PN-ABK-336
75439

The Koli Privatization Plan

THE KOLI PRIVATIZATION PLAN

October 18, 1991

Coopers & Lybrand has prepared
this document
for the United States Agency
for International Development, Washington, D.C.

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November 11, 1991

Mr. Peter J. Tischler
Director of Country Operations
Czech & Slovak American Enterprise Fund
Blanicka 28/1008
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Dear Mr. Tischler:

As requested, we are enclosing our privatization plan and valuation analysis of the business enterprise known as Konzervarny and Lihovary ("Koli" or the "Company") solely to assist you with your assessment and review of Koli.

The scope of our activities included the following:

- Visiting Koli's headquarters in Nove Mesto nad Metuji, approximately 135 kilometers from Prague in northern Bohemia.

- Visiting eight production facilities operated by the Company in order to assess equipment and sanitation, product quality, management, plant utilization and overall efficiency.

- Meeting with Company management to understand the Company's corporate structure and organization, product lines, markets, financial condition, future prospects and the main business risks inherent in their overall strategy.

- Analysis of historical and expected industry and economic trends.

- Translation of Czech financial records to International Accounting Standards ("IAS") as set forth in the EC's Fourth Directive for the presentation of financial information.

- Meetings with Czech government officials and the Company's banks to identify government and business leaders' objectives for privatization and the overall reputation of the Company.

- Development of a suggested ownership structure for privatization that can be implemented rapidly, satisfies the objectives of the various participants in the privatization plan, and promotes the efficient operation of the enterprise and its ability to attract additional capital.

- Valuation of the enterprise considering the income and market approaches, augmented by a sensitivity analysis and matrix presentation.

Because our review and analysis procedures were necessarily limited, they do not constitute an examination made in accordance with generally accepted auditing standards; accordingly, we do not express an opinion on any of the historical financial statements or any financial or other data included in the accompanying report, which sets forth our comments and findings.

With regard to the budgets and projections prepared by Koli's management as described above, our procedures do not constitute an examination of the compilation of such projections made in accordance with standards established by the American Institute of Certified Public Accountants ("AICPA") and accordingly we do not express an opinion as to whether such projections are presented in conformity with AICPA presentation and measurement guidelines for prospective financial statements, or as to whether the underlying assumptions provide a reasonable basis for their presentation.

Had we preformed additional procedures, conducted an audit of the historical financial statements in accordance with generally accepted auditing standards or made an examination of the compilation of budgets and projections in accordance with AICPA standards, other matters may have come to our attention that would have been reported to you. Furthermore, there will usually be differences between projected and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

Because of the confidential nature of the report, it should not be associated with the financial statements of Koli. This report is solely for your information and should not be referred to or distributed for any purpose to anyone who is not a member of management or the board of directors of Koli or the Czech & Slovak American Enterprise Fund. We have no responsibility to

update this report for events and circumstances occurring after the date of this report.

After you have had the opportunity to review this report, we will be pleased to answer any questions you may have.

Very truly yours,

Coopers & Lybrand

HTS
MDG:cl

cc: Dr. Petr Maur
Konzervarny and Lihounry

PREFACE

This is the final report of the privatization plan for Konzervarny and Lihounry ("Koli" or the "Company"), a company located in Nove Mesto nad Metuji, Bohemia. The information was collected from the Company's head office in Nove Mesto nad Metuji, and from meetings in Prague. In addition, we have also had meetings with the Director of Country Operations, the Chief Executive Officer and two Investment Officers of the Czech and Slovak American Enterprise Fund, the Deputy Minister of Agriculture for Czechoslovakia, and senior officers of both the Komercni Banka and Agrobanka.

Our report relies primarily on information supplied by Koli. We have not conducted an audit. We have, however, held interviews with all the senior management of Koli, and we have obtained supplementary information from other sources.

Throughout our extensive field work, we have been enormously assisted by the full cooperation and assistance of Koli management and staff, the Czech and Slovak American Enterprise Fund, and the United States Agency for International Development.

We are extremely grateful to them for their unfailing willingness to make time available - sometimes over weekends and holidays - to help us meet a very tight timescale.

STATEMENT OF LIMITING CONDITIONS

1. Nothing has come to our attention to cause us to believe that the facts and data set forth in this report are not correct.

2. Neither Coopers & Lybrand nor any of its employees has a financial interest in the property appraised.

3. The fee for this report is not contingent upon values reported.

4. No investigation of the title of the property has been made, and owner's claim to the property has been assumed to be valid. No consideration has been given to liens or encumbrances which may be against the property except as specifically stated in this report.

5. Information furnished by others was assumed to be reliable.

6. No responsibility is assumed for matters of a legal nature.

7. This report is for the purposes stated and should not be used for any other purpose.

8. Neither all nor part of the contents of this report shall be disseminated to the public through advertising, public relations, news, sales or any other public media without prior approval of Coopers & Lybrand.

9. In the course of our analysis, we were provided with both written and verbal information, including financial and operating data, which we accepted as accurate without verification.

10. We have used certain forecasted data supplied by management in our valuation. We have not examined the forecasted data or the assumptions underlying the forecasted data and do not express an opinion or any other form of assurance on the forecasted data and related assumptions.

11. The estimates of future operations herein are solely for use in the valuation and are not intended for use as forecasts or projections of future operations. In addition, there will usually be differences between estimated and actual results because events and circumstances frequently do not occur as expected and those differences may be material.

12. We have no responsibility to update this report for events and circumstances occurring after the date of valuation.

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1.0 OBJECTIVES

1.1 Objectives of the Report

The objectives of this report are to assess whether Koli is suitable for early privatization and if so:

- To examine different methods of privatization
- To prepare an approximate valuation
- To outline a future program for implementation.

This Section sets out the objectives of privatizing Koli. The remainder of the report is structured as follows:

- Section 2.0 is the Executive Summary of the privatization plan.
- Section 3.0 describes the Company history, the organization structure, and an economic and political overview.
- Section 4.0 describes the products and markets of Koli.
- Section 5.0 discusses the evaluation of the production plants and processes.
- Section 6.0 discusses the financial statements and includes an analysis of these statements.
- Section 7.0 examines different methods of privatization and includes recommended ownership percentages for each class of owner.
- Section 8.0 includes a discussion of the future prospects of Koli.
- Section 9.0 discusses various risk factors of privatization.
- Section 10.0 discusses the valuation of the owner's equity (net assets) of Koli.
- Four Appendices:

I. A strategic investor analysis of the Chrudim Distillery

II. An overview of investing and the privatization process in Czechoslovakia

III. A memorandum of key strategic human resources issues.

IV. Supplementary Financial Statement data.

2.0 EXECUTIVE SUMMARY

Coopers & Lybrand has prepared a privatization plan with regard to Koli, which is headquartered in Nove Mesto nad Metuji ("Nove Mesto"), approximately 135 kilometers northeast of Prague (see following Exhibit).

2.1 Objective

The purpose of our engagement has been to provide data and analysis in order to make recommendations to develop a capitalization scheme for Koli. It is our understanding that the results of our analysis will help facilitate the plans to privatize the company.

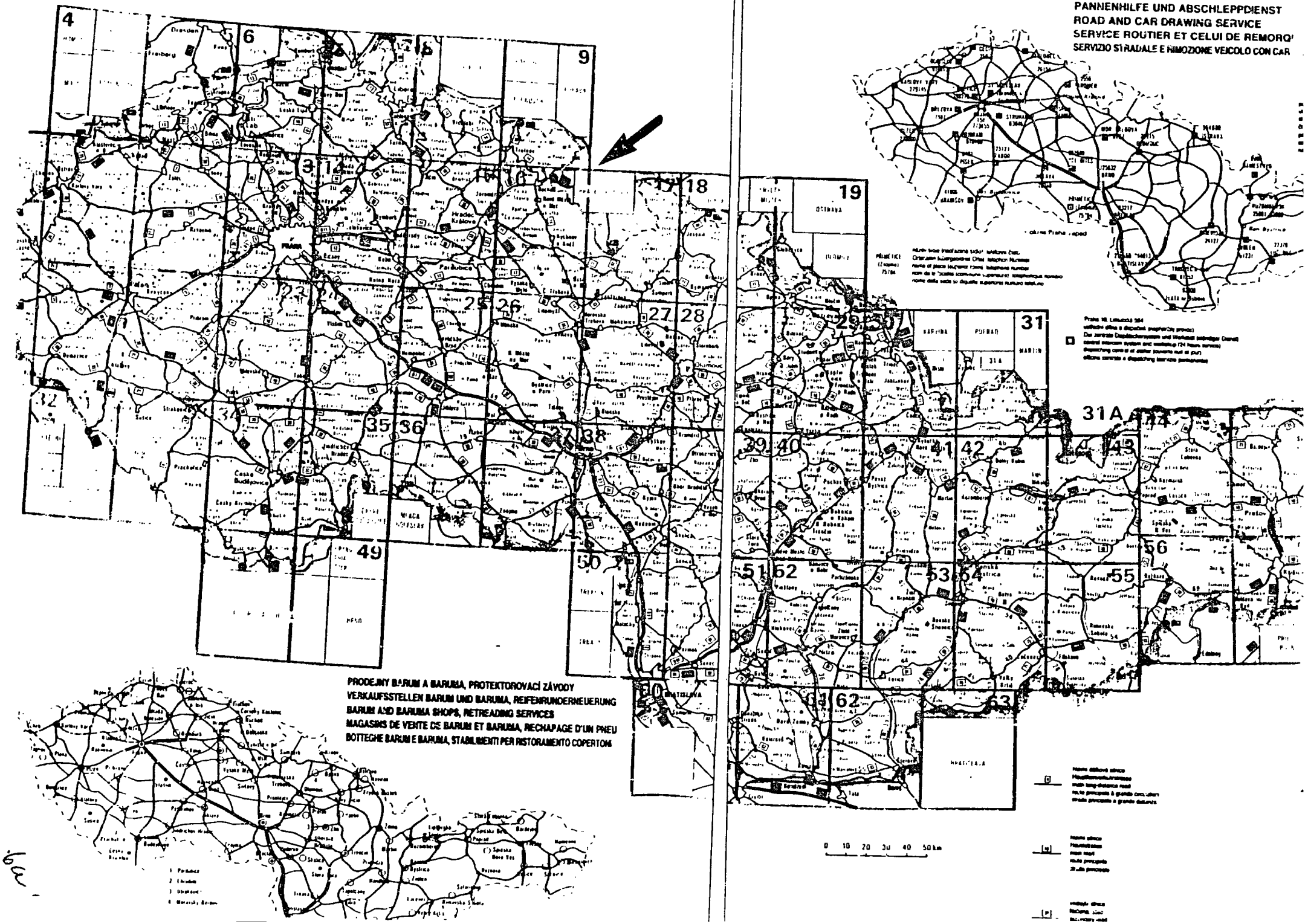
2.2 Scope

This report is in the English language. We understand that there also may be a version of this report in the Czech language. We recognize that, in translation, certain concepts may be interpreted in different ways. Where there are such differences, the English version will prevail.

The scope of our analysis has included:

- Visits to the subject business.
- Discussions with key employees concerning the business, market strategy, financial condition and prospects.
- Discussions with key managers of each department of Koli.
- An analysis of the Company's historical financial performance and management's projections for future business operations.
- An analysis of historical and expected industry and economic trends.
- Translation of Czech financial records to Western reporting standards.
- Valuation analysis considering the income approach.

SILNIČNÍ A ODTAHOVÁ SLUŽBA
PANNENHILFE UND ABSCHLEPPDIENST
ROAD AND CAR DRAWING SERVICE
SERVICE ROUTIER ET CELUI DE REMORQ
SERVIZIO STRADALE E RIMOZIONE VEICOLO CON CAR



- Valuation sensitivity analysis and a matrix presentation.
- Recommendations for a capitalization structure for Koli.

In conjunction with our work, we were provided with information that we accepted as fairly reflecting business operations.

2.3 Overview

The Company is engaged in canning fruits and vegetables, and the production of apple juice concentrate, pectin and ethyl alcohol.

The major products of the company include baby food, ketchup, canned vegetables, canned meats, canned fruits in syrup, non-alcoholic carbonated beverages and mustard.

2.4 Suitability for Privatization

We believe that Koli is a suitable candidate for privatization, because:

- It has the potential for profit and growth
- It has been operating autonomously as a "commercial" enterprise
- Its product line is diversified
- It is widely perceived in Czechoslovakia as a successful enterprise
- The Czech and Slovak American Enterprise Fund has expressed a strong desire to participate in the privatization of Koli, subject to Board approval.
- Its management and employees are in favor of privatization
- Southern Touch, a company based in the United States, is considering a significant investment in a later stage of privatization. The funds would be used for additional equipment and for modernization of the plants.

There are, however, other important features which should influence the choice of how Koli is privatized:

- There was a decrease in sales and profitability in 1991 compared with 1990. The medium term prospects are subject to considerable uncertainties including reduction of subsidies for baby food and other products, and the political and social evolution to a market economy.
- The success of the enterprise is highly dependent on the retention of key senior management.

2.5 Privatization Objectives

The evaluation of privatization methods should take into account the objectives of the Czech government, Koli management, and the Czech and Slovak American Enterprise Fund. These can be summarized as follows:

- Common objective: a successful privatization in the sense that it is both achieved and is widely perceived as being in the interest of Czechoslovakia. This includes maximizing value of the enterprise in the long-term by operating as a profit-making organization.
- Koli management's main objectives:
  - A rapid privatization to achieve freedom to pursue commercial practices
  - Participation in buying shares in the company for both management and employees.
- The Ministry of Agriculture's main objective:
  - Transfer of ownership to include Czech citizens and agricultural cooperatives.
  - The Czech government also appears to have the objective of raising cash from privatization of State owned companies. However, the priority of this objective was not clear.

- The Czech and Slovak American Enterprise Fund's main objectives:
  - To support small and medium-sized businesses and increase their potential for growth
  - To participate in strategic decisions and to assist in maximizing a company's future value
  - To earn an adequate return on investment as well as a full recovery of capital.
  - To include Company management and employees in the ownership of the Company
  - To include incentive plans so that future share participation by management and employees is a function of performance
  - To include ownership by the citizens of Czechoslovakia.

2.6 Privatization Options

There are four primary methods for the privatization of Koli:

1. Management/Employee Buy-out
2. Coupons
3. Direct Investment by a Foreign Investor
4. Direct Investment by a Domestic Investor.

2.7 Complete Management/Employee Buy-out

A 100 percent management/employee buy-out, while it would allow management and employees to own the enterprise, would not achieve the objective of maximizing value. At this stage in the development of the Company, equity capital investment is needed to upgrade production equipment as well as to improve efficiencies in the production process. A large loan to management required for share purchases would have the effect of increasing the financial

risk of the enterprise and, therefore, not maximize the long-term value of the Company.

2.8 Coupons

A complete transfer of ownership via coupons to the Czech citizens would fulfill one of the government's goals of transferring ownership to the general population. It would not, however, give management the necessary equity ownership in order to maximize value, because they would not have the proper incentives to maximize profits and increase the value of their shares. Due to its nominal issue price, coupon ownership also raises very few funds for the Czechoslovakian government. These funds could be used to develop other sectors of the economy.

2.9 Direct Investment by a Foreign Investor

The sale of 100 percent of Koli to a foreign investor would not achieve the Government's or Koli management's privatization objectives of including Czech citizens and management in ownership of the Company. The main advantage would be the availability of additional capital if a suitable foreign investor could be found. The introduction of a minority equity position by a foreign investor could provide a valuable contribution to a privatization that is consistent with the objectives of the parties involved.

There are a number of advantages for the Government in allowing a foreign investor to purchase a minority interest in Koli. First, assuming that the investor is from a similar industry and is financially secure, it would assist in the introduction of certain disciplines which would facilitate the development of a market economy. Such disciplines would include management and information systems, accounting systems, and more commercialism and competitiveness.

Furthermore, a foreign investor would be paying for its stake in the business in hard currency. These funds could be used by the Government for the development of other sectors of the economy.

In the case of Koli, these advantages could all apply. In addition, the investor could become a source of new business and products or provide an opportunity for Koli to diversify with regard to new markets, technology and know how.

2.10 Private Domestic Investor

The introduction of a private domestic investor, (i.e., a Czechoslovakian financial institution), would be desirable for purposes of introducing financial judgments and linking the goals of the Company with those of the Government, since senior officers of the financial institutions also play important roles in the development of long-term privatization strategies for the Government.

Based on our discussions with the Czech and Slovak American Enterprise Fund and Koli management, there are two financial institutions that could be investors in Koli: the Komercni Banka and Agrobanka. It is also our understanding that the National Property Fund (a government entity) could be subsidizing a portion of the equity interests of these two institutions in Koli.

2.11 Preliminary Conclusion - First Stage of Privatization

We believe that Koli is suitable for privatization. It is a commercially run enterprise with a recent record of profitability, a high public profile, and the management and employees are in favor of privatization. The way in which Koli is privatized should take into account the short and medium-term uncertainties facing the enterprise, and its reliance on key senior management.

Our recommendations for the privatization of Koli for the first stage include the following:

Investor	Ownership Percentage	Note
Koli Management	11 %	1
Koli Employees	10 %	1
CSAEF	17 %	2
Coupon Holders	25 %	3
Komercni Banka	24 % *	3
Agrobanka	10 % *	3
Restitution	3 %	3

* may be subsidized by the National Property Fund suggested at 3 percent for Agrobanka; 7 percent for Komercni Banka.

Notes:

1. Koli management and employees could be issued their shares through the Company taking out a loan. Their shares could receive a nominal dividend based on a majority decision (greater than 50 percent) of the new board of directors of Koli. Options for an additional 10 percent interest in the Company would be granted based on performance objectives established by a majority of the board of directors and would dilute existing shares on a pro rata basis. These options would have a price and exercise date to be determined by a majority decision (greater than 50 percent) of the new board of directors.

2. CSAEF shares would not receive a dividend for a period of 3 years. These shares would have a liquidation preference over all other shares.

3. Other shares could receive a dividend based on a majority decision (greater than 50 percent) of the board of directors of Koli.

In addition, voting rights would be allocated on the same basis as the ownership percentage in the equity of Koli.

2.12 Second Stage Financing

It is our understanding that Southern Touch, a company based in the United States, is considering making an investment in Koli which the Company could use for needed capital additions. If structured as an equity investment, the new investment would have the effect of diluting the ownership percentages established in the first stage of privatization.

In addition, the agricultural cooperatives could take out a loan to purchase shares of the first stage shareholders. This would achieve certain objectives of the Ministry of Agriculture.

2.13 Later-Stage Financing

After the second stage investment, the investors, depending on future growth and profits, could pursue exit strategies such as a public offering or a sale of all or a portion of their interest to a foreign investor.

2.14 Valuation

Based on the discounted cash flow models and the use of other supplemental approaches to valuation, we are recommending that the market value of 100 percent of the equity of Koli is in the range of 234 million - 346 million Czech crowns ("Kcs"). We note that the recommended value is below the stated, net book value (net asset value) of the Company but above the orderly liquidation value

of the Company. Since it is not clear whether the company owns the land that it occupies, we have not included land values in the liquidation analysis.

We also assumed that the stated balance sheet accounts are correctly represented by management and that the liabilities of the Company are not forgiven in the orderly liquidation analysis. In the event that bank loans are forgiven or liabilities transferred to other entities (i.e., TOZ loans payable to the Konsolidacni Banka), the value of the enterprise would be increased by the amount of the loans excluded.

The market value appears to be below the net book value because the expected cash flow of the enterprise does not support a higher valuation, based on the forecasts of management.

Conclusion

We have prepared an exhibit illustrating the different privatization methods and satisfaction of privatization objectives.

PRIVATIZATION METHODS	PRIVATIZATION OBJECTIVES		
	Wide share ownership	Revenue to Government in First Stage	Share participation by Management
Management Buy-out	* *	* *	* * *
Coupons	* * *	*	* *
Foreign Investor	*	* * *	*
Domestic investor	*	* *	*

* * * - best option to achieve objective
* * - partial achievement of objective
* - worst option to achieve objective

3.0 POLITICAL AND ECONOMIC OVERVIEW;[1] COMPANY BACKGROUND

3.1 Political and Historical Background

Czechoslovakia borders Poland, Austria, Germany and the U.S.S.R. The country includes the territories of Bohemia, Moravia, part of Silesia and Slovakia. Czechoslovakia was organized in 1918 after the collapse of the Habsburg empire. The new state benefitted from inheriting 70 percent of the industrial capacity of the former Habsburg empire, and it was regarded as a progressive liberal democracy.

The Soviet Red Army liberated Czechoslovakia from the Nazis in 1945. Popular gratitude to the U.S.S.R. and the increasing support for socialist ideas resulted in elections that brought the Communists to power in 1946. While the Communists initially sought a democratic state balanced between West and East, inception of the Cold War finally caused the party to crush dissent, and, as a result, there was a "Stalinization" of both the economy and the political system.

The country was almost completely nationalized in this period, which led to central economic planning and the collectivization of agriculture. As a result, the economy was redirected from the export of light, industrial goods to one of heavy industrialization oriented towards the U.S.S.R. and the Eastern Bloc countries. This strategy was subsidized by cheap energy and massive extraction of raw materials, often at a heavy environmental cost.

While this program resulted in rapid growth during the 1950s, the system began deteriorating in the early 1960s due to tensions in

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[1] Source: The Economist Intelligence Unit ("EIU"), Czechoslovakia - Country Report (London), No. 2, 1991, Country Profile, 1990-91.

economic relationships with its major trading partners. A break in relations with China led to a collapse of exports and shortages of many basic raw materials. In addition, the strategy of isolation from the West made Czechoslovakia's products increasingly obsolete.

In 1956, when Khrushchev denounced the "crimes of Stalin era", the Czech people responded by demanding greater political freedom as well as economic reform. Far reaching economic reforms were proposed to include a reorientation of the economy to light industry as well as a general decentralization of industries. Reformers wanted central planners to only focus on major strategic issues. They also advocated a return to a market pricing system. However, these reforms were neither widely understood, nor were they ever implemented. Conflict within the ruling Communist party culminated with the election of Alexander Dubcek as party leader in January 1968.

Events now known as "Prague Spring" included the virtual elimination of press censorship and calls for a radical transformation of the system to a political democracy and market economy. However, threatened by the tide of liberalization, the Soviet Union intervened in August of 1968, replacing Dubcek with a hard line leader, Gustav Husak, a Slovak communist.

Husak began a program of "normalization" - a period of repression where 500,000 of 1.65 million party members were expelled or resigned. Economic reforms were reversed, and the system reverted back to a traditional centralist mode.

With Mikhail Gorbachev's rise to power in the Soviet Union, pressures for reform became more difficult to suppress. Beginning March 1987, the party did a "reversal" and advocated the policies of Gorbachev's perestroika. However, the changes were kept within strict limits.

Street demonstrations developed throughout 1989, and the government's position became more precarious. After the collapse of communist power in East Germany, increasing protests and demonstrations ultimately forced the government's party leaders to resign in December 1989.

Beginning 1990, the "velvet revolution" ushered in a return to a political democracy and a purge of communist influence. A political consensus was then established to direct the country toward a market economy.

3.2 The Economy

3.2.1 Economic Growth in 1960s and 1970s

After 1968, central planning resumed with partial success. Growth averaged 5 percent per annum, but at the expense of a dependence on the U.S.S.R. and a decline in trade and competitiveness with the West. The economy's structural weaknesses were ultimately manifested by falling growth rates during the end of the 1970s. After an austerity and debt reduction program, the economy recovered briefly in 1983 with national income rising by 2.3 to 3.5 percent annually during the mid-eighties.

3.2.2 Economic Reform Begins

Czech economists acknowledged that problems in the economy were a result of the socialist economic system. Criticism centered on three major areas. First, there was a reliance on heavy and extractive industries. While the West was shifting towards light, high technology products, Czechoslovakia was left with products that directly competed with low-wage, newly industrialized countries in developing countries. Second, due to the Eastern Bloc's emphasis on self sufficiency and

isolation from the West, the economy produced products for which it often lacked any meaningful competitive advantage. Third, there was a lack of pricing signals to promote efficient allocation and utilization of scarce resources.

The government has made economic reform a priority with the objective of creating a full market economy. The dominant person in this process has been the finance minister, Vaclav Klaus, whose aims are:

- elimination of excess demand by permitting consumer prices to float freely;
- elimination of subsidies for industries and consumers;
- distribution of shares of state owned enterprises to the population
- restrictive monetary and fiscal measures to dampen inflation.

3.2.3 Economic Results to Date[2]

The government reported growth of net material product ("NMP") of 2.3 percent and 0.7 percent for 1988 and 1989 with a deficit of 3.5 percent experienced in 1990. NMP differs from GNP primarily due to the exclusion of services and foreign trade. Czechoslovakia is currently in the process of changing its system of reporting national statistics to be comparable to western standards.

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[2] Source: "Report of the Federal Statistical Office", January-June 1991, Czech Federal Government.

The Federal government reported a decrease of gross national product ("GNP") of 9.2 percent for the first half of 1991, with a 12 percent decline projected for the full year. For the first six months of 1991, consumer spending declined 22.9 percent and purchasing power declined a full 28.2 percent. While wages increased 13 percent during the six month period, consumer prices surged 49.2 percent following the government's elimination of subsidies and the liberalization of most domestic prices. For 1991, economists are projecting a 60 percent inflation rate. Unemployment, nominal in the past, now averages 3.4 percent in the Czech republic and 8.7 percent in the Slovak republic.

These poor economic results are due to two principal factors. First, the absorption of East Germany has reduced trade as that country shifted its economic direction to the West. However, the primary reason has been the virtual collapse of trade with the Soviet Union.

The reformers, including Vaclav Klaus, believe that the rapid changes taking place will create a system that will function satisfactorily on its own without state intervention. They believe that the market will decide which enterprises are efficient enough to survive. However, most enterprises face cash flow problems with the majority of enterprises on the verge of bankruptcy. This prompted the state Komercni Banka to announce that, as of March 1, 1991 all short term credits for inventories would be refinanced and provided extended repayment terms. This illustrates the dilemma being faced by Czechoslovakian leaders. While this policy alleviated some enterprises' problems, it also represented a diversion from strict market reforms and could ultimately be counterproductive.

