Reconstruction Capital II Ltd

Quarterly Report

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neweuropecapital

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Message from the Investment Manager and Advisers

Dear Shareholders

On 8 October, RC2 acquired a 21.3% shareholding in East Point Holdings ("EPH" or the "Group") for a total consideration of €30m. EPH is a Cyprus-based holding company with extensive interests in Agribusiness, Copper Processing, Bakeries, River Shipping and Real Estate. The bulk of the Group's operations are in Serbia and Romania, but it also owns subsidiaries in other countries, including Hungary and Austria. Under the investment agreement signed with RC2, the shareholders of EPH have agreed to work towards the separation of the Group into different entities reflecting the business lines outlined above, allowing RC2 to convert its shares in EPH into shares in newly-created sub-holding companies for each business line.

EPH and RC2 are also working towards attracting third party investors into the different business lines, which is already the case with the River Shipping business, where Darby Overseas (part of Franklin Templeton Investments) has already taken a minority stake. On 23 December EPH, RC2 and Deutsche Investitions- und Entwicklungsgesellschaft ("DEG") signed an agreement pursuant to which DEG is to become a shareholder in the Bakery business.

In addition to the EPH investment, during the quarter RC2 increased its shareholding in Albalact from 19.2% to 24.5%, taking advantage of a 67.4% decline in the company's market value in euros over the first three quarters of 2009.

RC2's tender offer to repurchase 12,681,054 of its own shares (representing 11.25% of the Company's then issued share capital) at €0.9849 per share closed on 12 December 2008, resulting in €12.5m of the realized net profit made in 2007 being distributed back to shareholders, in line with the Fund's Admission Document.

As a result of the developments outlined above, RC2 has become primarily a private equity fund, with 85.9% of its total assets invested in seven companies. The Trading Programme represents a further 9.2% of total assets, whilst cash has shrunk to 4.9% of total assets, pursuant to the December share buyback.

The focus of the Fund has now shifted away from making new investments towards preparing the Private Equity Programme's investee companies for an exit over the period 2010-2012. In some cases, this will involve following through a restructuring programme (e.g. Policolor, parts of EPH) whilst in others it will involve nurturing the companies' future growth.

Yours truly,

New Europe Capital

Statistics

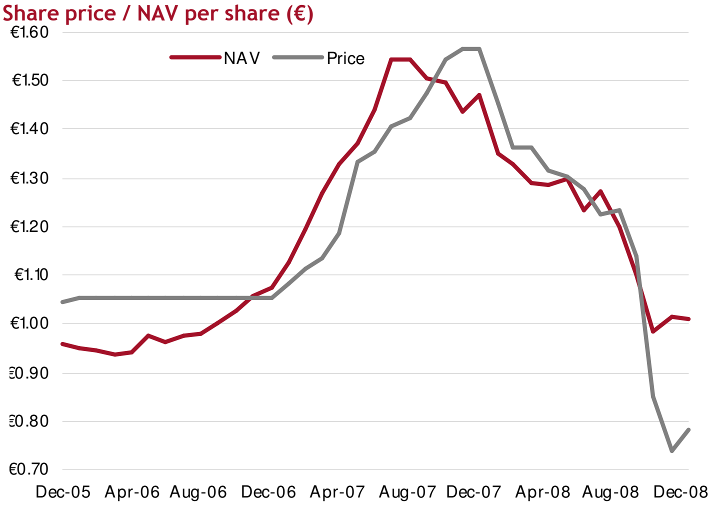
NAV per share (€)	1.0086
Share price (€)	0.7800
Total NAV (€ m)	100.9
Mk Cap (€ m)	78.0
# of shares (m)	100.0
Return since inception	5.45%
12-month CAGR	-31.43%
Annualized Return*	1.78%
Annualized Volatility*	14.42%
Best month	6.93%
Worst month	-10.52%
# of months up	20
# of months down	16

** since inception*

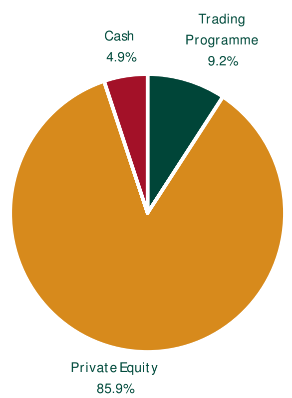
RC2 NAV returns

	2006	2007	2008
Jan	-0.61%	4.70%	-8.27%
Feb	-0.73%	6.17%	-1.48%
Mar	-0.87%	5.90%	-3.03%
Apr	0.44%	5.05%	-0.26%
May	3.73%	3.08%	0.93%
Jun	-1.25%	5.19%	-4.75%
Jul	1.23%	6.93%	2.85%
Aug	0.61%	0.22%	-5.55%
Sep	2.18%	-2.50%	-8.34%
Oct	2.74%	-0.69%	-10.52%
Nov	2.80%	-4.09%	3.03%
Dec	1.70%	2.46%	-0.60%
YTD	12.47%	36.74%	-31.43%

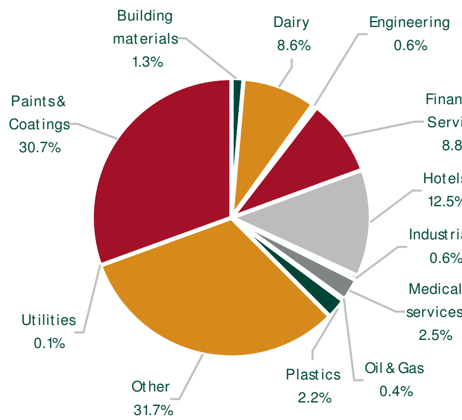
Share price / NAV per share (€)



Portfolio Structure by Asset Class

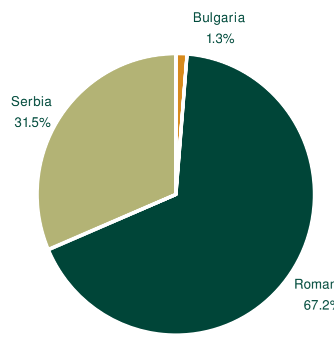


Equity Portfolio Structure by Sector



Note: EPH investment included under Other

Portfolio Structure by Geography



Note: EPH investment included under Serbia

East Point Holdings

On 8 October 2008, RC2 acquired a 21.3% shareholding in East Point Holdings Limited ("EPH" or the "Group") for a total consideration of €30m, of which €25.3m represented new shares and €4.7m existing shares, implying a pre-money valuation of €115.4m. EPH is a Cyprus-based holding company with significant business interests across South East Europe. The bulk of the Group's operations are in Serbia and Romania, but it is also active in other countries, including Hungary and Austria, and has a network of sales, procurement and representative offices in New York, Moscow, Frankfurt, Beijing and Sofia. EPH operates along the following main business lines: Agribusiness, Copper Processing, Bakeries, River Shipping, Real Estate and Other.

Background

Initially a metals and soft commodities trading firm, EPH was founded in 1990 by some of the former top managers of Generalexport (Genex), the former Yugoslavia's leading international trading company. Over time, the Group built up physical assets to support its trading operations (for example, in 1997 it built Silotrans, its flagship grains silo in Constanta port on the Black Sea, with financing from the EBRD). However, unlike some of the other privately-owned Serbian groups, EPH did not participate in privatizations during the Milosevic period, but rather focused on business outside the country. After the fall of the Milosevic regime, the Group started acquiring assets from the Serbian state and got involved in their restructuring and turnaround. In 2003, EPH acquired Fabrika Kablova Zajecar (FKZ), a copper cable producer, for $7.3m, which was successfully turned around and then sold to Tele-Fonika Kable, a Polish strategic investor, for approximately $26.7m over 2007-08. Also in 2003, EPH started acquiring shares in Zitomlin (milling) and Klas (bakeries) on the Belgrade Stock Exchange resulting in both companies being delisted in 2008. Valjaonica bakra Sevojno AD (VBS), a copper processor, was acquired in 2003 through a privatization tender, and a majority stake in Beogradska pekarska industrija AD (BPI), another bakery, was acquired in late 2006. In 2007, a further step in the development of EPH's business was the acquisition of Erste Donau-Dampfschiffahrts-Gesellschaft (EDDSG), an Austrian /Hungarian river shipping company with a history of almost 180 years of operations along the Danube.

