Energy of Transformation

Annual Report 2006

ҚазМұнайГаз
БАРЛАУ ӨНДІРУ АКЦИОНЕРЛІК ҚОҒАМЫ

Kazakhstan oil infrastructure

Kazakhstan has good access to the world oil markets given its geographical location and developed infrastructure.

KAZAKHSTAN OIL INFRASTRUCTURE

RUSSIA
KAZAKHSTAN
UZBEKISTAN
TURKMENISTAN
KYRGYZSTAN
CHINA

Kazan
Nizhnekamsk
Chernushki
Yekaterinburg
Tyumen
Anzhero-Sudzhensk
Kemerovo
Novosibirsk
Ulyanovsk
Almetyevsk
Ufa
Yurgamysh
Tobol
Petropavlovsk
Omsk
Barnaul
Biysk
Syzran
Samara
Saratov
Magnitogorsk
Kostanai
Kokshetav
Aysary
Kochary
Tavolzhan
Pavlodar
Amankaragay
Orenburg
Karachaganak
Bol. Chagan
Orsk
Ishim
Astana
Volgograd
Volga
Irtysh
Semey
Temirtau
Karakayly
Zaysan Lake
Temir
Kenkiyak
Alibekmola
S. Alibek
Zhanazhol
Kozhasai
Karmanovo
Dossor
Martyshi
Makat
Atasu
CPC Pipeline
Astrakhan
Atyrau
N. Zaburunye
Kashagan
Iskine
Komsomolskiy
Kulsary
Koschagyl
N. Zhanbai
Sayak
Aktogay
Balkhash
Balkhash Lake
Karamai
Druzhba (Alashankou)
Urumchi
Tushanszi
Munayly
Kurmangazi
Karaton
Opornyy
Sarykamys
N. Buzachi
Kalamkaz
Tengiz
Karazhanbas
Sarykamys
Kalamkas
Bautino
Beyneu
Tauchik
Karakuduk
Arystanov
Aralsk
Kumkol N.
Kumkol S.
Maybulak
Aryskum
Kumkol
Qyzylkiyak
Aryskum
Dzhusaly
Nuraly
Aksai
Akshabulak
Baku-Tbilisi-Ceyhan
Aktau
Say-Utes
Zhetybay
Uzen
Zhanaozen
Tenge
Tasty
Almaty
Birlik
Bishkek
Aral Sea
Caspian Sea
Syrdaria
Kungrad
Amudaria
Zhambyl
Uchkuduk
Shymkent
Baku
Tashkent
Fergana
Turkmenbashi
Bukhara

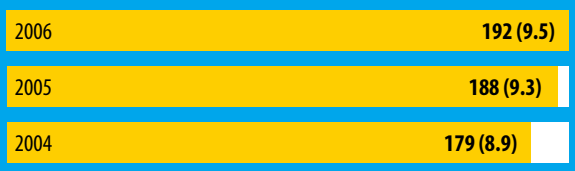
Legend

- Oil refinery
- Oil pipeline
- Field
- Railway
- State production
- State border

Key Operational and Financial Highlights

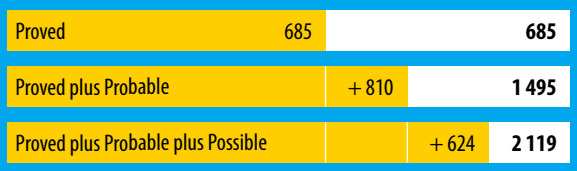
Crude oil production

Thousands of barrels per day (millions of tonnes) [1]



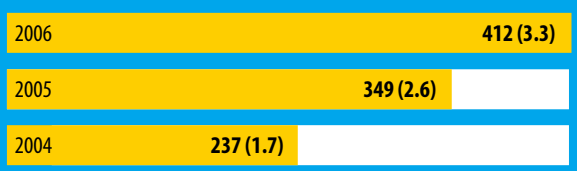
Reserves as of 31.12.2006

Millions of barrels [2]



Revenue

Billions of KZT (Billions of US$) [3]

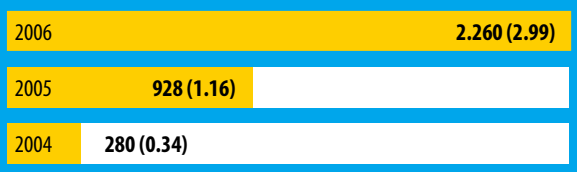


Net income [4]

Billions of KZT (Millions of US$) [3]

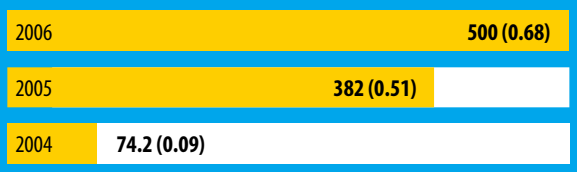
Earnings per share/GDR [5]

KZT per share (US$ per GDR) [3]



Dividend per share/GDR

KZT per share (US$ per GDR) [6]



Notes:

1. Converted at 7.36 barrels per tonne of crude oil.
2. As estimated by Gaffney, Cline & Associates.
3. Amounts shown in US dollars have been translated solely for the convenience of the reader at the average rate over the applicable year, in particular at KZT/US$ 136.04, 132.88, 126.09 for 2004, 2005 and 2006 respectively.
4. Profit for the year from continuing operations.
5. EPS from continuing operations—basic and diluted.
6. Convenience translation from Tenge at KZT/US$ 134.91, 125.09 and 121.8 for 2004, 2005 and 2006 respectively. One GDR corresponds to one sixth of ordinary share. The dividend per GDR for 2004 and 2005 are pro-forma based.

KazMunaiGas Exploration Production aims to grow bigger, stronger and to develop more sustainable, transparent and responsible business practices as a leader in the Kazakhstan Oil and Gas Industry.

KazMunaiGas Exploration Production at a glance

- Created through the merger of JSC Uzenmunaigas and JSC Embamunaigas **in March 2004**.
- The 3rd largest Kazakh oil producing company in 2006. Now **the 2nd largest** oil producer following the addition of a 50% in JV Kazgermunai LLP ("Kazgermunai") acquired in April 2007.
- KMG EP is developing **44 fields** in Western Kazakhstan, the largest being the Uzen field - in production since 1965.
- At the end of 2006, proved plus probable oil reserves were estimated to be **203 million tonnes** (1.5 billion barrels), with an estimated reserves life of 22 years at 2006 production levels.
- Over **100 years of experience** and knowledge of the geology of its fields in the western region of Kazakhstan.
- KMG EP has reached agreements that provide **guaranteed access** to the Uzen-Atyrau-Samara (UAS) pipeline and the Caspian Pipeline Consortium (CPC) pipeline.
- **Exports accounted for 73%** of 2006 sales in volume terms (71% in 2005).

Relations with the parent company

JSC KazMunaiGas Exploration Production (KMG EP or the Company) is majority owned by JSC NC KazMunaiGas (NC KMG), the national oil and gas company controlled by the Government of the Republic of Kazakhstan. NC KMG owns about 60% of the Company's ordinary shares after the initial public offering in October 2006.

KMG EP enjoys excellent relations with its parent company, as evidenced by various agreements between the two. These agreements are based on transparent market principles of interaction whilst allowing KMG EP to act in the interests of all of its shareholders.

Agreements with the parent company also ensure that KMG EP has the right of first refusal on the acquisition of existing onshore oil and gas assets, access to new oil and gas acreage and guaranteed access to pipeline infrastructure.

KMG EP is the only company in Kazakhstan that has these advantages.

Initial Public Offering (IPO)

US$2 Billion - In September 2006 KMG EP sold approximately 38% of its stock and raised US$2.0 billion from an initial public offering on the Kazakhstan Stock Exchange and a placing of global depositary receipts (GDRs) on the London Stock Exchange (LSE).

17.9 Million - More than 17.9 million shares were placed on the Kazakhstan Stock Exchange. Fifteen Kazakh pension funds and pension asset management companies received about 7.4 million shares. Another 9.2 million were used for the purchase of bonds of a KMG EP financing subsidiary. The approximately 1.3 million shares were placed on a pro-rata basis among other investors.

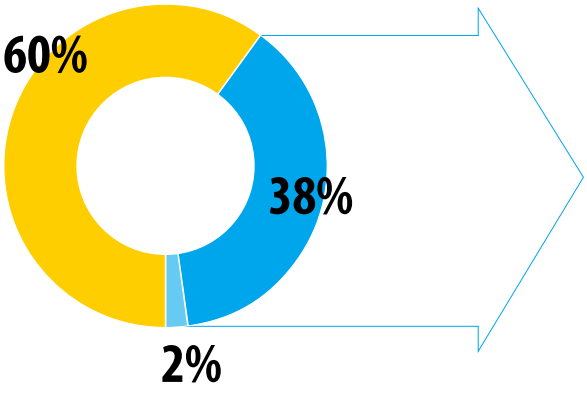
8.7 Million - Over 51.9 million GDRs, representing about 8.7 million shares, were placed on the LSE. The buyers of GDRs were various institutional investors from the UK, Continental Europe, the USA, Russia, Asia and the Middle East.

Visor Capital was the lead manager for the domestic share offering with ABN Amro and Credit Suisse acting as joint lead managers for the International offering and Merrill Lynch acting as co-manager for the deal.

Any IPO on the LSE requires accounting transparency and adherence to International Financial Reporting Standards (IFRS). KMG EP has made great progress in order to meet its new international reporting requirements. The adoption of a New Company Charter, appointment of Independent Non-Executive Directors to the Board of Directors of the Company, and the creation of committees of the Board of Directors' on Audit, Nominations and Remuneration are just a few examples of KMG EP's achievements since October 2006. We are proud to be setting an example for international corporate governance standards for other aspiring companies in Kazakhstan.

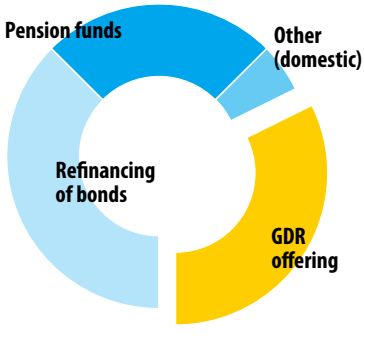
Shareholder structure at IPO

(ordinary shares)



NC KMG
IPO tranche
Pre-IPO minority investors

Broad range of domestic and international minority shareholders



Placed on LSE
KASE

Chairman's Statement

Kazakhstan is a young country, independent only since 1991. It is a country with enormous potential. It is the ninth-largest country in the world by geography, larger than Western Europe; it is rich in natural resources, particularly oil and gas. The activities of the Kazakhstan oil and gas industries contribute to the consistent economic growth of the country. The annual increase in GDP has been greater than 9% for each of the past five years. Among the former Soviet republics Kazakhstan is the second-largest oil producer, after Russia, and has the Caspian region's largest recoverable reserves of crude oil.

JSC KazMunaiGas Exploration Production (KMG EP) is also young. It was created in March 2004 through the merger of JSC Uzenmunaigas and JSC Embamunaigas. Now, the Company's unique relationship with the Government, its available funds and its management resources provide KMG EP with exceptional potential for growth and development.

The Company is a subsidiary of the JSC NC KazMunaiGas (NC KMG), and its core activity is exploration and production of oil and gas onshore in Western Kazakhstan. Based on 2006 operating results it is the third-largest Kazakh hydrocarbons producer (and the only top-ranking one directly available to portfolio investors). At the end of 2006, Gaffney, Cline & Associates (GCA) estimated that it had proved and probable oil reserves of 203 million tonnes (1.5 billion barrels) and 22 years of proved and probable reserves life at 2006 production levels. Last year it produced 9.5 million tonnes (192 kbopd) and its 2006 revenue was 412.2 billion Tenge or US$3.2 billion.

The theme of this our first annual report as a listed company is one of transformation. In my opinion, the transformation of KMG EP reached a watershed in 2006, a year where all the building blocks were put in place to ensure a strong and successful future for the Company. This transformation has been driven by a number of elements.

First of these is the sound management skills that we possess within our Company. Although KMG EP is a relatively new organisation, its underlying subsidiaries have nearly 100 years of production experience in Kazakhstan, and the majority of our leadership is drawn from those ranks. It is this management team who have put in place measures that will allow us to maximise the potential of our existing assets and to achieve growth through acquisitions and exploration.

It is this same management team who have reversed over ten years of underinvestment and restored production. Thanks to the retraining of our existing employees and the utilisation of new technology and equipment to maximise production from our existing assets, it has been possible to achieve an increase of 80% in production between 1998 and 2006.

Second is KMG EP's close relationship with the Kazakh Government, with NC KMG offering KMG EP the right of first refusal on any onshore transaction, gives the company a clear competitive advantage.

Third is our on-going adoption of the highest international standards of corporate ethics and health and safety regulations. For example, we have reduced accidents at work tenfold in recent years while completely fulfilling eco-control undertakings. Added to this we have adopted new standards of corporate governance, appointing Audit, Remuneration and Nominations sub-Committees at Board level and improving our financial reporting partly through the completion of our adoption of International Financial Reporting Standards (IFRS).

Last, and probably most importantly, we have transformed the Company by raising additional finance through our IPO to ensure we have sufficient funds to achieve our ambitious goals going forwards.

I would like to take this opportunity to thank everyone within the Company for their outstanding performance since its formation. I believe that our latest results confirm that a bright future lies ahead for our Company.

Finally, I would like to thank our Board, including the new members, for their continued contribution and support through a highly challenging but ultimately significant time for the development of our Company.

Uzakbai Karabalin
Chairman of KMG EP

Chief Executive Officer's Statement

The Chairman has identified a number of factors behind what we believe has been a transformation of KMG EP. To these I would draw attention to and expand on several practical and strategic elements.

First a few words about our 2006 financial results. The Company's revenues increased by 18.1% year on year to 412.2 billion Tenge (US$3.27 billion). We were able to use favorable oil market conditions when Brent oil prices increased by approximately 13% in Tenge terms and our average sale price grew by 17% from 37,182 Tenge per tonne (US$38.21 per bbl) to 43,428 Tenge per tonne (US$46.99 per bbl). The growth of net profits was even higher with profits after tax (net income) from continuing operations at 122.6 billion Tenge (US$972 million), 171% higher than in 2005.

This improvement in financial performance was possible due to a number of achievements no less important than increasing average oil prices. We increased sales volume by 0.7% to 9.3 million tonnes (187 kbopd). Exports accounted for 73% of 2006 sales in volume terms (71% in 2005). There was growth in the use of the most effective export route – CPC. As a result of work undertaken in 2006, a number of issues related to subsoil use contracts and environmental protection have been resolved and this also positively influenced our financial results. Finally, we continued our efforts to control and reduce costs. While these results speak for themselves this success is largely due to the work put in by the management of the Company.

Moving on to strategic developments, it is important to say a few words about our recently completed Initial Public Offering (IPO). In September 2006 we conducted an IPO in Almaty and, simultaneously, in London. This was a highly significant milestone in our development: it raised approximately US$2.0 billion for the Company substantially strengthening our balance sheet. Indeed, by the end of 2006 we had net financial assets of approximately US$2.6 billion, leaving us able to take advantage of our position as a consolidator within the Kazakhstan oil and gas industry. Whilst the IPO was primarily a capital-raising exercise for the Company it was also a sign of our commitment to complying with all the financial reporting and governance standards now expected of a truly international oil and gas producer.

In line with this strategy, and since the year end, we have completed certain agreements with NC KMG and have been working on acquiring a number of key assets.

In April 2007 we formalised the agreement to acquire a 50% stake in JV Kazgermunai LLP (Kazgermunai) from NC KMG for a cash consideration of 118.3 billion Tenge (US$969 million). Kazgermunai is the 8th largest Kazakh oil and gas producing company with nearly 3.0 million tonnes a year (60 kbopd) of crude oil production in 2006 and 40.7 million tonnes (310 million barrels) of proved and probable reserves at the end of September 2006.

We also expect to acquire a 50% interest in Nations Energy Company Ltd (Nations Energy). Nations Energy produced approximately 2.3 million tonnes (42 kbopd) of crude oil in 2006.

Finally we are evaluating the acquisition of a stake of 33% in PetroKazakhstan Inc. This company has increased production rapidly in recent years and would strengthen our business in key strategic geographic areas.

Other opportunities for acquisitions will be considered as they arise and we will keep our shareholders informed of these developments.

On operational matters, 2006 has been a significant year in a number of ways and our core business is continuing to thrive and expand. Our two core producing assets, Uzenmunaigas (UMG) and Embamunaigas (EMG) have now been fully restored to a sustainable production level from low levels reached in the 1990's due to underinvestment. This turnaround has been achieved by an increased workover and drilling campaign and an improvement in artificial lift and water injection. This programme has modernised our overall production facilities and we believe further improvements can be made. In 2006, oil production at the UMG fields and EMG fields combined was over 9.5 million tonnes (192 kbopd).

Exploration is a vital element in the achievement of our long-term objectives. Our exploration goal is not just to replace existing reserves, as these are run down through continued working, but to increase our overall production levels. Much of the geology of Western Kazakhstan is well explored, but we are focusing on less well-explored areas within that region, and elsewhere in the country. This year the Company intends to focus on seismic work in the sub-salt horizons of the Precaspian basin with a view to locating large reserves of hydrocarbons.

We have put great emphasis on growing and replacing our reserves and maintaining production in existing fields as well as rationalising our cost and asset base. To these I would add that we have also gone to great lengths to implement policies to meet international environmental, human resource and safety standards. These themes are developed later in this Annual Report: suffice it to say here that all these strands played their part in growing the Company.

These are exciting times for oil producers and KMG EP is well placed to meet the challenges and possibilities we are now experiencing. A strong balance sheet provides us with the resources to exploit the exploration, acquisition and technological opportunities. At the same time, we have the possibility of increasing our profitability by continuing to drive down our cost base. I look forward to the future with confidence.

Askar Balzhanov
Chief Executive Officer


Stro

Stronger

Core business

The core production assets of the Company are its two production divisions: Uzenmunaigas (UMG) and Embamunaigas (EMG), with combined production of 192 kbopd in 2006. Of the two divisions UMG accounted for more than 75% of reserves and 71% of 2006 production.

With regard UMG and EMG, the Company's strategy is to maintain existing production levels in the forthcoming years by drilling and completing new wells, performing well work-overs and enhancing oil recovery by implementing new technologies.

The Company also intends to focus on the improvement of efficiencies by continuing to reduce operating costs and rationalising its operations across the board. This will be achieved through divesting non-core and ancillary businesses and by bringing the Company's operations in line with international standards.

Vladimir Miroshnikov
First Deputy General Director

"Investment in new drilling and the optimisation of production processes have restored production levels. Our strategy now is to maintain those levels from existing assets and negotiate increased access to the export market."

Recent oil production growth

General economic difficulties and an acute lack of investment in the early to mid 1990s led to significant falls in production levels at the major oil-producing assets of KMG EP. However, towards the end of the 1990s the Company managed to halt the decline in production and then to ensure impressive production growth.

Production has risen by a total of 80% from 1998 to 2006. Enhanced investment in new drilling and more efficient recovery from existing fields has restored production levels. A major role in the recovery process was played by well workovers and the use of modern technologies such as hydro-fracturing. The Company's strategy now is to maintain production from existing assets at the current optimal level for the next few years.

