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REVIEW

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The *Western NIS Enterprise Fund*, capitalized with \$150 million by the U.S. Government, invests in private companies in Ukraine, Moldova and Belarus. The Fund has been fully operational in the region since June 1995. The Fund generally provides equity capital and loans in amounts between \$500,000 and \$5 million to small- and medium-sized private companies in any of the three countries in which it operates. The Small Business Loan Fund, a separate fund managed by the Western NIS Enterprise Fund makes commercial loans under \$100,000 to small businesses and entrepreneurs in Ukraine.



#### MISSION STATEMENT

The Western NIS Enterprise Fund (capitalized initially with \$150 million by the U.S. Government) was created to support the development of small- and medium-sized private enterprises in Ukraine, Moldova and Belarus through the investment of capital. To fulfill its purpose, the Fund provides capital and management tools for restructuring and expanding private enterprises, which in turn creates jobs and wealth for the people of the region. An additional objective of the Fund is to demonstrate to the global financial community that profitable activities can be undertaken in the Western NIS region. It is hoped that this will lead to the infusion of private investment capital to the region.

#### INVESTMENT OBJECTIVE

The Fund seeks to achieve long-term appreciation with a modest current return on its capital by investing in equity and debt securities of private enterprises with prospects for growth. Equity investments are made through the private purchase of common or preferred stock or convertible instruments. Debt transactions include direct loans to enterprises and lease financing for equipment and/or property. These investment activities involve illiquid investments in a high-risk environment with potential for significant losses. In general, investments are only made when the Fund believes that the investment will create growth in real jobs and will provide a return on capital commensurate with the inherent risks. As investments are liquidated, the Fund may invest in short-term instruments or hold cash on deposit.

## LETTER FROM MANAGEMENT

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The Fund completed its first, full year of operations in the region with \$30 million committed to 45 small- and medium-sized companies. Over \$29 million was committed through the Direct Investment Program to 18 companies employing approximately 6,500 workers. An additional \$1.2 million in loans and leases was committed through the Small Business Loan Fund to 27 small businesses and entrepreneurs employing approximately 600 workers. These portfolio companies operate in Ukraine and Moldova and in a number of different industry sectors, including food processing, agriculture, construction materials manufacturing, packaging, and distribution.

During the year the Fund took steps to expand its presence in the region. Gregory Berenstein, a native of Moldova who had emigrated to the West, was appointed Country Manager in Moldova in May 1996. Vladimir Gontcharenok, formerly the commercial attaché of the Belarussian Embassy in Washington, DC, was hired to open an office in Minsk and develop the Fund's efforts in Belarus. In addition, the Fund opened a satellite office in L'viv to support the Fund's work with portfolio companies in western Ukraine.

Despite the success of the Fund's efforts to develop its investment activities within the region, macro-economic factors, overwhelming government regulation, and a severe drought impeded the development of the local economies. For example, official real GDP in Ukraine for the nine months ended September 30, 1996 fell 10% when compared to the same period in

1995. Onerous national and local regulation of commercial activities continued to obstruct the creation and development of private business in the region. In addition, complex and conflicting national and local tax codes continued to push private enterprise out of the official economy.

Portfolio companies operating in the food processing and agricultural sectors, which represent over half of the Fund's commitments, were negatively affected by the drought this past summer. The grain harvest in 1996 amounted to slightly over 21 million tons with an average yield of 2.1 tons per hectare, compared to approximately 30 million with an average yield of 2.6 tons per hectare in 1995. Similar decreases in yield were experienced in the harvest of sunflower, sugar beets, and corn. The effects of the drought were magnified by inefficient farming methods used by large state-run farms and the limited availability of farm chemicals due to the lack of a private market to allocate resources.

Sources of optimism were not entirely absent. The drop in real GDP in Ukraine represented a slower decline than in previous years, 11.8% in 1995 and 23.0% in 1994. In addition, while in 1995 the decline was recorded in virtually all industries, selected industry sectors, particularly those involving natural resources such as metallurgy, oil and chemicals production, demonstrated some strength. Furthermore, electricity usage declined significantly less (approximately 2%) than the decline in output, which suggests that some portion of the production declines can be attributed to slippage of the official economy into the shadow economy. Finally, the National Bank of Ukraine was quite successful in introducing monetary reforms. The central bank significantly reduced the rate of inflation and was able to introduce a new currency, the hryvnia, in September.

Despite the problems with the 1996 harvest, the Fund continued to expand its efforts in the food processing and agricultural sectors. Developments in land reform and privatization of farms were encouraging. Private farms represented only 2% of total farms in Ukraine, yet they produced a disproportionately higher amount of vegetables and meat than the collective and state-owned farms.

The Fund also diversified into other sectors. Construction materials manufacturing is always one of the fastest growing sectors in an emerging market, so the Fund made commitments to a manufacturer of windows and doors and a manufacturer of bricks. The Fund also made investments and commitments to companies involved in the distribution of consumer goods, man-

ufacturing of auto parts, and manufacturing of packaging and bottling materials. The Fund put a great deal of effort into developing prospects in the furniture manufacturing sector which has been a growth sector in Central Europe; however, the slowdown in western European retail demand weakened the expansion interests of strategic investors.

Like other early-stage venture capital funds, the Fund provided more than capital to its portfolio companies. The Fund's local partners had demonstrated great skill and determination in starting up their companies, yet needed help taking their organizations to the next level. Most of the portfolio companies had little marketing and sales experience, and all of the companies used statutory accounting systems to make managerial decisions. The Fund began by bringing in retired western executives with marketing and sales experience in appropriate industry sectors. The Fund also initiated separate training programs for portfolio company chief executive officers, marketing and sales personnel, and accountants and financial personnel. The training for accountants and personnel represented the first step in improving the quality and flow of financial information to senior management. To prepare the companies for the transition from local entrepreneurially-run businesses to nationwide professionally-run organizations, the Fund introduced appropriate corporate governance policies and procedures which protect the interests of financial investors and small shareholders.

Improvements in the overall commercial environment are necessary in order for these private companies to develop further. Large state-run enterprises continue to dominate all sectors of the economy, especially agriculture and food processing. Reform programs in Moldova and Ukraine have only just started to promote the growth of private enterprise through privatization. Unfortunately, in Belarus, the privatization process has been halted, and certain large financial institutions have been re-nationalized. In addition to privatization, the need for a simplified tax code and transparency in the regulation and licensing of commercial activity are reform priorities.

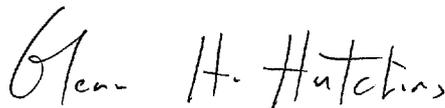
We are quite proud of the people who represent the Fund and bring so much to the Fund's portfolio companies and their employees. The challenges of an emerging market affect the Fund's investment professional and support personnel, as well as the portfolio companies. Particularly in the early stages of development, changes can create hardships for people living and working in the region. The people working for the Fund in the region faced these challenges and hardships and were directly responsible for the

success of the Fund. They brought an enthusiasm and energy to the management of new companies, who until recently had felt completely isolated.

We are equally proud to be working with the International Executive Service Corps ("IESC") and Volunteers for Overseas Cooperative Assistance ("VOCA"), organizations which help bring retired business executives to the region. The men and women from these organizations generously contribute their time to share their vast management skills and years of experience with the managements of local companies. They are an invaluable resource in transferring technical know-how to the Fund's portfolio companies.

Finally, we would like to recognize the members of the Board of Directors for their contributions to the Fund's development. They provided good counsel and guidance as the Fund moved from its own start-up phase into a fully-operational venture capital fund. Once again, the Fund could not have met its objectives this year and had its successes without their support.

On behalf of the Board of Directors and the Fund's personnel, we conclude by stating that in 1997 we look forward to meeting the challenges of the emergence of the market economies in the Western NIS, and working with the many fine people at the portfolio companies to demonstrate the tangible benefits of economic freedom through wealth and job creation in the region.



