

# **SEAF Quarterly Report for the period ended June 30<sup>th</sup>, 2005**

**(Covering USAID Award Number: 116-A-00-01-00033-00)**

**SEAF Central Asia**

**July 29<sup>th</sup>, 2005**

## **I. Introduction**

**This report covers SEAF's activities in the region during the past three months and ends with the third anniversary of CASEF's incorporation and the start of operations in July of 2002.**

**It has been a busy period made all the more so by the on-going developments in Kyrgyzia and the unfortunate events in Andijon.**

**There have been no new investments approved or any changes to staff.**

**The major development during the period was the official signing with the National Innovation Fund of Kazakhstan (NIF) of their investment in CASEF. This took place in Almaty on April 15<sup>th</sup>, and will be described in more detail later in the report.**

**As SEAF/CASEF complete three year's of activities in Central Asia it is time to take note of the fact that CASEF's investment period is now more than half over. With five confirmed investments to-date and more than 50% of CASEF's capital still uncommitted, it is necessary to increase the pace and do more deals. This will be a key issue for CASEF's board to review and discuss when they next meet in Bukhara on October 4<sup>th</sup>.**

## **II. Activities to-date**

**SEAF's activities during the past quarter were largely centered on: (i) working with the portfolio companies (PCs); (ii) completing the procedural requirements for the participation of the NIF; (iii) conducting due diligence on potential new investments; and (iv) interacting with the ICD and USAID on procedural matters and in the case of the former, disbursements for two of the PCs.**

**Considerable attention was centered on Kazakhstan, largely dealing with the following:**

- Siaband Fuel Storage Company where CASEF has disbursed \$568,000 and where we are working to complete the documentation for disbursement of the approved ICD credit.**
- The investment of the Kazakh National Innovation Fund (NIF) in CASEF. As mentioned earlier, the official signing took place on April 15<sup>th</sup>, whereby the NIF committed to invest \$2,058,000 in newly created special shares of CASEF. This is a significant development in that it unlocks further investments from both Seco and the IFC. With this CASEF's committed capital is almost \$11.0 million. The NIF has also confirmed its interest in making an additional investment of approximately \$6.7 million in CASEF, bringing their total commitment to \$8.8 million or 49%. This second**

commitment is currently being processed and we expect it to be ratified and confirmed by September 30<sup>th</sup>, 2005. This will bring CASEF's total committed capital to almost \$17.0 million, which when added to the ICD Facility, raises the total of available investment capital to more than \$22.0 million. As mention in the introduction CASEF's investment period is already in year four and it will be necessary to significantly accelerate the pace of investment approvals and disbursements.

- **Preparation for the expansion of SEAF/CASEF's activities in western Kazakhstan.** These continue as more time and resources are dedicated to this initiative.
- **Processing and due diligence in connection with the proposed investment in the Swiss Technology Center (Almaty).** The investment of \$1.5 million will be a combination of equity and debt with closure expected prior to September 30<sup>th</sup>.

From Almaty SEAF also monitors activities in neighboring Kyrgyzstan where most attention is centered on the El Gas LPG Distribution Company. Since the last report, considerable progress has been made in resolving the sourcing of raw material and in planning for El Gas's expansion. Sites have been acquired and the documentation for the ICD credit facility is also being prepared. Another interesting development is El Gas's proposed expansion in southern Kyrgyzia where the company is looking to lease a storage distribution center in Djilal-Abad.

In Uzbekistan, SEAF's activities have largely been centered on consolidating CASEF's ownership of Business Leasing and in dealing with Semurg Estates after the fallout from what happened in Andijon on May 13<sup>th</sup>. As was noted in the last report, the Uzbek troops did have orders to shoot and the slaughter in Andijon resulted in close to one thousand local civilians being killed. There is no evidence of terrorist involvement and the government's refusal to allow a real investigation is tantamount to a confession of the alleged massacre.

