

HUNGARIAN-AMERICAN ENTERPRISE FUND



3 THIRD ANNUAL REPORT

For the Fiscal Year Ended September 30, 1992

"The economies of our region must cope with the consequences of having been cut off by force from the technologies, the markets and the competition of the free world economy for more than forty years (and in the case of the former Soviet Union for more than seventy years). Economic freedom and competition are not without problems; they are not an easy road to follow. But it is the only one that can lead to sustained growth and general prosperity . . .

What is at stake is not only our own economic reconstruction and prosperity. The outcome will affect the stability and the integration of the entire world economy. This is the first time in almost eight decades that there is a serious chance for the peaceful and free integration and efficient development of the entire world economy . . .

In Hungary, the stability of the new political institutions and the proper functioning of parliamentary democracy provide the indispensable backdrop for economic recovery and integration. We know that for reconstruction and growth to be assured, our economy needs a large volume of foreign capital, foreign partners, investors and managers, and a complex manifold integration into the modern world economy. We are gratified by the confidence expressed in the political stability and in the economic potential of our country by the large direct investment inflow we have witnessed during the past two years . . .

During that period Hungary has made considerable progress in the development of a market economy. There are countless signs of this transformation at the macro-economy level and, even more importantly perhaps, at the level of households and the actions and attitudes of private citizens and entrepreneurs. There is a full consensus in Hungary that, like the change in the political system, the change in the economic system has also become irreversible. The growing integration with the European and world economy has stimulated competition and the strengthening of the market economy . . ."

His Excellency József Antall, Prime Minister of Hungary
Budapest, April 13, 1992

HUNGARIAN-AMERICAN ENTERPRISE FUND

The Hungarian-American Enterprise Fund ("the Fund" or "HAEF") is a private tax-exempt [Section 501(c)(3) of the Code] Delaware corporation established pursuant to the Support for East European Democracy (SEED) Act of 1989, U.S. Congress, for the purpose of promoting the development of private enterprise in Hungary, including small businesses, agricultural projects and joint ventures between United States and Hungarian businesses or entrepreneurs, through equity investments, loans, grants, feasibility studies, technical assistance, training, insurance, guarantees and other measures.

The Fund, which commenced operations in July, 1990, takes this as a broad mandate to consider proposals, or to originate activities, which are directed toward:

Developing the business infrastructure of Hungary;

Expanding and developing Hungary's capital markets;

Strengthening and diversifying Hungary's economy, and

Broadening the Hungarian public's understanding of private enterprise.

Under the SEED Act, the U.S. Congress authorized HAEF to receive a total of \$60 million over a three year period. HAEF may also raise additional amounts from the private sector and from foundations. Initial U.S. Government funding was received on May 17, 1990, and a total of approximately \$47 million had been made available to the Fund as of September 30, 1992. The Fund maintains offices in Washington and Budapest; proposals for investment or technical cooperation may be submitted to either office.

OFFICES OF THE FUND

HUNGARIAN-AMERICAN

ENTERPRISE FUND

1620 Eye Street, N.W.
Suite 703
Washington D.C. 20006

Tel: (202) 467-5444

Fax: (202) 467-5469

MAGYAR-AMERIKAI

VÁLLALKOZÁSI ALAP

East-West Building (6th Floor)
Rákóczi út. 1-3
1088 Budapest

Tel: (36-1) 266-7175 or 266-7230

Fax: (36-1) 266-7086

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**This is the Annual Report of the Hungarian-American
Enterprise Fund published pursuant to Section 201(p) of
the Support for East European Democracy Act of 1989
(Public Law 101-179 - November 28, 1989)**

PRESIDENT'S LETTER

Washington, D.C.
January 15, 1993

This Third Annual Report of the Fund covers the second full year of its operation ending September 30, 1992 and our comments reflect two and one-half years of experience. Like the Hungarians, we are still meeting new and unusual problems and challenges, and learning much that was not anticipated about the process of transforming an entire economy from a command system to a free market. The scale of our activities is still expanding, and during the current year we will be pressing against the limits of our funds provided by the U.S. Government.

Our own experience mirrored that of the country as a whole. The good news for Hungary is that start-ups of new businesses continued at a rapid rate; it is estimated that private enterprise may now account for close to half of the real GDP (making allowance for estimated unreported business activity). We are proud to have had a part in this continuing development; through our direct investments and our small loan program we have assisted the start up or expansion of over 130 small and medium-sized businesses.

PROGRESS OF THE FUND

The increase in our activity last year reflected a number of things. These include our rise on the learning curve of how to make useful and profitable investments in Hungary, a broadening of our activities, and the somewhat faster pace of privatization in Hungary. During the year we approved 19 new direct loans and investments aggregating \$27.3 million (compared with 13 deals totalling \$11.7 million the preceding year). Actual disbursements in this category were \$22 million during the past year (\$4.6 million in the prior year), and an additional \$9.2 million was disbursed in October and November of the new fiscal year. Further discussion of this growth in activity appears on page 8 of this report.

Categories of entrepreneurial activity represented by the aggregate of our direct investments and loans approved as of December 31, 1992 were as follows:

	<u>US \$ Equivalent</u>	<u>% of Total</u>
Agriculture	\$7,298,565	19.8%
Communications	1,550,000	4.2
Computer Hardware/Software	3,514,021	9.6
Finance, Insurance	4,250,000	11.6
Manufacturing	4,725,626	12.8
Real Estate	802,549	2.2
Retail Trade	5,082,000	13.8
Services	5,563,403	15.1
Wholesale Trade	<u>4,002,149</u>	<u>10.9</u>
Total	\$36,788,313	100.0%

Included in these figures for the year is our \$4 million investment in EurAmerica Capital Corporation; a new financial services organization with broad investment banking skills. While EurAmerica is not restricted to working with the Fund, the effect of its establishment is to make such professional services available to the Fund and to small and medium-size businesses and to offer the opportunity of participating directly in privatizations with the intention of resale. It is the first such firm headquartered in Budapest and working in the new republics of Central Europe and the Commonwealth of Independent States (CIS). As such, we hope it will contribute to development of Budapest as an important financial and trade center for the entire area, with the concurrent stimulation of private enterprise activity in Hungary. Also, it is our first step toward leveraging the funds received from the U.S. Government by providing professional access to the world money markets. (Further discussion of EurAmerica appears on page 18.)

During the year we made our first sale of a profitable investment, the major portion of our holding of shares of Quint Records Kft. which was purchased by a strategic investor. This was a transaction which we believed would best assure the future in international competition of this so far successful enterprise. Also during the year our \$5 million Small Loan Program through two banks became fully committed to over 100 loans, and two loans made under the program were fully repaid. Arrangements to obtain outside funding to expand this program are being pursued.

A major activity over the past year has been the development of our monitoring program, to assure that we are continually aware of the financial situation of the companies in which we have invested, and can determine if they need help or other close attention. This has been the third year of contraction of the Hungarian economy. Due to the bankruptcy law passed late in 1991 in Hungary, a large number of companies were required to negotiate with their creditors, and a number are expected to fail. Experience with our own investment portfolio in this environment led us to write down four investments, all of them relatively small and suffering from major sales declines (and in one case inattention on the part of the American joint venture partner, where we may take legal steps to protect our position). We also terminated without loss our involvement in an aborted entry into the leasing business. Our conservative write-downs were more than balanced by three we found it appropriate to write up. The latter primarily reflected the above-mentioned sale of most of our investment in Quint Records Kft. (which occasioned the write-up of our remaining holding, now EMI-Quint Records, Ltd.) at a price 28% above cost, and a purchase of additional shares of Petőfi Kft. at a price 45% above the cost of our original shares (giving rise to a write-up of those shares, based on a valuation by Morgan Stanley & Co.). The resultant average annual return was 24.6% for Quint and 44.6% for Petőfi.

OUTLOOK FOR FUND ACTIVITIES

Our projections for Fund activities for the current year are that our own higher pace of investment operations in 1992 will continue, because the opportunities are there and much remains to be done. While the SEED Act contemplated a three year program to assist Hungary and Poland, it is evident to everyone that unforeseen problems and pitfalls in the transformation of these economies will require continuing external assistance. We hope the new administration will support further U.S. Government funding and that the track record of the Fund will make it possible for us to raise substantial additional funds from the private sector. We are, in fact, laying plans for two private securities offerings this year, one for Hungarian banks and other financial institutions and the other for U.S. and foreign pension funds and other international investing institutions. These will be separate

equity investment funds to be managed by the Fund. In addition, we have already begun the solicitation of contributions to the Fund from foundations and individuals for use in our Technical Cooperation Program. These projects all show promise of success.

