

**STRATEGY PREPARATION FOR PRIVATIZATION OF  
LARGE INDUSTRIAL ENTERPRISES OF AZERBAIJAN REPUBLIC  
INSTITUTION BUILDING TECHNICAL ASSISTANCE, LOAN NO. 27690AZ**

**COMPANY PROFILE – SUMGAI HOUSEHOLD CHEMICAL GOODS JSC**

**June 2003**

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*The contents of this report is subject to and does not override the terms and conditions of our appointment as set out in the Contract of February 17, 2003.*

*ã Ernst & Young 2003*

## ABBREVIATIONS

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AZM	Azerbaijan Manats
USD	United States of America dollar
RUR	Russian Roubles
WIP	Work-in-Progress
Q	Quarter of the year
The Company	Sumgait Household Chemical Goods JSC
EBITDA	Earnings before interest, tax, depreciation and amortization
K	Thousands
M	Million
B/S	Balance Sheet
P&L	Profit and Loss Statement
FCST	Forecast
AGAAP	Azeri Generally Acceptable Accounting Principles
FSs	Financial Statements
IAS	International Accounting Standards
GOA	Government of Azerbaijan Republic
IVS	International Valuation Standards
MED	Ministry of Economic Development of Azerbaijan Republic
MoL	Ministry of Labor of Azerbaijan Republic
SWOT	Strengths, Weaknesses, Opportunities and Threats
TOR	Terms of Reference
US GAAP	US Generally Acceptable Accounting Principles
GBV	Gross book value
AD	Accumulated depreciation
NBV	Net book value

## Overview of Business and Operations

### General

Sumgait Household Chemical Goods JSC is located in the industrial area of Sumgait on the Apsheron peninsula of the Azerbaijan Republic. The Company was established in 1966 and the first detergent production workshop was launched to produce 30 thousand tones of detergent per year. In 1978 the second detergent workshop was erected increasing detergent production of the factory by 60 thousand tones per year to the total capacity of 90 thousand tones of detergent. In 1997 further use of building of the first detergent shop was considered dangerous due to the damage of the main structure.

The Company's core business is the production of household synthetic detergents (powder and liquid) and packaging them in boxes and containers ready for retail sale. The Company is able to print its own carton boxes for packing detergents.

In addition the Company has recently launched production of:

- Spased perlite which is being used in construction as noise/thermal insulation material and in beverage industry as filtering material; and
- Soluble glass used mainly in construction industry as flashing material.

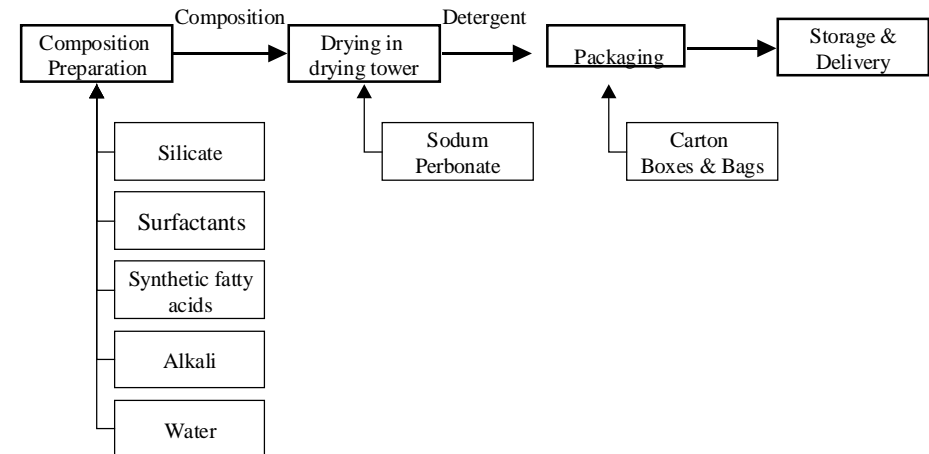
The total area of Sumgait Household Chemical Goods factory is 36.2 hectares. The Company possesses the following main production facilities:

- Synthetic detergent production shop No.1 of 10.4 thousand square meters (the main structural elements of the shop are in critical condition);
- Synthetic detergent production shop No. 2 of 18.4 thousand square meters;
- Partially roofed spased perlite production facilities;
- Partially roofed soluble glass production facilities;
- Several auxiliary shops and warehouses facilities; and

- Four-floor administrative building.

