



Arco Vara AS

Annual Report 2019

Consolidated annual report

(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year:	1 January 2019
End of financial year:	31 December 2019
Registry number:	10261718
Address:	Maakri 19/1 10145, Tallinn Republic of Estonia
Telephone:	+372 6 144 630
E-mail:	info@arcovara.com
Corporate website:	www.arcovara.com
Core activities:	Construction of residential and non-residential buildings (EMTAK 41201) Rental and operating of own or leased real estate (EMTAK 6820) 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

Group CEO's overview

In 2019, Arco Vara group made 13 million euros in revenue and 400 thousand euros in net profit on its equity of 13 million euros. This reflects the group's sensitivity to the development and selling pace of its real estate development projects. Had we achieved the planned result in the Iztok Parkside development project in Bulgaria, the revenue would have exceeded 22 million euros and net profit 2,2 million euros. The group certainly has plenty of room for increasing return on equity and this was also reflected in the share price.

The group's equity is invested into assets that have been stabilized and are manageable. Manageability means that Arco Vara has a freedom of choice for commencing, timing and pricing development projects in Estonia and Bulgaria, and that the rental property on Madrid Blvd in Sofia is backed with a new long-term bank loan, which requires partial occupancy by tenants in order to serve the loan. In reality, the occupancy rate was close to 100% at the end of the year.

In terms of internal processes, organizational structure, as well as the balance sheet and expected cash flows, the group has achieved a level of quality that allows to firmly continue with its growth plans. The main assets of the group are its seasoned and motivated development teams in Estonia and Bulgaria, together with its well-known trademark and trust earned in the real estate sector. This trust and reputation can be transformed into measurable success in financing, constructing, marketing and selling real estate projects. On top of that, the group is earning additional income through license agreements in Estonia, Latvia and Bulgaria.

The company's equity to debt ratio of 46/54 as of 31.12.2019 is too high, considering existing cash position, expected increase in equity upon realization of Iztok Parkside project and the weighted average term of loan liabilities. Therefore, the company must either increase investments, or start share buybacks or cash distributions to shareholders. Of course, the company's capitalization and cash usage may be revised in the middle of April, as the global economic environment is very dynamic and may offer new opportunities.

In 2020, the group continues with two Estonian developments projects, Kodulahe in Tallinn and Kodukalda in Tartu, with a total of 80 apartments under the cranes. Bank financing for finalising the construction has been secured and does not depend on new presales. Depending on the market situation, primarily the yet unclear consequences of the Covid-19 crisis, new constructions are theoretically possible in Botanica Lozen project in Sofia with a potential of over 600 units, as well as in Kodulahe project in Tallinn, where the detail plan allows to construct further 200+ apartments. In the first half of 2020, Iztok Parkside project with 68 apartments (GSA of 6,553 m²) should be realised – a project where two thirds of the time to date has been spent on bureaucracy and one third on construction and sale. By the end of the year, Kodukalda project in Tartu with 30 apartments (GSA of 1,967 m²) should be realised and a decision should be made about acquiring second stage land plots in Botanica Lozen project in Sofia. Further, we will continue close cooperation with real estate agencies using Arco Vara brand name and offering valuation and brokerage services – businesses that received mostly positive feedback from clients in 2019. Thus, on one hand, Arco Vara will continue with targeted residential real estate developments in Estonia and Bulgaria, but on other hand, will keep seeking information-based synergies with brokers and evaluators working under Arco Vara brand name.

General information

Arco Vara AS (hereafter 'the Company') 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 develops complete living environments and commercial real estate. Fully developed housing solutions are sold to the end-consumer. In some cases, the Group also develops commercial properties until they start to generate cash flow for two possible purposes: for the support of the Group's cash flows or for resale. The Group is currently holding completed commercial properties that generate rental income.

From the beginning of 2019, the Group itself no longer offers real estate brokerage and appraisal services, but in both Estonia, Latvia and Bulgaria, these services continue to be provided under Arco Vara trademarks through license agreements, from which the Group earns license fees.

Vision and mission

Arco Vara's vision:

- We are the most people focused real estate company
- We know real estate the best

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

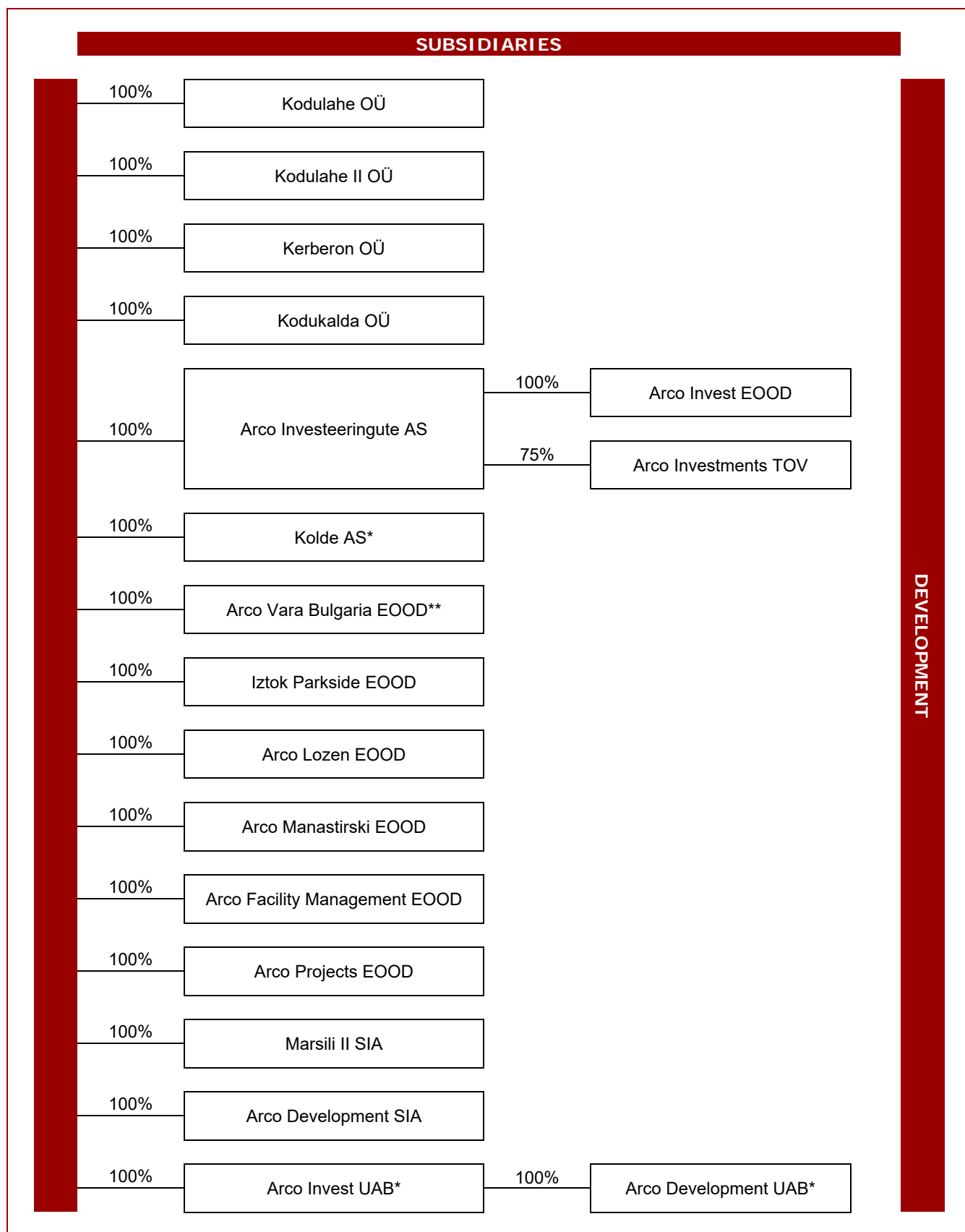
Scope of consolidation

As of 31 December 2019, the Group consisted of 19 companies, which is the same as on 31 December 2018.

Significant subsidiaries as of 31 December 2019

Company name	Location	Segment	Share capital (nominal value)	Equity balance on 31 December 2019	The Group's interest
In thousands of euros					
Arco Invest EOOD	Bulgaria	Development	31,762	2,662	100%
Iztok Parkside EOOD	Bulgaria	Development	1,433	158	100%
Arco Lozen EOOD	Bulgaria	Development	2,931	2,392	100%
Kodulahe OÜ	Estonia	Development	3	2,960	100%

Group structure as of 31 December 2019



* In liquidation

Key performance indicators

- In 2019, the Group's revenue was 13.1 million euros, increasing 3.6 times from 2018's revenue from continuing operations of 3.6 million euros.
- In 2019, the Group's operating profit (=EBIT) was 950 thousand euros and net profit 388 thousand euros. In 2018, the Group made operating profit from continuing operations of 101 thousand and net loss of 382 thousand euros. Discontinued operations brought an additional operating loss of 161 thousand euros in 2018.
- In 2019, 82 apartments were sold in the development projects of the Group (in 2018: 12 apartments, 3 commercial spaces and 2 land plots). Lahepea 9 apartments constituted the largest part of the sales.
- In 2019, the Group's debt burden (net loans) decreased by 2.8 million euros down to the level of 11.5 million euros as of 31 December 2019. As of 31 December 2019, the weighted average annual interest rate of interest-bearing liabilities was 4.2%, which is 0.8% lower than on 31 December 2018.

Operations

	2019	2018
In thousands of euros		
Revenue		
Development	12 976	3 481
Services	0	2 997
Parent company	133	154
Total revenue	13 109	6 632
Operating profit/loss (EBIT)		
Development	1 392	676
Services	0	-161
Parent company income and expenses	-442	-575
Total operating profit/loss (EBIT)	950	-60
Financial income and expenses	-562	-482
Profit before tax	388	-542
Income tax	0	-2
Net profit/loss	388	-544

Main ratios

	2019	2018
Earnings per share, EPS (in euros)	0.04	-0.06
Diluted earnings per share (in euros)	0.04	-0.06
Gross profit margin	13.8%	32.7%
ROIC (rolling, four quarters)	1.3%	-2.1%
ROE (rolling, four quarters)	3.0%	-4.4%
ROA (rolling, four quarters)	1.2%	-1.9%

As of 31 December	2019	2018
In thousands of euros		
Total assets	28,754	33,515
Invested capital	25,619	30,343
Net loans	11,450	14,205
Equity	13,299	13,001
Equity ratio	46.3%	38.8%
Current ratio	1.80	1.25
Quick ratio	0.15	0.19
Financial leverage	2.16	2.58
Average loan term (in years)	2.8	1.2
Average annual interest rate of loans	4.2%	5.0%
Number of staff, end of period	17	20

Cash flows

	2019	2018
In thousands of euros		
Cash flows from/used in operating activities	-1,517	-3,906
Cash flows from/used in investing activities	-201	-3,027
Cash flows from/used in financing activities	261	7,393
Net cash flows	-1,457	460
Cash and cash equivalents at the beginning of period	2,327	2,284
Decrease in cash and cash equivalents through sale of subsidiaries	0	-417
Cash and cash equivalents at the end of period	870	2,327

Revenue and net profit/loss from operations

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Total 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Total 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Total 2019
In millions of euros															
Revenue	1.6	1.0	7.7	8.0	18.3	2.1	1.1	2.1	1.3	6.6	1.1	0.7	0.4	10.9	13.1
Net profit/loss	-0.3	-0.3	0.6	0.8	0.8	-0.1	-0.3	0.1	-0.2	-0.5	-0.1	-0.2	-0.2	0.9	0.4

Formulas used:

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

Diluted earnings per share (Diluted EPS) = net profit attributable to owners of the parent / (weighted average number of ordinary shares outstanding during the period + number of all potentially issued shares)

Invested capital = current + 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)

Gross profit margin = gross profit / revenue

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

Equity ratio = equity / 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

Discontinued operations

Arco Vara AS sold its real estate agencies in Estonia and in Bulgaria to the management teams of these subsidiaries as of 31.12.2018. The real estate agencies in Estonia, Latvia and Bulgaria continue to operate under Arco Vara trademarks and to use the databases and other intellectual property of Arco Vara under a 5-year license agreement. As a result of the sale of shares, the two companies do not belong to Arco Vara consolidation group from 31.12.2018, but the license fees paid on the basis on sales revenues of both companies continue to contribute to the revenues of Arco Vara group.