We expect also to be able to work cooperatively with two Japanese institutions, the Japanese Export-Import Bank (JEXIM) and Japan International Development Organization Ltd. (JAIDO), the latter a private organization funded primarily by industrial companies. To achieve this (as well as to meet other needs of the Fund), we are examining the proposed purchase of a 25% interest in a small well-capitalized Hungarian bank, through whose intermediation loans may be made from the \$100 million loan fund recently established by JEXIM for Hungarian small and medium-sized businesses. JAIDO has already joined us in one equity investment, and we are exploring with them other opportunities to co-invest.

THE HUNGARIAN ECONOMY

The current economic contraction in Hungary reflects the broader economic downturn as well as the problems besetting the Hungarian economy in transition. Output is down, unemployment is up and the national budget deficit is much larger than planned. Exports, however, continued to expand, and even though imports also rose, there remained a favorable balance on current account for the year 1992. Investment inflows continued strong. The inflation rate declined significantly and at year-end was running at an annual rate of about 23%. Interestingly enough, both savings and the apparent savings rate increased in 1992, perhaps due in part to fears of unemployment. As a result, the decline in interest rates is expected to continue.

The unpredicted large budget deficit resulted from a significant decline in output with rising unemployment, which inevitably reduced revenues and increased expenditures. The wave of bankruptcies caused by compliance with a new bankruptcy law passed late in 1991 reduced tax revenues, as did a new accounting regulation; tax evasion is common, especially among the newer companies in the private sector.

PROGRESS IN PRIVATIZATION

In assessing Hungary's progress in privatization, it must be kept in mind that, along with other countries in the region, Hungary is in the middle of a transformation unprecedented in recorded history. Not only is the entire economic system being restructured, but so is the entire framework of society. All this is happening in a situation where the traditional eastern markets are unable to pay and western markets are in recession. In this environment Hungarians can be credited with managing consistently to increase their exports to the West and are at the same time improving many of the vital signs of their economy.

Hungary has pursued a very deliberate one-by-one policy in the privatization of state enterprises, which has been delayed by the slow progress of legal transformation of industrial activities of the state into corporate form. Of the total state assets involved in this program, only about 50% were transformed between mid-1990 and October 1992, and only 20% were privatized. In the past year the authorization by the State Property Agency of company-led privatization of small and medium-sized enterprises has resulted in expediting such transactions. Recently, to further accelerate

the process and increase the participation of Hungarians, the Government has indicated it is considering some new techniques not dissimilar to the methods of mass privatization in neighboring states.

Privatizing Major State Enterprises - Debates over the partial sale or privatization of the larger state enterprises have persisted over considerable periods of time, and in most cases without action even to this day. The relatively slow pace of privatization could delay Hungary's economic recovery and may undermine Hungary's leading position among the countries racing to achieve an efficient market economy. The presumed initial adverse impact of privatizing large enterprises on employment (ignoring that the effect of privatization would ultimately be favorable on the economy, with discharged workers moving to more productive jobs) may have led to excessive caution, and there is wide public apprehension that the process may have become highly politicized, and hence perhaps at least partially paralyzed. In the manufacturing field particularly, investors' interest has been chilled by the complicated process of privatization, the latter frequently reflecting a bureaucratic desire to avoid criticism at whatever cost to the public interest.

The law to regulate privatization in the *telecommunications industry* was bogged down in Parliament for nearly a year and a half before its recent passage, even though it has long been widely recognized that the development of a free market economy in Hungary depends more than anything else on the rapid investment of billions of dollars in the improvement of telecommunications facilities, something that can in reality only be financed by the private sector (principally foreign investment). The costs of that delay alone, while prices rose and present plant became increasingly obsolete, could exceed \$1 billion.

Privatization of the major *state-owned banks*, at one time promised for mid-1991, is urgent if banking support is to be provided for private enterprise, and if Hungary is to take its deserved place as an important regional financial center. Unfortunately it has been subjected to endless analysis of the possible means of curing the illiquidity of the banks stemming from their large non-performing holdings of obligations of state enterprises, many of which are unlikely to survive. That decision has now been taken in principle and is to be implemented in detail over the next couple of months, through the exchange of 20-year Government bonds for well above HUF 100 billion (US \$1.2 billion equivalent) of worthless or questionable loans held by the banks. It is now intended that privatization of all four major banks will follow during 1993. However, it is still not clear what kind of guarantees will be or should be built into the system to avoid future repetition of the build-up of non-performing assets.

Adverse developments in the Hungarian economy, including rising unemployment and declines in market values of state enterprises have led to a small but vocal nationalism, expressing itself in a concern about foreign investment. This concern ignores that the essence of privatization is to put ineffective state enterprises in the hands of someone who will provide capital, technology and marketing know-how. This is often a foreign investor. It seems not to be recognized that government regulation can protect the national interest without government control. This has been the pattern of development worldwide, without apparent detriment, including the United States in the nineteenth and early twentieth centuries when it had to catch up with an industrialized Europe.

There is a widespread fear that the recent creation of the new State Asset Management Agency will further delay privatization. This Agency was mandated by Parliament to provide independent, profitable and professional management of those major state enterprises regarded as strategic, in which the Government intends to hold specific shares, in some cases representing control. In many of these cases there are substantial excess holdings which are permitted to be sold. The Agency has stated its intention to, and should, move rapidly to divest such shares (which include the four banks).

Company Registration Requirements - A quite separate impediment to privatization - and to new investments and joint ventures - is the judicial process required for the establishment of a new company. This can take as long as eight months, whether in connection with private or foreign investment or merely the initial transformation of a state enterprise to corporate form, where the county judge, on finally completing the process of review (often with little background qualifications for the task) finds fault with the proposed business or capital structure. It is estimated that hundreds of company privatizations (or partial sales), representing millions of dollars, have been abandoned because of this delay and uncertainty, regardless of their actual merit. The Fund is co-sponsoring a study by Hungarian counsel to develop a means of eliminating such delays (at least in routine cases) without new legislation.

TESTING THE ENTERPRISE FUND CONCEPT

In light of nearly three years of experience, it may be appropriate to assess the effectiveness of the enterprise fund idea, conceived in 1989 as an alternative to established means of providing U.S. foreign assistance. So far enterprise funds have been established for Hungary, Poland, the Czech and Slovak Republics and Bulgaria, and others are planned. The idea, expressed in its simplest form, was "if the job is to help develop private enterprise, use the private sector to do it - particularly if government budgetary considerations severely limit funding possibilities." Tested against advance expectations for the enterprise funds, HAEF experience in Hungary allows some conclusions to be drawn:

An efficient method of providing assistance to meet targeted goals -

The Fund's clear mandate and restricted funding have led to a single-minded and disciplined focus on activities likely to help develop private enterprise. This has made for relatively clear-cut decisions.

Unlike most conventional U.S. grants for foreign assistance, our funds have been used principally for equity investments and term loans, which may be expected in most cases to lead to significant long term benefits to Hungary and its economy.

Maximum leverage and "bang for the buck" with limited funds -

As was anticipated, leverage has been possible. On the basis of the \$47 million we had received as of September 30, 1992, we have been able to play a leadership role in investing. We can identify additional funds of about \$35 to \$45 million to date whose managers have followed our lead into companies in which we have invested - nearly one and one-half times our own direct investments, or approximately equal to our expenditures for all purposes. As

indicated above, we expect to raise private sector funds to expand our own investment programs, and to continue to lead others.

Of the total funds we received in the last year from the U.S. Government or from interest on investments and loans, 88 cents out of every dollar has gone to Hungary.

Provide benefits of private sector experience -

The Fund's 15-person office in Budapest includes eight dedicated and bilingual professionals in regular communication with both government officials and business people. This is an essential means to identify and evaluate problems and needs where a contribution can be made toward private enterprise development.

We have been able, by various means, to reach and support small and medium-sized business. This sector has clearly become the engine for transformation of the economy. Through our involvement as an investor, we have been able to provide badly needed management training on a realistic on-the-job basis.

