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KAZAKHSTAN STOCK EXCHANGE ANNUAL REPORT

2010

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CONTENTS

78	KASE President's Address to Shareholders and Market Players
80	Conditions on Kazakhstan's Financial Market in 2010
82	Measures to Draw Issuers and to Increase Liquidity of Securities
86	Development of Trading and Settlements Technologies
90	Development of Derivatives Market
92	International Cooperation
94	Corporate Governance
96	Financial Performance in 2010
100	Financial Statements
108	Glossary

KASE President's Address to Shareholders and Market Players



DEAR LADIES AND GENTLEMEN,

The Year that is discussed in this report became for the Exchange the year of the completion of an important phase; a phase in which we learnt lessons from the crisis and solved detected problems. In this phase we prioritised tasks that would increase the reliability of the stock market.

In an attempt to minimise defaults inherent to foreign currency transactions the Exchange has set up the Currency Market Committee, which tracks the solvency of foreign exchange players and is designated to take measures to make less reliable players supply tenge and foreign currency in advance of transactions. A system of compensatory payments with a weekly revaluation of traders' liabilities has been devised in the "nego" repo transactions market that was the cause of so many disappointments at the height of the crisis. In 2010 we designed and began implementing a blueprint for a system of settlements on the securities market according to the T+0 scheme with complete preliminary delivery of securities and cash in order to considerably improve the reliability of the stock market of securities transactions. A fundamentally new risk management system that meets international standards was adopted by KASE on the futures and options market in 2010. Against this background, the Exchange for the first time acted as a central counterparty and assured the implementation of deals concluded in any circumstances in the amount of reserve and guarantee funds. Another reason these activities are important to us is that KASE is now applying the same principles when developing the risk management of multiparty net clearing and settlements on the securities market in accordance with the T+3 scheme. Jointly with regulators, we have drafted, adopted and improved a methodology to respond to defaults on listed bonds by corporate issuers. Even though only few names returned from the buffer to other categories of the official list, each of these returns is valuable for our market. In the year in question, the Exchange, the FSA and ARA RFCA made considerable advances on issues of cooperation with auditors that have been granted the right to audit financial statements

of listed companies. The work performed has made it possible to include measures to dramatically improve the situation in this sphere in the 2011–2013 Strategic Plan.

We should highlight the Exchange's efforts to minimise its operating risks. The shareholders have more than doubled the equity capital of KASE, building a factor of safety to allow the Exchange to meet prudential requirements. During the entire year the Internal Audit Service worked intensively on the Exchange and by the end of the year it had managed to audit all chief aspects of KASE activities. A system to manage this service was also perfected. The Risk Management Service was set up in 2010 and it has already arrived at an understanding of what to do within the next three years and how. On our behalf Ernst and Young carried out a technical audit of IT processes of the Exchange and drafted recommendations on improvements in this field. All this should bring the provision of uninterrupted operations of KASE to a fundamentally new level.

And now, having done significant work on the reliability of the stock market, KASE is at the threshold of a new phase – the phase of post-crisis development. We can clearly see where we should move to and what we need to do. A three-year Strategic Plan has been drafted on the basis of work on a crucial increase in the liquidity of financial instruments traded on the Exchange. During the reporting year we, along with our partner structures, created the foundation for this path.

The most important here is the government programme, “people's IPO”. The initiatives proposed by KASE and RFCA agencies were backed by government bodies. The programme of floating national companies' shares on the local market instils great hopes for a fundamental increase in the liquidity of shares on Kazakhstan's stock market. Another state programme – the *Roadmap for the Development of the Securities Market*, many provisions of which were drafted by Exchange specialists – will work in the same direction.

Other projects by the Exchange are also worth noting, as they create a basis for increasing liquidity. For instance, in 2010 new *Rules for the Activities of Market Makers* were adopted to offer more comfortable, in our opinion, conditions for the work of brokers on KASE. During the entire reporting year the Exchange studied other trade and post-trade technologies and assessed the possibility of using them on its own floor to improve liquidity. The year 2010 was the first year when the Exchange supplied trade data in the real-time regime to major global providers of market information, using established international standards and protocols in this sphere. Investors from any country are now able to efficiently use our data when making decisions. The Exchange completed the design of a new terminal for trading shares on KASE via the Internet. In December 2010 we successfully used this terminal to organise an exchange simulation game for an unlimited number of private investors.

