Monor State Farm: Phase II
Final Report

MONOR STATE FARM: PHASE II
FINAL REPORT

February 7, 1992

Coopers & Lybrand has prepared
this document
for the United States Agency
for International Development, Washington, D.C.

MONORI ÁLLAMI GAZDASÁG, MONOR
ADY ENDRE UTCA 02.
2201 Pf. 8.
MNB EGYSZÁMLASZÁM: 380.07420
TELEFON: 06-20-11124 MONOR – 191, 198
TELEX: 022-4025

November, 1991

DÁTUM:
ÜGYINTÉZŐ:
JELÜNK:
TÁRGY:

Dr. Lajos Csepi
Director
State Property Agency
Budapest
Hungary

Dear Dr. Csepi:

It is with great pleasure that I submit to the SPA the application for transformation of Monor State Farm. The transformation of Monor is crucial to our overall restructuring strategy, which includes the modernization of our production operations and the introduction of modern organizational and management structures.

The transformation plan has been reviewed and subsequently approved by the Monor State Farm Enterprise Council.

As we set out to implement our restructuring and transformation plans, we have had the good fortune to receive technical advisory services in agribusiness, management, and accounting from Coopers & Lybrand, and Chemonics International, both located in Washington, D.C.

I have the pleasure of presenting to you the following documents for your review and approval:

1. The transformation plan of Monor State Farm (including closing balance sheets before and after asset evalution);
2. The terms of incorporation and the statutes of the new company;
3. An installment contract for deed to the land assets;
4. A draft agreement between the State Property Agency and Monor concerning an Employee Share Ownership Plan
5. A review of the asset valuation;
6. A written statement of approval of transformation by the Monor State Farm Enterprise Council; and
7. The asset valuation

I would like to express my gratitude to your office for your review of the above documents. I am confident that Monor and the SPA can and will work closely in the coming months to ensure a successful transformation of the enterprise.

Sincerely yours,

Jozsef Agocs
General Director
Monor State Farm

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proposals concerning the above-mentioned requirements for a successful restructuring.

The following document first offers general introductions to Monor's business operations and to the transformation plan (Sections I and II), and then spells out in detail the components of the plan (Section III). The Annexes comprise the appropriate legal documentation.

SECTION I
INTRODUCTION TO MONOR STATE FARM--BUSINESS OPERATIONS

A. General Background

Monor State Farm was founded in 1970 through the consolidation of several state farms. The farm's land holdings total 11,220 hectares, of which 7,316 are arable. This territory is divided into nine semi-autonomous geographic units with mixed production operations at each. These production operations are: crop production, animal feeds, consumer products, vineyard operations, dairy operations, and swine production. From these operations Monor produces a wide array of agricultural products, ranging from wheat, barley, and corn, to processed animal feed and grape must, to a variety of manufactured consumer food items. Monor currently employs 780 people[1]. Total sales for Monor in 1990 were HF 1.493 billion. The 1990 annual turnover was approximately HF 700 million for the domestic market, HF 600-650 million for hard currency markets, and HF 80-90 million for the former Council of Mutual Economic Assistance (CMEA) market. The adjusted value of the firm's total assets (excluding land) in 1991 is HF 1.428 billion.

B. Principal Business Operations

1. Crop Production Division

Monor grows spring and winter wheat and barley, corn for grain and silage, mustard seed, vegetables for local markets, alfalfa hay, and a relatively small amount of specialty crops. These crops are grown on 8,000 hectares. The operation is partially supplied with seeds and fertilizers from outside sources. The division has a complete, though antiquated array of tillage and harvesting machinery as well as storage facilities. Gross output totalled 12,906 tons in 1990. Monor has comparative advantages in wheat and barley production, whose yield per hectare (4.8 and 5.1, respectively) are above domestic averages. Twenty-five per cent of Monor's grain yield is used in its feed and food processing business; the rest is sold domestically on the open market. Gross revenue from crop sales for 1990 was approximately HF 15.7 million. Sales from the food and

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[1] As of December, 1990, Monor employed 1,113 people. The reduction in staff is directly tied to Monor's drop in retained earnings.

feed processing facilities constitute more than 50 per cent of Monor's gross revenues, establishing crop production as a key component of Monor's business operations. As such, crop production, and in particular wheat and barley production, will be emphasized and improved, particularly with regard to technology modernization. These improvements, however, will require outside investment.

2. Feed Processing Division

Animal feed production consists primarily of flaked, extruded, and pelleted processed and semi-processed feed grains and grain by-products, mineral supplements, feed additives, and a limited line of complete feeds and premixes. The division employs 120 people. Total grain input is partially supplied from Monor's own stock; the remainder is purchased from outside. The gross output for 1990 was 72,085 metric tons. Gross revenue from feed sales for the year was HF 809 million. Feed processing constitutes the largest operating division at Monor when measured in sales and profit contribution. It accounted for 54.2 percent of total 1990 sales. Of particular note is the export of nearly 35-40 percent of Monor's feed production, in the form of flaked and extruded feed, to Italy; the remainder is sold domestically. Feed processing has demonstrated a strong comparative advantage in hard currency export markets, and will therefore continue to be central to Monor's business activity.

3. Consumer Products Division

The consumer products division produces pet foods, snack and cereal foods, chocolate products, pasta, and limited quantities of cold-pressed vegetable oils. The division currently employs around 50 people. Manufacturing plant facilities include extruder and packaging machinery. Gross output of principal products--pet foods, snack foods, and pasta--was 4,400 tons in 1990. Gross 1990 sales for these items were approximately HF 188 million. The division is small in relation to Monor's overall business profile, comprising roughly 13 percent of Monor's total revenues in 1990. This is due in large part to the total loss of cereal and chocolate markets in the Soviet Union, Czechoslovakia, and Romania. Comparative advantage, however, is evident in the pet foods, snack foods, and pasta operations. We are therefore intent on modernizing and expanding the production of these items. This undertaking will also require the participation of outside investment.

4. Vineyards Division

Monor currently produces 14 varieties of grapes which are processed into must (grape juice) and sold for further processing. Monor also produces a limited quantity of wines. The vineyards comprise 322 hectares. The division employs approximately 45 individuals throughout the year, but upwards to 200-300 during the harvest period. Externally procured production inputs include fertilizers, additives, and sugar. The total production of "grape must" came to 31,657 hectoliters in 1990. Gross sales for 1990 amounted to approximately HF 63.5 million. This figure comprised 4.25 percent of Monor's gross sales for the year. All of the must is sold to Hungarovin. The division has been hurt by a 40 percent fall in Hungarovin sales, caused largely by a precipitous drop in exports to the Soviet Union and the former German Democratic Republic. The division is also adversely impacted by a domestic glut of grape and wine production. We would nonetheless like to increase our winemaking operations because we believe that wine production could become a high gross margin operation. This was confirmed by an independent winemaking expert, who, upon recently inspecting our operations, concluded that, given favorable market conditions and after operational restructuring, the division could potentially generate more than HF 60 million a year. Again, it is important to understand that, as with the crop production and consumer products divisions, operational restructuring of the vineyards division will require outside investment.

5. Dairy Division

The dairy division primarily produces milk for domestic consumption. The division maintains on the average 920 cows, and employs 70 people. The division procures grain supplements, vitamins, and medicine supplies for animal feeding. It features a fully self-contained production system and developed procedures in breeding, feeding, and healthcare. Total production of milk in 1990 came to 51,567 hectoliters, or roughly 56.7 hectoliters per cow. Gross sales for 1990 amounted to HF 75 million. This figure comprised 5.02 percent of Monor's total sales volume for 1990. The total volume of milk produced is sold under contract to the national milk enterprise.

6. Swine Division

The swine division currently produces pork for sale on the domestic market. The facilities feature a comprehensive farrow-to-finish production system. The division procures vitamin supplements for feeding. It employs 41 individuals. Total output of pork in 1990 was 1,094 tons, or 1.2 tons per progeny. Gross sales for the same year amounted to HF 75 million. This figure comprised 5.02 percent of Monor's total sales volume for 1990. The depressed market prices for pork have had a negative impact on the division's earnings potential. We are therefore intent on developing a hybrid stock that will match the genetic standards of the European Community (EC), so as to increase our exports to Western Europe and to develop a new domestic market niche in higher-quality pork products.