In relation to these changes, the Service Division in Arco Vara group ceased to exist from 31.12.2018 and the Group continues with the Development Division only.

Consolidated profit and loss statements for continuing and discontinued operations

	2019			2018		
	Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
In thousands of euros						
Revenue from sale of own real estate	12,152	0	12,152	2,778	0	2,778
Revenue from rendering of services	957	0	957	857	2,997	3,854
Total revenue	13,109	0	13,109	3,635	2,997	6,632
Cost of sales	-11,295	0	-11,295	-2,446	-1,884	-4,330
Gross profit	1,814	0	1,814	1,189	1,113	2,302
Other income	137	0	137	135	108	243
Marketing and distribution expenses	-96	0	-96	-133	-412	-545
Administrative expenses	-777	0	-777	-1,224	-875	-2,099
Other expenses	-121	0	-121	-108	-89	-197
Gain/loss on revaluation of investment property	-7	0	-7	14	-6	8
Gain on sale of subsidiaries	0	0	0	228	0	228
Operating profit/loss	950	0	950	101	-161	-60
Finance income and costs	-562	0	-562	-482	0	-482
Profit/loss before tax	388	0	388	-381	-161	-542
Income tax	0	0	0	-1	-1	-2
Net profit/loss for the period	388	0	388	-382	-162	-544

Operating report

The revenue of the Group totalled 13,109 thousand euros in 2019 (in 2018: 6,632 thousand euros, out of which 3,635 thousand euros from continuing operations), including revenue from the sale of properties in the Group's own development projects in the amount of 12,152 thousand euros (in 2018: 2,778 thousand euros).

Most of the other revenue consists of rental income from commercial and office premises in Madrid Blvd building in Sofia, amounting to 696 thousand euros in 2019 (in 2018: 586 thousand euros). As of the publishing date of the annual report, all office and commercial spaces together with parking places were being rented out.

In 2019, the Group had operating profit of 388 thousand euros. In 2018, operating profit from continuing operations was 101 thousand euros.

In 2019, construction works finished in Stage II of Kodulahe project and keys were handed over to 65 apartment owners out of the total of 68 apartments during 2019. By the publishing date of the annual report, 1 apartment and a commercial space remained unsold.

In 2019, construction of Kodulahe Stage III began. In Stage III, a residential building with 50 apartments is being constructed at Soodi 4 in Merimetsa district in Tallinn. Under favourable market conditions, the joint construction of Stages IV-V will be started in 2020. The apartment buildings will become ready for final sale in about 1,5 years after the start of construction. By the publishing date of the interim report, presale agreements for 19 apartments in the Stage III building have been concluded.

In 2019, construction of 4 smaller apartment buildings with a total of 30 apartments began on Oa street plots in Tartu under the project name of Kodukalda. The construction is scheduled to end in Q4 2020. By the publishing time of the interim report, 12 apartments have been presold.

In Iztok Parkside project in Sofia, the final sale of apartments started at the end of Q4 2019, but the main sales are planned to take place during 2020 after receiving an occupancy permit. By the publishing date of the interim report, presale agreements for 10 apartments have not been concluded. Iztok project consists of three apartment buildings with a total of 67 apartments.

In Madrid Blvd building, the apartments previously used for offering accommodation service are all sold as of the date of this report.

In Lozen Botanica project near Sofia in Bulgaria, design works have been completed and main contractor has been chosen for Stage 1. Construction permit is expected in Q3 2020. The project foresees construction of 179 homes (apartments and houses), commercial spaces and a kindergarten. Under favourable market conditions, construction may start in Q3 2020, divided into smaller stages. Considering the nature of terrain on a mountain slope, minimum construction period is 2 years.

As of 31 December 2019, 4 Marsili residential plots remained unsold in Latvia.

Summary table of Arco Vara's active projects as of 31 December 2019

Project name	Address	Product main type	Stage	Area of plot(s) (m ²)	GSA / GLA (above grade) available or <future target>	No of units (above grade) available or <future target>
Madrid Blvd	Madrid Blvd, Sofia	Lease: Retail/Office	S6	-	7,350	22
Madrid Blvd	Madrid Blvd, Sofia	Apartments	S5	-	308	2
Iztok Parkside	Iztok, Sofia	Apartments	S5	2,470	6,553	64
Marsili residential plots	Marsili, near Riga	Residential plots	S5	6,153	-	4
Kodulahe, Stage 2	Lahepea 9, Tallinn	Apartments	S5	3,686	632	4
Kodulahe, Stage 3	Soodi 4, Tallinn	Apartments	S4	3,199	3,406	50
Kodulahe, Stages 4-5	Pagi 3 and 5, Tallinn	Apartments	S3	7,383	4,774	72
Paldiski road 74	Paldiski road 74, Tallinn	Apartments	S2	9,793	<9,300>	<123>
Kodukalda	Oa street 37,39,41, Tartu	Apartments	S4	4,146	1,967	30
Lozen Botanica, stage 1	Lozen, near Sofia	Apartments, houses	S3	47,450	<25,200>	<179>

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 2019, 17 people worked for the Group (20 as of 31 December 2018). Employee remuneration expenses amounted to 494 thousand euros in 2019 (in 2018: 668 thousand euros).

The remuneration of the member of the management board / CEO of the Group's parent company including social security charges amounted to 121 thousand euros in 2019 (99 thousand euros in 2018). Remuneration for the members of the Group's supervisory board was 8 thousand euros in 2019 and 7 thousand euros in 2018.

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 2021) on the supervisory board meeting held in October 2018.

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 luteCredit 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 2019, the 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, OÜ Silverpool, Andrimal OÜ, Inglise Kolledži SA, Inglise Kolledži Hariduskeskus SA.

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, KLT Air OÜ, ABC Kinnisvarateenuste OÜ, Thermory AS, OÜ Cuber Technology, Lohmus Capital OÜ, OÜ Tarbegaas, OÜ Ihaste Gaas, AS Audentes, Kõrberebane OÜ, OÜ Kodreste, MTÜ Outset Eesti, OÜ Tondi Tennisekeskus, OÜ Evernord 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 luteCredit 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).

Kert Keskaik

Mr Keskaik graduated from the Tallinn Technical University with a degree in business administration in 2007. Mr Keskaik is member of management board of OÜ K Vara and founder of OÜ A&K Vara. His companies have been active Tallinn Stock Exchange investors since 2000. In 2001, Mr Keskaik 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. Keskaik is also member of management Board of Sporditurg OÜ, Mittetulundusühing Rulluisufestival, One Eleven OÜ, Uisuklubi Albe, Silverticket OÜ, Silverticket SPV1 OÜ, Ticketmarket OÜ, Tripalium OÜ, Lead Invest OÜ and Boost Yourself SPV1 OÜ and member of supervisory board of Arco Transport AS.

Description of main risks

Strategic risk

Most of the Group's equity is invested into real estate development. The Group is focused mainly on residential real estate development where development cycle lasts for years, starting from the acquisition of a land plot, moving on to detail

planning, design and construction, and ending with the sale of end products to customers. The equity is invested mainly in the early phase of the cycle (purchase of land) on the assumption that there will be a demand for certain products in the future. Considering that the demand for development product is largely based on forecasts, the main risk for the Group is investing equity into a development product for which there is no or too little demand in the future.

For mitigating the risk, the Group: (i) invests equity into different development projects in different markets (in 2018, 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 sale 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 bank 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 2019, the Group's interest-bearing liabilities amounted to 12.3 million euros (decreased by 5.0 million euros during 2019), out of which 6.4 million euros is due within next 12 months (see also note 21). Group's cash and cash equivalents totalled 0.9 million euros as of 31 December 2019 (2.3 million euros as of on 31 December 2018). The Group's weighted average loan interest rate was 4.2% as of 31 December 2019. This is a decrease by 0.8 percentage points compared to the end of year 2018. The reason for the decrease is the new borrowings raised in 2019 which bear a below-average interest rate and refinancing loan for Madrid building in Sofia in more favourable terms.

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

Today, the main business of Arco Vara is real estate development; until the end of 2018, it also included real estate brokerage and appraisal services. Therefore, our social responsibility has several important dimensions.

The 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 the 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

Arco Vara AS has issued a total of 8,998,367 ordinary shares with nominal value of 0.7 euros per share. The shares are freely traded on NASDAQ Tallinn stock exchange. The share price closed at 1.14 euros on 31 December 2019; the closing price was 1.12 euros on 31 December 2018. During the period, the highest traded price per share was 1.32 euros and the lowest price 0.99 euros. As of 31 December 2019, market capitalization of shares amounted to 10,258 thousand euros and P/B (price to book value) ratio was 0.77 (31 December 2018: 10,078 thousand euros and 0.78, respectively). P/E (price to earnings) ratio of the share was 26.44 on 31 December 2019, negative on 31 December 2018.

The following charts reflect the movements in the price and daily turnover of Arco Vara's share in 12 months 2019 and during the last three years.