Subsequent to the shootings in Andijon, many of the foreign embassies in Tashkent declared a high state of emergency and evacuated all non-essential personnel and dependents. This caused the tour operators to cancel all bookings and the Semurg hotel in Bukhara saw its occupancy rate drop from 75% to less than 3%. This unexpected development came within two months of the hotel's opening and has caused major disruptions to the cashflow and ability of Semurg to deal with its financial obligations. As Semurg's local partners are also experiencing similar problems with the Grand Orzu Hotel in Tashkent, their ability to service their obligations has been severely reduced. Compounding their problem is a real estate project they are in the process of developing in Gazalkent, a small town in the foothills of the mountains some sixty kilometers from Tashkent. The combined obligations are more than they can service and it's up to CASEF to provide the required funding for Semurg. This is in process and it calls for approximately

**\$155,000 of added commitment and a dilution of the local partner's holding. In the meantime, and during the past quarter, SEAF staff was directly involved in monitoring the financial activities of the hotel. This has taken considerable effort and is likely to increase in the future as CASEF's ownership increases from the current 52%.**

**As previously reported, with the closure of Business Bank it was decided that CASEF should buy the banks outstanding shares in Business Leasing and increase its ownership to 100%. This has been done and Business Leasing is now directly subordinated to SEAF's management oversight. While there have been delays in getting Business Leasing's frozen accounts released by the banks liquidation committee, the process is proceeding and should be resolved shortly. The delay is apparently caused by the lack of liquidity in the marketplace and the unexpected difficulty the liquidators are experiencing in getting paid for the assets being sold. There is no lack of assets and/or collateral, merely a lack of liquidity. SEAF is closely monitoring the situation and is in regular contact with the chairman of the liquidation committee. Given the pipeline of potential lessee's, Business Leasing is looking to obtain credit facilities from several sources including the IFC's recently announced "Leasing facility for Central Asia". As mentioned in the past, SEAF's strategy is to merge Business Leasing with and/or into a commercial bank in order to create a larger more diversified financial services group. Efforts in this respect are continuing.**

**CASEF's third PC in Uzbekistan is the Aqua Tudakul Fish Farming and Processing Company that is located in Navoi. Following a slower than expected start the second quarter was not good and significant losses were incurred. SEAF is assessing the reasons for the losses but it appears they are the result of: (i) the ban on fishing that takes place from April 15<sup>th</sup> through the end of May; (ii) lower than expected prices for fresh fish; (iii) higher than expected costs for fuel, net repairs and boat maintenance; and (iv) agricultural activities that may or may not be relevant. Prospects for the balance of the year are good given the fact that the fish resource in Lake Tudakul is proving to be better than expected, and the company's plan to concentrate sales in the fourth quarter when prices are twice today's, should allow the company to end the year with a reasonable profit. It is still expected that the company will catch and sell 700 tons of fish. At an average price of \$1.00 per kilo that represents \$700,000 in total revenues. With costs budgeted at a monthly average of \$30,000, the potential profit before taxes and depreciation should be at least \$300,000. CASEF's local partner who had previously indicated that he was disinterested in having CASEF disburse the balance of its commitment has relented and now says he wants the remaining equity commitment of \$257,000 to use towards improvements and more machinery and equipment. Before agreeing to any further use of funds SEAF will conduct a new assessment in order to determine what conditions and/or requirements should be imposed.**

**From Tashkent SEAF oversees Tajikistan and the proposed cotton gin project in Khojand. Unfortunately, there is nothing positive to report in that after expressing**

great interest the EBRD has withdrawn and the project is now in search of a funding source. The Australian owners of Sydney-Khojand remain committed as do the local farmers, but Tom Bryant has suffered further reversals in Uzbekistan and may not be interested, and the Giovanni interest seems to be waning. SEAF continues to collaborate closely with the sponsors but the prospects for the project are not encouraging. An effort is being made to interest the ADB and we are waiting to see the results.

As southern Tajikistan is more readily accessible from Almaty, SEAF may shift coverage as SEAF's presence and staffing in Kazakhstan increases.

SEAF's regional management is in regular contact with USAID both in Almaty and Tashkent; however, there has been no indication that any further TA funding might be available. The best hope is for USAID to fund some of the cost of the SEAF/NIF training session that is planned for the week of September 26<sup>th</sup>, 2005.

The pipeline of potential investment opportunities is quite robust insofar as Kazakhstan and Uzbekistan. A copy of the list of deals is attached to this report.

