

Strategic overview

Interview with the Chief Executive



Kurmangazy Iskaziyeu
Chief Executive Officer of KMG EP

“Our company constantly improves technologies for crude production; and optimises operations to reduce capital expenditure and the costs of extracting crude. We are in favour of increasing exploration.”

Q

Mr. Iskaziyeu, how would you characterize the results achieved in 2015?

A

In 2015 the oil industry, not only in Kazakhstan but around the world, suffered a serious decline which affected our further plans. Low oil prices are forcing us to review investments and to seek possibilities for savings, while supporting current production levels with minimal costs.

Despite negative external factors, production levels remain stable and in line with set plans. At our main field at Ozenmunaigas JSC we produced 5.5 million tonnes in 2015 which is 3% more than last year. On the whole, higher production was achieved by bringing new wells into operation and improvements in completions of producing wells.

Net profit for 2015 was higher at 244 billion tenge (US\$ 1,096m) although the increase in net profits is mainly due to exchange rate gains which compensated for lower revenues caused by the fall in oil prices.

Q

What production targets have you set yourself in the business plan?

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We plan a 1% rise in volumes from our main fields of Ozenmunaigas JSC (OMG) and Embamunaigas JSC (EMG) in 2016, raising total production volumes to 8.4 million tonnes, primarily due to production from the transfer fund of wells. At the same time we plan to reduce capital expenditure by 21% compared to 2015, primarily by reducing the volume of exploratory drilling. By 2020 overall production at OMG and EMG should increase by 4% compared to 2015, but this is conditional on improving the effectiveness of our currently producing wells, specifically including production increases from the declining well stock as a result of improvements of the recovery factor.

Production will decline by 17% compared to 2015 at our joint ventures of JV Kazgermunai LLP, Karazhanbasmunai JSC and PetroKazakhstan Inc., due to depletion of reserves. This means that the overall production of KMG EP, including its shares in KGM, CCEL and PKI is expected to be 3% lower by 2020 than in 2015.

Q What financial results are you planning to achieve?

A Present market conditions have impacted most significantly on the profitability of OMG. To support the enterprise, which is the sole urban employer in the area, the Board of Directors has agreed to provide 45 billion tenge of additional financial support in 2016. Taking into account the support of 37 billion tenge provided to OMG in 2015, this brings the total amount of support over two years to 82 billion tenge. Under the agreement terms, OMG should repay these funds by the end of 2017.

I would like to point out that both the budget and the business plan require additional work. Taking changes in external factors into account, we shall take all possible measures towards reducing costs and improving efficiency at KMG EP.

Q Will you be reducing operational expenditures through, for example, cutting employee numbers? In light of the crisis many global oil companies have already announced personnel cuts.

A We have done the utmost to reduce those expenditures, which do not affect the levels of production by postponing long-term projects to later dates. Regarding operational costs, the lion's share is made up of wages and salaries. In 2014 these rose by 32%, including the annual indexation of salaries, the 10% increase of salaries to compensate for devaluation of the tenge and also the introduction from April 1, 2014 of a Unified System of Wages (USoW) of the "Exploration & Production" business department, set up on the initiative of the NC KMG holding company.

In 2015 expenditures on salaries rose by 13%, mainly due to the annual indexation of salaries by 7% and the effects of USoW over three months of the previous year. We treat labour costs as fixed, in other words these are costs that we cannot influence due to the social responsibility of KMG EP towards the Company's workforce. However, we are trying to keep other expenditure items at present levels by raising efficiency.

Under our business plan the optimisation of production costs does not envisage reductions in headcounts, conditional on present macroeconomic conditions remaining unchanged. But in the case of deterioration in the situation, the Company will be forced to consider a range of anti-crisis measures, such as the shortening of working hours, holidays without pay, etc. If such measures would have to be introduced, and they would be extreme, then the management of the Company would be forced to include in the discussions of these matters representatives of trade unions and of the staff.