Glenn H. Hutchins  
Chairman of the Board of Directors



Scott A. Carlson  
President and Chief Executive Officer



## UKRAINE

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Ukraine is the second largest country in Europe, with a population of 52 million people and a landmass of 604 million square kilometers. Its strategic location, rich natural resources, highly educated work force, and improving economic situation make Ukraine an increasingly attractive investment environment.

The second largest republic in the former Soviet Union, Ukraine contributed over 15% of Soviet GNP. Often called the "breadbasket of Europe," Ukraine possesses approximately 40% of the world's supply of black soil. The agricultural sector produces grain, oilseed, sugar, and livestock and nearly 25% of the former Soviet Union's agricultural goods. The largest industrial sectors, including heavy machinery, industrial equipment, iron, steel, coal, chemicals, agricultural machinery, and shipbuilding, remain primarily state-owned and operated.

### ECONOMY

After declaring its independence on August 24, 1991, Ukraine faced enormous political and economic challenges resulting from the Soviet Union's collapse. In June of 1994, the Ukrainian people elected a new president, Leonid Kuchma, who launched a comprehensive program of economic reform. The program embraced three major strategic priorities: macroeconomic stabilization, mass privatization, and liberalization. As a result of this reform program, Ukraine has observed significant improvement of its macroeconomic climate during the last two years:

- introduction of a permanent currency, the hryvnia, in September 1996;
- decrease of the average monthly inflation rate, with a record low quarterly inflation of 3.2% in the second quarter and 5.7% monthly rate in August of 1996;
- price liberalization — only a few categories of goods remain under government regulation;
- stable currency exchange rate with an appreciation of 2% from January 1 to August 1, 1996;

- increase of the official average wage dollar equivalent from \$61 in January 1996 to \$75 in June 1996 — the highest since independence;
- liberalization of foreign trade — Ukraine is working toward admission to GATT/WTO in 1997;
- small-scale privatization was completed in June 1996;
- active cooperation and substantial funding from international financial institutions — International Monetary Fund, World Bank, European Bank for Reconstruction and Development, and International Finance Corporation.

#### SOCIOPOLITICAL

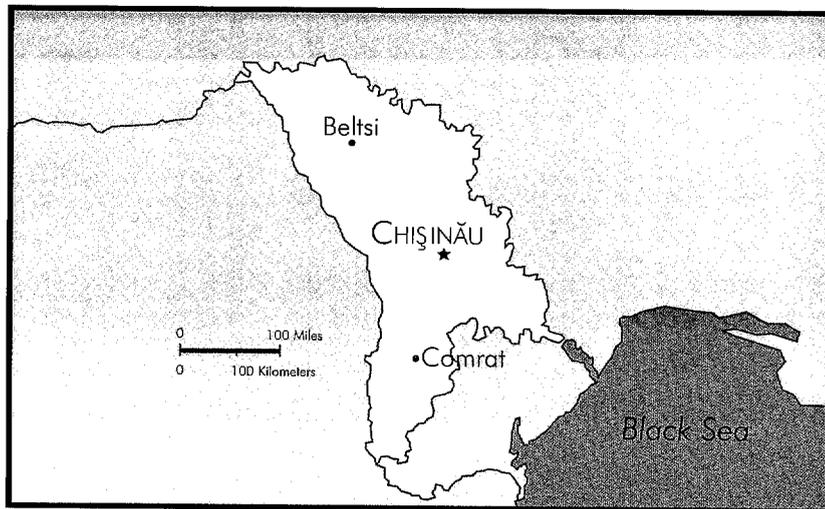
A new constitution providing private property rights was adopted on June 28, 1996. The Constitution creates a tripartite form of government thereby providing appropriate checks and balances. Ukraine has gained international respect for peaceful resolution of ethnic and religious issues, as well as democratic elections at all levels of government.

#### INVESTMENT ENVIRONMENT

Economic reform has resulted in substantial improvement of the investment climate in Ukraine. The number of Ukrainian companies that received foreign investment increased from 3,842 in 1995, to 4,669 in July 1996. As of July 1, 1996, direct foreign investment aggregated \$1,082.9 million, compared to \$483.5 million in January 1995.

Multi-national corporations in Ukraine have moved from distribution of products to investment in local manufacturing facilities. In 1995, Kraft Jacob Suchard purchased a confectionery factory, investing about \$35 million. In 1996, Coca-Cola Amatil established a joint venture with a L'viv bottling company producing a diverse line of PET bottled soft drinks. AT&T became a major shareholder of Utel, a \$60 million telecommunications company formed in 1992. In March of 1996, McDonald's Ukraine Ltd. was registered in Ukraine with the intention of opening several locations in Kyiv. Other investors include: Asea Brown Boveri Ltd. (ABB), Johnson Wax, Tambrands, Philip Morris, and Tate & Lyle. In addition, firms such as Procter & Gamble, IBM, Monsanto, Mars, DEC, Eli Lilly, and Cadbury are rapidly building brand recognition.

Ukraine is poised to rapidly realize its potential as one of the largest, richest, and most promising markets in Europe.



## MOLDOVA

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Moldova, the second smallest country in the former Soviet Union, is located in south-eastern Europe between Ukraine and Romania. It has a population of nearly 4.4 million people with a territory covering 33,800 square kilometers. With a strategic location among the world's most fertile soil and an improving economic situation, Moldova has an increasingly favorable business and investment climate.

The economy of the Republic of Moldova is agroindustrial based. Agri-business represents 43% of Moldovan GDP. The agricultural sector of the country is known for its production of wine, sugar, sunflower, perfume oils and tobacco.

### ECONOMY

Moldova gained its independence on August 27, 1991, and has undertaken a rigorous program of economic and political reforms. The Parliament has adopted legislation on private property, business activities, banking, taxation, and local self-administration. The primary objectives of the economic transition legislation was to ensure macroeconomic stabilization, to initiate land reform, and the mass privatization of enterprises. These reforms create macroeconomic stability in Moldova as evidenced by the following:

- change in GDP in comparison with previous years: 1994 - (31%), 1995 - (3.0%), 1996 - 4.0%.\*
- decrease of the inflation rate from 837% in 1993 to 118% in 1994 and to 9.4% in 1995. During the summer months of 1996, Moldova experienced deflation.
- decrease of the average monthly interest rates on bank loans: from 400% in 1993 to 50% in 1994, to 30% in 1995, and to 21% in 1996.
- price liberalization - since 1994, no production has been subsidized by the state.

- stabilization of the local currency exchange rate: the Moldovan lei was introduced in 1993 with an exchange rate of 3.9 per USD; in 1994 the average exchange rate was 4.1; in 1995 - 4.5, in 1996 - 4.6.
- liberalization of foreign trade: Moldova has received observer status in GATT/WTO and has signed an EU Partnership and Cooperation Agreement, and the Free Trade Agreement with CIS countries and Romania.

#### SOCIOPOLITICAL

On July 29, 1994, Parliament passed a new Constitution which mandated a free market economy based on protection of private property rights. The Constitution also created a stable legal base with effective legal guarantees and safeguards for the rights of individuals and businesses.

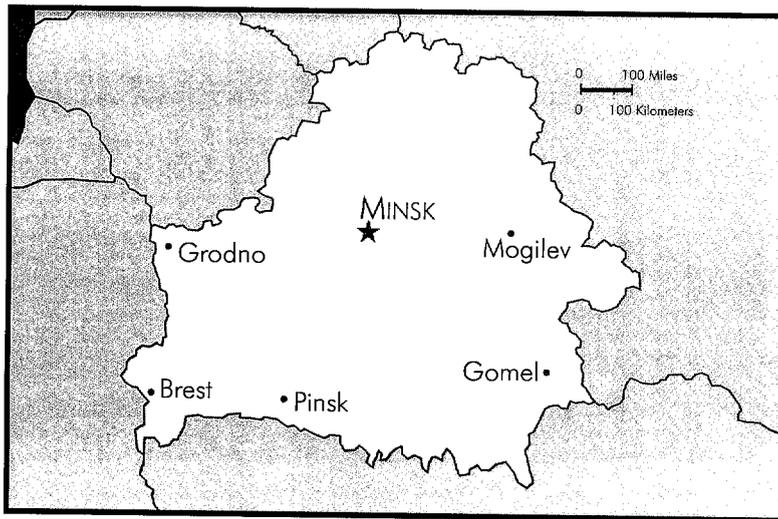
#### INVESTMENT ENVIRONMENT

The best indicators of the investment environment are the more than 650 companies representing 30 countries which have been established in Moldova and operate there today. The most active investors are from Romania, USA, Austria, Sweden, Israel, Bulgaria, Germany, Greece, Italy, and Turkey. Among the companies operating in Moldova are Tetra-Laval, Massey Ferguson, Dell, Monsanto, IBM, Acer, Redeco, and Coca-Cola.