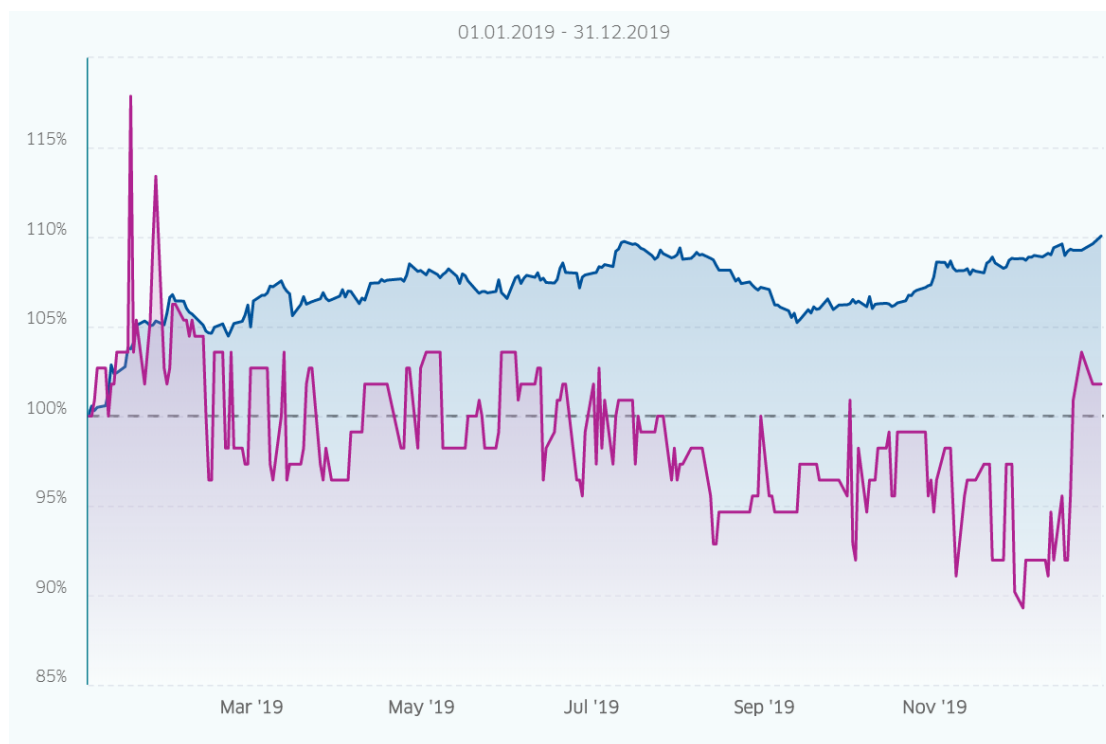
Performance of Arco Vara's shares in 2019



Performance of Arco Vara's shares from 1 January 2017 until 31 December 2019



Changes in Arco Vara share price compared with the benchmark index OMX Tallinn in 2019

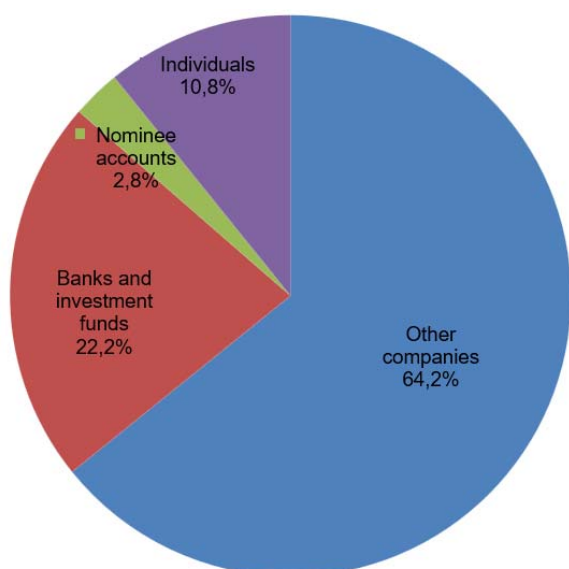


Index/equity	1 Jan 2019	31 Dec 2019	+/-%
-- OMX Tallinn	1,162.86	1,279.70	10.05
-- ARC1T	1.12 EUR	1.14 EUR	1.79

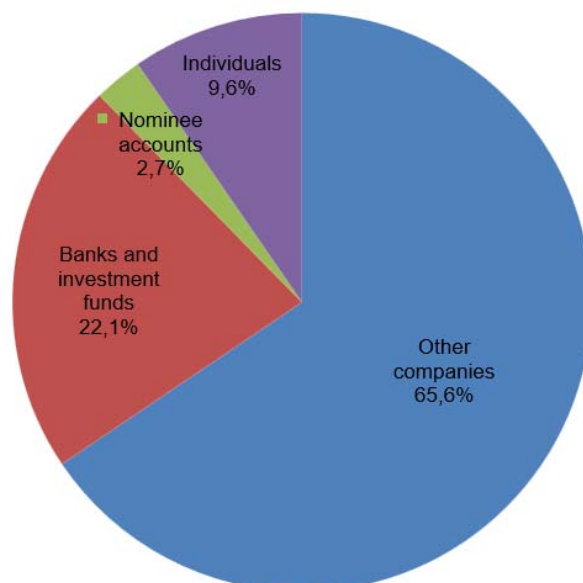
Structure of shareholders

As of 31 December 2019, Arco Vara AS had 1,315 shareholders (on 31 December 2018: 1,352), including 1,138 individuals as shareholders (on 31 December 2018: 1,164 individuals) who jointly owned 10.8% (on 31 December 2018: 9.6%) of the company. Complete shareholder structures are presented on the following diagrams:

Ownership structure as of 31 December 2019



Ownership structure as of 31 December 2018



Major shareholders on 31 December 2019

Name	No of shares	Share, %
Alarmo Kapital OÜ	2,517,405	28.0%
AS Lõhmus Holdings	850,000	9.4%
Baltplast AS	837,498	9.3%
LHV Pensionifond L	832,026	9.2%
Gamma Holding Investment OÜ	562,893	6.3%
LHV Pensionifond XL	365,619	4.1%
Firebird Republics Fund LTD	356,428	4.0%
HM Investeeringud OÜ	330,505	3.7%
Firebird Avrora Fund LTD	185,800	2.1%
Firebird Fund L.P.	150,522	1.7%
Other shareholders	2,009,671	22.2%
Total	8,998,367	100.0%

Holdings of management and supervisory board members on 31 December 2019

Name	Position	No of shares	Share, %
Tarmo Sild and Allar Niinepuu (Alarmo Kapital OÜ)	member of management board/ member of supervisory board	2,517,405	28.0%
Rain Lõhmus (AS Lõhmus Holdings)	member of supervisory board	850,000	9.4%
Hillar-Peeter Luutsalu (HM Investeeringud OÜ, related persons)	chairman of supervisory board	369,259	4.1%
Kert Kesksaik (privately and through K Vara OÜ)	member of supervisory board	206,371	2.3%
Steven Yaroslav Gorelik ¹	member of supervisory board	0	-
Total		3,943,035	43.8%

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 7.7% 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 held on 10.05.2016 decided 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 entitled 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.

The CEO of Arco Vara had fully used its subscription rights by the end of 2019, as verified by the Supervisory Board. The deadline for paying for the subscribed shares is April 30, 2020.

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. The Group's net profit during years 2017-2019 was less than 5.5 million euros.

CORPORATE GOVERNANCE REPORT

The shares of Arco Vara AS (the "Company") were listed in the main list of the Tallinn Stock Exchange on 21 June 2007. As a listed company, Arco Vara AS 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 2019, 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 21 May 2019. The notice was published in the national daily newspaper *Eesti Päevaleht* on 22 May 2019. 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 took place on 13 June 2019 from 10:05 a.m. until 10:25 a.m. in Tallinn at Rävala pst 5, in Arco Vara Kinnisvarabüroo's office.

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 2018
- distribution of profit.

The following decisions were adopted at the annual general meeting:

- To approve the annual report of Arco Vara AS for 2018.
- To cover the net loss for the year ended on 31 December 2018 in the amount of 543,700 euros from retained earnings.
- To pay dividends to the shareholders 0.01 euros per share, in the total amount of 89 984 euros. The list of shareholders entitled to dividends shall be fixed on 5 July 2019, as at the end of the working day of Nasdaq CSD Estonian Settlement System. The dividends shall be paid to the shareholders by transfer to the bank account of the shareholders on 12 July 2019.

The meeting was chaired by Kristel Tumm, 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 59,9% 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 2018 and the Company's prognosis for the near future. The meeting was also attended by the chairman of the Supervisory Board, Hillar-Peeter Luutsalu and two members of the Supervisory Board, Allar Niinepuu and Kert Keskaik. Two remaining members of the Supervisory Board, Steven Yarsolav Gorelik and Rain Lõhmus were unable to attend the meeting because they were not in Estonia. The auditors did not participate.

The voting was carried out by the representatives of AS eCSD. The voting was organized electronically, with a help of voting devices handed out to the registered participants.

The resolutions, minutes and materials of all general meetings held in 2019 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 11 October 2018, 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 15 October 2021.

Service contract 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 10 May 2016 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 2019 for 0.7 euros per share. Tarmo Sild decided to use this right in 2019. The deadline for paying for the shares is April 30, 2020.

In 2019, 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 luteCredit 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.

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. Allar Niinepuu, Rain Lõhmus, Steven Yaroslav Gorelik and Kert Keskspaik are independent members of the Supervisory Board.

In 2019, there were no changes in the composition of the Company's Supervisory Board. During 2019, the composition of the Supervisory Board was the following: Allar Niinepuu, Hillar-Peeter Luutsalu, Rain Lõhmus, Steven Yaroslav Gorelik, Kert Keskspaik.

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 has been Hillar-Peeter Luutsalu.

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 2019, the Supervisory Board had 3 meetings, out of which two were attended by Allar Niinepuu, Hillar-Peeter Luutsalu, Kert Keskspaik, Steven Yaroslav Gorelik; in the third meeting, all Supervisory Board members participated.

In addition to being members of the Supervisory Board, all members also fill the obligations of an Audit Committee.

The Supervisory Board did not approve any transactions between a member of the Management Board or his affiliated person or a related party and the Company in 2019. No such transactions took place during the year.

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 2019 and 2018 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.arcovara.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 October 2020, i.e. until publishing the Q3 interim report for 2020.

The Company's website does not include information about 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 annual 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 3 May 2018, AS PricewaterhouseCoopers was appointed as the Company's auditor for the next financial year for the seventh 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 performed monthly. 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	2019	2018
In thousands of euros			
CONTINUING OPERATIONS			
Revenue from sale of own real estate		12,152	2,778
Revenue from rendering of services		957	857
Total revenue	7,8	13,109	3,635
Cost of sales	9	-11,295	-2,446
Gross profit		1,814	1,189
Other income	10	137	135
Marketing and distribution expenses	11	-96	-133
Administrative expenses	12	-777	-1,224
Other expenses	10	-121	-108
Gain on revaluation of investment property	18	-7	14
Gain on sale of subsidiaries	6	0	228
Operating profit		950	101
Finance income and cost	13	-562	-482
Profit/loss before tax		388	-381
Income tax	14	0	-1
Net profit/loss from continuing operations		388	-382
Net loss from discontinued operations	5	0	-162
Net profit/loss for the period		388	-544
Total comprehensive income/ expense for the period		388	-544
Earnings per share from continuing operations (in euros)			
- basic		0.04	-0.04
- diluted		0.04	-0.04
Earnings per share (in euros)			
- basic	15	0.04	-0.06
- diluted		0.04	-0.06

The notes presented on pages 22 to 54 form an integral part of the consolidated financial statements.

Consolidated statement of financial position

	Note	31 December 2019	31 December 2018
In thousands of euros			
Cash and cash equivalents	23	870	2,327
Financial investments		0	69
Receivables and prepayments	16	544	739
Inventories	17	15,807	17,482
Total current assets		17,221	20,617
Receivables and prepayments	16	0	25
Investment property	18	11,051	12,344
Property, plant and equipment	19	265	267
Intangible assets	19	217	262
Total non-current assets		11,533	12,898
TOTAL ASSETS		28,754	33,515
Loans and borrowings	20	6,416	12,547
Payables and deferred income	21	3,135	3,982
Total current liabilities		9,551	16,529
Loans and borrowings	20	5,904	3,985
Total non-current liabilities		5,904	3,985
TOTAL LIABILITIES		15,455	20,514
Share capital	22	6,299	6,299
Share premium	22	2,285	2,285
Statutory capital reserve	22	2,011	2,011
Other reserves	15	245	245
Retained earnings	25	2,459	2,161
Total equity attributable to owners of the parent		13,299	13,001
TOTAL EQUITY		13,299	13,001
TOTAL LIABILITIES AND EQUITY		28,754	33,515

The notes presented on pages 22 to 54 form an integral part of the consolidated financial statements.

