CONTENTS

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The Western NIS Enterprise Fund capitalized with $150 million by the U S Government invests in private companies in Ukraine Moldova and Belarus The Fund has been fully operational in the region since June 1995 The Fund generally provides equity capital and loans in amounts between $750 000 and $7 5 million to small and medium sized private companies in any of the three countries in which it operates The Small Business Loan Fund a separate fund managed by the Western NIS Enterprise Fund, makes commercial loans under $100 000 to small businesses and entrepreneurs in Ukraine

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

The Western NIS Enterprise Fund has completed its third full year of operations with over $56 million of venture capital committed to 18 companies operating in Ukraine and Moldova. Many of the Fund's portfolio companies have worked with the Fund for two or more years. With the Fund's capital and guidance, the companies managed effectively through the recent financial crisis and, in fact, took advantage of opportunities created as their weaker competitors fell away. These results validated the Fund's strategy of placing our capital directly – not investing in the secondary public markets – into companies with smart, competitive local partners. As an active financial partner, we secured proper governance rights, then worked with management to add value to operations. We finished the year pursuing this strategy with the competitive advantages of an experienced staff of investment professionals and a substantial amount of available capital.

During 1998 the quality of the Fund's portfolio improved significantly as the Fund aggressively sought out new investment opportunities. The Fund added six new companies to the portfolio with commitments of over $21 million and supported the growth of seven existing portfolio companies with $4.3 million of expansion capital. At the same time, it was important for the Fund to adhere to rigorous investment procedures in order to prudently manage its risks. Over $14 million of commitments made to five companies in prior years were allowed to expire because the companies were unable to meet the conditions required for investment. Often this was more the result of the negative aspects of the legal and regulatory environment than weakness of commercial factors.

In 1998 the Fund continued lending to entrepreneurs and small businesses through the Small Business Loan Fund ("SBLF"), which has made over $2.4 million of loans to more than 50 small businesses in the last four years. During 1998 the SBLF closed $930,000 of new loans to sixteen clients that, collectively, employ 310 people. SBLF also expanded its geographic reach into eastern Ukraine by opening an office in Kharkiv.

The lack of economic reforms compounded the effects of the financial crisis on the governments and private enterprises. Economic reforms, such as tax reform, privatization and regulatory transparency, did not proceed, and the state continued to impede commercial activity. Due to the lack of fundamental change, the local financial markets were violently disrupted in August when institutional investors started to withdraw investment capital indiscriminately from all emerging capital markets. Large sale orders of publicly traded stocks and bonds caused security prices to fall dramatically, giving public equity funds huge losses and limiting government access to the Treasury bill market. Once concerns about the creditworthiness of sovereign debt spread to the commercial banks, local governments lost their last source of liquidity. Ukraine and Moldova were forced to react and managed the initial stage of the crisis better than Russia. Their central banks had better liquidity positions and subsequently stabilized their currencies. The governments also negotiated voluntary restructurings and avoided official defaults on their sovereign debt.

Despite these macro economic impediments, most of the Fund's venture portfolio companies have improved their operations and are poised for growth. The Fund's equity investments were made directly into the companies, and the proceeds were used to install capital equipment. As a result, the companies now produce higher quality products at a lower cost and offer these products at competitive prices. In addition, the Fund's post-investment activities with each of the portfolio companies have contributed to strengthening other functional areas. Many of the companies have established new advertising programs for their branded products. Under the guidance of the Fund, eight companies have installed computerized management information systems and trained their personnel to make management decisions in a more timely and informed manner. Nine companies are preparing to be audited by an independent Western firm for the second year in a row. We have also helped several companies expand their management teams by recruiting local financial and marketing managers.

All of the Fund's equity investments, with the exception of two, are in satisfactory condition and are carried at cost. In one of the two exceptions, the company had management problems during its start up phase and depended heavily upon sales to Russia. Company management has been replaced, and the new management team is attempting to diversify the customer base The other portfolio company uses a large amount of imported raw materials and production costs have increased dramatically with the depreciation of the local currency In both cases, no write offs were considered imminent, however Fund management and the Board elected to create a $4 0 million equity reserve in accordance with the guidelines of the European Venture Capital Association In addition to the equity reserve, the Fund has established a loan reserve of approximately $1 5 million for debt transactions in the venture capital portfolio and the Small Business Loan Fund

Like our portfolio companies, the Fund was well positioned to take advantage of the disruptions caused by the financial crisis We adhered to our strategy of making primary equity investments with local partners driven to build the competitive strengths of their companies Most other funds in the Region invested in secondary securities through the local public debt and equity market, as well as private equity As a result of the losses in their public securities portfolios, many funds closed or significantly reduced the size of their operations in the region Simultaneously, local banks had to increase interest rates to prohibitive levels, making debt an unattractive alternative to private equity In addition local owner/operators seeking long term capital were forced to adjust their value expectations of their existing businesses These competitive changes in the public, as well as private, debt and equity markets improved the Fund s investment opportunities significantly

As a result we remain cautiously optimistic about the investment opportunities in the region The market is large yet more manageable than the Russian market In Ukraine alone, there are over 50 million people, and the country has a tremendous renewable natural resource with over 25% of the world s most fertile soil The region s greatest resource, however, is its highly educated workforce In addition, the economy has been industrialized and has good proximity to Western European markets, as well as the Russian market – a renewed advantage once the Russian market comes back to health

Like the Fund, a few far-sighted strategic investors are attracted to the region Many see the potential demand for their products and want to take advantage of reduced asset prices to build local operating bases The recent slowdown in the market is keeping some multinational competitors away, which has allowed more aggressive strategic investors to build entry barriers, such as local manufacturing, brand awareness and distribution networks

We are pleased to conclude our third full year of operations with an expanding portfolio of dynamic and competitive firms These companies continue to strengthen their market positions and are headed, in accordance with the Fund s investment strategy, toward leadership positions in their industry sectors The recent financial turmoil has weakened local demand for the short term, and many of the portfolio companies weaker competitors have fallen along the way The Fund is proud of the way its portfolio companies have used the opportunity to identify new openings in the markets and to address weaknesses within their own organizations This has led to further development and growth

We would like to thank all of the people who have made the last year so successful The Fund s investment professionals and staff have worked very hard and demonstrated great resourcefulness in a very challenging market The members of the Board of Directors have helped us with their vast experience and judgement Finally, we would like to recognize the contribution of the senior executives and consultants from various industries, especially the late Barron Gray They sacrificed time with family and friends to come to the region and work with these young management teams and companies They set an inspiring example for all of us and make us proud to be Americans

Glenn H Hutchins	Scott A Carlson
Chairman of the Board	President and Chief Executive Officer

UKRAINE

Although the country has a strategic location rich natural resources and highly educated work force, which makes Ukraine an attractive investment environment, it has not yet achieved its expected potential

Ukraine is one of the largest countries in the region Ukraine s landmass of 604 million square kilometers (220 million square miles) is the largest in Europe after the European part of Russia, and its population of 50 5 million ranks fourth in Europe The agricul tural sector produces grain, oilseed, sugar, and livestock The most important industrial sectors are heavy machinery, industrial equipment, iron, steel coal chemicals, agricultural machinery, and shipbuilding

Economy

Some positive changes in the economy were observed in the first half of 1998 including

- the beginning of large scale privatization,
- a decrease in the annual inflation rate to 9 6 % for the twelve months ending,
- several attempts to liberalize the economy including introduction of clearer tax proce dures, deregulation and simplified bank ruptcy procedures
- a tighter 1998 budget with a consolidated budget deficit of 2 3% of GDP instead of 3 3% adopted by the Parliament at the end of 1997

However these reforms were not systematic and did not lead to sustainable growth The financial and political crisis in Russia became a catalyst for the Ukrainian financial market crisis

The economic situation in September – October 1998 further deteriorated due to lack of coordi nation between monetary and budget policies hryvnia nominal depreciation by 82 41% for the period from October 1, 1997 through October 1 1998 excessive government spending – the need to finance it raises interest rates to as high as 60 92% per annum and lack of progress on land reform Consequently, lack of economic reforms and accelerated liquidity problems contributed to foreign investors lack of confidence and their withdrawal from the Ukrainian T bill market At the same time, in an attempt to support the hryv nia the National Bank of Ukraine (NBU) utilized most of its foreign reserves

Sociopolitical

In October 1997, Ukraine adopted new election legislation, which provides for a mixed majoritar ian proportional electoral system and on March 29 1998, Ukraine held its third democratic par liamentary elections based on this new system In contrast to many forecasts, voter turnout was as high as 70% and elections themselves were con sidered by international observers to be free and fair Politically left parties won about 40% of the seats, but their influence appears stronger due to their control of the speakership and the weakness of the parliament s fractured center and right Progress in adopting much needed reform con tinues to be tortuous and complicated by a rise in political tension in light of the upcoming presi dential election in October 1999 In terms of leg islation adopted during 1998 several important new legal Codes were drafted, including Civil, Land, Criminal and Procedural Codes This basic foundation is required to provide a legal frame work for all current and future laws and regula tions