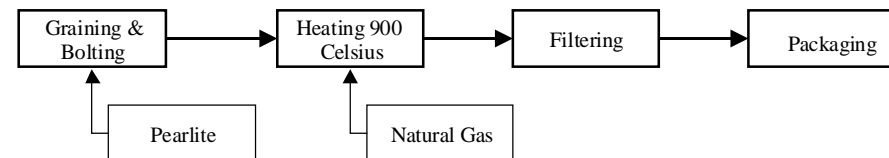
### Production process for household detergents

The principal stages for the household detergents production is presented at the scheme below:



### Spased perlite production process

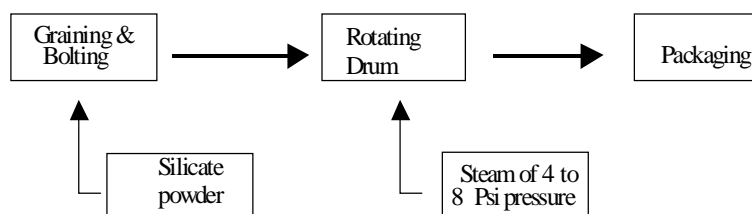
The principal stages for the spased perlite production are presented at the scheme below:



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### Soluble glass production process

The principal stages for the soluble glass production is presented at the scheme below:



### Geographical Markets

Sungait Household Chemical Goods JSC was originally established to satisfy the demand in household washing detergents in the Caucasus region.

The management of the Company believes that the main market of the Company for household detergents is mainly in Azerbaijan. Since the Company is not producing any detergents since mid nineties the Company lost its brand and consumer awareness of the national producer of the detergents.

Below we will summarize our analysis of the local market of synthetic detergents, as we believe this market is the most appropriate to determine whether the opportunity for the Company to restart its operations exists.

Table 1 below presents the most popular brands of detergents being sold through the retail stores in Baku and across Azerbaijan. The average retail price of one kilogram of detergent is approximately AZM 7,400 or USD 1.5. Brands Ariel and Tide of Procter & Gamble and Bingo and OMO of Turkish producers are most popular in the high quality/high price segment. Cheaper Mif and Bonux of Procter & Gamble and Darya of Tolypers appear to be leading the lower segment of the market.

**Table 1: Brands of detergents present in Azerbaijan market**

Brand Name	Packag e weight	Producer	Country of origin	Price (AZM/kg)
Bingo	300	Hyatt Kimiya Senaye	Turkey, Ukraine, Russia	8,333
Barf	300	Paxanco	Iran	6,667
OMO	450	Tever Elides ve Kisesel Bakim Urunleri Senaye	Turkey	10,000
Persil	450	Henkel Waschmittel GmbH	Russia	14,444
Emrooz	320	Behdad Chemical Co	Iran	6,250
Tara	320	Behdad Chemical Co	Iran	6,250
Darya	300	Tolypers	Iran	6,000
MiF	450	P&G	Turkey, Russia	6,667
Dosia	400	Reckitt Benckiser	Russia, Ukraine	8,125
Ariel	450	P&G	Russia, Turkey	10,556
Tide	450	P&G	Russia, Turkey	8,889
Bonux	350	P&G	Russia, Turkey	5,714

According to the data published by the State Statistics Committee of Azerbaijan synthetic detergents constituted 0.58% of the retail trade turnover in Azerbaijan in 2001 or approximately AZM69 billion (USD15 million). Assuming the average price of detergent is USD1.5, the total amount of detergents sold in Azerbaijan in 2001 was 10 thousand tones. Thus for Azerbaijan population of some 8 million the detergent consumption per capita in 2001 was 1.2 kg per year. This rate is, however, much lower than for instance in EU countries where on average people consume 7 to 10 kg of detergent. Taking into consideration lower than in EU purchasing power of population in Azerbaijan and heavy use of cheaper laundry soap (SSC: 0.63% of retail turnover) we believe that detergent consumption in Azerbaijan is approximately 3 to 5 kg per capita per year which gives the total consumption of 24 to 40 thousand tones of detergent per year. Thus the total market of detergents in Azerbaijan should be in the rage of USD36 and USD60 million.

Taking into account the expected raise of domestic purchasing power and growth of Azerbaijan population, the Company has an opportunity to restart its operation and gain certain share of domestic detergent market. Obviously, the

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ability to regain the market would depend on a number of factors, including such important ones as heavy investments in replacement of the outdated equipment, divesting of excessive capacities and reducing costs of production, investment in the marketing and product quality upgrade, etc.

As to other products manufactured by the Company, according to the management, the market for the spased pearlite and liquid silicate is limited to the national construction industry.

The application of the pearlite as the filtering material in the beverage industry is limited as most of the potential customers (Pepsi, Coca Cola, breweries etc.) prefer to deal with traditional suppliers from abroad.

