Arco Vara AS

Annual Report 2020

Consolidated annual report

(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year:	1 January 2020
End of financial year:	31 December 2020
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:	Tarmo Sild, Steven Yaroslav Gorelik, Kert Keskpaik, Hillar-Peeter Luitsalu, Allar Niinepuu, Rait Riim
Management board:	Miko-Ove Niinemäe
Auditor:	KPMG Baltics OÜ

CONTENTS

MANAGEMENT REPORT

Group CEO's overview

At the beginning of 2020, due to the constraints of COVID-19, price fluctuations and rapid market adjustment were also expected in the real estate sector, but this did not take place for new developments. Arco Vara and our partners reacted quickly to limit the spread of the virus, which ensured the timely completion of the sites and the fulfilment of the set sales targets.

The improved terms of development loans can be considered an important development, which are important for the successful implementation of Estonian development projects also in 2021 and 2022. In Bulgaria, the main keyword is obtaining an usage permit for Iztok Parkside, where most of the final sales took place in the first quarter of 2021.

On the Estonian side of development activities, Arco Vara has achieved the reputation of a reliable developer, which is shown by the success of the Kodulahe and Kodukalda projects. Today, Kodulahe Phase 3 building has been sold out and approximately 70% of the Phase 4 and Phase 5 buildings have been pre-sold. There are 4 unsold apartments in the Tartu Kodukalda project, but the interest in the development is constant, which provides certainty for achieving final sales in the second quarter.

In addition to the finalised projects and the projects to be completed, we started designing the 6th stage of Kodulahe at the end of 2020, the public sale of which will commence 3 months earlier than had been planned - in the third quarter of 2021.

The Bulgarian development activity achieved the long-awaited authorisation for use of Iztok Parkside, which is expected to be sold out in the second quarter of 2021. At the moment, 66 out of the 67 apartments have been sold there in the development project.

The commercial property site Madrid BLVD had an occupancy rate of approximately 95% during 2020, which is a successful achievement for the team there, taking into account the situation of last year. Due to the multiple purposes of the building and the restrictions that favoured the building, the tenants were able to continue their business for most of the year, which ensured a lower-than-expected decrease in sales revenue.

Based on the results of 2020, and pointing out the 2.5-fold increase in the return on equity and an increase of the net profit margin of almost 2 times, we are on the track to increase development volumes in the next three years. This is also supported by the contracts concluded at the beginning of 2021 for the development of the registered immovables at Paldiski road 124b and Soodi street 6.

In 2021, the main tasks are the successful start of the 6th stage of Kodulahe and the start of designing new development projects in both Estonia and Bulgaria.

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 Estonia, Latvia and Bulgaria, these services continue to be provided under the trademarks of Arco Vara through license agreements, from which the Group earns license fees.

Vision and mission

Arco Vara's vision:

- We are the most people-oriented real estate company.
- We know real estate best.
- We offer homes with the best comfort of use.

Arco Vara's mission is to create high-quality real estate and well thought-through living environments.

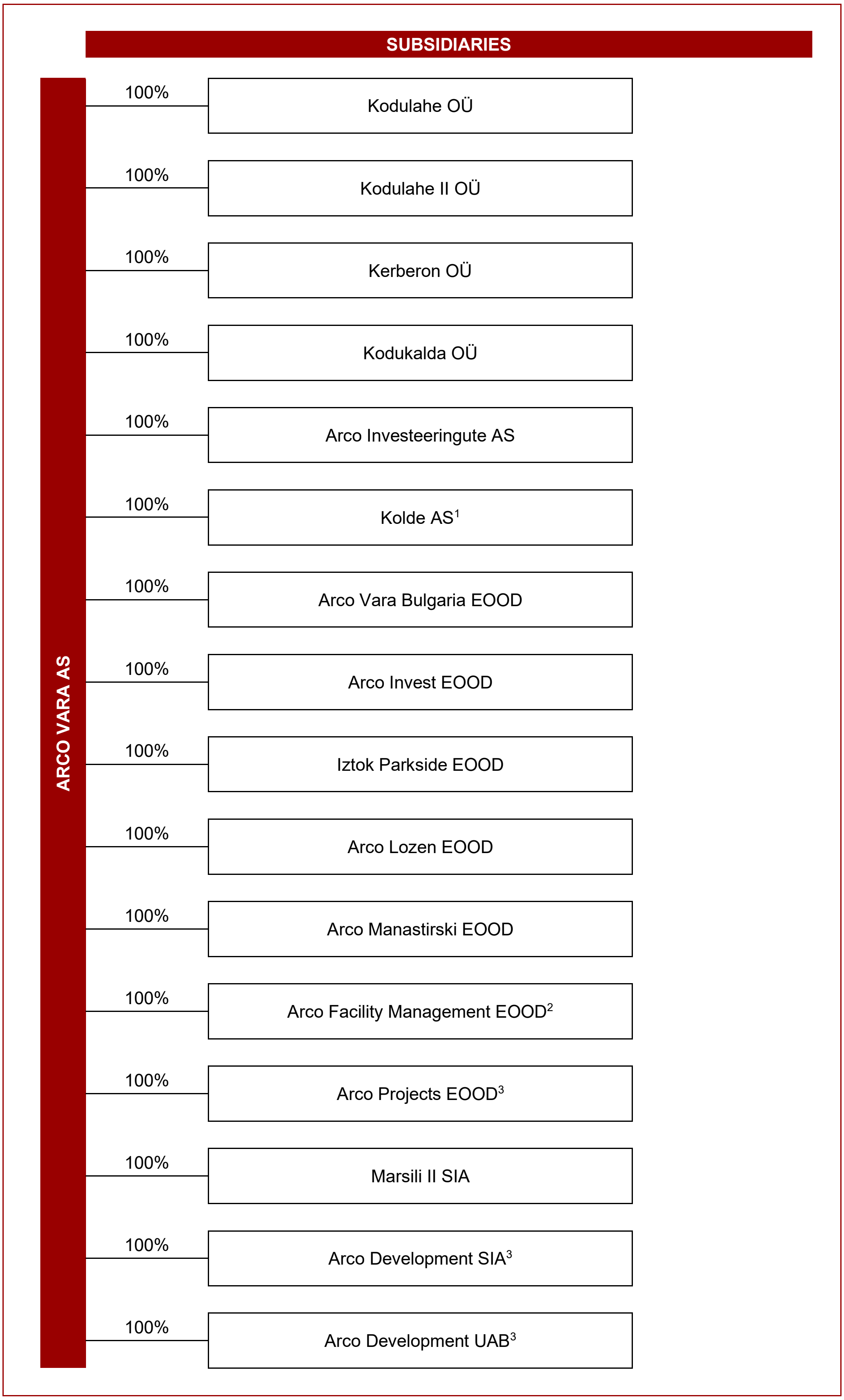
Scope of consolidation

As of 31 December 2020, the Group consisted of 17 companies, which is two less than on 31 December 2019.

Significant subsidiaries as of 31 December 2020

Company name	Location	Segment	Share capital (nominal value)	Equity balance on 31 December 2020	The Group's interest
In thousands of euros					
Arco Invest EOOD	Bulgaria	Development	31,762	2,717	100%
Iztok Parkside EOOD	Bulgaria	Development	1,433	1,132	100%
Arco Lozen EOOD	Bulgaria	Development	2,931	2,146	100%
Kodukalda OÜ	Estonia	Development	3	437	100%
Kodulahe OÜ	Estonia	Development	3	3,090	100%

Group structure as of 31 December 2020



1 Kolde OÜ since 16 February 2021
2 In liquidation
3 Liquidated in Q1 2021

Key performance indicators

- In 2020, the Group's revenue was 14,056 thousand euros, which is 7% more than the revenue of 13,109 thousand euros in 2019.
- In 2020, the Group's operating profit (=EBIT) was 1,449 thousand euros and net profit 1,012 thousand euros. In 2019, the Group made operating profit of 950 thousand and net profit of 388 thousand euros.
- In 2020, 81 apartments and one land plot in Latvia were sold in the development projects of the Group (in 2019: 82 apartments).
- In 2020, the Group's debt burden (net loans) decreased by 2,951 euros down to the level of 8,499 thousand euros as of 31 December 2020. As of 31 December 2020, the weighted average annual interest rate of interest-bearing liabilities was 4.8%, which is 0.6% higher than on 31 December 2019.

Key financial indicators

	2020	2019
In thousands of euros		
Revenue	14,056	13,109
Operating profit (EBIT)	1,449	950
Finance income and expense	-437	-562
Net profit	**1,012**	**388**
Cash flows from/used in operating activities	-1,042	-1,517
Cash flows used in investing activities	-295	-201
Cash flows from/used in financing activities	2,667	261
Net cash flows	**1,330**	**-1,457**
Cash and cash equivalents at beginning of period	870	2,327
Cash and cash equivalents at end of period	2,200	870
Total assets at the end of period	28,231	28,754
Invested capital at the end of period	24,923	25,619
Net loans at the end of period	8,499	11,450
Equity at the end of period	14,224	13,299

Revenue and net profit/loss from operations

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	**Total 2018**	Q1 2019	Q2 2019	Q3 2019	Q4 2019	**Total 2019**	Q1 2020	Q2 2020	Q3 2020	Q4 2020	**Total 2020**
In millions of euros															
Revenue	2.1	1.1	2.1	1.3	**6.6**	1.1	0.7	0.4	10.9	**13.1**	2.1	1.0	0.6	10.3	**14.0**
Net profit/loss	-0.1	-0.3	0.1	-0.2	**-0.5**	-0.1	-0.2	-0.2	0.9	**0.4**	0.0	-0.1	-0.2	1.3	**1.0**

Main ratios

As of 31 December	2020	2019
In thousands of euros		
Earnings per share, EPS (in euros)	0.11	0.04
Diluted earnings per share (in euros)	0.11	0.04
EBITDA per share (in euros)	0.17	0.12
ROIC (rolling, four quarters)	3.8%	1.3%
ROE (rolling, four quarters)	7.6%	3.0%
ROA (rolling, four quarters)	3.4%	1.2%
Equity ratio	50.4%	46.3%
Current ratio	2.73	1.80
Quick ratio	0.52	0.15
Financial leverage	1.98	2.16
Average loan term (in years)	2.5	2.8
Average annual interest rate of loans	4.8%	4.2%
Number of staff, end of period	11	17

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)
EBITDA per share = operating profit + depreciation and amortisation / weighted average number of ordinary shares outstanding during the period
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

Operating report

The revenue of the Group totalled 14,056 thousand euros in 2020 (in 2019: 13,109 thousand euros), including revenue from the sale of properties in the Group's own development projects in the amount of 13,129 thousand euros (in 2019: 12,152 thousand euros).