The Government of Moldova has taken steps to attract foreign capital by creating a climate conducive to business by reducing regulatory burdens, rationalizing the tax code and adhering to the tenets of contract law. While improvement is still required in these areas, the trend is clearly in the right direction.

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\*Source: Transition Report 1996 Infrastructure and Savings, European Bank for Reconstruction and Development.



## BELARUS

Belarus is a country with a population of 10.4 million people, and a territory of approximately 207 million square kilometers. The major natural resources of Belarus include iron ore, chalk, aluminum, phosphates, gypsum and potassium oxide. The country's most important industrial sectors are wood processing, chemical and petrochemical, machinery and equipment building, and textiles. Belarus accounts for 11% of world output of potassium fertilizers, making the country the third largest producer of such fertilizers in the world. The country's primary agricultural products are livestock, potatoes and barley, with livestock contributing 60% of agricultural output.

### ECONOMY

As many of the former Soviet Union countries, Belarus has faced significant economic difficulties over the past five years. However, in 1996, the country achieved some macroeconomic improvements:

- decrease of inflation — the spiral of 2,321.0% hyperinflation in 1994 was brought down to 809.3% in 1995; monthly inflation declined from 5.6% in January to 1.3% in August 1996;
- real GDP slowed its rate of decline from (12.2%) in 1994 to (10.2%) in 1995, and (5.0%) in 1996.\*

Belarus's major trade partners are Russia, Poland, Germany, and the Netherlands. The main Belarussian exports include machinery and equipment, wheeled transport, and fertilizers.

Unfortunately, during the past year, the Belarussian government has not been active in implementing proclaimed economic reforms and privatization. This has led to the suspension of the Stand-by Loan Agreement with the IMF concluded in September 1995.

#### SOCIOPOLITICAL

In April of 1996, the Presidents of Belarus and Russia signed a bilateral treaty which outlines steps to integrate the two countries economically. The treaty provides for common energy and transport infrastructures, common monetary credit and budgeting systems (to be completed in 1997) and intends to eventually create conditions for a common currency.

The second half of 1996 marked the elevation of political tension between President Lukashenko and the Belarussian Parliament. In November 1996, President Lukashenko organized a referendum where a new constitution granted him sweeping powers to control the Parliament and the Constitutional Court. This led to the resignation of the Prime Minister Michail Chigir. Although President Lukashenko claimed that the majority of the electorate supported him in the plebiscite, the conduction of the referendum was condemned by the international community.

#### INVESTMENT ENVIRONMENT

Total declared foreign direct investment since 1990 is estimated at \$400 million, of which paid-up capital constituted less than \$50 million by the first quarter of 1996. The total number of companies with foreign capital participation reached 2,695 in March 1996.

During the past few years, the Belarussian Parliament and the Government adopted a number of laws and regulations setting the framework of the country's investment environment aimed at facilitating foreign business activities in Belarus. As a result, many western companies started researching their trade and investment opportunities in Belarus. To encourage foreign financing and support small- and medium-sized private business development, the European Bank for Reconstruction and Development established a special fund to provide commercial loans through local banks. In 1996, Ford Motor Company concluded a joint venture agreement to assemble Ford cars in Minsk. Motorola has become another major investor and formed a joint venture in the field of micro-electronics. Navistar Corporation has been working on a joint venture project to produce diesel engines in Belarus. In December 1996, McDonald's opened several locations in Minsk.

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\*Source: Transition Report 1996 Infrastructure and Savings, European Bank for Reconstruction and Development.

## ACTIVITIES OF THE FUND

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### DIRECT INVESTMENT PROGRAM

The Fund has allocated a large part of its resources to making investments between \$500,000 and \$5,000,000 in small- and medium-sized private companies. The Fund focuses its efforts on industry sectors which it believes offer high potential growth and thus have the ability to create value-added jobs as the local economy emerges. Within these sectors, the Fund actively seeks out managers and owners who have a vision for their companies operating in a market economy and the desire to develop the new and critical management skills to fulfill that vision.

### THE FUND'S FIVE SERVICES

To prepare portfolio companies for sustainable growth and ensure their competitiveness, the Fund provides five services to portfolio companies: capital, know-how transfer, management information systems, corporate governance and recruiting. Each is vital to the ultimate success or failure of a portfolio company.

#### *Capital*

Capital is used for large equipment purchases to improve the production capabilities of portfolio companies. Companies are not given cash; all equity investments are made as contributions in-kind with equipment purchased directly by the Fund. This equipment is used to add to product features and/or reduce average unit cost. However, having better production capability does not benefit the companies if management does not have the skills to control costs and market products effectively.

#### *Know-how Transfer*

The Fund transfers competitive business know-how through advisory services and training programs. Advisory services are provided mostly through retired US executives who spend four to eight weeks at a time with each portfolio company. The executives come from organizations such as IESC and VOCA and are select-

ed based on their industry and functional backgrounds. The efforts of these volunteers have been well received by the portfolio companies. This is evidenced by the almost immediate, numerous practical improvements in their operations.

Other know-how transfers come through a series of training programs offered by the Fund at different levels of each company. First, the general directors or CEO's of the portfolio companies are brought together every spring and fall for a seminar to discuss corporate strategy, marketing strategy, sales techniques, corporate finance, and accounting controls. Second, personnel in functional areas, such as finance, accounting, marketing, and sales are given direct training. Finance and accounting programs cover western financial and accounting practices and the use of information systems. Third, each company is offered training in marketing strategy, salesforce management, and selling techniques through a series of tailored weekend seminars.

#### *Management Information Systems*

Much of this training creates a foundation for the development of management information systems within each company. The objective of installing these systems is primarily to improve management decision making with a secondary benefit of improved financial reporting to outsiders. The Fund starts by showing company personnel a number of techniques to create checks and balances within the current accounting system. Then, following training in western finance and control procedures, the Fund adds a computerized western management information system to modify the existing statutory accounting system.

#### *Corporate Governance*

Proper corporate governance is important to each company's evolution from an entrepreneurial-run company to a professionally-run corporation. The Fund requires that each company create a supervisory council equivalent to a board of directors which represents the interests of all shareholders. Prior to the Fund making an investment, the company must put in place policies and procedures requiring all major corporate decisions, such as acquisitions, capital expenditures and management appointments, be reviewed by the supervisory council. This makes the decision-making process more transparent and protects the rights of small shareholders. Finally, the Fund takes at least one seat on the supervisory council to ensure that the new policies and procedures are followed.

#### *Recruiting*

Some of the existing personnel at the portfolio companies may not be capable of developing the necessary functional skills to improve the companies' competitiveness. The Fund will then assist the companies in looking outside the current pool of employees for qualified personnel. Operating managers usually do not have the time or the contacts to undertake or manage personnel searches. Currently, the market for local professionals is not very broad in terms of skills or deep in terms of numbers of candidates. It is also difficult for cultural and regulatory reasons to get professionals to move to different parts of the country. As in other emerging markets, the market for professionals will improve and people will become more mobile.

#### SMALL BUSINESS LOAN FUND

The Fund has made available \$5 million for loans and leases to small, privately-held businesses and entrepreneurs in Ukraine. Loans and leases are made in the amounts of \$10,000 to \$100,000 directly to the borrower; no financial intermediary is used. Loans and leases are made at market rates of interest for periods of up to two years. The financing is usually used by the companies to modernize by purchasing better equipment. The initial loans and leases have been made primarily in the agriculture and food processing sectors; a trend the Fund expects to continue. Until new offices are opened in L'viv and Kharkiv in 1997, the activity will remain within a 200 kilometer radius of Kyiv.

