

Annual report

(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year: 1 January 2014

End of financial year: 31 December 2014

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Regional websites: www.arcovara.ee

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Core activities: Rental and operating of own or leased real estate (EMTAK 6820)
Real estate agencies (EMTAK 6831)
Management of real estate on a fee or contract basis (EMTAK 6832)

Supervisory board: Hillar-Peeter Luitsalu, Rain Lõhmus, Allar Niinepuu,
Kert Keskaik, Steven Yaroslav Gorelik

Management board: Tarmo Sild

Auditor: AS PricewaterhouseCoopers

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Directors' report

Introduction of Arco Vara group

Arco Vara AS and other entities of Arco Vara group (hereafter together 'the group') are engaged in various aspects of the real estate business. The group regards Estonia, Latvia and Bulgaria as its home markets. Until the end of year 2013, the group's three business lines – services, development and construction had been organised into corresponding divisions. Since year 2014, the group has two continuing business lines: Service division and Development division. The group has no plans on independent construction activities in next few years.

The Service division is engaged in real estate brokerage, valuation, management and consulting as well as in short-term investment in residential real estate. The Service division offers to the group additional value by generating analytical data on market demand and supply, also behaviour of potential clients. Analytical data allows making better decisions on purchase of land plots, planning and designing, also on timing the start of construction.

The Development division develops complete living environments and commercial real estate. Fully developed housing solutions are sold to the end-consumer. In some cases the group is developing also commercial properties until they start generating cash flow for two possible purposes: for the support of the groups' cash flows or for resale. The group is currently holding completed commercial properties that generate rental income.

The Construction division provided general construction and environmental engineering services, operating as a construction manager as well as a subcontractor. In 2013, the provision of construction services was finished and in February 2014, the group sold its construction company Arco Ehitus OÜ. Arco Vara is still responsible for completing possible warranty works, together with Arco Ehitus. The last guarantee period for completing warranty works will end in October 2015.

The goal and core values

Common **goal** for all Arco Vara companies is:

- 1) to provide clients with trustworthy real estate services which are based on quality information and integrated real estate products of high value in use, being innovative in the same time;
- 2) to gain stable and high return on equity for the shareholders, which beats the competition in real estate business and justifies investing and holding Arco Vara shares;
- 3) and to create the best conditions for self-realization in real estate industry for the people working for the group.

Arco Vara's **core values** include:

Partnership – our client is our partner
 Reliability – we are reliable, open and honest
 Professionalism – we deliver quality
 Consideration – we value our clients as individuals
 Responsibility – we keep our promises

Scope of consolidation

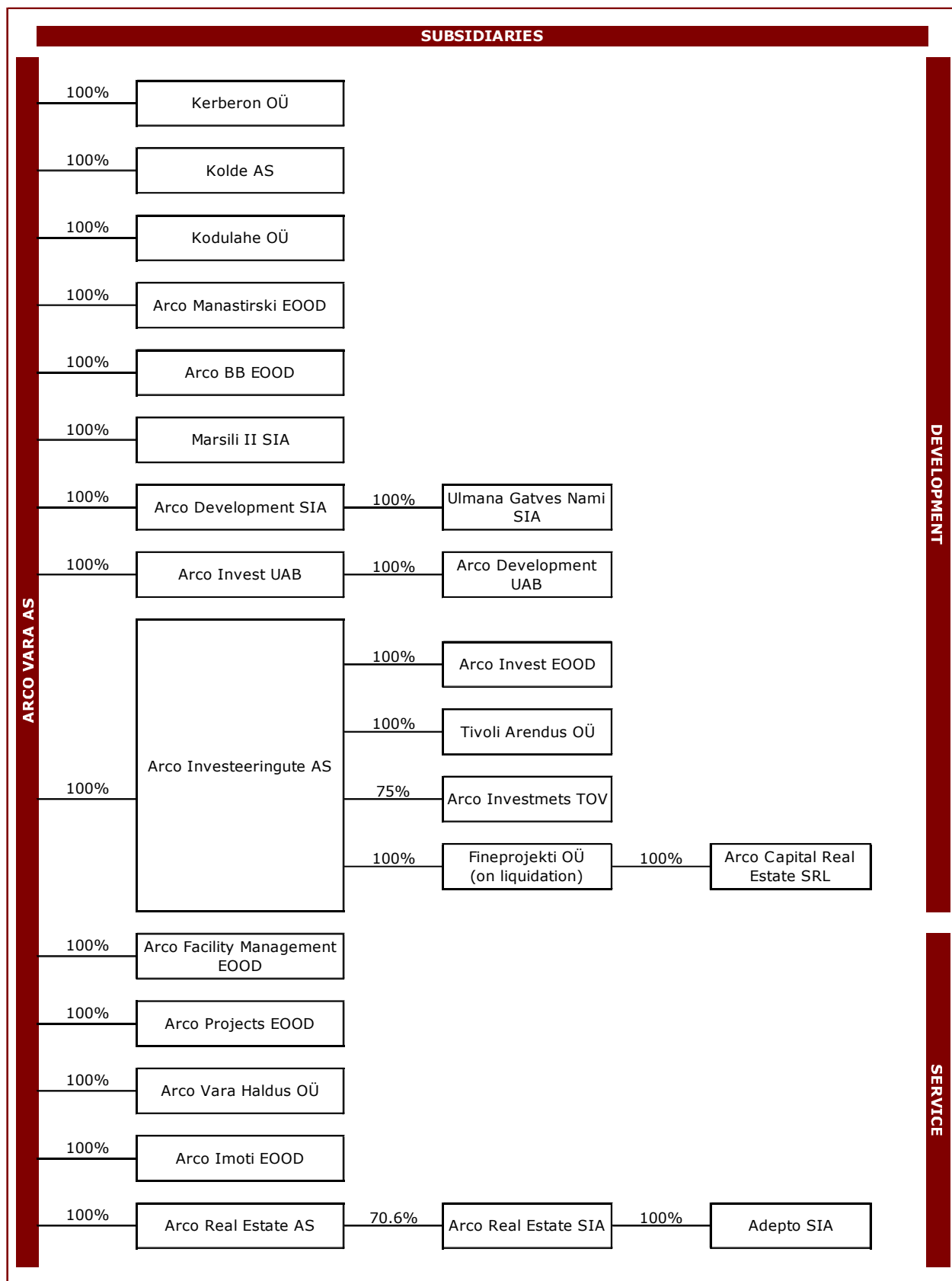
At 31 December 2014, the group comprised 24 companies (31 December 2013: 23). At 31 December 2013, the group had also interests in one joint venture and one associate. In third quarter 2014, 40% ownership in associate Arco Property Management SIA was sold and all remaining shares of joint venture company Tivoli Arendus OÜ were acquired, as a result of which Tivoli Arendus OÜ transformed to subsidiary of the group. In Q4 2014, two new SPV-s were established: Kodulahe OÜ in Estonia and Arco BB EOOD in Bulgaria.

Significant subsidiaries

Company name	Location	Segment	Share capital (nominal value)	Equity balance at 31 Dec 2014	The group's interest
In thousands of euros					
Arco Manastirski EOOD	Bulgaria	development	2,676	3,261	100%
Arco Invest EOOD	Bulgaria	development	25,976	-793	100%
Kolde AS	Estonia	development	28	-157	100%
Kerberon OÜ	Estonia	development	5	1,204	100%
Marsili II SIA	Latvia	development	1,524	944	100%
Arco Development SIA	Latvia	development	6,473	-1,936	100%
Arco Real Estate AS	Estonia	service	42	-646	100%
Arco Real Estate SIA ¹	Latvia	service	1,905	122	70.6%
Arco Imoti EOOD	Bulgaria	service	444	78	100%

¹ - Non-controlling interest in Arco Real Estate SIA equals to the group's total non-controlling interest

Group structure as at 31 December 2014



KEY PERFORMANCE INDICATORS

- The group's revenue for 2014 from continuing operations was 9.2 million euros, declined by 1.5 million euros (14.6%) compared to year 2013. Revenue of Service division increased 6% on yearly basis up to 3.1 million euros. Revenue of Development division was 6.5 million euros in 2014 (in 2013: 8.1 million euros), having decreased by 19.4%. The main reason for decrease of revenue in Development division is because the group's development projects are in such a stage, where revenue is not yet accrued. Most of Development division revenue in 2014 was accrued in the last quarter of the year when sale of apartments to clients amounted to 4.9 million euros.
- In 2014, the group earned operating profit from continuing operations of 2.3 million euros and net profit from continuing operations of 1.1 million euros. In previous year, the corresponding figures were 4.5 million euros and 3.5 million euros respectively. Better profit figures in 2013 were due to the reversal of provisions and revaluation of assets and liabilities in total amount of 3.3 million euros (in 2014: 0.5 million euros). The group ended year 2014 with net profit of 0.8 million euros (in 2013: 3.4 million euros).
- Equity to assets ratio has been recovered compared to the year end 2013, achieving 33.5% as at 31 December 2014. As at 31 December 2013, the ratio was 27.2%. In addition to the profitable activities reason contributing to growth was also the share issue conducted in Q3 2014 which raised 1.3 million euros in equity.
- The balance of the group's total assets is increased by 1.8 million euros in 2014. Main reason is increase of inventory through construction of Manastirski Livadi II stage apartment building in Sofia.
- The group's loan burden (net loans) have decreased by 0.8 million euros in 2014. As at 31 December 2014, the weighted average annual interest rate of loans is 5.8%. This is a decrease by 0.2 percentage point since the end of year 2013 mainly due to very low Euribor rates in second half of 2014.
- In 2014, the group sold 77 apartments and commercial areas and 4 residential plots (in 2013: 78 apartments and commercial areas and 5 residential plots) in its own development projects.

	2014	2013
In millions of euros		
Revenue from continuing operations	9.2	10.7
Operating loss from continuing operations	2.3	4.5
Net profit from continuing operations	1.1	3.5
Net loss from discontinued operations	-0.3	-0.1
Net profit for the year	0.8	3.4
EPS (in euros)	0.15	0.72
ROIC (rolling, four quarters)	3.4%	20.7%
ROE (rolling, four quarters)	10.7%	66.7%
ROA (rolling, four quarters)	3.1%	12.6%

At 31 December	2014	2013
In millions of euros		
Total assets	27.0	25.2
Invested capital	24.1	21.7
Net loans	13.3	14.1
Equity	9.1	6.9
Average loan term (in years)	2.3	0.3
Average interest rate of loans (per year)	5.8%	6.0%
Number of staff	189	178

FORMULAS USED

Earnings per share (EPS) = net profit attributable to owners of the parent / (weighted average number of ordinary shares outstanding during the period – own shares)

Invested capital = current interest-bearing liabilities + non-current liabilities + equity (at end of period)

Net loans = current interest-bearing liabilities + non-current liabilities - cash and cash equivalents - short-term investments in securities (at end of period)

Return on invested capital (ROIC) = past four quarters' profit before tax and interest expense / average invested capital

Return on equity (ROE) = past four quarters' net profit / average equity

Return on assets (ROA) = past four quarters' net profit / average total assets

Number of staff = includes persons working for the group under employment or authorization contract

CONTINUING OPERATIONS

Revenue and profit

	2014	2013
In millions of euros		
Revenue		
Development	6.5	8.1
Service	3.1	2.9
Eliminations	-0.4	-0.3
Total revenue	9.2	10.7
Operating profit		
Development	1.9	5.1
Service	0.3	0.2
Unallocated income and expenses	0.0	-0.5
Eliminations	0.1	-0.3
Total operating profit	2.3	4.5
Finance income and expense	-1.1	-1.0
Income tax expense	-0.1	0.0
Net profit	1.1	3.5

Cash flows

	2014	2013
In millions of euros		
Cash flows from operating activities	0.4	0.3
Cash flows from investing activities	0.2	1.6
Cash flows from/used in financing activities	0.3	-2.8
Net cash flows	0.9	-0.9
Cash and cash equivalents at beginning of period	0.8	1.8
Changes in cash and cash equivalents	0.0	-0.1
Cash and cash equivalents at end of period	1.7	0.8

Revenue and net profit/loss from continuing operations 2012-2014

	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Total 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Total 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Total 2014
In millions of euros															
Revenue	1.3	3.7	2.4	3.5	10.9	1.7	3.5	3.5	2.0	10.7	1.1	1.1	1.2	5.8	9.2
Net profit/loss	-1.2	-0.3	0.3	-16.5	-17.7	0.0	1.4	0.1	2.0	3.5	0.4	-0.3	0.4	0.6	1.1

In Q4 2012, financial results were negatively affected by recognition of provisions and revaluation of assets and liabilities in total amount of 15.6 million euros.

Group chief executive's review

In 2014, focus was on restarting Arco Vara development activities. By the end of year, development in Sofia with 135 apartments and smaller commercial spaces - second stage of Manastirski Livadi, which construction started in November 2013, was finalised. Moreover, through adoption of detail plan we got building right for up to 330 apartments for Paldiski road 70C property in Tallinn. The plot was acquired in June 2013.

Business activities remained profitable and at the same time were oriented to growth. In 2013, profit was resulted mainly from successful release of the group from liabilities and risks beyond the reach of the group and clearing the balance sheet. But in 2014, significant role in profit had the group's main activities: sale of development products and provision of real estate services.

The group achieved the targets set for year 2014: revenue exceeded 9 million euros (targeted was 9 million euros), net profit was 0.8 million euros (target was 0.5 million euros) and yield from selling development products exceeded 20%. The group's return on equity did not exceed 20% yet, because about one quarter of balance sheet consisted of assets not suitable for development. Predominantly, this includes 'land bank' acquired in previous years in Latvian and Estonian regions with low demand. The management is continuously working on 'land bank' to bring it to active development, to sell it or exchange it against property more suitable to our goal: to be an active developer.

Forecast and objectives for 2015

The management is predicting for the group at least 11 million euros as revenue and at least 1 million euros as net profit in 2015. In addition to changes of the general economic environment, the achievement of the forecast in 2015 and the results of the group in 2015 – 2017 also depend on the following critical intermediate results.

(i) Final stabilisation of the Madrid Blvd loan and extension of important rent contracts. By the reporting date, the group has made the repayment of the principal in amount of 950 thousand euros, after which the loan balance dropped below 11 million euros and the loan agreement is prolonged until December 2017. The main tasks for the next couple of years will be: 1) to keep stable rental income in amount of approx. 1 million euros and 2) sale of remaining apartments in Madrid Blvd building (as at 31 December 2014 the sellable area is 3,762 m²) at amount of approx. 1 million euros per year or letting out with annual yield at least 6%.

(ii) Sell out of apartments in Manastirski AB block by the end of the year.

(iii) Finishing the construction of Manastirski D-block (final stage of the development project) in December 2015 and delivery and sale to the final customers in 2016.

(iv) Buying a new plot suitable for development in Sofia, with gross sellable area (GSA) of at least 7,000 m², on which to build in 2016 and sell to customers in 2017.

(v) The completion of the construction project for Paldiski road 70c first stage and beginning construction in the fourth quarter 2015. The sellable volume of first stage is predicted to exceed 120 apartments and the gross sellable area (GSA) of apartments will be 8,000 m².

The sales of remaining completed products in Latvia also influences the results to an extent, but the management board is not particularly optimistic about the outlook of new developments in Latvia. The management board is the most optimistic about the real estate market in Sofia, which is indicating the strongest absolute demand, the increase of demand and the margins of the developer. In Tallinn, the key issue is entering the market with a product which would exceed the customers' expectations by its properties, the developed and added quality for apartment supply, and bring the using apartment usage costs lower. Arco Vara does not need to bring more trees into the forest.

Moreover, Arco Vara needs to strengthen its ability to gather and analyse information about customers' preferences and needs not fulfilled yet. It means, that the work on development of service division data processing capabilities will continue and second generation of Arco Vara information system (AVIS 2) will be launched during the year.

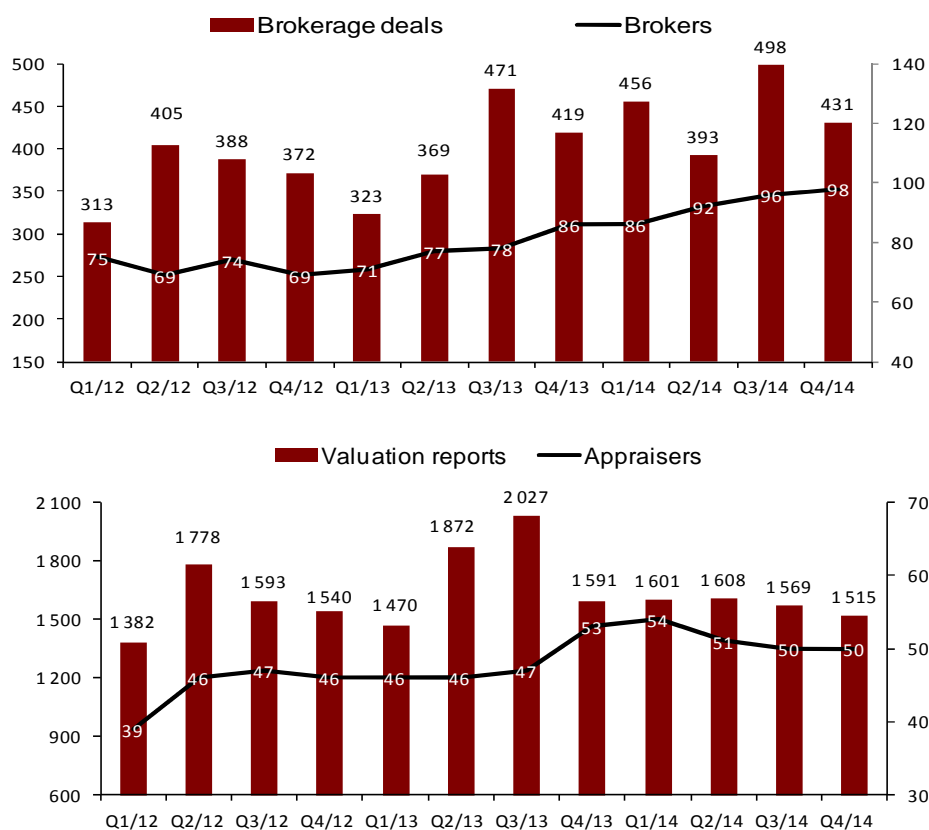
SERVICE DIVISION

In 2014, the sales revenue of the service division increased by 6% compared to the previous year, up to 3,139 thousand euros (includes 451 thousand euros of intra-group revenue). Sales revenue increased in Latvia and Bulgaria where revenue from main activities of real estate agencies, brokerage and valuation of real estate, increased by 17% in Latvia and very good 61% in Bulgaria. The turnover of the Estonian real estate agency has decreased by 17% compared to previous year mainly due to drop in revenue from valuation services in 2014 by 25%.

