Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

30 September 2018

New Europe Capital SRL
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Statistics

NAV per share (€)	0.2335
Total NAV (€ m)	33.7
Share price (€)	0.1900
Mk Cap (€ m)	27.4
# of shares (m)	144.3
NAV/share since inception†	-51.96%
12-month NAV/share perfomance	-7.02%

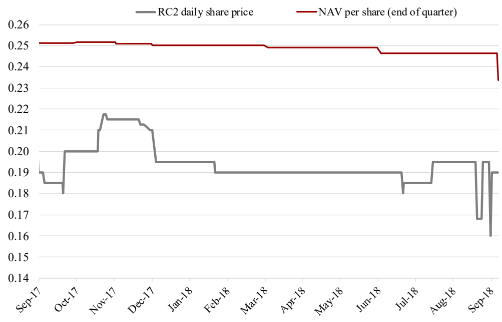
† assumes pro-rata participation in the 2008 share buy-back and the 2017 return of capital

RC2 Quarterly NAV returns

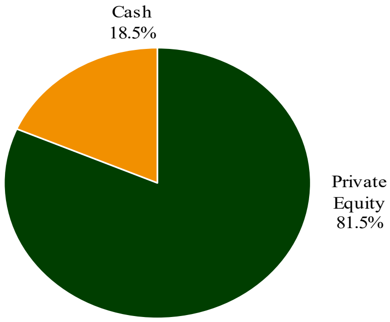
	2015	2016	2017	2018
1Q	-1.11%	8.62%	-29.08%*	-0.51%
2Q	3.68%	3.79%	-1.55%	-1.11%
3Q	2.67%	-0.33%	-1.99%	-5.20%
4Q	-5.90%	-12.57%	-0.32%	
YTD	-0.94%	-1.75%	-31.79%	-6.73%

** € 17m returned to shareholders in 1Q 2017*

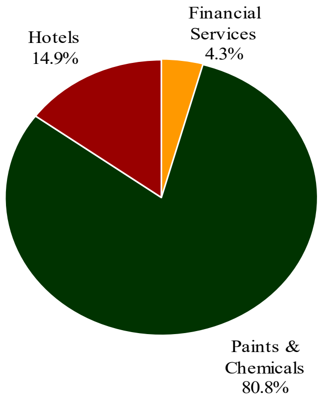
Share price / NAV per share (€)



Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Message from the Adviser

Dear Shareholders

During the third quarter, RC2's total NAV fell by € 2.0m, and its NAV per share fell by 5.2% from € 0.2463 to € 0.2335, the effect of a € 1.8m write down of RC2's investment in Telecredit prompted by a recent regulatory change (please see below) which will have a significant effect on Telecredit's business model from January 2019. RC2's 80% shareholding is now valued at € 0.89m, which reflects its share of Telecredit's most recent net book value. Over the quarter, RC2 bought back for cancellation 0.64m of its own shares for a total consideration of € 0.18m.

In May, Policolor and the buyers of its main site in Bucharest agreed to bring forward the sale of 4.4 out of its remaining 7.6 hectares from 2019 to 2018. The land being sold in 2018 has been divided into three plots, with the first plot having been sold in May, generating cash proceeds of € 1.4m. A second plot was sold in July, generating proceeds of € 1.5m, and a further 2.2ha was sold in October, generating cash proceeds of € 3m. Policolor is planning to distribute dividends of € 0.72m out of the cash proceeds from the land sale by the end of October (of which RC2's share would be € 0.29m), whilst another € 2.3m (of which RC2's share would be € 0.92m) are envisaged for distribution in the first half of 2019 following the completion of an interim audit, subject to bank approval. Meanwhile, the Policolor Group's nine-month operating revenues were 3.5% above the same period last year, whilst the Group's recurring EBITDA fell by 7.7%.

Mamaia Resort Hotels achieved a good occupancy rate of 77.5% in the third quarter, compared to a budgeted 74.7%. However, its EBITDA was 23.6% below budget at € 0.67m, mainly due to lower than expected sales in May and July, and increased salary expenses prompted by difficulties in finding suitable personnel due to the shortage of labour faced by the overall Romanian economy, and in particular the highly seasonal Romanian seaside tourism industry.

