
**Quarterly Performance Report and Action Plan
Armenia Privatization and Bankruptcy Project
April 1, 2001 through June 30, 2001**

Submitted to:

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Contract # PCE-I-00-97-00017-00
Task Order # OUT-PCE-I-804-97-00017-00

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**QUARTERLY PERFORMANCE REPORT AND ACTION PLAN
ENTERPRISE PRIVATIZATION AND BANKRUPTCY PROJECT
USAID Contract No. PCE-I-00-97-00017-00
April 1, 2001 through June 30, 2001**

I. Executive Summary

1. Task Order Number: OUT-PCE-I-804-97-00017-00
2. Performance Dates: April 1, 2000 through June 30, 2001
3. Start Date of TO: December 29, 2000
4. Completion Date of TO: January 4, 2002
5. Project Management: Alan Gogbashian and Roy Nygaard
6. Project Description: "Securing investment and private sector growth via privatization"

IBTCI provides the Government of Armenia targeted assistance in the privatization of state-owned enterprises (SOEs). These services include policy and legal development, transactional support and public awareness/investor outreach activities. The primary objective of IBTCI's Task Order activity is to develop a strategy for the privatization of Armenian Airlines. Additional activity objectives are the privatization of other strategic enterprises and privatization of enterprises through bankruptcy and liquidation proceedings. To achieve these objectives, IBTCI continues to work closely with the Ministry of State Property Management (MSPM), while focusing increased attention on relations with the Ministry of Justice (MOJ), a key player in the Armenian Airlines case, and building a new relationship with the Ministry of State Revenue.

The second quarter of the current Task Order activity was quite eventful on the whole and saw the achievement of the greater portion of our deliverables and tangible results. This is not to say that such progress was effortless. On the contrary, we continued to encounter hurdles to our work as in the past. These have been documented for USAID in previous project reports for the quarter.

Due to significant delays related to commencement of full-fledged activity on Armenian Airlines in the first quarter, certain of our original projections had to be revised accordingly. These changes are indicated in our Quarter Two Work Plan. It is encouraging to note that, following our nomination and acceptance as official advisors to the GOA Armenian Airlines Privatization Preparation Commission in April, we were able to achieve the objectives assigned to our project according to schedule. Similarly, as the second quarter progressed and IBTCI was afforded access to required documents, we became fully aware of the magnitude of the task at hand. This has not led to delays, but instead to considerable rethinking of our original methodology. These developments have been taken into account in the no-cost extension SOW and are visually represented in the work plan accompanying this report.

Project activity on strategic privatization proved highly effective in the second quarter of Task Order implementation. As detailed in monthly reports for April, May and June, our efforts focused on Ararat Cement and Mars, with secondary attention given to the sale of Almast and Sapfir. It should be noted that both of the latter two transactions took interesting turns as the reporting period progressed. The deal with Iranian Kohe Noor for Almast fell through, while the MSPM SEPPC returned to the Sapfir transaction and, by the end of the reporting period, had moved closer to identifying a qualified international investor. Our involvement in both of these unexpected finales was limited, although, as has been documented previously, we were actively engaged in the earlier stages of both transactions.

Activity on the bankruptcy front during the reporting period was limited and fraught with frustration throughout. As reported, the Bankruptcy Group under new leadership, had placed its hopes on several new initiatives, which we believed would break the bankruptcy deadlock and inject new life into the staling process (the author refers here to a relationship with the Ministry of State Revenue for new pilot cases and Tax Payment Privatization). Unfortunately, it became clear almost immediately that both of these schemes were doomed to failure for any number of reasons, including ongoing uncertainty at USAID regarding the future of its bankruptcy component in Armenia and a lack of political will and foresight within the MSPM. Despite these setbacks, the Bankruptcy Group did provide valuable insight to the Ministry of Justice in relation to its intention to redraft or otherwise amend current bankruptcy legislation, and maintained limited contact with ongoing bankruptcy case administrators.

The PR Group intensified its efforts to attract visibility and legitimacy to the GOA's privatization program with notable success, although activity on other Task Order areas was necessarily limited by factors outside of our control. Among the Group's primary achievements were its investor outreach activities in support of the sale of Ararat Cement and Mars. We also offered regular assistance to other project initiatives on a proactive, as needed basis. Significantly, and in accordance with the Task Order (Tangible Result/Benchmark #10: A core group of reform-oriented activists capable of influencing Armenian public opinion on privatization issues is created), the PR Group initiated and facilitated the creation of an NGO of public information officers in support of privatization.

