KODULAHE.EE

# Arco Vara AS

## CONSOLIDATED ANNUAL REPORT 2015

ARCO VARA

# Annual report

*(Translation of the Estonian original)*

# ARCO VARA AS

| | |
|---|---|
| Beginning of financial year: | 1 January 2015 |
| End of financial year: | 31 December 2015 |



| | |
|---|---|
| Registry number: | 10261718 |
| Address: | Rävala pst 5<br>10143, Tallinn<br>Republic of Estonia |
| Telephone:<br>Fax:<br>E-mail: | +372 6 144 630<br>+372 6 144 631<br>info@arcovara.ee |
| Corporate website: | www.arcorealestate.com |
| Regional websites: | www.arcovara.ee<br>www.arcoreal.lv<br>www.arcoreal.bg |



| | |
|---|---|
| Core activities: | Real estate development<br>Rental and operating of own or leased real estate (EMTAK 6820)<br>Real estate agencies (EMTAK 6831)<br>Management of real estate on a fee or contract basis (EMTAK 6832) |
| Supervisory board: | Hillar-Peeter Luitsalu, Rain Lõhmus, Allar Niinepuu,<br>Kert Keskpaik, Steven Yaroslav Gorelik |
| Management board: | Tarmo Sild |
| Auditor: | AS PricewaterhouseCoopers |

# Contents

**DIRECTORS' REPORT** .... **3**
GROUP CHIEF EXECUTIVE'S REVIEW .... 7
**CORPORATE GOVERNANCE REPORT** .... **16**
**CONSOLIDATED FINANCIAL STATEMENTS** .... **20**
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME .... 20
CONSOLIDATED STATEMENT OF FINANCIAL POSITION .... 21
CONSOLIDATED STATEMENT OF CASH FLOWS .... 22
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY .... 23
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS .... 24
*1 General information .... 24*
*2 Statement of compliance and basis of preparation .... 24*
*3 Changes in accounting policies and presentation of information .... 25*
*4 Significant accounting policies .... 26*
*5 Segment information .... 34*
*6 Acquisition and sale of subsidiaries .... 35*
NOTES TO THE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME .... 36
*7 Revenue .... 36*
*8 Cost of sales .... 36*
*9 Other income and expenses .... 36*
*10 Marketing and distribution expenses .... 37*
*11 Administrative expenses .... 37*
*12 Gain on transactions involving subsidiaries and joint ventures .... 37*
*13 Finance income and costs .... 37*
*14 Income tax .... 38*
*15 Earnings per share .... 38*
*16 Operating lease expenses .... 38*
NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION .... 39
*17 Cash and cash equivalents .... 39*
*18 Receivables and prepayments .... 39*
*19 Inventories .... 40*
*20 Investment property .... 41*
*21 Property, plant and equipment and intangible assets .... 42*
*22 Loans and borrowings .... 43*
*23 Payables and deferred income .... 45*
*24 Provisions .... 45*
*25 Share capital .... 46*
*26 Financial instruments and financial risk management .... 46*
OTHER INFORMATION .... 49
*27 Assets pledged as collateral .... 49*
*28 Contingent liabilities .... 50*
*29 Related party disclosures .... 50*
*30 Joint ventures .... 51*
*31 Discontinued operations .... 52*
*32 Events after the reporting date .... 52*
*33 Structure of Arco Vara group .... 53*
*34 Parent company's unconsolidated primary financial statements .... 54*
**STATEMENT BY THE MANAGEMENT BOARD** .... **58**
**INDEPENDENT AUDITOR'S REPORT** .... **59**
**PROPOSAL FOR DISTRIBUTION OF PROFIT** .... **61**

# 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. The group's two business lines – services and development have been organised into corresponding divisions.

The Service division is engaged in real estate brokerage, valuation, management and consulting as well as in short-term investments in residental 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 real estate development: purchase of land plots, planning and designing, pricing the end products and 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 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

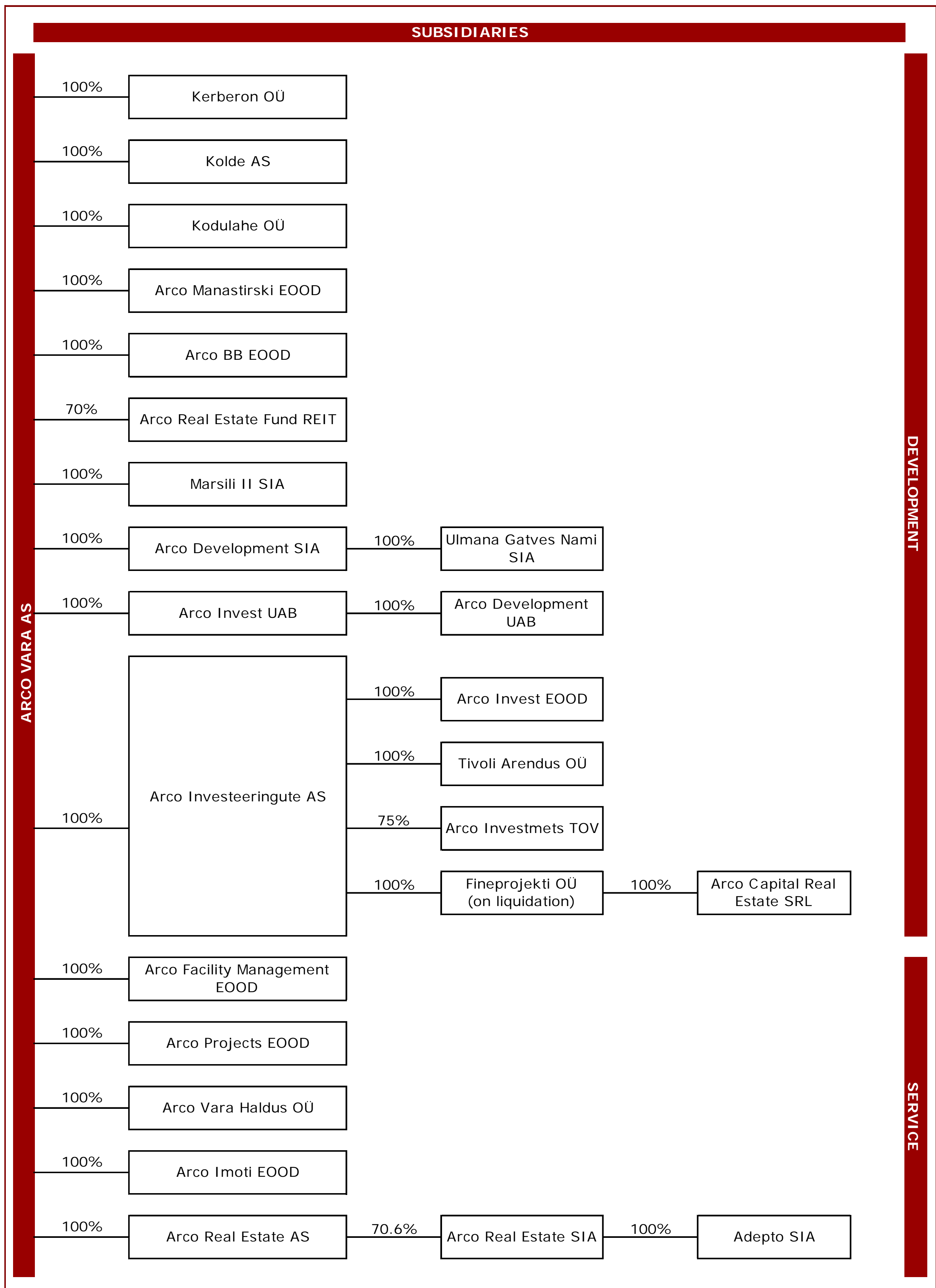
At 31 December 2015, the group comprised 25 companies (at 31 December 2014: 24). On 31 July 2015, was registered a real estate fund in Bulgaria named Arco Real Estate Fund REIT, with starting capital of 256 thousand euros. The group holds 70% interest in the fund.

## Significant subsidiaries

| Company name | Location | Segment | Share capital (nominal value) | Equity balance at 31 Dec 2015 | The group's interest |
|---|---|---|---|---|---|
| In thousands of euros | | | | | |
| Arco Manastirski EOOD | Bulgaria | Development | 2,676 | 3,679 | 100% |
| Arco Invest EOOD | Bulgaria | Development | 26,826 | -106 | 100% |
| Arco Real Estate Fund REIT [1] | Bulgaria | Development | 256 | 256 | 70% |
| Kodulahe OÜ | Estonia | Development | 3 | -115 | 100% |
| Kerberon OÜ | Estonia | Development | 5 | 1,280 | 100% |
| Marsili II SIA | Latvia | Development | 1,524 | 934 | 100% |
| Arco Real Estate AS | Estonia | Service | 42 | -855 | 100% |
| Arco Real Estate SIA [1] | Latvia | Service | 1,905 | 49 | 70.6% |
| Arco Imoti EOOD | Bulgaria | Service | 444 | 190 | 100% |

[1] - Non-controlling interest in Arco Real Estate SIA and Arco Real Estate Fund REIT equals to the group's total non-controlling interest

## Group structure as at 31 December 2015



## KEY PERFORMANCE INDICATORS

- In 2015, the group's revenue was 10.7 million euros, exceeding by 16% the revenue of year 2014, when revenue amounted to 9.2 million euros. The increase of the group's annual revenue comes from Development division, where revenue amounted to 7.9 million euros in 2015 (in 2014: 6.5 million euros). The revenue of Service division reached to 3.3 million euros in 2015, increased by 4% compared to 2014. The sales figures of brokerage and valuation services have shown growth in second half of the year 2015, after the falling trend in second half of year 2014 and in the beginning of year 2015.
- In 2015, the group's operating profit (=EBIT) from continuing operations was 1.3 million euros and net profit 0.5 million euros, a year ago the same figures were 2.3 million euros and 1.1 million euros respectively. The result of 2014 was impacted by two single events with total effect of 1.2 million euros on profit: gain from the sale of a subsidiary and reversal of inventory write-down. Loss from discontinued operations amounted to 15 thousand euros in 2015 and 324 thousand euros in 2014.
- The group has rapidly decreased debt burden in 2015. The group's net loans have decreased by 1.3 million euros in 2015, down to the level of 12.0 million euros as at 31 December 2015. Total loans and borrowings amounted to 12.8 million euros at 31 December 2015, decreased by 2.3 million euros through a year. As at 31 December 2015, the weighted average annual interest rate of loans was 5.0%. This is a decrease by 0.8 percentage points compared to 31 December 2015.
- In 2015, 96 apartments and commercial spaces and four residential in projects developed in the group were sold. In 2014, 77 apartments and commercial spaces and 4 plots were sold.