## DEVELOPMENT OF AN INVESTMENT

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### DEVELOPMENT EFFORTS FOR A BRICK PRODUCTION PLANT

The recent experience of Eastern European countries has demonstrated that the gradual stabilization of an economy will result in an increase in construction and, as a result, an increase in demand for building materials. With no manufacturers of exterior bricks in oblasts near Kyiv, construction companies must deliver exterior bricks from Artemovsk (eastern Ukraine), Mukachevo (western Ukraine), and even from Russia. From this evidence, the Fund determined that brick production would be an attractive segment in the construction materials sector.

In the initial steps of the process, it was crucial to focus attention on the most promising plants. In the Ukrainian construction materials sector, the Fund contacted 328 companies of which approximately 100 were brick production plants. A Fund representative called each of these plants to discuss their competitive position, their privatization status, and their interest in partnering with the Fund. Of these 100 plants, only half had established an appropriate legal structure and had management who were interested in outside investment. Many of the plants were either not moving significant amounts of product, or even operating. In fact, in Ukraine, less than 10% of the brick plants are actually functioning.

A Fund representative visited 20 to further assess their condition and to interview members of management. After serious consideration, the representative, in conjunction with the Investment Officer, determined that six plants were viable entities for investment.

With six viable candidates, the Fund conducted a search for an expert industry consultant to come to Ukraine to assess the operations of the plant. An experienced, retired brick production executive from North Carolina volunteered to come for four weeks. This retired executive visited all six plants to assess the quality of raw materials and finished products, the condition of the production

line, and the need for capital improvements. During these visits, he provided suggestions and low-cost recommendations to each plant to improve quality and efficiency. In addition, he assessed the potential of each plant for investment.

After careful review, the Fund determined that one company, "BPP", was the best prospect for investment in this sector. The Company's management was quick to take suggestions and implement changes to improve their facility. Unlike some other plant directors, BPP's General Director worked with his staff to improve the product features of the brick.

The Fund proposed an investment to BPP based on its many advantages in the Ukrainian marketplace including the following:

- technically strong and open-minded management team,
- geographic proximity to the large markets of Kyiv, Kharkiv, and Moscow, and
- minimal strong Ukrainian competitors within a 500 km radius.

The Fund also contacted several brick manufacturers including American, Austrian, and British companies to determine their interest in a joint investment with the Company. A strategic investor could implement further value-added improvements. Although none of those contacted were interested in the emerging market of Ukraine, the Fund was confident in its decision to invest in BPP.

After much deliberation, the Fund and BPP agreed to contribute equity in the form of equipment and cash along with the Company's assets to create a new legal entity with proper western corporate governance standards and specific performance objectives. Terms of the investment were negotiated and informally agreed upon.

Following this preliminary agreement, two representatives of the Fund began a detailed examination, typically executed through the process of due diligence. Several days of operational and legal due diligence were conducted and followed by further requests for supporting documents.

After the Fund resolved several issues, the next steps in this process included careful documentation, typically employed by Western venture capital firms, and further legal and auditing due diligence. In addition, the Fund's investment team will assist the management team in preparing an initial budget and operating plan to create specific annual targets for the Company.

After investing in the new entity, the Fund representative and Investment Officer will continue to work with management to build the plant into a leader in its industry. Further value-added support will come in the form of training seminars in sales, marketing, finance, and management; a computerized management information system; and other technical assistance as needed. This assistance, in conjunction with the invested equipment, will be followed by further improvements in the automation of the production line. Upon completion, the plant is expected to be able to manufacture and sell over 45 million exterior ceramic bricks per year within five years.

### Time and Effort

An extraordinary effort is required to develop an investment in a challenging environment like the Western NIS region. In all, the management, officers, associates and staff of the Fund have spent close to 2000 hours developing the investment. After screening 100 companies, it took over five weeks to visit and evaluate the twenty brick plants considered potential investment candidates, including over 300 hours in travel-time alone. The expert brick consultant spent four weeks touring the six most promising. Since returning from Ukraine, he has continued to work with BPP on its endeavor to improve the quality of its product.

Since selecting BPP, the transaction team has held over ten meetings with the management including several days of preliminary due diligence sessions. Certainly it will take considerably more time to complete the execution of legal documents, full due diligence, and funding of the new entity.

Challenges to completing an investment unique to the emerging markets come in a variety of forms: (i) a lack of public disclosure; (ii) a lack of detailed research information on potential industries and companies; (iii) the client's lack of understanding of the process; and (iv) poor infrastructure and minimal transportation alternatives. Each of these difficulties increase the time needed to accurately evaluate the potential of an entity, often making the investment process four times slower than in Western countries.



## INVESTMENT INFORMATION

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### DIRECT INVESTMENT PROGRAM

#### MANAGEMENT INFORMATION SYSTEMS

Date of Approval: October 1995

Equity: \$1,750,000

A staged equity investment of \$1,750,000 in a management information systems ("MIS") company. The company provides much needed Western-standard MIS and accounting systems to local companies.

#### WINDOW AND DOOR MANUFACTURER

Date of Approval: November 1995

Loan: \$500,000

This loan financed the purchase and installation of equipment for a new wooden window manufacturing facility in western Ukraine. The loan was made with the prospects of an incremental equity investment of \$2 million to \$3 million. The new production line employs an additional 75 people.

#### WINERY JOINT VENTURE

Date of Approval: November 1995

Loan: \$390,000

A joint venture between a Moldovan winery and private company which packaged wine produced at the winery. Product launch has been successful. Most of the product is exported to Russia, a small portion is sold in Moldova. The loan financed the purchase of a Western-standard packaging line. The company doubled its work force in 1996 to 50 employees.

#### FRUIT AND VEGETABLE PROCESSING COMPANY

Date of Approval: November 1995

Loan: \$725,000

This Moldovan company produces apple juice concentrate, ketchup, tomato paste, pickled vegetables and fruit, for export to Western Europe and Russia. Loan proceeds were

used to finance the purchase of a Western-standard packaging line, enabling the company to produce a value-added higher margin product, apple juice with one year shelf-life, for export to Russia. The company is one of the strongest, formerly state-owned canneries in Moldova and employs over 1,000 people.

#### JUICE PACKAGING COMPANY

Date of Approval: November 1995

Loan: \$840,000

A start-up juice packaging company, which packages juice prepared from imported concentrate. Loan proceeds were used to finance the purchase of a Western-standard packaging line to package the juice. Juice is sold in western Ukraine and exported to Russia. The company employs 40 people.

#### AGRICULTURAL DISTRIBUTION COMPANY

Date of Approval: November 1995

Lease: \$323,300

The Fund's proceeds were used to finance the purchase of new combines. Co-investors are a prominent agricultural distributor in western Ukraine and a major Western farm equipment manufacturer. The Ukrainian distributor has 200 employees in ten different oblasts.

#### AGRICULTURAL DISTRIBUTION COMPANY

Date of Approval: December 1995

Equity: \$1,247,000

Lease: \$400,000

An equity and working capital investment to finance the expansion of an existing agricultural input supply and custom farming business in Donetsk oblast. Proceeds will be used to purchase eight Western combines and support equipment to add to existing inventory and expand services provided. The company employs 30 people.

#### FOOD PROCESSING - DAIRY

Date of Approval: December 1995

Lease: \$630,000

This lease financed the purchase of a Western ice cream manufacturing line. The company has received targeted consultation in general management, marketing, sales, production, has participated in GAAP accounting seminars, and is in the process of installing a management information system with the assistance of the Fund. The Fund is negotiating a larger equity investment of \$1 - \$2 million. The dairy employs 600 employees and is one of the most efficient dairies in Ukraine.