Development Strategy

Many of the Group's operating businesses were acquired from the Serbian state or from distressed sellers and are currently undergoing a restructuring process. This process generally involves operational restructuring in order to maximize operating efficiencies, but also, in certain cases, will involve the development of new production facilities in order to relocate production and redevelop the underlying real estate assets. In particular, Klas and BPI, the Belgrade-based bakery businesses, and Zitomlin, the integrated grain silo and flour mill also located in Belgrade, are sitting on prime real estate assets which should be suitable for residential and commercial re-development.

Under the investment agreement signed with RC2, all parties have agreed to work towards the separation of the Group into different entities reflecting its different business lines, following which EPH will remain the majority shareholder of these entities whilst RC2 shall own direct equity stakes in the newly-created sub-holding companies. EPH and RC2 also aim to attract third party

Development Strategy (cont'd)

investors into the different business lines, which is already the case with the River Shipping business. RC2's ultimate objective is to sell its interest in the different business lines either by means of a trade sale or by means of a listing on the Belgrade Stock Exchange or a regional stock exchange.

Financial results

US$m	2006A	2007A	3Q08*
Income statement (according to IFRS)			
Sales	482.3	520.3	467.9
COGS	(445.8)	(478.1)	(398.7)
Gross profit	36.4	42.2	69.2
Other operating income	6.4	10.8	19.5
Other gains	15.1	13.4	(1.1)
Administrative expenses	(33.1)	(37.8)	(65.8)
Operating profit	24.8	28.6	21.8
Finance costs	(5.9)	(19.8)	(16.5)
Share in profit/(loss) of associates	0.5	(0.4)	0.1
Profit before tax	19.4	8.4	5.4
Tax	(0.2)	(0.5)	(0.7)
Profit after tax	19.2	7.9	4.7
Minority interest	(0.5)	(0.9)	(0.6)
Profit for the year	18.8	7.0	4.2

** unaudited*

Because of the acquisitions made over the last three years, the financial results are not comparable with the respective previous period. For example, 2007 was the first year that two major companies undergoing restructuring (EDDSG and VBS) were fully consolidated. Furthermore, at the end of 2007, EPH sold most of its 88.9% shareholding in FKZ to TeleFonika. Consequently, the results of this operation no longer appear in 2008.

In the first nine months of 2008, the Group's overall profitability was affected by EDDSG, which made an operating loss of $2.2m and a net loss of approximately $10m after financing costs of $7.7m. Consequently, this has reduced the Group's bottom line from $14.2m to $ 4.2m.

Agribusiness

Introduction

EPH's Agribusiness comprises the trading of agricultural products (mainly wheat, corn, barley, and rape and sunflower seeds) and the operation of a network of agricultural storage facilities along or near the Danube in Hungary, Serbia and Romania with a total vertical storage capacity of 295,000 tons. In Romania, the key asset is Silotrans, a sea port grains terminal in Constanta. Another subsidiary (Soyaplus) has obtained a concession at the port where it

Introduction (cont'd)

intends to build a new soya terminal. The Group has also invested in the development of a small silo on the Danube in Giurgiu, Romania. In Serbia, the Group owns six smaller grain storage facilities which are located in Vojvodina, Serbia's most fertile agricultural region, and in Belgrade. These facilities typically are integrated with flour mills and one has also recently invested $5m in a new pasta factory. EPH's total monthly milling capacity is 14,000 tons. Approximately 15% of the wheat produced is sold to EPH's own bakeries. In Hungary, EPH owns a 43,000 tons silo. EPH is the majority owner of all the storage and milling assets in Serbia, except for one, which is a JV with a family-owned business.

Operations

In the first 9 months of 2008, the combined agribusiness operations of EPH generated an EBITDA attributable to the Group of approximately $13.5m based on the company's management accounts. The main drivers were the milling and storage operations of Zitomlin ($6.2m), the trading activities of the Group (generating EBITDA of $3.5m) and the results of Silotrans, the main grain storage asset ($3m). In 2008 the total annual throughput at Silotrans increased by 228% year-on-year to 1.1m tons, a record for the silo. EPH management expects the bumper harvest of 2008 to continue having a positive impact on the Agribusiness division's results throughout the first half of 2009. An investment programme at EPH's smallest mill, Zitoprodukt Backa Palanka, aimed at converting it from a wheat mill to a niche-market corn mill dedicated to the brewing industry has been finalized, but EBITDA for the first half of the year was still negative.

Prospects

EPH's Agribusiness operations are strongly geared towards the ability of South East Europe to generate a surplus of cereal production over consumption, resulting in a portion of the harvest being exported. Historically, South East Europe has been a net exporter of grains. However, the policy of collectivization during communism and the subsequent privatization of land into highly fragmented plots, together with a lack of support for farmers from the state, have resulted in a slow recovery process across the region. In recent years crop yields have improved but are still substantially below west European ones. Although the yearly harvest fluctuates based on climatic conditions, the long term trend is positive, as a result of the consolidation of land into larger commercially managed units, combined with growing subsidies for farmers, in particular in the new EU states.

In 2004, EPH obtained a 30-year lease on a pier adjacent to Silotrans. The Group intends to design and build a storage facility to be used primarily for soybean meal, which would be integrated with Silotrans. The envisaged facility, estimated to cost approximately €30m, would partially lift the shortage of soybean meal which is primarily used for animal feeds in the region and could offer significant scale and synergy effects with Silotrans and the river transportation business (barges being loaded downriver for the export of cereals and upriver with imported soya meal).

EPH is considering moving the Zitomlin milling and storage

Prospects (cont'd)

EAST POINT Holdings Ltd

operations from its current location along the Danube near the centre of Belgrade to a new production site where its bakery business would also be relocated. This would free up 2.2ha of real estate and result in a more efficient milling operation, due to the commissioning of new milling equipment and synergies with the Bakery business, which accounts for approximately 15% of Zitomlin's overall sales.

Bakeries

Introduction

EPH's Bakery business consists of three formerly state-owned bakeries: Klas, BPI and Izvor. EPH owns 100% of Klas which, following a reorganization of EPH's holdings, is now the parent company for the Bakery business. Klas owns 87% of BPI, which is also based in Belgrade, and a 46% share in Izvor, which is located approximately 100km south of Belgrade in the city of Paracin. More recently, Klas has acquired a 25% shareholding in Zitopek, the largest bakery in Nis, Serbia's 3rd largest city with approximately 300,000 inhabitants. EPH's bakery business is the leader on the Serbian market, with an estimated market share of 22% in the capital of Belgrade and a 6% market share nationwide. The total number of retail outlets of the Bakery business (including Zitopek) amounts to 89, which gives the group a geographical leadership across Serbia.

Operations

BPI and Klas operations have gradually been merged into a single production site in the centre of Belgrade. Despite closing down more than half of its baking facilities, BPI still maintains two other satellite production sites in the city's outskirts. During the first nine months of 2009, BPI-Klas extended its retail network in Belgrade by opening three premium "coffee point" shops and renovating five shops. The combined Klas-BPI EBITDA increased by 38% from €2.3m to €3.2m over January – September 2008 compared to the same period last year, equivalent to an EBITDA margin of 16%; whilst the net profit expanded by 85% from €1.1m to €2.0m. At Izvor, in the first nine months of 2008, EBITDA reached €0.5m, an increase of 58%, whilst the net profit increased by 48% to €0.2m.

