegen Bozzhanov     | Member of the Board of Directors       |
| Kenzhebek Ibrashev    | Member of the Board of Directors       |
| Christopher Mackenzie | Independent Non-Executive Director     |
| Paul Manduca          | Independent Non-Executive Director     |
| Edward Walshe         | Independent Non-Executive Director     |

The following changes in the composition of the Board of Director of the Company during the year of 2008 were made based on decisions of general meeting of shareholders upon proposal of the major shareholder:

- On January 23, 2008 Assia Syrgabekova resigned, and Zhannat Satubaldina was elected.
- On September 24, 2008 Uzakbay Karabalin, who had chaired the Board of Directors since 2006, and Zhannat Satubaldina resigned, and Kairgeldy Kabyldin and Tolegen Bozzhanov were elected.
- By resolution of the Board of Directors (Minutes No.27 dated October 8, 2008) Kairgeldy Kabyldin was elected a the Chairman of the Board of Directors.

In accordance with the Corporate Governance Code, the Board of Directors established the fact of independence of the directors and considers that Christopher Mackenzie, Paul Manduca and Edward Walshe are independent by nature and in decision making. The Board of Directors determined that there exist no relations or circumstances that affect or may significantly affect the independent decisions made by these directors.

## The Management Board structure

The Company's Management Board includes senior executives of the Company, including the CEO, the First Deputy CEO and the CFO.

Members of the Management Board as of December 31, 2008:

| Name                 | Position   |
|----------------------|--|
| Askar Balzhanov      | CEO and Chairman of the Management Board             |
| Vladimir Miroshnikov | First Deputy CEO                                     |
| Zhanneta Bekezhanova | Chief Financial Officer                              |
| Kairolla Yerezhopov  | Managing Director, Human Resources and Social Policy |
| Kairbek Yeleusinov   | Director of UMG                                      |
| Bagitkali Biseken    | Director of EMG                                      |

Based on a resolution of the Company's Board of Directors, the following changes were made in the Management Board membership:

- On February 1, 2008 employment relationship with Askar Aubakirov, a member of the Management Board, was terminated due to his employment outside of the Company.
- On October 8, 2008 employment relationship with Murat Kurbanbayev was terminated due to his transfer to another position, and Kairbek Yeleusinov was elected.

## Responsibility of the Board of Directors and Management Board

Distribution of authority between the Board of Directors, Management Board and CEO of the Company is set out in articles 12 and 13 of the Company's Charter.

The Board of Directors is responsible to the shareholders for effective management and control of the Company and acts in compliance with the approved decision making system. The most important functions of the Board of Directors are to determine directions of the Company's strategic development and policy, to consider potential acquisitions, and to review other essential issues.

In turn, the Management Board is responsible for developing an action plan on implementation of these functions and for the current operating activity of the Company. The Management Board reports to the Board of Directors on the progress made in achieving the Company's goals.

The Board of Directors holds meetings on a regular basis and as required.

During 2008 the Board of Directors had 34 meetings, including 6 meetings held by voting in person, 4 meetings held by voting in person by a conference call, and 24 meetings held by proxy voting. Throughout the year the Board of Directors reviewed such issues as preliminary approval of the Company's consolidated financial statements for 2007, dividend recommendation to the annual general meeting of shareholders, share buyback programme, approval of the revised Regulations for the Company's personnel remuneration. The Board of Directors also approved the Procurement Policy, Treasury Policy, Risk Management Policy, Financial Statements Auditing Policy, discussed the key performance indicators (KPI) of the Board members, Head of Internal Audit and Corporate Secretary of the Company, and approved a fee payable to the Company's independent auditors.

## Directors' Attendance at the Meetings of the Board of Directors and Committees

|                                 | Board of Directors | Audit Committee | Nominations Committee | Remuneration Committee | Strategic Planning Committee |
|---------------------------------|--------------------|-----------------|-----------------------|------------------------|------------------------------|
| Number of meetings held in 2008 | 34                 | 7               | 3                     | 9                      | 3                            |
| Kairgeldy Kabyldin *            | 8                  | -               | -                     | -                      | -                            |
| Uzakbay Karabalin *             | 26                 | -               | -                     | -                      | -                            |
| Askar Balzhanov                 | 34                 | -               | -                     | -                      | 3                            |
| Yerzhan Zhangaurov              | 29                 | -               | -                     | -                      | -                            |
| Kenzhebek Ibrashev              | 34                 | -               | -                     | -                      | 3                            |
| Christopher Mackenzie           | 33                 | 4               | 3                     | 9                      | -                            |
| Paul Manduca                    | 34                 | 7               | -                     | 8                      | -                            |
| Tolegen Bozzhanov **            | 8                  | -               | -                     | -                      | -                            |
| Zhannat Satubaldina **          | 26                 | -               | -                     | -                      | -                            |
| Edward Walshe                   | 34                 | 7               | 3                     | 8                      | 3                            |

The Management Board is the executive body and manages the current activities of the Company. In 2008 the Management Board held thirty eight meetings on a regular basis and as required, including six meetings held by voting in person, thirty two meetings held by proxy voting. In 2008 the Company's Management Board reviewed a number of issues related to the Company's operating activity, including approval of the Company's internal procedures compliant with the Integrated Management Standards; organisation of the KMG EP's Engineering Center, approval of the action plan for improving the Company's corporate governance rating, review and approval of potential acquisition of oil and gas assets located both in the Republic of Kazakhstan and abroad, approval of the Company's procurement procedure subject to the applicable regulations of the Republic of Kazakhstan, approval of stand-alone and consolidated 2009-2013 KMG EP's business plan, review of possible participation in construction of the first integrated petrochemical complex in the Atyrau region, approval of the Regulation on quarterly bonuses for production units of the Company, approval of key performance indicators (KPIs) of senior management.

The Management Board makes decisions on other issues of the Company's operations that are not referred to the exclusive competence of the general meeting of shareholders, the Board of Directors or Company's officials.

*Performance Evaluation of the Board of Directors*

A Board performance evaluation process was undertaken in December 2008 with the results presented at the Board of Directors meeting on March 31, 2009. The evaluation process involved the completion of detailed questionnaires of the performance of the Board, its committees and its executive and Non-Executive Directors by each Director. The evaluation also included individual interviews of the Directors conducted by an external independent consultant. The assessment showed that the Company is making considerable efforts to improve the performance of the Board of Directors, optimising its composition and organisation. A number of opportunities for further improvement were identified.

\* On September 24, 2008 Uzakbay Karabalin resigned from and Kairgeldy Kabyldin was elected to the Board of Directors. Mr. Kabyldin was elected the Chairman of the Board of Directors on October 8, 2008.

\*\* On September 24, 2008 Zhannat Satubaldina resigned from and Tolegen Bozzhanov was elected to the Board.

## Audit Committee

### *Membership*

This Committee includes only Independent Non-Executive Directors: Christopher Mackenzie, Paul Manduca (Chairman of the Committee), and Edward Walshe. Appointments to the Audit Committee are made for a period of up to three years, extendable by no more than two additional three-year periods by resolution of the Board of Directors, as long as the member continues to be independent.

### *Number of Meetings*

During 2008 the Audit Committee held seven meetings. The Chairman of the Audit Committee decides the frequency and timing of the Committee's meetings. A number of meetings shall be determined in compliance with the requirements for roles and responsibilities of the Committee. However, there are not less than four meetings throughout a year which coincide with key dates of the Company's financial statements preparation and audit cycle (when internal and external audit plans are available for review, and when interim financial statements, preliminary announcements and annual report are close to being completed).

### *Role and Responsibilities*

The Audit Committee bears responsibility, among other things, for any statements containing financial information of the Company, monitoring of the risk management system and internal controls system, and for involvement of the Company's auditors in this process. Also, it receives information from the Company's Internal Audit Department that monitors the internal controls procedures compliance. In particular, the Committee deals with the issues of complying with the requirements of the legislation, accounting standards, applicable UKLA and Kazakhstan Stock Exchange (KASE) rules, ensuring an effective internal controls system. The Board of Directors is responsible for preliminary approval of the annual financial report.

The Audit Committee reviews from time to time major acquisition and disposal transactions and any other issues which the Board of Directors may address to the Audit Committee.

Annually, at the general shareholders meeting, the Chairman of the Audit Committee through the Chairman of the Board of Directors reports the Audit Committee's performance results and answers the questions related to the activity of the Audit Committee.

### *Activity of the Audit Committee in 2008*

#### *Financial Reporting*

- Review of financial statements preparation in compliance with IFRS.
- Approval of quarterly and annual financial statements for disclosure at the Kazakhstan and London Stock Exchanges.

### *Internal Controls and Risk Management System*

- Review of approval of the Treasury Policy.
- Discussion of introduction of the Risk Management System.
- Assessment of effectiveness of the internal controls and Risk Management system.
- Analysis of the Regulation for the Audit Committee.
- Self-assessment of the Audit Committee.

### *Internal Audit*

- Review and approval of the key performance indicators (KPI).
- Review and approval of the 2009 Internal Audit Service plans.
- Assessment of effectiveness of the internal audit.

### *External Audit*

- Assessment of effectiveness of the external auditor's activity, and in particular, the independence of Ernst & Young Kazakhstan LLP.
- Review and approval of the annual financial report provided by external auditor, Ernst & Young Kazakhstan LLP.
- Recommendation of Ernst & Young Kazakhstan LLP as an external auditor of the Company.

## Remuneration Committee

### *Membership*

This Committee comprises only Independent Non-Executive Directors. Its members are Christopher Mackenzie (Chairman of the Committee), Paul Manduca and Edward Walshe. The terms of office of the Committee members coincide with their terms of office in the capacity of members of the Board of Directors.

### *Roles and Responsibilities*

The Remuneration Committee bears responsibility for monitoring the Company's existing remuneration system for members of the Board of Directors, CEO, members of the Management Board and other employees of the Company, including analysing the remuneration policy versus other companies.

Also, the Remuneration Committee is responsible for developing and making recommendations to the Board of Directors concerning the principles and criteria for determining an amount and terms of remuneration and compensation payment to members of the Board of Directors, CEO, members of the Management Board, approval of the terms and conditions of the Company's option plans and other long-term employee incentive programmes for stimulating members of the Company's bodies and other Company employees.

The Remuneration Committee oversees the Company's remuneration policy and the existing remuneration system for consistency with the Company's strategy and its financial position, and monitors the labour market situation.

The Remuneration Committee monitors appropriate information disclosure with regard to remuneration and compensation of members of the Company's Management Board and the Board of Directors in compliance with the requirements of the legislation of the Republic of Kazakhstan, Listing Rules and internal documents of the Company.

In addition, the Remuneration Committee exercises control over implementation of the decisions of the shareholders general meeting in terms of determining an amount and procedure of remuneration payment of members of the Board of Directors.

The members of the Remuneration Committee report to the Board of Directors on regular basis, and analyse the compliance of the committee's activities with its Terms of Reference annually. The full Terms of Reference for the Remuneration Committee are available upon request at Company's head office during usual business hours.

#### *Activity of the Remuneration Committee in 2008*

During 2008 the Remuneration Committee held nine meetings. Meetings of the Committee are held as required

but not less than once every six months. Meetings may be convened at the initiative of the Chairman of the Committee, members of the Committee, or as decided by the Board of Directors.

In 2008 the Remuneration Committee reviewed issues such as:

- Approval of a set of key performance indicators (KPI) for members of the Management Board, Head of Internal Audit Department and Corporate Secretary of the Company.
- Remuneration of the Independent Non-Executive Directors, Financial Controller, Head of Internal Audit Department.
- Salary increase for Company employees.
- Remuneration strategy and system in the Company.
- Bonuses to the employees based upon the performance results in 2007 and 1H 2008.
- Review of discretionary performance indicators for members of the Company's Management Board.

The total amount of remuneration paid to members of the Board of Directors for the year ending December 31, 2008 is presented in the table below:

| Name                  | Annual Fee<br>000 US\$ | Physical<br>Attendance<br>000 US\$ | Telephone/<br>Video Link<br>Attendance<br>000 US\$ | INED<br>Meeting Fee<br>000 US\$ | Committee<br>Chairman-<br>ship Fee<br>000 US\$ | Total 2008<br>(excluding<br>taxes)<br>000 US\$ | Total 2008<br>(including<br>taxes )<br>000 KZT |
|-----------------------|------------------------|------------------------------------|--|---------------------------------|--|--|--|
| Christopher Mackenzie | 100                    | 40                                 | 25   | 15                              | 15   | 195  | 26,107   |
| Paul Manduca          | 100                    | 60                                 | 20   | 15                              | 25   | 220  | 29,459   |
| Edward Walshe         | 100                    | 60                                 | 20   | 15                              | 15   | 210  | 28,120   |
| Total                 | 300                    | 160                                | 65   | 45                              | 55   | 625  | 83,686   |

Other members of the Board of Directors do not receive any remuneration as members of the Board but are

entitled to reimbursement for the costs related to such appointment.

The total amount of remuneration paid to members of the Management Board for the year ending December 31, 2008 is given in the table below:

| Name                   | Position   | Salary<br>000 KZT | Other<br>Annual Co-<br>mensation<br>000 KZT | Total 2008<br>000 KZT | Total 2007<br>000 KZT | Total 2008<br>000 US\$ | Total 2007<br>000 US\$ |
|------------------------|--|-------------------|---|-----------------------|-----------------------|------------------------|------------------------|
| Askar Balzhanov *      | CEO  | 30,418            | 26,505                                      | 56,923                | 37,779                | 473                    | 308                    |
| Vladimir Miroshnikov * | First Deputy Director  | 25,479            | 18,917                                      | 44,396                | 30,448                | 369                    | 248                    |
| Zhanneta Bekezhanova   | CFO  | 20,506            | 18,090                                      | 38,595                | 67,104                | 321                    | 548                    |
| Askar Aubakirov **     | Deputy CEO<br>on Corporate<br>Development                    | 2,063             | 8,632                                       | 10,695                | 22,940                | 89                     | 187                    |
| Kairolla Yerezhepov    | Managing Director<br>on Human Resources<br>and Social Policy | 12,016            | 9,485                                       | 21,502                | 17,912                | 179                    | 146                    |
| Kairbek Yeleusinov *** | Director UMG   | 4,000             | 3   | 4,003                 | -                     | 33                     | -                      |
| Bagitkali Biseken      | Director EMG   | 16,470            | 12,456                                      | 28,926                | 18,594                | 240                    | 152                    |
| Murat Kurbanbayev ***  | Director UMG   | 10,725            | 11,198                                      | 21,923                | 54,262                | 182                    | 443                    |
| Total                  |  | 121,677           | 105,285                                     | 226,963               | 249,039               | 1,887                  | 2,033                  |

### Nominations Committee

The Nominations Committee comprises Independent Non-Executive Directors Christopher Mackenzie, Edward Walshe and Chairman of the Board of Directors Kaigeldy Kabyldin who is also the Chairman of the Committee.

During 2008 the Committee held three meetings.

The main purpose of the Committee's activity is to improve the effectiveness and quality of work of the Board of Directors in selection of specialists for substituting positions in the Company's bodies and to ensure continuity in change of officials and members of the Company's bodies, to determine criteria for selection of candidates for the positions of the Board of Directors, CEO, members of the Management Board and Corporate Secretary of the Company.

The Nominations Committee reviews issues related to changes in membership of the Board of Directors, retirement and appointment of additional and substituting directors, and makes relevant recommendations to the Board of Directors.

### Strategic Planning Committee

The Committee includes members of the Board of Directors Askar Balzhanov, Kenzhebek Ibrashev and Independent Non-Executive Director Edward Walshe, who is the Chairman of the Committee.

The main purpose of the Committee's activity is to develop and advise the Company's Board of Directors on prioritisation and direction of Company operations and development strategy.

\* The total amount for 2007 excludes annual bonus («premia») for 2006 paid in 2007 to Askar Balzhanov in the amount of 44,443,361 tenge (including taxes of 4,443,361 tenge) and for Vladimir Miroshnikov in the amount of 38,887,805 tenge (including taxes of 3,887,805 tenge) as these amounts were returned to the Company on August 4, 2008 and on October 3, 2008 respectively.

\*\* On February 1, 2008 Askar Aubakirov resigned from the Company.

\*\*\* On October 8, 2008 Murat Kurbanbayev resigned, and Kairbek Yeleusinov was elected.

#### Activity of the Strategic Planning Committee in 2008

During 2008 the Committee held three meetings by voting in person where the following issues were reviewed:

- Prospects of the Company's development in the context of the NC KMG development strategy.
- Measures on increasing the shareholder value of the Company.
- New oil and gas assets acquisitions projects.
- Summary on the joint work of NC KMG, KMG EP and BG Group.

### Risk Management Committee

The Risk Management Committee is chaired by KMG EP's CEO Askar Balzhanov. It comprises the first deputy CEO, CFO, managing directors on economics and finance, managing director on business development, managing director on legal issues, managing director on information technologies, managing director on human resources and social policy, director of safety and environmental protection department and compliance officer. The Head of Internal Audit participates in the Committee's meetings as an observer.

The primary goal of the Committee is the timely consideration of issues related to risk management, preparation of recommendations to the management board to support decision making on such issues, and monitoring of the risk management system's performance. It also looks at development of recommendations to structural divisions of the Company on improvement of

risk management system in order to increase effectiveness of business processes and reach strategic goals of the Company.

In 2008 the Risk Management Committee met four times and made decisions with regard to the following:

- Development of a risk management culture and improvement of internal environment, internal trainings for employees.
- Formation of specialised structural unit for risk management.
- Corporate insurance programme of the Company.
- Current risk management procedures by different functional directions of Company activities.
- Identification and evaluation of the risk portfolio of the Company.
- Current situations arising from the process of normal operations of structural divisions of the Company in 2008.

### Interests of Directors, Senior Executives and other persons

#### Interests of the Directors and Members of the Management Board

The interests of the directors and members of the Management Board in ordinary, preference shares and GDRs of the Company all of which are beneficiary unless stated otherwise are in the following table.

Interests are shown as of December 31, 2008 according to the information given by the members:

| Name                  | Number of ordinary shares | Number of GDRs | Number of preferred shares |
|-----------------------|---------------------------|----------------|----------------------------|
| Kairgeldy Kabyldin *  | -                         | -              | -                          |
| Uzakbay Karabalin *   | -                         | -              | -                          |
| Askar Balzhanov       | -                         | 23,158         | -                          |
| Kenzhebek Ibrashev    | -                         | -              | -                          |
| Yerzhan Zhangaurov    | -                         | 8,681          | -                          |
| Tolegen Bozzhanov     | -                         | -              | -                          |
| Christopher Mackenzie | -                         | 6,996          | -                          |
| Paul Manduca          | -                         | 6,828          | -                          |
| Edward Walshe         | -                         | 6,828          | -                          |
| Vladimir Miroshnikov  | 1,163                     | 9,494          | -                          |
| Zhanneta Bekezhanova  | -                         | -              | -                          |
| Kairolla Yerezhepov   | -                         | -              | -                          |
| Kairbek Yeleusinov    | -                         | -              | -                          |
| Bagitkali Biseken     | -                         | -              | 280                        |
| Murat Kurbanbayev **  | 2,497                     | 2              | 1,236                      |

\* On September 24, 2008 Uzakbay Karabalin resigned from and Kairgeldy Kabyldin was elected to the Board of Directors. He was elected as the Chairman of the Board of Directors on October 8, 2008.

\*\* On October 8, 2008 Murat Kurbanbayev resigned from the Company and Kairbek Yeleusinov, the new Director of UMG was elected to the Management Board. Information is shown as of September 30, 2008.