3.2.4 Economic Prospects

Reduced consumer demand has reduced pricing pressure. Agreements by trade unions to minimize wage increases may temporarily stabilize the inflation rate. One of the most dramatic actions taken by the government was eliminating subsidies on most important consumer prices. While this has caused large price increases, removal of subsidies will benefit the most efficient businesses.

Previously, subsidies were financed by distributing most enterprise profits to the state. This resulted in efficient firms retaining little if any earnings for reinvestment. The removal of subsidies will allow efficient firms to retain earnings for financing future growth. However, a continued decline in consumers' standard of living is likely to increase demands for wage increases and could result in a slower pace of economic reform.

Although recent developments indicate Czechoslovakia is facing a difficult period, the long term prospects are considered good. The French Center for Foreign Trade ranked Czechoslovakia as the best risk of any East European Country for Western investors. They cited advantages such as the diversified industrial potential, the low level of debt and an attractive foreign exchange rate.

3.3 The Food Processing Industry

Agriculture has been hit hard by the economic crisis. On a year to year basis, meat purchases in January 1991 were down 30 percent, milk down 14 percent, eggs down 32 percent while only poultry showed a slight increase of 4.5 percent. No statistics on fruit and vegetable purchases are currently available. However, Koli

management indicates that consumption has declined markedly in response to large decreases in consumer purchasing power.

3.4 Company Overview

3.4.1 Company History

Koli was established in 1950 as an association of 36 small operating units processing fruits and vegetables. These operations were gradually consolidated into six major plants. In 1958, four additional plants were added to include the production of coffee substitutes, pectin, alcoholic spirits and yeast. Coffee production and yeast production were subsequently terminated and canned meat products and vinegar added. In 1986, a pectin processing plant also began operations.

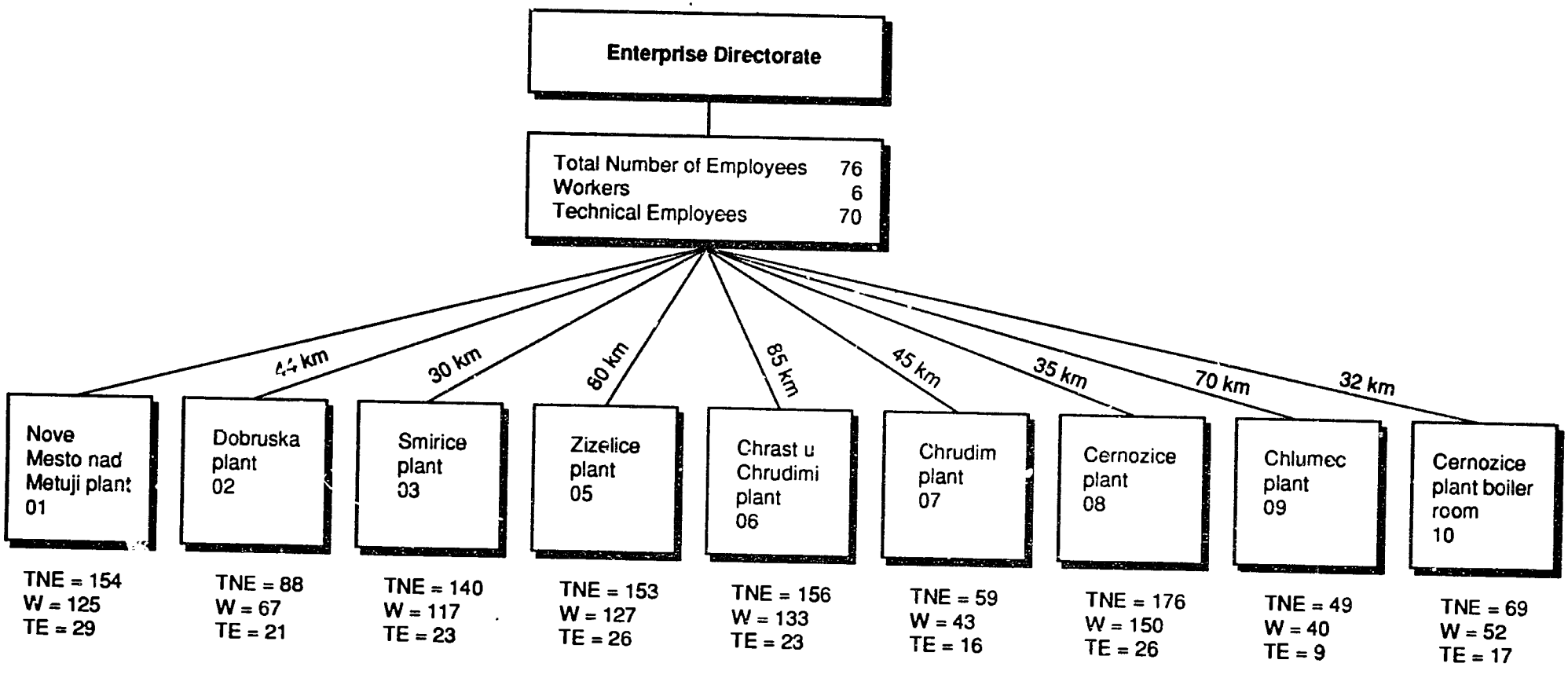
The Company consisted of eleven plants operated by enterprise management under the direction of the Ministry of Agriculture and various regional government authorities. Central planning authorities established production targets and quotas and also appointed management. Trade union leaders generally operated largely in cooperation with management and the policies of central authorities. There was no collective bargaining.

3.4.2 Current Organization Structure

Koli is in process of being reorganized as a holding company with nine operating subsidiaries (see Exhibit 3.1 on the following page). Two subsidiaries (alcohol plants) were divested on January 1 and July 1, 1991 primarily to satisfy restitution requirements to previous owners. For additional discussion of restitution requirements and liabilities, see Section 6.0, "Financial Statements and Analysis".

Exhibit 3.1

SUMMARY OF KOLI PLANT FACILITIES



Explanation:

TNE = Total number of employees
W = Workers
TE = Technical employees

224

1091-26

The holding company structure provides several benefits to Koli. First, this form facilitates the creation of joint ventures or investments for individual operating units. Second, those units that do not fit in with the enterprise's future strategies can be restructured or divested.

Third, Koli is decentralizing much of its operations to the plant level. This includes production, marketing and limited financial areas. Each subsidiary will maintain separate financial and bank accounts. Performance will be measured by requiring that financial statements be prepared consistent with Western standards. After paying expenses and corporate overhead, each subsidiary will retain 60 percent of profits while remitting the remaining 40 percent to the head office.

This structure is expected to improve the effectiveness of the company by placing authority at the operating level. However, the head office will retain ultimate authority for establishing policies and major decisions such as granting credit to large customers.

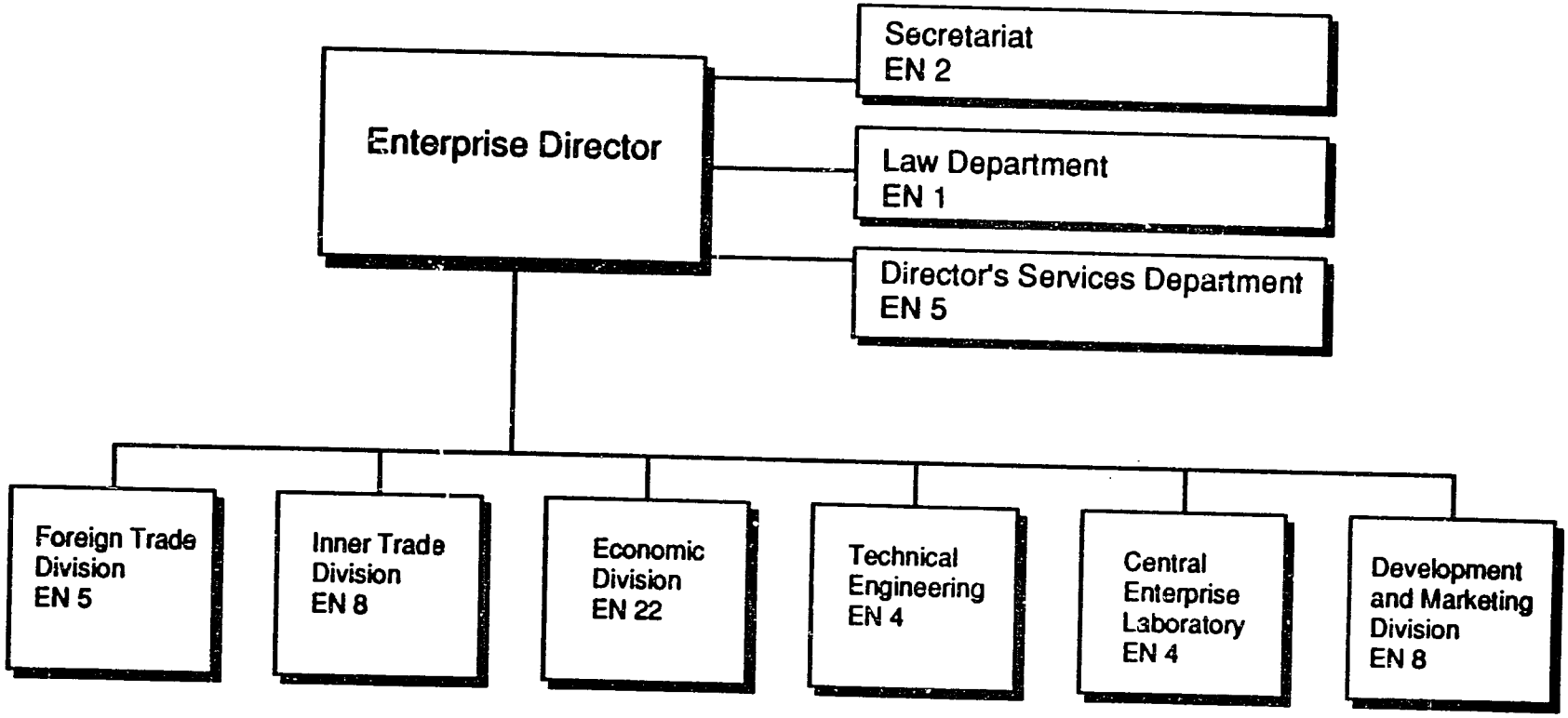
As shown in Exhibit 3.2, the corporate headquarters is comprised of domestic and export sales divisions and an economics division consisting of accounting, finance, planning and EDP. Technical engineering and central laboratory divisions are responsible for developing new products and ensuring quality control. A new division was recently established for marketing research, marketing support, advertising and promotion.

3.4.3 Employees

Koli currently has 1,180 employees of which 272 are in technical and management positions, the remaining 908 in production.

Exhibit 3.2

KOLI HEADQUARTERS STRUCTURE



EN — Employees Number

3.4.4 Management

Senior management is headed by Dr. Petr Maur. Dr. Maur appears to be highly capable of fulfilling his responsibilities as General Director. He is innovative, creative, and receptive to introduction of modern management practices for Koli.

Mr. Oldrich Hastrdlo directs Koli's Economics Division. This division includes finance, accounting, credit, collections and a computer department. Mr. Hastrdlo is developing Koli's financial planning and controls. His division is increasingly utilizing computers to track a variety of statistics and trends for each major product line.

Other members of senior management team include Jandera Jaroslav, Director of the Inner ("Domestic Sales") Trade Division Sales, Vlasakova Lenka, Director of the Foreign Trade Division ("Exports"), and Jaroslav Capek, Director of Marketing and Development.

Based on our evaluation, we believe that management is competent to effectively direct the activities of the company in a free market environment. Its knowledge of local practices, customs, and emerging markets makes a significant contribution to the effective management of the enterprise.

For a discussion of human resource issues pertinent to Koli, see Appendix III, "Key Strategic Human Resource Issues".

4.0 PRODUCT AND MARKET ASSESSMENT

4.1 Introduction

Key background considerations important in the discussion of the consumer food products segment of Koli's business include:

1. The Czech consumption of food, while retaining strong Czech characteristics, may tend to more closely resemble consumption patterns in Western Europe.

2. After a period of turmoil, as existing food marketing channels break down, and the system is privatized, the market structure may become similar to that in Western Europe. This structure is characterized by groups of large retail establishments, central warehouse operations, and common buying and merchandising programs. There may also be an emergence of large food service businesses with foreign connections. Such businesses would engage in bulk purchasing programs for restaurants, institutions and small grocers.

3. Koli's success will depend on successfully penetrating the new market channels (i.e., controlling shelf space, developing brand recognition for Koli products).

4. According to management, domestic food processors are now protected by an 8 percent duty and a 15 percent tax on imported products. This is due to expire on December 31, 1991, but a policy of substantial protection for Czech producers is expected to continue.

4.2 Overview of Koli

Koli's business is comprised of three primary segments (see Exhibit 4.1). The first, and the core of the business, is domestic sales

Exhibit 4.1
Koli Sales by Distribution Channel *

Distribution Channel	1990 Tonnage	1990 Revenue 000's Kcs	1991 Tonnage	1991 Revenue 000's Kcs	1992 Tonnage (Proj.)	1997 Tonnage (Proj.)
Domestic Consumer Food Sales	52,028 (98%)	563,353 (86%)	30,973 (88%)	450,512 (69%)	47,560 (72%)	66,160 (76%)
Domestic Industrial Sales	172 (-)	47,150 (7%)	129 (-)	23,680 (4%)	1,300 (2%)	2,400 (3%)
Domestic Co-Pack Sales	-	-	-	-	9,600 (14%)	9,600 (14%)
Export Sales-Bulk Concentrates	1,280 (2%)	36,072 (5%)	3,400 (10%)	162,366 (25%)	3,400 (5%)	3,600 (4%)
Export Sales-Other	-	-	539 (2%)	8,928 (1%)	4,250 (6%)	4,550 (5%)
Pektavit	N/A	5,681 (1%)	45 (-)	9,917 (2%)	300 (-)	600 (-)
Misc.	N/A	9,720 (1%)	-	-	-	-
TOTAL	53,480 (100%)	661,976 (100%)	35,086 (100%)	655,403 (100%)	66,410 (100%)	86,910 (100%)

* - Exclusive of sales of wine, spirits, alcohol and alcohol-related products. Revenues for these products amounted to 134 million Kcs in 1990, and an estimated 118 million Kcs in 1991.

of consumer food products to retail and wholesale consumers in the Czech Republic (see Exhibit 4.2). Domestic consumer food sales are projected to account for 88 percent of tonnage and 69 percent of revenue in 1991. Approximately 8-10 percent of these sales are in the Slovak Republic. Gross profit margins vary substantially from 22 percent to 58 percent, depending on the product.

The second segment (10 percent of 1991 tonnage, 25 percent of revenue) is the export of bulk apple juice concentrate to Western markets, a high volume, commodity type business. The product appears to meet international standards, but its growth is limited by the availability of apples for processing. These sales are now Koli's only major source of hard currency, and will play a crucial role in the company's corporate strategy.

The third segment is a small but profitable business in domestic industrial sales, primarily pectin (4 percent of estimated 1991 revenue, tonnage less than 1 percent of total tonnage, and a gross profit margin of 76 percent).

4.3 Marketing Initiatives

Koli's management has implemented two marketing initiatives.

First, the company is attempting to export consumer food products, particularly baby food and ketchup, to the former Comecon (Eastern Bloc) market. This can benefit Koli by taking up the slack from a reduced domestic economy. Exclusive of alcohol (much of which has been divested), 1991 sales to the Eastern Bloc amounted to only 2 percent of estimated tonnage and 1 percent of sales. Eastern Bloc exports are projected to account for 5 percent of Koli tonnage by 1997.

In addition, the Czech government is negotiating with the Soviet Union to barter food for oil, which could benefit food related

Exhibit 4.2
Domestic Sales by Major Product

Product	1990 Tonnage	1990 Revenue 000's Kcs	1991 Tonnage	1991 Revenue 000's Kcs	1992 Tonnage (Proj.)	1997 Tonnage (Proj.)	1991 Market Share Koli	1991 Market Share Competitor	1991 Gross Profit Margin
Baby Food	8,000 (15%)	124,569 (22%)	3,791 (12%)	63,285 (14%)	5,400	7,000	50%	30%	41%
Non-Alcoholic Beverages	9,901 (19%)	95,416 (17%)	3,966 *(13%)	43,882 (10%)	10,000	20,000	N/A	N/A	58%
Condiments:									
Mustard	2,615 (5%)	27,399 (5%)	3,432 (11%)	53,580 (12%)	3,500	4,000	17%	19%	26%
Ketchup	1,708 (3%)	47,849 (8%)	1,123 (4%)	38,211 (8%)	2,000	3,500	40%	50%	51%
Other	-	-	103 (-)	2,190 (-)	500	1,000	N/A	N/A	N/A
Subtotal	4,323 (8%)	75,248 (13%)	4,658 (15%)	93,981 (21%)	6,000	8,500			
Pickled & Salted Products	10,695 (21%)	120,620 (21%)	5,924 (19%)	54,888 (12%)	10,500	11,000	7%	26%	22%-37%
Preserves	1,366 (3%)	23,901 (4%)	1,059 (3%)	21,989 (5%)	1,500	3,000	8%	18%	26%
Compotes	7,080 (14%)	9,779 (2%)	652 (2%)	6,400 (1%)	2,000	2,000	3%	N/A	37%
Syrups	5,933 (11%)	54,734 (10%)	6,183 (20%)	72,645 (16%)	8,000	10,000	13%	20%	26%
Pecto-Gel	151 (-)	12,391 (2%)	159 (1%)	17,652 (4%)	160	160	100%	—	N/A
Vinegar	3,158 (6%)	10,854 (2%)	3,526 (11%)	24,118 (5%)	3,500	3,500	18%	N/A	N/A
Meat Spreads	1,421 (3%)	35,831 (6%)	1,055 (3%)	51,672 (11%)	500	1,000	N/A	N/A	33%
TOTAL CONSUMER FOODS	52,028 (100%)	563,353 (100%)	30,973 (100%)	450,512 (100%)	47,560 (100%)	66,160 (100%)			

Note: An estimated 8%-10% of the above is sold in Slovakia. The balance is sold in the Czech Republic.

* - Includes an estimated 2,900 tons of "CAPPY".

companies like Koli. However, due to the tremendous uncertainties facing these former communist countries, neither the short-term nor long-term viability of this export strategy is assured.

The second initiative is the development of a proprietary health food from pectin with cholesterol lowering properties called Pektavit. This is a new business, using different distribution channels than other Koli products. Pektavit will be marketed domestically through drug and health food wholesalers and internationally through importers specializing in health foods.If successful, this could contribute to Koli's overall profitability, however, the market for any such product appears limited.

4.4 Organization of the Marketing Function

One of the Company's strengths is that the individual products are generally sold through similar distribution channels. Previously, individual plants acted unilaterally in making product sales. However, effective January 1, 1991, the Company centralized controls over the marketing process. This should facilitate a more efficient company-wide sales program.

Koli has three divisions with marketing responsibilities at the headquarters unit. As the result of a reorganization in January 1991, each division head reports directly to the General Director.

4.4.1 Foreign Trade Division

The Foreign Trade Division is responsible for Koli's export sales. This division is made up of 6 employees as follows:

1 Division director - overall division responsibility
1 Assistant division director - primary responsibility is to purchase raw materials
1 Sales engineer

2 Sales representatives
1 Secretary

4.4.2 Inner Trade Division

The Inner Trade Division is responsible for all domestic sales of Koli's products. This division is made up of 8 employees as follows:

1 Division director - overall responsibility
1 Trade department manager - supervises sales force
5 Salesmen - maintain customer contacts, prepare contracts
1 Secretary

In addition, each manufacturing plant has its own trade director, who reports to the plant manager. These plant trade directors are primarily responsible for smaller accounts. However, this role is not clearly defined; in some cases they have responsibility for larger accounts and export sales. Ultimate authority, though, is retained by Koli's General Director.

4.4.3 Development and Marketing Division

The Development and Marketing Division was recently created by Koli management. This division has responsibility for many marketing support functions. This includes conducting marketing research, working with the engineering staff to develop new or enhanced products, and handling advertising and promotion. This division is made up of eight employees and two departments as follows:

1 Division Director
1 Secretary

New Product Development Department

1 Manager of Development

2 Technical Assistants

1 General Assistant

Promotion and Advertising Department

1 Manager of Marketing

4.5 Domestic Consumer Food Segment

4.5.1 Market Characteristics

The domestic market is in transition from a centrally controlled structure (with state-owned wholesalers and retailers) to a private market system. Although some private wholesalers have begun operations, 70 percent of distribution activity continues to be controlled by the state.

As part of the Czech government's program of economic reforms, prices of most consumer goods were decontrolled on January 1, 1991. Food prices experienced average rises of as much as 50 percent. Consumers responded by drastically cutting back purchases. In particular, many stockpiled supplies in late 1990 in anticipation of price increases. People also substituted less expensive products and, in some cases, began producing and canning their own food.

The erosion of consumer purchasing power was intensified by an additional factor. Many state-owned wholesalers and retailers have been intentionally maintaining low levels of inventory in anticipation of privatization. Since managements of these enterprises are prospective buyers of the companies, their motivation for carrying minimal inventories is to reduce the required purchase price for the privatized company to a bare minimum.

4.5.2 Koli Product Line

Koli initially responded to the market changes by raising prices for many products as much as 50 percent. However, demand plummeted as shown in Exhibit 4.2. Volume decreased 41 percent from 52,000 tons in 1990 to 31,000 tons projected in 1991. Domestic sales revenue is expected to decrease 20 percent from 563 million Kcs in 1990 to 451 Kcs in 1991.

The Company has a broad range of domestic consumer food products, none of which comprise more than 19 percent of tonnage or 16 percent of revenues.

Baby Food

Traditionally, Koli's single biggest product has been the sale of baby food. Management estimates that the Company controls 72 percent of the market in the Czech Republic. In 1991, shipments of baby food are expected to drop 53 percent, while revenues drop 49 percent. Sales have been hurt by several factors. While product sales suffered due to the general loss of consumer purchasing power, this problem was compounded by the elimination of government subsidies, which enabled consumers to purchase the product at or below wholesale cost. With subsidies eliminated, Koli was forced to reduce wholesale prices to mitigate this loss. In addition, input costs such as raw materials and energy increased but Koli could not pass these costs along. As a result, Koli was forced to lower prices to breakeven levels simply to reduce inventory levels.

Demand is expected to rebound as economic conditions stabilize. However, due to its previous low price, even adults had consumed this product as a snack food. As a result of the increased prices, overall consumption is unlikely to recover to previous levels.

Current marketing strategies include redesigning product packaging, conducting joint marketing programs with pediatricians, and expanding the product line. Through such steps, management forecasts volume to recover from its current low of 3,791 to 7,000 tons by 1997. They also hope to augment domestic sales with an intensive export marketing program.

Non-Alcoholic Beverages

As shown in Exhibit 4.2, Koli's sales of non-alcoholic beverages dropped 60 percent in tonnage, 54 percent in revenues. Most of the actual revenues recorded were from sale of Cappy, a product produced under a co-packing agreement with a Coca-Cola affiliate.

Management has signed an agreement with Coca-Cola AMATIL Ltd. to supply a minimum of 4,000,000 bottles per month for distribution throughout Czechoslovakia. This will be produced entirely at the Chrast u Chrudimi plant and will utilize its entire capacity.

Management also hopes to increase sales of its own carbonated, apple based beverages. However, they are competing against a wide range of fruit based drinks produced domestically and from imports.

Some of the planned growth could come from expected increases in domestic juice consumption. In support of such growth, an industry source, EuroMonitor, reported that fruit juice consumption in Western Europe increased 61 percent between 1984 and 1989. Other sources estimate that consumption in the U.S. and Europe should double in the next decade. Such trends may also apply to the Czech market.

Mustard

Sales of mustard have risen between 1990 and 1991 both in tonnage and revenues. Market share increased from 14 to 17 percent during this period. Management forecasts an increase in shipments from 3,432 tons in 1991 to 4,000 tons by 1997. The Company benefits from having three major products in this product group and a favorable perception of product quality.

Ketchup

Koli's 1991 sales of ketchup dropped 34 percent in tonnage, 20 percent in revenues. In spite of this drop, Koli has an estimated 56 percent of the domestically manufactured market. The quality of Koli ketchup is considered inferior to imported brands, therefore, the Company must compete on a price basis. The Company faces competition from foreign manufacturers and also a Czech company, SPAK, recently acquired by an Austrian concern.

Due to the substantial and increasing competition, management's plan to increase shipments from 1,123 tons in 1991 to 3,500 tons in 1997 appears uncertain.

Pickled & Salted Products

With cold refrigeration in limited supply, pickled and salted products are an important food staple for the Czech consumer. These products primarily consist of sauerkraut, vegetable mixes, cucumbers, root vegetables and vegetable salads, and represent 21 percent of Koli's revenues and tonnage in 1990. However, 1991 shipments dropped 45 percent and revenues were down 55 percent.

Koli's market share is 7 percent compared to 26 percent for the largest competitor. It is unclear to what extent Koli's drop in sales was from a drop in overall consumption rather than a loss of market share.

Management forecasts a return to 1990 sales levels by 1992 and then to level off. However, it appears unlikely that the Company can recover to 1990 levels as early as 1992.

Syrups

Syrups are used in preparing fruit drinks. Koli has experienced increases in sales of syrups in both tonnage shipped and revenues recorded. As a result, this product group represents 20 percent of company tonnage, 16 percent of revenues.

The success of this product is due to its lower cost than alternative juice forms. However, syrups have very low profit margins. Management anticipates increasing sales from 6,200 tons in 1991 to 8,000 tons in 1992 and 10,000 by 1997. In view of its poor profitability and limited market share (13 percent), management places low priority on this product group.

Other Products

Koli's other products include preserves, compotes, meat spreads, and vinegar. To varying degrees, each has poor market shares and growth prospects appear only fair.

