INFORMATION MEMORANDUM

Issuer

MKT Istehsalat-Kommersiya MMC (Azerbaijan)

Guarantor: Lucot Limited (Liechtestein)

Security: Notes

Number of securities: 5 000 Notes

Nominal: USD 1000.00

Size of the issue: USD 5 000 000

Annual interest rate: 14.4%

Maturity: 11 August 2008

Arranger:

March 2006

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Definitions and Abbreviations

Azerbaijan – The Republic of Azerbaijan.

Business day – a day which is not Saturday or Sunday and when the banks in Latvia are open for conducting business.

Coupon – an interest payment for the Notes. All the Coupon payments are made according to the Term Sheet.

Latvia – The Republic of Latvia.

Legislation – legal acts of the Republic of Azerbaijan.

Lucot or the Guarantor – Lucot Limited is a juridical person registered under the laws of Principality of Liechtenstein and with the cotton trading as a primary business activity.

MKT or the Company or the Issuer - MKT Istehsalat-Kommersiya MMC is a juridical person registered under the laws of Azerbaijan and with the cotton processing as a primary business activity.

Note Holders – investors who are legitimate owners of the Notes and are entitled to receive the Coupon and the Principal.

Notes – debt securities issued by MKT as a private placement and registered in the Latvian Central Depositary.

Principal – face value of a Note which is repaid according to the Term Sheet.

Executive Summary

The Notes are issued by MKT Istehsalat-Kommersiya MMC, which is registered in the Republic of Azerbaijan. The Notes are guaranteed by Lucot Limited, which is registered in the Principality of Liechtenstein. Master Guarantee Agreement is in the Appendix 1.

MKT is the largest cotton processing company in Azerbaijan. It currently owns five cotton processing plants, one cotton oil extraction plant, a metal rolling shop, and a synthetic fiber plant and a yarn plant under construction. Audited MKT revenues in 2005 reached 143 849 million AZM (31.3 million USD) and the net profit was 1 072 million AZM (0.233 million USD). MKT purchases raw cotton from Azeri farmers, processes it and sells cotton fiber to large international cotton trading or manufacturing companies. Oil, seeds and other products are sold either locally or to Georgia, Iran and other countries.

Table 1 – Issuer's Summary Historical Financials, '000 USD

	2002	2003	2004	2005
Sales	24 283	32 805	31 168	31 319
EBITDA	4 005	9 972	6 373	1 497
EBIT	1 894	9 387	5 311	1 211
Net profit	392	5 999	3 838	234
Assets	33 292	36 075	47 298	56 890
Liabilities	24 635	21 419	28 805	38 605
- short term loans	3 729	3 756	4 107	8 474
Equity	8 657	14 655	18 493	18 285
Net cash from operating activities	2 716	2 429	4 728	7 156
Net cash from investing activities	(2 771)	(1 771)	(3 120)	(3 378)
Net cash from financing activities	22	(294)	(1 525)	(4 204)
Total net cash flow	(33)	364	83	(426)
Cash at the end of period	7	371	454	28

Source: Audited annual reports for 2003, 2004 and 2005. The exchange rate used for translating financials is AZM 4593 per 1 USD as fixed by the National Bank of Azerbaijan on 31 December 2005.

The main source for bond repayment is net cash flow from operating activities. MKT has strong positive cash flows from operating activities in all analyzed financial periods, which amounted 32.9 million AZM in 2005. Operating cash flow includes servicing of short-term loans. Therefore, the Company has ability to service its liabilities.

The Company has a strong cash generating abilities and uses internally generated resources for investing in fixed assets, construction and purchase of shares in subsidiaries. Current short-term loans are used for investment in working capital and short-term liquidity needs.

Repayment of the Note principal and Coupons depends on the cash flow generated by MKT and Lucot therefore the prospective Investors should carefully examine all the risks associated with MKT and Lucot.

Responsibility statement

Upon my knowledge the information included in this Information Memorandum is true and there are no unmentioned facts that can alter the contents herein or influence the decision of a potential investor to purchase the proposed Notes.

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Ikram Kerimli

General Director

MKT Istehsalat-Kommersiya MMC

Risks

Investment in the Notes involves a high degree of risk. Potential investors should carefully review this entire Information Memorandum and in particular should consider all the risks inherent in making such an investment, including the risk factors set forth below, before making a decision to invest. The materialisation of these risks, individually or together, could have a material adverse effect on the Company's business, operations and financial condition and/or the trading price of the Notes.

RISKS RELATED TO AZERBAIJAN

General. Since independence in 1991, Azerbaijan has undergone a substantial political transformation from a constituent republic of the former Soviet Union to an independent sovereign state. Concurrently with this transformation, Azerbaijan is progressively changing to a market economy. Although some progress has been made since independence to reform Azerbaijan's economy and its political and judicial systems, to some extent Azerbaijan still lacks the necessary legal infrastructure and regulatory framework that is essential to support market institutions, the effective transition to a market economy and broad-based social and economic reforms. Set forth below is a brief description of some of the risks incurred by investing in Azerbaijan, although the list is not an exhaustive one.

Risks Associated with Emerging Markets including Azerbaijan. Investors in emerging markets such as Azerbaijan should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant political, economic and legal risks. Investors should also note that emerging economies such as Azerbaijan's are subject to rapid change and that the information set out in this Information Memorandum may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is suitable only for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult with their own legal and financial advisors before making an investment in the Notes.

Currency regulation. Although some restriction on foreign currency transfers from Azerbaijan exist the National Bank of Azerbaijan has issued statement which shows that the Issuer's bank will be able to make all the appropriate Coupon and Principal transfers.

COTTON MARKET RISK

Majority of MKT revenues comes from the sale of cotton fiber to the large cotton trading and manufacturing companies. Although all of the exports are either 100% prepaid or have an unrevocable letter of credit the prices are normally fixed only for the deliveries for the next 3-4 months. Any decline in the world cotton prices will have an immediate impact on the credit worthiness of MKT and its ability to repay the Notes. The prices of cotton depend on the world demand and supply of the commodity. For example, new synthetic fabrics may emerge and substitute cotton fabrics or new regions may start growing cotton. Technologically it is possible to make pulp out of raw cotton but there is no guarantee that MKT will be able to properly set up pulp production and find clients.

CURRENCY EXCHANGE RATE RISK

The principal operating assets of the Company are located in Azerbaijan and its costs are primarily in manats. However, most of its revenues are in U.S. dollars. The manat has appreciated against the U.S. dollar, from AZM 4918.00 to USD 1.00 on 5 January 2005 to AZM 4572.50 (if converted from the new manat to the the old manat) to USD 1.00 on 7 March 2006. Such appreciation reduces MKT’s revenues in manat terms. Consistent with the prevailing market practice in Azerbaijan, MKT does not hedge against currency fluctuations. The continued appreciation of the manat against the US dollar may adversely affect MKT’s competitiveness in the export markets and may have a negative impact on MKT’s business, financial condition and results of operations.

Currency denomination and pegging to USD took place in Azerbaijan in 2006. Starting from 1 January 2006, one new manat (AZN) is equal to 5000 old manats (AZM) and is pegged to USD. This will reduce currency exchange risk for MKT.

COMPETITION

MKT is competing on two sides. On the buy side the Company is competing with other cotton processing companies in Azerbaijan. Although MKT has created well managed chain of operations starting from the financing farmers to offering competitive prices for raw cotton other companies may try to copy MKT practice and lure farmers away from MKT.

On the sell side MKT has to compete with other processing companies worldwide. MKT produces cotton fiber which is medium quality if compared with cotton from other countries. Medium quality comes from the mix of thickness and length of each fiber. Thickness depends on the region’s climate but length of fiber can be improved by better technology. At the moment, MKT has invested in roller ginning equipment in 4 plants which ensure that the length of fiber is the best possible. However, in the future other companies in Azerbaijan or other regions that produce similar quality cotton may adopt the same or better technologies than MKT and thus increase the competition.

DIVERSIFICATION

The management of MKT has started several non-core businesses: metal processing, production of synthetic fibers, real-estate, and is also sponsoring the football team. All of these businesses require industry knowledge and management attention. So far new businesses are developed using MKT internal cash flows. If the non-core businesses fail to succeed this can have substantial negative impact on MKT ability to continue modernization of cotton processing plants.

The sponsorship of the football team leads to significant cash outflows and should MKT experience decline in revenues or profitability the management might be forced to either cut the funding or abandon the sponsorship at all.

MANAGEMENT RISK

The future performance of the Issuer and the Issuer is heavily dependent on the quality and motivation of the management and personnel. Should any of the key team players leave MKT its performance may be significantly negatively affected. Management of MKT is well motivated through adequate salary and bonus packages.

Each investor considering purchase of Notes should be aware of risks that the Company faces and that could potentially undermine the Company's ability to service its obligations.

THE GUARANTOR

The Guarantor is a company 100% owned by Mr. Osman Nureddin Paksu (citizen of Turkey) who also holds 20% of the Issuer. Should Mr. Paksu and the owner of "Renessans Co." Ltd. have any sort of conflict the Guarantee could have little value as cotton trading might be done through other trading companies.

