

Elektrim S.A.

The Inside View of What Happened, and
any Pieces worth picking up from the
Rubble

(A personal view)

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Presentation to the MBO / MBI Club of Warsaw

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Agenda

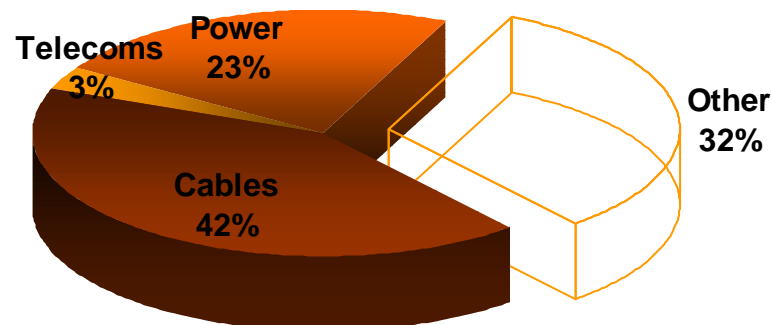
- The Inside View of What Happened ('99-'01)
 - Elektrim pre-B. Lundberg
 - Strategic and Operational Choices 1999
 - Shortcomings
 - 1999: Strategic volteface and Teutonic vengeance
 - 2000: Irrational exuberance, and between a rock and two hard places
 - 2001: Protracted operation successful, patient left to die
 - Benefits of Hindsight: Achievements Overshadowed
 - A personal epilogue: Ethics and Law Enforcement
- Sifting through the Rubble for Pieces
 - Non-core assets divested '99-'01
 - Elektrim Motor and Elektrim Electrical Equipment (trade sales)
 - Elektrim Kable through LBO
 - WEH through LMBO
 - Potentially interesting assets
 - Rafako, Megadex, Elektrim Volt

Inside View

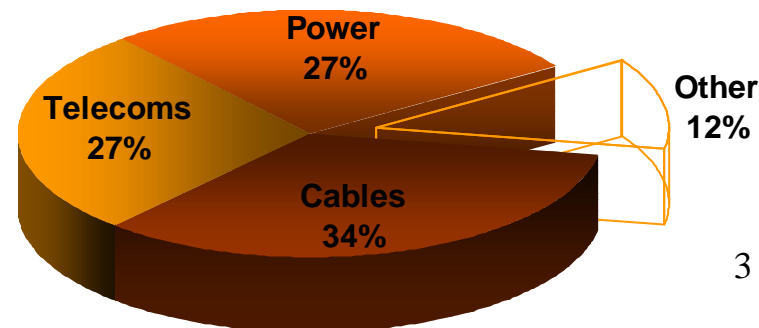
Elektrim pre - B. Lundberg

- Opaque holding with 126 subsidiaries/affiliates
 - no strategic focus
 - dispersed sectoral portfolio
 - no integrated concept of telecoms offering, but significant financial exposure to fixed telecoms
 - inadequate financial controls
- Illiquid 34% stake in PTC, not consolidated, not leverable
- Loss of confidence in previous management team (Kulczyk option on PTC shares not disclosed)

Consolidated Revenues
1998 (pre)



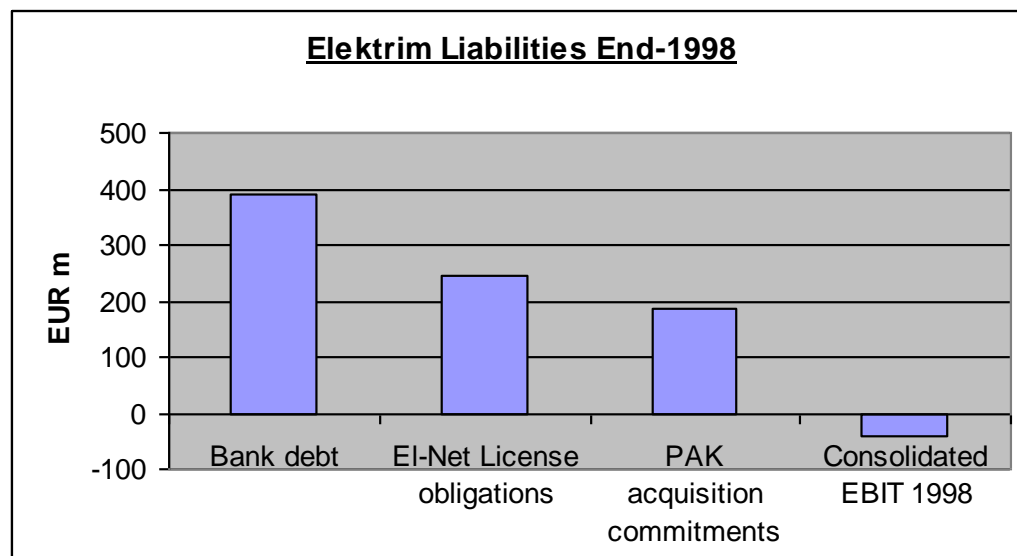
1999 (refocused)



Inside View

Elektrim pre - B. Lundberg (ctd.)