4.6 Export Consumer Food Segment

4.6.1 Apple Juice Concentrate

The international apple juice concentrate sector has undergone dramatic changes over the past decade. During the 1970's, sales were generally confined to local markets. However, in the 1980's, sales became increasingly internationalized. As a result, apple juice is the second most widely sold fruit juice after orange juice. This growth was supported by the opening of the U.S. market to imports and the emergence of new suppliers, particularly in Eastern bloc countries. Due primarily to rising U.S. demand, world imports increased during the 1980's, reaching approximately 282,000 tons in 1984, and over 400,000 tons by 1990.

For leading world exporters, the North American market, including Canada, has now become so dominant it has a major impact on world trading prices. Poor harvests in North America, coupled with increased demand from these markets, have created opportunities for foreign producers. The favorable foreign exchange rate for the Czech crown also creates favorable trading conditions. Conversely, improved North American harvests, increases in U.S. or Canadian production capacity, or a decline in future demand for such products could hurt future sales of this product by companies like Koli.

Koli has signed contracts with five firms to sell its entire 1991 production of 3,400 tons. Koli's potential for increased sales of apple concentrate is good.

4.7 Summary and Recommendations

1. Overview

Koli management is faced with two primary concerns for long-term profitability; improving penetration of the domestic consumer food market, and increasing the sources of apple supplies, as well as other fruits, to support its concentrate export program.

2. Sales Management

a) Koli's recent formation of a centralized sales operation is essential to a successful marketing program. However, the roles of the plant trade directors may need to be better defined, with their activities limited and subordinated to a central marketing department.

b) Because sales of apple juice concentrate are crucial to the success of Koli's export strategy, it is important for the company to have one or more staff members concentrating on this area. In the event it is not possible to recruit such a specialist, one should be identified for training in this area. This person should maintain regular contact with trade sources, attend relevant trade shows, and subscribe to pertinent periodicals and literature.

3. Marketing Strategy

As discussed earlier, Koli's core business is the producing and marketing of consumer food products in the Czech Republic. Domestic consumer food products constitute an estimated 69 percent of sales in 1991. Only baby food and mustard have strong market shares and, according to management, these account for only 26 percent of consumer food products segment sales. Based on

management reports, the balance of the products have poor market shares, ranging from 3 percent to 18 percent.

Uncertain market conditions over the next several years provide the company with both opportunities and threats. Due to the Czech market's limited size and concentration, an effective strategy will require a broad range of products and an intensive marketing approach similar to that conducted in the U.S. soft drink, bakery and dairy industries.

Management appears to be concentrating its promotion efforts on the use of printed and other media. However, management also may need to focus on in-store promotion augmented by strong personal relationships with store buyers, managers and clerks.

4. Products

a) Management expects that non-alcoholic beverages will be an important area for future growth. To attain this goal, product lines must be developed and marketed by utilizing imported products on either a co-pack or other basis. Once the direction of the market becomes clear and reliable volumes are established, Koli can develop domestic production facilities.

b) Due to the uncertainty in the market, the Company may consider selling two grades of ketchup as a way to maximize and protect shelf space. Offerings could include a premium grade with Western standards as well as a regular domestic product. If the Company is unable to manufacture a premium grade, it could contract with a Western supplier to manufacture under the Koli brand name. This would help the Company maintain access to food service accounts while protecting shelf space from both foreign imports and inroads by the Czech product, SPAK.

5.0 EVALUATION OF PRODUCTION PLANTS AND PROCESSES

5.1 Overview

Plant Visits

Nine plant visits were made. Equipment and sanitation were evaluated in each plant. Ratings varied from Poor to Good.

Managers

Managerial personnel were evaluated for education and experience by personal interviews and all were judged competent for their present responsibilities with six out of nine exceeding that level.

Unutilized Line Time

Production line time available (because it is not presently utilized) varies from 33 percent to 96 percent.

Line Efficiencies

A great variation was also found in production line efficiencies. They varied from approximately 19 percent to 96 percent.

Production Procedures and Processes

All production procedures and processes could not be reviewed in detail but some changes should be made as soon as possible after recommended improvements are studied and approved. Examples are:

1. Baby food - batch production and sterilization procedure.
2. Ketchup - many aspects of production and sanitation.
3. Mustard - production, sterilization and sanitation
4. Jams and Marmalades - reduce holding time at high temperatures.

New Product Possibilities

There are many new product possibilities, some of which are line extensions and others are new lines. Both types can be produced with the equipment available. The choice of which potential new products should be chosen in the future for market testing depends directly on the Marketing department.

5.2 Introduction - Production Plants

There are nine production plants associated with the Koli enterprise at the present time. Headquarters for the organization is located in Nove Mesto nad Metuji ("Nove Mesto") which is approximately 135 kilometers northeast of Prague and the number 01 plant is located in Nove Mesto. The other 8 plants are located within a radius of eighty (80) kilometers from the headquarters, mostly in the direction of south and west.

The plants were initially numbered from zero one (01) to eleven (11) but the number 04 plant and number 11 plant were divested from the organization. The divestiture of another plant (number 07) is also planned. The number 10 plant does not produce food. It produces steam for the number 03 and 08 plants and is located between them.

5.2.1 Plant Visits

The production lines in each of eight Koli plants were evaluated for equipment and sanitation. Ratings were based on judgments of design and speed of equipment, age, condition, cleanliness, protection from pests, and hygienic conditions in general.

The results were as follows:

Plant	Location	Line	Equipment	Sanitation
01	Nove Mesto	Baby Food	Good	Fair
02	Dobruska	Ketchup	Poor	Fair
03	Smirice	Pectin	Good	Fair to Good
		Vinegar	Fair	Fair
05	Zizilice	All	Fair	Poor to Fair
06	Chrast	Apple concentrate	Good	Good
		Beverages	Good	Good
		Syrups	Fair	Fair
07	Chrudim	Alcohol	Fair	Fair
08	Cernosice	Fruits	Fair	Fair
		Jams	Good	Good
		Vegetables	Fair	Fair
		Meals	Fair	Fair
		Apple concentrate	Good	Good
09	Chlumec	Mustard	Poor	Poor

5.3 Personnel

The managers appear to be competent to carry out their responsibilities in each plant. However, some were much better prepared than the others to understand the technical reasons for

recommended future improvements and changes. The education and experience of managers are summarized in Exhibit 5.1 at the conclusion of this Section. The number of people working on different production lines varies considerably from product to product and from plant to plant. The larger relative number of workers on the line is due primarily to the absence of automatic equipment.

Exhibit 5.2 gives the summary of the number of senior managers per plant, the number of workers per line, other personnel in the plant and the total number of people working in the plant.

5.4 Finished Products and Containers

A variety of products are produced by Koli in many types and sizes of containers. A summary of the products produced by each plant with their container types and sizes is given in Exhibit 5.3 for the years 1989 - 1991.

5.5 Raw Materials

The primary fresh raw materials utilized by the Koli group include the following:

1. Fruits - primarily apples
2. Vegetables - many types
3. Meats - pork and beef

The main ingredients used by the Koli group are the following:

1. Fruit Juice Concentrates
2. Fruit Pulps
3. Vinegar
4. Sugar
5. Hydrolized Potato Starch

6. Salt
7. Spices
8. Essences (includes flavors and aromas)
9. Colors
10. Acids - mainly citric
11. Preservatives - benzoate, sorbic acid and sulfur dioxide.

Exhibit 5.4 gives the summary of the raw materials and ingredients used, their cost in 1991 and the indication of their availability.

5.6 Containers

There are five types of retail containers used by the plants in the Koli group:

1. Glass bottles and jars
2. Tin cans
3. Paper bags
4. Cardboard containers
5. Plastic containers

Exhibit 5.5 contains a summary of the types, sizes and costs of these containers and an indication of their availability.

5.7 Utilities

Costs and availability of energy (fuel and/or steam), electricity and water are shown in Exhibit 5.6.

5.8 Efficiencies

Efficiencies varied greatly from plant to plant and from product to product. Some of the highest efficiency levels are in the apple juice concentrate facilities and beverage filling lines where equipment is new (or relatively new) and most steps in the

procedure are handled automatically by machines and equipment. Low efficiencies were in plants with old equipment (in poor condition) and with a significant amount of manual labor. In a few cases, very poor condition of the equipment was evidenced by frequent stops to solve problems, but the cause of these stops could not be determined rapidly since they could be due to worn out equipment, lack of spare parts, the design of the equipment, or deficiencies in the plant's repair shop equipment.

A summary of efficiencies is given in Exhibit 5.7.

5.9 Production Procedures and Processes

5.9.1 Plant #01 - Observations on Aseptic Storage

1. The heat exchanger which sterilizes and cools intermediate products (fruit pulps and purees) is not installed correctly.

2. Storage of low Brix products in large tanks for long periods of time requires great care to prevent spoilage.

5.9.2 Plant #02 at Dobruska - Observations of Ketchup Production

1. A high percentage of benzoate (0.12 percent) is added to the ketchup batch as a part of the formula for purposes of preservation.

2. Ketchup is batched in vacuum kettle and heated to 85 degrees Centigrade and held at this temperature for 20 minutes with agitation.

3. Ketchup is held in the holding tank after batching and mixing before it is pumped to a tank above the filler bowl.

4. Ketchup is held in the tank above the filler bowl for some period of time at a high temperature and flows into the filler bowl only as needed.

5. No deaerator is used before the ketchup flows into the filler bowl.

6. There is no temperature measuring device in the filler bowl.

7. Bottles are not washed before they are filled.

8. Bottle tops and caps do not receive any sterilization treatment after they are filled and capped.

9. Bottles are not cooled before they are wrapped in shrink-wrap and palletized.

10. Bottles frequently fall in the conveyer belt after they are shrink-wrapped.

5.9.3 Plant #08 at Cernosice - Observations on the production of Jams and Marmalades

1. No trial batches are made in the laboratory the day before actual production to test texture and the exact amount of pectin required for each batch.

2. Batches are prepared in vacuum kettles to retain flavor at a low temperature but they are then held at a much

higher temperature for a considerable period of time before filling.

3. Bottles and caps do not receive any sterilization treatment after they are filled and capped.

5.9.4 Plant #09 - Observations on Mustard Production

1. The final mustard is not sterilized or pasteurized before filling.

2. A high percentage of benzoate (0.08 percent) is used as a preservative.

3. Containers and caps do not receive any sterilization after filling and capping.

5.10 Plant Evaluations

5.10.1 General

Many lines of production appear to be slow due to the use of manual labor. In order to lower costs and compete in international markets, old equipment may need to be replaced by newer and faster equipment. This will result in a reduction in manual labor and its cost. In general also, the quality of the food is improved with faster production processes.

It was also noted that the technical and production personnel do not have ready access to sources of modern technology. As a result, it is difficult for them to evaluate and improve many aspects of production, such as quality, sanitation, yield, efficiencies, processes, etc.

Some of the processes in the plants are antiquated. These include methods for handling raw materials, methods for handling batches, and heating methods for sterilization. Other important steps are missing, such as deaeration, exhausting, steam-sealing or steam-capping and inversion of hot containers to sterilize tops. There also appears to be a lack of an organized system of production planning and inventory control for non-seasonal items, but this was not confirmed.

5.11 Equipment and Sanitary Conditions

5.11.1 Plant #01 - Nove Mesto nad Metuji

Baby Food Line

Equipment: Most of the equipment on this line is good. Equipment before the filling line (raw material handling, preparation and batching procedures and equipment) can be improved and modernized.

Sanitation: Fair for a baby food plant. The baby food production areas are not up to standard. Ceilings, walls, windows, floors, overhead pipes and structures are not completely free of dirt and dust. Birds were present in the processing area. Entrances were not protected by screen doors to prevent the entrance of insects. No electric insect killers were in evidence.

5.11.2 Plant #02 - Dobruska

Ketchup Line

Equipment: Slow, old and in poor to very poor condition. Frequent stops are necessary to fix or adjust equipment. Neither a heat exchanger nor a deaerator was available.

Neither was a cooler available for lowering the temperature of bottles immediately after filling and capping. A transfer plate to shrink-wrap machine permits many sets of bottles to fall.

Sanitation: Fair

5.11.3 Plant #03 - Smirice

Pectin line

Equipment: Good equipment in the factory, some in good condition and some appeared to be in fair condition because of age.

Sanitation: In general, it is good. However, the area for the belt presses for apple pulp and the rotatory continuous filters are not thoroughly cleaned or properly protected from insects and pests.

Vinegar Line

Equipment: Vinegar is the product of fermentation of the alcohol in wine. The equipment is old and in fair condition.

Sanitation: Sanitation is fair. Production areas are not thoroughly cleaned or adequately protected from insects.

5.11.4 Plant #05 - Zizelice

General - All Lines

Equipment: Fair. Slow, old and in only fair condition. A high degree of manual labor.

Sanitation: Poor. Buildings are old and constructed in such away that they are difficult to keep clean. Especially hard to clean are the meat-handling areas because of the fat which accumulates on the floors.

5.11.5 Plant #06 - Chrast

Apple Juice Concentrate
Equipment: Good.
Sanitation: Good.

Beverages
Equipment: Good.
Sanitation: Good.

Syrups
Equipment: Fair.
Sanitation: Fair.

5.11.6 Plant 07 - Chrudim

Alcohol
Equipment: Fair.
Sanitation: Fair.

5.11.7 Plant 08 - Cernosice

Fruits
Equipment: Fair.
Sanitation: Fair.

Jams
Equipment: Good.
Sanitation: Good.

Vegetables
Equipment: Fair
Sanitation: Fair.

Ready Meals
Equipment: Fair.
Sanitation: Fair.

Apple Juice Concentrate
Equipment: Good.
Sanitation: Good.

5.11.8 Plant #09 - Chlumec

Mustard
Equipment: Poor.
Sanitation: Poor.

Apple Concentrate
Equipment: Good.
Sanitation: Good.

Syrups
Equipment: Fair.
Sanitation: Fair.

Beverages
Equipment: Fair.
Sanitation: Fair.

Alcoholic Beverages
Equipment: Fair.
Sanitation: Fair.

5.12 Unutilized Time

A great deal of production time is available on most lines. It ranges from about 33 percent to about 96 percent. A summary is given in Exhibit 5.8.

5.13 Percentage of Contributing Items to Cost of Selected Products

Items contributing to costs of selected products vary greatly with regard to their percentage of the total cost of the different products. A summary is given in Exhibit 5.9. Those items with the highest percentage contributions give the greatest promise for cost savings.

5.14 New Product Possibilities

New product possibilities are listed in Exhibit 5.10.

5.15 Capital Expenditures

Estimated capital expenditures for modernization of Koli are included in Exhibit 5.11.

5.16 Recommendations for Enhancements to the Production Process

1. Give special immediate attention to the sanitation, hygiene and appearance of the baby food line and area and the CAPPY line and area because of their importance.

2. Facilitate contact of technical and production staffs with modern technological developments through consultants, books, literature, technical meetings, and visits to modern facilities, some of which can be arranged through the American Embassy.

3. Improve the sanitation, hygienic conditions and appearance of all plants as soon as economically possible.

4. Eliminate the use of preservatives by the proper heat sterilization of products and containers.

5. Review procedures followed for each product and revise by modern technological standards.

6. Add to the Quality Control procedures already in use the objective measurement of consistency (viscosity), texture, color and other important characteristics of raw materials and finished products, especially tomato paste, ketchup, baby food, and jams and marmalades.

7. Study the possibility of packaging products which must be sterilized over 100 degrees Centigrade (usually 121 degrees Centigrade in an autoclave) in plastic bags called "Retort Pouches" instead of cans or jars since they cost so much less.

8. Use heat exchangers instead of batch heating to sterilize products before filling to reduce long exposures of products to high temperatures. Hot filling followed by short special heat treatment after filling and capping can be substituted for a long tunnel heating which uses much energy and damages quality.

Exhibit 5.1

Summary of Education and Experience of Managers*

Plant	Managers with MSc.	Managers with High School	Managers with Basic Ed.	Experience Average (Range)
01	3	2	0	12 (2.5-30)
02	1	3	1	20 (11-30)
03	2	2	0	N/A
05	1	4	0	17 (2-28)
06	1	4	0	11 (5-17)
07	1	4	0	17 (7-25)
08	4	1	0	N/A
09	0	5	0	9 (5-17)

* ... Plant Managers or Directors specifically interviewed were the following:

01 Nove Mesto:	Vladimir Darebnik
02 Dobruska:	Mirek Dyntar
03 Smirice:	Pavel Ptacnik
05 Zizelice:	Anezka Fislova
06 Chrast:	Vaclav Rocek
07 Chrudim:	Josef Divis
08 Cernosice:	Vaclav Smetana
09 Chlumek:	Milan Havranek

Exhibit 5.2

Summary of Personnel per Plant, Managers, Workers per Line of Production shift, Other.

Plant	Number of Managers	Line	Workers per shift	Shifts Number	Other	Total
01	5	Baby Food	18	**	N/A	135
		Tom. Juice	18	*		
		Spreads	18	*		
02	5	Ketchup	17	**	18	73
		Beverage	20	****		
03	4	Pectin	8	***	10	125
		Vinegar	13	*		
05	5	OM370	N/A	*	33	132
		OM720	N/A	*		
		S4/1	N/A	*		
06	5	Syrup	14	**	N/A	159
		Cappy+Drinks	24	N/A		
		Concentrate	22	*		
07	5	Ethylalcohol	4	N/A	N/A	49
08	5	Stewed fruit	63	*	36	180
		Vegetables	72	*		
		RTE	28	*		
		Jams&Marmel.	30	*		
		Concentrate	21	*		
09	5	Mustard	29	**	8	52

* .... line produces only sometimes
** .... line produces sometimes in 2 shifts
*** .... line produces sometimes in 3 shifts
**** .... line produces in 1 shift
RTE .... Ready-to-Eat Meals

Note: Since there are differences in the numbers of shifts on various lines throughout the year, and because of seasonality of production and changing marketing demands, the total number listed in the last column will normally not be the sum of the other columns for most plants.

Exhibit 5.3

Summary of Products Types Produced by Each Plant and Their Containers for 1989, 1990 and 1991.

Plant	Class of Product	Containers Type	Containers Size	Amount 1989	Amount 1990 [in MT]	Amount 1991	
01	Baby Food	GJ	TO205	8900	9100	5000	
	Tom. Juice	T	P1/2	300	510	200	
	Spreads	T	P80				
			P120	500	500	100	
02	Ketchup	GB	330g				
			380g	1395	1813	1135	
	Beverage	GB	0.71	6701	5715	1100	
03	Pectin	PP	25g				
			40g	200	218	200	
	Vinegar	PB	1l	2617	3144	3157	*
05	RTE	T	P1/2				
			P1/1	1488	1264	433	**
	Spreads	T	P80				
			P120	245	98	23	**
	Vegetables+	GJ	OM280				
	Cucumber+		OM370				
	Mushrooms		OM720				
			S4/1				
			OK4/1				
		T	P5/1	4160	1902	3124	**
	Orange Juice	GJ	TO720	0	223	147	**
06	Syrups+						
	Fruit Wines	GB	1l	7500	7500	5202	**
	Cappy+	GB	0.21				
	Carb. Bever.		0.321	7000	7000	4566	**
	Concentrate	TN	N/A	800	800	N/A	**
07	Ethyl alcohol	TN	N/A	404	404	147	**
							***

Plant	Class of Product	Containers Type	Size	Amount 1989	1990 [in MT]	1991
08	Concentrate	N/A	N/A	N/A	N/A	N/A
	Apple pomace	N/A	N/A	N/A	N/A	N/A
	Jams and	T	P12kg			
	Marmalades	GJ	345g			
	Stew.Fruits	T	P1/1			
		GJ	OM370			
			OM720			
			S4/1			
			TO735	N/A	N/A	N/A
	Vegetables	GJ	OM370			
			OM720			
			S4/1	N/A	N/A	N/A
	RTE	GJ	TO460			
		T	P1/2			
			P1/1	N/A	N/A	N/A
09	Mustard	GJ	TO290			
		PC	120g			
			200g			
			400g	2888	3297	3800

* ... in 000's of liters
** ... for Jan-Aug 1991
*** ... in cubic meters

GJ ... glass jar
GB ... glass bottle
T ... tin can
TN ... tank (fiberglass or stainless steel)
PC ... plastic container
PB ... plastic bottle
PP ... paper bag

Exhibit 5.4

Summary of main raw materials and their prices in 1990 and 1991

Type	Plant Using it	Price 1990 per kg,l	Price 1991 per kg,l
Apples	01,06,08	2.95	3.35
Other Fruits	01,06,08	8.20	10.85
Vegetables	01,02,05,08	9.86	12.00
Meats	01,05,08	34.08	42.80
Vinegar	02,05,08	2.63	3.90
Sugar	01,02,05,06, 08,09	8.20	10.97
Mustard Seed	05,09	9.10	8.05
Tomato Paste	02,05	17.60	20.75
Hydrolyzed Potato Starch	02	16.96	17.72

Exhibit 5.5

Summary of Containers, their Sizes and Costs before 1991 and in 1991, with their Availability

Container	Size	Cost before 1991	Cost in 1991	Availability
plastic	120g	N/A	0.37	G
	200g	N/A	0.51	G
	400g	N/A	0.94	G
plastic cap	120g	N/A	0.135	G
	200g	N/A	0.135	G
	400g	N/A	0.376	G
glass jar	TO290	N/A	1.33	L
cap for glass	TO290	N/A	0.484	L
tin can	9 kg	N/A	16.40	G
	P1/2	1.15	3.093	G
	P1/1	1.695	3.345	G
	P12	10.50	16.90	G
glass jar	OM720	0.895	1.18	G
	OM280	0.59	1.18	G
	OM370	0.63	1.20	G
	OM460	0.685	1.40	G
	TO375	0.655	1.25	G
	TO735	0.94	1.85	G
	S4/1	3.12	6.24	G
cap for glass	OM68D	0.174	0.40	G
	TO66	0.374	0.71	G
	TO82	0.429	1.012	G
	TO83D	0.254	0.71	G
	ACN83	0.338	0.97	G
	PANO4/1	0.486	1.012	G
tank	200l	N/A	200	G
	600l	N/A	350	G
fibre-glass tank	25l	N/A	96	G
glass bottle	0.2 Cappy	1	2.70	G
	0.32	1	1.70	G
	1l	1	2.40	L
glass	OK1/1	1.16	2.56	G

Container	Size	Cost before 1991	Cost in 1991	Availability
tin can	P80	0.75	1.24	G
	P120	0.56	0.83	G
glass bottle	TO330	N/A	1.88	G
glass jar	TO205	0.60	0.90	G
cap for glass	TO205	0.22	0.46	G

L ... limited
G ... good

Exhibit 5.6

Total Consumption of Steam, Electricity and Water with their Costs in 1990 and in 1990 and 1991

Plant	Amount in 1990	Cost per Unit 1990	Cost per Unit 1991	Availab.	Quality
01-Steam	60035	107.32	178.38	G	
-Electr.	1286	0.63	2.11	LP	
-Water	N/A	N/A	4.50	G	G
02-Steam	13994	60.52	N/A	G	
-Electr.	400	0.66	N/A	G	
-Water	N/A	N/A	N/A	G	N/A
03-Steam	146631	91.66	118.00	G	
-Electr.	4343	0.53	1.29	G	
-Water	N/A	N/A	2.52	G	G
05-Steam	39013	101.43	157.92	G	
-Electr.	1060	0.59	1.58	G	
-Water	118000	5.82	9.83	G	G *
06-Steam	41557	119.90	188.11	G	
-Electr.	1033	0.78	2.55	LP	
-Water	N/A	3.70	4.50	G	G
07-Steam	74483	79.26	N/A	G	
-Electr.	740	0.53	N/A	G	
-Water	N/A	0.46	0.51	G	N/A **
08-Steam	80808	N/A	118.00	N/A	
-Electr.	1468	0.58	2.50	N/A	
-Water	N/A	1.75	5.50	N/A	N/A
09-Steam	1475	135.60	N/A	G	
-Electr.	229	0.61	1.14	G	
-Water	3856	3.72	4.34	G	G

G ... good
LP ... little problems
* ... also wasted water
** ... water for cooling
Units: Steam .. 1GJ
Electricity .. 1MWh for Amount
.. 1kWh for Cost
Water .. 1 cubic meter

Exhibit 5.7

Efficiencies of selected Production Lines (1991)

Plant	Line	Actual Average per min	Maximal Capacity per min	Efficiency based on Maximum [percent]
01	Baby Food	276	450	61
	Tom. Juice	160	250	64
	Spreads	131	250	94
02	Ketchup	51	270	19
05	Spreads (80g+120g)	102	108	94
	Meat & RTE	25	26	96
	Juices	33	60	56
06	Syrup	10.4	12.5	83
09	Mustard	26	33	79

Exhibit 5.8

Unutilized Time of Selected Lines (1991)

Plant	Line	Shifts NOT Utilized 1991	Maximum Shifts Available	Percent Not Utilized
01	Baby Food	235	705	33%
	Tom.Juice	670	690	94%
	Spread	670	720	93%
05	OM730	600	720	83%
	OM720	550	720	76%
	S4/1	608	720	84%
	Spread	635	720	88%
	Meat&RTE	635	720	88%
	Juice OM720	695	720	96%
06	Cappy+Drinks	240	720	33%
	Concentrate	660	960	69%
07	Ethylalcohol	N/A	N/A	
08	Stew. Fruits	445	720	62%
	RTE	390	720	54%
	Jams&Marmel.	510	720	71%

Exhibit 5.9

Summary of Percentage Costs for Main Products

	Pectin	RTE Leco	Ketchup	Syrup
Raw Material	6.1	72.8	21.3	53.5
Bought Semi-products	17.5		26.0	26.2
Containers	0.1	7.3	22.8	0.9
Semi-prod. of other branch	0.6		0.4	
Semi-prod. of this branch			5.6	
Direct Wages	1.7	1.5	1.0	0.8
Social Insurance Fees	0.9		0.5	
Technological Burden			11.0	
General Production Burden	68.1			
Administrative Burden	2.0		4.2	
Supply Burden	0.5		4.4	18.1
Selling Burden	2.2	3.8	2.8	

	Jam	Canned Fruit	Spirit	Vegetab. (Paprika)
Raw Material	74.4	59.7	48.2	48.3
Bought Semi-products				
Containers	0.5	11.5	17.0	
Direct Wages	0.8	5.7	7.6	1.0
Social Insurance Fees				0.5
Technological Energy				20.8
General Production Burden				22.3
Administrative Burden				4.3
Supply Burden				2.9
Selling Burden	2.83	12.5	12.4	

	Vinegar	Mustard Fullfat	Apple Concentrate
Raw Material	26.0		80.6
Bought Semi-products	1.2		15.0
Containers	2.9	61.6	
Semi-prod. of this branch	46.7	19.9	
Direct Wages	0.7	1.7	0.2
Social Insurance Fees	0.3	0.8	
Technological Burden		3.8	
General Production Burden	16.3		
Administrative Burden	3.3	1.6	15.0
Supply Burden	0.7	1.0	
Selling Burden	2.2		

Exhibit 5.10

Summary of New Product Possibilities

Plant	New Products
01	pulp juices marmalades other types of meat spreads
02	new types of ketchups new types of dressings
03	expansion of Pectin types (low-methoxy and others) expansion of medical products assortment
05	vegetable - Kvetuska salad (made of cauliflower) - vegetable soup rational nutrition products - Soya products new types of canned meat products canned mushrooms (champignons)
06	SPRITE and FANTA drinks - with Coca Cola Corp.
07	wastes used as animal feed using of heat as a medium in haals for flower growing
08	Cottage Goulash with lower meat contents Stewed pumpkin with pine-apple aroma Apple fruit juice - Jantar
09	new mustard types: - mustard with ketchup - mustard with smoked meat - mustard with ham, etc.

