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# HUNGARIAN-AMERICAN ENTERPRISE FUND
# MAGYAR-AMERIKAI VÁLLALKOZÁSI ALAP

4

## FOURTH ANNUAL REPORT

For the Fiscal Year Ended September 30, 1993

# Hungarian-American Enterprise Fund

The Hungarian-American Enterprise Fund ("the Fund" or "HAEF") is a private, tax-exempt (§501(c)(3) of the Internal Revenue Code) Delaware corporation established pursuant to the Support for East European Democracy (SEED) Act of 1989, enacted by the U.S. Congress, for the purpose of promoting the development of private enterprise in Hungary, including small businesses, agricultural projects and joint ventures between U.S. and Hungarian businesses or entrepreneurs, through equity investments, loans, grants, feasibility studies, technical cooperation, training, insurance, guarantees and other measures.

The Fund, which commenced operations in July 1990, takes this obligation as a broad mandate to consider proposals or to originate activities, which are directed toward:

- Developing the business infrastructure of Hungary;
- Expanding and developing Hungary's capital market;
- Strengthening and diversifying Hungary's economy; and
- Broadening the Hungarian public's understanding of private enterprise.

Under the SEED Act, the U.S. Congress authorized HAEF to receive a total of $60 million over a three-year period. An additional $10 million was approved by AID to be used specifically for technical cooperation projects. HAEF may also raise additional amounts from the private sector and from foundations. Initial U.S. Government funding was received on May 17, 1990, and a total of approximately $53 million has been made available to the Fund as of September 30, 1993. The Fund maintains offices in Washington and Budapest; proposals for investment or technical cooperation will be evaluated in Budapest but may be submitted to either office.

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# Board of Directors

**John C. Whitehead,** ***Chairman.*** Chairman of AEA Investors, Inc.; former U.S. Deputy Secretary of State; former Co-Senior Partner and Co-Chairman of Goldman Sachs.

**George D. Gould,** ***Vice Chairman.*** Vice Chairman of Klingenstein, Fields & Company (investment management); former U.S. Under Secretary of the Treasury.

**Daniel B. Burke**, President and Chief Executive Officer of Capital Cities/ABC Inc.; Chairman of International Executive Service Corps.

**Zsigmond Járai**, Managing Director of Samuel Montagu Securities, Budapest; former Chairman of the Hungarian Stock Exchange Council; former Deputy Minister of Finance.

**Paul Marer**, Professor of International Business, Indiana University School of Business; co-organizer of the Blue Ribbon Commission on the Economic Transformation of Hungary.

**György Surányi**, Managing Director of the Central European International Bank; former President of the National Bank of Hungary; member of the Blue Ribbon Commission on the Economic Transformation of Hungary; member of the Institute for Public Finance, and the United Nations Development Committee.

**György Varga**, Editor-in-Chief, *FIGYELŐ* (Hungarian economic and business weekly); Member of the Advisory Board, Commercial and Credit Bank; Adjunct Professor, Budapest University of Economic Sciences.

# Officers

Charles A. Huebner, *Managing Director*

Thomas M. Hughes, *Chief Financial Officer*

Zsuzsa Fekete, *Director of Operations and Control*

László Oláh, *Director of Investments*

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This is the Annual Report of the Hungarian-American Enterprise Fund published pursuant to Section 201(P) of the Support for East European Democracy Act of 1989 (Public Law 101-179, November 28, 1989)

# Letter from the Chairman and Vice Chairman

## HUNGARIAN ENVIRONMENT

1993 was an extraordinarily challenging year for the Republic of Hungary and, by extension, for the Hungarian-American Enterprise Fund.

Hungary's economic recession now stretches into its fourth year. Its Gross Domestic Product is estimated to decrease in 1993 by two percent, and its currency, compared to the U.S. dollar, declined in value almost 20 percent. Exports to southern Europe, Greece and Italy remain disrupted due to the continued unrest in the former Yugoslavia and the Balkan states. While on average in 1993, more than five million people were officially employed, unemployment -- though decreasing -- still stood at an unacceptably high 12 percent. Clearly, one of the Fund's chief goals in 1994 will be to leverage its scarce investment dollars into creating as many jobs as possible.

The Fund welcomes Hungary's Association Agreement with the European Community, which comes into force in February 1994, given the great importance for Hungary's economic recovery of expanding exports to the West. At the same time, Hungary's prospects for exports, and as an even more attractive location for foreign investment, would be enhanced by a firm commitment by the European Community of Hungary's eventual admission to its ranks.

## HIGHLIGHTS OF FUND ACCOMPLISHMENTS

It is in this environment that the Fund disbursed some $11.4 million for investments during fiscal year 1993. Since its inception, the Fund has disbursed a total of $43.3 million for equity investments and loans. These total disbursements, subtracting investments which have been sold, and adjusting for year-end investment revaluations (driven mainly by the 20 percent devaluation of the Hungarian forint) comprise an investment portfolio now valued at some $35 million. Seven new investments, together with increases in five existing investments, were made in 1993, and a new Micro Loan Program was funded.

The Fund's "Small Loan Program," which makes local currency loans from $10,000 to $100,000 to small entrepreneurs for terms of up to five years, was augmented in mid-1993 by a "Micro Loan Program." The Micro Loan Program targets very small entrepreneurs and makes loans in the range of $1,000 to $20,000. To date, under the original Small Loan Program, loans totaling approximately $5 million have been made to 109 borrowers. Under the just-started Micro Loan Program, some 18 loans have already been disbursed. While the Fund does not expect these small and micro loan programs to generate as much income as the

Fund's larger equity program, the Board is especially pleased to make this capital available to small entrepreneurs who have few alternative sources of capital, and limited access to loans exceeding one year's maturity.

The Fund's investment portfolio spans the spectrum of the Hungarian economy, and while many investments are in the capital region -- in or surrounding Budapest -- companies in which the Fund has invested equity or lent funds are located in all 19 counties of Hungary. In 1993, the Fund's investments included companies in the service sector, high-tech, manufacturing, agriculture and other sectors key to Hungary's transition to a market economy.

In 1994, the Fund expects to continue its investment focus in companies that contribute to infrastructure development (communications, transportation, agriculture, etc.), that fulfill demand for consumer goods and services (which were ignored under the centrally directed economy), and whose products have good export potential.

## RECYCLING INVESTMENT DOLLARS

The Fund made its first investment in December 1990. After three years, some investments have matured to the point where the Fund can take a profit and recycle those dollars into companies that are still in an early stage of development. We are pleased to report that the Fund has been able to sell -- at a profit -- its holdings in several companies, including a portion of its investments in the Pick Salami Company and EMI-Quint Recordings. Currently, the Fund is identifying new investment opportunities for these recycled dollars. It intends to continue this cycle of "planting and harvesting" in 1994.

## DEVALUATION -- THE SILENT THIEF

Because of the ongoing restructuring of the Hungarian economy, the world-wide recession, and other factors (see "Outlook for Hungary" on page 8), the Hungarian forint continued to decline. Because the Fund's equity investments are denominated in local currency, the Fund is subject to significant currency exposure.

The Fund's mandate under its enabling legislation, the Support for East European Democracy Act, is to make investments in the Republic of Hungary and to reinvest in Hungary the proceeds realized from those investments. Because of this constant in-country reinvestment, mostly in equity, and the fact that most of the Fund's operational costs are incurred in Hungary, the Fund is under no pressure to repatriate forints into dollars. This approach, however, causes problems in assessing the Fund's progress because, as a U.S.-based investment fund, it must report the results of its operations and investments in U.S. dollars. As devaluations occur in the forint, the value of assets denominated in forints is similarly diminished to the dollar since there is no hedging mechanism, no liquid market, and

generally no trading of its investments on a stock exchange. The Fund's challenge is to separate, for monitoring purposes, changes in the value of an investment caused solely by re-stating the forint investment in dollars from those changes in value that are caused by the underlying favorable (or unfavorable) operations of the investment. Of the $2.5 million currently held in a valuation reserve for all investments, the majority of that reserve was set aside to offset possible currency losses.

When calculating target returns on investment, the Fund considers the need to obtain a "currency-adjusted" premium for all forint-denominated investments so that the overall return on those investments, when converted to dollars, are at acceptable levels.

## RETIREMENT OF THE FOUNDING PRESIDENT

When the Fund was formed in 1990, the Board was extraordinarily fortunate in convincing Alexander C. Tomlinson, a former Managing Director of Morgan Stanley and a former senior officer of First Boston, to come out of retirement to serve as President. At that time, he agreed to "about a three-year hitch" and this year, shortly after his 71st birthday, he announced his retirement from the Fund. During his three-year tenure, President Tomlinson took the Fund from a fledgling operation with only a single employee to a mature investment fund with $40 million under management and a staff of more than a dozen trained professionals. The Board is indebted to him for his leadership and organizational ability. We expect to appoint his successor shortly.

## MAJOR CHALLENGES IN 1993

Notwithstanding the Fund's investment successes, it was challenged by two major issues during 1993. First, at the request of the Hungarian Government, the Fund made the decision to supplement the salary of a U.S. citizen recruited by the Hungarian Government to serve as head of Hungary's independent State Asset Holding Company. While the Fund's objective was only to support Hungary's efforts to speed the privatization of its largest companies, the Fund regrettably did not communicate this information in a timely manner. We have taken steps to insure there will not be a repetition of the complications caused by the Fund undertaking this type of assistance.

Second, to help return Hungary to its place as a pre-eminent economic and financial center in Eastern Europe, the Fund invested in EurAmerica Capital Corp., an investment advisory services company. Unfortunately, at the time the Fund made the investment, we did not fully appreciate the sensitivity to EurAmerica's principals being compensated at investment banking salary levels.

We are pleased to report, however, that with the cooperation of the EurAmerica principals and many helpful individuals in the U.S. Congress and the

Administration, these issues were resolved to the satisfaction of all. We are also pleased to note that since its inception, EurAmerica has already attracted $37 million new investment dollars into Hungary and Eastern Europe, representing a total of approximately 1,100 jobs.

## A SPECIAL NOTE OF THANKS

One of the Fund's first Hungarian Directors, László Rózsahegyi, President of ROLITRON Bioelectronics, Ltd., resigned in 1993 after three years of service to devote more time to his growing business interests. His counsel and advice have been influential in Board of Directors' deliberations and decisions, and he will be missed. In his place, the Board elected Zsigmond Járai, Managing Director of Samuel Montagu Securities in Budapest. We look forward to working with Mr. Járai, whose background includes Chairmanship of the Hungarian Stock Exchange Council and a tenure of several years as Deputy Finance Minister in charge of State Banking Securities Supervision. Also resigning was one of the Fund's first American Directors, Robert Hormats, Vice-Chairman of Goldman Sachs International. Mr. Hormats is now serving as one of the Directors of the recently-formed Russian-American Enterprise Fund.