Term sheet of the Issue

Issuer:	MKT Istehsalat-Kommersiya MMC registered under the laws of Azerbaijan
Guarantor:	Lucot Limited registered under the laws of the Principality of Liechtenstein
ISIN (International Securities Identification Number):	LV0000601102
Currency:	United States dollar (USD)
Denomination:	1,000 (one thousand) USD
Issue size:	5,000 (five thousand) notes
Aggregate nominal amount:	5,000,000 (five million) USD
Minimum subscription lot:	65 000 (sixty five thousand) USD
Issue price:	
▪ **1st stage**	99% of the Principal;
▪ **2nd stage**	99% of the Principal plus accrued interest on the respective settlement date
Type of notes:	Senior unsecured
Subscription:	
▪ **1st stage**	22 March 2006 – 8 August 2006
▪ **2nd stage**	9 August 2006 – 26 August 2006
Value date for the 1st stage:	11 August 2006
Final maturity date:	11 August 2008
Coupon rate:	14.4% p.a.
Interest payment dates:	Semi-annual (each February 11 and August 11)
Day count fraction:	Act/Act
Put option:	Not applicable
Call option:	Not applicable
Use of funds:	For the general corporate purposes
Redemption value:	Principal of the Note is redeemed in one payment at the Final maturity date
Lead manager:	Parex banka
Paying agent	Latvian Central Depository
Depository:	Latvian Central Depository
Listing:	not listed
Governing law:	Latvian

Description of Notes Issue

COUPON PAYMENT

The Issuer will make Coupon payments twice a year on the dates specified in Information Memorandum section "Term Sheet of the Issue" through LCD and according to LCD regulations that are in force and regulate the terms of repayment of income for debt securities.

If the date of a Coupon payment is a holiday the Issuer shall make the relevant Coupon payment on the first Business day after the holiday. However if the closest Business day after the holiday occurs in the next month, the Coupon payment shall be made on the Business day preceding the holiday.

PROCEDURE OF THE NOTES REPAYMENT

The Issuer will make payments of Principle of the Notes on the Final maturity date through LCD in accordance with LCD rules that are in force at the time of the repayment.

If the Final maturity date is a holiday then the Issuer will repay Principle of the Notes on the first Business day after the holiday observing the terms stated in this section. However if the nearest Business day after the holiday falls in the next month, Principle of the Notes shall be repaid on the Business day preceding the holiday.

ACCRUED INTEREST

Interest amount on bonds shall be calculated using the following formula:

G=N*F/100*Akt 1 / Akt 2

where:

G – amount of interest,

N – nominal value of one bond,

F – annual interest rate (profitability) of bonds.

Akt 1 – number of days during the term of payment of appropriate interests on bonds.

Akt 2 – actual number of days of the year.

SUBSCRIPTION

The prospective investors may submit bids to Parex banka (Smilsu iela 3, Riga, LV-1050, Latvia) during the subscription period. The bids may be submitted either directly or through brokers of other banks or brokerage companies. If the prospective investors wish to submit bids directly they have to be Parex banka's clients. The prospective investors have to indicate the maximum amount of the Notes they are ready to buy.

This Issue does not constitute the public offering of the Notes. During the initial placement the Notes are sold with minimum investment to one investor of USD 65 000 and USD 1 000 thereafter.

By placing an order to purchase the Notes a prospective investor agrees to accept the terms and conditions set out in the Master Guarantee Agreement (see Appendix 1).

SUBSCRIPTION PERIOD

The subscription period is divided in two stages:

- 1st stage starts at 10:00 on 22 March 2006 and ends at 12:00 on 8 August 2006;
- 2nd stage starts 10:00 on 9 August 2006 and ends at 12:00 on 26 August 2006.

The prospective investors may submit their bids every Latvian business day from 10:00 till 18:00.

ALLOCATION OF NOTES TO INVESTORS

On 8 August 2006 after the end of the 1st stage of the subscription period Parex banka will announce the results of the subscription and will allocate the Notes to investors as follows:

- If the prospective investors subscribe to the total number of the Notes which equals or is less than 5 000 then all the bids are fully satisfied;
- If the prospective investors subscribe to the total number of the Notes which is greater than 5 000 then the Notes are allocated according to the decision of the Arranger.

During the 2nd stage the Notes will be allocated to Investors each Business day depending on the submission date of the subscription primarily satisfying earlier orders. If the orders have been submitted at the same time, Parex banka will allocate the Notes proportionally to the subscribed number of the Notes.

REDUCTION IN SIZE OF THE ISSUE AND CANCELLATION OF THE NOTES ISSUE

If the total number of the Notes subscribed during the 1st stage as defined in the Term Sheet, the Issuer has the right to declare the issue completed in the actual subscribed amount or cancel the Issue at all.

SETTLEMENT AND DELIVERY OF THE NOTES

Settlement of the Notes will be executed as DVP (delivery versus payment) transaction in accordance with the LCD rules No. 15 “On DVP settlements in foreign currency” 27 February 2004. The Notes will be transferred to investors’ security accounts with settlement date T+3 (on the third Business day after the announcement of the 1st stage results or on the third Business day after the subscription date in the 2nd stage).

Investors cover their own expenses in connection with the subscription to the Notes.

RIGHTS OF NOTE HOLDERS

An investor receives the Notes after paying the full price.

Note Holder has the right to receive and the Issuer has the obligation to pay Coupon payments and the Principal in the amounts and according to the schedule specified in the Term Sheet.

Note Holder is entitled to other rights in respect to the Notes and the Issuer as defined by the Legislation.

DECISIONS OF THE ISSUER ON THE ISSUE OF THE NOTES

The Notes are issued according to the Minutes No.1 dated on 30 January 2006 of the General Meeting of the Issuer’s shareholder.

REPRESENTATION OF THE NOTE HOLDERS

It is not envisaged to create any organisation or trustee that would represent the Note holders jointly. In case of the insolvency of the Issuer every Note holder has the right to represent own interests in creditors’ meetings.

RESTRICTIONS ON FREE CIRCULATION OF THE NOTES

There are no restrictions regarding transfer (sale and purchase) of the Notes in the secondary market. However such transfers cannot be made as a public offering.

TAXES IN AZERBAIJAN

According to the laws of Azerbaijan the interest payments on the Notes are subject to 10% withholding tax. The Issuer undertakes to make all Coupon and Principal payments due to this Information Memorandum free and clear of, and without deduction for, any set-off, claim or applicable taxes (with appropriate gross-up for any taxes deducted or withheld). For this purpose, "taxes" means all forms of taxation, duties (including stamp duty), levies, imposts, charges and withholdings (including any related or incidental penalty, fine, interest or surcharge), whenever created or imposed, and whether required by the law or regulations of the Republic of Azerbaijan.

The investors should seek an independent tax advice regarding the tax payments on Coupons and Principal in their place of residence.

ACTIONS IN CASE OF DEFAULT

EVENTS OF DEFAULT

The Issuer is in default if at least one of the following occurs:

- the Issuer has not paid the Coupon in full amount for more than 15 Business days;
- the Issuer has not paid the Principal in full amount for more than 15 Business days;
- there has been submitted insolvency claim by the Issuer or by the third party in the appropriate state authorities of Azerbaijan;
- the Issuer has filed for liquidation in the appropriate state authorities of Azerbaijan.

ACTIONS

In the event of Default the investors have the right to demand repayment of the Principal and the accrued interest from the Issuer or from the Guarantor. If an investors wishes to claim repayment from the Issuer the investor will have to file the claim in the Azerbaijan courts. Before the Issuer is forced to make the Principal and accrued interest transfers the Azerbaijan court will have to issue the appropriate decision. If an investor wishes to claim repayment from the Guarantor then the investor will have to file the claim in the Liechtenstein courts.

SUBORDINATION OF THE NOTES

The Notes rank pari passu with other unsecured obligations of the Issuer. In case of insolvency of the Issuer, the Note holders will be entitled to recover their investment on the same terms as other creditors in the respective claims group according to the relevant legal acts of Azerbaijan. There are no contracts or other transaction documents that would subordinate the claims of the Note holders to other unsecured liabilities of the Issuer.

ENFORCEMENT OF FOREIGN JUDGEMENTS

The Issuer and substantially all of its assets are located in the Republic of Azerbaijan. In addition, most of the directors and officers of the Issuer are residents of the Republic of Azerbaijan and substantially all of their personal assets are located in the Republic of Azerbaijan. As a result, it may be difficult for foreign investors of various jurisdictions to effect litigation process in the same manner as in their own jurisdiction on the Issuer or its directors or officers in connection with any lawsuits against the Issuer or such persons related to the Notes. Furthermore, foreign investors may have difficulties enforcing judgments of foreign courts against the Issuer or its directors or officers in the Republic of Azerbaijan.

The Republic of Azerbaijan is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. Arbitration awards in countries that are signatories are enforceable in the Republic of Azerbaijan subject to this convention and certain other limitations (including applicable provisions of Azerbaijan law). The Notes provide information for arbitration in a case of enforcement of any claims.

The Issuer – MKT

MKT is the largest cotton processing company in Azerbaijan. In 2005, MKT had audited revenues of AZM 143.8 billion (USD 31.3 million) and net profit of AZM 1.1 billion (USD 233.6 thousand). In 2004, MKT had revenues of AZM 143.2 billion (USD 29.2 million) and net profit of AZM 17.6 billion (USD 3.6 million). Apart from its main business MKT has also a metal processing plant, a football team and a synthetic fiber plant and a yarn plant under the construction.

LEGAL INFORMATION

MKT Production-Commercial LLC is registered under the Certificate No. 736 dated 22 April 2002. MKT code of Identification is 1652155. The registered office of MKT is located at 31, Istqlaliyyet Street, Baku, Azerbaijan.

Authorized and paid up share capital of the Issuer amounts to AZM 29.4 billion (USD 6.4 million) as at 31 December 2005. The share capital of MKT is owned by two private investors: “Renessans Co.” Ltd. (fully owned by Mr. Hikmet Abuzar Oghlu Ismayilov (citizen of Azerbaijan)) which holds 80% of share capital and Mr. Osman Nureddin Paksu (citizen of Turkey) who holds 20%.

KEY ASSETS OF THE ISSUER

During the privatization of cotton processing plants the government of Azerbaijan sold each plant as a separate Open Joint Stock Company. Therefore MKT now holds varying stakes in the cotton processing companies and in one oil extracting company. MKT has also established two subsidiaries in non-core business. Total value of long term investments in subsidiaries is 64.9 billion AZM (14.1 million USD[1]) as of 31 December 2005.

