



**BULGARIAN  
AMERICAN  
ENTERPRISE  
FUND**

# 1996



**ANNUAL  
REPORT**

**T**he Bulgarian-American Enterprise Fund ("BAEF" or the "Fund") is a private U.S. corporation established to promote the development of free enterprise and entrepreneurship in Bulgaria. The Fund was created by the U.S. Congress through the Support for East European Democracy (SEED) Act, which authorizes the U.S. government to disburse up to \$55 million to the BAEF for investment in the private sector of Bulgaria. The BAEF also may raise additional amounts from the U.S. private sector and foundations.

Based in Sofia, Bulgaria and Chicago, Illinois, U.S.A., the BAEF received its initial funding January 14, 1992. Under the direction of a volunteer board of directors, the Fund makes equity investments in and loans to private businesses in Bulgaria, considering proposals and originating activities that will help develop Bulgaria's private sector.

The Fund's activities include:

- Starting new businesses and encouraging entrepreneurship in Bulgaria
- Establishing joint ventures
- Promoting Bulgaria's investment opportunities to U.S. and other Western investors
- Providing management and industry assistance to Bulgarian businesses
- Assisting in the privatization of state enterprises
- Broadening the understanding of private enterprise among managers, government, and the Bulgarian public.

*(cover)*

*Bulgaria's Black Sea coast*

*offers an idyllic holiday.*

*The BAEF has invested*

*in 19 small hotels along*

*the Black Sea coast.*

## TABLE OF CONTENTS

<b>4</b>	Letter from Management
<b>7</b>	Investment Map
<b>10</b>	Investment Portfolio
	Micro & Small Lending Programs
	Hotel & Tourism Program
	Larger Investments
	1997 Investments & Opportunities
	Activities to Support Investment
<b>15</b>	General Guidelines for Investment
<b>16</b>	Financial Statements
<b>23</b>	Board of Directors and Fund Management





*Agence France - Presse*

Publication of the BAEF Annual Report for fiscal 1996 has been intentionally delayed so that the Fund's operations can be placed in the context of the extraordinary political and economic events now erupting almost daily in Sofia, making the oft-ignored country front-page news in the world's leading newspapers and economic journals.

While they have come as no surprise to the BAEF staff or board, these events dramatically and graphically illustrate the extraordinarily difficult environment in which the Fund has labored over the past few years.

Hailed by then Deputy Secretary of State Lawrence Eagleburger in 1990 as "the best kept secret in Eastern Europe," Bulgaria was expected by many to become one of Eastern Europe's successes in the post-Communist era. Sadly, six years later, Bulgaria is one of Eastern Europe's laggards, sinking rapidly into political chaos and economic ruin.

After a series of ineffectual democratic and coalition governments were unable or unwilling to create a more market-oriented, democratically pluralist society, the Bulgarian people elected the Bulgarian Socialist Party (composed mostly of former communists) to a parliamentary majority in 1994. A new government headed by a 37-year-old Moscow-trained economist assumed power. While promising land restitution, privatization, economic reforms and an increase in foreign investment to spur development, in fact the government delivered little. It continued to subsidize

loss-making state-owned enterprises and dissipated its foreign currency reserves. It permitted a network of newly-formed, privately-owned banks to accept deposits and extend to owners' affiliates loans that were never repaid. Little was privatized. Politically well-connected trading groups received lucrative contracts with state enterprises, or became owners of them, seemingly without paying for them or competing at auction with real buyers.

The consequences for most ordinary Bulgarians have been both tragic and financially disastrous:

- The national currency lost 85 percent of its value in 1996, falling from 71 to 487 versus the dollar by December, draining foreign currency reserves. As of publication date, the lev has fallen even further to 2,700 to the dollar.
- Inflation, partly due to devaluation, increased to over 300 percent in 1996 and has entered hyperinflation as we begin 1997.
- The banking system is near collapse; many banks have been closed. Others, technically solvent, are operating but considered shaky. Many depositors have lost most of their savings, and bank runs are a common occurrence.

- Foreign investment, never large, is now almost non-existent. One of the largest western investors recently departed, walking away from \$20 million.
- Crime and corruption are commonplace. The fact that a former prime minister – a member of the Socialist Party and a leader of its "reform" wing – was recently assassinated, is symptomatic of a pervasive lawlessness.
- Average salaries have fallen to below \$30 per month, while pensioners must make do with far less. Many people are turning off their heat to save money. Once a net exporter of its agricultural products, Bulgaria now faces food shortages.

As this report goes to press, anti-government forces demonstrate daily in Sofia, demanding new elections, while a newly elected democratic president and a neo-Communist Socialist Parliament haggle over whether, and what kind of new government should be formed in the wake of the resignation of the last one. Meanwhile the IMF, having secured agreement on the imposition of a currency board as a precondition of a bail-out loan, is withholding the proceeds pending agreement on a new government. Failure to resolve this crisis could earn Bulgaria the dubious distinction of becoming the first country to default on its Brady Bond obligations (already once renegotiated debt backed by U.S. Treasury securities), due mid-year.

As would be expected, the BAEF has been sorely tested by Bulgaria's crises, its hostile political environment, and the future uncertainty these have spawned. Indeed, an already challenging task has been made more daunting. Consider the following:

- Nachala, our heretofore successful micro-lending program across the country, experienced a sharp increase in delinquencies and some outright defaults, as few borrowers could repay U.S. dollar-denominated loans given the lev's collapse.
- Kompass, a venture with the South Shore Bank of Chicago and four Bulgarian banks to provide small business with loans otherwise not available in Bulgaria, ceased new lending and also experienced increases in delinquencies. One of the participating banks was seized by the Bulgarian National Bank and shut down, while two others have become inactive, citing political and economic uncertainty.
- Dobrich Bank, a Kompass participant, illegally seized the repayments deposited in BAEF's account there, citing its own financial difficulties. After weeks of futile negotiating and pressure from the Bulgarian government, BAEF staff crafted a creative solution to swap the Fund's blocked deposits for 100 rail cars of corn from a borrower whose debt to the bank was in turn extinguished. Assuming that our corn is not stolen or illegally seized, the Fund will have been repaid, albeit by unconventional means.

