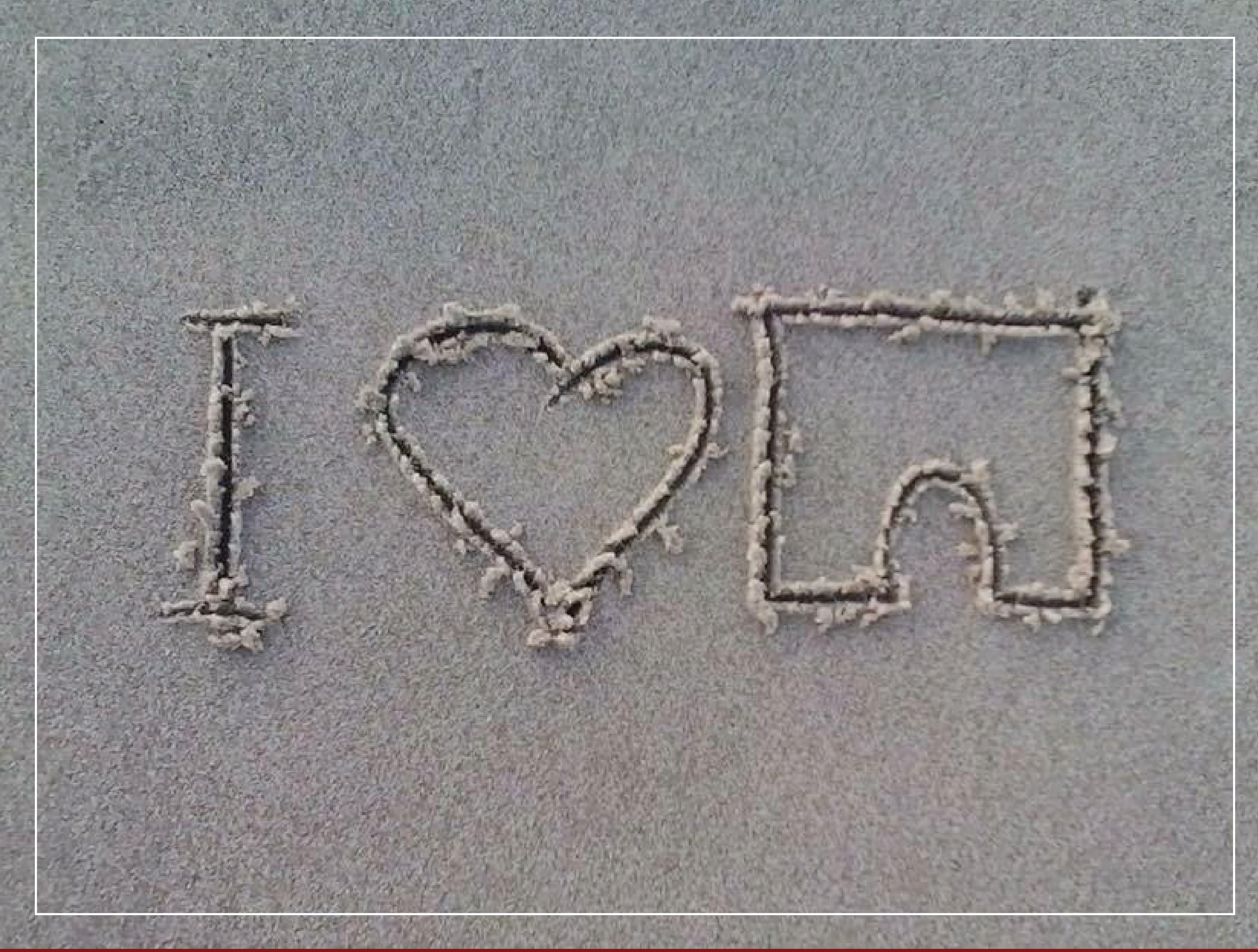

Arco Vara AS

CONSOLIDATED ANNUAL REPORT 2016

ARCO VARA

Consolidated annual report

(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year:	1 January 2016
End of financial year:	31 December 2016

Registry number:	10261718
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Regional websites:	www.arcovara.ee www.arcoreal.bg

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

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MANAGEMENT REPORT

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: the Service Division and the 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, and 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 either for supporting of the groups' cash flows or for resale. The group is currently holding completed commercial properties that generate rental income.

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
Consideration – we value our clients as individuals
Responsibility – we keep our promises

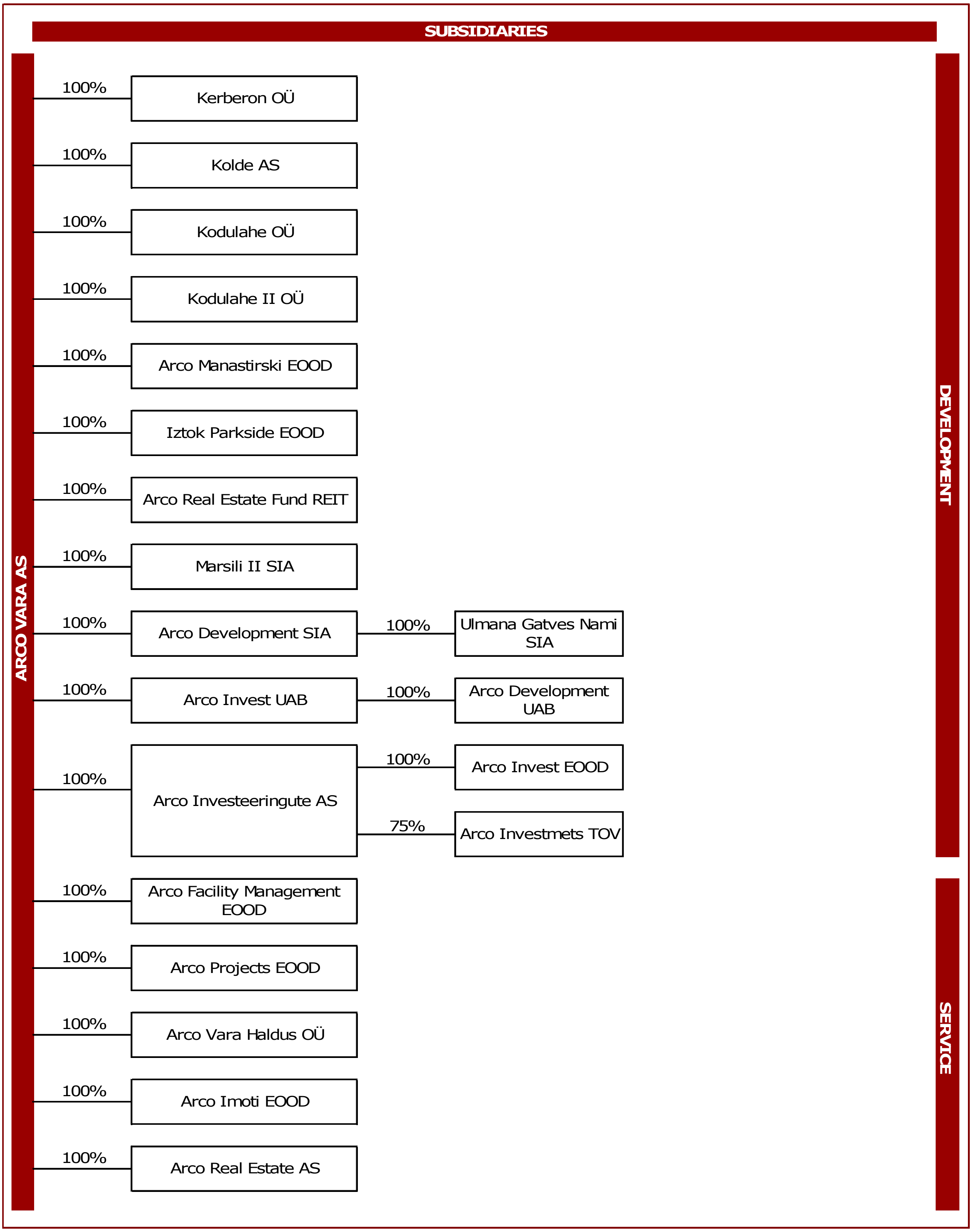
Scope of consolidation

As of 31 December 2016, the group consisted of 21 companies, which is four less than at the end of 2015. On 19 February 2016, the group's subsidiary Fineprojekti OÜ was erased from Estonian Commercial Register, after the liquidation process that had started in 2014. The liquidation also resulted in derecognition of the 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. In May 2016, the group acquired a 100% subsidiary Iztok Parkside EOOD in Bulgaria. On 31 October 2016, the group sold its 70.6% ownership in Arco Real Estate SIA (including its subsidiary Adepto SIA). On 2 November 2016, the group's subsidiary Tivoli Arendus OÜ was erased from Estonian Commercial Register. On 22 December 2016, the group established a new subsidiary Kodulahe II OÜ. None of these transactions had significant impact on the group's net assets. Non-controlling interest disappeared from the group's statement of financial position as a result of the sale of Arco Real Estate SIA.

Significant subsidiaries

Company name	Location	Segment	Share capital (nominal value)	Equity as of 31 Dec 2016	The group's interest
In thousands of euros					
Arco Invest EOOD	Bulgaria	Development	26,826	-1,170	100%
Iztok Parkside EOOD	Bulgaria	Development	1,433	1,177	100%
Arco Real Estate Fund REIT	Bulgaria	Development	332	306	100%
Kodulahe OÜ	Estonia	Development	3	-330	100%
Kerberon OÜ	Estonia	Development	5	1,332	100%
Marsili II SIA	Latvia	Development	1,524	743	100%
Arco Real Estate AS	Estonia	Service	42	-1,095	100%
Arco Imoti EOOD	Bulgaria	Service	444	171	100%

Group structure as of 31 December 2016



Key performance indicators

- In 2016, the group's revenue was 9.7 million euros, decreasing by 8.5% from 2015. The revenue of the Development Division decreased by 11.3%, down to 7.0 million euros in 2016. The revenue of the Service Division was 3.2 million euros, decreasing by 0.7% from 2015.
- In 2016, the group's operating loss (=EBIT) was 0.1 million euros and net loss 0.8 million euros. In 2015, the group earned operating profit of 1.3 million euros and net profit of 0.5 million euros. The group's financial performance for 2016 was affected by the loss from devaluation of assets in the amount of 0.6 million euros. The Development Division earned operating profit of 0.6 million euros in 2016 (1.8 million euros in 2015). Operating loss of the Service Division was 0.2 million euros in 2016 (0.1 million euros in 2015).
- As of 31 December 2016, the group's debt burden had increased by 1.5 million euros compared to the year-end of 2015. Net loans had increased by 1.4 million euros over 2016, up to the level of 13.4 million euros as of 31 December 2016. As of 31 December 2016, the weighted average annual interest rate of interest-bearing liabilities was 5.3%. This is an increase of 0.3 percentage points compared to 31 December 2015.
- In 2016, 77 apartments, 9 commercial spaces and 8 land plots were sold (in 2015: 90 apartments, 6 commercial spaces and 4 land plots).

Continuing operations

	2016	2015
In millions of euros		
Revenue		
Development	7.0	7.9
Service	3.2	3.3
Eliminations	-0.5	-0.5
Total revenue	**9.7**	**10.7**
Operating profit (EBIT)		
Development	0.6	1.8
Service	-0.1	-0.1
Unallocated income and expenses	-0.6	0.1
Eliminations	0.0	-0.5
Total operating profit (EBIT)	**-0.1**	**1.3**
Finance income and expense	-0.6	-0.7
Income tax	-0.1	-0.1
Net profit	**-0.8**	**0.5**

Main ratios

	2016	2015
Earnings per share, EPS (in euros)	-0.13	0.08
Diluted earnings per share (in euros)	-0.13	0.07
ROIC (rolling, four quarters)	-3.7%	2.0%
ROE (rolling, four quarters)	-8.4%	4.6%
ROA (rolling, four quarters)	-3.2%	1.8%

As of 31 December	2016	2015
In millions of euros		
Total assets	27.7	24.5
Invested capital	23.2	22.4
Net loans	13.4	12.0
Equity	9.0	9.6
Current ratio	1.15	3.22
Quick ratio	0.09	0.32
Financial leverage	3.09	2.54
Average loan term (in years)	1.2	1.7
Average annual interest rate of loans	5.3%	5.0%
Number of staff, end of period	110	178

Cash flows

	2016	2015
In millions of euros		
Cash flows from operating activities	1.7	2.5
Cash flows used in investing activities	-2.4	-0.3
Cash flows from/used in financing activities	0.8	-3.2
Net cash flows	**0.1**	**-1.0**
Cash and cash equivalents at the beginning of period	0.7	1.7
Cash and cash equivalents at the end of period	0.8	0.7

Revenue and net profit/loss from continuing operations

	Q1 2014	Q2 2014	Q3 2014	Q4 2014	**Total 2014**	Q1 2015	Q2 2015	Q3 2015	Q4 2015	**Total 2015**	Q1 2016	Q2 2016	Q3 2016	Q4 2016	**Total 2016**
In millions of euros															
Revenue	1.1	1.1	1.2	5.8	**9.2**	4.4	2.1	2.1	2.1	**10.7**	5.1	2.1	1.2	1.3	**9.7**
Net profit/loss	0.4	-0.3	0.4	0.6	**1.1**	0.7	0.0	0.2	-0.4	**0.5**	1.1	-0.2	-0.4	-1.3	**-0.8**

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) = net profit of last four quarters / average invested capital
Return on equity (ROE) = net profit of last four quarters / average equity
Return on assets (ROA) = net profit of last four quarters / average total assets
Current ratio = current assets / current liabilities
Quick ratio = (current assets - inventory) / current liabilities
Financial leverage = total assets / equity
Number of staff = number of people working for the group under employment or authorization (service) contracts

Group CEO's overview

For Arco Vara Group, 2016 became a year of internal growth which will be reflected in the performance results for 2017 and subsequent years.

