# Reconstruction Capital II Ltd

("RC2" or the "Fund")

# Quarterly Report

June 30th, 2011

neweuropecapital

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## Statistics

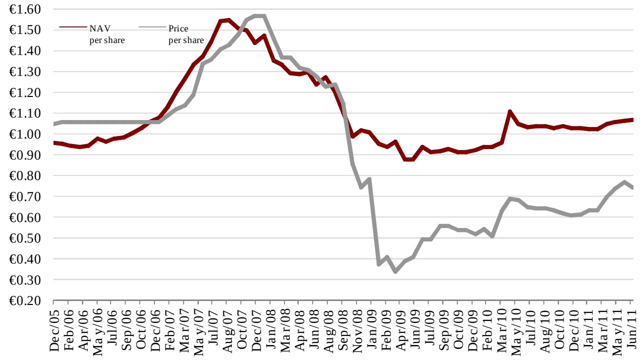
| | |
|---|---|
| NAV per share (€) | 1.0645 |
| Share price (€) | 0.7425 |
| Total NAV (€ m) | 106.5 |
| Mk Cap (€ m) | 74.3 |
| # of shares (m) | 100.0 |
| NAV return since inception | 11.29% |
| 12-month NAV CAGR | 3.42% |
| NAV annualized Return* | 1.96% |
| NAV annualized Volatility* | 13.75% |
| Best month (NAV) | 15.60% |
| Worst month (NAV) | -10.52% |
| # of months up (NAV) | 39 |
| # of months down (NAV) | 27 |

** since inception*

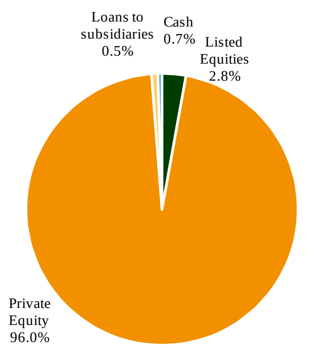
## RC2 NAV returns

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|
| Jan | 4.70% | -8.27% | -5.65% | 1.36% | -0.54% |
| Feb | 6.17% | -1.48% | -1.51% | 0.03% | 0.24% |
| Mar | 5.90% | -3.03% | 2.39% | 2.07% | 2.48% |
| Apr | 5.05% | -0.26% | -8.40% | 15.60% | 0.70% |
| May | 3.08% | 0.93% | -0.26% | -5.42% | 0.55% |
| Jun | 5.19% | -4.75% | 3.08% | -1.57% | 0.25% |
| Jul | 6.93% | 2.85% | 1.08% | 0.53% | |
| Aug | 0.22% | -5.55% | 0.23% | 0.07% | |
| Sep | -2.50% | -8.34% | 1.20% | -0.62% | |
| Oct | -0.69% | -10.52% | -1.79% | 0.96% | |
| Nov | -4.09% | 3.03% | 0.46% | -1.15% | |
| Dec | 2.46% | -0.60% | 1.08% | -0.06% | |
| YTD | 36.74% | -31.43% | -8.38% | 11.07% | 3.71% |

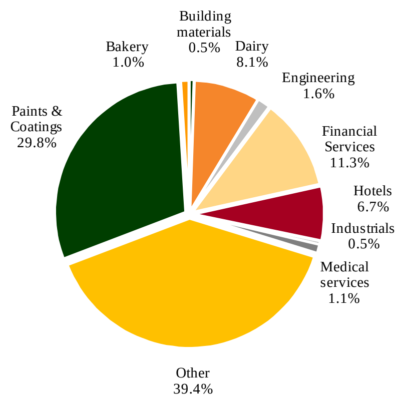
## Share price / NAV per share (€)




## Portfolio Structure by Asset Class

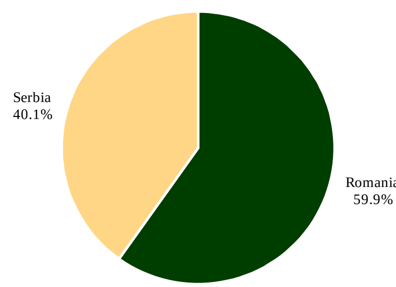



## Equity Portfolio Structure by Sector




*Note: EPH investment included under Other*

## Portfolio Structure by Geography




*Note: EPH investment included under Serbia*

## Message from the Investment Manager and Advisers

Dear Shareholders

Over the second quarter of 2011, RC2's NAV per share increased by 1.5%, ending the period at €1.0645. The discount to NAV fell from 33.7% to 30.2%, as a result of the share price increasing by 6.8% over the quarter.

EPH's results for the first six months of 2011 are in line with the budget. The Group achieved revenues of €179.3m, slightly above the €176.2m generated the year before. EBITDA reached €5.8m, more than double compared to the €2.6m achieved in the first half of 2010, mainly due to the Milling division's impressive results. The Copper Processing business ended the semester on budget, while Novkabel, EPH's cable division, achieved a strong increase in sales driven by strong orders from the Russian market. The plan for relocating the Bakery division's main production facility has been finalized, and is set to begin in mid-August.