- A state-owned feed mill confiscated and illegally resold for its own account corn stored in its facility and earmarked for a BAEF portfolio company. The situation between the BAEF and its borrower was eventually resolved, but today, eight months later, the borrower is still seeking compensation from the government.
- After a minor traffic accident involving a Bulgarian staff member, four thugs appeared at the BAEF Sofia office demanding DM2,000 and threatening physical harm if not paid. The BAEF refused to pay and the staff member is unharmed, but the episode served as an unnerving reminder that the BAEF is not unaffected by Bulgaria's rising criminality.

As the above anecdotes convey, Bulgaria's deteriorating condition posed new and extreme challenges for the Fund. First among these was the question of whether the BAEF should even continue to operate in such a hostile and unpredictable environment. After vigorous debate over several meetings, the board concluded that staying the course, while difficult and clearly requiring changes in strategy, was the correct response for now, and consistent with the intent and purposes of the SEED Act.

There were two principal reasons for this decision. First, the board concluded that as virtually the only source of capital, the Fund has never been more critical in supporting the hard-pressed entrepreneurial private sector than it is today. Secondly, bearing in mind

- NACHALA LOANS
- ▲ ENTREPRENEUR AWARD
- KOMPASS PROGRAM
- ◆ LARGE INVESTMENT
- ⬠ HOTEL LOAN PROGRAM
- DAIRY LENDING PROGRAM

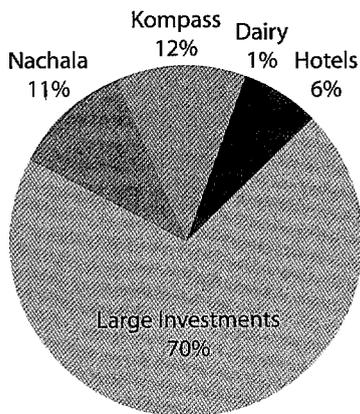


the Napoleonic era maxim "buy on the sound of the cannons, sell on the sound of the trumpets," Bulgaria's decline and the absence of competition in our sector might, with luck and perseverance, prove economically advantageous for Bulgaria and the Fund.

As a practical matter, this reaffirmation has required several shifts in investment policy and practice, most of them evolved by management and the board over the past year in response to unraveling conditions in Bulgaria. Chief among these are the following:

- Suspending for the time being micro-lending through Nachala, pending a stabilization of the exchange rate and some sort of resolution of the political/economic crisis. The focus instead is on rescheduling, repayment, and training Nachala staff in risk assessment and portfolio administration and collection procedures.
- Recognizing the difficulties of working through Bulgarian banks, the Kompass program will take in-house the responsibility for mid-sized loans, consistent with the new credit and risk management policies cited below. BAEF staff were de facto the credit officers for Kompass anyway and this change merely eliminates some of the risks and complexities of the existing program.
- Focusing new investment activity on somewhat larger (though still small and mid-sized) businesses with export-oriented products and services that can adjust quickly to or are relatively insulated from lev devaluations and fluctuations. Our hotel program is a case in point.
- Raising credit standards and interest rates (to levels still considerably below Bulgarian bank rates) and seeking equity participation in more transactions, especially where the company in question may be a candidate for acquisition by a Western firm, should Bulgaria once again become attractive to foreign investors.
- Minimizing exposure to Bulgarian banks and currency. Establishing a BAEF limited-form bank, minimizing in-country exposure, and using only non-Bulgarian depositories are among the many implications of this policy.
- Utilizing more stringent and explicit risk assessment evaluation procedures and involving the board in their development, utilization and interpretation. The BAEF board and board designees who participate in the Fund's investment decision process combine many years of investment, lending, and operating management experience in the U.S., Western and Eastern Europe, Asia, Latin America, and the Middle East. These procedures, too detailed to describe here, stratify the risk in ways unique to this environment, and ensure that the board's diverse experiences are brought to every investment decision.

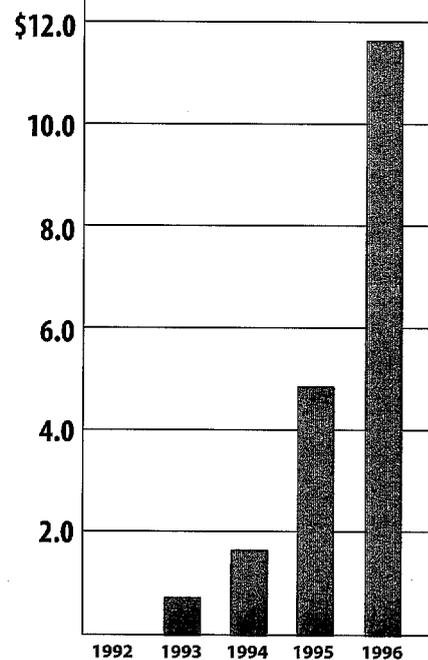
**Investment as a % of Total Portfolio**



This is an intentionally candid and sobering report about Bulgaria's difficulties and the impact on BAEF. Paradoxically, the last year saw an improved quality and quantity of transactions offered to the Fund, and there have been a record number of new commitments to large and more viable firms run by capable, highly resourceful people who have survived and in some cases prospered amid the chaos. It is those entrepreneurs who reaffirm our board's decision to carry on despite the difficulties and challenges, and give us reason to believe that the Fund is fulfilling its SEED Act role and can someday be viable.

