

# *Small Enterprise Assistance Funds*

## Quarterly Report to USAID (April to June 2001)

for Grant # NIS-G-00-97-00043-00

# SEAF/Macedonia

*Investing Growth Capital in Macedonian Enterprises*

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## 1. Aggregate Results at Quarter End

Please see Appendix 1.

## 2. Investment Pipeline Activities

As noted in all previous reports, SEAF/Macedonia has established six different categories to describe where companies are in the different phases of SEAF's investment process. Noted here is a summary of the number of companies in each category for SEAF/Macedonia at the end of the second quarter, including companies rejected since the beginning of January.

Category	No. of Firms	Essential Activities Being Performed
Potentials	10	Vetting firms' fit to SEAF policy and entrepreneurs' ability and integrity
Prospects	4	Primary due-diligence-testing assumptions, financial modeling, etc.
Candidates	0	Term sheet signed-awaiting Supervisory Board Approval
Approvals	0	Term sheet signed & Board approved-moving towards closing deal
Investees	10	Investment made by SEAF in the company
Graduates	1	SEAF has exited its investment
Rejects	37	Rejected due to lack of (1) policy fit, (2) attractive market opportunity, (3) managerial integrity, ability or commitment to equity, (4) agreement of terms, or (5) interest on part of company
Total	62	

A national crisis in the first half of the year had significant impact on all SEAF activities and investees. The effects of the crisis summarized in the first quarter report submitted to USAID earlier, have continued in the second quarter, with most of the companies suffering further deterioration of their business. SEAF has undertaken numerous activities in attempt to alleviate the situation. More detailed descriptions of the effects of the crisis and the activities in this period undertaken by SEAF are provided in section 5 of this report.

The following is a brief discussion of those companies in which SEAF either has already made an investment or are the most promising for SEAF at their respective stages in SEAF's due diligence process. In the companies where SEAF made an investment, 140 new jobs were created and before the crisis, there was on average, a 36% increase in revenues. In the last quarter however, due to the crisis, portfolio companies experienced a decline in the revenues from 10 - 40% comparing to the previous quarter.

### A. Investees

Ivoprom, Strumica SEAF/Macedonia provided 356,500 USD in financing to Ivoprom, a producer of household cleaning products and food preserving products. The financing was for working capital, equipment and some minor bank refinancing. Ivoprom's operating performance continues to disappoint and has resulted in considerable financial strain. Ivoprom is behind in payments to SEAF and in danger of default to other creditors as well. SEAF has worked with management to address problems, including a successful cost rationalization program and financial management assistance. However this investment is now in jeopardy and SEAF is considering the discontinuation of operations.

Krug, Skopje SEAF invested 354,730 USD in this newspaper publisher in March of 1999, with funds being for (1) working capital to increase the size of the paper and (2) vehicles to improve its distribution. Inputs of local assistance in affecting a price increase, USAID funded training for the general manager, and an IESC consultant in the beginning of the investment continue to boost financial results. The number of employees over the last two years has about doubled, totaling 130 full time staff.

ASP, Ohrid SEAF/Macedonia invested 208,033 USD into ASP for the purpose of purchasing equipment and providing working capital for the production and distribution of polyethylene, netted bags for agricultural products, otherwise known as "onion bags." The equipment and material for production arrived last winter/spring and production began shortly thereafter. SEAF has since exited this investment but is reconsidering with one of the principals an investment of similar nature in Serbia.

Nasto International, Tetovo SEAF/Macedonia provided 470,000 USD in financing for Nasto International, a producer and distributor of a variety of cheeses. The purpose of the financing was for the production and distribution of UHT, or long-life, milk. Of the total SEAF funds, 420,000 USD was for Tetrapak equipment and 50,000 USD was for working capital, with the financing being divided into 270,000 USD in equity and 200,000 USD in debt. After initial technical inputs from both Land O' Lakes and ACDI/VOCA specific to dairy operations, SEAF has focused on expanding organizational capacity to deal with the business's growth, including a changing of the accounting firm and hiring a new financial manager. The company was severely effected by the crisis in Tetevo which is discussed in section 5. The company is considering relocating their production operation to Skopje.