The most crucial aspects of internal growth are driven by our people and by development of ideas which bring benefits to Arco Vara's clients. Compared to 2012-2013, the group's assets no longer need to be saved or restructured. We must keep the momentum, but we cannot do that without a good road map.

Our aim is to be a real estate company centred on people. This means that we value everyone who turns to us or whom we encounter. We want to know who these individuals are and where they come from. Knowing a person's story helps us to understand if and how Arco Vara can be useful to him and vice versa. We cannot reach out to all, but many will surely benefit from our expertise in the real estate sector. This being said, we should also change the ways in which people perceive real estate and make use of available solutions and services.

Here, we are talking not only about clients to whom Arco Vara is a service provider, seller or lessor, but also about our partners – real estate brokers and appraisers – who operate under the Arco Vara brand. The latter are given the opportunity to fulfil their potential relying on the support services offered by the group: marketing, IT, data bank, training, various partner relationships and, most notably, the renowned and trusted brand.

We have had a long and arduous journey developing and implementing our ideas, but it is not over yet. In fact, we are just getting started, and the first results can already be seen. Our clientèle in Estonia alone is 50,000 strong; relationships with clients are becoming more substantive; people keep coming back for more; information provided by Arco Vara is in high demand. The logical outcome of it all is a larger number of transactions. Our growing team unites professionals who share the same values.

As the developer of the Kodulahe Quater and Iztok Parkside, we can see that people value a healthy living environment. Given a limited amount of free capital, we focus on those clients who have already tried different things in life and are buying their second, third, etc. home from us (either for themselves or for their parents). They attach great importance to the convenience of the location, low time input, picturesque views from the window, the quality of the building and pastimes that can be enjoyed in the vicinity. To sum up, they prefer the outskirts to the city centre. The preliminary sales figures for both development projects show that our target group is strong and does not solely depend on the ability or desire of banks to finance their acquisitions.

The above describes inner quality that is the foundation for everything else. There is still much to be done in this respect too.

The situation on the markets has been quite favourable for us. The number and volume of transactions in Bulgaria has grown, which is matched by the dynamics in Estonia. We have been less successful in Latvia, so we chose to sell our majority holding in the Latvian unit to the local management and entered into a licence agreement with them in the first quarter of 2017.

Looking back at the previous year, the following timeline can be drawn.

In January, we completed the reconstruction of the office premises in Madrid Blvd and started looking for new tenants. In February, we began the first stage of the construction of the Kodulahe Quarter in Tallinn. In March, we found the first major tenant for Madrid Blvd. In April, we sold the last Manastirski apartments in Sofia and acquired a plot for the Iztok Parkside development. There were some delays with obtaining a detailed plan over the summer. The detailed plan came into effect in October when we entered into an agreement for financing the construction works in 2017. In August, we laid the symbolic cornerstone of the Kodulahe development and exceeded the 40% threshold in presales. In October, we landed the second commercial lease contract for office premises in Madrid Blvd. In December, we acquired a plot for constructing about 40 apartments in Oa Street in Tartu and sold the last business premises in Manastirski. Throughout the year we were selling the last apartments in Madrid Blvd building and Baltezers plots for detached houses in Latvia. We have not been successful in one important undertaking: renting out the office premises in the Madrid Blvd building. This resulted in lost profits and devaluation of investment property in the amount of 0.8 million euros.. The year was thus over, and the stock had been sold out. The results are unsatisfactory in monetary terms, but they have laid the groundwork for the future.

The aim for 2017 is to help at least 15,000 clients by acting as an intermediary or evaluating their properties in Estonia and Bulgaria. Real estate brokerage and appraisal services are offered in Latvia under a franchise. We are aiming to sell our own development products to at least 120 clients in Estonia. We intend to begin the construction of Iztok Parkside and commence the second stage in the construction of Kodulahe. We are also looking to acquire new building rights and plots. Financially, we expect that our income will amount to 18 million and our net profit will be 1.8 million euros in 2017.

Service Division

Revenue of the Service Division amounted to 3,231 thousand euros in 2016 (2015: 3,254 thousand euros), which included intra-group revenue of 418 thousand euros (2015: 467 thousand euros). In 2016, revenue of the Service Division from main services (real estate brokerage and valuation services) decreased by 3% compared to 2015. The main reason is the fact that the revenue from Latvian agency was included in the group revenue only for the first 10 months of 2016. Latvian agency was sold out from the group on 31 October 2016. In 10 months of 2016, revenue of Latvian agency was 771 thousand euros (including 7 thousand euros of intra-group revenue) and net loss amounted to 11 thousand euros. With the sale of Latvian agency, the number of employees working for the group decreased by 70 people. The revenue from main services increased in Estonian 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 - 97 thousand euros less in year 2016 compared to year 2015.

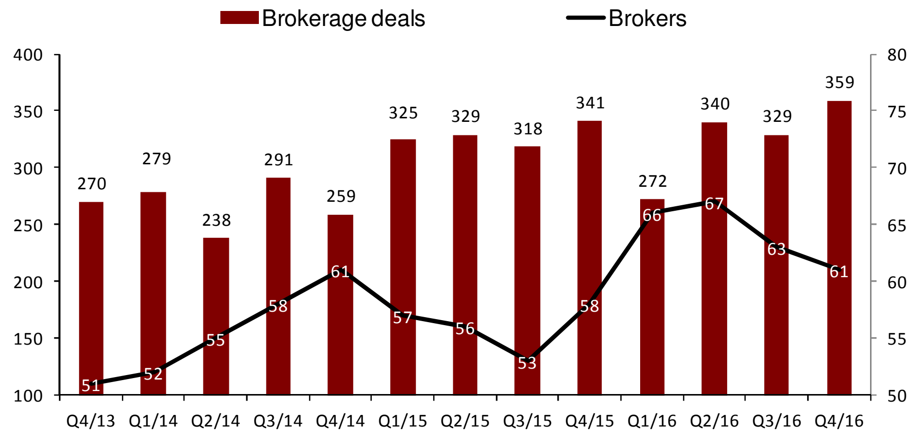
Revenue of real estate agencies from brokerage and valuation

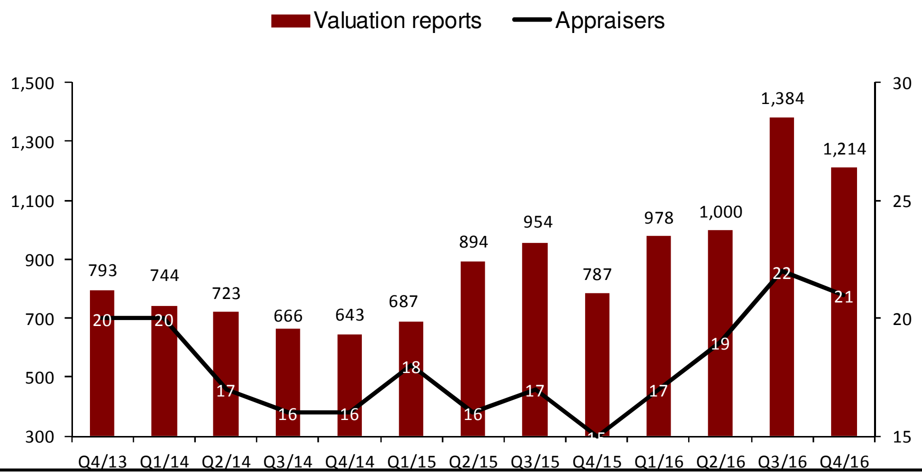
In thousands of euros	**2016**	2015	Change, %
Estonia	1,422	1,282	11%
Latvia	771	898	-14%
Bulgaria	639	746	-14%
Total	**2,832**	**2,926**	**-3%**

In 2016, all 3 brokerage agencies operated at a loss: Estonian agency had net loss of 188 thousand euros, Bulgarian agency 19 thousand euros and Latvian agency 11 thousand euros (Latvian agency in 10 months). In 2015, Estonian and Latvian agencies had net loss of 209 thousand euros and 73 thousand euros, respectively. Bulgarian agency had net profit of 109 thousand euros in 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 118 thousand euros in 2016, 100 thousand euros of which was intra-group revenue (in 2015: 141 thousand and 105 thousand euros, respectively). Revenue from accommodation services amounted to 144 thousand euros in 2016 (in 2015: 132 thousand euros).

The numbers of brokerage deals and valuation reports of the Service Division, together with the number of staff are shown in the following graphs. For better comparability, only Bulgarian and Estonian figures are shown.





At of 31 December 2016, the number of staff in the Service Division was 97 (on 31.12.2015: 165). The number decreased in 2016 due to the sale of the Latvian agency in October.

Development Division

In 2016, revenue of the Development Division amounted to 7,048 thousand euros, which is 899 thousand euros or 11.3% less compared to 2015. In 2016, the revenue from the sale of properties in the group's own development projects reached 6,562 thousand euros (in 2015: 7,019 thousand euros).

Most of the other revenue of the Development Division consists of rental income from commercial and office premises in Madrid Blvd building in Sofia, amounting to 369 thousand euros in 2016 (838 thousand euros in 2015). Rental income has decreased compared to the 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 smaller 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 with the aim of renting out all rental areas by no later than in Q2 2017.

In 2016, operating profit of the Development Division was 611 thousand euros (in 2015: 1,790 thousand euros). This included a loss in the amount of 708 thousand euros from the decrease in value of inventories and investment property.

In February 2016, the construction and presale of apartments of the first stage apartment building (with 125 apartments and 5 commercial spaces) in the group's biggest development project Kodulahe in Tallinn had started. By the publishing date of the annual report, presale agreements for 85 apartments and one commercial space have been concluded. The construction of the apartment building should be finished by summer 2017.

In 2016, the group completed a land exchange agreement in Tartu, where a joint ownership in a commercial property on Turu street 34a was exchanged for land plots on Oa street 37, 39, 41 with building right for smaller apartment buildings with GSA above grade of up to 2,300 m2 (ca 40 apartments). Design works have started and the project is scheduled for completion by the end of 2018.

As of 31 December 2016, 5 apartments remained unsold in Madrid Blvd complex in Sofia, one of which was presold. In 2016, 9 apartments were sold in this project (5 apartments in 2015). 15 apartments in the same building are furnished and are being rented out as accommodation service. Unsold 103 parking places are also being rented out.

In 2016, the sale of apartments and commercial spaces in Manastirski Livadi project in Sofia was concluded. In 2016, 76 apartments and commercial spaces were sold in last two stages of the project (in 2015: 85 apartments and commercial spaces). The whole residential project developed in 3 stages has near 300 apartments and commercial spaces in total.

In May 2016, the group finalized the purchase of a company Iztok Parkside EOOD. As a result, the group's development portfolio has gained a new development project in Iztok district in Sofia. In September 2016, a bank loan agreement was concluded to fully finance further development costs of the project in the maximum amount of 4.9 million euros. In Q4 2016, detail plan for the project's property was established and construction tender was carried out. Unfortunately, obtaining the construction permit has been delayed due to the complicated bureaucracy in the city of Sofia. By the publishing date of this report, presale agreements for 18 apartments have been concluded, but further presales have been stopped until the situation with the construction permit will be cleared out. Three apartment buildings with 68 apartments (7,070 square meters of apartments' sellable area) will be built in Iztok..

By the end of 2016, an agreement for the sale of the whole Baltezers-3 project in Latvia (68 plots) was reached. The transaction was completed in January 2017. Accounting loss from the transaction in the amount of 200 thousand euros was recognized already in 2016. On 31 December 2016, 10 Marsili residential plots remained unsold in Latvia, but a presale agreement had been concluded for one of those plots. In 2016, four Marsili residential plots were sold (in 2015, only one).

As of 31 December 2016, 5 people were employed in the Development Division, the same number as at the end of 2015.

