Consolidated Annual Report 2018

EfTEN Real Estate Fund III AS

Commercial register number: 12864036

Beginning of financial year: 01.01.2018

End of financial year: 31.12.2018

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MANAGEMENT REPORT

Comment of the Fund manager

The most important economic events of EfTEN Real Estate Fund III AS in 2018 were the acquisition of the "Evolution" office building in Vilnius, the completion of DSV Riga logistics center and the beginning of the construction of Hortes gardening centre in the business district of Tähesaju in Tallinn. The gardening center serving eastern Tallinn and Viimsi is scheduled to open in the 4th quarter of 2019. In the last month of the year, the fund entered into a contract under the Law of Obligations for the purchase and leaseback of the Renault center rented by ABC Motors. The transaction will be completed in the beginning of 2019. In addition, a substantial renewal of the tenants' composition will be carried out at Saules Miestas shopping center. SportsDirect and Pepco will open the city's new flagship stores. The two anchor tenants will significantly increase the attractiveness of the second floor of the shopping center. In the spring of 2019, the fund plans to conduct an additional emission of shares to fund the acquisition of new objects in the future. The fund completed its first full year as a listed company in the main list of Nasdaq Baltic. The fund will continue its investment activities based on an opportunistic and value-adding investment strategy. After the listing on the stock exchange at the end of 2017, the fund is open-ended.

The Group's cash balance allows dividends to be paid from the 2018 profit to investors in a total amount of EUR 3.055 million (95 cents per share), which is 28% more than determined by the dividend policy of EfTEN Real Estate Fund III. The detailed methodology for dividend calculation is given below in the financial overview. The dividend pay-out from the year 2018 profit will proceed after the general shareholders' meeting in spring 2019.

Financial overview

The consolidated sales revenue of EfTEN Real Estate Fund III AS for 12 months of 2018 was EUR 8.672 million (12 months of 2017: EUR 7.300 million), which increased by 19% in a year. The Group's profit before revaluation of investment properties, cost of success fee, depreciation and financial income/-costs and income tax expense in 2018 totalled EUR 6.763 million (12 months of 2017: EUR 5.659 million), which increased by 19.5% in a year. The Group's net profit for the same period amounted to EUR 6.299 million (12 months of 2017: EUR 6.574 million). The smaller net profit in 2018 is due to lower investment property revaluation profit, which in the current year was EUR 1.562 million, but EUR 2.855 million last year.

The consolidated gross profit margin in the 12 months of 2018 was 96% (12 months of 2017: 98%). Therefore, expenses directly related to management of properties (incl. land tax, insurance, maintenance and improvement costs) accounted for 4% (12 months of 2017: 2%) of the revenue. The Group's expenses related to properties, marketing costs, general expenses, other income and expenses accounted for 22.3% of the revenue in 2018. The respective indicator was 22.8% in the 12 months of 2017.

	2018	2017
EUR million		
Rental revenue, other fees from investment properties	8.672	7.300
Expenses related to investment properties, incl. marketing costs	-0.754	-0.611
Interest expense and interest income	-1.096	-0.691
Net rental revenue less finance costs	**6.822**	**5.998**
Management fees	-0.632	-0.549
Other revenue and expenses	-0.544	-0.501
Profit before change in the value of investment property, change in the success fee liability, fair value change of interest rate swap and income tax expense	**5.646**	**4.948**

As at 31.12.2018, the Group's total assets were in the amount of EUR 108.503 million (31.12.2017: 97.291 million), including fair value of investment property, which accounted for 95% (31.12.2017: 91%) of the total assets.

	31.12.2018	31.12.2017	31.12.2016	31.12.2015
EUR million				
Investment property	102.787	88.390	73.539	36.506
Other non-current assets	0.138	0.090	0.058	0.080
Current assets, excluding cash	0.719	0.678	0.444	0.327
Net debt	-53.150	-42.773	-43.721	-21.567
Net asset value (NAV)	50.494	46.385	30.320	15.346
Net asset value (NAV) per share (in EUR)	15.67	14.39	12.71	11.08

During 2018, the net asset value of the share of EfTEN Real Estate Fund III AS increased by 8.9%. From the 2017 profit, EUR 2.191 million (in spring 2017: EUR 1.503 million) was paid out in dividends in April 2018. Without the dividend payment, the Fund's NAV would have increased by 13.7% in 2018. Return on invested capital (ROIC) was 17.6% in the 2018 financial year (12 months of 2017: 21.6%).

Access to flexible financing conditions will help to increase the Group's competitiveness. In 2018, the Group entered into new loan contracts in the total amount of EUR 7.692 million in connection with the acquisition of new investment properties. In addition, the subsidiary which owns the Saules Miestas shopping center in Lithuania refinanced its loan, receiving EUR 1.8 million of additional funds that the Group used for investments in new projects. As at the end December, the average interest rate on Group's loan agreements (including interest swap contracts) was 1.8% (31.12.2017: 1.73%) and the LTV (Loan to Value) ratio was 52% (31.12.2017: the same).

The dividend policy of EfTEN Real Estate Fund III AS provides that the Group will pay out 80% of the free cash flow to shareholders as (gross) dividends in each accounting year. In April 2018, EfTEN Real Estate Fund III AS paid the shareholders (net) dividends in the amount of EUR 2.191 million (2017: EUR 1.5 million).

During 2018, the Group earned a free cash flow of EUR 3.151 million (12 months of 2017: EUR 2.408 million). Following the deduction of Lithuanian income tax expense and the calculation of the dividend income tax expense in Estonian and Latvian companies, EfTEN Real Estate Fund III would be able to pay net dividends to the shareholders in the total amount of EUR 2.378 million (74 cents per share) from the profit earned in this year. However, the Group's cash balance at the end of 2018 allows to pay more dividends than the dividend policy establishes, which is why the Management Board of the Fund proposes to the Council in the spring of 2019 to pay a dividend of EUR 3.055 million (95 cents per share). For the entire previous year, the fund paid the shareholders a net dividend of 68 cents per share.

Potential dividend payment calculation

	12 months	
	2018	**2017**
EUR thousand		
Operating profit	**8,258**	**8,033**
Adjustment for revaluation gains on investment property	-1,562	-2,855
Adjustment for depreciation of fixed assets	21	20
Adjustment for profit on sale of investment property	-7	-40
Adjustment for non-monetary change in success fee	0	461
EBITDA	**6,710**	**5,619**
Interest expense	-965	-770
Bank loan repayments	-2,431	-2,003
Income tax expense on profit (Latvia, Lithuania)	-163	-438
Free cash flow	**3,151**	**2,408**
80% of the free cash flow	2,521	1,926
Dividend income tax expense	-143	-70
Potential net dividend according to dividend policy	**2,378**	**1,856**
Number of shares at the end of the period	3,222,535	3,222,535
Potential net dividends according to dividend policy per share (in EUR)	**0.74**	**0.58**
Potential additional cash flow[1]	750	335
Dividend income tax on additional cash flows	-73	0
Potential net dividend with additional cash flow	**3,055**	**2,191**
Potential net dividend per share, in EUR	**0.95**	**0.68**

[1] The potential additional cash flow at the end of the reporting period includes funds accumulated in the accounts of the Fund and the subsidiaries of the Fund, which are not intended to be invested or used in daily business operations to ensure liquidity.

Key performance and liquidity ratios

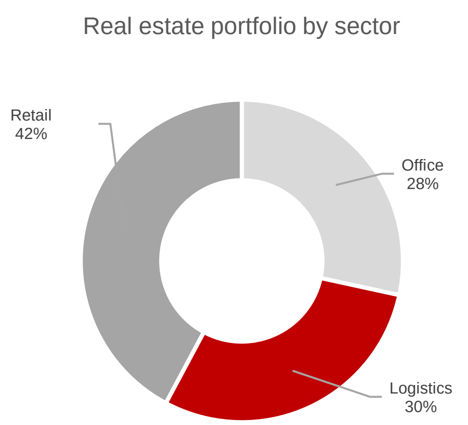
12 months	31.12.2018	31.12.2017
ROE, % (*net profit of the period / average equity of the period) x 100*	13.0	17.1
ROA, % (*net profit of the period / average assets of the period) x 100*	6.1	7.5
ROIC, % *(net profit of the period / average invested capital of the period*[1]*) x 100*	17.6	21.6
EBITDA (EUR thousand)	6,710	5,619
EBITDA margin, %	77.4	77.0
EBIT (EUR thousand)	8,258	8,033
EBIT margin, %	95.2	110.0
Liquidity ratio (current assets / current liabilities)	0.6[2]	2.2
DSCR (EBITDA/*(interest expenses + scheduled loan payments))*	2.0	2.0

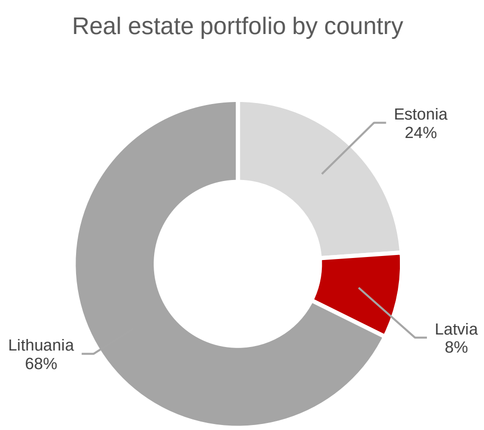
[1] The average invested capital of the period is the paid-in share capital of EfTEN Real Estate Fund III AS's equity, and the share premium. The indicator does not show the actual investment of the funds raised as equity.

[2] As at 31.12.2018, the Group's liquidity ratio is 0.6, i.e. the Group's current assets account for 60% of its current liabilities. The level of this indicator is due to the short-term recognition of the long-term bank loan portion of the Group's subsidiary EfTEN Evolution UAB in the amount of EUR 5,437 thousand due to the non-compliance of the loan service coverage ratio (DSCR) provisionally stipulated in the loan agreement. The covenant is below the required level in relation to the costs and temporary vacancy associated with the rental agreement ending in April 2019 in the Evolution office building. After the balance sheet date, in January 2019, the lender has issued a written waiver to EfTEN Evolution UAB to continue the loan agreement until the agreed deadline, i.e. until 30.05.2023. As at 31.12.2018, the loan of EfTEN Evolution UAB has been recognised in the financial statements as short-term according to International Accounting Standard IAS 1 paragraph 74. If the loan was recognised as long-term according to the contractual maturity, the Group's liquidity ratio as at 31.12.2018 would be 1.4.

Real estate portfolio

The Group invests in commercial real estate with a strong and long-term tenant base. At the end of 2018, the Group had 10 (31.12.2017: 8) commercial investment properties with a fair value as at the balance sheet date of EUR 102.787 million (31.12.2017: EUR 88.4 million) and acquisition cost of EUR 94.627 million (31.12.2017: EUR 81.7 million).





Key indicators of the Group's real estate portfolio:

Investment property, as at 31.12.2018	Group's ownership	Fair value of investment property	Net leasable area	Rental revenue per annum (EUR thousand)	Occupancy, %	Average length of rental agreements	Number of tenants
DSV Tallinn	100	12,850	16,014	1,006	100	7.6	1
DSV Riga	100	8,660	12,149	711	100	7.6	1
DSV Vilnius	100	8,730	11,687	692	100	7.5	1
Total logistics		**30,240**	**39,850**	**2,409**	**100**	**7.6**	**3**
Saules Miestas shopping center	100	31,640	19,881	2,980	98	4.5	119
Hortes gardening center, Laagri	100	3,430	3,470	263	100	13.4	1
Selver in Laagri	100	6,650	3,063	499	99	9.0	9
Hortes gardening center, Tallinn	100	1,636			*development stage*		
Total retail		**43,356**	**26,414**	**3,742**	**99**	**5.8**	**129**
Ulonu office building	100	9,220	5,174	706	100	2.9	15
L3 office building	100	9,971	6,151	763	100	1.8	35
Evolution office building	100	10,000	6,172	639	90	1.4	40
Total office		**29,191**	**17,497**	**2,108**	**94**	**2.0**	**90**
Total real estate portfolio		**102,787**	**83,761**	**8,260**		**5.2**	**222**

After the balance sheet date, on 6 February 2019, the Group's subsidiary EfTEN Kolmas OÜ acquired the properties of ABC Motor's sales and service center on Paldiski highway. The acquisition cost of the properties is EUR 3 million and a loan agreement was entered in the amount of EUR 1.8 million for the acquisition. The maturity of the loan is 25.02.2024 and the interest rate is 2.95% + 6 month EURIBOR. A 0% floor is set for the EURIBOR rate. The expected annual rental income from the investment property is EUR 252 thousand.

