

ERG CAPITAL - 3 ADSIP

**FINANCIAL STATEMENTS,
PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL
REPORTING STANDARDS
31 DECEMBER 2016**

**TOGETHER WITH
INDEPENDENT AUDITORS' REPORT**

AND

**ANNUAL MANAGEMENT REPORT ON
THE ACTIVITY**

**ANNUAL REPORT THE ACTIVITIES
FOR 2016**

ANNUAL MANAGEMENT REPORT ON THE ACTIVITY OF ERG CAPITAL – 3 ADSIP FOR 2016

28 March 2017

“ERG Capital – 3” ADSIP (“ERG-3” or “the Company”) is a Bulgarian joint stock company with special investment purpose. Its activity is governed by the Special Investment Purpose Companies Act (“SIPCA”) and its related regulations. The Company raises funds through the issue of securities and uses these funds to acquire real estate, in effect implementing real estate securitization.

In 2007, the Company was licensed as a Special Investment Purpose Company by the Financial Supervision Commission (“FSC”). In the same year the Company increased its capital by 50%.

Since its listing as a public company ERG-3 complies with its obligations under the agreements to which it is a party. Its activity is oriented towards managing and/or developing its own real estate investments (three as at the date of this report) in the cities of Sofia, Varna and Burgas and described below and in Note 4 to the financial statements.

ACTIVITY REVIEW

On 25 April 2007 the Financial Supervision Commission approved the prospectus for mandatory initial capital increase of ERG-3 and licensed the Company as a company with special investment purpose.

Below are the highlights of activity in 2016.

At the May 2016 Annual General Meeting of the Shareholders of ERG-3 (“AGM”), the Directors of the Company were released from responsibility for 2015 and a registered auditor was elected for 2016.

An Extraordinary General Meeting of the Shareholders of ERG-3 (“EGM”), was held in December 2016, on which Boyan Nikolov Ikononov was elected as a member of the Board of Directors of the Company. Boyan Nikolov Ikononov was also elected for a Executive director of the Company, whereas his election was duly filed and recorded in the Commercial Register as of the Recording Agency.

In the following discussion we present some comments regarding important aspects of the activity of the Company during 2016:

1. Liquidity

As of 31 December 2016 the Company's cash and cash equivalents are in the amount of BGN 694 thousand and other current assets are in the amount of BGN 9 thousand. The current liabilities are in the amount of BGN 35 thousand. With respect to the maturity date of the bond in February 2018, the Board of Directors of the Company are considering several different options to settle the bond's obligations - which options are related to extension of the term or payment of part or of the entire outstanding principal, together with interest accrued, through possible sale of an investment property.

2. Capital resources

As of 31 December 2016 ERG-3's shareholders' equity is BGN 16,436 thousand. The capital of the Company was paid in full and despite the accumulated losses for the period 2008 - 2016, and it is currently sufficient to support the Company's business activity. At this stage, ERG-3 does not plan any future capital increases.

For each of the properties described below and in Note 4 to the Financial statements, the Company considers two alternatives: a/ to develop it as commercial property and lease it or sell it and b/ to sell it without development in its current condition. In the cases when the Company decides to develop a property, because the management deems this alternative better for the shareholders, the Company will have significant capital outlays for construction, which it is planning to finance with bank loans.

3. Information about the properties, owned by ERG-3 (Art. 41 of Ordinance 2 of FSC)

Acquisitions or sales of real estate investments

As of 31 December 2016 the Company owned three real estate investments: “Yavor property”, “Sofia Ring property” and “Burgas retail property”.

Yavor property represents a 14,483 sq. m. land plot (the cadastre measured area is 14,724 sq. m.) and buildings, located in Varna, with administrative address 2 Oreh Str. The property is on Slivnitsa Blvd, which is one of the main boulevards in Varna.

The land represents regulated land plot № I-65, located in district 14 from the 26th region of Varna and has cadastre identification number 10135.3513.216. During 2009 part of the buildings were demolished. The total built-up area of the buildings as of 31 December 2016 is 14,916 sq. m. (the cadastre measured area), the biggest of which was built in 1989 with total built-up area of 13,383 sq. m., and could be used in future development of the property. The maximum building-development intensity for plot № I-65 is 3.5, which means possible construction of buildings with total built-up area of up to 51,534 sq. m., according to the city plan.

Sofia Ring property represents two land plots with total area of 131,284 sq. m. located on the inner side of the Ring Road with 400 meters face on the Ring Road close to the intersection with Botevgradsko Shosse. The maximum building development intensity is 1.5, which means possible construction of buildings with total built-up area of up to 196,926 sq. m.

Burgas retail property represents 24,966 sq. m. land plot (the cadastre measured area is 24,959 sq. m.) adjacent to Todor Aleksandrov Blvd, which is one of the main boulevards in Burgas. The plot consisted of two regulated land plots: LI - 265 and L – 636, which in 2009 were united in one regulated land plot L-265,636 and has cadastre identification number 07079.659.505. The property is cleared from buildings and construction scrap. According to the effective regulation and the city plan the property is in the 3/СмФ1 zone, which, according to the existing standards allows maximum building development intensity up to 2.5 and respectively the possible construction of buildings with total built-up area up to 62,397.5 sq. m.

