

Consolidated Annual Report 2017

(translation of the Estonian original)

EfTEN Kinnisvarafond II AS

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MANAGEMENT REPORT

In 2017, the fund made its first investment in the logistics segment by acquiring the “Kaunas Terminal” logistics centre in Lithuania, with an approx. 30,000 m² of storage capacity. In addition, a large-scale renovation of the Domina Shopping Centre in Riga was completed, which resulted in the opening of 26 new stores on the former rental area of Prisma grocery store. The largest stores were Maxima XXX hypermarket, Sports-Direct and JYSK. Radisson Sky hotel in Tallinn contributed significantly to the fund’s excellent results, with sales exceeding EUR 10 million in 2017. The last time the hotel surpassed EUR 10 million in turnover was exactly 10 years ago, in 2007. The tourist accommodation market in Tallinn was positively influenced by the European Union Council presidency in the second half of 2017.



Radisson Blu Sky hotel in Tallinn

Financial overview

The consolidated sales revenue of EFTEN Kinnisvarafond II AS in 2017 was EUR 24 million (2016: EUR 16 million) and net profit was EUR 20 million (2016: EUR 11 million). The consolidated gross profit margin was 72% (2016: 68%).

The Group’s expenses related to properties, marketing costs, general expenses, other income and expenses accounted for 44.1% of the revenues in 2017 (2016: 49.4%).

	2017	2016
EUR million		
Revenue	24,404	16,048
Expenses related to investment properties, incl. marketing costs	-8,223	-6,064
Interest expense and interest income	-1,505	-1,040
Net rental revenue less finance costs	14,676	8,944
Management fees	-0,969	-0,639
Other revenue and expenses	-1,560	-1,231
Profit before change in the value of investment property, change in the succes fee liability and income tax expense	12,147	7,074

EFTEN Kinnisvarafond II AS has a 100% ownership interest in Astlanda Hotelli AS, the operator of the Radisson Blu Sky Hotel. The operating results of the hotel are consolidated in the fund's report.

As at 31.12.2017, the Group total assets were in the amount of EUR 222 million (31.12.2016: EUR 194 million), including investment property at fair value and fixed assets, which accounted for EUR 209 million of the total assets (31.12.2016: EUR 176 million).

	31.12.2017	31.12.2016
<i>EUR million</i>		
Investment property	162,090	129,891
Property, plant and equipment	46,442	46,350
Other non-current assets	0,008	0,043
Current assets, excluding cash	1,051	0,805
Net debt	-99,278	-83,314
Net asset value (NAV)	110,313	93,7739
Net asset value (NAV) per share (in euros)	13,6665	11,6175

Net asset value of the share of EFTEN Kinnisvarafond II AS increased by 17.6% in a year (2016: 5.6%), including the dividend payment made in April 2017, and the related income tax expense totalling EUR 4.6 (2016: 2.7) million. Without dividends, the NAV would have increased by 22%. Return on invested capital (ROIC) was 24%. The weighted average interest rate of Group's borrowings was 1.09% at the end of the accounting period (31.12.2016: 1.15%).

For the year	31.12.2017	31.12.2016
ROE, % (net profit of the period / average equity of the period)x100	19,5	16,0
ROA, % (net profit of the period / average assets of the period)x100	9,6	7,8
ROIC, % (net profit of the period / average invested capital of the period)x100 ¹	24,0	17,8
DSCR (EBITDA/(interest expenses + scheduled loan payments))	3,5	3,8

¹ The average invested capital of the period is the paid-in share capital and share premium of EFTEN Kinnisvarafond II AS's equity. The indicator does not show the actual investment of the funds raised as equity.

Real estate portfolio

The Group made one investment in the year 2017. In August, the Fund purchased a logistic centre in Kaunas located at Terminalo 8 and 10, the investment volume was EUR 16.2 million. As at 31.12.2017, the Group holds five investments:

Premises	Address	Type	Net leasable area (m ²)	Acquisition time
<i>EUR thousand</i>				
Radisson Blu Sky hotel	Rävala pst 3/ Kuke tn 2 Tallinn Estonia	hotel	24,499	01.2015
Duntes Biroji office building	Duntes 6, Riga Latvia	office building	12,650	11.2015
Magistral shopping centre	Sõpruse pst 201/203 Tallinn Estonia	shopping centre	11,720	02.2016
Domina shopping centre	Ieriku 3, Riga Latvia	shopping centre	47,493	07.2016
Kaunas Terminal logistics centre	Terminalo 8 and 10, Kaunas Lithuania	logistics centre	27,895	08.2017
Total			124,257	

Weighted average expiry of rent agreements of investment property of the Group is 3.3 (31.12.2016: 5.5) years, and as at 31.12.2017, the Group has a total of 360 (31.12.2016: 342) rent contracts. Income from none of the rental agreements exceeds 10% of consolidated rental income.



Kaunas Terminal logistics centre in Lithuania

Valuation of investment property

EFTEN Kinnisvarafond II AS revalues its investment properties twice a year – in June and in December. In 2017 and 2016, the Group's investment property was valued by Colliers International Advisors OÜ.

The independent appraiser of the Group values the investment properties individually with the discounted cash flow method. The estimates of the cash flows of all properties have been updated to determine the fair value and the discount rates and exit yields have been differentiated depending on the location of the properties, their technical condition and the tenant risk level.

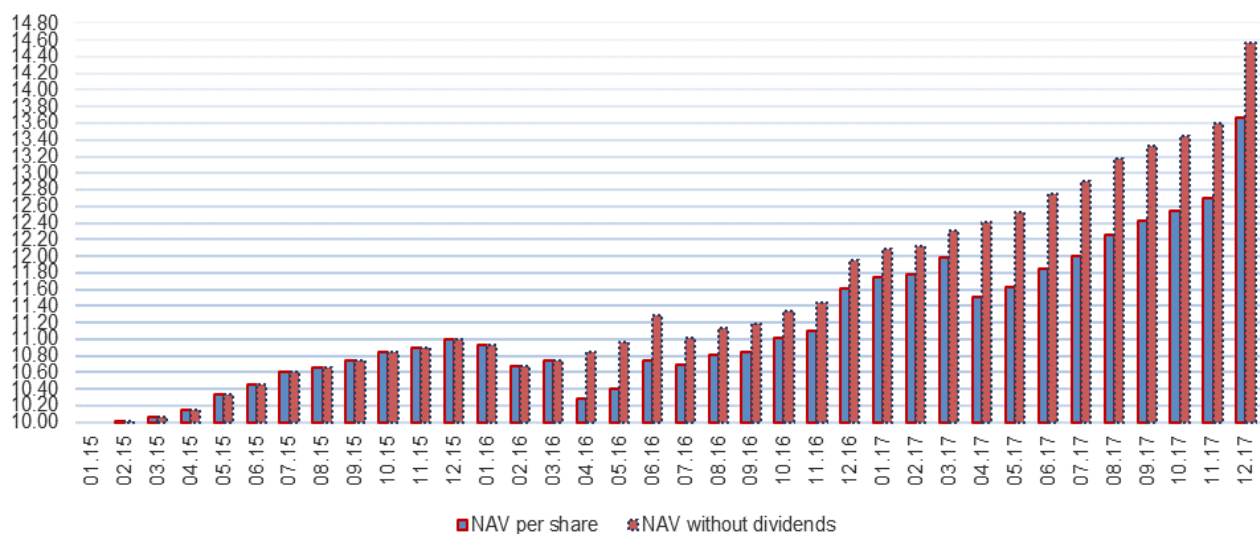
The group uses the hotel and office building acquired in January 2015 located at Rävala pst 3 / Kuke tn 2 in its operations and therefore classifies it as property, plant and equipment.

Information on shares

As at 31.12.2017, payments made to the share capital of EFTEN Kinnisvarafond II AS total EUR 80.72 million:

	31.12..2017	31.12.2016
Number of shares outstanding at the beginning of the period	8,071,756	3,424,254
Issue of shares during the period	0	4,647,502
Number of shares outstanding at the end of the period	8,071,756	8,071,756

The share's net asset value



The dividend policy of EFTEN Kinnisvarafond II AS provides that the Group will pay out 80% of the free cash flow to shareholders as (gross) dividends in each accounting year. In 2017, the shareholders were paid dividends in amount of EUR 4 (2016: 2.1) million.

Shareholder structure of EFTEN Kinnisvarafond II AS as at 31.12.2017

	Ownership percentage in share capital, %
Swedbank Pension Funds	69,4%
Luminor Pension Funds	15,4%
ERGO Life Insurance SE Estonian branch	3,6%
SEB Bankas AB	2,6%
LHV Pension Funds	1,2%
Others	7,8%
	100,0%

Outlook for 2018

Two major factors influencing the real estate market current year are the monetary policy decisions made by the European Central Bank and the developments in the real estate market in Scandinavia, Sweden and Norway in particular. Presumably, we can expect the tightening of the monetary policy, which has been extremely loose so far and the end of the Central Bank's bond purchase. These decisions are accompanied by the appreciation of the euro against other currencies and the expected rise of interest rates in the future. It does not directly impede the development of the real estate market, although it raises doubts about further growth of currently fast growing real estate prices. From the point of view of the sentiment, the trend in the housing market in Sweden is of great significance, which may, in the case of negative developments, cool the growing optimism of foreign investors towards investing in the Baltic States.

Considering all the above, the market share of risks is currently higher than the opportunities offered, in terms of new investments. It will not have a direct impact on the current real estate portfolio of the fund, rather it will make the management conservative in making new investment decisions.

In 2018, we will primarily be focusing on managing the existing portfolio of investment properties.

Management

On April 11, 2017, a regular general meeting of shareholders was held which approved the 2016 annual report and decided to pay a net dividend in the amount of EUR 4,000,000. There were no extraordinary general meetings. The approval of amendments to the articles of association and the management agreement in connection with the new Investment Funds Act is scheduled for the 2018 Annual General Meeting.

There have been no changes in the compositions of the fund's Supervisory Board in 2017. Since its formation, the fund's Supervisory Board is comprised of: Arti Arakas (Chairman of the Supervisory Board), Siive Penu, Sander Rebane and Olav Miil. The task of the Supervisory Board is to provide instructions for the management of the fund in accordance with the articles of association and the management agreement and make decisions about transactions that go beyond normal course of business.

In addition, there have been no changes in the fund's Management Board, the members of the Board since its formation are Viljar Arakas and Tõnu Uustalu.

According to the management agreement and the fund's articles of association, the fund's assets are managed and controlled by the fund management company EFTEN Capital AS.