Revenue of real estate agencies from main activities

	2014	2013	Change, %
In thousand of euros			
Estonia	1,166	1,409	-17%
Latvia	1,170	1,004	17%
Bulgaria	536	332	61%
Total	2,872	2,745	5%

The revenue growth of Latvian and Bulgarian agencies was caused both by general increased activity on the market and strongly seizing the market by increasing the number of employees. But growth in Latvian remains mainly to the first half of 2014 and is slowed down in second half of the year. It would not be a big surprise to see further slow-down in 2015 due to adverse effect of recent changes in laws that directly influencing real estate sales. In 2014, brokerage of the group's own development projects had 44% of Bulgarian agency's revenue, providing significant part of turnover of Bulgarian agency.



All three real estate agencies finished the year 2014 with net profit: the net profit of the Estonian agency was 48 thousand euros (in 2013: 156 thousand euros), the net profit of the Latvian agency was 65 thousand euros (in 2013: 81 thousand euros) and the net profit of the Bulgarian agency was 90 thousand euros (in 2013: 25 thousand euros).

In addition to brokerage and valuation services, the service division also provides real estate management and accommodation services in Bulgaria. The revenue from real estate management was 148 thousand euros in 2014, including 105 thousand euros of which was intra-group revenue (in 2013: 135 thousand and 103 thousand euros, respectively). Revenue from accommodation services amounted to 74 thousand euros in 2014 (in 2013: 24 thousand euros). The accommodation services have been provided since July 2013.

The number of staff in service division has been increased to 176 employees as at 31 December 2014, growing by 15 people within a year.

DEVELOPMENT DIVISION

In 2014, revenue of development division totalled 6,466 thousand euros, dropped by 20% compared to previous year (in 2013: 8,049 thousand euros). Most of 2014 revenue from development activities accrued in fourth quarter due to getting permit of use for two apartment buildings In November: for Manastirski Livadi second stage building (with 135 apartments and smaller commercial spaces in total) and for last stage building (with 14 apartments) in Bisumuiza-1 project in Riga. In Q4 2014, 72 apartments were sold in these two projects. Information on sold real estate properties in the group's own development projects is presented in following table.

Number of sold real estate properties	2014	2013
Estonia, Tallinn	0	20
<i>Tehnika 53, apartments</i>	0	14
<i>Helme 16, Kodukolde, apartments</i>	0	6
Latvia, Riia	18	16
<i>Kometas street, Bišumuiza-1, apartments</i>	14	11
<i>Baltezers-5 plots in Marsili, residential plots</i>	4	5
Bulgaria, Sofia	63	47
<i>Madrid Blvd, apartments</i>	1	8
<i>Manastirski Livadi, apartments and commercial spaces</i>	62	39
Total	81	83

Most of other revenue of development division consisted of rental income from commercial and office space in Madrid Blvd building in Sofia, amounted to 953 thousand euros in 2014 (in 2013: 956 thousand euros).

In 2014, operating profit of development division was 1,942 thousand euros (in 2013: 5,100 thousand euros). In 2013, the impact of extraordinary items to the profit amounted to 3,332 thousand euros and 521 thousand euros in 2014.

As at 31.12.2014, the group had in stock 113 apartments and smaller commercial spaces ready for sale, of which 109 in Bulgaria and 4 in Riga. Pre-sale agreements were concluded to 48 apartments and commercial spaces in stock, revenue from final sales will be accrued in first quarter of 2015.

In fourth quarter 2014, after a year break, the sale of free apartments in Madrid Blvd building restarted. In December, the first sale transaction was concluded and as at the annual report date two more apartments have been presold. 15 apartments and all parking places, out of all Madrid Blvd unsold assets, are rented out. In Q4 2014, four more apartments were prepared for letting out.

In Bulgaria, the group will be coming to the end with preparations for the construction of Manastirski Livadi D-block (also named as Manastirski III stage). Construction will start in Q1 2015. The building will have 87 apartments and commercial areas with saleable area of nearly 6,900 m² and construction will be finished by the end of 2015.

In the most important Estonian development project for the group, Paldiski road 70C, has been reached to the final stage of concluding first stage design contract. The construction works of the apartment building (at least 120 apartments and 4-5 smaller commercial spaces) should start in fourth quarter of 2015.

In February 2014, the group acquired as an addition to the land bank, two land plots with building right for 2 apartment buildings (30 apartments with GSA of 2,100 m²) near Tallinn, at Instituudi tee 7 and 9 in Harku. In Q3 2014, the development of the project was suspended due to the need to use the group's finances for carrying out best yielded projects (Paldiski road 70c foremost). The sale of the development project could also be an option.

As at 31 December 2014, 5 people were employed in development division, one employee hired during a year.

SUMMARY TABLE OF ARCO VARA'S PROJECTS AS AT 31 DECEMBER 2014

Project name	Address	Product main type	Stage	Area of plot(s) (m ²)	GSA / GLA (above grade) available or <future target>	No of units (above grade) available or <future target>
Manastirski A/B	Manastirski, Sofia	Apartments	S5	-	6,906	74
Manastirski C	Manastirski, Sofia	Apartments	S5	-	204	2
Manastirski D	Manastirski, Sofia	Apartments	S3	2,223	6,869	87
Madrid Blvd	Madrid Blvd, Sofia	Lease: Retail/Office	S5/S6	-	7,350	16
Madrid Blvd	Madrid Blvd, Sofia	Apartments	S5/S6	-	3,726	33
Bisumuiza-1	Kometas 2, Riga	Apartments	S5	-	105	1
Bisumuiza-1	Kometas 4, Riga	Apartments	S5	-	278	3
Marsili residential plots	Marsili, near Riga	Residential plots	S5	-	27,545	15
Marsili residential plots	Marsili, near Riga	Residential plots	S2	120,220	<120,220>	<68>
Instituudi 7, 9	Instituudi tee 7,9 Harku	Apartments	S3/S5	5,003	2,035	32
PM 70C	Paldiski road 70C, Tallinn	Apartments	S3	28,498	21,420	334
Lehiku carpet building	Lehiku 21,23 Tallinn	Apartments	S2	5,915	<1,100>	<5>
Liimi	Liimi 1b, Tallinn	Lease: Office	S2	2,463	<6,500>	<1>
Viimsiranna	Haabneeme, Viimsi vald	Office/Mix	S3/S5	14,174	500	1

Note: Value presented inbetween < > means future target value as the project is in early (S1, S2) development stage and the building rights or the design have not been finished yet. The table does not reflect sellable or lettable volumes below grade including parking spaces and storages.

Description of stages

S1: Land plot acquired

S2: Building Rights Procedure

S3: Design and Preparation Works

S4: Construction

S5: Marketing and Sale

S6: Property Management and/or Lease

PEOPLE

As at 31 December 2014, 189 people worked for the group under employment or authorization contract (178 at 31 December 2013). Employee remuneration expenses in 2014 amounted to 2.5 million euros (in 2013: 2.5 million euros).

The remuneration of the member of the management board/chief executive and the members of the supervisory board of the group's parent company including social security taxes in 2014 amounted to 102 thousand euros (in 2013: 174 thousand euros).

The management board

The management board of Arco Vara AS has one member. Since 22 October 2012, the chief executive officer/member of the management board of Arco Vara AS has been Tarmo Sild.

Tarmo Sild graduated from University of Tartu faculty of law B.A. in 1998, with further studies in University of Helsinki, faculty of law in 1997-1998 and in Vrije Universiteit Brussel: PILC, LL.M (cum laude) in 1999.

Work experience before joining Arco Vara:

1998 - 2003: Law office HETA, attorney at law and member of the management board;

2003 - 2012: Law office LEXTAL, founder, attorney at law, member of the management board, counsel;

since 2000: MFV Lootus OÜ, founder, member of the management board;

since 2008: AS luteCredit Europe, founder, member of the management board.

Tarmo Sild is also member of management board of following companies outside Arco Vara group: Catsus OÜ, Aia Tänav OÜ and Alarmo Capital OÜ.

The members of supervisory board

At the time of publishing the annual report, supervisory board of Arco Vara AS consist of 5 members. As at 31.12.2014, the supervisory board had 7 members. After the reporting date, extraordinary shareholders meeting held on 10 February 2015, previous supervisory board was recalled and new supervisory board with 5 members was elected. Hillar-Peeter Luitsalu, Allar Niinepuu and Rain Lõhmus, remained from the previous supervisory board and two new members are Steven Yaroslav Gorelik and Kert Keskaik. The members of previous supervisory board Toomas Tool, Arvo Nõges, Aivar Põlv and Stephan David Balikh will not continue in new board.

Hillar-Peeter Luitsalu

Mr Luitsalu graduated from University of Tartu faculty of law in 1994. In 1993, he joined Arco Vara and since then has been active in different management bodies of Arco Vara group companies. In 1999 – 2004, Mr Luitsalu was a member of Arco Vara management board. Since 2005, Mr Luitsalu has been member of Arco Vara supervisory board (since 2012 chairman of supervisory board).

Mr Luitsalu is a member of management board of following companies outside Arco Vara group: OÜ HM Investeeringud, Loodusvarade Halduse MTÜ, OÜ TIK Spordimaja

Rain Lõhmus

Mr Lõhmus graduated in 1988 from Tallinn Technical University with a degree in business administration. He has extensive work experience in various financial institutions, including Bank of Estonia and AS Hansapank. He is the founder and the biggest shareholder of AS LHV Group and member of supervisory board of AS LHV Pank. Mr. Lõhmus is also member of management board of AS Lõhmus Holdings, OÜ Merona Systems, OÜ Umblu Records and Zerospotnrg OÜ and Cuber Technology OÜ. He serves as member of supervisory board of AS LHV Finance, AS LHV Pank, AS Audentes, AS Arhiivikeskus, Baltic Digital Archive AS and Kodumajagupi AS.

Mr Lõhmus has served as member of Supervisory Board of Arco Vara AS since 2012.

Allar Niinepuu

Mr Niinepuu has graduated from Estonian Center of Maritime Education in 1992 as shipmaster. After two years' work at Estonian Shipping Company, he established in 1994 his first company AS Kavass, that initially was involved in shipping consumables business and thereafter acquired and operated local supermarkets set in Tallinn. Currently its main activities are providing management services and investing.

Mr Niinepuu has served as member of Supervisory Board of Arco Vara AS since 2013. He is also member of management board of OÜ Alarmo Kapital, GEST Invest Grupp OÜ, Intelligent Robots OÜ and OÜ Kavass and chairman of supervisory board of AS luteCredit Europe.

Steven Yaroslav Gorelik

Mr Gorelik has graduated from Carnegie Mellon University and Columbia University. He joined Firebird Private Equity Advisors LLC in 2005 and currently serves there as portfolio manager. Mr Gorelik also holds CFA (Chartered Financial Analyst) charter. Mr Gorelik is member of supervisory board of Farmsintez OAO (LIFE.MM). Mr Gorelik serves as member of Supervisory Board of Arco Vara AS since February 2015.

Kert Keskaik

Mr Keskaik graduated from Tallinn Technical University with a degree in business administration. Mr Keskaik has been a practicing real estate broker in Tallinn until 2010. Mr Keskaik is member of management board of OÜ K Vara and the founder OÜ A&K Vara. His companies have been active Tallinn Stock Exchange investors since 2000. Mr Keskaik also founded in 2001 a skating sports club Spordiklubi Albe Team where he serves as member of management board, and has won multiple Estonian Championships in speed skating and inline skating. Mr. Keskaik is also member of Management Board of Sporditurg OÜ and member of Supervisory Board of Arco Transport AS.

SOCIAL RESPONSIBILITY

Main business lines of Arco Vara are real estate development, real estate brokerage and valuation services. In our work, we follow principles which are environmentally friendly and sustainable.

We plan real estate developments which have excellent energy class and are environmentally friendly and buildings fit well into surrounding. We turn attention to construction quality of our buildings, because we would like to create living environments, which will last for generations.

Services we provide have noticeable weight in society. Customers invest to real estate each year tens of millions of euros through our mediation and make credit decision in almost the same volume based on our professional valuation. It is important to achieve and to maintain operating real estate market which is balanced informatively, making it also more sustainable. Each and every client, out of thousands who purchase real estate mediated by us, has to make balanced and informative decision and broker has to help client in getting the right and timed information about object properties, merits and demerits and alternatives. Each credit in form of real estate collateral should be supported by objective expertise. Our brokers and valuers are aware of social responsibility when providing services.

In 2014, Arco Vara turned special attention to well-being of its employees and improvement of working conditions – we replaced computers, renewed offices and office furniture, organised joint events. In our everyday work we are following sustainability principles by using digital possibilities – digital signature, digital archiving and intra-office data processing without physical data carriers.

We inspire and encourage our people to participate voluntarily in charity projects and contribute to environmental initiatives. Our people are participating in support of orphanage children and activities for the benefit of community.

SHARE AND SHAREHOLDERS

Arco Vara AS has issued a total of 6,117,012 ordinary shares (as at 31 December 2013: 4,741,707 shares) with nominal value of 0.7 euros per share. The shares are freely traded on NASDAQ OMX Tallinn stock exchange. In September 2014, share capital was raised by issuing 1,375,305 new shares. As at 31 December 2014, the company had 1,668 shareholders and the share price closed at 0,828 euros, a decrease by 40.86% within 2014. During the year, the highest price per share was 1.55 euros and the lowest price 0.821 euros. As at 31 December 2014, market capitalization of shares amounted to 5,065 thousand euros (as at 31 December 2013: 6,638 thousand euros) and P/E ratio of the share was 5.5 (as at 31 December 2013: 1.9).

The following charts reflect movements in the price and daily turnover of Arco Vara share in 2012 - 2014.

In 2014



In 2012 - 2014



Changes in share price compared with the benchmark index OMX Tallinn in 2014.

Index/equity	1 Jan 2014	31 Dec 2014	+/-%
OMX Tallinn	817.72	755.05	-7.66
ARC1T	1.40 EUR	0.828 EUR	-40.86



Major shareholders at 31 December 2014	No of shares	Interest %
AS Baltplast	862,820	14.1%
AS Lõhmus Holdings	587,378	9.6%
Gamma Holding Investment OÜ	554,759	9.1%
Alarmo Kapital OÜ	489,188	8.0%
HM Investeeringud OÜ	485,000	7.9%
LHV PENSIONIFOND L	378,765	6.2%
FIREBIRD REPUBLICS FUND LTD	356,428	5.8%
FIREBIRD AVRORA FUND, LTD.	185,800	3.0%
LHV PENSIONIFOND XL	169,583	2.8%
FIREBIRD FUND L.P.	150,522	2.5%
Other shareholders	1,896,769	31.0%
Total	6,117,012	100.0%

Holdings of members of the management and supervisory boards (and connected persons) at 31 December 2014	Position	No of shares	Interest %
Toomas Tool (AS Baltplast)	member of supervisory board, until 10.02.2015	862,820	14.1%
Rain Lõhmus (AS Lõhmus Holdings)	member of supervisory board	587,378	9.6%
Arvo Nõges (Gamma Holding Investment OÜ)	member of supervisory board, until 10.02.2015	554,759	9.1%
Hillar-Peeter Luitsalu (HM Investeeringud OÜ, connected persons)	chairman of supervisory board	513,884	8.4%
Tarmo Sild and Allar Niinepuu (Alarmo Kapital OÜ)	member of management board/ member of supervisory board	489,188	8.0%
Kert Keskaik (privately and through K Vara OÜ)	member of supervisory board, since 10.02.2015	176,657	2.9%
Steven Yaroslav Gorelik ¹	member of supervisory board, since 10.02.2015	3,150	0.1%
Stephan David Balkin	member of supervisory board, until 10.02.2015	-	-
Aivar Pilv	member of supervisory board, until 10.02.2015	-	-
Total		3,187,836	52.1%

¹ - Steven Yaroslav Gorelik is active as fund manager in three investment funds holding interest in Arco Vara (Firebird Republics Fund Ltd, Firebird Avrora Fund Ltd ja Firebird Fund L.P) of 692,750 shares (total of 11.3% interest).

DESCRIPTION OF THE MAIN RISKS

Liquidity risk

The group's free funds are placed on current accounts or short-term deposits with the banks operating in Estonia, Latvia and Bulgaria. Owing to high refinancing risk, cash flow management is critical. The group's cash and cash equivalents balance is constantly smaller than the balance of loans that require refinancing in the next 12 months. At 31 December 2014, the weighted average duration of interest-bearing liabilities was 2.3 years. At the end of 2014, the group's cash and cash equivalents totalled 1.7 million euros (at the end of 2013: 0.8 million euros). Liquidity and refinancing risks continue to be the most significant risks for the group.