Policolor started the 2011 summer season in force, with first half-year revenues reaching €34.9m, compared to €32.7m over the first half of 2010. However, in line with the international coatings industry, Policolor continued to experience strong inflation in its cost of raw materials, which negatively impacted its profitability. Consequently, the EBITDA fell by 23% year-on-year, from €3.5m in the first half of 2010 to €2.7m in the first half of 2011.

Over the first six months of 2011, Albalact's sales powered ahead by 31.6% year-on-year, reaching €39.7m. However, high raw milk prices and increased marketing and logistic expenses resulted in a fall in profitability, with EBITDA falling from €3.1m in first half of 2010 to €2.1m in the first half of 2011.

Top Factoring achieved revenues of €2.6m over the first seven months of 2011, a significant improvement over the €2.0m generated the same period the previous year. However, its profitability was negatively affected by start-up and amortisation expenses on the new debt portfolios acquired in December 2010. The Group's profitability should recover in the remaining months of the year.

Despite the unfavourable weather in May and June, and the overall fall in the average occupancy rate at Romanian seaside hotels, Mamaia achieved a 2.4% year-on-year increase in revenues for the first seven months of 2011, and EBITDA reached €190,000, compared to a loss of €145,000 over the first seven months of 2010.

At the end of June 2011, the Fund had cash and cash equivalent balances of approximately €1.3m, compared to €1.2m at the end of March.

Yours truly,

New Europe Capital

## East Point Holdings Ltd

### Background

East Point Holdings Ltd ("EPH" or the "Group") is a Cyprus-based holding company with significant business interests across South East Europe in which RC2 acquired a 21.3% shareholding in 2008. In April 2010, RC2 increased its shareholding to 42% in exchange for waiving certain claims against EPH's other shareholders for zero consideration. At the same time, Darby, the private equity arm of Franklin Templeton Investments, exchanged a mezzanine loan for 24.7% of EPH's equity. EPH operates along the following main business lines: Copper Processing, Cable Production, Bakeries, Milling and Real Estate. In March 2010, RC2 acquired an 11.1% shareholding in Klas DOO ("Klas"), the holding company for EPH's Bakeries business, for €2.7m. In June 2010, RC2 acquired 3.9% of the share capital of Agri Point Ltd ("Agri Point") for €1.6m and a further 5.5% in December 2010 for 2.2m. In November 2010, RC2 acquired a 49.9% shareholding in East Point Metals Ltd ("EPM") for a total consideration of €2.2m. Both the Agri Point and EPM purchases, which were governed by put and call arrangements with EPH, were used to provide bridge financing to the Group. In January, RC2 sold all its shares in Agri Point back to EPH for €3.8m, in order to enable the sale of 100% of that business to CHS, a trade buyer.

### Recent Developments

In April, RC2 sold its shareholding in EPM back to EPH, and in return it received non-core real estate assets from EPH which it is in the process of swapping with the founding shareholders of EPH for an 11.7% shareholding in EPH, of which it had received 7.5% by the end of June. In addition, in a related transaction, RC2 increased its shareholding in EPH from 42.0% to 44.1% in May, resulting in its overall shareholding in EPH increasing from 42.0% to 51.6% over the quarter.

### Financial Results

| *(EURm)* | 2009A | 2010 * | 2010A | 2011B | 1H10* | 1H11* |
|---|---|---|---|---|---|---|
| **Income Statement (according to IFRS)** | | | | | | |
| **Net Sales** | **323.1** | **395.1** | **390.5** | **364.9** | **176.2** | **179.3** |
| Cost of Sales | (273.0) | (356.2) | (351.7) | 325.6 | (156.5) | (155.4) |
| Gross Profit | 50.1 | 38.9 | 38.9 | 39.3 | 19.7 | 23.9 |
| **EBITDA** | **8.2** | **1.4** | **1.4** | **10.7** | **2.6** | **5.8** |
| *EBITDA margin (%)* | *2.5%* | *0.3%* | *0.4%* | *2.9%* | *1.5%* | *3.2%* |
| Depreciation | (8.2) | (6.8) | (7.1) | n/a | (3.8) | (3.3) |
| Release of negative good will | 6.8 | - | 0.0 | n/a | - | - |
| Other income / expense, net | (1.3) | 45.6 | 42.1 | n/a | 0.0 | (1.1) |
| Creditors / Debt write-off | 18.6 | (0.0) | (2.8) | n/a | - | (2.7) |
| Imapirment charge of assets | 0.8 | (0.3) | (0.9) | n/a | - | - |
| FV adjustment on investment property | (1.0) | (0.5) | (0.8) | n/a | - | - |
| Exceptional items | 2.8 | (15.3) | (16.6) | n/a | (2.4) | (4.9) |
| **EBIT** | **26.7** | **24.0** | **15.3** | **5.9** | **(3.6)** | **(6.3)** |
| *EBIT margin (%)* | *8.3%* | *6.1%* | *3.9%* | *1.6%* | *-2.0%* | *-3.5%* |
| Net interest (expenses) | (9.0) | (6.8) | (7.8) | (7.5) | (3.0) | (3.6) |
| FX gain (loss) | (3.5) | (6.8) | (4.4) | n/a | (6.9) | 1.6 |
| Share of profit (loss) of associates | (0.7) | (0.2) | (0.1) | n/a | (0.2) | 0.1 |
| **Income/(loss) before taxes** | **13.4** | **10.2** | **3.0** | **(1.7)** | **(13.7)** | **(8.1)** |
| Income tax (expense)/benefit | (0.7) | (0.5) | 0.6 | (0.2) | (0.3) | (0.1) |
| **Profit/ (loss) for the year from continuing operations** | **12.7** | **9.7** | **3.5** | n/a | **(14.0)** | **(8.2)** |
| **Profit/ (loss) for the year from discontinuing operations** | **(55.6)** | **(12.5)** | **(11.7)** | n/a | **(8.4)** | **(0.2)** |
| **Profit/ (loss) for the year** | **(42.9)** | **(2.8)** | **(8.1)** | **(1.8)** | **(22.4)** | **(8.5)** |
| **Attributable to:** | | | | | | |
| Minority interest | (0.1) | 1.3 | (0.9) | n/a | (0.9) | (0.5) |
| **Owners of the parent** | **(42.9)** | **(4.0)** | **(7.3)** | **(1.8)** | **(21.5)** | **(8.0)** |

