Reconstruction Capital II Ltd

(“RC2” or the “Fund”)

Quarterly Report

31 December 2023

neweuropecapital

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Statistics

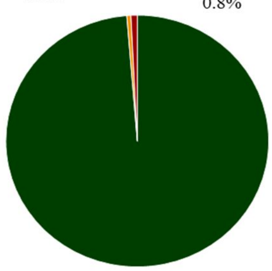
NAV per share (€)	0.2072
Total NAV (€ m)	28.1
# of shares (m)	135.6
NAV/share since inception†	-54.70%
12-month NAV/share perfomance	17.95%

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

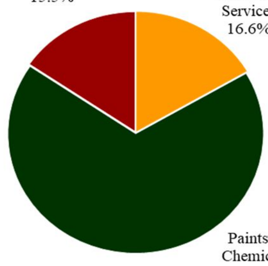
RC2 Quarterly NAV returns

	2020	2021	2022	2023
1Q	-0.77%	-0.75%	-0.76%	-0.80%
2Q	-0.75%	-0.78%	-0.07%	-0.80%
3Q	-0.86%	-0.74%	-0.93%	-1.07%
4Q	12.04%	27.16%	-9.29%	21.16%
YTD	9.40%	24.30%	-10.88%	17.95%

Portfolio Structure by Asset Class



Equity Portfolio Structure by Sector



Message from the Adviser

Dear Shareholders

During the fourth quarter, RC2's NAV per share grew by 21.2% from € 0.1710 to € 0.2072, driven by a strong uplift in the value of the investments in Policolor and Telecredit, whilst the value of the shareholding in Mamaia Resorts Hotels was written down, as shown in the table below:

	Prior valuations €	Revised valuations €
Policolor SA	14,080,000	17,560,000
MamaiaResort Hotels	4,814,247	4,013,219
Telecredit IFN SA	3,230,000	4,284,000
Total	**22,124,247**	**25,857,219**

2023 was characterised by a high-interest rate regime in Romania which successfully curtailed inflationary pressures, bringing the rate of inflation from 16.4% at the end of 2022 to 6.1% at the end of 2023. Romanian consumers were squeezed by the high interest regime and the cost of living crisis, which affected the sales of both the Policolor Group's Romanian business and Mamaia Resort Hotels, whilst Telecredit, which is not directly affected by the plight of consumers, achieved another high growth year. The Bulgarian business of the Policolor Group was not so affected by the interest rate squeeze, as the local currency is pegged to the euro, and interest rates remained relatively subdued, whilst the government compensated consumers for the high energy prices until the end of the year.

Whilst the Policolor Group's turnover fell 16.8% from € 85.6m in 2022 to € 71.2m, almost entirely due to the closure of its phthalic anhydride plant for a large part of the year, the Group achieved a significant improvement in its gross margin, from 23.6% in 2022 to 30.4%, mainly driven by an improved performance at its coatings and resins divisions. Importantly, the Romanian Coatings division achieved a € 1.9m turnaround in its EBITDA, which was € 0.5m in 2023 compared to an negative € -1.4m in 2022, whilst the Group's total EBITDA of € 3.7m was 34.5% higher year-on-year. For 2024, Policolor is budgeting a further increase in its EBITDA to reach € 6.35m, and a 9.1% increase in sales.

Based on preliminary unaudited results, in 2023, Telecredit's financing volumes grew by 40% to € 40.4m, generating interest revenues of € 2.0m and an Operating profit before depreciation and interest expenses of € 0.75m, 48% higher than in 2022. Telecredit's 2024 budget targets a 27.4% increase in interest revenues, based on € 41.4m of funds deployed., and an Operating profit before depreciation and interest expenses of just over € 1.1m.

