



EUROCASTLE

REG-Eurocastle Inv. Ltd Final Results - Part 2

Feb 24, 2005

RNS Number:9742I

Eurocastle Inv. Ltd

Part 2 : For preceding part double-click [nRNSX9742I]

Fair values for all investment property have been determined by reference to the existing rental income and operating expenses for each property and the current market conditions in each geographical market. Fair values also incorporate current valuation assumptions which are considered reasonable and supportable by willing and knowledgeable parties.

Deferred Financing Costs

Deferred financing costs represent costs associated with the issuance of financings.

Interest-Bearing Loans and Borrowings

All loans and borrowings, including the Company's repurchase agreements, are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Minority Interests

Minority interests represent interests held by outside parties in the Company's consolidated subsidiaries.

Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured.

Interest income and expenses are recognised in the income statement as it accrues, taking into account the effective yield of the asset/liability or an applicable floating rate. Interest income and expense include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Rental income is recognised on an accruals basis.

Income Tax

The Company is a Guernsey, Channel Islands limited company. No provision for income taxes has been made. The company's subsidiaries, EFL, CDO I, CDO II and

| | | | | | | | | | |
|--|-----------|-----------|-------|---------|-----------|-------|-------|-------|-------|
| III | | | | | | | | | |
| CMBS | 121,232 | 121,505 | 1,079 | (204) | 122,380 | BBB+ | 4.62% | 4.51% | 3.80 |
| Other ABS | 97,550 | 96,398 | 878 | (175) | 97,101 | BBB+ | 4.24% | 4.77% | 3.32 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| | 218,782 | 217,903 | 1,957 | (379) | 219,481 | BBB+ | 4.45% | 4.63% | 3.59 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Total Portfolio | 782,419 | 779,859 | 7,260 | (786) | 786,333 | BBB+ | 4.11% | 4.28% | 4.07 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Other Securities | | | | | | | | | |
| CMBS | 131,472 | 130,630 | 300 | (417) | 130,513 | AA- | 3.32% | 3.63% | 2.26 |
| Other ABS | 83,928 | 84,187 | 273 | (26) | 84,434 | A+ | 3.04% | 2.96% | 4.89 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| | 215,400 | 214,817 | 573 | (443) | 214,947 | AA- | 3.21% | 3.37% | 3.29 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| | 997,819 | 994,676 | 7,833 | (1,229) | 1,001,280 | BBB+ | 3.91% | 4.08% | 3.90 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Short Term Investments Asset Backed commercial paper | | | | | | | | | |
| | 255,073 | 254,051 | - | - | 254,051 | A1+ | n/a | 2.13% | 0.19 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Total | 1,252,892 | 1,248,727 | 7,833 | (1,229) | 1,255,331 | | | | |
| | ===== | ===== | ===== | ===== | ===== | | | | |

CMBS - Commercial Mortgage Backed Securities
Other ABS - Other Asset Backed Securities

The Carrying Value in the table above excludes restricted cash of e9.2 million included in Portfolio I pending its reinvestment in additional CMBS and other ABS.

The securities within Portfolio I are encumbered by the CDO I securitization (Note8). The securities within Portfolio II and Portfolio III are encumbered by the borrowings under the warehouse credit facilities for CDO II and CDO III described in Note 9. Most of the securities categorised as other above were subject to repurchase agreements described in Note 10 as at 31 December 2004.

5. REAL ESTATE LOANS

| | Current Face Amount | Amortised Cost Basis | Gross Unrealised | | Carrying Value | Weighted Average | | | |
|-------------------|---------------------|----------------------|------------------|--------|----------------|------------------|--------|-------|------------------|
| | | | Gains | Losses | | S&P Rating | Coupon | Yield | Maturity (Years) |
| | e'000 | e'000 | e'000 | e'000 | e'000 | | | | |
| Real estate loans | 22,165 | 21,938 | - | - | 21,938 | NR | 8.35% | 8.44% | 5.88 |
| | ===== | ===== | ===== | ===== | ===== | ===== | ===== | ===== | ===== |

6. OTHER ASSETS

| | 31 December 2004 | 31 December 2003 |
|---------------------|------------------|------------------|
| | e'000 | e'000 |
| | ----- | ----- |
| Interest receivable | 7,800 | - |

| | | |
|--------------------------|-------|-------|
| Rent receivable | 344 | - |
| Deferred financing costs | 217 | 203 |
| Prepaid insurance | 227 | 111 |
| Derivative assets | 990 | - |
| Other assets | - | 2 |
| | ----- | ----- |
| | 9,578 | 316 |
| | ===== | ===== |

Deferred financing costs represent costs associated with the issuance of a collateralised debt obligation and will be offset against the proceeds of the issuance.