Balance Sheet
of Monor State Farm Assets
(based on March 31, 1991 valuation)

Assets		Value (000s forints)		
Number	Item	Book	Market	Balance
05	Cash	18.753	18.753	-
06	Bonds	7.330	3.690	-3.640
07	Domestic assets receivable	239.328	193.768	-45.560
08	Expatriate assets receivable	97.828	84.372	-13.426
10	Accounts with employees	15.846	8.686	-7.160
11	Active accounts except for fixed assets	.464	.464	-
16	Livestock inventory	104.321	69.931	-34.390
17	Agricultural and industrial semi-processed and fully-processed products' inventory	67.287	67.670	.383
20	Other raw materials	178.365	124.638	-53.727
21	Commodities	1.340	1.366	.26
23	Doubtful receivables	7.777	-	-7.777
24	Other active accounts	-12.953	-13.233	-.280
25	Active carryforwards	.192	.192	-
30	Invested assets	127.856	82.829	-45.027
31-2	Net value of fixed assets	509.487	697.073	187.586
33	Investments	92.045	87.629	-4.416
35	Registered assets total	1,455.246	1,427.828	27.418
	Arable lands	-	447.080	447.080
	Forestry	-	44.545	44.545
	Total Assets	1,455.246	1,919.453	464.207
Deductions (outside sources)				
48	Short term liabilities	-613.678	-616.554	-2.876
53	Long term liabilities (debt)	-98.119	-98.119	-
	Net Asset Value (unencumbered)	743.449	1,204.780	461.331

SECTION II
INTRODUCTION TO THE TRANSFORMATION PLAN

A. Overview

As mentioned in the Executive Summary, the transformation plan should be introduced in the context of our operating business environment, and in particular with an understanding of our need to restructure the firm, ie. to bring in new production technology, capital investment, and managerial structures, in order to exploit our comparative advantages under new market conditions at home and abroad.

B. External Challenges

Prior to 1989, Monor State Farm enjoyed a secure standing and a healthy profitability in the domestic agricultural market, in several Western European agricultural sectors such as animal feeds, and within the CMEA trading bloc. The external business environment in which Monor operates has, however, changed radically over the past two years. The domestic agricultural market is suffering from oversupply, and thus lowered demand and suppressed prices. Our continued success in exporting products to the European Community (EC) and particularly to Italy, as well as our ability to expand our market base in the EC, is challenged by the imposition of quota restrictions on agricultural imports from Central Europe. The most dramatic change has of course been the evaporation of the CMEA market. The switch of payment method from ruble clearing and barter to hard currency has disadvantaged our clients in the region. Many among them have been unable to continue their business association with us.

The shrinking of these markets contributed to Monor's first ever non-profitable year in 1990. The situation has only worsened this year, to the extent that Monor's continued existence is threatened. Immediate action in the form of enterprise restructuring is needed to save Monor. A successful restructuring plan, in turn, requires the transformation of Monor's ownership structure. This strategy, we believe, will allow Monor to meet the challenges of the new market economy.

C. The Need to Restructure

Our response to this situation, in other words, has been to seek internal improvements as a means to meet these external challenges effectively. Toward this end, we have undertaken a comprehensive restructuring of the enterprise as a whole. This entails a modernization of our production operations in all six divisions, a more streamlined organizational structure, the introduction of strategic planning and investment practices, new marketing and sales techniques, quality control mechanisms, and finally Western financial and accounting methods. Underlying this effort is an emphasis on strengthening our comparative advantages, namely in the production of wheat, barley, animal feeds, and snack food items. Our objective is to improve the quality and efficiency of Monor's business operations, reduce production costs, and thereby restore the firm's competitiveness and profit-making ability in the Hungarian, EC, Central European, and Soviet markets.

Having recognized the need for restructuring, our senior management, together with the Enterprise Council, engaged the services of a consultant team composed of agribusiness, marketing, and financial specialists. This assistance was partially financed by the United States Agency for International Development (AID). The team performed a diagnostic survey of Monor's business operations, organizational structures, and accounting procedures in June and July of this year. In August the team submitted to Monor a restructuring plan based on its findings. The plan outlined, on the basis of comparative advantage, specific measures to restructure and modernize the production, organizational, financial, and marketing operations of Monor with a view to transforming the enterprise into a market- and profit-driven company. This plan has been approved by Monor management and by the Enterprise Council.

D. The Role of Ownership Transformation

According to our plan, the catalyst for this restructuring effort is the transformation of Monor from a state-owned enterprise into a Rt. This transformation will encourage outside investment, the development of an employee stock ownership plan, and an agreement with Monor's creditors regarding a debt-for-equity swap. These are three essential components to a successful privatization of Monor.

1. Outside Investment

Transformation will provide a flexible and transparent legal structure which will facilitate and encourage the participation of outside investors. Their participation is of primary importance. Outside investment will furnish vital working capital to be used in the modernization of production operations, technology, and marketing. It will also provide managerial guidance in the formulation of targeted investment strategies in such areas as capital formation and product development. The resulting increase in production efficiency and decrease in production costs will have a "multiplier effect", since it will lead to greater sales and gross margins, which will, in turn, provide a larger financial base from which to reinvest capital, improve product quality, create new product lines, generate employment, build upon established domestic and foreign markets, and access new ones. In short, the infusion of outside capital will allow Monor to stabilize its operations in the short term and to grow in the medium to long term.

It should be emphasized that the transformation plan not only provides an indirect means to meet Monor's external challenges (ie. by expediting Monor's internal restructuring), but also introduces new and direct ways in which to strengthen the firm's market competitiveness, particularly in the West. Among outside investors will be Western agribusiness interests which will bring to Monor established contacts in Western markets and a practiced knowledge of sophisticated marketing techniques. This added marketing dimension will be incorporated into renewed marketing efforts aimed at traditional and potential clients in Hungary and throughout Central Europe and the Soviet republics.

2. Employee Stock Ownership Plan (ESOP) Creditor Debt-for-Equity Swap Agreement

Transformation can also strengthen Monor in at least two other important aspects. First, the privatization of Monor following its transformation will create "ownership motivation" among Monor's present employees through employee ownership mechanisms which establish a direct and causal link between enterprise success and individual profit. We are aware of such mechanisms in other countries. They have shown that ownership of significant amounts of stock by all employees, if properly structured, creates large increases in productivity and profitability for the enterprise.

Secondly, it is intended that the ability to transfer ownership into private hands will allow Monor to negotiate debt-for-equity agreements with creditors to strengthen the financial position of the business.

E. Proposed Legal Structure

1. Transformation into a Rt

The Monor transformation plan seeks to take full advantage of the benefits accruing from a private ownership structure. Monor State Farm will first be transformed into a company limited by shares (Rt), and will then be completely acquired from the State Property Agency (SPA). It will be named Monor Agro-Industries, Inc. (MAI).

2. Ownership Group

Monor State farm will be acquired by a group of investors which will include outside investors, current employees, and current creditors.

A principal aim of the transformation plan is to create a vehicle to attract outside investment, since external capital is vital to both the acquisition and the restructuring of the enterprise. Given this requirement, it is intended that majority ownership in MAI will be held by outside investors.

The new ownership structure will include employees as owners of up to 30 percent of MAI shares, using all legal possibilities afforded by the Company Act, the Transformation Act, and the new ESOP law which is expected to be promulgated in January, 1992. An ESOP will be organized to support the employees in their effort to reach this objective.

Monor's present creditors will be offered stock in exchange for debt. The issued stock will consist of non-voting, preferred dividend shares as well as full-voting common stock.

3. Installment Contract for Deed to Land Assets

The transformation plan features an installment contract for the deed to Monor's land assets. The objective of this contract is to allow the enterprise to retain its most valuable asset--the land--without compromising the legitimate claims of land recompensation by other parties. The contract is appended for review.

4. Advantages of Rt Relative to Kft

The suggested ownership structure of a single, integrated, share-held company (Rt) carries several distinct advantages over the limited liability structure (Kft). First, a Rt will offer a more transparent and accessible investment portfolio to outside investors. Secondly, it will enable Monor to remain structurally intact as one legal entity. Thirdly, it will lead to a more efficient distribution of resources as well as a streamlined management of support functions, such as finance and marketing. Finally, a Rt structure will afford future opportunities for the development of profit-driven Kfts and other business arrangements based on economic comparative advantage and on the best interests of the enterprise as a whole.

SECTION III
DETAILS OF THE TRANSFORMATION PLAN

A. <u>Name and Address of the New Company</u>

1. The name of the new association is Monor Agro-Industries, Inc.

2. The address of the new association is:

   Ady Endre utca, 62
   2201 Monor
   Hungary

Privatization Timetable
1991-1992

ber	Task	October	November	December	January	February	March	April	May	June	July
	Submission of Transformation Plan to the SPA	Oct.									
	Development of ESOP ESOP Education ESOP Negotiation	Oct.				Feb.15					July 1
	Selling Memorandum	Oct.									
	Identification of Prospective Investors	>	>	>	>	>	>	>	>	>	July 1
	Contact Prospective Investors	>	>	>	>	>	>	>		>	July 1
	Transformation Deadline				Jan. 1						
	Evaluation and Negotiation of Offers				>	>	>	>	>	>	July 1
	Negotiation and Final Agreement with Bank Creditors										July 1
	Actual Privatization										July 1
	Management Training	>	>	>	>	>	>	>	>	>	July 1
	Enterprise Education	>	>	>	>	>	>	>	>	>	July 1

Continued technical assistance will be provided by Coopers & Lybrand and Chemonics during the above-noted process and will not be limited exclusively to these tasks, but may include nical assistance in enterprise-specfic areas such as marketing, technology transfer, feasibility studies, and identifying and negotiating with specific sources of finance.

C. Expected Business Operations of the New Company

1. Overview

The consultant team which reviewed Monor's business operations concluded that, despite its current difficulties, Monor has the potential to develop its various enterprises into more profitable, market-driven operations. To realize this potential, a series of specific recommendations was made by the team for each of the six principal business divisions as well as for the firm's overall organizational structure. In general, the recommendations are technical and managerial in nature. They emphasize operational efficiency, improved performance, and mutual support. These recommendations, approved by Monor management, will serve as the basis for business operations of Monor Agro-Industries, Inc. (MAI).