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[1] All balances as at 31 December 2005 are converted into USD using the exchange rate 1 USD = 4593 AZM, as stated by the National Bank of Azerbaijan Republic as at 31.12.2005.

Figure 1 – MKT and its subsidiaries as of 31 December 2005

Source: Management of MKT

OJSC "Saatli-Pambig", OJSC "Yevlakh-Pambig", OJSC "Bilasuvar-Pambig", OJSC "Salyan-Pambig" are cotton processing companies which using either saw or roller ginning method to produce cotton fiber, seeds and cotton waste from raw cotton. In OJSC "Bilasuvar-Pambig" MKT changed cotton processing technology in 2004 to a more effective roller ginning method. OJSC "Ali-Bairamli Fat-and-Oil Factory" is extracting oil from cotton seeds that are brought from cotton processing plants. "MKT-Araz" is a football club in Imishli town, "Silk Way Motors" is a car dealership which started its operations in 2005 but the management has discontinued the dealership, and "Bahruz Ltd." is a trading company established in 2004. In 2006, MKT bought 67.7% stake in a yarn plant "Sumgait Hovlu Iplik" in Sumgait city. The plant is now under reconstruction and the management plans to fully utilize the capacity within two years.

Other shareholders in the cotton processing plants and the oil extraction plant are the government of Azerbaijan (appx. 30%), employees of these plants and other entities. One of the restrictions that are imposed by the state shareholder is limitation of the sale of plant's vehicles. Every time the plant wishes to sell these assets it needs to get an approval from the state authorities.

In order to secure its short-term bank loans, MKT pledged shares in subsidiaries to the total amount of 39.8 billion AZM (4.7 million USD) as at 31 December 2005.

Property, plant and equipment include buildings, machinery and equipment, vehicles, office equipment and other fixed assets, with total net book value 11.9 billion AZM (2.6 million USD) as at 31 December 2005.

The Issuer owns six buildings with the total net book value of 504 million AZM (110 thousand USD) as of 31 December 2005.

Table 2 – Buildings owned by MKT

Building	Location	Net book value as at 31.12.2005 '000 AZM
Office building	Baku	66 266
Scale platform	Agdjabedi	79 512
Scale platform	Beylagan	118 008
Scale platform	Bilasuvar	85 770
Scale platform	Barda	75 750
Scale platform	Saatli	78 650
Total		**503 956**

Source: Company management

At present, MKT is constructing 9-floor high office building on 7-hectare large plot of land on the Baku major street. MKT has invested USD 1 million to complete the exterior part of the building. The management of MKT estimates that additional amount of investment to complete the construction is USD 5-5.5 million. The total office space is projected up to 14 000 m^2. According to the real estate industry standards this office building will be almost A class. The upper three floors will house the administration of MKT. The lower six will be let to other companies. The building complex will include a small hotel, conference halls, a restaurant and a parking lot. The new MKT office building is set to open by the end of 2006.

Net book value of property, plant and equipment amounted to 11.9 billion AZM (2.6 million USD). The largest item is machinery and equipment, which includes cotton processing and cotton oil refining equipment, amounted to 9.6 billion AZM (2.1 million USD) as at 31 December 2005.

In addition to property, plant and equipment, the Issuer has construction in progress, which represents uninstalled equipment and costs of construction works of metal-roll works, fat and oil complex and synthetic fiber plant. As at 31 December 2005, construction in progress balance amounted to 31.1 billion AZM (6.8 million USD). Management plans to complete construction and installation in late 2005 – early 2006.

KEY LIABILITIES OF THE ISSUER

The Issuer finances investment in fixed assets and working capital primarily with retained earnings and advance payments from customers.

Additional liquidity is obtained from short-term loans provided by Azerbaijan banks. These are loans with maturity of less than one year.

Table 3 – Short term loans of MKT

	As at 31.12.2005		Maturity
	AZM '000	**USD '000**	
Turan Bank	3 109 260	677	2006
Bank Respublika	7 048 680	1 535	2006
Kapital Bank	14 566 534	3 172	2006
Standard Bank	14 195 305	3 091	2007
Total	**38 919 779**	**8 476**	

Source: Audited annual report 2005.

DESCRIPTION OF MAIN ACTIVITIES

History of MKT

MKT was registered in 19 April 1995 under the laws of Azerbaijan. When in 1997 the government of Azerbaijan started privatization of cotton industry assets MKT was one of the most active private companies to acquire production assets at the cost of USD 8.02 million. Due to the rapid expansion, MKT has become the largest cotton processing company in Azerbaijan. Since 22 April 2002 MKT, acts as a limited liability company.

Production

Raw cotton is procured from local farmers. MKT concludes three-party treaties with a farmer and one of its cotton processing plants. Under these agreements a farmer undertakes to deliver a specific amount of cotton of appropriate quality to the cotton processing plant for a fixed price (AZM 1500/kg in 2005/06 season). The plant undertakes to correctly weigh the delivered cotton and properly store it before processing. MKT undertakes to pay for the delivered cotton according to the payment schedule.

In order to assure quality and volume of raw cotton supplied, MKT is actively involved in financing farmers, providing seeds, farming equipment, fertilizers, transport (trucks) industry know-how. For the first two year of co-operation, a farmer pledges its land plot. If the farmer fulfils his obligations under the agreement MKT may cancel the requirement to pledge the land plot.

Occasionally, farmers fail to fulfill contract obligations for delivery of certain amount of raw cotton. If the amount of financing received from MKT is more that 1 thousand USD, MKT submits the claim to the court.

According to the management of MKT during the last two years MKT had around 200 cases against the farmers for the total amount of USD 600 thousand. Usually the cases are won in the first court level and after that a law enforcement officer recovers the debt.

At the present, MKT does business with farmers in Saatly, Beilagan, Barda, Agdzhabedi, Udzhar, Salyan, Terter, Bilyasuvar, Neftchala, Sabirabad, Imishly and Evlah regions. The number of farmers who sell raw cotton to MKT has gradually risen from 9.9 thousand in 2002 to almost 13.5 thousand in 2005.

Figure 2 – Azerbaijan regions that grow cotton for MKT

Source: Management of MKT

In 2005, the total area that has been planted with cotton by MKT farmers reached 66 thousand hectares. This constitutes a rise of 33.2% since 2002. Increase in cotton growing area was achieved by increase in the number of farmers contracted. Average area per farmer has been stable amounting at 4.9 ha in 2005.

Depending on the fertility of the soil of the particular region MKT experts set the minimum crop level per hectare. Multiplying this ratio with the farmer's area, total amount of raw cotton is calculated and fixed in the three-party treaty. Due to the increasing quality of cotton seeds, MKT has raised the minimum level of raw cotton per hectare from 17.5 centers in 2004/05 to 20 in 2005/06. The three-party treaties also include *force majeure* conditions that unbind farmers to supply the minimum amount of raw cotton.

MKT has a bilateral agreement with each of the 12 cotton-processing plants, including five in which MKT has equity stakes. Under these agreements the plants undertake to process the raw cotton delivered by farmers and MKT undertakes to pay for the delivered cotton according to the price fixed in the contract. Price fixing is done each year and currently is 650-750 thousand AZM per ton depending on various factors.

Apart from electronic weighting stations at the cotton processing plants, MKT has also five additional weighting stations for managing workflow during the harvest season.

Out of all seeds produced from raw cotton, 90% are technical seeds and 10% are for planting new crop. Technical cottonseeds are processed by the cotton oil extraction company OJSC "Ali-Bairamli Fat-and-Oil Factory", in which MKT has 54% shareholding. The plant was build in 1961, and at the moment MKT undertakes its modernization. New oil extraction equipment will be installed during 2005. In 2004/5 production season, the company managed to process 35 000 tons of seeds. After installation of new equipment, the plant will be able to process 50-60 thousand tons of cottonseeds in 2005/6 and 60-70 thousand tons in 2006/7.

New equipment installed in the cotton processing plants and in the oil extraction plant is the property of MKT.

Product sales

Table 4 – MKT sales by product (incl. VAT in some cases), thousand USD

	2002	2003	2004	2005
Cotton fiber	19 810	25 104	25 107	25 725
Cotton yarn	836	2 771	3 957	10 271
Cotton seeds	3 048	2 480	1 964	
Other products	1 604	1 894	1 391	
Total	**25 298**	**32 250**	**32 419**	**35 996**

Source: Management of MKT

Out of all the cotton fiber amount produced 20% have 1/1 quality type (the best), 20% have 1/2 quality type (the second best), 50% have 1/3 quality type (the third best or basic) and the remaining 10% below basic and are sold with a discount. 1/1 and 1/2 cotton types are sold with some premium to the basic type.

Export accounts for major part of sales, 92% in the first quarter of 2005, 85% in 2004 and 2003, and 100% in 2002. Major clients are either trading or manufacturing companies.

Table 5 – Major MKT customers

Trading companies	Manufacturing companies
▪ "Lucot" (Liechtenstein) ▪ "Paul Reinhart AG" (Switzerland); ▪ "JECOT" (Switzerland); ▪ "Goenka-Impex" (Spain); ▪ "Dunavant AS" (USA); ▪ "A.P.Teks" (USA)	▪ MEM Pamuk Senayi ve Ticaret sti Depolari (Turkey); ▪ Ivanovo –Tekstiltorg (Russia)

Source: Management of MKT

MKT actively sells cotton fiber to the trading companies and not directly to the manufacturing companies because trading companies can make substantial prepayments 3-4 months before the actual delivery. Normally MKT agrees with the client on the total amount of cotton fiber to be delivered. Prices are based on Cotlook A index, published by Cotlook Ltd., Liverpool, UK, and are fixed individually for each delivery as part of the agreement. Depending on the quality of cotton in each bale, prices include either some premium or a discount from the standard price.