The reporting period brought with it further strengthening of our relationships with counterpart Ministries. The Ministry of Justice, although playing less of a role in our bankruptcy activity, has become the focal point of our work on the Armenian Airlines case. Our long-term ties with the Ministry of State Property Management have also evolved and we have noticed a greater reliance on the part of the Ministry and the SEPPC on IBTCI input and recommendations regarding major privatizations.

In addition to the summary above, tangible results and successes over the reporting period have already been documented in monthly reports for April, May and June, which were submitted to USAID. We will therefore not repeat in this document the accomplishments identified therein. Rather, we will incorporate these reports by reference in the Quarterly Action Plan, which is annexed to this text in the form of a Gantt chart.

The Quarterly Action Plan lays out the subsequent three months of the project beginning July 2, 2001, and attempts to reflect realistically what may be accomplished between now and the end of the next quarter. The attached Gantt chart identifies each project task as stipulated in the revised scope of work for the no-cost extension period (see above) and projected completion dates. Details on the realization (or non-realization) of the various sub-tasks in the reporting period are provided below. In this way, the reader is presented with a clearer picture of our anticipated workload for the next three months.

Beginning July 3, 2001, our scope of work under a no-cost extension to the Task Order indicated above has been narrowed to focus exclusively on support for Civil Aviation Reform, our involvement with which began late last year. According to the wording of the no-cost extension document for the period September 4, 2001 through January 4, 2002, "the contractor is hereby authorized on a case-by-case basis, with the prior approval of the CTO, to devote a modest amount of resources to continue working on strategic enterprises. This refers in particular to assistance to the Strategic Enterprise Privatization Preparation Commission (SEPPC)...relative to enterprises that have been or are likely to become the focus of serious interest from international investors. These include Ararat Cement and Mars..."

II. Quarterly Progress Versus The Work Plan

TASK ONE: Armenian Airlines

Financial Audit Preparation

Following our official acceptance as advisors to the GOA Armenian Airlines Privatization Preparation Commission (AAPPC), we readily attained completion of this sub-task through the methodical implementation of the steps involved. With the aid of international airline finance consultant Donald Schenk, we performed a thorough review of Armenian Airlines' financial condition. As noted in our April Project Summary and Report, our findings were not particularly encouraging; notably the fact that the last audit of the enterprise was conducted in 1998. Nonetheless, here and in the following sub-tasks, we succeeded in creating as coherent a picture of the air carrier's financial standing as possible.

Certain minor tactical changes regarding timing were incorporated under this sub-task and those that follow as our work progressed. The reader will note that in our Second Quarter Work Plan, IBTCI proposed presenting our findings to the Government on an ad hoc basis as information became available. This approach was revisited and deemed incorrect, leading us to instead incorporate aggregate findings (financial audit analysis, due diligence, etc.) into the final strategy paper.

Financial Audit Analysis

This sub-task was accomplished in early April with the assistance of Donald Schenk.

Regulatory and Legal Review

Intensive document collection and due diligence was commenced in April and proceeded through the end of May. Despite initial security concerns stemming from the numerous entrenched interests within the Armenian Airlines structural hierarchy, our approach was thorough and covered the numerous subdivisions loosely attached to Armenia's overall aviation infrastructure. These include financial, legal, commercial, flight planning, maintenance and technical, human resources, check-in, baggage claim, catering and airline security. Armed with this mass of raw data IBTCI consultants, aided by local and international airline advisors, began drafting the Armenian Airlines Privatization Strategy Paper. Input provided by SH&E consultant Fredrik Anderson was particularly welcome as it put our initial findings into a global context.

Key Relationships

This sub-task was accomplished parallel to the above activities. It should be noted that IBTCI has worked closely with the GOA AAPPCC at all stages, providing progress summaries to Commission members and keeping them abreast of our findings. Our relationship building efforts have met with stunning success and our position with the Commission has become entrenched and marked by mutual respect.

Armenian Airlines Privatization Strategy Report

As noted above, our document collection measures were complete by the end of May. By that time, we had amassed an enormous volume of information, which then had to be distilled and analyzed to be of any real value. In light of this fact we requested, and received USAID permission to push back the date of this deliverable until August 1.