Prospects

The main plan for the bakery business involves relocating all production in Belgrade to a new production facility to be built on a site recently acquired by EPH about 10km from the centre of Belgrade. This would free up Klas' main production site in the city centre, which has considerable potential for residential development, and should result in significant operating savings.

On 23 December, the German investment group Deutsche Investitions- und Entwicklungsgesellschaft mbH ("DEG") signed an agreement to undertake a capital increase of Klas, by subscribing for €15m of new shares in return for a 25.1% shareholding, in order to finance the construction of a new state-of-the-art bakery facility on the land which was acquired by EPH for this purpose. The deal has not yet closed

Copper Processing

Background

EPH has a majority shareholding in VBS, a producer of semi-finished and special copper or copper alloy products, based in Sevojno, western Serbia. VBS was acquired from the Serbian state in 2004 in a deal whereby EPH and a partner committed to invest a total of €23.9m in the business both to modernize the production facility and to compensate workers for job losses pursuant to a personnel restructuring programme. In order to finance these investment commitments, EPH borrowed €16m from the EBRD at the time. In 2007, EPH bought out its partner in VBS, thereby increasing its shareholding from 40.4% to 80.9%.

Operations

During the first nine months of 2008, VBS continued to make progress in its restructuring and modernization efforts. For example, the headcount reduction continued, resulting in a total headcount at the end of September 2008 of 1,281, compared to 2,160 at the time of EPH's original investment. Meanwhile, total output for the first nine months of 2008 was 29,474 tons which compares favourably to the 31,377 tons achieved over the whole of 2007. Over the first three quarters of 2008, VBS registered sales of $88.5m and an EBITDA of $6.7m. The overall EBITDA of EPH's copper division for the first nine months of 2008, which includes both the EBITDA of VBS attributable to EPH's shareholding and the Group's copper trading activities, amounted to $9.7m, which compares to $6.5m for the whole of 2007.

Prospects

The deteriorating global economic outlook (VBS sells approximately half of its production to Western Europe) is expected to affect the copper business, but not hugely. For example, orders for November and December were only slightly below budget. One reason for this is the fact that VBS has been able to take over orders from one of its key European competitors which went out of business. Furthermore, VBS has benefited from the fall in copper prices, as this has greatly reduced its working capital needs whilst causing clients to switch from substitute products back to copper and copper alloys.

EPH has gradually been buying up the debt of Novkabel AD, Serbia's second largest cable producer, on the secondary market, and by the end of 2008 owned more than 85% of the total outstanding debt of this heavily indebted company. This has enabled the Group to acquire on 23 January 2009 a 93% interest in Novkabel from the Serbian state for a mere €0.1m. Over the first nine months of 2008, Novkabel reported sales of $50.7m and an EBITDA of $2.7m, resulting in an EBITDA margin of only 5.2%. The high debt burden of the company generated financial costs of $5.4m which resulted in a net loss of $2.3m for the period. EPH has already demonstrated restructuring expertise in the copper cable industry by turning around and then selling FKZ, Serbia's third largest cable producer. EPH management believes that Novkabel's EBITDA can be substantially increased by closing excess capacity and by exploiting synergies in production, financing, distribution and procurement with VBS.

Currently the Serbian state is interested in privatizing RTB Bor, a copper mine and smelter complex based in Eastern Serbia, which is the main source of copper which VBS and Novkabel process. EPH is currently studying if and how to become involved in this privatization as part of a consortium of investors and banks.

Prospects (cont'd)

EAST POINT Holdings Ltd.

River Transportation

Background

In 2007, EPH acquired DDSG-Cargo, now renamed Erste Donau-Dampfschiffahrts-Gesellschaft ("EDDSG"), an Austrian river shipping company. The acquisition was partly financed by a €20m loan from Darby Overseas, the mezzanine arm of Franklin Templeton Investments, which also took a 15% equity interest in the business. EDDSG had previously acquired MAHART, the Hungarian river shipping fleet, in 2004. Today, EDDSG owns a fleet of 258 vessels and is specialized in the transport of bulk cargos such as iron ore and grains, primarily along the Danube, but also along the Rhine, the Main and the Rhine-Main-Danube Canal.

Operations

Under the previous owner, both DDSG and MAHART were operated and managed separately, causing substantial duplication of administration and operating costs, and inefficiencies in fleet management. A new group CFO was appointed in 2008 and a new group COO (previously the general manager of MAHART) replaced the former general manager. Since the summer, both companies have been managed as one entity. For the first nine months of 2009, sales growth of 30% (from €42.7 to €55.7) outpaced a modest increase in shipped volumes (+8%). Albeit from a low base of €2.2m in the same period last year, EBITDA reached €3.5m, an increase of 59%. However, the increase would have been much higher had it not been for the effects of the 2007 drought in South East Europe which resulted in hardly any grains being transported downriver until the Summer of 2008.

Prospects

The good harvest of 2008 throughout the region provides for an encouraging outlook, as shipping capacities going downriver are now sold out until late spring (an inverse situation to last year) and the ongoing cost cutting measures are expected to improve EDDSG's overall performance significantly. However, the deteriorating outlook for the central European steel producers will result in lower ore volumes going into central Europe.

In February 2009, EDDSG signed a contract to acquire a 70% shareholding in JRB, the Serbian river shipping company from the Serbian State. The deal would add JRB's fleet of approximately 120 barges and vessels to EDDSG's existing fleet of 258 vessels.

Furthermore, JRB's product mix is strongly geared towards the transportation of liquid cargo (roughly 50% of sales), a segment where EDDSG is not present. Finally, the practically debt-free JRB has substantial non-core real estate assets, which could be sold off to generate cash for the core business. EDDSG expects to achieve synergies in sales, procurement, repairs and maintenance, and the manning of crews, from its prospective investment in JRB.

Real Estate

EPH has substantial non-core real estate assets, as well as certain real estate assets used in its existing operations which could be re-developed if production is relocated to new factories or reorganized. Some of these have already been valued by international property valuers, as follows: (1) a 2.2ha plot of land on the Danube in close vicinity to the Belgrade city centre where Zitomiln's grain mill is currently located but which could be relocated; (2) "Juzni Bulevar", the main production site of Klas built on a 5,558sqm plot of land in a residential area of Belgrade for which planning consent already exists for 25,000sqm of gross buildable area; (3) Klas' idle production facility on Sajkaska street located on a 2,140sqm plot of land also in a residential area in central Belgrade; (4) the "Automobilsko" site on the outskirts of Belgrade which was acquired to relocate Klas' Juzni Bulevar facility, which is made up of a 6.2ha concrete platform partially covered by an office building and a warehouse with a surface of 16,658sqm over four floors; (5) EPH's headquarters in central Belgrade, comprising 2,700sqm of prime office space over four floors; (6) several production units of BPI in Belgrade and its outskirts; (7) the "Ikaterm" production facility comrpising a 1.6ha plot in Zemun (a suburb of Belgrade) and (8) offices in Novi Sad (467sqm). The results of the valuations of the various properties outlined above are shown below:

In addition, the Group has a number of properties which have not been independently valued, including offices in Bucharest with a total built area of 1,075sqm, and long-term leases on premises in Moscow (617sqm) and Beijing (581sqm). Finally, the two recent acquisitions of Novkabel and JRB, once completed, will add 43ha of land near the city centre of Novi Sad as well as JRB's headquarters comprising 6,500sqm in the centre of Belgrade.

