ARCO VARA

Arco Vara AS

Annual Report 2017

Consolidated annual report

(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year:	1 January 2017
End of financial year:	31 December 2017
Registry number:	10261718
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E-mail:	info@arcovara.ee
Corporate website:	www.arcorealestate.com
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 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 making 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.

Vision and mission

Arco Vara's vision:

- We are the most people focused real estate company
- We know real estate the best
- We help the biggest number of people.

Arco Vara's mission is to excel in helping people find their own place and leaving them with unforgettable experiences beyond expectations.

Scope of consolidation

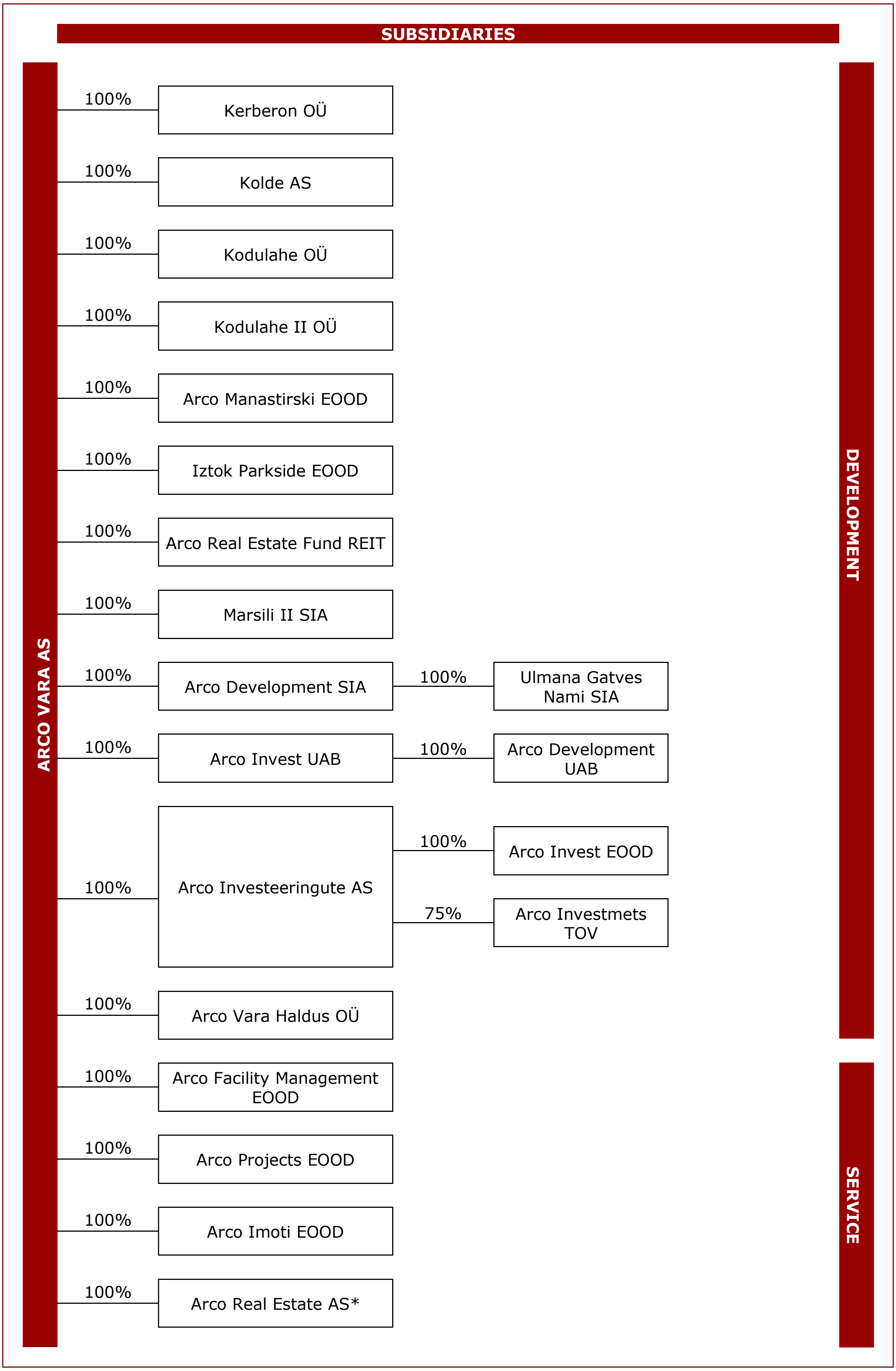
As of 31 December 2017, the group consisted of 21 companies, the same as at the end of 2016.

Significant subsidiaries

Company name	Location	Segment	Share capital (nominal value)	Equity as of 31 Dec 2017	The group's interest
In thousands of euros					
Arco Invest EOOD	Bulgaria	Development	28,762	233	100%
Iztok Parkside EOOD	Bulgaria	Development	1,433	945	100%
Arco Manastirski EOOD	Bulgaria	Development	4	122	100%
Kodulahe OÜ	Estonia	Development	3	1,717	100%
Kerberon OÜ	Estonia	Development	5	1,398	100%
Marsili II SIA	Latvia	Development	1,524	739	100%
Arco Real Estate AS*	Estonia	Service	42	-205	100%
Arco Imoti EOOD	Bulgaria	Service	444	221	100%

* Arco Real Estate AS was renamed Arco Vara Kinnisvarabüroo AS on January 23, 2018

Group structure as of 31 December 2017



* Arco Real Estate AS was renamed Arco Vara Kinnisvarabüroo AS on January 23, 2018

Key performance indicators

- In 2017, the group's revenue was 18.3 million euros, increasing by 88.7% from 2016. The revenue of the Development Division increased 1.3 times, up to 15.9 million euros in 2017. The revenue of the Service Division was 2.9 million euros, decreasing by 9.2% from 2016.
- In 2017, the group's operating profit (=EBIT) was 1.3 million euros and net profit 0.8 million euros. In 2016, the group made operating loss of 0.1 and net loss of 0.8 million euros. The Development Division earned operating profit of 2.0 million euros in 2017 (0.6 million euros in 2016). Operating loss of the Service Division was 0.2 million euros in 2017 as also in 2016.
- In 2017, 117 apartments, 2 commercial spaces and 6 land plots were sold (in 2016: 77 apartments, 9 commercial spaces and 8 land plots). In the first half of 2016, active sales were made in Manastirski project in Bulgaria; in the second half of 2017, Lahepea 7apartments got ready for final sale.
- In 2017, the group's debt burden (net loans) decreased by 3.7 million euros down to the level of 9.7 million euros as of 31 December 2017. As of 31 December 2017, the weighted average annual interest rate of interest-bearing liabilities was 5.4%, which is 0.1% higher than on 31 December 2016.

Operations

	2017	2016
In millions of euros		
Revenue		
Development	15.9	7.0
Service	2.9	3.2
Eliminations	-0.5	-0.5
Total revenue	**18.3**	**9.7**
Operating profit (EBIT)		
Development	2.0	0.6
Service	-0.2	-0.2
Unallocated income and expenses	-0.5	-0.4
Eliminations	0.0	-0.1
Total operating profit (EBIT)	**1.3**	**-0.1**
Financial income and expenses	-0.5	-0.6
Income tax	0.0	-0.1
Net profit	**0.8**	**-0.8**

Main ratios

	2017	2016
Earnings per share, EPS (in euros)	0.12	-0.13
Diluted earnings per share (in euros)	0.11	-0.13
ROIC (rolling, four quarters)	3.2%	-3.7%
ROE (rolling, four quarters)	8.8%	-8.4%
ROA (rolling, four quarters)	2.8%	-3.2%

As of 31 December	2017	2016
In millions of euros		
Total assets	24.3	27.7
Invested capital	21.8	23.2
Net loans	9.7	13.4
Equity	9.8	9.0
Current ratio	2.72	1.15
Quick ratio	0.69	0.09
Financial leverage	2.49	3.09
Average loan term (in years)	1.7	1.2
Average annual interest rate of loans	5.4%	5.3%
Number of staff, end of period	140	110

Cash flows

	2017	2016
In millions of euros		
Cash flows from/used in operating activities	-2.0	1.7
Cash flows from/used in investing activities	-0.5	-2.4
Cash flows from/used in financing activities	3.9	0.8
Net cash flows	**1.4**	**0.1**
Cash and cash equivalents at the beginning of period	0.8	0.7
Cash and cash equivalents at the end of period	2.2	0.8

Revenue and net profit/loss from operations

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	**Total 2015**	Q1 2016	Q2 2016	Q3 2016	Q4 2016	**Total 2016**	Q1 2017	Q2 2017	Q3 2017	Q4 2017	**Total 2017**
In millions of euros															
Revenue	4.4	2.1	2.1	2.1	**10.7**	5.1	2.1	1.2	1.3	**9.7**	1.6	1.0	7.7	8.0	**18.3**
Net profit/loss	0.7	0.0	0.2	-0.4	**0.5**	1.1	-0.2	-0.4	-1.3	**-0.8**	-0.3	-0.3	0.7	0.8	**0.8**

<u>Formulas used:</u>
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 + non-current interest-bearing loans and borrowings + equity (at the end of period)
Net loans = current + non-current interest bearing loans and borrowings – 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 service contracts

Group CEO's overview

For Arco Vara, year 2017 ended with healthy sales revenue of 18 million euros, which, among other things, is a sustainable level. Compared to the end of 2016, we had created a much stronger foundation by the end of 2017.

Firstly, we now have two active ongoing developments, Iztok Parkside and Kodulahe, in addition to which we gained opportunities to increase our development volumes. We have used these opportunities by the reporting date by acquiring Lozen project in Sofia and Paldiski mnt 74 plot in Tallinn. Figuratively speaking, at any point in time, we have at least two cranes up and working, and 1000+ apartments lined up in the Group's development portfolio.