Information on shares

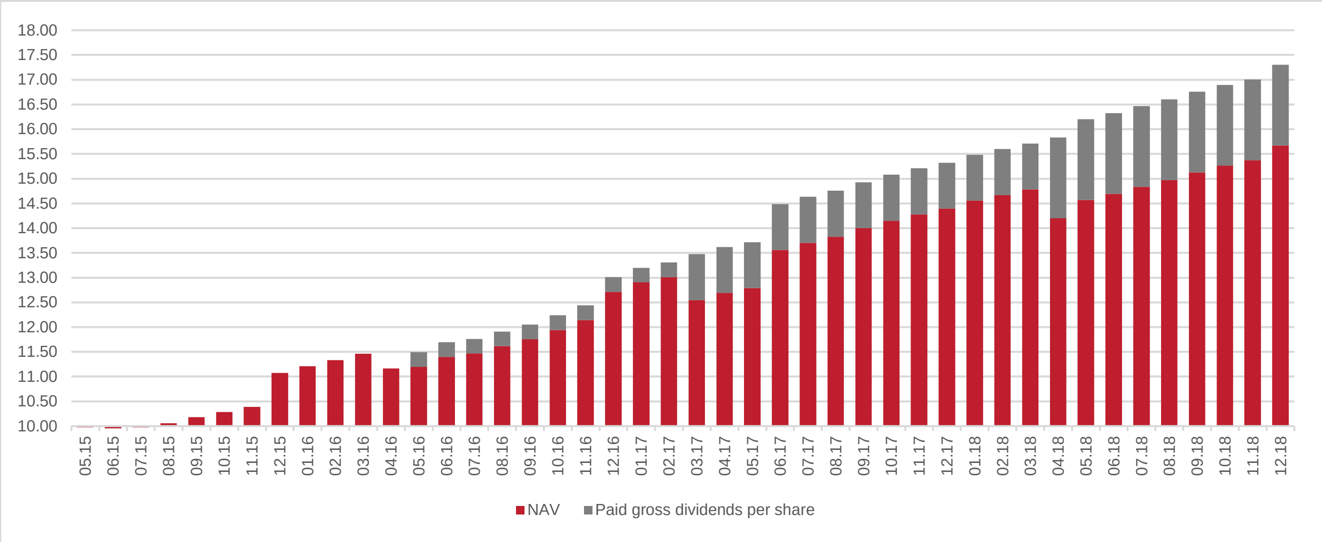
The net asset value of the share of EfTEN Real Estate Fund III as at 31.12.2018 was EUR 15.67 (31.12.2017: EUR 14.39). The shares of EfTEN Real Estate Fund III AS are freely tradable on the Tallinn Stock Exchange from 1 December 2017. The year of 2018 was successful for EfTEN Real Estate Fund III AS on the stock exchange, maintaining a stable price increase during the year despite the overall market decline – the closing price of EFT1T share as at 31.12.2018 was EUR 16.2, rising 5.9% in a year (from a price level of EUR 15.3 as at 31.12.2017). During 2018, EFT1T shares were traded at price levels from EUR 15.3 to 16.55 per share and the average closing price was EUR 15.8 during the year. In 2018, the volume of transactions with EFT1T shares totalled EUR 2,981 thousand.

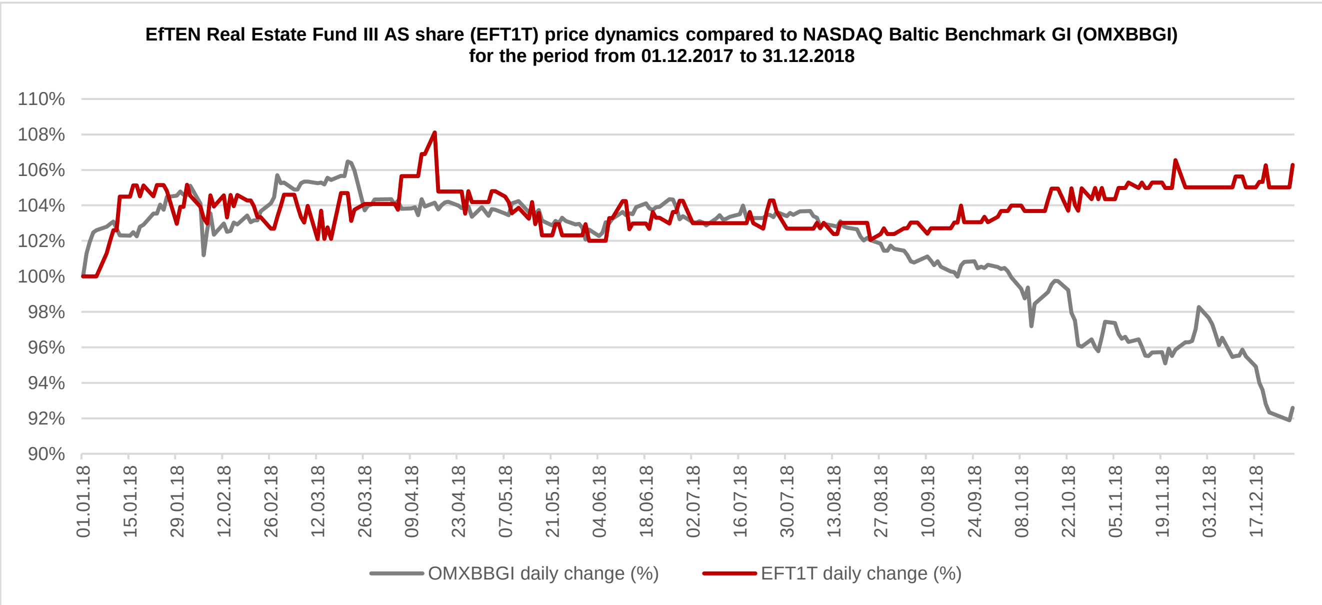
In addition to the aforementioned share net asset value calculated according to IFRS, EfTEN Real Estate Fund III AS also calculates the net asset value of the share recommended by EPRA (European Public Real Estate Association) to provide investors with the most relevant net asset value. The EPRA recommended guide assumes a long-term economic strategy for real estate companies, so temporary differences in the situation where asset sales are unlikely to occur in the near future obscure the transparency of the fair value of the fund's net assets. Therefore, to get the net asset value according the EPRA, the fair value of the deferred tax expense on investment property and the fair value of financial instruments (interest swap) is eliminated from the net asset value calculated according to IFRS.

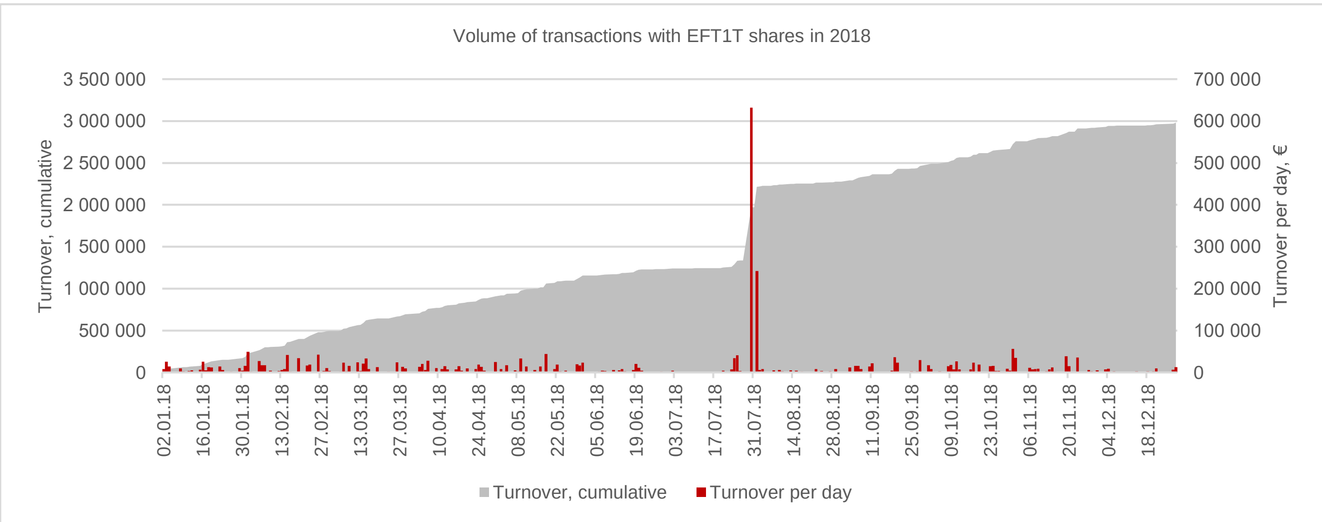
EUR thousand	**31.12.2018**	**31.12.2017**
Net asset value calculated in accordance with IFRS	50,494	46,385
Exclusion of deferred income tax on investment property	3,496	2,864
Exclusion of the fair value of financial liabilities	189	58
EPRA net asset value	**54,179**	**49,307**
Number of shares at the balance sheet date	3,222,535	3,222,535
EPRA net asset value per share, EUR	**16.81**	**15.30**
EPRA NAV growth, in EUR	1.51	1.55
Dividend paid per share, in EUR	0.68	0.63
Income tax on dividends paid per share, in EUR	0.02	0.00
Period earnings per share, in EUR	**2.21**	**2.18**
Period earnings per share, increase compared to the net asset value of EPRA at the balance sheet date of the previous period	**14.5%**	**15.9%**

As at 31.12.2018, the contributions made to the share capital of EfTEN Real Estate Fund III AS totalled EUR 35.883 million (31.12.2017: the same). The number of shares as at 31.12.2018 was 3,222,535 (31.12.2017: the same). EfTEN Real Estate Fund III AS listed its shares on the NASDAQ Tallinn Stock Exchange in November 2017. The Fund has one class of registered shares with a nominal value of EUR 10 per share. Each share grants one vote to the Fund's shareholder.

The net asset value of EfTEN Real Estate Fund III AS share and dividends paid (cumulative)







As at 31.12.2018, EfTEN Real Estate Fund III AS had 1,709 (31.12.2017: 1,816) shareholders, 24% (31.12.2017: the same) of whom were legal entities. A total of 75.2% (31.12.2017: 75.3%) of the total share capital of the fund was held by legal entities. The distribution of shares is shown in the table below.

	Shareholders, pcs		Total shareholders	Number of shares		Total shares	Ownership		Total ownership
	Legal entities	Private individuals		Legal entities	Private individuals		Legal entities	Private individuals	
Austria	-	1	**1**	-	1,255	**1,255**	-	0.0%	**0.0%**
China	-	1	**1**	-	254	**254**	-	0.0%	**0.0%**
Estonia	402	1,286	**1,688**	2,419,331	777,745	**3,197,076**	75.1%	24.1%	**99.2%**
Finland	-	2	**2**	-	427	**427**	-	0.0%	**0.0%**
Germany	-	1	**1**	-	309	**309**	-	0.0%	**0.0%**
Hong Kong	1	-	**1**	256	-	**256**	0.0%	-	**0.0%**
Latvia	3	1	**4**	3,714	6,555	**10,269**	0.1%	0.2%	**0.3%**
Lithuania	4	2	**6**	904	9,201	**10,105**	0.0%	0.3%	**0.3%**
Russia	-	2	**2**	-	1,620	**1,620**	-	0.1%	**0.1%**
Saudi Arabia	-	1	**1**	-	75	**75**	-	0.0%	**0.0%**
Singapore	-	1	**1**	-	590	**590**	-	0.0%	**0.0%**
Turkey	-	1	**1**	-	299	**299**	-	0.0%	**0.0%**
Total	**410**	**1,299**	**1,709**	**2,424,205**	**798,330**	**3,222,535**	**75.2%**	**24.8%**	**100.0%**

As at 31.12.2018, EfTEN Real Estate Fund III AS has three shareholders with more than 10% ownership:

	As at 31.12.2018	
Company	**Number of shares**	**Ownership, %**
Altius Energia OÜ	455,439	14.13
Järve Kaubanduskeskus OÜ	329,692	10.23
Hoiukonto OÜ	328,167	10.18

CORPORATE GOVERNANCE REPORT

Corporate Governance Recommendations report

Companies listed on the Nasdaq Tallinn Stock Exchange are advised to comply with the Corporate Governance Recommendations approved by the Financial Supervision Authority as a guide and approved by the Baltic Stock Exchanges.

EfTEN Real Estate Fund III AS has decided to follow this Corporate Governance Recommendations since the listing of the Fund's shares on the Nasdaq Tallinn Stock Exchange on 1 December 2017 and has done so throughout the 2018 financial year, unless otherwise stated in this report (in particular, in the management of an investment fund registered as a public limited company, from statutory differences). Prior to the listing of the shares, the Corporate Governance Recommendations were not mandatory for the Fund, as the fund is a public limited-liability company and, according to the preamble to the practice, does not apply to such companies.

This report has been prepared in accordance with the principles of the Accounting Act and the Corporate Governance Recommendations and provides an overview of the compliance of the management of EfTEN Real Estate Fund III AS with the Corporate Governance Recommendations as of December 31, 2018.

General meeting

EfTEN Real Estate Fund III AS is an investment company founded as a public limited company, which has one type of registered shares with a nominal value of EUR 10 per share. Each share gives the Fund’s shareholder one vote at the general meeting. The share grants the shareholder the right to participate at the general meeting and in the distribution of profits and remaining assets upon the termination of the Fund, as well as other rights prescribed by law and the articles of association. There are no differences between shareholders that would give them different voting or other rights.

None of the shareholders of EfTEN Real Estate Fund III has control over the Fund. As far as EfTEN Real Estate Fund III AS is aware, there is no shareholder agreement or other agreements between shareholders that could subsequently give control over the Fund.

As at 31.12.2018, EfTEN Real Estate Fund III AS had three major shareholders: 1) Altius Energia OÜ with an ownership interest of 14.13%, owned equally through holding companies by Arti Arakas and Frank Õim; 2) Järve Kaubanduskeskus OÜ with an ownership interest of 10.23%, owned through his holding company by Vello Kunman and 3) Hoiukonto OÜ with an ownership interest of 10.18%, owned through holding companies by Marcel Vichmann (69.5%) and by Hanno Murrand (30.5%).

The Fund Management Company EfTEN Capital AS owns 2.7% of the Fund’s share capital.

