

Arco Vara AS

Annual Report 2018

Consolidated annual report

(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year:	1 January 2018
End of financial year:	31 December 2018
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E-mail:	info@arcovara.com
Corporate website:	www.arcorealestate.com
Core activities:	Real estate development Rental and operating of own or leased real estate (EMTAK 6820) Real estate agencies (EMTAK 6831) Management of real estate on a fee or contract basis (EMTAK 6832)
Supervisory board:	Hillar-Peeter Luitsalu, Rain Lõhmus, Allar Niinepuu, Kert Keskpaik, Steven Yaroslav Gorelik
Management board:	Tarmo Sild
Auditor:	AS PricewaterhouseCoopers

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MANAGEMENT REPORT

Group CEO's overview

2018 brought significant strategic change.

The Group could not make its brokerage and valuation services business profitable and decided to sell it and turn it into a franchise model across all countries, while keeping the ownership of Arco Vara trademark, databases and the underlying software. The expectation for 2019 and longer future is that the licensed services business will generate turnover-based fee income for the Group. At the core, the Group will focus only on real estate development in Estonia and Bulgaria.

As the management promised a year ago, the Group has two ongoing development projects with cranes up, and continues acceleration, if prevailing market conditions allow. The Group's equity of 13 million euros is split between five major projects, all of which look promising.

Kodulahe phase I development with 130 units was sold out at what looks in retrospect a very good 20% ROE per annum since land acquisition in 2013. Kodulahe phase II development with 68 units is under construction and presale had crossed 60% threshold by year's end, so we can expect full sell-out by 2019 year's end when construction will become completed. It is likely that the Group will commence construction of Kodulahe phase III already before completion phase II.

Iztok Parkside development works were practically finished and settled by year's end but delays in Bulgarian public administration will last well into 2019 and have postponed obtaining the permission of usage, which in turn has postponed the delivery of apartments to customers. The problem lies beneath a section of the access street where the land belongs to several public authorities, who must complete transfer of land ownership to Sofia municipality. While we remain certain that the administrative problem becomes resolved during 2019, we have underestimated the time expense, and that diminished greatly our 2018 results. Presale of 67 units at year's end stood at 2/3 and we expect to have full sell-out by 2019 year's end at the latest.

Madrid Blvd building became fully occupied during the year and also became a cash generating entity in the Group. The loan interest expenses went down. In 2019, we expect further improvement of the situation by connecting the building to public heating network and by having public access via metro station that will be completed within 350 meters in September 2019. Rental apartments in the building, 15 units in total, will be sold out and the Group retains only office and commercial premises, 7350 sqm GLA in total, plus 100 underground parking lots. Expected annual rent income on commercial areas should exceed 800,000 euros.

Also, we expect to commence construction and presale of Botanica Lozen residential district. The design and construction permit preparations reached an advanced stage by December 2018. If the Group will decide to proceed with Stage I in full, then we can expect construction of up to 180 residential units and up to 6000 sqm lettable commercial, educational and recreational areas during 2019-2021 and sale in 2021-2022.

In summary, 2018 ended sooner than we could complete our development targets. Delay is the biggest enemy of Arco Vara, given our relatively small equity that is spread between different development projects. Delay explains also the humble revenue of 6 million Euros and a small loss, against the relatively big balance sheet of 34 million euros. The balance sheet keeps growing, when constructions and presale are ongoing. For 2019 however, we expect to reap both the postponed Iztok fruits of 2018, and the fruits of Kodulahe II. All in all, the expectation can be quantified into a total revenue of more than 20 million Euros and net profit of more than 2 million euros.

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. Until 31 of December 2018, the Group had two business lines: the Service Division and the Development Division.

The Service Division was engaged in real estate brokerage, valuation, management and consulting as well as in short-term investment in residential real estate. The Service Division offered to the Group additional value by generating analytical data on market demand and supply, and behaviour of potential clients. Analytical data allowed making better decisions on real estate development: purchase of land plots, planning and designing, pricing end products, and timing the start of construction.

The Development Division develops complete living environments and commercial real estate. Fully developed housing solutions are sold to the end-consumer. In some cases the Group also develops commercial properties until they start to generate cash flow either for supporting of the Groups' cash flows or for resale. The Group is currently holding completed commercial properties that generate rental income.

Vision and mission

Arco Vara's vision:

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

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

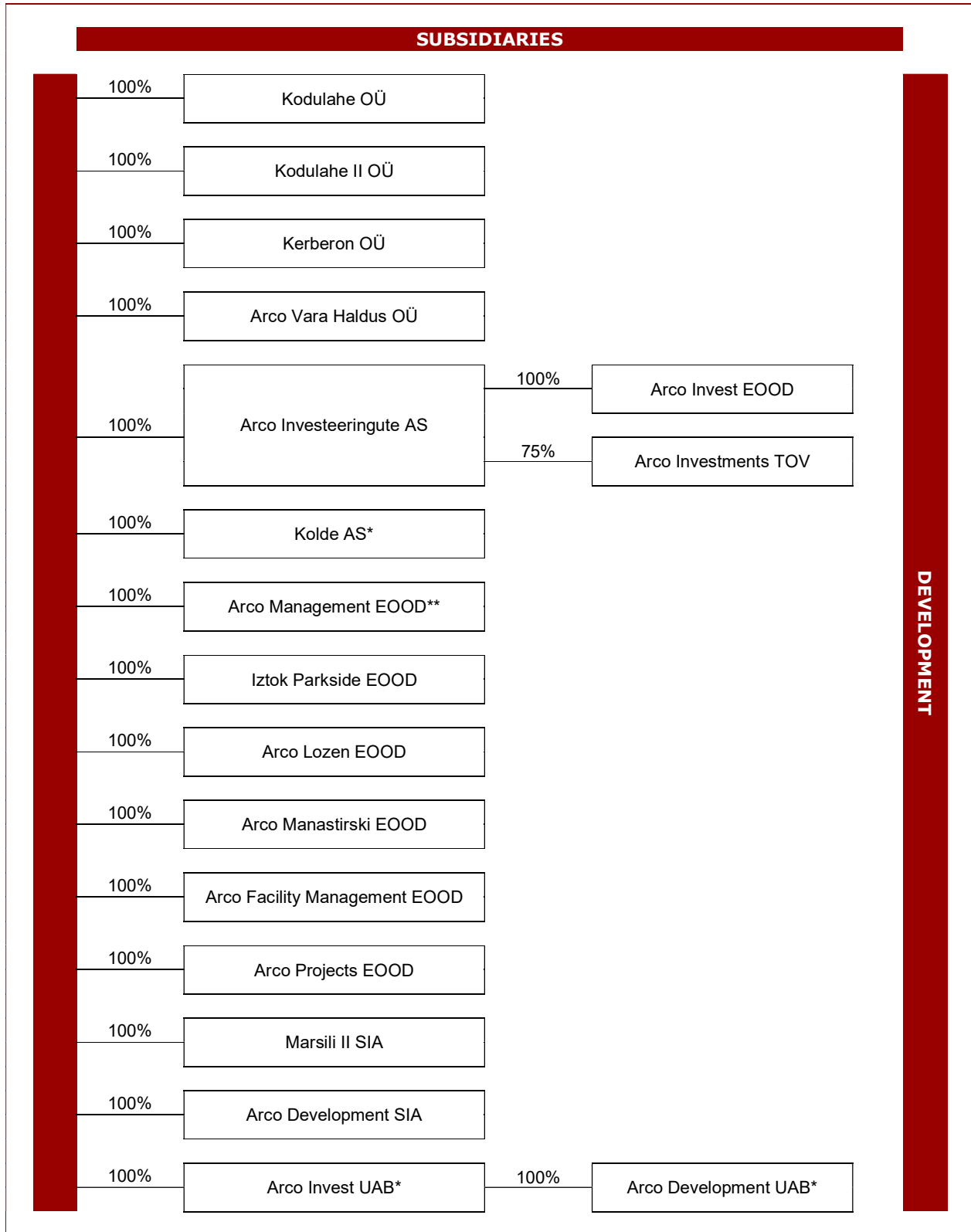
Scope of consolidation

As of 31 December 2018, the Group consisted of 19 companies, which is two less than on 31 December 2017. In 2018, three companies were sold, one was liquidated, one purchased and one established.

Significant subsidiaries

Company name	Location	Segment	Share capital (nominal value)	Equity balance on 31 December 2018	The Group's interest
In thousands of euros					
Arco Invest EOOD	Bulgaria	Development	28,762	-212	100%
Iztok Parkside EOOD	Bulgaria	Development	1,433	500	100%
Arco Lozen EOOD	Bulgaria	Development	2,931	2,734	100%
Kodulahe OÜ	Estonia	Development	3	1,957	100%

Group structure as of 31 December 2018



* In liquidation

** Arco Management EOOD was renamed Arco Vara Bulgaria EOOD on March 25, 2019

Key performance indicators

- In 2018, the Group's revenue together with discontinuing operations was 6.6 million euros, decreasing 2.8 times from 2017. The revenue of the Development Division decreased by 77%, down to 3.6 million euros in 2018. The revenue of the Service Division was 3.3 million euros, increasing by 14% from 2017.
- In 2018, the Group's operating loss (=EBIT) was 0.1 million euros and net loss 0.5 million euros. In 2017, the Group made operating profit of 1.3 and net profit of 0.8 million euros. The Development Division earned operating profit of 0.1 million euros in 2018 (2.0 million euros in 2017). Operating loss of the Service Division was 0.1 million euros in 2018, 0.2 million euros in 2017.
- In 2018, 12 apartments, 3 commercial spaces and 2 land plots were sold in the development projects of the Group (in 2017: 117 apartments, 2 commercial spaces and 6 land plots). Lahepea 7 apartments constituted the largest part of the sales.
- In 2018, the Group's debt burden (net loans) increased by 4.5 million euros up to the level of 14.2 million euros as of 31 December 2018. As of 31 December 2018, the weighted average annual interest rate of interest-bearing liabilities was 5.0%, which is 0.4% lower than on 31 December 2017.

Operations

	2018	2017
In millions of euros		
Revenue		
Development	3.6	15.9
Service	3.3	2.9
Parent company	0.1	0.0
Eliminations	-0.4	-0.5
Total revenue	6.6	18.3
Operating profit/loss (EBIT)		
Development	0.1	2.0
Service	-0.1	-0.2
Parent company income and expenses	-0.2	-0.5
Eliminations	0.1	0.0
Total operating profit/loss (EBIT)	-0.1	1.3
Financial income and expenses	-0.5	-0.5
Net profit/loss	-0.5	0.8

Main ratios

	2018	2017
Earnings per share, EPS (in euros)	-0.06	0.12
Diluted earnings per share (in euros)	-0.06	0.11
Gross profit margin	32.7%	17.1%
ROIC (rolling, four quarters)	-2.1%	3.2%
ROE (rolling, four quarters)	-4.4%	8.8%
ROA (rolling, four quarters)	-1.9%	2.8%

As of 31 December	2018	2017
In millions of euros		
Total assets	33.5	24.3
Invested capital	30.4	21.8
Net loans	14.2	9.7
Equity	13.0	9.8
Equity ratio	38.8%	40.2%
Current ratio	1.25	2.72
Quick ratio	0.19	0.69
Financial leverage	2.58	2.49
Average loan term (in years)	1.2	1.7
Average annual interest rate of loans	5.0%	5.4%
Number of staff, end of period	20	140

Cash flows

	2018	2017
In millions of euros		
Cash flows from/used in operating activities	-3.9	-2.0
Cash flows from/used in investing activities	-3.0	-0.5
Cash flows from/used in financing activities	7.4	3.9
Net cash flows	0.5	1.4
Cash and cash equivalents at the beginning of period	2.2	0.8
Cash and cash equivalents at the end of period	2.3	2.2

Revenue and net profit/loss from operations

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Total 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Total 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Total 2018
In millions of euros															
Revenue	5.1	2.1	1.2	1.3	9.7	1.6	1.0	7.7	8.0	18.3	2.1	1.1	2.1	1.3	6.6
Net profit/loss	1.1	-0.2	-0.4	-1.3	-0.8	-0.3	-0.3	0.6	0.8	0.8	-0.1	-0.3	0.1	-0.2	-0.5

Formulas used:

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

Invested capital = current + non-current interest-bearing loans and borrowings + equity (at the end of period)

Net loans = current + non-current interest-bearing loans and borrowings – cash and cash equivalents – short-term investments in securities (at the end of period)

Gross profit margin = gross profit / revenue

Return on invested capital (ROIC) = net profit of last four quarters / average invested capital

Return on equity (ROE) = net profit of last four quarters / average equity

Return on assets (ROA) = net profit of last four quarters / average total assets

Equity ratio = equity / total assets

Current ratio = current assets / current liabilities

Quick ratio = (current assets - inventory) / current liabilities

Financial leverage = total assets / equity

Number of staff = number of people working for the Group under employment or service contracts

Discontinued operations

Arco Vara AS sold its 100% holdings in its subsidiaries Arco Vara Kinnisvarabüroo AS (subsidiary registered in Estonia) and Arco Imoti EOOD (subsidiary registered in Bulgaria) to the management teams of these subsidiaries as of 31.12.2018. Arco Vara Kinnisvarabüroo AS and Arco Imoti EOOD will continue to operate under Arco Vara trademarks and to use the databases and other intellectual property of Arco Vara under a 5-year license agreement. As a result of the sale of shares, the two companies do not belong to Arco Vara consolidation group from 31.12.2018, but the license fees paid on the basis on sales revenues of both companies will remain to contribute to the revenues of Arco Vara group.

In addition, Arco Vara has started to sell the 15 apartments in the Madrid Blvd building in Sofia, which have so far been kept for offering accommodation service. The proceeds from the sale of apartments will be used to decrease the loan balance associated with the Madrid Blvd building to a level which is necessary for refinancing the existing loan at a lower interest rate during 2019. The activities of two group companies – Arco Projects EOOD (which has offered accommodation service with the apartments) and Arco Facility Management EOOD (which has offered facility management services in Madrid Blvd building) – will be discontinued. Until liquidation, Arco Projects EOOD and Arco Facility Management EOOD will operate as part of the Development Division.