Export transportation

MKT exports products with FCA sale conditions, under which a buyer is responsible for transportation and insurance. Deliveries up to 20 tons or 90-110 bales are transported by trucks. Large quantities starting from 50 tons or 240 bales are transported by railway to Batumi (Georgia) harbour and then shipped further. MKT loads cotton fiber or other product cargo on the cotton processing plant territory if transported by trucks or loads the cargo in the nearest railway station.

Seasonality of cash flow

Monthly influence on MKT business is quite predictable. From September to December, farmers collect and deliver raw cotton. During this period MKT experiences cash outflow, as it pays for raw cotton according to the agreed terms. The standard schedule is the following:

Payments to farmers, % of the total price	Timing
20%	March – July as a prepayment
30%	August – October upon delivery

15%	Till 1 December
15%	in January
20%	in February – March

Source: Management of MKT

Such diversified payment schedule benefits both sides. MKT is able to even cash outflows and the farmers get payments in several lots and therefore they do not have to worry about the safety of the cash since most of the people still do not use bank accounts.

From September to August MKT processes raw cotton to cotton fiber, seeds and other products and sells them to its clients. Under normal business practice, the clients make an advance payment to MKT a couple of months before the actual delivery.

Employees

The number of personnel employed by MKT increased in recent years reflecting strong development of the company.

Table 6 – The number of employees at MKT, at the end of the period

	2004	2005
Management	5	4
Financial department	13	8
Commercial department	2	10
Legal department	12	3
Administrative & Protocol department	11	19
Agrarian & Industrial department	7	9
Textile department	1	3
Security department	2	3
Information technology department	3	8
Steel Rolling factory of the “MKT IK” Ltd.	74	115
Total	**130**	**182**

Source: Management of MKT

Employees of the cotton-processing companies and oil extraction plant are not included in this table.

Security

The Company implemented strict security and fire protection mechanism and policies.

Investments in non-core business

As part of its strategy, MKT plans to stay in the textile business and therefore it has purchased equipment for a synthetic fiber plant in Baku. The market for synthetic fiber has been less volatile than cotton fiber market and running the synthetic fiber plant would provide diversification benefits in the future. Synthetic fibers will be marketed to foreign textile companies.

Apart from its main business activities, MKT also operates a metal processing plant, taking advantage of opportunity to acquire metal processing equipment at large discounts in 2003. Currently, the plant is under its way to utilize its spare capacity and MKT management plans to achieve the maximum production output in 2006.

For efficiency reasons, MKT also operates two metal shops. One is for production of metal spare parts for cotton and agricultural equipment and another one is for production of special metal strand for binding cotton bales.

In addition, MKT opened a car dealership for brand new car trading in 2005, near the new office building.

Sponsorship

In 2003, MKT started to sponsor a football team in Imishly town in the South Central part of Azerbaijan. MKT has signed lease agreement with the municipality for the football stadium for 20 years. MKT has invested in the stadium renovation works approximately USD 2.5 million. The football team “MKT-Araz” plays in the top national football league and the annual financing necessary to run the football club is estimated at around USD 1 million.

On the stadium territory there are also wrestling team premises where children and teenagers of the region can attend the Wrestling school. Imishly Wrestling School members have achieved top results in the national and international tournaments.

MANAGEMENT TEAM

Mr. Osman Nurettin Paksu – President of MKT

Mr. Paksu was born on 10 February 1959 in Turkey and in 1982 graduated Technical University in Orta Dogu (Turkey) as an engineer. In 1985, he established Open Joint Stock Company “MEM” (Turkey) where he remains as a President. In 1997, Mr. Paksu acquired Manufacturing – Commercial company “MKT” (Azerbaijan) and became a General Director. In 2002, Mr. Paksu restructured his Azerbaijan operations and he became the President of “MKT IK Limited Liability Company”.

Mr. Paksu is married and has three children – two sons and a daughter. He is fluent in Turkish, Azeri and English.

Mr. Ikram Shamshid Kerimli – General Director of MKT

Mr. Kerimli was born on 3 November 1962 in Baku (Azerbaijan). In 1984, he graduated the construction department of Azerbaijan Construction Institute with a degree in civil engineering. Mr. Kerimli holds a Ph.D. degree in economics in the sphere of “Improving economic prosperity and attracting foreign investments in transition to market economy”, he has published many scientific articles in the field of economics, agriculture and scientific-technical information in such magazines as “Economics and Audit”, “Magazine of Social Sciences”, “Cotton Outlook” (UK), “Gubernator” (Ukraine), in the newspaper “Izvestiya” (Russia) and also in many Azerbaijan newspapers and magazines.

In 1991, Mr. Kerimli founded Manufacturing – Commercial company “Ilkin” where he became the President. In September 1997 he became an economic adviser of MKT. In August 1999 was promoted to Deputy General Director of MKT and since April 2004 he is General Director of MKT.

Mr. Kerimli is married and has a son and a daughter. He is fluent in Azeri, Russian and English.

Mr. Arif Gambar Ibragimov – First General Director Deputy of MKT

Mr. Ibragimov was born on 6 March 1955 in Baku (Azerbaijan). In 1979, he graduated Azerbaijan State University as an interpreter of Farsi language. In 1991, Mr. Ibragimov graduated Azerbaijan Academy of Agriculture in the field of economics and agricultural management.

After serving in the Soviet Army in Afganistan as a military interpreter from 1979 till 1982 Mr. Ibragimov started his professional carrier in the fields of agriculture, manufacturing and international economic relations. He has worked in the State Committee of Agricultural Manufacturing, Baku City Council, Society of International Economics “Agroinkom” and in the State Privatization Committee.

Since 14 July 1997 Mr. Ibragimov started to work with MKT as the Head of Transport department and later was promoted to First General Director Deputy.

Mr. Ibragimov is married, has a son and a daughter. He is fluent in Azeri, Russian, Farsi and English.

Mr. Adygezal Avaz Agaev – Deputy General Director of MKT, Chief Financial Officer

Mr. Agaev was born on 25 November 1958 in Imishly region in Azerbaijan. In 1980, he graduated Agricultural Institute in Giandja (Azerbaijan) as a economist-manager of agricultural production. He has large professional experience as an economist and chief accountant in manufacturing-commercial and agricultural areas.

Since 11 August 1997 Mr. Agaev started to work for MKT as the Chief Accountant and later was promoted to the Deputy General Director.

Mr. Agaev is married and has two daughters. He is fluent in Azeri and Russian.

Mr. Farruh Eldar Ahadov – Deputy General Director, Head of Agricultural Production department

Mr. Ahadov was born on 7 February 1957 in Saatly region in Azerbaijan. In 1989, he graduated Baku City Cooperation College as a commodity expert.

He has been with MKT since 13 October 1997. Mr. Ahadov started as the Company’s expert and later was promoted to the Head of Agricultural Production department and the Deputy General Director.

Mr. Ahadov is married and has two daughters. He is fluent in Azeri and Russian.

Mr. Bairam Djumshud Mamed-Rzyaev – Head of Administrative Minutes department of MKT

Mr. Mamed-Rzyaev was born on 22 March 1940 in Giandja (Azerbaijan). In 1963, he graduated Azerbaijan Polytechnical Institute in Baku as a technological engineer. In 1971, Mr. Mamed-Rzyaev graduated Central Institute of Patent Management in Moscow as a patent expert. In 1976, he graduated All Union Academy of Foreign Trade in Moscow as an economist of international economic relations.

Mr. Mamed-Rzyaev has an extensive experience in the field of heavy industry and oil industry as well as he has long professional experience in the international economics and trade in Moscow, Turkey and Hungary.

He has been working in MKT since 24 September 1997. He started as a advisor to General Director and was promoted to the Head of Administrative Minutes Department.

Mr. Mamed-Rzyaev is married and has two daughters. He is fluent in Azeri, Russian, English, Turkish and Hungarian.

Mr. Bahruz Aliaga Djamalov – Head of Commercial department of MKT

Mr. Djamalov was born on 1 February 1973 in Bilasuvar region in Azerbaijan. In 1995, he graduated Baku State University in the major of applied mathematics. He has passed the Master degree program in mathematical modeling of economics.

Mr. Djamalov has working experience in the field of foreign trade and finance. He is with MKT since 6 October 1997 when he started as an inspector in foreign trade division and later was promoted as the Head of Commercial department.

Mr. Djamalov is married, has two daughters. He is fluent in Azeri, Russian and English.

Mr. Eldaniz Hidayat Guliyev – Head of Legal department of MKT

Mr. Guliyev was born on 15 January 1963 in Bardinsky region in Azerbaijan. He has graduated Baku College of Finance-Credit in the field of law and later he graduated Azerbaijan International University in the same field.

Mr. Guliyev has an extensive working experience as a lawyer in the large Azerbaijan companies such as State Committee of Citiculture and Wine-Making, State Agricultural Manufacturing Committee under the Ministry of Agriculture, Military Tribunal in Baku Garrison, Ministry of Agriculture and State Privatization Committee. He has been with MKT since 2 August 1999 when he was hired as a lawyer and later was promoted as the Head of Legal department.

Mr. Guliyev is married and has a son and a daughter. He is fluent in Azeri and Russian.

Mr. Tahir Zaman Agaev – Head of Security department of MKT

Mr. Agaev was born on 15 October 1961 in Baku. In 1985, he graduated Azerbaijan Institute of Engineering and Construction as a engineer – constructor.

Mr. Agaev has previously work in the security department of Azerbaijan Operational Company and BP Exploration Caspian Sea Ltd. He is with MKT since 2 September 2003.

Mr. Agaev is married and has two daughters. He is fluent in Azeri, Russian and English.

Historical Financial Information

The financial statements of MKT have been prepared in accordance with International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), interpretations issued by International Financial Reporting Interpretations Committee (IFRIC), and applicable requirements of the Azerbaijan Law. The financial statements were audited by AGN MAK Azerbaijan Ltd, which is a member firm of an international company Accountants Global Network (AGN International).