Consolidated statement of cash flows

Note	2019	2018
In thousands of euros		
Cash receipts from customers	9,084	10,993
Returned prepayments	-876	-318
Cash paid to suppliers	-8,936	-13,036
Other taxes paid and recovered (net)	-457	-333
Cash paid to employees	-328	-1,177
Other cash payments and receipts related to operating activities	-4	-35
NET CASH FROM / USED IN OPERATING ACTIVITIES	-1,517	-3,906
Payments made on purchase of tangible and intangible assets	-5	-114
Proceeds from sale of tangible assets	28	0
Payments made on purchase and improvement of investment property	-300	-584
Proceeds from sale of a subsidiary	0	632
Payments made on purchase of a subsidiary	0	-2,939
Proceeds from sale of financial investments	69	0
Loans	0	-12
Repayment of loans	7	0
Other payments related to investing activities	0	-10
NET CASH FROM/USED IN INVESTING ACTIVITIES	-201	-3,027
Proceeds from loans received	10,735	6,604
Settlement of loans and borrowings	-9,418	-2,074
Interest paid	-886	-730
Dividends paid	-90	-90
Proceeds from share capital increase	0	3,737
Other payments related to financing activities	-80	-54
NET CASH FROM/USED IN FINANCING ACTIVITIES	261	7,393
NET CASH FLOW	-1,457	460
Cash and cash equivalents at beginning of period	2,327	2,284
Change in cash and cash equivalents	-1,457	460
Decrease in cash and cash equivalents through sale of subsidiaries	0	-417
Cash and cash equivalents at end of period	870	2,327
Net cash flow from discontinued operations	0	40

The notes presented on pages 22 to 54 form an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

	Equity attributable to owners of the parent					Total equity
	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	
In thousands of euros						
Balance as of 31 December 2017	4,555	292	2,011	134	2,795	9,787
Total comprehensive income for the period	0	0	0	0	-544	-544
Transactions with owners:	1,744	1,993	0	111	-90	3,758
<i>Increase of share capital</i>	1,744	1,993	0	0	0	3,737
<i>Dividends paid</i>	0	0	0	0	-90	-90
<i>Formation of other reserves</i>	0	0	0	111	0	111
Balance as at 31 December 2018	6,299	2,285	2,011	245	2,161	13,001
Balance as of 31 December 2018	6,299	2,285	2,011	245	2,161	13,001
Total comprehensive income for the period	0	0	0	0	388	388
Transactions with owners:	0	0	0	0	-90	-90
<i>Dividends paid</i>	0	0	0	0	-90	-90
Balance as of 31 December 2019	6,299	2,285	2,011	245	2,459	13,299

Further information on changes in share capital is provided in notes 15, 22 and 25.

The notes presented on pages 22 to 54 form an integral part of the consolidated financial statements.

Notes to the Consolidated Financial Statements

1. General information

These consolidated financial statements of Arco Vara AS and its subsidiaries as of and for the year ended on 31 December 2019 were authorised for issue by the chief executive officer / member of the management board on 2 April 2020. 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 Maakri 19/1 Tallinn. As at the end of 2019, 17 people provided services to the Group under the employment or authorization contract (31 December 2018: 20 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 2019 is presented in note 27.

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.

Estimation of the net realisable value of inventories

The Group has several 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 2019 and 31 December 2018 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 17.

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 2018, the Group did not request valuation reports from independent appraisers. In 2019, both internal and external experts were used. 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 18.

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 adequately.

Except as described below, the accounting policies applied in these financial statements are the same as those applied in the Group's consolidated financial statements as of and for the year ended 31 December 2018. A number of new standards (including IFRS 16 "Leases") did not have a material effect on the Group's financial statements as of 1 January 2019 (see note 4).

4. Significant accounting policies

New accounting pronouncements from 1 January 2019

The following new or revised standards and interpretations are mandatory for the Group's annual periods starting from 1 January 2019.

IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Group as a lessor did not have assets with a term of over 12 months and a significant value; thus, the new standard did not have a significant effect for the Group.

New accounting pronouncements after 1 January 2020

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 2020, which the Group has not adopted earlier:

Changes in the conceptual framework for financial reporting (effective for annual periods beginning on or after 1 January 2020).

The revised conceptual framework includes a new chapter on measurement, guidance on financial reporting, improved concepts and guidance (e.g. definition of obligation) and explanations on the role of key areas in financial reporting, such as diligence, conservatism and uncertainty of measurement in the use of resources entrusted to management. The Group assesses the impact of the amendments on the financial statements.

Definition of materiality - Amendments to IAS 1 and IAS 8 (effective for annual periods beginning on or after 1 January 2020).

The changes clarify the concept of materiality and how to apply the concept by incorporating into the definition those guidelines that were previously contained in other standards. The explanation of the concept has also been supplemented. As a result of the amendments, the concept of materiality is consistent in all IFRS standards. Information is important if its non-disclosure, misrepresentation or concealment can reasonably affect decisions made by the main users of company's

general purpose financial statements based on those reports. The Group assesses the impact of the amendments on the financial statements.

“Definition of a Business” – amendments to IFRS 3 (effective from annual reporting periods starting from 1 January 2020 or later; not approved by the EU yet).

The amendments clarified the definition of business. A business must have inputs and a substantive process that together significantly contribute to the ability to create output. New guidelines provide a framework for determining when inputs and a substantive process exist, including for early stage companies, which have not created outputs yet. If there are no outputs yet, presence of an organised workforce is needed to be classified as a business. Definition of outputs has been narrowed and it now concentrates on goods and services provided to customers, investment income and other income; the definition no longer includes lower costs or other economic benefits. Market participants no longer need to evaluate whether they are capable of replacing missing elements or integrating acquired activities or assets. A company may opt for a “concentration test”: acquired assets do not constitute a business if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or group of similar identifiable assets. The Group assesses that there is no significant impact on financial reports.

Other new or revised standards or interpretations which are not yet effective are not expected to have a material impact on the Group.

Business combinations and basis of consolidation

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

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

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

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

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

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

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

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

Segment reporting

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

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

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

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

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

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

Foreign currency transactions

All group entities prepare their financial statements in the currency of the primary economic environment in which they operate (their functional currency), i.e. in the local currency. The functional currency of the Group's parent company and Latvian 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 income arising in the course of the Group's ordinary activities. Revenue is measured in the amount of transaction price. Transaction price is the amount of consideration to which the Group expects to be entitled to in exchange of transferring control over promised goods or services to a customer, excluding the amounts collected on behalf of third parties. The Group recognises revenue when it transfers control of a good or service to a customer.

Revenue from sale of real estate

The Group develops and sells real estate (mostly apartments). Revenue is recognised when control over the property has been transferred to the customer. The properties have generally no alternative use for the Group due to contractual restrictions. However, an enforceable right to payment does not arise until legal title has passed to the customer. Therefore, revenue is recognised at a point in time when the legal title has passed to the customer.

Revenue from franchise agreements

The Group is selling licensing rights to its trademarks to real estate agencies in Estonia, Latvia and Bulgaria. Revenues are recognized in periods when services are provided. Revenues depend on the turnover of real estate agencies, which are reported on a monthly basis.

Revenue from real estate brokerage and valuation services, real estate leasing and other services

The Group provided brokerage and valuation services related to real estate on the basis of brokerage and valuation contracts, as well as rented commercial premises belonging to the Group. Revenue from the rendering of services is recognized in the period when the services are rendered and the income from the leased commercial premises is linear during the lease term.

Financing component

Group does not have any contracts where the period between the transfer of the promised goods or services to the customer and payment by the customer exceeds one year. Consequently, the Group does not adjust any of the transaction prices for the time value of money.

Cash and cash equivalents and the statement of cash flows

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

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

Financial assets

Classification

The Group classifies its financial assets in the following measurement categories:

- to be measured subsequently at fair value (either through other comprehensive income or through profit or loss)
- to be measured at amortised cost.

The classification depends on the Group's business model for managing the financial assets and the contractual terms of the cash flows.

Recognition and derecognition

Ordinary purchases and sales of financial assets are recognised on transaction date, when the Group commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

Measurement

At initial recognition, the Group measures a financial asset at its fair value plus transaction costs that are directly attributable to the acquisition, except for of financial assets carried at fair value through profit or loss statement. Transaction costs of financial assets carried at fair value through profit or loss statement are expensed in profit or loss statement.

Debt instruments

Subsequent measurement of debt instruments depends on the Group's business model for managing financial assets and on the cash flow characteristics of the asset. All Group's debt instruments are classified in amortised cost measurement category.

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in financial income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss statement and presented in other income/expenses. Foreign exchange gains and losses and impairment losses are presented as separate line items in profit or loss statement.

Equity instruments

The Group records equity instruments at their fair value. If the Group has made an irreversible decision to record the fair value changes of equity instruments not held for trading purposes through other comprehensive income, then it is not possible upon derecognition of such equity instrument to reclassify changes and record them through profit and loss statement. Dividends received from such investments will continue to be recorded in the other income row of the profit or loss statement if the Group has received a right of dividends.

Profit or loss from equity instruments measured at fair value through profit or loss statement is recorded on the other income or loss row of the profit or loss statement. Devaluations (or reversals thereof) of equity instruments measured at fair value through other comprehensive income statement are not recorded separately from changes in fair value.

Impairment

The Group assesses on a forward-looking basis the expected credit losses associated with its debt instruments carried at amortised cost and fair value with changes through profit and loss. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

The measurement of expected credit losses reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

The Group measures impairment as follows:

- receivables from purchasers in an amount equal to expected credit losses over lifetime;
- cash and cash equivalents the credit risk of which is assessed to be low during the reporting period (the management considers an investment-grade credit rating by at least one major credit rating agency to prove a low credit risk) in an amount equal to the expected credit losses over 12 months;
- for all other financial assets, the expected credit losses over 12 months if the credit risk (i.e. default risk over the life of the financial asset) has not increased significantly after initial recognition; if there is a significant increase in risk, the credit loss is measured at the amount of credit losses expected over the lifetime.

Inventories

The Group's inventories include mostly land and buildings that have been acquired or are being developed for housing developments. 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 rental income 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, on the basis of valuations performed by qualified independent appraisers. This means that in the case of significant investment properties valuation reports are also commissioned, if necessary, from independent real estate appraisers. Fair value is determined using the following methods:

- Income method (discounted cash flow analysis or income capitalisation). The income method is used to determine the value of investment properties that generate stable rental income and properties whose fair value, according to management's assessment, cannot be determined reliably under the comparison method (for example, inactive property market in the location of the property being valued, absence of comparable transactions or an extensive period between a comparable transaction and the date of valuation). In order to calculate the fair value of a property using income method the appraiser has to forecast the property's future rental income (including rental per 1 square metre and the occupancy rate) and operating expenses. Depending on the terms of the lease (whether and how easily the lease can be terminated by the lessee), the appraiser will base the projections on either the property's existing cash flows or the market's current average cash flows for similar properties. The present value of the future net cash flow is found by applying a discount rate, which best reflects the current market assessments of the time value of money and the risks specific to the asset. The discount rate is selected based on the market's average capital structure. Capitalization rate applied on using income capitalisation method is based on the investors' market average expected yield for the same type of assets.
- Comparison method. The comparison method is applied to properties that do not generate rental cash flow and are held for future development or capital appreciation. Under this method, the market value of a property is determined by reference to the price per square metre agreed in transactions performed with similar properties. As the transactions selected for comparison are practically never identical with the property being valued, their prices are adjusted to reflect differences in time, location, size and detailed design plan. Where necessary, another valuation technique is applied (e.g. the income method) if management believes that the latter can measure the fair value of the property more reliably.
- Residual value method. The method is applied to determine the value of a property that requires development or reconstruction in a situation where the comparison method cannot be applied due to the absence of a suitable basis for comparison. The method is applied on the assumption that the buyer is willing to pay for a property an amount equal to the value of the property after its development or reconstruction less its estimated development or reconstruction costs and a reasonable profit margin.
- Existence of a sales contract under the law of obligations (a presale contract). In the case of properties which at the reporting date have been sold based on a contract under the law of obligations but in respect of which the real right contract has not been signed (title has not transferred), fair value is determined by reference to the sales price of the property in the contract under the law of obligations. The sales price agreed in the contract under the law of obligations is used for determining the fair value of a property only when the group has reasonable assurance that the related real right contract will be concluded under the same terms and conditions (e.g. the buyer has made a substantial prepayment for the property by the reporting date or the real right contract is concluded after the reporting date but before the date management approves the financial statements for issue).

