Approved by

The Board of Directors of JSC "Samrұқ-Kazyna"

№113 from September 17, 2014

decision

The Board of Directors of JSC "Samrұқ-Kazyna"

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The Board of Directors of JSC "Samrұқ-Kazyna"

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Transformation program for «Sovereign Wealth Fund «Samruk-Kazyna» JSC

25 August 2014

Contents

EXECUTIVE SUMMARY

‘Kazakhstan 2050 Strategy: New Political Course of the Established State’ outlines Kazakhstan’s aspirational target to become one of the world’s top 30 developed nations. To achieve this aspiration, Kazakhstan will need to make a major breakthrough in terms of investment growth and improved productivity of its existing assets. Samruk-Kazyna controls some of the country’s key assets and has a critical role in setting the necessary conditions to achieve the Strategy goals.

Currently, the Fund’s operational and investment performance indicators are not sufficient to set the necessary conditions to achieve the Strategy goals. To deliver the required improvement in operational and investment performance, the Fund has developed a program of large-scale transformation of the Fund itself and of the portfolio companies it controls (“Transformation program of JSC Sovereign Wealth Fund Samruk-Kazyna”, hereinafter referred to as the Program). The Program was developed by the Fund’s top management and serves as a blueprint which outlines general principles of transformation for the entire Samruk-Kazyna Group, including the Fund and its portfolio companies.

The next critical step will be aligning and detailing these principles jointly with the management of the Fund’s portfolio companies. This work will result in transformation plans for the portfolio companies. The Program encompasses three axes: 1) value improvement in portfolio companies, 2) portfolio restructuring and changing the Fund’s approach to investing, and 3) reforming powers and responsibilities in the Fund’s and portfolio companies’ governance. The implementation of the Program will require substantial changes to the mode of operation of the Fund and its portfolio companies, as well as to the interaction mechanism with the state bodies that are involved in the Fund’s operations.

Meeting the Program’s goals will require not only implementing a number of initiatives, but also changing the mindsets of all stakeholders.

The transformation of Samruk-Kazyna and its portfolio companies will progress in two stages: in the first stage (2014-2015) the Program will involve the Fund itself and three pilot companies, and in the second stage (2015-2016) the Program will cascade into the other portfolio companies. By starting the transformation program the Fund’s group will launch a process of continuous improvement which will become the new corporate norm after completion of the Program.

Samruk-Kazyna Transformation Project Management Office at the Fund level will ensure the success of the transformation program by monitoring progress, reporting, providing centralized guidelines, managing risk and communicating progress to all stakeholders.

1. THE NEED FOR TRANSFORMATION AND GOALS OF THE PROGRAM

Key messages of this chapter:

- ‘*Kazakhstan 2050 Strategy: New Political Course of the Established State*’ outlines the aspirational target of becoming a top 30 developed nation.
- To achieve this aspiration, Kazakhstan needs a major breakthrough in terms of investment growth and improved productivity of existing assets.
- Samruk-Kazyna owns a number of key assets in Kazakhstan and plays a critical role in making such a step-change happen.
- The Fund’s and portfolio companies’ operational and investment performance targets are not sufficient to deliver on the state strategy.
- To deliver the required improvement in operational and investment performance, the Fund has developed a program of large-scale transformation of itself and of the portfolio companies it controls (“Transformation program of JSC Sovereign Wealth Fund Samruk-Kazyna”).

In ‘*Kazakhstan 2050 Strategy: New Political Course of the Established State*’, President Nursultan Nazarbayev has set the main goal to enter the list of the world’s 30 most developed countries. As Kazakhstan implements this aspirational development strategy over the next 35 years, it can build on a number of important advantages:

- A comparatively young and well educated population, providing an excellent basis for rapid labor productivity improvement
- Substantial natural resources, creating many attractive investment opportunities in sectors with high value add
- Large neighboring markets (e.g., Russia and China) for the additional products and services produced in Kazakhstan

All these advantages have already had a significant positive impact on Kazakhstan’s economic development, with average annual real GDP growth of 7% from 1997 to 2012. Nevertheless, the base case scenario (drawing on the current development trajectory and existing development plans) demonstrates that continuing what Kazakhstan is doing today is not going to be enough to achieve the aspirational 2050 target. Kazakhstan risks falling into the middle income trap – when a country fails to surpass a certain income per capita due to insufficient investments, high dependence on raw material exports, and shortage of skilled labor.

In the last 50 years, of 100 countries that achieved middle income status, only 13 (Japan, South Korea, Taiwan, Singapore, Hong Kong, Israel, Ireland, Spain, Mauritius, Portugal, Greece, Puerto Rico and Equatorial Guinea) have managed to break through and enter the high income group of countries. Kazakhstan has been doing well so far, as China, Panama and Kazakhstan are among the few countries whose historical growth has consistently been above that required to become an OECD country by 2050 *[Figure 1]*.

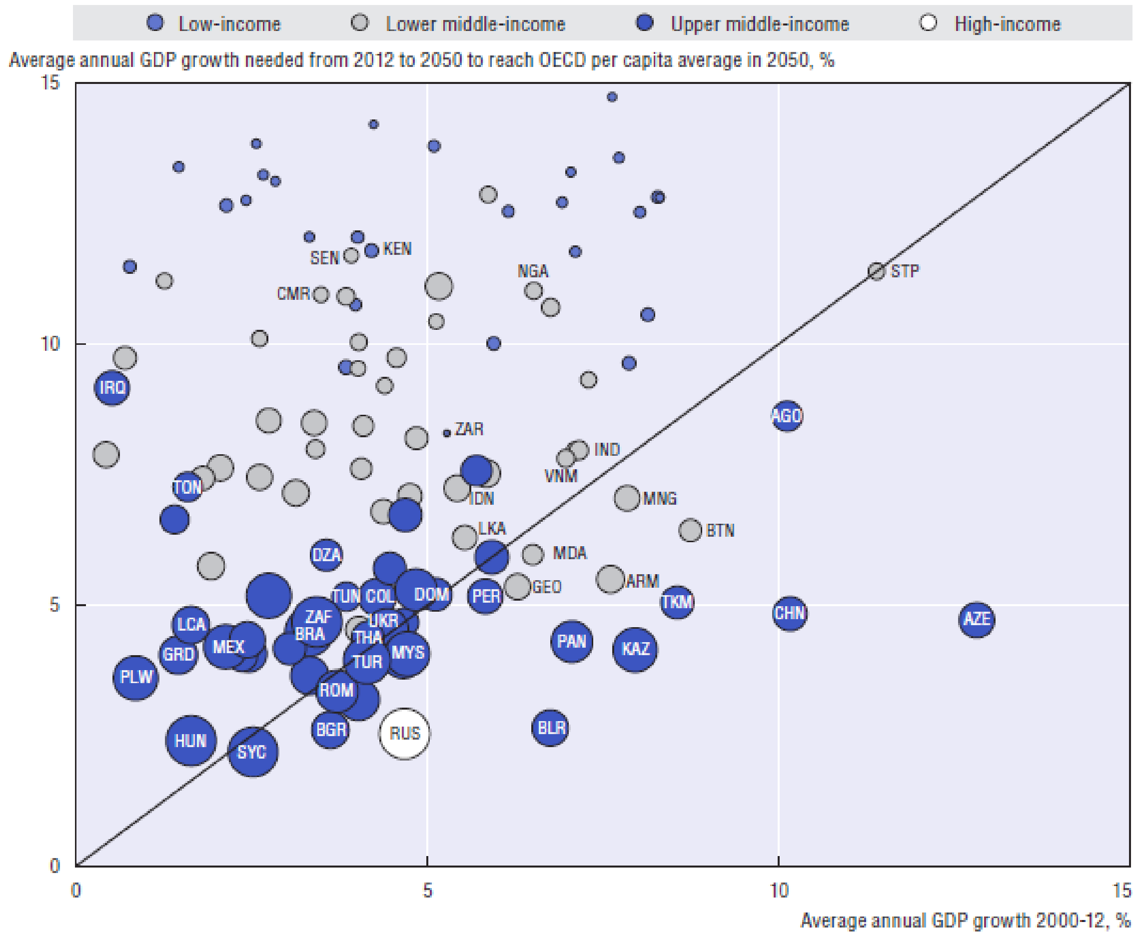


Figure 1: Many middle-income countries may never achieve the high-income country status

A recent OECD report, '*Perspectives on global development 2014 – Boosting productivity to meet the middle-income challenge'*, highlights the critical role of efficient investments into capital stock and greater labor productivity as key factors for sustaining such a development path over an extended period.

The '*Kazakhstan 2050 Strategy*' highlights the need for increased efficient investments into capital stock and a step change in productivity. The national strategy sets ambitious targets:

- **Significantly expand the scale and efficiency of investments in capital stock**: increase investments' share of GDP, from the 2009-13 average of 21.4% (KZT6.1 trillion in 2013) to the target of 30% by 2018 (KZT19.7 trillion).
- **Double productivity growth**: from 3.6% in 2010-12 to 6.5% in 2015-20. Productivity will need to grow from KZT3.6 million per employed person in 2012 to KZT5.5 million in 2020 in constant prices.

In Kazakhstan, Samruk-Kazyna is best positioned to drive productivity improvements and efficient investments into asset classes that require high up-front investments, long pay-back periods and/or close links to regulatory decisions.

International experience shows that sovereign wealth funds manage the efficiency of their operational and investment activities through three key indicators *(More details in Appendix 1)*:

1. **Asset value growth.** International peers have seen the market value of their assets grow by 10-20% p.a. In 2009-2013. The Fund has demonstrated a book value growth of 7.7% p.a. (book value is the closest proxy, since the market value of the Fund's assets is not available before 2013).
2. **Dividend yield to shareholders.** International peers with assets similar to Samruk-Kazyna have provided up to 40% per annum of their net income as cash dividends to shareholders (for example, Khazanah in 2009-2013). In the same period the Fund has paid on average 13,2% of its net income (2.2% as cash dividends and 11% as other distributions to the shareholder). In addition, the Fund and its portfolio companies annually bear costs that may be characterized as distributions to the shareholder in the amount of 20% of net income.
3. **Value creation measured as economic profit.** In 2013 the Fund was able to continue EBITDA growth, but its economic profit was still negative. The best performing public investors are able to generate positive economic profit. From the three strategic targets above, the one requiring most attention is value creation measured as economic profit.

To identify the root causes for this, portfolio companies' performance was benchmarked against international peers. The results of this benchmarking are shown below.

In terms of the first key driver of economic profit, 'Net Operating Profit Less Adjusted Taxes / Revenues', most portfolio companies are in a satisfactory position – the Fund's focus on EBITDA margin has clearly driven performance improvements in recent years. However, in terms of the second key driver, 'Revenues / Invested Capital', the portfolio companies clearly lag behind their peers – the amount of capital they require to generate business is significantly higher. This is the result of below-peer productivity, inefficient capital allocation and poor execution of capital projects *[Figure 2]*.

Company	Operational profit margin EBITA/revenue	Capital efficiency Revenue/ invested capital	ROIC EBITA/inves ted capital	Notes
Air Astana	+	+	+	▪ Strong market position as the main performance driver
Kazakhtelecom	=	–	–	▪ Overinvestment in capacity as the main driver on lower ROIC
Kazatomprom	=	+	+	▪ Proprietary technology drives higher capital efficiency & ROIC
KazPost	–	–	–	▪ Excessive investments and lower profit margin result in lower ROIC
KEGOC	–	=	–	▪ Lower profit margin results in lower ROIC
KazMunaiGaz	=	–	–	▪ Overinvestment in capacity as the main driver on lower ROIC
KTZ	+	–	+	▪ Very strong profit margin outweighing lower capital efficiency
Samruk Energy	–	–	–	▪ Capacity overinvestment as the bigger drag on ROIC

Figure 2: Benchmarking results of Portfolio companies compared to global industry peers

Furthermore, benchmarking revealed three major differences between best practice and the management methods used by the Fund, that contribute towards portfolio companies' negative economic profit:

- **Focus on reporting and regulation**: Working time analysis revealed that Fund employees spend a lot of time on correspondence with governmental authorities, official reporting, and checking regulatory compliance. Only a small number of Fund employees spend their time on assessing the potential to extract more value from the existing portfolio companies. In order to match the performance of international peers, Samruk-Kazyna should become a '**private equity-like owner**'
- **Passive capital distribution:** Most of the cash flows generated by portfolio companies are reinvested by the portfolio companies themselves. Currently the Fund does not actively redistribute capital between the portfolio companies to optimize its risk-return profile, nor does it have a clear vision of the target year-by-year portfolio composition. Many portfolio companies also span multiple industries, have complex legal structures and a significant amount of capital tied up in non-core assets, making efficient management of the asset base difficult. In order to match the performance of international peers, Samruk-Kazyna should become an '**active investor**', i.e. actively reallocate capital among existing portfolio companies and new projects according to its investment strategy.
- **Functional management model with extensive government involvement**: The Fund's anti-crisis manager role between 2008 and 2010 led to a "manual mode" of management, resulting in the portfolio companies' functions working directly with those of the Fund in many areas, and also working closely with government institutions (often bypassing the recognized model of corporate governance). This ensured quick changes and an increase in control, but led to a gap in accountability – it is not fully clear who at the Fund level is accountable for portfolio company performance where the Fund has share ownership. The separation between the Fund as investment holding arm and the ministries and regulator is also not as clear as it is for peer funds. In order to match the performance of international peers, Samruk-Kazyna should become a '**commercial strategic holding**' with clearly defined powers and areas of responsibility.

Thus, Samruk-Kazyna's transformation program should be launched with the following objectives:

1. Portfolio company productivity should be on a par with or above that of their global peers.
2. The Fund should deliver on three strategic targets in parallel: 1) asset value growth, 2) dividend yield for shareholder, and 3) value creation measured as economic profit.

International experience shows that improving the way a nation's sovereign wealth fund works can significantly contribute towards national strategic targets. For example, Khazanah (Malaysia) launched its transformation program in 2004, and Temasek (Singapore) started its transformation program in the late 1990s. Both funds achieved significant results which had a positive impact on the development of their respective countries. *(More details in Appendix 2)*

Changes in the Fund (where about 150 people are employed) will improve the productivity and efficiency of investments among its portfolio companies (where about 350,000 people are employed). Better productivity and investment efficiency among the portfolio companies will have a positive impact across the supplier network (employing 600,000-900,000 people) and the whole Kazakhstan business community. As a result of the transformation, Samruk-Kazyna and its portfolio companies will thus become a talent factory for the whole country.

The objectives of the transformation described above are fully in line with the Fund's strategy in terms of its social responsibility to the people of Kazakhstan. Better efficiency among the Fund's portfolio companies will lead to better quality and competitiveness of the goods and services they provide. This will have a positive impact on Kazakhstan's private and corporate consumers. Improving the Fund's financial capacities will lead to more taxes collected from the portfolio companies, more dividends to the government, and increased capability of the Fund to finance strategic projects of national importance.