The directors and members of the Management Board were granted the following options for GDRs subject to the Option Programme of the Company:

| Name                 | Date of option award | Number of GDRs for which options were granted | Option exercise price | Maturity date   |
|----------------------|----------------------|---|-----------------------|---|
| Kairgeldy Kabyldin   | –                    | –   | –                     | –   |
| Askar Balzhanov      | October 4, 2006      | 38,916  | US\$14.64             | One third on each October 4, 2007, 2008 and 2009<br>December 29, 2007<br>December 4, 2010 |
|                      | December 29, 2006    | 10,662  | US\$0.00              |   |
|                      | December 4, 2007     | 15,300  | US\$26.47             |   |
| Vladimir Miroshnikov | October 4, 2006      | 33,844  | US\$14.64             | One third on each October 4, 2007, 2008 and 2009<br>December 29, 2007<br>December 4, 2010 |
|                      | December 29, 2006    | 9,935   | US\$0.00              |   |
|                      | December 4, 2007     | 12,240  | US\$26.47             |   |
| Zhanneta Bekezhanova | October 4, 2006      | 29,262  | US\$14.64             | One third on each October 4, 2007, 2008 and 2009<br>December 29, 2007<br>December 4, 2010 |
|                      | December 29, 2006    | 8,590   | US\$0.00              |   |
|                      | December 4, 2007     | 10,880  | US\$26.47             |   |
| Kairolla Yerezhpov   | October 4, 2006      | 22,025  | US\$14.64             | One third on each October 4, 2007, 2008 and 2009<br>December 29, 2007<br>December 4, 2010 |
|                      | December 29, 2006    | 6,465   | US\$0.00              |   |
|                      | December 4, 2007     | 4,604   | US\$26.47             |   |
| Kairbek Yeleusinov   | October 4, 2006      | 9,854   | US\$14.64             | One third on each October 4, 2007, 2008 and 2009<br>December 4, 2010                      |
|                      | December 4, 2007     | 2,714   | US\$26.47             |   |
| Bagitkali Biseken    | May 18, 2007         | 16,968  | US\$20.00             | One third on each May 18, 2008, 2009 and 2010<br>December 4, 2010                         |
|                      | December 4, 2007     | 6,347   | US\$26.47             |   |
| Yerzhan Zhangaurov   | December 29, 2006    | 9,154   | US\$0.00              | December 29, 2007   |
| Kenzhebek Ibrashev   | –                    | –   | –                     | –   |
| Tolegen Bozzhanov    | December 29, 2006    | 7,001   | US\$0.00              | December 29, 2007   |

## Principal Shareholders and/or GDR Holders

In accordance with the legislation of the Republic of Kazakhstan below is shown a list of the Company's shareholders as of December 31, 2008:

| Shareholder                            | Number of ordinary shares | Number of preferred shares | Total share capital |
|--|---------------------------|----------------------------|---------------------|
| Number of shares issued <sup>(1)</sup> | 70,220,935                | 4,136,107                  | 74,357,042          |
| Owned by JSC NC KazMunayGas            | 43,087,006                | –                          | 43,087,006          |
| Percentage of issued share capital     | 61.36%                    | 0.00%                      | 57.95%              |

## Directors' Employment Contracts and Letters of Appointment

### *Employment Contracts with Directors*

Kairgeldy Kabyldin is the Chairman of the Board of Directors and a member of the Board of Directors of the Company. He was appointed a director at the extraordinary general shareholders meeting on September 24, 2008. The Board elected Mr Kabyldin as its Chairman on October 8, 2008. Kairgeldy Kabyldin does not receive any remuneration as a member of the Board of Directors but is entitled to reimbursement of the costs related to such appointment.

Askar Balzhanov is a member of the Board of Directors and CEO of the Company. He was appointed CEO of the Company on June 7, 2006 and a member of the Board of Directors at the general shareholders meeting on June 12, 2006. Mr Balzhanov does not receive any remuneration as a member of the Board of Directors but is entitled to reimbursement for the costs related to such appointment.

Yerzhan Zhangaurov is a member of the Board of Directors of the Company. He was appointed a member of the Board of Directors at the general shareholders meeting on June 12, 2006. Mr Zhangaurov does not receive any remuneration as a member of the Board of Directors but is entitled to reimbursement of the costs related to such appointment.

Tolegen Bozzhanov is a member of the Board of Directors of the Company. He was appointed a member of the Board of Directors at the general shareholders meeting on September 24, 2008. Mr Bozzhanov does not receive any remuneration as a member of the Board of Directors but is entitled to reimbursement of the costs related to such appointment.

Kenzhebek Ibrashev is a member of the Board of Directors of the Company. He was appointed a member of the Board of Directors at the general shareholders meeting on October 30, 2007. Mr Ibrashev does not receive any remuneration as a member of the Board of Directors but is entitled to reimbursement of the costs related to such appointment.

Christopher Mackenzie was appointed an Independent Non-Executive Director of the Company on August 28, 2006 with the term of office not exceeding the term of office of the existing Board of Directors of the Company as of March 30, 2007. At the same time, by resolution of the general shareholders meeting of the Company dated April 12, 2007 the term of office of the existing Board of Directors of the Company was extended from March 30, 2007 until March 29, 2010.

Paul Manduca was appointed an Independent Non-Executive Director of the Company on August 28, 2006 with the term of office not exceeding the term of office of the existing Board of Directors of the Company as of March 30, 2007. At the same time, by resolution of the general shareholders meeting of the Company dated April 12, 2007, the term of office of the existing Board of Directors of the Company was extended from March 30, 2007 until March 29, 2010.

<sup>(1)</sup> Including GDRs purchased to implement the Company's Option Programme and held in trust (as of December 31, 2008 – 1,528,749 GDRs), and the shares and GDRs purchased in accordance with own share buyback program (as of December 31, 2008 – 236,156 GDRs and 16,389 shares).

Edward T. Walshe was appointed an Independent Non-Executive Director of the Company on August 28, 2006 with the term of office not exceeding the term of office of the existing Board of Directors of the Company as of March 30, 2007. At the same time, by resolution of the general shareholders meeting of the Company dated April 12, 2007, the term of office of the existing Board of Directors of the Company was extended from March 30, 2007 until March 29, 2010.

#### *Employment Contracts of Members of the Management Board*

All members of the Management Board have entered into employment contracts with the Company which generally provide for business travel insurance and reimbursement of the costs incurred during business trips on the Company's business in accordance with the Company's internal regulations. Other than set out above, no employment contracts exist or anticipated to be entered into between the Company and members of the Board of Directors or Management Board.

### **United Kingdom Tax Considerations**

The comments below are of a general nature and are based on current United Kingdom law and HM Revenue & Customs practice at the date of this document, both of which are subject to change, possibly with retrospective effect. Except as otherwise stated, the summary only discusses certain UK tax consequences of holding the shares or the GDRs (1) for individuals who are resident or ordinarily resident in the UK for tax purposes; (2) who are not resident for tax purposes in any other jurisdiction; and (3) who do not have a permanent establishment or fixed base in Kazakhstan with which the holding of the shares or the GDRs is connected («UK holders»).

In addition, the summary (1) only addresses the tax consequences for UK holders who hold the shares and the GDRs as capital assets, and does not address the tax consequences which may be relevant to certain other categories of UK holders, for example, dealers; (2) assumes that the UK holder does not either directly or indirectly control 10% or more of the voting power of the company; (3) assumes that a holder of the GDRs is beneficially entitled to the underlying shares and to the dividends on those shares; and (4) does not address the tax consequences of UK holders that are insurance companies, collective investment schemes or pensions connected with the Company.

The following is intended only as a general guide and is not intended to be, nor should it be considered to be, legal or tax advice to any particular UK holder. Accordingly, potential investors should satisfy themselves as to the overall tax consequences, including, specifically, the consequences under UK law and HM Revenue & Customs practice, of the acquisition, ownership and disposal of the shares or the GDRs in their own particular circumstances.

#### *Withholding Tax*

Assuming that the income received under the GDRs does not have a United Kingdom source, there should be no United Kingdom withholding tax on payment of any such income. Dividend payments in respect of the shares will not be subject to UK withholding tax.

#### *Taxation of Dividends*

A UK holder that receives a dividend on the shares or the GDRs may be subject to UK income tax or corporation tax as the case may be, on the gross amount of any dividend paid before the deduction of any Kazakhstan withholding taxes, subject to the availability of any credit for Kazakhstan tax withheld. A UK holder who is an individual resident and domiciled in the UK will generally be subject to UK income tax on the dividend paid on the shares or the GDRs. A UK holder who is an individual resident but not domiciled in the UK and who is entitled to be taxed in the UK on the remittance basis will generally be subject to UK income tax on the dividend paid on the shares or the GDRs to the extent that the dividend is remitted, or treated as remitted, to the UK. A corporate UK holder will generally be subject to UK corporation tax on the dividend paid on the shares or the GDRs. A corporate holder of the shares or the GDRs that is not resident in the UK will generally be subject to UK corporation tax on the dividend paid on the shares or the GDRs where the shares or the GDRs in question are attributable to a trade carried on by the holder in the UK through a permanent establishment.

The UK is currently considering changing the way in which companies are taxed on dividends paid by non-UK entities. Draft legislation has been published which, if enacted, would generally (subject to some exceptions, for example relating to anti-avoidance and small companies) exempt corporate UK holders from UK tax payable on the shares or GDRs. As at 1 March 2009, it was not clear when these provisions will be enacted.

#### *Taxation of Disposals or Deemed Disposals*

The disposal by a UK holder of interests in the shares or the GDRs may give rise to a chargeable gain or allowable loss for the purposes of UK taxation of chargeable gains, depending on the UK holder's circumstances and subject to any available exemption or relief. A UK holder who is an individual and domiciled in the UK will generally be liable to UK capital gains tax on chargeable gains made on the disposal of an interest in the shares or the GDRs. A UK holder who is an individual but not domiciled, in the UK and who is entitled to be taxed in the UK on the remittance basis will generally be liable to UK capital gains tax to the extent that the chargeable gains made on the disposal of an interest in the shares or the GDRs are remitted or treated as remitted to the UK. In particular, dealings in the GDRs on the London Stock Exchange may give rise to remitted profits that would, therefore, give rise to UK capital gains tax liability.

An individual holder of the shares or the GDRs who ceases to be resident or ordinarily resident in the UK for UK tax purposes for a period of less than five years and who disposes of such shares or GDRs during that period may also be liable on returning to the UK for UK tax on capital gains despite the fact that the individual may not be resident or ordinarily resident in the UK for UK tax purposes at the time of the disposal.

A corporate UK holder will generally be subject to UK corporation tax on any chargeable gain arising from a disposal of the shares or the GDRs.

#### *Effect of Kazakhstan Withholding Taxes*

Dividend payments in respect of the shares and the GDRs will be subject to Kazakhstan withholding taxes. Under current law, a UK holder should generally be entitled to a credit for Kazakhstan tax properly withheld from such payments against such investor's liability to income tax or corporation tax on such amounts, subject to UK tax rules for calculation of such a credit.

#### *Stamp Duty and Stamp Duty Reserve Tax («SDRT»)*

Assuming that any document effecting a transfer of, or containing an agreement to transfer, one or more of the shares or the GDRs is neither (i) executed in the UK nor (ii) relates to any property situate, or to any matter or thing done or to be done, in the UK (which may include involvement of UK bank accounts in payment mechanics), then no UK ad valorem stamp duty should be payable on such a document.

Even if a document effecting a transfer of, or containing an agreement to transfer, one or more of the shares or the GDRs is (i) executed in the UK and/or (ii) relates to any property situate, or to any matter or thing done or to be done, in the UK, in practice it should not be necessary to pay any UK ad valorem stamp duty on such a document unless the document is required for any purposes in the UK. If it is necessary to pay UK ad valorem stamp duty, it may also be necessary to pay interest and penalties.

As the GDRs relate to stock expressed in a currency other than sterling, no «bearer instrument» stamp duty should be payable on either the issue of the GDRs or any transfer of stock transferable by means of the GDRs.

Assuming that the shares are neither (i) registered in a register kept in the UK nor (ii) paired with shares issued by a company incorporated in the UK, no SDRT should be payable in respect of any agreement to transfer the shares or the GDRs.

# Annual Operating and Financial Review

*The following is intended to assist in the understanding and assessment of trends and significant changes in the Company's results and financial condition. In this document, the consolidated financial statements presented are those of the Company. This review is based on the consolidated financial statements of the Company and should be read in conjunction with its consolidated financial statements and the accompanying notes. All of the financial data and discussions thereof are based upon financial statements prepared in accordance with IFRS.*

## Overview

KazMunaiGas Exploration Production Joint Stock Company (KMG EP or the Company) is engaged in the acquisition, exploration, development, production, processing and export of hydrocarbons with its core operations of oil and gas properties located in the Pre-Caspian and Mangistau basins of western Kazakhstan. The Company's direct majority shareholder is JSC National Company KazMunayGas (NC KMG), which represents the state's interests in the Kazakhstan oil and gas industry. The Company conducts its core production activities at 41 oil and gas fields including the production branch Uzenmunaigas (UMG) – consisting of 2 fields and the production branch Embamunaigas (EMG) – 39 fields. In addition the Company has a 50% interest in a jointly controlled oil and natural gas producer and a receivable from a jointly controlled entity.

Production of the Company and its associates based on the Company's working interest (a 50% share in JV Kazgermunai LLP and a 50% share in CCEL) was 11,954 thousand tonnes or 240 kbopd in 2008 (UMG and EMG – 190 kbopd, JV Kazgermunai LLP – 33 kbopd and CCEL – 17 kbopd).

The above two associates are described in more detail in the section «Overview of Associates' Operations». Elsewhere in this Operating and Financial Review the discussion is limited to the core assets of the Company unless indicated otherwise.

## Business Environment and Outlook

Economic factors affecting the Company's financial performance during the period under review include movements in crude oil prices, foreign exchange, particularly the Tenge-US dollar rate, and domestic inflation rates.

### Business Environment in 2008

The price of Brent averaged US\$97.08 per barrel in 2008, an increase of US\$24.7 per barrel from the average price in 2007.

|           | 4Q 2008     | 3Q 2008 | 4Q 2007 | 4Q on 4Q change | 2008        | 2007  | Change |
|-----------|-------------|---------|---------|-----------------|-------------|-------|--------|
|           | (US\$ /bbl) |         |         |                 | (US\$ /bbl) |       | %      |
| Brent     | 55.48       | 114.68  | 88.45   | (37%)           | 97.08       | 72.39 | 34%    |
| CPC blend | 56.26       | 116.77  | 89.07   | (37%)           | 98.44       | 73.02 | 35%    |
| Urals     | 53.74       | 112.31  | 86.09   | (38%)           | 94.08       | 69.53 | 35%    |

Most of the Company's revenues and net financial assets are denominated in US dollars (US\$), while the majority of the Company's operating expenses are denominated in Tenge (KZT). The impact of foreign currency fluctuations on the Company's results depends on its net foreign

currency position and the magnitude and direction of any fluctuation in foreign exchange rates.

KZT/US dollar exchange rates and domestic inflation, as measured by the consumer price index (CPI) for the periods presented, were as follows:

|                                   | 4Q 2008             | 3Q 2008 | 4Q 2007 | 4Q on 4Q change | 2008   | 2007   | Change |
|-----------------------------------|---------------------|---------|---------|-----------------|--------|--------|--------|
|                                   | Average US\$ vs KZT | 120.16  | 119.99  | 120.75          | 0%     | 120.29 | 122.55 |
| CPI                               | 1.4%                | 2.4%    | 10.2%   | (86%)           | 9.5%   | 18.8%  | -      |
| US\$ vs KZT at balance sheet date | 120.77              | 119.81  | 120.30  | 0%              | 120.77 | 120.30 | 0%     |

Source: National Bank of Kazakhstan

### Outlook for Business Environment and Operating Risks in 2009

The Company is exposed to the effect of fluctuations in the price of crude oil, which is quoted in US dollars on the international markets. The Company prepares its annual budgets and periodic forecasts including sensitivity analyses in respect of various levels of crude oil prices in the future. The fall of the world oil price that started in the middle of 2008 continued into 4Q 2008. In January and February 2009 the Brent oil price was, on average, US\$43.59 and US\$43.82 per barrel respectively. The Company currently uses Brent US\$40 per barrel price for budgeting purposes in 2009.

On the February 4, 2009 the National Bank of Kazakhstan announced that it «considers the new level of exchange rate objectively necessary» and stated that it is possible

that «the exchange rate corridor will be around KZT150 per US\$1 ±3%». As a consequence in February 2009 Tenge weakened against the US dollar and averaged 145.20 Tenge/US\$, a depreciation of KZT24.91 from the 2008 average rate of KZT120.29/US\$1. According to preliminary estimates, an increase in the KZT/US\$ exchange rate of KZT10 per US\$1 in relation to the current level of about KZT150 per US\$1 would, in the short term, lead to a 6% increase in revenue and approximately 3% increase in operating costs. The actual changes in costs would depend on several factors, including inflation, pricing by various suppliers and the Company's measures on cost optimization.

The National Bank of Kazakhstan forecasts the inflation rate for 2009 at 9%, which is almost the same as in 2008. The Company uses this inflation rate in its budgeting process. The CPI increased by 0.3% and 0.8% in January and February 2009, compared to 1.1% and 0.8% for the respective months of 2008.

The New Tax Code of the Republic of Kazakhstan took effect from January 1, 2009. The introduction of the new tax regime, according to the Company's preliminary calculations, leads to an increase in tax take (measured as the ratio of the total amount of taxes and the pre-tax profit before all taxes) by around 0.5% at the budgeted US\$40 per barrel, increasing at higher oil prices. The increase of the tax burden with the growth of the oil price is explained by the use of a progressive scale of rent tax and excess profit tax. This estimate assumes for the 2008 tax regime a constant export duty at the actual average rate in 2008 (approximately US\$11 per barrel).

The Company does not expect significant changes in other aspects of its business environment such as transportation tariffs and route capacities, availability of production, finance and human resources.

An overview of the principal market risks can be found at the end of this Operating and Financial Review. Some of the Company's operating and financial risks are discussed in Notes 18 and 20 to the audited consolidated financial statements for the year ended December 31, 2008.

## Operational activity in 2008

The Company largely achieved its targeted production goals for 2008 with oil production of 9,470 thousand tonnes which was 1% less than the level of oil production

for 2007 and marginally below the oil production plan for 2008. Of this total oil production 6,646 thousand tonnes were produced by UMG and 2,824 thousand tonnes by EMG.

|                  | 4Q 2008           | 3Q 2008 | 4Q 2007 | 4Q on 4Q<br>change | 2008              | 2007  | Change |
|------------------|-------------------|---------|---------|--------------------|-------------------|-------|--------|
|                  | (thousand tonnes) |         |         | %                  | (thousand tonnes) |       | %      |
| UMG              | 1,703             | 1,654   | 1,699   | 0%                 | 6,646             | 6,724 | (1%)   |
| EMG              | 698               | 723     | 724     | (4%)               | 2,824             | 2,806 | 1%     |
| Total production | 2,401             | 2,377   | 2,423   | (1%)               | 9,470             | 9,530 | (1%)   |

As at December 31, 2008 the Company had 6,014 production wells and 1,675 injection wells.

The majority of the Company's existing oil fields are at the mature stage of development, characterized by high watercut and declining oil production. The Company performed production drilling, workover operations and enhanced recovery in order to mitigate natural production decline and maintain planned volumes of oil production in 2008.

In 2008 the Company constructed 149 wells which contributed 216,452 tonnes to production. Workovers were conducted on 1,201 wells and provided an incremental production of 495,444 tonnes. The Company applied enhanced oil recovery techniques, including hydro-fracturing and polymer systems. As a result an additional 440,557 tonnes were recovered following 493 well operations.

The Company conducted exploration activities on the following blocks/fields in 2008: Taisoigan (Uaz, Kondybai), R-9, Liman, territories adjacent to the Uzen and Karamandybas fields and S. Nurzhanov field. Overall exploration drilling in 2008 amounted to 5,950 meters on 3 exploration wells.

Due to the revision of the exploration plan for 2008 drilling of four of planned structural wells (2 wells at R-9 block and 2 wells at Liman block) was canceled in 2008.

During 2008 700 km of 2D and 360 km<sup>2</sup> of 3D seismic field surveys were performed at Liman and R-9 blocks respectively. At both blocks a number of prospective sectors were identified at subsalt layers.

## Planned activity in 2009

Crude oil production in 2009 is expected to be 9.14 million tonnes, or 3.5% less than was produced in 2008. The planned reduction of production level reflects the adjustment of the Company's budget to the lower oil price environment anticipated in 2009. The Company's current budgeting assumption is US\$40 per barrel (Brent) versus US\$97 per barrel actual average price in 2008. In order partly to offset the natural production decline in 2009 the Company is planning to drill 70 development wells and perform operations on existing wells, including reservoir recovery improvements, well workovers, bottomhole zone treatment and the rehabilitation of previously abandoned wells.

In 2009, the Company is planning exploration activities in prospective areas focusing on the identification of geological structures in the above-salt and sub-salt complex and selecting drilling candidates. In particular, the Company is planning to conduct exploration on the R-9 block. In 2009 400 km of 2D-MOGT seismic field surveys are planned. It also plans to drill two exploration

wells with projected depth of 3500 meters on S. Nurjanov field. The Company is planning to start drilling one sub-salt and one above-salt well on R9 exploration block in 2009. Exploration programmes for other exploration blocks are under review.

The Company's capital expenditure in 2009 is expected to be around KZT40 bn. The Company's budget is subject to periodic reviews to reflect changes in oil prices, the KZT/US\$ exchange rate and inflation among other factors.

The Company remains well positioned for potential acquisition of production assets in the Republic of Kazakhstan and abroad. KMG EP has examined a number of potential acquisition opportunities, including certain assets owned or contemplated for acquisition by NC KMG, and prepared specific proposals. Further decision making and timing of the acquisition of these assets by KMG EP depends primarily on the support and decisions of NC KMG and its sole shareholder Samruk-Kazyna National Wealth Fund («Samruk-Kazyna»).

## Results of Operations

Amounts shown in US dollars are included solely for the convenience of the reader. Amounts derived from the consolidated income statements and consolidated cash flow statements are translated at the average rate

over the applicable periods and amounts derived from the consolidated balance sheets are translated at the end of the period rate. See «Business Environment and Outlook».

