Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

31 December 2018

neweuropecapital

New Europe Capital SRL
Str. Tudor Arghezi nr.21, et.6
Bucuresti - Sector 2
Tel +40 21 316 7680
bucharest@neweuropecapital.com

Statistics

NAV per share (€)	0.2238
Total NAV (€ m)	31.4
Share price (€)	0.1775
Mk Cap (€ m)	24.9
# of shares (m)	140.3
NAV/share since inception†	-52.98%
12-month NAV/share perfomance	-10.61%

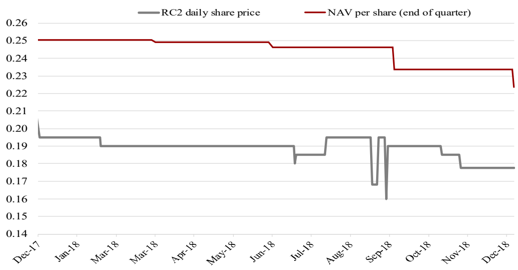
† assumes pro-rata participation in the 2008 share buy-back and the 2017 return of capital

RC2 Quarterly NAV returns

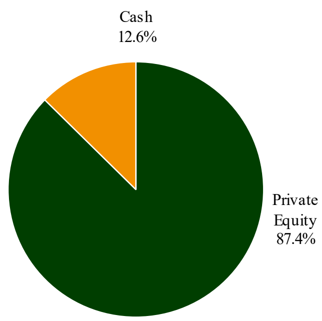
	2015	2016	2017	2018
1Q	-1.11%	8.62%	-29.08%*	-0.51%
2Q	3.68%	3.79%	-1.55%	-1.11%
3Q	2.67%	-0.33%	-1.99%	-5.20%
4Q	-5.90%	-12.57%	-0.32%	-4.17%
YTD	-0.94%	-1.75%	-31.79%	-10.61%

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

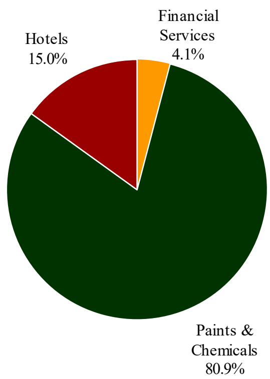
Share price / NAV per share (€)



Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Message from the Adviser

Dear Shareholders

During the fourth quarter, RC2's total NAV fell by € 2.3m, and its NAV per share fell by 4.17% from € 0.2335 to € 0.2238, mainly the effect of the annual independent valuations of RC2's shareholdings. The annual valuation exercise resulted in the following changes to the valuations of RC2's private equity positions:

	Prior valuations €	Revised valuations €
Policolor SA	20,500,053	18,320,000
Mamaia Resort Hotels SRL	4,404,658	4,228,219
Telecredit IFN SA	889,398	849,514
Total	**25,794,109**	**23,397,733**

Over the quarter, RC2 bought back for cancellation 3.97m of its own shares for a total consideration of € 0.66m. It also purchased 1.1% of the share capital of the Romanian Investment Fund Ltd. ("RIF") for a total consideration of € 0.13m, bringing its total shareholding in RIF to 11.3%, and 1.1% of the share capital of Reconstruction Capital Plc ("RC") for € 0.08m, bringing its total shareholding in RC to 23.3%. Shares in Policolor represent the bulk of the underlying assets of both these investment companies, and RC2's holdings in them have been valued based on their respective NAVs per share, which in turn reflect the same valuation of their underlying investment in Policolor as is being used by RC2.

The Policolor Group generated consolidated operating revenues of € 64.2m in 2018, 1.5% below 2017 and 11.2% below budget, reflecting a good performance by the resins and anhydrides divisions, but disappointing sales of paints and coatings. The poor performance of the coatings divisions is mainly due to unseasonally bad weather in March and July (two very important months for the year), and the interruption of a state-sponsored building thermal rehabilitation programme in Bulgaria, which had driven strong sales of construction materials in that country. In October 2018, Policolor sold another plot of land which was originally scheduled to be sold in 2019, thereby bringing forward by almost a year proceeds of € 3.1m, with the remaining balance of € 4.2m being due over the summer of 2019. The land sale helped generate an overall group net profit of € 1.8m in 2018.