Table 1: Measurable targets for the Samruk-Kazyna transformation portfolio

Expected results	**2019**
Asset value growth [KZT; % increase in book value]	630- 1 000 bn 8-12%
Recorded dividend yield for shareholder [KZT; % of net income]	190 bn 20%
Value creation measured as economic profit	Break-even in EVA terms (for 12 largest companies) by 2020
Portfolio companies performing at par or above the global industry peers in productivity (based on three above indicators)	8/8

2. ACTIONS ON WHICH THE TRANSFORMATION WILL FOCUS

Key messages of this chapter:

- Samruk-Kazyna's transformation program includes 9 initiatives across three axes of transformation: 1) value improvement in portfolio companies, 2) portfolio restructuring and changing the Fund's approach to investing, 3) reforming powers and responsibilities in the Fund's and portfolio companies' governance
- The transformation will deliver its intended results only if all improvement areas are successfully implemented in both the Fund and the portfolio companies

- The implementation of the transformation Program will require significant changes at the Fund, portfolio companies, as well as government bodies, interacting with the Fund

The Samruk-Kazyna transformation Program consists of three critical axes of transformation, involving nine initiatives across the Fund and the portfolio companies:

- **Transformation axis 1: Value improvement focus within the core business.** Becoming a '**private equity-like owner**' requires a value improvement focus within the core business, enabled by the following initiatives:
  - 1A: Implement business process re-engineering
  - 1B: Redefine the strategic KPIs for the fund and portfolio companies
  - 1C: Align portfolio companies' strategies with the strategic KPIs
- **Transformation axis 2: Portfolio restructuring.** Becoming an '**active investor**' requires portfolio restructuring and revising the investment approach, enabled by the following initiatives:
  - 2A: Simplify the legal structures of the portfolio companies
  - 2B: Bring public investors into core assets, and remove non-core business assets and social assets from the portfolio
  - 2C: Establish a new, active investment approach
- **Transformation axis 3: Governance.** Becoming a '**commercial strategic holding**' requires major changes in powers and responsibilities in the Fund's and portfolio companies' governance system, enabled by the following initiatives:
  - 3A: Increase effectiveness of interactions with government
  - 3B: Strengthen the sectorial teams
  - 3C: Clarify the role, mandate and capacity of the Board of Directors

	Initiatives	Fund level	Portfolio company level
Transformation axis 1: Value improvement focus with the core business	1A: Implement business process re-engineering	▪ Capture productivity improvements by implementing the four step common methodology	▪ Capture productivity improvements by implementing the four step common methodology
	1B: Redefine the strategic KPIs for the fund and portfolio companies	▪ Start using in practice the agreed three fund level KPIs and targets	▪ Define 5-10 strategic KPIs with targets for each portfolio company ▪ Annual benchmarking of productivity / ROIC to global industry peers
	1C: Align Portfolio companies' strategies with the strategic KPIs		▪ Revisit portfolio company strategies in light of newly set strategic KPIs and targets
Transformation axis 2: Portfolio restructuring	2A: Simplify the legal structures of the Portfolio companies		▪ Identify potential legal entities to be eliminated by applying the agreed working principle (legal entities in max in 3 layers) ▪ Execute the approved plan
	2B: Bring public investors into core assets, and remove non-core business assets and social assets from the Portfolio	▪ Implement the restructuring plan in-line with the government decision	▪ Implement the restructuring plan in-line with the government decision ▪ Transfer any social assets outside the Portfolio companies and the Fund
	2C: Establish new active investment approach	▪ Develop Fund investment strategy ▪ Define investment process and standard financial model for investment projects ▪ Monitor on-time on-schedule performance	▪ Start applying the defined working practices
Transformation axis 3: Governance	3A: Increase effectiveness of interactions with the Government	▪ Identify the principal legislation that requires to be changed in order to implement the program ▪ Participate targeted efforts (lead by the ministries) to enhance the industry regulation ▪ Define the appropriate formal and informal interactions with the Public sector institutions, and run training campaigns related to it	
	3B: Strengthen the sectorial teams	▪ Build 6 sectorial teams and strengthen their capabilities ▪ Establish the working process for sectorial teams ▪ Build management accounting infrastructure	
	3C: Clarify the role, mandate and capacity of the Board of Directors	▪ Expand the Board of Directors power ▪ Create World-class Board of Directors composition ▪ Establish an effective system for the Board of Directors performance evaluation ▪ Ensure applying of the commonly known best practices in BoD operations	

Figure 3: Three transformation axes and nine initiatives of the transformation Program

TRANSFORMATION AXIS 1: VALUE IMPROVEMENT FOCUS WITHIN THE CORE BUSINESS

Initiative 1A: Implement business process re-engineering

A growth in value of portfolio companies is closely linked to an increase in efficiency in managerial, operational, and supporting business processes at the Fund and portfolio companies. Benchmarking various process and performance indicators of subsidiary companies has identified significant scope for operational improvements.

In order to address this major gap in the operational performance of the portfolio companies, an operational transformation has already been formally launched at three pilot companies at the beginning of 2014 . Four strategic pillars are in the core of this initiative:

- A "**Value-Centric**" approach – move from managing discrete, tactical "project budgets" to a programmatic mode of value-driven decision making based on enabling the relevant business strategy.
- A "**Process-Centric**" approach –a global best practices consistently across the group and ensure continuity in creating and delivering information.
- A "**People-Centric**" approach – attract, develop, manage, and retain staff throughout the group's ecosystem to ensure development of human capital within the sector.

- A **“Technology-Centric”** approach – adopt globally proven technologies to enable company management teams to make informed decisions based on timely and accurate data.

The Fund’s and portfolio companies’ processes will be optimized, transparently structured, defined in a standardized way and clearly connected to key performance indicators at all levels. They will be contained in a unified knowledge base, enabling reviews of their efficiency and providing direct access to information.

Similar processes will be performed across the portfolio companies, thus enabling fast responses to problems and simultaneous implementation of changes. This will also ensure automatic control of execution and reporting with the required speed, detail and reliability of information. All regulations and policies related to processes will be generated automatically based on logic captured in process flow designs.

The processes will be clearly connected with the organizational structure; allocation of powers will be fully determined; and descriptions will be created of controls and control procedures required for internal controls. This level of clarity and transparency will make it possible to assess personnel needs, as well as the knowledge and skills required for each position. Any discrepancies will be eliminated through development, training and re-allocation of human resources.

In order to maximize impact, the aim is to identify and prioritize quick wins as the work to modernize the processes progresses. Based on the value estimates the purpose is also to revise the current portfolio of optimization initiatives within each portfolio company. For the processes, best practice processes from global leaders will be used as a baseline, but will need to be tailored to the particular needs and circumstances of the Fund’s companies.

Within each portfolio company, business process re-engineering will be executed in four stages, using a common methodology that includes a set of templates and tools to support execution:

- **Preparation**. During this stage (typically ~1 month) the project team is assembled and trained, and required documents are developed and approved within the portfolio company.
- **Diagnostics and design**. During this stage (typically 6-9 months) the project team creates a high level process map, identifies and prioritizes improvement opportunities, and develops and details the target state (including target IT architecture and process automation schedule). This stage covers all elements of the system including processes, people (organization structure, skills, etc.) and systems. Benchmarking and standardized analyses (such as the Organizational Health Index) are used extensively.
- **Planning**. Lasting ~1 month, this stage results in an approved program of projects to be implemented within a portfolio company.
- **Implementation**. This stage can take 12 months or more (the duration and necessary resources depend on the complexity of the project portfolio). At this stage, changes designed at the previous stage are implemented.

The Fund has initially prioritized three pilot portfolio companies: Kazakhstan Temir Zholy, KazMunayGas and Kazpost. After this effort has gained sufficient momentum the program will be rolled out to other portfolio companies. This approach has been successfully applied in two of the pilot companies, and the results so far are promising.

Expected results	2014	2015	2016	2017	2018	2019
Business process re-engineering program launched in top 7 companies	3	7	7	7	7	7
Number of entities out of the targeted seven (the Fund and six industrial groups) with new set of KPIs approved	1	7	7	7	7	7

Initiative 1B: Redefine the strategic KPIs for the fund portfolio companies

The objectives of the transformation Program for the Fund and its portfolio companies are to ensure asset value growth of 8-12% p.a., increase the dividend payout to shareholders to 20-30% and as achieve positive economic profit. The portfolio companies' strategic KPIs will thus also need to be reviewed.

Analysis shows that the current performance planning and evaluation system has a number of drawbacks:

- Excessive number of KPIs for portfolio companies
- Insufficient number of indicators measuring the efficiency of capital utilization and value creation
- Excessive number of industry-specific financial and operational indicators.

Within the transformation Program these drawbacks will be remedied as a result of a review of the portfolio companies' strategic KPIs. The new strategic KPIs for portfolio companies should meet two requirements:

- **Evaluate expected value creation and operational efficiency:** focus on ensuring both short-term and long-term value creation, and boosting the long-term competitiveness of the portfolio company.
- **Determine boundary conditions:** ensure achievement of KPI targets based on the principle of cascading the Fund KPIs.

The list of portfolio company KPIs may include 5-7 KPIs involving both boundary conditions (assuming compulsory compliance) and expected results. In exceptional cases when a portfolio company encompasses a broad spectrum of business activities, the number of KPIs could be as high as 10. To illustrate, the following strategic KPIs are planned for KazMunayGaz JSC, the Fund's largest portfolio company:

- Economic profit

- Growth in the company value
- Reserve replacement ratio
- Up-time (upstream, midstream, downstream)
- Average unit cost to market (upstream)
- Return on equity, while maintaining debt/equity and EBIT/interest expense ratios
- Total dividends
- Lost time injury frequency rates
- Social stability rating

The Fund's sectorial teams will prepare a draft list of key performance indicators for the portfolio companies. This list will be discussed with the Board of Directors, which will then decide on the final list of key performance indicators and related targets.

Expected results	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Number of entities out of the targeted seven (the Fund and six industrial groups) with new set of KPIs approved	1	7	7	7	7	7
Number of entities out of targeted seven (the Fund and six industrial groups) with new targets related to the new KPIs approved	0	0	7	7	7	7

Initiative 1C: Align portfolio companies' strategies with the strategic KPIs

The current five year strategic plans for the portfolio companies have been developed to optimize EBITDA margin, not value creation measured as economic profit. Analysis reveals that successfully delivering on these plans would provide a steady improvement in profitability. But a closer look at the five year strategic plans indicates that they are not aligned with the value-creation objective, and would perpetuate the current negative economic profit.

To correct this mismatch, portfolio companies' five year strategic plans need to be aligned with the updated strategic KPIs for the portfolio companies. Therefore, by the end of the first quarter 2015 the Fund will require portfolio companies to conduct a comprehensive review of their value creation agenda. Portfolio companies need to work out mid-term and long-term development strategies, which will be reviewed and granted final approval by the Board of Directors and representatives of the Fund sectorial teams. The strategy review process will consist of the following:

■ Prioritization and increased focus on existing core business with high value creation potential

■ Substantial improvement in productivity

■ Gradual divestment from value destroying assets and de-prioritization of low value growth initiatives

■ Identification of potential M&A deals which might bring synergies to existing operations without impairing Kazakhstan's competitive business environment

Strategy development will take place in a new format, fully involving the top management of the portfolio companies in the process of defining the strategic vision, KPIs, targets and the roadmap. The process will consist of the following steps:

- **Build alignment around transformation goals and principles:** a series of meetings, seminars and off-sites will take place between Fund top management/ board members and portfolio companies' top management to openly discuss the goals and principles of transformation, their applicability to particular companies, and the concerns of portfolio companies' top managers. The goal of this step is to build a full understanding and consensus around the need for transformation and its goals and key principles within the top management of the portfolio companies.
- **Define the long-term strategic vision of the companies:** portfolio company top management will define the vision that will get them to the desired value creation objective. Having full freedom to set this long-term vision and the interim KPIs and targets will ensure full ownership of these goals from the portfolio company management team.
- **Create an action plan to achieve the vision:** portfolio company top management will develop an operational strategy and a roadmap to achieve the vision. This will be done also with participation of key employees within portfolio companies beyond top management team to get a broader buy-in for the transformation Program within portfolio companies.

Strategies will be prepared together with the Fund sectorial teams and approved by the Board of Directors of the portfolio companies.

Expected results	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Number of entities out of the targeted seven (the Fund and six industrial groups) with updated strategy in compliance with the new strategic KPIs approved	0	3	6	6	6	6
Expected results	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Number of entities out of the targeted seven (the	0	3	6	6	6	6

Fund and six industrial groups) with updated strategy in compliance with the new strategic KPIs approved						

TRANSFORMATION AXIS 2: PORTFOLIO RESTRUCTURING

Initiative 2A: Simplify the legal structures of the portfolio companies

The Fund directly or indirectly owns ~600 legal entities, in a Group structure consisting of up to nine layers. The Fund also uses complex legal forms (e.g., many legal entities in portfolio companies are structured as Joint Stock Companies requiring a separate Board of Directors).

To enable the Fund to act efficiently as an active shareholder, the number of layers in which there are legal entities will be reduced from nine to three as a general principle (i.e., parent company, business units, and individual operations). The exact number of layers and legal entities for each portfolio company should be defined as a joint effort by the Fund and the portfolio companies based on legal requirements, international agreements and other restrictions.

The targeted decrease in the number of layers and legal entities will be delivered through one or more of the following four actions:

- Merging legal entities at portfolio company level
- Merging companies conducting similar activities to create a new portfolio company (Liquidation Asset sales (see the ‘Asset privatization and separation of social assets’ initiative below)
- Liquidation
- Sale of assets (see Initiative 2B for details)

Delivering successfully on this initiative will deliver four benefits:

- Increased transparency of operations
- better liquidity management
- better leadership focus on the core activities
- reduced administrative costs by removing additional management bodies, auditing and reporting

The Fund will approve the new streamlined legal structures for the portfolio companies at the same time as approving the portfolio company strategies in 2015.

Expected results	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**

Number of legal entities across portfolio companies	593	500	400	300	300	300
The number of layers with legal entities (incl. the Fund)	9	8	8	5	5	5

Initiative 2B: Attracting foreign investors and disposal of non-core assets from the Fund's portfolio

Less than 30% of the Fund's group of companies' base is currently listed, significantly less than is the case with comparable international peers. Limited equity participation by private investors does not promote external market discipline in portfolio company operations, and makes it unfeasible to use market value as the basis for objective evaluation of portfolio company performance. Most portfolio companies also include assets of varying profiles: core business activities, non-core assets, and socially oriented assets. *[Figure 4]*

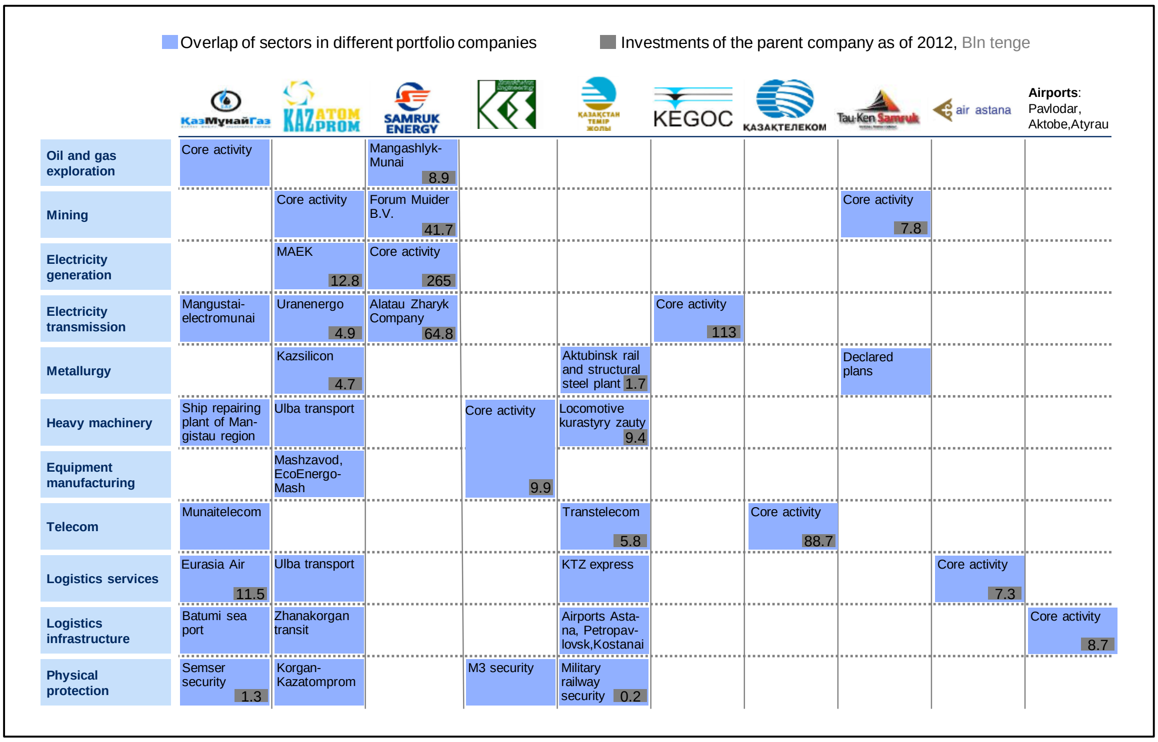


Figure 4: Mapping of portfolio companies assets across industries

The Government of the Republic of Kazakhstan under the instruction of the Head of State approved the Complex Privatization Plan according to which 216 Fund's assets are subject to be transferred to the competitive environment in 2016-2020. 44 assets from attachment No.3 are expected to realize with the assistance of independent consultants. 172 assets from attachment No.4 are planned to dispose through electronic auction. In relation to the Fund the privatization program can help to solve the following problems:

- Exposing core assets to external market discipline to drive value creation

- Attracting strategic partners with access to markets, advanced technologies and best practice management processes
- Releasing capital to be invested in strategic priorities of the Fund
- Development of the private sector in general and small and medium-sized enterprises in particular, as well as the reduction in public participation and presence in sectors where private companies and competitors are present
- Developing the share market of Kazakhstan

In implementing the Comprehensive Privatization Plan it is planned to use the following mechanisms of assets disposal:

1. **Launching an IPO for core assets** (portfolio companies) to increase transparency and create an external stimulus for improved performance. In accordance with the 2016-2020 Comprehensive Privatization Program it is planned the withdrawal of 7 companies of the Fund's group to the IPO: JSC "NC "KazMunayGas", JSC "NC "Kazakhstan Temir Zholy", JSC "NAC "Kazatomprom", Samruk-Energy JSC, Kazpost JSC, JSC "NMC "Tauken-Samruk", Air Astana JSC.
2. **Liquidation of assets by the Fund's decision.** According to the current edition of the Decree of the Government of the Republic of Kazakhstan, the assets subject to transfer to the competitive environment, may be reorganized or liquidated by the decision of the owner in the absence of economic feasibility in the pre-sale preparation. Also, by the Law "On Sovereign Wealth Fund" it is established the obligation of the owner to reorganize or liquidate assets which have failed to find a demand in the market in the three trading.
3. **Realization of major assets through competition (including variations)**. When disposing major assets it is necessary to consider additional conditions, exposure of which is crucial for the continued existence and operation of the privatized assets. In particular, the social responsibility of the Fund can be most fully realized through this mechanism. In order to implement the asset with conditions, the methods of electronic competition, as well as an open two-stage competition can be used.
4. **Attracting strategic investors to the portfolio companies**. It is assumed that a part of the major assets can be sold to the strategic investors (in particular, the current co-owners, technology partners), however, these decisions should be taken with account of recommendations of independent consultants.
5. **Transferring existing social assets** from the portfolio companies to the relevant public sector institution the process should be noted apart. In the framework of the Comprehensive Privatization Plan of the Fund and portfolio companies should not be involved in social assets. Portfolio companies have until the end of the 2020 to make such transfers. If any of the social assets are providing critical services, a mechanism needs to be developed to guarantee their continued delivery to portfolio company employees.

KPI and expected results	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
1. Preparation of companies determined for IPO, SPO						

1.1 Hiring Investment Advisors / banks	-	0	4	2	1	0
1.2 Preparedness of investment advisors reports on basic sales parameters	-	0	3	1	2	1
1.3 Development and approval of the communication strategy and realization of international investment activities for the respective companies	-	0	2	3	3	1
2. Realization of the remaining 37 major assets of Attachment No.3						
2.1 Appointment of appraisers where appropriate, and realization of the remaining 37 large assets of attachment No.1 (number)	-	0	20	17	0	0
2.2 Ratio of actual value 3) the sale of 37 assets from attachment No.3 to their appraised value (min. ratio)	-	-	1	1	1	1
3. Realization of assets of attachment No.4 (including liquidation and reorganization)	-	60	90	22	-	-

Initiative 2C: Establish new active investment approach

The Fund's investment process and approach currently feature certain inefficiencies:

- Portfolio companies play the initiator role on major capital spending, while the Fund's role is more focused on meeting capital requirements. The function that would actively scan for opportunities outside the existing portfolio companies or for a desired risk-return profile for the Fund is not mature yet. This limits the possibility of reallocating capital across the Fund's portfolio in sectors where it could have the desired risk-return profile.
- Individual investment cases are not presented using a standard format. This makes it difficult to compare investment projects, leading to suboptimal capital allocation. There is no efficient process to monitor the performance of individual investment projects, and the roles of participants across the Fund and portfolio companies are not clear. There is also a concern that equity investments /acquisitions are at times motivated by the desire to circumvent procurement rules.
- Portfolio companies run both commercially non-viable projects (e.g., motivated by government programs and economic development plans) as well as social assets (e.g., motivated by needs in the surrounding society). The negative value impact of implementing such projects for the Fund and portfolio companies cannot be evaluated systematically, but the capital used is estimated to be 20-30% of annual revenue.

As part of implementation of the Transformation Program, the Fund will implement a proactive approach to investment through the implementation of these initiatives:

1. **Develop a Fund-level Principles and Approaches on identification and building of new industries.** The Fund should assess investment opportunities within the existing portfolio companies as well as potential new investments outside the current portfolio in a systematic and consistent way. The Fund should develop a parallel view on the potential liquid funds available for investment activities year-by-year. Modeling the potential risk-return outcomes of a plausible number of portfolio alternatives will enable the Fund to identify the implications of the main portfolio choices. The Fund should then decide on an adjustable investment principles and approaches based on the risk-return profile of the options. The end product will be a target portfolio structure divided by sectors and portfolio companies, risk and return, and time horizon for investments.
2. **Define the investment process for the Fund and the portfolio companies with clear responsibilities in the investment decision-making process.** A clear and codified investment process should be developed both at the Fund and the portfolio company level. There should be five key participants in the investment process:

- **Investment committee at the Fund level:**
  - Provides recommendations to the Management board on proposals of new investments team regarding investments into new companies/projects
  - Approves/rejects investment proposals of portfolio companies which can significantly affect the company's business or overall Fund's portfolio standing (i.e., investments equal to 5-50% of the balance of the portfolio company's total assets)
  - Provides recommendations to the Management board on any transactions related to the capital of the portfolio companies (sales or acquisition of shares, except for statutory privatization program)
  - Prepares the fact base and proposes the investment plan to the Fund's Management Board.
- **Sectorial teams:**
  - Prepare an independent opinion on the results, strategy and investment needs of the portfolio companies
  - Participate in creating the portfolio companies' investment strategy, annual budget, defining key indicators and amount of dividends through Directors and other representatives of sectorial teams as members of portfolio company Boards
  - Create conditions for improving the operations of portfolio companies
- **Portfolio companies' Boards of Directors:**
  - Approve the investment strategy, annual budget, key performance indicators and dividends of the portfolio companies
  - Based on the charters of portfolio companies, review transactions exceeding established limits or of specified types (M&A, new production and establishment of new legal entities)
- **Portfolio companies:**
  - Depending on the portfolio company charter and the Board of Directors, portfolio companies are responsible for their own operations/investments within the approved budget.
- **Fund's new Investments Department:**

- Proactively seeks and screens investment themes focusing on a priority sectors defined by the Strategy and Portfolio Investment Management block
- Conducts investment analysis on a themes that have passed initial screening and conducts market testing and assumption validation exercises
- Proactively seeks strategic investors for a co-investment with an appropriate expertise, management, and technological strength profile
- Presents and seeks approval from Investment Committee for investment projects both on pre-feasibility and final approval stage

3. **Development of a standard financial model for investment projects and a process to monitor on-time, on-budget execution.** In order to ensure a transparent view on the return of the investment project portfolio, the Fund should establish an effective process to monitor the project performance. This process should focus on identifying deviations and risks compared to the approved investment case. This information could then be used to develop the investment process and to learn from experience.
4. **Increase transparency of commercially non-viable projects related to core business activities.** For such projects, the Fund should carry out a transparent evaluation of the gap relative to the hurdle rate (calculated case by case and externally audited). The gap between the project business case and the hurdle rate should be accepted by government as an 'in-kind' dividend during the investment decision process. New social projects should no longer be permitted.

<table>
<tr><th>Expected results</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th><th>2019</th></tr>
<tr><td rowspan="2">Strategic direction proposed for investing activities</td><td rowspan="2">-</td><td rowspan="2">Corporate Standard for investing activities is approved</td><td rowspan="2">Fund's Principles and Approaches on identification and building of new industries approved</td><td>Application of the principles and approaches of the Fund for all industries</td><td colspan="2">New investments in accordance with the approved principles</td></tr>
<tr><td>> 10 are concepts approved by the Investment Committee</td><td>>10 concepts and 3 drafts are approved by the Investment Committee</td><td>>10 and 3 drafts are approved by the Investment Committee</td></tr>
<tr><td>Assessment of investment activity</td><td>-</td><td>-</td><td>Fund's financial model is developed</td><td>Development of a financial model for the 12 largest PCs</td><td colspan="2">The use of a financial model for monitoring and evaluation of investment projects</td></tr>
</table>

				Development of criteria for the approval of new investment projects	The use of investment criteria and standards in investing activities	Improving criteria
Monitoring of investment activity	-	-	-	Creating a database of investment projects and monitoring reports		
				Development of criteria for stopping unprofitable projects		

TRANSFORMATION AXIS 3: GOVERNANCE

Initiative 3A: Increase effectiveness of interactions with government

The current governance allows the participation of government authorities in operating and investment decision-making at the Fund level and portfolio companies. This practice could change commercial logic in decision-making and contradicts governance practice in effective international Funds, that is focused on maximizing portfolio value. Decreasing government influence and formalizing government's involvement in operation and investment decision-making is one of the key priorities of the transformation program.

Furthermore, where portfolio companies are subject to regulation in natural monopolies or other markets, their performance is strongly affected by their interactions with regulators. Comparative analysis of such interactions and assessment of best-practice government tariff regulation has shown that there is significant potential for improvement in regulation in specific industries (for example, in process of tariff costs confirmation, divergence from tariff methodology based on "costs+").

International sovereign wealth funds operate better in more effective government regulation frameworks and with a lesser degree of government influence in their operations.*[Figure 5]*

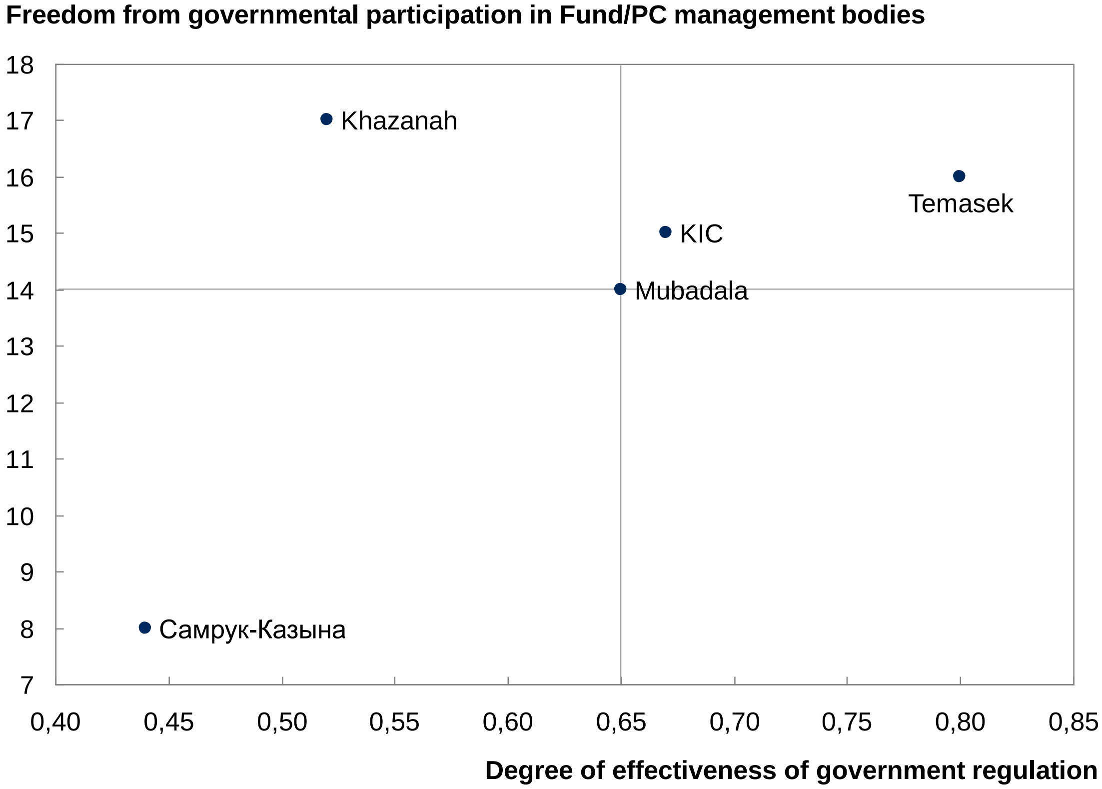


Figure 5: Correlation between effectiveness of government regulation and government's involvement in the fund and portfolio company level management bodies

To overcome these challenges, the following actions should be taken:

- Analyze the current practice of the Fund's interactions with government authorities and identify key areas for improvement similar to global practices in governance.
- Define a list of actions to reduce the volume of interactions with government, such as amending legislation, establishing working groups to improve industry and tariff regulations, and decreasing document flows with government authorities.

Expected results	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Creation of GR-function in the Fund and Portfolio companies [Companies quantity]	0	0	1	7	7	7
Reducing the correspondence rate from the Government to the Fund and its companies and requiring meaningful response vs. base line year 2014 [%]	0%	30%	50%	50%	60%	70%

Initiative 3B: Strengthen Sectorial teams

Currently the Fund has three sectorial teams. Their headcount is 30 FTEs, which accounts for 20% of the total FTEs of the Fund. In global peer organizations the employees located in sectorial teams account for 60% of the total FTEs. 67% of the sectorial team employees currently have a purely technical background, 97% have industrial experience only in Kazakhstan based companies and 41% have governmental service experience. Only 23% are fluent in a foreign language, and one third meet the competence level in managerial skills typically seen as a requirement by the Fund's international peers.

Furthermore, nobody in the sectorial teams has experience of managing successful international companies in the global market context, conducting high quality business analysis or identifying at a granular level the value creation opportunities with the portfolio companies. There are no sectorial team members with a business degree (e.g., MBA) or people with internationally recognized relevant certification (e.g., ACCA or PMA). The current set of competences within the sectorial teams enables the Fund to play its current role focused on reporting and regulation, but prevents it from acting as a fully commercial strategic holding / active strategic investor.