* * *

The achievements of this year, in which all of us working for the Fund take great pride, represent hard work, long hours and intense concentration on the part of a dedicated organization. The Directors join me in expressing appreciation for the efforts of all the staff and the excellent progress which has resulted.

Thanks must also be expressed to the Directors for the time and hard work they have committed to the Fund. They have been unstinting in their provision of advice, counsel and decisions which have been key to our steady progress.

While we jealously guard our independence as a private sector organization, we cannot fail to recognize that we have enjoyed the advantage of dedicated public officials to lean on when we have problems, and to assist us when we see opportunities otherwise beyond our grasp. As in previous years, we have benefitted tremendously from the wise counsel and strong support we have received from the U.S. Ambassador to Hungary, the Honorable Charles H. Thomas, who with his staff has been unsparing in assistance. Secretary of State Lawrence S. Eagleburger and his staff with primary oversight for U.S. Government activities in eastern Europe have likewise given us strong backing. At the same time, we have received excellent cooperation and support from Hungarian government officials whenever we needed it, and we are very grateful for that. We hope we have reciprocated in some measure for all this assistance by sharing with all of them what we have learned through our intensive private sector experience in a limited area of activity, and such occasional leverage as our funds can provide.



Alexander C. Tomlinson

ATTRACTIVENESS FOR FOREIGN INVESTMENT

Since the beginning of its economic and political transformation in 1990, Hungary has consistently attracted the greatest amount of international investment capital within the region, despite the relatively small size of its domestic economy. By the end of 1992, the investment inflow totalled about \$4.3 billion, or more than the aggregate of all the other former East Bloc countries (excluding East Germany). Although the reasons for this strong performance are numerous and varied, some of the principal factors may be summarized as follows:

GEOGRAPHIC LOCATION

Hungary is ideally located to serve the markets of western Europe and the potential markets of eastern Europe, the CIS and the Middle East

HUMAN RESOURCES

The Hungarian population is highly educated and highly motivated, having a literacy rate of over 99%. Mathematic, scientific and linguistic skills are particularly advanced, and entrepreneurship is highly developed and widely esteemed. Managers benefitted from economic liberalization under Communism, and are more familiar with western business concepts than elsewhere in centrally-planned economies. The labor force is well-skilled, hard working and extremely cost-competitive.

POLITICAL ENVIRONMENT

Hungary has a stable, democratic, parliamentary government that has demonstrated its commitment to a pluralistic society and a free market economy. Because of its relatively homogeneous population, Hungary has been able to avoid ethnic and nationalistic conflicts in the region; its stability has led to an inflow of capital from neighboring states seeking a safe haven.

LEGAL INFRASTRUCTURE

The legal infrastructure necessary for private investment has been substantially enacted, and a full array of policy incentives are in place to encourage foreign investment, including tax holidays, guaranteed repatriation of earnings and capital, etc.

MAJOR U. S. INVESTORS IN HUNGARY

Alcoa	General Motors	Ralston-Purina
American International Group	Guardian Glass	R.J. Reynolds
American Express	Levi Strauss	Sara Lee
Digital Equipment	Lockheed	Schwinn
Ford	Phillip Morris	United Technologies
General Electric	Pioneer Hi-Bred	U.S. West

HUNGARIAN-AMERICAN ENTERPRISE FUND

INCREASING PACE OF FUND ACTIVITIES

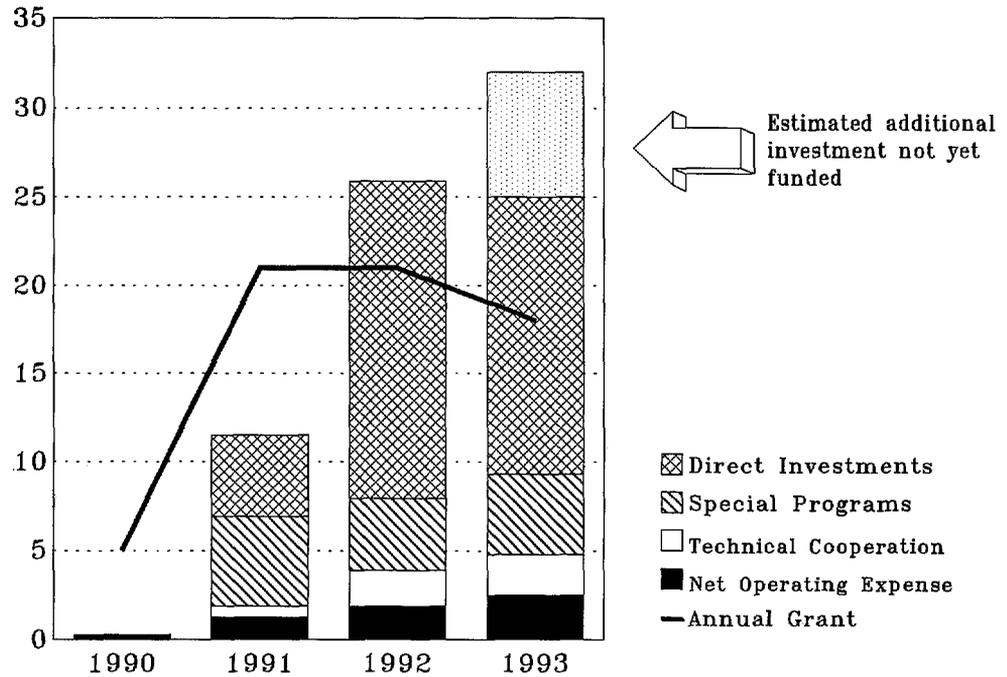
The following table sets forth the schedule of receipt by the Fund of annual instalments of its assigned U.S. Government grant (originally set by the SEED Act at \$60 million, since increased by \$10 million, to be provided by USAID, specifically for technical assistance). It also shows the increasing pace over the same period of approvals and disbursements for direct investments and loans, for the small loan program through two banks, and for the technical cooperation program. Amounts are in millions of dollars.

	Fiscal Year ended September 30			3 months ended Dec 31, 1992 (Estimated)
	1990	1991	1992	
Government Grant to HAEF:				
Available Funds (cumulative)	4.9	26.0	47.0	47.0 ¹
Funds received in period	4.9	21.0	18.2	2.8
Funds received (cumulative)	4.9	25.9	44.1	46.9
Direct Investments and Loans:				
Approved in Period ²	.5	11.7	27.3	-
Funds disbursed in period	-	4.6	22.0	9.2
Funds disbursed (cumulative)	-	4.6	26.6	35.8
Small Loan Program:				
Funds disbursed	-	5.0	-	-
Technical Cooperation Program:				
Grant commitments in period	-	.5	3.7	.5
Funds disbursed in period	-	.6	2.0	.2
Funds disbursed (cumulative)	-	.6	2.6	2.8
Operating Expenses, net of investment income:				
During periods	.2	1.4	1.9	.2
Totals:				
Investments, Loans and Grants				
Approved in period	.5	17.2	31.0	.1
Funds disbursed (incl. operating expenses, net of income):				
During period	.2	11.6	25.9	9.6
Cumulative	.2	11.8	37.7	47.3

Notes: 1: The Fund presently expects to receive \$18 million in the current fiscal year ending September 30, 1993, bringing the cumulative total to \$65 million.
2: Excludes subsequent cancellations.

This table reveals the quickening pace of the various activities in which the Fund is engaged, reflecting the lead time required in the Fund's original start-up period as well as the subsequent gradually increasing private sector activity in Hungary. There is little reason to think this rate of increase will not continue. The needs are still there and the interest in entrepreneurship is still on the increase despite setbacks and disappointments resulting from the recession. Disbursements for all

purposes in the current fiscal year ending September 30, 1993 are projected at more than \$30 million, compared with \$26 million for the fiscal year just ended. It follows, as the graph below shows, that the Fund's ability to commit at the rate management anticipates will be subject to the availability of additional U.S. Government funding beyond that presently scheduled (\$18 million) and to the development of private sector sources as well.