It is customary in annual report letters to conclude with token words of thanks to staff and board members for their contributions to the collective effort. In this case, however, our words are of astonishment at the skill, creativity and selfless perseverance of the BAEF managers and staff. They truly are an inspiration. To the all-volunteer board and board nominees goes our genuine appreciation for dedicated commitment without pay, for candid and constructive criticism, for collective wisdom, and for impressive dedication to the Fund's work in the face of extreme adversity.

**BAEF Portfolio Growth**  
*(in millions of dollars)*



Sincerely,

Stephen W. Fillo  
*Chairman of the Board*

Frank L. Bauer  
*President & Chief Executive Officer*

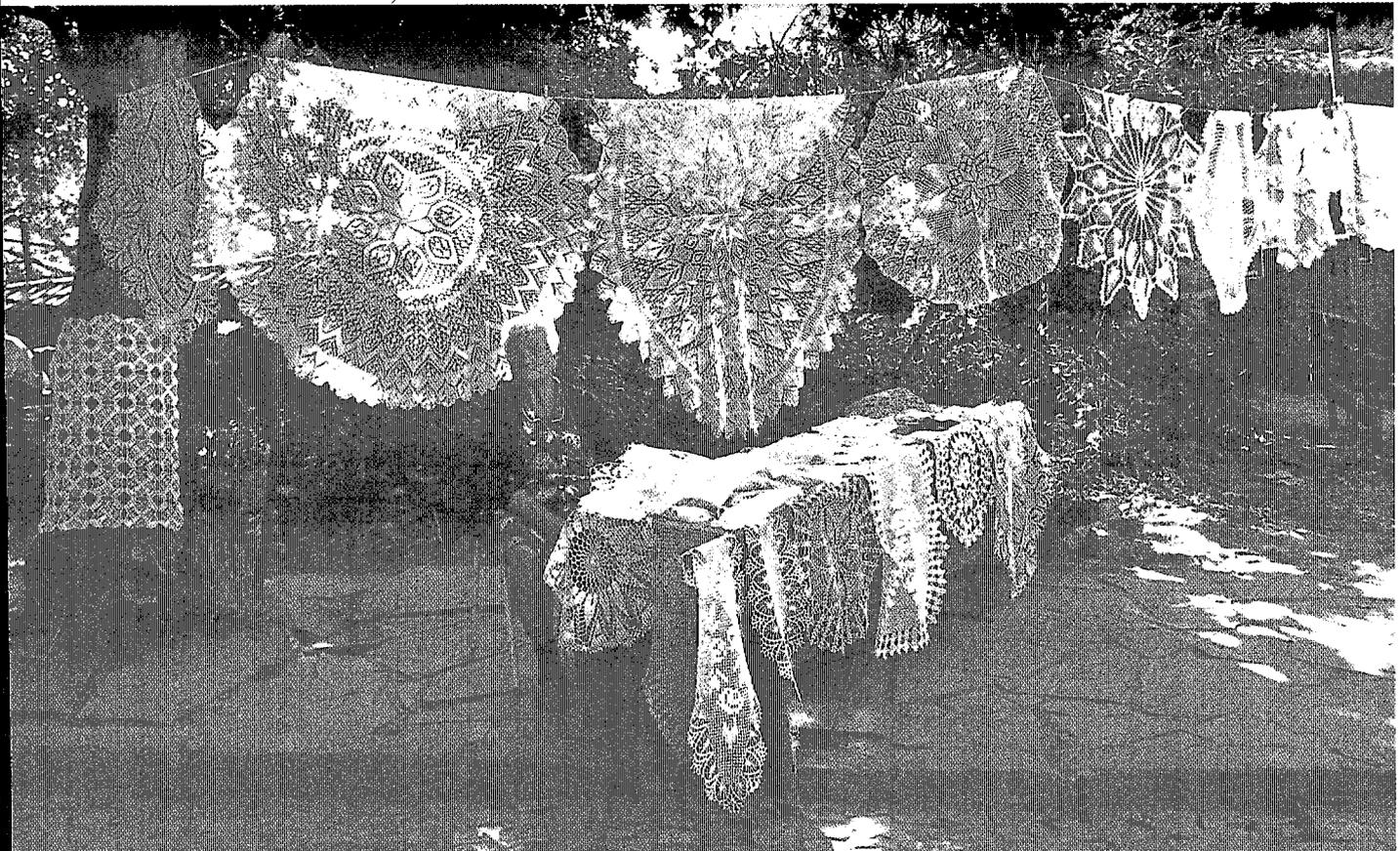
## INVESTMENT PORTFOLIO

The BAEF has invested across a wide spectrum of Bulgarian businesses. In 1996, the Fund built on its expertise in making small loans to small businesses to increase activity, particularly in larger debt and equity investments. During the year, investment more than doubled, totaling \$11.5 million as of September 30, 1996.

### **Micro & Small Lending Programs**

Over the years, the Fund has increasingly reached out to small and very small businesses, the most vital and dynamic sector of the Bulgarian economy and the one in which we believed BAEF investments could have major impact. Under the Fund's Micro & Small Enterprise program, loans ranging from \$1,000 to \$75,000 have been made throughout the country in almost all sectors. This program represents 88 percent of the total number of Fund investments and 22 percent of the Fund's investment portfolio.

Unfortunately, 1996 was a difficult year for Bulgarian small businesses. The Bulgarian economy and its currency collapsed, with particularly severe consequences for small businesses operating solely in the domestic economy. Mostly lacking in export markets, these businesses were unable to reprice their products as quickly as the lev fell, giving them no escape route as economic activity cut back. Dollar-denominated loans proved difficult to repay.



### *Nachala*

The Nachala (Bulgarian for "Beginnings") program, which since its inception has disbursed 412 loans for a total of \$2.5 million, had a September 30, 1996 portfolio balance of \$1,213,440. Opportunity International, a not-for-profit organization with more than 20 years of successful loan management, operates this program in collaboration with the Fund.