Gains and losses arising from changes in the fair value of investment property are recognised in the profit or loss on the period in which they arise (on a separate row within 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 of 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, 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 18.

Property, plant and equipment

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

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

After recognition, an item of property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses. If an item of property, plant and equipment consists of significant parts that have different useful lives, the parts are accounted for separately and assigned depreciation rates that correspond to their useful lives.

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

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

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

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

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

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

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

Intangible assets

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

Intangible assets are initially measured at cost. Following initial recognition, intangible assets are measured at cost less any accumulated amortisation and any accumulated impairment losses. Accumulated amortization is recognised within administrative expenses and reduction in value within other 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 assessment is made 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, an estimation about the recoverable amount of that asset is made. When recoverable amount of that asset or cash-generating unit exceeds the carrying amount of an asset or a cash-generating unit the prior impairment shall be reversed and the carrying amount of the asset shall be increased. The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

Financial liabilities

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

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

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

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

Employee benefits

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

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

Share-based payments

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

If the share options are exercised by the CEO/member of the management board 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.

Leases – Group as a lessee

Accounting policies from 1 January 2019

The Group has applied IFRS 16 "Leases" starting from 01.01.2019.

Lessees will be required to recognise:

- (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and
- (b) depreciation of lease assets separately from interest on lease liabilities in the income statement.

Lease agreements are recognized as right-of-use assets and corresponding liabilities as of the date when leasable asset becomes available for use.

Lease liabilities are recognized at present value of lease payments. Right-of-use assets are recognized in the amount equal to lease liabilities, unless adjustments to rights-of-use assets are necessary. All lease payments are divided between liabilities and financial expenses. Financial expenses are recorded in the income statements of the lease period in a manner that produces a constant periodic discount rate on the remaining balance of the liability. Lease assets are depreciated linearly over the period that is the shorter of its useful life or the lease period.

Lease liabilities include the present value of the following rental payments:

- fixed payments less any lease incentives
- variable lease payments that depend on an index or a rate (e.g. inflation, Euribor)
- payments by the lessee under residual value guarantees
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option.

Lease payments are discounted using the interest rate implicit in the lease contract if that rate can be readily determined, or the Group's incremental borrowing rate. Incremental borrowing rate is the rate of interest that the lessee would have to pay to borrow the funds necessary to obtain similar assets in a similar economic environment and with similar terms.

A short-term lease is a lease that has a lease term of less than 12 months. Low-value assets include IT-equipment and smaller office equipment. In determining the lease term, management considers all relevant facts and circumstances that create an economic incentive to exercise the option to extend the lease, or not to exercise the option to terminate the lease. Periods covered by extension options (or periods after termination options) are added to the lease terms if it is reasonably certain that the lease will be extended (or not terminated). The management considers changes in facts and circumstances that are under management's control and affect the likelihood of using the options. For example, when the extension period of lease has changed (the Group has exercised an option that was earlier considered unlikely, or has not realised an option that was earlier considered unlikely).

According to the lease agreements, the Group's lease assets have no balance sheet value upon termination.

The Group has used the following practical exemptions allowed by the standard:

- lease agreements that, as of 1 January 2019, had a term of less than 12 months, have been recorded as short-term leases
- leases of low value assets have been excluded

- initial direct costs of the measurement of right-of-use assets at the date of initial application have been excluded.

The Group leases different real estate assets. When adopting IFRS 16, the Group analysed lease obligations that had been earlier classified as operating leases under IAS 17 "Leases". Lease agreements in force as of 31.12.2019 contain termination options of less than 12 months, but involve extension options. Lease terms are agreed separately for each lease agreement and may include different terms.

In relation to changing the accounting policies, no leases were recorded as right-of-use assets in 2019 because the assets did not have a substantial value or a term of over 12 months.

Accounting policy until 31 December 2018

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 Group 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 25.

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 29) represent supplementary information that is presented in accordance with the requirements of the Estonian Accounting Act and they do not constitute separate financial statements as defined in IAS 27.

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

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

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

Discontinued operations in reports

A discontinued operation is a component of the Group that is sold or classified as held for sale as of the reporting date and represents a separate major line of business or geographical area of operations and is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations. Non-current asset or disposal group is classified as held for sale when its carrying amount is to be covered principally through a sale transaction rather than through continuing use, and the sale is considered highly probable. The disposal group is recognized at carrying amount or fair value less costs related to the transaction of sale, depending on which is lower.

Earnings and cash flows of discontinued operations, if any, are disclosed separately from continuing operations with comparatives being re-presented. Intergroup transactions between discontinued and continuing operations are eliminated depending on whether the transactions will continue after the sale.

5. Discontinued operations

On 31 December 2018, Arco Vara AS sold its two real estate agencies to the managements of these companies. In addition, 15 apartments were put on sale in the Madrid Blvd Building in Sofia, which so far had been used for providing accommodation services. Based on the above, the entire service segment was classified as discontinued from thereon.

Consolidated profit and loss statement for discontinued operations

Note	2019	2018
In thousands of euros		
Revenue from rendering of services	0	2,997
Total revenue	0	2,997
Cost of sales	0	-1,884
Gross profit	0	1,113
Other income	0	108
Marketing and distribution expenses	0	-412
Administrative expenses	0	-875
Other expenses	0	-89
Loss on revaluation of investment property	0	-6
Operating profit/loss	0	-161
Income tax	0	-1
Net profit/loss from discontinued operations	0	-162

Consolidated cashflows of discontinued operations

	2019	2018
In thousands of euros		
Cash from/used in operating activities	0	64
Cash from/used in investing activities	0	-24
Cash from/used in financing activities	0	0
Net cashflows of discontinued operations	0	40

6. Acquisition and sale of subsidiaries

Scope of consolidation

As of 31 December 2019, the Group consisted of 19 companies, which is the same as on 31 December 2018. There were no changes in the Group's structure in 2019. In 2018, three companies were sold, one was liquidated, one purchased and one established. The structure of the Group is presented in note 27.

Acquisitions and establishments of subsidiaries

In 2019, no subsidiaries were acquired nor established.

In January 2018, the Group acquired a 100% subsidiary Arco Lozen EOOD in Bulgaria. 2,939 thousand euros were paid to the seller. The Group does not consider the purchase of Arco Lozen EOOD as business combination, because essentially it was a purchase of land with strong development potential and the acquired company had no business activity.

Effect of acquisition on the Group's statement of financial position in 2018

In thousands of euros	
Increase in inventories	2,939
Paid in cash on acquisition of subsidiary	-2,939
Total effect on the Group's net assets	0

On 26 February 2018, the Group established a new subsidiary Arco Management EOOD with paid-in capital of 2,556 euros.

Sale of subsidiaries

In 2019, no subsidiaries were sold.

In February 2018, Arco Vara AS received 332 thousand euros from the sale of Arco Fund REIT. At the time of sale, Arco Fund REIT had a cash position of 291 thousand euros.

Summary consolidated statement of financial position of sold subsidiary Arco Fund REIT

	31.03.2018	31.12.2017
In thousands of euros		
Prepayments	1	1
Intangible assets	1	2
Current liabilities	4	30
Total net assets	-2	-27

On 31 December 2018, the Group sold its real estate agencies in Estonia and Bulgaria: Arco Vara Kinnisvarabüroo AS and Arco Imoti EOOD. For the sale, the Group received 250 thousand and 50 thousand euros accordingly. At the time of sale, Arco Vara Kinnisvarabüroo AS had a cash position of 100 thousand euros and Arco Imoti EOOD had a cash position of 26 thousand euros.

Summary consolidated statement of financial position of sold subsidiary Arco Vara Kinnisvarabüroo AS

	31.12.2018	31.12.2017
In thousands of euros		
Receivables from clients and other short-term assets, except cash	25	1
Non-currents assets	14	154
Current liabilities	237	188
Total net assets	-198	-33

Summary consolidated statement of financial position of sold subsidiary Arco Imoti EOOD

	31.12.2018	31.12.2017
In thousands of euros		
Receivables from clients and other short-term assets, except cash	245	142
Non-currents assets	30	33
Current liabilities	148	211
Total net assets	127	-36

Arco Vara Kinnisvarabüroo AS and Arco Imoti EOOD continue to operate under Arco Vara trademarks and to use the databases and other intellectual property of Arco Vara under a 5-year license agreement.

Liquidation of subsidiaries in 2018

On 6 July 2018, the Group's subsidiary Ulmana Gatves Nami SIA was erased from Latvian Commercial Register.

7. Segment information

Until the end of 2018, the Group had 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.

After discontinuing of Service division in 2018 only geographical segments remained: Estonia, Bulgaria, Latvia.

External revenue by location

	2019	2018
In thousands of euros		
Estonia	10,004	2,858
Bulgaria	3,105	687
Latvia	0	90
Total revenue	13,109	3,635

External operating profit by location

	2019	2018
In thousands of euros		
Estonia	603	-91
Bulgaria	355	201
Latvia	-8	-9
Total revenue	950	101

External assets and liabilities by location

On 31 December	2019	2018
In thousands of euros		
Assets	28,754	33,515
Estonia	8,082	11,213
Bulgaria	20,546	22,174
Latvia	126	128
Liabilities	15,455	20,514
Estonia	2,859	5,940
Bulgaria	12,596	14,574

Non-current assets by location

On 31 December	2019	2018
In thousands of euros		
Total non-current assets	482	529
Tangible assets	265	267
Estonia	9	11
Bulgaria	256	256
Intangible assets	217	262
Estonia	171	256
Bulgaria	46	6

Notes to the Consolidated Statements of Comprehensive Income

8. Revenue

External revenue by the type of goods and services and by client location

	Estonia		Bulgaria		Latvia		Consolidated	
	2019	2018	2019	2018	2019	2018	2019	2018
In thousands of euros								
Sale of own real estate	9,865	2,688	2,287	0	0	90	12,152	2,778
Rental of real estate	5	12	696	586	0	0	701	598
Property management services	0	4	88	81	0	0	88	85
Franchise	74	0	34	0	20	12	128	12
Other revenue	5	0	35	162	0	0	40	162
Total revenue	9,949	2,704	3,140	829	20	102	13,109	3,635

9. Cost of sold real estate and services

	2019	2018
In thousands of euros		
Cost of real estate sold (note 17, 18)	-10,296	-2,071
Brokerage fees	-347	0
VAT cost	-161	0
Property management costs	-342	-292
Personnel expenses (note 12)	-33	-28
Depreciation, amortisation and impairment losses (note 19)	-85	0
Other costs	-31	-55
Total cost of sold real estate and services	-11,295	-2,446

10. Other income and expenses

Other income

	2019	2018
In thousands of euros		
Gain on reversal of property, plant and equipment impairment (note 19)	9	0
Received penalties and compensations	90	133
Miscellaneous income	38	2
Total other income	137	135

Other expenses

	2019	2018
In thousands of euros		
Write-down of receivables (note 16)	0	-13
Write-down of inventory (note 17)	-73	-21
Late payment interest and penalty charges	-2	-9
Loss-making contract	-38	-32
Miscellaneous expenses	-8	-33
Total other expenses	-121	-108

11. Marketing and distribution expenses

	2019	2018
In thousands of euros		
Advertising expenses	-47	-67
Brokerage fees	0	-10
Other marketing and distribution expenses	-49	-56
Total marketing and distribution expenses	-96	-133

12. Administrative expenses

	2019	2018
In thousands of euros		
Personnel expenses	-461	-640
Office expenses	-63	-96
IT expenses	-42	-110
Services purchased	-125	-182
Depreciation and amortisation (note 19)	-30	-115
Legal service fees	-28	-48
Other expenses	-28	-33
Total administrative expenses	-777	-1,224

In 2019, employee remuneration expenses of the Group amounted to 494 thousand euros, out of which 461 thousand were administrative expenses and 33 thousand were cost of sold real estate and services (see note 9). In 2018, employee remuneration expenses from continuing operations were 668 thousand euros, out of which 640 thousand were administrative expenses and 28 thousand were cost of sold real estate and services (see note 9).