Interest rate risk

The base currency of most of the group's loan agreements is euro and the base interest rate is 3 or 6 months EURIBOR. As a result, the group is exposed to developments in international capital markets. The group does not use hedging instruments to mitigate its long-term interest rate risk. In 2014, the group's interest-bearing liabilities has increased by 0.1 million euros and amounted to 15.0 million euros at 31 December 2014. In 2014, interest payments on interest-bearing liabilities totalled 1.1 million euros (in 2013: 1.0 million euros). The group's weighted average loan interest rate is 5.8%. This is a decrease by 0.2 percentage point within year 2014 mainly due to decreased EURIBOR rates.

Currency risk

Purchase and sales contracts are mostly signed in local currencies: euros (EUR) or Bulgarian lev (BGN). Real estate sales are mostly nominated in euros, as a result of which the group's assets and liabilities structure does not denote a significant currency risk. The group is not protected against currency devaluations. Most liquid funds are held in short-term deposits denominated in euros. Devaluation risk has decreased since the beginning of year 2014 because Republic of Latvia transferred to euro.

Corporate governance report

The shares of Arco Vara AS were listed in the main list of the Tallinn Stock Exchange on 21 June 2007. As a listed company, Arco Vara AS (hereinafter also "Company") observes the laws and regulations that are effective in Estonia, the rules and recommendations of NASDAQ OMX Tallinn Stock Exchange, and its own core values.

Together with the annual report the Company discloses its corporate governance report in which the Management confirms the Company's compliance with the Corporate Governance Recommendations ('the CGR'). Any instances of non-compliance with the CGR are disclosed and the reasons for non-compliance are explained.

The annual report has been prepared in accordance with the guidance of the CGR. The current corporate governance report is a separate section of the directors' report, which is part of the Company's annual report.

I General meeting

The Company's highest governing body is the general meeting of its shareholders. The competence of the general meeting and the procedure for convening general meetings and passing resolutions are set out in the Company's articles of association.

In 2013, one annual general meeting and one extraordinary general meeting took place.

Annual general meeting

The annual general meeting was held on 5 June 2014 from 10:04 a.m. until 10:46 a.m. in Tallinn at Viru Square 4, in *Bolero* meeting room of Sokos Hotel Viru.

Notice of the annual general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website on 14 May 2014. The notice was published in the national daily newspaper *Postimees* on 14 May 2014. The notice included information on where materials concerning the general meeting had been made available, where shareholders could submit their questions and a direct link to information on the agenda and relevant documents on the Company's website. The information was published in Estonian and in English.

The proposals of the Supervisory Board were published in the notice of the annual general meeting. On the agenda of the annual general meeting was the following:

- approval of the annual report for 2013 and distribution of profit;
- raising share capital;
- appointment of Auditor.

The following decisions were adopted at the annual general meeting:

- To approve the year 2013 annual report of Arco Vara AS and allocate the net profit for the year ended on 31 December 2014 in the amount of 3 427 thousand euros to retained earnings.
- To appoint an auditor for one year (until the next annual general meeting of shareholders) and appoint AS PricewaterhouseCoopers as the auditor. To pay the auditor for auditing the 2014 annual report according to an agreement to be signed between Arco Vara AS and AS PricewaterhouseCoopers.

The meeting was chaired by Hannes Vallikivi, who is neither the chairman of the Company's Supervisory Board nor a member of the Company's Management Board. The meeting was attended by 52 shareholders whose votes represented 81.51% of total voting power. The meeting was conducted in Estonian and the chairman of the meeting made sure it was conducted smoothly. The meeting was also attended by the member of the Management Board of the Company, Tarmo Sild, who gave an overview of the company's performance in 2013.

Extraordinary general meetings

The annual general meeting was held on 4 July 2014 from 10:08 a.m. until 10:36 a.m. in Tallinn at Viru Square 4, in *Bolero* meeting room of Sokos Hotel Viru.

Notice of the annual general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website on 11 June 2014. The notice was published in the national daily newspaper *Postimees* on 12 June 2014. The notice included information on where materials concerning the general meeting had been made available, where shareholders could submit their questions and a direct link to information on the agenda and relevant documents on the Company's website. The information was published in Estonian and in English.

The extraordinary general meeting was convened at the request of shareholders and their proposals were published in the notice of the extraordinary general meeting. On the agenda of the annual general meeting was the following:

- raising share capital;
- recall of the Supervisory Board;
- Election of members of the Supervisory Board.

The decision to raise the share capital of the Company on the terms disclosed in the notice was adopted at the extraordinary general meeting:

The meeting was chaired by Hannes Vallikivi, who is neither the chairman of the Company's Supervisory Board nor a member of the Company's Management Board. The meeting was attended by 205 shareholders whose votes represented 89.93% of total voting power. The meeting was conducted in Estonian and the chairman of the meeting made sure it was conducted smoothly.

The resolutions, minutes and materials of all general meetings held in 2014 were made available on the Company's website. Information on the agenda items of all annual and extraordinary general meetings as well as questions submitted by the shareholders before the meetings and answers to those questions are available online at least until the information on the next general meeting is published on the Company's website.

II Management Board

Since 4 September 2009 the Management Board of the Company has had one member. Since 22 October 2012, the CEO (and only member of the Management Board) of the Company is Tarmo Sild.

On assignment, three-year service contract was concluded with the member of the Management Board. The member of the Management Board was not concurrently a member of the Management Board or Supervisory Board of any other listed company.

When the member of the Management Board assumed office, service contract was signed which sets forth the powers, obligations and responsibilities of the member of the Management Board and also regulates the disbursement of his basic remuneration. Remuneration was agreed taking into account the Management Board member's duties and activities and the Company's current financial performance and future prospects. Under the service contract, Tarmo Sild is entitled to termination benefits equal to his five months' basic board member remuneration in case the contract is terminated without a good reason. The Management Board member has an incentive scheme that is linked to the Company's securities in connection to which the shareholders decided on the annual general meeting on 1 July 2013 to increase the share capital of the Company conditionally by issuing one convertible bond with the nominal value of 1,000 euros. The convertible bond enables Tarmo Sild to subscribe for 390 thousand ordinary shares of the Company in 2016 for 0.7 euros per share.

In 2014, the remuneration of member of the Management Board member Tarmo Sild (for the period 1 January 2014 to 31 December 2014) amounted to 88 thousand euros (includes social security tax). In 2014, the member of the Management Board was not paid any bonuses.

The member of the Management Board has notified the Company of his interests and involvement in the governing bodies of the companies which are not part of the group. Holding certain ownership interests and being involved in the governing bodies of other companies does not constitute breach of the prohibition on competition. Under the service contract, the member of the Management Board has agreed not to breach the prohibition on competition. In addition, the Company's internal regulations provide that no member of the Management Board or staff may demand or accept for personal gain money or any other benefits from third parties in connection with their work and may not grant unlawful or unjustified benefits or discounts to third parties.

III Supervisory Board

The Supervisory Board is responsible for planning and organising the operation of the Company and overseeing the activities of the Management Board. Members of the Supervisory Board of the Company are elected by the general meeting.

Under the CGR, half of the members of the Supervisory Board of a listed company have to be independent. In the event of an odd number of members in the Supervisory Board, the number of independent members may be smaller by one. Company's Supervisory Board meets the CGR's requirement regarding independent members of the Supervisory Board.

In 2014, there were no changes in the composition of the Company's Supervisory Board. During 2014, the composition of the Company's Supervisory Board was the following: Allar Niinepuu, Aivar Pilv, Arvo Nõges, Hillar-Peeter Luitsalu, Rain Lõhmus, Stephan David Balkin, Toomas Tool.

Members of the Supervisory Board elect the chairman of the Supervisory Board from among themselves. Since 10 June 2013, the chairman of the Supervisory Board is Hillar-Peeter Luitsalu.

Since 1 July 2013, the members of the Supervisory Board are paid remuneration in the amount of 500 euros (net amount) for each participated meeting but not more than 1000 euros (net amount) per month. The payment of the remuneration is dependent on the signing of the minutes of the meetings of the Supervisory Board. The travel and living expenses of the members of the Supervisory Board are not compensated.

In 2014, the Supervisory Board had 4 meetings. Members of the Supervisory Board attended the meetings as follows:

- Allar Niinepuu, Arvo Nõges and Hillar-Peeter Luitsalu - 4 meetings;
- Rain Lõhmus - 3 meetings;
- Aivar Pilv - 2 meetings;
- Toomas Tool - 1 meeting;
- Stephan David Balkin did not attend any of the meetings.

IV Cooperation of the Management and Supervisory Boards

In line with the Company's articles of association and historical practice, the Management and Supervisory Board cooperate closely. The Management and the Supervisory Board hold joint meetings for discussing matters related to the Company's strategy and exchange information about the Company's strategic development on an ongoing basis. At the meetings, the member of the Management Board informs the Supervisory Board about any deviations from the Company's plans and objectives and the reasons for those deviations. During the period under review the member of the Management Board attended all meetings of the Supervisory Board.

The members of the Supervisory Board do not take part in everyday management of the Company but the manager updates the Supervisory Board on regular basis of important issues regarding planning the operations of the Company and business activities. In addition the Supervisory Board is able to turn to the manager at any time with additional questions

and/or inquiries. In information exchange, all parties observe the rules approved by the Supervisory Board for keeping and disclosing inside information, making transactions with Company's shares and segregating the functions of the Management and Supervisory Board. It has become customary that at the meetings of the Supervisory Board the manager provides the members of the Supervisory Board an overview of important issues and developments related to the Company.

V Disclosure of information

Since the Company's shares were listed in the Tallinn Stock Exchange, the Company has disclosed information in accordance with the rules of the Tallinn Stock Exchange, the laws of the Republic of Estonia and the principle that all shareholders should be treated equally.

The Company discloses information in the information system of the Tallinn Stock Exchange and on its website at www.arcorealestate.com in Estonian and in English. On the website, the information intended for shareholders is in the "Investor Relations" menu. The Company discloses on its website all facts, forecasts and estimates that have been disclosed to financial analysts or other parties. Disclosed information includes *inter alia* information connected to the general meetings and general information about the Company. General and more specific information about the Company can be found in different menus of the corporate website. The information is logically structured and easy to find.

On the website the Company has posted its financial calendar until March 2016.

The Company's website does not include information on shareholder agreements on concerted exercise of shareholder rights because the Company is not aware that such agreements have been concluded.

The Company has not organised presentations to investors and analysts directly before the release of a financial report and has never disclosed inside information or unreleased financial data at meetings with analysts or investors.

VI Financial reporting and auditing

The consolidated financial statements of the Company are prepared in accordance with International Financial Reporting Standards as adopted by the European Union. Quarterly financial statements are prepared in accordance with IAS 34 Interim Financial Reporting and are designed to be read in conjunction with the Company's most recent consolidated annual financial statements. Quarterly financial statements are not audited.

The consolidated financial statements of the Company are audited. During recent years it has become customary to appoint the groups auditor for the period of 3 years. But at the same time at yearly shareholders' meeting the auditor is appointed for the next financial year. At the shareholders' meeting on 5 June 2014 AS PricewaterhouseCoopers was appointed as Company's auditor for the next financial year the third time in a row. While choosing the auditor the Company considers the ratio of the auditing price and quality and also professionalism to be important. In addition it is important for the Company that the auditor is familiar with the group's three main home markets – prerequisite for that is the existence of the auditor company's subsidiary in a country that is of great importance to the group.

For better risk assessment and management, the group entities that have active financial activity prepare a budget for the next financial year. The group's consolidated budget is approved by the Supervisory Board of the Company. Execution of and adherence to approved budgets is monitored by the Company's CFO.

To ensure high-quality financial reporting and to counteract the risks related to financial reporting, the Company has created the position of a CFO. The CFO participates actively in the preparation of the consolidated annual and quarterly reports. The consolidated financial statements are prepared using uniform group-wide cross-border financial accounting and reporting software. Consolidation procedures have largely been automated and are performed monthly. Monthly reporting is presented to the managements of relevant entities and monthly consolidated reporting is presented to the group's management.

Consolidated financial statements

Consolidated statement of comprehensive income

	Note	2014	2013
In thousands of euros			
Continuing operations			
Revenue from rendering of services		3,744	3,791
Revenue from sale of own real estate		5,414	6,937
Total revenue	5, 7	9,158	10,728
Cost of sales	8	-5,902	-7,749
Gross profit		3,256	2,979
Other income	9	37	404
Marketing and distribution expenses	10	-324	-278
Administrative expenses	11	-1,811	-1,676
Other expenses	9	-82	-196
Gain on reversal of inventory write-down	19	572	299
Gain on transactions involving joint ventures	12	-27	2,897
Gain on sale of subsidiaries	12, 31	662	98
Operating profit		2,283	4,527
Finance income and costs	13	-1,062	-972
Profit before tax		1,221	3,555
Income tax	14	-75	0
Net profit from continuing operations		1,146	3,555
Discontinued operations			
Loss from discontinued operations	31	-324	-128
Net profit for the period		822	3,427
<i>attributable to owners of the parent</i>		803	3,410
<i>attributable to non-controlling interests</i>		19	17
Total comprehensive income for the period		822	3,427
<i>attributable to owners of the parent</i>		803	3,410
<i>attributable to non-controlling interests</i>		19	17
Earnings per share (in euros)	15		
- basic		0.15	0.72
- diluted		0.14	0.66

The notes presented on pages 22 to 56 form an integral part of the consolidated financial statements.

Consolidated statement of financial position

As at 31 December	Note	2014	2013
In thousands of euros			
Cash and cash equivalents	17	1,691	818
Receivables and prepayments	18	1,205	656
Inventories	19	11,970	10,780
Assets belonging to sales group	31	0	847
Total current assets		14,866	13,101
Investments in equity-accounted investees		0	1
Receivables and prepayments	18	5	252
Investment property	20	11,585	11,331
Property, plant and equipment	21	434	459
Intangible assets	21	113	13
Total non-current assets		12,137	12,056
TOTAL ASSETS		27,003	25,157
Loans and borrowings	22	3,194	12,589
Payables and deferred income	23	2,659	1,746
Provisions	24	274	172
Liabilities belonging to sales group	31	0	1,488
Total current liabilities		6,127	15,995
Loans and borrowings	22	11,826	2,308
Total non-current liabilities		11,826	2,308
TOTAL LIABILITIES		17,953	18,303
Share capital	25	4,282	3,319
Share premium	25	292	0
Statutory capital reserve	25	2,011	2,011
Other reserves	15	179	60
Retained earnings		2,250	1,452
Total equity attributable to owners of the parent		9,014	6,842
Equity attributable to non-controlling interests		36	12
TOTAL EQUITY		9,050	6,854
TOTAL LIABILITIES AND EQUITY		27,003	25,157

The notes presented on pages 22 to 56 form an integral part of the consolidated financial statements.

Consolidated statement of cash flows

Note	2014	2013
In thousands of euros		
Cash receipts from customers	10,812	10,516
Cash paid to suppliers	-8,945	-7,058
Taxes paid	-1,150	-1,976
Taxes recovered	805	189
Cash paid to employees	-866	-846
Other cash payments and receipts related to operating activities	-41	-218
Net cash flow of discontinued operations	-250	-317
NET CASH FROM OPERATING ACTIVITIES	365	290
Purchase of property, plant and equipment	-71	-34
Proceeds from sale of property, plant and equipment	0	118
Proceeds from sale of investment property	0	80
Proceeds from sale of a subsidiary	10	1,610
Proceeds from sale of an associate	1	0
Loans provided	-3	-48
Placement of security deposits	-438	-263
Release of security deposits	701	258
Interest received	5	7
Net cash flow of discontinued operations	0	-56
NET CASH FROM INVESTING ACTIVITIES	205	1,672
Proceeds from loans received	4,885	3,046
Settlement of loans and finance lease liabilities	-4,800	-4,809
Interest paid	-1,091	-964
Proceeds from share capital issue	1,375	0
Other payments related to financing activities	-76	-75
NET CASH FROM/USED IN FINANCING ACTIVITIES	293	-2,802
NET CASH FLOW	863	-840
Cash and cash equivalents at beginning of period	818	1,775
Decrease in cash and cash equivalents	863	-840
Change in cash through purchase/sale of a subsidiaries	10	-37
Cash and cash equivalents reclassified to sales group assets	0	-80
Cash and cash equivalents at end of period	1,691	818

The notes presented on pages 22 to 56 form an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

	Equity attributable to owners of the parent						Non-controlling interests	Total equity
	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total		
In thousands of euros								
Balance as at 31 December 2012	3,319	0	2,011	0	-1,958	3,372	-5	3,367
Formation of equity reserve (note 15)	0	0	0	60	0	60	0	60
Total comprehensive income for the period	0	0	0	0	3,410	3,410	17	3,427
Balance as at 31 December 2013	3,319	0	2,011	60	1,452	6,842	12	6,854
Balance as at 31 December 2013	3,319	0	2,011	60	1,452	6,842	12	6,854
Total comprehensive income for the period	0	0	0	0	803	803	19	822
Increase of share capital (note 25)	963	292	0	0	0	1,255	0	1,255
Formation of equity reserve (note 15)	0	0	0	119	0	119	0	119
Change in non-controlling interests	0	0	0	0	-5	-5	5	0
Balance as at 31 December 2014	4,282	292	2,011	179	2,250	9,014	36	9,050

Further information on share capital is provided in note 25.

The notes presented on pages 22 to 56 form an integral part of the consolidated financial statements.

Notes to the consolidated financial statements

1 General information

These consolidated financial statements of Arco Vara AS and its subsidiaries as at and for the year ended 31 December 2014 were authorised for issue by the chief executive officer/member of the management board on 31 March 2015. Under the Commercial Code of the Republic of Estonia, final approval of the annual report prepared by the management board and approved by the supervisory board rests with the shareholders' general meeting. The consolidated financial statements are part of the annual report that has to be approved by the shareholders, and they serve as a basis for adopting a resolution for distributing the profit. Shareholders may decide not to approve the annual report, which has been prepared by the management board and approved by the supervisory board, and may demand that a new annual report be prepared.

