



Annual report 2012

Arco Vara AS

Annual report

(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year:	1 January 2012
End of financial year:	31 December 2012
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Corporate website:	www.arcorealestate.com
Regional websites:	www.arcovara.ee www.arcoreal.lv www.arcoreal.bg
Core activities:	Construction of buildings (EMTAK 41000) Civil engineering (EMTAK 42000) Specialised construction activities (EMTAK 43000) Real estate activities (EMTAK 6800)
Supervisory board:	Richard Tomingas, Hillar-Peeter Luitsalu, Toomas Tool, Aivar Pilv, Stephan David Balkin, Arvo Nõges, Rain Lõhmus
Management board:	Tarmo Sild
Auditor:	AS PricewaterhouseCoopers

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Directors' report

ARCO VARA GROUP

Arco Vara AS (hereafter also 'the parent company' or 'the Company') and other entities of Arco Vara group (hereafter together 'the group') are engaged in various aspects of the real estate business. The group's three business lines – services, development and construction have been organised into corresponding divisions that provide a broad range of real estate services.

At 31 December 2012, the group comprised the parent company and its 23 subsidiaries (31 December 2011: 27). At the end of 2012, the group had interests in two joint ventures (31 December 2011: 5) and one associate (31 December 2011: 1).

The performance of all divisions is subject to seasonal fluctuations. The transaction volumes of the Service division usually increase in autumn and spring and the Construction division's turnover and the Development division's investment volumes decline in winter.

The Service division is engaged in real estate brokerage, valuation, management and consulting as well as in short-term investment in residential real estate.

The Development division develops complete living environments and commercial real estate. Fully developed housing solutions are sold to the end-consumer. Commercial properties are developed until they start generating cash flow after which they are sold to a real estate fund or another developer. Despite the strategy, the group is currently holding some completed commercial properties that generate rental income because they have not been developed to their full potential.

The Construction division provides general construction and environmental engineering services, operating as a general contractor and construction manager as well as a subcontractor.

The group regards Estonia, Latvia and Bulgaria as its home markets.

Mission, vision and shared values

The **mission** of Arco Vara is to be a comprehensive and valued provider of real estate solutions.

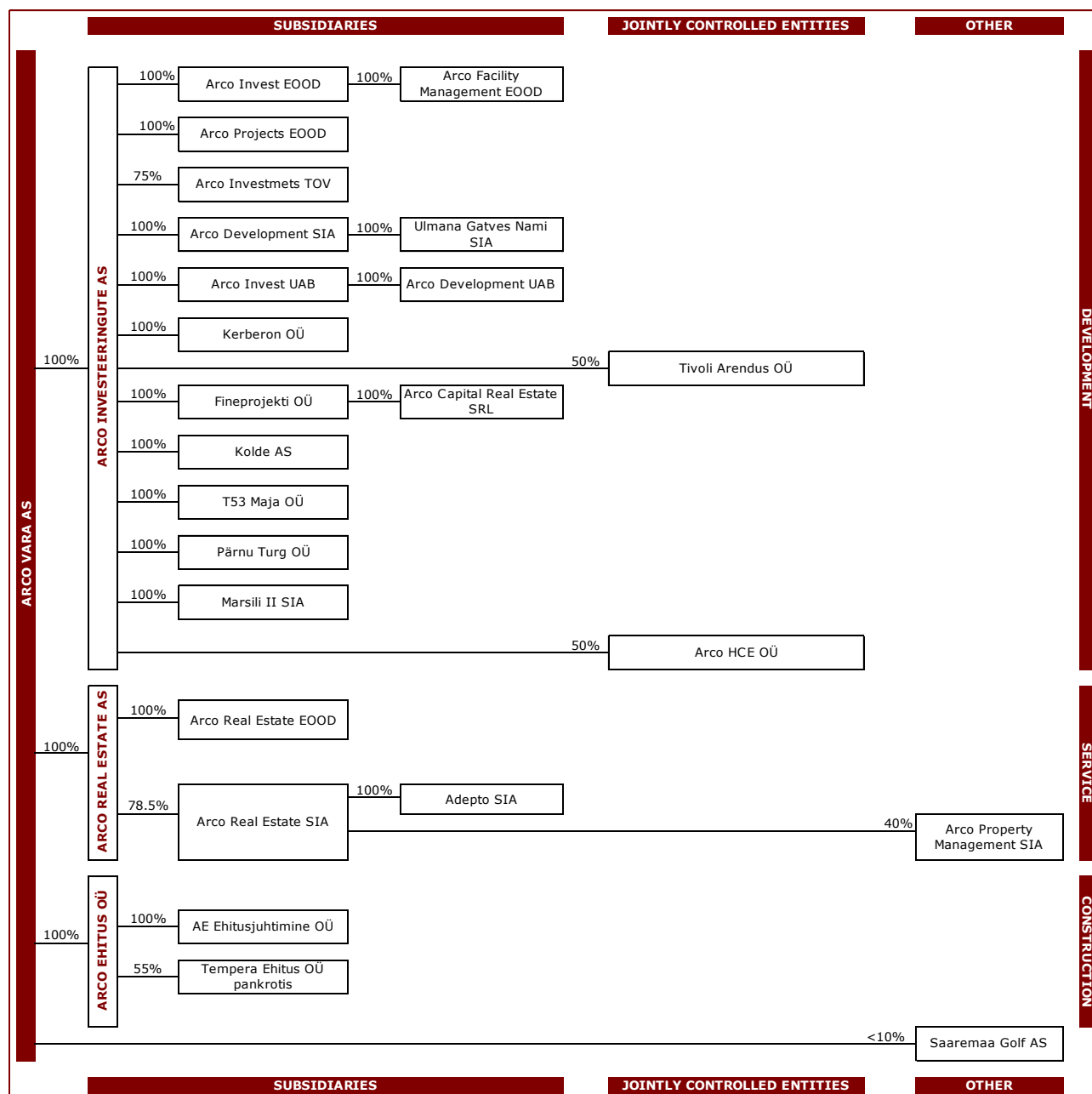
The **vision** of Arco Vara is to become a symbol of real estate.

Arco Vara's **core values** include:

- Partnership – our client is our partner
- Reliability – we are reliable, open and honest
- Professionalism – we deliver quality
- Consideration – we value our clients as individuals
- Responsibility – we keep our promises

GROUP STRUCTURE

As at 31 December 2012



Key performance indicators of Arco Vara group

KEY PERFORMANCE INDICATORS

- Revenue for 2012 was 20.7 million euros. Compared with 2011 when the figure was 43.1 million euros (includes 8.3 million euros from sale of the Tivoli properties to a joint venture), revenue declined by 52%.
- The group ended the year 2012 with an operating loss of 16.1 million euros. In 2011, the group incurred an operating loss of 2.4 million euros.
- Net loss for 2012 was 18 million euros compared with a net loss of 3.4 million euros for 2011.
- The year-end equity to assets ratio was 10.8% (31 December 2011: 37.0%). Return on equity (12 months rolling) was negative.
- At the year-end, the group's order backlog in the construction business stood at 3.4 million euros compared with 11.7 million euros at the end of 2011.
- In 2012, the group sold 81 apartments and plots (2011: 111 apartments and plots) in its own development projects.

	2012	2011
EUR, millions		
Revenue	20.7	43.1
Operating loss	-16.1	-2.4
Net loss	-18.0	-3.4
EPS (in euros)	-3.79	-0.71
Total assets at period-end	31.2	57.2
Invested capital at period-end	21.4	48.8
Net loans at period-end	17.1	22.9
Equity at period-end	3.4	21.2
Average loan term (in years, at period-end) ¹	2.0	2.2
Average interest rate of loans (per year, at period-end)	6.5%	7.4%
ROIC (rolling, four quarters)	neg	neg
ROE (rolling, four quarters)	neg	neg
Number of staff at period-end	86	146

¹ - As at 31 December 2012, the figure has been determined taking into account the amendments to the loan agreements agreed after the reporting date.

FORMULAS USED

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

Invested capital = current interest-bearing liabilities + non-current liabilities + equity (at end of period)

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

Equity to assets ratio = equity at end of period / total assets at end of period

Average equity = past four quarters' equity at end of period / four

Return on equity (ROE) = past four quarters' net profit / average equity

Average invested capital = past four quarters' current interest-bearing liabilities, non-current liabilities and equity / four

Return on invested capital (ROIC) = past four quarters' profit before tax and interest expense / average invested capital

Group chief executive's review

For Arco Vara group, the year 2012 was a period of critical reassessment of the organisation, the operating principles and the underlying assets. The long-term effect of the conclusions made should become evident from 2013 onwards.

Commentary on sales volumes

The only division that increased sales while also generating a profit was the Service division. In particular, the sales of brokerage and valuation services grew thanks to the recovery of the real estate market in Estonia and, to a minor extent, also in Bulgaria and Latvia.

Historically, most of our revenue has resulted from development operations but in recent years relevant volumes have been declining on an annual basis. Partly this is attributable to the corrections that have taken place in the real estate market and partly to the realisation of business risks, which in 2012 put the sustainability of the entire group in jeopardy. Revenue for 2012 was significantly undermined by the suspension of the transfer of apartments in the Manastirski Livadi and Madrid Boulevard projects in Bulgaria, which lasted until the restructuring of the bank loans in February 2013, as well as the suspension of the Bišumuiža apartment development project in Latvia.

The sales volumes of the Construction division decreased because the group was unable to secure new profitable projects. Continuing environmental engineering and infrastructure construction operations is not part of the group's long-term strategy.

Commentary on downsizing

In 2012, we continued optimising our work processes and downscaling unprofitable operations. The most visible outcome was a decrease in the number of staff employed in general management (-31% compared with 2011) and the Construction division (-55%). Headcount also declined in the Development division but mostly on account of shrinkage in development operations. The staff of the Service division did not change significantly.

Commentary on the net result

We ended 2012 with a net loss of 18 million euros. A major share of this (over 16 million euros) resulted from a reassessment of the values of the group's assets and recognition of additional provisions. In 2013 it should become apparent whether the additional provisions of 2.9 million euros will have to be used or whether associated problems have been resolved. Our objective is to end 2013 with an operating profit.

Commentary on the loan burden

In 2012, the group reduced its loan burden considerably. At 31 December 2012, our interest-bearing loans and borrowings totalled 18.8 million compared with 25 million at 31 December 2011. Thus, in 2012 the group decreased its interest-bearing loans and borrowings by 6.2 million euros.

Changes in the composition of the supervisory and management boards of Arco Vara AS

On 30 April 2012, following the resignation of members of the supervisory board Kalev Tanner and Ragnar Meitern, an extraordinary general meeting of Arco Vara AS elected Stephan David Balkin and Toomas Tool as new members of the supervisory board.

On 20 April 2012, member of the supervisory board Aare Tark tendered his resignation. In connection with that, the annual general meeting that convened on 15 May 2012 elected Aivar Pilv as a new member of the supervisory board.

On 30 July 2012, an extraordinary general meeting elected Arvo Nõges and Rain Lõhmus as members of the supervisory board.

On 16 October 2012, the supervisory board resolved to remove member of the management board Lembit Tampere from office and to appoint Tarmo Sild as the new member of the management board.

Other significant events within the group in 2012

On 27 April 2012, Arco Vara AS's wholly-held subsidiary Arco Investeeringute AS sold its 49.4% stake in the joint venture Bišumuižas Nami SIA for 2 euros to the venture partner SIA Linstow Baltic. Through the transaction, the group disposed of its interest in Bišumuižas Nami SIA and SIA Linstow Baltic became the sole shareholder of the entity. The transaction had no significant effect on the group's financial position and financial performance. However, by divesting the interest the group disposed of a potential obligation to support the joint venture in the development of apartment buildings and in servicing loan liabilities. As a result of the transaction, the group's interest in Bišumuižas Nami SIA's subsidiary Sportings Riga SIA also decreased from 49.4% to nil.

On 20 June 2012, group entities Fineprojekti OÜ, Waldrop Investments OÜ, AIP Projekti OÜ and Arco Vara Ärikinnistute OÜ signed a merger agreement. The acquirer in the transaction aimed at streamlining the group's structure and cutting administration costs was Fineprojekti OÜ. The balance sheets of the entities were combined as from 1 January 2012 and the merger was registered at the Commercial Register on 24 July 2012.

On 28 June 2012, group entities Arco Real Estate AS, AS Arco Vara Kinnisvarabüroo and OÜ Koduküla signed a merger agreement. The acquirer in the transaction aimed at streamlining the group's structure and cutting administration costs was Arco Real Estate AS. The balance sheets of the entities were combined as from 1 January 2012 and the merger was registered at the Commercial Register on 17 August 2012.

In June 2012, before the group's present member of the management board/chief executive officer assumed office, 9 cars were sold to a related party (to a company connected with OÜ Baltplast) for 94 thousand euros. According to the assessment of the member of the management board, the transaction was not conducted on market terms.

On 8 August 2012, the group's subsidiary Fineprojekti OÜ divested its 4% stake in Balti Kindlus Kinnisvara OÜ. The transaction was conducted at the nominal value of the interest. The transaction had no significant effect on the group's financial position and financial performance.

Through a transaction finalised on 5 September 2012, the Latvian entity Arco Development SIA in which Arco Vara AS's subsidiary Arco Investeeringute AS had a 70% stake was divided into two companies - Arco Development SIA and Newcom SIA. By the transaction, Newcom SIA acquired some of the assets and liabilities that used to belong to Arco Development SIA. Under the division agreement, Arco Investeeringute AS became the sole owner of Arco Development SIA and the former non-controlling shareholder Viktors Savins became the sole owner of the new entity, Newcom SIA. The transaction was undertaken to allow the non-controlling shareholder exit from the investment in Arco Development SIA. As a result of the division, net assets of the group increased by 212 thousand euros and loan obligations decreased by 620 thousand euros. As a result of the division of assets, the group's stake in Ulmana Gatves Nami SIA increased from 70% to 100% and its stake in Arco Development SIA's joint venture AD Saulkrasti SIA decreased from 35% to nil.

On 30 November 2012, the bank loan of the group's joint venture Arco HCE OÜ fell due. Despite active negotiations with Danske Bank, aimed at extending the loan agreement and continuing development operations, no positive solution was found by the year-end. However, the process has not ended. Arco Vara AS's subsidiary Arco Investeeringute AS has provided a surety guarantee to the joint venture's loan commitments, which extends to 1.9 million euros. The group has covered the obligation by recognising a provision of the same amount. By the date of release of this report, the bank has initiated enforcement proceedings against Arco HCE OÜ, which are currently suspended based on an injunction issued in response to a petition filed by Arco HCE OÜ. Because of an objective change in circumstances, our goal is to exit the project with minimal loss. Exiting the Ahtri 3 project successfully is a key to ensuring the group's sustainability.

On 31 December 2012, a principal payment of 2.4 million euros to be made under a bank loan taken for the Madrid Boulevard project fell due but the group's subsidiary Arco Invest EOOD was not capable of making the payment. Partly, this was because a block transaction that had been agreed with Cleves was cancelled, resulting in unearned revenue of over 2 million euros. In line with the contract, Cleves paid a contractual penalty of 235 thousand euros by the year-end. Consequently, under the terms of the loan agreements the bank had the right to call in the entire loan amount early. In March 2013, Arco Invest EOOD and the bank agreed amendments to the loan agreements according to which out of the total liability of 15.7 million euros 4 million euros is to be repaid in 2013 and 11.7 million euros in 2014-2015. In addition, as a result of the amendments, the interest rate of the loan was lowered by 1.5 percentage points.

REVENUE AND PROFIT

	2012	2011
EUR, millions		
Revenue		
Development	8.6	23.0
Service	2.6	2.4
Construction	9.8	18.1
Eliminations	-0.3	-0.4
Total revenue	20.7	43.1
Operating profit/loss		
Development	-13.9	1.3
Service	0.3	0.1
Construction	-0.3	-2.8
Eliminations	0.0	0.3
Unallocated income and expenses	-2.2	-1.3
Total operating loss	-16.1	-2.4
Interest income and expense	-1.4	-1.4
Other finance income and costs	-0.3	0.2
Income tax expense/income	-0.2	0.2
Net loss	-18.0	-3.4

In 2011, the Development division's revenue was strongly influenced by the sale of inventory of 8.3 million euros to the joint venture Tivoli Arendus OÜ.