DIRECT INVESTMENTS AND LOANS

POLICIES

In pursuit of its objective of encouraging the development of profitable privately-owned and managed enterprises within Hungary, the Fund established the following policy criteria for its loans and equity investments in Hungarian enterprises and joint ventures:

- **BUSINESS PLAN:** The Fund requires any investment proposal to be supported by a well-conceived business plan evidencing due regard to financing and marketing analyses. We are prepared to assist in the preparation of this plan for promising proposals from Hungarian entrepreneurs. We expect the proposed business activity to have a proven history, not to be an untried concept. We look for a seasoned management team having relevant business experience, whether in Hungary or abroad. In the case of a joint venture with foreign participation, the Fund will look to the foreign partner to provide experienced technical and managerial assistance to build an effective Hungarian management team.

- **ECONOMIC IMPACT:** The proposed project must have a favorable effect on the Hungarian economy, by increasing employment and/or exports, or contributing to the infrastructure of a private enterprise economy.
- **OWNERSHIP STRUCTURE:** Existence of a meaningful private-sector Hungarian ownership share in the enterprise. The Fund does not finance either state-owned businesses or 100% foreign-owned projects.
- **SIZE OF PARTICIPATION:** \$500,000 minimum to \$3,000,000 maximum for any single investment, reflecting the Fund's preference for small to medium-sized business. (See also "Small Loan Program" on page 16.)
- **RISK-SHARING:** Other investors are expected to contribute risk capital to the enterprise such that (under most circumstances) the Fund's holding will not constitute a majority. The Fund's intent is that its participation serve as a catalyst to attract co-investors.
- **FINANCIAL RETURN:** The enterprise must demonstrate the potential for profitable operations, managed growth and cash flow sufficient to service indebtedness and to provide a return on investment commensurate with the degree of risk.
- **EXIT STRATEGY:** The Fund does not enter into any investment with the intent of acquiring a long-term holding, but rather of providing financial and investment support for formation or growth of an enterprise. Upon the enterprises attaining critical mass, the Fund would expect to divest its interest, whether through an initial public offering of stock, a private placement, or a buyout by a partner, by management and/or by employees.

The Fund is prepared to consider exceptions to the foregoing criteria under appropriate circumstances.

APPROVAL PROCEDURE

After thorough review of investment proposals, completion of due diligence and negotiation of the principal terms of investment, proposals are submitted to the Board of Directors or, between board meetings, to the Investment Committee. Following official approval, detailed legal documents are drafted which specify the complete agreement among the parties, including all conditions precedent to disbursement of funds, one of which is the simultaneous delivery of any funding required from other investors.

MONITORING AND MANAGEMENT ASSISTANCE

After disbursement, investments and loans are monitored carefully; in appropriate cases we place a Fund representative on the investee's board of directors or supervisory board. Through the monitoring process we seek both to obtain a current flow of information regarding the status of our investments and to assist investee management in the introduction, understanding and use of

international accounting standards and the development of management information systems for planning and the daily conduct of the business.

An area of concern is the financial capabilities of management and their understanding of corporate governance and responsibility, concepts not necessarily familiar to corporate management dealing for the first time with foreign investors. Under consideration is the development and sponsorship of a one-day seminar for investee top management covering such topics as the role and responsibilities of the board of directors and supervisory board; the role of the annual shareholders meeting; internal communication; definition of functions and job descriptions; the role of budgets and management by objectives; and investor relations.

To supplement our internal review of investments, we are recruiting a team of senior Hungarian-speaking American executives who will periodically visit assigned groups of companies and thoroughly review their business progress, strategies and financial performance. They would be positioned to alert the Fund to adverse developments requiring remedial action or identify situations where experts from the International Executive Service Corps (IESC) might assist management.

DESCRIPTION OF APPROVED INVESTMENTS AND LOANS

The following table briefly describes each of the investments which has been approved by the Fund's Board of Directors or its Investment Committee as of December 31, 1992.

DIRECT INVESTMENTS AND LOANS APPROVED AS OF DECEMBER 31, 1992 (All amounts in US\$)

Company	Amounts Approved	% of Total Equity	Total Disbursed
Alfa Kereskedelmi, Rt (Alfa Trading Company, Rt) A privatization of Hungary's largest food and household products wholesaler. Operates "cash and carry" distribution centers servicing small retailers as well as its own retail outlets.	\$3,000,000 Equity	22.4% 46,560 shares	\$3,000,000 Equity
AlphaGraphics Hungary, Kft A joint venture which operates western style franchised print shops. It holds the master franchise for Alphagraphics print shops in Hungary. HAEF holds right of first refusal to finance future franchisees.	\$250,000 Equity	45.0%	\$0
Bíró, Kft (Biro Metal Fabricating, Kft) A private tool and die manufacturer and sheet metal fabricating shop, Biro also produces various molded plastic parts for Hungarian manufacturers.	\$264,638 Equity \$600,000 Loan	39.9% N.A.	\$264,638 Equity \$600,000 Loan

HUNGARIAN-AMERICAN ENTERPRISE FUND

Company	Amounts Approved	% of Total Equity	Total Disbursed
<p>Irodház Befektetési és Beruházási, Kft (Budapest Business Center, Kft) A joint venture which provides high quality office facilities in a prime location in Budapest. The Center is geared to providing international firms with fully equipped office suites and a wide range of business services.</p>	\$802,549 Equity	15.0%	\$802,549 Equity
<p>Budapest Furnér Művek, Kft (Budapest Veneer Works, Kft) A joint venture to produce wood products, principally veneers, to domestic and international export markets.</p>	\$859,895 Loan	N.A.	\$859,895 Loan
<p>Bulldog-Hungaria, Kft A joint venture manufacturing customized security vehicles, armored vans and personal cars.</p>	\$200,000 Equity	30.0%	\$94,900 Equity
<p>Central European Franchise Group, Rt The exclusive franchisor of Pizza Hut, Kentucky Fried Chicken and Dunkin' Donuts in Hungary. The company has opened several restaurants in Budapest.</p>	\$2,000,000 Equity	6.6% 5,000 shares	\$2,000,000 Equity
<p>Centern Textil Tisztító, Kft (Centern Services, Kft) The master franchisor of the "Martinizing" dry cleaning process. It opened the first privately owned, western style dry cleaning service in Hungary.</p>	\$300,000 Equity \$400,000 Loan	67.5% N.A.	\$300,000 Equity \$0
<p>Duna Elektronika, Rt (Danube Electronics, Rt) The exclusive franchisor of "MicroAge" computer stores in Hungary and a value-added reseller of computer hardware and software. IBM's largest business partner in eastern Europe.</p>	\$500,000 Equity	15.0% 555 shares	\$500,000 Equity
<p>EurAmerica Capital Corporation, Kft An investment and financial advisory affiliate of the Fund. EurAmerica has offices in Budapest and Prague providing investors with counseling and advice on private sector financing, mergers and acquisitions, and performing privatization advisory work.</p>	\$4,000,000 Equity	80.0%	\$4,000,000 Equity
			continued . . .

Company	Amounts Approved	% of Total Equity	Total Disbursed
Első Pesti Telefontársaság, Rt (First Pest City Telephone, Rt) A joint venture of the state owned telephone company, Helsinki Telephone and others, it is the first telephone company in Hungary with majority private ownership. It will install and operate a digital telecommunications network in three districts of Budapest.	\$1,550,000 Equity	5.0% 10,000 shares	\$1,550,575 Equity
Fjord Művek, Kft (Fjord Manufacturing, Kft) A private freezer and refrigerator manufacturer for both domestic and export markets.	\$600,000 Loan	N.A.	\$600,000 Loan
Fornax Műszaki és Gazdasági Tanácsadó Rt (Fornax, Rt) An information services company that provides on-line financial data services from Budapest's stock and commodity exchanges to stock-brokers, traders and the financial community.	\$558,021 Equity	31.0% 1,913 shares	\$558,021 Equity
Első Amerikai Magyar Fozsolgtatási, Rt (Fotex, Rt) Hungary's leading private retailer operates a chain of optical and photo stores and has recently opened a chain of drug/cosmetic stores.	\$2,582,000 Equity	1.6% 750,000 shares	\$2,542,824 Equity
Nemzetközi Divatház, Rt (International Fashion House, Rt) A women's ready to wear apparel company that provides high quality, fashionable and reasonably priced clothing for professional women in Hungary.	\$328,167 Equity	30.1% 26,086 shares	\$328,167 Equity
Loranger Ipari, Kft (Loranger Manufacturing, Kft) A private manufacturer and supplier of plastic automotive parts. Loranger is the sole source supplier of plastic component parts for the DIS system to Ford Motor Company's Hungaria Alba plant.	\$1,250,000 Equity	50.0%	\$1,250,000 Equity
MAVAD (Magyar Vadgazdálkodási és Kereskedelmi Részvénytársaság, Rt) (Hungarian Game Management & Trading Co) Formed in 1934, Mavad is Hungary's leading game management and game meat processor. Mavad processes game meat for both domestic and export trade.	\$2,527,565 Equity	15.5% 108,108 shares	\$2,527,565 Equity