Secondly, our cash position has improved and our loan burden has decreased by over 20%. In addition, the loan burden has been restructured from mostly short-term to mostly long-term.

Thirdly, the Group made a profit and the profit reached our bank account. As a director and as a shareholder, this is the kind of profit I value the most.

The only thing where we remained below our expectations was the size of the profit, which amounted to 0.8 million euros. Return on equity of 8.8% p.a. is not enough. Here we have to take a look in the mirror and find opportunities to increase equity turnover. In Madrid Blvd building in Sofia, the rental income was below expectations because we did not achieve full occupancy, and the lost profits were in the same ballpark. In Kodulahe project Estonia, about 10% of the project remained unsold by year-end, to be sold during 2018. We saw no good reason to accelerate sales in the situation where construction prices are on the rise and where we will not have new sellable apartments in Kodulahe before 2019. In our real estate services business, we did not yet reach profit in 2017, despite increased revenues.

In 2018, we will mostly be laying foundation for the results of 2019-2020, which will mostly come from Lozen, Kodulahe and smaller developments. We will continue providing real estate services with the aim of becoming the most people-focused real estate company. Towards the end of the year, we will start selling Iztok Parkside apartments and thus the fourth quarter will have the largest bearing on our annual results. The results of Iztok Parkside project will also have the largest impact on our net profit. In terms of distributing the net profit of 2017, dividend payments should remain at previous levels and earned cash should be reinvested into growth.

In summary, Arco Vara will continue accelerating. As the pace of real estate development is comparable to that of a road roller, the acceleration may be less visible, but will have a longer-lasting impact.

Service Division

Revenue of the Service Division amounted to 2,935 thousand euros in 2017, a decrease by 9.2% compared to 2016 revenue of 3,231 thousand euros.

The main services of the Service Division are real estate brokerage and valuation services through real estate agencies. In 2017, revenue from real estate agencies decreased by 9% compared to 2016. The main reason is the fact that the Latvian agency was sold out from the group during Q4 of 2016. In 2016, revenue of Latvian agency was 771 thousand euros.

As the table below demonstrates, sales revenues of both Estonian and Bulgarian real estate agencies have actually increased significantly.

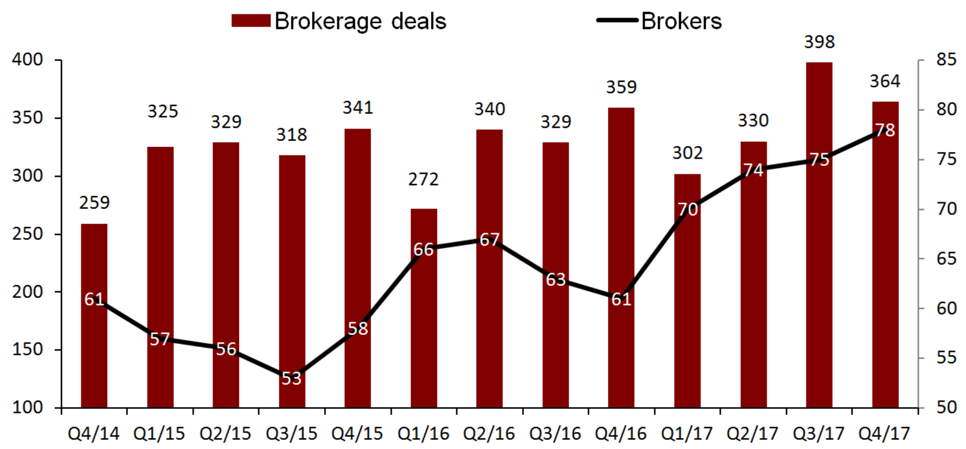
Revenue of real estate agencies from brokerage and valuation

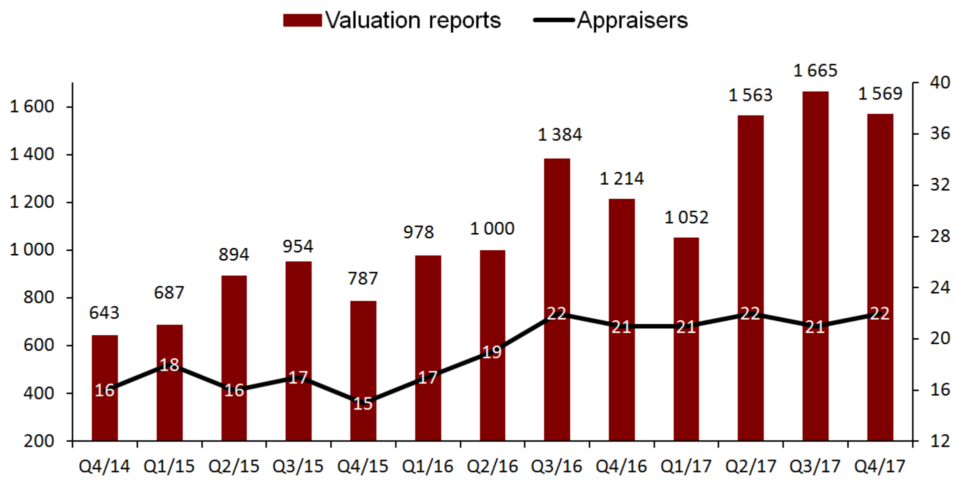
	2017	2016	Change, %
In thousands of euros			
Estonia	1,793	1,422	26%
Bulgaria	798	639	25%
Latvia	-	771	-
Total	**2,591**	**2,832**	**-9%**

In 2017, Estonian agency had net loss of 235 thousand euros (in 2016: 188 thousand euros). Bulgarian agency earned net profit of 50 thousand euros in 2017 (in 2016: net loss of 19 thousand euros).

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 124 thousand euros in 2017, 102 thousand euros of which was intra-group revenue (in 2016: 118 thousand and 100 thousand euros, respectively). Revenue from accommodation services amounted to 182 thousand euros in 2017 (in 2016: 144 thousand euros).

The numbers of brokerage deals and valuation reports of the Service Division over the last three years, 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 2017, the number of staff in the Service Division was 126 (on 31.12.2016: 97).

Development Division

The revenue of the Development Division totalled 15,860 thousand euros in 2017 (in 2016: 7,048 thousand euros), including revenue from the sale of properties in the group's own development projects in the amount of 14,390 thousand euros (in 2016: 6,562 thousand euros). In Q3, the construction of apartments of the first stage apartment building (with 125 apartments and 5 commercial spaces) in the group's largest ongoing development project Kodulahe came close to an end, and active final sales started. By the publishing date of the annual report, sale agreements for 121 apartments and 2 commercial spaces have been concluded.

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 493 thousand euros in 2017 (in 2016: 369 thousand euros). By the publishing date of the annual report, one office space remains vacant.

In 2017, the Development Division had operating profit of 2 million euros. In 2016, the Development Division had operating profit of 611 thousand euros.

In 2017, four apartments were sold in Madrid Blvd complex in Sofia. By the end of the year, 1 apartment remained unsold. Additional 15 apartments have been furnished and are being rented out as accommodation service. Unsold parking places are also being rented out.

In 2017, preparatory works in the second stage of Kodulahe project continued, where a building with 68 apartments and 1 commercial space is planned. Preparatory works also continued for Oa street properties in Tartu, where 4 smaller apartment buildings are planned. Both projects are expected to be finalised by mid-2019.

In Iztok Parkside project in Sofia, construction started in October 2017. By the publication date of this report, presale agreements for 28 apartments have been signed. Iztok project consists of three apartment buildings with 68 apartments (7,070 square meters of apartments' sellable area).

As of 31 December 2017, 6 Marsili residential plots remained unsold in Latvia. During 2017, 4 plots were sold in the project. Additionally, the sale of Baltezers-3 project (68 undeveloped land plots as a whole) was finished. By the publishing date of the annual report, 4 plots remain unsold in Marsili project.

As of 31 December 2017, 5 people were employed in the Development Division, the same number as at the end of 2016.

Summary table of Arco Vara's active projects as of 31 December 2017

Project name	Address	Product main type	Stage	Area of plot(s) (m²)	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	23
Madrid Blvd	Madrid Blvd, Sofia	Apartments	S5/S6	-	1,501	16
Iztok Parkside	Iztok, Sofia	Apartments	S3	2,470	7,070	68
Marsili residential plots	Marsili, near Riga	Residential plots	S5	-	10,831	6
Kodulahe, stage 1	Lahepea 7, Tallinn	Apartments, commercial premises	S5	6,102	1,335	15
Kodulahe, stage 2	Lahepea 9, Tallinn	Apartments	S3	3,686	5,079	69
Kodulahe, stages 3-5	Soodi 4, Pagi 3, 5, Tallinn	Apartments	S3	10,578	<8,100>	<120>
Oa street apartments	Oa street, Tartu	Apartments	S3	4,146	1,950	30
Lehiku residential units	Lehiku 21,23 Tallinn	Apartments	S3	5,915	<700>	<5>

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 2017, 140 people worked for the group (110 as of 31 December 2016). As of 31 December 2017, 77 persons worked with an employment contract, 62 with a service agreement and 1 with a board member agreement (31.12.2016: 59, 50, 1, accordingly). Employee remuneration expenses amounted to 2.6 million euros in 2017 (in 2016: 2.8 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 120 thousand euros in 2017 (111 thousand euros in 2016).

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.

In addition Tarmo Sild is also a member of management board of the following companies and non-profit organizations outside Arco Vara group: Aia Tänav OÜ, Alarmo Capital OÜ, OÜ Catsus, Eesti Kaugpüüdjate Liit, Eesti Porsche Klubi.