We are also appreciative of the generous amount of time donated by our fellow Board members, Daniel Burke of Capital Cities/ABC, Paul Marer of Indiana University, György Surányi of Central European International Bank, and György Varga of *FIGYELŐ*. Our Hungarian Directors particularly have provided the Fund with special insights into Hungary's financial and business community, greatly assisting the Board in making investment decisions.

U.S. Ambassador Charles Thomas, who is leaving Budapest after almost four years, has been invaluable to us in his active support of the Fund. We look forward to developing a similar close working relationship with his successor, Ambassador-designate Donald Blinken. We are grateful for the help and support of those mentioned above and the assistance of many others in the U.S. and Hungarian governments.

On a somber note, we were saddened by the death in December 1993 of the Hungarian Prime Minister, József Antall. Several members of the Board were personally acquainted with the Prime Minister, and the Fund benefited from his support. While we share a sense of loss with the Hungarian people, we also share their optimism that Hungary's strong commitment to democratic principles will continue the peaceful and orderly transition to a market economy with the new Prime Minister, Péter Boross.

## LOOKING TO THE FUTURE

Operations of the Fund are guided by a Strategic Management Plan. This plan, updated and approved by the Board of Directors in December 1993, revises the

Fund's original Plan with the benefit of three years of experience investing in Hungary.

The revised Strategic Management Plan clearly articulates the dual mandates of the Fund as a demanding investor as well an investor with important public policy objectives. The Board believes this new Plan will benefit investment decisions in that it more clearly defines the Fund's major activities and brings into sharper focus the boundary lines of the for-profit and public policy activities performed under the Fund's dual mandates.

With more than three years' experience, the Fund is actively seeking moneys to manage from the private sector. The Fund seeks co-investors to form closed-end equity funds, as well as investors who would like to invest privately in Hungary but lack the knowledge and access to Hungarian equity markets. We believe that potential investors who are interested in Hungary will find Fund expertise, on-site experience and extensive contacts invaluable.

## IN CLOSING

During World War II, the Hungarians entrusted to the people of the United States of America one of their most treasured national symbols, the crown of Saint Stephen. Stephen, the first Christian King of Hungary, was crowned on Christmas Eve in the year 1000. This year, almost a millennium later, that same crown is proudly displayed in Hungary's National Museum, just a few steps from the Fund's Budapest office. With this sense of history and together with the Fund's Hungarian-born staff, we are proud to participate in Hungary's march to full economic freedom. We begin 1994 hopeful that Hungary will commence its long-awaited economic recovery. We look forward to the job creation and investment opportunities of this recovery and to cementing the economic and free market gains made since 1989.

John C. Whitehead
*Chairman*

George D. Gould
*Vice Chairman*

Washington, D.C.
January 24, 1994

# Benefits of Investing in Hungary

Since the beginning of its economic and political transformation in 1990, and despite the relatively small size of its domestic economy, Hungary has consistently attracted the largest amount of international investment capital within the region -- particularly American investment.

By the end of 1993, total investment inflow to Hungary is estimated to be about $5.6 billion. Although there are many reasons for this strong performance, some of the central factors are summarized below.

## HUMAN RESOURCES

Hungary has a highly educated and highly motivated population with a literacy rate over 99 percent. Mathematics and scientific and linguistic skills are particularly advanced, and entrepreneurship is highly developed and widely esteemed. Many people benefited from economic liberalism under Communism ("goulash communism") and thus are more familiar with Western business concepts than those elsewhere in centrally-directed economies. The labor force is well-skilled, hard-working and extremely cost competitive.

*At 20 years old, Gabor Lachmann is the youngest individual to receive money from the Fund's Small Loan Program. He originally took out a loan to build a three level greenhouse to grow mushrooms and other vegetables for export and for sale to restaurants. After a few months, he decided it was more profitable to convert the first floor to growing more mushrooms. He now is building a second floor, and we are hopeful his zeal for additional profits will be recognized by continued market demand for his products.*

## GEOGRAPHIC LOCATION

Hungary is at the crossroads of Western Europe and the emerging markets of Eastern Europe and the former U.S.S.R. It is less than two and one-half hours by air from all the major capitals of Europe, and Budapest is within three hours driving time of Vienna. Budapest is served by a modern airport -- Ferihegy -- and several international railroad routes pass through it. Hungary is ideally located to serve the markets of Western Europe and the potential markets of Central and Eastern Europe, the N.I.S., and the Middle East.

## PHYSICAL INFRASTRUCTURE

Improvements in Hungary's physical infrastructure have been dramatic since 1989. Hungary possesses an extensive railroad system, most of which is electrified. Several Western-style motorways have been recently constructed, and work is almost complete on the final stage of the Budapest to Vienna motorway. Work continues on Budapest's "ring road" or "beltway." When finished, it will allow east-west truck traffic to bypass the traffic jams of Budapest. Hungary has also made great progress in modernizing its telecommunications system, and several private telephone companies are getting reading to compete with the state-owned system. The government is selling concessions to private joint venture consortia which will accelerate improvements. MATÁV, the state-owned telephone company, was privatized in December 1993, and this privatization should greatly accelerate the modernization of the system and the availability of telephone service for the average Hungarian. Large parts of Budapest's central business district, including the Fund's offices, are served by a modern digital switching system.

*Although Hungary cannot yet fully afford the environmental protection common in Western countries, it has nonetheless moved aggressively to implement Western-style pollution controls on its burgeoning automobile population. Effective last fall, it became illegal to import into Hungary automobiles that are more than six years old.*

## POLITICAL ENVIRONMENT

Despite the recent death of Prime Minister József Antall, Hungary remains strongly committed to the democratic process. Hungary possesses a stable, parliamentary government that has demonstrated its commitment to a pluralistic society and a free market economy. This is not expected to change with Minister Antall's passing.

Because of its relatively homogeneous population, Hungary has been able to avoid ethnic and nationalistic conflicts in the region. Its stability has led to an inflow of capital from neighboring states seeking a safe haven.

## LEGAL INFRASTRUCTURE

The legal infrastructure necessary for private investment has been substantially enacted, and a full array of policy incentives are in place to encourage foreign investment including guaranteed repatriation of earnings and capital, etc. Last year, significant legislation that will speed up the transfer of land and buildings from the state to private owners was passed. Also in 1993, Hungary made major changes in its regulations on copyright protection and patent protection which will bring them substantially in line with

*The Fund has supported this effort by funding the International Management Center in Budapest, where it has sponsored seminars on corporate governance, management responsibilities to shareholders and similar programs designed to bring Western-style corporate practices to Hungary.*

both U.S. and E.C. standards. These changes include increased protection for copyrighted music and computer software and on patents for pharmaceuticals, chemical-based products and food products.

### INTANGIBLES

America is the "preferred brand" in Hungary. New York Mets baseball caps can be seen on Budapest's subway, the latest U.S. rock music is heard in the basement pubs, American fast food franchises have become so plentiful that one could eat at a different franchise seven days a week and not repeat the selection. From pizza to burgers to ice cream, Hungarians embrace things American. Hungarians take great pride in their English language capabilities, and except in the most rural parts of the country, an English-speaking Hungarian is never far away. These intangibles all work to make U.S. investors welcome in Hungary.

### MAJOR U.S. INVESTORS IN HUNGARY

| | | |
|---|---|---|
| Alcoa | Guardian Glass | Ralston-Purina |
| American Express | Levi Straus | R. J. Reynolds |
| Digital Equipment | Lockheed | Sara Lee |
| Ford Motor Company | Institutional Investors | Schwinn |
| General Electric | Marriott | United Technologies |
| General Motors | Phillip Morris | |

## Outlook for Hungary – On the Road to a Market Economy

The transformation of the Hungarian economy into one which is market-driven is taking place during a difficult period for the global economy. In addition to the economic disarray of its former COMECON trading partners, many of Hungary's Western trading partners are experiencing one of the worst recessions on record. The structural changes in Hungary needed for economic transformation -- total liberalization of foreign trade, privatization of state-owned enterprises, and improvement in its legal and institutional frameworks -- have to be accomplished in an environment of declining GDP, stubborn inflation, high unemployment, and deteriorating exchange rates. Nevertheless, Hungary seems to be succeeding in its struggle to create a market economy, as estimates for 1993 indicate that some 45-50 percent of GDP was generated by private enterprises.

The most important economic policy objective for Hungary in 1993 was to stop the decline in national output, which had been sliding since 1990, and to produce modest economic growth. This objective was only partially reached. The continued slide in GDP of two percent was a significant improvement over the 4.5 percent drop in 1992 and the 11.9 percent decline in 1991. The private sector however did increase its share in the economy. The number of incorporated enterprises increased considerably from

69,300 in 1992 to 82,000 in 1993, and many businesses -- especially in the consumer products and services sector -- did very well. The increase of attractive stores filled with an ample supply of products from all parts of the world, renovated houses and new office buildings, is a strong indication that beneath all the macroeconomic data, a new, vibrant economy is emerging.

In spite of the overall decline of the GDP, the volume of industrial production as a whole increased by approximately three percent, and several sectors produced even greater growth, (*e.g.*, the equipment, steel and construction sectors) exceeded the previous year's level by ten percent. However, in other significant areas (*e.g.*, agriculture, transportation of goods, and some services) output fell below 1992 levels. There are encouraging signs in the accelerating pace of large projects aimed at infrastructure development. The World Bank and other international financial institutions have allocated in aggregate $1.2 billion for projects such as motorways, railways, bridge construction and telecommunications. On the whole, capital investment activities have expanded noticeably over 1992 levels and will continue to grow especially in the case of infrastructure projects financed by the central budget, local governments, or concessional funding. Investments in the agricultural sector are at an extremely low level due to uncertainties about legal ownership which have come about by the effort to return nationalized properties to their former owners, or to compensate owners for their losses.

The total foreign capital invested in Hungary during 1993 was $2.3 billion, bringing the aggregate invested in Hungary since 1989 to $5.6 billion. It is of note that the more than 50 percent growth in 1993 in foreign capital invested was partly due to the December 1993 privatization of Hungarian Telecom (MATÁV), the largest-ever privatization transaction in Central Europe. The consortium of Deutsche Telecom and Ameritech invested $875 million for 30 percent ownership of MATÁV.

The number of foreign joint ventures exceeds 17,000, ten percent more than in 1992. However, the average capitalization of newly established joint ventures in 1993 declined by 40 percent in dollar-terms from the 1992 average of $215,000. This drop in average capitalization was heavily influenced by the year-end devaluation of the forint. It is estimated that in 1993 at least ten percent of the Hungarian GDP was produced by firms with dominant foreign ownership. The willingness of foreign partners to enter Hungary is still strong.

An economic trend of 1993 deserving attention is that, while the overall GDP declined, total domestic demand increased by approximately five percent. Such an increase has not been experienced in many years. It may be attributed in part to the off-book part of the GDP, estimated to be between 25 and 35 percent of the official GDP figures, as well as a major replenishment of inventories which had plummeted in previous years.

While the real income of the population declined slightly, consumption expenditures, at the expense of household savings, stopped declining. Medium and high income groups seemed to catch up on consumption, which had been postponed, through purchases of new, primarily durable household products and household services.