Most of the other revenue consists of rental income from commercial and office premises in Madrid Blvd building in Sofia, amounting to 614 thousand euros in 2020 (in 2019: 696 thousand euros). In 2020, Covid-19 brought changes in the economic situation of tenants. Several tenants have been replaced during 2020, but in a more favourable direction for Arco Vara. In the end of 2020, 95% of retail and office spaces were rented out.

In the II Stage of the Kodulahe quarter, which was completed and mainly sold in 2019, commercial space remains unsold – the last apartment was sold in Q2 2020. In 2020, Lahepea 9 house received usage permit.

In Q4 2020, construction works ended in Stage III of Kodulahe quarter, where a building with 50 apartments was finished at Soodi 4 Merimetsa. By the publishing date of the annual report, all apartments have been sold and the house has a usage permit.

At the end of 2020, the joint construction of Stages IV and V of Kodulahe started. Two 36-apartment residential buildings at Pagi 3 and Pagi 5 in Merimetsa are under construction. The apartment buildings will become ready for final sale in about 1,5 years. By the publishing date of the annual report, 38 apartments of total 72 have been presold and 18 booked for waiting for notary.

In Q4 2020, final sales of Oa street plots in Tartu started, where 4 smaller apartment buildings were constructed under the Kodukalda project name. By the publishing time of the interim report, 26 of the 30 apartments have been sold.

In Iztok Parkside project in Sofia, the majority of final sales of apartments started in December 2020, after receiving a usage permit. By the publishing date of the annual report, presale agreement for 1 apartment has not been concluded. Iztok project consists of three apartment buildings with a total of 67 apartments. As the apartments were handed over a year later than promised due to bureaucratic obstacles, 2 clients want compensation in the total amount of 40 thousand euros. As these apartment owners want compensation for pain and suffering, but not to give up the apartments, the obligation to pay compensation is not realistic and no reserve has been formed for this purpose.

In the Lozen project near Sofia in Bulgaria, design works have been completed. As the development was designed as a premium class product, it has been decided to temporarily freeze the project and wait for the market to recover from Covid-19. Under favourable market conditions, construction may start in Q3 2021, divided into smaller sub-stages. The project foresees construction of 179 homes (apartments and houses), commercial spaces and a kindergarten. Minimum expected construction period is 2 years.

In the third quarter of 2020, 1 plot of land with no book value was sold in Latvia for 40 thousand euros. As of 31 December 2020, 4 Marsili residential plots remained unsold in Latvia.

Summary table of Arco Vara's active projects as of 31 December 2020

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
Iztok Parkside	Iztok, Sofia	Apartments	S5	2,470	3,045	29
Marsili residential plots	Marsili, near Riga	Residential plots	S5	6,153	-	4
Kodulahe, Stage 2	Lahepea 9, Tallinn	Apartments	S5	3,686	380	1
Kodulahe, Stage 3	Soodi 4, Tallinn	Apartments	S5	3,199	1,393	24
Kodulahe, Stages 4-5	Pagi 3 and 5, Tallinn	Apartments	S4	7,383	4,774	72
Kodulahe, Stage 6	Paldiski road 74, Tallinn	Apartments	S3	9,525	8,880	113
Kodukalda	Oa street, Tartu	Apartments	S5	4,146	955	11
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 2020, 11 people worked for the Group (17 as of 31 December 2019). Employee remuneration expenses amounted to 468 thousand euros in 2020 (in 2019: 494 thousand euros).

The remuneration of the member of the management board / CEO of the Group's parent company including social security charges amounted to 89 thousand euros in 2020 (121 thousand euros in 2019). Remuneration for the members of the Group's supervisory board was 18 thousand euros in 2020 and 8 thousand euros in 2019.

The Management Board

The management board of Arco Vara AS has one member. Since 30 April 2020, the chief executive officer / member of the management board of Arco Vara AS is Miko-Ove Niinemäe.

Miko-Ove Niinemäe graduated from Tallinn University of Technology, Faculty of Engineering, M.Sc. in 2018.

Work experience: 2012-2017 project sales QLS Eesti OÜ; 2017-2019 project manager Kodulahe OÜ.

Miko-Ove Niinemäe is the 2015 and 2016 Estonian champion in the car rally class EMV3.

Miko-Ove Niinemäe is a member of the board of Babyface OÜ.

The Supervisory Board

From April 30, 2020 to January 12, 2021, the Supervisory Board of Arco Vara AS consisted of Tarmo Sild (Chairman of the Supervisory Board), Kert Keskpaik, Hillar-Peeter Luitsalu, Allar Niinepuu, Rait Riim and Steven Yaroslav Gorelik. As of January 12, 2021, the Supervisory Board has 5 members: Tarmo Sild (Chairman of the Supervisory Board), Kert Keskpaik, Hillar-Peeter Luitsalu, Allar Niinepuu and Steven Yaroslav Gorelik.

Tarmo Sild

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. Tarmo Sild was the CEO of Arco Vara AS from 2012 until 2020. Prior to joining Arco Vara, he was a sworn advocate and a member of the board of the law firm HETA from 1998 to 2003; from 2003 to 2012 a founder, sworn advocate, board member, advisor at the law firm LEXTAL; from 2008 a founder and member of the Management Board of AS IuteCredit Europe.

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

Steven Yaroslav Gorelik

Mr Gorelik has graduated from Columbia University and Carnegie Mellon University. He joined Firebird Private Equity Advisors LLC in 2005 and currently serves there as portfolio manager. Mr Gorelik also holds CFA (Chartered Financial Analyst) charter. Mr Gorelik is member of supervisory board of Farmsintez OAO (LIFE.MM) and Teliani Valley (WINE.GG).

Kert Keskpaik

Mr Keskpaik graduated from the Tallinn Technical University with a degree in business administration in 2007. Mr Keskpaik 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 Keskpaik founded a skating sports club Spordiklubi Albe Team where he serves as member of management board and has won multiple Estonian championships in speed skating and inline skating. Mr. Keskpaik is also member of management Board of Sporditurg OÜ, Mittetulundusühing Rulluisufestival, One Eleven OÜ, Uisuklubi Albe, Silverticket SPV1 OÜ, Tripalium OÜ, Lead Invest OÜ and Boost Yourself SPV1 OÜ and member of supervisory board of Arco Transport AS.

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 the following companies and non-profit organizations outside Arco Vara group: OÜ HM Investeeringud, Loodusvarade Halduse Mittetulundusühing, P457 OÜ, Noah Villas OÜ, TIK Spordimaja OÜ and OÜ Silverpool.

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. Mr Niinepuu has served as member of Supervisory Board of Arco Vara AS since 2013. He is also member of management board of OÜ Alarmo Kapital, GEST Invest Grupp OÜ and OÜ Kavass and chairman of supervisory board of AS IuteCredit Europe.

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 2020, 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 2020, the Group's interest-bearing liabilities amounted to 10.7 million euros, out of which 3.5 million euros is due within the next 12 months (see also note 18). Group's cash and cash equivalents totalled 2.2 million euros as of 31 December 2020 (0.9 million euros as of on 31 December 2019). The Group's weighted average loan interest rate was 4.8% as of 31 December 2020. This is an increase by 0.6 percentage points compared to the end of year 2019. The reason for the increase in the average interest rate on loan liabilities is the increase in the share of Estonian development loans with a higher-than-average interest rate in 2020.

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

The main business of Arco Vara is real estate development.

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 (ARC1T, ISIN EE3100034653) are freely traded on NASDAQ Tallinn stock exchange. The share price closed at 1.21 euros on 31 December 2020; the closing price was 1.14 euros on 31 December 2019. During the period, the highest traded price per share was 1.35 euros and the lowest price 0.84 euros. As of 31 December 2020, market capitalization of shares amounted to 10,888 thousand euros and P/B (price to book value) ratio was 0.77 (31 December 2019: 10,258 thousand euros and 0.77, respectively). P/E (price to earnings) ratio of the share was 10.76 on 31 December 2020, 26.44 on 31 December 2019.

The following charts reflect the movements in the price and daily turnover of Arco Vara's share during the last three years and 12 months of 2020.