2. Production Profile

Monor's business operations will continue to center on its six principal divisions: crop production, feed processing, consumer products, vineyards, dairy, and swine. There are four essential restructuring efforts to be undertaken in these six operational divisions. First, we will concentrate production on those products which have relative comparative advantage and which show high earning potential. The crop production division, for example, will focus on wheat and barley production. The consumer products division, likewise, will emphasize pet foods and certain human consumption items, such as pasta.

Secondly, division management will be strengthened along functional lines in each of the six operations. Each division will feature, in addition to the division manager, an operations manager, a sales and marketing manager, a financial officer, and other personnel, such as maintenance staff and agronomists, as warranted by the needs of the division.

Thirdly, new production techniques and the modernization of existing facilities will be implemented with the intention of decreasing production costs and increasing revenues. This will entail, for example, computerization of equipment, the creation of informational databases, and new methods for planting, maintenance, harvesting, and storage.

Finally, pre-production marketing and sales efforts will be undertaken so as to direct production toward client needs and preferences. The consumer products division will, in particular, develop a well-coordinated, efficient marketing strategy under the leadership of an experienced sales and marketing manager.

3. Organizational Structure

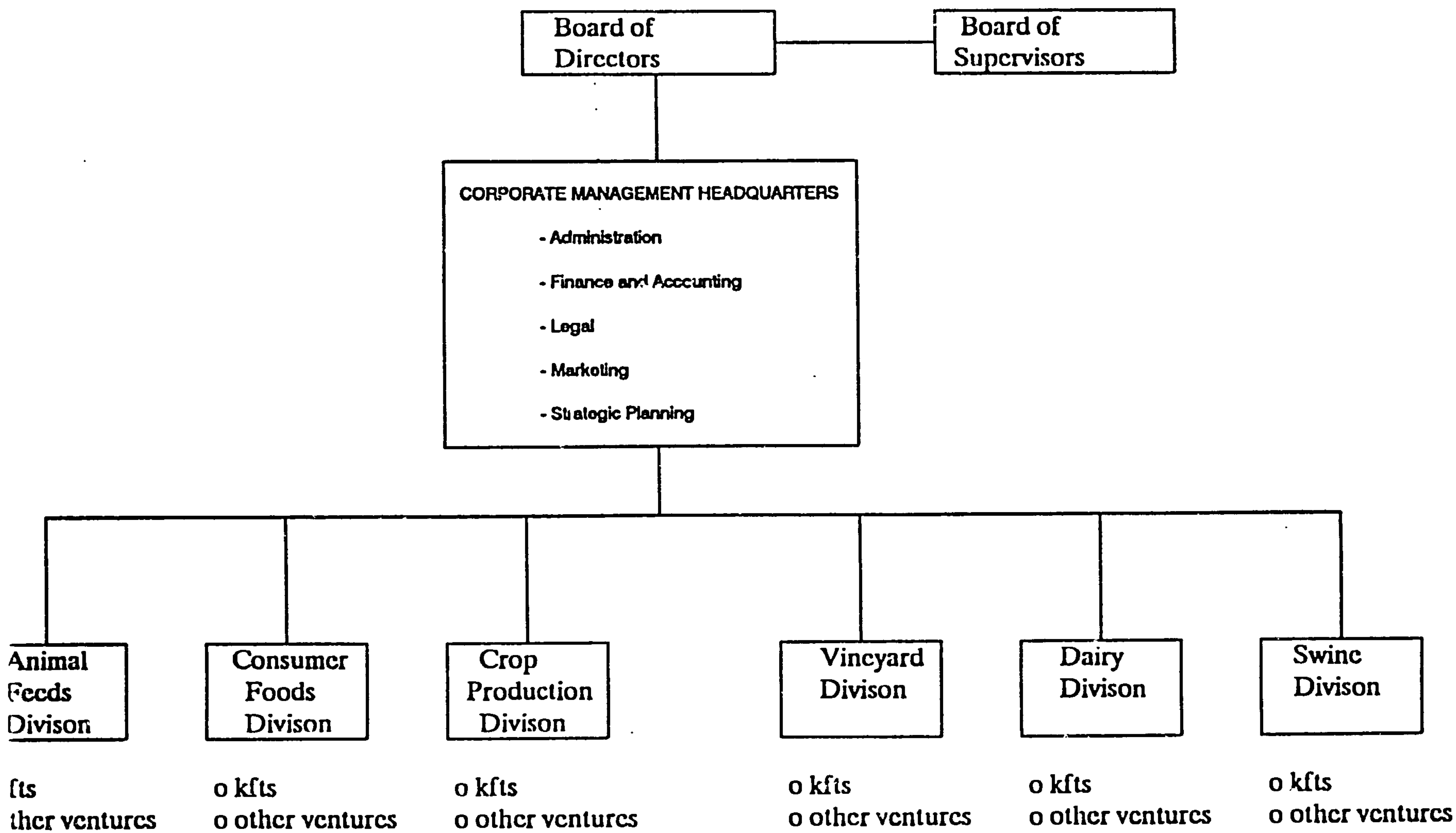
Monor will base its overall organizational structure on the idea that it must maximize the comparative advantages of its operations by achieving economies of scale in key management and operational functions. The enterprise will be reorganized from geographic to enterprise divisions so as to increase efficiency and productivity. Monor will also use profit performance as the measure of corporate success. The proposed Rt ownership structure for MAI supports and reinforces these objectives.

Headquarters will retain responsibility for strategic planning, overall corporate finance, overall marketing, and certain aspects of procurement. A General Director/Chief Executive Officer will be the most senior executive of MAI. He or she will be appointed by and serve at the discretion of MAI's owners, who will be represented by the Board of Directors. Based on the transformation plan, the Board will be composed of present Monor employees, creditors, and outside investors. As outside investors will have a controlling interest in the corporation, they will hold a majority of seats on the board. A supervisory board will be created in addition to the board of directors. Two-thirds of the supervisory board will consist of representatives of the owners. The remaining third will consist of representatives of the employees.

The organizational structure will recognize each enterprise activity as a separate profit center. Division managers will be responsible for all profits and losses. Each enterprise division will be supported with finance, procurement, and marketing functions, as well as legal and accounting services. Such a design will allow for the natural development of Kfts, rental arrangements, and other business forms on the basis of comparative advantage and the interests of maximum corporate performance.

Attached is a chart outlining MAI's organizational model.

MONOR AGRO-INDUSTRIES (MAI) ENTERPRISE MODEL



ons described are illustrative of the primary responsibilitios to be performed. They are not intended to be all-inclusive.

D. Identification of Advisors

Coopers & Lybrand and Chemonics will continue to provide technical advisory services and general consultation to Munor throughout the period of transformation.

Please consult the privatization timetable (Section III.B) for specific tasks requiring technical assistance and/or consultation.

E. Planned Share Capital of the New Company

According to the Agrar Bross re-evaluation of the Monor State Farm, the asset value of Monor--excluding land and outstanding liabilities--is HF 713 million. Of this amount, HF 642 million (90 percent of the net asset value) will be Share capital of the transformed MAI. 64,200 shares at HF 10,000 each will be issued to the SPA, reflecting its 100% ownership of the transformed Monor.

The HF 71 million, above the share capital (10 percent of the net asset value) will be accumulated assets. As soon as possible following transformation, this amount will be converted to share capital and we will issue employee shares (in accordance with Art. 244 of the Company Act). Employees will pay for these "employee shares" 10% of the par value within the limits of the Property Policy Guidelines in force at that time.

The creation of MAI will create a vehicle which will be used to encourage outside investment leading toward the eventual privatization of Monor. In addition, it will facilitate the continuation of negotiations with creditors to swap debt for equity in the new company and advance discussions towards the implementation of an employee share ownership plan. We would expect the SPA's ownership interest to be eliminated in accordance with the privatization timetable set forth in Section III.B.

The SPA-MAI contract will reflect the authorization of additional shares which may be issued after transformation. Actual issuance of shares will depend upon the outcome of discussions with creditors and prospective investors. In addition, this will also create the legal framework which will enable Monor to raise additional equity capital to fund growth after the completion of the privatization process.

F. Outside Investor Profile

1. We believe that the investor group will be divided into three subgroups having the following profiles:

a. Private/Institutional Investors

It is likely that private/institutional investors will provide the majority of investment required to privatize Monor and will exercise controlling interest over the operations of MAI. Private/institutional investors may include various investment funds such as the Hungarian American Enterprise Fund (HAEF) with which we have had initial discussions. The Hungarian American Enterprise Fund has expressed interest in continuing discussions and is awaiting the selling memorandum. Discussions have also begun with small companies and individual expatriate investors of Italian, Austrian, and American origin, all of which bring not only capital but also potential markets and technology. We will rely on a Hungarian-American joint venture investment bank to provide access to not only additional American investors but also sources of Hungarian capital.

b. Bank Creditors

Discussions have commenced with our single largest bank creditor to swap debt for equity in the newly privatized Monor. Please see Section III.H for a detailed description of the proposed Creditor Debt-for-Equity Swap Agreement.

c. Employees

Employees will play an active ownership role in the newly privatized Monor. Please see Section III.G--ESOP Concept Paper--for more detail.