- Precarious financial situation:
 - bank/bond debt of EUR 390m
 - El-net Warsaw license commitments (EUR 245m)
 - PAK acquisition commitments (EUR 188m)
 - No ability to lever PTC for fixed telephony
 - No network in Warsaw to assist with license build-out obligations
 - Negative consolidated EBIT and corresponding cashflow



Inside View

Strategic and Operational Choices 1999

- Regulatory Window of Opportunity:
 - Telco foreign ownership restricted to 49%
 - Chance for ‘Polish’ alternative operator to emerge
- Financial Window of Opportunity
 - Elektrim had a wide following among institutional investors, who had a key role in nominating B. Lundberg as new CEO
 - Funding conditions for alternative telcos were excellent
- Strategic Opportunity:
 - Take control of 51% of PTC ERA GSM and build full-service alternative telecoms operator around it (mobile, fixed, internet, data)
 - Acquire Warsaw CATV network to accelerate / enable El-Net roll-out of fixed telephony/internet/CATV (triple play, emulating UPC strategy)
 - Power as 2nd leg, with expectation of similar benefit from sectoral liberalisation as in telecoms

Inside View

Strategic and Operational Choices 1999 (ctd.)

- Key Decisions -- Telecoms:

- Discontinue JV Discussions with DT and acquire 15.8% of PTC from minorities/BRE with EUR 650m equity participation from Vivendi
- Acquire Bresnan CATV for EUR 310m to accelerate El-Net Warsaw roll-out and use economies of triple-play (telephony, internet, CATV)
- Attempt to acquire several minor local telcos (Pilicka, PTO), but terminated
- Execute near-complete acquisition of power producer PAK for EUR 88m (plus EUR 100m capital increase commitment)
- Raise EUR 440m convertible to fund Bresnan and PAK (largest CEE CB to date)

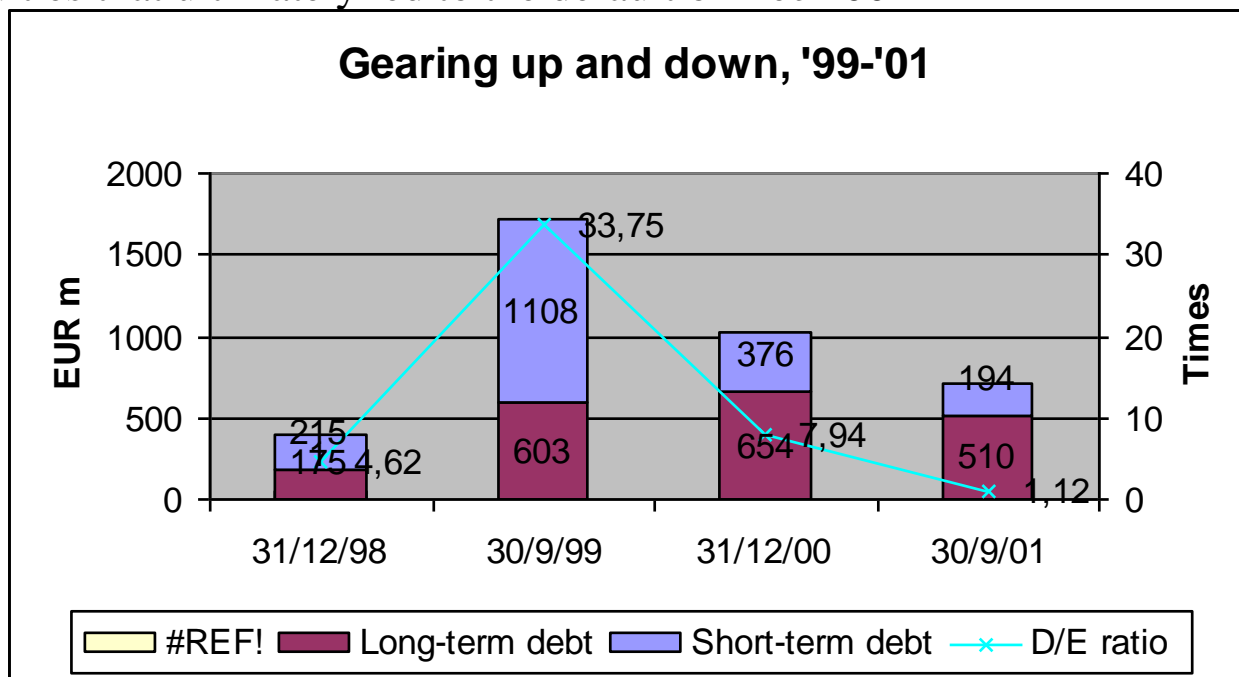
- Key Decisions -- Restructuring:

- Divest Elektrim Motor (USD 13.2m) and Elektrim Electrical equipment (USD 14.1m) to strategic buyers
- Close trading departments at Elektrim holding and reduce staff from 300+ to 160; transforming Elektrim into pure financial holding (without sufficient regard for Polish tax and banking realities ... tax, regulatory and cashflow disadvantages)
- Hiving-off 50+ non-core holdings into Warsaw Equity Holdings (WEH), an outsourced divestment vehicle (reducing consolidated entities from 32 to 15, unconsolidated from 56 to 6, minorities from 21 to 8, improving transparency and freeing management time)
- Consolidate three Elektrim Kable plants, reducing staff by 1200 (-28%)

Inside View

Shortcomings: #1, Balance Sheet

- Elektrim's balance sheet was insufficiently strong, with no ability to tap PTC's cashflow (once turned positive) and imperfect ability to tap cashflow of other major operating subsidiaries (E. Kable, PAK)
- Convertible bond, while big success, turned out to be debt rather than quasi-equity
- DT's legal obstructivism raised Elektrim's leverage to high levels by end-1999, before Vivendi deal allowed significant de-leveraging
- Blocking of capital increase by funds and Vivendi in June 2000 ('own goal') created renewed financial difficulties that ultimately led to the default of Dec 2001



Inside View

Shortcomings: #2, Shareholders and Governance

- **Fragmented Shareholder Structure:**
 - Elektrim's shareholder structure was very fragmented, with London funds initially dominating (ML, Capital Research, Invesco, Flemings, Schroders), very high free float
 - Institutional investors did not understand, had no time and no patience for major restructuring to run its course, and lost faith in management quickly when it came under fire from DT in 1999 and Vivendi in early 2000
 - Institutional shareholders had rejected Supervisory Board seats in mid-1999, but subsequently felt that they were not adequately represented, creating a disconnect that was instrumental in the failure of the crucial June 2000 rights issue
- **Lop-sided Supervisory Board (SB):**
 - Elektrim's SB included one Vivendi representative and, in Mr Bruckner, a Vivendi business associate, as well as Polish businessmen and bankers
 - In two years of board deliberations of many competing offers and deals by both DT and Vivendi, Vivendi's representative never excused himself, and quite on the contrary made full use of his board position to bias the debate and sentiment in favour of Vivendi offers
 - Over time, Elektrim's SB's have sought to take over MB functions, impossible to do in such a complicated holding with fast-moving developments
- **Lack of proper representation of investors led to distrust and disconnect, depriving Elektrim's management of the support of its shareholders when faced with aggression from its two strategic partners seeking to acquire control of PTC without paying a full and fair price.**

Inside View

Shortcomings: #3, Picking a Fight with two Gorillas

- Don't pick a fight with a Gorilla, a German one at that ...
 - DT and Elektrim had not reached a deal over PTC during 6 months of exclusivity, control issues being the key issue (51/49 or 49/51)
 - DT felt that Polish regulatory restrictions provided a non-level playing field (correct)
 - DT was caught out by BL's quick execution and backing from Vivendi, and resorted to a legal battle to throw many spanners into the works (with tactical success; arbitration was lost 3 1/2 years after being launched, but cost Elektrim dearly in the interim)
 - Elektrim's financials were not sufficiently strong to withstand the uncertainty associated with a protracted struggle over ownership of PTC, a weakness that Elektrim's foreign partners repeatedly sought to instrumentalise for their gain
- Effects of DT's rearguard action:
 - Loss of confidence from markets and investors as key long-term partner went hostile
 - Several months delay in closing Vivendi's EUR 650m investment, turning it into high-cost debt rather than equity in the interim, raising leverage
 - Near-illiquidity at end-1999 due to delays in executing share transfer to ET which was CP for Vivendi equity investment

