

Small Enterprise Assistance Funds

Quarterly Report to USAID **(April to June 2002)**

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 fourth quarter, including companies rejected since the beginning of January, 2002.

| Category | No. of Firms | Essential Activities Being Performed |
|-----------------|---------------------|--|
| Potentials | 7 | Vetting firms' fit to SEAF policy and entrepreneurs' ability and integrity |
| Prospects | 1 | 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 | 13 | Investment made by SEAF in the company |
| Graduates | 1 | SEAF has exited its investment |
| Rejects | 14 | 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 | 36 | |

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, over 150 new jobs were created and before the crisis, there was on average, a 36% increase in revenues. During the last year however, primarily due to the crisis, portfolio companies experienced a decline in the revenues from 5 - 20% compared to their sales in 2001, some of them even reducing number of employees.

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 has been disappointing and has resulted in considerable financial strain. Despite all efforts by SEAF, Ivoprom has not been able to turnaround. The operation of the company has been discontinued. SEAF has negotiated a settlement with the other owners in the company to collect some of the principal of the loans extended. The procedure is going through the courts and the finalization is expected by the end of the third quarter.

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 over 150 full time staff. The financial performance of the

company is excellent, with profits significantly exceeding projections (the first six months profits are in excess of 400,000 USD). So far through dividends SEAF has recouped its initial investment. SEAF is working actively with the company management to prepare it for the negotiations with the strategic investor from Germany.

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 spring 2001 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 Skopje, where much larger facility should be built.

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 changing the accounting firm and hiring a new financial manager. The company was severely affected by the crisis in Tetovo, which was discussed in previous reports. Due to milk supply problems in the region, SEAF and the company management are working on taking additional loan in order to relocate the production operation to newly identified location in 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 in the second quarter of 2002 started a new weekly teenage magazine called Teen Schema. Right from the outset, both magazines became market leaders with circulation above 5,000 copies per week. The management is constantly considering publishing additional magazines with different concepts. The company recovered from start-up expenses in 2001 and in the first half of 2002 made modest profits of some 25,000 USD. The company is progressing very well and is increasing the number of employees.

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. In the second quarter 2001, SEAF provided an additional 50,000 USD of financing to support the weak cash flow of the company and further improvements in the production. The funds were used for purchasing equipment and working capital. SEAF is working hard in developing financial systems that will help the company manage its operations. In the first quarter SEAF has brought in the company one of the leading poultry production experts from Europe, assisting the company improving the efficiency and reducing the losses. The expert recommendations have been accepted and the company was working on their implementation. Unfortunately, the Ministry of Economy doubled the quota for imports of cheap frozen chicken, which adversely is impacting the sales. The company losses are mounting and additional capital would be needed to survive. SEAF is also considering a liquidation scenario.

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. In 2002 most of the efforts have been focused on export of lamb and paprika. The management of the company is also spending considerable amount of time in Pilko, which is related company to Medium Export.

On.net, Skopje A 394,000 USD equity/debt financing package for this internet start-up company was closed in September, 2000. The ISP market remains extremely dynamic and competitive. The crisis in the country as well as illegal activities/retaliation from some of the local ISP affected the sales. Yet the cash flow in the first half of 2002 was on break-even, thus stabilizing the financial condition of the company. One local investor expressed an interest to become a shareholder in the company. SEAF is working on strategy to expand the activities of the company and make it profitable.

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 have been 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. In the first quarter SEAF has brought in the company an apparel retailing/manufacturing consultant from NMCP. His work extended in the second quarter and some efforts have been made to start exporting the company products to Netherlands. However, the demand for high quality children clothing is weak and the sales are below expectations. SEAF and the management are working on a new marketing strategy in order to reposition the business and make it more competitive.

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. Due to the crisis last year the investment activities have been delayed, but everything that was planned was purchased and installed in the first quarter of 2002. Company moved to larger premises and has increased the sales using the new equipment purchased with SEAF investment. The company performance is close to the original projections. SEAF and the management are working on further improving the sales department in the company.