### Continuing operations

| In millions of euros | **2015** | 2014 |
|---|---|---|
| **Revenue** | | |
| Development | 7.9 | 6.5 |
| Service | 3.3 | 3.1 |
| Eliminations | -0.5 | -0.4 |
| **Total revenue** | **10.7** | **9.2** |
| | | |
| **Operating profit (EBIT)** | | |
| Development | 1.8 | 1.9 |
| Service | -0.1 | 0.3 |
| Unallocated income and expenses | 0.1 | 0.0 |
| Eliminations | -0.5 | 0.1 |
| **Total operating profit (EBIT)** | **1.3** | **2.3** |
| | | |
| Finance income and expense | -0.7 | -1.1 |
| Income tax | -0.1 | -0.1 |
| **Net profit** | **0.5** | **1.1** |

### Main ratios

| | **2015** | 2014 |
|---|---|---|
| **Earnings per share, EPS (in euros)** | 0.08 | 0.15 |
| **Diluted earnings per share (in euros)** | 0.07 | 0.14 |
| **ROIC (rolling, four quarters)** | 2.0% | 3.4% |
| **ROE (rolling, four quarters)** | 4.6% | 10.7% |
| **ROA (rolling, four quarters)** | 1.8% | 3.1% |

| As at 31 December | 2015 | 2014 |
|---|---|---|
| In millions of euros | | |
| **Total assets** | 24.5 | 27.0 |
| **Invested capital** | 22.4 | 24.1 |
| **Net loans** | 12.0 | 13.3 |
| **Equity** | 9.6 | 9.1 |
| | | |
| **Current ratio** | 3.22 | 2.43 |
| **Quick ratio** | 0.32 | 0.47 |
| **Financial leverage** | 2.54 | 2.98 |
| **Average loan term (in years)** | 1.7 | 2.3 |
| **Average annual interest rate of loans** | 5.0% | 5.8% |
| **Number of staff, at period end** | 178 | 189 |

## *Cash flows*

| | 2015 | 2014 |
|---|---|---|
| In millions of euros | | |
| Cash flows from operating activities | 2.4 | 0.4 |
| Cash flows from/used in investing activities | -0.2 | 0.2 |
| Cash flows from/used in financing activities | -3.2 | 0.3 |
| **Net cash flows** | **-1.0** | **0.9** |
| | | |
| Cash and cash equivalents at beginning of period | 1.7 | 0.8 |
| Cash and cash equivalents at end of period | 0.7 | 1.7 |

## *Revenue and net profit/loss from continuing operations*

| | Q1 2013 | Q2 2013 | Q3 2013 | Q4 2013 | **Total 2013** | Q1 2014 | Q2 2014 | Q3 2014 | Q4 2014 | **Total 2014** | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | **Total 2015** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| In millions of euros | | | | | | | | | | | | | | | |
| Revenue | 1.7 | 3.5 | 3.5 | 2.0 | **10.7** | 1.1 | 1.1 | 1.2 | 5.8 | **9.2** | 4.4 | 2.1 | 2.1 | 2.1 | **10.7** |
| Net profit/loss | 0.0 | 1.4 | 0.1 | 2.0 | **3.5** | 0.4 | -0.3 | 0.4 | 0.6 | **1.1** | 0.7 | 0.0 | 0.2 | -0.4 | **0.5** |

**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' net profit / 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
**Current ratio** = current assets / current liabilities
**Quick ratio** = (current assets - inventory) / current liabilities
**Financial leverage** = total assets / equity
**Number of staff at period-end** = number of people working for the group under employment or authorization (service) contracts

## Group Chief Executive's review

One should start the year's end with a resume. The resume is as follows: we were profitable and grew. Yet the fourth quarter and full year results turned out weaker than we expected. We expected the group's revenue to be at least 11 million euros and net profit at least 1 million euros. Actually we achieved 10.7 million euros revenue and only 0.5 million euros net profit. The management is not proud at all. We need to improve our results. The following part of comments sums up, what has been done and what exactly should be improved in order to keep the group moving forward with necessary speed.

**Service division**

The equity in service division companies is negative and during 2015 we did not invest additional equity into them. The division as a whole operates on the edge of profitability, although countrywise the results are different. We are pleased with profitable results and cash earned during 2015 by our Bulgarian unit. Considering the Latvian real estate market's prolonged weakness, the Latvian unit's results were satisfactory. The single outstanding loss-making unit of the group is in Estonia. The reasons of loss lie within the company itself and the solutions are in the hands of management. We have started rearrangements within the service division to improve the work processes and along with rearrangements, executed also replacements in the middle management.

The objective of 2016 is to achieve the profitability of services division as a whole and also increase its usability factor for Arco's development projects – both in preparatory and in sales phase.

In the big picture the group's results are determined by development division, where 100% of the group's equity is allocated to. Development division's results in turn are determined overwhelmingly by three pillars within it: (i) Madrid Blvd cash flow property in Sofia, (ii) Manastirski residential development in Sofia (and its possible successor project Izstok Parkside) and (iii) Kodulahe residential development in Tallinn.

**Madrid Blvd property**

By publication date of this report, the renovation works of 1st and 2nd floor office space and restructuration of it into seven autonomous lettable office units has been completed. There are ongoing negotiations with potential tenants. The post-restructuration gross lettable area (GLA) of the office space is ca 4,700 sqm, in addition to 113 underground parking places, that are rented out by piece.

Since there was no rent income from the offices during their renovation in Q4, it affected negatively annual revenue and profit. The loss of income from rents and maintenance fees amounted to more than 150 thousand euros. The impact to net profitability is approximately the same amount. It is one of the reasons, why we did not achieve our annual revenue and net profit target.

Our objective is 100% coverage of the office spaces with long-term lease contracts during Q3 of 2016 at the latest.

In other parts of the property we continue profitable operation of the lettable premises (incl. shopping area GLA ca 2,200 sqm and short-term rental apartments GLA ca 1,500 sqm) and sale of remaining apartments (GSA ca 1,700 sqm). In Q4, pre-sale agreements were concluded for two apartments, revenue for which will be recognized in 2016. The remaining balance of Piraeus bank loan on the property is below 10.5 million euros.

**Manastirski Livadi**

Construction of Block D was complete in November and the permission of usage was issued on 22 December, ie more than 2 weeks later than we forecasted. Due to this delay we had to suspend also execution of many apartments' sales agreements and accounting of respective revenue in our books into Q1 2016. Q4 revenue from Manastirski Block D amounted to 628 thousand euros. The negative impact of the delay on targeted Q4 and full year results amounted to 800 thousand euros in revenue and over 300 thousand euros in net profit. The good news is that the missed revenue and profit is carried over into Q1 2016 revenue and net profit. However, the delay is also a live demonstration, how exposed the group's results and key parameters such as ROE and ROA are to loss of time, even only for two weeks.

By end of Q4, 95% of apartments in Block D were presold. As at the publication date of this report, the whole Manastirski Livadi project is completed and the outstanding bank loan to UniCredit Bulbank repaid in full. Expected free cashflow from Block D alone is expected to exceed 2 million euros.

Since the beginning of Q1 2016 we can concentrate only to selling out the last remaining products in Manastirski. Our objective is full sale of outstanding inventory by end of 2016 at the latest. However the main focus from now on is on commencement of successor project in Sofia during Q1. At the moment the selected successor project is Izstok Parkside. By end of Q4, the preconditions of closing the purchase contract were not yet fulfilled by the Seller.

**Kodulahe**

Our long term efforts eventually bore fruit by end of year and we could select amongst competing offers both the best bidder of finance and construction works for the first stage of Kodulahe project in Tallinn. After the reporting date - in February 2016, financing and construction contracts were signed.

Kodulahe first phase volume is 130 apartments and shops (GSA ca 8,700 sqm), and in addition to it respective number of parking places and storages. Gross build-up area (GBA) for phase one exceeds 15,000 sqm. Expected sale revenue of first phase exceeds 15 million euros and conclusion of presale contracts was started in February 2016.

In summary, Arco Vara is back on Tallinn residential development market with Kodulahe project. Comparing with Sofia, Tallinn residential market is less stormy and has tighter competition, but it is possible to make money here, too.

**Other directions of development**

Besides the three development pillars described above we have undertaken two additional directions: A. to sell off all assets, that are not production-ready immediately or where the development volume is too small. Selling off the land bank that the group has historically accumulated allows us to concentrate our forces for developments that really matter; and B. launch Arco Real Estate Investment Trust (Arco REIT) in Sofia. We want to engage external capital under our management and continue in Bulgaria with targeting and implementation of new development projects, utilizing the knowhow and reputation of Arco's team.

In terms of selling off the assets, the autumn of 2015 was successful. We sold profitably two development projects: Instituudi road properties in Harku parish and Suur-Sepa properties in Pärnu. It's worth noting that it took only three weeks from the moment of communicating the sales team the order to commence the sale, until the moment of receiving sale price to the account. It gives credibility to our own conservative valuation of our assets in our books. We will continue selling off other properties and adding maximum value before that, for example by achieving construction rights through a detail plan or otherwise. For example, the detail plan allowing 8-floor office building onto Liimi 1b, Tallinn, entered into force in Q4.

Arco REIT project has progressed as anticipated. Shortly after the publication date of this report, Arco REIT will be listed on Sofia stock exchange where Arco Vara is the sole shareholder (by end of the year shareholding was 70%). We have placed 332 thousand euros into its share capital. The next and crucial step ahead is issue of additional shares and raising external capital into the fund during 2016, in order to commence effective business operations by end of the year.

**Summary**

To sum up with what I began with: 2015 profit of 0.5 million euros does not meet management's expectations (1 million euros).

In addition to already described reasons of smaller profit (suspended Manastirski D sale: negative effect of ca 300 thousand euros; and dropping rent income from Madrid Blvd offices in Q4: negative effect of ca 150 thousand euros) there is one more accounting factor that killed part of the profit. It is the accounting effect of share option issued to the management in 2013, what entitles the option holder to subscribe 390,000 Arco Vara shares at 70 cents per share during 2016.

According to IFRS regulations, the company must account in the income statement also the effect of share option issued to the management board. According to the prescribed methodology, the effect has to be measured as difference between the nominal acquisition price (70 cents) and the measurement price determined according to the rules (1.46 cents). Respective provision into equity reserve had to be established. The cost of establishing the provision is distributed between 2.5 years since issue of the share option in July 2013 until January 1 2016 (first possible date for using the option). Respective cost for 2015 year is 119 thousand euros. The 2013 share option will not impact in any way the profit statement of 2016 or following years.

While being the stakeholder and cause of the additional 119 thousand euros accounting loss, the management board would still like to point out that there is no effective damage to the company. In order to effectuate the option, one has to pay into the company share capital 273 thousand euros and to improve the cash position of the company. The option does not give any right to cash out from the company.

The company's target revenue for 2016 is 10.3 million euros and net profit 0.8 million euros. Year 2016 should be distinct from 2015 with one big feature: instead of one development under construction with revenue potential of ca 4-5 million euros (Manastirski D construction in Sofia), there should be two developments under construction with revenue potential of ca 20 million euros (Kodulahe 1st phase in Tallinn and Manastirski successor project in Sofia). That positive dynamics should reflect strongly in 2017 results.

## SERVICE DIVISION

In 2015, revenue of service division was 3,254 thousand euros (in 2014: 3,139 thousand euros), that included intra-group revenue of 467 thousand euros (in 2014: 451 thousand euros). Revenue of service division from main services (real estate brokerage and valuation services) was 2,926 thousand euros increased by 2% compared to previous year. Revenue continues to increase in Bulgaria, seeing 39% annual increase. The revenue increased by 10% also in Estonian agency. The revenue from main services is strongly decreasing in Latvian real estate agency, having decreased by 23%.