Performance of Arco Vara's shares from 1 January 2018 until 31 December 2020

Source: https://nasdaqbaltic.com 2nd of January 2021

Performance of Arco Vara's shares in 2020

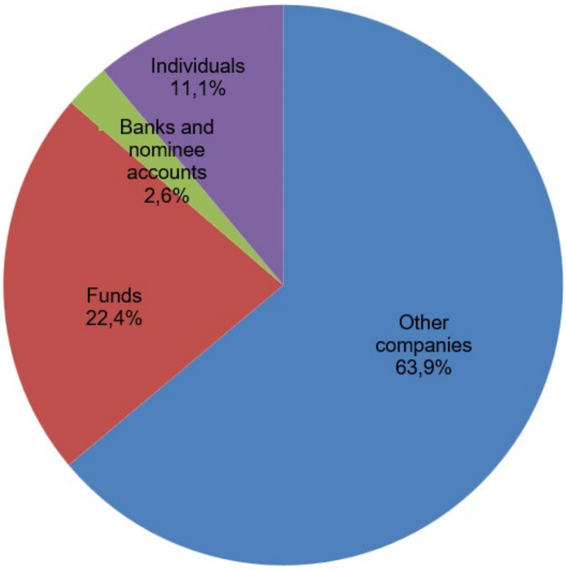
Changes in Arco Vara share price compared with the benchmark index OMX Tallinn in 2020

Index/equity	31 Dec 2019	31 Dec 2020	+/-%
-- OMX Tallinn	1,279.70	1,343.72	+5.00
-- ARC1T	1.14 EUR	1.21 EUR	+6.14

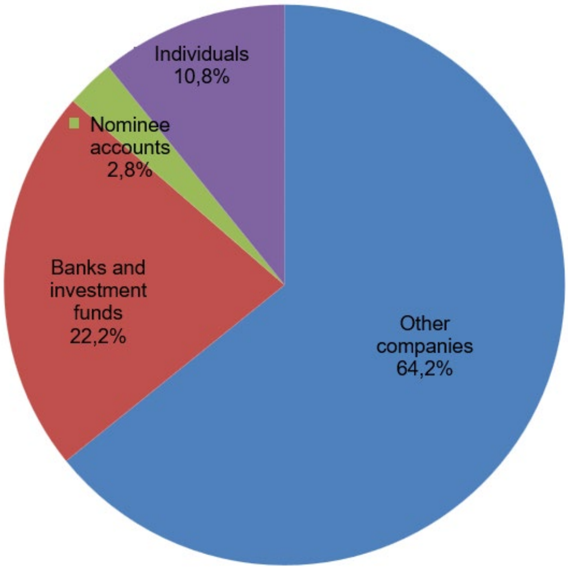
Structure of shareholders

As of 31 December 2020, Arco Vara AS had 1,475 shareholders (on 31 December 2019: 1,315), including 1,311 individuals as shareholders (on 31 December 2019: 1,138 individuals) who jointly owned 11.1% (on 31 December 2019: 10.8%) of the company. Complete shareholder structures are presented on the following diagrams:

Ownership structure as of 31 December 2020



Ownership structure as of 31 December 2019



Major shareholders on 31 December 2020

Name	No of shares	Share, %
Alarmo Kapital OÜ	2,517,405	28.0%
LHV Pensionifond L	869,587	9.7%
AS Lõhmus Holdings	850,000	9.4%
Baltplast AS	837,498	9.3%
Gamma Holding Investment OÜ	580,369	6.4%
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%
Marko Teimann	162,439	1.8%
Other shareholders	1,942,717	21.5%
Total	**8,998,367**	**100.0%**

Holdings of management and supervisory board members on 31 December 2020

Name	Position	No of shares	Share, %
Tarmo Sild and Allar Niinepuu (Alarmo Kapital OÜ)[3]	chairman/member of supervisory board	2,517,405	28.0%
Tarmo Sild (Aia Tänav OÜ)	chairman of supervisory board	19,880	0.2%
Hillar-Peeter Luitsalu (HM Investeeringud OÜ, related persons)	member of supervisory board	369,259	4.1%
Kert Keskpaik (privately and through K Vara OÜ)	member of supervisory board	206,371	2.3%
Rait Riim [1, 3]	member of supervisory board	0	-
Steven Yaroslav Gorelik[2]	member of supervisory board	0	-
Miko-Ove Niinemäe	member of management board	722	-
Total		**3,113,637**	**34.6%**

[1] - Rait Riim is a real estate investment manager of LHV Pension Funds. LHV Pensionifond, LHV Pensionifond XL, LHV Pensionifond M and LHV Täiendav Pensionifond hold 1,296,837 shares (total 14.4% interest) of Arco Vara.

[2] - 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 7.7% interest).

[3] - In January 2021, LHV Pension Funds. LHV Pensionifond, LHV Pensionifond XL, LHV Pensionifond M and LHV Täiendav Pensionifond sold their shares to OÜ Alarmo Kapital, who after the transaction held 3,814,242 of shares of Arco Vara (total 42.4% 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, as verified by the Supervisory Board.

An equity reserve in the amount of 245 thousand euros that was formed for the option associated with the bond was used in Q2 2020, when 273 thousand euros cash was transferred to Arco Vara for the option. The added 390,000 shares are still awaiting registration.

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 2020, one annual 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 7 April 2020. The notice was published in the national daily newspaper *Eesti Päevaleht* on 8 April 2020. 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 30 April 2020 from 10:15 a.m. until 10:35 a.m. in Tallinn at Maakri 19/1 conference room.

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

- Approval of the annual report for 2019
- Distribution of profit and dividend payment
- Recall of the Supervisory Board
- Election of members of Supervisory Board
- Appointment of Auditor
- Changing the articles of association.

The following decisions were adopted at the annual general meeting:

- To approve the annual report of Arco Vara AS for 2019.
- To transfer the net profit of the financial year in the amount of 388 thousand euros to retained earnings on 31.12.2019.
- To pay dividends to the shareholders 0.04 euros per share. The list of shareholders entitled to receive dividends will be fixed as of 15.05.2020 at the end of the business day of the Nasdaq CSD Estonian settlement system. The dividend will be paid to the shareholders on 22.05.2020 by transfer to the shareholder's bank account.
- To appoint a six-member Supervisory Board and to elect the following persons as members of the Supervisory Board:
  - Steven Jaroslav Gorelik
  - Kert Keskpaik
  - Hillar-Peeter Luitsalu
  - Allar Niinepuu
  - Rait Riim
  - Tarmo Sild
- To elect one auditor for the next two years and appoint KPMG Baltics OÜ for this purpose. To pay the auditor a fee for auditing the economic activities of Arco Vara AS for the financial years 2020 and 2021 in accordance with the agreement to be entered into between Arco Vara AS and KPMG Baltics OÜ.
- To supplement Article 3.11 of the Articles of Association and establish it in the following wording:

  3.11. Shareholders may attend the general meeting and exercise their rights by electronic means without being physically present at the general meeting and without appointing a representative. The procedure for electronic participation and voting shall be determined by the Management Board in accordance with the legislation in force.

The meeting was chaired by CEO Tarmo Sild. The meeting was attended by 14 shareholders whose votes represented 63.28% 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 as a listener by the new member of the Management Board of the

Company Miko-Ove Niinemäe. Allar Niinepuu, a member of the Supervisory Board, and Rait Riim, a new member of the Supervisory Board, also participated in the general meeting. The members of the Supervisory Board Hillar-Peeter Luitsalu, Steven Yaroslav Gorelik and Kert Keskpaik were not able to participate in the general meeting. The auditor did not attend the meeting.

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

The resolutions, minutes and materials of all general meetings held in 2020 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 September 04, 2009, the company's management board has had one member at a time. As of October 22, 2012, the company's CEO and the only member of the Management Board was Tarmo Sild. This role was handed over to Miko-Ove Niinemäe on April 30, 2020.

Contract of service 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.

Based on the resolution of the annual general meeting of shareholders of Arco Vara AS held on May 10, 2016, a convertible bond with a nominal value of 1,000 euros was issued in May 2016. The convertible bond gave the former manager of the parent company of the group the right to subscribe for an additional 390,000 ordinary shares of Arco Vara AS at a price of 0.7 euros per share in 2019, and the manager also used this opportunity. In 2020, 273 thousand euros were transferred to Arco Vara for the option related to the convertible bond. The additional 390,000 shares are awaiting registration.

The contract of service of a member of the management board, entered into with the member of the management board, specifies the rights, obligations and responsibilities of the member of the management board, and also regulates the payment of basic remuneration. The amount of remuneration was agreed taking into account the duties and activities of the member of the Management Board, the current state of business and future directions. According to the contract of service of the member of the Management Board, the amount of the termination payment of the members of the Management Board was up to five months' basic remuneration, if the member of the Management Board is recalled without good reason.

In 2020, no remuneration was paid to the member of the Management Board other than the remuneration arising from the contract o service. The executive bonus system will be decided in 2021.

Member of the Management Board, Miko-Ove Niinemäe, has informed the company about his activities as a controlling owner or member of the Management Board in the following business and non-profit associations that do not belong to the group:

- Babyface OÜ.

Under the contract of service, 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. During the reporting periods Tarmo Sild, Steven Yaroslav Gorelik, Kert Keskpaik, Rain Lõhmus, Allar Niinepuu and Rait Riim were independent members of the Supervisory Board.

During 2019, the composition of the Supervisory Board was the following: Allar Niinepuu, Hillar-Peeter Luitsalu, Rain Lõhmus, Steven Yaroslav Gorelik, Kert Keskpaik. The composition of the company's supervisory board changed on April 30, 2020: the members of the new supervisory board were Tarmo Sild, Steven Yaroslav Gorelik, Kert Keskpaik, Hillar-Peeter Luitsalu, Allar Niinepuu and Rait Riim.

Members of the Supervisory Board elect the chairman of the Supervisory Board from among themselves. From June 10, 2013 to April 30, 2020, the chairman of the supervisory board was Hillar-Peeter Luitsalu, thereafter Tarmo Sild.

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 2020, the Supervisory Board had 3 meetings, which were attended by all Supervisory Board members: Tarmo Sild, Hillar-Peeter Luitsalu, Kert Keskpaik, Allar Niinepuu, Rait Riim and Steven Yaroslav Gorelik.

In addition to being members of the Supervisory Board, all members also perform 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 2020 nor 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 a 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

General meeting has the right to change the dividend policy. The dividend policy for 2019 was to pay dividends of 1 cent per share per year, in 2020 4 cents per share - regardless of the net profit for the year.

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 related 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 2021, i.e. until publishing the Q3 interim report for 2021.