An excess of domestic consumption over production was covered by an increase of imports over exports. The volume of exports in 1993 dropped by 15 percent while the volume of imports increased by 8 percent. Thus, according to preliminary estimates, the foreign trade deficit amounted to $3 billion. The current balance of payments shows a similar deterioration. Because of Hungary's excellent credit rating (S&P Baa), it was able to borrow $4.7 billion on the international markets. By the end of 1993 foreign currency reserves increased to around $6.8 billion, exceeding seven times monthly imports. Nevertheless, the country's gross foreign debt at the end of September 1993 was $24.5 billion (the net debt was $15.7 billion), which is $2.4 billion more than at the beginning of the year.

Though most of the deterioration in the economy was due to factors outside Hungary's control, Hungarian economic policy also played a significant role in the decline. The lack of a consistent plan for returning expropriated properties, the significant tax and social security liabilities of enterprises, and the still predominant role of the state in the economy, all contributed to the deterioration of the economy.

In 1993, the rate of inflation remained at the 1992 level of 23 percent. Inflation was generated partly by excess demand, partly by lenient monetary policy and partly by structural changes. Its main causes include the increase of VAT, particularly in food and housing, the elimination of certain price subsidies, market transformation of infrastructure, including significantly higher fares for public transportation systems on which most Hungarians rely; the relatively high budget deficit and its effects on increased interest rates and the unavoidable and repeated devaluation of the forint.

Interest rates on loans remained high, in the range of 24 percent per annum on average, but rates are down from 1992's average of 34 percent. Loans are available mainly for short-term periods, typically less than one year. Demand for such loans by creditworthy clients has been low. This has been exacerbated by the fact that large, creditworthy companies are borrowing from foreign hard currency sources.

Some 655,000 Hungarians, approximately 12 percent of the workforce, were registered as unemployed in 1993. This rate is practically the same as that for 1992 though unemployment decreased slightly in the second half of 1993. This drop may be ascribed to the fact that many of the unemployed are no longer entitled to benefits and have been dropped from the official registry. The number of long-term unemployed is estimated to be at least in the order of 200,000. However, hundreds of thousands of people officially registered as unemployed find work in the under-ground economy. It is in these unreported figures that much of the unofficial but physically apparent growth of the economy occurs.

In addition to the 1993 second half decline in unemployment, several promising developments of the last months of 1993 show that the Hungarian economy may have bottomed out. Industrial output and construction activity is growing, the government budget deficit is lower than expected, and the Budapest Stock Exchange index has exhibited a continuous upward trend. Since its low of 648 in mid-May 1993, the index has risen to a closing high of 1229 at year-end.

## ECONOMIC INDICES

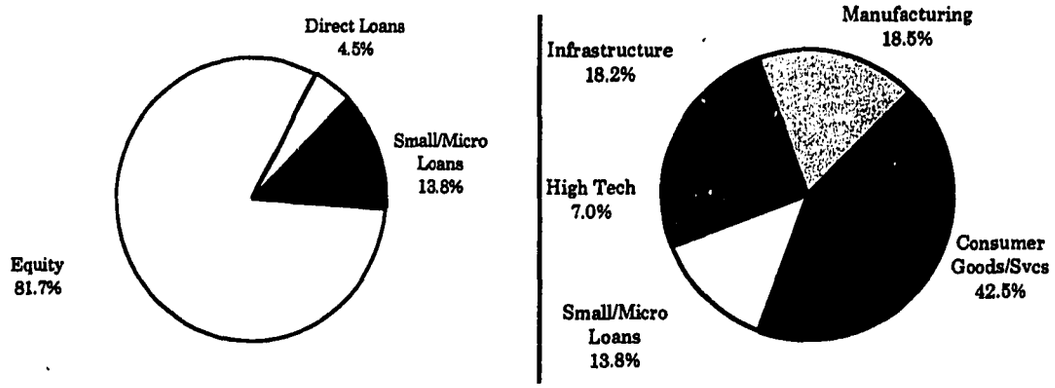
| | 1990 Actual | 1991 Actual | 1992 Actual | 1993 Est. | 1994 Forecast |
|---|---|---|---|---|---|
| **DOMESTIC ECONOMY** | | | | | |
| Real GDP % change | -3.5 | -11.9 | -4.5 | -2.0 | 0.0 |
| Consumer prices (annual % change) | 28.9 | 35.0 | 23.0 | 22.8 | 22-24 |
| Unemployment (% at year end) | 1.9 | 7.8 | 13.2 | 12.0 | 11.0 |
| Government deficit (% GDP) | 0.0 | 2.3 | 6.3 | 7.0-7.5 | 7.5-8.0 |
| **EXTERNAL ECONOMY** $ million | | | | | |
| Merchandise exports | 9,587.6 | 10,186.9 | 10,705.1 | 8,000.0 | 8,500.0 |
| Merchandise imports | 8,646.8 | 11,382.1 | 11,078.9 | 11,000.0 | 11,800.0 |
| Trade balance | 940.8 | -1,195.2 | -373.8 | -3,000.0 | -3,300.0 |
| Current account balance | 127.0 | 267.0 | 324.0 | -2,800.0 | -3,000.0 |
| Exchange rate, average (HUF/$) | 65.20 | 74.72 | 78.98 | 95.0 | 113.0 |
| **EXTERNAL DEBTS & RESERVES** ($ million) | | | | | |
| Gross convertible currency external debt (end of year) | 21,270.0 | 22,658.0 | 21,438.0 | 24,500.0 | 25,000.0 |
| Convertible currency debt/GDP (%) | 64.6 | 73.3 | 60.4 | 68.4 | 69.8 |
| Reserves excluding gold (end of year) | 1,069.0 | 3,935.0 | 4,347.0 | 6,800.0 | 4,500.0 |
| Reserves/monthly imports (end of yr.) | 1.4 | 3.8 | 4.0 | 7.4 | 4 |
| Net interest payment | 1,414.0 | 1,331.0 | 1,216.0 | 1,200.0 | 1,300.0 |
| Amortization paid | 2,547.0 | 2,409.0 | 3,098.0 | 2,800.0 | 3,000.0 |
| Total debt service | 3,961.0 | 3,740.0 | 4,314.0 | 4,000.0 | 4,300.0 |
| Debt service/exports (%) | 41.3 | 36.7 | 40.3 | 50.0 | 51.0 |

# Fund Activities – Assisting Hungary's Transformation

Since July 1990, the Hungarian-American Enterprise Fund has been privileged to assist Hungarians in the transformation of their economy from a command to a market-driven one.

The Fund's investment record has been a very positive one, despite the difficult economic conditions in Hungary. Since its inception, the Fund has disbursed approximately $43.3 million to 31 different companies located throughout the Republic of Hungary, representing investments in nine major industries.

**APPROVED INVESTMENTS AND LOANS AS OF 12/31/93**




A description of the Fund's investments follows, grouped according to its impact on the Hungarian economy. A company whose name ends in "Rt." (Részvénytársaság) is a limited liability company that issues shares to investors, while a "Kft." (Korlátolt Felelősségú Társaság) is a limited liability company whose ownership is represented by "quotas," which are registered with the Hungarian Court of Registry, instead of shares.

## SUPPLYING CONSUMER GOODS AND SERVICES TO HUNGARIANS

The consumer goods and services sector is one of the fastest growing in the Hungarian economy. One of the Fund's investment targets is companies that meet demand for consumer goods and services, which were ignored under the centrally directed economy.

**Alfa Kereskedelmi Rt.**
*Alfa Trading Company, Inc.*

Approved: $3,000,000 equity
Disbursed: $3,000,000
Ownership: 22.4%; 42,560 shares

1992 Sales: $218,000,000
Location: Budapest and surrounding areas Employees: 1,361

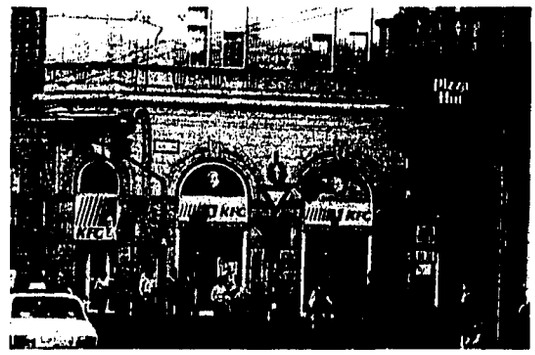
A privatization of one of Hungary's largest food and household products wholesaler, Alfa operates "Cash and Carry" distribution centers, servicing small retailers as well as retail customers. The "Cash and Carry" centers are similar in format to such U.S. stores as "The Price Club," "Sam's Mart" and similar chains.

**Central European Franchise Group Rt.**

Approved: $3,000,000 equity
Disbursed: $3,000,000
Ownership: 9.3%; 7,500 shares

1992 Sales: $1,200,000
Location: Stores in Budapest and Győr Employees: 500

The exclusive Hungarian franchisor for Pizza Hut, Kentucky Fried Chicken, and Dunkin' Donuts. The company has opened 14 restaurants and stores in Hungary. In 1994 CEFG plans an aggressive store-opening campaign including adding the Baskin-Robbins "31 Flavor" ice-cream franchise.



**Centern Textil Tisztító Kft.**
*Centern Dry Cleaning, Ltd.*

Approved: $300,000 equity
Disbursed: $300,000
Ownership: 67.5%

1992 Sales: $24,000 (2 months)
Location: Budapest Employees: 10

Centern is the first privately owned, Western-style dry cleaning service in Budapest. Centern opened its first store in late 1992, and is now in the process of opening a pickup location in a downtown office building, and is expected to open a second store in an exclusive shopping center on the Buda side of the Danube River in 1994.

**Első Amerikai Magyar Fotoszolgáltatási Rt.**
*Fotex, Inc.*

Approved: $2,542,823 equity
Disbursed: $2,542,823
Ownership: 1.6%; 750,000 shares

1992 Sales: $104,000,000 Employees: 4,500
Location: Stores throughout Hungary's larger cities

Hungary's leading private retailer, Fotex operates a chain of photo, optical, cosmetics, electronics and department stores as well as crystal and furniture factories. HAEF's investment was key to the success of Fotex's first public offering. Fotex is making a significant contribution to Hungary's return to a demand driven economy by emphasizing world class levels of customer service and courtesy, which were virtually eradicated under the socialist regime.

**EMI-Quint Recording, Ltd.**

Approved: $128,403 equity
Disbursed: $128,403
Ownership: 5.0%

1992 Sales: $3,200,000
Location: Budapest Employees: 25

A private record publishing company that produces classical and pop music primarily for the Hungarian market. EMI-Quint also licenses, imports and distributes foreign recordings. The Fund has sold, at a substantial profit, approximately 95 percent of its original ownership.

**Nemzetközi Divatház Kft.**
*International Fashion House, Ltd.*

Approved: $578,626 equity
Disbursed: $578,626
Ownership: 73.5%

1992 Sales: N/A
Location: Budapest Employees: 60

International Fashion House is a women's ready-to-wear apparel company that provides high quality, fashionable, and reasonably priced clothing for professional women in Hungary.