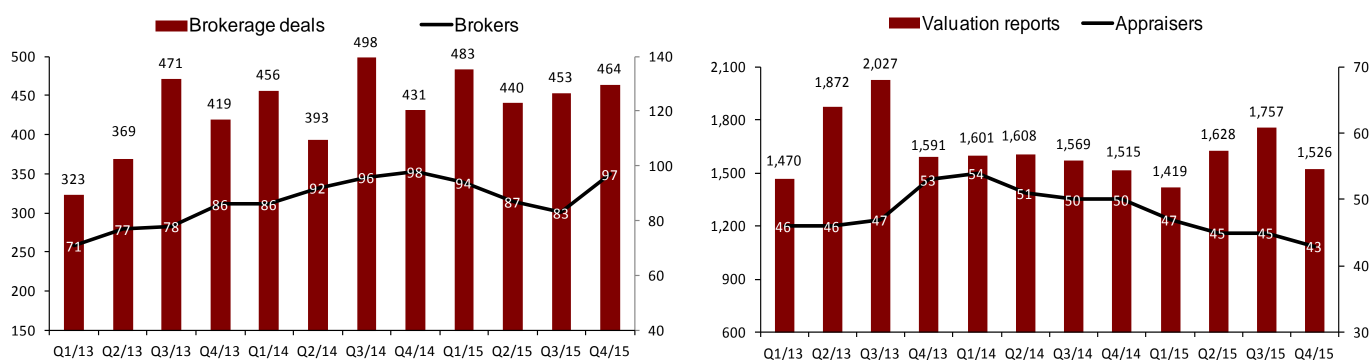
***Revenue of real estate agencies from brokerage and valuation***

| In thousands of euros | **2015** | 2014 | Change, % |
|---|---|---|---|
| Estonia | 1,282 | 1,166 | 10% |
| Latvia | 898 | 1,170 | -23% |
| Bulgaria | 746 | 536 | 39% |
| **Total** | **2,926** | **2,872** | **2%** |

In 2015, the Estonian and Latvian agencies have operated on a loss: 209 thousand and 73 thousand euros, respectively. In 2014, Estonian and Latvian agencies had net profit of 48 thousand euros and 65 thousand euros, respectively. The decrease in profitability of Estonian agency is caused by significant increase of marketing and IT expenses: the goal is set to reach higher level in revenues and accordingly growth of profit. Revenues will increase with the help of wider reputation and bigger number of contacts, customer oriented data processing and smarter work environment. Bulgarian agency's net profit was 109 thousand euros in 2015 (in 2014: 90 thousand euros).

In addition to brokerage and valuation services, the service division also provides real estate management services as well as accommodation service in Bulgaria. The revenue from real estate management was 141 thousand euros in 2015, 105 thousand euros of which was intra-group revenue (in 2014: 148 thousand and 105 thousand euros, respectively). Revenue from accommodation services amounted to 132 thousand euros in 2015 (in 2014: 74 thousand euros). In 2015, the sales of accommodation service have shown a nice 78% growth.

Service division numbers for brokerage deals and valuation reports, and number of staff are shown in following graphs.




The number of staff in service division has been decreased down to 165 employees as at 31 December 2015, which is 11 people less compared to year end 2014. The number of staff is decreased in Estonia and Latvia and increased in Bulgaria.

## DEVELOPMENT DIVISION

In 2015, revenue of development division totalled 7,947 thousand euros (in 2014: 6,503 thousand euros). The leap in revenues comes from the sale of properties in the group's own development projects, amounting to 7,019 thousand euros in 2015 (5,414 thousand euros in 2014).

Most of the remaining revenue of development division consist of rental income from commercial and office premises in Madrid Blvd building in Sofia, amounted to 838 thousand euros in 2015 (in 2014: 953 thousand euros). In 2015, rental income has decreased due to conclusion of rental agreements in Q3, after which the rental spaces were renovated. In first half of 2016, the search of new tenants is in pipeline. The rental income is planned to recover on the previous level in Q3 2016 at latest.

In 12 months 2015, operating profit of development division was 1,790 thousand euros. In 2014, was earned 1,942 thousand euros of operating profit.

By December 2015, the apartment building of third stage in Manastirski Livadi project has been completed and permit of use has been obtained on 22 December. In 2015, 13 apartments were handed over, which corresponds to revenue of 628

thousand euros. As at 31 December 2015, 76 apartments out of 80 and one commercial space out of 8 have been sold or presold.

In 2015, 92 apartments and commercial spaces were sold in the group's Bulgarian projects (in 2014: 63 apartments and commercial spaces). At 31 December 2015, two commercial spaces and some parking places remained in stock from first two stages of Manastirski Livadi project (blocks C and AB). 26 apartments and 113 parking places remained unsold in Madrid Blvd complex in Sofia. 16 apartments, out of all Madrid Blvd unsold apartments, are rented out on providing accommodation service. Unsold parking places are also rented out.

In 2015, four last apartments were sold in Bishumuiza-1 project in Latvia. That means the whole project could be considered as closed for the group. There remains 14 residential plots in Marsili to be sold in from the group's stock in Latvia. A presale agreement was concluded for one of these plots in December 2015.

By Q4 2015, a goal was set to start construction of the first stage apartment building (with 125 apartments and 5 commercial spaces) in Kodulahe project in Tallinn. Design project was concluded and permit for construction of apartment building was obtained at the end of September. After the reporting date - in February 2016, the construction and financing contracts have been signed as well as the first apartment presale agreements. The construction of the apartment building started in March 2016.

In June 2015, a smaller land plot in Suur-Sepa street, in centre town of Pärnu, was acquired as an addition to the group's land bank. The plot is suitable for apartment building. After preparing preliminary design the plot was sold profitably at the beginning of October. Also at the beginning of October, the group sold another smaller development: Instituudi road residential development project, acquired in February 2014. The latter project was also up-valued with the preliminary design. Selling smaller projects bears the goal of focusing on most important projects in Estonia and Bulgaria.

At 31 December 2015, 5 people were employed in development division, the same number as at the end of year 2014.

## SUMMARY TABLE OF ARCO VARA'S ACTIVE PROJECTS AS AT 31 DECEMBER 2015

| 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 | - | 140 | 2 |
| Manastirski D | Manastirski, Sofia | Apartments | S5 | - | 5,832 | 75 |
| Madrid Blvd | Madrid Blvd, Sofia | Lease: Retail/Office | S5/S6 | - | 7,350 | 21 |
| Madrid Blvd | Madrid Blvd, Sofia | Apartments | S5/S6 | - | 3,216 | 28 |
| Marsili residential plots | Marsili, near Riga | Residential plots | S5 | - | 25,389 | 14 |
| Marsili residential plots | Marsili, near Riga | Residential plots | S2 | 120,220 | <120,220> | <68> |
| Kodulahe, stage 1 | Lahepea 7, Tallinn | Apartments | S3 | 6,102 | 8,732 | 130 |
| Kodulahe, stages 2-5 | Lahepea, Soodi, Pagi streets, Tallinn | Apartments | S2 | 22,396 | <13,300> | <200> |
| Lehiku carpet building | Lehiku 21,23 Tallinn | Apartments | S2 | 5,915 | <1,100> | <5> |
| Liimi | Liimi 1b, Tallinn | Lease: Office | S2/S5 | 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. The table does not give complete overview of the group's land bank.*

**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 2015, 178 people worked for the group (189 as at 31 December 2014). Employee remuneration expenses in 2015 amounted to 2.7 million euros (in 2014: 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 charges in 2015 amounted to 108 thousand euros (102 thousand euros in 2014).

### 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. The mandate of the chief executive was prolonged by 3 years (until October 2018) on the supervisory board meeting held in September 2015.

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 IuteCredit 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 31 December 2015, supervisory board of Arco Vara AS consists of 5 members. As at 31.12.2014, the supervisory board had 7 members. At the 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 Keskpaik. The members of previous supervisory board Toomas Tool, Arvo Nõges, Aivar Pilv and Stephan David Balikn 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, P457 OÜ.

**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, LH Capital AS, AS Audentes, AS Arhiivikeskus, Baltic Digital Archive AS and Kodumaja 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 IuteCredit 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 Keskpaik**

Mr Keskpaik graduated from Tallinn Technical University with a degree in business administration. Mr Keskpaik has been a practicing real estate broker in Tallinn until 2010. Mr Keskpaik 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 Keskpaik 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. Keskpaik 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. Therefore, our social responsibility has several important dimensions.

Firstly, society uses real estate valuation service mainly on valuating loan guarantees. Both, production and consumption, and part of it also real estate market, are based largely on loan relations. The latter in turn is based on guarantees. Expertise given to the value of real estate property as loan guarantee therefore influences creditor's evaluation of risks and decisions to boost capital onto the credit market. Too optimistic valuation policies might support initiating real estate bubble and irresponsible borrowing. Overly conservative valuation policies might slow down normal market activity and growth. Total value of properties valuated by the group only in Estonia exceeds 200 million euros a year and whereby having considerable effect on functioning balanced real estate market. Therefore, the group has a policy that expert opinions are appraised only by certified valuators, who are guided by the minimum requirements set out by professional organisations and additional intra-group rules. History of provided services to each valuated object will be stored in Arco Vara database. That includes object view i.e all previously issued appraisals can be found for the object to ensure better consistency of valuations.

Secondly, bonus value of real estate mediation services embodies sharing true and competent information between people. Bonus value of brokerage service, if compared with real estate portal mediation service, is in the amount, verifiability and truthfulness of additional information. The role of the broker in gathering information is to represent interest of both: his/her client (who initiates the deal) and possible counterparty. Both parties should have equal and verified information in all important questions on concluding the transaction. Therefore, the group's policy concerning brokerage services is to accept for mediation only verified property eligible for transaction. Transaction eligibility, depending on the type of the property, means prior inspection of the property, prior review of legal aspects and control of the person (i.e. whether he/she is the owner?) initiating the transaction. To comply it's standards, Arco Vara will not mediate uncontrolled real estate transactions.

Thirdly and most importantly, real estate products developed in the group will have an effect on appearance and usage functions of future cities. Therefore we always evaluate beside business aspects broader impact of our activities and expect to achieve maximum positive result in following areas:

- detail planning and design of living environment (not only design of individual building);
- architectural solution as a form that has the most long-term impact on people;
- room planning;
- technological shift, that means each new development product will be a seedbed for some new technology, we do not make the same things all the time;
- building quality and optimization of operating costs, that means our interest is to develop products with long-lasting usage value and endure generation after generation.

Arco Vara turns special attention to well-being of its employees and improvement of working conditions – in 2015, we renewed offices and 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

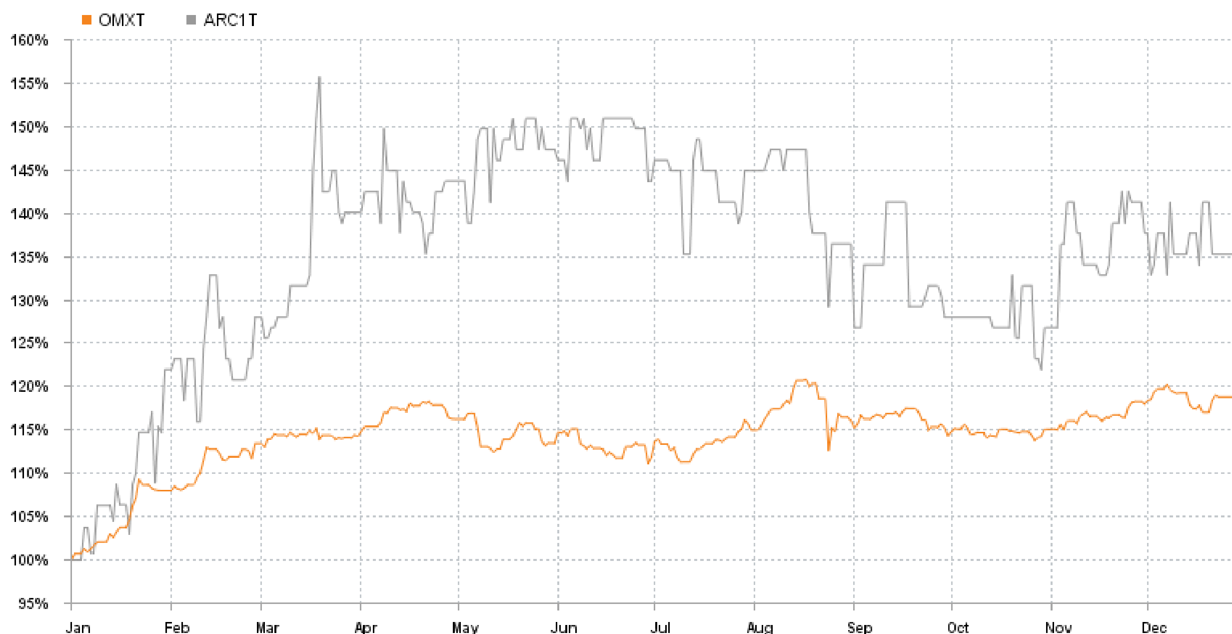
Arco Vara AS has issued a total of 6,117,012 ordinary shares with nominal value of 0.7 euros per share. The shares are freely traded on NASDAQ OMX Tallinn stock exchange. As at 31 December 2015, the company had 1,600 shareholders (at 31 December 2014: 1,668) including 1,381 individuals as shareholders (at 31 December 2014: 1,441 individuals). The share price closed at 1.15 euros. The price has increased by 39% within year 2015 (closing price at the end of 2014 was 0.828 euros). During the period, the highest price per share was 1.29 euros and lowest price 0.83 euros. As at 31 December 2015, market capitalization of shares amounted to 7,035 thousand euros and P/E ratio of the share was 15.8 (at 31 December 2014: 5,065 thousand euros and 5.5, respectively).