Arco Vara AS is a company incorporated and domiciled in Estonia whose registered office is at Jõe 2B, Tallinn, Estonia. As at the end of 2014, 189 people provided services to the group under the employment or authorization contract (31 December 2013: 178 people). The core business lines of the group are described in note 5 and discontinued operations in note 31. In addition to Estonia, the group has, through its subsidiaries, active operations also in Latvia and Bulgaria.

The structure of the group as at 31 December 2014 is presented in note 33.

2 Statement of compliance and basis of preparation

The consolidated financial statements of Arco Vara AS and its subsidiaries have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The consolidated financial statements have been presented and submitted for approval in conformity with the requirements of the Estonian Accounting Act and the Estonian Commercial Code.

The consolidated financial statements are presented in thousands of euros, unless indicated otherwise.

The consolidated financial statements have been prepared under the historical cost convention, unless explained otherwise in note 4 *Significant accounting policies*.

Use of accounting estimates and judgements

The preparation of consolidated financial statements in conformity with IFRS as adopted by the EU requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses, and the disclosure of contingent assets and contingent liabilities.

Although estimates and underlying assumptions are reviewed on an ongoing basis and they are based on historical experience and expectations of future events that are believed to be reasonable under the circumstances, actual results may differ from the estimates.

Information about management's critical judgements and estimates that have a material effect on the amounts reported in the financial statements is provided below.

Classification of real estate

Items of real estate (properties) are classified as inventories, investment properties and items of property, plant and equipment both on initial recognition and on any subsequent reclassification based on management's intentions regarding their further use. Realization of management's plans depends, among other factors, on resolutions adopted by other parties (e.g. changes in the designated purpose of the land, approval of detailed design plans, issue of construction permits, etc).

Properties which are acquired for development and subsequent sale as living environments, single residential buildings, or residential plots and properties which are acquired for resale in the ordinary course of business are classified as inventories.

Properties which are held to earn operating lease rentals or for capital appreciation and properties which are held over an extended period for an undetermined future use are classified as investment property.

Properties which are being developed for future use as commercial or business environments that will be leased out under operating leases and commercial and business properties which are being extensively reconstructed or renovated are also classified as investment properties.

Estimation uncertainty

The estimates made by management are based on historical experience and the information that has become available by the date the financial statements are authorised for issue. There is a risk that the estimates applied at the reporting date in respect of assets and liabilities and associated income and expenses need to be revised in the future. The key sources of estimation uncertainty that have a significant risk of causing material adjustments to the consolidated financial statements are discussed below.

Measurement of loans and receivables

The group's loans and receivables include mostly trade receivables and loans provided. Loans and receivables are measured based on management's best estimates. The measurement principles applied are disclosed in note 4 *Significant accounting policies*. Changes in market conditions or the customers' financial position may cause management to significantly revise its estimates. Further information on risks that may affect the carrying value of loans and receivables is presented in note 26.

Estimation of the net realisable value of inventories

The group has a number of items of real estate (properties) that have been classified as inventories. The net realisable values of all significant properties classified as inventories were measured as at 31 December 2014 and 31 December 2013 in order to determine whether:

- 1) the net realisable value of any item had decreased below its carrying amount;
- 2) any impairments recognised in prior periods needed to be reversed.

The net realisable values of the properties were measured in the same way as the fair value of investment properties is measured, i.e. by using the following methods:

- the discounted cash flow analysis;
- comparison method;
- residual value method.

Valuation methods are described in more detail in notes 4 and 19.

Determination of the fair value of investment properties

At each reporting date, investment properties are measured at their fair values. In addition to management's estimates, where necessary, the fair value of investment properties is measured based on valuation reports issued by independent real estate appraisers. This means that in the case of significant investment properties, where necessary, parallel appraisals are commissioned from independent appraisers. In determining the fair value of its investment properties as at 31 December 2014 and 31 December 2013, the group did not request valuation reports from independent appraisers. Fair value is mainly determined by using two basic techniques - the discounted cash flow method and comparison method. Valuation methods are described in more detail in notes 4 and 20.

Recognition and measurement of provisions and reassessment of provisions made in previous periods

A provision is recognised in the statement of financial position when the group has a present obligation arising from a past obligating event deriving from a contract, legislation or an established pattern of the group's past practice, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation although the timing or amount of the arising liability are uncertain. The amount recognised as a provision is management's best estimate of the expenditure required to settle the obligation and the time the obligation should be settled. The best estimate of the expenditure required to settle a present obligation is the amount that the group would rationally be expected to pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. Expenses related to provisions are recognised as an expense in the period in which they arise. At each reporting date, management assesses the need for recognising additional provisions or adjusting or reversing existing provisions.

3 Changes in accounting policies and presentation of information

The consolidated financial statements are prepared in accordance with the principles of consistency and comparability, which means that the group consistently applies the same accounting and presentation policies. Accounting policies and presentation are changed only when this is required by new or revised International Financial Reporting Standards (IFRS) as adopted by the EU and their interpretations or when a new accounting policy or presentation practice represents the group's financial position, financial performance and cash flows more faithfully.

Change in presentation of information in the statement of comprehensive income and related notes

From 2014, the group changed the presentation of information in some rows of comprehensive income to gain more precise disclosure of expense structure. The most significant change is the presentation of inventory write-down and reversal of inventory write-down in separate line of statement of comprehensive income. Previously the information was presented on the row *Cost of sales*. Comparative information for year 2013 has been aligned with the changed presentation.

Adoption of new or revised standards and interpretations

The following new or revised standards and interpretations became effective for the group from 1 January 2014:

IFRS 12, Disclosure of Interest in Other Entities - The standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 sets out the required disclosures for entities reporting under the two new standards: IFRS 10, Consolidated financial statements, and IFRS 11, Joint arrangements, and replaces the disclosure requirements currently found in IAS 28, Investments in associates. According to requirements of the standard, additional disclosures related to interest in other entities have been presented in the annual report.

The other new or revised standards or interpretations, which became effective in the financial year starting 1 January 2014 or are not yet effective, are not expected to have a material impact on the group

New accounting pronouncements

Certain new or revised standards and interpretations have been issued that are mandatory for the group's annual periods beginning on or after 1 January 2015, and which the group has not early adopted.

IFRIC 21 Levies – the interpretation clarifies the accounting for an obligation to pay a levy that is not income tax. The obligating event that gives rise to a liability is the event identified by the legislation that triggers the obligation to pay the levy. The fact that an entity is economically compelled to continue operating in a future period, or prepares its financial statements under the going concern assumption, does not create an obligation. The same recognition principles apply in interim and annual financial statements. The application of the interpretation to liabilities arising from emissions trading schemes is optional. The group will evaluate the impact of the amendments to financial statements.

IFRS Amendments in 2012 – The amendments involve changes in 7 standards. Among others, IFRS 8 was amended to require (1) disclosure of the judgements made by management in aggregating operating segments, including a description of the segments which have been aggregated and the economic indicators which have been assessed in determining that the aggregated segments share similar economic characteristics, and (2) a reconciliation of segment assets to the entity's assets when segment assets are reported. Implementation of amendments to IFRS 8 may require additional disclosures in financial statements.

The other new or revised standards or interpretations which are not yet effective, are not expected to have a material impact on the group

4 Significant accounting policies

Business combinations and basis of consolidation

The consolidated financial statements comprise the financial statements of Arco Vara AS and its subsidiaries, combined line by line, and the group's interests in joint ventures and associates, accounted for using the equity method. The financial statements of all group entities coincide with the calendar year. The group entities use in all material respects uniform accounting policies and measurement bases. Where necessary, the accounting policies and measurement bases of group entities are adjusted for consolidation to ensure consistency with the policies adopted by the group.

The subsidiaries are all entities that are controlled by the group. The group has control over entity then it gets or has rights to the variable returns from its involvement with the entity and is able to use its power over the entity to affect the amount of the returns.

In preparing the consolidated financial statements, all transactions, balances and unrealised profits and losses arising from transactions between consolidated entities are eliminated in full. Unrealised losses are eliminated only to the extent that there is no evidence of impairment. Subsidiaries are consolidated from the date the control commences until the date the control ceases.

A non-controlling interest, i.e. the portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, is separately presented in the consolidated statement of financial position (within equity) and the consolidated statement of comprehensive income.

Acquisitions of subsidiaries and interests in joint ventures are accounted for using the acquisition method whereby the assets acquired and liabilities and contingent liabilities assumed ('net assets') are recognised and measured at their acquisition-date fair values. For each business combination, the group decides whether to measure the non-controlling interests in the acquiree at either fair value or the non-controlling interests' proportionate share in the recognised amounts of the acquiree's identifiable net assets. If the aggregate of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of the group's previously held equity interest in the acquiree exceeds the group's interest in the net of the acquisition-date amounts of identifiable assets acquired and the liabilities assumed, the difference is recognised as goodwill. When a bargain purchase is made and the fair value of the net assets acquired exceeds the above aggregate amount, the resulting gain is recognised in profit or loss immediately. Acquisition-related costs are recognised as expenses as incurred.

Transactions with non-controlling interests (changes in the group's ownership interests in subsidiaries) that do not result in a loss of control over a subsidiary are accounted for as equity transactions. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity.

When the parent loses control of a subsidiary, it derecognises the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts and the carrying amount of any non-controlling interests in the former subsidiary. Any investment retained in the former subsidiary is subsequently accounted for as an investment in an associate or a joint venture or an investment in other financial assets, measured at its fair value at the date the control was lost. Any difference between the consideration received and the aggregate of the derecognised net assets and the investment recognised is recognised in profit or loss in the period in which it arises.

In the parent company's separate financial statements the investments in subsidiaries are accounted for at cost less impairment.

Investments in associates and joint ventures

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control exists when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control. Associates are all entities over which the group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

Investments in associates and joint ventures are accounted for using the equity method whereby the investment is initially recognised at cost, i.e. at the fair value of the consideration paid for it on acquisition, and its carrying amount is adjusted to recognise the investor's share of the profit or loss of the associate or joint venture after the date of acquisition. In preparing the consolidated financial statements, the group's share of unrealised gains and losses on transactions between the group and its associates and joint ventures are eliminated unless there is evidence of impairment.

When the group's share of losses of an associate or joint venture exceeds the carrying amount of its investment in the associate or joint venture (i.e. the investment together with any long-term loan receivables that in substance form part of the group's investment), the carrying amount of the investment is reduced to zero and additional losses are not recognised unless the group has incurred legal or constructive obligations on behalf of the associate or joint venture and at the reporting date it is evident that the associate or joint venture is unable to meet its commitments. In such cases additional losses are provided for and recognised to the extent that the group has incurred obligations on behalf of the investee.

Segment reporting

Reportable segments are identified and segment information is reported on the same principle as the group's structural units are grouped for internal accounting and reporting purposes (management accounting and budgeting). Segment reporting complies with internal reporting submitted to the group's chief operating decision maker. The group has identified the parent company's chief executive officer/member of the management board as its chief operating decision maker. The chief executive officer/member of the management board reviews the group's operating results by business line, whereby an operating segment is a component of the group that provides clearly distinguishable products or services and operates as an independent profit centre.

Segment revenue is revenue that a segment earns from sales to external customers or other segments of the group. Segment expenses are expenses resulting from the operating activities of a segment that are directly attributable to the segment, including expenses from transactions with external suppliers and other segments of the group. Segment expenses do not include finance costs and investment expenses, the group's general administrative expenses and other expenses that arise at the group level. The costs incurred at the group level are allocated to a segment only if they relate to the segment's operating activities and they can be attributed to the segment on a reasonable basis.

Unrealised profits and losses which arise within the group from transactions performed between its segments are not allocated to any segment but are reported as eliminations of inter-segment profits and losses. Unrealised profits and losses that arise from transactions between the group's head office and the segments and which can be allocated to a segment on a reasonable basis are included in the segment's operating profit.

Segment assets are assets that are employed by a segment in its operating activities and that are directly attributable to the segment. Segment assets include, for example, current assets, investment properties, property, plant and equipment and intangible assets used in a segment's operating activities. Segment assets do not include assets used for the group's general needs or which cannot be directly allocated to the segment.

Segment liabilities are liabilities that result from the operating activities of a segment and that are directly attributable to the segment. Segment liabilities include, for example, trade and other payables, accrued expenses, advances from customers, warranties provisions and other liabilities related to the segment's products and services. Segment liabilities include also loans and finance lease liabilities arisen from financing activities.

Unallocated items comprise revenue and expenses and assets and liabilities which have not been allocated to any segment under the above principles.

Foreign currency transactions

All group entities prepare their financial statements in the currency of the primary economic environment in which they operate (their functional currency), i.e. in the local currency. The functional currency of the group's parent company and Latvian and Estonian subsidiaries is the euro. The presentation currency of the consolidated financial statements is the euro. Foreign currency is any currency other than the functional currency. A transaction in foreign currency is recorded by applying the foreign exchange rate of the European Central Bank ruling at the date of the transaction. Monetary assets (cash, cash equivalents and receivables) and monetary liabilities (loans and borrowings, payables and other monetary liabilities) denominated in foreign currency at the reporting date are retranslated to euros at the exchange rates of the European Central Bank ruling at the reporting date. Foreign exchange gains and losses are recognised in finance income

and finance costs respectively in the period in which they arise. A non-monetary item denominated in foreign currency that is measured in terms of historical cost is recorded using the exchange rate of the European Central Bank ruling at the date of the original transaction. A non-monetary item denominated in foreign currency that is measured at fair value is recorded in the functional currency using the exchange rate of the European Central Bank ruling at the date the fair value was determined.

When the functional currency of a subsidiary differs from the parent's functional currency, the financial statements of the subsidiary (e.g. in Lithuania and Bulgaria) are translated for consolidation purposes using the central exchange rate of the currency against the euro, which is why translation does not give rise to any significant exchange differences. All relevant countries, i.e. Lithuania and Bulgaria, have pegged their currency to the euro.

Revenue

Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be measured reliably.

Revenue from the sale of real estate

Sales of real estate (including real estate development projects: buildings, apartments, etc built on properties belonging to group companies) are recognised when all significant risks and rewards related to the properties have been transferred to the buyer and the group has no obligation to perform significant additional work. In general, a sale is deemed to have occurred when the real right contract (the contract by which title is transferred) has been signed. Payments made by customers before the signature of the real right contract are recognised as deferred income.

Revenue from long-term service contracts

The revenue and expenses arising from long-term service contracts (including construction contracts) are recognised using the stage of completion method. The stage of completion of a service is determined as the proportion that the costs incurred until the reporting date bear to the estimated total costs of the transaction. If the amount of progress billings as at the reporting date differs from the revenue determined by reference to the stage of completion method, the difference is recognised in the statement of financial position as a payable or a receivable.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Revenue from the rendering of other services

Revenue from the rendering of other services arises when the service has been rendered. Revenue from brokerage services is recognised when the brokerage transaction has been concluded. Rental income from investment properties is recognised on a straight-line basis over the lease term. Revenue from intermediation of utilities services (payments for electricity, heating, water supply, etc) is offset against the costs of purchasing those services.

Cash and cash equivalents and the statement of cash flows

Cash and cash equivalents comprise cash and short-term (with a term of up to 3 months from the date of acquisition) highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in market value. Such assets are cash, demand deposits and term deposits with a maturity of up to three months.

In the statement of cash flows, cash flows are presented using the direct method.

Financial assets

Financial assets are classified to different categories and designated to the appropriate category upon initial recognition.

The group classifies its financial assets to the following categories:

- 1) loans and receivables;

When a financial asset is recognised initially, it is measured at cost, which is the fair value of the consideration given for it. Acquisition costs are any costs that are directly attributable to the acquisition of the asset, including fees and commissions paid to agents, advisers, brokers and dealers, as well as any non-recoverable levies, taxes and duties.

A regular way purchase or sale of financial assets is recognised using trade date accounting. The trade date is the date on which the group commits itself to purchase or sell a financial asset (e.g. the date on which the agreement is signed). A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established by regulation or convention in the marketplace concerned.

Loans and receivables

After initial recognition, loans and receivables are measured at amortised cost using the effective interest method. The effective interest rate is found for the entire expected life of a financial asset, taking into account any premiums or discounts on acquisition and any directly attributable transaction costs.

If there is objective evidence, which indicates that an impairment loss on a financial asset carried at amortised cost has been incurred (e.g. significant financial difficulty of the debtor, default or delinquency in settlement, etc), the carrying amount of the financial asset is written down to its recoverable amount. The recoverable amount is the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses on financial assets

related to operating activities are charged to other expenses and impairment losses on financial assets related to investing activities are charged to finance costs. Financial assets that are individually significant are assessed for impairment on an individual basis.

If a receivable that has been written down is collected or any other event occurs which reverses an impairment loss that has been recognised, the reversal is recognised by reducing the line item in the statement of comprehensive income within which the impairment loss was originally recognised.

Interest income on loans and receivables is recognised within finance income.

Inventories

The group's inventories include mostly land and buildings that have been acquired or are being developed for housing development. Finished goods and work in progress are initially recognised at their cost of conversion. The cost of conversion includes all direct and indirect production costs incurred in bringing the inventories to their present location and condition. Other inventories are initially recognised at cost. The cost of inventories includes all direct and indirect costs incurred in bringing the inventories to their present location and condition. Indirect costs that are included in the cost of items of real estate classified as inventories include borrowing costs incurred in financing the construction of the assets. Capitalisation of borrowing costs commences when borrowing costs and expenditures for development of inventories have been incurred and development activities have been undertaken. Borrowing costs are capitalised during the active development stage. Capitalisation of borrowing costs ceases when the asset is complete (usually when the building has been granted a permit of use) or its development has been suspended for an extended period.