2. Methodology

The Hungarian-American investment bank mentioned above, in combination with our other advisors, will target specific potential investors, both domestic and foreign, which have previously been determined to have interest in investing in the agricultural sector in Hungary. Most importantly, we will focus on investors who possess the required capital, technology, and markets which are required for the future viability of Monor. Those potential investors expressing interest will be asked to signify their interest formally by executing a confidentiality agreement. Upon receipt of signed confidentiality agreements, our advisors will disseminate selling memoranda to interested parties. Investors will then be invited to submit expressions of interest in the form of non-binding bids and will be invited to commence due diligence which will be managed by our advisors. The conclusion of the due diligence process will result in the submission of final bids from investors. Bids will be evaluated based on a weighted criteria which gives higher ratings to those bids which assure the transfer of state-of-the-art technology and future markets to Monor.

G. Employee Share Ownership at Monor

1. Objective

The objective of employee share participation at Monor is to provide MAI employees with the opportunity to acquire up to 30 percent of MAI shares and consequently to enjoy dividends and voting rights on such shares, as well as ultimately the value of their shares in cash. The employees of Monor are aware of the benefits of ownership and are keenly interested in the opportunity to become owners of 30 percent of MAI shares.

Experience elsewhere has indicated that such employee share ownership gives employees the attitude of owners and has significant motivational effect. The resulting increases in productivity are likely to make MAI out-perform similar agro-industrial complexes in which employees do not have ownership. This will bring benefits to the other shareholders through increased profits, to the national economy through additional production, and to the government through increased taxes.

2. Basic features

Share purchase for the employees will be based on three elements:

a. Conversion of Monor's accumulated capital (HF 71 million) to "employee shares", to be sold to employees at 10 percent of their par value in accordance with Art. 244 of Act no. VI of 1988;

b. Purchase of convertible preferred shares with a par value of HF 150,000,000 for the employees at a 50 percent discount as provided by the Property Policy Guidelines;

c. Establishment of an Employee Share Ownership Plan (ESOP) to assist in financing share purchase by the employees.

The ESOP will be legally formed as a special action to assist in the acquisition of 30 percent of MAI stock. The ESOP will be open to all full-time MAI employees who meet the eligibility requirements.

The objective of the ESOP is to make the employees behave like owners who work for long-term growth rather than like speculators who seek short-term profit. Every employee will have an individual account in the ESOP. All net assets of the ESOP will be allocated gradually to the employees' accounts. The method of distribution of the property (acquisition of property) will be defined later in the Statutes of the MAI.

Every employee will have in the ESOP legally enforceable rights to:

- o participation in general meetings; vote the shares in his account, with one vote for each share;
- o right of property; receive distribution of the dividends which remain after making the installment payment on the shares and setting aside the necessary reserves;
- o other minority rights that the shareholders are entitled to have (Company Act 264-276)
- o receive the shares or their equivalent in cash upon termination of the right of participation in general meetings.

3. Financing the employee share acquisition

The key to employee ownership is financing. If the capitalization of MAI is HF 1.28 billion, the par value of 30 percent of the shares is HF 384 million. However, by using fully the discounts which are available under the Company Act and the Property Policy Guidelines for employee share purchase, this capital requirement may be considerably reduced.

Whatever mechanism is used to raise the capital initially, the employee shares are ultimately fully paid for out of three sources:

a. Employee contributions: A certain amount could be raised from the employees through small deductions from their monthly salaries; this is important to make the employees feel that they are making a financial effort, and consequently to make them appreciate share ownership more.

   Furthermore, some employees who have savings will want to invest them in the ESOP, realizing the benefits of ESOP leveraging. The MAI ESOP plan will accommodate this, while keeping the plan reasonably equitable.

b. Payment out of dividends: A part or all of the dividends on shares lacquired by the ESOP can be used for repayment.

c. MAI contributions: The rest of the cost of the ESOP shares will be met by annual MAI contributions to the ESOP. The interest of MAI in making such contributions is that (1) in this way MAI can give employees incentive payments - thus encouraging them to be more productive - while such payments are not used by the employees for consumption, but invested back in MAI; and (2) in this way MAI can repay credits in a tax-advantaged manner.

Three sources of financing are potentially available for the purchase of up to 30 percent of MAI shares for the employees:

- o Employee cash payments: The accumulated assets of MAI (HF 71 million) is to be converted to "employee shares" which may be acquired by employees at discounts of 90 percent, on condition of paying 10 % in cash.

- o Hungarian privatization credit at concessional interest rates: Such credit may be provided by: (1) Hungarian National Bank credit at 21.5 percent interest; (2) "existence credits" at 20.5 percent interest; and (3) credits which may be provided especially for employee share purchases under the forthcoming "Employee Ownership Plan" bill, expected to be promulgated in January 1992. The maximum amount will be raised from this source within the limits posed by the availability of funds and the requirements of such credits for employee matching funds and guarantees.

- o The Hungarian-American Enterprise Fund (HAEF): HAEF financing could take two forms: a part as a low-interest credit to the ESOP organization, and a part as an HAEF equity investment in MAI shares, which will be gradually bought out by the employees. USAID loan funds to HAEF could advantageously be used for this purpose. HAEF financing could be accomplished as follows:

  (1) HAEF credit: The ESOP organization would obtain from HAEF a dollar-denominated loan to purchase MAI shares. The loan will be repaid from the dividends on such shares, as well as from MAI and employee contributions.

  (2) HAEF equity investment: HAEF will take a position in MAI by investing in convertible preferred shares, which will be issued by MAI for this purpose. These shares would form part of MAI's foundation capital and would carry guaranteed dividends. The ESOP association will have a permanent option to gradually purchase these shares from HAEF at par value, using MAI and employee contributions. After purchase by the ESOP, the shares will be converted at a 1:1 ratio to MAI common shares, which will then be held by the ESOP Organization on behalf of the employees.

Both financing modes (1) and (2) have the advantage of bringing into Hungary dc'' .'-denominated investments. Apart from giving MAI the opportunity to purchase imported equipment for modernization, this will give MAI important tax advantages. The disadvantage of this mode is that the tax advantages resulting from ESOP would not be available.

The advantage of financing mode (1) for HAEF is that loan repayment is senior to payment of preferred dividends. On the other hand, the advantage of (2) for HAEF is that the HAEF shares will have voting rights (although this is not usual for preferred shares, it is legal), so that HAEF will sit on MAI's board and thus be more able to safeguard its investment. (A part of the vote could be passed through to the employees). Consequently, a combination of the two financing modes may be best.

H. Creditor Debt-for-Equity Swap Agreement

1. Rationale

Under the present operating conditions of Monor, it is imperative that Monor negotiate relief from debt servicing which presently amounts to more than HF 100 million per annum. Therefore, our objective is to offer our principal bank creditor the opportunity to exchange Monor's present indebtedness for equity in the new transformed and privatized company. As we have stated elsewhere in our application, it is doubtful that Monor can survive as a state farm under the present economic circumstances and in a market-oriented economy. Therefore, in our opinion, and in the opinion of our advisors, the bank's interests are best protected by exchanging debt for equity in the new Rt. In addition to vastly strengthening Monor's financial position, this will also strengthen the ability of Monor to compete successfully in the new market economy.

2. Negotiation of Agreement

Several meetings have taken place with the bank, during which various ideas and concepts have been explored. In the last such meeting our advisors took part and we agreed at that time to provide additional information as requested by the bank. Thus far the bank has agreed in principal to the idea of a debt-for-equity swap, but will reserve its final decision until the information requested has been provided. We will continue to receive assistance from our advisors during negotiations with the bank.

3. Brief Overview of Agreement

Based on the amount of the debt in proportion to the expected selling price of Monor, an agreement will be developed in which the bank will receive the amount of stock proportionate to outstanding debt. We are proposing that the stock be divided into two categories: (1) common stock having full voting rights and privileges; and (2) preferred stock with no voting privileges but with first preference to dividends. The reason for dividing the shares into these two classes is to ensure that the outside investors maintain control over the operations of the newly privatized Monor.

Annex A STATUTES OF MONOR AGRO-INDUSTRIES, INC.

1. Name of the Company

Name of the Company: Monori Agrar Ipari, Rt.
(The Monor municipal government has approved the inclusion of Monor in the new name of the company)

The company's name in English: Monor Agro-Industries, Inc.

2. Abbreviation of the company: MAI Rt

3. The company is the legal successor to Monor State Farm.

4. Principal Headquarters of the Company

The principal headquarters of the company: 2201 Monor, Ady Endre u. 62., Hungary

Branch establishment of the company: 1125 Budapest, Szamoca u., 9.

Name of the branch establishment: Budapest Trade Office

5. Duration of the Company:

The company is established for an indefinite period of time.