Telecredit granted 18,400 loans over the first nine months of 2018, a 27% year-on-year fall due to higher competition from other lenders, and an improving economy resulting in lower demand for the types of loans which Telecredit provides. Furthermore, in October, the National Bank of Romania announced new prudential regulations due to come into effect on 1 January 2019 which will cap Romanian individuals' debt service level at 40% of their incomes. The new regulation will have a serious impact on Telecredit's business model, as many of its existing clients already have a debt service level in excess of 40%. For the above reasons, the Board of RC2 has decided to write down the value of this investment to € 0.89m, with immediate effect.

At the end of the quarter, the Fund had cash and cash equivalents of approximately € 6.7m and short-term liabilities of € 2.5m, of which € 2.1m are due for the acquisition of shares in Reconstruction Capital Plc and The Romanian Investment Fund.

Yours truly,

New Europe Capital

Policolor Group

Background

RC2 has a 40.0% shareholding in Policolor, the parent company of the Policolor Group ("Policolor" or the "Group"), which operates along the following business lines: coatings (architectural, automotive and industrial), resins and specialty chemicals. The Romanian company Policolor SA and its 100%-owned Bulgarian subsidiary Orgachim AD produce and sell coatings, primarily in Romania and Bulgaria. The Group also includes Orgachim Resins, a producer of resins, and Ruse Chemicals, a producer of anhydrides, both being located in Bulgaria. All the Group companies are unlisted.

Group Financial results and operations

(EUR '000)	2016*	2017**	2018B	9M 2017**	9M 2018**	9M 2018B
Group Consolidated Income statement						
Sales revenues	**58,722**	**64,992**	**72,254**	**51,355**	**53,179**	**58,867**
sales growth year-on-year	*3.1%*	*10.7%*	*11.2%*	*7.3%*	*3.6%*	*14.6%*
Other operating revenues	160	209		122	115	270
Total operating revenues	**58,882**	**65,201**	**72,254**	**51,477**	**53,294**	**59,137**
Gross margin	20,577	22,031	23,711	18,105	17,076	19,761
Gross margin %	*34.9%*	*33.8%*	*32.8%*	*35.2%*	*32.0%*	*33.4%*
Total operating expenses	**(60,923)**	**(65,492)**	**(70,308)**	**(49,871)**	**(51,524)**	**(55,700)**
Operating profit	**(2,041)**	**(291)**	**1,946**	**1,607**	**1,769**	**3,437**
Operating margin	*-3.5%*	*-0.4%*	*2.7%*	*3.1%*	*3.3%*	*5.8%*
EBITDA	**1,219**	**2,815**	**4,745**	**3,988**	**3,681**	**5,300**
EBITDA margin	*2.1%*	*4.3%*	*6.6%*	*7.7%*	*6.9%*	*9.0%*
Net extraordinary result - land sale	(668)	4,689	(424)	4,401	1,652	(366)
Orgachim squeeze out revenues		555		555		
Financial Profit/(Loss)	(1,023)	(1,825)	(1,077)	(1,660)	(276)	(672)
Profit before tax	**(3,732)**	**3,128**	**445**	**4,902**	**3,145**	**2,399**
Income tax	(279)	(719)	(217)	(494)	(334)	-
Profit after tax	**(4,011)**	**2,409**	**228**	**4,409**	**2,811**	**2,399**
avg exchange rate (RON/EUR)	*4.49*	*4.57*	*4.65*	*4.55*	*4.65*	*4.65*

*Note: * IFRS audited, ** IFRS unaudited*

The Group generated consolidated operating revenues of € 53.3m in the first nine months of 2018, 3.5% above the same period last year but 9.9% below budget, reflecting a good performance by the resins and anhydrides divisions, and lower than expected sales of paints and coatings. The gross margin decreased from 35.2% in the first nine months of 2017 to 32%, compared to a budgeted margin of 33.4%, mainly due to increased raw materials costs. The Group generated recurring EBITDA (net of revenues and expenses allocated to the sale of real estate) of approximately € 3.7m, 7.7% below the same period last year and significantly below the budget.