MAVAD RT.

**Magyar Vadgazdálkodási és Kereskedelmi Rt.**
*MAVAD, Inc.*

Approved: $2,527,565 equity
Disbursed: $2,527,565
Ownership: 15.8%; 108,108 shares

1992 Sales: $16,900,000
Location: Budapest
Employees: 220

Formed in 1934, MAVAD is Hungary's leading game management and game meat processor. MAVAD processes game meat for both domestic and export trade. MAVAD's products can be found in many leading food markets throughout Hungary and abroad, including selected gourmet markets in Europe. MAVAD's export earnings in 1992 were $14 million.

ÖREGLAK

**Öreglak Vadfeldolgozó Kft.**
*Öreglak Game Meat Processing, Ltd.*

Approved: $515,000 equity
Disbursed: $515,000
Ownership: 26.6%

1992 Sales: N/A
Location: Öreglak, southwestern Hungary
Employees: 70

Öreglak processes game meat products and is a complementary business to MAVAD, which assists Öreglak with technical, marketing and management skills. Öreglak is expected to forge closer ties with MAVAD over the coming months.

PICK Szeged

**Pick Szalámigyár és Húsüzem Rt.**
*Pick Salami Company, Inc.*

Approved: $1,899,500 equity
Disbursed: $1,899,500
Ownership: 5.8%; 123,000 shares

1992 Sales: $146,000,000
Location: Szeged, southeastern Hungary
Employees: 1,990

A privatization of a leading meat processor and the producer of the famous "Pick Winter Salami," the company processes fresh pork and beef products, sausages and salami. Exports account for approximately 50 percent of total sales. Pick's products can be found in some American and most European gourmet stores. In 1993, the Fund sold approximately 13 percent of its original ownership at prices up to 190 percent above original cost.

SZUCS, bt.

**Szűcs Bt.**
*Szűcs Stock Breeding & Trading*

Approved: $571,000 loan
Disbursed: $571,000
Ownership: N/A

1992 Sales: $357,300
Location: Debrecen, eastern Hungary
Employees: 14

Szűcs is one of the largest private sheep breeding companies in Hungary with over 4,500 sheep. It provides sheep and lambs for processing to both the domestic and export market.

## DEVELOPING THE INFRASTRUCTURE

Without a solid physical, legal and communications infrastructure, privately owned businesses cannot function effectively and profitably. Other chief targets of the Fund's investment program are companies that improve the Hungarian infrastructure.

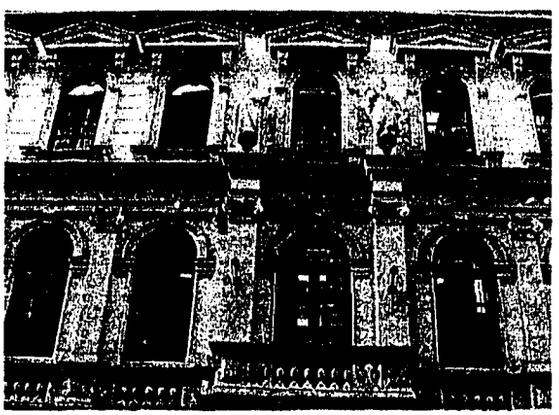
IRODAHÁZ KFT

**Irodaház Befektetési és Beruházási Kft.**
*Budapest Business Center, Ltd.*

Approved: $802,549 equity
Disbursed: $802,549
Ownership: 15.0%

1992 Sales: $807,000 (6 months)
Location: Budapest
Employees: 19

A joint venture, which provides high quality office facilities in a prime location in Budapest, Budapest Business Center is an outstanding renovation of an architecturally significant 19th century building. The Center is geared to providing international firms with fully equipped office suites and a wide range of business services. Many Western companies find the "full service" rental package, which includes telephones, fax machines and secretarial and travel services extremely valuable for quickly starting a business in Hungary.



**Első Pesti Telefontársaság Rt.**
*First Pest Telephone Company*

Approved: $1,550,578 equity
Disbursed: $1,550,578
Ownership: 5.0%; 10,000 shares

1992 Sales: None
Location: Budapest
Employees: 110

A joint venture of the state-owned telephone company, Helsinki Telephone and others, it is the first telephone company in Hungary with majority private ownership. It is installing and operating a digital telecommunications network in three districts of Budapest.

**HAEF Holding Corp., S.A.**
*Holding Company of EurAmerica Capital Corp., Ltd.*

Approved: $2,844,472 equity
Disbursed: $2,844,472
Ownership: 80%

1992 Sales: N/A
Location: Budapest
Employees: 13

HAEF Holding Corp., S.A. is the holding company for EurAmerica Capital Corp., S.a.r.l. EurAmerica provides financial advisory services to clients in Hungary, Eastern Europe and the territory of the former U.S.S.R.

**Polichem Kft.**
*Polichem Chemical Distributing Ltd.*

Approved: $1,002,148 equity
Disbursed: $1,002,148
Ownership: 6.8%

1992 Sales: $40,026,000
Location: Budapest
Employees: 215

This joint venture is a wholesale distributor of base chemicals and reagents, paints, plastics and polymers for Hungarian manufacturers.

**Rogerson Hungarian Aviation Investments, LP**

Approved: $660,000 equity
Disbursed: $660,000
Ownership: 36.0%

1992 Sales: N/A
Location: Budapest
Employees: 12

A joint venture of a U.S. partner with Hungarian operating companies, Rogerson provides airborne pesticide spraying and seeding services to the Hungarian agricultural community.

**Stewart Information Hungary Kft.**

Approved: $400,000 equity
Disbursed: $400,000
Ownership: 40.0%

1992 Sales: None
Location: Budapest

Employees: 6

A joint venture established in 1993 with a U.S. partner to establish a for-profit computerization of the government land title records in Hungary, Stewart's first major contract is to computerize the municipal land records in Budapest's District III. Ultimately, municipalities with up-to-date land recording and transfer systems will be more attractive to private enterprises locating there than in areas which lack these systems. Stewart Information Hungary is the outgrowth of a project originally begun under the Fund's Technical Cooperation Program.

**Western-Rotary Olajipari Szolgáltato Kft.**
*Western-Rotary Petroleum Services, Ltd.*

Approved: $400,000 equity
Disbursed: $400,000
Ownership: 14.0%

1992 Sales: N/A
Location: Nagykanizsa, southwestern Hungary

Employees: 42

A joint venture with an American company, Western-Rotary provides pressure pumping services in oil fields in Hungary and abroad. The Fund sold its entire interest in the firm, at a profit, in December 1993.

## SUPPORTING WORLD CLASS MANUFACTURING

One of Hungary's chief assets is its human resources. Hungarians are virtually 100 percent literate, have excellent education, especially in mathematics, and there are fine apprenticeship programs for young workers.

One of the Fund's goals is to provide financing to Hungarian manufacturers to assist them in modernizing their factories, training their workers, and retrofitting

facilities, where necessary, to bring them into compliance with ever-stricter Hungarian environmental regulations.

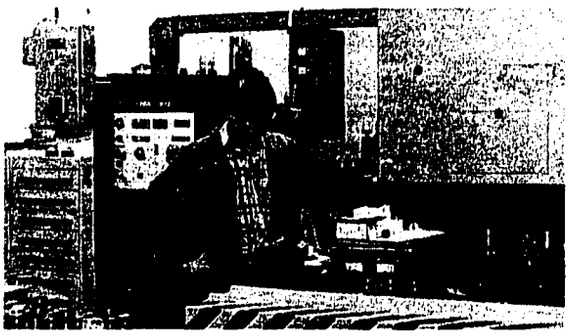
**Bíró Szerszám és Alktrész Gyártó Kft.**
*Bíró Metal Fabricating Company, Ltd.*

| | |
|---|---|
| Approved: | $264,638 equity<br>$600,000 loan |
| Disbursed: | $264,638 equity<br>$600,000 loan |
| Ownership: | 39.9% |

1992 Sales: $901,000
Location: Budapest

Employees: 80

A private tool and die manufacturer and sheet metal fabricating shop, Bíró also produces various molded plastic parts for Hungarian manufacturers and performs subcontracting fabricating work. Bíró employs the latest computer-controlled tool and die making equipment. One of Bíró's current major clients is a seller of natural gas heaters, which will displace the more polluting, coal burning systems.



**Budapest Furnér Múvek Kft.**
*Budapest Veneer Works, Ltd.*

| | |
|---|---|
| Approved: | $859,895 loan |
| Disbursed: | $859,895 |
| Ownership: | N/A |

1992 Sales: $5,433,000
Location: Budapest suburbs

Employees: 128

Budapest Veneer Works is a joint venture to produce wood products, principally veneers, for domestic and international export markets. The Fund's loan proceeds were used to purchase a high technology boiler, which, in addition to significantly reducing airborne pollution, will produce heat, steam, and electricity from the wood waste generated in the manufacturing process.

**Bulldog-Hungaria Kft.**

| | |
|---|---|
| Approved: | $94,900 equity |
| Disbursed: | $94,900 |
| Ownership: | 30.0% |

1992 Sales: $142,000
Location: Budapest

Employees: 10

Bulldog Hungarian is a joint venture manufacturing customized security vehicles, armored vans and personal cars.

**Loranger Ipari Kft.**
*Loranger Manufacturing Company, Ltd*

Approved: $1,250,000 equity
Disbursed: $1,250,000
Ownership: 50.0%

1992 Sales: N/A
Location: Székesfehérvár, central Hungary Employees: 70

A private manufacturer and supplier of high precision injection molded automotive parts. Loranger is the sole source supplier of plastic components for the "distributorless ignition system" for Ford Motor Company's Hungaria Alba plant. Loranger is located on a former Russian Army base, and it has renovated the tank maintenance facility into a world class, highly computerized manufacturing facility. Loranger is developing much of the 650 acres of the former army base into an office and industrial park catering to "high-tech" and engineering clients. Székesfehérvár is noted for a labor force which has an exceptionally high percentage of engineers and technically trained people.

**Petófi Nyomda Rt.**
*Petófi Printing Company, Inc.*

Approved: $2,524,280 equity
Disbursed: $2,524,280
Ownership: 10.9%; 3,232 shares

1992 Sales: $42,300,000 Employees: 667
Location: Kecskemét, south central Hungary

A privatization of the third largest printer in Hungary, Petófi primarily produces cardboard packaging. It also prints labels, books, magazines, newspapers, and other materials and holds contracts to print much of the fast food restaurant packaging in Hungary.

## EXPANDING HIGH TECH FRONTIERS

Since the Middle Ages, Hungary has been renowned for the quality of its system of high schools and universities. There are several centers of high-tech learning in the country, and Hungary leads many East European countries in individuals with advanced degrees. The Fund has targeted several companies to help usher Hungary into the 21st Century.