The supervisory board

As of 31 December 2017, supervisory board of Arco Vara AS consisted 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 and non-profit organizations outside Arco Vara group: OÜ HM Investeeringud, Loodusvarade Halduse Mittetulundusühing, P457 OÜ, Noah Villas OÜ, TIK Spordimaja 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 largest 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. He serves as member of supervisory board of AS LHV Finance, AS LHV Pank, AS LHV Group, AS Hortes, OÜ HA Serv 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 in 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 and OÜ Kavass and chairman of supervisory board of AS IuteCredit Europe.

Steven Yaroslav Gorelik

Mr Gorelik has graduated from Columbia University and Carnegie Mellon 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 in 2007. 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, Mittetulundusühing Rulluisufestival, One Eleven OÜ, Uisuklubi Albe 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 2017, in Tallinn 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 presale 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 1, 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 2017, the group's interest-bearing liabilities amounted to 12.3 million euros (decreased by 3.2 million euros during 2017), out of which 2.1 million euros is due within next 12 months (see also note 21). At the same time, the group's cash and cash equivalents totalled 2.3 million euros as of 31 December 2017 (on 31 December 2016: 0.8 million euros). In 2017, interest payments on interest-bearing liabilities totalled 0.9 million euros (in 2016: 0.8 million euros). The group's weighted average loan interest rate was 5.4% as of 31 December 2017. This is an increase by 0.1 percentage points compared to the end of year 2016. The reason for the increase is new borrowings raised in 2017, 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 internal 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;
- construction 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. 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

Share price

As of 31 December 2017, the company had issued 6,507,012 ordinary shares. The share capital of the company increased during the share issue carried out in January 2018 from 6,507,012 to 8,998,367 ordinary shares with nominal value of 0.7 euros per share.

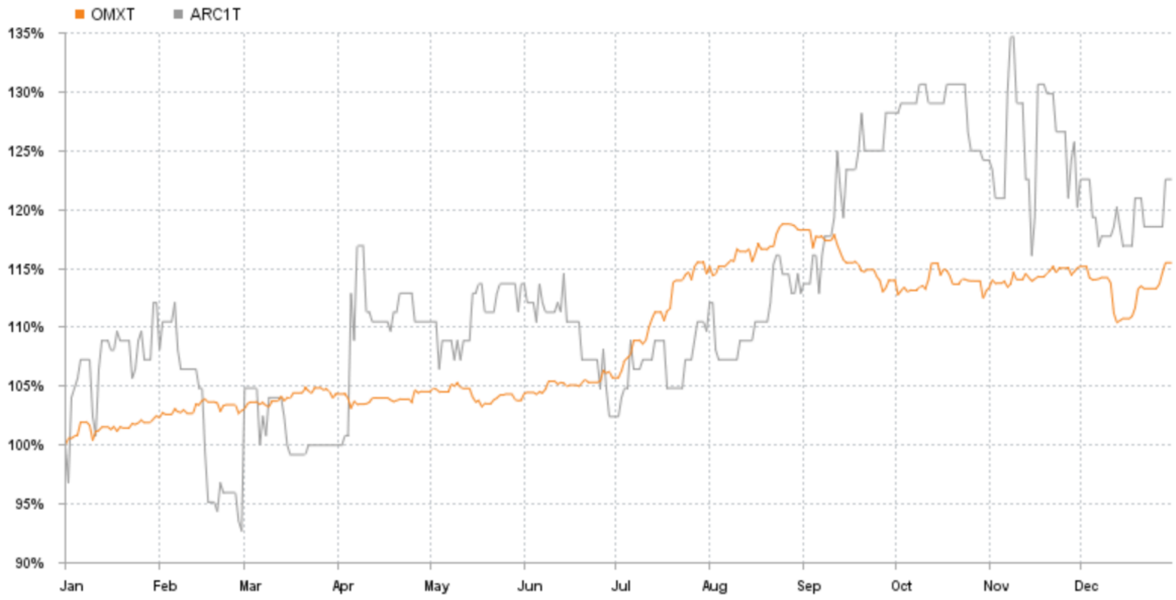
The shares of Arco Vara AS are freely traded on NASDAQ Tallinn stock exchange. The share price closed at 1.52 euros on 31 December 2017 (1.24 euros on 31 December 2016). During the period, the highest traded price per share was 1.69 euros and the lowest price 1.15 euros. As of 31 December 2017, market capitalization of shares amounted to 9,891 thousand euros and P/B (price to book value) ratio was 1.01 (31 December 2016: 8,069 thousand euros and 0.90, respectively). Based on the last four quarters' profit, P/E (price to earnings) ratio was 12.60 on 31 December 2017, but negative on 31 December 2016.

The following charts reflect the movements in the price and daily turnover of Arco Vara's share in 12 months of 2017 and during the last three years.

Performance of Arco Vara's shares in 2017

Performance of Arco Vara's shares from 31 December 2014 until 31 December 2017

Changes in Arco Vara share price compared with the benchmark index OMX Tallinn in 2017

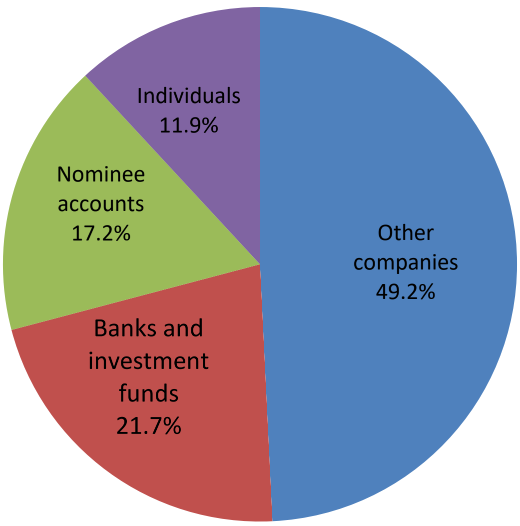


Index/equity	31 Dec 2017	31 Dec 2016	+/-%
OMX Tallinn	1,242.12	1,075.50	+15.49
ARC1T	1.52 EUR	1.24 EUR	+22.58

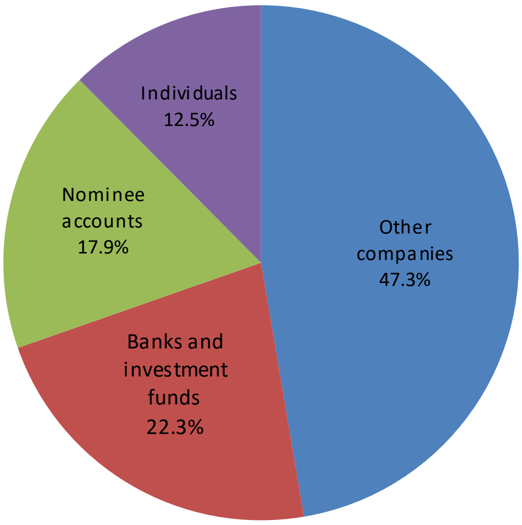
Structure of shareholders

As of 31 December 2017, Arco Vara AS had 1,403 shareholders (on 31 December 2016: 1,502), including 1,211 individuals as shareholders (on 31 December 2016: 1,297 individuals) who jointly owned 11.9% (on 31 December 2016: 12.5%) of the company. Complete shareholder structures are presented on the following diagrams:

Ownership structure as of 31 December 2017



Ownership structure as of 31 December 2016



Major shareholders on 31 December 2017

Name	No of shares	Share, %
Alarmo Kapital OÜ	1,015,805	15.6%
NORDEA BANK FINLAND PLC client	862,820	13.3%
AS Lõhmus Holdings	602,378	9.3%
Gamma Holding Investment OÜ	562,893	8.7%
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	1,876,513	28.8%
Total	**6,507,012**	**100.0%**

Holdings of management and supervisory board members on 31 December 2017

Name	Position	No of shares	Share, %
Tarmo Sild and Allar Niinepuu (Alarmo Kapital OÜ)	member of management board/ member of supervisory board	1,015,805	15.6%
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	206,371	3.2%
Steven Yaroslav Gorelik [1]	member of supervisory board	0	-
Total		**2,193,813**	**33.8%**

[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.

According to the decision of the annual general meeting of Arco Vara AS, held on 30 May 2017, twelve convertible bonds were issued with the nominal value of 500 euros each. The convertible bonds will give to the key employees of the group the right to subscribe to the total of up to 200 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2020 if the net profit for years 2017-2019 combined is at least 5.5 million euros.

CORPORATE GOVERNANCE REPORT

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

Together with the annual report, the Company discloses its corporate governance report in which the Management confirms the Company's compliance with the Corporate Governance Recommendations ("the CGR"). Any instances of non-compliance with the CGR are disclosed and the reasons for non-compliance are explained. The annual report has been prepared in accordance with the guidance of the CGR. The current corporate governance report is a separate section of the 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 governed by the Company's articles of association and the Commercial Code.

In 2017, one annual and one extraordinary general meeting took place.

Annual general meeting

Notice of the annual general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website on 11 April 2017. The notice was published in the national daily newspaper *Postimees* on 12 April 2017. 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 convened general meeting did not take place on 5 May 2017 as planned due to lack of quorum. The notice of the new general meeting was disclosed in the information system of the Tallinn Stock Exchange and on the Company's website on 5 May 2017 and the general meeting took place on 30 May 2017 from 10:05 a.m. until 10:25 a.m. in Tallinn at Rävala pst 3, in Hamburg meeting room of Radisson Blu Sky Hotel.