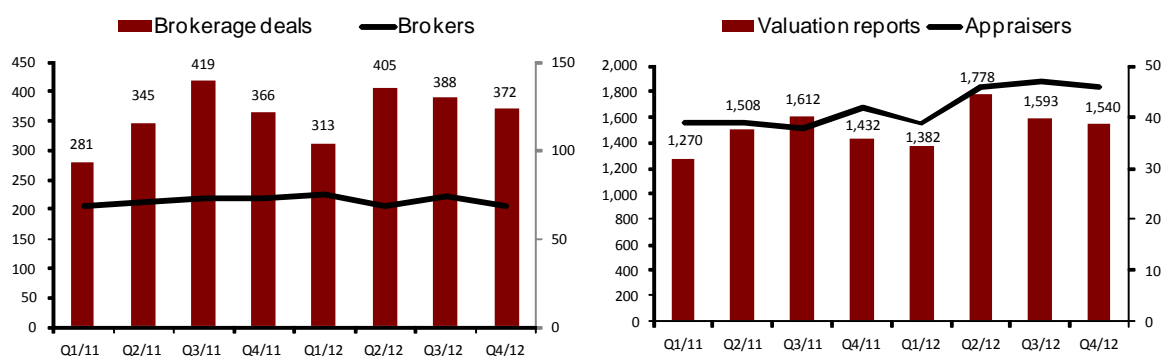
CASH FLOWS

	2012	2011
EUR, millions		
Cash flows from operating activities	2.3	-0.7
Cash flows from investing activities	0.8	0.3
Cash flows from financing activities	-3.5	-1.6
Net cash flow	-0.4	-2.0
Cash and cash equivalents at beginning of year	2.2	4.2
Cash and cash equivalents at end of year	1.8	2.2

In the past two years, the main factor that has caused negative net cash flow is the settlement of bank loans - principal and interest payments totalled 5.9 million euros in 2012 and 8.3 million euros in 2011.

SERVICE DIVISION

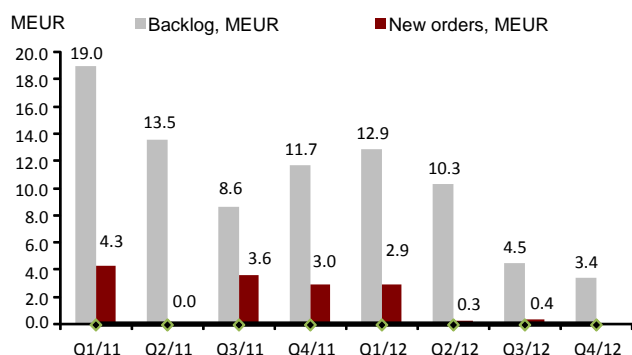
In 2012, the Service division performed better than in the previous year, generating an operating profit of 337 thousand euros (includes exceptional income of 553 thousand euros from a waived loan commitment and expenses of 417 thousand euros from asset write-downs) compared with an operating profit of 140 thousand euros for 2011. Revenue for 2012 was 2,597 thousand euros, 8% up on 2011. The number of brokerage transactions increased by 5% and the number of valuation reports issued grew by 8% year over year. At the same time, the number of brokers decreased by 5% and the number of appraisers increased by 10%. In 2012, the segment's Estonian entities were merged in order to streamline the group's structure and cut administrative expenses.



	2012	2011	Change, %
Number of completed brokerage transactions	1,478	1,411	5%
Number of projects on sale	196	139	41%
Number of valuation reports issued	6,293	5,822	8%
Number of appraisers*	46	42	10%
Number of brokers*	69	73	-5%
Number of staff at end of period	37	45	-18%

* Includes people working under service contracts

CONSTRUCTION DIVISION



The Construction division specialises in environmental engineering and infrastructure construction.

At the end of 2012, the largest contracts in progress were the construction of the Paide wastewater treatment plant (remaining balance 1.8 million euros) and the construction of the Kuusalu public water and wastewater network (remaining balance 1.5 million euros).

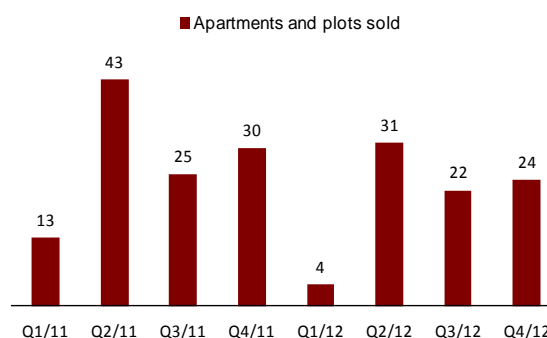
In the end of 2012, the order backlog stood at 3.4 million euros compared with 11.7 million euros at the end of 2011.

At 31 December 2012, the Construction division employed 26 people (31 December 2011: 58).

DEVELOPMENT DIVISION

In 2012, Arco Vara sold 75 apartments and 6 plots in its own development projects: 7 apartments in the Bišumuiža project and 6 plots in the Baltezers project in Latvia and 45 apartments in the Kodukolde project in Estonia. In addition, the group sold 23 apartments in the Manastirski and Madrid projects in Bulgaria.

Phase VI of the Kodukolde development project at Helme 16 in Tallinn, which consists of two apartment buildings with a total of 48 apartments, was completed in June and during the period June to December, 42 of the apartments were sold under real right contracts (final sales). At the end of 2012, the project's inventory comprised 6 unsold apartments and at the date of release of this report the figure is 3.



In the fourth quarter of 2011, Tivoli Arendus OÜ obtained a permit for the construction of six residential buildings. The design and build contract with Nordecon AS was signed in May 2012. On 1 February 2013, Tivoli Arendus OÜ cancelled the contract with Nordecon AS because the counterparty had seriously breached its contractual obligations. At the moment, Tivoli Arendus OÜ is being restructured and its business plan is being revised.

In January 2012, the group obtained a permit for the construction of a residential and commercial building of energy class B called Kastanimaja (Chestnut House) at Tehnika 53 in Tallinn. The work was put out to tender in the first quarter and the construction contract with AS Parmeron was signed in June. According to plan, construction work should be completed within 12 months. Pre-sale of the apartments, which began in May 2012, has been successful: by the year-end 12 of the 14 apartments were covered with contracts under the law of obligations (pre-sale contracts).

In Bulgaria, the construction of phase I of the Manastirski project has been completed. By 31 December 2012, 85% of the 74 apartments were either reserved or sold. In the commercial and residential building Boulevard Residence Madrid in Sofia the division continues to lease out commercial premises, to deliver reserved apartments under real right contracts, and to sell the remaining free apartments.

In the third quarter of 2012, development and construction of apartment buildings in the Bišumuiža 1 project in Latvia was suspended. However, in February 2013 the construction permit was extended and development of the project continued. A building with 14 apartments and a sellable area of 1,149 square metres, which is currently in the stage of interior finishing works, will be completed in May 2013. After that, the last building, also with 14 apartments, will be developed. The outer shell has already been erected. All apartments in the project's previously completed seven buildings have been sold.

In April 2012 we divested our stake in the joint venture Bišumuižas Nami SIA to the venture partner SIA Linstow Baltic. Arco Vara sought possibilities for exiting the project for over a year. Through the transaction, the group disposed of the obligation to support the joint venture in the development of apartment buildings and in servicing loan liabilities. Bišumuižas Nami SIA's loan liabilities totalled 14 million euros.

In July, the group completed merging smaller project companies. Arco Vara Ārikinnistute OÜ, OÜ Waldrop Investments and AIP Projekti OÜ were merged with Fineprojekti OÜ.

Through a transaction finalised in September 2012, the Latvian development entity Arco Development SIA was divided into two companies - Arco Development SIA and Newcom SIA. By the transaction, Newcom SIA acquired some of the assets and liabilities that used to belong to Arco Development SIA. After the division, Arco Investeeringute AS became the sole owner of Arco Development SIA and the former non-controlling shareholder Viktors Savins became the sole owner of the new entity, Newcom SIA. The transaction was undertaken to allow the non-controlling shareholder to exit from the investment in Arco Development SIA.

At the end of 2012, the Development division employed 10 people (31 December 2011: 24).

For further information on our projects, please refer to: www.arcorealestate.com/development.

SUMMARY TABLE OF MAJOR PROJECTS

Project type	Project name	Location	Legal interest	Building rights according to business plan	Current status	Classification in the statement of financial position
Commercial	Ahtri 3	Estonia, Tallinn	50%	48,518 m ²	Building rights have been obtained.	Investments in joint ventures
Project type	Project name	Location	Legal interest	Leasable area	Current status	Classification in the statement of financial position
Cash flow	Madrid	Bulgaria, Sofia	100%	7,350 m ²	Generates cash flow.	Investment property
Cash flow	Pärnu market	Estonia, Pärnu	100%	2,529 m ²	Building rights have been obtained. Generates cash flow.	Investment property
Project type	Project name	Location	Legal interest	Building rights according to business plan	Current status	Classification in the statement of financial position
Apartments	Bišumuiža 1	Latvia, Riga	100%	Unsold: 29 apartments with a total area of 2,365 m ²	Sale and completion of two buildings are under way.	Inventories
Apartments	Hills	Lithuania, Vilnius	100%	6,500 m ²	Building rights have been obtained.	Inventories
Apartments	Kodukolde	Estonia, Tallinn	100%	Area of unsold/unreserved apartments 449.1 m ²	Construction of phase VI was completed in June 2012. Sale is under way.	Inventories
Apartments	Madrid	Bulgaria, Sofia	100%	Area of unsold/unreserved apartments 3,927 m ²	The building is complete, sales continue.	Inventories
Apartments	Manastirski	Bulgaria, Sofia	100%	Area of unsold/unreserved apartments and commercial premises 1,090 m ²	Construction of phase I (Block C) is complete. On sale.	Inventories
Apartments	Paldiski mnt 70c	Estonia, Tallinn	33%	ca 34,000 m ²	Application for initiating the detailed design plan has been filed.	Investment property
Apartments	Tehnika 53	Estonia, Tallinn	100%	Area of unsold/unreserved apartments 187.3 m ²	The apartment building will be completed in summer 2013.	Inventories
Apartments	Tivoli	Estonia, Tallinn	50%	58,470 m ²	The company is being restructured and its business plan is being reviewed/revised.	Investments in joint ventures
Plots	Baltezers-3	Latvia, Riga	100%	68 residential plots with a total area of 120,220 m ²	The plots are being registered. Preparations for construction of phase I infrastructure are under way.	Inventories
Plots	Baltezers-5	Latvia, Riga	100%	Total area of unsold plots 42,254 m ²	Building rights have been obtained. On sale.	Inventories
Plots	Palusambla 1	Estonia, Nõmme	100%	19,773 m ²	The detailed design plan for the formation of 12 plots for one detached building each is in the final phase of adoption.	Inventories
Plots	Pärtli	Estonia, Saue	100%	40 plots, average plot 1,600 m ²	No building rights. The detailed design plan process is under way. Is awaiting the right market situation.	Investment property
Plots	Tooma	Estonia, Saue	100%	47 plots, average plot 1,900 m ²	No building rights. The detailed design plan process is under way. Is awaiting the right market situation.	Investment property
Plots	Vahi	Estonia, Vääna	100%	21 plots, average plot 3,000 m ²	Building rights have been obtained. Construction design documentation has been prepared. Is awaiting the right market situation.	Investment property

PEOPLE

At the end of 2012, the group employed 86 people compared with 146 at the end of 2011. Employee remuneration expenses for 2012 totalled 3.6 million euros. The figure for 2011 was 3.8 million euros.

In 2012, the remuneration of the member of the management board and the members of the supervisory board of the group's parent company including social security charges amounted to 230 thousand euros. In 2011, the corresponding figure was 220 thousand euros.

Since 22 October 2012, the chief executive officer/member of the management board of Arco Vara AS has been Tarmo Sild. The service contract of the former chief executive officer/member of the management board Lembit Tampere was terminated as from the same date. The management board of Arco Vara AS has one member.

Similarly to previous years, in 2012 management upheld all of the group's traditions. Staff events included in a country-wide Arco Vara briefing day, corporate summer days and a Christmas party, as well as the selection of the best employees of the year. For further information on our employees of the year, visit our website at: <http://www.arcovara.ee/en/arco-vara-best-employees>.

In February 2012, Arco Vara celebrated its 20th anniversary with a gala for its staff and business partners. Throughout the year, employees could participate in various training courses aimed at enhancing their professional and management competencies. There is also an induction programme for new employees.

CHARITABLE ACTIVITIES AND SOCIAL RESPONSIBILITY

In 2012 Arco Vara continued to support grassroots and youth sports. Through our partnership with the Estonian Ski Association, we sponsored young skiers Karel Tammjärv and Madis Vaikmaa.

We are also a major sponsor of the non-profit cyclists' club Pro Jalgratturite Klubi that organises grassroots sports events for cyclists. Cycling has always been one of the most popular sports for the group's staff.

Arco Vara endeavours to fulfil its social responsibility by supporting charity and sports events and creating a good work environment for its staff.

SHARE AND SHAREHOLDERS

The Company has issued a total of 4,741,707 shares. At 31 December 2012, the Company had 1,883 shareholders and the share price closed at 1.58 euros, a 23.30% decrease from the previous year-end.

The following charts reflect movements in the price and daily turnover of the Arco Vara share in 2012.

In euros (EUR)



Changes in share price compared with the benchmark index OMX Tallinn in 2012



Index/equity	1 January 2012	31 December 2012	+/-%
—OMX Tallinn	531.17	734.20	+38.22
—ARC1T	EUR 2.06	EUR 1.58	-23.30

Major shareholders at 31 December 2012	Number of shares	Interest, %
OÜ HM INVESTEERINGUD	902,664	19.04%
OÜ TOLETUM	898,878	18.96%
OÜ BALTPLAST	764,000	16.11%
GAMMA HOLDING OÜ	405,105	8.54%
FIREBIRD REPUBLICS FUND LTD	205,064	4.32%
LHV PENSIONIFOND L	187,000	3.94%
Central Securities Depository of Lithuania	160,607	3.39%
FIREBIRD AVRORA FUND, LTD.	106,897	2.25%
FIREBIRD FUND L.P.	86,600	1.83%
Other	1,024,892	21.61%
Total	4,741,707	100.00%

Holdings of members of the management and supervisory boards at 31 December 2012	Position	Number of shares held	Interest, %
Tarmo Sild	member of the management board	0	0%
Richard Tomingas (Toletum OÜ)	chairman of the supervisory board	898,878	18.96%
Hillar-Peeter Luitsalu (HM Investeeringud OÜ, connected persons)	member of the supervisory board	912,171	19.24%
Toomas Tool (OÜ Baltplast)	member of the supervisory board	764,000	16.11%
Stephan David Balkin	member of the supervisory board	0	0%
Aivar Pilv	member of the supervisory board	0	0%
Rain Lõhmus (LHV pension funds M, L, XL)	member of the supervisory board	270,145	5.70%
Arvo Nõges (Gamma Holding OÜ)	member of the supervisory board	405,105	8.54%
Total		3,250,299	68.55%

DESCRIPTION OF THE MAIN RISKS

Credit risk

Credit risk exposure is the greatest at the Construction division. Accordingly, counterparties' settlement behaviour is monitored on an ongoing basis.

Liquidity risk

The group's free funds are placed in overnight or short-term fixed-interest term deposits with the largest banks operating in Estonia. The duration of a term deposit is generally one week. Owing to high refinancing risk, cash flow management is critical. The group's cash and cash equivalents balance is constantly smaller than the balance of loans that require refinancing in the next 12 months. At 31 December 2012, the weighted average duration of interest-bearing liabilities was 2 years; the figure has been determined taking into account the amendments to the loan agreements of the group's Bulgarian subsidiaries, which were agreed after the reporting date. This means that on average all loans need to be refinanced every two years. Although at the end of 2012 the group's cash and cash equivalents totalled 1.8 million euros, 0.9 million euros of this was under the group's own control but the rest was in accounts with restricted withdrawal opportunities (mostly accounts of designated purpose where withdrawal requires the bank's consent). Liquidity and refinancing risks continue to be the most significant risks for the group.

