PD-ABL-628

CZECH & SLOVAK AMERICAN

Enterprise Fund

1991 Annual Report

"Perhaps you are asking what kind of republic I am dreaming about. I will answer you: a republic that is independent, free, democratic, a republic with economic prosperity and also social justice, a humane republic that serves man and that for that reason also has the hope that man will serve it..."

Václav Havel

First Annual Report

For the Period March 6, 1991 (date of incorporation)
to September 30, 1991

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Purpose and Description

The Czech and Slovak American Enterprise Fund (the "Fund" or "CSAEF") was established by the U.S. government to foster the development of successful small and medium-sized private enterprises in the Czech and Slovak Federal Republic ("CSFR"). This includes especially joint investments involving U.S. parties. U.S. taxpayers have provided the money for the Fund through appropriations by the U.S. Congress. The Fund is privately managed by a Board of Directors (the "Board") consisting of U.S. and Czech and Slovak private citizens, and a staff located at offices in Prague, Bratislava and Washington, D.C.

The Fund invests in Czech and Slovak enterprises through loans and the provision of equity capital. It does not make grants except in rare cases and only then where small amounts are needed for technical cooperation related to specific projects in which the Fund has elected to invest. The Board is accountable for management of the Fund to the U.S. government. All profits from investments will be reinvested in the Fund and no dividends will be paid.

The Fund provides capital to both new and existing private businesses and assists in the process of privatizing existing businesses in the CSFR.

The Fund may seek security for loans by requiring liens on machinery, export receivables, or other collateral. In making an equity investment, the Fund will not take more than a minority interest in an enterprise and will reserve the right to dispose of this interest at an appropriate early time.

Letter from the U.S. Directors

The Czech and Slovak Federal Republic (CSFR) presents an attractive and particularly promising investment environment. As the old system collapsed, the example and leadership of President Václav Havel spawned a democratic awakening which fostered a spirit of optimism, a sense of self-worth and a respect for the initiative of individuals. This attitude, already pervasive throughout the country, is exemplified by newly painted homes in rural hamlets and ambitious efforts to restore the architectural achievements of a proud heritage.

The Enterprise Fund finds the underpinnings of entrepreneurship broadly exhibited and conscientiously pursued throughout the economy. In each of the Republics, in the agricultural and recreational areas as well as in industrial factories and urban centers, there is widespread recognition that effective effort earns deserved rewards. Innovation and receptiveness to new ideas are highly visible to all observers of the CSFR today. These factors have already built a momentum for growth and economic improvement which augers well for continued development.

From a macroeconomic point of view, policies implemented to date have served well to constrain the erosive impact of inflation and to facilitate the economic transition to a free market system. The continued effectiveness of these policies, together with the healthy developments in the CSFR's international balance of payments, are solid grounds for continued optimism.

The Czech and Slovak American Enterprise Fund, in its pursuit of micro investments, is a beneficiary of this macro environment. For many, a cataloging of the unknowns in the CSFR might result in the mentality of "the glass is half empty". The CSAEF, on the contrary, finds "the glass half full" and rising. We believe the best time to invest in the CSFR is <u>now</u>. It is also the right time to help a friend which is doing the right things to help itself!

The Fund concluded its first fiscal year on September 30, 1991, barely six months after President Bush announced his designation of the U.S. Directors. During this brief start-up period a staff was hired and offices were opened in Prague, Bratislava and Washington, D.C. As of December 31, 1991, the Board had approved commitments on 19 transactions totaling about $19 million.

Now that the organizational and start-up phase of the CSAEF nears completion, we look forward to a period of expanding investment activities. In particular, we anticipate inviting other investors to participate in investment transactions structured by the Fund. This will serve to expand the pool of monies available to finance viable investments and will attract new investors to the CSFR as well.

In December the five U.S. Directors were joined by two from the Federal Republic, Mr. Jan Tauber and Mr. Milan Tomašovič. We benefit already from their involvement.

The evolving elements of change in the CSFR will require expanded responses from the Enterprise Fund as we broaden our effort.

We commend the President and Congress for the initiative which resulted in the Support for Eastern European Democracy legislation and the creation of this Enterprise Fund in particular. The Fund provides the right formula for action and the Board is privileged to be associated with this vital and promising endeavor.