6. Scope of Activities of the Company:

3111	Agricultural production
3121	Agricultural services
3211	Forestry production
3221	Forestry services
1411	Machinery production
1422	Maintenance/repairs of vehicles
1914	Canning industry
1915	Milling industry
1918	Confectionery industry
1922	Wine production
2113	Miscellaneous surface construction
8471	Other activities related to education

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2121	Road, railway, bridge construction
7221	Other activities relating to materials
5131	Wholesale food trade
5151	Catering trade
5211	Trading of external commodities, technical, and intellectual products and services
5141	Food retail trade
5146	Retail trade of miscellaneous activities
1916	Baking and pasta industry
1919	Vegetable oil industry
4171	Garage/maintenance activities
1931	Food industry research and development
4179	Other transport services

7-11: Share Capital of the Company

7.1 The equity capital of the Rt is HF 642 million, ie. six-hundred and forty-two million forint at the time of transformation.

7.2 The contribution of the State Property Agency as the founder (headquarters: 6 Vigado Ter, 1051 Budapest) is HF 713 million, according to the company balance sheet certified by an auditor. It is an inseparable part of the Terms of Incorporation, and is attached to the document (Terms of Incorporation) as Annex No. . The HF 713 million were contributed from their own assets by the SPA, which is the company founder, in order to raise an equity capital of HF 642 million, and an accumulated capital of HF 71 million, which is the balance of the total sum and the equity capital.

The company's own assets, presented in Annex F, were evaluated by Agrar Bross. The valuation contains the book value of the assets taken into the company by the State Property Agency as well as the assets value according to the technical evaluation.

The croplands and forests to be purchased by the Rt from the State of Hungary (owner) do not constitute a part of the property of the company. Consequently, they are not included in the value of the contribution. The Rt will purchase the above-mentioned croplands and forests from the State of Hungary on the basis of this contract, which forms an inseparable part of the Terms of Incorporation.

The non-financial contribution was checked and approved on the basis of the valuation by a qualified chartered accountant and auditor. The firm's registered license number is: _____.

The founder has accepted the asset contribution of HF 713 million by the SPA. This corresponds with the auditor's valuation.

8. Shares and Shareholders

The equity capital of the company:

8.1 49,200 shares at HF 10,000 each: HF 492 million total. These shares are registered without any limitation (first type of shares).

8.2 15,000 shares at HF 10,000 each: HF 150 million total. These shares are registered preferred, with no limitations and a 10 percent dividend preference for three full fiscal years (1992, 1993, and 1994) (second type of shares).

8.3 The company registers the remaining balance, ie. HF 140 million as accumulated assets. This remaining balance is the difference between the assets according to the closing balance sheet of the company (excluding the value of the arable lands and forests), ie. HF 782 million, and the equity capital, ie. HF 642 million.

The company authorizes the Board of Directors to raise the equity capital by HF 71 million by virtue of the accumulated assets following the registration of the company. In raising the capital, the Board of Directors is authorized to issue employee shares on the basis of the Law on Economic Associations, article 244.

8.4 All shareholders are entitled to have all rights included in articles 264-276 of the Law on Economic Associations. If any share is acquired by the association, then article 247 of the above Act will regulate the exercise of the shareholding rights.

The bearers of shares which are registered and have a 10 percent dividend preference for 3 fiscal years are entitled to exercise the rights specified in articles 246-247 of the Law on Economic Associations. These shares will remain in transactions from the fiscal year of 1995 as registered, non-limited shares.

When transferring registered, non-limited shares worth HF 10,000 each, owned by natural persons who are employees of the company, the natural persons, as employees of the company, have the right of pre-emption according to the order in which they announce their disposition to purchase the shares. The registered shareholders are obliged to submit a written statement concerning their intention to transfer the shares and the offers they have received. This statement must be submitted to the Board of Directors.

If the Board of Directors offers no opinion within 15 days following the submission of the above written statement concerning the transfer of shares, the right of pre-emption will be conferred upon the shareholders.

The shareholders who wish to exercise their right of pre-emption are obliged to keep the Board of Directors informed in writing concerning their intention to purchase shares, specifically about the extent and criteria of the purchase for the registry. The Board of Directors, as the representative of the shareholders, can exercise the right of pre-emption on behalf of the shareholders according to the registry.

The detailed rules (rules of procedure) of the pre-emptive rights are elaborated by the Board of Directors and are approved by the first general assembly after the company's foundation and following a review of the relevant legal regulations as well as the company statutes.

8.5 After the par value of all the formerly issued shares has been paid, the general assembly can decide to lower or raise the share capital. This decree does not concern the case in which that portion of the share capital raised either wholly or partly is not covered by financial contribution.

8.6.1 In the case of raising the share capital, the shareholders can exercise the right of preemption for the issued shares in proportion to their existing shares. Should any shareholder not wish to exercise his or her right of pre-emption, the right of pre-emption held by other shareholders is valid for his or her shares as well.

8.6.2 The share capital can be raised for the purpose of issuing shares to company employees. The general assembly can decide to raise the share capital only from the net assets exceeding the share capital, and on the condition that newly-issued, registered shares of up to 10 percent of the raised capital can be obtained by company employees. Those employees who, according to the general assembly, are entitled to obtain such shares, can acquire shares for __ percent of the par value or acquire shares free-of-charge.

8.6.3 The announcement for the general assembly meeting which will decide on the raising of share capital must provide information concerning:

8.6.3.1 the motive for raising the share capital, the method of raising the share capital, and the minimum amount;

8.6.3.2 the modifications of the those statutes relating to the raise in share capital;

8.6.3.3 the number, par value, and issuance value of the new shares;

8.6.3.4 if new shares are issued, the rights connected to those shares must be specified, and the modification of rights connected to formerly issued shares must be clarified;

8.6.3.5 in the event that the raise in share capital is done by registration of shares, the opening and closing dates of registration must be specified; and

8.6.3.6 In the event that the raise in share capital is not accomplished through financial contribution, an alternative proposal must be offered.

8.6.4 Upon the registration of new shares stemming from the raise in the share capital, the shareholders must pay the amount determined by the general assembly. This amount cannot be less than 30 percent of the par value. The remaining amount has to be paid within one year following the registration of the new shares.

8.6.5 If the share capital is raised from the net assets exceeding the share capital and the general assembly does not take any further decisions, the shares must be offered without countervalue to the shareholders--in proportion to their shareholdings. A public announcement relating to this transaction must appear twice in major newspapers and must include the place and time of the transaction (as specified in Section 24.2). The transaction must occur within fifteen (15) days of the announcement.

8.7 A reduction in the share capital is possible with the approval of the general assembly, either by exchanging and stamping shares, or by redeeming shares whose par value corresponds to the rate of the reduction in share capital to the appropriate shareholders.

<u>9-14</u> <u>General Assembly</u>

9.1 The company will convene a meeting of the general assembly no later than March 31 of each year. The meeting must be called by the Board of Directors.

9.2 The Board of Directors may call an extraordinary meeting in the event that a decision must be taken exclusively by the Board or if the Board finds it necessary to convene such a meeting. The Board must convene a meeting if the company has lost one-third of its share capital, or if the company is insolvent, ie. assets do not cover liabilities.

9.3 Shareholders representing at least 10 percent of the share capital can ask the Board of Directors to call an extraordinary meeting, provided that the shareholders state their reason and objectives. The Board of Directors is obligated to honor this request.

9.4 The Supervisory Board may call an extraordinary meeting if it judges this action to be in the best interest of the company.

10.1 The time of the general assembly meeting must be publicly announced thirty (30) days prior to the meeting. The bearers of registered shares must be notified of the meeting and invited to attend, as must the members of the Supervisory Board.

10.2 The name and headquarters of the company, and the time, place, and agenda of the general assembly must be included in the announcement. The announcement must include a notice which makes mention of the right to vote of holders of registered shares. The share ownership is certified by registration in the registration book.

Voting rights can be exercised by a representative of the shareholders in the event that the representative has a written authorization to this effect. Shares against which the countervalue has not been paid by the day of the general assembly meeting do not carry a right to vote.

10.3 Shareholders representing 10 percent of the share capital and exercising voting rights may ask the Board of Directors to include any additional item on the agenda, provided it is requested within eight (8) days following the announcement of a general assembly meeting. The Board of Directors must subsequently inform the shareholders of any amendment to the agenda within 8 days of receiving the request. Decisions can be taken on items not included in the agenda provided that all voting shares are represented and that there is unanimous agreement to table the item(s).

10.4 Each share is equal to one vote.

11. Activities under the Exclusive Jurisdiction of the General Assembly:

11.1 Determination and modification of the statutes;

11.2 Reducing and raising the share capital;

11.3 Changes in the rights connected to certain types of shares;

11.4 Decisions concerning the merging of the company with another Rt, the merging of the company into other companies, de-merging, the liquidation of the company, and its transformation into other corporate forms;

11.5 Appointing and recalling members of the Board of Directors, the Supervisory Board (except those appointed by the employees), and auditors, and the determination of their compensation; ensuring that the company makes no claims against the members of the Supervisory Board;

11.6 Handling of the balance sheet and annual profit sharing;

11.7 Issuance of bonds assuming the right of first refusal;

11.8 Decision-making on all questions which fall under the jurisdiction of the general assembly according to legal decrees or to the present Statutes;

12.1 The general assembly has a quorum in the event that at least 50 percent of voting shares is represented by its owners or by other authorized persons.