### **III. Staffing**

As reported earlier, there have been no changes and/or additions.

### **IV. Country Reports**

Polarization in the region continues with Kazakhstan showing all of the signs of a regional leader whereas Uzbekistan seems to be returning to its prior alliances and policies.

Foreign direct investment in Kazakhstan continues unabated in all sectors of the economy. Kazakh companies are looking to list on the exchanges in London and/or New York, and there is every reason to believe that the economy will continue to benefit from the high demand for oil & gas, minerals and agricultural commodities.

With the election of Kurmanbek Bakiev in Kyrgyzia things should stabilize. Discussions and rumors as to the future of the US base have hopefully been dispelled with Secretary Rumsfeld's visit and it is hoped business will return to normal.

Tajikistan seems to be the regional "darling" of the donor community and the economy is doing quite well. How much of the increase is due to the growing drug trade remains to be seen, but for the time being the country is peaceful and enjoying increased growth and prosperity.

In Uzbekistan the Andijon incident has accelerated a reversal of relationships and a closing of the window to the west. Preferred investors are now from Russia and

**China is the new trading partner. It is unfortunate, in that a return to past policies means less reform and little or no constructive change.**

**V. Future Activities**

**SEAF's priorities for the current quarter are:**

- **Consolidation of the relationship with the NIF and rapid implementation of a more aggressive investment program in Kazakhstan.**
- **Continued work with the ICD to initiate use of the CASEF Facility.**
- **Continued hand-holding with Siaband and El Gas insofar as implementation of their expansion programs.**
- **Closer managerial involvement in the day-to-day activities of Business Leasing and Semurg Estates.**
- **Detailed oversight of Aqua Tudakul and a careful assessment of what's needed to assure that this year's profitability targets are met.**
- **Resolution of the proposed cotton gin in Tajikistan.**
- **Realization of the scheduled training session in Almaty during the last week of September.**

**SEAF  
Tashkent, Uzbekistan  
July 29<sup>th</sup>, 2005**

**SEAF Central Asia Small Enterprise Fund (CASEF)**

**SUMMARY of CURRENT PROJECTS as of July 29, 2005**

**Total Current Projects Under Consideration: 13**

<b>Project</b>	<b>Starting Date</b>	<b>Industry</b>	<b>Status</b>	<b>Potential CASEF Investment</b>	<b>Probable Total Investment</b>	<b>Comments</b>
<b>Stages 2/3/4</b>						
<b><u>Uzbekistan</u></b>						
Asian Stone Holdings	Feb 04	Building Materials	Stage 3	\$1,000,000	\$1,000,000	As mentioned in the last report this project has lost momentum and will be deferred from active consideration. The concept remains valid but it requires a manager/entrepreneur capable of working in several of the Central Asian republics that also knows and appreciates the need for proper management, financial controls and marketing.
Pharmaceutical Packaging/distribution	December 04	Pharmaceutical processing and distribution	Stage 2	\$300,000	\$600,000	Proposed joint venture with local and Chinese investors to acquire an existing pharmaceutical facility that would be restructured to concentrate on the importation of generic compounds that would be processed/ packaged and distributed throughout Uzbekistan.
Shoe Factory	July 04	Athletic shoe production	Stage 2	\$250,000	\$500,000	Proposed joint venture with local and Chinese investors to establish a facility to manufacture athletic shoes for children.
Medical Cotton	December 04	Processing of Medical Cotton	Stage 2	TBD	TBD	Project has gone dormant and will be dropped.
Commercial Property Development	November 04	Commercial Real Estate	Stage 2	TBD	TBD	Project has gone dormant and will be dropped.
Commercial Bank	August 04	Commercial Banking	Stage 3	\$1,000,000	TBD	Proposed investment in a local commercial bank. The IRC approved an investment of \$1.0 million in Business Bank and the EBRD was going to also invest an additional \$2.5 million. With no advance warning and without proper justification the bank had its license cancelled and is being liquidated. CASEF's investment has been cancelled and a suitable alternative is being sought.