John R. Petty
Charles Vanik
David Maxwell
Milan Ondrus
Julia Walsh

Operations of the Czech and Slovak American Enterprise Fund

Helping foster small and medium-sized business in the Czech and Slovak Federal Republic is the purpose of the Czech and Slovak American Enterprise Fund. Bringing in investors with U.S. know-how is especially attractive. At this critical stage of transition, from a command to a free market economy, actions which stimulate a pluralistic economic environment are a key priority. Nothing addresses the issue more directly than helping worthy entrepreneurs become commercially viable in a free market environment.

With this in mind the President and Congress, in December 1990, expanded the Support for Eastern European Democracy Act (SEED) to include the CSFR, by providing $5 million--an initial installment toward a sum of at least $60 million. On March 18, 1991 the President designated the Board of U.S. Directors of the CSAEF.

The new Board, in its first meeting in March, and at subsequent monthly sessions, recognized the urgency of moving ahead quickly and the desirability of participating promptly in the privatization process which was already underway. Accordingly, staffing and operational decisions were made resulting in the establishment in June of offices in Washington, D.C., Prague and Bratislava.

Initial investment decisions followed with several Board authorizations in August and September.

To a large extent the CSFR schedule of privatization influenced the Enterprise Fund's priorities. The initial plan on the First Round of Privatization was scheduled for September 30, 1991 (later delayed one month). In order to participate in this key event, it was necessary to be in a position to propose specific investment recommendations and offers to local enterprise managers before that date. To accommodate this procedure the Board authorized the issuance of Preliminary Subscription Letters. These letters address specific enterprises and amounts representing what the Enterprise Fund would be prepared to commit, subject to certain conditions and pending final Board approval. By this means the Fund's willingness to participate could be included in proposed Privatization plans, laying a basis for final arrangements should the nod be given by the Privatization Ministry. As this governmental review process is now underway, it is too soon to determine whether all of these initiatives will result in actual investments.

Other Board actions have developed into firm commitments. These arise from negotiations with enterprises already privately owned. Such situations have arisen as a result of the initiative of individuals creating start-up business activities since the Velvet Revolution. Alternatively, some small private companies have been created through management purchasing a discrete element of a larger State enterprise which is not yet privatized.

The private companies are able to conclude transactions quickly and the Board has authorized eleven such investments. In some of these cases disbursement of funds has already commenced and in others documentation and other necessary details are being concluded. However, with the CSAEF commitment in hand, the entrepreneur may move ahead with new investment decisions--a point in time more critical in Central Europe today than the point at which money actually changes hands.

Micro Industry Investments

This priority area of the Fund's activity received our first loan. An entrepreneur established a new bakery less than a year ago and she now employs about 20 people. The bakery is already in need of expansion and this is being facilitated by our financing.

Additional micro industry investments have been made to very small diverse enterprises ranging from, for example, the generation of electricity from water turbines to an entrepreneur expanding beeswax processing. In the agricultural area the Fund will finance the conversion of dairy cattle herds to beef cattle herds by introducing superior breeds and employing the latest techniques of embryo transplantation.

These experiences of investing in micro industry have demonstrated both the value of investing in micro industry and the difficulty of doing so right away on as broad a scale as we would like. The difficulties are three: education, administration, and cost.

The heart of the educational issue is the inadequate level of understanding by the entrepreneur of the common elements of commerce and finance which are normally used in discussion. For example, under the Communist regime, there was no opportunity to understand the difference between the two basic elements of financial capital--debt and equity. Accounting expressions and usage vary considerably. Utilizing financial data in a manner helpful to running an enterprise in a market environment is a new experience. Once the concept and method is grasped it is eagerly accepted--but it requires considerable effort and much time to get to that point.

The administrative issue centers around the amount of time and number of people required to interface with entrepreneurs. Much effort is required to understand the proposition and help shape a possible investment. The analysis time of an investment involving six employees may not be much different from that required of one employing sixty. The numbers are rarely in a condition that allows one to make assessments of values without considerable additional work. There is little public data which helps one analyze a product's potential market. Legal documentation of a transaction is required in an environment with little such tradition and which is now in the midst of changing its commercial code. The only thing known about the tax laws and regulations is that they will be changed and there are simply more questions than answers.

The cost of dealing with these issues quickly and on a large scale is beyond the direct resources of the Fund. Therefore, we have been actively developing indirect methods of providing this support. Simplified documentation for small loans that could be used as a standard would be a big help. Basic computer software systems that are the counterpart of packages some of our bigger accounting firms provide to their small businesses would be most helpful in the CSFR. Developing special efforts with local banks is an important avenue of contact. Training centers (similar to "incubation houses" employed successfully in North Carolina and elsewhere) staffed partly by individuals from the MBA Enterprise Corps already receive the Fund's support and encouragement. Our close cooperation with them provides a mutually productive interaction.