Exhibit 5.11

Summary of Capital Expenditures Required by Plants (1991)

Plant	Demand	Expenditure [in 000's Kcs]	
01	to put boilers on gas	10 000	
	water cleaning station	40 000	
	aseptic storage	10 000	
	other	10 000	
	TOTAL	70 000	
02	improving of ketchup line	1 700	
	other	5 000	
	TOTAL	6 700	
03	enlargement of Pectin production for 500MT/year	70 000	
	equipment repairs	5 000	
	new apple pomace warehouse	15 000	
	TOTAL	90 000	
05	N/A		
06	N/A		
07	total improving of whole plant	100 000	
08	N/A		
09	equipment for new containers	2 280	
	new intermediate products production	1 650	
	new fillers	1 500	
	new complete lines (3x)	6 000	
	TOTAL	11 430	
Koli	all capital expenditures		278 100

6.0 FINANCIAL STATEMENT PRESENTATION

KOLI: RESTATEMENT OF HISTORICAL FINANCIAL INFORMATION IN ACCORDANCE WITH INTERNATIONAL ACCOUNTING STANDARDS

Section I: Scope of work

1. We have restated the Czechoslovak financial statements of Koli at 31 December 1990, 1 January 1991, and 31 August 1991 in accordance with International Accounting Standards ("IAS") and the EC Fourth Directive for the presentation of financial information.

2. We have not performed any audit procedures.

3. We have visited the factory in Nové Město and spoke to the following members of Koli's senior management and Finance Department:

Name	Title
Ing Petr Maur	Managing Director
Ing Oldřich Hastrdlo	Finance Director
Ing Jaroslav Čapek	Marketing and Development Director (former Production Director)
Mrs Dvořáková	Chief Accountant
Ing Jitka Rýdlová	Chief of Financing Department
Mr Kubík	Responsible for accounting methodology

4. We draw to your attention that in performing these restatements of financial information we have relied to a greater degree on management representation than would normally be the case. This reflects the relatively short period of time allocated to this part of the overall assignment together with the complication of the separation of two divisions during the period under review (see below).

Section II: Comments on divisions which have gained their independence or have been restituted during the 20 months ended 31 August 1991

Koli:

5. In 1990 Koli was comprised of 11 divisions.

6. On 1 January 1991, one of the three distillery divisions comprising Koli gained its independence (division name: Hobé, division number: 04).

7. On 1 July 1991, a second of the three distillery divisions was restituted to a representative of its former owner (division name: Kord, division number: 11).

8. In addition, during 1991 two additional partial restitutions of divisions of Koli occurred, being a workshop (division name: Nové Město, division number: 01) and a sauerkraut production facility (division name: Dobruška, division number: 02). Partial restitution has not resulted in either of these plants ceasing operations.

9. We set out below an analysis of profit before tax and profit allocations by division for both the year ended 31 December 1990 and the six months ended 30 June 1991 (source: management reports):

Plant No	Business	Profit/(loss) before tax and profit allocations		% of total	
		Year ended 31 December 1990	6 months ended 30 June 1991	Year ended 31 December 1990	6 months ended 30 June 1991
		000Kcs	000Kcs		
01*	Baby food	30,239	(9,437)	36	(77)
02*	Ketchup, soft drinks	18,015	3,431	21	28
03	Pectin	17,771	5,572	21	45
04*	Distillery	6,537	--	8	--
05	Vegetables	717	1,817	1	15
06	Beverages	1,032	322	1	3
07	Distillery	(698)	7,353	(1)	60
08	Pickles	2,038	(1,500)	2	(12)
09	Mustard	2,300	1,598	3	12
10	Heat plant	(1,207)	(914)	(1)	(7)
11*	Distillery	1,026	3,177	1	26
Subtotal		77,770	11,419	92	93
Headquarters		6,888	835	8	7
Total		84,658	12,254	100	100

* Referred to above

10. The implication of restitution is that certain land and fixed assets are returned to [representatives of] the former owner for nil consideration.

11. We draw to your attention that Koli does not include land in its balance sheet. We have been informed that Koli has not

identified the location and size of land for which it previously had "management's right of use", including that portion which has been the subject of successful restitution claims and that portion for which there will be no restitution.

12. The net book value of fixed assets transferred at nil consideration due to restitution is immaterial:

	000 Kcs
Nové Město (01)	139
Dobruška (02)	226
Kord (11)	403

13. Restituted fixed assets are reflected in the 31 August 1991 Koli balance sheet.

14. The outstanding issues relating to the above restitutions do not appear to represent a significant financial contingency.

Section III: IAS Adjusted financial statements

15. We set out on the following pages:

- The adjusted balance sheets at 1 January 1991 for Koli, exclusive of Hobé (which gained its independence as of that date), as well as the adjusted balance sheets at 31 August 1991. We have used the January 1991 balance sheet rather than the 31 December 1990 balance sheet (excluding Hobé) as we have not been given any information relating to the profit allocations attributable to Hobé for the year ended 31 December 1990.

- The adjusted profit and loss accounts for Koli, inclusive of Hobé, for the year ended 31 December 1990 and exclusive of Hobé for the eight months ended 31 August 1991. We note that it is not possible to compile a complete profit and loss account for Hobé for the year ended 31 December 1990 as the management of Koli can not identify the profit allocations attributable to Hobé. However, sales and profit before tax and profit allocations are readily available being 100 million Kcs and 6.5 million Kcs, respectively.

16. We have made the following IAS adjustments to the above financial statements:

- Reclassification of the write off of recreational facilities to nil net book value in 1991 from funds to the profit and loss account (depreciation)

- Creation of provisions for doubtful debts

- Reclassification of funds in the nature of accrued expenses to wages payable

- Elimination of the profit allocated during the period as shown on the "active" side of the balance sheet against profit for the period shown on the "passive" side of the balance sheet

- Creation of a provision for slow-moving and obsolete inventories

- Write off of residual inventories in Kord not purchased by the representative of the former owner.

17. After making the above adjustments the net assets of Koli at 1 January 1991 and 31 August 1991 are as follows:

1 January 1991	31 August 1991
000Kcs	000Kcs
775,066	779,488

Using the exchange rate 30.5 Kcs : $ 1:

1 January 1991	31 August 1991
000$	000$
25,412	25,557

18. After making the above adjustments the sales, profit/(loss) before tax and profit/(loss) after tax of Koli (exclusive of Hobé) for the year ended 31 December 1990 (inclusive of Hobé) and the eight months ended 31 August 1991, for the eight months ended 31 August 1991 are as follows:

	Year ended 31 December 1990 000Kcs	Eight months ended 31 August 1991 000Kcs
Sales	793,608	487,772
Profit before tax	76,888	14,663
% Sales	9.7%	3.0%
Profit after tax	35,993	4,267
% Sales	4.5%	0.9%

19. We draw to your attention that:

- Under Czechoslovak law, tax losses cannot be carried forward into future periods.
- The tax charge shown above is the relevant charge on the Czechoslovak tax base.

Adjusted balance sheets

20. We set out on the next page adjusted balance sheets for Koli.

	31 January 1991 000Kcs	31 August 1991 000Kcs
FIXED ASSETS		
Tangible fixed assets	683,161	667,984
Investments	9,100	9,110
Total fixed assets	692,261	677,094
CURRENT ASSETS		
Cash	14,645	27,124
Accounts receivable (net)	91,472	89,798
Prepaid expenses and other receivables	513	448
Taxes refundable	7,203	3,940
Inventories (net)	415,902	356,190
Total current assets	529,735	477,500
TOTAL ASSETS	1,221,996	1,154,594
CURRENT LIABILITIES		
Accounts payable	122,904	56,472
Taxes payable	57,818	2,045
Accruals & other payables	18,530	68,667
Current portion of loans	107,973	113,523
Total current liabilities	307,225	240,707
LONG TERM PORTION OF LOANS	139,705	134,399
TOTAL LIABILITIES	446,930	375,106
NET ASSETS	775,066	779,488

21. We discuss below the individual line items in the adjusted balance sheets.

Tangible fixed assets

22. Tangible fixed assets are valued at cost less accumulated depreciation. Depreciation is charged on a straight line basis so as to write down fixed assets over their estimated economic lives.

23. Tangible fixed assets are comprised as follows:

	1 January 1991 000Kcs	31 August 1991 000Kcs
Koli (excl. Hobé)	683,161	667,984

24. Czechoslovak accounting regulations prescribe the useful economic lives to be used for different types of fixed assets. These prescribed lives are, in some cases, significantly longer than those adopted in Western Europe or in USA. Coopers & Lybrand Prague do not normally make IAS adjustments to reflect the difference in estimated economic lives for a number of reasons, the principal one being that Czechoslovakia has a long tradition of engineering expertise and repairs and maintenance of plant and machinery. Large stocks of spare parts are kept in order to enable machinery to stay productive, sometimes relatively efficiently, long after such machinery would have been scrapped elsewhere. It has been our view that if an adjustment is to be made it should be estimated after referring to the results of any technical due diligence.

25. We set out below both the estimated economic lives and the depreciation rates used by Koli in 1991:

	Estimated economic life (in years)	Depreciation rate %
Land		NA
Non production buildings	77	1.3
Production buildings	50	2.0
Boiler room	25	4.0
Structures: chimney	30	3.3
waste water treatment structure	25	4.0
roads	77	1.3
railroad	30	3.3
water pipes	67	1.5
sewers	20	5.0
Energy machines	12-20	5-8
Production machines and equipment:		
machine tools	14	7
canning and distillery machines	17	6
Vehicles: cars and trucks	8	12
buses	6	17
lifts	17	6
forklift trucks	6	17
Other: lamps	5	20
furniture	17-25	4-6
fixtures and fittings	17	6

Investments

26. The only investments are held by Koli (9.1 million Kcs at both 1 January 1991 and 31 August 1991) and represent 91 shares, at par value, in Agrobanka. Koli does not exercise any control over Agrobanka.

Accounts receivable

27. Accounts receivable are comprised as follows:

1 January 1991	31 August 1991
000Kcs	000Kcs
91,472	89,798

28. The credit terms for all customers of Koli are two weeks and three days (for delivery of the invoice).

29. We set out below the gross amount of accounts receivable, together with the amounts overdue (total and over 90 days). We have only provided for the amounts overdue 90 days but we draw to your attention that the level of insolvencies in Czechoslovakia is rising. This is partially due to the fragmentation of the wholesaler and retailer distribution network. The doubtful debt provision reflects the best information available at the time of writing this briefing paper.

	1 January 1991	31 August 1991
	000Kcs	000Kcs
Gross accounts receivable	91,471	92,020
Total overdue	976	15,873
Overdue 90 days	-	2,222

Prepaid expenses and other receivables

30. Prepaid expenses and other receivables is immaterial: for the combined entities 0.5 million Kcs at 1 January 1991 and 0.8 million Kcs at 31 August 1991. The largest item is social security refundable for Koli.

Taxes refundable

31. Taxes refundable (profit and payroll) of 7.2 million Kcs at 1 January 1991 and 3.9 million Kcs at 31 August 1991 are recorded. In the time available, the management of Koli have been unable to provide us with a split of profit and wages tax refundable. However, we are informed that the above balances principally relate to the former category.

32. Profit tax is payable monthly in advance: in 1990 profit tax was payable in accordance with planned profit, whereas in 1991 profit tax is estimated in January and paid thereafter in accordance with the monthly profit and loss account required to be prepared under State regulations.

Inventories

33. Inventories are comprised as follows:

1 January 1991	
	000Kcs
Materials in transit and in stock	203,383
Fuel	3,680
Supplies in use	21,553
Semi-finished products and work-in-progress	100,900
Finished goods	86,104
Goods for resale	282
Gross inventories	415,902
Provision for obsolete and slow-moving inventories	-
Net inventories	415,902

31 August 1991	
	000Kcs
Materials in transit and in stock	172,681
Fuel	4,088
Supplies in use	21,107
Semi-finished products and work-in-progress	78,153
Finished goods	75,010
Goods for resale	7,214
Gross inventories	358,253
Provision for obsolete and slow-moving inventories	(2,063)
Net inventories	356,190

34. We note that in value terms the mix, by major inventory category, is the same at both 1 January 1991 and 31 August 1991.

35. All major inventory categories, with the exception of semi-finished and finished goods are valued at cost. In 1990, these costs were, for the large part, fixed and therefore Koli was effectively adopting weighted average. In 1991, subsequent to price liberalization, Koli adopted LIFO.

36. Both semi-finished and finished goods are valued at:

- Direct costs (materials and labor)
- Production overheads

37. Overheads are allocated on the basis of direct wages.

38. The largest category of inventories at both dates is materials in transit and in stock.

39. The inventory levels at 31 August 1991, using average monthly sales and materials consumed in production, would appear to represent the following:

	Koli
Semi-finished and finished goods (with reference to sales)	2.5 months (a)
Materials in transit and in stock (with reference to materials consumed in production)	5.0 months (b)

(a) 153 million Kcs/ (488 million Kcs / 8 months)
(b) 173 million Kcs/ (271 million Kcs / 8 months)

40. There are considerable dangers in placing undue reliance on such analyses:

- Sales and materials consumed in production reflect liberalized prices, whilst the value of inventories is not truly comparable due to the adoption of LIFO in 1991
- Business is seasonal
- Semi-finished products and certain finished products have long shelf lives

- We do not know what proportion of materials in transit and in stock for Koli are perishable compared to raw materials with longer, if not indefinite, storage lives.

- There may be, in the short term, significant downward pressure on selling prices due to the incomes policy which has eroded the real purchasing power of consumers and price elasticity of demand.

41. The drop in gross inventory levels for Koli (356 million Kcs at 31 August 1991 compared to 416 million Kcs at 1 January 1991) can be attributed to a number of factors, including:

    - Seasonality (peak: November/December; low point: around harvest time -May/June/July)

    - Introduction of a stock reduction program combined with decentralization of responsibility for inventory levels at each division.

    - The tailoring of production to reflect sales opportunities. We note that the former Production Director now holds the position of Director of Marketing and Development.

    - Move away from a suppliers' market which necessitated a certain degree of stockpiling.

42. The inventory levels for Koli may appear to be relatively high to a western investor in a similar business. We make the following observations which we have not discussed with the management of Koli:

    - Czechoslovakia is a relatively small country and therefore there is less opportunity to spread purchases of perishable seasonal fruits and vegetables by "staggering" purchases from different regional areas.

    - The Czechoslovak agricultural sector has been relatively neglected and there is not a sophisticated approach taken to, for example, "phasing" planting and harvesting.

    - Cool storage systems are both less common and also less sophisticated.

43. We requested the management of Koli to prepare a volume/value movement analysis, by quarter, for the year ended 30 June 1991, of those inventory line items which represent 60 percent or more of any given division's inventories at 30 June 1991. These were summarized and we indicate the extent of coverage given below:

	30 June 1990	30 June 1991
Raw materials (excluding packaging materials)	82%	96%
Semi-finished goods	97%	67%
Finished goods	91%	99%

44. We discussed the schedule (including the basis of its compilation) with the Finance Director and the Marketing and Development Director of Koli. Slow-moving line items were attributed to seasonal factors or reference was made to their shelf life.

45. In the limited time available nothing came to our attention to suggest that a significant net realizable value adjustment was required. The Finance Director of Koli believed that the only provision required related to the remaining Kord inventory, 2.0 million Kcs (refer to the discussion on accruals and other payables above).

Accounts payable

46. Accounts payable are comprised as follows:

	1 January 1991 000Kcs	31 August 1991 000Kcs
	122,904	56,472
being:		
Accounts payable	92,397	2,536
Accounts payable, goods but no invoice received	13,303	37,529

Accounts payable relating to assets in the course of construction	17,204	16,407
Total	122,904	96,472

47. There is a significant decrease in the accounts payable of Koli at 31 August 1991 compared to 1 January 1991. We have been informed that the high balance of 1 January 1991 relates to the restructuring of the State financing of inventories at the end of 1990. In the past, the State required all State owned enterprises to borrow money in order to finance their permanently turning inventories. The State, through State owned banks, could therefore monitor the level and mix of stocks. This unique credit arrangement was called the "TOZ". At the end of 1991, the TOZ, which had been a long term loan with very favorable interest rates, was converted into a normal trading loan attracting interest at 23 percent p.a. (compared with 6% p.a. previously) and the repayment installments were bought forward. Whilst this initial phase of the restructuring of the TOZ occurred, the commercial bank did not action the payments authorized by certain enterprises. In the case of Koli, payment orders for approximately 59 million Kcs, covered by loan financing, were temporarily deferred.

48. A second reason for the difference in the size of the amount due by Koli at the two dates relates to cut-off. At the end of the year, Czechoslovak accounting regulations require the books of account to be held open until 14 January 1991. In contrast, balance sheets which are prepared for internal purposes only reflect a cut-off at the month end.

49. We have been informed that Koli does not "squeeze" its suppliers and generally pays on time. In particular, with the exception of the late payment of turnover tax, for which a penalty of approximately 2 million Kcs, was levied in 1991, Koli has paid tax installments (profit, payroll, wages or turnover), loan installments or wages and salaries on time.

Taxes payable

50. Taxes payable (turnover and wages) are comprised as follows:

1 January 1991	31 August 1991
000Kcs	000Kcs
57,818	2,045

51. In the time available, the management of Koli was unable to provide a split of the above balances into turnover tax and wages tax payable. We have been informed, however, that the vast majority of the balances relate to the former category. The substantial decrease in the turnover tax payable by Koli reflects the independence and restitution of Hobé and Kord, respectively during 1991, both of which were distilleries which attract the highest rate of turnover tax. We remind you that on gaining its independence, Hobé was allocated loans, which reflected, amongst other things, an amount equal to its turnover tax liability. At 31 August 1991, Koli has one remaining distillery; the smallest of the three in existence at the end of 1990.

Accruals and other payables

52. Accruals and other payables are comprised as follows:

	1 January 1991 000Kcs	31 August 1991 000Kcs
	18,530	68,667
being:		
Accruals	6,941	33,464
Wages payable	6,587	4,036
Other payables	5,002	31,167

53. We have been informed that the large increase in the accruals of Koli at 31 August 1991 relative to 1 January 1991 reflects normal seasonal purchasing patterns, as well as the inclusion of a 10 million Kcs general reserve.

54. Other payables for Koli at 31 August 1991 principally relates to an amount due from the representative of the former owner of KORD who purchased 20.5 million Kcs of KORD's 22.5 million Kcs inventories. An additional 4.7 million Kcs relates to both inventories and fixed assets which have been invoiced to him, but which he has not yet agreed to purchase, as he claims they should also have formed a part of the restituted property. We have been informed by the management that production will not be possible without these additional fixed assets, however, the necessity for the labels, bottles etc

comprising the remaining 2.0 million Kcs of inventory is less clear and we have accordingly written this off.

Loans

55. We refer you to our previous discussion on the "TOZ" and note that during the first quarter of 1991 it became apparent that all enterprises in the supply chain were experiencing liquidity problems: manufacturers could not sell their products and wholesalers and retailers were overstocked due to speculation prior to the price liberalization on 1 January 1991. As a consequence, in March 1991 all or a significant proportion of the TOZ for all enterprises (80 percent for Koli) was frozen and transferred from commercial banks to a bank specially formed for the purpose in March (Konsolidační Banka).

56. The terms of the frozen portion, called a "consolidation credit", are unknown except that 6.25 percent of the outstanding balance will be repayable in January and July of next year. We draw to your attention that whilst it is provisionally intended that the frozen portion of the TOZ will be repayable over eight years, the State has indicated that terms may be changed with three months notice.

57. None of the loans shown below are secured (which has been a common practice in Czechoslovakia in the past).

58. We set out below an analysis of the loans of Koli at 31 August 1991 split into long term and short term:

	31 August 1991
	000 Kcs
Short term	113,523
Long term	134,399
Total	247,922

Koli:

Bank/loan	Interest rate	Short term portion	Long term portion	Total
		31 August 1991		
	%	000Kcs	000Kcs	000Kcs
<u>Komerční banka</u>				
Long term loan for capital expenditure	7	4,866	11,303	16,169
Loans for machinery (15 loans)	4 - 6	5,223	4,607	9,830
Inventories (TOZ)	Base + 4.5	6,780	15,820	22,600
Account receivable	Base + 7.5	1,987	-	1,987
Current assets	Base + 2.5	40,000	-	40,000
<u>Agrobanka</u>				
Inventories (seasonal)	Base + 2.5	40,000	-	40,000
<u>Konsolidační banka</u>				
TOZ (80 %, frozen portion)	13	14,667	102,669	117,336
		113,523	134,399	247,922

Adjusted profit and loss accounts

59. We set out on the next page adjusted profit and loss accounts for Koli.

	31 December 1990 000Kcs	31 August 1990 000Kcs
SALES	793,608	487,772
CHANGE IN STOCK (work-in-progress, semi-finished and finished goods)	30,406	(33,840)
OPERATING COSTS		
Material consumed in production	(483,028)	(271,478)
Depreciation	(39,216)	(32,722)
Fuel	(25,012)	(17,086)
Wages	(60,915)	(28,603)
Energy	(17,861)	(10,528)
Delivery costs	(29,439)	(13,469)
Repairs and maintenance	(17,530)	(6,126)
Payroll tax	(29,131)	(14,929)
Other operating costs	(35,164)	(27,695)
Change in accruals	(7,630)	(26,561)
Provision against write-off of inventories re Kord restitution	--	(2,063)
Write-off of slow moving or obsolete inventories	--	--
	(744,926)	(451,260)
OTHER INCOME	15,367	36,474
PROFIT BEFORE INTEREST AND TAX	94,455	39,146
INTEREST	(17,567)	(24,483)
PROFIT/(LOSS) BEFORE TAX	76,888	14,663
TAX[3]	(40,895)	(10,396)
PROFIT/(LOSS) AFTER TAX	35,993	4,267

60. For the eight months ended 31 August 1991, Koli reflects trading results with modest profitability, after making the net realizable value adjustments described above.

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[3] Taxes based on Czechoslovak tax base. See Appendix IV for presentation of Czech statements.

61. We have not performed any detailed review of either seasonality or sales/production volumes/values as we understand that all this information was provided to both the consulting and valuation teams.

62. We do, however, make the following observations with respect to Koli which impact on the view taken of maintainable earnings:

- The semi-finished products consumed in production to a large extent are comprised of raw materials purchased prior to price liberalization, however, LIFO was adopted in 1991 and therefore the post price liberalization prices have been reflected in the 1991 trading results.

- A substantial proportion of purchases of fresh raw materials at post liberalization prices did not occur until May-June due to the timing of the harvests. As a consequence, the impact of price liberalization on the principal cost category, materials consumed in production, has to some extent been deferred and will be spread over 1991, unlike many other Czechoslovak entities. This is evident from the relative stability of the relationship between materials consumed in production to both sales and total costs:

	Year ended 31 December 1990	Eight months ended 31 August 1991
Materials consumed in production:		
As a % of sales	60%	56%
As a % of total operating costs	65%	61%

- There are three cost categories for which the impact of inflation in 1991 has not been fully reflected:

  Depreciation (no cash flow)

  Wages and payroll tax (due to the adoption of an incomes policy (see below)).

- Koli has responded to price elasticity of demand by lowering the selling prices of some of its goods after initially raising them following price liberalization. The erosion in the real purchasing power of consumers (approximately 20 - 25 percent for the first three quarters of 1991 relative to 31 December 1990) will continue as inflation grows, albeit at a slower rate, fuelled by the further removal of energy subsidies, the restructuring and

removal of rental subsidies in early 1992 and the continuation of the incomes policy.

- We remind you that the 1990 and 1991 trading results are not comparable because of Hobé gaining independence from 1 January 1991.

- Further, we note from the point of view of maintainable earnings, Kord (based on the analysis of profit before tax and profit allocations for the six months ended 30 June 1991) was contributing significantly to Koli's overall profitability.

- We make the following detailed comments on some individual line items in the adjusted profit and loss accounts of Koli.

Sales

63. Sales are recognized when an invoice is raised

64. There are no subsidies in 1991, however in 1990 the State did compensate Koli partially for the difference between the sales price received for its exports and the fixed domestic price.

Change in inventories (semi-finished and work-in-progress, and finished goods)

65. The change in inventories reflects a number of items which have been previously discussed: the stock reduction program, adoption of LIFO, seasonality, the delayed impact of price liberalization due to the lumpiness of raw material purchases around harvest time, the independence of Hobé. To some extent, the change in inventories also reflects a switch towards lower-value products; for example, the production of more apple based baby foods, syrups etc.

