

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

**COMPANY PROFILE – JSC “MINGICHEVIR FACTORY OF RUBBER PRODUCTS”**

**June 2003**

# Contents

## Abbreviations

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### 1. Overview of Business and Operations

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### 2. Reformatted Financial Statements


---

### 3. Financial Performance

---

### 4. Pricing Analysis

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*The content 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.*

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ABBREVIATIONS

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AZM	Azerbaijan Manats
USD	United States of America dollar
WIP	Work-in-Progress
Q	Quarter of the year
The Company	Joint Stock Company “Mingichevir Factory of Rubber Products”
EBITDA	Earnings before interest, tax, depreciation and amortization
K	Thousands
B/S	Balance Sheet
P&L	Profit and Loss Statement
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
GBV	Gross book value
AD	Accumulated depreciation
NBV	Net book value

## ***Overview of Business and Operations***

### **General**

JSC Mingichevir Factory of Rubber Products was put into operation in 1970 to supply Caucuses, Central Asia and Far East of the Russian Federation with over one thousand kind of rubber-made products. Proximity to water and power resources and availability of unoccupied labor in the region were the main factors behind the decision to build the factory in Mingichevir. Built during 50s next to one of the largest power generation stations in Azerbaijan, Mingichevir is approximately 300 kilometers northwest of Baku with population of 120 thousand people. The population was occupied primarily in the power generation, textile, chemical, food and machinery industries.

Up until late 80s the Company was actively producing various types of rubber bands, belts, hoses, molded and non-molded products by employing services of over two thousand workers.

After collapse of the Soviet Union the Company faced difficulties with finding the markets for sale of its output. Most of its customers became insolvent and dormant. Rapid drop in orders put the Company in severe distress and cut in production to 5-10 percent of the factory's overall capacity. Currently, the factory is producing small amounts of rubber-made industrial and consumer products employing services of some sixty people. According to the management, current production utilizes less than one percent of the total capacity of the Company and is considered as temporary solution to keep those few qualified people involved and factory operating.

### ***Plant and equipment***

Production is being organized on the land plot of 9.56 hectares in one and three-storey main production facilities of some thirty thousand square meters which includes the following workshops:

- stock preparation workshop;

- workshop of molded and non-molded products;
- rubber bands workshop;
- rubber belts workshop; and
- workshop of rubber hoses

In addition, a number of supporting facilities exist at the Company, including:

- administrative buildings;
- repair shops;
- warehouses;
- testing and laboratory facilities;
- pumping station;
- compressor facilities;
- heating and cooling facilities, etc.

Most of the production and supporting facilities are in poor condition and require urgent repair. During our site visits we evidenced numerous roof leakages, spills of oil, deteriorated air conditioning and heating, etc.

In addition to the production facilities the Company maintains on its balance sheet facilities of social nature, including two hostels and unfinished residential building.

The average age of equipment installed at the Company is over 20 years. It is technologically outdated and poorly maintained. While most of it requires replacement, the remaining needs urgent maintenance.

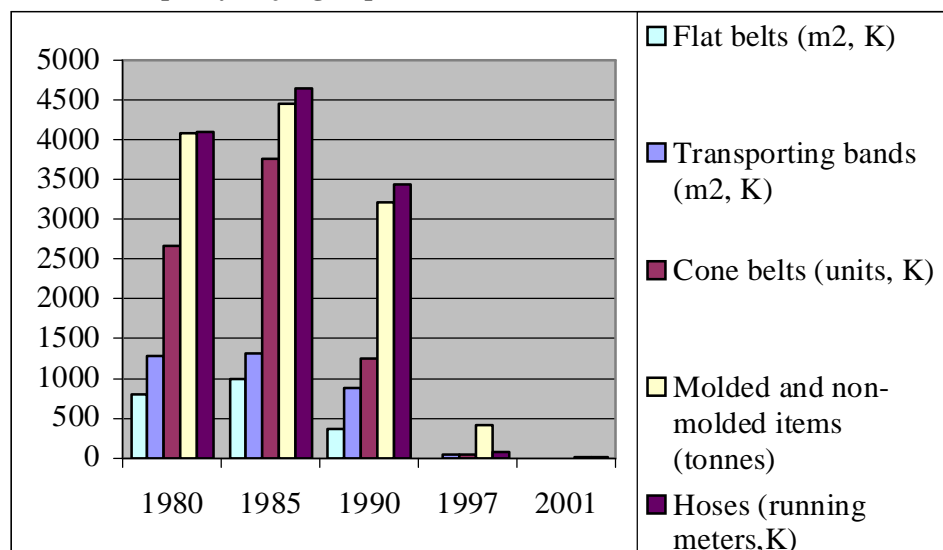
### ***Historic and current output***

The Company was built in 1970 to produce at its full capacity a large selection of rubber made products that could be classified in the following main groups:

## 1. OVERVIEW OF BUSINESS AND OPERATIONS

Product groups	Capacity	1980	1985	1990	1997	2001
Transporting bands (m2, K)	1,600	1,285	1,320	876	41	-
Flat belts (m2, K)	1,436	801	1,000	369	1	-
Cone belts (units, K)	4,054	2,665	3,770	1,249	45	-
Hoses (running meters, K)	7,195	4,099	4,640	3,434	69	2.9
Molded and non-molded items (tonnes)	4,500	4,088	4,455	3,216	415	8.4

Picture 1. Output by major groups



The output was steadily increasing during 70s and 80s. While in 1972 the Company produced goods for the amount of 8 million rubles, in 1982 the output exceeded 45 million rubles.

However, after collapse of the Soviet Union output of the Company has significantly reduced. As true for many other enterprises in Azerbaijan, the

production technology at the Company is such that use of equipment and facilities becomes not feasible at output levels below certain volumes. After collapse of the Soviet Union and loss of traditional markets the output of the Company had been gradually decreased to the levels below that level when use of production facilities and equipment became not feasible.

Currently, the Company produces a limited number of rubber made items following sporadic and unpredictable orders of the local enterprises. The items being produced include various molded items, hoses and consumer products. In 2002 total sales amounted to 368 million mantas (approx. USD 75 thousand).

### Major Suppliers

Supplies of raw materials were and continue to be predominantly from outside of Azerbaijan. According to the management of the Company, over ninety five percent of components used to be imported from Russia, Ukraine, Byelorussia, Georgia and Turkmenistan. Current overproduction of supply materials on the territory of former Soviet Union offer access to cheap and ample volumes of supply.

### Geographical Markets

Initially, the Company was oriented to supply its output to the republics of Central Asia, Caucuses and Far East. However, over time the factory reached its maximum capacity by supplying products to broader regions of Russia, Ukraine, Byelorussia and all republics of the Central Asia and Kazakhstan. Supplies to the local market of Azerbaijan did not exceed 5 percent of the overall output of the Company.

After disintegration of the Soviet Union followed by the years of economic turmoil and downturn in the markets, the Company failed to preserve its competitive power in hyperinflationary environment which completely diluted the working capital, led to losing the position on the market and, finally, ceasing operations.

## 1. OVERVIEW OF BUSINESS AND OPERATIONS

Current insignificant production is oriented to local consumers. Sales are irregular and insignificant.

Major competitors of the Company are similar production factories in Russia, Ukraine, Uzbekistan and other countries. There are more than 20 similar enterprises on the territory of the Soviet Union capable of producing the output of similar or better quality. Most of these enterprises are, however, experiencing similar problems. Some goods are also being imported from close foreign destinations, including Iran and Turkey.

The management estimates that the local market is sufficient to maintain the Company operating at a maximum of 10 percent of its original production capacity.

### *Industry Overview*

The global rubber product industry is characterized with a high level of industry concentration due to high costs of entry, low profit margin and the power exerted by established market leaders. The largest finished rubber products manufacturers, such as Bayer AG (Germany), Aeroquip Group (USA), Ruetgers AG (Germany), Hutchinson SA (France), have their own synthetic rubber production facilities.

Other major players include:

- Achilles Corp (Japan)
- Bando Chemicals Industries Ltd. (Japan)
- Mitsuboshi Belting Ltd. (Japan)
- Myers Industries Inc. (USA)
- Nagase & Co Ltd. (Japan)
- Nishikawa Rubber Co Ltd. (Japan)
- Nitta Corp (Japan)
- NOK Corp (Japan)
- Semperit AG Holding (Austria)
- Tokai Rubber Industries Ltd. (Japan)

It is expected that the pressure to increase quality and efficiency will motivate many in the industry to pursue further mergers and acquisitions. Most industrial rubber products demand is linked to the production of major durable goods, including motor vehicles, which account for about 70% total demand, industrial machinery, appliances, office equipment, off-road equipment, and aerospace and other transportation equipment.

Due to global overcapacity of rubber production industry, availability of low-cost products from South-East Asia and stagnation of industrial production across the CIS the Company is unlikely to find markets for its products outside Azerbaijan. Due to poor quality of goods produced at the factory they are unlikely to be suitable for oil and gas industry needs.

### *Investment requirements*

Clearly, 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. The management of the Company believes, however, that some equipment may be refurbished at minimum cost and used for production.

