Arco Vara AS

INTERIM REPORT FOR THE THIRD QUARTER AND NINE MONTHS 2016

ARCO VARA

INTERIM REPORT FOR THE
THIRD QUARTER AND NINE MONTHS
ENDING ON 30 SEPTEMBER 2016
(UNAUDITED)

Company name:	Arco Vara AS
Registry number:	10261718
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E-mail:	info@arcovara.ee
Corporate website:	www.arcorealestate.com
Regional websites:	www.arcovara.ee www.arcorealestate.lv www.arcoreal.bg
Core activities:	Real estate development Renting and operating of real estate (EMTAK 6820) Activities of real estate agencies (EMTAK 6831) Real estate management (EMTAK 6832)
Financial year:	1 January 2016 – 31 December 2016
Reporting period:	1 January 2016 – 30 September 2016
Supervisory board:	Hillar-Peeter Luitsalu, Rain Lõhmus, Allar Niinepuu, Kert Keskpaik, Steven Yaroslav Gorelik
Chief executive:	Tarmo Sild
Auditor:	AS PricewaterhouseCoopers

CONTENTS

Directors' report for Q3 and 9 months 2016

General information

Arco Vara AS and other entities of Arco Vara group (hereafter together 'the group') are engaged in real estate development and services related to real estate. The group considers Estonia, Latvia and Bulgaria as its home markets. The group has two business lines: Service division and Development division.

The Service division is engaged in real estate brokerage, valuation, management and consulting as well as in short-term investment in residential real estate. The Service division offers to the group additional value by generating analytical data on market demand and supply, and behaviour of potential clients. Analytical data allows to make better decisions on real estate development: purchase of land plots, planning and designing, pricing end products, 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 also develops commercial properties until they start to generate cash flow for two possible purposes: for the support of the group's cash flows or for resale. The group is currently holding completed commercial properties that generate rental income.

As of 30 September 2016, the group consisted of 23 companies, which is two less than at the end of year 2015. On 19 February 2016, the group's subsidiary Fineprojekti OÜ was erased from Estonian Commercial Register, the liquidation process was started in 2014. The liquidation also resulted in derecognition of Romanian subsidiary Arco Capital Real Estate SRL from the group's structure. In Q1 2016, the group's interest in Bulgarian real estate fund Arco Real Estate Fund REIT was increased from 70% to 100% and the share capital of the fund was additionally increased by 77 thousand euros. In April 2016, the group sold its 100% subsidiary Arco BB EOOD in Bulgaria and in May 2016 the group purchased 100% subsidiary Iztok Parkside EOOD in Bulgaria. None of these transactions had significant impact on the group's net assets.

Goals and core values

Common **goals** for all Arco Vara companies are:

1) to provide clients with trustworthy real estate services which are based on quality information and integrated real estate products of high use value, while remaining innovative;
2) to achieve stable and strong return on equity for the shareholders, which beats the competition in real estate business and justifies investing in and holding Arco Vara's shares;
3) 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

Caring – we value our clients as individuals

Responsibility – we keep our promises

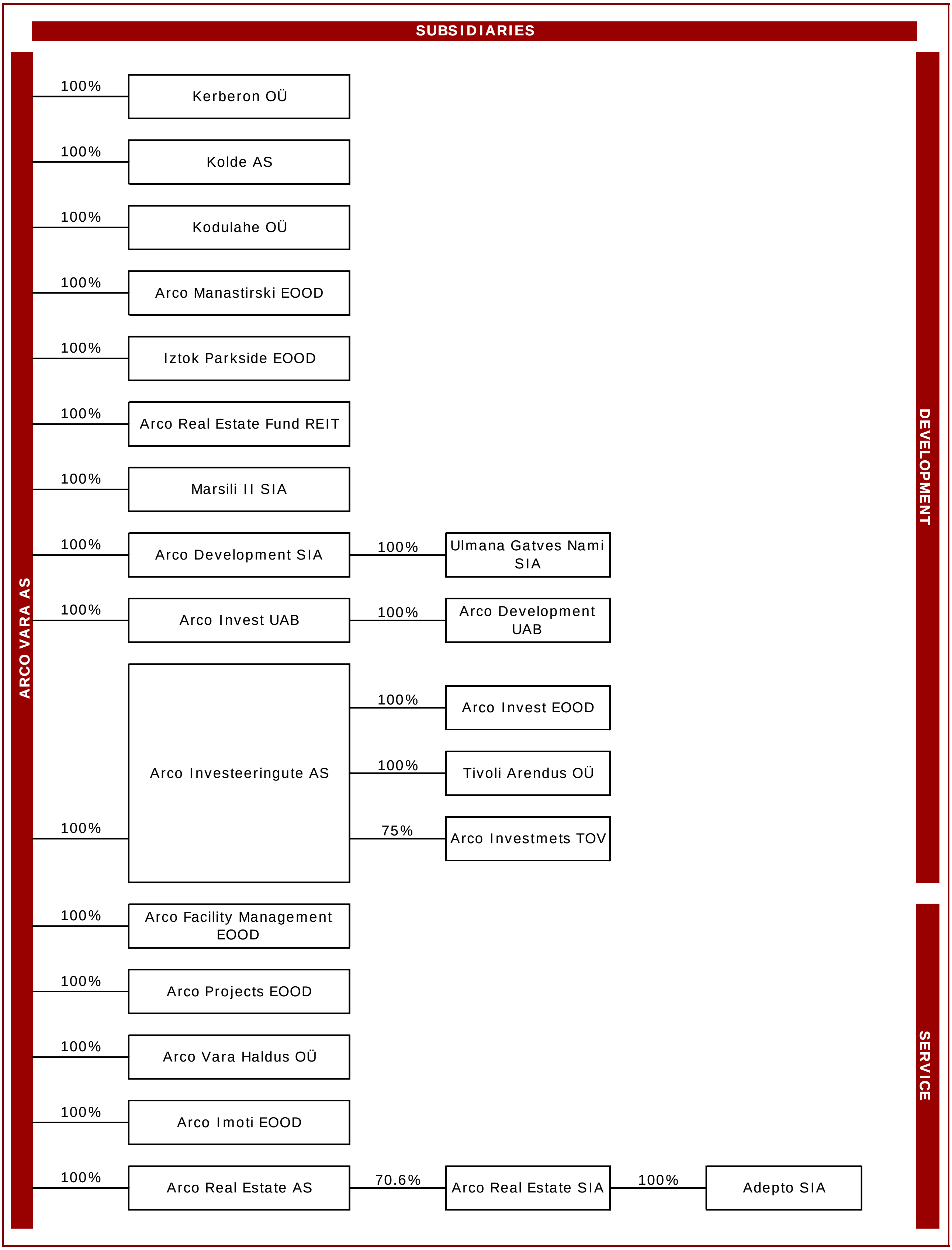
Significant subsidiaries

Company name	Location	Segment	Share capital (nominal value)	Equity balance at 30 Sept 2016	The group's interest
In thousands of euros					
Arco Manastirski EOOD	Bulgaria	Development	2,676	4,091	100%
Arco Invest EOOD	Bulgaria	Development	26,826	-501	100%
Iztok Parkside EOOD	Bulgaria	Development	1,433	1,234	100%
Arco Real Estate Fund REIT [1]	Bulgaria	Development	332	298	100%
Kodulahe OÜ	Estonia	Development	3	-265	100%
Kerberon OÜ	Estonia	Development	5	1,259	100%
Marsili II SIA	Latvia	Development	1,524	954	100%
Arco Real Estate AS	Estonia	Service	42	-1,058	100%
Arco Real Estate SIA [1]	Latvia	Service	1,905	31	70.6%
Arco Imoti EOOD	Bulgaria	Service	444	174	100%