12.2 If the general assembly does not achieve a quorum, the Board of Directors will call another general assembly meeting within fifteen (15) days and send an announcement in the form of a registered letter to the shareholders. The general assembly can discuss issues included in the agenda for the prior meeting, regardless of the number of persons in attendance.

12.3 At its first convocation, the general assembly will appoint a chairman, a keeper of the minutes, and two witnesses to the minutes.

13.1 The general assembly will make decisions based on a simple majority unless legal requirements necessitate a qualified majority.

13.2 In the case of a voting tie, the chairman casts the deciding vote.

<u>14-17 Board of Directors</u>

14. The Board of Directors will consist of at minimum three (3) members, and at maximum seven (7) members. All are appointed by the general assembly for a period of five (5) years. All members of the Board can be re-elected.

14.1 The first Board of Directors is nominated by the company founder.

15.1 One member of the Board of Directors must be elected or appointed by the General Director.

15.2 The General Director will have full authority to control the activities undertaken by the company in accordance with the guidelines stipulated by the Board of Directors. He or she will ensure the implementation of resolutions approved by the Board of Directors, exercise the employer's rights concerning the employees of the company at his or her discretion, and will retain a general scope of authority regarding company activities.

16. The Board of Directors is obligated to:

16.1 Prepare the company's balance sheet and financial statements and the profit sharing

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plan. The above must be made available to shareholders at the headquarters of the company, as well as delivered to bearers of registered shares;

16.2 Prepare and draft reports on the management, the financial conditions, and the business practices of the company for the annual general assembly meeting;

16.3 Provide for the formal and standard bookkeeping of the company.

17.1 The Board of Directors may meet as deemed necessary, but must convene at least once every six weeks. The General Director must announce the meeting to the members of the Board of Directors by letter, telegram, or telex such that delivery of the announcement occurs at least eight days prior to the meeting. The agenda of the meeting should be included in the announcement. Items not included in the agenda can be discussed at the meeting if all members are present and there is a general agreement to discuss these items.

17.2 The Chairman of the Board is required to call a meeting within fifteen (15) days if any member of the Board of Directors requests to place a new item on the agenda.

17.3 A quorum is achieved if more than 50 percent of the members of the Board of Directors is present. The passing of a resolution will require a simple majority among the members attending. In case of a tie, the General Director's vote is decisive.

17.4 The Board of Directors can pass a resolution without convening a meeting--by means of a letter, telex, telegram, or telefax. The written resolution may be sent by the General Director to the members of the board, and will be considered passed if each member sends a written approval to the Chairman within the following 8 days.

<u>18-24 Supervisory Board</u>

18.1 The supervisory board consists of 3-5 members who are elected for 5 year terms by the general assembly. One member of the supervisory board is elected by the employees. The members of the first supervisory board are nominated by the company founder.

18.2 The supervisory board will supervise the administration of the company. In so doing, the board is allowed to ask the senior officers and the senior employees of the company for reports or information. The supervisory board may review the company books themselves, or alternatively enlist the services of accounting experts.

18.3 The supervisory board is obliged to review all important documents disseminated to the general assembly, and in particular those documents cited in 15.2, the balance sheets, and the asset valuation. Comments on these reports are presented by the supervisory board to the general assembly. The general assembly may pass a resolution concerning a particular issue, provided it is familiar with the appropriate report submitted by the supervisory board.

18.4 The supervisory board will represent the company in a lawsuit against the Board of Directors or one of its members.

18.5 The supervisory board will control and supervise internal company activities (including quality control mechanisms)

19.1 The supervisory board will elect a president from among its members. The assignment will last for 5 years.

19.2 Meetings of the supervisory board are called by the president through letters, telexes, and telefaxes sent in such a manner that notification occurs at least 15 days prior to the meeting. The announcement must include the agenda of the meeting and all documentation concerning items on the agenda.

19.3 The supervisory board is required to convene if at least two members so request and state their motive and objectives for so doing. If the president of the board does not call a meeting within 8 days of the request, those members which made the request have the right to hold a meeting.

19.4 The supervisory board has a quorum if the 3 members are present. Resolutions are passed by simple majority.

20.1 The general assembly will appoint a registered auditor for __ years. The auditor can be re-appointed upon the expiration of his or her assignment. The first auditor will be appointed by the company founder.

20.2 The auditor will be responsible for the review of all reports submitted to the general assembly (in particular the balance sheets and the asset valuations), if they are based on real data and if they meet legal requirements.

20.3 The general assembly can pass a resolution only if it is familiar with the auditor's comments on the given report. If the auditor conveys his or her comments verbally, the comments must be included in the minutes of the meeting.

20.4 In cases defined by legal measures, the auditor is obliged to inform the supervisory board of the pertinent facts and request that a general assembly be convened. If the Board has not called the general assembly together in 15 days, the auditor has the right to convene the meeting himself.

21. The Registration of the Company

The registration of the company may be done by two members of the Board of Directors or by two employees who have authorization to sign, and must include the pre-written, pre-stencilled, or printed name of the company. The General Director will register the company independently.

22. Profit Sharing

A portion of the company's annual profit, specified by the general assembly, must be placed in reserve. The general assembly can direct the placement of no more than __percent of the annual profit into the "dividend fund", to be used for employee remuneration. The leftover sum must be distributed to shareholders as dividends based on each shareholder's stake.

23. Liquidation of the Company

23.1 The company will be considered liquidated if:

23.1.1 The general assembly decides to disband the company by at least a three-fourths majority;
23.1.2 The company is merged into another company, it is disunited, or it is transformed into another corporate form;
23.1.3 The Court of Registration declares the company liquidated;
23.1.4 The Court of Registration terminates the company through a liquidation procedure;

23.2 The liquidation or final settlement is performed by the Board of Directors, unless otherwise specified by the Court of Registration. The Board of Directors is responsible for the final settlement.

24. Miscellaneous

24.1 The first fiscal (business) year of the company will begin on the day in which the Statutes have been accepted by the founding general assembly. The first fiscal year will terminate at the end of that calendar year. Subsequent fiscal years will begin and end with calendar years.

24.2 Company announcements are to be published in the "Heti Vilaggazdasag" ("Weekly Business Review), unless a legal measure mandates publication in the Company

Bulletin.

24.3 All questions not regulated in these statutes are to be addressed according to the VI Decree (law), 1988, concerning economic associations and companies.

Date

Countersignatory

The State Property Agency
Founder

Prepared by:
Dr. Gyôzô Ovári
Attorney-at-Law
189 sz. Ugvédi Iroda
1055 Budapest, Kossuth Lajos Tér, 11

TERMS OF INCORPORATION

The State Property Agency (SPA)--as founder--has decided on the establishment of a Rt. All shares are to be given to the SPA, according to the provisions described here.

1. The name of the Rt. to be established: Monor Agrar Ipari Rt.

   The company's name in English: Monor Agro-Industries, Inc.

   The company is the legal successor to the Monor State Farm (2Cj.50.035/1989/2)

2. Company headquarters: 2201 Monor
   Ady Endre utca, 62.

3. Scope of Company Activities:

   3111 Agricultural production
   3121 Agricultural services
   3211 Forestry production
   1411 Machinery production
   1422 Maintenance/repair of vehicles
   1914 Canning industry
   1915 Milling industry
   1918 Confectionery industry
   1922 Wine production
   2113 Miscellaneous surface construction
   8471 Other activities related to education
   2121 Road, railway, bridge construction
   7221 Other activities relating to materials
   5131 Wholesale food trade
   5151 Catering trade
   5211 Trading of external commodities, technical, and intellectual products and services
   5141 Food retail trade
   5146 Retail trade of miscellaneous activities
   1916 Baking and pasta industry
   1919 Vegetable oil industry
   4171 Garage/maintenance activities
   1931 Food industry research and development
   4179 Other transport services

4. The company is established for an indefinite period of time.

5. Share capital: The value of the company share capital: HF 642 million. This consists of 492,200 registered shares at a par value of HF 10,000 each for a total of HF 492 million (first type of shares), and 15,000 shares at a par value of HF 10,000 each for a total of HF 150 million. These are unlimited, preferred shares and carry a preferred entitlement to a 10 percent dividend for three fiscal years (second type of shares).

6.1 The State Property Agency undertakes to take over all shares of the company.

6.2 The State Property Agency will sell 15,000 of the second type of shares indicated in article 5 to company em·loyees within fifteen (15) following the company's registration. The terms of this purchase and sale are determined in a separate agreement provided for this purpose (Annex C 6.1.a-f)

7. Balance of the countervalue of shares:

7.1 The contribution of the State Property Agency as the founder (headquarters: 6 Vigado Ter, 1051 Budapest) is HF 713 million, according to the company balance sheet certified by an auditor. The State Property Agency accepts--in accordance with the valuation of the auditor--the amount of HF 713 million as its contribution as founder. The balance sheet is an inseparable part of the Terms of Incorporation, and is attached to the document (ie. Terms of Incorporation) as annex no. . The HF 713 million were contributed from their own assets by the SPA, which is the company founder, in order to raise an equity capital of HF 642 million, and an accumulated capital of HF 71 million, which is the balance of the total sum and the equity capital.