Interest rate risk

The base currency of most of the group's loan agreements is the euro and the base interest rate is 3 or 6 month EURIBOR. As a result, the group is exposed to developments in international capital markets. At the moment, the group does not use derivative financial instruments to hedge its long-term interest rate risk. In 2012, the group's interest-bearing liabilities decreased by 6.2 million euros to 18.8 million euros at 31 December 2012. In 2012, interest payments on interest-bearing liabilities totalled 1.4 million euros. Compared with 2011, the weighted average interest rate decreased from 7.4% to 6.5%, mainly thanks to a decrease in EURIBOR over the past year.

Currency risk

Purchase and sales contracts are mostly signed in local currencies: euros (EUR), Latvian lats (LVL) and Bulgarian leva (BGN). The group is not protected against currency devaluations. Most liquid funds are held in short-term term deposits denominated in 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 the Tallinn Stock Exchange, and its own corporate values:

- Partnership – our client is our partner
- Reliability – we are reliable, open and honest
- Professionalism – we deliver quality
- Consideration – we value our clients as individuals
- Responsibility – we keep our promises

The annual report of Arco Vara AS includes its corporate governance report in which management confirms the Company's compliance with the Corporate Governance Recommendations ('the CGR') of the Tallinn Stock Exchange. Any instances of non-compliance with the CGR are disclosed and explained.

This annual report has been prepared in accordance with the guidance of the CGR. The corporate governance report is a separate section of the directors' report, which is part of the Company's annual report.

I General meeting

The Company's highest governing body is the general meeting of its shareholders.

The powers of the general meeting and the procedure for calling general meetings and passing resolutions are set out in the Company's articles of association.

In 2012, the Company called one annual general meeting and three extraordinary general meetings.

The annual general meeting was held on 15 May 2012 at 9 a.m. at Narva mnt 7c in Tallinn, in the Studio II meeting room of the conference centre of the Park Inn by Radisson Central Hotel.

Notice of the annual general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website on 20 April 2012. For technical reasons, the notice was published in the national daily newspaper *Postimees* one day later, i.e. on 21 April. The notice included information on where materials concerning the general meeting had been made available, where shareholders could submit their questions and a direct link to information on the agenda and relevant documents on the Company's website. The information was published in Estonian and in English.

The proposals of the supervisory board were published in the notice of the annual general meeting and were as follows:

- To approve the annual report for 2011.
- To transfer the net loss for the year ended 31 December 2011 of 3,381,662 euros to retained earnings.

The meeting was chaired by Hannes Vallikivi, who is neither the chairman of the Company's supervisory board nor a member of the Company's management board.

The agenda of the annual general meeting included approving the annual report for 2011, adopting a profit allocation resolution, electing a member of the supervisory board and appointing an auditor for the Company.

On 20 April 2012, Arco Vara AS announced to the Tallinn Stock Exchange that the member of its supervisory board Aare Tark would like to resign and the annual general meeting that convened on 15 May 2012 resolved to elect Aivar Pilv as a new member of the supervisory board.

The meeting was attended by 12 shareholders whose votes represented 62.79% of total voting power. The meeting was conducted in Estonian and the chair of the meeting made sure it was conducted smoothly. The meeting was also attended by the member of the management board of Arco Vara AS, Lembit Tampere, who gave an overview of the company's performance in 2011 and answered the question of a shareholder.

Extraordinary general meetings

The first extraordinary general meeting was held on 10 February 2012 at 9 a.m. at Paadi 5 in Tallinn, in the East Europe A meeting room of the Clarion Hotel Euroopa.

Notice of the extraordinary general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website on 18 January 2012 and in the national daily newspaper *Eesti Päevaleht* on 19 January 2012. The notice included information on where materials concerning the meeting had been made available, where shareholders could submit their questions and a direct link to information on the agenda and relevant documents on the Company's website. The information was published in Estonian and in English.

Two shareholders made proposals to the extraordinary general meeting, which were published in the notice of the extraordinary general meeting and were as follows:

- Proposal by HM Investeeringud OÜ: To elect Arvo Nõges and Stephan David Balkin as additional members of the supervisory board of Arco Vara AS.

- Proposal by Baltplast OÜ: To remove members of the supervisory board Aare Tark, Ragnar Meitern and Kalev Tanner from the supervisory board of Arco Vara AS.

The meeting was chaired by Hannes Vallikivi, who is neither the chairman of the Company's supervisory board nor a member of the Company's management board.

The agenda of the extraordinary general meeting included removing Ragnar Meitern, Aare Tark and Kalev Tanner from the supervisory board of Arco Vara AS and electing Toomas Tool, Aivar Pilv and Stefan David Balkin as new members of the supervisory board of Arco Vara AS.

The meeting was attended by 10 shareholders whose votes represented 63% of total voting power. The meeting was conducted in Estonian and the chair of the meeting made sure it was conducted smoothly. The meeting was also attended by the member of the management board of Arco Vara AS, Lembit Tampere, who provided explanations of the draft resolution.

The second extraordinary general meeting was held on 30 April 2012 at 9 a.m. at Rävåla puistee 3 in Tallinn, in the conference centre of the Radisson Blu Hotel.

Notice of the general meeting was given in the information system of the Tallinn Stock Exchange and on the Company's website at <http://www.arcorealestate.com> on 4 April 2012 and in the national daily newspaper *Eesti Päevaleht* on 5 April 2012. The notice included information on where materials concerning the general meeting had been made available, where shareholders could submit their questions and a direct link to information on the agenda items and relevant documents on the Company's website. The information was published in Estonian and in English. No questions were asked about the agenda items before the meeting.

The meeting was chaired by Hannes Vallikivi, who is neither the chairman of the Company's supervisory board nor a member of the Company's management board.

One shareholder, OÜ Toletum, made a proposal to the extraordinary general meeting, which was published in the notice of the extraordinary general meeting and was as follows:

- To elect Toomas Tool and Stephan David Balkin as members of the supervisory board of Arco Vara AS.

The agenda of the extraordinary general meeting included electing new members in place of members of the supervisory board Kalev Tanner and Ragnar Meitern that had tendered their resignations. Based on the proposal made by the shareholder OÜ Toletum, the meeting resolved to elect Toomas Tool and Stephan David Balkin as members of the supervisory board of Arco Vara AS.

The meeting was attended by 7 shareholders whose votes represented 71.83% of total voting power. The meeting was conducted in Estonian and the chair of the meeting made sure it was conducted smoothly. The meeting was also attended by the member of the management board of Arco Vara AS, Lembit Tampere, who provided explanations of the draft resolution.

The third extraordinary general meeting was held on 30 July 2012 at 9 a.m. at Narva mnt 7c in Tallinn, in the conference centre of the Park Inn by Radisson Central Hotel.

Notice of the general meeting was given in the information system of the Tallinn Stock Exchange on 4 July 2012 and in the national daily newspaper *Eesti Päevaleht* on 5 July 2012. The notice included information on where materials concerning the general meeting had been made available, where shareholders could submit their questions and a direct link to information on the agenda items and relevant documents on the Company's website. No questions were asked about the agenda items before the meeting.

The meeting was chaired by Rolan Jankelevitš, who is neither the chairman of the Company's supervisory board nor a member of the Company's management board.

Calling of the extraordinary general meeting was demanded by the shareholder OÜ HM Investeeringud, which at the date held 20.04% of the share capital of Arco Vara AS and made the following proposal (was taken back on 27 July 2012):

- To elect Margus Kangro and Aivar Pihlak as members of the supervisory board of Arco Vara AS. The new members will assume their powers as of the adoption of the resolution of the general meeting.

The agenda of the extraordinary general meeting, which was held on 30 July 2012, included electing two additional members to the supervisory board of Arco Vara AS. The meeting resolved to elect Rain Lõhmus and Arvo Nõges as members of the supervisory board, effective immediately.

The meeting was attended by 14 shareholders whose votes represented 83.15% of total voting power. The meeting was conducted in Estonian and the chair of the meeting made sure it was conducted smoothly. The meeting was also attended by the member of the management board of Arco Vara AS, Lembit Tampere, who provided explanations of the draft resolution.

The resolutions and minutes of all general meetings held in 2012 as well as other relevant materials 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.

II Management board

Since 4 September 2009 the management board of Arco Vara AS has had one member:

- Lembit Tampere – until 22 October 2012
- Tarmo Sild – from 22 October 2012

When the members of the management board assumed office, service contracts were signed with them. Both contracts were signed for a term of three years. The former member of the management board was not and the present 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 signed with the member of the management board sets forth the powers, obligations and responsibilities of the member of the management board and regulates disbursement of his basic remuneration. Remuneration is 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, in the event of removal without due cause Lembit Tampere was entitled to termination benefits equal to his four months' basic board member remuneration. Under the service contract, Tarmo Sild is entitled to termination benefits equal to his five months' basic board member remuneration. The Company does not have any incentive schemes for members of the management board that are linked to the Company's securities.

In 2012, the remuneration of member of the management board Lembit Tampere (for the period 1 January to 22 October 2012) amounted to 107 thousand euros (includes social security tax) and the remuneration of member of the management board Tarmo Sild (for the period 22 October to 31 December 2012) amounted to 17 thousand euros (includes social security tax). In 2012, members of the management board were not paid any bonuses or termination benefits.

Members of the management board have notified the Company of their interests and involvement in the governing bodies of the following companies that are not part of the group:

- Lembit Tampere – member of the management board of OÜ Alasniidu, OÜ Harku Projektijuhtimine, OÜ Overseas (his powers as member of the management board of OÜ Overseas expired on 28 February 2012) and OÜ Remmelga Aiand.
- Tarmo Sild – member of the management board of AS luteCredit Europe, MFV Lootus OÜ, Aia Tänav OÜ, and Alarmo Kapital OÜ.

Holding certain ownership interests and being involved in the governing bodies of other companies does not constitute breach of the prohibition on competition. Under the service contract, the member of the management board may not breach the prohibition on competition. In addition, the Company's internal regulations provide that no member of the management board or staff may demand or accept for personal gain money or any other benefits from third parties in connection with their work and may not grant unlawful or unjustified benefits or discounts to third parties.

III 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 Arco Vara AS 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 of the supervisory board, the number of independent members may be smaller by one.

In 2012, there were several changes in the composition of the Company's supervisory board. At the beginning of 2012, members of the supervisory board were Richard Tomingas, Hillar-Peeter Luitsalu, Aare Tark, Kalev Tanner and Ragnar Meitern. During the year, the composition of the supervisory board was changed at three general meetings, which took place on 30 April, 15 May and 30 July. From 30 July 2012, the composition of the supervisory board has been as follows: Richard Tomingas, Hillar-Peeter Luitsalu, Aivar Pilv, Toomas Tool, Stephan Balkin, Rain Lõhmus and Arvo Nõges. Richard Tomingas (chairman) and Hillar-Peeter Luitsalu were members of the supervisory board throughout the reporting year.

Members of the supervisory board elect the chairman of the supervisory board from among themselves.

Richard Tomingas has been chairman of the supervisory board since 21 January 2008.

Throughout 2012, the remuneration of a member of the supervisory board was 959 euros per month (the net amount paid). The remuneration was approved by the general meeting with a resolution adopted on 17 December 2009. Members of the supervisory board are not eligible for any additional remuneration or termination benefits and the remuneration of the chairman of the supervisory board does not differ from that of other members of the supervisory board.

In 2012, the supervisory board had 13 meetings. Members of the supervisory board attended the meetings as follows:

- Richard Tomingas and Hillar-Peeter Luitsalu attended 13 meetings;
- Rain Lõhmus and Aivar Pilv attended 6 meetings.
- Arvo Nõges, Stephan Balkin and Toomas Tool attended 5 meetings;
- Kalev Tanner and Aare Tark attended 3 meetings.

IV Cooperation of the management and supervisory boards

In line with the Company's articles of association and historical practice, the management and supervisory boards cooperate closely.

Members of the supervisory board Hillar-Peeter Luitsalu and Richard Tomingas are also actively involved in the work of the supervisory boards of companies controlled by Arco Vara AS (Arco Investeeringute AS, Arco Real Estate AS and Arco Development SIA).

The management and supervisory boards 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. During the period under review the member of the management board attended all meetings of the supervisory board. 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.

The chairman of the supervisory board and the member of the management board meet and exchange information as and when necessary. There is a routine in place according to which the member of the management board provides an overview of significant matters and developments concerning the Company on a regular basis. In information exchange, all parties observe the rules approved by the supervisory board for keeping and disclosing inside information, making transactions with Arco Vara AS shares and segregating the functions of the management and supervisory boards.

V Disclosure of information

Since the flotation of its shares on the Tallinn Stock Exchange, Arco Vara AS has disclosed information in accordance with the rules of the Tallinn Stock Exchange, the laws of the Republic of Estonia and the principle that all shareholders should be treated equally.

Arco Vara AS 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 are disseminated to financial analysts or other parties. Publicly disclosed information includes annual and interim reports, stock exchange announcements, information pertaining to the general meeting, general information about the Company, etc. The Company also discloses on its website information about meetings with analysts, the times and locations of presentations and press conferences organised for analysts, investors or institutional investors and the Company's general strategic plans. 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 19 April 2012, the Company posted on its website its financial calendar for the period April 2012 to April 2013. The financial calendar is available in Estonian and in English.

The Company's website does not include information on shareholder agreements on concerted exercise of shareholder rights because no 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.

VI Financial reporting and auditing

The consolidated financial statements of Arco Vara AS 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 they are designed to be read in conjunction with the Company's most recent consolidated annual financial statements.

The consolidated financial statements of Arco Vara AS are audited. The auditor is elected and appointed once a year, at the annual general meeting. On 15 May 2012, the annual general meeting appointed AS PricewaterhouseCoopers as auditor of the Company.

For better risk assessment and management, most group entities prepare a budget for the next financial year, which is approved by the entity's supervisory board or general meeting. The group's consolidated budget is approved by the supervisory board of Arco Vara AS. Execution of and adherence to approved budgets is monitored by the Company's controller and, where necessary, additional internal audit services are purchased from qualified professionals.

To ensure high-quality financial reporting and to counteract the risks related to financial reporting, the Company has created the position of a financial controller. The financial controller participates actively in the preparation of the consolidated annual and interim reports. The consolidated financial statements are prepared using uniform group-wide cross-border financial accounting and reporting software. Consolidation procedures have largely been automated and are performed monthly. Monthly reporting is presented to the managements of relevant entities and monthly consolidated reporting is presented to the group's management.