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

GROUP STRUCTURE

As of 30 September 2016



Key Performance Indicators

- In Q3 2016, the group's revenue was 1.3 million euros, which is 39% less compared to the revenue of 2.1 million euros in Q3 2015. Revenue of Development division amounted to 0.6 million euros in Q3, decreasing by 57% compared to Q3 2015. The revenue of Service division amounted to 0.8 million euros in Q3 2016, decreasing by 5.4% compared to Q3 2015. The group's revenue of 8.4 million euros for the 9 months 2016 decreased by 1.4% compared to the same period of year 2015. The revenue of Development division decreased by 2.2% to 6.4 million euros for 9 months 2016 and the revenue of Service division amounted to 2.4 million euros in 9 months 2016, decreasing by 1.5% compared to 9 months 2015.
- In Q3 2016, the group's operating loss (=EBIT) was 0.2 million euros and net loss 0.4 million euros. In Q3 2015, 0.3 million euros of operating profit and 0.2 million euros of net profit were earned. In 9 months 2016, the group's operating profit (=EBIT) was 1.0 million euros and net profit was 0.5 million euros (in 9 months 2015: 1.4 million euros and 0.9 million euros, respectively). The group's operating profit comes from Development division, amounting to 1.5 million euros for 9 months 2016 (in 9 months 2015: 1.6 million euros). The operating profit of Service division was practically at zero level in the first 9 months of both 2016 and 2015.
- As of 30 September 2016, the group's debt burden has remained practically on the same level compared to the year-end 2015. Net loans have increased by 0.3 million euros in first 9 months 2016 up to the level of 12.3 million euros as of 30 September 2016. Total loans and borrowings amounted to 12.7 million euros on 30 September 2016, decreasing by 0.1 million euros during last 9 months. As of 30 September 2016, the weighted average annual interest rate of loans was 6.1%. This is an increase of 1.1 percentage points compared to 31 December 2015.
- In Q3 2016, 2 apartments and 2 land plots were sold in projects developed in the group (in Q3 2015, 12 apartments, one commercial space and one land plot were sold). In 9 months 2016, 75 apartments, 5 commercial spaces and 6 land plots have been sold (in 9 months 2015: 73 apartments, 6 commercial spaces and one land plot).

	9 months 2016	9 months 2015	**Q3 2016**	Q3 2015
In millions of euros				
Revenue				
Development	6.4	6.5	0.6	1.4
Service	2.4	2.4	0.8	0.9
Eliminations	-0.4	-0.4	-0.1	-0.1
Total revenue	**8.4**	**8.5**	**1.3**	**2.2**
Operating profit (EBIT)				
Development	1.5	1.6	0.0	0.4
Service	-0.1	0.1	0.0	0.0
Unallocated income and expenses	-0.5	-0.4	-0.2	0.0
Eliminations	0.1	0.1	0.0	0.0
Total operating profit/loss (EBIT)	**1.0**	**1.4**	**-0.2**	**0.4**
Finance income and expense	-0.5	-0.5	-0.2	-0.2
Net profit/loss	**0.5**	**0.9**	**-0.4**	**0.2**
Key ratios				
EPS (in euros)	0.08	0.15	-0.06	0.03
Diluted EPS (in euros)	0.07	0.14	-0.05	0.03
ROIC (rolling, four quarters)	0.3%	5.6%		
ROE (rolling, four quarters)	0.6%	13.9%		
ROA (rolling, four quarters)	0.3%	5.1%		

	30 Sept 2016	31 Dec 2015
In millions of euros		
Total assets, at period end	26.6	24.5
Invested capital, at period end	22.7	22.4
Net loans, at period end	12.3	12.0
Equity, at period end	10.0	9.6
Current ratio	3.22	3.22
Quick ratio	0.20	0.32
Financial leverage	2.67	2.54
Average loan term (in years)	1.2	1.7
Average annual interest rate of loans	6.1%	5.0%
Number of staff, at period end	185	178

Cash flows

	9 months 2016	9 months 2015	**Q3 2016**	Q3 2015
In millions of euros				
Cash flows from/used in operating activities	2.6	3.1	-1.0	-0.1
Cash flows from/used in investing activities	-2.0	-0.1	-1.1	0.0
Cash flows from/used in financing activities	-0.9	-3.5	1.6	0.3
Net cash flows	**-0.3**	**-0.5**	**-0.5**	**-0.2**
Cash and cash equivalents at beginning of period	0.7	1.7	0.9	1.0
Cash and cash equivalents at end of period	0.4	1.2	0.4	1.2

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**
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**
Net profit/loss	0.0	1.4	0.1	2.0	**3.5**	0.4	-0.3	0.4	0.6	**1.1**

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	**Total 2015**	Q1 2016	Q2 2016	Q3 2016	**Total 9M 2016**
In millions of euros									
Revenue	4.4	2.1	2.1	2.1	**10.7**	5.1	2.1	1.2	**8.4**
Net profit/loss	0.7	0.0	0.2	-0.4	**0.5**	1.1	-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
Diluted earnings per share (Diluted EPS) = net profit attributable to owners of the parent / (weighted average number of ordinary shares outstanding during the period + number of all potentially issued shares)
Invested capital = current interest-bearing liabilities + non-current liabilities + equity (at the end of period)
Net loans = current interest-bearing liabilities + non-current liabilities – cash and cash equivalents – short-term investments in securities (at the 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

Arco Vara Group has been pushing simultaneously one acceleration of restructured rental property, two constructions of residential developments, and three internal gear-shiftings in our brokerage and valuation units in our home markets. The push is quite different from a walk in the park, one should rather compare it to an expedition through the desert. All the ongoing push efforts consume money, before they start making money. As I have warned in previous quarterly reports, our following quarters will be humble.

Nevertheless, we should be clear on two things: first, the period of push „through the desert“ must be over in Q3 2017 when we will start delivery of Kodulahe first stage apartments, and the Group must return to profitability again; and second, despite my own nice explanation of what is happening, we underperformed in Q3. The net loss of 0.4 million euros was more than we ourselves expected.

We performed quite well with activities that are not yet visible in the balance sheet and income statement. That means, Kodulahe construction proceeded according to the schedule and current presales met our expectations. We intend to sell out 1st stage (more than 8,700 sqm GSA, 16 million euros expected revenue) by the end of 2017 and must start preparations for the 2nd stage soon. Iztok Parkside land acquisition and the detail plan process has also been completed as at the date of this report and we will proceed with a construction tender, with a view to start construction this year. In Q4, we also started presale of Iztok. Finally, we have made progress with several smaller development projects in Tallinn and Tartu, where we expect to have in our balance sheet sellable development products (attractive land with building rights) in the first half of 2017 or finalized consumer products (apartments or residential plots) in 2018. Our aim is still to double the revenue and net profit of Arco Vara (from 10 and 1 million to 20 and 2 millions, respectively) by the end of 2018.

