Ukraine Enterprise Corporation

1999 Annual Report

UEC

Ukraine Enterprise Corporation

(UEC) is a Canadian company organized to provide capital for high return enterprises in Ukraine, in part from its own resources and in part from co-investors or acting as agent. The objective of UEC is to achieve superior capital appreciation by making convertible debt and equity oriented investments in Ukraine. UEC invests primarily in established or newly privatized commercial and industrial enterprises, the potential profitability of which can be enhanced by the injection of capital to improve productivity. UEC will also invest in new ventures which can demonstrate economic viability.

Incorporated in November 1994, UEC has successfully managed its transition from a company in its formative stage to a publicly quoted operating company with shares listed on The Alberta Stock Exchange, Symbol: UKN.

Last year my report ended by saying that the outlook for the company had improved and that we could look forward to a better year. Unfortunately I was wrong.

Business conditions in Ukraine are more, not less, difficult than a year ago. The economy contracted another five percent over the past year and now produces about half the output of 1991, when independence was achieved. Inflation is running well over twenty percent and will almost certainly get worse this year. The exchange rate has fallen by half, and could well fall further if the impending election leads to looser fiscal policy.

Investing in Ukraine is the purpose for which UEC was established, and we continue to pursue that mandate. It is not an easy country in which to do business, however, it is not an impossible one. The pace of reform has been slow, certainly when compared to its central European neighbours, but the changes in almost every aspect of the country's life in the past half-dozen years have been enormous.

Building new businesses in an environment where the rules keep changing while at the same time dealing with customs, laws and habits shaped by three generations of state socialism requires patience and persistence. Commercial risks to private investors, no matter what the business, are higher, and the tools to deal with them more limited. Add to this a climate in which international capital markets have for the most part abandoned any interest, where barter continues to squeeze out the cash economy, where neither businesses nor governments routinely pay their bills, and where commodity prices continue to reach new lows, it requires a certain determination to stay the course.

UEC's strategy in this climate has been and will continue to be to concentrate on those sectors where we can find good local partners in businesses capable of generating high rates of return in convertible currencies in sectors not dependent on governments. We do not yet claim to have achieved those goals, but your board and management believes that it has identified businesses and projects which can generate the returns promised to shareholders when the company was originally capitalized. The core of that strategy is the coal recovery business where we have two projects which should generate attractive returns, which in turn should open the way to additional financing for further such projects. This is a business capable of considerable expansion based on a low cost, exportable, dollar-based product selling in established international markets.

There are too many risks and uncertainties in Ukraine to allow for confident forecasts, but your board believes that the company is focusing its efforts on businesses which are capable of delivering good results. The challenge is to make those businesses work while insulating them from all the added risks which are part and parcel of commercial life in Ukraine. This we will continue to try to do.

"Frank Potter" (signed)

Frank Potter
Chairman

August 5, 1999

UEC

Ukraine Enterprise Corporation has completed its second full year of operations since its initial public offering in November 1996. It successfully entered into one investment and realized a profit on its realization. It has placed the funds raised into four investments that meet the criteria established at the outset of the company.

- A 20.8% holding in Electron Bank JSC - a regional bank based in Lviv
- A 28.7% interest in the Kalininskaya coal recovery project based in Horlivka
- A 29.0% interest in the Sukhodolska coal recovery project based in Krasnodon
- A 50.0% interest in a property redevelopment project in Kyiv

Much has been written, including elsewhere in this annual report, about the problems encountered by Ukraine in its move to a free market economy and more open democracy. In spite of the gloomy reports and even more disappointing predictions, the investments currently in place should be able to persevere, prosper and generate for the company meaningful returns and valuations.

The company made the decision to concentrate its efforts and focus on the coal recovery sector. The company had identified knowledgeable and competent local partners; the sector had the ability to generate returns in convertible currencies; the production costs are lower than other coal mining processes; there is a plentiful supply of tailings ponds in Ukraine; and the timeframe to generate cash return was shorter than for other investments.

Fiscal 1999 saw the start-up of the Kalininskaya project. This was later than anticipated in coming on stream and first results were not up to expectations. However, with diligent effort, the project generated a 15% return on investment to the company. Technical experts examined the project and recommended appropriate upgrades to increase production and quality of the product. These upgrades are in place and improved results are expected.

The second coal recovery project, Sukhodolska, was started in fiscal 1999 and construction is expected to be completed and commissioning started in mid-summer. The company currently owns 29% of the project, but provision has been made to increase the holdings to 45% after the project has met certain performance criteria. This project was delayed while efforts were concentrated on Kalininskaya, with construction and financing suspended in late summer of 1998, recommencing in the spring of 1999.

When these two recovery projects are operating at planned efficiencies, plans call for the company and its partners to develop a further eight projects. The tailings pond that is being reclaimed by the Sukhodolska project can, alone, support several more plants. A marketing search is underway to identify long-term buyers for coal with specific attributes that can be matched to recoverable ponds, in addition to the search for additional ponds. Discussions have also commenced with other investors and financing institutions that wish to participate in further projects.