In May, Policolor and the buyers of its main site in Bucharest agreed to bring forward the sale of 4.4 of its remaining 7.6 hectares of land from 2019 to 2018. The 4.4 hectares being sold in 2018 has been divided into three plots, with the first plot having been sold in May, generating cash proceeds of € 1.4m. A second plot was sold in July, generating proceeds of € 1.5m, and a further 2.2 hectares was sold in October, generating cash proceeds of € 3m. The remaining 3.2 hectares is due to be sold, as initially agreed with the buyers, in mid-2019.

The construction of Policolor's new Bucharest factory and warehouse is progressing according to plan and is on track to be operational in 2019.

Prospects

Due to the earlier than expected land sale proceeds, Policolor plans to distribute € 0.72m to its shareholders by the end of October (of which RC2's share would be € 0.29m), in addition to the € 0.25m already distributed during the previous quarter, and is aiming to make a further € 2.3m distribution (of which RC2's share would be € 0.92m), following the completion of an interim audit in the spring of 2019 and subject to bank approval.

Mamaia Resort Hotels

Background

Mamaia Resort Hotels SRL (the "Company") is the owner and operator of the ZENITH – Conference & Spa Hotel (the "Hotel"), located in Mamaia, Romania's premium seaside resort next to the city of Constanta. RC2 owns 63% of the Company, with the remaining 37% being owned by a Romanian private individual.

Financial results and operations

(EUR '000)	2016*	2017*	2018B	9M 2017**	9M 2018**	9M 2018B
Income Statement						
Total Operating Revenues	**2,337**	**2,562**	**2,759**	**2,330**	**2,458**	**2,588**
Total Operating Expenses	(2,200)	(2,740)	(2,222)	(1,835)	(1,902)	(1,837)
Operating Profit	**137**	**(178)**	**537**	**495**	**556**	**752**
Operating margin	*5.9%*	*neg.*	*19.5%*	*21.3%*	*22.6%*	*29.0%*
EBITDA	**353**	**472**	**710**	**624**	**673**	**881**
EBITDA margin	*15.1%*	*18.4%*	*25.7%*	*26.8%*	*27.4%*	*34.1%*
Profit after Tax	**40**	**(284)**	**364**	**438**	**500**	**597**
Net margin	*1.7%*	*neg.*	*13.2%*	*18.8%*	*20.3%*	*23.1%*
Avg exchange rate (RON/EUR)	*4.49*	*4.57*	*4.65*	*4.55*	*4.65*	*4.65*

*Note: *RAS (audited), **RAS (management accounts)*

The Hotel generated operating revenues of € 2.5m over the first nine months of 2018, up 5.5% year-on-year, but 5% below budget, mainly due to poor results in May and July which were affected by bad weather. The August and September revenues were above budget, but not enough to make up the loss generated by the underperformance over the prior months. Overall, the occupancy rate over January to September 2018 was 36.8%, which is better than the 35.4% achieved over the same period last year, whilst the average net tariff per room also increased, from (€ 44 achieved over the first nine months of 2017 to € 48 over the same period of the current year).

Accommodation revenues amounted to € 1.3m, up 10.5% year-on-year but slightly (-1.7%) below budget. Food & beverage revenues accounted for 41% of overall operating revenues, and were virtually unchanged compared to the same period of 2017.

The nine-month EBITDA of € 0.67m was well below the budgeted € 0.88m, but slightly better than the € 0.62m achieved over the same period last year. The main reasons for the underachievement in the operating profit compared to budget are the lower than expected sales in May and July, coupled with increased staff related expenses. The latter reflects labour shortages, with the Romanian seaside hospitality industry facing severe difficulties in finding suitable personnel.

The Company has contracted a € 1m new investment loan, which will add to its current € 0.5m of bank debt. The new loan, which is repayable over eight years, will be used for a general upgrade of the Hotel, including renovating the facades, the public areas and some of the bedrooms.

Telecredit

telecredit
Imprumutul la nevoie se cunoaste

Background

RC2's wholly-owned subsidiary Glasro Holdings Ltd owns an 80% shareholding in Telecredit IFN S.A. ("Telecredit" or the "Company"), a Romanian Non-Banking Financial Institution ("IFN") that provides consumer loans to individuals. The balance of 20% is owned by RC2's former partner in Top Factoring and his family.