In successful peer funds at least 75% of the work of the sectorial teams is focused on value creation, with the remainder including activities such as interaction with the regulatory authorities and other tasks. Toda, 60% of the Fund's employees' time is spent on regulatory correspondence with the government. To improve the quality of managing the portfolio companies the Fund should transform the sectorial teams' activities and focus them on strategic assessments, investments and economic analysis. The sectorial teams' senior leaders should represent the Fund on portfolio companies' boards of directors with a strong focus on driving productivity and efficient investments.

As well as analyzing portfolio companies' operational efficiency and efficiency of investments, the sectorial teams' responsibilities should cover:

- Determining strategic development areas and long-term goals for the portfolio companies taking into consideration the sector specific global development trends

- Defining and developing a strategic KPI system focused on value improvements and total return to shareholder (TRS)
- Building an efficient model for asset portfolio management
- Exposing problem areas in the portfolio companies' activities and preparing a plan for solving them
- Improving the management reporting system to increase the efficiency of the decision making
- Improving the operational efficiency of the assets under their supervision, optimizing the debt portfolio and seeking alternative sources of financing for the assets under their supervision
- Overseeing portfolio companies' investments and seeking and analyzing investment opportunities and attractive financing sources
- Implementing a system to monitor the performance of the investment activities within the portfolio companies

In order to be successful in the above mentioned tasks, the sectorial teams need to review management accounts, which will enable them to conduct regular performance reviews for the portfolio companies with accurate data. These performance review meetings should be conducted on a regular basis (monthly and quarterly) and should be based on regular standardized reports that include the latest numbers coming from upgraded managerial accounting systems (and not the financial accounting systems that are currently the main source of data). The meetings should also include sectorial teams' analysts' insights on how to improve the KPIs of the respective portfolio companies. The 'Initiative 1A: Implement business process re-engineering' will be a critical enabler for enabling this in practice.

The priority focus of each sectorial team should be defined by the Fund, taking into account the external factors (global markets) and internal factors (social stability) in the area of the specific sectorial team. For example, in the current situation the oil and gas sectorial team should be focused on optimizing the existing assets' operation rather than seeking new investment projects.

The Fund should follow the example of peer Funds such as Khazanah, Temasek and Mubadala in creating sectorial teams that engage global expertise. When recruiting for managerial positions the Fund should focus on hiring people with the optimal combination of industrial, financial, and investment background. For example, suitable candidates would include people who have successfully acted as a CEO, CFO or CIO in a large global company, or who have experience in areas such as investment portfolio management, merger & acquisitions and project financing. The sectorial team composition overall should include experience in both major Kazakhstan-based companies as well as international companies.

Expected results	2014	2015	2016	2017	2018	2019
Relative share of ‘Commercial block’ of the total Fund staff [% of headcount employees]	n/a	n/a	55%	60%	60%	60%
‘Commercial block’ positions filled in with target capability level [%]	-	-	50%	100%	100%	100%

Initiative 3C: Clarify the role, mandate and capacity of Boards of Directors

Boards of Directors currently lack sufficient mandate, independence, skills, experience and authority to collaborate with and oversee portfolio company CEOs. Boards also do not have the full powers they should, including selection, appointment and dismissal of CEOs.

Within the Program, the role and responsibility of Boards of Directors is recognized as a critical enabler for transformation. Over the next two years the Fund will change the corporate governance model by putting in place highly skilled Boards of Directors with the full set of required competencies, powers, expertise and skills, as well as relevant responsibility. The following tasks will be implemented for this purpose:

1. **Expand the powers of Boards:** Provide Boards of Directors with a complete set of decision making rights and relevant responsibility for the portfolio companies’ performance. Strengthen the role of the Chairman and give the BoD the right to appoint and dismiss the CEO and define compensation levels for the management board and employees. Determine the main areas for the BoD to work on by setting clear expectations through the new strategic KPIs.
2. **Create world class Boards**: Increase the number of Board members to 7-11 persons and lay down the main requirements for new directors, e.g., global CEO level industry expertise, functional knowledge associated with strategic initiatives and at least one director having experience in an international audit company at the level of partner or higher. The proportion of independent directors should be also increased to 50% or more. The Fund’s role in the BoD should be also strengthened: the head of the sectorial team should be Chairman of the portfolio company Board of Directors and members of the sectorial teams (Director and two Vice Presidents) should also sit on the BoD.
3. **Establish an effective system for Board performance evaluation**. The BoD itself, led by the Chairman, should perform a proper assessment of its results and efficiency. The shareholders should also evaluate the performance of the BoD (independently or involving an independent advisor) in line with the procedure established by the Fund. Areas for performance improvement across the Board or for certain directors should be defined accordingly.

4. **Align BoD operations with best practices**. Increase the number of Board meetings to 8-12 per year and establish a traditional committee structure: an audit committee, a compensation committee and work safety and environment protection committees (in portfolio companies whose activities involve technological disaster risk). The functions of General Director, Board Chairman and Board Committee Chairman should be clearly separated to enable the efficient work of the Board.

In the first stage of the Program (2014-2015), the Fund will develop new methods of working for the Board, as well as models of interaction with all participants. The Fund together with OECD experts has already started developing a Corporate Management Code, which will promote implementation of Fund initiatives for the improved efficiency of Boards.

In the second stage of the Program (2015-2016), the Fund will focus on establishing world class Boards by involving directors with global expertise in relevant industries. The Fund has already begun a KazPost Board transformation, changing the principles of work and Board composition.

Expected results	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
■ Approval by the Government of new Corporate Governance Code for the Fund		Completed				
Number of portfolio companies, 100% of shares belonging to the Fund, approved new Corporate Governance code	0	16	16	16	16	16
Number of companies out of the targeted six industrial groups approved the results of the GAP analysis and Action Plan on implementation of new Corporate Governance Code by the Boards of Directors of the Companies	0	3	6	6	6	6

Approval of new Methodology on diagnostics of Corporate Governance system by the Management Board of the Fund			Compl eted			
Approval of new Methodology on diagnostics of Corporate Governance system by the Management Board of the Fund:						
Agree on criteria and set the targets			Compl eted			
Run assessment	0	0	0	6	6	6
Number of companies out of the targeted six industrial groups with Board of Directors appointed in-line with the requirements of the new Corporate Governance Code [Number of portfolio companies out of the targeted six industrial groups]	0	1	4	6	6	6

3. HOW THE TRANSFORMATION WILL BE DELIVERED

Key messages of this chapter:

- Given the transformation's challenging targets, all stakeholders will need to change their mindsets and behaviors so they are aligned with the Fund's future operating model.
- The change management effort will enable the required mindset and behavior shifts, targeting everyone from individual employees to managers, senior leaders, the Board of Directors and key representatives of public sector institutions**.** By getting change management right at this critical time, the Fund and the portfolio companies will become healthier organizations and increase the transformation's chances of success to more than 80%.
- Successfully managing change means improving the organizational health of the Fund by addressing four key drivers: capabilities, leadership, culture, and communication. Change management initiatives will be put in place across four levers to improve these drivers: communication, role-modeling, skill building and reinforcing mechanisms.

In addition to agreeing on a clear set of initiatives for the transformation (the three transformation axes), it is equally important to ensure the right enablers are in place for the Fund to execute those initiatives. The change management effort will support Fund employees to shift their mindsets and behaviors in line with the three transformation axes. Research shows that by managing change actively and professionally, the Fund will dramatically increase the transformation's chances of success to more than 80%.

Given the magnitude of change, all internal Fund stakeholders will need to shift their mindsets and behaviors to successfully execute and embed the transformation. The change management effort will focus on sustainably shifting mindsets and behaviors so they are aligned with the Fund's future operating model. It will target all relevant groups of internal stakeholders including individuals, teams, managers, senior leaders, the Board of Directors, management teams of portfolio companies and key representatives of public sector institutions. Successfully managing change means improving the organizational health of the Fund.

One of the most important aspects of successful transformation is to create full understanding of the need of transformation and its goals among the top management of portfolio companies. To secure this understanding Fund's management board the supervisory board members will dedicate significant amount of time to align these topics with the top management of the portfolio companies through a series of workshops, meetings, and implementation of world best practices in execution of similar transformation programs.

There are four key drivers to address: capabilities, leadership, culture and communication.

One of the most important ingredients for success is the full understanding and commitment from the portfolio companies' management teams to the goals and principles of the program. To achieve this, a lot of time will be spent by the management team of the Fund and by its Board members to work together with the portfolio company top management to build this alignment through seminars, off-sites, working meetings, and visits to other funds to learn about successful transformation programs.

As described in the previous section, accountability for each transformation initiative will be allocated to individual line managers (from the Fund, from portfolio companies, or both). The approach is to use the same four change management levers across the three axes. This will instil a common change management approach across the Fund and the portfolio companies and enable the deployment of Fund-level change management experts to support the portfolio companies, ensure knowledge sharing, and allow efficient use of limited resources to achieve success.

The role of the Fund-level change management experts will be to support each portfolio company – at the right time and by request – with guidance and practical change management tools. The change management expert team will be formed in Q4 2014 and is expected to ramp up to 5-10 employees as the portfolio companies start transforming.

The four levers needed to drive behavior and mindset changes are described in the 'influence model' developed through McKinsey & Company research over many years *[Figure 6]*. The model includes both 'traditional' change management elements to engage people, skill building to drive a new level of performance; as well as methodologies to redraw organisational structures and codify the new ways of working.

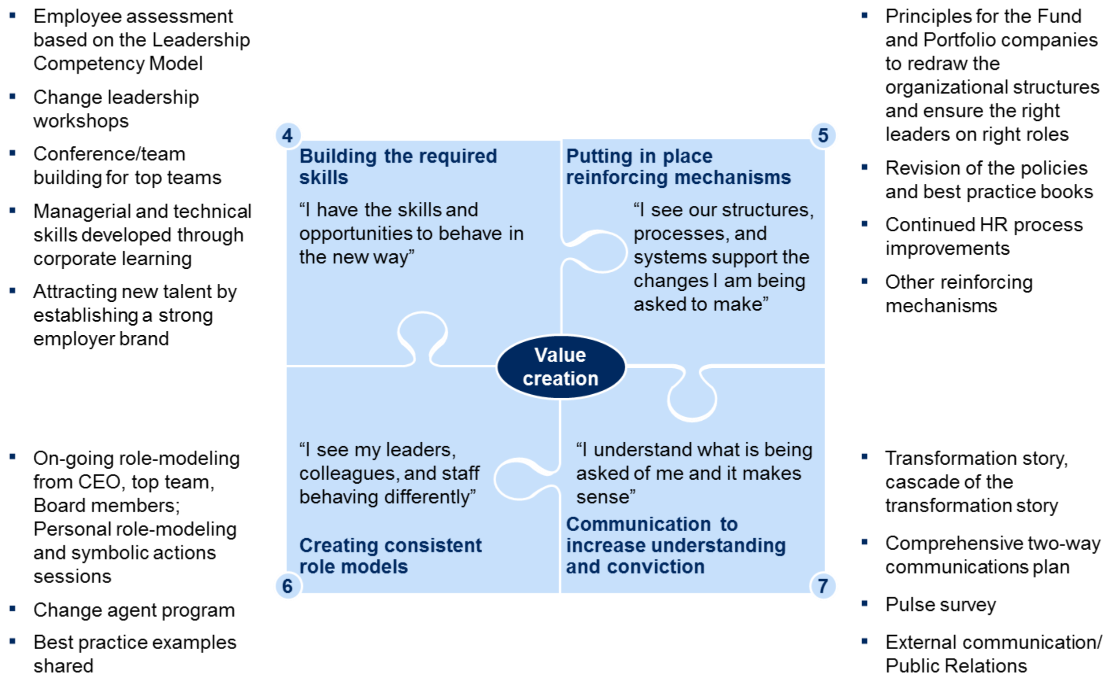


Figure 6: Influence model with four change management levers

Change management lever 4: Building the required skills

Employees must be confident in their ability to behave in the way the new operating model requires. This can be achieved through training, coaching, on the job development and rotations (usually a combination of these). Currently the majority of skill-building efforts are class-room training and almost exclusively focused on technical skills. In light of the skills required in the future, this approach left gaps in leadership, establishment of efficient teams, strategic thinking and project management. Research shows transformations that invest a great deal in developing leaders are two-and-a-half times more likely to succeed than those that do not. Initiatives here would include:

- **Employee assessment based on the Leadership Competency Model** laying out the behavioral foundation needed by Fund employees, to result in individual development plans, recruiting methods, etc.
- **Change leadership workshops (‘Change Leaders Forums’) for senior managers:** a rigorous approach to build change skills across management teams in each department, e.g., through proven two-day workshops resulting in a detailed action plan; regular check-ins; subsequent two-day workshops to review progress and further build change leadership skills 6-12 months later
- **Conference/team building for top teams of the Fund and portfolio companies** – a one-off event to visibly kick off the transformation
- **Attracting new talent by establishing a strong employer brand** that appeals to the best and brightest Kazakh talents at all levels, not only through salary and benefits offered, but also through corporate values, inspiring leaders and interesting job content. Compensation benchmarking should be the first step to ensure competitiveness
- **Managerial and technical skills developed through corporate learning,** including the Samruk-Kazyna Corporate University. The University will be strengthened to incorporate world-class elements, as described in *[Figure 7]*. Among the first enhanced offerings will be:
  - Leadership development program for the top 200 senior managers to quickly fill the leadership pipeline
  - Core trainings for managers (e.g., situational leadership, establishment of efficient teams, strategic thinking and project management, ownership of own development, mentoring and coaching, feedback), developed and implemented throughout 2014-15
  - E-learning Portal providing self-development resources and materials for employees to access at their own pace online

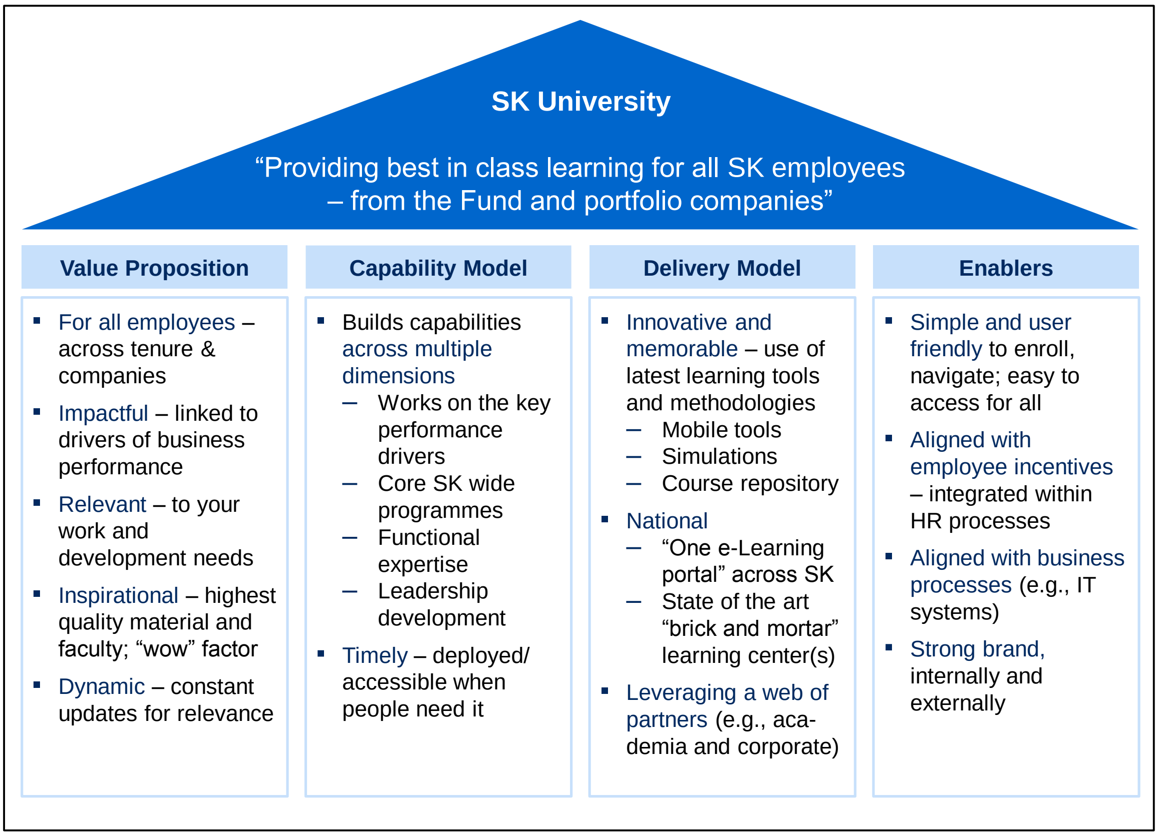


Figure 7: The Samruk-Kazyna University will evolve into a distinctive offering, which may include some of these elements