Unfortunately our two other investments, in Electron Bank and in the property redevelopment project, have been affected by the events within Ukraine. As mentioned elsewhere in this report, the real estate market is in turmoil due to the economic changes and the slowing of western investors arriving in Ukraine. A decision has been made to withdraw from that sector until a more stable or predictable market can be identified. Efforts are underway to liquidate our holdings.

The banking sector of Ukraine felt the impact of two major developments in 1998. First, the National Bank of Ukraine, in an effort to strengthen the financial sector, imposed a series of new capitalization minimums that each bank must achieve to retain their licenses. The rules call for the minimums to be based on stated capital as opposed to equity. Accordingly, any dividends expected from Electron Bank since 1998 will have to be reinvested into share capital. The cash return to the company was and will, in the near future, be negative, as additional funds beyond the dividends will need to be invested to meet the minimum capitalization rules. As a result of these new rules and as part of the efforts to grow the bank, a search is underway for other strategic investors or possible merger candidates. Such a search could also result in the sale of some or all of the company's investment.

Second, the economic downturn in the last half of 1998 affected the operating results of Electron Bank. The government restructuring of treasury bills and flirtation with default severely harmed the whole banking sector. Fortunately, the direct effect upon Electron was contained due to the bank's limited exposure to government debt compared to other Ukrainian banks. However, the overall decline in the economy necessitated the recording of a high loan loss provision that was in excess of the rules in existence for Ukrainian banks, but was reasonable in the view of the western auditors. This extra provision caused Electron Bank to show a slight loss for the year ended December 31, 1998.

Ukraine Enterprise Corporation has established a strategy for future investments and for the handling of its current investments. This strategy will show a cash return to the company in the near future, recognize the value of its investments and begin the expansion that has been contemplated since the outset.

MANAGEMENT RESPONSIBILITY

The accompanying consolidated financial statements and all information in the Annual Report have been prepared by management and approved by the Board of Directors of the Corporation. The consolidated financial statements were prepared in accordance with accounting principles generally accepted in Canada and, where appropriate, reflect management's best estimates and judgements. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality and for the consistency of financial data included in the text of the Annual Report with that contained in the consolidated financial statements.

Management is responsible for the maintenance of a system of controls designed to provide reasonable assurance that the Corporation's assets are safeguarded; that only valid and authorized transactions are executed; and that accurate, timely and comprehensive financial information is prepared.

The Corporation's Audit Committee is appointed by the Board of Directors and is comprised entirely of non-management directors. The Audit Committee meets with management as well as with the independent auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the independent auditors' report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for presentation to the shareholders. The independent auditors have direct access to the Audit Committee of the Board of Directors.

"GM Keaney" (signed)

Gregory M. Keaney
Managing Director

August 5, 1999

These management comments on the financial condition of the company and results of operations for the years ended March 31,1999 and 1998 are the views of management and should be read in conjunction with the consolidated financial statements including related notes in this 1999 annual report.

The company has been formed to invest in ventures and opportunities in Ukraine. These investments will take various forms based upon the specific investment opportunity arising and might include direct equity investment as well as debt with appropriate conversion factors. Other operations will include acting as intermediary for entities in Ukraine seeking capital or others wishing to invest in Ukraine. Investments will be recorded either on an investment basis, equity basis or proportionate consolidation basis, determined individually.

CURRENCY DEVALUATION

Together with other currencies of the world, especially Russia's, the Ukrainian currency, the hryvnia, came under massive pressure in August of 1998. Prior to that time, the hryvnia had been trading at an average of 2.05 to the US dollar which was the mid-point in the currency trading band established by the government. This financial crisis led to an increase in the band to 2.5 to 3.5 being established with trading soon reaching the upper limits. In early 1999, the government again raised the corridor to 3.5 to 4.5 to the US dollar. For the past number of months the exchange rate has stabilized at the rate of 4 to the US dollar, which is the rate used by the government in the preparation of its latest budgets.

This devaluation has hurt the economy of Ukraine and contributed to the economic downturn. The reported results show an increase in annual inflation at December 31,1998 to 20% from the previous year's 10%. The decline in GDP of 1.7% to December 31, 1998 was not significantly greater than anticipated, but it has further declined by 4.8% on a year over year basis at March 31,1999. Indications are that 1999 will show high inflation and a greater drop in GDP. The financial sector has been hurt with bad loans denominated in Russian rubles as well as defaults from companies that have been affected by the currency devaluation and general slow-down in growth.

Ukraine Enterprise Corporation reviewed its investment portfolio to determine if there has been a decline in value caused by the devaluation of the hryvnia. The coal recovery projects were determined to be unaffected because the revenue is denominated and collected in US dollars, the assets are depreciable against that revenue and the current replacement costs are consistent with the original cost.