Inside View

Shortcomings: #3, Picking a Fight with two Gorillas

- ... and don't count on a French Gorilla to bail you out, he'll turn nasty when he does not get his way:
 - Vivendi sat on the fence June-Dec 1999, as DT-induced legal obstacles made financial closure of original deal difficult
 - Only when faced with loss of EUR 650m unsecured loan in Dec 1999 did Vivendi come through with EUR 1.2bn investment (and EUR 100m liability guarantee on arbitration), for a revised 49% in Elektrim Telco rather than 30%
 - Shortcomings of the deal meant that Vivendi had acquired 49% of Elektrim's 51% of PTC, 49% of CATV, but 0% of Fixed Telephony
 - Lack of willingness to spend additional significant cash in Q1/Q2 2000 on fixed telephony led to souring of relationship
- **Elektrim's management underestimated the vengeance and ruthlessness with which both DT and Vivendi resorted to all possible means, above board and underhand, in order to discredit management and cajole the stakeholders of Elektrim to approve solutions conducive to the interests of its rivaling strategic partners.**

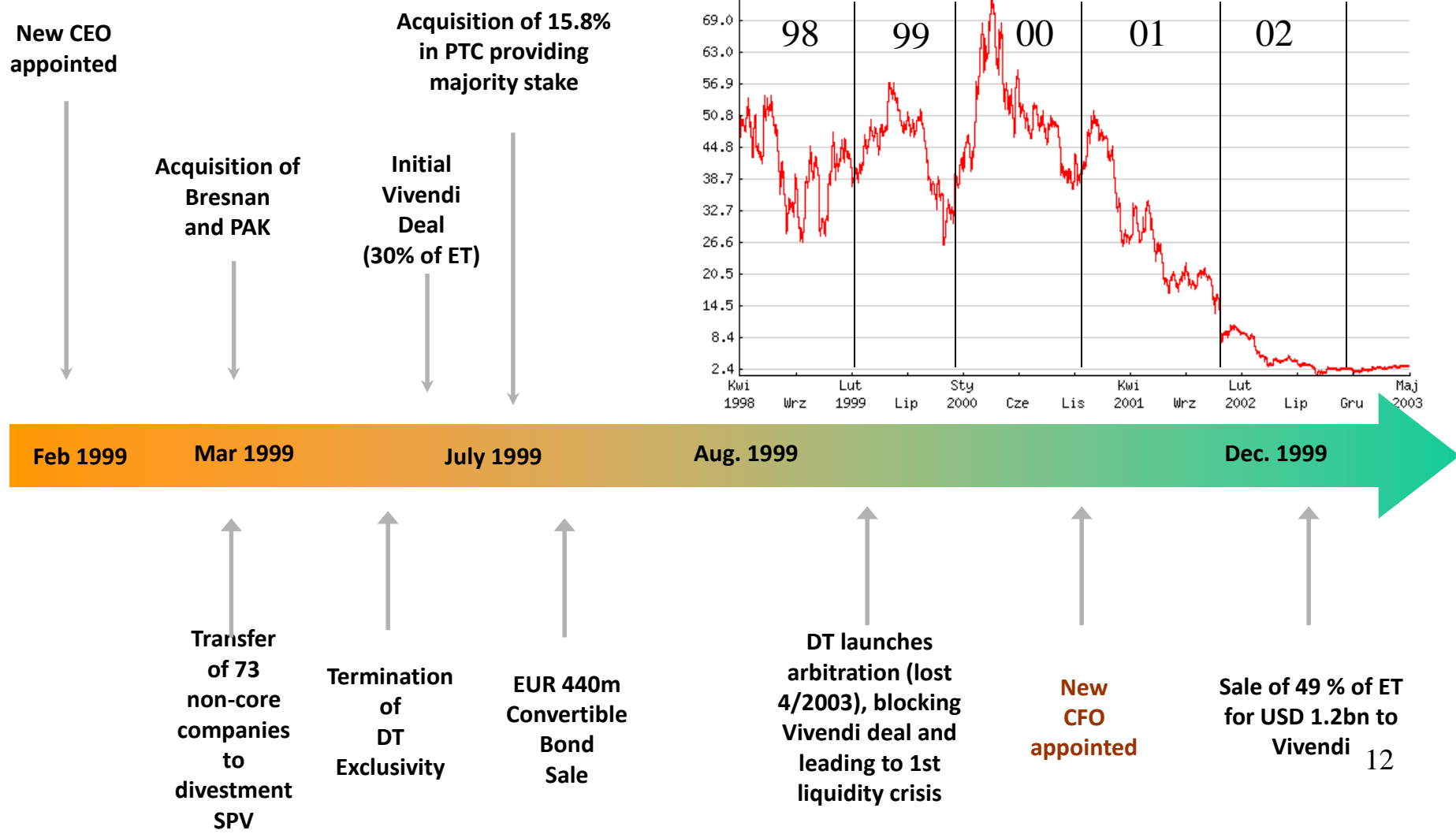
Inside View

Shortcomings: #3, Picking a Fight with two Gorillas

- Effects of Vivendi's 'Trojan Horse' Tactics:
 - Lack of ability to close fixed telephony deal on mutually agreeable terms in Q1/Q2 2000 led Vivendi to use a mix of internal and external pressure to get its way:
 - Vivendi did not want to close a deal on fair terms as time was on its side -- Elektrim had to fund CATV 51/49 through shareholder loans and fixed telephony 100% through shareholder loans, as bankability was only attainable once there was a joint ownership structure