Investment Environment

Macroeconomic stabilization during the first half of the year resulted in a modest improvement of the investment climate in Ukraine Foreign direct investment reached approximately $2 62 billion by October 1998, as compared to $483 million in January 1995 However declared deregulation measures were not completely implemented and many investor complaints remained unresolved According to World Markets Research Center (WMRC) in terms of risk rating Ukraine received a medium rating, which means that the overall business environment is acceptable but needs improvement To date, despite the financial crisis and internal difficulties, several multi national corporations have invested in local manufactur ing facilities in Ukraine Most recently Nestle has announced its intention to invest US$ 40 million into the Lviv based confectionery company Svitoch Other major foreign investors include AT&T, Kraft Jacobs Suchard, and Coca Cola Amatil The AvtoZaz Daewoo joint venture founded in July 1997, began manufacturing cars in 1998

Although the country has a strategic location rich natural resources and highly educated work force, which makes Ukraine an attractive invest ment environment, it has not yet achieved its expected potential because of the failure to mini mize state interference with operation of markets remove administrative barriers to business opera tions, meet privatization targets or make itself attractive to foreign and domestic investors

MOLDOVA

Despite the worldwide financial turmoil, the Moldovan government continues to implement market reforms, liberalize the regulatory environment, and encourage foreign direct investment

The Republic of Moldova is located in southeastern Europe between Ukraine and Romania Moldova is one of the smallest European countries, with a population of 4 6 million people and a territory of 33 8 thousand square kilometers Favorable weather conditions and above average fertility of agricultural land have made agriculture the backbone of the Moldovan economy The agricultural sector including food processing and wine making, represents more than 60% of GDP, provides employment to over 42% of the active labor force and accounts for nearly three quarters of total exports Moldova s other major industries are light manufacturing, building materials wood and wood products

Economy

In 1998 the Moldovan economy experienced positive growth despite the growing budget deficit, a heavy foreign debt burden, and a restructuring of the energy sector Moldova s investment climate benefits from stable and generally favorable macroeconomic conditions

- Official GDP growth of 1% in 1998 is widely believed to underestimate the rapid growth of the so called shadow economy, especially in construction and the booming retail sector in Chişinău the capital of Moldova
- Inflation remained low in 1998 at the annual rate of 10% (compared with 11 2% in 1997)
- The national currency, the leu, was introduced in 1993 and remained relatively stable through mid 1998 However, after the Russian financial crisis, the Central Bank of Moldova started to devalue the domestic currency in an attempt to avoid the erosion of competitiveness of Moldovan exports to the Russian market
- The government has revised the 1998 budget but continues to face problems collecting taxes and duties
- Moldova is the only country of the former Soviet Union to implement a credible land reform program This includes breaking up state run collective farms under the National Program of Privatization Restrictions on the sale and purchase of land were annulled in 1998 The Moldovan government also made public its intentions to sell key companies in the cement tobacco and telecom industries to foreign strategic investors
- Moldova completely liberalized its current account transactions and is in the process of applying to join the WTO Moldova signed the Partnership and Cooperation Agreement and applied for Associate membership with the European Union

In August 1998 the Moldovan economy suffered from the worldwide financial crisis Moldovan exports of agricultural products and wines remain heavily dependent on the NIS primarily Russian market In addition due to a lack of domestic energy resources Moldova has to import almost all of its energy requirements leaving little maneuverability to reverse the persistent balance of payments deficit

Sociopolitical

After the March 1998 Parliamentary elections a center right wing coalition of three parties was formed The government began implementing a liberal economic program with economic austerity measures Adherence to this program is expected to lead to a resumption of disbursements from IMF and World Bank by the end of 1998 Moldova has made little progress in negotiations on the Transdniestr territory, a breakaway region dominated by a faction of the Russian army, but the government has resolved its territorial disputes with Ukraine

Investment Environment

Moldova has steadily liberalized its foreign investment regime This legal framework ensures foreign investors equal treatment with domestic firms Moreover local companies with foreign capital are eligible for corporate tax benefits (100% corporate tax exemption if foreign investment is over $1 million) Foreign investment is about $260 million as of July 1998 Over 1000 enterprises with foreign participation are registered including 303 with 100% foreign ownership These enterprises generated more than 10% of Moldovan GDP in 1998 The most active investors are France Germany Russia, USA Spain Greece and Italy Among the most visible US companies in Moldova are McDonald s, Coca Cola Redeco Hewlett Packard and IBM

The current financial crisis in Russia has demonstrated the threat of a unilateral orientation of export to Russia But despite the worldwide financial turmoil, the Moldovan government continues to implement market reforms liberalize the regulatory environment and encourage foreign direct investment

BELARUS

Being a potentially attractive country for investment, Belarus will require economic and political stability, as well as a willingness to move towards market economy for its further development

The Republic of Belarus is a country with a population of 10 4 million people and a territory of 207 million square kilometers The major natural resources of Belarus include mineral fertilizers, wood, chalk and gypsum The country s major industrial sectors are electronics, machinery and equipment production, chemical and petrochemical and textiles industries Belarus main agricultural products include meat and dairy products, potatoes and grain

Economy

In 1998, Belarus experienced a financial crisis caused by a highly interventionist economic policy and the crisis in Russia In addition the 1998 harvest was the lowest since 1953 President Lukashenka is continuing a policy of high economic growth and full employment which is conducted via direct control of the government over most economic entities and activities The country s major economic indicators in 1998 include

- According to official statistics in January September 1998, GDP increased by 11% in adjusted prices compared to the same period of 1997 Belarus industrial production increased by 12% and agricultural output rose by 6%
- During the first nine months of 1998, official consumer prices rose by 30 1%, and the average monthly inflation rate was 3 4% Despite harsh administrative measures taken by the government to avoid inflation, the monthly inflation rate rose to 8% in September
- Since the beginning of the year the Belarusian ruble s exchange rate fell against the US dollar by all estimates National Bank rate (Inter Bank Exchange rate) by 72 7% and the street market rate by 376% As of September 30, 1998, the spread between the National Bank rate and the informal rate reached 276%

Since the Belarusian currency crisis in March 1998, the National Bank of Belarus has been implementing an administrative regulatory policy in the currency market in order to restore stability in the market That policy includes an uncontrolled monetary emission Further measures have been taken to strengthen state control over private businesses and export operations including heavier taxation Though President Lukashenka signed a privatization decree in March privatization and other structural economic reforms are non existent These economic policies stymied the country s cooperation with international financial institutions As a result the IMF and the World Bank recalled their representatives from the country The World Bank has suspended new projects in Belarus

Sociopolitical

Belarus continues its policy of establishing closer ties with Russia and calling upon Ukraine to join with them and Russia to form a single Slavic state The regime also continues its deliberately defiant attitude towards the West Five European Union countries the United States Japan and several others have recalled their ambassadors from the country claiming Belarus has violated the Vienna Convention on Treatment of diplomats and denied access to ambassador s residencies

Investment Environment

As of September 1998, there were 2,162 enterprises with foreign investments in Belarus, including 1 311 joint ventures and 851 companies with foreign capital For the first eight months of 1998 Belarus attracted only $11 7 million of additional foreign investment However, several investments have been announced in Belarus in 1998 The German company MAN has invested $3 6 million in a joint venture with Minsk based MAZ a heavy duty trucks producer The European Bank for Reconstruction and Development (EBRD) extended financing totaling $8 7 million to a new Canadian Belarusian glass making joint venture In addition the EBRD bought 27% of Priorbank the country s fifth largest bank for ECU 2 75 million McDonald's announced plans to open its sixth restaurant in Minsk with an investment of $1 2 million At the same time, as reported by the US magazine *Institutional Investor* Belarus is ranked 122nd for its solvency rating (12 9), a step down from its previous ranking of 121st in September 1997

The president s intention to reconstruct the economic system of the late Soviet Union and the lack of progress in implementing reforms and privatization took Belarus back to the depressed economic level of recent years Being a potentially attractive country for investment Belarus will require economic and political stability as well as a willingness to move towards market economy for its further development

POST-INVESTMENT ACTIVITIES

The Fund strongly believes that the investment of capital must be accompanied by a company s commitment to change and management s ability to drive this change Management teams which have done an excellent job identifying good commercial opportunities and starting up businesses, often are not able to manage problems created by rapid growth, or to adapt to changes in the marketplace

To bridge this gap, the Fund has a whole range of post investment activities aimed at ensuring that portfolio companies are strategically well positioned in the marketplace and have the right organizational platform to achieve their goals

People are the most important resource in any company It is the Fund s objective to work with its portfolio company management teams to develop this valuable asset for the business and to provide them with the right skills, capabilities and motivation to grow the business and realize its potential