TASK TWO: Strategic Privatization

Sale of Almast (Strategic Enterprise #1)

Our involvement with this transaction was limited at the start of the reporting period to assisting the MSPM to negotiate and draft a contract consummating the deal with Iran's Kohe Noor. While we believe that we were successful in getting the transaction as far as it did, it is unfortunate that parties to the agreement in the end were unable to agree on terms. On a positive note, however, at the time of this writing there was significant interest in the company from the Lion Enterprises international business consortium.

Sale of Yerevan Jewelry Factory (Strategic Enterprise #2)

As the reader will recall, IBTCI was actively involved in the sale of Yerevan Jewelry Factory from the autumn of last year. As part of our engagement, we conducted numerous site visits, interviewed management, and prepared and distributed a full information memorandum to potential investors and market players.

Unfortunately, during 2001 the MSPM kept its intentions in relation to the facility hidden from us. We eventually gave up trying to solicit information and became resigned to the fact that the MSPM was probably going to give the company to the incumbent director by way of a sale to the company collective.

This indeed occurred in May; we discovered that a new company had been incorporated into which Yerevan Jewelry Factory's main assets were transferred. The collective bought the assets in "NewCo" while the original company, complete with debt and unmarketable assets, has been left on the shelf awaiting liquidation. It is certainly a disappointing outcome, but one that is perhaps unsurprising considering the director's powerful connections.

Preparation and Sale of Sapfir (Strategic Enterprise #3)

Following a period of intensive IBTCI preparatory and due diligence activity for the sale of Sapfir during the first quarter of 2001, culminating in the publication of a sales notice in the April 21 edition of The Economist, interest in the transaction on the part of the MSPM apparently petered out. The enterprise was the subject of discussion at several sessions of the SEPPC during the current reporting period, however, and by the latter part of the quarter, the Commission had reopened the bidding process and was nearing a final decision. While this MSPM-driven process was conducted in a less than transparent manner, it is believed that our initial investor outreach campaign sufficed to convince the Commission that a suitable international investor for the facility could be found.

Preparation and Sale of Mars (Strategic Enterprise #4)

As expected, this particular transaction was not completed by the end of our original Task Order. Nevertheless, we continued to engage the MSPM and SEPPC in constructive dialogue throughout the quarter with the aim of overcoming the political hurdles associated with the enterprise. These lobbying efforts were met with the approval of Minister Vardanyan, and IBTCI was requested to actively pursue the matter, ultimately creating and presenting an overview of the facility during the JETRO South Caucasus Investor Conference in Japan. Since then, we have been following up with global leaders in the high-tech industry interested in Mars.

Further activities related to the privatization of Mars are outlined in the Work Plan accompanying this text.

Preparation and Sale of Ararat Cement (Strategic Enterprise #5)

As with Mars, the sale of Ararat Cement had not been completed by the close of our original Task Order. Here, too, however, our proactive government and investor relations efforts appear to be producing suitable results. The reader will recall that significant advances were made during the reporting period towards the sale of Ararat Cement, including visits by delegations from Holcim and Seament, two globally recognized cement manufacturers. At the time of this writing, the fate of the transaction was in the hands of the Government and we await a formal tender announcement.

Further activities related to the privatization of Ararat Cement are outlined in the Work Plan accompanying this text.

TASK THREE: Bankruptcy And Liquidation

MOJ-Selected Bankruptcy Liquidations in Progress

The Bankruptcy Group continued to pursue its approach of limited involvement in on-going bankruptcy cases for reasons documented numerous times in previous project reports. This strategy was decided upon in part due to our hopes for a new relationship with the Ministry of State Revenue, which is described below.

Additional Pilot Bankruptcy Cases

Due to the limited success of our work on current pilot projects described above, the Bankruptcy Group concluded that the approach of partnering with reluctant administrators to privatize SOEs through bankruptcy proceedings was not likely to lead to success. In early February, the Group began searching for new ways to resolve the indebtedness of SOEs, simultaneously identifying partners who would have a similar orientation vis-à-vis the goals of bankruptcy proceedings.

The full course of these events, i.e. our overtures to the Ministry of State Revenue as a source of additional pilot bankruptcy cases, is documented in the Final Report on Bankruptcy Activities for the period of January-June 2001. As noted above we were successful in eliciting interest at the MSR for cooperation with our project, but these efforts ultimately did not produce the desired result as USAID was contemplating a transfer of bankruptcy activity to its Commercial Law Project.

