

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

**COMPANY PROFILE – “BAKU HOUSEHOLD AND INDUSTRIAL GAS EQUIPMENT FACTORY” 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.*

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## 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 | “Baku Household & Industrial Gas Equipment Factory” 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**

“Baku Household and Industrial Gas Equipment Factory” JSC was established in 1957 and was manufacturing gas household equipment from the date of being put into operation.

“Baku Household and Industrial Gas Equipment Factory” JSC was the largest manufacturer of the gas cookers and gas water heaters in Azerbaijan in the past. Apart from household gas equipment the Company was manufacturing industrial gas and oil equipment such as pumps, filters and valves.

In its best years the Company was producing over 120 thousand gas cookers and over 30 thousand gas water heaters.

Currently the Company is involved in sporadic production of gas valves, flanges, gas meter boxes, pipe plugs, pipe carriers, fire-prevention kits and wagon houses mainly for oil and gas industries.

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

The Company possesses the following main structural departments:

- Foundries and forges;
- Machine tooling;
- Small household stuff production;
- Wood working;
- Gas stoves and gas water heaters assembly;
- Valves production;
- Bodies enamelling.
- Administrative;
- Catering.

The Company owns the following main structural production and administrative buildings:

- Main production hall;
- Two administrative buildings;
- Modular warehouse;
- Foundry shop;
- 12 warehouses;
- Heating station;
- Tools hall;
- Water supply & sewerage stations;
- Garage and Dining-hall.

The total area of the factory is around 7 hectares. Buildings and facilities occupy over 32 thousand square meters.

### ***Geographical Markets***

During the Soviet times the Company was supplying the gas stoves and gas heaters to the entire market of the Soviet Union.

The standard design of a gas cooker included a gas stove and built-in gas oven. In the early 80s the oven producing equipment became obsolete but was never replaced. The Company continued manufacturing gas stoves but of such a poor design that nobody was willing to buy these stoves through the retail shops. However, thanks to the USSR government requirement for compulsory provision of all newly commissioned apartments with gas stoves and gas water heaters, the Company products were purchased by the state owned construction companies for installation in new apartment blocks.

The Company has started gradually losing the household appliances market from 1983. Since 1983 the Company started manufacturing industrial gas equipment.

Since 1990 the Company has not been producing any core products.

## 1. OVERVIEW OF BUSINESS AND OPERATIONS

The management believes that the future of the Company lies with production of oil equipment, steel profiles used in the construction, gas-meters and plastic pipes for Azerbaijan market.

Evaluation of the market for gas cookers and water heaters, the Company's core products, is given below.

**Table 1: Estimates of the current market**

| Products      | Total number of households, m | # of products per 100 households (estim.) | Total, '000 units | Average life expectancy, years | Replacements, '000 units (estim.) |
|---------------|-------------------------------|---|-------------------|--------------------------------|-----------------------------------|
| Cookers       | 2.0                           | 60  | 1,200             | 20                             | 60                                |
| Water Heaters | 2.0                           | 50  | 1,000             | 15                             | 67                                |

*Source: Ernst & Young estimates*

Referring to the table above:

- We have chosen the year 2007 arbitrarily as the year when majority of Soviet-built gas cookers and gas water heaters will go out of order and people who can afford to buy cookers and water heaters will have to purchase one.
- Number of households – estimate based on current data for Azerbaijan, based on estimated household size and population in 2007.
- Products per 100 households is a very conservative estimate of the number of cookers and water heaters divided by number of households.
- Total units – estimated approximate number of working household appliances outstanding.
- It should be taken into account that both gas and electrical appliances have the same average life expectancy.
- Total replacements – purchases for replacement – estimated number of appliances outstanding divided by replacement cycle.

There is no data available about amounts of gas water heaters and gas cookers imported to Azerbaijan. However prices for imported appliances vary from US\$100 for Iranian/Turkish-made goods and up to US\$500 for gas cookers of worldwide known brands. The low-price segment is dominated by so called 'samovar'-type (accumulating) water heaters with design similar to Ariston and made locally at many small workshops. Depending on the capacity, prices for these devices vary from US\$20 to US\$50.

Assuming that the average price of cookers and water heaters are US\$200 and US\$60, respectively, the estimated market for these household items in Azerbaijan is in the range of US\$10 and US\$20 million.

As to industrial equipment, modern gas and oil pumps, filters and valves, particularly of the large size are electronically controlled sophisticated devices and starting-up production of such equipment will require large investments in equipment and staff training and significant time to commission such production. Such large investments must be justified with the large potential market for the equipment.

### *Industry Overview*

The household gas appliances is a highly competitive market in Azerbaijan and other CIS countries. All international brands are presented in the high price end of the market. The Russian, Turkish and Iranian companies supply appliances for lower and medium price segments.

Domestic demand in cheap gas water heaters is met by small local workshops making gas water heaters of large-diameter steel pipes available at the local market.

Since the Company ceased production of gas cookers and gas water heaters in 1983 and thus lost the expertise it would be difficult to attract investments for restarting the manufacturing of these products at the factory.

## 1. OVERVIEW OF BUSINESS AND OPERATIONS

### *Suppliers*

In the past the Company was receiving all its supplies from Russia. Currently in order to fulfil the sporadically coming orders the Company is purchasing low quantities of metal and necessary equipment at the construction markets in Baku.

### *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. Some of the items that may be used include milling machines of German origin with numerical programmed control and silkscreen printing machine.

The potential investment required is summarised in the table below:

| Investment                                    | Value 000'USD |
|---|---------------|
| Major repair of all production buildings      | 500           |
| Recreation of heating and suvege system       | 500 to 1,000  |
| Purchase of the necessary moulds and licences | 300           |
| Investment into working capital               | 200           |
| <b>Total Estimation</b>                       | <b>2,000</b>  |

The above amount represents the investment required to bring the factory back into life with the old product range. A much greater investment will be required should the Company be able to justify feasibility of producing high quality products able to compete with imports.

### *Privatisation developments*

According to the management one of the German companies was examining possibility to produce gas-meters at the site. The examination results were negative. The reasons were the Company's too large territory and bad condition of the equipment and infrastructure.

Some Iranian company was also considering production of the metal reinforcement for building application the Company's site was considered to be unacceptable mainly due to the same reasons.

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

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

### *Remuneration and Personnel*

In its best years the Company was employing 1,500 persons. At present the Company has 52 active employees on the Company's payroll.

The 2002 payroll has been paid to employees and the old debts have also been partly settled. Monthly payroll is approximately US\$1.7 K.

### **Summary SWOT Analysis**

#### *Strengths*

- The Company has experience in production of gas household and industrial equipment;
- The Company has large site territory with good automotive and railroad links;
- The Company has new production hall that was hardly ever used.

#### *Weaknesses*

- The Company lost majority of skilled labour force;
- The majority of the equipment is obsolete and not capable of producing competitive products;
- The majority of the buildings are hardly usable and require major repair;
- The site is located in a long distance from Baku.

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## 1. OVERVIEW OF BUSINESS AND OPERATIONS

### *Opportunities*

- Organize production of gas-meters and other gas equipment;
- Get rid of old buildings and excessive territory;
- Consider using the site for other activities such as agriculture.

### *Threats*

- The Company cannot be a going concern without heavy support of the State;
- The household and industrial gas equipment is a highly competitive market;
- The Company's production buildings will be completely ruined if they are not repaired in the short time.

**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.**