The General Meeting is the highest governing body of EfTEN Real Estate Fund III AS. The General Meeting has the authority to amend the Fund’s articles of association, decide on the listing of shares on the stock exchange, increase and decrease the share capital, insofar as it is not in the competence of the Supervisory Board according to the articles of association, decide to conclude, amend and terminate the management agreement concluded with the Fund Management Company, amend the policy for making payments to shareholders at the expense of the Fund, amend the Fund’s investment policy, insofar as it is not in the competence of the Supervisory Board according to the articles of association, elect members of the Supervisory Board, renew and revoke their powers and determine their remuneration policy and amount, determine the necessity of special control, approve the annual report and decide on the distribution of profits, decide on the liquidation or merger of the Fund, decide on a transaction with a Supervisory Board member, determine the terms of the transaction, decide on legal disputes and appoint a representative of the Fund in this transaction or dispute, as well as decide on other issues in the competence of the General Meeting.

A decision of the General Meeting is adopted if more than one half of the votes represented at the meeting are in favour, unless the provisions of the law or the articles of association prescribe a greater majority requirement. 2/3 of the votes represented at the meeting need to be in favour in order to amend the articles of association, the term of the Fund and decide on liquidation or merger. 2/3 of the votes of all the shareholders need to be in favour in order to decide on the conclusion, amendment and termination of the management agreement concluded with the Fund Management Company.

A shareholder has the right to participate at the general meeting, address the general meeting with regard to items on the agenda, ask relevant questions and make proposals.

The annual General Meeting of Shareholders is called at least once a year within four months after the end of EfTEN Real Estate Fund III AS financial year. An extraordinary General Meeting of shareholders is called if the Fund Management Company or the Fund’s Management Board deems it necessary or if required by the Fund’s Supervisory Board, auditor, Fund Management Company, the Financial Supervision Authority or the Fund’s depository. In addition to other persons prescribed by the law, shareholders may also request the convening of the General Meeting, provided that their shares represent at least 1/20 of the share capital. The request to call an extraordinary General Meeting must be submitted to the Management Board in writing, indicating the reason for the call.

The shareholders will be notified of the convening of ordinary and extraordinary meetings of shareholders through the Nasdaq Tallinn Stock Exchange system and the notice will also be published on the website of Real Estate Fund III AS and in a national daily newspaper at least three weeks prior to the meeting. Information related to the general meeting is published as a stock exchange announcement and on the website in both Estonian and English. The newspaper will only publish the notice of the meeting in Estonian.

The agenda of the General Meeting, proposals of the Management and Supervisory Board, draft resolutions and other relevant materials are made available to the shareholders before the General Meeting with the notice of the General Meeting.

In 2018, there was one ordinary General Meeting, all the related materials related to the General Meeting were available to the shareholders until the day of the meeting at the Fund’s location. The shareholders were given the opportunity to ask questions about the items on the agenda, make suggestions and ask questions at the meeting. Statements and disagreements were not presented at the ordinary General Meeting. The General Meeting was held in Estonian. It was not possible to participate in the General Meetings electronically, as the implementation of reliable solutions would be unreasonably expensive and complicated.

The General Meeting presented an overview of the Fund's activities, including the valuation of investment property, improvements to the principles of holding reserves, the share price, as well as the situation of the real estate market in general. Subsequently, the 2017 Annual Report was approved as a separate item on the agenda and a decision was made on the distribution of profits.

The chairman of the 2018 annual General Meeting was an independent person, Mr. Raino Paron, who introduced the procedure for conducting the meeting, including the questions from the Management Board and voting on the items on the agenda, and chaired the meeting.

All members of the Management Board, members of the Supervisory Board Sander Rebane and Siive Penu, and Rando Rand, Lead Auditor of PricewaterhouseCoopers AS, participated in the meeting. Members of the Supervisory Board, Arti Arakas and Olav Miil, were unable to attend the general meeting due to their absence.

Management Board

To the extent and in the manner prescribed by the management agreement, the Management Board shall monitor the Fund Management Company’s Fund related activities, i.e. monitor Fund Management Company’s compliance with the obligations arising from the management agreement and supervise the activities of the depository as prescribed in the depository contract, as well as supervise other functions related to management and transferred tasks carried out by third parties.

The Management Board of EfTEN Real Estate Fund III does not manage the assets of the Fund under the current legislation, the articles of association and the management agreement.

According to the Articles of Association of EfTEN Real Estate Fund III, the Management Board consists of one to three members. The Management Board members are elected and recalled by the Supervisory Board. Since the establishment of the company, the Management Board has consisted of Viljar Arakas and Tõnu Uustalu, and in 2018 no changes were made to the members of the Management Board. The Chairman of The Management Board has not been elected. The member of the Management Board is appointed for a term of five years. Re-election of a Management Board member is permitted. Each member of the Management Board may represent EfTEN Real Estate Fund III AS in all legal acts.

Members of the Management Board have not entered into separate Management Board member contracts. There are no remunerations paid to the members of the Management Board and there are no decisions for the Management Board to receive any remunerations or benefits (including non-cash) in the future.

Viljar Arakas, member of the Management Board of EfTEN Real Estate III AS, is simultaneously a member of the Management Board of the Fund Management Company, with whom he has a Management Board member contract. Tõnu Uustalu, member of the Management Board of EfTEN Real Estate III AS, is simultaneously the manager of the investment department of the Fund Management Company, with whom he has an employment contract.

As regards to the management of EfTEN Real Estate Fund III AS, the Fund Management Company has established internal rules to ensure the functioning of risk management and internal controls of the Fund, as well as internal rules to organise accounting and preparation of financial statements, and, together with the management, organise a control and reporting system. Once a year, members of the Management Board submit a declaration of economic interest.

In 2018, there were no transactions between EfTEN Real Estate Fund III AS and members of the Management Board, their close relatives or related persons, except the management services provided to EfTEN Real Estate Fund III AS by the Fund Management Company. Participation in other associations or entities (besides the responsibilities of the Management Board) is disclosed in the Fund’s prospectus, which is available on the website of EfTEN Real Estate Fund III AS www.eref.ee and has taken place with the consent of the Supervisory Board. The members of the Management Board do not participate simultaneously in the work of other publicly listed entities Management or Supervisory Boards.

Viljar Arakas, a member of the Management Board, owns 0.33% of the Fund’s share capital and 27.4% of the Fund Management Company’s share capital through a holding company and as a private individual. Tõnu Uusatalu, a member of the Management Board, owns 0.28% of the Fund’s share capital and 20.55% of the Fund Management Company’s share capital.

The member of the Management Board or an employee of the company does not require or accept money or other benefits for personal gain from third parties in connection with his or her work and does not give unlawful or unjustified benefits to third parties on behalf of the Fund. In 2018, the Management Board is not aware of any misconduct by the management itself or the Group’s employees.

The members of the Management Board are not authorised to issue and repurchase shares.

Supervisory Board

According to the articles of association of EfTEN Real Estate Fund III AS, the Supervisory Board consists of three to five members. Since the establishment of the company, the Supervisory Board has consisted of four members: Arti Arakas (Chairman of the Supervisory Board), Olav Miil, Siive Penu and Sander Rebane. Re-election of a Supervisory Board member is permitted (according to the articles of association). There were no changes in the composition of the Supervisory Board in 2018.

The work of the Supervisory Board is organised by the Chairman, elected by the members of the Supervisory Board amongst themselves. The Supervisory Board makes decisions on Board meetings or without convening a meeting. A decision of the Supervisory Board is adopted if more than one half of the votes represented at the meeting are in favour, unless the legislation or the articles of association prescribe a greater majority requirement. The Chairman of the Supervisory Board has no decisive vote in the event of equal division of votes. In order to make decisions without convening a meeting, all members of the Supervisory Board must be in favour.

No contracts have been concluded with members of the Supervisory Board. There are no remunerations paid to the members to the Supervisory Board and there are no decisions for the Supervisory Board to receive any remunerations or benefits (including non-cash) in the future.

According to the articles of association of EfTEN Real Estate Fund III AS, the Supervisory Board is authorised to approve a budget, appoint and recall a procurator, appoint an audit firm, approve the terms of a deposit agreement, approve a stockholder, decide on a transaction with a Management Board member, determine the terms of the transaction, decide on legal disputes and appoint a representative of the Fund in this transaction or dispute, approve semi-annual reports, approve opening balance and annual report of a liquidation, supervise the Management Board and increase share capital within three years from the date of establishment.

The Supervisory Board’s approval is required for transactions that go beyond the normal course of business, including the acquisition and termination of holdings in other companies, the establishment or termination of a subsidiary, the approval and amendment of a Fund’s operating strategy, significant changes to the Fund’s activities or the involving the Fund in business activities that are not directly related to the objectives of the Fund’s current economic activity and transactions in excess of EUR 250,000.

Members of the Supervisory Board avoid conflicts of interest in their activities. A member of the Supervisory Board favours the interests of the issuer to his or her personal or third party interests. A member of the Supervisory Board does not use commercial offers, directed at the issuer, for personal gain. In 2018, EfTEN Real Estate Fund III AS is not aware of any misconduct by the Supervisory Board members. Once a year, members of the Supervisory Board submit a declaration of economic interests.

In 2018, there were no transactions between EfTEN Real Estate Fund III AS and EfTEN Real Estate Fund III AS Supervisory Board members, their close relatives or related persons, except the management services provided to EfTEN Real Estate Fund III AS by the Fund Management Company. The members of the Supervisory Board do not participate simultaneously in the work of other publicly listed entities Management or Supervisory Boards. Participation in other associations or entities is disclosed in the Fund’s prospectus, which is available on the website of EfTEN Real Estate Fund III AS www.eref.ee.

Arti Arakas, member of the Supervisory Board, owns 7.35% of the Fund’s share capital and 10.56% of the Fund Management Company’s share capital through a holding company. Olav Miil owns 0.75% of the Fund’s share capital and 5.55% of the Fund Management Company’s share capital. Siive Penu owns 0.03% of the Fund’s share capital. Siive Penu is a member of the Management Board of HTB Investeeringud OÜ, which owns 1.55% of the Fund’s share capital and 5.55% of the Fund Management Company’s share capital. Sander Rebane does not own any shares in the Fund or the Fund Management Company.

All members of the Supervisory Board participated in more than half of the meetings.

EfTEN Real Estate Fund III does not have an audit or remuneration committee. The functions of the audit and remuneration committee are exercised by the Supervisory Board.

Cooperation of Management and Supervisory Board

The Management Board and Supervisory Board work in close co-operation to best protect the interests of EfTEN Real Estate Fund III. The co-operation is, above all, based on an open exchange of views between as well as within the Management Board and the Supervisory Board. The members of the Management Board participate in the Supervisory Board meetings where the Supervisory Board reviews the financial results of the issuer or makes decisions regarding the approval of the acquisition of investment objects. Generally, members of the Management Board are also invited to Supervisory Board meetings where EfTEN Real Estate Fund III management related issues are discussed.

The Management Board informs the Supervisory Board of all important management and business activity related events outside of meetings, to ensure prompt transmission of urgent and important information.

Information, where sufficient time is needed for a decision to be reached (e.g. making investment decisions, approving annual reports), is forwarded by the Management Board to the members of the Supervisory Board before the meeting takes place.

Confidentiality requirements are being applied throughout the exchange of information between the Management and Supervisory Board, which ensures control over sensitive information. On 27 November 2017, internal rules for handling internal information, keeping a list of persons that have access to sensitive information and the disclosure of that information were established.

As far as EfTEN Real Estate Fund III AS is aware, in 2018 the Management Board has not deviated from the instructions given by the Supervisory Board.

Disclosure of information and Investor Relations

The Corporate Governance Recommendation applied by EfTEN Real Estate Fund III and the reports are available on the Fund's website at https://eref.ee/fondi-info/hea-uhingujuhtimise-tava/.

The Corporate Governance Recommendation report has been compiled from the annual report for the year 2017 onwards and subsequently as an integral part of the annual report.

The Fund's annual reports are published on the website of the Nasdaq Tallinn Stock Exchange and on the Fund's website. In addition, the Fund's annual reports can also be found on the website of the management company EfTEN Capital AS.

Before the end of each financial year, EfTEN Real Estate Fund III publishes the financial calendar of the following year through the Nasdaq Tallinn Stock Exchange system, which sets out the dates for the disclosure of quarterly and annual financial results and the date of the annual general meeting of shareholders. Following the publication of information through the Nasdaq Tallinn Stock Exchange, all of this information is also available on the Fund's website. In addition to the quarterly interim reports and annual report, EfTEN Real Estate Fund III AS publishes the net asset value of the Fund's share on a monthly basis through the Nasdaq Tallinn Stock Exchange system, which is also available on the Fund's website.

EfTEN Real Estate Fund III AS has regular contacts with its shareholders. At least once a year, a general meeting of shareholders is convened, where the Management Board reviews the Fund's activities as a separate item on the agenda and where each shareholder has the opportunity to ask questions to the members of the Management Board and Supervisory Board. The Management Board also meets with shareholders outside general meetings, including conferences and meetings.

EfTEN Real Estate Fund III publishes the notice and related information of the General Meeting through the Nasdaq Tallinn Stock Exchange system and then also on the website and in at least one nationally distributed newspaper. Decisions of General Meetings are published immediately after the General Meeting is held through the Nasdaq Tallinn Stock Exchange. The minutes of the General Meeting shall be published no later than seven days after the meeting. The information and documents disclosed through the Nasdaq Tallinn Stock Exchange are also available on the Fund's website.

Financial reporting and auditing

EfTEN Real Estate Fund III AS consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The annual report is audited and approved by the Supervisory Board and approved at the General Meeting of Shareholders.

The auditor of EfTEN Real Estate Fund III AS is AS PricewaterhouseCoopers, who was appointed as the auditor of the Fund upon its establishment (06.05.2015). There is a valid contract with the auditor until the year 2019, which includes the audit of financial year 2019. The contract with the auditor specifies the auditor's duties, timetable and remuneration.