FINANCIAL STATEMENTS OF THE CONSOLIDATION GROUP FOR THE YEAR 2017

CONSOLIDATED INCOME STATEMENT

	Notes	2017	2016
<i>EUR thousand</i>			
Revenue	4	24,404	16,048
Cost of services and goods sold	5	-6,769	-5,201
Gross profit		17,635	10,847
Marketing costs	6	-1,454	-864
General and administrative expenses	7	-4,800	-2,911
Gain / loss from revaluation of investment properties	14	10,219	5,833
Other income	8	129	4
Other expenses		-57	-4
Operating profit		21,672	12,905
Finance income		5	1
Finance costs	9	-1,506	-1,041
Profit before income tax		20,171	11,865
Income tax expense	10	-241	-1,357
Net profit for the financial period		19,930	10,508

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	2017	2016
<i>EUR thousand</i>			
Net profit for the financial year		19,930	10,508
Other comprehensive income/loss:			
Revaluation of property, plant and equipment	15	52	457
Income/loss from revaluation of hedging instruments	19	557	-734
Total other comprehensive income/loss		608	-277
Total comprehensive income for the financial year		20,539	10,231

Notes on pages 12 to 44 are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	31.12.2017	31.12.2016
<i>EUR thousand</i>			
ASSETS			
Cash and cash equivalents	11	11,874	16,890
Receivables and accrued income	12	886	663
Prepaid expenses	13	52	56
Inventories		113	86
Total current assets		12,925	17,695
Long-term receivables		0	1
Long-term investments in securities		8	12
Investment property	14	162,090	129,891
Property, plant and equipment	15	46,442	46,379
Total non-current assets		208,540	176,283
TOTAL ASSETS		221,465	193,978
LIABILITIES AND EQUITY			
Borrowings	16	2,649	2,299
Derivative instruments	19	703	1,260
Payables and prepayments	17	2,831	2,773
Total current liabilities		6,183	6,332
Borrowings	16	100,335	90,481
Other long-term liabilities	17	1,354	1,029
Success fee liability	18	3,236	1,041
Deferred income tax liability	10	44	1,321
Total non-current liabilities		104,969	93,872
Total liabilities		111,152	100,204
Share capital	21	80,718	80,718
Share premium		2,321	2,321
Statutory reserve capital	21	676	151
Hedging reserve	19	-703	-1,260
Revaluation reserve	15	647	595
Retained earnings		26,654	11,249
Total equity		110,313	93,774
TOTAL LIABILITIES AND EQUITY		221,465	193,978

Notes on pages 12 to 44 are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2017	2016
<i>EUR thousand</i>			
Net profit		19,930	10,508
<i>Adjustments:</i>			
Finance income		-5	-1
Finance costs	9	1,506	1,041
Gains / losses from investment property revaluation	14	-10,219	-5,833
Change in success fee liability	7	2,195	1,041
Depreciation	15	337	295
Income tax expense	10	241	1,357
Total adjustments with non-cash changes		-5,946	-2,100
Cash flow from operations before changes in working capital		13,985	8,408
Change in receivables and payables related to operating activities		-172	1,146
Change in inventories		-28	0
Net cash generated from operating activities		13,785	9,554
Purchase of property, plant and equipment	15	-348	-191
Purchase of investment property	14	-6,284	-75,553
Acquisition of subsidiaries, net cash flow	2	-6,289	-11,634
Sale of other investments		8	0
Loans granted	2	-275	0
Interest received		1	1
Net cash generated from investing activities		-13,187	-87,377
Loans received	16	2,966	45,000
Scheduled loan repayments	16	-2,509	-1,180
Interest paid		-1,440	-1,123
Proceeds from issuance of shares		0	48,014
Dividends paid		-4,000	-2,127
Income tax paid on dividends	10	-631	-532
Net cash generated from financing activities		-5,614	88,052
NET CASH FLOW		-5,016	10,229
Cash and cash equivalents at the beginning of the period	11	16,890	6,661
Change in cash and cash equivalents		-5,016	10,229
Cash and cash equivalents at the end of the period	11	11,874	16,890

Notes on pages 12 to 44 are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory reserve capital	Hedging reserve	Revaluation reserve	Retained earnings	Total
<i>EUR thousand</i>							
Balance as at 31.12.2015	34,243	782	0	-526	138	3,019	37,656
Issue of shares	46,475	1,539	0	0	0	0	48,014
Transfers to reserve capital	0	0	151	0	0	-151	0
Dividends paid	0	0	0	0	0	-2,127	-2,127
Total transactions with owners	46,475	1,539	151	0	0	-2,278	45,887
Net profit for the financial year	0	0	0	0	0	10,508	10,508
Revaluation of property, plant and equipment	0	0	0	0	457	0	457
Loss from revaluation of hedging instruments	0	0	0	-734	0	0	-734
Total comprehensive income	0	0	0	-734	457	10,508	10,231
Balance as at 31.12.2016	80,718	2,321	151	-1,260	595	11,249	93,774
Balance as at 31.12.2016	80,718	2,321	151	-1,260	595	11,249	93,774
Transfers to reserve capital	0	0	525	0	0	-525	0
Dividends paid	0	0	0	0	0	-4,000	-4,000
Total transactions with owners	0	0	525	0	0	-4,525	-4,000
Net profit for the financial year	0	0	0	0	0	19,930	19,930
Revaluation of property, plant and equipment	0	0	0	0	52	0	52
Income from revaluation of hedging instruments	0	0	0	557	0	0	557
Total comprehensive income	0	0	0	557	52	19,930	20,539
Balance as at 31.12.2017	80,718	2,321	676	-703	647	26,654	110,313

More information on share capital and changes in equity is provided in Notes 19, 21 and 22.

Notes on pages 12 to 44 are an integral part of the consolidated financial statements.

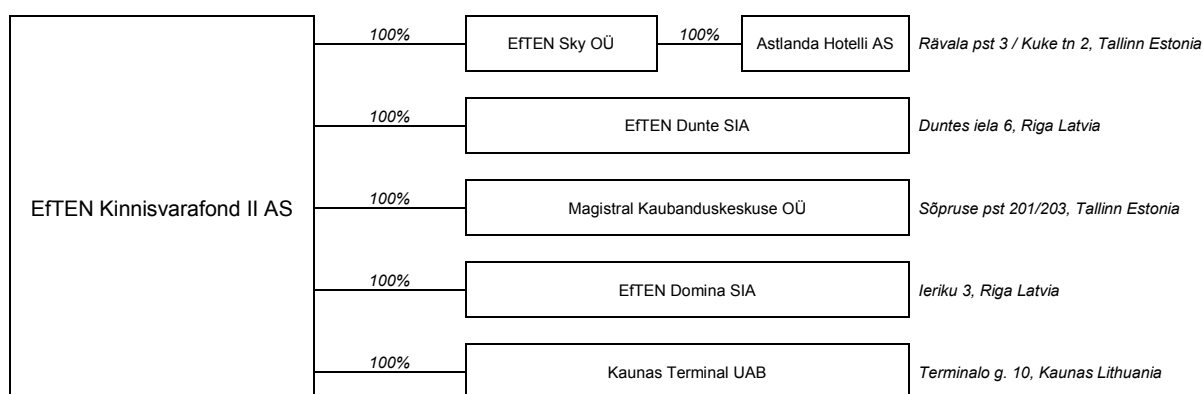
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 General principles used in preparing the financial statements

Consolidated financial statements of EFTEN Kinnisvarafond II AS and its subsidiaries for the year ended 31.12.2017 have been signed by the Management Board on 28 February 2018. In accordance with the requirements of the Commercial Code of the Republic of Estonia, the annual report prepared by the Management Board and approved by the Supervisory Board is approved on the annual general meeting of shareholders. These consolidated financial statements are part of the annual report that is to be approved by the shareholders and serve as a basis for the decision concerning the distribution of profit. Shareholders may decide not to approve the annual report, which has been prepared by the Management Board and approved by the Supervisory Board, and may demand that a new annual report be prepared.

EFTEN Kinnisvarafond II AS (Parent company) is a company registered and operating in Estonia.

The structure of EFTEN Kinnisvarafond II AS Group as at 31.12.2017 is as follows:



The consolidated financial statements of EFTEN Kinnisvarafond II AS and its subsidiaries have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The financial statements of the Group are presented in thousands of euros.

The financial statements have been prepared under the historical cost convention, except for land and buildings that have been revalued and measured using the revaluation model as described in the respective accounting policies and except for investment property that has been measured at fair value.

1.1 Changes in the accounting policies and presentation

Adoption of new or revised standards and interpretations

„**Disclosure initiative**“ – **Amendments to IAS 7** (effective for annual periods beginning on 1 January 2017). Revised standard IAS 7 requires the disclosure of movements between the opening and closing balances of liabilities arising from financial activities. The Group has disclosed the required information in accordance with the new standard in Appendix 20.

New standards, interpretations and their amendments

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning at or after 1 January 2018, and which the Group has not early adopted.

IFRS 9, Financial Instruments: Classification and Measurement (effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).

Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

The Group has assessed that IFRS 9 did not have a material impact on its financial statements as at 1 January 2018 because impairment of receivables has been historically not material and cash and deposits are held in credit institutions with a high rating; therefore applying the expected loss model, including assessment of forward-looking information, did not cause material impairment losses. All the financial assets (except for derivatives) meet SPPI requirement and are held to collect, thus will continue to be measured using the amortised cost method. Derivatives are accounted for in fair value through profit and loss (trading derivatives) or through other comprehensive income (hedge instruments) both according to existing standards and IFRS 9.

The Group has assessed that IFRS 9 will not impact the accounting for hedge instruments as the Group has confirmed that its current hedge relationships will qualify as continuing hedges upon the adoption of IFRS 9.

IFRS 15, Revenue from Contracts with Customers, amendment to enforcement of IFRS 15 (effective for annual periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The Management of the Group has analysed the effect of the named change to the consolidated income statement and finds that the change does not have significant influence to Group's financial statements because the Group's revenue materially consists of rental income and the Group does not sell goods and services under one contract.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify

its leases as operating leases or finance leases, and to account for those two types of leases differently. The Group is currently assessing the impact of the new standard on its financial statements.

Revenue from Contracts with Customers – Amendments to IFRS 15 (effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new standard. The Group is currently assessing the impact of the amendments on its financial statements.

Transfers of Investment Property – Amendments to IAS 40 (effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). The amendment clarified that to transfer to, or from, investment properties there must be a change in use. This change must be supported by evidence; a change in intention, in isolation, is not enough to support a transfer. The Group is currently assessing the impact of the amendments on its financial statements.

There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on the Group.

1.2 Summary of the most important accounting principles

Management's critical estimates and judgements

The preparation of consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union requires management to make judgments, 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 by the management 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.

Management's critical judgements and estimates that have a material effect on the amounts reported in the financial statements relate to the following accounting areas:

Estimation uncertainty

The estimates made by management are based on historical experience and the information that has become available by the date of preparation of the financial statements. Therefore there is a risk with the assets and liabilities presented at the balance sheet date, and the related revenue and expenses, that the estimates applied need to be revised in the future. The key sources of estimation uncertainty that have a significant risk of causing material restatements to the financial statements are described below.

a) Valuation of property, plant and equipment measured using the revaluation model

Management has evaluated as at 31.12.2017 the value of property, plant and equipment measured using the revaluation model (fair value less subsequent depreciation and impairment) based upon an appraisal provided by an independent valuation specialist for the market value of the asset. The Group owns land and buildings (Radisson Blu Sky Hotel) that are measured using the revaluation model. The appraisal provided by Colliers International Advisors OÜ as to the market value of the hotel has been used in the estimation of fair value. Independent valuation specialist of the Group has valued the assets using the discounted cash flows method, taking into account the location, condition and wear and tear of the assets and prevailing market conditions. The carrying amount of the property, plant and equipment measured using the revaluation model as at 31.12.2017 is provided in Note 15.

b) Property, plant and equipment: assets with a significant residual value

Group management considers it very likely that the Radisson Blu Sky Hotel building is sold at the end of the 10-year term of the EFTEN Kinnisvarafond II AS fund. Management estimates that the residual value of the building in ten years' time is at least as high as the cost, therefore it has been decided to divide the cost of the hotel building into two components - the non-depreciable portion and the depreciable portion. Using as a basis the assumption that the annual estimated capital expenditures required to maintain the present condition of the hotel building amount to EUR 150 thousand, the management defined EUR 1,500 thousand as the depreciable cost component of the building to be depreciated over ten years. The remaining portion of the cost of the building is allocated to the non-depreciable component.