The Fund has a whole range of post-investment activities aimed at ensuring that portfolio companies are strategically well-positioned in the marketplace and have the right organizational platform to achieve their goals

Strategy and Business Development

Mission vision and values must be shared and agreed upon with portfolio companies so that resources and energies are utilized effectively and efficiently Strategy planning sessions are important tools used for this purpose portfolio company management and the Fund s investment team are guided by strategy consultants and industry specialists through a high level strategy development exercises The main steps of such a process are

- identification of the company s mission, vision and strategic goals
- assessment of the company s market position
- definition of resources and competencies required to achieve that mission, and
- alignment of the company s organizational structure to achieve these goals

Strategy planning sessions are held also on a pre investment basis as part of the due diligence process in order to ensure that interests of all stakeholders are clearly aligned

Corporate Governance

Proper corporate governance is important to each company s evolution from an entrepreneurially operated company to a professionally operated corporation The Fund takes a lead role in providing strategic guidance to portfolio companies in this area thus adding value that goes beyond the investment of capital

The Fund requires each portfolio company to create a supervisory council equivalent to a board of directors that represents the interests of all shareholders Prior to the Fund making an investment the company must put in place policies and procedures requiring all major corporate decisions, such as acquisitions, capital expenditures and senior management appointments be reviewed by the supervisory council This makes the decision making process more transparent and protects the rights of minority shareholders

Leadership, Management and Business Skills

A strong management team is key to achieving company goals The Fund implements a broad spectrum of activities aimed at supporting and developing key players within portfolio company management teams

Chief Executive Officers of portfolio companies are brought together twice a year to discuss management and leadership issues competitive business practices and methodologies, marketing strategy human resource management sales force management techniques corporate finance, and accounting controls

The first seminar held in 1998 for Chief Executive Officers focused on Organizational Management while the second one centered on the issues of Market and Client Orientation These seminars helped CEOs to develop a broader understanding of their leadership role inside their companies As a result several CEOs subsequently decided to take their high and middle level managers through a several day workshop aimed at building cohesiveness among the management team involving all key players in the development of company objectives and business strategies

A number of seminars and training activities are organized for the entire portfolio All new portfolio companies are offered an initial Market and Client Orientation seminar The aim is to help new companies which often tend to be produc tion driven to transform into market and client driven businesses, where the leading role is taken by the marketing function, and other activities of the company, including production, are carefully determined on the basis of information received from customers through the marketing department

Other Fund post investment activities in this area are designed on the basis of the specific needs of each portfolio company and its management team In 1998 several portfolio companies participated in tailored team building workshops These seminars, facilitated by experienced trainers and consultants, were successful in helping various members of the management team in identifying and coordinating common and individual goals, functions and responsibilities As an example, in one portfolio company this awareness produced a structural improvement and systematization of internal information flows among individuals and departments Moreover, individual management team members functions and responsibilities were clearly defined and measured by introducing job descriptions and a periodic performance evaluation process

Tailored one on one assistance and consultancy is provided by the Fund in order to give portfolio company management the competencies and skills needed to achieve individual and company goals Volunteer executives from organizations such as IESC (International Executive Service Corps), VOCA (Volunteers in Overseas Cooperative Assistance) and CESO (Canadian Volunteers Advisers to Business) are selected based on their industry and functional background and are brought in with the purpose of transferring competitive know how to key managers of portfolio companies

Summary Case Studies

One of these experienced volunteer executives spent a total of nine weeks between March and August 1998 assisting one of the Fund s companies As a result of his efforts, the Sales and Marketing Department was completely restructured, use of personnel rationalized, and responsibilities clearly defined and assigned Each member of the portfolio company s sales and marketing staff received on the job training by the volunteer executive

One of the major problems the company faced was the lack of a clearly established pricing policy, and guidelines to be used during the negotiation phase As a result, particularly in the case of non standard and customized products sales people would negotiate contracts without knowing exactly acceptable pricing and margins for each specific product, sometimes resulting in a loss for that particular sale To resolve the problem, the Volunteer Executive assisted in the development of a clear pricing policy for the company, supported by an internal communication system which gives salespeople clear guidelines on prices, product availability parameters for product design and pricing for customized products

Tailored one-on-one assistance and consultancy is provided by the Fund in order to give portfolio company management the competencies and skills needed to achieve individual and company goals

During the past year, the Fund invited MBA Corps volunteers to stay for one full year with select portfolio companies During 1998 six portfolio companies had the opportunity of utilizing these on site financial marketing and management consultants The individual contribution of each of these volunteers was very valuable for portfolio companies

- At one portfolio company that produces construction materials the assistance from one of these experienced business school graduates, in addition to a number of seminars and training courses which were organized on site gave birth to the sales and marketing department, which now includes one sales and marketing director, nine sales people and a network of distributors in Kyiv and northeastern Ukraine The marketing strategy has been developed and implemented, and an advertising campaign has been launched
- At a dairy products company, a comprehensive, integrated strategy aligned with company s values, mission and vision has been developed and implemented This is the foundation for long term growth through the creation of a strong brand identity
- At another food processing company, a brand name strategy was created for a variety of processed and semi processed meat products This is the fastest growing branded line of meat products appearing on the Ukrainian retail market

Technical Know-How

Capital invested by the Fund is generally used for large equipment purchases to improve the production capabilities of portfolio companies. During the first phase of operations, technical experts and industry specialists are hired by the Fund to help portfolio companies in selecting and managing equipment vendors, installing the equipment, starting up the operations, and improving the production process to ensure the desired performance and quality. Assistance from such specialists resulted in a much quicker and smoother installation and commissioning of technical equipment in six portfolio companies this past year.

Companies are also provided support in developing quality control procedures, labor safety measures, developing performance data and collection procedures and performing data analysis, enabling more reliable and consistent management decision making.

The operating and regional experience of the Fund's investment team contributes towards a more accurate assessment of potential candidates, compensation issues, and organizational development issues

Management Information Systems

At each portfolio company, the Fund installs a management information system which can produce both statutory as well as International Accounting Standard financial statements. The objective of installing these systems is primarily to improve management decision making with a secondary benefit of improved financial reporting.

Installations are carried out by Universal Business Systems (UBS), a Fund portfolio company. UBS installs the system and trains the company staff in the use of it. Eight installations have been completed, and both portfolio company management and the Fund are now regularly provided with reliable financial reports such as aged receivables and payables schedules, current inventory status reports, and sales and purchasing schedules. Another two MIS installations are currently under implementation.

Recruiting

Access to a large network of professionals, entrepreneurs, and executive search firms allows the Fund to add value during the senior management recruiting process. The Fund assists portfolio companies in developing new functional skills to improve the companies' competitiveness. The operating and regional experience of the Fund's investment team contributes towards a more accurate assessment of potential candidates, compensation issues, and organizational development issues. This ultimately leads to hiring a motivated and more successful entrepreneurial management team.

Over the past year, financial directors at two portfolio companies were hired after a selection process carried out by the Fund itself. In order to source suitable candidates, a wide range of recruiting methods were utilized, including advertisements published in Ukrainian and English language newspapers, career fairs, Internet, coordination with universities, formal and informal referral networks. An impressive number of financial professionals from all over Ukraine submitted resumes and applications for each of the vacant positions. Candidates were screened by the Fund by analyzing qualifications and matching these with hiring criteria. Dozens of candidates were interviewed and the best ones were then submitted to company executives for their examination. As result of this process, the two portfolio companies have been able to build very strong financial departments which now take an active role in the management of the company by contributing in drafting long term goals and strategies for the company, designing and implementing all financial procedure and control policies, developing the company budget and monitoring adherence to it.

