EFSE

EUROPEAN FUND FOR SOUTHEAST EUROPE

Building Bridges

Public-Private Partnership for Development Finance in Southeast Europe

Annual Report 2006

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A DEVELOPMENT FINANCE INITIATIVE SUPPORTED BY

European Commission
Federal Ministry for Economic Cooperation and Development (BMZ), Germany
Swiss Agency for Development and Cooperation (SDC)
Austrian Development Cooperation (ADC)

KfW
European Bank for Reconstruction and Development (EBRD)
International Finance Corporation (IFC)
Netherlands Development Finance Company (FMO)

Bankakademie
Crédit Coopératif
Sal. Oppenheim

Letter from the Chairman

It is my pleasure to present the European Fund for Southeast Europe's (EFSE) first Annual Report. This report documents a first year of successes for one of the world's largest microfinance investment funds. Beginning with its launch on 15 December 2005, the Fund has already generated an impressive track record – both in terms of development impact and financial performance.

EFSE is a unique public-private partnership initiative based on an innovative investment structure. Development finance is mutually provided by donors, international finance institutions and private institutional investors. EFSE uses structured finance techniques to sub-divide its capital structure into three tranches, each bearing a different risk profile, to leverage donor funds to attract private investments. This approach creates efficiency gains and divides risk in a manner that allows each investor to bear an appropriate risk level – indeed, through subordination mechanisms, donor funds are used as a risk cushion to offer investment opportunities to institutional and private investors interested in combining attractive financial returns with demonstrated social impact.

An additional innovative feature of the Fund is a Development Facility, which provides complementary non-financial services, primarily technical assistance and capacity-building services in support of our partner institutions. Our approach is to provide focused assistance that caters to the specific needs of each institution.

Looking back, 2006 has been a year of successes: since inception, the Fund has achieved dynamic growth, increasing its total investment portfolio to EUR 244.5 million. Private institutional investors, joining in December 2006, have made significant additional commitments of EUR 102 million.

These investments enabled the Fund to provide refinancing to 38 partner institutions, reaching more than 44,000 end-borrowers. The Fund has demonstrated its development impact across all economic sectors by supporting micro and small enterprises (MSEs)– enterprises which contribute to employment and income creation in the region. Moreover, by refinancing housing loans, the Fund helped to improve the quality of housing for low-income families throughout Southeast Europe. Recently, EFSE was granted the Microfinance Label by the Luxembourg Fund Labeling Agency a.s.b.l. (LuxFLAG), one of the first three microfinance funds to receive the label – a confirmation of the Fund's important development objective.

Looking ahead, the Fund will continue to expand its outreach – through refinancing new partner institutions in the region, as well as through offering new, innovative products to best meet the needs of these fast-developing institutions. These investments will be financed by our existing investors, and by additional private capital expected to be raised this year – including from local private institutional investors – contributing to truly sustainable local financial market development.

Klaus Glaubitt

Dr. Klaus Glaubitt,
Chairman Board of Directors

Olli Rehn,
Commissioner for Enlargement, European Commission

Today, there is innovation in the air. Political leaders of Europe agree that the path to prosperity, stability and security during the years to come will not be possible without innovation. The Commission has taken this into account when it decided that its political agenda will be driven by the objective of creating „growth and jobs" for Europe. This ambitious objective is also part of the enlargement strategy.

The countries of the Western Balkans have now moved on from the post war reconstruction process to focus on the full development of their economic potential. Private sector development is an important pre-condition for the development of a functioning market economy, which itself is a key criterium for all future candidate countries to be fulfilled, if they want to join the Union. Private sector development is needed for trade to develop and investments to take place. This in turn will provide the conditions for creating jobs in the countries of the Western Balkans where unemployment levels are particularly high.

The challenges ahead and the funding needs of the Western Balkans exceed the availability of Community funds for the years to come. EFSE is a welcome innovation at a time where innovation is highly needed. It acts as a bridge bringing together sovereign donors, Member States and non Member States, national and international financial institutions and the Commission. EFSE has given private sector support a regional dimension. This is particularly welcome in the Western Balkans consisting of small economies, where regional co-operation and exchange is key to economic integration. The prospect of becoming future shareholders of EFSE shall be an incentive for an active involvement and exchange and can help our fellow citizens in Southeast Europe to move further on the road to the EU.

HIGHLIGHT OF THE YEAR: FORMATION OF ADVISORY GROUP

On 16 October 2006 the Advisory Group was officially established in Vienna. Governors and other representatives of the Central Banks and Bank Supervisory Agencies from six countries participated in this first meeting. In addition to discussing the overall role and future agenda of the Advisory Group, the members of the Advisory Group exchanged their views on the current stage of development of the financial sector in the region. Among the current trends and challenges discussed were the control of money supply and credit expansion, increasing foreign ownership in the banking sector and the need for securing long-term financing – all of which call for increased regional co-operation. In this regard, the Advisory Group serves as an important platform of exchange between the monetary authorities in the region.

Letter from the Management

During 2006, Southeast Europe saw a number of groundbreaking developments, be it the independence of Montenegro or the final steps towards EU accession of Bulgaria and Romania. As the political and economic situation has been continuously improving so did the financial sectors of the target region: EFSE began its operations in a phase of continued consolidation and rapid deepening of financial intermediation.

Against this background, the Fund had a dynamic start, doubling the volume of the investment portfolios that were transferred from preceding development finance initiatives. The Fund established relations with eleven new partner institutions and made substantial investments outside the core nations/national entities of Bosnia and Herzegovina, Kosovo, Montenegro and Serbia within its first months of operation. However, it is not only size that matters: the quality of the investment portfolio has been excellent throughout the year, with no impairments recorded. Finally, Fund management has generated a sound return for the Fund's investors, ensuring the attractiveness of the Fund.

In order to keep the promise to scale up the outreach of financial services to hundreds of thousands of MSEs and low-income private households, the Fund's capital base must grow accordingly. Leveraging substantial amounts of private capital for development purposes is therefore a primary objective of the Fund. It has been particularly encouraging that within only one year after inception, private institutional investors already represent more than 25% of the Fund's committed capital. This underscores the excellent reception the Fund has received in the international capital markets, based on an outstanding track record – both in terms of development impact and financial performance.

The combination of social development and financial performance is certainly one of the unique features of the Fund. Fund management is fully committed to this double bottom line. Furthermore, we strive to provide development finance by providing long-term funding and complementary non-financial services in the area of capacity-building to create win-win situations at three different levels: firstly, we seek to serve the ultimate target group, MSEs and private households, with appropriate financial services allowing them to make better use of their economic opportunities. Secondly, we seek to make a contribution to creating sound financial institutions with a clear target-group orientation. Thirdly, we want to create financial markets that are stable and work for the majority of people.

The success of the Fund during its first year of operation would not have been possible without the support of various stakeholders. Fund management has greatly benefited from the commitment and backing from its shareholders. We have also been working closely with the Board of Directors, the Investment Committee, Development Facility Committee and the Advisory Group that have been instrumental in providing important guidance to us.

New challenges will arise in 2007. Rapidly maturing markets require continuous innovation in the field of financial products and instruments. Fund management is therefore preparing to introduce guarantees, local currency loans and structured finance transactions to respond to these market needs. Finally we strive to attract private and local institutional investors such as pension funds or insurance companies. Broadening our capital structure in this respect would be another milestone on our way to build local capital markets to which the Fund is also committed to.

Oppenheim Pramerica
Asset Management S.à r.l

Harry Rosenbaum

Johann Will

Bankakademie e.V.