The following charts reflect movements in the price and daily turnover of Arco Vara share in last three years: for the period from 1 January 2013 to 31 December 2015.

### In 2015

### In the period from 1 January 2013 to 31 December 2015

Changes in Arco Vara share (ARC1T) price compared with the benchmark index OMX Tallinn in 2015.




| Index/equity | 31 Dec 2014 | 31 Dec 2015 | +/-% |
|---|---|---|---|
| OMX Tallinn | 755.05 | 898.99 | +19.06 |
| ARC1T | 0.828 EUR | 1.15 EUR | +38.89 |

| Major shareholders at 31 December 2015 | No of shares | Interest % |
|---|---|---|
| NORDEA BANK FINLAND PLC client | 862,820 | 14.1% |
| AS Lõhmus Holdings | 602,378 | 9.8% |
| Gamma Holding Investment OÜ | 565,356 | 9.2% |
| Alarmo Kapital OÜ | 489,188 | 8.0% |
| LHV PENSIONIFOND L | 389,765 | 6.4% |
| FIREBIRD REPUBLICS FUND LTD | 356,428 | 5.8% |
| OÜ HM Investeeringud | 325,505 | 5.3% |
| FIREBIRD AVRORA FUND, LTD. | 185,800 | 3.0% |
| LHV PENSIONIFOND XL | 173,583 | 2.8% |
| FIREBIRD FUND L.P. | 150,522 | 2.5% |
| Other shareholders | 2,015,667 | 33.0% |
| **Total** | **6,117,012** | **100.0%** |

| Holdings of members of the management and supervisory boards at 31 December 2015 | Position | No of shares | Interest % |
|---|---|---|---|
| Rain Lõhmus (AS Lõhmus Holdings) | member of supervisory board | 602,378 | 9.8% |
| Tarmo Sild and Allar Niinepuu (Alarmo Kapital OÜ) | member of management board/ member of supervisory board | 489,188 | 8.0% |
| Hillar-Peeter Luitsalu (OÜ HM Investeeringud, related persons) | chairman of supervisory board | 364,259 | 6.0% |
| Kert Keskpaik (privately and through K Vara OÜ) | member of supervisory board | 194,633 | 3.2% |
| Steven Yaroslav Gorelik [1] | member of supervisory board | 3,150 | 0.1% |
| **Total** | | **1,653,608** | **27.0%** |

[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 and Firebird Fund L.P) of 692,750 shares (total of 11.3% interest).

## DESCRIPTION OF THE MAIN RISKS

### Strategic risk

Most of the group's equity is placed in real estate development. The group is focused mainly on residential real estate development where development cycle lasts for years consisting of detail planning, designing, construction and sale - starts from purchase of land plot and finishes with the sale of end products to customers. The equity is invested mainly in starting phase of the cycle (purchase of land) on the assumption that there will be a demand for certain products in the future. Considering that the demand for development product is largely based on forecast and not on transaction then the main risk for the group is investing equity to the development product for which there is no demand in the future.

For mitigating the risk: (i) the group invests equity into different development projects in different markets (in 2016, in Sofia and Tallinn), (ii) monitors current demand and supply in its home markets and (iii) makes efforts to narrow the time between moment of investment and moment when the demand is rising - signing pre-agreements with clients, purchases land without using equity or postpones it using project financing alternatives where equity placement is not necessary.

### Credit risk

The group's credit risk arises mainly from two sources: real estate development activities and reliability of the banks where bank deposits are placed. As on real estate transactions a lot of counterparty financing goes through banks, co-operation with different financing banks is common to mitigate counterparty risk. And not all cash and cash equivalents are placed on the same banking group. As a consequence, the group considers credit risk as substantially mitigated.

### Liquidity and interest rate risks

The base currency of all 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 on the international capital markets. The group does not use hedging instruments to mitigate its long-term interest rate risk. In 2015, the group's interest-bearing liabilities have decreased by 2.3 million euros and at 31 December 2015 amounted to 12.8 million euros, of which 2.3 million euros is due within next 12 months. At the same time, the group's cash and cash equivalents totalled 0.7 million euros as at 31 December 2015 (at 31 December 2014: 1.7 million euros). In 2015, interest payments on interest-bearing liabilities totalled 0.8 million euros (in 2014: 1.1 million euros). The group's weighted average loan interest rate was 5.0% as at 31 December 2015. This is a decrease by 0.8 percentage points if compared to the end of year 2014. The main reason for the decrease of average interest rate is the premature redemption of bonds in February 2015. The bonds bore higher than average interest rate. Marginal effect had also the decrease of EURIBOR rates even below zero-level.

### Currency risk

Purchase and sales contracts of provided services 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 demand or short-term deposits denominated in euros.

# 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. According to the Commercial Code of the Republic of Estonia and The Company’s articles of association at least 2/3 out of all shareholders participating in shareholders meeting should vote for to make changes in articles of association.

In 2015, one annual general meeting and one extraordinary general meeting took place.

Annual general meeting

The annual general meeting was held on 23 April 2015 in Tallinn at Rävala pst 3, Lübeck meeting room of Radisson Blu Sky Hotel.

Notice of the annual general meeting was given in the information system of the Tallinn Stock Exchange and on the Company’s website on 31 March 2015. The notice was published in the national daily newspaper *Postimees* on 1 April 2015. 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 2014;
- distribution of profit;
- appointment of Auditor.

The following decisions were adopted at the annual general meeting:

- To approve the year 2014 annual report of Arco Vara AS and to distribute the net profit for the year ended on 31 December 2014 in the amount of 803 thousand euros as follows:
    - to pay dividends to the shareholders 0.01 euros per share, in the total amount of 61 thousand euros. The list of shareholders entitled to dividends shall be fixed as at 15 May 2015, 23:59 PM. Dividends shall be paid to the shareholders by transfer to the bank account of the shareholders on 29 May 2015;
    - to allocate 742 thousand euros to retained earnings.
- to appoint an auditor for one year (until the next annual general meeting of shareholders) and appoint PricewaterhouseCoopers AS as the auditor. To pay the auditor for auditing the 2015 annual report according to an agreement to be signed between Arco Vara AS and PricewaterhouseCoopers AS.

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 24 shareholders whose votes represented 52.38% 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 2014.

Extraordinary general meetings

The extraordinary general meeting was held on 10 February 2015 from 10:00 a.m. until 10:30 a.m. at the Company’s headquarter in Tallinn at Jõe tn 2B.

Notice of the extraordinary general meeting was given in the information system of the Tallinn Stock Exchange and on the Company’s website on 16 January 2015. The notice was published in the national daily newspaper *Postimees* on 19 January 2015. 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 general meeting was the following:

- recall of the Supervisory Board;
- election of members of Supervisory Board;
- remuneration and compensation for Supervisory Board.

The following decisions were adopted at the extraordinary general meeting:

1) to recall all members of the Supervisory Board, i.e. Hillar-Peeter Luitsalu, Rain Lõhmus, Arvo Nõges, Aivar Pilv, Allar Niinepuu, Toomas Tool, Stephan David Balkin;
2) to appoint a Supervisory Board that consists of five members, and to elect the following persons to Supervisory Board:
    - Rain Lõhmus
    - Steven Yaroslav Gorelik
    - Hillar-Peeter Luitsalu
    - Allar Niinepuu
    - Kert Keskpaik
3) to pay members of Supervisory Board (hereinafter: Board) 500 euros (net amount) for every participated meeting but not more that 1,000 euros (net amount) per month. Make the payment of remuneration dependant on the signing of the minutes of the Board meetings. As Board members may choose to hold Board meetings by utilizing electronic devices through real-time two-way audio communications or through other similar solutions that enable to follow the meeting, participate in discussions and vote on decisions while physically not participating in the meeting, Board members will be compensated reasonable travel expenses in connection with participation in physical Board meetings.

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 also attended by the member of the Management Board of the Company, Tarmo Sild, who answered the shareholders' questions, and also by the notary public Kaata Kartau. The meeting was attended by 26 shareholders whose votes represented 54.37% 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 2015 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 15 September 2015, the Supervisory Board of the Company adopted the decision to extend the term of office of Tarmo Sild, the manager of Arco Vara, by three years as of 22 October 2015, i.e. until 21 October 2018.

Service contact has been concluded with the member of the Management Board. The member of the Management Board is not concurrently a member of the Management Board or Supervisory Board of any other listed company.

The service contract 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 up 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 year 2016 for 0.7 euros per share. At the moment of disclosing the Company's annual report for 2015 the member of the Management Board had not subscribed for the shares on the basis of the convertible bond.

In 2015, the member of the Management Board was not paid any other fees except the basic remuneration according to the service contract.

The member of the Management Board has notified the Company of his involvement as a member of the Management Board or as a controlling shareholder in the following companies which are not part of the group: AS IuteCredit Europe, MFV Lootus OÜ, Aia Tänav OÜ, Alarmo Kapital OÜ, Catsus OÜ.

Under the service contract, the member of the Management Board has agreed not to breach the prohibition on competition. Holding certain ownership interests and being involved in the governing bodies of other companies does not constitute breach of the prohibition on competition.

**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 2015, there were changes in the membership of the Company's Supervisory Board. Until the extraordinary general meeting of the Company held on 10 February 2015 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. On 10 February 2015, the Company's general meeting appointed a Supervisory Board of the Company in the following composition: Rain Lõhmus, Steven Yaroslav Gorelik, Hillar-Peeter Luitsalu, Allar Niinepuu ja Kert Keskpaik.

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. On 27 February 2015 Hillar-Peeter Luitsalu was re-elected as the chairman of the Supervisory Board.

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. On 10 February 2015 the general meeting of the Company decided to compensate in reasonable amount the travel expenses of the members of the Supervisory Board connected to the physical participation in the meetings of the Supervisory Board.

In 2015, the Supervisory Board had 4 meetings which were participated by all the members of the Supervisory Board.