Change management lever 5: Putting reinforcing mechanisms in place

Employees must see that the processes, structures, systems and incentives they experience reinforce the requested change in culture. Currently, a lot has been achieved for example on re-shaping the key human resource management processes, e.g., recruitment and performance evaluation. However, additional effort is needed to adjust organizational structures, procedures and rewards. Research shows transformations where change is reinforced using targets and incentives are more than four times more likely to be successful than those where no such targets and incentives are used. A common methodology should be used when rolling out the following four initiatives:

- **Principles for the Fund and portfolio companies to redraw organizational structures and ensure the right leaders in the right roles.** The Fund will set principles for the organization re-design that will help simplify the organizational structures of portfolio companies. Based on these principles the Fund and its portfolio companies will implement changes in three areas: “lines and boxes” (reporting relationships and spans of control), roles and responsibilities, and boundaries for organizational units (i.e., which functions are performed internally and which are contracted from a provider):

  It will be necessary to review the organizational structures at least to the CEO-2 level for each portfolio company, taking into account the experience of comparable companies and efficient management principles such as spans of control (number of subordinates per executive), number of levels, etc. The following rules of thumb will be observed:

- **Reduce number of levels**. Fewer layers are better, as a rule. The number of levels from the CEO to frontline employee should be minimized to 7-8 levels in the entire company and less than 5-6 levels for the management structures. Practice and research results show that top management proximity to line personnel contributes to lower costs, higher productivity, faster decision-making and better organizational flexibility.
- **Standardize the number of direct reports.** The CEO should have 8-12 direct reports; key executives should have 5-10 subordinates. The number of subordinates per mid-level manager should be consistent with the function type: in mass processes one executive per 20-25 specialists; for sophisticated/unique processes one executive per 7-10 specialists or less. Company-wide, the ratio of executives to specialists should be comparable with good practice in the respective industry.
- **Standardize division types** and group divisions with similar functions. The type of the unit and executive's position should reflect the unit's contribution to the company's goals and the number of subordinates. For example, a department will consist of 50-70+ employees, a team will consist of up to 10 employees, and so on. Functions should be bundled in blocks based on similarity of skills, knowledge and/or culture (e.g., an administrative block, a financial block). Corporate functions (legal, HR, etc.) should be independent from business units.
- **Set KPIs** and responsibilities of divisions. The responsibility of each unit should be well defined and tied to KPIs and business process steps.

The Fund will also set the framework for appointment of the right leaders in the right roles. An assessment in line with this framework should be performed across the portfolio companies, and hiring new leaders or experts per the result of this analysis should be targeted by Q2/3 2015.

- **Revision of policies and best practice books.** A study of best international practices among government holding companies shows that it is usually optimal to systematize and consolidate fragmented internal documents into a series of policy books divided by topic. Existing policies will be simplified and revised in line with global best practices. The Fund will develop 8-10 books (including a 'code of conduct' book and a book on corporate governance) that will include principles, purposes and methods of transformation. These books will set the tone of the transformation programs both within the Fund and in the portfolio companies. Such books tend to have the following characteristics:
  - Consist of two parts: a mandatory and a recommendation part, the relative sizes of which may vary depending upon the topic. The mandatory part describes the basic set of requirements essential in light of governance and reputational concerns (portfolio companies' scope for autonomy increases over time). The recommendation part describes best practices.
  - Have the same impact on all the organizations controlled by the Fund
  - Cover all the relevant issues, do not overlap, and are internally consistent.

The process of developing these books is as important as their content and should be based on two main principles: focus on creating added value for the users, and involve all stakeholders. Khazanah is one of the best examples of codifying policies in a series of books. The publication of ten best-practice “Colored Books” in Khazanah was a key part of its transformation. They stimulated open discussion of the principles, goals, and methods of transformation in such aspects as the role of the Board of Directors, procurement, capital management, HR, performance management, etc. The Colored Books were a stimulus for the significant cultural changes required for transformation and contributed to further penetration of changes into the governmental structures of Malaysia

By 2016 Samruk-Kazyna needs to have revised or developed 8-10 policy books, including but not limited to:

a. Corporate Governance Code: Authority, procedure for forming and remuneration of the boards of directors and relationships with the shareholder.

b. KPIs and performance management: Determination of KPIs for the fund, the portfolio companies and their management personnel at various levels, and their impact on management remuneration and responsibilities.

c. Management of capital and investment activities: Procedure for approval and management of investment projects.

d. Efficient business process management: Regulation of key business processes.

e. Human capital development and management: Approach to improve labor productivity through investment in human capital, and to facilitate social cooperation and stability.

f. Procurement: Setting goals for transparent and cost efficient procurement

g. Social responsibility and steady resource deployment: Protection of the valid interests of stakeholders and the environment.

The sequence of creating these books is also important. Not all should be started at the same time – some should start upon the approval of the strategy, others after the business process redesign is complete.

- **Continued HR process improvements**, such as a performance management process to clarify expectations, motivate high achievement, provide timely feedback and development opportunities; or a high potential talent management process using a database owned by the Fund HR Managing Director and individual development plans

- **Other reinforcing mechanisms**, such as:
  - Special awards and incentives to motivate and reward teams and individuals behaving in line with the Fund’s new operating model
  - Compensation review for employees and Board members, following the compensation benchmarking. Salary surveys in by December 1, 2014
  - Salary structure ready by January 1, 2015

In addition to change management initiatives at Fund level, each of the three transformation axes will be reviewed to incorporate specific actions to manage change in that area – helping people behave in such a way that the axis can be successfully implemented. These actions would for example include identifying key stakeholders where communication is needed to drive understanding; ensuring sponsors role-model desired behaviors; helping define the new skills employees need; assessing any additional reinforcing mechanisms needed.

Change management lever 6: Creating consistent role models

Employees need to see people they respect and admire behaving in the new way. This means transforming the top team, taking symbolic actions, and catalyzing a cadre of influence leaders. Currently leaders are perceived as hierarchical, top-down and not supportive of personal development. Employees can working in silos, reactive and risk-averse. Research shows transformations where leaders at all levels role-model the change are four times more likely to be successful than those where leaders do not. Senior leaders' visible role-modeling is especially critical in top-down cultures. Initiatives here would include:

- **Ongoing role-modeling from CEO, top team, Board members,** e.g., by participating in weekly transformation meetings, taking time to coach and mentor employees, showing a 'common front' and sending aligned messages about the transformation and p**ersonal role-modeling and symbolic actions** embedded in each 'change leadership workshop', with individual and collective commitments and peer coaching and support
- **Change agent program** rolled out to engage informal influencers in sending transformation messages, role-modeling and capturing feedback
- **Best practice examples** of leading change (internal) shared across the Fund

Change management lever 7: Communication to increase understanding and conviction

Employees must have a purpose to believe in, be able to say, "I know what is expected of me, and I agree and find it meaningful". This means creating a meaningful transformation story and adopting a language of transformation. Currently a clear story hasn't been articulated and communicated, so employees may lack the full understanding of why change is needed, what is the aspiration and how the Fund or the Portfolio company will get there. For the purposes of internal communication, successful transformations often appoint a dedicated, senior and experienced communication specialist; the Fund should also follow this good practice. Initiatives here would include:

- **Pro-active alignment around** the program goals and objectives by the Fund management and transformation project office with top managers of the portfolio companies. As was previously mentioned in chapter 2 first step in strategy development/renewal will be a serious of meetings and seminars to discuss the architecture and goals of the Program, and their applicability to a particular portfolio company. The main goal this step is aiming to achieve is to build full understanding and alignment around the Program within portfolio companies management teams.

- **Transformation story** for the Fund, first articulated by the CEO. Research shows transformations with a compelling "story" are almost four times more likely to be successful than those without. The transformation story is a narrative that lays out in direct language, personal to the sender, why change is needed, what needs to change, how the transformation will be achieved, the leader's commitments and expectations from his/ her reports. This should be followed by the **cascade of the transformation story**, from CEO to direct reports and so on deeper into the organization (Deadline: Oct-Dec 2014). Given the strong relationships between managers and direct reports, the cascade amplifies the key messages in the CEO's transformation story. Messages should be delivered verbally and reinforced over time
- **Comprehensive two-way communications plan** including town-hall meetings, newsletters, blogs, etc., giving Fund employees the opportunity to ask questions, communicate concerns, suggest ideas and be heard
- **Pulse survey** to ensure two-way communication during the transformation, polling groups of Fund employees on how they view the most critical mindset and behavior shifts
- **External communication/ public relations**, to establish proper positioning of the program and proactively align the external stakeholders and public opinion. Given the Fund's eminent role in Kazakhstani society, external stakeholders will have a major impact on how internal Fund and portfolio company stakeholders transform

Initiative	KPI and expected results	2014	2015	2016	2017	2018	2019
People transformation							
Implementation of the principles of a meritocracy through Job Matching	The number of companies with completed job matching in the transition to the new organizational structure (CEO-1, key positions of CEO-2 upon decision of companies)	0	0	5	12		
Implementation of the principles of a meritocracy through target HR processes **[The number of implemented target processes in 12 PCs]**	Implemented processes: search and selection, performance assessment, remuneration management are implemented				7	12	
	Implemented processes: learning and development, talent				2	7	12

	management, assessment of the level of satisfaction with HR are implemented						
	Implemented processes: management strategy, HR, HR-analysis metrics, administrative organizational structure are implemented					5	12
Development of the shared services center	Implementation of the development plan of the shared services center	0	0	0	100%	100 %	100 %
	Execution of KPI recorded in the SLA	0	0	0	100%	100 %	100 %
Development of corporate culture	The number of companies with the implementation of projects for the development of corporate culture (ie, the current corporate culture is diagnosed, the target culture is determined, a road map to minimize the gaps between current and target corporate culture is developed)	0	0	1	5	9	12
Implementation of the internship program	The number of selected (for multi-tier selection system) internship program participants				20		20
Change Management							

4. TRANSFORMATION ROADMAP

Key messages of this chapter:

- Samruk-Kazyna transformation program will progress in stages, beginning from the Fund and the selected pilot portfolio companies and subsequently cascading onto the rest of the Fund's portfolio companies

- Major initiatives of the Transformation program described in this document are expected to last until the end of 2017. Overall program is long-term and is expected to last over 5 years

The transformation includes the description of activities, their timeline, and responsible individuals to deliver the goals of the transformation. These activities will be detailed further into more specific steps, after initiative teams are formed. The roadmap covers both initiatives (the “what” has to change part of the transformation) as well as change management (the “how” of the transformation). This roadmap is starting from the basis that the already done work on business process re-engineering has created. It spans a four year period until the end of 2018 and is divided into three stages *[Figure 8]*:

5. Preliminary stage: Final preparation stage at Fund level, continuing with the pilot portfolio companies (Q4 2014 – Q1 2015)
6. Full rollout: Changes at the Fund level and peak at pilot portfolio companies (2015)
7. First results of transformation (2015-16 onwards).

Overview of stages in roadmap is shown below.

	Preliminary phase	Full roll-out	First results
	Q4 2014 - Q1 2015	*2015*	*2015-16*
	Examples of activities		
Transformation actions	▪ KPI approval for the Fund ▪ Analysis of the new strategies for portfolio companies ▪ Plan for legal structure optimization ▪ Documenting the existing business processes at pilot companies	▪ Development and implementation of a Fund-level investment strategy ▪ Approval and implementation of the new strategies for portfolio companies ▪ Implementation of business processes based on the pilot companies' international best practice	▪ Implement personnel changes in Boards of Directors ▪ Implementation of changes in the business processes of other companies ▪ IPO with regard to core assets
Change management	▪ Organizational structure strengthening ▪ Recruitment of experienced experts for the key roles ▪ Change management workshops ▪ Team-building sessions for top managers of the Fund and the portfolio companies	▪ Continuous role modeling by the Chairman and top management ▪ Cascading the transformation story ▪ External communication ▪ Organizational structure review ▪ Revision of the policies and best practice books	

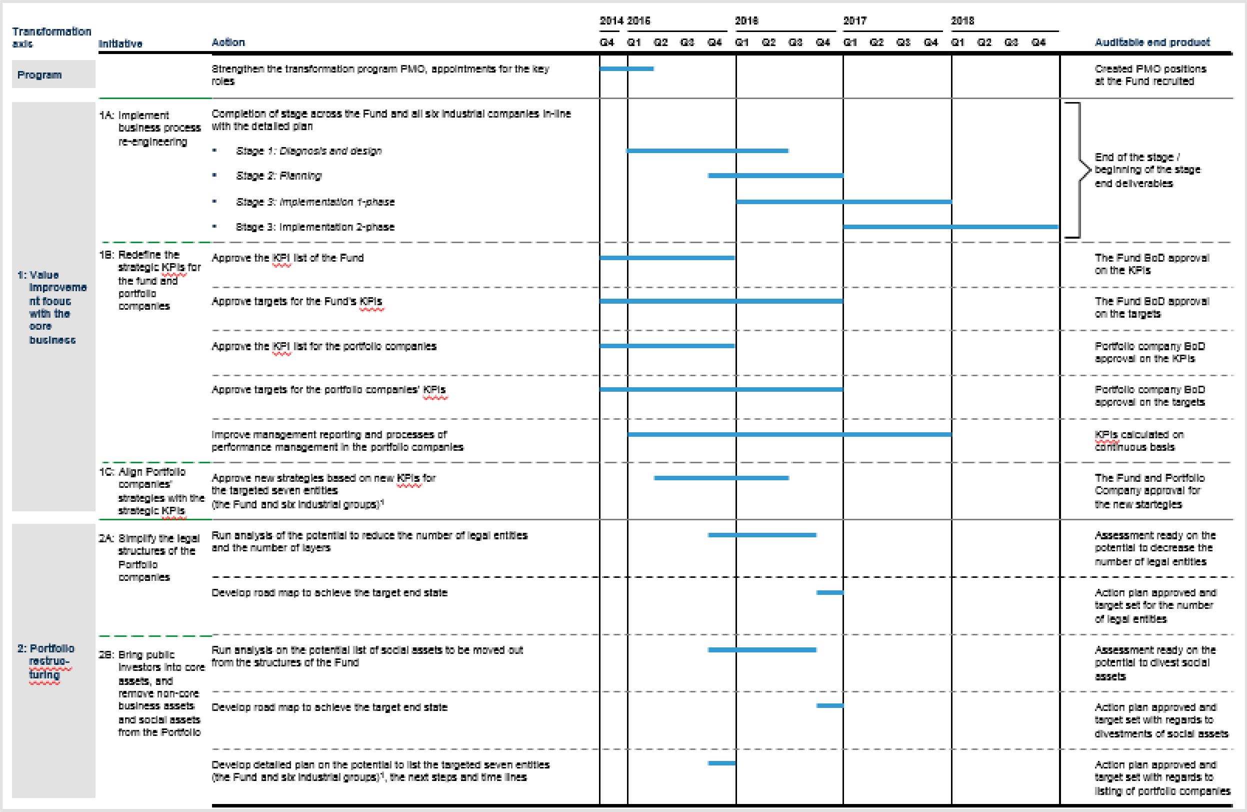
Figure 8: Three stages of the transformation

Transformation initiatives roadmap

During preliminary stage the project governance and infrastructure will be adjusted to the new expanded scope and complexity. This includes recruiting the additional people to the Samruk-Kazyna transformation PMO and appointing responsible for each initiative. Other critical activities at this time will include approving a list of KPIs at the Fund level. The portfolio companies’ legal structure will be also reviewed and the action plan for its simplification will be developed; non-core and social assets will be identified for subsequent disposal. Also in late 2014 the review and approval process will begin for the legislative amendments that are necessary for the transformation to be successful.