In performing these tasks, KASE continued to develop as a commercial structure. In the reporting year for the first time in its history, the Exchange paid dividends to its shareholders. In 2010 the Exchange reached double its target for net profit, despite the continued fall in turnover in certain sectors of the market that did not recover from the crisis.

In conclusion, I would like to express my gratitude to shareholders and Exchange members for their joint productive work and to reassure you that the Exchange will put every effort into implementing the intended strategic tasks.

Kadyrzhan Damitov
President of the Kazakhstan Stock Exchange

Conditions on Kazakhstan's Financial Market in 2010



The reporting year was marked by a better economic situation in Kazakhstan amid the continued volatility on global financial markets and, as a result, by differently directed and contradictory dynamics of the main indicators of the domestic financial market.

The end of the acute phase of the financial crisis in Kazakhstan can be fairly linked to the completion in 2010 of the process of restructuring debts of the three major Kazakh banks that declared default on their liabilities in spring 2009. Various estimates put the size of written-off debts of Alliance Bank JSC, BTA Bank JSC and Temirbank JSC somewhere between USD11bn and USD12bn; the remaining debts were converted to shares and new bonds in these banks.

The situation on Kazakhstan's corporate debt market significantly stabilised in the second half of 2010. Beginning from May KASE-listed companies had not committed any new defaults. The volume of unsettled debts fell, our estimates show, by 54% to KZT94bn in the second half of the year¹. By the end of 2010, the official list of the Exchange included securities of only nine companies that had committed defaults. One of these companies paid up its debts fully during the reporting year, while three companies settled their liabilities on debenture bonds through restructuring them. The remaining companies in arrears were made report to the Exchange every three months about their progress towards settling their liabilities before shareholders.

Despite a significant reduction in credit risks in the corporate sector of Kazakhstan's financial market, players continued to adopt conservative investment strategies. Investors were inclined to buy government securities and corporate bonds with the highest investment quality – liabilities of major state-owned and quasi-state-owned companies (Figure 1). The Ministry of Finance heavily issued MEKAM, financing the state budget deficit that stood at 2.89% of GDP at the end of the year (Figure 2). High demand and supply on the government securities market sustained the stock market of government securities, with the size of transactions on it growing by 1.7% year-on-year to KZT1,431.4bn in 2010.

In the context of strong demand for first-class instruments with fixed yield, the role of the primary market of corporate bonds grew significantly. In 2010 the Kazatomprom National Nuclear Company JSC, KazMunayGas National Company JSC and the Development Bank of Kazakhstan JSC issued bonds on local and foreign markets. This resulted in the volume of funds raised only through Kazakhstan's stock primary market of corporate bonds reaching a record high for KASE of KZT64.8bn (USD438.8m).

At the same time, the year 2010 was marked by relatively high prices on global commodities markets. The Brent oil price jumped by 14.6% to USD93.49 per barrel. The three-month futures contract of copper on the London Metal Exchange soared by 23.8% to USD4,213 per tonne (Figure 3).

¹ The Exchange does not possess comprehensive information about the volume of unrealised liabilities on corporate debt, as well as measures taken by issuers to settle them, because bonds of several companies committed default were de-listed and their issuers lost liabilities before the Exchange on disclosing information of their activities.

