

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

COMPANY PROFILE – JSC “MINGICHEVIR IZOLIT”

June 2003

Contents


Abbreviations

1. Overview of Business and Operations

2. Reformatted Financial Statements

3. Financial Performance

4. Pricing Analysis



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.

© Ernst & Young 2003



ABBREVIATIONS

ABBREVIATIONS

AZM	Azerbaijan Manats
USD	United States of America dollar
WIP	Work-in-Progress
Q	Quarter of the year
The Company	Joint Stock Company “Mingichevir Izolit”
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 Izolit was built to be one of the largest producers and suppliers to the Caucasus and Central Asia region of electrical insulation and glass fiber laminates. The Company was commissioned in 1963, its production facilities were designed to produce a wide variety of insulation and plastic materials, including the following main groups:

- Varnish;
- Glass fiber laminate;
- Fiberglass plastic tubes and materials;
- Tread rings;
- Electrical insulation paper; and
- Pressed fiberglass materials.

The historic maximum production capacity of the equipment allowed production of 5,425 tons of glass fiber laminate and insulation materials and 8,100 tons of fiberglass plastics.

The Company supplied with its products over eight hundred customers across former Soviet Union competing with ten major producers of similar goods, including the major producer Moldizolit in Moldova, four producers in Russia, one in Kazakhstan, Georgia and Tajikistan. Mingechevir Izolit was one of the best in terms of quality of its output.

Regional demand for insulation materials, proximity to water and power resources and availability of unoccupied labor in the region were the main reasons for choosing the location of the Company in Mingichevir. Built during 50s next to one of the largest power generation stations in Azerbaijan, Mingichevir is approximately 300 kilometers north-west of Baku with population of 150 thousand people occupied primarily in the power generation, textile, chemical, food and machinery industries.

Up until late 80s the Company was actively producing various insulation and fiberglass materials by employing services of over one thousand workers.

After disintegration 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 and gradual reduction of production put the Company in severe distress. Frequent changes in the management significantly accelerated reductions in the production and loss of the traditional markets to stronger competitors. Over the last several years the Company has practically been dormant, rare and limited orders were immaterial compared to the Company's production capacities.

Plant and equipment

Production is being organized on two separate areas of 17 and 5.5 hectares located within the near distance from each other.

Production Area No. 1, the older of two, consists of the following main facilities and workshops:

Fiberglass plastic tubes and materials workshop;
Tread rings workshop;
Workshop of flat and rolling materials;
Repair workshop;
Heating and compressor facilities;
Transportation facilities;
Warehouse; and
Administrative building.

Production Area No. 2 includes the following main facilities and workshops:

Varnish steam boiling workshop;
Treatment and pressing workshop;
Heating and compressor facilities;
Transportation facilities;

1. OVERVIEW OF BUSINESS AND OPERATIONS

Warehouse; and
Administrative building.

Most of the production and supporting facilities are in poor condition and require urgent repair. During our site visits we evidenced collapsed roofing, numerous roof leakages, deteriorated air conditioning and heating, etc. According to the management, some of the facilities are not repairable.