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

From the consolidated group turnover, the Service Division contributed 3.0 million euros (45%) in 2018 and 2.5 million euros (14%) in 2017. As the Service Division has been operating with a small loss in recent periods, its discontinuation will have a slight positive effect on the bottom line of the Group.

Consolidated profit and loss statements for continuing and discontinued operations

	2018			2017		
	Continuing operations	Discontinued operations	Total	Continuing operations	Discontinued operations	Total
In thousands of euros						
Revenue from sale of own real estate	2,778	0	2,778	15,245	0	15,245
Revenue from rendering of services	857	2,997	3,854	519	2,489	3,008
Total revenue	3,635	2,997	6,632	15,764	2,489	18,253
Cost of sales	-2,446	-1,884	-4,330	-13,073	-1,614	-14,687
Gross profit	1,189	1,113	2,302	2,691	875	3,566
Other income	135	108	243	63	27	90
Marketing and distribution expenses	-133	-412	-545	-154	-333	-487
Administrative expenses	-1,224	-875	-2,099	-1,048	-827	-1,875
Other expenses	-87	-89	-176	-60	-14	-74
Gain/loss on revaluation of investment property	14	-6	8	68	0	68
Loss on inventory write-down	-21	0	-21	0	0	0
Gain on sale of subsidiaries	228	0	228	0	0	0
Operating profit	101	-161	-60	1,560	-272	1,288
Finance income and costs	-482	0	-482	-489	0	-489
Profit before tax	-381	-161	-542	1,071	-272	799
Income tax	-1	-1	-2	-4	-10	-14
Net profit/loss	-382	-162	-544	1,067	-282	785
Net profit/loss for the period	-382	-162	-544	1,067	-282	785

Service Division

Unconsolidated revenue of the Service Division amounted to 3,348 thousand euros in 2018, an increase by 14.1% compared to 2017 revenue of 2,935 thousand euros, out of the Group revenue grew 20.4% (2,997 thousand in 2018, 2,489 in 2017).

The main services of the Service Division were real estate brokerage and valuation services through real estate agencies. In 2018, revenue from real estate agencies increased by 20% compared to 2017.

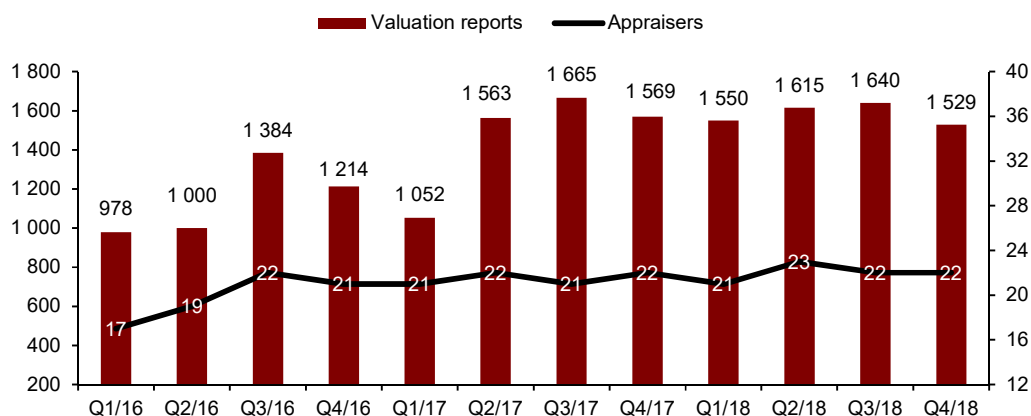
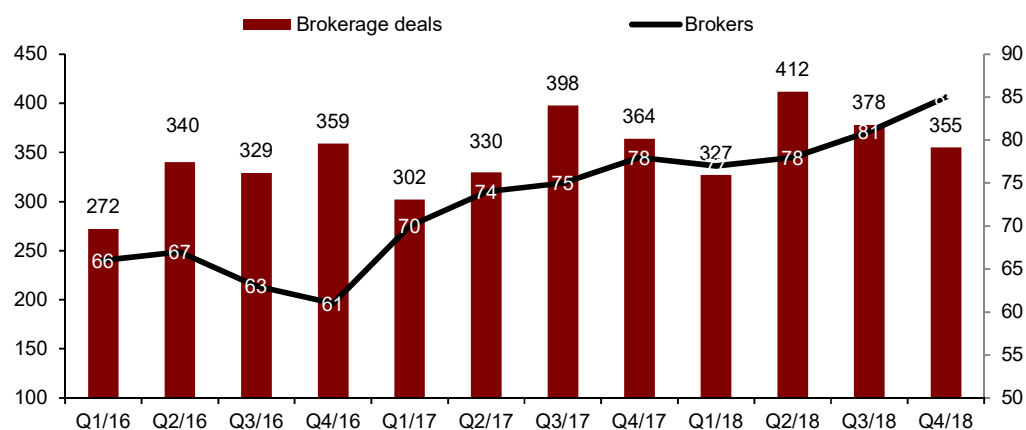
Revenue of real estate agencies from brokerage and valuation

	2018	2017	Change, %
In thousands of euros			
Estonia	2,089	1,793	17%
Bulgaria	1,030	798	29%
Total	3,119	2,591	20%

In 2018, Estonian agency had net loss of 109 thousand euros (in 2017: 235 thousand euros). Bulgarian agency earned net profit of 1 thousand euros in 2018 (in 2017: net loss of 50 thousand euros).

In addition to brokerage and valuation services, the service division also provided real estate management services and accommodation service in Bulgaria. The revenue from real estate management was 47 thousand euros in 2018, 40 thousand euros of which was intra-group revenue (in 2017: 124 thousand and 100 thousand euros, respectively). Revenue from accommodation services amounted to 160 thousand euros in 2018 (in 2017: 182 thousand euros).

The numbers of brokerage transactions and valuation reports of the Service Division, together with the number of staff, in Estonia and Bulgaria combined are shown in the following graphs.



On 30 December 2018, the number of staff in the Service Division was 119, on 31 December 2018 the Service Division was discontinued (on 31 December 2017: 126).

Development Division

The revenue of the Development Division totalled 3,577 thousand euros in 2018 (in 2017: 15,860 thousand euros), including revenue from the sale of properties in the Group's own development projects in the amount of 2,778 thousand euros (in 2017: 15,245 thousand euros).

Most of the other revenue of the Development Division consists of rental income from commercial and office premises in Madrid Blvd building in Sofia, amounting to 586 thousand euros in 2018 (in 2017: 493 thousand euros). By the publishing date of the annual report, all office and commercial spaces together with parking places were rented out.

In 2018, the Development Division had operating profit of 114 thousand euros. In 2017, the Development Division had operating profit of 2 million euros.

Revenue and profitability figures were higher in 2017 due to the completion of most sale agreements for the apartments in Stage I of Kodulahe project. The construction of the apartment building with 125 apartments and 5 commercial areas was finished in Q3 2017. As of 31 December 2018, Kodulahe project Stage I was completely sold.

In 2018, construction works continued for Stage II of Kodulahe project, a building with 68 apartments and 1 commercial space. The project is expected to be finalized by the end of 2019. By the publishing date of the annual report, 51 apartments have been presold.

In 2018, design works for Stages III to V of Kodulahe project started and are scheduled to end in the summer of 2019. The construction of Stage III is planned to begin in the autumn of 2019 and the joint construction of Stages IV and V in 2020. The buildings will be ready for final sale in about 1,5 years after the beginning of construction.

In 2018, preparatory works also continued for Oa street properties in Tartu, where 4 smaller apartment buildings are planned. The construction is planned to start in the summer of 2019.

In Madrid Blvd complex in Sofia, 16 apartments were on sale as of 31.12.2018, out of which 15 apartments had been rented out as accommodation service until late fall. By the date of this report, 7 apartments have been sold and 3 presold. Total expected revenue from the sale of apartments is about 1.8 million euros.

In Iztok Parkside project in Sofia, construction was nearly finished by the end of 2018. By the date of this report, presale agreements for 51 apartments out of 67 have been concluded. We hope to commence final sales in Q2 2019 and sell out the project fully by the end of 2019.

In 2018, Arco Vara acquired land plots in the Lozen project in Bulgaria with total area of 5.3 ha, on 4.7 ha of which the approved detail plan allows construction of buildings, while the remaining 0.6 ha are intended for street infrastructure. The design works started in 2018 and will largely be finished by the end of Q1 2019. The project will include 179 residential units (apartments and houses), commercial spaces and a kindergarten. If market conditions remain favorable, the construction will commence in the second half of 2019, possibly divided into smaller stages. Given the nature of the terrain on a mountain slope, the minimum construction time will be 2 years.

As of 31 December 2018, 4 Marsili residential plots remained unsold in Latvia. During 2018, 2 plots were sold in the project.

As of 31 December 2018, 7 people were employed in the Development Division, which is two more than at the end of 2017.

Summary table of Arco Vara's active projects as of 31 December 2018

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	23
Madrid Blvd	Madrid Blvd, Sofia	Apartments	S5	-	1,501	16
Iztok Parkside	Iztok, Sofia	Apartments	S4	2,470	6,930	67
Marsili residential plots	Marsili, near Riga	Residential plots	S5	6,153	-	4
Kodulahe, Stage 2	Lahepea 9, Tallinn	Apartments	S4	3,686	5,079	69
Kodulahe, Stage 3	Soodi 4, Tallinn	Apartments	S3	3,199	<3,361>	<50>
Kodulahe, Stages 4-5	Pagi 3 and 5, Tallinn	Apartments	S3	7,379	<4,874>	<72>
Paldiski road 74	Paldiski road 74, Tallinn	Apartments	S2	9,525	<9,300>	<123>
Oa street apartments	Oa street 37,39,41, Tartu	Apartments	S3	4,146	<1,950>	<30>
Lozen, 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 2018, 20 people worked for the Group (140 as of 31 December 2017). As of 31 December 2018, 15 persons worked with an employment contract, 4 with a service agreement and 1 with a board member agreement (on 31 December 2017: 77, 62, 1, accordingly). Employee remuneration expenses amounted to 3.0 million euros in 2018 (in 2017: 2.6 million euros).

The remuneration of the member of the management board / CEO, of the Group's parent company including social security charges amounted to 99 thousand euros in 2018 (103 thousand euros in 2017). Remuneration for the members of the Group's supervisory board was 7 thousand euros in 2018 and 17 thousand euros in 2017.

The management board

The management board of Arco Vara AS has one member. Since 22 October 2012, the chief executive officer / member of the management board of Arco Vara AS has been Tarmo Sild. The mandate of the CEO was extended by 3 years (until October 2021) on the supervisory board meeting held in October 2018.

Tarmo Sild graduated from the University of Tartu, faculty of law B.A. in 1998, with further studies in University of Helsinki, faculty of law in 1997-1998 and in Vrije Universiteit Brussel: PILC, LL.M (cum laude) in 1999.

Work experience before joining Arco Vara:

1998 - 2003: Law office HETA, attorney at law and member of the management board;

2003 - 2012: Law office LEXTAL, founder, attorney at law, member of the management board, counsel;

Since 2000: MFV Lootus OÜ, founder, member of the management board;

Since 2008: AS luteCredit Europe, founder, member of the management board.

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

The supervisory board

As of 31 December 2018, the supervisory board of Arco Vara AS consisted of 5 members:

Hillar-Peeter Luitsalu

Mr Luitsalu graduated from the University of Tartu, faculty of law in 1994. In 1993, he joined Arco Vara and since then has been active in different management bodies of Arco Vara group companies. In 1999-2004, Mr Luitsalu was a member of Arco Vara management board. Since 2005, Mr Luitsalu has been member of Arco Vara supervisory board (since 2012, chairman of supervisory board).

Mr Luitsalu is a member of management board of following companies and non-profit organizations outside Arco Vara group: OÜ HM Investeeringud, Loodusvarade Halduse Mittetulundusühing, P457 OÜ, Noah Villas OÜ, TIK Spordimaja OÜ, OÜ Silverpool.

Rain Lõhmus

Mr Lõhmus graduated from Tallinn Technical University with a degree in business administration in 1988. He has extensive work experience in various financial institutions, including Bank of Estonia and AS Hansapank. He is the founder and the largest shareholder of AS LHV Group and member of supervisory board of AS LHV Pank. Mr. Lõhmus is also member of management board of AS Lõhmus Holdings, OÜ Merona Systems, OÜ Umblu Records and Zerospotnrg OÜ. He serves as member of supervisory board of AS LHV Finance, AS LHV Pank, AS LHV Group, AS Hortes, OÜ HA Serv and Kodumaja AS. Mr Lõhmus has served as member of Supervisory Board of Arco Vara AS since 2012.

Allar Niinepuu

Mr Niinepuu graduated from the Estonian Center of Maritime Education as shipmaster in 1992. After two years' work in Estonian Shipping Company, he established his first company AS Kavass in 1994, which was initially involved in shipping consumables business and thereafter acquired and operated local supermarkets in Tallinn. Currently its main activities are providing management services and investing.

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

Steven Yaroslav Gorelik

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

Kert Keskaik

Mr Keskaik graduated from the Tallinn Technical University with a degree in business administration in 2007. Mr Keskaik is member of management board of OÜ K Vara and founder of OÜ A&K Vara. His companies have been active Tallinn Stock Exchange investors since 2000. In 2001, Mr Keskaik founded a skating sports club Spordiklubi Albe Team where he serves as member of management board, and has won multiple Estonian championships in speed skating and inline skating. Mr. Keskaik is also member of management Board of Sporditurg OÜ, Mittetulundusühing Rulluisufestival, One Eleven OÜ, Uisuklubi Albe, Silverticket OÜ, Silverticket SPV OÜ and member of supervisory board of Arco Transport AS.