Summary table of Arco Vara's active projects as of 31 December 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>
Madrid Blvd	Madrid Blvd, Sofia	Lease: Retail/Office	S5/S6	-	7,350	21
Madrid Blvd	Madrid Blvd, Sofia	Apartments	S5/S6	-	2,408	20
Iztok Parkside	Iztok, Sofia	Apartments	S3	2,470	7,070	68
Marsili residential plots	Marsili, near Riga	Residential plots	S5	-	18,047	10
Kodulahe, stage 1	Lahepea 7, Tallinn	Apartments	S4/S5	6,102	8,732	130
Kodulahe, stages 2-5	Lahepea, Soodi, Pagi streets, Tallinn	Apartments	S3	22,396	<13,300>	<200>
Oa street apartments	Oa street, Tartu	Apartments	S3	4,146	<2,300>	<40>
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: Values presented between < > sign represent future target values for projects where 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 sales
S6: Property management and/or lease

People

As of 31 December 2016, 110 people worked for the group (178 as of 31 December 2015). The number of employees has decreased significantly due to the sale of the Latvian brokerage agency Arco Real Estate SIA in October 2016. Employee remuneration expenses in 2016 amounted to 2.8 million euros (in 2015: 2.7 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 111 thousand euros in 2016 (108 thousand euros in 2015).

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 CEO was extended by 3 years (until October 2018) on the supervisory board meeting held in September 2015.

Tarmo Sild graduated from the 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 the following companies outside Arco Vara group: Catsus OÜ, Aia Tänav OÜ and Alarmo Capital OÜ.

The supervisory board

As of 31 December 2016, supervisory board of Arco Vara AS consists of 5 members:

Hillar-Peeter Luitsalu

Mr Luitsalu graduated from the 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,P457 OÜ.

Rain Lõhmus

Mr Lõhmus graduated from Tallinn Technical University with a degree in business administration in 1988. 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 graduated from the Estonian Center of Maritime Education as shipmaster in 1992. After two years' work at Estonian Shipping Company, he established his first company AS Kavass in 1994, which was initially involved in shipping consumables business and thereafter acquired and operated local supermarkets 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) and Teliani Valley (WINE.GG). Mr Gorelik serves as member of Supervisory Board of Arco Vara AS since February 2015.

Kert Keskpaik

Mr Keskpaik graduated from the Tallinn Technical University with a degree in business administration. Mr Keskpaik has was a 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. In 2001, Mr Keskpaik founded 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.

Description of 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 Tallin and Sofia), (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 delayed equity investment, using different project financing options that don't involve equity.

Credit risk

The group considers credit risks to be substantially mitigated. The final sales of real estate development products takes place simultaneously with customer payment, therefore customer debts do not arise. Also, cash and cash equivalents are not held in the same banking group.

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 31 December 2016, the group's interest-bearing liabilities amounted to 15.5 million euros (increased by 2.7 million euros during 2016), out of which 9.4 million euros is due within next 12 months, including bank loan in the amount of 9 million euros in Madrid project in Bulgaria. At the same time, the group's cash and cash equivalents totalled 0.8 million euros as of 31 December 2016 (on 31 December 2015: 0.7 million euros). In 2016, interest payments on interest-bearing liabilities totalled 0.8 million euros (in 2015: 0.8 million euros). The group's weighted average loan interest rate was 5.3% as of 31 December 2016. This is an increase by 0.3 percentage points compared to the end of year 2015. The reason for the increase is new borrowings raised in 2016, which bear an 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 contain 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.

Social responsibility

Main business lines of Arco Vara are real estate development, real estate brokerage and appraisal services. Therefore, our social responsibility has several important dimensions.

First, society uses real estate valuation service mainly for evaluating loan guarantees. Modern economy is largely based on loan relations and loans in turn are largely based on securities. Appraisal given to the value of real estate property as a loan security therefore influences creditor's evaluation of risks and decisions to release capital onto the credit market. Too optimistic valuation policies may support the development of a real estate bubble and irresponsible borrowing. Overly conservative valuation policies may slow down normal market activity and growth. Total value of properties evaluated by the group in Estonia only exceeds 200 million euros annually and the group's practices therefore have a considerable effect on a maintaining a balanced real estate market. Therefore, the group has a policy that appraisals are given only by certified evaluators, who are guided by the minimum requirements set out by professional organisations and additional intra-group rules. History of provided services for each evaluated object will be stored in Arco Vara database. That includes object view, i.e all previously issued appraisals can be found for an object to ensure better consistency of valuations.

Second, real estate brokerage creates added value by sharing true and competent information between people. Added value of brokerage service, when compared the value proposition of a real estate internet portal, lies in the amount, verifiability and validity of information. The role of the broker in gathering and validating information is to represent interest of both his client (who initiates the deal) and the potential counterparty. Both parties should have equal and verified information in all important questions when concluding the transaction. Therefore, the group's policy concerning brokerage services is to take into brokerage only property which has a verified eligibility for transaction. Transaction eligibility, depending on the type of the property, means prior inspection of the property, prior review of legal aspects and background checks of the initiating person (e.g, is he/she the owner?). Arco Vara does not intermediate real estate transactions that have not been verified according to its standards,

Third and most important aspect is that real estate products developed by the group will have an effect on the look and usage options of future cities. Therefore, we always consider, beside business aspects, a 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 an individual building);
- architectural solution as a format that has the most long-term impact on people;
- room planning;
- technological shift, which means that each new development product will be a seedbed for some new technology; we do not make the same things over and over again;
- building quality and optimization of operating costs, which means that our interest is to develop products with long-lasting value of use that will last from generation to generation.

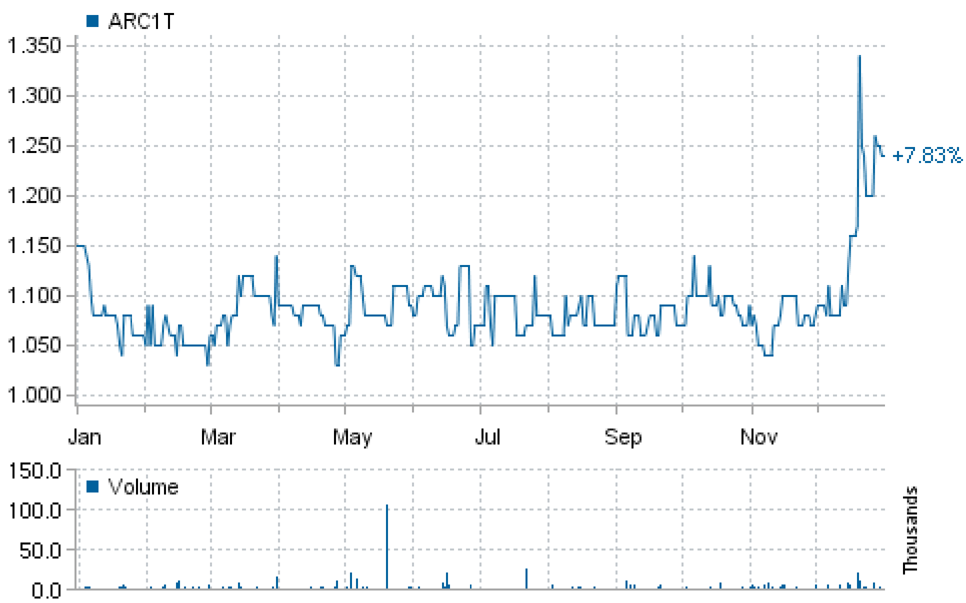
Arco Vara pays special attention to the well-being of its employees and improvement of working conditions – in 2015, we renewed offices and organised joint events. We inspire and encourage our people to volunteer in charity projects and contribute to environmental initiatives. In our everyday work, we follow sustainability principles by using digital options – digital signature, digital archiving and intra-office data processing without physical data carriers.

Shares and shareholders

Arco Vara AS has issued a total of 6,507,012 ordinary shares with nominal value of 0.7 euros per share. In November 2016, the share capital increased by 390 thousand shares, when a convertible bond issued to CEO was executed. The shares are freely traded on NASDAQ Tallinn stock exchange. The share price closed at 1.24 euros on 31 December 2016. The price has increased by 7.8% during 2016 (closing price at the end of 2015 was 1.15 euros). During the period, the highest traded price per share was 1.35 euros and the lowest price 1.00 euros. As of 31 December 2016, market capitalization of shares amounted to 8,069 thousand euros, P/E ratio of the share was negative (-9.2) and P/B ratio was 0.90 (on 31 December 2015: 7,035 thousand euros, 15.8 and 0.73, respectively).

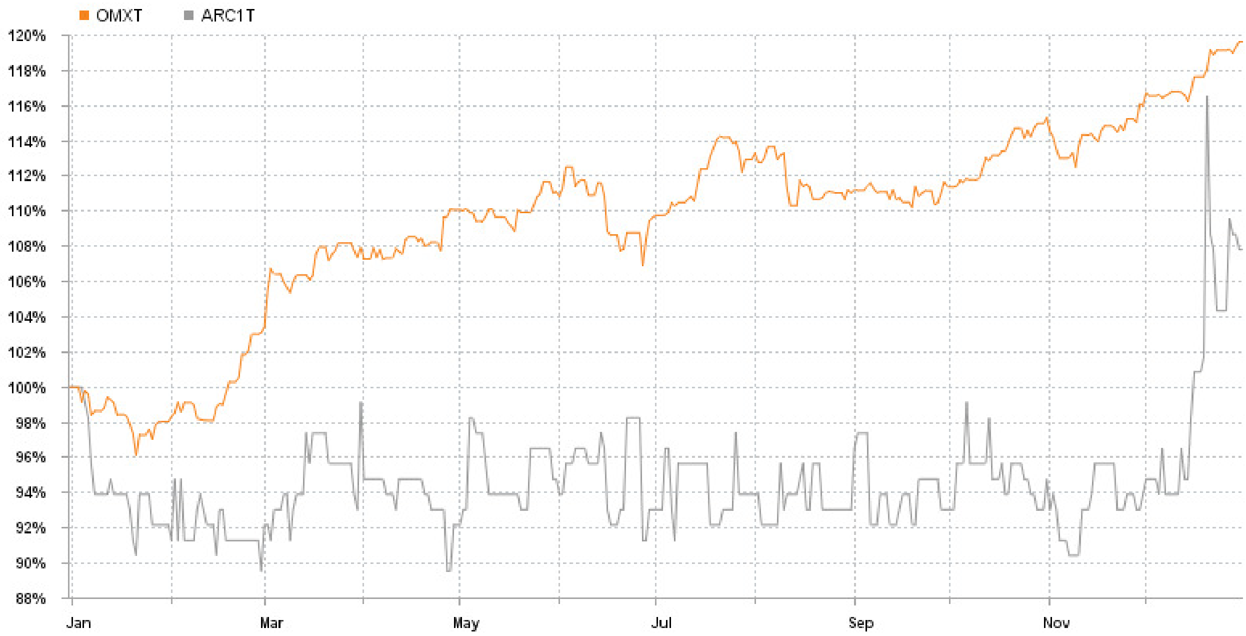
The following charts reflect the movements in the price and daily turnover of Arco Vara's share in the last three years.