In case of items with a significant residual value, only the depreciable portion of the difference between the cost and the residual value is depreciated into an expense over their useful lives. The appraisal provided by Colliers International Advisors OÜ as to the market value of the hotel has been used in the estimation of residual value. Independent valuation specialist of the Group has valued the assets using the discounted cash flows method, taking into account the location, condition and wear and tear of the assets and market conditions. If residual value has substantially declined by the balance sheet date, the management of the Group will review the estimates that have been made regarding the applied depreciation rates, depreciation methods and estimated residual value and modify them if necessary. Any impact from a change in depreciation rate, depreciation method or residual value is accounted for as a change in accounting estimates.

c) Determination of the fair value of investment property

At each balance sheet date, investment properties are measured at their fair values. The Group's investment property is valued by Colliers International Advisors OÜ. The independent appraiser of the Group values the investment properties on an individual basis using the discounted cash flow method.

More information on the assumptions used in valuation of fair value is provided in Note 14.

d) Business combinations and acquisitions of assets

As a rule, purchases of real estate are treated as purchase of assets. According to management estimate the purchase is not considered to be a business combination, if the investment property has a single or a few tenants, the Fund acquires no other assets and rights in addition to the investment property and recruits no past employees. The Fund does not acquire know-how for business process management, but manages all acquired objects centrally.

Classification of real estate

Items of real estate (properties) are classified as investment property or property, plant and equipment both on initial recognition and on any subsequent reclassification based on management's intentions regarding further use of the properties. Implementation of plans may require additional decisions independent of the Group (changing the intended purpose of land, approving a detailed plan, issuing building permits, etc.), reducing the accuracy of asset classification.

The purpose of acquisition of properties is to hold it for long-term rental yields or for capital appreciation. In addition, properties that are held for a longer period and that have several possible purposes of use, are classified as investment property.

Investment company

The Group's management has assessed their compliance with the definition of an investment company, and finds that EFTEN Kinnisvarafond II AS does not meet the definition of an investment company, since it has characteristics of a real estate company rather than of a purely investment firm. Although also the investors of EFTEN Kinnisvarafond II AS expect their capital investment to both increase asset value and generate profit from current economic activity, EFTEN Kinnisvarafond II AS in its investments assumes significant development risks that are characteristic to more traditional real estate company. In addition, in accordance with IFRS 10, an investment firm should make direct investments in companies, which are valued at fair value. In case of the parent company of EFTEN Kinnisvarafond II AS, the fair value is assessed indirectly - assets that are in the subsidiaries of EFTEN Kinnisvarafond II AS are assessed for fair value, thereby obtaining the fair value of the subsidiary, which may not necessarily be the final market price of the subsidiary. It

also assesses the Group's business activities based on rental income, profit margins, volume of assets and other financial ratios characteristic to real estate companies, which cannot be made only based on the fair value of the subsidiary.

Consolidation

The consolidated financial statements present the financial information of EFTEN Kinnisvarafond II AS and its subsidiaries, consolidated on a line-by-line basis. The subsidiaries are consolidated from the date on which control or joint control is transferred to the Group, and subsidiaries are deconsolidated from the date that control or joint control ceases.

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the group is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

The subsidiaries use the same accounting policies in preparing their financial statements as the parent company. All inter-company transactions, receivables and payables and unrealised gains and losses from transactions between the Group companies have been fully eliminated in the financial statements. Unrealised losses are not eliminated if it constitutes asset impairment by substance.

Business combinations are accounted for in the consolidated financial statements using the acquisition method.

The cost of a business combination accounted for using the acquisition method is allocated to the fair value of assets, liabilities and contingent liabilities as at the date of acquisition. The difference between the cost of the acquisition and the fair value of acquired assets, liabilities and contingent liabilities is recognised as goodwill. If fair value exceeds cost, the difference (negative goodwill) is immediately recognised as income of the period.

Segment reporting

The Group allocates raised capital and available resources for investments in accordance with the Group's investment policy, analysing the reasonable allocation of risks by real estate sector.

In disclosing information on segments, the Group adheres to the principles of grouping used in the Group's internal accounting and reporting. Independent business segments are sub-sectors of commercial real estate, which differentiate from one another by type of rented space and have different yield rates (rental income per sqm, acquisition price of one sqm, capitalisation rates).

The Group has four business segments and three geographical segments, which are provided in the following table:

The segment of business / Country	Estonia	Latvia	Lithuania
Retail premises	Sõpruse pst 201/203, Tallinn	Ieriku 3, Riga	
Office premises	Rävala pst 3 / Kuke tn 2, Tallinn	Duntes iela 6, Riga	
Logistics premises			Terminalo 8 and 10, Kaunas
Hotels and restaurants	Rävala pst 3 / Kuke tn 2, Tallinn		

The main indicators used by the management in making business decisions are sales revenue, net operating income (net sales less the cost of sales and marketing costs), EBITDA and operating profit. It is also important to monitor the volume of property investments by segments. The Group analyses all indicators on a monthly basis.

Investments in subsidiaries in the separate balance sheet of the Parent company

In the separate balance sheet of the parent company (presented in Note 25), the investments in subsidiaries are measured at fair value. Dividends paid by subsidiaries are recognised at the moment when the parent company obtains the right to these dividends.

Revenue recognition

Revenue from the sale of goods and from services rendered in the ordinary course of business is measured at the fair value of the consideration received or receivable. Revenue is recognised only when the amount of revenue can be measured reliably, it is probable that future economic benefits attributable to the transaction will flow to the group, significant risks and rewards of ownership have been

transferred from the seller to the buyer. The amount of revenue is considered to be reliably measurable only when all circumstances related to the transaction are unambiguous.

Rental income from investment properties is recognised on a straight-line basis over the lease term.

Income from intermediation of services (utility fees of subtenants, sublease, and other intermediated services) is offset against the expense on services purchased.

Finance income

Interest income is recognised on an accrual basis, using the effective interest rate method. Dividend income is recognised when the right to receive payment has been established.

Cash and cash equivalents

Cash and cash equivalents are cash and short-term (up to 3 months from the moment of acquisition) high-liquidity investments that are readily convertible into a known amount of cash for up to three months from the actual transaction date 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.

Financial assets

All financial assets are initially recognised at cost, which is the fair value of the consideration paid for the financial asset. Acquisition costs are any costs that are directly attributable to the acquisition of the financial asset, including fees and commissions paid to agents and advisers, as well as any non-recoverable levies, taxes and duties. An exception is financial assets measured at fair value through profit or loss, the additional expenses related to the acquisition are recognised as an expense in the income statement.

A regular way purchase or sale of financial assets is recognised using trade date accounting. A trade date is the date at which the Group commits itself to purchase or sell a certain financial asset. 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.

Upon initial recognition, financial assets are classified in one of the following four categories of financial assets (see below). The following principles are used for measurement of financial assets in each category:

- Financial assets at fair value through profit or loss – fair value;
- Held-to-maturity investments – amortised cost;
- Loans and receivables – amortised cost;
- Available-for-sale financial assets – fair value or cost in case of equity instruments, the fair value of which cannot be reliably measured.

In 2017 and 2016, the Group only had financial assets in the "Loans and receivables" category.

Loans and receivables from other parties

After initial recognition, loans and receivables are measured at amortised cost using the effective interest rate method. Amortised cost is calculated for the whole term of useful life of the financial asset, including any discount or premium arising upon 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, the carrying amount of the financial asset is written down by the difference between the book value and the recoverable amount. The recoverable amount is the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

Financial assets that are individually significant are assessed for impairment on an individual basis. If 180 days or more has passed from the due date of the receivable, the amount receivable is classified as a doubtful receivable and written off as an expense to the extent of 100%. If a decrease in the value of assets becomes evident more quickly, the receivables are written down earlier.

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 income statement within which the impairment loss was originally recognised.

Interest income from receivables is recognised in the income statement on the line "Finance income".

Financial assets are derecognised when the company loses the right to cash flows from the financial assets and also when a liability arises to transfer these cash flows in full extent and without significant delay to third parties, to whom most of the risks and benefits related to the financial assets are transferred.

Derivative instruments

The risk policy of the Group specifies that company may use interest rate swaps from among derivative instruments to hedge the risks related to change in interest rates of financial liabilities. Such derivative instruments are initially recognised in the balance sheet at their fair value at the date of entering into a contract and subsequently remeasured in accordance with the change in the fair value of the instruments at the balance sheet date. A derivative instrument with a positive fair value is recognised as an asset and a derivative instrument with a negative fair value is recognised as a liability. In determining the fair value of interest rate swaps, bank quotations at the balance sheet date are used as a basis.

The group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Cash flow hedge

The effective portion of changes in the fair value of derivative instruments that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement on the line item "Finance income" or "Finance costs". Amounts accumulated in equity are reclassified in the income statement in the periods when the hedged item affects profit or loss. The gain or loss that is related to the effective portion of an instrument that hedges a credit risk with a variable interest rate is recognised in the income statement on the line item "Interest expense". When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss accumulated in equity at that time remains in equity and is classified in the income statement when the forecast transaction takes place. If the future transaction is no longer expected, the cumulative gain or loss recognised in equity is immediately recognised in the income statement.

Property, plant and equipment

Property, plant and equipment are tangible assets with a useful life of over one year when it is probable that future benefits attributable to them will flow to the group.

Land and buildings are measured using the revaluation model: land and buildings are measured after initial recognition at the revalued amount, which is equal to the fair value of the assets at the date of revaluation less accumulated depreciation and any accumulated impairment losses. Appraisals are carried out regularly by independent real estate specialists. Previously accumulated depreciation is eliminated on the date of revaluation and the former cost of the asset is replaced with its fair value at the date of revaluation.

If a revaluation of land and buildings results in an increase in the carrying amount of such land and buildings, it is credited to other comprehensive income and accumulated in equity under the heading "revaluation surplus". The reversal of a revaluation decrease of the same asset previously recognised as an expense is recognised in profit or loss. A decrease arising as a result of a revaluation is recognised as an expense to the extent that it exceeds any amount previously credited to the revaluation surplus relating to the same asset. The difference in depreciation arising from the difference between the initial cost and revaluation amount of the assets is transferred on an annual basis from the heading "revaluation surplus" to the heading "retained earnings".