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

- approval of the annual report for 2016
- distribution of profit;
- 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 2016.
- To cover the net loss for the year ended on 31 December 2016 in the amount of 832 thousand euros from retained earnings;

  to pay dividends to the shareholders 0.01 euros per share, in the total amount of 65 070.12 euros. The list of shareholders entitled to dividends shall be fixed as at 14 June 2017, 23:59 PM. Dividends shall be paid to the shareholders by transfer to the bank account of the shareholders on 16 June 2017.
- To increase the share capital of Arco Vara AS conditionally by issuing up to 12 convertible bonds with the nominal value of 500 euros each in accordance with the conditions of the convertible bonds which are included in the materials of the AGM made available to the shareholders;

  provided that the net profit of Arco Vara group for the years 2017-2019 is at least 5.5 million euros, the convertible bonds will give the owners the right to subscribe for the total of up to 200,000 shares of Arco Vara AS for 0.7 euro per share starting from 10 May 2020 until 31 December 2020;

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

  the existing shareholders will waive their pre-emptive rights for the subscription of the convertible bonds as well as the pre-emptive rights for the shares issued after the conversion 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 2017 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 16 shareholders whose votes represented 53.47% 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 2016 and the Company's prognosis for the near future.

Extraordinary general meeting

Extraordinary general meeting took place on 27 December 2017 from 10:10 a.m. until 10:38 a.m. in Tallinn at Rävala pst 3, in Hamburg meeting room of Radisson Blu Sky Hotel.

Notice of the extraordinary general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website on 29 November 2017. The notice was published in the national daily newspaper *Eesti Päevaleht* on 30 November 2017. 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 agenda and the draft decisions approved by the Supervisory Board were published in the notice of the extraordinary general meeting. The agenda consisted of the following:

- Increasing Arco Vara AS' share capital, public offer to existing shareholders and listing the new shares on Nasdaq Tallinn Stock Exchange's Baltic Main List

The following decision was adopted at the extraordinary general meeting:

- To increase Arco Vara AS' (hereinafter: the "Company") share capital as follows:
  - The Company will issue 2,670,000 new common shares with nominal value of 0.7 EUR per share.
  - Issuance price of one new common share will be 1.5 EUR, which consists of 0.7 EUR nominal value and 0.8 EUR premium.
  - The new share capital of the Company will be 6,423,908 EUR.
  - The subscription period for the new shares will commence on 29 December 2017 at 09:00 and terminate on 15 January 2018 at 16:00, but the Management Board may change, prolong or shorten the subscription period in accordance with the law.
  - The issue is directed to the Company's existing shareholders and will take place only in Estonia. The existing shareholders of the Company will have the preferential right to subscribe for the new shares. The list of shareholders eligible to use the preferential right to subscribe will be fixed on the last day of the subscription period as at the end of the working day of Nasdaq CSD Estonian settlement system.
  - Payment for the shares shall be made by monetary contribution at the latest during 3 working days after the end of the subscription period, i.e. by 17 January 2018 at the latest; the Management Board may specify the deadline and the procedure of the payment.
  - In allocating new shares, the Management Board will honour the preferential subscription rights of the Company's existing shareholders as derived from the law, and follow the principle of equal treatment of shareholders.
  - In case the amount of shares subscribed for during the subscription period is under the volume of the planned share capital increase, the Management Board of the Company will have the right to cancel the shares that were not subscribed for during the subscription period. The Management Board will have the right to exercise this right during 15 days after the end of the subscription period.
- To arrange the public offering of the aforementioned shares to be issued to the Company's existing shareholders, and the listing of the new shares on Nasdaq Tallinn Stock Exchange's Baltic Main List.

The meeting was chaired by Evelin Kanter, Arco Vara AS' chief legal officer, 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 19 shareholders whose votes represented 55.16% 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 explained to the shareholders why the Management Board has proposed to vote on the agenda item.

The resolutions, minutes and materials of all general meetings held in 2017 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 only member of the Management Board) of the Company is Tarmo Sild. On 15 September 2015, the Supervisory Board prolonged Tarmo Sild's term of office as the member of the Management Board of the Company by three years, i.e. until 21 October 2018.

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

The service contract sets forth the powers, obligations and responsibilities of the member of the Management Board and also regulates the disbursement of his basic remuneration. Remuneration was agreed taking into account the Management Board member's duties and activities and the Company's current financial performance and future prospects. Under the service contract, Tarmo Sild is entitled to termination benefits equal 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 1000 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. 14).

In 2017, 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;
- Eesti Kaugpüüdjate Liit;
- Eesti Porsche Klubi.

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 note 14 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 2017, there were no changes in the composition of the Company's Supervisory Board. During 2017 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 2017, the Supervisory Board had 5 meetings which were participated by Allar Niinepuu, Hillar-Peeter Luitsalu, Kert Keskpaik. Steven Yaroslav Gorelik and Rain Lõhmus participated in 4 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.

Dividend policy

The dividend policy for 2016 and 2017 was to pay dividends of 1 cent per share per year. General meeting has the right to change the dividend policy.

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 2019, i.e. until publishing the annual report for 2018.

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 30 May 2017, AS PricewaterhouseCoopers was appointed as the Company's auditor for the next financial year the sixth 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 two 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	**2017**	2016
In thousands of euros			
Revenue from sale of own real estate		15,245	6,620
Revenue from rendering of services		3,008	3,127
Total revenue	7	**18,253**	**9,747**
Cost of sold real estate and services	8	-14,687	-6,745
Gross profit		**3,566**	**3,002**
Other income	9	90	182
Marketing and distribution expenses	10	-487	-556
Administrative expenses	11	-1,875	-2,064
Other expenses	9	-74	-99
Fair value adjustments to investment property	19	68	-584
Gain on sale of subsidiaries	6	0	4
Operating profit/loss		**1,288**	**-115**
Financial income and costs	12	-489	-590
Profit/loss before tax		**799**	**-705**
Income tax	13	-14	-127
Net profit/loss		**785**	**-832**
Net profit/loss for the period		**785**	**-832**
attributable to owners of the parent		*785*	*-832*
Total comprehensive income/expense for the period		**785**	**-832**
attributable to owners of the parent		*785*	*-832*
Earnings per share (in euros)	14		
- basic		**0,12**	**-0,13**
- diluted		**0,11**	**-0,13**

The notes presented on pages 23 to 54 form an integral part of the consolidated financial statements.

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Consolidated statement of financial position

	Note	31 December 2017	31 December 2016
In thousands of euros			
Cash and cash equivalents	16	2,284	845
Receivables and prepayments	17	747	470
Inventories	18	8,974	14,593
Total current assets		**12,005**	**15,908**
Receivables and prepayments	17	18	11
Financial investments		34	0
Investment property	19	11,299	10,835
Property, plant and equipment	20	704	718
Intangible assets	20	275	248
Total non-current assets		**12,330**	**11,812**
TOTAL ASSETS		**24,335**	**27,720**
Loans and borrowings	21	1,871	9,372
Payables and deferred income	22	2,507	4,369
Provisions	23	38	108
Total current liabilities		**4,416**	**13,849**
Loans and borrowings	21	10,132	4,886
Total non-current liabilities		**10,132**	**4,886**
TOTAL LIABILITIES		**14,548**	**18,735**
Share capital	24	4,555	4,555
Share premium	24	292	292
Statutory capital reserve	24	2,011	2,011
Other reserves	14	134	52
Retained earnings		2,795	2,075
Total equity attributable to owners of the parent		**9,787**	**8,985**
TOTAL EQUITY		**9,787**	**8,985**
TOTAL LIABILITIES AND EQUITY		**24,335**	**27,720**

The notes presented on pages 23 to 54 form an integral part of the consolidated financial statements.

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Consolidated statement of cash flows

	Note	2017	2016
In thousands of euros			
Cash receipts from customers		12,613	14,290
Returned prepayments	21	-1,194	0
Cash paid to suppliers		-10,469	-9,608
Income tax paid from profits	13	-41	-106
Other taxes paid and recovered (net)		-2,124	-1,631
Cash paid to employees		-964	-1,151
Other cash payments and receipts related to operating activities		217	-96
NET CASH FROM / USED IN OPERATING ACTIVITIES		**-1,962**	**1,698**
Payments made on purchase of tangible and intangible assets		-101	-99
Proceeds from sale of property, plant and equipment		0	1
Payments made on purchase and improvement of investment property	19	-370	-383
Proceeds from sale of a subsidiary	6	0	41
Payments made on purchase of a subsidiary	6	0	-1,890
Loans		-7	0
Repayment of loans		4	0
Other payments related to investing activities		-34	-3
NET CASH FROM/USED IN INVESTING ACTIVITIES		**-508**	**-2,333**
Proceeds from loans received	21	6,719	6,135
Settlement of loans and borrowings	21	-1,809	-4,637
Interest paid		-879	-797
Dividends paid	27	-65	-61
Proceeds from share capital increase		0	273
Other payments related to financing activities		-57	-138
NET CASH FROM/USED IN FINANCING ACTIVITIES		**3,909**	**775**
NET CASH FLOW		**1,439**	**140**
Cash and cash equivalents at beginning of period	16	845	745
Change in cash and cash equivalents		**1,439**	**140**
Decrease in cash and cash equivalents through sale of subsidiaries	6	0	-40
Cash and cash equivalents at end of period	16	2,284	845

The notes presented on pages 23 to 54 form an integral part of the consolidated financial statements.