Figure 1

STRUCTURE OF CONSOLIDATED INVESTMENT PORTFOLIO OF KAZAKHSTAN'S PENSION ASSETS IN 2005-2010, %

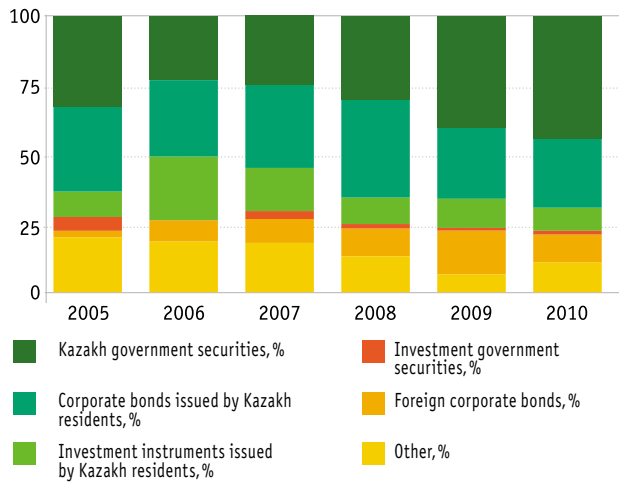


Figure 2

STATE BUDGET DEFICIT IN 2005-2010, % OF GDP

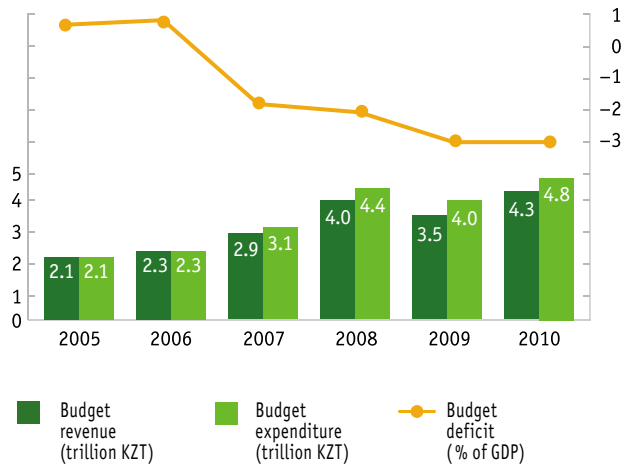
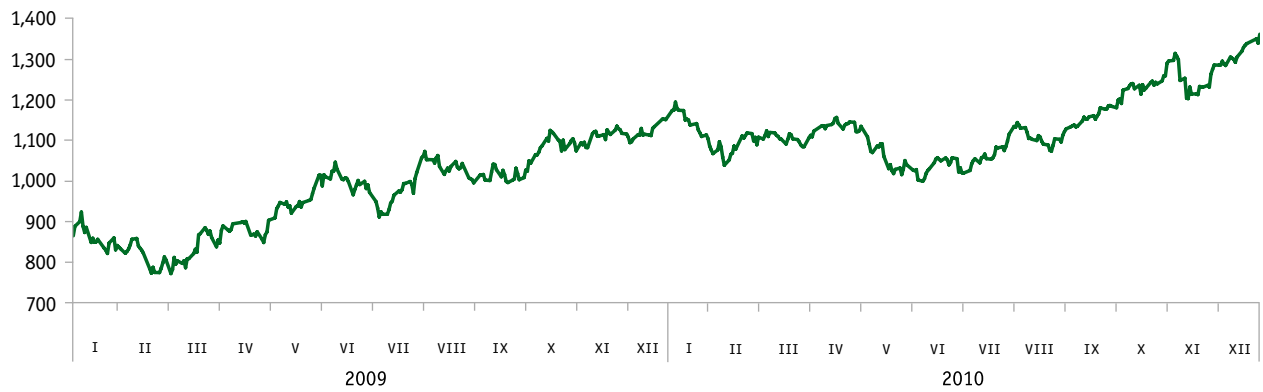


Figure 3

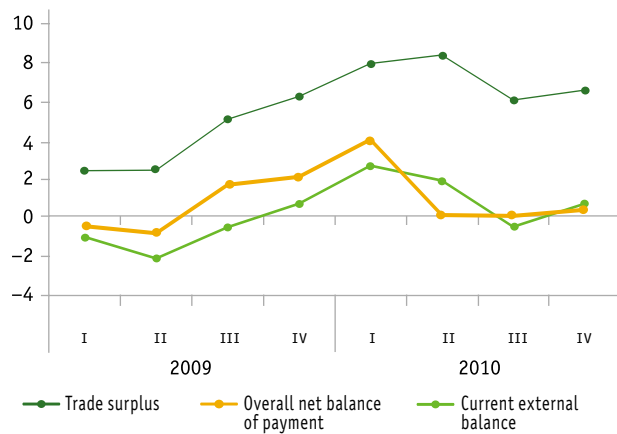
DYNAMICS OF COMMODITIES MARKETS INDEX UBS CMCI COMPOSITE USD TOTAL RETURN*, ITEMS**



* An index that reflects the yield of a wide diversified basket of commodities futures contracts
 ** Bloomberg data

Figure 4

KAZAKHSTAN CURRENT ACCOUNT BALANCE INDICATORS DYNAMICS IN 2009 AND 2010, BILLION USD*



* Data of the National Bank of Kazakhstan

Figure 5

DYNAMICS OF MONEY MARKET INDICATORS IN 2010, % PER YEAR