#### AGRICULTURAL DISTRIBUTION COMPANY

Date of Approval: June 1996

Equity: \$773,000

Lease: \$400,000

The company provides custom farm services to agricultural businesses, primarily in Dnipropetrovsk oblast of Ukraine. The equity and loan financed the purchase of multi-purpose grain combines, tractors, balers, trucks, and additional support equipment. The use of Western-manufactured farming equipment allow the agricultural enterprises to improve agricultural yields and limit the losses of crops during harvesting. The Fund owns 55% of the company which currently employs 20 people.

#### ICE CREAM IMPORTER AND MANUFACTURER

Date of Approval: July 1996

Equity: \$1.5 million

Loan: \$600,000

The equity investment financed the purchase of Western ice cream equipment which will allow the company to increase its capacity to meet strong local demand for high quality, reasonably-priced ice cream. The loan financed seasonal working capital needs. The new line will produce Western-standard ice cream competitive in taste and packaging to imports. Pricing will be affordable for the average consumer. The company employs 125 people.

#### DISTRIBUTION COMPANY

Date of Approval: August 1996

Loan: \$600,000

This company began operations as a coffee and tea packager and distributor. Today, the company is expanding its distribution business to include other and mostly Ukrainian packaged foodstuffs. Loan proceeds will be used to purchase packaging machines, packaging materials and trucks. These purchases will allow the company to expand the range of packaged foodstuffs under the company's private label and to improve the effectiveness of their distribution network. The company is located in Kyiv and employs approximately 150 people.

#### GLASS MANUFACTURER

Date of Approval: August 1996

Lease: \$1,000,000

Founded in 1912, this company is considered to be the number two producer of glass bottles in Ukraine today. It manufactures clear and colored beverage, medical, and cosmetic/perfume glass. Loan proceeds will increase capacity and yields of outdated lines and allow the company to expand its output to satisfy the growing needs of large local beverage companies. The company employs approximately 600 people.

#### INTERNATIONAL HOTEL

Date of Approval: August 1996

Equity: \$5,000,000

The total project cost of this four-star international hotel is \$55 million of which \$33.2 million will be debt-provided by an international financial institution and syndication. Two other regional venture capital funds will provide the remaining equity capital. This hotel would be the first of its kind in Ukraine and would assist in attracting additional foreign investment to Ukraine.

#### CONFECTIONERY MANUFACTURER

Date of Approval: August 1996

Equity: \$3,500,000

This is the leading, independent confectionery company in Ukraine. In addition to the Fund's equity, an incremental \$10 million in equity and debt will be provided by an international financial institution and another regional venture capital fund. The proceeds will be used to purchase three new lines of equipment, to provide working capital, as well as to finance a restructuring program for the company. The company currently employs 3,200 people.

#### SUNFLOWER OIL PROCESSING COMPANY

Date of Approval: September 1996

Equity: \$2,500,000

An equity investment to develop a vertically-integrated manufacturer of sunflower oil. The company is to manufacture the highest quality refined, deodorized sunflower oil attractively packaged in PET bottles and market the product under its own brand name. The Fund capital was used to purchase a Western-standard seeds press and refining/deodorizing line to supplement the company's existing bottle manufacturing and bottling lines. The Fund owns 45% of the company which employs approximately 150 people.

#### AUTOMOTIVE SPARE PARTS MANUFACTURER

Date of Approval: September 1996

Equity: \$800,000

Loan: \$400,000

This company is a joint venture started in 1994 between one of the largest cardan shaft producers in the FSU and a successful German components supplier. The equity and loan proceeds will be used to finance equipment and the expanded working capital requirements needed to satisfy outstanding contracts and purchase orders from Western car and truck manufacturers. The company employs approximately 200 people.

#### GRAIN TRANSIT AND STORAGE FACILITY

Date of Approval: September 1996

Equity: \$1,200,000

Loan: \$2,400,000

This company was created to develop a storage and transit terminal for agricultural commodities at a deep-water seaport on the Black Sea. Creation of this terminal will be a significant step in creating full value for Ukraine's agricultural products on the world market. The terminal would employ over 50 people.

#### BRICK MANUFACTURER

Date of Approval: September 1996

Equity: \$1,900,000

Proceeds will be used for working capital, to upgrade the quality of the product produced to enter the higher margin market of exterior bricks, as well as to purchase new equipment for energy conservation. The company will employ 300 people.

## SMALL BUSINESS LOAN FUND

### FLOUR MILL

Lease: \$60,000

In an area of only state-run milling facilities, this small, private flour mill is an exceptional example of how private companies can efficiently produce superior quality products. The mill has ample access to suppliers of wheat and storage facilities and strong management.

### HOUSEHOLD CERAMICS MANUFACTURER

Lease: \$9,500

The lease financed a high-quality kiln to allow the expansion of a small ceramics business which manufactures and sells tableware and housewares in Kyiv. The new equipment increased ceramic baking capacity and improved quality control.

### BAKERY

Lease: \$79,100

This lease upgraded the existing baking facility of a catering company. The new equipment increased baking capacity, expanded product line, and significantly cut costs. This operation employs 80 people.

### FARM

Lease: \$11,468

The lease financed a small delivery vehicle and a sprayer for a farm. The truck will allow the farmer to deliver his crops to local markets and also to perform trading operations in the off-season. The sprayer will be used to apply fertilizers and herbicides to his fields.

### DAIRY

Lease: \$90,000

The lease financed the outfitting of a small dairy to produce milk and butter. The credit facility provided milk processing equipment, packaging equipment, a septic plant, a back-up power generator, and an insulated truck. The family-run company is located in a dairy farming region of Ukraine that does not have a local dairy.

### BAKERY

Lease: \$44,725

This lease financed the upgrade of a small bakery's existing facilities. Additional forming and dividing machines, dough roller, and cooling table provide for a reduction of costs, expansion of product line, and an increase in volume. This operation employs 10 people.

### FLOUR MILL

Lease: \$46,200

The lease will finance a flour mill in an area southwest of Kyiv that has ample supplies of grain and storage facilities, but no flour milling capacity. The credit facility will create an additional 12 jobs.

### BAKERY

Lease: \$54,900

One purpose of the lease is to finance confectionery equipment for a baking company. The new equipment will be used to bake cookies and pastries in addition to bread prod-

ucts which the company is currently producing. Using route salesmen, the company covers about 70% of Kyiv's retail market. The operation employs over 45 people.

#### STORE FIXTURES

Lease: \$65,000

This retail company used this credit facility to acquire store fixtures in order to expand its newest store in the heart of Kyiv. The company employs over 150 people on a full-time and part-time basis.

#### MEAT PROCESSING COMPANY

Lease: \$88,000

This lease is for a small meat processing company which produces meat products for consumers in the Kyiv area. The lease covers meat processing, refrigeration, and refrigerated delivery equipment. This operation employs approximately 50 individuals.

#### PRINTING EQUIPMENT

Lease: \$92,000

This lease financed the purchase of a high-capacity color offset printer. The owner has been working as a private printer for over three years. Most consumers are from the growing business sector in Kyiv.

#### FARM

Lease: \$11,900

This credit facility was used to finance a medium-sized tractor for a sugar beet farm located near Kyiv. Sugar is processed at the local plant and sold through wholesaling and retailing markets.

#### PARQUET MANUFACTURING

Lease: \$58,000

This wood processing company produces raw oak parquet and exports it to Europe. It is located in the Zhitomyr region. The lease financed manufacturing equipment and a delivery trailer. The company employs 40 people.

#### CHEESE MANUFACTURING

Lease: \$37,000

The purpose of the lease was to finance a delivery truck and refrigerating for a small cheese manufacturing business located near Kyiv.

#### FLOUR MILLS

Lease: \$66,360

This is a grain processing business located south of Kyiv. The credit facility was used to finance two Ukrainian-made flour mills.

#### FLOUR MILL

Lease: \$35,680

This credit facility is to finance a flour mill for a grain farm located near Kyiv.

#### CABBAGE AND POTATO FARM

Loan: \$27,000

This farm is located 180 km from Kyiv. The loan was issued to finance a delivery truck and a tractor. It is the first loan made through the recently registered entity, WNISEF Finance Company Ltd.

#### SALON

Lease: \$24,000

Located in one of the resident districts of Kyiv, the credit facility will finance new equipment for a hairdressing salon.