Description of main risks

Strategic risk

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

For mitigating the risk, the Group: (i) invests equity into different development projects in different markets (in 2018, in Tallinn and Sofia), (ii) monitors current demand and supply in its home markets and (iii) makes efforts to narrow the time between making initial investment and selling the final product – by signing presale agreements with clients, acquiring land without no or delayed equity investment, using different project financing options that don't involve equity.

Credit risk

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

Liquidity and interest rate risks

The base currency of all of the Group's bank loan agreements is euro and the base interest rate is 1, 3 or 6 months EURIBOR. As a result, the Group is exposed to developments on international capital markets. The Group does not use hedging instruments to mitigate its long-term interest rate risk. On 31 December 2018, the Group's interest-bearing liabilities amounted to 17.3 million euros (increased by 5.1 million euros during 2018), out of which 13.4 million euros is due within next 12 months (see also note 21). Group's cash and cash equivalents totalled 2.3 million euros as of 31 December 2018 (as also on 31 December 2017). The Group's weighted average loan interest rate was 5.0% as of 31 December 2018. This is a decrease by 0.4 percentage points compared to the end of year 2017. The reason for the decrease is the new borrowings raised in 2018, which bear a below-average interest rate.

Currency risk

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

Social responsibility

Until 31 December 2018, the main business lines of Arco Vara were real estate development, real estate brokerage and appraisal services. Therefore, our social responsibility has several important dimensions.

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

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

Third and most important aspect is that real estate products developed by the Group will have an effect on the look and usage options of future cities. Therefore, we always consider, beside business aspects, a broader impact of our activities and expect to achieve maximum positive result in following areas:

- detail planning and design of living environment (not only design of an individual building);
- architectural solution as a format that has the most long-term impact on people;
- room planning;
- technological shift, which means that each new development product will be a seedbed for some new technology; we do not make the same things over and over again;

- construction quality and optimization of operating costs, which means that our interest is to develop products with long-lasting value of use that will last from generation to generation.

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

Shares and shareholders

Share price

Arco Vara AS has issued a total of 8,998,367 ordinary shares with nominal value of 0.7 euros per share. The shares are freely traded on NASDAQ Tallinn stock exchange. The share price closed at 1.12 euros on 31 December 2018; the closing price was 1.52 euros on 31 December 2017. During the period, the highest traded price per share was 1.53 euros and the lowest price 1.04 euros. As of 31 December 2018, market capitalization of shares amounted to 10,078 thousand euros and P/B (price to book value) ratio was 0.78 (31 December 2017: 9,891 thousand euros and 1.01, respectively). P/E (price to earnings) ratio of the share was negative on 31 December 2018 and 12.60 on 31 December 2017.

The following charts reflect the movements in the price and daily turnover of Arco Vara’s share in 12 months 2018 and during the last three years.

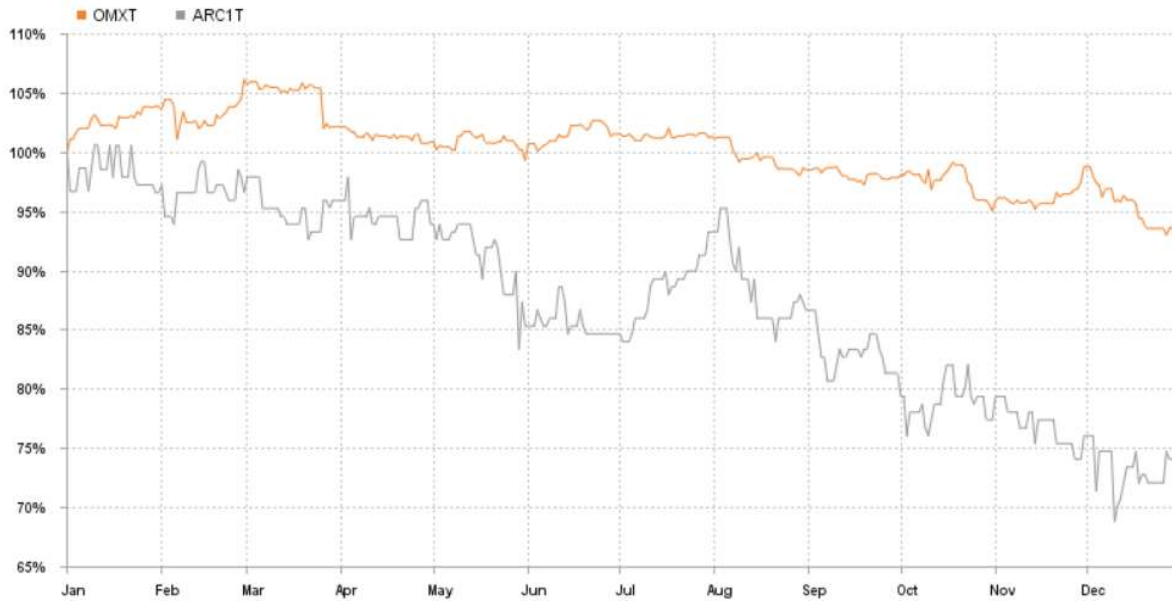
Performance of Arco Vara’s shares in 2018



Performance of Arco Vara’s shares from 31 December 2015 until 31 December 2018



Changes in Arco Vara share price compared with the benchmark index OMX Tallinn in 2018

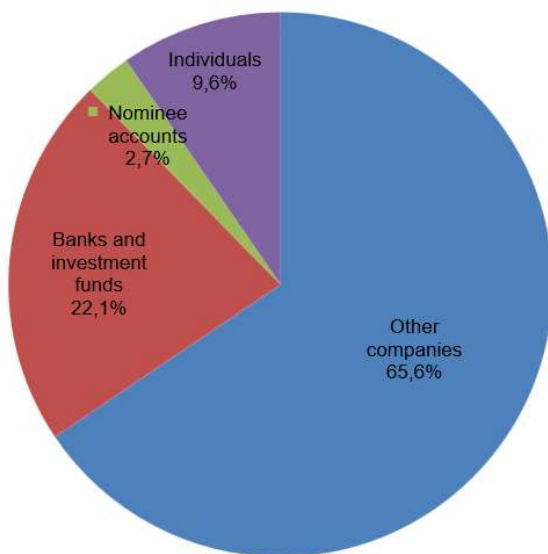


Index/equity	1 Jan 2018	31 Dec 2018	+/-%
OMX Tallinn	1,242.12	1,162.86	-6.38
ARC1T	1.51 EUR	1.12 EUR	-25.89

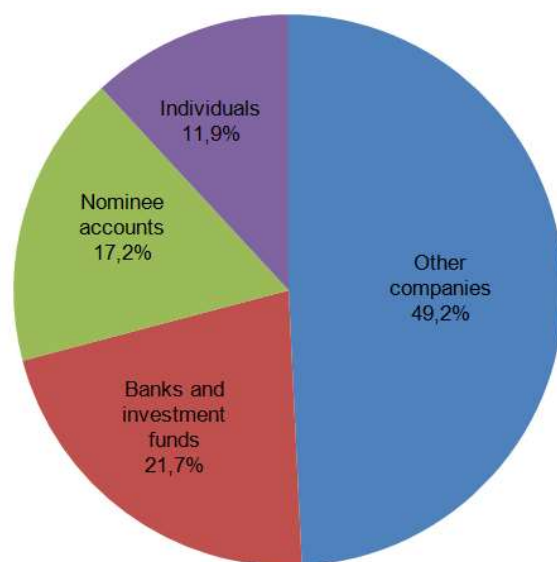
Structure of shareholders

As of 31 December 2018, Arco Vara AS had 1,352 shareholders (on 31 December 2017: 1,403), including 1,164 individuals as shareholders (on 31 December 2017: 1,211 individuals) who jointly owned 9.6% (on 31 December 2017: 11.9%) of the company. Complete shareholder structures are presented on the following diagrams:

Ownership structure as of 31 December 2018



Ownership structure as of 31 December 2017



Major shareholders on 31 December 2018

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

Holdings of management and supervisory board members on 31 December 2018

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

¹ - Steven Yaroslav Gorelik is active as fund manager in three investment funds holding interest in Arco Vara (Firebird Republics Fund Ltd, Firebird Aurora Fund Ltd and Firebird Fund L.P) of 692,750 shares (total of 7.7% interest).

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

Convertible bonds

The Annual General Meeting of Arco Vara AS held on 10.05.2016 decided to issue to the CEO of the parent company of the Group a convertible bond with a nominal value of 1000 euros. The convertible bond entitles its holder to subscribe to up to 390,000 shares of Arco Vara AS for 0.7 euros per share in 2019 as follows:

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

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

CORPORATE GOVERNANCE REPORT

The shares of Arco Vara AS were listed in the main list of the Tallinn Stock Exchange on 21 June 2007. As a listed company, Arco Vara AS 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 2018, one annual and one extraordinary general meeting took place.

Annual general meeting

Notice of the annual general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website on 5 April 2018. The notice was published in the national daily newspaper *Postimees* on 6 April 2018. 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 3 May 2018 from 11:05 a.m. until 11:25 a.m. in Tallinn at Rävåla pst 3, in Cuxhaven meeting room of Radisson Blu Sky Hotel.

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

- approval of the annual report for 2017
- distribution of profit;
- appointment of auditor.

The following decisions were adopted at the annual general meeting:

- To approve the annual report of Arco Vara AS for 2017.
- To distribute the net profit for the year ended on 31 December 2017 in the amount of 784 945 euros as follows:
 - to pay dividends to the shareholders 0.01 euros per share, in the total amount of 89 984 euros. The list of shareholders entitled to dividends shall be fixed on 25 May 2018, as at the end of the working day of Nasdaq CSD Estonian Settlement System. The dividends shall be paid to the shareholders by transfer to the bank account of the shareholders on 31 May 2018.
 - to allocate 694 961 euros to retained earnings.
- To appoint an auditor for two years and appoint PricewaterhouseCoopers AS as the auditor. To pay the auditor for auditing the annual report of Arco Vara AS for 2018 and 2019 according to the agreement concluded between Arco Vara AS and PricewaterhouseCoopers AS.

The meeting was chaired by Evelin Kanter, who is neither the chairman of the Company's Supervisory Board nor a member of the Company's Management Board. The meeting was attended by 19 shareholders whose votes represented 59,87% of total voting power. The meeting was conducted in Estonian and the chairman of the meeting made sure it was conducted smoothly. The meeting was also attended by the member of the Management Board of the Company, Tarmo Sild, who gave an overview of the company's performance in 2017 and the Company's prognosis for the near future. The meeting was also attended by the chairman of the Supervisory Board, Hillar-Peeter Luitsalu and two members of the Supervisory Board, Allar Niinepuu and Kert Keskaik. Two remaining members of the Supervisory Board, Steven Yarsolav Gorelik and Rain Lõhmus were unable to attend the meeting because they were not in Estonia. The auditors did not participate.

The resolutions, minutes and materials of all general meetings held in 2018 were made available on the Company's website. Information on the agenda items of all annual and extraordinary general meetings as well as questions submitted by the shareholders before the meetings and answers to those questions are available online at least until the information on the next general meeting is published on the Company's website.

Management Board

Since 4 September 2009, the Management Board of the Company has had one member. Since 22 October 2012, the CEO (and only member of the Management Board) of the Company is Tarmo Sild. On 11 October 2018, the Supervisory Board

prolonged Tarmo Sild's term of office as the member of the Management Board of the Company by three years, i.e. until 15 October 2021.

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

The service contract sets forth the powers, obligations and responsibilities of the member of the Management Board and also regulates the disbursement of his basic remuneration. Remuneration was agreed taking into account the Management Board member's duties and activities and the Company's current financial performance and future prospects. Under the service contract, Tarmo Sild is entitled to termination benefits equal to up to his five months' basic board member remuneration in case the contract is terminated without a good reason. The Management Board member has an incentive scheme that is linked to the Company's securities in connection with which the shareholders decided on the annual general meeting on 10 May 2016 to increase the share capital of the Company conditionally by issuing one convertible bond with the nominal value of 1000 euros. The convertible bond enables Tarmo Sild to subscribe for 390 thousand ordinary shares of the Company in 2019 for 0.7 euros per share. According to the Supervisory Board decision from 11 October 2018, the member of the Management Board has a right to receive a net bonus of 5% of the Group's audited net profit of the period of 2019 to 2021.

In 2018, the Management Board was paid only remuneration according to the service contract. No bonuses were paid.

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

- AS IuteCredit Europe;
- MFV Lootus OÜ;
- Aia Tänav OÜ;
- Alarmo Kapital OÜ;
- OÜ Catsus;
- Eesti Kaugpüüdjate Liit;
- Eesti Porsche Klubi.

Under the service contract, the member of the Management Board has agreed not to breach the prohibition on competition. Holding certain ownership interests and being involved in the governing bodies of other companies does not constitute breach of the prohibition on competition.

Supervisory Board

The Supervisory Board is responsible for planning and organising the operation of the Company and overseeing the activities of the Management Board. Members of the Supervisory Board of the Company are elected by the general meeting.

Under the CGR, half of the members of the Supervisory Board of a listed company have to be independent. In the event of an odd number of members in the Supervisory Board, the number of independent members may be smaller by one. Company's Supervisory Board meets the CGR's requirement regarding independent members of the Supervisory Board. Allar Niinepuu, Rain Lõhmus, Steven Yaroslav Gorelik and Kert Keskaik are independent members of the Supervisory Board.

In 2018, there were no changes in the composition of the Company's Supervisory Board. During 2018 the composition of the Supervisory Board was the following: Allar Niinepuu, Hillar-Peeter Luitsalu, Rain Lõhmus, Steven Yaroslav Gorelik, Kert Keskaik.

Members of the Supervisory Board elect the chairman of the Supervisory Board from among themselves. Since 10 June 2013, the chairman of the Supervisory Board is Hillar-Peeter Luitsalu.