**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 in Estonian and in English until March 2017, i.e. until disclosing the annual report for 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. At the shareholders' meeting on 23 April 2015 AS PricewaterhouseCoopers was appointed as Company's auditor for the next financial year the fourth 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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

# Consolidated financial statements

## Consolidated statement of comprehensive income

| | Note | **2015** | 2014 |
|---|---|---|---|
| In thousands of euros | | | |
| **Continuing operations** | | | |
| Revenue from sale of own real estate | | 7,019 | 5,414 |
| Revenue from rendering of services | | 3,633 | 3,744 |
| **Total revenue** | 5,7 | **10,652** | **9,158** |
| | | | |
| Cost of sales | 8 | -6,865 | -5,902 |
| **Gross profit** | | **3,787** | **3,256** |
| | | | |
| Other income | 9 | 80 | 37 |
| Marketing and distribution expenses | 10 | -530 | -324 |
| Administrative expenses | 11 | -2,020 | -1,811 |
| Other expenses | 9 | -151 | -82 |
| Gain on revaluation of investment property | 20 | 95 | 0 |
| Gain on reversal of inventory write-down | 19 | 0 | 572 |
| Gain on transactions involving joint ventures | 12 | 0 | -27 |
| Gain on sale of subsidiary | 12,31 | 0 | 662 |
| **Operating profit** | | **1,261** | **2,283** |
| | | | |
| Finance income and costs | 13 | -666 | -1,062 |
| **Profit before tax** | | **595** | **1,221** |
| Income tax | 14 | -135 | -75 |
| **Net profit from continuing operations** | | **460** | **1,146** |
| | | | |
| **Discontinued operations** | | | |
| Loss from discontinued operations | 31 | -15 | -324 |
| | | | |
| **Net profit for the period** | | **445** | **822** |
| *attributable to owners of the parent* | | *467* | *803* |
| *attributable to non-controlling interests* | | *-22* | *19* |
| | | | |
| **Total comprehensive income for the period** | | **445** | **822** |
| *attributable to owners of the parent* | | *467* | *803* |
| *attributable to non-controlling interests* | | *-22* | *19* |
| | | | |
| **Earnings per share (in euros)** | 15 | | |
| - basic | | **0.08** | 0.15 |
| - diluted | | **0.07** | 0.14 |

The notes presented on pages 24 to 57 form an integral part of the consolidated financial statements.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

# Consolidated statement of financial position

| | Note | **31 December 2015** | 31 December 2014 |
|---|---|---|---|
| In thousands of euros | | | |
| Cash and cash equivalents | 17 | 745 | 1,691 |
| Receivables and prepayments | 18 | 679 | 1,205 |
| Inventories | 19 | 12,818 | 11,970 |
| **Total current assets** | | **14,242** | **14,866** |
| | | | |
| Receivables and prepayments | 18 | 0 | 5 |
| Investment property | 20 | 9,513 | 11,585 |
| Property, plant and equipment | 21 | 489 | 434 |
| Intangible assets | 21 | 229 | 113 |
| **Total non-current assets** | | **10,231** | **12,137** |
| **TOTAL ASSETS** | | **24,473** | **27,003** |
| | | | |
| Loans and borrowings | 22 | 2,345 | 3,194 |
| Payables and deferred income | 23 | 1,935 | 2,659 |
| Provisions | 24 | 146 | 274 |
| **Total current liabilities** | | **4,426** | **6,127** |
| | | | |
| Loans and borrowings | 22 | 10,417 | 11,826 |
| **Total non-current liabilities** | | **10,417** | **11,826** |
| **TOTAL LIABILITIES** | | **14,843** | **17,953** |
| | | | |
| Share capital | 25 | 4,282 | 4,282 |
| Share premium | 25 | 292 | 292 |
| Statutory capital reserve | 25 | 2,011 | 2,011 |
| Other reserves | 15 | 298 | 179 |
| Retained earnings | | 2,656 | 2,250 |
| **Total equity attributable to owners of the parent** | | **9,539** | **9,014** |
| Equity attributable to non-controlling interests | | 91 | 36 |
| **TOTAL EQUITY** | | **9,630** | **9,050** |
| **TOTAL LIABILITIES AND EQUITY** | | **24,473** | **27,003** |

The notes presented on pages 24 to 57 form an integral part of the consolidated financial statements.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## Consolidated statement of cash flows

| | Note | 2015 | 2014 |
|---|---|---|---|
| In thousands of euros | | | |
| Cash receipts from customers | | 13,770 | 10,812 |
| Cash paid to suppliers | | -7,679 | -8,945 |
| Income tax paid from profits | | -197 | -4 |
| Other taxes paid and recovered (net) | | -2,399 | -341 |
| Cash paid to employees | | -1,015 | -866 |
| Other cash payments and receipts related to operating activities (net) | | 9 | -41 |
| Net cash flow of discontinued operations | | -15 | -250 |
| **NET CASH FROM OPERATING ACTIVITIES** | | **2,474** | **365** |
| | | | |
| Purchase of tangible and intangible assets | | -196 | -71 |
| Proceeds from sale of a subsidiary | 6 | 0 | 10 |
| Proceeds from sale of an associated company | | 0 | 1 |
| Loans provided | | 0 | -3 |
| Placement of security deposits | | 0 | -438 |
| Release of security deposits | | 0 | 701 |
| Interest received | | 4 | 5 |
| **NET CASH FROM/USED IN INVESTING ACTIVITIES** | | **-192** | **205** |
| | | | |
| Proceeds from loans received | 22 | 2,734 | 4,885 |
| Settlement of loans and borrowings | 22 | -5,025 | -4,800 |
| Interest paid | | -788 | -1,091 |
| Dividends paid | | -61 | 0 |
| Proceeds from share capital issue | 25 | 0 | 1,375 |
| Other payments related to financing activities | | -88 | -76 |
| **NET CASH FROM/USED IN FINANCING ACTIVITIES** | | **-3,228** | **293** |
| | | | |
| **NET CASH FLOW** | | **-946** | **863** |
| | | | |
| Cash and cash equivalents at beginning of period | 17 | 1,691 | 818 |
| **Increase or decrease in cash and cash equivalents** | | **-946** | **863** |
| Increase in cash and cash equivalents through purchase of a subsidiary | 6 | 0 | 10 |
| Cash and cash equivalents at end of period | 17 | 745 | 1,691 |

The notes presented on pages 24 to 57 form an integral part of the consolidated financial statements.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 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 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** |
| Transactions with owners: | 963 | 292 | 0 | 119 | -5 | **1,369** | 5 | **1,374** |
| *Increase of share capital* | *963* | *292* | *0* | *0* | *0* | *1,255* | *0* | *1,255* |
| *Change in non-controlling interests* | *0* | *0* | *0* | *0* | *-5* | *-5* | *5* | *0* |
| *Formation of equity reserve* | *0* | *0* | *0* | *119* | *0* | *119* | *0* | *119* |
| **Balance as at 31 December 2014** | **4,282** | **292** | **2,011** | **179** | **2,250** | **9,014** | 36 | **9,050** |
| | | | | | | | | |
| **Balance as at 31 December 2014** | **4,282** | **292** | **2,011** | **179** | **2,250** | **9,014** | **36** | **9,050** |
| Total comprehensive income for the period | 0 | 0 | 0 | 0 | 467 | **467** | -22 | **445** |
| Transactions with owners: | 0 | 0 | 0 | 119 | -61 | **58** | 77 | **135** |
| *Dividends paid* | *0* | *0* | *0* | *0* | *-61* | *-61* | *0* | *-61* |
| *Change in non-controlling interest* | *0* | *0* | *0* | *0* | *0* | *0* | *77* | *77* |
| *Formation of equity reserve* | *0* | *0* | *0* | *119* | *0* | *119* | *0* | *119* |
| **Balance as at 31 December 2015** | **4,282** | **292** | **2,011** | **298** | **2,656** | **9,539** | **91** | **9,630** |

Further information on share capital is provided in note 25.

Further information on other reserves is provided in note 15.

The notes presented on pages 24 to 57 form an integral part of the consolidated financial statements.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 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 2015 were authorised for issue by the chief executive officer/member of the management board on 31 March 2016. 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 Rävala pst 5, Tallinn, Estonia. As at the end of 2015, 178 people provided services to the group under the employment or authorization contract (31 December 2014: 189 people). 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 2015 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.

<u>Classification of real estate</u>

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 residental buildings, or residental 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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

### 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.

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 2015 and 31 December 2014 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 using the following methods (depending on the asset usage):

- comparison method;
- residual value method;
- evaluation of contractual agreement for sale of an asset.

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 2015 and 31 December 2014, 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.

Evaluation of amortisation rates and recoverable amounts of intangible assets

Management bases its estimations on minimum expected usage period in determining amortisation rates for intangible assets: business software developed for the group. On estimating the recoverable value of intangible assets management monitors profitability of units utilizing the software and attractiveness of the software as marketable product. Other principles used for measuring intangible assets are described in note 4.

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.

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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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

From 2015, the group changed the presentation of information in the note related to revenue to gain more precise disclosure of revenue structure. Income from providing accommodation services is presented on the row *Rental of real estate.* Previously the information was presented on the row *Other revenue.* Comparative information for year 2014 has been aligned with the changed presentation.

## *4 Significant accounting policies*

### 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 2016, and which the group has not early adopted.

***Annual Improvements to IFRSs 2012*** 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.

***Equity Method in Separate Financial Statements - Amendments to IAS 27*** The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

***Annual Improvements to IFRSs 2014*** IAS 34 will require a cross reference from the interim financial statements to the location of "information disclosed elsewhere in the interim financial report".

***Disclosure Initiative – Amendments to IAS 1*** The standard was amended to clarify the concept of materiality, new guidance on subtotals in financial statements, structure of the financial statements and disclosures of accounting policies.

***IFRS 16, Leases*** The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

***Disclosure Initiative - Amendments to IAS 7*** The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities.

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

### 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 when 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

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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 as profit or loss on the statement of comprehensive income 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 accumulated 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, Lithuanian and Estonian subsidiaries is the euro. The presentation currency of the consolidated financial

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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 (in 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. Bulgaria has 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 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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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 equals 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*).

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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. Intangible asset classes are assigned the following annual amortisation rates:

- Business software 20–33%

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 five 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

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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 grand 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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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.

**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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn



## 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 residental 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 | | Eliminations | | Consolidated | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| In thousands of euros | | | | | | | | | | |
| External revenue | 7,861 | 6,466 | 2,787 | 2,688 | 4 | 4 | | | 10,652 | 9,158 |
| *Annual change* | *22%* | *-20%* | *4%* | *1%* | | | | | *16%* | *-15%* |
| Inter-segment revenues | 86 | 37 | 467 | 451 | | | -553 | -488 | 0 | 0 |
| **Total revenue** | **7,947** | **6,503** | **3,254** | **3,139** | **4** | **4** | **-553** | **-488** | **10,652** | **9,158** |
| | | | | | | | | | | |
| **Operating profit/loss** | **1,790** | **1,942** | **-94** | **246** | **73** | **-25** | **-508** | **120** | **1,261** | **2,283** |
| *Of which reversals of inventory write-downs* | *0* | *572* | *0* | *0* | *0* | *0* | | | *0* | *572* |
| *Fair value adjustments to investment property, net* | *95* | *0* | *0* | *0* | *0* | *0* | | | *95* | *0* |
| *Gain on sale of a subsidiary* | *0* | *0* | *0* | *0* | *0* | *662* | | | *0* | *662* |

### External revenue by location

| Segment | Development | | Service | | Parent company | | Consolidated | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| In thousands of euros | | | | | | | | |
| Estonia | 263 | 0 | 1,271 | 1,181 | 4 | 4 | 1,538 | 1,185 |
| Bulgaria | 7,170 | 5,364 | 636 | 393 | - | - | 7,806 | 5,757 |
| Latvia | 428 | 1,102 | 880 | 1,114 | - | - | 1,308 | 2,216 |
| **Total revenue** | **7,861** | **6,466** | **2,787** | **2,688** | **4** | **4** | **10,652** | **9,158** |

### Operating profit/loss of Development and Service segment by location

| Segment | Development | | Service | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| In thousands of euros | | | | |
| Estonia | 2 | 374 | -182 | 40 |
| Bulgaria | 1,778 | 1,566 | 161 | 141 |
| Latvia | 10 | 2 | -73 | 65 |
| **Total operating profit/loss** | **1,790** | **1,942** | **-94** | **246** |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

***Assets and liabilities by operating segments and by location***

| Segment | Development | | Service | | Unallocated | | Consolidated | |
|---|---|---|---|---|---|---|---|---|
| At 31 December | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| In thousands of euros | | | | | | | | |
| **Assets** | **23,318** | **25,602** | **505** | **668** | **650** | **733** | **24,473** | **27,003** |
| Estonia | 5,292 | 4,883 | 186 | 190 | 650 | 733 | 6,128 | 5,806 |
| Bulgaria | 16,986 | 19,294 | 181 | 231 | - | - | 17,167 | 19,525 |
| Latvia | 1,040 | 1,425 | 138 | 247 | - | - | 1,178 | 1,672 |
| **Liabilities** | **14,060** | **16,265** | **518** | **499** | **265** | **1,189** | **14,843** | **17,953** |
| Estonia | 520 | 1,422 | 274 | 262 | 265 | 1,189 | 1,059 | 2,873 |
| Bulgaria | 13,467 | 14,685 | 154 | 109 | - | - | 13,621 | 14,794 |
| Latvia | 73 | 158 | 90 | 128 | - | - | 163 | 286 |