The company's own assets, presented in Annex F, were evaluated by Agrar Bross. The valuation contains the book value of the assets taken into the company by the State Property Agency as well as the asset value according to the technical evaluation. The amount of the non-financial contribution was evaluated and accepted by _____ .

The croplands and forests to be purchased by the Rt from the State of Hungary (owner) do not constitute a part of the property of the company. Consequently, they are not included in the value of the contribution. The Rt will purchase the above-mentioned croplands and forests from the State of Hungary on the basis of the contract, which forms an inseparable part of the Terms of Incorporation.

7.2 The entire property of the legal predecessor is due to the Rt from this day and the Rt will bear the corresponding burdens from this day forward. The cancellation of credits will occur on the day of the company's registration.

8. The founder determines the statutes of the Rt in the enclosed document. The Terms

of Incorporation form an inseparable part of the statutes.

9. The founder appoints the following members to the Board of Directors for a period of five (5) years.

10. The following persons are appointed to the Supervisory Board for a period of five (5) years:

    One member of the Supervisory Board will be appointed by the company employees.

11. The founder appoints ____ as auditor for a period of ____ years.

12. The founder declares that the present company is established in the interest of the implementation of the company's transformation and privatization. The decision to transform and the privatize the company was made by the Enterprise Council with full approval from company employees.

    As a consequence of the above, the founder assumes the irrevocable obligation to exercise its full ownership rights--in accordance with prevailing legal decrees--in the general meeting of the Rt as established on the basis of the present Statutes and Terms of Incorporation in a manner that exclusively serves the purposes of transformation and privatization. The transformation and privatization plan is approved by the Board of Directors of the State Property Agency. This plan is an inseparable part of the present documentation.

13. The founder declares its renunciation of the right to breach or otherwise not fulfill its obligations to this present contract on a unilateral basis.

____
Date

____
Countersignatory

____
State Property Agency
Founder

Prepared by:
Dr. Gyôzô Ovári
Attorney-at-Law
189 sz. Ugyvédi Iroda
1055 Budapest, Kossuth Lajos Tér, 11.

Annex B

INSTALLMENT CONTRACT FOR DEED TO MONOR STATE FARM LAND ASSETS

Concluded by the parties defined in the first section. The parties agree to the following:

I. The Parties' Legal Status

1. The Ministry of Agriculture (hereinafter "seller") is aware of Monor State Farm's transformation into a single entity Rt (public company). The seller is ready to exercise the ownership rights of the state on the basis of the Law I (1987), article 18, section 1, paragraph b, and sell the agricultural land defined with specific data in Annex 1 of this agreement to the association defined in the second paragraph of this contract.

2. Monor Agro-Industries, Inc., as legal successor to Monor State farm (hereinafter "buyer"), is prepared to purchase the croplands specified in the Annex from the seller. It is understood that the seller or another body directly assigned by the seller is the representative of the Hungarian state.

   The signatory of the contract is the General Director of Monor State Farm. He is authorized to sign the contract by Law XIII, article 24, section 1 (1988).

3. It is understood by the parties that Monor Agro-Industries, Inc., upon its establishment, will be completely owned by the State Property Agency (SPA). The present agreement will therefore enter into force with the approval of the State Property Agency.

II. The Subject of the Contract

1. The croplands defined in the annex to this contract, along with movable and fixed assets, non-harvested crops, plants, and forestry, all of which is owned by the State of Hungary, are to be sold by the seller and purchased by the buyer.

2. The seller and buyer agree that the seller will retain his ownership right to the land--on the basis of the Civil Code, article 368, paragraph 1--until the buyer has paid the purchase price, defined in the contract, to the seller, or until the parties conclude another agreement.

3. Excluding the transfer of ownership title, the seller is to transfer all usual rights/guarantees due to him according to the purchase agreement.

The buyer declares that he is aware of the state of the croplands and that he will not raise an objection over the quality of those lands.

4. The parties are aware of the fact that the croplands carry certain mortgage rights (as defined in Annex No. 2) of the agreement on the land.

The parties state that, if the owners of the right to mortgage wish to exercise their legal rights during the period of this contract, both seller and buyer will make all necessary arrangements for the owners of the right to mortgage.

III. Terms of Payment

1. The parties mutually agree that the value of the land according to the enclosed experts' valuation is HF___ million at the time that this contract is concluded. The parties agree that this is the price to be paid by the buyer to the seller under the contract.

2. The parties mutually agree that, on the basis of paragraph 1:

   The value of 1 hectare of land is ___ forint on the average;
   The value of 1 gold crown of land is ___ forint on the average;
   The value of 1 ple of land is ___ forint on the average.

   The parties agree to assess their liabilities resulting from the present agreement according to the above values, independently from the real value of the particular land(s) which remain beyond the application of this contract for whatever reason (eg. compensation)

3 It is understood by both the buyer and the seller that this contract will remain in force for the period of thirty (30) days beginning from the date the contract is signed by the parties and ending on December 31 of the thirtieth year from the date the contract is signed. The parties also agree that the only two events which alter the term of the contract are: 1) default as set out in Section VI of this contract; or 2) pre-payment by the buyer of the remaining principal due under the contract as stipulated in paragraph III.3.c of this contract.

   a. The parties have agreed to HF___ as the entire purchase price of the land, buildings, and other improvements in possession of Monor State Farm at the time of the signing of this agreement, and so listed and described in Annex 1 of this contract. The buyer agrees and the seller accepts that the entirety of the purchase price be paid in equal, annual installments. The first such installment is due and payable one year after the signing of this contract. The last such payment will be made on December 31 of the thirtieth year of this contract, unless, of course, the buyer executes his option rights to pre-pay the entirety of the amount of this contract under his option for pre-payment. The seller agrees that when the buyer has made the last principal payment or has paid in full the value of this contract, the seller should surrender good and merchandisable title in the form of a deeds or other appropriate conveyances to the buyer simultaneously with the receipt of payment.

b. The buyer agrees and the seller accepts that for the first five years of this contract the seller grants a moratorium on interest payments and interest on the unpaid balance will begin five years from the date of the signing of this contract. The buyer agrees to pay ___rate of interest on the unpaid principal balance of this contract in annual installments due and payable to the seller under the same conditions and jointly with the principal payments. The parties agree that interest will be paid at the rate of __ on the unpaid balance again beginning at the end of the fifth year and until the entire principal balance has been paid.

c. The seller agrees that the buyer has the right to pre-pay the entire principal amount due and payable to the seller at any time during the life of this contract. If the buyer elects for pre-payment the seller agrees to deliver good and merchandisable title to the property at the time that the payment is made. The only condition to the buyer's right of pre-payment is that the buyer must guarantee that he has met all requirements stemming from the Compensation Law (XXV Law, 1991) in accordance with the regulations specified in the Sections IV and V of this contract.

d. The seller agrees that under conditions of Force Majeure (Acts of God), ie. drought, inundation, hail, or other natural acts that prevent the buyer from obtaining reasonable production from croplands, thus depriving the buyer of income sufficient to meet his annual obligation of the terms of payment set forth in this contract, that the buyer may elect not to pay the annual payment of both interest and principal due, during the year, to occurrences of Force Majeure (Acts of God). The parties agree that the entire sum of both interest and principal will be added to the remaining principal amount of this contract and will be subject to the same amortization as the previous remaining balance, and will thus be paid over the remaining life of the contract.

IV. Other Rights and Liabilities of the Contractors

1. The buyer will become the owner of the land on the day this contract enters into force. From that day onward, the buyer will be entitled to the profit from the land,

and will assume all related liabilities (eg. taxes).

The buyer alone will bear losses stemming from compensation.

2. The buyer will be obligated to utilize the land properly. The buyer is obligated to meet all liabilities stemming from the use of the land, including measures that involve changes in the use of the land and withdrawal from cultivation.

3. If, as a consequence of any legal procedure, the buyer is deprived of use of the land either temporarily or permanently, the buyer is, under this contract, due all compensation and other benefits otherwise due to the owner (eg. compensation law, expropriation)

4. The buyer will assume all burdens and responsibilities connected to the land to which he--as the owner--has a legal obligation.

5. According to legal regulations, until the buyer has obtained title to ownership, the land can be sold or mortgage can be raised only with the permission of the seller.

   a. The seller hereby gives his permission to the buyer to transfer the buyer's rights stemming from the present contract to third parties. It is understood, however, that the buyer, in this event, is not relieved of his responsibility/liability to the owner.

   b. The seller hereby gives his permission to the buyer to transfer ownership of contiguous, detached lands to any third party provided that the liabilities stemming from the lands in question are paid in full by the buyer.

6. The buyer must employ good husbandry practices on the lands.

The parties agree that the buyer has the right to undertake developments relating to the proper use of the land. The seller will, for this purpose, provide all necessary aid, but will not assume responsibility for the success of these undertakings.

V. Regulations Concerning Compensation

1. The parties are fully aware that a portion of the lands connected to this contract is subject to compensation in kind for private persons under Law XXV (1991). The parties also understand that, at the time this contract is signed, the amount of hectares subject to this provision is not known.

As concerns the above paragraph, the buyer states that he is willing to meet all liabilities that would have fallen to Monor State Farm and will bear all related expenses that would have fallen to Monor State Farm.