Other property, plant and equipment is carried in the balance sheet at cost less accumulated depreciation and any accumulated impairment losses. Other property, plant and equipment is initially recognised at its cost, comprised of its purchase price and any expenditure directly attributable to the acquisition.

When an item of property, plant and equipment takes a substantial period of time to get ready for its intended use, the borrowing costs attributable to it are capitalized in the cost of the asset. Capitalization of borrowing costs is terminated when the asset is ready for its intended use to a material extent or its active development has been suspended for a substantial period of time.

Subsequent expenditures incurred on an item of property, plant and equipment are capitalized as non-current assets if it is probable that the company will obtain future economic benefits related to the item and if the cost of the item can be measured reliably. All other repair and maintenance costs are recognised as an expense during the financial period in which they are incurred.

The straight-line method is used for depreciation. A depreciation rate is assigned to each non-current asset individually depending on its useful life.

The ranges of depreciation rates for groups of property, plant and equipment are the following:

Buildings	2.5-10%
Machinery and equipment	7-10%
Fixtures	15-20%
Computers	20-33%

Depreciation begins when the asset is available for use for the purposes intended by management and continues until the residual value of the asset exceeds its carrying amount, when the asset is retired from use or when the asset is reclassified as "non-current assets held for sale". At each balance sheet date, the validity of applied depreciation rates, the depreciation method and the residual values applicable to assets is assessed.

At each balance sheet date, management estimates whether there is any evidence of impairment. If there are known facts, which may cause impairment of non-current assets, management calculates the recoverable amount of non-current assets (i.e. higher of the two following indicators: an asset's fair value less costs to sell and value in use). If the recoverable amount is lower than the carrying amount, the items of property, plant and equipment are written down to their recoverable amount. An impairment loss recognised in previous periods is reversed if a change has occurred in the estimates that were used as a basis for the determination of recoverable amount and if the recoverable amount has increased.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount and they are included in the income statement under other operating income and expenses.

Investment property

Investment property is property (land or a building or both) held or developed to earn rental income or for capital appreciation rather than for use in the production or supply of goods or services for administrative purposes. In addition, investment property includes properties, which are held over an extended period for an undetermined future use.

An investment property is initially recognised in the balance sheet at cost, including any directly attributable expenditure (e.g. notary fees, property transfer taxes, professional fees for legal services, and other transaction costs without which the transaction would not have taken place). After initial recognition, investment property is measured at fair value at each balance sheet date. The fair value of investment property reflects market conditions at the balance sheet date.

The fair value of investment property is determined based on the valuation performed by qualified appraisers. In determining the fair value, the method of discounted cash flows is used. 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 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, not asset structure. The discounted cash flow method is used to determine the value of investment properties that generate stable rental income. Gains and losses arising from changes in the 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 from the balance sheet on disposition or when the property is permanently withdrawn from use and the asset is expected to generate no future economic benefits. Gains and losses arising from the derecognition of investment property are recognised in profit or loss in the period of derecognition (in other income and other expenses, respectively).

When the purpose of use of an investment property changes, the asset is reclassified in the balance sheet. From the date of the change, the accounting policies of the group where the item has been transferred are applied. For a transfer from investment property to property, plant and equipment, the property's deemed cost for subsequent accounting is its fair value at the date of transfer.

Financial liabilities

All financial liabilities (trade payables, borrowings, accrued expenses, bonds issued and other current and non-current liabilities) are initially measured at cost that also includes all directly attributable expenditure incurred in the acquisition. Subsequent measurement is at amortised cost. Exceptions are financial liabilities acquired for the purpose of resale that are measured in fair value.

The amortised cost of current financial liabilities generally equals their nominal value; therefore, current financial liabilities are carried in the balance sheet in their net realisable value. For determining the amortised cost of non-current financial liabilities they are initially recognised at the fair value of the consideration received (less transaction costs), and subsequently interest expense is recognised on the liabilities using the effective interest rate method. Interest expenses on financial liabilities are recognised on the line "finance income" and "finance costs" in the income statement on an accrual basis. Interest expenses on financing the development of assets from the start of the development period until the acceptance of completed assets (real estate projects carried as inventories, investment properties, and items of property, plant and equipment) are capitalized and added to the carrying amount of the asset as borrowing costs.

A financial liability is classified as current if it is due within 12 months from the balance sheet date or if the company does not have an unconditional right to postpone payment of the liability more than 12 months after the balance sheet date. Loans with due date within 12 months after the balance sheet date which are refinanced as non-current after the balance sheet date but before the financial statements are authorised for issue, are recognised as current. Borrowings that the lender has the right to recall at the balance sheet date as a consequence of a breach of contractual terms are also recognised as current.

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

Success fee liability

EFTEN Kinnisvarafond II AS and EFTEN Capital AS have entered into a management agreement according to which EFTEN Capital AS is entitled to receive a success fee in the amount of 20% of the gain on sale of an investment or aggregate of investments above a hurdle rate of 7% on an annual basis. If the actual return of an investment is lower than 7% per annum during the lifetime of the investment, the difference between the actual return and the hurdle rate is also deducted from the sale price of the investment, so that the return before success fees would be at least 7% per annum. According to the management contract, the success fee is payable upon termination of the fund.

The basis for accounting for success fees on an accrual basis is the fair value estimates of investment property. Period expenses from the change in success fees are included in the general and administrative expenses of the Group.

Provisions and contingent liabilities

A provision is recognised in the balance sheet only when the company has a present legal or factual obligation as a result of an event that occurred before the balance sheet date, 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.

Present obligations arising from events that occurred before the balance sheet date, the realisation of which according to management's judgement is improbable, are also disclosed as contingent liabilities.

Leases

Leases, which transfer substantially all the risks and rewards incidental to ownership to the lessee, are classified as finance leases. Other leases are classified as operating leases.

Assets subject to operating leases are recognised in the lessor's balance sheet. Operating lease payments received and made are recognised as income and expenses, respectively, on a straight-line basis over the period of the lease.

Statutory reserve capital

According to the Estonian Commercial Code, the statutory reserve capital of a company has to amount to at least 10% of its share capital. Based on that, the parent company shall allocate at least 5% of the net profit to the statutory reserve capital annually. Transfers are continued until the required level has been achieved. The statutory reserve capital may not be paid out as dividends but it may be used for covering accumulated losses if there is an insufficient amount of unrestricted equity to cover the losses. The statutory reserve capital may also be used to increase equity through issuing new shares.

Income tax

Parent company and subsidiaries registered in Estonia

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Corporate income tax is paid on dividends. The tax rate on (net) dividends is 20/80. Income tax arising from dividend distribution is expensed when dividends are declared.

From 2019, tax rate of 14/86 can be applied to dividend payments. The more beneficial tax rate can be used for dividend payments in the amount of up to the average dividend payment during the three preceding years that were taxed with the tax rate of 20/80. When calculating the average dividend payment of three preceding years, 2018 will be the first year to be taken into account.

Subsidiaries in Latvia and Lithuania

The net profit of companies is taxed with a 15% income tax in Lithuania. Taxable income is calculated from the company's profit before income tax, adjusted in income tax returns by temporary or permanent income or expense adjustments under the requirements of the local income tax legislation.

For Lithuanian subsidiaries, the deferred income tax assets or liabilities are determined for all temporary differences between the tax bases of assets and liabilities and their carrying amounts at the balance sheet date. Deferred tax assets are recognised in the balance sheet only when it is probable that future taxable profit will be available against which the deductions can be made.

In accordance with the tax law effective until 2017, profits of entities in Latvia were taxable with income tax. Therefore, until that, deferred tax was provided for on all temporary differences arising between the tax bases of assets and liabilities of Latvian subsidiaries and their carrying amounts in the consolidated financial statements. In accordance with the new Corporate Income Tax Law, starting from 1 January 2018, corporate income tax with a rate of 20/80 is levied on profits arisen after 2017 only upon their distribution. Transitional provisions of the law allow for reductions in the income tax payable on dividends, if the entity has unused tax losses or certain provisions recognised by 31 December 2017.

Due to the new tax law, there are no longer differences between the tax bases and carrying amounts of assets and liabilities, and hence, deferred income tax assets and liabilities no longer arise in respect of subsidiaries in Latvia. All deferred tax assets and liabilities recognised in previous periods were derecognised in 2017 and related income tax expense/income was recorded in the statement of profit or loss.

2 Subsidiaries

Company name	Country of domicile	Investment property	Group's ownership interest, %	
			31.12.2017	31.12.2016
Parent company				
EFTEN Kinnisvarafond II AS	Estonia			
Subsidiaries				
EFTEN Sky OÜ	Estonia	Rävala pst 3 / Kuke tn 2, Tallinn, Estonia	100	100
Astlanda Hotelli AS	Estonia	Hotel operator company, Rävala pst 3 / Kuke tn 2, Tallinn, Estonia	100	100
EFTEN Dunte SIA	Latvia	Duntes 6, Riga, Latvia	100	100
Magistral Kaubanduskeskuse OÜ	Estonia	Sõpruse pst 201/203, Tallinn, Estonia	100	100
EFTEN Domina SIA	Latvia	Ieriku 3, Riga, Latvia	100	100
Kaunas Terminal UAB	Lithuania	Terminalo g. 10, Kaunas, Lithuania	100	0

On 3 August 2017, EFTEN Kinnisvarafond II AS acquired 100% of Kaunas Terminal UAB with the objective of acquiring the property at Terminalo 8 and 10 in Kaunas, Lithuania. In the course of the transaction, the Group paid EUR 6,473 thousand for the subsidiary and repaid the bank loan of the acquired subsidiary in the amount of EUR 275 thousand. Kaunas Terminal UAB cash balance at the time of the acquisition was EUR 184 thousand.

The fair value of the assets acquired and liabilities accompanied through the acquisition was as follows:

	Fair value
<i>EUR thousand</i>	
Cash	184
Receivables and prepaid expenses	146
Investment property (Note 14)	16,200
Bank loan (Note 16)	-9,995
Other liabilities	-160
Fair value of net assets	6,375
Acquisition cost	6,375
Goodwill	0

As at 31.12.2017, the Group has a claim against the seller in the amount of EUR 98 thousand.

No shares of a subsidiary are publicly listed.