Since 1 July 2013, the members of the Supervisory Board are paid remuneration in the amount of 500 euros (net amount) for each participated meeting but not more than 1000 euros (net amount) per month. The payment of the remuneration is dependent on the signing of the minutes of the meetings of the Supervisory Board. On 10 February 2015 the general meeting of the Company decided to compensate in reasonable amount the travel expenses of the members of the Supervisory Board connected to the physical participation in the meetings of the Supervisory Board.

In 2018, the Supervisory Board had 3 meetings which were attended by Allar Niinepuu, Hillar-Peeter Luitsalu, Kert Keskaik, Steven Yaroslav Gorelik. Rain Lõhmus did not participate in meetings of the Supervisory Board.

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

The Supervisory Board did not approve any transactions between a member of the Management Board or his affiliated person or a related party and the Company in 2018. No such transactions took place during the year.

Cooperation of the Management and Supervisory Boards

In line with the Company's articles of association and historical practice, the Management and Supervisory Board cooperate closely. The Management and the Supervisory Board hold joint meetings for discussing matters related to the Company's strategy and exchange information about the Company's strategic development on an ongoing basis. At the meetings, the member of the Management Board informs the Supervisory Board about any deviations from the Company's plans and

objectives and the reasons for those deviations. During the period under review, the member of the Management Board attended all meetings of the Supervisory Board.

The members of the Supervisory Board do not take part in everyday management of the Company, but the manager updates the Supervisory Board on regular basis on important issues regarding planning the operations of the Company and business activities. In addition, the Supervisory Board is able to turn to the manager at any time with additional questions and/or inquiries. In information exchange, all parties observe the rules approved by the Supervisory Board for keeping and disclosing inside information, making transactions with Company's shares and segregating the functions of the Management and Supervisory Board. It has become customary that at the meetings of the Supervisory Board, the manager provides the members of the Supervisory Board an overview of important issues and developments related to the Company.

Dividend policy

The dividend policy for 2018 and 2017 was to pay dividends of 1 cent per share per year. General meeting has the right to change the dividend policy.

Disclosure of information

Since the Company's shares were listed on the Tallinn Stock Exchange, the Company has disclosed information in accordance with the rules of the Tallinn Stock Exchange, the laws of the Republic of Estonia, relevant EU regulations and the principle that all shareholders should be treated equally.

The Company discloses information in the information system of the Tallinn Stock Exchange and on its website at www.arcorealestate.com in Estonian and in English. On the website, the information intended for shareholders is in the "Investor Relations" menu. The Company discloses on its website all facts, forecasts and estimates that have been disclosed to financial analysts or other parties. Disclosed information includes inter alia information connected to the general meetings and general information about the Company. General and more specific information about the Company can be found in different menus of the corporate website. The information is logically structured and easy to find.

On the website, the Company has posted its financial calendar in Estonian and in English until April 2020, i.e. until publishing the annual report for 2019.

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 consolidated financial statements of the Company are audited. Annual General Meeting of shareholder appoints the auditor for the next financial year. At the shareholders' meeting on 3 May 2018, AS PricewaterhouseCoopers was appointed as the Company's auditor for the next financial year the seventh time in a row. While choosing the auditor the Company considers the ratio of the auditing price and quality and also professionalism to be important. In addition, it is important for the Company that the auditor is familiar with the Group's two main home markets – therefore existence of a subsidiary office of the auditing company on these markets is a prerequisite.

For better risk assessment and risk management, the Group entities that have active financial activity prepare a budget for the next financial year. The Group's consolidated budget is approved by the Supervisory Board of the Company. Execution of and adherence to approved budgets is monitored by the Company's CFO.

The Company's CFO ensures the high quality of financial reporting. The consolidated financial statements are prepared using uniform group-wide cross-border financial accounting and reporting software. Consolidation procedures have largely been automated and are usually performed quarterly. Monthly reports of different subsidiaries and separate units are prepared and presented to the managers of corresponding units.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of comprehensive income

	Note	2018	2017
In thousands of euros			
CONTINUING OPERATIONS			
Revenue from sale of own real estate		2,778	15,245
Revenue from rendering of services		857	519
Total revenue	7,8	3,635	15,764
Cost of sales	9	-2,446	-13,073
Gross profit		1,189	2,691
Other income	10	135	63
Marketing and distribution expenses	11	-133	-154
Administrative expenses	12	-1,224	-1,048
Other expenses	10	-108	-60
Gain on revaluation of investment property	19	14	68
Gain on sale of subsidiaries		228	0
Operating profit/loss		101	1,560
Finance income and cost	13	-482	-489
Profit/loss before tax		-381	1,071
Income tax		-1	-4
Net profit/loss from continuing operations		-382	1,067
Net profit/loss from discontinued operations	5	-162	-282
Net profit/loss for the period		-544	785
Total comprehensive income/ expense for the period		-544	785
Earnings per share from continuing operations (in euros)			
- basic		-0.04	0.16
- diluted		-0.04	0.15
Earnings per share (in euros)			
- basic	15	-0.06	0.12
- diluted		-0.06	0.11

The notes presented on pages 23 to 56 form an integral part of the consolidated financial statements.

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Consolidated statement of financial position

	Note	31 December 2018	31 December 2017
In thousands of euros			
Cash and cash equivalents	24	2,327	2,284
Financial investments		69	0
Receivables and prepayments	17	739	747
Inventories	18	17,482	8,974
Total current assets		20,617	12,005
Financial investments		0	34
Receivables and prepayments	17	25	18
Investment property	19	12,344	11,299
Property, plant and equipment	20	267	704
Intangible assets	20	262	275
Total non-current assets		12,898	12,330
TOTAL ASSETS		33,515	24,335
Loans and borrowings	21	12,547	1,871
Payables and deferred income	22	3,982	2,507
Provisions		0	38
Total current liabilities		16,529	4,416
Loans and borrowings	22	3,985	10,132
Total non-current liabilities		3,985	10,132
TOTAL LIABILITIES		20,514	14,548
Share capital	23	6,299	4,555
Share premium	23	2,285	292
Statutory capital reserve	23	2,011	2,011
Other reserves	15	245	134
Retained earnings	26	2,161	2,795
Total equity attributable to owners of the parent		13,001	9,787
TOTAL EQUITY		13,001	9,787
TOTAL LIABILITIES AND EQUITY		33,515	24,335

The notes presented on pages 23 to 56 form an integral part of the consolidated financial statements.

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Consolidated statement of cash flows

	Note	2018	2017
In thousands of euros			
Cash receipts from customers		10,993	12,613
Returned prepayments	21	-318	-1,194
Cash paid to suppliers		-13,036	-10,469
Other taxes paid and recovered (net)		-333	-2,165
Cash paid to employees		-1,177	-964
Other cash payments and receipts related to operating activities		-35	217
NET CASH FROM / USED IN OPERATING ACTIVITIES		-3,906	-1,962
Payments made on purchase of tangible and intangible assets		-114	-101
Payments made on purchase and improvement of investment property	10	-584	-370
Proceeds from sale of a subsidiary	6	632	0
Payments made on purchase of a subsidiary	6	-2,939	0
Loans		-12	-7
Repayment of loans		0	4
Other payments related to investing activities		-10	-34
NET CASH FROM/USED IN INVESTING ACTIVITIES		-3,027	-508
Proceeds from loans received	21	6,604	6,719
Settlement of loans and borrowings	21	-2,074	-1,809
Interest paid		-730	-879
Dividends paid	26	-90	-65
Proceeds from share capital increase	23	3,737	0
Other payments related to financing activities		-54	-57
NET CASH FROM/USED IN FINANCING ACTIVITIES		7,393	3,909
NET CASH FLOW		460	1,439
Cash and cash equivalents at beginning of period	24	2,284	845
Change in cash and cash equivalents		460	1,439
Decrease in cash and cash equivalents through sale of subsidiaries	6	-417	0
Cash and cash equivalents at end of period	24	2,327	2,284
Net cash flow from discontinued operations	5	40	48

The notes presented on pages 23 to 56 form an integral part of the consolidated financial statements.

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Consolidated statement of changes in equity

	Equity attributable to owners of the parent					Total equity
	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	
In thousands of euros						
Balance as of 31 December 2016	4,555	292	2,011	52	2,075	8,985
Total comprehensive income for the period	0	0	0	0	785	785
Transactions with owners:	0	0	0	82	-65	17
<i>Dividends paid</i>	0	0	0	0	-65	-65
<i>Formation of other reserves</i>	0	0	0	82	0	82
Balance as at 31 December 2017	4,555	292	2,011	134	2,795	9,787
Balance as of 31 December 2017	4,555	292	2,011	134	2,795	9,787
Total comprehensive income for the period	0	0	0	0	-544	-544
Transactions with owners:	1,744	1,993	0	111	-90	3,758
<i>Increase of share capital</i>	1,744	1,993	0	0	0	3,737
<i>Dividends paid</i>	0	0	0	0	-90	-90
<i>Formation of other reserves</i>	0	0	0	111	0	111
Balance as of 31 December 2018	6,299	2,285	2,011	245	2,161	13,001

Further information on changes in share capital is provided in notes 15, 23 and 26.

The notes presented on pages 23 to 56 form an integral part of the consolidated financial statements.

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Notes to the Consolidated Financial Statements

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Kuupäev/date	4.04.2019
PricewaterhouseCoopers, Tallinn	

1. General information

These consolidated financial statements of Arco Vara AS and its subsidiaries as of and for the year ended on 31 December 2018 were authorised for issue by the chief executive officer / member of the management board on 4 April 2019. 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 Rävåla pst 5, Tallinn, Estonia. As at the end of 2018, 20 people provided services to the Group under the employment or authorization contract (31 December 2017: 140 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 2018 is presented in note 28.

2. Statement of compliance and basis of preparation

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

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

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

Use of accounting estimates and judgements

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

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

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

Classification of real estate

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

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

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

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

Estimation uncertainty

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

Estimation of the net realisable value of inventories

The Group has a number of items of real estate (properties) that have been classified as inventories. The net realisable values of all significant properties classified as inventories were measured as of 31 December 2018 and 31 December 2017

in order to determine whether:

- 1) the net realisable value of any item had decreased below its carrying amount;
- 2) any impairments recognised in prior periods needed to be reversed.

The net realisable values of the properties were measured using the following methods (depending on the asset usage):

- comparison method;
- residual value method;
- evaluation of contractual agreement for sale of an asset.

Valuation methods are described in more detail in notes 4 and 18.

Determination of the fair value of investment properties

On each reporting date, investment properties are measured at their fair values. In addition to management's estimates, where necessary, the fair value of investment properties is measured based on valuation reports issued by independent real estate appraisers. This means that in the case of significant investment properties, where necessary, parallel appraisals are commissioned from independent appraisers. In determining the fair value of its investment properties as of 31 December 2018 and 31 December 2017, the Group did not request valuation reports from independent appraisers. Fair value was mainly determined by using two basic techniques - income method and comparison method. Valuation methods are described in more detail in notes 4 and 19.

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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 2017. The Group has adopted IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments from 1 January 2018. A number of other new standards are effective from 1 January 2018 but they do not have a material effect on the Group's financial statements. The application of IFRS 15 and IFRS 9 did not have any material effect on the Group's financial statements as of 01.01.2018 (see note 4).

4. Significant accounting policies

New accounting pronouncements from 1 January 2018

The following new or revised standards and interpretations are mandatory for the Group's annual periods starting from 1 January 2018.

IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and certain contracts for buying or selling non-financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous IAS 39 categories for financial assets held to maturity, loans and receivables and financial assets available for sale. Under IFRS 9, on initial recognition, a financial asset is classified as measured at either (a) amortised cost, or (b) fair value with changes recognised in other comprehensive income, such as for debt and equity instruments; or (c) fair value with changes recognised in profit or loss

The following table explains the measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Group's financial assets as of 1 January 2018.

	Measurement category		Carrying amount (In thousands of euros)	
	Original (IAS 39)	New (IFRS 9)	Original	New
Financial assets				
Cash and cash equivalents	Amortised cost	Amortised cost	2,284	2,284
Receivables	Amortised cost	Amortised cost	765	765
Investments	Fair value change through profit and loss	Fair value change through profit and loss	34	34

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model applies to financial assets measured at amortised cost and to financial assets recorded at fair value with changes recognised in

other comprehensive income, but not to investments in equity instruments. Under IFRS 9, credit losses are recognised earlier than under IAS 39.

For assets in the scope of the IFRS 9 impairment model, impairment losses are generally expected to increase and become more volatile. The Group has valued expected impairment loss as of 1 January 2018 and according to valuation, impairment losses are not substantially higher than losses recognised under IAS 39 as of 31 December 2017.

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied without restating comparative figures; impact on adoption has been recorded in initial balance sheet as of 1 January 2018. Figures as of 31 January 2017 are recorded under IAS 39.

IFRS 15 Revenue from contracts with customers

The Group has adopted IFRS 15 using modified retrospective approach which requires that the cumulative effect of initially applying this standard is recognised in retained earnings at the date of initial application (i.e. 1 January 2018) and the information presented for 2017 is recognised, as previously reported, under IAS 18, IAS 11 and related interpretations. There was no material impact of adoption of IFRS 15 to the retained earnings as of 1 January 2018, therefore no adjustments to the reports have been made.

Under the new standard, revenue is recognised when a customer obtains control of the goods or services and the revenue is recorded in the transaction price. The goods and services sold together, which are distinguishable, must be recognized separately, and the price reductions provided by the contract price should as a rule be allocated to separate items. If, for certain reasons, the consideration received may change, the minimum amount of revenue is recognized unless there is a significant risk of cancellation / repayment. Costs incurred to secure customer contracts must be capitalized and depreciated over the period in which the contract generates revenue. The Group assessed the impact of the new standard on the financial statements. The Group's revenues arise mainly from the sale, brokerage and rental of real estate, the time and principles of do not differ from the previous accounting policies, and therefore the management estimates that there is no significant impact on the financial statements.