HUNGARIAN-AMERICAN ENTERPRISE FUND

Company	Amounts Approved	% of Total Equity	Total Disbursed
<p>Micro Lending Program Structured conceptually similar to the Fund's Small Loan Program, this Program will make loans of \$1,000 to \$10,000 to small Hungarian entrepreneurs.</p>	\$250,000 Loan	N.A.	\$0 Loan
<p>Micronetics Europe, Rt A joint venture serving the industrial controls market. It provides data acquisition and statistical quality control systems to food, chemical, and machine tool producers in Hungary.</p>	\$372,000 Equity	25.4% 2,615 shares	\$370,180 Equity
<p>Microsystem Műszaki és Számítástechnikai Részvénytársaság, Rt (Microsystem, Rt) A joint venture of a computer software and telecommunications company which sells computer hardware, telefax and telecommunications equipment.</p>	\$2,576,000 Equity	13.0% 5,000 shares	\$2,576,638 Equity
<p>Petőfi Nyomda, Rt (Petőfi Printing Company, Rt) Privatization of the third largest printer in Hungary producing primarily cardboard packaging materials, but also prints labels, books, magazines, newspapers, and other materials.</p>	\$2,930,000 Equity	10.6% 3,092 shares	\$2,773,301 Equity
<p>Pick Szeged, Rt (Pick Sausage Company, Rt) Privatization of a leading meat processor and producer of the famous "Pick Winter Salami". The company processes fresh pork and beef products, sausages and salami. Exports account for approximately 50% of total sales.</p>	\$2,500,000 Equity	6.0% 141,000 shares	\$2,044,000 Equity
<p>Polichem, Kft This joint venture is a wholesale distributor of base chemicals and reagents, paints, plastics and polymers to Hungarian manufacturers.</p>	\$1,002,149 Equity	10.5%	\$1,002,149 Equity
<p>EMI-Quint, Ltd (EMI-Quint Records, Ltd) A private recording company that produces classical and pop music primarily for the Hungarian market and also licenses, imports and distributes foreign recordings.</p>	\$128,403 Equity	5.0%	\$128,403 Equity
continued . . .			

Company	Amount Approved	% of Total Equity	Total Disbursed
Rogerson Hungarian Aviation Investments, LP A joint venture of a U.S. company with Hungarian Kfts. Rogerson provides airborne pesticide spraying and seeding services to the Hungarian agricultural community.	\$1,700,000 Equity	36.0%	\$660,000 Equity
Semilab, Rt A producer of semiconductor testing equipment exporting 100% of its product. Customers include IBM, Texas Instruments, Siemens.	\$250,926 Equity	26.0% 2,132 shares	\$250,926 Equity
Stewart Information International, Kft A joint venture with a U.S. partner to establish a for-profit computerization of the land title registry system in Hungary. A pilot project is underway in three districts of Budapest.	\$400,000 Equity	40.0%	\$400,000 Equity
SzKi Recognita, Rt A private computer software development company which specializes in optical character recognition software, a Hewlett-Packard business partner.	\$380,000 Equity	30.0% 1,036 shares	\$249,308
Szücs, Bt (Szücs Stock Breeding & Trading Deposit Company, Bt) The largest private sheep farming company in Hungary with over 4,500 sheep. Szücs provides sheep and lambs for processing to both the domestic and export market.	\$571,000 Loan	N.A.	\$571,000 Loan
Western-Rotary Olajipari Szolgáltató, Kft (Western-Rotary Petroleum Services, Kft) A joint venture with an American company, Western will provide pressure oil and gas pumping services in Hungary and abroad.	\$400,000 Equity \$755,000 Loan	14.0% N.A.	\$0 \$0
Totals	\$36,788,313		\$32,805,039

Note: Of the thirty investments and loans listed in this table, seven were revalued at fiscal year end. Of the seven, four were valued downward and three upward. The net effect of these revaluations was to increase the carrying value of the total portfolio by \$292,320.

SMALL LOAN PROGRAM

The transformation of the Hungarian economy to date is largely a reflection of the increasing activity of the private sector. Not only has the number of joint ventures and partnerships increased rapidly, but it is reported that the number of one-person companies established in 1992 increased by more than 50% over 1991, and had doubled in the previous year.

The Fund has assisted in this private sector development through its Small Loan Program, now two years old. Credit is made available through two Hungarian banks: Széchenyi Bank, an affiliate of Hungary's largest bank, focuses on loans to light manufacturing and service-oriented companies, and Mezőbank, established by 1,400 agricultural cooperatives, emphasizes agriculture and small rural businesses. The banks share the risk of losses equally with the Fund. Loans are denominated in Forints, and range in size (in dollar equivalent amounts) from \$10,000 to \$100,000. They are secured, and mature in three to five years.

The \$5 million allocated by the Fund to the Small Loan Program has been fully committed. To date, the portfolio of 108 loans has an impressive track record when viewed in light of the contracting economy. Over 95% of the loans are current and performing in compliance with the loan agreement.

Portfolio of HAEF Small Business Development Program

<i>As of November 20, 1992</i> <i>(US\$, 000's omitted)</i>	Széchenyi Bank			Mezőbank			TOTAL		
	#	\$	%	#	\$	%	#	\$	%
Satisfactory	50	2,837	93	46	1,618	87	96	4,455	91
Watch	3	169	6	1	82	4	4	251	5
Non-Performing	1	41	1	5	161	9	6	202	4

In the above table, loans are considered to be *satisfactory* when they are performing in accordance with the loan agreement, and *nonperforming* when they are in default of the agreement. Loans in the *watch* category are performing, but certain business or economic conditions have been identified that may adversely affect the customer's ability to continue to service the loan.

The Fund is engaged in negotiations to obtain outside funds to continue this successful program.

TECHNICAL COOPERATION PROGRAM

The initial focus of the Fund was on investment and loans for development and support of private enterprise in Hungary. The establishment of the Technical Cooperation Program in June 1991, with a \$5 million commitment from USAID, enabled the Fund to extend its activities to include grants for projects important to laying the basic foundation stones for a private sector economy. The criteria

for such grants are primarily that (1) the proposed project contributes to the development of the infrastructure of private enterprise or a market economy and (2) other sources of funding are not available to meet the proposed time schedule, which is appropriate to the relative urgency of the project. As of September 30, 1992, the Fund had committed \$4.21 million for 21 projects, of which \$2.65 million has been disbursed. USAID provided an additional \$5 million commitment in 1993. The Fund is currently attempting to solicit up to a similar amount in private sector gifts from foundations and individuals having a particular interest in providing assistance to Hungary.

Illustrative of the projects for which the Fund provides grants are the selected examples below, which are in various stages of completion; in many instances disbursements will occur over an extended period.

PUBLIC ECONOMIC UNDERSTANDING

Budapest Stock Exchange Visitors Centre \$363,000

Design and installation of a tourist exhibit which will present stock exchange-related concepts (e.g., the meaning and nature of equity shares, and the role of a stock exchange in a private enterprise economy) in a way that will be meaningful and educational for people who have had little experience with the mechanism of enterprise ownership. The design of the center has been influenced by the New York Stock Exchange and should have its opening in early 1993.

Economic Literacy Project \$1,421,000

This project is currently finalizing the design and production of 45 self-contained Hungarian-language video training programs. This video system encompasses basic business training that can be shown to wide audiences, which include organizations already in, or interested in entering, the private sector. Subjects covered are *Basic Marketing*, *Basic Accounting*, *How to Start a New Business* and *How to Succeed in a Market Economy*. Distribution of the system is slated for mid-1993.