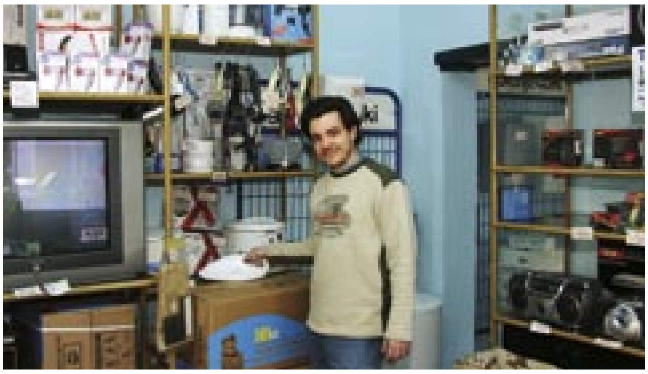
Dr. Klaus Maurer

Sylvia Wisniwski

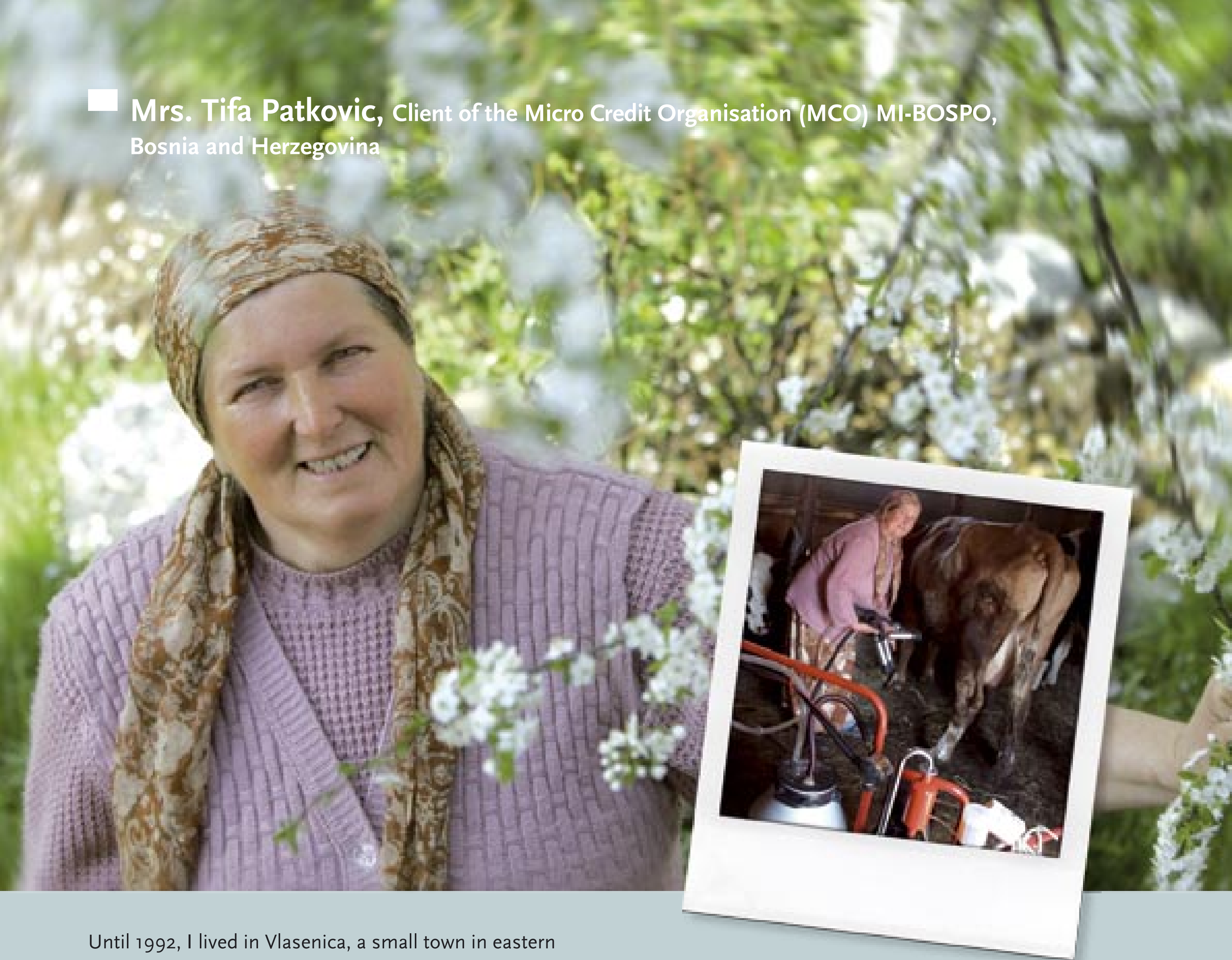
Our Mission

The Fund aims to foster economic development and prosperity in the Southeast Europe region through the sustainable provision of additional development finance, notably to micro and small enterprises and to private households, via qualified financial institutions.

In pursuing its development goal the Fund will observe principles of sustainability and additionality, combining its development and market orientations.



Mrs. Tifa Patkovic, Client of the Micro Credit Organisation (MCO) MI-BOSPO, Bosnia and Herzegovina



Until 1992, I lived in Vlasenica, a small town in eastern Bosnia and Herzegovina. I had a house, a small farm, a car and a perfect life with my family. In just one day we lost everything. Twenty years of hardship and work of my family disappeared. I hit bottom. We moved to Živinice, a town nearby Tuzla to organise our lives again. We worked for other people to earn enough to have regular meals. I was grateful for having a chance to survive, but my pride was at the lowest level – I was crying all the time. Then I learned about psychotherapy organised by MI-BOSPO. I felt much better, but again I was not making any economic progress. I was not earning. This was killing me.

One day, a French woman, Maria Novak, visited us. She was telling us how people around the world started companies with KM 1. I asked her 'Madam, do you have any money?' and she said 'I do, and do you have a business plan?'. I did not know what the business plan was, so I said slowly 'Madam, I just want to buy a goat, one goat. I need food'. Surprisingly, she gave me a loan of KM 500. We made a small stable, we bought a goat and a haystack. One month later, the goat had 4 kids and suddenly my stable was full.

Those 4 little creatures were my big capital. I hugged them, kissed them, and played with them. Sometimes I would even fall asleep in the stable. My heart and soul were filled with joy when I watched them. I had something of my own, even if it was a goat. When they grew up I sold three of them for KM 600, and I left the goat and one little one for myself.

In the meantime, MI-BOSPO has started to grant loans and has become a partner institution of EFSE. I wanted to have a cow, so I learned that I should find a solidarity group of three women and MI-BOSPO will lend me KM 1,000. I sold the goat and the kid, took a loan and bought a cow. From that moment, I have established a relationship with MI-BOSPO. They are part of my family. Until this day, I borrowed KM 60,000 in total, always taking care of repaying the rates correctly and on time. Thanks to this money, I have a decent income to support my family, I have established a small farm, and I bought the land, built a house and a big stable. I got my "old life" back.

Highlights in 2006

THE FUND'S ORGANISATIONAL SET-UP: BREAKING NEW GROUNDS IN DEVELOPMENT FINANCE

- The Fund was launched on 15 December 2005 as the successor fund of the four European Funds in Bosnia and Herzegovina, Kosovo, Montenegro and Serbia. The result was the successful transfer of various preceding development finance initiatives, supported by several donor agencies and their integration into a new sustainable institutional structure.

- The Fund was set up as a Luxembourg SICAV. With the new Law on Specialised Investment Funds that became effective in February 2007, the legal form changed to a SICAV-SIF (Societé d'Investissement à Capital Variable – Fonds d'Investissement Spécialisé). It is promoted by KfW Entwicklungsbank. The Fund management and administration is carried out through a consortium of private financial service providers. The Fund manager is Oppenheim Pramerica Asset Management and the advisor is Bankakademie. Citibank Luxembourg is in charge of Fund administration and custody.

THE FUND'S SHAREHOLDER GROUP: A UNIQUE PUBLIC-PRIVATE PARTNERSHIP

- The Fund's investor base consists of first-class shareholders, among which are the European Union, the German, Swiss and Austrian governments as well as renowned international finance institutions such as IFC, EBRD, KfW Entwicklungsbank and FMO. Bankakademie as the Fund's Advisor has also invested in the Fund to underscore its commitment to this innovative investment structure.

- In December 2006, the first two private investors besides Bankakademie invested in the Fund.

MAJOR EVENTS

- In June 2006, the Development Facility started its operations complementary to the Fund's investment activities.

- In October 2006, the Advisory Group was established. Members are the Governors and representatives of the Central Banks of 6 nations/national entities.

- The Fund was officially launched through major public events during October and November in the core nations/national entities Bosnia and Herzegovina, Kosovo, Montenegro and Serbia.

- During the second half of the year, the Fund expanded operations to FYR Macedonia, Moldova and Romania. At present, it operates in the region from five local offices through its Advisor, Bankakademie.

IMPRESSIVE DEVELOPMENT PERFORMANCE

- The Fund's investments helped to extend more than 30,000 new loans to end-borrowers during 2006, including MSEs and private low-income households.

- At year-end 2006, more than 44,000 micro and small entrepreneurs and private households in the region had outstanding loans refinanced by EFSE funding.

RAPID LOAN PORTFOLIO GROWTH AND DIVERSIFICATION

- The Fund's initial loan portfolio outstanding of EUR 122 million, transferred from the preceding European Funds, has increased by 200% to EUR 244.5 million at year-end 2006. Within one year of operations, the Fund has become one of the largest microfinance investment vehicles globally.

- The number of partner institutions with active investments has grown from 27 at inception to 38 at year-end 2006, ranging from small microfinance institutions to international banking groups.

FINANCIAL PERFORMANCE

- During 2006, the average composite yield on the Fund's 2006 investments was 3.22% over 6-months Euribor.

Our History

EFSE is the successor of various development finance initiatives known as the "European Funds for Bosnia and Herzegovina, Kosovo, Montenegro and Serbia" that were implemented in 1998 as a post-conflict reconstruction effort in South-east Europe. These initiatives received financial support in the form of grants from the European Union, the German, Swiss and Austrian governments, as well as a loan from the Netherlands Development Finance Company (FMO). KfW Entwicklungsbank managed these funds under a fiduciary arrangement.

The preceding initiatives provided long-term loans to local financial institutions for onlending to MSEs and private households. Comprehensive technical assistance programmes assisted in adjusting lending techniques in partner institutions to increase outreach to the target groups.

This donor co-operation generated an impressive track record in terms of both development impact and financial performance:

- The nominal value of the initial donor contributions to the various European Funds was fully preserved. The sub-loan portfolio was of excellent quality.
- More than 45,000 loans were granted to end-borrowers between 1998 and the end of 2005 at a total amount of EUR 280 million.
- Some 10,000 jobs were preserved and/or created in the micro and small enterprises which have benefited from the funding.
- The institutional capacities of around 30 partner institutions were strengthened.

On 15 December 2005, the Fund was established under the laws of the Grand Duchy of Luxembourg in the form of a SICAV. At that time, the preceding European Funds were merged in the new Fund together with a regional funding facility for Albania, Bulgaria, FYR Macedonia, Moldova and Romania, which was enabled by financing from the German government. In this perspective, the successful transfer of existing refinancing programmes to the Fund was an important milestone to set up a new generation of development finance vehicles of considerably greater scale and scope.