The Enterprise Fund has efforts underway with the specific objective of addressing these three difficult areas; education, administration and cost. We expect developments to permit us to broaden our activity in the micro business area.

Other Investment Priorities

The CSFR has a good number of small and medium size enterprises employing from 25 to 1,000 people. Their activities are in diverse areas. A significant percentage draw upon basic mechanical engineering skills that have been developed in the two Republics over the last decades. These activities involve metal processing and fabrication and they entail skills associated with machine tools. Fostering this comparative advantage, the CSFR has exhibited that investing in promising endeavors--especially with the prospect of foreign investors bringing technology and improved market access--presents an attractive opportunity to the Fund.

Other sectors also deserve the Fund's attention. Indeed, our investment priorities require that the enterprises we support:

1. benefit the level of employment,
2. promote exports,
3. contribute to environmental improvement, and
4. raise the level of energy efficiency.

In the agricultural sector the Fund will support the upgrading of animal stock, the modernization of food processing facilities, and the attainment of high quality food production.

We have identified many investments with these attributes and will continue to consider these priorities.

Technical Cooperation

Technical assistance and cooperation is an important adjunct to investment. It takes several rationales and has many forms. Such assistance contributes to the total environment through supporting broad general issues such as education, business training institutes, or the exchange of experiences and ideas. The more people understand, witness, and experience, the more effectively they participate.

This key area of technical cooperation is being addressed by others, all well oriented toward needs felt by much of the society. The CSAEF program of technical cooperation, however, is primarily project related. That is, assistance is directed toward employing outside expertise to address a specific knowledge need critical to a prospective investment. Indeed, this cooperation is sufficiently specific that if an investment results, the CSAEF would expect to receive recompense, possibly including equity or debt for the technical assistance it provided. Other approaches are too indirect to permit such a direct identification.

The CSAEF has been given the authority for an additional $5 million for the purpose of providing specific, project related, technical cooperation. As this amount represents about 1/13th of total anticipated funding, the Fund has begun to commit these resources gradually. So far, we have made project specific allocations to six projects totaling $270,000. Included were the Central European Institute and the MBA Enterprise Corps. Both are dedicated to directing high talent at low cost to the service of fostering micro and small business in the CSFR.

Summary of Commitments of the CSAEF

The initial operating priorities of the CSAEF were determined, to a considerable extent, by the schedule of privatization adopted by the CSFR.

The Privatization program of the CSFR, announced early in 1991, focused upon October 1, 1991 as the key date when a specific privatization plan was to be submitted to the appropriate ministry in the respective Republics. Consequently, a considerable portion of time was committed to participating in transactions governed by this schedule.

Other opportunities also received our initial attention. These were new recently formed enterprises as well as new enterprises created from divisions of state enterprises. Although less than one year old, these newly emerging enterprises are displaying good promise and an ability to thrive in the transforming economic environment. With increased need for capital to expand, they are promising candidates for CSAEF investment. We have found that negotiation and resolution of issues proceed more rapidly with these investments because governmental timetables do not govern.

Of the 19 investments which the Board has agreed to support, at least three involve U.S. joint venture partners involving capital sums in excess of our own commitments of $5 million dollars. Other investments are under consideration.

The privatization program, directed toward retail stores and restaurants, commenced in January 1991 and it has proceeded rapidly and efficiently through a local auction system. The CSAEF is involved in assisting the expansion of an enterprise privatized in this manner.

All of the investments benefit the adjustment in the employment level. While the economic transformation of the CSFR is now impacting the over staffing endemic to the prior system, new investment is already creating additional jobs. This is most evident in increased export potential--the growth of which is a primary priority of CSAEF investment.

Environmental benefits have been sought and identified in each transaction, as have benefits to the work environment, especially worker safety. Improved energy efficiency is an objective sought as much by the entrepreneur as by the CSAEF. Indeed, throughout the CSFR we have been impressed by the general recognition of the need to reverse the environmental degradation and energy waste so prevalent in the past.

Employee stock ownership plans (ESOPs) are a new concept, not yet in practice. The CSAEF has an active interest in fostering such ownership. However, in view of the early stages of privatization and the voucher system which broadens ownership, the Fund has so far limited itself to making entrepreneurs aware of the concept and eliciting an agreement in principle to consider such an employee ownership plan at a later date.