IFRS 15 Revenue from contracts with customers - amendments

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

Reclassification of investment property - IAS 40 amendments

The amendment clarified that to transfer assets into, or from, investment properties there must be a change in use. This change must be supported by evidence; a change in intention, in isolation, is not enough to support a transfer. The Group's management assesses that there is no significant impact to its financial statements.

The management estimates that other new or revised standards or interpretations that are mandatory for the Group's annual periods beginning on or after 1 January 2018 have not had a material impact on the Group.

New accounting pronouncements after 1 January 2019

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2019, which the Group has not adopted earlier:

IFRS 16 Leases

The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

As a result of these amendments, the total amount of assets and liabilities in the balance sheet as of 01.01.2019 will increase by 26 thousand euros.

Changes in the conceptual framework for financial reporting (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the European Union).

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.

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Definition of materiality - Amendments to IAS 1 and IAS 8 (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the European Union).

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.

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

Business combinations and basis of consolidation

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

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

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

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

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

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

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

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

Segment reporting

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

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

Unrealised profits and losses which arise within the Group from transactions performed between its segments are not allocated to any segment but are reported as eliminations of inter-segment profits and losses. Unrealised profits and losses

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that arise from transactions between the Group's head office and the segments and which can be allocated to a segment on a reasonable basis are included in the segment's operating profit.

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

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

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

Foreign currency transactions

All group entities prepare their financial statements in the currency of the primary economic environment in which they operate (their functional currency), i.e. in the local currency. The functional currency of the Group's parent company and Latvian and Estonian subsidiaries is the euro. The presentation currency of the consolidated financial statements is the euro. Foreign currency is any currency other than the functional currency. A transaction in foreign currency is recorded by applying the foreign exchange rate of the European Central Bank ruling at the date of the transaction. Monetary assets (cash, cash equivalents and receivables) and monetary liabilities (loans and borrowings, payables and other monetary liabilities) denominated in foreign currency at the reporting date are retranslated to euros at the exchange rates of the European Central Bank ruling at the reporting date. Foreign exchange gains and losses are recognised in finance income and finance costs respectively in the period in which they arise. A non-monetary item denominated in foreign currency that is measured in terms of historical cost is recorded using the exchange rate of the European Central Bank ruling at the date of the original transaction. A non-monetary item denominated in foreign currency that is measured at fair value is recorded in the functional currency using the exchange rate of the European Central Bank ruling at the date the fair value was determined.

When the functional currency of a subsidiary differs from the parent's functional currency, the financial statements of the subsidiary (in Bulgaria) are translated for consolidation purposes using the central exchange rate of the currency against the euro, which is why translation does not give rise to any significant exchange differences. Bulgaria has pegged its currency to the euro.

Revenue

Accounting policies from 1 January 2018

Revenue is income arising in the course of the Group's ordinary activities. Revenue is measured in the amount of transaction price. Transaction price is the amount of consideration to which the Group expects to be entitled to in exchange of transferring control over promised goods or services to a customer, excluding the amounts collected on behalf of third parties. The Group recognises revenue when it transfers control of a good or service to a customer.

Revenue from sale of real estate

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

Revenue from 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.

Accounting policies until 31 December 2017

Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be measured reliably.

Revenue from the sale of real estate

Sales of real estate (including real estate development projects: buildings, apartments, etc built on properties belonging to Arco Vara group companies) are recognised when all significant risks and rewards related to the properties have been transferred to the buyer and the Group has no obligation to perform significant additional work. In general, a sale is deemed to have occurred when the real right contract (the contract by which title is transferred) has been signed. Payments made by customers before the signature of the real right contract are recognised as deferred income.

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Revenue from the rendering of other services

Revenue from the rendering of other services arises when the service has been rendered. Revenue from brokerage services is recognised when the brokerage transaction has been concluded. Rental income from investment properties is recognised on a straight-line basis over the lease term. Revenue from intermediation of utilities services (payments for electricity, heating, water supply, etc) is offset against the costs of purchasing those services.

Cash and cash equivalents and the statement of cash flows

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

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

Financial assets**Accounting policies from 1 January 2018**Classification

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

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

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

Recognition and derecognition

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

Measurement

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

Debt instruments

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

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

Equity instruments

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

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

Impairment

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

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

The Group measures impairment as follows:

- receivables from purchasers in an amount equal to expected credit losses over lifetime;
- cash and cash equivalents the credit risk of which is assessed to be low during the reporting period (the management considers an investment-grade credit rating by at least one major credit rating agency to prove a low credit risk) in an amount equal to the expected credit losses over 12 months;

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- 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.

Accounting policy until 31 December 2017

Financial assets are classified into different categories and designated to the appropriate category upon initial recognition. The Group's financial assets are loans and receivables.

When a financial asset is recognised initially, it is measured at cost, which is the fair value of the consideration given for it. Acquisition costs are any costs that are directly attributable to the acquisition of the asset, including fees and commissions paid to agents, advisers, brokers and dealers, as well as any non-recoverable levies, taxes and duties.

An ordinary purchase or sale of financial assets is recognised using trade date accounting. The trade date is the date on which the group commits itself to purchase or sell a financial asset (e.g. the date on which the agreement is signed). An ordinary purchase or sale is a purchase or sale of a financial asset with a delivery time that is statutory or customary in the relevant marketplace.

Loans and receivables

After initial recognition, loans and receivables are measured at amortised cost using the effective interest method. The effective interest rate is found for the entire expected life of a financial asset, taking into account any premiums or discounts on acquisition and any directly attributable transaction costs.

If there is objective evidence indicating that an impairment loss on a financial asset carried at amortised cost has been incurred (e.g. significant financial difficulty of the debtor, default or delinquency in settlement, etc), the carrying amount of the financial asset is written down to its recoverable amount. The recoverable amount is the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses on financial assets related to operating activities are charged to other expenses and impairment losses on financial assets related to investing activities are charged to financial expenses. Financial assets that are individually significant are assessed for impairment on an individual basis.

If a receivable that has been written down is collected or any other event occurs which reverses an impairment loss that has been recognised, the reversal is recognised by reducing the line item in the statement of comprehensive income within which the impairment loss was originally recognised.

Interest income on loans and receivables is recognised within financial income.

Inventories

The Group's inventories include mostly land and buildings that have been acquired or are being developed for housing developments. Finished goods and work in progress are initially recognised at their cost of conversion. The cost of conversion includes all direct and indirect production costs incurred in bringing the inventories to their present location and condition. Other inventories are initially recognised at cost, which includes all direct and indirect costs incurred in bringing the inventories to their present location and condition. Indirect costs that are included in the cost of items of real estate classified as inventories include borrowing costs incurred in financing the construction of the assets. Capitalisation of borrowing costs commences when borrowing costs and expenditures for development of inventories have been incurred and development activities have been undertaken. Borrowing costs are capitalised during the active development stage. Capitalisation of borrowing costs ceases when the asset is complete (usually when the building has been granted a permit of use) or its development has been suspended for an extended period.

The cost of inventories is assigned using the weighted average cost formula except when the cost of registered immovable properties and apartments treated as movable properties is assigned by specific identification of their individual costs.

In the statement of financial position, inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Inventory write-downs to net realisable value are recognised in the statement of comprehensive income in cost of sold real estate and services.

Investment property

Investment property is property (land or a building or both) held to earn rental income or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes. In addition, investment property includes properties, which are held over an extended period for an undetermined future use. Properties being constructed or developed for future use as investment properties (commercial buildings) and buildings treated as movable properties (commercial buildings under reconstruction and renovation) are carried as investment properties.

An investment property is measured initially at its cost. Directly attributable transaction costs are included in the initial measurement. Transaction costs that are directly attributable to acquisition include notary's fees, stamp duties, advisors' fees and other transaction costs without which the purchase transaction could probably not have been performed. After initial recognition, investment properties are measured using the fair value model. The fair value of investment property reflects market conditions at the reporting date.

In addition to estimates made by management, the fair value of investment property is determined, where necessary, on the basis of valuations performed by qualified independent appraisers. This means that in the case of significant investment properties valuation reports are also commissioned, if necessary, from independent real estate appraisers. Fair value is determined using the following methods:

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

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

An investment property is derecognised on disposal or when the property is permanently withdrawn from use and no future economic benefits are expected from its disposal. Gains and losses arising from the retirement or disposal of investment property are recognised in profit or loss of the period of retirement or disposal (in other income and other expenses respectively).

Transfers to and from investment property are made when there is a change in use. From the date of transfer, an asset is accounted for using the policies applied to the class of assets to which it has been transferred. For a transfer from investment property to inventories or property, plant and equipment, the property's deemed cost for subsequent accounting is its fair value at the date of transfer.

When an item of property, plant and equipment is transferred to investment property, any positive difference between the fair value and carrying amount of the property at the date of transfer is recognised in the revaluation reserve in equity. Any negative difference is recognised as an impairment loss. When a property is transferred from inventories to investment property, any difference between fair value and carrying amount is recognised in profit or loss, within other income or other expenses as appropriate.

According to the requirements set out in IFRS 13 the fair value measurement methods are the following:

- quoted prices (unadjusted) in an active market for identical assets (Level 1);
- inputs other than quoted prices included within Level 1 that are observable for the asset, directly or indirectly (Level 2);
- unobservable inputs for the asset (Level 3).

Fair value of the Group's investment property is measured using level 3 inputs. Additional information on used estimates is presented in note 19.

Property, plant and equipment

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

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

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

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

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

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

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

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

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

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

Intangible assets

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

Intangible assets are initially measured at cost. Following initial recognition, intangible assets are measured at cost less any accumulated amortisation and any accumulated impairment losses. Accumulated amortization is recognised within administrative expenses and reduction in value within other expenses in the statement of comprehensive income.

Intangible asset classes are assigned the following annual amortisation rates:

- Business software 20–33%

The Group's intangible assets comprise assets with finite useful lives only. Intangible assets with finite useful lives are amortised on a straight-line basis over their estimated useful lives (generally three to five years). Amortisation expense is recognised in profit or loss for the period, in the expense category consistent with the function of the underlying asset. The amortisation periods and amortisation methods of intangible assets with a finite useful life are reviewed at each financial year-end. Changes in the expected useful life of an asset and the pattern in which the asset's future economic benefits are expected to be consumed are accounted for as changes in accounting estimates and are applied prospectively.

Impairment of property, plant and equipment and intangible assets

The Group assesses at each reporting date whether there is any indication that an item of property, plant and equipment or an intangible asset may be impaired. If any such indication exists, the asset's recoverable amount is estimated.

The recoverable amount of an asset is the higher of the fair value of the asset or its cash-generating unit less costs to sell and value in use. In measuring value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped into the smallest identifiable groups that generate cash inflows that are largely independent of the cash inflows from other assets or asset groups (cash-generating units).

An impairment loss is recognised when the carrying amount of an asset or a cash-generating unit exceeds the recoverable amount of that asset or cash-generating unit. Impairment losses are recognised in profit or loss in the period in which they are incurred. The impairment loss for a cash-generating unit is recognised by reducing the carrying amounts of the items of property, plant and equipment or intangible assets belonging to the unit *pro rata*.

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

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Financial liabilities

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

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

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

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

Employee benefits

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

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

Share-based payments

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

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

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

If the share options are exercised by the CEO/member of the management board or key employees, the Group will issue new shares, which will be redeemed by the CEO/member of the management board or key employees for 0.7 euros per share. The fair value of share options accumulated in equity will be transferred to retained earnings at the exercise date.

Provisions and contingent liabilities

A provision is recognised in the statement of financial position only when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Other possible commitments that may transform into obligations under certain circumstances (which have not yet occurred) are disclosed as contingent liabilities in the notes to the consolidated financial statements.

Present obligations arising from past events, which according to management's judgement will not realise or cannot be measured reliably are also disclosed as contingent liabilities.

Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer of the guarantee to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. On initial recognition, a financial guarantee contract is measured at its fair value at the date of issue of the guarantee. After initial recognition, financial guarantee contracts are measured at the higher of: (a) the originally recognised amount less amortisation; and (b) the amount determined as described in the section on measurement of provisions.

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Leases

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

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

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

Statutory capital reserve

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

Income tax

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

Parent company and subsidiaries registered in Estonia

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

Because of the specific nature of the taxation system, deferred income tax liabilities and assets do not arise for companies registered in Estonia. The contingent tax liability reflecting the obligation that would arise on the distribution of retained earnings as dividends is not recognised in the statement of financial position. Maximum possible tax liability in case all retained earnings were distributed is disclosed in note 26.

Bulgarian subsidiaries

In Bulgaria, the profit earned by companies is subject to income tax. The tax rate in Bulgaria is 10% of taxable income. Taxable income is identified by adjusting profit before tax for the temporary and permanent differences permitted by the local tax laws.

In the case of foreign subsidiaries, deferred income tax assets and deferred income tax liabilities are recognised for all temporary differences between the carrying amounts and tax bases of assets and liabilities. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Latvian subsidiaries

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

Investments in subsidiaries and joint ventures in the parent company's unconsolidated primary financial statements presented in accordance with the Estonian Accounting Act

The parent company's unconsolidated primary financial statements (note 29) represent supplementary information that is presented in accordance with the requirements of the Estonian Accounting Act and they do not constitute separate financial statements as defined in IAS 27.