*Note: 2009 & 2010 audited accounts; * unaudited management accounts;*

EPH has released its 2010 audited accounts, which separate the results of the two discontinued operations (the Agribusiness and Logistics divisions which were sold at the end of last year), and also reclassifies the results of these two divisions as "discontinued" for the prior year. Excluding discontinued operations, the Group achieved positive EBITDA of €1.4m and made a small net profit of €3.5m.

EPH's results for the first six months of 2011 are a significant improvement on the same period last year, with €179.3m of revenues, compared to €176.2m generated in the first half of 2010, whilst EBITDA doubled from €2.6m to €5.8m.

*Copper Processing*

Revenues in the first half of 2011 stood at €121m, a 5.5% year-on-year increase compared to the €115m generated in the first half of 2010. Because this was mainly due to the increase in the price of copper (which is passed through to clients) the division's EBITDA was largely unchanged at €3.4m. In June, a new CEO for the business with over 20 years of industrial experience, including in a restructuring of Dupont's worldwide operations, was recruited. The new CEO's initial plans are to reorganize the management team and the copper division's sales offices. Furthermore, the new management team has started to implement a new ERP system, which is expected to significantly improve processes and operational efficiencies in the Group, whilst helping the Group focus on more added-value products. The ERP system is planned to be implemented by the end of 2011, and to become fully operational in the first quarter of 2012.

*Cable Production*

Novkabel, EPH's cable producer, achieved a 37.7% year-on-year increase in sales volumes. Most of the sales growth was due to increased exports on the Russian market, where the division has been positioning itself as a supplier of cables to a wide range of industries. Total exports reached 1,600 tons, a 77.3% year-on-year increase from 910 tons in the first half of 2010. The domestic market has also shown signs of recovery, with a 14.8% year-on-year increase in volumes sold. Coupled with the higher copper price (which is passed on directly to clients), this has resulted in revenues increasing by 64.4% from €9.6m in the first half of 2010 to €15.8m in 2011. Normalized EBITDA also significantly improved: excluding one-off costs – predominantly €530,000 in redundancy expenses – Novkabel's EBITDA in the first half of 2011 was €-230,000, compared to a negative €590,000 generated in the first half of 2010. Including the one-off restructuring cost, reported EBITDA for the first six months reached €-915,000.

The management is working on a detailed restructuring plan, which will consolidate production in three buildings from the current six. This, together with new equipment and a new ERP system should help optimize the cost structure and increase overall operational efficiency, whilst releasing over 20 ha of real estate in Novi Sad, Serbia's 2nd largest city. Management anticipate that the full operational impact to be seen in late 2012, depending on the exact deliveries of the new equipment, most of which has already been ordered.

*Bakeries*

During the first half of 2011, EPH's bakery division achieved revenues of €12.2m, a 3.2% year-on-year increase compared to the €11.9m generated in the first half of 2010. However, the high cost of raw materials (due to the poor 2010 harvest) reduced the gross margin from 41.5% to 37%, and EBITDA came in at €-430,000. The plan to relocate the main production facility to two existing satellite facilities on the outskirts of Belgrade has been finalized, and is set to begin in mid-August. This is expected to substantially increase operational efficiencies and improve product quality, whilst releasing two important real estate assets for sale or re-development: the main original production site in central Belgrade, and a plot of 4.2 ha of land 20 km from the city centre, which EPH had originally acquired to relocate all its bakery activities to a single site. Management expect the relocation project to generate annual savings of over €2m, which should, along with modest sales growth, bring the EBITDA margin to around 12% by 2014.