Investment Commitments Approved as of 12/31/91

Transactions with enterprises already private
(11 Transactions) and technical assistance

Marbrot Bakery, Prague	Bakery	$	64,000
Helas, Bratislava	Orthopedic devices crutches, etc.	$	138,000
US joint venture, Slovakia	Animal husbandry	$	275,000
BSK Rudne Bane, B.Bystrica	Cement roof tile	$	1,000,000
EMU, Brno	Small hydroelectric	$	39,000
Uniset, Nitra	Soft drink bottler	$	707,000
Klic, Svaty Peter	Beeswax processor	$	250,000
Rotor, Kosice	Small hydroelectric	$	433,000
US joint venture, Bohemia	Animal husbandry	$	275,000
plus 2 others and technical assistance		$	819,000
		$	4,000,000

Preliminary Subscription Letters Approved as of 12/31/91

Transactions presently in Privatization Process
(8 proposals) * $ 15,000,000

Total ** $ 19,000,000

* These figures represent rounded best estimates and are subject to the on-going approval process in each Republic.

** It is possible that portions of investments will be sold to other investors; perhaps over 1/3 of this total may be so effected.

Czech and Slovak American Enterprise Fund

Audited Financial Statements

**For The Period March 6, 1991 (date of incorporation)
To September 30, 1991**

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors
Czech and Slovak American Enterprise Fund

We have audited the accompanying balance sheet of the Czech and Slovak American Enterprise Fund (the "Fund") as of September 30, 1991, and the related statements of revenues, expenses and changes in fund balance, and cash flows for the period from March 6, 1991 (date of incorporation) to September 30, 1991. 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 and Government Auditing Standards, issued by the Comptroller General of the United States. 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. 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 financial position of the Czech and Slovak American Enterprise Fund at September 30, 1991 and the results of its operations, changes in fund balance, and its cash flows for the period March 6, 1991 (date of incorporation) to September 30, 1991 in conformity with generally accepted accounting principles.

Washington, D.C.
November 1, 1991, except for Notes 6 and 7,
for which the date is December 19, 1991.

Coopers & Lybrand

CZECH AND SLOVAK AMERICAN ENTERPRISE FUND
BALANCE SHEET
SEPTEMBER 30, 1991

Assets

Cash and cash equivalents	$4,355,777
Prepaid expenses and other assets	21,787
Fixed assets, net (Note 4)	224,212
Total assets	$4,601,776

Liabilities and Fund Balance

Accounts payable and accrued expenses	$ 35,261
Deferred grant revenue	4,240,000
Total liabilities	4,275,261
Fund balance	326,515
Total liabilities and fund balance	$4,601,776

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

CZECH AND SLOVAK AMERICAN ENTERPRISE FUND
STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND BALANCE
FOR THE PERIOD MARCH 6, 1991 (DATE OF INCORPORATION)
TO SEPTEMBER 30, 1991

Revenues	
US Federal grants	$ 760,000
Interest income	110,027
Total revenues	870,027
Expenses	
Employee compensation and benefits	281,856
Program development	96,266
Legal	62,483
Depreciation and amortization	12,754
Occupancy	51,338
Other	38,815
Total expenses	543,512
Excess of revenues over expenses and fund balance end of period	$ 326,515

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

CZECH AND SLOVAK AMERICAN ENTERPRISE FUND
STATEMENT OF CASH FLOWS
FOR THE PERIOD MARCH 6, 1991 (DATE OF INCORPORATION) TO SEPTEMBER 30, 1991

Cash flows from operating activities:	
Excess of revenues over expenses	$ 326,515
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:	
Depreciation and amortization	12,754
Changes in operating assets & liabilities:	
Increase in prepaid expenses & other assets	(21,787)
Increase in accounts payable and accrued expenses	35,261
Increase in deferred grant revenue	4,240,000
Net cash provided by operating activities	4,592,743
Cash flows from investing activities	
Purchases of fixed assets	(236,966)
Net cash used in investing activities	(236,966)
Net increase in cash and cash equivalents	4,355,777
Cash and cash equivalents at beginning of period	0
Cash and cash equivalents at end of period	$4,355,777

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

Czech and Slovak American Enterprise Fund
Notes to Financial Statements
September 30, 1991

1. **Organization of Fund**

The Czech and Slovak 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 Czech and Slovak Federal Republic private sector and policies and practices conducive to such development. It is similar to Funds now operating in Poland and Hungary. As part of the SEED Act, the United States Congress authorized appropriations of $300 million over a three year period to be granted to Enterprise Funds by the Agency for International Development ("AID") to be used for program purposes and administrative expenditures of the Enterprise Funds. 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.