Table 7 – Balance Sheet of MKT

	31.12.2002 AZM '000	31.12.2003 AZM '000	31.12.2004 AZM '000	31.12.2005 AZM '000	31.12.2005 USD '000
Cash	32 687	1 705 340	2 087 205	129 066	28
Trade receivables	28 572 485	7 098 142	4 215 312	5 098 494	1 110
Other receivables	5 919 836	39 755 954	47 971 134	60 998 680	13 281
Inventories	67 267 562	59 213 293	88 595 304	87 182 099	18 982
Total current assets	**101 792 570**	**100 674 587**	**142 868 955**	**153 408 339**	**33 401**
Long-term financial investment	37 249 520	38 602 501	45 605 622	64 916 297	14 134
Construction under progress	2 635 527	9 399 579	17 538 942	31 052 460	6 761
Property, plant, equipment	11 233 386	9 915 738	11 228 387	11 918 711	2 595
Total long-term assets	**51 118 433**	**57 917 818**	**74 372 951**	**107 887 468**	**23 490**
TOTAL ASSETS	**152 911 003**	**158 592 405**	**217 241 906**	**261 295 807**	**56 891**
Trade payables & other payables	51 280 953	72 793 087	108 244 957	137 799 568	30 002
Provisions and accrued expenses	44 122 190	7 556 323	5 190 331	587 907	128
Short term loan	17 125 500	17 249 750	18 864 684	38 919 779	8 474
Total current liabilities	**112 528 643**	**90 501 018**	**132 299 972**	**177 307 254**	**38 604**
Long-term liabilities (Employee's vacation benefits)	621 840	779 377	1 467	3 605	1
Share capital	101 000	101 000	101 000	29 443 451	6 411
Retained earnings	39 659 520	67 211 010	84 839 467	54 541 497	11 875
Total equity	**39 760 520**	**67 312 010**	**84 940 467**	**83 984 948**	**18 286**
TOTAL EQUITY AND LIABILITIES	**152 911 003**	**158 592 405**	**217 241 906**	**261 295 807**	**56 891**

Note: Balances as at 31.12.2005 were translated into USD using the exchange rate 1 USD = 4593 AZM, as stated by the National Bank of Azerbaijan Republic on 31.12.2005

Source: Audited annual reports for 2003, 2004 and 2005.

Trade receivables originates from sales of cotton fiber and yarn to local and overseas customers. As at 31.12.2005, 73% of trade receivables were from overseas debtors, which comprised 71% and 82% at the end of 2004 and 2003 respectively. Top 5 customers comprise 17.4% of trade receivables at 31.12.2005. These are

A.R.Teks (leading cotton yarn supplier in Russia) 2.3 billion AZM, Syardar Ltd (textile producer in Azerbaijan) 551 million AZM, Sardar (textile producer in Azerbaijan) 147 million AZM, Roya (production company in Azerbaijan) 133 million AZM, Caberlotto 112 million AZM.

Largest constituents of other receivables are settings with related parties and advances paid to suppliers. Settings with related parties amounted to 44.5 billion AZM in 2005, 37.8 billion AZM in 2004, and 33.3 billion AZM in 2003. At the end of 2002, settings with related parties were included in trade receivables and amounted to 28.6 billion AZM. Advances paid to suppliers related to cash advances, seeds, transport and fertilizers provided to farmers and amounted to 6.0 billion AZM as at 31.12.2005, 6.1 billion AZM as at 31.12.2004, 133 million AZM as at 31.12.2003 and 180 million AZM as at 31.12.2002.

Inventories are valued using FIFO method at lower cost or net realizable value and include mainly raw materials and finished goods. Raw materials amounted 31.3 billion AZM as at 31.12.2005, 34.3 billion AZM as at 31.12.2004, 15.2 billion AZM as at 31.12.2003 and 18.7 billion AZM as at 31.12.2002. Finished goods amounted to 52.0 billion AZM as at 31.12.2005, 50.0 billion AZM as at 31.12.2004, 40.5 billion AZM as at 31.12.2003 and 44.7 billion AZM as at 31.12.2002.

Changes of inventory balance were caused to a large extent by cotton sales price dynamics and raw cotton supplies, which was the reason for increase of inventory balance the end of 2004 by 29.4 billion AZM compared with 2003. Cotlook A index averaged 71.6 cents/lb in the third quarter of 2003, compared with 51.8 cents/lb in the third quarter of 2004. Therefore, sales in 2003 were higher than usual to take advantage of good prices; but at the end of 2004, sales were deferred in anticipation of favorable changes of world cotton prices. In addition, raw cotton procured amounted to 92 800 tons, which was higher by 10 970 tons than procurement in 2003.

Long-term financial investments represent shares of subsidiaries and associated enterprises. All long-term financial investments of the Company are located in Azerbaijan.

Table 8 – Investments in subsidiaries of MKT

Enterprise	**As at 31.12.2005**	
	Share, %	**AZM '000**
OJSC “Bilasuvar-Pambig”, cotton processing plant	51.4	6 366 270
OJSC “Yevlakh-Pambig”, cotton processing plant	50.4	7 568 000
OJSC “Saatli-Pambig”, cotton processing plant	56.8	9 844 000
OJSC “Salyan-Pambig”, cotton processing plant	51.0	5 440 000
OJSC “Beylagan-Pambig”, cotton processing plant	51.0	2 145 660
OJSC “Ali-Bairamli fat-and-oil complex”	54.1	8 429 520
Bahruz Ltd, trading company	100.0	1 352 981
Silk Way Motors Ltd., car trading company	50.0	987 550
International Trade Center Ltd.	65.0	3 250
Sumgayit Khovlu Iplik	67.7	7 577 050
“MKT-Araz football club” Ltd.	100.0	15 202 017
Total		**64 916 297**

Source: Company management

In order to secure its loans in Kapital bank and Bank Respublika, MKT put as collateral shares of subsidiaries in the total amount of 39.9 billion AZM (62.8% of total long-term financial investments) as at 31.12.2005.

Table 9 – Collateral of shares in subsidiaries

	As at 31.12.2005, AZM
OJSC "Yevlakh-Pambig"	7 599 443 703
OJSC "Bilasuvar-Pambig"	6 392 720 702
OJSC "Salyan-Pambig"	5 462 602 239
OJSC "Beylagan-Pambig"	2 154 574 849
OJSC "Saatli-Pambig"	9 884 900 058
OJSC "Ali-Bairamli Fat-and-Oil Factory"	8 464 543 165
Total	**39 958 784 716**

Source: Company management

Construction in progress represent uninstalled equipment and costs of construction works of metal-roll works, fat and oil complex and textile factory. Construction in progress as at 31.12.2005 amounted to 31.1 billion AZM.

Property, plant and equipment include buildings, office equipment, machinery and equipment, vehicles and other fixed assets. The Company owns six buildings with the total net book value of 504 million AZM as at 31.12.2005.

Machinery and equipment is the largest asset class in property, plant and equipment balance with net book value amounting 9.6 billion AZM as at 31.12.2005, 9.3 billion AZM as at 31.12.2004, 9.1 billion AZM as at 31.12.2003 and 10.7 billion AZM as at 31.12.2002. Machinery and equipment includes cotton processing and cotton oil refining equipment.

Trade payables include advances from customers and liabilities to suppliers. Trade payables increased by 27.3% up to 137.8 billion AZM as at 31.12.2005, compared to the end of 2004. This is explained mainly by increase in advances received from customers, which amounted to 97.1 billion AZM as at 31.12.2005, 67.3 billion AZM as at 31.12.2004, 33.3 billion AZM as at 31.12.2003. At the end of 2002, advances received from customers were accounted within Provisions and accrued expenses item of the balance sheet and amounted to 42.1 billion AZM as at 31.12.2002.

Provisions and accrued expenses include unpaid profits tax, salaries and social insurance. This item accounted to 0.587 billion AZM as at 31.12.2005, 5.2 billion AZM as at 31.12.2004, 7.6 billion AZM as at 31.12.2003 and 1.3 billion AZM as at 31.12.2002.

Short term loan comprised of loans at four local banks. Traditionally, loans were taken on one-year term, but one of the loans is up to 2007.

Authorized, issued and paid up capital of MKT consists of 100 shares of 294 434 506 AZM each.

Table 10 – Income Statement of MKT

	2002 AZM '000	2003 AZM '000	2004 AZM '000	2005 AZM '000	2005 USD '000
Sales	111 531 774	150 673 529	143 152 397	143 849 351	31 319
COGS	(97 635 842)	(102 699 347)	(113 439 305)	(142 214 259)	(30 963)
Gross profit	**13 895 932**	**47 974 182**	**29 713 092**	**1 635 092**	**356**
General and administrative expenses	(5 202 577)	(4 859 987)	(6 066 924)	(5 471 103)	(1 191)
Financial expenses	(2 505 666)	(2 885 203)	(1 148 565)	(4 022 970)	(876)
Operating profit	**6 187 689**	**40 228 992**	**22 497 603**	**(7 858 981)**	**(1 711)**
Other income, net	7 138	1 067	746 484	9 400 240	2 047
Profit before taxes	**6 194 827**	**40 230 059**	**23 244 087**	**1 541 259**	**336**
Taxes	(4 170 168)	(12 678 569)	(5 615 630)	(468 540)	(102)
Profit after taxes, before extraordinary items	**2 024 659**	**27 551 490**	**17 628 457**	**1 072 719**	**335**
Extraordinary items	(225 426)	-	-	-	-
Net profit	**1 799 233**	**27 551 490**	**17 628 457**	**1 072 719**	**234**

Note: Balances as at 31.12.2005 were translated into USD using the exchange rate 1 USD = 4593.00 AZM, as stated by the National Bank of Azerbaijan Republic on 31.12.2005

Source: Audited annual reports for 2003, 2004 and 2005.