Many Nachala borrowers have struggled during the past year. Due to these difficulties, Nachala lending was suspended in May of 1996 to focus on collections and loan restructuring. As of this writing, the program's delinquency problem continues, but appears to be easing. Looking forward, we are considering the possibility of restructuring Nachala to concentrate on the smallest loans where our repayment results are best. We hope that lending will resume this Spring.

### *Kompass*

Since its inception, the Kompass program has approved 81 loans and disbursed 63 for a total of \$3.2 million. It had a September 30, 1996 portfolio balance of \$1,330,434.

After a very successful start, the Kompass program was also affected by last year's economic downturn and has experienced problems similar to Nachala's. The program was to work through Bulgarian banks that wished to lend to mid-sized firms and receive concurrent training in Western credit analysis techniques.

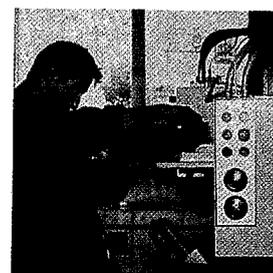
Today, Kompass staff, with the on-going assistance of our partner Chicago-based South Shore Bank, are concentrating on monitoring the existing portfolio and restructuring loans as necessary. New business is being added selectively and the program is being re-designed to address the current banking and economic climate.

### *Dairy Lending*

Since the Fund's inception, nine dairy loans have been disbursed. The five currently outstanding had a portfolio balance of \$116,079 at September 30, 1996.

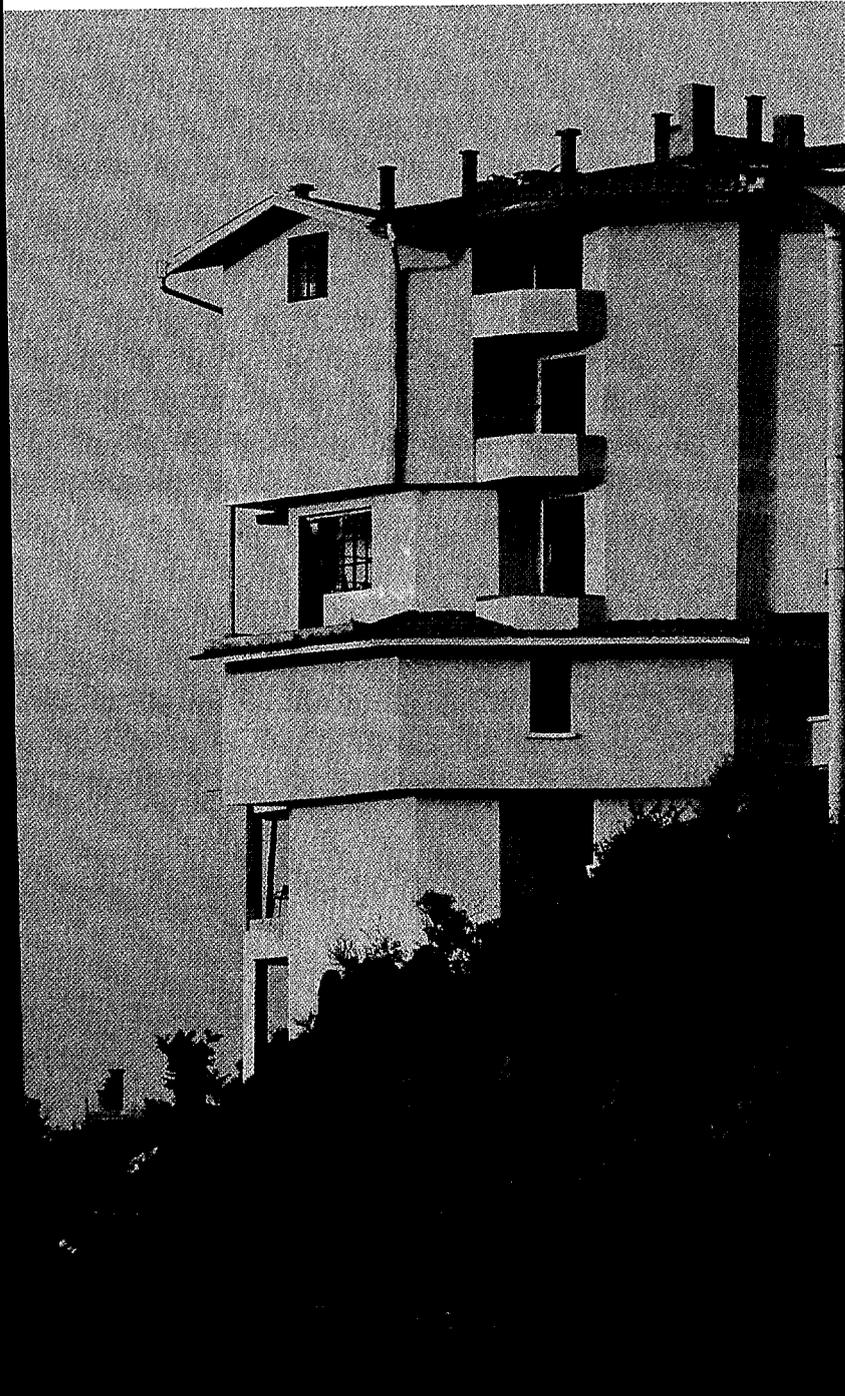
The dairy industry, like many agricultural segments, has been under pressure for several years. Because of state-mandated low milk and dairy-product prices and a resultant lack of producer profitability, it is unlikely that any new dairy loans will be made in the near future.