Materials consumed in production

66. In 1990, Koli earned a 24.6 million Kcs subsidy with respect to imported spirits. There were no subsidies in 1991.

Depreciation

67. The depreciation rates used by Koli are shown above.

68. The depreciation charge for the eight month period appears to be high relative to the year ended 31 December 1990. This is

because Koli started to depreciate a heat plant costing 280 million Kcs at 4 percent p.a. during 1991.

Wages

69. In addition to the impact of the incomes policy which has restricted the cumulative increase in wages to 22 percent and 29 percent for the two and three quarters of 1991 relative to December 1990, wages as a proportion of total costs have fallen because of Hobé and Kord. We note that at the end of 1990, Hobé had 120 employees, whilst Kord had 60.

Energy

70. Distilleries are the divisions with the highest energy consumption in Koli. We note that the energy requirements of Hobé and Kord have not been reflected in the 1991 trading results from January and July, respectively. Partially offsetting the removal of two of the three distilleries, is the impact of the gradual restructuring of energy prices and the elimination of subsidies.

Change in accruals

71. We refer you to the discussion on other payables and accruals above for Koli.

Other operating costs

72. Other operating costs in 1990 include a number of non-recurring items: 2 million Kcs for late payment of turnover tax and 5 million Kcs contribution to certain special industry funds which no longer exist in 1991.

Other income

73. Other income for the year ended 31 August 1991 includes 27.9 million Kcs profit on the purchase and sale of imported molasses to the other distilleries in Czechoslovakia. This transaction is unlikely to be repeated as it related to the restructuring of foreign trade in the beginning of 1991.

74. Other income for the eight months ended 31 August 1991 also includes 5.2 million Kcs profit on the sale of the majority of Koli's delivery fleet, together with various other vehicles.

75. Finally, exchange gains of approximately 4.8 million Kcs and 1.5 million Kcs are included in other income for the year ended 31 December 1990 and the eight months ended 31 August 1991, respectively. The gain in 1990 reflect the significant shift in rates corresponding to the introduction of limited internal convertibility on 28 December 1990, as well as certain exports conducted on Koli's own account. The exchange gains in 1991 are similar but reflect much smaller shifts in the exchange rate.

Interest

76. The interest rates applicable to all loans outstanding are disclosed above. We draw to your attention, however, that there a number of loans still at very low interest rates. These loans primarily relate to capital expenditure and machinery and were negotiated in 1987 and 1988. Koli appears to have a reasonable amount of negotiating power with the local branch of the commercial bank and unlike many other Czechoslovak enterprises was not forced to accept the new, higher interest rates for these loans which are due for repayment in 1992.

Taxation

77. As with payroll tax, profit tax is levied at 50 percent for all enterprises in the agricultural sector. Comparing profit before tax and profit allocations to the tax charge per the Czechoslovak financial statements the effective tax rates for Koli are as follows:

	Year ended 31 December 1990 %	Eight months ended 31 August 1991 %
Effective tax rate	48	50

7.0 PRIVATIZATION OPTIONS

7.1 Suitability for Privatization

We believe that Koli is a suitable candidate for privatization, because:

- It has the potential for profit and growth
- It has been operating autonomously as a "commercial" enterprise
- Its product line is diversified
- It is widely perceived in Czechoslovakia as a successful enterprise
- The Czech and Slovak American Enterprise Fund has expressed a strong desire to participate in the privatization of Koli, subject to Board approval.
- Its management and employees are in favor of privatization
- Southern Touch, a company based in the United States, is considering a significant investment in a later stage of privatization. The funds would be used for additional equipment and for modernization of the plants.

There are, however, other important features which should influence the choice of how Koli is privatized:

- There was a decrease in sales and profitability in 1991 compared with 1990, and the medium term prospects are subject to considerable uncertainties
- The success of the enterprise is highly dependent on the retention of key senior management.

7.2 Privatization Objectives

Consideration of the methods of privatization should take into account the objectives of both the Czech government, Koli

management, and the Czech and Slovak American Enterprise Fund. These have already been referred to in Section I and can be summarized as follows:

- Common objective: a successful privatization in the sense that it is both achieved and is widely perceived as being in the interest of Czechoslovakia. This entails increasing efficiencies of the enterprise, improving productivity, and maximizing value of the enterprise in the long-term.
- Koli management's main objectives:
  - A rapid privatization to achieve freedom to pursue commercial practices
  - Participation in buying shares in the company for both management and employees.
- The Ministry of Agriculture's main objectives:
  - Transfer of ownership to include Czech citizens and agricultural cooperatives
  - The Czech government also appears to have the objective of raising cash from privatization of State owned companies. However, the priority of this objective was not clear.
- The Czech and Slovak American Enterprise Fund's main objectives :
  - To support small and medium-sized businesses, to increase their potential for growth
  - To participate in strategic decisions as to assist in maximizing a company's future value
  - To earn an adequate return on investment as well as a full recovery of capital
  - To include Company management and employee participation in the shares of the Company
  - To include incentive plans so that future share participation by management and employees is a function of performance
  - To include ownership by citizens of Czechoslovakia.

7.3 Privatization Options

There are four primary methods for privatization of Koli:

1. Management/Employee buy-out
2. Coupons
3. Direct Investment by a Foreign Investor
4. Direct Investment by a Domestic Investor.

7.3.1 Complete Management/Employee Buy-out

A 100 percent management/employee buy-out, while it would allow management and employees to own the enterprise, would not achieve the objective of maximizing value. At this stage in the development of the Company, equity capital investment is needed to upgrade production equipment as well as to improve efficiencies in the production process. A large loan to management required to finance such a share purchase would have the effect of increasing the financial risk of the enterprise and, therefore, not maximize the long-term value of the Company.

7.3.2 Coupons

A complete transfer of ownership via coupons to the Czech citizens would fulfill one of the government's goals of transferring ownership. It would not, however, give management the necessary ownership participation in order to maximize value, because they would not have the proper incentives to maximize profits and increase the value of their shares. Coupon ownership also raises very few funds for the Czechoslovakian government that could be used to develop other sectors of the economy.

7.3.3 Direct Investment by a Foreign Investor

The sale of 100 percent of Koli to a foreign investor would not achieve the Government's or Koli management's privatization objectives of including Czech citizens and management in ownership of the Company. The main advantage would be the availability of additional capital if a suitable foreign investor could be found. The introduction of a minority equity position by a foreign investor could provide a valuable contribution to a privatization that is consistent with the objectives of the parties involved.

There are a number of advantages for the Government in allowing a foreign investor to purchase a minority interest in Koli. First, assuming that the investor is from a similar industry and is financially secure, it would assist in the introduction of certain disciplines which would facilitate the development of a market economy. Such disciplines would include management and information systems, accounting systems, and more commercialism and competitiveness.

Furthermore, a foreign investor would be paying for its stake in the business in hard currency. These funds could be used by the Government for the development of other sectors of the economy.

In the case of Koli, these advantages could all apply. In addition, the investor could become a source of new business and products or provide an opportunity for Koli to diversify with regard to new markets, technology and know how.

7.3.4 Private Domestic Investor

The introduction of a private domestic investor (i.e., a Czechoslovakian financial institution) would be desirable for

purposes of introducing financial controls and linking the goals of the Company with those of the Government, since senior officers of the financial institutions also play important roles in the development of long-term privatization strategies for the Government. Based on our discussions with the Czech & Slovak American Enterprise Fund and Koli management, there are two financial institutions that could be investors in Koli: the Komercni Banka and Agrobanka. It is also our understanding that the National Property Fund (a government entity) would be subsidizing a portion of the equity interests of these two institutions in Koli.

7.4 Preliminary Conclusion - First Stage of Privatization

We believe that Koli is suitable for privatization. It is a commercially run enterprise with a recent record of profitability and a high public profile, and the management and employees are in favor of privatization. But the way in which Koli is privatized should take account of the short and medium-term uncertainties facing the enterprise, and its reliance on key senior management.

Our recommendations for the privatization of Koli for the first stage include the following:

Investor	Ownership Percentage	Note
Koli Management	11 %	1
Koli Employees	10 %	1
CSAEF	17 %	2
Coupon Holders	25 %	3
Komercni Banka	24 % *	3
Agrobanka	10 % *	3
Restitution	3 %	3

* may be subsidized by the National Property Fund - 3 percent for Agrobanka; 7 percent for the Komercni Banka.

Notes:

1. Koli management and employees could be issued their shares via the Company taking out a loan. Their shares could receive a nominal dividend based on a majority decision (greater than 50 percent) of the new board of directors of Koli.

   Options for an additional 10 percent interest in the Company would also be granted based on performance objectives established by a majority (greater than 50 percent) of the new board of directors of Koli. These options would have a price and exercise date to be determined by a majority decision (greater than 50 percent) of the new board of directors.

2. CSAEF shares would not receive a dividend for a period of 3 years. These shares would have a liquidation preference over all other shares.

3. The shares could receive a dividend based on a majority decision (greater than 50 percent) of the new board of directors of Koli.

In addition, voting rights would be allocated on the same basis as the ownership percentage in the equity of Koli.

7.5 Second Stage Financing

It is our understanding that Southern Touch, a company based in the United States, is interested in making an investment in Koli which the Company could use for needed capital additions. If structured as an equity investment, the new investment would have the effect of diluting the ownership percentages established in the first stage of privatization.

In addition, the agricultural cooperatives could take out a loan to purchase shares of the first stage shareholders.

7.6 Later Stage Financing

After the second stage investment, the Company, depending on future growth and profits, could pursue exit strategies such as a public offering or a sale to a foreign investor.

7.7 Conclusion

On the following page, we have prepared an exhibit illustrating the different privatization methods and satisfaction of privatization objectives.

PRIVATIZATION METHODS	PRIVATIZATION OBJECTIVES		
	Wide share ownership	Revenue to Government in First Stage	Share participation by Management
Buy-out	* *	* *	* * *
Coupons	* * *	*	* *
Foreign Investor	*	* * *	*
Domestic investor	*	* *	*

* * * - best option to achieve objective
* * - partial achievement of objective
* - worst option to achieve objective

8.0 FUTURE PROSPECTS

8.1 Overview

Our general conclusions for Koli's prospects in the next several years are as follows:

- Koli faces considerable uncertainties in the domestic economy during the next one to two years. The economy has experienced a substantial decline in 1991 and the timing and extent of any recovery is unclear. As a result, Koli's sales levels could remain below 1990 levels from 1991 - 1992.

- The disintegration of traditional state owned suppliers and distributors adds uncertainty to Koli's prospects in the domestic markets.

- Management is optimistic that it can expand exports to the other former Eastern bloc countries. In particular, Koli anticipates strong market potential in Poland, the U.S.S.R., and other developing countries. However, these countries lack hard currency with which to pay for imported products.

- The company's objectives of exporting to Western Europe are hampered by tariffs and other barriers. In addition, most of Koli's products do not currently comply with international product and sanitation standards.

- Koli is exporting increasing amounts of apple concentrate to the United States. Management is also entering into agreements to export substantially more concentrate to the U.S. in 1992.

- The company faces the imminent entry of Western food processing companies to the Eastern European market.

- Koli is sufficiently flexible and entrepreneurial to exploit new market opportunities and adapt to changing market conditions.

In the following paragraphs, we discuss the prospects for Koli in its domestic market, exports to the former Comecon countries, and also exports to Western countries.

8.2 Domestic Markets

The company's unit sales volume for 1991 is projected to decline 40 percent from 1990 levels. Much of Koli's competition has responded to similar declines by halting production for several weeks or months.

In particular, Koli is expected to experience a 53 percent decrease in tonnage of baby food shipped during 1991.

Collapse in domestic demand resulted not only from consumers finding substitutes for the company's products (i.e. mothers making baby food at home), but also consumers dramatically reducing consumption as they experience massive declines in purchasing power.

Future sales and profitability from Koli's current business activities in Czechoslovakia may recover and ultimately exceed prior levels. As standards of living rise, consumers are likely to increase both the amount and quality of food items bought.

Foreign companies are now entering Eastern European markets including Czechoslovakia. Armed with greater financial resources and marketing advantages than Koli, they could severely undermine Koli's competitive position.

As Western firms acquire existing companies in Eastern Europe, it will become increasingly important for Koli to form strategic alliances with foreign companies. Such alliances may include joint ventures and marketing agreements. Koli may also gain a long term advantage through ultimately merging or being acquired by a Western food processing company.

8.3 Eastern Bloc

Koli's markets in Eastern Europe are experiencing radical social and political change which could significantly affect the level and profitability of Koli's future activities in these markets.

In the event Czechoslovakia successfully negotiates a major barter agreement for Soviet oil, Koli could benefit by exporting food products to the Soviet Union. However, there are major uncertainties including the fragmentation of the U.S.S.R. into individual nations.

We do not anticipate the former Comecon countries will be a major source of revenues for Koli during the next two to three years.

8.4 Western Markets

Koli's favorable access to raw materials, low cost of production, and the low value of the Czech crown combine to offer good opportunities to sell to Western markets.

Sales to Western Europe are hampered by trade barriers including tariffs and quotas. Prospects are considerably stronger for the U.S. market.

Market expansion is dependent on Koli's production capacity and availability of apples at sufficiently low prices. Poor harvests in Europe have considerably raised apple raw material prices.

The Company has entered into agreements to sell substantial concentrate in the U.S.

We believe that Koli could benefit greatly from expansion and further development into the U.S. market.

8.5 Diversification

There are two types of possible diversification

- Diversification into new products
- Diversification into new markets.

Koli's strength is its strong position in select products in the Czech consumer market. By developing its reputation for "healthy food", Koli could introduce fresh produce or other products likely to benefit from increased demand as living standards improve.

However, constrained by financial and other resources, management may be required to focus initially on those existing areas in which the company has a strong market position (i.e., large market share).

Koli's ability to diversify into new geographical markets is more difficult. Problems include barriers to entry, tariffs and quotas, intense competition, and lack of hard currency by developing Eastern economies.

Further penetration into the export market for apple concentrate for the U.S. appears to be Koli's best prospect for substantial increases in export sales.

We believe that Koli will be in a good position after privatization to identify and develop new opportunities because:

- the management is entrepreneurial with an established track record
- Koli has a good reputation
- Koli has strong distribution channels in the Czech republic
- the company has developed relationships in Eastern and Western Europe, as well as the U.S.

Koli's ability to appropriately respond to market conditions could be greatly enhanced by forming business relationships with successful Western companies.

9.0 RISK FACTORS

9.1 General Economic Factors

The performance of the Company may be affected by the performance of the Czechoslovakian economy. The economy has not been strong in recent years and it suffers from slow or even negative growth in GDP, increasing inflation and potential future wage inflation.

9.2 Problems of Transition

The transition to a more market-oriented economy may be difficult. Managers and workers face a new and, for them, untried environment. There will inevitably be problems of adjustment, compounded by years of under-investment. Many businesses may not be able to adapt to the demands of a market economy.

9.3 Currency Risk

The crown, in which a high proportion of the Company's assets will be invested, is not freely convertible into other currencies and is not internationally traded. If the crown becomes freely convertible into other currencies its value may depreciate.

9.4 Illiquidity of Investments

The Czechoslovakian Stock Exchange is not yet in operation. Although it is the intention that the majority of investments should eventually be listed on an exchange, there can be no guarantee of any significant degree of liquidity. The high degree of liquidity seen on some Western stock exchanges may not develop.

9.5 Business Failures

It is only recently that Czech enterprises have been allowed to go into insolvent liquidation. The full effects of this change remain to be seen.

9.6 Czechoslovakian Accounting Standards

Accounting standards and the role of accounts in Czechoslovakia are different from those of the West. Although Czechoslovakia is moving to adopt international Generally Accepted Accounting Principles ("GAAP"), there is no history of auditing enterprise accounts to such standards.

9.7 Enforcement of Rights

It may be difficult for the Company to obtain effective enforcement of its rights by legal or arbitration proceedings in Czechoslovakia.

10.0 VALUATION

10.1 Premise of Value

Our valuation is based on the premise of fair market value. Fair market value is defined as the price negotiated by a willing buyer and willing seller, each having knowledge of the company, and each acting in their own self-interest without undue compulsion or pressure.

10.2 General Assumptions

For purposes of this valuation, we also assume that the business will continue operation as a going concern. This is in contrast to liquidation value where it is assumed that the sum of the proceeds from sale of assets exceeds the value of the company based on its profitability as a going concern.

Secondly, in conducting our valuation, we assumed no synergies between the business activities of Koli and those of a potential acquirer or investor. In those cases where an acquirer's business activities have synergies with the business being purchased, substantial premiums may be paid. In the U.S., acquirers of manufacturing companies have been paying premiums averaging 47 percent over the market value of the company on a stand alone basis.[4]

Koli previously divested two alcohol distilleries in January and July, 1991. Current plans are to sell the remaining distillery known as the Chrudim plant (plant #07). As a result, we have not included the Chrudim plant in our valuation analysis.

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[4] Source: "Control Premiums and Data Sources", Houlihan, Lokey, Howard & Zukin, Inc., March 9, 1991.

Under the premise of going concern, the value of Koli is not represented by the value of specific assets, but, rather, the value based on future cash flow and profit of the enterprise. Therefore, the most appropriate methods for valuing Koli are discounted cash flow ("DCF") and multiple of earnings ("P/E").

The valuation of Koli is subject to considerable uncertainties including:

- the rapid inflation experienced in 1991 and the resultant loss of purchasing power by consumers

- the current economic recession resulting from this loss of purchasing power and its dampening effect on consumer demand

- limited liquidity in the economy due to financial problems being experienced by many firms. With many such enterprises facing the prospects of bankruptcy, even viable businesses could experience reduced liquidity and cash flow as many customers are unable to pay debts

- the disintegration of both state wholesalers and expected changes in ownership of collective and state farms is dramatically altering supplier relationships and distribution channels

- restrictive monetary policies by the government have limited the quantity of new bank credit available. This is consistent with the objective of reducing inflation

- general uncertainties regarding future political developments including the pace and extent of future economic reforms. Political pressures could result in the government initiating stimulative fiscal and monetary

policies which increase inflation and start a wage-price upward spiral.

- potential disruption to markets in the event Slovakia chooses to separate from Czechoslovakia

- increased competition in Poland due to the recent agreement by Gerber, a leading U.S. manufacturer of baby products, with Poland's state-owned Alima baby-food company.

10.3 Net Assets

Koli's recent balance sheets are included in Section 6.0. We are unable to determine the value of individual assets because we do not have sufficient information on each item in the balance sheet.

We understand that it is the practice of some authorities in Czechoslovakia to value an enterprise on the basis of its net asset balances. However, we do not believe that such an asset valuation is appropriate for several reasons.

As previously mentioned, we are valuing Koli as a going concern. As a result, the specific value of its individual assets has little relevance to the enterprise's value. If sold individually, the realizable value of the assets would be below their book values.

The limited relevance of the "Net Assets" amounts shown on the accountant's financial statements is highlighted by several factors. Fixed assets represent 59 percent of Koli's assets. Such assets principally represent buildings, fixed structures, machinery, equipment, tools and motor vehicles. Under Czech accounting principles, buildings and property are depreciated over periods as long as 77 years. This is greatly in excess of their reasonable economic lives, and, as a result, the reported assets are probably overvalued.

In addition, the current economic recession further depresses the likely values that could be received from sale of assets. Many enterprises are experiencing financial problems and the supply of available property and equipment is likely to increase. Moreover, the modifications required to convert the company's assets to an alternative use would further reduce available proceeds of asset sales.

As a result, the value of Koli determined by the discounted future cash flow and multiple of earnings approaches represent the highest realizable value.

10.4 Reliance on Management Projections

In making our assessment of future cash flow, we have relied on projections provided by management and an analysis of the company's historical financial statements. For a summary of these assumptions, see notes to Exhibit 10.2. We recommend that these assumptions be reviewed on a periodic basis and as new information becomes available.

10.5 Discounted Cash Flow (DCF)

The most appropriate approach for valuing companies is by reference to the future cash generating capability of those companies. The DCF approach values the company based on estimating future operating cash flows. These cash flows are then discounted to a present value by applying a rate of return which reflects the opportunity costs of the investment funds and the risk of the investment.

The forecasts of future cash flows exclude the impact of future inflation. That is, projections of sales were made using 1991 prices. We utilized this approach due to the high degree of uncertainty regarding future price levels.

10.5.1 Selection of Discount Rate

In selecting the discount rate, we utilized a weighted average cost of capital ("WACC"). The WACC is divided between required returns on debt and equity. The "real" cost of debt (without the effects of inflation) was utilized based on "real" rates earned by U.S. banks (approximately 5 percent) as a base rate. This "real" rate of return was then increased due to the additional risk of the Czech economy. The cost of debt rate was then reduced by an amount resulting from the deductibility of interest payments for Czech tax purposes.

The cost of equity was based on application of the Capital Asset Pricing Model ("CAPM"). CAPM is a widely accepted method for valuing equity capital as developed at the University of Chicago. CAPM begins with identifying the return on a risk free investment, such as a U.S. Treasury bond. The model then incorporates the additional return received by investors from investing in stocks in the U.S.

Finally, an additional premium is added reflecting the higher returns traditionally earned by investments in smaller stocks (i.e., companies with sales less than $100 million).

To make this return consistent with our assumption of no inflation, we deducted the expected U.S. inflation rate of 5 percent.

We utilized this U.S. investment rate as a base rate for required returns in Czechoslovakia. An additional return is required by an investor due to the greater political and economics risks in Czechoslovakia. This required return also considers the greater uncertainties associated with management's projections than those made by companies operating in the more stable U.S. environment.

The required returns on debt and equity were then weighted based on the proportions of debt and equity applicable to a Czech company like Koli. Based on discussions with management and review of food processing companies in the U.S., we selected the proportion of debt and equity that would be appropriate for Koli.

Based on the application of the above methodology, we determined that the discount rate ranged from 18 - 22 percent.

10.5.2 Application of Discount Cash Flow (DCF) Method

Application of the DCF method is shown on summary Exhibit 10.1 and supporting Exhibits 10.2 to 10.7.

We deducted operating expenses from future revenues to derive the earnings before interest and taxes ("EBIT"). EBIT was then reduced by the applicable tax rate.

We increased this amount by the depreciation expense since this accounting entry represents a non-cash expense. We deducted the additional working capital and the fixed assets required for the increased level of projected sales. Koli plans to reduce working capital levels in the first and second years through the reduction of inventory levels to those more consistent with those of a Western company. As sales continue to increase, additional working capital is necessary after 1993.

After making these adjustments, we calculated net debt-free cash flow. These amounts (for the five-year projection period) were then discounted to present value at the applicable discount rates of 18, 20 and 22 percent.

In order to estimate net cash flow beyond 1996 into the future (indefinitely), a terminal value was calculated. This amount was then discounted and added to the discounted amounts for the preceding years. Finally, to determine the market value for the company's equity, we deducted the interest bearing debt of 247,992 million Kcs for Koli.

The value recommendations for Koli at discount rates of 18 percent, 20 percent and 22 percent, respectively are as follows:

Value	Discount Rate
- 346 million Kcs or US$ 11.5 million	18 %
- 284 million Kcs or US$ 9.5 million	20 %
- 234 million Kcs or US$ 7.8 million	22 %

Note that these scenarios assume foreign investment of less than 30 percent of invested capital. If foreign investors have greater than a 30 percent equity interest, there could be tax benefits that could enhance the value of the company.

We have also been informed that state authorities may transfer the liabilities for certain old debts owed to the Konsolidacni banca ("TOZ") to the state owned National Property Fund. For Koli, these loans (subject to transfer) total approximately 117 million Kcs. In the event this transfer is approved, the value of Koli would be increased by the amount of the transferred liabilities.

10.6 Earnings (Profits) Multiple

The earnings (profits) multiple method of valuation is a market based methodology which involves applying a suitable multiple

(price earnings or "P/E" ratio) to maintainable earnings (profits). Maintainable earnings are the post-tax profits which would occur in the normal course of business.

We base our estimate on projected net earnings in 1992 (see Exhibit 10.2. Use of 1991 projected results are not appropriate for several reasons. First, the economy is currently in severe recession as the government implements policies to transform the country to a market economy. As a result, current results are depressed below likely sustainable levels.

Second, major provisions were made to expenses in 1991 that are not likely to recur. For Koli, nonrecurring items total 4.5 million Kcs from the writeoff of bad debts, inventories relating to restitution, and certain company recreational assets.

In selecting an appropriate multiple, we have reviewed relevant P/E ratios on American stock exchanges. We also obtained information on P/E ratios applicable to stocks of Hungarian companies traded on the Vienna stock exchange. The average American company in the food processing industry trades at a multiple of approximately 15 times earnings. Review of data on Hungarian companies indicates a relevant P/E ratio of 8.

Based on consideration of these stock multiples and the current absence of a Czech stock market to provide liquidity for share sales, we believe that a lower P/E ratio applies to Koli. We selected a P/E ratio of 6 to apply to Koli's earnings (profit).

Utilizing estimates of 1992 projected earnings and a multiple of 6, the following value is applicable to Koli:

1992 earnings est.[5]	49 million Kcs
Applicable multiple	6
Value estimate	294 million Kcs
or $US	9.8 million

10.7 Comparison of DCF and Earnings Multiple Valuation Methods

Our valuation indicates a range of 234 to 346 million Kcs for Koli utilizing the DCF approach, while the P/E method results in an estimated value of 294 million Kcs. Based primarily on utilization of DCF with consideration of the P/E derived result, we estimate the value for Koli to be in the following range:

234 - 346 million Kcs ($US 7.8 - $US 11.5 million)

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[5] Based on estimated operating income of 130 million, interest 31 million, and a 50 percent tax rate:

EBIT	130
Interest	31
EBT	99
Taxes	50
Profit	49

EXHIBIT 10.1

KOLI PRIVATIZATION
VALUATION OF KOLI

MATRIX OF ENTERPRISE VALUES
(In millions Kcs and US $)

Discount Rate	Value of Koli Enterprise
18.00%	346 Kcs ($11.5)
20.00%	284 Kcs ($9.5)
22.00%	234 Kcs ($7.8)

EXHIBIT 10.2

KOLI PRIVATIZATION
FORECAST OF DEBT FREE CASH FLOW

As of August 31, 1991
(in Kcs 000's)

Category	1992	1993	1994	1995	1996	1997 and Beyond
Total Revenues (1)	1,024,338	1,085,378	1,146,393	1,221,220	1,356,785	1,383,921
Operating Expenses (2)	894,758	941,947	992,362	1,059,391	1,163,415	1,190,172
Operating Income	129,580	143,431	154,031	161,829	193,370	193,749
Taxes (3)	64,790	71,716	69,314	72,823	87,017	87,187
Net Earnings	64,790	71,716	84,717	89,006	106,354	106,562
Add: Depreciation (4)	42,000	40,000	38,000	40,500	41,000	41,820
Gross cash flow	106,790	111,716	122,717	129,506	147,354	148,382
Deduct:						
Additions to Working Capital (5)	(8,422)	(70,102)	15,254	18,707	33,891	6,784
Additions to Fixed Assets (6)	42,000	40,000	38,000	40,500	41,000	41,820
Net debt-free cash flow	73,212	141,817	69,463	70,299	72,462	99,778

See footnotes on following pages.