Areas where we did not perform well look like a bottom of a water bucket, with small holes in it. The revenue was smaller than expected and certain expenses bigger than expected. Normally, we need to sell for 2 million euros of goods and services in order to break even as a group.

First, we failed to sign in new tenants into Madrid Blvd offices in Sofia, where we still have 4,100 sqm vacancy, and missed significant rental income as a result. As a reaction, we have adjusted the ask prices, as we prefer a busy house with lower rents to a not so busy house with high rents. We are also watching the construction progress of the nearby 'Theater' metro station, due in 2018, and expect it to improve the Madrid Blvd connectivity to the rest of the metropolis.

Second, our brokerage and valuation units in Estonia, Latvia and Bulgaria have not been making profit so far, without having work from Arco's own development projects. The solution here is to change the way of thinking and redesign certain work processes, as the group is interested in autonomously profit-making units. Management buy-out of Latvian Arco Real Estate SIA, announced on 1 November, is part of that solution, as we could not agree on change. In Bulgaria and Estonia, we will continue with internal changes in work process and thinking.

Third, we sold less than expected from our own remaining stock of development products. The remaining stock in Madrid Blvd and Manastirski (both in Sofia), and Marsili (Riga) was worth approximately 1 million euros at the end of Q3. We should have sold for more than 600 thousand euros. On the other hand, the thin stock will be sold out in any case in the coming quarters, and there will be no additions to the stock before Q3 2017.

And finally, in Q3, we took some one-off marketing and administrative expenses which the management considered unavoidable, looking at the tightening competition both in Tallinn and in Sofia and then making forcefully space for Arco's 2017-2018 products.

So all in all, we will continue on the selected course, and financial performance of the following three quarters will not look attractive until Q3 2017 and thereafter – the results of which are being written now and these look good. Until second half of 2017, the cash flows will be tense and some sales from the landbank, or debt issues, are possible. Then again, there is a lot we can pursue even before Q3 2017 and two of those things are getting in new tenants into Madrid Blvd and increasing our brokerage and valuation revenue in Estonia and Bulgaria.

SERVICE DIVISION

In Q3 2016, revenue of the group's service division was 806 thousand euros (in Q3 2015: 852 thousand euros), which included intra-group revenue of 76 thousand euros (in Q3 2015: 107 thousand euros). Service division revenue decreased by 1.5% in 2016 if 9 months periods were compared: 2,404 thousand euros in 9 months 2016 and 2,440 thousand euros in 9 months 2015. In 9 months 2016, revenue of service division from main services (real estate brokerage and valuation services) remained at the same level of the 9 months period of 2015 and dropped by 4% if third quarters are compared. Revenue from main services has increased in Estonian and Latvian brokerage agency and decreased in Bulgarian agency. The drop in the revenue of Bulgarian agency can be attributed to the decreased income from mediating the sales of the group's own properties.

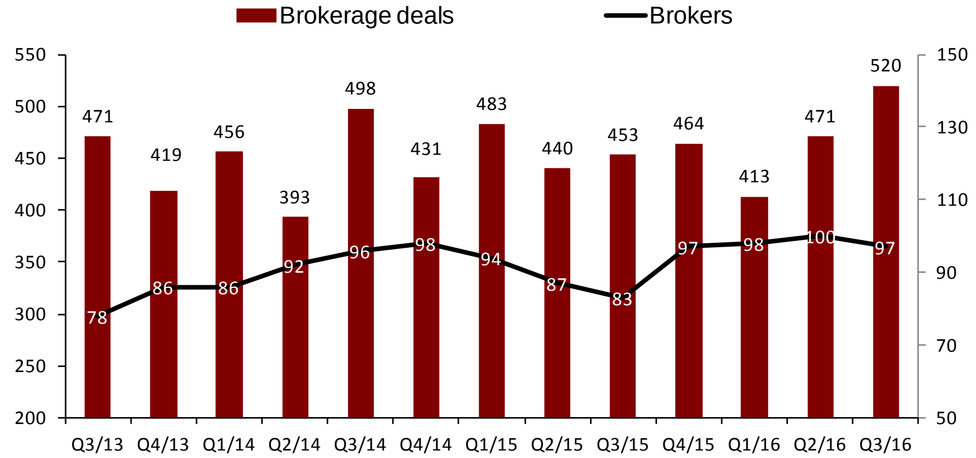
Revenue of real estate agencies from brokerage and valuation

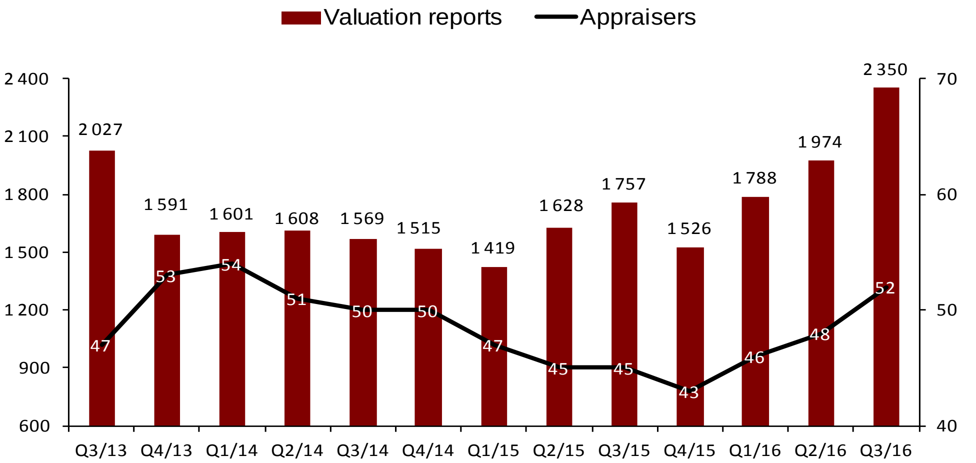
	9 months 2016	9 months 2015	Change, %	**Q3 2016**	Q3 2015	Change, %
In thousands of euros						
Estonia	1,036	963	8%	381	355	7%
Latvia	694	679	2%	226	243	-7%
Bulgaria	444	538	-17%	115	158	-27%
Total	**2,174**	**2,180**	**0%**	**722**	**756**	**-4%**

In 9 months 2016, Estonian and Latvian agencies have operated at a loss: 152 thousand euros and 18 thousand euros respectively (in 9 months 2015, losses of 68 thousand euros and 51 thousand euros respectively). Bulgarian agency had net loss of 17 thousand euros in 9 months 2016, but earned net profit of 137 thousand euros in 9 months 2015.

In addition to brokerage and valuation services, the service division also provides real estate management services and accommodation service in Bulgaria. The revenue from real estate management was 87 thousand euros in 9 months 2016, 75 thousand euros of which was intra-group revenue (in 9 months 2015: 104 thousand and 77 thousand euros, respectively). Revenue from accommodation services amounted to 104 thousand euros in 9 months 2016 (in 9 months 2015: 105 thousand euros).

Service division's numbers for brokerage deals and valuation reports, together with the number of staff are shown in the following graphs.





The number of staff in service division increased to 172 employees in first nine months of 2016, up by 7 people compared to year end 2015. The number of staff increased mainly in Bulgaria.