7. INVESTMENT PROPERTIES

The table below shows the items aggregated under investment property in the consolidated balance sheet:

| EUR '000 | Land & Buildings | Leasehold Property | Total |
|------------------------------------|------------------|-----------------------|---------|
| ----- | ----- | ----- | ----- |
| At 1 January 2004 | - | - | - |
| Additions | 303,480 | 15,034 | 318,514 |
| | ----- | ----- | ----- |
| At 31 December 2004 (unaudited) | 303,480 | 15,034 | 318,514 |
| | ===== | ===== | ===== |

The property portfolio consists of 96 office and retail assets located throughout metropolitan and regional Germany, predominantly in western Germany. The properties were acquired from Deutsche Bank, who remains the largest occupant of the portfolio, occupying approximately 52% of the portfolio by area. Deutsche Bank's weighted average unexpired lease term is 7.2 years.

A summary of the location and proportionate value of each property in the portfolio is as follows:

| Location | Number of Properties | Proportionate Value |
|----------------------------|----------------------|---------------------|
| ----- | ----- | ----- |
| Nordrhein-Westfalen | 30 | 33.71% |
| Baden-Wuerttemberg | 20 | 23.91% |
| Hesse | 9 | 8.56% |
| Lower Saxony | 8 | 9.66% |
| Bayern | 7 | 7.30% |
| Rhineland-Palatinate | 6 | 4.54% |
| Saxony-Anhalt | 3 | 4.45% |
| Thuringia | 5 | 2.68% |
| Saxony | 2 | 1.63% |
| Schleswig-Holstein | 1 | 1.33% |
| Hamburg | 1 | 0.99% |
| Bremen | 1 | 0.43% |
| Mecklenburg-West Pomerania | 2 | 0.51% |
| Brandenburg | 1 | 0.29% |
| | ----- | ----- |
| | 96 | 100.00% |
| | ===== | ===== |

8. BONDS PAYABLE

CDO Bonds

| Class | Rating | Current Face Amount | Carrying Amount | Weighted Average | Weighted Average |
|-------|--------|---------------------------|--------------------|---------------------|---------------------|
| ----- | ----- | ----- | ----- | ----- | ----- |

| | | e'000 | e'000 | Cost of Financing | Maturity (in years) |
|---------------|--------|---------|---------|-------------------|---------------------|
| ----- | ----- | ----- | ----- | ----- | ----- |
| A and B Notes | AAA/AA | 351,000 | 347,877 | 2.777% | 7.30 |
| ===== | ===== | ===== | ===== | ===== | ===== |

9. BANK BORROWINGS

The bank borrowings comprises of:

| | | 31 December 2004 e'000 | 31 December 2003 e'000 |
|--------------------------------------|-------|---------------------------|---------------------------|
| ----- | ----- | ----- | ----- |
| Warehouse borrowing (Note 9.1) | | 350,843 | - |
| Term finance (Note 9.2) | | 244,006 | - |
| Revolving credit facility (Note 9.3) | | 14,000 | - |
| ----- | ----- | ----- | ----- |
| | | 608,849 | - |
| ===== | ===== | ===== | ===== |

9.1 Warehouse Borrowings

In July 2004, through its subsidiaries CDO II and CDO III, the Company exercised its option to purchase securities under the securities portfolio contract for an aggregate purchase price of approximately e77.5 million. The Company financed the purchase price through a revolving credit facility arrangement with a major investment bank, whereby the securities purchased, along with any additional securities to be acquired, are financed and held in a custody account by the bank. The Company is using this credit facility as a means of accumulating securities intended to be used in future securitisation transactions. The Company currently anticipates completing the securitisations in the near term.

The terms of the credit facility provide for interest to be calculated with reference to floating rate benchmarks (i.e. Euribor or Sterling Libor) plus 75 basis points. The weighted average financing cost was 2.89% at 31 December 2004.