3 Segment reporting

SEGMENT RESULTS

	Retail		Office		Logistics		Hotels and restaurants		Non-allocated		Total	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
<i>EUR thousands</i>												
Sale revenue (Note 4), incl.	11,212	5,227	2,279	2,143	540	0	10,373	8,679	0	0	24,404	16,048
Estonia	2,452	1,930	449	374	0	0	10,373	8,679	0	0	13,274	10,982
Latvia	8,760	3,297	1,830	1,769	0	0	0	0	0	0	10,590	5,066
Lithuania	0	0	0	0	540	0	0	0	0	0	540	0
Operating income, net, incl.	9,771	4,671	2,093	1,832	507	0	5,264	4,344	0	0	17,635	10,847
Estonia	2,397	1,936	330	218	0	0	5,264	4,344	0	0	7,992	6,498
Latvia	7,374	2,735	1,763	1,614	0	0	0	0	0	0	9,137	4,349
Lithuania	0	0	0	0	507	0	0	0	0	0	507	0
Operating profit, incl.	14,509	8,548	1,828	1,597	1,807	0	3,599	2,902	-70	-141	21,672	12,905
Estonia	1,831	3,515	260	129	0	0	3,599	2,902	-70	-141	5,620	6,405
Latvia	12,678	5,033	1,568	1,468	0	0	0	0	0	0	14,245	6,500
Lithuania	0	0	0	0	1,807	0	0	0	0	0	1,807	0
EBITDA, incl.	7,866	3,696	1,864	1,653	455	0	3,871	3,203	-70	-141	13,985	8,409
Estonia	2,026	1,660	296	185	0	0	3,871	3,203	-70	-141	6,123	4,906
Latvia	5,840	2,036	1,568	1,468	0	0	0	0	0	0	7,407	3,504
Lithuania	0	0	0	0	455	0	0	0	0	0	455	0
Operating profit											21,672	12,905
Net finance costs											-1,501	-1,040
Profit before income tax expense											20,171	11,865
Income tax expense (Note 10)											-241	-1,357
NET PROFIT FOR THE FINANCIAL YEAR											19,930	10,508

SEGMENT ASSETS

	Retail		Office		Logistics		Hotels and restaurants		Total	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
<i>EUR thousands</i>										
Investment property (Note 14)										
Estonia	26,090	26,320	0	0	0	0	0	0	26,090	26,320
Latvia	94,346	80,051	23,764	23,520	0	0	0	0	118,110	103,571
Lithuania	0	0	0	0	17,890	0	0	0	17,890	0
Total investment property	120,436	106,371	23,764	23,520	17,890	0	0	0	162,090	129,891
Non-current assets (Note 15)										
Estonia	3	2	6,000	6,000	0	0	40,390	40,350	46,393	46,352
Latvia	49	27	0	0	0	0	0	0	49	27
Lithuania	0	0	0	0	0	0	0	0	0	0
Total non-current assets	52	29	6,000	6,000	0	0	40,390	40,350	46,442	46,379
Other non-current assets									8	13
Net debt									-99,278	-83,314
Other current assets									1,051	805
Net assets									110,313	93,774

In 2017 and in 2016, no transactions were made between business segments. The Group's main income is from investment property located in the same countries where the subsidiary that made the property investment is located.

Income from none of the rental agreements exceeds 10% of consolidated rental income.

4 Revenue

Areas of activity	2017	2016
<i>EUR thousand</i>		
Rental income from office premises	2,078	1,974
<i>incl. investment property rental income</i>	1,722	1,683
<i>incl. fixed assets rental income</i>	356	291
Rental income from retail premises	9,238	4,546
<i>incl. investment property rental income</i>	9,171	4,486
<i>incl. fixed assets rental income</i>	67	61
Rental income from warehousing	539	0
<i>incl. investment property rental income</i>	539	0
Other revenue from rental premises	2,175	849
Hotel revenue from rooms	7,242	6,039
Hotel revenue from food and beverage	1,916	1,796
Hotel revenue from conference sales	1,215	844
Other sales revenue	1	1
Total revenue by areas of activity	24,404	16,048

Geographical areas	2017	2016
<i>EUR thousand</i>		
Estonia	13,274	10,982
Latvia	10,590	5,066
Lithuania	540	0
Total revenue by geographical areas	24,404	16,048

5 Cost of goods and services sold

Cost of goods and services sold	2017	2016
<i>EUR thousand</i>		
Repair and maintenance of rental property	-1,070	-398
Hotel direct costs from rooms	-797	-641
Hotel direct costs from food and beverage	-914	-741
Hotel royalty fees	-334	-316
Other direct costs related to hotel operation	-165	-132
Wages and salaries related to hotel operation, incl. taxes	-1,877	-1,538
Administrative expenses related to hotel operation	-618	-602
Property insurance	-69	-80
Land tax	-454	-238
Other administrative expenses	-82	-214
Amortization expense (Note 15)	-336	-295
Improvement costs	-24	-52
Impairment of receivables and receipt of impaired receivables	-29	47
Total cost of goods and services sold	-6,769	-5,201

6 Marketing costs

Marketing costs	2017	2016
<i>EUR thousand</i>		
Commission expenses on rental property	-22	-5
Wages and salaries, incl. taxes	-168	-144
Advertising, promotional events	-962	-454
Corporate marketing	-302	-260
Total marketing costs	-1,454	-864

7 General and administrative expenses

General and administrative expenses	2017	2016
<i>EUR thousand</i>		
Management services (Note 23)	-969	-639
Office expenses	-212	-212
Wages and salaries, incl. taxes	-997	-639
Consulting expenses	-301	-268
Change in success fee liability (Note 18)	-2,195	-1,041
Other general and administrative expenses	-125	-112
Amortization expense (Note 15)	-1	0
Total general and administrative expenses	-4,800	-2,911

8 Other income

Other income	2017	2016
<i>EUR thousand</i>		
Contractual penalties and late payment fees received	121	2
Other income	8	2
Total other income	129	4

9 Finance costs

Finance costs	2017	2016
<i>EUR thousand</i>		
Interest expenses, incl.	-1,506	-1,041
Interest expense on borrowings	-1,139	-645
Interest expense on swap transactions (Note 19)	-367	-396
Total finance costs	-1,506	-1,041

10 Income tax

	2017	2016
<i>EUR thousand</i>		
Income tax expense of Latvian subsidiaries	390	-826
Income tax on dividends	-631	-532
Total income tax expense	-241	-1,357

Due to changes in accounting policies for corporate income tax in Latvia, the Group reduced the deferred income tax liability by 1,027 thousand euros as at 31 December 2017.

As at 31.12.2017, the Group has a deferred income tax liability in connection with the use of tax amortization in Lithuania in the amount of EUR 44 thousand (31.12.2016: deferred income tax liability in the amount of EUR 1,321 thousand in connection with the use of tax amortization in Latvia). Deferred income tax liability arises upon the Group after the expiry of the tax amortization period.

11 Cash and cash equivalents

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Demand deposits	11,820	16,821
Cash in hand	54	69
Total cash and cash equivalents (Note 20)	11,874	16,890

12 Receivables and accrued income

Short-term receivables

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Trade receivables		
Receivables from customers	634	611
Allowance for doubtful trade receivables	-50	-29
Total trade receivables (Note 20)	584	582
Other short-term receivables		
Receivable from the acquisition of business combination (Note 2)	98	0
Other short-term receivables	22	19
Total other short-term receivables	120	19
Accrued income		
Other accrued income	182	62
Total accrued income	182	62
Total receivables (Note 20)	886	663

Trade receivables	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Undue	337	360
Expired, incl.	297	251
<i>Up to 30 days</i>	206	142
<i>30-60 days</i>	22	56
<i>More than 60 days</i>	69	53
Allowance for doubtful receivables	-50	-29
Total trade receivables	584	582

13 Prepayments

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Prepayments to suppliers	2	2
Prepayments of insurance	10	9
Prepayments of utility fees intermediation	3	20
Deferred expenses	37	25
Total prepayments	52	56

14 Investment property

As at 31.12.2017, the Group owns one investment property in Estonia, two in Latvia and one in Lithuania:

Name of the property	Location	Net leasable area (m2)	Date of acquisition	Acquisition cost	Market value at 31.12.2017	Share of market value of the fund's assets
<i>EUR thousand</i>						
Duntes Biroji office building	Duntes 6, Riga Latvia	12,650	11.2015	23,746	23,764	11%
Magistrali shopping centre	Sõpruse pst 201/203 Tallinn Estonia	11,720	02.2016	24,000	26,090	12%
Domina shopping centre	Ieriku 3, Riga Latvia	47,493	07.2016	74,500	94,315	43%
Kaunas Terminal logistic centre	Terminalo 8 and 10, Kaunas Lithuania	27,895	08.2017	16,200	17,890	8%
Total		99,758		138,446	162,059	73%

In 2017, the following changes have occurred in the Group's investment property:

	Completed investment property	Prepayments for investment property	Total investment property
<i>EUR thousand</i>			
Balance as at 31.12.2015	23,746	0	23,746
Acquisition and development	74,500	301	74,801
Acquisition from business combinations	24,000	0	24,000
Capitalized improvements	1,511	0	1,511
Gain/loss on changes in the fair value (Note 8)	5,833	0	5,833
Balance as at 31.12.2016	129,590	301	129,891
Acquisition and development	5,780	0	5,780
Acquisition from business combinations (Note 2)	16,200	0	16,200
Capitalized improvements	270	-270	0
Gain/loss on changes in the fair value (Note 8)	10,219	0	10,219
Balance as at 31.12.2017	162,059	31	162,090

The income statement and balance sheet of the Group include, among other items, the following income and expenses and balances related to investment property:

	2017	2016
Rental income earned on investment property	11,432	6,169
Expenses directly attributable to management of investment property	-1,533	-711
Prepayments for investment property	31	301
Carrying amount of investment property pledged as collateral to borrowings as at December 31	162,059	129,590

Investment property is pledged as collateral to long-term bank loans.

The terms of lease agreements entered into by the Group and tenants correspond to non-cancellable operating lease terms. Income from the aforementioned lease agreements is divided as follows:

Payments receivable under non-cancellable operating lease agreements	31.12.2017	31.12.2016
<i>EUR thousand</i>		
up to 1 year	11,467	9,155
1-5 years	22,974	21,971
Over 5 years	6,312	7,050
Total	40,753	38,176

Assumptions and basis for the calculation of fair value of investment property

An independent appraiser values the investment property of the Group. The fair value of all investment properties presented in the financial statements of the Group as at 31.12.2017 and 31.12.2016 was determined using the discounted cash flow method.

The following assumptions are used to determine fair value:

Sector	Fair value	Valuation method	Rental income per annum	Discount rate	Capitalization rate	Average rent €/m2
<i>EUR thousand</i>						
Office premises	23,764	Discounted cash flows	1,687	7.60%	7.0%	11.67
Logistics premises	17,890	Discounted cash flows	1,459	8.6%	8.5%	4.54
Retail premises	120,405	Discounted cash flows	9,569	8.6%-7.5%	7.2%-7.6%	13.99
Total	162,059					

As at 31.12.2016

Sector	Fair value	Valuation method	Rental income per annum	Discount rate	Capitalization rate	Average rent €/m2
<i>EUR thousand</i>						
Office premises	23,520	Discounted cash flows	1,694	7.60%	7.0%	11.48
Retail premises	106,070	Discounted cash flows	9,121	8.6%-9.25%	7.8%-8.0%	12.12
Total	129,590					

The fair value of investment property is based on the following:

- Rental income: real growth rates and rents under current lease agreements are used;
- Vacancy rate: the actual vacancy rate of the investment properties, taking into account the risks associated with the property;
- Discount rate: calculated using the weighted average cost of capital (WACC) associated with the investment property;

- Capitalization rate: based on the estimated level of return at the end of the estimated holding period, taking into consideration the forecasted market conditions and risks associated with the property.

