Reconstruction Capital II Ltd

("RC2" or the "Fund")

Quarterly Report

31 December 2017

neweuropecapital

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Statistics

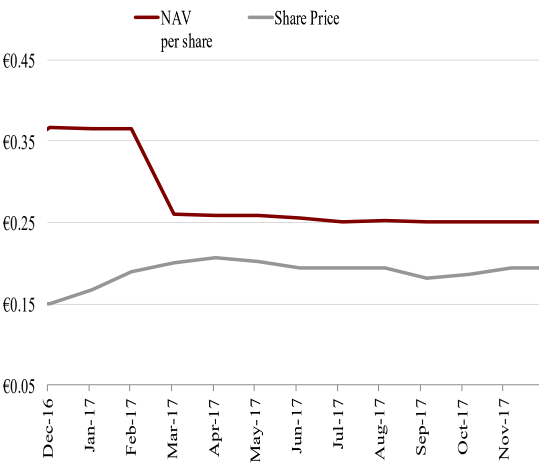
NAV per share (€)	0.2504
Total NAV (€ m)	36.3
Share price (€)	0.1950
Mk Cap (€ m)	28.3
# of shares (m)	144.9
NAV/share since inception†	-50.20%
12-month NAV/share perfomance	-31.79%
NAV/share annualized Return*†	-5.64%
NAV/share annualized Volatility*†	17.52%
Best month (NAV/share)*†	13.98%
Worst month (NAV/share)*†	-28.27%
# of months up (NAV/share)*†	74
# of months down (NAV/share)*†	70

** since inception † assumes pro-rata participation in the 2008 share buy-back and the 2017 return of capital*
Note: € 17m returned to shareholders in 2017

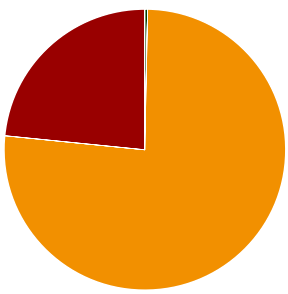
RC2 NAV returns

	2014	2015	2016	2017
Jan	-0.65%	-0.07%	8.03%	-0.26%
Feb	-0.34%	-0.34%	1.22%	-0.21%
Mar	2.94%	-0.70%	-0.66%	-28.75%
Apr	2.73%	0.93%	-0.49%	-0.31%
May	2.70%	3.11%	3.09%	-0.23%
Jun	0.28%	-0.38%	1.18%	-1.02%
Jul	0.44%	3.24%	6.83%	-1.84%
Aug	3.23%	-0.85%	2.11%	0.10%
Sep	0.01%	0.31%	-8.63%	-0.26%
Oct	1.87%	-0.35%	-21.79%	0.15%
Nov	0.15%	3.17%	-0.24%	-0.24%
Dec	0.73%	-8.47%	12.06%	-0.23%
YTD	14.91%	-0.94%	-1.75%	-31.79%

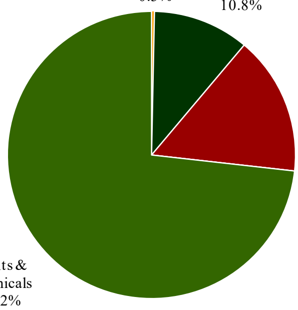
Share price / NAV per share (€)



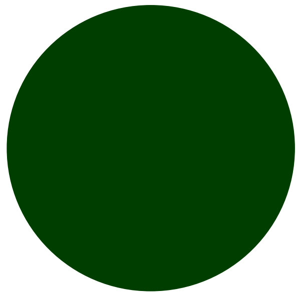
Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Portfolio Structure by Geography



Message from the Adviser

Dear Shareholders

During the fourth quarter, RC2's total NAV fell by € 0.5m, whilst its NAV per share fell by 0.2% to € 0.2504, compared to € 0.2512 at the end of the previous quarter. During the quarter, RC2 bought for cancellation 1.6m shares at a price of € 0.1675 per share, and a total cost of € 0.26m. The annual independent valuation exercise resulted in the following changes to the valuations of the private equity positions:

	Prior valuations €	Revised valuations €
Policolor SA	20,640,000	20,600,000
Telecredit IFN SA	2,823,234	2,664,000
Mamaia Resort Hotels SRL	4,079,921	4,404,658
Total	**27,543,155**	**27,668,658**

The Policolor Group's 2017 consolidated sales were 10.7% higher than in 2016, as all divisions reported improved sales figures, whilst its EBITDA more than doubled from € 1.2m to € 2.8m.