Whilst Mamaia Resort Hotels' operating revenues of € 2.57m were virtually unchanged year-on-year, EBITDA of € 0.3m was significantly below both the 2017 result and the 2018 budget, mainly due to higher staff costs which reflects general labour shortages in Romania and strong wage growth. In 2018, the Hotel arranged a loan to finance a € 1m investment plan, aimed at upgrading the Hotel's beach-facing "Junona" wing bedrooms, the Hotel's facades, its public areas (including the lobby, restaurants and bar) and the kitchen. Renovations started at the end of 2018, with the aim of completing the "Junona" wing bedrooms, the restaurant terrace and the kitchen by mid-April, prior to the start of the 2019 season. The rest of the upgrade to the Hotel is due to take place after the end of the 2019 summer season.

In October 2018, the National Bank of Romania decided to cap the indebtedness level (debt service-to-income) for RON-denominated loans to individuals at 40%, effective 1 January 2019. Due to the above threat to Telecredit's business model, Telecredit has decided to re-direct the focus of its operations towards SME financing services, in particular factoring. Accordingly, in early 2019 it recruited a new CEO with extensive experience in factoring services, and is planning to launch these new services during the second quarter.

At the end of December, the Fund had cash and cash equivalents of approximately € 4m, and short-term liabilities of € 0.7m.

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	2018A	2019B
Group Consolidated Income statement					
Sales revenues	**58,722**	**65,176**	**72,254**	**64,193**	**69,751**
sales growth year-on-year	*3.1%*	*11.0%*	*10.9%*	*-1.5%*	*8.7%*
Other operating revenues	160	764		144	87
Total operating revenues	**58,882**	**65,940**	**72,254**	**64,337**	**69,838**
Gross margin	20,577	21,825	23,711	21,055	23,409
Gross margin %	*34.9%*	*33.1%*	*32.8%*	*32.7%*	*33.5%*
Other operating expenses	(22,618)	(21,787)	(21,765)	(21,480)	(22,339)
Operating profit	**(2,041)**	**37**	**1,946**	**(425)**	**1,069**
Operating margin	*-3.5%*	*0.1%*	*2.7%*	*-0.7%*	*1.5%*
EBITDA	**1,219**	**3,161**	**4,745**	**2,598**	**3,854**
EBITDA margin	*2.1%*	*4.3%*	*6.6%*	*4.0%*	*5.5%*
Net extraordinary result - land sale	(668)	816	(424)	3,509	1,861
Nonrecurring items including relocation		555		2	
Financial Profit/(Loss)	(1,023)	(942)	(1,077)	(357)	(246)
Profit before tax	**(3,732)**	**466**	**445**	**2,729**	**2,684**
Income tax	(279)	25	(217)	(884)	(1,269)
Profit after tax	**(4,011)**	**491**	**228**	**1,845**	**1,415**
avg exchange rate (RON/EUR)	*4.49*	*4.57*	*4.65*	*4.65*	*4.75*

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

The Policolor Group generated consolidated operating revenues of € 64.2m in 2018, 1.5% below 2017 and 11.2% below the 2018 budget, reflecting a good performance by the resins and anhydrides divisions but disappointing sales of paints and coatings, mainly due to unseasonally bad weather in March and July (two very important months for the year), and the interruption of a state-sponsored building thermal rehabilitation programme in Bulgaria, which had driven strong sales of construction materials in that country. Furthermore, the gross margin was just under a percentage point lower than the prior year, affected by a cyclical increase in raw material prices, while recurring EBITDA amounted to € 2.6m, 17.8% below 2017.

In October 2018, Policolor sold another plot of land which was originally scheduled to be sold in 2019, thereby bringing forward by almost a year proceeds of € 3.1m, with the remaining balance of € 4.2m due in the summer of 2019 when Policolor has to deliver its last remaining plot. The land sale helped generate an overall group net profit of € 1.8m in 2018.

Prospects

The Group's 2019 budget provides for consolidated sales of € 69.8m, up 8.7% year-on-year, driven by 10% overall sales growth at the paints and coatings divisions, resins sales estimated to grow by 7%, while the specialty chemicals division's sales are expected to grow by 9.8%. EBITDA is budgeted at € 3.9m, significantly above the 2018 result, mainly as a result of a significant improvement from the coatings and resins divisions.