Sales represent sales of cotton fiber, cottonseeds, cotton yarn and oil. Most of net sales originated from export, 84.4% in 2005, 85% in 2004 and 2003, and 100% in 2002. Cotton fiber accounts for 71.5% of total sales in 2005, compared to 69% in 2004, 72% in 2003 and 76% in 2002. At the same time, cotton yarn share increased from 3% of total sales in 2003 up to 16% in the first quarter of 2005.

Cost of goods sold includes cost of purchased raw cotton and direct production expenses. Gross margins exhibit considerable fluctuation and were equal 12% in 2002, 32% in 2003, 21% in 2004 and 1% in 2005. The main reason for gross margin fluctuation is changes in cotton price index Cotlook A index, based on which sales prices for cotton fiber are determined. As it is seen in Figure 6, cotton price peaked at 79.75 cents/lb in October 2003 and decreased to 49 cents/lb in December 2004. During the 2005, Cotlook A index was within the range of 49-60 cents/lb. Purchase price of raw cotton exhibit increase over time, as settled in annual contracts with farmers.

General and administrative expenses comprised 3.8% of sales in 2005, 4% in 2004, 3% in 2003 and 5% in 2002. Largest expense items are salaries 1 070 million AZM in 2005 (969 million AZM in 2004, 575 million AZM in 2003 and 428 million AZM in 2002) and other expenses amounted to 1 234 million AZM in 2005 (1.2 billion AZM in 2004, 1.1 billion AZM in 2003 and 1.5 billion AZM in 2002).

During 2005, other net income include gain from foreign exchange fluctuations 4 075 million AZM (64 million AZM in 2004) and sanctions 3 819 million AZM (242 million AZM in 2004).

Table 11 – Cash flow statement of MKT

	2002 AZM '000	2003 AZM '000	2004 AZM '000	2005 AZM '000	2005 USD '000
Cash flows from operating activities:					
Net profit	1 799 233	27 551 490	17 628 457	1 072 719	234
Adjustments for:					
Depreciation	9 696 057	2 685 744	4 880 156	1 312 466	286
Prior year adjustment	-	-	-	(2 028 238)	(442)
Operating profit before changes in operating assets and liabilities	11 495 290	30 237 234	22 508 613	356 947	78
(Increase)/decrease in inventories	8 517 389	8 054 269	(29 382 011)	1 413 205	308
(Increase)/decrease in trade receivables	(58 477)	(4 734 197)	(4 538 660)	(883 182)	(192)
(Increase) in other receivables	(944 258)	(529 436)	(3 676 520)	(13 027 546)	(2 836)
Increase/(decrease) in trade & other payables	(41 497 807)	(11 830 533)	1 530 098	29 554 611	6 435
Increase/(decrease) in provisions and accrued expenses	33 457 111	(10 321 342)	34 438 610	(4 602 424)	(1 002)
Increase/(decrease) in short term loan	1 361 800	124 250	1 614 934	20 055 095	4 366
Cash from operations	12 331 048	11 000 245	22 495 064	32 866 706	7 157
Increase/(decrease) in employee's vacation payment provision	144 849	157 537	(777 911)	2 138	-
Net cash from operating activities	**12 475 897**	**11 157 782**	**21 717 153**	**32 868 844**	**7 157**
Cash flows from investing activities:					
Purchases of fixed assets	(10 992 242)	(1 368 096)	(6 460 439)	(2 826 910)	(616)
Proceeds from sale of fixed assets	-	-	267 634	824 120	179
Construction in progress	(1 732 820)	(6 764 052)	(8 139 362)	(13 513 518)	(2 942)
Net cash (used in) investing activities	**(12 725 062)**	**(8 132 148)**	**(14 332 167)**	**(15 516 308)**	**(3 379)**
Cash flows from financing activities:					
Proceeds from share issue	100 000	-	-	-	-
Capital invested	-	-	(7 003 121)	(19 310 675)	(4 204)
Shares of subsidiaries	-	(1 352 981)	-	-	-
Net cash from/(used in) financing activities	**100 000**	**(1 352 981)**	**(7 003 121)**	**(19 310 675)**	**(4 204)**
Net increase/(decrease) of cash and cash equivalents	**(149 165)**	**1 672 653**	**381 865**	**(1 958 139)**	**(426)**
Cash and cash equivalents at the beginning of the year	181 852	32 687	1 705 340	2 087 205	454
Cash and cash equivalents at the end of year	32 687	1 705 340	2 087 205	129 066	28

Note: Balances as at 31.12.2005 were translated into USD using the exchange rate 1 USD = 4593.00 AZM, as stated by the National Bank of Azerbaijan Republic on 31.12.2005

Source: Audited annual reports for 2003, 2004 and 2005.

Guarantor - Lucot

DESCRIPTION OF THE GUARANTOR

Lucot Limited is a cotton trading company registered under the laws of the Pricipality of Liechtenstein. Lucot is one of the largest customers of MKT and sells cotton products mostly to clients in Russia. MKT trades cotton through Lucot for tax reasons therefore a part of the cash flows and net profit is shifted to Lucot.

Lucot is guaranteeing the repayment of the Notes also because of relatively high political risk in Azerbaijan. If for some reason outgoing currency payments in Azerbaijan are restricted Lucot will be able to repay the Notes on behalf of MKT.

LEGAL INFORMATION

Lucot Limited was registered in 1999 under the trade licence No. H.1051-92. Legal address is Trefundor Treuunternhemen reg., Spaniahof - Heiligkreuz 46, P.O.Box 736 - FL – 9490, Vaduz, Liechtenstein. Lucot is 100% owned by Mr. Osman Nureddin Paksu (citizen of Turkey) who also holds 20% of the Issuer.

FINANCIAL STATEMENTS

The financial statements of Lucot have been prepared in accordance with International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), interpretations issued by International Financial Reporting Interpretations Committee (IFRIC), and applicable requirements of the Liechtenstein Law. The financial statements were audited by AGN MAK Azerbaijan Ltd, which is a member firm of an international company Accountants Global Network (AGN International).

Table 12 – Balance Sheet of Lucot, USD '000

	31.12.2003	31.12.2004	31.12.2005
Cash	102 351	56 420	1 941
Trade receivables	742 409	2 054 570	0
Other receivables	2 132 338	7 888 433	13 729 479
Inventories	3 125 224	3 967 731	550 000
Total current assets	**6 102 322**	**13 967 154**	**14 281 420**
Total long-term assets	**0**	**0**	**0**
TOTAL ASSETS	**6 102 322**	**13 967 154**	**14 281 420**
Trade & other payables	564 318	1 481 503	1 949 703
Short term loan	192 000	4 167 731	862 226
Total current liabilities	**756 318**	**5 649 234**	**2 811 929**
Total liabilities	**756 318**	**5 649 234**	**2 811 929**
Share capital	36 147	36 147	36 147
Retained earnings	5 309 857	8 281 774	11 433 344
Total equity	**5 346 004**	**8 317 920**	**11 469 491**
TOTAL EQUITY AND LIABILITIES	**6 102 322**	**13 967 154**	**14 281 420**

Table 13 – Income Statement of Lucot, USD '000

	2003	2004	2005
Sales	6 016 225	9 255 415	20 210 893
COGS	(5 996 034)	(6 142 834)	(16 775 041)
Gross profit	**20 191**	**3 112 581**	**3 435 852**
General and administrative expenses	(191 563)	(140 665)	(284 281)
Total Operating expenses	(191 563)	(140 665)	(284 281)
Operating profit	**(171 371)**	**2 971 916**	**3 151 571**
Other income, net	768 445	0	0
Net profit	**597 074**	**2 971 916**	**3 151 571**

Table 14 – Cash flow statement of Lucot, USD '000

	2003	2004	2005
Cash flows from operating activities:			
Net profit	**597 074**	**2 971 916**	**3 151 571**
Operating profit before changes in operating assets and liabilities	597 074	2 971 916	3 151 571
(Increase)/decrease in inventories	(3 125 224)	(842 507)	3 417 731
(Increase)/decrease in trade receivables	1 561 631	(1 312 161)	2 054 570
(Increase) in other receivables	1 131 618	(5 756 095)	(5 841 046)
Increase/(decrease) in trade & other payables	(435 682)	917 184	468 200
Increase/(decrease) in short term loan	192 000	3 975 731	(3 305 505)
Net cash from operating activities	**(78 583)**	**(45 931)**	**(54 479)**
Net increase/(decrease) of cash and cash equivalents	(78 583)	(45 931)	(54 479)
Cash and cash equivalents at the beginning of the year	108 934	102 351	56 420
Cash and cash equivalents at the end of year	102 351	56 420	1 941

Looking Forward

The 2006 - 2008 forecasts are based on a positive market outlook and strong competitive position of MKT in the cotton processing industry. The increase of total annual sales is planned to rise by 20% in 2006, 15% in 2007 and 10% in 2008.

Table 15 – MKT Projected Income and Cash Flow, '000 USD

	2005	2006	2007	2008
Purchased raw cotton, tones	85 000	95 000	105 000	115 000
Sales	31 326	37 591	43 230	47 553
EBITDA	1 243	1 492	1 715	1 887
EBIT	958	1 150	1 322	1 454
Net Profit	233	280	322	354
Cash at the end of period	28	228	528	828
EBITDA margin	4.0%	4.0%	4.0%	4.0%
Net margin	0.7%	0.7%	0.7%	0.7%

Source: Company management

Lucot sales completely depend on MKT ability to produce cotton fiber and therefore MKT management forecasts the increase in Lucot revenues at the same pace as MKT's. Since at the end of 2005 Lucot made almost USD 6 million prepayment to MKT, which the management considers as extra ordinary, cash at the end of the period should gradually rise as the prepayment amounts are lowered.