Mamaia Resort Hotels' EBITDA of € 0.44m was above last year's result of € 0.35m, but below the budgeted € 0.78m due to lower than expected results in May and August. The occupancy rate reached 29.9% in 2017, compared to 25.9% in 2016, as management managed to generate higher corporate contracts over the low season months.

Telecredit granted 32,100 loans with a total value of € 4.9m over 2017, and the net value of Telecredit's loan book was € 0.54m, including accrued interest of € 0.11m, at the end of December. The operating profit after depreciation fell from € 0.2m in 2016 to € 0.1m in 2017, as a result of an expanded cost base, mainly in marketing and salaries.

At the end of the quarter, the Fund had cash and cash equivalents of approximately € 8.6m and short-term liabilities of € 0.4m, of which € 0.15m represents outstanding B Class share redemptions, and € 0.28m represents sundry liabilities.

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 form the largest producer of coatings in Romania and Bulgaria. The Group also includes Orgachim Resins, the leading supplier of resins in South East Europe, and Ruse Chemicals, a producer of anhydrides. All the Group companies are unlisted.

Group Financial results and operations

(EUR '000)	2015*	2016*	2017B	2017**	2018B
Group Consolidated Income statement					
Sales revenues	**56,935**	**58,722**	**63,869**	**64,992**	**72,254**
sales growth year-on-year	*6.1%*	*3.1%*	*8.0%*	*10.7%*	*11.2%*
Other operating revenues	356	160		209	
Total operating revenues	**57,291**	**58,882**	**63,869**	**65,201**	**72,254**
Gross margin	19,807	20,577	24,175	22,031	23,711
Gross margin %	*34.6%*	*34.9%*	*37.9%*	*33.8%*	*32.8%*
Total operating expenses	**(59,092)**	**(60,923)**	**(63,717)**	**(65,492)**	**(70,308)**
Operating profit	**(1,801)**	**(2,041)**	**152**	**(291)**	**1,946**
Operating margin	*-3.6%*	*-3.5%*	*0.8%*	*-0.4%*	*2.7%*
EBITDA	**2,089**	**1,219**	**3,452**	**2,815**	**4,745**
EBITDA margin	*3.6%*	*2.1%*	*5.4%*	*4.3%*	*6.6%*
Net extraordinary result - land sale	204	(668)	655	4,689	(424)
Orgachim squeeze out revenues				555	-
Financial Profit/(Loss)	(1,147)	(1,023)	(1,000)	(1,825)	(1,077)
Profit before tax	**(2,744)**	**(3,732)**	**(194)**	**3,128**	**445**
Income tax	(31)	(279)	(579)	(719)	(217)
Profit after tax	**(2,775)**	**(4,011)**	**(773)**	**2,409**	**228**
avg exchange rate (RON/EUR)	*4.44*	*4.49*	*4.50*	*4.57*	*4.65*

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

Sales grew by 10.7% in 2017 due to all divisions reporting improved sales, whilst EBITDA more than doubled from € 1.2m in 2016 to € 2.8m in 2017, although it came in below budget mainly due to higher raw materials costs which are affecting the entire industry. The specialty chemicals (anhydrides) division was able to reach a tolling agreement with one of its clients in the second half of the year thus increasing its 2017 sales by 58% year-on-year. Overall, sales of paints and coatings grew by 7.3% year-on-year, and sales of resins were up 10.2%.

At the end of December 2017, the Group's consolidated net debt amounted to € 15.5m, compared to € 22.4m at the end of 2016, mainly due to € 8.4m of net proceeds received from the sale of its main site during the year, after having reached a settlement with the former buyers of the land.

Prospects

The Group's 2018 budget provides for consolidated sales of € 72.3m, up 11.2% year-on-year, made up of 8% overall sales growth at the paints and coatings divisions, resins sales estimated to grow by 4%, while the specialty chemicals division's sales are expected to grow by 66% due to the continuation of the tolling agreement signed in the second half of 2017 with its biggest client. EBITDA is budgeted at € 4.7m, significantly above the 2017 result, mainly as a result of a significant improvement from the coatings and resins divisions.

Having completed the sale of half of its main site in 2017, Policolor is due to receive a further € 0.7m advance for the sale of its remaining land in the summer of 2018, with the balance of € 9.9m being due in June 2019, when Policolor is due to finally vacate its existing site, and move its remaining production in Bucharest to a new location in the capital.

Mamaia Resort Hotels

Background

Mamaia Resort Hotels SRL (the "Company") is the owner and operator of the ZENITH – Conference & Spa Hotel (the "Hotel"), which is located in Mamaia, Romania's premium seaside resort next to the city of Constanta. In March 2008, RC2 acquired 63% of the Company, with the remaining 37% being owned by a Romanian private individual.