During the year, the company recorded a reduction in the carrying value of its investment in Electron Bank of $1,060,000. This amount is recorded as a reduction of shareholders' equity of the company. Accounting rules state that any reduction in value of a self-sustaining operation resulting from currency valuation is to be recorded outside of the earnings statement as a foreign currency translation adjustment within the equity section. Since Electron Bank carries on its activities predominately in Ukraine and reports its assets, liabilities and operations in hryvnia, it is considered to be a self-sustaining operation.

In addition, the carrying value of the property redevelopment project was determined to have declined by $48,500. This is recorded as a foreign exchange loss in the earnings statement since this project does not qualify as a self-sustaining operation.

SHAREHOLDERS' EQUITY

Ukraine Enterprise Corporation was incorporated on November 21,1994 and listed its common shares on the Alberta Stock Exchange, after an initial public offering, on November 18,1996. Since that date to March 31,1999 the share capital has remained constant at $11,168,214 with 4,115,361 shares outstanding.

After March 31,1999 the company issued 1,000,000 common shares for proceeds of $250,000 for further investment in a coal recovery project. The issue was offered to directors of the company at a price higher than market, and no significant costs were incurred in the placement.

During the fiscal year ended March 31,1998 the company issued stock options to its management, directors and consultants. These options allow the holders to purchase up to 411,000 shares at a price of $2.00 per share for the employees on 122,000 shares and $2.50 per share for the directors and consultant on 289,000 shares. These options expire on October 16, 2002. The options to the agents who handled the initial public offering to acquire 122,708 common shares of the company at $3.50 each as additional compensation expired on November 7,1998 without being exercised.

As explained above, the shareholders' equity section of the balance sheet includes a foreign currency translation adjustment of $1,060,000 as a reduction.

INVESTMENT PORTFOLIO

The company, as at March 31,1999, has investments in four projects or entities in Ukraine. In fiscal 1998 the company had made another investment that was resold during 1998. Note 5 to the financial statements gives further details of the investments including the company's proportionate share of the assets, liabilities and operating performance of these investments.

The first investment was an interest in Electron Bank JSC, based in Lviv, Ukraine. The bank has a full license to engage in all banking and finance operations including trust and custodial operations. They provide a full service through a number of branches and are considered one of the largest banks in western Ukraine.

The initial investment was $1,489,496. During fiscal 1998 the company invested a further $299,811 to reach the holding of 20.8% as well as to meet its share of a rights issue. This amount included the capitalization of dividends of $57,560. During fiscal 1999 further investments of $117,918 were made to meet the company's share of rights issues. This was accomplished almost entirely by way of capitalization of dividends of $114,960. The company records its share of earnings on an equity basis as the company has significant representation on the board and in management especially with regard to the long-term strategy. Due to the inherent problems found in converting results into western standards it has been decided that results will be presented three months in arrears.

The company's share of earnings to December 31,1997 was $312,159. This amount was recorded in fiscal 1998. In fiscal 1999, the company recorded its share of earnings to December 31,1998 which was a loss of $11,000.

The results to December 31,1998 were impacted by the economic crisis in Ukraine as discussed above. During the audit of the financial results, it was decided that further reserves should be taken against receivables in excess of the provision that would have been recorded in accordance with the rules of the National Bank of Ukraine. The financial statements of Electron Bank are audited in accordance with International Accounting Standards, which are substantially the same as Canadian standards. In addition, it was decided that the financial statements of Electron Bank would be prepared without any adjustment for hyperinflation on a retroactive basis. This made the statements more comparable to other banks. There was a relatively minor impact on the earnings, as the majority of the adjustment was to the equity and fixed assets.

As outlined above, the value of Electron Bank had to be examined in light of the currency devaluation. Within Ukraine it was fairly strong and stable, but in converting the balances to a foreign currency, the value would have to be diminished. This procedure allows investors outside of Ukraine to determine what the value would be in their currency if it were liquidated at book value.

The carrying value of the company's investment in Electron Bank at March 31,1999 is $935,148. The investment in shares of $1,907,225 is increased by the accumulated share of earnings since acquisition of $301,159 less dividends received of $213,236. As mentioned above, the dividends included stock dividends of $172,520 that were capitalized and a cash dividend of $40,716 that was received in fiscal 1999. The foreign currency translation adjustment of $1,060,000 reduces the value to the amount reported.

The company has made investments in two separate coal recovery projects with the same Ukrainian partner. The technology to recover discarded fines is proven and is in use elsewhere. Since historic methods of mining in Ukraine have resulted in these fines being collected in sediment or tailings ponds, as opposed to being recovered during the production cycle, there are significant recovery potentials throughout Ukraine. It is significant that the recovery costs are substantially less than the costs of current mining techniques.