ECONOMIC POLICY STUDIES

Blue Ribbon Commission (BRC-2) Up to \$1,000,000

The original joint Hungarian-International Commission was reconstituted ("BRC-2") and is conducting studies and making recommendations on policy issues central to Hungary's transition to a market-based economy. The Fund agreed to finance selected studies closely related to issues in the development of a market economy. The first study, *Sustainable Forint Convertibility*, was completed in June 1992. Work is currently in progress on *Privatization and Corporate Governance; Reforming Budget and Social Policy by Expanding the Role of the Private Sector in Delivering and Financing Services; The Role of Financial Services in Developing the Private Sector in Hungary*, and *Comparative Investment-Worthiness of Hungary, with Policy Recommendation to Improve it*.

TRAINING PROGRAMS

MBA Enterprise Corps

\$100,000

The Fund has contributed to the support of this program, which places recent Master of Business Administration graduates in private enterprises in former East Bloc countries for advisory assignments of up to two years. Corps members have been placed in six Hungarian companies related to the Fund's activities.

"Perhaps the greatest contribution we can make to the process of economic reform in Eastern Europe and the former Soviet Union is as providers of basic management training and market economics education. And we must also train the indigenous trainers of tomorrow in the basic precepts of the free market, so that they will be able to pass these lessons on to future business leaders of the region."

The Honorable John E. Robson, Deputy Secretary of the Treasury
Washington, D.C., December 2, 1992

International Management Center, Budapest

The Fund is working with the Center, a graduate management training facility, to increase its outreach; this program, which is still in the planning stage, will involve establishment of a short-term consulting arm of the Center staffed by four members of the MBA Enterprise Corps. It will also involve working with the Fund on management information systems design and other matters.

OTHER

Corporate Registration

The Fund is providing legal support for a study to determine how the current Hungarian corporate registration requirements could be changed to avoid the long delays that are slowing (and sometime forestalling) privatization transactions.

Advisory

The Fund frequently provides consultants or advisors, and occasionally staff assistance, in connection with specific programs of the Government related to privatization.

EURAMERICA CAPITAL CORPORATION

In furtherance of its objective to contribute to the expansion and development of Hungary's capital markets, the Hungarian-American Enterprise Fund in April, 1992 invested \$4,000,000 to establish EurAmerica Capital Corporation, an investment banking and financial advisory services affiliate headquartered in Budapest.

EurAmerica's financial services include advising companies on their capital structure and funding, the attraction of private capital, mergers and acquisitions, privatization and other advisory work, and the raising of equity capital for emerging private-sector companies, both in Hungary and elsewhere throughout central and eastern Europe. They also include raising private investment funds, asset management and the representation of major American, western European and Asian companies in the region.

Engaged clients include Hungarian, Czech, Slovak and Polish companies, regional governments and governmental authorities, privatization candidates and international investment groups. They include newly-established as well as existing companies, and are engaged both directly and upon referral from the Fund. EurAmerica fills a unique market niche in the provision of investment banking and financial advisory services to small and medium-sized companies often overlooked by major international institutions.

The principals of EurAmerica, resident in Budapest, have broad financial backgrounds as well as several years' direct, hands-on investment banking experience throughout central and eastern Europe in association with a major investment banking firm. They have had considerable success in raising equity capital for Hungarian private sector companies.

The Fund believes that Budapest has the potential to become a major financial and trade center for central and eastern Europe, and that our investment in EurAmerica - with its Budapest location, the extensive financial experience and skills of its principals, and its particular focus on small and medium-sized businesses - will contribute significantly to the development of Hungary's financial links with developing free markets throughout the region, providing excellent opportunities for related private sector development.

"To achieve the successful economic transformation of these countries, we must temper our optimism with the realization that the road to economic reform will not be straight or well-paved. Rather, it will be full of curves, bumpy stretches, and unexpected detours, and we must all be prepared to endure some wrong turns and a few pit stops. So it is important that the American government and our private sector continue to provide support and encouragement along the way."

"With the help of both the public and private sectors we have already done much to aid the economic reform process and advance the cause of democracy in Eastern Europe and the Soviet Union. But there is much more to do. And I think it is appropriate here and now that we rededicate ourselves to seeing it through until the economic reforms in Eastern Europe and the former Soviet Union are durable in place."

The Honorable John E. Robson, Deputy Secretary of the Treasury,
Washington D.C., December 2, 1992

OUTLOOK ON THE HUNGARIAN ECONOMY

Despite the current recession, marked by a further decline in the GNP estimated at close to 5% for the year, there have been significant favorable developments in Hungary. Inflation, which peaked in mid-1991 at over 38%, continued its fall since that time and at year-end 1992 is estimated to have been running at an annual rate of 23%, with expectations of further decline. Capital inflow continued strong, contributing to the favorable balance of payments. Although official unemployment reached 11.6% at the end of October, there are strong indications that this may owing to the understatement of the actual growth of small business. The major problem of the year has been the public sector (especially central budget) deficit. The recession, the implementation of the new laws on accounting, bankruptcy and banking and inefficient tax collection made it impossible to keep the deficit within guidelines set by the International Monetary Fund. Measures have recently been taken to increase tax and other revenues to get the deficit down in 1993. After this disappointing year, the official forecast is that the recession has bottomed and recovery is in the cards for 1993.

With the development of many new small businesses operating on a competitive market basis (now 13,250 joint ventures with foreign companies, and 2,252 companies 100% foreign-owned), a new class of Hungarian entrepreneurs and executives is emerging. At the same time, the mass of the population continues to experience economic strains. For example, those on fixed incomes, such as older Hungarians drawing pensions, have suffered severely as inflation eroded their purchasing power. While these strains have been felt in the political sphere, they do not appear to threaten the government's commitment to continue economic liberalization. In any event, recovery of the economy will be welcome.

ECONOMIC INDICES

	1990 Actual	1991 Actual	1992 Estimated	1993 Official Forecast
DOMESTIC ECONOMY				
Real GDP % change	-3.6	-10.2	-5.0	0.0 to 3.0
Consumer prices annual % change	28.9	35.0	23.0	16.0
General government borrowing % GDP	0.8	4.6	7.2	5.5
Unemployment (% at year end)	1.6	8.3	11.8	15.0 to 16.0
EXTERNAL ECONOMY (convertible currency)				
Trade Balance (\$ million)	348.0	189.0	-450.0	-750.0
Merchandise exports	6,346.0	9,258.0	10,800.0	11,800.0
Merchandise imports	5,998.0	9,069.0	11,250.0	12,550.0
Current account balance	127.0	267.0	500.0	-100 to 100
Exchange rate, average (HUF/\$)	63.20	74.73	79.00	85.50

	1990 Actual	1991 Actual	1992 Estimated	1993 Official Forecast
EXTERNAL DEBTS & RESERVES (\$ million)				
Convertible Currency External Debt	21,270.0	22,658.0	22,000.0	21,500.0
% GDP	64.6	72.5	62.2	55.3
Reserves excluding gold	1,069.0	3,935.0	5,255.0	6,400.0
Months of convertible currency payments: import goods, services & income	1.4	3.8	4.7	5.2
Total debt service	4,207.0	4,037.0	4,305.0	3,540.4
% of convertible currency revenues: export goods, services & income	47.2	34.1	31.6	24.2
Interest payments	1,644.0	1,628.0	1,445.0	1,300.0
Amortization paid	2,563.0	2,409.0	2,860.0	2,240.4

Sources: National Bank of Hungary, The Institute of International Finance, Eastern Europe Business Information Center and *PlanEcon*. For 1992-1993 foreign trade figures are from the Ministry of International Economic Relations, Budapest.

HUNGARIAN-AMERICAN ENTERPRISE FUND
AUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 1992

Report of Independent Auditors**Board of Directors
Hungarian-American Enterprise Fund**

We have audited the accompanying consolidated balance sheet of the Hungarian-American Enterprise Fund (the Fund) as of September 30, 1992, and the related consolidated statements of revenues, expenses and changes in fund balance, and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation and examination of securities owned at September 30, 1992. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Hungarian-American Enterprise Fund at September 30, 1992, and the consolidated results of its operations and changes in fund balance, and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As explained in Note 6, the consolidated financial statements include investments valued at \$24,394,054 (73% of net assets), as of September 30, 1992, whose values have been estimated by management and approved 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 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, and the differences could be material.

November 16, 1992
except for Note 7, as to which the date is
December 1, 1992.