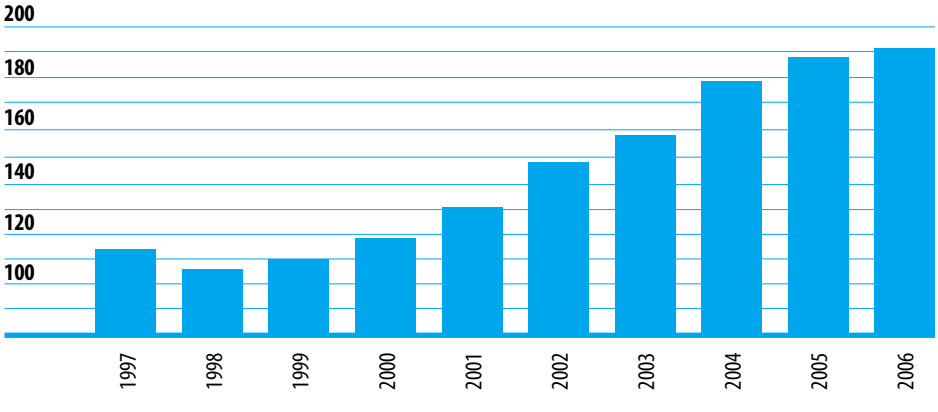
Secured access to export pipelines

Kazakhstan is essentially a landlocked country, so increased production for export requires an improved transportation infrastructure. Fortunately, this infrastructure has been developed considerably in recent years.

Until recently the main outlet for the Company's production has been through Russia via the 1,500 km Uzen-Atyrau-Samara (UAS) pipeline to Samara. Since 2001 this has been complemented by the Caspian Pipeline Consortium's (CPC) 1,510 km pipeline to the Russian city-port of Novorossiysk on the Black Sea – a more profitable route for the Company and the reason behind our efforts to increase the proportion of exports through CPC.

Oil production

Thousands of barrels per day



Production growth between 1998 and 2006 was an impressive 80%.

The 1,000 km Atasu-Alashankou pipeline between Kazakhstan and China became operational in December 2005, with a capacity of 10 million tonnes p.a. (200 kbopd) projected to double in the coming years. Other pipeline routes from Kazakhstan are being considered.

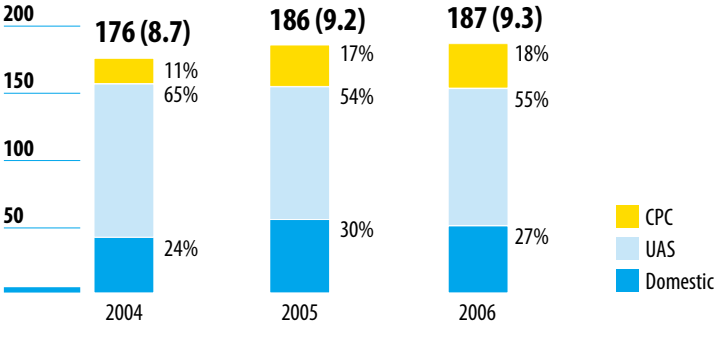
In July 2006 an alternative route has been developed: the first direct pipeline with capacity of 50 million tonnes (1,000 kbopd) link between the Caspian and the Mediterranean Sea. The Baku-Tbilisi-Ceyhan pipeline runs through Baku in Azerbaijan to the Turkish port of Ceyhan and began operating in July 2006. This pipeline is a potential alternative route for Kazakhstan's oil.

The above examples indicate that despite Kazakhstan's dependence on its neighbours to export its oil overseas, the country enjoys considerable growing and diversified access to the export market. Through our good relations with our parent company, the Company has guaranteed access to the oil transport infrastructure owned by NC KMG.

KMG EP exported 73% of its output in 2006. During that period access to use of the CPC pipeline rose from 17% to 19% of our sales volume. The usage of the UAS route was 54% of the total volume of export.

Sales volume by routes

Thousands of barrels per day (millions of tonnes)



Uzen Field Rehabilitation Project

Uzen is the largest field in the KMG EP portfolio and the third largest oil field in Kazakhstan in terms of current annual crude oil production. It contributes about 70% of the Company's total oil production.

Uzen is a mature field that has been in production since 1965. Geologically the field is a multi-layered and complex structure with reservoir depths ranging from 852m to 1,800m and the horizontal pits measuring some 39km by 9km. Many operational wells are needed at any given time to achieve desired production levels.

Following the break up of the Soviet Union oil production at the Uzen field fell significantly as the numbers of active wells diminished. Surface facilities suffered a noticeable decline due to chronic underinvestment.

The Uzen Rehabilitation Project started in 1997. One out of 16 blocks of the Uzen field was selected for a targeted effort of oil recovery enhancement, namely Block 3A. The successful completion of the Project, using concepts and methodologies suggested by the World Bank, meant that the approach and experience gained could be transferred to the remaining blocks of the field.

The Project aimed to achieve improvements in secondary and enhanced recovery along with improving well stimulation techniques and to set an example for rehabilitation of other blocks of the field. As a result of a determined and targeted effort by KMG EP, improved reservoir management, optimisation of water injection, implementation of new technologies and approaches, the field production levels have been significantly increased.

The project was financed by the International Bank for Reconstruction and Development (IBRD) to the amount of US$105 million with a further US$41 million provided by KMG EP.

Big

Bigger

Growth Strategy

KMG EP is the third-largest oil producer in Kazakhstan based on 2006 production results, currently producing an average 9.5 million tonnes (192 kbopd). The Company had proved and probable oil reserves of approximately 203 million tonnes (1.5 billion barrels) as at 31 December 2006 (in accordance with an independent energy consultancy Gaffney, Cline & Associates or GCA).

KMG EP's goal is to maintain its position as a leading oil and gas company in Kazakhstan. To do so it plans to increase its overall production and replace its reserves through acquisitions in the short-to-medium term and exploration in the long term.

Askar Aubakirov
Deputy General Director on Corporate Development

"Our ambition is to grow bigger through our stated acquisition strategy and our on-going exploration activities. We are particularly well positioned to achieve our goals due to our extensive local knowledge and close partnership with NC KMG."

Acquisition potential

The close relationship with the parent company has already resulted in a number of positive developments on the acquisition front.

The first significant acquisition following the IPO was the agreement to acquire 50% of JV Kazgermunai LLP ("Kazgermunai") from NC KMG. Participation in Kazgermunai has been acquired for 118.3 billion Tenge (US$969 million) and led to the Company becoming the second largest oil producing company in Kazakhstan. (See in more detail in this chapter's Case Study).

The Company is now considering the acquisition of a second asset – a 50% stake in Nations Energy, the company that was acquired by a Chinese Company CITIC at the end of 2006. At the same time NC KMG obtained the option to this stake. Nations Energy holds exploitation rights to develop the Karazhanbas oil and gas field in the western part of Kazakhstan, which according to the company, has proved reserves in excess of 51.1 million tonnes (340 million barrels). In 2006 approximately 2.3 million tonnes (42 kbopd) of crude oil were produced at Karazhanbas field.

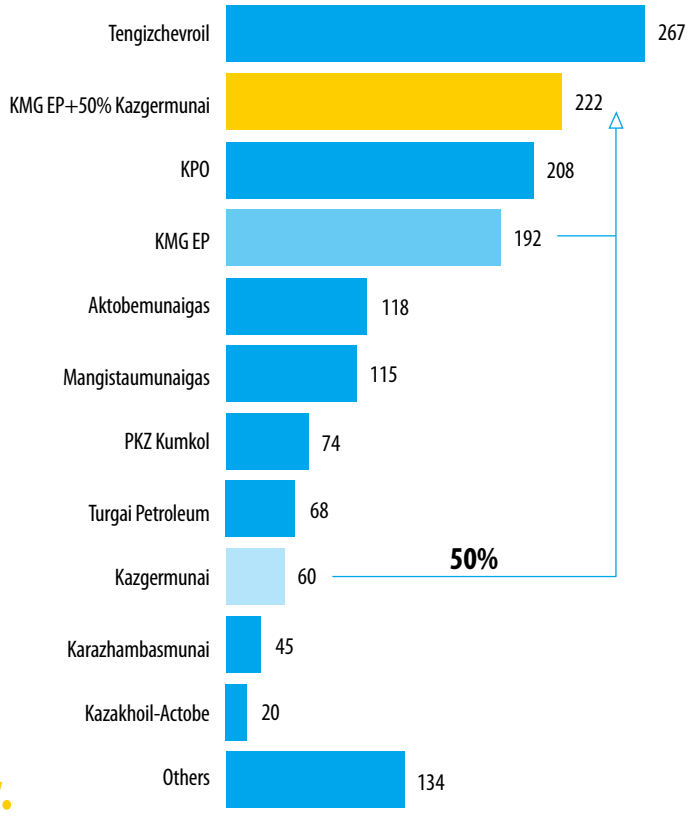
A third acquisition was flagged at the time of the IPO, a 33% stake in PetroKazakhstan. PetroKazakhstan was formed in 1986 and operates in the 80 thousand square metres of South Turgai Basin in South Central Kazakhstan. PetroKazakhstan has interests in 11 fields. In 2006 NC KMG acquired a 33% stake in PetroKazakhstan for US$1.4 billion from Chinese National Oil Corporation (CNPC). The Company expects that this share will be offered to KMG EP.

Other possible acquisitions will be evaluated on their merit as they arise, both from the parent company and from other sources.

The Company is already working on a number of acquisition opportunities implementing its growth strategy.

Kazakh oil operating entities

Thousands of barrels per day, 2006

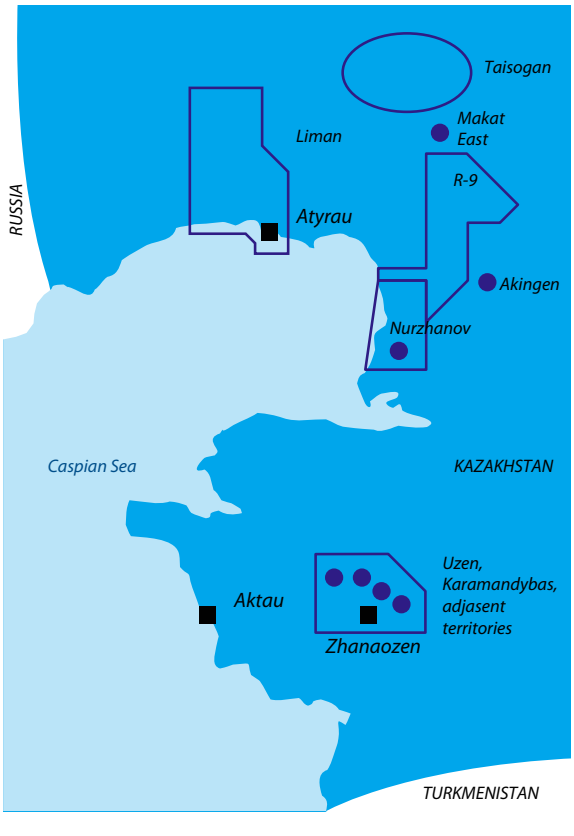


Continued exploration activities

KMG EP has preferential access to resources due to its relationship with the Kazakh Government and the parent company. Together with the pre-emption rights to acquire existing oil & gas assets offered for sale, the Company has access to new exploration acreage obtained by NC KMG via direct negotiations with the Government. Such advantage allows the Company to replenish its exploration portfolio and to compete effectively with the largest transnational oil corporations.

The Company maintains that the potential for exploration in Kazakhstan is considerable, both offshore and onshore. KMG EP is currently carrying out exploration on the blocks Liman, Taisogan, R-9 and also in the areas neighbouring the Uzen and Karamandybas fields. Onshore the country has been well explored down to a depth of 3 – 3.5 kilometres. KMG EP believes, however, that there are large potential resources lying beneath that depth, particularly in the subsalt horizons. The thorough research of subsalt structures using modern seismic methods is a major priority for the exploration programme of KMG EP in 2007.

Key exploration blocks



Kazgermunai acquisition

In April 2007, the Company finalised the acquisition of a 50% stake in JV Kazgermunai LLP from NC KMG for 118.3 billion tenge (US$969 million).

This transaction is significant as the first major step in the acquisition strategy that was stated publicly at the time of the IPO in September 2006.

Kazgermunai is the eighth-largest Kazakh oil and gas producing company, operating the Akshabulak, Nuraly and Aksai fields in the Kyzilorda region of the country. In 2006, its production of crude was approximately 3.0 million tonnes per year (60 kbopd); and at the end of September 2006 it had 40.7 million tonnes (310 million barrels) of proved and provable reserves. Prior to the acquisition agreement, Kazgermunai was jointly owned by NC KMG and PetroKazakhstan Kumkol Resources.

Production began at Kazgermunai as recently as 1996, so its fields are young and therefore provide considerable potential. Its existing infrastructure facilitates good access to important export markets, including traditional Western consumer markets and China. It has a strong balance sheet, with a notably strong cash balance as at the end of 2006.

This acquisition is also significant in the sense that it highlights the Company's commitment to best practice in international corporate governance. The acquisition was unanimously approved by KMG EP's Independent Non-Executive Directors appointed at the time of the IPO and by the minority shareholders at an EGM held on 12 April 2007 in Astana. NC KMG, as an interested party in this transaction, was excluded from the voting.


TIC

Efficient

Technology

The Company regards investment in and implementation of modern technology as a key element of the overall increase of efficiency and, ultimately, of the shareholder value in the Company. In the area of production, improved technology, new modelling systems, use of modern equipment and materials, and automation will lead to the optimisation of the field development systems, extending the overhaul period of wells and increasing the lifetime of pipelines. The Company is also in the process of modernising oil collection and preparation stations.

Many technological processes as well as marketing and procurement practices either have been, or are being, improved.

These improvements have gone forward hand in hand with new ecologically-friendly ways of conducting business (a point developed below in the "Responsible" section of this Annual Report). So the Company has been able to improve production and revenue levels without damaging the environment or jeopardising the safety of its workers.

Sisengali Utegaliyev
Deputy General Director on Production

"The Company's investment in and implementation of modern technology and the adoption of best practice in all its activities are in progress and will subsequently lead to efficiency gains across the board."

Cost reduction programme

The Company has implemented a cost reduction programme with targeted savings of US$100 million in annual on-going operating costs by 2010. The programme is mainly centred on production operations such as improving field-development planning and enhancing the management of reservoirs. Other initiatives include more widespread use of electrical submersible pumps to boost the time between workovers, replacing steel pipes with fibreglass pipes and monitoring wells more effectively.

Modernising collection and preparation stations through the building of new preparation facilities at Uzen will play its part; as will the optimisation of logistics and business processes such as the automation of measurement systems.

In addition to reducing operating costs, the Company also aims to cut a total of US$50 million from annual capital expenditure on the existing assets over the next five years.

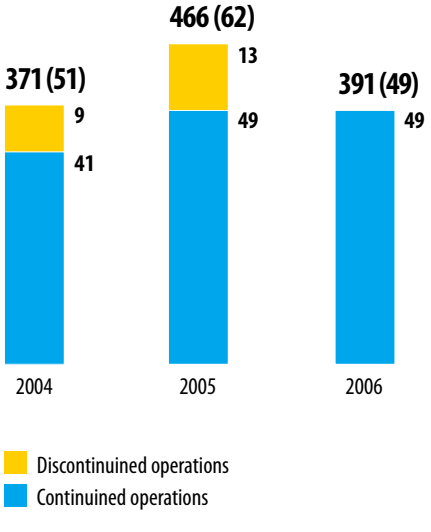
Divesting non-core businesses

Efficiency gains can also be made by moving away from those businesses ancillary to our core operations. As part of the Company's Asset Optimisation Programme, the Company has begun to divest its ownership interests in most of its subsidiaries whose operations are not considered to be a key part of the upstream operations and development strategy.

At the beginning of 2006 there were approximately 20 assets identified as non-core or non-essential and of these three have already been offered for sale. The main work associated with the divestment programme of the non-core assets is expected to be completed by the end of 2007.

Capital expendutures

Millions of US$ (Billions of KZT)



Empowering Management

Adopting International Management and Environmental Standards (ISO) and System Applications and Processing (SAP).

Soon after its formation in 2004 the Company set a target of modernising existing information systems and financial controls.

As part of this process the Company made a decision to adopt ISO and national Kazakh Standards and to implement SAP system in March 2005. This process has gathered pace in 2006.

The Company has encouraged its operating subsidiaries to set up the necessary working committees to enable the adoption of key ISO Standards including ISO 9001:2000, ISO 14001:2004 and OHSAS 18001:1999 and to enable the dissemination of critical information and best practices throughout the Company.

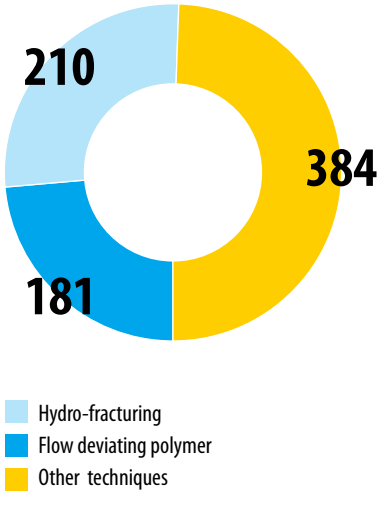
In 2006 a total of 637 employees in central management from both UMG and EMG were trained and a further eighteen seminars were held to educate employees as to the necessary requirements for compliance to ISO Standards. Working groups were set up to ensure disseminate information throughout the Company.

SAP system is an integrated information system and it is one of the core components of efficient record keeping reporting and monitoring functions of the business. The Company plans to finalise the implementation of this system in 2007.

The creation of a multifunctional automated system of company management that works in real time will allow efficient management of company's financial and material flows. The concept allows for the system to be used in Finance, Monitoring, Controlling, Sales, Planning and Contracting areas of business. The implementation has been planned in three stages – UMG branch, EMG branch, and the head company.

New technologies – applied enhanced recovery techniques

# of well operations



The Company is implementing a programme aimed at reducing production costs at the existing fields by US$100 million by 2010.


Kes

Responsible

Social Projects and Human Resources

The Company believes strongly that it has a responsibility to contribute to the local communities in which it operates. These social responsibilities include the construction of medical, cultural, rehabilitation and recuperation facilities, community centres, housing and infrastructure. The Company also invests heavily in training of the local workforce, upgrading qualifications of its employees and providing educational grants.

In 2006 these activities were very diverse .The Company provided funds for the computerisation of a school; social support to pensioners and disabled people in Mangistau and Atyrau regions; electrification of the Rahat-2 district in the town of Zhanaozen, purchasing of sports equipment for a local Zhanaozen school. In total approximately 3 billion Tenge were spent on social causes in 2006 alone.

The Company also provides significant input in the training of local workforces and improving the qualifications of its own staff workers. Continuous training and retraining of personnel works in accordance with the following scheme: training of specialists – retraining and improving of qualifications – rotation of personnel. In this manner the Company believes it making best use of its training resources to create a continuously improving working environment for the majority of personnel.

During 2006, 3,275 KMG EP staff received training on different courses amounting to approximately 20% of the Company's personnel. The cost of training was about 107,882 Tenge per person, and 148 people were sent on a secondment to world leading companies. Additionally in 2006 the Company sponsored approximately one thousand Kazakh students for studying at educational institutions in Kazakhstan and overseas.

Kairolla Erezhepov
Managing Director
on Personnel and Information policy

"KMG EP believes strongly that it has an obligation to protect the environment, to operate in a socially responsible manner and to contribute to the local communities where it has operations. These principles are fundamental to the future success of our Company."

Health and Safety

Health and safety within the Company is now receiving more attention than ever before. KMG EP considers the issues as a priority and the responsibility for them is given the highest consideration at Board level.

In accordance with international health and safety regulations the Company introduced uniform for the field personnel, systematically improved the working environment, provided training and implemented new technologies and equipment with the goal of improving health and safety conditions.