In 2016



In the period from 31 December 2013 to 31 December 2016

Changes in Arco Vara share (ARC1T) price compared to the benchmark index OMX Tallinn in 2016

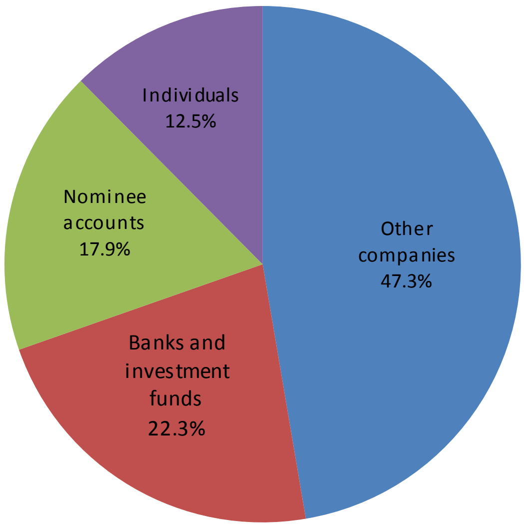


Index/equity	31 Dec 2015	31 Dec 2016	+/-%
OMX Tallinn	898.99	1,075.50	+19.63
ARC1T	1.15 EUR	1.24 EUR	+7.83

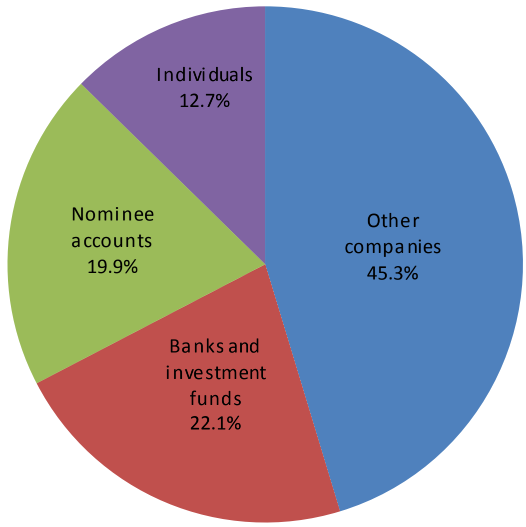
Structure of shareholders

As of 31 December 2016, Arco Vara had 1,502 shareholders (on 31 December 2015: 1,600) including 1,297 individuals as shareholders (on 31 December 2015: 1,381 individuals) who jointly owned 12.5% (on 31 December 2015: 12.7%) out of all Arco Vara shares. Complete shareholder structures are presented on the following diagrams:

Ownership structure as of 31 December 2016



Ownership structure as of 31 December 2015



Major shareholders as of 31 December 2016	No of shares	Share, %
Alarmo Kapital OÜ	890,188	13.7%
NORDEA BANK FINLAND PLC client	862,820	13.3%
AS Lõhmus Holdings	602,378	9.3%
Gamma Holding Investment OÜ	553,975	8.5%
LHV PENSIONIFOND L	389,765	6.0%
FIREBIRD REPUBLICS FUND LTD	356,428	5.5%
HM Investeeringud OÜ	330,505	5.1%
FIREBIRD AVRORA FUND, LTD.	185,800	2.9%
LHV PENSIONIFOND XL	173,583	2.7%
FIREBIRD FUND L.P.	150,522	2.3%
Other shareholders	2,011,048	30.9%
Total	**6,507,012**	**100.0%**

Holdings of members of the management and supervisory boards (and related persons) as of 31 December 2016	Position	No of shares	Share, %
Tarmo Sild ja Allar Niinepuu (Alarmo Kapital OÜ)	member of management board/ member of supervisory board	890,188	13.7%
Rain Lõhmus (AS Lõhmus Holdings)	member of supervisory board	602,378	9.3%
Hillar-Peeter Luitsalu (HM Investeeringud OÜ, related persons)	chairman of supervisory board	369,259	5.7%
Kert Keskpaik (privately and through K Vara OÜ)	member of supervisory board	202,171	3.1%
Steven Yaroslav Gorelik [1]	member of supervisory board	0	0.0%
Total		**2,063,996**	**31.7%**

[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 10.6% interest).

According to the articles of association of Arco Vara AS, the shareholders have no restrictions for transferring or encumbering their shares.

Convertible bonds

The Annual General Meeting of Arco Vara AS decided on 10.05.2016 to issue to the CEO of the parent company of the group a convertible bond with a nominal value of 1000 euros. The convertible bond entitles its holder to subscribe to up to 390,000 shares of Arco Vara AS for 0,7 euros per share in 2019 as follows:

- if the CEO will not be recalled before 21.10.2016 – up to 130 000 shares;
- if the CEO will not be recalled from 22.10.2016 to 21.04.2017 – up to 65 000 shares;
- if the CEO will not be recalled from 22.04.2017 to 21.10.2017 – up to 65 000 shares;
- if the CEO will not be recalled from 22.10.2017 to 21.04.2018 – up to 65 000 shares;
- if the CEO will not be recalled from 22.04.2018 to 21.10.2018 – up to 65 000 shares.

On 10.05.2016, the Annual General Meeting also decided to issue up to 12 convertible bonds to key employees of Arco Vara (see detailed conditions on page 16). As the incentive program of Arco Vara is currently under review, the management and supervisory council have decided not to proceed with issuing these convertible bonds.

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 management report, which is part of the Company’s annual report.

General meeting

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

In 2016, one annual general meeting took place.

Annual general meeting

The annual general meeting was held on 10 May 2016 from 10:00 a.m. until 10:45 a.m. in Tallinn at Rävala Avenue 3, in *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 14 April 2016. The notice was published in the national daily newspaper *Postimees* on 15 April 2016. The notice included information on where materials concerning the general meeting had been made available and where shareholders could submit their questions. 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. The agenda of the annual general meeting was the following:

- approval of the annual report for 2015
- distribution of profit
- issuance of a convertible bond (in connection with the incentive scheme of the Management Board member)
- issuance of convertible bonds (in connection with the incentive scheme of the division managers)
- appointment of auditor.

The following decisions were adopted at the annual general meeting:

- To approve the annual report of Arco Vara AS for 2015;

- To distribute the net profit for the year ended on 31 December 2016 in the amount of 467 thousand euros as follows:
  - to pay dividends to the shareholders 0.01 euros per share, in the total amount of 61 170,12 euros. The list of shareholders entitled to dividends shall be fixed as of 25 May 2016, 23:59 PM. Dividends shall be paid to the shareholders by transfer to the bank account of the shareholders on 30 May 2016;
  - to allocate 406 thousand euros to retained earnings.

- To increase the share capital of Arco Vara AS conditionally by issuing one convertible bond with the nominal value of 1,000 euros in accordance with the conditions of the convertible bond which are found among the materials of the AGM made available to the shareholders.

  The convertible bond will give its owner the right to subscribe up to 390,000 shares of Arco Vara AS for 0.7 euro per share starting from 10 May 2019 until 31 December 2019.

  In case of subscription the Management Board of Arco Vara may increase the share capital up to 273,000 euros, i.e by 390,000 shares.

  The existing shareholders will give up the right of privileged subscription of the convertible bond as well as the right of privileged subscription of the shares issued after the exchange of the convertible bond.

- To increase the share capital of Arco Vara AS conditionally by issuing up to 12 convertible bonds with the nominal value of 500 euros in accordance with the conditions of the convertible bonds which are found among the materials of the AGM made available to the shareholders.

Provided that the net profit of Arco Vara group for the years 2016-2018 is at least 5.5 million euros, the convertible bonds will give the owners the right to subscribe for all together up to 200,000 shares of Arco Vara AS for 0.7 euro per share starting from 10 May 2019 until 31 December 2019.

In case of subscription the Management Board of Arco Vara may increase the share capital up to 140,000 euros, i.e by 200,000 shares.

The existing shareholders will give up the right of privileged subscription of the convertible bonds as well as the right of privileged subscription of the shares issued after the exchange of the convertible bonds.

- 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 2016 annual report according to the agreement concluded 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 28 shareholders whose votes represented 54.7% 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 2015 and answered the shareholders' questions.

The resolutions, minutes and materials of all general meetings held in 2016 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.

Management Board

Since 4 September 2009, the Management Board of the Company has had one member. Since 22 October 2012, the CEO (and the only member of the Management Board) of the Company has been Tarmo Sild. On 15.09.2015, the Suervisory Council decided to extend the powers of Tarmo Sild by three years starting from 22.10.2015, i.e. until 21.10.2018.

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 to 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 with 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 enabled Tarmo Sild to subscribe for 390 thousand ordinary shares of the Company in 2016 for 0.7 euros per share, which Tarmo Sild fully used in 2016. In addition, the Annual General Meeting decided on 10.05.2016 to issue to the Management Board member a new convertible bond, which was described in detail in the previous section (see p. 16).

In 2016, the Management Board was paid only remuneration according to the service contract. No bonuses were paid.

The member of the Management Board has notified the Company of his interests and involvement in the governing bodies of the following companies that are not part of the group:

- AS IuteCredit Europe;
- MFV Lootus OÜ;
- Aia Tänav OÜ;
- Alarmo Kapital OÜ;
- OÜ Catsus.

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.

The Management Board has, according to the resolution of the Annual General Meeting from 10.05.2016, the right to issue up to 390,000 shares according to the conditions of the convertible bond held by the member of the Management Board (see p. 16 for details). The Management Board has no right to repurchase issued shares.

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 2016, there were no changes in the composition of the Company's Supervisory Board. During 2016 the composition of the Company's Supervisory Board was the following: Allar Niinepuu, Hillar-Peeter Luitsalu, Rain Lõhmus, Steven Yaroslav Gorelik, 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.

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 2016, the Supervisory Board had 4 meetings which were participated by Allar Niinepuu, Hillar-Peeter Luitsalu, Steven Yaroslav Gorelik, Kert Keskpaik. Rain Lõhmus participated in 3 meetings of the Supervisory Board.

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 on 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.

Disclosure of information

Since the Company's shares were listed on 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, relevant EU regulations 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 April 2018, i.e. until publishing the annual report for 2017.

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.

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. Annual General Meeting of shareholder appoints the auditor for the next financial year. At the shareholders' meeting on 10 May 2016, AS PricewaterhouseCoopers was appointed as the Company's auditor for the next financial year the fifth 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 – therefore existence of a subsidiary office of the auditing company on these markets is a prerequisite.

For better risk assessment and risk 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.

The Company's CFO ensures the high quality of financial reporting. 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 usually performed quarterly. Monthly reports of different subsidiaries and separate units are prepared and presented to the managers of corresponding units.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of comprehensive income

	Note	**2016**	2015
In thousands of euros			
Continuing operations			
Revenue from sale of own real estate		6,620	7,019
Revenue from rendering of services		3,127	3,633
Total revenue	7	**9,747**	**10,652**
Cost of sold real estate and services	8	-6,745	-6,865
Gross profit		**3,002**	**3,787**
Other income	9	182	80
Marketing and distribution expenses	10	-556	-530
Administrative expenses	11	-2,064	-2,020
Other expenses	9	-99	-151
Fair value adjustments to investment property	19	-584	95
Gain on sale of subsidiaries	6	4	0
Operating profit/loss		**-115**	**1,261**
Finance income and costs	12	-590	-666
Profit/loss before tax		**-705**	**595**
Income tax	13	-127	-135
Net profit/loss from continuing operations		**-832**	**460**
Discontinued operations			
Profit/loss from discontinued operations		0	-15
Net profit/loss for the period		**-832**	**445**
attributable to owners of the parent		*-832*	*467*
attributable to non-controlling interests		*0*	*-22*
Total comprehensive income/expense for the period		**-832**	**445**
attributable to owners of the parent		*-832*	*467*
attributable to non-controlling interests		*0*	*-22*
Earnings per share (in euros)	14		
- basic		**-0,13**	0,08
- diluted		**-0,13**	0,07

The notes presented on pages 24 to 56 form an integral part of the consolidated financial statements.

Consolidated statement of financial position

	Note	31 December 2016	31 December 2015
In thousands of euros			
Cash and cash equivalents	16	845	745
Receivables and prepayments	17	470	679
Inventories	18	14,593	12,818
Total current assets		**15,908**	**14,242**
Receivables and prepayments	17	11	0
Investment property	19	10,835	9,513
Property, plant and equipment	20	718	489
Intangible assets	20	248	229
Total non-current assets		**11,812**	**10,231**
TOTAL ASSETS		**27,720**	**24,473**
Loans and borrowings	21	9,372	2,345
Payables and deferred income	22	4,369	1,935
Provisions	23	108	146
Total current liabilities		**13,849**	**4,426**
Loans and borrowings	21	4,886	10,417
Total non-current liabilities		**4,886**	**10,417**
TOTAL LIABILITIES		**18,735**	**14,843**
Share capital	24	4,555	4,282
Share premium	24	292	292
Statutory capital reserve	24	2,011	2,011
Other reserves	14	52	298
Retained earnings		2,075	2,656
Total equity attributable to owners of the parent		**8,985**	**9,539**
Equity attributable to non-controlling interests		0	91
TOTAL EQUITY		**8,985**	**9,630**
TOTAL LIABILITIES AND EQUITY		**27,720**	**24,473**

The notes presented on pages 24 to 56 form an integral part of the consolidated financial statements.

Consolidated statement of cash flows

	Note	**2016**	2015
In thousands of euros			
Cash receipts from customers		14,290	13,770
Cash paid to suppliers		-9,608	-7,569
Income tax paid from profits	13	-106	-197
Other taxes paid and recovered (net)		-1,631	-2,399
Cash paid to employees		-1,151	-1,015
Other cash payments and receipts related to operating activities		-96	9
Net cash flow of discontinued operations		0	-15
NET CASH FROM OPERATING ACTIVITIES		**1,698**	**2,584**
Payments made on purchase of tangible and intangible assets		-99	-196
Proceeds from sale of property, plant and equipment		1	0
Payments made on purchase and improvement of investment property	19	-383	-110
Proceeds from sale of a subsidiary	6	41	0
Payments made on purchase of a subsidiary	6	-1,890	0
Interest received		0	4
Other payments related to investing activities		-3	0
NET CASH USED IN INVESTING ACTIVITIES		**-2,333**	**-302**
Proceeds from loans received	21	6,135	2,734
Settlement of loans and borrowings	21	-4,637	-5,025
Interest paid		-797	-788
Dividends paid	27	-61	-61
Proceeds from share capital increase	24	273	0
Other payments related to financing activities		-138	-88
NET CASH FROM/USED IN FINANCING ACTIVITIES		**775**	**-3,228**
NET CASH FLOW		**140**	**-946**
Cash and cash equivalents at beginning of period	16	745	1,691
Increase in cash and cash equivalents		**140**	**-946**
Decrease in cash and cash equivalents through sale of subsidiaries	6	-40	0
Cash and cash equivalents at end of period	16	845	745

The notes presented on pages 24 to 56 form an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

	Equity attributable to owners of the parent							
	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total	Non-controlling interests	**Total equity**
In thousands of euros								
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**
Balance as at 31 December 2015	**4,282**	**292**	**2,011**	**298**	**2,656**	**9,539**	**91**	**9,630**
Total comprehensive income for the period	0	0	0	0	-832	**-832**	0	**-832**
Transactions with owners:	273	0	0	-246	251	**278**	-91	**187**
Increase of share capital	*273*	*0*	*0*	*-298*	*298*	*273*	*0*	*273*
Dividends paid	*0*	*0*	*0*	*0*	*-61*	*-61*	*0*	*-61*
Change in non-controlling interest	*0*	*0*	*0*	*0*	*14*	*14*	*-91*	*-77*
Formation of equity reserve	*0*	*0*	*0*	*52*	*0*	*52*	*0*	*52*
Balance as at 31 December 2016	**4,555**	**292**	**2,011**	**52**	**2,075**	**8,985**	**0**	**8,985**

Further information on changes occurred in share capital is provided in notes 14, 24, 27.