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 shareholders appoints the auditor for the next financial year. At the shareholders’ meeting on 30 April 2020, KPMG Baltics OÜ was appointed as the Company’s auditor for the next two financial years. 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	**2020**	2019
In thousands of euros			
CONTINUING OPERATIONS			
Revenue from sale of own real estate		13,129	12,152
Revenue from rendering of services		927	957
Total revenue	6,7	**14,056**	**13,109**
Cost of sales	8	-11,313	-11,295
Gross profit		**2,743**	**1,814**
Other income	9	10	137
Marketing and distribution expenses	10	-89	-96
Administrative expenses	11	-922	-777
Other expenses	9	-273	-121
Gain on revaluation of investment property	16	-20	-7
Operating profit		**1,449**	**950**
Finance cost	12	-437	-562
Profit before tax		**1,012**	**388**
Net profit for the period		**1,012**	**388**
attributable to owners of the parent		1,012	388
Total comprehensive income for the period		**1,012**	**388**
attributable to owners of the parent		1,012	388
Earnings per share (in euros)	13		
- basic		**0.11**	**0.04**
- diluted		**0.11**	**0.04**

The notes presented on pages 22 to 53 form an integral part of the consolidated financial statements.

Consolidated statement of financial position

	Note	31 December 2020	31 December 2019
In thousands of euros			
Cash and cash equivalents	21	2,200	870
Receivables and prepayments	14	1,344	544
Inventories	15	14,960	15,807
Total current assets		**18,504**	**17,221**
Receivables and prepayments	14	5	0
Investment property	16	9,564	11,051
Property, plant and equipment	17	22	265
Intangible assets	17	136	217
Total non-current assets		**9,727**	**11,533**
TOTAL ASSETS		**28,231**	**28,754**
Loans and borrowings	18	3,482	6,416
Payables and deferred income	19	3,308	3,135
Total current liabilities		**6,790**	**9,551**
Loans and borrowings	18	7,217	5,904
Total non-current liabilities		**7,217**	**5,904**
TOTAL LIABILITIES		**14,007**	**15,455**
Share capital	20	6,299	6,299
Unregistered share capital	13	273	0
Share premium	20	2,285	2,285
Statutory capital reserve	20	2,011	2,011
Other reserves	13	0	245
Retained earnings	23	3,356	2,459
Total equity attributable to owners of the parent		**14,224**	**13,299**
TOTAL EQUITY		**14,224**	**13,299**
TOTAL LIABILITIES AND EQUITY		**28,231**	**28,754**

The notes presented on pages 22 to 53 form an integral part of the consolidated financial statements.

Consolidated statement of cash flows

	Note	2020	2019
In thousands of euros			
Cash receipts from customers		10,268	9,084
Returned prepayments	18	0	-876
Cash paid to suppliers		-10,960	-8,936
Other taxes paid and recovered (net)		44	-457
Cash paid to employees		-380	-328
Other cash payments and receipts related to operating activities		-14	-4
NET CASH FROM / USED IN OPERATING ACTIVITIES		**-1,042**	**-1,517**
Payments made on purchase of tangible and intangible assets		-8	-5
Proceeds from sale of tangible assets		0	28
Payments made on purchase and improvement of investment property	16	-37	-300
Proceeds from sale of financial investments		0	69
Repayment of loans		0	7
Other payments related to investing activities	26	-250	0
NET CASH FROM/USED IN INVESTING ACTIVITIES		**-295**	**-201**
Proceeds from loans received	18	7,849	10,735
Settlement of loans and borrowings	18	-4,369	-9,418
Interest paid		-727	-886
Dividends paid	23	-360	-90
Proceeds from share capital increase	13	273	0
Other payments related to financing activities		1	-80
NET CASH FROM/USED IN FINANCING ACTIVITIES		**2,667**	**261**
NET CASH FLOW		**-1,330**	**-1,457**
Cash and cash equivalents at beginning of period	21	870	2,327
Change in cash and cash equivalents		**1,330**	**-1,457**
Cash and cash equivalents at end of period	21	2,200	870

The notes presented on pages 22 to 53 form an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

	Equity attributable to owners of the parent						
	Share capital	Unregistered share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total equity
In thousands of euros							
Balance as of 31 December 2018	**6,299**	**0**	**2,285**	**2,011**	**245**	**2,161**	**13,001**
Total comprehensive income for the period	0	0	0	0	0	388	388
Transactions with owners:	0	0	0	0	0	-90	-90
Dividends paid	*0*	*0*	*0*	*0*	*0*	*-90*	*-90*
Balance as of 31 December 2019	**6,299**	**0**	**2,285**	**2,011**	**245**	**2,459**	**13,299**
Balance as of 31 December 2019	**6,299**	**0**	**2,285**	**2,011**	**245**	**2,459**	**13,299**
Total comprehensive income for the period	0	0	0	0	0	1,012	1,012
Transactions with owners:	0	273	0	0	-245	-115	-87
Increase of share capital	*0*	*273*	*0*	*0*	*0*	*0*	*273*
Dividends paid	*0*	*0*	*0*	*0*	*0*	*-360*	*-360*
Formation of other reserves	*0*	*0*	*0*	*0*	*-245*	*245*	*0*
Balance as of 31 December 2020	**6,299**	**273**	**2,285**	**2,011**	**0**	**3,356**	**14,224**

Further information on changes in share capital is provided in notes 13, 20 and 23.

The notes presented on pages 22 to 53 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 2020 were authorised for issue by the chief executive officer / member of the management board on 1 April 2021. 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 of the end of 2020, 11 people provided services to the Group under the employment or authorization contract (31 December 2019: 17 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 2020 is presented in note 25.

2. Statement of compliance and basis of preparation

The consolidated financial statements of Arco Vara AS and its subsidiaries have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The consolidated financial statements have been presented and submitted for approval in conformity with the requirements of the Estonian Accounting Act and the Estonian Commercial Code.

The consolidated financial statements are presented in thousands of euros, unless indicated otherwise.

The consolidated financial statements have been prepared under the historical cost convention, unless explained otherwise in note 4 *Significant accounting policies*.

Use of accounting estimates and judgements

The preparation of consolidated financial statements in conformity with IFRS as adopted by the EU requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses, and the disclosure of contingent assets and contingent liabilities, based on the likelihood of respective events happening.

Although estimates and underlying assumptions are reviewed on an ongoing basis and they are based on historical experience and expectations of future events that are believed to be reasonable under the circumstances, actual results may differ from the estimates.

Information about management's critical judgements and estimates that have a material effect on the amounts reported in the financial statements is provided below.

<u>Classification of real estate</u>

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

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

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

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

Estimation uncertainty

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

<u>Estimation of the net realisable value of inventories</u>

The Group has several items of real estate (properties) that have been classified as inventories. The net realizable values of all significant properties classified as inventories were measured as of 31 December 2020 and 31 December 2019 in order to determine whether:

1) the net realizable value of any item had decreased below its carrying amount;

2) any impairments recognized in prior periods needed to be reversed.

The net realizable 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 15.

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 2020, 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 16.

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 2019. 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 2020 (see note 4).

4. Significant accounting policies

New accounting pronouncements after 1 January 2020

The following new or revised standards and interpretations are mandatory for the Group's annual periods starting from 1 January 2020.

Changes in the conceptual framework for financial reporting.

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.

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.

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 organized 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.

New accounting pronouncements after 1 January 2021

The following new standards, interpretations and amendments are not yet effective for the annual reporting period ended 31 December 2020 and have not been applied in preparing these consolidated financial statements. The Group plans to adopt these pronouncements when they become effective.

Business Combinations - Amendments to IFRS 3 (effective from annual reporting periods starting from 1 January 2022 or later; not endorsed by the EU yet).

The amendments to IFRS 3 update a reference in IFRS 3 to the 2018 Conceptual Framework for Financial Reporting instead of the 1989 Framework. At the same time, the amendments add a new paragraph to IFRS 3 to clarify that contingent assets do not qualify for recognition at the acquisition date. The Group does not expect the amendments to have a material impact on its financial statements when initially applied.

Provisions, Contingent Liabilities and Contingent Assets - Amendments to IAS 37 (effective from annual reporting periods starting from 1 January 2022 or later; not endorsed by the EU yet).

In determining costs of fulfilling a contract, the amendments require an entity to include all costs that relate directly to a contract. The amendments clarify that the cost of fulfilling a contract comprises both: the incremental costs of fulfilling that contract and an allocation of other costs that relate directly to fulfilling contracts.

An entity must apply those amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments (the date of initial application). The entity will not restate comparative information. Instead, the entity will recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application. The Group does not expect the amendments to have a material impact on its financial statements when initially applied, because in determining costs of fulfilling a contract the entity/group takes into account both incremental costs and other costs that relate directly to fulfilling contracts.

Presentation of Financial Statements - Amendments to IAS 1 (effective from annual reporting periods starting from 1 January 2023 or later; not endorsed by the EU yet).

The amendments clarify that the classification of liabilities as current or non-current is based solely on the entity's right to defer settlement at the end of the reporting period. The company's right to defer settlement for at least 12 months from the reporting date need not be unconditional but must have substance. The classification is not affected by management's intentions or expectations about whether and when the entity will exercise its right. The amendments also clarify the situations that are considered settlement of a liability. The Group does not expect the amendments to have a material impact on its financial statements when initially applied.

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 unrealized profits and losses arising from transactions between consolidated entities are eliminated in full. Unrealized 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 recognized 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 recognized 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 recognized 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 recognized in profit or loss immediately. Acquisition-related costs are recognized 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 recognized directly in equity. Profits or losses arising from the sale of non-controlling interests are also recognized in equity.

When the parent loses control of a subsidiary, it derecognizes 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 derecognized net assets and the investment recognized is recognized 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.

Unrealized 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. Unrealized 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 recognized 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 recognizes revenue when it transfers control of a good or service to a customer.

<u>Revenue from sale of real estate</u>

The Group develops and sells real estate (mostly apartments). Revenue is recognized 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 recognized 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 recognized on transaction date, when the Group commits to purchase or sell the asset. Financial assets are derecognized 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 recognized 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 recognized 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 recognized 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 an authorisation for 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 recognized 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 recognized in the profit or loss on the period in which they arise (on a separate row within operating income/loss).

An investment property is derecognized 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 recognized 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 recognized in the revaluation reserve in equity. Any negative difference is recognized as an impairment loss. When a property is transferred from inventories to investment property, any difference between fair value and carrying amount is recognized 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 16.