In 2006 alone the number of accidents at work dropped by 50% in comparison with 2005 and since 2001 this figure has been reduced tenfold. KMG EP strongly maintains that establishing and adhering to rigorous health and safety standards is an important factor of its success.

Environmental Protection

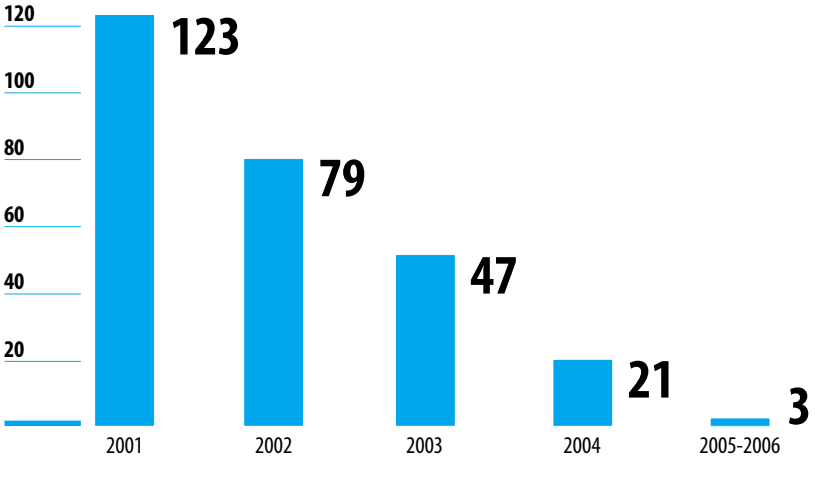
KMG EP takes environmental responsibilities very seriously and fully understands the importance of the issues related to protection of the environment and the consequences of not addressing these issues.

In 2005 KMG EP commissioned AMEC Earth and Environmental UK Ltd (AMEC), the UK-based project management and services company, to conduct an independent due diligence assessment of various assets of the Company, including UMG, EMG and the Uzen gas treatment facility.

AMEC delivered its findings in a report on 26 June 2006 which complied with ISO 14015 and International Accounting Standards (IAS 37). The report included accurate emission forecasts and the assessment of the environmental and financial impact of historical contaminations.

In its conclusion, the AMEC report stated that by 2025 the Company needed to meet costs of US$240 million, which will include the expenditure on treating historical pollution, waste disposal in certain areas as well as on-going compliance with ecological standards. On the basis of the Report by AMEC the Company has accrued an appropriate provision for environmental purposes.

Reduction in oil pit numbers



Cleaning up and restoring the natural environment in the Uzen field area

KMG EP acknowledges that environmental risks are inherent in the oil and gas industries. The Company's predecessors generated substantial environmental liabilities and KMG EP has made significant efforts to cleanse and redeem the ecological balance in the areas in which it operates.

Following a large scale technical break down in 1974 a decision was made to fill a natural dip in the landscape with surplus oil while urgent repairs were attempted. As a result, a large area of land was polluted with oil and used as a collection of 'natural' technical reservoirs.

Opened technical reservoirs, also known as oil pits, were created in the past both as a result of technical accidents and in the process of developing the oilfields following the technology applied then. Over time 170 of the reservoirs have been liquidated with only three large ones remaining including the Central Technical Reservoir at the Uzen field.

A research study was undertaken by KMG EP to estimate the scale of damage done to the environment and to devise a strategy and programme for correcting past mistakes. A US Company "Ecology and Environment" was contracted to purchase the necessary field and laboratory equipment, computers and software and provide training for the staff. The work continues with 4 local companies now sub-contracted to execute the Long-term Programme of Liquidation of the Central Technical Reservoir for 2004-2010.

The cleansing of contaminated soil takes place in stages. Firstly, the soil is excavated and transported to waste collectors with a waste drainage system. Secondly, the contaminated soil is treated, mainly by thermal cracking to produce an inert material.

In 2006 the Company continued pumping of stored oil waste out of the Central Technical Reservoir through engaging specialist contractors who have special technology and equipment. During the year over 57,774 tonnes of stored oil waste was removed. As a result the polluted area was reduced by 10.5 ha.

Additionally the Company performed pilot application of the biological method of land recovery. In 2006 36,000 sq. meters were recovered by the biological method.

Bringing its operations in line with Kazakh and international standards of environmental protection remains one of The Company's key strategic priorities. In its financial reports the Company stated that it has set aside the funds necessary for the execution of its environmental programs and related work.

In 2006 alone the Company spent over three billion Tenge on social programmes.

rah

Transparent

Corporate Governance at KMG EP

World class corporate governance is of vital importance to the success of companies in a free and increasingly competitive market. Companies need an efficient structure, defining the relationships between the Board of Directors, management and shareholders and offering assurance to investors that their funds are being used to strengthen the company, create value and increase market capitalisation. Compliance to these principles has taken on particular relevance since the Company's IPO in 2006.

Zhanneta Bekezhanova
Chief Financial Officer

The system of Corporate Governance at KMG EP is determined by a number of documents issued and decisions made in 2006.

The Company adopted the Kazakhstan Corporate Management Code, modified to include certain provisions from the Combined Code (which governs UK listed companies), as its Corporate Governance Code.

The Kazakhstan Corporate Management Code is based on existing international best practices in corporate governance and sets out recommendations for applying the principles of corporate governance by Kazakhstan joint-stock companies. It was approved by the Expert Council for Securities Market Matters under the National Bank of the Republic of Kazakhstan in September 2002.

The relationship with the controlling shareholder is one of the key corporate governance issues. KMG EP signed a Relationship Agreement with its parent company NC KMG to ensure that the two companies conduct business in a transparent manner and on an arms-length basis. Under the Relationship Agreement the Company can operate its business independently and in the interests of all its shareholders

The Company has incorporated certain provisions in its Charter. According to these provisions the Board of Directors now includes three Independent Non-Executive members who assist the Company in implementing good corporate governance arrangements. They are Christopher Mackenzie, Paul Manduca and Edward Walshe (see their biographies on pages 28-29 for more detail).

"Good corporate governance is of vital importance to the success of companies in a free and competitive market. We have successfully transformed our corporate management structure and systems and will undoubtedly see these efforts contribute to the maintenance of future financial stability and prosperity."

Many of KMG EP's activities, transactions, acquisitions, changes in Dividend policy, including those between the Company and NC KMG, can only take place if approved by a majority of the Independent Non-Executive Directors at the relevant meeting of the full Board of Directors.

The three Independent Non-Executive Directors work closely with other Directors and the Management Board to ensure that the Company complies with its corporate governance obligations. The Directors have adopted terms of reference for and have formed an Audit Committee, a Nominations Committee and a Remuneration Committee.

The Audit Committee focuses in particular on compliance with international and internal legal and accounting standards and controls. The Nominations Committee considers the composition of the Board of Directors, retirements and appointments as well as making appropriate recommendations on these issues. The Remuneration Committee has responsibility for making recommendations to the Board of Directors on the Company's policy on the remuneration of key senior members of the Board and for maintaining reports for corporate governance purposes.

By rigorously following the financial and legal information disclosure requirements of the KASE and the LSE, the Company is becoming more open and transparent and is working more and more closely with financial analysts and the investment community at large.

Management Compensation Plan

The manner in which staff are remunerated, from the main Board of Directors down to the operational level is of high importance for KMG EP in the future. Incentivising our people and ensuring that they are competitively remunerated will increase loyalty to the Company. In recognition of this a new compensation system, consisting of three parts, has been introduced. The first is Fixed pay (salary). These are granted according to job duties, seniority, responsibilities and other factors.

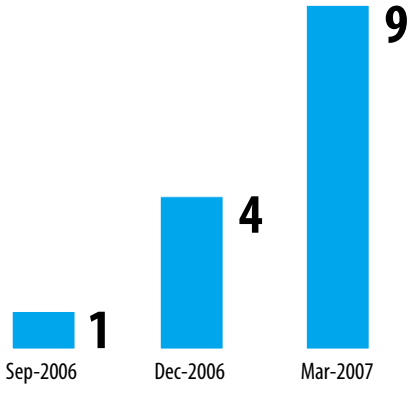
The second part is Variable pay (performance related bonus) – this system has been developed to motivate management on an annual basis for achieving short term targets, and is set for individuals and business units by the Company. The average bonus amount may reach up to 50% of annual salary if the set targets are met.

The third part is Share Option Plan – to motivate top management and to retain key valuable employees on a long-term basis.

The Remuneration Committee is currently reviewing every aspect of the compensation plan to ensure that management's interests are closely aligned with shareholders'.

Analyst Coverage

# of investment banks



Improvement in quality of Financial Reporting

International Financial Reporting Standards (IFRS)

All consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards. The KMG EP's original date of transition to IFRS was January, 2003.

The Company has established an audit committee which meets not less than four times a year. This Committee comprises the Independent Non-Executive Directors and has responsibility, amongst other things, for reviewing and challenging the annual and interim reports. The Committee also focuses on compliance with legal requirements, accounting standards, rules of the UK Listing Authority and the KASE and ensures that the effective system of financial controls is permanently maintained.

The success of these measures has been clearly demonstrated in the 2006 Auditor's report signed on 12 March 2007 (2005 report signed on June 2, 2006). No material audit adjustments were provided by the auditors and they reported to the Audit Committee that there was significant improvement in the quality of the reporting and competency of the finance and accounting department.

The Company has also invested further in building and training the finance and accounting department' team:

- 17 employees are studying in professional accounting programs such as the Association of Chartered Certified Accountants (ACCA) and the Certified Public Accountants (CPA). The Company is expecting to have its first internal graduates from the ACCA and CPA programs in 2007.
- In April 2007, Arkadiusz Kowalevski as the Head of Internal Audit was hired. Arkadius is fluent in Russian and headed the Enterprise Risk Services division for one of the Big 4 global accountancy firms over the past two years. His immediate focus will be on reviewing, testing and improving internal controls and financial reporting processes.
- In January 2007 the Financial Controller position was filled by Shane Drader, a former Big 4 Audit Partner who has over nine years audit and accounting experience in the CIS including three years in Kazakhstan.
- Continuing to add experienced local staff who are multi- lingual and have professional qualifications. The majority of hired staff is IFRS competent.

Furthermore, KMG EP's management is devoting resources to the development of internal controls in order to minimise the risks to critical business decisions regarding budgeting, planning and other matters that may be based on incomplete or inaccurate information. These new procedures and processes include the implementation of a monthly IFRS reporting pack which is reviewed by the Board and the Management of the Company.

The Company has introduced a new Charter, Corporate Governance Code and has invited three Independent Non-Executive Directors to its Board.

Board of Directors

Uzakbai Karabalin
(Chairman of the Board of Directors and Non-Executive Director) has been the President of NC KMG since March 2003 and a member of KMG EP's Board of Directors since 24 November 2006. On 28 November 2006 he was elected as Chairman. Mr. Karabalin is a graduate of the Moscow Institute of Petrochemical and Gas Industry and a candidate of technical sciences (PhD). He has occupied senior executive positions with the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan. He is the Chairman of the Nominations Committee.

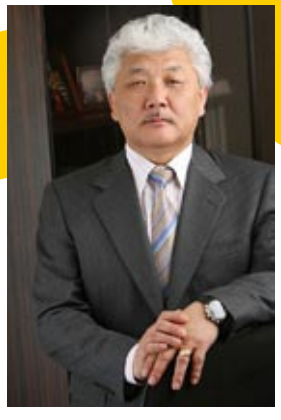
Askar Balzhanov
(Chief Executive Officer) was appointed CEO of the Company on 7 June 2006. Prior to this, he was General Director of JSC KazMunaiTeniz, a subsidiary of NC KMG specialising in off-shore oil and gas operations. After graduating from the Moscow Institute of Petrochemical and Gas Industry, he has gained broad experience in the oil and gas field working in various positions in a range of hydrocarbon enterprises including Embaneft PA, KazakhstanNefteGas SE, KazakhstanMunayGas SE, KazRosGas CJSC, and NC KMG.

Christopher Mackenzie
(Independent Non-Executive Director) has over 20 years of international experience in mergers and acquisitions and investment banking, having worked for companies such as JP Morgan, GE Capital and Brunswick Capital in UK, US, Japan and Russia. He holds a Master's degree from University of Oxford (Jurisprudence and Modern Languages) and an MBA from INSEAD. He was elected as a director of the Company on 28 August 2006. Christopher is the Chairman of the Remuneration Committee and a member of the Audit and of the Nominations Committees.

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

The Company operates with two boards, the Board of Directors and a separate Management Board (the executive body). The Chief Executive Officer, who heads the Management Board, is also a director of the Company. He is the only representative of the Management Board who is also a member of the Board of Directors. The Board of Directors therefore only contains one executive member of the Company's management.

In order to improve the balance of the Board of Directors, the Company appointed three Independent Non-Executive Directors, being Christopher Mackenzie, Paul Manduca and Edward Walshe, at the time of the IPO. The other four members of the Board of Directors, including its Chairman, Uzakbai Karabalin, are representatives of NC KMG.



Yevgeny Ogay
(Non-Executive Director) has been Managing Director of NC KMG since 11 November 2004 and was elected as a director of the KMG EP on 12 June 2006. Since 2003 he has worked as director of the department for share management in joint ventures in NC KMG. He has worked as an oil projects manager in Needham Group Inc. since 1992. He graduated from Moscow Oil and Gas Institute in 1969. Dr. Ogay is the author of 2 books, 7 patents and more than 50 publications.

Assia Syrgabekova
(Non-Executive Director) was appointed Managing Director of economics and finances at NC KMG in July 2006 and was elected as a director of KMG EP on 4 July 2006. Prior to this appointment she was First Deputy Chairman at Halyk Bank from October 2003 as well as the Chairwoman of the Management Board of Halyk Bank of the Republic of Kazakhstan from 2004 to 2005. From 1998 to 2003 Ms. Syrgabekova worked in the national oil and gas company holding various top management positions in KazakhOil, KazTransGas. She graduated from Kazakh state University's Department of Economics in 1982.

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

Yerzhan Zhangaulov
(Non-Executive Director) was appointed Managing Director of NC KMG on 6 June, 2006 and was elected as a director of KMG EP on 12 June 2006. Prior to this appointment he was Executive Director on Legal Support of NC KMG. He also headed the legal service and HR department in the Administration of the President of Kazakhstan and was the adviser to the Vice-President in NC KMG. He obtained a law degree in Karaganda State Institute in 1992.

Corporate governance information

As an overseas company with GDRs admitted to the Official List, the Company is not required to comply with the provisions of the UK Combined Code on Corporate Governance ("Combined Code"). In addition, it is not required to disclose in its annual report whether or not it complies with the corporate governance regime of the Republic of Kazakhstan and the significant ways in which its actual governance practices differ from those set out in the Combined Code. However, the Directors consider corporate governance to be very important and support high standards of corporate governance.

Directors' Responsibility Statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable Kazakhstan law and those International Financial Reporting Standards (IFRS) adopted by the European Union.

The Directors are required to prepare financial statements for each financial year which present a true and fair view of the financial position of the Company and the financial performance and cash flows of the Company for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to un derstand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- state that the Company has complied with IFRS, subject to an material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping accounting records which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the requirements of Kazakhstan law, the UKLA's Disclosure and Transparency Rules and the Company's Corporate Governance Code. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors, whose names appear on pages 28-29 of this Annual Report, confirms that to the best of his or her knowledge:

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

Corporate Governance

Corporate governance best practice in Kazakhstan is set out in the Kazakhstan Corporate Management Code. The Kazakhstan Corporate Management Code is based on existing international best practice in the area of corporate governance and sets out recommendations for applying the prin-

ciples of corporate governance by Kazakhstan joint-stock companies. It was approved by the Expert Council for Securities Market Matters under the National Bank of the Republic of Kazakhstan in September 2002. The Company currently complies with the provisions of the Kazakhstan Corporate Management Code in all material respects.

The Company has adopted the Kazakhstan Corporate Management Code, modified to include certain provisions from the Combined Code, as its Corporate Governance Code. The modifications adopted by the Company impose additional corporate governance obligations on the Company and include certain requirements that are set out in the Combined Code. The Company believes that these additional modifications significantly strengthen the corporate governance regime adopted by the Company. The Company will also take into consideration the terms of the Combined Code and will seek to improve its standards of corporate governance in the future.

The Combined Code provides that the board of directors of a UK listed company should include a balance of executive and non-executive directors, with non-executive directors comprising at least one-half of the board of directors (excluding the Chairman). The Combined Code states that the board of directors should determine whether a director is independent in character and judgment and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment.

The Company currently operates with two boards, the Board of Directors (the supervisory body) and a separate Management Board (the executive body). The General Director, who heads the Management Board, is also a director of the Company. The Board of Directors therefore only contains one executive member of the Company's management. The Company currently has three Independent Non-Executive Directors, being Christopher Mackenzie, Paul Manduca and Edward Walshe. The Independent Non-Executive Directors work closely with the other directors and the Management Board to ensure that the Company complies with its corporate governance obligations. Under the terms of the Company's Corporate Governance Code, the Company uses the same standards set out in the Combined Code to determine the independence of its directors. The Company's Management Board comprises senior executives of the Company, including its General Director (CEO) and Chief Financial Officer (CFO).

The Directors have adopted terms of reference for and have formed an audit committee (28 November 2006), a nominations committee (1 September 2006) and a remuneration committee (1 September 2006). All the members of the Audit Committee and Remuneration Committee and a majority of the members of the Nominations Committee are Independent Non-Executive Directors.

The Board of Directors Structure

As at 31 December 2006, the Board comprised eight members, being the Chairman (Non-Executive Director), Uzakbai Karabalin, the General Director and CEO, Askar Balzhanov and six Non-Executive directors. Since 1 January 2006, the Board has implemented a number of changes to the way the Company is directed and controlled. The following changes in the composition of the Board of Director of KazMunaiGas EP JSC during 2006 were made based on decisions of general meetings of shareholders upon proposals from representatives of shareholders:

- on 27 February 2006 N.K. Rakhmetov was removed as a director and D.R. Abulgazin was elected;
- on 12 June 2006 M.D. Batyrbaev, G.K. Keshubaev, K.B. Safinov were removed as directors and E.A.Zhangaulov, Y.K. Ogay, A.K. Balzhanov were elected;
- on 4 July 2006 of D.R. Abulgazin was removed as a director and A. Syrgabekova was elected;
- on 28 August 2006 Paul Manduca, Christopher Mackenzie, Edward Thomas Walsh were elected as independent members of the Board of Directors; and
- on 24 November 2006 Zh. Marabayev was removed as a director and U.S. Karabalin was elected.

Members of the Board of Directors as of 31 December 2006:

Name	Position with the Company
Uzakbai Karabalin	Chairman and Non-Executive Director
Askar Balzhanov	General Director, CEO
Assia Syrgabekova	Non-Executive Director
Erzhan Zhangaulov	Non-Executive Director
Yevgeny Ogay	Non-Executive Director
Christopher Mackenzie	Independent Non-Executive Director
Edward Walshe	Independent Non-Executive Director
Paul Manduca	Independent Non-Executive Director

In accordance with the provisions of the Corporate Governance Code, consideration has been given to the independence of all the non-executive directors. The Board considers Mr Mackenzie, Mr Walsh and Mr Manduca to be independent of management and free from any business or other relationship that could materially interfere with the exercise of independent judgment.

The Management Board Structure

During 2006 subject to resolutions of the Board of Directors of KazMunaiGas EP JSC the composition of the Management Board of the Company has been amended as follows:

- on 7 June 2006 the powers of Zh. Marabayev were terminated, A.K. Balzhanov was elected; and
- on 25 August 2006 the powers of T.V. Palamar were terminated, A. Aubakirov was elected.