Financial Results and operations

EUR'000	2016*	2017*	2018B	9M 2017**	9M 2018**	9M 2018B
Income Statement						
Total interest revenues:	**1,020**	**1,617**	**1,785**	**1,170**	**1,345**	**1,344**
"regular" interest	814	1,219	1,137	930	846	856
penalty interest	175	397	648	239	500	488
fixed fees	31	0		0	0	
Total net operating expenses	**(800)**	**(1,450)**	**(1,475)**	**(1,038)**	**(1,273)**	**(1,111)**
Operating profit (before depreciation)	**220**	**167**	**311**	**132**	**72**	**233**
Depreciation	(9)	(19)	(24)	(14)	(17)	(18)
Operating profit (after depreciation)	**211**	**148**	**286**	**118**	**55**	**215**
Operating profit (after depreciation) margin	*20.6%*	*9.2%*	*16.0%*	*10.1%*	*4.1%*	*16.0%*
Financial result	(4)	(1)		(2)	(1)	
Profit before tax	207	148		116	54	
Profit after tax	**175**	**122**		**92**	**35**	
net margin	*17.2%*	*7.6%*		*7.9%*	*2.6%*	
Net Operating Cash Flow	(155)	98	(23)	63	41	2
Avg exchange rate (RON/EUR)	*4.49*	*4.57*	*4.65*	*4.55*	*4.65*	*4.65*

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

Telecredit's interest revenues amounted to € 1.3m over the first nine months of 2018, during which the Company granted 18,400 loans amounting to € 3.3m.

Overall, Telecredit experienced a fall in the number of credit requests compared to the prior year, with the monthly average number of credit requests amounting to 4,300 over the first nine months of 2018, compared to a monthly average of 6,300 over the same period last year. The fall is most likely explained by the wage increases promoted by the Romanian government over the past year coupled with greater competition on the lending market, not only from other IFN's, but also from commercial banks which are increasingly offering their customers quicker and easier access to loans.

After depreciation, Telecredit made an operating profit of € 55,000 over the first nine months of 2018, half of last year's operating result and also significantly lower than the budgeted profit of € 215,000. Whilst interest revenues were on budget at € 1.35m over the first nine months in spite of the lower volumes of loans granted, the underperformance in the operating profit compared to budget was due to higher than expected provisions for unpaid penalty interest. The year-on-year increase in provisions is due to the Company's decision to sell less NPL's, prompted by changes in the Romanian tax regime which limit the tax deductibility of such sales.

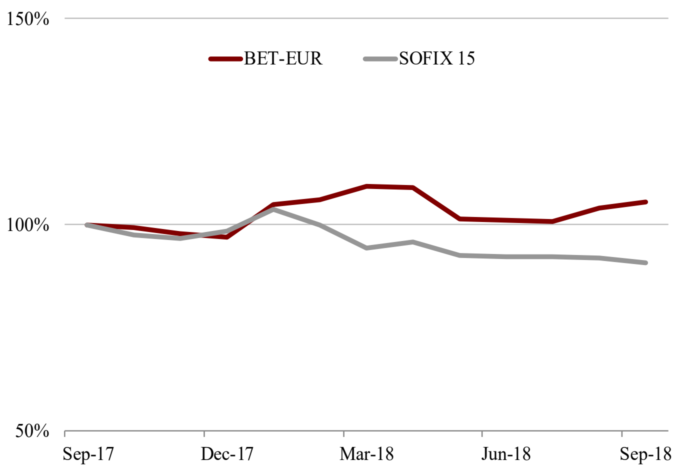
Prospects

In mid-October, the National Bank of Romania ("NBR") decided to cap at 40 % the indebtedness level (debt service-to-income) for RON-denominated loans to individuals, effective 1 January 2019, due to prudential reasons. This restrictive measure, which does not apply to rollovers and may allow up to 15% of a lender's portfolio to be exempted subject to certain conditions still to be published by the NBR, will still greatly impact Telecredit's business model. Telecredit's management have estimated that, once the 40% cap is in place, the volume of loans it grants as well as the average value of its loans would fall significantly, affecting its business since many of its customers have much higher debt service-to-income ratios.

Telecredit has started to adapt its business to the new regulations, and is studying the possibility of launching new lending products which would not be affected by them, However, given the negative impact of the new rules on Telecredit's existing business model, the Board of RC2 has decided to write down its 80% shareholding in Telecredit from € 2.66m to € 0.89m, the latter being RC2's share of the book value of Telecredit at the end of August.