*Milling*

Over the first half of 2011, sales at EPH's Milling division almost tripled to €12.1m, compared to €4.6m in the first half of 2010, mainly due to higher volumes sold (+31.9% y-o-y), as well as higher flour prices. The division's profitability was very high over the second quarter, with EBITDA in the first half of 2011 reaching €2.9m, compared to €550,000 in the first half of 2010.

## Policolor Group

### Background

RC2 has a 40% shareholding in Policolor, the parent company of the Policolor Group ("Policolor" or the "Group"), the largest producer of coatings (architectural, automotive and industrial) in Romania and Bulgaria, as well as a producer of insulation materials, resins and specialty chemicals. The Group comprises Policolor SA, an unlisted Romanian company, and Orgachim AD, its 77.1%-owned Bulgarian subsidiary which is quoted on the Bulgarian Stock Exchange.

### Financial results

| *(EUR '000)* | 2009A* | 2010A* | 2011B | H1 2010A** | H1 2011A** |
|---|---|---|---|---|---|
| **Income statement (according to IFRS)** | | | | | |
| **Sales revenues** | **71,792** | **67,187** | **79,170** | **32,707** | **34,877** |
| Other operating revenues | 2,030 | 1,737 | 1,499 | 365 | 324 |
| **Total operating revenues** | **73,822** | **68,924** | **80,669** | **33,072** | **35,201** |
| Total Operating Expenses | (70,609) | (67,924) | (74,914) | (31,170) | (34,074) |
| **Operating profit** | **3,213** | **1,000** | **5,755** | **1,903** | **1,127** |
| *Operating margin* | *4.4%* | *1.5%* | *7.1%* | *5.8%* | *3.2%* |
| **EBITDA** | **9,078** | **4,209** | **9,091** | **3,482** | **2,673** |
| *EBITDA margin* | *12.3%* | *6.1%* | *11.3%* | *10.5%* | *7.6%* |
| Financial Profit/(Loss) | (1,023) | (740) | (1,355) | (541) | (401) |
| Other extraordinary items | | (1,214) | (100) | | 1 |
| **Profit before tax** | **2,190** | **(953)** | **4,300** | **1,362** | **727** |
| Income tax | 282 | (441) | (570) | (129) | 6 |
| **Profit after tax** | **2,472** | **(1,394)** | **3,730** | **1,232** | **733** |
| Minority interest | (163) | (28) | (528) | (294) | (124) |
| **Profit for the year** | **2,309** | **(1,422)** | **3,202** | **939** | **609** |
| *Avg exchange rate (RON/EUR)* | *4.237* | *4.210* | *4.200* | *4.148* | *4.200* |

*Note: * IFRS (audited), ** IFRS (unaudited)*

The Group has had a good start to the 2011 summer season, and its first half-year sales grew by 6.6% year-on-year, from €32.7m to €34.9m. However, EBITDA came under pressure from higher raw material costs, which increased by 27% year-on-year. This is part of a worldwide trend which is having a strong impact on the profitability of paints producers, and is linked to the ongoing consolidation of the chemicals industry, and plant closures (especially in Europe) since the credit crunch started. Primarily due to this, but also due to weak demand at the Group's Chemicals division, the half year operating profit fell from €1.9m to €1.1m, while the EBITDA margin lost 3%, resulting in EBITDA decreasing from €3.5m to €2.7m.

### Operations

During the first six months, the Architectural business unit's ("SBU") sales increased from €12.9m to €13.6m (+5%). Part of this growth was generated by higher volumes of cheaper product categories, as the recession has re-orientated consumers' purchases towards lower-end products. During the second quarter, the SBU re-vamped its retail operations, closing two of its shops, refurbishing others, and opening or preparing the opening of four new "colour centre" outlets in Timisoara, Constanta, Iasi and Sofia.

Sales of the Automotive SBU remained stable at €3.2m year-on-year, whilst the Industrial coatings SBU achieved a 27% year-on-year sales increase, from €2.7m to €3.5m, due to a more focussed sales effort and new tinting machines closer to customers.

Although the Thermo-Insulation SBU's sales remained unchanged year-on-year at €2.9m, the division managed to break even compared to an EBITDA loss of €183,000 during the first half of last year.

The Resins SBU achieved an excellent result, with sales growing by 140% from €2.4m to €5.7m. This is in line with the division's strategy of diversifying into unsaturated polyester resins, consolidating its position as the leading producer of resins in the SE European area, and expanding its sales to other European countries via third party agents.

Due to weak demand for anhydrides, causing production to be interrupted at times, the Specialty Chemicals SBU achieved sales of €5.3m (32% lower than last year).

Policolor owns a 14 ha site in the eastern periphery of Bucharest, of which only 5 ha are used for the Group's operations. Having completed demolition works on its surplus land, Policolor has appointed Colliers as its real estate agent for the sale of this real estate.

## Albalact

### Background

Albalact SA ("Albalact" or the "Company") is a Romanian dairy producer quoted on the RASDAQ section of the Bucharest Stock Exchange in which RC2 owns a 25.4% stake under its Private Equity Programme. A local entrepreneur and his family own 48.4%, with the remaining 26.2% representing the free float. With Albalact's market capitalization decreasing by 5% over the quarter, RC2's shareholding in Albalact had a market value of €8.7m as at 30 June, compared to €9.2m at the end of the previous quarter.