DIRECT INVESTMENT PROGRAM COMMITMENTS
AS OF SEPTEMBER 30, 1998
(US Dollar amounts in thousands)

Portfolio Company	Commitment	Type
Troyanda-Express	[redacted]	[redacted]
Sonola	[redacted]	[redacted]
Ecoprod	[redacted]	[redacted]
Glass Container Company	[redacted]	[redacted]
Vitanta	[redacted]	[redacted]
Slobozhanska Budivelna Keramica	[redacted]	[redacted]
Kuhar	[redacted]	[redacted]
Prettl Kabel Ukraine	[redacted]	[redacted]
Universal Business Systems	[redacted]	[redacted]
Svitanok	[redacted]	[redacted]
Hostomel	[redacted]	[redacted]
Roua Universe	[redacted]	[redacted]
Franko Krok	[redacted]	[redacted]
Lan-Invest	[redacted]	[redacted]
Active Transaction		
Confectionery Group	[redacted]	[redacted]
Meat Processor	[redacted]	[redacted]
Retail Distribution	[redacted]	[redacted]
Tea and Coffee Packaging and Distribution	[redacted]	[redacted]
Total	[redacted]	[redacted]

DIRECT INVESTMENT PROGRAM

TROYANDA-EXPRESS

New Ukrainian Quality

ICE CREAM MANUFACTURER AND DISTRIBUTOR

COMMITTED CAPITAL $5 431 000

Troyanda Express is the preeminent producer and distributor of premium ice cream in Ukraine It is located in the city of Lutsk in the northwestern part of the country The company's mission is to be the leading premium ice cream producer and distributor in Ukraine, building a national brand name and providing natural tasting import quality ice cream in a wide variety of innovative flavors and at an affordable price Troyanda Express is managed by an entrepreneurial management team focused on achieving consistently high product quality and broad market share Today, the company s ice cream is sold through a nationwide network of 34 distributors selling through 4,800 retail freezers

Troyanda Express was started in 1994 by four entrepreneurs who began by growing and selling cut roses (troyanda in Ukrainian means rose) The capital earned from selling cut flowers was invested in the development of an ice cream distribution business for which they spotted an opportunity in the local market The company s business was operating well, and it soon became the main Ukrainian distributor of a major Polish ice cream producer At the time a strong and largely unsatisfied demand existed for ice cream in Ukraine since the majority of local state run producers were standing idle Realizing there was an opportunity to parley their knowledge of the ice cream business into further success, the entrepreneurs decided to invest in ice cream production In 1995, they took a bank loan and purchased a second hand production line, which turned out to be of limited value in achieving their mission So the entrepreneurs sought out an investor to expand and improve their ice cream production business

In 1996 the Fund made an investment in Troyanda Express that financed a modern production line capable of tripling production of high quality ice cream bars To help the company commission the equipment and see it through this expansion, the Fund brought in a well respected and highly qualified Western consultant, Barron Gray, who had over 30 years experience in processing and marketing ice cream Mr Gray worked hands on with the management team to install the line The new line was commissioned in the spring of 1997 and its maximum capacity was achieved within a few months Troyanda Express dramatically increased sales of premium quality ice cream and substantially expanded its market share

The increased production volume required the expansion of the company s distribution network To resolve this problem, the company purchased 778 retail freezers, for which the Fund provided a guarantee to the vendor The freezers were provided to the distributors of the company s products who would place them with retailers In 1997, Troyanda Express was able to sell everything it could produce and to establish a wide distribution network of branded points of retail sale Overall, that year was very successful for the company with its revenues surging 400%

Since the demand for the company s products was still in excess of its existing capacity a $6 7 million expansion project was undertaken to increase production capacity four fold Funding for the project was provided by the Fund two commercial banks and a local development fund Proceeds from this capital increase were used to purchase two state of the art production lines, additional retail freezers and delivery trucks Mr Gray was brought in again and put in charge of project implementation at its initial stage The project was completed in August 1998 when the new production lines were put into operation To help the company refine and strengthen its marketing and sales strategy the Fund also brought in an on site consultant with Baskin Robbins marketing experience who worked full time with the company for one year

Today, Troyanda Express successfully competes with European producers of high end ice cream demonstrating mettle and determination to become the market leader Spearheading innovation in the industry the company continues to test and introduce new branded products all of which are unique for Ukraine, and was the first Ukrainian producer to offer nine different flavors of ice cream in one liter family sized packs This has enabled Troyanda to become a household name in many Ukrainian homes and one of the most popular national brands Building on this success, Troyanda Express has been expanding its operations and market share in a robust ice cream market in Ukraine The Fund has a 70% stake in the company which employs 330 people

SLOBOZHANSKA BUDIVELNA KERAMICA

Building on Highest Quality

BRICK MANUFACTURER

COMMITTED CAPITAL $2 910 000

Slobozhanska Budivelna Keramica (SBK) is the leading, private, exterior brick manufacturer in Ukraine The company is located in the north eastern part of the country approximately 200 kilometers east of the capital Kyiv The company s mission is to produce the best exterior ceramic bricks in the market and to deliver the highest product value to its customers by providing quality guarantees, responsive service and convenience The company s CEO and his management team have proven their ability to operate in a harsh business environment by turning the formerly state run company around and successfully resolving marketing and distribution problems which have forced many other brick producers to close their doors

Built in 1989, the production facility was one of the newest brick plants in Ukraine However, the plant began production with energy inefficient equipment purchased during the Soviet period This prevented it from producing competitive high quality bricks To cover high costs caused by obsolete machinery, it was forced to keep prices high though delivering poor quality products As a result, the formerly state owned company s bricks became unaffordable for most customers and brought the company close to shutdown in 1996

This management team and production facility was chosen for investment after the Fund s extensive research of the industry was carried out with support from an experienced American brick industry expert The three primary factors for the investment decision were the company s motivated innovative and resourceful management, close proximity to major construction material markets, and strong growth potential Following the Fund s investment in July 1997, a new company called SBK was formed, and a major reconstruction of the plant s production facilities began The renovation program was completed in June 1998 when a modern, Western made energy efficient and fully computerized production line was commissioned This new line was capable of producing 30 million high quality exterior bricks annually, giving SBK the manufacturing muscle of the largest producers of quality bricks in Eastern Europe

Today, the company is focused on producing bricks of the highest quality and providing superior customer service To ensure consistently high quality of its product SBK has installed preventive on line quality control systems These systems proved to be a very effective quality control tool and also allowed the company to minimize losses in production

By introducing locally made premium exterior bricks to the Ukrainian market the company is distinguishing itself from competitors In an industry not known for quality or service, SBK is successfully developing a brand name for its products and rapidly increasing its market share Building a reputation as a truly customer oriented company SBK is expanding its range of value added customer services This includes shrink wrapping of bricks and on time delivery directly to the customer s site – which has never been offered by brick producers in Ukraine and has proven to be a significant competitive advantage

Since transportation costs play a large role in the construction material industry SBK s relative proximity to Kyiv, the primary market for bricks in Ukraine, gives it a strategic advantage over other major brick producers located in the far east and west of the country Capitalizing on this the company has been intensifying its marketing and sales efforts aimed at expanding its customer base in Kyiv

To best utilize its strengths the company is creating a countrywide distribution network which will initially encompass major distributors in the three largest metropolitan areas of the country SBK is also developing a productive and incentive motivated sales force, which has recently been reinforced by hiring a new experienced sales manager and more sales agents

SBK s managers operate with the latest Western business practices They are now supported in their decision making by computerized information systems that provide International Accounting Standards financial statements and other management reporting tools The company s future plans include the reconstruction of the second production line which will enable a doubling of capacity This will allow SBK to move from being a technological leader to a market share leader as well The Fund has a 78% stake in the company, which employs 200 people

SONOLA

Golden Gift

SUNFLOWER OIL PROCESSING

COMMITTED CAPITAL $5 400 000

A vertically-integrated processor and marketer of sunflower oil, Sonola is producing high quality refined, deodorized sunflower oil attractively packaged in PET bottles and marketed under its own brand name The company's mission is to become a market leader in the premium segment of bottled vegetable oils To achieve this objective, Sonola has developed skills and resources to capture a dominant market share in selective geographic regions within Ukraine The company s CEO has effectively combined his talent for capitalizing on short-term opportunities with adherence to a long-term vision This allowed him to build a modern processing facility from groundbreaking to start up while many large multinationals have failed The company has developed an imaginative and enterprising promotional strategy to differentiate its product from the competition In order to enhance the Sonola brand image, a new label has been designed and a unique bottle form has been manufactured The company is in the process of developing an extensive distribution system that will initially encompass from two to five distributors in each of the six major metropolitan areas across Ukraine Sonola has installed a computerized accounting system that allows the company to transform Ukrainian statutory accounting documents into International Accounting Standards financial statements, thereby providing the company's managers with superior information for improved decision-making The Fund has a 46% stake in the company, which employs 150 people

ECOPROD

Maximizing the Potential of Ukraine s Black Soil

AGRICULTURAL DISTRIBUTION COMPANY

COMMITTED CAPITAL $5 319 414

An agricultural distribution center in eastern Ukraine, Ecoprod provides state of the-art agricultural equipment, inputs and services to agricultural enterprises in the region The company s mission is to establish itself as a major regional agricultural producer and a leading distributor of a broad variety of agricultural services and equipment To enhance its competitiveness, Ecoprod recently became the first private provider of elevator services in the region To accomplish its strategy, Ecoprod has begun to offer a private sector alternative to the state structure of agricultural supplies and improve agricultural productivity in eastern Ukraine The company s CEO has proven himself to be a talented businessman and savvy commodities trader who has weathered the difficulties faced by Ukrainian agriculture under the existing state-run collective farm system The company is an exclusive distributor of AGCO (Massey Ferguson) agricultural equipment in eastern Ukraine and provides a full range of custom-farming services to Ukrainian farms, thereby showcasing the Massey Ferguson equipment and generating equipment sales Ecoprod has built a 20,000 ton capacity grain elevator, which provides value-added elevator services to local farms, thereby breaking the state s monopoly on grain storage The Fund has a 66% stake in the company, which employs 80 people

GLASS CONTAINER COMPANY

'Green Field to Green Bottle'

Glass Container Company (GCC) is a Moldovan manufacturer of green glass packaging serving the wine and champagne industries of Moldova, Russia, Ukraine, Belarus, and Romania. The company's mission is to become the best, quality glass container maker in the region. GCC possesses a complete array of modern Western glass production equipment and utilizes Western know-how provided by a team of foreign production specialists with a strong operating background in glass manufacturing. This combination ensures the highest level of quality of glass production and gives the company a competitive edge. High quality production, pro-active marketing and competitive prices will assure GCC a leading market position in the region, where its target customers traditionally imported glass packaging products. The Fund has a 25% stake in the company, which employs 195 people.