Table 16 – Lucot Projected Income and Cash Flow, '000 USD

	2005	**2006**	**2007**	**2008**
Sales	20 211	24 253	27 891	30 680
EBITDA	3 152	3 782	4 350	4 785
EBIT	3 152	3 782	4 350	4 785
Net Profit	3 152	3 782	4 350	4 785
Cash at the end of period	2	2 002	4 002	5 002
EBITDA margin	15.6%	15.6%	15.6%	15.6%
Net margin	15.6%	15.6%	15.6%	15.6%

Source: Company management

Although the financial reports of MKT and Lucot are not consolidated both companies are financially linked therefore the cash item at the end of each period may be summed.

Table 17 – Cash Flow for Notes servicing, '000 USD

	2005	**2006**	**2007**	**2008**
Combined cash at the end of period of MKT and Lucot	30	2 230	4 530	5 830
CF from bond	0	4 950	-720	-5 670
Cash after the bond pmt	30	7 180	3 810	160

Source: Company management

MKT plans to increase the procurement of raw cotton by 10 000 tones annually. Raw cotton purchase price is forecasted to stay flat at AZM 1 400 per kilogram. At the same time MKT will continue to invest in the most advanced cotton processing equipment that will help to ensure better quality and higher revenues.

The cotton fibre sales are forecasted to increase by 11.6% annually, cotton seeds and oil by 8.9%, other cotton products by 15.2% and other products that are not related to cotton processing by 76.1%. In the next two years the management of MKT foresees the rapid increase in revenues from other business like metal processing, synthetic fiber and yarn production.

The management of the Company estimates that the average price for cotton fibre in 2006 in 2008 is going to be USD 1 000. For cotton seeds and oil as well as for other cotton products the management foresees the prices to be stable.

The share of cotton processing is going to drop from 89.7% in 2006 to 77.8% in 2008. Such decrease is due to diversification towards the metal processing and other businesses. Thus the management of MKT wants to gradually level out the seasonal factor.

In accordance with the current tax system MKT foresees no changes in the corporate tax, which is 24%, and property tax (1%). Projected MKT revenues include the assumption of AZM to USD appreciation by 9% in 2006 and 14% in 2007 and 2008.

Industry overview

MAIN MARKET TRENDS

World cotton production fluctuated from 98.8 million bales in 2001/2002[2], 88.3 million bales in 2002/2003 and up to 95.1 million bales in 2003/2004.

Growth in cotton production volumes is influenced mainly by dynamics of cotton prices and good weather conditions. Cotlook A index is one of main indicators of world cotton prices. During 2004/2005 season (period from 1 August 2004 to 31 July 2005), Cotlook A index averaged at 54 cents/pound compared to 69 cents/pound in 2003/2004 and 56 cents/pound in 2002/2003 season.

Main cotton producers are China, USA and India, which is estimated to supply respectively 24%, 19% and 15% of total production volume in 2004/2005.

Top cotton consumption countries are China, India and Pakistan generating 35%, 14% and 10% of total cotton demand, which is projected to reach 108 124 thousand bales in 2004/2005.

Figure 3 – Cotton price dynamics, Cotlook A Index, in US cents per pound

Source: Bloomberg

Cotton growing and land productivity was increasing rapidly in Azerbaijan over the recent years. Total yield amounted to 135.7 thousand tons in 2004, showing 36% growth compared to 2003 and 69% growth compared to 2002.

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[2] Cotton season lasts from 1 August till 31 July next year, e.g. 2001/2002 season is from 1 August 2001 till 31 July 2002.

Table 18 – Main indicators of cotton growing in Azerbaijan

		2002	2003	2004	2005
Total yield	Thousand tons	80.4	99.6	135.7	196.4
Productivity of total picking area	Metric centner/ha	13.2	15.0	17.4	17.5

Source: Ministry of Economic Development of the Republic of Azerbaijan

Figure 4 – Production of cotton in Azerbaijan

Source: United States Department of Agriculture – Foreign Agricultural Service

After the period of stagnation, production of cotton started to grow in 2003/2004 season. Total cotton production in Azerbaijan is expected to be 225 thousand bales in 2004/2005, making 0.2% of world production.

MAIN MARKETS

Russian market of cotton fiber and cotton yarn is traditionally important for Azerbaijan producers and also for the Issuer. MKT increased its direct export to Russia from 6% in 2003 to 13% in 2004 and 16% the first quarter of 2005. In addition, most of cotton selling to Lucot Limited (Liechtenstein) is re-exported to Russia. Russian cotton market is growing rapidly. Import of cotton fiber increased from 204 thousand tons in 2003 up to 312 thousand in 2004, showing 46% increase. Market experts estimated consumption of cotton fiber in 2005-2006 in Russia to stay at the same level as in 2004. Currently, Azerbaijan cotton comprises 9% of total imported volume.

COMPETITION

Azeri cotton processing industry is highly concentrated. MKT is the market leader with production volume of 70 710 tons (53% of total volume). Taking into account production of the company Azercot, which belongs to the same group of investors as MKT and has with it partnership relations, MKT and Azercot together produced 82 010 tons and have 69% market share.

Figure 5 – Market shares by procured raw cotton in Azerbaijan in 2004

Source: Company management

INDUSTRY OUTLOOK

Industry experts estimate world cotton production to increase up to 119.8 million bales of cotton in 2004/2005 season[3], which is considered to be all-time high with growth of 26% over the last year. The basis for this estimation is increase in growing area from 32.5 million ha in 2003/2004 to 35.9 million ha in 2004/2005, as well as very good weather conditions in 2004.

In 2005/2006 season, world production is projected to decline slightly to 108.6 million bales, with increase in Cotlook A index to 66 cents per pound. Production of cotton is expected to increase up to 275 thousand bales in 2005/06 season.

Cotton industry in Azerbaijan is expected to grow, in line with country economic development.

REGULATORY FRAMEWORK

As a result of the privatization, which was conducted in 1997, the cotton industry moved from the state monopoly to being held by private companies.

Legislation of Azerbaijan went through significant reforms in recent years, whereas key legislative acts were adopted to support economic development, improve investment climate and protection of ownership rights. The Law on Investment Activity and the Law on Protection of Foreign Investments established certain guarantees to investments. Legal framework for arbitration and enforcement was established with adoption of the Law on International Arbitration and the Law on Execution of Court Orders, which stipulates enforcement procedures applicable both to judgements of Azerbaijan courts and foreign courts as well as decisions of foreign arbitration.

Cotton processing industry does not require licenses and is not regulated by the state. Business activity in the industry is regulated by applicable general legislation.

Farmers and business entities engaged in production of agricultural products are exempt from all taxes, except for land tax, till 2009. There are no other subsidies.

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[3] International Cotton Advisory Committee, Terry Townsend “The World Cotton Outlook”

Macroeconomic overview

Azerbaijan enjoyed rapid economic growth during recent years with macroeconomic stability. Gross domestic product exhibited high growth rates in consequent several years with increase by 10.2% in 2004 and 11.2% in 2003. Investments in oil sector and increasing world oil prices contributed to GDP growth. Crude oil and natural gas extraction comprise the largest chare of GDP of 28.2% in 2004, followed by construction 13.5%, social services 12.4% and agriculture 11.3%. In 2004, GDP at current prices totaled $8.52 billion and GDP per capita at current prices reached $1,041.

Table 19 – Key macroeconomic indicators for Azerbaijan

	2000	2001	2002	2003	2004
Population (million)	8.08	8.14	8.2	8.27	8.35
GDP nominal ($ billion)	5.27	5.71	6.24	7.28	8.52
GDP per capita ($)	665	714.3	774.5	896.7	1,041
GDP real growth (%)	11.1	9.9	10.6	11.2	10.2
FDI nominal ($ million)	927	1,092	2,235	3,273	4,056
Real wage growth (%)	20.2	17.3	21.3	22.7	24.9
CPI (%)	1.8	1.5	2.8	2.2	6.7

Source: The State Statistical Committee of Azerbaijan Republic

Staying within 1.5-2.8% range up to 2004, inflation rose to 6.7% in 2004. Main reasons are reported to be growth of monetary supply and increase in world oil prices, which lead to appreciation of imported goods and increase of domestic oil and gas prices.

Improvement of legal system attracted foreign direct investments in recent years, which amounted to 5.37 billion USD in 2004 with exhibited growth of 27% in 2004 and 51% in 2003. Investments in oil sector comprised 90% of FDI in 2004 and 86% in 2003.

In January 2006, Fitch confirmed long term foreign currency rating for Azerbaijan sovereign debt at BB with stable outlook. Confirmation reflected macroeconomic stability, low government debt, and development of the oil and gas sector. Azerbaijan's forecasted economic performance, according to Fitch, will enjoy continued GDP real growth of 13.4% in 2005 and 15.4% in 2006.

Contacts

For further information please contact

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Disclaimer

Appendix 1 – Master Guarantee Agreement

Master Guarantee Agreement

Concluded between

MKT Istehsalat-Kommersiya MMC

31, Istqlaliyyet Street, Baku, Azerbaijan

with its seat in Baku, Republic of Azerbaijan

(hereinafter referred to as "**Issuer**")

on the one side and

Lucot Limited Aktiengesellschaft

Heiligkreuz 46, FL-9490 Vaduz, Principality of Liechtenstein

with its seat in Vaduz, Principality of Liechtenstein

(hereinafter referred to as "**Guarantor**")

on the other side.

WHEREAS, the Issuer is a company incorporated under the laws of the Republic of Azerbaijan and the Issuer is going to issue bonds in a non-public offer in Latvia. The nominal amount of one bond is proposed to be USD 1'000. It is planned to issue a total of 5'000 bonds and the nominal amount in total is therefore USD 5'000'000.--; the term of the Secured Bonds is not longer than two years and they are not listed; and

WHEREAS, the Guarantor desires to guarantee the payment obligations under these bonds and issue therefore Guarantees for the benefit of the holders of the Secured Bonds, as provided herein; and

WHEREAS, the Guarantor desires hereby irrevocably and unconditionally to authorize the Issuer to conclude Guarantee Agreements in the name and on behalf of the Guarantor for the benefit of the Holders of the Secured Bonds in accordance with the terms of this Master Guarantee Agreement.