#### AUTOMOTIVE REPAIR STATION

Lease: \$35,000

The credit facility will finance tire mounting, balancing, alignment equipment and lifts. The company is completing construction of their building.

#### TRUCKING

Lease: \$46,000

This is a trucking company which is expanding its fleet. They plan to be repeat customers by using cash generated from their existing fleet and increase financing to grow.

#### PASTA MANUFACTURING

Lease: \$60,000

This credit facility will be used to finance a pasta production line for a company involved in grain processing and retailing. The company is located in Zhitomyr.

#### COLD STORAGE WAREHOUSE

Lease: \$87,000

This company established a secured warehouse operation to store fruit and vegetables under a climate-controlled environment. The warehouse serves food retailers and restaurants in the Kyiv market and employs approximately 50 people.

#### GROCERY RETAILER

Lease: \$6,760

This lease financed noodle production alongside a small bakery located inside this shop. The products are sold at the grocery store, which is surrounded by a number of recently-built, high-rise apartment buildings. This operation employs five people.

#### FOOD PRODUCTS DISTRIBUTION

Lease: \$8,000

This company will slice and package cheese and sausages (vacuum and thermotractable packaging). Products will be distributed to over 100 grocery stores in Kyiv. This operation will employ six people.

#### BAKERY

Lease: \$5,060

This company will bake bread products and sell them through retailing outlets just outside of Kyiv. This operation will employ four people.

#### WOOD PRODUCT MANUFACTURING

Lease: \$55,000

This lease will finance a high-quality kiln and wood-processing equipment to allow the expansion of this business which manufactures and sells custom-made furniture, windows, and doors.

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It is the policy of the Fund not to divulge the names of its clients without the client's expressed consent. As some clients are reluctant to release their name in a public forum, we have chosen to release none in this report.

1996 FINANCIAL STATEMENTS

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## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of Western NIS Enterprise Fund:

We have audited the accompanying statement of financial position of Western NIS Enterprise Fund (the "Fund") as of September 30, 1996, and the related statement of activities, 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 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 Western NIS Enterprise Fund as of September 30, 1996, and the result of its activities and changes in its capital invested, and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 2 to the financial statements, effective October 1, 1995, the Fund adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 116, *Accounting for Contributions Received and Contributions Made*, and SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*.



New York, New York  
December 16, 1996

# STATEMENT OF FINANCIAL POSITION, UNRESTRICTED

September 30, 1996

|                                                                                             | <u>Total<br/>(Unrestricted)</u> | <u>Direct<br/>Investment<br/>Program</u> | <u>Small<br/>Business<br/>Loan Fund</u> |
|---------------------------------------------------------------------------------------------|---------------------------------|------------------------------------------|-----------------------------------------|
| <b>Assets:</b>                                                                              |                                 |                                          |                                         |
| Investments, at estimated fair value <sup>2,4</sup>                                         | \$ 6,499,420                    | \$ 6,499,420                             | \$ -                                    |
| Net investment in direct financing leases <sup>4</sup>                                      | 597,148                         | -                                        | 597,148                                 |
| Cash and cash equivalents <sup>2</sup>                                                      | 9,690,955                       | 9,690,577                                | 378                                     |
| Accrued interest income                                                                     | 94,378                          | 88,000                                   | 6,378                                   |
| Prepaid rent and other prepaid expenses                                                     | 449,417                         | 445,929                                  | 3,488                                   |
| Other assets                                                                                | 411,001                         | 411,001                                  | -                                       |
| Fixed assets, net of accumulated depreciation<br>and amortization of \$213,831 <sup>6</sup> | <u>1,445,795</u>                | <u>1,341,220</u>                         | <u>104,575</u>                          |
| <b>Total assets:</b>                                                                        | <u>\$ 19,188,114</u>            | <u>\$ 18,476,147</u>                     | <u>\$ 711,967</u>                       |
| <b>Liabilities and Unrestricted Net Assets:</b>                                             |                                 |                                          |                                         |
| Accounts payable and accrued expenses                                                       | \$ 403,565                      | \$ 403,525                               | \$ 40                                   |
| Other liabilities                                                                           | 266,958                         | -                                        | 266,958                                 |
| Unrestricted net assets                                                                     | <u>18,517,591</u>               | <u>18,072,622</u>                        | <u>444,969</u>                          |
| <b>Total liabilities and unrestricted net assets:</b>                                       | <u>\$ 19,188,114</u>            | <u>\$ 18,476,147</u>                     | <u>\$ 711,967</u>                       |

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

STATEMENT OF ACTIVITIES,  
CHANGES IN UNRESTRICTED NET ASSETS

For the year ended September 30, 1996

|                                                                                     | Total<br>(Unrestricted) | Direct<br>Investment<br>Program | Small<br>Business<br>Loan Fund |
|-------------------------------------------------------------------------------------|-------------------------|---------------------------------|--------------------------------|
| Revenue:                                                                            |                         |                                 |                                |
| Interest from direct financing leases                                               | \$ 65,469               | \$ -                            | \$ 65,469                      |
| Interest from loans                                                                 | 242,410                 | 242,410                         | -                              |
| Interest on cash and cash equivalents                                               | 341,559                 | 341,538                         | 21                             |
| Total revenue                                                                       | <u>649,438</u>          | <u>583,948</u>                  | <u>65,490</u>                  |
| Expenses:                                                                           |                         |                                 |                                |
| Employee compensation and benefits                                                  | 1,733,414               | 1,627,117                       | 106,297                        |
| Professional fees                                                                   | 668,707                 | 635,187                         | 33,520                         |
| Business travel expenses                                                            | 531,393                 | 516,609                         | 14,784                         |
| Occupancy                                                                           | 394,803                 | 377,039                         | 17,764                         |
| Other operating expenses                                                            | 712,921                 | 651,744                         | 61,177                         |
| Depreciation and amortization                                                       | 176,485                 | 158,941                         | 17,544                         |
| Total expenses                                                                      | <u>4,217,723</u>        | <u>3,966,637</u>                | <u>251,086</u>                 |
| Loss before U.S. Government grants for<br>program purposes and technical assistance | (3,568,285)             | (3,382,689)                     | (185,596)                      |
| U.S. Government grants received for program purposes                                | 18,601,145              | 17,970,580                      | 630,565                        |
| Technical assistance                                                                | (577,898)               | (577,898)                       | -                              |
| Increase in unrestricted net assets                                                 | 14,454,962              | 14,009,993                      | 444,969                        |
| Unrestricted net assets, beginning of year                                          | <u>4,062,629</u>        | <u>4,062,629</u>                | <u>-</u>                       |
| Unrestricted net assets, end of year:                                               | <u>\$ 18,517,591</u>    | <u>\$ 18,072,622</u>            | <u>\$ 444,969</u>              |