The main benefits of incorporating the preceding development finance initiatives into the Fund include the following:

1. Ensuring sustainability of operations through institutionalisation, including the future transfer of ownership of donor funding to local stakeholders;

2. Leveraging additional funds from private investors that otherwise would not be mobilised without the risk protection of donors and international finance institutions. In this perspective, an innovative public-private partnership was formed that entails significant growth potential;

3. Extending the scope of financial services to the partner institutions and the ultimate target groups; and

4. Generating operational efficiency gains through private management.

Our Clients and Impact

Through its partner institutions, the Fund provides financing to micro and small businesses as well as to households for housing purposes. In order to track the Fund's development performance, the partner institutions report on the use of the funds on a regular basis.

HOW MANY END-BORROWERS WERE REACHED THROUGH EFSE FINANCING?

In line with its rapid expansion, the number of end-borrowers has also rapidly increased in 2006. During the year, the Fund's investments have enabled our partner institutions to disburse 30,975 new loans totalling EUR 159.0 million. At the end of 2006, the Fund refinanced outstanding loans to 44,286 end-borrowers, amounting to EUR 190.7 million. The volume of funds placed with end-borrowers is lower than the Fund's overall outstanding investments with partner institutions as the Fund's refinancing facilities are subject to mandatory minimum reserves in some countries. Furthermore, partner institutions generally need some weeks to transform the Fund's investments into sub-loans.

TARGET GROUP OUTREACH AS OF 31 DECEMBER 2006

Sub-loan portfolio:	**191 million**	**EUR**
- MSEs	88 million	EUR
- Rural MSEs	37 million	EUR
- Housing	66 million	EUR
Number of active end-borrowers:	**44,286**	
- MSEs	19,689	
- Rural MSEs	12,825	
- Housing	11,772	
Average loan amount outstanding:	**4,307**	**EUR**
Total volume disbursed in 2006:	**159 million**	**EUR**
- MSEs	77 million	EUR
- Rural MSEs	34 million	EUR
- Housing	48 million	EUR
Total number of loans disbursed in 2006:	**30,975**	

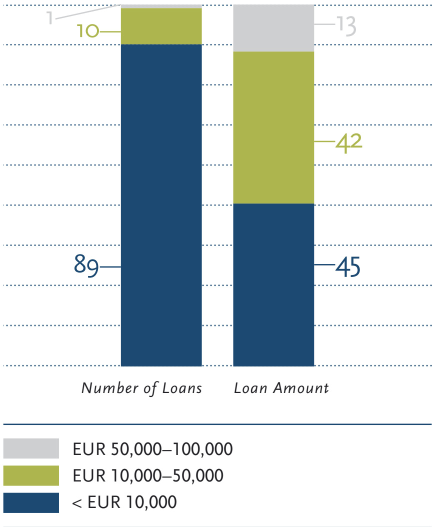
WHAT IS THE AVERAGE SUB-LOAN SIZE?

The Fund reaches with its investments low income households and very small enterprises. The average size of sub-loans at disbursement amounts to EUR 5,147, while the average loan size outstanding is EUR 4,307. This is substantially below the amount of EUR 10,000 which is commonly used as the microfinance threshold in Southeast Europe.

MSE loans tend to be lower in size than housing loans – 91% of all MSE loans are below EUR 10,000. For housing loans, this share stands at a still high figure of 79%.

Subloan Disbursements by Loan Size during 2006

Total Fund in %



Ingrid Matthäus-Maier,

Spokeswoman of the Board of Managing Directors, KfW Bankengruppe

... enabling people to make better use of their opportunities ...

»One of the significant effects the EFSE has is that it empowers people. It opens the door to a wide range of financial services for many ordinary people – from the paycheck-receiver to the small entrepreneur. The use of these financial services enables people to make better use of their economic opportunities and shape their lives more autonomously.

EFSE also fosters the empowerment of women. Many of EFSE's partner banks have both a significant share of female staff and credit clients. Both factors give many women a chance to pursue a professional career and earn their own living – an opportunity which is still not common for many women in Southeast Europe and can help pave the way for the development of more equitable societies.«

Mr. Selim Zezunovi,

Client of the MCO Alter Modus, Montenegro

A plumber by vocation, I had to leave my job in a building construction company in the early 1990s. At that time, due to the general crisis in former Yugoslavia, there were no jobs available with regular salaries. I had no time to lose. I quickly had to find a way to provide daily bread to my family of five. I turned to agriculture, and for ten years now we have been growing potatoes and watermelons. Since my family does not own any land, I rented the plots.

Because I did not have any money, I had to borrow some to start production, i.e. to buy fertiliser, potato and watermelon seeds. But that was a difficult time, because whoever lent you money would not wait until the end of the season so that I could sell my potatoes and watermelons and pay the debt back. They all wanted their money back quickly.

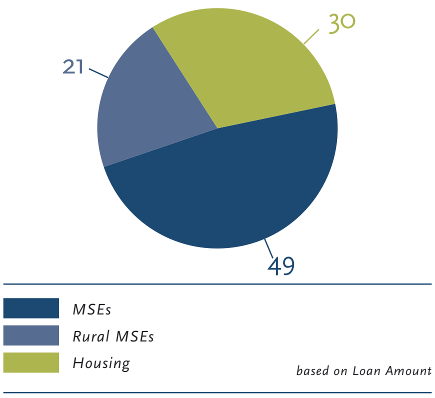
That was a period of hardship until two years ago when I heard of Alter Modus, which is one of EFSE's partner institutions. Since then, my wife and I have been clients. These loans are good for us because we get the money when we need it, and the repayment period and the amount of instalments are tailored to our needs. On the other hand, we know that next year we can take a new loan and start the production again.

In comparison to last year's 27 acres, thanks to the loans, we managed to expand the production of potatoes and watermelons to 72 acres of land. For next year, I plan to boost the potato crops and keep the watermelons at this year's level.

WHICH SEGMENTS OF THE TARGET GROUP WERE REACHED?

The majority of loans in terms of volume during 2006 (70%) were disbursed to the MSE segment, including also MSEs in rural areas. The remaining 30% of the loans were disbursed to households for investments in housing.

Subloan Disbursements by Product during 2006
Total Fund in %

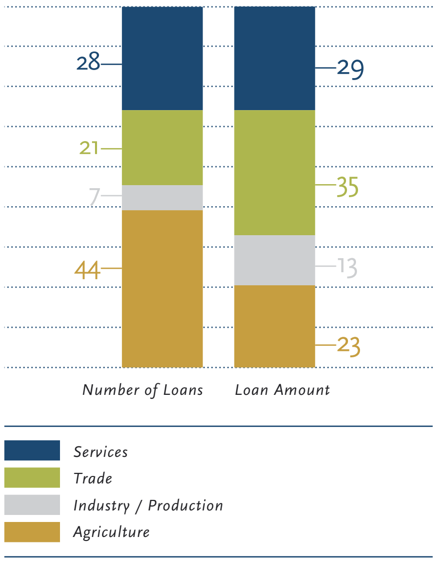


WHICH ECONOMIC SECTORS BENEFITED FROM MICRO AND SMALL BUSINESS LOANS?

The distribution of the sub-loans to MSEs, including rural MSEs, by economic activity largely reflects the economic structure of the target region. In terms of loan amounts disbursed, trade and services take the lead with a share of 35% and 29% respectively, illustrating the predominance of these sectors in the local economies.

The situation, however, looks differently when analysing the number of loans disbursed. In this perspective, the agricultural sector receives by far the highest share with 44%. This reflects the very small size of the sub-loans invested in agricultural activities in contrast to small-scale industries, for example, were few companies obtain larger sub-loan amounts. The Fund therefore generates a significant impact among the rural population where it has a considerable outreach in terms of scale and depth.

Subloan Disbursements by Economic Sector during 2006
MSEs/Rural MSEs in %

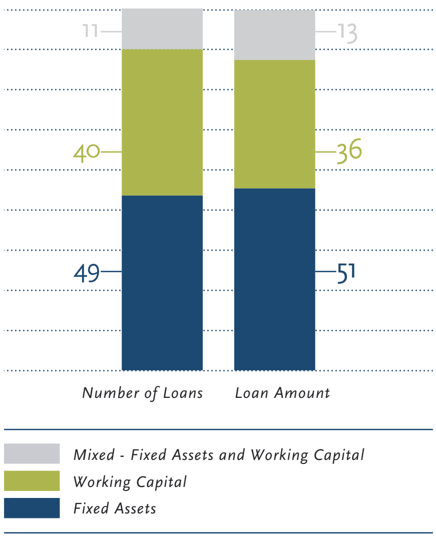


FOR WHAT PURPOSE WERE LOANS USED?

MSE loans were used primarily for investments in fixed assets. This confirms that small loans contribute to capital formation in Southeast Europe. Housing loans were mainly used for improvement purposes, reflecting the micro-loan orientation of the Fund also in the housing area.