Real Estate (cont'd)

EAST POINT Holdings Ltd

Valuations					
Property	Location	Surface (sqm)	(€m)	Valuer	Date
Zitomlin[1,3]	Belgrade	22,243	24.1	CBRE	Jan-08
Juzni Bulevar[1]	Belgrade	5,558	9.1	CBRE	Jan-08
Sajkaska[1,3]	Belgrade	2,140	1.8	CBRE	Jan-08
Automobilsko[1]	Belgrade	61,712	12.6	CBRE	Nov-08
Headquarters[2]	Belgrade	2,686	6.3	CBRE	Dec-07
BPI non-core portfolio	Belgrade	n.a.	4.1	Colliers	Mar-07
Novi Sad offices[2]	Novi Sad	467	0.5	CBRE	Dec-07
Ikaterm[1]	Belgrade	16,424	1.4	CBRE	Mar-08
Total			**60.0**		

[1]total land surface; [2] net built area; [3]best-use re-development analysis

Under the reorganization plan agreed with RC2, any non-core real estate assets are to be transferred to a new Sub-holding company for the Real Estate business in which RC2 shall own a direct shareholding.

Other

EPH has subsidiaries active in securities trading on the Belgrade Stock Exchange; an engineering business; and in November 2008, its 95%-owned subsidiary Bio Energy Point commissioned Serbia's largest wood pellets plant with a yearly output capacity of approximately 35,000 tons.

Policolor Group

Policolor ORGACHIM

The Policolor Group ("Policolor" or the "Company") is the leading producer of coatings in Romania and Bulgaria. The Group comprises Policolor S.A., a Romanian company quoted on the Bucharest Stock Exchange, and Orgachim AD, its 64%-owned Bulgarian subsidiary which is quoted on the Bulgarian Stock Exchange. RC2 has shareholdings in both companies, and over the quarter slightly increased its shareholding in Policolor from 38.3% to 38.4%, whilst its shareholding in Orgachim remained unchanged at 2.4%. RC2's strategy for its investment in Policolor is to collaborate closely with the Romanian Investment Fund Ltd (RIF), the owner of 57.3% of Policolor S.A. at the end of 2008, to reorganize the Group's assets and activities and prepare it for exit. In September 2008 both funds launched a tender offer to buy out the remaining minorities with the intention of reaching a 100% shareholding pursuant to a squeeze-out process, with RC2 owning 40% and RIF 60%. On 23 December, Policolor S.A. was suspended from trading by the Bucharest Stock Exchange until the squeeze-out is completed. The process should be finalised by the end of the first quarter of 2009, following which Policolor will cease to be a listed company.

Financial Results

Policolor S.A.

(EUR '000)	2006A*	2007A*	9M07**	9M08**
Income Statement				
Sales Revenues	**42,408**	**48,134**	**39,644**	**45,574**
Other operating revenues	-	(961)	(2,387)	(844)
Total Operating Revenues	**42,408**	**47,173**	**37,257**	**44,730**
Total Operating Expenses	(39,726)	(47,514)	(34,690)	(43,220)
Operating Profit	**2,681**	**(341)**	**2,567**	**1,510**
Operating margin	*6.3%*	*neg.*	*6.9%*	*3.4%*
EBITDA	**3,664**	**1,254**	**3,721**	**3,411**
EBITDA margin	*8.6%*	*2.6%*	*10.0%*	*7.6%*
Financial Profit/(Loss)	**216**	**(2,648)**	**(188)**	**(549)**
Profit before Tax	**2,897**	**(2,989)**	**2,379**	**961**
Income Tax	(477)	-	(361)	-
Profit after Tax	**2,420**	**(2,989)**	**2,017**	**961**
Net margin	*5.7%*	*neg.*	*5.4%*	*2.1%*
Avg exchange rate(RON/EUR)	*3.525*	*3.337*	*3.300*	*3.640*

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

Orgachim

(EUR '000)	2006A*	2007A*	9M07**	9M08**
Income Statement				
Sales Revenues	**48,368**	**62,633**	**47,984**	**55,503**
Other operating revenues	1,592	1,888	705	663
Total Operating Revenues	**49,959**	**64,521**	**48,689**	**56,165**
Total Operating Expenses	(46,993)	(59,444)	(43,674)	(53,242)
Operating Profit	**2,967**	**5,077**	**5,016**	**2,923**
Operating margin	*5.9%*	*7.9%*	*9.7%*	*5.4%*
EBITDA	**3,905**	**7,268**	**6,508**	**5,159**
EBITDA margin	*7.8%*	*11.3%*	*12.8%*	*9.3%*
Financial Profit/(Loss)	**1,714**	**340**	**546**	**(706)**
Profit before Tax	**4,680**	**5,417**	**5,561**	**2,217**
Income Tax	(541)	(1,958)	(229)	56
Profit after Tax	**4,139**	**3,458**	**5,333**	**2,273**
Net margin	*8.3%*	*5.4%*	*10.4%*	*4.2%*
Avg exchange rate (BGN/EUR)	*1.956*	*1.956*	*1.956*	*1.956*

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

Financial Results

The unconsolidated nine-months results show a 15% year-on-year growth in Policolor S.A.'s sales from €39.6m to €45.6m, and a 17% increase in Orgachim's sales, from €48.0m to €56.0m. Whilst the core coatings division has held up well to the effects of the global recession, the chemicals division of Orgachim, which is much more cyclical, had a poor performance, with a 15% decline in sales compared to the previous year. Furthermore, Orgachim had to write down the value of its raw material stocks used by its chemicals division, resulting in a provision of €0.7m.

Operations

Mr Achille Bardelli took over as the new Group CEO on 15 October. Mr Bardelli has had a 44-year career in the coatings business, including work at Max Mayer, Glidden-Salchi, BASF, Degussa-Inxel, DuPont and Akzo Nobel. He started his career as a laboratory chemist and, most recently, ran a restructuring programme at Akzo Nobel's Italian unit. During the last quarter of 2008, Mr Bardelli has reorganized the Policolor Group into several SBU's (strategic business units), each one with its own management team operating across both Romania and Bulgaria, as follows: Architectural Coatings, Automotive Refinish Coatings, Industrial Coatings, Architectural Insulation Systems, Resins, and Specialty Chemicals (Anhydrides).

Outlook

Mr Bardelli has presented a strategy for the Group with the following main objectives: (1) further rationalizing production at the group's Romanian and Bulgarian plants; (2) increasing the annual EBITDA level by €11m; and, (3) preparing the Group for exit.

The strategy involves:

- maximising synergies between Policolor and Orgachim
- avoiding duplication by concentrating production of each product category in one location;

Outlook (cont'd)

- creating a single management structure across both companies;
- initiating a program to cut costs; and,
- realizing the value of non-core assets.

The strategy envisages the following specific actions:

- changing the pricing strategy to maximise profits, not sales (a price increase of 9% was introduced in November 2008, followed by a further 6% price increase in February 2009);
- one third of the current 1,600 employees are to leave the Group, of which 380 are to be laid off, with a further 180 to be externalized in newly-created companies;
- all decorative paints production is being transferred to Bulgaria, whilst all industrial paints, automotive paints, and wet plasters production is being transferred to Bucharest. At a later stage, the closure of all production at the Bucharest site is envisaged;
- the Group's subsidiaries in Serbia and Ukraine, which act as local distributors, are being sold or shut down. In the future, the respective markets will be covered by independent local dealers.
- transportation, merchandising and retail activities are to be externalized. As a consequence, more than 228 drivers, maintenance workers, merchandisers and shop agents should leave the company.

Implementation of the new strategy already started in the last quarter of 2009, including the laying off of 219 staff from Orgachim which was completed in January 2009 with a further 144 due to leave Policolor by the end of February 2009. Price increases have already been implemented and Policolor has already ceased production of certain low-margin products.