Capital Market Developments

BET-EUR and SOFIX-15: 1 year performance



Commentary

During the third quarter of 2018, the Romanian BET index gained 4.2%, whilst the Bulgarian SOFIX 15 index lost 1.6%, both in euro terms. Over the same quarter, the MSCI Emerging Market Eastern Europe and S&P indices were up by 5.5% and 7.8%, respectively, whilst the MSCI Emerging Market and FTSE100 were down by 1.5% and 2.3%, respectively, all in euro terms.

Over the first three quarters of 2018, the BET-EUR index gained 5.5% while the SOFIX 15 index fell by 9.3%, both in euro terms. By comparison, the MSCI Emerging Market Eastern Europe, the FTSE100 and the S&P indices gained 5.1%, 0.8%, and 17.5%, respectively, whilst the MSCI Emerging Market lost 1.5%, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:
GDP Growth (y-o-y)	4.2%	6M18	3.4%	6M18
Inflation (y-o-y)	5.0%	Sep-18	3.6%	Sep-18
Ind. prod. growth (y-o-y)	3.6%	Aug-18	2.3%	Aug-18
Trade balance (EUR bn)	-9.0	8M18	-1.9	8M18
y-o-y	*14.0%*		*474.1%*	
FDI (EUR bn)	2.9	8M18	0.2	8M18
y-o-y change	*-3.1%*		*-71.6%*	
Budget balance/GDP	-1.8%	9M18	2.3%	8M18
Total external debt/GDP	49.3%	Aug-18	64.0%	Aug-18
Public sector debt/GDP	34.9%	Jul-18	22.6%	Aug-18
Loans-to-deposits	78.7%	Sep-18	73.3%	Sep-18

Commentary

Romania

Romania's GDP grew by 4.2% year-on-year during the first semester of 2018. With unemployment at a historical low (the unemployment rate was 4.1% at the end of June, the lowest level of the past ten years) and the government promoting increases in pensions, public wages and the minimum wage, the average gross salary was 37% higher year-on-year at the end of June, increasing Romanians' disposable income. Consequently, private consumption was the main GDP growth driver, having increased by 5.4% year-on-year over the first semester, while investment (gross fixed capital formation) fell by 0.6%. Agriculture and industry, which increased by 6.7% and 4.4% year-on-year, respectively, over the first half of 2018, also made a positive contribution, whilst construction activity fell by 0.5%. Although private consumption is still the main growth driver, its growth dynamic has slowed down, having increased by 3.3% in the second quarter, down from a 5.9% year-on-year increase in the first quarter.

Romania's inflation rate reached 5% in September, up from 3.3% in December 2017, but below the 5.4% registered at the end of the first quarter of 2018. According to its latest estimate, the NBR forecasts the inflation rate to decrease to 3.5% at the end of December 2018 as the base effect of the price increases of the last quarter of 2017 due to mounting energy and oil prices is expected to dissipate. The decreasing rate of growth of domestic demand is also expected to contribute to the lower increase in consumer prices.

The Romanian leu fell by 0.06% against the euro over the second quarter, bringing the total year-to-date fall to 0.09%.

The budget deficit was € 3.6bn over the first nine months of 2018, or -1.8% of GDP, worse than the January-September 2017 deficit of -0.8%. Budgetary receipts increased from € 39.7bn to € 44.1bn (+13.6% year-on-year in RON terms), triggered by higher social contributions which increased by 37.3%, whilst receipts from corporate profit taxes grew by only 3.0% year-on-year. On the other hand, total budgetary expenses increased by 18.4% year-on-year in RON terms, from € 41.2bn to € 47.7bn, with personnel and social expenditures, which accounted for 63% of total expenses, increasing by 18% due to wage increases for public sector workers as well as an overall increase in pensions implemented in July. Public investment amounted to only € 2.4bn, or 1.2% of GDP.