HUNGARIAN-AMERICAN ENTERPRISE FUND

**HUNGARIAN-AMERICAN ENTERPRISE FUND
CONSOLIDATED BALANCE SHEET
SEPTEMBER 30, 1992**

Assets

Cash and cash equivalents	\$8,384,911
Cash designated for possible realized future losses in Small Loan Program	101,951
Cash reserves held against investments (Note 6)	299,000
Investments, at fair value (Notes 2 and 6):	
Direct investments and loans	19,894,054
Small Loan Program	4,500,000
Investment in EurAmerica Capital Corporation	4,000,000
Prepaid expenses and other assets	57,523
Accrued interest receivable	334,008
Fixed assets, net (Note 4)	392,526
Organization costs, net	<u>5,711</u>
Total assets	<u>\$37,969,684</u>

Liabilities and Fund Balance

Accounts payable and accrued expenses	\$207,092
U.S. Federal grants received and held for future program purposes	<u>4,171,513</u>
Total liabilities	4,378,605
Commitments (Notes 3 and 7)	
Fund balance	<u>33,591,079</u>
Total liabilities and fund balance	<u>\$37,969,684</u>

The accompanying notes are an integral part of the financial statements

HUNGARIAN-AMERICAN ENTERPRISE FUND
CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED SEPTEMBER 30, 1992

Revenues	Loan/ Investment Program	Technical Cooperation Program	Totals
Income from investments & loans	435,386	-	435,386
Interest income - other	<u>415,532</u>	-	<u>415,532</u>
Total revenues	<u>850,918</u>	-	<u>850,918</u>
 Expenses			
Employee compensation and benefits	1,106,514	26,156	1,132,670
Employee business expenses	162,141	-	162,141
Program development	194,827	-	194,827
Professional services	582,506	-	582,506
Depreciation and amortization	100,691	-	100,691
Occupancy	215,689	-	215,689
Administrative and other	<u>398,372</u>	<u>4,023</u>	<u>402,395</u>
Total expenses	<u>2,760,740</u>	<u>30,179</u>	<u>2,790,919</u>
 Net operating loss	 <u>(1,909,822)</u>	 <u>(30,179)</u>	 <u>(1,940,001)</u>
 Realized gains on direct investments and loans	 166,271	 -	 166,271
Unrealized gains on direct investments and loans	292,320	-	292,320
Unrealized losses on Small Loan Program	<u>(500,000)</u>	-	<u>(500,000)</u>
Total net investment gains and (losses)	<u>(41,409)</u>	-	<u>(41,409)</u>
 Subtotal	 (1,951,231)	 (30,179)	 (1,981,410)
 US Federal grants recognized for program expenditures (Note 2)	 \$25,546,673	 2,076,231	 \$27,622,904
 Technical cooperation grants	 <u>-</u>	 <u>2,046,052</u>	 <u>2,046,052</u>
 Excess of revenues over expenses and technical cooperation grants	 23,595,442	 -	 23,595,442
 Fund balance, beginning of year	 <u>9,995,637</u>	 -	 <u>9,995,637</u>
 Fund balance, end of year	 <u>\$33,591,079</u>	 <u>-</u>	 <u>\$33,591,079</u>

The accompanying notes are an integral part of the financial statements

HUNGARIAN-AMERICAN ENTERPRISE FUND

**HUNGARIAN-AMERICAN ENTERPRISE FUND
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30, 1992**

Cash flows from operating activities:

Excess of revenues over expenses and technical cooperation grants	\$23,595,442
Adjustments to reconcile excess of revenues over expenses and technical cooperation grants to net cash provided by operating activities:	
Depreciation and amortization	100,691
Total net realized and unrealized (gains) losses on investments and loans	41,409
Changes in operating assets & liabilities:	
Increase in cash designated for possible realized future losses in Small Loan Program	(1,951)
Increase in cash reserves held against investments	(299,000)
Increase in prepaid expenses & other assets	(9,083)
Increase in accrued interest receivable	(319,987)
Decrease in accounts payable and accrued expenses	(153,141)
Decrease in U.S. Federal grants received and held for future program purposes	<u>(9,422,908)</u>
Net cash provided by operating activities	13,531,472
Cash flows from investing activities	
Purchases of fixed assets	(281,797)
Proceeds from sales of investments	3,139,203
Purchases of new investments	<u>(22,018,658)</u>
Net cash used in investing activities	<u>(19,161,252)</u>
Net decrease in cash and cash equivalents	(5,629,780)
Cash and cash equivalents at beginning of year	<u>14,014,691</u>
Cash and cash equivalents at end of year	<u>\$8,384,911</u>

The accompanying notes are an integral part of the financial statements

**HUNGARIAN-AMERICAN ENTERPRISE FUND
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 1992**

1. Organization of Fund

The Hungarian-American Enterprise Fund (the "Fund") is a not-for-profit corporation formed pursuant to the Support for East European Democracy Act of 1989 (the "SEED Act") for the primary purpose of promoting the development of the Hungarian private sector and policies and practices conducive to such development. As part of the SEED Act, the United States Congress authorized \$60 million to be appropriated over a three year period to the Fund by the Agency for International Development ("AID") to be used for program purposes, technical cooperation grants and administrative expenditures. Grants received from AID are conditioned on the Fund's compliance with the requirements of the SEED Act, which imposes certain U.S. policy objectives and reporting obligations. Under the terms of the grant agreement with AID, the Fund may hold funds in interest bearing accounts and may retain interest, investment income and investment profits for program purposes.

The consolidated financial statements includes the Hungarian-American Enterprise Fund and Enterprise Fund Holding, S.A.. Enterprise Fund Holding is a wholly-owned subsidiary established to invest in EurAmerica Capital Corporation (see note 6). EurAmerica Capital Corporation is accounted for using the equity method of accounting.

The Fund's capital is used principally to foster small and medium sized businesses in Hungary which have a likelihood of becoming commercially viable in a free market environment through equity investments and lending activities. The Fund maintains offices in Washington, D.C. and Budapest, Hungary.

2. Summary of significant accounting policies

The significant accounting policies are as follows:

Cash equivalents

For purposes of the statement of cash flows, the Fund considers all highly liquid financial instruments purchased with a maturity of three months or less to be cash equivalents. Cash held in bank accounts in excess of FDIC insurance limits is collateralized by US Government and Agency securities.

Investment valuation

The Fund's loans and equity investments are stated at fair value as determined by management and approved by the Board of Directors. In determining fair value, management considers relevant qualitative and quantitative information available. This includes such factors as the financial condition and operating results of each company, the economic and market conditions

HUNGARIAN-AMERICAN ENTERPRISE FUND
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 1992

Investment valuation (continued)

affecting its operations, and any subsequent events or financing transactions that may be indicative of a change in value. Cost is used to represent the fair value of investments in the absence of information that would support the need for a lower or higher valuation. The 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 circumstances. Investment valuation is conducted by management annually, and more often if circumstances warrant.

Fixed assets and organization costs

Fixed assets (which include leasehold improvements) are stated at cost net of depreciation or amortization. Computer hardware and furniture and equipment are depreciated on a straight-line basis over their estimated useful lives, principally 5 years. Leasehold improvements are amortized on a straight-line basis over the lesser of their useful lives or the term of the lease. Organization costs are amortized on a straight-line basis over three years.

Revenue recognition

Amounts received from AID are conditioned on the Fund's compliance with the requirements of the AID Grant and the SEED Act, which imposes certain U.S. policy objectives and reporting obligations. Under the terms of the AID Grant, the Fund may hold funds in interest bearing accounts and may retain investment and program income for program purposes. AID has granted the Fund an additional \$10 million for technical cooperation which is managed separately from other program funds.

As of September 30, 1992, the status of the AID Grant was as follows (in millions):

Funds received from AID:	
Inception through September 30, 1991	\$25.9
Fiscal 1992	<u>18.2</u>
Total funds received	44.1
Remaining funds available from 1992 appropriations	2.9
Funds to be made available from 1993 appropriations	13.0
Total initial authorization	60.0
Technical assistance grants from AID	<u>10.0</u>
Total funding	\$70.0

The Fund accounts for its grant activities in accordance with generally accepted accounting principles for not-for-profit organizations. Accordingly, the extent to which grant funds are disbursed during the year for program purposes is considered revenue.