Albalact

Introduction

Albalact S.A ("Albalact") is a quoted Romanian dairy producer in which RC2 has acquired a significant stake under its Private Equity Programme. In February 2008, taking advantage of the decline in the company's market value, RC2 restarted purchasing Albalact shares. Over the fourth quarter of 2008 Albalact's market capitalization dropped by 22.4%, while RC2 increased its shareholding from 19.2% to 24.5%. Based on 31 December 2008 prices, RC2's shareholding in Albalact had a market value of €8.3m compared to a cost of €13m.

At the end of the year, Albalact was 47.6% owned by the Ciurtin family, 24.5% by RC2 and 27.9% represents the free float. The strategy of RC2 is to work alongside the Ciurtin family to bring the company to exit over a 1-2 year time-horizon. In October 2008, the company announced the acquisition of a 77% shareholding in Raraul SA ("Raraul"), a smaller dairy processor specialized in cheese products, for €3.7m. The transaction was closed in December, following its approval by the Romanian Competition Council.

Financials

In the first nine months of 2008, RON-denominated sales increased by 20% year-on-year, corresponding to an 8.7% increase in euros. Despite the good sales performance, the company's profitability was below expectations, being affected by delays in commissioning

Financials (cont'd)

a new production facility and teething issues related to the new equipment. As a result, certain products had to be recalled from the market due to quality problems, and new and old production facilities had to operate in parallel, resulting in short-term hikes in personnel, raw material and transportation costs. These problems were resolved by September, following which the company was back on track in terms of sales volumes and product quality. Good September sales of €4.7m (up 20% month-on-month) and a 10.7% quarter-on-quarter drop in operating expenses led to an operating profit of €0.3m in the third quarter, up from €0.1m the previous quarter.

At a meeting held in September 2008, the company's shareholders approved a revised 2008 budget targeting sales of €52m and a net profit of €0.9m. While the company was on target to meet the revised budget in local currency, the RON's 7.4% devaluation over the fourth quarter will mean that the net profit target will probably not be achieved. Final 2008 results are due to be disclosed to the market in April 2009.

(EUR '000)	2006A*	2007A*	9M07**	9M08**
Income Statement				
Sales Revenues	**28,965**	**46,389**	**33,893**	**36,841**
Other operating revenues	1,467	4,183	2,057	2,814
Total Operating Revenues	**30,431**	**50,572**	**35,950**	**39,655**
Total Operating Expenses	(28,634)	(47,795)	(33,384)	(38,906)
Operating Profit	**1,798**	**2,777**	**2,567**	**748**
Operating margin	*6.2%*	*6.0%*	*7.6%*	*2.0%*
EBITDA	**3,146**	**5,257**	**4,322**	**2,826**
EBITDA margin	*10.9%*	*11.3%*	*12.8%*	*7.7%*
Financial Profit/(Loss)	279	(1,632)	(524)	(406)
Profit before Tax	**2,077**	**1,145**	**2,042**	**342**
Income Tax	(368)	(174)	(317)	(66)
Profit after Tax	**1,709**	**971**	**1,725**	**276**
Net margin	*5.9%*	*2.1%*	*5.1%*	*0.7%*
Avg exchange rate (RON/EUR)	*3.525*	*3.337*	*3.300*	*3.640*

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

Operations

In August, the company introduced a new ERP system in order to improve its cost control process, focussing on personnel, administrative and logistics costs. Most of the transportation services were externalized and a large part of the company's fleet of trucks was sold off. As a consequence of Albalact moving its entire production to the new factory, 100 employees were laid off. The fourth quarter of 2008 was the first one with the new production facility operating at full capacity.

Operations (cont'd)

In December 2008, the Romanian Competition Council endorsed the takeover by Albalact of local cheese producer Raraul. In 2007, Raraul which primarily focuses on traditional cheeses, recorded sales of €4.9m. Albalact plans to undertake a €1m investment programme to increase the company's cheese processing capacity, and to start a personnel restructuring programme. Albalact will also transfer part of its cheese-making equipment from its old factory to Raraul.

The opening of the Bucharest logistics centre, initially scheduled for December 2008, was postponed to February 2009 due to delays caused by the contractor.

Prospects

According to the company's management, Albalact is expecting a 40% year-on-year increase in sales in local currency for 2009. The main growth driver is the acquisition of Raraul. The full 2009 budget figures will be disclosed by the company in April. With the RON losing ground against the euro, Albalact's cost base should increase, as part of its raw materials are imported. According to Albalact officials, there will be an increase in the prices of its dairy products but this will not match the increase in costs, resulting in a shrinkage of margins. The devaluation of the domestic currency will also hurt the bottom line since most of the company's liabilities to banks and leasing companies is euro-denominated.

Despite the worsening macroeconomic situation, Albalact is well-positioned to achieve higher sales and profitability in 2009: it has one of the best raw material collection networks in the country and is the market leader in the fresh milk and butter segments; it now has one of the largest and most modern production facilities in the country; it owns three well established brands; and has a strong management team and strong distribution and logistics functions.

Mamaia Resort Hotels

Mamaia Resort Hotels (formerly Antares Hotels SRL) is the owner and operator of the 290-room Golden Tulip Mamaia Hotel (the "Hotel") located in Mamaia, Romania's premium holiday resort on the Black Sea coast close to the city of Constanta. In addition, the company owns a 2,257sqm plot of land adjacent to the Hotel for which it is seeking planning permission to develop an "aparthotel". In March 2008, RC2 acquired a 63% shareholding in Mamaia Resort Hotels from a distressed seller for a total consideration of €8m. The main motivation behind the acquisition was the possibility to buy an asset at a discounted price due to excessive borrowings under the previous majority owner. In August, an independent valuation report confirmed a value of €11.6m for RC2's shareholding and a valuation of €18m for the company's assets. Shortly after the acquisition, RC2 appointed a professional Romanian hotel management company to run the Hotel. In May 2008, the Hotel signed a franchise agreement with *Golden Tulip Hotels and Resorts* and the hotel was renamed the *Golden Tulip Mamaia*. The adviser intends to operate the Hotel all year round and the integration of the Hotel into the *Golden Tulip* platform is aimed at increasing the Hotel's attractiveness to business customers. As at 31 December 2008, RC2's investment in Mamaia Resort Hotels was valued at €11.6m in RC2's books.

Financial Results

Revenues over January-November 2008 amounted to €1.7m, 40% higher than the full-year 2007 results. However, a number of one-off expenses undertaken to prepare the Hotel for the 2008 summer season after the change of ownership and management negatively affected the bottom line. Over April-November, the average occupancy rate was 34%. This is in line with the investment adviser's projections for the

Financial Results

(EUR '000)	2006A*	2007A**	11M08*
Income Statement			
Sales Revenues	**1,287**	**1,140**	**1,679**
Other operating revenues	42	120	89
Total Operating Revenues	**1,329**	**1,260**	**1,768**
Total Operating Expenses	(1,259)	(1,320)	(1,638)
Operating Profit	**70**	**(60)**	**130**
Operating margin	*5.5%*	*neg.*	*7.7%*
EBITDA	**196**	**144**	**296**
EBITDA margin	*15.3%*	*12.6%*	*17.6%*
Financial Profit/(Loss)	(264)	(593)	(170)
Profit before Tax	**(194)**	**(653)**	**(41)**
Income Tax	0	0	0
Profit after Tax	**(194)**	**(653)**	**(41)**
Net margin	*neg.*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*3.525*	*3.337*	*3.662*

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

business, which indicate that the hotel is financially viable with a minimum occupancy rate of 33%. In terms of the revenue structure, over 60% of the Hotel's turnover was generated by tourism agencies, 10% by walk-ins, and the remainder from corporate events. The growth in revenues in 2008 was achieved in spite of the new management inheriting an old tariff structure which had been sold to tourist agencies the previous year.

Operations

Due to the decrease in the occupancy rates off-season, only 100 rooms are being operated at present and staff levels have been reduced from 122 during the high season to 49.