NOTES TO EXHIBIT 10.2

We set out below the assumptions used to estimate future earnings and cash flow for our valuation of Koli.

Sales

1. Sales are based on management's projections of future sales in metric tons and then multiplying these estimates by current 1991 selling prices. Current selling prices were used in order to exclude the effects of inflation. The assumptions are summarized below:

	Unit sales (tons)				
Food categories	1992	1993	1994	1995	1996
Apple concentrate	3000	3600	3600	3600	3600
Baby food	9000	9000	9200	9500	9700
Ketchup	2000	2300	2500	2600	3000
Pektin	310	310	310	310	500
Syrups	8000	8000	8000	8000	10000
Pectavite	300	300	400	500	600
Read-to-eat foods	1000	1000	1000	1000	1000
Apple fiber	100	120	140	100	180
Carbonated fruit drinks	10000	12000	14000	16000	18000
Unprocessed pectin juices	1000	1000	1100	1200	1300
Mustard	3500	3500	3500	4000	4000
Marmelades	2500	2500	3000	3800	4200
Compotes	2000	2000	2000	2000	2000
Sterilized cabbage	2500	2500	2500	2500	2500
Pickles	3000	3000	3000	3000	3000
Pickled Vegtables	1000	1000	1000	1000	1000
Spreads	500	700	800	900	1000
Coca Cola beverages	9600	9600	9600	10000	10000
	59310	62430	65650	70070	75580

Food categories	1991 selling prices (Kcs 000's)
Apple concentrate	50.00
Baby food	22.50
Ketchup	32.00
Pektin	231.00
Syrups	13.33
Pectavite	200.00
Read-to-eat foods	24.00
Apple fiber	36.00
Carbonated fruit drinks	5.32
Unprocessed pectin juices	17.15
Mustard	11.26
Marmelades	24.00
Compotes	14.00
Sterilized cabbage	8.00
Pickles	13.72
Pickled Vegtables	11.50
Spreads	50.40
Coca Cola beverages	4.83

2. Operating expenses based on management projections of direct and indirect costs for each product line.

	as a percent of revenues				
Food categories	1992	1993	1994	1995	1996
Apple concentrate	82.19%	80.59%	80.59%	80.59%	80.59%
Baby food	89.07%	89.07%	89.07%	89.07%	89.07%
Ketchup	66.49%	66.49%	63.98%	63.98%	63.98%
Pektin	94.94%	94.94%	94.94%	94.94%	83.72%
Syrups	89.70%	89.70%	89.70%	89.70%	87.83%
Pectavite	85.50%	85.50%	84.66%	84.17%	84.17%
Read-to-eat foods	97.74%	97.74%	97.74%	97.74%	97.74%
Apple fiber	53.33%	53.33%	53.33%	53.33%	53.33%
Carbonated fruit drinks	99.75%	99.75%	99.75%	99.75%	99.75%
Unprocessed pectin juices	93.01%	93.01%	93.01%	93.01%	93.01%
Mustard	76.28%	76.28%	76.28%	77.82%	77.82%
Marmelades	101.72%	101.72%	100.90%	100.90%	99.40%
Compotes	96.20%	96.20%	96.20%	96.20%	96.20%
Sterilized cabbage	94.55%	94.55%	94.55%	94.55%	94.55%
Pickles	77.26%	77.26%	77.26%	77.26%	77.26%
Pickled Vegtables	93.96%	93.96%	93.96%	93.96%	93.96%
Spreads	82.32%	81.48%	81.48%	81.48%	79.99%
Coca Cola beverages	84.01%	84.01%	84.01%	84.01%	84.01%

3. Tax rate assumed at 50 percent in 1992 and 1993, 45 percent thereafter.

4. Based on management projections.

5. Based on reduction of inventories in 1992 and 1993 to levels more consistent with industry standards. Assume sales to working capital turnover of 3 in 1992, 4 for the years thereafter.

6. Due to significant excess capacity, capital expenditures are set equal to depreciation. That is such expenditures are limited to replacing existing equipment.

7. We assumed a real long term growth rate (exclusive of inflation) of 2 percent in years 1996 and beyond.

EXHIBIT 10.3

KOLI PRIVATIZATION
VALUATION OF DEBT FREE CASH FLOW @ 18.00%

As of August 31, 1991
(in Kcs 000's)

Description	1992	1993	1994	1995	1996
Debt Free Cash Flow	73,212	141,817	69,463	70,299	72,462
Present Value Factor (1)	0.9206	0.7801	0.6611	0.5603	0.4748
Present Value Cash Flow	67,397	110,638	45,925	39,388	34,407

Sum of Present Values cash flows 1992 - 1996:	297,755
Terminal value:	
Stabilized cash flow, 1997	99,778
Terminal Multiple (2)	6.25
	623,612
Present value factor	0.4748
P.V. terminal value	296,105
Value estimate	593,860
Less: Value interest bearing debt (3)	247,922
Recommended market value	345,938
in US $ (4)	$11,531

See footnotes on following pages.

EXHIBIT 10.4

KOLI PRIVATIZATION
VALUATION OF DEBT FREE CASH FLOW @ 20.00%

As of August 31, 1991
(in Kcs 000's)

Description	1992	1993	1994	1995	1996
Debt Free Cash Flow	73,212	141,817	69,463	70,299	72,462
Present Value Factor (1)	0.9129	0.7607	0.6339	0.5283	0.4402
Present Value Cash Flow	66,833	107,884	44,035	37,138	31,900

Sum of Present Values cash flows 1992 – 1996:	287,791
Terminal value:	
Stabilized cash flow, 1997	99,778
Terminal Multiple (2)	5.56
	554,322
Present value factor	0.4402
P.V. terminal value	244,032
Value estimate	531,822
Less: Value interest bearing debt (3)	247,922
Recommended market value	283,900
in US $ (4)	$9,463

See footnotes on following pages.

EXHIBIT 10.5

KOLI PRIVATIZATION
VALUATION OF DEBT FREE CASH FLOW @ 22.00%

As of August 31, 1991
(in Kcs 000's)

Description	1992	1993	1994	1995	1996
Debt Free Cash Flow	73,212	141,817	69,463	70,299	72,462
Present Value Factor (1)	0.9054	0.7421	0.6083	0.4986	0.4087
Present Value Cash Flow	66,283	105,242	42,253	35,050	29,614

Sum of Present Values cash flows 1992 - 1996:	278,442
Terminal value:	
Stabilized cash flow, 1997	99,778
Terminal Multiple (2)	5.00
	498,890
Present value factor	0.4087
P.V. terminal value	203,885
Value estimate	482,327
Less: Value interest bearing debt (3)	247,922
Recommended market value	234,405
in US $ (4)	$7,813

See footnotes on following pages.

NOTES TO EXHIBITS 10.3 TO 10.5

1. Present value factors based on following discount rates:

Exhibit 10.2	18.00%
Exhibit 10.3	20.00%
Exhibit 10.4	22.00%

2. Terminal multiple based on Gordon growth model as follows:

   1/ K – G where:

   K = discount rate
   G = long term growth rate in real terms

3. From balance sheet as of August 31, 1991.

4. Based on exchange rate of 30 crowns to one U.S. dollar.

APPENDIX I

CHRUDIM DISTILLERY
STRATEGIC INVESTOR ANALYSIS

ASSESSMENT OF THE STRATEGIC INVESTMENT
The Chrudim Distillery offers the foreign investor a number of interesting challenges. They include hedging the agricultural threat, product reformulation, availability of alternative sources of raw materials and the cost of development of by-product markets.

Agricultural Threat
Current production of Chrudim's fine spirits is dependent on the use of "molasses" produced from sugar beets. While the distillery enjoys an abundance of sugar beet sourcing in the Eastern Bohemia area there is the uncontrollable risk of crop failure which could severely limit and disrupt production. These risks include drought, harvest labor disruptions and the decline of agricultural productivity due to the shift away from "collective" farming. Each of these risks could severely impact the return on investment for the potential investor. The strategic investor must hedge these risks to ensure the probability of a "sustained" cashflow and return on investment. Hedging options include backward integration into farming/harvesting source products like sugar beets and product reformulation to include sugar and corn starch materials. Without these alternatives, foreign investment is likely to be minimized.

Product Reformulation
The distillery will probably have to reformulate its products to fully utilize alternative raw materials like corn or sugar starches to hedge the risk of product failure. This will however require additional investment dollars to cover the conversion cost of product formulation, product testing costs and quality control, product failure costs and the related loss of market share. There is little evidence that the company has begun its own efforts to assess the cost of utilizing alternative raw material sources. As a result the foreign investor must either utilize existing technology or establish an R & D effort to assess the impact on the existing product in terms of quality and costs. Product reformulation could significantly increase the cost of manufacturing the alcohol product and in turn reduce its existing and future competitive posture in the Global market. Product reformulation could take time and will require technology transfer as well as the need to retrain the existing labor force.

Product reformulation will also require ongoing product testing costs in terms of quality control. The company has an established quality control laboratory and utilizes obsolete equipment. With or without product reformulation the foreign investor will have to cover costs of ongoing product testing as well as the costs to update or replace existing equipment.

Product reformulation could adversely affect the use of the alcohol product which could reduce market acceptance. The foreign investor

must assess the market's response to the product prior to full reformulation to hedge against lost market share.

Availability of Alternative Sources of Raw Materials
If the company switches to an alternative source of raw materials such as corn starch, it must have adequate access to corn crops. If these crops are located in the same region as the current sugar beet crops there is the same existing risk of product failure. The cost of transporting raw materials from other countries or regions within Czechoslovakia could increase the manufacturing cost of the product. To hedge this risk, the foreign investor should utilize existing manufacturing capabilities of corn and sugar starch products either in Czechoslovakia or abroad probably the latter scenario.

This could be done through an alliance with a corn/sugar starch manufacturer or through the acquisition of the distillery by a corn/sugar starch manufacturer.

The Cost of Fully Developing By-Products
There are currently a number of potentially lucrative byproducts resulting from the distilling process. Prior to investing in Chrudim, the foreign investor should assess the market potential of each product as well as the cost of fully "developing" each product. The foreign investor should study the feasibility of selling and marketing the company's byproducts and should consider the cost of further market development, packaging costs as well as shipping costs. If the cost exceeds that benefit of internally marketing related products, the company should consider establishing an alliance with a foreign investor dependent on the related by-product.

The foreign investor must also hedge the risk of contaminated water sources and establish an inhouse packaging facility to adequately sustain long term cashflows and returns on investment.
The company does not currently have the ability to package its own products.

ASSESSMENT OF POTENTIAL TARGET INVESTORS
Despite these challenges however, there are a number of potential opportunities for the foreign investor. They include the warehousing for inventory storage and other materials, the water management area, fermenting capabilities and its distilling operations. Each of these "resources" appear to offer an opportunity to investor companies in the beverage/food industry, the corn/sugar starch industry and the pharmaceutical/medical industries.

Potential investors will have the opportunity to develop the market and become a fully integrated player in the developing Eastern European trade environment as well as the European Economic Community as a whole. The early entrant can take advantage of learning and experience curves and establish local industry technology and quality standards which are critical for long term

sustainability. The venture is risky however and will require an investor who is already established in the industry with easy access to critical scarce resources including corn/sugar starch technology. The following is a short list of potential **"strategic"** investors as well as a number of potential "financial" investors that may be willing to assist a potential strategic investor.

Strategic Investors
Table A - Companies with Access and Knowledge of Corn/Sugar Milling Technology

Financial Investors
Table B - Potential "Alliance" Investors in the Beverage Industry
Table C - Potential "Alliance" Investors in the Pharmaceutical/ Medical Industry

ASSESSMENT OF STRATEGIC OPTIONS
The successful investor must be fully committed to both the industry and the technology to ensure the long term sustainability of cashflows and investment returns. Commitment can be measured by "Sticky Factors" such as flexible time horizons, investment experience in Eastern Europe or other developing countries, relevant experience with Chrudim's needed manufacturing technology and easy access to the latest manufacturing technology. Successful sustainable strategies must hedge against the risk of technology imitation, substitution and retaliation. "Sustainable" strategic options include licensing existing technology, alliance relationships between companies with access and knowledge of Corn/Sugar Milling Technology and a company listed on either Table B or Table C, testing and transferring corn/sugar milling technology through piloted operations and backward integration.

Licensing Existing Technology
Licensed corn/sugar milling technology would permit the foreign investor to establish the industry standard in the Czechoslovakian Beverage market and could provide the opportunity to expand Chrudim's product market beyond alcohol based products to include other beverages such as soft drinks and ales. It would also provide a vehicle for the investor to share the risk of the initial capital infusion. Licensing arrangements should include stipulations concerning product quality, material sources, patent transfers and local R & D to protect the reputation of the patent holder.

Alliance Relationships
An alliance between companies with access and knowledge of the Corn/Sugar Milling technology and either Beverage/food companies or pharmaceutical companies will dramatically reduce the foreign investment risks while providing for technology transfer on both the manufacturing and product marketing levels. Chrudim would gain access to technology needed to hedge the agricultural threat while developing production economies of scale as well as access to new product areas such as alcoholic and non-alcoholic beverages and medical products.

The foreign investor will in turn gain needed experience in both product marketing and manufacturing in each respective industry.

Piloted Operations
Piloted operations will provide the foreign investor with a means of testing and implementing technology on a small scale. If technology transfer is infeasible the foreign investor will limit the risk of long term losses. This option could be utilized by both companies with access to corn/sugar milling technology and/or beverage or medical companies.

Backward Integration
Once committed the foreign investor should consider purchasing and managing the agricultural operations of raw material sources to reduce the agricultural threat and to manage the shift from the state owned and managed farms to privately owned farms. Reliance on existing agricultural system could adversely affect the companies ability to meet future market demands.

CURRENTLY AVAILABLE CORN/SUGAR SWEETENING TECHNOLOGY
The Clinton Corn company has patented a corn starch conversion technology called High Fructose Corn Syrup (HFCS). The patented technology is based on the discovery of an enzyme called glucose isomerase which converts glucose into fructose. Upon application to corn syrup, technology yields a syrup which is chemically identical to a liquid sucrose which is widely used in industrial sweetener applications.

Development of a commercially successful production process for HFCS is aided by enzyme production and immobilization. By immobilizing or embedding the enzyme in an inert material, much less of it is required to produce a pound of fructose. Producers believe that HFCS is identical to modicum invert sugar with the benefit of no aftertaste or secondary flavor.

Table A

OHRUDIM DISTILLERY
PRIVATIZATION TARGET SEARCH
COMPANIES WITH ACCESS & EXPERIENCE WITH
CORN/SUGAR MILLION TECHNOLOGY

Company Name	Company Locaton	Date Founded	Historically Active in M & A	Primary Business
American Maize Products	Roby, Indiana	1908	yes	Industrial Corn Syrup and Starch Production
Cargill	Cedar Rapids, Iowa	n/a	yes	International processor of cereals, sugar, molasses and flour
CPC International	Illinois and Missouri	1906	yes	Producer of refined Corn Products including starch, syrum and dextrose
Hubinger Company	Keokuk, Iowa	n/a	no	Producer of Unmodified Starch and Corn Syrup
National Starch and Chemical	Indianapolis, Indiana	n/a	yes	Producer of Specialty Starches and Adhesives
R.J. Reynolds	Cedar Rapids, Iowa	n/a	yes	Producer of Starch and Corn Syrup
A.E. Staley	Decatur, Illinois	1898	n/a	Producer of Corn Starch and Corn Syrup
Standard Brands	Clinton, Iowa	1956	yes	Producer of Sugar related enzymes

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Table B

OHRUDIM DISTILLERY
PRIVATIZATION TARGET SEARCH
POTENTIAL "ALLIANCE" INVESTORS
IN THE BEVERAGE INDUSTRY

Company Name	Company Location	Date Founded	Annual Sales 000's	Total Employees	Primary Business
IMC Holdings, Inc.	Northbrook, IL	1906	844	5,800	Medicinal and botanical juices
UST Inc.	Greenwich, CT	1911	683	3,337	Wines, brandy, and brandy spirits
Grand Metropolitan Inc.	Montvale, NJ	1962	7,136	70,000	Flour, grain mill products, wine and distilled beverages
Seagram J.E. Corporation	New York, NY	1981	4,160	11,882	Distilled and blended liquors, wines and brandy
E.J. Gallo Winery	Modesto, CA	1933	1,050	2,500	Wines and brandy
Quaker Oats Company	Chicago, IL	1901	5,031	28,200	Cereal breakfast foods, flour & grain mill products
Archer Daniels Midland Co.	Decatur, IL	1902	7,751	10,214	Malt, wet com milling products
American Brands, Inc.	Old Greenwich, CT	1904	13,781	43,300	Cigarettes, distilled and blended liquors
Heublein, Inc.	Farmington, CT	1875	1,800	3,500	Distilled and blended liquors

Table C

OHRUDIM DISTILLERY
PRIVATIZATION TARGET SEARCH
POTENTIAL "ALLIANCE" INVESTORS
IN THE PHARMACEUTICAL/MEDICAL INDUSTRY

Company Name	Company Locaton	Date Founded	Annual Sales 000's	Total Employees	Primary Business
AHSC Holdings Corporation	Malvern, PA	1988	2,564	2,400	Drugs, proprietaries and medical equipment
McKesson Corporation	San Francisco, CA	1833	7,791	13,800	Drugs, proprietaries and sundries
Amway International, Inc	Ada, MI	1978	975	2,800	Drugs and proprietaries
Dowbrands, Inc.	Indianapolis, IN	1985	966	2,400	Drugs and proprietaries
Core–Mark International, Inc	S. San Francisco, CA	1989	2,000	2,400	Drugs and proprietaries
National Intergroup, Inc.	Carrollton, TX	1905	2,755	2,200	Drugs and proprietaries
Cardinal Distribution, Inc.	Dublin, OH	1979	874	1,200	Drugs and proprietaries
Foxmeyer Corporation	Carrollton, TX	1986	2,736	4,000	Drugs and proprietaries
Bergen Brunswig Corporation	Orange, CA	1888	4,442	3,700	Drugs and proprietaries
Owens & Minor, Inc.	Glen Allen, VA	1882	953	1,609	Drugs and proprietaries
Alco Health Services	Malvern, PA	1988	2,564	2,331	Drugs and proprietaries
Durr–Fillauer Medical, Inc.	Montgomery, AL	1896	816	1,263	Drugs and proprietaries
Mark Steven Service	Woonsocket, RI	1969	1,318	2,100	Drugs and proprietaries
Culbro Corporation	New York, NY	1906	909	4,250	Drugs and proprietaries

APPENDIX II

"Investing in Czechoslovakia"

APRIL 1991

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2. General Information

2.1 Geography

Czechoslovakia (ČSFR) is a federal republic, consisting of the **Czech Republic** (Bohemia and Moravia) and the **Slovak Republic.** The total population comprises approximately 15.5 million people: 10.5 million Czechs; 3.5 million Slovaks; 700,000 Hungarians; and 800,000 members of different minorities (Germans, Russians, Ukrainians, Poles).

ČSFR covers an area of 49,370 square miles.

Among the largest cities in CSFR are Prague (capital of Czechoslovakia), with a population of 1.2 million; Bratislava (capital of the Slovak Republic) with 421,000; Brno (capital of Moravia) with 385,000; Ostrava with 328,000; and Plzeň (Pilsen) with 175,000 inhabitants.

Czech and Slovak are the two **official languages** in Czechoslovakia.

2.2 Administration

In the ČSFR there are three administrations in effect three governments i.e. Federal, Czech and Slovak. There are separate ministries for the federation as well as for the two republics, upon which have been given partly different jurisdictions.

On the federal level, 12 ministries have been established, and it is worth noticing that among these (still) are a Ministry for Strategic Planning and a Ministry for Inspection.

In the Czech Republic, there are 15 ministries. In the Slovak Republic, there are 17 ministries. In both republics, a Ministry for Privatisation ("Ministry for Administration of Public Property and Its Privatisation") has been established. The Slovak Republic even has a Foreign Ministry ("Ministry for International Relations").

2.3 Economy

Kčs 16 billion is projected for 1990. It should be kept in mind that this enourmous increase is not only due to an increase in imports but also to a devaluation of the Czechoslovak currency.

Inflation

The annual inflation rate amounted to approximately 15 percent during 1990. In 1991, because of the lifting of prices controls cs forecast on most goods the annual inflation rates to be in order of 50%.

Rate of Interest
The cost of borrowing is in the range 19 to 24%.

Foreign Debt
The foreign debt of Czechoslovakia amounted to **7.7 billion US dollars** in November 1990, and so was quite low in comparison with other former socialist countries. Czechoslovakia, being a member of the International Monetary Fund and the World Bank, is hoping for credit from the World Bank to support the reconstruction of its economy. The World Bank is planning to grant loans aimed at restoring the environment, introducing technologies for environmental protection, improving the infrastructure, and realizing new energy concepts.

Productivity
In 1989, the gross domestic product (GDP) amounted to 617 billion crowns.

Presently, approximately 2500 joint ventures with foreign partners are registered in Czechoslovakia with a total capital of 16,000 million Kčs of which the foreign capital amounts to 50 %. The most publicised and biggest JV signed to date is VW-Škoda.

2.4 Currency

1 Czechoslovakian crown (Kčs) = 100 haler

Official mean exchange rate of the Czechoslovakian State Bank (as of March 29, 1991):

1 US dollar	=	Kčs 30,50
1 Austrian Schilling	=	Kčs 2,50
1 German Mark	=	Kčs 17,54

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Basket of currencies + rates/ convertibilities

3. Structuring the Investment

Foreign investment in Czechoslovakia can take place by way of a number of vehicles as follows:

* the establishment of a **trade representation office;**
* the creation of a **wholly foreign-owned subsidiary;**
* the creation of a **joint venture** with a Czechoslovak enterprise.

3.1 Trade Representation of a Foreign Company

A trade representation acts as an agent of a foreign company and constitutes a branch or representative office. Since it is only an agent, Czechoslovakian law places restrictions on the activities and transactions which a trade representation can undertake. The most important of these restrictions is the inability to purchase property and technically, to negotiate contracts. However, in practice provided the trade representation is acting under a power of attorney from its head office contracts can be entered into.

This is the simplest and cheapest option to take in the initial stages of setting up in Czechoslovakia. Trade representations need to obtain permission to practice from the Ministry of Finance as well as registering with the Ministry of Foreign Trade. The cost of registration is between 900-1800 D marks and takes about 30 days. The following data is required (2 copies) in Czech:-

- parent office name, address and the individual in charge;
- an abstract from the company register translated and notarised;
- confirmation from a local bank that an account will be opened and funds have been transfered in foreign exchange;
- address of office in Prague;
- name of company representative in Czechoslovakia;
- details of proposed activities;
- annual company report or equivalent document demonstrating credentials;
- number of proposed employees (Czech, Slovak and expatriate);
- certificate of registration with local tax authority.

Note: all the above information to be provided in one of the official Czechoslovak languages.

Operation of a representative office may only be started after registration of the representative office at the Federal Ministry of Foreign Trade. The Ministry has to implement registration within 30 days, but there is no legal remedy for delay by the Ministry.

Trade representations may employ foreign as well as Czechoslovak employees and operate both crown and foreign currency accounts in Czechoslovakia.

Since Trade representations offices are not Czechoslovak legal entities, the foreign company which has established the representative office, or its Czechoslovak partner, needs authorization to conduct foreign trade in certain business activities.

3.2 Wholly Owned Foreign Company

Since May 1, 1990, it is possible for foreign investors to establish a company in Czechoslovakia without Czechoslovak participation.

The following forms of business enterprises are available to foreign investors and are deemed to be legal entities in Czechoslovakia.

* **Joint Stock Company** (a one-stockholder company is permitted, but the stockholder may not be an individual. Currently this status is only available to state enterprises as part of privatisation process)
* **Company with Limited Liability** (a one-shareholder company is permitted and the sole shareholder may be an individual);
* **Unlimited Partnership;**
* **Limited Partnership;**
* **Limited Partnership with Stock;**
* **"Association"** (depending on the structure, either a joint ownership of a business enterprise similar to an Austrian Civil Law Partnership, or a corporate enterprise);
* **Cooperative.**

The above structures are described in more detail in Chapter 6 of this booklet. At present, only the Joint Stock Company and the Company with Limited Liability are of practical importance for foreign investors.

3.3 Joint Venture

The term "Joint Venture" as used herein means the participation by a foreign company in a Czechoslovak company. A joint venture is a legal person under Czechoslovak law. Such participation is possible in the following forms:

* **Direct Participation:**
  Foreigners can participate by purchasing stock or by becoming partners in existing Czechoslovak companies, at present, the majority of Czechoslovak businesses are State Enterprises ("státní podnik", "s.p."). State Enterprises are a separate form of business, established by governmental agencies. The property of a State Enterprise is owned by the state; the State Enterprise has a permanent Right of Use in it. In the course of privatisation (Transformation Act effective from 1 April 1991), this form of business is expected to be abolished and State Enterprises are expected to be transformed into joint Stock Companies or other types of companies.