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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 of 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 other reserves	*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**
Balance as of 31 December 2016	**4,555**	**292**	**2,011**	**52**	**2,075**	**8,985**	**0**	**8,985**
Total comprehensive income for the period	0	0	0	0	785	785	0	**785**
Transactions with owners:	0	0	0	82	-65	17		**17**
Dividends paid	*0*	*0*	*0*	*0*	*-65*	*-65*	*0*	*-65*
Formation of other reserves	*0*	*0*	*0*	*82*	*0*	*82*	*0*	*82*
Balance as of 31 December 2017	**4,555**	**292**	**2,011**	**134**	**2,795**	**9,787**	**0**	**9,787**

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

The notes presented on pages 23 to 54 form an integral part of the consolidated financial statements.

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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 2017 were authorised for issue by the chief executive officer / member of the management board on 3 April 2018. 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 2017, 140 people provided services to the group under the employment or authorization contract (31 December 2016: 110 people). In addition to Estonia, the group has, through its subsidiaries, active operations also in Bulgaria.

The structure of the group as of 31 December 2017 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.

Classification of real estate

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.

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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 2017 and 31 December 2016 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 2017 and 31 December 2016, 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.

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 2017.

Disclosure Initiative – Amendments to IAS 7

Revised Standard IAS 7 requires the disclosure of movements between the opening and closing balance of liabilities arising from financing activities. In accordance with the requirements of the standard, the annual report discloses movements in debt between the opening and closing balances.

Other new or revised standards or interpretations that are mandatory for the group's annual periods beginning on or after 1 January 2017 have not had 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 2018, 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.

IFRS 15 Revenue from contracts with customers - amendment

Amendments do not change the core principles of the standard, but explain how these principles should be applied. The changes explain how to identify performance obligations (a promise to deliver goods to a customer or to provide a service) in the contract; how to determine whether the company is a principal (provider of goods or service) or an agent (responsible for organizing the supply of goods or services); and how to determine whether the revenue from granting a license must be recorded at a particular time or in a period. In addition to these explanations, the amendments include two additional simplifications with the aim of reducing costs and complexity of the company when implementing the standard for the first time. The amendment to the standard does not have a significant impact on the group.

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IFRS 16 Leases (standard will become mandatory from 1 January 2019)

The new standard determines the principles of recognizing, evaluating, presenting and disclosing lease agreements. All lease agreements grant the lessee a right to use the asset from the beginning of the lease agreement, and – in case lease payments are made over a period – also financing. Therefore, IFRS 16 ends the classification of lease agreements into operating and capital leases like IAS 17 did and establishes an uniform model for lessees. Lessees must (a) recognize assets and liabilities for all lease agreements with duration of over 12 months, except when the leased asset is small in value, and (b) show depreciation from leased assets and interest cost from lease obligations in their income statement. For lessors, the rules of IFRS remain essentially the same as in IAS 17: the lessor will continue classifying its lease agreements into operating and capital leases and treating them differently.

The Group estimates that as a result of implementing IFRS 16, the size of balance sheet will increase by 300 thousand euros.

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

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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 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.

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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, which 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 when 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:

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- 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*.

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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 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

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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 and key employees 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 and key employees 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 or key employees, the group will issue new shares, which will be redeemed by the CEO/member of the management board or key employees for 0.7 euros per share. 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

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terms of a debt instrument. On initial recognition, a financial guarantee contract is measured at its fair value at the date of issue of the guarantee. After initial recognition, financial guarantee contracts are measured at the higher of: (a) the originally recognised amount less amortisation; and (b) the amount determined as described in the section on measurement of provisions.

Leases

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

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

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

Statutory capital reserve

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

Income tax

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

Parent company and subsidiaries registered in Estonia

Under the Estonian Income Tax Act, in Estonia companies do not have to pay income tax on their earnings (profit for the year). Instead, income tax is levied on profit distributions (dividends). 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. From 2019, tax rate of 14/86 can be applied to dividend payouts. This more favourable tax rate can be applied to the dividend payment the size of which is the average dividend payment of up to three latest financial years, which have been taxed at a rate of 20/80. The average dividend payment for the three latest financial years is calculated starting from year 2018.

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.

Bulgarian subsidiaries

In Bulgaria the profit earned by companies is subject to income tax. The tax rate in Bulgaria is 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.

Latvian subsidiaries

Under the Income Tax Act valid until 2017, profits from Latvian companies were taxed. Therefore, until that, deferred tax was provided for on all temporary differences arising between the tax bases of assets and liabilities of Latvian subsidiaries and their carrying amounts in the consolidated financial statements. According to the new Income Tax Act, valid from 1 January 2018, the profits made after 2017 will be taxed only upon distribution at a rate of 20/80. As a result of the application of the new law, there will be no more differences between the taxable and book value of assets and liabilities and therefore deferred tax assets and liabilities are not recognized for Latvian subsidiaries.

The Group did not have income tax assets and liabilities for Latvian companies.

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.

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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 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**		**Parent company**		**Eliminations**		**Consolidated**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
In thousands of euros										
External revenue	15,760	6,932	2,489	2,813	4	2	0	0	18,253	9,747
Annual change	*127.4%*		*-11.5%*		*100.0%*				*87.3%*	
Inter-segment revenues	100	116	446	418			-546	-534	0	0
Total revenue	**15,860**	**7,048**	**2.935**	**3,231**	**4**	**2**	**-546**	**-534**	**18.253**	**9,747**
Annual change	*125.0%*		*-9.2%*		*100.0%*				*87.3%*	
Operating profit/loss	**2,000**	**611**	**-143**	**-174**	**-533**	**-464**	**-36**	**-97**	**1.288**	**-124**
Of which inventory write-downs	*0*	*-124*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*-124*
Fair value adjustments to investment property, net	*68*	*-584*	*0*	*0*	*0*	*0*	*0*	*0*	*68*	*-584*

External revenue by segment and location

Segment	**Development**		**Service**		**Parent company**		**Consolidated**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
In thousands of euros								
Estonia	14,203	196	1,616	1,426	4	2	15,823	1,624
Bulgaria	1,079	6,552	873	623	-	-	1,952	7,175
Latvia	478	184	0	764	-	-	478	948
Total revenue	**15,760**	**6,932**	**2,489**	**2,813**	**4**	**2**	**18,253**	**9,747**

Unconsolidated operating profit/loss of Development and Service segment by location

Segment	**Development**		**Service**	
	2017	**2016**	**2017**	**2016**
In thousands of euros				
Estonia	2,023	-213	-224	-146
Bulgaria	-1	1,019	81	-16
Latvia	-22	-195	-	-12
Total operating profit/loss	**2,000**	**611**	**-143**	**-174**

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Assets and liabilities by operating segments and by location

Segment	Development		Service		Parent company		Consolidated	
On 31 December	2017	2016	2017	2016	2017	2016	2017	2016
In thousands of euros								
Assets	**23,104**	**26,892**	**527**	**385**	**705**	**443**	**24,335**	**27,720**
Estonia	7,429	11,471	263	230	705	443	8,396	12,144
Bulgaria	15,455	14,723	264	155	-	-	15,719	14,878
Latvia	220	698	-	-	-	-	220	698
Liabilities	**12,569**	**16,816**	**457**	**344**	**1,522**	**1,575**	**14,548**	**18,735**
Estonia	1,171	6,088	190	189	1,522	1,575	2,884	7,852
Bulgaria	11,393	10,721	267	155	-	-	11,659	10,876
Latvia	7	7	-	-	-	-	5	7

6. Acquisition and sale of subsidiaries

Scope of consolidation

On 31 December 2017 as well as on 31 December 2016, Arco Vara group comprised 21 consolidated entities. There were no acquisitions, establishments, sales or liquidations of subsidiaries during 2017. 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.

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. 1000 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 was 3 thousand euros. 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.

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.

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Notes to the Consolidated Statements of Comprehensive Income

7. Revenue

In thousands of euros	2017	2016
Sale of own real estate	15,245	6,620
Real estate brokerage and valuation	2,181	2,515
Rental of real estate	646	486
Property management services	73	46
Other revenue	108	80
Total revenue	**18,253**	**9,747**

8. Cost of sold real estate and services

In thousands of euros	2017	2016
Cost of real estate sold (note 18)	-12,785	-4,555
Personnel expenses	-1,420	-1,578
Property management costs	-297	-301
Inventory write-down (note 18)	0	-124
Vehicle expenses	-40	-25
Depreciation of property, plant and equipment (note 20)	-9	-12
Other costs	-136	-150
Total cost of sold real estate and services	**-14,687**	**-6,745**

9. Other income and expenses

Other income

In thousands of euros	2017	2016
Gain on reversal of property, plant and equipment impairment (note 20)	3	135
Received penalties and compensations	49	34
Miscellaneous income	38	13
Total other income	**90**	**182**

Other expenses

In thousands of euros	2017	2016
Write-down of receivables	-3	-64
Late payment interest and penalty charges	-9	-11
Gifts and donations	-16	-7
Miscellaneous expenses	-46	-17
Total other expenses	**-74**	**-99**

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10. Marketing and distribution expenses

In thousands of euros	**2017**	2016
Advertising expenses	-221	-294
Personnel expenses	-119	-119
Market research	-27	-7
Brokerage fees	0	-6
Other marketing and distribution expenses	-120	-130
Total marketing and distribution expenses	**-487**	**-556**

11. Administrative expenses

In thousands of euros	**2017**	2016
Personnel expenses	-1,069	-1,104
Office expenses	-296	-372
Services purchased	-152	-231
IT expenses	-159	-150
Depreciation and amortisation (note 20)	-104	-93
Legal service fees	-26	-37
Vehicle expenses	-26	-33
Other expenses	-43	-44
Total administrative expenses	**-1,875**	**-2,064**

12. Finance income and costs

In thousands of euros	**2017**	2016
Interest expense	-443	-530
Interest income	0	1
Other finance income and costs	-46	-61
Total finance income and costs	**-489**	**-590**

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 100% capitalised in inventory and real estate investments. In 2017, capitalised interest expenses amounted to 381 thousand euros (in 2016: 286 thousand euros).