The cost of inventories is assigned using the weighted average cost formula except that the cost of registered immovable properties and apartments treated as movable properties is assigned by specific identification of their individual costs.

In the statement of financial position, inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Inventory write-downs to net realisable value are recognised in the statement of comprehensive income in other expenses or in separate line if the amount is material.

Investment property

Investment property is property (land or a building or both) held to earn rentals or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes. In addition, investment property includes properties which are held over an extended period for an undetermined future use. Properties being constructed or developed for future use as investment properties (commercial buildings) and buildings treated as movable properties (commercial buildings under reconstruction and renovation) are carried as investment properties.

An investment property is measured initially at its cost. Directly attributable transaction costs are included in the initial measurement. Transaction costs that are directly attributable to acquisition include notary's fees, stamp duties, advisors' fees and other transaction costs without which the purchase transaction could probably not have been performed. After initial recognition, investment properties are measured using the fair value model. The fair value of investment property reflects market conditions at the reporting date.

In addition to estimates made by management, the fair value of investment property is determined, where necessary, based on the valuations performed by qualified independent appraisers. This means that in the case of significant investment properties valuation reports are also commissioned, if necessary, from independent real estate appraisers. Fair value is determined using the following methods:

- Discounted cash flow analysis. The discounted cash flow method is used to determine the value of investment properties that generate stable rental income and properties whose fair value, according to management's assessment, cannot be determined reliably under the comparison method (for example, inactive property market in the location of the property being valued, absence of comparable transactions or an extensive period between a comparable transaction and the date of valuation). In order to calculate the present value of a property's future cash flows, the appraiser has to forecast the property's future rental income (including rental per 1 square metre and the occupancy rate) and operating expenses. Depending on the terms of the lease (whether and how easily the lease can be terminated by the lessee), the appraiser will base the projections on either the property's existing cash flows or the market's current average cash flows for similar properties. The present value of the future net cash flow is found by applying a discount rate which best reflects the current market assessments of the time value of money and the risks specific to the asset. The discount rate is selected based on the market's average capital structure.
- Comparison method. The comparison method is applied to properties that do not generate rental cash flow and are held for future development or capital appreciation. Under this method, the market value of a property is determined by reference to the price per square metre agreed in transactions performed with similar properties. As the transactions selected for comparison are practically never identical with the property being valued, their prices are adjusted to reflect differences in time, location, size and detailed design plan. Where necessary, another valuation technique is applied (e.g. the discounted cash flow analysis) if management believes that the latter can measure the fair value of the property more reliably.
- Residual value method. The method is applied to determine the value of a property that requires development or reconstruction in a situation where the comparison method cannot be applied due to the absence of a suitable basis for comparison. The method is applied on the assumption that the buyer is willing to pay for a property an

amount equal to the value of the property after its development or reconstruction less its estimated development or reconstruction costs and a reasonable profit margin.

- Existence of a sales contract under the law of obligations (a presale contract). In the case of properties which at the reporting date have been sold based on a contract under the law of obligations but in respect of which the real right contract has not been signed (title has not transferred), fair value is determined by reference to the sales price of the property in the contract under the law of obligations. The sales price agreed in the contract under the law of obligations is used for determining the fair value of a property only when the group has reasonable assurance that the related real right contract will be concluded under the same terms and conditions (e.g. the buyer has made a substantial prepayment for the property by the reporting date or the real right contract is concluded after the reporting date but before the date management approves the financial statements for issue).

Gains and losses arising from changes in the fair value of investment property are recognised in profit or loss in the period in which they arise (in other income and other expenses respectively).

An investment property is derecognised on disposal or when the property is permanently withdrawn from use and no future economic benefits are expected from its disposal. Gains and losses arising from the retirement or disposal of investment property are recognised in profit or loss in the period of retirement or disposal (in other income and other expenses respectively).

Transfers to and from investment property are made when there is a change in use. From the date of transfer, an asset is accounted for using the policies applied to the class of assets to which it has been transferred. For a transfer from investment property to inventories or property, plant and equipment, the property's deemed cost for subsequent accounting is its fair value at the date of transfer.

When an item of property, plant and equipment is transferred to investment property, any positive difference between the fair value and carrying amount of the property at the date of transfer is recognised in the revaluation reserve in equity. Any negative difference is recognised as an impairment loss. When a property is transferred from inventories to investment property, any difference between fair value and carrying amount is recognised in profit or loss, within other income or other expenses as appropriate.

According to the requirements set out in IFRS 13 the fair value measurement methods are the following:

- quoted prices (unadjusted) in an active market for identical assets (Level 1);
- inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly (Level 2);
- unobservable inputs for the asset (Level 3).

Fair value of the group's investment property is measured using level 3 inputs. Additional information on used estimates is presented in note 20.

Property, plant and equipment

Assets are classified as items of property, plant and equipment when their useful life extends beyond one year.

An item of property, plant and equipment is initially recognised at cost. The cost of an item of property, plant and equipment comprises its purchase price and any costs directly attributable to its acquisition. The cost of items of real estate, which are carried as items of property, plant and equipment, includes borrowing costs incurred in financing their construction. For the principles of capitalising borrowing costs, see the policy *Inventories*.

After recognition, an item of property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses.

If an item of property, plant and equipment consists of significant parts that have different useful lives, the parts are accounted for separately and assigned depreciation rates that correspond to their useful lives.

Subsequent expenditure on an item of property, plant and equipment (e.g. the costs of replacing a part of an item) is added to the carrying amount of the item, provided that it meets the following criteria: (a) it is probable that future economic benefits associated with the item will flow to the group; and (b) the cost of the item can be measured reliably. The carrying amounts of the parts that are replaced are derecognised. All other subsequent expenditures related to items of property, plant and equipment are recognised as an expense in the period in which they are incurred.

Items of property, plant and equipment are depreciated on a straight-line basis. Each item of property, plant and equipment is assigned a depreciation rate that corresponds to its useful life. Asset classes are assigned the following annual depreciation rates:

- | | |
|--|--------|
| • Buildings and structures | 2–18% |
| • Plant and equipment | 8–20% |
| • Vehicles | 15–25% |
| • Other equipment and fixtures and tools | 20–40% |

Items of property, plant and equipment are depreciated until their residual value increases to an amount equal to their carrying amount. The residual value is the estimated amount that the group would currently obtain from the disposal of the asset if the asset were already of the age and in the condition expected at the end of its useful life.

Depreciation methods, depreciation rates and residual values are reviewed at least at each financial year-end.

The carrying amounts of items of property, plant and equipment are reviewed for impairment when there is evidence that the carrying amount of an asset may exceed its recoverable amount. Impairment testing is described in more detail below (see the policy *Impairment of property, plant and equipment and intangible assets*).

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. Gains and losses arising from the derecognition of items of property, plant and equipment are recognised in profit or loss, within other income and other expenses respectively, in the period in which the item is derecognised.

Items of property, plant and equipment that are available for immediate sale and whose sale within the next 12 months is highly probable are reclassified to non-current assets held for sale. Non-current assets held for sale are presented separately from other assets in the statement of financial position and their depreciation is discontinued. A non-current asset held for sale is measured at the lower of its carrying amount and fair value less costs to sell.

Intangible assets

An intangible asset is recognised when it is controlled by the group, future economic benefits from the asset are expected to flow to the group and its cost can be measured reliably. Intangible assets comprise computer software that is not an integral part of the related hardware.

Intangible assets are initially measured at cost. Following initial recognition, intangible assets are measured at cost less any accumulated amortisation and any accumulated impairment losses.

The group's intangible assets comprise assets with finite useful lives only. Intangible assets with finite useful lives are amortised on a straight-line basis over their estimated useful lives (generally three to six years). Amortisation expense is recognised in profit or loss for the period, in the expense category consistent with the function of the underlying asset. The amortisation periods and amortisation methods of intangible assets with a finite useful life are reviewed at each financial year-end. Changes in the expected useful life of an asset and the pattern in which the asset's future economic benefits are expected to be consumed are accounted for as changes in accounting estimates and are applied prospectively.

Impairment of property, plant and equipment and intangible assets

The group assesses at each reporting date whether there is any indication that an item of property, plant and equipment or an intangible asset may be impaired. If any such indication exists, the asset's recoverable amount is estimated.

The recoverable amount of an asset is the higher of the fair value of the asset or its cash-generating unit less costs to sell and value in use. In measuring value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped into the smallest identifiable groups that generate cash inflows that are largely independent of the cash inflows from other assets or asset groups (cash-generating units).

An impairment loss is recognised when the carrying amount of an asset or a cash-generating unit exceeds the recoverable amount of that asset or cash-generating unit. Impairment losses are recognised in profit or loss in the period in which they are incurred. The impairment loss for a cash-generating unit is recognised by reducing the carrying amounts of the items of property, plant and equipment or intangible assets belonging to the unit *pro rata*.

Financial liabilities

Financial liabilities (trade and other payables, loans and borrowings and accrued expenses) are initially recognised at their fair value less any transaction costs directly attributable to their acquisition. After initial recognition, financial liabilities are measured at amortised cost using the effective interest rate method.

Interest expenses on financial liabilities are recognised in finance costs on an accrual basis except that interest expenses on financing the development of assets (real estate projects carried as inventories, investment properties, and items of property, plant and equipment) are capitalised and added to the carrying amount of the asset as borrowing costs.

A financial liability is classified as current when it is due to be settled within 12 months after the reporting date or the group does not have an unconditional right to defer settlement of the liability for more than 12 months after the reporting date. Financial liabilities which are due to be settled within 12 months after reporting date are classified as current even if an agreement to refinance on a long-term basis is completed after the reporting date and before the financial statements are authorised for issue. When a contract is breached on or before the reporting date with the effect that the liability becomes payable on demand, the liability is also classified as current.

A financial liability is removed from the statement of financial position when it is discharged or cancelled or expires.

Employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus plans if the group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Termination benefits are recognised as an expense when the group is demonstrably committed, without a realistic possibility of withdrawal, to a detailed formal plan to either terminate employment before the normal retirement date or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for

voluntary redundancies are recognised as an expense when the group has made an offer of voluntary redundancy, it is probable that the offer will be accepted and the number of acceptances can be estimated reliably.

Share-based payments

The share options granted to the group's CEO/member of the management board are recognised as equity-settled consideration for services rendered to the Group. Owing to the complexity of determining the fair value of services received, the fair value of the services rendered by the CEO/member of the management board is measured by reference to the fair value of the equity instruments granted.

The cost of equity-settled share-based payment transactions is recognised as an expense with a corresponding increase in equity over the period in which the employee provided services until the date of vesting of equity instruments. At each balance sheet date, the Group recognises expenses related to share-based payments based on an estimate of the number of equity instruments expected to vest. Any change in the cumulative remuneration expense from the date of the current reporting period is recognised in profit or loss for the period.

The grant of share options is conditional on the length of the employee's employment in the group between the grant date of the options and the end of the vesting period. Vesting conditions, other than market conditions, are not taken into account when estimating the fair value of the share options at the measurement date. Instead, vesting conditions are taken into account by adjusting the number of equity instruments included in the measurement of the transaction so that, ultimately, the amount recognised for services received as consideration for the equity instruments granted is based on the number of equity instruments that will eventually vest. Hence, on a cumulative basis, no amount is recognised for services received if the equity instruments granted do not vest because of the failure to satisfy a vesting condition, e.g. when the counterparty fails to complete a specified service period.

If the share options are exercised by the CEO/member of the management board the group will issue new share, which will be redeemed by the CEO/member of the management board for 0.7 euros per shares. The fair value of share options accumulated in equity will be transferred to retained earnings at the exercise date.

Provisions and contingent liabilities

A provision is recognised in the statement of financial position only when the group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Other possible commitments that may transform into obligations under certain circumstances (which have not yet occurred) are disclosed as contingent liabilities in the notes to the consolidated financial statements.

Present obligations arising from past events which according to management's judgement will not realise or cannot be measured reliably are also disclosed as contingent liabilities.

Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer of the guarantee to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. On initial recognition, a financial guarantee contract is measured at its fair value at the date of issue of the guarantee. After initial recognition, financial guarantee contracts are measured at the higher of: (a) the originally recognised amount less amortisation; and (b) the amount determined as described in the section on measurement of provisions.

Leases

A lease that transfers substantially all the risks and rewards incidental to ownership of the leased asset to the lessee is classified as a finance lease. All other leases are classified as operating leases.

As a lessee, the group recognises finance leases at the commencement of the lease term as assets and liabilities at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments. If the group does not obtain ownership of the leased asset by the end of the lease term, the asset is depreciated over the lease term or its estimated useful life. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. A constant periodic rate of interest is applied throughout the lease term.

Assets subject to operating leases are recognised in the lessor's statement of financial position. Operating lease payments received and made are recognised as income and expenses respectively on a straight-line basis over the lease term.

Statutory capital reserve

According to the Estonian Commercial Code, the statutory capital reserve of a company has to amount to at least 10% of its share capital. Accordingly, the Company transfers at least 5% of its net profit for the year to the capital reserve until the required level has been achieved. The capital reserve may not be distributed as dividends but it may be used for covering accumulated losses if the latter cannot be covered with unrestricted equity, and for increasing share capital through a bonus issue.

Income tax

Income tax assets and liabilities and income tax expense and income comprise current and deferred items. Current tax is recognised as a short-term asset or liability and deferred tax is recognised as a long-term asset or liability.

Parent company and subsidiaries registered in Estonia

Under the Estonian Income Tax Act, in Estonia companies do not have to pay income tax on their earnings (profit for the year). Instead, income tax is levied on profit distributions (dividends). Since 1 January 2015, the amount of tax payable is calculated as 20/80 of the net amount of dividends distributed in Estonia. Until the end of 2014, the applied rate was 21/79. The income tax payable on a dividend distribution is recognised as the income tax expense of the period in which the dividends are declared.

Because of the specific nature of the taxation system, deferred income tax liabilities and assets do not arise for companies registered in Estonia. The contingent tax liability reflecting the obligation that would arise on the distribution of retained earnings as dividends is not recognised in the statement of financial position. Maximum possible tax liability in case all retained earnings were distributed is disclosed in note 28.

Latvian, Lithuanian and Bulgarian subsidiaries

In Latvia, Lithuania and Bulgaria the profit earned by companies is subject to income tax. The tax rate in Latvia and Lithuania is 15% and in Bulgaria 10% of taxable income. Taxable income is identified by adjusting profit before tax for the temporary and permanent differences permitted by the local tax laws.

In the case of foreign subsidiaries, deferred income tax assets and deferred income tax liabilities are recognised for all temporary differences between the carrying amounts and tax bases of assets and liabilities. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Discontinued operations and sales group assets and liabilities

Sales group assets and liabilities are measured at carrying amount.

Investments in subsidiaries and joint ventures in the parent company's unconsolidated primary financial statements presented in accordance with the Estonian Accounting Act

The parent company's unconsolidated primary financial statements (note 34) represent supplementary information that is presented in accordance with the requirements of the Estonian Accounting Act and they do not constitute separate financial statements as defined in IAS 27.

In the parent's unconsolidated primary financial statements, investments in subsidiaries and joint ventures are measured using the cost method whereby an investment is initially recognised at cost, i.e. at the fair value of the consideration paid for it on acquisition and after initial recognition it is carried at cost less any impairment losses.

Investments are tested for impairment by measuring their recoverable amounts whenever there is any indication of impairment. Impairment losses are recognised in the statement of comprehensive income in other expenses or in separate line if the amount is material.

Dividends received and receivable from subsidiaries and joint ventures are recognised as income when the right to receive payment has been established.

5 Segment information

The group has the following reportable segments:

Service – real estate services: real estate brokerage, valuation, management and short-term investment in real estate.

Development – real estate development: development of residential and commercial environments.

Inter-segment transactions are conducted at market prices and priced on the same basis as transactions with external counterparties. A significant proportion of inter-segment transactions is generated by the Service segment that sells real estate brokerage services to the Development segment. Unallocated items include primarily income, expenses, assets and liabilities of the group's parent.

Revenue and operating profit/loss by operating segment

Segment	Development		Service		Unallocated items		Eliminations		Consolidated	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
In thousands of euros										
External revenue	6,466	8,049	2,688	2,674	4	5			9,158	10,728
<i>Annual change</i>	-20%	-6%	1%	13%					-15%	-2%
Inter-segment revenues	37	16	451	285					0	0
Total revenue	6,503	8,065	3,139	2,959	4	5	-488	-301	9,158	10,728
Operating profit/loss	1,942	5,100	246	213	-25	-442	120	-344	2,283	4,527
<i>Of which reversals of inventory write-downs</i>	572	299	0	0	0	0			572	299
<i>Fair value adjustments to investment property, net</i>	0	-113	0	0	0	0			0	-113
<i>Depreciation, amortisation and impairment losses</i>	-22	53	-22	-15	-2	-2			-46	36
<i>Gain/loss on reassessment of other assets and liabilities</i>	-2	98	0	0	0	43			-2	141
<i>Gain on sale of a subsidiary</i>	0	98	0	0	662	0			662	98
<i>Profit/loss from joint ventures</i>	-27	2 897	0	0	0	0			-27	2,897

External revenue by location

Segment	Development		Service		Parent company		Consolidated	
	2014	2013	2014	2013	2014	2013	2014	2013
In thousands of euros								
Estonia	0	2,620	1,181	1,405	4	5	1,185	4,030
Bulgaria	5,364	4,051	393	295	-	-	5,757	4,346
Latvia	1,102	778	1,114	974	-	-	2,216	1,752
Lithuania	-	600	-	-	-	-	-	600
Total	6,466	8,049	2,688	2,674	4	5	9,158	10,728

Operating profit of Development and Service segment by location

Segment	Development		Service	
	2014	2013	2014	2013
In thousands of euros				
Estonia	374	3,356	40	145
Bulgaria	1,566	1,683	141	-14
Latvia	2	38	65	82
Lithuania	-	23	-	-
Total	1,942	5,100	246	213

Assets and liabilities by operating segments and by location

Segment	Development		Service		Sales group assets and liabilities		Unallocated items		Consolidated	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
In thousands of euros										
Assets	25,602	23,433	668	580	0	847	733	297	27,003	25,157
Estonia	4,883	4,175	190	256	0	847	733	297	5,806	5,575
Bulgaria	19,294	17,130	231	138	0	0	0	0	19,525	17,268
Latvia	1,425	2,128	247	186	0	0	0	0	1,672	2,314
Liabilities	16,265	15,309	499	572	0	1,488	1,189	934	17,953	18,303
Estonia	1,422	1,445	262	380	0	1,488	1,189	934	2,873	4,247
Bulgaria	14,685	13,634	109	70	0	0	0	0	14,794	13,704
Latvia	158	230	128	122	0	0	0	0	286	352

Minor changes in service and development segment 2013 referenced data of segment reporting compared to disclosures in 2013 annual report are caused by amendments to the intra-group accounting principles for segment reporting since the beginning of 2014.