Planet Press, Skopje A 131,000 USD financing package was provided to this publishing start-up, consisting of 86,000 USD in equity and 45,000 USD in debt. This company began with a weekly women's magazine (TEA Moderna) and is still considering publishing additional magazines with different concepts. The company recovered start-up expenses and achieved breakeven in November. In the first quarter the magazine continued to have strong sales and profitability. Due to the crisis however, a decision was made to start publishing the magazine on monthly instead of on weekly basis.

Pilko, Skopje In June, 2000 a 430,000 USD financing package was provided that facilitated the start-up of the only chicken processing plant in Macedonia. The funds were used for purchasing equipment and working capital. Currently Pilko is selling 8 tons of chicken per week and the brand is very popular. SEAF is working hard in developing financial systems that will help the company manage its operations. Currently the company is seeking some extra bank financing to help with overruns in start-up operating expenses. ACDI/VOCA and Land O'Lakes provided technical assistance and support in various aspects of the operation. During the second quarter SEAF provided additional 50,000 USD of financing supporting the weak cash flow of the company and further improvements in the production.

Medium Export, Skopje A 100,000 USD financing package for this agricultural product trading company was closed in June of 2000, with 50,000 USD in equity and 50,000 USD in debt. During the second quarter, the company has started numerous activities for exporting locally produced paprika. In 2000, the company was the largest exporter of fresh and frozen paprika from Macedonia to the European Union countries.

On.net, Skopje A 390,000 USD equity/debt financing package for this internet start-up company was closed in September, 2000. The ISP market remains extremely dynamic and competitive which has seen consumer prices for ISP fall as much as 50% during certain time periods. A private consultant spent two weeks with On.net and SEAF staff in April realigning strategies and developing operating systems. The crisis in the country as well as illegal activities/retaliation from some of the local ISP affected the sales. More detailed discussion is outlined in section 5 below.

Magnolia, Skopje A 200,000 USD equity/debt financing package was closed in December 2000 for this well-known, premier retailer of high quality imported Italian baby and children's clothing. The funds will be used to initiate domestic production of Magnolia-labeled, high quality baby/children's clothing, expand retail outlets, and for working capital. Magnolia has moved into their new production facility in the village of Volkovo near Skopje. Equipment successfully arrived in May when production was started. SEAF initiated procedures for bringing an apparel retailing/manufacturing consultant from NMCP, but due to the crisis the process was postponed. During the second quarter 10 more people were hired by the company for its production department, a figure which is expected to rise by the end of the year.

Datapons, Skopje A financial package of a 490,000 USD equity/debt was closed in December 2000 for financing a new pre-press technology, a four color printing press, finishing equipment and working capital. Some of the equipment was purchased and installed but due to the crisis investment activities have been delayed. The company has still not found a suitable new location for their operations, albeit the efforts are continuing.

Tinex, Skopje This is the latest SEAF investment, where 560,000 USD financing package was provided to the company. Three new stores were opened since the investment with an additional two planned by the end of 2001. The budget includes an allocation of \$20,000 for technical assistance and an external consultant has already worked with the firm providing a plan which they are currently implementing. The company also plans to renovate two locations. The principal attended a training program in the US that was coordinated by Land O'Lakes. The sales and the profitability due to the crisis were badly hurt. More detailed discussion on the effects of the crisis is provided in section 5 below.

## **B. Prospects**

Fonko, Skopje The company is the market leader in HVAC systems in Macedonia. The firm has been in existence since 1992 and now employs 50 full time employees and provides regular work to about the same number of installation contractors. Having maximized their market share in Macedonia they are considering expanding their operations into Serbia where they already have a small presence. SEAF is interested in financing working capital that would allow Fonko to increase purchasing power and participate in regional integration and the benefits of economic scale which is essential for successful Macedonian firms. SEAF has presented a term sheet for 750,000 USD financial package that should support the expansion of the company in the region.

Metro, Skopje This company is involved in importing, storing, and distributing frozen food products, primarily fish and chicken. The company currently has 30% market share in Macedonia. The owners of the company would like to to expand the current cold storage

facilities and increase the processing capacities capturing more of the value in the value adding chain. SEAF has started negotiations and presented a term sheet for 470,000 USD financial package.