Members of the Management Board as of 31 December 2006 were:

Name	Position with the Company
Askar Balzhanov	General Director, CEO
Vladimir Miroshnikov	First Deputy of General Director
Zhanneta Bekezhanova	Deputy General Director, CFO
Askar Aubakirov	Deputy General Director, Corporate Development
Kairolla Erezhepov	Managing Director on Human Resources and Information Policy
Murat Kurbanbayev	Head of UMG
Maxim Izbasov	Director of EMG

During January 2007 subject to resolutions of the Board of Directors of KazMunaiGas EP JSC the composition of the Management Board of the Company has been amended as follows:

- on 08 January 2007 the powers of M.S. Izbasov were terminated, B.L. Biseken was elected.

The Board of Directors and the Management Board Responsibilities

The Board of Directors is responsible to shareholders for the effective and proper management and control of the Company and has a formal schedule of matters reserved for its decisions. Its primary roles are to determine and review the Company's strategy and policy, consider acquisitions and give consideration to all other significant financial matters. This process is undertaken following discussions in conjunction with Management Board which in turn is responsible for the day to day conduct of the Company's operations and for reporting to the Board of Directors on the progress being made in meeting the objectives of the Company. The Board of Directors holds meetings on a regular basis and additionally for specific purposes as and when required.

During 2006 there were 34 meetings of the Board of Directors including 8 meetings by voting in presence, 2 meetings in the form of voting in presence by conference-call and 24 meetings by written resolution. During 2006, as part of its formal business the Directors adopted terms of reference for and formed an audit committee, a nominations committee and a remuneration committee. In addition the Board conducted a review of the Group's system of internal controls and approved the Guidance for internal audit of the Company and Internal Audit Service work schedule for 2006.

Implementing the Company's strategies of acquisition and rationalisation of operations the Board also discussed and approved the Assets Restructuring Program of the Company for 2006-2008 and the Company's new edition of Rules on disposal of assets.

The Management Board holds meetings on a regular basis and additionally for specific purposes as and when required. During 2006 there were 48 meetings of the Management Board, including 9 meetings by voting in presence and 39 held by written resolution. The following important issues were among those considered by the Management Board: cost of transporting and processing,, price of crude oil and oil products, annual plan of purchase of goods and services, approval of condensed consolidated interim financial statements of the Company and human resource and management related issues..

Audit Committee

This Committee is staffed exclusively by the Independent Non-Executive Directors being Mr Manduca, Mr Mackenzie and Mr Walshe, and it is chaired by Mr Manduca. It is for the Audit Committee Chairman to decide the frequency and timing of Audit Committee meetings. There are as many meetings as the Audit Committee's role and responsibilities require. However, there are no less than four meetings during the year, held to coincide with key dates within the Company's financial reporting and audit cycle (when the audit plans, internal and external, are available for review and when interim financial statements, preliminary announcements and the full annual report are near completion). Appointments to the Audit Committee are for a period of up to three years, extendable by no more than two additional three-year periods by resolution of the Board of Directors, so long as the members continue to be independent.

The Audit Committee has responsibility, for amongst other things, to review and challenge the Company's annual and interim reports. It also has the benefit of the services of the Company's Internal Audit Service, which reviews the Company's internal controls. The Committee focuses in particular on compliance with legal requirements, accounting standards, the applicable rules of the UKLA and the KASE and on ensuring that an effective system of internal financial control is maintained. The ultimate responsibility for reviewing and approving the annual and interim report and accounts remains with the Board of Directors.

The duties of the Audit Committee covered in the terms of reference are: financial reporting, internal controls and risk management systems, whistle blowing, internal audit, external audit, and reporting responsibilities. The terms of reference also set out the authority of the Committee to exercise its duties.

The Audit Committee, where practicable, periodically reviews certain major acquisition and disposal transactions and deals with any matters which the Board may refer to the Audit Committee.

The Chairman of the Audit Committee is presented at the shareholders general meeting to answer questions, through the Chairman of the Board, on the report on the Audit Committee's activities and matters within the scope of the Audit Committee's responsibilities.

In 2006 the Audit Committee was involved in the preparation of IFRS financial statements and the approval of quarter and annual reports applied to KASE and LSE. The Audit Committee was responsible for procedures related to the Company's Internal Audit Service and monitored the processes of addressing material weaknesses in the Company's internal controls identified by the external auditor Ernst & Young Kazakhstan LLP.

Remuneration Committee

TThe Remuneration Committee normally meets not less than twice a year. This Committee is staffed exclusively by the Independent Non-Executive Directors. It is chaired by Mr Mackenzie and its other members are Mr Manduca and Mr Walshe. The Remuneration Committee has responsibility for making recommendations to the Board of Directors on the Company's policy on the remuneration of certain senior executives (including the Management Board), the implementation and operation of share incentive schemes and for the determination, within agreed terms of reference, of specific remuneration packages for each of the members of the Management Board, including pension rights, contracts of employment and any compensation payments. In addition to making recommendations on remuneration and share packages, the remuneration committee maintains reports for corporate governance purposes.

The terms of reference of the Remuneration Committee cover such issues as membership and frequency of meetings, as mentioned above, the requirements of notice of and quorum for and the right to attend meetings. The duties of the Remuneration Committee covered in the terms of reference relate to the following: determining and monitoring policy on and setting arrangements, authorising claims for expenses from the General Director and Chairman and reporting and disclosure. The terms of reference also set out the reporting responsibilities and the authority of the Committee to exercise its duties.

From the date of its establishment the Remuneration Committee has developed the recommendations to the Board of Directors for two types of options schemes: ordinary option scheme for the employees' motivation and a special option for participation in the IPO process.

Nominations Committee

The Nominations Committee meets not less than twice a year. The majority of members of the Nominations Committee are Independent Non-Executive Directors, with the remaining member being the General Director. It is chaired by Mr Balzhanov and its other members are Mr Mackenzie and Mr Walshe. The Nominations Committee considers the composition of the Board of Directors, retirements and appointments of additional and replacement directors and makes appropriate recommendations to the Board of Directors.

Directors', senior executives' and others' interests

Directors' and members of the Management Board's interests

The interests of the Directors and the members of the Management Board in the ordinary shares and preference shares of the Company all of which are beneficial unless otherwise stated are as follows (as at 31 Desember 2006):

Name	Number of Ordinary Shares	Number of Preference Shares
Christopher Mackenzie	1,166	—
Paul Manduca	1,138	—
Edward Walshe	1,138	—
Assia Syrgabekova	796	—
Askar Aubakirov	565	34
Zhanneta Bekezhanova	474	—
Vladimir Miroshnikov	401	—
Murat Kurbanbayev	401	1,236
Maxim Izbasov*	—	510

* On 08 January 2007 the powers of Maxim Izbasov were terminated, Bagitkali Biseken was elected. Bagitkali Biseken owns an interest in the amount of 280 preference shares.

The Directors and members of the Management Board as Shareholders have the same voting rights as all other Shareholders.

Options over GDRs have been granted to Directors and members of the Management Board as follows (as at 31 Desember 2006):

Name	Name of Scheme	Number of GDRs over which options granted	Exercise price	Dates exercisable between
Askar Balzhanov	Company's Share Option Plan	36,916	US$14.64	One-third on each of 4 October 2007, 2008 and 2009
		10,662	Nil	29 December 2007
Vladimir Miroshnikov	Company's Share Option Plan	33,844	US$14.64	One-third on each of 4 October 2007, 2008 and 2009
		9,935	Nil	29 December 2007
Zhanneta Bekezhanova	Company's Share Option Plan	29,262	US$14.64	One-third on each of 4 October 2007, 2008 and 2009
		8,590	Nil	29 December 2007
Kairolla Erezhepov	Company's Share Option Plan	22,025	US$14.64	One-third on each of 4 October 2007, 2008 and 2009
		6,465	Nil	29 December 2007
Murat Kurbanbayev	Company's Share Option Plan	27,044	US$14.64	One-third on each of 4 October 2007, 2008 and 2009
		7,938	Nil	29 December 2007
Askar Aubakirov	Company's Share Option Plan	27,044	US$14.64	One-third on each of 4 October 2007, 2008 and 2009
		7,938	Nil	29 December 2007

Principal Shareholders and/or GDR Holders

In so far as is known to the Company, the name of each person who, directly or indirectly, has an interest in the ordinary shares or GDRs which is notifiable under Kazakhstan law, and the amount of such person's interest as of 31 December 2006 are as follows:

Shareholder	Number of Ordinary Shares	Number of Preferred Shares	Total Share Capital
Total number of shares issued[1]	70,220,935	4,136,107	74,357,042
Held by JSC NC KazMunaiGas[2]	42,213,429	-	42,213,429
Percentage of issued share capital	60.12%	0.00%	56.77%

(1) Including 341,530 of treasury stock.
(2) As of the date of publishing the Annual Report: 43,087,006 common shares or 61.36% held by JSC NC KazMunaiGas.

Service agreements and letters of appointment

Directors' Service Contracts

Uzakbai Karabalin is engaged by the Company as a non-executive Director and Chairman. He was appointed Director at an extraordinary general meeting of the Shareholders on 24 November 2006. On 28 November 2006, the Board of Directors of the Company elected Mr. Karabalin as Chairman. Mr. Karabalin will not receive any fee in respect of his role as a Director of the Company but will be entitled to reimbursement for costs and expenses associated with such appointment.

Askar Balzhanov is engaged by the Company as an executive Director and CEO of the Company. He was appointed CEO on 7 June 2006 and appointed a Director at a general meeting of the Shareholders held on 12 June 2006. Mr. Balzhanov will not receive any fee in respect of his role as a Director of the Company but will be entitled to reimbursement for costs and expenses associated with such appointment.

Yerzhan Zhangaulov is engaged by the Company as a non-executive Director. He was appointed Director at a general Shareholders meeting of the Shareholders held on 12 June 2006. Mr. Zhangaulov will not receive any fee in respect of his role as a Director of the Company but will be entitled to reimbursement for costs and expenses associated with such appointment.

Yevgeny Ogay is engaged by the Company as a non-executive Director. He was appointed Director at a general meeting of the Shareholders held on 12 June 2006. Dr. Ogay will not receive any fee in respect of his role as a Director of the Company but will be entitled to reimbursement for costs and expenses associated with such appointment.

Assia Syrgabekova is engaged by the Company as a non-executive Director. She was appointed Director at a general meeting of the Shareholders held on 4 July 2006. Ms Syrgabekova will not receive any fee in respect of her role as a Director of the Company but will be entitled to reimbursement for costs and expenses associated with such appointment.

Christopher Mackenzie is engaged by the Company as a Non-Executive Director on the terms of a letter of appointment and decision of a general meeting of the Shareholders dated 28 August 2006. Under the letter of appointment, Mr. Mackenzie is entitled to an annual fee of US$100,000, a fee of US$10,000 for each meeting of the Board of Directors that he physically attends (US$5,000 if attended by telephone or video conference), a fee of US$2,500 for each separate meeting of the Independent Non-Executive Directors that he attends and an annual fee of US$15,000 in respect of his duties as chairman of the Remuneration Committee of the Board of Directors. The letter of appointment may be terminated by either the Company or Mr. Mackenzie on three months' notice, although it is anticipated that the appointment will initially be for 24 months from the date of appointment.

Paul Manduca is engaged by the Company as a Non-Executive Director on the terms of a letter of appointment and decision of a general meeting of the Shareholders dated 28 August 2006. Under the letter of appointment, Mr. Manduca is entitled to an annual fee of US$100,000, a fee of US$10,000 for each meeting of the Board of Directors that he physically attends (US$5,000 if attended by telephone or video conference), a fee of US$2,500 for each separate meeting of the Independent Non-Executive Directors that he attends and an annual fee of US$25,000 in respect of his duties as chairman of the Audit Committee of the Board of Directors. The letter of appointment may be terminated by either the Company or Mr. Manduca on three months' notice, although it is anticipated that the appointment will initially be for 24 months from the date of appointment.

Edward Walshe is engaged by the Company as a non-executive Director on the terms of a letter of appointment and decision of a general meeting of the Shareholders dated 28 August 2006. Under the letter of appointment, Mr. Walshe is entitled to an annual fee of US$100,000, a fee of US$10,000 for each meeting of the Board of Directors that he physically attends (US$5,000 if attended by telephone or video conference) and a fee of US$2,500 for each separate meeting of the Independent Non-Executive Directors that he attends. The letter of appointment may be terminated by either the Company or Mr. Walshe on three months' notice, although it is anticipated that the appointment will initially be for 24 months from the date of appointment.

Other
All members of the Management Board have entered into service contracts with the Company which generally provide for business travel insurance, for reimbursement for expenses incurred while travelling on the Company business in accordance with the internal rules of the Company, and for a car and driver. Save as set out above, there are no existing or proposed service contracts between the Directors or members of the Management Board of the Company.

The aggregate remuneration paid to the members of the Board of Directors and Management Board for the year ended 31 December 2006 (including any contingent or deferred compensation) and benefits in kind granted to the members of the Board of Directors and Management Board by the Company was KZT605 million.

At 31 December 2006 there were no benefits set aside or accrued by the Company to provide pension, retirement or similar benefits to the Directors or members of the Management Board.

United Kingdom tax considerations

The comments below are of a general nature and are based on current United Kingdom law and HM Revenue & Customs practice at the date of this document, both of which are subject to change, possibly with retrospective effect. Except as otherwise stated, the summary only discusses certain UK tax consequences of holding the shares or the GDRs for the absolute beneficial owners of the shares or the GDRs (1) who are resident or ordinarily resident in the UK for tax purposes; (2) who are not resident for tax purposes in any other jurisdiction; and (3) who do not have a permanent establishment or fixed base in Kazakhstan with which the holding of the shares or the GDRs is connected ("UK holders"). In addition, the summary (1) only addresses the tax consequences for UK holders who hold the shares and the GDRs as capital assets, and does not address the tax consequences which may be relevant to certain other categories of UK holders, for example, dealers; (2) assumes that the UK holder does not either directly or indirectly control 10% or more of the voting power of the company; (3) assumes that a holder of the GDRs is beneficially entitled to the underlying shares and to the dividends on those shares; and (4) does not address the tax consequences of UK holders that are insurance companies, collective investment schemes or pensions connected with the Company.

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

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

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

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

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

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

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

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

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

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

Operating and financial review

The following document is intended to assist in the understanding and assessment of the trends and significant changes in the Company's results of operations and financial condition.

This document was published on 19.03.2007

Operational activity in 2006

JSC KazMunaiGas Exploration Production (hereinafter – the Company) conducts its production activities at 44 oil and gas fields including production branch JSC Uzenmunaigas (hereinafter – UMG) – 7 fields, production branch JSC EmbamunaiGas (hereinafter – EMG) – 37 fields.

The Company achieved its targeted production goals for 2006 with oil production of 9.53 million tonnes which was 102% of 2005 oil production. Of this total oil production 6.73 million tonnes were produced by UMG and 2.80 thousand tonnes by EMG.

Crude oil production, million tonnes

Production branch	2006	2005	%
Uzenmunaigas	6.73	6.55	103%
Embamunaigas	2.80	2.79	100%
Total	9.53	9.34	102%

As at 01 January, 2007 the Company had 5,865 production wells and 1,693 injection wells. During 2006 the share of idle wells decreased to 1.7%, compared to 2.0% a year before.

The majority of the Company's existing oil fields are at the mature stage of development, characterised by high watercut and decline of oil production. The Company performed production drilling, workover operations, enhanced recovery and sidetrack drilling in order to mitigate natural production decline and maintain planned volume of oil production in 2006.

In 2006 the Company constructed 221 wells which contributed 279,700 tonnes to production. Workovers were conducted on 1,361 wells and provided an incremental production of 558,000 tonnes. Sidetrack drilling operations were performed on 16 wells resulting in an incremental production of 17,100 tonnes. The Company applied enhanced recovery techniques, including hydro-fracturing and various chemical and thermal methods. As a result an additional 616,800 tonnes were recovered following 775 well operations.

In 2006 the Company conducted exploration activities on the following blocks/fields:

- Greenfield exploration – Taisoigan (Uas, Kondybai), R-9 (Koikara, Duiseke North, Akingen, Kulsary NW) and territories adjacent to the Uzen and Karamandybas fields.
- Supplementary exploration – S. Nurzhanov, Akingen (south wing), Prorva West, Uzen (Pasmurun East) and Karamandybas.

During the year 10 exploration wells were drilled. The following wells were productive: Kondybai 8, Uas15, 16, Nurzhanov 501, Akingen1-A and Uzen-6244.

The seismic field surveys were performed at 2,100 running km/ 70 square km. Infrasonic passive differential spectroscopy ("IPDS") works were conducted on the Nurzhanov and Kenbay fields. Seismic survey on the Liman and R-9 blocks provided encouraging data including the identification of positive raises of post-salt structures at the depth of 4,800 - 5,100 meters.

Planned operational activity in 2007

Crude oil production in 2007 is expected to reach 9.5 million tonnes, approximately the same level as in 2006. In order to offset the natural production decline the Company is planning to drill 175 production wells in 2007 as well as perform operations on the existing wells, including reservoir recovery improvements, well work-overs, bottomhole zone treatment and the rehabilitation of previously abandoned wells.

For 2007, the Company is planning increased exploration activities in prospective blocks focusing on identification of geological structures and drilling candidates. In particular, the Company is planning exploration works on the R-9, Taisoigan and Liman blocks and on territories adjacent to the Uzen and Karamandybas fields. In addition, supplementary exploration works on the S. Nurzhanov, Uzen-Karamandybas and Akingen fields are planned.

The Company's capital expenditures in 2007, calculated on a cash basis, are expected to be KZT39.8 billion.

Business Environment and Outlook

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

Crude oil sales are the Company's primary source of revenue. The Company's business, prospects, financial condition and results of operations are heavily dependent on prevailing crude oil prices. Historically, crude oil prices have been highly volatile. The Company's revenues and net income fluctuate significantly with changes in crude oil prices. Although oil prices worldwide have increased significantly since 2001, there can be no assurance that such growth, or the existing level of oil prices, will be maintained in the future. Any future declines (even relatively modest declines) in oil prices could adversely affect the Company's business, prospects, financial condition and results of operations.

Business Environment in 2006

The price for Brent averaged US$ 65.14 per barrel in 2006, an increase of almost US$12 per barrel from 2005 average price.

	Year ended 31 December	
Average for the year indicated	2006 (US$ /bbl)	2005 (US$ /bbl)
Brent	65.14	54.38
CPC blend	65.23	53.50
Urals	60.99	50.52

Source: Bloomberg, Platts

Most of the Company's revenues and borrowings are denominated in US dollars, while most of the Company's operating expenses are denominated in Tenge. The impact of foreign currency fluctuations on the Company's results of operations depends on the Company's net foreign currency position and the magnitude and direction of the fluctuation.

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

	Year ended 31 December	
Average for the year indicated	2006 (US$ /bbl)	2005 (US$ /bbl)
Tenge—US$ average exchange rate	126.09	132.88
CPI	8.4%	7.6%

Source: National Bank of Kazakhstan

In 2006 the Tenge has strengthened against the US dollar from 132.88 Tenge/US$ in 2005 to 126.09 Tenge/US$ in 2006. The CPI has reached the level of 8.4% in 2006, compared with 7.6% in 2005. The appreciation of the Tenge during 2006 has tended to dampen the positive effect of higher crude oil prices and depress the Company's revenue expressed in Tenge. In addition, most of the Company's expenses are affected by the increased local inflation rate which may not be offset by inflation related increases in the Company's revenues.