The notes presented on pages 24 to 56 form an integral part of the consolidated financial statements.

Notes to the Consolidated Financial Statements

1. General information

These consolidated financial statements of Arco Vara AS and its subsidiaries as of and for the year ended 31 December 2016 were authorised for issue by the chief executive officer / member of the management board on 31 March 2017. Under the Commercial Code of the Republic of Estonia, the annual report prepared by the management board and approved by the supervisory board must be approved by the shareholders' general meeting. The consolidated financial statements are part of the annual report, which 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 2016, 110 people provided services to the group under the employment or authorization contract (31 December 2015: 178 people). In addition to Estonia, the group has, through its subsidiaries, active operations also in Latvia and Bulgaria.

The structure of the group as of 31 December 2016 is presented in note 30.

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, based on the likelihood of respective events happening.

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

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

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

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

Estimation uncertainty

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

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 of 31 December 2016 and 31 December 2015 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 18.

Determination of the fair value of investment properties

On 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 of 31 December 2016 and 31 December 2015, the group did not request valuation reports from independent appraisers. Fair value was mainly determined by using two basic techniques - income method and comparison method. Valuation methods are described in more detail in notes 4 and 19.

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. 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 25.

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, which derives from a contract, legislation or an established pattern of the group's past practice, which requires an outflow of assets, which is likely to happen and which can be reliably measured, but the time and amount of which is not known exactly. 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. A provision is recorded in the amount, which the management estimates to be necessary for fulfilling the obligations that are related to the provision, or for transferring it to a third party. Expenses related to provisions are recognised as an expense in the period in which they arise. On 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.

4. Significant accounting policies

New accounting pronouncements

Following new or revised standards and interpretations are mandatory for the group's annual periods beginning on or after 1 January 2016.

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". The group estimates that there is no material impact on financial statements.

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. The group estimates that there is no material impact on financial statements.

Other new or revised standards or interpretations that are mandatory for the group's annual periods beginning on or after 1 January 2016 are not expected to have a material impact on the group.

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 2017, which the group has not adopted earlier:

IFRS 15 Revenue from contracts with customers - amendments to adoption of IFRS 15

According to the main principle on the new standard, revenue is recognised when a good or service is delivered to the customer and revenue is recognised at transaction price. Distinguishable goods and services which were sold together shall be recognised separately and price discounts shall be allocated to individual elements. In case the consideration received could change in certain circumstances and there is no significant risk for withdrawal of repayment then minimum possible amount is recognised as revenue. The expenses made for securing customer contracts shall be capitalised and depreciated for the period when the contract generates income. The group estimates that the changes in standard have no impact on revenue recognition principles of the group.

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

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

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 makers. 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 ones 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 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 its 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.

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 cost of sold real estate and services.

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:

- Income method (discounted cash flow analysis or income capitalisation). The income 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 fair value of a property using income method 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. Capitalization rate applied on using income capitalisation method is based on the investors' market average expected yield for the same type of assets.
- 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 income method) if management believes that the latter can measure the fair value of the property more reliably.
- Residual value method. The method is applied to determine the value of a property that requires development or reconstruction in a situation where the comparison method cannot be applied due to the absence of a suitable basis for comparison. The method is applied on the assumption that the buyer is willing to pay for a property an amount equal to the value of the property after its development or reconstruction less its estimated development or reconstruction costs and a reasonable profit margin.
- Existence of a sales contract under the law of obligations (a presale contract). In the case of properties which at the reporting date have been sold based on a contract under the law of obligations but in respect of which the real right contract has not been signed (title has not transferred), fair value is determined by reference to the sales price of the property in the contract under the law of obligations. The sales price agreed in the contract under the law of obligations is used for determining the fair value of a property only when the group has reasonable assurance that the related real right contract will be concluded under the same terms and conditions (e.g. the buyer has made a substantial prepayment for the property by the reporting date or the real right contract is concluded after the reporting date but before the date management approves the financial statements for issue).

Gains and losses arising from changes in the fair value of investment property are recognised in profit or loss in the period in which they arise (in separate row inside operating income/loss).

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 19.

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*).

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.

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. Accumulated amortization is recognised within administrative expenses and reduction in value within other business expenses in the statement of comprehensive income.

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.*

An entity shall assess at the end of each reporting period whether there is any indication that recoverable amount of the impaired asset has increased. If any such indication exists, the entity shall estimate the recoverable amount of that asset. When recoverable amount of that asset or cash-generating unit exceeds the carrying amount of an asset or a cash-generating unit the prior impairment shall be reversed and the carrying amount of the asset shall be increased. The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

Financial liabilities

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

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

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

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

Employee benefits

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

Termination benefits are recognised as an expense when the group is demonstrably committed, without a realistic possibility of withdrawal, to a detailed formal plan to either terminate employment before the normal retirement date or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense when the group has made an offer of voluntary redundancy, it is probable that the offer will be accepted and the number of acceptances can be estimated reliably.

Share-based payments

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

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

The grant of share options is conditional on the length of the employee's employment in the group between the 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.

<u>Parent company and subsidiaries registered in Estonia</u>

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. 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 27.

<u>Latvian, Lithuanian and Bulgarian subsidiaries</u>

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 31) 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 are measured using the cost method whereby an investment is initially recognised at cost, i.e. at the fair value of the consideration paid for it on acquisition and after initial recognition it is carried at cost less any impairment losses.

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

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

5. Segment information

The group has the following reportable segments:

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

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

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

Revenue and operating profit/loss by operating segment

Segment	Development		Service		Unallocated		Eliminations		Consolidated	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
In thousands of euros										
External revenue	6,932	7,861	2,813	2,787	2	4			9,747	10,652
Annual change	*-11.8%*		*0.9%*						*-8.5%*	
Inter-segment revenues	116	86	418	467			-534	-553	0	0
Total revenue	**7,048**	**7,947**	**3,231**	**3,254**	**2**	**4**	**-534**	**-553**	**9,747**	**10,652**
Annual change	*-11.3%*		*-0.7%*							
Operating profit/loss	**611**	**1,790**	**-174**	**-94**	**-455**	**73**	**-97**	**-508**	**-115**	**1,261**
Of which inventory write-downs	*-124*	*0*	*0*	*0*	*0*	*0*			-124	0
Fair value adjustments to investment property, net	*-584*	*95*	*0*	*0*	*0*	*0*			-584	95

External revenue by location

Segment	Development		Service		Parent company		Consolidated	
	2016	2015	2016	2015	2016	2015	2016	2015
In thousands of euros								
Estonia	196	263	1,426	1,271	2	4	1,624	1,538
Bulgaria	6,552	7,170	623	636	-	-	7,175	7,806
Latvia	184	428	764	880	-	-	948	1,308
Total revenue	**6,932**	**7,861**	**2,813**	**2,787**	**2**	**4**	**9,747**	**10,652**

Operating profit/loss of Development and Service segment by location

Segment	Development		Service	
	2016	2015	2016	2015
In thousands of euros				
Estonia	-213	2	-146	-182
Bulgaria	1,019	1,778	-16	161
Latvia	-195	10	-12	-73
Total operating profit/loss	**611**	**1,790**	**-174**	**-94**

Assets and liabilities by operating segments and by location

Segment	Development		Service		Unallocated		Consolidated	
On 31 December	2016	2015	2016	2015	2016	2015	2016	2015
In thousands of euros								
Assets	**26,892**	**23,318**	**385**	**505**	**443**	**650**	**27,720**	**24,473**
Estonia	11,471	5,292	230	186	443	650	12,144	6,128
Bulgaria	14,723	16,986	155	181	-	-	14,878	17,167
Latvia	698	1,040	-	138	-	-	698	1,178
Liabilities	**16,816**	**14,060**	**344**	**518**	**1,575**	**265**	**18,735**	**14,843**
Estonia	6,088	520	189	274	1,575	265	7,852	1,059
Bulgaria	10,721	13,467	155	154	-	-	10,876	13,621
Latvia	7	73	-	90	-	-	7	163

6. Acquisition and sale of subsidiaries

Scope of consolidation

On 31 December 2016, Arco Vara group comprised 21 consolidated entities (on 31 December 2015: 25). The structure of the group is presented in note 30.

Acquisitions and establishments of subsidiaries in 2016

In May 2016, the group acquired a 100% subsidiary Iztok Parkside EOOD in Bulgaria. 2,100 thousand euros was paid to the seller of the company, of which 210 thousand euros had been prepaid already in 2015. The group does not consider the purchase of Iztok Parkside EOOD as business combination. Essentially, it was a purchase of land with strong development potential and the purchased company had no business activity.

Effect of acquisition on the group's statement of financial position in 2016

In thousands of euros	
Decrease in prepayments for inventories	-210
Increase in inventories	2,100
Paid in cash on acquisition of subsidiary	-1,890
Total effect on the group's net assets	**0**

On 22 December 2016, the group established a new subsidiary Kodulahe II OÜ with paid-in capital of 2500 euros.

The only change in the group's structure in 2015 occurred on 31 July 2015, when a real estate fund in Bulgaria named Arco Real Estate Fund REIT, with starting capital of 256 thousand euros was registered. On 31 December 2015, the group held 70% interest in the fund. 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.

Sale of subsidiaries in 2016

In April 2016, the group sold its 100% subsidiary Arco BB EOOD in Bulgaria. The sold company had no assets or liabilities at the moment of the sale. 1,000 euros were paid by the acquirer to the group.

On 31 October 2016, the group sold its 70.6% ownership in Arco Real Estate SIA (including its subsidiary Adepto SIA). The effect of the sale on the statement of financial position is presented in the following table. Also, non-controlling interest is no longer recognized in the group's statement of financial position as a result of the sale of Arco Real Estate SIA.

Effect of sale of ownership in Arco Real Estate SIA on the group's statement of financial position

In thousands of euros	
Decrease in cash	-40
Decrease in receivables	-63
Decrease in inventory and property, plant and equipment	-30
Decrease in liabilities and prepayments collected	96
Cash receipts from the sale	40
Total effect on the group's net assets	**3**

Liquidation of subsidiaries in 2016

On 19 February 2016, the group's subsidiary Fineprojekti OÜ was erased from Estonian Commercial Register, the liquidation process had started in 2014. The liquidation also resulted in derecognition of Romanian subsidiary Arco Capital Real Estate SRL from the group's structure. On 2 November 2016, the group's subsidiary Tivoli Arendus OÜ was erased from Estonian Commercial Register.

Notes to the Consolidated Statements of Comprehensive Income

7. Revenue

	2016	2015
In thousands of euros		
Sale of own real estate	6,620	7,019
Real estate brokerage and valuation	2,515	2,505
Rental of real estate	486	913
Property management services	46	95
Other revenue	80	120
Total revenue	**9,747**	**10,652**

8. Cost of sold real estate and services

	2016	2015
In thousands of euros		
Cost of real estate sold (note 18)	-4,555	-4,883
Personnel expenses	-1,578	-1,497
Property management costs	-301	-314
Inventory write-down (note 18)	-124	0
Vehicle expenses	-25	-22
Depreciation of property, plant and equipment (note 20)	-12	-12
Other costs	-150	-137
Total cost of sales	**-6,745**	**-6,865**

9. Other income and expenses

Other income

	2016	2015
In thousands of euros		
Gain on reversal of property, plant and equipment impairment (note 20)	135	0
Received penalties and compensations	34	64
Miscellaneous income	13	16
Total other income	**182**	**80**

Other expenses

	2016	2015
In thousands of euros		
Write-down of receivables	-64	-40
Late payment interest and penalty charges	-11	-30
Loss on ending litigations	0	-43
Impairment loss of property plant and equipment	0	-2
Miscellaneous expenses	-24	-36
Total other expenses	**-99**	**-151**

10. Marketing and distribution expenses

In thousands of euros	2016	2015
Advertising expenses	-294	-285
Personnel expenses	-119	-123
Market research	-7	-9
Brokerage fees	-6	0
Other marketing and distribution expenses	-130	-113
Total marketing and distribution expenses	**-556**	**-530**

11. Administrative expenses

In thousands of euros	2016	2015
Personnel expenses	-1,104	-1,126
Office expenses	-372	-446
Services purchased	-231	-157
IT expenses	-150	-138
Depreciation and amortisation (note 20)	-93	-44
Legal service fees	-37	-42
Vehicle expenses	-33	-33
Other expenses	-44	-34
Total administrative expenses	**-2,064**	**-2,020**

12. Finance income and costs

In thousands of euros	2016	2015
Interest expense	-530	-600
Interest income	1	4
Other finance income and costs	-61	-70
Total finance income and costs	**-590**	**-666**

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 2016, capitalised interest expenses amounted to 286 thousand euros (in 2015: 97 thousand euros).