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

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

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

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Discontinued operations in reports

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

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

5. Discontinued operations

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

Consolidated profit and loss statement for discontinued operations

Note	2018	2017
In thousands of euros		
Revenue from rendering of services	2,997	2,489
Total revenue	2,997	2,489
Cost of sales	-1,884	-1,614
Gross profit	1,113	875
Other income	108	27
Marketing and distribution expenses	-412	-333
Administrative expenses	-875	-827
Other expenses	-89	-14
Loss on revaluation of investment property	-6	0
Operating profit/loss	-161	-272
Income tax	-1	-10
Net profit/loss from discontinued operations	-162	-282

Consolidated cashflows of discontinued operations

	2018	2017
In thousands of euros		
Cash from/used in operating activities	64	92
Cash from/used in investing activities	-24	26
Cash from/used in financing activities	0	-70
Net cashflows of discontinued operations	40	48

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6. Acquisition and sale of subsidiaries

Scope of consolidation

As of 31 December 2018, the Group consisted of 19 companies, which is two less than on 31 December 2017. In 2018, three companies were sold, one was liquidated, one purchased and one established. There were no changes in the Group's structure in 2017. The structure of the Group is presented in note 28.

Acquisitions and establishments of subsidiaries in 2018

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

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

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

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

Sale of subsidiaries in 2018

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

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

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

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

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

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

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

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

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

Liquidation of subsidiaries in 2018

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

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7. Segment information

Until the end of 2018, the Group had the following reportable segments:

Service – real estate services: real estate brokerage, valuation, management and short-term investments in real estate;
Development – real estate development: development of residential and commercial environments.

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

External revenue by location

	2018	2017
In thousands of euros		
Estonia	2,858	14,207
Bulgaria	687	1,079
Latvia	90	478
Total revenue	3,635	15,764

External operating profit by location

	2018	2017
In thousands of euros		
Estonia	-91	1,328
Bulgaria	201	261
Latvia	-9	-29
Total revenue	101	1,560

External assets and liabilities by operating segments and by location

Segment	Development		Service		Parent company		Consolidated	
	2018	2017	2018	2017	2018	2017	2018	2017
On 31 December								
In thousands of euros								
Assets	31,563	23,104	-	527	1,952	705	33,515	24,335
Estonia	9,261	7,429	-	263	1,952	705	11,213	8,396
Bulgaria	22,174	15,455	-	264	-	-	22,174	15,719
Latvia	128	220	-	-	-	-	128	220
Liabilities	18,571	12,569	-	457	1,943	1,522	20,514	14,548
Estonia	3,997	1,171	-	190	1,943	1,522	5,940	2,884
Bulgaria	14,574	11,393	-	267	-	-	14,574	11,659
Latvia	0	5	-	-	-	-	0	5

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Notes to the Consolidated Statements of Comprehensive Income

8. Revenue

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

	Estonia		Bulgaria		Latvia		Consolidated	
	2018	2017	2018	2017	2018	2017	2018	2017
In thousands of euros								
Sale of own real estate	2,688	14,203	0	564	90	478	2,778	15,245
Rental of real estate	12	0	586	464	0	0	598	464
Property management services	4	0	81	50	0	0	85	50
Other revenue	0	2	162	1	12	2	174	5
Total revenue	2,704	14,205	829	1,079	102	480	3,635	15,764

9. Cost of sold real estate and services

	2018	2017
In thousands of euros		
Cost of real estate sold (note 18)	-2,071	-12,785
Personnel expenses	-28	0
Property management costs	-292	-199
Other costs	-55	-89
Total cost of sold real estate and services	-2,446	-13,073

10. Other income and expenses

Other income

	2018	2017
In thousands of euros		
Gain on reversal of property, plant and equipment impairment (note 20)	0	3
Received penalties and compensations	133	32
Miscellaneous income	2	28
Total other income	135	63

Other expenses

	2018	2017
In thousands of euros		
Write-down of receivables (note 17)	-13	-3
Write-down of inventory (note 18)	-21	0
Late payment interest and penalty charges	-9	-9
Gifts and donations	-1	-14
Miscellaneous expenses	-64	-34
Total other expenses	-108	-60

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11. Marketing and distribution expenses

	2018	2017
In thousands of euros		
Advertising expenses	-67	-84
Brokerage fees	-10	-11
Other marketing and distribution expenses	-56	-59
Total marketing and distribution expenses	-133	-154

12. Administrative expenses

	2018	2017
In thousands of euros		
Personnel expenses	-640	-585
Office expenses	-96	-89
Services purchased	-110	-108
IT expenses	-182	-126
Depreciation and amortisation	-115	-82
Legal service fees	-48	-20
Vehicle expenses	-16	-15
Other expenses	-17	-23
Total administrative expenses	-1,224	-1,048

13. Finance income and costs

	2018	2017
In thousands of euros		
Interest expense	-433	-443
Other finance income and costs	-49	-46
Total finance income and costs	-482	-489

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 2018, capitalised interest expenses amounted to 277 thousand euros (in 2017: 381 thousand euros).

14. Income tax

	2018	2017
In thousands of euros		
Income tax expense from Bulgarian subsidiaries	-1	-4
Total income tax expense	-1	-4

In 2018, the Group's Bulgarian companies paid 1 thousand euros (in 2017: 4 thousand euros) of income tax on profits.

The Group has off-balance contingent income tax assets in its Bulgarian subsidiaries. The contingent tax assets can be used against the entities' future income tax liabilities. The Group's management estimates that the realisation of these income tax assets is unlikely because the companies which have potential income tax assets will not earn significant profits in the future.

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15. Earnings per share

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the period. Calculations for the number of shares for 2018 take into account that 2,491,355 new shares issued during the latest share offering were registered in the Commercial register on 29 January 2018.

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

	2018	2017
Weighted average number of ordinary shares outstanding during the period	8,807,249	6,507,012
Number of ordinary shares potentially to be issued	590,000	590,000
Net profit/loss attributable to owners of the parent (in thousands of euros)	-544	785
Earnings per share (in euros)	-0.06	0.12
Diluted earnings per share (in euros)	-0.06	0.11

According to the decision of the annual general meeting of Arco Vara AS, held on 30 May 2017, twelve convertible bonds were issued with the nominal value of 500 euros each. The convertible bonds will give to the key employees of the Group the right to subscribe to the total of up to 200 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2020 if the employees still work at the Group at the time and if the net profit for years 2017-2019 combined is at least 5.5 million euros. The Black-Scholes model was used to calculate the fair value of the key employee option, according to which no equity reserve was formed on 31 December 2018.

According to the decision of the annual general meeting of Arco Vara AS, held on 10 May 2016, another convertible bond was issued with the nominal value of 1000 euros. The new convertible bond will give to the CEO of the Group's parent company the right to subscribe to up to 390 thousand ordinary shares of Arco Vara AS for 0.7 euros per share during the year 2019. Calculated fair value of the option provided to the CEO is 0.63 euros per share. The option value is recognised proportionally over 3 years as payroll expense in income statement and as an equity reserve. As of 31 December 2018, an equity reserve in the amount of 245 thousand euros has been formed as the proportionate value of the option, of which 111 thousand euros was expensed in 2018 and 82 thousand in 2017. See also note 27. For calculating the fair value of the CEO's option, Black-Scholes model was used. 72% was calculated for 3-year volatility of Arco Vara's share price, 0% was used as risk-free interest rate and 1 cent per share for expected dividend payment.

16. Operating lease expenses

In the reporting period, the Group used office premises under operating leases.

	2018	2017
In thousands of euros		
Office premises	45	37
Total	45	37

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

As of 31 December	2018	2017
In thousands of euros		
No later than 1 year	48	155
Later than 1 year and no later than 5 years	21	153
Total	69	308

Most of the future lease payables (from non-cancellable operating leases) consist of future lease payments of Arco Vara's head office and Kodulahe's office and showroom.

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Notes to the Consolidated Position of Financial Statement

17. Receivables and prepayments

Short-term receivables and prepayments

As of 31 December	2018	2017
In thousands of euros		
Trade receivables		
Receivables from customers	91	192
Total trade receivables	91	192
Other receivables		
Loans provided	1	3
Miscellaneous receivables	6	6
Total other receivables	7	9
Accrued income		
Prepaid and recoverable taxes	335	163
Other accrued income	17	26
Total accrued income	352	189
Prepayments	289	357
Total short-term receivables and prepayments	739	747

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

Long-term receivables

As of 31 December	2018	2017
In thousands of euros		
Loans provided	5	0
Prepayments	20	18
Total long-term receivables and prepayments	25	18

In 2018, 13 thousand euros of receivables from customers were written off. In 2017, 3 thousand euros of other receivables were written off (see note 10).

18. Inventories

As of 31 December	2018	2017
In thousands of euros		
Properties purchased and being developed for resale	17,467	8,963
Materials and finished goods	15	11
Total inventories	17,482	8,974

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Properties purchased and being developed for resale

	2018	2017
In thousands of euros		
Balance at the beginning of period, 1 January	8,963	14,571
Properties purchased for development	2,943	12
Construction costs of apartment buildings	6,665	6,598
Capitalized borrowing costs	211	351
Inventory write-down (note 10)	-21	0
Other capitalized costs	777	206
Reclassification from/to investment property (note 19)	0	10
Cost of sold properties (note 9)	-2,071	-12,785
Balance at the end of period, 31 December	17,467	8,963

In 2018, the Group wrote down inventories in the amount of 21 thousand euros. In 2017, the Group reversed inventory write-downs in the amount of 13 thousand euros, considering the increase of apartment prices in Sofia during the last 1-2 years.

The Group's management estimates that the Group has inventories realisable during one year in carrying value of 11,687 thousand euros as of 31 December 2018. Inventories in carrying value of 5,780 thousand euros are realisable in a longer period than one year.

For information on inventories pledged as loan collateral, see note 25.

Projects under development, which are classified as inventories, have been measured for the purpose of establishing the need for, and amount of, a write-down using the comparison method or the residual value method. In 2018 as well as in 2017, the value of the Group's inventories was determined by internal experts. Estimates used in valuations are based on real market prices and the Group's recent experience with comparable assets. As of 31 December 2018, inventories in the total amount of 17,276 thousand euros did not require a write-down or reversal of write-down (as of 31 December 2017: 8,727 thousand euros).

As of 31 December	2018	2017
In thousands of euros		
Measured using the residual value method	16,939	8,332
Measured using the comparison method	528	631
Total inventories	17,467	8,963

As of 31 December 2018, the total carrying value of inventories carried at cost was 16,939 thousand euros (on 31 December 2017: 8,347 thousand euros) and total carrying value of inventories measured at net realisable value was 528 thousand euros (on 31 December 2017: 616 thousand euros).

19. Investment property

Investment properties comprise the following types of assets:

- 1) Commercial spaces (including apartments for letting out) earning rental income in multipurpose building in Sofia (total carrying value of 10,918 thousand euros on 31 December 2018, including shops and office spaces in the amount of 8,194 thousand euros).
- 2) Land plots that have a development potential but the future use of which is still uncertain (carrying value of 1,426 thousand euros on 31 December 2018).

	2018	2017
In thousands of euros		
Balance at the beginning of period, 1 January	11,299	10,835
Net profit/loss on changes in fair value	8	68
Capitalised development costs	89	76
Capitalised borrowing costs	66	30
Reclassification from/to inventories (note 18)	0	-10
Reclassification to property, plant and equipment (note 20)	378	0
Purchase of land plots	504	300
Balance at the end of period, 31 December	12,344	11,299

For information on pledged assets, see note 25.

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Changes in fair value of investment property

Valuation of land

Land plots and apartments, which are classified as investment properties, have been valued using comparison method, i.e. specialists have estimated the price for which the assets could be realised within one year by reference to prevailing market prices.

Valuation of commercial and office spaces

Commercial and office spaces of Madrid Blvd building in Sofia have been valued using income method. In 2018, fair value of these assets did not change (in 2017, devaluation loss was 105 thousand euros).

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 2018, the value of these assets increased by 29 thousand euros (in 2017: 173 thousand euros). Apartments are valued using comparison method, they will be sold in the near future in order to decrease loan taken from Piraeus Bank for developing Madrid building. See also note 19.

On 31 December 2018, investment properties with carrying value of 10,761 thousand euros did not require value adjustment (as of 31 December 2017: 1,518 thousand euros). In 2018, the fair value of investment property was increased in the total amount of 8 thousand euros (including a gain of 14 thousand euros on investment property of the continuing operations and a loss of 6 thousand euros on investment property of non-continuing operations). In 2017, the fair value of investment property was decreased in the amount of 68 thousand euros (all of it on investment property of continuing operations). In 2018 and 2017, the values of all of the Group's investment properties were determined by internal experts.

As of 31 December	2018	2017
In thousands of euros		
Measured using the income method	8,194	7,859
Measured using comparison method	4,150	3,440
Total investment property	12,344	11,299

In 2018 as well as in 2017, the exit yield used for valuation of investment properties with the income capitalisation method was 8%, which could be considered as a conservative yield expectation in the current era of low interest rates. Monthly average rental income per m2 from commercial and office areas was 9,5 euros in 2018 and 9,8 euros in 2017.

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

- A change of 5% (+/-) in the forecasted net operating cash flows would increase or reduce the fair value of investment property by 411 thousand euros (in 2017: by 408 thousand euros).
- A decrease of 1% in the exit yields would increase the fair value of investment property by 1,174 thousand euros (in 2017: by 1,166 thousand euros) and an increase of 1% would reduce the fair value by 913 thousand euros (in 2017: by 907 thousand euros).

Operating leases: the Group as a lessor

In 2018, the Group's rental income on investment properties (Madrid Blvd building in Sofia) amounted to 834 thousand euros (in 2017: 717 thousand euros). Rental income increased because more spaces were rented out in 2018 than in 2017. All commercial spaces are being rented out as of the publication date of the annual report.

Direct property management expenses totalled 215 thousand euros in 2017 (in 2017: 262 thousand euros) including expenses in the amount of 12 thousand euros (in 2017: 8 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	2018	2017
In thousands of euros		
Up to 1 year	647	389
2-5 years	387	397
Total	1,034	786

Lease contracts are considered non-cancellable if:

- 1) they have been concluded for a fixed term (with the expiration date in 2019 or later);
- 2) lessee has the right to cancel the contract with 3-6 month notice but only after arrival of fixed date in 2019 or later.