Prospects

In order to boost its out-of-season corporate events business, the Hotel intends to finish work on a conference centre which had been started under the former owners. Work on the conference centre, which occupies 1,150sqm, re-started in December 2008 and is due to be finalized by June 2009. The cost is estimated at €1m. A bank loan to finance the centre as well as to renovate the public spaces, and to support the company's working capital needs, is currently being negotiated.

For 2009, the hotel's management is targeting a 73% increase in revenues and an EBITDA of approx €1m. The improvement is the result of a projected increase in both tariffs (+15% in euro terms) and improved occupancy rates, the latter being mainly the consequence of the inauguration of the new conference centre which is expected to attract an increasing number of corporate clients.

Top Factoring

In May 2007, RC2 invested €3m in new and existing Top Factoring shares, thereby acquiring a 92.3% shareholding in this receivables collection company. RC2's investment in Top Factoring is valued at €4.2m in RC2's December NAV calculations. RC2's strategy for Top Factoring is to build the company up both organically and, potentially, by merging it with another local player, and then exiting to a strategic buyer with operations across Europe.

Financial results

(EUR '000)	2006A*	2007A**	11M07*	11M08*
Income Statement				
Total Operating Revenues	**23**	**694**	**670**	**1,065**
Total Operating Expenses	(52)	(913)	(746)	(1,545)
Operating Profit	**(29)**	**(220)**	**(76)**	**(480)**
EBITDA	**(29)**	**(213)**	**(67)**	**(451)**
Financial Profit/(Loss)	(0)	110	44	(15)
Profit before Tax	**(29)**	**(109)**	**(32)**	**(495)**
Income Tax	0	0	(35)	(19)
Profit after Tax	**(29)**	**(109)**	**(67)**	**(513)**
Avg exchange rate (RON/EUR)	*3.525*	*3.337*	*3.320*	*3.662*

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

Top Factoring earns revenues from two sources: agency and principal business. The agency business involves collecting receivables on behalf of clients for which Top Factoring is paid a commission. The principal business involves acquiring packages of receivables. During the first eleven months of 2008, Top Factoring's turnover reached €1.1m, up 59% compared to the same period last year. 83% of revenues were generated by the principal business.

Operations

Top Factoring has to date acquired two packages of receivables, both from Vodafone Romania. The first package was acquired in December 2006 at a cost of €0.5m and a nominal value (including accrued penalties) of €12m. The second package, which was of a better quality, was acquired in December 2007 at a cost of €1.3m, compared to a nominal value (with penalties) of €15m. Typically, each package generates revenues over at least two years. The first Vodafone package generated revenues of €210k in 2008, while total collections from the second Vodafone package reached almost € 0.8m. The main expense incurred by the Company is the cost of amortizing the two Vodafone receivable packages, which are considered to have a two-year useful life and are revalued based on the fair value approach at the end of each financial year. For the first Vodafone package, the acquisition will have been fully expensed by the end of 2008, although the package is expected to continue generating income in 2009. The other important cost items are salaries, and postal and telecommunications expenses. In an effort to increase the efficiency of its operations, Top Factoring has negotiated a significantly improved tariff scheme with Romtelecom, the telecom services provider. The new tariffs are in force since November 2008 and should result in a 50% reduction in telecommunication costs.

In 2008, Top Factoring had agency agreements with Avon Cosmetics, Rompetrol, Volksbank, Fin Group, Unicredit and telecom operator Zapp Mobile. Romanian Public Television became a client in December 2008 with a first set of 35,000 cases being received by Top Factoring. The total contract refers to over 220,000 cases with a face value of €22m.

Top Factoring created a new B2B department at the end of August 2008 which had secured 80 new contracts by the end of 2008. Top Factoring had managed to collect €0.2m out of a total collectable amount of €1.3m under these contracts by the end of the year.

Romar

Romar is one of Romania's leading private healthcare groups with a network of 17 policlinics and 7 laboratories. It is the national leader in occupational health services. The group is made up of a holding company in Cyprus (RHL) and 6 operating subsidiaries in Romania. RC2 injected €4m into the group and now owns a 40.0% shareholding. The remaining 60% is owned by the Founder, Erghin Hagicalil, who is also the CEO. In November 2008, RC2 commissioned an independent valuation of its shareholding, which resulted in the write-down of this investment from €4.1m to €2.4m, effective December 2008.

Financial results

(EUR '000)	2006A*	2007A**	11M07**	11M08**
Combined Income Statement				
Total Operating Revenues	**8,848**	**7,901**	**6,962**	**6,968**
Total Operating Expenses	(8,134)	(7,425)	(7,100)	(7,245)
Operating Profit	**714**	**477**	**(138)**	**(277)**
Operating margin	*8.1%*	*6.0%*	*neg.*	*neg.*
EBITDA	**1,087**	**853**	**163**	**15**
EBITDA margin	*12.3%*	*10.8%*	*2.3%*	*0.2%*
Financial Profit/(Loss)	18	(72)	(6)	(71)
Earnings before Tax	**732**	**405**	**(144)**	**(348)**
Income Tax	(186)	(86)	(40)	(12)
Earnings after Tax	**546**	**319**	**(185)**	**(360)**
Net margin	*6.2%*	*4.0%*	*neg.*	*neg.*
Avg exchange rate (RON/EUR)	*3.525*	*3.337*	*3.320*	*3.662*

*Note: * IFRS (audited), ** RAS (unaudited); excludes Evolution Med*

During the first eleven months of 2008, sales remained steady at €7m, but the group made a loss of €0.4m. Over the first eleven months of 2008, occupational services remained the most important revenue generator, accounting for 51% of sales, with contracts with public insurance houses coming in second place at 27% of total sales.

Operations

Currently, Romar operates 17 clinics in twelve cities across Romania, up from 16 clinics in 2007 ,as well as 7 laboratories.

Operations (cont'd)

However, the new openings have not been supported by a sufficient sales and marketing effort. In terms of corporate clients, the most important new clients were the Rovinari Power Plant (3,700 employees) and part of the Carrefour network (3,700 employees). In January 2009, Romar renewed its contract with the Romanian Post Office, one of Romar's main clients. The value of the contract is €1.4m per annum, and is valid until 2012.

In 2007, Romar paid €1.9m for the acquisition of Evolution Med, a private medical services company, which owns a clinic in the northern part of Bucharest and an unfinished hospital, also in the north of Bucharest. The main reason for the acquisition was that it was supposed to allow Romar to gain time in the establishment of its own hospital. However, the company lost its financing facility to complete the building, the clinic proved to be a loss-maker, whilst the hospital remained unfinished. As a solution to release Romar from the liabilities generated by Evolution, the later was transferred back to its former owner as compensation for unmet liabilities arising from the acquisition contract. The results of Evolution are excluded from the *Financial Results* table above.

Bulgarian Stock Exchange

RC2 owns an 1.8% shareholding in the company which operates the Bulgarian Stock Exchange (BSE). These shares are not traded on an organized market and are valued at cost (€0.5m) by RC2. The BSE is 44% owned by the Bulgarian state, 35% owned by Bulgarian brokerage firms, and the balance is owned by a combination of institutions and private individuals.

Financial results

Results for the first half of 2008 show a 25% year-on-year decrease in sales and a 55% decrease in operating profits, primarily as a result of the international economic context and reduced interest in emerging markets. The full year results are due to be published in April 2009.