 - Vivendi took a 4.9% stake directly in Elektrim, and a further non-disclosed 4.9% stake through a Luxembourg SPV, and actively used both stakes to oppose Elektrim's planned rights issue at the June 2000 AGM (now under investigation by French SEC)
 - By helping to defeat the planned equity issue, Vivendi weakened Elektrim financially
 - Vivendi used its representation on Elektrim's Supervisory Board, in flagrant violation of usual conflict-of-interest situations, to further its specific interest at the expense of Elektrim's interests and to undermine the trust of Elektrim's Supervisory Board members and institutional investors in the management (now under investigation by French SEC)
 - Vivendi stalled where possible in order to increase the financial pressure on Elektrim
 - Vivendi used a tactical arbitration suit in Feb 2001 to block the implementation of the fixed telephony JV LoI signed by DT and Elektrim in Dec 2000, successfully

Inside View

1999 -- Strategic Volteface and Teutonic Vengeance



Inside View

2000 -- Irrational Exuberance, and between a Rock and two Hard Places

First Internet
Acquisitions

Eastbridge
Internet
Acquisition

Vivendi builds 10%
stake (partially
concealed)

Warsaw/
London/NY
Roadshow
to explain
rights issue



Feb 2000

Mar 2000

June 2000

July 2000

Sep 2000

Dec. 2000

Standstill
in Negotiations with
Vivendi
on Fixed Line

AGM
blocks
EUR 250m
capital increase,
triggering
2nd liqu. crisis

MSDW
retained to
advise on Poland's
takeover and
M&A options

Launch of
Warsaw's first integrated
telecom offer

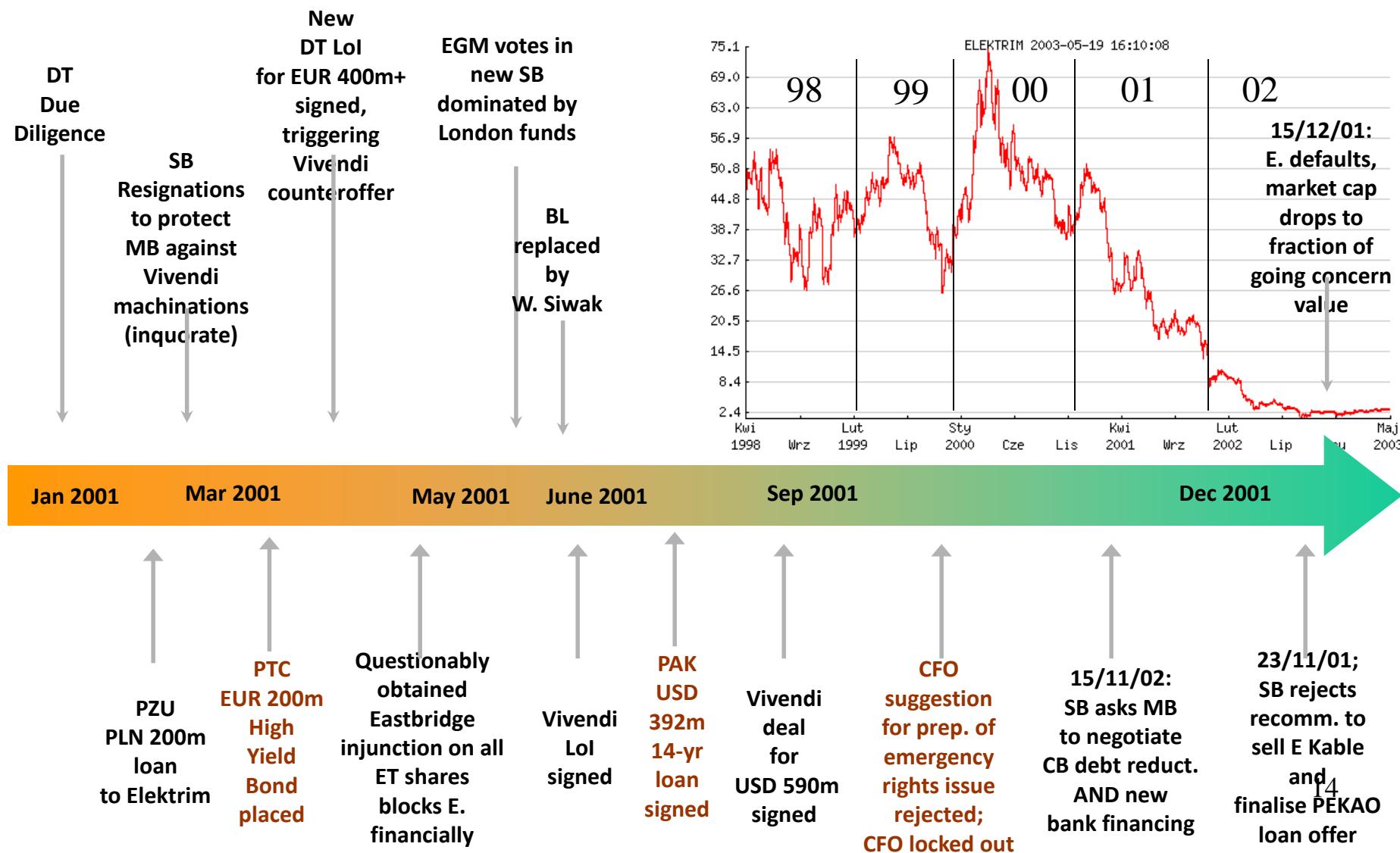
Compreh. DT
deal incl.
tender offer
rejected by
DT board