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 recognized 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 derecognized. All other subsequent expenditures related to items of property, plant and equipment are recognized 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%
• 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 derecognized 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 recognized in profit or loss, within other income and other expenses respectively, in the period in which the item is derecognized.

Intangible assets

An intangible asset is recognized 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 recognized 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 recognized 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 recognized 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 recognized in profit or loss in the period in which they are incurred. The impairment loss for a cash-generating unit is recognized 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 the 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 the 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 recognized for the asset in prior years.

Financial liabilities

Financial liabilities (trade and other payables, loans and borrowings and accrued expenses) are initially recognized 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 recognized 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 recognized 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 recognized 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 recognized 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 recognized 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 recognized 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 recognizes 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 recognized 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 recognized 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 recognized 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 recognized 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 recognize:

(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 on a straight-line basis 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 31.12.2020 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 2020 nor 2019 because the assets did not have a substantial value or a term of over 12 months.

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 recognized as a short-term asset or liability and deferred tax is recognized 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 recognized 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 2019.

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 recognized in the statement of financial position. Maximum possible tax liability in case all retained earnings were distributed is disclosed in note 23.

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 recognized for all temporary differences between the carrying amounts and tax bases of assets and liabilities. A deferred tax asset is recognized 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 27) 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 recognized 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 recognized 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 recognized as income when the right to receive payment has been established.

5. Acquisition and sale of subsidiaries

Scope of consolidation

As of 31 December 2020, the Group consisted of 17 companies, which is two less than on 31 December 2019. In 2020, one company was sold and one was liquidated. There were no changes in the Group's structure in 2019. The structure of the Group is presented in note 25.

Sale of subsidiaries in 2020

In 2020, the sale of Arco Investments TOV for 0 euros was recorded. In 2020, Arco Investments TOV had no assets.

Summary consolidated statement of financial position of sold subsidiary Arco Investments TOV

	31.10.2020	31.12.2019
In thousands of euros		
Assets	0	0
Liabilities	0	0
Total net assets	**0**	**0**

Liquidation of subsidiaries in 2020

On 12 October 2020, the Group's subsidiary Arco Invest UAB was erased from Lithuanian Commercial Register.

6. Segment information

Group identifies geographical segments: Estonia, Bulgaria, Latvia, active segments are Estonia and Bulgaria.

External revenue by location

	2020	**2019**
In thousands of euros		
Estonia	7,610	10,004
Bulgaria	6,406	3,105
Latvia	40	0
Total revenue	**14,056**	**13,109**

External operating profit (loss) by location

	2020	**2019**
In thousands of euros		
Estonia	156	661
Bulgaria	1,263	301
Latvia	30	-12
Total revenue	**1,449**	**950**

External interest expense by location

	2020	2019
In thousands of euros		
Estonia	-107	-73
Bulgaria	-319	-381
Total revenue	**-426**	**-454**

For interest expense, see note 12.

External net profit (loss) by location

	2020	2019
In thousands of euros		
Estonia	49	588
Bulgaria	933	-188
Latvia	30	-12
Total revenue	**1,012**	**388**

External assets and liabilities by location

On 31 December	2020	2019
In thousands of euros		
Assets	**28,231**	**28,754**
Estonia	9,642	8,082
Bulgaria	18,462	20,546
Latvia	127	126
Liabilities	**14,007**	**15,455**
Estonia	4,938	2,859
Bulgaria	9,069	12,596

Non-current assets by location

On 31 December	2020	2019
In thousands of euros		
Total non-current assets	**158**	**482**
Property, plant and equipment	**22**	**265**
Estonia	6	9
Bulgaria	16	256
Intangible assets	**136**	**217**
Estonia	86	171
Bulgaria	50	46

For property, plant and equipment and intangible assets, see note 17.

Depreciation and amortisation by location

On 31 December	2020	2019
In thousands of euros		
Total depreciation and amortisation	**-109**	**-115**
Total depreciation	**-14**	**-23**
Estonia	-3	-10
Bulgaria	-11	-13
Total amortisation	**-95**	**-92**
Estonia	-85	-88
Bulgaria	-10	-4

For depreciation and amortisation, see note 17.

Notes to the Consolidated Statements of Comprehensive Income

7. Revenue

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

	Estonia		Bulgaria		Latvia		Consolidated	
	2020	2019	2020	2019	2020	2019	2020	2019
In thousands of euros								
Sale of own real estate	7,414	9,865	5,675	2,287	40	0	13,129	12,152
Rental of real estate	5	5	614	696	0	0	619	701
Property management services	1	0	84	88	0	0	85	88
Franchise	137	74	35	34	12	20	184	128
Other revenue	6	5	33	35	0	0	39	40
Total revenue	**7,563**	**9,949**	**6,441**	**3,140**	**52**	**20**	**14,056**	**13,109**

8. Cost of sold real estate and services

	2020	2019
In thousands of euros		
Cost of real estate sold (note 15, 16)	-10,405	-10,296
Brokerage fees	-276	-347
VAT cost	-39	-161
Property management costs	-347	-342
Personnel expenses (note 11)	-15	-33
Depreciation, amortisation and impairment losses (note 17)	-84	-85
Write-down of inventory (note 15)	-40	0
Other costs	-107	-31
Total cost of sold real estate and services	**-11,313**	**-11,295**

The write-down of inventories in 2019 is recorded under other operating expenses (see note 9).

9. Other income and expenses

Other income

	2020	2019
In thousands of euros		
Gain on reversal of property, plant and equipment impairment (note 17)	0	9
Received penalties and compensations	0	90
Miscellaneous income	10	38
Total other income	**10**	**137**

Other expenses

	2020	2019
In thousands of euros		
Write-down of inventory (note 15)	0	-73
Late payment interest and penalty charges	-253	-2
Loss-making contract	0	-38
Miscellaneous expenses	-20	-8
Total other expenses	**-273**	**-121**

The write-down of inventories in 2020 is recorded under the cost of sold real estate and services (see note 8).

The group was obliged to buy out the Lozen Phase II land by December 2020, otherwise it would have had to pay a fine of EUR 1 million. An agreement was reached with the seller of the land to reduce the fine to 250 thousand euros, and this fee was also transferred in December 2020.

10. Marketing and distribution expenses

	2020	2019
In thousands of euros		
Advertising expenses	-39	-47
Other marketing and distribution expenses	-50	-49
Total marketing and distribution expenses	**-89**	**-96**

11. Administrative expenses

	2020	2019
In thousands of euros		
Personnel expenses	-453	-461
Office expenses	-67	-63
IT expenses	-28	-42
Services purchased	-310	-125
Depreciation and amortisation (note 17)	-25	-30
Legal service fees	-22	-28
Other expenses	-17	-28
Total administrative expenses	**-922**	**-777**

In 2020, employee remuneration expenses of the Group amounted to 468 thousand euros, out of which 453 thousand were administrative expenses and 15 thousand were cost of sold real estate and services (see note 8). In 2019, employee remuneration expenses were 494 thousand euros, out of which 461 thousand were administrative expenses and 33 thousand were cost of sold real estate and services (see note 8).

As of 31 December 2020, 9 persons worked with an employment contract, 1 with an authorisation agreement and 1 with a board member agreement (on 31 December 2019: 13, 3, 1, respectively).

12. Finance costs

	2020	2019
In thousands of euros		
Interest expense (note 6)	-426	-454
Other finance costs	-11	-108
Total finance costs	**-437**	**-562**

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 2020, capitalised interest expenses amounted to 280 thousand euros and in 2019 to 371 thousand euros (see notes 15 and 16).

13. 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.

	2020	2019
Weighted average number of ordinary shares outstanding during the period	8,998,367	8,998,367
Number of ordinary shares potentially to be issued	390,000	390,000
Net profit/loss attributable to owners of the parent (in thousands of euros)	1,012	388
Earnings per share (in euros)	**0.11**	**0.04**
Diluted earnings per share (in euros)	**0.11**	**0.04**

According to the decision of the annual general meeting of Arco Vara AS, held on May 10, 2016, a 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 recognized proportionally over 3 years as payroll expense in income statement and as an equity reserve. An equity reserve in the amount of 245 thousand euros that was formed for the option associated with the bond was used in Q2 2020, when 273 thousand euros cash was transferred to Arco Vara for the option. The added 390,000 shares are still awaiting registration. See also note 24.

Notes to the Consolidated Position of Financial Statement

14. Receivables and prepayments

Short-term receivables and prepayments

As of 31 December	2020	2019
In thousands of euros		
Receivables from customers	1,283	204
Miscellaneous receivables	12	12
Prepaid and recoverable taxes	19	226
Other accrued income	13	18
Prepayments	17	84
Total short-term receivables and prepayments	**1,344**	**544**

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

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.

Long-term receivables

As of 31 December	2020	2019
In thousands of euros		
Deposit	5	0
Total long-term receivables and prepayments	**5**	**0**

In 2020 and 2019, no receivables from customers were written off.

15. Inventories

As of 31 December	2020	2019
In thousands of euros		
Properties purchased and being developed for resale	14,943	15,779
Materials and finished goods	17	28
Total inventories	**14,960**	**15,807**

Properties purchased and being developed for resale

	2020	2019
In thousands of euros		
Balance at the beginning of period, 1 January	**15,779**	**17,467**
Construction costs of apartment buildings	7,117	4,994
Capitalized borrowing costs	266	276
Inventory write-down (note 8)	-40	-73
Other capitalized costs	474	1,655
Reclassification from/to investment property (note 16)	1,358	468
Cost of sold properties (note 8)	-10,011	-9,008
Balance at the end of period, 31 December	**14,943**	**15,779**

In 2020, the Group wrote down inventories in the amount of 40 thousand euros. 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.

The Group's management estimates that the Group has inventories realisable during one year in carrying value of 8,169 thousand euros as of 31 December 2020. Inventories in carrying value of 6,791 thousand euros are realisable in a longer period than one year.

For information on inventories pledged as loan collateral, see note 22.