Nova High School, Skopje This private, for-profit institution offers an "American Style" English language education for grades 9-12. In four years it has grown from 40 to 160 students and its new school has the capacity to reach almost 500 students. SEAF is interested in financing curriculum development, teacher training, and certain teaching materials to help ensure a quality service and to assist in financial management and promotion of the institution. Nova HS employs 35 people and will double its staff if growth projections are met. SEAF has presented a term sheet for 450,000 USD financial package that should support the growth of the school and improvements of the curriculum.

Vispak, Skopje Vispak is a private company, involved in production of cardboard boxes used for various packaging purposes. Throughout its short history of two year, the growth has been excellent and the company became one of the dominant players on the market of cardboard boxes. Vispak employs 20 people and is looking for additional funds in order to expand the production and improve the quality of the final product.

Login, Skopje The company is one of the leading IT companies in Macedonia and the local distributor for Microsoft products. Throughout its ten year history the company has been growing constantly. Today Login is hiring 18 people and would like: (1) to expand into production of MIS software, (2) extend its educational line of business and (3) improve its distribution network for Microsoft products. In a short period of time, the company could grow to 30 employees with the overall goal of becoming a serious regional player.

Ksenos, Demir Hisar This company was identified by SEAF as part of a comprehensive research into domestic vegetable processing for export and serving the local market. In the SEAF range of small medium enterprises this company is a leading candidate for its capabilities in added value processing and building a brand name. Most of the production is exported to European Union and the owner is looking into further expansion of the production facilities. Due to the crisis, the owner decided to put the process with SEAF on hold.

### **3. Investment Proposals Made**

Since its inception in 1998, SEAF/Macedonia has made twenty three investment proposals to various Macedonian companies. The following is a summary of these investment proposals:

	<i>Company</i>	<i>Date</i>	<i>Industry</i>	<i>Location</i>	<i>Result</i>
1.	MDS	May 98	Wireless cable television	Skopje	Never closed; company could not obtain operating license from the Broadcasting council
2.	Kooperativa	June 98	Potato chips	Kocani	Offer withdrawn; misrepresentations by principal and serious flaws in the business plan
3.	Elkom	Aug 98	Industrial springs	Ohrid	Offer withdrawn; principal did not disclose a 300,000 DM loan liability.
4.	Ivoprom	Nov 98	Cleaning products	Strumica	Investment closed

5.	Marian Puposki	Dec 98	Essential oils	Struga	Offer mutually withdrawn after SEAF discovered that the principal had unintentionally seriously overestimated the market size
6.	Grafopromet 1	Dec 98	Printing company	Skopje	Offer rejected; principals returned in one year to reopen discussions, but business had deteriorated significantly
7.	Krug	Dec 98	Newspaper pub.	Skopje	Investment closed
8.	Alsto	May 99	Safe manufacturer	Ohrid	Offer rejected; principal reneged on commitment to put in additional funds
9.	ASP	Jul 99	Agricultural packaging	Ohrid	Investment closed
10.	Nasto	Sep 99	Cheese and UHT milk	Tetovo	Investment closed
11.	Planet Pres	Dec 99	Publishing	Skopje	Investment closed
12.	Bonum	Dec 99	Mushrooms and compost	Kriva Palanka	Offer ultimately rejected as the principal chose to pursue a 2,000,000 DM grant from the Dutch Government
13.	Neocom	Feb 00	Information technology	Skopje	Approved; but not closed as company did not have clear title to real estate, as represented, and would not consent to SEAF incorporating previously agreed upon terms in legal docs
14.	Konti-Hidroplast	Mar 00	Industrial piping	Gevgelija	Offer ultimately rejected by counterproposal that would have yielded SEAF a five percent return on its investment
15.	Medium Export	May 00	Agricultural products	Skopje	Investment closed
16.	Pilko	Jun 00	Chicken processing	Skopje	Investment closed
17.	Tinex	Jun 00	Supermarket chain	Skopje	Investment closed
18.	On.net	Jun 00	Internet company	Skopje	Investment closed
19.	Magnolia	Sep 00	Baby & children's clothes	Skopje	Investment closed
21.	Nova High School	June 01	High School Education	Skopje	An offer was presented, but due to the crisis, negotiations postponed after the summer holidays
22.	Fonko	June 01	Heating, Ventilation and Air Conditioning	Skopje	Negotiations under way. If successful, approval is expected in September
23.	Metro	Apr 01	Distribution of Frozen Food (Sea food and chicken)	Skopje	Negotiations started, but stopped until the crisis is over at request of the principals of the company