DEVELOPMENT DIVISION

In Q3 2016, revenue of development division totalled 586 thousand euros (in Q3 2015: 1,374 thousand euros) including revenue of 367 thousand euros (Q3 2015: 770 thousand euros) from the sale of properties in the group's own development projects. In 9 months 2016, development division's revenue amounted to 6,401 thousand euros, which is 143 thousand euros or 2.2% less compared to 9 months 2015. In 9 months 2016, the revenue from the sale of properties in the group's own development projects reached 6,043 thousand euros (in 9 months 2015: 5,713 thousand euros).

Most of the other revenue of development division consists of rental income from commercial and office premises in Madrid Blvd building in Sofia, amounting to 89 thousand euros in Q3 2016 and 252 thousand euros in 9 months 2016 (in 2015: 234 thousand euros in Q3 and 708 thousand euros in 9 months). Rental income has decreased compared to previous year due to ending the rental agreement with anchor tenant in Q3 2015 and the renovation works of rental area in Q4 2015. The rental area that was previously rented out to one anchor tenant is now divided into 7 separate areas. Finding new tenants at the same level of rental fee has proved to be difficult. At the end of Q3 2016, a decision was taken to decrease rental income expectations and with the aim of renting out all rental areas by no later than the spring of 2017.

In 9 months 2016, operating profit of development division was 1,524 thousand euros, out of which 33 thousand euros were earned in Q3 (In 9 months 2015: 1,598 thousand euros, out of which 377 thousand euros in Q3).

During Q3 2016, the construction of first stage apartment building (with 125 apartments and 5 commercial spaces) in the group's biggest development project Kodulahe continued in Tallinn. In August, the requirements of self-financing set by the financing bank were fulfilled and credit limit in the total amount of 8.8 million euros was opened. By the publishing date of the interim report, presale agreements for 59 apartments and one commercial space have been concluded. The construction of the apartment building should be finished by summer 2017.

As of 30 September 2016, 20 apartments remained unsold in Madrid Blvd complex in Sofia. In Q3 2016, 2 apartments were sold. 15 apartments, out of all Madrid Blvd unsold apartments, are being rented out as accommodation service. Unsold 105 parking places are also rented out.

Four commercial spaces and a few parking places remained unsold in Manastirski Livadi project.

In May 2016, the group finalized the purchase of a company Iztok Parkside EOOD. As a result, the group's development portfolio has gained new development project in Iztok district in Sofia. In September 2016, bank loan agreement was concluded to fully finance further development costs of the project in maximum amount of 4.9 million euros. By the date of publishing the interim report, detail plan for the project's property has been established, presale of apartments has started and construction tender has been announced. Three apartment buildings with 68 apartments (7,070 square meters of apartments' sellable area) will be built. The construction should start in Q4 2016 and apartment buildings should be completed by the end of 2017.

In third quarter, two Marsili residential plots were sold. 10 plots remained unsold in the project as of 30 September 2016.

As of 30 September 2016, 5 people were employed in development division, the same number as at the end of year 2015.

SUMMARY TABLE OF ARCO VARA'S ACTIVE PROJECTS AS OF 30 SEPTEMBER 2016

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 D	Manastirski, Sofia	Apartments	S5	-	372	4
Madrid Blvd	Madrid Blvd, Sofia	Lease: Retail/Office	S5/S6	-	7,350	20
Madrid Blvd	Madrid Blvd, Sofia	Apartments	S5/S6	-	2,060	20
Iztok Parkside	Iztok, Sofia	Apartments	S3	2,470	7,070	68
Marsili residential plots	Marsili, near Riga	Residential plots	S5	-	18,047	10
Marsili residential plots	Marsili, near Riga	Residential plots	S2/S5	120,220	<120,220>	<68>
Kodulahe, stage 1	Lahepea 7, Tallinn	Apartments	S4/S5	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

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 provide 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: Facility Management and/or Lease

PEOPLE

As of 30 September 2016, 185 people worked for the group (178 as of 31 December 2015). Employee remuneration expenses in the first 9 months of 2016 amounted to 2.1 million euros (in 9 months 2015: 1.9 million euros).

The remuneration of the member of the management board / CEO, and the members of the supervisory board of the group's parent company including social security charges amounted to 82 thousand euros in 9 months 2016 (83 thousand euros in 9 months 2015).

MANAGEMENT BOARD AND SUPERVISORY BOARD

The management board of Arco Vara AS has one member. Since 22 October 2012, the member of the management board and chief executive officer of Arco Vara AS has been Tarmo Sild. The mandate of the CEO was extended by 3 years (until October 2018) by the supervisory board in September 2015.

The supervisory board of Arco Vara AS has 5 members. Since 10 February 2015, the supervisory board consists of Hillar-Peeter Luitsalu (the chairman), Allar Niinepuu, Rain Lõhmus, Steven Yaroslav Gorelik and Kert Keskpaik.

Additional information on key persons of Arco Vara is presented on company's corporate web page www.arcorealestate.com.

DESCRIPTION OF THE MAIN RISKS

Strategic risk

Most of the group's equity is invested into real estate development. The group is focused mainly on residential real estate development where development cycle lasts for years, starting from the acquisition of a land plot, moving on to detail planning, design and construction, and ending with the sale of end products to customers. The equity is invested mainly in the early 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 forecasts, the main risk for the group is investing equity into a development product for which there is no or too little demand in the future.

For mitigating the risk, the group: (i) 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 making initial investment and selling the final product – by signing pre-agreements with clients, acquiring land without no or little upfront equity investment etc.

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. In real estate transactions, much of of counterparty financing is arranged through banks, therefore co-operation with financing banks is used to mitigate counterparty risk. Further, not all cash and cash equivalents are held in the same banking group. As a result, the group considers credit risk to be 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 international capital markets. The group does not use hedging instruments to mitigate its long-term interest rate risk. On 30 September 2016, the group's interest-bearing liabilities amounted to 12.7 million euros (decreased by 0.1 million euros during 9 months 2016), out of which only 1.2 million euros is due within next 12 months. At the same time, the group's cash and cash equivalents totalled 0.4 million euros as of 30 September 2016 (on 31 December 2015: 0.7 million euros). In 9 months 2016, interest payments on interest-bearing liabilities totalled 0.6 million euros (in 9 months 2015: 0.6 million euros). The group's weighted average loan interest rate was 6.1% as of 30 September 2016. This is an increase by 1.1 percentage points compared to the end of year 2015. The reason for the increase is new borrowings raised in 2016, which bear above-average interest rate.