**Duna Elektronika Rt.**
*Danube Electronics, Inc.*

Approved: $500,000 equity
Disbursed: $500,000
Ownership: 15.0%; 555 shares

1992 Sales: $6,200,000
Employees: 35
Location: Budapest, with stores in major cities.

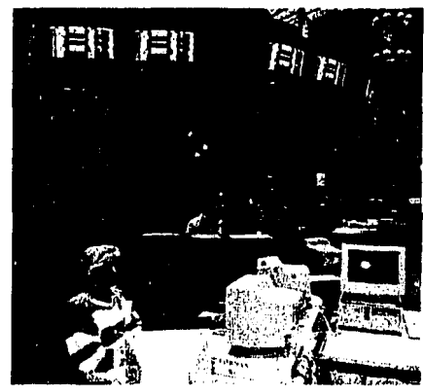
The exclusive franchisor of "MicroAge" computer stores in Hungary, Duna is a value-added reseller of computer hardware and software and is IBM's largest business partner in Eastern Europe. The company has recently constructed one of Hungary's largest personal computer training facilities.

**Fornax Műszaki és Gazdasági Tanácsadó Rt.**
*Fornax Information Services, Inc.*

Approved: $558,021 equity
Disbursed: $558,021
Ownership: 31.0%; 1,913 shares

1992 Sales: $1,500,000
Location: Budapest
Employees: 25

Fornax is a high-tech information services company which provides on-line financial data services for Budapest's stock and commodity exchanges to stockbrokers, traders and the financial community. Fornax also offers "store and forward" electronic mail and data transmission services. It provides the electronic mail link between the Fund's Budapest and Washington offices.



**Microsystem Műszaki és Számítástechnikai Rt.**
*Microsystem Technical Services Co., Inc.*

Approved: $2,576,639
Disbursed: $2,576,639
Ownership: 13.0%; 5,000 shares

1992 Sales: $21,100,000
Location: Budapest
Employees: 120

A computer software and telecommunications joint venture company, Microsystem sells computer hardware and telefax and telecommunication equipment. It provides systems integration consulting and services and owns and operates several retail computer stores.

**Recognita Corp Rt.**

| | |
|---|---|
| Approved: | $332,180 equity |
| Disbursed: | $332,180 |
| Ownership: | 33.4%; 1,576 shares |

1992 Sales: $2,600,000
Location: Budapest

Employees: 50

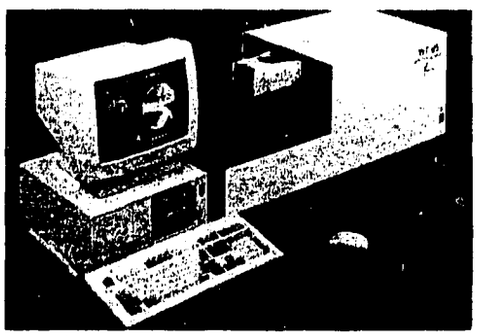
A private computer software development company specializing in optical character recognition software. Recognita owns and operates a subsidiary in Silicon Valley, California and is a Hewlett Packard business partner. One of the company's principal products, "Recognita PLUS" character recognition software, was awarded the Silver Medal at the Software for Europe Competition in 1992.

**Semilab Semiconductor Physics Laboratory Rt.**

| | |
|---|---|
| Approved: | $152,550 equity<br>$108,583 loan |
| Disbursed: | $152,550 equity;<br>$108,583 loan |
| Ownership: | 19.3%; 1,187 shares |

1992 Sales: $1,300,000
Location: Budapest

Employees: 23



A producer of state-of the-art semiconductor testing equipment exporting 100 percent of its products. Semilab's principal products include Deep Level Spectrometers, Life Time Scanners, Electro-chemical Profilers and Scanning Infrared Microscopes. Its customers include IBM, Texas Instruments, and Siemens. Semilab's worldwide sales and service centers are located in Europe, the U.S.A., Canada and Asia.

## ASSISTING THE SMALLER ENTREPRENEUR

Under its public policy objectives, the Fund has made available $5.4 million for small and micro loans.

The Fund's Small Loan Program, operating since 1991, has made loans totaling approximately $5 million to 109 entrepreneurs as of September 30, 1993. These loans, disbursed in forints, generally range from $10,000 to $100,000. Loans under the Small Loan Program are made available through two Hungarian commercial banks: Széchenyi Bank, an affiliate of the Magyar Hitel Bank, Hungary's largest, and Mezóbank. The banks perform all loan servicing tasks and share the risk of

losses equally with the Fund. These loans are all collateralized and mature in three to five years.

As of this writing, the Fund has reserved a portion of the total $5 million program for possible credit losses, but despite a few non-performing loans, the Fund has yet to write off a single loan. This is an impressive record when viewed in light of Hungary's continuing economic recession.

*Typical of the Fund's small and micro Loan borrowers is György Murvai of Tiszaföldvár. Mr. Murvai owns a sweets-shop and has been making his specialty "Diós Grillázs" under special patent from the Hungarian government since 1954. He borrowed $64,000 to expand his production facilities into buildings vacated by a bankrupt agricultural cooperative.*

The Fund's Micro Loan Program, instituted in mid-1993, has committed $400,000 through a commercial bank and three savings cooperatives. These loans, disbursed in forints, generally range from $1,000 to $20,000. They are geared principally to those very small entrepreneurs who have few alternative sources of capital. As the program is not yet six months old, it is premature to draw conclusions from its performance to date, but the Fund expects a performance ratio similar to that of the Small Loan Program.

## Measuring Success

The Hungarian-American Enterprise Fund was created to provide capital to assist in the development of the Hungarian private sector. The Fund combines a "for-profit" investment approach with implementation of sound "public policy" -- such as helping Hungary to become a pluralistic democracy with a free market economy. Thus, the Fund can be said to have a "dual mandate." On the one hand, it is expected to make prudent investment decisions with a for-profit motivation, and on the other hand, some of its activity must be geared toward fulfilling public policy purposes that will ultimately result in further encouraging private investors to view Hungary as an attractive place to invest.

The Board and management are constantly aware of this dual mandate when making investment decisions. The projects the Fund invests in must be among the most promising business investments in the private sector. Projects that involve the Fund's public policy mandate complement its investment program, usually directly, but of course, serve broader purposes.

U.S.-based investment management and venture capital companies are usually judged on both their return on assets and their operating expense ratios. Because of its "Enterprise Fund" status, the Fund must maintain offices both in the United States and Hungary. It must also devote staff and resources to complying with U.S. Government reporting requirements for grantees. The Fund would not have obligations such as these were it not a recipient of federal grants. This situation clearly and substantially impacts expense ratios and return on capital calculations.

Additionally, the Fund's dual objectives -- for-profit revenue producing and not-for-profit public policy programs -- dictate that return on capital measurements be applied very carefully. Investment industry standard ratios of expense to invested assets are similarly not applicable as a measure of Fund performance, because the Fund carries on wide-ranging informational activities for interested business and government visitors. Those activities also have a measurable impact on expense levels and translate into substantial time demands on senior management -- time which would otherwise be available to the Fund's investment programs. Thus, while the Fund seeks to minimize expense where possible, it is not reasonable to compare the Fund's expense burden (which is currently about six percent of assets) to a U.S.-based mutual fund, whose expenses seldom exceed two or three percent.

In making equity investments and loans, however, the Board believes that having a public policy or non-profit purpose is not the same as being "soft" or "fuzzy" in making investment decisions. Those who invest with the Fund or for whom the Fund manages money, will not be burdened with the cost of the Fund fulfilling its public policy objectives.

The ultimate measure of the Fund's success will come years in the future if its legacy is a vibrant Hungarian private sector with the companies it has financed leading the way for the nation and business community. The monetary return on investment in these ventures will be just one element in assessing HAEF's success; the fuller array of measures being as follows:

INVESTMENT IN PROFITABLE ENTERPRISES -- the enterprises in which the Fund invests are commercially viable as determined by the profits generated through the needed goods and services they provide. The Fund's efforts would be counter-productive if it invested in companies that have little chance to be economically viable.

CREATION OF EMPLOYMENT AND EXPORTS -- these freshly-capitalized enterprises create a growing base of good jobs at competitive salaries for their workers. In some cases, the firms financed offer their workers an opportunity to share in their enterprise's success through ownership in that enterprise (*e.g.*, ESOPs, stock options, etc.). The creation and/or increase of Hungarian exports where possible is another key indicator of success.

SUCCESS IN ATTRACTING PRIVATE MONEYS -- the Fund's investment track record is such that private moneys are attracted. The Fund manages this money to produce a positive return, and the Fund makes a profit in providing this service.

ENVIRONMENTAL IMPROVEMENT -- Fund investments do not contribute to the degradation of the Hungarian environment and in fact assist in its restoration. Our enterprises recognize that good environmental policies, in the long run, are good business policies.

EXPENSE AND OVERHEAD CONTROL -- moneys granted in trust by the U.S. Government are invested and disbursed prudently and the expense of administering the Fund is kept to a minimum commensurate with properly achieving the goals and objectives of the Fund.

# Investing with the Fund

The Board of Directors has established certain guidelines for equity investments and loans. These guidelines are meant to provide a framework for management and guidance to potential investees. They represent how the Board believes the Fund can most effectively invest its limited capital and how it can best foster the development of small and medium-sized businesses in Hungary, consistent with its "dual mandate" of for-profit and public policy purposes.

## PHILOSOPHY AND GUIDELINES

BUSINESS PLAN: The Fund requires investment proposals to be supported by a well-conceived business plan evidencing due regard to financing and marketing analyses. We are prepared to assist in the preparation of this plan for promising proposals from Hungarian entrepreneurs. We expect the proposed business activity to have a proven history, not to be an untried concept. We look for a seasoned management team having relevant business experience, whether in Hungary or abroad. In the case of a joint venture with foreign participation, the Fund will look to the foreign partner to provide experienced technical and managerial assistance for building an effective Hungarian management team.

ECONOMIC IMPACT: The proposed project must have a favorable impact on the Hungarian economy, by increasing employment and/or exports, or by contributing to the infrastructure of a private enterprise economy.

OWNERSHIP STRUCTURE: There must be meaningful private-sector Hungarian ownership in the enterprise. The Fund does not normally finance state-owned businesses or 100 percent foreign-owned projects. Other considerations being equal, the Fund favors joint ventures with American companies, which will, in addition to contributing to Hungary's economy, favorably impact U.S. job creation and/or U.S. exports.

PARTICIPATION SIZE: The normal range of Fund investment is $500,000 to $3,000,000, reflecting the Fund's preference for small to medium-sized businesses. The Fund is prepared to consider amounts outside this range under exceptional circumstances.

RISK SHARING: Other investors are expected to contribute risk capital to the enterprise such that the Fund's holdings under most circumstances will not constitute a majority. The Fund's intent is that its participation serve as a catalyst for attracting co-investors.