### Selected measures

|  | 4Q 2008                                  | 3Q 2008     | 4Q 2007     | 4Q on 4Q<br>change | 2008                                     | 2007        | Change |
|--|--|-------------|-------------|--------------------|--|-------------|--------|
|  | (KZT thousands, unless otherwise stated) |             |             | %                  | (KZT thousands, unless otherwise stated) |             | %      |
| Revenue  | 85,457,281                               | 182,504,504 | 148,136,521 | (42%)              | 604,993,422                              | 486,974,879 | 24%    |
| Operating expenses   | 100,022,583                              | 75,367,696  | 58,581,892  | 67%                | 297,167,473                              | 210,834,485 | 41%    |
| Operating expenses (KZT per bbl) <sup>(1)(2)</sup>             | 3,519                                    | 3,441       | 3,285       | 3%                 | 3,277                                    | 3,006       | 9%     |
| Operating expenses (USD per bbl) <sup>(1)(2)</sup>             | 29.29                                    | 28.68       | 27.20       | 4%                 | 27.24                                    | 24.53       | 11%    |
| Profit (loss) from operations                                  | (14,565,302)                             | 107,136,808 | 89,554,629  | (114%)             | 307,825,949                              | 276,140,394 | 11%    |
| Net income <sup>(3)</sup>                                      | 22,739,530                               | 71,027,962  | 53,638,521  | (58%)              | 241,282,369                              | 157,119,081 | 54%    |
| Oil Production and other cost                                  | 34,806,950                               | 24,077,307  | 27,995,126  | 22%                | 101,769,924                              | 89,243,901  | 14%    |
| Oil Production and other costs (USD per bbl) <sup>(1)(4)</sup> | 16.39                                    | 11.47       | 13.00       | 24%                | 12.14                                    | 10.38       | 17%    |
| Capital expenditure  | 13,056,824                               | 8,665,743   | 11,657,237  | 12%                | 41,891,804                               | 40,095,396  | 4%     |

<sup>(1)</sup> Converted at 7.36 barrels per tonnes of crude oil.

<sup>(2)</sup> Operating expenses net of export customs duty expense.

<sup>(3)</sup> Profit for the period.

<sup>(4)</sup> Oil production and other costs represent an aggregate of the following operating expenses line items (as presented in the Company's consolidated financial statements for the year ended December 31, 2008 (see the Company website for a soft copy): employee benefits, materials and supplies, repairs and maintenance, energy and other costs. These include costs related to gas producing and processing activities, oil processing activities and general and administrative costs which are not directly related to oil production and which increased the US dollar cost per barrel by approximately US\$2.04 and US\$1.66 for the year ended December 31, 2008 and 2007 respectively (US\$1.79 and US\$2.54 for quarter ended December 31, 2008 and September 30, 2008). Oil production and other costs exclude royalties (production tax) and all other taxes.

### Transport Routes

The Company delivers its crude oil through three principal routes: export markets via the pipeline owned by the Caspian Pipeline Consortium (CPC), the Uzen-Atyrau-

Samara pipeline (UAS) owned by JSC KazTransOil (in Kazakhstan) and the domestic market, as outlined in the following table:

|   | 4Q 2008 | 3Q 2008 | 4Q 2007 | 2008 | 2007 |
|---|---------|---------|---------|------|------|
| <b>Exports via UAS</b>                  |         |         |         |      |      |
| Volume of crude oil (in million tonnes) | 1.2     | 1.3     | 1.3     | 4.9  | 5.2  |
| % total crude oil sales volume          | 55%     | 57%     | 52%     | 54%  | 55%  |
| % total sales value of crude oil        | 63%     | 70%     | 64%     | 65%  | 64%  |
| <b>Exports via CPC</b>                  |         |         |         |      |      |
| Volume of crude oil (in million tonnes) | 0.6     | 0.5     | 0.5     | 2.1  | 2.1  |
| % total crude oil sales volume          | 27%     | 20%     | 22%     | 23%  | 22%  |
| % total sales value of crude oil        | 28%     | 25%     | 29%     | 29%  | 28%  |
| <b>Other</b>                            |         |         |         |      |      |
| Volume of crude oil (in million tonnes) | 0.4     | 0.6     | 0.6     | 2.1  | 2.2  |
| % total crude oil sales volume          | 18%     | 23%     | 26%     | 23%  | 23%  |
| % total sales value of crude oil        | 9%      | 5%      | 7%      | 6%   | 8%   |

Relative profitability of the two export routes depends on the quality of oil in the pipeline, prevailing international market prices and applicable pipeline tariffs. Specifically, CPC tends to be more advantageous due to higher quality crude oil in the CPC pipeline in a higher price oil environment even after taking into account quality bank payments. In the 4Q 2008, however, CPC route was less attractive on a netback basis compared to UAS. The increase between the CPC blend quote and realized price differential in 4Q 2008 in comparison to 3Q 2008 was due to the following two factors. First, sales transactions reflect prices as of the date of sale and not the average crude oil quotations for the quarter (US\$44.08 and US\$56.26 per

barrel accordingly), which may be significantly different due to volatility of the oil price. The second factor is the increase of quality bank expenses in 4Q 2008 to US\$9.42 per barrel or by 15% due to the growth of crude oil prices in the first three quarters of 2008. Future quality bank expenses should decrease as a result of falling oil prices in the latter part of 2008.

It should be noted that the Ministry of Energy and Mineral Resources of Kazakhstan controls the volumes of crude oil that can be shipped through the pipelines and the Company's ability to allocate export volume to different pipelines is therefore limited.

### Revenue

The following table shows sales volumes and realized prices for 3Q 2008, 4Q 2008, 4Q 2007, 2008 and 2007:

|  | 4Q 2008                                  | 3Q 2008            | 4Q 2007            | 4Q on 4Q<br>change | 2008                                     | 2007               | Change      |
|--|--|--------------------|--------------------|--------------------|--|--------------------|-------------|
|  | (KZT thousands, unless otherwise stated) |                    |                    | %                  | (KZT thousands, unless otherwise stated) |                    | %           |
| <b>Export sales of crude oil</b>         |  |                    |                    |                    |  |                    |             |
| <b>UAS pipeline</b>                      |  |                    |                    |                    |  |                    |             |
| Net sales                                | 51,992,450                               | 122,879,988        | 91,178,765         | (43%)              | 383,714,296                              | 305,100,868        | 26%         |
| Volume (in thousand tonnes)              | 1,227                                    | 1,321              | 1,253              | (2%)               | 4,898                                    | 5,237              | (6%)        |
| Average price (KZT/tonne)                | 42,384                                   | 93,021             | 72,766             | (42%)              | 78,347                                   | 58,260             | 34%         |
| Average price (US\$/bbl) <sup>(1)</sup>  | 48.79                                    | 107.23             | 83.35              | (41%)              | 90.09                                    | 65.75              | 37%         |
| <b>CPC pipeline</b>                      |  |                    |                    |                    |  |                    |             |
| Net sales                                | 23,184,104                               | 44,025,216         | 41,881,709         | (45%)              | 168,406,193                              | 132,450,248        | 27%         |
| Volume (in thousand tonnes)              | 605                                      | 456                | 540                | 12%                | 2,110                                    | 2,117              | 0%          |
| Average price (KZT/tonne)                | 38,294                                   | 96,528             | 77,569             | (51%)              | 79,813                                   | 62,559             | 28%         |
| Average price (US\$/bbl) <sup>(1)</sup>  | 44.08                                    | 111.27             | 88.85              | (50%)              | 91.77                                    | 70.61              | 30%         |
| <b>Total sales of crude oil-exported</b> | <b>75,176,555</b>                        | <b>166,905,204</b> | <b>133,060,474</b> | <b>(44%)</b>       | <b>552,120,489</b>                       | <b>437,551,117</b> | <b>26%</b>  |
| <b>Domestic sales of crude oil</b>       |  |                    |                    |                    |  |                    |             |
| Net sales                                | 6,831,651                                | 9,864,455          | 10,282,161         | (34%)              | 36,933,575                               | 37,401,142         | (1%)        |
| Volume (in thousand tonnes)              | 379                                      | 557                | 611                | (38%)              | 2,072                                    | 2,230              | (7%)        |
| Average price (KZT/tonne)                | 18,041                                   | 17,726             | 16,817             | 7%                 | 17,827                                   | 16,768             | 6%          |
| Average price (US\$/bbl) <sup>(1)</sup>  | 20.77                                    | 20.43              | 19.26              | 8%                 | 20.50                                    | 18.93              | 8%          |
| <b>Total domestic sales of crude oil</b> | <b>6,831,651</b>                         | <b>9,864,455</b>   | <b>10,282,161</b>  | <b>(34%)</b>       | <b>36,933,575</b>                        | <b>37,401,142</b>  | <b>(1%)</b> |

<sup>(1)</sup> Converted at 7.23 barrels per tonne of crude oil.

|  | 4Q 2008                                  | 3Q 2008            | 4Q 2007            | 4Q on 4Q<br>change | 2008  | 2007               | Change     |
|--|--|--------------------|--------------------|--------------------|---|--------------------|------------|
|  | (KZT thousands, unless otherwise stated) |                    |                    |                    | (KZT thousands, unless<br>otherwise stated) |                    | %          |
|  |  |                    |                    | %                  |   |                    | %          |
| <b>Total sales of crude oil</b>            |  |                    |                    |                    |   |                    |            |
| Net sales                                  | 82,008,206                               | 176,769,659        | 143,342,635        | (43%)              | 589,054,064                                 | 474,952,259        | 24%        |
| Volume (in<br>thousand tonnes)             | 2,211                                    | 2,334              | 2,404              | (8%)               | 9,079                                       | 9,585              | (5%)       |
| Average price<br>(KZT/tonne)               | 37,094                                   | 75,750             | 59,618             | (38%)              | 64,878                                      | 49,554             | 31%        |
| Average price<br>(US\$/bbl) <sup>(1)</sup> | 42.70                                    | 87.32              | 68.29              | (37%)              | 74.60                                       | 55.93              | 33%        |
| Other sales                                | 3,449,075                                | 5,734,845          | 4,793,886          | (28%)              | 15,939,358                                  | 12,022,620         | 33%        |
| <b>Total revenue</b>                       | <b>85,457,281</b>                        | <b>182,504,504</b> | <b>148,136,521</b> | <b>(42%)</b>       | <b>604,993,422</b>                          | <b>486,974,879</b> | <b>24%</b> |

#### *Key features of crude oil sales in 2008*

Total sales of crude oil in 2008 in comparison to 2007 increased by 24%, to KZT589 bn, primarily due to the 31 per cent increase in 2008 of the average realization price. The positive effect of price growth in 2008 was partly offset by a decrease in the volume of crude oil sales in the amount of 506 thousand tonnes, or 5%. This decrease was caused by the growth of the crude oil balance in 2008 and the large opening balance at the end of 2006 which was sold in 2007.

#### *Export – UAS pipeline*

Sales of crude oil exported via the UAS pipeline in 2008 increased by 26%, to KZT384 bn, compared to 2007 mainly due to the growth of the average realization price to KZT78,347 per tonne, an increase of 34%, which was diminished in part by the decrease in volume exported via the UAS pipeline by 339 thousand tonnes, or 6%.

Revenue from export sales by the UAS pipeline in 4Q 2008 in comparison to 4Q 2007 fell by 43% primarily due to the average realization price drop by 42% to KZT42,384 per tonne.

#### *Export – CPC pipeline*

Sales of exported crude oil via CPC pipeline in 2008 increased by 27%, to KZT168 bn, compared to 2007. The increase was primarily due to the average realization price increase to KZT79,813 per tonne, or 28%.

Revenue from export sales by CPC pipeline in 4Q 2008 in comparison with 4Q 2007 decreased by 45% mainly due to a decrease of 51% in the average price. The negative effect of this average price decrease was partly mitigated by any increase in the volume of oil sold by 65 thousands tonnes, or 12%.

#### *Domestic market – Sales of crude oil*

Domestic sales of crude oil decreased by 1% in 2008 compared to 2007 and by 34% in 4Q 2008 compared to 4Q 2007. The decrease in sales was primarily due to decrease of the oil volume sold in 4Q 2008 which was caused by the inability of Atyrau Refinery to receive the planned volume of oil. Part of the unaccepted volume was exported.

<sup>(1)</sup> Converted at 7.23 barrels per tonne of crude oil.

The following table shows the Company's realized sales prices adjusted for crude oil transportation and other expenses for the periods ended December 31, 2008, September 30, 2008 and December 31, 2007:

|   | 4Q 2008    | 3Q 2008 | 4Q 2007 | 4Q on 4Q<br>change | 2008       | 2007  | Change |
|---|------------|---------|---------|--------------------|------------|-------|--------|
|   | (US\$/bbl) |         |         | %                  | (US\$/bbl) |       | %      |
| <b>UAS</b>                                |            |         |         |                    |            |       |        |
| Benchmark end-market quote <sup>(1)</sup> | 53.74      | 112.31  | 86.09   | (38%)              | 94.08      | 69.53 | 35%    |
| Realized price <sup>(2)</sup>             | 48.79      | 107.23  | 83.35   | (41%)              | 90.09      | 65.75 | 37%    |
| Export customs duty <sup>(3)</sup>        | 23.77      | 9.84    | n/a     | -                  | 11.29      | n/a   | -      |
| Transportation                            | 7.32       | 7.42    | 6.24    | 17%                | 7.38       | 6.13  | 20%    |
| Sales commissions                         | 0.07       | 0.07    | 0.07    | 4%                 | 0.07       | 0.07  | 6%     |
| Adjusted realized price                   | 17.63      | 89.90   | 77.04   | (77%)              | 71.35      | 59.55 | 20%    |
| <b>CPC</b>                                |            |         |         |                    |            |       |        |
| Benchmark end-market quot <sup>(1)</sup>  | 56.26      | 116.77  | 89.07   | (37%)              | 98.44      | 73.02 | 35%    |
| Realized price <sup>(2)</sup>             | 44.08      | 111.27  | 88.85   | (50%)              | 91.77      | 70.61 | 30%    |
| Export customs duty <sup>(3)</sup>        | 23.77      | 9.84    | n/a     | -                  | 11.29      | n/a   | -      |
| Transportation                            | 7.65       | 7.68    | 7.76    | (1%)               | 7.79       | 6.89  | 13%    |
| Sales commissions                         | 0.07       | 0.07    | 0.07    | 4%                 | 0.07       | 0.07  | 6%     |
| Adjusted realized price                   | 12.59      | 93.68   | 81.02   | (84%)              | 72.62      | 63.65 | 14%    |

<sup>(1)</sup> The following quoted prices are used as benchmarks: Urals blend (FOB Odessa) for shipments through the UAS pipeline and CPC blend (FOB Novorossiysk) for shipments through the CPC pipeline.

<sup>(2)</sup> Converted at 7.23 barrels per tonne of crude oil.

<sup>(3)</sup> Customs duty on export of crude oil in the amount of US\$109.91 per tonne took effect from May 17, 2008 and changed to US\$203.8 per tonne effective from October 11, 2008.

|                                    | 4Q 2008    | 3Q 2008 | 4Q 2007 | 4Q on 4Q<br>change | 2008       | 2007  | Change |
|------------------------------------|------------|---------|---------|--------------------|------------|-------|--------|
|                                    | (US\$/bbl) |         |         | %                  | (US\$/bbl) |       | %      |
| <b>Other</b>                       |            |         |         |                    |            |       |        |
| Realized price <sup>(2)</sup>      | 20.77      | 20.43   | 19.26   | 8%                 | 20.50      | 18.93 | 8%     |
| Transportation                     | 1.01       | 1.04    | 0.88    | 15%                | 0.94       | 0.83  | 13%    |
| Adjusted realized price            | 19.76      | 19.39   | 18.38   | 8%                 | 19.56      | 18.10 | 8%     |
| <b>Average</b>                     |            |         |         |                    |            |       |        |
| Realized price <sup>(2)</sup>      | 42.70      | 87.32   | 68.29   | (37%)              | 74.60      | 55.93 | 33%    |
| Export customs duty <sup>(3)</sup> | 19.70      | 7.49    | n/a     | -                  | 8.71       | n/a   | -      |
| Transportation                     | 6.33       | 5.95    | 5.22    | 21%                | 6.00       | 5.07  | 19%    |
| Sales commissions                  | 0.06       | 0.05    | 0.05    | 16%                | 0.05       | 0.05  | 6%     |
| Adjusted realized price            | 16.61      | 73.83   | 63.02   | (73%)              | 59.84      | 50.81 | 18%    |

The difference between the benchmark quote and realized price on sales through the CPC pipeline mainly comprises freight costs, CPC quality bank payments, port charges, customs fees, certain sales commissions and averaging effects. The difference between the benchmark quote and realized price on sales through the UAS pipeline

mainly comprises freight costs, port charges, customs fees and certain sales commissions. The price received for domestic sales of crude oil is determined primarily by agreement with NC KMG (production cost +3%) and the price is usually significantly below market prices.

<sup>(1)</sup> The following quoted prices are used as benchmarks: Urals blend (FOB Odessa) for shipments through the UAS pipeline and CPC blend (FOB Novorossiysk) for shipments through the CPC pipeline.

<sup>(2)</sup> Converted at 7.23 barrels per tonne of crude oil.

<sup>(3)</sup> Customs duty on export of crude oil in the amount of US\$109.91 per tonne took effect from May 17, 2008 and changed to US\$203.8 per tonne effective from October 11, 2008.

*Operating Expenses*

The Company's operating expenses relate primarily to the

cost of producing crude oil. The following table presents the components of the Company's operating expenses:

|  | 4Q 2008            | 3Q 2008           | 4Q 2007           | 4Q on 4Q<br>change | 2008               | 2007               | Change     |
|--|--------------------|-------------------|-------------------|--------------------|--------------------|--------------------|------------|
|  | (KZT thousands)    |                   |                   | %                  | (KZT thousands)    |                    | %          |
| Export customs duty                      | 37,828,310         | 15,164,818        | -                 | -                  | 68,796,006         | -                  | -          |
| Transportation                           | 13,596,236         | 13,784,561        | 11,374,459        | 20%                | 53,135,541         | 48,247,039         | 10%        |
| Employee benefits                        | 14,481,320         | 10,672,173        | 11,065,804        | 31%                | 43,117,573         | 39,389,555         | 9%         |
| Depreciation, depletion and amortization | 9,189,229          | 8,982,929         | 9,070,117         | 1%                 | 34,368,825         | 34,663,502         | (1%)       |
| Royalties                                | 4,215,738          | 7,136,487         | 5,687,704         | (26%)              | 25,312,574         | 17,948,868         | 41%        |
| Repairs and maintenance                  | 9,520,458          | 5,901,833         | 6,252,956         | 52%                | 24,653,917         | 20,496,194         | 20%        |
| Materials and supplies                   | 2,385,015          | 3,599,466         | 4,271,200         | (44%)              | 12,717,118         | 13,878,706         | (8%)       |
| Energy                                   | 2,912,728          | 1,717,231         | 1,959,118         | 49%                | 9,291,579          | 7,633,700          | 22%        |
| Management fees and sales commissions    | 2,115,113          | 2,111,549         | 1,977,999         | 7%                 | 8,439,633          | 8,002,198          | 5%         |
| Other taxes                              | 2,087,593          | 1,508,202         | 993,009           | 110%               | 5,690,873          | 4,830,875          | 18%        |
| Fines and penalties                      | (193,026)          | 581,464           | 70,420            | (374%)             | 1,808,845          | 2,735,535          | (34%)      |
| Social projects                          | (1,100,810)        | 1,455,466         | 1,166,134         | (194%)             | 1,649,078          | 3,660,170          | (55%)      |
| Loss on disposal of fixed assets         | 503,142            | 85,469            | 1,794,865         | (72%)              | 852,909            | 2,992,114          | (71%)      |
| Change in crude oil balance              | (3,025,892)        | 479,444           | (1,547,941)       | 95%                | (4,656,735)        | (1,489,717)        | 213%       |
| Other                                    | 5,507,429          | 2,186,604         | 4,446,048         | 24%                | 11,989,737         | 7,845,746          | 53%        |
| <b>Total operating expenses</b>          | <b>100,022,583</b> | <b>75,367,696</b> | <b>58,581,892</b> | <b>71%</b>         | <b>297,167,473</b> | <b>210,834,485</b> | <b>41%</b> |

Operating expenses in 2008 increased by 41% to KZT297bn, compared to 2007 primarily due to the introduction of export customs duty from May, 2008 and the increase in royalties and transportation expenses. Excluding the export customs duty and increases in royalties and transportation expenses in 2008, the total operating expenses increased (by 2.5%) compared to 2007. The most significant amounts and movements are explained as follows:

Export customs duty expenses in 2008 occurred as a result of the introduction of customs fee on exported crude oil from May 17, 2008. The initial export duty rate was US\$109.91 per tonne, later changed to US\$203.8

per tonne effective from October 11, 2008. In accordance with the new tax code enacted on January 1, 2009 the Company in 2009 is not taxable by export customs duty in 2009 and instead will be subject to rent tax on export sales introduced from January 1, 2009.