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20. Property, plant and equipment and intangible assets

Property, plant and equipment

	Land and buildings	Office equipment	Total property, plant and equipment
In thousands of euros			
Carrying amount on 31 December 2016	615	103	718
<i>Of which cost</i>	673	220	893
<i>Of which accumulated depreciation</i>	-58	-117	-175
Additions	0	21	21
Reversal of earlier years' impairments (note 10)	3	0	3
Depreciation for the year	-5	-33	-38
Carrying amount on 31 December 2017	613	91	704
<i>Of which cost</i>	677	224	901
<i>Of which accumulated depreciation</i>	-64	-133	-197
Additions	0	15	15
Reclassification to investment property (note 19)	-378	0	-378
Depreciation for the year	-4	-35	-39
PPE of sold subsidiary	0	-35	-35
Carrying amount on 31 December 2018	231	36	267
<i>Of which cost</i>	232	188	420
<i>Of which accumulated depreciation</i>	-1	-152	-153

As of 31.12.2018, the cost of property, plant and equipment that was fully amortized but still in use was 102 thousand euros (on 31 December 2017: 40 thousand euros).

Intangible assets

	Total intangible assets
In thousands of euros	
Carrying amount on 31 December 2016	248
<i>Of which cost</i>	342
<i>Of which accumulated amortisation</i>	-94
Purchases and software development	102
Amortisation for the year	-75
Carrying amount on 31 December 2017	275
<i>Of which cost</i>	444
<i>Of which accumulated amortisation</i>	-169
Purchases and software development	99
Amortisation for the year	-102
Intangible assets of sold subsidiaries	-10
Carrying amount on 31 December 2018	262
<i>Of which cost</i>	507
<i>Of which accumulated amortisation</i>	-245

Intangible assets of the Group consist mainly of Arco Vara business software AVIS in the total amount of 407 thousand euros (out of which 94 thousand euros in 2018 and 96 thousand euros in 2017).

As of 31.12.2018, the cost of intangible assets that was fully amortized but still in use was 69 thousand euros (on 31 December 2017: 24 thousand euros).

For pledged assets, see note 25.

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21. Interest bearing liabilities

Interest bearing liabilities comprise the following items:

	As of 31 December 2018			As of 31 December 2017		
	Total	of which current portion	of which non-current portion	Total	of which current portion	of which non-current portion
In thousands of euros						
Bank loans	14,653	11,995	2,658	10,625	500	10,125
Bonds	1,329	2	1,327	1,127	1,120	7
Finance lease liabilities	0	0	0	1	1	0
Other loans	550	550	0	250	250	0
Total loans and borrowings	16,532	12,547	3,985	12,003	1,871	10,132
Prepayments	810	810	0	265	265	0
Total interest bearing liabilities	17,342	13,357	3,985	12,268	2,136	10,132

In 2018, the Group settled loans and borrowings in the amount of 2,075 thousand euros (in 2017: 8,974 thousand euros) and raised new loans and borrowings in the amount of 6,604 thousand euros (in 2017: 6,719 thousand euros). Additionally, in 2018, interest-bearing prepayments were returned and received in the amount of 265 and 810 thousand euros accordingly, which, together with value added tax, amounted to 318 and 972 thousand euros (in 2017: returned interest bearing prepayments 995 thousand euros, with value added tax amounted to 1,194 thousand euros).

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

The Group's management estimates that carrying amounts of the Group's loans and borrowings do not significantly differ from their fair value. The Group's major interest bearing liabilities are mostly related to Euribor and therefore reflect adequately the situation of current market interest rates.

	Cash and cash equivalents	Bank loans	Bonds	Finance lease liabilities	Other loans	Total
In thousands of euros						
Net loans 31 Dec 2016	845	-12,827	-1,121	-10	-300	-13,413
Annual change	1,439	2,202	-6	9	50	3,694
Net loans 31 Dec 2017	2,284	-10,625	-1,127	-1	-250	-9,719
Annual change	43	-4,028	-202	1	-300	-4,486
Net loans 31 Dec 2018	2,327	-14,653	-1,329	0	-550	-14,205

Changes in loans and borrowings in 2018

In 2018, the following major loan obligations were settled:

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

In 2018, the Group raised the following new loans:

- construction financing bank loan of Iztok Parkside apartment building in the amount of 3,710 thousand euros;
- construction financing bank loan of Kodulahe 2. stage apartment building in the amount of 1,569 thousand euros;
- Arco Vara bonds in the amount of 1,325 thousand euros;
- interest bearing prepayments in the amount of 810 thousand euros.

300 thousand euros of bonds were converted to loan liability.

Changes in loans and borrowings in 2017

In 2017, the following major loan obligations were settled:

- Madrid Blvd project's bank loan in the amount of 455 thousand euros;
- construction financing bank loan of Kodulahe 1. stage apartment building in the amount of 8,421 thousand euros, out of which Arco Vara paid 1,260 thousand euros and 7,161 thousand euros were paid by customers directly to bank.

In 2017, the Group raised the following new loans:

- construction financing bank loan of Iztok Parkside apartment building in the amount of 1,005 thousand euros;
- construction financing bank loan of Kodulahe 1. stage apartment building in the amount of 5,708 thousand euros.

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

Description of the liability	Maturity date (month/year)	Liability amount, in thousands of euros		Interest rate, %		Type of interest rate
		31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	
Bank loan, development	12/2019	7,961	8,570	5.0	5.0	3M Euribor
Bank loan, development	6/2020	5,123	2,055	2.5	2.5	1M Euribor
Bank loan, development	3/2020	1,569	-	3.7	-	6M Euribor
Bonds, development	12/2020	1,325	1,120	12.0	12.0	Fixed
Prepayments, development	12/2019	810	265	6.0	6.0	Fixed
Other loan, land acquisition	12/2019	550	250	12.0	12.0	Fixed
Convertible bonds	3/2020	4	7	5.0	5.0	Fixed
Capital leases	2/2018	-	1	8.1	8.1	Fixed
Total		17,342	12,268			

On 31 December 2018, the weighted average interest rate of interest-bearing liabilities was 5.0% (31 December 2017: 5.4%).

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

As of 31 December	2018	2017
In thousands of euros		
Trade payables	761	261
Miscellaneous payables	0	22
Taxes payable		
Value added tax	12	37
Corporate income tax	4	30
Social security tax	19	48
Personal income tax	11	27
Land tax	0	70
Garbage tax	0	140
Other taxes	2	15
Total taxes payable	48	367
Accrued expenses		
Payables to employees	54	170
Interest payable	31	61
Other accrued expenses	470	900
Total accrued expenses	555	1,131
Deferred income		
Prepayments received on sale of real estate	2,502	695
Guarantee deposits	73	21
Other deferred income	43	10
Total deferred income	2,618	726
Total short-term payables and deferred income	3,982	2,507

As of 31 December 2018, the balance of prepayments received on sale of real estate was significant due to prepayments collected on presale of apartments of Kodulahe 2. stage and Iztok Parkside projects in the amounts of 1,687 and 774 thousand euros; 41 thousand were prepayments for Madrid's former rental apartments. An unpaid invoice from Kodulahe 2. stage main contractor in the amount of 598 thousand euros increased trade payables balance as of 31 December 2018.

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

23. Share capital

As of 31 December	2018	2017
Number of issued shares fully paid up	8,998,367	6,507,012
Share capital (in thousands of euros)	6,299	4,555
Share premium (in thousands of euros)	2,285	292
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.

On 29 January 2018, 2,491,355 new shares issued through a public offering were registered in the Commercial Register. After the share issue, the share capital of Arco Vara AS consists of 8,998,367 shares with a nominal value of 6,299 thousand euros.

As a result of the share issue in January 2018, additional paid-in capital was increased in the amount of 1,993 thousand euros when a total of 3,740 thousand euros was paid for the 2,491,355 shares with nominal value of 0,7 euros each. The 31.12.2017 share premium in the amount of 292 thousand euros was formed during the public share issue held in 2014, when investors bought shares over nominal value of shares.

Under the Commercial Code of the Republic of Estonia, every year a limited liability company has to transfer to the capital reserve at least 5% of its profit for the year until the capital reserve amounts to at least 10% of its share capital. The statutory capital reserve of the Group's parent company is in compliance with the regulatory requirement, amounting to 32% of share capital as of 31 December 2018.

24. Financial instruments and financial risk management

The Group's activities expose it to various financial risks: credit risk, liquidity risk and market risk.

The Group's overall risk management programme is based on the assumption that the financial markets are unpredictable and appropriate measures have to be adopted to minimise potential adverse impacts on the Group's financial activities. The Group has not used derivative financial instruments to hedge certain risk exposures in recent years.

The Group's risk management process is based on the premise that the Group's success depends on constant monitoring, accurate assessment and effective management of risks. Centralised financial risk management is the responsibility of the Group's financial team. The main objective of financial risk management is to prevent any damage or financial loss that could jeopardise the Group's equity and ability to continue operating as a going concern. The Group designs and implements risk management policies and activities that are aimed at identifying and evaluating risks and spreading risks across time, activities and geographical areas. Risk management policies and activities are implemented by the managers of group entities.

In managing its financial risks, the Group's main focus is on monitoring the risk exposures of the Development segment because a significant proportion of the Group's liquidity and interest rate risks are concentrated in one segment, the Development segment, and in two geographical areas, Estonia and Bulgaria.

Credit risk

Credit risk is the risk that the counterparty to a financial instrument will cause a financial loss to the Group by failing to discharge an obligation. The Group's credit risk exposures result from cash placed in bank deposits, and trade and other receivables.

Although cash and cash equivalents are also included in the expected credit loss model of IFRS 9, the impairment recognized was insignificant as of 1 January 2018 and 31 December 2018.

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

As of 31 December	2018	2017
In thousands of euros		
Cash on hand and demand deposits	2,327	2,284
Total cash and cash equivalents	2,327	2,284

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At the end of year 2018, out of the Group's cash and cash equivalents balance, 265 thousand euros (31 December 2017: 332 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 25.

The Group's cash and cash equivalents are held at different banks which reduces credit risk associated with deposits. Credit ratings of 3 banks, where 94% out of group's total cash are deposited, are presented in following table.

Bank or banking group	Bank's share of the Group's cash balance	Standard & Poor's	Moody's
Raiffeisenbank Bulgaria	12.4%	BBB+	A3
Luminor Bank Estonia	16.1%	Not rated	Baa1
LHV Pank AS	65.5%	Not rated	Baa1
Cash in other banks and petty cash	6.0%	-	-

Credit risk is managed mainly by making sure that there are no major concentrations of credit risk. Group entities prevent and minimize credit risk by monitoring and managing customers' settlement behaviour daily so that appropriate measures could be applied on a timely basis. In addition, sales and construction activities are partly financed with customer prepayments and in real estate transactions, where the counterparty is often financed by a credit institution, the Group cooperates with banks. Consequently, the Group considers the total risk arising from customer insolvency to be, in all material respects, mitigated.

Allowances are made for potential losses. Potential losses are estimated based on historical experience, the counterparty's ability to meet existing obligations in the short term, and developments in the economic environment.

Group entities perform transactions only with counterparties who are considered creditworthy. As a rule, a prepayment is demanded. Credit is granted against additional collateral. Accordingly, management believes that the need for additional mitigation of credit risk is minimal.

Other financial assets – trade and other receivables – are also exposed to credit risk. The Group has receivables that are past due but have not been provided for in the amount of 98 thousand euros as of 31 December 2018. Management has estimated the value of such receivables on an individual basis and has determined that the items are recoverable. In addition, due to the nature of the Group's sales, where receivables from sale and lease of own properties are generally collected within a very short period of time, the write-down of receivables based on the principles described above is insignificant as of 31 December 2018 and 1 January 2018 (at the date of application of IFRS 9).

The total amount of financial assets exposed to credit risk was 2,425 thousand euros as of 31 December 2018 (31 December 2017: 2,485 thousand euros).

Financial assets by maturity

By maturity	on 31 December 2018			
	< 3 months	3-12 months	1-2 years	Total
In thousands of euros				
Cash and cash equivalents	2,327	0	0	2,327
Trade and other receivables (note 17)	98	0	0	98
Total	2,425	0	0	2,425
By maturity	on 31 December 2017			
	< 3 months	3-12 months	1-2 years	Total
In thousands of euros				
Cash and cash equivalents	2,284	0	0	2,284
Trade and other receivables (note 17)	201	0	0	201
Total	2,485	0	0	2,485

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.

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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 2018				
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	502	12,855	3,985	17,342
Interest payable	160	441	187	788
Other financial liabilities (trade payables, accrued expenses, excluding liabilities to employees)	1,310	0	0	1,310
Total	1,972	13,296	4,172	19,440
on 31 December 2017				
By maturity	< 3 months	3-12 months	1-5 years	Total
In thousands of euros				
Interest-bearing liabilities	1,886	250	10,132	12,268
Interest payable	157	355	404	916
Other financial liabilities (trade payables, accrued expenses, excluding liabilities to employees)	1,611	0	0	1,611
Total	3,654	605	10,536	14,795

Based on the maturities of liabilities included in the Group's loan portfolio, as of 31 December 2018, the average weighted maturity of the Group's loans and borrowings was 1.2 years (as of 31 December 2017: 1.7 years). For more information on loans and borrowings see also note 21.

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 2018, Euribor interest rates have been negative. Therefore, there is practically no Euribor component in the Group's loans as of 31 December 2018 and also as of 31 December 2017.

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 2018, 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 173 thousand euros (on 31 December 2017: 123 thousand euros).

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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 2018, 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 2018, the share capital of Arco Vara AS was 6,299 thousand euros and net assets were 13,001 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 2018, the equity was not positive in one group entity, which had bank loans, but an agreement has been reached with the bank allowing amendment of this deficiency on condition that all loan obligations are fulfilled according to agreed terms. As of 31 December 2017, 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 2018, total capital amounted to 27,206 thousand euros (on 31 December 2017: 19,506 thousand euros).