(EUR '000)	2006A*	2007A*	1H07**	1H08**
Income Statement (according to IFRS)				
Revenues	**2,474**	**4,886**	**1,980**	**1,493**
Total Operating Expenses	(1,522)	(2,057)	(936)	(1,022)
Operating Profit	**952**	**2,828**	**1,044**	**471**
Operating margin	*38.5%*	*57.9%*	*52.7%*	*31.5%*
EBITDA	**1,090**	**2,993**	**1,124**	**564**
EBITDA margin	*44.1%*	*61.3%*	*56.8%*	*37.8%*
Financial Profit/(Loss)	53	156	47	82
Earnings before Tax	**1,005**	**2,984**	**1,091**	**553**
Income Tax	(152)	(300)	-	-
Earnings after Tax	**852**	**2,685**	**1,091**	**553**
Net margin	*34.4%*	*54.9%*	*55.1%*	*37.0%*
Avg exchange rate (BGN/EUR)	*1.956*	*1.956*	*1.956*	*1.956*

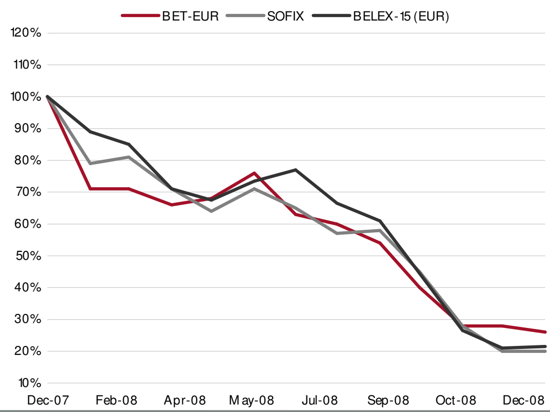
*Note: * IFRS (audited), ** IFRS (unaudited)*

Capital Market Developments

Commentary

In 2008 stock markets throughout South East Europe declined dramatically. In euro-terms, the BET was down 74.0%, whilst the SOFIX lost 79.8% and the BELEX-15 shrank by 78.6%, faring worse than the MSCI Emerging Markets index (-52.4%), the MSCI Emerging Markets Eastern Europe index (-68.2%), the FTSE100 (-47.2%) and the S&P500 (-35.7%).

Over the fourth quarter and measured in euro-terms, the BET lost 35.5%, the SOFIX 54.9% and the BELEX-15 was down by 51.7%. By comparison, the MSCI Emerging Markets index fell by 27.4%, the MSCI Emerging Markets Eastern Europe index lost 47.1%, the FTSE100 25.3% and the S&P500 21.9%.



Macroeconomic Overview

Overview

	RO	as of:	BG	as of:	SRB	as of:
GDP Growth (y-o-y)	8.9%	9M08	7.0%	9M08	6.5%	9M08
Inflation (y-o-y)	6.3%	12M08	7.8%	12M08	7.9%	12M08
Ind. prod. growth (m-o-m)	-11.5%	Nov-08	-5.0%	Nov-08	-2.6%	Nov-08
Trade deficit (EUR bn)	21.0	11M08	8.2	11M08	9.0	12M08
y-o-y	*7.2%*		*26.0%*		*21.5%*	
FDI (EUR bn)	8.6	11M08	5.3	11M08	1.9	11M08
y-o-y change	*31.9%*		*-11.6%*		*2.7%*	
Total external debt/GDP	44.6%	Sep-09	107.1%	Oct-09	64.0%	Nov-09
Reserves to short-term debt	118.3%	Sep-09	102.2%	Oct-09	427.9%	Nov-09
Loans-to-deposits	137.3%	Oct-09	123.3%	Nov-09	125.3%	Nov-09

Commentary

Romania

In the third quarter of 2008, the Romanian economy expanded by 9.1% year-on-year, much faster than expected. Over the first nine months, GDP grew by 8.9% year-on-year, primarily driven by high growth in the agricultural and construction sectors, which increased by 23.4% and 31.1%, respectively. Whilst contracting external demand and lower levels of FDI make a slowdown in economic growth unavoidable, the European Commission (EC) expects it will remain positive in 2009 (+ 1.75%) whilst the IMF sees Romania recording negative growth of -1% in 2009.

Romania's CPI was up 6.3% year-on-year in December 2008, below the National Bank's forecast of 6.7% and also down from 6.6% in 2007. The global recession and lower commodity prices should help ease the surge in inflation, with the IMF seeing overall CPI growth over 2009 at 6.2%. Nonetheless, the steep devaluation of the leu could generate renewed inflationary pressures.

Over the last quarter of 2008, the leu lost 6.7% against the euro, with the Romanian currency losing further ground at the beginning of 2009. However, so far, despite much speculation on the contrary, Romania has not demanded financial aid from either the IMF or the EU. Nonetheless, President Basescu has stated that Romania plans to request a €6-7bn loan from the European Commission. Furthermore, the IMF has announced that a mission will visit Romania at the beginning of February to evaluate the macroeconomic situation.

According to media statements of the Romanian Minister of Finance, the country posted a budget deficit of 5.2% in 2008, much outside the 3.0% threshold imposed by the Maastricht criteria. One of the drivers of the public deficit was the populist measures undertaken by the former government ahead of the parliamentary elections of November 2008. With fewer funds in hand and the higher cost of external financing, the Government is turning to the domestic market for its debt issuance needs. Overall, the public debt accounted for 21% of GDP in 2008 (approximately €30bn) which compares to 20% of GDP in 2007. The external public medium and long term debt stood at €10.8bn at the end of November, or 7% of 2008 projected GDP, and accounted for 21.7% of the total medium and long term debt, compared to 26.5% at the end of 2007.

The 30 November parliamentary elections produced an inconclusive result with the Liberal Democrats ("PDL"), closely linked to President Basescu, and the Social Democrat Party ("PSD") both securing about a third of the vote and agreeing to from a coalition government. On paper, the new Government has approved an austere budget plan for 2009, committing to cut the budget deficit to 2% of GDP and to keep wage growth under control. Accordingly, increases in pensions and public sector wages are to be capped at 5% in 2009, matching the expected average inflation rate. However, the 2009 budget is built on an estimated economic growth of 2.5%, an average inflation of 5%, a current-account deficit of 10.3% and a RON/EUR exchange rate of 4.0, which some observers see as optimistic. The Government intends to allocate 20% of the 2009 state budget to investments in sectors such as infrastructure and the environment to stimulate the economy. Spending cuts in the public sector are to be applied in order to help narrow the budget deficit. As part of its efforts, the new Government has announced that companies' re-invested profits will not be subject to taxation, starting from the second half of 2009. Otherwise, the fiscal regime has so far been left virtually unchanged.

The high economic growth of recent years has come at the price of an ever larger current account deficit. Romania's January-November 2008 current account deficit stood at €16.0bn, 7.8% higher than the same period in 2007. Current transfers (mainly remittances) increased by 21.7% year-on-year to €5.4bn and covered 34% of the current account deficit, whilst FDI flows covered 54% of the current account deficit by the end of November 2008. Given the current economic climate, with credit growth slowing down, low oil prices and a weakening of the leu, *Romania (cont'd)*

the IMF expects the current account deficit to fall to 10.5% of GDP in 2009.

Over January–November 2008, Romania's trade balance recorded a deficit of €21.0bn, up 7.2% from €19.6bn the previous year. Continuing the trend which started in 2007, export growth (+ 15.9% year-on-year) outpaced import growth (+13.2%) over the first 11 months of 2008. An important consequence of the decline in credit growth should be less imported consumer and capital goods resulting in an improvement in the trade balance. The domestic currency's depreciation should also contribute to an improved balance. On the other hand, decreasing foreign demand should result in declining exports (the EU accounted for around 70% of Romania's exports and imports in the first eleven months of 2008).

Romania's total external debt position stood at €70.1bn at the end of September, or 44.6% of estimated 2008 GDP. The trend is decreasing, as at the end of 2007, the external debt accounted for 48.5% of GDP. The National Bank of Romania's foreign reserves (excluding gold) were €26.2bn at the end of December. The short-term external debt (the bulk being inter-company loans or debt owed by local banks to their foreign parents) was €22bn, bringing the reserves to short-term debt ratio to 118.3%, while the short-term debt to GDP ratio was around 14%.