In the reporting period, the contractual auditor of EfTEN Real Estate Fund III AS provided the following additional services: translation services and other services for the execution of agreed procedures. The Group paid auditors EUR 35 thousand in total for the services provided.

In 2018, the auditor did not inform the Supervisory Board of any material circumstances that may affect the work of the Supervisory Board and EfTEN Real Estate Fund III AS management in general. Also, the auditor did not notify the Supervisory Board of any threats to auditor's independence or professionalism.

In 2018, auditor Rando Rand, the Lead Auditor of PricewaterhouseCoopers AS, attended the ordinary General Meeting of Shareholders, where the previous year's annual report was approved.

Risk management

In its daily activities, EfTEN Real Estate Fund III AS faces various risks. The Fund and the Management Company address the risk as a potential danger that an event, activity or omission may result in loss of property or reputation or jeopardise the effective performance of tasks / objectives. The main risks related to the activities of the Fund and its subsidiaries are described in the prospectus of the Fund, which is available on the website of EfTEN Real Estate Fund III AS www.eref.ee.

EfTEN Real Estate Fund III AS and the Management Company treat risk management as a continuous process of defining, assessing, measuring and hedging risks, and as part of the day-to-day management of the company. The principle is that risks should be taken in a balanced manner, taking into account the internal rules of risk management established by the Management Company, the restrictions on investment and risk diversification specified in the Fund's articles of association and risk mitigation measures, as appropriate. When investing the assets of the Fund, excessive risk-taking is unacceptable and appropriate risk identification, risk assessment, risk analysis and result evaluation measures must be applied to manage the risks. Thus, the risk management process covers both the risks related to the investment planned or made on the account of the Fund as well as the Management of the Fund and its own operational and other risks.

An independent internal auditor is also involved in the assessment of the risk management process and measures and, in addition, the compliance function acts as a part of the internal control of the management company.

The task of risk management and internal control is to ensure that risks are recognised and addressed at every level within the risk management process. The Management Board ensures that each employee and member of the management body is aware of the requirements that it has to comply with in order to perform its duties and that the performance of various functions does not prevent the member of staff or the management body from acting in a reliable, fair and appropriate manner.

FINANCIAL STATEMENTS OF THE CONSOLIDATION GROUP

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Notes	2018	2017
EUR thousand			
Revenue	4,5	8,672	7,300
Cost of services sold	6	-319	-167
Gross profit		**8,353**	**7,133**
Marketing costs	7	-435	-444
General and administrative expenses	8	-1,225	-1,556
Gain / loss from revaluation of investment properties	14	1,562	2,855
Other operating income and expense		3	45
Operating profit	**4**	**8,258**	**8,033**
Interest income		0	0
Finance costs	9	-1,096	-691
Profit before income tax		**7,162**	**7,342**
Income tax expense	10	-863	-768
Total comprehensive income for the financial year, including	**4**	**6,299**	**6,574**
Parent company's share of profits	**4**	**6,299**	**6,574**
Earnings per share	11		
- Basic		1.96	2.39
- Diluted		1.96	2.39

The notes on pages 17-45 are an integral part of the financial statements

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	31.12.2018	31.12.2017
EUR thousand			
ASSETS			
Cash and cash equivalents	12	4,859	8,133
Receivables and accrued income	13	673	641
Prepaid expenses		46	37
Total current assets		**5,578**	**8,811**
Long-term receivables	13	24	49
Investment property	4,14	102,787	88,390
Property, plant and equipment		114	37
Intangible assets		0	4
Total non-current assets		**102,925**	**88,480**
TOTAL ASSETS		**108,503**	**97,291**
LIABILITIES AND EQUITY			
Borrowings	15	8,105	2,109
Derivative instruments	18	189	58
Payables and prepayments	16	1,019	1,848
Total current liabilities		**9,313**	**4,015**
Borrowings	15	44,743	43,667
Other long-term liabilities	16	457	360
Deferred income tax liability	10	3,496	2,864
Total non-current liabilities		**48,696**	**46,891**
Total liabilities		**58,009**	**50,906**
Share capital	19	32,225	32,225
Share premium	19	3,658	3,658
Statutory reserve capital	19	621	293
Retained earnings	20	13,990	10,209
Total equity		**50,494**	**46,385**
TOTAL LIABILITIES AND EQUITY		**108,503**	**97,291**

The notes on pages 17-45 are an integral part of the financial statements

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PricewaterhouseCoopers, Tallinn

CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2018	2017
EUR thousand			
Net profit		**6,299**	**6,574**
Adjustments:			
Finance costs	9	1,096	691
Gain (loss) from revaluation of investment properties	14	-1,562	-2,855
Change in success fee liability		0	461
Profit / loss from the sale of investment property		-7	-40
Depreciation, amortisation and impairment	8	21	20
Income tax expense	10	863	768
Total adjustments with non-cash changes		**411**	**-955**
Cash flow from operations before changes in working capital		**6,710**	**5,619**
Change in receivables and payables related to operating activities		-115	-1,471
Net cash generated from operating activities		**6,595**	**4,148**
Purchase of property, plant and equipment		-96	-20
Purchase of investment property	14	-13,526	-9,880
Sale of investment property	14	7	40
Acquisition of subsidiaries	3	-100	-1,141
Net cash generated from investing activities		**-13,715**	**-11,001**
Loans received	15	9,492	5,111
Scheduled loan repayments	15	-2,431	-2,003
Interest paid		-954	-770
Proceeds from issuance of shares		0	10,993
Dividends paid	18	-2,191	-1,503
Income tax paid on dividends	10	-70	-35
Net cash generated from financing activities		**3,846**	**11,793**
NET CASH FLOW		**-3,274**	**4,940**
Cash and cash equivalents at the beginning of period	**12**	**8,133**	**3,193**
Change in cash and cash equivalents		-3,274	4,940
Cash and cash equivalents at the end of period	**12**	**4,859**	**8,133**

The notes on pages 17-45 are an integral part of the financial statements

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory reserve capital	Retained earnings	Total
EUR thousand					
Balance as at 31.12.2016	**23,853**	**1,038**	**75**	**5,355**	**30,321**
Issue of shares	8,372	2,620	0	0	**10,992**
Dividends paid	0	0	0	-1,503	**-1,503**
Transfers to statutory reserve capital	0	0	218	-218	**0**
Total transactions with owners	**8,372**	**2,620**	**218**	**-1,721**	**9,489**
Net profit for the financial year	0	0	0	6,574	**6,574**
Total comprehensive income	**0**	**0**	**0**	**6,574**	**6,574**
Balance as at 31.12.2017	**32,225**	**3,658**	**293**	**10,209**	**46,385**
Dividends paid	0	0	0	-2,191	**-2,191**
Transfers to statutory reserve capital	0	0	328	-328	**0**
Total transactions with owners	**0**	**0**	**328**	**-2,519**	**-2,191**
Net profit for the financial year	0	0	0	6,299	**6,299**
Total comprehensive income	**0**	**0**	**0**	**6,299**	**6,299**
Balance as at 31.12.2018	**32,225**	**3,658**	**621**	**13,990**	**50,494**

For additional information on share capital and retained earnings, please see Note 19 and 20.

The notes on pages 17-45 are an integral part of the financial statements

NOTES TO THE CONSOLIDATED STATEMENTS

1 General information

The consolidated financial statements of EfTEN Real Estate Fund III AS and its subsidiaries for the financial year ended 31.12.2018 have been signed by the Management Board on 22 February 2019. 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 shall be approved at the general meeting of shareholders. These consolidated financial statements form a part of the annual report to be approved by the shareholders and they 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 until being approved at the General Meeting.

EfTEN Real Estate Fund III AS (Parent company) is a company registered and operating in Estonia.

The structure of EfTEN Real Estate Fund III AS Group as at 31.12.2018 is as follows (also see Note 3):

EfTEN Real Estate Fund III AS

	SUBSIDIARIES	*Investment property:*
100%	Saulės Miestas UAB	*Saulės Miestas shopping center, Šiauliai*
100%	Verkių projektas UAB	*Ulonu office building, Vilnius*
100%	EfTEN Laisves UAB	*L3 office building, Vilnius*
100%	EfTEN Stasylu UAB	*DSV logistics center, Vilnius*
100%	EfTEN Tänassilma OÜ	*DSV logistics center, Tallinn*
100%	EfTEN Krustpils SIA	*DSV logistics center, Riga*
100%	EfTEN Laagri OÜ	*Laagri Selver grocery store, Tallinn*
100%	EfTEN Seljaku OÜ	*Hortes gardening center, Laagri*
100%	EfTEN Tähesaju tee OÜ	*Hortes gardening center, Tallinn*
100%	EfTEN Evolution UAB	*Evolution office building, Vilnius*
100%	EfTEN Kolmas OÜ	-

2 Statement of compliance and basis for preparation

The consolidated interim financial statements of EfTEN Real Estate Fund III AS and its subsidiaries have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

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

In the preparation of the financial reports, the cost method has been used as a basis, unless stated otherwise (for example investment property is measured at fair value).

2.1 Changes in the accounting policies and presentation

Adoption of new or revised standards and interpretations

The following new or revised standards and interpretations became mandatory for the Group's annual periods beginning at 1 January 2018:

IFRS 9 "Financial Instruments" (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.

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 both according to existing standards. Further information on changed accounting policies is provided in Note 2.2.

IFRS 15 “Revenue from Contracts with Customers“ (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 Group's management has analysed the impact of this change on consolidated profit and loss accounts and considers that, as the Group's revenue is largely derived from rental income and the Group does not sell goods and services under one contract, the changes have no significant impact on the Group's financial statements. Further information on changed accounting policies is provided in Note 2.2.

Amendments to IFRS 15 “Revenue from Contracts with Customers” (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 changes have no significant impact on the Group's financial statements. Further information on changed accounting policies is provided in Note 2.2.

“Transfers of Investment Property” - Amendments to IAS 40 (effective for annual periods beginning on or after 1 January 2018).

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 does not have any investment property that would have changed the use of the item, so the amendment to IAS 40 has no impact on the Group's financial statements.

“Annual Improvements to IFRSs 2014–2016 Cycle” (effective for annual periods beginning on or after 1 January 2018 (changes to IFRS 1 and IAS 28)).

IFRS 1 was amended to delete some of the short-term exemptions from IFRSs after those short-term exemptions have served their intended purpose. The amendments to IAS 28 clarify that venture capital organisations or similar entities have an investment-by- investment choice for measuring investees at fair value. Additionally, the amendment clarifies that if an investor that is not an investment entity has an associate or joint venture that is an investment entity, the investor can choose on an investment-by-investment basis to retain or reverse the fair value measurements used by that investment entity associate or joint venture when applying the equity method.

The amendments have no impact on the Group's financial statements.

New standards, interpretations, and their changes

New or revised standards and interpretations have been issued that become mandatory for the Group from 1 January 2019 or later, and which the Group has not implemented early.

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.

As a lessee, the Group has no lease agreements with a maturity of more than 12 months, so the standard has no impact on the Group.

Yet not adopted standards

Annual Improvements to IFRSs 2015-2017 cycle ((effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU).

The narrow scope amendments impact four standards. IFRS 3 was clarified that an acquirer should remeasure its previously held interest in a joint operation when it obtains control of the business. Conversely, IFRS 11 now explicitly explains that the investor should not remeasure its previously held interest when it obtains joint control of a joint operation, similarly to the existing requirements when an associate becomes a joint venture and vice versa. The amended IAS 12 explains that an entity recognises all income tax consequences of dividends where it has recognised the transactions or events that generated the related distributable profits, eg in profit or loss or in other comprehensive income. It is now clear that this requirement applies in all circumstances as long as payments on financial instruments classified as equity are distributions of profits, and not only in cases when the tax consequences are a result of different tax rates for distributed and undistributed profits. The revised IAS 23 now includes explicit guidance that the borrowings obtained specifically for funding a specified asset are excluded from the pool of general borrowings costs eligible for capitalisation only until the specific asset is substantially complete.

The Group analyses and discloses the effect of this change after its implementation.

"Amendments to the Conceptual Framework for Financial Reporting" (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting.

The Group analyses and discloses the effect of this change after its implementation.

"Definition of a business – Amendments to IFRS 3" (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The amendments revise definition of a business. A business must have inputs and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present, including for early stage companies that have not generated outputs. An organised workforce should be present as a condition for classification as a business if are no outputs. The definition of the term 'outputs' is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets. An entity can apply a 'concentration test'. The assets acquired would not represent a business if substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets).

The Group analyses and discloses the impact of this other change after its implementation.

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

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The Group analyses and discloses the impact of this other change after its implementation.

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

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

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

2.2.1 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) 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. The investment properties owned by the Group generate (or will start to generate when they are completed) rental revenue, therefore the applied method best indicates the fair value of the investment properties among the alternatives (comparison method for example). The estimates of the cash flows of 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. Compared to previous year, EfTEN Real Estate Fund III AS real estate portfolio discount rates have not changed significantly in the 2018 assessments, remaining between 7.9% and 8.6% (2017: the same). The capitalisation rates are the same compared to last year (7.5%-8.0%).

Additional information on the assumptions used in valuation of fair value can be found in Note 14.

b) Business combinations and acquisition 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.