While the difficulties of Bulgaria's small business sector are very real, we continue to believe that micro and small lending play an important role in helping this sector and will therefore continue to look for new ways to resume these programs. Until the economic situation and banking sector stabilize, however, our activity will be curtailed.



*Micro and small  
businesses represent  
the most vital sector  
of the Bulgarian  
economy.*

*One of the 37 private hotels in  
which BAEF has invested  
overlooks the Black Sea in the  
ancient town of Sozopol.*



## **Hotel & Tourism Program**

Now in its fourth year, the Hotel & Tourism program focuses on the development of Bulgaria's private-hotel sector for both tourist and business travelers, typically providing funds for completion of construction, refurbishment, and new equipment. Since the program's inception, just under \$1 million has been loaned to 37 private hotels in the regions of Bansko, Smolyan, the Black Sea Coast, and Sofia. The average loan is \$25,000, with \$150,000 the largest to date. With the Fund's help, a total of 818 beds have been created in the 37 recipient hotels, ranging from 8 to 82 beds per establishment. As of September 30, 1996 the program's outstanding portfolio balance was \$645,624.

While most businesses were hurt by the past year's unfriendly economic environment, the hotel and tourism business has been the exception to the rule. With skiing, beaches, and historic sites, Bulgaria continues its tradition as an attractive tourist destination for East and West Europeans bringing hard currency. Thus, most hotel borrowers continue to prosper. This past year saw tremendous growth on the Black Sea Coast, particularly in Nesebar and Sozopol. In the coming year, the Fund is considering additional projects for financing small family-owned hotels in four Black Sea locations and for two hotel-privatization investments.

## Larger Investments

The Fund's portfolio of larger loans grew substantially in 1996, far surpassing all prior years combined. Despite the difficulties of making investments in the private sector, in 1996 the Fund invested nearly \$7 million of debt and equity in agribusiness, manufacturing, construction and housing, and financial enterprises. In addition, a backlog of approved deals awaits funding as this report goes to press.

### *Agribusiness and Agriculture*

Investment in agribusiness and agriculture represents 29 percent of the BAEF's \$11.5 million portfolio, including a \$524,000 loan to a vegetable-dehydration company, a \$500,000 loan to a producer of broilers and eggs, a \$300,000 loan to a meat-processing facility, debt and equity of \$250,000 in a soybean-processing company, and several loans totaling \$1,900,000 to a cooperative producing wine, bread, and cheese.

### *Manufacturing, Distribution, and Technology*

Until recently, the majority of the Fund's investment in manufacturing entities has been made through the Kompas program. This past year, however, several larger investments were approved, including a \$250,000 investment in a plastic-bag manufacturing and packaging company, an \$85,000 loan to a wood flooring company, and a \$150,000 loan to a garment manufacturer. Additionally, the BAEF has made an \$85,000 loan to a food distributor and a small equity investment in a software-design company with US and Bulgarian partners.

### *Construction and Housing*

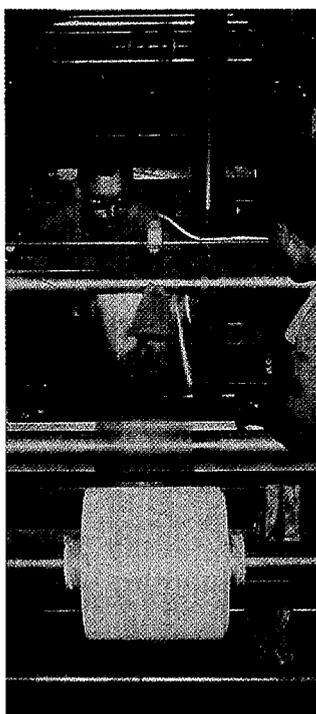
Twenty-two percent of the BAEF's portfolio is made up of investments in the construction and housing sector. Investments here include a \$955,000 equity investment in an apartment and office building in Plovdiv, a \$710,000 equity investment in an apartment building in Sofia, and a \$1,000,000 loan to build a townhouse development in Varna. The Fund also has a debt and equity investment in a Sofia townhouse development, which was completed last year.

### *Financial*

The BAEF recently established a banking entity, the Bulgarian-American Credit Bank (BACB). BACB is a limited-purpose bank licensed by the Bulgarian government to facilitate the Fund's investment in Bulgarian businesses. It is not a depository institution and does not trade foreign currency. Its purpose is to speed the flow of approved transactions by eliminating a cumbersome, costly and Byzantine approval process heretofore imposed on the Fund by Bulgarian government ministries.

*Agribusiness represents  
29% of BAEF's  
investment portfolio.*





### **1997 Investments & Opportunities**

In addition, the BAEF Board recently approved a number of ventures which are in the process of being finalized. These include, among others:

- \$350,000 equity in a poultry producer
- \$300,000 additional debt in a soybean processor
- \$1,000,000 debt and equity in a Sofia apartment complex
- \$1,000,000 debt for equipment for an electric heater manufacturer
- \$1,250,000 debt and equity in a coffee roaster and packager
- \$800,000 loan for a hotel privatization.

### **Activities to Support Investment**

The BAEF participates as a founding member of the American Chamber of Commerce in Bulgaria and the Bulgarian International Business Association, both of which provide a forum through which American, Bulgarian, and international companies can discuss issues of importance and speak with a unified voice on economic policy matters.

The Fund's continued emphasis on promoting business development is exemplified by its Young Entrepreneur Award, now in its fourth year. The BAEF sponsors the annual award to stimulate development of business ideas and plans by Bulgarians 18 to 29 years of age. Since inception, more than 2,000 entrepreneurs have participated in the country-wide training seminars and approximately 450 business plans have been submitted, reviewed, and critiqued.

To help support its investments, the BAEF occasionally grants technical assistance funds to its borrowers for training in marketing, business management, and technology. In addition to the \$50 million the BAEF has to invest in projects, \$5 million has been earmarked specifically for technical assistance. As of September 30, 1996, \$1.7 million had been allocated or pledged.