Liquidity has been the command word that has recently governed the behaviour of Romanian banks. In this context, lending shrank as a consequence of prudential behaviour and decreasing external financing from Romanian banks' foreign parents. At the end of October 2008, total domestic non-governmental credit (which excludes loans to financial institutions) reached €52.9bn, slightly down (-1%) from the September level of €53.4bn but up 44.8% year-on-year. Of this, 44.5% was leu-denominated and the balance of 55.5 % was foreign currency loans. The Romanian banking system's total loans-to-deposits ratio was around 137.3% at the end of October. Asset quality improved at least up to October 2008, when 63.0% of loans were classified as "standard" versus 46.4% as at December 2007: a reason might be that since the spring of 2008 the National Bank has required higher provisions on FX denominated loans for the population. The Romanian banking sector has virtually no exposure to the toxic assets that decimated the balance sheets of international banks; and overdue and doubtful loans had a low (0.4%) share of total outstanding loans as of October 2008.

In January, the National Bank decided to maintain its key interest rate at 10.25% and to leave unchanged the existing minimum reserve requirement ratios on both the leu-denominated (18%) and foreign currency-denominated (40%) liabilities of credit institutions.

The National Bank decided to sweeten the lending norms enforced in October 2008 by making a distinction between lending requirements on mortgage-backed loans and 'pure' consumer loans for households. This was because default rates were considerably lower among debtors with mortgage collaterals compared to other categories (e.g. unsecured consumer loans). Under the new norms, banks have the possibility to calculate a higher indebtedness level for borrowers with high-quality real estate assets as collateral for their loans.

Bulgaria

In the third quarter, Bulgaria recorded 6.8% year-on-year economic growth, placing the January-September GDP growth rate at 7.0%. The good performance of the Bulgarian economy was supported by a 24% year-on-year increase in the agricultural sector, while services and industry were up by 5.4% and 6.8%, respectively. Lower foreign demand and a drop in capital flows should make the Bulgarian economy slow down in the last quarter of 2008: the IMF sees 2008 GDP growth falling to 6.3% while for 2009 it has revised its forecast of economic growth from 4.2% to 2%. Meanwhile, the European Commission sees Bulgaria's GDP growth at 1.8% in 2009, mainly due to lower external demand and tighter credit conditions.

Bulgaria's CPI was up 7.8% year-on-year in December, continuing the descending trend after the peak inflation of 15.3% in June. The IMF sees CPI growth over 2009 at 4.5%, helped by falling international commodity prices.

Although much speculation was generated by the possibility of Bulgaria renouncing the currency board regime, so far there has been little sign of this happening. At the end of 2008, Bulgaria had €12.7bn of foreign currency reserves, and the total external debt amounted to €36.4bn at the end of October, 36.6% higher year-on-year. Of this, public external debt was only €4.2bns. The reserves-to-short-term-debt ratio was 102.2% at the end of October, while short term debt accounted for 40.8% of GDP. Out of a total external debt of €36.4bn (107.1% of GDP at the end of October), only 11.6% was attributable to the public sector. The Bulgarian banking system has a total loans-to-deposit ratio of around 120%, computed at the end of November.

Bulgaria's consolidated budget surplus reached €2.4bn at the end of November, equal to 7% of GDP, representing a 16.1% year-on-year increase. The surplus was lower than €2.6bn at the end of October as the Government started spending a planned €0.6bn for social and infrastructure purposes. Fortunately for Bulgaria, its fiscal surplus should buffer the limitations on its economic policies resulting from its currency board regime. With EU funds (approx. €0.8bn) being frozen for Bulgaria due to corruption issues, a tight budgetary execution has an even more important role. The 2009 budget targets a surplus of 3% of GDP, but allows for a narrowing to 2% of GDP in case a worsening macroeconomic climate requires more spending.

Over January-November, Bulgaria's current account deficit stood at €7.5bn, or 21.9% of GDP, compared to a €5.4bn deficit over

Bulgaria (cont'd)

the same period in 2007, or 18.6% of GDP. The high current account deficit is a consequence of the concentration of GDP growth in construction, real estate and financial intermediation. FDI dropped by 11.6% year-on-year to €5.3bn over the same period. This covered only 70.7% of the current account deficit compared to 111.2% the previous year. Lower levels of FDI should slow down economic activity (industrial production dropped by 5% year-on-year in November). The IMF has projected a current account deficit of 15% of GDP in 2009, while the EC sees it at around 20%.

The January-November 2008 trade deficit stood at €8.2bn, up 26.0% on the same period last year. Exports grew by 15.5% to €14.3bn, but this was still below import growth of 19.1%.

Shrinking foreign demand will negatively affect Bulgarian exports further. Another dark spot for Bulgaria is that slowing export growth is triggered by the pegged currency which makes the country's production less competitive vis-à-vis other exporters. On the other hand, imports should fall in line with declining levels of investment (investment goods account for around 20% of total imports).

The Bulgarian National Bank decreased the level of minimum reserve requirement ratios from 12% to 10% on all attracted funds effective at the beginning of December. The move should free up about €0.6bn of extra liquidity. In addition, the Central Bank decided to lower the ratio on funds attracted from abroad from 10% to 5% as of January 2009.

Serbia

Over the third quarter, the Serbian economy's growth pace decelerated to 4.9% year-on-year compared to 6.3% the previous quarter, bringing total GDP year-on-year growth over the first nine months of 2008 to 6.5%. According to the European Bank for Reconstruction and Development, Serbia's GDP growth will be reduced to 3% in 2009.

The 2008 trade deficit stood at €9bn, 21.5% higher year-on-year. The value of exports amounted to €11.7bn, a 25.7% increase compared to 2007, whilst imports amounted to €20.7bn, 23.8% higher than in 2007.

In December, Serbian inflation fell to 7.9%, its lowest rate since August 2007. In January, the National Bank of Serbia decided to keep its key policy rate on hold at 16.5% in an effort to keep inflation under control.

Over the fourth quarter, the Serbian dinar lost 16.9% against the euro. Since the beginning of the year, the Serbian dinar has lost 14.0% compared to a slight appreciation of 1.3% in 2007.

Industrial production fell by 2.6% year-on-year in November compared to a 3.4% fall the previous month. In the January - November 2008 period, industrial production grew by 2.0% compared to the same period in 2007.

At the end of 2008, Serbia's public debt stood at €8.8bn, or 25.3% of the country's estimated 2008 GDP. In 2007, the public debt was €8.9bn.

The government intends to continue to pursue the goal of EU integration. However, the EU has yet to activate the interim agreement governing the trade-related aspects of the stabilisation and association agreement (SAA). Differences over Kosovo and uncertainty about future enlargement will further complicate relations.

The restrictive monetary policy that the National Bank of Serbia has been enforcing for years now seems to have been farsighted. The strict regulatory framework of Serbian banks (average capital adequacy ratio of 28%) is the highest in CEE countries and can provide a buffer. As a result, Serbia has one of the lowest per capita indebtedness ratios in Europe (approximately €534 per capita).

Withdrawals of retail deposits coupled with heavy interventions of the National Bank of Serbia on the foreiegn exchange market shrank Serbia's foreign currency reserves to €8.2bn in December.

The IMF has approved a 15-month €402.5m Stand-By Arrangement to support the Serbian government's program aimed at maintaining macroeconomic and financial stability. The arrangement with the IMF includes upfront fiscal restraint (2009 deficit to be capped at 1.75% of GDP), keeping inflation under control, the continuance of structural reforms to boost the economy's exports and growth, and a floating foreign exchange rate. The new pro Western government is expected to remain committed to this package, and to force through cuts in public expenditure aimed at reducing domestic demand and the external deficits.

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