Vivendi
pretends to
prepare
tender
offer for E.

DT/E
sign
fixed telco
LoI 13

Inside View

2001 -- Protracted Operation Successful, Patient left to die



Inside View

Benefits of Hindsight: Achievements

- The positive achievements have been overshadowed by the default of December 2001, and the emotions of the rollercoaster developments of '99-'01. Significant results included:
 - Using regulatory and funding window to **take control of PTC**, making it the strategic and financial core of telecom growth ambitions
 - Resisting pressure and foul play from DT and Vivendi and hostility from shareholders to retain control of co-controlling stake in PTC to sell it to maximum bidder (two competing offers on the table in May 2001), **maximising value for Elektrim's** shareholders
 - Elektrim went from 34% of PTC to 25%, selling the right to co-control (51% of 51%) to Vivendi at the height of the market for USD 1.22bn + USD 0.59m = **USD 1.71bn in gross cash proceeds**, a multiple of market cap
 - Elektrim assisted PTC and PAK to become fully financed by raising EUR 650+200m l/t debt for PTC and USD 390m for PAK, and raised biggest CE CB issue (EUR 440m), bringing **total funds raised in two years from divestments and debt financings to over EUR 3.5bn**, versus average market cap of EUR 0.5bn
 - **PTC improved** its EBITDA margin from 26% to 42% (99 vs. 01), retaining No. 1 position
 - **Restructure and focus sprawling holding** through asset disposals and strategic re-focusing of group, increasing transparency in the process
 - **Share price** was stable at PLN 34.5 when BL was asked to leave in May 2001, against a major telco universe decline (and PLN 2-3 today)

Inside View

A personal epilogue: Ethics and Law Enforcement

- Poland's institutions suffer from a crisis of confidence:
 - Capitalism is built on two sets of norms, informal rules of behaviour and formalised rules of the game
 - Formal rules only work when two factors are given:
 - Law enforcement works sufficiently well to encourage rule-abiding behaviour most of the time
 - Impunity before the law and weak rule enforcement encourages disregard for the rules of the game
 - Ethical behaviour and the state of formal law-abiding standards are closely correlated, where the latter does not work, the former is threatened
- Impunity before the law hurts the regard by all citizens for the new order and undermines the credibility of the system
- Repeated disregard for the letter of the laws that are supposed to protect minority investors in publicly listed companies undermines the position of the Warsaw Stock Exchange as a capital market

Inside View

A personal epilogue: Ethics and Law Enforcement (ctd.)