GLASS CONTAINER MANUFACTURER

COMMITTED CAPITAL
$4 800 000

VITANTA

'Viva Beer! in Wine Country'

Vitanta is the dominant producer of beer, flavored alcoholic beverages, and soft drinks in Moldova. The company's mission is to sustain its leadership position in the Moldovan beer and flavored beverages markets by building strong national brands. A dynamic CEO manages the company with more than 33 years of experience in the brewery business. He is the driving force behind the company's success and has been instrumental in the resurgence of the business since the collapse of the former Soviet Union. Vitanta's brand names are among the most widely recognized and popular in the country as a result of extensive advertising, promotional campaigns and a highly developed distribution network for the company's products that encompasses 140 major regional distributors, as well as over 1,000 other wholesalers and retailers. The Fund has a 52% stake in the company, which employs 600 people.

BREWERY

COMMITTED CAPITAL
$3 750 000

KUHAR

'Recipes from your Grandmother'

Kuhar is a start up, high-quality ketchup producer based in Kyiv. The company's mission is to become the leading brand-name ketchup and food condiments producer in Ukraine. Kuhar is managed by a talented team of entrepreneurs, who have already built a ketchup and related products distribution business in the region using aggressive marketing techniques and strong relationships with distributors. To accomplish its objectives, the company plans to build one of the most modern and competitive ketchup operations in Ukraine. The Fund's equity interest will grow to a significant level by the end of the start up, and the company is expected to employ 50 people.

FOOD PROCESSING

COMMITTED CAPITAL
$2 500 000

PRETTL KABEL UKRAINE

A Former Soviet Monopolist Looks Westward'

AUTOMOTIVE PARTS MANUFACTURER

COMMITTED CAPITAL $2 350 000

Prettl Kabel Ukraine (PKU) is a joint venture among three partners a respected German manufacturer of wire harnesses, whose customers include major European automobile manufacturers, a privatized Ukrainian manufacturer of wire harnesses and the Fund The company's mission is to become the leading manufacturer of wire harnesses and wire related products in Ukraine and Eastern Europe, utilizing Western know how, access to Western markets, and a low cost and highly skilled local labor force The company's management team consists of German and Ukrainian professionals with extensive experience in both manufacturing and marketing of wire harnesses These specialists and state of the-art machinery will ensure the highest quality standards compatible with Western requirements This year PKU received ISO 9002 certification, which will support its efforts to increase export sales to Western Europe The Fund has a 40% stake in the company, which employs 100 people

UNIVERSAL BUSINESS SYSTEMS

Better Management Information Better Decision Making

MANAGEMENT INFORMATION SYSTEMS COMPANY

COMMITTED CAPITAL $1 750 000

Universal Business Systems (UBS) is a start-up Management Information Systems (MIS) consulting and implementation company The company s mission is to provide Ukrainian and Moldovan businesses with consulting and implementation services for computerized MIS systems The company s goal is to become a leader in this specific market niche and to create value in companies with little or no computerized management reporting capabilities The systems provide management with International Accounting Standards financial and other key management information and produce local statutory financial statements, allowing companies to fulfill local statutory accounting and tax requirements UBS provides training and consulting services to teach managers how to make informed business decisions with more accurate information The company s competitive strength is its entirely integrated Ukrainian/Western management team with extensive International Accounting Standards and statutory accounting expertise UBS was among the first in Ukraine to offer and successfully implement MIS systems capable of transforming Ukrainian statutory financial statements into International Accounting Standards statements The Fund has a 95% stake in the company, which employs 20 people

SVITANOK

Window of Opportunity

WINDOW AND DOOR MANUFACTURER

COMMITTED CAPITAL $1 645 000

Svitanok is an innovative company that produces and markets a diversified range of wooden and polyvinyl chloride (PVC) windows and doors, as well as aluminum curtain wall systems manufactured on a modern machinery base The company's mission is to become Ukraine's market leader in innovative and customized doors and windows by providing high-quality products at a competitive price on a timely basis Svitanok s management team has strong engineering and manufacturing skills and over five years of experience working with Western partners Production with a computer aided design system enables the company to compete successfully with Western European manufacturers for contracts of large commercial and government construction projects

Svitanok has established itself as an innovator in the design and manufacturing capability of customized, highly engineered curtain wall facade systems in Ukraine. To ensure future growth prospects, the company is committed to expanding its product line by introducing enhanced products, such as security doors, fireproof windows and doors, as well as innovative mixes of aluminum and PVC products. Today Svitanok is shifting its focus from its historical base of large government projects towards smaller private construction projects. The Fund has a 28% stake in the company, which employs 285 people.

HOSTOMEL

'From Vial to Bottle

GLASS CONTAINER MANUFACTURER

COMMITTED CAPITAL $1 570 000

Founded in 1912, this company is the second largest glass factory in Ukraine. The company's mission is to establish itself as the leader in the Ukrainian market for both beverage and food glass packaging and to become the most customer-focused company in the industry. Hostomel is managed by a team of highly qualified professionals with a strong operating background, who have demonstrated flexibility and determination in steering the company through a period of severely depressed demand after the collapse of the Soviet Union. Management was able to turn the company around by shifting the entire focus of the business from pharmaceutical glass to food and beverage glass containers. Today the company manufactures clear and colored glass containers for the beverage, medical and cosmetic/perfume industries, and enjoys a significant local industry presence and customer recognition. Already the quality leader by Ukrainian standards, Hostomel is the only approved supplier of Coca Cola in Ukraine. At the present time, the company is developing plans to become more cost effective and, with the aid of modern equipment, plans to continue to improve the quality of its glass containers. The company employs 1,000 people.

ROUA UNIVERSE

Efficient Machinery   Higher Yields

AGRICULTURAL DISTRIBUTION COMPANY

COMMITTED CAPITAL $1 450 000

Roua Universe is the first agricultural distribution center in Moldova, and its mission is to provide high quality agricultural equipment and services, including custom farming, to agricultural enterprises in Moldova. Like Ecoprod in Ukraine, the company offers an alternative to the state structures of supply and improve the agricultural productivity in the country. The company's CEO, who is an innovator in the field of value-added agricultural distribution services in the country, has many years of experience in the agricultural machinery supply and maintenance business. Roua Universe is the exclusive dealer of AGCO (Massey Ferguson) agricultural equipment in Moldova. In 1998, in addition to providing custom harvesting services on 9,000 hectares, the company began a small custom-farming operation on leased land, thereby expanding the range of its high quality agricultural services offered to local farms. The Fund has a 50% stake in the company, which employs 60 people.

FRANKO KROK

'Taste It Every Day

MEAT PROCESSOR

COMMITTED CAPITAL
$1 300 000

Franko Krok is a fast growing, regional meat processor in western Ukraine The company produces sausages and processed meat products, as well as carcass and boxed beef for Ukrainian and export markets The company s mission is to become a regional leader in the branded meat products market Franko Krok is managed by a talented and aggressive team of owner managers that includes meat and sales experts, as well as financial professionals, each with more than ten years of business and trade experience The company has developed a broad variety of attractively packaged high quality sausages and meat products for the Ukrainian palate and tailored to the Ukrainian market Franko-Krok sells its products through one regional distributor and direct-store deliveries to 70 local retailers The Fund will have a significant equity stake in the company upon completion of its expansion program The company employs 51 people

LAN-INVEST

"From Distribution to Value-Added Services

AGRICULTURAL DISTRIBUTION COMPANY

COMMITTED CAPITAL
$1 187 486

Lan Invest is an agricultural distribution company located in eastern Ukraine The company s mission is to provide high quality agricultural equipment, inputs and services to agricultural enterprises Like Ecoprod and Roua Universe, the company is providing a private supply source competitive with the state structures of supply and improving agricultural productivity in eastern Ukraine Lan Invest is led by a CEO who was among Ukraine's first entrepreneurs to enter the agricultural inputs market The key business segments of Lan Invest are the marketing of Western manufactured farming equipment and chemicals to Ukrainian farms These products enable local farmers to significantly improve agricultural yields A major U S based crop protection and biotechnology firm has recently acquired a 31% equity stake in the company, thereby providing a third-party validation of the Fund s investment and bringing in Western management In addition, the equity infusion by the U S firm has allowed Lan Invest to expand its range of services offered to its customers and to add a new business segment – distribution of fuel and lubricant products of a major West European producer The Fund has a 35% stake in the company, which employs 30 people