Transportation expenses in 2008 increased by 10% compared with 2007 primarily due to the growth of average export tariff for crude oil transportation on export by UAS pipeline on the territory of Kazakhstan by 24.9% from January 1, 2008 and transportation tariff by CPC pipeline by 25.7% from October 1, 2007. This effect was partly mitigated by the decrease in volume of crude oil transported by 5% and a decline in demurrage expense in the amount KZT964 m in 2008 compared with 2007.

The increase of employee benefits in 2008 by 9% in comparison to 2007 is primarily due to the growth of basic salary by 10% to reflect inflation and the additional salary increase of production branch workers by approximately 40% starting from July 2008.

Royalties expense increased by KZT7.4bn, or 41% in 2008 compared with 2007. This increase is due to the general increase of average market prices for crude oil in 2008 comparing with 2007. From January 1, 2009 in accordance with the new tax code the royalties were replaced by the mineral extraction tax.

Repairs and maintenance expenses increased due to the increase in the cost and number of wells repaired, reservoir pressure maintenance G&G works and seismic works on R9 and Liman blocks.

Energy expenses increased by 22% due to the increase of energy tariff by 15% and energy transmission tariff by 37%.

Management fees are paid according to the management services agreement with NC KMG adjusted for a budgeted inflation rate of 7% (KZT8.01bn in 2008 compared to KZT7.49bn in 2007).

Other taxes expense increased by 18%, or KZT860m, in 2008 compared to the same period of 2007 primarily due to derecognizing reserves in 2007 for tolling VAT in the amount of KZT2.1bn which was partly diminished by the decrease of VAT expenses on VAT-exempt operations in 2008 for the amount KZT913m.

The expenses incurred due to fines and penalties in 2008 decreased by 34% compared to 2007 due to the fact that in 2007 the Company paid penalties on CIT, EPT, royalty, social tax upon a tax audit related to the period 2003-2004 years in total amount of KZT717.1m.

The decrease in expenses for social projects in 2008 was mainly due to scheduled completion of construction projects.

Losses on the disposal of fixed assets decreased by 71% to KZT853m in 2008 compared with 2007 primarily due to the write off of non-productive wells in 2007 due to the lower number of non-productive wells written off in 2008 versus 2007.

The change in crude oil balance of KZT4.7bn in 2008 was due to the growth of crude oil inventory.

Other expenses in 2008 increased by KZT4.1bn primarily due to the impairment in 2008 of investments and receivables in LLP KPI for KZT2.4bn, accrual in 2008 of bad debt provision in the amount of KZT1.1bn and reverse of due diligence expenses in 2007 for JV Kazgermunai LLP acquisition for KZT1.0bn.

Within the year 2008, significant increases in employee benefits, repairs and maintenance, energy and other expenses in 4Q 2008 primarily reflected seasonal factors and relevant accounting accruals.

#### *Finance income/costs and foreign exchange gain/loss (Net financial income/costs)*

The Company's financial income in each of the periods relates mainly to interest on deposits. The Company's financial costs in each of the periods mainly comprise interest on borrowings and the unwinding of a discount relating to asset retirement obligations.

The net financial income for 2008 was KZT42.9bn compared to the net financial income of KZT13.2bn in 2007. This was mainly due to the increase in interest income by KZT15.3bn, interest income from CCEL acquisition of KZT2.9bn and the decrease of foreign exchange loss for KZT9.1bn. The weighted average interest rate on deposits in 2008 was 8.84% per annum or 0.31% more than in 2007.

#### *Share of result of associates and joint ventures*

The Company's income from its share in associates and joint ventures in 2008 increased to KZT57.6bn in comparison to KZT17.4bn in 2007 primarily due to the increase of net income from JV Kazgermunai LLP' in the amount of KZT58.8bn.

#### *Income Tax Expense*

The income tax expense in 2008 increased by KZT16.6bn, or 11% to KZT167.1bn. The Company's overall effective tax rate decreased from 49% in 2007 to 41% in 2008.

|   | 4Q 2008         | 3Q 2008     | 4Q 2007     | 4Q on 4Q<br>change | 2008            | 2007        | Change |
|---|-----------------|-------------|-------------|--------------------|-----------------|-------------|--------|
|   | (KZT thousands) |             |             | %                  | (KZT thousands) |             | %      |
| Profit before tax   | 20,282,608      | 125,900,076 | 102,526,265 | (80%)              | 408,374,235     | 307,630,358 | 33%    |
| Profit before tax<br>(net of associates<br>and JV's results)  | 911,034         | 114,902,529 | 93,989,630  | (99%)              | 350,750,351     | 290,200,508 | 21%    |
| Income tax  | (2,456,922)     | 54,872,114  | 48,887,744  | (105%)             | 167,091,866     | 150,511,277 | 11%    |
| Effective tax rate  | (12%)           | 44%         | 48%         | (60%)              | 41%             | 49%         | (8%)   |
| Effective tax rate<br>(net of associates<br>and JV's results) | (270%)          | 48%         | 52%         | (322%)             | 48%             | 52%         | (4%)   |

The decline in the effective income tax rate in 2008 compared with 2007 was caused by the growth of the shared results of JV Kazgermunai LLP, a decrease in the effective excess profit tax rate, a decrease in non-deductible expenses together with higher deferred tax benefit as a result of the introduction of the new tax code and of lower income tax rates.

*Profit for the period*

As a result of the factors described above, in 2008 the Company's profit for the period increased by 54% to KZT241.3bn compared to 2007.

## Overview of Associates' Operations

### JV Kazgermunai LLP

JV Kazgermunai LLP' key financial and operational indicators are shown below:

|                                     | 4Q 2008  | 3Q 2008 | 4Q 2007 | 4Q on 4Q change | 2008      | 2007      | Change |
|-------------------------------------|----------|---------|---------|-----------------|-----------|-----------|--------|
| Revenue, US\$ thousands             | 159,618  | 547,412 | 399,610 | (60%)           | 1,768,697 | 1,275,844 | 39%    |
| Operating expenses, US\$ thousands  | 183,493  | 154,408 | 103,058 | 78%             | 494,908   | 278,529   | 78%    |
| Income tax expense, US\$ thousands  | 7,370    | 162,594 | 120,293 | (94%)           | 529,502   | 424,059   | 25%    |
| Net income, US\$ thousands          | (31,245) | 230,410 | 176,259 | (118%)          | 744,287   | 573,256   | 30%    |
| Capital expenditure, US\$ thousands | 54,316   | 55,171  | 47,485  | 14%             | 207,240   | 55,691    | 272%   |
| Crude oil production, th. tonnes    | 805      | 784     | 817     | (1%)            | 3,140     | 3,055     | 3%     |
| Crude oil sales, th. tonnes         | 813      | 760     | 719     | 13%             | 3,026     | 2,717     | 11%    |
| Export via Aktau                    | 375      | 255     | 413     | (9%)            | 1,448     | 1,435     | 1%     |
| Export via Kazakh-Chinese pipeline  | 370      | 373     | 170     | 118%            | 1,193     | 933       | 28%    |
| Export to Uzbekistan                | -        | -       | -       | -               | 5         | -         | -      |
| Domestic market                     | 68       | 132     | 136     | (50%)           | 380       | 349       | 9%     |

The Company's share (50%) in JV Kazgermunai LLP's oil production in 2008 is 1,570 thousand tonnes. In 2008 Kazgermunai incurred capital expenses in the amount of US\$207m. Equity income from the joint venture, included in the consolidated financial statements of the Company in 2008, is KZT58.8bn. The Company received US\$325m in distributed net profit from JV Kazgermunai LLP in 2008 (US\$300m in 2007).

In 2009 JV Kazgermunai LLP plans to produce 3.18m tonnes of crude oil and drill 17 development wells. Capital expenditures of US\$184m in 2009 is planned.

## CCEL

CCEL' key financial and operational indicators are shown below:

|                                     | 4Q 2008   | 3Q 2008 | 4Q 2007 | 4Q on 4Q change | 2008      | 2007    | Change |
|-------------------------------------|-----------|---------|---------|-----------------|-----------|---------|--------|
| Revenue, US\$ thousands             | 149,118   | 335,891 | 235,170 | (37%)           | 1,032,914 | 794,413 | 30%    |
| Operating expenses, US\$ thousands  | 179,372   | 134,787 | 143,056 | 25%             | 538,476   | 410,610 | 31%    |
| Income tax expense, US\$ thousands  | (123,652) | 107,186 | 40,337  | (407%)          | 148,489   | 190,069 | (22%)  |
| Net income, US\$ thousands          | 93,398    | 93,918  | 51,778  | 80%             | 345,949   | 193,734 | 79%    |
| Capital expenditure, US\$ thousands | 63,296    | 65,328  | 75,408  | (16%)           | 229,914   | 176,547 | 30%    |
| Crude oil production, th. tonnes    | 484       | 484     | 437     | 11%             | 1,829     | 1,942   | (6%)   |
| Crude oil sales, th. tonnes         | 491       | 490     | 433     | 13%             | 1,814     | 1,884   | (4%)   |
| Export via Makhachkala              | 403       | 371     | 346     | 17%             | 1,369     | 1,132   | 21%    |
| Export via Primorsk                 | 60        | 60      | 40      | 50%             | 234       | 229     | 2%     |
| Export via Iran                     | -         | -       | -       | -               | -         | 183     | (100%) |
| Export via Odessa                   | -         | -       | -       | -               | -         | 110     | (100%) |
| Domestic market                     | 28        | 59      | 48      | (41%)           | 211       | 230     | (8%)   |

In 2008 the Company recognized finance income from its investment in CCEL of KZT2.9bn. Capital expenses in 2008 of US\$230m were incurred, which was 30% more than in 2007.

In 2009 CCEL planned to produce 1.8 million tonnes of crude oil and drill 40 development wells versus the 304 drilled in 2008. Capital expenditure in 2009 is planned up to the amount of US\$81m. The decrease in CCEL's capital expenditure in 2009 mainly due to the decrease of production well drilling, construction and modernization of production assets.

## Liquidity and Capital Resources

### Summary of Cash Flows

The Company's liquidity requirements arise principally from the need to finance its existing operations (working capital), to finance investment (capital expenditure) and

realize its growth targets primarily via acquisition. The management believes that the Company has adequate liquidity to meet its short-term obligations and pursue investment opportunities.

|  | 4Q 2008         | 3Q 2008      | 4Q 2007       | 4Q on 4Q<br>change | 2008            | 2007          | Change |
|--|-----------------|--------------|---------------|--------------------|-----------------|---------------|--------|
|  | (KZT thousands) |              |               | %                  | (KZT thousands) |               | %      |
| Net cash generated from (used in) operating activities | (1,409,748)     | 89,873,087   | 63,639,283    | (102%)             | 163,854,907     | 172,961,468   | (5%)   |
| Net cash generated from (used in) investing activities | 257,172,971     | (47,338,347) | (113,038,098) | (328%)             | 140,539,758     | (164,678,826) | (185%) |
| Net cash used in financing activities                  | (937,815)       | (39,392,142) | (667,551)     | 40%                | (40,977,580)    | (44,974,056)  | (9%)   |

In 2008 net cash generated from operating activities was KZT163.9bn, KZT9.1bn less than in 2007. This decrease was mainly due to the introduction of the export duty and large amount of income taxes paid based on 2007 results and project 2008 profitability, which more than offset the growth in sales.

Net cash generated from investing activities increased to KZT140.5bn in 2008. The increase was due to a KZT229.9bn increase in net cash inflows from the operations with financial assets held to maturity, decrease in 2008 of cash used for purchase of interest in joint ventures for the amount of KZT135.3bn and increase of cash inflows from interest received by KZT31.2bn. The increase of cash generated from investing activities was partly mitigated by a decrease in 2008 of loan repayments received from related parties and associates to the amount of KZT95.5bn.

In 2008 and 2007, the Company's capital expenditure, calculated on a cash basis, was KZT41.9bn and KZT40.1bn, respectively.

Net cash used in financing activities reached KZT41.0bn in 2008 compared to KZT45.0bn in 2007. The decrease of cash used was mainly due to decrease in cash outflows for repayment of borrowings in 2008 for the amount of KZT7.9bn, which was partly offset by an increase of cash outflow for dividends paid to Company's shareholders by KZT3.8bn.

## Borrowings and cash position

The following table below shows the Company's net cash for the periods ended December 31, 2008, September 30, 2008 and December 31, 2007:

|                                      | As at December<br>31, 2008               | As at September<br>30, 2008 | As at December<br>31, 2007 | December on<br>December change |
|--------------------------------------|--|-----------------------------|----------------------------|--------------------------------|
|                                      | (KZT thousands, unless otherwise stated) |                             |                            | %                              |
| Current portion                      | 14,905,744                               | 18,624,980                  | 18,713,954                 | (20%)                          |
| Maturity over 1 year                 | 5,532,332                                | 878,213                     | 14,135,480                 | (61%)                          |
| Total borrowings                     | 20,438,076                               | 19,503,193                  | 32,849,434                 | (38%)                          |
| Cash and cash equivalents            | 285,131,743                              | 30,085,316                  | 21,658,451                 | 1216%                          |
| Other current financial assets       | 264,677,096                              | 512,237,965                 | 378,603,924                | (30%)                          |
| Non-current financial assets         | 5,108,021                                | 7,042,096                   | 1,953,799                  | 161%                           |
| Total financial assets               | 554,916,860                              | 549,365,377                 | 402,216,174                | 38%                            |
| US\$-denominated financial assets, % | 67%                                      | 67%                         | 47%                        | -                              |
| Net cash (debt)                      | 534,478,784                              | 529,862,184                 | 369,366,740                | 45%                            |

### Financial assets in BTA Bank

As reported in the press at the beginning of February 2009, during a press conference the Chairman of the Board of Directors of BTA Bank, Arman Dunaev, confirmed that BTA Bank has declined to make certain payments on behalf of some of the National Companies. One of KMG EP's February 2009 payment instructions, in the amount of KZT17bn, has been accepted for payment but delayed by BTA Bank. In April 2009 KMG EP made a number of relatively small payments out of its accounts with BTA Bank. The total sum of the Company's financial assets held in BTA Bank is approximately KZT43.5bn at the end of April 2009. Although the Company's access to its entire funds with BTA Bank remains uncertain, the current situation does not preclude KMG EP from conducting its business operations as normal and timely fulfilment of its obligations.

### Esomet Arrangement

On August 16, 2004 the Company entered into a crude oil sale agreement with Esomet and received a US\$600m long term advance with interest at Libor plus 1.75% per annum. On July 24, 2006 Esomet and the Company amended the Esomet Arrangement to include an additional payment of US\$50m, a reduction of the interest margin from 1.75% to 1.1% and the release of the existing NC KMG guarantee. As at December 31, 2008 the outstanding principal amount owed by the Company to Esomet amounted to US\$111m, or approximately KZT13.4bn and it is anticipated that the liability to Esomet will be fully discharged in 2009.

### **Forward-looking statements**

*This document includes statements that are, or may be deemed to be, «forward-looking statements». These forward-looking statements can be identified by the use of forward-looking terminology, including, but not limited to, the terms «believes», «estimates», «anticipates», «expects», «intends», «may», «target», «will», or «should» or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They include, but are not limited to, statements regarding the Company's intentions, beliefs and statements of current expectations concerning, amongst other things, the Company's results of operations, financial condition, liquidity, prospects, growth, potential acquisitions, strategies and as to the industries in which the Company*

*operates. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that may or may not occur. Forward-looking statements are not guarantees of future performance and the actual results of the Company's operations, financial condition and liquidity and the development of the country and the industries in which the Company operates may differ materially from those described in, or suggested by, the forward-looking statements contained in this document. The Company does not intend, and does not assume any obligation, to update or revise any forward-looking statements or industry information set out in this document, whether as a result of new information, future events or otherwise. The Company does not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved.*

# Risk Factors

The Company's operation is exposed to many risks and uncertainties in the economic, political, legislative, social and financial fields. When making decisions, stakeholders should take into consideration the risks that may affect the Company's financial and operational results.

In 2008 the Company implemented the corporate risk management system aimed to identify and manage risks. Based upon the results of risk identification and assessment, the Risk Management Committee (see page 25) developed a risk portfolio of the Company.

The Company's risk portfolio includes 24% of internal source risks and 68% of external influence source risks.

Internal source risks are fully under the Company's management control, and are directly connected to efficiency of the management and internal control system.

External source risks are beyond the Company's control and management system, but the Company takes possible measures in order to minimize and mitigate such risks.

Some information on risks is disclosed in the IPO and GDRs prospectus published on September 29, 2006, and the key financial risks analysis is included in the annual audited statements (see pages 77-80).

An additional, inexhaustive list of major risks is provided below.

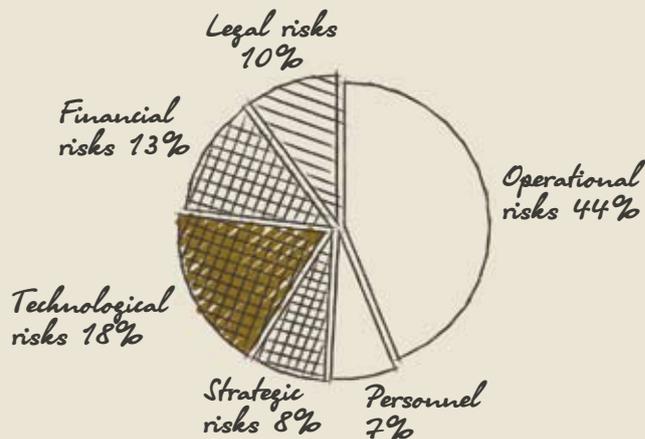
## *Volatility of the Price for Crude oil and Oil Products*

Changes in the price for crude oil and oil products are caused by the global macroeconomic conditions, political instability or conflict, actions of major crude oil exporting countries, weather conditions and natural calamities. Changes in crude oil and oil products prices may affect the level of expected revenues, investment decision making and operational activity. To this end, the Company drafts annual budgets and prepares periodic forecasts, including sensitivity analyses with regard to various future price levels for crude oil.

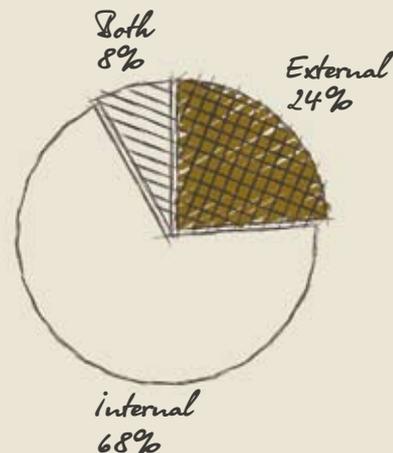
## *Personnel Risk*

Highly qualified personnel are a competitive advantage and the foundation for achieving the Company's strategic goals. Every year the Company encounters the problem of attracting the personnel possessing relevant qualifications. First of all it relates to the difficulty in recruiting qualified personnel due to the deficiency of a required category of experts on the labour market. Based on some reviews, the Company's current salary level is lower than the market indicators of salary level in the companies that are comparable by capitalization and by industry. To reduce this risk, the Company has initiated a project to implement an employee incentive scheme to bring salary levels to the level of market indicators in order to motivate and retain highly qualified personnel.

*Risk portfolio classified by categories*



*Analysis of risk sources*



In 2008 by resolution of the Company's Management Board, salaries were recalculated taking into account on the level of inflation.

*Changes in Legislation, Fiscal and Regulatory Regimes*

Changes in legislation on sub-soil use, tax and customs regulations may lead to an increase in the Company's fiscal burden, a decrease in its financial results, difficulties in operations and a reduction in its available investment resources. Depending on the change in tax and customs burden, the Company intends to revise its production and investment plans and amend them as required.

*Labour Protection, Safety and Environmental Protection*

The Company's operational activity is exposed to a wide range of risks. The main categories of HSE risk are the failure to comply with safety conditions, industrial accidents, environmental damage, ecological impact and natural disasters. The consequences of such risks can be very severe, including loss of life, pollution of air, soil and water, fire, layoff or shutdown of production. Depending upon the cause of these events, the consequences may have a negative impact on reputation, financial and operational activity of the Company. With regard to industrial safety and labour protection, the Company takes all advanced measures for risk liability prevention by exercising operative control over safety and labour protection, identifying hazards and training the personnel.

In 2008 Company implemented and now successfully operates the integrated system in accordance with international standards ISO 14001 and OHSAS 18001.

*Exploration*

As is experienced worldwide, exploration always carries a risk of non-commercial hydrocarbon discovery and/or drilling a dry well. To mitigate exploration risks, a number of geology and geophysics surveys is conducted which, in addition to a traditional seismic survey, includes a geochemical survey, high-resolution electric exploration, and special methods such as seismic exploration and gravimetric measurements.

*Partners*

The Company cooperates with many foreign and local companies on a variety of areas of its business. The Company has a limited opportunity to influence the behavior and operations of its partners which may affect the operational and financial results of the Company. Therefore, the Company is working to develop long-term, loyal and mutually beneficial partnerships. In order to mitigate risks of violations or defaults on partners' obligations the Company insists on serious penalty clauses in contracts.