*Large investments include a soybean processing facility (upper left), a plastic bag manufacturer (lower left), and a 16-unit townhouse development in Varna (above).*

Although 1996 was a difficult year for Bulgarians and Bulgarian business, the BAEF is a positive force in helping realize the many opportunities that continue to exist. We continue to convey our belief in the future of Bulgaria's market economy by accepting speaking engagements and hosting meetings and BAEF Board members are also actively involved in spreading the message about opportunities in the country.

Despite our efforts, however, we have been concerned about the limited involvement of U.S. companies in Bulgaria. The Fund can be very helpful in identifying opportunities, finding joint-venture prospects, and providing an overview of the Bulgarian business environment. We remain hopeful that, once the current crisis passes, interested firms will contact us.

### **General Guidelines for Investment**

The Bulgarian-American Enterprise Fund provides financing principally to small and medium-sized private businesses in Bulgaria able to demonstrate their commercial viability. General factors that are considered when reviewing business opportunities include:

- The ability of the investment to be quickly implemented and to have an economic impact in Bulgaria
- The proven competence of the management team and its willingness to share in the risk
- The viability of the business plan, including evidence of market demand
- The prospect of favorable earnings
- The company's competitive position and the percentage of export sales
- The ability of the venture to bring hard currency into Bulgaria
- The impact on employment in Bulgaria
- The amounts and sources of debt and equity being proposed

**REPORT OF  
INDEPENDENT  
PUBLIC  
ACCOUNTANTS**

**TO THE BOARD OF DIRECTORS OF THE BULGARIAN-AMERICAN ENTERPRISE FUND:**

We have audited the accompanying Statements of Financial Position of the BULGARIAN-AMERICAN ENTERPRISE FUND (a Delaware corporation, organized not-for-profit) as of September 30, 1996 and 1995, and the related Statements of Activities and Cash Flows for the years then ended. These financial statements are the responsibility of the Bulgarian-American Enterprise Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bulgarian-American Enterprise Fund as of September 30, 1996 and 1995, and the changes in its net assets and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 2 to the financial statements, in 1996 the Fund changed its revenue recognition policy.

As discussed in Note 2 to the financial statements, the financial statements include investments valued at \$10,408,688, whose values have been estimated by management and adopted by the Board of Directors in the absence of readily ascertainable market values. We have reviewed the procedures used by management in arriving at its estimate of value of such investments and have inspected the underlying documentation, and in the circumstances we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed.

Chicago, Illinois  
November 26, 1996

*Arthur Andersen LLP*

**STATEMENTS  
OF FINANCIAL  
POSITION**

*As of September 30,  
1996 and 1995*

<b>ASSETS</b>	<b>1996</b>	<b>1995</b>
Cash and cash equivalents (Note 2 and Note 3)	\$6,560,306	\$ 2,945,476
Board restricted cash and cash equivalents (Note 2 and Note 3)	843,249	838,335
Investments at fair value	11,512,388	5,047,743
Less reserve on investments	<u>(1,103,700)</u>	<u>(428,535)</u>
Investment at fair value, net	<u>10,408,688</u>	<u>4,619,208</u>
Prepaid expenses and other assets	225,759	200,955
Fixed assets, net (Note 5)	<u>258,235</u>	<u>309,596</u>
Total assets	<u>\$18,296,237</u>	<u>\$ 8,913,570</u>

**LIABILITIES AND NET ASSETS**

Accounts payable and accrued expenses	<u>\$1,186,207</u>	<u>\$ 277,340</u>
Total liabilities	<u>1,186,207</u>	<u>277,340</u>
Unrestricted net assets	<u>17,110,030</u>	<u>8,636,230</u>
Total liabilities and net assets	<u>\$18,296,237</u>	<u>\$ 8,913,570</u>

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

**STATEMENTS  
OF ACTIVITIES**

*For the years ended  
September 30, 1996  
and 1995*

	<b>1996</b>	<b>1995</b>
<b>Investment Revenue</b>	\$1,254,717	\$ 551,384
<b>Expenses:</b>		
Employee compensation and benefits	\$1,102,817	\$1,106,624
Program development (Note 2)	457,550	144,750
Investment Costs (Note 2)	313,521	75,769
Professional fees	411,677	204,461
Occupancy and telecommunications	147,467	162,489
Depreciation and amortization (Note 2)	88,115	92,549
General and administrative	<u>349,157</u>	<u>336,700</u>
Total Expenses	(2,870,304)	(2,123,342)
Realized and unrealized depreciation on investments	(1,379,001)	(510,127)
Reserve on investments	(140,000)	—
U.S. Government grant revenue	11,608,388	4,886,590
Technical assistance expenses (Note 2)	(371,612)	(871,410)
Technical assistance grant revenue	<u>371,612</u>	<u>871,410</u>
<b>Increase in Net Assets</b>	8,473,800	2,804,505
<b>Cumulative Effect of Change in Accounting Policy</b>	—	1,781,642
<b>Unrestricted Net Assets at Beginning of Year</b>	<u>8,636,230</u>	<u>4,050,083</u>
<b>Unrestricted Net Assets at End of Year</b>	<u>\$17,110,030</u>	<u>\$ 8,636,230</u>

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

**STATEMENTS  
OF CASH  
FLOWS**

*For the years ended  
September 30, 1996  
and 1995*

<b>Cash Flows From Operating Activities</b>	<b>1996</b>	<b>1995</b>
Change in net assets	\$ 8,473,800	\$ 2,804,505
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Technical assistance included in investing activities	371,612	871,410
Realized and unrealized depreciation on investments	1,379,001	510,127
Recovery of depreciated investment	45,201	49,784
Loss on disposition of fixed assets	3,208	2,119
Depreciation and amortization	88,115	92,549
Changes in operating assets and liabilities:		
(Increase) in prepaid expenses and other assets	(24,804)	(25,500)
Increase in accounts payable and accrued expenses	908,867	61,330
Net Cash Provided by Operating Activities	<u>11,245,000</u>	<u>4,366,324</u>