ACTIVE TRANSACTIONS

As of September 30, 1998

CONFECTIONERY GROUP

Committed Capital $8,713 000

This group of five confectioneries operates as a single concern and is one of the premier confectionery producers in the eastern part of Ukraine The group s mission is to become the leading confectionery in the country, capitalizing on its strong brand name identity and growing demand for its products The group's managers have strong marketing and sales skills and have proven themselves successful at growing the business through a series of acquisitions and quick turn arounds of under performing and mismanaged, formerly state owned confectioneries The group's products are aggressively marketed under a single trademark and are distributed through a network of over 70 distributors and over 50 large wholesalers in Ukraine, as well as more than 20 distributors in Russia The group has enjoyed rapid growth in recent years, with its sales grow ing nearly 100% per year due to heavy demand for its premium quality products and as a result of extensive advertising and promotional campaigns The group employs 2,000 people

MEAT PROCESSOR

Committed Capital $3,000,000

This formerly state owned meat processor is one of the largest in Ukraine The company s mis sion is to become the national leader in high margin, value-added meat products This will be achieved by building a brand name, ensuring consistently high quality of the products, and estab lishing a strong relationship with local distributors Currently, the company sells its products through its own 14 retail outlets, approximately 100 independent retailers, and over 30 distributors The company's management team is one of the most talented and dedicated group of managers in the industry and has demonstrated its ability to turn around a formerly state-run business Capitalizing on its location, which has an abundant supply of livestock, the company has been increasing production and market share The company employs 1,000 people

RETAIL DISTRIBUTION

Committed Capital $2,400,000

The company's mission is to become the leading cash and-carry distribution company in Ukraine by providing easy access to a broad assortment of fast moving consumer products at reasonable prices The company's core strategy is to build a nationwide network of cash and carry centers and provide innovative distribution services to suppliers This will enable the company s clients to increase sales and market penetration while targeting a wider and more diverse client base To implement this strategy, the company will be developing the business by concentrating on prod ucts, locations and services in which market prospects are the greatest and which offer the company the on-going potential to earn attractive margins The company s management team has an impressive track record and several years of experience Capitalizing on a unique and cost-effective opportunity that Ukraine currently offers to establish market positions that will endure into the next century, the company has been expanding its operations The company employs 75 peo ple

TEA AND COFFEE PACKAGING AND DISTRIBUTION

Committed Capital $1,500,000

This company is the undisputed domestic leader in tea distribution and sales in Ukraine The company's mission is to establish itself as the leading Ukrainian specialty tea and coffee producer by building a unique retail distribution channel and brand name recognition An experienced team of entrepreneurs manages the company, which has demonstrated superior growth prospects, with an impressive track record in the tea and coffee distribution business The company will be the first in Ukraine to possess a tea bag packaging line, which will provide an opportunity for the company to capture a greater share of this segment of the tea market It is expected that local packaging together with its unique brand name and image will give the company a competitive advantage over foreign tea and coffee imports Currently, the company sells its products through 100 dealers all around the country The company employs 75 people

SMALL BUSINESS LOAN FUND

As of September 30, 1998

The Fund has made available $5 million in credit to small, privately held businesses and entrepreneurs in Ukraine Loans and leases are extended in the amounts of $10,000 to $100,000 directly to the borrowers Financial intermediaries are not used to source and service our clients Credit is extended at market rates of interest with a tenor of up to two years The financing is generally used to purchase better, more productive equipment to improve the capabilities of the businesses The Fund has focused on the agriculture and food processing sectors since 1995 but plans to expand its attention to other sectors in the coming year

Small Business Loan Division

During 1998 the division closed $929,500 of new loans to 16 customers which employ 310 people The Fund opened an office in Kharkiv in 1998 With offices in three major regions, Kyiv, Lviv and Kharkiv, the Fund has adequate geographic coverage to service small businesses in Ukraine

The portfolio, as of September 30, 1998, has been divided into five categories

BAKERIES AND FLOUR MILLS — **12 LOANS AND LEASES**
$296,008 outstanding — *325 employees*

Representative of this sector is a flour mill and bakery operating in a small village The flour mill is located in the owner's barn and the bakery in her house As the state subsidizes state-run bakeries with cheap raw material, she faces artificial competition but makes a higher quality, affordable product for the people of her village

MEAT DAIRY AND OIL PROCESSING — **FIVE LOANS**
$109,780 outstanding — *99 employees*

Representative of this sector is a company 125 km from Kyiv that used a loan from the Fund to purchase a bottling line for sunflower oil Production and sales have increased and quality has improved making a better, more valuable product The Fund expects this company to be a repeat customer in 1999

WOOD PROCESSING — **SIX LOANS AND LEASES**
$76,038 outstanding — *20 employees*

Representative of this sector is a company in the Kyiv region that makes high quality, oak furniture on an individual basis The Fund's loan was used to purchase wood drying equipment to better control quality and better manufacturing equipment In the term of the loan, sales have increased threefold and the company has added 50 skilled people as employees

LIGHT MANUFACTURING/SERVICES — **SEVEN LOANS AND LEASES**
$281,287 outstanding — *221 employees*

Representative of this sector is a company in the Kyiv region that borrowed from the Fund to purchase sewing equipment to increase their high quality overcoat manufacturing capabilities Their name now appears regularly in Kyiv stores and is sought for its quality and value

FARMING — **TWO LOANS**
$51,748 outstanding — *21 employees*

Representative of this sector is a farm located in the Kyiv region that used a loan from the Fund to purchase agricultural inputs to plant an additional 400 hectares (app 1,000 acres) of land The output per hectare is about 2 5X that of a state or collective farm

FINANCIAL STATEMENTS

As of and for the years ended September 30, 1998 and 1997

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PRICEWATERHOUSECOOPERS

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Report of Independent Accountants

To the Board of Directors of Western NIS Enterprise Fund

In our opinion, the accompanying statements of financial position and the related statements of activities and cash flows present fairly, in all material respects, the financial position of Western NIS Enterprise Fund ('the Fund) as of September 30, 1998 and 1997, and the results of its activities and its cash flows for the years then ended, in conformity with generally accepted accounting principles 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 of these statements in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material mis statement An audit includes examining, on a test basis, evidence supporting the amounts and disclo sures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation We believe that our audit provides a reasonable basis for the opinion expressed above

As explained in Note 2, the financial statements include debt and equity investments valued at $28,296,377 (72% of total assets), whose values have been estimated by management in the absence of readily ascertainable market values 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

PricewaterhouseCoopers LLP

New York, New York
October 29, 1998

As of September 30, 1998 and 1997

	1998	1997
Assets		
Equity investments and debt, at estimated fair value	$28,296,377	$16,044,134
Net investment in small business loans	452,293	255,660
Net investment in direct financing leases	179,971	780,035
Cash and cash equivalents	5 956,794	7,226 279
Marketable securities, held to maturity	2,368,673	366 197
Accrued interest income	143,588	145,938
Prepaid rent and other prepaid expenses	88,724	485,917
Other assets	400,875	85 404
Fixed assets net	1,687,034	1,671,870
Total Assets	$39,574,329	$27,061,434
Liabilities and Unrestricted Net Assets		
Accounts payable and accrued expenses	$440,906	$523 511
Other liabilities	97,206	36,224
Total liabilities	538 112	559,735
Unrestricted net assets	39 036,217	26,501,699
Total Liabilities and Unrestricted Net Assets	$39,574 329	$27,061,434

The accompanying notes are an integral part of these financial statements

For the years ended September 30, 1998 and 1997

	Management and General	Direct Investment Program	Small Business Loan Fund	Total 1998	Total 1997
Changes in unrestricted net assets					
Revenue					
Interest from direct investment loans		$565,258		$565,258	$442 398
Interest from small business loans			$90 867	90 867	9 674
Interest from direct financing leases			78,656	78 656	90 093
Interest on cash and cash equivalents	$152 248			152 248	218 001
Interest on marketable securities		131,189		131 189	78 365
Other income		8,870	106	8,976	29,579
Total revenue	152,248	705,317	169,629	1,027,194	868,110
Expenses					
Employee compensation and benefits	217,432	2,455,454	313,301	2,986,187	2,406,822
Professional fees	89,751	552,111	26,420	668 282	657,135
Business travel expenses	96,668	595,964	68,767	761 399	633 147
Occupancy	109,962	486,087	14,852	610 901	587 221
Other operating expenses	138,659	653 132	58,463	850,254	703 160
Depreciation and amortization	55,160	222,026	29,256	306 442	260,819
Total expenses	707,632	4,964,774	511,059	6,183 465	5,248,304
Decrease in net assets before unrealized gains and (losses), U S Government grants and technical assistance	(555,384)	(4,259 457)	(341 430)	(5,156 271)	(4,380,194)
Translation gain (loss) from foreign currency transaction		39,730		39 730	(39,940)
Provision for unrealized depreciation on equity and unrealized losses on loans and leases		(4,649,381)	(465,220)	(5,114,601)	(319,152)
U S Government grants	555,384	23,412,894	836,722	24,805,000	14,010,000
Technical assistance		(1,904,701)		(1,904,701)	(1,284,810)
Increase in unrestricted net assets before income taxes	–	$12,639,085	30 072	12 669 157	7 985 904
Income tax foreign			(134,639)	(134,639)	(1,796)
Increase (decrease) in unrestricted net assets		$12,639,085	$(104,567)	12 534 518	7 984 108
Unrestricted net assets beginning of year				26,501,699	18,517,591
Unrestricted net assets, end of year				$39,036,217	$26,501,699