2.2.2 Investment company

The Group's management has assessed their compliance with the definition of an investment company, and finds that EfTEN Real Estate Fund III 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 Real Estate Fund III AS expect their capital investment to both increase asset value and generate profit from current economic activity, EfTEN Real Estate Fund III AS in its investments assumes significant development risks that are characteristic to more traditional real estate company. Also, 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 Real Estate Fund III AS, the fair value is assessed indirectly - assets that are in the subsidiaries of EfTEN Real Estate Fund III 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. The Group's business activities are also assessed 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 Real Estate Fund III AS and its subsidiaries, consolidated on a line-by-line basis. The subsidiaries are consolidated from the date on which control is transferred to the Group, and subsidiaries are deconsolidated from the date that 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's three business segments and geographical segments are presented in the following table:

Premises / country	Estonia	Latvia	Lithuania
Office premises	-	-	Ulonu office building, Vilnius L3 office building, Vilnius Evolution office building, Vilnius
Storage and logistics premises	DSV logistics centre, Tallinn	DSV logistics centre, Riga	DSV logistics centre, Vilnius
Retail premises	Laagri Selver, Tallinn Hortes gardening centre, Saue Hortes gardening centre, Tallinn	-	Saules Miestas shopping centre

The main indicators used by the management in making business decisions is 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 23), 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 accounting policies from 1 January 2018

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

The Group's revenue includes rental income, administration fees, marketing fees, and utility and administrative agency fees.

Lease income from operating leases is recognised on a straight-line basis over the lease term. If the Group agrees with the tenants during the lease-free period, the said expense is also recognised on a straight-line basis over the lease term, reducing rental income.

Administrative fees and marketing fees are recognised in the period in which the control over the services is transferred to the customer, i.e. during the service period.

Some management fees may include different service components. In this case, the Group assesses whether they give rise to a number of implementation obligations. If such different implementation obligations exist, then the total transaction fee is allocated to each obligation to execute on the basis of a separate selling price. If there is no separate selling price, it is derived from the expected cost plus margin.

The Group acts as an agent for resale of utility and administrative expenses, and therefore such income is not shown in gross amount but is offset by the related expense.

Financing component

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

Revenue accounting policies applied until 31 December 2017

Revenue is recognised at the fair value of the consideration received or receivable from the transactions. Revenue is recognised only to the extent that it is probable that the economic benefits will be received and at a reliable rate.

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

The Group acts as an agent in the intermediation of services (fees for sub-tenants' utilities, sublease, other intermediated services), therefore, such income is not shown on a gross basis but is offset by the related costs.

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

Accounting policies from 1 January 2018

(i) Classification

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

- those to be measured subsequently at fair value (either through OCI or through profit or loss), and

- those to be measured at amortised cost.

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

(ii) Recognition and derecognition

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

(iii) Measurement

At initial recognition, the Company measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

Debt instruments

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

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

As at 1 January 2018 and 31 December 2018, all the Company's financial assets were classified in this category:

- cash and cash equivalents;
- trade receivables.

Equity instruments

The Company does not have any investments in equity instruments.

(iv) Impairment

The Company assesses on a forward-looking basis the expected credit losses (“ECL”) associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

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

For trade receivables and contract assets without a significant financing component the Company applies a simplified approach permitted by IFRS 9 and measures the allowance for impairment losses at expected lifetime credit losses from initial recognition of the receivables. The Company uses a provision matrix in which allowance for impairment losses is calculated for trade receivables falling into different ageing or overdue periods.

Accounting policies applied until 31 December 2017

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

The Group only had financial assets in the "Loans and receivables" category in 2017.

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. Derivative instruments are measured at fair value through profit or loss.

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.

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 (including rent per 1 square meter and the occupancy rate) and operating expenses. Depending on the terms of the lease (whether and how easily the lease can be terminated by the lessee), the appraiser will base the projections on either the property's existing cash flows or the market's current average cash flows for similar properties. The present value of the future net cash flow is found by applying a discount rate, which best reflects the current market assessments of the time value of money and the risks specific to the asset. The discount rate is selected based on the market's average capital structure, 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 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 capitalised 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 Group 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 settled or cancelled or expires.

Success fee liability

EfTEN Real Estate Fund III AS and EfTEN Capital AS have entered into a management contract according to which EfTEN Capital AS was entitled to receive a success fee in the amount of 20% (until EfTEN Real Estate Fund III was listed on the stock exchange (until November 2017)) of the difference between the sales and acquisition price of investment property above a hurdle rate of 10% on an annual basis. The success fee was calculated on a cumulative basis on all investment properties. When EfTEN Real Estate Fund III AS was listed on the stock Exchange in November 2017, the accumulated success fee liability was exchanged for the Fund's shares.

Following the listing on the stock Exchange, the success fee will be calculated based on the growth of the adjusted share closing prices on the stock exchange for the last two years, adjusting the closing prices of the trading day by dividends paid, income tax on dividends and minimum expected return (the minimum expected return is 10% of the closing price of the last trading day). The success fee is equal to 20% of the change in the closing price of the last trading day of the current and the previous reporting year, multiplied by the number of shares of the Fund. The costs incurred due to changes in the success fee are recognised as general expenses (see Note 8).

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

Business as a lessor

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 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 (when the liability arises).

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.

3 Subsidiaries

Company name	Country of domicile	Investment property	The subsidiary's equity, EUR thousand		Group's ownership interest, %	
			31.12.2018	31.12.2017	31.12.2018	31.12.2017
Parent company						
EfTEN Real Estate Fund III AS	Estonia					
Subsidiaries						
Saules Miestas UAB	Lithuania	Shopping centre Saules Miestas	13,855	12,980	100	100
Verkiu projektas UAB	Lithuania	Ulonu office building, Vilnius	3,961	3,855	100	100
EfTEN Laisves UAB	Lithuania	L3 office building, Vilnius	4,755	4,286	100	100
EfTEN Stasylu UAB	Lithuania	DSV logistics centre, Vilnius	4,046	3,683	100	100
EfTEN Tänassilma OÜ	Estonia	DSV logistics centre, Tallinn	6,215	6,007	100	100
EfTEN Krustpils SIA	Latvia	DSV logistics centre, Riga	2,511	2,134	100	100
EfTEN Seljaku OÜ	Estonia	Hortes gardening centre, Laagri	1,864	1,445	100	100
EfTEN Tähesaju tee OÜ	Estonia	Hortes gardening centre, Tallinn	1,759	-	100	-
EfTEN Evolution UAB	Lithuania	Evolution office building	4,168	-	100	-
EfTEN Laagri OÜ	Estonia	Selver grocery store, Laagri	3,670	3,255	100	100
EfTEN Kolmas OÜ	Estonia	Investment property to be acquired	5	-	100	100

All subsidiaries are engaged in the lease of investment property. The subsidiaries are not publicly listed.

On 19 April 2018, EfTEN Real Estate Fund III founded the 100% subsidiary EfTEN Tähesaju tee OÜ with the aim of acquiring the Hortes Garden Center building in Tallinn. When the company was founded, the share capital of the subsidiary was EUR 2,500. In May 2018, in addition EUR 1,080 thousand was paid to the equity of the subsidiary for the investment property acquisition.

On 30 May 2018, EfTEN Real Estate Fund III acquired a 100% subsidiary of EfTEN Evolution UAB with the aim of acquiring Evolution office building in Vilnius. EUR 2,500 was paid for the acquired company and the equity of the company was equal to the purchase price at the time of the acquisition. After the acquisition EfTEN Real Estate Fund III paid additional equity of EUR 3,205 thousand to the equity of the subsidiary. The subsidiary placed the funds as an investment in the cost of the Evolution office building.

On 13 December 2018, EfTEN Real Estate Fund III established a 100% subsidiary EfTEN Kolmas OÜ, paying the share capital of the subsidiary EUR 2,500. The subsidiary plans to acquire investment property by the end of January 2019.

In 2018, EfTEN Real Estate Fund III AS paid the last part of the stake in EfTEN Laagri OÜ of EUR 100 thousand, which was acquired last year.

4 Segment reporting

SEGMENT RESULTS

	Office		Logistics		Retail		Non-allocated		Total	
12 months	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
EUR thousand										
Revenue (Note 5), incl.	**1,894**	**1,470**	**2,323**	**2,065**	**4,455**	**3,765**	**0**	**0**	**8,672**	**7,300**
Estonia	0	0	989	977	738	172	0	0	1,727	1,149
Latvia	0	0	652	417	0	0	0	0	652	417
Lithuania	1,894	1,470	682	671	3,717	3,593	0	0	6,293	5,734
Operating income, net, incl.	**1,708**	**1,412**	**2,320**	**2,063**	**3,890**	**3,214**	**0**	**0**	**7,918**	**6,689**
Estonia	0	0	989	977	726	167	0	0	1,715	1,144
Latvia	0	0	650	417	0	0	0	0	650	417
Lithuania	1,708	1,412	681	669	3,164	3,047	0	0	5,553	5,128
Operating profit, incl.	**2,518**	**1,953**	**1,929**	**2,458**	**3,958**	**3,763**	**-147**	**-141**	**8,258**	**8,033**
Estonia	0	0	679	1,302	901	563	-147	-141	1,433	1,724
Latvia	0	0	506	399	0	0	0	0	506	399
Lithuania	2,518	1,953	744	757	3,057	3,200	0	0	6,319	5,910
EBITDA, incl.	**1,484**	**1,275**	**2,083**	**1,847**	**3,291**	**2,638**	**-147**	**-141**	**6,711**	**5,619**
Estonia	0	0	899	886	610	98	-147	-141	1,362	843
Latvia	0	0	570	358	0	0	0	0	570	358
Lithuania	1,484	1,275	614	603	2,681	2,540	0	0	4,779	4,418
Operating profit									**8,258**	**8,033**
Net financial expense (Note 9)									-1 096	-691
Profit before income tax expense									**7,162**	**7,342**
Income tax expense (Note 10)									-863	-768
NET PROFIT FOR THE FINANCIAL YEAR									**6,299**	**6,574**

SEGMENT ASSETS

	Office		Logistics		Retail		Total	
As of year end	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
EUR thousand								
Investment property (Note 12)								
Estonia	0	0	12,850	13,070	11,716	9,790	24,566	22,860
Latvia	0	0	8,660	6,980	0	0	8,660	6,980
Lithuania	29,191	18,960	8,730	8,600	31,640	30,990	69,561	58,550
Total investment property	**29,191**	**18,960**	**30,240**	**28,650**	**43,356**	**40,780**	**102,787**	**88,390**
Other non-current assets							138	90
Net debt							-53,151	-42,773
Other short-term assets							720	678
NET ASSETS							**50,494**	**46,385**

In 2018 and in 2017, 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.

The Group's largest customers are DSV Transport AS, DSV SIA and DSV Transport UAB that account for 11.4%, 7.8% and 7.5% of the Group's consolidated rental income, respectively. The revenue from the rest of tenants is less than 6% of consolidated revenue.

5 Revenue

Areas of activity	**2018**	2017
EUR thousand		
Rental income from office premises	1,851	1,437
Rental income from retail premises	3,785	3,092
Rental income from warehousing and logistics premises	2,322	2,065
Other sales revenue	714	706
Total revenue by areas of activity (Note 4, 14)	**8,672**	**7,300**

Revenue by geographical area	2018	2017
EUR thousand		
Estonia	1,727	1,148
Latvia	652	417
Lithuania	6,293	5,735
Total revenue by geographical area (Note 4)	**8,672**	**7,300**

6 *The cost of services sold*

Cost of services sold	2018	2017
EUR thousand		
Repair and maintenance of rental premises	-100	-29
Property insurance	-14	-13
Land tax and real-estate tax	-74	-104
Wages and salaries, incl. taxes	-12	0
VAT proportional costs	-47	-30
Other sales costs	-68	0
Impairment losses of doubtful receivables	-4	9
Total cost of service sold (Note 14)	**-319**	**-167**

7 *Marketing costs*

Marketing costs	2018	2017
EUR thousand		
Commission expenses on rental premises	-8	-2
Advertising, promotional events[1]	-427	-442
Total marketing costs	**-435**	**-444**

[1]The cost of advertising and promotional events is largely comprised of the cost of shopping mall events that tenants cover as an agreed marketing fee.

8 *General and administrative expenses*

	2018	2017
EUR thousand		
Management services (Note 21)	-632	-549
Office expenses	-38	-45
Wages and salaries, incl. taxes	-229	-241
Consulting expenses	-132	-172
Regulator charges	-73	-27
Change in success fee liability (Note 17, 21)	-46	-461
Other general and administrative expenses	-54	-41
Depreciation	-21	-20
Total general and administrative expenses	**-1,225**	**-1,556**

9 Finance costs

	2018	2017
EUR thousand		
Interest expenses, incl.	-965	-770
Interest expenses from loans	-889	-770
Interest expense on derivatives (-) / cost reduction (+)	-76	0
Change in fair value of interest swaps (Note 18)	-131	79
Total finance costs	**-1,096**	**-691**

10 Income tax

	2018	2017
EUR thousand		
Income tax from dividends	-70	-35
Deferred income tax in Latvian and Lithuanian subsidiaries	-630	-295
Income tax expense from Latvian and Lithuanian profit	-163	-438
Total income tax expense	**-863**	**-768**

As at 31.12.2018, the Group has a deferred tax liability in connection with the use of tax amortisation in Lithuania in the amount of EUR 3,496 thousand (31.12.2017: EUR 2,864 thousand). Deferred tax expense payment / netting obligation arises after the expiration of the tax depreciation period.

The Group's effective income tax rate (income tax expense / profit before tax) was 12.0% in 2018 (2017: 10.5%).