Whilst the construction of Policolor's new Bucharest factory and warehouse is progressing according to plan, with both facilities being on track to start operating during the summer of 2019, any potential unexpected delays could have impact on the sales and profitability of the Group in 2019.

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	2018**	2019B
Income Statement					
Total Operating Revenues, of which:	**2,337**	**2,562**	**2,759**	**2,570**	**3,046**
Accommodation revenues	1,212	1,265	1,368	1,338	1,742
Food & beverage revenues	1,017	1,135	1,199	1,066	1,159
others	108	162	192	167	145
Total Operating Expenses	(2,200)	(2,740)	(2,222)	(2,406)	(2,602)
Operating Profit	**137**	**(178)**	**537**	**164**	**443**
Operating margin	*5.9%*	*neg.*	*19.5%*	*6.4%*	*14.6%*
EBITDA	**353**	**472**	**710**	**320**	**595**
EBITDA margin	*15.1%*	*18.4%*	*25.7%*	*12.4%*	*19.5%*
Profit after Tax	**40**	**(284)**	**364**	**54**	**299**
Net margin	*1.7%*	*neg.*	*13.2%*	*2.1%*	*9.8%*
Avg exchange rate (RON/EUR)	*4.49*	*4.57*	*4.65*	*4.65*	*4.75*

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

Whilst the Hotel's operating revenues of € 2.57m were virtually unchanged year-on-year, EBITDA of €0.3m is significantly below both the 2017 result and the 2018 budget, negatively influenced by higher staff costs, which increased from € 0.8m in 2017 to € 1m in 2018. This reflects general labour shortages, particularly acute at the seaside during the summer, compounded by the Romanian government's policy of increasing the minimum wage by over 40% in the past year to reach the equivalent of € 440 in January 2019.

In 2018, the Hotel arranged a loan to finance a € 1m investment plan, aimed at upgrading the Hotel's beach-facing "Junona" wing bedrooms, the Hotel's facades, its public areas (including the lobby, restaurants and bar,) and the kitchen. Renovations started at the end of 2018, with the aim of completing the "Junona" wing bedrooms, the restaurant terrace and the kitchen by mid-April, prior to the start of the 2019 season. The renovation of the facades, lobby, restaurants and bar is due to start in the autumn after the end of the summer season.

Prospects

Due to the improvements to the Hotel being made prior to the opening of the 2019 summer season, the 2019 budget envisages an increase in accommodation revenues from € 1.3m to € 1.7m, driven by both an increase in the average tariff per room and in the occupancy rate. The increase in net tariffs should also be helped by the VAT rate for tourism services which having been lowered from 9% to 5% in November.

Management aims to mitigate the increased competition from holiday lets by having a higher portion of revenues guaranteed by contracts with agencies, whilst still leaving enough available rooms for "walk-in" clients and online channels during the peak season when the demand and rates are higher. The budget also provides for an increase in food & beverage revenues to reach € 1.2m in 2019, resulting in overall budgeted EBITDA of approximately € 0.6m, or 86% higher year-on-year.

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	2018**	2019B
Income Statement					
Pay Day Loans					
Total interest revenues:	**1,020**	**1,617**	**1,785**	**1,791**	**1,137**
"regular" interest	814	1,219	1,137	1,124	659
penalty interest	175	397	648	667	477
fixed fees	31	0		0	
SMEs Lending					
Interest revenues					**274**
Total operating expenses:	**(800)**	**(1,450)**	**(1,475)**	**(1,719)**	**(863)**
Provisions	(58)	(159)	(234)	(564)	138
Other Operating expenses	(742)	(1,290)	(1,241)	(1,155)	(1,001)
Operating profit (before depreciation)	**220**	**167**	**311**	**73**	**547**
Depreciation	(9)	(19)	(24)	(23)	(48)
Operating profit (after depreciation)	**211**	**148**	**286**	**49**	**499**
Operating profit (after depreciation) margin	*20.6%*	*9.2%*	*16.0%*	*2.7%*	*35.4%*
Financial result	(4)	(1)		0	-
Profit before tax	207	148		49	
Profit after tax	**175**	**122**		**18**	**419**
net margin	*17.2%*	*7.6%*		*1.0%*	*29.7%*
Net Operating Cash Flow	**(155)**	**98**	**(23)**	**23**	**(120)**
Avg exchange rate (RON/EUR)	*4.49*	*4.57*	*4.65*	*4.65*	*4.75*

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

In spite of tougher conditions for pay day lenders due to improved macro conditions, wage increases and easier access to bank lending, Telecredit's 2018 performance was relatively close to budget.