Currency risk

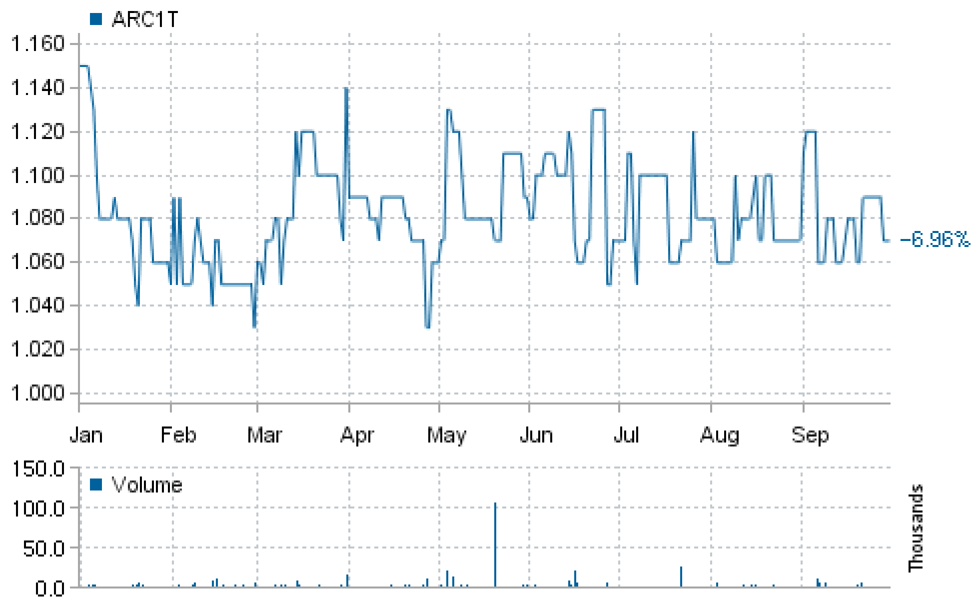
Purchase and sales contracts of provided services are mostly signed in local currencies: euros (EUR) or Bulgarian lev (BGN). Real estate sales are mostly nominated in euros, as a result of which the group's assets and liabilities structure does not denote a significant currency risk. The group is not protected against currency devaluations. liquid assets are mostly held on demand or short-term deposits denominated in euros.

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 Tallinn stock exchange. The share price closed at 1.07 euros on 30 September 2016. The price has decreased by 7% within 9 months 2016 (closing price at the end of 2015 was 1.15 euros). During the period, the highest traded price per share was 1.15 euros and lowest price 1.01 euros. As of 30 September 2016, market capitalization of shares amounted to 6,545 thousand euros, P/E ratio of the share was 104 and P/B ratio 0.66 (at 31 December 2015: 7,035 thousand euros, 15.8 and 0.73, respectively).

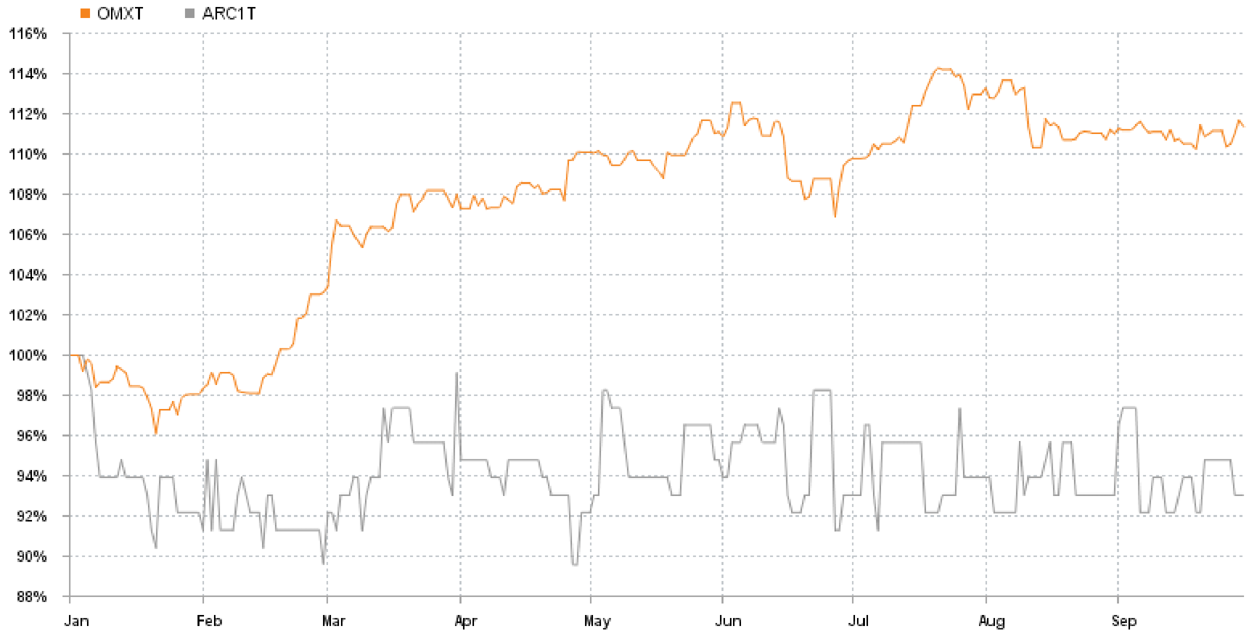
The following charts reflect movements in the price and daily turnover of Arco Vara's share in the last three years: for the period from 30 September 2013 until 30 September 2016.

In 9 months 2016:



In the period from 30 September 2013 until 30 September 2016:

Changes in Arco Vara share (ARC1T) price compared with the benchmark index OMX Tallinn in 9 months 2016 are presented in the graph below:

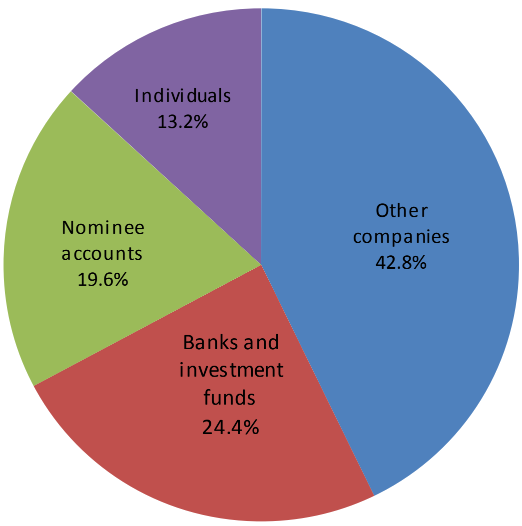


Index/equity	31 Dec 2015	30 Sept 2016	+/-%
OMX Tallinn	898.99	1,001.34	+11.38
ARC1T	1.15 EUR	1.07 EUR	-6.96

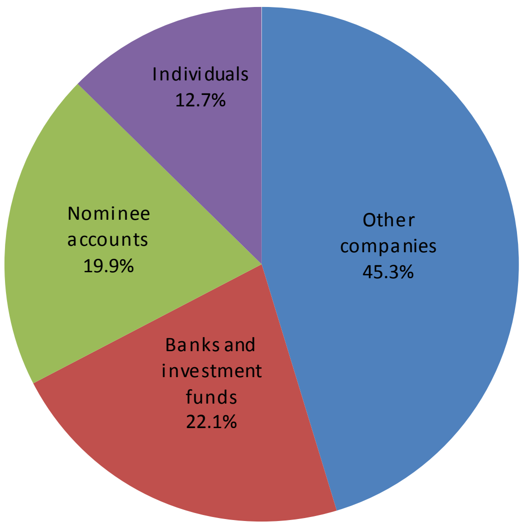
Structure of shareholders

As at 30 September 2016, Arco Vara had 1,519 shareholders (at 31 December 2015: 1,600) including 1,317 individuals as shareholders (at 31 December 2015: 1,381 individuals) who jointly owned 13.2% (at 31 December 2015: 12.7%) interest out of all Arco Vara shares. Structure of total interest by shareholder's category as at 30 September 2016 and at 31 December 2015 are presented on following diagrams:

Ownership structure as at 30 September 2016



Ownership structure as at 31 December 2015



Major shareholders at 30 September 2016	No of shares	Interest %
NORDEA BANK FINLAND PLC client	862,820	14.1%
AS Lõhmus Holdings	602,378	9.8%
Gamma Holding Investment OÜ	553,975	9.1%
Alarmo Kapital OÜ	500,188	8.2%
LHV PENSIONIFOND L	389,765	6.4%
FIREBIRD REPUBLICS FUND LTD	356,428	5.8%
HM Investeeringud OÜ	330,505	5.4%
FIREBIRD AVRORA FUND, LTD.	185,800	3.0%
LHV PENSIONIFOND XL	173,583	2.8%
AS LHV Pank	158,526	2.6%
Other shareholders	2,003,044	32.7%
Total	**6,117,012**	**100.0%**

Holdings of members of the management and supervisory boards (and related persons) on 30 September 2016	Position	No of shares	Interest %
Rain Lõhmus (AS Lõhmus Holdings)	member of supervisory board	602,378	9.8%
Tarmo Sild ja Allar Niinepuu (Alarmo Kapital OÜ)	member of management board/ member of supervisory board	500,188	8.2%
Hillar-Peeter Luitsalu (HM Investeeringud OÜ, related persons)	chairman of supervisory board	369,259	6.0%
Kert Keskpaik (privately and through K Vara OÜ)	member of supervisory board	202,171	3.3%
Steven Yaroslav Gorelik [1]	member of supervisory board	0	0.0%
Total		**1,673,996**	**27.4%**

[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).

CEO’s confirmation on director’s report

The CEO / member of the management board confirms that the director’s report of Arco Vara AS for the third quarter and nine months ended 30 September 2016 provides a true and fair view of business developments, financial performance and financial position of the group as well as a description of the main risks and uncertainties.

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

On 3 November 2016

Condensed consolidated interim financial statements

Consolidated statement of comprehensive income

	Note	**9 months 2016**	9 months 2015	**Q3 2016**	Q3 2015
In thousands of euros					
Continuing operations					
Revenue from sale of own real estate		6,043	5,713	461	1,097
Revenue from rendering of services		2,395	2,842	826	1,001
Total revenue	2, 3	**8,438**	**8,555**	**1,287**	**2,098**
Cost of sales	4	-5,554	-5,433	-862	-1,264
Gross profit		**2,884**	**3,122**	**425**	**834**
Other income		35	70	7	47
Marketing and distribution expenses	5	-418	-359	-138	-125
Administrative expenses	6	-1,519	-1,373	-498	-428
Other expenses		-29	-32	-11	-6
Gain on sale of subsidiary		1	0	0	0
Operating profit/loss		**954**	**1,428**	**-215**	**322**
Finance income and costs	7	-459	-538	-163	-150
Net profit/loss from continuing operations		**495**	**890**	**-378**	**172**
Discontinued operations					
Profit/loss from discontinued operations		0	-13	0	0
Net profit/loss for the period		**495**	**877**	**-378**	**172**
attributable to owners of the parent		*500*	*892*	*-378*	*173*
attributable to non-controlling interests		*-5*	*-15*	*0*	*-1*
Total comprehensive income/expense for the period		**495**	**877**	**-378**	**172**
attributable to owners of the parent		*500*	*892*	*-378*	*173*
attributable to non-controlling interests		*-5*	*-15*	*0*	*-1*
Earnings per share (in euros)	8				
- basic		**0.08**	0.15	**-0.06**	0.03
- diluted		**0.07**	0.14	**-0.05**	0.03

Consolidated statement of financial position

	Note	30 September 2016	31 December 2015
In thousands of euros			
Cash and cash equivalents		414	745
Receivables and prepayments	9	616	679
Inventories	10	15,525	12,818
Total current assets		**16,555**	**14,242**
Receivables and prepayments	9	11	0
Investment property	11	9,360	9,513
Property, plant and equipment		466	489
Intangible assets		248	229
Total non-current assets		**10,085**	**10,231**
TOTAL ASSETS		**26,640**	**24,473**
Loans and borrowings	12	1,164	2,345
Payables and deferred income	13	3,903	1,935
Provisions		81	146
Total current liabilities		**5,148**	**4,426**
Loans and borrowings	12	11,505	10,417
Total non-current liabilities		**11,505**	**10,417**
TOTAL LIABILITIES		**16,653**	**14,843**
Share capital		4,282	4,282
Share premium		292	292
Statutory capital reserve		2,011	2,011
Other reserves	8	298	298
Retained earnings		3,095	2,656
Total equity attributable to owners of the parent		**9,978**	**9,539**
Equity attributable to non-controlling interests		9	91
TOTAL EQUITY		**9,987**	**9,630**
TOTAL LIABILITIES AND EQUITY		**26,640**	**24,473**

Consolidated statement of cash flows

	Note	**9 months 2016**	9 months 2015	**Q3 2016**	Q3 2015
In thousands of euros					
Cash receipts from customers		12,282	10,945	2,647	2,250
Cash paid to suppliers		-7,133	-4,766	-2,948	-1,808
Other taxes paid and recovered (net)		-1,627	-2,305	-478	-270
Cash paid to employees		-894	-766	-258	-227
Other cash payments and receipts related to operating activities (net)		-73	24	-11	-9
NET CASH FROM/USED IN OPERATING ACTIVITIES		**2,555**	**3,132**	**-1,048**	**-64**
Payments made on purchase of tangible and intangible assets		-81	-137	-7	-38
Proceeds from sale of a subsidiary		1	0	0	0
Payments made on purchase of a subsidiary		-1,890	0	-1,050	0
Interest received		0	4	0	1
Other payments related to investing activities		-3	0	0	0
NET CASH USED IN INVESTING ACTIVITIES		**-1,973**	**-133**	**-1,057**	**-37**
Proceeds from loans received	12	3,285	1,385	2,214	515
Settlement of loans and borrowings	12	-3,378	-4,109	-380	-144
Interest paid		-621	-588	-230	-113
Dividends paid		-61	-61	0	0
Other payments related to financing activities		-138	-82	-10	0
NET CASH FROM/USED IN FINANCING ACTIVITIES		**-913**	**-3,455**	**1,594**	**258**
NET CASH FLOW		**-331**	**-456**	**-511**	**157**
Cash and cash equivalents at beginning of period		745	1,691	925	1,078
Increase in cash and cash equivalents		**-331**	**-456**	**-511**	**157**
Cash and cash equivalents at end of period		414	1,235	414	1,235

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 2014	**4,282**	**292**	**2,011**	**179**	**2,250**	**9,014**	**36**	**9,050**
Profit distribution	0	0	0	0	-61	-61	0	**-61**
Change in non-controlling interest	0	0	0	0	0	0	77	**77**
Total comprehensive income for the period	0	0	0	0	892	892	-15	**877**
Balance as at 30 September 2015	**4,282**	**292**	**2,011**	**179**	**3,081**	**9,845**	98	**9,943**
Balance as at 31 December 2015	**4,282**	**292**	**2,011**	**298**	**2,656**	**9,539**	**91**	**9,630**
Profit distribution	0	0	0	0	-61	-61	0	**-61**
Change in non-controlling interest	0	0	0	0	0	0	-77	**-77**
Total comprehensive income for the period	0	0	0	0	500	500	-5	**495**
Balance as at 30 September 2016	**4,282**	**292**	**2,011**	**298**	**3,095**	**9,978**	**9**	**9,987**

Notes to the condensed consolidated interim financial statements

1. Significant accounting policies

The unaudited condensed consolidated interim financial statements of Arco Vara AS for the third quarter and 9 months ended on 30 September 2016 have been prepared in accordance with IAS 34 *Interim Financial Reporting*. The condensed consolidated interim financial statements should be read in conjunction with the audited consolidated annual financial statements for the year ended 31 December 2015, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

All amounts in the financial statements are presented in thousands of euros unless indicated otherwise.

