

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

COMPANY PROFILE – GANJA MACHINERY PLANT

June 2003

Contents


Abbreviations

1. Overview of Business and Operations

2. Reformatted Financial Statements

3. Financial Performance

4. Pricing Analysis



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

ABBREVIATIONS

AZM	Azerbaijan Manats
USD	United States of America dollar
WIP	Work-in-Progress
Q	Quarter of the year
The Company	Ganja Machinery Plant
EBITDA	Earnings before interest, tax, depreciation and amortization
‘000	Thousands
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 Labour 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 Background

The construction of Ganja Machinery Plant began in 1983. The plant is located on the outskirts of Ganja. The size of the plant is significant: the fenced plot of land that accommodates the plant has the total area of 32 hectares with production buildings and facilities exceeding 75 thousand square meters.

The Company was established to produce various components used in military and defence equipment, primarily in anti-missile and anti-aircraft weaponry. The project was funded by various Ministries that oversaw military production.

Following the disintegration processes in the former Soviet Union the construction of the plant was stopped in early 90-s. By that time a number of production, administrative and service objects were erected.

On average, the construction works are 60% completed. The rate of the overall completion per major single work unit varies significantly, from 15% to 95%.

The list below shows the percentage of completion against the projected costs per major work unit:

1.	mechanical processing workshop	-	60%
2.	testing and laboratory unit	-	15%
3.	water treatment and cooling plant	-	90%
4.	auxiliary workshops	-	90%
5.	final assembly workshop	-	40%
6.	catering facility (1,000 seats)	-	60%
7.	heat and steam power plant	-	60%
8.	pumping plant	-	25%
9.	water supply unit	-	90%
10.	compressed-air plant	-	95%

The designed number of personnel to be engaged in production company was in excess of 6,700 people. The maximum staff that ever worked at the plant accounted for less than 500 people, back in late 80-s when the plant was first phased out into operation.

In 1992 by the decree of Azerbaijan Government the Company was integrated into the corporate structure of Azerigas, the state gas distribution monopoly. Since then the company operated as a business unit of Azerigas and was reorganized into a joint stock company only recently. As per the management, the foundation documents have not yet been made available to the company by the Ministry office.

Currently the plant employs 47 people with another 25 registered as being on the unpaid leave for many years.

The only operational unit is the mechanical processing workshop that accommodates a number of production sections, namely:

1. turning processing
2. milling processing
3. drilling processing
4. grinding processing
5. pressing and moulding
6. thermal processing
7. welding
8. metal smelting
9. plastics thermosetting

Other production, administrative and service buildings remain abandoned for over 10 years including heat and steam power plant that is not operational for 13 years.

There are around 300 of various pieces of production machinery installed in the mechanical processing workshop. Some of the installed equipment has never

1. OVERVIEW OF BUSINESS AND OPERATIONS

been used, the other part is under-utilised for years. Approximately half of the total production area of the workshop is a free space.

Net revenue of Ganja Machinery Plant amounted to USD 80,000 in 2002. The core product that the Company produces is gas distribution switch boxes and pressure control valves, which the company supplies to Azerigas, the major single customer. The switch box is a gas flow control unit that is used as a connector between high and low pressure gas pipe network in residential areas. Production of switch boxes and valves account for somewhat 80% of the revenue. The balance is generated by the sales of other products and services that include:

- a. production of various plastic and rubber items with a mass of 63-125 grams,
- b. bolts and other similar fixings
- c. blade wheels for well pumps
- d. vehicle maintenance, repair and overhaul

Also the company started leasing out some of the equipment to individual entrepreneurs who are engaged in production of various metal and plastic items. The amount of rental revenue was not disclosed to us. It was also mentioned by the management that the Company produces some foundry items for the Azerbaijan railroad transport and considers this activity to be growing in the future with no underlying details or statistics for such an assumption disclosed to us.

The Company has no short or long-term liabilities towards commercial banks on its balance sheet and have allegedly won a number of litigations.