In 2023, Mamaia Resort Hotels underperformed expectations, with operating revenues of € 3.0m 25.8% below budget and 24.7% below 2022, due to lower off-season rental contracts, and weaker peak-season demand. As the Hotel failed to adapt its off-season cost base to the lower revenues, it turned loss-making, generating negative EBITDA of € -0.3m, 0.8m below budget and € 0.9m below the previous year. Over the winter, the Hotel made significant efforts to adjust its off-season cost base to the lower expected revenues, based on which it is budgeting a return to profitability in 2024, with the 2024 EBITDA target set at € 0.4m, still lower than the record € 0.7m achieved in 2023.

During the fourth quarter, RC2 received a € 0.03m dividend from Policolor, and drew down € 0.1m on its loan from Mr. Ion Florescu, a substantial shareholder. At the end of December, RC2 and RC2 (Cyprus) Ltd had cash and cash equivalents of € 0.14m, receivables of € 0.23m, and short-term payables of € 0.34m.

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, 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.

Group Financial results and operations

(EUR '000)	2022A*	2023B	2023A**	2024B
Group Consolidated Income statement				
Sales revenues	**85,593**	**92,906**	**71,205**	**77,710**
sales growth year-on-year	*7.8%*	*8.5%*	*-16.8%*	*9.1%*
Other operating revenues	1,382	-	145	-
Total operating revenues	**86,975**	**92,906**	**71,350**	**77,710**
Gross margin	**20,531**	**24,570**	**21,660**	**25,695**
Gross margin %	*23.6%*	*26.4%*	*30.4%*	*33.1%*
Other operating expenses	(20,483)	(22,888)	(20,275)	(22,518)
Operating profit	**48**	**1,683**	**1,385**	**3,177**
Operating margin	*0.1%*	*1.8%*	*1.9%*	*4.1%*
EBITDA	**2,810**	**4,653**	**3,792**	**6,350**
EBITDA margin	*3.2%*	*5.0%*	*5.3%*	*8.2%*
Nonrecurring items / Extraordinary Items	-	-	1,077	-
Net extraordinary result	-	-	1,077	-
Nonrecurring items	-	-	-	-
Financial Profit/(Loss)	(383)	(924)	(1,245)	(1,484)
Profit before tax	**(335)**	**759**	**1,217**	**1,693**
Income tax	(183)	-	-	-
Profit after tax	**(518)**	**759**	**1,217**	**1,693**
avg exchange rate (RON/EUR)	*4.91*	*4.97*	*4.97*	-

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

Based on preliminary unaudited results, the Policolor Group achieved consolidated sales of € 71.2m in 2023, 16.5% below 2022 and 23.4% below budget. This was almost entirely due to a fall in sales at the Chemicals division (from € 9.7m in 2022 to € 3.2m), due to its inability to source alternative sources of orthoxylene for the production of phthalic anhydrides, pursuant to the EU banning imports of Russian orthoxylene from mid-2022.

The Coatings division’s sales of € 50.7m were 1% lower year-on-year and 8.3% below budget, reflecting lower discretionary spending and weak construction activity particularly in Romania, due to high inflation and high interest rates, and the resulting ongoing cost of living crisis. The Resins division generated sales of € 23.1m, 13.7% below budget and 24.7% below 2022, due to weak demand across Europe.

In spite of the falls in sales, the Group strongly improved its profitability, with the consolidated gross margin increasing from 23.6% in 2022 to 30.4% in 2023, which was also significantly higher than the budgeted 26.4%.

Due to the improved gross margin but also a strong control of fixed costs, the Group’s EBITDA increased from € 2.8m in 2022 to € 3.8m in 2023. However, this was still 18.5% below budget due to the underperformance at the Chemicals division.

Prospects

The Policolor Group’s 2024 budget targets 9.1% year-on-year growth in consolidated sales to reach € 77.7m, driven by improved sales at the coatings division, with the resins division continuing to be affected by weak demand across Europe.

The Group’s gross margin is budgeted to reach 33.1% in 2024, compared to 30.4% in 2023, helped by greater operational efficiencies and, to a lesser extent, lower raw materials prices.