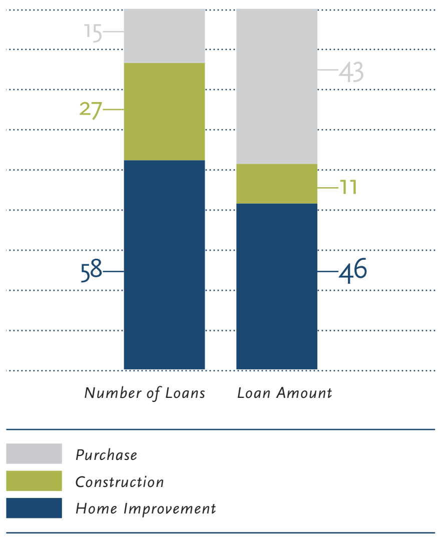
Subloan Disbursements by Loan Purpose during 2006

MSE/ Rural MSE in %



Subloan Disbursements by Loan Purpose during 2006

Housing in %

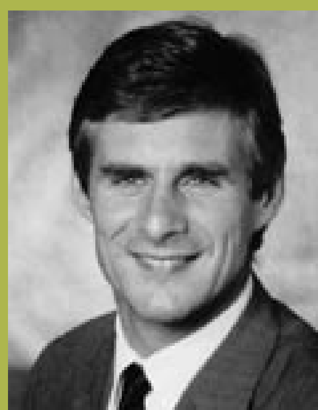


... providing long-term funds for rebuilding local economies from scratch ...

» The primary objective of EFSE is to promote economic development and generate employment in a region whose economies had to be rebuilt from scratch after the conflict. EFSE provides not only much needed funding for self-employed micro businesses, but also strives to strengthen the asset base of small enterprises in the local economies in order to contribute to a more diversified economic structure and the creation of a significant number of jobs.

As EFSE co-operates with a large number of different partner institutions, the Fund also promotes competition in the financial market. This contributes to better financing conditions for the target group, such as a larger range of financial services on offer, lower interest rates and lengthened maturities.

EFSE is considered to serve as an international role model for the intelligent and innovative provision of long-term funds for onlending to micro and small enterprises and low-income households. «



Dr. Michael Linhart,
Managing Director,
Austrian Development Agency (ADA)

Impact

The Fund carries out an Annual Impact Study to assess its development focus. In order to ensure an objective assessment, the Impact Study is always commissioned to third parties. In 2006, the first study focussed on the Fund's refinancing for housing purposes in Kosovo and Bosnia and Herzegovina, carried out by IHS Rotterdam together with Prisma BiH and Riinvest Kosovo. The study confirmed the high impact of housing loans on end-borrowers, as well as of housing refinancing and the provision of technical assistance on partner institutions.

- Firstly, EFSE's predecessor funds, through a combination of financing and technical assistance, were credited with creating the housing finance market. Prior to the housing improvement programme initiated in 1998 in Bosnia and Herzegovina and in 2002 in Kosovo, it was virtually impossible to obtain financing for the renovation or extension of one's house – which was urgently needed at the time, considering the damages that the war had left.

- Secondly, the implemented products and lending technology ensured a depth in outreach to lower income households. One quarter of housing loan clients refinanced by the Fund report a household income of less than EUR 300 per month, and half of the clients report income of less than EUR 500.

- Thirdly, access to housing finance has lead to significant improvements in the standard of living of the end-borrowers. The primary uses of the home improvement loans have been bathroom and kitchen improvements, followed by improvements in heating, electric wiring, or plumbing.

The study report is available from the Fund's website at www.efse.lu

Our Investment Principles and Business Ethics

The Funds' mission underlines our clear target group orientation, and our goal to develop financial markets in Southeast Europe to become more inclusive and efficient at the same time. The Fund seeks to implement this mission in a responsible manner, basing our corporate values on high standards of business ethics.

Additionality. The Fund aims to provide additional development finance: The Fund considers itself to be an incubator and risk-taker to pave the way for private investors. The Fund is ready to withdraw or change its role where the private sector begins to provide financial services previously offered by the Fund. Additionally, the Fund complements ongoing development finance initiatives, contributing to the harmonisation of policies.

Transparency and disclosure of information. We adhere to the principle of transparent operations. In this perspective, we publish information on our investment activities on a quarterly basis. At present, there are two Quarterly Fact Sheets: one summarising achievements in the area of development performance, one presenting key information on the Fund's investment transactions.

The Fund continuously provides updated information to MIX Market, a global, web-based, microfinance information platform that seeks to contribute to greater information and investment flows in the sector (www.mixmarket.org).

Finally, as one of the first microfinance funds to receive the LuxFLAG label, the Fund regularly submits information to this Luxembourg-based fund labelling agency.

Compliance of our partner institutions with high standards of business ethics. Besides analysing the financial strength of our partner institutions and their target group orientation as minimum conditions to make an investment, the Fund requires that partner institutions adhere to the principles of corporate social responsibility.

The following areas are scrutinised on a regular basis in the relationship with partner institutions:

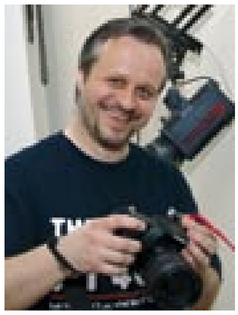
- **Anti-money laundering and anti-terrorist financing.** All partner institutions are assessed to what extent they protect themselves against becoming a vehicle for money laundering or other illicit financial transactions such as terrorist financing. The Fund therefore continuously reviews the level of compliance with international best practices of "knowing your client".

- **Integrity checks of managers and owners.** The Fund investigates the reputation, business conduct and any other track record of managers and owners of partner institutions when initiating a relationship with partner institutions.

- **Environmental and social guidelines.** The Fund applies a comprehensive set of guidelines to align our investment activities with international environmental and social best practices.

  The Fund screens potential new partner institutions during the due diligence process regarding their implementation of environmental management systems, social policies, and the environmental compliance of their current portfolio. The basis for this screening is a social and environmental exclusion list that has been developed according to international standards. This exclusion list serves as a guideline to facilitate the rejection of loan applications from companies whose activities are considered environmentally hazardous. By doing so, the Fund wishes not only to raise awareness on the matter among staff from partner institutions but also to create an impact at the client level.

- **Adequate lending technology and equal access to end-borrowers.** The Fund requires that partner institutions do apply or are willing to apply lending technologies that



respond to the specific needs of MSEs. In particular, we expect that partner institutions focus primarily on the repayment capacity of the end-borrowers and, hence, base their credit analysis on the cash-flows of the small businesses.
Furthermore, partner institutions should provide non-discriminatory access to end-borrowers, i.e. independent of their sex, religious or ethnic background.

- **Fair business practices.** Partner institutions must be committed to the principles of fair competition and refrain from subsidised, unsound lending practices or price dumping. Additionally, clients must receive transparent information on the terms and conditions of the services offered by the partner institutions. By the same token, the Fund also expects that partner institutions fully disclose information as required by law and according to standard requirements of international creditors.

Close monitoring of partner institutions and end-borrowers. The Fund adheres to the principle "what you want to promote, you have to measure". The Fund analyses financial and other relevant institutional information on the partner institutions on a regular basis, particularly in view of the aspects mentioned above.

Additionally, we carry out quarterly sub-loan monitoring in order to assess how and where the funds are invested and whether this onlending process has been in compliance with the Fund's development objectives.

Finally, the Fund carries out an Annual Impact Study, which scrutinises in-depth the development orientation of the Fund, retrieving primary data from partner institutions and end-borrowers. Another part of the Annual Impact Study is the assessment of the level of compliance of the partner institutions with the above-mentioned ethical business principles. To ensure the objectivity of results, the Annual Impact Study is commissioned to third parties.

Presence in the markets and proximity to partner institutions to establish long-term relations. Through the local offices of the Fund Advisor, the Fund has established a strong presence in the region and is in day-to-day contact with the partner institutions. This allows not only close risk monitoring but also a high service quality through immediate access of the local stakeholders and partner institutions to the Fund whenever needed. Proximity to our local partners through permanent offices is also essential to build long-term relations and underlines our long-term commitment to the target region, even in difficult times.

Responsible HR policy of Fund service providers. The Fund cares about how its service providers – primarily the Advisor due to its day-to-day contact with the partner institutions and local stakeholders - represent the Fund's "face to the customer". In this respect, staff management is key. The Advisor carefully selects staff involved in the Fund's operations. All staff must endorse the Fund's fundamental principle of combining a social mission with a commercial approach. The Advisor's staff benefits from substantial investments in training and coaching to continuously improve their skills to enhance the Fund's service quality. Finally, the Advisor promotes the accountability of staff through decentralised operations, delegation of tasks and recognition of individual and group performance.

Our Investment Transactions

WHAT IS THE GEOGRAPHIC DISTRIBUTION OF THE APPROVED INVESTMENTS?

Since its inception in December 2005 until the end of 2006, the Fund has approved 44 investments in 24 partner institutions in 9 nations/national entities at a total amount of EUR 178.8 million. The size of the average investment transaction was EUR 4 million during 2006.