The company has invested $1,971,608 in the Kalininskaya coal recovery project in the Donbas region of Ukraine. The initial investment was $1,575,504 in fiscal 1998 with a further $396,104 invested in fiscal 1999 to cover cost overruns on the original construction and upgrades that were required to prepare for the 1999 production cycle. These additional investments increased the company's percentage ownership in the project. The investment consists of a loan of $1,574,710, with interest at 20%, to a western company, as well as a direct investment in the western company of $171,128. The western company owns 40.3% of the Ukrainian joint venture that owns the equipment and infrastructure. The company has a 59.5% interest in this western company. Direct investment in the Ukrainian joint venture is 4.7%, acquired for $225,770, which results in an effective holding of 28.7% in the total project. The company will record revenue on an equity basis, based upon the interest income earned, its share of consulting and commission fees earned from the project, as well as its share of earnings in the Ukrainian joint venture. Although interest has been accruing since August 1,1997, the company has elected to record as income only $264,736, which is the amount attributable from production up to March 31,1999. This decision was taken since the actual production period was shorter than planned with a late commissioning period and with some start-up problems. In addition, amortization of the fixed assets was not recorded during this start-up phase. At March 31,1999 the cash collected from this project was $197,856, which results in a carrying value of $2,038,488.

The upgrades recommended by the technical experts were completed after March 31,1999 and indications are that the project will produce at budgeted levels. This should result in increased output in future periods, however, the marked fall in worldwide prices for coal will partially offset this gain. The project will still be able to achieve significant returns at these lower prices. Should prices rise during the next year, the returns will increase dramatically.

The Sukhodolska coal recovery project is to recover fines from a tailings pond in Krasnodon in eastern Ukraine. The company has made a commitment for a 29% direct participation in a Ukrainian joint venture that will own and operate the equipment and infrastructure. The investment to March 31,1999 is $952,445 with a further $237,490 made after that date. The company has the rights to increase its ownership to 45% by purchasing the additional percentage from the Ukrainian partners at cost plus interest. The rights expire in 2000. This project is in the construction phase with completion and commissioning scheduled for August 1999. Revenue will be recorded on an equity basis based upon the company's share of consulting and commission fees earned from the project, as well as its share of earnings in the Ukrainian joint venture.

The company has a 50% interest in a joint venture to acquire and redevelop property in Kyiv that was formed in fiscal 1998. This venture purchased a vacant office building in the Podil area of Kyiv for $144,146. During fiscal 1999 a further investment of $50,039 was made to meet the costs of redevelopment. The project has commenced applications to renovate the property to western standards and increase its size to at least 800 square meters. It was the original intention to sell the property after completion of the renovations but a decision has been made to attempt to liquidate the property in its current state. The real estate market in Kyiv is in a state of flux and the benefits of continuing the project over the next few years, as opposed to a current sale, do not appear to be high. As discussed above, the real estate market was also affected by the currency devaluation. In examining this project, it was determined that a foreign exchange loss of $48,500 should be recognized and the carrying value was accordingly reduced.

During fiscal 1998 the company entered into a commitment to invest in a building materials importing and distribution business. Pursuant to the contracts an initial investment of $502,385 was made to purchase inventory. The initial investment was sold back to the other partner during the year, which gave rise to a profit of $30,750 on the transaction as recorded at March 31,1998. A further profit of $23,460, based upon the performance of that business to July 31,1998, was received and recorded in fiscal 1999.

ASSETS AND LIABILITIES

The company holds its excess cash in short-term instruments. At March 31,1999 this amounted to $471,230, which included $33,098 denominated in US currency. The balance at March 31,1998 was $2,098,050 including US$264,601. Accounts receivable represent amounts due under contracts, expenditures and advances that are recoverable and accrued earnings. At March 31,1998 this included a receivable of $186,674 from the sale of the building materials business reported above. Prepaid expenses represent that portion of expenditures that apply to future periods. This includes a portion of the costs of an insurance policy. Capital assets are comprised of office and computer equipment and furniture, as well as an 89 sq.m. office apartment in Kyiv, Ukraine. The amount spent on the acquisition of office equipment in both Kyiv and Toronto and for improvements to the property was $19,066 in fiscal 1998 with no amounts spent in fiscal 1999.

Accounts payable and accrued liabilities represent various costs and expenses that have been incurred but not yet paid in the normal course.

OPERATIONS

Revenue for fiscal 1999 was $317,888, which is down from the previous year's $513,859. Included in this total for fiscal 1999 is $264,736 as our share of earnings from the Kalininskaya coal recovery project, $11,000 as our share of the operating loss of Electron Bank, and a further gain from the sale of the building material business of $23,460. These components of revenue are outlined further above. Revenue also included interest of $40,692.

In fiscal 1998 the revenue was comprised of the company's share of earnings from Electron Bank of $312,159, the gain on the sale of the building materials business of $30,750, interest earned of $105,694, and a foreign exchange gain of $65,256.

The conversion of foreign currency during fiscal 1999 resulted in a gain of $40,130. However this was offset by the foreign exchange loss of $48,500 from the revaluation of the property redevelopment assets, as explained above, creating a total foreign exchange loss of $8,370 included in the expense section of the statement of operations.