* **Joint Venture with foreign participation**
  In this case, a foreign investor forms a company (usually a joint Stock Company or a Company with Limited Liability) with a Czechoslovak company. The Czechoslovak enterprise or that part which is to be contributed, is valued and contributed into the joint company as a capital contribution in **kind.** The foreign investor is usually required to make his contribution in the form of capital, the amount of which determines the size of his participation in the company. This capital contribution may also take the form of equipment etc.

The Enterprises with Foreign Participation Act (Act 173/1988 as amended by Act 112/1990) applies to both wholly owned foreign companies and joint venture companies with a Czechoslovak partner.

Offshore companies, i.e. companies which are established in duty-free areas do not exist under Czechoslovak law.

4. Formation of Companies

4.1 Authorization by the Federal Ministry of Finance or by the Czechoslovak State Bank

The foundation of a 100 percent foreign owned company or a joint venture with a Czechoslovak company other than a "State Enterprise" does not require, the authorization of the Federal Ministry of Finance,only registration is necessary (see 4.2). An authorization is required only for setting up a JV in which a Czechoslovak State Enterprise is involved and can only be granted in concurrence with the Ministry of Finance, Prices, and Wages of the republic in which the company will have its domicile.

Enterprises with foreign participaton that engage in banking are granted authorization by the Czechoslovak State Bank and not the Ministry of Finance.

The application must be supported by the following:

(a) Name, domicile, legal form, and business activity of the company; -

(b) Name, domicile, and business activities of the participants with an abstract from the company's register translated and notarised;

(c) Amount of the capital, size of the participation of each participant, form and currency of their contributions, amount of the reserve fund (see), representation of the participants, distribution of profits and losses, and the legal structure;

(d) Draft of the articles of association; and

(e) Financial plan and profitability forecast for the first three years of the new company (on a form provided by the Federal Ministry of Finance).

(f) Confirmation from a local bank that an account will be opened.

The agency authorized to grant permission is empowered to require a financial report from the Czechoslovak participant about the foreign participant.

The agency authorized to grant permission is required to decide on the application within 60 days. An appeal can be made within 15 days in the event of an adverse decision.

4.2 Company Registration

Companies can commence trading only when they have been entered in the Business Register. The Business Register is an institution similar to the Register of Companies in the UK and is responsible for maintaining information on registered companies. The Business Register is administered by the Court of Registration.

The application for registration requires the following information:

- Name of the company;
- Date the articles of association were concluded;
- Name, marital status, and domicile of every participant;
- Representative authority of the corporate bodies;
- Business activity;
- Identification number (each company must, prior to registration, apply for a number at the Statistics Agency);
- Name of individual(s) fully authorized to represent the company; and
- Authorization to conduct foreign trade activities (in certain cases).

4.3 Formation Costs

Legal fees for the formation of a simple Joint Stock Company with Limited Liability vary from 2,000 to 10,000 US dollars. Czechoslovak Lawyers expect to be paid in hard currency. The administrative fees for formation amount (presently) to approximately Kčs 1,000.

4.4 Time Required for formation

An average time period of six weeks is required to receive authorization for the formation of a company from the Federal Ministry of Finance. However, due to a severe shortage of court personnel actual registration of the company in the Business Register can take up to 5 months.

5. Authorised Business Activities

5.1 General Information

Companies with foreign participation are allowed to undertake activities in all sectors of the economy except for those which concern defense and security of CSFR. However, companies will only be authorised to operate if their business activities are in the interests of the Czechoslovak economy and if they can generate sufficient financial resources.

5.2 Foreign Trade Activities

An authorization by the Ministry of Foreign Trade (in some areas of the service sector, the Ministry has jurisdiction over the service) is required for the export or import of certain strategic products (oil, gas, some chemicals etc) and other operations (sea-shipping and mediation of employment of Czechoslovak citizens abroad and employment of foreigners in Czechoslovakia). This authorisation can only be applied for after the company has been registered in the Business Register and a security deposit of Kčs 100,000 has been deposited with a Czechoslovak bank. At present, it can take up to two months to receive authorisation.

6. Company Law

6.1 General Information

Joint Stock Companies are regulated by the Joint Stock Companies Act (104/1990), Cooperatives by Act 176/1990, "Associations" by the Legal Relations in International Trade Act (101/1963), and all other companies by the Economic Code (Act 109/1964 as amended by Act 103/1990). In addition to the above-mentioned acts, the Enterprises with Foreign Capital Participation Act 173/1988 (as amended by the Act 112/1990) applies to companies with foreign participation.

On July 1, 1991, a Commercial Code, which will regulate all legal forms of business enterprises (modelled after the German and Austrian examples), is expected to come into force. **This Commercial Code will apply to companies with or without foreign participation.** At the same time, the Economic Code and the Enterprises with Foreign Participation Act will be repealed.

6.2 Reserve Fund ("reservní fond")

Each company with foreign participation is obliged, under the Enteprises with Foreign Participation Act, to set up a reserve fund. The reserve fund covers possible losses. The size of the reserve fund is determined by the company's articles of association. However, the reserve fund must not be less than 10 percent of the capital, or participation capital. As long as the reserve fund has not reached this amount, 5 percent of the annual profits (after taxes) must be transferred to the fund.

6.3 Audit of the Annual Financial Statements

All companies in which foreigners participate are required, under § 14 of the Enterprises with Foreign Participation Act, to have their annual financial statements audited by two certified public accountants. At least one of these must be licensed in Czechoslovakia, and the other may be licensed in a foreign country. The audit requirements for 1992 onwards are expected to be dramatically revised.

6.4 Joint Stock Company ("akciová společnost", "a.s.")

On May 1, 1990, the old Stock Companies Act, which contained only general provisions on Joint Stock Companies, was repealed. The new Joint Stock Companies Act is based on the Austrian, German, and Hungarian Stock Companies Acts.It should be noted that the law provides for the shareholders' meeting to elect the management board of the company and contains other detailed regulations to be followed.

Formation

The initial formation of a Joint Stock Company occurs either at the meeting of the founders or upon acceptance of the articles of association by the stockholders. Actions and resolutions adopted at the meeting of founders must be recorded by a notary.

Joint Stock Company with only one shareholder can only be founded by legal entities. The initial formation of this type of company requires a deed drawn up by a notary. This type of structure was especially created for the transformation of State Enterprises into Joint Stock Companies in which the state is initially the only shareholder. In view of the limited purpose of this form, it has been announced that after the completion of the privatisation of State Enterprises, no further one shareholder Stock Companies will be permitted.

- A Joint Stock Company comes into existence only when it has been entered in the Business Register (§ 27 Joint Stock Companies Acts - see also 4.2).

Share Capital ("základní kapitál")

The share capital of a Czechoslovak Stock Company must amount to at least **Kčs 100,000.**

A minimum of **30 percent** of the share capital, but not less than **Kčs 50,000** must be **contributed in cash.** At the time of registration in the Business Register, at least 30 percent of the share capital must have been paid. The remainder must be paid within the time period fixed in the articles of association, but not later than one year after registration in the Business Register. For late payments, interest has to be paid to the Company at 20 % per annum.

Contributions in kind ("věcný vklad") must be valued by a court-appointed expert (§ 18 Stock Companies Act). The value per the articles of association, may not be higher than the value determined by the court-appointed expert.

Stock ("akcie")

Not only **registered stock,** but also **bearer stock** may be issued to foreign stockholders. The articles of association may also provide for **preferential shares** with limited or no voting rights. Preferential shares may only be issued for up to half of the share capital of a Joint Stock Company.

The articles of association may also provide for **debenture stock** with interest rate calculated from the par value of the stock. This interest must be paid even if the Company does make a profit. A maximum of 10 percent of the share capital may be issued in the form of **debenture stock.**

The articles of association may provide for the issue of **employee shares** as registered stock at favourable or at no cost. There is no limit on the percentage of stock that may be issued as employees shares.

Corporate Bodies

All stockholders have the right to participate at **shareholders' meetings** ("valná hromada"). Preferential shareholders may not have voting rights.

The shareholders' meeting has authority over the following matters (§ 43 Stock Companies Act):

* Amendment of the articles of association (2/3 majority necessary);
* Increase or reduction of stock capital (2/3 majority necessary);
* Election and removal of the members of the management board;
* Election and removal of the members of the board of directors;
* Resolution on the distribution of profits;
* Dissolution of the company (2/3 majority necessary).

Note: To the extent that there is no provision to the contrary imposed by the law or by the articles of association, a **simple majority vote** is sufficient for passing a resolution.

board of directors

The ~~management board~~ (officers-"představenstvo") should have as a minimum 3 and a maximum of 11 members who represent the company individually or collectively. The representative authority of the management board can be limited by resolution of the shareholders or the board of directors. The members of the management board are personally liable to the company for all damages which occur due to violation of the limitation of the representative authority.

supervisory board

The ~~board of directors~~ ("dozorčí rada") must consist of a minimum of 3 members. Employees of Joint Stock Companies may not become members of the board of directors. If, however, the Joint Stock Company employs an average of more than 200 employees per year, a third of the board of directors must be elected from their number (§ 55 para 3 Stock Companies Act). They are required to approve the annual financial statements and propose the distribution of profits. The members of the board of directors may inspect the records of the company at any time.

6.5 Company with Limited Liability ("společnost s ručením omezeným", "spol. s r.o.")

The Czechoslovak Economic Code provides a general legal framework for a Company with Limited Liability. Therefore, it is recommended that the articles of association should be structured in some detail.

Formation
The initial formation of the company occurs upon the signing of the articles of association. The signatures must be certified by a notary. Single shareholder Companies with Limited Liability must be formed by notarial deed (§ 106 a Act 103/1990).

The company comes into existence only when it has been registered in the Business Register.

Shares Capital ("kmenové jmění")
The share capital must amount to a minimum of **Kčs 100,000.**

Capital Contribution ("vklad")
The capital contribution of a participant determines his share in the company and must amount to a minimum of Kčs 20,000 (§ 106n para 4 Act 103/1990). The contribution to capital may be made as a **contribution in cash** ("peněžitý vklad") or as a **contribution in kind** ("věcný vklad"). There is no minimum cash capital contribution, therefore a company can be formed purely on the basis of non-cash contributions. The Economic Code does not contain any provisions for the valuation of capital **contributions in kind**; but the Federal Ministry of Finance, which authorizes companies with foreign participation, requires valuation of capital contributions in kind to be undertaken by court-appointed experts, (similar to the valuation required by the Joint Stock Companies Act [see 6.4].

The **transfer of shares** requires the consent of the majority of the participants, if the articles of association do not provide otherwise.

Corporate Bodies
The law does not specify which corporate bodies must be formed. It only provides for the duty to state, in the articles of association, the composition of the corporate bodies, the method of their appointment, and their authority. The articles of association usually provide for managing directors (management board) and a shareholders' meeting.

Withdrawal of Participants
No participant may unilaterally withdraw from the company. A withdrawal is only permitted, if, at the same time, the shares are transferred to another individual.

6.6 Unlimited Partnerships ("veřejná obchodní společnost","v.o.s.")

Unlimited Partnerships are deemed legal entities in Czechoslovakia. They require a minimum of two individuals. The other partners may be legal entities. The partners are personally liable without limit for the debts of the partnership. Therefore, this legal form of business is normally not suitable for companies with foreign participation.

6.7 Limited Partnerships ("komanditní společnost", "k.s.")

Limited Parnerships are legal entities in Czechoslovakia. Individuals as well as legal entities may be partners in a Czechoslovak Limited Partnership. However, at least one of the partners must be an individual.

6.8 Limited Partnerships with Shares ("komanditní společnost na akcie")

For Limited Parnerships the shares are issued in the form of registered stock. The management of the business is the responsibility of the general partners. The shareholders are obliged to elect a board of directors.

6.9 Silent Partnerships ("tichá společnost")

Foreign investors may also participate as silent partners in Czechoslovak companies or sole proprietorships.

6.10 Cooperatives ("družstvá")

Cooperatives are considered to be legal entities in Czechoslovakia. They require a minimum of 5 members. Legal entities may be members, if the articles of association provide for this. Cooperatives are formed for business or other purposes. The articles of association are required to specify the extent of the members' liability for losses.

The Cooperative does not have practical importance as a legal form of business for foreign investors.

6.11 "Associations" ("sdružení")

Associations are only briefly covered. This form of legal entity is relatively unimportant.

7. Protection of Investments

7.1 Statutory Protection

A company's property in the territory of Czechoslokia may only be expropriated if compensation is paid (§ 22 **Enterprises with Foreign Participation Act**). This compensation must be paid in the currency in which the foreign investor's participation was paid. It can be freely transferred abroad.

Articles Seven et seq. of the **Czechoslovak Constitution** also provide general protection against nationalisation. Nationalisation and restriction of the rights of ownership may only be made in the public interest and only if compensation is paid. An action may be filed with a court opposing any nationalisation or restriction of the rights of ownership.

7.2 Protection by Treaties

Czechoslovakia has signed treaties for the protection of investments with the following countries:

- Austria,
- Belgium,
- Germany,
- Great Britain,
- Switzerland.

Only the treaty with Belgium has been ratified so far.

Treaties are planned for the following countries:

- Finland,
- France,
- Italy
- Sweden.

The treaties for the protection of investments guarantee foreign investors the same protection of property as domestic investors. Furthermore, the right to fully transfer profits abroad is also guaranteed.

8. Privatisation

At present, the majority of businesses are owned either by the state or by large Cooperatives. It is planned to return some of these businesses to their former owners (see chapter 9 - Reprivatisation) and to privatise then as follow:

There are two methods being adopted for privatising state owned enterprises, depending on the size of the enterprise:

Small Privatisation

The Act on "Small Privatisation" has already been passed and came into force on December 1, 1990.

The object of "Small Privatization" is to increase the private sector in the areas of trade, supply, services, and, where appropriate, other non-agricultural areas. To accomplish this, state-owned small businesses or individual parts of businesses (e.g. shops, workshops, etc.) will be publicly auctioned. These auctions, which will be organised by especially created agencies and will take place in two phases. In the first phase, only Czechoslovak citizens and companies in which only Czechoslovak citizens participate, will be allowed to participate and in the second phase, foreigners and companies with foreign participation will be permitted to participate.

The bid amount will only relate to the buildings and equipment. A separate consideration will have to be paid for stock of goods. Both components of the price will have to be paid in cash within 30 days after the date of the auction. The acquiror of the business is not permitted to resell the business to foreigners or companies with foreign participation during the first 2 years. If the business premises are not owned, (but only leased), the rental contract may not be terminated by the lessor for a time period of two years.

"Small Privatisation" does not affect the property which is to be returned to former owners or successors by way of restitution (see chapter 9). However, since claims for restitution can only be asserted within a certain time period, and the Act on "Small Privatisation" has no expiry date, this property may also be privatised by way of an auction.

Large Privatisation

The so-called "Large Privatisation act" dealing with the transfer of large state enterprises to the private sector was enacted on the 26 February 1991 and came into effect on 1 April 1991.

State enterprises which fall rate this category are required to prepare a privatisation project which details the procedure the enterprise should follow.

Privatisation projects require the approval of the Federal Ministry of Finance and the governments of Czech or Slovak Republics.

The act provides for the foundation of a Fund of National Property for each of the two republics. The property of state enterprises will be obliged to pass to the appropriate Fund of national property. The Act specifies the rule and jurisdiction of the Fund in the privatisation process.

The transfer from the Fund of National Property is

9. Restitution

The Act 403/1990 (First Reprivatisation Act) regulates the restitution of certain nationalised real estate and other property to their former owners or successors. It deals mainly with small businesses, apartment houses, and single-family houses, which were expropriated on the basis of the following provisions:

* Order 15/1959 (in some cases expropriated with payment of a "sales price");
* Act 71/1959; or
* Resolutions passed after 1955, which referred to the nationalization provisions of 1948.

Such property has to be returned by the company (including a company with foreign participation) which possesses this property. Individuals and companies in which only individuals participate, are not obliged to return property. In the latter case, the original owner or his successor is only entitled to assert a claim against the legal entity which sold the property to the individual or company not obliged to return the property to the original owner. The original owner or his successor may only recover the sales price that the legal entity obtained for the property.

Restoration can only be claimed by the original owner or his successor. The group of successors under Act 403/1990 is defined more narrowly than under the Czechoslovak law of succession.

Also, non-residents can assert a claim for restoration if "the compensation for the nationalisation was not regulated by a treaty" (§ 20 First Reprivatisation Act).

Land on which buildings were erected after the nationalisation of the land, need not be returned. The former owners of the land may only make a claim for compensation at the "Ministry for Administration of State Property and its Privatisation" (Ministry of Privatisation).

In the case of a **depreciation of the value** of a property since its nationalisation, the former owner can require compensation from the Ministry of Privatisation. If the value of a property is higher than at the time of its nationalisation, the former owner can either assert a claim for compensation amounting to the value of the property at the time of its nationalisation, or let the property be returned and pay "compensation for expenses" for the appreciation to the Ministry of Privatisation.

The First Reprivatisation Act does not affect leasing contracts.

All claims based on this Act must be registered before April 30, 1991. Sep. 30, 1991
Sept.

Further laws are being prepared which will regulate reprivatisation of property expropriated before 1955.

This is an extremely complicated subject and clients are recommended to seek legal advice before entering into contracts relating to land, property etc. in Czechoslovakia.

10. Taxation

10.1 Taxation of Representative Offices

10.1.1 Profit Tax ("důchodová daň)

Representative offices are subject to a profit tax of 40 percent.

The tax base for the profit tax is the profit that can clearly be attributed to the representative office. The tax base cannot be less than the profit that a comparable enterprise resident in Czechoslovakia would have generated (Act 157/1989 as amended by Act 108/1990).

10.1.2 Payroll Tax ("daň z objemu mezd")

At present, representative offices are subject to a payroll tax of 10 % of Gross pay.

10.1.3 Turnover Tax ("daň z obratu")

Representative offices of foreign companies are required to pay a turnover tax (Act 73/1952). Presently, representative offices are not liable for turnover tax.

The sale of goods (including the cost of imported goods and or own manufactured goods) is subject to the turnover tax. However, the turnover tax will not apply to goods exported to a foreign country.

At present, the provision of services (including the receipt of any rental income) is not subject to the turnover tax.

From January 1, 1991, four rates of turnover tax apply zero, 12, 22 and 32 percent. However, there will be a few products, ie alcohol, coffee, tea, tobacco, jewellery, fuel, and cars, where the existing tax rates will continue to apply. VAT and excise duties according to EEC guidelines wil be introduced in 1993 as part of the overall Tax reform.

10.2 Taxation of Companies with Foreign Participation

10.2.1 Profit Tax ("důchodová daň)

All companies with foreign participation are subject to the profit tax under Act 157/1989 as amended by Act 108/1990. Apart from Silent Partnerships and under certain circumstances, "Associations", all companies and partnerships are treated as legal entities (see chapter 6).

The period for computing the profit tax is the calendar year and is calculated in accordance with the current accounting law. Under this legislation losses cannot be carried forward. However, it has been announced that a loss carry forward period of 3 years will be introduced in the new tax reforms proposed for 1993.

A company with foreign participation is subject to tax at **20 percent** on profits up to Kčs 200,000 and **40 percent** on any amount above this.

From January 1, 1991. These rates will only apply where the foreign interest in the company exceeds 30 percent. Joint ventures with a lower foreign participation will be taxed at the same rates applicable to Czechoslovak companies. Joint Stock Companies with or without foreign participation (including insurance companies and banks previously 65 percent), 20 percent on profits up to Kčs 200,000 and at 55 percent on amounts above this.

There is no general exemption from, or reduction of, profit tax applicable to companies with foreign participation in its first years of trading. However, in practice the Federal Ministry of Finance will grant an **exemption** from the profit tax for the first 2 financial years after the foundation of the business, provided that the company undertakes to re-invest all of its profits for the period concerned (no dividends to be paid). Under special conditions, the exemption may be extended for a further two years.

At present, there are no general tax reliefs available as incentives for investing in designated areas.

10.2.2 Payroll Tax ("daň z objemu mezd")
All Czechoslovak companies and partnerships, including enterprises with foreign participation, are subject to a payroll tax amounting to **50 percent** (in the case of certain services, **20 percent**) of total gross wages and salaries paid to employees. The payroll tax consists partly of a contribution by the employer to the social security costs of the employees. The payroll tax is a deductible business expense.

The Federal Ministry of Finance may grant an exemption from, or a reduction of, payroll tax under the same conditions and for the same period of time as for the profit tax (see 10.2.1). Expatriates can seek exemption from this tax provide they can demonstrate that they are paying into a scheme in their home country.

10.2.3 Turnover Tax ("daň z obratu")
Enterprises with foreign participation are subject to the turnover tax, and the general rules apply (see (10.1.3).

10.3 Taxation of Foreign Investors

10.3.1 Taxation of Dividends
Dividends paid to non-resident legal entities (i.e. companies etc.) and also, individuals are subject to a **25 percent** withholding tax. This rate is reduced by virtue of the operation of Czechoslovakia's double-taxation treaties to between 5 and 15 percent depending on the individual country agreement (see Appendix A for list of double taxation agreements).

10.3.2 Taxation of a Partner's Profit Share

As from January 1, 1991 a 25 percent withholding tax applies to profits distributed to non-resident individuals. It will depend on the relevant double-taxation treaty whether Czechoslovakia will effectively tax those profit distributions.

10.3.3 Taxation of Royalties and Lease Rentals

Royalties and lease rentals paid to non-resident legal entities and foreign individuals are subject to a 30 percent withholding tax. Copyright royalties are subject to a withholding tax at 25 percent. The rates are reduced under the terms of the relevant double-taxation treaties (see appropriate Double Taxation Treaty).

10.3.4 Taxation of interest

Interest paid to non-resident legal entities and non-resident individuals are subjec to a 25 percent withholding tax. This rate applies also to interest on foreign bank loans and foreign shareholder's loans. The rate is reduced sometimes to zero under double-taxations treaties (see Appropriate Double Taxation Treaty).

10.4 Personal Income Tax

10.4.1 Czechoslovak Citizens

Czechoslovak citizens are subject to a wage-tax on employment income from Czechoslovak sources and income tax on their other income. Wage and income tax are different and independent taxes (there is no cumulation of income from employment and other sources to determine the marginal tax rates applicable).

Wage Tax ("daň ze mzdy")
Czechoslovak citizens are subject to a wage tax on income derived from any employment in Czechoslovakia.

The wage tax is withheld by the employer. Benefits-in-kind are also subject to the wage-tax.

The tax rate varies from zero to 32 percent, depending on the level of income and the number of the taxpayer's dependents.

Income tax ("daň z příjmů obyvatelstva")
A Czechoslovak citizen's income from sources other than from employment is subject to income tax.

On January 1, 1991 a new Income Tax Act came into effect under the terms of which the former progressive rates were reduced and a maximum tax rate of 55 percent introduced.

10.4.2 Taxation of Foreign nationals

Foreign employees of Czechoslovak legal entities

Foreign employees are subject to a wage tax (on the same basis as Czechoslovak citizens) in relation to income from employment in Czechoslovakia. The tax rate usually ranges **between 20 and 32 percent** (see 10.4.1). Remuneration for work carried out abroad is not subject to the wages tax. The wages tax is withheld by the company and paid over to the local tax office.

Representative offices

Foreign employees of Czechoslovak representative offices (of foreign companies) are subject to the wages tax at a flat rate of 20 percent, regardless of the level of income and the number of dependents. The 20 % rate is applied to the gross salary less a lump sum allowance of 15 percent. Thus, the effective tax rate is **17 percent.** The wages tax is withheld by the representative office and paid over to the local tax price.

Note:

Income for work performed in Czechoslovakia is sometimes exempt from the wage tax by virtue of a double-taxation treaty.

Taxation of other income

With effect from January 1, 1991 foreigners, who are present in Czechoslovakia for more than 183 days in any one calendar year or who have a residence in Czechoslovakia, will be subject to income tax on their worldwide income (excluding income from employment which is subject to the wages tax). Thus, foreigners will be taxed the same way as Czechoslovak citizens. However, income from foreign sources may remain free of tax under the terms of an appropriate double-taxation-treaty.

11. Profit Distribution

From January 1, 1991 the concept of **"Internal convertibility"** (see chapter 12) was introduced and permits companies with foreign participation to convert profits into hard currencies and to freely transfer them abroad. However, due to the shortage of hard currency in the country delays are likely to be incurred.

12. Exchange Control

On 1 January 1991 "internal convertibility" was introduced. (Act of November 28, 1990). Every company (partnership), including enterprises with foreign participation, will be required to sell all foreign currency held to Czechoslovak banks at the official exchange rate. If, however, foreign currency is needed for the acquisition of foreign imported goods and services or for profit distribution to foreign participants, etc. then foreign currency may be purchased from Czechoslovak banks at the official exchange rates prevailing.

These rules do not apply to funds advanced by participants in cash which may be kept in bank accounts denominated in foreign currency.

If goods are sold or services rendered in Czechoslovakia for consideration in a foreign currency, permission from the Federal Ministry of Finance under Decree 370/1990 is required. Permission is very seldom granted.

The following services rendered to foreigners do not require the above-mentioned permission:

* accommodation (hotels);
* rental of office and business space;
* consultancy and audit services;
* translation and interpreter's services;
* legal advice by lawyers.

13. Labour Law

The provisions of the Czechoslovak Code of Labor (Act 65/1965) apply to Czechoslovak and foreign employees. Foreign employees in Czechoslovakia require a work permit from the public employment agency and a residents visa.

13.1 Employment Contract

Employment contracts must be concluded in writing and contain as a minimum the following provisons:

- Type of work;
- Place of work
- Start Date of employment
- Salary, benefits.

13.2 Wages

At present wages paid (for all occupations) are determined by regulations. The average monthly salary amounts to approximately Kčs 3,300. During 1991, the provisions on wages paid by companies with foreign participation will be repealed imposing only a minimum wage (no maximum limit). Presently, bonuses may be freely fixed by the employer.

13.3 Duration of Employment

If the employment contract does not provide otherwise, the employment relationship is deemed to have been concluded for an unlimited time period. Limited employment relationship may be concluded for a maximum of three years. The employment contract may provide for a probationary period of up to three months.

13.4 Dismissal ("výpověď")

A notice of dismissal is required to be in writing. A notice period of two months must be given by the employer or employee. A dismissal always becomes effective on the last day of the month.