2. Segment information

The group has the following reportable operating segments:

Development - development of residential and commercial real estate environments;

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

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 providing real estate brokerage services to the Development segment. Unallocated items include primarily income, expenses, assets and liabilities of the group's parent company.

Revenue and operating profit by operating segment

Segment	**Development**		**Service**		**Unallocated**		**Eliminations**		**Consolidated**	
	Q3 2016	**Q3 2015**	**Q3 2016**	**Q3 2015**	**Q3 2016**	**Q3 2015**	**Q3 2016**	**Q3 2015**	**Q3 2016**	**Q3 2015**
in thousands of euros										
External revenue	557	1,353	730	745	0	0			1,287	2,098
Annual change	*-58.8%*		*-2.0%*						*-38.7%*	
Inter-segment revenue	29	21	76	107			-105	-128	0	0
Total revenue	**586**	**1,374**	**806**	**852**	**0**	**0**	**-105**	**-128**	**1,287**	**2,098**
Annual change	*-57.4%*		*-5.4%*							
Operating profit	**33**	**377**	**-44**	**20**	**-165**	**-42**	**-39**	**-33**	**-215**	**322**

Segment	**Development**		**Service**		**Unallocated**		**Eliminations**		**Consolidated**	
	9M 2016	**9M 2015**	**9M 2016**	**9M 2015**	**9M 2016**	**9M 2015**	**9M 2016**	**9M 2015**	**9M 2016**	**9M 2015**
in thousands of euros										
External revenue	6,316	6,479	2,122	2,073	0	3			8,438	8,555
Annual change	*-2.5%*		*2.4%*						*-1.4%*	
Inter-segment revenue	85	65	282	367			-367	-432	0	0
Total revenue	**6,401**	**6,544**	**2,404**	**2,440**	**0**	**3**	**-367**	**-432**	**8,438**	**8,555**
Annual change	*-2.2%*		*-1.5%*							
Operating profit	**1,524**	**1,598**	**-161**	**80**	**-487**	**-410**	**78**	**160**	**954**	**1,428**

Assets and liabilities by operating segment

Segment	**Development**		**Service**		**Unallocated**		**Consolidated**	
	30 Sept 2016	**31 Dec 2015**	**30 Sept 2016**	**31 Dec 2015**	**30 Sept 2016**	**31 Dec 2015**	**30 Sept 2016**	**31 Dec 2015**
in thousands of euros								
Assets	25,604	23,318	564	505	472	650	26,640	24,473
Liabilities	13,903	14,060	412	518	2,338	265	16,653	14,843

3. Revenue

	9 months 2016	9 months 2015	**Q3 2016**	Q3 2015
In thousands of euros				
Sale of own real estate	6,043	5,713	461	1,097
Real estate brokerage and valuation	1,953	1,863	676	654
Rental of real estate	355	813	128	285
Property management services	33	85	12	22
Other revenue	54	81	10	40
Total revenue	**8,438**	**8,555**	**1,287**	**2,098**

4. Cost of sales

	9 months 2016	9 months 2015	**Q3 2016**	Q3 2015
In thousands of euros				
Cost of real estate sold (note 10)	-4,043	-3,994	-367	-770
Personnel expenses	-1,207	-1,109	-395	-394
Property management costs	-190	-212	-61	-55
Vehicle expenses	-18	-16	-6	-6
Depreciation, amortisation and impairment losses	-9	-8	-3	-2
Other costs	-87	-94	-30	-37
Total cost of sales	**-5,554**	**-5,433**	**-862**	**-1,264**

5. Marketing and distribution expenses

	9 months 2016	9 months 2015	**Q3 2016**	Q3 2015
In thousands of euros				
Advertising expenses	-220	-202	-69	-66
Personnel expenses	-94	-91	-31	-31
Market research	-6	-7	-1	-2
Brokerage fees	-5	0	-2	0
Other marketing and distribution expenses	-93	-59	-35	-26
Total marketing and distribution expenses	**-418**	**-359**	**-138**	**-125**

6. Administrative expenses

	9 months 2016	9 months 2015	**Q3 2016**	Q3 2015
In thousands of euros				
Personnel expenses	-779	-709	-232	-227
Office expenses	-292	-332	-103	-94
Services purchased	-177	-116	-68	-33
IT expenses	-117	-105	-37	-30
Depreciation, amortisation and impairment losses	-70	-30	-24	-10
Vehicle expenses	-25	-24	-9	-9
Legal service fees	-26	-32	-11	-14
Other expenses	-33	-25	-14	-11
Total administrative expenses	**-1,519**	**-1,373**	**-498**	**-428**

7. Financial income and costs

In thousands of euros	**9 months 2016**	9 months 2015	**Q3 2016**	Q3 2015
Interest expenses	-400	-475	-114	-148
Interest income	0	3	0	1
Other financial income and costs	-59	-66	-49	-3
Total financial income and costs	**-459**	**-538**	**-163**	**-150**

8. Earnings per share

Basic earnings per share are calculated by dividing profit or loss for the period 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 potentially issued shares.

	9 months 2016	9 months 2015	**Q3 2016**	Q3 2015
Weighted average number of ordinary shares outstanding during the period	6,117,012	6,117,012	6,117,012	6,117,012
Number of ordinary shares potentially to be issued	780,000	390,000	780,000	390,000
Net profit/loss attributable to owners of the parent (in thousands of euros)	500	892	-378	173
Earnings per share (in euros)	**0.08**	0.15	**-0.06**	0.03
Diluted earnings per share (in euros)	**0.07**	0.14	**-0.05**	0.03

According to the decision of the annual general 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 gives to the CEO of the group's parent company the right to subscribe up to 390 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2016. An equity reserve in the amount of 298 thousand euros has been formed for the option associated with the bond. See also note 14.

According to the decision of the annual general meeting of Arco Vara AS, held on 10 May 2016, another convertible bond was issued with the nominal value of 1,000 euros. The new convertible bond will give to the CEO of the group's parent company the right to subscribe additionally up to 390 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2019. See also note 14.