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

# STATEMENT OF CASH FLOW

For the year ended September 30, 1996

|                                                                                                                 | <u>Total</u>        | <u>Direct<br/>Investment<br/>Program</u> | <u>Small<br/>Business<br/>Loan Fund</u> |
|-----------------------------------------------------------------------------------------------------------------|---------------------|------------------------------------------|-----------------------------------------|
| <b>Cash Flows from Operating Activities:</b>                                                                    |                     |                                          |                                         |
| Change in unrestricted net assets                                                                               | \$ 14,454,962       | \$ 14,009,993                            | \$ 444,969                              |
| <i>Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities:</i> |                     |                                          |                                         |
| Provision for minimum lease receivable                                                                          | 21,100              | -                                        | 21,100                                  |
| Depreciation and amortization                                                                                   | 176,485             | 158,941                                  | 17,544                                  |
| <i>Changes in operating assets and liabilities:</i>                                                             |                     |                                          |                                         |
| Increase in accrued interest income                                                                             | (94,378)            | (88,000)                                 | (6,378)                                 |
| Increase in prepaid rent and other prepaid expenses                                                             | (163,623)           | (160,135)                                | (3,488)                                 |
| Increase in other assets                                                                                        | (284,181)           | (284,181)                                | -                                       |
| Increase in accounts payable and accrued expenses                                                               | 187,527             | 187,487                                  | 40                                      |
| Decrease in U.S. Government grants received and held for future purposes                                        | <u>(572,750)</u>    | <u>(572,750)</u>                         | <u>-</u>                                |
| Net cash provided by operating activities                                                                       | <u>13,725,142</u>   | <u>13,251,355</u>                        | <u>473,787</u>                          |
| <b>Cash Flows from Investing Activities:</b>                                                                    |                     |                                          |                                         |
| Disbursements for equity investments                                                                            | (202,500)           | (202,500)                                | -                                       |
| Disbursements for loan investments                                                                              | (6,660,271)         | (6,660,271)                              | -                                       |
| Purchase of property under direct financing leases                                                              | (805,863)           | -                                        | (805,863)                               |
| Proceeds from direct financing leases                                                                           | 187,614             | -                                        | 187,614                                 |
| Repayment of loan principal                                                                                     | 363,351             | 363,351                                  | -                                       |
| Purchase of fixed assets                                                                                        | <u>(640,331)</u>    | <u>(518,212)</u>                         | <u>(122,119)</u>                        |
| Net cash used in investing activities                                                                           | <u>(7,758,000)</u>  | <u>(7,017,632)</u>                       | <u>(740,368)</u>                        |
| Net increase in cash and cash equivalents                                                                       | 5,967,142           | 6,233,723                                | (266,581)                               |
| Cash and cash equivalents at beginning of the year                                                              | <u>3,723,813</u>    | <u>3,456,854</u>                         | <u>266,959</u>                          |
| Cash and cash equivalents at end of the year:                                                                   | <u>\$ 9,690,955</u> | <u>\$ 9,690,577</u>                      | <u>\$ 378</u>                           |

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

## NOTES TO FINANCIAL STATEMENTS, *September 30, 1996*

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### 1. Organization of Fund

The Western NIS (Newly Independent States) 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") and the 1992 Freedom for Russia and Emerging Eurasian Democracies and Open Markets Support Act (the "FREEDOM Support Act"). The Fund's primary purpose is promoting the development of the private sector and the policies and practices conducive to such development of the Western NIS region (the "Region") which consists of Ukraine, Moldova and Belarus. The United States Congress has authorized appropriations of \$150 million of which the initial capital of \$45 million has been committed by the United States Agency for International Development ("USAID") for Fund program purposes and administrative expenditures (the "Grant"). Grants received from USAID are conditioned upon the Fund's compliance with the requirements of the Grant agreement with USAID and the SEED and FREEDOM Support Acts, which imposes certain U.S. policy objectives and reporting obligations. Under the terms of the Grant agreement with USAID, the Fund may hold funds in interest-bearing accounts and may retain investment and program income for program purposes.

The Fund is engaged in a broad private investment program in the Region which, through equity investments, loans, leases, technical assistance and other measures, emphasizes a commitment to small- and medium-sized private businesses. The Fund provides technical assistance to businesses in the Region's private sector, including companies in which the Fund has invested. Through its direct role in investments in the Region's private sector, the Fund seeks to generate profits that will further support its activities and attract investments by others. As part of its investment operations, the Fund may obtain representation on management and supervisory councils of investee companies.

### 2. Summary of Significant Accounting Policies

#### Basis of Presentation

The Fund prepares its financial statements in accordance with the requirements for not-for-profit organizations. Fund management has developed two investment programs

which operate autonomously but are the same legal entity. The Direct Investment Program provides financing and equity investments ranging from \$500,000 to \$5 million to small- and medium-sized private businesses and the Small Business Loan Fund provides various types of financing to small businesses and entrepreneurs ranging from \$10,000 to \$100,000. Management believes the separate financial information included in the statement of financial position, the statement of activities, and the statement of cash flows presents a more meaningful analysis of the Fund's financial position and operating activities.

The accounting and reporting policies of the Fund are in accordance with generally accepted accounting principles. The Fund has adopted in the current year the requirements of Statement of Financial Accounting Standards ("SFAS") No. 116 "Accounting for Contributions Received and Contributions Made" and SFAS No. 117, "Financial Statements of Not-For-Profit Organizations."

#### Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Investment Valuation

The Fund's investments, as set forth in Note 4, are not readily marketable and are not listed on an exchange or quoted in an open market. These 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 in the absence of information that would support the need for a lower or higher valuation. The carrying values assigned to the investments are based on available information and do not necessarily represent amounts that might ultimately be realized, since such amounts depend on future circumstances and cannot be determined with certainty until the individual positions are liquidated. Due to the inherent uncertainty of the valuation, those estimated carrying values may differ significantly from the values that would have been used had a ready market for the investments existed, and the difference could be material. Investment valuation is conducted by management annually, and more often if circumstances warrant.

#### Investment in Loans and Direct Financing Leases

The fair value of loans and leases is based upon management's continuing review and evaluation of the loan portfolio and is intended to maintain an allowance adequate to absorb potential losses on loans and leases outstanding. The level of the allowance, in addition to the amount allocated to impaired investments (specific loans), is based on an evaluation of the risk characteristics of the investment portfolio and considers such factors as past and expected future loan loss experience, sovereign and currency risk considerations, the average financial condition of the borrowers, current economic conditions in

the Region and other relevant factors. Management considers a loan or lease impaired when, based on available information, it is probable that the Fund will be unable to collect principal and interest when due in accordance with the contractual terms of the agreement.

Interest on loans and leases is accrued at the contractual rate based upon the principal amount outstanding and credited to income as earned. It is the policy of management to discontinue the accrual of interest and reverse previously accrued but unpaid interest in the event that the quality of the credit has deteriorated to the extent that collectability of all or a portion of interest and/or principal cannot be reasonably expected or when it is 90 days past due. Collection of interest and principal on loans and leases in nonaccrual status and considered impaired are generally applied as a reduction to the outstanding principal. Once future collectability has been established, interest income may be recognized on a cash basis.

Adjustments to the allowance due to changes in measurement of impaired loans and loan characteristics are incorporated in the provision for loan losses.

#### Concentration of Credit Risk

By statute, all of the Fund's investments are in business activities conducted in the Region. As such, these investments are subject to the political and economic uncertainties associated with doing business in the Region.

#### Cash and Cash Equivalents

The Fund considers all highly liquid financial instruments purchased with a maturity of three months or less to be cash equivalents.

#### Grant Funds Recognition

The Fund accounts for its grant activities in accordance with generally accepted accounting principles for not-for-profit organizations, which require that income be recognized when such unrestricted contributions are received to be utilized for program purposes which includes disbursements for investments, loans, leases, operating expenditures, and fixed assets. Additions to unrestricted net assets are represented by U.S. Government grants which are for a specific time period. In the statement of activities, USAID grants totaling approximately \$18,601,000 are treated in this manner.

#### Depreciation and Amortization

Real estate is depreciated on a straight-line basis over 31 years. Leasehold improvements are amortized on a straight-line basis over the lesser of their useful lives or the term of the lease. Vehicles, furniture, fixtures and other equipment are depreciated on a straight-line basis over their estimated useful lives, principally 5-7 years.

#### Translation of Foreign Currency

The Fund's functional currency is the U.S. dollar. Generally, the Fund's operating transactions are initiated in U.S. dollars and exchanged for local currency as needed. Revenues and expenses transacted in local currency are translated into U.S. dollars at historical rates. Foreign currency translation or transaction gains or losses have been immaterial.

#### Technical Assistance

Technical assistance which has been accounted for separately from the Fund's other expenses, includes the Fund's expenses for business plan development, business consulting services and the training of residents of the Region in business disciplines.

#### Donated Services

Members of the board donate significant amounts of their time to the Fund's programs and receive no compensation or fees for serving as directors. 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.