#### 4. Technical Assistance

The SEAF/Macedonia operating model continues to depend heavily on technical assistance from various sources to reach better investment decisions and to enhance its investments over time. Many of the providers of technical assistance are contractors or grantees of USAID and some of these have already been noted in the above text. The following table is a summary of external technical assistance accessed for various SEAF investees and potential investees:

No	Company	Type of Assistance	Provider	Time	Participant
1.	Ivoprom	U.S training	World Learning	Winter 1998	Stole Ivanov
2.	Krug	Vol. Consultant	IESC	Fall 1999	N/A
3.	Krug	U.S. training	World Learning	Winter 2000	Saso Damovski

4.	Krug	Vol. Consultant	IESC	Fall 2000	N/A
5.	Medium Export	U.S. training	World Learning	Winter 2000	Ljubco Drenkovski
7.	Nasto	In-country TA	Land O'Lakes	Ongoing	Ljubco Genadiev
8.	Nasto	Vol. Consultant	CDC	Fall 1999	N/A
9.	Nasto	Vol. Consultant	ACDI/VOCA	Fall 2000	N/A
10.	Datapons	Consultant	Independent	Fall 2000	N/A
11.	Pilko	Vol. Consultant	ACDI/VOCA	Feb 2001	N/A
12.	Tinex	Vol. Consultant	BESO	Jan 2001	N/A
13.	Tinex	U.S. training	Land O'Lakes	May 2001	Vladimir Todorovic
14.	On.net	Consultant	Independent	April 2001	N/A

There was little activity during the quarter involving external consultants due to the uncertain security situation. A Dutch consultant due to commence an assignment at Magnolia in June cancelled his visit for that reason and it has been provisionally rescheduled for October.

In addition internal resources at SEAF/Macedonia have also been used as in-house consultants to undertake specific technical assistance projects in certain specialist areas. These are summarized in the following table:

<i>No</i>	<i>Company</i>	<i>Type of Assistance</i>	<i>Provider</i>	<i>Time</i>	<i>Participant</i>
1.	Ivoprom	Product Costing / Budgeting	Clive Whiting	Spring 2000	N/A
2.	Nasto	Product Costing / Budgeting	Clive Whiting	Fall 1999	N/A
3.	Nasto	Preparation of preliminary credit application (DEG/GTZ)	Clive Whiting	Winter 2000	N/A
4.	Nasto	Finance Appreciation Seminar	Clive Whiting / Oliver Kosturanov	June / July 2001	Saso & Ljubco Genadiev
5.	Pilko	Product Costing / Budgeting	Clive Whiting	Spring 2001	N/A
6.	Pilko	Review of accounting system / guidance in selection of replacement	Clive Whiting	Spring 2001	N/A
7.	Datapons	Finance Appreciation Seminar	Clive Whiting / Oliver Kosturanov	June / July 2001	Slave Gerasimovski / Vasko Evkoski
8.	Magnolija	Finance Appreciation Seminar	Clive Whiting / Oliver Kosturanov	June / July 2001	Jasmina Miteva

## **5. SEAF Activities with Investees during the Crisis**

During the crisis, in the month of June, SEAF staff prepared general guidance notes that were provided to all investees on recommended approaches to be taken in dealing with the impacts of the Macedonian crisis. The main topics covered in the guidelines were:

- Actions to be taken in anticipation of a possible devaluation of the denar;
- Recommended security precautions with respect to (1) physical assets (2) legal documentation and (3) back up of computer systems.
- Information on tax refunds and benefits for employees recruited by the Macedonian security forces;

- Procedures for efficient management of the new war tax imposed on companies.