*Information Technology*

The Company is exposed to risks in the area of information technology due to the utilization and implementation of a variety of high-technology hardware and software to maintain effective operations. In this connection, problems with the adaptation of new hardware and software, and providing a safe storage of confidential business data may emerge. In order to ensure effective work in this area, every year the Company analyses the technology used and, while selecting and purchasing, gives preference to the most adaptable and reputable information technology, and ensures reliable control of access to the databases.

## Independent Auditors' Report

*To the shareholders and management of Joint Stock Company KazMunaiGas Exploration Production*

We have audited the accompanying consolidated financial statements of Joint Stock Company KazMunaiGas Exploration Production and its subsidiaries («the Company»), which comprise the consolidated balance sheet as at 31 December 2008, and the consolidated statement of income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Ernst & Young LLP*



# Consolidated Financial Statements



*KazMunaiGas Exploration Production Joint Stock Company  
For the year ended December 31, 2008*

## Consolidated Balance Sheet

Tenge thousands

As at December 31,

|  | Notes | 2008                 | 2007               |
|--|-------|----------------------|--------------------|
| <b>ASSETS</b>                                |       |                      |                    |
| <b>Non-current assets</b>                    |       |                      |                    |
| Property, plant and equipment                | 4     | 248,920,924          | 246,673,657        |
| Other financial assets                       | 6     | 5,108,021            | 1,953,799          |
| Receivable from jointly controlled entity    | 7     | 18,862,017           | 18,478,228         |
| Intangible assets                            | 5     | 2,831,782            | 5,548,240          |
| Investments in associates and joint ventures | 7     | 121,910,766          | 102,999,132        |
| Deferred tax asset                           | 16    | 1,428,948            | –                  |
| Other assets                                 |       | 3,519,908            | 4,045,763          |
| <b>Total non-current assets</b>              |       | <b>402,582,366</b>   | <b>379,698,819</b> |
| <b>Current assets</b>                        |       |                      |                    |
| Inventories                                  | 8     | 14,405,863           | 11,583,258         |
| Taxes prepaid and VAT recoverable            |       | 8,352,503            | 5,378,089          |
| Prepaid and deferred expenses                |       | 6,562,709            | 4,845,333          |
| Trade and other receivables                  | 6     | 37,819,473           | 50,083,867         |
| Other financial assets                       | 6     | 264,677,096          | 378,603,924        |
| Cash and cash equivalents                    | 6     | 285,131,743          | 21,658,451         |
| <b>Total current assets</b>                  |       | <b>616,949,387</b>   | <b>472,152,922</b> |
| <b>Total assets</b>                          |       | <b>1,019,531,753</b> | <b>851,851,741</b> |
| <b>EQUITY</b>                                |       |                      |                    |
| Share capital                                | 9     | 259,724,847          | 259,365,914        |
| Other reserves                               |       | 1,308,839            | 580,988            |
| Retained earnings                            |       | 586,058,950          | 386,494,710        |
| <b>Total equity</b>                          |       | <b>847,092,636</b>   | <b>646,441,612</b> |
| <b>LIABILITIES</b>                           |       |                      |                    |
| <b>Non-current liabilities</b>               |       |                      |                    |
| Borrowings                                   | 11    | 5,532,332            | 14,135,480         |
| Deferred tax liability                       | 16    | –                    | 7,784,439          |
| Provisions                                   | 12    | 38,716,666           | 48,157,460         |
| <b>Total non-current liabilities</b>         |       | <b>44,248,998</b>    | <b>70,077,379</b>  |
| <b>Current liabilities</b>                   |       |                      |                    |
| Borrowings                                   | 11    | 14,905,744           | 18,713,954         |
| Income taxes payable                         |       | 55,806,901           | 59,356,770         |
| Trade and other payables                     |       | 32,380,235           | 35,184,485         |
| Provisions                                   | 12    | 25,097,239           | 22,077,541         |
| <b>Total current liabilities</b>             |       | <b>128,190,119</b>   | <b>135,332,750</b> |
| <b>Total liabilities</b>                     |       | <b>172,439,117</b>   | <b>205,410,129</b> |
| <b>Total liabilities and equity</b>          |       | <b>1,019,531,753</b> | <b>851,851,741</b> |

The notes on pages 57 to 83 are an integral part of these consolidated financial statements.

## Consolidated Statement of Income

| <i>Tenge thousands</i>                           | For the year ended December 31, |               |               |
|--|---------------------------------|---------------|---------------|
|  | Notes                           | 2008          | 2007          |
| <b>CONTINUING OPERATIONS</b>                     |                                 |               |               |
| Revenue  | 13                              | 604,993,422   | 486,974,879   |
| Operating expenses                               | 14                              | (297,167,473) | (210,834,485) |
| Profit from operations                           |                                 | 307,825,949   | 276,140,394   |
| Finance income                                   | 15                              | 45,374,578    | 27,336,231    |
| Finance costs                                    | 15                              | (3,146,631)   | (6,093,363)   |
| Foreign exchange gain (loss)                     |                                 | 696,455       | (8,042,582)   |
| Gain on sale of subsidiaries                     |                                 | –             | 859,828       |
| Share of result of associates and joint ventures |                                 | 57,623,884    | 17,429,850    |
| Profit before tax                                |                                 | 408,374,235   | 307,630,358   |
| Income tax expense                               | 16                              | (167,091,866) | (150,511,277) |
| Profit for the year                              |                                 | 241,282,369   | 157,119,081   |
| <b>EARNINGS PER SHARE</b>                        |                                 |               |               |
| Basic and diluted                                | 10                              | 3.26          | 2.12          |

*The notes on pages 57 to 83 are an integral part of these consolidated financial statements.*

## Consolidated Statement of Cash Flows

Tenge thousands

For the year ended December 31,

|   | Notes | 2008          | 2007          |
|---|-------|---------------|---------------|
| <b>Cash flows from operating activities</b>                                 |       |               |               |
| Profit before income tax  |       | 408,374,235   | 307,630,358   |
| Adjustments to add (deduct) non-cash items                                  |       |               |               |
| Depreciation, depletion and amortisation                                    |       | 34,368,825    | 34,663,502    |
| Share of result of associates and joint ventures                            |       | (57,623,884)  | (17,429,850)  |
| Settlement of crude oil under the terms of a pre-export financing agreement |       | (17,862,800)  | (18,173,826)  |
| Loss on disposal of property, plant and equipment (PPE)                     |       | 852,909       | 2,992,114     |
| Impairment of PPE   |       | 183,086       | 1,863,910     |
| Recognition of share-based payments   |       | 354,612       | 1,579,975     |
| Impairment of investments in joint venture                                  |       | 2,396,198     | –             |
| Accrual of allowance for doubtful receivables                               |       | 1,057,105     | –             |
| Gain on disposal of subsidiaries  |       | –             | (859,828)     |
| Unrealised foreign exchange (gain) loss                                     |       | (464,941)     | 7,906,399     |
| Other non-cash income and expense   |       | 5,840,391     | 4,049,298     |
| Add interest expense  |       | 3,146,631     | 5,787,911     |
| Deduct interest income relating to investing activity                       |       | (45,374,578)  | (27,030,779)  |
| Working capital adjustments   |       |               |               |
| Change in other assets  |       | (10,008)      | (202,451)     |
| Change in inventories   |       | (2,607,882)   | 2,552,904     |
| Change in taxes prepaid and VAT recoverable                                 |       | (2,587,032)   | 114,467       |
| Change in prepaid and deferred expenses                                     |       | (1,815,510)   | (999,296)     |
| Change in trade and other receivables                                       |       | 11,241,450    | (13,303,022)  |
| Change in trade and other payables  |       | 1,241,412     | (5,496,872)   |
| Change in provisions  |       | (3,578,130)   | (2,455,217)   |
| Income tax paid   |       | (173,277,182) | (110,228,229) |
| Net cash generated from operating activities                                |       | 163,854,907   | 172,961,468   |

The notes on pages 57 to 83 are an integral part of these consolidated financial statements.

## Consolidated Statement of Cash Flows (continued)

| <i>Tenge thousands</i>  | For the year ended December 31, |                     |                      |
|---|---------------------------------|---------------------|----------------------|
|   | Notes                           | 2008                | 2007                 |
| <b>Cash flows from investing activities</b>   |                                 |                     |                      |
| Purchases of PPE  |                                 | (41,891,804)        | (40,095,396)         |
| Proceeds from sale of PPE   |                                 | 545,183             | 65,759               |
| Purchases of intangible assets  |                                 | (227,771)           | (26,464)             |
| Purchases of joint venture interests and loan receivable from jointly controlled entity |                                 | (1,816,093)         | (137,157,588)        |
| Dividends received from joint ventures and associates                                   |                                 | 39,164,528          | 36,179,141           |
| Sale (purchases) of financial assets held-to-maturity, net                              |                                 | 91,555,956          | (138,309,725)        |
| Sale (purchases) of available-for-sale financial assets, net                            |                                 | 6,449,113           | (6,767,606)          |
| Loan repayments received from related parties   |                                 | 2,036,327           | 97,540,000           |
| Proceeds related to disposal of subsidiaries  |                                 | -                   | 10,346,935           |
| Interest received   |                                 | 44,724,319          | 13,546,118           |
| <b>Net cash generated from (used in) investing activities</b>                           |                                 | <b>140,539,758</b>  | <b>(164,678,826)</b> |
| <b>Cash flows from financing activities</b>   |                                 |                     |                      |
| Exercise of share-based options   |                                 | 299,279             | -                    |
| Purchase of treasury shares   |                                 | (521,318)           | -                    |
| Proceeds from borrowings  |                                 | 30,000              | 1,995,378            |
| Repayment of borrowings   |                                 | (311,960)           | (8,174,960)          |
| Dividends paid to Company's shareholders  |                                 | (39,504,759)        | (35,705,178)         |
| Interest paid   |                                 | (968,822)           | (3,089,296)          |
| <b>Net cash used in financing activities</b>  |                                 | <b>(40,977,580)</b> | <b>(44,974,056)</b>  |
| <b>Net change in cash and cash equivalents</b>  |                                 | <b>263,417,085</b>  | <b>(36,691,414)</b>  |
| Cash and cash equivalents at beginning of the year                                      | 6                               | 21,658,451          | 62,459,415           |
| Exchange losses on cash and cash equivalents  |                                 | 56,207              | (4,109,550)          |
| <b>Cash and cash equivalents at end of the year</b>                                     | <b>6</b>                        | <b>285,131,743</b>  | <b>21,658,451</b>    |

*The notes on pages 57 to 83 are an integral part of these consolidated financial statements.*

## Consolidated Statement of Changes in Equity

Tenge thousands

|   | Attributable to equity holders of the Company |                |                |                   | Minority interest | Total equity |
|---|---|----------------|----------------|-------------------|-------------------|--------------|
|   | Share capital                                 | Treasury stock | Other reserves | Retained earnings |                   |              |
| As at January 1, 2007   | 263,094,581                                   | (3,818,100)    | 92,249         | 266,383,385       | 5,700             | 525,757,815  |
| Disposal of subsidiaries  | -   | -              | -              | -                 | (5,700)           | (5,700)      |
| Foreign currency translation  | -   | -              | (655,350)      | -                 | -                 | (655,350)    |
| Recognition of share-based payments   | -   | -              | 1,579,975      | -                 | -                 | 1,579,975    |
| Exercise of employee options  | -   | 89,433         | -              | -                 | -                 | 89,433       |
| Net loss on available-for-sale financial investments  | -   | -              | (435,886)      | -                 | -                 | (435,886)    |
| Dividends   | -   | -              | -              | (37,007,756)      | -                 | (37,007,756) |
| Profit for the year   | -   | -              | -              | 157,119,081       | -                 | 157,119,081  |
| As at December 31, 2007   | 263,094,581                                   | (3,728,667)    | 580,988        | 386,494,710       | -                 | 646,441,612  |
| Foreign currency translation  | -   | -              | 579,154        | -                 | -                 | 579,154      |
| Recognition of share-based payments   | -   | -              | 354,612        | -                 | -                 | 354,612      |
| Exercise of employee options  | -   | 880,251        | (641,801)      | -                 | -                 | 238,450      |
| Share buy back  | -   | (521,318)      | -              | -                 | -                 | (521,318)    |
| Realised loss on available-for sale financial investments reclassified to statement of income | -   | -              | 435,886        | -                 | -                 | 435,886      |
| Dividends   | -   | -              | -              | (41,718,129)      | -                 | (41,718,129) |
| Profit for the year   | -   | -              | -              | 241,282,369       | -                 | 241,282,369  |
| As at December 31, 2008   | 263,094,581                                   | (3,369,734)    | 1,308,839      | 586,058,950       | -                 | 847,092,636  |

The notes on pages 57 to 83 are an integral part of these consolidated financial statements.

# Notes to the Consolidated Financial Statements

*Tenge thousands unless otherwise stated*

## 1 Organization and principal activities

KazMunaiGas Exploration Production Joint Stock Company («the Company») has been incorporated in the Republic of Kazakhstan and is engaged in the acquisition, exploration, development, production, processing and export of hydrocarbons with its core operations of oil and gas properties located in the Pre-Caspian and Mangistau basins of western Kazakhstan. The Company's direct majority shareholder is Joint Stock Company National Company KazMunaiGas («NC KMG» or the «Parent Company»), which represents the state's interests in the Kazakh oil and gas industry and which holds 58.19% of the Company's outstanding shares as at December 31, 2008 (2007: 57.95%). From June 2006 NC KMG was 100%-owned by joint stock company Kazakhstan Holding for Management of State Assets «Samruk» («Samruk») which is in turn 100% owned by the government of the Republic of Kazakhstan (the «Government»). In October 2008 Samruk was merged with the Government owned Sustainable Development Fund «Kazyna» and formed joint stock company SamrukKazyna National Welfare Fund.

The Company conducts its principal operations through the Uzenmunaigas and Embamunaigas production divisions. In addition the Company has a 50% interest in a jointly controlled oil and natural gas producer and a receivable from a jointly controlled entity (Note 7). These consolidated financial statements reflect the financial position and results of operations of those divisions, jointly controlled entities and certain other controlling and non-controlling interests in predominantly non-core entities. Such other non-core interests represented approximately 1% of the Company's net assets at December 31, 2008 (2007: 2%).

## 2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

### 2.1 Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards («IFRS»). The consolidated financial statements have been prepared under the historical cost convention except for financial instruments.

#### *Adopted accounting standards and interpretations*

The Company has adopted the following new and amended IFRS and International Financial Reporting Interpretations Committee («IFRIC») interpretations during the year. Adoption of these revised standards and interpretations did not have any effect on the financial performance or position of the Company.

- IAS 23 Borrowing costs - amendment
- IFRIC 11 / IFRS 2 Group and Treasury Share Transactions
- IFRIC 12 Service Concession Arrangements
- IFRIC 14 / IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

#### *IAS 23 Amended – Borrowing costs*

This standard has been revised to require capitalization of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. This standard has no effect on the financial position or performance of the Company.

#### *IFRIC 11 / IFRS 2 – Group and Treasury Share Transactions*

This interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. The amendment of its accounting policy had no impact on the financial position or performance of the Company.

#### *IFRIC 12 Service Concession Arrangements*

The IFRIC issued IFRIC 12 in November 2006. This interpretation applies to service concession operators and explains how to account for the obligations taken and rights received in service concession arrangements. The Company has no such concessions, therefore this interpretation has no impact on the Company.

#### *IFRIC 14 / IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

IFRIC Interpretation 14 provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under IAS 19 Employee Benefits. The Company amended its accounting policy accordingly. The Company's defined benefit schemes have been in deficit, therefore the adoption of this interpretation had no impact on the financial position or performance of the Company.

#### *New accounting developments*

The following IFRS and IFRIC interpretations are not yet in effect as at December 31, 2008:

- IFRS 2 Share-based Payment – Vesting Conditions and Cancellations - amendment
- IFRS 3R Business Combinations
- IFRS 8 Operating Segments
- IAS 1 Presentation of Financial Statements - amendment
- IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation – amendments
- IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items - amendment

- IFRIC 13 Customer Loyalty Programmes
- IFRIC 15 Agreements for the Construction of Real Estate
- IFRIC 16 Hedges of a Net Investment in a Foreign Operation
- IFRIC 17 Distributions of Non-Cash Assets to Owners
- IFRIC 18 Transfer of Assets from Customers

Management does not expect the above standards and interpretations to have a material impact on the Company's financial position or results of operations.

## **2.2 Consolidation**

### *Subsidiaries*

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are no longer consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries are consistent with those of the Company.

### *Associates*

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Company's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Company's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in equity is recognised in equity. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Company's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Company does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

*Interests in joint ventures*

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control, and a jointly controlled entity is a joint venture that involves the establishment of a separate entity in which each venturer has an interest.

The Company recognizes its interest in joint ventures using the equity method. The financial statements of the joint ventures are prepared for the same reporting period as the parent company, using consistent accounting policies.

When the Company contributes or sells assets to the joint ventures, any portion of gain or loss from the transaction is recognized based on the substance of the transaction. When the Company purchases assets from the joint ventures, the Company does not recognize its share of the profits of the joint venture from the transaction until it resells the assets to an independent party.

**2.3 Foreign currency translation**

The consolidated financial statements are presented in Kazakhstan Tenge («Tenge»), which is the Company's functional and presentation currency. Each subsidiary, associate and joint venture of the Company determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to profit or loss. Non monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

The assets and liabilities of foreign operations are translated into Tenge at the rate of exchange ruling at the balance sheet date and their income statements are translated at the weighted average exchange rates for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in profit or loss.

**2.4 Oil and natural gas exploration and development expenditure***Exploration license costs*

Exploration license costs are capitalized within intangible assets and amortized on a straight-line basis over the estimated period of exploration. Each property is reviewed on an annual basis to confirm that drilling

activity is planned and it is not impaired. If no future activity is planned, the remaining balance of the license costs is written off. Upon determination of economically recoverable reserves («proved reserves» or «commercial reserves»), amortization ceases and the remaining costs are aggregated with exploration expenditure and held on a field-by-field basis as proved properties awaiting approval within other intangible assets. When development is approved internally, and all licenses and approvals are obtained from the appropriate regulatory bodies, then the relevant expenditure is transferred to property, plant and equipment (oil and natural gas properties).

*Exploration expenditure*

Geological and geophysical exploration costs are charged against income as incurred. Costs directly associated with an exploration well are capitalized within property, plant and equipment (construction work-in-progress) until the drilling of the well is complete and the results have been evaluated. These costs include employee remuneration, materials, fuel and energy used, rig costs and payments made to contractors. If hydrocarbons are not found, the exploration expenditure is written off as a dry hole. If hydrocarbons are found and, subject to further appraisal activity, which may include the drilling of further wells (exploration or exploratory-type stratigraphic test wells), are likely to be capable of commercial development then, the costs continue to be carried as an asset. All such carried costs are subject to technical, commercial and management review at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off.

When proved reserves of oil and natural gas are determined and development is sanctioned, the relevant expenditure is transferred to property, plant and equipment (oil and natural gas properties).

*Development expenditure*

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, except for expenditure related to development or delineation wells which do not find commercial quantities of hydrocarbons and are written off as dry hole expenditures in the period, is capitalized within property, plant and equipment.

**2.5 Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation, depletion and impairment.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation and the initial estimate of any decommissioning obligation, if any. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Oil and natural gas properties are depreciated using a unit-of-production method over proved developed reserves. Certain oil and gas property with useful lives less than the remaining life of the fields are depreciated on a straight-line basis over useful lives of 4-10 years.

Other property, plant and equipment principally comprise buildings and machinery and equipment which are depreciated on a straight-line basis over average useful lives of 24 and 7 years respectively.

The expected useful lives of property, plant and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The carrying value of property, plant and equipment is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

An item of property, plant and equipment, inclusive of production wells which stop producing commercial quantities of hydrocarbons and are scheduled for abandonment, is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognized.

## 2.6 Impairment of non-financial assets

The Company assesses assets or groups of assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Individual assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. If any such indication of impairment exists or when annual impairment testing for an asset group is required, the Company makes an estimate of its recoverable amount. An asset group's recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of an asset group exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are adjusted for the risks specific to the asset group and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment

loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss.

After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

## 2.7 Intangible assets

Intangible assets are stated at cost, less accumulated amortization and accumulated impairment losses. Intangible assets include expenditure on acquiring licenses for oil and natural gas exploration and computer software. Intangible assets acquired separately from a business are carried initially at cost. The initial cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

The expected useful lives of the assets are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively. Computer software costs have an estimated useful life of 3 to 7 years.

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

## 2.8 Financial assets

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, held to maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

The Company determines the classification of its financial assets on initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end.

All regular way purchases and sales of financial assets are recognized on the trade date, which is the date that the Company commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

*Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. After initial measurement held-to-maturity investments are measured at amortized cost using the effective interest method.

*Trade and other receivables*

Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement trade and other receivables are carried at amortized cost using the effective interest method less any allowance for impairment.