*Investments must pass the most rigorous standards of business and risk assessment. The Board and management recognize that in investing in small and medium-sized businesses, there is a distinction between investing in an enterprise which cannot secure funding from other sources, and investing in an enterprise that is so poorly conceived and operated that it is not worthy of investment.*

CASH CONTRIBUTIONS BY CO-INVESTORS: The Fund will not normally be the only cash investor in a business. Co-owners are expected to make cash and "in-kind" contributions of a tangible nature. "Sweat equity" is generally insufficient, and the Fund avoids investments where co-investors want large ownership interests in companies without providing meaningful cash or personal guarantees.

FINANCIAL RETURN: The enterprise must demonstrate the potential for profitable operations, managed growth, cash flow sufficient to service indebtedness, and a return on investment commensurate with the degree of risk.

EXIT STRATEGY: The Fund does not enter into any investment with the intent of acquiring a long-term holding. Rather it wishes to provide financial and investment support for the formation and early growth of an enterprise. Upon the enterprises attaining "critical mass," the Fund would expect to divest its interest, whether through an initial public offering of stock, a private placement, or a buyout by a partner, management and/or by employees.

*The Fund's investees must be mindful of their impact on the Hungarian environment*

ENVIRONMENTAL CONSIDERATIONS: The Fund will not invest in companies that harm the Hungarian environment or pollute the air, water or land. The Fund actively works with its investments to assist entrepreneurs in understanding that, in the long run, sound environmental policies are good business practices.

MANAGEMENT AND FINANCIAL REPORTING SYSTEMS: Comprehensive and timely management and financial reporting systems are critical to the success of an enterprise. The Fund will not invest in companies that do not possess the capability and commitment to produce comprehensive and timely financial and management reports. In selected cases, the Fund is prepared to assist entrepreneurs in developing these systems.

PREFERRED INDUSTRIES: The Fund prefers to invest in companies that allow for the greatest employment, consistent with maximizing capital returns, export growth, employee ownership, and environmental enhancement.

The Fund is most interested in investing in companies that work to fulfill demand for infrastructure development (communications, transportation, agriculture, etc.), for consumer goods and services which were ignored under the centrally directed economy, and those enterprises that have export possibilities.

INDUSTRIES THE FUND AVOIDS: The Fund generally does not invest in real estate projects, spas, hotels, tourism, individual restaurants, or any cash-and-carry business that lacks the ability to monitor cash flow. The Fund does not invest in companies, or subsidiaries, or affiliates whose primary business is defense-related, those who manufacture munitions or armaments, ones that are environmentally-threatening or companies which provide abortion equipment and services. In extremely rare circumstances, the Fund would consider investing in a defense related company to assist its transition from defense to non-defense work.

GEOGRAPHICAL PREFERENCES: The Fund expects to find financially attractive investments throughout Hungary and is especially hopeful of finding such investments in the economically depressed northeast region.

LEGAL AND DEAL FEES: The Fund expects that the legal and other expenses of forming a joint venture, partnership, or other new entity will be shared, *pro-rata*, by all investors in a deal.

## APPROVAL PROCEDURES

After thorough review of investment proposals, completion of due diligence, and negotiation of the principal terms of investment, proposals are submitted to the Board of Directors or, between meetings, to the Investment Committee. Following approval, detailed legal documents are drafted, which specify the complete agreement among the parties including all conditions precedent to disbursement of funds. Simultaneous delivery of any funding required from other investors is always a requirement.

## MONITORING AND MANAGEMENT ASSISTANCE

After disbursement, equity investments and loans are monitored carefully. In general, investees are required to submit, within 60 days of the end of each quarter, a detailed set of financial statements, consisting of a Balance Sheet, Income Statement and Cash Flow Statement. Through the monitoring process, we seek both to obtain a current flow of information regarding the status of our investments and to assist investee management in the introduction, understanding, and use of international accounting standards, as well as in the development of management information systems for planning and for the daily conduct of business.

Senior Fund management is available to advise investees on issues such as corporate governance, executive compensation, shareholder relations, and other matters. Generally, the Fund assumes a pro-active participation in the oversight of investees through a seat on the enterprise's board of directors or supervisory board.

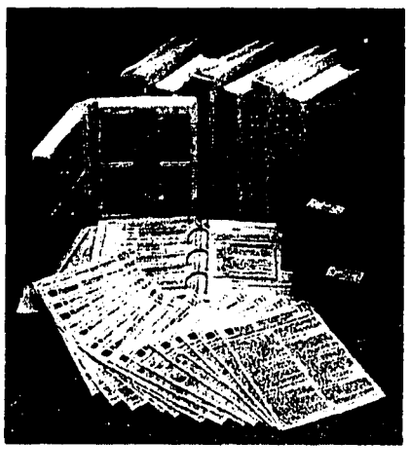
# Technical Cooperation

The U.S. Agency for International Development has approved a grant of $10 million to the Fund to be used for technical cooperation grants as part of the Fund's public policy mandate. These grants, made to various individuals and organizations, are designed to complement the Fund's investment program in the areas of marketing and product research, MIS, accounting, organizational planning, education and environmental impact studies. The Fund does not normally expect to generate revenues from this program; in at least one case however, the assistance provided was of such broad application that royalty income was generated.

The Fund expects an operating company participating in a technical cooperation project to contribute, where possible, towards the cost of such assistance. The Fund disburses and accounts for technical cooperation program moneys separately from the Fund's investment program.

In fiscal 1993, the Fund was active in several major programs, some of which are described below. In fiscal 1994, the Fund expects to tailor its technical cooperation program even more closely to the specific and direct needs of its investees.

**ECONOMIC LITERACY PROJECT**



This project produced a series of basic business lessons -- "*Business az Biznisz*" -- whose topics include: How to be successful in a market economy; How to start a business; Basic marketing; and Accounting/Finance. The series, filmed in Hungary and utilizing Hungarian actors, consists of a complete set of materials, which includes videotapes, trainers' manuals and individual-study materials. Through a company formed by the grantee, the Fund has sold 200 sets (*i.e.*, 800 series) of these materials so far and expects to sell them to various publics in Hungary. The World Bank has expressed interest in translating the tapes and materials for use outside Hungary. The Hungarian daily newspapers *Népszabadság, Magyar Hírlap,* and *Új Magyarország* serialized some parts of "*Business az Biznisz*" earlier in 1993. Hungarian television is currently televising the videos nationally three

days a week. The Fund receives royalties on copies sold and expects to eventually recover most of the production costs.

### BUDAPEST STOCK EXCHANGE VISITORS' CENTER

Budapest's Stock Exchange re-opened in 1991. The Fund provided a grant to construct and open a "Visitors' Center," modeled after the one in the New York Stock Exchange. The purpose of the Center is to present stock exchange-related concepts (*e.g.*, what stock is, the role of individuals in purchasing ownership in companies, etc.) in a way that is meaningful and educational for people who have had limited exposure to a free-market economy.

### INTERNATIONAL MANAGEMENT CENTER, BUDAPEST

Because Hungary existed for almost two generations under a centrally directed system, the Fund supports the International Management Center ("IMC") in developing outreach programs designed to fill gaps in entrepreneurs' expertise. Topics include: how to select and operate a board of directors, conflicts of interest, executive compensation, marketing, shareholder relations, how to hold a public stock offering, cash and liquidity management and other timely topics. The Fund has matched grants to the IMC from the Soros Foundation and the Rockefeller Brothers Foundation and the Fund is represented on the IMC's Board of Directors. One recent program the Fund sponsored was a seminar on "Corporate Governance," which was aimed at explaining the roles and responsibilities of a company's board of directors and the responsibilities of its management toward its shareholders.

### BUDAPEST COMMODITY EXCHANGE

The Fund provided grants to develop a sophisticated data communications capability for the Commodity Exchange, providing both real time trading data and developing a historical price database. This infrastructure development project was implemented by one of the Fund's investee companies, the Fornax Company.

## Fund Disbursements

The development of a uniform wind-up and liquidation policy for adoption by all Enterprise Funds resulted in the Fund recording significantly lower approval and disbursement totals in fiscal 1993 as compared to fiscal 1992. The wind-up and liquidation policy has since been agreed to and adopted by the Fund, and all other issues of concern to the U.S. Government have been similarly resolved. As a result, the Fund expects to return in fiscal 1994 to approvals and disbursements of loans,

equity investments and technical cooperation grants in amounts commensurate with moneys available to it.

The Fund is pleased to report that its ratio of operating expenses to assets under management continues to drop, and that -- since inception -- over 90 cents of each dollar disbursed has been disbursed in the Republic of Hungary.

The following table details the Fund's major categories of disbursements from inception through September 30, 1993. The reader should note that Operating Expenses are stated net of income, hence total funds disbursed are not additive.

## FUND DISBURSEMENTS SINCE INCEPTION

FISCAL YEAR ENDED SEPTEMBER 30
(IN MILLION OF DOLLARS)

| | 1990 | 1991 | 1992 | 1993 |
|---|---|---|---|---|
| **Government Grant to HAEF** | | | | |
| Available Funds (cumulative) | 4.9 | 26.0 | 47.0 | 54.4 |
| Funds received in period | 4.9 | 21.0 | 18.2 | 8.3 |
| Funds received (cumulative) | 4.9 | 25.9 | 44.1 | 52.4 |
| **Direct Investments & Loans** | | | | |
| Approved in period | 0.5 | 11.7 | 27.3 | 2.0 |
| Funds disbursed in period | -- | 4.6 | 22.0 | 11.4 |
| Funds disbursed (cumulative) | -- | 4.6 | 26.6 | 38.0 |
| **Small Loan Program:** | | | | |
| Funds disbursed | -- | 5.0 | -- | -- |
| **Technical Cooperation:** | | | | |
| Grants committed in period | -- | 0.5 | 3.7 | 2.7 |
| Funds disbursed in period | -- | 0.6 | 2.0 | 2.4 |
| Funds disbursed (cumulative) | -- | 0.6 | 2.6 | 5.0 |
| **Operating Expenses, net of income:** | | | | |
| During periods | 0.2 | 1.4 | 1.9 | 2.6 |
| **Totals:** | | | | |
| **Investments, loans and grants** | | | | |
| Approved in period | 0.5 | 17.2 | 31.0 | 4.4 |
| Funds disbursed during period | 0.2 | 11.6 | 25.9 | 13.8 |
| Funds disbursed (cumulative) | 0.2 | 11.8 | 37.7 | 51.5 |

# HUNGARIAN-AMERICAN ENTERPRISE FUND

## AUDITED CONSOLIDATED FINANCIAL STATEMENTS

**SEPTEMBER 30, 1993**

ERNST & YOUNG

1225 Connecticut Avenue, N.W.
Washington, D.C. 20036

Phone: 202 327 6000

Report of Independent Auditors

Board of Directors
Hungarian-American Enterprise Fund

We have audited the accompanying consolidated balance sheet of the Hungarian-American Enterprise Fund (the Fund) as of September 30, 1993, and the related consolidated statements of revenues, expenses and changes in fund balance, and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation and examination of securities owned as of September 30, 1993. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Hungarian-American Enterprise Fund as of September 30, 1993, and the consolidated results of its operations and changes in fund balance, and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As explained in Note 6, the consolidated financial statements include investments valued at $32,595,174 (84% of net assets), as of September 30, 1993, whose values have been estimated by management and approved by the Board of Directors, in the absence of readily ascertainable market values. We have reviewed the procedures used by management in arriving at its estimate of value of such investments and have inspected underlying documentation, and, in the circumstances, we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