Employers may only dismiss employees for the following reasons:

- Winding-up or relocation of the business;
- Transfer of the business to another enterprise which cannot employ the employee;
- Restructuring of the business;
- Endangering the health of the emloyee;

- Lack of qualifications of the emloyee (this is interpreted restrictively);
- Existence of a reason to dismiss with Immediate Effect (see 13,5);
- Serious violations by the employee.

In the case of a dismissal for one of the first three reasons mentioned above, the employer is obliged to notify the appropriate public employment agency of the discharge at least one month before the employment relationship ends.

13.5 Dismissal with Immediate Effect ("okamžité zrušení")

A dismissal with immediate effect may only be made for the following reasons:

- Unconditional confinement of more than one year to prison because of the intentional commission of a crime;
- Unconditional confinement of more than six months to prison because of the intentional commission of a crime committed in connection with employment duties;
- Serious or repeated violation of the duties of emloyment;
- Endangering the state's security.

14. Property Law

14.1 Land Title Register ("pozemková kniha")/Real Estate Record ("evidence nemovitostí")

Until April 1, 1964, in Czechoslovakia a **Land Title Register** was maintained, which was very similar to the one in Austria. However, after 1948, registrations were made sporadically and incompletely, because rights in real estate were of little importance during the Communist regime. Furthermore, since January 1, 1951, registration in the Land Title Register has not been a required formality necessary to transfer ownership of property, but for information purposes only.

As a result of Act 22/1964 on the Real Estate Record, Land Title Registers were abolished and replaced by **Real Estate Records** located at the agencies for surveying. Since that time, the Land Title Registers have been stored at the state notaries' offices, but no new registrations have been made.

Reliance on entries in the Real Estate Records is not legally protected. Furthermore, Real Estate Records are maintained very carelessly and incompletely, so significant legal uncertainty occurs. In practice, to determine the actual legal situation with respect to real property, extracts from the Real Estate Record are gathered as well as information from the Land Title Register.

There are plans to transfer to the Real Estate Record the functions of the former Land Title Register.

14.2 Ownership (vlastnické právo")

Czechoslovak legislation recently abandoned the hitherto used classification of property rights. These were classified according to social-economic criteria, into state, cooperative, personal, and private ownership. Current legislation is trying to standardise property rights. The amendment to the Constitution (Act 100/190) still distinguishes among ownership by citizens, companies, and the state; but all property rights are equivalent and equally protected by the Constitution and statutes (Article 7 para 1 and 2 of the Amendment to the Constitution). Foreign individuals and companies are guaranteed the same protection of property and other property rights as Czechoslovakian citizens and companies (Article 14 of the Amendment to the Constitution, see also 7.1).

The regulation of property rights is made in different provisions, depending on the subject: Civil Code 40/1964. Economic Code 109/1964 (both in amended versions), Act 111/1990 on State Enterprises, Act 105/1990 on Private Business Activities of Citizens.

Within the framework of the present reform of civil law, further fundamental changes of property rights are expected.

14.3 Rights of Use

In Czechoslovakia a system of Rights of Use exists which enables organizations and citizens to use nationalised or private property without owning it:

Right of Use by State Organizations
The property used by State Enterprises and other state organisations is usually owned by the state. State organisations are granted the so-called "**Right of Management**" ("právo hospodaření") as to the property entrusted to them (§§ 5 and 6 Act 111/1990).This right not only includes the right to use the property, but also the authority to dispose of the property (§§ 65 to 71 Economic Code). State organisations are therefore entitled, under certain conditions, to entrust real estate to other companies or individuals for temporary use (§ 348 Economic Code). In special cases, they are even entitled to transfer the ownership of this property (§ 69 Economic Code).

Right of Use by Agricultural Organizations
The land cultivated by agricultural cooperatives and other agricultural organisations is usually owned by the original farmers or their successors. However, the agricultural organisations have a permanent Right of Use. Recent legislation has shown a tendency to strengthen the legal position of the owner of agricultural land (Act 162/1990 on Agricultural Cooperatives; amendment 114/1990 to the Act on Use of Real Estate and other Agricultural Property for Securing Production).

Right of Use by Private Persons
In general, residential buildings are most often owned either by the state or by apartment cooperatives. The occupants have a permanent "Personal Right of Use in Apartments and Pieces of Land" ("osobní užívání bytů a pozemků" - Section 3 of the Civil Code). On April 1, 1991 an amendment to the Civil Code is intended to enter into force, by which the Personal Right of Use of apartments will be transformed into a leasing right. The right has to be newly created, because presently there only exists the right to lease commercial premises. The Right of Use of land will be transformed into ownership of the land.

14.4 Acquisition of Real Estate Property

Under the Civil Code, if the ownership of real property is to be transferred by a sales contract, the purchaser acquires ownership only upon **registration of the sales contract at the appropriate state notary's office.** Prior to registration, the state notary's offices are obliged to check if the sales contract complies with the law. They are empowered to refuse registration. The decision of the state notary's office to allow registration, and not the actual entry in the Real Estate Record, is the formality necessary to transfer ownership of real estate property.

In Czechoslovakia, real estate property can only be acquired by "residents" (§ 26 Act on Foreign Currency 162/198 as amended by Act 100/1990). A resident for the purpose of this Act is any company with its domicile in Czechoslovakia (including joint ventures and, theoretically, 100 % foreign-owned companies), and any individual who has his domicile in Czechoslovakia or has been residing in the territory of Czechoslovakia for at least twelve months.

"Non-residents" are entitled to acquire real property as folloving:

* Inheritance;
* Restoration of real estate property to the former owner by way of reprivatization (see chapter 9);
* Acquisition by way "small privatisation" (see chapter 8).

14.5 Taxes and Fees Accruing at Acquisition and Sale

At present a property acquisition tax does not exist.

When the ownership of property is transferred for consideration, the seller must pay a **notary's fee**. The amount of the fee is based on the sales price. When the transfer is made to individuals or companies, which are members of the so-called "third group of individuals" (the first and second groups of persons are composed of close relatives and live-in companions) the notary's fee amounts to **5 percent** of the sales price.

Entry of the transfer of ownership in the Real Estate Record is free of charge.

14.6 Current Land, Property Taxes

There is no general land/property tax.

Only land used for agricultural purposes is subject to a **"land tax"** ("daň z pozemků"). This tax is levied annually and varies from **0 to 3,000 Kčs per hectare** (one hectare=2.471 acres), depending on the productivity of the land.

Presently, buildings not owned by the state are subject to a "house tax" ("domovní daň"). The maximum tax rate for apartment buildings subject to this tax is **50 percent** of the rental income, but this will be reduced in 1991 to 20 percent.

In the long term the government plans to introduce a general property tax. This tax will replace the present property and house taxes.

14.7 Mortgages ("zástavní právo")

The amendment to the Economic Code (Act 103/1990) contains a new regulation on liens on personal and real estate property. As a result of this law, mortgages on property come into affect only when entry in the Real Estate Record (§ 129 Economic Code). This is the only instance in Czechoslovakian law where actual entry of information about an act in the Real Estate Record is a formality required for the act to have legal effect.

14.8 Building Regulations

Prior to the commercement of construction, a construction permit must be obtained from the Czechoslovak administrative agencies. In the event of an adverse initial administrative decision, an appeal to another administrative agency is possible. Construction must be started within two years after receiving the construction permit.

After the construction of the building is completed, a permit to occupy and use the finished building must be obtained.

Changes to the building regulations (Act 50/1976) are planned.

15. Jurisdiction

15.1 Courts

Disputes between business entities (State Enterprises, companies, sole proprietors) are decided by Economic arbitration ("hospodářská arbitráž"). the introduction of commercial courts is planned.

Other disputes are handled by Civil Courts ("soud").

Decisions of Czechoslovak courts are enforceable in only a few foreign countries.

15.2 Arbitration

An arbitration clause in contracts with Czechoslovak enterprises is recommended.

Since Czechoslovakia has signed several multilateral and bilateral arbitration agreements (e.g. New York Convention of June 10, 1959; European Convention for International Trade Arbitration of April 21, 1961) enforcement of arbitration awards in a number of foreign countries is ensured.

Appendix A

Czechoslovakia has signed double-taxation treaties with the following countries:

Austria
Belgium
Brazil
Bulgaria
China
Cyprus
Denmark
Federal Republic of Germany
Finland
France
Hungary
India
Great Britain (not ratified)
Italy
Japan
Netherlands
Norway
Poland
Portugal
Rumania
Soviet Union
Spain
Sri Lanka
Sweden
Yugoslavia

Treaties are planned with the following countries:

Luxembourg
Switzerland

APPENDIX III

Key Strategic Human Resources Issues
Pertaining to
CSFR - KOLI Privatization Study

BACKGROUND

Assessing an enterprise's key human resources components is of strategic importance as assessing that enterprise's products, capital equipment and plant, markets and competitors. It provides the basis to characterize the human resources as an organizational asset and provides a foundation upon which to base future strategic enterprise decisions.

PHASE I. Assessment of Enterprise

A. Labor Management Relations - An overall assessment or characterization of the relationship between the labor leaders and plant management should be made. The primary purpose of this component is to determine the union's role and position regarding privatization changes that directly impact the workforce. A starting place would be to ask plant management to detail their working relationship and negotiating history, if any, with the union in the major areas in which the parties interface.

In addition, directly inquire, in discussions with the labor leaders, as to their position on these major areas. For example, determine the union's position and discretion on:

worker job duties:

worker incentives;

number of workers per shift and process segment;

production level per worker;

redundant workers; and

wage rates.

It is also important to determine the legal foundation upon which the union exists. Given the significant economic changes in the CSFR, has the government reached an understanding or made any agreements with national labor leaders with respect to privatization and the probable unemployment resulting from this process?

The information gathered above will help determine whether the union will be an impediment, proponent (partnership) or have a benign impact on privatization efforts. The proponent or partnership role is highly desirable.

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B. Quality of Workers - Worker knowledge and skills play a key role in determining an organization's competitive advantage. In discussions with plant management, inquire whether there are formalized training programs. If so, what is the scope and depth of training offered and to what classes of workers. For example, are training programs or classes offered in the following areas:

manufacturing process;

production quality;

marketing, and;

maintenance.

Ask plant management to provide course outlines and other records of the training programs. In the short timeframe allowed, it will be difficult to characterize the effectiveness of such programs. However, on a random basis, it would be appropriate to individually ask various workers about the training they have received and its applicability to their jobs.

C. Management Style - Managerial style can significantly impact the effectiveness of the organization. Supervisors with an autocratic management style can be an impediment when confronted with substantial change to the organization. This management style is usually resistant to change, where individuals wish to retain their status and authority. On the other end of the spectrum, a participative or team management style provides the foundation for a learning environment -- one which recognizes changes as challenges to be met and as opportunities to improve the organization.

Obviously, the latter style is highly desirable. Identifying the characteristic managerial style will provide an understanding of the possible managerial, training, communications and organization cultural changes that would be required for the organization to become a viable and competitive international manufacturer of food products.

D. Incentive Plans - Simply put, are there quality, cost or production incentive or bonus plans in use? If so, are these plans effective? What are the target goals and results that have been identified (verified)? What incentive payouts have been provided to the workers? Further, which groups of workers: production, managerial, staff etc. are participants and how are payouts differentiated between these groups?

If no or minimal incentives exist, what are the key stakeholder's (worker's, manager's & staff's) beliefs and thoughts about incentives. Within the framework of the findings of the above strategic human resources components, this is one of the key components to determine whether the organization will be receptive and able to respond to incentive reward systems to make it more competitive.

PHASE II - Privatization and Restructuring Plan Development

Successful market-focused enterprises have certain organizational and human resources characteristics that distinguish these enterprises from less successful enterprises. The following provides an overview of some of the key organizational and human resources characteristics an enterprise should strategically assess, adopt as its way of doing business and part of its culture.

A. Mission, Goals and Objectives - A characteristic shared by many successful enterprises is a concise and well-defined mission statement on the enterprise's principal purpose for existing. A mission statement provides a definition of what the enterprise is about and a vision that employees understand and can strive to achieve. The process of developing a mission statement is as important a task as the actual mission statement itself. One of the most effective methods for developing a mission statement is to have senior managers of the enterprise meet together, at a preferably off-site meeting dedicated for that purpose. Oftentimes, this meeting is facilitated by a management consultant familiar with the enterprise, and also serve as a neutral party to help build understanding and consensus. Further in developing the mission statement, the enterprise may wish to communicate its intents and thoughts to employees to provide a forum to allow employees to input into the mission process. This opportunity will support the enterprise's communication strategy and provide employees with a feeling of contributing to the direction of the enterprises. Senior managers are key to this process since they are in the positions to interpret and communicate the mission to employees and operationalize the mission statement in the enterprise's goals and objectives.

Therefore, the enterprise must develop:

1. Concise, well-defined and easily understood mission statement,

2. Specific and descriptive goals, long and short term, that directly support the mission, and;

3. Detailed objectives by functional departments that operationalize the goals of enterprize that are closely linked to day-to-day activities.

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B. Communication Strategy - Significant organizational and cultural change is occurring and employees will need to be reassured and have a clear understanding of what is happening a the organization and their jobs. There will be systemic enterprise change, future and cultural shock. The enterprise, to emerge successful from this transition, should implement an effective communication strategy. Employees will be more productive, less turnover (this may not be an issue) and will help set the climate for communicating the mission, goals and objectives of the organization. Further, this strategy can assist in avoiding potential labor problems with the union.

The communication strategy could include letters to employees, various forms of meetings, articles in local newspaper or enterprise publication, etc.

C. Compensation Strategy - The enterprise must determine its compensation strategy to attract, retain, motivate and reward all employees. The following outlines discusses some key compensation components:

1. Base Compensation - For a period of time, with the restructuring of the economy, there may be a general surplus of labor. However, the specific and unique skills needed to raise the enterprise's productivity maybe in short supply. Therefore, the enterprise must develop a strategy to find potential employees with those specific skills and attract them. This requires developing a competitive base pay to attract and retain these critical employees. The enterprise should be able to research and determine other enterprises' base pay rates, either by directly asking other enterprises, asking employees of those enterprises about pay levels or possibly reviewing government publications, if available. This data gathering should provide sufficient information upon which to establish competitive base pay rates for specific enterprise positions.

2. Incentive Compensation- Compensation above base pay should be objectively linked to achieving specific goals and objectives of the enterprise and should include both short and long term compensation plans.

a. Short-Term Incentive Plans - Short term incentive plans are usually one (1) year in duration and provide bonus opportunity at the end of the period. The frequency of payout is determined by the needs of the enterprise with regard to its operations and business cycle. Some key plan design components include:

-Participant population (managers, officers, staff, production workers, etc)

-Financial & operational plan targets (net income, financial ratios, market penetration, etc.)

-Percent of base pay as annual target bonus payout (possible percentages; senior management, 20-30%; first-level supervisors and middle management, 10-15%; staff, 5-10%)

- Production employees - A productivity or gainsharing plan for production workers would be appropriate in many situations in the CSFR.. These types of plans directly address the enterprise's need to increase quality, productivity, decrease cost, etc. Attached is some information on gainsharing plans.

The short term plan should include checks and balances to the extent participants are **not** incented to maximize short-term gains at the expense of the long term health of the enterprise. One method to address this concern is to ensure that profit margins increase over the previous financial period or maintain a constant percentage as net income increases. A method would be to utilize two key financial measures that would generate the plan payout which could include growth in earnings balance against cost control.

b. Long-Term Incentive Plans - Long-term incentive plans usually cover a 3, 5 or 10 year time periods and provide the enterprise with a strong motivational tool to incent senior managers to operate and manage the enterprise in the best interest of the shareholders.

(i) Stock-based plans - The opportunity exists to award enterprise stock to key employees. The stock based plans come in many versions. The type of stock plan that would be beneficial is dependent on the needs of the enterprise, its senior managers, principal shareholders and tax laws. Stock base plan a way to get the senior managers to act like shareholders. An example that might be useful in this situation:

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To facilitate and encourage management support and commitment to the enterprise, it may be appropriate to grant key senior managers an equity stake in the organization. A possible configuration of that equity could be both restricted stock and regular stock. The restricted stock plan would allow vesting in the shares over the time period: 3, 5 or 10 years. The employee could sell the stock at the time of vesting or later depending on the plans restrictions or conditions. The regular stock grant would be an outright award of stock which the employee could sell in the market, to another employee, or back to the enterprise at whatever price the market will bear. Further, a grant of stock or restricted stock could be tied to achievement of specific long term financial or operational targets as mentioned below. The employee assume the risks associated with owning the stock.

Stock options may be appropriate depending on the situation. However within the next several years senior managers, that would be eligible for stock option awards may not have the financial resources to pay the option price. Therefore, a hybrid type of stock plan called a performance stock plan could be developed which may include some of the following characteristics:

- Eligibility - senior management.

- Award of stock tied to achievement of financial goals,

- 3, 5 or 10 year vesting or payout of stock to grantee,

- Number of shares of stock limited to reduce dilution of majority shareholder, and

- At time of vesting or payout, awards may be in cash or stock, at Board of Directors discretion.

(ii) Cash Incentives - Senior management could be also rewarded in cash for achieving long term enterprise objectives at the end of a 3 to 5 year period. Oftentimes the enterprise will look at cumulative growth in earnings or use continuous increases in other key financial measures as compared to a base year, three year moving average or against a pre-set financial targets. Operational targets are also used such as market penetration or plant modernization completed within specific parameters.

APPENDIX IV

SUPPLEMENTARY FINANCIAL STATEMENT DATA

Prepared by Coopers & Lybrand
Prague, Czechoslovakia

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Balance sheets at 1 January 1991 and 31 August 1991

	Czechoslovak financial statements		IAS Adjustments		IAS Adjusted		Grouping/ cross reference
	1 January 1991 000k	31 August 1991 000k	1 January 1991 000k	31 August 1991 000k	1 January 1991 000k	31 August 1991 000k	
Fixed assets	946,830	938,362	-	-	946,830	938,362	
Accumulated depreciation	(312,316)	(321,005)	-	-	(312,316)	(321,005)	
Fixed assets in the course of construction	46,361	44,582	-	-	46,361	44,582	
Payments on account	2,286	6,045	-	-	2,286	6,045	
	683,161	667,984	-	-	683,161	667,984	(a)
Investments							
Cash in hand	9,100	9,110	-	-	9100	9,110	(b)
Cash in bank:	12	2	-	-	12	2	(c)
Current account	-	8,947	-	-	-	8,947	(c)
Special bank account	4,930	10,750	-	-	4,930	10,750	(c)
Foreign currency account	9,316	8,152	-	-	9,316	8,152	(c)
	23,358	36,961	-	-	23,358	36,961	
Vouchers							
Cash in transit	387	711	-	-	387	711	(c)
Cash in transit-foreign currency	-	149	-	-	-	149	(c)
	-	(1,587)	-	-	-	(1,587)	(c)
	23,745	36,234	-	-	23,745	36,234	
Accounts receivable	91,472	92,020	-	(2,222)	(2) 91,472	89,798	(d)
Other accounts receivable	(1,926)	(29,191)	-	-	(1,926)	(29,191)	(j)
Other receivables (social security refundable)	475	435	-	-	475	435	(e)
Other receivables (individuals)	(107)	13	-	-	(107)	13	(j) ~~31/8/91~~ 1/1/91
	89,914	63,277	-	(2,222)	89,914	61,055	(e) ~~1/1/91~~ 31/8/91
Inventories	415,902	358,253	-	(2,063)	415,902	356,190	(g)
Prepaid expenses	38	-	-	-	38	-	(e)
Profit allocated during the period	-	21,561	-	(21,561)	(4) -	-	(m)
TOTAL ACTIVE ACCOUNTS	1,212,760	1,147,309	-	(25,846)	1,212,760	1,121,463	

	Czechoslovak financial statements		IAS Adjustments			IAS Adjusted		Grouping/ cross reference
	1 January 1991 000k	31 August 1991 000k	1 January 1991 000k	31 August 1991 000k		1 January 1991 000k	31 August 1991 000k	
Accounts payable re assets in the course of construction	17,204	16,407	-	-		17,204	16,407	(h)
Equity	768,681	768,645	-	185	(1)	768,681	768,830	(m)
Other funds:								
Development	-	NA						
Reserve fund	6,385	15,128	-	-		6,385	15,128	(m)
Welfare fund	830	(1,485	(830)	↑		-	-	
Bonus fund	2,296	(	(2,296)	(1,485)	(3)	-	-	
	9,511	16,613	(3,126)	(1,485)		6,385	15,128	
Accruals and provisions	6,941	33,464	-	-		6,941	33,464	(j)
Accounts payable	92,397	2,536	-	-		92,397	2,536	(h)
Wages payable	3,461	2,551	3,126	1,485	(3)	6,587	4,036	(j)
Taxes refundable (profit and payroll)	(7,203)	(3,940)	-	-		(7,203)	(3,940)	(f)
Bank loans	247,678	247,922	-	-		107,973	(ST) 113,523	(ST) (k)
						139,705	(LT) 134,399	(LT) (l)
Other accounts payable	2,934	1,957	-	-		2,934	1,957	(j)
Taxes payable (turnover and wages)	57,818	2,045	-	-		57,818	2,045	(i)
Other accounts payable (private individuals)	35	19	-	-		35	19	(j)
Accounts payable: goods received, no invoice	13,303	37,529	-	-		13,303	37,529	(h)
Subsidies, additional sources	-	753	-	(753)	(4)	-	-	
			-	(2,063)				
			-	(20,808)	(4)			
Profit for the period	-	20,808	-	(185)	(1)	-	(4,470)	(m)
				(2,222)	(2)			
TOTAL PASSIVE ACCOUNTS	1,212,760	1,147,309	-	(25,846)		1,212,760	1,121,463	

(1) Write off of recreational facilities
(2) Provision for debts of doubtful collection
(3) Reclassification of funds in the nature of accrued expenses
(4) Elimination of profit allocated against profit for the period

Profit and loss account for the year ended 31 December 1990 and eight months ended 31 August 1991

	Czechoslovak Financial Statements		
	Year ended 31 December 1990	8 months ended 31 August 1991	Grouping/ cross reference
EARNINGS:			
Operating	795,981	487,772	(n)
Trading	1,633	1,168	(z)
Non-operating	1,010	573	(z)
Revenue subsidies	181	112	(z)
Material capitalised	30	3	(z)
Earnings from sale of inventories	7,443	27,890	(z)
Earnings/(loss) from sale of tangible fixed assets	(43)	5,215	(z)
Change in inventories of WIP and semi-finished goods	2,083	(22,747)	(o)
Change in inventory of finished goods	28,323	(11,093)	(o)
Price penalty	(6)	-	(x)
	836,635	488,893	
Price differential between manufactures' fixed price and export price achieved	(12,114)	N/A	(n)
Related reimbursement by State re price differential	9,741	N/A	(n)
Extraordinary gains	4,880	1,510	(z)
Other income: revenue subsidies and similar	233	3	(z)
TOTAL EARNINGS	839,375	490,406	

	Czechoslovak Financial Statements		
	Year ended 31 December 1990	8 months ended 31 August 1991	Grouping/ cross reference
COSTS:			
Material consumed in production	(490,939)	(270,062)	(p)
Fuel consumption	(25,012)	(17,086)	(r)
Price differential for raw materials and fuel	7,867	(1,416)	(p)
Energy	(17,861)	(10,528)	(t)
Repairs and maintenance	(17,530)	(6,126)	(v)
Delivery costs	(29,439)	(13,469)	(u)
Postal charges	(2,184)	(1,355)	(x)
Other material costs	(883)	(3,877)	(x)
Write off of tools and similar	(3,490)	(977)	(x)
Change in accrued expenses	(7,630)	(26,561)	(y)
Intangible costs	(9,699)	(9,865)	(x)
	(596,800)	(361,322)	
Depreciation charge	(39,216)	(32,537)	(q)
Part-timers and contractors costs	(52,518)	(27,311)	(s)
Wages costs	(697)	(417)	(s)
	(53,215)	(27,728)	
Interest	(17,567)	(24,483)	(B)
Payroll tax	(29,131)	(14,929)	(w)
Deficit and damage	(4,304)	(705)	(x)
Fines and penalties	(2)	(2,660)	(x)
Contribution to funds from costs	(9,128)	N/A	(x)
Other financial costs	(5,238)	(5,231)	(x)
Movement in accrual for financial costs	73	-	(x)
	(65,297)	(48,008)	
Credit notes received	44	-	(p)
TOTAL COSTS	(754,484)	(469,595)	
EARNINGS LESS COSTS i.e. PROFIT FOR THE PERIOD	84,891	20,811	

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	Czechoslovak Financial Statements		
	Year ended 31 December 1990	8 months ended 31 August 1991	Grouping/ cross reference
PROFIT ALLOCATION:			
Profit for the period	84,891	20,811	
Transfer from reserve fund	8,457	750	
Profit available for allocation	93,348	21,561	
Profit tax	(40,895)	(10,396)	(C)
Other levies, revisions and tax refunds	(249)	-	
Non-deductible expenses	(54)	(803)	(x)
Allocation to funds:			
Welfare fund			
- statutory	(1,300)	-	(s)
Reserve fund	(7,969)	(9,487)	
Development fund (statutory)	(36,481)	N/A	
Bonus (discretionary)	(6,400)	(875)	(s)
Profit allocated	(93,348)	(21,561)	

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	Year ended 31 December 1990	8 months ended 31 August 1991	Grouping/ cross reference
	000k	000k	
ADJUSTED PROFIT FOR THE PERIOD			
Profit for the period	84,891	20,811	
Profit tax	(40,895)	(10,396)	(b)
Other levies	(249)	-	(s)
Non-deductible expenses	(54)	(803)	(x)
Allocation to funds:			
* Welfare fund (statutory and discretionary)	(1,300)	-	(s)
* Bonus fund	(6,400)	(875)	(s)
Depreciation resulting from write off of recreational assets to nil net book value	-	(185)	(q)
Doubtful debts expense	-	(2,222)	(x)
Provision against write off of inventories relating to Kord restitution	-	(2,063)	(z)
	35,993	4,267	

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