The total expenses for fiscal 1999 were $660,883 compared to $986,619 the previous year.

The salaries and benefits recorded in fiscal 1999 of $346,457 included two senior management staff for the full year as well as the chairman on a reduced salary basis. Support staff was kept to a low level with one in Toronto and one in Kyiv. This salary cost is a reduction from the previous year's $412,767. The administrative expenses of $153,463 for fiscal 1999 is reduced from $362,714 reported in fiscal 1998. These costs include such items as office rent in Toronto, telephone including long distance, office expenses, insurance, corporate filing fees, reporting and expenses. Included in those administrative expenses for fiscal 1998 were directors' fees of $76,500. Only $7,000 of the directors' fees had been paid with the balance accrued for future payment. In fiscal 1999 these accrued fees were cancelled and reversed. In addition fiscal 1998 included costs related to project investigation in previous years of $22,375.

Travel costs of $65,081 in 1999 and $97,447 in 1998 reflects, predominately, the cost of travel to and from Ukraine to monitor the investments, as well as the negotiation of the investments during the relevant year. Professional fees of $69,777 in 1999 and $72,272 in 1998 relate to legal and audit costs while consulting fees of $24,763 in 1998 relate to the acquiring of outside assistance from time to time.

Net loss for the year ended March 31,1999 was $342,995 or 8 cents per share compared to a loss of $472,760 or 11 cents per share in 1998. The weighted average number of shares outstanding used to calculate the loss per share was 4,115,361 in both years.

YEAR 2000 COMPLIANCE

The company has examined its exposure to the year 2000 problem as it relates to computerization and its effect upon operations and reporting. From the viewpoint of the company, our exposure is limited to the impact of others such as financial institutions and their compliance. Our internal reporting is handled by readily available software packages, which are stated to be year 2000 compliant.

Electron Bank has stated that they are examining and monitoring the situation and its impact upon them and their operations. They have complied with new reporting requirements of the National Bank of Ukraine and are confident that their computer programs are year 2000 compliant. Their remaining software is predominantly purchased from large software companies and is stated to be compliant. The impact will be based upon interaction with other entities that are not compliant. As all financial transactions go through central banking sources, which have indicated compliance, they do not anticipate significant problems on a direct basis.

Our other investments also utilize common software packages and accordingly there should be no impact upon the operations of the projects.

No significant expenditures have been made to become year 2000 compliant and it is estimated that future costs will be minimal.

RISKS

It is an inherent risk that the company might not generate sufficient earnings from its investments, on a cash basis, to fund the level of operations and expenses that are currently in existence. The failure to achieve those returns, on a timely basis, could lead to a reduction in the operations of the company and a need to raise additional funds at levels and rates below the appropriate or anticipated levels. Circumstances beyond the control of the company could influence the anticipated returns such as the actual operations and profits of the investees. Further, the company's anticipated returns could be flawed.

In addition, due to the location of the company's proposed investments, there are a significant number of additional risks that could severely impact upon the future profitability of the company and its abilities to sustain operations. These include political and economic risks, currency risks, non-liquidity of investments, transfer risks, lack of protection and difficulties in enforcing rights and taxation. Ukraine, similar to other Central European and former Soviet Union countries, is evolving slowly from the former centrally planned, socialist economy to a market-oriented democratic model. In achieving that position there are various factors and steps that they must go through. In the process there is the possibility that certain laws and rules will be enacted that could render the value of the company's investment to a much lower level. These rules could include the expropriation of assets or nationalization, enactment of tax laws that are onerous, imposition of currency controls and restrictions that might limit the amount of funds that can be withdrawn or that would require major adjustments to the carrying value, and imposition of controls on foreign ownership.

Beyond government intervention, the investment process is influenced by the speed to which the country moves to a market economy, the process of the amendment of laws relating to the protection of assets and investments as is found in the west, the acceptance of Ukraine into the international trading community, success in dealing with inflation and the restabilization of the currency, and obviously, general market risks.

OUTLOOK

Ukraine Enterprise Corporation firmly believes that investment in Ukraine will over time be profitable. Other former Soviet Union countries have moved towards a market economy and those who have invested in that process have received generous benefits. Ukraine is a number of years behind in the process but progress, although slow, can be seen.

The company has determined that, in the short-term, the operation of coal recovery projects should generate cash at significant levels which will result in positive returns for its shareholders. Accordingly, the company is examining other potential sites as well financing sources such as export credit agencies and other government supported financing arms. The company is hampered by its lack of resources and ability to access additional funds at appropriate rates until such time as the current projects have proven the level of return that is acceptable.

The investment in Electron Bank is currently under pressure for additional capital infusion to meet the increasing levels of capitalization imposed by the National Bank of Ukraine on the banking sector. The bank continues to be well run and is a strong entity within the banking sector of Ukraine. With the management of the bank, we are exploring areas of potential growth including strategic alliances with other financial institutions in Ukraine and the west, as well as attracting other sources for capitalization.