Enterprise Rehabilitation

Our assessment of the feasibility of enterprise rehabilitation in Armenia was submitted to USAID on April 30, according to schedule.

Improved Bankruptcy Legislation

As documented in monthly reports throughout the quarter, the IBTCI Bankruptcy Group actively discouraged its counterparts at the Ministry of Justice from undertaking any significant changes to the Law on Bankruptcy out of concern that efforts to amend the Law could result in less progressive, populist legislation. Our focus was to emphasize opportunities to effect meaningful change through the development of regulations on administrator activity, the issuance of interpretive guidelines by the Council of Court Chairmen, and changes to other legislation that would affect bankruptcy.

Despite our entreaties, the MOJ pressed forward with its plan to either develop amendments to the Law or to introduce an entirely new piece of legislation, with drafting to begin in earnest in late June or early July. In order to minimize any possible negative consequences emerging from

this, and at the request of MOJ and with consent of the USAID Mission, the Bankruptcy Group developed the following materials for use by the Ministry:

- Memorandum on Companies that Failed to Re-Register under the New Requirements to the Civil Code (April 25, 2001);
- Issues for Consideration in Drafting a Bankruptcy Law (May 16, 2001);
- Comments to the Law on Bankruptcy (May 25, 2001);
- Illustrative Amendatory Language for the Law on Bankruptcy (May 31, 2001); and,
- Translation of the Executive summary of the World Bank Principles and Guidelines for Effective Insolvency Systems (April 2001).

These documents are annexed in their entirety to the Bankruptcy Group final report.

Bankruptcy/Liquidation NGO

Several meetings with bankruptcy case administrators were held over the reporting period and by the end of the quarter a draft charter for the organization had been developed. Questions remain, however, as to whether there would be sufficient demand for a stand-alone association of bankruptcy administrators and if it would not be more expedient to create a subdivision of the Association of Auditors.

Professional Bankruptcy/Liquidation Regulations, Certification Standards, Code of Ethics

The Bankruptcy Group urged the MOJ to pursue this approach in lieu of making significant amendments to the Law on Bankruptcy. The MOJ's subsequent decision to undertake considerable changes to the existing Law or draft a new one made our work in this area inopportune. Such regulations should be developed after the new or amended Law is passed.

Bankruptcy/Liquidation Training

The opportunity for the Bankruptcy Group to provide a noteworthy amount of training to administrators was hampered by an MOJ decision to initiate training in February under World Bank funding without having informed USAID. We did, however, submit comments on the MOJ's curriculum, in particular recommending that the training involve bankruptcy practitioners from the Russian Federation and Ukraine, countries with insolvency problems similar to Armenia.

The MOJ's response to this suggestion was positive, and we began evaluating several administrators from Russia, Ukraine and Kazakhstan, and submitted a field of two candidates to the MOJ for approval. At the time of this writing, an administrator from Russia was expected to fly to Yerevan to make a presentation to aspiring bankruptcy administrators on practical

approaches to handling bankruptcy cases in the NIS. Per previous agreement, the Commercial Law Project was to handle trip logistics.

III. Conclusion

The second quarter of the Task Order was eventful and productive. We firmly believe that our activity on all fronts met the challenges set forth in the Task Order document and succeeded in moving the privatization process forward. While this was not accomplished without the usual hurdles and foot-dragging, it is clear that IBTCI has positioned itself solidly to play an ongoing role in the GOA's future privatization and restructuring initiatives.