Financial results and operations

(EUR '000)	2015*	2016*	2017B	2017**	2018B
Income Statement					
Total Operating Revenues	**2,349**	**2,337**	**2,751**	**2,524**	**2,759**
Total Operating Expenses	(2,044)	(2,200)	(2,148)	(2,258)	(2,222)
Operating Profit	**305**	**137**	**603**	**267**	**537**
Operating margin	*13.0%*	*5.9%*	*21.9%*	*10.6%*	*19.5%*
EBITDA	**484**	**353**	**783**	**438**	**710**
EBITDA margin	*20.6%*	*15.1%*	*28.5%*	*17.4%*	*25.7%*
Profit after Tax	**176**	**40**	**651**	**180**	**364**
Net margin	*7.5%*	*1.7%*	*23.7%*	*7.1%*	*13.2%*
Avg exchange rate (RON/EUR)	*4.44*	*4.49*	*4.50*	*4.57*	*4.65*

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

The Company's 2017 operating revenues were € 2.5m, up 8% year-on-year but 8% below budget, mainly due to lower than expected results in May and August.

Accommodation revenues accounted for 49% of overall sales and increased by 2.8% year-on-year. The occupancy rate reached 29.9%, compared to 25.9% in 2016, as the management managed to generate corporate contracts over the low season months, but the average net tariff per room fell from € 45.9 to € 41.4 as, confronted with higher competition mainly from Airbnb-type short term holiday lets, management decided to lower tariffs, especially in August and September.

In terms of sales channels, 62% of accommodation revenues were generated through agencies, 9% by corporate contracts (both percentages being unchanged year-on-year), 18% by "walk-in" clients (compared to 16% in 2016), and the balance of 11% were generated by online bookings (compared to 13% the previous year).

The food & beverage department's revenues of € 1.1m were on budget, and 11.3% higher year-on-year, mainly due to improved *a la carte* sales, which were also positively influenced by the increased number of higher spending "walk-in" clients.

The 2017 EBITDA of € 0.44m was significantly below the budgeted € 0.78m, as overall revenues were 8% below budget whilst operating costs came in 5% above budget. The local hotel industry has faced strong pressure on salaries due to a chronic shortage of labour of all types, compounded by the Romanian government's policy of increasing the minimum wage. Overall, the Hotel's personnel expenses increased from € 0.7m in 2016 to € 0.8m in 2017.

Prospects

The 2018 budget is based on accommodation revenues reaching € 1.4m, up 10% year-on-year due to a higher envisaged average room tariff (up from € 41.4 in 2017 to € 45 in 2018), and no change to the occupancy rate. Management has already increased the tariffs on its contracts with agencies for the summer of 2018. Operating expenses are expected to reach € 2.2m, in line with 2017, with the resulting budgeted EBITDA of € 0.7m being significantly higher than the € 0.4m achieved in 2017.

Telecredit

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 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	2015*	2016*	2017B	2017**	2018B
Income Statement					
Total interest revenues:	**441**	**1,020**	**1,799**	**1,617**	**1,785**
"regular" interest	370	814		1,219	1,137
penalty interest	58	175		397	648
fixed fees	13	31		0	
Total operating expenses	**(233)**	**(550)**	**(1,085)**	**(1,025)**	**(1,086)**
Operating profit (before depreciation)	**48**	**220**	**309**	**158**	**311**
Depreciation	(5)	(9)	(19)	(19)	(24)
Operating profit (after depreciation)	**43**	**211**	**291**	**139**	**286**
Operating profit (after depreciation) margin	*9.8%*	*20.6%*	*16.2%*	*8.6%*	*8.6%*
Financial result	(4)	(4)		(0)	
Profit before tax	39	207		139	
Profit after tax	**36**	**175**		**114**	
Net Operating Cash Flow	**(158)**	**(155)**	**(40)**	**98**	**(23)**
Avg exchange rate (RON/EUR)	*4.445*	*4.491*	*4.550*	*4.568*	*4.650*

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

In 2017, Telecredit generated interest revenues of € 1.6m, up 58.5% year-on-year but 10.1% below budget, due to less loans granted than expected. Overall, the Company granted 32,000 loans with a total value of € 4.9m over 2017, which is 18% lower than budget. Of the 32,000 loans granted, 27% were rollovers, 47% were to recurring clients (who had already taken a loan at some point in time), and the balance of 26% represents new clients.