Property redevelopment in Kyiv continues to be a fluctuating sector especially with the apprehension of western companies and investors as a result of the economic downturn in Ukraine. Accordingly, we have agreed with our partners that at this time we should liquidate our holdings and examine a reentry into this sector at a later time.

As stated, the investments that Ukraine Enterprise Corporation has undertaken in coal recovery projects should provide returns sufficient to show positive results to the shareholders at a level that is anticipated for the area of investment. The other investments will over time contribute to the value of the company.

Report to the Shareholders

We have audited the consolidated balance sheets of Ukraine Enterprise Corporation as at March 31, 1999 and 1998 and the consolidated statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 1999 and 1998 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

"KPMG LLP" (signed)

Toronto, Canada

Chartered Accountants

June 9, 1999

CONSOLIDATED BALANCE SHEETS

As at March 31, 1999 and 1998

	1999	1998
Assets		
Current assets:		
Cash and short-term investments (note 4)	$ 471,230	$ 2,098,050
Accounts receivable	55,045	221,500
Prepaid expenses	36,198	1,876
	562,473	2,321,426
Investments (note 5)	4,071,766	3,763,556
Capital assets, net (note 6)	178,250	193,668
	$ 4,812,489	$ 6,278,650
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 84,477	$ 147,643
Shareholders' equity:		
Capital stock (note 7(a))	11,168,214	11,168,214
Deficit	(5,380,202)	(5,037,207)
Foreign currency translation adjustment	(1,060,000)	—
	4,728,012	6,131,007
Subsequent event (note 7 (c))		
	$ 4,812,489	$ 6,278,650

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Frank Potter" (signed) | **"GM Keaney" (signed)**

Director | *Director*

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

Years ended March 31, 1999 and 1998

	1999	1998
Revenue:		
Share of earnings from investments (note 5)	$ 253,736	$ 312,159
Gain on sale of investment (note 5 (e))	23,460	30,750
Interest income	40,692	105,694
Foreign exchange gain	—	65,256
	317,888	513,859
General and administrative expenses:		
Salaries and benefits	346,457	412,767
Administrative	153,463	362,714
Travel	65,081	97,447
Professional fees	69,777	72,272
Consulting fees	2,317	24,763
Foreign exchange loss	8,370	—
Amortization	15,418	16,656
	660,883	986,619
Loss for the year	342,995	472,760
Deficit, beginning of year	5,037,207	4,564,447
Deficit, end of year	$ 5,380,202	$ 5,037,207
Loss per common share (note 8)	$ 0.08	$ 0.11

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended March 31, 1999 and 1998

	1999	1998
Cash provided by (used in):		
Operating activities:		
Loss for the year	$ (342,995)	$ (472,760)
Items which do not involve cash:		
Amortization	15,418	16,656
Share of earnings from investments	(253,736)	(312,159)
Foreign exchange loss	48,500	—
Gain on sale of investment	—	(30,750)
Decrease (increase) in accounts receivable	166,455	(203,931)
Decrease (increase) in prepaid expenses	(34,322)	31,341
Decrease in accounts payable and accrued liabilities	(63,166)	(150,493)
	(463,846)	(1,122,096)
Investing activities:		
Investments advanced	(1,516,506)	(2,521,846)
Proceeds on sale of investment	—	533,135
Distributions from investments	353,532	57,560
Additions to capital assets	—	(19,066)
	(1,162,974)	(1,950,217)
Decrease in cash	(1,626,820)	(3,072,313)
Cash and short-term investments, beginning of year	2,098,050	5,170,363
Cash and short-term investments, end of year	$ 471,230	$ 2,098,050

See accompanying notes to consolidated financial statements.

Years ended March 31, 1999 and 1998

1. Incorporation and principal activities:

Ukraine Enterprise Corporation (the "Corporation") was incorporated on November 21, 1994 under the laws of the Province of Ontario. The objective of the Corporation is to invest in commercial and industrial enterprises in Ukraine as an operating management company. The Corporation's common shares are listed on the Alberta Stock Exchange.

2. Future operations:

The Corporation has incurred substantial operating losses since inception and has an accumulated deficit, the recovery of which is dependent upon the Corporation's ability to generate profitable future operations and positive cash flows. Ultimate recoverability of the Corporation's investments in Ukraine is subject to a number of risks and uncertainties, including the general risk of conducting business in Ukraine due to its uncertain economic, foreign exchange and political environment.

3. Significant accounting policies:

(a) Basis of presentation:

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the years specified. Actual results could differ from those estimates.

(b) Basis of consolidation:

These consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

(c) Short-term investments:

Short-term investments are valued at cost plus accrued interest which approximates fair value.

(d) Investments:

Investments over which the Corporation is able to exercise significant influence are accounted for by the equity method. Under the equity method, the original cost of the shares is adjusted for the Corporation's share of post-acquisition earnings or losses less dividends or distributions.