Consolidated financial statements

Consolidated statement of comprehensive income

For the year ended 31 December	Note	2012	Restated 2011
EUR, thousands			
Revenue from rendering of services	7	13,700	23,214
Revenue from sale of goods	7	7,032	19,918
Total revenue		20,732	43,132
Cost of sales	8	-23,560	-42,790
Gross loss/profit		-2,828	342
Other income	9	1,092	3,049
Marketing and distribution expenses	10	-267	-346
Administrative expenses	11	-3,409	-3,903
Other expenses	9	-5,445	-634
Share of losses of equity-accounted joint ventures	31	-5,272	-914
Operating loss		-16,129	-2,406
Finance income	12	84	586
Finance costs	12	-1,738	-1,811
Loss before income tax		-17,783	-3,631
Income tax expense/income	13	-251	250
Loss for the year		-18,034	-3,381
<i>Loss attributable to owners of the parent</i>	14	-17,964	-3,343
<i>Loss attributable to non-controlling interests</i>		-70	-38
Total comprehensive loss for the year		-18,034	-3,381
<i>Total comprehensive loss attributable to owners of the parent</i>		-17,964	-3,343
<i>Total comprehensive loss attributable to non-controlling interests</i>		-70	-38
Earnings per share (in euros)	14		
- Basic		-3.79	-0.71
- Diluted		-3.79	-0.71

Consolidated statement of financial position

	Note	31 December 2012	Restated 31 December 2011	Restated opening balance 1 January 2011
EUR, thousands				
Cash and cash equivalents	16	1,775	2,209	4,209
Receivables and prepayments	17	3,094	7,445	6,174
Inventories	18	11,701	21,564	35,518
Non-current assets held for sale	19	0	469	0
Total current assets		16,570	31,687	45,901
Investments in equity-accounted investees	6	1	4	1
Other investments		0	8	995
Receivables and prepayments	17	0	3,058	76
Deferred income tax asset	13	0	250	0
Investment property	20	14,097	21,252	20,093
Property, plant and equipment	21	540	934	703
Intangible assets		21	26	20
Total non-current assets		14,659	25,532	21,888
TOTAL ASSETS		31,229	57,219	67,789
Loans and borrowings	22	16,838	9,662	27,126
Trade and other payables	23	3,822	7,735	4,813
Deferred income	24	2,823	2,012	4,859
Provisions	25	3,084	1,205	1,378
Total current liabilities		26,567	20,614	38,176
Loans and borrowings	22	1,231	14,675	3,855
Other payables	23	64	741	724
Total non-current liabilities		1,295	15,416	4,579
TOTAL LIABILITIES		27,862	36,030	42,755
Share capital	26	3,319	3,319	3,030
Statutory capital reserve	26	2,011	2,011	2,011
Retained earnings		-1,958	16,306	20,063
Equity attributable to owners of the parent		3,372	21,636	25,104
Non-controlling interests		-5	-447	-70
Total equity		3,367	21,189	25,034
TOTAL LIABILITIES AND EQUITY		31,229	57,219	67,789

Consolidated statement of cash flows

For the year ended 31 December	Note	2012	2011
EUR, thousands			
Loss for the year		-18,034	-3,381
<i>Adjustments for the effects of non-cash transactions:</i>			
Interest income and expense	12	1,356	1,381
Gains and losses on sale of investments in subsidiaries and joint ventures	12	0	-285
Share of profits and losses of equity-accounted joint ventures	31	5,272	914
Change in fair value of investment property	9	4,080	-2,998
Gains and losses on sale of investment property	9	699	92
Depreciation, amortisation and impairment losses on property, plant and equipment and intangible assets	8, 11	398	99
Gain/loss on sale of property, plant and equipment and intangible assets	9	4	28
Loss on write-down of inventories	8	5,869	1,214
Gain on sale of other assets	9	-192	0
Income tax expense/income	13	251	-250
Other non-cash transactions		276	226
Operating cash flow before working capital changes		-21	-2,960
Changes in working capital		2,360	2,290
NET CASH FROM/USED IN OPERATING ACTIVITIES		2,339	-670
Acquisition of property, plant and equipment and intangible assets		-28	-94
Proceeds from sale of property, plant and equipment and intangible assets		14	5
Paid on development of investment property		0	-967
Proceeds from sale of investment property	20	1,160	774
Acquisition of investments in subsidiaries and joint ventures		-12	-4
Proceeds from sale of investments in subsidiaries and joint ventures		0	893
Loans provided		-400	-631
Repayment of loans provided		77	114
Other payments related to investing activities		-90	0
Interest received		17	197
NET CASH FROM INVESTING ACTIVITIES		738	287
Proceeds from loans received	22	2,399	6,646
Settlement of loans and finance lease liabilities	22	-4,392	-6,308
Interest paid		-1,487	-1,955
Other payments related to financing activities		-31	0
NET CASH USED IN FINANCING ACTIVITIES		-3,511	-1,617
NET CASH FLOW		-434	-2,000
Cash and cash equivalents at beginning of year	16	2,209	4,209
Decrease in cash and cash equivalents		-434	-2,000
Cash and cash equivalents at end of year	16	1,775	2,209

Consolidated statement of changes in equity

	Equity attributable to owners of the parent				Non-controlling interests	Total equity
	Share capital	Statutory capital reserve	Retained earnings	Total		
EUR, thousands						
Original balance as at 31 December 2010	3,030	2,011	22,857	27,898	-70	27,828
Adjustment	0	0	-2,794	-2,794	0	-2,794
Restated opening balance as at 1 January 2011	3,030	2,011	20,063	25,104	-70	25,034
Change in non-controlling interests through change in the group's interest in a subsidiary (restated)	0	0	339	339	-339	0
Effect of acquisition of a subsidiary	0	0	-464	-464	0	-464
Increase of share capital	289	0	-289	0	0	0
Total comprehensive loss for the year (restated)	0	0	-3,343	-3,343	-38	-3,381
Restated balance as at 31 December 2011	3,319	2,011	16,306	21,636	-447	21,189
Acquisition of non-controlling interests	0	0	-300	-300	512	212
Total comprehensive loss for the year	0	0	-17,964	-17,964	-70	-18,034
Balance as at 31 December 2012	3,319	2,011	-1,958	3,372	-5	3,367

Further information on share capital is provided in note 26 and further information on changes in non-controlling interests in 2011 and 2012 is provided in note 6. The effects of the restatement of the statement of changes in equity are disclosed in note 3.

Notes to the consolidated financial statements

1 General information

These consolidated financial statements of Arco Vara AS and its subsidiaries as at and for the year ended 31 December 2012 were authorised for issue by the chief executive officer/member of the management board on 24 April 2013. Under the Commercial Code of the Republic of Estonia, final approval of the annual report prepared by the management board and approved by the supervisory board rests with the shareholders' general meeting. The consolidated financial statements are part of the annual report that has to be approved by the shareholders, and they serve as a basis for adopting a resolution for covering the loss. 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 Jõe 2B, Tallinn, Estonia. At the end of 2012, the group employed 86 people (31 December 2011: 146 people). The core business lines of the group are described in note 5. In addition to Estonia, the group operates through its subsidiaries in Latvia, Lithuania and Bulgaria.

The structure of the group as at 31 December 2012 is presented in note 34.

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.

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 and 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.

Measurement of loans and receivables

The group's loans and receivables include mostly trade receivables and loans provided. Loans and receivables are measured based on management's best estimates. The measurement principles applied are disclosed in note 4 *Significant accounting policies*. Changes in market conditions or the customers' financial position may cause management to significantly revise its estimates. Further information on risks that may affect the carrying value of loans and receivables is presented in note 27.

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 at 31 December 2012 and 31 December 2011 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 in the same way as the fair value of investment properties is measured, i.e. by using the following methods:

- the discounted cash flow analysis;
- the sales comparison method;
- residual value method.

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

Determination of the fair value of investment properties

At 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 at 31 December 2012, the group did not request valuation reports from independent appraisers. Fair value is mainly determined by using two basic techniques - the discounted cash flow method and the sales comparison method. Valuation methods are described in more detail in notes 4 and 20.

Determination of the stage of completion of construction contracts

The revenue and expenses associated with long-term construction contracts are recognised by reference to the stage of completion method. The stage of completion of a contract is determined as the proportion that the contract costs incurred for work performed until the reporting date bear to the estimated total contract costs. If the amount of progress billings as at the reporting date differs from the revenue determined by reference to the stage of completion method, the difference is recognised in the statement of financial position as a payable or a receivable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. A key input for determining the stage of completion of a contract at the reporting date is management's estimate of the contract's future contract costs and revenues.

Recognition and measurement of provisions and reassessment of provisions made in previous periods

A provision is recognised in the statement of financial position when the group has a present obligation arising from a past obligating event deriving from a contract, legislation or an established pattern of the group's past practice, 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 although the timing or amount of the arising liability are uncertain. The amount recognised as a provision is management's best estimate of the expenditure required to settle the obligation and the time the obligation should be settled. The best estimate of the expenditure required to settle a present obligation is the amount that the group would rationally be expected to pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. Expenses related to provisions are recognised as an expense in the period in which they arise. At each reporting date, management assesses the need for recognising additional provisions or adjusting or reversing existing provisions.

3 **Changes in accounting policies and presentation of information**

The consolidated financial statements are prepared in accordance with the principles of consistency and comparability, which means that the group consistently applies the same accounting and presentation policies. Accounting policies and presentation are changed only when this is required by new or revised International Financial Reporting Standards (IFRS)

as adopted by the EU and their interpretations or when a new accounting policy or presentation practice represents the group's financial position, financial performance and cash flows more faithfully.

Correction of prior period balances

The group has restated comparative prior period figures in these consolidated financial statements because in previous periods investment properties were accounted for and non-controlling interests were identified using incorrect accounting policies. The following line items in the consolidated statement of financial position and the consolidated statement of changes in equity have been restated:

Restatements in the consolidated statement of financial position

	Adjustment	Original 31 Dec 2011	Restated 31 Dec 2011	Original 31 Dec 2010	Restated opening balance 1 Jan 2011
EUR, thousands					
Investment property	-2,794	24,046	21,252	22,887	20,093
Retained earnings	-2,794	18,653	15,859	22,787	19,993

Restatements in the consolidated statement of changes in equity and statement of comprehensive income

	Adjustment	Original 2011	Restated 2011
EUR, thousands			
Change in non-controlling interests through change in the group's interest in a subsidiary	-574	235	-339
Change in equity attributable to owners of the parent from change in the group's interest in a subsidiary	574	-235	339
Total comprehensive expense for the year attributable to non-controlling interests	-28	-10	-38
Total comprehensive expense for the year attributable to owners of the parent	28	-3,371	-3,343

Change in presentation of information in the statement of comprehensive income

The group has decided to change the presentation of profits and losses from its interests in joint ventures and to report such items within operating profit. Previously, profits and losses from the group's interests in joint ventures were reported within finance income and costs. The change was made because the joint ventures operate in business lines that coincide with the group's core business and, thus, the new presentation represents the group's financial performance more faithfully.

Adoption of new standards, amendments to standards and interpretations

The new standards, amendments to standards and interpretations that first became effective for annual periods beginning on 1 January 2012 had no a material effect on the group's financial statements.

Adoption of new standards, amendments to standards and interpretations not yet effective

A number of new standards, amendments to standards and interpretations have been published which will be effective for the group in annual periods beginning on or after 1 January 2013 and which the group has not elected to adopt early. From the group's perspective, the new standards IFRS 12 and IFRS 13 might have the most significant impact on the financial statements of group.

IFRS 12, Disclosure of Interest in Other Entities

The standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 sets out the required disclosures for entities reporting under the two new standards: IFRS 10, Consolidated financial statements, and IFRS 11, Joint arrangements, and replaces the disclosure requirements currently found in IAS 28, Investments in associates. IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including (i) significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, (ii) extended disclosures on share of non-controlling interests in group activities and cash flows, (iii) summarised financial information of subsidiaries with material non-controlling interests, and (iv) detailed disclosures of interests in unconsolidated structured entities. The group is currently assessing the impact of the standard on its financial statements.

IFRS 13, Fair Value Measurement

The standard aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its financial statements.

4 Significant accounting policies

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, and the group's interests in joint ventures and associates, accounted for using the equity method. The financial statements of all group entities coincide with the calendar year. 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.

A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity under a statute or an agreement or by some other means so as to obtain benefits from its activities. Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity.

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control exists when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

Subsidiaries are consolidated from the date the control commences until the date the control ceases.

In preparing the consolidated financial statements, all receivables, liabilities, income, expenses, cash flows and unrealised profits and losses arising from transactions between the parent and its subsidiaries are eliminated in full. Unrealised losses are eliminated only to the extent that there is no evidence of impairment.

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 and interests in joint ventures 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.

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 in profit or loss in the period in which it arises.

Investments in associates and joint ventures

Investments in associates and joint ventures are accounted for using the equity method whereby the investment is initially recognised at cost, i.e. at the fair value of the consideration paid for it on acquisition, and its carrying amount is adjusted to recognise the investor's share of the profit or loss of the associate or joint venture after the date of acquisition. In preparing the consolidated financial statements, the group's share of unrealised gains and losses on transactions between the group and its associates and joint ventures are eliminated unless there is evidence of impairment.

When the group's share of losses of an associate or joint venture exceeds the carrying amount of its investment in the associate or joint venture (i.e. the investment together with any long-term loan receivables that in substance form part of the group's investment), the carrying amount of the investment is reduced to zero and additional losses are not recognised unless the group has incurred legal or constructive obligations on behalf of the associate or joint venture and at the reporting date it is evident that the associate or joint venture is unable to meet its commitments. In such cases additional losses are provided for and recognised to the extent that the group has incurred obligations on behalf of the investee.

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 maker. The group has identified the parent company's chief executive officer/member of the management board as its chief operating decision maker. The chief executive officer/member of the management board reviews the group's operating results by business line, whereby

an operating segment is a component of the group that provides clearly distinguishable products or services and operates as an independent profit centre.

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

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

Segment assets are assets that are employed by a segment in its operating activities and that are directly attributable to the segment. Segment assets include, for example, current assets, investment properties, property, plant and equipment and intangible assets used in a segment's operating activities. Segment assets do not include assets used for the group's general needs or 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 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 (e.g. in Latvia, Lithuania and 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. All relevant countries, i.e. Latvia, Lithuania and Bulgaria, have pegged their currency to the euro. The Latvian lats has the widest permitted fluctuation corridor – its exchange rate may differ from the fixed central exchange rate by up to 1%.

Revenue

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

Revenue from the sale of real estate

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

Revenue from long-term service contracts

The revenue and expenses arising from long-term service contracts (including construction contracts) are recognised using the stage of completion method. The stage of completion of a service is determined as the proportion that the costs incurred until the reporting date bear to the estimated total costs of the transaction. If the amount of progress billings as at the reporting date differs from the revenue determined by reference to the stage of completion method, the difference is recognised in the statement of financial position as a payable or a receivable.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

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.

Revenue from the sale of other goods

Revenue from the sale of other goods is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer and the amount of revenue can be measured reliably.

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 from operating activities are reported using the indirect method. Cash flows from investing and financing activities are reported using the direct method, i.e. by disclosing separately gross cash receipts and gross cash payments.

Financial assets

Financial assets are classified to different categories and designated to the appropriate category upon initial recognition.

The group classifies its financial assets to the following categories:

- 1) loans and receivables;
- 2) available-for-sale financial assets.

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

A regular way purchase or sale of financial assets is recognised using trade date accounting. The trade date is the date on which the group commits itself to purchase or sell a financial asset (e.g. the date on which the agreement is signed). A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established by regulation or convention in the marketplace concerned.

Loans and receivables

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

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

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

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

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available for sale and are not classified to any other category of financial assets. A gain or loss on an available-for-sale financial asset is recognised in other comprehensive income or expense. When an available-for-sale financial asset is sold or its value declines (it becomes impaired), the cumulative gain or loss that has been recognised in other comprehensive income or expense is reclassified to profit or loss.

Inventories

The group's inventories include mostly land and buildings that have been acquired or are being developed for housing development. Finished goods and work in progress are initially recognised at their cost of conversion. The cost of conversion includes all direct and indirect production costs incurred in bringing the inventories to their present location and condition. Production overheads are allocated to the costs of conversion based on the normal capacity of the production facilities. Other inventories are initially recognised at cost. The cost of inventories includes all direct and indirect costs incurred in bringing the inventories to their present location and condition. Indirect costs that are included in the cost of items of real estate classified as inventories include borrowing costs incurred in financing the construction of the assets. Capitalisation of borrowing costs commences when borrowing costs and expenditures for development of inventories have been incurred and development activities have been undertaken. Borrowing costs are capitalised during the active

development stage. Capitalisation of borrowing costs ceases when the asset is complete (usually when the building has been granted a permit of use) or its development has been suspended for an extended period.

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

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

Investment property

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

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

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

- Discounted cash flow analysis. The discounted cash flow 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 sales 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 present value of a property's future cash flows, 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.
- Sales comparison method. The sales 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 discounted cash flow analysis) 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 sales comparison method cannot be applied due to the absence of a suitable basis for comparison. The method is applied on the assumption that the buyer is willing to pay for a property an amount equal to the value of the property after its development or reconstruction less its estimated development or reconstruction costs and a reasonable profit margin.
- Existence of a sales contract under the law of obligations (a presale contract). In the case of properties which at the reporting date have been sold based on a contract under the law of obligations but in respect of which the real right contract has not been signed (title has not transferred), fair value is determined by reference to the sales price of the property in the contract under the law of obligations. The sales price agreed in the contract under the law of obligations is used for determining the fair value of a property only when the group has reasonable assurance that the related real right contract will be concluded under the same terms and conditions (e.g. the buyer has made a substantial prepayment for the property by the reporting date or the real right contract is concluded after the reporting date but before the date management approves the financial statements for issue).