The main difference comes from provision expenses, which amounted to € 0.56m compared to a budgeted € 0.23m, thereby wiping out most of Telecredit's profit for the year. However, the increase in provisions was driven by a change in the fiscal regime introduced in May 2018 which disallowed the tax deductibility of sales of NPLs. Due to this, Telecredit now retains ownership over its NPL's but generally outsources the collection process, creating a time lag until part of the NPL's are successfully collected. This explains both the higher provisions in 2018 and the projected reversal of provisions in 2019, resulting in net revenue from provisions of € 0.14m in that year.

Telecredit granted 23,900 loans during the year, compared to a budgeted 27,600, and 32,000 in 2017, whilst the average value per loan increased from € 150 to € 180. Of the 23,900 loans granted in 2018, 33% were rollovers, 52% were to recurring clients, and only 15% represented new clients. Overall, the value of loans granted fell from € 4.9m the prior year to € 4.3m.

Prospects

In October 2018, the National Bank of Romania decided to cap the indebtedness level (debt service-to-income) for RON-denominated loans to individuals at 40%, effective 1 January 2019, due to prudential reasons. The measure is expected to undermine Telecredit's business model, as the vast majority of its loans in 2018 were to clients with higher indebtedness ratios.

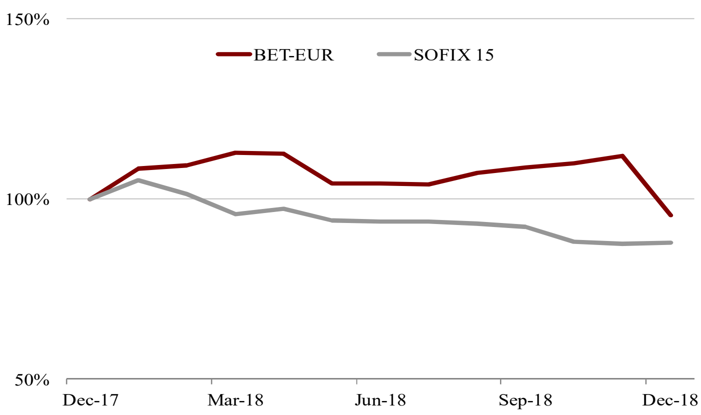
Due to the above threat to Telecredit's business model, Telecredit has decided to re-direct the focus of its operations towards SME financing services, in particular factoring. Accordingly, in early 2019 it recruited a new CEO with extensive experience in factoring services, having been involved in the establishment of a new factoring "fintech" business, and prior to that having headed up the factoring department of Romania's largest bank.

The new CEO has developed an ambitious business plan based on a shift to factoring, discounting and lending services for SMEs, whilst continuing with pay day loans to individuals, and also launching a new micro credit facility for individuals.

Telecredit's 2019 budget targets interest revenues of € 0.27m from SME financing operations, mainly factoring, and an overall operating profit after depreciation of € 0.5m.

Capital Market Developments

BET-EUR and SOFIX-15: 1 year performance



Commentary

During the fourth quarter of 2018, the Romanian BET index and the Bulgarian SOFIX 15 indices lost 12.2% and 4.8%, respectively, both in euro terms. Over the same quarter, the MSCI Emerging Market Eastern Europe, the MSCI Emerging Market, the FTSE100 and S&P indices were down by 6.1%, 6.5%, 11.2% and 12.8%, respectively, all in euro terms.