Beginning in 2015 the larger changes at the Fund level starts showing as well as in the three selected pilot portfolio companies (KMG, KTZh, KazPost): development a new Fund's investment strategy and new employees will gradually be hired in sectorial teams who will be one of the key elements in success of the transformation program. At the same time, changes will be made in the powers and composition of the Boards of Directors with a view making them closer to best practices. At the Fund and in portfolio companies, the new KPIs and their targets will be approved, which will result in new strategies being developed for these companies. The implementation of new business processes based on best global practices starts in H2 2015 with a projected completion being in 2016. The disposal of non-core and social assets will start in mid-2016 to be completed by the end of 2017.

In 2016 the transformation process will encompass all the portfolio companies. Most activities within the Group are expected to be completed by the end of 2016. Disposal of non-core and social assets, business process reengineering in the wave 2 portfolio companies, and the IPOs of core assets. are expected to be over by the end of 2018. *[Figure 9]*



1 The Fund, KazMunaiGas, Kazakhstan Temir Zholy, KazAtomProm, KazPost, Samruk-Energy and KEGOC

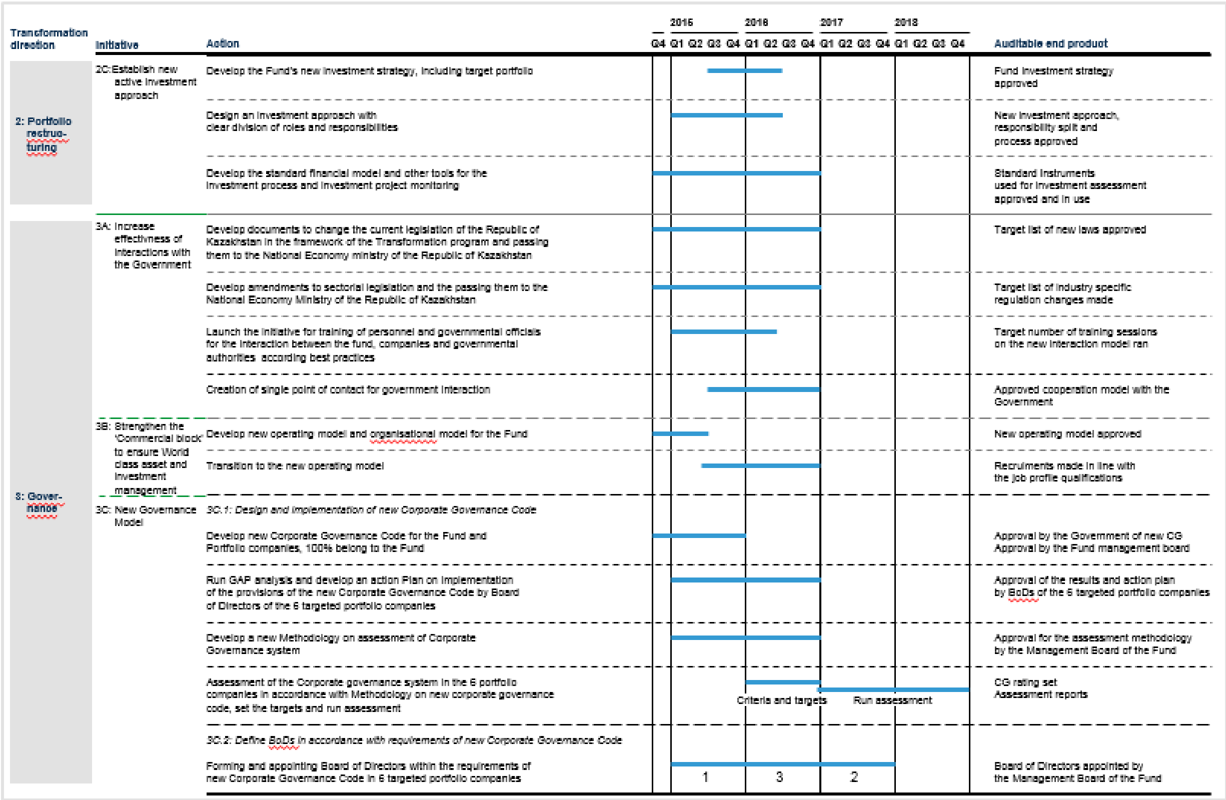


Figure 9: Transformation initiatives roadmap

Change management roadmap

The change management roadmap shows the activities meant at facilitating, supporting, and reinforcing the transformation of the Fund and its portfolio companies. These activities will start with the Fund in Q4 2014 and then cascade onto portfolio companies at the end of Q1 2015. At the Fund level, top management will begin by developing a transformation story and an internal two-way communication plan. Top management will spearhead the transformation by continuously role-modeling the new behaviors. By conducting employee assessments, management will identify potential leaders who will then be trained to become change agents who will drive the transformation.

When transformation kicks off at portfolio companies in Q1 2015, the transformation story will be cascaded through these organizations, supported by extensive communication, both internally and externally. The required new skills will be built through extensive training. Best practice examples will be diligently collected and widely shared within the Group. As the transformation progresses, its results will be reinforced through changes in the organization structures and processes and codified in internal books and policies. *[Figure 10]*

	Initiative	Action	2015 1 q. 2 q. 3 q. 4 q.	2016 1 q. 2 q. 3 q. 4 q.	2017 1 q. 2 q. 3 q. 4 q.	Controlled result
A: Transformation in the field of personnel	1. Transition to a new function model	Implementation of project on assessment of compliance to qualification requirements of positions of a new organization structure (Job matching)		Fund and 3 corpor. Centers of PC	2 corpor. Centers of PC	HR Audit
	2. Implementation of the principles of a meritocracy through target HR processes	Hiring, assessment, training and development remuneration management		Fund	12 corpor. Centers of PC	HR Audit
		Succession management, HR strategy, HR metrics				HR Audit
		Satisfaction with the HR function, administration of an organization structure, management of corporate culture				HR Audit
	3. Implementation of the new HR operational model	Creation of Centre of expertize Creation of the Shared Service Centre (SSC) Introduction of HR Business Partners		Fund	4 corpor. Centers of PC	The approved normative documents
	4. Development of corporate culture	Implementation of projects on development of corporate culture		Fund	4 corpor. Centers of PC	HR Audit

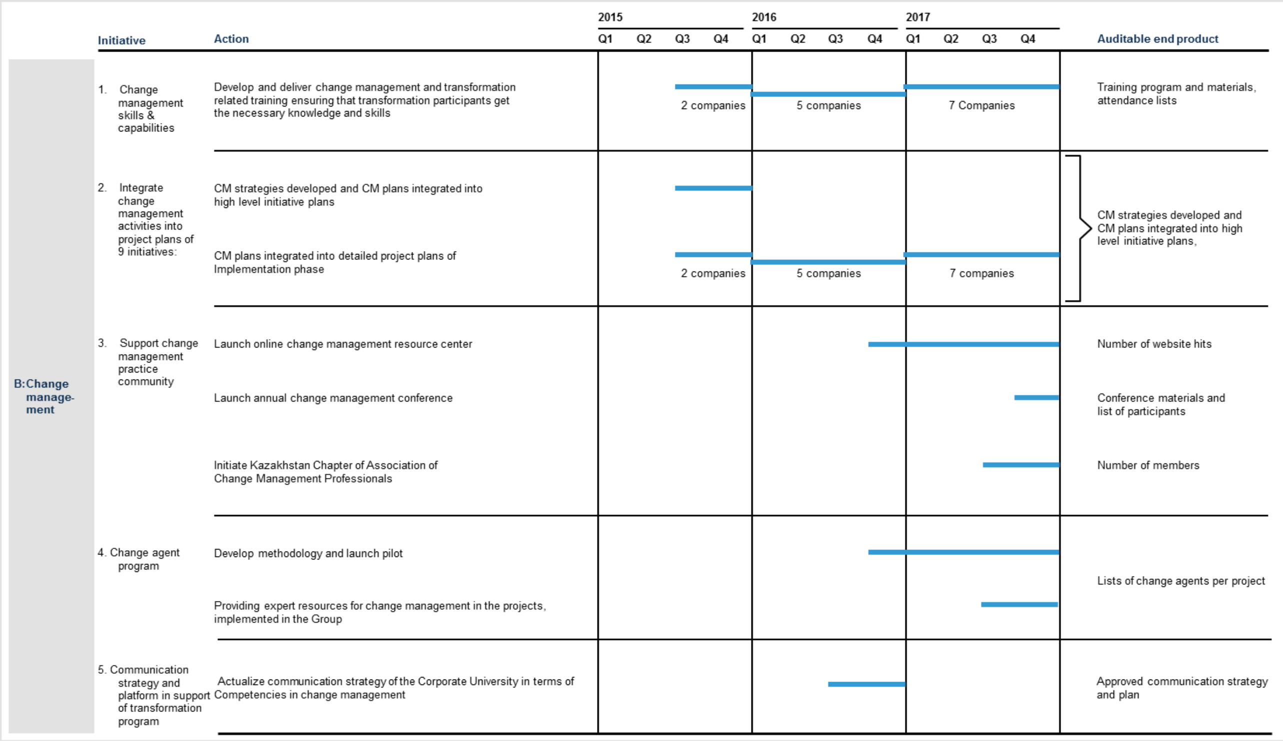


Figure 10: Change management roadmap

5. Program Management and governance

Key messages of this chapter:

- As the transformation program moves to the next stage of implementation existing program management structures should be adjusted to reflect additional scope and scale requirements.
- Samruk-Kazyna Transformation Project Management Office at the Fund level ensures the success of the transformation program through monitoring of progress, reporting, centralized guidelines development and expert support to the owners of initiatives.
- Effective operation of PMO will require resources (both people and monetary) and governance mechanisms (regular meetings, opportunity to elevate resolution of key decisions to the steering committee).

As Samruk-Kazyna transformation program transitions from the current business process re-engineering focused phase to include also more strategic levers, the program governance should be updated to reflect the additional scope and complexity. The original program management footprint established to serve the operational transformation should be continued going forward:

- One Samruk-Kazyna transformation program PMO at the Fund level (core transformation team which is responsible for supporting the whole transformation and for transformation at the Fund level)
- One PMO within each Tier 2 portfolio company (responsible for supporting the transformation in portfolio companies)

Samruk-Kazyna Transformation Project Management Office (PMO) mandate is to support the Fund and the portfolio companies in implementation of the transformation program through:

- Development of common guidelines in high value / high risk areas despite the diversity of the portfolio companies business activities
- Expert support to initiative owners on implementation and challenge them on the content decisions
- Tracking and progress reporting against the planned timelines and targets at the Fund level
- Content development for the communication related to the transformation program
- Organizing key meetings in-line with the planned working rhythm

To deliver on this mandate the Samruk-Kazyna Transformation PMO should consist of a team of 10-15 full time employees *[Figure 11]* led by Transformation Program Director. The role that these people play should be divided into three categories: Project management related roles, cross cutting methodological and CxO councel / Business Process Owner –type of roles. Each of these people would be interacting with external resources on as needed basis in order to get specific expertise or capacity during a certain moment during the project.

Role type	Roles	Key Responsibilities
Project management	**Transformation program director**	▪ Provide day-to-day leadership for the operations of the program ▪ Coordinate resources and schedule with senior management ▪ Escalate and resolve problems in Fund and/or Portfolio companies transformation
	Tracking and reporting	▪ Keep the transformation on track by actively monitoring completion of deliverables ▪ Communicate progress during status meetings
	Communication	▪ Develop communication master-plan (internal and external) ▪ Spark change – energize organization(s) around compelling vision for change, celebrate achievements, and build/maintain momentum ▪ Develop communication content and communicate impact of change
	Change management facilitator	▪ Manage the change management part of the transformation ▪ Facilitation of application of change management tools and instruments
Methodological support	**Business Process Re-engineering methodology**	▪ Define the methodology for business processes reengineering including process mapping, and definition, technology enablement, etc. ▪ Provide expert knowledge to initiative owners ▪ Coordinate usage of external resourcing
	Technology enablement	▪ Define approach towards IT and other technology enablement ▪ Provide expert opinion on technology solutions related to core processes
CxO counsels, content experts in high value areas critical to implementation	**HR / people processes**	▪ Define guidelines for HR processes and people related changes ▪ Ensure compliance to common principles, help to solve problems
	Management accounting	▪ Define guidelines for management accounting, finance function and treasury transformation ▪ Help to transform investment case modeling
	Purchasing	▪ Define guidelines for establishing procedures for purchasing ▪ Provide expert knowledge to optimize high priority cost categories
	Legal	▪ Perform assessment of best practices for delayering of legal structures ▪ Provide expert support regarding legislation changes for transformation

Figure 11: Roles and responsibilities in the Samruk-Kazuna Transformation PMO

The Samruk-Kazyna Transformation PMO would interact with the other parties in the following way *[Figure 12]*:

- When developing the common principles and cross cutting methodology, they would collaborate systematically with the initiative owners in the Fund and in the portfolio companies to collect input, discuss the key choices, get portfolio company specific understanding and share global best practice experience. This would ensure highest possible quality as well as buy-in from the different parties. Common principles cross cutting methodology gets approved by Transformation Steering Committee, after which they get implemented by the initiative owners with the support and quality control of the Samruk-Kazyna Transformation PMO resources

- When providing expert support for the initiative owners, either by themselves or in combination with external resources, they would interact either directly or in combination with the portfolio company PMO. This model of working could include either content related guidance or very hands-on support to solve one-off challenge or for a short period of time to accelerate the development in a critical areas

  When doing tracking & reporting the progress, at the Fund directly collecting the status information from the initiative owners and with regards to the portfolio companies from the portfolio company specific PMO, which would collect it in their own portfolio company. Tracking and reporting will be done both against the deliverables and deadlines, by assessing compliance to the agreed guidelines and cross-cutting methodology, as well as against the expected results