Outlook for Business Environment in 2007

After falling approximately by US$10 per barrel from the beginning of 2007, and almost touching the level of US$50 per barrel, the Brent price has since rebounded and spent February trading at about the level of US$60 per barrel. Prices for crude oil are expected to remain volatile in 2007 in response to a variety of factors.

During the first two months of 2007 the Tenge continued strengthening against the US dollar and averaged 125.27 Tenge/US$ for the period, an appreciation of more than 0.82 Tenge above 2006 average rate of 126.09 Tenge/US$. Based on the Government's forecast, the Tenge/US$ exchange rate is expected to continue its declining trend.

The CPI increased by 1.1% and 1.9% for January and February 2007, compared to 0.9% and 2.4% for the related months of 2006. The National Bank of Kazakhstan forecasts CPI for 2007 within the range from 7.3% to 8.3% or slightly lower than the actual 8.4% in 2006.

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

Results of Operations

Amounts shown in US dollars have been translated solely for the convenience of the reader at the average rate over the applicable year for information derived from the consolidated statements of income and consolidated statements of cash flows and the end of the year rate for information derived from the consolidated balance sheets. See "Business Environment and Outlook".

				Year ended 31 December
	2006 (US$ thousands)	2006 (KZT thousands)	2005 (US$ thousands)	2005 (KZT thousands)
Revenue	3,269,155	412,207,787	,625,586	348,887,820
Operating expenses	1,542,787	194,530,080	1,558,052	207,033,927
Operating expenses (KZT/USD per bbl produced)[1]	21.99	2,773	22.66	3,012
Profit from operations	1,726,367	217,677,707	1,067,534	141,853,893
Profit for the year from continuing operations	972,013	122,561,217	329,288	43,755,822
Oil Production and other cost [2]	735,415	92,728,483	685,042	91,028,417
Oil Production and other costs (KZT/USD per bbl produced)[1][2]	10.48	1,322	9.96	1,324
Capital expenditure[3]	390,876	49,285,538	365,106	48,515,240
Net cash[4]	1,821,812	231,370,078	47,504	6,354,581

1. Converted at 7.36 barrels per tonne of crude oil.
2. Oil production and other costs represent an aggregate of the following operating expenses line items (as presented in the Company's IFRS financial statements): employee costs, materials expense, repair, maintenance and other services, energy and other costs. These include costs related to gas producing and processing activities, oil processing activities and general and administrative costs which are not directly related to oil production and which increased the US dollar cost per barrel by approximately US$1 to US$2 for both the year ended 31 December 2006 and for the year ended 31 December 2005. Oil production and other costs exclude royalties (production tax) and all other taxes.
3. Excludes capital expenditure of discontinued operations. See "Capital Expenditures".
4. Current financial assets exclude loans receivable from NC KMG, as at 31 December 2006 and 31 December 2005 respectively, of KZT100.9 billion and KZT12.6 billion. The consolidated net cash translated at the year-end rates of 127.00 Tenge/US$ and 133.77 Tenge/US$ for 2006 and 2005 respectively.

Continuing Operations

Transport Routes

The Company delivers its crude oil through three principal routes: export markets via the CPC and UAS pipelines and the domestic market, as outlined in the following table:

	Year ended 31 December	
	2006	2005
EXPORTS VIA CPC		
Volume of crude oil (in million tonnes)	1.7	1.5
% total crude oil sales volume	18%	17%
% total sales of oil and oil products	23%	22%
EXPORTS VIA UAS		
Volume of crude oil (in million tonnes)	5.1	5.0
% total crude oil sales volume	55%	54%
% total sales of oil and oil products	66%	66%
OTHER[1]		
Volume of crude oil (in million tonnes)	2.5	2.7
% total crude oil sales volume	27%	29%
% total sales of oil and oil products	11%	12%

1. Until 2006, "other" is predominantly sales of refined crude oil, a small proportion of which is exported

The Company exports crude oil through the Uzen-Atyrau-Samara pipeline (hereinafter – UAS) owned by JSC KazTransOil (in Kazakhstan) and through the pipeline owned by Caspian Pipeline Consortium (hereinafter – CPC). Relative profitability of the two export routes depends on the quality of oil shipped by the Company, prevailing international market prices and applicable pipeline tariffs. Specifically, CPC tends to be more advantageous for shipments of higher quality crude oil in a higher price oil environment even after taking into account quality bank payments. Although it has been more profitable for the Company in recent periods to ship crude oil through the CPC pipeline rather than the UAS pipeline, the Ministry of Energy and Mineral Resources of Kazakhstan (hereinafter – MEMR) controls the volumes of crude oil that can be shipped through the pipelines and the Company's ability to allocate exported volume to different pipelines is therefore constrained.

Revenue

The following table shows sales volumes and realised prices for the years ended 31 December 2006 and 2005:

	Year ended 31 December	
	2006	2005
	(KZT thousands, unless otherwise stated)	
EXPORT SALES OF CRUDE OIL		
UAS pipeline		
Net sales	266,395,404	226,798,166
Volume (in thousand tonnes)	5,076	4,953
Average price (KZT/tonne)	52,487	45,790
Average price (US$/bbl)(1)	57.57	47.66
CPC pipeline		
Net sales	92,991,304	75,690,507
Volume (in thousand tonnes)	1,663	1,536
Average price (KZT/tonne)	55,902	49,284
Average price (US$/bbl)(1)	61.32	51.30
Total sales of crude oil-exported	359,386,708	302,488,673
OTHER SALES OF CRUDE OIL AND OIL PRODUCTS		
Net domestic sales of crude oil and total oil products	44,705,552	40,394,425
Volume (in thousand tonnes) (2)	2,551	2,733
Average price (KZT/tonne)	17,525	14,780
Average price (US$/bbl) (1)	19.22	15.38
Total domestic sales of crude oil and total oil product sales	44,705,552	
TOTAL SALES OF CRUDE OIL AND OIL PRODUCTS		
Total net sales of crude oil and oil products	404,092,260	
Total volume (in thousand tonnes)	9,290	
Average price (KZT/tonne)	43,428	
Average price (US$/bbl)	46.99	
Other sales	8,115,527	
Total revenue	412,207,787	

1. Converted at 7.23 barrels per tonne of crude oil.
2. Volume of crude oil delivered for processing and crude oil sales.

Total volumes shipped, both export and domestic via the UAS pipeline in 2006 remained stable. At the same time export volumes via the CPC pipeline are increased. In 2006 sales of exported crude oil via the UAS pipeline increased by KZT39.6 billion, or 17.5%. The increase in sales in 2006 compared to 2005 was due to increases in both volumes and prices.

Sales of crude oil via the CPC pipeline increased by KZT17.3 billion, or 22.9%, in 2006 compared to 2005. The increase in sales for both 2006 was due to increases in both volumes and prices.

Other sales of oil and oil products increased by KZT4.3 billion, or 10.7%, in 2006. Although in 2006 the volumes of oil and oil products supplied to the domestic market were down by 182,000 tonnes, average prices were up to KZT17,525 per tonne from KZT14,780 per tonne in 2005 which resulted in an increase of sales to KZT44.7 billion from KZT40.4 billion.

The following table shows the Company's realised sales prices adjusted for oil and oil products transportation and other expenses for the years ended 31 December 2006 and 2005:

	Year ended 31 December 2006		
	CPC	UAS	Other
			(US$/bbl)
Benchmark end-market quote [1]	65.23	60.99	-
Realized price (pre QB [6] and boe diff.)	62.86 [3]	-	-
Net effect of QB [6] cost and boe diff. [2]	(1.54) [4]	-	-
Realised price	61.32 [4]	57.57	19.22
Transportation	(5.93) [4]	(6.16)	(0.80)
Sales commissions	(0.07) [4]	(0.07)	(0.02)
Processing fees	-	-	(0.55)
Adjusted realised price	55.32 [4]	51.34	17.85

	Year ended 31 December 2006		
	CPC	UAS	Other
			(US$/bbl)
Benchmark end-market quote [1]	53.50	50.52	-
Realized price (pre QB [6]and boe diff.)	52.25 [3]	-	-
Net effect of QB [6] cost and boe diff. [5]	(0.95) [4]	-	-
Realised price	51.30 [4]	47.66	15.38
Transportation	(5.25) [4]	(5.82)	(0.73)
Sales commissions	(0.07) [4]	(0.07)	(0.09)
Processing fees	-	-	(2.54)
Adjusted realised price	45.98 [4]	41.77	12.02

1. The following quoted prices are used as benchmarks: CPC blend (FOB Novorossiysk) for shipments through the CPC pipeline and Urals blend (FOB Odessa) for shipments through the UAS pipeline.
2. Net effect (-1.54) = QB cost (-6.41) + boe difference premium (4.87).
3. Converted at 7.79 barrels per tonne of crude oil.
4. Converted at 7.23 barrels per tonne of crude oil.
5. Net effect (-0.95) = QB cost (-5.00) + boe difference premium (4.05).
6. QB – Quality Bank monetary adjustment to compensate for difference in the quality of crude oil injected into the CPC pipeline to the CPC Blend.

The difference between the benchmark quote and realised price on the sales through the CPC pipeline mainly comprises CPC quality bank payments, port charges, customs fees, certain sales commissions and averaging effects. The difference between the benchmark quote and realised price on the sales through the UAS pipeline mainly comprises port charges, customs fees and certain sales commissions. The price received for other sales of oil and oil products is determined primarily by agreement with NC KMG and the price is significantly below market prices.

Operating Expenses

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

	Year ended 31 December			
	2006	2005	2005 Adjusted [1]	Change [2]
	(KZT thousands, unless otherwise stated)			
Transportati on	44,060,096	40,106,224	40,106,224	3,953,872
Employee benefits	37,512,548	37,116,032	36,537,043	975,505
Depreciation, depletion and amortization	27,758,826	24,362,896	24,083,651	3,675,175
Repairs and maintenance	18,988,262	16,845,303	16,637,232	2,351,030
Royalties	15,850,891	15,180,580	15,180,580	670,311
Materials and supplies	11,661,063	21,658,853	17,539,543	(5,878,480)
Taxes other than on income	9,666,804	7,103,491	7,103,491	2,563,313
Social projects	7,850,402	1,791,551	1,791,551	6,058,851
Management fees and commissions	7,678,179	11,976,634	11,976,634	(4,298,455)
Energy	6,563,701	5,824,741	5,824,741	738,960
Fines and penalties	363,994	4,056,539	4,056,539	(3,692,545)
Environmental fine	(11,427,595)	11,427,595	11,427,595	(22,855,190)
Other	18,002,909	9,583,488	9,443,041	8,559,868
Total operating expenses	194,530,080	207,033,927	201,707,865	(7,177,785)

1. Operating expenses of 2005 excluding Atyrau refinery (ANPZ)
2. Change for the year has been calculated excluding ANPZ

Operating expenses decreased in the year primarily as a result of provision reversals and the disposal of various non-core businesses in the year. The more significant amounts and movements are explained as follows (for the purposes of comparison the costs related to tolling operations in 2005 at Atyrau refinery have been excluded):

Transportation expenses for the year increased by 9% as a result of a 1% increase in the total volume of oil supplied and a higher share of exports in the supply mix.

Total costs for employee benefits for 2006 were in line with 2005, however average salaries increased by 4% and various professionals were added to the Head Office to increase the Company's capabilities in a number of areas including mergers and acquisitions, internal controls, IFRS reporting and investor relations. The above increases to employee benefits were offset by a reduction in the overall number of employees by 2% (related to non-core businesses disposed of in the year).

Depreciation, depletion and amortization increased by 13% as a result of significant capital expenditures in 2006 and 2005 and the initiation of amortization on the Liman exploration license. The average depletion rate for the company dropped to approximately 10% in 2006 from 11% in 2005, as a result of upward revisions to the Company's proved reserves.

Materials and supplies decreased significantly due to the disposal of subsidiaries involved in non-core businesses in 2006.

Management fees and commissions decreased due to the conclusion of a new Management services agreement with NC KazMunaiGaz in 2006.

At year end 2005 the Company accrued fines of KZT11.4 billion for exceeding permitted norms at certain production sites. The Government linked the fines to the delayed submission by the Company of a remediation plan in accordance with the terms of a Memorandum of Understanding signed with the Company in mid-2005. The Company has successfully appealed this amount and as a result the provision was reversed in 2006.

Other expenses increased, primarily due to the following:

- Accrual of bad debt allowance on receivables in the amount of KZT3.1 billion mainly related to receivables from Atoll and accrual of impair ment provision on investment in Atoll in the amount of KZT0.8 billion;
- ncreased use of consulting services related to improvement of busi ness processes within the Company; including the development of a management motivation program, implementation of IT procedures, improvement of financial statements process in the amount of KZT0.9 billion; and
- Write-off of obsolete property, plant and equipment in the amount of KZT0.6 billion.

Finance Income (Expense)

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

Income Tax Expense

Profit before tax increased by 34% to KZT217.2 billion while at the same time income tax expense decreased by KZT4.5 billion to KZT94.7 billion. The Company's overall effective tax rate in 2006 reduced to 44% from 69% in 2005 (the effective rate for 2006 was 55% when non-recurring items are excluded). The following table provides a reconciliation of the effective rate of tax to the 30% statutory rate that was in effect for both 2006 and 2005:

	Year ended 31 December	
	2006	2005
	(KZT thousands)	
Profit before tax	217,234,038	142,948,461
Income tax	94,672,821	99,192,639
Effective tax rate	44%	69%
	% of profit before tax	
Statutory income tax	30	30
Increase (decrease) resulting from		
Excess profit tax	20	32
Excess profit tax of prior years	(9)	–
Movement in provisions	(2)	–
Tax effect of items which are not deductible or assessable for taxation purposes	5	7
Effective tax rate	44	69

The substantial decrease in the overall excess profit tax rate (EPT) in 2006 was a result of the Company obtaining clarification from the relevant Government authorities that the rate on the maximum EPT rate payable on its Uzen field should be calculated at 30% instead of the 50% rate which was used in prior years. The corresponding changes to the subsoil contract were applied retrospectively and have resulted in a significant amendment to the 2005 and 2004 EPT returns. The 2006 income tax expense was reduced by the reduction in prior year's EPT and the related cash flow benefit is expected to be realized by the Company in 2007 when the 2006 EPT obligation is settled. The movement in the Company's tax provisions is also primarily related to the above clarification.

The Company's non-deductible items for tax purposes relate primarily to non-core activities, as defined by the relevant hydrocarbon contracts and tax legislation, and IFRS adjustments that are not allowed for deduction in the tax legislation applicable to the Company. The Company is undergoing an extensive review of its non-deductible amounts to ensure that the proper tax treatment has been afforded to these items.

Profit from Continuing Operations

As a result of the factors described above, in 2006 the Company's profit from continuing operations increased by 180% to KZT122.6 billion.

Capital Expenditures

In 2006 and 2005, the Company's capital expenditures, calculated on a cash basis and excluding Atyrau refinery disposed of in 2005, were KZT49.3 billion and KZT48.5 billion respectively. This represented 12.0% and 13.9% of sales, respectively. Annual average production capital expenditures over the years 2007 to 2010 are expected to be lower than the 2006 level as a result of the efficiency improvements being implemented by the Company.

Liquidity and Capital Resources

Summary of Cash Flows

The Company's liquidity requirements arise principally from the need to finance its existing operations (working capital) and the need to finance investment (capital expenditure). Management believes that the Company has adequate liquidity to meet its short-term obligations. In the years under review, the Company has been able to meet most of its liquidity needs out of net cash provided by operating activities and, to a lesser extent, out of borrowings.

	2006	2006	2005	2005
	(US$ thousands)	(KZT thousands)	(US$ thousands)	(KZT thousands)
Net cash generated from operating activities	969,232	122,210,461	564,823	75,053,723
Net cash used in investing activities	(2,366,480)	(298,389,467)	(748,769)	(99,496,430)
Net cash from financing activities	1,738,914	219,259,624	226,385	30,082,102

Net cash generated from operating activities was KZT122.2 billion in 2006 compared to KZT75.1 billion in 2005. The increases were mainly a result of increases in crude oil prices.

Net cash used in investing activities was KZT298.4 billion in 2006 compared to KZT99.5 billion in 2005. The increase was primarily due to the increased holdings of held-to-maturity financial assets and an increase in loans to related parties, including NC KMG. On July 10, 2006, the Company's finance subsidiary, Munaishy Finance B.V., issued US$800 million of 6.5% fixed rate senior notes due in 2009 and loaned the proceeds from the issue to NC KMG. The repayment of the loan is scheduled for 2009 (same date as the Munaishy Finance B.V. issuance) and accrues interest at 6.6% fixed per annum.

Net cash flow from financing activities was KZT219.3 billion in 2006 compared to KZT30.1 billion in 2005. The main reason for the increase is IPO proceeds, net of transaction costs, which amounted to about KZT144.6 billion along with the proceeds from bonds issue by Munaishy Finance B. V.

Borrowings

The following table below sets forth the Company's net cash:

	2006	2005
		(KZT thousands)
Current portion	21,695,307	21,121,175
Maturity between 1 and 2 years	19,816,717	19,082,221
Maturity between 2 and 5 years	17,393,391	34,451,834
Maturity over 5 years	762,279	494,685
Total borrowings	59,667,694	75,149,915
Cash and cash equivalents	62,459,415	20,187,588
Other current financial assets [1]	226,523,024	7,353,770
Non-current financial assets [1]	2,055,333	53,963,138
Net cash	231,370,078	6,354,581

1. Current and non-current financial assets, respectively, which comprise US dollar and Tenge denominated deposits and bonds and exclude loans receivable from NC KMG, as at 31 December 2006 and 31 December 2005 respectively, of KZT100.9 billion and KZT12.6 billion.

The Company's principle credit facilities and borrowings are described below:

World Bank Loan. The Uzen Rehabilitation Project has been financed by a US$109 million credit line from the World Bank granted in July 1996. The principal amount of this facility is repayable in equal installments of US$4.5 million on 15 May and 15 November of each year from November 2001 through May 2013. Interest for each semi-annual period is accrued on the outstanding principal amount at a rate equal to the cost of qualified borrowings plus 0.5%. In addition, the Company pays NC KMG a commitment charge of 0.25% per annum on the principal amount of the facility not utilised. Pursuant to a pledge agreement executed by the Ministry of Finance and the Company on 24 March 2005 the Company pledged property with the value of KZT13.6 billion to guarantee its obligations under the loan documents. The outstanding balance of this loan as at 31 December 2006 was US$44 million.

Esomet Arrangement. On 16 August 2004, the Company entered into a crude oil sale agreement with Esomet and received a long term advance with interest at Libor plus 1.75% per annum. To assure Esomet that payments are made, the Company has agreed to ship certain amounts of crude oil to Esomet which are sold at market prices (usually by reference to the mean quotations for Urals blend quoted on Platt's crude oil market wire) with the pro-

ceeds being used to fund the capital payments due to Esomet. The Company is obliged to deliver 150,000 tonnes of crude oil per month to Esomet until September 2009. Any surplus funds arising from the sale of the 150,000 tonnes of crude oil per month above the required capital repayments are transferred to the Company. In addition to these terms, the Company also agreed to maintain various financial ratios and significant covenants that require Esomet's prior written consent to dispose of assets, grant security or make loans that are not in the ordinary course of business in each case exceeding a specified threshold. On 12 October 2005, the Company entered into a swap transaction with Goldman Sachs International and fixed the floating interest term of the crude oil sale agreement at the rate of 4.6% per annum. On 21 December 2006 terms of the swap transaction were amended with the fixed rate gradually decreasing from 4.6% to 4.3% per annum by the end of 2007 unless Libor rate exceeds predefined trigger levels 5.4%-5.0%, in which case the rate is equal to Libor minus 20 b.p. On 24 July 2006, Esomet and the Company amended the Esomet Arrangement to include an additional payment of US$50.0 million, a reduction of the interest margin from 1.75% to 1.1% and release of the existing NC KMG guarantee. As at 31 December 2006, the Company's long-term debt to Esomet amounted to US$402 million, or KZT51.0 billion.