### Financial results

| (EUR '000) | 2009A* | 2010A* | 2011B | 1H10** | 1H11** |
|---|---|---|---|---|---|
| **Standalone Income Statement** | | | | | |
| **Sales Revenues** | **53,330** | **62,058** | **80,600** | **30,151** | **39,685** |
| Other operating revenues | 1,557 | 733 | 1,509 | 1,040 | 5,697 |
| **Total Operating Revenues** | **54,887** | **62,790** | **82,109** | **31,191** | **45,382** |
| Total Operating Expenses | (52,422) | (61,731) | (78,715) | (29,655) | (44,711) |
| **Operating Profit** | **2,465** | **1,060** | **3,395** | **1,536** | **671** |
| *Operating margin* | *4.5%* | *1.7%* | *4.1%* | *4.9%* | *1.5%* |
| **EBITDA** | **5,489** | **4,257** | **6,481** | **3,128** | **2,105** |
| *EBITDA margin* | *10.0%* | *6.8%* | *7.9%* | *10.0%* | *4.6%* |
| Financial Profit/(Loss) | (1,803) | (780) | (540) | (825) | (42) |
| **Profit before Tax** | **662** | **280** | **2,855** | **712** | **629** |
| Income Tax | (48) | (142) | (588) | (129) | (87) |
| **Profit after Tax** | **614** | **138** | **2,267** | **583** | **542** |
| *Net margin* | *1.1%* | *0.2%* | *2.8%* | *1.9%* | *1.2%* |
| *Avg exchange rate (RON/EUR)* | *4.237* | *4.210* | *4.220* | *4.148* | *4.180* |

*Note: * RAS (audited), ** RAS (unaudited)*

Albalact achieved an impressive 31.6% year-on-year growth in its euro-denominated sales over the first six months of 2011, driven by increased sales by value across all product categories due to a strong marketing and distribution push. This performance contrasts with a depressed local consumer market, with overall Romanian food retail sales falling by 10% year-on-year in the first half of the year (according to the National Statistics Institute).

However, the first semester EBITDA fell from €3.1m in 2010 to €2.1m, due to higher raw milk prices (which started to increase in the second half of last year) and increased marketing and logistic expenses.

An improved financial result due to a stronger performance of the Leu resulted in the bottom line being almost unchanged at €542,000.

### Operations

In mid April 2011, Albalact launched a new range of yoghurts in order to become more active in a product category dominated by Danone. The new products were well received by the market and Albalact's yoghurt sales volumes have increased significantly in the months following the launch.

On 1 July, Albalact signed an agreement for the sale of its 1.6 ha non-core real estate in Alba Iulia for a total price of €1.6m. This follows the divestment of the Company's dairy farm to a Dutch company for €4.7m in March 2011. Sale proceeds from the two transactions were mainly used to finance the Company's working capital needs, but also to slightly reduce indebtedness.

### Prospects

Given the fall in EBITDA over the first semester, Albalact plans to be more focused on profitability in the second half on the year, and in particular is studying ways to reorganize its logistics in order to reduce costs.

## Top Factoring

### Background

Top Factoring ("Top Factoring" or the "Group") is a Romanian receivables collection company in which RC2 owns a 93% shareholding. The remaining 7% is owned by the Company's CEO. The debt purchase part of the business is now being undertaken by an SPV owned by RC2 (Glasro Holdings Ltd) which sub-contracts the debt collection process to Top Factoring. Top Factoring and Glasro Holdings Ltd are together referred to as the "Group".

### Group Financial results

| (EUR '000) | 2009A | 2010A | 2011B | 7M10 | 7M11 |
|---|---|---|---|---|---|
| **Combined Group Income Statement** | | | | | |
| **Total Operating Revenues** | **1,587** | **2,702** | **4,642** | **1,956** | **2,550** |
| Debt portfolios | 1,064 | 1,681 | 3,781 | 1,291 | 2,009 |
| Agency contracts | 523 | 1,021 | 861 | 665 | 541 |
| B2C | 370 | 928 | 861 | 576 | 541 |
| B2B | 153 | 93 | 0 | 89 | |
| **Total Operating Expenses** | **(1,490)** | **(2,320)** | **(3,799)** | **(1,345)** | **(2,159)** |
| Amortization of debt portfolios | (388) | (510) | (1,300) | (294) | (717) |
| Other operating expenses | (1,102) | (1,810) | (2,499) | (1,051) | (1,442) |
| **Operating Profit** | **97** | **381** | **844** | **611** | **392** |
| **EBITDA** | **132** | **435** | **910** | **640** | **423** |
| *EBITDA margin* | *8.3%* | *16.1%* | *19.6%* | *32.7%* | *16.6%* |
| Financial Profit/(Loss) | (5) | 13 | (25) | 2 | 0 |
| **Profit before Tax** | **92** | **394** | **819** | **613** | **392** |
| Income Tax | (0) | (2) | (80) | | (82) |
| **Profit after Tax** | **91** | **392** | **739** | **613** | **309** |
| *Net margin* | *5.8%* | *14.5%* | *15.9%* | *31.3%* | *12.1%* |
| *Avg exchange rate (RON/EUR)* | *4.237* | *4.210* | *4.220* | *4.164* | *4.188* |

*Note: IFRS (unaudited, combined accounts)*

The Group's seven month turnover increased by 30% year-on-year from €2.0m to €2.6m. However, Top Factoring's profitability was negatively affected by the start-up costs related to four receivable portfolios acquired between December 2010 and March 2011.