As of 31 December 2019, 13 persons worked with an employment contract, 3 with a service agreement and 1 with a board member agreement (on 31 December 2018: 15, 4, 1, accordingly).

13. Finance income and costs

	2019	2018
In thousands of euros		
Interest expense	-454	-433
Other finance income and costs	-108	-49
Total finance income and costs	-562	-482

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 2019, capitalised interest expenses amounted to 371 thousand euros and in 2018, 277 thousand euros (see notes 17 and 18).

14. Income tax

	2019	2018
In thousands of euros		
Income tax expense from Bulgarian subsidiaries	0	-1
Total income tax expense	0	-1

In 2018, the Group's Bulgarian companies paid 1 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.

15. Earnings per share

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the period.

Diluted earnings per share are calculated by taking into account the effects of all dilutive potential ordinary shares.

	2019	2018
Weighted average number of ordinary shares outstanding during the period	8,998,367	8,807,249
Number of ordinary shares potentially to be issued	390,000	590,000
Net profit/loss attributable to owners of the parent (in thousands of euros)	388	-544
Earnings per share (in euros)	0.04	-0.06
Diluted earnings per share (in euros)	0.04	-0.06

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 gave 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 Group at the time and if the net profit for years 2017-2019 combined is at least 5.5 million euros. As the net profit of the Group for 2017-2019 was less than 5.5 million euros, key employees had not acquired the right to subscribe to the new shares as of 31 December 2019.

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 gave to the CEO of the Group's parent company the right to subscribe to up to 390 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2019. The CEO used his right in full amount. 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 2019, an equity reserve in the amount of 245 thousand euros has been formed as the proportionate value of the option, of which 0 thousand euros was expensed in 2019 and 111 thousand euros was expensed in 2018. See also note 26. 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.

Notes to the Consolidated Position of Financial Statement

16. Receivables and prepayments

Short-term receivables and prepayments

As of 31 December	2019	2018
In thousands of euros		
Trade receivables		
Receivables from customers	204	91
Total trade receivables	204	91
Other receivables		
Loans provided	0	1
Miscellaneous receivables	12	6
Total other receivables	12	7
Accrued income		
Prepaid and recoverable taxes	226	335
Other accrued income	18	17
Total accrued income	244	352
Prepayments	84	289
Total short-term receivables and prepayments	544	739

The balance of prepaid and recoverable taxes consists of VAT paid on construction of apartment buildings.

Long-term receivables

As of 31 December	2019	2018
In thousands of euros		
Loans provided	0	5
Prepayments	0	20
Total long-term receivables and prepayments	0	25

In 2019, no receivables from customers were written off. In 2018, 13 thousand euros of receivables from customers were written off (see note 10).

17. Inventories

As of 31 December	2019	2018
In thousands of euros		
Properties purchased and being developed for resale	15,779	17,467
Materials and finished goods	28	15
Total inventories	15,807	17,482

Properties purchased and being developed for resale

	2019	2018
In thousands of euros		
Balance at the beginning of period, 1 January	17,467	8,963
Properties purchased for development	0	2,943
Construction costs of apartment buildings	4,994	6,665
Capitalized borrowing costs	276	211
Inventory write-down (note 10)	-73	-21
Other capitalized costs	1,655	777
Reclassification from/to investment property (note 18)	468	0
Cost of sold properties (note 9)	-9,008	-2,071
Balance at the end of period, 31 December	15,779	17,467

In 2019, the Group reversed inventory write-downs in Sofia in the amount of 3 thousand euros, but devalued land plots in Estonia in the amount of 76 thousand euros. In 2018, the Group wrote down inventories in the amount of 21 thousand euros.

The Group's management estimates that the Group has inventories realisable during one year in carrying value of 10,706 thousand euros as of 31 December 2019. Inventories in carrying value of 5,073 thousand euros are realisable in a longer period than one year.

For information on inventories pledged as loan collateral, see note 24.

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, also taking into account their cost value. In 2019 as well as in 2018, 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 2019, inventories in the total amount of 15,748 thousand euros did not require a write-down or reversal of write-down (as of 31 December 2018: 17,276 thousand euros).

As of 31 December	2019	2018
In thousands of euros		
Measured using the residual value method	15,416	16,939
Measured using the comparison method	363	528
Total inventories	15,779	17,467

As of 31 December 2019, the total carrying value of inventories carried at cost was 15,416 thousand euros (on 31 December 2018: 16,939 thousand euros) and total carrying value of inventories measured at net realisable value was 363 thousand euros (on 31 December 2018: 528 thousand euros).

18. Investment property

Investment properties comprise the following types of assets:

- 1) Commercial spaces (including apartments for letting out) earning rental income in multipurpose building in Sofia (total carrying value of 9,624 thousand euros on 31 December 2019, including shops and office spaces in the amount of 8,086 thousand euros).
- 2) Land plots that have a development potential but the future use of which is still uncertain (carrying value of 1,367 thousand euros on 31 December 2019).

	2019	2018
In thousands of euros		
Balance at the beginning of period, 1 January	12,344	11,299
Net profit/loss on changes in fair value	-7	8
Capitalised development costs	75	89
Capitalised borrowing costs	95	66
Reclassification from/to inventories (note 17)	-468	0
Reclassification to property, plant and equipment (note 19)	0	378
Sale of real estate (note 9)	-1,288	0
Purchase of land plots	300	504
Balance at the end of period, 31 December	11,051	12,344

For information on pledged assets, see note 24.

Changes in fair value of investment property

Valuation of land

Land plots and apartments, which are classified as investment properties, have been valued 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 valued using income method. In 2019, devaluation loss was 109 thousand euros (in 2018, fair value of these assets did not change). Rentable garages and parking lots of the same building were valued up by 88 thousand euros in 2019.

Valuation of apartments

Madrid Blvd apartments reclassified from inventory to investment property have been valued using comparison method, which is based on market price of similar assets. In 2019, the value of these assets increased by 14 thousand euros (in 2018: 29 thousand euros). All apartments had found buyers by the time of the annual report.

On 31 December 2019, investment properties with carrying value of 2,765 thousand euros did not require value adjustment (as of 31 December 2018: 10,761 thousand euros). In 2019, the fair value of investment property was decreased in the total amount of 7 thousand euros. In 2018, the fair value of investment property was increased in the amount of 8 thousand euros (including a gain of 14 thousand euros on investment property of the continuing operations and a loss of 6 thousand euros on investment property of non-continuing operations). In 2018, the values of all of the Group's investment properties were determined by internal experts. In 2019, both internal and external experts were used.

As of 31 December	2019	2018
In thousands of euros		
Measured using the income method	8,086	8,194
Measured using comparison method	2,965	4,150
Total investment property	11,051	12,344

In 2019 as well as in 2018, the exit yield used for valuation of investment properties with the income capitalisation method was 8%, which could be considered as a conservative yield expectation in the current era of low interest rates. Monthly average rental income per m² from commercial and office areas was 9,3 euros in 2019 and 9,5 euros in 2018.

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

- A change of 5% (+/-) in the forecasted net operating cash flows would increase or reduce the fair value of investment property by 405 thousand euros (in 2018: by 411 thousand euros).
- A decrease of 1% in the exit yields would increase the fair value of investment property by 1,158 thousand euros (in 2018: by 1,174 thousand euros) and an increase of 1% would reduce the fair value by 901 thousand euros (in 2018: by 913 thousand euros).

Operating leases: the Group as a lessor

In 2019, the Group's rental income on investment properties (Madrid Blvd building in Sofia) amounted to 795 thousand euros (in 2018: 834 thousand euros). Rental income increased by 110 thousand euros because more spaces were rented out in 2019 than in 2018. On the other hand, property management services were offered in smaller amounts, which in total led to decrease of rental and property management services by 39 thousand euros. By the publishing date of the annual report, one commercial space was not rented out, the rest were rented out.

Direct property management expenses totalled 255 thousand euros in 2019 (in 2018: 215 thousand euros) including expenses in the amount of 10 thousand euros (in 2018: 12 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	2019	2018
In thousands of euros		
Up to 1 year	381	647
2-5 years	1,338	387
Total	1,719	1,034

Lease contracts are considered non-cancellable if:

- 1) they have been concluded for a fixed term (with the expiration date in 2020 or later);
- 2) lessee has the right to cancel the contract with 3-6-month notice but only after arrival of fixed date in 2020 or later.

19. Property, plant and equipment and intangible assets

Property, plant and equipment

	Land and buildings	Office equipment	Total property, plant and equipment
In thousands of euros			
Carrying amount on 31 December 2017	613	91	704
<i>Of which cost</i>	677	224	901
<i>Of which accumulated depreciation</i>	-64	-133	-197
Additions	0	15	15
Reclassification to investment property (note 19)	-378	0	-378
Depreciation for the year	-4	-35	-39
PPE of sold subsidiary	0	-35	-35
Carrying amount on 31 December 2018	231	36	267
<i>Of which cost</i>	232	188	420
<i>Of which accumulated depreciation</i>	-1	-152	-153
Additions	2	37	39
Depreciation for the year	0	-18	-18
PPE of sold subsidiary	-2	-21	-23
Carrying amount on 31 December 2019	231	34	265
<i>Of which cost</i>	234	203	437
<i>Of which accumulated depreciation</i>	-3	-169	-172

As of 31.12.2019, the cost of property, plant and equipment that was fully amortized but still in use was 7 thousand euros (on 31 December 2018: 102 thousand euros).

Intangible assets

	Total intangible assets
In thousands of euros	
Carrying amount on 31 December 2017	275
<i>Of which cost</i>	444
<i>Of which accumulated amortisation</i>	-169
Purchases and software development	99
Amortisation for the year	-102
Intangible assets of sold subsidiaries	-10
Carrying amount on 31 December 2018	262
<i>Of which cost</i>	507
<i>Of which accumulated amortisation</i>	-245
Purchases and software development	47
Amortisation for the year	-92
Carrying amount on 31 December 2019	217
<i>Of which cost</i>	552
<i>Of which accumulated amortisation</i>	-335

Intangible assets of the Group consist mainly of Arco Vara business software AVIS in the total amount of 407 thousand euros (there were no software developments in 2019, developments cost 94 thousand euros in 2018).