November 12, 1993

Ernst + Young

## HUNGARIAN-AMERICAN ENTERPRISE FUND
## CONSOLIDATED BALANCE SHEET
## SEPTEMBER 30, 1993

### Assets

| | | |
|---|---|---|
| Cash and cash equivalents | | $2,723,534 |
| Cash reserves held against investments (Note 6) | | 299,000 |
| Investments (Notes 2 and 6): | | |
| At fair value: | | |
| Small & micro loan program | 4,838,823 | |
| Direct loan program | 1,772,786 | |
| Equity investments | 25,983,565 | |
| | 32,595,174 | |
| Other equity investments | 2,844,472 | |
| Total investments | | 35,439,646 |
| Prepaid expenses and other assets | | 359,808 |
| Accrued interest receivable | | 303,968 |
| Fixed assets, net (Note 4) | | 332,761 |
| Total assets | | $39,458,717 |

### Liabilities and Fund Balance

| | |
|---|---|
| Accounts payable and accrued expenses | $808,096 |
| U.S. Federal grants received and held for future program purposes | 0 |
| Total liabilities | 808,096 |
| Commitments (Notes 3 and 7) | |
| Fund balance | 38,650,621 |
| Total liabilities and fund balance | $39,458,717 |

The accompanying notes are an integral part of the financial statements.

## HUNGARIAN-AMERICAN ENTERPRISE FUND
## CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCE
## FOR THE YEAR ENDED SEPTEMBER 30, 1993

| Revenues | Loan/ Investment Program | Technical Cooperation Program | Totals |
|---|---|---|---|
| Income from investments & loans | $954,390 | - | $954,390 |
| Interest and other income | 143,167 | - | 143,167 |
| Total revenues | 1,097,557 | - | 1,097,557 |
| **Expenses** | | | |
| Employee compensation and benefits | 1,388,051 | 17,500 | 1,405,551 |
| Employee business expenses | 144,652 | - | 144,652 |
| Program development | 479,492 | - | 479,492 |
| Professional services | 879,813 | 36,930 | 916,743 |
| Depreciation and amortization | 112,750 | - | 112,750 |
| Occupancy | 239,159 | - | 239,159 |
| Administrative and other | 457,125 | 4,617 | 461,742 |
| Total expenses | 3,701,042 | 59,047 | 3,760,089 |
| **Net operating loss** | (2,603,485) | (59,047) | (2,662,532) |
| Realized gains on direct investments and loans | 211,943 | - | 211,943 |
| Unrealized losses on direct investments and loans | (2,520,036) | - | (2,520,036) |
| Total net investment losses | (2,308,093) | - | (2,308,093) |
| **Subtotal** | (4,911,578) | (59,047) | (4,970,625) |
| US Federal grant income recognized for program expenditures (Note 2) | 9,971,120 | 2,500,395 | 12,471,515 |
| Technical cooperation grants | - | 2,441,348 | 2,441,348 |
| **Excess of revenues over expenses and technical cooperation grants** | 5,059,542 | - | 5,059,542 |
| **Fund balance, beginning of year** | 33,591,079 | - | 33,591,079 |
| **Fund balance, end of year** | $38,650,621 | - | $38,650,621 |

The accompanying notes are an integral part of the financial statements.

## HUNGARIAN-AMERICAN ENTERPRISE FUND
## CONSOLIDATED STATEMENT OF CASH FLOWS
## FOR THE YEAR ENDED SEPTEMBER 30, 1993

| | |
|---|---|
| **Cash flows from operating activities:** | |
| Excess of revenues over expenses and technical cooperation grants | $5,059,542 |
| Adjustments to reconcile excess of revenues over expenses and technical cooperation grants to net cash provided by operating activities: | |
| Depreciation and amortization | 112,750 |
| Total net realized and unrealized losses on investments and loans | 2,308,093 |
| Changes in operating assets & liabilities: | |
| Decrease in cash designated for possible realized future losses in Small Loan Program | 101,951 |
| Increase in prepaid expenses & other assets | (302,285) |
| Decrease in accrued interest receivable | 30,040 |
| Increase in accounts payable and accrued expenses | 601,004 |
| Decrease in U.S. Federal grants received and held for future program purposes | (4,171,513) |
| Net cash provided by operating activities | 3,739,582 |
| **Cash flows from investing activities** | |
| Purchases of fixed assets | (47,263) |
| Proceeds from sales and maturities of investments | 1,954,897 |
| Purchases of new investments | (11,308,593) |
| Net cash used in investing activities | (9,400,959) |
| Net decrease in cash and cash equivalents | (5,661,377) |
| Cash and cash equivalents at beginning of year | 8,384,911 |
| Cash and cash equivalents at end of year | $2,723,534 |

The accompanying notes are an integral part of the financial statements.

## 1. Organization of Fund

The Hungarian-American Enterprise Fund (the "Fund") is a not-for-profit corporation formed pursuant to the Support for East European Democracy Act of 1989 (the "SEED Act") for the primary purpose of promoting the development of the Hungarian private sector and policies and practices conducive to such development. As part of the SEED Act, the United States Congress authorized $60 million to be appropriated over a three year period to the Fund by the Agency for International Development ("AID") to be used for program purposes, technical cooperation grants and administrative expenditures. Grants received from AID are conditioned on the Fund's compliance with the requirements of the SEED Act, which imposes certain U.S. policy objectives and reporting obligations. Under the terms of the grant agreement with AID, the Fund may hold funds in interest bearing accounts and may retain interest, investment income and investment profits for program purposes.

The consolidated financial statements includes the Hungarian-American Enterprise Fund and HAEF Holding Corp, S.A. HAEF Holding Corp, S.A. is a wholly-owned subsidiary established to invest in EurAmerica Capital Corporation (see note 6). EurAmerica Capital Corporation is accounted for using the equity method of accounting.

The Fund's capital is used principally to foster small and medium-sized businesses in Hungary which have a likelihood of becoming commercially viable in a free market environment through equity investments and lending activities. The Fund maintains offices in Washington, D.C. and Budapest, Hungary.

## 2. Summary of significant accounting policies

The significant accounting policies are as follows:

### Cash equivalents

For purposes of the statement of cash flows, the Fund considers all highly liquid financial instruments purchased with a maturity of three months or less to be cash equivalents. Cash held in bank accounts in excess of FDIC insurance limits is collateralized by U.S. Government and Agency securities.

### Investment valuation

The Fund's loans and equity investments are stated at fair value as determined by management and approved by the Board of Directors. In determining fair value, management considers relevant qualitative and quantitative information available. This includes such factors as the financial condition and operating results of each company, the economic and market conditions affecting its operations, and any subsequent events or financing transactions that may be indicative of a change in value. Cost is used to represent the fair value of investments

Investment valuation (continued)

in the absence of information that would support the need for a lower or higher valuation. The values assigned to investments are based on available information and do not necessarily represent amounts that might ultimately be realized, since such amounts depend on future circumstances. Investment valuation is conducted by management annually, and more often if circumstances warrant.

Fixed Assets

Fixed assets (which include leasehold improvements) are stated at cost net of depreciation or amortization. Computer hardware and furniture and equipment are depreciated on a straight-line basis over their estimated useful lives, principally 5 years. Leasehold improvements are amortized on a straight-line basis over the lesser of their useful lives or the term of the lease.

Revenue recognition

Amounts received from AID are conditioned on the Fund's compliance with the requirements of the AID Grant and the SEED Act, which imposes certain U.S. policy objectives and reporting obligations. Under the terms of the AID Grant, the Fund may hold funds in interest bearing accounts and may retain investment and program income for program purposes. AID has granted the Fund an additional $10 million to provide technical cooperation grants which are managed separately from other program funds.

As of September 30, 1993, the status of the AID Grant was as follows (in millions):

| | |
|---|---|
| Funds received from AID: | |
| Inception through September 30, 1992 | $44.1 |
| Fiscal 1993 | 8.3 |
| Total funds received | $52.4 |
| Remaining funds available from 1993 appropriations | 7.6 |
| Funds to be made available from 1994 appropriations | 0.0 |
| Total initial authorization | 60.0 |
| Technical assistance grants from AID | 10.0 |
| Total funding | $70.0 |

The Fund accounts for its grant activities in accordance with generally accepted accounting principles for not-for-profit organizations. Accordingly, the extent to which grant funds are received and disbursed during the year for program purposes is considered revenue. In practice, as disbursements are made an equal amount of grant funds received are considered utilized and recorded as revenue. In the accompanying consolidated statement of revenues, expenses and changes in fund balance, this revenue is reported as "U.S. federal grants

Revenue recognition (continued)

recognized for program expenditures." Program income is not recognized to the extent that it exceeds U.S. federal grant funds received and held for future program purposes. The Fund's operating cash exceeds the amount of U.S. federal grants received and held for program purposes because, under the terms of the AID Grant, the Fund retains interest income, loan principal repayments and principal from the sale of investments for program purposes.

Employee benefits

The Fund offers its full-time U.S. citizen employees a defined contribution plan under IRS §403(b)(7). Upon reaching eligibility after one year's service, employees may contribute up to 7% of base salary which is matched by the Fund. The 403(b) Plan custodian and administrator is T. Rowe Price Retirement Services, Inc. Fund contributions to this plan totalled $84,176 in 1993.

Hungarian nationals are covered by an extensive state system which is funded by a 51% employer tax on salaries of Hungarian nationals.

Employee business expenses

Non-salary employee expenses directly attributable to the Fund's investment and technical cooperation activities (such as travel, lodging, meals, etc.) are classified as employee business expenses.

Program development expenses

Expenses directly attributable to the Fund's investment and technical cooperation activities (such as consulting, non-employee travel, certain legal fees, etc.) are classified as program development expenses.

Professional services

Legal fees, accounting and audit fees, and consulting fees are classified as Professional Services fees.

Foreign currency translation

The Fund's operating assets and liabilities are principally denominated in U.S. dollars with the exception of investments and certain loans. Revenues and expenses transacted in Hungarian forints are translated into U.S. dollars at historical rates. Adjustments resulting from translation are immaterial to the accompanying financial statements.

Donated services

Members of the Fund's Board of Directors donate significant amounts of their time to the Fund's work. No amounts have been reflected in the accompanying financial statements for such donated services inasmuch as no objective basis is available to measure the value of such services.

Related parties

The Fund shares the cost of certain operating expenditures in Washington, D.C. with the Czech and Slovak American Enterprise Fund. Such shared operating costs consist of occupancy and employee compensation and benefits. They approximated $148,000 and $3,893, respectively, for 1993.