# 6 Acquisition and sale of subsidiaries

## Scope of consolidation

At 31 December 2015, Arco Vara group comprised 25 consolidated entities (at 31 December 2014: 24). On 31 July 2015, a real estate fund in Bulgaria named Arco Real Estate Fund REIT, with starting capital of 256 thousand euros was registered. At 31 December 2015, the group holds 70% interest in the fund. 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** |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn



# Notes to the consolidated statement of comprehensive income

## *7 Revenue*

| In thousands of euros | **2015** | 2014 |
|---|---|---|
| Sale of own real estate | 7,019 | 5,414 |
| Real estate brokerage and valuation | 2,505 | 2,520 |
| Rental of real estate | 913 | 1,029 |
| Property management services | 95 | 128 |
| Other revenue | 120 | 67 |
| **Total revenue** | **10,652** | **9,158** |

## *8 Cost of sales*

| In thousands of euros | **2015** | 2014 |
|---|---|---|
| Cost of real estate sold (note 19) | -4,883 | -3,918 |
| Personnel expenses | -1,497 | -1,528 |
| Property management costs | -314 | -311 |
| Vehicle expenses | -22 | -18 |
| Depreciation of property, plant and equipment | -12 | -11 |
| Other costs | -137 | -116 |
| **Total cost of sales** | **-6,865** | **-5,902** |

## *9 Other income and expenses*

### *Other income*

| In thousands of euros | **2015** | 2014 |
|---|---|---|
| Received penalties and compensations | 64 | 0 |
| Miscellaneous income | 16 | 37 |
| **Total other income** | **80** | **37** |

### *Other expenses*

| In thousands of euros | **2015** | 2014 |
|---|---|---|
| Loss on ending litigations | -43 | 0 |
| Write-down of receivables | -40 | -2 |
| Late payment interest and penalty charges | -30 | -35 |
| Impairment loss of property plant and equipment | -2 | -1 |
| Miscellaneous expenses | -36 | -44 |
| **Total other expenses** | **-151** | **-82** |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 10 Marketing and distribution expenses

| | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| Advertising expenses | -285 | -179 |
| Personnel expenses | -123 | -61 |
| Market research | -9 | -7 |
| Other marketing and distribution expenses | -113 | -77 |
| **Total marketing and distribution expenses** | **-530** | **-324** |

## 11 Administrative expenses

| | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| Personnel expenses | -1,126 | -929 |
| Office expenses | -446 | -362 |
| Services purchased | -157 | -217 |
| IT expenses | -138 | -140 |
| Depreciation and amortisation | -44 | -34 |
| Legal service fees | -42 | -62 |
| Vehicle expenses | -33 | -38 |
| Other expenses | -34 | -29 |
| **Total administrative expenses** | **-2,020** | **-1,811** |

## 12 Gain on transactions involving subsidiaries and joint ventures

| | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| Gain on sale of subsidiary (note 6) | 0 | 662 |
| Loss on acquisition of shares in a joint venture (notes 6) | 0 | -27 |
| **Total** | **0** | **635** |

## 13 Finance income and costs

| | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| Interest expense | -600 | -975 |
| Interest income | 4 | 5 |
| Other finance income and costs | -70 | -92 |
| **Total finance income and costs** | **-666** | **-1,062** |

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 2015, capitalised interest expenses amounted to 97 thousand euros (in 2014: 208 thousand euros).

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn



## 14 Income tax

| | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| Income tax expense from Bulgarian subsidiaries | 135 | 75 |
| **Total income tax expense** | **135** | **75** |

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.

| | **2015** | 2014 |
|---|---|---|
| Weighted average number of ordinary shares outstanding during the period | 6,117,012 | 5,186,326 |
| Number of ordinary shares potentially to be issued | 390,000 | 390,000 |
| Net profit/loss attributable to owners of the parent (in thousands of euros) | 467 | 803 |
| **Earnings per share (in euros)** | **0.08** | 0.15 |
| **Diluted earnings per share (in euros)** | **0.07** | 0.14 |

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 2015, an equity reserve in amount of 298 thousand euros has been formed (at 31 December 2014: 179 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 | 170 | 139 |
| Office equipment | 28 | 22 |
| Vehicles | 5 | 1 |
| **Total** | **203** | **162** |

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

| **As at 31 December** | **2015** | **2014** |
|---|---|---|
| In thousands of euros | | |
| No later than 1 year | 137 | 51 |
| Later than 1 year and no later than 5 years | 276 | 22 |
| **Total** | **413** | **73** |

Future lease payables (from non-cancellable operating leases) have significantly increased due to the Arco Vara's head office movement in 2015 accompanied by conclusion of new 5-year lease agreement. Other lease agreements considered as non-cancellable are concluded for renting offices to brokerage units, also renting office equipment. Non-cancellable lease agreements do not include any unusual restrictions or special terms.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

# 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 | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| Cash on hand and demand deposits | 745 | 1,691 |
| **Total cash and cash equivalents** | **745** | **1,691** |

At the end of year 2015, out of the group's year-end cash and cash equivalents balance 82 thousand euros (31 December 2014: 30 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 | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| **Trade receivables** | | |
| Receivables from customers [1] | 235 | 989 |
| Allowance for doubtful trade receivables | -12 | -22 |
| **Total trade receivables** | **223** | **967** |
| | | |
| **Other receivables** | | |
| Loans provided | 6 | 6 |
| Miscellaneous receivables | 119 | 154 |
| **Total other receivables** | **125** | **160** |
| | | |
| **Accrued income** | | |
| Prepaid and recoverable taxes | 75 | 22 |
| Other accrued income | 3 | 4 |
| **Total accrued income** | **78** | **26** |
| | | |
| **Prepayments** | **253** | **52** |
| **Total short-term receivables and prepayments** | **679** | **1,205** |

[1] - as at 31 December 2014, the balance of receivables from customers had 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.

### Long-term receivables

| As at 31 December | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| Prepayments | 0 | 5 |
| **Total long-term receivables and prepayments** | **0** | **5** |

### Allowance for doubtful trade receivables

| As at 31 December | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| **Balance at beginning of year** | **-22** | **-22** |
| Receivables considered doubtful during the year | 0 | -2 |
| Receivables considered irrecoverable during the year | 10 | 2 |
| **Balance at end of year** | **-12** | **-22** |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn


## 19 Inventories

| As at 31 December | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| Properties purchased and being developed for resale | 12,580 | 11,942 |
| Materials and finished goods | 12 | 12 |
| Prepayments for inventories | 226 | 16 |
| **Total inventories** | **12,818** | **11,970** |

### Properties purchased and being developed for resale

| | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| **Balance at the beginning of period, 1 January** | **11,942** | **10,762** |
| Properties purchased for development | 70 | 120 |
| Construction costs of apartment buildings | 2,464 | 4,236 |
| Capitalized borrowing costs | 127 | 233 |
| Reversal of inventory write-down | 0 | 572 |
| Other capitalized costs | 583 | 345 |
| Reclassification from/to investment property (note 20) | 2,277 | -408 |
| Cost of sold properties (note 8) | -4,883 | -3,918 |
| **Balance at the end of period, 31 December** | **12,580** | **11,942** |

Reclassification of Madrid Blvd project assets in 2015 and 2014 between inventory and investment property are partially based on the change in usage of assets: since 2013, the project's apartments are renovated and furnished for providing accommodation services. Initially, the apartments (and accompanying parking places) prepared for provision of accommodation services were reclassified from inventory to investment property. At the end of 2015, the presentation was changed by the management based on his change in estimate in such a way that all unsold apartments and parking places in this project are presented as inventory. That includes reclassification (from investment property to inventory) of apartments and accompanying parking places which are used in providing accommodation services as the main goal of the group is sell all apartments and parking places to end customers.

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

No write-downs were made to inventories in 2015 and 2014.

The group's management estimates that the group has inventories realisable during one year in carrying value of 5,737 thousand euros. Inventories in carrying value of 7,081 thousand euros are realisable in longer period than one year.

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

Projects under development, which are classified as inventories, have been measured for the purpose of establishing the need for, and amount of, a write-down using the comparison method or the residual value method. In 2015 and also in 2014, the value of the group's inventories was determined by internal experts. At the end of year 2015, an external expert was additionally used for the valuation of Kodulahe project assets. Estimates used in valuations are based on real market prices and the group's recent experience with comparable assets. As at 31 December 2015, inventories in total amount of 12,818 thousand euros had not required a write-down or reversal of write-down (in 2014: 8,159 thousand euros).

| As at 31 December | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| Measured using the comparison method | 7,969 | 7,187 |
| Measured using the residual value method | 4,386 | 4,550 |
| Other | 463 | 233 |
| **Total inventories** | **12,818** | **11,970** |

As at 31 December 2015, the total carrying value of inventories carried at cost was 5,171 thousand euros (at 31 December 2014: 4,502 thousand euros) and total carrying value of inventories measured at net realisable value was 7,647 thousand euros (at 31 December 2014: 7,468 thousand euros).

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn



## 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.

| | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| **Balance at the beginning of period, 1 January** | **11,585** | **11,331** |
| Net profit/loss on changes in fair value | 95 | -160 |
| Capitalised development costs | 110 | 6 |
| Reclassification from/to inventories (note 19) | -2,277 | 408 |
| **Balance at the end of period, 31 December** | **9,513** | **11,585** |

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 2015 and 2014, the values of all of the group's investment properties were determined by internal experts.

At 31 December 2015, investment properties with carrying values of 9,263 thousand euros did not require value adjustment (in 2014: 11,594 thousand euros). ). In 2015, the fair value of investment property was increased in amount of 95 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 | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| Measured using the discounted cash flow method | 8,752 | 10,920 |
| Measured using comparison method | 761 | 665 |
| **Total investment property** | **9,513** | **11,585** |

In 2015, variables used on valuations of investment properties measured using the discounted cash flow method were following: exit yields were 9% (in 2014: 9.5%) on office and commercial spaces. Monthly rental income per m2 from commercial and office areas was 10 euros on average, the same assumption applied in valuation of year 2015 and 2014.

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 452 thousand euros (in 2014: by 544 thousand euros).
- A decrease of 1% in the exit yields, would have increased the fair value of investment property by 1,131 thousand euros (in 2014: by 1,314 thousand euros) and an increase of 1% would reduce the fair value by 905 thousand euros (in 2014: by 1,022 thousand euros).

### Operating leases: the group as a lessor

In 2015, the group's rental income on investment properties amounted to 1,006 thousand euros (in 2014: 1,134 thousand euros). Direct property management expenses totalled 242 thousand euros (in 2014: 239 thousand euros).