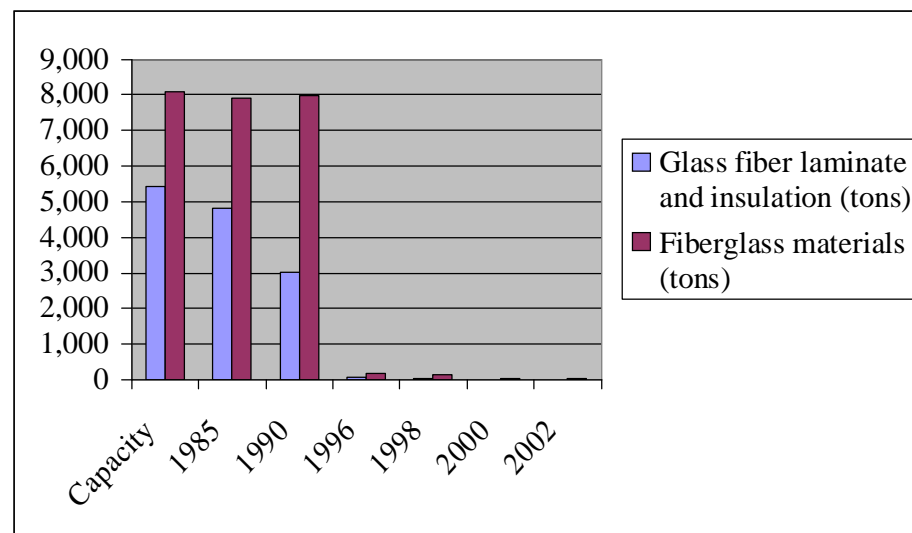
The average age of equipment installed at the Company is over 20 years. It is technologically outdated and poorly maintained. While most of it requires replacement, the remaining needs urgent maintenance.

Historic and current output

The Company was put into operation in 1963 to produce at its full capacity a large selection of laminate, insulation and fiberglass plastics. The maximum historic capacity and the actual production by groups of products follow:

Product groups	Capacity	1985	1990	1996	1998	2000	2002
Glass fiber laminate and insulation (tons)	5,425	4,815	3,012	83	14	-	-
Fiberglass materials (tons)	8,100	7,920	7,995	182	155	38	23

Picture 1. Output by major groups



The output was steadily increasing during 70s and 80s. Increase in the output was due to the growing orders distributed among similar enterprises by the central authorities. However, after collapse of the Soviet Union the output of the Company has significantly reduced, as no orders have been made and the Company had to offer its output on slowly emerging markets. 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 has gradually decreased to the levels below that level when use of production facilities and equipment became not feasible.

Currently, the Company produces a limited amount of fiberglass plastic tubes and coating materials. Recent orders include fiberglass tubes and coats for Baku underground. In 2002 total sales amounted to 289 million mantas (approx. USD 60 thousand). While in the past goods were dispatched by railroad, currently the customers collect their orders themselves.

Major Suppliers

Supplies of raw materials were and continue to be predominantly from outside of Azerbaijan. According to the management of the Company, over eighty percent of components used to be imported from Russia and Ukraine. Dependence on foreign supplies puts the Company in competitive disadvantage compared to the similar producers in Russia. The management, however, believes that the local share of supplies can be significantly increased and therefore reduce the Company's dependence on foreign supply can be reduced.

Geographical Markets

The Company was purposed to supply its output to the republics of Central Asia and Caucuses. Over time the Company expanded its geographical markets to include most of the Soviet Republics and several foreign destinations, including Poland, Bulgaria, Mongolia and Vietnam. Supplies to the local market of Azerbaijan did not exceed ten 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 reducing the output.

According to the management after several years of downturn the Company managed to boost its sales and production in 1996 thanks to the new management. However, during subsequent years the sales have dropped again. According to the management the reason behind this were the protection mechanisms set forth in the Russian Federation, the Company's main geographical market. Supposedly, the mechanisms protected Russian producers by offering domestic supplies at lower cost, supporting their technological advancement and re-equipment, and imposing import tariffs.

The management complains that no such similar support is extended by the state to the Company. Local customers often import insulation and fiberglass materials from overseas, while the Company would be able to meet their demands at comparable price and quality. There were numerous efforts to promote the output of the Company to major potential customers without significant success.

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

Major competitors of the Company are similar production factories in Moldova, Russia, Kazakhstan and Tajikistan. There are ten similar enterprises on the territory of the Soviet Union capable of producing the output of similar or better quality. Some of these enterprises are experiencing similar problems, while the others, including the ones located in Russia and Moldova continue their operations.