*Available-for-sale financial investments*

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the other categories. After initial measurement, available-for-sale financial assets are measured at fair value with unrealized gains or losses recognized directly in equity until the investment is derecognized or determined to be impaired at which time the cumulative gain or loss previously recorded in equity is recognized in profit or loss.

*Fair value*

The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis or other valuation models.

*Impairment of financial assets*

The Company assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

*Assets carried at amortised cost*

If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (ie the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss shall be recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed, to the extent that the carrying value of the

asset does not exceed its amortised cost at the reversal date. Any subsequent reversal of an impairment loss is recognized in profit or loss.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

*Available-for-sale financial investments*

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognised in profit or loss. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

*Derecognition of financial assets*

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a «pass through» arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

**2.9 Inventories**

Inventories are stated at the lower of cost and net realizable value on a first-in first-out («FIFO») basis. Cost includes all costs incurred in the normal course of business in bringing each item to its present location and condition. The cost of crude oil is the cost of production, including the appropriate proportion of depreciation, depletion and amortization («DD&A») and overheads based on normal capacity. Net realizable value of crude oil is based on estimated selling price in the ordinary course of business less any costs expected to be incurred to complete the sale. Materials and supplies inventories are carried at amounts that do not exceed the expected amounts recoverable in the normal course of business.

### 2.10 Value added tax (VAT)

The tax authorities permit the settlement of VAT on sales and purchases on a net basis. VAT recoverable represents VAT on domestic purchases net of VAT on domestic sales. Export sales are zero rated.

### 2.11 Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand deposits with banks, other short-term highly liquid investments with original maturities of three months or less.

### 2.12 Share capital

#### *Share Capital*

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares are shown as a deduction from the proceeds in equity.

#### *Treasury Shares*

Where the Company or its subsidiaries purchases the Company's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from equity as treasury shares until such time as the shares are cancelled or reissued. No gain or loss is recognized in the income statement on the purchase, sale, issue or cancellation of the Company's own equity instruments. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at weighted average cost.

#### *Dividends*

Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorised for issue.

### 2.13 Trade payables

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

### 2.14 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised.

### 2.15 Deferred income tax

Deferred tax assets and liabilities are calculated in respect of temporary differences using the balance sheet method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

### 2.16 Employee benefits

#### *Pension scheme*

The Company withholds 10% from the salary of its employees as the employees' contribution to their designated pension funds. The pension deductions are limited to 75 minimal monthly salary levels of 10,515 Tenge per month in first six months of 2008 and 12,025 Tenge per month in last six months of 2008 (2007: 9,752 Tenge). Under the current Kazakhstan legislation, employees are responsible for their retirement benefits.

## 2.17 Revenue recognition

The Company sells crude oil under short-term agreements priced by reference to Platt's index quotations and adjusted for freight, insurance and quality differentials. Title typically passes and revenues are recognized when crude oil is physically placed onboard a vessel or offloaded from the vessel, transferred into pipe or other delivery mechanism depending on the contractually agreed terms.

The Company's crude oil sale contracts generally specify maximum quantities of crude oil to be delivered over a certain period. Crude oil shipped but not yet delivered to the customer is recorded as inventory in the balance sheet.

## 2.18 Income taxes

Excess profit tax (EPT) is treated as an income tax and forms part of income tax expense. In accordance with the subsoil agreements, the Company accrues and pays EPT, at a rate of 30% of after tax profit which has been adjusted for specific deductions in accordance with the applicable subsoil agreements, when certain internal rates of return are exceeded.

The internal rate of return is calculated based on the cash flows from each subsoil agreement, adjusted for the national inflation rate. Deferred tax is calculated with respect to both corporate income tax (CIT) and EPT. Deferred EPT is calculated on temporary differences for assets allocated to contracts for subsoil use at the expected rate of EPT to be paid under the contract.

# 3 Significant accounting estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities during the reporting period. The most significant estimates are discussed below:

### *Oil and gas reserves*

Oil and gas reserves are a material factor in the Company's computation of DD&A. The Company estimates its reserves of oil and gas in accordance with the methodology of the Society of Petroleum Engineers (SPE). In estimating its reserves under SPE methodology, the Company uses long-term planning prices. Using planning prices for estimating proved reserves removes the impact of the volatility inherent in using year end spot prices. Management believes that long-term planning price assumptions, which are also used by management for their investment decisions, are more consistent with the long-term nature of the upstream business and provide the most appropriate basis for estimating oil and gas reserves.

All reserve estimates involve some degree of uncertainty. The uncertainty depends chiefly on the amount of reliable geological and engineering data available at the time of the estimate and the interpretation of this data.

The relative degree of uncertainty can be conveyed by placing reserves into one of two principal classifications, either proved or unproved. Proved reserves are more certain to be recovered than unproved reserves and may be further sub-classified as developed and undeveloped to denote progressively increasing uncertainty in their

recoverability. Estimates are reviewed and revised annually. Revisions occur due to the evaluation or re-evaluation of already available geological, reservoir or production data; availability of new data; or changes to underlying price assumptions. Reserve estimates may also be revised due to improved recovery projects, changes in production capacity or changes in development strategy. Proved developed reserves are used to calculate the unit of production rates for DD&A. The Company has included in proved reserves only those quantities that are expected to be produced during the initial license period. This is due to the uncertainties surrounding the outcome of such renewal procedures, since the renewal is ultimately at the discretion of the Government. An increase in the Company's license periods and corresponding increase in reported reserves would generally lead to lower DD&A expense and could materially affect earnings. A reduction in proved developed reserves will increase DD&A expense (assuming constant production), reduce income and could also result in an immediate write-down of the property's book value. Given the relatively small number of producing fields, it is possible that any changes in reserve estimates year on year could significantly affect prospective charges for DD&A.

### *Asset retirement obligations*

Under the terms of certain contracts, legislation and regulations the Company has legal obligations to dismantle and remove tangible assets and restore the land at each production site. Specifically, the Company's obligation relates to the ongoing closure of all non-productive wells and final closure activities such as removal of pipes, buildings and recultivation of the contract territories. Since the license terms cannot be extended at the discretion of the Company, the settlement date of the final closure obligations has been assumed to be the end of each license period. If the asset retirement obligations were to be settled at the end of the

economic life of the properties, the recorded obligation would increase significantly due to the inclusion of all abandonment and closure costs. The extent of the Company's obligations to finance the abandonment of wells and for final closure costs depends on the terms of the respective contracts and current legislation. Where neither contracts nor legislation include an unambiguous obligation to undertake or finance such final abandonment and closure costs at the end of the license term, no liability has been recognized. There is some uncertainty and significant judgment involved in making such a determination. Management's assessment of the presence or absence of such obligations could change with shifts in policies and practices of the Government or in the local industry practice. The Company calculates asset retirement obligations separately for each contract. The amount of the obligation is the present value of the estimated expenditures expected to be required to settle the obligation adjusted for expected inflation and discounted using average long-term risk-free interest rates for emerging market sovereign debt adjusted for risks specific to the Kazakhstan market. The Company reviews site restoration provisions at each balance sheet date, and adjusts them to reflect the current best estimate in accordance with IFRIC 1 «Changes in Existing Decommissioning, Restoration and Similar Liabilities». Estimating the future closure costs involves significant estimates and judgments by management. Most of these obligations are many years in the future and, in addition to ambiguities in the legal requirements, the Company's estimate can be affected by changes in asset removal technologies, costs and industry practice. Approximately 11.5% and 12.7% of the provision at December 31, 2008 and 2007 relates to final closure costs, respectively. Uncertainties related to the final closure costs are mitigated by the effects of discounting the expected cash flows. The Company estimates future well abandonment cost using current year prices and the average long-term inflation rate.

The long-term inflation and discount rates used to determine the balance sheet obligation at December 31, 2008 were 5.0% and 7.9% respectively (2007: 5.0% and 7.9%). Movements in the provision for asset retirement obligations are disclosed in Note 12.

#### *Environmental remediation*

The Company also makes judgments and estimates in establishing provisions for environmental remediation obligations. Environmental expenditures are capitalized or expensed depending upon their future economic benefit. Expenditures that relate to an existing condition caused by past operations and do not have a future economic benefit are expensed.

Liabilities are determined based on current information about costs and expected plans for remediation and are recorded on an undiscounted basis if the timing of the procedures has not been agreed with the relevant authorities. The Company's environmental remediation provision represents management's best estimate based on an independent assessment of the anticipated expenditure necessary for the Company to remain in compliance with the current regulatory regime in Kazakhstan. Pursuant to a memorandum of understanding («MOU») signed with the Ministry of the Environment in July 2005, the Company agreed to take responsibility for remediation of certain soil contamination and oil waste disposal which resulted from oil extraction dating back to the commencement of production. As at the date of these financial statements the scope and timing of the remediation plan has not been formally agreed with the Government. Accordingly, the liability has not been discounted. As the terms of the liability have not yet been established and management reasonably expects to execute the remediation plan over a period of up to ten years, the Company has classified this obligation as non-current except for the portion of costs, agreed with the relevant authorities, expected to be incurred in 2009. For environmental remediation provisions, actual costs can differ from estimates because of changes in laws and regulations, public expectations, discovery and analysis of site conditions and changes in clean-up technology.

Further uncertainties related to environmental remediation obligations are detailed in Note 20. Movements in the provision for environmental remediation obligations are disclosed in Note 12.

#### *Taxation*

The Company accrues and pays CIT at a rate of 30% of taxable income in 2008. Taxable income is computed in accordance with stabilized tax legislation of each subsoil contract. EPT is treated as an income tax and forms part of income tax expense. In accordance with the subsoil agreements, the Company accrues and pays EPT, at a rate of 30% of after tax profit which has been adjusted for specific deductions in accordance with the applicable subsoil agreements, when certain internal rates of return are exceeded. The internal rate of return is calculated based on the cash flows from each subsoil agreement, adjusted for the national inflation rate.

Deferred tax is calculated with respect to both CIT and EPT. Deferred CIT and EPT are calculated on temporary differences for assets and liabilities allocated to contracts for subsoil use at the expected rates that were enacted by the new tax code of Kazakhstan on January 1, 2009. Both deferred CIT and EPT bases are calculated under the terms of the tax legislation enacted in the above mentioned new tax code disclosed in Note 16.

## 4 Property, plant and equipment

|   | Oil-and-gas<br>properties | Other<br>assets | Construction<br>work-in-progress | Total         |
|---|---------------------------|-----------------|----------------------------------|---------------|
| <b>2007</b>                                     |                           |                 |                                  |               |
| Opening net book amount<br>at January 1, 2007   | 202,670,160               | 46,267,153      | 10,396,059                       | 259,333,372   |
| Additions                                       | 882,535                   | 3,905,958       | 37,259,086                       | 42,047,579    |
| Change in ARO estimate                          | (2,204,963)               | –               | –                                | (2,204,963)   |
| Disposal of subsidiaries                        | –                         | (8,526,860)     | –                                | (8,526,860)   |
| Disposals                                       | (3,253,513)               | (4,232,607)     | (2,788,893)                      | (10,275,013)  |
| Transfers from work-in-progress                 | 34,384,609                | 4,584,445       | (38,969,054)                     | –             |
| Depreciation charge                             | (26,581,417)              | (5,255,131)     | –                                | (31,836,548)  |
| Impairment / reversal                           | 553,868                   | 149,460         | (2,567,238)                      | (1,863,910)   |
| Closing net book amount<br>at December 31, 2007 | 206,451,279               | 36,892,418      | 3,329,960                        | 246,673,657   |
| <b>At December 31, 2007</b>                     |                           |                 |                                  |               |
| Cost  | 304,590,605               | 47,139,649      | 3,329,960                        | 355,060,214   |
| Accumulated depreciation                        | (98,139,326)              | (10,247,231)    | –                                | (108,386,557) |
| Net book amount                                 | 206,451,279               | 36,892,418      | 3,329,960                        | 246,673,657   |
| <b>2008</b>                                     |                           |                 |                                  |               |
| Opening net book amount<br>at January 1, 2008   | 206,451,279               | 36,892,418      | 3,329,960                        | 246,673,657   |
| Additions                                       | 962,924                   | 371,751         | 42,062,732                       | 43,397,407    |
| Change in ARO estimate                          | (6,769,655)               | –               | –                                | (6,769,655)   |
| Disposals                                       | (1,208,967)               | (1,162,411)     | (810,685)                        | (3,182,063)   |
| Transfers from work-in-progress                 | 30,036,378                | 3,226,796       | (33,263,174)                     | –             |
| Internal transfers                              | 5,602,827                 | (5,626,288)     | 23,461                           | –             |
| Depreciation charge                             | (26,885,283)              | (4,130,053)     | –                                | (31,015,336)  |
| Impairment / reversal                           | (186)                     | (759,145)       | 576,245                          | (183,086)     |
| Closing net book amount<br>at December 31, 2008 | 208,189,317               | 28,813,068      | 11,918,539                       | 248,920,924   |
| <b>At December 31, 2008</b>                     |                           |                 |                                  |               |
| Cost  | 332,724,973               | 41,972,079      | 11,918,539                       | 386,615,591   |
| Accumulated depreciation                        | (124,535,656)             | (13,159,011)    | –                                | (137,694,667) |
| Net book amount                                 | 208,189,317               | 28,813,068      | 11,918,539                       | 248,920,924   |

As at December 31, 2008, construction work-in-progress included exploration and evaluation assets with a net book value in the amount of 472,037 thousand Tenge (2007: 467,479 thousand Tenge). Additions of these

assets during 2008 amounted to 517,613 thousand Tenge (2007: 666,300 thousand Tenge) and disposals amounted to 513,055 thousand Tenge (2007: 933,334 thousand Tenge).

## 5 Intangible assets

|  | 2008        | 2007        |
|--|-------------|-------------|
| At January 1                           |             |             |
| Opening net book amount                | 5,548,240   | 7,921,252   |
| Additions                              | 641,198     | 1,074,150   |
| Disposals                              | (4,167)     | (27,337)    |
| Amortization charge                    | (3,353,489) | (3,419,825) |
| Closing net book amount at December 31 | 2,831,782   | 5,548,240   |
| At December 31                         |             |             |
| Cost                                   | 12,575,142  | 11,938,752  |
| Accumulated amortization               | (9,743,360) | (6,390,512) |
| Net book amount                        | 2,831,782   | 5,548,240   |

## 6 Financial assets

### Other financial assets

|                                     | 2008        | 2007        |
|-------------------------------------|-------------|-------------|
| US dollar-denominated term deposits | 3,863,736   | –           |
| Tenge-denominated term deposits     | 613,815     | 706,456     |
| Other                               | 630,470     | 1,247,343   |
| Total non-current                   | 5,108,021   | 1,953,799   |
| Tenge-denominated term deposits     | 129,292,592 | 184,767,036 |
| US dollar-denominated term deposits | 124,625,296 | 187,559,204 |
| Held-to-maturity financial assets   | 10,758,938  | –           |
| Available-for-sale financial assets | –           | 6,277,414   |
| Other                               | 270         | 270         |
| Total current                       | 264,677,096 | 378,603,924 |
|                                     | 269,785,117 | 380,557,723 |

The weighted average interest rate on US dollar-denominated term deposits in 2008 was 8.9% (2007:

8.5 %). The weighted average interest rate on Tenge-denominated term deposits in 2008 was 10.2% (2007: 9.1%).

## Trade and other receivables

|                                    | 2008        | 2007        |
|------------------------------------|-------------|-------------|
| Trade receivables                  | 37,640,937  | 51,213,760  |
| Other                              | 1,467,613   | 511,192     |
| Allowance for doubtful receivables | (1,289,077) | (1,641,085) |
|                                    | 37,819,473  | 50,083,867  |

As of December 31, 2008 US dollar-denominated trade and other receivables represented 94% of total receivables (2007: 98%). The remaining balances are

Tenge-denominated. Trade receivables are non-interest bearing and are generally on 30 - 60 days' terms.

The ageing analysis of trade receivables is as follows as at:

|                      | 2008       | 2007       |
|----------------------|------------|------------|
| Current              | 31,684,394 | 48,927,795 |
| 0 - 30 days overdue  | 6,134,596  | 1,125,816  |
| 60 - 90 days overdue | 483        | 30,256     |
|                      | 37,819,473 | 50,083,867 |

## Cash and cash equivalents

|  | 2008        | 2007       |
|--|-------------|------------|
| US dollar denominated term deposits with banks | 241,278,281 | 818,040    |
| Tenge-denominated term deposits with banks     | 42,926,389  | 19,824,415 |
| Cash in bank and on hand                       | 927,073     | 1,015,996  |
|  | 285,131,743 | 21,658,451 |

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Company, and earn interest at the respective short-term deposit rates.

The weighted average interest rate on US dollar-denominated deposits in 2008 was 3.6% (2007: 4.1%). The weighted average interest rate on Tenge-denominated deposits in 2008 was 8.6% (2007: 5.7%). Approximately 85% of total cash and cash equivalents at year end 2008 are US dollar-denominated (2007: 5%). The remaining balances are Tenge-denominated.

## 7 Investments in and receivables from associates and jointly controlled entities

## Investments in associates and jointly controlled entities

|  | 2008        | 2007        |
|--|-------------|-------------|
| Interest in JV Kazgermunai LLP («Kazgermunai») | 120,814,950 | 100,757,096 |
| Other  | 1,095,816   | 2,242,036   |
|  | 121,910,766 | 102,999,132 |

*JV Kazgermunai*

On April 24, 2007 the Company acquired from NC KMG a 50% participation interest in Kazgermunai, which is

involved in oil and natural gas production in south central Kazakhstan. The Company's share of joint venture's assets and liabilities are as follows:

|                         | 2008        | 2007        |
|-------------------------|-------------|-------------|
| Cash                    | 5,797,262   | 7,212,286   |
| Current assets          | 8,971,883   | 12,811,469  |
| Non-current assets      | 131,413,798 | 139,900,055 |
|                         | 146,182,943 | 159,923,810 |
| Current liabilities     | 4,470,120   | 5,785,528   |
| Non-current liabilities | 20,897,873  | 53,381,186  |
|                         | 25,367,993  | 59,166,714  |
| Net assets              | 120,814,950 | 100,757,096 |

The share of results of the joint venture included into the consolidated financial statements of the Company is:

|  | 2008         | 2007         |
|--|--------------|--------------|
| Revenues   | 106,058,916  | 56,436,402   |
| Operating expenses   | (48,216,992) | (26,625,703) |
| Profit from operations   | 57,841,924   | 29,810,699   |
| Finance income, net  | 55,335       | 821,556      |
| Profit before tax  | 57,897,259   | 30,632,255   |
| Income tax benefit (expense)   | 872,844      | (12,720,687) |
| Profit for the period  | 58,770,103   | 17,911,568   |
| Foreign currency translation gain (loss) recognized directly in equity | 579,154      | (655,350)    |

## Receivable from jointly controlled entity

|  | 2008       | 2007       |
|--|------------|------------|
| Receivable from CITIC Canada Energy Limited («CCEL») | 18,862,017 | 18,478,228 |

*CCEL investment*

On November 8, 2007 the Company signed an agreement for the purchase («PA») of a 50% interest in a holding company, CCEL, whose investments are involved in oil and natural gas production in western Kazakhstan. On December 12, 2007 the Company completed the acquisition and received from State Alliance Holdings Limited (a holding company ultimately belonging to CITIC Group, a company listed on the Hong Kong stock exchange) a 50% participation interest in CCEL for fifty US cents.

This jointly controlled entity and its subsidiaries are contractually obliged to declare dividends based on available distributable equity. In addition, under the terms of the PA, the Company has obtained the right to receive cash flows from a financial asset but assumed an obligation to pay these cash flows, in excess of a guaranteed payment of 26.2 million US dollars until 2020, to CITIC under a «pass through arrangement» up to 778.8 million US dollars (94,056,389 thousand Tenge) as at December 31, 2008 (2007: 782.5 million US dollars or 94,106,228 thousand Tenge). This obligation

represents the original obligation plus interest on that amount of Libor plus 1.45% per annum. The Company has no obligation to pay amounts to CITIC unless it receives an equivalent amount from the jointly controlled entity. Accordingly, this right and obligation are not recognized on the Company's balance sheet. The note receivable of 153.5 million US dollars (18,533,003 thousand Tenge) (2007: 150 million US dollars equivalent of 18,045,000 thousand Tenge) represents the portion of the financial asset that has not been derecognized as a result of the «pass through arrangement».

Additionally, the Company has the right in the event of certain conditions precedent, as stipulated by the PA, to exercise a put option and return the investment to CITIC

and receive back the 150 million dollars plus interest of 8% less the cumulative amount of any of the 26.2 million US dollar payments received.

On November 17, 2008 the Company signed an amendment to the PA, which revised the guaranteed payment to 26.87 million US dollars and set the annual dates of payment as one half due not later than June 12 and December 12, respectively for each year. However, as at December 31, 2008 interest has been accrued since September 12, 2008. After the above amendment the effective interest rate on the receivable is 15% per annum (2007: 14%).