New Investments Approved since Inception until 31 December 2006 (in EUR million)

Nation/National Entity	MSEs	Rural MSEs	Total MSEs	Housing	Grand Total	Share
Bosnia & Herzegovina	12.0	4.5	16.5	43.5	60.0	34%
Serbia	23.8	12.0	35.8	-	35.8	20%
Romania	14.0	-	14.0	10.0	24.0	13%
Montenegro	4.5	4.8	9.3	10.0	19.3	11%
Kosovo	11.0	1.5	12.5	2.5	15.0	8%
Moldova	7.9	4.3	12.2	-	12.2	7%
FYR Macedonia	5.0	-	5.0	5.0	10.0	6%
Albania	1.5	-	1.5	-	1.5	1%
Bulgaria	1.0	-	1.0	-	1.0	1%
Total Fund	**80.7**	**27.1**	**107.8**	**71.0**	**178.8**	**100%**
Share (%)	**45%**	**15%**	**60%**	**40%**	**100%**	

Investments in Bosnia and Herzegovina as well as Serbia have substantially increased, building on the Fund's strong regional presence. Approved investments in Romanian, Moldovan as well as Macedonian partner institutions have shown the largest increase on a relative basis. This reflects the rapid expansion of the Fund to new countries during 2006.

WHAT IS THE DISTRIBUTION OF THE APPROVED INVESTMENTS BY PRODUCT?

The new investments since inception largely benefited MSEs, with a share of 60% (MSEs and rural MSEs with the latter accounting for 15%), with housing loans comprising the remaining balance of 40%.

WHAT IS THE TOTAL AMOUNT OF INVESTMENTS DISBURSED?

Out of the total approved investment volume, 79% (EUR 142 million) were disbursed during 2006. Furthermore, an additional amount of EUR 8.8 million was disbursed from earlier commitments inherited from the preceding funds.

Olivier Descamps,

Business Group Director, Southern and Eastern Europe, Caucasus and Central Asia, Small Business Financing, Management Advisory Services, European Bank for Reconstruction and Development (EBRD)

… supporting sustainable access to finance for MSEs in a critical region … strengthening financial intermediaries … and creating a demonstration effect for other private commercial investors …

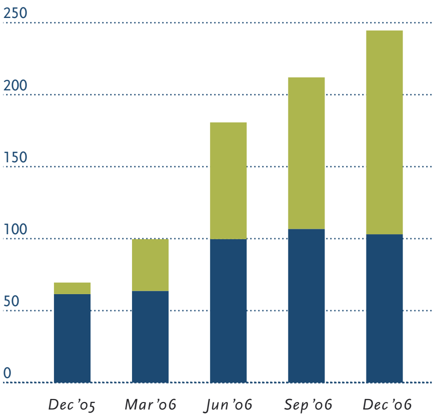
>> Southeast Europe is an important region in view of EBRD's investment strategy. Countries in Southeast Europe have many of the building blocks for progress towards the EU, such as making inroads into comprehensive economic, market and political reforms.

Through EFSE, EBRD wishes to support the sustainable access to finance for MSEs in a critical region. EFSE contributes to the development of new mechanisms to support the sector and strengthening of financial intermediaries, expanding their scope and scale of services for microentrepreneurs and low-income households. EFSE also will have an important demonstration effect. Successful EFSE investments will attract other private commercial investors to a region and a sector still perceived high risk in international capital markets as of today. <<

Our Outstanding Investment Portfolio and Products

Portfolio Development since Inception

in EUR million, until 31 December 2006



HOW QUICKLY HAS THE OUTSTANDING INVESTMENT PORTFOLIO DEVELOPED?

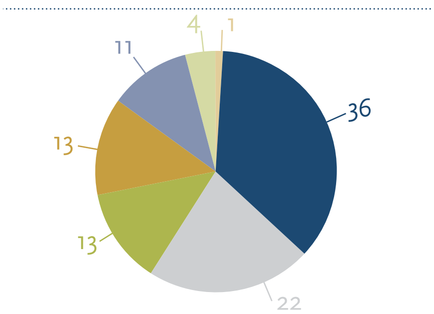
Within only twelve months, the outstanding investment portfolio has more than tripled from EUR 67.6 million (year-end 2005) to EUR 244.5 million (year-end 2006). In this light, the Fund is one of the fastest growing microfinance development funds in the world.

About half of the outstanding portfolio has been contributed by a two-step in-kind transfer of the invested portfolios of the preceding development finance initiatives to the Fund. The first part of the transfer took place during the first closing on 15 December 2005. The transfer was completed during a second closing on 19 June 2006.

WHAT IS THE GEOGRAPHIC DISTRIBUTION OF OUR OUTSTANDING INVESTMENT PORTFOLIO?

Investment Portfolio by Nation/National Entity

in %



31 December 2006

Bosnia & Herzegovina	Serbia
Montenegro	Kosovo
Romania	Moldova
FYR Macedonia	

At the end of 2006, 84 % of the portfolio is concentrated in the core nations/national entities, with Bosnia and Herzegovina having the largest share at 36%, followed by Serbia, Montenegro and Kosovo.

Regarding the specific type of investments, 95% of the Fund's current investment portfolio consists of long-term senior loans. However, new instruments have already been introduced in the course of 2006, including the Fund's first subordinated loan. Furthermore, the Fund has participated in a first club deal together with other international finance institutions in view to promote co-ordination among principal creditors in the region. The Fund also currently prepares the introduction of new demand-driven financial instruments, i.e. local currency loans and structured finance transactions.

EFSE participates in Club Deal with Banca Transilvania - Romania

EUR 60 MILLION LOAN BY INTERNATIONAL FINANCE INSTITUTIONS TO FINANCE DEVELOPMENT

EFSE has granted a EUR 12 million subordinated loan to Banca Transilvania as part of a EUR 60 million facility provided in a club deal with the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC), Netherlands Development Finance Company (FMO) and the German DEG as member of KfW Bankengruppe. The loan helps to sustain Banca Transilvania's substantial growth and ambitious development plans, with a focus on the small enterprise sector. Dr. Klaus Glaubitt, Chairman of the Board of EFSE, underlined the strong position of Banca Transilvania. "This transaction underlines the strategic goal of developing the Romanian markets for housing and MSEs. By strengthening the Bank's Tier 2 capital, the subordinated loan provides a vital support for the Bank's planned growth of its loan portfolio". Robert C. Rekkers, CEO of Banca Transilvania, emphasised that Banca Transilvania is proud of being able to put together five first-class international finance institutions in this deal, which will allow the bank to expand its asset size in view of the Bank's strategic move to increase market share.

WHAT IS THE DISTRIBUTION OF THE OUTSTANDING INVESTMENT PORTFOLIO BY PRODUCT?

Fund management has continued its strategy of product diversification with all three products now being offered in all nations/national entities.

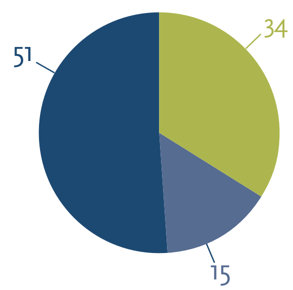
The current portfolio is focused on MSEs with a share of 66%. Thereof, loans to farms and other rural enterprises comprise 15%.

The demand for housing loans has significantly increased with a share of 34% at year-end 2006 compared to 15% one year earlier. Within the housing loan product, the main growth factors were:

- The increased demand for home improvement loans particularly in those countries where the product has only been introduced during 2006.
- The introduction of housing finance in the range of services offered by MCOs.
- The Fund's possibility to provide longer maturities in comparison to the preceding European Funds.

Distribution of Investment Portfolio by Product

in %

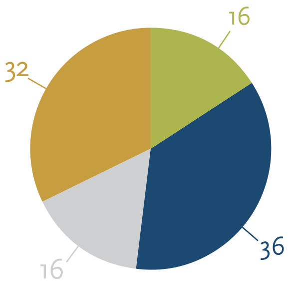


31 December 2006

MSEs
Rural MSEs
Housing

Distribution of Investment Portfolio by Partner Institutions

in %



31 December 2006

Large Banks, 6	
Small and Medium Banks, 14	
Microfinance Banks, 6	
Micro Credit Organisations, 12	*based on Number of Partner Institutions*

WHAT IS THE DISTRIBUTION OF THE OUTSTANDING INVESTMENT PORTFOLIO BY PARTNER INSTITUTIONS?

The Fund is open to serve all financial institutions that have a clear orientation or potential to serve the target group and contribute to the development mission of the Fund. It seeks to establish long-term business relationships with its partner institutions. Some of the current partnerships, particularly with local banks, began about ten years ago, when no other long-term funding sources were available in the target region. Through these partnerships the Fund wishes to create a win-win situation for both the partner institutions and the target group by growing together.

Of the 38 partner institutions with outstanding investments at year-end 2006, about half are classified as commercial banks and the other half as specialised microfinance banks and MCOs. In terms of investment volume, there is also an almost equal distribution between these two main categories.

Edward Nassim,
Vice President, Europe, Africa, and Middle East, International Finance Corporation (IFC)

... forging a close co-operation between governments, development finance institutions, EFSE's managers and beneficiary financial institutions ...

>> We are pleased to see EFSE achieving a very significant growth in its investment portfolio and products in its first year of operation. This growth is a testament to the success of the Fund, especially in terms of forging a close co-operation between governments, development finance institutions, EFSE's managers, and beneficiary financial institutions. EFSE is a great example of public-private partnership, and we expect and hope that it continues to increase its support to the micro and small enterprises and private households in Southeast Europe. <<

Mr. Bekim Osmani, Client of the MCO FINCA, Kosovo

Before the Kosovo conflict in 1999, I was working in the construction sector together with my younger brother. During the war, my family of 7 – I am the oldest son – immigrated to Albania from where we immediately returned once the UNMIK administration was in place. As there were no job opportunities for young people like me, as businesses were completely destroyed during the war, I started working as a kitchen assistant with the German KFOR troops.