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

Industry Overview

While the Company did very well before collapse of the Soviet Union, the events that took place after the collapse placed the Company in severe economic distress. Other major industry players in the region include:

1. Moldizolit (Teraspol), Moldova (approximately three times the size of the Company);
2. Electroizolit (Khotkovo), Russia (approximately two times the size of the Company);
3. Electroizolit (Yekaterinburg), Russia (approximately 1½ times the size of the Company);

1. OVERVIEW OF BUSINESS AND OPERATIONS

4. Mosizolit (Moscow), Russia (approximately ½ times the size of the Company);
5. Petropavlovsky Electroizolit (Petropavlovsk), Kazakhstan;
6. Kardaniksky Electroizolit (Kardanik), Russia;
7. Malisaysky Electroizolit (Malisay), Tajikistan.

The management is skeptical about the opportunities of attracting private investor to the Company and believes that the Company should be liquidated.

Investment requirements

Clearly, the Company requires replacement of most of its equipment and significant repair works of the production facilities. 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's estimated requirement for working capital and urgent repairs do not exceed one million dollars. Construction of the new facilities may require ten to fifteen million dollars. Thorough analysis of the potential market is, however, required to estimate feasible capital investment in the Company.

Privatization developments

The management believes that prudent investor would not be interested in the Company, at existing market capacities a cheaper alternative would be to build a smaller green-field factory.

According to the law on privatization, employees are allowed to buy out 15% of shares at discounted price, however, only 1.2% were acquired by the existing and former employees of the Company. Such trend is common among other state-owned enterprises undergoing through privatization.

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 almost all of its 1,120 employees since collapse of the Soviet Union and is currently employing services of sixty management and security personnel. The following table demonstrates sliding dynamics in the labor force of the Company:

Year	1986	1996	1998	2000	2002
No. of employees, including	1,120	490	420	293	217*
Workers	n/a	382	305	204	154*
Administrative personnel	n/a	108	115	89	63*
Average salary ('000 AZM)	n/a	94	90	92	87

* Most on unpaid leave, in 2002 some 60 workers were on actual payroll.

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 December of 2002. Currently, average monthly salary at the Company is AZM 87K (approx. USD20). 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 7 former employees who were injured at work and therefore eligible for regular compensation by the Company. As per management, the Azeri law requires monthly payments of AZM 353K (approx. USD 70) to such individuals. The Company, however, does not pay such obligatory payments.

Trade Union

Trade Union is not active at the Company.

SWOT Analysis

Strengths

- The major producer of insulation materials in the Caucasus;
- Knowledge of technology and processes;
- Availability of qualified and cheap labor resources;
- Proximity to power and water resources;
- Access to railroad transportation routes.

Weaknesses

- The domestic market is relatively small. Production capacity of the Company is approximately 5 to 10 times higher than domestic market requirements;
- Cannot compete in the traditional markets of the former Soviet Union due to higher transportation costs, customs tariffs and higher costs of supplies;
- Outdated and obsolete equipment and production facilities that require refurbishment and/or replacement;
- Competition is better equipped, technologically more advanced and heavily supported by the governments;
- Most of the Company's supplies must be imported from former Soviet Republics, including Russia, Byelorussia and Ukraine. Only five to ten percent of the supplies are produced in Azerbaijan;
- Frequent changes in the management of the Company and poor marketing capabilities.
- The management does not see in the near future any realistic opportunities for subleasing Company's excessive capacities;
- The Government does not extend sufficient support for recovery of the Company through tax holidays and protectionism against cheaper and illegal imports;

1. OVERVIEW OF BUSINESS AND OPERATIONS

- 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.

Opportunities

- Production of supplies in Azerbaijan;
- Target local customers (Socar, Azelectromash). Recent order for Metrostroy demonstrated Company's ability to supply local consumers with comparable products at reasonable cost. If sufficient state support is provided (customs 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 15 percent of the total capacity;
- Restructuring and downsizing of the Company to produce smaller volumes of output for the local market;
- Improved marketing efforts to increase public awareness of the Company's production capabilities and gain additional orders.

Threats

- Competitors improving their positions in the Company's traditional markets. Further delays reduce the chance of being able to regain lost markets;
- 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.