More specifically with the companies in the portfolio SEAF carried out specific activities addressing the particular needs of every company. The following outlines more detailed description of effects of the crisis as well as activities (if any) carried out by SEAF over the last quarter:

#### Ivoprom, Strumica

The company continues to default on bank loans (as well as SEAF) but the banks (who have priority on all collateral) have not yet foreclosed on them. SEAF is not starting the bankruptcy procedure, giving the principals of the company a chance to survive. The company is still active, and has carried out some cost and product rationalization, but is considered to have no real hope of survival.

#### Krug, Skopje

The circulation of main product, the newspaper Dnevnik, during the crisis remained stable, with advertising revenues dropping generally 20-30%. Due to the crisis some plans for expansion of the newspaper have been postponed. SEAF activities in this period included:

- Guidelines to the company were provided for more efficient banking procedures that would result in some savings for the company.
- SEAF prepared a loan application / business plan for 2 million DEM loan to be supported by Media Development Loan Fund out of Czech Republic. Due to the crisis, MDLF postponed the project and will reconsider it in autumn, providing the situation in the country calms down.
- SEAF and the management began the process of preparing a long term strategy for the company for the period over the next five years, under assumption that the crisis will be over by the end of this year.
- A process for attracting a strategic investor was started, using the expertise of Mr. Philippe Leroux, an experienced investment banker and new SEAF Washington employee. Initial interest from several companies was positive, though, everyone wishes to wait until the crisis is over.

#### Nasto, Tetovo

Being located in Tetovo, this company was one of the most dramatically affected of all SEAF portfolio companies. Some of the employees have been mobilized in the reserves, but more importantly the milk supply has been almost completely cut off. With reduced staff and limited raw material supplies the company reduced production levels by 80%. Customers buying on account stopped transferring payments further straining Nasto's cash position. Production at the moment is stopped, and lost revenues for the first half of 2001 are estimated to be 250-300,000 USD. SEAF is supporting the company by providing moral support to the principals as well as carrying out other activities that would support the business. The list of undertaken steps is the following:

- Unit cost analysis by group of products and by product has been performed.
- Financial Statement Analysis for the period January –May & January-June 2001 has been carried out.
- Proposed advising letter related to the crisis in Macedonia was submitted.
- Preparation of preliminary application for credit to DEG / GTZ was completed. Due to the crisis DEG postponed the project.

- Financial Appreciation Seminar- first seminar (Understanding Financial Statements) delivered at end of June 2001.

### Planet Pres, Skopje

During the crisis SEAF helped the company to find and relocate to new premises, resulting in some cost savings and better access for its customers. Yet, being primarily in advertising business, the revenues have been hurt. The company was furnished with the general guidelines on coping with the crisis. In addition SEAF and the principal analyzed the business during the crisis and decided to switch from printing the magazine every week to print it once a month.

### Medium Export / Pilko, Skopje

The company was frustrated in its expansion plans to extend its new distribution system to include the closest population centers, Kumanovo and Tetovo. Sales growth and development have been adversely affected by the crisis and are running well below original expectations. Assuming an improvement in the situation, it is now planned to attack the market with an advertising campaign in the autumn (October). SEAF assistance in the period was focused in the following areas:

- Unit Cost analysis and preparation of Budget for 2001;
- Review of A/c system and guidance in selecting replacement of MIS system;
- Assistance in obtaining second financing-Loan from Komercijalna Bank;
- Working capital support during the crisis. SEAF's loan commitment of \$50,000 was converted into equity and the funds were disbursed in June.

### On.net, Skopje

This investment has found itself in a very difficult position. Despite months of intensive advertising and constant promotional pricing, the increase in demand has been disappointing. The company has taken various steps to cut costs and preserve cash. Being a start-up, actual lost sales are difficult to assess but sales are well below projections. SEAF is possibly facing a situation where additional capital investment may be necessary to keep the company functioning before a settling of the market takes place. SEAF provided assistance in the following areas:

- Mediation in the removal of the illegal blockage started by other private ISP to the company;
- Assistance in signing up several important clients;
- Assistance in developing the strategy for cutting costs, improving the sales process and general customer relationship management;
- Extension of the grace period on the loan was given and all fees associated with SEAF have been put on hold, until the crisis is over and the company has better cash flow.