6 Acquisition and sale of subsidiaries

Scope of consolidation

At 31 December 2014, Arco Vara group comprised 24 consolidated entities (31 December 2013: 23). The structure of the group is presented in note 33.

Sale of a subsidiary in 2014

On 14 February 2014, Arco Vara AS divested its 100% share in Arco Ehitus OÜ to the company Stratcorp OÜ. The sale price of the share included two parts:

- 1) 10 thousand euros paid on transfer of the share;
- 2) 30% out of the amount, that Arco Ehitus OÜ will gain from actions brought by Arco Ehitus OÜ through Ministry of Education and Research and OÜ Loksa Haljastus. Income tax is to be deducted from proceeds.

The group's gain on the transaction amounted to 662 thousand euros not considering the impact of 2) part of sale price.

Effect of subsidiary's sale on the group's statement of financial position

In thousands of euros	
Decrease in cash	-18
Decrease in receivables	-300
Decrease in inventory and property, plant and equipment	-50
Decrease in liabilities and prepayments collected	1,020
Cash receipts from the sale	10
Total effect on the group's net assets (note 12)	662

Joint venture became a subsidiary in 2014

On 30 September 2014, the group's Estonian subsidiary Arco Investeeringute AS acquired for the purchase price of 1 euro additional 50% ownership in the group's joint venture Tivoli Arendus OÜ. As a result of the transaction, Arco Investeeringute AS has 100% ownership of Tivoli Arendus OÜ and Tivoli Arendus OÜ became a subsidiary for the group. The group's loss on the transaction amounted to 27 thousand euros. There could be also long-term impact on the group's income statement depending on the results of ongoing court disputes between Tivoli Arendus OÜ and Nordecon AS, where Tivoli Arendus claims Nordecon for 1.2 million euros and Nordecon claims Tivoli Arendus for 0.2 million euros.

Effect of acquisition on the group's statement of financial position

In thousands of euros	
Increase in cash	10
Decrease in receivables	-28
Increase in liabilities	-9
Total effect on the group's net assets (note 12)	-27

Sale of a subsidiary in 2013

On 1 March 2013, Arco Investeeringute AS divested its 100% interest in the subsidiary Pärnu Turg OÜ to Bellvory Turg OÜ. The group's sales gain on the transaction amounted to 98 thousand euros. As a result of the divestment, the group's assets decreased by 2,067 thousand euros and its loan liabilities declined by 772 thousand euros (of which 325 thousand euros was paid just before the sale). The group's annual revenue will decrease by around 300 thousand euros.

Effect of subsidiaries sale on the group's statement of financial position

In thousands of euros	
Decrease in cash	-37
Decrease in receivables	-30
Decrease in investment property (note 20)	-2, 000
Decrease in loans and borrowings (note 22)	447
Decrease in other liabilities	108
Cash receipts from the sale	1, 610
Total effect on the group's net assets (note 12)	98

Notes to the consolidated statement of comprehensive income

7 Revenue

	2014	2013
In thousands of euros		
Sale of own real estate	5,414	6,937
Real estate brokerage and valuation	2,520	2,560
Rental of real estate	955	1,001
Property management services	128	110
Other revenue	141	120
Total revenue	9,158	10,728

8 Cost of sales

	2014	2013
In thousands of euros		
Cost of real estate sold (note 19)	-3,918	-5,620
Personnel expenses	-1,528	-1,596
Property management costs	-311	-407
Vehicle expenses	-18	-21
Depreciation, amortisation and impairment losses	-11	-11
Other costs	-116	-94
Total cost of sales	-5,902	-7,749

9 Other income and expenses

Other income

	2014	2013
In thousands of euros		
Income on reassessment of liabilities	0	160
Gain on reversal of property, plant and equipment devaluation	0	72
Gain on sale of investment property	0	60
Gain on sale of property, plant and equipment	0	3
Miscellaneous income	37	109
Total other income	37	404

Other expenses

	2014	2013
In thousands of euros		
Late payment interest and penalty charges	-35	-43
Loss on sale and impairment of other non-current assets	-1	-1
Loss on changes in the fair value of investment property	0	-113
Write-down of receivables	-2	-19
Miscellaneous expenses	-44	-20
Total other expenses	-82	-196

10 Marketing and distribution expenses

	2014	2013
In thousands of euros		
Advertising expenses	-179	-159
Personnel expenses	-61	-54
Market research	-7	-13
Brokerage fees	-2	-7
Other marketing and distribution expenses	-75	-45
Total marketing and distribution expenses	-324	-278

11 Administrative expenses

	2014	2013
In thousands of euros		
Personnel expenses	-929	-870
Office expenses	-362	-352
Services purchased	-217	-158
IT expenses	-140	-98
Legal service fees	-62	-88
Vehicle expenses	-38	-36
Depreciation, amortisation and impairment losses	-34	-27
Other expenses	-29	-47
Total administrative expenses	-1,811	-1,676

12 Gain on transactions involving subsidiaries and joint ventures

	2014	2013
In thousands of euros		
Gain on sale of subsidiary (note 6)	662	98
Gain on reversal of provisions related to sureties given to joint venture obligations (notes 24)	0	2,917
Loss on acquisition of shares in a joint venture (notes 6)	-27	0
Allowances made to receivables from joint ventures	0	-20
Total	635	-2,995

13 Finance income and costs

	2014	2013
In thousands of euros		
Interest expense	-975	-828
Interest income	5	22
Other finance income and costs	-92	-166
Total finance income and costs	-1,062	-972

Interest expense consists mainly of interest expense on loans taken for acquiring and building real estate projects. Interest expenses on loans taken for financing development projects in progress are capitalised in inventory. In 2014, capitalised interest expenses amounted to 208 thousand euros (in 2013: 59 thousand euros).

14 Income tax

	2014	2013
In thousands of euros		
Income tax expense from Bulgarian subsidiaries	75	0
Total income tax expense	75	0

The group has off-balance contingent income tax assets at its Bulgarian and Latvian subsidiaries. The contingent tax assets can be used against the entities' future income tax liabilities. The group's management estimates that the realisation of these income tax assets is unlikely because the companies which have potential income tax assets will not earn significant profits in the future.

15 Earnings per share

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share are calculated by taking into account the effects of all dilutive potential ordinary shares.

	2014	2013
Weighted average number of ordinary shares outstanding during the period	5,186,326	4,741,707
Number of ordinary shares potentially to be issued at the end of year	390,000	390,000
Net profit attributable to equity holders of the parent (in thousands of euros)	803	3,410
Basic earnings per share (in euros)	0.15	0.72
- of which continuing operations	0.22	0.75
- of which discontinued operations	-0.07	-0.03
Diluted earnings per share (in euros)	0.14	0.66
- of which continuing operations	0.21	0.69
- of which discontinued operations	-0.07	-0.03

In September 2014, Arco Vara AS share capital was raised by additional share issue, which increased the number of ordinary shares by 1,375,305. See also note 25.

According to the decision of the annual general shareholders' meeting of Arco Vara AS, held on 1 July 2013, one convertible bond was issued with the nominal value of 1,000 euros. The convertible bond will give to the chief executive of the group's parent company the right to subscribe up to 390,000 ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2016. As at 31 December 2014, an equity reserve in amount of 179 thousand euros has been formed (at 31 December 2013: 60 thousand euros) for the option associated with the bond. See also note 29.

16 Operating lease expenses

In the reporting period, the group used office premises, vehicles and office equipment under operating leases.

	2014	2013
In thousands of euros		
Office premises	139	141
Office equipment	22	22
Vehicles	1	26
Total	162	189

Future lease payables under non-cancellable operating lease contracts are as follows:

As at 31 December	2014	2013
In thousands of euros		
No later than 1 year	51	90
Later than 1 year and no later than 5 years	22	10
Total	73	100

Notes to the consolidated statement of financial position

17 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposit accounts in commercial banks.

As at 31 December	2014	2013
In thousands of euros		
Cash on hand and demand deposits	1,691	818
Total cash and cash equivalents	1,691	818

Out of the group's year-end cash and cash equivalents balance 30 thousand euros (31 December 2013: 139 thousand euros) was in accounts with a designated purpose limited to the cash flows of specific projects (mostly receipts from customers, direct project development costs and loan and interest payments to banks). For pledged assets see note 27.

18 Receivables and prepayments

Short-term receivables and prepayments

As at 31 December	2014	2013
In thousands of euros		
Trade receivables		
Receivables from customers ¹	989	164
Allowance for doubtful trade receivables	-22	-22
Total trade receivables	967	142
Other receivables		
Loans provided	6	33
Term deposits (with maturities from 3 to 12 months)	0	23
Miscellaneous receivables	154	163
Total other receivables	160	219
Accrued income		
Prepaid and recoverable taxes	22	127
Other accrued income	4	9
Total accrued income	26	136
Prepayments	52	159
Total short-term receivables and prepayments	1,205	656

¹ - as at 31 December 2014, the balance of receivables from customers is increased significantly mainly due to the active sales of Manastirski project II stage in December. The receivables from that project amounted to 852 thousand euros and will be collected during first quarter 2015.

Long-term receivables

As at 31 December	2014	2013
In thousands of euros		
Term deposits (with maturities more than 1 year)	0	240
Prepayments	5	12
Total long-term receivables and prepayments	5	252

For pledged assets see note 27.

Allowance for doubtful trade receivables

As at 31 December	2014	2013
In thousands of euros		
Balance at beginning of year	-22	-463
Receivables considered doubtful during the year	-2	-1
Receivables considered irrecoverable during the year	2	442
Balance at end of year	-22	-22

19 Inventories

As at 31 December	2014	2013
In thousands of euros		
Properties purchased and being developed for resale	11,942	10,762
Materials and finished goods	12	5
Prepayments for inventories	16	13
Total inventories	11,970	10,780

Properties purchased and being developed for resale in 2014

In thousands of euros	
Balance at 31 December 2013	10,762
Properties purchased for development	120
Construction costs of apartment buildings	4,236
Capitalized borrowing costs	233
Reversal of inventory write-down	572
Other capitalized costs	345
Reclassification to investment property (note 20)	-408
Cost of sold properties (note 8)	-3,918
Balance at 31 December 2014	11,942

In 2014, the group reversed prior period inventory write-downs of 572 thousand euros (in 2013: 302 thousand euros). In 2014, the reversal is grounded by the adoption of a detailed plan for the Paldiski road 70C project in Tallinn, therefore resulting in an increase of the value of the property.

In 2013, the net realisable values of some inventories decreased below their carrying values and the group wrote them down by 3 thousand euros. No write-downs were made in 2014.

For information on inventories pledged as loan collateral, see note 27.

Projects under development, which are classified as inventories, have been measured using the comparison method or the residual value method. In 2014 and also in 2013, the value of the group's inventories was determined by internal experts. Estimates used in valuations are based on real market prices and the group's recent experience with comparable assets. As at 31 December 2014, inventories in total amount of 8,159 thousand euros had not required a write-down or reversal of write-down (in 2013: 5,045 thousand euros).

As at 31 December	2014	2013
In thousands of euros		
Measured using the residual value method	4,550	6,612
Measured using the comparison method	7,187	4,003
Other	233	165
Total inventories	11,970	10,780

As at 31 December 2014, the total carrying value of inventories carried at cost was 4,502 thousand euros (at 31 December 2013: 555 thousand euros) and total carrying value of inventories measured at net realisable value was 7,468 thousand euros (at 31 December 2013: 10,225 thousand euros).

20 Investment property

Investment properties comprise commercial buildings that have been leased out and properties that have development potential but whose future use is still uncertain.

In thousands of euros	
Balance at 31 December 2012	14,097
Loss on changes in fair value (note 9)	-113
Reclassification to inventories	-630
Sales	-2,023
Balance at 31 December 2013	11,331
Loss on changes in fair value (note 31)	-160
Capitalised development costs	6
Reclassification from inventories (note 19)	408
Balance at 31 December 2014	11,585

In March 2013, Arco Investeeringute AS sold its subsidiary Pärnu Turg OÜ. The assets of Pärnu Turg OÜ included an investment property at Suur-Sepa 18 in Pärnu, where the "old" Pärnu market operates. At the date of sale, the carrying amount of the investment property was 2,000 thousand euros. The group's gain on the sale of the subsidiary amounted to 98 thousand euros. The group received 1,610 thousand euros from the sale of Pärnu Turg OÜ. See also note 6.

For information on pledged assets, see note 27.

Land plots, which are classified as investment properties, have been measured using comparison method, i.e. specialists have estimated the price for which the assets could be realised within one year by reference to prevailing market prices. Assets that generate cash flow have been measured using the discounted cash flow method. In 2014 and 2013, the values of all of the group's investment properties were determined by internal experts.

As at 31 December 2014, investment properties with carrying values of 11,594 thousand euros did not require value adjustment (in 2013: 672 thousand euros). In 2014, the fair value of investment property was decreased in amount of 160 thousand euros, the loss was recognised as the loss from discontinued operations, see note 31.

As at 31 December	2014	2013
In thousands of euros		
Measured using the discounted cash flow method	10,920	10,509
Measured using comparison method	665	822
Total investment property	11,585	11,331

In 2014, variables used on valuations of investment properties measured using the discounted cash flow method were following: exit yields were 9.5% (in 2013: 9.5-10%) on office and commercial spaces and 6.5% on rental apartments (in 2013: 5-6%). Monthly rental income per m² from commercial and office areas was 10 euros on average, the same assumption applied in valuation of year 2014 and 2013.

The sensitivity of the carrying amount of investment properties measured using the discounted cash flow method to the key valuation assumptions applied was as follows.

- A change of 5% (+/-) in the forecasted net operating cash flows, would have increased or reduced the fair value of investment property by 544 thousand euros (in 2013: by 529 thousand euros).
- A decrease of 1% in the exit yields, would have increased the fair value of investment property by 1,314 thousand euros (in 2013: by 1,304 thousand euros) and an increase of 1% would reduce the fair value by 1,022 thousand euros (in 2013: by 1,008 thousand euros).

Operating leases: the group as a lessor

In 2014, the group's rental income on investment properties amounted to 1,134 thousand euros (in 2013: 1,012 thousand euros). Direct property management expenses totalled 374 thousand euros (in 2013: 367 thousand euros).

Future operating lease rentals receivable under non-cancellable contracts break down as follows:

As at 31 December	2014	2013
In thousands of euros		
No later than 1 year	688	389
Later than 1 year and no later than 5 years	806	697
Later than 5 years	86	255
Total	1,580	1,341

Lease contracts are considered non-cancellable if:

- 1) concluded for fixed term (with the expiration date in 2015 or later);
- 2) or then lessee has the right to cancel the contract with 3- to 6-month notice but only after arrival of fixed date in 2015 or later.

21 Property, plant and equipment and intangible assets

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Total property, plant and equipment
In thousands of euros				
Carrying amount at 31 December 2012	445	13	82	540
<i>Of which cost</i>	926	195	413	1,534
<i>Of which accumulated depreciation</i>	-481	-182	-331	-994
Additions	0	0	34	34
Disposals	0	0	-1	-1
Reversal of write-down	72	0	0	72
Depreciation for the year	-9	-5	-27	-41
Changes in sales group assets	-137	-8	0	-145
Carrying amount at 31 December 2013	371	0	88	459
<i>Of which cost</i>	431	0	392	823
<i>Of which accumulated depreciation</i>	-60	0	-304	-364
Additions	0	0	27	27
Disposals	0	0	-7	-7
Depreciation for the year	-9	0	-36	-45
Carrying amount at 31 December 2014	362	0	72	434
<i>Of which cost</i>	431	0	350	781
<i>Of which accumulated depreciation</i>	-70	0	-278	-348

Intangible assets

Intangible assets of the group consist mainly of business software development costs made in 2014 in amount of 99 thousand euros, of which 30 thousand euros was not paid yet as at 31 December 2014 and are recognised as trade payables or capital lease liabilities. As at 31 December 2014, total intangible assets cost value amounted 114 thousand euros and accumulated amortization amounted 1 thousand euros (31.12.2013: 13 thousand euros and 0 euros respectively).

For pledged assets see note 27.

22 Loans and borrowings

Loans and borrowings comprise the following items:

	As at 31 December 2014			As at 31 December 2013		
	Total	of which current portion	of which non-current portion	Total	of which current portion	of which non-current portion
In thousands of euros						
Bank loans	14,081	3,010	11,071	14,121	12,576	1,545
Bonds	911	160	751	751	0	751
Finance lease liabilities	28	24	4	25	13	12
Total	15,020	3,194	11,826	14,897	12,589	2,308

At 31 December 2014, the weighted average interest rate of loans and borrowings was 5.8% (31 December 2013: 6.0%).