The accompanying notes are an integral part of these financial statements

For the years ended September 30, 1998 and 1997

	1998	1997
Cash flows from operating activities		
Increase in unrestricted net assets	$12,534,518	$7,984,108
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities		
Provision for unrealized depreciation on equity and unrealized losses on loans and leases	5,114,601	319,152
Depreciation and amortization	306,442	260,819
Non cash income on direct investment and small business loans and leases	(49,838)	-
Gain on the sale of fixed assets	(451)	-
Foreign currency translation gain on foreign currency transaction	(39,940)	-
Changes in operating assets and liabilities		
Decrease (increase) in accrued interest income	2,350	(51,560)
Increase (decrease) in other liabilities	60,982	(230,734)
Decrease (increase) in prepaid rent and other prepaid expenses	397,193	(36,500)
(Increase) decrease in other assets	(315,471)	325,597
(Decrease) increase in accounts payable and accrued expenses	(82,605)	119,946
Net cash provided by operating activities	17,927 781	8,690,828
Cash flows from investing activities		
Disbursements for equity investments	(15 789,107)	(11,231,212)
Disbursements for marketable securities	(4,237 386)	(3 353,640)
Disbursements for direct investment loans	(1,933 094)	(1 775,728)
Disbursements for small business loans	(633,350)	(278,502)
Purchase of property under direct financing leases	-	(629,257)
Proceeds from payment of principal on direct investment loans	903,928	3 231 390
Proceeds from payment of principal on small business loans	211,380	22,842
Proceeds from payment of principal on direct financing leases	366,607	358 054
Maturity of marketable securities	2,234 911	2,987,443
Purchase of fixed assets	(331,978)	(486 894)
Proceeds from sale of fixed assets	10,500	
Net cash used in investing activities	(19,197 589)	(11 155,504)
Net (decrease) in cash and cash equivalents	(1,269,808)	(2 464,676)
Cash and cash equivalents at beginning of the year	7,226,279	9 690,955
Effect of exchange rates on cash and cash equivalents	323	-
Cash and cash equivalents at end of the year	$5 956 794	$7 226 279
Cash paid for taxes	$134 639	$1 796

The accompanying notes are an integral part of these financial statements

NOTES TO FINANCIAL STATEMENTS

1 Organization of Fund

The Western NIS (Newly Independent States) Enterprise Fund (the Fund) is a not for profit corporation formed pursuant to the Support for East European Democracy Act of 1989 (the SEED Act) and the 1992 Freedom for Russia and Emerging Eurasian Democracies and Open Markets Support Act (the FREEDOM Support Act) The Fund s primary purpose is promoting the development of the private sector and the policies and practices conducive to such development of the Western NIS region (the Region) which consists of Ukraine, Moldova and Belarus The United States Congress has authorized appropriations of $150 million of which capital of $83 4 million has been committed by the United States Agency for International Development (USAID ') for Fund program purposes and administrative expenditures (the Grant) Grants received from USAID are conditioned upon the Fund s compliance with the requirements of the Grant agreement with USAID and the SEED and FREEDOM Support Acts which impose certain U S policy objectives and reporting obligations Under the terms of the Grant agreement with USAID, the Fund may hold funds in interest bearing accounts and may retain investment and realized gain income for program purposes

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

2 Summary of Significant Accounting Policies

Basis of Presentation

The Fund prepares its financial statements in accordance with the requirements for not for profit organizations

The Fund s management has developed two investment programs which operate autonomously but are the same legal entity Typically the Direct Investment Program provides financing and equity investments ranging from $1,000 000 to $7,500,000 to small and medium sized private businesses, and the Small Business Loan Fund provides various types of debt financing to small businesses and entrepreneurs ranging from $10,000 to $100 000 Management believes the separate financial information included in the Statements of Activities presents a more meaningful analysis of the Fund s operating activities

Management Estimates

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

Investment Valuation

The Fund s investments, as set forth in Note 4, are not readily marketable and are not listed on an exchange or quoted in an open market These investments are stated at fair value in accordance with the European Venture Capital Association methodology and as determined in good faith by management and approved by the Board of Directors Cost is used to represent the fair value of unquoted venture investments unless this basis is untenable The valuation is made after evaluating the portfolio current economic conditions and information about specific investment situations including third party financing net asset value, earnings, budget to actual results and other factors considered relevant by management These are subject to change over time and are reviewed periodically As adjustments become necessary they are reported in the period in which they become known The carrying values assigned to the investments are based on available information and do not necessarily represent amounts that might ultimately be realized since such amounts depend on future circumstances and cannot be determined with certainty until the individual positions are liquidated Due to the inherent uncertainty of the valuation, those estimated carrying values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material There is limited precedent for valuing such investments in the Region Therefore there is little experience upon which to base the estimate of risk and amount of possible losses

Loans and Direct Financing Leases

The fair value of loans and leases is based upon management s continuing review and evaluation of the loan and lease portfolio and is intended to maintain an allowance adequate to absorb potential losses on loans and leases outstanding The level of the allowance on specific loans and leases is based on an evaluation of the risk characteristics of the loan and lease portfolio and considers such factors as past loss experience and expected future losses sovereign and currency risk considerations, the average financial condition of the borrowers, current economic conditions in the Region and other relevant factors Management considers a loan or lease impaired when, based on available information it is probable that the Fund will be unable to collect principal and interest when due in accordance with the contractual terms of the agreement

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

Concentration of Credit Risk

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

Cash and Cash Equivalents

The Fund considers all highly liquid financial instruments purchased with original maturities of three months or less to be cash equivalents

Marketable Securities Held to Maturity

The Fund invests in U S Treasury Bills with maturities of less than one year Investments are stated at fair value which approximates cost Interest is recognized when earned The investments are utilized as collateral for letters of credit provided by a commercial banking institution as support for specific investments for the Direct Investment Program

Grant Funds Recognition

Grants are recognized in the Statements of Activities when funds are utilized consistent with the purposes of the Fund set forth in the SEED and FREEDOM Support Acts

The Fund accounts for its grant activities in accordance with generally accepted accounting principles for not for profit organizations which require that income be recognized when such unrestricted contributions are received and related conditions have been satisfied for its utilization for program purposes which includes disbursements for investments, loans, leases operating expenditures and fixed assets Additions to unrestricted net assets are represented by U S Government grants The Statements of Activities include USAID grants totaling approximately $24 805 000 and $14 010 000 for the years ended September 30 1998 and 1997 respectively

Depreciation and Amortization

Apartments are depreciated on a straight line basis over 31 years Automobiles computer equipment and software, furniture and other office equipment are depreciated on a straight line basis over their estimated useful lives principally 5 7 years 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 local currency as needed Assets and liabilities, revenues and expenses transacted in local currency are translated into U S dollars using historical rates Foreign currency translation or transaction gains or losses are reflected in the Statement of Activities

Technical Assistance

Technical assistance which has been accounted for separately from the Fund s other expenses, includes the Fund s expenses for management information systems (MIS) implementation business consulting services and industry training of the portfolio investment company personnel

Donated Services

Members of the board donate significant amounts of their time to the Fund s programs and receive no compensation or fees 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

Functional Expenses

As of September 30, 1998 and 1997 functional expenses presented in the Statements of Activities totaled $707 632 and $849 480 respectively for management and general administration and totaled $7 380 534 and $5,683 634 respectively, for Direct Investment and Small Business Loan Fund programs, which includes technical assistance

3 U S Government Grants

For the years ended September 30, 1998 and 1997, USAID has committed in a letter of credit contributions of $4 4 million and $34 million, respectively to the Fund for program purposes including administrative expenditures Under the terms of the Grant, the Fund may hold funds in interest bearing accounts and may retain investment and realized gain income for program purposes At September 30, 1998 and 1997 the status of the Grant was as follows

	1998	1997
Planned Grant fundıng	$150,000,000	$150,000 000
Commıtted ıncrement	$83,400,000	$79,000,000
Less amounts receıved	64,102,497	39,297,497
Balance avaılable under letter of credıt from USAID	$19,297 503	$39,702,503