The trade gap continued to widen, having increased by 14% year-on-year during the first eight months of 2018 (from € -7.9bn to € -9.0bn), with imports growing by 10.4% while exports increased by 9.7%. The negative evolution of the trade balance led to a € -5.8bn current account deficit, which is the equivalent of 2.9% of GDP and compares unfavourably to a € -4.2bn deficit over the same period of 2017. FDI flows amounted to € 2.9bn, down from € 3.0bn over the same period last year. Romania's total external debt amounted to € 98bn at the end of August, which represents a 0.7% year-to-date increase and amounts to approximately 49% of Romania's 2018 estimated GDP of € 199bn. Total public debt was € 65.7bn, or 34.9% of GDP, at the end of July, up 1.6% in nominal RON terms.

Total domestic non-governmental credit (which excludes loans to financial institutions) was € 53.3bn at the end of September, up 3.9% year-to-date in RON terms. Household loans reached € 28.2bn at the end of September, having increased by 7.8% year-to-date, and accounted for 52.4% of the total loans outstanding. Consumer and housing loans increased by 7.3% and 8.3% year-to-date, respectively. In terms of quarterly dynamics, the growth pace has slowed down as consumer and housing loans increased by 2% and 2.6%, respectively in the third quarter, compared to increases of 2.1% and 3.2%, respectively in the second quarter. Corporate loans increased by 5.6% year-to-date and accounted for 45% of the total loan stock. The overall deposit base has increased by 3.9% in RON terms since the end of December, and amounted to € 67.7bn at the end of September. The NPL ratio has continued to fall, reaching 5.5% at the end of August 2018, down from 6.4% at the end of 2017.

Bulgaria

Bulgaria's second quarter GDP grew by 3.4% year-on-year, helped by private consumption which increased by 8%, driven by improved employment rates, increased wages and growing consumer loans. At the end of June, the unemployment rate was 5.6%, which is one of the lowest levels of the past ten years. The average monthly wage at the end of June was up 9% year-on-year. Real estate had the biggest contribution to GDP growth having increased by 7.2% year-on-year in the second quarter. Overall, GDP grew by 3.4% year-on-year during the first six months of 2018.

Bulgaria's inflation rate suffered a slight increase over the third quarter, reaching 3.6% in September, compared to an inflation rate of 3.2% recorded in June.

Over the first eight months of 2018, Bulgaria achieved a budget surplus of € 1.2bn, or 2.3% of GDP, close to the € 1.1bn surplus recorded over the same period of the prior year. Tax proceeds, including revenues from social security contributions, increased by 11.6% year-on-year, whilst total budgetary expenses increased by 11.3%. Public investment grew by 54% year-on-year and amounted to 1.8% of GDP over the period. The Bulgarian government now expects a full year 2018 public sector budget surplus of 0.5% of GDP, compared to an initially budgeted target of -1% of GDP. Bulgaria's public sector debt fell by 4.7% year-to-date, from € 12.7bn to € 12.1bn, and amounted to 22.6% of GDP at the end of August, down from 24.9% at the end of December 2017. Gross external debt amounted to 64% of GDP at the end of August, or € 33.8bn, having increased from € 33.4bn at the end of 2017, as private sector debt increased by 2.1% while public sector debt fell by 2.5%, both year-to-date.

Bulgaria's trade deficit over the first eight months of 2018 of € -1.9bn is considerably worse than the € -0.33bn deficit recorded over the same period in 2017. Exports fell by 0.9% (from € 17.6bn to € 17.4bn), due to lower demand from Turkey, one of Bulgaria's most important foreign trade partners. Exports to this market fell by 26.3% year-on-year, from € 1.6bn to € 1.2bn, while overall imports increased by 8.1% year-on-year, from € 17.9bn to € 19.3bn. The trade deficit was compensated by a € 1.3bn surplus from primary and secondary incomes and a € 2.6bn surplus from services, resulting in a positive current account balance of € 1.8bn over the first eight months of the year, which was still short of the € 3.0bn surplus recorded over the same period of 2017. FDI inflows amounted to € 0.2bn, 71.6% lower than the same period of 2017, as equity investments fell by € 0.19bn and intra-group loans decreased by € 0.4bn.

Total domestic non-governmental credit (which excludes loans to financial institutions) increased from € 25.9bn to € 27.6bn over the first nine months of 2018, as corporate and household loans increased by 5% and 9.1%, respectively. Whilst housing loans increased by 8.2% year-on-year, consumer loans grew at a much higher rate of 15.3%. The deposit base was € 37.7bn at the end of September, up 5.4% year-to-date.

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