Fair value sensitivity analysis

The table provided below illustrates the sensitivity of the fair value of investment property included in the balance sheet of the Group as at 31.12.2017 to the most significant management's assumptions, which was made on the acquisition:

Sector	Sensitivity to management estimates			Sensitivity to discount rate and capitalization rate				
	Assess- ment	Effect of decrease to value	Effect of increase to value		Change in discount rate			
					-0.5%	0.0%	0.5%	
<i>EUR thousand</i>					<i>Fair value</i>			
Office premises	Change in rental income +/-10%	-2,554	2,526	Change in the capitalization rate	-0.5%	25,624	25,100	24,580
					0.0%	24,260	23,764	23,280
					0.5%	23,080	22,610	22,152
Logistics premises	Change in rental income +/-10%	-1,900	1,880	Change in the capitalization rate	-0.5%	19,030	18,650	18,280
					0.0%	18,250	17,890	17,540
					0.5%	17,560	17,220	16,880
Retail premises	Change in rental income +/-10%	-14,155	14,045	Change in the capitalization rate	-0.5%	129,400	126,760	124,168
					0.0%	122,900	120,405	117,960
					0.5%	117,233	114,860	112,553

As at 31.12.2016

Sector	Sensitivity to management estimates			Sensitivity to discount rate and capitalization rate				
	Assess- ment	Effect of decrease to value	Effect of increase to value		Change in discount rate			
					-0.5%	0.0%	0.5%	
<i>EUR thousand</i>					<i>Fair value</i>			
Office premises	Change in rental income +/-10%	-2,510	2,500	Change in the capitalization rate	-0.5%	25,350	24,830	24,320
					0.0%	24,010	23,520	23,050
					0.5%	22,850	22,390	21,940
Retail premises	Change in rental income +/-10%	-12,480	12,380	Change in the capitalization rate	-0.5%	113,480	111,160	108,900
					0.0%	108,270	106,070	103,930
					0.5%	103,680	101,580	99,540

Level three inputs are used to determine the fair value of all of the investment properties of the Group.

More information on property investments is provided in Notes 2 and 20.

15 Property, plant and equipment

	Land and buildings ¹	Depreciated buildings	Machinery and equipment	Other property, plant and equipment	Advance payments	Total
<i>EUR thousand</i>						
Carrying amount 31.12.2016	44,539	1,212	248	322	58	46,379
<i>Cost 31.12.2016</i>	<i>44,539</i>	<i>1,500</i>	<i>394</i>	<i>898</i>	<i>58</i>	<i>47,389</i>
<i>Accumulated depreciation 31.12.2016</i>	<i>0</i>	<i>-288</i>	<i>-146</i>	<i>-576</i>	<i>0</i>	<i>-1,010</i>
Purchases	0	0	87	216	45	348
Reclassification	0	0	0	52	-52	0
Revaluation through comprehensive income	52	0	0	0	0	52
Depreciation charge	0	-150	-45	-142	0	-337
Carrying amount 31.12.2017	44,591	1,062	290	448	51	46,442
<i>Cost 31.12.2017</i>	<i>44,591</i>	<i>1,500</i>	<i>481</i>	<i>1,166</i>	<i>51</i>	<i>47,789</i>
<i>Accumulated depreciation 31.12.2017</i>	<i>0</i>	<i>-438</i>	<i>-191</i>	<i>-718</i>	<i>0</i>	<i>-1,347</i>

¹ Radisson Blu Sky Hotel, the sole asset in the land and buildings category, is measured using the revaluation method as an investment in property, plant and equipment. According to the management estimate, the asset contained in the land and buildings category is of a substantial residual value and therefore it is a non-depreciable asset. Gains and losses of revaluation of property, plant and equipment are recognised in Group equity as a reserve.

If the cost method had been used, the residual value of land and buildings would have been as follows:

	Land and buildings	Depreciated buildings
Carrying amount 31.12.2016	43,944	1,212
<i>Cost 31.12.2016</i>	<i>43,944</i>	<i>1,500</i>
<i>Accumulated depreciation 31.12.2016</i>	<i>0</i>	<i>-288</i>
Depreciation charge	0	-150
Carrying amount 31.12.2017	43,944	1,062
<i>Cost 31.12.2017</i>	<i>43,944</i>	<i>1,500</i>
<i>Accumulated depreciation 31.12.2017</i>	<i>0</i>	<i>-438</i>

The property, plant and equipment of the group is divided into two categories:

- 1) Property, plant and equipment of insignificant residual value whereby the cost is depreciated to profit and loss over the useful life of the asset;
- 2) Property, plant and equipment with a significant residual value, for which only the depreciable portion of the difference between the cost and the residual value is depreciated into an expense over their useful lives.

The group owns Radisson Blu Sky Hotel, which is subject to appraisal of its residual value at each balance sheet date. The appraisal provided by Colliers International Advisors OÜ as to the market value of the hotel has been used in the estimation of residual value. Independent valuation specialist of the group has valued the assets using the discounted cash flows method, taking into account the location, condition and wear and tear of the assets and market conditions. As a result of the appraisal of residual value that was carried out, it was concluded that the asset is not sold at a significantly lower value compared to its carrying amount as at 31.12.2017 because it is very favourably located in central Tallinn and the hotel is new and does not require major capital expenditure. If the cost model had been used, the carrying amount of land and buildings (incl. depreciated buildings) as at 31.12.2017 would have amounted to EUR 45,006 (31.12.2016: 45,156) thousand.

Assumptions and basis for the calculation of fair value of land and buildings

Radisson Blu Sky Hotel, the Group's sole asset in the land and buildings category, is appraised by an independent valuation specialist. The fair value of the land and buildings as provided in the Group's financial statements as at 31.12.2017 has been determined with discounted cash flows method. The following assumptions were used to determine fair value:

	Fair value	Valuation method	Rental income per annum	Discount rate	Capitalization rate	Average rent €/m2
<i>EUR thousand</i>						
Radisson Blu Sky hotel	45,653	Discounted cash flows	3,473	8.1%	7.0%	13.39
Total	45,653					

As at 31.12.2016

	Fair value	Valuation method	Rental income per annum	Discount rate	Capitalization rate	Average rent €/m2
<i>EUR thousand</i>						
Radisson Blu Sky hotel	45,751	Discounted cash flows	3,273	8.1%	7.0%	13.39
Total	45,751					

Fair value sensitivity analysis

The table provided below illustrates as at 31.12.2017 the sensitivity of the fair value of land and buildings included in the balance sheet of the Group to the most significant assumptions:

	Sensitivity to management estimates			Sensitivity to discount rate and capitalization rate						
	Assessment	Effect of decrease to value	Effect of increase to value	Change in discount rate						
				-0.5%	0.0%	0.5%	Fair value			
<i>EUR thousand</i>										
Radisson Blu Sky hotel	Change in rental income +/-10%	-4,920	4,900	Change in the capitalization rate	-0.5%	49,193	48,920	47,193		
					0.0%	47,340	45,653	45,460		
					0.5%	44,353	44,190	42,573		

As at 31.12.2016

	Sensitivity to management estimates			Sensitivity to discount rate and capitalization rate						
	Assessment	Effect of decrease to value	Effect of increase to value	Change in discount rate						
				-0.5%	0.0%	0.5%	Fair value			
<i>EUR thousand</i>										
Radisson Blu Sky hotel	Change in rental income +/-10%	-4,910	4,910	Change in the capitalization rate	-0.5%	49,940	48,920	47,930		
					0.0%	47,310	46,350	45,420		
					0.5%	45,030	44,120	43,240		

The income statement and balance sheet of the Group include, among other items, the following income and expenses and balances related to non-current assets:

	2017	2016
<i>EUR thousands</i>		
Revenue from hotel operation	10,373	8,679
Direct costs related to hotel operation	-4,772	-4,028
Rental income from property, plant and equipment	423	351
Direct costs attributable to management of property, plant and equipment	-127	-168
Depreciation expense on property, plant and equipment	-337	-294
Carrying amount of property, plant and equipment provided as collateral to secure borrowings as at 31 December	45,653	45,752

The terms of lease agreements entered into by the Group and tenants correspond to non-cancellable operating lease terms. Income from the aforementioned lease agreements is divided as follows:

Payments received under non-cancellable operating lease agreements	31.12.2017	31.12.2016
<i>EUR thousand</i>		
up to 1 year	454	401
2-5 years	683	817
Over 5 years	410	242
Total	1,547	1,460

16 Borrowings

As at 31.12.2017, the Group has the following borrowings:

Lender	Country of lender	Loan amount as per agreement, EUR thousand	Loan balance as at 31.12.2017	Contract term	Interest rate as at 31.12.2017	Loan collateral (Note 13, 14)	Value of collateral	Loan balance's share of the fund's net asset value
SEB	Estonia	23,000	23,000	28.01.19	0.708%	mortgage - Rāvāla 3, Astlanda Hotelli AS warranty	45,653	20.8%
SEB	Latvia	4,420	4,106	30.11.20	1.30%	mortgage - Duntē iela 6, Riga Latvia	23,764	3.7%
SEB	Latvia	9,780	9,034	30.11.20	1.30%	mortgage - Sõpruse pst 201/203, Tallinn Estonia	26,090	8.2%
Danske	Estonia	12,000	11,250	25.02.21	1.35%	mortgage- Ieriku 3, Riga Latvia	94,315	10.2%
Luminor	Latvia	27,360	26,334	25.06.21	1.30%	mortgage - Terminalo 8 and 10, Kaunas Lithuania	17,890	23.9%
Luminor	Latvia	20,640	19,832	25.06.21	1.30%			18.0%
Luminor	Lithuania	9,720	9,549	30.06.22	1.37%			8.7%
Total		106,920	103,105				207,712	93%

Short-term borrowings	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Repayments of long-term bank loans in the next period	2,691	2,339
Discounted contract fees on bank loans	-42	-40
Total short-term borrowings	2,649	2,299

Long-term borrowings	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Total long-term borrowings	102,984	92,781
Incl. current portion of borrowings	2,649	2,299
<i>Bank loans</i>	2,691	2,339
<i>Discounted contract fees on bank loans</i>	-42	-40
Incl. non-current portion of borrowings, incl.	100,335	90,481
<i>Bank loans</i>	100,414	90,589
<i>Discounted contract fees on bank loans</i>	-79	-107

Bank loans are divided as follows according to repayment date:

Repayment of bank loans by maturity dates	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Less than 1 year	2,691	2,339
2-5 years	100,414	90,589
Repayment of bank loans by maturity dates	103,105	92,928

In 2017, the following changes have occurred in the Group's loan balances:

Lender	Loan balance as at 31.12.2016	Loans received	Additions through business combinations	Loan repayments	Loan balance as at 31.12.2017
<i>EUR thousand</i>					
SEB	23,000	0	0	0	23,000
SEB	4,257	0	0	-152	4,106
SEB	9,370	0	0	-336	9,034
Danske Bank	11,661	0	0	-411	11,250
Luminor Bank	44,640	2,966	0	-1,440	46,166
Luminor Bank	0	0	9,720	-171	9,549
Total	92,928	2,966	9,720	-2,509	103,105

More information on borrowings is provided in Note 2 and 20.