With the savings I accumulated with that job, I started selling shoes in bazaars and on the street to better support my family in financial terms. As the business developed very well, I decided to open a shoe shop in a busy street in 2003.

My younger brother helped me to run the business. However, my stocks were not enough to compete with the other shops around me. I had just too little capital to have more stock on display. That was the time when I looked for some credit facility and learned about FINCA, which is a partner institution of the EFSE.

When I first came to FINCA I was very frightened. The idea of having a loan made me feel uncomfortable. But I had to take the risk to raise my business capacity. I received EUR 3,000 and invested it all in stocks. During the summer season I also continued selling in bazaars as an additional business activity. My working capacity grew and my business started to generate higher income. After finishing my first loan, I received EUR 2,000 in the second cycle. I didn't need more because I am on my feet now.

Our Complementary Non-Financial Services

The provision of non-financial services through the Development Facility is a unique feature of the Fund. Complementing its financial investment activities, the Fund through the Development Facility provides technical assistance and training for its partner institutions. Feasibility and market studies are also financed by the Facility, as well as the Fund's Annual Impact Study. Services under the Development Facility are contracted to independent individual consultants or consulting firms.

In addition to responding to partner institution demand, the Fund looks proactively for technical solutions or capacity building needs of its partner institutions, reflecting the Fund's investment strategy. In this way, the Fund seeks to establish long-term partnerships with partner institutions.

The Fund's approach to capacity building has focused on increasing the outreach of the Fund's investments and addressing the investment risks of the Fund. To this aim, the Fund's emphasis has been on enhancing relevant key areas or processes in a partner institution, combining training and on-the-job coaching. To allow institutions the possibility to absorb and implement training and consulting input, technical assistance is structured in short-term, intensive intervals. Finally, to ensure commitment and reduce costs, the Fund requires the participant institutions to share into the cost of the assistance.

The Development Facility puts emphasis on tracking the performance of the services provided and the impact achieved through regular evaluations and a monitoring system. An important element in this monitoring system is the Annual Impact Study.

Since its inception in June 2006, the Facility has sponsored thirteen assignments:

- Six technical assistance assignments
- Six research and development assignments
- The Annual Impact Study (see also box on page 19)

The total budget of these activities amounted to EUR 614,000 during 2006.

EXAMPLES OF TECHNICAL ASSISTANCE DURING 2006

Implementing peri-urban lending.
The Development Facility contributed in the costs for a consulting assignment with AgroInvest Montenegro, an MCO, to implement a new MSE product. The consultant reviewed the product features and lending procedures, and provided classroom training and on-the-job coaching regarding client assessment.

Strengthening risk and asset-liability management.
The Development Facility contributed to the costs to enhance management capacity in asset-liability management and to formalise risk management in CAPA Romania and Microinvest Moldova, two MCOs. The consultant reviewed existing processes and procedures, provided tailor-made training and coaching of ALCO and risk committees.

Strengthening the efficiency of the lending process.
The Development Facility contributed to the costs of a product costing exercise in Microinvest Moldova to identify areas for increasing efficiency as well as to provide management information for strategic business planning.

Therese Adam,
Head of Department for Cooperation with Eastern Europe and the CIS, Swiss Agency for Development and Cooperation (SDC)

… helping to create strong institutional capacities …

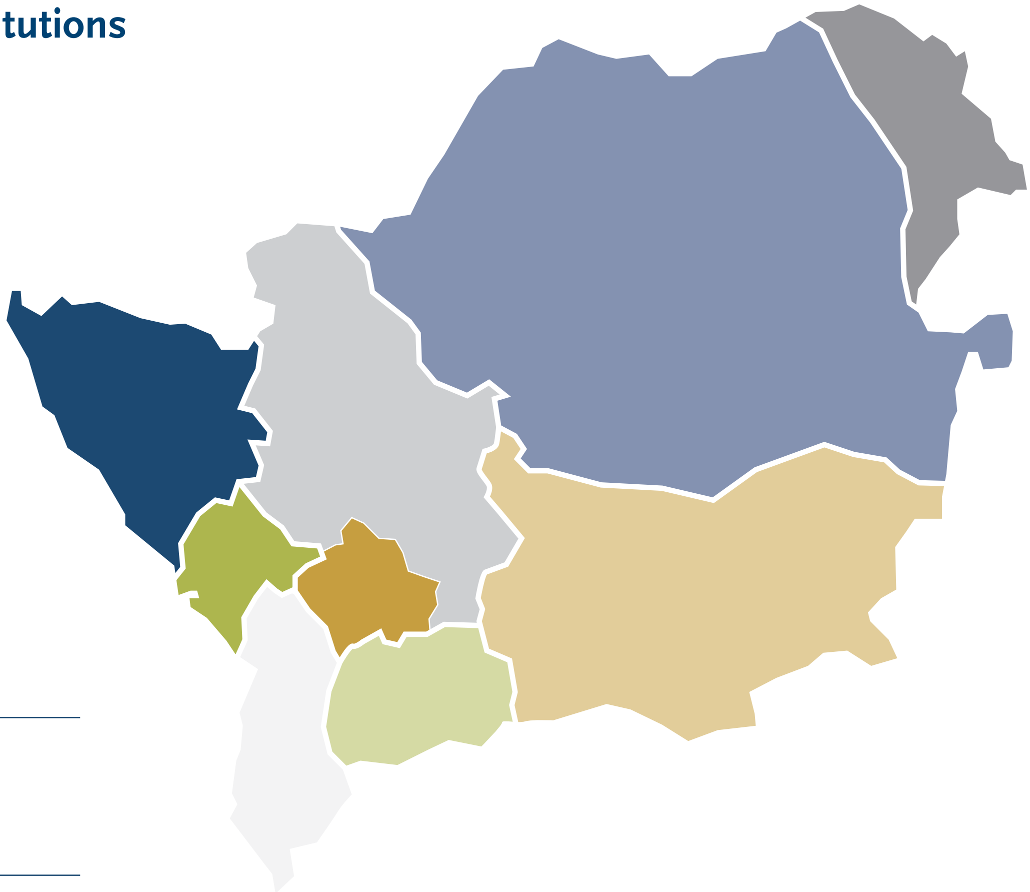
>> The provision of non-financial services in the form of technical assistance and capacity-building to the partner institutions adds significant value to EFSE's investments both from a target group as well as financial sector perspective.

Technical assistance will help partner institutions to become more efficient providers of quality financial services to their clients. This certainly will translate into better servicing of the final target groups, including meeting the needs in the rural areas.

Capacity-building efforts will also strengthen their governance and risk management and, hence, ensure that partner institutions operate in a sustainable manner.

The gains in professionalism and transparency are expected to make the partner institutions also more attractive to commercial investors beyond EFSE, broadening their funding sources. <<

Our Partner Institutions



Bosnia & Herzegovina
Montenegro
Romania
FYR Macedonia
Albania
Serbia
Kosovo
Bulgaria
Moldova

- The Fund operates with a diverse range of institutions that employ different strategies to service the final target group. The portfolio of institutions includes MCOs such as EKI in Bosnia and Herzegovina, specialised micro-finance banks such as Opportunity Bank Montenegro or the ProCredit Banks, as well as small commercial banks and also large international banking groups given their strong presence in the region.

- All partner institutions must apply a credit technology that caters to the specific characteristics of the target group. Emphasis is put on cash-flow based lending methodologies and on the repayment capacity of the end-borrowers. Notwithstanding, the Fund's partner institutions apply different lending technologies within this overall framework, from lending to groups or village communities in rural areas to lending to individuals. With the help of the Fund, some institutions have broadened their target group and adjusted their lending technologies.

- Through its inclusive approach in terms of partner institutions and support in broadening the target groups, the Fund helps to make available funding to entrepreneurs through their growth cycle from a micro to a small entrepreneur. Just as the Fund grows with its clients, so do the partner institutions grow with theirs.

- The Fund has investments outstanding to 38 partner lending institutions with an average amount of EUR 6.4 million at the end of 2006.

PARTNER INSTITUTIONS WITH INVESTMENT OUTSTANDING DURING 2006

Bosnia and Herzegovina

Commercial Banks: ABS Banka, Gospodarska Banka, Nova Banka Bijeljina, Raiffeisen Bank, UniCredit Zagrebacka Banka, UPI Banka, Volksbank

Microfinance Banks: ProCredit Bank

Microcredit Organisations: EKI, MI-BOSPO, Mikrofin, Partner, Prizma, Sinergija, Sunrise

Bulgaria

Commercial Banks: Union Bank

Kosovo

Commercial Banks: Bank for Private Business, Kasabank, New Bank of Kosovo, Raiffeisen Bank

Microfinance Banks: ProCredit Bank

Microcredit Organisations: FINCA International

FYR Macedonia

Commercial Banks: IK Banka

Moldova

Commercial Banks: Mobiasbanca

Microcredit Organisations: Microinvest

Montenegro

Commercial Banks: Crnogorska Komercijalna Banka, NLB Montenegrobanka

Microfinance Banks: Opportunity Bank

Microcredit Organisations: AgroInvest, Alter Modus

Romania

Commercial Banks: Banca Transilvania,

Microfinance Banks: ProCredit Bank

Microcredit Organisations: CAPA

Serbia

Commercial Banks: Komercijalna Banka, Kulska Banka, HVB Banka, LHB Banka, Zepter Banka

Microfinance Banks: ProCredit Bank

Other Non-Bank Financial Institutions: ProCredit Leasing

Our Investors

WHO ARE THE MAIN INVESTORS?