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Revenue recognition (continued)

In practice, as disbursements are made an equal amount of grant funds received is considered utilized and recorded as revenues. In the accompanying consolidated statement of revenues, expenses and changes in fund balance, this revenue is reported as "U.S. federal grants recognized for program expenditures". For the fiscal year ended September 30, 1992, AID Grant funds were utilized for the following program purposes (in millions):

Investments	\$22.0
Operating expenditures, net of depreciation and amortization	2.7
Technical assistance	2.6
Fixed assets	<u>0.3</u>
	\$27.6

Since inception, the Fund has received \$44.2 million of the AID Grant, of which \$40.0 million has been disbursed for program purposes, leaving \$4.2 million available at September 30, 1992 for future program purposes. The Fund's operating cash balance exceeds the amount of U.S. federal grants received and held for program purposes because, under the terms of the AID Grant, the Fund retains interest income, loan principal repayments and principal from the sale of investments for program purposes.

Employee benefits

The Fund offers its full time U.S. citizen employees a defined contribution plan under IRS §403(b)(7). Upon reaching eligibility after one year's service, employees may contribute up to 7% of base salary which is matched by the Fund. The 403(b) Plan custodian and administrator is T. Rowe Price Retirement Services, Inc. Fund contributions to this plan totalled \$41,632 in 1992.

Hungarian nationals are covered by an extensive state system which is funded by a 49% employer tax on salaries of Hungarian nationals.

Employee business expenses

Non-salary employee expenses directly attributable to the Fund's investment and technical cooperation activities (such as travel, lodging, meals, etc.) are classified as employee business expenses.

HUNGARIAN-AMERICAN ENTERPRISE FUND

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Program development expenses

Expenses directly attributable to the Fund's investment and technical cooperation activities (such as consulting, non-employee travel, certain legal fees, etc.) are classified as program development expenses.

Professional services

Legal fees, accounting and audit fees, and consulting fees are classified as Professional Services fees.

Foreign currency translation

The Fund's operating assets and liabilities are principally denominated in U.S. dollars with the exception of investments and certain loans. Revenues and expenses transacted in Hungarian forints are translated into U.S. dollars at historical rates. Adjustments resulting from translation are immaterial to the accompanying financial statements.

Donated services

Members of the Fund's Board of Directors donate significant amounts of their time to the Fund's work. No amounts have been reflected in the accompanying financial statements for such donated services inasmuch as no objective basis is available to measure the value of such services.

Related parties

The Fund shares the cost of certain operating expenditures in Washington, D.C. with the Czech and Slovak American Enterprise Fund. Such shared operating costs consist of occupancy and employee compensation and benefits. They approximated \$142,000 and \$156,000, respectively, for 1992 and were allocated equally between the two Funds.

Transactions with related parties are closely monitored by management and the Board of Directors of the Fund. As a matter of Fund policy, directors who have a related party relationship, if any, do not participate in decisions involving those related parties.

Technical cooperation

The Fund generally disburses funds for Technical Cooperation grants as expenses on the project are incurred. Funds earmarked for approved grants but not yet disbursed amounted to approximately \$1,661,000 at September 30, 1992.

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3. Lease commitments and rental expense

The Fund is obligated under noncancelable operating leases for its Washington and Budapest offices. Lease terms are 5 years for both leases. The Budapest lease is denominated in Deutsche Marks and payable in Hungarian forints. Future commitments under these leases are as follows:

<u>Fiscal Year</u>	<u>(\$US)</u>
1993	195,686
1994	195,686
1995	195,686
1996	<u>151,254</u>
Total	<u>\$738,312</u>

The Fund was granted an initial free rent period under the lease on its Washington, D.C. facility. However, the accompanying financial statements reflect net rent expense on a straight-line basis over the life of the lease. An amount equal to three month's lease expense in Budapest (\$40,000) is held in escrow offset against the Fund's cash on hand. The leases are subject to annual (Washington) and bi-annual (Budapest) escalations based on increases in the applicable consumer price index.

4. Fixed assets

At September 30, 1992 fixed assets consisted of:

	<u>Cost</u>	<u>Accumulated Depreciation/ Amortization</u>	<u>Net Book Value</u>
Furniture, equipment & computers	417,791	87,611	330,180
Computer software	\$53,295	\$12,205	\$41,090
Leasehold improvements	<u>24,806</u>	<u>3,550</u>	<u>21,256</u>
Totals	<u>\$495,892</u>	<u>\$103,366</u>	<u>\$392,526</u>

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5. Tax status

United States

The Fund has received a determination from the Internal Revenue Service that it is exempt from federal income tax under Internal Revenue Code section 501(c)(3). The Fund has also received exemption from District of Columbia corporate income and franchise taxes.

Hungary

The tax status of the Fund's Budapest office is currently being negotiated by the U.S. Department of State with the Republic of Hungary. A bilateral agreement covering this issue is expected to be concluded shortly. Management expects that this bilateral agreement will not result in any tax liability in the Republic of Hungary.

6. Investments

Direct investments and loans

As of September 30, 1992, the Fund had invested in 4 loans and 17 equity investments with a carrying value totalling \$19,894,054 (excluding the Small Loan Program). The loans to Budapest Veneer Works Kft, Biro Kft and Szucs Kft are denominated in Hungarian forints. These three loans have a total of \$299,000 pledged as cash reserves.

Small Loan Program

The Fund has authorized \$5,000,000 to develop a program to provide loans to small businesses throughout Hungary. \$5,000,000 has been funded through September 30, 1992. This "Small Loan Program" is operated in conjunction with the Szechenyi Bank (a division of the Magyar Hitel (Hungarian Credit) Bank) and with MEZOBANK ("the banks").

Credit experience with the program has caused management to revalue the investment to a carrying value of \$4,500,000 at September 30, 1992. Arrangements under the Agreements between the Fund and the banks may lead to recovery of all or a portion of losses experienced by the Fund over the five year life of the Agreements.

The banks perform all credit checks and administrative and monitoring work, and share credit risk equally with the Fund. The Fund has retained the right to review the banks' credit checks and to veto or override their loan decisions.

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EurAmerica Capital Corporation

In May, 1992 the Fund provided, through its wholly owned subsidiary, \$4,000,000 for the establishment of EurAmerica Capital Corporation, a financial and investment services company with headquarters in Budapest. EurAmerica's scope of activities include advising and serving the Fund and its investees, and other companies or individuals in Hungary and elsewhere in Central and Eastern Europe, on deal structuring, acquisitions, securities issues and placement, and related matters.

Outstanding Investments and Loans as of September 30, 1992

Investment	Original Cost	Investment Type
Biro, Kft	\$ 600,000	Loan (HUF)
Biro, Kft	264,638	Equity
Budapest Business Center, Kft	802,549	Equity
Budapest Veneer Works, Kft	859,895	Loan (split \$/HUF)
Bulldog-Hungaria, Kft	94,900	Equity
Centern Services, Kft	300,000	Equity
Duna Elektronika, Rt	500,000	Equity
First Pest Telephone, Rt	1,550,578	Equity
Fjord, Kft	600,000	Loan (\$)
Fornax, Rt	558,022	Equity
Fotex, Rt	2,542,824	Equity
International Fashion House, Rt	328,167	Equity
Mavad, Rt	2,527,565	Equity
Micronetics Europe, Rt	370,180	Equity
Microsystem, Rt	2,576,638	Equity
Petőfi, Rt	2,773,301	Equity
Polichem, Kft	1,002,148	Equity
Quint Records, Ltd	128,403	Equity
Semilab, Kft	250,926	Equity
Stewart Information Systems, Ltd	400,000	Equity
Szűcs, Bt	571,000	Loan (HUF)
Direct Investments and Loans	\$19,601,734	
Small Loan Program	5,000,000	
Total original cost	24,601,734	
Net revaluations at year end	(207,680)	
Total current carrying value	24,394,054	
EurAmerica Capital Corporation	4,000,000	

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7. Subsequent events

Investments

Subsequent to fiscal year end and prior to December 1, 1992, the Fund has closed on several additional investments. They are:

- \$2,000,000 equity investment in the Central European Franchise Group, the exclusive franchisee for Hungary of Pizza Hut, Dunkin' Donuts and Kentucky Fried Chicken.
- \$660,000 equity investment in Rogerson Hungarian Aviation, Limited, an agricultural chemical and seed spraying helicopter service.
- \$1,250,000 equity investment in Loranger Ipari, Kft, a plastics fabricator and molder.
- \$3,000,000 equity investment in Alfa Trading Rt, a wholesale grocery distributor and supermarket operator.