Gains and losses arising from changes in the fair value of investment property are recognised in profit or loss in the period in which they arise (in other income and other expenses respectively).

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

Transfers to and from investment property are made when there is a change in use. From the date of transfer, an asset is accounted for using the policies applied to the class of assets to which it has been transferred. For a transfer from

investment property to inventories or property, plant and equipment, the property's deemed cost for subsequent accounting is its fair value at the date of transfer.

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

Property, plant and equipment

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

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

After recognition, an item of property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses.

If an item of property, plant and equipment consists of significant parts that have different useful lives, the parts are accounted for separately and assigned depreciation rates that correspond to their useful lives.

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

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

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

Items of property, plant and equipment are depreciated until their residual value increases to an amount equal 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. When measurement bases are revised, the revisions are applied prospectively.

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.

Items of property, plant and equipment that are available for immediate sale and whose sale within the next 12 months is highly probable are reclassified to non-current assets held for sale. Non-current assets held for sale are presented separately from other assets in the statement of financial position and their depreciation is discontinued. A non-current asset held for sale is measured at the lower of its carrying amount and fair value less costs to sell.

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 (except for intangible assets with an indefinite useful life) are measured at cost less any accumulated amortisation and any accumulated impairment losses.

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 six 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*.

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.

Provisions and contingent liabilities

A provision is recognised in the statement of financial position only when the group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Other possible commitments that may transform into obligations under certain circumstances (which have not yet occurred) are disclosed as contingent liabilities in the notes to the consolidated financial statements.

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

Financial guarantee contracts

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

Leases

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

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

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

Statutory capital reserve

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

Income tax

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

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 21/79 of the net amount of dividends distributed in Estonia. The income tax payable on a dividend distribution is recognised as the income tax expense of the period in which the dividends are declared.

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

Latvian, Lithuanian and Bulgarian subsidiaries

In Latvia, Lithuania and Bulgaria the profit earned by companies is subject to income tax. The tax rate in Latvia and Lithuania is 15% and in Bulgaria 10% of taxable income. Taxable income is identified by adjusting profit before tax for the temporary and permanent differences permitted by the local tax laws.

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

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

The parent company's unconsolidated primary financial statements (note 35) 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 and joint ventures 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.

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

5 Segment information

The group has the following reportable segments:

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

Development – real estate development: development of residential and commercial environments and long-term investment in real estate.

Construction – general and sub-contracting and construction supervision in the field of building construction and environmental engineering.

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

Segment	Development		Service		Construction		Unallocated items		Eliminations		Consolidated	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
EUR, thousands												
External revenue ¹	8,604	22,941	2,326	2,086	9,801	18,102	1	3	0	0	20,732	43,132
Change compared with previous year	-62%	50%	12%	30%	-46%	110%					-52%	104%
Inter-segment revenue	35	73	271	318	0	0	0	0	-306	-391	0	0
Total revenue	8,639	23,014	2,597	2,404	9,801	18,102	1	3	-306	-391	20,732	43,132
Operating profit/loss	-14,917	1,348	337	140	-272	-2,859	-1,451	-1,348	174	313	-16,129	-2,406
Of which inventory write-downs and reversals of inventory write-downs, net	-5,844	-1,214	0	0	-25	0	0	0	0	0	-5,869	-1,214
Fair value adjustments to investment property, net	-3,824	2,998	-256	0	0	0	0	0	0	0	-4,080	2,998
Depreciation, amortisation and impairment losses	-344	-18	-16	-28	-36	-45	-2	-8	0	0	-398	-99
Gain/loss on reassessment of other assets and liabilities	-390	-19	364	-3	-439	-40	-79	-57	0	0	-544	-119
Loss from joint ventures	-5,272	-914	0	0	0	0	0	0	0	0	-5,272	-914

¹ The Development segment's revenue for 2011 includes revenue of 8,309 thousand euros earned on the sale of inventory to the group's joint venture Tivoli Arendus OÜ on 18 March 2011. Excluding that transaction, the Development segment's revenue for 2012 would have been 41% smaller than the year before.

Segment	Development		Service		Construction		Unallocated items		Eliminations	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
EUR, thousands										
Assets	27,605	49,794	486	405	2,310	5,460	828	1,560	31,229	57,219
Liabilities	23,382	29,716	623	281	2,746	5,932	1,111	101	27,862	36,030

Geographical information

Revenue by country	2012	2011
EUR, thousands		
Estonia	15,959	34,750
Bulgaria	3,416	6,424
Latvia	1,357	1,958
Total revenue	20,732	43,132

Properties (real estate) by location ¹	As at 31 December 2012	As at 31 December 2011
EUR, thousands		
Bulgaria	18,113	27,498
Estonia	4,977	11,100
Latvia	2,486	3,477
Lithuania	575	575
Total properties	26,151	42,650

¹ Comprises properties held for sale in the category of inventories, investment properties, and land and buildings classified as property, plant and equipment (notes 18, 20 and 21).

6 Changes in the structure of Arco Vara group

Scope of consolidation and changes in the group's ownership interests

At 31 December 2012, Arco Vara group comprised 24 consolidated entities (31 December 2011: 28): 10 in Estonia (31 December 2011: 15), five in Latvia (31 December 2011: 5), two in Lithuania (31 December 2011: 2), one in Ukraine (31 December 2011: 1), four in Bulgaria (31 December 2011: 4) and one in Romania (31 December 2011: 1). In addition, at 31 December 2012 the group had investments in two joint ventures (31 December 2011: 5) and one associate (31 December 2011: 1). The two joint ventures are domiciled in Estonia and the associate is domiciled in Latvia. In 2011 there were also three joint ventures in Latvia.

In 2012, the number of consolidated entities decreased by five through mergers of the entities with other subsidiaries. In two subsidiaries, the group increased its interest from 70% to 100%. In addition, the group divested its investments in three joint ventures.

In 2011, the number of consolidated entities increased by one - the group disposed of two subsidiaries and established three subsidiaries, one of which was subsequently sold. The group reduced its interest in a subsidiary from 100% to 50% as a result of which the investment became an investment in a joint venture. In addition, the group reduced its interest in three subsidiaries and increased its interest in a joint venture from 50% to 100% as a result of which the latter became a subsidiary. The group also acquired an investment in an associate.

The structure of the group is presented in note 34.

Changes in the group's structure in 2012

Mergers of subsidiaries

In 2012, there were two mergers of subsidiaries:

1) On 20 June 2012, group entities Fineprojekti OÜ, Waldrop Investments OÜ, AIP Projekti OÜ and Arco Vara Ärikinnistute OÜ signed a merger agreement. The acquirer was Fineprojekti OÜ and the date of the merger for accounting purposes was 1 January 2012. The merger was registered at the Commercial Register on 24 July 2012.

2) On 28 June 2012, group entities Arco Real Estate AS, AS Arco Vara Kinnisvarabüroo and OÜ Koduküla signed a merger agreement. The acquirer was Arco Real Estate AS and the date of the merger for accounting purposes was 1 January 2012. The merger was registered at the Commercial Register on 17 August 2012.

The purpose of the mergers was to streamline the group's structure and to cut administrative expenses. The transactions had no effect on the group's financial position and financial performance.

Increase in interests in group entities

Through a transaction finalised on 5 September 2012, the Latvian entity Arco Development SIA in which Arco Vara AS's subsidiary Arco Investeeringute AS had a 70% stake was divided into two companies - Arco Development SIA and Newcom SIA. By the transaction, Newcom SIA acquired some of the assets and liabilities that used to belong to Arco Development SIA. Under the division agreement, Arco Investeeringute AS became the sole owner of Arco Development SIA and the former non-controlling shareholder Viktors Savins became the sole owner of the new entity Newcom SIA. The transaction was undertaken to allow the non-controlling shareholder exit from the investment in Arco Development SIA. As a result of the division of assets, the group's stake in Ulmana Gatves Nami SIA increased from 70% to 100% and Arco Development SIA's 50% stake in the joint venture AD Saulkrasti SIA was transferred to Newcom SIA. The effect of the transaction on the group's statement of financial position is following.

Effect of increase in interest in the subsidiary on the group's statement of financial position	2012
EUR, thousands	
Decrease in inventories	-334
Decrease in receivables	-143
Decrease in liabilities	689
Total effect on the group's net assets	212

Changes in the group's structure in 2011

On 27 May 2011, the group increased its interest in Koduküla OÜ from 50% to 100%. The additional stake was acquired for 1 euro. The effect on the group's assets and liabilities of 464 thousand euros was recognised within equity, as a reduction of retained earnings, because the transaction may be regarded as a transaction between entities under common control. As a result of the transaction, Koduküla OÜ that used to be a joint venture became a subsidiary.

Effect of acquisition of the subsidiary on the group's assets and liabilities	2011
EUR, thousands	
Increase in other current assets	9
Increase in inventories	360
Increase in investment property (note 20)	55
Increase in short-term loans and borrowings	-952
Reversal of provisions	64
Total effect on the group's assets and liabilities	-464

On 18 March 2011, the group divested 50% of its stake in Tivoli Arendus OÜ. As a result of the transaction, the group's interest in Tivoli Arendus OÜ decreased from 100% to 50%. Following the transaction, the investment in Tivoli Arendus OÜ is accounted for as an investment in a joint venture. The transaction was conducted at the nominal value of the shares, which was 1,278 euros.

On 15 June 2011, the group sold its 100% interest in Alasniidu LA OÜ for 361 thousand euros. In addition, the buyer paid 530 thousand euros for the group's receivables from Alasniidu LA OÜ. The transaction resulted in sales gain of 275 thousand euros.

On 15 September 2011, the group divested its investment in Lilletee LA OÜ for 68 thousand euros of which 65 thousand euros was paid for the group's receivables from Lilletee LA OÜ.

Effect of disposals of subsidiaries on the group's assets and liabilities	2011
EUR, thousands	
Cash and cash equivalents	-156
Inventories	-575
Other current assets	-176
Investment property (note 20)	-1,650
Other short-term payables	-8
Long-term loans and borrowings	-1,862

On 7 February 2011, the group divested 29.99% of its interest in the Latvian subsidiary Arco Development SIA for 104 euros to SL Development SIA, which at the date of the transaction was a related party. As a result of the transaction, the group's equity attributable to non-controlling interests decreased by 339 thousand euros.

On 29 November 2011, the share capital of the group's subsidiary Arco Real Estate SIA was increased. As a result, the group's interest in the subsidiary decreased from 80% to 78.5% and the group's interest in Arco Real Estate SIA's subsidiary Adepto SIA decreased to the same extent.

On 21 December 2011, the group's subsidiary Arco Real Estate SIA acquired a 40% stake in Arco Property Management SIA, a Latvian property management company. The group accounts for the investment as an investment in an associate.

On 26 April 2011, the group established Fineprojekti OÜ, a subsidiary with a share capital of 2,500 euros.

On 5 July 2011, the group established Märsili II SIA, a subsidiary with a share capital of 1,524 thousand euros (1,071 thousand Latvian lats). The subsidiary's share capital was paid in with a non-monetary contribution consisting of the plots of the Baltezers 5 project that used to belong to Arco Investeeringute AS.

On 29 July 2011, Arco Investeeringute AS established a 70% subsidiary, Prime Capital SIA, whose share capital is 3 thousand euros (2 thousand Latvian lats). On 25 August 2011, Arco Investeeringute AS transferred its entire stake in Prime Capital SIA to a related party, Dreilīņi-Ulbroka-1 SIA, an entity connected with Viktors Savins, for 2 thousand euros (1,400 Latvian lats).

For the changes in ownership shares of the group's joint ventures in 2011 and 2012 see note 31.

Notes to the consolidated statement of comprehensive income

7 Revenue

	2012	2011
EUR, thousands		
Revenue from construction services	9,892	19,330
Revenue from sale of properties (real estate) ¹	7,032	19,918
Revenue from brokerage services	2,205	1,692
Rental revenue	1,349	1,668
Revenue from property management services	160	417
Other revenue	94	107
Total revenue	20,732	43,132

¹ The figure for 2011 includes revenue of 8,309 thousand euros from the sale of a property to the group's joint venture Tivoli Arendus OÜ.

8 Cost of sales

	2012	2011
EUR, thousands		
Cost of construction services purchased	-8,554	-20,330
Cost of properties (real estate) sold ¹	-6,180	-18,095
Personnel expenses	-2,103	-2,042
Inventory write-downs (note 18)	-5,869	-1,214
Management and administration costs	-557	-773
Vehicle expenses	-164	-203
Depreciation, amortisation and impairment losses	-19	-13
Other costs	-114	-120
Total cost of sales	-23,560	-42,790

¹ The figure for 2011 includes the acquisition cost of inventory of 8,300 thousand euros sold to the group's joint venture Tivoli Arendus OÜ.

9 Other income and expenses

Other income	2012	2011
EUR, thousands		
Gain on changes in the fair value of investment property (note 20) ¹	0	2,998
Gain on sale of investment property	13	0
Gain on sale of property, plant and equipment	5	3
Gain on sale of other assets ²	192	0
Income on reassessment of liabilities ³	604	0
Miscellaneous income	278	48
Total other income	1,092	3,049

¹ The figure for 2011 comprises gain on remeasuring the investment properties of the Madrid project in Bulgaria.

² Comprises gain on sale of non-current assets held for sale, earned in January 2012 when the group's subsidiary Arco Ehitus OÜ sold a property at Odra 16 in Tallinn. See also note 19.

³ The figure for 2012 includes income of 553 thousand euros from a forgiven loan.

Other expenses

	2012	2011
EUR, thousands		
Loss on changes in the fair value of investment property (note 20)	-4,080	0
Loss on sale of investment property (note 20)	-712	-92
Loss on sale and impairment of other non-current assets	-9	-28
Write-down of receivables and prepayments ¹	-587	0
Late payment interest and penalty charges	-47	-457
Miscellaneous expenses	-10	-57
Total other expenses	-5,445	-634

¹ The largest write-downs include a write-down of 283 thousand euros relating to an amount due for a company sold in 2010 and write-downs of 297 thousand euros relating to prior period prepayments.

10 Marketing and distribution expenses

	2012	2011
EUR, thousands		
Advertising expenses	-155	-199
Personnel expenses	-43	-48
Brokerage fees	-26	-3
Market research expenses	-4	-22
Other marketing and distribution expenses	-39	-74
Total marketing and distribution expenses	-267	-346

11 Administrative expenses

	2012	2011
EUR, thousands		
Personnel expenses	-1,405	-1,697
Office expenses	-558	-507
Legal and consulting fees	-328	-1,088
Vehicle expenses	-109	-168
Depreciation, amortisation and impairment losses	-379	-86
Impairment losses on receivables ¹	-561	-131
Other expenses	-69	-226
Total administrative expenses	-3,409	-3,903

¹ Most of the figure for 2012 is made up of a write-down of 433 thousand euros recognised for amounts due from a bankrupt consortium partner of Arco Ehitus OÜ.

12 Finance income and costs**Finance income**

	2012	2011
EUR, thousands		
Gain on sale of subsidiaries	0	285
Interest income	84	298
Foreign exchange gain	0	2
Other finance income	0	1
Total finance income	84	586

Finance costs

	2012	2011
EUR, thousands		
Interest expense	-1,440	-1,679
Foreign exchange loss	-8	-9
Other finance costs	-290	-123
Total finance costs	-1,738	-1,811

Interest expense consists mainly of interest expense on loans taken for acquiring and building real estate projects. Interest expense on loans taken for financing development projects in progress is capitalised. In 2012, capitalised interest expenses totalled 110 thousand euros (2011: 225 thousand euros).

13 Income tax

	2012	2011
EUR, thousands		
Income tax expense from Bulgarian subsidiaries	-1	0
Change in deferred income tax expense	-250	250
Total income tax expense/income	-251	250

As at 31 December 2011, the group's Bulgarian subsidiary Arco Invest EOOD recognised a deferred income tax asset of 250 thousand euros as an item to be used against the income tax payable on the profit of subsequent years. As at 31 December 2012, the same deferred tax asset was written down.