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

| As at 31 December | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| No later than 1 year | 239 | 688 |
| Later than 1 year and no later than 5 years | 661 | 806 |
| Later than 5 years | 0 | 86 |
| **Total** | **900** | **1,580** |

Lease contracts are considered non-cancellable if:

1) concluded for fixed term (with the expiration date in 2016 or later);
2) or when lessee has the right to cancel the contract with 3- to 6-month notice but only after arrival of fixed date in 2016 or later.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn



## 21 Property, plant and equipment and intangible assets

| In thousands of euros | Land and buildings | Renovation of rented office space | Office equipment | Total property, plant and equipment |
|---|---|---|---|---|
| **Carrying amount at 31 December 2013** | **371** | **0** | **88** | **459** |
| *Of which cost* | *431* | *0* | *392* | *823* |
| *Of which accumulated depreciation* | *-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** |
| *Of which cost* | *431* | *0* | *350* | *781* |
| *Of which accumulated depreciation* | *-69* | *0* | *-278* | *-347* |
| Additions | 0 | 31 | 82 | 113 |
| Disposals | 0 | 0 | -2 | -2 |
| Depreciation for the year | -10 | -5 | -41 | -56 |
| **Carrying amount at 31 December 2015** | **352** | **26** | **111** | **489** |
| *Of which cost* | *431* | *31* | *429* | *891* |
| *Of which accumulated depreciation* | *-79* | *-5* | *-318* | *-402* |

### Intangible assets

| In thousands of euros | Software and licences | Prepaid for intangible assets | Total intangible assets |
|---|---|---|---|
| **Carrying amount at 31 December 2013** | **2** | **10** | **12** |
| *Of which cost* | *42* | *10* | *52* |
| *Of which accumulated amortisation* | *-40* | *0* | *-40* |
| Purchases and software development | 3 | 99 | 102 |
| Amortisation for the year | -1 | 0 | -1 |
| **Carrying amount at 31 December 2014** | **4** | **109** | **113** |
| *Of which cost* | *45* | *109* | *154* |
| *Of which accumulated amortisation* | *-41* | *0* | *-41* |
| Purchases and software development | 17 | 103 | 120 |
| Reclassification | 195 | -195 | 0 |
| Amortisation for the year | -4 | 0 | -4 |
| **Carrying amount at 31 December 2015** | **212** | **17** | **229** |
| *Of which cost* | *257* | *17* | *274* |
| *Of which accumulated amortisation* | *-45* | *0* | *-45* |

Intangible assets of the group consist mainly of business software development costs made in 2015 and 2014 in total amount of 202 thousand euros (of which 103 thousand euros in 2015 and 99 thousand euros in 2014).

For pledged assets see note 27.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn


## 22 Loans and borrowings

Loans and borrowings comprise the following items:

| | As at 31 December 2015 | | | As at 31 December 2014 | | |
|---|---|---|---|---|---|---|
| | 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 | 12,585 | 2,179 | 10,406 | 14,081 | 3,010 | 11,071 |
| Bonds | 151 | 150 | 1 | 911 | 160 | 751 |
| Finance lease liabilities | 26 | 16 | 10 | 28 | 24 | 4 |
| **Total** | **12,762** | **2,345** | **10,417** | **15,020** | **3,194** | **11,826** |

At 31 December 2015, the weighted average interest rate of loans and borrowings was 5.0% (31 December 2014: 5.8%).

In 2015, the group settled loans and borrowings of 5,025 thousand euros (in 2014: 4,800 thousand euros) through cash transactions and raised new loans and borrowings of 2,734 thousand euros (in 2014: 4,885 thousand euros).

**Changes in loans and borrowings in 2015**

In 2015, following major loan obligations were settled:

- In January, the group repaid last part, in amount of 606 thousand euros, loan used for financing the construction of Manastirski Livadi project II stage. Contractual repayment deadline of the loan was 30 May 2016.

- 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. See also note 29.

- 1,428 thousand euros of Madrid Blvd project loan principal was repaid to Piraeus bank in Bulgaria. The amount includes a principal repayment in amount of 950 thousand euros from 20 February 2015. 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.

- In June, the group repaid 900 thousand euros of bank loan, which was raised for the acquisition of Kodulahe project land plot in 2013. After the reporting date – in March 2016, the last part of the loan in amount of 500 thousand euros has been repaid to the bank.

In April 2015, a new loan agreement for financing construction of third stage apartment building in Manastirski Livadi project in Bulgaria was signed. As at 31 December 2015, loan limit in amount of 2,734 thousand euros was used, of which 1,199 thousand euros was repaid already. In December 2015, after getting permit of use for the apartment building, the final sale of apartments and simultaneous loan repayments were started. After the reporting date – in February 2016, the whole loan amount has been repaid to the bank.

**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 was 20 June 2015 and annual interest rate was 9.8%. The bonds were redeemed in December 2015 and in January 2016. 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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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

| Description of the loan/borrowing | Maturity date (month/year) | Loan amount, in thousands of euros | | Interest rate, % | | Type of interest rate |
|---|---|---|---|---|---|---|
| | | **31 Dec 2015** | 31 Dec 2014 | **31 Dec 2015** | 31 Dec 2014 | |
| Bank loan, development | 12/2017 | 10,406 | 11,834 | 5.0 | 5.1 | 3M Euribor |
| Bank loan, development [1] | 9/2017 | 1,286 | - | 4.4 | - | 3M Euribor |
| Bank loan, acquisition of land [2] | 3/2016 | 500 | 1,400 | 6.5 | 7.7 | 6M Euribor |
| Bank loan, working capital [1] | 12/2016 | 250 | - | 4.4 | - | 3M Euribor |
| Bonds, working capital [2] | 1/2016 | 150 | 160 | 9.8 | 9.8 | Fixed |
| Bank loan, acquisition of land | 8/2017 | 95 | 150 | 4.0 | 4.2 | 6M Euribor |
| Bank loan, development | 10/2016 | 48 | 91 | 6.0 | 6.3 | 6M Euribor |
| Finance leases | 2/2018 | 23 | 14 | 8.0 | 7.9-14.7 | Fixed |
| Finance leases | 3/2017 | 3 | 14 | 3.0 | 3.0-3.1 | 3M Euribor |
| Convertible bond | 9/2017 | 1 | 1 | 5.0 | 5.0 | Fixed |
| Bonds, development | - | - | 750 | - | 14.0 | Fixed |
| Bank loan, development | - | - | 455 | - | 5.6 | 3M Euribor |
| Bank loan, working capital | - | - | 151 | - | 5.6 | 3M Euribor |
| **Total** | | **12,762** | **15,020** | | | |

[1] by the publishing date of the report, all loan amounts have been repaid prematurely

[2] by the publishing date of the report, all loan amounts have been repaid

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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 23 Payables and deferred income

| 31 December | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| **Trade payables** | **296** | **208** |
| **Miscellaneous payables** | **172** | **91** |
| | | |
| ***Taxes payable*** | | |
| Corporate income tax | 114 | 125 |
| Value added tax [1] | 47 | 820 |
| Social security tax | 40 | 33 |
| Personal income tax | 31 | 19 |
| Other taxes | 336 | 343 |
| **Total taxes payable** | **568** | **1,340** |
| | | |
| ***Accrued expenses*** | | |
| Payables to employees | 174 | 144 |
| Interest payable | 8 | 100 |
| Other accrued expenses | 11 | 19 |
| **Total accrued expenses** | **193** | **263** |
| | | |
| **Deferred income** | | |
| Prepayments received on sale of real estate | 704 | 757 |
| Other deferred income | 2 | 0 |
| **Total deferred income** | **706** | **757** |
| | | |
| **Total short-term payables and deferred income** | **1,935** | **2,659** |

[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 |
|---|---|
| In thousands of euros | |
| **Provisions at 31 December 2013** | **172** |
| Amounts used and reversed | -135 |
| Additional provisions made | 237 |
| **Provisions at 31 December 2014** | **274** |
| Amounts used and reversed | -241 |
| Additional provisions made | 113 |
| **Provisions at 31 December 2015** | **146** |

### Warranty provisions

The group's Bulgarian development companies have created provisions related to warranty given by the construction contractor. The provision amount is 5% from the initial 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 during one year, as a rule, from the take-over of the construction. At 31 December 2014, the provision amounted to 202 thousand euros. In 2014, the provision was increased due to the completion of Manastirski Livadi project second stage apartment building in November 2014. In 2015, 169 thousand euros was paid out to constructor and new provision in amount of 113 thousand euros was recognised after the completion of construction on the third stage of Manastriski Livadi project.

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

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 25 Share capital

| As at 31 December | 2015 | 2014 |
|---|---|---|
| Number of issued shares fully paid up | 6,117,012 | 6,117,012 |
| Share capital (in thousands of euros) | 4,282 | 4,282 |
| Share premium (in thousands of euros) | 292 | 292 |
| 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 2015.

## 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 3 banks, where are deposited 78% out of all the group's cash are presented in following table. At 31 December 2015, the share of other banks remains below 5% out of total cash and cash equivalents.

| Bank or banking group | Bank's share of the group's cash balance | Standard & Poor's | Moody's | Fitch |
|---|---|---|---|---|
| UniCredit group banks | 64% | BBB- | Baa1 | BBB+ |
| LHV Pank AS | 9% | Not rated | Not rated | Not rated |
| Piraeus Bank group banks | 5% | SD | Caa3 | RD |
| Cash in other banks and petty cash | 22% | - | - | - |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

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 2015 is 1,093 thousand euros (31 December 2014: 2,823 thousand euros).

### *Financial assets by maturity*

| | at 31 December 2015 | | | |
|---|---|---|---|---|
| **By maturity** | < 3 months | 3-12 months | 1-2 years | Total |
| In thousand of euros | | | | |
| Cash and cash equivalents (note 17) | 745 | 0 | 0 | 745 |
| Trade and other receivables (note 18) | 348 | 0 | 0 | 348 |
| **Total** | **1,093** | **0** | **0** | **1,093** |

| | 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** |

## 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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

***Maturity structure of financial liabilities (undiscounted)***

| | | | at 31 December 2015 | |
|---|---|---|---|---|
| **By maturity** | < 3 months | 3-12 months | 1-5 years | Total |
| In thousands of euros | | | | |
| Interest-bearing liabilities | 2,205 | 140 | 10,417 | 12,762 |
| Interest payable | 144 | 394 | 521 | 1,059 |
| Other financial liabilities | 487 | 0 | 0 | 487 |
| **Total** | **2,836** | **534** | **10,938** | **14,308** |

| | | | 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 | 418 | 0 | 0 | 418 |
| **Total** | **2,291** | **2,062** | **12,939** | **17,292** |

Based on the maturities of liabilities included in the group's loan portfolio, as at 31 December 2015, the average weighted maturity of the group's loans and borrowings was 1.7 years (as at 31 December 2014: 2.3 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. By the end of year 2015, Euribor interest rates have decreased down even below zero. Therefore, there is practically no Euribor component in group's loans as at 31 December 2015.

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 2015, indicated that a 1 percentage point change (increase or decrease) in interest rates would have affected (increased or reduced) profit before tax by 127 thousand euros (at 31 December 2014: 150 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.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

### *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 2015, 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 2015, the share capital of Arco Vara AS was 4,282 thousand euros and net assets were 9,630 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 2015, 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 amendment of this deficiency, but on condition that all loan obligations are fulfilled according to agreed terms. At 31 December 2015, the group has such loans in total amount of 11,001 thousand euros.

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 2015, total capital amounted to 21,647 thousand euros (at 31 December 2014: 22,379 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 2015, equity accounted for 39.3% (at 31 December 2014: 33.5%) 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** | **2015** | **2014** |
|---|---|---|
| In thousands of euros | | |
| Cash and cash equivalents | 40 | 33 |
| Receivables | 22 | 98 |
| Inventories | 11,708 | 10,832 |
| Investment property | 8,762 | 11,545 |
| Property, plant and equipment | 322 | 326 |
| **Total carrying value of assets pledged as collateral** | **20,854** | **22,834** |

### 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 loan with balance at 31 December 2015 of 10,406 thousand euros (at 31 December 2014: 11,834 thousand euros).

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 28 Contingent liabilities

**Contingent income tax liability**

As at 31 December 2015, the group's retained earnings amounted to 2,656 thousand euros (at 31 December 2014: 2,250 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 531 thousand euros and the amount to be paid out to shareholders would total 2,125 thousand euros. Income tax liability could be decreased by income tax amount paid on distributing profit in subsidiaries and joint ventures. In 2015, the option was utilized paying out dividends to shareholders in amount of 61 thousand euros and there was no need to pay income tax. Income tax obligation was covered by the income tax what had been previously paid from profits of Bulgarian subsidiaries.