(e) Capital assets:

Capital assets are recorded at cost and amortized annually as follows:

Asset	Basis	Rate
Office facilities	Straight-line	20 years
Office equipment	Diminishing balance	20%

(f) Foreign currency translation:

Monetary assets and liabilities expressed in foreign currencies are translated at the rates of exchange in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when assets are acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in the consolidated statements of operations and deficit.

Unrealized gains and losses arising from translating self-sustaining investments in foreign operations are included in shareholders' equity as foreign exchange translation adjustment. Realized translation gains and losses related to foreign operations are included in the consolidated statements of operations and deficit.

(g) Financial assets and liabilities:

The fair values of investments are not readily determinable. Other financial assets and liabilities recorded at cost are short term in nature and therefore, their carrying values approximate fair values. Short-term investments mature within one year but are redeemable at any time without penalty. They bear interest at rates between 3% and 5%.

4. Cash and short-term investments:

	1999	1998
Bankers' acceptance	$ —	$ 1,296,745
Short-term deposits held at Canadian banks	390,000	275,000
Cash (including U.S. $33,098; 1998 - U.S. $264,601)	81,230	526,305
	$ 471,230	$ 2,098,050

5. Investments:

As at March 31, 1999, investments were comprised as follows:

(a) A 20.8% interest (1998 - 20.8%) in Electron Bank JSC, a fully licensed bank based in Lviv in Western Ukraine. The investment was acquired for cash consideration and is accounted for by the equity method for Electron Bank's fiscal year ended December 31, 1998. In the year ended March 31, 1999, stock dividend distributions of $114,960 were received and reinvested in Electron Bank JSC.

(b) A 28.7% interest (1998 - 25.9%) in the Kalininskaya Coal Recovery Project in the Donbas Region of Eastern Ukraine. This project is to recover discarded coal fine particles from a sediment or tailings pond. The investment was acquired for cash consideration and consists of $396,898 equity and a loan of $1,574,710 (U.S. $1,142,500) with interest at 20% per annum which is due on demand after August 1, 1998. Earnings from this investment are accounted for by the equity method.

(c) A 29% interest in the Sukhodolska Coal Recovery Project in Krasnodon in Eastern Ukraine. This project is to recover discarded coal fine particles from a sediment or tailings pond. The investment was acquired for cash consideration. The project is in the construction phase with production scheduled for the summer of 1999. Earnings from this investment will be accounted for by the equity method once production commences.

(d) A 50% interest in a Property Redevelopment Project in the Podil area of Kyiv, Ukraine. The project is an 800 square meter office building that is now vacant and will be renovated to western standards after receipt of municipal approvals. It is intended that the building be sold after completion of the renovations. A foreign exchange loss of $48,500 has been recorded in the consolidated statements of operations and deficit for the Property Redevelopment Project.

(e) During 1998, the Corporation acquired a 25% interest in a building materials import and distribution business for $502,385 and resold it to the original partners for a gain of $30,750 in 1998 and a further gain of $23,460 in 1999.

(f) The continuity schedule of the investments is as follows:

During the year, the hryvnia, the currency of Ukraine, devalued significantly against western currencies. The Corporation examined its exposure to this devaluation and its impact upon the carrying value of its investments. As a result, the carrying value of the investments in Electron Bank was reduced by $1,060,000. Electron Bank is deemed to be a self-sustaining operation and, accordingly, this reduction in carrying value is recorded as a component of shareholders' equity.

	Electron Bank	Kalininskaya Coal Project	Property Redevelopment	Sukhodolska Coal Project	1999 Total	1998 Total
Balance, March 31, 1998	$ 2,043,906	$ 1,575,504	$ 144,146	$ —	$ 3,763,556	$ 1,489,496
Acquired during the year	117,918	396,104	50,039	952,445	1,516,506	2,521,846
Share of earnings (loss)	(11,000)	264,736	—	—	253,736	312,159
Gain on sale	—	—	—	—	—	30,750
Distributions	(155,676)	(197,856)	—	—	(353,532)	(57,560)
Proceeds on sale	—	—	—	—	—	(533,135)
Foreign currency translation adjustment	(1,060,000)	—	—	—	(1,060,000)	—
Foreign exchange loss	—	—	(48,500)	—	(48,500)	—
Balance, March 31, 1999	$ 935,148	$ 2,038,488	$ 145,685	$ 952,445	$ 4,071,766	$ 3,763,556

The Corporation's proportionate share of the underlying assets and liabilities (excluding loans owing to the Corporation) and operating performance of the investments as at March 31, 1999 is summarized as follows:

	Electron Bank (Dec. 31, 1998)	Kalininskaya Coal Project	Property Redevelopment	Sukhodolska Coal Project	1999 Total	1998 Total
Assets	$ 3,583,000	$ 1,362,269	$ 145,685	$ 952,445	$ 6,043,399	$ 6,218,037
Liabilities	2,436,000	338,348	—	—	2,774,348	2,964,941
Loans from UEC	—	1,574,710	—	—	1,574,710	1,583,266
Revenue	1,214,000	195,157	—	—	1,409,157	1,376,470
Net earnings (loss)	(11,000)	264,736	—	—	253,736	312,519
Cash flows:						
Operations	$ (7,000)	$ (129,885)	$ —	$ —	$ (136,885)	$ 217,104
Investing	358,000	(225,192)	(50,039)	(952,445)	(869,676)	(1,664,009)
Financing	37,000	396,104	50,039	952,445	1,435,588	1,530,084
Total	$ 388,000	$ 41,027	$ —	$ —	$ 429,027	$ 83,179

6. Capital assets:

			1999	1998
	Cost	Accumulated amortization	Net book value	Net book value
Office equipment	$ 52,704	$ 24,342	$ 28,362	$ 35,453
Office facilities – Kyiv	166,542	16,654	149,888	158,215
	$ 219,246	$ 40,996	$ 178,250	$ 193,668

7. Share capital:

(a) Capital stock continuity:

	1999	1998
Authorized:		
Unlimited common shares		
Issued:		
4,115,361 common shares (1998 - 4,115,361)	$ 11,168,214	$ 11,168,214

(b) Share option plan:

The Corporation has a share option plan for the officers, employees and directors of the Corporation. The plan provides for the granting of rights for the purchase of up to 10% of the issued and outstanding shares of the Corporation, subject to regulatory approval, at an exercise price that is not less than the closing price of the shares on the Alberta Stock Exchange immediately prior to the granting. The Directors shall award the options and set the exercise price. The period for the exercise of the right to purchase shall not exceed five years from the granting of the option. No one participant shall be eligible to hold options to acquire more than 5% of the issued and outstanding shares at any given time. At March 31, 1999, there are 411,000 options outstanding under this plan all expiring on October 16, 2002. The exercise price is $2.00 on 122,000 and $2.50 on 289,000.

(c) Subsequent event:

On April 16, 1999, the Corporation issued 1,000,000 common shares for proceeds of $250,000. This issue was by private placement, open to the directors of the Corporation. The only costs associated with this issue were the requisite filing fees and legal costs. The proceeds were used to fund the capital requirements of the Sukhodolska Coal Recovery Project (note 5(c)).

8. Loss per common share:

The weighted average number of common shares used to calculate loss per common share for the years ended March 31, 1999 and 1998 is 4,115,361.

9. Income taxes:

As of March 31, 1999, the Corporation has non-capital losses of approximately $4,151,000 for income tax purposes available to carry forward and apply against future years' taxable income, of which approximately $62,000 expires in the year 2002, $1,000,000 in 2003, $2,300,000 in 2004, $460,000 in 2005 and $329,000 in 2006. In addition, share issue costs of approximately $1,300,000 incurred in 1995, 1996 and 1997 have been charged to deficit for accounting purposes which are deductible for income tax purposes on a straight-line basis over five years of which $858,088 has been deducted to date. The tax benefit of these losses and share issue costs have not been recognized in these financial statements.

10. Profit-sharing plan:

Effective June 12, 1996, a profit-sharing plan was approved by the Board of Directors. The plan will allow for 10% of the Corporation's annual consolidated net income, before corporate taxes, as determined in accordance with the Corporation's consolidated financial statements, to be distributed to senior management within 180 days following completion of the Corporation's fiscal year.

11. Uncertainty due to the Year 2000 Issue:

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Corporation, including those related to the efforts of its investees, suppliers, or other third parties, will be fully resolved.

CORPORATE INFORMATION

UEC

BOARD OF DIRECTORS

Peter M. Aitken, Brawley Cathers Ltd., Toronto, Ontario (2)
Dr. Walter Curlook, Toronto, Ontario
Sen. Jerry S. Grafstein, Q.C., Minden, Gross, Grafstein & Greenstein, Toronto, Ontario
James Hatt, PLD Telekom Inc., New York, New York
Gregory M. Keaney, Ukraine Enterprise Corporation, Toronto, Ontario
Ben B. Kizemchuk, Altus Securities Inc., Toronto. Ontario
Charles B. Loewen, Corporate Services International Inc., Toronto, Ontario (2)
Barbara J. Morrow, Barronett Global Investors Inc., New York, New York (2)
Frank Potter, Emerging Markets Advisors Inc., Toronto, Ontario (1)
James C. Temerty, Northland Power, Toronto, Ontario

(1) Chairman of the Board
(2) Member of Audit Committee

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REGISTRAR & TRANSFER AGENT

Montreal Trust Company
Toronto, Calgary

EXCHANGE LISTING

Alberta Stock Exchange – Symbol UKN

ANNUAL & SPECIAL MEETING

Wednesday, September 22, 1999 at 11:30 a.m.
Sheraton Centre, Peel Room (Mezzanine)
Toronto, Ontario

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