As at 31 December 2012, the group's contingent income tax assets at its Bulgarian and Latvian subsidiaries totalled 3.3 million euros (31 December 2011: 2.3 million euros). The contingent tax assets, which are accounted for off the statement of financial position result mostly from losses incurred in 2008 to 2012. The assets can be used against the entities' future income tax liabilities.

14 Earnings per share

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

	2012	2011
Weighted average number of ordinary shares outstanding during the period	4,741,707	4,741,707
Net loss attributable to equity holders of the parent (EUR, thousands)	-17,964	-3,371
Earnings per share (EUR per share)	-3.79	-0.71

Diluted earnings per share are calculated by taking into account the effects of all dilutive potential ordinary shares. At the reporting date, the group did not have any dilutive potential ordinary shares. Therefore, diluted earnings per share equalled basic earnings per share.

15 Operating lease expenses

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

Operating lease expenses on	2012	2011
EUR, thousands		
Premises	176	161
Vehicles	67	128
Office equipment	23	41
Total	266	330

Future lease rentals payable under non-cancellable operating leases are as follows:

Future operating lease rentals payable		
As at 31 December	2012	2011
EUR, thousands		
No later than 1 year	128	191
Later than 1 year and no later than 5 years	396	493
Later than 5 years	179	356
Total	703	1,040

Notes to the consolidated statement of financial position

16 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, cash in the group's bank accounts and term deposits with a maturity of less than three months.

As at 31 December	2012	2011
EUR, thousands		
Cash on hand and demand deposits	1,764	1,915
Term deposits	11	294
Total cash and cash equivalents	1,775	2,209

Besides term deposits that qualify for recognition within cash and cash equivalents, at 31 December 2012 the group had term deposits of 19 thousand euros reported within *Receivables and prepayments* (see note 17) (31 December 2011: 65 thousand euros).

Out of the group's year-end cash and cash equivalents balance 872 thousand euros (31 December 2011: 1,579 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). See also note 28.

17 Receivables and prepayments

Short-term receivables and prepayments

As at 31 December	2012	2011
EUR, thousands		
Trade receivables		
Receivables from customers	2,214	4,874
Allowance for doubtful trade receivables	-463	-130
Total trade receivables	1,751	4,744
Other receivables		
Loans provided	580	634
Term deposits	19	19
Miscellaneous receivables	202	498
Total other receivables	801	1,151
Accrued income		
Interest receivable	230	200
Due from customers under long-term construction contracts (note 23)	0	425
Prepaid and recoverable taxes	112	491
Other accrued income	12	1
Total accrued income	354	1,117
Prepayments	188	433
Total short-term receivables and prepayments	3,094	7,445

Long-term receivables

As at 31 December	2012	2011
EUR, thousands		
Loans provided (note 31)	0	2,981
Interest receivable	0	17
Term deposits	0	46
Other long-term receivables	0	14
Total long-term receivables	0	3,058

Allowance for doubtful trade receivables

	2012	2011
EUR, thousands		
Balance at beginning of year	-130	-320
Receivables considered doubtful during the year	-467	-64
Receivables considered irrecoverable during the year	134	254
Balance at end of year	-463	-130

18 Inventories

As at 31 December	2012	2011
EUR, thousands		
Properties purchased and being developed for resale	11,090	20,604
Materials and finished goods	92	155
Prepayments for inventories	519	805
Total inventories	11,701	21,564

In 2012 the net realisable values of some inventories decreased below their carrying amounts and the group wrote them down by 5,869 thousand euros (2011: 1,412 thousand euros). In 2011, the group reversed prior period inventory write-downs of 198 thousand euros. See also note 8.

For information on inventories pledged as loan collateral, see note 28.

Projects under development, which are classified as inventories, have been measured using the sales comparison method, the residual value method and the discounted cash flow method. In 2012, the value of the group's inventories was determined by internal experts. In 2011, the proportion of internally performed valuations was 35%.

Inventory write-downs were influenced by events that occurred in 2012 as well as a change in measurement bases. The greatest change in measurement policy is that the values of apartments and plots classified as inventories are now estimated based on their expected sales price during a roughly one-year realisation period.

The Company changes the measurement bases taking into account the overall economic uncertainty in its target markets as well as the current maintenance and finance costs of inventories completed but not yet realised. Estimating a very distant future value of inventories would be based on too many variables that are beyond the group's control and could not be forecast reliably.

The precise effect of the change in measurement bases (its proportionate share in inventory write-downs) cannot be identified because several significant inventory items were written down taking into account both the events of 2012 and the change in measurement bases. In 2011, measurement bases did not change.

As at 31 December 2012, inventories of 2,530 thousand euros did not require a write-down (2011: 7,538 thousand euros).

As at 31 December	2012	2011
EUR, thousands		
Measured using the discounted cash flow method	3,277	19,772
Measured using the sales comparison method	1,461	1,572
Measured using the residual value method	6,804	155
Other	159	65
Total inventories	11,701	21,564

At 31 December 2012, the carrying amount of inventories tested for impairment using the discounted cash flow method and measured at net realisable value was 3,277 thousand euros. The corresponding figure for the end of 2011 was 19,772 thousand euros. In 2012 the discount rates applied fell between 8% and 13% and in 2011 between 9% and 12%.

At the reporting date, the sensitivity of the carrying amount of inventories tested for impairment using the discounted cash flow method to the key valuation assumptions applied was as follows:

- a change of 1 percentage point (+/-) in the discount rate, on average, would have reduced or increased the net realisable value of inventories by 50 thousand euros (at end of 2011: by up to 429 thousand euros);
- a change of 5% (+/-) in the forecasted sales price of apartments/plots, on average, would have increased or reduced the net realisable value of inventories by 430 thousand euros (at end of 2011: by 1,442 thousand euros).

19 Non-current assets held for sale

At 31 December 2011, the group classified as held for sale a property located at Odra 16 in Tallinn. Previously part of the property was classified as an item of property, plant and equipment with a carrying amount of 160 thousand euros and part of it was classified as an investment property of 309 thousand euros. The property was sold in January 2012.

20 Investment property

Investment properties comprise commercial buildings that have been leased out and properties that have development potential but whose future use is still uncertain.

EUR, thousands	
Balance at 31 December 2010 (restated)	20,093
Acquisitions	640
Additions through acquisition of subsidiaries	55
Capitalised development costs	1,047
Net gain on changes in fair value (note 9)	2,998
Reclassification from inventories	501
Sales	-1,739
Disposals through disposal of subsidiaries	-1,650
Reclassification to non-current assets held for sale (note 19)	-309
Reclassification to property, plant and equipment (note 21)	-384
Balance at 31 December 2011 (restated)	21,252
Net loss on changes in fair value (note 9)	-4,080
Reclassification from inventories	992
Reclassification from property, plant and equipment (note 21)	8
Sales	-4,075
Balance at 31 December 2012	14,097

Out of total sales of investment property in 2012, 4,065 thousand euros (carrying amount at the date of sale) stemmed from the sale of a right of superficies (building rights) by Kerberon OÜ in February 2012. The transaction price was 3,400 thousand euros. As a result of the transaction, the group repaid a bank loan of 2,200 thousand euros and received cash of 1,140 thousand euros. Together with direct sales costs, the transaction gave rise to a loss of 712 thousand euros. Sales of 2011 include the sale of the Laeva 2 property in December 2011. As a result of the transaction, the group repaid a bank loan of 1,124 thousand euros. Together with direct sales costs the transaction gave rise to a loss of 92 thousand euros. See also note 9.

For information on investment properties pledged as loan collateral, see note 28.

Buildings and plots, which are classified as investment properties, have been measured using the sales 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. Assets that generate cash flow have been measured using the discounted cash flow method. In 2012, the values of all of the group's investment properties were determined by internal experts. In 2011, more significant investment properties were measured with the assistance of external experts.

Reassessment of the values of investment properties was influenced by events that occurred in 2012 as well as changes in measurement bases. The greatest change in measurement policy compared with 2011 is that previously a key factor in estimating the value of a plot classified as an investment property was potential income from the development of the plot into an end product but under the new policy the value of a plot is estimated on the assumption that it should be sold within one year. As of 31.12.2012, we used more conservative estimates (expected cash-flow from rental income and exit yields) on valuation of rental spaces in Bulgaria recognised as investment property.

The group changes the measurement bases taking into account the overall economic uncertainty in its target markets as well as the maintenance and finance costs related to its investment properties. Estimating a very distant future value of investment properties would be based on too many variables that are beyond the group's control and could not be forecast reliably.

The precise effect of the change in measurement bases cannot be identified because in the case of several major assets value adjustments were made by taking into account both the events of 2012 and the change in measurement bases. In 2011 measurement bases did not change.

Investment properties of 565 thousand euros did not require value adjustment (2011: 8,141 thousand euros).

As at 31 December	2012	2011
EUR, thousands		
Measured using the discounted cash flow method	10,659	19,028
Measured using the sales comparison method	3,438	2,224
Total investment property	14,097	21,252

At 31 December 2012, the carrying amount of investment properties measured using the discounted cash flow method was 10,659 thousand euros (31 December 2011: 19,028 thousand euros). The discount rates applied were around 8% in 2012 and between 9% and 15% in 2011. At 31 December 2012, the exit yields used were 8-10.5% on office spaces, 10% on sales areas and 5-6% on rental apartments.

At the reporting date, the sensitivity of the carrying amount of investment properties measured using the discounted cash flow method to the key valuation assumptions applied was as follows:

- a change of 1 percentage point (+/-) in the discount rate, on average, would have reduced or increased the fair value of investment property by 104 thousand euros (at end of 2011: by 860 thousand euros);
- a change of 5% (+/-) in the forecasted net operating cash flows, on average, would have increased or reduced the fair value of investment property by 542 thousand euros (at end of 2011: by 1,038 thousand euros);
- a decrease of 1% in the exit yields, on average, would have increased the fair value of investment property by 1,275 thousand euros and an increase of 1% would reduce the fair value by 993 thousand euros.

Operating leases: the group as a lessor

In 2012, the group's rental income on investment properties amounted to 1,349 thousand euros (2011: 1,667 thousand euros). Direct property management expenses totalled 390 thousand euros (2011: 423 thousand euros).

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

As at 31 December	2012	2011
EUR, thousands		
No later than 1 year	445	395
Later than 1 year and no later than 5 years	748	708
Later than 5 years	414	564
Total	1,607	1,667

21 Property, plant and equipment

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total property, plant and equipment
EUR, thousands					
Carrying amount at 31 December 2010	602	41	50	10	703
<i>Of which cost</i>	1,039	268	418	10	1,735
<i>Of which accumulated depreciation</i>	-437	-227	-368	0	-1,032
Additions	6	12	81	0	99
Disposals	0	0	-3	-1	-4
Reclassification from investment property (note 20)	384	0	0	0	384
Reclassification to non-current assets held for sale	-160	0	0	0	-160
Depreciation for the year	-38	-22	-28	0	-88
Carrying amount at 31 December 2011	794	31	100	9	934
<i>Of which cost</i>	1,247	221	485	9	1,962
<i>Of which accumulated depreciation</i>	-453	-190	-385	0	-1,028
Additions	0	8	21	-1	28
Disposals	0	-9	-11	0	-20
Write-down	-318	0	0	0	-318

Reclassification to investment property (note 20)	0	0	0	-8	-8
Depreciation for the year	-31	-17	-28	0	-76
Carrying amount at 31 December 2012	445	13	82	0	540
<i>Of which cost</i>	<i>926</i>	<i>195</i>	<i>413</i>	<i>0</i>	<i>1,534</i>
<i>Of which accumulated depreciation</i>	<i>-481</i>	<i>-182</i>	<i>-331</i>	<i>0</i>	<i>-994</i>

The write-down of 2012 of 318 thousand euros represents the write-down of part of a building in the Madrid project in Bulgaria that the group is using as office space. The reasons for the write-down are the same as those described for investment property in note 20. For information on items of property, plant and equipment pledged as loan collateral, see note 28.

22 Loans and borrowings

Loans and borrowings comprise the following items:

	As at 31 December 2012			As at 31 December 2011		
	Total	Of which current portion	Of which non-current portion	Total	Of which current portion	Of which non-current portion
EUR, thousands						
Bank loans	18,032	16,824	1,208	22,019	7,381	14,638
Finance lease liabilities	37	14	23	49	12	37
Other loans	0	0	0	2,269	2,269	0
Total	18,069	16,838	1,231	24,337	9,662	14,675

At 31 December 2012, the weighted average interest rate of loans and borrowings was 6.5% (31 December 2011: 7.4%).

Amounts, interest rates and maturity dates of loans and borrowings:

	Maturity date (month/year)	Loan amount, EUR, thousands		Interest rate, %		Type of interest rate
		As at 31 December 2012	2011	As at 31 December 2012	2011	
Bank loan, development ¹	6/2015	13,288	13,455	6.7	7.9	3M Euribor
Bank loan, development ¹	12/2013	2,255	3,793	6.7	7.9	3M Euribor
Bank loan, cash flow	8/2021	783	663	6.7	7.8	6M Euribor
Bank loan, development	1/2013	547	761	3.7	5.1	3M Euribor
Bank loan, acquisition of land ²	12/2013	350	350	4.7	5.2	3M Euribor
Bank loan, acquisition of land	11/2014	282	343	4.9	6.2	6M Euribor
Bank loan, development	10/2014	278	400	6.3	7.7	6M Euribor
Bank loan, working capital ³	2/2013	174	54	10	10	Fixed
Bank loan, development	7/2013	75	-	3.5	-	6M Euribor
Finance leases	1/2016	37	49	3.2-3.7	3.4-5.1	3M Euribor
Bank loan, cash flow	-	-	2,200	-	8	Fixed
Other loan, development	-	-	1,304	-	6.5	Fixed
Other loan, working capital	-	-	553	-	8	Fixed
Other loan, working capital	-	-	408	-	5	Fixed

¹ At 31 December 2012, the group was in breach of loan terms and the bank had the right to call in the entire amount early. Therefore, the whole balance is reported as a current liability. In March 2013, the group and the bank agreed amendments to the loan agreements that changed, among other things, the repayment schedule of the loans and lowered the interest rate by 1.5 percentage points. See also note 33.

² At 31 December 2012, the loan had matured. In January 2013, the loan was extended by 12 months in an amount of 310 thousand euros.

³ The base currency of the loan is the Bulgarian lev. The base currency of all other loans and borrowings is the euro.

In 2012, the group settled loans and borrowings of 4,392 thousand euros (2011: 6,308 thousand euros) through cash transactions and raised new loans and borrowings of 2,399 thousand euros (2011: 6,646 thousand euros). As regards non-cash transactions, loans and borrowings were affected the most by repayment of a bank loan of 2,200 thousand euros in the framework of the sale of a right of superficies by the group's subsidiary Kerberon OÜ, payments of 2,957 thousand euros that customers who purchased apartments in the Kodukolde and Baltezers-5 projects made directly to the creditor,

transfer of loan liabilities of 620 thousand euros in connection with purchase of the non-controlling interest in Arco Development SIA (see note 6) and waiver of a loan of 553 thousand by a creditor (see note 9). Growth in loans and borrowings in 2012 resulted mainly from financing of construction costs of 2,025 thousand euros provided by the builder of the Kodukolde project.

As regards non-cash transactions, in 2011 the group's loans and borrowings were affected the most by the sale of the Tivoli property to the joint venture Tivoli Arendus OÜ as a result of which the counterparty settled the group's loan liabilities of 5,387 thousand euros. Other major non-cash transactions included the sale of Alasniidu LA OÜ and Lilletee LA OÜ that reduced the group's loans and borrowings by 1,038 thousand euros and 758 thousand euros respectively. The sale of the Laeva 2 property reduced loans and borrowings by 1,124 thousand euros while an increase of the group's stake in Koduküla OÜ (from 50% to 100%) increased loans and borrowings by 937 thousand euros.

Information on the contractual maturities of the group's loans and borrowings is presented in note 27. Information on assets pledged as loan collateral is presented in note 28.