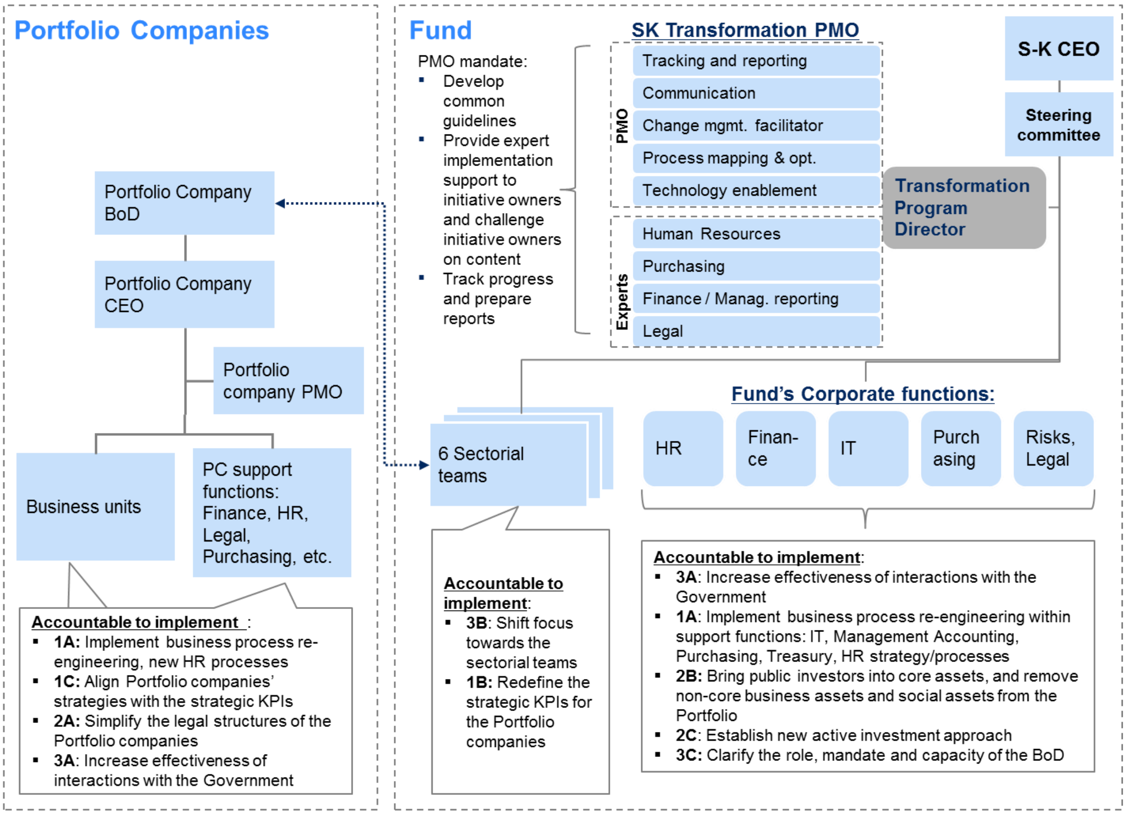


Figure 12: Transformation program governance model

Main responsibility on following up the progress and results of the transformation follows the normal lines of the corporate governance, i.e., transformation program related progress reviews within the portfolio companies happen at the management board and portfolio company board of directors levels, and similarly at the Fund level the Fund's management board and the Fund's board of directors. In order to ensure coordination and boarder transformation program related discussions there should be regular monthly meetings between the Samruk-Kazyna transformation PMO and the portfolio company PMOs, and quarterly between the Fund top management and the portfolio company top management in Modernization board meeting *[Figure 13]*.

Meetings	Role description	Frequency	Participants
Steering Committee Meeting	▪ Reviews program status reports ▪ Makes key decisions	Each month	CEO, 1st deputy CEOs, Program director
Modernization board meeting	▪ Reviews overall transformation program status across the Fund and the Portfolio companies ▪ Facilitates experience sharing ▪ Debates any directional changes on the program	Once in 2-3 months	CEO, 1st deputy CEOs, CEOs and PMO directors of portfolio companies
Fund and portfolio companies PMO	▪ Reviews transformation status for each portfolio company and the Fund ▪ Discusses any required changes / shares experience on the common principles and methodology	Each month	Fund PMO, PMO directors of portfolio companies
Transformation PMO core team meeting	▪ Regular status meeting ▪ Elevates the issues to the steering committee	Each week	Core 5-10 members of the Fund's PMO
Initiative owners meeting	▪ Reviews progress status for each initiative that is driven by the support function heads ▪ Reviews implementation plan	Each two weeks	Program Director, analyst, initiative owners
Sectorial team meeting	▪ Reviews progress status for each initiative in which the sectorial team is involved in ▪ Reviews implementation plan	Each two weeks	Program director, analyst, sector team heads
Ad-Hoc meetings	▪ Meets with project owners as needed to review project status and resolve the issues	On demand	On demand

Figure 13: Program governance, mode of operation

The Samruk-Kazyna transformation PMO will have an implementation budget that will consist of three major buckets:

- Full staff costs that include up to 10-15 senior experts with global experience in transformations in such areas as tracking & reporting, communications, process mapping, technology enablement, management accounting, purchasing, human resources and legal
- External support costs that include management consulting (e.g., advise on the choice of portfolio company specific strategic KPIs), Business Process Re-engineering and IT consulting (e.g., best practice process maps and capacity to help to apply them) as well as function-specific consulting (e.g., specific legal advice). This would allow efficient use of knowledge and capabilities and guarantee the implementation of best practices and their transfer to fund and portfolio companies' employees.
- Training and communication expenses that include trainings on functional topics, interpersonal skills and milestone trainings for Fund employees. Communications budget will support execution of communications master plan – development of various communication instruments (e.g., web, posters, newspapers and videos)

By initial estimates the Fund will require USD ~50 mln. to support the transformation program. This expected budget covers Fund's PMO staff costs, recruitment of world-class industrial experts to sectorial teams, external support, training and other expenses.

6. RISK MANAGEMENT

Key messages of this chapter:

- Preliminary analysis has identified a number of key risks related to the transformation process. The most severe risks relate to ensuring employees are committed to the change, and to required legislative changes
- The Fund will implement a risk management process consisting of four steps: identification; assessment and prioritization; mitigation; monitoring and reporting.

Implementing large-scale transformation programs always entails significant risks. In order to reduce the probability, as well as the potential impact of occurrence of risks, the Fund has worked to identify key risks. Identified risks can be divided into those related to multiple initiatives and those related to a single initiative. The Project Management Office will assign risks related to many initiatives to the Fund's Board members, while individual initiative leaders will be responsible for risk management of their own initiatives. For each identified risk mitigation plans will be approved and implemented, actively utilizing elements of the Fund's existing risk management system, cinluding methodologies, models, frameworks for assigning responsibility and controlling implementation etc.

Preliminary analysis has identified and assessed the following risk drivers related to many initiatives:

Risk	Risk factor	Probability[1]	Impact[2]	Mitigation
Limited top management involvement	Divergent understanding of goals by top management	4	5	■ Involve all top managers in the decision making process on the program implementation ■ Conduct top team alignment workshops
Adverse reaction of employees	Resistance of employees to changes	4	5	■ Actively communicate the need for change ■ Use informal leaders and change agents to support

[1] On scale: 1 = 0-5% probability, 2 = 5-25%, 3 = 25-40%, 4 = 40-80%, 5 = 80-100%

[2] On scale: 1 = minimal, 2 = limited, 3 = medium, 4 = considerable, 5 = critical

				program implementation
Lack of resources	Lack of necessary knowledge and skills (Project management, etc.)	3	3	■ Search globally for qualified staff with experience in similar programs ■ Train employees by implementing a system for developing skills and competencies (trainings, mentor programs etc.)
	Lack of resources to complete the program	1	3	■ Identify the required resources (including outside resources) before the start of the program implementation
	Operations are disrupted as resources are re-allocated to the program	5	3	■ Clearly assign responsibility for the implementation of initiatives ■ Implement a structured process for managing the program implementation effectiveness
Adverse external drivers	Required changes in the law do not take place	3	5	■ Agree on understanding of the transformation with the government ■ Ensure personal involvement from the Prime Minister in resolving controversial issues on changes in the law

	Excessive involvement of the authorities in managing the program	3	3	■ Provide regular feedback with the authorities involved
	Negative press coverage	1	2	■ Carry out preemptive explanatory work with the press and the public

Certain risks related to specific initiatives were also identified:

Initiative	Risk description	Probability[3]	Impact[4]	Mitigation actions
1A	New best practice-based business processes are not followed by staff	4	3	■ Automate the processes where feasible ■ Invest sufficient resources in re-education and building new skills ■ Ensure regular monitoring of process performance
1B	Portfolio companies' KPIs are not aligned with the Fund's KPIs	2	4	■ Cascade the three new KPIs on the portfolio company level ■ Approve KPIs and portfolio company targets on the companies' Boards of Directors in the presence of

3 On scale: 1 = 0-5% probability, 2 = 5-25%, 3 = 25-40%, 4 = 40-80%, 5 = 80-100%

4 On scale: 1 = minimal, 2 = limited, 3 = medium, 4 = considerable, 5 = critical

				sectorial team members
1C	Portfolio companies do not divest or restructure value-destroying assets	4	4	▪ Develop and approve asset optimization plans on the Board of Directors level ▪ Meet with portfolio companies' management to educate them on the impact of asset optimization initiative on the KPIs
2A	Loss of manageability or financial losses due to the changes in the current ownership structure	4	2	▪ Proactively study legal, financial, and operational consequences of the changes in the ownership structure and develop a detailed plan on changing the ownership structure taking into account the likely consequences
2B	Potential resistance from outside Samruk-Kazyna to transferring social assets from the holding	4	2	▪ Ensure support from the government for transfer of social assets ▪ Sign agreements with local authorities on the transfer of social

				obligations and produce detailed plans on asset disposal
2C	Management of cash-rich companies resist transferring resources to the Fund	5	3	■ Establish clear dividend policies for portfolio companies
	Inability to decline to engage in projects with negative EVA	4	4	■ All projects with negative EVA must be formally approved by: a) the requesting party, b) the Fund's Board of Directors ■ The negative EVA resulting from such projects must be counted as a dividend-in-kind
3A	Legislative changes required to complete the transformation are delayed	3	5	■ Establish a joint working group with the authorities to develop proposals on legislative changes ■ Prioritize key changes in the law, as well as changes that do not need a protracted approval process

3B	Inability to recruit and retain sufficiently qualified individuals for sectorial teams	4	3	■ Engage reputable executive search firms ■ Ensure compensation packages are competitive ■ Implement best practices in HR management
3C	Skills and experiences of the Boards of Directors members are nt used efficiently	4	4	■ Clearly define and communicate the powers and responsibilities of the members of the Board of Directors ■ Define and codify the functioning of the members of the Board of Directors (including mentoring the management)

Risk management within transformation is a continuous process consisting of four steps:

1. **Identification:** Cross-functional teams will collect and analyze expert opinions of the Fund and portfolio companies' employees involved in the process on risks within specific initiatives and those affecting several initiatives at the same time. Opinions will be collected by means of questionnaires and personal interviews. The teams will then compile a list of risks.
2. **Assessment and prioritization:** Teams assess the identified risks in terms of probability and consequences, and then segment the risks: those with high probability and strongly negative consequences are given top priority for mitigation. The end products of this step are a risk register and a risk map.
3. **Mitigation:** Teams, working together with the Fund and portfolio company employees involved in the process, develop risk probability mitigation plans, consequence mitigation plans, and back-up plans in case of key risks.

4. **Monitoring and reporting:** Team representatives exercise constant control over implementation of risk mitigation plans and report to the Project Management Office.

Risk management within the transformation process will be the responsibility of the Project Management Office, including final assessment and prioritization of risks. A risk manager within the Project Management Office will provide constant control over risks, keep in touch with initiative leaders, and maintain a list of approved risks.

APPENDIX 1: LESSONS LEARNED FROM OTHER TRANSFORMATIONS

The international experience of comparable Funds and individual companies shows that this kind of transformations are challenging. McKinsey & Company conducted a research that covered the experience of more than 800 organizations that had launched a transformative effort in various countries in the last 10 years. According to the research, transformation failed in 70% cases. The research identified the following reasons behind the failure:

- Employee resistance to change (one of the reasons for a transformation failure in 39% cases)
- Management behavior does not support the goals and objectives of the transformation (one of the reasons for a transformation failure in 33% cases)
- Inadequate allocation of human resources, time or monetary budget for the transformation (one of the reasons for a transformation failure in 14% cases)
- Other reasons (identified as one of the reasons for a transformation failure in 14% cases)

The research also studied the experience of 30% of successful transformations. The following four key factors were in place that enabled to overcome the three main categories of failures described above:

- Skill gap to deliver against the transformation's aspirations identified and addressed through dedicated capability building efforts
- Employees engaged through pro-active change communication and continuous involvement in the transformation
- Leaders taking an active role in designing the desired change and visibly changing their way of working in line with the transformation plan
- Key roles and responsibilities defined. Sufficient and right resources deployed in those roles to progress at high pace

During the preparation of the Samruk-Kazyna transformation program, a detailed assessment of the transformation efforts of similar funds in similar country context (e.g., Khazanah and Temasek) and individual companies (e.g., Sberbank, La Poste and Statoil) was conducted. The following key learning was able to be identified:

1. **Clear transformation mandate and support at the top level are critical.** The Fund and the Portfolio company employees need to experience that the transformation program is demanded by both the Board of Directors as well as the top political leadership of the country. This will enable the changes within the Fund and Portfolio companies to overcome the inevitable resistance. The launch of transformation program and the key decisions along the way should be supported publicly both by the Board of Directors as well as by the top political leadership of the country.
2. **Aligning the laws and regulation.** As the first thing in the transformation the required legislative and political decisions would need to be done to enable the transformation program to start. After fixing these, there is a solid basis to push the transformation program forward.
3. **Set few clear measurable targets and track them.** The measurable goals for both the Portfolio companies as well as for the Fund should be determined and tracked

continuously. The employees need to understand these goals and share the key drivers of them in their own performance contracts. Each manager needs to understand his or her area of responsibility and be able to make the link between his or her contribution into achievement of the common goals. In many cases this means setting up well functioning key performance system that is focused on the priority areas and has accurate data in timely manner. The key performance indicators needs to be clearly connected with the Fund's aspirations and should include both financial and operational elements. For the key performance indicators to function efficiently the system needs to be linked to the incentives.

4. **Use the Fund as the nucleus for the transformation.** The most efficient way of getting the transformation program going is to transform the way how the Fund works first. As the Fund has significantly less employees than the Portfolio companies, but still with their actions they influence the Portfolio companies' activities significantly, it is easiest to get the transformation started this way. Then the transformation naturally rolls down to the Portfolio companies, where the large long-term effort will be ahead.

5. **Best practice sharing.** Along the way there will be a lot of learnings. There best practices should be efficiently shared within the Fund and with the Portfolio Companies. This can be best done by sharing a common methodology in areas where feasible, and documenting and sharing the results and learning.

6. **Sequencing the Portfolio companies' intensive phase of transformation.** As the task of transforming an individual Portfolio company is an intense effort and they are large in scope, simultaneous transformation of all these companies is usually impossible due to limited human resources and management time. Also sequencing enables utilizing the learning from the first Portfolio companies with the latter ones de-risking the effort significantly. This is the reason why choosing the first batch of Portfolio companies to go through the intensive transformation is critical.

7. **Demonstrate sustainable success quickly.** In order to have the positive momentum among all parties involved in the transformation, it is critical to demonstration of the positive impact and have reason to celebrate success. This will help to mobilize the support for the transformation program both with the Fund as well as with the Portfolio companies, and will provide the required impulse for further transformation program.

8. **Without the right people in the key roles the transformation fails.** Careful human resource management is the key to successful transformation of the Fund and the Portfolio companies. This includes targeted capability building with the current employees and bringing in new talent. In order to enable this, both up-front human resources evaluation against the requirements is needed as well as changing the key human resources related support processes.

9. **Board of Directors plays critical role in the transformation.** The common nominator for all successful transformations has been step change in the way how Board of Directors operates. Typically this includes strengthening the composition of the Board of Directors, making it more independent and introducing more discipline for the operations of the Board of Directors. Also in many cases to make the Board of Directors better functioning the mandate and the role needs to be clarified towards the shareholders as well as towards the management team.