As of 31.12.2019, the cost of intangible assets that was fully amortized but still in use was 62 thousand euros (on 31 December 2018: 69 thousand euros).

For pledged assets, see note 24.

20. Interest bearing liabilities

Interest bearing liabilities comprise the following items:

	As of 31 December 2019			As of 31 December 2018		
	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	10,993	5,089	5,904	14,653	11,995	2,658
Bonds	1,327	1,327	0	1,329	2	1,327
Other loans	0	0	0	550	550	0
Total loans and borrowings	12,320	6,416	5,904	16,532	12,547	3,985
Prepayments	0	0	0	810	810	0
Total interest bearing liabilities	12,320	6,416	5,904	17,342	13,357	3,985

In 2019, the Group settled loans and borrowings in the amount of 14,958 thousand euros (in 2018: 2,075 thousand euros) and raised new loans and borrowings in the amount of 10,746 thousand euros (in 2018: 6,604 thousand euros). 5,540 thousand euros of the settled loans were paid by customers directly to the bank. Additionally, in 2019, interest bearing prepayments were returned in the amount of 810 thousand euros, which, together with value added tax, amounted to 972 thousand euros (in 2018: interest-bearing prepayments were returned and received in the amount of 265 and 810 thousand euros accordingly, which, together with value added tax, amounted to 318 and 972 thousand euros).

Information on assets pledged as loan collateral is presented in note 24.

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.

	Cash and cash equivalents	Bank loans	Bonds	Finance lease liabilities	Other loans	Total
In thousands of euros						
Net loans 31 Dec 2017	2,284	-10,625	-1,127	-1	-250	-9,719
Annual change	43	-4,028	-202	1	-300	-4,486
Net loans 31 Dec 2018	2,327	-14,653	-1,329	0	-550	-14,205
Annual change	-1,457	3,660	2	0	550	2,755
Net loans 31 Dec 2019	870	-10,993	-1,327	0	0	-11,450

Changes in loans and borrowings in 2019

In 2019, the following major loan obligations were settled:

- 5,912 thousand euros of Kodulahe project II Stage bank loan principal, out of which 372 thousand by cash transaction through Kodulahe's bank account;
- 7,960 thousand euros of Madrid Blvd project's bank loan principal;
- 534 thousand euros of bank loan for financing construction of apartment building in Iztok Parkside project;
- 2 thousand euros of Arco Vara convertible bonds;
- 550 thousand euros of other loans of Arco Vara.

In 12 months 2019, the group raised the following new liabilities:

- 6,000 thousand euros of bank loan for refinancing apartment building in Madrid Blvd project;
- 61 thousand euros of bank loan for financing construction of apartment building in Iztok Parkside project;
- 4,342 thousand euros of bank loan for financing construction of apartment building in Kodulahe project Stage II;
- 169 thousand euros of bank loan for financing construction of apartment building in Kodulahe project Stage III;
- 174 thousand euros of bank loan for financing construction of apartment building in Kodukalda project.

Changes in loans and borrowings in 2018

In 2018, the following major loan obligations were settled:

- 609 thousand euros of Madrid Blvd project's bank loan;
- 642 thousand euros of construction financing bank loan of Iztok Parkside apartment building;
- 823 thousand euros of Arco Vara bonds;
- 265 thousand euros of interest bearing prepayments.

In 2018, the Group raised the following new loans:

- 3,710 thousand euros of construction financing bank loan of Iztok Parkside apartment building;
- 1,569 thousand euros of construction financing bank loan of Kodulahe Stage II apartment building;
- 1,325 thousand euros of Arco Vara bonds;
- 810 thousand euros of interest bearing prepayments.

300 thousand euros of bonds were converted to loan liability.

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 2019	31 Dec 2018	31 Dec 2019	31 Dec 2019	
Bank loan, development	10/2024	6,000	7,961	3,4	5,0	3M Euribor
Bank loan, development	12/2020	4,650	5,123	2,5	2,5	1M Euribor
Bank loan, development	9/2021	174	-	8,8	-	Fixed
Bank loan, development	10/2021	169	-	9,9	-	6M Euribor
Bonds, development	12/2020	1,325	1,325	12,0	12,0	Fixed
Convertible bonds	3/2020	2	4	5,0	5,0	Fixed
Bank loan, development	3/2020	-	1,569	-	3,7	6M Euribor
Other loan, land acquisition	12/2019	-	550	-	12,0	Fixed
Prepayments, development	12/2019	-	810	-	6,0	Fixed
Total		12,320	17,342			

On 31 December 2019, the weighted average interest rate of interest-bearing liabilities was 4.2% (31 December 2018: 5.0%).

21. Payables and deferred income**Short-term payables and deferred income**

As of 31 December	2019	2018
In thousands of euros		
Trade payables	590	761
Miscellaneous payables	142	0
Taxes payable		
Value added tax	415	12
Corporate income tax	1	4
Social security tax	14	19
Personal income tax	8	11
Other taxes	0	2
Total taxes payable	438	48
Accrued expenses		
Payables to employees	82	54
Interest payable	41	31
Other accrued expenses	345	470
Total accrued expenses	468	555
Deferred income		
Prepayments received on sale of real estate	1,412	2,502
Guarantee deposits	61	73
Other deferred income	24	43
Total deferred income	1,497	2,618
Total short-term payables and deferred income	3,135	3,982

As of 31 December 2019, the balance of prepayments received on sale of real estate included prepayments collected on presale of apartments of Iztok Parkside project of 1,166 thousand euros, Kodulahe 3. stage of 173 thousand euros, Kodukalda of 31 thousand euros, Lozen of 17 thousand euros and 25 thousand were prepayments for sale of Madrid Blvd's former rental apartments. As of 31 December 2018, the balance of prepayments received on sale of real estate included prepayments collected on presale of apartments of Kodulahe 2. stage and Iztok Parkside projects in the amounts of 1,687 and 774 thousand euros; 41 thousand were prepayments for Madrid Blvd's former rental apartments.

22. Share capital

As of 31 December	2019	2018
Number of issued shares fully paid up	8,998,367	8,998,367
Share capital (in thousands of euros)	6,299	6,299
Share premium (in thousands of euros)	2,285	2,285
Statutory capital reserve (in thousands of euros)	2,011	2,011

The articles of association of Arco Vara AS set out the size of the 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.

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 company is in compliance with the regulatory requirement, amounting to 32% of share capital as of 31 December 2019.

23. 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.

Cash and cash equivalents comprise cash on hand and demand deposit accounts in commercial banks as follows:

As of 31 December	2019	2018
In thousands of euros		
Cash on hand and demand deposits	870	2,327
Total cash and cash equivalents	870	2,327

At the end of year 2019, out of the Group's cash and cash equivalents balance, 252 thousand euros (31 December 2018: 265 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 24.

The Group's cash and cash equivalents are held at different banks, which reduces credit risk associated with deposits. Credit ratings of 3 banks holding 91% of the Group's cash deposits as of 31 December 2019, are presented in the following table.

Bank or banking group	Bank's share of the Group's cash balance	Standard & Poor's	Moody's
Raiffeisenbank Bulgaria	35.4%	BBB+	A3
Luminor Bank Estonia	14.0%	AA-	Aa3
LHV Pank AS	42.0%	Not rated	Baa1
Cash in other banks and petty cash	8.6%	-	-

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.

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 216 thousand euros as of 31 December 2019. Management has estimated the value of such receivables on an individual basis and has determined that the items are recoverable. In addition, due to the nature of the Group's sales, where receivables from sale and lease of own properties are generally collected within a very short period of time, the write-down of receivables based on the principles described above is insignificant as of 31 December 2019 and 1 January 2019 (at the date of application of IFRS 9).

The total amount of financial assets exposed to credit risk was 1,086 thousand euros as of 31 December 2019 (31 December 2018: 2,425 thousand euros).

Financial assets by maturity

on 31 December 2019				
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousands of euros				
Cash and cash equivalents	870	0	0	870
Trade and other receivables (note 17)	216	0	0	216
Total	1,086	0	0	1,086
on 31 December 2018				
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousands of euros				
Cash and cash equivalents	2,327	0	0	2,327
Trade and other receivables (note 17)	98	0	0	98
Total	2,425	0	0	2,425

Liquidity risk

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

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

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

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

Maturity structure of financial liabilities

	on 31 December 2019			
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	1,301	5,115	5,904	12,320
Interest payable	126	309	200	635
Other financial liabilities (trade payables, accrued expenses, excluding liabilities to employees)	1,515	0	0	1,515
Total	2,942	5,424	6,104	14,470

	on 31 December 2018			
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	502	12,855	3,985	17,342
Interest payable	160	441	187	788
Other financial liabilities (trade payables, accrued expenses, excluding liabilities to employees)	1,279	0	0	1,279
Total	1,941	13,296	4,172	19,409

Based on the maturities of liabilities included in the Group's loan portfolio, as of 31 December 2019, the average weighted maturity of the Group's loans and borrowings was 2.8 years (as of 31 December 2018: 1.2 years). For more information on loans and borrowings see also note 20.

The Group's management estimates that the carrying amount of the 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 riskInterest 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 2019, Euribor interest rates have been negative. Therefore, there is practically no Euribor component in the Group's loans as of 31 December 2019 and also as of 31 December 2018.

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 2019, 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 2018: 173 thousand euros).

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

Fair value of financial instruments

Management estimates that the carrying amount of the Group's financial assets and liabilities does not significantly differ from their fair value.

Trade receivables and payables are short-term and therefore the management estimates that their carrying amount is close to their fair value. Most of the Group's long-term borrowings are based on floating interest rates, which change according to the market interest rate. According to the management's opinion, the Group's risk margins have not significantly changed compared to the time when the loans were received and the Group's interest rates on borrowings correspond to market conditions. Based on the above, the management estimates that the fair values of long-term payables and receivables are an approximation of their carrying amount. To determine the fair value, a discounted cash flow analysis has been used, by discounting contractual future cash flows with current market interest rates that are available to the Group for using similar financial instruments.

Fair value of financial instruments is level 3.

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 liability 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 2019, the share capital of Arco Vara AS consists of 8,998,367 ordinary shares (with nominal value of 70 eurocents 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 2019, the share capital of Arco Vara AS was 6,299 thousand euros and net assets were 13,299 thousand euros. Thus, the Group'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 2019, the equity was positive in all group companies with bank loans. As of 31 December 2018, the equity was not positive in one group entity, which had bank loans, but an agreement has been reached with the bank allowing amendment of this deficiency 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 2019, total capital amounted to 24,749 thousand euros (on 31 December 2018: 27,206 thousand euros).

The guiding principle in capital management is to safeguard the Group's reliability and sustainable development. The Group finances its operations with both debt and equity capital. Property development is very capital intensive. Therefore, 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 2019, equity accounted for 46.3% (on 31 December 2018: 38.8%) of total assets.

Other Information

24. Assets pledged as collateral

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

As of 31 December	2019	2018
In thousands of euros		
Cash and cash equivalents	252	265
Receivables ¹	28	21
Inventories	9,541	14,109
Investment property	9,624	10,918
Property, plant and equipment	231	231
Total carrying value of assets pledged as collateral	19,676	25,544

¹ - Pledged receivables must be collected to bank accounts with limited usage.

