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FACSIMILE MESSAGE

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PAGES: (inc cover page)

Message:

John:

Attached is a summary of the meetings Sergei held in Saratov last week. Based on our discussions, it sounds as though the trip was very productive.

I will be returning to Moscow on Sunday (leaving Dallas on Saturday). I will call you at the office on Monday to review last week's trip and to outline thoughts for next week's meetings.

Things here are great. Best regards to you and the family for the New Year!

Todd.

If you have any problems receiving this fax please call Rita Avdolna at (7) (095) 369-2647

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MEMORANDUM

To: John Paterson
CC: Rodgar Alford
David Rivlin
From: Todd Berman
Sergei Savchenko
Date: December 29, 1993
Re: Project Olga Meetings, December 22-23, 1993

The following summary outlines the results of discussions held in Saratov between Sergei Savchenko and others as indicated on December 22 and 23, 1993. In addition, I have suggested several agenda items for our discussions next week in Moscow as well as immediate next steps that need to be taken.

Overview

Consistent expressions of support for the broad concept of a B.A.T. investment in the factory were made by members of the local administration and by members of the factories' management. However, three key insights were gained on this trip:

First, no one in Saratov envisions a scenario in which B.A.T. achieves majority ownership other than by means of capital contributions. The possibility of purchases from the Workers' Collective clearly exists but does not appear to be the preferred route at this time.

Second, management is very concerned about its role post-investment. We have begun receiving tentative questions about what role there would be for management, how management might secure a role for itself and what has been seen at other factories where western investment has taken place.

Third, the Workers' Collective -- and even some of the management team -- has little or no idea of what is happening. This may be appropriate at this point in the discussions but it has begun to create some level of tension at the factory and nascent factions may be forming within the ranks of the Collective. An emphasis should be placed on developing a communication plan designed to both inform and persuade the Collective.

Summary of Discussions

- Anti-Monopoly Committee (Deputy): The Committee appears very supportive of the reform process generally and of B.A.T.'s potential role specifically. In fact, they offered to help resolve the

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export issue with the Administration. It is clear, however, that the General Director has refrained from enlisting their help (although probably legally entitled to do so) in order to avoid angering members of the Administration who have maintained the restrictions. The Committee also offered to provide assistance in the tender process "by providing information" although it is not clear what exactly they have in mind.

They raised the issue of pricing policy and stated that discriminatory pricing (ie, different prices for different customers) would be a violation and fines could be imposed. It is not clear, however, whether the Committee has the ability to impose such fines. In practice, the Committee's powers would appear to be limited.

- Kramov (deputy head of administration for food distribution): Kramov reiterated his general support for a B.A.T. investment in the factory. He expressed the view that price and export controls were no longer an issue although the relevant legislation is still in place.

In the past, the General Director applied to Kramov for the necessary licenses; he would approve the request which would then be submitted to a committee within the administration (Committee on Natural Resources, but name needs to be verified). Although there have been no problems acquiring licenses in the past the potential definitely exists for bottlenecks in the future.

Kramov's general impression was that there would be no problem with B.A.T.'s majority shareholding. However, two issues were raised: First, Kramov et al still appear to view the factory as a "local asset". That creates a powerful lever which management can use as necessary. Second, although Kramov recognises that B.A.T. could gain majority ownership through increased investment (and did not mention the possibility of direct share purchases), he also alluded to the fact that the investment required depended on "the value of the assets", an allusion to the possible revaluation of assets in the future (no time specified).

- Oleg (lawyer/Workers' Collective representative): Sergei and Oleg met for over three hours and have developed a very positive relationship. Oleg has been very open with Sergei and will likely be an ally in this process.

Oleg indicated that the Workers' Collective has little or no knowledge of what is happening with respect to B.A.T. They have seen foreigners at the factory but have been given no indication of the reason. This has created a fairly high tension level because of the uncertainty; One shop foreman apparently complained to management. Oleg's view is that the General Director needs to communicate to the Collective what exactly is happening. There have been no meetings of the Workers' Collective since discussions with B.A.T. began. Oleg believes a nascent split is occurring with some division of the Collective seen between skilled labor which supports the General Director (mechanics and other qualified labor, approximately 50 persons) and others who either oppose the Director or have no position at this point. The one clear point, however, is that the Collective is not informed. Oleg stated that some of the managers at the factory have no idea what is happening.

Oleg expressed some level of understanding of B.A.T.'s concern with investing in the factory without protection for its investment such as through a majority shareholding. However, his vision of the transaction is clearly one in which B.A.T. invests through the tender initially and then increases its shareholding through capital contributions. He definitely knew the details of the Yava discussions and it's clear that STF has communicated with Yava.

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At the same time, Oleg stated that he believed members of the Workers' Collective (himself included) would be willing to sell their shares at the right price. He pointed out that one fund offered to sell its shares to the factory at 60 times the nominal price but he believes 100 times would be fair. He said he would sell at 100 times but had no rationale for that multiple versus any other. He explained in detail the very difficult conditions in which he and other workers lived (communal flats, no car etc.) and that anything that contributes to improving those conditions would obviously be very well received.

Oleg raised the issue of management's role in the future and specifically asked Sergei for details of what occurred at the Uritsky plant. STP's Chief Mechanic visited Uritsky in the autumn and said that all but 3 of the prior management team had been fired. He stated that management is very concerned about its role in the future.

- **Chief Engineer (Samonov (sp.7)):** A meeting was arranged between Sergei and the Chief Engineer at the General Director's request. Basically, the Chief Engineer was testing to determine what role there would be for the management team in the future after the investment. He expressed concern generally about the future of the management team at the factory and how they might be able to secure their positions. He agreed that the period "of vodka and smiles" was over and that the hard part had begun. He had no clear vision to present of management's role or of how the investment would occur but expressed general concern.

Proposed Agenda for January 3-7 Strategy Session

The following outlines key issues to be addressed during our working sessions next week. These are initial thoughts on agenda items and should not be considered final:

- **Options:** Full review and discussion of potential options; short list of options agreed; approval plan for pursuit of priority option developed with timing, timing and responsibilities detailed.
- **Valuation:** Review of valuation range based on B.A.T. cash flow model, Bain Link valuation; pricing and share purchase process agreed.
- **Communication Plan:** Outline key messages to Collective/management team/others; outline timing and responsibilities; develop plan independent of approach taken.
- **Tender Process:** Outline timing and obligations associated with tender process; review business plan format and requirements; discuss implications and timing.

Immediate Next Steps

- 1) Obtain model for tender process business plan (Responsibility: Bain Link).
- 2) Detail internal approval process for January/February (JP).

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