### Operations

During the first seven months of the year, collections from proprietary debt packages amounted to €2.0m, of which 86% was generated by the portfolios acquired in December 2010 and March 2011, respectively. As at end of July, the Group owned eight debt packages (seven telecoms and one banking) made up of 420,000 cases with a total nominal value of €106m.

The turnover generated by the B2C agency business line was €0.6m, almost unchanged on the previous year.

Currently, Top Factoring employs 160 people, of which 120 are collectors in the call centre and 14 are field collection agents. The field collection network covers almost half of the territory of

Romania and broadly reflects the geographic distribution of receivables purchased by the Group.

**Prospects**

The Group has participated in a number of auctions this year, and in July was awarded a telecom receivables package consisting of 90,000 cases with a face value of €21m. The Group hopes to start the collection process on this package at the end of August. Top Factoring remains an active player on the debt purchase market and is currently studying further acquisition opportunities, using both its own cash-flow and the bank financing it received in March.

## Mamaia Resort Hotels

**Background**

Mamaia Resort Hotels SRL (the "Company") is the owner and operator of the Golden Tulip Mamaia Hotel (the "Hotel"), which is located at Romania's premium seaside resort Mamaia, next to Constanta. In March 2008, RC2 acquired 63% of the Company, with the remaining 37% being owned by a Romanian entrepreneur.

**Financial results**

| *(EUR '000)* | 2009A* | 2010A* | 2011B | 7M10** | 7M11** |
|---|---|---|---|---|---|
| **Income Statement** | | | | | |
| **Sales Revenues** | **1,489** | **1,591** | **2,033** | **814** | **837** |
| Other operating revenues | 78 | 232 | 5 | 11 | 7 |
| **Total Operating Revenues** | **1,567** | **1,823** | **2,038** | **825** | **845** |
| Total Operating Expenses | (2,103) | (2,111) | (1,896) | (1,093) | (864) |
| **Operating Profit** | **(536)** | **(288)** | **142** | **(268)** | **(19)** |
| *Operating margin* | *neg.* | *neg.* | *7.0%* | *neg.* | *neg.* |
| **EBITDA** | **(306)** | **(61)** | **358** | **(145)** | **192** |
| *EBITDA margin* | *neg.* | *neg.* | *17.6%* | *neg.* | *22.7%* |
| Financial Profit/(Loss) | (62) | (135) | (83) | (51) | (126) |
| **Profit before Tax** | **(598)** | **(423)** | **59** | **(318)** | **(145)** |
| Income Tax | (2) | (5) | 0 | 0 | 0 |
| **Profit after Tax** | **(600)** | **(428)** | **59** | **(318)** | **(145)** |
| *Net margin* | neg. | neg. | 0 | neg. | neg. |
| *Avg exchange rate (RON/EUR)* | *4.237* | *4.210* | *4.220* | *4.164* | *4.188* |

*Note: * IFRS (audited), ** RAS (unaudited)*

Although the Romanian seaside's summer season was officially opened on the 1st May, the unusually bad weather in May and June badly affected seaside hotel operators. According to a public statement by the "Litoral" Association (a public-private partnership promoting Romanian seaside tourism), the revenues and occupancy rate of seaside hotels was down 40% year-on-year in May and June, and by 20% in July.

Against this backdrop, the Hotel achieved a commendable 2.4% year-on-year increase in revenues over the first 7 months of 2011. Furthermore, the cost-cutting measures implemented in the first quarter resulted in a 21% year-on-year fall in operating expenses, resulting in positive EBITDA of €0.2m, compared to a loss of €0.1m over January-July 2010. The performance was particularly good in July, with revenues increasing by 12% year-on-year, from €447,000 to €500,000, and EBITDA increasing by 77% from €154,000 to €272,000.

**Operations**

The occupancy rate was 18% over the first seven months of the year, below the 23% recorded over the same period last year due to the poor results of May and June. In July, the occupancy rate reached 70%, whilst the August rate is expected to reach 85%. The September rate is budgeted at 35%, with firm bookings received by the end of July already reaching 23%.