9.2 Term Financing for Investment Properties

On 23 December 2004, in order to finance the acquisition of investment properties the Company's subsidiaries entered into a e246.5 million term loan facility with a major real estate lending bank. The facility is secured in the customary manner for German real estate lending, granting security over, inter alia, all the real estate purchased as well as over rental streams and bank accounts. The term of the facility is 8.3 years with final maturity in April 2013. The interest rate on the loan is Euribor + 1.15% p.a, payable quarterly.

9.3 Revolving Credit Facility

In December 2004, the Company entered into a revolving e35 million credit facility with a major investment bank as a means of securing access to temporary working capital. The facility is secured over receivables flowing from CDO I, CDO II, CDO III and EFL and with security assignments of the Company's rights under its management agreement with Fortress Investment Group LLC. The facility contains a number of financial covenants including a maximum leverage ratio and a minimum interest cover ratio. The interest rate on drawn amounts is Euribor + 2.5% p.a., while on undrawn amounts it is 0.5% p.a.

10. REPURCHASE AGREEMENTS

In 2004, the Company's consolidated subsidiary EFL entered into a master repurchase agreement with certain major investment banks to finance the purchase of available-for-sale securities. The obligations under those agreements are guaranteed by the Company. The terms of the repurchase agreements provide for

interest to be calculated with reference to floating rate benchmarks (i.e. Euribor or Sterling Libor) which resets or rolls monthly or quarterly, with the corresponding security coupon payment dates, plus an applicable spread.

The Company's carrying amount and weighted average financing cost of these repurchase agreements was approximately e197.6 million and 2.35%, respectively at 31 December 2004.

11. TRADE AND OTHER PAYABLES

| | 31 December 2004 | 31 December 2003 |
|-----------------------------------|------------------|------------------|
| | e'000 | e'000 |
| ----- | ----- | ----- |
| Unsettled security purchases | 254,051 | - |
| Security deposit | 5,000 | - |
| Interest payable | 2,283 | - |
| Accrued expenses | 2,264 | 307 |
| Due to affiliates - Manager | 237 | 381 |
| Finance & operating lease payable | 2,925 | |
| Other payables | 127 | - |
| ----- | ----- | ----- |
| | 266,887 | 688 |
| ===== | ===== | ===== |

The unsettled security purchase of e254.0 million relates to the purchase of commercial paper bonds, which settled on 6 January 2005.

12. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net profit (loss) available to ordinary shareholders by the weighted average number of shares of ordinary stock outstanding during the period.

Diluted earnings per share is calculated by dividing net profit (loss) available to ordinary shareholders by the weighted average number of ordinary shares outstanding plus the additional dilutive effect of ordinary share equivalents during the period.

The Company's ordinary share equivalents outstanding during the period were the stock options issued under its share option plan.

There have been no other transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of the financial statements.

13. SHARE CAPITAL

The Company was registered in Guernsey on 8 August 2003 under the provisions of the Companies (Guernsey) Law, 1994 (as amended). On 21 October 2003, the Company issued 118,576,700 shares at e1.00 each. Pursuant to a written resolution of the Company dated 18 June 2004 the Shareholders resolved to receive one share for every ten shares previously held by them. In June 2004, through its initial public offering, the Company received subscriptions for and issued 6,600,000 ordinary shares at a price of e12 each. At the same time, the Company issued 5,000 shares to Paolo Bassi and 1,000 shares to Keith Dorrian in their capacity of Directors of the Company.

Under the Company's Articles of Association, the Directors have the authority to effect the issuance of additional ordinary shares or to create new classes of shares as they deem necessary.

The following is a reconciliation of the weighted average number of ordinary shares outstanding on a diluted basis.

| | Year Ended 31 December 2004 | 8 August 2003 (Formation Date) to 31 December 2003 |
|--|-----------------------------------|--|
| ----- | ----- | ----- |
| Weighted average number of ordinary shares, outstanding basic | 15,214,818 | 11,857,670 |
| Dilutive effect of ordinary share options | 280,965 | - |
| ----- | ----- | ----- |
| Weighted average number of ordinary shares outstanding, diluted | 15,495,783 | 11,857,670 |
| ===== | ===== | ===== |

14. MANAGEMENT AGREEMENT AND RELATED PARTY TRANSACTIONS

The Company entered into the Management Agreement with the Manager in August 2003, which provides for an initial term of ten years with automatic three year extensions, subject to certain termination rights. The Management Agreement may be terminated by the Company by payment of a termination fee, as defined in the Management Agreement, equal to the amount of management fees earned by the Manager during the twelve consecutive calendar months immediately preceding the termination, upon the vote of a majority of the holders of the outstanding ordinary shares. Pursuant to the Management Agreement, the Manager, under the supervision of the Company's board of directors, will formulate investment strategies, arrange for the acquisition of assets, arrange for financing, monitor the performance of the Company's assets and provide certain advisory, administrative and managerial services in connection with the operations of the Company. For performing these services, the Company will pay the Manager an annual fee (payable monthly in arrears) of 1.5% of the gross equity of the Company, as described in the Management Agreement.