In 2014, the group settled loans and borrowings of 4,800 thousand euros (in 2013: 4,809 thousand euros) through cash transactions and raised new loans and borrowings of 4,885 thousand euros (in 2013: 3,046 thousand euros).

Changes in loans and borrowings in 2014

Changes in the balance of loans and borrowings in 2014 were mainly due to loan used for financing the construction of Manastirski Livadi project II stage in Bulgaria. The open limit of the loan was used in amount of 3,836 thousand euros. There were also repayments made of the same loan in total amount of 3,526 thousand euros.

On 21 March 2014, Arco Vara AS issued bonds as targeted issue in total amount of 160 thousand euros. The bonds maturity date is 20 June 2015 and annual interest rate is 9.8%. See also note 29.

In October 2014, the group agreed with Piraeus bank on the changes in terms of the bank loan raised by the group's Bulgarian subsidiary. As a result, 950 thousand euros will be payable in January 2015 (the amount is paid by the time of publishing annual report) and the repayment term of the remaining loan amount of 10,884 thousand euros was prolonged up to December 2017. In Q4 2014, the same loan was partially repaid in amount of 320 thousand euros.

Changes in loans and borrowings in 2013

In 2013, the group's loans and borrowings also decreased through non-cash transactions:

- by 447 thousand euros through the sale of Pärnu Turg OÜ (see note 6);
- by 963 thousand euros that customers who purchased real estate property paid directly to banks.

On 21 August 2013, Arco Vara AS issued bonds as targeted issue in total amount of 750 thousand euros. The bonds maturity date is 21 August 2016 and annual interest rate is 14%. See also note 29.

In June 2013, the group's subsidiary Kolde AS raised new bank loan in amount of 1 400 thousand euros, which was used to acquired land plot at Paldiski road 70c Tallinn. For additional information on acquisition see also note 29.

Amounts, interest rates and maturity dates of loans and borrowings:

As at 31 December	Maturity date (month/year)	Loan amount, in thousands of euros		Interest rate, %		Type of interest rate
		2014	2013	2014	2013	
Bank loan, development ¹	12/2017	11,834	12,155	5.1	5.3	3M Euribor
Bank loan, acquisition of land	6/2015	1,400	1,400	7.7	7.9	6M Euribor
Bonds, development ²	8/2016	750	750	14.0	14.0	Fixed
Bank loan, development ³	5/2016	455	145	5.6	5.8	3M Euribor
Bonds, working capital	6/2015	160	-	9.8	-	Fixed
Bank loan, working capital ³	12/2015	151	20	5.6	5.8	3M Euribor
Bank loan, acquisition of land	8/2017	150	217	4.2	4.7	6M Euribor
Bank loan, development	10/2016	91	184	6.3	6.3	6M Euribor
Finance leases	3/2017	14	25	3.0-3.1	3.2-3.7	3M Euribor
Finance leases	4/2017	14	-	7.9-14.7	-	Fixed
Convertible bond	12/2016	1	1	5.0	5.0	Fixed
Total		15,020	14,897			

¹ At 31 December 2013, the group was in breach of loan terms and the bank had the right to call in the entire amount early. Therefore, the whole balance is reported as a current liability at 31 December 2013.

² by the publishing date of the report, all bonds have been redeemed prematurely

³ by the publishing date of the report, all loan amounts have been repaid prematurely

The Group's management estimates that carrying amounts of the group's loans and borrowings do not significantly differ from their fair value. The group's major interest bearing liabilities were raised or refinanced in 2013 or in 2014 and are mostly related to Euribor and therefore reflect adequately the situation of current market interest rates.

Information on the contractual maturities of the group's loans and borrowings is presented in note 26. Information on assets pledged as loan collateral is presented in note 27.

23 Payables and deferred income

As at 31 December	2014	2013
In thousands of euros		
Trade payables	208	464
Miscellaneous payables	91	15
Taxes payable		

Value added tax ¹	820	172
Corporate income tax	125	11
Personal income tax	19	20
Social security tax	33	41
Other taxes	343	270
Total taxes payable	1,340	514
Accrued expenses		
Interest payable	100	8
Payables to employees	144	132
Other accrued expenses	19	38
Total accrued expenses	263	178
Deferred income		
Prepayments received on sale of real estate	757	575
Total deferred income	757	575
Total short-term payables and deferred income	2,659	1,746

¹ as at 31 December 2014, the balance of value added tax payable is increased significantly mainly due to apartments sales of Manastirski project in Sofia in December.

24 Provisions

	Warranty provisions	Other provisions related to operating activities	Total provisions
In thousands of euros			
Provisions at 31 December 2012	167	2,917	3,084
Amounts used and reversed	-41	-2,917	-2,958
Additional provisions made	46	0	46
Provisions at 31 December 2013	172	0	172
Amounts used and reversed	-135	0	-135
Additional provisions made	237	0	237
Provisions at 31 December 2014	274	0	274

Warranty provisions

The group's Bulgarian development companies have created provisions related to warranty given by the construction contractor. The provision amount is initially 5% from the price of construction contract. The provisioned amount will be paid off to the constructor after the fulfilment of all the contractual obligations by the constructor. At 31 December 2014, the provision amounted to 202 thousand euros (31 December 2013: 61 thousand euros). In 2014, the provision was increased due to the completion of Manastirski Livadi project second stage apartment building in November 2014.

Due to the joint responsibility for warranty provisions given by former group company Arco Ehitus OÜ, the group continues the recognition of related provisions until the end of warranty periods in October 2015. The carrying value of warranty provisions from construction activities amounts to 72 thousand euros as at 31 December 2014 (31.12.2013: 111 thousand euros).

Other provisions related to operating activities

At 31 December 2012, other provisions included:

- An amount of 1,917 thousand euros consisted of a provision made for a surety guarantee provided by the group to a bank loan taken by a joint venture. The provision amounted to 100% of the surety guarantee.
- In 2012, the group also recognised a provision for a surety guarantee provided to a loan taken by another joint venture. The maximum amount of the surety guarantee was 5,650 thousand euros. Management assessed the probability of the realisation of the surety guarantee and recognised a provision of 1,000 thousand euros.

In 2013, the group was released from both sureties and reversed both provisions related to the sureties in full amount. See also note 29.

In the statement of comprehensive income, expenses relating to provisions made in connection with joint ventures and income earned from reversal of provisions are recognised within *Gain on transactions involving joint ventures*.

25 Share capital

As at 31 December	2014	2013
Number of issued shares fully paid up	6,117,012	4,741,707
Share capital (in thousands of euros)	4,282	3,319
Share capital (in thousands of euros)	292	0
Statutory capital reserve (in thousands of euros)	2,011	2,011

The articles of association have to set out the size of a company's share capital or the minimum and maximum amount of its capital. In accordance with its articles of association, the Company's minimum and maximum authorised share capital amount to 2,500 thousand euros and 10,000 thousand euros respectively. The Company has issued registered ordinary shares of one class. The par value of a share is 70 cents and each share carries one vote. A share provides the holder with the right to participate in the Company's general meetings, the allocation of the Company's profit, and the distribution of remaining assets on the dissolution of the Company as well as with other rights provided by law and the Company's articles of association.

The extraordinary general meeting of shareholders of Arco Vara AS held on 4 July 2014 adopted the decision to approve the issuance of 3.5 million new shares with the nominal value of 0.7 euros per share and the issuance price of 1 euro per share, therefore the amount of share premium will be 0.3 euros per share. The subscription period lasted from 8 August until 29 August 2014 and pre-emptive right of subscription had shareholders who were in the list of Arco Vara AS shareholders as at 7 August 2014. 1,375,305 shares were subscribed in total, 39.3% out of targeted volume. The raise of share capital was registered in trade register on 15 September 2014. As a result of share issue the share capital of Arco Vara AS has been increased by 963 thousand euros and new share capital amounts to 4,282 thousand euros. The increased share capital consists of 6,117,012 ordinary shares.

The share issue was conducted with share premium in amount of 292 thousand euros, of which 412 thousand euros was total premium paid by investors over nominal value of shares and the amount is decreased by direct costs of share issue amounted to 120 thousand euros.

Under the Commercial Code of the Republic of Estonia, every year a limited liability company has to transfer to the capital reserve at least 5% of its profit for the year until the capital reserve amounts to at least 10% of its share capital. The statutory capital reserve of the group's parent is in compliance with the regulatory requirement, amounting to 47% of share capital as at 31 December 2014.

26 Financial instruments and financial risk management

The group's activities expose it to various financial risks: credit risk, liquidity risk and market risk.

The group's overall risk management programme is based on the assumption that the financial markets are unpredictable and appropriate measures have to be adopted to minimise potential adverse impacts on the group's financial activities. The group has not used derivative financial instruments to hedge certain risk exposures in recent years.

The group's risk management process is based on the premise that the group's success depends on constant monitoring, accurate assessment and effective management of risks. Centralised financial risk management is the responsibility of the group's financial team. The main objective of financial risk management is to prevent any damage or financial loss that could jeopardise the group's equity and ability to continue operating as a going concern. The group designs and implements risk management policies and activities that are aimed at identifying and evaluating risks and spreading risks across time, activities and geographical areas. Risk management policies and activities are implemented by the managers of group entities.

In managing its financial risks, the group's main focus is on monitoring the risk exposures of the Development segment because a significant proportion of the group's liquidity and interest rate risks are concentrated in one segment, the Development segment, and in two geographical areas, Estonia and Bulgaria.

Credit risk

Credit risk is the risk that the counterparty to a financial instrument will cause a financial loss to the group by failing to discharge an obligation. The group's credit risk exposures result from cash placed in bank deposits and trade and other receivables.

The group's cash and cash equivalents are held at different banks which reduces credit risk associated with deposits. Credit ratings of 4 banks, where are deposited about 95% out of all the group's cash are presented in following table:

Bank or banking group	Bank's share of the group's cash balance	Standard & Poor's	Moody's	Fitch
UniCredit group banks	45%	BBB-	Baa2	BBB+
LHV Pank AS	36%	Not rated	Not rated	Not rated
Swedbank AB group banks	11%	A+	A1	A+
First Investment Bank AD	3%	Not rated	Not rated	BB-
Cash in other banks and petty cash	5%	-	-	-

Credit risk is managed mainly by making sure that there are no major concentrations of credit risk. Group entities prevent and minimize credit risk by monitoring and managing customers' settlement behaviour daily so that appropriate measures could be applied on a timely basis. In addition, sales and construction activities are partly financed with customer prepayments and in real estate transactions, where the counterparty is often financed by a credit institution, the group cooperates with banks. Consequently, the group considers the total risk arising from customer insolvency to be, in all material respects, mitigated.

Allowances are made for potential losses. Potential losses are estimated based on historical experience, the counterparty's ability to meet existing obligations in the short term, and developments in the economic environment.

Group entities perform transactions only with counterparties who are considered creditworthy. As a rule, a prepayment is demanded. Credit is granted against additional collateral. Accordingly, management believes that the need for additional mitigation of credit risk is minimal.

Other financial assets, trade and other receivables, are also exposed to credit risk. The group has receivables that are past due but have not been provided for. Management has estimated the value of such receivables on an individual basis and has determined that the items are recoverable. The total amount of financial assets exposed to credit risk as at 31 December 2014 is 2,823 thousand euros (31 December 2013: 1,431 thousand euros).

Financial assets by maturity

at 31 December 2014				
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousand of euros				
Cash and cash equivalents (note 17)	1,691	0	0	1,691
Trade and other receivables (note 18)	1,127	0	5	1,132
Total	2,818	0	5	2,823

at 31 December 2013				
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousand of euros				
Cash and cash equivalents (note 17)	818	0	0	818
Term deposits (note 18)	5	18	240	263
Trade and other receivables (note 18)	338	0	12	350
Total	1,161	18	252	1,431

Liquidity risk

Liquidity risk is the risk that a potential change in its financial position will cause the group to encounter difficulty in meeting its financial liabilities in a due and timely manner, or that the group will be unable to realise its assets at market price and within the desired timeframe. Above all, the group's liquidity is affected by the following factors:

- group entities' ability to generate independent positive net operating cash flows and the volatility of those cash flows;
- mismatch in the maturities of assets and liabilities and flexibility in changing them;
- marketability of long-term assets;
- volume and pace of real estate development activities;
- financing structure.

Short-term liquidity management is based mainly on group entities' continuously monitored monthly cash flow forecasts. The purpose of short-term liquidity management is to guarantee the availability of a sufficient amount of highly liquid funds (i.e. cash and cash equivalents and highly liquid investments in financial instruments). The main tool for short-term liquidity management both in Estonia and at group entities outside Estonia is intra-group borrowing from the parent company.

Long-term liquidity is primarily influenced by investment decisions. The group observes the principle that group entities' total net cash inflow from operating and investing activities has to cover the group's total cash outflows from financing activities. Accordingly, the purpose of long-term liquidity management is to ensure sufficient liquidity of the real estate portfolio (investment properties portfolio), to match the timing of cash flows from investing and financing activities, and to use the optimal financing structure. Long-term projects are monitored to ensure that the timing and amounts of investing cash flows do not differ significantly from the timing and amounts of financing cash flows.

Maturity structure of financial liabilities

	at 31 December 2014			
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	1,579	1,615	11,826	15,020
Interest payable	294	447	1,113	1,854
Other financial liabilities	562	0	0	562
Total	2,435	2,062	12,939	17,436

	at 31 December 2013			
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	12,195	393	2,309	14,897
Interest payable	228	780	662	1,670
Other financial liabilities	657	0	0	657
Total	13,080	1,173	2,971	17,224

Based on the maturities of liabilities included in the group's loan portfolio, as at 31 December 2014, the average weighted maturity of the group's loans and borrowings was 2.3 years (as at 31 December 2013: 0.3 years). For more information on loans and borrowings see also note 22.

The group's management estimates that the carrying amount of group's financial liabilities does not differ significantly from their fair value.

Refinancing risk is managed by monitoring the liquidity position on a daily basis, analysing different financing options on an ongoing basis and involving partner banks from different countries already in the initial stage of the process.

Market risk

Interest rate risk

Interest rate risk is the risk that a rise in market interest rates will increase interest expense to an extent that will have a significant impact on the group's performance. The group's exposure to interest rate risk results from:

- use of loans and borrowings with a floating interest rate;
- refinancing liabilities on the arrival of their due dates;
- and raising new loans for realising an investment plan in a situation where the volatility of financial markets is increasing and the economic environment is changing.

The group's long-term loans and borrowings are mostly linked to 3-month or 6-month Euribor. Therefore, the group is exposed to developments in the international financial markets. Interest rate risk is managed, among other things, by monitoring movements in the money market interest rate curve, which reflects the market participants' expectations of market interest rates and allows estimating a trend for euro-denominated interest rates. In 2014, Euribor interest rates have decreased by couple of percentage points reaching close to the lowest level in its history.

The sensitivity analysis of the group's profit before tax, which was conducted based on the balance of loans and borrowings as at 31 December 2014, indicated that a 1 percentage point change (increase or decrease) in interest rates would have affected (increased or reduced) profit before tax by 150 thousand euros (at 31 December 2013: 149 thousand euros).

In managing its short-term interest rate risks, the group regularly compares potential losses from changes in interest rates against corresponding risk hedging expenses. To date, no financial instruments have been used to hedge short-term interest rate risks because according to management's assessment hedging expenses would exceed the losses that might be incurred from changes in interest rates.

The interest rate of liabilities with a fixed interest rate does not differ significantly from the current market interest rates.

Currency risk

Because the only significant currency for the group beside euro, Bulgarian lev, is pegged to the euro, the main currency risk is the risk of devaluation of Bulgarian lev. Currency risk is mitigated also by conducting most of transactions and signing all major agreements, including loan contracts in euros. In view of the abovementioned facts the group's management considers currency risk to be insignificant.

Capital management

The Commercial Code of the Republic of Estonia sets forth the following requirements to the share capital of companies registered in Estonia:

- the minimum share capital of a limited liability company defined as *aktsiaselts* has to amount to at least 25 thousand euros;
- the net assets of a limited liability company defined as *aktsiaselts* have to amount to at least half of its share capital but no less than 25 thousand euros.

The size of the share capital or the minimum and maximum capital of a limited company have to be set out in the company's articles of association whereby minimum capital has to amount to at least one quarter of maximum capital. As at 31 December 2014, the Company's share capital consists of 6,117,012 ordinary shares (with nominal value of 70 euro cents per share) and has been fully paid in. According to the effective articles of association of Arco Vara AS, share capital may be increased or reduced within the range of 2,500 thousand to 10,000 thousand euros without changing the articles of association. As at 31 December 2014, the share capital of Arco Vara AS was 4,282 thousand euros and net assets were 9,050 thousand euros. Thus, the Company's share capital and net assets (equity) were in accordance with the regulatory requirements of the Republic of Estonia.

In addition to meeting regulatory requirements, the net assets of some of the group's subsidiaries have to meet the loan covenants agreed with credit institutions. These refer to legal requirements to the capital of a company and are limited to the obligation of obtaining the credit institution's written consent for changing the debtor's capital. As at 31 December 2014, the equity was negative on three group companies with loans raised from banks. But on all these cases, agreement has been reached with banks allowing to amend this deficiency, but on condition that all loan obligations are fulfilled according to agreed terms

The total capital of Arco Vara AS is the sum of its short- and long-term interest-bearing liabilities and equity less cash and cash equivalents. At 31 December 2014, total capital amounted to 22,379 thousand euros (at 31 December 2013: 20,933 thousand euros).

The guiding principle in capital management is to safeguard the Company's reliability and sustainable development.

The group finances its operations with both debt and equity capital. Property development is very capital intensive. Therefore, related investment projects are financed on the assumption that, as a rule, equity financing should amount to at least 20-30% of the total cost of the investment.

In designing the optimal financing structure and identifying and evaluating risks, the group monitors its equity to assets ratio. At 31 December 2014, equity accounted for 33.5% (at 31 December 2013: 27.2%) of total assets.