23 Trade and other payables

Short-term trade and other payables

As at 31 December	2012	2011
EUR, thousands		
Trade payables	2,050	6,040
Miscellaneous payables¹	739	103
Taxes payable		
Value added tax	291	143
Corporate income tax	220	210
Personal income tax	33	68
Social security tax	61	106
Other taxes	91	13
Total taxes payable	696	540
Accrued expenses		
Interest payable	91	3
Payables to employees	217	256
Accrued expenses from service contracts	0	649
Other accruals	29	144
Total accrued expenses	337	1,052
Total short-term trade and other payables	3,822	7,735

Long-term payables

As at 31 December	2012	2011
EUR, thousands		
Retentions and deposits received	64	65
Interest payable ¹	0	35
Other long-term payables ¹	0	641
Total long-term payables	64	741

¹ Includes a debt (31 December 2012: 707 thousand euros; 31 December 2011: 674 thousand euros) for an investment property acquired in 2010. Interest on the liability accrues at 5% per year and the maturity date of the debt is in November 2013.

Amounts due from and due to customers under long-term construction contracts

As at 31 December	2012	2011
EUR, thousands		
Costs under the stage of completion method	1,725	5,963
Estimated gross profit of projects	246	588
Revenue under the stage of completion method	1,971	6,551
Progress billings	2,713	6,431
Difference between progress billings and revenue recognised under the stage of completion method	-742	120

Due from customers under long-term construction contracts (note 17)	0	425
Due to customers under long-term construction contracts (note 24)	-742	-305

24 Deferred income

As at 31 December	2012	2011
EUR, thousands		
Advances received in connection with sale of real estate	2,080	1,596
Due to customers under long-term construction contracts (note 23)	742	305
Other deferred income	1	111
Total deferred income	2,823	2,012

25 Provisions

	Warranties provisions ¹	Other provisions related to operating activities ²	Total provisions
EUR, thousands			
Provisions at 31 December 2010	355	1,023	1,378
Amounts used and reversed	-287	-64	-351
Additional provisions made	178	0	178
Provisions at 31 December 2011	246	959	1,205
Amounts used and reversed	-157	0	-157
Additional provisions made	78	1,958	2,036
Provisions at 31 December 2012	167	2,917	3,084

¹ The warranties provisions of the group's subsidiary Arco Ehitus OÜ are recognised based on management's estimates, i.e. by reference to the terms and conditions of each construction contract (whether work is performed as a general contractor or using own labour, who the subcontractors are, how complicated the project is, where the project is performed, etc). A provision amounts to up to 2% of the cost of a contract. The specific percentage applied to a contract depends on its cost. Warranties provisions are recognised for covering the costs that may be incurred during the warranty period. A warranty period lasts for two years from the delivery of work performed. At 31 December 2012, warranties provisions totalled 108 thousand euros (31 December 2011: 190 thousand euros).

The group's Bulgarian development company has created a builder's warranty provision. At 31 December 2012, the provision amounted to 59 thousand euros (31 December 2011: 56 thousand euros).

² At 31 December 2012, other provisions related to operating activities of 1,917 thousand euros consisted of a provision made for a surety guarantee provided by the group to a bank loan taken by a joint venture. The provision amounts to 100% of the surety guarantee (see note 30). In 2012, the provision was increased by 959 thousand euros. In 2012, the group also recognised a provision for a surety guarantee provided to a loan taken by another joint venture. The maximum amount of the surety guarantee is 5,650 thousand euros. Management assessed the probability of the realisation of the surety guarantee and recognised a provision of 1,000 thousand euros. The provision was made in an amount expected to be required for covering the loan balance that cannot be covered by realising other collateral of the same loan. In the statement of comprehensive income, expenses relating to provisions made in connection with joint ventures are recognised within *Share of losses of equity-accounted joint ventures*.

26 Share capital

As at 31 December	2012	2011
Number of issued shares fully paid up	4,741,707	4,741,707
Share capital (EUR, thousands)	3,319	3,319
Statutory capital reserve (EUR, thousands)	2,011	2,011

The articles of association have to set out the size of a company's share capital or the minimum and maximum amount of its capital. In accordance with its articles of association, the Company's minimum and maximum authorised share capital

amount to 2,500 thousand euros and 10,000 thousand euros respectively. The Company has issued registered ordinary shares of one class. The par value of a share is 70 cents and each share carries one vote. A share provides the holder with the right to participate in the Company's general meetings, the allocation of the Company's profit, and the distribution of remaining assets on the dissolution of the Company as well as with other rights provided by law and the Company's articles of association.

Based on the resolution of the annual general meeting of shareholders held on 12 May 2011, the par value of the shares in Arco Vara AS was increased through a bonus issue to 0.7 euros per share. The bonus issue was conducted using retained earnings. As a result, share capital grew by 288,632 euros to 3,319,195 euros. The change in the share capital of Arco Vara AS was registered at the Commercial Register on 31 August 2011. The transaction was undertaken to convert the par value of the Company's shares from Estonian kroons into euros.

Under the Commercial Code of the Republic of Estonia, every year a limited 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. At 31 December 2012, the statutory capital reserve of the group's parent was in compliance with the regulatory requirement, amounting to 61% of share capital.

27 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 may use derivative financial instruments to hedge certain risk exposures.

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. The main reasons are the extensive capital needs of development operations and the fact that several major investment projects fall in the same time period.

Credit risk

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

The group's cash and cash equivalents are held at different banks which reduces credit risk associated with deposits. At 31 December 2012, 71% of the group's cash and cash equivalents were held at two banks: Swedbank and Piraeus Bank. For further information on cash and cash equivalents, see note 16.

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.

The group has receivables that are past due but have not been provided for. Management has estimated the value of such receivables on an individual basis and has determined that the items are recoverable.

Liquidity risk

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

- group entities' ability to generate independent positive net operating cash flows and the volatility of those cash flows;

- mismatch in the maturities of assets and liabilities and flexibility in changing them;
- marketability of long-term assets;
- volume and pace of real estate development activities;
- financing structure.

Short-term liquidity management is based mainly on group entities' continuously monitored quarterly 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 at 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

As at 31 December 2012					
By maturity	< 3 months	3-12 months	1-5 years	>5 years	Total
EUR, thousands					
Interest-bearing liabilities	16,651	818	940	291	18,700
Other financial liabilities	2,388	68	0	0	2,456
Total	19,039	886	940	291	21,156

As at 31 December 2011					
By maturity	< 3 months	3-12 months	1-5 years	>5 years	Total
EUR, thousands					
Interest-bearing liabilities	3,209	6,453	14,931	383	24,976
Other financial liabilities	7,107	0	35	0	7,142
Total	10,316	6,453	14,966	383	32,118

Based on the maturities of liabilities included in the group's loan portfolio, at 31 December 2012 the average weighted maturity of the group's loans and borrowings was 2.0 years (31 December 2011: 2.2 years). At 31 December 2012, the figure has been determined taking into account the amendments to the loan agreements agreed after the reporting date, see note 33.

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.

Principal amounts of loans and borrowings falling due in 2013 total 16,289 thousand euros.

Out of short-term loans and borrowings, 15,874 thousand euros is made up of loans related to active development projects whose settlement is linked to sales transactions. Those loans do not require extensive refinancing because their due dates are mostly linked to the completion dates of the projects.

Refinancing risk is higher in the case of loans taken for the purchase of land in projects where the commencement of development operations has been postponed. Such short-term loan liabilities total 415 thousand euros. The group deals actively with minimising the refinancing risk of the loans by holding negotiations with various credit institutions and potential investors.

In addition, in the first quarter of 2013 the group divested its investment in group company Pärnu Turg OÜ thereby disposing of a long-term loan liability which at 31 December 2012 amounted to 783 thousand euros and, based on an agreement reached with the bank, the repayment schedule of the Bulgarian loans was changed, see note 33.

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; and

- 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 linked to 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. In 2012, 6 month Euribor dropped by around 1.3 percentage points (2011: +0.4 percentage points) and in the first quarter of 2013 it has not changed significantly.

The sensitivity analysis of the group's profit before tax, which was conducted based on the balance of loans and borrowings as at 31 December 2012, indicated that a 1 percentage point change (increase or decrease) in interest rates would have affected (increased or reduced) profit before tax by 181 thousand euros (2011: 189 thousand euros).

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

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

Currency risk

Currency risks are mitigated by conducting most transactions and signing most agreements and contracts in euros or currencies pegged to the euro. The main currency risk is the risk that the local currency may be devalued against the euro. In view of the fact that the group's liabilities are mainly euro-based and the main operations are conducted in countries where the local currency is the euro or a currency pegged to the euro (the largest deviation, 1% from the central rate, is permitted in the case of the Latvian lats), the group's management considers currency risk to be insignificant. Currency risk exposures are mitigated with euro-based transactions between countries and matching the maturities of receivables and payables in the country involved.

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 company defined as *aktsiaselts* has to amount to at least 25 thousand euros;
- the net assets of a limited company defined as *aktsiaselts* have to amount to at least half of its share capital but no less than 25 thousand euros.

The size of the share capital or the minimum and maximum capital of a limited company have to be set out in the company's articles of association whereby minimum capital has to amount to at least one quarter of maximum capital.

According to the effective articles of association of Arco Vara AS, the Company's share capital consists of 4,742 thousand ordinary shares that have been fully paid for and without changing the articles of association share capital may be increased or reduced within the range of 2,500 thousand to 10,000 thousand euros. As at 31 December 2012, the share capital of Arco Vara AS was 3,319 thousand euros and net assets were 3,367 thousand euros. Thus, the Company's share capital and net assets (equity) were in accordance with the regulatory requirements of the Republic of Estonia.

In addition to meeting regulatory requirements, the net assets of some of the group's subsidiaries have to meet the loan covenants agreed with credit institutions. These refer to legal requirements 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. Group entities are not in breach of any covenants imposed by credit institutions.

The total capital of Arco Vara AS is the sum of its short- and long-term interest-bearing liabilities and equity less cash and bank balances. At 31 December 2012, total capital amounted to 19,661 thousand euros (31 December 2011: 43,317 thousand euros).

The guiding principle in capital management is to safeguard the Company's reliability and sustainable development.

The group finances its operations with both debt and equity capital. Property development is very capital intensive. Therefore, related investment projects are financed on the assumption that, as a rule, equity financing should amount to at least 20-30% of the total cost of the investment.

In designing the optimal financing structure and identifying and evaluating risks, the group monitors its equity to assets ratio. At 31 December 2012, equity accounted for 10.8% (31 December 2011: 37.0%) of total assets.

Other information

28 Assets pledged as collateral

The group has secured its loans and borrowings (see also note 22) by putting up the following collateral:

As at 31 December	2012	2011
EUR, thousands		
Cash and cash equivalents	872	,1,579
Receivables	235	198
Properties (real estate) recognised as inventories	10,378	19,942
Investment property	13,272	19,468
Property, plant and equipment	427	338
Total carrying value of assets pledged as collateral	25,184	41,525

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 loans of 15,543 thousand euros.

29 Contingent assets and liabilities

Open credit line

Group entity T53 Maja OÜ has a credit line at Swedbank, arranged for the construction of a residential and commercial building at Tehnika 53. The credit line was made available on 16 August 2012 and it has to be repaid in full by 16 September 2013. The credit limit is 730 thousand euros. As at 31 December 2012, the credit line was not in use.

Statements of claim and claims related to Arco Ehitus OÜ

At 31.12.2012, Arco Ehitus OÜ was a respondent to 10 statements of claim of 1,644 thousand euros in aggregate. According to the group's assessment, the statements of claim are largely unsubstantiated and their realisation probability is remote. On the other hand, Arco Ehitus OÜ has defended claims of 849 thousand euros in five different bankruptcy proceedings. In addition, Arco Ehitus OÜ has filed two statements of claim of 1,043 thousand euros in aggregate.

Bank guarantees for construction activities

Group entities' obligations under construction contracts are secured with various guarantees and surety bonds. Banks have issued the letters of guarantee required by customers against mortgages. The guarantees expire within up to three years. The group considers the probability of the realisation of the guarantees and surety bonds remote. Therefore, relevant provisions have not been recognised in the statement of financial position.

At the end of 2012, bank guarantees provided to customers to secure group entities' commitments under construction contracts totalled 1,434 thousand euros (31 December 2011: 620 thousand euros).

Surety guarantee provided to joint venture Tivoli Arendus OÜ

Arco Vara AS has agreed to stand surety for a bank loan taken by the group's joint venture Tivoli Arendus OÜ to the extent of 5,650 thousand euros. The group's management board has estimated the probability of the realisation of the surety guarantee and has made a provision extending to 17.7% of the maximum surety obligation, i.e. 1,000 thousand euros.

30 Related party disclosures

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

- 1) **the group's joint ventures and associates;**
- 2) **companies under the control of the members of the supervisory board of Arco Vara AS that have a significant interest in the group's parent company** – OÜ Toletum and OÜ HM Investeeringud;
- 3) **Other related parties** – companies under the control of the chief executive officer/member of the management board and members of the supervisory board of Arco Vara AS (excluding companies that have a significant interest in the group's parent company). Viktors Savins that had significant influence (and non-controlling interest

shares) over the group's Latvian operations and companies under his control were regarded as related parties until 30 September 2012. For the information on the purchase of non-controlling interest see note 6.

Transactions with related parties

	2012	2011
EUR, thousands		
Joint ventures and associate (note 31)		
Revenue	2	0
Sale of properties	0	8,309
Provision of loans	314	3,331
Conversion of receivables	959	0
Other related parties		
Sale of goods and services	95	13
Purchase of services	248	304
Settlement of other payables	309	24
Prepayments made	62	0
Repayment of loans provided	633	0
Receipt of loans	207	102
Repayment of loans received	52	32

Balances with related parties

As at 31 December	2012	2011
EUR, thousands		
Joint ventures and associate (note 31)		
Trade receivables	0	36
Trade payables	0	1
Short-term loan receivables	0	0
Long-term loan receivables	0	2,981
Short-term interest receivables	0	85
Long-term interest receivables	0	102
Companies that have a significant interest in the group's parent company		
Trade receivables	4	4
Short-term loan receivables ¹	376	376
Short-term interest receivables ¹	136	114
Other related parties		
Trade receivables	0	0
Short-term loan receivables ¹	175	226
Short-term interest receivables ¹	93	84
Other short-term receivables	7	7
Prepayments for assets	0	445
Trade payables	3	12
Other short-term payables	0	309
Short-term loans and borrowings	0	411
Short-term interest payables	0	3

¹ At 31 December 2012, the group's interest-bearing receivables from companies controlled by members of the supervisory board of Arco Vara AS totalled 551 thousand euros. Associated interest receivables totalled 229 thousand euros. Underlying interest rates range from 4% to 6%. The maturity date for the receivables is in September 2013.

In 2012, the remuneration provided to the group's key management personnel, i.e. the chief executive officer/member of the management board and the members of the supervisory board of the group's parent company, including social security

charges, amounted to 230 thousand euros (2011: 220 thousand euros) in aggregate. The remuneration provided to the chief executive officer/member of the management board is based on his service contract. The remuneration provided to members of the supervisory board is based on the resolution of the general meeting of Arco Vara AS adopted in 2009. In 2012 and 2011, the group's key management personnel did not receive any other remuneration (bonuses, termination benefits etc). Under the service contract, in the event of removal without due cause Lembit Tampere, the former chief executive officer/member of the management board of Arco Vara AS, was entitled to termination benefits equal to his four months' basic board-member remuneration. The termination benefits agreed with Tarmo Sild, who was appointed chief executive officer/member of the management board of Arco Vara AS in October 2012, amount to up to five months' basic board member remuneration. The Company does not have any incentive schemes for members of the management board that are linked to the Company's securities.

In June 2012, before the group's present member of the management board/chief executive officer assumed office, 9 cars were sold to a related party (to a company connected with OÜ Baltplast) for 94 thousand euros. According to the assessment of the member of the management board, the transaction was not conducted on market terms.

31 Joint ventures

As at 31 December 2012, the group had interests in two joint ventures, Arco HCE OÜ and Tivoli Arendus OÜ, compared with five at the end of 2011.