Over 2018, the BET-EUR and SOFIX 15 indices fell by 4.5% and 12.2%, respectively, both in euro terms. By comparison, the MSCI Emerging Market Eastern Europe, the MSCI Emerging Market, the FTSE100 and the S&P indices lost 3.6%, 12.5%, 13.4% and 1.6%, respectively, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:
GDP Growth (y-o-y)	4.1%	FY18	3.1%	FY18
Inflation (y-o-y)	3.3%	Dec-18	2.7%	Dec-18
Ind. prod. growth (y-o-y)	0.3%	Dec-18	-3.8%	Dec-18
Trade balance (EUR bn)	-15.1	FY18	-2.3	FY18
y-o-y	*16.8%*		*195.7%*	
FDI (EUR bn)	4.9	FY18	1.7	FY18
y-o-y change	*2.9%*		*-24.6%*	
Budget balance/GDP	-2.9%	FY18	0.1%	FY18
Total external debt/GDP	48.3%	Dec-18	59.3%	Dec-18
Public sector debt/GDP	35.1%	Dec-18	22.1%	Dec-18
Loans-to-deposits	76.2%	Dec-18	73.0%	Dec-18

Commentary

Romania

After the strong performance of 2017, when Romania's GDP increased by approximately 7%, GDP growth slowed down to a still strong 4.1% in 2018, driven by higher private consumption growth, which also grew at a slower pace than in 2017 (household consumption increased by 3.4% in 2018, compared to 10% in 2017). Agriculture and industry, which increased by 0.4% and 1% year-on-year, respectively, in 2018, also made a positive contribution, whilst construction activity fell by 0.3%. According to its latest forecast published in February, the EU Commission expects Romania's GDP growth to slow down further to 3.8% in 2019, reflecting a further slowdown in domestic demand growth.

Romania's inflation rate was 3.3% in December 2018, unchanged from December 2017. According to its latest estimate, the National Bank of Romania ("NBR") is forecasting the inflation rate to fall to 3% by December 2019.

The Romanian leu was virtually flat against the euro in the fourth quarter, and fell overall by 0.1% since the beginning of 2018.

Romania's Social Democrat government has continued to pursue aggressively pro-cyclical fiscal policies, including large pension and public sector wage increases which resulted in a public sector deficit of 2.9% of GDP in 2018. Budgetary receipts increased from € 55.1bn to € 63.3bn (+17.2% year-on-year in RON terms), triggered by higher social contributions (+36.8%), whilst receipts from corporate profit taxes grew by 6.2%. On the other hand, total budgetary expenses increased by 16.8% in RON terms, from € 60.4bn to € 69.2bn, with personnel and social expenditures, which accounted for 58% of total expenses, increasing by 15.6% due to wage increases for public sector workers as well as an overall increase in pensions implemented in July. Public investment amounted to € 4.9bn, or 2.4% of GDP. The target deficit for 2019 is 2.6% of GDP, based on a probably unrealistic expectation of 5% year-on-year GDP growth.

Desperate to tame its widening budget deficit, the Romanian government adopted a number of emergency measures at the end of December which shocked the business community, including a quarterly tax on banks' assets ranging from 0.1% to 0.5% (depending on the level of interbank interest rates); a 2% and 3% tax on the turnover of energy and telecom companies, respectively; and a cap on energy prices. Due to strong pressure from the NBR and other institutions, the Government has recently amended the tax on banks' assets, which is no longer linked to the level of interbank rates, but rather a much lower flat annual tax of 0.2% for small banks (i.e. with a market share below 1%), and 0.4% for large banks (i.e. with a market share above 1%), which can be further reduced should a bank expand its lending activities by a certain threshold in a given year, and if the net interest margin is kept below a certain level. Nevertheless, the taxes on energy and telecom companies have not been softened, and the Government is also squeezing the private pillar of the pensions system with caps on the fees charged by fund administrators, and higher capital requirements. The measures were heavily criticized by the opposition parties, representatives of civil society and the business community, and the NBR.