2. The seller states that, in complying with the provisions in Section 1 above, he transfers all rights and (asset) advantages which, according to the relevant legal decrees, redound to the administrator of the land.

3. The parties agree that installments paid on lands to be subject to compensation remain outside the purview of this agreement, and must be credited to the payment of remaining installments.

4. The parties state that this Section is approved and signed with the full knowledge of the extent of compensation.

   In the event that the (compensation law) changes before the fulfillment of the contract, and to the extent that these changes cause further and severe burdens for the buyer, the buyer will have the right to address this section of the contract according to present legal regulations, or withdraw his obligation to this section.

VI. Procedure in Case of Default on the Contract

1. If the buyer does not fulfill his liabilities undertaken in this contract, or does not fulfill other provisions in the contract (eg. payment deadlines), the seller is entitled to send a formal request to the buyer demanding fulfillment of these obligations.

   The request must be sent by registered mail, and must specify the liabilities of the buyer and provide a deadline for fulfillment of those liabilities.

2. If the buyer still does not meet his liabilities following the submission of a formal request by the seller, the seller is entitled to claim the principal and the interest, and all other unpaid expenses which, according to the contract, are due to the seller.

   It is possible for the seller to exercise this right on only a portion of the lands.

3. The seller agrees that, in the event that he is unable for whatever reason to fulfill the seller's obligations to the buyer, as set forth in this contract, the seller agrees to compensate the buyer, notwithstanding any future decrees or laws, by returning to the buyer the full amount of interest and principal paid up to the date of the seller's default. In addition, the seller agrees to pay compensation penalty of 200 percent of the total principal paid to-date by the buyer, or the net difference between the fair market value of the land as determined by licensed appraisals, and the amount of interest and principal paid by the buyer--whichever of the two is greater. Furthermore, in the event of default, the seller agrees to provide the buyer with two years' occupancy before relinquishing control of the assets subject to this contract.

VII. Registration

The seller gives his absolute and irrevocable consent that the buyer's rights resulting from the contract be registered according to valid regulations. The registration must be done on the day in which the contract enters into force.

VIII. Other Conditions of this Contract

The parties state that the contract will become valid on the day in which the appropriate representatives of either party sign the contract.

The regulations of the contract will be enforceable from the day that Monor Rt is registered.

In the event that this registration does not occur, this contract will cease to have effect.

Annex C

MONOR-SPA AGREEMENT ON EMPLOYEE SHARE OWNERSHIP PLAN

Between: Monor State Farm
2200 Monor, Ady Endre u. 62
Henceforth: "Company"

-and-

State Property Agency
1051 Budapest, Vigado u. 6
Henceforth: "SPA"

1. The subject of this contract is the transformation plan submitted by the company on ____, 1991.

2. With the approval of the SPA on ___, 1991, the company is transformed into a Rt <u>by exclusive establishment</u> and under the following conditions and main indicators:

   a) Founder: State Property Agency
   b) The value of the company assets according to the company balance sheet on ____, 1991 is HF 713 million, ie. seven-hundred and thirteen million forints, of which HF 642 million, ie. six-hundred and forty-two million forints the SPA, as founder, contributes to the property of the company as the share value.
   c) The difference between share capital and the value of capital according to the balance sheet will be registered as accumulated capital.
   d) The contractors agree that any changes in the share capital dating from , 1991 until the establishment of the company on ____, 1991, will be registered as assets in excess of the share capital of the company.
   e) Upon transformation, those shares representing the share capital of the company are transferred into the ownership of the SPA. The shares are worth HF 642 million from which the SPA - after the company has been registered - gives the local governments a certain amount of shares the par value of which equals to the value of inner lands.

3. The SPA authorizes the Board of Directors that after the company has been registered, the accumulated capital brought into the company by the SPA can be transformed into share capital, and that from that capital, the company can issue shares for its employees in the par value up to 10 percent of the share capital, at a purchase price that equals to 10 % of the par value, according to the Company Act, section 244. The employees are entitled to pay the purchase price according to the general rules of the Company Act (30 percent upon purchase and the arrears can be

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paid free of interest within one year). The SPA approves the issuance of 7,100 employee shares for the employees of the company, at a par value of HF 10,000 each.

4. The SPA agrees to allow creditors of the company to exchange company debts for property - at not more than par value - in the form of raising the share capital of the company and in the form of issuing and overtaking shares at par value.

5. The SPA approves outside investment (domestic and expatriate) of HF 194 million in the form of raised share capital and the issuance of new shares. The issue price of these shares can not be lower than par par value.

6. The SPA authorizes the board of directors to enter into legal transactions mentioned in " 4." and "5." on behalf of the SPA , with respect to the conditions prescribed in "4." and "5.".

7. Within the framework of selling SPA shares, the SPA agrees that:

7.1 the employees of the company may purchase shares - at a preferential price- from the share capital of the company at par value for HF 150 million according to the decrees found in the Property Policy Guidelines.

The purchase price of shares--in the case of immediate payment--is discounted by 50 percent, ie. HF 75 million. The terms of preferential purchase are determined by the SPA and are as follows:

a) The SPA, exercising its rights stated in the Property Policy Guidelines, gives a discounted price and a three-year installment payment preference through the following: the discounted price of the interest connected to the installment payment is calculated against the 50 percent discount. In calculating the discount rate the interest rate of the refinancing credit of the Hungarian National Bank (HNB) is determined according to the anticipation of the HNB.

b) Upon the signing of this contract, the purchasers are obligated to pay one fourth of the purchase price (75,000,000 HF) and that of the amount of interests calculated for the three-year-period of installment payment. This amount has to be paid as the first installment of the purchase price to the revenue account of the SPA: HNB 232-09107-8024, and its name is "Selling state property on own effort".The remainder of the purchase price together with its interests will be paid through March 31, 1995, in three equal installments following the annual payment of dividends.

c) It is the responsibility of the Board of Directors to provide for the

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e) It is the responsibility of the Board of Directors to provide for the organization and arrangement of the sale, including the installment payments.

f) The total value of the share package is HF 150 million, which consists of 15,000 registered shares at HF 10,000 each, with a 10 percent dividend preference for three full fiscal years. These shares will be exchanged for registered, non-limited shares following the end of the third fiscal year, ie. fiscal year 1995.

The company employees declare their intention to purchase shares in a declaration of intention. The detailed terms of the sale are defined in the draft contract of purchase and sale attached to the Terms of Incorporation.

6.2 The SPA agrees that outside investors, defined in point 5, may purchase shares totalling HF 357 million on their par value from the SPA. In accordance with the Transformation Law, the SPA will return 20 percent of the purchase price to the company.

7. When selling its remaining shares, the SPA retains a share package of HF 107 million (equal to 9 percent of the share capital), to be used within the framework of the Employee Stock Ownership Plan (ESOP).

The interested parties must declare their claims to the SPA in a legally mandated form within six months following the legal decree concerning ESOPs. Within six months after the lodging of claims by interested parties to the SPA, the interested parties may exercise their optional rights in accordance with the criteria indicated in the legal decree. The participants of ESOP provide for the joint arrangement of the sale through a representative in an organized manner.

8. The SPA, as the founder, approves the enforcement of the rights of foundation, determined in the Terms of Incorporation, the execution of which must be provided by the Board of Directors of the Rt.

Questions which are not regulated in this contract are to be decided in accordance with the Terms of Incorporation and other relevant laws and decrees.

Budapest, ______, 1991.

Monor State Farm Representative	State Property Agency Representative

ASSET VALUATION REVIEW

In valuing the assets of Monor, Agrar Bross applied the depreciated replacement cost method. This method assumes that all assets are employed productively in the business to generate income. Our advisors from Coopers & Lybrand and Chemonics have indicated that, based on their review of the Agrar Bross valuation, it is highly unlikely that the values arrived at by Agrar Bross are indicative of the real market value of the assets or, for that matter, of the proceeds to be realized in an actual transaction assuming the sale of Monor as a business. The reason for this is that although Agrar Bross' analysis may be technically correct based on its methodology, investors will evaluate an investment in Monor as an investment in a business and not as an investment in a collection of individual assets. Since many of Monor's assets are currently not in use, the technology that those assets represent is antiquated and not efficient, and the state of repair of such assets is such that an item will most likely be replaced by a new one for economic reasons, investors should not be expected to pay the depreciated replacement cost for these assets as represented in the valuation.

In addition, investors will analyze trends in sales and earnings in determining an offering price for Monor. Given the deterioration in Monor's sales and earnings due to the collapse of trade with the CMEA, it will be difficult to convince an investor to pay a price in excess of the value of the land and productive assets invested in Monor.

Agrar Bross has suggested that a discount factor of 22 percent be applied to the asset valuation to adjust for the above considerations. Both Coopers & Lybrand and Chemonics have indicated that this discount factor may in fact be too low, and that the true test will be the buyers' offering price and subsequent negotiations to establish a market value that is appropriate and realistic. Therefore, we suggest that when the State Property Agency undertakes its review of the asset valuation, it take the above into account and be flexible in negotiations with potential buyers since, in fact, the market may not agree and the real value of assets such as farm machinery, some buildings and equipment, and accounts receivable may be considerably less than the figures used in the closing balance sheet.

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