17 Payables and prepayments

Short-term payables and prepayments

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Trade payables	745	1,224
Total trade payables	745	1,224
Tax liabilities		
Value added tax	255	189
Corporate income tax	427	264
Personal income tax	55	49
Social tax	121	103
Other tax liabilities	14	12
Total tax liabilities	872	617
Accrued expenses		
Interest payable	14	15
Payables to employees	200	168
Tenant security deposits	413	368
Other accrued liabilities	511	316
Total accrued expenses	1,138	868
Prepayments		
Prepayments received from buyers	73	57
Other deferred income	3	8
Total prepayments	76	65
Total payables and prepayments	2,831	2,773

Long-term payables

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Tenant security deposits	1,354	1,029
Total other long-term payables	1,354	1,029

More information on payables and prepayments is provided in Note 20.

18 Success fee liability

As at 31.12.2017, the Group has accounted for a success fee liability in the amount of EUR 3,236 (31.12.2016: EUR 1,041) thousand. The accounting for success fee on an accrual basis is based on fair value assessments of investment property as at the balance sheet date. Expenses from the change in success fees are included in the Group's general and administrative expenses (Note 7).

19 Derivative instruments

As at 31.12.2017, the Group had three effective interest rate swap agreements fixing the interest rate on long-term borrowings at notional value of EUR 58,883 thousand (31.12.2016: one agreement at notional value of EUR 50,360 thousand).

The terms and payment schedule of the interest rate swap transactions correspond to the loan repayment schedule of the loan that is subject to the hedge and has been accounted for as a cash flow hedging instrument.

The derivative instruments will expire in 2021 and 2022, the base interest rate is the 1- or 3-month EURIBOR. The Group's floating interest rate is fixed at the level of 0-0.65% according to the interest rate swap agreement.

The fair value of the derivative instruments is based on the quotation provided by the banks that are contractual partners, the fair value of the derivative position as at 31.12.2017 was negative in the amount of EUR 703 thousand (31.12.2016: negative in the amount of EUR 1,260 thousand).

The Group's interest expense attributable to the interest rate swap transactions in 2017 was EUR 367 thousand (2016: EUR 396 thousand) (Note 9).

More information on derivative instruments is provided in Note 20.

20 Financial instruments, management of financial risks

The main financial liabilities of the Group are borrowings that have been raised to finance the investments of the Group. The Group's balance sheet also includes cash, accounts receivable, other receivables, accounts payable and liabilities related to interest rate derivatives used for the mitigation of interest rate risk.

The table below indicates the division of the Group's financial assets and financial liabilities according to financial instrument type.

Carrying amounts of financial instruments

	Notes	31.12.2017	31.12.2016
<i>EUR thousand</i>			
Financial assets - loans and receivables			
Cash and cash equivalents	11	11,874	16,890
Trade receivables	12	584	582
Total financial assets		12,458	17,472
Financial liabilities			
Borrowings	16	102,984	92,780
Trade payables	17	745	1,224
Tenant security deposits	17	1,767	1,397
Accrued expenses	17	511	316
Success fee liability	18	3,236	1,041
Financial liabilities measured at amortised cost		109,243	96,758
Derivative instruments (interest derivatives)	19	703	1,260
Financial liabilities measured at fair value		703	1,260
Total financial liabilities		109,946	98,018

The fair value of such financial assets and financial liabilities that are measured at amortised cost, presented in the table provided above, does not materially differ from their fair value.

In 2017, the following changes have occurred in the Group's financial liabilities:

	As at 31.12.2016	Change in the cash flows	Non-cash changes			As at 31.12.2017
			Additions through business combinations	Fair value adjustment	Other non-cash adjustments	
EUR thousands						
Borrowings	92,780	484	9,720	0	0	102,984
Trade payables	1,224	-576	97	0	0	745
Tenant security deposits	1,397	350	20	0	0	1,767
Accrued expenses	316	170	25	0	0	511
Success fee liability	1,041	0	0	0	2,195	3,236
Derivative instruments (interest derivatives)	1,260	0	0	-557	0	703
Total financial liabilities	98,018	428	9,862	-557	2,195	109,946

Risk management of the Group is based on the principle that risks must be assumed in a balanced manner, by taking into consideration the rules established by the Group and by applying risk mitigation measures according to the situation, thereby achieving stable profitability of the Group and growth in the value of shareholder assets. In making new investments, extensive evaluation is undertaken on the solvency of potential customers, duration of lease contracts, possibility of replacing tenants and the risk of increases in the interest rates. The terms and conditions of financing agreements are adjusted to match the net cash flow of each property, ensuring the preservation of sufficient unrestricted cash for the Group and growth even after the financial liabilities have been met.

In investing the Group's assets, the risk expectations of the Group's investors are taken as a basis, therefore, excessive risk-taking is unacceptable and suitable measures need to be applied for the mitigation of risks.

The Group considers a financial risk to be risk that arises directly from making investments, including the market risk, liquidity risk and credit risk, thus reducing the company's financial capacity or reducing the value of investments.

Market risk

Market risk is a risk involving change in the fair value of financial instruments due to changes in market prices. The Group's financial instruments most influenced by changes in market prices are borrowings and interest rate derivatives. The main factor influencing these financial instruments is interest rate risk.

Interest rate risk

Interest rate risk is the risk of changes in the future cash flows of financial instruments due to changes in market interest rates. A change in market interest rates mainly influences the long-term floating rate borrowings of the Group.

As at 31.12.2017, all of the Group's borrowings bear interest based on a floating interest rate and are linked to the 1- or 3-month EURIBOR. The 1-month EURIBOR fluctuated in 2017 within the range of -0.366% to -0.375% (2016: -0.21% to -0.374%) and the 3-month EURIBOR fluctuated between the range of -0.318% to -0.332% (2016: -0.132% to -0.139%). The covenants of the Group's loan agreements require the Group to maintain a debt coverage ratio in excess of 3.0. As at 31.12.2017, the Group's debt coverage ratio was 3.5 (2016: 3.8).

Due to the currently prevailing low level of interest rates and market expectations as to the persistence of such interest rates in the near future, the mitigation of interest rate risk is mainly important in the long-term perspective. The Group's management assesses the most significant impact arising from the potential increase in interest rates over the perspective of 4-7 years.

As a result of the long-term nature of the Group's investments and the long-term borrowings associated with the investments, the management of EFTEN Kinnisvarafond II AS decided in 2015 to mitigate the risk of an increase of the long-term floating interest rate applicable to the loan portfolio by fixing the applicable floating interest rate. It was decided to use interest rate swap agreement for the risk mitigation whereby the floating interest rate loan agreements were exchanged for a fixed interest rate. The decision was made to enter into the interest rate swap agreements considering the following conditions:

- (1) The asset that secures the loan agreement that the cash flow hedge applies to is unlikely to be sold prior to the maturity of the fund (i.e. before the year 2025);
- (2) The loan agreement that the cash flow hedge applies to is being extended at maturity until the expiry date of the swap agreement in order for the cash flows of the loan agreements to coincide with the cash flows of the swap agreement settlement schedule.

For hedging the interest rate risk, three interest rate swap contracts have been concluded:

Country	Contract nominal value, EUR thousands	Fixed interest rate	Contract term	Fair value, EUR thousands		
				31.12.2017	31.12.2016	
SEB	Estonia	23,000	1-month EURIBOR fixed at 0.65%	30.08.2022	-579	-996
Luminor	Latvia	26,334	1-month EURIBOR fixed at 0%	25.06.2021	-42	-264
Luminor	Lithuania	9,549	3-month EURIBOR fixed at 0.65%	30.06.2022	-82	0
Total		58,883			-703	-1,260

As at 31.12.2017, the borrowings related to interest rate swap agreements made up 57% (31.12.2016: 54%) of all the Group's borrowings.

The group accounts for the interest rate swap agreements based on the principle of hedge accounting. The total fair value of the Group's interest rate swap agreements as at 31.12.2017 was negative in the amount of EUR 703 thousand (31.12.2016: negative in the amount of EUR 1,260 thousand) (Note 19).

Liquidity risk

Liquidity risk arises from potential changes in the financial position, reducing the Group's ability to meet its liabilities in due time and in a correct manner. Above all, the group's liquidity is affected by the following factors:

- Decrease or volatility of rental- and accommodation income, reducing the Group's ability to generate positive net cash flows;
- Vacancy of rental property;
- Hotel utility rate;
- Mismatch between the maturities of assets and liabilities and flexibility in changing them;
- Financing structure.

The objective of the Group is to manage its net cash flows, so not to use debt in making investments in excess of 60% of the cost of the investment.

The financing policy of the Group specifies that loan agreements for raising debt are entered into on a long-term basis, also taking into consideration the maximum duration of the lease agreements on these investment objects. The table below summarises the information on the maturities of the Group's financial liabilities (undiscounted cash flows):

As at 31.12.2017	Less than 1 month	1-4 months	Between 4 and 12 months	Between 1 and 5 years	Over 5 years	Total
<i>EUR thousand</i>						
Interest-bearing liabilities	192	662	1,794	100,336	0	102,984
Interest payments	126	377	999	2,670	0	4,173
Interest derivatives liabilities	0	0	0	703	0	703
Interest payable	14	0	0	0	0	14
Trade payables	745	0	0	0	0	745
Success fee liability	0	0	0	0	3,236	3,236
Tenant security deposits	4	177	232	1,034	320	1,767
Accrued expenses	511	0	0	0	0	511
Total financial liabilities	1,593	1,217	3,025	104,743	3,556	114,133

As at 31.12.2016	Less than 1 month	1-4 months	Between 4 and 12 months	Between 1 and 5 years	Over 5 years	Total
<i>EUR thousand</i>						
Interest-bearing liabilities	191	574	1,534	90,481	0	92,780
Interest payments	111	330	872	3,230	0	4,543
Interest derivatives liabilities	0	0	0	263	996	1,259
Interest payable	15	0	0	0	0	15
Trade payables	1,224	0	0	0	0	1,224
Success fee liability	0	0	0	0	1,041	1,041
Tenant security deposits	4	63	301	799	230	1,397
Accrued expenses	316	0	0	0	0	316
Total financial liabilities	1,862	967	2,706	94,774	2,267	102,575

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 is subject to credit risk due to its business operations (mainly arising from trade receivables) and transactions with financial institutions, including through cash on bank accounts and deposits.

The Group's activity in preventing reduction of cash flows due to credit risk and minimising such risk lies in the daily monitoring and guiding of clients' payment behaviour, so that appropriate measures could be applied on a timely basis.

The Group's companies generally only enter into co-operation and rental agreements with parties that have been determined to be eligible for credit. The corresponding analysis of customers is carried out before entering into a contract.

If it becomes evident that there is a risk of a client or tenant becoming insolvent, the Group assesses each receivable individually and decides whether the receivables should be classified as doubtful. In general, receivables that have exceeded the payment term by more than 180 days are classified as doubtful, except in cases where the Group has sufficient certainty as to the collectability of the receivable or there is a payment schedule in place for the payment of the receivables.