The guiding principle in capital management is to safeguard the Group's reliability and sustainable development. The Group finances its operations with both debt and equity capital. Property development is very capital intensive. Therefore, investment projects are financed on the assumption that, as a rule, equity financing should amount to at least 20-30% of the total cost of the investment.

In designing the optimal financing structure and identifying and evaluating risks, the Group monitors its equity to assets ratio. On 31 December 2018, equity accounted for 38.8% (on 31 December 2017: 40.2%) of total assets.

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Other Information

25. Assets pledged as collateral

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

As of 31 December	2018	2017
In thousands of euros		
Cash and cash equivalents	265	332
Receivables ¹	21	0
Inventories	14,109	3,041
Investment property	10,918	10,557
Property, plant and equipment	231	563
Total carrying value of assets pledged as collateral	25,544	14,493

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

Share pledges

Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, has pledged its 100% interest in the subsidiary Arco Invest EOOD to Piraeus Bank. The shares have been pledged to secure investment loan with balance of 7,960 thousand euros as of 31 December 2018 (on 31 December 2017: 8,570 thousand euros).

26. Contingent liabilities

Contingent income tax liability

As of 31 December 2018, the Group's retained earnings amounted to 2,161 thousand euros (on 31 December 2017: 2,795 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 2018 and in 2017, this opportunity was used when paying out dividends to shareholders in the amount of 90 and 65 thousand euros, respectively (0.01 euros per share) without income tax obligation. As of 31.12.2018, Arco Vara could pay dividends in the amount of 1,856 thousand euros without income tax obligation. Upon the payment of all retained earnings in 2019, income tax liability would be 61 thousand euros and the amount to be paid out to shareholders would total 2,100 thousand euros.

Contingent liabilities related to tax authorities

Tax authorities have the right to review the Group's tax records for up to 5 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. Tax authorities have performed narrow scope tax reviews in 2013-2018 only for some of group companies. The management of the Group's parent company believes that there are not any circumstances, which may lead the tax authorities to impose significant additional taxes on group companies.

Contingent liabilities related to buying Lozen land

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

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27. Related party disclosures

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

- 1) companies under the control of the chief executive officer and the members of the supervisory board of Arco Vara AS that have a significant interest in the Group's parent company;
- 2) Other related parties – the chief executive officer and the members of the supervisory board of Arco Vara AS and companies under the control of these persons (excluding companies that have a significant interest in the Group's parent company).

Transactions with related parties

	2018	2017
In thousands of euros		
Companies that have a significant interest in the Group's parent company		
Share capital contribution	2,624	0
Services purchased	21	56
Paid interest	0	12
Other related parties		
Services sold	1	5
Sale of own real estate	0	98
Paid contractual penalty	0	-1

Balances with related parties

As of 31 December	2018	2017
In thousands of euros		
Companies that have a significant interest in the Group's parent company		
Bonds issued	0	100
Other related parties		
Bonds issued	1	1

Significant transactions with related parties in 2018 and 2017

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

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 2018, the remuneration of the CEO, including social security charges amounted to 99 thousand euros (103 thousand euros in 2017). Remuneration of the members of the Group's supervisory board was 7 thousand euros in 2018 and 17 thousand euros in 2017.

The remuneration provided to the CEO is based on his service contract. The termination benefits agreed with Tarmo Sild amount to up to five months' base remuneration. The mandate of the CEO was extended by 3 years (until October 2021) on the supervisory board meeting held in October 2018. According to the resolutions of the general meeting of Arco Vara AS, the members of the supervisory board will receive 500 euros (net amount) for every meeting where they have participated, but not more than 1000 euros (net amount) per month. The payment of the remuneration is dependent on signing of the minutes of the meetings of the supervisory board. Reasonable travel expenses made for participating in the board meetings are also compensated to the members of the supervisory board. The Group's key management personnel have not been granted or received any other remuneration or benefits (bonuses, termination benefits, etc) in the reporting period.

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

In 2018 and 2017, all transactions with related parties have been conducted on market conditions and no receivables from related parties were impaired.

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28. Structure of Arco Vara group

Group	Domicile	Group's ownership interest	
		On 31 December 2018	On 31 December 2017
%			
Development segment			
Subsidiaries			
Arco Investeeringute AS	Estonia	100	100
Kerberon OÜ	Estonia	100	100
Kolde AS	Estonia	100	100
Kodulahe OÜ	Estonia	100	100
Arco Vara Haldus OÜ	Estonia	100	100
Kodulahe II OÜ	Estonia	100	100
Arco Management EOOD	Bulgaria	100	0
Iztok Parkside EOOD	Bulgaria	100	100
Arco Lozen EOOD	Bulgaria	100	0
Arco Invest EOOD*	Bulgaria	100	100
Arco Manastirski EOOD	Bulgaria	100	100
Arco Facility Management EOOD	Bulgaria	100	100
Arco Projects EOOD	Bulgaria	100	100
Marsili II SIA	Latvia	100	100
Arco Development SIA	Latvia	100	100
Arco Invest UAB	Lithuania	100	100
Arco Development UAB*	Lithuania	100	100
Arco Investments TOV*	Ukraine	75	75

* - Interest through a subsidiary

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29. Parent company's unconsolidated primary financial statements

In accordance with the Accounting Act of Estonia, unconsolidated primary financial statements of consolidating unit (parent company) have been disclosed in the notes of the consolidated annual report. The parent company's primary reports are prepared using the same accounting principles and estimation basis used in consolidated financial statements, excluding subsidiaries, which are accounted for in parent company's unconsolidated primary financial statements using cost method.

UNCONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	2018	2017
In thousands of euros		
Revenue from rendering of services	701	306
Other income	1	39
Marketing and distribution expenses	-12	-18
Administrative expenses	-939	-849
Other expenses	-2	-11
Operating profit/loss	-251	-533
Gain on investments in subsidiaries	228	61
Interest income	328	391
Interest expense	-240	-306
Total finance income and costs	316	146
Net profit/loss for the year	65	-387
Total comprehensive income/expense for the year	65	-387

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UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

As of 31 December	2018	2017
In thousands of euros		
Cash and cash equivalents	1,520	381
Investments	69	0
Receivables and prepayments	979	531
Total current assets	2,568	912
Investments into subsidiaries	7,344	5,027
Receivables and prepayments	5,942	5,562
Property, plant and equipment	11	18
Intangible assets	256	256
Total non-current assets	13,553	10,863
TOTAL ASSETS	16,121	11,775
Loans and borrowings	2,293	2,652
Payables and prepayments	185	228
Total current liabilities	2,478	2,880
Loans and borrowings	2,187	1,262
Total non-current liabilities	2,187	1,262
TOTAL LIABILITIES	4,665	4,142
Share capital	6,299	4,555
Share premium	2,285	292
Statutory capital reserve	2,011	2,011
Other reserves	245	134
Retained earnings	616	641
Total equity	11,456	7,633
TOTAL LIABILITIES AND EQUITY	16,121	11,775

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UNCONSOLIDATED STATEMENT OF CASH FLOWS (direct method)

	2018	2017
In thousands of euros		
Cash receipts from customers	536	231
Cash paid to suppliers	-656	-587
Taxes paid and recovered (net)	125	601
Cash paid to employees	-214	-197
Other payments and receipts related to operating activities (net)	-3	1
NET CASH FROM/USED IN OPERATING ACTIVITIES	-212	49
Paid on acquisition of tangible and intangible assets	-105	-87
Paid into share capitals of subsidiaries	-3	-72
Paid on purchase of a subsidiary	-2,938	0
Proceeds from sale of a subsidiary	632	0
Loans provided	-2,122	-987
Repayment of loans provided	1,707	1,013
Dividends received	208	0
Interest received	0	5
NET CASH FROM/USED IN INVESTING ACTIVITIES	-2,621	-128
Proceeds of loans received	1,964	1,286
Settlement of loans and borrowings	-1,508	-646
Proceeds from share capital issue	3,737	0
Dividends paid	-90	-65
Interest paid	-131	-236
NET CASH FROM FINANCING ACTIVITIES	3,972	339
NET CASH FLOW	1,139	260
Cash and cash equivalents at beginning of year	381	121
Change in cash and cash equivalents	1,139	260
Cash and cash equivalents at end of year	1,520	381

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UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total
In thousands of euros						
Balance on 31 December 2016	4,555	292	2,011	52	1,086	7,996
Profit distribution	0	0	0	0	-65	-65
Share capital issue	0	0	0	0	0	0
Formation of other reserves	0	0	0	82	0	82
Net loss for the year	0	0	0	0	-380	-380
Balance on 31 December 2017	4,555	292	2,011	134	641	7,633
Profit distribution	0	0	0	0	-90	-90
Share capital issue	1,744	,1,993	0	0	0	3,737
Formation of other reserves	0	0	0	111	0	111
Net profit for the year	0	0	0	0	65	65
Balance on 31 December 2018	6,299	2,285	2,011	245	616	11,456

Adjusted unconsolidated equity

As of 31 December	2018	2017
In thousands of euros		
Parent company's unconsolidated equity	11,456	7,633
Carrying amount of investments in subsidiaries in the parent company's unconsolidated statement of financial position (-)	-7,344	-5,027
Value of investments in subsidiaries under the equity method (+)	8,889	7,181
Parent company's adjusted unconsolidated equity	13,001	9,787

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STATEMENT BY THE MANAGEMENT BOARD

The member of the management board of Arco Vara AS declares and confirms that according to his best knowledge, the annual accounts for year 2018 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.

4 April 2019



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



Independent auditor's report

To the Shareholders of Arco Vara AS

(Translation of the Estonian original)*

Report on the audit of the consolidated financial statements

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Arco Vara AS and its subsidiaries (together the Group) as at 31 December 2018, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

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

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2018;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

Independence

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

During 2018, we have not provided any non-audit services to the Group.

Our audit approach

Overview



Materiality

Overall group audit materiality is EUR 335 thousand, which represents 1% of the Group's total assets.

Audit scope

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

Key audit matter

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

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

Materiality

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

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

Overall group audit materiality	EUR 335 thousand
How we determined it	1% of total assets
Rationale for the materiality benchmark applied	We have applied this benchmark, as the value of the Group's assets (consisting mainly of inventories and investment properties) is a key performance indicator monitored both internally and externally. Furthermore, we did not consider profit before tax to be suitable as it fluctuates significantly over the years depending on when development projects are sold.



Key audit matter

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

Key audit matter

Valuation of office and commercial spaces in Bulgaria classified as investment property (refer to Note 4 “Significant accounting policies”, Note 2 “Statement of compliance and basis of preparation” and Note 19 “Investment properties” for further details).

As at 31 December 2018, the carrying amount of the Group’s investment property portfolio in Bulgaria, including office and commercial spaces, amounted to EUR 8.2 million.

Investment property is measured at fair value. Fair value of office and commercial spaces in Bulgaria is assessed by the management using income approach.

The valuation technique uses various observable and unobservable inputs such as maximum rentable area, vacancy by property, net rent charge per square meter and capitalisation rates. Reasonableness of the valuation is evaluated by comparison with market data for comparable transactions, if available.

For the purposes of the valuation the management takes into account existing property-specific information, such as current tenancy agreements. However, other inputs are based on future forecasts and assumptions, such as estimated future rental rates, vacancy trends, and capitalisation rates.

The valuation of the Group’s office and commercial premises portfolio in Bulgaria is inherently subjective due to, among other factors, the individual nature, historic performance and the location of property. The results of valuation are sensitive to changes in the inputs used in the valuation model.

Due to the magnitude and related estimation uncertainty, valuation of office and commercial spaces in Bulgaria is considered a key audit matter.

How our audit addressed the key audit matter

We considered the management’s expertise to perform property valuation. We found that the management has sufficient expertise in valuations in the markets in which the Group operates.

We assessed the valuation methodology used by the management and found that the valuation techniques used were in accordance with IFRS requirements.

On a sample basis, we performed detailed testing of the inputs used in the valuation model. For inputs based on existing contracts and regulations (including total rentable space, existing rent charge per square meter, property taxes, etc.) we reconciled them to the underlying contracts and property-specific information.

For inputs based on forecasts and assumptions we assessed their reasonableness by comparing them with historical property-specific data and available market information (including market rents and yields) obtained from the reports of independent real estate advisory companies active in Bulgaria.

It was evident from our work that close attention has been paid to each property’s individual characteristics, as well as considering the overall quality, geographic location and desirability of the property as a whole.

We also read the disclosures provided in respect of fair values of investment properties, including sensitivity analysis, and found that they comply with IFRS requirements. We recalculated sensitivity analysis on key assumptions, such as changes in rental prices and capitalisation rates.

We concluded that the assumptions used in the management’s valuations were supportable in light of available property-specific and market evidence. We noted no material exceptions in respect of valuations or respective disclosures.



How we tailored our audit scope

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

The Group comprises a number of subsidiaries that mostly operate in the Baltics and Bulgaria (refer to Note 28). Based on our risk and materiality assessments, we determined which entities were required to be audited at full scope, taking into account the relative significance of each entity to the Group as a whole and in relation to each material line item in the consolidated financial statements.

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

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

Other information

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

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

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

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

The Management Board is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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



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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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



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

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

We were first appointed as auditors of Arco Vara AS for the financial year ended 31 December 2012. Our appointment has been renewed by a tender and shareholder resolutions in the intermediate years, representing the total period of our uninterrupted engagement appointment for Arco Vara AS of 7 years.

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Tiit Raimla', written in a cursive style.

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

A handwritten signature in blue ink, appearing to read 'Janno Hermanson', written in a cursive style.

Janno Hermanson
Auditor's certificate no.570

4 April 2019

** This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

PROPOSAL FOR DISTRIBUTION OF LOSS

The chief executive officer proposes that the annual general meeting of Arco Vara AS transfer the net loss for the year ended 31 December 2018 of 544 thousand euros to retained earnings.

Retained earnings will amount to 2,161 thousand euros after the transfer of year 2018 net loss.

4 April 2019



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