9. Receivables and prepayments

Short-term receivables and prepayments

In thousands of euros	**30 September 2016**	31 December 2015
Trade receivables		
Receivables from customers	180	235
Allowance for doubtful trade receivables	-12	-12
Total trade receivables	**168**	**223**
Other receivables		
Loans provided	6	6
Miscellaneous receivables	36	119
Total other receivables	**42**	**125**
Accrued income		
Prepaid and recoverable taxes	241	75
Other accrued income	9	3
Total accrued income	**250**	**78**
Prepayments	**156**	**253**
Total short-term receivables and prepayments	**616**	**679**

10. Inventories

In thousands of euros	**30 September 2016**	31 December 2015
Properties purchased and being developed for resale	15,498	12,580
Materials and finished goods	12	12
Prepayments for inventories	15	226
Total inventories	**15,525**	**12,818**

Properties purchased and being developed for resale

In thousands of euros	**2016**	2015
Balance at the beginning of period, 1 January	**12,580**	**11,942**
Properties purchased for development	2,102	70
Construction costs of apartment buildings	3,984	1,540
Capitalized borrowing costs	360	90
Other capitalized costs	84	320
Reclassification from investment property (note 11)	431	81
Cost of sold properties (note 4)	-4,043	-3,994
Balance at the end of period, 30 September	**15,498**	**10,049**

11. Investment property

In thousands of euros	**2016**	2015
Balance at the beginning of period, 1 January	**9,513**	**11,585**
Capitalised development costs	278	43
Reclassification to inventories (note 10)	-431	-81
Balance at the end of period, 30 September	**9,360**	**11,547**

12. Loans and borrowings

	As at 30 September 2016			As at 31 December 2015		
In thousands of euros	**Total**	of which current portion	of which non-current portion	**Total**	of which current portion	of which non-current portion
Bank loans	10,433	53	10,380	12,585	2,179	10,406
Bonds	1,122	1	1,121	151	150	1
Finance lease liabilities	14	10	4	26	16	10
Other loans	1,100	1,100	0	0	0	0
Total	**12,669**	**1,164**	**11,505**	**12,762**	**2,345**	**10,417**

In 9 months 2016, the group settled loans and borrowings in the amount of 3,378 thousand euros (in 9 months 2015: 4,109 thousand euros) through cash transactions and raised new loans in the amount of 3,285 thousand euros (in 9 months 2015: 1,385 thousand euros).

In 9 months 2016, the following major loan obligations were settled:

- In January and February, the group repaid the remaining 1,536 thousand euros of bank loan used for financing the construction of Manastirski Livadi project III stage.

- In March, the group repaid final 500 thousand euros of bank loan, which was raised for the acquisition of Kodulahe project land plot in 2013.

- 1,190 thousand euros of Madrid Blvd project’s bank loan principal was repaid to Piraeus bank in Bulgaria.

- In January, the group redeemed bonds (issued in March 2014) in the amount of 150 thousand euros, out of which 50 thousand euros was settled in cash. 100 thousand euros out of total bond issue was converted to new bonds. New bonds were issued at the beginning of January with the total volume of 1 120 thousand euros. The bonds' redemption date is on 6 January 2018 and annual interest rate is 12%. The new bonds are not secured. See also note 14.

In Q3 2016, the group raised new loans in the total amount of 2,214 thousand euros, out of which:

- 1,164 thousand euros is bank loan for financing construction of first stage apartment building in Kodulahe project. The loan was activated in August 2016.

- 1,050 thousand euros is short-term bridge loan raised for final payment of purchase price on acquisition of the group's Bulgarian subsidiary Iztok Parkside EOOD. By the publication date of interim report, the loan has been repaid.

13. Payables and deferred income

Short-term payables and deferred income

	30 September 2016	31 December 2015
In thousands of euros		
Trade payables	**796**	**296**
Miscellaneous payables	**15**	**172**
Taxes payable		
Value added tax	66	47
Corporate income tax	3	114
Social security tax	41	40
Personal income tax	28	31
Other taxes	273	336
Total taxes payable	**411**	**568**
Accrued expenses		
Payables to employees	118	174
Interest payable	28	8
Other accrued expenses	1	11
Total accrued expenses	**147**	**193**
Deferred income		
Prepayments received on sale of real estate	2,531	704
Other deferred income	3	2
Total deferred income	**2,534**	**706**
Total short-term payables and deferred income	**3,903**	**1,935**

14. Related party disclosures

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

1) companies under the control of the chief executive and the members of the supervisory board of Arco Vara AS that have a significant interest in the group's parent company;
2) other related parties – the CEO and the members of the supervisory board of Arco Vara AS and companies under their control (excluding companies that have a significant interest in the group's parent company).

Transactions with related parties	**9 months 2016**	9 months 2015
In thousands of euros		
Companies that have a significant interest in the group's parent company		
Services purchased	27	25
Bonds issued	100	0
Redemption of bonds	150	500
Paid interest	9	89
Other related parties		
Services sold	1	2
Prepayments received	6	0
Bonds issued	1	0
Redemption of bonds	0	250
Paid interest	0	39

Balances with related parties	**30 September 2016**	31 December 2015
In thousands of euros		
Companies that have a significant interest in the group's parent company		
Bonds issued	100	150
Other related parties		
Deferred income	6	0
Bonds issued	2	11

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 was 9.8%. In June 2015, it was agreed with bondholders to postpone the redemption by six months. In January 2016, the bonds were redeemed, including bonds in amount of 100 thousand euros which were converted into the new bond issue conducted in December 2015 and January 2016. See also note 12.

In 9 months 2016, the remuneration provided to the group's key management personnel, i.e. the CEO / member of the management board and the members of the supervisory board of the group's parent company, including social security charges, amounted to 82 thousand euros (in 9 months 2015: 83 thousand euros). The remuneration provided to the CEO / member of the management board is based on his service contract. The termination benefits agreed with Tarmo Sild, who was appointed the CEO / member of the management board of Arco Vara AS in October 2012, amount to up to five months' base remuneration. The mandate of the CEO was extended 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 was slightly amended in February 2015. According to the resolutions of the general meeting of Arco Vara AS, the members of the supervisory board will receive 500 euros (net amount) for every meeting where they have participated, but not more than 1,000 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. 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 has not been granted or received any other remuneration or benefits (bonuses, termination benefits, etc) in the reporting period.

A convertible bond has been issued to the CEO / member of management board, which gives him the right to subscribe for up to 390,000 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 the amount of 298 thousand euros and has been recognized as payroll expense distributed over the period from July 2013 until December 2015. By the end of 2015, equity reserve was formed for the whole value of the option. See also note 8.

According to the decision of the annual general shareholders' meeting of Arco Vara AS, held on 10 May 2016, new convertible bond was issued with the nominal value of 1,000 euros. The new convertible bond will give to the CEO of the group's parent company the right to subscribe for additional 390 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2019. See also note 8.

15. Events after the reporting date

On 31 October 2016, the group's subsidiary Arco Real Estate AS sold its 70.6% share in Arco Real Estate SIA to the other shareholder and chairman of the management board of Arco Real Estate SIA. In the last five years (2011-2015), Arco Real Estate SIA generated on average 5% of the group's revenue (in 9 months 2016: 8%) and had no significant impact on the financial performance of the group. The group will retain brand name 'Arco Real Estate' in Latvia.

Statement by the CEO / member of the management board

The CEO / member of the management board of Arco Vara AS has prepared Arco Vara AS's condensed consolidated interim financial statements for the third quarter and nine months ended 30 September 2016.

The condensed consolidated interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* and they give a true and fair view of the financial position, financial performance and cash flows of Arco Vara AS. Arco Vara AS is a going concern.

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

On 3 November 2016