- Elektrim was very public, its assets very prized, and it was not protected against repeated infringements of formal and informal rules, e.g.:
 - Frequent violations of conflict-of-interest rules (supervisory board, law firms, strategic partners and shareholders)
 - April 2001 injunction over its telecoms assets by Eastbridge based on two questionable and questionably-obtained judgements in Polish courts when international arbitration had just commenced and those courts had no jurisdiction
 - Three times Elektrim's shareholders violated the spirit (and sometimes the letter) of Poland's stock exchange law, acquiring a significant stake (in excess of 10% within 3 months without having to call a tender as foreseen by law) without ever being called to account by the Polish SEC (KPW): Vivendi mid-2000, BRE/Opara/Jakubas end-2001, Polsat/TCF early 2002)
 - CEO Siwak's irresponsible statements in the summer of 2001 as to full financing being available to repay the 12/2001 CB were only recently penalised with a PLN 400k penalty by the KPW, with no personal liability to him thus far

Sifting through the Rubble

Non-Core Assets Divested '99-'01

- From the start, Elektrim's management sought to divest non-core assets to simplify operations, raise cash, and increase transparency of the holding
- Key assets sold in trade sales 1999-2001 were:
 - **Elektrim Motor**, a group of companies producing electrical motors, were sold to a long-time Italian customer, Interelektra, for USD 13.2m (after significant repackaging and pre-sale restructuring led by Tuomo Hattaka)
 - **Elektrim's Electrical Equipment Division** was sold to Schneider Electric for USD 14.1m (after significant repackaging and pre-sale restructuring led by Tuomo Hattaka)
 - **Elektrim Kable** was sold to KFK/Telefonika for USD 110m in Dec 2001 (LoI for USD 100m signed in April 2001, and after turnaround under Tuomo Hattaka as CEO) financed 100% through incremental loans by bank consortium organised by PEKAO S.A.

Sifting through the Rubble

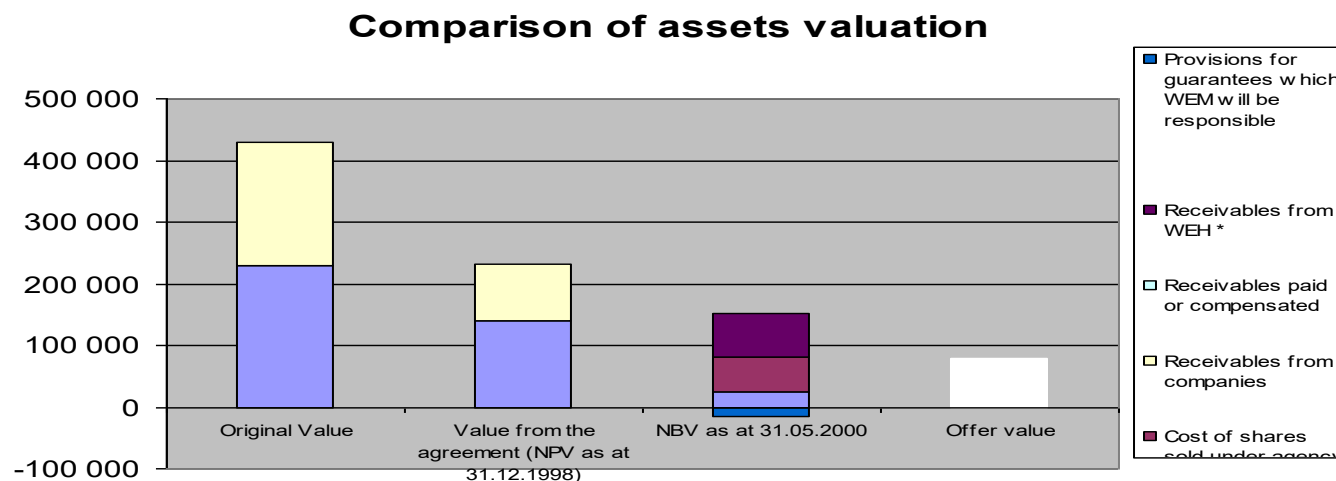
Non-Core Assets Divested '99-'01 (ctd.)

- The lion's share of Elektrim's assortment of holdings (73 companies) were transferred to a divestment vehicle (**Warsaw Equity Holdings**) managed by a third-party (Landford, managed by Kouri Capital)
- Logic of creation in March 1999 was manyfold:
 - outsource task of selling majority and minority stakes in companies in all kinds of sectors
 - improve transparency of holding through sectoral focus
 - maximise cashflow to Elektrim while minimising management time required to deal with marginal assets
 - asset manager to restructure companies prior to divestment, to reduce all contingent liabilities on Elektrim's balance sheet (guarantees), and to maximise collection of Elektrim's receivables from subsidiaries prior to or at moment of sale
- Terms of asset management contract were the following:
 - quarterly management fee of 0.625% of NBV of assets under mgmt
 - 5% success fee on sale of assets
 - 10% success fee on release of guarantees
 - distribution of net proceeds after fees 80% to Elektrim, 20% to asset manager (akin to private equity carry structures)

Sifting through the Rubble

Non-Core Assets Divested '99-'01 (ctd.)