On October 22, 1991 the Fund was granted incorporation of a wholly-owned subsidiary in the CSFR, the CSAEF Enterprise Fund, spol. s.r.o.. It is capitalized at 300,000 Kčs (approximately $10,000 at the exchange rate on the day of incorporation).

The Fund's capital will be used principally to foster small and medium sized businesses in the Czech and Slovak Federal Republic which have a likelihood of becoming commercially viable in a free market environment through equity investments and lending activities.

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 banking accounts in excess of FDIC insurance limits is collateralized by US Government and Agency securities.

Fixed assets

Fixed assets and leasehold improvements are stated at cost. 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

Grants from AID are recognized as revenue when funds are invested or expended consistent with the purpose of the Fund set forth in the SEED Act. Amounts received but not yet recognized as revenue are reported as Deferred Grant Revenue.

Program development

Expenses directly attributable to the Fund's investment and technical assistance activities (such as consulting, travel, etc.) are recorded as program development expenses.

Donated services

Members of the Fund's Board of Directors donate significant amounts of their time to the Fund's program. 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 party

The Fund shares the cost of certain operating and capital expenditures in Washington, D.C. with the Hungarian-American Enterprise Fund. The shared operating costs include occupancy ($141,828 annually) and employees who serve both Funds ($141,000 annually), one of whom is the officer responsible for financial accounting and reporting. These operating costs are currently allocated equally between the two Funds.

3. **Lease commitments and rental expense**

The Fund is obligated under noncancelable operating leases for its Washington, Prague and Bratislava offices. Lease terms are 5, 2 and 2 years respectively. The Prague lease is payable in German Deutsche marks, the Bratislava lease is payable in US dollars.

Fiscal Year	($US)
1992	$146,512
1993	117,096
1994	70,914
1995	70,914
1996	47,272
Total	$452,708

The Fund has been granted free rent periods under the lease on its Washington, D.C. facility. The accompanying statement of revenues, expenses and changes in fund balance reflects rent expense on a straight-line basis over the life of the lease. The leases are subject to annual escalation based on increases to the consumer price index.

4. **Fixed assets**

At September 30, 1991 fixed assets consist of:

	Cost	Accumulated Depreciation/ Amortization	Net Book Value
Computer Hardware/Software	$116,529	$ 6,809	$109,720
Furniture and Equipment	112,714	4,912	107,802
Leasehold Improvements	7,723	1,033	6,690
	$236,966	$ 12,754	$224,212

5. **Investments**

As of September 30, 1991, the Fund had made no disbursements on approved loans and investments. On October 25, 1991, a loan of 2,000,000 Kčs (approximately $64,000 at the exchange rate on the day of loan disbursement) was made to the Marbrot Bakery of Prague. Total commitment to Marbrot is 3,600,000 Kčs.

6. **Tax Status**

United States

The Fund has applied for exemption from federal income tax under Internal Revenue Code section 501(c)(3). This exemption was granted on November 22, 1991. The Fund is in the process of applying for exemption from District of Columbia franchise and income taxes.

Czech and Slovak Federal Republic

On November 14, 1991 the Fund was granted exemption from income and wage taxes in the Czech Republic, retroactively from date of incorporation until 12/31/92. The Fund expects to retain the exemption under the new Czech Republic tax law which is scheduled to take effect January 1, 1993.

On November 26, 1991, Federal Ministry of Finance of the Czech and Slovak Federal Republic (CSFR), granted the Fund exemption from payment of CSFR federal income taxes under §26, Section 2, letter "e"of law #15I/1989.

7. **Subsequent events**

Through December 19, 1991 the Fund received an additional $10,000,000 in the form of amendments to the existing Letter of Credit from the Agency for International Development. These monies, available immediately, may be used for any purpose covered by the SEED Act. Of the $10,000,000, $5,000,000 was applicable to fiscal year 1991 appropriations. Total grants received are now at $15,000,000.

Board of Directors:

John R. Petty, former Chairman and CEO of the
Marine Midland Bank (Chairman)

Charles A. Vanik, former member of Congress and
attorney with the law firm of Squire,
Sanders and Dempsey (Vice Chairman)

David O. Maxwell, former Chairman and CEO of
Federal National Mortgage Association

Milan Ondrus, International Business Advisor

Julia M. Walsh, Managing Director of
Tucker/Anthony, Inc.

Mr. Jan Tauber, former advisor to the Federal Minister of Finance

Mr. Milan Tomašovič

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