13. Income tax

In thousands of euros	2016	2015
Income tax expense from Bulgarian subsidiaries	127	135
Total income tax expense	**127**	**135**

In 2016, the group's Bulgarian companies paid 106 thousand euros (in 2015: 197 thousand euros) of income tax on profits.

The group has off-balance contingent income tax assets in 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.

14. 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.

	2016	2015
Weighted average number of ordinary shares outstanding during the period	6,177,750	6,117,012
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)	-832	467
Earnings per share (in euros)	**-0.13**	**0.08**
Diluted earnings per share (in euros)	**-0.13**	**0.07**

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 gave 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. The CEO transferred the right for subscription to the company Alarmo Kapital OÜ where he has controlling interest. On 4 November 2016, 390 thousand new shares were issued after the subscription right was executed. Alarmo Kapital OÜ paid 273 thousand euros for the shares. After the share issue, Arco Vara AS share capital consists of 6,507,012 shares in the nominal value of 4,555 thousand euros.

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. Calculated fair value of the option provided to the CEO is 0.63 euros per share. The option value is recognised proportionally over 3 years as payroll expense in income statement and as an equity reserve. As of 31 December 2016, an equity reserve in the amount of 52 thousand euros has been formed as the proportionate value of the option. See also note 28.

For calculating the fair value of the option, Black-Scholes model was used. 72% was calculated for 3-year volatility of Arco Vara's share price, 0% was used as risk-free interest rate and 1 cent per share for expected dividend payment.

15. Operating lease expenses

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

	2016	2015
In thousands of euros		
Office premises	162	170
Office equipment	20	28
Vehicles	4	5
Total	**186**	**203**

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

As of 31 December	**2016**	2015
In thousands of euros		
No later than 1 year	119	137
Later than 1 year and no later than 5 years	198	276
Total	**317**	**413**

Most of the future lease payables (from non-cancellable operating leases) consist of future lease payments of a new 5-year lease agreement related to the movement of Arco Vara's head office in 2015. Other lease agreements considered as non-cancellable are concluded for renting offices to brokerage units, and also for renting office equipment. Non-cancellable lease agreements do not include any unusual restrictions or special terms.

Notes to the Consolidated Position of Financial Statement

16. Cash and cash equivalents

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

As of 31 December	2016	2015
In thousands of euros		
Cash on hand and demand deposits	845	745
Total cash and cash equivalents	**845**	**745**

At the end of year 2016, out of the group's year-end cash and cash equivalents balance, 14 thousand euros (31 December 2015: 82 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 26.

17. Receivables and prepayments

Short-term receivables and prepayments

As of 31 December	2016	2015
In thousands of euros		
Trade receivables		
Receivables from customers	193	235
Allowance for doubtful trade receivables	0	-12
Total trade receivables	**193**	**223**
Other receivables		
Loans provided	0	6
Miscellaneous receivables	10	119
Total other receivables	**10**	**125**
Accrued income		
Prepaid and recoverable taxes	107	75
Other accrued income	5	3
Total accrued income	**112**	**78**
Prepayments	**155**	**253**
Total short-term receivables and prepayments	**470**	**679**

Long-term receivables

As of 31 December	2016	2015
In thousands of euros		
Prepayments	11	0
Total long-term receivables and prepayments	**11**	**0**

Allowance for doubtful trade receivables

As of 31 December	2016	2015
In thousands of euros		
Balance at beginning of year	**-12**	**-22**
Receivables considered irrecoverable during the year	12	10
Balance at end of year	**0**	**-12**

18. Inventories

As of 31 December	2016	2015
In thousands of euros		
Properties purchased and being developed for resale	14,571	12,580
Materials and finished goods	6	12
Prepayments for inventories	16	226
Total inventories	**14,593**	**12,818**

Properties purchased and being developed for resale

	2016	2015
In thousands of euros		
Balance at the beginning of period, 1 January	**12,580**	**11,942**
Properties purchased for development	2,102	70
Construction costs of apartment buildings	5,633	2,464
Capitalized borrowing costs	455	127
Inventory write-down (note 8)	-124	0
Other capitalized costs	141	583
Reclassification from/to investment property (note 19)	-1,661	2,277
Cost of sold properties (note 8)	-4,555	-4,883
Balance at the end of period, 31 December	**14,571**	**12,580**

Reclassifications of Madrid Blvd project assets in 2016 and 2015 between inventory and investment property result from a change in planned usage of certain assets. More specifically, this concerns 14 apartments, which had been renovated and furnished since 2013 for providing accommodation services. At the end of 2015, the earlier presentation as investment property was changed and the apartments together with associated parking places were reclassified from investment property to inventory because at that time, the intention was to start selling these apartments. During 2016, the management gradually got convinced that the apartments should be kept for rental business, because it is a profitable business, generates stable cash flow and helps to serve the Madrid Blvd building development loan from Piraeus bank. Thus, the plan to sell the apartments in the near future was abandoned, and apartments and associated parking places were reclassified back from inventory to investment property.

In 2016, the group wrote down inventories in the amount of 208 thousand euros. At the same, the group reversed earlier inventory write-downs in the amount of 84 thousand euros, considering the remarkable increase of apartment prices in Sofia during the last 1-2 years. No write-downs or reversals of write-downs were made to inventories in 2015.

The group's management estimates that the group has inventories realisable during one year in carrying value of 8,860 thousand euros as of 31 December 2016. Inventories in carrying value of 5,733 thousand euros are realisable in a longer period than one year.

For information on inventories pledged as loan collateral, see note 26.

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 2016 and also in 2015, 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 of 31 December 2016, inventories in the total amount of 13,557 thousand euros did not require a write-down or reversal of write-down (as of 31 December 2015: 12,818 thousand euros).

As of 31 December	2016	2015
In thousands of euros		
Measured using the residual value method	12,718	4,386
Measured using the comparison method	1,851	7,969
Other	26	463
Total inventories	**14,593**	**12,818**

As of 31 December 2016, the total carrying value of inventories carried at cost was 12,742 thousand euros (on 31 December 2015: 5,171 thousand euros) and total carrying value of inventories measured at net realisable value was 1,851 thousand euros (on 31 December 2015: 7,647 thousand euros).

19. Investment property

Investment properties comprise the following type of assets:

1) Commercial spaces (including apartments for letting out) earning rental income in multipurpose building in Sofia (total carrying value of 10,463 thousand euros on 31 December 2016, including shops and office spaces in the amount of 7,934 thousand euros).
2) Land plots that have development potential but whose future use is still uncertain (carrying value of 372 thousand euros at on December 2016).

	2016	2015
In thousands of euros		
Balance at the beginning of period, 1 January	**9,513**	**11,585**
Net profit/loss on changes in fair value	-584	95
Capitalised development costs	325	110
Reclassification from/to inventories (note 18)	1,661	-2,277
Reclassification to property, plant and equipment (note 20)	-138	0
Purchase of land plots	58	0
Balance at the end of period, 31 December	**10,835**	**9,513**

For information on pledged assets, see note 26.

Land plots and apartments, 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.

Commercial and office spaces of Madrid Blvd building in Sofia have been measured using income method. As of 31 December 2016, a loss in the amount of 929 thousand euro arose from these assets, resulting from change in fair value.

Madrid Blvd apartments reclassified from inventory to investment property in 2016 were measured using comparison method, which is based on market price of similar assets. As of 31 December 2016, such assets were valued to their fair value with a gain in the amount of 379 thousand euros. Despite using comparison method for valuation, the group does not intend to sell these assets in the near future. Instead, they will be held for rent in order to generate stable cash flows and service the loan taken from Piraeus Bank for developing Madrid building. See also note 18.

On 31 December 2016, investment properties with carrying values of 372 thousand euros did not require value adjustment (as of 31 December 2015: 9,263 thousand euros). In 2016, the fair value of investment property was decreased in the amount of 584 thousand euros. In 2015, the fair value of investment property was increased in the amount of 95 thousand euros. In 2016 and 2015, the values of all of the group's investment properties were determined by internal experts.

As of 31 December	**2016**	2015
In thousands of euros		
Measured using the discounted cash flow method	7,934	8,752
Measured using comparison method	2,901	761
Total investment property	**10,835**	**9,513**

In 2016, the exit yield used for valuation of investment properties with the income method was 8% (in 2015: 9%), which could be considered as conservative approach for yield expectation in the current era of low interest rates. Monthly rental income per m2 from commercial and office areas was 9 euros on average in 2016 (in 2015: 10 euros). Rental income input was lowered because the group failed in renting out office spaces of Madrid Blvd building in 2016 and new rental agreements are concluded on lower levels than initially expected. As of 31 December 2016, only 2 office spaces were rented out from the total of 7 spaces that had been created during renovation works in early 2016. As of the date of this report, two more office spaces had been rented out in 2017.

The sensitivity of the carrying amount of investment properties measured using the income capitalisation 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 397 thousand euros (in 2015: by 452 thousand euros).
- A decrease of 1% in the exit yields would have increased the fair value of investment property by 1,133 thousand euros (in 2015: by 1,131 thousand euros) and an increase of 1% would have reduced the fair value by 882 thousand euros (in 2015: by 905 thousand euros).

Operating leases: the group as a lessor

In 2016, the group's rental income on investment properties (Madrid Blvd building in Sofia) amounted to 530 thousand euros (in 2015: 1,006 thousand euros). The rental income decreased compared to previous year due to ending the rental agreement with anchor tenant in 2015 and the renovation works thereafter. The rental area that was previously rented out to one anchor tenant is now divided into 7 smaller areas. Finding new tenants at the same level of rental fee has proven to be difficult: only 2 office spaces out of 7 that were created during reconstructions were rented out by the end of 2016. However, two more spaces have been rented out in 2017, before publication date of the annual report.

Direct property management expenses totalled 234 thousand euros in 2016 (in 2015: 242 thousand euros) including expenses in the amount of 9 thousand euros (in 2015: 11 thousand euros) from properties from which the group did not earn any income.

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

As of 31 December	**2016**	2015
In thousands of euros		
No later than 1 year	299	239
Later than 1 year and no later than 5 years	543	661
Total	**842**	**900**

Lease contracts are considered non-cancellable if:

1) they have been concluded for a fixed term (with the expiration date in 2017 or later);
2) lessee has the right to cancel the contract with 3-6 month notice but only after arrival of fixed date in 2017 or later.

20. Property, plant and equipment and intangible assets

Property, plant and equipment

	Land and buildings	**Renovation of rented office space**	**Office equipment**	**Total property, plant and equipment**
In thousands of euros				
Carrying amount on 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 on 31 December 2015	**352**	**26**	**111**	**489**
Of which cost	*431*	*31*	*429*	*891*
Of which accumulated depreciation	*-79*	*-5*	*-318*	*-402*
Additions	0	0	46	46
Reclassification from investment property (note 19)	138	0	0	138
Reversal of earlier years' impairments (note 9)	135	0	0	135
Disposals	0	-26	-9	-35
Depreciation for the year (notes 8, 11)	-10	0	-45	-55
Carrying amount on 31 December 2016	**615**	**0**	**103**	**718**
Of which cost	*673*	*0*	*220*	*893*
Of which accumulated depreciation	*-58*	*0*	*-117*	*-175*

Intangible assets

In thousands of euros	Software and licences	Prepaid for intangible assets	Total intangible assets
Carrying amount on 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 on 31 December 2015	**212**	**17**	**229**
Of which cost	*257*	*17*	*274*
Of which accumulated amortisation	*-45*	*0*	*-45*
Purchases and software development	26	54	80
Reclassification	54	-54	0
Disposals	0	-11	-11
Amortisation for the year (notes 8, 11)	-50	0	-50
Carrying amount on 31 December 2016	**242**	**6**	**248**
Of which cost	*336*	*6*	*342*
Of which accumulated amortisation	*-94*	*0*	*-94*

Intangible assets of the group consist mainly of business software development costs in the total amount of 256 thousand euros (out of which 54 thousand euros in 2016 and 103 thousand euros in 2015). The cost of business software is amortized during 5 years (until year 2021).