The Fund brings together a unique universe of first-class shareholders in the form of a public-private partnership. At the Fund's inception, the primary funding base was comprised of donor contributions from the European Union, the German, Swiss and Austrian governments as the main sponsors of the preceding European Funds. There was an in-kind transfer of the existing investment portfolios to EFSE, where the respective funds were used to build the first-loss tranche. International financial institutions such as IFC, EBRD, KfW and FMO provided additional mezzanine capital.

The objective was to establish a risk cushion strong enough to attract private investors that otherwise would neither invest in the target region nor for the benefit of the target groups.

Arthur Arnold,
Chief Executive Officer,
Netherlands Development
Finance Company (FMO)

... leveraging commercial investors ...

>> FMO has long been an active partner to financial intermediaries, who in turn serve the small and medium size enterprises (SMEs) in emerging markets. Our unique product mix, including local currency financing with long-term tenors and equity, among others, enables us to meet their very specific needs. Our involvement in EFSE, not only through finance but also as a Board Member and a member of the Investment Committee, makes it possible for us to effectively reach this market segment. Together with preferred partners like KfW, EBRD and IFC, FMO facilitates the involvement of commercial investors in EFSE. This is FMO's catalytic role: by pulling in a wider group of financiers, we all end up working together to expand the financial options available to the micro and SME segments. As the backbone of any economy, flourishing businesses like these are to everyone's benefit. <<

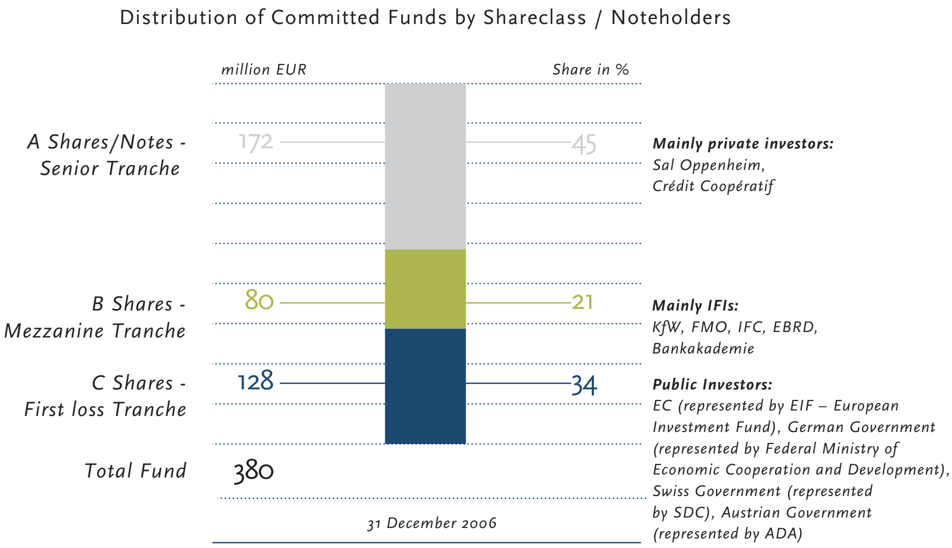
WHAT IS THE LEVEL OF COMMITMENTS?

At the end of 2006, the Fund's commitments stood at EUR 380 million. It is noteworthy that already within the first year of operation, mainly private investors have contributed to the senior risk tranche that represents almost half of the total committed funds. In this perspective, within a very short period of time the Fund has established an excellent track record and gained the confidence of institutional investors.

WHAT IS THE LEVEL OF SUBSCRIPTIONS?

Out of the total amount of Fund commitments, 63% or EUR 240.4[1] million has been subscribed by year-end 2006. The remaining balance of EUR 139.6 million is expected to be drawn down in the next months.

[1] There is a difference between the capital subscribed and the gross investment portfolio as the investments from the preceding European Funds were transferred at a discount that is amortised over time.



... creating a public-private partnership at its best ...

>> Funding provided in the framework of the German Financial Cooperation with the countries of Southeast Europe played a pivotal role in creating EFSE. The use of the funds – namely for the provision of first-loss capital – is an illustrative example of innovative public development financing. It facilitates attracting private investors that would otherwise stay away from the region. Thus, EFSE is a trailblasing example of the intelligent use of public budget funds available for development purposes. It leverages the impact of scarce budget funds, and at the same time opens the gateway for private capital investments to our neighbouring countries in Southeast Europe. It displays public-private partnerships at its best: EFSE enables the realisation of goals that none of the two parties alone would be able to achieve. <<

Erich Stather,

State Secretary at the Federal Ministry for Economic Cooperation and Development (BMZ), Germany

Mrs, Ana Fekete, Client of ProCredit Bank, Serbia

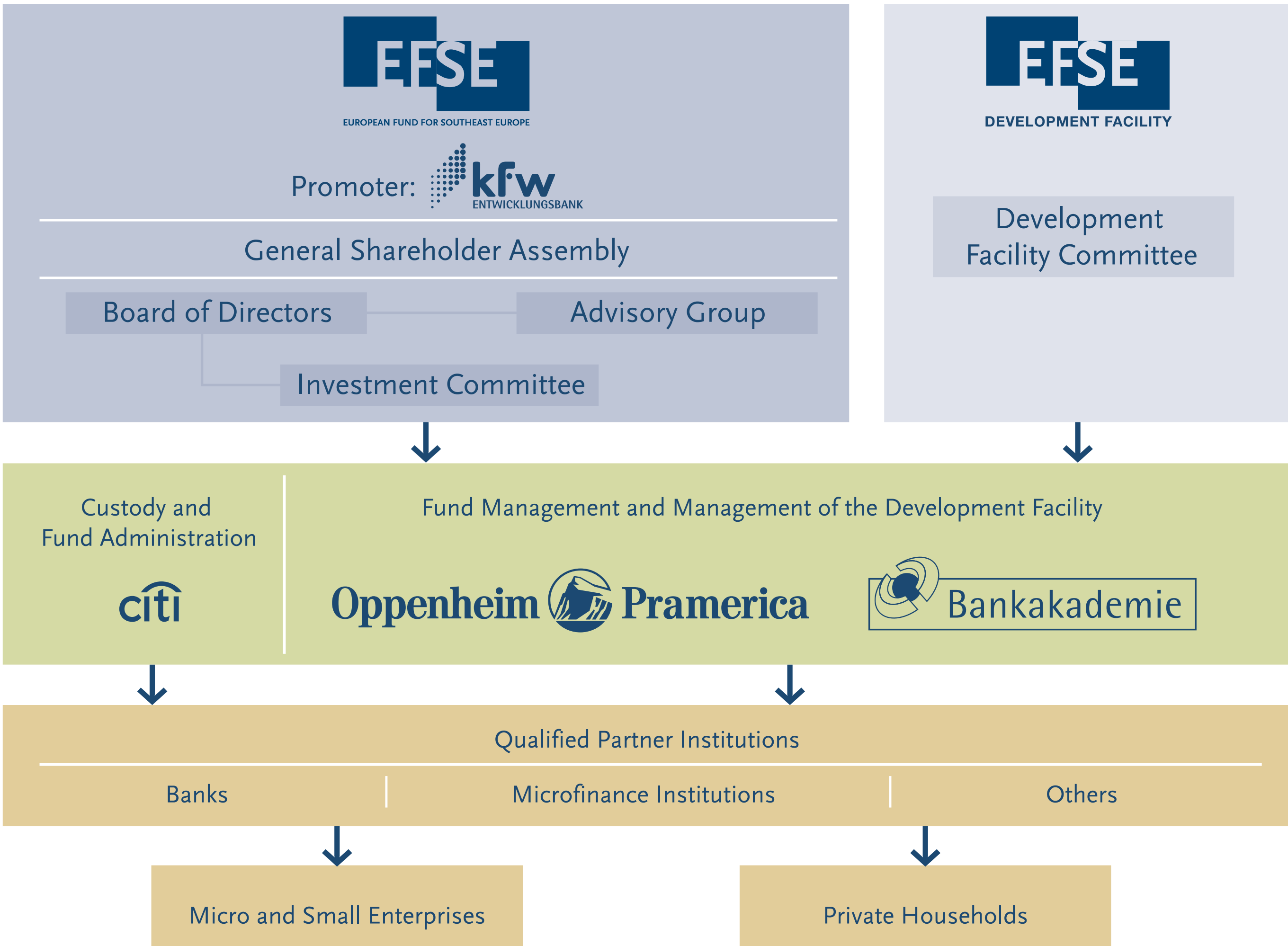
For more than 30 years, my family has been running our 30-acre farm in Gložan, a village near Novi Sad. Today, it is my mother and my daughter who are engaged in farming together with me. We grow vegetables, corn, sunflower and sugar rape. Most of it is sold to large food producers who appreciate the quality of our products.

The secret of our business success is probably a combination of experience, hard work and innovations. The most innovative ideas come from my daughter who is an agricultural student in Novi Sad.

Each year, besides investing in land, equipment and infrastructure, we prepare new, improved sorts of the most sought-after plants. Our products are presented on agricultural fairs, where we have won already several prizes.

ProCredit Bank Serbia, one of the Fund's partner institutions in Serbia, has already granted three loans to us – for the purchase of a tractor and of an additional storage space. We are very grateful for the support provided to us.