The change in deferred tax liability consists of the following components:

Balance as at 31.12.2016	**2,348**
Change in deferred income tax liability in the income statement in 2017	295
Expected income tax expense	221
Balance as at 31.12.2017	**2,864**
Change in deferred income tax liability in the income statement in 2018	630
Expected income tax expense	2
Balance as at 31.12.2018	**3,496**

11 Earnings per share

Earnings per share	2018	2017
Net profit of the period, *in EUR thousands*	6,299	6,574
Dividends per share, in EUR	0.68	0.63
Weighted average number of shares over the period, in pcs	3,222,535	2,749,761
Earnings per share, in EUR	1.96	2.39

12 Cash and cash equivalents

	31.12.2018	31.12.2017
EUR thousand		
Demand deposits	4,855	8,114
Cash in hand	4	19
Total cash and cash equivalents (Note 18)	**4,859**	**8,133**

13 Receivables and accrued income

Short-term receivables and accrued income

	31.12.2018	31.12.2017
EUR thousand		
Receivables from customers	490	480
Prepaid taxes and receivables for reclaimed value-added tax	115	65
Other accrued income	69	96
Total receivables and accured income	**674**	**641**

Non-current receivables

	31.12.2018	31.12.2017
EUR thousand		
Receivables and prepayments for investment properties	24	49
Total long-term receivables	**24**	**49**

14 Investment property

As at 31.12.2018, the Group has made investments in the following investment properties:

Name	Location	Area (m2)	Year of construction	Date of acquisition	Acquisition cost	Market value at 31.12.2018	Share of market value of the Fund's assets
EUR thousand							
Saules Miestas shopping centre	Saules Miestas, Lithuania	19,881	2007	08.2015	28,312	31,640	29%
DSV logistics centre	Vilnius, Lithuania	11,687	2005	06.2016	8,470	8,730	8%
DSV logistics centre	Tallinn, Estonia	16,014	2003	07.2016	12,228	12,850	12%
DSV logistics centre	Riga, Latvia	12,149	2000	07.2016	8,789	8,660	8%
L3 office building	Vilnius, Lithuania	6,150	2004	10.2016	8,707	9,970	9%
Ulonu office building	Vilnius, Lithuania	5,174	2012	12.2015	8,124	9,220	8%
Hortes gardening centre Laagri	Tallinn, Estonia	3,470	2006	05.2017	3,108	3,430	3%
Hortes gardening centre Tähesaju	Tallinn, Estonia	in development	2019	05.2018	1,637	1,637	2%
Selver grocery store	Tallinn, Estonia	3,063	2017	05.2017	6,223	6,650	6%
Evolution office building	Vilnius, Lithuania	6,172	2009	05.2018	9,030	10,000	9%
Total		**83,761**			**94,627**	**102,787**	**95%**

For more information on investment property, please see Note 4 “Segment reporting”.

In the years 2018 and 2016, the following changes have occurred in the Group's investment property:

	Investment property in the development stage	Completed investment property	**Total investment property**
Balance as at 31.12.2016	**0**	**73,539**	**73,539**
Acquisitions	4,318	5,068	**9,386**
Additions from business combinations (Note 3)	1,900	0	**1,900**
Capitalised improvements	0	710	**710**
Reclassifications	-6,218	6,218	**0**
Gain (loss) on changes in the fair value	0	2,855	**2,855**

Balance as at 31.12.2017	**0**	**88,390**	**88,390**
Acquisitions and developments	1,636	10,774	**12,410**
Capitalised improvements	0	425	**425**
Gain (loss) on changes in the fair value[1]	0	1,562	**1,562**
Balance as at 31.12.2018	**1,636[2]**	**101,151**	**102,787**

[1] The increase in value of investment properties in 2018 is mainly caused by improved cash flow projections.

[2] As of 31 December 2018, the Group has recognised the Hortes gardening center in Tallinn, on Täesaju Road, at the acquisition cost. As of the reporting date, the Group has not assessed the investment property as the property does not currently have rental income and the expected cash flow. According to management's estimates, the carrying amount of this investment property is likely to be close to its market value as of 31 December 2018.

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

As at 31 December or the period	2018	2017
Rental income earned on investment property (Note 5)	7,958	6,594
Expenses directly attributable to management of investment property (Note 6)	-319	-167
Amounts owed from the acquisition of investment property (Note 16)	178	1,000
Prepayments for investment property (Note 13)	17	49
Carrying amount of investment property pledged as collateral to borrowings	101,151	88,390

Lease agreements concluded between EfTEN Real Estate Fund III AS and tenants correspond to the terms of non-cancellable operating leases. The income from these leases is divided as follows:

Payments from non-cancellable operating leases	**31.12.2018**	31.12.2017
EUR thousand		
Up to 1 year	6,872	5,668
Between 2 and 5 years	18,279	15,554
Over 5 years	13,489	15,367
Total	**38,640**	**36,589**

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 31.12.2018 and 31.12.2017 was determined using the discounted cash flow method, except for investment property under development (Tähesaju Hortes), where the acquisition cost was used. The following assumptions were used to determine fair value:

As at 31.12.2018:

Sector	**Fair value**	**Valuation method**	**Rental income per annum**	**Discount rate**	**Capitalisation rate**	**Average rent, EUR/m2**
EUR thousand						
Office premises	29,190	Discounted cash flows	2,110	7.9%	7.5%-8.0%	11.4
Storage and logistics premises	30,240	Discounted cash flows	2,408	8.0%-8.6%	7.8%-8.0%	6.1
Retail premises	41,720	Discounted cash flows	3,742	8.25%-8.6%	7.5%-8.0%	11.4
Total	**101,150**		**8,260**			

In 2017:

Sector	Fair value	Valuation method	Rental income per annum	Discount rate	Capitalisation rate	Average rent, EUR/m2
EUR thousand						
Office premises	18,960	Discounted cash flows	1,476	7.9%	7.5%-8%	11.2
Storage and logistics premises	28,650	Discounted cash flows	2,336	8.25%-8.6%	7.9%-8%	5.9
Retail premises	40,780	Discounted cash flows	3,636	7.9%-8.6%	7.5%-8%	11.1
Total	**88,390**		**7,448**			

Independent expert valuation as to 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;
- Capitalisation rate: based on the estimated level of return at the end of the estimated holding period, taking into consideration the forecasted market condition and risks associated with the property.

Fair value sensitivity analysis

The table provided below illustrates **as at 31 December 2018** the sensitivity of the fair value of investment property included in the balance sheet of the Group to the most significant assumptions:

Sector	Sensitivity to management estimate			Sensitivity to discount rate and capitalisation rate				
	Assessment	Effect to decrease to value	Effect to increase to value			Change in discount rate		
						-0.5%	0.0%	0.5%
EUR thousand							*Fair value*	
Office premises	Change in rental income +/-10%	*-2,350*	*2,350*	Change in the capitalisation rate	-0.5%	*30,420*	*30,610*	*29,200*
					0.0%	*29,800*	*29,190*	*28,610*
					0.5%	*29,200*	*27,970*	*28,040*
Storage and logistics premises	Change in rental income +/-10%	*-2,413*	*2,414*	Change in the capitalisation rate	-0.5%	*31,478*	*31,655*	*30,240*
					0.0%	*30,857*	*30,240*	*29,638*
					0.5%	*30,240*	*28,994*	*29,061*
Retail premises	Change in rental income +/-10%	*-3,830*	*3,840*	Change in the capitalisation rate	-0.5%	*43,450*	*43,680*	*41,720*
					0.0%	*42,580*	*41,720*	*40,900*
					0.5%	*41,720*	*40,010*	*40,100*

As at 31.12.2017

Sector	Sensitivity to management estimates			Sensitivity to discount rate and capitalisation rate				
	Assessment	Effect of decrease to value	Effect of increase to value			Change in discount rate		
						-0.5%	0.0%	0.5%
EUR thousand							*Fair value*	
Office premises	Change in rental income +/-10%	*-1,550*	*1,540*	Change in the capitalisation rate	-0.5%	*20,300*	*19,890*	*19,480*
					0.0%	*19,350*	*18,960*	*18,570*
					0.5%	*18,510*	*18,140*	*17,770*
Storage and logistics premises	Change in rental income +/-10%	*-2,370*	*2,370*	Change in the capitalisation rate	-0.5%	*30,664*	*30,031*	*29,413*
					0.0%	*29,254*	*28,650*	*28,061*
					0.5%	*28,001*	*27,436*	*26,864*
Retail premises	Change in rental income +/-10%	*-3,770*	*3,770*	Change in the capitalisation rate	-0.5%	*43,570*	*42,680*	*41,840*
					0.0%	*41,610*	*40,780*	*39,960*
					0.5%	*39,890*	*39,110*	*38,330*

Level three inputs are used to determine the fair value of all of the investment properties of the Group (Note 18).

15 Borrowings

As at 31 December 2018, the Group has the following borrowings:

Lender	Country of lender	Loan amount as per agreement	Loan balance as at 31.12.2018	Contract term	Interest rate as at 31.12.2018	Loan collateral	Value of collateral	Loan balance share of the fund's net asset value
Swedbank	Lithuania	16,500	16,027	14.08.20	1.70%	Mortgage – Saules Miestas shopping centre	31,640	31.7%
SEB	Lithuania	5,500	4,895	29.06.21	1.55%	Mortgage – DSV building in Vilnius	8,730	9.7%
SEB	Latvia	3,323	4,547	29.06.21	1.55%	Mortgage – DSV building in Riga	8,660	9.0%
SEB	Estonia	7,950	7,113	29.06.21	1.55%	Mortgage – DSV building in Estonia	12,850	14.1%
SEB	Lithuania	5,620	5,076	30.09.21	1.90%	Mortgage – L3 office building in Vilnius	9,970	10.1%
SEB	Lithuania	5,200	4,490	21.12.20	1.75%	Mortgage – Ulonu office building in Vilnius	9,220	8.9%
SEB	Lithuania	5,850	5,699	30.05.23	2.00%	Mortgage – Evolution office building in Vilnius	10,000	11.3%
SEB	Estonia	1,860	1,728	05.07.22	1.82%	Mortgage – Hortes gardening centre	3,430	3.4%
Swedbank	Estonia	3,700	3,333	26.06.22	1.40%	Mortgage – Selver grocery store	6,650	6.6%
Total		**55,503**	**52,908**				**101,150**	**47.8%**

For additional information on borrowings, please see Note 18.

As at 31 December 2017, the Group has the following borrowings:

Lender	Country of lender	Loan amount as per agreement	Loan balance as at 31.12.2017	Contract term	Interest rate as at 31.12.2017	Loan collateral	Value of collateral	Loan balance share of the fund's net asset value
Swedbank	Lithuania	16,500	15,006	14.08.20	1.70%	Mortgage – Saules Miestas shopping centre	30,990	32.4%
SEB	Lithuania	5,500	5,137	29.06.21	1.55%	Mortgage – DSV building in Vilnius	8,600	11.1%
SEB	Latvia	3,323	3,121	29.06.21	1.55%	Mortgage – DSV building in Riga	6,980	6.7%
SEB	Estonia	7,950	7,463	29.06.21	1.55%	Mortgage – DSV building in Estonia	13,070	16.1%
SEB	Lithuania	5,620	5,316	30.09.21	1.90%	Mortgage – L3 office building in Vilnius	9,760	11.5%
SEB	Lithuania	5,200	4,730	21.12.20	1.75%	Mortgage – Ulonu office building in Vilnius	9,200	10.2%
SEB	Estonia	1,860	1,821	05.07.22	1.82%	Mortgage – Hortes gardening centre	3,210	3.9%
Swedbank	Estonia	3,700	3,251	26.06.22	1.40%	Mortgage – Selver grocery store	6,580	7.8%
Total		**49,653**	**45,845**				**88,390**	**98.8%**

Short-term borrowings	**31.12.2018**	31.12.2017
EUR thousand		
Short-term recognition of long-term part of long-term bank loans[1]	5,437	0
Repayments of long-term bank loans in the next period	2,698	2,129
Discounted contract fees on bank loans	-30	-20
Total short-term borrowings	**8,105**	**2,109**

[1]Additional information on the short-term recognition of long-term part of long-term bank loans is provided in Note 18 in the liquidity section.

Long-term borrowings	**31.12.2018**	31.12.2017
EUR thousand		
Total long-term borrowings (Note 18)	**47,411**	**45,776**
incl. current portion of borrowings	2,668	2,109
incl. non-current portion of borrowings, incl.	44,743	43,667
Bank loans	*44,773*	*43,716*
Discounted contract fees on bank loans	-30	*-49*

Bank loans are divided as follows according to repayment date:

	31.12.2018	31.12.2017
EUR thousand		
Less than 1 year	8,135	2,129
2-5 years	44,773	43,716

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Cash flows of borrowings	2018	2017
EUR thousand		
Balance at the beginning of period	**45,776**	**42,667**
Bank loans received	9,492	5,111
Annuity payments on bank loans	*-2,431*	*-2,003*
Capitalised contract fees	*-13*	*-17*
Change of discounted contract fees	*24*	*18*
Balance at the end of period	**52,848**	**45,776**

16 Payables and prepayments

Short-term payables and prepayments

	31.12.2018	31.12.2017
EUR thousand		
Trade payables from fixed asset transactions	0	503
Other trade payables	242	205
Total trade payables	**242**	**708**
Payables from securities transactions	0	100
Payables from fixed asset transactions	178	497
Total other payables	**178**	**597**
Value added tax	189	206
Corporate income tax	14	43
Social tax	9	8
Land tax and real-estate tax	125	50
Other tax liabilities	1	0
Total tax liabilities	**338**	**307**
Payables to employees	20	25
Interest liabilities	7	4
Tenant security deposits	120	138
Other accrued liabilities	114	20
Total accrued expenses	**261**	**187**
Prepayments received from buyers	0	24
Other deferred income	0	25
Total prepayments	**0**	**49**
Total payables and prepayments	**1,019**	**1,848**

Long-term payables

	31.12.2018	31.12.2017
EUR thousand		
Tenants security deposits	457	360
Total other long-term payables	**457**	**360**

For additional information on payables and prepayments, please see Note 18.