For pledged assets see note 26.

21. Loans and borrowings

Loans and borrowings comprise the following items:

	As of 31 December 2016			As of 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	12,827	9,063	3,764	12,585	2,179	10,406
Bonds	1,121	0	1,121	151	150	1
Finance lease liabilities	10	9	1	26	16	10
Other loans	300	300	0	0	0	0
Total	**14,258**	**9,372**	**4,886**	**12,762**	**2,345**	**10,417**

On 31 December 2016, the weighted average interest rate of loans and borrowings was 5.3% (31 December 2015: 5.0%).

In 2016, the group settled loans and borrowings of 4,637 thousand euros (in 2015: 5,025 thousand euros) through cash transactions and raised new loans and borrowings of 6,135 thousand euros (in 2015: 2,734 thousand euros).

<u>Changes in loans and borrowings in 2016</u>

In 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.

- In November, the group repaid 1,050 thousand euros of short-term bridge loan raised in September for final payment of purchase price on acquisition of the group's Bulgarian subsidiary Iztok Parkside EOOD.

- 1,381 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 28.

In 2016, the group raised new loans in the total amount of 6,135 thousand euros, out of which:

- 1,020 thousand euros is bond issue described in the previous paragraph;
- 2,714 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;
- 1,050 thousand euros is bank loan from Raiffeisenbank Bulgaria raised for completion of acquisition of Iztok Parkside EOOD;
- 250 thousand euros is short term loans from Estonian companies raised in December for financing the first payment of the new property acquisition close to Kodulahe project in Tallinn.

Changes in loans and borrowings in 2015

In 2015, following major loan obligations were settled:

- In January, the group repaid last part, in the amount of 606 thousand euros, of the 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, consisting 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 for 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 the amount of 950 thousand euros from 20 February 2015. Also, an agreement was reached with the bank for amendments to loan contract which mitigate risks regarding the terms of a 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 the amount of 500 thousand euros was 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 of 31 December 2015, loan limit in amount of 2,734 thousand euros was used, out 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 was repaid to the bank.

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 2016	31 Dec 2015	**31 Dec 2016**	31 Dec 2015	
Bank loan, development	12/2017	9,024	10,406	5.0	5.0	3M Euribor
Bank loan, development	1/2018	2,714	-	3.7	-	6M Euribor
Bonds, development	1/2018	1,120	-	12	-	Fixed
Bank loan, development	11/2019	1,050	-	2.5	-	1M Euribor
Other loan, acquisition of land	12/2017	250	-	12	-	Fixed
Other loan, working capital	5/2017	50	-	6.0	-	Fixed
Bank loan, acquisition of land	8/2017	39	95	4.0	4.0	6M Euribor
Finance leases	2/2018	10	23	8.1	8.1	Fixed
Convertible bond	3/2020	1	1	5.0	5.0	Fixed
Bank loan, development	-	-	1,286	-	4.4	3M Euribor
Bank loan, acquisition of land	-	-	500	-	6.5	6M Euribor
Bank loan, working capital	-	-	250	-	4.4	3M Euribor
Bonds, working capital	-	-	150	-	9.8	Fixed
Bank loan, development	-	-	48	-	6.0	6M Euribor
Finance leases	-	-	3	-	3.0	3M Euribor
Total		**14,258**	**12,762**			

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 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 25. Information on assets pledged as loan collateral is presented in note 26.

22. Payables and deferred income

Short-term payables and deferred income

As of 31 December	2016	2015
In thousands of euros		
Trade payables [1]	**800**	**296**
Miscellaneous payables	**21**	**172**
Taxes payable		
Value added tax	66	47
Corporate income tax	53	114
Social security tax	47	40
Personal income tax	27	31
Other taxes	173	336
Total taxes payable	**366**	**568**
Accrued expenses		
Payables to employees	117	174
Interest payable	76	8
Other accrued expenses	5	11
Total accrued expenses	**198**	**193**
Deferred income		
Prepayments received on sale of real estate [1]	2,958	704
Other deferred income	26	2
Total deferred income	**2,984**	**706**
Total short-term payables and deferred income	**4,369**	**1,935**

[1] as of 31 December 2016, the balances of prepayments received on sale of real estate and trade payables have increased significantly mainly due to prepayments collected on presale of apartments of first stage apartment building in Kodulahe project in the amount of 2,669 thousand euros and an unpaid invoice for December 2016 to the main contractor in the amount of 600 thousand euros.

23. Provisions

	Provisions
In thousands of euros	
Provisions on 31 December 2014	**274**
Amounts used and reversed	-241
Additional provisions made	113
Provisions on 31 December 2015	**146**
Amounts used and reversed	-76
Additional provisions made	38
Provisions on 31 December 2016	**108**

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 contractual obligations by the constructor typically within one year from handing over the construction. In 2015, 169 thousand euros was paid out to constructor and new provision in the amount of 113 thousand euros was recognised after the completion of construction on the third stage of Manastriski Livadi project. In 2016, the provisions were realised in the amount of 76 thousand euros. As of 31 Decemebr 2016, the balance of warranty provisions of Manastirski Livadi project amounted to 70 thousand euros.

On 31 December 2016, a new provision in the amount of 38 thousand euros was recognised for covering the warranty works expenses of Kodukolde project.

24. Share capital

As of 31 December	2016	2015
Number of issued shares fully paid up	6,507,012	6,117,012
Share capital (in thousands of euros)	4,555	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, allocation of the Company's profit, and distribution of remaining assets on dissolution of the Company as well as with other rights provided by law and the Company's articles of association.

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 gave 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. The CEO transferred the right for subscription to the company Alarmo Kapital OÜ where he has a controlling interest. On 4 November 2016, 390 thousand new shares were issued after the subscription right was executed. Alarmo Kapital OÜ paid 273 thousand euros for the shares. After the share issue, Arco Vara's share capital consists of 6,507,012 shares in the nominal value of 4,555 thousand euros.

The share premium in the amount of 292 thousand euros was formed after public share issue held in 2014, when investors bought shares over nominal value of shares.

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 44% of share capital as of 31 December 2016.

25. 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 5 banks, where 90% out of group's total cash are deposited, are presented in following table. On 31 December 2016, the share of other banks remains below 3% 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	36.7%	BBB-	Baa1	BBB+
Raiffeisenbank Bulgaria	18.0%	BBB+	Baa2	BBB-
Swedbank AS group banks	12.4%	AA-	Aa3	AA-
Nordea group banks	12.2%	AA-	Aa3	AA-
LHV Pank AS	11.7%	Not rated	Not rated	Not rated
Cash in other banks and petty cash	9%	-	-	-

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 of 31 December 2016 was 1,048 thousand euros (31 December 2015: 1,093 thousand euros).

Financial assets by maturity

				on 31 December 2016
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousand of euros				
Cash and cash equivalents (note 16)	845	0	0	845
Trade and other receivables (note 17)	203	0	0	203
Total	**1,048**	**0**	**0**	**1,048**

				on 31 December 2015
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousand of euros				
Cash and cash equivalents (note 16)	745	0	0	745
Trade and other receivables (note 17)	348	0	0	348
Total	**1,093**	**0**	**0**	**1,093**

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 in group entities outside Estonia is intra-group borrowing from the parent company.

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

Maturity structure of financial liabilities (undiscounted)

				on 31 December 2016
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	17	9,356	6,145	15,518
Interest payable	179	624	187	990
Other financial liabilities	858	44	0	902
Total	**1,054**	**10,024**	**6,332**	**17,410**

				on 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**

Based on the maturities of liabilities included in the group's loan portfolio, as of 31 December 2016, the average weighted maturity of the group's loans and borrowings was 1.2 years (as of 31 December 2015: 1.7 years). For more information on loans and borrowings see also note 21.

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.

31 December 2017 is the repayment date of the loan concluded between Arco Invest EOOD (the company developing Madrid Blvd building) and Piraeus bank in the amount of 9 024 thousand euros (balance on 31 December 2016). Assets in the amount of 11 905 thousand euros (incl financial assets in the amount of 197 thousand euros) have been pledged for this loan. The value of the pledged assets has been determined by assuming the receipt of economic value from these assets during ordinary course of business.

In Q1 2017, pre-negotiations for extending the loan were started and the bank has initially expressed their willingness to extend the loan. Detailed negotiations will continue during 2017. Considering that the loan has been extended in previous years and that the loan has been served by Arco Invest EOOD in compliance with the loan terms, it could be expected that an agreement will be reached for extending the loan.

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;
- 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. During 2016, Euribor interest rates have been negative. Therefore, there is practically no Euribor component in group's loans as of 31 December 2016 and also as of 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 of 31 December 2016, indicated that a 1 percentage point change (increase or decrease) in interest rates of floating rate loans would have affected (increased or reduced) profit before tax by 128 thousand euros (on 31 December 2015: 121 thousand euros).

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

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

Currency risk

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

Capital management

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

• the minimum share capital of a limited liability company defined as *aktsiaselts* has to amount to at least 25 thousand euros;

• the net assets of a limited liability company defined as *aktsiaselts* have to amount to at least half of its share capital but not 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 of 31 December 2016, the Company's share capital consists of 6,507,012 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 of 31 December 2016, the share capital of Arco Vara AS was 4,555 thousand euros and net assets were 8,985 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; otherwise, the bank may apply higher interest rates to existing loans.. These covenants refer to legal requirements in respect 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 of 31 December 2016, the equity was negative in three group companies which had bank borrowings. On all these cases so far, agreement has been reached with banks allowing amendment of this deficiency, but on condition that all loan obligations are fulfilled according to agreed terms. On 31 December 2016, the group has such loans in total amount of 11,777 thousand euros (on 31 December 2015: 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. On 31 December 2016, total capital amounted to 22,398 thousand euros (on 31 December 2015: 21,647 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. On 31 December 2016, equity accounted for 32.4% (on 31 December 2015: 39.3%) of total assets.

Other Information

26. Assets pledged as collateral

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

As of 31 December	2016	2015
In thousands of euros		
Cash and cash equivalents	19	40
Receivables [1]	140	22
Inventories	13,410	11,708
Investment property	10,474	8,762
Property, plant and equipment	587	322
Total carrying value of assets pledged as collateral	**24,630**	**20,854**

[1] - Pledged receivables should be collected to the bank accounts with limited usage (see also note 16).

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 of 9,024 thousand euros as of 31 December 2016 (on 31 December 2015: 10,406 thousand euros).

27. Contingent liabilities

Contingent income tax liability

As of 31 December 2016, the group's retained earnings amounted to 2,075 thousand euros (on 31 December 2015: 2,656 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 2017, income tax liability would be 415 thousand euros and the amount to be paid out to shareholders would total 1,660 thousand euros. Income tax liability can be decreased by the amount of income tax already paid on distributing profit in subsidiaries. In 2016 and in 2015, this reduction was used when paying out dividends to shareholders in the amount of 61 thousand euros (0.01 euros per share); 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 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. Tax authorities have performed narrow scope tax reviews in 2012-2016 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.

28. 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 officer 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 chief executive officer and the members of the supervisory board of Arco Vara AS and companies under the control of these persons (excluding companies that have a significant interest in the group's parent company).

Transactions with related parties

	2016	2015
In thousands of euros		
Companies that have a significant interest in the group's parent company		
Share capital contribution	273	0
Services purchased	34	32
Bonds issued	100	0
Redemption of bonds	150	500
Paid interest	9	92
Other related parties		
Services sold	1	2
Prepayments received	6	0
Bonds issued	1	0
Redemption of bonds	0	260
Paid interest	0	40

Balances with related parties

As of 31 December	2016	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	1	1

Significant transactions with related parties in 2016 and 2015

On 19 and 20 February 2015, 18 months before maturity date, Arco Vara redeemed bonds in the 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, consisting 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 for the proposal for earlier redemption.

On 21 March 2014, Arco Vara AS issued bonds as targeted issue in the 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. The bonds were redeemed by January 2016, including bonds in the amount of 100 thousand euros which were converted into the new bond issue conducted in December 2015 and January 2016. See also note 21.

Remuneration of key management personnel

In 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 111 thousand euros (in 2015: 108 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 signing of the minutes of the meetings of the supervisory board. Reasonable travel expenses made for participating in 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 had been issued to the CEO / member of management board in 2013, which gave 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 was recognized as payroll expense distributed over the period from July 2013 until December 2015. In November 2016, the subscription right was executed by the company Alarmo Kapital OÜ where CEO has controlling interest. Alarmo Kapital paid in 273 thousand euros for issue of additional shares.

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. As of 31 December 2016, an equity reserve in the amount of 52 thousand euros has been formed for the option associated with the bond. See also note 14.

In 2016 and 2015, all transactions with related parties have been conducted in market conditions and no receivables from related parties were impaired.