Other information

27 Assets pledged as collateral

The group has secured its loans and borrowings by putting up the following collateral:

As at 31 December	2014	2013
In thousands of euros		
Cash and cash equivalents	33	160
Receivables	98	149
Inventories	10,832	9,243
Investment property	11,545	11,291
Property, plant and equipment	326	343
Total carrying value of assets pledged as collateral	22,834	21,186

Share pledges

Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, has pledged its 100% interest in the subsidiary Arco Invest EOOD to Piraeus Bank. The shares have been pledged to secure investment loans with balance at 31 December 2014 of 11,834 thousand euros (at 31 December 2013: 12,155 thousand euros).

28 *Contingent liabilities*

Contingent income tax liability

As at 31 December 2014, the group's retained earnings amounted to 2,250 thousand euros (at 31 December 2013: 1,452 thousand euros). Income tax of 20/80 of net dividend paid is imposed on the profit distributed as dividends. Upon the payment of all retained earnings in 2015, income tax liability would be 450 thousand euros and the amount to be paid out to shareholders would total 1,800 thousand euros. Income tax liability could be decreased by income tax amount paid on distributing profit in subsidiaries and joint ventures.

Contingent liabilities related to the tax authorities

Tax authorities have the right to review the Group's tax records for up to 5 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have performed narrow scope tax reviews in 2010-2014 only for some of the group companies. The management of the group's parent company believes that there are not any circumstances which may lead the tax authorities to impose significant additional taxes on the group companies.

29 *Related party disclosures*

The group has conducted transactions or has balances with the following related parties:

- 1) **the group's joint ventures and associates;**
- 2) **companies under the control of the chief executive officer and the members of the supervisory board of Arco Vara AS that have a significant interest in the group's parent company;**
- 3) **Other related parties** – companies under the control of the chief executive officer and members of the supervisory board of Arco Vara AS (excluding companies that have a significant interest in the group's parent company)..

Transactions with related parties

	2014	2013
In thousands of euros		
Joint ventures and associate		
Services sold	0	1
Services purchased	26	0
Provided loans	3	48
Companies that have a significant interest in the group's parent company		
Inventories purchased ¹	0	1,102
Services purchased	239	24
Bonds issued	150	500
Paid interest	81	25
Other related parties		
Services sold	4	0
Inventories purchased ¹	0	1,102
Services purchased	4	27
Bonds issued	0	251
Paid interest	35	13

Balances with related parties

As at 31 December	2014	2013
In thousands of euros		
Joint ventures and associate		
Short-term loan receivables	0	33
Short-term interest receivables	0	1
Companies that have a significant interest in the group's parent company		
Trade payables	0	3
Bonds issued	650	500
Other related parties		
Trade payables	0	7
Bonds issued	251	251

¹ - The group's receivables to companies controlled by members of the supervisory board of Arco Vara AS of 804 thousand euros in aggregate were offset against part of the purchase cost (total of 2,204 thousand euros) of a property at Paldiski road 70c in Tallinn, acquired by the group from the same companies.

Significant transactions with related parties in 2014

On 21 March 2014, Arco Vara AS issued bonds as targeted issue in total amount of 160 thousand euros. 150 thousand euros out of the total issued bonds were subscribed by the companies that have significant interest in the group's parent company. The bonds maturity date is 20 June 2015 and annual interest rate is 9.8%. The issued bonds are guaranteed with mortgage on property that belongs to the subsidiary of Arco Vara AS. See also note 22.

Significant transactions with related parties in 2013

In June 2013, the group's partner in joint venture company Tivoli Arendus OÜ purchased the properties belonging to Tivoli Arendus OÜ at a public auction. Through the transaction, Arco Vara AS disposed of the surety guarantee it had provided to the loan commitments of Tivoli Arendus OÜ and, thus, the group could reverse a provision of 1,000 thousand euros that had been recognised in 2012.

In November 2013, the group sold its 50% share in joint venture company Arco HCE OÜ. As a result of transaction, the group disclaimed all its receivables to Arco HCE OÜ (loss from allowance of loan claims in amount of 20 thousand euros) and was released from bank loan surety obligation (gain from reversal of provision in amount of 1,917 thousand euros). See also notes 12 and 30.

On 21 August 2013, Arco Vara AS issued bonds as targeted issue in total amount of 750 thousand euros. The bonds maturity date is 21 August 2016 and annual interest rate is 14%. Whole issue was subscribed by key management personnel and by the companies that have a significant interest in the group's parent company. The issued bonds are guaranteed with mortgage on property in Sofia that belongs to the subsidiary of Arco Vara AS. After the reporting date - on 19 and 20 February 2015, the bonds were redeemed by the group, 18 months before maturity date. See note 32.

In 2014 and 2013, no receivables from related parties were impaired.

Remuneration of key management personnel

In 2013, the remuneration provided to the group's key management personnel, i.e. the chief executive/member of the management board and the members of the supervisory board of the group's parent company, including social security charges, amounted to 102 thousand euros (in 2013: 174 thousand euros). The remuneration provided to the chief executive/member of the management board is based on his service contract. The termination benefits agreed with Tarmo Sild, who was appointed chief executive officer/member of the management board of Arco Vara AS in October 2012, amount to up to five months' basic board member remuneration. The basis for the remuneration provided to the members of the supervisory board was changed since July 2013. According to the resolution of the general meeting of Arco Vara AS, the members of the supervisory board will get paid 500 euros (net amount) for every participated meeting but not more than 1,000 euros (net amount) per month. The payment of the remuneration is made dependent on the signing of the minutes of the meetings of the supervisory board. The group's key management personnel was not provided or paid any other remuneration or benefits (bonuses, termination benefits, etc) in 2014 and in 2013.

In favour of chief executive/member of management board is issued convertible bond, which gives him the right to subscribe up to 390 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2016. See also note 15.

30 Joint ventures

As at 31 December 2013, the group had interests in one joint venture, Tivoli Arendus OÜ. In 2014, the ownership in the company was increased and since October 2014 it is a subsidiary of the group. See also note 6.

Assets and liabilities of joint ventures

As at 31 December	2014		2013	
	Assets	Liabilities	Assets	Liabilities
In thousands of euros				
Tivoli Arendus OÜ	-	-	390	3,761
Total	-	-	390	3,761

Income and expenses of joint ventures

	2014		2013	
	Income	Expenses	Income	Expenses
EUR, thousands				
Arco HCE OÜ ¹	-	-	21	67
Tivoli Arendus OÜ ²	615	384	7,800	8,717
Total	615	384	7,821	8,784

¹ - Income and expenses have been recognised until the date of sale of the joint venture.

² - Income and expenses are recognised until the date of acquisition of additional 50% interest in joint venture

On 29 November 2013, Arco Investeeringute AS sold its 50% share in the joint venture Arco HCE OÜ to Ahtrimaa OÜ, the other 50% shareholder of the joint venture. In the framework of the transaction the credit relations related to Ahtri 3 were restructured and all court disputes between Danske bank on the one hand and Arco HCE OÜ, Arco Investeeringute AS and Ahtrimaa OÜ on the other hand became settled. The group has no more rights or obligations related to Arco HCE OÜ or Ahtri 3 land plot. As a result of the transaction the group reversed provision in amount of 1,917 thousand euros that was created in previous years to cover the possible obligations arising from the surety to Danske bank.

Information on group's transactions and balances with joint ventures is provided in note 29.

31 Discontinued operations

On 14 February 2014, Arco Vara AS divested its 100% share in subsidiary Arco Ehitus OÜ to the company Stratcorp OÜ. See also note 6.

With the divestment of Arco Ehitus OÜ the group completed the exit from construction business. That was one of the targets for the group during 2013. Therefore, construction business line income and expenses are presented as discontinued operations, and construction business line assets and liabilities are presented as sales group assets and liabilities as at 31 December 2013. The sales group assets and liabilities are measured at carrying values. In 2014, mainly expenses related to fulfilment of warranty obligations of construction activities are recognised as discontinued operations.

Components of net loss from discontinued operations

	2014	2013
In thousands of euros		
Revenue	0	3,497
Cost of goods sold and services provided	0	-3,299
Administrative expenses	-13	-329
Fair value adjustment of investment property (note 20)	-160	0
Other income and expenses	-151	3
Net loss from discontinued operations	-324	-128
Earnings per share from discontinued operations (in euros)	-0,06	-0.03

Sales group assets and liabilities

As at 31 December	2013
In thousands of euros	
Cash and cash equivalents	80
Receivables and prepayments	717
Inventories	44
Property, plant and equipment and intangible assets	6
Total sales group assets	847
Liabilities and prepayments	1,488
Total sales group liabilities	1,488

32 *Events after the reporting date*

Election of new supervisory board

On 10 February 2015, Arco Vara extraordinary shareholders meeting recalled supervisory board consisting of 7 members: Hillar-Peeter Luitsalu, Toomas Tool, Aivar Pilv, Stephan David Balkin, Arvo Nõges, Rain Lõhmus and Allar Niinepuu; and elected 5 members to new supervisory board: Rain Lõhmus, Steven Yaroslav Gorelik, Hillar-Peeter Luitsalu, Allar Niinepuu and Kert Kesksaik. In first meeting of new supervisory board held on 27 February 2015, Hillar-Peeter Luitsalu was re-elected as chairman of the supervisory board.

Redemption of Arco Vara 21.08.2016 bonds 18 months before maturity date

On 19 and 20 February 2015, 18 months before maturity date, Arco Vara redeemed bonds at nominal value of 750 thousand euros issued in August 2013 for restarting Manastirski Livadi development project. Redemption price of bonds was 1,155 euros per bond, consisted of bond's nominal value of 1,000 euros and accrued interest of 155 euros per bond. Redemption of bonds before the maturity date was possible due to faster than planned sales pace and unanimous consent among bondholders then accepting the proposal for earlier redemption. In January 2015, the group returned last part of the bank loan which had been raised for the construction of apartment building in Manastirski Livadi development project. Contractual repayment deadline of the loan was 30 May 2016.

950 thousand euros loan repayment to Piraeus bank

On 20 February 2015, the group made loan principal instalment in amount of 950 thousand euros to Piraeus bank. There was also agreed with the bank on amendments to loan contract what mitigate risks regarding the terms of the possible recall of the loan before maturity date by the bank. The residual loan principal amounts to 10 874 thousand euros, after the loan repayment of 950 thousand euros.

33 Structure of Arco Vara group

Company	Domicile	Group's ownership interest	
		At 31 December 2014	At 31 December 2013
%			
Service segment			
Subsidiaries			
Arco Real Estate AS	Estonia	100	100
Arco Real Estate SIA ¹	Latvia	70.6	78.5
Adepto SIA ¹	Latvia	70.6	78.5
Arco Imoti EOOD	Bulgaria	100	100
Arco Facility Management EOOD	Bulgaria	100	100
Arco Project EOOD	Bulgaria	100	100
Associates			
Arco Property Management SIA ¹	Latvia	-	40
Development segment			
Subsidiaries			
Arco Investeeringute AS	Estonia	100	100
Kerberon OÜ	Estonia	100	100
Kolde AS	Estonia	100	100
Arco Vara Haldus OÜ ³	Estonia	100	100
Fineprojekti OÜ (on liquidation) ¹	Estonia	100	100
Tivoli Arendus OÜ ¹	Estonia	100	50
Kodulahe OÜ	Estonia	100	-
Arco Manastirski EOOD	Bulgaria	100	100
Arco Invest EOOD ¹	Bulgaria	100	100
Arco BB EOOD	Bulgaria	100	-
Marsili II SIA	Latvia	100	100
Arco Development SIA	Latvia	100	100
Ulmana Gatves Nami SIA ¹	Latvia	100	100
Arco Invest UAB	Lithuania	100	100
Arco Development UAB ¹	Lithuania	100	100
Arco Capital Real Estate SRL ¹	Romania	100	100
Arco Investments TOV ¹	Ukraine	75	75
Construction segment (discontinued operations)			
Subsidiaries			
Arco Ehitus OÜ	Estonia	-	100
AE Ehitusjuhtimine OÜ ¹	Estonia	-	100

¹ - Interest through a subsidiary

34 *Parent company's unconsolidated primary financial statements as required by the Estonian Accounting Act*

PARENT COMPANY'S INCOME STATEMENT

	2014	2013
In thousands of euros		
Revenue from rendering of services	318	137
Other income	8	4
Marketing and distribution expenses	-30	-36
Administrative expenses	-773	-719
Other expenses	-139	-148
Gain/loss on investments in subsidiaries and joint ventures	-213	2,352
Operating loss	-829	1,590
Interest income	162	551
Interest expense	-220	-40
Total finance income and costs	-58	511
Net profit/loss for the year	-887	2,101

PARENT COMPANY'S STATEMENT OF FINANCIAL POSITION

As at 31 December	2014	2013
In thousands of euros		
Cash and cash equivalents	603	29
Receivables and prepayments	2,793	1,762
Total current assets	3,396	1,791
Investments ¹	5,479	5,440
Receivables and prepayments	342	1,104
Property, plant and equipment	5	7
Intangible assets	101	0
Total non-current assets	5,927	6,551
TOTAL ASSETS	9,323	8,342
Loans and borrowings	380	81
Payables and prepayments	196	74
Provisions	72	0
Total current liabilities	648	155
Loans and borrowings	752	751
Total non-current liabilities	752	751
TOTAL LIABILITIES	1,400	906
Share capital	4,282	3,319
Share premium	292	0
Statutory capital reserve	2,011	2,011
Other reserves	179	60
Retained earnings	1,159	2,046
Total equity	7,923	7,436
TOTAL LIABILITIES AND EQUITY	9,323	8,342

¹ - Investments line item includes investments in subsidiaries.

In Arco Vara AS's unconsolidated statement of financial position investments in subsidiaries are carried at cost less impairment losses.

PARENT COMPANY'S STATEMENT OF CASH FLOWS

(direct method)

	2014	2013
In thousands of euros		
Cash receipts from customers	347	360
Cash paid to suppliers	-740	-540
Taxes paid	-47	-136
Cash paid to employees	-162	-209
Other payments and receipts related to operating activities, net	-132	-76
NET CASH USED IN OPERATING ACTIVITIES	-734	-601
Paid on acquisition of property, plant and equipment	-36	-9
Proceeds from sale of property, plant and equipment	0	6
Paid on formation and acquisition of subsidiaries	-32	0
Proceeds from sale of investments in subsidiaries	10	1,610
Loans provided	-1,250	-2,664
Repayment of loans provided	1,108	879
Placement of security deposits	-438	-258
Release of security deposits	438	258
Interest received	7	19
NET CASH USED IN INVESTING ACTIVITIES	-193	-159
Proceeds of loans received	125	486
Settlement of loans and finance lease obligations	-41	-430
Proceeds of bond issues	160	751
Proceeds from share capital issue	1,375	0
Interest paid	-118	-38
NET CASH FROM FINANCING ACTIVITIES	1,501	769
NET CASH FLOW	574	9
Cash and cash equivalents at beginning of year	29	20
Change in cash and cash equivalents	574	9
Cash and cash equivalents at end of year	603	29

PARENT COMPANY'S STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total
In thousands of euros						
Balance at 31 December 2012	3,319	0	2,011	0	-55	5,275
Formation of equity reserve	0	0	0	60	0	60
Profit for the year	0	0	0	0	2,101	2,101
Balance at 31 December 2013	3,319	0	2,011	0	2,046	7,436
Share capital issue	963	292	0	0	0	1,255
Formation of equity reserve	0	0	0	119	0	119
Loss for the year	0	0	0	0	-887	-887
Balance at 31 December 2014	4,282	292	2,011	179	1,159	7,923

Adjusted unconsolidated equity

As at 31 December	2014	2013
In thousands of euros		
Parent company's unconsolidated equity	7,923	7,436
Carrying amount of investments in subsidiaries in the parent company's unconsolidated statement of financial position (-)	-5,479	-5,440
Value of investments in subsidiaries under the equity method (+)	6,710	5,484
Parent company's adjusted unconsolidated equity	9,154	7,480

Statement by the management board

The member of the management board of Arco Vara AS declares and confirms that according to his best knowledge, the annual accounts for year 2014, prepared according to the Financial Reporting Standards (IFRS) as adopted by the EU, present a correct and fair view of the assets, liabilities, financial situation and loss or profit of Arco Vara AS and the group as a whole, and the management report gives a correct and fair view of the development and results of the business activities and financial status of Arco Vara AS and the group as a whole and contains a description of the main risks and doubts.

31 March 2015



Tarmo Sild
Chief Executive Officer and Member of the Management Board of Arco Vara AS



INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of Arco Vara AS

We have audited the accompanying consolidated financial statements of Arco Vara AS and its subsidiaries, which comprise the consolidated statement of financial position as of 31 December 2014 and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Arco Vara AS and its subsidiaries as of 31 December 2014, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Tiit Raimla', written in a cursive style.

Tiit Raimla
Auditor's Certificate No. 287

A handwritten signature in blue ink, appearing to read 'Märten Padu', enclosed within a large, hand-drawn oval shape.

Märten Padu
Auditor's Certificate No. 513

31 March 2015

** This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

Proposal for distribution of profit

The chief executive officer proposes that the annual general meeting of Arco Vara AS distribute the net profit for the year ended 31 December 2014 of 803 thousand euros (share of Arco Vara shareholders in net profit) as follows:

- 1) pay dividends to shareholders 1 eurocent per share, i.e. 61 thousand euros in total;
- 2) transfer 742 thousand euros to retained earnings.

Retained earnings will amount to 2,189 thousand euros after the transfer of year 2014 net profit.

31 March 2015

A handwritten signature in blue ink, appearing to be 'Jarmo Peltola', is written over a faint dotted line.

Chief Executive Officer and Member of the Management Board of Arco Vara AS