17 Success fee liability

Since the listing on the stock exchange from December 2017, EfTEN Real Estate Fund III AS has calculated the success fee based on the growth of the adjusted closing prices on the last trading day of the last two years. Expenses from the change in success fees are included in the Group's general and administrative expenses (see Note 8). As at 31 December 2018, the Group had a success fee liability to the Management Company in the amount of EUR 46 thousand.

18 *Financial instruments, management of financial risks*

The main financial liabilities of the Group are borrowings that have been raised to finance the investment properties of the Group. The balance sheet of the Group also contains cash and short-term deposits, trade receivables, other receivables and trade payables. For additional information on the Group's finance costs, please see Note 9.

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	31.12.2018	31.12.2017
EUR thousand			
Financial assets - measured at amortised cost			
Cash and cash equivalents	12	4,859	8,133
Trade receivables	13	490	480
Total financial assets measured at amortised cost		**5,349**	**8,613**
Financial liabilities measured at amortised cost			
Borrowings	15	52,848	45,776
Trade payables	16	242	708
Tenant security deposits	16	577	498
Interest payables	16	7	4
Accrued expenses	16	134	45
Success fee liabilities		46	0
Total financial liabilities measured at amortised cost		**53,854**	**47,031**
Financial liabilities measured at fair value			
Derivative instruments (interest rate swaps)		189	58
Total financial liabilities measured at fair value		**189**	**58**
Total financial liabilities		**53,997**	**47,089**

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.

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 in real estate, 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 December 2018, 56% of the Group's loan contracts were based on floating interest rate (margin range from 1.40% to 2.0% plus the 3-month and 1-month EURIBOR), and 44% of loan contracts carries fixed interest rate ranging from 1.55% to 1.9%. Of contracts based on floating interest rate, 54% are related to an interest rate swap contract in which the 3-month EURIBOR is in turn fixed at 0.35%. In 2018, the 3-month EURIBOR fluctuated between -0.329% and -0.309%, i.e. the maximum change within the year was 0.2 basis points. All contracts in the loan portfolio of EfTEN Real Estate Fund III have a 0% limit (floor) as protection against negative EURIBOR, i.e. in case of negative EURIBOR the loan margin of these loan commitments does not decrease.

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 fund's management assesses the most significant impact arising from the potential increase in interest rates over the perspective of 3-6 years.

As a result of the long-term nature of the Group's real estate investments and the long-term borrowings associated with the investments, the management of EfTEN Real Estate Fund III AS decided in 2016 to mitigate the risk of an increase in the long-term floating interest rate applicable to the loan portfolio and hedge part of the loan portfolio by fixing the applicable floating interest rate (3-month EURIBOR). It was decided to use interest rate swap agreements for the risk mitigation whereby the floating interest rate of a subsidiary's loan agreement was exchanged for a fixed interest rate. The decision was made to enter into the interest rate swap agreements considering the three following conditions:

(1) The investment property that secures the loan agreement that the cash flow hedge applies to is unlikely to be sold in the 10 year perspective;
(2) The total nominal values of swaps at the time of conclusion does not exceed 50% of the total consolidated loan portfolio of EfTEN Real Estate Fund III;
(3) The loan agreements that the cash flow hedge applies to are being extended at maturity until the expiry date of the swap agreements 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, an interest swap contract was concluded in 2016 in the total nominal amount of EUR 14,835 thousand by fixing the three-month EURIBOR at the level of 0.35%. The maturity of interest rate swaps contracts is in year 2023, whereas quarterly payments of the interest rate swap contract will start in the spring of 2018.

The Group recognises interest rate swaps through change in profit or loss. The fair value of interest rate swap contracts as at 31 December 2018 was negative in the amount of EUR 189 thousand (31 December 2017: EUR 58 thousand). Additional information on finding the fair value of interest rate swaps is provided in the section "Fair value" below.

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 income, reducing the Group's ability to generate positive net cash flows;
- Vacancy of rental property;
- Mismatch between the maturities of assets and liabilities and flexibility in changing them;
- Marketability of long-term assets;
- Volume and pace of real estate development activities;
- Financing structure.

The objective of the Group is to manage its net cash flows, so as to not use debt in making real estate investments in excess of 65% of the cost of the investment and to maintain the Group's debt coverage ratio in excess of 1.2. As at 31 December 2018, the Group's interest-bearing liabilities accounted for 51.4% (31 December 2017: 51.8%) of rental income generating investment property and the debt coverage ratio for the last 12 months was 2.0 (2017: the same).

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 properties. The table below summarises the information on the maturities of the Group's financial liabilities (undiscounted cash flows):

As at 31.12.2018	Less than 1 month	2-4 months	Between 5 and 12 months	Between 2 and 5 years	Over 5 years	**Total**
EUR thousand						
Interest-bearing liabilities	224	673	1,804	50,207	0	**52,908**
Interest payments	77	230	598	1,314	0	**2,219**
Interest payables	7	0	0	0	0	**7**
Trade payables	242	0	0	0	0	**242**
Tenant security deposits	8	31	94	338	107	**577**
Accrued expenses	134	0	0	0	0	**134**
Total financial liabilities	**692**	**934**	**2,496**	**51,859**	**107**	**56,087**

As at 31.12.2017	Less than 1 month	2-4 months	Between 5 and 12 months	Between 1 and 5 years	Over 5 years	**Total**
EUR thousand						
Interest-bearing liabilities	165	484	1,298	43,898	0	**45,845**
Interest payments	66	195	510	1,651	0	**2,422**
Interest payables	4	0	0	0	0	**4**
Trade payables	205	0	0	0	0	**205**
Tenant security deposits	12	36	91	294	65	**498**
Accrued expenses	49	0	0	0	0	**49**
Total financial liabilities	**501**	**715**	**1,899**	**45,843**	**65**	**49,023**

Report of working capital

	31.12.2018	31.12.2017
EUR thousand		
Cash and cash equivalents (Note 12)	4,859	8,133
Receivables and accrued income (Note 13)	673	641
Prepaid expenses	46	37
Total current assets	**5,578**	**8,811**
Short-term portion of long-term liabilities (Note 15)	-8,105	-2,109
Short-term payables and prepayments (Note 16)	-1,208	-1,848
Total current liabilities	**-9,313**	**-3,957**
Total working capital	**-3,735**	**4,854**

As at 31.12.2018, the Group's working capital is negative in the amount of EUR 3,735 thousand (31.12.2017: positive in the amount of EUR 4,854 thousand). The working capital is negative due to the short-term recognition of the long-term bank loan portion of the Group's subsidiary EfTEN Evolution UAB in the amount of EUR 5,437 thousand due to the non-compliance of the loan service coverage ratio (DSCR) provisionally stipulated in the loan agreement with the terms of the loan agreement. The covenant is below the required rate in relation to the costs associated with the rental agreement ending in April 2019 in the Evolution office building and the temporary vacancy. After the balance sheet date in January 2019, the lender has issued a written confirmation to EfTEN Evolution UAB to continue the loan agreement until the agreed deadline, i.e. until 30.05.2023. As of 31.12.2018, the loan of EfTEN Evolution UAB has been recognised in the financial statements as short-term in connection with International Accounting Standard 1 p. 74. If the loan were recognised as a long-term loan according to the maturity specified in the contract, the Group's working capital would be positive in the amount of EUR 1,702 thousand. As the loan does not have to be repaid early, the Group's management estimates that working capital is sufficient to meet the requirements of everyday business.

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. In addition, agreements with customers generally provide payment of rent at the beginning of the calendar month, giving sufficient time for monitoring the customers' payment discipline and ensuring existence of sufficient liquidity on bank accounts at the date of annuity payment of financing contracts. For hedging the risk, the Group has entered into a contract with one anchor tenant under which the tenant's financial institution has underwritten rental payments during the entire rent period. Most rent contracts also include the obligation to pay guarantee funds that entitle the Group to cover debts incurred in case of the tenant's insolvency.

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

If it becomes evident that there is a risk of a 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.

For measuring expected credit losses, trade receivables and contractual assets are grouped according to the common features of the credit risk and the expiration period. Expected credit loss rates are based on payment discipline over the past 36 months to 31 December 2018, or until 1 January 2018, respectively, and historical credit losses in the respective periods. Historical losses have been adjusted to reflect current and future information relating to macroeconomic factors and the ability of buyers to pay claims. The company has estimated that GDP and unemployment rates in the countries where its goods and services are sold are the most relevant indicators and accordingly adjusts historical loss rates based on the expected change in these indicators.

The discount of receivables based on the principles described above at 31 December 2018 and 1 January 2018 (at the date of application of IFRS 9) was negligible. Although cash and cash equivalents are also included in the expected credit loss model of IFRS 9, the impairment recognised was insignificant as of 1 January 2018 and 31 December 2018.

Accounts receivable are illustrated by the table below:

	31.12.2018	31.12.2017
Undue	386	332
Past due, incl.	**104**	**148**
up to 30 days	*91*	*134*
30-60 days	*13*	*6*
more than 60 days	*0*	*8*
Total trade receivables	**490**	**480**

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

	31.12.2018	31.12.2017
EUR thousand		
Cash and cash equivalents (Note 12)	4,859	8,133
Trade receivables (Note 13)	490	480
Total maximum credit risk	**5,349**	**8,613**

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	31.12.2018	31.12.2017
A1	4,855	8,111
Aa2	0	3
Total (Note 12)	**4,855**	**8,114**

Capital management

The Group's capital includes borrowings and equity.

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 continues to invest in real estate that generates cash flow and raises new equity for making investments. The investment policy of the Group prescribes that at least 30% of equity is invested in new real estate projects. 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.

After making an investment, the net operating profit on investment of any of the cash flow producing investment properties cannot be less than 120% of the loan annuity payments.

According to the Group's management estimate the free cash flow of the Group allows to pay out in the form of dividends an average of 80% of the adjusted cash flow for the calendar year (EBITDA minus interest expense minus loan payments). In April 2018, EfTEN Real Estate Fund III AS paid (net) dividends to shareholders of EUR 2.191 million (2017: EUR 1.5 million). During 2018, the Group has earned a free cash flow of EUR 3.151 million (12 months of 2017: EUR 2.408 million). After deduction of Lithuanian corporate income tax and calculation of the calculated dividend income tax in Estonian and Latvian companies, according to the established dividend policy, EfTEN Real Estate Fund III would be able to pay net dividends to the shareholders of this year's profit of EUR 2.378 million (74 cents per share). However, the Group's cash balance at the end of 2018 allows to pay more dividends than established in the dividend policy, which is the reason the Management Board of the Fund proposes to the Supervisory Board in spring 2019 to pay a dividend of EUR 3.055 million (95 cents per share). For the whole previous year, the Fund paid a net dividend of 68 cents per share to shareholders.

Report of capitalisation

	31.12.2018	31.12.2017
EUR thousand		
Mortgage guaranteed short-term liabilities (Note 15)	8,135	2,129
Unsecured short-term liabilities	1,178	1,886
Total short-term liabilities	**9,313**	**4,015**
Mortgage guaranteed long-term liabilities (Note 15)	44,773	43,716
Unsecured long-term liabilities	3,923	3,175
Total long-term liabilities	**48,696**	**46,891**
Share capital and share premium (Note 19)	35,883	35,883
Reserves	621	293
Retained earnings (Note 20)	13,990	10,209
Total shareholder's equity	**50,494**	**46,385**
Total liabilities and equity	**108,503**	**97,291**

More detailed information on mortgages established as collateral for the obligations provided in the capitalisation report is available in Note 15 of the report.

Report of net debt

	31.12.2018	31.12.2017
EUR thousand		
Cash (Note 12)	4,859	8,133
Cash equivalents	0	0
Tradable securities	**0**	0
Total liquid assets	**4,859**	**8,133**
The short-term portion of long-term liabilities (Note 15)	8,135	2,129
Short-term bank loans	0	0
Other short-term financial liabilities	0	0
Net short-term debt	**3,276**	**-6,004**
Long-term bank loans (long-term portion) (Note 15)	**44,773**	43,716
Issued debt securities	0	0
Other long-term loans	0	0
Total long-term debt	**44,773**	**43,716**
Total net debt	**48,049**	**37,712**

Fair value

The valuation methods used to analyse the Group's assets and liabilities measured at fair value 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 31.12.2018 and 31.12.2017, the Group had 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 are measured at fair value and according to the valuation method are included within Level 3 of the fair value hierarchy (see Note 14). 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.

For hedging the interest rate risk, the Group has entered into interest rate swaps the fair value of which is obtained by discounting the cash flows of interest rate swaps in a way incoming and outgoing cash flows are determined according to EURIBOR market expectations and they are discounted at zero rate. For recognising the fair value of interest rate swaps, the Group uses information received from credit institutions who are contract partners.

19 Share capital

As at 31.12.2018, the registered share capital of EfTEN Real Estate Fund III AS was EUR 32,225 thousand (31.12.2017: the same). As at 31.12.2018, the share capital consisted of 3,222,535 shares (31.12.2017: the same) with a nominal value of EUR 10 (31.12.2017: the same). All shares are fully paid for. Without amending the articles of association, the company has the right to increase its share capital to EUR 39,440 thousand. As at 31.12.2018, the share capital has been paid in the amount of EUR 35,883 thousand (31.12.2017: the same).

In 2018, EfTEN Real Estate Fund III AS transferred EUR 328 thousand (2017: EUR 218 thousand) of retained earnings to reserve capital. The amount of the reserve capital as of 31.12.2018 was EUR 621 thousand (31.12.2017: EUR 293 thousand).