13. Income tax

In thousands of euros	**2017**	2016
Income tax expense from Bulgarian subsidiaries	-14	-127
Total income tax expense	**-14**	**-127**

In 2017, the group's Bulgarian companies paid 41 thousand euros (in 2016: 106 thousand euros) of income tax on profits.

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

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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.

	2017	2016
Weighted average number of ordinary shares outstanding during the period	6,507.012	6,177,750
Number of ordinary shares potentially to be issued	590,000	390,000
Net profit/loss attributable to owners of the parent (in thousands of euros)	785	-832
Earnings per share (in euros)	**0.12**	**-0.13**
Diluted earnings per share (in euros)	**0.11**	**-0.13**

According to the decision of the annual general meeting of Arco Vara AS, held on 30 May 2017, twelve convertible bonds were issued with the nominal value of 500 euros each. The convertible bonds will give to the key employees of the group the right to subscribe to the total of up to 200 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2020 if the employees still work at the company at the time and if the net profit for years 2017-2019 combined is at least 5.5 million euros. The Black-Scholes model was used to calculate the fair value of the key employee option, according to which no equity reserve was formed at 31 December 2017.

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 1000 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 2017, an equity reserve in the amount of 134 thousand euros has been formed as the proportionate value of the option, of which 52 thousand euros was expensed in 2016 and 82 thousand in 2017. See also note 28. For calculating the fair value of the CEO's 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.

	2017	2016
In thousands of euros		
Office premises	137	162
Office equipment	15	20
Vehicles	12	4
Total	**164**	**186**

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

As of 31 December	**2017**	2016
In thousands of euros		
No later than 1 year	155	119
Later than 1 year and no later than 5 years	153	198
Total	**308**	**317**

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.

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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	2017	2016
In thousands of euros		
Cash on hand and demand deposits	2 284	845
Total cash and cash equivalents	**2 284**	**845**

At the end of year 2017, out of the group's year-end cash and cash equivalents balance, 332 thousand euros (31 December 2016: 14 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	2017	2016
In thousands of euros		
Trade receivables		
Receivables from customers	192	193
Allowance for doubtful trade receivables	0	0
Total trade receivables	**192**	**193**
Other receivables		
Loans provided	3	0
Miscellaneous receivables	6	10
Total other receivables	**9**	**10**
Accrued income		
Prepaid and recoverable taxes	163	107
Other accrued income	26	5
Total accrued income	**189**	**112**
Prepayments	**357**	**155**
Total short-term receivables and prepayments	**747**	**470**

Long-term receivables

As of 31 December	2017	2016
In thousands of euros		
Prepayments	18	11
Total long-term receivables and prepayments	**18**	**11**

Allowance for doubtful trade receivables

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

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18. Inventories

As of 31 December	2017	2016
In thousands of euros		
Properties purchased and being developed for resale	8,963	14,571
Materials and finished goods	11	6
Prepayments for inventories	0	16
Total inventories	**8,974**	**14,593**

Properties purchased and being developed for resale

	2017	2016
In thousands of euros		
Balance at the beginning of period, 1 January	**14,571**	**12,580**
Properties purchased for development	12	2,102
Construction costs of apartment buildings	6,598	5,633
Capitalized borrowing costs	351	455
Inventory write-down (note 8)	0	-124
Other capitalized costs	206	141
Reclassification from/to investment property (note 19)	10	-1,661
Cost of sold properties (note 8)	-12,785	-4,555
Balance at the end of period, 31 December	**8,963**	**14,571**

Reclassifications of Madrid Blvd project assets in 2016 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 2017, the group reversed inventory write-downs in the amount of 13 thousand euros, considering the increase of apartment prices in Sofia during the last 1-2 years. 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.

The group's management estimates that the group has inventories realisable during one year in carrying value of 3,914 thousand euros as of 31 December 2017. Inventories in carrying value of 5,049 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 2017 and also in 2016, the value of the group's inventories was determined by internal experts. Estimates used in valuations are based on real market prices and the group's recent experience with comparable assets. As of 31 December 2017, inventories in the total amount of 8,727 thousand euros did not require a write-down or reversal of write-down (as of 31 December 2016: 13,557 thousand euros).

As of 31 December	2017	2016
In thousands of euros		
Measured using the residual value method	8,332	12,718
Measured using the comparison method	631	1,851
Other	0	26
Total inventories	**8,963**	**14,593**

As of 31 December 2017, the total carrying value of inventories carried at cost was 8,347 thousand euros (on 31 December 2016: 12,742 thousand euros) and total carrying value of inventories measured at net realisable value was 616 thousand euros (on 31 December 2016: 1,851 thousand euros).

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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 10,557 thousand euros on 31 December 2017, including shops and office spaces in the amount of 7,859 thousand euros).
2) Land plots that have development potential but whose future use is still uncertain (carrying value of 742 thousand euros on 31 December 2017).

	2017	2016
In thousands of euros		
Balance at the beginning of period, 1 January	**10,835**	**9,513**
Net profit/loss on changes in fair value	68	-584
Capitalised development costs	76	325
Capitalised borrowing costs	30	0
Reclassification from/to inventories (note 18)	-10	1,661
Reclassification to property, plant and equipment (note 20)	0	-138
Purchase of land plots	0	58
Prepayments for real estate investments	300	0
Balance at the end of period, 31 December	**11,299**	**10,835**

For information on pledged assets, see note 26.

Changes in fair value of investment property

Valuation of land

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.

Valuation of commercial and office spaces

Commercial and office spaces of Madrid Blvd building in Sofia have been measured using income method. As of 31 December 2017, a loss in the amount of 105 thousand euros arose from these assets, resulting from change in fair value (in 2016: loss in the amount of 929 thousand euros).

Valuation of apartments

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 2017, such assets were valued to their fair value with a gain in the amount of 173 thousand euros (in 2016: 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 2017, investment properties with carrying values of 1,518 thousand euros did not require value adjustment (as of 31 December 2016: 372 thousand euros). In 2017 in summary, the fair value of investment property was increased in the amount of 68 thousand euros. In 2016 in summary, the fair value of investment property was decreased in the amount of 584 thousand euros. In 2017 and 2016, the values of all of the group's investment properties were determined by internal experts.

As of 31 December	**2017**	2016
In thousands of euros		
Measured using the income method	7,859	7,934
Measured using comparison method	3,440	2,901
Total investment property	**11,299**	**10,835**

In 2017 as well as in 2016, the exit yield used for valuation of investment properties with the income capitalisation method was 8%, 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 10 euros on average in 2017 (in 2016: 9 euros). 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 office spaces have not been rented out.

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

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- A change of 5% (+/-) in the forecasted net operating cash flows would have increased or reduced the fair value of investment property by 408 thousand euros (in 2016: by 397 thousand euros).
- A decrease of 1% in the exit yields would have increased the fair value of investment property by 1,166 thousand euros (in 2016: by 1,133 thousand euros) and an increase of 1% would have reduced the fair value by 907 thousand euros (in 2016: by 882 thousand euros).

Operating leases: the group as a lessor

In 2017, the group's rental income on investment properties (Madrid Blvd building in Sofia) amounted to 717 thousand euros (in 2016: 530 thousand euros). Rental income increased because more spaces had been rented out in 2017 than in 2016. Two of seven spaces have not been rented out in 2018, on publication date of the annual report.

Direct property management expenses totalled 262 thousand euros in 2017 (in 2016: 234 thousand euros) including expenses in the amount of 8 thousand euros (in 2016: 9 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	2017	2016
In thousands of euros		
No later than 1 year	389	299
Later than 1 year and no later than 5 years	397	543
Total	**786**	**842**

Lease contracts are considered non-cancellable if:

1) they have been concluded for a fixed term (with the expiration date in 2018 or later);
2) lessee has the right to cancel the contract with 3-6 month notice but only after arrival of fixed date in 2018 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 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*
Additions	0	0	21	21
Reclassification from investment property (note 19)	0	0	0	0
Reversal of earlier years' impairments (note 9)	3	0	0	3
Disposals	0	0	0	0
Depreciation for the year (notes 8, 11)	-5	0	-33	-38
Carrying amount on 31 December 2017	**613**	**0**	**91**	**704**
Of which cost	*677*	*0*	*224*	*901*
Of which accumulated depreciation	*-64*	*0*	*-133*	*-197*

As at 31.12.2017 the cost of property, plant and equipment that was fully amortized but still in use was 40 thousand euros.

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Intangible assets

	Software and licences	Prepaid for intangible assets	Total intangible assets
In thousands of euros			
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
Disposal	0	-11	-11
Amortisation for the year	-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*
Purchases and software development	6	96	102
Reclassification	102	-102	0
Disposals	0	0	0
Amortisation for the year (notes 8, 11)	-75	0	-75
Carrying amount on 31 December 2017	**275**	**0**	**275**
Of which cost	*444*	*0*	*444*
Of which accumulated amortisation	*-169*	*0*	*-169*

Intangible assets of the group consist mainly of business software development costs in the total amount of 352 thousand euros (out of which 96 thousand euros in 2017 and 54 thousand euros in 2016). The cost of business software is amortized during 5 years.

As at 31.12.2017 the cost of intangible assets that was fully amortized but still in use was 24 thousand euros.

For pledged assets see note 26.