Transactions with related parties are closely monitored by management and the Board of Directors of the Fund. As a matter of Fund policy, directors who have a related party relationship, if any, do not participate in decisions involving those related parties.

Technical cooperation

The Fund generally disburses funds for Technical Cooperation grants as expenses on the project are incurred. Funds earmarked for approved grants but not yet disbursed amounted to approximately $361,000 at September 30, 1993.

3. Lease commitments and rental expense

The Fund is obligated under noncancelable operating leases for its Washington and Budapest offices. Lease terms are 5 years for both leases. The Budapest lease is denominated in Deutsche Marks and payable in Hungarian forints. Future commitments under these leases are as follows:

| Fiscal Year | ($US) |
|---|---|
| 1994 | 195,686 |
| 1995 | 195,686 |
| 1996 | 151,254 |
| Total | $542,626 |

The Fund was granted an initial free rent period under the lease on its Washington, D.C. facility. However, the accompanying financial statements reflect net rent expense on a straight-line basis over the life of the lease. An amount equal to three month's lease expense in Budapest ($40,000) is held in escrow offset against the Fund's cash on hand. The leases are subject to annual (Washington) and bi-annual (Budapest) escalations based on increases in the applicable consumer price index.

4. **Fixed assets**

At September 30, 1993 fixed assets consisted of:

| | Cost | Accumulated Depreciation/ Amortization | Net Book Value |
|---|---|---|---|
| Furniture, equipment & computers | $445,830 | $176,106 | $269,724 |
| Computer software | 55,296 | 28,317 | 26,979 |
| Leasehold improvements | 41,756 | 5,698 | 36,058 |
| Totals | $542,882 | $210,121 | $332,761 |

5. **Tax status**

United States

The Fund has received a determination from the Internal Revenue Service that it is exempt from federal income tax under Internal Revenue Code section 501(c)(3). The Fund has also received exemption from District of Columbia corporate income and franchise taxes.

Hungary

The tax status of the Fund's Budapest office is currently being negotiated by the U.S Department of State with the Republic of Hungary. A bilateral agreement covering this issue is expected to be concluded shortly. Management expects that this bilateral agreement will not result in any tax liability in the Republic of Hungary.

6. **Investments**

Direct investments and loans

As of September 30, 1993, the Fund had invested in 5 loans and 25 equity investments with a net carrying value totalling $30,600,823 (excluding the Small and Micro Loan Programs). The loans to Budapest Veneer Works Kft., Biro Kft. and Szucs Kft. are denominated in Hungarian forints. These three loans have a total of $299,000 pledged as cash reserves.

6. Investments (continued)

Small Loan Program

The Fund has authorized $5,000,000 to develop a program to provide loans to small businesses throughout Hungary. $5,000,000 has been funded through September 30, 1993. This "Small Loan Program" is operated in conjunction with the Szechenyi Bank, a division of the Magyar Hitel (Hungarian Credit) Bank and with MEZOBANK ("the banks").

Credit experience with the program has caused management to revalue the investment to a carrying value of $4,500,000 at September 30, 1993. Arrangements under the Agreements between the Fund and the banks may lead to recovery of all or a portion of losses experienced by the Fund over the five-year life of the Agreements.

The banks perform all credit checks and administrative and monitoring work, and share credit risk equally with the Fund. The Fund has retained the right to review the banks' credit checks and to veto or override their loan decisions.

Loan Guarantee and Pledged Assets

The Fund has guaranteed a loan made by the Inter-Europa Bank, Budapest to one of the Fund's investees in an amount up to $1,000,000 in return for a loan guarantee fee. This loan is secured by both inventory and accounts receivable. The combined collateral pledged by the investee equals approximately 200% of the total loan guaranteed by the Fund.

A portion of the Fund's shares in an equity investment with a carrying value approximating $400,000 has been pledged as security to the Hungarian State Property Agency as required under a share purchase agreement for a privatized enterprise.

Outstanding Investments and Loans as of September 30, 1993

| Investment | Original Cost | Investment Type |
|---|---|---|
| Alfa Trading Company, Rt. | $3,000,000 | Equity |
| Biro Industrial Equipment, Kft. | $600,000 | Loan (HUF) |
| Biro Industrial Equipment, Kft. | 264,638 | Equity |
| Budapest Business Center, Kft. | 802,549 | Equity |
| Budapest Veneer Works, Kft. | 859,895 | Loan (split $/HUF) |
| Bulldog-Hungaria, Kft. | 94,900 | Equity |
| Centern Services, Kft. | 300,000 | Equity |
| Central European Franchise Group, Rt. | 3,000,000 | Equity |
| Duna Elektronika, Rt. | 500,000 | Equity |
| First Pest Telephone, Rt. | 1,550,578 | Equity |
| Fjord, Kft. | 474,595 | Loan ($) |
| Fornax, Rt. | 558,021 | Equity |
| Fotex, Rt. | 2,542,823 | Equity |
| International Fashion House, Rt. | 578,626 | Equity |
| Loranger Ipari, Kft. | 1,250,000 | Equity |
| Mavad, Rt. | 2,527,565 | Equity |
| Micronetics Europe, Rt. | 370,180 | Equity |
| Microsystem, Rt. | 2,576,639 | Equity |
| Petofi, Rt. | 2,524,280 | Equity |
| Pick Szeged, Rt. | 1,899,500 | Equity |
| Polichem, Kft. | 1,002,148 | Equity |
| Quint Records, Ltd. | 128,403 | Equity |
| Recognita Software, Rt. | 332,180 | Equity |
| Rogerson Hungarian Aviation, Limited | 660,000 | Equity |
| Semilab, Kft. | 152,550 | Equity |
| Semilab, Kft. | 52,571 | Loan (HUF) |
| Stewart Information Hungary, Kft. | 400,000 | Equity |
| Szucs, Bt. | 571,000 | Loan (HUF) |
| Western Petroleum Services-Rotary, Kft. | 400,000 | Equity |
| | 29,973,641 | |
| Less valuation reserve for unrealized gains and losses | (2,217,290) | |
| Subtotal - Direct Investments and Loans | 27,756,351 | |

Outstanding Investments and Loans as of September 30, 1993 (continued)

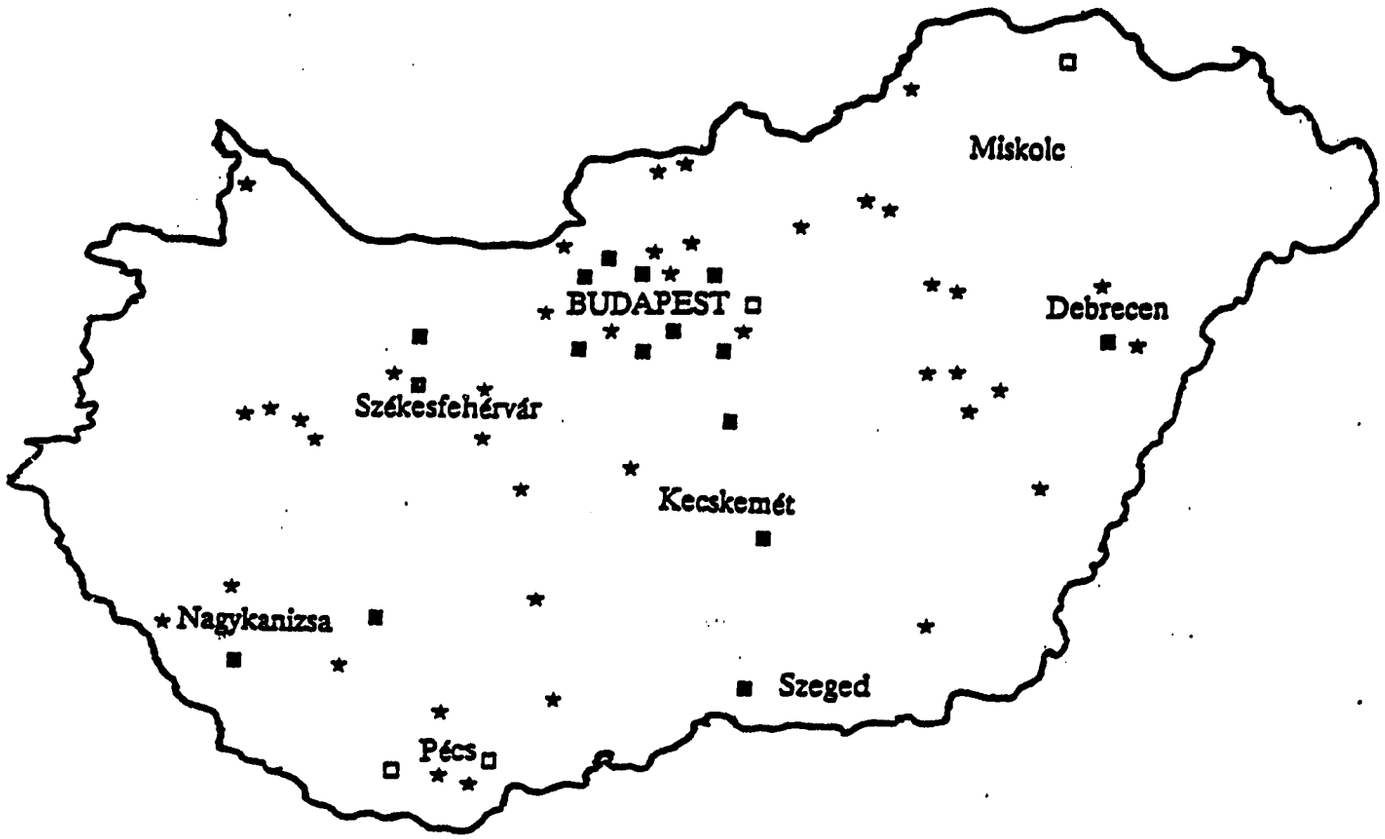
| | |
|---|---|
| Small Loan Program | 5,000,000 |
| Micro Loan Program | 349,249 |
| | 5,349,249 |
| Less valuation reserve for unrealized gains and losses | (510,426) |
| Subtotal - Small & Micro Loan Program | 4,838,823 |
| Other equity investments | 2,844,472 |
| **Total current carrying value** | $35,439,646 |

7. Subsequent events

Subsequent to fiscal year end and prior to November 12, 1993, the following events have occurred:

- $49,925 was disbursed on October 8th to the Pecsi Ipartestulet Savings Cooperative as the fourth tranche of the Fund's Micro Loan Program.
- The Fund's investment in Polichem, Kft. was sold back to the company for approximately $445,000 in an installment sale arrangement.
- The Fund's investment in Western Petroleum Services-Rotary, Kft. was sold for approximately $455,000. Sale closing is expected in December 1993.
- The Fund's Investment Committee approved the purchase of $515,000 in Öreglak Game Meat Processing, Rt. Funds were disbursed in November 1993.

# REPRESENTATIVE INVESTMENTS AND LOANS
# DECEMBER 31, 1993




■ DIRECT INVESTMENTS AND LOANS

★ REPRESENTATIVE SMALL LOANS

□ MICRO LOAN LENDERS