29. Events after the reporting date

In January 2017, transaction for selling the Baltezers-3 project (68 plots) in Latvia was completed. As the agreement for this transaction had been reached in December 2016 already, the accounting loss from this transaction in the amount of 200 thousand euros was recorded in 2016.

In February 2017, Arco Vara AS signed a franchise agreement with its former subsidiary SIA Arco Real Estate, the minority holding of which had been sold to the management in October 2016. With the new franchise agreement, conditions of using Arco Vara trademark in Latvia were fixed.

In the first quarter of 2017, a delay has emerged in Iztok Parkside project. This will also delay initial deadlines of the project: beginning of construction in the first quarter of 2017 and end of sales period in the first quarter of 2018. By the date of this annual report, the construction has not started yet due to delays in obtaining construction permit from Sofia municipality. The project will be developed simultaneously with construction of a new access street that will be built onto state-owned land plots. According to Sofia municipality, the respective Bulgarian state institutions that own the land underneath the future access street and the municipality itself must complete the process of either municipalisation of those land plots or registering a street servitude in favour of the city, before the construction permit can be issued. Construction of the new access street is foreseen in the detail plan that has entered into force. The company cooperates with the municipality to facilitate the land municipalisation or servitude process.

30. Structure of Arco Vara group

Company	Domicile	Group's ownership interest On 31 December 2016	On 31 December 2015
%			
Service segment			
Subsidiaries			
Arco Real Estate AS	Estonia	100	100
Arco Imoti EOOD	Bulgaria	100	100
Arco Facility Management EOOD	Bulgaria	100	100
Arco Projects EOOD	Bulgaria	100	100
Arco Real Estate SIA [1]	Latvia	-	70,6
Adepto SIA [1]	Latvia	-	70,6
Development segment			
Subsidiaries			
Arco Investeeringute AS	Estonia	100	100
Kerberon OÜ	Estonia	100	100
Kolde AS	Estonia	100	100
Kodulahe OÜ	Estonia	100	100
Arco Vara Haldus OÜ	Estonia	100	100
Kodulahe II OÜ	Estonia	100	-
Arco Manastirski EOOD	Bulgaria	100	100
Arco Invest EOOD [1]	Bulgaria	100	100
Arco Real Estate Fund REIT	Bulgaria	100	70
Iztok Parkside EOOD	Bulgaria	100	-
Marsili II SIA	Latvia	100	100
Arco Development SIA	Latvia	100	100
Ulmana Gatves Nami SIA [1]	Latvia	100	100
Arco Invest UAB	Lithuania	100	100
Arco Development UAB [1]	Lithuania	100	100
Arco Investments TOV [1]	Ukraine	75	75
Arco BB EOOD	Bulgaria	-	100
Fineprojekti OÜ (likvideerimisel) [1]	Estonia	-	100
Tivoli Arendus OÜ [1]	Estonia	-	100
Arco Capital Real Estate SRL [1]	Romania	-	100

[1] - Interest through a subsidiary

31. 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 in 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

	2016	2015
In thousands of euros		
Revenue from rendering of services	**349**	**329**
Other income	0	1
Marketing and distribution expenses	-55	-6
Administrative expenses	-753	-751
Other expenses	-5	-15
Gain on investments in subsidiaries	9	503
Operating profit/loss	**-455**	**61**
Interest income	349	242
Interest expense	-321	-125
Total finance income and costs	**28**	**117**
Net profit/loss for the year	**-427**	**178**
Total comprehensive income/expense for the year	**-427**	**178**

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

As of 31 December	**2016**	2015
In thousands of euros		
Cash and cash equivalents	121	70
Receivables and prepayments	7,423	211
Inventories	0	210
Total current assets	**7,544**	**491**
Investments[1]	7,407	5,312
Receivables and prepayments	11	5,076
Property, plant and equipment	27	36
Intangible assets	216	210
Total non-current assets	**7,661**	**10,634**
TOTAL ASSETS	**15,205**	**11,125**
Loans and borrowings	4,121	2,844
Payables and prepayments	624	111
Total current liabilities	**4,745**	**2,955**
Loans and borrowings	2,464	11
Total non-current liabilities	**2,464**	**11**
TOTAL LIABILITIES	**7,209**	**2,966**
Share capital	4,555	4,282
Share premium	292	292
Statutory capital reserve	2,011	2,011
Other reserves	52	298
Retained earnings	1,086	1,276
Total equity	**7,996**	**8,159**
TOTAL LIABILITIES AND EQUITY	**15,205**	**11,125**

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

UNCONSOLIDATED STATEMENT OF CASH FLOWS (direct method)

	2016	2015
In thousands of euros		
Cash receipts from customers	330	503
Cash paid to suppliers	-754	-865
Taxes paid and recovered (net)	368	-38
Cash paid to employees	-189	-177
Other payments and receipts related to operating activities, net	-6	-149
NET CASH USED IN OPERATING ACTIVITIES	**-251**	**-726**
Paid on acquisition of tangible and intangible assets	-54	-128
Paid on formation and acquisition of subsidiaries	-83	-179
Paid on purchase of a subsidiary	-1,890	0
Proceeds from sale of a subsidiary	1	0
Loans provided	-2,490	-3,352
Repayment of loans provided	114	1,642
Dividends received	1,002	624
Interest received	0	170
NET CASH USED IN INVESTING ACTIVITIES	**-3,400**	**-1,223**
Proceeds of loans received	5,190	2,392
Settlement of loans and borrowings	-1,566	-781
Proceeds from share capital issue	273	0
Dividends paid	-61	-61
Interest paid	-134	-134
NET CASH FROM FINANCING ACTIVITIES	**3,702**	**1,416**
NET CASH FLOW	**51**	**-533**
Cash and cash equivalents at beginning of year	**70**	**603**
Change in cash and cash equivalents	51	-533
Cash and cash equivalents at end of year	**121**	**70**

UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total
In thousands of euros						
Balance on 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
Net profit for the year	0	0	0	0	178	178
Balance on 31 December 2015	**4,282**	**292**	**2,011**	**298**	**1,276**	**8,159**
Profit distribution	0	0	0	0	-61	-61
Share capital issue	273	0	0	-298	298	273
Formation of equity reserve	0	0	0	52	0	52
Net loss for the year	0	0	0	0	-427	-427
Balance on 31 December 2016	**4,555**	**292**	**2,011**	**52**	**1,086**	**7,996**

Adjusted unconsolidated equity

As of 31 December	**2016**	**2015**
In thousands of euros		
Parent company's unconsolidated equity	**7,996**	**8,159**
Carrying amount of investments in subsidiaries in the parent company's unconsolidated statement of financial position (-)	-7,407	-5,312
Value of investments in subsidiaries under the equity method (+)	8,396	6,783
Parent company's adjusted unconsolidated equity	**8,985**	**9,630**

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 2016 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 profit or loss 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 uncertainties.

31 March 2017

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

Independent auditor's report

To the Shareholders of Arco Vara AS

(Translation of the Estonian original)*

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Arco Vara AS and its subsidiaries (together the Group) as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS).

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of comprehensive income for the year ended 31 December 2016;
- the consolidated statement of financial position as at 31 December 2016;
- the consolidated statement of cash flows for the year ended 31 December 2016;
- the consolidated statement of changes in equity for the year ended 31 December 2016; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

Independence

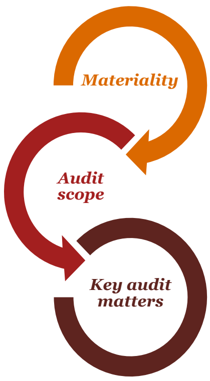
We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

Emphasis of matter

We draw attention to Note 25 to these consolidated financial statements, which describes the circumstances around the Group's short-term borrowings and assets pledged against them. The measurement of assets pledged against short-term borrowings (investment properties, property, plant and equipment and inventories in Bulgaria with the carrying amount of EUR 11.7 million) assumes the realization of economic benefits from these assets in the ordinary course of business. If the Group is unable to prolong the repayment date of its short-term borrowings then it may be forced to sell the pledged assets in a distressed sale at a price lower than their carrying amount as at 31 December 2016. Our opinion is not qualified in respect of this matter.

Our audit approach

Overview



Materiality

Overall group materiality is EUR 255 thousand, which represents approximately 1% of the Group's total assets.

Audit scope

Substantially all assets and revenue related to Group entities, which are audited by the Group audit team or component auditors as per instructions issued by the Group audit team.

Key audit matter

- Valuation of office and commercial spaces in Bulgaria, classified as investment property

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the Management Board made subjective judgments; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgment, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall group materiality	EUR 255 thousand
How we determined it	1% of total assets
Rationale for the materiality benchmark applied	We have applied this benchmark, as the value of the Group's assets (consisting mainly of inventories and investment properties) is a key performance indicator monitored both internally and externally. Furthermore, we did not consider profit before tax to be suitable as it fluctuates significantly over the years depending on when development projects are sold.

How we tailored our audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group comprises a number of subsidiaries that mostly operate in the Baltics and Bulgaria (refer to Note 30). Based on our risk and materiality assessments, we determined which entities were required to be audited at full scope, taking into account the relative significance of each entity to the Group as a whole and in relation to each material line item in the consolidated financial statements.

For Arco Vara AS, Arco Real Estate AS, Arco Investeeringute AS, AS Kolde and Kodulahe OÜ, full scope audits were performed by the Group audit team. For Arco Invest EOOD and Arco Manastirski EOOD full scope audits were performed by component auditors as per instructions issued by the Group audit team. In respect of remaining entities we performed full scope audit procedures on selected balances and transactions, relating primarily to valuation of investment properties, inventories, and sales revenue.

Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

Key audit matter

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	*How our audit addressed the key audit matter*
Valuation of office and commercial spaces in Bulgaria classified as investment property (refer to Note 4 'Significant accounting policies', Note 2 'Statement of compliance and basis of preparation' and Note 19 'Investment properties' for further details). As at 31 December 2016, the carrying amount of the Group's investment property portfolio in Bulgaria, including office and commercial spaces, amounted to EUR 7.9 million. Investment property is measured at fair value. Fair value of office and commercial spaces in Bulgaria is assessed by the management using income approach. The valuation technique uses various observable and unobservable inputs such as maximum rentable area, vacancy by property, net rent charge per square meter and capitalisation rates. Reasonableness of the valuation is evaluated by comparison with market data for comparable transactions, if available. For the purposes of the valuation the management takes into account existing property-specific information, such as current tenancy agreements. However, other inputs are based on future forecasts and assumptions, such as estimated future rental rates, vacancy trends, and capitalisation rates. The valuation of the Group's office and commercial premises portfolio in Bulgaria is inherently subjective due to, among other factors, the individual nature, historic performance and the location of property. The results of valuation are sensitive to changes in the inputs used in the valuation model. Due to the magnitude and related estimation uncertainty, valuation of office and commercial spaces in Bulgaria is considered a key audit matter.	Given the inherent subjectivity involved in the valuation of properties and the need for deep market knowledge and valuation expertise, we engaged our internal valuation specialists to assist us in our audit of this area. We considered the management's expertise to perform property valuation. We found that the management has sufficient expertise in valuations in the markets in which the Group operates. We assessed the valuation methodology used by the management and found that the valuation techniques used were in accordance with IFRS requirements. On a sample basis, we performed detailed testing of the inputs used in the valuation model. For inputs based on existing contracts and regulations (including total rentable space, existing rent charge per square meter, property taxes, etc.) we reconciled them to the underlying contracts and property-specific information. For inputs based on forecasts and assumptions we assessed their reasonableness by comparing them with historical property-specific data and available market information (including market rents and yields) obtained from the reports of independent real estate advisory companies active in Bulgaria. It was evident from our work that close attention had been paid to each property's individual characteristics, as well as considering the overall quality, geographic location and desirability of the property as a whole. We also read the disclosures provided in respect of fair values of investment properties, including sensitivity analysis, and found that they comply with IFRS requirements. We recalculated sensitivity analysis on key assumptions, such as changes in rental prices and capitalisation rates. We concluded that the assumptions used in the management's valuations were supportable in light of available property-specific and market evidence. We noted no material exceptions in respect of valuations or respective disclosures.

Other information

The Management Board is responsible for the other information contained in the Group's Consolidated Annual Report in addition to the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Management Board and those charged with governance for the consolidated financial statements

The Management Board is responsible for the preparation and fair presentation of the 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.

In preparing the consolidated financial statements, the Management Board is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management Board either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

AS PricewaterhouseCoopers

Tiit Raimla	Kristiina Veermäe
Certified auditor in charge, auditor's certificate no.287	Auditor's certificate no.596

31 March 2017

* *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 LOSS

The chief executive officer proposes that the annual general meeting of Arco Vara AS transfer the net loss for the year ended 31 December 2016 of 832 thousand euros to retained earnings.

Retained earnings will amount to 2,075 thousand euros after the transfer of year 2016 net loss.

31 March 2017

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