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 2020 as well as in 2019, the value of the Group's inventories was determined by internal experts and partly by external experts. Estimates used in valuations are based on real market prices and the Group's recent experience with comparable assets. As of 31 December 2020, inventories in the total amount of 14,482 thousand euros did not require a write-down or reversal of write-down (as of 31 December 2019: 15,748 thousand euros).

As of 31 December	**2020**	2019
In thousands of euros		
Measured using the residual value method	14,581	15,444
Measured using the comparison method	379	363
Total inventories	**14,960**	**15,807**

16. Investment property

Investment properties comprise the following types of assets:

1) Commercial spaces earning rental income in Sofia and Viljandi (total carrying value of 9,522 thousand euros on 31 December 2020, 9,330 thousand euros on 31 December 2019) and apartments (carrying value of 0 euros on 31 December 2020; 354 thousand euros on 31 December 2019).
2) Land plots that have a development potential but the future use of which is still uncertain (carrying value of 42 thousand euros on 31 December 2020, 1,367 thousand euros on 31 December 2019).

As of 31 December	**2020**	2019
In thousands of euros		
Land plots	42	1,367
Shops and offices	8,378	8,146
Garages and parking places	1,144	1,184
Rental apartments	0	354
Total investment property	**9,564**	**11,051**

If it is decided to start developing the registered immovable property with development potential, the future use of which was not yet certain for the time being, instead of selling them, the property shall be reclassified to inventories. In 2020, such investment properties amounted to 1,358 thousand euros (2019: 468 thousand euros).

	2020	2019
In thousands of euros		
Balance at the beginning of period, 1 January	**11,051**	**12,344**
Net loss on changes in fair value	-20	-7
Capitalised development costs	42	75
Capitalised borrowing costs	14	95
Reclassification from/to inventories (note 15)	-1,358	-468
Reclassification to property, plant and equipment (note 17)	229	0
Sale of real estate (note 8)	-394	-1,288
Purchase of land plots	0	300
Balance at the end of period, 31 December	**9,564**	**11,051**

For information on pledged assets, see note 22.

Changes in fair value of investment property

Valuation of land

Land plots, 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 2020, revaluation profit was one thousand euros (in 2019, fair value of these assets was devalued by 109 thousand euros). Rentable garages and parking lots of the same building were valued using income method in 2020 but comparison method in 2019. The value of the rentable garages and parking lots did not change in 2020 but was 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. By the beginning of 2020, all apartments had found a buyer.

On 31 December 2020, investment properties with carrying value of 1,497 thousand euros did not require value adjustment (as of 31 December 2019: 2,765 thousand euros).

In 2020, the values of all of the Group's investment properties were determined by internal experts, in 2019 by internal and partly by external experts. In 2020, the fair value of investment property was decreased in the total amount of 20 thousand euros and in the total amount of 7 thousand euros in 2019.

As of 31 December	**2020**	2019
In thousands of euros		
Measured using the income method	9,462	8,086
Measured using comparison method	102	2,965
Total investment property	**9,564**	**11,051**

In 2020 as well as in 2019, 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 m^2 from commercial and office areas was 9,5 euros in 2020 and 9,3 euros in 2019.

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 1% (+/-) in the forecasted net operating cash flows would increase or reduce the fair value of investment property by 95 thousand euros (in 2019: by 81 thousand euros).

  A change of 5% (+/-) in the forecasted net operating cash flows would increase or reduce the fair value of investment property by 474 thousand euros (in 2019: by 405 thousand euros).

- A decrease of 0.5% in the exit yields would increase the fair value of investment property by 640 thousand euros (in 2019: by 541 thousand euros) and an increase of 0.5% would reduce the fair value by 548 thousand euros (in 2019: by 477 thousand euros).

  A decrease of 1% in the exit yields would increase the fair value of investment property by 1,363 thousand euros (in 2019: by 1,158 thousand euros) and an increase of 1% would reduce the fair value by 1,043 thousand euros (in 2019: by 901 thousand euros).

Operating leases: the Group as a lessor

In 2020, the Group's rental income on investment properties (Madrid Blvd building in Sofia) amounted to 699 thousand euros (in 2019: 795 thousand euros). Rental income decreased by 82 thousand euros because in 2020, we offered tenants discounts due to Covid-19, and during the period of tenant changes, there were rent-free months. Property management services were also offered in smaller amounts, which in total led to decrease of rental and property management services by 96 thousand euros. By the publishing date of the annual report, two commercial spaces were not rented out, the rest were rented out.

Direct property management expenses totalled 244 thousand euros in 2020 (in 2019: 255 thousand euros) including expenses in the amount of 13 thousand euros (in 2019: 10 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	**2020**	2019
In thousands of euros		
Up to 1 year	751	381
2-5 years	1,897	1,338
Total	**2,648**	**1,719**

Lease contracts are considered non-cancellable if:

1) they have been concluded for a fixed term (with the expiration date in 2021 or later);
2) lessee has the right to cancel the contract with 3-6-month notice but only after arrival of fixed date in 2021 or later.

17. Property, plant and equipment and intangible assets

Property, plant and equipment

In thousands of euros	Land and buildings	Office equipment	Total property, plant and equipment
Carrying amount on 31 December 2018	**231**	**36**	**267**
Of which cost	*232*	*188*	*420*
Of which accumulated depreciation	*-1*	*-152*	*-153*
Additions	2	37	39
Sale of PPE	0	-18	-18
Depreciation for the year (note 5)	-2	-21	-23
Carrying amount on 31 December 2019	**231**	**34**	**265**
Of which cost	*234*	*203*	*437*
Of which accumulated depreciation	*-3*	*-169*	*-172*
Reclassification to investment property (note 16)	-229	0	-229
Depreciation for the year (note 5)	-2	-12	-14
Carrying amount on 31 December 2020	**0**	**22**	**22**
Of which cost	*0*	*170*	*170*
Of which accumulated depreciation	*0*	*-148*	*-148*

As of 31.12.2020, the cost of property, plant and equipment that was fully amortized but still in use was 6 thousand euros (on 31 December 2019: 7 thousand euros).

Intangible assets

In thousands of euros	Total intangible assets
Carrying amount on 31 December 2018	**262**
Of which cost	*507*
Of which accumulated amortisation	*-245*
Purchases and software development	47
Amortisation for the year (note 5)	-92
Carrying amount on 31 December 2019	**217**
Of which cost	*552*
Of which accumulated amortisation	*-335*
Purchases and software development	14
Amortisation for the year (note 5)	-95
Carrying amount on 31 December 2020	**136**
Of which cost	*522*
Of which accumulated amortisation	*-386*

Amortisation of intangible assets is recorded in the cost of real estate and services sold in 2020 in the amount of 84 thousand euros (see note 8) and in general administrative expenses in the amount of 10 thousand euros (see note 11); in 2019 85 thousand and 7 thousand euros, respectively.

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 for AVIS in 2020 nor 2019.

As of 31.12.2020, the cost of intangible assets that was fully amortized but still in use was 257 thousand euros (on 31 December 2019: 62 thousand euros).

For pledged assets, see note 22.

18. Interest bearing liabilities

The overview of changes in net loans is as follows:

In thousands of euros	Cash and cash equivalents	Bank loans	Bonds	Other loans	Total
Net loans 31 Dec 2018	**2,327**	**-14,653**	**-1,329**	**-550**	**-14,205**
Annual change	-1,457	3,660	2	550	2,755
Net loans 31 Dec 2019	**870**	**-10,993**	**-1,327**	**0**	**-11,450**
Annual change	1,330	2,344	-453	-270	2,951
Net loans 31 Dec 2020	**2,200**	**-8,649**	**-1,780**	**-270**	**-8,499**

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. Information on assets pledged as loan collateral is presented in note 22.

Interest bearing liabilities comprise the following items:

	As of 31 December 2020			As of 31 December 2019		
In thousands of euros	**Total**	*of which current portion*	*of which non-current portion*	**Total**	*of which current portion*	*of which non-current portion*
Bank loans	8,649	3,212	5,437	10,993	5,089	5,904
Bonds	1,780	0	1,780	1,327	1,327	0
Other loans	270	270	0	0	0	0
Total interest bearing liabilities	**10,699**	**3,482**	**7,217**	**12,320**	**6,416**	**5,904**

In 2020, the Group settled loans and borrowings in the amount of 9,470 thousand euros (in 2019: 14,958 thousand euros) and raised new loans and borrowings in the amount of 7,849 thousand euros (in 2019: 10,746 thousand euros). 5,101 thousand euros of the settled loans were paid by customers directly to the bank (in 2019: 5,540 thousand euros). 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.

Changes in loans and borrowings in 2020

In 2020, the following major loan obligations were settled:
- 283 thousand euros of Madrid Blvd project's bank loan principal;
- 2,786 thousand euros of bank loan for financing construction of apartment building in Iztok Parkside project;
- 3,646 thousand euros of Kodulahe project III Stage bank loan principal, all without cash transactions through Kodulahe's bank account;
- 1,607 thousand euros of Kodukalda project bank loan principal, out of which 152 thousand by cash transactions through Kodukalda's bank account;
- 1,148 thousand euros of Arco Vara convertible bonds.

In 2020, the group raised the following new liabilities:
- 3,884 thousand euros of bank loan for financing construction of apartment building in Kodulahe project Stage III;
- 2,094 thousand euros of bank loan for financing construction of apartment building in Kodukalda project;
- 1,601 thousand euros of Arco Vara convertible bonds;
- 270 thousand euros of other loans of Arco Vara.

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 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.

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

Description of the liability	Maturity date (month/year)	Liability amount, in thousands of euros 31 Dec 2020	Liability amount, in thousands of euros 31 Dec 2019	Interest rate, % 31 Dec 2020	Interest rate, % 31 Dec 2019	Type of interest rate
Bank loan, development	10/2024	5,717	6,000	3.4	3.4	3M Euribor
Bank loan, development	6/2021	1,864	4,650	2.5	2.5	1M Euribor
Bank loan, development	9/2021	661	174	7.4	8.8	Fixed
Bank loan, development	10/2021	407	169	5.4	9.9	6M Euribor
Bonds, development	12/2022	1,780	-	10.0	-	Fixed
Bonds, development	12/2020	-	1,325	-	12.0	Fixed
Convertible bonds	3/2020	-	2	-	5.0	Fixed
Other loan, settlements	11/2021	270	-	10.0	-	Fixed
Total		**10,699**	**12,320**			

On 31 December 2020, the weighted average interest rate of interest-bearing liabilities was 4.8% (31 December 2019: 4.2%).