**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 2011-2015 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*

| In thousands of euros | **2015** | 2014 |
|---|---|---|
| **Joint ventures and associate** | | |
| Services sold | - | 0 |
| Services purchased | - | 26 |
| Provision of loans | - | 3 |
| **Companies that have a significant interest in the group's parent company** | | |
| Services purchased | 32 | 239 |
| Bonds issued | 0 | 150 |
| Redemption of bonds | 500 | 0 |
| Paid interest | 92 | 81 |
| **Other related parties** | | |
| Services sold | 2 | 4 |
| Services purchased | 0 | 4 |
| Redemption of bonds | 260 | 0 |
| Paid interest | 40 | 35 |

*Balances with related parties*

| **At 31 December** | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| **Companies that have a significant interest in the group's parent company** | | |
| Bonds issued | 150 | 650 |
| **Other related parties** | | |
| Bonds issued | 1 | 251 |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

**Significant transactions with related parties in 2015**

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. See also note 22.

**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 was 20 June 2015 and annual interest rate is 9.8%. In June 2015, were agreed with bondholders on new maturity date of bonds: 20 December 2015. At 31 December 2015, 150 thousand euros was not redeemed from the bond issue. After the balance sheet date, in the beginning of January 2016, all bonds were redeemed. See also note 22.

In 2015 and 2014, no receivables from related parties were impaired.

**Remuneration of key management personnel**

In 2015, 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 108 thousand euros (in 2014: 102 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 mandate of the chief executive was prolonged by 3 years (until October 2018) on the supervisory board meeting held in September 2015. The basis for the remuneration provided to the members of the supervisory board was changed in July 2013 and were slightly amended in February 2015. According to the resolutions 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. Reasonable travel expenses made for participating on the board meetings are also compensated to the members 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 2015.

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. On issuing the bond, the fair value of the option was measured in amount of 298 thousand euros and has been recognized as payroll expense distributed to the period from July 2013 until December 2015. At 31 December 2015, equity reserve has been formed for the whole value of the option (at 31 December 2014: 179 thousand euros). See also the note 15.

In 2015 and 2014, all transactions with related parties have been conducted in market conditions.

## 30 Joint ventures

Since the October 2014, the group has no interests in joint ventures. In 2014, the ownership in the company Tivoli Arendus OÜ was increased and since October 2014 it is a subsidiary of the group. See also note 6.

***Income and expenses of joint ventures***

| | 2015 | | 2014 | |
|---|---|---|---|---|
| EUR, thousands | Income | Expenses | Income | Expenses |
| Tivoli Arendus OÜ [1] | - | - | 615 | 384 |
| **Total** | **-** | **-** | **615** | **384** |

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

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

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 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*

| | 2015 | 2014 |
|---|---|---|
| In thousands of euros | | |
| Administrative expenses | 0 | -13 |
| Fair value adjustment of investment property (note 20) | 0 | -160 |
| Other income and expenses | -15 | -151 |
| **Net loss from discontinued operations** | **-15** | **-324** |
| **Earnings per share from discontinued operations (in euros)** | **0,00** | **-0.06** |

## 32 Events after the reporting date

### Arco Vara bond issue

On 7 January 2016, Arco Vara AS issued bonds in total amount of 1,120 thousand euros. The bonds are unsecured with annual interest rate of 12% and redemption date on 6 January 2018. The funds raised from bond issue will be used mainly in residential development in Estonia.

### Repayment of Manastirski Livadi project third stage construction loan

On 9 February 2016, the group's Bulgarian subsidiary Arco Manastirski EOOD carried out last repayment on investment loan that was concluded in April 2015 for construction of third stage apartment building (Block D) of Manastirksi Livadi project. 2,734 thousand euros was the total loan amount used.

### Conclusion of Kodulahe project first stage construction and financing contracts

On 11 February 2016, the group's Estonian subsidiary Kodulahe OÜ and main constructor RAMM Ehituse OÜ concluded a contract for construction of first stage apartment building of Kodulahe residential development project in Tallinn. The contract price exceeds 10 million euros. The construction started at the end of February 2016 and apartment building should be ready in July 2017. At the beginning of February, Kodulahe OÜ and Nordea Bank AB Estonia Branch concluded loan contract with total loan limit of 9,350 thousand euros for financing the construction of apartment building. The group also started with the conclusion of the apartment presale agreements.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

## 33 Structure of Arco Vara group

| Company | Domicile | Group's ownership interest | |
|---|---|---|---|
| | | **At 31 December 2015** | At 31 December 2014 |
| % | | | |
| **Service segment** | | | |
| **Subsidiaries** | | | |
| Arco Real Estate AS | Estonia | 100 | 100 |
| Arco Real Estate SIA [1] | Latvia | 70.6 | 70.6 |
| Adepto SIA [1] | Latvia | 70.6 | 70.6 |
| Arco Imoti EOOD | Bulgaria | 100 | 100 |
| Arco Facility Management EOOD | Bulgaria | 100 | 100 |
| Arco Project EOOD | Bulgaria | 100 | 100 |
| **Development segment** | | | |
| **Subsidiaries** | | | |
| Arco Investeeringute AS | Estonia | 100 | 100 |
| Kerberon OÜ | Estonia | 100 | 100 |
| Kolde AS | Estonia | 100 | 100 |
| Arco Vara Haldus OÜ | Estonia | 100 | 100 |
| Fineprojekti OÜ (on liquidation) [1] | Estonia | 100 | 100 |
| Tivoli Arendus OÜ [1] | Estonia | 100 | 100 |
| Kodulahe OÜ | Estonia | 100 | 100 |
| Arco Manastirski EOOD | Bulgaria | 100 | 100 |
| Arco Invest EOOD [1] | Bulgaria | 100 | 100 |
| Arco Real Estate Fund REIT | Bulgaria | 70 | - |
| Arco BB EOOD | Bulgaria | 100 | 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 |

[1] - Interest through a subsidiary

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn



## *34 Parent company's unconsolidated primary financial statements*

In accordance with the Accounting Act of Estonia, unconsolidated primary financial statements of consolidating unit (parent company) have been disclosed in the notes of the consolidated annual report. The parent company's primary reports are prepared using the same accounting principles and estimation basis used on consolidated financial statements, excluding subsidiaries, which are accounted for in parent company's unconsolidated primary financial statements using cost method.

### UNCONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| **Revenue from rendering of services** | **329** | **318** |
| | | |
| Other income | 1 | 8 |
| Marketing and distribution expenses | -6 | -30 |
| Administrative expenses | -751 | -773 |
| Other expenses | -15 | -139 |
| Gain/loss on investments in subsidiaries | 503 | -213 |
| **Operating profit/loss** | **61** | **-829** |
| | | |
| Interest income | 242 | 162 |
| Interest expense | -125 | -220 |
| **Total finance income and costs** | **117** | **-58** |
| **Net profit/loss for the year** | **178** | **-887** |
| **Total comprehensive income/expense for the year** | **178** | **-887** |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

# UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

| **As at 31 December** | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| Cash and cash equivalents | 70 | 603 |
| Receivables and prepayments | 211 | 2,793 |
| Inventories | 210 | 0 |
| **Total current assets** | **491** | **3,396** |
| | | |
| Investments[1] | 5,312 | 5,479 |
| Receivables and prepayments | 5,076 | 342 |
| Property, plant and equipment | 36 | 5 |
| Intangible assets | 210 | 101 |
| **Total non-current assets** | **10,634** | **5,927** |
| **TOTAL ASSETS** | **11,125** | **9,323** |
| | | |
| Loans and borrowings | 2,844 | 380 |
| Payables and prepayments | 111 | 196 |
| Provisions | 0 | 72 |
| **Total current liabilities** | **2,955** | **648** |
| | | |
| Loans and borrowings | 11 | 752 |
| **Total non-current liabilities** | **11** | **752** |
| **TOTAL LIABILITIES** | **2,966** | **1,400** |
| | | |
| Share capital | 4,282 | 4,282 |
| Share premium | 292 | 292 |
| Statutory capital reserve | 2,011 | 2,011 |
| Other reserves | 298 | 179 |
| Retained earnings | 1,276 | 1,159 |
| **Total equity** | **8,159** | **7,923** |
| | | |
| **TOTAL LIABILITIES AND EQUITY** | **11,125** | **9,323** |

[1] - *Investments* line item includes investments in subsidiaries.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

# UNCONSOLIDATED STATEMENT OF CASH FLOWS
(direct method)

| | **2015** | 2014 |
|---|---|---|
| In thousands of euros | | |
| Cash receipts from customers | 503 | 347 |
| Cash paid to suppliers | -865 | -740 |
| Taxes paid | -38 | -47 |
| Cash paid to employees | -177 | -162 |
| Other payments and receipts related to operating activities, net | -149 | -132 |
| **NET CASH USED IN OPERATING ACTIVITIES** | **-726** | **-734** |
| | | |
| Paid on acquisition of tangible and intangible assets | -128 | -36 |
| Paid on formation and acquisition of subsidiaries | -179 | -32 |
| Proceeds from sale of investments in subsidiaries | 0 | 10 |
| Loans provided | -3,352 | -1,250 |
| Repayment of loans provided | 1,642 | 1,108 |
| Placement of security deposits | 0 | -438 |
| Release of security deposits | 0 | 438 |
| Dividends received | 624 | 0 |
| Interest received | 170 | 7 |
| **NET CASH USED IN INVESTING ACTIVITIES** | **-1,223** | **-193** |
| | | |
| Proceeds of loans received | 2,392 | 125 |
| Settlement of loans and finance lease obligations | -21 | -41 |
| Proceeds of bond issues | 0 | 160 |
| Paid on redemption of bonds | -760 | 0 |
| Proceeds from share capital issue | 0 | 1,375 |
| Dividends paid | -61 | 0 |
| Interest paid | -134 | -118 |
| **NET CASH FROM FINANCING ACTIVITIES** | **1,416** | **1,501** |
| | | |
| **NET CASH FLOW** | **-533** | **574** |
| | | |
| **Cash and cash equivalents at beginning of year** | **603** | **29** |
| Change in cash and cash equivalents | -533 | 574 |
| **Cash and cash equivalents at end of year** | **70** | **603** |

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials L.M.
Kuupäev/date 31.03.2016
PricewaterhouseCoopers, Tallinn

# UNCONSOLIDATED 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 2013** | **3 319** | **0** | **2 011** | **60** | **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** |
| Profit distribution | 0 | 0 | 0 | 0 | -61 | -61 |
| Formation of equity reserve | 0 | 0 | 0 | 119 | 0 | 119 |
| Profit for the year | 0 | 0 | 0 | 0 | 178 | 178 |
| **Balance at 31 December 2015** | **4 282** | **292** | **2 011** | **298** | **1 276** | **8 159** |

## *Adjusted unconsolidated equity*

| **As at 31 December** | **2015** | **2014** |
|---|---|---|
| In thousands of euros | | |
| **Parent company's unconsolidated equity** | **8,159** | **7,923** |
| Carrying amount of investments in subsidiaries in the parent company's unconsolidated statement of financial position (-) | -5,312 | -5,479 |
| Value of investments in subsidiaries under the equity method (+) | 6,783 | 6,710 |
| **Parent company's adjusted unconsolidated equity** | **9,630** | **9,154** |

## 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 2015 are 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 2016

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 2015 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 2015, 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

| | |
|---|---|
| Tiit Raimla | Märten Padu |
| Auditor's Certificate No. 287 | Auditor's Certificate No. 513 |

31 March 2016

---

* *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 2015 of 467 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 406 thousand euros to retained earnings.

Retained earnings will amount to 2,595 thousand euros after the transfer of year 2015 net profit.

31 March 2016

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