Due to the higher sales and improved gross margin, the Group is targeting a significant increase in EBITDA, which is budgeted to reach € 6.4m in 2024, compared to € 3.8m in 2023.

The Group is budgeting total CAPEX of € 4.5m in 2024, comprising € 1.3m for the Romanian coatings division, € 0.8m for the Bulgarian coatings division, € 1.2 for resins and €0.1m for the chemicals division, all for operational improvements, in addition to € 1.1m of regulatory-mandated capex.

Telecredit

Background

Telecredit IFN S.A. (“Telecredit” or the “Company”) is a Romanian Non-Banking Financial Institution (“IFN”) whose main activity is providing factoring, discounting, and microloans to small and medium-sized companies (“SMEs”). RC2 owns an 85% shareholding, with the balance of 15% being owned by the Company’s CEO, Elisa Rusu.

Financial Results and operations

(EUR '000)	2022A*	2023B	2023 A**	2024B
Income Statement				
Interest revenues from SMEs lending, of which:	**1,625**	**2,141**	**1,973**	**2,513**
Factoring and Discounting	1,606	2,109	1,896	2,266
Microloans	19	32	77	247
Total operating expenses:	**(999)**	**(1,234)**	**(1,120)**	**(1,363)**
Provisions, of which:	27	(124)	(29)	(197)
Pay day lending	32	-	63	-
SMEs lending	(5)	(124)	(91)	(197)
Other Operating expenses	(1,027)	(1,110)	(1,092)	(1,167)
Operating profit before depreciation and interest expenses	**626**	**907**	**852**	**1,150**
Depreciation	(97)	(173)	(108)	(79)
Operating profit before interest expenses (EBIT)	**529**	**734**	**745**	**1,071**
EBIT margin, %	*32.6%*	*34.3%*	*37.8%*	*42.6%*
Profit after tax	**174**	**273**	**322**	**569**
Net margin %	*10.7%*	*12.7%*	*16.3%*	*22.7%*
Avg exchange rate (RON/EUR)	*4.92*	*4.92*	*4.97*	-

*Note: * RAS audited, ** IFRS management accounts, unaudited*

Telecredit had another high-growth year, achieving, according to the preliminary unaudited 2023 results, interest revenues of € 2.0m, 21.4% above 2022 although 8% below budget, and an Operating profit before depreciation and interest expenses of € 0.85m, 36% above 2022 but still 6% below budget.

Telecredit's growth compared to 2022 was driven by record financing volumes that peaked in July, September and December, resulting in an annual total of € 40.4m, which was 40% higher than the € 28.8m achieved in 2022, and 11.2% above budget.

The value of the financing book net of provisions was € 6.4m at the end of 2023, made up of € 5.46m of factoring exposure, € 0.03m of discounting exposure, € 0.63m of pre-financings and € 0.24m of microloans. The increase in the financing book from €4.1m at the end of 2022 is reflected in the evolution of net debt, which amounted to € 4.8m at the end of 2023, significantly up on € 2.9m at the end of 2022.

The non-performing loan (NPL) rate (defined as the balance of receivables accelerated or over 90 days overdue, divided by the gross book value of the portfolio) was 5.2% at the end of December 2023, down from 6.3% at the end of 2022. In 2023, defaulted financings amounted to € 0.1m, representing 1.5% of the year-end gross book value.

Prospects

Telecredit's 2024 budget targets a 27.4% year-on-year increase in interest revenues, based on € 41.4m of funds deployed. The Company is targeting an operating profit before depreciation and interest expenses of € 1.15m, compared to € 0.85m in 2023.