Our Organisational Set-up



WHAT ARE THE FUND'S SPECIAL ORGANISATIONAL FEATURES COMPARED TO OTHER INVESTMENT FUNDS?

The organisational set-up of EFSE is unique in various regards:

- The Board of Directors serves as a co-ordination platform for different donor agencies and international finance institutions that are active in the region. The Fund aims at drawing on existing experiences, complementing ongoing initiatives and striving to harmonise efforts in development finance.

- The combination of investments with non-financial services is reflected in the Fund's organisational structure: the Development Facility operates independently next to the Investment Fund under a fiduciary arrangement. The Development Facility is open to any sponsors that adhere to the basic principles and policies of the facility.

- The Advisory Group to the Board of Directors, comprised of the Central Bank Governors of the region, plays a critical role in ensuring regional entrenchment. It provides the Fund with better linkages to local markets. Furthermore, it serves as a platform to exchange experiences across countries. Finally, it prepares local governments for their future role as shareholders: ownership of the donor contributions will eventually be transferred to local governments.

- While all decision-making power lies with the Board of Directors and the Investment and Development Facility Committees, the day-to-day management of the Fund and the Development Facility has been outsourced to a group of professional service providers.

WHAT IS THE COMPOSITION OF THE BOARD OF DIRECTORS AND COMMITTEES?

Board of Directors:
Dr. Klaus Glaubitt, Franz-Josef Flosbach, Karlo de Waal, Dominik Ziller, Monika Beck, Chikako Kuno, Syed Aftab Ahmed, Dr. Christoph Achini, Alessandro Tappi

Investment Committee:
Karlo de Waal, Monika Beck, Chikako Kuno, Syed Aftab Ahmed

Development Facility Committee:
Monique Koël, Hans Ramm, Monika Beck

Advisory Group:
Ardian Fullani (Albania),
Kemal Kozarić (Bosnia and Herzegovina),
Michel Svetchine (Kosovo),
Toni Stojanovski (FYR Macedonia),
Goran Knežević (Montenegro),
Radovan Jelašić (Serbia)

WHO ARE THE FUND'S SERVICE PROVIDERS?

Fund Manager
Oppenheim Pramerica Asset Management S.à r.l. (OPAM) Luxembourg

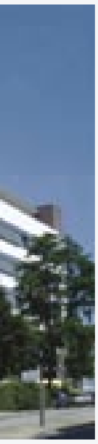
Oppenheim Pramerica Asset Management S.à r.l. (OPAM) specialises in the establishment, administration and management of tailor-made undertakings for collective investments under Luxembourg law, to the widest extent possible. Backed by Sal. Oppenheim jr. & Cie. and Prudential Financial, it services innovative funds for prestigious clients, ranging from Fortune 500 companies through first-tier European Financials to ultra high net worth individuals. Together with its sister companies Oppenheim Pramerica Fonds Trust, the total fund volume stands at EUR 15 billion.

Detlef Bierbaum, Managing Partner Sal. Oppenheim jr. and Cie. K.G.a.A., Cologne and Chairman of OPAM:

»Sal. Oppenheim, founded in 1789, has always been at the forefront of financial innovations. The Bank has raised finance for development oriented projects since the 19th century and continues this tradition as first Notes-Investor for the European Fund for Southeast Europe. EFSE creates favourable conditions for prosperity in Southeast Europe.«

Advisor
Bankakademie e.V. Frankfurt

Bankakademie e.V. was founded in 1957 as a non-profit member-based organisation. It is one of the largest and most renowned banking institutes worldwide with 16,000 students annually. In addition to professional degree courses, it offers academic programmes as well as tailor-made training concepts. The international division provides consulting and training services in all areas of banking and finance. Serving microfinance institutions or the microfinance sector at large is one of the key areas of expertise. Bankakademie has been involved in the concept development and implementation of the development finance initiatives preceding EFSE and has been active in the region since the late nineties.



Prof. Dr. Udo Steffens, Chairman of the Board Bankakademie e.V. :

»As a representative organ of the German banking and finance industry, Bankakademie is proud to take an active stake in implementing EFSE as a flagship development finance initiative. Through EFSE, we want to assist in opening new market opportunities both to local financial institutions as well as to private institutional investors. In this regard, Bankakademie's role is to be an incubator for innovations at the interface between capital markets and development finance.«

Fund Administrator and Custodian
Citibank International plc (Luxembourg Branch)

Citibank International plc (Luxembourg Branch) is part of Citi, the leading global financial services company, which has some 200 million accounts in more than 100 countries. Operations in Luxembourg started in 1970 as First National City Bank (Luxembourg) SA. The scope of services in Luxembourg comprises global transaction services, global relationship banking and funds servicing.

Marc Pecquet, Managing Director, Citibank International plc (Luxembourg Branch):

»We at Citi were very excited to have been appointed as the service provider for EFSE, during the UN Year of Microcredit in 2005. Acting as custodian and fund administrator to this innovative and demanding fund, which supports the microfinance industry, is very rewarding bearing in mind the large number of people and small enterprises that benefit from this important initiative.«

WHAT IS THE FUND'S REGIONAL PRESENCE?

In order to establish close rapport with the partner institutions and the target market, the Fund Advisor has set up local offices. During 2006, the five local offices were based in those countries with the highest investment portfolio share: Bosnia and Herzegovina (Sarajevo), Kosovo (Pristina), Montenegro (Podgorica) Serbia (Belgrade) and Romania (Bucharest). At the end of 2006, 15 professional staff assisted in the day-to-day operations of the Fund in the region.

1 Local office Bosnia and Herzegovina - Sarajevo

2 Local office Kosovo – Pristina

3 Local office Montenegro – Podgorica

4 Local office Serbia – Belgrade

5 Local office
Romania – Bucharest

Bankakademie Head Office – EFSE Team, Frankfurt

Our Financial Performance

THE EUROPEAN FUND FOR SOUTHEAST EUROPE FINANCIAL STATEMENTS
Condensed version

Balance Sheet – As at December 31, 2006			EUR
Assets			
	Gross Loans to Partner Lending Institutions		244,490,028
	Un-amortized discount		(18,360,333)
	Loans to Partner Lending Institutions		226,129,695
	Interest accruals on loans		2,305,413
	Cash at bank		15,868,139
	Receivables from loans		2,638,566
	Other receivables		388,218
Total assets			**247,330,031**
Liabilities			
	Notes		22,000,000
	Payable resulting from interest on Notes		6,426
	Accrued expenses		1,428,215
	Dividends payable		5,267,262
	Withholding tax payables		227,005
Total liabilities			**28,928,908**
Net assets attributable to holders of redeemable ordinary shares			**218,401,123**
Total equity		A-Shares	30,945,100
		B-Shares	59,922,605
		C-Shares	127,533,418
Total liabilities and shareholder value			**247,330,031**

Breakdown of equity – As at December 31, 2006			EUR
Total Share Capital			**210,291,480**
		A-Shares	30,945,100
		B-Shares	59,922,605
		C-Shares	119,423,775
	Total share premium		**2,203,877**
		A-Shares	661,301
		B-Shares	1,476,305
		C-Shares	66,271
	Total retained earning		**5,905,766**
		A-Shares	(661,301)
		B-Shares	(1,476,305)
		C-Shares	8,043,372
Total Equity			**218,401,123**
		A-Shares	30,945,100
		B-Shares	59,922,605
		C-Shares	127,533,418

Income Statement – For the period from December 15, 2005 to December 31, 2006		EUR
Revenue		
	Interest income on loans	7,962,140
	Interest income on deposits	461,147
	Net change in discount amortisation	7,981,841
	Other income	835,202
Total investment income		**17,240,330**
Expenses		
	Interest expenses on Notes	6,425
	Fund management fees	3,881,959
	Development Facility	488,980
	Direct Operating Expenses	888,143
	Unrealised loss on foreign exchange	4,065
Total operating expenses		**5,269,572**
Operating profit before tax		**11,970,758**
Withholding tax on interest income		797,731
Increase/(decrease) in net assets attributable to holders of redeemable ordinary shares from operations		**11,173,027**

Cash Flow Statement – For the period from December 15, 2005 to December 31, 2006			EUR
Operating profit before tax			**11,970,758**
	Adjustment for		
		Interest income on loans	(7,962,139)
		Interest income on deposits	(461,147)
		Interest expenses on Notes	6,425
Operating profit before working capital changes			**3,553,897**
	Loan agreements contributed		(226,129,695)
	Net (increase)/decrease in other accrued income and prepaid expenses		(5,332,197)
	Net increase/(decrease) in accounts payable and accrued expenses		6,928,908
	Net increase/(decrease) in withholding tax on interest income		(797,731)
	Distributions paid to holders of redeemable ordinary shares		(5,267,261)
Cash-flow used in operating activities			(227,044,079)
	Net interest income on loans		7,962,139
	Net interest income on deposits		461,147
	Net interest expenses on Notes		(6,425)
Net cash-flow used in operating activities			(218,627,218)
	Cash provided by financing activities		
		Cash received on notes issued	22,000,000
		Cash received on shares issued	212,495,357
		Cash paid out on shares redeemed	-
Cash-flow provided by financing activities			**234,495,357**
Net increase in cash and cash equivalents			**15,868,139**
Opening cash and cash equivalents			**-**
Closing cash and cash equivalents			**15,868,139**

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