Tinex, Skopje SEAF provided a debt/equity financing package of 560,000 USD in the first half of 2001. Three new stores have been opened since the investment and a new one in Ohrid is under preparation. The budget includes an allocation of \$20,000 for technical assistance and an external consultant has already worked with the firm providing a plan that they are currently implementing. The competition is getting stronger and the company needs to bring more technical experts to help it streamline the operation. Internal management experts of SEAF are working with the company to improve the inventory management and provide better incentive systems for the store managers.

Fonko, Skopje A 750,000 USD of combined debt/equity was provided to the company in the last quarter of 2001. Fonko 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 and using the capital provided by SEAF, the

company is expanding its operations into Serbia and Croatia where it already has some presence. The expansion activities are advancing better than planned. SEAF investment provided additional working capital that would allow Fonko to increase purchasing power and participate in regional integration and the benefits of economic scale. Yet, to support its strong growth, the company would need additional financing.

Mako Market, Skopje In the first quarter of 2002, SEAF has made its largest investment in Macedonia amounting \$800,000 and consisting of \$630,000 equity and \$170,000 convertible debt. This company is the second largest Macedonian distributor and wholesaler of Fast Moving Consumer Goods, and leading supplier to Tinex and Vero supermarket chains. The company has annual sales of \$10 million and over 70 employees. The investment was used to expand the current business by purchasing more distribution vehicles, increasing storage capacity and improving cash flow. SEAF internal experts are working with the company management on improvements in the inventory control systems, which are of critical importance for any FMCG distributor.

Login, Skopje A \$430,000 financing package consisting of \$280,000 equity and \$150,000 convertible debt has been provided to Login in the first quarter of 2002. The company is one of the leading IT companies in Macedonia and the local distributor for Microsoft products. Company is using the investment to expand into software production and improving the training facilities. The efforts have been focused on legalizing the software used by the Macedonian government and is using the assistance of the local USAID office in these efforts. These efforts came to fruition in the second quarter of 2002, which combined with other business activities made the company reach the full year projections only in the first half of 2002.

B. Prospects

Company A. This company belongs to the pharmaceutical sector and is one of the largest drug distributors and retailers in the country. The funds are needed to improve the production process that was recently introduced. SEAF is working jointly with EBRD to co-finance the project. The estimated size of the SEAF investment is around 1 million USD. SEAF has conducted an audit of the company and is devising investing strategy with EBRD.

3. Investment Proposals Made

Since its inception in 1998, SEAF/Macedonia has made 26 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 |

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|-----|------------------|---------|--|---------------|---|
| 5. | Marian Poposki | 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 | Initial reaction from the principals on the presented proposal was negative. In Q2-2002 however, the negotiations continued. is still pending. |
| 22. | Fonko | June 01 | Heating, Ventilation and Air Conditioning | Skopje | Investment closed |
| 23. | Metro | Apr 01 | Distribution of Frozen Food (Sea food and chicken) | Skopje | Due to the crisis and summer holiday season, negotiations were stopped, but continued in September. New proposal will be made in October. |
| 24. | Login | Dec 01 | Information technology, distributor of Microsoft for Macedonia | Skopje | Investment closed |
| 25. | Mako Market | Dec 01 | Distributor and wholesaler of Fast Moving Consumer Goods | Skopje | Investment closed |
| 26. | Yellow Pages | Dec 01 | Yellow Pages advertising directory | Skopje | Term sheet presented and negotiations are under way. |
| 27. | Povardarie | Jun 02 | Wine producer and bottler | Negotino | After the term sheet was presented, the new audit revealed that the company was insolvent (negative book value). |

4. Technical Assistance

The SEAF/Macedonia operating model continues to depend 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:

| <i>No</i> | <i>Company</i> | <i>Type of Assistance</i> | <i>Provider</i> | <i>Time</i> | <i>Participant</i> |
|-----------|----------------|---------------------------|-----------------|-----------------|--------------------|
| 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 |
| 15. | Pilko | Consultant | Independent | March 2002 | N/A |
| 16. | Magnolija | Consultant | NMCP | Mar./April 2002 | N/A |