The Management Agreement provides that the Company will reimburse the Manager for various expenses incurred by the Manager or its officers, employees and agents on the Company's behalf, including the cost of legal, accounting, tax, auditing, administrative and other similar services rendered for the Company by providers retained by the Manager or, if provided by the Manager's employees, in amounts which are no greater than those that would be payable to external professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arms-length basis. Such expenses have been included in the Consolidated Income Statement.

To provide an incentive for the Manager to enhance the value of the Company's ordinary stock, the Manager is entitled to receive incentive compensation on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the euro amount by which (1) funds from operations ("FFO") of the Company before the incentive compensation per ordinary share, exceeds (2) an amount equal to (a) the weighted average of the price per ordinary share in any offerings by the Company (adjusted for any prior capital dividends or distributions) multiplied by (b) a simple interest rate of eight percent (8%) per annum multiplied by (B) the weighted average number of ordinary shares outstanding during such period.

FFO is used to compute the Company's incentive compensation to the Manager. FFO, for these purposes, represents net income (computed in accordance with International Financial Reporting Standards), plus depreciation and amortisation on real estate property (and excluding accumulated depreciation and amortisation from the computation of gain or loss on sold real estate property), after adjustments for unconsolidated partnerships and joint ventures (calculated to reflect FFO on the same basis).

At 31 December 2004 and 31 December 2003, management fees and expense reimbursements of approximately e0.2 million and e0.4 million respectively, were due to the Manager.

15. FINANCIAL INSTRUMENTS

Derivative Financial Instruments - Securities Portfolio Contract

In November 2003, the Company entered into a securities portfolio contract with a major investment bank (the 'Bank') whereby the Bank purchased European commercial mortgage backed and other asset backed securities, targeted to aggregate approximately e500 million, subject to the Company's right, but not the obligation, to purchase such securities from the Bank. The Company had paid a deposit to the Bank. In June and July 2004 the Company exercised its right to purchase the securities. The fair value of the contract was calculated as the value of the securities purchased by the Bank, adjusted for the cost of funding the purchase of securities and any other applicable costs. The fair value of the contract as at 31 December 2003 was approximately e57.6 million.

Risk Management

This section provides details of the Company's exposure to risk and describes the methods used by management to control risk. The most important types of financial risk to which the Company is exposed are market risk, credit, liquidity, interest rate and foreign currency risk.

Market Risk

The Company's exposure to market risk is comprised mainly of movements in the value of its security and property investments. The investment portfolios are managed within the parameters disclosed in the Company's prospectus.

The Company's securities are predominantly floating rate and as such are valued based on a market credit spread over Euribor and Libor benchmarks for euro and sterling denominated assets respectively. Increases in the credit spreads above such benchmarks may affect the Company's net equity, net income or cash flow directly through their impact on unrealised gains or losses on available-for-sale securities, and therefore its ability to realise gains on such securities, or indirectly through their impact on its ability to borrow and access capital.

Under the terms of the securities contract the Company was exposed to market risk on the underlying securities as, should the intended securitisation of such assets not be consummated, the Company would be required to either purchase the securities or pay the loss realised on the disposal up to the amount of any deposits made by the Company under the contract, less any interest earned on the deposits.

Credit risk

The Company is subject to credit risk with respect to its investments in real estate and other asset backed securities and loans.

The securities the Company invests in are generally junior in right of payment of interest and principal to one or more senior classes, but benefit from the support of one or more subordinate classes of securities or other form of credit support within a securitisation transaction. While the expected yield on these securities is sensitive to the performance of the underlying assets, the more subordinated securities are designed to bear the first risk of default and loss.

The Company further minimises credit risk by actively monitoring its securities portfolios and the underlying credit quality of its holdings and, where appropriate, repositioning its investments to upgrade the credit quality and yield on the investments.