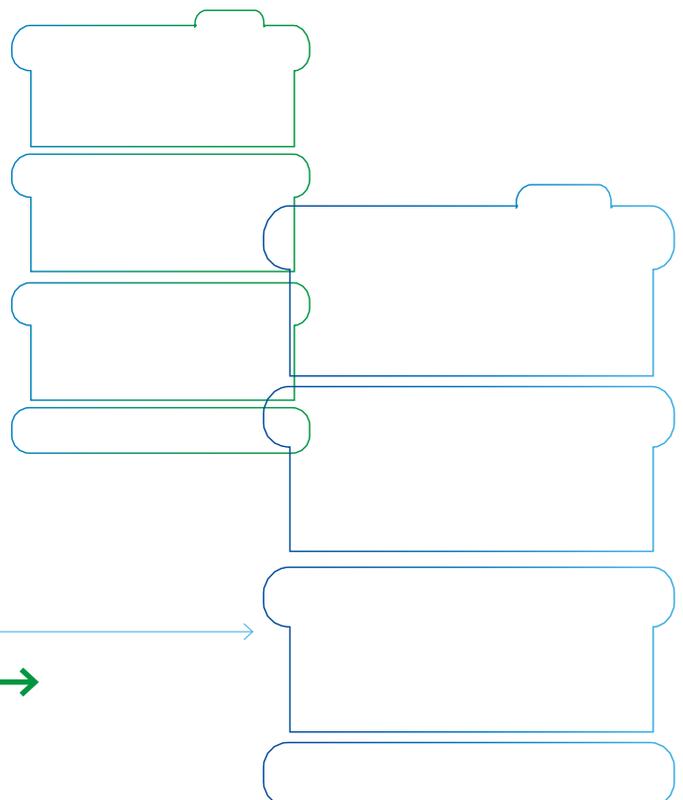
Q How are you planning to replenish reserves, given that KMG EP has not made large acquisitions recently and has cut back on exploration?

A Our company is aiming to re-activate exploration to replenish our reserves as soon as market conditions permit. At present we are looking at ways of securing sub-surface exploration and production rights at new blocks, which have attractive prospects, including on pre-salt prospects. In March 2015, for example, EMG adopted a long-term strategy which includes exploratory studies of deep pre-salt prospects in the Caspian basin.

We have worked hard to identify partners, investigate the feasibility of projects and secure corporate permissions. In future, should commercial deposits be located, we would also consider joint ventures. In particular, we are planning to explore several promising sites with potential oil bearing reservoirs below 7,000 metres.

At Zhanaozen we have started to broaden the resource base of KazGPZ. This plant provides residents with liquid gas, dry benzene-free gas and furnace fuel and also supplies Mangistau enterprises with technical-grade oxygen. Under plans up to 2024 we envisage a four stage increase in reserves and production.

NC KMG has also initiated a business transformation programme involving all of its subsidiary companies.



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Interview with the Chief Executive continued

Q

What sort of transformation is happening at KMG EP? What are the manifestations of these changes?

A

This programme envisages optimisation of expenditures and processes, increases in effectiveness and, ultimately, in the profitability of the enterprise. Taking EMG where this programme is already being introduced as an example, there are three directions being realised, which are the cornerstone for future progress. These are the introduction of smart wells in the Uaz field, the optimisation of material-technical support services (MTO) and the optimisation of technical support and equipment maintenance processes (TORO).

The MTO and TORO projects will allow us to improve processes at all levels of control over the supply system, to lower stock levels in storage and also to shorten the lead times for organising purchases and their sales. The economic benefits generated within the framework of the MTO process between January 2015 and January 2016 have already reached 1.3 billion tenge. The overall effect by the end of 2017 should be 3.3 billion tenge.

Another project being delivered by specialists at EMG using their own resources is the "smart field". At all stages of oil production at the Uaz field, equipment has been installed that takes readings and delivers them in real time to the control centre. In parallel, all information is delivered to the Centre for visualisation, where we can analyse it – and make long-term planning decisions on the basis of this information.

According to preliminary forecast data, thanks to the "smart field" project, production at the Uaz field could be about 3% higher. The time required to repair wells will also be cut by 15-20%. More careful handling of sub-surface equipment will reduce the frequency of maintenance operations from 20 to 15 per annum.

Q

What social programmes are being delivered at KMG EP?

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We continue to make payments within the framework of our sub-surface production contracts towards the development of regions where KMG EP is active. In 2015 we contributed 1.9 billion tenge towards various social projects in the Atyrau and Mangistau regions. Local councils decide which social needs should be addressed by these funds, depending on regional requirements and on applications from residents. The Company also provides sponsorship assistance to sports associations, veterans of war conflicts and the Munayshi fund. Collaboration on social development continues and we are trying to improve living standards every year within those areas where we are present.

Q

In the present economic conditions it is quite difficult to remain optimistic. What would you like to say to the workers of KMG EP, who number over 26,000 people across several regions of Kazakhstan?

A

The Board has set serious tasks before management, which are geared towards taking KMG EP to a new stage of development. Our company constantly improves technologies for crude production; and optimises operations to reduce capital expenditure and the costs of extracting crude. We are in favour of increasing exploration. If each and every one of us performs their tasks with the emphasis on quality, we will transform our operating and management processes, deliver a stable level of crude production and enhance the shareholder value of KMG EP. We have all the prerequisites for this; we only need to work hard and to support each other to accomplish all our plans.