ANNEX

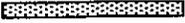
ID	Task Name	bruar	March 4	April 1	April 29	May 27	June 24	July 22	August	Septem	October	Novemb	Decemb
			4	18	6	3	18	5	29	7	4	29	
1	Armenian Airlines Privatization Strategy Paper						7/2						
2							7/2	8/1					
3	Submit Paper to USAID for review and approval						7/24	◆					
4	Present Paper to GOA						8/1	◆					
5	Department of Civil Aviation Restructuring Proposal Paper						7/2	8/1					
6	Submit Paper to USAID for review and approval						7/24	◆					
7	Present Paper to GOA						8/1	◆					
8	Draft Legislation Defining Role and Regulatory Authority of Department of Civil Aviation						7/2	8/1					
9	Submit draft to USAID for review and approval						7/24	◆					
10	Present draft to GOA						8/1	◆					
11	Guidelines for Restructuring and Development of Aviation Infrastructure						7/2			9/28			
12	Submit Guidelines to USAID for review and approval								9/20	◆			
13	Present Guidelines to GOA								9/28	◆			
14	Seminars on Recommended Changes											12/3	
15	To AAPPC members											12/3	12/4
16	To Department of Civil Aviation officials											12/10	12/14
17	To Armenian Airlines management and staff											12/17	1
18	Monthly Television Programming Highlighting Industry Problems and Advocating Proposed Change						8/7						
19	Monthly Radio Programming Highlighting Industry Problems and Advocating Proposed Changes						8/13						
20	Newspaper Articles Highlighting Industry Problems and Advocating Proposed Changes						8/1						
21	TASK TWO: LIMITED SUPPORT TO MSPM ON STRATEGIC PRIVATIZATION						7/2						
22	On-Going Support to MSPM on Mars Transaction						7/2					10/19	
23	Investor outreach efforts						7/2					9/28	

Project: Armenian Airlines
Date: Thu 7/26/01

Task		Summary		Rolled Up Progress	
Split		Rolled Up Task		External Tasks	
Progress		Rolled Up Split		Project Summary	
Milestone	◆	Rolled Up Milestone	◇		

ID	Task Name	bruar	March 4	April 1	April 29	May 27	June 24	July 22	August	Septem	October	Novemb	Decemb
			4	18	6	3	18	5	29	7	4	29	
24	Assist with draft of GOA tender announcement								9/3	9/7			
25	Respond to investor needs and questions						7/2				9/28		
26	Advise GOA on merits of bids received								9/10		10/12		
27	Assist with draft of GOA decision on sale									10/15	10/19		
28	Assist with draft and negotiation of sale and purchase agreement									10/15	10/19		
29	On-Going Support to MSPM on Ararat Cement Transaction						7/2					10/5	
30	Investor outreach efforts							8/6		9/6			
31	Assist with draft of GOA tender announcement						7/2		8/3				
32	Respond to investor needs and questions							8/6		9/6			
33	Advise GOA on merits of bids received							8/20		9/24			
34	Assist with draft of GOA decision on sale								9/24	10/5			
35	Assist with draft and negotiation of sale and purchase agreement								9/24	10/5			
36	Provide informational support for transaction						7/2					10/5	

Project: Armenian Airlines
Date: Thu 7/26/01

- Task 
- Split 
- Progress 
- Milestone 

- Summary 
- Rolled Up Task 
- Rolled Up Split 
- Rolled Up Milestone 

- Rolled Up Progress 
- External Tasks 
- Project Summary 

4 Present Paper to GOA

According to the Task Order, this report is a deliverable and must be submitted no later than May 1, 2001.

5 Department of Civil Aviation Restructuring Proposal Paper

The deliverables for Step 2 (Financial Audit Analysis) shall shed light on total market demand, its trends and the role of Armenian Airlines and its competitors. Also, Step 2 shall provide a clear view of the financial performance of the airline, its sources of revenue, its costs and the route operating ratios.

6 Submit Paper to USAID for review and approval

See comments to entry 24 above.

9 Submit draft to USAID for review and approval

The deliverables for Step 3 (Regulatory and Legal Review) would represent an agreed regulatory environment to encourage and manage entrepreneurial activity in developing all aspects of Armenia's civil aviation activity, mindful of the imperatives of safety, fairness and consumer interests.

22 On-Going Support to MSPM on Mars Transaction

Mars is by far the biggest of the 14 Strategic Enterprises. It was build just prior to the collapse of the Soviet Union at a cost of approximately \$800 million. It is mammoth in scale. This in itself makes it a complicated sale. To make matters more challenging, the company is run by the son of Karen Demerchyan, the late Speaker of the National Assembly assassinated in October 1999. The family has considerable political weight, which means that there may well be political obstacles to our involvement. However, Mars is of such strategic importance to the Armenian privatization program that to overlook this enterprise on account of political challenges would be too timid an approach.

29 On-Going Support to MSPM on Ararat Cement Transaction

We would select a fifth enterprise once more information has been released to the MSPM from the few remaining strategic companies still unprepared for sale.

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