Market Position

There is no a distinct product market on which the Company can be considered as a player except for gas switch boxes. In this regard Ganja

Machinery Plant appears to be a monopolist. However, the prospects of the market are limited and fully dependant on the growth of gas distribution network in Azerbaijan, which remains undisclosed to us by the management. Indirectly, based on the verbal information regarding the 2003 contract value with Azerigas, we can assume that such prospects to exist given a 25% increase in orders for gas switches.

On the other hand there is no certainty that:

- a. such growth is sustainable in the foreseeable future;
- b. the Company will be able to consume the future growth without investing in capital equipment expansion which the Company is very much unlikely to find;
- c. Azerigas would not place orders for switch boxes with another contractor if it loses control over the Company after it gets privatised as currently there is no long term contract concluded by Ganja Machinery Plant with Azerigas which could mitigate the risk of the Company's losing the major customer and the business as it is;
- d. product /technology substitution risk is low.

In other product markets the Company's share does not appear to be noticeable at all to require further comments.

Industry Overview

Given the above there is no ground to determine industry specialization of Ganja Mechanical Plant and, thus, to comment on such an industry trends and prospects. Once there is more clarity on the long-term relations with Azerigas, it would be possible to define the industry's major players and prospects.

1. OVERVIEW OF BUSINESS AND OPERATIONS

Privatisation developments

We received no documented or verbal evidence of any interested parties approaching the management in the past regarding any investment projects that could involve the Company or its assets, or intentions to buy or lease property or land except for a cotton processing venture that leased a piece of the Company's plot of land and built production work shops to produce cotton yarns. The details of this arrangement were not disclosed to us.

Management plans

There are no forward looking plans that were made available to us by the management.

In fact, every current year expectations are centred on the contract with Azerigas.

Other activities are being developed on an ad hoc basis, as and when the opportunity arises. Among such opportunities further development of relations with Azerbaijan railroads appears to be the key priority. Although the implementation plan of reaching the target does not seem to exist.

Other ideas include a possibility of assembling UAZ off-road cars however, we found no trace of any feasibility study or calculations to confirm that such an opportunity is at all viable.

Organizational Structure, Management and Personnel

Based on our interviews, the management and organizational structure of the company includes:

1. General Director
2. Chief Accountant
3. Heads of production units

We received no evidence of the existence of the Board of Directors or Shareholders' Committee or any other corporate structures that exercise management functions.

Summary SWOT Analysis

Strengths

Among the companies very few, if any, strengths the existence of the core customer, Azerigas, could be listed as the top strongest.

If the prospects of the gas distribution network in Azerbaijan are as good as they look based on the growth in orders for gas switch boxes, Ganja Machinery Plant should be actively seeking to expand its product/service portfolio by offering Azerigas other products or substitutes, or modifications, or upgrade, or maintenance in order to retain the customer from moving to another contractor.

The absence of commercial loans and other borrowing could also be considered as a positive factor. Once there is an investor willing to invest in the company, equity capital can be leveraged by borrowed funds to increase the investor's return.

Weaknesses

Limited product portfolio represents the most crucial business risk that may affect the Company dramatically should Azergas decide to place orders for gas switch boxes elsewhere or switch to an alternative technologies or device.

Poor marketing skills and market research knowledge limit the scope of opportunities, which could be open to the Company in order to increase operational assets utilisation.

Opportunities

Once there is enough evidence proving a) reasonable costs saving and b) economically viable demand for certain types of cars or vehicles the

1. OVERVIEW OF BUSINESS AND OPERATIONS

opportunity to start SKD-based production is worth being explored in more detail.

Other opportunities are to be sought based on the competitive costs analysis for various products that can be produced with the hardware available at Ganja Machinery Plant.

Threats

Threats to Ganja Machinery Plant in its current state are rather numerous both on macro and micro levels. However, as far as the short-term prospects are concerned, the loss of orders from Azerigas due to either management changes or product substitution remains the most crucial.

Other treats include enhanced depletion of the idle equipment which will result in a built-up of maintenance and repair costs and weakening competitiveness of the production.

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.