The drop in loan applications is explained by an improved macroeconomic environment, with higher wages resulting in less need for pay-day loans, and increased competition not only from a larger number of non-banking financial institutions, but also from banks who have sped up the process for granting lower value loans to consumers.

The operating profit after depreciation fell from € 0.2m in 2016 to € 0.1m in 2017, as a result of an expanded cost base, mainly in marketing and salaries.

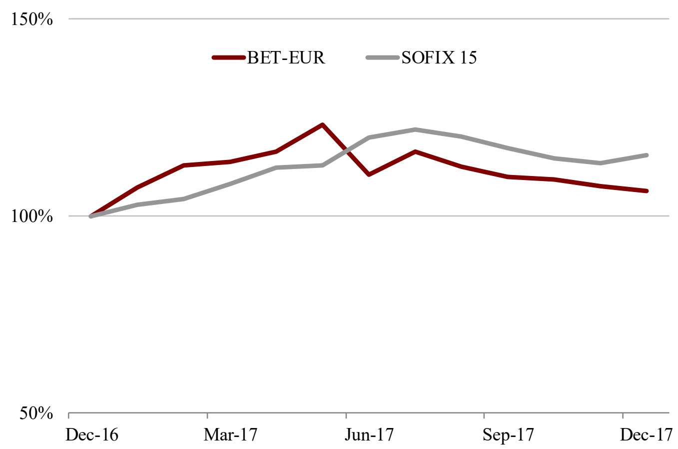
Prospects

The 2018 budged is based on the assumption that Telecredit grants 27,600 pay-day loans, or an average of 2,300 loans per month, which is similar to the average number of loans granted over the second half of 2017, and a total face value of € 4.9m.

The 2018 interest revenues are budgeted at € 1.8m, of which 64% represents revenues generated by "regular" interest and the balance of 36% is penalty interest. However, Telecredit's business model is under threat as a Romanian senator has recently proposed an 18% cap on the effective annual interest charged by financial institutions, which would have a devastating effect on the profitability of the consumer lending industry. The legislative proposal has already been approved by the Senate and is due to be submitted for approval to the Chamber of Deputies, which has the decisive vote.

Capital Market Developments

BET-EUR and SOFIX-15: 1 year performance



Commentary

During the fourth quarter, both the Romanian BET and the Bulgarian SOFIX indices lost 3.1% and 1.5%, respectively, all in euro terms. Over the same quarter, the MSCI Emerging Market Eastern Europe, the MSCI Emerging Market, the FTSE100 and S&P indices were up by 2.3%, 5.1%, 3.4% and 4.2%, respectively, all in euro terms.

Over 2017, the BET-EUR and SOFIX 15 indices were up by 6.5% and 15.6%, respectively, all in euro terms. By comparison, the MSCI Emerging Market Eastern Europe index lost 1.0%, whilst the MSCI Emerging Market, the FTSE100 and the S&P indices gained 17.9%, 3.4% and 4.8%, respectively, all in euro terms.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:
GDP Growth (y-o-y)	7.0%	FY17	3.6%	FY17
Inflation (y-o-y)	3.3%	Dec-17	2.8%	Dec-17
Ind. prod. growth (y-o-y)	13.5%	Dec-17	2.0%	Dec-17
Trade balance (EUR bn)	-13.0	FY17	-2.0	FY17
y-o-y	*29.9%*		*107.3%*	
FDI (EUR bn)	4.6	FY17	0.9	FY17
y-o-y change	*1.5%*		*36.7%*	
Budget balance/GDP	-2.9%	FY17	0.8%	FY17
Total external debt/GDP	52.7%	Dec-17	63.5%	Nov-17
Public sector debt/GDP	42.0%	Nov-17	24.9%	Dec-17
Loans-to-deposits	76.7%	Dec-17	72.6%	Dec-17

Commentary

Romania

Romania's GDP increased by 7% year-on-year in 2017, mainly triggered by higher private consumption, with household consumption increasing by 10% over the year. According to its latest forecast published in February, the EU Commission expects Romania's GDP growth to slow down to 4.5% in 2018, as rising inflation erodes disposable income, tempering domestic demand.

After a couple of years of falling consumer prices, the inflation rate turned positive, reaching 3.3% in December 2017, compared to -0.5% in December 2016. The higher inflation rate was the consequence of increasing domestic demand and higher energy and oil prices. To counter the effect of the rising inflation rate, the National Bank of Romania ("NBR") has increased its base lending rate from 1.75% to 2.25% after more than two years of unchanged rates. As a consequence, borrowing costs are set to increase, which should hinder consumer lending in 2018. The NBR is forecasting an inflation rate of 3.5% by December 2018.