The Company's securities portfolio is diversified by asset type, industry, location and issuer. This diversification minimises the risk of capital loss. At December 31, 2004, the Company's securities, which serve as collateral for its

CDO financings and other borrowings, had an overall weighted average credit rating of approximately BBB+.

The Company's asset backed securities for sale portfolio was split between countries within Europe as follows:

| Country | Number of Securities 31 December 2004 | Face Value of Securities e'000 | Location Split |
|----------------|--|-----------------------------------|----------------|
| United Kingdom | 32 | 387,653 | 38.85% |
| Italy | 15 | 255,941 | 25.65% |
| Pan European | 9 | 135,703 | 13.60% |
| Germany | 11 | 101,578 | 10.18% |
| France | 5 | 46,399 | 4.65% |
| Other | 11 | 70,545 | 7.07% |
| | 83 | 997,819 | 100.00% |

The Company's hedging transactions using derivative instruments also involve certain additional risks such as counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. The counterparties to the Company's derivative arrangements are major financial institutions with investment grade credit ratings with which the Company and its affiliates may also have other financial relationships. As a result, it is not anticipated that any of these counterparties will fail to meet their obligations.

Liquidity risk

The Company's ability to execute its business strategy, particularly the growth of its investment portfolio, depends to a significant degree on the Company's ability to obtain additional capital.

The Company's primary source of funds for liquidity consist of net cash provided by operating activities, borrowings under loans and the issuance of debt and equity securities. The Company's loans and debt securities are generally secured directly over its assets. The Company expects that its cash on hand and cash flow provided by operations will satisfy its liquidity needs with respect to its current investment portfolio over the next twelve months. The Company expects to meet its long-term liquidity requirements, specifically the repayment of its debt obligations, through additional borrowings and the liquidation or refinancing of its assets at maturity.

A significant portion of the Company's investments are financed with collateralised debt obligations, known as CDOs. If spreads for CDO liabilities widen or if demand for such liabilities ceases to exist, then the ability to execute future CDO financings will be restricted. Proceeds from the sale of real estate and other asset backed securities which serve as collateral for the Company's CDO financings, including gains thereon, are required to be retained in the CDO structure until the related bonds are retired and are therefore not available to fund current cash needs.

The Company's real estate securities are financed long-term and their credit status is continuously monitored; therefore, these investments are expected to generate a generally stable current return, subject to interest rate fluctuations. The Company's operating real estate is also financed long-term and primarily leased to credit tenants with long-term leases and is therefore also expected to generate generally stable current cash flows.

As described in Note 9.3, the Company has access to temporary working capital through a revolving e35 million credit facility.

Interest Rate Risk

The Company's primary interest rate exposures relate to its real estate and other asset backed securities, loans and floating rate debt obligations, as well as its interest rate swaps. Changes in the level of interest rates also can affect the Company's ability to acquire securities and loans and its ability to realise gains from the settlement of such assets.

The Company's general financing strategy focuses on the use of match-funded structures, meaning that it seeks to match the maturities of its debt obligations with the maturities of its investments to minimise the risk that the Company will have to refinance its liabilities prior to the maturities of its assets, reducing the impact of changing interest rates on its earnings. In addition, the Company match funds interest rates on its investments with like-kind debt directly or through the use of interest rate swaps.

As of December 31, 2004, a 100 basis point increase in short-term interest rates would increase the Company's earnings by approximately €1 million per annum.

The weighted average interest rate on the fixed rate portion of the asset backed securities available-for-sale portfolio shown in the table below is 7.14%.

The fixed interest rate portion of the bank loan and the relating interest rate swap was 4.53%.

The interest rate profile of the Company at 31 December 2004 and 31 December 2003 was as follows:

| Assets Type | Total per consolidated balance sheet e'000 | Non interest bearing assets e'000 | Within 1 year | | 1 to 5 years | | Over 5 years | |
|--|--|---|---------------|---------------|--------------|---------------|--------------|---------------|
| | | | Fixed % | Variable % | Fixed % | Variable % | Fixed % | Variable % |
| 2004 | | | | | | | | |
| Cash and cash equivalents | 10,293 | - | - | 10,293 | - | - | - | - |
| Restricted cash | 2,812 | - | - | 2,812 | - | - | - | - |
| Asset backed securities, available for sale | 1,264,484 | - | - | - | 46,850 | 389,893 | - | - |
| Real estate related loans available for sale | 21,938 | - | - | - | - | 21,938 | - | 827,741 |
| Investment property | 318,514 | 318,514 | - | - | - | - | - | - |
| Other assets | 9,578 | 8,588 | - | 276 | - | - | 714(1) | - |
| | 1,627,619 | 327,102 | - | 13,381 | 46,850 | 411,831 | 714 | 827,741 |
| 2003 | | | | | | | | |
| Cash and cash equivalents | 1,690 | - | - | 1,690 | - | - | - | - |
| Securities portfolio contract | 57,611 | - | - | 57,611 | - | - | - | - |
| Other assets | 316 | 316 | - | - | - | - | - | - |
| | 59,617 | 316 | - | 59,301 | - | - | - | - |