<b><u>Kazakhstan</u></b>						
Commercial Leasing Company	April 04	Financial Services	Deferred	\$800,000	\$2,400,000	Proposed joint venture with international commercial bank and the ICD to establish a new commercial leasing company. Project has been deferred due to uncertain status of local partner; search for alternative partners has begun.
Swiss Tech Center	January 04	Commercial Real Estate	Stage 4	\$1,500,000	\$2,500,000	Early-stage joint venture with locally based Swiss entrepreneur to purchase and refit a commercial building in Almaty that would be largely pre-leased to Swiss companies. Final negotiations are being held with partner, expected to close in Q3 2005.
Oil Field Logistics Base/Training Facility	October 04	Industrial warehousing; services and storage	Stage 2	\$1,000,000	\$1,500,000	Greenfield joint venture with local Kazakh partners to establish logistics warehouse and technical training center in Aktau. Company would provide storage facilities and would serve as the operational base for training, office, and product distribution.
Regional Logistics & Distribution	May 05	Distribution and Logistics	Stage 1	TBD	TBD	Discussions ongoing with Kazakh partner; proposal in draft stage for presentation to Moscow affiliate of US –based IT manufacturer. Local training and regional distribution.
Battery Company	April 05	Alternative Energy	Stage 1	\$1,500,000	\$4,000,000	Expansion/technical improvement of locally owned commercial battery manufacturer supplying OEM and replacement markets in Kazakhstan, China and Russia. Letter of intent, jointly with the BankTuronAlem “Araket” Fund presented to the Company on July 19; awaiting response.
Caspian Airlines	July 05	Commercial airline	Stage 2	TBD	TBD	Re-activation of regional airline handling both passengers and cargo. Primary service would be within western Kazakhstan with scheduled flights to Baku and Tashkent.
<b><u>Kyrgyzstan</u></b>						
Micro finance institution	July 04	Financial Services	Stage 2	\$1,000,000	\$3,000,000	Market assessment completed to determine future prospects for conversion of Kyrgyzstan’s three largest micro finance institutions into private commercial entities. Serious interest exists on behalf of all target MFIs. Commercial banks in Kazakhstan and international investors have also expressed serious interest. Uses of financing including additional internal infrastructure support, increased capitalization to expand loan portfolios,

						and technical training. Excellent exit potential.
Retail Supermarkets	May 05	Retail Sales	Stage 2	\$1,000,000	\$4,000,000	Investment in the expansion of an existing supermarket chain that also has wholesale distribution.
<b><u>Tajikistan</u></b>						
Tajik Cotton Gin	June 03	Cotton processing	Stage 4	\$400,000	\$2,700,000	This is the continuation of the once approved cotton gin project. The project is still under active consideration and new sponsors have joined, but the term funding is not yet committed and final closure is unsure.

## Central Asia Small Enterprise Fund (CASEF)

### Summary of Approved Investments as of July 29<sup>th</sup>, 2005

Name	Date Approved	Approved Investment			Current Outstanding	Description
		Equity	Debt	Total Approved		
<i>Kazakhstan</i>						
KSS	July, 2004	\$600,000	\$200,000	\$800,000		Commercial catering company. Proposed investment deferred.
Siaband	July, 2004	\$568,000	\$242,000	\$810,000	\$568,000	Fuel depot and distribution company
<i>Kyrgyzstan</i>						
Caindy El Gas LPG	March, 2004	\$500,000	\$200,000	\$700,000	\$500,000	Storage and distribution of LPG
<i>Tajikistan</i>						
EBUS Cotton Gin	May, 2004	\$310,000	\$400,000	\$710,000		Cotton gin. Approval has expired and a new proposal must be submitted.
<i>Uzbekistan</i>						
Aqua Tudakul	September, 2003	\$490,000	\$310,000	\$800,000	\$232,290	Fish hatchery/incubator with grow-out facilities and commercial fishing/processing.
Business Leasing	December, 2003	\$1,202,469		\$1,202,469	\$1,196,712	Commercial leasing
Semurg Estates	September, 2003	\$260,000	\$640,000	\$900,000	\$900,000	Hotel ownership company
<b>Total</b>		<b>\$3,930,469</b>	<b>\$1,992,000</b>	<b>\$5,922,469</b>	<b>\$3,397,002</b>	