### *Industry Overview*

#### *Detergents Business*

The household detergents business is highly competitive in Azerbaijan. The biggest and most close competitors are:

- Novomoskovsk (Novomoskovsk, Russia) and Sefakoy Fabrikası (Istanbul, Turkey) controlled by Procter & Gamble;
- Pakvash (Iran) and Pemos (Perm, Russia) controlled by Henkel;
- Hyatt Kimiya Senaye (Turkey, Russia and Ukraine);
- Paxanco, Behdad Chemical and Tolypers (all based in Iran);
- Tever Elides ve Kisesel Bakim Urunleri Senaye (Turkey), etc.

According to the management there were plans to open two new household detergent production factories in Azerbaijan in the nearest future, including production of Iranian brand Emrooz in Sadarak, Azerbaijan and Darya (the location is not disclosed).

#### *Spased Pearlite*

The spased perlite and soluble glass are quite commonly produced by many companies in Russia and neighbouring countries.

- Dmitrovskaya Teploizolatsiya (Dmitrov Russia);
- Stroidetal (St. Petersburg, Russia); and
- Sovetski Zavod TMK (Sovetsk, Russia) and others.

#### *Suppliers*

The following main raw materials are necessary for the household detergents production:

Raw material	Value USD per ton
Natrium tripolyphosphate	450
Sulphate natrium	120
Sulphanol	400
Bleach (2% per ton required)	n/a
Soluble glass	280
Other additives (2-3% per tone)	n/a

The main raw materials for the household detergents producers are located in Kazakhstan.

The Company is buying pearlite from the local suppliers.

The Company is using old stock of silicate for soluble glass production.

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### *Investment requirements*

It is clear that the Company requires replacement of most of its equipment and significant repair works of the production facilities. The existing equipment has not been maintained for many years and it is technologically outdated.

According to the management, in order to resume production of the detergent significant investment should be made in the raw materials.

The required investment is presented for production of 60 thousand tones of the detergent per year.

Costs	Value 000'USD
Raw materials	180
Utilities	20
Wage and other labour related expenses	50
Sales general & admin	10
<b>Total Estimation</b>	<b>260</b>

Apart from the amount shown in the table above representing the initial investment into the working capital the management estimates that approximately 200 to US\$250 K need to be invested into the major repair of the buildings and equipment.

### *Privatisation developments*

According to the management the Company was visited by the potential investors several times but no concrete interest was expressed to establish any formal co-operation with any of them. As per the management's opinion, the major reasons for inability to find a strategic investor were the size of the production facilities compared to the potential market opportunity and the poor state of the equipment installed.

According to the Law on Privatization, employees are allowed to buy out 15% of shares at discounted price, however, less than one percent was acquired by the existing and former employees of the Company.

### **Organizational Structure, Management and Personnel**

The Company key management is represented in the chart at Attachment 2.

### *Remuneration and Personnel*

The number of employees reduced from 900 persons in 1990 to 612 in 2002. Among this 612 employees 70 are active and are on the Company's payroll. Other employees are on unpaid leave.

Salaries are paid irregularly and the company's payroll liabilities have increased by approximately US\$10 K. Monthly payroll is approximately US\$2.5 K. The Company additionally has employees who receive allowances for injuries.

### **Summary SWOT Analysis**

#### *Strengths*

- The Company has experience in production of household detergents;
- The Company is the only potential large scale manufacturer of the household detergents in Azerbaijan at the moment and is well positioned to regain the local market;
- The Company has the management and technical staff capable to launch household detergents production;
- The Company has access to infrastructure and cheap labour resources;

#### *Weaknesses*

- The market of detergents is very competitive, as numerous producers are located in the neighbouring countries, including Turkey, Iran and Russia;
- The Company lost majority of skilled labour force;
- The majority of the equipment is damaged and obsolete and requires major repair;
- The majority of the infrastructure requires urgent investments;
- The Company has poor environmental protection systems in place.

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### *Opportunities*

- Organize production of the household detergents to supply the market in Azerbaijan;
- Promote soluble glass and spased pearlite more aggressively on the construction market;
- Consider forming alliance with international household detergent manufacturers.

### *Threats*

- The Company cannot be a going concern without support of the State;
- The Company may not be able to secure the interest of a strategic or financial investor;
- The competitors can establish production of the household detergents in Azerbaijan in the recent future.

**Additional information and data including Reformatted Financial Statements and Financial Performance materials are available upon request.**

**When writing to AIPAF please provide a short background on your company activities and plans about the project.**