#### 3. U.S. Government Grants

USAID has committed to an initial contribution of \$45 million to the Fund for program purposes, including administrative expenditures. Under the terms of the Grant, the Fund may hold funds in interest-bearing accounts and may retain investment and program income for program purposes. At September 30, 1996, the status of the Grant was as follows:

|                                                     |                      |
|-----------------------------------------------------|----------------------|
| Planned Grant funding                               | <u>\$150,000,000</u> |
| First committed increment                           | \$ 45,000,000        |
| Less amounts received                               | <u>18,601,000</u>    |
| Balance available under letter of credit from USAID | <u>\$ 26,399,000</u> |

#### 4. Equity and Debt Investments

In the accompanying Statement of Financial Position, investments are carried at cost which approximates fair value. Below summarizes the investments of the Fund as of September 30, 1996:

##### Direct Investment Program

| <u>Business</u>                       | <u>Cost</u>         | <u>Type</u> | <u>Percentage Owned</u> | <u>Country</u>  |
|---------------------------------------|---------------------|-------------|-------------------------|-----------------|
| Food and dairy processing             | \$ 1,300,106        | Debt        |                         | Ukraine/Moldova |
| Agricultural distribution center      | 1,474,617           | Equity/Debt | 55%                     | Ukraine         |
| Agricultural distribution center      | 1,169,486           | Equity/Debt | 53%                     | Ukraine         |
| Management information services       | 999,332             | Equity      | 100%                    | Ukraine         |
| Dairy products                        | 624,459             | Debt        |                         | Ukraine         |
| Window and door manufacturer          | 500,000             | Debt        |                         | Ukraine         |
| Agricultural distribution center      | 281,420             | Debt        |                         | Ukraine         |
| Sunflower oil bottler and distributor | <u>150,000</u>      | Equity      | 45%                     | Ukraine         |
| Investment Balance                    | <u>\$ 6,499,420</u> |             |                         |                 |

### Small Business Loan Fund - Direct Financing Leases

The Fund's direct financing leases (the "Leases"), are repayable in U.S. dollars at fixed rates and have various maturities up to three years. The leases may be collateralized by property and other assets of the borrower. Below summarizes the Leases of the Fund as of September 30, 1996:

| <u>Business</u>     | <u>Minimum Lease Payments Receivable</u> | <u>Estimated Residual Values of Leased Property (Unguaranteed)</u> | <u>Unearned Income</u> | <u>Allowance for Lease Receivables</u> | <u>Net Investment in Direct Financing Leases</u> |
|---------------------|------------------------------------------|--------------------------------------------------------------------|------------------------|----------------------------------------|--------------------------------------------------|
| Print services      | \$ 40,549                                | \$ 9,200                                                           | \$ (18,573)            |                                        | \$ 31,176                                        |
| Meat processing     | 90,664                                   | 8,800                                                              | (18,600)               | \$ (21,100)                            | 59,764                                           |
| Food processing     | 4,264                                    | 676                                                                | (1,839)                |                                        | 3,101                                            |
| Retail              | 28,319                                   | 6,500                                                              | (11,986)               |                                        | 22,833                                           |
| Retail              | 76,431                                   | 8,700                                                              | (26,837)               |                                        | 58,294                                           |
| Bakery              | 51,427                                   | 4,473                                                              | (14,214)               |                                        | 41,686                                           |
| Farm                | 47,525                                   | 4,714                                                              | (7,889)                |                                        | 44,350                                           |
| Wood processing     | 50,186                                   | 5,800                                                              | (15,474)               |                                        | 40,512                                           |
| Food processing     | 43,547                                   | 3,700                                                              | (12,190)               |                                        | 35,057                                           |
| Flour mill          | 76,345                                   | 6,000                                                              | (28,825)               |                                        | 53,520                                           |
| Dairy               | 110,670                                  | 9,000                                                              | (36,413)               |                                        | 83,257                                           |
| Farm                | 10,671                                   | 1,190                                                              | (1,639)                |                                        | 10,222                                           |
| Light manufacturing | 9,337                                    | 950                                                                | (3,457)                |                                        | 6,830                                            |
| Bakery              | 99,434                                   | 7,900                                                              | (35,005)               |                                        | 72,329                                           |
| Automobiles         | 11,116                                   |                                                                    |                        |                                        | 11,116                                           |
| Retail              | 23,101                                   |                                                                    |                        |                                        | 23,101                                           |
| <b>Total</b>        | <b>\$ 773,586</b>                        | <b>\$ 77,603</b>                                                   | <b>\$ (232,941)</b>    | <b>\$ (21,100)</b>                     | <b>\$ 597,148</b>                                |

As of December 15, 1996, the Investment Committee of the Fund approved investments for the Small Business Loan Fund and the Direct Investment Program totaling approximately \$595,000 and \$20,560,000 respectively that were subject to the satisfaction of all parties.

#### 5. Cash and Cash Equivalents

At September 30, 1996, the Fund's cash and cash equivalents are deposited primarily in two United States financial institutions. Approximately \$8,327,000 is invested via one United States financial institution (principally money market funds).

#### 6. Fixed Assets

At September 30, 1996, fixed assets consisted of:

|                                                 | <u>Total</u>       | <u>Direct Investment Program</u> | <u>Small Business Loan Fund</u> |
|-------------------------------------------------|--------------------|----------------------------------|---------------------------------|
| Real estate and leasehold improvements          | \$ 714,160         | \$ 708,901                       | \$ 5,259                        |
| Furniture, fixtures, and equipment              | 717,483            | 629,856                          | 87,627                          |
| Vehicles                                        | 227,983            | 198,750                          | 29,233                          |
| Total cost                                      | 1,659,626          | 1,537,507                        | 122,119                         |
| Less: Accumulated depreciation and amortization | (213,831)          | (196,287)                        | (17,544)                        |
| Fixed assets, net                               | <u>\$1,445,795</u> | <u>\$1,341,220</u>               | <u>\$104,575</u>                |

## 7. Retirement Plan

The Fund has established a defined contribution retirement plan designed to be qualified under Section 403(b) of the Internal Revenue Code. All employees meeting certain age and service requirements are eligible to participate. Eligible employees may contribute amounts not less than \$200 nor more than an amount equaling 10% of their base salary to the plan. In addition, the Fund makes monthly contributions to each eligible employee's account equal to 10% of the employee's base salary plus 5% of the amount of salary in excess of the Taxable Wage Base (\$61,200 as of September 30, 1996). Participants are eligible to participate in the plan immediately and are fully vested after two years of service. Contributions to the plan by the Fund totaled approximately \$120,600 for the year ending September 30, 1996.

## 8. Commitments

### Leases

The Fund is committed to make rental payments under operating leases for office space. Rent expense for the year ending September 30, 1996 was approximately \$395,000. Minimum annual lease commitments subsequent to September 30, 1996 are as follows:

|       | <u>Total</u> | <u>Direct<br/>Investment<br/>Program</u> | <u>Small<br/>Business<br/>Loan Fund</u> |
|-------|--------------|------------------------------------------|-----------------------------------------|
| 1997: | \$589,000    | \$567,000                                | \$22,000                                |
| 1998: | 598,000      | 576,000                                  | 22,000                                  |
| 1999: | 573,000      | 573,000                                  |                                         |
| 2000: | 492,000      | 492,000                                  |                                         |

## 9. Tax Status

### United States

The Fund is exempt from Federal income taxes under Section 501 (c)(3) of the U.S. Internal Revenue Code (the "Code"), and has been classified as an organization that is not a private foundation as defined in Section 509 (a)(1) of the Code. In addition, the Fund is exempt from payment of state and local income taxes.

### Western NIS Region

The registration of the Fund's accredited representative offices in Ukraine, Belarus, and Moldova occurred on March 31, June 30, and July 28, 1995, respectively. Under a bilateral agreement between the Government of the United States of America and the Governments of Ukraine and Moldova regarding cooperation to facilitate the provision of assistance, the Fund is exempt from taxation on income received in connection with implementation of the United States assistance programs.

## BOARD OF DIRECTORS

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## FUND MANAGEMENT

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Chief Investment Officer

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Country Manager - Ukraine

GREGORY BERENSTEIN  
Country Manager - Moldova

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Country Representative - Belarus

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Controller

IHOR V. FIGLUS  
Executive Director, Small Business Loan Fund

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