Private Placement of Notes. On 10 July 2006, the Company's finance subsidiary, Munaishy Finance B.V., issued Senior Notes due 2009 and loaned the proceeds of the issue to NC KMG for NC KMG's purchase of a 50% stake in JV Kazgermunai LLP. The Company also provided an interest-free loan to NC KMG in an amount of KZT24.4 billion (fully repaid as of 31 December 2006) to fund this acquisition and has entered into an option arrangement which gives it the right to acquire the interest in JV Kazgermunai LLP from NC KMG. The loan due to Munaishy Finance B.V. is repayable when the lender shall be obliged to repay the Senior Notes or earlier by mutual agreement of NC KMG and Munaishy Finance B.V.

Potential Acquisitions

JV Kazgermunai LLP

On 5 March the Company announced its agreement to acquire a 50% stake in JV Kazgermunai LLP for a cash consideration of KZT133.3 billion. On 2 March 2007 the independent non-executive directors approved the acquisition, which is subject to satisfaction of a number of conditions including the approval of a majority of independent shareholders and GDR holders at an Extraordinary General Meeting scheduled for 12 April 2007 in Astana.

Credit Suisse Securities (Europe) Limited presented to the Company's Board of Directors its fairness opinion that, subject to customary assumptions, the consideration to be paid by the Company in respect of the proposed acquisition of JV Kazgermunai LLP is fair to the Company from a financial point of view.

OJSC PetroKazakhstan

In July 2006, NC KMG acquired a 33% stake in OJSC PetroKazakhstan for approximately US$1.4 billion. The Company is considering the possibility of acquiring these assets from NC KMG (but is under no obligation to do so). If the Company proceeds with the acquisition, necessary actions by the Company, such as full due diligence and corporate approvals including minority shareholders approval of the acquisition, will be carried prior to closing of the transaction.

Nations Energy Company Ltd

On October 25, 2006 Nations Energy Company Ltd. (Canada) entered into an agreement with CITIC Group (China) ("CITIC") to sell to CITIC the Kazakhstan oil assets of Nations Energy for an aggregate consideration of US$1.91 billion before adjustment for cash and debt.

On December 30, 2006 NC KMG and CITIC announced that CITIC has granted to NC KMG a call option under which NC KMG may acquire a 50% interest in Nations Energy Company Ltd. The option is exercisable within one year and the price is based on acquisition price.

Currently, the Company is negotiating the transfer of the option to purchase a 50 percent interest in Nations Energy Company Ltd from NC KMG to the Company.

Risk

The detailed description of risks and uncertainties the Company is subject to was provided in the Prospectus dated 29 September 2006, issued by the Company in respect of an offering of common shares representing common shares and Global Depositary Receipts. The Directors believe that there have been no significant changes in risks and uncertainties since 29 September 2006, i.e. the date of the Prospectus preparation.

Forward-looking statements

This document includes statements that are, or may be deemed to be, "forward-looking statements". These forward-looking statements can be identified by the use of forward-looking terminology, including, but not limited to, the terms "believes", "estimates", "anticipates", "expects", "intends", "may", "target", "will", or "should" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They include, but are not limited to, statements regarding the Company's intentions, beliefs and statements of current expectations concerning, amongst other things, the Company's results of operations, financial condition, liquidity, prospects, growth, potential acquisitions, strategies and as to the industries in which the Company operates. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that may or may not occur. Forward-looking statements are not guarantees of future performance and the actual results of the Company's operations, financial condition and liquidity and the development of the country and the industries in which the Company operates may differ materially from those described in, or suggested by, the forward-looking statements contained in this document. The Company does not intend, and does not assume any obligation, to update or revise any forward-looking statements or industry information set out in this document, whether as a result of new information, future events or otherwise. The Company does not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved.

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Independent Auditors' Report

To the shareholders of Joint Stock Company Exploration and Production KazMunaiGas

We have audited the accompanying financial statements of Joint Stock Company Exploration and Production KazMunaiGas and its subsidiaries ("the Company"), which comprise of the balance sheet as at December 31, 2006, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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

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

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

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

Opinion
In our opinion, the financial statements give a true and fair view of the financial position of the Company as of December 31, 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP

March 12, 2007

Consolidated Financial Statements

Joint Stock Company Exploration Production KazMunaiGas
For the year ended December 31, 2006

Consolidated Balance Sheet

Tenge thousands unless otherwise stated

As at December 31

	Notes	2006	2005
ASSETS			
Non-current assets			
Property, plant and equipment	7	259,333,372	243,131,834
Other financial assets	9	102,841,401	53,963,138
Intangible assets	8	7,921,252	1,340,657
Investments in associates		2,884,207	4,516,696
Other assets		3,843,312	2,808,028
Total non-current assets		376,823,544	305,760,353
Current assets			
Inventories	10	15,131,619	15,409,658
Taxes prepaid and VAT recoverable		11,690,358	22,121,101
Prepaid and deferred expenses		4,952,828	6,993,525
Trade and other receivables	9	37,356,601	45,918,226
Other financial assets	9	226,523,024	19,993,257
Cash and cash equivalents	9	62,459,415	20,187,588
Total current assets		358,113,845	130,623,355
Total assets		734,937,389	436,383,708
EQUITY			
Share capital	11	259,276,481	11,792,208
Other equity		92,249	–
Retained earnings		266,383,385	161,860,819
Equity holders of the Company		525,752,115	173,653,027
Minority interest		5,700	79,536
Total equity		525,757,815	173,732,563
LIABILITIES			
Non-current liabilities			
Borrowings	13	37,972,387	54,028,740
Deferred tax	18	10,715,701	14,197,680
Provisions	14	52,155,874	49,701,648
Total non-current liabilities		100,843,962	117,928,068
Current liabilities			
Borrowings	13	21,695,307	21,121,175
Income taxes payable		25,551,751	46,994,090
Trade and other payables		40,457,729	51,167,595
Provisions	14	20,630,825	25,440,217
Total current liabilities		108,335,612	144,723,077
Total liabilities		209,179,574	262,651,145
Total liabilities and equity		734,937,389	436,383,708

The notes on pages 54 to 75 are an integral part of these consolidated financial statements

Consolidated Statement of Income

Tenge thousands unless otherwise stated

For the year ended December 31

	Notes	2006	2005
CONTINUING OPERATIONS			
Revenue	15	412,207,787	348,887,820
Operating expenses	16	(194,530,080)	(207,033,927)
Profit from operations		217,677,707	141,853,893
Finance (expense) income	17	(115,881)	1,381,060
Share of result of associates		(327,788)	(286,492)
Profit before tax		217,234,038	142,948,461
Income tax expense	18	(94,672,821)	(99,192,639)
Profit for the year from continuing operations		122,561,217	43,755,822
DISCONTINUED OPERATIONS			
Profit for the year from discontinued operations	6	–	1,521,130
Profit for the year		122,561,217	45,276,952
Attributable to:			
Equity holders of the Company		122,561,334	45,074,642
Minority interest		(117)	202,310
		122,561,217	45,276,952
EARNINGS PER SHARE	12		
Attributable to equity holders of the Company			
From continuing operations – basic and diluted		2.26	0.93
From discontinued operations – basic and diluted		–	0.03

The notes on pages 54 to 75 are an integral part of these consolidated financial statements

Consolidated Statement of Cash Flows

Tenge thousands unless otherwise stated

For the year ended December 31

	Notes	2006	2005
Cash flows from operating activities			
Receipts from customers		410,468,348	333,283,661
Payments to suppliers and employees		(160,982,545)	(181,300,015)
Income tax paid		(127,275,342)	(76,929,923)
Net cash generated from operating activities		122,210,461	75,053,723
Cash flows from investing activities			
Purchases of property, plant and equipment (PPE)		(49,285,538)	(61,916,479)
Proceeds from sale of PPE		829,906	2,755,953
Purchases of intangible assets		(8,838,611)	(650,170)
Purchases of held-to-maturity financial assets		(170,235,221)	(25,696,389)
Loans granted to related parties		(118,250,000)	(30,304,487)
Loan repayments received from related parties		37,011,854	17,000,000
Investments in associates		–	(1,810,335)
Disposal of subsidiaries, net of cash disposed		3,653,483	(2,978,059)
Interest received		6,724,660	4,103,536
Net cash used in investing activities		(298,389,467)	(99,496,430)
Cash flows from financing activities			
Proceeds from the issue of shares		151,880,637	31,078
Transaction costs related to the issue of shares		(7,300,142)	–
Purchase of treasury shares		(3,818,100)	–
Proceeds from the issue of bonds		94,792,000	–
Transaction costs related to the issue of bonds		(721,328)	–
Proceeds from borrowings		7,681,060	71,002,146
Repayment of borrowings		(1,695,391)	(30,407,622)
Dividends paid		(17,631,460)	(3,408,598)
Other distributions to owners		–	(2,115,615)
Interest paid		(3,927,652)	(5,019,287)
Net cash from financing activities		219,259,624	30,082,102
Net change in cash and cash equivalents		43,080,618	5,639,395
Cash and cash equivalents at beginning of the year	9	20,187,588	14,127,579
Exchange (losses) gains on cash and cash equivalents		(808,791)	420,614
Cash and cash equivalents at end of the year	9	62,459,415	20,187,588

The notes on pages 54 to 75 are an integral part of these consolidated financial statements

Consolidated Statement of Changes in Equity

Tenge thousands unless otherwise stated

	Attributable to equity holders of the Company				
	Share capital	Other equity	Retained earnings	Minority interest	Total Equity
As at January 1, 2005	11,761,130	1,315,825	154,162,438	1,494,303	168,733,696
Issue of shares (Note 11)	31,078	–	–	–	31,078
Changes in ownership in subsidiaries	–	(1,315,825)	(31,253,594)	(1,617,077)	(34,186,496)
Profit for the year	–	–	45,074,642	202,310	45,276,952
Dividends (Note 11)	–	–	(3,499,715)	–	(3,499,715)
Other distributions to owners	–	–	(2,622,952)	–	(2,622,952)
As at December 31, 2005	11,792,208	–	161,860,819	79,536	173,732,563
Issue of shares (Note 11)	251,302,373	–	–	–	251,302,373
Treasury stock (Note 11)	(3,818,100)	–	–	–	(3,818,100)
Stock options (Note 11)	–	92,249	–	–	92,249
Changes in ownership in subsidiaries	–	–	–	(73,719)	(73,719)
Profit for the year	–	–	122,561,334	(117)	122,561,217
Dividends (Note 11)	–	–	(18,025,525)	–	(18,025,525)
Other distributions to owners (Note 19)	–	–	(13,243)	–	(13,243)
As at December 31, 2006	259,276,481	92,249	266,383,385	5,700	525,757,815

The notes on pages 54 to 75 are an integral part of these consolidated financial statements

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

1 Organization and principal activities

Joint Stock Company Exploration and Production KazMunaiGas (the "Company") is engaged in the acquisition, exploration, development, production, processing and export of hydrocarbons with its core operations of oil and gas properties located in the Pre-Caspian and Mangistau basins of western Kazakhstan. The Company's direct majority shareholder is Joint Stock Company National Company KazMunaiGas ("NC KMG" or the "Parent Company"), which represents the state's interests in the Kazakh oil and gas industry and which holds 56.77% of the Company's outstanding shares as at December 31, 2006. From June 2006 NC KMG was 100%-owned by Samruk State Holding which is in turn 100% owned by the government of the Republic of Kazakhstan (the "Government").

The Company conducts its principal operations through the UzenMunaiGas and EmbaMunaiGas production divisions. These consolidated financial statements reflect the financial position and results of operations of those divisions and certain other controlling and non-controlling interests in predominantly non-core entities. Such other interests represented approximately 3% of the Company's net assets at December 31, 2006 (2005: 7%). The Company plans to dispose of the remaining non-core businesses by the end of 2008.

These consolidated financial statements were authorized for issue by the Company's Chief Executive Officer, Chief Financial Officer and Group Financial Controller on March 12, 2007.

2 Summary of significant accounting policies

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

2.1 Basis of preparation

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

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 5.

New accounting developments

The following new standards, amendments to standards and interpretations are mandatory for the financial year ended December 31, 2006:

IAS 19 (Amendment), *Actuarial Gains and Losses, Group Plans and Disclosures*, effective for annual periods beginning on or after January 1, 2006, introduces an additional recognition option for actuarial gains and losses in post-employment defined benefit plans. The amendments to IAS 19 did not have a material impact on the Company's financial position or results of operations.

AS 21 (Amendment), *Net Investment in a Foreign Operation*, effective for annual periods beginning on or after January 1, 2006. The amendments to IAS 21 did not have a material impact on the Company's financial position or results of operations.

IAS 39 (Amendment), *The Fair Value Option*; IAS 39 (Amendment), *Cash Flow Hedge Accounting of Forecast Intragroup Transactions*; IAS 39 and IFRS 4 (Amendment), *Financial Guarantee Contracts*, all effective for annual periods beginning on or after January 1, 2006, clarified the use of fair values, clarified that the definition of a financial hedge extends to certain intercompany transactions and clarified the accounting for insurance contracts.

The amendments to IAS 39 and IFRS 4 did not have a material impact on the Company's financial position or results of operations.

IFRS 6, *Exploration for and Evaluation of Mineral Resources*, is effective for annual periods beginning on or after January 1, 2006. IFRS 6 permits the continued use of recognition and measurement practices for exploration and evaluation assets applied immediately before adopting the IFRS. IFRS 6 also provides specific guidance on impairment of exploration and evaluation assets. The adoption of IFRS 6 did not have a material impact on the Company's financial position or results of operations.

IFRIC 4, *Determining Whether an Arrangement Contains a Lease*, is effective for annual periods beginning on or after January 1, 2006. The adoption of IFRIC 4 did not have a material impact on the Company's financial position or results of operations.

IFRIC 5, *Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*, is effective for annual periods beginning on or after January 1, 2006. The adoption of IFRIC 5 did not have a material impact on the Company's financial position or results of operations.

IFRIC 6, *Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*, is effective for annual periods beginning on or after December 1, 2005. The adoption of IFRIC 6 did not have a material impact on the Company's financial position or results of operations.

IFRSs and IFRIC Interpretations not yet effective
The Company has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IFRS 7 "Financial Instruments: Disclosures";
- IAS 1 (amended 2005) "Presentation of Financial Statements – Capital Disclosures";
- IFRIC 8 "Scope of IFRS 2";
- IFRIC 9 "Reassessment of Embedded Derivatives";
- IFRIC 10 "Interim Financial Reporting and Impairment";
- IFRIC 11 "IFRS 2 - Group and Treasury Share Transactions"
- IFRIC 12 "Service Concession Arrangements"

The Company expects that the adoption of the pronouncements listed above will have no significant impact on the Company's results of operations and financial position in the period of initial application.

2.2 Consolidation

Subsidiaries
Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

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

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

Unrealised gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company.

Dilution gains and losses in associates are recognised in the income statement.

2.3 Foreign currency translation

Functional and presentation currency
Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Kazakhstan Tenge ("Tenge"), which is also the Company's functional currency.

Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Subsidiaries
The results and financial position of all of the Company's subsidiaries (none of which has the currency of a hyperinflationary economy) that have a func-

tional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet pre sented are translated at the closing rate at the date of thwat balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonableap proximation of the cumulative effect of the rates prevailing on the trans action dates, in which case income and ex
- penses are translated at the rate on the dates of the transactions);
- all resulting exchange differences are recognised as a separate component of equity.

2.4 Oil and natural gas exploration and development expenditure

License and property acquisition costs
License and property acquisition costs are capitalized within intangible assets and amortized on a straight-line basis over the estimated period of exploration. Each property is reviewed on an annual basis to confirm that drilling activity is planned and it is not impaired. If no future activity is planned, the remaining balance of the license and property acquisition costs is written off. Upon determination of economically recoverable reserves ('proved reserves' or 'commercial reserves'), amortization ceases and the remaining costs are aggregated with exploration expenditure and held on a field-by-field basis as proved properties awaiting approval within other intangible assets. When development is approved internally, the relevant expenditure is transferred to property, plant and equipment.

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

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

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

2.5 Property, plant and equipment

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

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

Oil and natural gas properties are depreciated using a unit-of-production method. Certain oil and gas property with useful lives less than the remaining life of the fields are depreciated on a straight-line basis over useful lives of 4-10 years. The cost of producing wells is amortized over proved developed reserves. License and property acquisition, decommissioning and field development costs are amortized over total proved reserves.

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

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

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

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

2.6 Impairment of assets

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

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss.

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

2.7 Intangible assets

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

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

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

2.8 Financial assets

Financial assets within the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available for sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Company determines the classification of its financial assets at initial recognition. All regular way purchases and sales of financial assets are recognized on the trade date, which is the date that the Company commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Company has the positive intention and ability to hold them to maturity. The Company classifies its cash deposits and bonds as held-to-maturity investments because management has the positive intention and ability to hold these instruments to maturity.

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

2.9 Inventories

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

2.10 Trade and other receivables

Trade receivables, which generally have a short term, are carried at original invoice amount less an allowance for any uncollectible amounts. Allowance is made when there is objective evidence that the Company will not be able to collect the debts.

2.11 Value added tax (VAT)

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

2.12 Cash and cash equivalents

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

2.13 Share capital

Share Capital
Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as an additional paid-in capital.

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

Minority Interest
Minority interest represents the interest in subsidiaries not held by the Company. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair value of the identifiable assets and liabilities of the subsidiaries at the acquisition date and the minorities' portion of movements in equity since the date of the Company's formation. Minority interest is presented within the shareholders' equity. Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiaries unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Company.

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

2.14 Trade payables

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

2.15 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Borrowing costs are recognised as an expense when incurred.

2.16 Deferred income tax

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

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

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

2.17 Employee benefits

Pension scheme
The Company withholds 10% from the salary of its employees as the employees' contribution to their designated pension funds. The pension deductions are limited to 75 minimal monthly salary levels of 9,200 Tenge per month in 2006 (2005: 7,000 Tenge). Under the current Kazakhstan legislation, employees are responsible for their retirement benefits

2.18 Revenue recognition

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

The Company's crude oil sale contracts generally specify maximum quantities of crude oil to be delivered over a certain period. Crude oil shipped but not yet delivered to the customer is recorded as inventory in the balance sheet. Revenues on sales of oil products are recognized when transfer of ownership occurs and title is passed, either at the point of delivery or the point of receipt, depending on contractual conditions.

2.19 Income taxes

Excess profit tax (EPT) is treated as an income tax and forms part of income tax expense. In accordance with the subsoil agreements, the Company accrues and pays EPT, at a rate in the range of 30 to 50% of after tax profit which has been adjusted for specific deductions in accordance with the applicable subsoil agreements, when certain internal rates of return are exceeded.

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

2.20 Comparative amounts

Certain prior period amounts have been reclas sified to conform to current period presentation.

3 Significant non-cash transactions

During 2006 the Company settled in crude oil 17,503,720 thousand Tenge due under the terms of a pre-export financing agreement (2005: 13,676,456 thousand Tenge).

At the date of IPO (Note 11.1) the Company exchanged 9,247,946 ordinary shares for US$800 million senior notes plus accumulated interest. The Company's notes had been placed on July 10, 2006 (Note 9).

These non-cash transactions are excluded from the consolidated statement of cash flows.