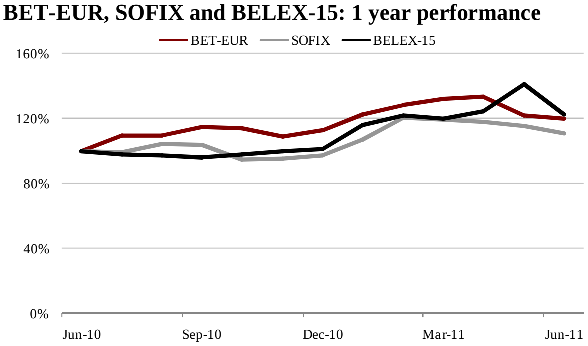
In spite of the fall in domestic demand, the Company managed to increase the average net tariff over the summer months by 20% year-on-year. This is a direct result of a better sales mix, with a higher number of "walk-in" clients, compared to bookings made through travel agencies. The Hotel has also promoted its services better internationally, with tourists from Germany, Russia and Poland at the Hotel over the summer.

**Prospects**

The Hotel has started gaining visibility on online booking platforms. Also, the sales team is directing its efforts towards designing new leisure packages and offers for the low season. The corporate events market continues to be significantly affected by the policy of large corporate clients to cut, or reduce their budgets for such events. The Hotel's management does not expect this market segment to improve in 2011 and is making efforts to replace it with other types of business.

## Capital Market Developments

**BET-EUR, SOFIX and BELEX-15: 1 year performance**




**Commentary**

Over the second quarter, the Romanian BET and Bulgarian SOFIX indices decreased by 9.5%and 7.1%, respectively, whilst the Serbian BELEX-15 index gained 2.3%, all in euro terms.

Over the last twelve months, the Romanian market (BET-EUR) increased by 19.7%, while the SOFIX and BELEX-15 indices rose by 10.9% and 22.6%, respectively. By comparison, over the same period, the MSCI Emerging Market index was up by 5.5%, the MSCI Emerging Market Eastern Europe index by 21.1%, whilst the FTSE100 and S&P indices increased by 9.7% and 8.2%, respectively.

# Macroeconomic Overview

## Overview

| | RO | as of: | BG | as of: | SRB | as of: |
|---|---|---|---|---|---|---|
| GDP Growth (y-o-y) | 1.6% | 6M11 | 3.4% | 3M11 | 3.4% | 3M11 |
| Inflation (y-o-y) | 4.9% | 7M11 | 4.8% | 6M11 | 12.7% | 6M11 |
| Ind. prod. growth (y-o-y) | 1.0% | Jun-11 | 2.2% | Jun-11 | 3.3% | Jun-11 |
| Trade balance (EUR bn) | -4.5 | 6M11 | -0.3 | 5M11 | 2.4 | 5M11 |
| *y-o-y* | *-7.0%* | | *-73.4%* | | *26.3%* | |
| FDI (EUR bn) | 1.0 | 6M11 | 0.0 | 5M11 | 0.5 | 5M11 |
| *y-o-y change* | *-17.3%* | | *n.a.* | | *24.7%* | |
| Total external debt/GDP | 75.9% | Jun-11 | 92.7% | May-11 | 68.2% | 5M11 |
| Reserves to short-term debt | 160.3% | Jun-11 | 115.1% | May-11 | 980.4% | Jun-11 |
| Loans-to-deposits | 122.6% | Jun-11 | 102.9% | Jun-11 | 114.9% | May-11 |
| Public sector debt-to-GDP | 37.0% | May-11 | 15.3% | May-11 | 39.6% | Jun-11 |

## Commentary

*Romania*

Romania's economic growth slowed down in the second quarter, recording a 0.2% quarter-on-quarter increase compared to 0.7% over the first quarter of the year. However, it grew by 1.6% year-on-year in the first half of 2011.The growth perspectives for the remainder of the year are good due to an excellent summer harvest. A joint IMF and EU mission visited Romania at the end of July to evaluate the evolution of the economy. They confirmed their confidence that the Romanian economy would grow by 1.5% year-on-year in 2011. On the other hand, they underlined the need for Romania to reform its remaining state-owned enterprises by either selling majority stakes or contracting private management.

Over the first six months of 2011, exports increased by 28% year-on-year, with imports increasing by 20%. Consequently, the January-June 2011 trade deficit recorded a 7% year-on-year fall. Helped by an improving trade balance and a 63.2% year-on-year increase in current transfers (from €1.0bn to €1.7bn), Romania's January-June 2011 current account deficit was down 28.6% year-on-year, from €3.6bn to €2.6bn, or 2% of GDP. FDI flows were €1bn (down 17.3% year-on-year), and covered 39% of the current account deficit.

Romania's CPI was up 4.9% year-on-year in June 2011, down from the 8% recorded at the end of 2010, as the base effect of the 5% VAT increase of July 2010 faded away. The good 2011 harvest is likely to ease the pressure on the CPI rate, and the National Bank is predicting an inflation rate of 4.6% for 2011.

Over the first six months, the budget deficit came in at 2.1% of GDP, within the 4.4% 2011 budget deficit approved by Parliament in late December 2010. Romania's total external debt position was €97.1bn at the end of June, or 76% of estimated GDP. Public debt stood at €48.7bn at the end of May, or 37% of GDP. Of the total public debt, 46% is RON-denominated and 44% is euro-denominated, with the balance of 10% being in other foreign currencies. The National Bank of Romania's foreign reserves (excluding gold) were €34.4bn at the end of June, or 1.6 times the short-term external debt level (€21.5bn). The good level of foreign reserves coupled with the €5bn precautionary agreement signed with the IMF and EU are strong tools to help cushion the threats from the current wave of the international debt crisis.