**Cash Flows From Investing Activities**

Investment and loans	(10,855,770)	(4,447,466)
Technical assistance	(371,612)	(871,410)
Purchases of fixed assets	(58,112)	(51,836)
Cash received on loan repayments	<u>3,660,238</u>	<u>896,352</u>
Net Cash Used in Investing Activities	(7,625,256)	(4,474,360)
Net increase (decrease) in cash and cash equivalents	3,619,744	(108,036)
Total Cash and Cash Equivalents at Beginning of Year	<u>3,783,811</u>	<u>3,891,847</u>
Total Cash and Cash Equivalents at End of Year	<u>\$7,403,555</u>	<u>\$ 3,783,811</u>
Unrestricted Cash and Cash Equivalents, End of Year	<u>\$6,560,306</u>	<u>\$ 2,945,476</u>
Board Restricted Cash and Cash Equivalents, End of Year	<u>\$ 843,249</u>	<u>\$ 838,335</u>

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

**NOTES TO  
FINANCIAL  
STATEMENTS**

*September 30, 1996  
and 1995*

**1. ORGANIZATION OF FUND**

The Bulgarian-American Enterprise Fund (the "Fund") is a not-for-profit corporation pursuant to the Support for East European Democracy Act of 1989 (the "SEED Act") for the primary purpose of promoting the development of the Bulgarian private sector and policies and practices conducive to such development. The United States Congress has authorized appropriations of \$50 million which has been granted to the Fund by the Agency for International Development ("AID") for program purposes and administrative expenditures (the "Grant"). AID has granted the Fund up to an additional \$5 million for technical assistance. As of September 30, 1996, AID has made \$37.1 million available and disbursed \$29.9 million of the Grant to the Fund. The Fund anticipates that the remaining \$17.9 million of the Grant will be made available on an as-required basis. Grants received from AID are conditioned upon the Fund's compliance with the requirements of the Grant agreement with AID and the SEED Act, which imposes certain U.S. policy objectives and reporting obligations. Under the terms of the Grant agreement with AID, the Fund may hold funds in interest bearing accounts and may retain investment and program income for program purposes.

The Fund is engaged in a broad private investment program in Bulgaria which, through equity investments, loans, grants, technical assistance and other measures, emphasizes a commitment to small-to-medium sized businesses. The Fund provides technical assistance to businesses in the Bulgarian private sector, including those in which the Fund has invested. Through its direct role in investments in the Bulgarian private sector, the Fund seeks to generate profits that will further support its activities and attract investments by others. As part of its investment operations, the Fund may obtain representation on management and supervisory boards of investee companies. In the normal course of business, entities in which the Fund invests may enter into business transactions with each other.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Cash and Cash Equivalents**

For purposes of the financial statements, the Fund considers all highly liquid financial instruments purchased with a maturity of three months or less to be cash equivalents.

**Board Restricted Cash and Cash Equivalents**

Board restricted cash consists of cash and cash equivalents to be used solely for specific Board approved investment programs. See Note 4.

**Investment Valuation**

The Fund's investments, as set forth in Note 4, are not readily marketable and are not listed on an exchange or quoted in an open market. These investments are stated at fair value as determined by management. In determining fair value, management considers relevant qualitative and quantitative information available. In general, the Fund's policy is to carry investment at cost except where a change in the investee company's circumstances warrants a lower or higher valuation. The values assigned to investments are based on available information and do not necessarily represent amounts that might ultimately be realized, since such amounts depend on future development inherent in long-term investments. Investment valuation is recommended by management and adopted by the Board of Directors (The "Board") annually, and more often if deemed necessary by management or the Board.

**Revenue Recognition**

During 1996 the Fund changed its revenue recognition policy to recognize grants when funds are received. The 1995 financial statements have been restated to reflect the acceleration of previously deferred revenues. The cumulative effect of this change on prior periods is an increase of \$1,781,642 in 1995 unrestricted net assets.

**Program Development**

Program development expenses consist of direct costs of investment activities, consisting of consulting, marketing, legal and travel expenses, and include investment expenses not reimbursed for transactions that did not close.

**Administered Small Loan Program**

Small loan programs administered by outside agents are funded upon approval of the Board.

**Depreciation and Amortization**

Computer equipment, furniture and equipment, and automobiles are depreciated on a straight-line basis over their estimated useful lives. Leasehold improvements are amortized on a straight-line basis over the lesser of their useful lives or the term of the lease.

**Translation of Foreign Currency**

The Fund's functional currency is the U.S. dollar.

Generally, the Fund's operating transactions are initiated in U.S. dollars and exchanged for Bulgarian leva when needed. At September 30, 1996 and 1995, the Fund's assets and liabilities were principally denominated in U.S. dollars at the year-end exchange rate. Revenues and expenses transacted in Bulgarian leva are translated into U.S. dollars at historical rates.

### Donated Services

Members of the Board donate significant amounts of their time to the Fund's programs and receive no compensation or fees for serving as directors. No amounts have been reflected in the accompanying consolidated financial statements for such donated services, inasmuch as no objective basis is available to measure the value of such services.

### Technical Assistance

The Fund generally disburses funds for Technical Assistance grants as expenses for the project are incurred. Funds earmarked to approved grants but not yet disbursed amounted to approximately \$3.3 million at September 30, 1996.

### Investment Costs

Investment costs are directly related to the ongoing operational expenses associated with a Board approved investment.