(1) Net interest rate swap receivable related to the fixed e210 million portion of the term loan financing the investment properties.

| Liabilities Type | Total per consolidated balance sheet e'000 | Non interest bearing liabilities e'000 | Within 1 year | | 1 to 5 years | | Over 5 years | |
|--------------------------|--|---|---------------|---------------|--------------|---------------|--------------|---------------|
| | | | Fixed % | Variable % | Fixed % | Variable % | Fixed % | Variable % |
| 2004 | | | | | | | | |
| CDO bonds payable | 347,877 | - | - | - | - | - | - | 347,877 |
| Bank loans | 608,849 | - | - | 364,843 | - | - | 210,000 | 34,006 |
| Repurchase agreements | 197,584 | - | - | 197,584 | - | - | - | - |
| Trade and other payables | 266,887 | 266,887 | - | - | - | - | - | - |
| | 1,421,197 | 266,887 | - | 562,427 | - | - | 210,000 | 381,883 |
| 2003 | | | | | | | | |
| Trade and other payables | 688 | 688 | - | - | - | - | - | - |
| | 688 | 688 | - | - | - | - | - | - |

Foreign Currency Risk

The Company's primary foreign currency exchange rate exposures relate to its sterling denominated portfolio of securities and loans. Changes in the currency rates can adversely impact the fair values and earnings streams of the Company's non euro denominated assets and liabilities. The Company has mitigated this impact through a combination of (i) sterling denominated financing and (ii) rolling forward foreign exchange contracts to hedge its net sterling equity investment. At 31 December 2004, the net unrealised gain on these contracts was approximately e0.28 million.

In connection with the Company's purchase of its available-for-sale real estate and other asset backed securities and real estate loans, the foreign currency risk is covered through forward foreign currency exchange contracts.

16. HEDGE ACCOUNTING - CASH FLOW HEDGES OF INTEREST RATE RISK

The Company's policy is to hedge its exposure to interest rates and foreign currencies on a case by case basis. Hedge accounting is only applied to cash flow hedges of interest rate risk exposures. Interest rate swaps under which the Bank pays a fixed rate and receives a floating rate have been used to hedge the interest rate risk on floating rate long term bank borrowing.

The gain or loss on measurement at fair value of both the hedged item and the interest rate swaps have been recognised in the statement of changes in equity to the extent that the swap is effective.

The details of interest rate swaps entered into by the Company are as follows:

| | 31 December 2004 e000 | 31 December 2003 e000 |
|----------------|--------------------------|--------------------------|
| Nominal amount | 210,000 | - |
| Pay rate | 3.47% | - |
| Receive rate | 3 Month Euribor | - |

| | | |
|----------------|-----------|---|
| Remaining life | 8.3 years | - |
| Fair value | 713 | - |

17. SHARE OPTION PLAN

In December 2003, the Company (with the approval of the Board of Directors and pursuant to the confidential information memorandum dated August 2003) adopted a nonqualified share option plan (the "Company Option Plan") for officers, directors, employees, consultants and advisors, including the Manager. In December 2003, for the purpose of compensating the Manager for its successful efforts in raising capital for the Company, the Manager was granted options representing the right to acquire 1,185,767 ordinary shares at an exercise price of e10 per share (number of shares and exercise price adjusted for share consolidation). In June 2004 following the IPO, the Manager was granted an additional 660,000 options at an exercise price of e12 per share. The Manager options represent an amount equal to 10% of the ordinary shares issued by the Company. The options granted to the Manager were fully vested on the date of grant and expire ten years from the date of issuance.

18. SEGMENTAL REPORTING

The Company operates in one geographical segment, being Europe. The company has conducted business through three primary segments: asset backed securities, real estate related loans and investment properties.