The Romanian leu inched up 1.2% against the euro in the first semester. Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to €50.5bn at the end of June, up 3.3% YTD. The Romanian banking system's total loans-to-deposits ratio was 123% at the end of June. Positively, the total loan stock increased by 2.9% month-on-month (and by 1.3% year-on-year) at the end of June, a sign of improved lending activity. Overdue loans accounted for 13.4% of the total loan stock at the end of June, an encouraging 1.5% monthly fall.

*Bulgaria*

Helped by an impressive 56% year-on-year growth in exports, Bulgaria's GDP increased by 3.4% year-on-year over the first quarter, and the IMF now sees 2011 overall growth coming in at 3%. However, with domestic consumption and investments still weak, the Bulgarian economy is reliant on exports to drive GDP growth this year. The relatively high unemployment rate (9.6% in June) is one of the main reasons domestic demand is still subdued.

Between January and May 2011, Bulgaria's current account balance was €0.4bn, or 1.1% of GDP, an improvement from a deficit of 2.3% over the same period of 2010. The trade balance moved from a deficit of €1.2bn over January-May 2010, to a deficit of €319m over the first five months of this year, mainly driven by the strong growth in exports. Unfortunately, FDI was a negative inflow of €30m over the period, due to the servicing of intercompany loans.

Bulgaria's CPI was up 4.8% year-on-year in June 2011, compared to 4.5% at the end of 2010. The increase was generated by higher food prices (+9.7% year-on-year), which should subdue over the second half of the year.

Between January and June 2011, Bulgaria's budget deficit came in at just 0.9% of GDP, a 57% year-on-year fall due to increased tax revenues and flat expenditures. However, the local and presidential elections scheduled for this autumn are likely to increase budgetary expenses, putting pressure on the deficit. For 2011, the Bulgarian authorities are projecting a deficit of 2.5% of GDP. The currency board regime remains in place as one of the pillars that has helped the Bulgarian economy withstand the challenges of the international economic crisis.

Bulgaria's external debt stood at €36.1bn at the end of May, or 92.7% of GDP, of which only 8% was attributable to the public sector. Both public and private debt has fallen since the end of 2010, by 3.4% and 1.5%, respectively. The country's reserves-to-short-term-debt ratio was 115.1% at the end of May.

The Bulgarian banking system had a total loans-to-deposit ratio of 103% at the end of June 2011. Whilst loans to non-financial institutions were flat at €26bn compared to the end of last year, the deposit base increased by 4.5% from €24bn to €25.3bn. Overdue loans accounted for 20.5% of total loans at the end of June 2011, up from 12% at the end of 2010.

*Serbia*

According to the National Bank of Serbia (NBS), real GDP grew by 3.4% y-o-y over the first quarter of 2011, outperforming the average growth rate in the CEE region (+2.7% y-o-y). Increases in transport (+9.8% y-o-y), electricity and gas supplies (+7.5% y-o-y) and manufacturing (+6.2% y-o-y) were the main drivers. On the other hand, despite a new state subsidy for affordable residential projects, the construction sector experienced a strong fall (-2.9% y-o-y), driven by low demand. The NBS forecasts GDP to slow down to 3.3% y-o-y in the second quarter of 2011, mainly due to the contraction of the construction industry, the temporary closure of U.S. Steel's factory in early May, and the closure for repairs of the Fiat factory.

In June, annual consumer price inflation came in at 12.7%, largely above the NBS targeted range (5.3% ± 1.8%), mainly driven by price increases in food and beverages (+17.8% y-o-y) and alcoholic beverages and tobacco (+19.0% y-o-y). Over the first half of 2011, the CPI rose by 6.8% year-to-date.

Between January and May 2011, foreign trade volumes increased by 22.5% y-o-y to €9.1bn. Exports grew by 23.3%, while imports grew 18.9%. Consequently, the trade deficit increased to €2.4bn (+14.2% y-o-y).

Due to the expected deflationary effect of a good harvest, the NBS has decided to cut its key interest rate by 50 bps, from 12.5% to 12%. The NBS has also announced that further relaxation of inflationary pressures is expected in the forthcoming period, provided that wage and fiscal policies remain prudent.

The Serbian dinar remained volatile over the second quarter, reflecting nervousness in financial markets. Overall, it appreciated by 1.1% against the euro. However, the NBS expects renewed volatility and a slight depreciation of the dinar over the short term, following the fears of contagion from the worsening euro zone crisis.

The extradition of Ratko Mladic to the International Criminal Tribunal for former Yugoslavia (ICTY) in the Hague in May and of Goran Hadzic in June is a strong boost for Serbia's EU accession prospects. However, even if it is invited to be a candidate in 2011 and to start negotiations in 2012, Serbia still faces a long route towards eventual accession.

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