25. Contingent liabilities

Contingent income tax liability

As of 31 December 2019, the Group's retained earnings amounted to 2,459 thousand euros (on 31 December 2018: 2,161 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 2019 and in 2018, this opportunity was used when paying out dividends to shareholders in the amount of 90 thousand euros per year (0.01 euros per share) without income tax obligation.

As of 31.12.2019, Arco Vara could pay dividends in the amount of 1,766 thousand euros without income tax obligation. Upon the payment of all retained earnings in 2020, income tax liability would be 139 thousand euros and the amount to be paid out to shareholders would total 2,320 thousand euros. In case Bulgarian subsidiaries would pay more than 693 thousand euros in dividends to the parent company before the retained earnings of the parent company accumulated as of 31.12.2019 were paid out to its shareholders, no income tax would be payable on parent's dividends in 2020 and all of 2,459 thousand euros could be paid out as net dividends.

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 2014-2019 only for some of 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 group companies.

Contingent liabilities related to buying Lozen land

The Group is obliged to purchase land plots for the 2. stage of Lozen project by December 2020, otherwise it will have to pay a penalty of 1 million euros. Management estimates that the Group has a plan and ability for the land purchase, which makes it unlikely that the penalty will be paid.

26. 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

	2019	2018
In thousands of euros		
Companies that have a significant interest in the Group's parent company		
Share capital contribution	0	2,624
Services purchased	29	21
Paid interest	28	0
Other related parties		
Services sold	3	1

Balances with related parties

As of 31 December	2019	2018
In thousands of euros		
Other related parties		
Receivables from customers	1	0
Bonds issued	1	1

Remuneration of key management personnel

The key management personnel are the member of the management board / CEO of the Group's parent and members of the supervisory board. In 2019, the remuneration of the CEO, including social security charges amounted to 121 thousand euros (99 thousand euros in 2018). Remuneration of the members of the Group's supervisory board was 8 thousand euros both in 2019 and 2018.

The remuneration provided to the CEO is based on his service contract. The termination benefits agreed with Tarmo Sild amount to up to five months' base remuneration. In 2019, In 2019, a termination provision of 36 thousand euros was reserved. The mandate of the CEO was extended by 3 years (until October 2021) on the supervisory board meeting held in October 2018.

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 have not been granted or received any other remuneration or benefits (bonuses, termination benefits, etc) in the reporting periods of 2019 and 2018.

For information about the convertible bonds / options to the CEO of the Group's parent and key employees, see also note 15.

In 2019 and 2018, all transactions with related parties have been conducted on market conditions and no receivables from related parties were impaired.

27. Structure of Arco Vara group

Group	Domicile	Group's ownership interest	
		On 31 December 2019	On 31 December 2018
%			
Development segment			
Subsidiaries			
Arco Investeeringute AS	Estonia	100	100
Kerberon OÜ	Estonia	100	100
Kolde AS	Estonia	100	100
Kodulahe OÜ	Estonia	100	100
Kodukalda OÜ	Estonia	100	100
Kodulahe II OÜ	Estonia	100	100
Arco Vara Bulgaria EOOD	Bulgaria	100	100
Iztok Parkside EOOD	Bulgaria	100	100
Arco Lozen EOOD	Bulgaria	100	100
Arco Invest EOOD*	Bulgaria	100	100
Arco Manastirski EOOD	Bulgaria	100	100
Arco Facility Management EOOD	Bulgaria	100	100
Arco Projects EOOD	Bulgaria	100	100
Marsili II SIA	Latvia	100	100
Arco Development SIA	Latvia	100	100
Arco Invest UAB	Lithuania	100	100
Arco Development UAB*	Lithuania	100	100
Arco Investments TOV*	Ukraine	75	75

* - Interest through a subsidiary

28. Events after reporting date

The Group treats (a) the corona virus, (b) the societal response to it and (c) the financial effects arising from this response as events after the reporting date and not as adjusting events. There are no changes in the statement of financial position and statement of comprehensive income of 2019.

Looking forward, we have analysed the effects of COVID-19 virus on our group in 2020 and thereafter.

The duration of the virus as a health problem is unknown, but we assume it to be 12 months. The turning point will arrive when the virus will become medically controllable, either by vaccination or by effective treatment for the population under retirement age. We believe that looking for a medical solution for the virus has become a global priority.

The effects of the societal response to the virus, mainly in the form of restrictions on movement, working and consumption, together with the fear will gradually start to fade after a medical solution has been found. We forecast the response to deepen until the third quarter of 2020, after which it will gradually start to loosen. It will be critical for the group that ongoing construction works can be continued and that the construction of Kodulahe III Stage and Kodukalda (Oa) projects will be finished on time. It is also critically important that the occupancy permit of Iztok Parkside project can be obtained and that all apartment presales made so far will be followed by final sales – which may become difficult if people who have entered presale agreements will not sign final sale agreements in the fear of the virus. Less critical, but still important is that the notaries will continue working and that the customers will have enough trust to sign new presale agreements. At the same time, we estimate that even in case presales will fully stop, the construction will not, and presales are not a prerequisite for successful construction or financing. Existing construction agreements are already covered by bank financing.

Direct financial effects of the virus for the group will be revealed in 2020 and later. It is likely that rental income will decrease in Madrid Blvd building where commercial areas apart from Billa supermarket have been closed due to the quarantine, and where pressure from office tenants can be expected to decrease rents or to move out due to the drop in economic activity. Second, we forecast a decrease in the license fees from real estate agencies in Estonia, Latvia and Bulgaria, as their revenues will decrease. Third, we must get prepared for longer selling periods in real estate developments. The valuations of existing plots may need to be revised again, which may affect the profit forecast for 2020. Arco Vara already optimised its costs before the spread of the virus, which, together with the high share of equity, will support the group's ability to go through today's difficult times.

29. 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

	2019	2018
In thousands of euros		
Revenue from rendering of services	736	701
Cost of sales	-85	0
Gross profit	651	701
Other income	9	1
Marketing and distribution expenses	-2	-12
Administrative expenses	-459	-939
Other expenses	-38	-2
Operating profit/loss	161	-251
Gain on investments in subsidiaries	0	228
Interest income	887	328
Interest expense	-328	-240
Total finance income and costs	559	316
Net profit for the year	720	65
Total comprehensive income for the year	720	65

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

As of 31 December	2019	2018
In thousands of euros		
Cash and cash equivalents	317	1,520
Investments	0	69
Receivables and prepayments	5,040	979
Total current assets	5,357	2,568
Investments into subsidiaries	7,344	7,344
Receivables and prepayments	3,576	5,942
Property, plant and equipment	9	11
Intangible assets	171	256
Total non-current assets	11,100	13,553
TOTAL ASSETS	16,457	16,121
Loans and borrowings	2,464	2,293
Payables and prepayments	427	185
Total current liabilities	2,891	2,478
Loans and borrowings	1,480	2,187
Total non-current liabilities	1,480	2,187
TOTAL LIABILITIES	4,371	4,665
Share capital	6,299	6,299
Share premium	2,285	2,285
Statutory capital reserve	2,011	2,011
Other reserves	245	245
Retained earnings	1,246	616
Total equity	12,086	11,456
TOTAL LIABILITIES AND EQUITY	16,457	16,121

UNCONSOLIDATED STATEMENT OF CASH FLOWS (direct method)

	2019	2018
In thousands of euros		
Cash receipts from customers	275	536
Cash paid to suppliers	-437	-656
Taxes paid and recovered (net)	135	125
Cash paid to employees	-115	-214
Other payments and receipts related to operating activities (net)	2	-3
NET CASH FROM/USED IN OPERATING ACTIVITIES	-140	-212
Paid on acquisition of tangible and intangible assets	-5	-105
Proceeds from sale of tangible assets	28	0
Paid into share capitals of subsidiaries	0	-3
Paid on purchase of a subsidiary	0	-2,938
Proceeds from sale of a subsidiary	0	632
Proceeds from sale of a financial investment	69	0
Loans provided	-1,763	-2,122
Repayment of loans provided	1,417	1,707
Dividends received	0	208
Interest received	150	0
NET CASH FROM/USED IN INVESTING ACTIVITIES	-104	-2,621
Proceeds of loans received	324	1,964
Settlement of loans and borrowings	-968	-1,508
Proceeds from share capital issue	0	3,737
Dividends paid	-90	-90
Interest paid	-225	-131
NET CASH FROM FINANCING ACTIVITIES	-959	3,972
NET CASH FLOW	-1,203	1,139
Cash and cash equivalents at beginning of year	1,520	381
Change in cash and cash equivalents	-1,203	1,139
Cash and cash equivalents at end of year	317	1,520

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 2017	4,555	292	2,011	134	641	7,633
Profit distribution	0	0	0	0	-90	-90
Share capital issue	1,744	1,993	0	0	0	3,737
Formation of other reserves	0	0	0	111	0	111
Net loss for the year	0	0	0	0	65	65
Balance on 31 December 2018	6,299	2,285	2,011	245	616	11,456
Profit distribution	0	0	0	0	-90	-90
Net profit for the year	0	0	0	0	720	720
Balance on 31 December 2019	6,299	2,285	2,011	245	1,246	12,086

Adjusted unconsolidated equity

As of 31 December	2019	2018
In thousands of euros		
Parent company's unconsolidated equity	12,086	11,456
Carrying amount of investments in subsidiaries in the parent company's unconsolidated statement of financial position (-)	-7,344	-7,344
Value of investments in subsidiaries under the equity method (+)	8,557	8,889
Parent company's adjusted unconsolidated equity	13,299	13,001

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 2019 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.

The member of the management board of Arco Vara AS also declares that Arco Vara group is a going concern.

2 April 2020



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

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 2019, 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 dated 2nd of April 2020.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of comprehensive income for the year ended 31 December 2019;
- the consolidated statement of financial position as at 31 December 2019;
- 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 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 2019, we have not provided any non-audit services to the Group.

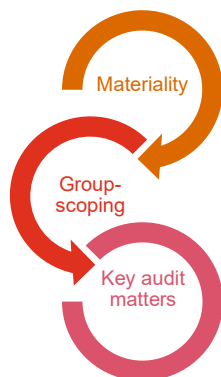
AS PricewaterhouseCoopers
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Translation note:

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Our audit approach

Overview



Overall group audit materiality is EUR 288 thousand, which represents 1% of the Group's total assets.

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

- 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 audit materiality	EUR 288 thousand
How we determined it	1% of the Group's 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.

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Key audit matters

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 2 “Statement of compliance and basis of preparation”, Note 4 “Significant accounting policies” and Note 18 “Investment properties” for further details).

As at 31 December 2019, the carrying amount of the Group’s investment property portfolio in Bulgaria, including office and commercial spaces, amounted to EUR 7.8 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

We considered the management’s expertise to perform property valuation.

We assessed the valuation methodology used by the management.

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.

We assessed whether 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. We recalculated sensitivity analysis on key assumptions, such as changes in rental prices and capitalisation rates.

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matter.

How we tailored our Group 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 27). 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 and Iztok Parkside 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 PwC network firm (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. The other information comprises the Management Report, Corporate Governance Report and Statement by the Management Board (but does not include 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.

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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

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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 tenders in the intermediate years, representing the total period of our uninterrupted engagement appointment for Arco Vara AS 8 years.

AS PricewaterhouseCoopers

Lauri Past
Certified auditor in charge, auditor's certificate no.567

Janno Hermanson
Auditor's certificate no.570

2 April 2020
Tallinn, Estonia

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