- Between April 1999 and May 2000, WEH generated:
 - PLN 62.5m through sale of 20 companies
 - PLN 31.6m of guarantees granted by Elektrim released
- But, it became clear that value of portfolio was considerably below even reduced NBV, and that subordination of payouts to cumulative fees of asset manager implied that cashflow from immediated sale was higher than lifetime-of-SPV expected cashflow
 - Previous Elektrim mgmt had created companies by contributing doubtful receivables at book value as contribution in kind, thereby inflating book values of companies relative to underlying value



Sifting through the Rubble

Non-Core Assets Divested '99-'01 (ctd.)

- Elektrim sold select portfolio (and transfer of all bank guarantees) to asset manager of WEH for PLN 34m, with internal analysis, E&Y appraisal, and PWC fairness opinion all concluding that NPV of immediate sale was higher than m/t divestment through SPV
- Asset manager of WEH was able to structure near-100% LBO of the portfolio from Kredyt Bank S.A., using the following elements:
 - assignment of senior rights to annual management fees to bank
 - securing loan by real assets (land, buildings, other fixed assets) of portfolio companies held by WEH (i.e. two levels below leveraged SPV)

Sifting through the Rubble

Potentially Interesting Assets

- Hard truth ... there are no hidden gems left in Elektrim, too many pirates have come through ...
- Most coherent assets are now power-related:
 - PAK power generator (38.5% owned)
 - Rafako, publicly-listed boiler-maker (49%)
 - Elektrim Megadex, turnkey EPC contractor (98% owned)
 - Elektrim Volt, energy trader (100% owned)
- With some other assets that are not going concerns:
 - Turkish real estate investments (NBV > USD 100m, but held on behalf of Polish state treasury, ringfenced on balance sheet)
 - Port Praski real estate (estimated value > USD 30m)
- And the one assets that all continue to fight over:
 - 24.99% indirect holding in PTC ERA GSM

Sifting through the Rubble

Potentially Interesting Assets

- All power assets are dependent on developments at PAK
- In Aug 2001, Elektrim arranged for PAK to sign a 14-year, limited-recourse, USD 390m facility to debt-finance 75% of the cost of Patnow 2, a new 460 MW coal-fired plant, which fully financed Patnow 2
- Elektrim Megadex is the EPC contractor for Patnow 2, Rafako is a key subcontractor for the boiler alongside Alsthom, and Elektrim Volt has trading contracts for the output of PAK on the Polish power market
- Elektrim's default cross-defaulted the Patnow 2 loan, which was never disbursed and cancelled by the banks in May 2002 in light of continuously changing CEOs at Elektrim and no resolution to Elektrim's default and associated credit risk as guarantor of Megadex EPC role
- Elektrim's four CEOs and two CFOs since mid-2001 have not succeeded in arranging a new bank facility for PAK, which has received USD 100m equity injection from Elektrim plus USD 35m shareholder loan, but which recently has had to stop most work on the site of Patnow 2 as funds have run out

Sifting through the Rubble

Potentially Interesting Assets

- *Assuming* that Patnow 2's funding problems can be resolved, the power assets have the following potentially interesting characteristics:
 - PAK power generator (38.5% owned)
 - Low-cost producer due to nearby coal mines and depreciated equipment
 - Well-positioned to benefit from market liberalisation, but maturity and impartiality of regulatory oversight an issue
 - No long-term offtakes on existing 2200 MW but selling into spot market
 - Rafako, publicly-listed boiler-maker (49%)
 - dominant position in coal-fired boilers, with significant potential for renewal contracts as 80% of installed base in Poland was built by Rafako
 - strong blocking minority owned by employees/unions, making control and restructuring difficult
 - Elektrim Megadex, turnkey EPC contractor (98% owned)
 - competent ex-ABB management, strong industry contacts
 - Elektrim Volt, energy trader (100% owned)
 - one profitable long-term Austrian export contract, otherwise piggy-backing on PAK

Conclusion

- Elektrim's management was probably too ambitious in trying to achieve multiple tasks in a very short time without adequate internal resources, and obviously made some mistakes in trying to pull all that off
- Elektrim's shareholders failed to support management at crucial times
- Elektrim's strategic partners pulled no punches in the fight for control of PTC (but were wrong each time and had to pay up in the end)
- BUT: All key objectives were in the end (May 2001) achieved, namely
 - Restructuring of holding into telecoms and power group
 - Restructuring and sale of over 80 non-core companies
 - Sale of controlling stake in PTC for EUR 1.7bn cumulative cash
 - Raising EUR 1.2bn debt financings to self-finance key subsidiaries (PTC, PAK)
- Holding mgmt responsible for the shenanigans, intrigues, incompetence and conflicts of interest of subsequent shareholders and mgmt teams means to confuse cause and effect.