4 Financial risk factors

Commodity price risk
The Company is exposed to commodity price risk, since oil prices are determined by the world market. The Company does not hedge this risk.

Interest rate risk
The Company's interest rate risk relates to interest receivable and payable on its cash deposits and borrowings. The Company hedges its exposure on its variable rate debt instruments.

Foreign exchange risk
Most of the Company's cash inflows as well as accounts receivable balances are denominated in US dollars, while most of the Company's purchases are denominated in Tenge. The Company does not use foreign exchange or forward contracts to manage its exposure to changes in foreign exchange rates.

Credit risk
Financial instruments that could subject the Company to credit risk principally comprise related party loans, accounts receivable and cash deposits. Most notably, at December 31, 2006 the Company had 69% (2005: 57%) of total trade and other receivable from one customer, a related party (Note 19). While the Company may be subject to losses up to the contract value of the instruments in the event of non-performance by its counterparts, it does not expect such losses to occur.

Fair values
The fair value of financial instruments, consisting of cash, loans and receivables, and payables and obligations under debt instruments, approximate their carrying values. For trade receivables fair value is the nominal value less provision for uncollectible amounts. The fair value of financial liabilities and other financial assets for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

5 Significant accounting estimates and judgments

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

Oil and gas reserves
Oil and gas reserves are a material factor in the Company's computation of DD&A. The Company estimates its reserves of oil and gas in accordance with the methodology of the Society of Petroleum Engineers (SPE). In estimating its reserves under SPE methodology, the Company uses long-term planning prices which are also used by management to make investment decisions about development of a field. Using planning prices for estimating proved reserves removes the impact of the volatility inherent in using year end spot prices. Management believes that long-term planning price assumptions are more consistent with the long-term nature of the upstream business and provide the most appropriate basis for estimating oil and gas reserves. All reserve estimates involve some degree of uncertainty. The uncertainty depends chiefly on the amount of reliable geological and engineering data available at the time of the estimate and the interpretation of this data.

The relative degree of uncertainty can be conveyed by placing reserves into one of two principal classifications, either proved or unproved. Proved reserves are more certain to be recovered than unproved reserves and may be further sub-classified as developed and undeveloped to denote progressively increasing uncertainty in their recoverability. The Company's proved reserves almost exclusively comprise proved developed reserves. Estimates are reviewed and revised annually. Revisions occur due to the evaluation or re-evaluation of already available geological, reservoir or production data; availability of new data; or changes to underlying price assumptions. Reserve estimates may also be revised due to improved recovery projects, changes in production capacity or changes in development strategy.
Proved reserves are used to calculate the unit of production rates for DD&A. The Company has included in proved reserves only those quantities that are expected to be produced during the initial license period. This is due to the uncertainties surrounding the outcome of such renewal procedures, since the renewal is ultimately at the discretion of the Government. An increase

in the Company's license periods and corresponding increase in reported reserves would generally lead to lower DD&A expense and could materially affect earnings. A reduction in proved developed reserves will increase DD&A expense (assuming constant production), reduce income and could also result in an immediate write-down of the property's book value. Given the relatively small number of producing fields, it is possible that any changes in reserve estimates year on year could significantly affect prospective charges for DD&A.

Asset retirement obligations

Under the terms of certain contracts, legislation and regulations the Company has legal obligations to dismantle and remove tangible assets and restore the land at each production site. Specifically, the Company's obligation relates to the ongoing closure of all non-productive wells and final closure activities such as removal of pipes, buildings and recultivation of the contract territories. Since the license terms cannot be extended at the discretion of the Company, the settlement date of the final closure obligations has been assumed to be the end of each license period. If the asset retirement obligations were to be settled at the end of the economic life of the properties, the recorded obligation would increase significantly due to the inclusion of all abandonment and closure costs. The extent of the Company's obligations to finance the abandonment of wells and for final closure costs depends on the terms of the respective contracts and current legislation. Where neither contracts nor legislation include an unambiguous obligation to undertake or finance such final abandonment and closure costs at the end of the license term, no liability has been recognized. There is some uncertainty and significant judgment involved in making such a determination. Management's assessment of the presence or absence of such obligations could change with shifts in policies and practices of the Government or in the local industry practice. If the Company's asset retirement obligation included the costs of abandoning all productive wells at the end of the license period and recultivating the related sites, the total asset retirement obligation would increase by approximately 9.5 billion Tenge. The Company calculates asset retirement obligations separately for each contract. The amount of the obligation is the present value of the estimated expenditures expected to be required to settle the obligation adjusted for expected inflation and discounted using average long-term risk-free interest rates for emerging market sovereign debt adjusted for risks specific to the Kazakhstan market. The Company reviews site restoration provisions at each balance sheet date, and adjusts them to reflect the current best estimate in accordance with IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities". Estimating the future closure costs involves significant estimates and judgments by management. Most of these obligations are many years in the future and, in addition to ambiguities in the legal requirements, the Company's estimate can be affected by changes in asset removal technologies, costs and industry practice. Approximately 9.4% of the provision at December 31, 2006 and 2005 relates to final closure costs. Uncertainties related to the final closure costs are mitigated by the effects of discounting the expected cash flows. The Company estimates future well abandonment cost using current year prices and the average long-term inflation rate.

The long-term inflation and discount rates used to determine the balance sheet obligation at December 31, 2006 were 5.0% and 7.9% respectively (2005: 5.0% and 7.9%). Movements in the provision for asset retirement obligations are disclosed in Note 14.

Environmental remediation

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

Liabilities are determined based on current information about costs and expected plans for remediation and are recorded on an undiscounted basis if the timing of the procedures has not been agreed with the relevant authorities. The Company's environmental remediation provision represents management's best estimate based on an independent assessment of the anticipated expenditure necessary for the Company to remain in compliance with the current regulatory regime in Kazakhstan. Pursuant to a memorandum of understanding ("MOU") signed with the Ministry of the Environment in July 2005, the Company agreed to take responsibility for remediation of certain soil contamination and oil waste disposal which resulted from oil extraction dating back to the commencement of production. As at the date of these financial statements the scope and timing of the remediation plan has not been formally agreed with the Government. Accordingly, the liability has not been discounted. Because the original terms of the liability have not yet been established and management reasonably expects to execute the remediation plan over a period of up to ten years, the Company has classified this obligation as non-current except for the portion of costs expected to be incurred in 2007. For environmental remediation provisions, actual costs can differ from estimates because of changes in laws and regulations, public expectations, discovery and analysis of site conditions and changes in clean-up technology. Further uncertainties related to environmental remediation obligations are detailed in Note 20. Movements in the provision for environmental remediation obligations are disclosed in Note 14.

Taxation

In assessing tax risks, management considers to be probable obligations the known areas of tax positions which the Company would not appeal or does not believe it could successfully appeal, if assessed by tax authorities. Such determinations inherently involve significant judgment and are subject to change as a result of changes in tax laws and regulations, amendments to the taxation terms of the Company's subsoil agreements, the determination of expected outcomes from pending tax proceedings and current outcome of ongoing compliance audits by tax authorities. The provision for tax risks disclosed in Note 14 relates mainly to the Company's application of Kazakhstan transfer pricing legislation to export sales of crude oil during the years 2002 to 2006. Further uncertainties related to taxation are detailed in Note 20.

Historical obligation

Included in trade and other payables is an accrual of 8.0 billion Tenge (2005: 8.4 billion) related to obligations of the Company under one of the subsoil agreements to reimburse the Government for exploration costs incurred prior to the beginning of the current license agreements. The Company was to conclude a separate agreement with the Government with respect to such reimbursement within sixty days of the signing of the subsoil use contract in 1998. As at December 31, 2006 no such agreement had been concluded. For about half of the contract fields the amount of the accrual has been determined based on calculations prepared by regulatory authorities in 2003. The remaining part of the accrual was estimated by management based on historical exploratory well data. The accrual is classified as current at December 31, 2006 due to the Company not having the unconditional right to defer such obligation for at least 12 months. The obligation is denominated in US dollars and the carrying value is adjusted each period for foreign exchange movements.

6 Discontinued operations

On December 29, 2005 the Company disposed of Atyrau refinery within the NC KMG Group for 3.5 billion Tenge after acquiring the refinery in a par value share exchange with the Parent Company. In 2005 the Company increased its interest from 86.7% to 99.1% through cash contributions of approximately 25 billion Tenge. The disposal resulted in a decrease in shareholders equity of 34.2 billion Tenge. The effects of the disposal were recorded in equity because the counterparty to this transaction is controlled by the principal equity holder. The disposal also resulted in decreases in the following balance sheet items: non-current assets (primarily property, plant and equipment) 58.7 billion Tenge, current assets 17.7 billion Tenge, borrowings 32.5 billion Tenge and other liabilities of 6.1 billion Tenge.

	2005
Revenue	8,854,241
Expenses	(5,350,959)
Profit before tax of discontinued operations	3,503,282
Tax	(1,982,152)
Profit after tax of discontinued operations	1,521,130
Operating cash flows	160,194
Investing cash flows	(13,401,139)
Financing cash flows	(809,995)
Total cash flows of discontinued operations	(14,050,940)

Historically the Company has purchased tolling services from the refinery to meet its local market obligation. Tolling expenses amounted to around 5 billion Tenge in each of the years presented and have been eliminated in these financial statements with all other inter-company transactions. In late 2005 the Company began selling crude oil directly to the refinery. Those sales amounted to around 6.5 billion Tenge and were also eliminated in consolidation. Going forward at least through 2010 the Company expects to increase crude oil sales to the refinery to around 2.2 million metric tons ("tons") per year at terms of cost plus 3% and reduce to an insignificant amount the purchase of tolling services.

7 Property, plant and equipment

	Oil-and-gas properties	Other assets	Construction work-in-progress	Total
2005				
Opening net book amount at January 1, 2005	171,791,340	51,018,310	35,148,550	257,958,200
Additions	10,975,517	10,766,359	60,065,268	81,807,144
Disposals related to discontinued operations	–	(10,935,164)	(50,852,587)	(61,787,751)
Other disposals	(3,003,271)	(6,218,463)	(999,857)	(10,221,591)
Transfers from work-in-progress	26,314,228	7,160,857	(33,475,085)	–
Depreciation charge	(18,332,498)	(6,224,762)	–	(24,557,260)
Impairment	–	(66,908)	–	(66,908)
Closing net book amount at December 31, 2005	187,745,316	45,500,229	9,886,289	243,131,834
At December 31, 2005				
Cost	235,613,254	54,966,841	9,886,289	300,466,384
Accumulated depreciation	(47,867,938)	(9,466,612)	–	(57,334,550)
Net book amount	187,745,316	45,500,229	9,886,289	243,131,834
2006				
Opening net book amount at January 1, 2006	187,745,316	45,500,229	9,886,289	243,131,834
Additions	16,642,063	8,352,989	29,711,178	54,706,230
Disposals	(2,829,741)	(6,047,369)	(3,803,098)	(12,680,208)
Transfers from work-in-progress	22,551,461	2,846,849	(25,398,310)	–
Depreciation charge	(21,438,939)	(4,385,545)	–	(25,824,484)
Closing net book amount At December 31, 2006	202,670,160	46,267,153	10,396,059	259,333,372
At December 31, 2006				
Cost	270,185,271	56,644,462	10,396,059	337,225,792
Accumulated depreciation	(67,515,111)	(10,377,309)	–	(77,892,420)
Net book amount	202,670,160	46,267,153	10,396,059	259,333,372

As at December 31, 2006, construction work-in-progress includes a net book value of exploration and evaluation assets in the amount of 166,298 thousand Tenge (2005: 343,928 thousand Tenge). Additions of these assets during 2006 amounted to 1,312,855 thousand Tenge (2005: 1,201,023 thousand Tenge) and disposals amounted to 1,490,485 thousand Tenge (2005: 1,304,754 thousand Tenge), including write off of dry exploratory wells during the period amounting to 526,596 thousand Tenge (2005: 1,304,754 thousand Tenge).

8 Intangible assets

	2006	2005
At January 1		
Opening net book amount	1,340,657	972,875
Additions	9,413,856	747,954
Disposals	(4,757)	(53,832)
Amortization charge	(2,828,504)	(326,340)
Closing net book amount	7,921,252	1,340,657
At December 31		
Cost	10,908,011	1,622,555
Accumulated amortization	(2,986,759)	(281,898)
Net book amount	7,921,252	1,340,657

Included in additions for 2006 are the contract and license rights for exploration and production activities in Western Kazakhstan that the Company purchased from Aral Petroleum LLP in January 2006 for total cash consideration of 8.6 billion Tenge. The acquired exploration rights expire in February 2009.

9 Financial assets

Other financial assets

	2006	2005
Loan receivable from NC KMG (Note 19)	100,786,068	–
US dollar-denominated deposits	–	47,488,350
Other	2,055,333	6,474,788
Total non-current	102,841,401	53,963,138
Tenge-denominated deposits	131,995,651	–
US dollar-denominated deposits	90,461,651	6,688,500
Loans receivable (Note 19)	–	12,639,487
Other	4,065,722	665,270
Total current	226,523,024	19,993,257
	329,364,425	73,956,395

The weighted average interest rate on US dollar-denominated deposits in 2006 was 7.6% (2005: 6.6%). The weighted average interest rate on Tenge-denominated deposits in 2006 was 8.1%. Other current financial assets as of December 31, 2006 consist primarily of US dollar-denominated bonds with weighted average interest rates of 4%.

On June 30, 2006 the Company entered into an agreement with NC KMG to acquire NC KMG's interests in JV KazGerMunai, representing 50% of the participatory interest in JV KazGerMunai (see Note 22). Under the terms of the agreement, in consideration of the Company providing financial support to NC KMG to finance the acquisition, the Company received a right to purchase the acquired interest at fair market value, which is to be negotiated and determined between the Company and NC KMG. Pursuant to the above on July 10, 2006, the Company's finance subsidiary, Munaishy Finance B.V., issued US$800 million of 6.5% fixed rate senior notes due in 2009 and loaned the proceeds from the issue to NC KMG (Note 3). The repayment of the loan is scheduled for 2009 (same date as the Munaishy Finance B.V. issuance) and accrues interest at 6.6% fixed per annum.

No amount has been recognised in these financial statements to account for the option to acquire KazGerMunai due to the negligible value of the option and ultimate exercise of the option being outside of the control of the Company.

Trade and other receivables

	2006	2005
Trade receivables	37,273,438	38,752,145
Other	3,378,453	8,061,865
Allowance for doubtful receivables	(3,295,290)	(895,784)
	37,356,601	45,918,226

As of December 31, 2006 US dollar-denominated trade and other receivables represented 89% of total receivables (2005: 80%). The remaining balances are Tenge-denominated.

In 2004 the Company purchased a 50% interest in Atoll JSC for approximately 5 billion Tenge. In 2005 the Company sold a 35% interest in Atoll to the other shareholder for 3.2 billion Tenge.

In 2006 the Company has fully provided for the 3.2 billion Tenge receivable from the above sale. Additionally, an impairment loss has been recognised as at December 31, 2006 to write the remaining investment in Atoll down to zero, which is management's best estimate of the current fair value of the investment.

Cash and cash equivalents

	2006	2005
Term deposits	58,399,928	9,815,804
Cash in bank and in hand	4,059,487	10,371,784
	62,459,415	20,187,588

The weighted average interest rate on US dollar-denominated deposits in 2006 was 5.6% (2005: 5%). The weighted average interest rate on Tenge-denominated deposits in 2006 was 5.6% (2005: 3.2%). Approximately 23% of total cash and cash equivalents at year end 2006 are US dollar-denominated (about 70% for 2005). The remaining balances are Tenge-denominated.

10 Inventories

	2006	2005
Materials	10,053,765	11,060,833
Crude oil	5,077,854	4,348,825
	15,131,619	15,409,658

11 Share capital

	Shares outstanding (number of hares)				
	Common shares	Preferred shares	Common shares	Preffered shares	Total share capital
As at January 1, 2005	42,926,820	4,117,699	10,731,705	1,029,425	11,761,130
Issue of shares	124,312	–	31,078	–	31,078
As at December 31, 2005	43,051,132	4,117,699	10,762,783	1,029,425	11,792,208
Issue of shares	27,169,803	18,408	251,297,771	4,602	251,302,373
Treasury stock	(341,530)	–	(3,818,100)	–	(3,818,100)
As at December 31, 2006	69,879,405	4,136,107	258,242,454	1,034,027	259,276,481

11.1 Share capital

Authorized shares

The total number of authorized ordinary and preferred shares is 70,220,935 (2005: 70,220,935) and 4,136,107 (2005: 4,136,107), respectively.

Initial public offering (IPO)

On September 28, 2006, the Company placed Ordinary Shares at 11,163.39 Tenge per share and Global Depository Receipts ("GDR") at US $14.64 (equivalent to 1,860.57 Tenge) per GDR (each GDR represents 1/6 of an ordinary share), on the Kazakhstan Stock Exchange and London Stock Exchange, respectively. The global offer consisted of 23,086,791 newly issued ordinary shares and 3,463,019 ordinary shares, which were offered by NC KMG. Ordinary Share and GDR trading has commenced on the Exchanges on October 4, 2006. At the time of the IPO 539,125 ordinary shares were issued to minority shareholders at 250 tenge per share. Each Ordinary share has the same voting rights as 6 GDRs.

Preferred stock

Preferred stockholders are entitled to participate equally in dividends with the holders of common stock and in any case are entitled, at the discretion of the Company's Board of Directors, to an annual cumulative dividend of 25 Tenge per share. Preferred shareholders receive the right to vote if the general meeting of shareholders considers decisions restricting rights of preferred shareholders, decisions on reorganization or liquidation of the Company and if dividends on preferred shares are not paid within three months after a specified payment date.

Treasury stock

On September 28, 2006 the Company purchased 2,049,180 GDRs at a weighted average price of US $14.64. The shares are held in trust by a special purpose entity and are expected to be used for employee share option plans. The Company consolidates the trust, as in substance, the activities of the trust are being conducted on behalf of the Company. Additionally, the ultimate benefits and risks of the trust reside with the Company.

Dividends

In accordance with Kazakhstan legislation, dividends may not be declared if the Company has negative equity in its Kazakh statutory financial statements or if the payment of dividends would result in negative equity in the statutory financial statements. Total dividends per share recognized as distributions to equity holders during the period amounted to 382 Tenge per share (2005: 74.20 Tenge per share) for both ordinary and preferred shares.

11.2 Employee share option plan

During 2006 the Company established a share option plan. A one-time award for its employees and directors was established to reward performance in relation to the IPO process. The IPO award date was December 29, 2006. An additional plan with an award date of October 4, 2006 was created to incentivise management. The following outlines the details of both plans and activity in the year:

	IPO Plan		Incentive Plan	
	Number of GDR's	Exercise price ($)	Number of GDR's	Exercise price ($)
Granted options	342,553	Nil	575,059	14.64
Outstanding as at December 31, 2006	342,553	Nil	575,059	14.64
		Other Plan Details		Other Plan Details
Weighted average fair value of options granted during the year ($)		19.17		7.93
Vesting period		1 year		1/3 each year over 3 years
Average life remaining		6 years		6 years

The Company recognized total expenses of 92,249 thousand Tenge related to equity-settled share-based payment transactions in 2006.

12 Earnings per share

	2006	2005
Weighted avg. number of all shares outstanding	54,119,532	47,150,748
Continuing operations		
Profit attributable to equity holders of the Company	122,561,334	43,755,822
Basic and diluted earnings per share	2.26	0.93
Discontinued operations		
Profit attributable to equity holders of the Company	–	1,318,820
Basic and diluted earnings per share	–	0.03

The above presentation includes both ordinary and preferred shares as preferred shareholders have cumulative participating rights which result in identical earnings per share for both classes of shares.