### Magnolija, Skopje

The company has successfully started the production of children clothing under its own label. Being in a premium clothing segment, the sales of the imported clothes, constituting a majority of the business, were hurt. Yet the company is surviving and SEAF has provided its assistance with the following activities:

- Assistance in equipment selection-review of the sales contracts from different equipment suppliers, including Brother, PFAFF and YUKI.

- Assistance in selection of new production premises and a new Chief Accountant
- Assistance in comparing, selecting and choosing of the accounting software
- Developing job descriptions format and job descriptions for the Chief Accountant
- Proposed advising letter related with the crisis in Macedonia.
- Assistance in developing price policy.
- Preparation of Financial Appreciation Seminar- Understanding Financial Statements

### Datapons, Skopje

Due to the crisis the company has lost 25% of the staff, who were mobilized in the army reserves. Demand for printing has decreased and collecting receivables has become increasingly difficult. Estimated sales lost in the first half is in the range of 150-200,000 USD and the amount is continuing to grow as the situation is not fully resolved. The company had losses in all of the last three months of the quarter. The management has temporarily suspended investing and expansion activities, despite strong support from SEAF to continue with the plans. During this period, the following activities have been undertaken by SEAF:

- Financial Statement Analysis for the period January –May & January-June 2001
- Assistance in equipment selection-review of the sales contracts from different equipment suppliers.
- Assistance in selection of new production premises and new Chief Accountant
- Assistance in comparing, selecting and choosing of the accounting software
- Proposed new functional organizational structure.
- Developing job descriptions format and some job descriptions related with the revised organizational structure
- Preparation of preliminary cost benefit analysis for the optimum order quantities and time intervals between two orders.
- Preparation of Financial Appreciation Seminar- Understanding Financial Statements

### Tinex, Skopje

Two of the larger stores of the company located in Tetovo and Kumanovo severely suffered from the crisis. To date the estimated lost sales is in the range of 400-500,000 USD. More importantly the demand for non-essential, higher profit margin products, in the other stores in the chain have dropped significantly affecting both sales and profitability of the company. During the second quarter SEAF was providing support with the following activities:

- Initiative started on Customer Service activities. Process was instigated by SEAF, customer service group was established and an action plan for training of the employees was agreed.
- Regular reviews of company performance and strategy have been performed including: (1) Sales and profitability analysis on by store basis and discussion with the Principals and key managers of the company;
- The Principal, Mr. Vladimir Todorovic, undertook a Study Tour to USA (in cooperation with MAMA project) in April/ May during which:
  - He visited food-retailing organizations;
  - He also had one week's training at Cornell University.

### Conclusion and Future Plans

The conflict in Macedonia has significantly damaged SEAF portfolio company cash positions via reduced sales and reduced collections of receivables. Reductions in foreign and domestic investment in the economy will reduce the quantity of SEAF investment opportunities. The altered consumer expenditure pattern reduces sales and value added activities which reduces profitability/returns and further impacts on investment opportunities.

Due to the local management and international character of the SEAF Macedonia funders, however, there is no anti-west sentiment towards SEAF. SEAF has decided to continue with its normal activities by: (1) Reassuring the business community that investors still believe in the viability of the economy, (2) Providing management support which has kept our portfolio companies solvent, and active in the market, (3) Continuing with disbursements of much needed cash, and (4) Continuing to seek new investments, presenting term sheets and negotiating with candidates which helps, in spirit and capital, to encourage investment in Macedonia.

## **6. Promotional and Representational Activities**

In order to promote its activities and educate the public about equity investment, SEAF actively participates in presentations, business fairs, exhibitions and other events. Activities for this quarter include:

<b>Activity</b>	<b>Organization/Event</b>	<b>Location</b>	<b>Description</b>
TV show	Macedonian Television	National	SEAF employee (Janko Trenkoski) was discussing on pros and cons of investing providing support to the investments via Macedonia stock exchange.
Press conference	SEAF Macedonia	Skopje – Hotel Alexander Palace	Announcement of the SEAF investment in Tinex. The USA Ambassador in MK, Michael Einik, participated.
Interview	The Macedonian Times	National	Promoting foreign investment in Macedonia and Tinex investment.
General Presentation	American Chamber of Commerce	Skopje	A PR activities have been undertaken which resulted in election of SEAF Director General in the Board of AmCham.