Mamaia Resort Hotels

Background

Mamaia Resort Hotels SRL (the "Company") is the owner and operator of the ZENITH – Conference & Spa Hotel (the "Hotel") 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)	2022A*	2023B	2023A**	2024B
Total Operating Revenues, of which:	**3,932**	**3,986**	**2,957**	**3,314**
Accommodation revenues	2,433	2,146	1,524	1,778
Food & beverage revenues	1,347	1,710	1,282	1,423
Other operating revenues	152	129	151	113
Total Operating Expenses	(3,394)	(3,572)	(3,381)	(3,076)
Operating Profit	**538**	**413**	**(423)**	**238**
Operating margin, %	*13.7%*	*10.4%*	*-14.3%*	*7.2%*
EBITDA	**657**	**493**	**(298)**	**392**
EBITDA margin, %	*16.7%*	*12.4%*	*-10.1%*	*11.8%*
Profit after Tax	**370**	**271**	**(616)**	**87**
Net margin, %	*9.4%*	*6.8%*	*-20.8%*	*2.6%*
Operational KPIs				
Occupancy rates	49%	33%	27%	36%
avg exchange rate (RON/EUR)	*4.92*	*4.92*	*4.97*	*4.97*

*Note: * RAS audited, ** RAS management accounts, unaudited*

Whilst 2022 had been a record year for the Hotel in terms of revenues and profitability, Mamaia Resort Hotels reported a loss in 2023, due to its failure to sufficiently reduce its costs to reflect significantly reduced contracts with large organisations during the off-season, and lower-than-expected demand from holidaymakers during the summer.

According to preliminary unaudited results, the Hotel's 2023 operating revenues of € 3.0m were 25.7% below budget and 24.7% below 2022, with the occupancy rate falling from a record 49% in 2022 to 27% in 2023. Accommodation revenues of € 1.5m were 37.3% below the prior year, while Food & Beverage revenues of € 1.3m were 4.7% lower.

In spite of the lower revenues, total operating expenses were almost unchanged since 2022, mainly due to high personnel expenses, resulting in an EBITDA loss of €-0.3m for the year, compared to an € 0.8m EBITDA budget target, and € 0.7m in 2022. Similarly, the net income result was a € 0.6m loss, compared to a budgeted € 0.3m net profit.

Over the year, the Hotel's net debt increased by € 0.1m to € 1.9m.

Prospects

The Hotel's 2024 budget targets revenues of € 3.3m based on an improved occupancy rate of 36%, which is closer to historical levels but well below the 49% achieved in 2022; a slightly higher average tariff per room, and higher F&B revenues. Management has set an EBITDA target of € 0.4m for the year, which, although € 0.7m higher than the EBITDA loss of 2023, is still below the record € 0.7m achieved in 2022.

Macroeconomic Overview

Overview

	RO	as of:	BG	as of:
GDP Growth (y-o-y)	2.1%	Dec-23	1.8%	Dec-23
Inflation (y-o-y)	6.6%	Dec-23	4.7%	Dec-23
Ind. prod. growth (y-o-y)	0.7%	Dec-23	-5.4%	Dec-23
Trade balance (EUR bn)	-22.7	Dec-23	-3.8	Dec-23
y-o-y change	*-33%*		*-17%*	
FDI (EUR bn)	6.6	Dec-23	3.6	Dec-23
y-o-y change	*-34%*		*51%*	
Budget balance/GDP	-5.7%	Dec-23	-2.9%	Dec-23
Total external debt/GDP	52.0%	Dec-23	47.4%	Dec-23
Public sector debt/GDP	48.9%	Dec-23	21.6%	Dec-23
Loans-to-deposits	67.8%	Dec-23	71.1%	Dec-23

Commentary

Romania

After the high growth of 2022, when Romanian GDP grew by 4.8%, the growth rate more than halved to 2.1% in 2023, when total GDP reached € 324.5bn. The EU Commission is now forecasting real GDP growth of 2.9% for 2024.

By the end of December, Romania's year-on-year inflation rate had fallen to 6.6%, from a high of 16.4% at the end of 2022. In response, the Romanian National Bank hiked interest rates to 7% in January 2023, and they have remained unchanged ever since. During the course of 2022, the Romanian government had implemented price caps on energy, due to rapidly rising European gas and electricity prices, in order to protect the most vulnerable consumers. The caps are expected to remain in place until at least March 2025. Meanwhile, energy prices for medium-sized industrial producers fell by 9.5% in 2023, but were still more than double the prices prior to the war in Ukraine.