4 *Equıty Investments and Debt*

In the accompanyıng Statements of Fınancıal Posıtıon ınvestments are carrıed at faır value as set forth ın Note 2, Investment Valuatıon Below summarızes the ınvestments of the Fund as of September 30 1998 and 1997, respectıvely The faır value of ınvestments greater than 5% of total assets lısted ındıvıdually

Dırect Investment Program

September 30, 1998

Busıness	Faır Value	Type	Percentage Owned	Country
Sunflower oıl bottler and dıstrıbutor	$4,648,244	Equıty/Debt	53%	Ukraıne
Agrıcultural dıstrıbutıon center/custom farmıng	4 595,121	Equıty/Debt	66%	Ukraıne
Ice cream manufacturer and dıstrıbutor	4,422,037	Equıty	70%	Ukraıne
Constructıon materıals	2 178,532	Equıty	78%	Ukraıne
Glass contaıner manufacturer	4 800 000	Equıty	25%	Moldova
Brewery	3 649,123	Equıty	52%	Moldova
Other ınvestments ıncludıng agrıcultural dıstrıbutıon centers automotıve parts manufacturer, constructıon materıals food and daıry processıng, glass contaıner manufacturer and management ınformatıon servıces	8,514,774	Equıty/Debt	28% 95%	Ukraıne/Moldova
	32,807 831			
Less Provısıon for unrealızed deprecıatıon on equıty and unrealızed losses on loans and leases	(4,511,454)			
Investment Balance	$28,296,377			

September 30, 1997

Busıness	Faır Value	Type	Percentage Owned	Country
Sunflower oıl bottler and dıstrıbutor	$3,778,453	Equıty/Debt	45%	Ukraıne
Agrıcultural dıstrıbutıon center/custom farmıng	2,559,907	Equıty/Debt	55%	Ukraıne
Constructıon materıals	1 524 643	Equıty/Debt	28%	Ukraıne
Ice cream manufacturer and dıstrıbutor	1,506,083	Equıty/Debt	50%	Ukraıne
Management ınformatıon servıces	1,471,066	Equıty	95%	Ukraıne
Agrıcultural dıstrıbutıon center/custom farmıng	1,439,752	Equıty	50%	Moldova
Other ınvestments ıncludıng agrıcultural dıstrıbutıon centers, constructıon materıals, daıry, food and daıry processıng and glass contaıner manufacturer	3,995,066	Equıty/Debt	25% 76%	Ukraıne/Moldova
	$16,274,970			
Less Provısıon for unrealızed deprecıatıon on equıty and unrealızed losses on loans and leases	(230,836)			
Investment Balance	$16,044,134			

Small Busıness Loan Fund - Small Busıness Loans and Dırect Fınancıng Leases

The Fund s small busıness loans (the loans ') and dırect fınancıng leases (the leases) are repayable ın U S dollars at fıxed rates and have varıous maturıtıes up to three years The loans and leases are collateral ızed by property and other assets of the borrower Below summarızes the loans and the leases of the Fund as of September 30, 1998 and 1997

Busıness	1998	1997
Loans		
Outstandıng balance	$562,521	$255,660
Less Provısıon for loan losses	(110,228)	–
Faır value of small busıness loans	$452,293	$255,660

Business	1998	1997
Leases		
Minimum lease payments receivable	$279,987	$946,716
Unearned income	(26,945)	(98,681)
Allowance for lease receivables	(73,071)	(68,000)
Net investment in direct financing leases	$179 971	$780,035

5 *Cash and Cash Equivalents*

At September 30, 1998, the Fund's cash and cash equivalents are deposited primarily in two large United States commercial banking institutions Approximately $4,921,906 and $5 709 000 (principally money market funds) is invested in one of these institutions at September 30, 1998 and 1997, respectively

6 *Fixed Assets*

At September 30, 1998 and 1997, fixed assets consisted of

	1998	1997
Leasehold improvements	$274,279	$249,821
Furniture, fixtures, and equipment	338,541	312,258
Computer equipment and software	506,204	417,870
Telephone equipment	70,999	68,115
Automobiles	290,784	313,264
Apartments	969,289	785,192
	2,450,096	2,146 520
Less Accumulated depreciation and amortization	(763,062)	(474,650)
Fixed assets, net	$1,687,034	$1,671,870

7 *Retirement Plan*

The Fund has established a defined contribution retirement plan designed to be qualified under Section 403(b) of the Internal Revenue Code All employees meeting certain age and service requirements are eligible to participate Eligible employees may contribute amounts not less than $200 nor more than an amount equaling 10% of their base salary, as defined, in the Plan In addition, the Fund makes monthly contributions to each eligible employee s account equal to 10% of the employee s base salary, as defined, plus 5% of the amount of salary in excess of the Taxable Wage Base ($68,400 as of September 30 1998 and $65,400 as of September 30, 1997) Participants are eligible to participate in the plan immediately and are fully vested in the employer s portion after two years of service Employer contributions to the plan totaled approximately $123,950 and $113,400 for the years ended September 30, 1998 and 1997, respectively

8 *Commitments*

Leases

The Fund is committed to make rental payments under operating leases for office space Rent expense for the years ended September 30, 1998 and 1997 was approximately $611 000 and $587,000, respectively Minimum annual lease commitments subsequent to September 30 1998 are as follows

	Total	Direct Investment Program	Small Business Loan Fund
1999	$666,200	$657 900	$8,300
2000	582 750	574,750	8,000
2001	99,600	91 600	8 000
2002	81 750	75 750	6 000
2003	75 750	75 750	
Thereafter	92,600	92,600	
Total	$1,598,650	$1,568,350	$30,300

Investment Funding

As of September 30 1998 and 1997 the Fund has committed to fund additional equity investments and loans totaling $21,741 731 and $28 285 000 respectively to various investees

9 Tax Status

United States

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

Western NIS Region

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

10 Related Party Transaction

Included in the technical assistance expense for the years ended September 30 1998 and 1997 was $745 197 and $481 525 respectively which was incurred as payment for management information systems consulting and implementation services rendered to the Direct Investment Program portfolio companies by an entity which is 95% owned by the Fund

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Report of Independent Accountants on Compliance with Laws, Regulations, Contracts and Grants Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

To the Board of Directors of the Western NIS Enterprise Fund

We have audited the financial statements of Western NIS Enterprise Fund (the "Fund") as of and for the year ended September 30, 1998, and have issued our report thereon, dated October 29, 1998

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement

Compliance with laws, regulations, contracts, and grants applicable to the Fund is the responsibility of the Fund's management As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Fund's compliance with certain provisions of laws, regulations, contracts, and grants However, providing an opinion on overall compliance with such provisions was not an objective of our audit of the financial statements Accordingly, we do not express such an opinion

The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards

This report is intended for the information of the Board of Directors, management and funding agencies However, this report is a matter of public record, and its distribution is not limited

PricewaterhouseCoopers LLP

New York, New York
October 29, 1998

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ACKNOWLEDGEMENT

The Fund s Board of Directors and Senior Management
would like to express its appreciation to the following senior executives and consultants
During 1998 they made invaluable contributions to the development of our portfolio companies and employees

VICTOR ALDEA
La Junta, Colorado
Ketchup industry, operations

ROBERT BREHM
Kent, Washington
Organizational management

WILLIAM CRESS
Sanford, North Carolina
Brick manufacturing, operations

JOSEPH CULLIGAN
Minett, Ontario, Canada
Tea and coffee industry operations

BARRON GRAY
Searcy, Arizona
Ice cream industry, operations

DON HALL
Stockton, Missouri
Plastic packaging material operations

RAY JOHNS
Hagerstown, Maryland
Agriculture, operations

HARRY S KAHN
Fort Worth, Texas
Meat processing, operations

MERRILY MANTHEY
Kent, Washington
Organizational management

WARWICK MATHEWS
Quebec City, Quebec, Canada
Textile industry, operations

ARNOLD AND LAUREN MCLEAN
Windsor, Ontario, Canada
Brewing industry, operations and marketing

MICHAEL NELSON
Godfron, Illinois
Glass industry, operations

BASIL PAPAHRONIS
Fullerton, California
Sunflower oil processing, operations

JACK SCHAEFER
Cincinnati, Ohio
Glass industry, marketing and sales

GORDON SCHMIDT
Henderson, Nebraska
Agriculture elevators operations

GEORGE SEDLON
DePere, Wisconsin
Printing and packaging, operations

BARNARDUS VERBEEK
Hackettstown, New Jersey
Confectionery industry, marketing and sales

LESLIE WATKINS
College Station, Texas
Sunflower oil processing, operations

And a special thanks
for their counsel and guidance to the Fund

JUNIOR LEE LEDBETTER
Eaton, Colorado
Venture capital investing

SPENCER OVERTON
Williamsburg, Washington
Commercial lending

In Memoriam

BARRON DANIEL GRAY
1930 – 1998