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 |
| 9. | Tinex | Development of Financial Reporting Software and Store Analysis | Janko Trenkoski/ Panche Kralev | July/August 2001 | Management Team of Tinex |
| 10. | Pilko | Preparation of a marketing strategy and promotion plan | Vladimir Cvetinovski | September 2001 | N/A |
| 11. | On.net | Preparation and execution of a new promotional campaign | Vladimir Cvetinovski | November 2001 | N/A |

| | | | | | |
|-----|---------------|---|-------------------------------------|---------------|-----------------------|
| 12. | Tinex | Reviewing the current marketing concept vis-à-vis existing competitors | Vladimir Cvetinovski | December 2001 | N/A |
| 13. | All portfolio | Providing advice on new tax changes that resulted in significant savings in profit making companies | Tanja Veljkovic/ Svetlana Dumova | December 2001 | N/A |
| 14. | Datapons | Review of the marketing strategy | Vladimir Cvetinovski | March 2002 | N/A |
| 15. | Mako Market | Introduction of Flash Reporting | Jim Jaffee | March 2002 | Management Team of MM |
| 16. | On.net | Introduction of Flash Reporting | Jim Jaffee | March 2002 | Predrag Cemerikic |
| 17. | Tinex | Introduction of Flash Reporting | Jim Jaffee | March 2002 | Company management |
| 18. | Login | Introduction of Flash Reporting | Jim Jaffee | March 2002 | Company management |
| 19. | Fonko | Introduction of Flash Reporting | Jim Jaffee | March 2002 | Company management |
| 20. | Login | Design and implementation of an employee incentive system | Jim Jaffee | June 2002 | Company management |
| 21. | Mako Market | Designing and implementing better inventory control systems | Jim Jaffee / Dejan Kalinikov | June 2002 | Company management |

5. Personnel Additions and Activities

In its constant efforts to help educate public about equity investing and along with its social role, during the summer SEAF continued with its practice of hiring interns. At the end of the second quarter SEAF has hired four interns, all Macedonian citizens and students from the University of Sheffield in Thessalonica. Three of them will work in-house in SEAF and one of them was assign to work with the company Login Systems.

As an addition to its full-time staff, at the end of the quarter, SEAF has hired one more Investment Officer. Mr. Dejan Kalinikov is a recent MBA graduate from Emory University, Goizueta Business School, where he was sent under the Ron Brown scholarship program. Dejan has previously worked for Macedonian Business Resource Center. He will be responsible for coordinating all post-investing activities of SEAF Macedonia.

6. Promotional and Networking Activities

In order to promote its activities and educate the public about equity investment, SEAF normally participates actively in presentations, business fairs, exhibitions and other events. In addition, SEAF has regular meetings with relevant business leaders both from local and international community whereby we explain our role and seek new deals. SEAF has been also active in assisting USAID in various segments of its operation. Activities and relevant meetings for this quarter include:

| Activity | Organization/Event | Location | Description |
|-----------------|---------------------------------|-----------------|---|
| Meeting | EBRD | Skopje | Discussion about environmental laws and aspects when making equity investments. |
| Meeting | EXIM bank | Skopje | Discussion with the president of EXIM bank from Washington about potentials of Macedonian economy and possible cooperation with local companies. |
| Meeting | AmCham | Skopje | Regular meeting of the Board members about plans and forthcoming activities of the AmCham. |
| Meeting | EBRD | Skopje | Meeting with the EBRD head of the financial institutions about SEAF plans in Macedonia. |
| Meeting | President of Macedonia | Skopje | Advising the President on possible actions that he could make in order to help SMEs in the regions affected with the crisis. |
| TV show | Economic Institute of Macedonia | Skopje | Guest speaker in a TV show. Discussing equity investing in SMEs. |
| Meeting | IRIS - USAID | Skopje | Working meetings on plans for providing free newspaper copies to remote areas in Macedonia, especially in the light of the forthcoming elections. |
| Interview | Utrinski Vesnik | Skopje | An interview about SEAF activities and challenges for FDI in the country. |
| Meeting | DEG | Skopje | Discussion about possible follow-up financing of DEG in SEAF investees. |
| Meeting | GTZ | Skopje | Discussion about Technical Assistance projects with some portfolio companies. |
| Meeting | FSVC | Skopje | Meetings about training programs for finance professional in the country. |