The Company's share of jointly controlled entity's assets and liabilities are as follows:

|                         | 2008        | 2007        |
|-------------------------|-------------|-------------|
| Current assets          | 35,420,789  | 24,881,950  |
| Non-current assets      | 121,482,925 | 132,980,689 |
|                         | 156,903,714 | 157,862,639 |
| Current liabilities     | 39,822,436  | 29,012,554  |
| Non-current liabilities | 117,081,278 | 128,850,085 |
|                         | 156,903,714 | 157,862,639 |
| Net assets              | -           | -           |

## 8 Inventories

|           | 2008       | 2007       |
|-----------|------------|------------|
| Materials | 5,832,084  | 7,666,214  |
| Crude oil | 8,573,779  | 3,917,044  |
|           | 14,405,863 | 11,583,258 |

As at December 31, 2008 the Company had 498,293 tons (2007: 224,590 tons) of crude oil in storage and transit.

## 9 Share capital

|  | Shares outstanding<br>(number of shares) |                     | Common<br>shares | Preferred<br>shares | Total<br>share capital |
|--|--|---------------------|------------------|---------------------|------------------------|
|  | Common<br>shares                         | Preferred<br>shares |                  |                     |                        |
| As at January 1, 2007  | 69,879,405                               | 4,136,107           | 258,242,454      | 1,034,027           | 259,276,481            |
| Reduction of treasury stock due to exercise of share options | 8,431                                    | –                   | 89,433           | –                   | 89,433                 |
| As at December 31, 2007                                      | 69,887,836                               | 4,136,107           | 258,331,887      | 1,034,027           | 259,365,914            |
| Reduction of treasury stock due to exercise of share options | 78,308                                   | –                   | 880,251          | –                   | 880,251                |
| Increase of treasury stock due to share repurchases          | (55,748)                                 | –                   | (521,318)        | –                   | (521,318)              |
| As at December 31, 2008                                      | 69,910,396                               | 4,136,107           | 258,690,820      | 1,034,027           | 259,724,847            |

### 9.1 Share capital

#### *Authorized shares*

The total number of authorized ordinary and preferred shares is 70,220,935 (2007: 70,220,935) and 4,136,107 (2007: 4,136,107), respectively. 43,087,006 of the outstanding common shares are owned by the Parent as at December 31, 2008 (2007: 43,087,006). Ordinary and preferred shares of the Company have no par value.

#### *Dividends*

In accordance with Kazakhstan legislation, dividends may not be declared if the Company has negative equity in its Kazakh statutory financial statements or if the payment of dividends would result in negative equity in the statutory financial statements. Total dividends per share recognized as distributions to equity holders during the period amounted to 563 Tenge per share (2007: 500 Tenge per share) for both of the outstanding ordinary and preferred shares as at June 9, 2008, the date of record.

### 9.2 Employee share option plans

The expense recognized for share option plans related to employee services received during the year is 354,612 thousand Tenge (2007: 1,579,975 thousand Tenge).

#### *Employee option plans*

Under the employee option plan 1 («EOP 1»), an award of global depositary receipt («GDR») options with an exercise price equal to the market value of GDRs at the time of award was made to executives. The exercise of options is not subject to performance conditions and vests 1/3 each year over 3 years and is exercisable till the fifth anniversary from the vesting date.

Under the employee option plan 2 («EOP 2»), share options are granted to incentivise and reward key employees, senior executives and members of the Board of Directors of the Company, except for independent directors. The exercise price of the options is equal to the market price of GDRs on the date of grant. The exercise of these options is not subject to the attainment of performance conditions. Options granted on or after July 1, 2007 vest on the third anniversary of the date of the grant and are exercisable till the fifth anniversary from the vesting date.

*Initial public offering («IPO») plan*

Following the Company's 2006 IPO a one off award of zero exercise price GDRs was made to key employees, senior executives and directors to reward them for contributions towards a successful IPO. The grant date for the IPO award was December 29, 2006. The options vested on December 29, 2007 and the entire allotment was exercised within one month of their vesting.

*Movement in the year*

The following table illustrates the number of GDR's (No.) and weighted average exercise prices in US dollars per GDR (WAEP) of, and movements in, share options during the year:

|                            | 2008      |       | 2007      |       |
|----------------------------|-----------|-------|-----------|-------|
|                            | No.       | WAEP  | No.       | WAEP  |
| Outstanding at January 1   | 1,340,786 | 14.88 | 926,595   | 9.09  |
| Granted during the year    | -         | -     | 502,825   | 25.39 |
| Exercised during the year  | (469,847) | 3.91  | (50,584)  | 14.64 |
| Expired during the year    | (62,238)  | 17.04 | (38,050)  | 13.02 |
| Outstanding at December 31 | 808,701   | 14.82 | 1,340,786 | 14.88 |
| Exercisable at December 31 | 196,287   | 15.12 | 490,617   | 4.28  |

The weighted average remaining contractual life for share options outstanding as at December 31, 2008 is 4.36 years (2007: 5.31 years). The range of exercise price for options outstanding at December 31, 2008 was \$14.64 - \$26.47 US dollars per GDR (2007: \$0 - \$26.47).

The EOP 1, EOP 2 and IPO plan are equity settled plans and the fair value is measured at the grant date.

## 10 Earnings per share

|   | 2008        | 2007        |
|---|-------------|-------------|
| Weighted average number of all shares outstanding | 74,092,287  | 74,015,512  |
| Profit for the year                               | 241,282,369 | 157,119,081 |
| Basic and diluted earnings per share              | 3.26        | 2.12        |

The above presentation includes both ordinary and preferred shares as preferred shareholders have

cumulative participating rights which result in identical earnings per share for both classes of shares.

## 11 Borrowings

|   | 2008              | 2007              |
|---|-------------------|-------------------|
| Fixed interest rate borrowings          | 20,438,076        | 32,849,434        |
| Weighted average interest rates         | 5.23%             | 5.74%             |
| <b>Total borrowings</b>                 | <b>20,438,076</b> | <b>32,849,434</b> |
| Tenge-denominated borrowings            | –                 | 8,874             |
| US dollar-denominated borrowings        | 20,438,076        | 32,840,560        |
| <b>Total borrowings</b>                 | <b>20,438,076</b> | <b>32,849,434</b> |
| Long-term borrowings                    | 5,532,332         | 14,135,480        |
| Current portion of long-term borrowings | 14,905,744        | 18,713,954        |

The Company's fixed rate borrowings (2008: 13,241,867 thousand Tenge, 2007: 30,774,074 thousand Tenge),

primarily relate to a pre-export financing arrangement which expires in 2009 and requires settlement in crude oil.

## 12 Provisions

|                         | Environmental remediation | Taxes       | Asset retirement obligation | Other     | Total       |
|-------------------------|---------------------------|-------------|-----------------------------|-----------|-------------|
| At January 1, 2007      | 30,018,963                | 17,785,480  | 21,757,268                  | 3,224,988 | 72,786,699  |
| Additional provisions   | –                         | 2,815,319   | 307,825                     | 534,291   | 3,657,435   |
| Unused amounts reversed | –                         | (2,963,176) | (283,311)                   | –         | (3,246,487) |
| Unwinding of discount   | –                         | –           | 1,725,248                   | –         | 1,725,248   |
| Changes in estimate     | –                         | –           | (2,229,477)                 | –         | (2,229,477) |
| Used during the year    | (1,776,114)               | –           | (499,302)                   | (183,001) | (2,458,417) |
| Current portion         | 2,813,003                 | 17,637,623  | 1,427,890                   | 199,025   | 22,077,541  |
| Non-current portion     | 25,429,846                | –           | 19,350,361                  | 3,377,253 | 48,157,460  |
| At December 31, 2007    | 28,242,849                | 17,637,623  | 20,778,251                  | 3,576,278 | 70,235,001  |
| Additional provisions   | –                         | 3,323,015   | 130,682                     | 945,415   | 4,399,112   |
| Unused amounts reversed | –                         | (2,120,138) | –                           | –         | (2,120,138) |
| Unwinding of discount   | –                         | –           | 1,647,715                   | –         | 1,647,715   |
| Changes in estimate     | –                         | –           | (6,769,655)                 | –         | (6,769,655) |
| Used during the year    | (2,737,510)               | –           | (603,290)                   | (237,330) | (3,578,130) |
| Current portion         | 4,882,783                 | 18,840,500  | 1,120,014                   | 253,942   | 25,097,239  |
| Non-current portion     | 20,622,556                | –           | 14,063,689                  | 4,030,421 | 38,716,666  |
| At December 31, 2008    | 25,505,339                | 18,840,500  | 15,183,703                  | 4,284,363 | 63,813,905  |

## 13 Revenue

|                          | 2008        | 2007        |
|--------------------------|-------------|-------------|
| Export:                  |             |             |
| Crude oil                | 552,120,489 | 437,551,117 |
| Domestic (Note 20):      |             |             |
| Crude oil                | 36,933,575  | 37,401,142  |
| Gas products             | 5,288,097   | 4,804,395   |
| Other sales and services | 10,651,261  | 7,218,225   |
|                          | 604,993,422 | 486,974,879 |

## 14 Operating expenses

|   | 2008        | 2007        |
|---|-------------|-------------|
| Export customs duty                       | 68,796,006  | -           |
| Transportation                            | 53,135,541  | 48,247,039  |
| Employee benefits                         | 43,117,573  | 39,389,555  |
| Depreciation, depletion and amortization  | 34,368,825  | 34,663,502  |
| Royalties                                 | 25,312,574  | 17,948,868  |
| Repairs and maintenance                   | 24,653,917  | 20,496,194  |
| Materials and supplies                    | 12,717,118  | 13,878,706  |
| Energy                                    | 9,291,579   | 7,633,700   |
| Management fees and commissions (Note 17) | 8,439,633   | 8,002,198   |
| Other taxes                               | 5,690,873   | 4,830,875   |
| Fines and penalties                       | 1,808,845   | 2,735,535   |
| Social projects                           | 1,649,078   | 3,660,170   |
| Loss on disposal of fixed assets          | 852,909     | 2,992,114   |
| Change in crude oil balance               | (4,656,735) | (1,489,717) |
| Other                                     | 11,989,737  | 7,845,746   |
|   | 297,167,473 | 210,834,485 |

## 15 Finance income / costs

### 15.1 Finance income

|  | 2008       | 2007       |
|--|------------|------------|
| Interest income on term deposits with banks                  | 39,451,659 | 24,118,397 |
| Interest income on receivable from jointly controlled entity | 2,851,148  | -          |
| Gain from restructuring of borrowings                        | 2,467,162  | -          |
| Interest income on held-to-maturity financial assets         | 508,358    | 2,912,382  |
| Other  | 96,251     | 305,452    |
|  | 45,374,578 | 27,336,231 |

### 15.2 Finance costs

|  | 2008      | 2007      |
|--|-----------|-----------|
| Unwinding of discount on asset retirement obligation | 1,647,715 | 1,725,248 |
| Interest expense                                     | 1,152,326 | 3,853,199 |
| Other  | 346,590   | 514,916   |
|  | 3,146,631 | 6,093,363 |

## 16 Income taxes

Income tax expense comprised the following for the years ended December 31:

|                      | 2008        | 2007        |
|----------------------|-------------|-------------|
| Corporate income tax | 116,119,081 | 99,361,566  |
| Excess profit tax    | 60,186,172  | 54,080,973  |
| Current income tax   | 176,305,253 | 153,442,539 |
| Corporate income tax | (5,997,466) | (1,598,601) |
| Excess profit tax    | (3,215,921) | (1,332,661) |
| Deferred income tax  | (9,213,387) | (2,931,262) |
| Income tax expense   | 167,091,866 | 150,511,277 |

The following table provides a reconciliation of the Kazakhstan income tax rate (30% in 2008 and 2007) to the effective tax rate of the Company on profit before tax. The law on the enactment of the new tax code decreased

the CIT rate from 20% in 2009 to 17.5% in 2010 and to 15% in 2011 and onwards. The mechanism for calculating EPT was also changed in 2009. The impact of the changes in tax rates was not significant.

|  | 2008                   | 2007        |
|--|------------------------|-------------|
| Profit before tax                                | 408,374,235            | 307,630,358 |
| Income tax                                       | 167,091,866            | 150,511,277 |
| Effective tax rate                               | 41%                    | 49%         |
|  | % of profit before tax |             |
| Statutory income tax                             | 30                     | 30          |
| Increase (decrease) resulting from               |                        |             |
| Excess profit tax                                | 14                     | 17          |
| Share of result of associates and joint ventures | (4)                    | (2)         |
| Non-deductible expenses                          | 1                      | 4           |
| Income tax expense                               | 41                     | 49          |

The movements in the deferred tax liability / (asset) relating to CIT and EPT were as follows:

|                         | Fixed assets | Provisions  | Other       | Total       |
|-------------------------|--------------|-------------|-------------|-------------|
| At January 1, 2007      | 18,264,106   | (1,375,143) | (6,173,262) | 10,715,701  |
| Income statement effect | (1,980,363)  | (988,784)   | 37,885      | (2,931,262) |
| At December 31, 2007    | 16,283,743   | (2,363,927) | (6,135,377) | 7,784,439   |
| Income statement effect | (13,428,407) | 1,079,503   | 3,135,517   | (9,213,387) |
| At December 31, 2008    | 2,855,336    | (1,284,424) | (2,999,860) | (1,428,948) |

## 17 Related party transactions

Halyk Bank of Kazakhstan is a related party due to the bank being controlled by a member of the management board of the joint stock company

Samruk-Kazyna National Welfare Fund, who was appointed on November 3, 2008.

|  | 2008        | 2007        |
|--|-------------|-------------|
| <b>Sales of goods and services (Note 13)</b>         |             |             |
| Entities under common control                        | 467,588,108 | 385,216,748 |
| Other state-controlled entities                      | 827,958     | 21,235      |
| Joint ventures                                       | 257,207     | 155,780     |
| Associates   | 13,131      | 2,490       |
| <b>Purchases of goods and services (Note 14)</b>     |             |             |
| Entities under common control                        | 26,067,031  | 24,365,343  |
| Parent Company                                       | 8,014,300   | 7,819,477   |
| Other state-controlled entities                      | 9,289,979   | 1,633,186   |
| Joint ventures                                       | –           | 1,754       |
| Associates   | 272,630     | 432,979     |
| Halyk Bank of Kazakhstan affiliates                  | 148,427     | 525,214     |
| <b>Interest earned on financial assets</b>           |             |             |
| Halyk Bank of Kazakhstan                             | 2,203,602   | 1,225,246   |
| Average interest rate on deposits                    | 8.88%       | 4.44%       |
| Parent Company                                       | –           | 2,933,230   |
| <b>Trade and other receivables (Note 6)</b>          |             |             |
| Entities under common control                        | 36,569,465  | 41,302,095  |
| Other state-controlled entities                      | 798,591     | 147,874     |
| Joint ventures                                       | 19,214,446  | 18,509,130  |
| Associates   | 4,567       | 7,254       |
| Halyk Bank of Kazakhstan affiliates                  | 189,910     | –           |
| <b>Trade payables</b>                                |             |             |
| Entities under common control                        | 444,739     | 823,812     |
| Parent Company                                       | 1,132,020   | 2,439,600   |
| Other state-controlled entities                      | 251,657     | 104,525     |
| Joint ventures                                       | 48,600      | –           |
| Associates   | 120,785     | 215,036     |
| <b>Financial assets (Note 6)</b>                     |             |             |
| Halyk Bank of Kazakhstan – term deposits             | 93,843,547  | –           |
| Halyk Bank of Kazakhstan – cash and cash equivalents | 91,888,302  | –           |
| <b>Salaries and other short-term benefits</b>        |             |             |
| Members of the Board of Directors                    | 83,686      | 166,525     |
| Members of the Management Board                      | 143,631     | 273,003     |
| <b>Share-based payments</b>                          |             |             |
| Members of the Board of Directors                    | –           | 131,987     |
| Members of the Management Board                      | 61,850      | 265,838     |

#### *Sales and receivables*

Sales to related parties comprise mainly export and domestic sales of crude oil and oil products to KMG group entities. Export sales to related parties represented 5,212,638 tons of crude oil in 2008 (2007: 5,559,108 tons). The sales of crude oil are priced by reference to Platt's index quotations and adjusted for freight, insurance and quality differentials. For these exports of crude oil the Company received an average price per ton of approximately 83,797 Tenge in 2008 (2007: 62,404 Tenge). In addition, the Company supplies oil and oil products to the local market at the directive of the Kazakhstan government, the ultimate controlling shareholder of the Parent Company. Those supplies to the domestic market represented 2,071,729 tons of crude oil production in 2008 (2007: 2,230,463 tons). Prices for the local market sales are determined by agreement with NC KMG. For deliveries to the local market in 2008 the Company received an average price per produced crude oil ton of around 17,812 Tenge (2007: 16,710 Tenge). Trade and other receivables from related parties principally comprise amounts related to export sales transactions.

At December 31, 2008 the Company had commitments under a government directive to deliver 1.9 million tons of crude oil to local markets in 2009 (2.2 million tons in 2008).

#### *Purchases and payables*

Management fees to the Parent Company amounted to 8,014,300 thousand Tenge in 2008 (2007: 7,490,000 thousand Tenge). Agency commissions for crude oil sales amounted to 425,333 thousand Tenge in 2008 (2007: 512,198 thousand Tenge). Transportation services related to the shipment of 6,972,820 tons of crude oil in 2008 (2007: 7,478,521 tons) were purchased from a KMG group entity for 20,845,471 thousand Tenge in 2008 (2007: 18,084,913 thousand Tenge). The remaining services purchased from KMG group entities include primarily payments for demurrage, sales commissions and electricity.

#### *Share based payments to members of the Management Board*

Share based payments to members of the Management Board represents the amortization of share based payments over the vesting period.

## 18 Financial risk management objectives and policies

The Company's principal financial liabilities comprise loans, payables to Government for geological information, trade and other payables. The main purpose of these financial liabilities is to raise finance for the Company's operations. The Company has various financial assets such as trade receivables, investments in held-to-maturity securities, short and long-term deposits and cash and cash equivalents.

The main risks arising from the Company's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. The Company's management reviews and agrees policies for managing each of these risks which are summarized below.

#### *Interest rate risk*

The Company's policy is to manage its interest cost using a mix of fixed and floating rate debts. To manage this, the Company enters into fixed interest rate swaps on a portion of its debt, in which the Company agrees to exchange, at specified intervals, the difference between fixed and floating rate interest amounts calculated by reference to an agreed-upon notional principal amount.

At December 31, 2008 the Company does not have any floating rate debt.

#### *Foreign currency risk*

As a result of investments denominated in US dollars the Company's consolidated balance sheet can be affected by movements in the US exchange rates. The Company seeks to mitigate the effect of its currency exposure by reducing or increasing exposure to the US dollar in its investment portfolio based on the management expectations on movements in the short and medium term US dollar to Tenge exchange rates.

The Company also has transactional currency exposures. Such exposure arises from sales of crude oil in currencies other than the Company's functional currency. Approximately 90% of the Company's sales are denominated in US dollars, whilst almost all of costs are denominated in Tenge. The majority of the sales receipts are received from thirty to sixty days of sale. Therefore, exposure to movement in the exchange rate on these amounts is limited at any one time to two months of sales. Management monitors but historically has not taken any action to mitigate this exposure.

When determining the composition of the investment portfolio, with respect to settlement currency, management takes into consideration the next three to six months of budgeted Tenge cash outflows and ensures that minimum Tenge assets are held to settle these amounts as they materialize or come due.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the

Company's profit before tax (due to changes in the fair value of monetary assets and liabilities).

|             | Increase / decrease<br>in Tenge to US dollar<br>exchange rate | Effect on profit<br>before tax |
|-------------|---|--------------------------------|
| <b>2008</b> |   |                                |
| US dollar   | + 25%   | 101,465,921                    |
| US dollar   | + 40%   | 162,345,473                    |
| <b>2007</b> |   |                                |
| US dollar   | + 5%  | 12,462,850                     |
| US dollar   | - 5%  | (12,462,850)                   |

#### *Credit risk*

The Company endeavors to trade only with recognized, creditworthy third parties. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant. For transactions that do not occur in the country of the relevant operating unit, the Company does not offer credit terms. However, the Company's credit concentration risk is significant as the vast majority of the receivables are from an affiliate of the Parent. Management believes that no provision is required to be made from the overdue balance of 6,130,724 thousand Tenge as at December 31, 2008 (2007: nil).

With respect to credit risk arising from the other financial assets of the Company, which comprise cash and cash equivalents and held-to-maturity financial investments, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

The Company is exposed to credit risk from its operating activities and certain investing activities. With regard to investing activities, the Company mostly places deposits with Kazakhstan banks.

The Company's treasury policy limits the amount of financial assets held at any one bank to the lower of a stipulated maximum threshold or a percentage of the bank's Tier I capital, which is linked to the bank's long term counterparty credit rating, as measured by Standard and Poor's rating agency, (e.g. not greater than 40% for a BB rated bank at December 31, 2008). This policy also stipulates that banks with credit ratings less than two levels below that of the Kazakhstan government's sovereign credit rating, cannot be used to deposit financial assets. However as a result of delays in the Company's acquisition program, the Government's requirement to hold the majority of the Company's financial assets in Kazakhstan banks (see Note 20) and a lack of banks within the requisite credit rating, the Company, as at December 31, 2008, is in violation of its treasury policy. The financial assets held at Kazkommertsbank and Halyk Bank both exceed the maximum threshold and maximum percentage of Tier I capital as at September 30, 2008, their latest published accounts.