13 Borrowings

	2006	2005
Fixed interest rate borrowings	53,947,580	69,309,083
Weighted average interest rates	5.83%	6.32%
Variable interest rate borrowings	5,720,114	5,840,832
Weighted average interest rates	5.44%	6.33%
Total borrowings	59,667,694	75,149,915
Tenge-denominated borrowings	664,257	859,377
US dollar-denominated borrowings	59,003,437	74,290,538
Total borrowings	59,667,694	75,149,915
Current portion	21,695,307	21,121,175
Maturity between 1 and 2 years	19,816,717	19,082,221
Maturity between 2 and 5 years	17,393,391	34,451,834
Maturity over 5 years	762,279	494,685
Total borrowings	59,667,694	75,149,915
Undrawn facilities at fixed rate:		
Expiring within one year	2,514,098	3,986,709
Expiring beyond one year	–	13,709,100
	2,514,098	17,695,809

Most of the Company's borrowings (2006: 51,094,758 thousand Tenge, 2005: 66,598,200 thousand Tenge) relate to a pre-export financing arrangement which expires in 2009 and requires settlement in crude oil.

14 Provisions

	Environmental remediation	Taxes	Asset retirement obligation	Other	Total
At January 1, 2005	33,028,060	18,644,946	16,305,869	1,659,876	69,638,751
Additional provisions	–	4,874,542	351,046	1,072,412	6,298,000
Unused amounts reversed	–	–	(29,772)	–	(29,772)
Unwinding of discount	–	–	1,293,055	–	1,293,055
Changes in estimate	(663,230)	–	995,322	–	332,092
Used during the year	(1,331,100)	–	(869,172)	(189,989)	(2,390,261)
Current portion	821,577	23,519,488	900,163	198,989	25,440,217
Non-current portion	30,212,153	–	17,146,185	2,343,310	49,701,648
At December 31, 2005	31,033,730	23,519,488	18,046,348	2,542,299	75,141,865
Additional provisions	–	974,524	805,286	868,694	2,648,504
Unused amounts reversed	–	(4,915,889)	(35,118)	–	(4,951,007)
Unwinding of discount	–	–	1,431,075	–	1,431,075
Changes in estimate	–	–	2,186,862	–	2,186,862
Used during the year	(1,014,767)	(1,792,643)	(677,185)	(186,005)	(3,670,600)
Current portion	1,619,352	17,785,480	1,026,968	199,025	20,630,825
Non-current portion	28,399,611	–	20,730,300	3,025,963	52,155,874
At December 31, 2006	30,018,963	17,785,480	21,757,268	3,224,988	72,786,699

Release of tax provision during 2006 primarily relates to the clarification in the Company's subsoil agreement for the Uzen field (Note18) and expiration of the statute of limitations with respect to provisions related to activities in 2001.

15 Revenue

	2006	2005
Export:		
Crude oil	359,386,708	302,488,673
Refined products	–	651,491
Domestic (Note 19):		
Crude oil	37,087,091	6,930,889
Refined products	7,618,461	32,812,045
Gas products	3,623,586	4,082,068
Other sales and services	4,491,941	1,922,654
	412,207,787	348,887,820

16 Operating expenses

	2006	2005
Transportation	44,060,096	40,106,224
Employee benefits	37,512,548	37,116,032
Depreciation, depletion and amortization	27,758,826	24,362,896
Repairs and maintenance	18,988,262	16,845,303
Royalties	15,850,891	15,180,580
Materials and supplies	11,661,063	21,658,853
Other taxes	9,666,804	7,103,491
Social projects	7,850,402	1,791,551
Management fees and commissions (Note 19)	7,678,179	11,976,634
Energy	6,563,701	5,824,741
Fines and penalties	363,994	4,056,539
Environmental fine (Note 20)	(11,427,595)	11,427,595
Other	18,002,909	9,583,488
	194,530,080	207,033,927

17 Finance (expense) income

	2005	2006
Financial income	13,525,630	6,221,012
Financial expense	(9,581,373)	(5,115,993)
Foreign exchange (losses) gains	(4,060,138)	276,041
	(115,881)	1,381,060

18 Income taxes

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

	2006	2005
Corporate income tax	75,691,683	55,407,550
Excess profit tax	41,105,194	47,411,026
Excess profit tax of prior years	(18,642,077)	–
Current income tax	98,154,800	102,818,576
Corporate income tax	(1,046,070)	(1,983,507)
Excess profit tax	(2,435,909)	(1,642,430)
Deferred income tax	(3,481,979)	(3,625,937)
Income tax expense	94,672,821	99,192,639

The following table provides a reconciliation of the Kazakhstan income tax rate (30% in 2006 and 2005) to the effective tax rate of the Company on profit before tax.

	2006	2005
Profit before tax	217,234,038	142,948,461
Income tax	94,672,821	99,192,639
Effective tax rate	44%	69%
		% of profit before tax
Statutory income tax	30	30
Increase (decrease) resulting from		
Excess profit tax	20	32
Excess profit tax of prior years	(9)	–
Movement in provisions	(2)	–
Tax effect of items which are not deductible or assessable for taxation purposes	5	7
Effective tax rate	44	69

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

	Fixed assets	Provisions	Other	Total
At January 1, 2005	29,500,770	(2,707,958)	(8,306,998)	18,485,814
Income statement effect	(4,965,164)	70,825	1,268,402	(3,625,937)
Acquisitions and disposals	(662,197)	–	–	(662,197)
At December 31, 2005	23,873,409	(2,637,133)	(7,038,596)	14,197,680
Income statement effect	(5,609,303)	1,261,990	865,334	(3,481,979)
At December 31, 2006	18,264,106	(1,375,143)	(6,173,262)	10,715,701

On December 29, 2006 the Kazakhstan government as represented by the Ministry of Energy and Mineral resources and the Company signed Agreement # 2 (state registration number 2272) on the introduction of changes and amendments to Contract # 40 dated 31 May 1996 on exploration and production of the Uzen and Karamandybas oil fields in the Mangistau oblast ("the Contract"). Agreement # 2 clarified certain aspects of the Contract's tax regime and also introduced the direct inclusion of social infrastructure obligations in the amount of up to KZT 900 million per year into the Contract.

Specifically, Agreement #2 has established clear excess profit tax calculation methodology, which was previously absent or lacking in the Contract. In prior periods the Company calculated and paid to the budget excess profit tax based on a conservative understanding of the Contract's provisions.

In accordance with the Agreement #2, the introduction of the specific excess profit tax calculation methodology was applied retrospectively from the Contract's inception date and resulted in a material decrease (18.6 billion Tenge) in the Company's prior years' excess profit tax liabilities. The effects of the change in the tax rate for the Contract have been fully reflected in the 2006 income tax expense.

In addition, Agreement #2 introduced certain changes that will be applied prospectively in the Company's financial statements. The Company's obligations on road use fund of 0.5% of turnover were abolished in exchange for an increase in royalty rate from 3% to 3.5%. Also, the social tax and value added tax rates were brought in line with the existing rates in current legislation. Other changes to the Contract were made in relation to smaller local taxes, which are not expected to have a material effect on the Company's financial statements.

As of December 31, 2006, total prepaid income taxes were 6.1 billion Tenge (2005: 4.1 billion Tenge).

19 Related party transactions

The category 'entities under common control' comprises entities of the Parents and all of those entities are state-controlled. Halyk Bank of Kazakhstan is a related party due to the bank being controlled by a member of the Parent Company's Board of Directors.

	2006	2005
Sales of goods and services (Note 15)		
Entities under common control	321,037,075	260,878,868
Parent Company	3,856,643	–
Associates	16,217	8,965
Purchases of goods and services (Note 16)		
Entities under common control	43,727,299	33,260,013
Parent Company	7,489,949	11,244,000
Associates	668,736	1,007,035
Halyk Bank of Kazakhstan affiliates	395,883	–
Interest earned on financial assets		
Halyk Bank of Kazakhstan	1,204,307	–
Average interest rate on deposits	3.25%	–
Parent Company	3,589,287	–
Trade and other receivables (Note 9)		
Entities under common control	31,996,067	36,719,618
Parent Company	–	180,772
Associates	226	667,877
Halyk Bank of Kazakhstan affiliates	273,492	–
Trade payables		
Entities under common control	1,725,051	1,128,480
Parent Company	2,114,180	408,124
Associates	293,088	129,324
Loans receivable		
Entities under common control	94,185	3,639,487
Parent Company (Note 9)	100,786,068	9,000,000
Loans payable (Note 13)		
Parent Company	5,720,113	5,840,833
Financial assets (Note 9)		
Halyk Bank of Kazakhstan	26,085,624	–
Cash and cash equivalents (Note 9)		
Halyk Bank of Kazakhstan	35,697,194	–
Key management compensation		
Salaries and other short-term benefits	574,077	133,483
Share-based payments	31,276	–

Sales and receivables

Sales to related parties comprise mainly export and domestic sales of crude oil and oil products to KMG group entities. Export sales to related parties represented 4,972,199 tons of crude oil in 2006 (2005: 4,693,968 tons). The sales of crude oil are priced by reference to Platt's index quotations and adjusted for freight, insurance and quality differentials. For these exports of crude oil the Company received an average price per ton of approximately 55,430 Tenge in 2006 (2005: 47,837 Tenge). In addition, the Company supplies oil and oil products to the local market at the directive of the Kazakhstan government, the ultimate controlling shareholder of the Parent Company. These supplies to the domestic market represented 2,541,685 tons of crude oil production in 2006 (2005: 2,733,409 tons). Prices for the local market sales are determined by agreement with the distributors. For deliveries to the local market in 2006 the Company received an average price per

produced crude oil ton of around 15,748 Tenge (2005: 13,288 Tenge). Trade and other receivables from related parties principally comprise amounts related to export sales transactions.

At December 31, 2006 the Company had commitments under a government directive to deliver 2.2 million tons of crude oil to local markets in 2007.

Purchases and payables
Management fees to the Parent Company amounted to 7,000,000 thousand Tenge in 2006 (2005: 11,244,000 thousand Tenge). Agency commissions for crude oil sales amounted to 678,179 thousand Tenge in 2006 (2005: 732,634 thousand Tenge). Transportation services related to the shipment of 7,649,026 tons of crude oil in 2006 (2005: 7,554,859 tons) were purchased from a KMG group entity for 32,024,409 thousand Tenge in 2006 (2005: 28,965,459 thousand Tenge). The remaining services purchased from Samruk group entities include primarily payments for demurrage, sales commissions and electricity.

Loans and guarantees
In 1996 a predecessor entity of the Company received from the Parent Company a facility of US $109,000 thousand for the rehabilitation of the Uzen oil field. Amounts drawn in 2006 totaled US $10,007 thousand (2005: US $2,633 thousand). The Company pays semi-annual installments of US $4,540 thousand through 2013 and a commitment charge of 0.75% per annum on the principal amount of the unutilized facility. This loan is secured by certain non-current assets of the Company (Note 20).

In 2006 the Company made an interest-free loan to the Parent Company in the amount of 24,371,325 thousand Tenge (2005: 26 billion Tenge), which was repaid in November 2006. The difference between the nominal value and the discounted amount of the loan has been recorded in equity.

20 Contingencies

Operating environment
The Kazakh economy, while deemed to be of market status beginning in 2002, continues to display certain characteristics consistent with that of an economy in transition. These characteristics have in the past included higher than normal historical inflation, lack of liquidity in the capital markets, and the existence of currency controls, which cause the national currency to be illiquid outside of Kazakhstan.

The Company's operations and financial position will continue to be affected by Kazakh political developments including the application of existing and future legislation and tax regulations. The Company does not believe that these contingencies, as related to its operations, are any more significant than those of similar enterprises in Kazakhstan.

Local market obligation
The Kazakhstan government requires oil producers to supply a portion of their crude oil production to meet domestic energy requirements (Note 19). While the price for such additional supplies of crude oil is agreed with the Company's Parent, this price may be materially below international market prices and may even be set at the cost of production. If the Government does require additional crude oil to be delivered over and above the quantities currently supplied by the Company, such supplies will take precedence over market sales and will generate substantially less revenue than crude oil sold on the export market, which may materially and adversely affect the Company's business, prospects, financial condition and results of operations.

Taxation
Kazakhstan's tax legislation and regulations are subject to ongoing changes and varying interpretations. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual. The current regime of penalties and interest related to reported and discovered violations of Kazakhstan's tax laws are severe. Penalties are generally 50% of the taxes additionally assessed and interest is assessed at the refinancing rate established by the National Bank of Kazakhstan multiplied by 2.5. As a result, penalties and interest can amount to multiples of any assessed taxes. Fiscal periods remain open to review by tax authorities for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. Because of the uncertainties associated with Kazakhstan's tax system, the ultimate amount of taxes, penalties and interest, if any, may be in excess of the amount expensed to date and accrued at December 31, 2006. As at December 31, 2006 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax positions will be sustained, except as provided for or otherwise disclosed in these financial statements (Notes 5 and 14).

Environment
The enforcement of environmental regulation in Kazakhstan is evolving and subject to ongoing changes. Penalties for violations of Kazakhstan's environmental laws can be severe. At year end 2005 the Company accrued fines of 11.4 billion Tenge for exceeding permitted norms at certain production sites. The Government linked the fines to the delayed submission by the Company of a remediation plan in accordance with the terms of a Memorandum of Understanding ("MOU") signed with the Company in mid-2005. Until the terms of the MOU are amended to extend the deadline specified therein, there can be no assurances that additional fines will not be assessed. Potential liabilities which may arise as a result of stricter enforcement of existing regulations, civil litigation or changes in legislation cannot be reasonably estimated. On July 7, 2006 the Specialized Inter-District Economic Court of the city of Astana ("SIDECA") decided the case in favor of the Company and fully dismissed the claim. On July 20, 2006, the Mangistau department of the MEP filed an appeal of the above court decision which was subsequently rejected by the Collegium on Civil Cases of the Astana City Court on August 9, 2006. The effect of the Collegium's rejection of the appeal is that the July 7 decision comes into force. Further to the August 9, 2006 decision the General Prosecutor's Office issued a supervisory protest with respect to the court judgment issued in favor of the Company on the payment of penalties for environmental damages. On November 16, 2006 the Supervisory Board of the Court

of Astana dismissed the supervisory protest and upheld the prior judgments made in favor of the Company. The Mangistau MEP can still ask the Supreme Court to reconsider the case as a whole and has until August 9, 2007 to do so. Following the favorable outcome of the SIDECA proceedings and the appeal court decision, management has released the accrual of 11.4 billion Tenge in 2006. Notwithstanding these developments, there can be no assurances that additional fines will not be assessed. Potential liabilities which may arise as a result of stricter enforcement of existing regulations, civil litigation or changes in legislation cannot be reasonably estimated. Other than those contingencies discussed here and obligations disclosed in Note 14, under existing legislation management believes that there are no probable or possible environmental liabilities which could have a material adverse effect on the Company's financial position, statement of income or cash flows.

Legal proceedings

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

Oilfield licenses

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

The Company's oil and gas fields are located on land belonging to the Mangistau and Atyrau regional administrations. Licenses are issued by the Ministry of Energy and Mineral Resources of Kazakhstan and the Company pays royalties and excess profits tax to explore and produce oil and gas from these fields.

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

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

Management believes that the Company will be successful in its attempts to extend its licenses beyond the initial expiration date under existing legislation where such extension is in the economic interest of the Company.

Guarantees, pledges and covenants

At December 31, 2006 the Company had collateralized non-current assets related to loans received in the amount of approximately 24 billion Tenge (2005: approximately 23 billion Tenge). Also, some of the Company's financing agreements require compliance with certain financial ratios and other terms. Non-compliance with such terms could result in long-term debt becoming callable by the creditor. At the end of each period presented management believes that the Company was in full compliance with all terms of such agreements.

21 Commitments

Oilfield licenses and contracts

Year	Capital expenditures	Operational expenditures
2007	24,362,706	4,510,761
2008	1,471,190	4,240,886
2009	858,000	3,875,761
2010	841,000	3,875,126
2011	841,000	3,875,126
2012-2021	–	30,377,170
Total	28,373,896	50,754,830

Crude oil supply commitments
Under the provisions of a pre-export financing agreement the Company has committed to deliver 150,000 tons of crude oil per month to the lender until September 2009 for fair value consideration determined at the date of shipment. The Company has further obligations to supply oil and oil products to the local market under government directives (Note 19).

22 Subsequent events

On March 5, 2007 the Company announced an agreement to purchase a 50% share of JV KazGerMunai from National Company KazMunaiGas (see Note 9) for cash consideration of 133.3 billion Tenge. The independent non-executive directors unanimously approved the purchase, which is subject to satisfaction of a number of conditions including the approval of a majority of non-controlling shareholders including GDR holders at an Extraordinary General Meeting scheduled for April 12, 2007 in Astana. If approved, the transaction is expected to close during the second quarter of 2007.

Kazakhstan

- The Republic of Kazakhstan is a large landlocked country in Northern and Central Eurasia. Its territory is over 2,7 million km^2 and is bigger than that of entire Western Europe.
- Kazakhstan borders with Russia, China, Kyrgyzstan, Uzbekistan and Turkmenistan and has a coastline on the Caspian Sea.
- The population of the country in 2006 was estimated at just over 15 million people.
- Together with other Central Asian republics Kazakhstan proclaimed its independence from the Soviet Union in 1991 and became the member of the Commonwealth of Independent States (CIS) in December of the same year.
- The first nation-wide Presidential elections were held on 1 December 1991. Nursultan Nazarbaev was supported by 98.7% of the voters. As a result of the latest election on 4 December 2005, the President Nazarbaev was re-elected for the next seven years.
- In 1997 the nation's capital changed from Almaty, the largest city, to Astana (formerly Akmola).
- Kazakhstan has enjoyed a steady growth of its GDP for the last five years with year-on-year increases of over 9%. The Government of Kazakhstan plans to double its GDP by 2008 compared to 2000.
- Due to its strong economic performance Kazakhstan has become the first former Soviet republic to repay its debt in full to the International Monetary Fund in 2000, 7 years ahead of schedule. In September 2002 Kazakhstan became the first CIS country to receive an investment grade credit rating.
- Kazakhstan has about 8 billion tonnes of proven recoverable oil reserves. Industry analysts believe that planned expansion of oil production, together with the development of new fields, will enable the country to produce as much as 3 million barrels per day by 2015 taking the country into the world's top 10 oil producers.


Kakhsta

Shareholder Information

Annual General Meeting

The AGM will be held at 10:30 am, on May 18, 2007, at
The Rixos President Hotel,
1st floor, conference-hall "Shanyrak",
7, First str., Left Bank,
Astana, 010000,
Republic of Kazakhstan.

Website

Information on the Company including details of activities, press releases and annual and interim reports is available at www.kmgep.kz.

Shareholders' Enquries

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

Holders of ordinary and preferred shares:
JSC Fondovyi Tsentr,
79 "A", Zheltoksan Street, Almaty,
Republic of Kazakhstan
Tel.: +7 (327) 250 89 61, 250 89 60
Fax: +7 (327) 250 16 96

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

Number Of Shares In Issue

	Common Shares	Preferred Shares	Total Share Capital [2]
Total number of shares issued [1]	70,220,935	4,136,107	74,357,042

[1] Including 341,530 of treasury stock and 43,087,006 common shares or 61.36% owned by JSC NC KazMunaiGas. The information is provided as of the date of publishing the Annual Report.
[2] The Company's shares are listed on Kazakhstan Stock Exchange and the GDRs are listed on the London Stock Exchange. Each GDR corresponds to one sixth of an ordinary share.

Contact Information

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