List of shareholders who own more than 5% of the shares in EfTEN Real Estate Fund III AS:

	As at 31.12.2018	
Company	**Number of shares**	**Ownership, %**
Altius Energia OÜ	455,439	14.13
Järve Kaubanduskeskus OÜ	329,692	10.23
Hoiukonto OÜ	328,167	10.18

Shares owned by EfTEN Real Estate Fund III AS Management or Supervisory Board members, their close relatives or companies under their control:

	As at 31.12.2018	
Company	**Number of shares**	**Ownership, %**
Viljar Arakas, member of the Management Board	2,000	0.06
Miemma Holding OÜ, a company owned by Viljar Arakas, member of the Management Board	8,793	0.27
Tõnu Uustalu, member of the Management Board	9,184	0.28
Meeli Leis, a close relative of Tõnu Uustalu, member of the Management Board	1,559	0.05
Altius Energia OÜ, a company controlled by Arti Arakas, member of the Supervisory Board	455,439	14.13
Olav Miil, member of the Supervisory Board	24,229	0.75
Siive Penu, member of the Supervisory Board	975	0.03

20 Contingent liabilities

Contingent income tax liability

	31.12.2018	31.12.2017
EUR thousand		
The company's retained earnings	13,990	10,209
Potential income tax liability	2,798	2,042
The amount that can be paid out as dividends	11,192	8,167

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 at 31.12.2018 and 31.12.2017.

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 not any circumstances, which may lead the tax authorities to impose additional significant taxes on the Group.

21 Related party transactions

EfTEN Real Estate Fund III AS considers the following as related parties:

- Management Board members and companies owned by the Management Board members of EfTEN Real Estate Fund III AS;

- Supervisory Board members and companies owned by the Supervisory Board members of EfTEN Real Estate Fund III AS;

- Employees and companies owned by the employees of EfTEN Real Estate Fund III AS;

- EfTEN Capital AS (fund management company).

The Group purchased management services from EfTEN Capital AS in 2018 in the amount of EUR 632 thousand (2017: EUR 549 thousand) (see Note 8). In addition to the periodic management service, the Group calculated a success fee of EUR 46 thousand in 2018 (2017: EUR 461 thousand).

EfTEN Real Estate Fund III AS did not purchase from other related parties or sell to other related parties any other goods or services in 2018 or 2017. There were no discounts in related party transactions during the reporting year or the reference period.

As at 31.12.2018, the Group had a total of 12 employees, who were paid a total of EUR 229 thousand (2017: EUR 236 thousand) including the associated taxes. No remuneration was paid to the members of the Management or Supervisory Board of the Group in 2018 or 2017. Members of the Group's management board are employed by the management company EfTEN Capital AS and expenses related to Management Board members' activities are included in management services.

22 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.

	2018	2017
EUR thousand		
General and administrative expenses	-147	-141
Gain from subsidiaries	6,367	6,663
Finance income	81	69
Finance expense	0	-8
Profit before income tax	**6,301**	**6,583**
Dividend income tax expense	0	-9
Total comprehensive income for the financial period	**6,301**	**6,574**

23 Parent company's separate balance sheet

	31.12.2018	31.12.2017
EUR thousand		
ASSETS		
Cash and cash equivalents	489	4,607
Receivables and accrued income	36	23
Short-term receivables from subsidiaries	704	158
Total current assets	**1,229**	**4,788**
Non-current assets		
Shares of subsidiaries	46,808	37,645
Long-term receivables from subsidiaries	2,513	4,097
Total non-current assets	**49,321**	**41,742**
TOTAL ASSETS	**50,550**	**46,530**
Payables	55	145
Total short-term liabilities	**55**	**145**
Total liabilities	**55**	**145**
Share capital	32,225	32,225
Share premium	3,658	3,658
Statutory reserve capital	621	293
Retained earnings	13,991	10,209
Total equity	**50,495**	**46,385**
TOTAL LIABILITIES AND EQUITY	**50,550**	**46,530**

24 Parent company's separate statement of cash flows

	2018	2017
EUR thousand		
Cash flows from operating activities		
Net profit	**6,301**	**6,574**
Adjustments to net profit:		
Finance income and finance costs	-81	-61
Gain/loss on the fair value adjustment of subsidiaries	-4,177	-5,195
Dividends received	-2,191	-1,468
Change in success fee liability	0	-1,222
Income tax expense	0	9
Total adjustments	**-6,449**	**-7,937**
Cash flow from operations before changes in working capital	**-148**	**-1,363**
Change in receivables and payables related to operating activities	-1	31
Net cash generated from operating activities	**-149**	**-1,332**
Cash flows from investing activities		
Acquisition of subsidiaries	-5,087	-4,084
Loans granted	-2,007	-3,585
Repayment of loans granted	3,125	2,560
Dividends received	2,191	1,468
Interest received	0	12
Net cash generated from investing activities	**-1,778**	**-3,629**
Cash flows from financing activities		
Loans received	0	-500
Interest paid	0	-11
Dividends paid	-2,191	-1,503
Income tax paid on dividends	0	-9
Proceeds from issuance of shares	0	10,993
Net cash generated from financing activities	**-2,191**	**8,970**
NET CASH FLOW	**-4,118**	**4,009**
Cash and cash equivalents at the beginning of the period	**4,607**	**598**
Change in cash and cash equivalents	-4,118	4,009
Cash and cash equivalents at the end of the period	**489**	**4,607**

25 Parent company's separate statement of changes in equity

	Share capital	Share premium	Statutory reserve capital	Retained earnings	**Total**
EUR thousand					
Balance as at 31.12.2016	**23,853**	**1,038**	**75**	**5,356**	**30,322**
Issue of shares	8,372	2,620	0	0	10,992
Dividends paid	0	0	0	-1,503	-1,503
Transfers to statutory reserve capital	0	0	218	-218	0
Comprehensive income for the financial period	0	0	0	6,574	6,574
Balance as at 31.12.2017	**32,225**	**3,658**	**293**	**10,209**	**46,385**
Dividends paid	0	0	0	-2,191	-2,191
Transfers to statutory reserve capital	0	0	328	-328	0
Comprehensive income for the financial period	0	0	0	6,301	6,301
Balance as at 31.12.2018	**32,225**	**3,658**	**621**	**13,991**	**50,495**

For additional information on changes in share capital, please see Note 19.

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

	31.12.2018	31.12.2017
EUR thousand		
Parent company's unconsolidated equity	50,495	46,385
Carrying amount of subsidiaries and joint ventures in the separate balance sheet of the parent company (minus)	-46,808	-37,645
Value of subsidiaries and joint ventures under the equity method (plus)	46,808	37,644
Total	**50,495**	**46,385**

26 Events after the balance sheet date

After the balance sheet date, February 6, 2019, the Group's subsidiary EfTEN Kolmas OÜ acquired the properties of ABC Motor's sales and service center on Paldiski highway. The acquisition cost of the properties is EUR 3 million and the loan was acquired in the amount of EUR 1.8 million. The maturity of the loan is 25.02.2024 and the interest rate is 2.95% + 6 months EURIBOR. EURIBOR is set to 0% floor. The expected annual rental income from the investment property is EUR 252 thousand.

Proposal for profit distribution

The Management Board of EfTEN Real Estate Fund III AS proposes to the General Meeting of Shareholders to distribute the profit as follows (in euros):

Retained earnings as at 31.12.2018	13,990,000
Allocation to statutory reserve capital	315,000
Dividend distribution	3,054,800
Retained earnings after allocation	10,559,400

/signed digitally/

Viljar Arakas

Member of the Management Board

/signed digitally/

Tõnu Uustalu

Member of the Management Board

22 February 2019

Signatures of the members of the Management Board and Supervisory Board to the 2018 annual report

We hereby confirm the correctness of data presented in the 2018 annual report of EfTEN Real Estate Fund III 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

/signed digitally/

Viljar Arakas

Member of the Management Board

/signed digitally/

Tõnu Uustalu

Member of the Management Board

Allocation of income according to EMTA classificators

	EMTAK code	2018	Revenue %	Main activity
EUR thousand				
Fund management	66301	0	-	Yes

Independent auditor's report

To the Shareholders of EfTEN Real Estate Fund III AS

(Translation of the Estonian original)*

Report on the audit of the consolidated financial statements

Our opinion

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

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

What we have audited

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

Basis for opinion

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

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

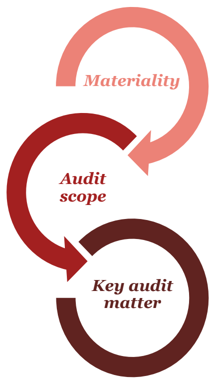
Independence

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

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59^1 of the Auditors Activities Act of the Republic of Estonia.

Our audit approach

Overview



Materiality
Overall group materiality is EUR 1 085 thousand, which represents 1% of the Group's total assets.

Audit scope
The Group audit team or component auditors, under our instructions, audited the Group companies essentially covering all parts of the consolidated statements financial position and comprehensive income.

Key audit matter
- Valuation of investment properties

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

Materiality

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

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

Overall group materiality	EUR 1 085 thousand
How we determined it	1% of total assets
Rationale for the materiality benchmark applied	We calculated the materiality from total assets as this is the key indicator on which the Group's value depends and that is monitored by the management board and investors.

Key audit matter

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

Key audit matter	*How our audit addressed the key audit matter*
Valuation of investment properties Addition information is disclosed in Note 2.2 "Summary of the most important accounting principles" and in Note 14 "Investment property". As at 31 December 2018 the investment properties carried at fair value amounted to EUR 103 million and the revaluation gain recognised in 2018 profit or loss statement was EUR 1.6 million. The management uses independent appraisers to evaluate the fair values by engaging an external valuation at least twice a year for each asset. The Group measures the fair value of the investment properties using the discounted cash flow method, based on the rental rates of these properties, using the existing rental rates for properties leased out. Among other factors, the valuation of the Group's investment property portfolio is inherently subjective due to the individual nature of each investment property, its location and the expected future rental rates.	Given the inherent subjectivity involved in the valuation of investment properties and the need for market knowledge and valuation expertise, we engaged PwC valuation specialists to assist us in our audit of this area. We obtained and read the valuation reports and valuation inputs for all the investment properties and assessed whether the valuation approach for each investment property was in accordance with the principles of measuring fair value under IFRS. We found the methods to be consistent with the guidance in IFRS. We assessed the qualifications and expertise of the external appraisers and we found that the appraisers performed their work in accordance with the respective professional valuation standards and that they have considerable experience in the markets in which the Group operates. We found no evidence to suggest that the objectivity of the appraisers was compromised. We compared the major assumptions such as rental rates, discount rates, capitalisation rates and vacancy rates used by the appraisers with our internally developed estimated ranges, determined via reference to published benchmarks when applicable. Where assumptions were outside the expected range or

In determining the fair value of investment property, the appraisers and the management take into account property-specific information such as the current tenancy agreements and rental income. Assumptions for yields and estimated market rent used are influenced by prevailing market yields and comparable market transactions. The existence of significant estimation uncertainty, coupled with the fact that only a small percentage difference in individual investment property valuations, when aggregated, could result in a material impact, warranted specific audit focus in this area.	otherwise deemed unusual, or valuations demonstrated unexpected movements not consistent with general trends in the market, we undertook further investigations and challenged the appraisers and Group management by requesting additional information and explanations on inputs and assumptions used. We concluded that the data and assumptions used by management were reasonable. It was evident from our interaction with management and the appraisers, and from our procedures in respect of the valuation reports that close attention had been paid to each investment property's individual characteristics, such as considering the overall quality, geographic location and cash flow potential of the property as a whole. We also found that the impact of recent and significant market transactions on each individual investment property's valuation were appropriately considered when determining the assumptions used in the valuation. We saw evidence that alternative assumptions had been considered and evaluated by management and the appraisers before determining the final fair value. We concluded that the assumptions used in the valuations were supported by the available and comparable market evidence. We also considered whether the disclosures made in note 14 to the financial statements met the requirements set out in IFRS and noted no issues.

How we tailored our audit scope

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

The Group's financial statements consolidate twelve reporting units. Based on our risk and materiality assessments, we determined which entities were required to be audited at full scope considering the relative significance of each entity to the Group and the overall coverage obtained over each material line item in the consolidated financial statements. For the subsidiaries EfTEN Real Estate Fund III AS, EfTEN Tänassilma OÜ, EfTEN Laagri OÜ and EfTEN Seljaku OÜ, full scope statutory audits were performed by the Group audit team and for Saules Miestas UAB and EfTEN Krustpils SIA by component auditors in accordance with our instructions. For other subsidiaries the Group audit team performed full scope audit procedures on investment properties' balances and the component auditors performed full scope audit procedures on cash and bank accounts, receivables from customers, notes payable and long-term debt, deferred income tax balances and revenue transactions from rental income. For the audit procedures performed by component auditors, we determined the level of involvement we needed to have in their audits to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

Other information

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

In relation to the listing of EfTEN Real Estate Fund III AS's shares on the Nasdaq Tallinn Stock Exchange from 1 December 2017, this is our second year as an auditor of EfTEN Real Estate Fund III AS as a public interest entity. The total period of our uninterrupted audit engagement appointment for the public interest entity EfTEN Real Estate Fund III AS can be up to 20 years. Our appointment as the auditor of EfTEN Real Estate Fund III AS can be extended up to the financial year ending 31 December 2036 in accordance with the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014.

AS PricewaterhouseCoopers

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

Rando Rand
Auditor's certificate no.617

22 February 2019

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* *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.*