NOW, THEREFORE, the Guarantor and the Issuer conclude the following Master Guarantee Agreement:

ARTICLE I

As used in this Master Guarantee Agreement, the terms set forth below shall, unless the context otherwise requires, have the following meanings.

"**Coupon**" shall mean any distributed coupons of the Secured Bonds payable by the Issuer on the nominal value of the Secured Bonds.

"**Guarantee**" or "**Guarantee Agreement**" shall mean the Guarantee which is issued by the Guarantor to secure the Guarantee Payments for the benefit of the Holders of the Secured Bonds as stipulated under this Master Guarantee Agreement.

"**Guarantee Payments**" shall mean the following payments, without duplication, to the extent not paid by the Issuer: (i) any accumulated and unpaid Coupons limited with an annual rate of 14,4 % and (ii) the nominal redemption amount payable with respect to any Secured Bond by the Issuer.

"**Holder**" shall mean any holder from time to time of any Secured Bond of the Issuer.

"Secured Bond" shall mean bonds which are issued by the Issuer with the terms set in the Information Memorandum and in the agreement with the Latvian Central Depository. The Secured Bonds have a total nominal value of USD 5'000'000.00.

ARTICLE II

(1) The Guarantor irrevocably and unconditionally agrees to pay in full to the Holders the Guarantee Payments, as and when due (except to the extent paid by the Issuer), regardless of any defense, right of set-off or counterclaim which the Issuer may have or assert. The Guarantor's obligation to make a Guarantee Payment may be satisfied by direct payment of the required amounts by the Guarantor to the Holders or by causing the Issuer to pay such amounts to the Holders.

(2) The Guarantor authorizes the Issuer to notify the Holders of the Secured Bonds of the Guarantees issued by the Guarantor for the benefit of the Holders of the Secured Bonds. This notification will be made in the offer/information memorandum with respect to the Secured Bonds and/or in the printout of the

depositary bank with respect to the Secured Bonds. This Master Guarantee Agreement stipulates the covenants and conditions of such Guarantees.

(3) The Holder of the Secured Bonds have to notice the non-payment of coupons or redemption payable by the Issuer to the Guarantor within one month of the default or non-payment.

(4) The obligations, covenants, agreements and duties of the Guarantor under this Master Guarantee Agreement and under the herewith connected Guarantee Agreements shall in no way be affected or impaired by any invalidity of, or defect or deficiency in, any of the Secured Bonds. The Holders are obliged to give notice to the Guarantor with respect to the happening of such a defect or deficiency within the period of one month.

(5) This Master Guarantee Agreement in connection with the Guarantee Agreements stipulate guarantees of payment and not of collection. A Holder may enforce the Guarantee Payments under the Guarantee Agreements directly against the Guarantor, and the Guarantor will waive any right or remedy to require that any action be brought against the Issuer or any other person or entity before proceeding against the Guarantor are initiated. All waivers herein contained shall be without prejudice to the Holders' right at the Holders' option to proceed against the Issuer, whether by separate action or by joinder of actions. The Guarantor agrees that the guarantee under this Master Guarantee Agreement in connection with the Guarantees shall not be discharged except by payment of the Guarantee Payments in full (to the extent not paid by the Issuer) or by expiration of the period of time for which the Guarantees are issued.

(6) The Guarantor shall be subrogated to all (if any) rights of the Holders against the Issuer in respect of any amounts paid to the Holders by the Guarantor and the Issuer accepts such an assignment.

(7) The Guarantor acknowledges that its obligations hereunder are independent of the obligations of the Issuer with respect to the Secured Bonds and that the Guarantor shall be liable as principal and sole debtor to make Guarantee Payments under the terms of the Guarantee Agreements.

ARTICLE III

The Guarantor hereby irrevocably and unconditionally authorizes the Issuer to conclude in his name and on his behalf Guarantee Agreements as stipulated herein with the respective Holders of the Secured Bonds. The Guarantor authorizes the Issuer to effect such Guarantee Agreements with the respective Holders of the Secured Bonds by offering such Guarantees to the Holders of the Secured Bonds in the offer/information memorandum of the Secured Bonds,. The Holders of the Secured Bonds are entitled to assign the rights out of the Guarantee Agreements together with the respective Secured Bonds to third persons.

ARTICLE IV

This Master Guarantee Agreement and the corresponding Guarantee Agreements shall terminate and be of no further force and effect upon full payment of the Coupons and the redemption of all Secured Bonds; provided, however, that this Master Guarantee Agreement and the respective Guarantee Agreements shall continue to be effective or shall be reinstated, as the case may be, if at any time any Holder of Secured Bonds must restore payment of any sums paid under the Secured Bonds or under this Master Guarantee Agreement or, respectively, under the Guarantee Agreements for any reason whatsoever.

The duration of this Master Guarantee Agreement and the Guarantee Agreements is in any event limited with 3 years.

ARTICLE V

(1) The Guarantees stipulated hereunder shall bind the successors, assignees, receivers, trustees and representatives of the Guarantor and shall inure to the benefit of the Holders.

(2) This Master Guarantee Agreement as well as the Guarantee Agreements may only be amended by instrument in writing signed by the respective parties.

(3) Any notice, request or other communication required or permitted to be given hereunder to the Guarantor shall be given in writing via mail or via facsimile transmission (confirmed by mail) or telex, addressed to the Guarantor (to the address as given above).

(4) This Master Guarantee Agreement and the Guarantee Agreements are solely for the benefit of the Holders of the Secured Bonds and the Guarantee Certificates are not separately transferable from the Secured Bonds.

(5) Any dispute which may arise among the Guarantor, the Issuer or the respective Holders of the Secured Bonds in connection with the Master Guarantee Agreement and the Guarantee Agreements shall be subject to the jurisdiction of the courts of Liechtenstein. The Guarantor and the Issuer hereby expressly and irrevocably submit to the jurisdiction of said courts.

(6) This Master Guarantee Agreement as well as the Guarantee Agreements shall be governed by and construed and interpreted in accordance with the laws of Liechtenstein.

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Baku, ___ June 2006

________________________	________________________
Ikram Kerimli	Ikram Kerimli
for	for
MKT Istehsalat Commercia	Lucot Limited Aktiengesellschaft

Appendix 2 - Overview of Production cycle

ENVIRONMENT

The technology of growing cotton has been developing in Azerbaijan since 1813. The country's climate fits very well with the necessary conditions for cotton industry. Hot and long summers and sufficient irrigation are two major components for successful cotton growing industry.

In Azerbaijan, the irrigation system is under the state control, which is fully responsible for its maintenance and does not charge farmers for this service.

PROCUREMENT OF RAW COTTON

Procurement of raw cotton is governed by agreements with suppliers, which are concluded in March-April. Depending on the fertility of the soil of the particular region and area of land slot owned by a farmer, quantity of raw cotton supplied is settled. Price of raw cotton is determined based on local market conditions.

Cotton processing companies in Azerbaijan often make prepayments to the farmers in terms of seeds, chemical fertilizers, farming equipment and cash in order to assure necessary quantity and quality of cotton to be supplied. Cotton harvest and delivery to cotton processing plants takes place from September till December. Final settlements with suppliers are made partly upon delivery and the rest as monthly payments up to February next year.

PRODUCTION

Production of cotton fiber, cotton oil, cotton yarn and other cotton products occurs mainly from September to March. Raw cotton is processed using either roller ginning or saw ginning methods.

- <u>Roller ginning method.</u> This method is considered to be the most technologically advanced and delivers cotton fiber (40% of raw cotton weight) and cotton seeds (60% of weight) only, without waste. This technology is less labor intensive and produces better quality cotton with longer fiber.

- <u>Saw ginning method.</u> Under this method, raw cotton has to be processed for longer time. Cotton processing by this technology results in cotton fiber (35-38% of total weight), cotton seeds (55-58%) and cotton waste, lint (3%), uluk (1%) and cotton-down (0.6%). Lint, uluk and cotton-down are also traded and used in production of various goods.

Cotton fiber is then processed to obtain cotton yarn. Seeds are further processed to cotton extraction residue, rafinated cotton oil and cotton oil acid.

QUALITY CERTIFICATION

Cotton fiber undergoes quality certification, which is conducted by internationally recognized quality assurance companies such as S.G.S. and Wakefield, which have established branches in Azerbaijan. After cotton is processed at the plants, packed in bales and is ready for export a customer buys S.G.S. or Wakefield services, which certify the cotton bales are of right quality. Experts from S.G.S. or Wakefield also participate at the time of loading for export. Customers normally cover quality certification costs.

COTTON OIL EXTRACTION

Technical cottonseeds are processed for extraction of cotton oil. Processing of technical seeds delivers approximately 16% of non-rafinated (“black”) oil and 84% of husk and cotton-cake. Husk and cotton-cake are sold for feeding cattle. Non-rafinated oil is processed further to produce refined oil and soap stock.

SALES AND DELIVERY

Sales terms of cotton products of the new harvest are settled in annual contracts with wholesale traders and textile enterprises in March-June. It is common in the cotton business that buyers of cotton fiber make substantial prepayments to cotton processing companies. Cotton fiber sales prices are settled in accordance with Cotlook A index and quality. Quality of cotton fiber depends on its sort and type, which determined at certification of cotton. Cotton delivery and subsequent cash settlement occurs from October to July.

Delivery of cotton products is normally done under FCA conditions. Under these terms, a buyer bears all the responsibility for transportation and insurance.

Appendix 3 - MKT in pictures

Raw cotton is collected manually to ensure high quality

Piles of newly delivered raw cotton in front of the cotton processing plant

Cotton processing plant that is equipped with the new and efficient roller ginning machinery which lowers costs of production per unit

Bales of packed cotton fiber in warehouse ready for loading. Each bale is appx. 200kg