Accounts receivable are illustrated by the table below:

	31.12.2017	31.12.2016
<i>EUR thousands</i>		
Undue	337	360
Past due	297	251
<i>up to 30 days</i>	206	142
<i>30-60 days</i>	22	56
<i>more than 60 days</i>	69	53
Allowance for doubtful receivables	-50	-29
Total trade receivables	584	582

The maximum credit risk of the Group is provided in the table below:

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Cash and cash equivalents	11,874	16,890
Trade receivables	584	582
Total maximum credit risk	12,458	17,472

The bank account balances presented as part of the cash and cash equivalents of the Group are divided according to the credit ratings of banks (*Moody's long-term*) as follows:

Rating	31.12.2017	31.12.2016
A1	2,418	1,741
Aa3	9,402	15,079
Total	11,820	16,821

Capital management

The aim of the Group in capital management is to ensure the Group's going concern status to provide an investment return to shareholders and maintain an optimal capital structure. The Group's capital includes borrowings and equity.

The Group invest in real estate that generates cash flow in Estonia and Latvia. The investment policy of the group stipulates that no more than 30% of the asset value of the fund can be invested in any one investment. The necessary equity level is calculated individually for each investment, taking into consideration the amount of net cash flows and loan payments of each investment and their proportion.

Fair value

The table below analyses assets and liabilities measured at fair value by valuation methods. The valuation methods have been defined as follows:

Level 1 – quoted prices in active markets;

Level 2 – inputs other than quoted market prices that are observable for the asset or liability, either directly or indirectly;

Level 3 – unobservable inputs at the market.

As at 31.12.2017, the Group has no assets measured at fair value that would be included within Level 1 of the fair value hierarchy. All of the Group's investment properties (Note 14) and property, plant and equipment measured at revaluation method (Note 15) are measured at fair value and according to the valuation method are included within Level 3 of the fair value hierarchy. All of the Group's borrowings and the derivative contracts entered into to mitigate the interest risk are included within Level 2 of the fair value hierarchy.

The group has entered into interest rate swap agreements (Note 19) for the mitigation of interest rate risk. The fair value of such agreements is determined through the discounting of cash flows from interest rate swap agreements by determining the cash inflows and outflows according to market expectations with regard to EURIBOR and such cash flows are discounted using the zero-rate. The group uses information sourced from credit institutions used as counterparties for the fair value accounting of interest rate swap agreements.

21 Share capital

In February 2016, EFTEN Kinnisvarafond II issued 1,347,663 shares with a nominal value of EUR 10. New shares were issued at a premium in the amount of EUR 0.1509 per share. Consequently, the share capital increased by EUR 13,477 thousand and share premium increased by EUR 203 thousand. A total of EUR 13,680 thousand in cash was paid for new shares and in share premium.

In June 2016, EFTEN Kinnisvarafond II issued 3,299,839 new shares with a nominal value of EUR 10 euros and at a premium of EUR 0.4046 per share. Consequently, the share capital increased by EUR 32,998 thousand and share premium increased by EUR 1,335 thousand. A total of EUR 34,333 thousand in cash was paid for new shares and in share premium.

The amount of registered share capital of EFTEN Kinnisvarafond II AS as at 31.12.2017 is EUR 80,718 thousand. The share capital consisted of 8,071,756 shares as at 31.12.2017 with nominal value of EUR 10. Without amending the articles of association, the company may increase its share capital to EUR 100,100 thousand

In the financial year, EUR 525 (2016: 151) thousand was transferred from retained earnings to the statutory reserve.

More information on share capital is provided in Note 27.

22 *Contingent liabilities*

Contingent income tax liability

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
The company's retained earnings	26,654	11,249
Potential income tax liability	5,331	2,250
The amount that can be paid out as dividends	21,323	8,999

The calculation of the maximum potential income tax liability is based on the assumption that the net dividends distributed and the arising income tax expense in total cannot exceed the profit eligible for distribution as at 31.12.2017 and 31.12.2016.

Potential liabilities arising from the tax audit

Estonia

The tax authorities have neither started nor performed any tax audits or individual case audits in any of the Group companies. The tax authorities have the right to verify the company's tax records up to 5 years from the time of filing the tax return and upon finding errors, impose additional taxes, interest and fines. The management estimates that there are not any circumstances, which may lead the tax authorities to impose additional significant taxes on the Group

Latvia and Lithuania

The management estimates that there are no circumstances which may lead the tax authorities to impose additional significant taxes on the Group.

23 *Related party transactions*

EFTEN Kinnisvarafond II AS considers the following as related parties:

- Management Board members and companies owned by the Management Board members of EFTEN Kinnisvarafond II AS;
- Supervisory Board members and companies owned by the Supervisory Board members of EFTEN Kinnisvarafond II AS;
- employees and companies owned by the employees of EFTEN Kinnisvarafond II AS;
- EFTEN Capital AS (fund management company).

The Group purchased management services from EFTEN Capital AS in the accounting period in the amount of EUR 969 (2016: 639) thousand (Note 7) and accounting and intermediary services in the amount of EUR 79 (2016: 62) thousand from the subsidiaries and affiliated companies of EFTEN Capital AS.

In the accounting period, the Group had 133 (2016: 124) employees who were remunerated including taxes in the amount of EUR 3,041 (2016: 2,321) thousand. In the accounting period, no compensations were calculated or paid to the management and supervisory board members of the Group. Members of the Group's management board are employed by EFTEN Capital AS, the company providing asset management services to the Group, and expenses related to management board members' activities are included in management services.

24 Parent company's separate income statement

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (Parent Company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the Parent Company, the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for reporting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the annual report in conjunction with IAS 27, Consolidated and Separate Financial Statements.

In the parent separate primary financial statements, disclosed to these consolidated financial statements (Supplementary disclosures), investments in subsidiaries are measured at fair value.

	2017	2016
<i>EUR thousand</i>		
Revenue	910	587
Gross profit	910	587
General and administrative expenses	-1,081	-729
Other income	100	0
Gain from subsidiaries	16,424	7,796
Dividend income	4,000	2,127
Finance income	186	450
Profit before income tax	20,539	10,232
Total comprehensive income for the financial year	20,539	10,232

25 Parent company's separate balance sheet

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
ASSETS		
Cash and cash equivalents	1,514	7,436
Receivables and accrued income	44	476
Total current assets	1,558	7,912
Non-current assets		
Shares of subsidiaries	103,358	77,960
Long-term receivables	5,408	7,908
Total non-current assets	108,766	85,868
TOTAL ASSETS	110,324	93,781
LIABILITIES AND EQUITY		
Current liabilities		
Payables	11	7
Total current liabilities	11	7
Total liabilities	11	7
Equity		
Share capital	80,718	80,718
Share premium	2,321	2,321
Statutory reserve capital	676	151
Retained earnings	26,598	10,584
Total equity	110,313	93,774
TOTAL LIABILITIES AND EQUITY	110,324	93,781

26 Parent company's separate statement of cash flows

	2017	2016
<i>EUR thousand</i>		
Cash flows from operating activities		
Net profit	20,539	10,232
<i>Adjustments to net profit:</i>		
Finance income and costs	-186	-450
Gain/-loss on the fair value adjustment of subsidiaries	-16,424	-7,796
Dividends received	-4,000	-2,127
Total adjustments with non-cash changes	-20,610	-10,373
Cash flow from operations before changes in working capital	-71	-141
Change in receivables and payables related to operating activities	-36	2
Net cash generated from operating activities	-107	-140
Cash flows from investing activities		
Acquisition and establishment of investments in subsidiaries	-6,474	-42,501
Loans granted	-725	-28
Repayment of loans granted	725	28
Dividends received	4,000	2,127
Interests received	659	1
Net cash generated from investing activities	-1,815	-40,374
Cash flows from financing activities		
Proceeds from issuance of shares	0	48,013
Dividends paid	-4,000	-2,127
Net cash generated from financing activities	-4,000	45,886
NET CASH FLOW	-5,922	5,373
Cash and cash equivalents at the beginning of the period	7,436	2,063
Change in cash and cash equivalents	-5,922	5,373
Cash and cash equivalents at the end of the period	1,514	7,436

27 Parent company's separate statement of changes in equity

	Share capital	Share premium	Statutory reserve capital	Retained earnings	Total
<i>EUR thousand</i>					
Balance as at 31.12.2015	34,243	782	0	2,631	37,656
Issue of shares	46,475	1,538	0	0	48,013
Dividends paid	0	0	0	-2,127	-2,127
Transfers to reserve capital	0	0	151	-151	0
Profit for the financial year	0	0	0	10,232	10,232
Balance as at 31.12.2016	80,718	2,321	151	10,584	93,774
Balance as at 31.12.2016	80,718	2,321	151	10,584	93,774
Dividends paid	0	0	0	-4,000	-4,000
Transfers to reserve capital	0	0	525	-525	0
Profit for the financial year	0	0	0	20,539	20,539
Balance as at 31.12.2017	80,718	2,321	676	26,598	110,313

Adjusted unconsolidated equity of the parent company (to account for compliance with the requirements set forth in the Commercial Code) is as follows:

	31.12.2017	31.12.2016
<i>EUR thousand</i>		
Parent company's unconsolidated equity	110,313	93,774
Carrying amount of subsidiaries in the separate balance sheet of the parent company (minus)	-103,358	-77,960
Value of subsidiaries under the equity method (plus)	103,358	77,960
Total	110,313	93,774



INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of EfTEN Kinnisvarafond II AS

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of EfTEN Kinnisvarafond II AS and its subsidiaries (together the Group) as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

We audited the Group's consolidated financial statements that comprise:

- the consolidated statement of financial position as at 31 December 2017;
- the consolidated income statement and statement of other comprehensive income for the year then ended;
- the consolidated cash flow statement for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

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

Other information

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



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

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

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

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

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

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

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

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.



- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

AS PricewaterhouseCoopers

/signed/

Lauri Past
Auditor's certificate no.567

/signed/

Rando Rand
Auditor's certificate no.617

28 February 2018

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

This independent auditor's report (translation of the Estonian original) should only be used with an annual report initialled for identification purposes by AS PricewaterhouseCoopers.

Proposal for profit allocation

The Management Board makes the following profit allocation proposal at the general meeting of EFTEN Kinnisvarafond II AS (in EUR):

Retained earnings as at 31.12.2017	26,654,182
Allocation to statutory reserve capital	996,519
Distribution of dividends	7,022,428
Retained earnings after allocations	18,635,235

/digitally signed/

Viljar Arakas

Member of the Management Board

/digitally signed/

Tõnu Uustalu

Member of the Management Board

28 February 2018

Signatures of the members of the Management Board and Supervisory Board to the 2017 annual report

We hereby confirm the correctness of data presented in the 2017 annual report of EFTEN Kinnisvarafond II AS.

Arti Arakas

Chairman of the Supervisory Board

Siive Penu

Member of the Supervisory Board

Sander Rebane

Member of the Supervisory Board

Olav Miil

Member of the Supervisory Board

/digitally signed/

Viljar Arakas

Member of the Management Board

/digitally signed/

Tõnu Uustalu

Member of the Management Board

Distribution of revenue in accordance with the Estonian Classification of Economic Activities

	Classification of Economic Activities code	2017	Revenue %	Main activity
EUR thousand				
Management of funds	66301	910	100%	yes