The Romanian leu fell by 2.6% against the euro in 2017, due to worries about the sustainability of the fiscal relaxation measures promoted by the ruling Social Democratic Party (PSD),and ongoing concerns about Romania's government and ruling majority in Parliament attacking the public prosecutors and the independence of the judiciary, in an attempt to water down their anti-corruption efforts, whilst promoting populist economic policies, including public sector hand-outs, salary increases, and attacks on banks and other lenders.

According to preliminary data, Romania's budget deficit reached -2.9% of GDP in 2017, compared to a deficit of -2.4% in 2016. Whilst budgetary receipts increased by 12.5% year-on-year, triggered by higher social contribution and personal income tax collections, corporate income tax revenues fell by 4.6%, in spite of the high economic growth. Budgetary expenses increased by 14%, mainly due to higher personnel and social expenditures, while infrastructure and public investments increased by only 2.4%. At 2.3% of GDP, public investments are at their lowest level since Romania joined the EU in 2007, according to the NBR. For 2018, the Romanian government is targeting a deficit of -2.97% of GDP.

Driven by excessive domestic demand, the trade gap widened by 30% in 2017 (from € -10bn in 2016 to € -13bn), as imports grew by 12.2% while exports increased by 9.1%. The negative evolution of the trade balance was the main reason behind the € -6.5bn current account deficit, which is the equivalent to 3.6% of GDP and compares to a € -3.5bn deficit in 2016. FDI flows amounted to € 4.6bn, virtually flat year-on-year, of which € 3.8bn were equity investments, whilst net intra-group loans amounted to € 0.8bn. Romania's total external debt was € 94bn at the end of December, which represents a 1.1% year-to-year increase and amounts to approximately 53% of GDP. Total public debt was € 77bn, or 42% of GDP, at the end of November, up 5.5% year-to-date in RON terms. In October, Romania successfully placed € 1bn of 10-year eurobonds at a yield of 2.16%, which positively compares to a yield of 2.38% achieved during the previous eurobond issue of € 1.8bn in April.

Total domestic non-governmental credit (which excludes loans to financial institutions) was € 49.9bn at the end of December, up 5.6% over the year in RON terms. Household loans increased by 7.8% year-on-year and accounted for 52.4% of the total loan stock at the end of 2017, compared to 51.4% at the end of 2016. The main trigger for the increase in household lending was housing loans which account for 54% of household loans and grew by 13.2% year-on-year in RON terms. Consumer loans account for 44% of household loans and increased by 11.8% year-on-year in RON terms. Corporate loans increased by 2.2% year-on-year and accounted for 44.7% of the total loan stock. The overall deposit base increased by 10.4% in RON terms over the year, and amounted to € 65bn at the end of 2017. The NPL ratio was 6.4% at the end of December, down from 9.6% at the end of 2016.

Bulgaria

Bulgaria's GDP increased by 3.6% in 2017, whilst the EU Commission forecasts it will grow by 3.7% in 2018, based on strong domestic demand.

Bulgaria's inflation rate has been increasing over the year and reached 2.8% in December 2017, compared to an inflation rate of 0.1% recorded in December 2016.

In 2017, Bulgaria ran a budget surplus of € 0.4bn, or 0.8% of GDP, which compares to a budget surplus of 1.6% of GDP in the prior year. While revenues increased by 4% year-on-year, total expenses increased by 6.2%, mainly triggered by higher personnel and social expenditures following an increase in pensions in July, whilst public investment fell by 2.9%. Bulgaria is targeting a deficit of -1% of GDP in 2018. Bulgaria's public sector debt was 24.9% of GDP at the end of December, down 3.7 basis points from the end of 2016. The fall was mainly due to the repayment of € 1bn of 5-year Eurobonds which matured in July.

Bulgaria's trade balance worsened from a € -1bn deficit over 2016 to a € -2bn deficit over 2017. While exports grew by 11.8%, the year-on-year increase in imports was significantly higher at 15.7%. Mainly helped by a € 3.0bn surplus in services, the current account balance was € 2bn in surplus in 2017, lower than the € 2.5bn surplus achieved in 2016. FDI inflows amounted to € 0.9bn, 36.7% higher compared to 2016.

Total domestic non-governmental credit (which excludes loans to financial institutions) amounted to € 25.9bn at the end of December, up 3.3% over the year. Total corporate and household loans increased by 1.7% and 6%, respectively. The deposit base was € 35.7bn at the end of December, up 7.9% since the end of 2016. The NPL ratio was 10.2% at the end of December, down from 11.4% at the end of the previous quarter.

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