19. Payables and deferred income

Short-term payables and deferred income

As of 31 December	2020	2019
In thousands of euros		
Trade payables	**811**	**590**
Miscellaneous payables	**76**	**142**
Taxes payable		
Value added tax	1,431	415
Corporate income tax	1	1
Social security tax	14	14
Personal income tax	17	8
Garbage tax	23	0
Total taxes payable	**1,486**	**438**
Accrued expenses		
Payables to employees	17	82
Interest payable	44	41
Other accrued expenses	100	345
Total accrued expenses	**161**	**468**
Deferred income		
Prepayments received on sale of real estate	631	1,412
Guarantee deposits	102	61
Other deferred income	41	24
Total deferred income	**774**	**1,497**
Total short-term payables and deferred income	**3,308**	**3,135**

As of 31 December 2020, the balance of prepayments received on sale of real estate included prepayments collected on presale of apartments of Iztok Parkside projects in the amounts of 330 thousand euros, Kodulahe 3. stage of 230 thousand euros and 4.-5. stage of 55 thousand euros and Kodukalda of 16 thousand euros.

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.

20. Share capital

As of 31 December	2020	2019
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 2020.

21. 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 majority of the Group's liquidity and interest rate risks are concentrated in the Development segment in 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	2020	2019
In thousands of euros		
Cash on hand and demand deposits	2,200	870
Total cash and cash equivalents	**2,200**	**870**

At the end of year 2020, out of the Group's cash and cash equivalents balance, 168 thousand euros (31 December 2019: 252 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 22.

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 99% of the Group's cash deposits as of 31 December 2020, 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	41.20%	A-	A3
LHV Pank AS	18.43%	Not rated	Baa1
Coop Pank AS	39.31%	Not rated	Baa2
Cash in other banks and petty cash	1.06%	-	-

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 1,344 thousand euros as of 31 December 2020. 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 during reporting periods.

All financial assets exposed to credit risk are recorded at amortized cost.

The total amount of financial assets exposed to credit risk was 3,544 thousand euros as of 31 December 2020 (31 December 2019: 1,086 thousand euros).

Financial assets by maturity

	on 31 December 2020			
By maturity	< 3 months	3-12 months	1-2 years	Total
In thousands of euros				
Cash and cash equivalents	2,200	0	0	2,200
Trade and other receivables (note 14)	1,344	0	0	1,344
Total	**3,544**	**0**	**0**	**3,544**

	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 14)	216	0	0	216
Total	**1,086**	**0**	**0**	**1,086**

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 2020
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	477	3,005	7,217	10,699
Interest payable	126	308	860	1,294
Other financial liabilities (trade payables, accrued expenses, excluding liabilities to employees)	2,473	0	0	2,473
Total	**3,076**	**3,313**	**8,077**	**14,466**

				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**

Based on the maturities of liabilities included in the Group's loan portfolio, as of 31 December 2020, the average weighted maturity of the Group's loans and borrowings was 2.5 years (as of 31 December 2019: 2.8 years). For more information on loans and borrowings see also note 18.

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 risk

Interest rate risk

Interest rate risk is the risk that a rise in market interest rates will increase interest expense to an extent that will have a significant impact on the Group's performance. The Group's exposure to interest rate risk results from:

- use of loans and borrowings with a floating interest rate;
- refinancing liabilities on the arrival of their due dates;
- raising new loans for realising an investment plan in a situation where the volatility of financial markets is increasing and the economic environment is changing.

The Group's long-term loans and borrowings are mostly linked to 1-month, 3-month or 6-month Euribor. Therefore, the Group is exposed to developments in the international financial markets. Interest rate risk is managed, among other things, by monitoring movements in the money market interest rate curve, which reflects the market participants' expectations of market interest rates and allows estimating a trend for euro-denominated interest rates. During 2020, Euribor interest rates have been negative. Therefore, there is practically no Euribor component in the Group's loans as of 31 December 2020 and also as of 31 December 2019.

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 2020, 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 107 thousand euros (on 31 December 2019: 123 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 2020, 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 2020, the share capital of Arco Vara AS was 6,299 thousand euros and net assets were 14,224 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 2020 and 31 December 2019, the equity was positive in all group companies with bank loans.

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 2020, total capital amounted to 22,723 thousand euros (on 31 December 2019: 24,749 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 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 2020, equity accounted for 50.4% (on 31 December 2019: 46.3%) of total assets.

Other Information

22. Assets pledged as collateral

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

As of 31 December	2020	2019
In thousands of euros		
Cash and cash equivalents	168	252
Receivables [1]	1,268	28
Inventories	9,237	9,541
Investment property	9,462	9,624
Property, plant and equipment	0	231
Total carrying value of assets pledged as collateral	**20,135**	**19,676**

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

23. Contingent liabilities

Contingent income tax liability

As of 31 December 2020, the Group's retained earnings amounted to 3,356 thousand euros (on 31 December 2019: 2,459 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 2020 and in 2019, this opportunity was used when paying out dividends to shareholders in the amount of 360 and 90 thousand euros accordingly (0.04 or 0.01 euros per share) without income tax obligation.

As of 31.12.2020, Arco Vara could pay dividends in the amount of 1,406 thousand euros without income tax obligation. Upon the payment of all retained earnings in 2021, income tax liability would be 390 thousand euros and the amount to be paid out to shareholders would total 2,966 thousand euros.

Contingent liabilities in connection with the delayed transfer of the Iztok apartments

As the Iztok Parkside project apartments in Sofia were handed over a year later than promised, due to bureaucratic obstacles, 2 clients want compensation in the total amount of 40 thousand euros. As these apartment owners want compensation for pain and suffering, but not to give up the apartments, the obligation to pay compensation is not realistic and no reserve has been formed for this purpose.

24. 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).

Balances with related parties

As of 31 December	2020	2019
In thousands of euros		
Other related parties		
Receivables from customers	0	1
Bonds issued	0	1

Transactions with related parties

In thousands of euros	2020	2019
Companies that have a significant interest in the Group's parent company		
Services purchased	58	29
Redemption of bonds	273	0
Paid interest	0	28
Other related parties		
Services sold	1	3

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 2020, the remuneration of the CEO, including social security charges amounted to 89 thousand euros (121 thousand euros in 2019). Remuneration of the members of the Group's supervisory board was 18 thousand euros in 2020 and 8 thousand in 2019.

The remuneration provided to the CEO / member of the management board is based on his contract of service. As of 30 April 2020, a fixed monthly fee has been set by a resolution of the Supervisory Board on the basis of the contract of service of Miko-Ove Niinemäe, the member of the Management Board of Arco Vara AS. The CEO's bonus system will be discussed in 2021.

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 chairman of the supervisory board receives an additional 500 euros per month (net amount).

According to the decision of the annual general shareholders' meeting of Arco Vara AS, held on 10 May 2016, a convertible bond was issued with the nominal value of 1,000 euros. The convertible bond gave to the CEO of the group's parent company the right to subscribe for additional 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. An equity reserve in the amount of 245 thousand euros that was formed for the option associated with the bond was used in Q2 2020, when 273 thousand euros cash was transferred to Arco Vara for the option. The added 390,000 shares are still awaiting registration. See also note 13.

The Group's key management personnel have not been granted or received any other remuneration or benefits (bonuses, etc.) in the reporting periods of 2020 and 2019.

In 2020 and 2019, all transactions with related parties have been conducted on market conditions and no receivables from related parties were impaired.

25. Structure of Arco Vara group

Group	Domicile	Group's ownership interest On 31 December 2020	On 31 December 2019
%			
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 Development UAB***	Lithuania	100	100

* - In liquidation
** - Liquidated on 21 January 2021
*** - Liquidated on 29 January 2021

26. Events after reporting date

Arco Vara has a parent company

After the balance sheet date, AS Lõhmus Holding, LHV Pension Fund L, LHV Pension Fund XL, LHV Pension Fund M and LHV Supplementary Pension Fund transferred a total of 2,146,837 shares of Arco Vara AS owned by them to OÜ Alarmo Kapital.

As a result of the transactions, OÜ Alarmo Kapital owns 51.83% of the voting shares of Arco Vara AS. In addition, OÜ Alarmo Kapital has subscribed but not issued 390,000 shares of Arco Vara AS, which after the issue would make OÜ Alarmo Kapital's holding 53.83%.

The parent company has stated that it does not intend to make any changes to Arco Vara's business operations, management or employment relationships.

Contingent liabilities in connection with the purchase of land by Lake Harku

Aktsiaselts Kolde, a subsidiary of Arco Vara, entered into a post-balance sheet agreement for the purchase of land on the shores of Lake Harku, at Paldiski road 124b, Tallinn. It is planned to develop more than 30,000 m^2 of residential and commercial real estate (gross construction volume). In connection with this, the subsidiary of Arco Vara is obliged to pay 3,252 thousand euros for the purchase of land by Lake Harku in 2021 and 3,252 thousand euros in 2023 if the building right permitted by the new detailed plan exceeds 30,000 m^2 GBA (gross construction volume). According to the management, the gross construction volume of 30,000 m^2 of construction is realistic and it is planned to pay the purchase price of the land.