Summary financial data of the Company's business segments is provided below:

| | Asset Backed Securities | Real Estate Related Loans | Investment Properties | Unallocated | Total Eurocastle |
|--------------------------------|----------------------------|---------------------------------|--------------------------|-------------|---------------------|
| For Year Ended | e'000 | e'000 | e'000 | e'000 | e'000 |
| 31 December 2004 | | | | | |
| Gross revenues | 28,502 | 284 | 344 | - | 29,130 |
| Interest expense | (13,353) | - | (310) | - | (13,663) |
| Other operating expenses | (147) | - | (33) | (3,256) | (3,436) |
| Net profit | 15,002 | 284 | 1 | (3,256) | 12,031 |
| | | | | | |
| As at | e'000 | e'000 | e'000 | e'000 | e'000 |
| 31 December 2004 | | | | | |
| Total assets | 1,278,992 | 22,568 | 320,884 | 5,175 | 1,627,619 |
| Total liabilities | (1,152,462) | - | (266,234) | (2,501) | (1,421,197) |
| Minority interest | - | - | - | (2) | (2) |
| Net assets | 126,530 | 22,568 | 54,650 | 2,672 | 206,420 |

The unallocated portion consists primarily of interest on short-term investments, general and administrative expenses, and management fees pursuant to the Management Agreement.

19. INVESTMENT IN SUBSIDIARIES

The legal entity group structure of Eurocastle is designed to support the Group's businesses within an efficient legal, tax, regulatory and funding framework.

The significant operating subsidiaries, in which the Company owns a 100% equity interest, are listed by jurisdiction below:

Luxemburg:

Luxgate s.a.r.l.
Eurobarbican s.a.r.l.

Germany:

| | |
|---|---|
| Shortwave Acquisition GmbH | L-Wave Grundstücksverwaltungsgesellschaft 29 GmbH |
| S-Wave Grundstücksverwaltungsgesellschaft 1 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 30 GmbH |
| S-Wave Grundstücksverwaltungsgesellschaft 2 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 31 GmbH |
| Longwave Acquisition GmbH | L-Wave Grundstücksverwaltungsgesellschaft 32 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 1 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 33 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 2 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 34 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 3 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 35 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 4 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 36 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 5 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 37 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 6 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 38 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 7 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 39 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 8 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 40 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 9 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 41 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 10 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 42 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 11 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 43 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 12 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 44 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 13 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 45 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 14 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 46 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 15 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 47 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 16 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 48 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 17 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 49 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 18 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 50 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 19 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 51 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 20 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 52 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 21 GmbH | L-Wave Grundstücksverwaltungsgesellschaft 53 GmbH |
| L-Wave Grundstücksverwaltungsgesellschaft 22 | L-Wave Grundstücksverwaltungsgesellschaft 54 |

| | | | |
|--|----|--|----|
| GmbH | | GmbH | |
| L-Wave Grundstücksverwaltungsgesellschaft GmbH | 23 | L-Wave Grundstücksverwaltungsgesellschaft GmbH | 55 |
| L-Wave Grundstücksverwaltungsgesellschaft GmbH | 24 | L-Wave Grundstücksverwaltungsgesellschaft GmbH | 56 |
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Additionally, the Company has investments in Eurocastle Funding Limited, Eurocastle CDO I PLC, Eurocastle CDO II PLC, and Eurocastle CDO III PLC which it consolidates in accordance with SIC 12.

20. SUBSEQUENT EVENTS

On 23 February 2005 the directors declared a fourth quarter 2004 interim dividend of e0.33 per share to all holders of shares on 2 March 2005, the record date. The total dividend payable on 11 March 2005 is e6.1 million. The Annual General Meeting will be held on 19 April 2005.

21. COMPARATIVES

The Company commenced operations on 21 October 2003. As the Company's first period of operations is shorter than one year, comparative periods for the consolidated statement of income, cash flows and statement of changes in equity are shown for the period 8 August to 31 December 2003.

22. OTHER NOTES

The financial information set out in this announcement does not constitute the Company's audited accounts for the years ended 31 December 2004 or 31 December 2003. The financial information for the year ended 31 December 2003 is derived from the audited accounts for that year. The 31 December 2003 accounts contained an unqualified audit report.

A copy of the Annual Report and Financial Statements for the year ended 31 December 2004 will be posted to the shareholders in due course. Copies of this announcement can be obtained from Eurocastle Investment Limited, 5-10 Bolton Street, London, W1J 8BA.

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