21. Interest bearing liabilities

Interest bearing liabilities comprise the following items:

	As of 31 December 2017			As of 31 December 2016		
	Total	*of which current portion*	*of which non-current portion*	**Total**	*of which current portion*	*of which non-current portion*
In thousands of euros						
Bank loans	10,625	500	10,125	12,827	9,063	3,764
Bonds	1,127	1,120	7	1,121	0	1,121
Finance lease liabilities	1	1	0	10	9	1
Other loans	250	250	0	300	300	0
Total loans and borrowings	**12,003**	**1,871**	**10,132**	**14,258**	**9,372**	**4,886**
Prepayments	265	265	0	1,260	1,260	0
Total interest bearing liabilities	**12,268**	**2,136**	**10,132**	**15,518**	**10,632**	**4,886**

In 2017, the group settled loans and borrowings of 8,974 thousand euros (in 2016: 4,637 thousand euros) and raised new loans and borrowings of 6,719 thousand euros (in 2016: 6,135 thousand euros). Additionally, in 2017, interest-bearing prepayments were returned in the amount of 995 thousand euros, which, with value added tax, amounted to 1 194 thousand euros (in 2016 received interest bearing prepayments 1,260 thousand euros, with value added tax 1,512 thousand euros).

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.

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 are mostly related to Euribor and therefore reflect adequately the situation of current market interest rates.

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In thousands of euros	Cash and cash equivalents	Bank loans	Bonds	Finance lease liabilities	Other loans	Total
Net loans 31 Dec 2015	**745**	**-12,585**	**-151**	**-26**	**0**	**-12,017**
Annual change	100	-242	-970	16	-300	-1,396
Net loans 31 Dec 2016	**845**	**-12,827**	**-1,121**	**-10**	**-300**	**-13,413**
Annual change	1,439	2,202	-6	9	50	3,694
Net loans 31 Dec 2017	**2,284**	**-10,625**	**-1,127**	**-1**	**-250**	**-9,719**

Changes in loans and borrowings in 2017

In 2017, the following major loan obligations were settled:
- Madrid Blvd project's bank loan of 455 thousand euros to Piraeus bank in Bulgaria;
- bank loan for financing construction of the first stage apartment building in Kodulahe project 8,421 thousand euros, of which Arco Vara paid 1,260 thousand euros and 7,161 thousand euros was paid by customers straight to bank.

In 2017, the group raised new loans in the total amount of 6,719 thousand euros, out of which:
- 5,708 thousand euros was a bank loan for financing construction of the first stage apartment building in Kodulahe project;
- 1,005 thousand euros was a bank loan for financing construction of the apartment buildings in Iztok Parkside project.

Changes in loans and borrowings in 2016

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, which were issued at the beginning of January 2016. 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 was bond issue described in the previous paragraph;
- 2,714 thousand euros was bank loan for financing construction of first stage apartment building in Kodulahe project (the loan was activated in August);
- 1,050 thousand euros was 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 was bank loan from Raiffeisenbank raised for completion of acquisition of Iztok Parkside EOOD;
- 250 thousand euros was 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.

Amounts, interest rates and maturity dates of interest bearing liabilities:

Description of the liability	Maturity date (month/year)	Liability amount, in thousands of euros		Interest rate, %		Type of interest rate
		31 Dec 2017	31 Dec 2016	**31 Dec 2017**	31 Dec 2016	
Bank loan, development	12/2019	8,570	9,024	5.0	5.0	3M Euribor
Bonds, development	1/2018	1,120	1,120	12.0	12.0	Fixed
Bank loan, development	11/2019	2,055	1,050	2.5	2.5	1M Euribor
Other loan, acquisition of land	12/2018	250	250	12.0	12.0	Fixed
Finance leases	2/2018	1	10	8.1	8.1	Fixed
Convertible bond	3/2020	7	1	5.0	5.0	Fixed
Prepayments, development	11/2018	265	1,260	6.0	6.0	Fixed
Bank loan, development	1/2018	-	2,714	-	3.7	6M Euribor
Other loan, working capital	5/2017	-	50	-	6.0	Fixed
Bank loan, acquisition of land	8/2017	-	39	-	4.0	6M Euribor
Total		**12,268**	**15,518**			

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On 31 December 2017, the weighted average interest rate of interest bearing liabilities was 5.4% (31 December 2016: 5.3%).

22. Payables and deferred income

Short-term payables and deferred income As of 31 December	2017	2016
In thousands of euros		
Trade payables	**261**	**800**
Miscellaneous payables	**22**	**21**
Taxes payable		
Value added tax	37	66
Corporate income tax	30	53
Social security tax	48	47
Personal income tax	27	27
Land tax	70	66
Garbage tax	140	103
Other taxes	15	4
Total taxes payable	**367**	**366**
Accrued expenses		
Payables to employees	170	117
Interest payable	61	76
Other accrued expenses	900	5
Total accrued expenses	**1,131**	**198**
Deferred income		
Prepayments received on sale of real estate	695	2,958
Guarantee deposits	21	0
Other deferred income	10	26
Total deferred income	**726**	**2,984**
Total short-term payables and deferred income	**2,507**	**4,369**

As of 31 December 2017, other accrued expenses included provisions in the amount of 803 thousand euros for future invoices of Kodulahe stage 1 project.

As of 31 December 2016, the balances of prepayments received on sale of real estate and trade payables were significant mainly due to prepayments collected on presale of apartments of first stage apartment building in Kodulahe stage 1project 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 2015	**146**
Amounts used and reversed	-76
Additional provisions made	38
Provisions on 31 December 2016	**108**
Amounts used and reversed	-70
Provisions on 31 December 2017	**38**

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 provision will be paid off to the constructor after the fulfilment of all contractual obligations by the constructor typically within one year from handing over

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the construction. In 2017, the provisions were realised in the amount of 70 thousand euros. As of 31 December 2017, the balance of warranty provisions of Manastirski Livadi project was fully used.

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. The provision was not used in 2017 but is planned to be realised in 2018.

24. Share capital

As of 31 December	2017	2016
Number of issued shares fully paid up	6,507,012	6,507,012
Share capital (in thousands of euros)	4,555	4,555
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 1000 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 2017.

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 93.6% out of group's total cash are deposited, are presented in following table. On 31 December 2017, the share of other banks remains at 5% out of total cash and cash equivalents.

Bank or banking group	Bank's share of the group's cash balance	Standard & Poor's	Moody's
UniCredit group banks	15.6%	BBB	Baa1

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Raiffeisenbank Bulgaria	14.0%	BBB+	A3
Swedbank AS group banks	6.4%	AA-	Aa3
Nordea group banks	42.0%	AA-	Aa3
LHV Pank AS	15.6%	Not rated	Not rated
Cash in other banks and petty cash	6.4%	-	-

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 in the amount of 74 thousand euros as at 31 December 2017. Management has estimated the value of such receivables on an individual basis and has determined that the items are recoverable. The age of receivables that are past due as at the end of the year 2017 but not impaired is the following:

- past due up to 30 days: 31 thousand euros,
- past due from 31 to 60 days: 3 thousand euros
- past due over 61 days: 33 thousand euros.

The total amount of financial assets exposed to credit risk as of 31 December 2017 was 2,485 thousand euros (31 December 2016: 1,048 thousand euros).

Financial assets by maturity

	on 31 December 2017			
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousand of euros				
Cash and cash equivalents (note 16)	2,284	0	0	2,284
Trade and other receivables (note 17)	201	0	0	201
Total	**2,485**	**0**	**0**	**2,485**

	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**

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

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(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 2017
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	1,886	250	10,133	12,268
Interest payable	157	355	404	916
Other financial liabilities	1,727	54	0	1,781
Total	**3,770**	**659**	**10,536**	**14,965**

				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**

Based on the maturities of liabilities included in the group's loan portfolio, as of 31 December 2017, the average weighted maturity of the group's loans and borrowings was 1.7 years (as of 31 December 2016: 1.2 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.

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 1-month, 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 2017, Euribor interest rates have been negative. Therefore, there is practically no Euribor component in group's loans as of 31 December 2017 and also as of 31 December 2016.

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 2017, 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 123 thousand euros (on 31 December 2016: 128 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

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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 2017, 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 2017, the share capital of Arco Vara AS was 4,555 thousand euros and net assets were 9,787 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 2017, the equity was positive in all group companies, which had bank loans. As of 31 December 2016, the equity was negative in three group companies with bank loans. On all these cases, agreement had been reached with banks allowing amendment of this deficiency, but on condition that all loan obligations are fulfilled according to agreed terms.

The total capital of Arco Vara AS is the sum of its short- and long-term interest bearing loans and borrowings less cash and cash equivalents. On 31 December 2017, total capital amounted to 19,506 thousand euros (on 31 December 2016: 22,398 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 2017, equity accounted for 40.2% (on 31 December 2016: 32.4%) 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	2017	2016
In thousands of euros		
Cash and cash equivalents	332	19
Receivables [1]	0	140
Inventories	3,041	13,410
Investment property	10,557	10,474
Property, plant and equipment	563	587

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Total carrying value of assets pledged as collateral	**14,493**	**24,630**

[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 8,570 thousand euros as of 31 December 2017 (on 31 December 2016: 9,024 thousand euros).

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27. Contingent liabilities

Contingent income tax liability

As of 31 December 2017, the group's retained earnings amounted to 2,795 thousand euros (on 31 December 2016: 2,075 thousand euros). Usually, income tax of 20/80 of net dividend paid is imposed on the profit distributed as dividends, but dividends from Bulgarian subsidiaries can be paid out to Arco Vara shareholders without additional tax. In 2017 and in 2016, this opportunity was used when paying out dividends to shareholders in the amount of 65 and 61 thousand euros, respectively (0.01 euros per share) without income tax obligation. As of 31.12.2017, Arco Vara could pay dividends in the amount of 937 thousand euros without income tax obligation. Upon the payment of all retained earnings in 2018, income tax liability would be 372 thousand euros and the amount to be paid out to shareholders would total 2,423 thousand euros.