### Use of Estimates

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

### Contingencies

The Fund is subject, from time to time, to administrative and legal proceedings incidental to its business. It is management's opinion that the resolution of these legal proceedings is not expected to have a material effect on the Fund's financial statements.

## 3. TOTAL CASH AND CASH EQUIVALENTS

At September 30, 1996, the Fund's cash is deposited primarily in three financial institutions. Approximately \$3.6 million is on deposit with the Bulgarian National Bank to secure the Fund's limited banking license, approximately \$3.0 million is deposited in one United States financial institution (principally a money market fund) and approximately \$.8 million is deposited in various Bulgarian commercial banks primarily denominated in U.S. dollars.

## 4. INVESTMENTS AND BOARD RESTRICTED CASH AND CASH EQUIVALENTS

The following summarizes the dollar equivalent of investments of the Fund and related board restricted cash and cash equivalents by program as of September 30, 1996.

Description	Type	Investments at	Board	Total	% Owned
		Carrying Value	Restricted Cash		
Bag manufacturer	Loan	\$20,513	\$ --	\$ 20,513	
Food processor	Loan	524,000	--	524,000	
Agribusiness	Loan	127,493	--	127,493	
Financial Institution	Equity	2,084,298	--	2,084,298	100%
Food Processor	Loan	190,000	--	190,000	
Food Processor	Equity	60,000	--	60,000	32.5%
Food Processor	Loan	300,000	--	300,000	
Garment Manufacturer	Loan	151,243	--	151,243	
Technology	Equity	5,600	--	5,600	10%
Construction/Housing	Equity	955,000	--	955,000	100%
Agribusiness	Loan	79,803	--	79,803	
Manufacturer	Loan	66,480	--	66,480	
Food distributor	Loan	42,988	--	42,988	
Construction/Housing	Equity	710,000	--	710,000	100%
Construction/Housing	Equity	80,000	--	80,000	51%
Construction/Housing	Loan	280,000	--	280,000	
Construction/Housing	Loan	550,130	449,870	1,000,000	
Agribusiness	Loan	1,944,263	--	1,944,263	
Food Processor	Loan	35,000	--	35,000	
Nachala Loan Program	Loan	1,213,440	30,300	1,243,740	
Kompass Loan Program	Loan	1,330,434	363,079	1,693,513	
Dairy Loan Program	Loan	116,079	--	116,079	
Hotel Loan Program	Loan	645,624	--	645,624	
<b>Subtotal</b>		<b>11,512,388</b>	<b>843,249</b>	<b>12,355,637</b>	
<b>Less Reserve for Losses on Investments</b>		<b>(1,103,700)</b>	<b>--</b>	<b>(1,103,700)</b>	
<b>Investments at Fair Value and Board Restricted Cash and Cash Equivalents</b>		<b>\$ 10,408,688</b>	<b>\$ 843,249</b>	<b>\$ 11,251,937</b>	

Majority-owned investments are temporary in nature, therefore they are not consolidated into the financial statements.

## 5. FIXED ASSETS

At September 30, fixed assets consisted of:

	<u>1996</u>	<u>1995</u>
Computer equipment	\$ 234,354	\$ 222,374
Furniture and equipment	169,445	154,947
Automobiles	92,602	75,059
Truck held for investment	40,343	60,514
Leasehold improvements	<u>45,451</u>	<u>45,451</u>
Total cost	\$ 582,195	\$ 558,345
Accumulated depreciation and amortization	<u>(323,960)</u>	<u>(248,749)</u>
	<u>\$ 258,235</u>	<u>\$ 309,596</u>

## 6. COMMITMENTS

### Investments

As of September 30, 1996, the Board had approved investments totaling \$4.2 million which were subject to the completion of negotiations and the signing of documents. These commitments are as follows:

	<i>(in millions)</i>
Food Processing	\$ 1.6
Construction/Housing	2.0
Manufacturing	.4
Transportation	<u>.2</u>
	<b>\$ 4.2</b>

### Leases

The Fund is committed to make minimum annual rental payments under operating leases for office space. Lease commitments for the fiscal years subsequent to September 1996 are approximately \$77,000 in 1997, \$60,000 in 1998, \$64,000 in 1999, and \$57,000 in 2000.

## 7. TAX STATUS

### United States

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

### Bulgaria

The Fund's Bulgarian office (the "Bulgarian Office") is registered in Bulgaria as a technical information office of the Fund. As such, the Bulgarian Office does not conduct trade in Bulgaria and is not subject to Bulgarian income and other corporate taxes.

## 8. ADOPTION OF ACCOUNTING STANDARD

During 1996 the Fund adopted Statement of Financial Accounting Standard No. 117 "Financial Statements of Not-For-Profit Organizations" ("SFAS 117"). In accordance with this standard, expenses as presented in the Statement of Activities reclassified on a functional basis include \$3,838,960 related to program services and \$921,957 of general and administrative expense related to supporting services.

**BOARD OF DIRECTORS**

**Stephen W. Fillo,**  
*Chairman*

*President*  
*Fillo & Co., Inc.*

**Frank L. Bauer,**  
*President & Chief Executive Officer*

**Gary E. MacDougal**  
*Chairman Emeritus,*  
*Bulgarian-American*  
*Enterprise Fund*

*Corporate Director,*  
*Trustee of Foundations*

**Marshall Lee Miller**  
*Partner*  
*Baise & Miller, P.C.*

**James M. Reed**  
*Vice Chairman*  
*& Chief Financial Officer*  
*Union Camp Corporation*

**John Train**  
*Chairman*  
*Montrose Advisors Incorporated*

**FUND MANAGEMENT**

**Frank L. Bauer,**  
*President & Chief Executive Officer*

**Virginia G. Rollins,**  
*Managing Director*  
*Sofia, Bulgaria*

**Nancy L. Schiller,**  
*Managing Director*  
*Chicago, Illinois*

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