The trade gap worsened in 2018, having increased by 16.8% compared to 2017 (from € -13bn to € -15.1bn), with imports growing by 9.6% while exports increased by 8.1%. The negative evolution of the trade balance led to a € -9.4bn current account deficit, which is the equivalent of -4.6% of GDP and compares unfavourably to the € -6.0bn deficit over 2017. FDI flows amounted to € 4.9bn, slightly up from € 4.8bn in the previous year. Romania's total external debt amounted to € 98.5bn at the end of December, which represents a 1.1% year-on-year increase and amounts to 48.3% of Romania's 2018 GDP of € 203.7bn. Total public debt was € 70.8bn, or 35.1% of GDP, at the end of 2018, up 9.6% in nominal RON terms, mainly due to increased RON-debt instruments which accounted for 50% of overall public debt, having increased by 13% year-on-year

Total domestic non-governmental credit (which excludes loans to financial institutions) was € 53.9bn at the end of December, up 7.9% over the year in RON terms. Household loans reached € 28.5bn at the end of December, having increased by 9.2% over the year, accounting for 52.9% of total loans outstanding. Consumer and housing loans increased by 7.3% and 11.1% year-on-year, respectively. In terms of quarterly dynamics, the growth pace has been moderate, with consumer loans falling by 0.1% whilst housing loans increased by 2.6% over the fourth quarter, compared to increases of 2% and 2.6%, respectively, in the second quarter. Corporate loans increased by 6.3%, from € 22.8bn at the end of 2017 to € 23.8bn. The overall deposit base was € 70.7bn at the end of December, up 9% over the year. The NPL ratio has continued to fall to 4.95% at the end of 2018 from 6.40% at the end of 2017.

Bulgaria

Bulgaria's GDP increased by 3.1% in 2018, helped by higher private consumption which grew by 6% year-on-year, driven by improved employment rates, increased wages and higher consumer lending. At the end of December, the unemployment rate was 5.2%, its lowest level of the past ten years. The average monthly wage at the end of December was 7.3% higher year-on-year. The real estate and financial sectors made the biggest contribution to 2018 GDP growth, having increased by 9.3% and 6.7% year-on-year, respectively. Following a recent visit to Bulgaria to assess the state of the domestic economy, the IMF is forecasting 3.3% GDP growth in 2019, as domestic demand is expected to maintain its growth dynamics.

Bulgaria's inflation rate fell over the fourth quarter, reaching 2.7% in December, compared to 3.6% in September.

In 2018, Bulgaria ran a positive surplus of € 70mn, or 0.1% of GDP, lower than both the 2017 surplus of 0.8% and the revised 2018 target surplus of 0.5%. Tax proceeds increased by 9.0% year-on-year, whilst total budgetary expenses increased by 14.4%. Although public investment grew by 42% year-on-year to reach 4.9% of GDP in 2018, the government delayed some public spending as the initial budget target for public investment was 5.6% of GDP. Bulgaria is targeting a deficit of 0.5% of GDP in 2019, with capital spending projected at 5.6%, and the wage bill reflecting a 20% increase in teachers' salaries. Bulgaria's public sector debt was 22.1% of GDP at the end of December, down 3.3 basis points from the end of 2017, owing to the fiscal surplus registered in the year, and the decision of the Bulgarian authorities not to issue any new external debt. Gross external debt amounted to 59.3% of GDP at the end of December, or € 32.7bn, having decreased from € 33.4bn at the end of 2017, with both public and private sector debt decreasing by 3.3% and 1.8%, respectively, compared to the beginning of the year.

Bulgaria's 2018 trade deficit of € -2.3bn was considerably worse than the € -0.8bn deficit recorded in 2017. Deteriorating external demand from Turkey, one of Bulgaria's most important trading partners, led to overall exports growing by only 1.5% (from € 27bn to € 27.3bn), while overall imports increased by 6.8% year-on-year, from € 27.7bn to € 29.6bn. The trade deficit was compensated by a € 1.5bn surplus from primary and secondary incomes and a € 3.3bn surplus from services, resulting in a positive current account balance of € 2.5bn in 2018, which was still short of the € 3.4bn surplus recorded in 2017. FDI inflows amounted to € 1.7bn, 24.6% lower than in 2017.

Total domestic non-governmental credit (which excludes loans to financial institutions) increased from € 25.9bn to € 27.9bn in 2018, as corporate and household loans increased by 5.4% and 11.2%, respectively. Whilst housing loans increased by 11.4%, consumer loans grew at a much higher rate of 17.7%. The deposit base was € 38.2bn at the end of December, up 7.4% over the year. Although the NPL ratio fell from 10.2% at the end of 2017 to 7.6% at the end of 2018, it is still one of the highest in Central and Eastern Europe.

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