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 2012-2017 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

	2017	2016
In thousands of euros		
Companies that have a significant interest in the group's parent company		
Share capital contribution	0	273
Services purchased	56	34
Bonds issued	0	100
Redemption of bonds	0	150
Paid interest	12	9
Other related parties		
Services sold	5	1
Sale of own real estate	98	0
Paid contractual penalty	-1	0
Prepayments received	0	6
Bonds issued	0	1

Balances with related parties

As of 31 December	**2017**	2016
In thousands of euros		
Companies that have a significant interest in the group's parent company		
Bonds issued	100	100
Other related parties		
Deferred income	0	6
Bonds issued	1	1

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Significant transactions with related parties in 2017 and 2016

In January 2016, Arco Vara AS issued bonds as targeted issue in the total amount of 1,120 thousand euros. The bonds' maturity date was 6 January 2018 and annual interest rate was 12%. 100 thousand euros out of the total issued bonds were subscribed by the companies that have significant interest in the group's parent company.

Remuneration of key management personnel

In 2017, 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 120 thousand euros (in 2016: 111 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 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. 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 1000 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.

About CEO's of the group's parent company and key employees' bonds see also note 14.

In 2017 and 2016, 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 2018, the share issue announced in December 2017 was completed. On 27.12.2017, the extraordinary general meeting of shareholders of Arco Vara AS decided to increase the share capital of the company and issue 2,670,000 new shares to existing shareholders. The public offering took place between 29.12.2017 and 15.01.2018, during which 2,491,355 shares were subscribed for; unsubscribed shares were annulled with the resolution of the management board. The new size of share capital of Arco Vara is 6,298,856.90 euros, which is divided into 8,998,367 shares. The relevant entry was made in the Commercial Register on 29.01.2018.

In January 2018, Arco Vara AS carried out a bond issue by issuing unsecured bonds in the total amount of 800,000 euros with annual interest rate of 12% and maturity date of 04.01.2019. Essentially, the company partially refinanced earlier bonds (due on 06.01.2018): out of 1,120,000 euros, 800,000 euros were refinanced on same terms.

On January 30, 2018, Arco Vara AS acquired 100% of Arco Lozen EOOD, a company registered in Sofia, Bulgaria. Arco Lozen EOOD owns 6 land plots in the outskirts of Sofia, close to Lozen village, out of which 3 are intended for construction and the remaining 3 for street infrastructure. Total area of the land plots is 52,780 m^2 (5.3 ha), out of which 47,450 m^2 (4.7 ha) is the area of the 3 construction land plots. Arco Vara plans to develop on the plots a high-class residential project with apartment blocks, houses, and commercial units like supermarket, kindergarten, sports facilities and other similar amenities. By the time of this report, the design bidding has been completed and the design process is about to start. Design should finish within 2018, by the end of which the Group also expects to obtain a construction permit for Stage 1 of the project.

On February 27, 2018, Arco Vara AS sold its 100% holding in real estate investment fund Arco Real Estate Fund REIT, a company listed on Sofia Stock Exchange. Arco REIT was established in 2015 with the purpose to raise capital for Arco Vara group's Bulgarian developments. As the group succeeded to raise money for Bulgarian developments through Arco Vara AS' share issue in January 2018 and there was no clear purpose for Arco REIT in foreseeable future, the management decided to sell the subsidiary. The holding was sold with a small profit for 333 thousand euros. The transaction does not have a significant effect on Arco Vara AS' operations and financial indicators.

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30. Structure of Arco Vara group

Company	Domicile	Group's ownership interest On 31 December 2017	On 31 December 2016
%			
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
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	100
Arco Manastirski EOOD	Bulgaria	100	100
Arco Invest EOOD **	Bulgaria	100	100
Arco Real Estate Fund REIT	Bulgaria	100	100
Iztok Parkside EOOD	Bulgaria	100	100
Marsili II SIA	Latvia	100	100
Arco Development SIA	Latvia	100	100
Ulmana Gatves Nami SIA **	Latvia	100	100
Arco Invest UAB	Lithuania	100	100
Arco Development UAB **	Lithuania	100	100
Arco Investments TOV **	Ukraine	75	75

* Arco Real Estate AS was renamed Arco Vara Kinnisvarabüroo AS on January 23, 2018

** - Interest through a subsidiary

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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

	2017	2016
In thousands of euros		
Revenue from rendering of services	**306**	**349**
Other income	39	0
Marketing and distribution expenses	-18	-55
Administrative expenses	-849	-753
Other expenses	-11	-5
Operating profit/loss	**-533**	**-464**
Gain on investments in subsidiaries	61	9
Interest income	391	349
Interest expense	-306	-321
Total finance income and costs	**146**	**37**
Net profit/loss for the year	**-387**	**-427**
Total comprehensive income/expense for the year	**-387**	**-427**

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UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

As of 31 December	**2017**	2016
In thousands of euros		
Cash and cash equivalents	381	121
Receivables and prepayments	531	7,423
Total current assets	**912**	**7,544**
Investments into subsidiaries	5,027	7,407
Receivables and prepayments	5,562	11
Property, plant and equipment	18	27
Intangible assets	256	216
Total non-current assets	**10,863**	**7,661**
TOTAL ASSETS	**11,775**	**15,205**
Loans and borrowings	2,652	4,121
Payables and prepayments	228	624
Total current liabilities	**2,880**	**4,745**
Loans and borrowings	1,262	2,464
Total non-current liabilities	**1,262**	**2,464**
TOTAL LIABILITIES	**4,142**	**7,209**
Share capital	4,555	4,555
Share premium	292	292
Statutory capital reserve	2,011	2,011
Other reserves	134	52
Retained earnings	641	1,086
Total equity	**7,633**	**7,996**
TOTAL LIABILITIES AND EQUITY	**11,775**	**15,205**

UNCONSOLIDATED STATEMENT OF CASH FLOWS (direct method)

	2017	2016
In thousands of euros		
Cash receipts from customers	231	330
Cash paid to suppliers	-587	-754
Taxes paid and recovered (net)	601	368
Cash paid to employees	-197	-189
Other payments and receipts related to operating activities, net	1	-6
NET CASH FROM/USED IN OPERATING ACTIVITIES	**49**	**-251**
Paid on acquisition of tangible and intangible assets	-87	-54
Paid into share capitals of subsidiaries	-72	-83
Paid on purchase of a subsidiary	0	-1,890
Proceeds from sale of a subsidiary	0	1

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Loans provided	-987	-2,490
Repayment of loans provided	1,013	114
Dividends received	0	1,002
Interest received	5	0
NET CASH FROM/USED IN INVESTING ACTIVITIES	**-128**	**-3,400**
Proceeds of loans received	1,286	5,190
Settlement of loans and borrowings	-646	-1,566
Proceeds from share capital issue	0	273
Dividends paid	-65	-61
Interest paid	-236	-134
NET CASH FROM FINANCING ACTIVITIES	**339**	**3,702**
NET CASH FLOW	**260**	**51**
Cash and cash equivalents at beginning of year	**121**	**70**
Change in cash and cash equivalents	260	51
Cash and cash equivalents at end of year	**381**	**121**

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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 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 other reserves	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**
Profit distribution	0	0	0	0	-65	-65
Share capital issue	0	0	0	0	0	0
Formation of other reserves	0	0	0	82	0	82
Net loss for the year	0	0	0	0	-380	-380
Balance on 31 December 2017	**4,555**	**292**	**2,011**	**134**	**641**	**7,633**

Adjusted unconsolidated equity

As of 31 December	**2017**	**2016**
In thousands of euros		
Parent company's unconsolidated equity	**7,633**	**7,996**
Carrying amount of investments in subsidiaries in the parent company's unconsolidated statement of financial position (-)	-5,027	-7,407
Value of investments in subsidiaries under the equity method (+)	7,181	8,396
Parent company's adjusted unconsolidated equity	**9,787**	**8,985**

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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 2017 are prepared according to the Financial Reporting Standards (IFRS) as adopted by the EU, present a true 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 true 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.

3 April 2018

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)*

Report on the audit of the consolidated financial statements

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 2017, 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.

Our opinion is consistent with our additional report to the Audit Committee.

What we have audited

The Group's consolidated financial statements comprise:
- the consolidated statement of financial position as at 31 December 2017;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; 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.

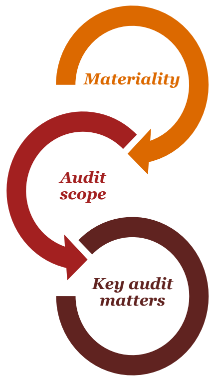
Independence

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.

During 2017, we have not provided any non-audit services to the Group.

Our audit approach

Overview



Materiality

Overall group materiality is EUR 239 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 239 thousand
How we determined it	Approximately 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.

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 2017, 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.	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 has 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.

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 and Kodulahe OÜ, full scope audits were performed by the Group audit team. For Arco Invest EOOD full scope audit 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.

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.

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

We were first appointed as auditors of Arco Vara AS for the financial year ended 31 December 2012. Our appointment has been renewed by a tender and shareholder resolutions in the intermediate years, representing the total period of our uninterrupted engagement appointment for Arco Vara AS of 6 years.

AS PricewaterhouseCoopers

Tiit Raimla
Certified auditor in charge, auditor's certificate no.287

Janno Hermanson
Auditor's certificate no.570

3 April 2018

* *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 profit for the year ended 31 December 2017 of 795 thousand euros to retained earnings.

Retained earnings will amount to 2,795 thousand euros after the transfer of year 2017 net profit.

3 April 2018

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