As the result of the current lack of liquidity caused by the ongoing global financial crisis the Company may not be able to withdraw significant sums of cash without causing severe disruption in the banks.

The table below shows the balances of investments and cash held in banks at the balance sheet date using the Standard and Poor's credit ratings.

| Rating <sup>(1)</sup> |                        |                 |                |             |             |
|-----------------------|------------------------|-----------------|----------------|-------------|-------------|
| Banks                 | Location               | 2008            | 2007           | 2008        | 2007        |
| Kazkommertsbank       | Kazakhstan             | BB (negative)   | BB (negative)  | 242,112,054 | 146,091,167 |
| Halyk Bank            | Kazakhstan             | BB+ (negative)  | BB+ (negative) | 184,726,459 | 187,909,655 |
| ATF Bank              | Kazakhstan             | Rating recalled | BB+ (stable)   | 42,667,028  | 16,686,036  |
| BTA Bank              | Kazakhstan             | BB (negative)   | BB (negative)  | 39,155,075  | 33,746,786  |
| HSBC                  | Kazakhstan             | AA-             | AA-            | 21,617,317  | 7,778,463   |
| RBS Kazakhstan        | Kazakhstan             | A+              | AA-            | 8,702,495   | -           |
| Credit Suisse         | British Virgin Islands | A+              | AA-            | 3,439,832   | 818,040     |
| ING Bank              | The Netherlands        | AA              | AA             | 341,780     | 354,524     |
| Other                 | Kazakhstan             |                 |                | 765,142     | 1,306,476   |
|                       |                        |                 |                | 543,527,182 | 394,691,147 |

#### Liquidity risk

The Company monitors its liquidity risk using a recurring liquidity planning tool. This tool considers the maturity of both its financial investments and financial assets (e.g. accounts receivables and other financial assets) and projected cash flows from operations.

The Company's objective is to maintain a balance between continuity of funding and flexibility through the use of short and long-term deposits in local banks.

The table below summarizes the maturity profile of the Company's financial liabilities at December 31, 2008 based on contractual undiscounted payments:

|                              | On demand  | Less than 3 months | 3-12 months | 1-5 years  | More than 5 years | Total      |
|------------------------------|------------|--------------------|-------------|------------|-------------------|------------|
| Year ended December 31, 2008 |            |                    |             |            |                   |            |
| Borrowings                   | -          | 4,680,905          | 10,840,351  | 4,361,042  | 4,508,649         | 24,390,947 |
| Trade and other payables     | 32,380,235 | -                  | -           | -          | -                 | 32,380,235 |
|                              | 32,380,235 | 4,680,905          | 10,840,351  | 4,361,042  | 4,508,649         | 56,771,182 |
| Year ended December 31, 2007 |            |                    |             |            |                   |            |
| Borrowings                   | -          | 5,021,473          | 15,196,143  | 14,054,260 | 1,425,215         | 35,697,091 |
| Trade and other payables     | 35,184,485 | -                  | -           | -          | -                 | 35,184,485 |
|                              | 35,184,485 | 5,021,473          | 15,196,143  | 14,054,260 | 1,425,215         | 70,881,576 |

<sup>(1)</sup> Source: Interfax – Kazakhstan, Factivia, official sites of the banks as at December 31 of the respective year.

*Commodity price risk*

The Company is exposed to the effect of fluctuations in the price of crude oil, which is quoted in US dollars on international markets. The Company prepares annual budgets and periodic forecasts including sensitivity analyses in respect of various levels of crude oil prices in the future.

The Company has historically not hedged its exposure to the risk of fluctuations in the price of crude oil.

*Capital management*

The primary objective of the Company's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize shareholder value.

The Company manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares.

## 19 Financial instruments

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments:

|   | Carrying amount |             | Fair value  |             |
|---|-----------------|-------------|-------------|-------------|
|   | 2008            | 2007        | 2008        | 2007        |
| <b>Current financial assets</b>           |                 |             |             |             |
| Cash and cash equivalents                 | 285,131,743     | 21,658,451  | 285,131,743 | 21,658,451  |
| Held-to-maturity financial assets         | 10,758,938      | –           | 10,710,003  | –           |
| Available-for-sale financial assets       | –               | 6,277,414   | –           | 6,277,414   |
| US dollar-denominated term deposits       | 124,625,296     | 187,559,204 | 124,625,296 | 187,559,204 |
| Tenge-denominated term deposits           | 129,292,592     | 184,767,036 | 129,292,592 | 184,767,036 |
| Other financial assets                    | 270             | 270         | 270         | 270         |
| <b>Non-current financial assets</b>       |                 |             |             |             |
| Receivable from jointly controlled entity | 18,862,017      | 18,478,228  | 18,862,017  | 18,478,228  |
| US dollar-denominated term deposits       | 3,863,736       | –           | 3,863,736   | –           |
| Tenge-denominated term deposits           | 613,815         | 706,456     | 613,815     | 706,456     |
| Other financial assets                    | 630,470         | 1,247,343   | 630,470     | 1,247,343   |
| <b>Financial liabilities</b>              |                 |             |             |             |
| Borrowings fixed rate interest            | 20,438,076      | 32,849,434  | 20,438,076  | 32,849,434  |

The fair value of borrowings has been calculated by discounting the expected future cash flows at prevailing

interest rates. The fair value of other financial assets have been calculated using market interest rates.

## 20 Commitments and contingencies

### *Operating environment*

Kazakhstan continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Kazakhstan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government.

The Kazakhstan economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The ongoing global financial crisis has resulted in capital markets and commodity price instability, significant deterioration of liquidity in the banking sector and tighter credit conditions within Kazakhstan. Consequently, the Kazakhstan Government has introduced a range of stabilization measures aimed at providing liquidity and supporting finance for Kazakhstan banks and companies. As part of these measures the Government of Kazakhstan, which is the ultimate controlling shareholder of the Company, has directed the Company to continue to deposit its cash and short-term investments with Kazakhstan banks (see note 18). This limits the Company's ability to diversify the majority of its credit risk beyond Kazakhstan.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Company's results and financial position in a manner not currently determinable.

### *Local market obligation*

The Kazakhstan government requires oil producers to supply a portion of their crude oil production to meet domestic energy requirements. While the price for such additional supplies of crude oil is agreed with the Company's Parent, this price may be materially below international market prices and may even be set at the cost of production. If the Government does require additional crude oil to be delivered over and above the quantities currently supplied by the Company, such supplies will take precedence over market sales and will generate substantially less revenue than crude oil sold on the export market, which may materially and adversely affect the Company's business, prospects, financial condition and results of operations. During the current year, in accordance with their obligations, the Company delivered 2,071,729 tons of oil (2007: 2,230,463 tons) and joint venture Kazgermunai have delivered 380,000 tons of oil (2007: 370,000 tons) on the domestic market.

### *Taxation*

Kazakhstan's tax legislation and regulations are subject to ongoing changes and varying interpretations. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual. The current regime of penalties and interest related to reported and discovered

violations of Kazakhstan's tax laws are severe. Penalties are generally 50% of the taxes additionally assessed and interest is assessed at the refinancing rate established by the National Bank of Kazakhstan multiplied by 2.5. As a result, penalties and interest can amount to multiples of any assessed taxes. Fiscal periods remain open to review by tax authorities for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. Because of the uncertainties associated with Kazakhstan's tax system, the ultimate amount of taxes, penalties and interest, if any, may be in excess of the amount expensed to date and accrued at December 31, 2008. As at December 31, 2008 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax positions will be sustained, except as provided for in these consolidated financial statements (Note 12).

### *Environment*

Environmental regulation in Kazakhstan is evolving and subject to ongoing changes. Penalties for violations of Kazakhstan's environmental laws can be severe. Potential liabilities which may arise as a result of civil litigation or changes in legislation cannot be reasonably estimated. Other than those amounts provided for in provisions (Note 12) management believes that there are no probable or possible environmental liabilities which could have a material adverse effect on the Company's financial position, statement of income or cash flows.

### *Legal proceedings*

During the year, the Company was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. There are no current legal proceedings or claims outstanding which management believes could have a material effect on the Company's financial position, statement of income or cash flows and which have not been accrued or disclosed in these consolidated financial statements.

### *Oilfield licenses*

The Company is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield licenses and related subsoil use contracts. Management cooperates with governmental authorities to agree on remedial actions necessary to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties, license limitation, suspension or revocation. The Company's management believes that any issues of non-compliance will be resolved through negotiations or corrective actions without any material effect on the Company's financial position, statement of income or cash flows.

The Company's oil and gas fields are located on land belonging to the Mangistau and Atyrau regional administrations. Licenses are issued by the Ministry of Energy and Mineral Resources of Kazakhstan and the

Company pays royalties and excess profits tax to explore and produce oil and gas from these fields.

The principle licenses of the Company and their expiry dates are:

| Field            | Contract | Expiry date |
|------------------|----------|-------------|
| Uzen (8 fields)  | No. 40   | 2021        |
| Emba (1 field)   | No. 37   | 2021        |
| Emba (1 field)   | No. 61   | 2017        |
| Emba (23 fields) | No. 211  | 2018        |
| Emba (15 fields) | No. 413  | 2020        |

*Commitments arising from oilfield licenses and contracts*

| Year      | Capital expenditures | Operational expenditures |
|-----------|----------------------|--------------------------|
| 2009      | 36,586,977           | 4,735,461                |
| 2010      | 841,000              | 3,834,857                |
| 2011      | 841,000              | 3,834,857                |
| 2012      | -                    | 3,834,857                |
| 2013      | -                    | 3,834,857                |
| 2013-2021 | -                    | 22,564,721               |
| Total     | 38,268,977           | 42,639,610               |

*Crude oil supply commitments*

Under the provisions of a pre-export financing agreement the Company has committed to deliver 150,000 tons of crude oil per month to the lender until September 2009 for fair value consideration determined at the date of shipment. The Company has further obligations to supply

oil and oil products to the local market under government directives (Note 17).

*Commitments of Kazgermunai*

The Company's share in the commitments of Kazgermunai is as follows as at December 31, 2008:

| Year  | Capital expenditures |
|-------|----------------------|
| 2009  | 10,740,257           |
| Total | 10,740,257           |

*Contingencies of Kazgermunai*

The tax authorities have commenced legal action against Kazgermunai in respect of obligations related to rates applied on the computation of fines for flaring gas in volumes above permitted amounts. In relation to this matter, in 2008, Kazgermunai appealed the assessment of the tax authorities with the Kyzylorda regional economic court and prevailed. However, the tax committee appealed this verdict with the Supervisory Panel of the Kyzylorda oblast court and the previous verdict was

overturned in favor of the tax committee. Kazgermunai is in the process of filing a further appeal to the Supreme Court of the Republic of Kazakhstan. Management of Kazgermunai believes that they will ultimately prevail in this matter and therefore no amounts have been accrued in the financial statements for the year ending December 31, 2008. Should Kazgermunai not prevail in their appeal the maximum amount of their liability is estimated by Kazgermunai's management is 9,873,360 thousand Tenge, inclusive of fines and penalties.

## 21 Subsequent events

### *Related parties*

On February 2, 2009 the Government represented by joint stock company SamrukKazyna National Welfare Fund agreed to become a major shareholder of Alliance Bank and BTA Bank with 76 and 78 percent of total shares, respectively. From the above date the Company, treats each bank as a related party for financial accounting and reporting purposes.

### *Tenge devaluation*

On February 4, 2009 the Tenge devalued against the US dollar and other major currencies. The exchange rate before and after devaluation were 120 Tenge / US dollar and 150 Tenge / US dollar respectively. As at February 27, 2009 the official exchange rate, as set by the National Bank of Kazakhstan, was 150.26 Tenge / US dollar.

### *Revision of Kazakhstan Banks credit rating*

On February 17, 2009 Standard and Poor's lowered its long term counterparty credit rating for a large number of Kazakhstan Banks including Kazkommerts bank, Halyk bank and BTA Bank. Under these new ratings both Kazkommerts bank and BTA bank fail to meet the treasury policy requirement to have a credit rating of no more than two levels below that of the Kazakhstan government's sovereign credit rating (see Note 18).

These consolidated financial statements have been signed below by the following persons on behalf of the Company and in the capacities indicated on February 27, 2009:

Chief Executive Officer Balzhanov A.K.

Chief Financial Officer Bekezhanova Zh.D.

Financial Controller Drader Sh., CA

# Reference Information

|  |   |
|--|---|
| <i>1P</i>                                | Proved Reserves.  |
| <i>2P</i>                                | Proved and Probable Reserves.   |
| <i>3P</i>                                | Proved, Probable and Possible Reserves.   |
| <i>BG Group plc</i>                      | World's leading gas company. Its main activities include exploration and production, liquefied natural gas (LNG) production, transportation and distribution and power generation.  |
| <i>Caspian Pipeline Consortium (CPC)</i> | A pipeline connecting the Tengiz field in Kazakhstan with the Russian port of Novorossiysk in the Black Sea. An important oil transportation route from the shores of the Caspian Sea on to international markets.  |
| <i>CCEL</i>                              | CCEL, CITIC Canada Energy Limited, 100% owner of CCPL, previously Nations Energy Company Ltd, with the main investment in the Karazhanbas field.  |
| <i>Condensate</i>                        | Light hydrocarbon fractions produced from natural gas, which condense into liquid as a result of lower temperature and pressure.  |
| <i>Embamunaigas (EMG)</i>                | One of the KMG EP's core production divisions. The branch operates in 39 fields in the Atyrau region in western Kazakhstan.   |
| <i>Engineering Centre</i>                | KMG EP branch, which monitors the exploration works, analyses the development process of the fields, provides professional appraisals of the development projects and their viability.  |
| <i>Gaffney, Cline &amp; Associates</i>   | Independent, international consulting company that specialises in certification of oil and gas reserves.  |
| <i>Hydraulic Fracture</i>                | A method of stimulating production from a low-permeability formation by creating fractures and fissures by applying very high fluid pressure.   |
| <i>IPO</i>                               | Initial Public Offering of a company's shares on the stock market.  |
| <i>Karazhanbasmunai (KBM)</i>            | Karazhanbasmunai OJSC owns 100% rights to exploration and development of the Karazhanbasmunai field in western Kazakhstan until 2020. At the end of 2006 the Company's 2P reserves (Proved and Probable) were 66 million tonnes. 50% of shares in the Company were acquired by KMG EP.                            |
| <i>KASE</i>                              | Kazakhstan Stock Exchange.  |
| <i>Kazakhstan Growth Forum</i>           | Annual international forum (London).  |
| <i>Kazgermunai (KGM)</i>                 | The eighth largest Kazakh oil producing company. At the end of September 2006 its proved and probable reserves at the end of September 2006 were circa 40.7 million tonnes (310 million barrels); production in 2007 was over 3 million tonnes (64 kbopd). PetroKazakhstan Kumkol Resources is a co-owner of KGM. |

|  |  |
|--|--|
| <i>KMG group</i>                             | The national company KazMunaiGas OJSC and its subsidiaries, including KMG NC KMG and its subsidiaries, including KMG EP, KazTransOil OJSC, KazTransGas OJSC, KazMunaiGas Trade House OJSC and others.  |
| <i>LSE</i>                                   | London Stock Exchange.   |
| <i>Mangistaumunaigas (MMG)</i>               | One of the largest private oil producing companies in Kazakhstan mainly focused on exploration, development, production and oil refining.  |
| <i>National Company KazMunayGas (NC KMG)</i> | State oil company of the Republic of Kazakhstan. A public company 100% owned by the National Welfare Fund, Samruk-Kazyna.  |
| <i>Nurzhanov</i>                             | Exploration platform in western Kazakhstan, near the north-east part of the Caspian Sea.   |
| <i>Paryz</i>                                 | Annual competition, established by the President of Kazakhstan in 2008, on Social Responsibility.  |
| <i>PetroKazakhstan Inc</i>                   | One of the largest private oil companies in Kazakhstan with 11 fields in the Southern-Turgaiskiy basin.  |
| <i>Re-Perforation</i>                        | Holes punched in the casing of a well at the pay zone to be produced, to allow oil or gas to enter the well. A Perforating gun is a cylindrical tool loaded with explosives that are triggered opposite the pay zone, the explosions perforate the casing in many places.  |
| <i>Samruk-Kazyna Fund</i>                    | National Welfare Fund, which manages the state assets, shares of the national companies and financial institutions of Kazakhstan.  |
| <i>Seismic</i>                               | A study of geological and tectonic structure of the Earth by using sound waves that are reflected from different layers in the subsoil strata. Echoes from each layer are detected by receivers, and the travel time and speed of sound in different materials determine the characteristics of the subsoil and the depth of sedimentary material. |
| <i>Standard &amp; Poor's</i>                 | International rating agency that awards short-term and long-term credit ratings.   |
| <i>Uzen-Atyrau-Samara (UAS)</i>              | 1,500 km pipeline, which passes through the Atyrau and Mangistau regions to Russia.  |
| <i>Uzenmunaigas (UMG)</i>                    | KMG EP's main producing branch, which operates in two main fields in the Mangistaumunai region.  |

# Shareholder Information

## Annual General Shareholders Meeting

The AGM will be held at 12:00 am, on May 28, 2009, at Rixos President Hotel Astana, 1st floor, Dhall conference hall, 7, Tauelsizdik st., Left Bank, Astana, 010000, Republic of Kazakhstan

## Web-site

A wide range of information on the Company is available at [www.kmgep.kz](http://www.kmgep.kz) including details of activities, press releases and annual and interim reports.

## Shareholders' Enquiries

For information about proxy voting, dividends and to report changes in personal details, shareholders should contact the Company's registrar/ depository:

### Holders of ordinary and preferred shares:

JSC Fondovyi Tsentr  
79 «A», Zheltoksan Street,  
Almaty, 050091, Republic of Kazakhstan  
Tel.: +7 727 250-89-61, 250-89-60  
Fax: +7 727 250-16-96

### Holders of GDRs:

The Bank of New York  
101 Barclay Street, 22nd Floor, New York  
NY 10286, United States of America  
Tel.: +1 212 815-44-93  
Fax: +1 212 571-30-50  
Telex: 62736 Western Union

### Total number of shares issued<sup>(1)</sup>

|                                    |            |
|------------------------------------|------------|
| Common Shares                      | 70 220 935 |
| Preferred Shares                   | 4 136 107  |
| Total Share Capital <sup>(2)</sup> | 74 357 042 |

<sup>(1)</sup> Including GDRs bought out to implement the Company's Option Program and being in trust management (as of December 31, 2008 – 1,528,749 GDRs), and the shares and GDRs bought out in accordance with own shares buyback programme (as of December 31, 2008 – 236,156 GDRs and 16,389 shares).

<sup>(2)</sup> The Company's shares are listed on Kazakhstan Stock Exchange and the GDRs are listed on the London Stock Exchange. Each GDR corresponds to one sixth of an ordinary share.

## Contact Information

### Registered office

JSC Exploration Production KazMunaiGas  
2, Tauelsizdik street  
Astana, 010000, Republic of Kazakhstan  
Tel.: +7 7172 97-74-27  
Fax: +7 7172 97-74-26

### Public relations (for general public enquires)

Tel.: +7 7172 97-76-00  
Fax: +7 7172 97-79-24  
E-mail: [pr@kmgep.kz](mailto:pr@kmgep.kz)

### Corporate secretary

(for general shareholders' enquiries)  
Tel.: +7 7172 97-54-13  
Fax: +7 7172 97-76-33  
E-mail: [info@kmgep.kz](mailto:info@kmgep.kz)

### Investor relations

(for institutional investors' enquiries)  
Tel.: +7 7172 97-54-33  
Fax: +7 7172 97-54-45  
E-mail: [ir@kmgep.kz](mailto:ir@kmgep.kz)

### Moscow representative office

Bolshaya Polyanka st. 53, Building 2  
Moscow, 119180, Russia  
Tel.: +7 495 627-73-18  
Fax: +7 495 627-73-19

### Auditors

Ernst and Young Kazakhstan LLP  
Esentai Tower, Al-Farabi Ave., 77/7  
Almaty, Kazakhstan  
Tel.: +7 727 258-59-60  
Fax: +7 727 258-59-61

### Registrar

JSC Fondovyi Tsentr  
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# 2009 Financial Calendar \*

|                       |                           |
|-----------------------|---------------------------|
| <i>12 March 2009</i>  | 2008 FY Financial Results |
| <i>May 2009</i>       | 1Q 2009 Financial Results |
| <i>28 May 2009</i>    | Annual General Meeting    |
| <i>8 June 2009</i>    | Dividends record date     |
| <i>September 2009</i> | 1H 2009 Financial Results |
| <i>November 2009</i>  | 3Q 2009 Financial Results |

*\* Dates correct at time of print, but subject to change.*