According to the management, insignificant investments are required to resume production at capacities sufficient to regain local markets. The Company requires urgent investment to repair heating and compressor facilities, refurbish circular water supply and repair the roofs in all production facilities.

Based on our discussions with the management, the Company investment requirements may be as low as USD 300 thousand to undertake refurbishment works and as much as tens of millions of dollars to bring the Company to world standard producer of rubber made goods. Thorough analysis of the potential market is required to estimate feasible capital investment in the Company.

### *Privatization developments*

According to the law on privatization, employees are allowed to buy out 15% of shares at discounted price, however, less than 2% were acquired by the existing

## 1. OVERVIEW OF BUSINESS AND OPERATIONS

and former employees of the Company. Such trend is common among other state-owned enterprises undergoing through privatization.

As for the remaining state-owned shares in the Company, the management believes the most appropriate method would be the one that would require the acquiring party to meet specific investment targets leading to rehabilitation of the Company and recreation of work places. Prior to its privatization the Company requires significant restructuring, including removal of excessive, non-core and social nature assets, restructuring and transfer of debts off the Company's balance, etc. The management believes that minor investments are required. Support of the Government and temporary protection against imports would, however, be critical prerequisites of investor interest in acquiring the Company.

According to the management there was no real interest of local and foreign investors in the past to acquire the Company.

### Organizational Structure, Management and Labor

While gradually reducing its output to becoming practically inoperative the Company shed over ninety percent of its labor force since collapse of the Soviet Union and is currently employing services of seventy employees among which about twenty are being involved in filling sporadic orders for simple to produce consumer and industrial products. The following table demonstrates sliding dynamics in the labor force of the Company:

Year	1970	1982	1991	2001	2002
No. of employees, including	320	2,452	2,300	501*	233*
Workers	n/a	n/a	2,201	455	206
Administrative personnel	n/a	n/a	99	46	27
Average salary (rubles)	135	315	n/a	20**	43**

\* Most on unpaid leave, in 2002 some 69 workers were on actual payroll.

\*\* USD.

According to the management, low pay, systematic non-payments of salaries and harsh working conditions have been the reasons for employees to look for opportunities outside the Company.

According to the management, the Company did not pay salaries since November of 2002. Currently, average monthly salary at the Company is AZM209,847 (approx. USD43). Payments are also outstanding to certain groups of former employees, including the ones on unpaid leave and those who have been injured at the Company.

The organization structure that was presented to us by the management of the Company represents a historic depiction of the management system that used to be in place at the Company but is currently not of meaningful substance.

#### *Injured and disabled employees*

The Company maintains records of 34 former employees who were injured at work and therefore eligible for regular compensation by the Company. As per

## 1. OVERVIEW OF BUSINESS AND OPERATIONS

management, the Azeri law requires monthly payments of AZM 353K to such individuals. The Company, however, pays only a fraction of such obligatory payments.

### Trade Union

Trade Union is not active at the Company.

## SWOT Analysis

### *Strengths*

The management considers the following as the strengths of the Company:

- The largest production facility in Mingechevir after textile production factory;
- Ability to produce a large variety of rubber made goods;
- Built in the region close to the target markets of Caucasus and Central Asia;
- Proximity to power and water resources;
- Ample and cheap labor resources;
- Overproduction of supplies in the region provide opportunities for low cost supplies;
- Access to railroad transportation routes.

### *Weaknesses*

- The domestic market is relatively small. Production capacity of the Company is approximately 10 times higher than domestic market requirements;
- The Government does not extend sufficient support for recovery of the Company through tax holidays and protectionism against imports;
- New technologies and equipment are required to produce competitive goods;
- Over 95 percent of supplies are to be imported from abroad;

- Production involves processes which are dangerous and harmful for health of employees. Early retirement and special food treatment are required with use of existing old technologies.
- The management believes that low demand for industrial premises offers limited opportunities for rent of redundant production facilities.

### *Opportunities*

- Restructuring and downsizing of the Company to produce smaller volumes of output for the local market;
- Ability to supply products to the local enterprises of oil and gas, transportation and chemical industries if sufficient state support is provided (customs anti-dumping barriers for imports, tax and power tariff holidays, restructuring of debts, encourage domestic production of supplies, etc.) The management estimates the local demand sufficient to support production at 10 percent of the total capacity and employing services of over 200 workers. Potential customers include Socar, Railroads, Caspar, and the enterprises of Azerkhimya;
- Improved marketing efforts to increase public awareness of the Company's production capabilities and gain additional orders.

### *Threats*

- Reducing number of qualified employees. Complex industry that requires specific qualification of workers.

**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.**