The Romanian leu enjoyed relative stability in 2023, with the euro foreign exchange rate growing from an average of 4.9313 in 2022 to an average of 4.9464 in 2023, a modest increase of only 0.3%.

In 2023, Romania's trade deficit narrowed by 12.8%, having fallen to € 22.7 billion. Relative to GDP, the deficit also improved, falling from 11.9% in 2022 (the highest percentage over the past decade) to 7.0% in 2023, based on preliminary data from the National Institute of Statistics. Foreign direct investment fell from €10 billion in 2022 to € 6.6 billion in 2023, the latter almost entirely made up of equity investments.

Romania posted a budget deficit of € -18.4bn in 2023, or 5.7% of GDP, just short of the 5.8% deficit reported in 2022. At €104.8bn, budgetary receipts were 12.6% higher than the previous year, but grew less than in 2022 due to inflation stabilising. Meanwhile, total budgetary expenses grew by 11.3% in EUR terms, from € 109.7bn to € 122.2bn. Due to the National Bank of Romania's tighter monetary policy, the interest expense had reached €5.6bn by the end of October, 15.2% higher than the same period in 2022. The average yield on 10-year Romanian Government bonds fell from 7.75% at the end of 2022 to 7.13% at the end of 2023.

Whilst Romania received € 6.3bn from the EU under its EU-approved € 28.5bn National Recovery and Resilience Plan (NRRP) in 2022, no new EU funds were received in 2023 due to the late submission by the Romanian Government of the third payment request for € 3.1bn.

Romania's total external debt amounted to € 168bn at the end of 2023, equal to approximately 52.0% of GDP, which represents a 17.3% year-on-year increase. Public debt has also continued to grow, having reached € 158.7bn, or 48.9% of GDP, at the end of December, up 5.8% over the year in nominal EUR terms.

Bulgaria

Bulgaria's GDP growth also slowed down, from 3.4% in 2022 to 1.8% in 2023. The European Commission estimates that Bulgaria's GDP will grow by 1.9% in 2024, and accelerate to 2.5% in 2025, suggesting a flatter growth rate compared to other countries in the region such as Romania.

Bulgaria's inflation rate fell dramatically in 2023, from a peak of 18.7% in September 2022 to 4.7% at the end of December 2023. The Government's scheme to compensate Bulgarian consumers for energy costs expired at the end of 2023. In any event, energy prices stabilised compared to their 2022 peaks, trending back to within 5% of their 2021 levels.

Bulgaria had reported a preliminary budget deficit of € -2.1bn, or 2.2% of GDP, in 2023, compared to a 2.9% deficit over the prior year, and 3.9% in 2021. However, the improved fiscal position enabled the government to approve a € 613 million package to finance municipal projects. Following this additional allocation for increased infrastructure spending, the final budget deficit is estimated to have reached 2.9% of 2023 GDP. Total budgetary revenues increased by 3.4% in 2023 to reach € 34.2bn, while total budgetary expenses grew by 9.9% to approximately € 37.1bn, due to increases in capital, social and personnel expenditures.

Public sector debt increased from € 18.9bn at the end of 2022, to € 21.1bn at the end of 2023. Gross external debt amounted to € 45.1bn, or 47.4% of GDP, at the end of December, having increased by 2.6% over the year.

Bulgaria's trade deficit fell substantially from € -7.4bn in 2022 to € -3.6bn in 2023, with exports declining by 7.9%, and imports by 10.0%. The trade deficit was counter-balanced by a € 3.8bn surplus from services, and primary and secondary incomes, resulting in a positive current account balance of € 273 million, significantly better than the € 0.6bn deficit recorded at the end of 2022. FDI inflows increased to € 3.6bn in 2023, compared to € 2.4bn in 2022.

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