On 27 April 2012, Arco Investeeringute AS sold its 49.4% stake in the joint venture Bišumuižas Nami SIA for 2 euros to the venture partner SIA Linstow Baltic. Through the transaction, the group disposed of its interest in Bišumuižas Nami SIA and SIA Linstow Baltic became the sole shareholder of the entity. The transaction had no significant effect on the group's financial position and financial performance. However, by divesting the interest the group disposed of a potential obligation to support the joint venture in the development of apartment buildings and in servicing loan liabilities. As a result of the transaction, the group's interest in Bišumuižas Nami SIA's subsidiary Sportings Riga SIA also decreased from 49.4% to nil.

Through a transaction finalised on 5 September 2012 by which the group increased its stake in the subsidiary Arco Development SIA, Arco Development SIA divested its 50% interest in the joint venture AD Saulkrasti SIA.

In 2011 there were two changes in the group's investments in joint ventures:

- the group divested 50% of its interest in the subsidiary Tivoli Arendus OÜ by which the entity became a joint venture;
- the group acquired the remaining 50% interest in the joint venture Kodukūla OÜ in which its existing interest was 50% by which the entity became a subsidiary.

Assets and liabilities of joint ventures

As at 31 December	2012		2011	
EUR, thousands	Assets	Liabilities	Assets	Liabilities
Arco HCE OÜ	12,062	12,330	12,203	13,722
Tivoli Arendus OÜ	10,630	10,944	9,331	9,534
Bišumuižas Nami SIA (together with Sportings Riga SIA)	-	-	1,664	14,646
AD Saulkrasti SIA	-	-	93	210
Total	22,692	23,274	23,291	38,112

Income and expenses of joint ventures

	2012		2011	
EUR, thousands	Income	Expenses	Income	Expenses
Arco HCE OÜ	23	689	23	1,552
Tivoli Arendus OÜ	0	110	0	206
Bišumuižas Nami SIA (together with Sportings Riga SIA) ¹	0	110	0	448
AD Saulkrasti SIA ¹	0	30	0	39
Total	23	939	23	2,245

¹ Income and expenses for 2012 have been recognised until the date of sale of the joint venture.

In 2012, the group gave the joint ventures loans of 314 thousand euros in aggregate (2011: 3,331 thousand euros). The largest loan provided in 2012 was an unsecured loan of 305 thousand euros given to Arco HCE OÜ that carries interest at the rate of 5% per year. In September 2012, the group made a non-monetary contribution of 959 thousand euros to the equity of Arco HCE OÜ. The contribution consisted of loan and other receivables from Arco HCE OÜ.

A major share of loans provided in 2011 was made up of a loan of 2,876 thousand euros provided to Tivoli Arendus OÜ through sale of properties under a hire purchase arrangement. In addition, the group gave ARCO HCE OÜ a loan of 232 thousand euros and Bišumuižas Nami SIA a loan of 223 thousand euros. Interest accruals on the hire purchase receivables from Tivoli Arendus OÜ have been suspended since December 2011. Excluding the hire purchase arrangement with Tivoli Arendus OÜ, other loans provided to joint ventures in 2011 and 2012 were given for settling their loan liabilities and covering their administrative and development expenses.

As at 31 December 2012, all receivables from joint ventures that totalled 3,162 thousand euros (31 December 2011: 4,159 thousand euros) were written down in full. In 2012, expenses from write-down of receivables from joint ventures amounted to 3,314 thousand euros (2011: 914 thousand euros). In addition, in 2012 the group made provisions of 1,958 thousand euros for the surety guarantees provided to its joint ventures' loan commitments (see note 25).

The group accounts for investments in joint ventures using the equity method. In 2012, the group's loss from equity-accounted joint ventures amounted to 5,272 thousand euros (2011: 914 thousand euros).

A list of the group's joint ventures is provided in note 34.

32 Events after the reporting date

On 1 February 2013, the group's joint venture Tivoli Arendus OÜ cancelled a design and build contract with Nordecon AS because Nordecon AS had substantially breached its contractual obligations.

On 4 February 2013, Arco Vara AS announced that in order to recover a loan, Danske Bank A/S had initiated enforcement proceedings against the group's joint venture Arco HCE OÜ. On 20 February 2013, the court satisfied Arco HCE OÜ's application for securing the action and suspended the enforcement proceedings against the company.

On 1 March 2013, Arco Investeeringute AS sold its entire 100% stake in the subsidiary Pärnu Turg OÜ to Bellvory Turg OÜ. The group's transaction gain amounted to 87 thousand euros and its assets decreased by 2,067 thousand euros and loans and borrowings decreased by 772 thousand euros. As a result of the transaction, the group's annual revenue will decrease by at least 300 thousand euros.

On 11 March 2013, Arco Vara AS announced that after negotiations Arco Invest EOOD, a Bulgarian subsidiary of Arco Investeeringute AS, and Piraeus Bank had agreed amendments to the loan agreements of the Madrid Boulevard and Manastirski developments, which lowered the loans' interest rates and changed their settlement terms and conditions.

On 13 March 2013, Arco Vara announced that Tivoli Arendus OÜ, a joint venture of Arco Investeeringute AS, had received a notice of cancellation of a loan agreement from International Invest Project OÜ by which Tivoli Arendus OÜ was requested to settle all its liabilities under the loan agreement, which exceeded 8 million euros. The group's surety guarantees to the loan taken by Tivoli Arendus OÜ extend to 5.65 million euros. Tivoli Arendus OÜ continues negotiations with International Invest Project OÜ in order to find a mutually satisfying solution.

On 9 April 2013, Danske Bank files a bankruptcy petition against Arco Investeeringute AS. The petition is based on the surety guarantee in amount of 1,917 thousand euros provided by Arco Investeeringute AS in favour of Danske Bank to loan obligations of Arco HCE OÜ. Arco Investeeringute AS has previously challenged the claim by Danske Bank for paying the surety. Arco Investeeringute AS is of the opinion that there is no basis for calling in the surety guarantee and intends to challenge the bankruptcy petition.

On 11 April 2013, Kylemore International Invest Corp, a creditor of the group's joint venture company Tivoli Arendus OÜ, presented a claim for payment and initiated execution proceedings for satisfying its claim through sale of the properties belonging to Tivoli Arendus OÜ. Arco Vara group will join the execution proceedings, claiming recovery of a loan in amount of 2.9 million euros. The creditors have reached a mutual compromise. A successful sale would also improve the group's financial position. Because of the weak position of the collateral of the loan provided by Arco Vara - the mortgage created for the benefit of the partner has a priority ranking, the loan to Tivoli Arendus OÜ in amount of 2.9 million euros had to be written down in full as at 31.12.2012. In addition, the group had to recognise a provision of 1 million euros for covering the surety guarantee Arco Vara AS had provided to the partner. Because of the lengthy and legally complicated history of the Tivoli project, the properties will be sold at a public auction conducted by a bailiff. The successful sale would be a step in the direction that the group could release the provision from balance sheet and could also satisfy part of its claim to Tivoli Arendus OÜ.

Except for the sale of Pärnu Turg OÜ and the amendments to the Bulgarian loan agreements (the effect is disclosed in note 33), other events after the reporting date do not have a direct and immediate effect on the group's financial position and financial performance.

33 The group's ability to continue as a going concern

At 31 December 2012, the group's current liabilities exceeded its current assets by 9,997 thousand euros. Negative working capital refers to the possibility that at the reporting date there were material uncertainties related to conditions that may cast significant doubt on the group's ability to realise its assets and meet its liabilities in the ordinary course of business.

The group has prepared cash flow forecasts, according to which the group has sufficient funds to settle its current liabilities in 2013.

At the reporting date, a major proportion of current liabilities was made up of the loan liabilities of the group's Bulgarian subsidiary Arco Invest EOOD that amounted to 15,717 thousand euros. All of the loans of Arco Invest EOOD were classified as current because in December 2012 the company was unable to make scheduled loan settlements and under the terms of the loan agreements the bank had the right to call in the entire loan amount early. In March 2013, Arco Invest EOOD and the bank agreed amendments to the loan agreements according to which out of the total liability of 15,717

thousand euros 4,018 thousand euros is to be repaid in 2013 and 11,699 thousand euros in 2014-2015. In addition, as a result of the amendments, the interest rate of the loan was lowered by 1.5 percentage points.

In 2013, the group is planning to make repayments of loan principal and interest payments in total amount of 7,482 thousand euros. The sale of inventories in 2013 should generate cash inflows of at least 6,160 thousand euros. After the reporting date, the group sold its subsidiary Pärnu Turg OÜ. The sales proceeds amounted to 1,610 thousand euros.

Taking into account the above, the group's financial statements have been prepared under the going concern assumption.

34 Structure of Arco Vara group

Company	Domicile	Group's ownership interest	
		As at 31 December 2012	As at 31 December 2011
%			
Service segment			
Subsidiaries			
Arco Real Estate EOOD ¹	Bulgaria	100	100
Arco Real Estate AS	Estonia	100	100
Arco Vara Kinnisvarabüroo (merged)	Estonia	0	100
Arco Real Estate SIA ¹	Latvia	78.5	78.5
Adepto SIA ¹	Latvia	78.5	78.5
Associates			
Arco Property Management SIA ¹	Latvia	40	40
Development segment			
Subsidiaries			
Arco Invest EOOD ¹	Bulgaria	100	100
Arco Facility Management EOOD ¹	Bulgaria	100	100
Arco Project EOOD ¹	Bulgaria	100	100
Arco Investeeringute AS	Estonia	100	100
AIP Projekti OÜ (merged)	Estonia	-	100
Arco Vara Ärikinnistute OÜ (merged)	Estonia	-	100
Fineprojekti OÜ ¹	Estonia	100	100
Kerberon OÜ ¹	Estonia	100	100
Koduküla OÜ (merged)	Estonia	-	100
Kolde AS ¹	Estonia	100	100
Pärnu Turg OÜ ¹	Estonia	100	100
T53 Maja OÜ ¹	Estonia	100	100
Waldrop Investments OÜ (merged)	Estonia	-	100
Marsili II SIA ¹	Latvia	100	100
Arco Development SIA ¹	Latvia	100	70
Ulmana Gatves Nami SIA ¹	Latvia	100	70
Arco Invest UAB ¹	Lithuania	100	100
Arco Development UAB ¹	Lithuania	100	100
Arco Capital Real Estate SRL ¹	Romania	100	100
Arco Investments TOV ¹	Ukraine	75	75
Joint ventures			
Arco HCE OÜ ¹	Estonia	50	50
Tivoli Arendus OÜ ¹	Estonia	50	50
AD Saulkrasti SIA ¹	Latvia	-	35
Bišumuižas Nami SIA ¹	Latvia	-	49.38
Sportings Riga SIA ¹	Latvia	-	49.38
Construction segment			
Subsidiaries			
Arco Ehitus OÜ	Estonia	100	100
AE Ehitusjuhtimine OÜ ¹	Estonia	100	100
Tempera Ehitus OÜ ¹	Estonia	bankrupt	bankrupt

¹ Interest through a subsidiary

35 *Parent company's unconsolidated primary financial statements as required by the Estonian Accounting Act*

PARENT COMPANY'S INCOME STATEMENT

	2012	Restated 2011
EUR, thousands		
Revenue from rendering of services	257	408
Other income	3	0
Marketing and distribution expenses	-48	-191
Administrative expenses	-936	-1,242
Other expenses	-286	-10
Gain/loss on investments in subsidiaries and joint ventures	-20,151	-15,787
Operating loss	-21,161	-16,822
Interest income	1,099	1,309
Interest expense	-1	-28
Other finance costs	-153	-1
Loss for the year	-20,216	-15,542

PARENT COMPANY'S STATEMENT OF FINANCIAL POSITION

As at 31 December	2012	Restated 2011
EUR, thousands		
Cash and cash equivalents	20	403
Receivables	5,871	23,919
Prepayments	0	147
Inventories	2	21
Total current assets	5,893	24,490
Investments ¹	0	4,469
Receivables and prepayments	494	145
Property, plant and equipment	4	14
Total non-current assets	498	4,628
TOTAL ASSETS	6,391	29,118
Loans and borrowings	0	1,282
Payables	116	2,345
Provisions	1,000	0
Total current liabilities	1,116	3,627
Loans and borrowings	0	0
Total non-current liabilities	0	0
TOTAL LIABILITIES	1,116	3,627
Share capital	3,319	3,319
Statutory capital reserve	2,011	2,011
Retained earnings	-55	20,161
Total equity	5,275	25,491
TOTAL LIABILITIES AND EQUITY	6,391	29,118

¹ At 31 December 2011, line item *Investments* included investments in subsidiaries of 4,461 thousand euros (31 December 2012: nil euros). In Arco Vara AS's unconsolidated statement of financial position investments in subsidiaries are carried at cost less impairment losses.

PARENT COMPANY'S STATEMENT OF CASH FLOWS

	2012	Restated 2011
EUR, thousands		
Operating loss	-21,161	-16,822
Adjustments for:		
Gain/loss on investments in subsidiaries and joint ventures	20,151	15,787
Depreciation and amortisation	9	8
Recognition of provisions	1,000	0
Other non-cash transactions	188	57
Operating loss after adjustments	187	-970
Changes in receivables and prepayments	607	122
Changes in inventories	19	-21
Changes in payables and deferred income	-2,103	990
NET CASH USED IN/FROM OPERATING ACTIVITIES	-1,290	121
Acquisition of property, plant and equipment and intangible assets	3	0
Acquisition of investments	0	-145
Proceeds from sale of investments in subsidiaries and joint ventures	3	0
Loans provided	-775	-254
Repayment of loans provided	458	23
Change in amount receivable from the group's cash pool	1,780	-1,611
Interest received	722	6
NET CASH FROM/USED IN INVESTING ACTIVITIES	2,191	-1,981
Repayment of loans received	-40	-315
Change in amount payable to the group's cash pool	-1,242	-722
Interest paid	-2	-28
NET CASH USED IN FINANCING ACTIVITIES	-1,284	-1,065
NET CASH FLOW	-383	-2,925
Cash and cash equivalents at beginning of year	403	3,328
Decrease in cash and cash equivalents	-383	-2,925
Cash and cash equivalents at end of year	20	403

PARENT COMPANY'S STATEMENT OF CHANGES IN EQUITY

	Share capital	Statutory capital reserve	Retained earnings	Total
EUR, thousands				
Balance at 31 December 2010	3,030	2,011	36,120	41,161
Increase of share capital	289	0	-289	0
Loss for the year	0	0	-14,784	-14,784
Balance at 31 December 2011	3,319	2,011	21,047	26,377
Loss for the year	0	0	-21,102	-21,102
Balance at 31 December 2012	3,319	2,011	-55	5,275

Adjusted unconsolidated equity

As at 31 December	2012	2011
EUR, thousands		
Parent company's unconsolidated equity	5,275	26,377
Carrying amount of investments in subsidiaries in the parent company's unconsolidated statement of financial position	0	-4,461
Value of investments in subsidiaries under the equity method	0	4,010
Parent company's adjusted unconsolidated equity	5,275	25,926

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, prepared according to the Financial Reporting Standards (IFRS) as adopted by the EU, present a correct and fair view of the assets, liabilities, financial situation and loss or profit of Arco Vara AS and the group as a whole, and the management report gives a correct and fair view of the development and results of the business activities and financial status of Arco Vara AS and the group as a whole and contains a description of the main risks and doubts.

24 April 2013

/signature/

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



INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of Arco Vara AS

We have audited the accompanying consolidated financial statements of Arco Vara AS and its subsidiaries (the Group), which comprise the consolidated statement of financial position as of 31 December 2012 and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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



Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Arco Vara AS and its subsidiaries as of 31 December 2012, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Emphasis of Matter

We draw attention to Note 33 in the financial statements which describes the uncertain conditions related to the Group's ability to continue as a going concern and management's action plan to ensure the Group's ability to discharge its liabilities in the normal course of business. Our opinion is not qualified in respect of this matter.

AS PricewaterhouseCoopers

/signature/

Tiit Raimla
Auditor's Certificate No.287

/signature/

Märten Padu
Auditor's Certificate No.513

24 April 2013

** 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 covering the 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 2012 of 18,034 thousand euros to retained earnings.

As at 31 December 2012, retained earnings (accumulated losses) amount to -1,963 thousand euros.

24 April 2013

/signature/

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