Establishing dedicated transformation office. Given the intensity of the transformation as well as the special requirements, a dedicated transformation office structure should be established to track the progress with the transformation, share common methodology in certain areas of change management (e.g., approach towards defining the processes) and manage certain shared activities (e.g., communication). The transformation office should be granted with the required authorities and resources, and the key roles in the transformation office should be staffed with personnel having the appropriate skills and experience.

Among transformations that have been successful, there are case studies to learn from both in terms of similar sovereign wealth funds that are active strategic holding companies (i.e., Mubadala, Khazanah and Temasek) that are relevant for Samruk-Kazyna as a Fund especially as well as individual Portfolio companies (e.g., Sberbank, La Poste and Statoil).) that are relevant for the Samruk-Kazyna Portfolio companies. Of all the case examples available, two most comparable case examples are described more in detail *[Exhibit 10]*:

- **Khazanah** is a Malaysian sovereign wealth fund that was able to transform itself from a passive holding company with negative economic profit into an incubator of regional champions and a catalyst for a nationwide transformation. The context as well as the aspiration level related to Samruk-Kazyna's transformation is very similar to Khazanah. *[Exhibit 11]*
- **Sberbank**, a Russian bank, was able to transform itself from an inefficient company into a leading edge bank by piloting Lean techniques and technology-enabled business processes in selected areas, and then rolling them out across the company. Being from the CIS region and having a similar legacy to many of the Samruk-Kazyna Portfolio companies Sberbank is a good example of successful individual Portfolio company transformation. *[Exhibit 12]*

Khazanah: A successful sovereign wealth fund transformation that catalyzed an entire country

In 2004 Khazanah was a small unit administering Malaysian state-owned assets as a passive shareholder. The focus of its activities was on processing dividends and collecting reports. It did not actively buy or sell Portfolio companies, nor did it use its ownership position to influence Portfolio company performance. Management at both the Khazanah fund level and at Portfolio company level was dominated by former political figures. Many companies were showing positive net profit, but compared to their industry peers they were lagging and out of the 15 largest companies only seven showed positive economic profit. For Malaysia as a country Khazanah's poor performance created a major obstacle, since the Portfolio companies made up 75% of market capitalization in the stock exchange and 1.5 million employees.

This situation motivated Malaysia's Prime Minister to embark on a large scale transformation of Malaysia's economy with a target for to transform Khazanah into "one of the biggest and most dynamic investment houses in the region" that will help to make Malaysia globally competitive by catalyzing economic growth, boosting nation-wide competitiveness and cultivating high performance. The transformation of Khazanah can be split into four periods.

Phase 1: Diagnostics, planning and mobilization (2nd half of 2004 – 1st half of 2005)

In June 2004, the newly appointed Managing Director for Khazanah, Dato' Azman Mokhtar received a strong mandate to restructure the fund and launch a change process. The Board of Directors also promised their long-term commitment for the transformation – even when it was explicitly discussed that the transformation would require many politically unpopular moves (e.g., decreasing headcount in Portfolio companies, replacing key individuals and tweaking regulation) and that economic performance would dip before it started to improve due to one-off effects. This prediction turned out to be correct (economic profit dropped from negative RM1000 million to negative RM5000 million before turning significantly positive two years later) and in the early years lay-offs and changes in the key positions were required. The main actions taken in the first phase included:

- **Revamping the Khazanah fund-level organization:** Khazanah's capabilities at the time did not match the ambitions set by the nation's leadership. In order to attract best talent, restrictions on salary and limitations on previous linkages to the civil service were removed, and a significant portion of total compensation was linked to individual performance. A significant number of new hires were foreign specialists, who brought global sectorial and investment expertise. Many of the new, senior employees served in expanded sectorial teams, which were assigned with responsibility to create an independent fact base on the Portfolio companies' performance, support Khazanah representatives on the Portfolio company Boards, source new investments within their sectors and partner with Portfolio companies to execute M&A transactions
- **Clarifying and establishing a clear mandate for Khazanah:** The Managing Director was rapidly able to gain agreement on the mandate of Khazanah. It consisted of both streamlining the legacy investments, transforming the business performance, making investments in new strategic sectors and actively developing human capital for the nation. Since the agreed Khazanah mandate consisted of both financial and developmental goals, the team established a process whereby potential projects are assessed against financial goals and efforts are made to quantify non-financial developmental goals. In particular, Khazanah started to evaluate and quantify potential non-financial impact such as contribution to GDP and number of jobs created, which would then be used to assign a discount to investment hurdle rates
- **Establishing key performance indicators (KPI):** Khazanah established a focused KPI system to assess the performance of the fund's sectorial teams, on, which the fund management's compensation was based. The KPIs for the sectorial teams were based on the following principles:
  - Value creation based on Economic Profit [(Return on Invested Capital – Weighted Average Cost of Capital) x Invested Capital)]
  - 1-2 key operational metrics specific to each sector, e.g., System Average Interruption Duration Indicator (SAIDI) in the power sector
  - Milestones or projects (e.g., completion of projects / investment deals or talent development within the sectorial team)
- **Reforming Board composition:** Many of the Boards were diagnosed as dysfunctional, with substantial trust issues. Given the situation in chosen pilot companies, a Lead Director (representing the largest shareholder) was appointed to guide a Board Performance Improvement program, with the Company Secretary driving day-to-day

actions. The working relationship between the CEOs and the Boards was clarified, and CEOs were hold accountable to deliver on these mandates. The Boards revised their meeting practices, and tightened their agendas and papers. The Boards introduced talent management as a key priority. The Boards instituted an annual review to track progress and identify new issues. Finally, the Boards increased their own commercial knowledge/experience by attracting recognized leaders and experts as directors.

Phase 2: Generating momentum at Portfolio company level (2nd half of 2005 – end of 2006)

The transformation program for Khazanah Portfolio companies was structured in a T-shaped manner: establishing a common approach/principles for the Portfolio company transformation through ten common initiatives, and developing specific transformation programs company-by-company.

The common principles/approach consisted of ten initiatives, codified in best practice books, which were made publicly available. These initiatives were rolled out during 2005/2006 over 18 months, with key policy decisions endorsed by the government. The approach was that applying these codified best practices was voluntary for Portfolio companies, but Portfolio companies were expected to deliver the same results regardless of whether they followed the best practices or delivered them in some other way (although certain sections of the best practice books were also rolled down as compulsory policies to the Portfolio companies, e.g., purchasing-related policies). The process of developing the books was collaborative, with representatives of the fund, Portfolio companies, the government, regulator and the private sector debating the key points, and a purpose-established secretariat ran the process of codifying the discussion using a standardized methodology.

These overarching initiatives and principles were supported using a company-by-company approach. Credibility and momentum was built through early successes. In 2004, Khazanah had 57 Portfolio companies. The Fund's Chief Executive Officer understood that he could not transform all Portfolio companies at once, but at the same time would need to start with more than one in order to be able to show a success case even if one program failed. Therefore, management analyzed the 20 largest Portfolio companies, thereafter narrowing the list to nine and then to three based on prospects for quick returns. Khazanah management looked for opportunities that would deliver most value and at the same time where transformation would meet least resistance. This meant the Chief Executive Officer of Khazanah could use his political capital effectively and deliver early results, which would then supply momentum for further transformation of the remaining Portfolio companies. Of the initial focus companies three were chosen (telecom, infrastructure and airline) to undergo a company-specific Performance Improvement Program focusing on both the key applicable parts of the ten initiatives and company-specific high-value improvement initiatives.

Phase 3: Tangible results at scale (2007– today)

The third phase of the transformation program focused on rapidly rolling out to cover all the major Portfolio companies. Significant continuous effort was also placed on sustaining the changes made at the Khazanah fund level and in the individual Portfolio companies already touched. Based on lessons learned, the transformation program was fine-tuned throughout the roll-out.

The roll-out has now covered all the key Portfolio companies, and the demonstrated impact of the program has been significant:

- The compound annual growth rate for the 20 largest Khazanah companies has been 14.5%, compared to an average of 11.6% for the Malaysian stock exchange
- Before the transformation Return on Equity was 2%, while today it is 7%
- The realizable Khazanah Portfolio has grown from US$51 billion to US$121 billion
- Economic profit has risen from negative RM1,000 million before the crisis to positive RM5,000 million in 2012
- Regional champions have been created, such as IHH Healthcare (the third largest initial public offering in the world at time of floating in 2008, which was oversubscribed 132 times)

Naturally there have also been less successful cases during the transformation. In most of these (e.g., the airline) the major root causes have been declaring victory too early, not sustaining the changes, and slipping back over time to the old practices and way of running the company.

Phase 4: Full national benefits (2009 – today)

At the end of 2009 the new Prime Minister reaffirmed support for the Khazanah transformation program. In addition, he decided to initiate a broader Government Transformation Program utilizing the successful principles of the Khazanah and Portfolio company transformations. This included setting 3-5 KPIs for all members of the cabinet of ministers and choosing a few priority areas on, which to focus and demonstrate clear material change. Within each priority area (e.g., petty crime) a clear KPI was set (e.g., number of incidents in specific area), a pilot region was chosen (e.g., notorious city blocks in Kuala Lumpur), a granular plan for delivering on the KPI was put in place (e.g., from where to move police officers to the chosen area, and what routine they exactly needed to follow) by a cross-functional team (comprising, e.g., the governor, police and social workers), and implementation was closely monitored (e.g., through weekly reviews by the cross-functional team). This enabled the Government to boost performance in the focus areas significantly:

- Fighting crime: 35% reduction in street crime within 12 months; 41% reduction in street crime sustained after 3 years
- Fighting corruption: 284 offenders publicly listed within 12 months; 34.7% of arrest cases brought to court within 3 years
- Improving education: 60,000 additional pre-school seats within 12 months; 768,145 additional preschool classes within 3 years
- Eradicating poverty: 2,000 women entrepreneurs trained within 12 months; 4,300 women entrepreneurs trained within 3 years
- Improving basic rural infrastructure: 35,000 households connected to clean water supply within 12 months; 187,567 households connected to clean water supply within 3 years
- Improving urban public transport: 2,000,000 increase in ridership within 12 months; 66% reduction in waiting time within 3 years

At the end of 2010, after both successfully transforming Khazanah as well as ensuring a successful start for the broader government transformation, Malaysia kicked off an Economic Transformation Program for individual industry sectors in cooperation between the government, private sector and government-linked companies. This followed the same principles as the Khazanah and government transformations. The transformation program covered 11 economic sectors and 1 geographic region that were projected to contribute the bulk of the additional growth in Gross National Income.

As a result of the successful Khazanah, government and industry sector transformations, Malaysia has been able to improve its ranking in multiple areas. In the global 'Ease of doing business' index, for example, Malaysia now ranks 6^{th} while in 2006 its rank was 17.

Sberbank: Successful transformation of an individual company in the CIS region, with a similar legacy to that of many Samruk-Kazyna Portfolio companies

Seven years ago, when the new management team joined Sberbank, this largest bank in Eastern Europe was losing market share. It was poorly run – essentially as a set of separate regional banks, did not capitalize on its scale and was years behind market practice in terms of customer service and internal processes. By this point, there were already multiple competitors in the Russian banking market, both domestic and foreign, operating in a vastly different way.

From that point to today Sberbank managed to become a modern bank with an attractive brand, significantly improved client service, excellent financial performance and a quest for continuous improvement and innovation. Its transformation can be loosely described in two "agendas", which are only partially chronological even though they somewhat coincide with the bank's strategic planning cycle – The Modernization Agenda (roughly 2008 – 2012 although some continues to date) and the Expansion and Innovation Agenda (roughly from 2012 onwards).

The Modernization Agenda

As the new management team embarked on the first phase of the transformation, they aimed at stabilizing market share, improving financial results, getting to "decent practices" both in terms of customer experience and internal processes and beginning an international expansion. Key aspects of how the Modernization Agenda was implemented and why it was largely successful:

- Broad design of the "modernization" program aimed at bringing the bank in line with market practices – as there were multiple aspects that required a near-total revamp, the bank chose to go with an "all at once" strategy. That decision was based on several factors. Firstly quite a few things were interdependent, e.g. revamping product lines, investing in IT systems, creating new Risk processes, so it was more efficient to do simultaneously all at once. Scondly, the bank was quite far behind on many aspects and was losing to competition rapidly – it seemed that the window of opportunity may be limited. Thirdly, for the transformation to succeed it was important to get to critical mass of changes relatively quickly

- Such broad design was complemented by a "bias for action" – it was for the most part clearly communicated that "mistakes of action" are far more tolerated than "mistakes of inaction"
- Initially firmly rooted in Lean principles – important in the beginning, especially in Retail, to show real tangible changes, both benefitting the customers and simplifying work for the employees. Lean was introduced through pilots – several processes were analyzed and changed in selected geographical locations by a team of 'change managers', and then rolled out across the company. This team was carefully selected from among the bank's employees, with significant support from hired experts with experience in implementing similar programs as well as with the right mindset.
- Relentless drive for change from the top. The CEO genuinely considered this his personal "life" challenge and recruited a top team that, for the most part, was also energized and motivated by the vision and the scale of the transformation.
- Substantial centralization in order to create manageability, unify customer experience levels, processes, products, etc. and gain more efficiencies of scale. This pertains both to unifying standards and literally centralizing risk processes and operations.
- Substantial change of management at all levels. Over 5 years ~70% of all managers have been replaced – in order to enable a new way of working. For example by the end of 2013 only 2 of the 17 heads of Territorial Banks (Sberbank's main regional BUs) remained the same as in 2007.
- Introduction of performance management and increase in professionalism in other people-related topics. For example, the bank both focused on bringing in "new blood" and new expertise, and devoted significant effort to growing managers and leaders from within. Also, clear sets of KPIs were developed and tied to the financial motivation system, both in HQ and in the multilayered regional; organizations.
- A willingness (and ability) to spend significant amounts on IT systems. In the period of 2008 to 2013 Sberbank spent substantial amounts on developing new systems, centralizing existing ones, etc. Without such investments, it would not have been able to improve internal processes, gain efficiencies of scale by centralizing operations, introduce mobile banking, etc.

The Expansion and Innovation Agenda

From 2011, while continuing to push its modernization agenda, Sberbank embarked on an ambitious growth path, as well as focused on leap-frogging and innovation in several core areas:

- **Expansion into new geographies:** For example the acquisition of the non-Austrian assets of Volksbank in 2012, acquisition of DenizBank in 2012 and opening a representative office in India. The bank now has a presence in 22 countries, including ~1500 foreign branches representing ~13% of assets
- **Expansion into new businesses, largely via acquisitions:** Insurance and Wealth Management (e.g. purchased a life insurance company in 2011), acquisition of investment bank Troika-Dialog in 2011-2012 and acquisition of a stake in French POS-loans player Cetelem and launching a new POS-lending business

- **Pursuing technology-enabled innovation, especially in retail and small business:** Market-leading remote channels and applications (e.g., Smartphone app, Mobile banking SMS-service and Online-banking) and “Delovaya sreda” – a specialized platform aimed at facilitating interaction between entrepreneurs and helping them grow their businesses.
- **Introduction of innovative aspects of internal corporate culture:** Focus on self-development and broadening of horizons, at least among a certain cadre of managers and establishing multiple vehicles for internal innovation, e.g. a crowdsourcing platform used both for idea generation and ideas discussion within the bank

The unprecedented success of the Sberbank transformation led to, among other things, an impressive shareholder return: a hundred dollars invested in Sberbank in February 2002 would be worth more than USD 3,700 in 10 years’ time, which is second best performance after Apple stock, which would have risen to almost USD 4,000.