27. 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

	2020	2019
In thousands of euros		
Revenue from rendering of services	**695**	**736**
Cost of sales	-85	-85
Gross profit	**610**	**651**
Other income	0	9
Marketing and distribution expenses	0	-2
Administrative expenses	-434	-459
Other expenses	-259	-38
Operating profit/loss	**-83**	**161**
Gain on investments in subsidiaries	-68	0
Interest income	821	887
Interest expense	-277	-328
Total finance income and costs	**476**	**559**
Net profit for the year	**393**	**720**
Total comprehensive income for the year	**393**	**720**

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

As of 31 December	**2020**	2019
In thousands of euros		
Cash and cash equivalents	62	317
Investments	0	0
Receivables and prepayments	3,783	5,040
Total current assets	**3,845**	**5,357**
Investments into subsidiaries	10,044	7,344
Receivables and prepayments	3,845	3,576
Property, plant, and equipment	6	9
Intangible assets	87	171
Total non-current assets	**13,982**	**11,100**
TOTAL ASSETS	**17,827**	**16,457**
Loans and borrowings	1,437	2,464
Payables and prepayments	463	427
Total current liabilities	**1,900**	**2,891**
Loans and borrowings	3,535	1,480
Total non-current liabilities	**3,535**	**1,480**
TOTAL LIABILITIES	**5,435**	**4,371**
Share capital	6,299	6,299
Unregistered share capital	273	0
Share premium	2,285	2,285
Statutory capital reserve	2,011	2,011
Other reserves	0	245
Retained earnings	1,524	1,246
Total equity	**12,392**	**12,086**
TOTAL LIABILITIES AND EQUITY	**17,827**	**16,457**

UNCONSOLIDATED STATEMENT OF CASH FLOWS (direct method)

	2020	2019
In thousands of euros		
Cash receipts from customers	883	275
Cash paid to suppliers	-326	-437
Taxes paid and recovered (net)	1,174	135
Cash paid to employees	-137	-115
Other payments and receipts related to operating activities (net)	9	2
NET CASH FROM/USED IN OPERATING ACTIVITIES	**1,603**	**-140**
Paid on acquisition of tangible and intangible assets	0	-5
Proceeds from sale of tangible assets	0	28
Proceeds from sale of a financial investment	0	69
Loans provided	-2,908	-1,763
Repayment of loans provided	614	1,417
Interest received	118	150
Other payments related to investing activities	-250	0
NET CASH FROM/USED IN INVESTING ACTIVITIES	**-2,426**	**-104**
Proceeds of loans received	2,101	324
Settlement of loans and borrowings	-1,282	-968
Proceeds from share capital issue	273	0
Dividends paid	-360	-90
Interest paid	-164	-225
NET CASH FROM FINANCING ACTIVITIES	**568**	**-959**
NET CASH FLOW	**-255**	**-1,203**
Cash and cash equivalents at beginning of year	**317**	**1,520**
Change in cash and cash equivalents	-255	-1,203
Cash and cash equivalents at end of year	**62**	**317**

UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Unregistered share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total
In thousands of euros							
Balance on 31 December 2018	**6,299**	**0**	**2,285**	**2,011**	**245**	**616**	**11,456**
Profit distribution	0	0	0	0	0	-90	-90
Net profit for the year	0	0	0	0	0	720	720
Balance on 31 December 2019	**6,299**	**0**	**2,285**	**2,011**	**245**	**1,246**	**12,086**
Profit distribution	0	0	0	0	0	-360	-360
Increase of share capital	0	273	0	0	0	0	273
Other reserves	0	0	0	0	-245	245	0
Net profit for the year	0	0	0	0	0	393	393
Balance on 31 December 2020	**6,299**	**273**	**2,285**	**2,011**	**0**	**1,524**	**12,392**

Adjusted unconsolidated equity

As of 31 December	**2020**	**2019**
In thousands of euros		
Parent company’s unconsolidated equity	**12,392**	**12,086**
Carrying amount of investments in subsidiaries in the parent company’s unconsolidated statement of financial position (-)	-10,044	-7,344
Value of investments in subsidiaries under the equity method (+)	11,876	8,557
Parent company’s adjusted unconsolidated equity	**14,224**	**13,299**

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 2020 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.

April 01, 2021

Miko-Ove Niinemäe
Chief Executive Officer and Member of the Management Board of Arco Vara AS

Independent Auditor's Report

(Translation of the Estonian original)

To the Shareholders of AS Arco Vara

Report on the Audit of the Consolidated Financial Statements

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS Arco Vara and its subsidiaries (collectively, the group) as at 31 December 2020, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS (EU)).

What we have audited

We have audited the consolidated financial statements of the Group, which are set out on pages 18 to 53 of the consolidated financial statements, which comprise:

- the consolidated statement of financial position as at 31 December 2020,
- the consolidated statement of profit or loss and other comprehensive income,
- the consolidated statement of changes in equity for the year then ended,
- the consolidated statement of cash flows for the year then ended, and
- the notes to the consolidated financial statements, comprising significant accounting policies and other explanatory information.

Basis of Opinion

We conducted our audit in accordance with International Standards on Auditing (Estonia) (ISAs (EE)). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the 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 ethical requirements of the Auditor's Activities Act of the Republic of Estonia and with the ethical requirements of the ethics standards for professional accountants as set out in the same act, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Audit Scope

Because we are solely responsible for our audit opinion, we are also responsible for the direction, supervision and performance of the group audit. In this respect, we have determined the type of work to be performed for Group entities based on their financial significance and/or the other risk characteristics..

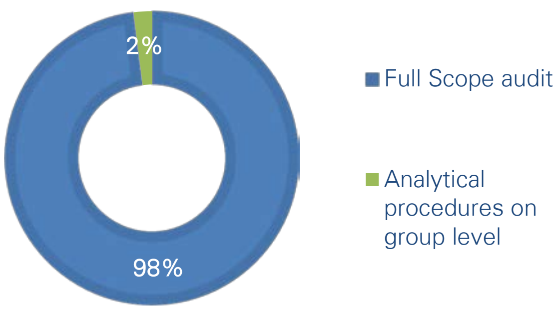
We, as Group auditors, determined 4 of the group's 17 entities to be significant group components and we subjected those components to a full scope audit. These components, which subjected to full scope audit, wereArco Invest EOOD, Iztok Parkside EOOD, Kodulahe OÜ and Kodukalda OÜ.

For the remaining non-significant components, we performed analytical procedures and specified audit procedures on the group level to re-examine our assessment that there were no sifnificant risks of material misstatment within them.

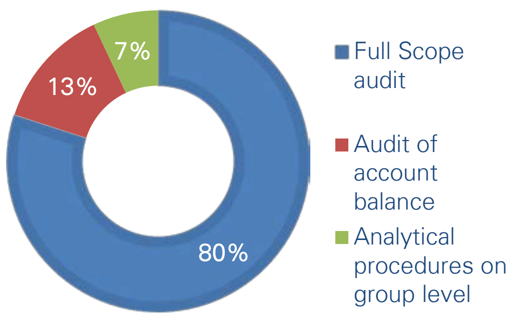
We also performed procedures over the consolidation process at group level.

Coverage of the group's consolidated revenue and consolidated total assets with procedures performed:

Consolidated Revenue



Consolidated Total Assets



The audit work on the financial information of all Group components was performed by the Group audit team in Estonia.

By performing the procedures mentioned above over the Group entities, together with additional procedures at the Group level, we have been able to obtain sufficient and appropriate audit evidence to form an opinion on the consolidated financial statements as a whole.

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

Fair value of investment properties

Refer to Note 4 "Summary of significant accounting policies", Note 2 "Statement of compliance and basis of preparation" and Note 16 "Investment properties"

The key audit matter	How the matter was addressed in our audit
As at 31 December 2020, the carrying amount of the group's investment property was 9.56 million euros. 9.45 million euros of the investment property balance, is a building in Bulgaria, Sofia, which is made up of office and commercial spaces together with parking spaces. The fair value of the investment property in Bulgaria was determined by the management. using income approach .	In this area, we conducted, among others, the following audit procedures: • Assessed the model used for measuring the fair values of the Group's investment properties against the requirements of relevant financial reporting standards, and against those applied by other appraisers for similar properties, • Assessed the reasonableness of the key valuation inputs applied in the model. On a sample basis, we performed detailed testing of the inputs used in the valuation model. For inputs based on existing contracts and

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 and parking spaces 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 premises and parking spaces in Bulgaria, the audit of investment property requires significant time and resources. Due to the above mentioned facts, the valuation of investment property in Bulgaria is considered a key audit matter.	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, vacancy and yields) obtained from the reports of independent real estate advisory companies active in Bulgaria. • We also read the disclosures provided in respect of fair values of investment properties, including sensitivity analysis, to assess the compliance of the disclosures with IFRS (EU). We recalculated sensitivity analysis on key assumptions, such as changes in rental prices and capitalisation rates.

Other Information

Management is responsible for the other information contained in the Group's consolidated annual report in addition to the consolidated financial statements and our auditors' 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 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 Management and Those Charged with Governance for the Consolidated Financial Statamenets

Management 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 management 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, management 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 management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the (consolidated) financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 International Standards on Auditing (Estonia) 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 International Standards on Auditing (Estonia), 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management'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 Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' 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 auditors' report. However, future events or conditions may cause the Company 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 communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the (consolidated) financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors´ report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that 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

Muud audiitori aruande nõuded tulenevalt Euroopa Parlamendi ja Nõukogu määrusest (EL) nr 537/2014

We were first appointed by those charged with governance on 20 April 2020 to audit the consolidated financial statements of AS Arco Vara for the periods ended 31 December 2020 to 31 December 2021. Our total uninterrupted period of engagement has lasted for one year, covering the period ended 31 December 2020. We confirm that our audit opinion is consistent with the additional report presented to the Audit Committee of the Group and we have not provided to the Group the prohibited non-audit services (NASs) referred to in Article 5(1) of EU Regulation (EU) No 537/2014. We also remained independent of the audited entity in conducting the audit.

Signed

Indrek Alliksaar

Certified Public Accountant, Licence No 446

Tallinn, 31 March 2021

Signed

Andres Soosalu

Certified Public Accountant, Licence No 693

KPMG Baltics OÜ
Licence No 17

KPMG Baltics OÜ

Narva mnt 5
Tallinn 10117
Estonia

Tel +372 626 8700
www.kpmg.ee