Acquisitions and disposals of real estate investments in 2016

During 2016 the Company did not have any acquisitions and disposals of real estate.

Lease agreements executed in 2016

In 2016 the Company did not execute new lease agreements.

Construction works, repairs and improvements made in 2016:

During 2016 ERG-3 did not make any significant constructions works, repairs and improvements to the properties it owns.

During 2016 the Company has received orders for extension of validity of the construction permits issued for Sofia Ring Property.

4. Results from operations

The Company ended 2016 with a loss for the year of BGN 746 thousand.

The revenue of the Company for 2016 is mainly from renting Varna property under short-term lease agreement with a lease term up to August 31, 2017 – BGN 106 thousand.

During 2016, the main costs are for interest amounting to BGN 620 thousand and operating expenses amounting to BGN 233 thousand.

5. Risks

The Company is operating in the area of real estate investment and the main risks it faces are related to the development of the real estate sector in Bulgaria and to retail space in particular. Listed below are the main Company specific risk factors:

- Rising construction costs
- Rising interest rates
- Market price decreases of both real estate assets and rental levels
- Increase in the cost of insurance
- Dependence of the income stream on the financial condition of the future tenants
- Unexpected maintenance expenses
- Risk of occurrence of an uninsured event.

In addition to the Company specific risk factors, ERG-3 also faces some general risks, associated with doing business in Bulgaria. These are as follows:

- Risk of unfavorable legislative changes
- Risk of economic downturn
- Credit risk

- Currency risk
- Inflation risk.

There was some recovery in the Bulgarian real estate market during 2016, which will probably continue in 2017, but there is no guarantee that this will lead to an increase in the prices of properties owned by the Company and accordingly to improvement of the financial condition and operating results of the Company.

6. Important events after the date of the Financial Statements

No important events (other than the ones described in this report) have occurred after the date of the Financial Statements until the date of this report that might have significant impact to the financial position and the operating results of the Company.

7. Expected developments and plans for 2017

At this stage, the Company does not plan any further capital increases or new real estate acquisitions. For each of the properties described above and in Note 4 to the Financial statements, the Company is actively looking for buyers, but there is no guarantee that it will be able to sell any of the properties in 2017. The Company also considers the alternative option to develop the properties and to lease / sell them as commercial properties. In such case, when the company choses this alternative option, due to the management judgement that such option is better off for shareholders, the Company will make significant capital construction costs, which plans to finance with bank loans.

8. Research and development

ERG-3 is operating in the real estate sector and is not involved in any research and development activities.

9. Use of financial instruments

As at 31 December 2016 the Company has outstanding bond's principal in the amount of EUR 2,890 thousand (out of issued EUR 6,800 thousand) maturing on 21 February 2018. The bond has coupon of 10.5% and it is secured by mortgage recorded over Sofia Ring property. The interest is due at the bond's maturity (*Please refer also to Part 1 Liquidity above*).

10. Branches

ERG-3 has not registered and does not have any branches.

11. Share buy backs

Unlike the other public companies the companies with special investment purpose are not allowed by law to buy-back their own shares under the conditions of art. 111, (5) of the Public Offering of Securities Act (POSA). Therefore, by virtue of the law, ERG-3 is not allowed to purchase or own any of its shares and the Company has never traded in its own shares.

CORPORATE GOVERNANCE

The Company adopted its Good Corporate Governance Program (GCGP) in 2007. During 2016 the activities of the Company and of the Board of Directors have been in compliance with the GCGP and the National Corporate Governance Code, after its approval by the FSC.

The discussion in the following sections provides additional information on the Company's share capital and disclosures related to its corporate governance, whereas in addition and pursuant to Article 100n, para 7 and 8 of the POSA and with respect to the corporate governance of the Company the Management hereby declares the following:

1. The Company complies as appropriate with the National Corporate Governance Code approved by the -Deputy- Chairman of FSC, running the "Investment Activity Supervision" division. The Company complies as appropriate with the recommendations of the Code contained in Chapters 1-5, as far as they are applicable to the nature, the structure and the activities of the Company (*for example with respect to the first chapter, the Company may comply only with the recommendations concerning the one-tier management system*), with the exceptions listed below;
2. In addition to the National Corporate Governance Code, the Company has adopted and complies with its own Program for good corporate governance, which can be found on the website of the Company;

3. Currently the Company does not comply with to the following recommendations of the National Corporate Governance Code:
- The Chairman of the Board of Directors of the Company is not the independent director, whereas this position is entrusted to Kostadin Petkov due to his the widest experience in the management and sales of real estates;
 - The Company has not designated in its Bylaws the number of companies in which members of the Board of Directors can hold managerial positions since such a restriction is not required by the legal form and activities of the Company. As a company with a special investment purpose, ERG Capital - 3 ADSIP cannot directly operate and maintain of the acquired real estates and assigns these activities to its servicing company. Therefore, the participation of the members of the Board of Directors in other companies would not obstruct their work as members of the Board of Directors of the Company;
 - The Company has not limited the number of consecutive mandates of its independent member. Yordan Chompalov has wide and valuable experience and his participation in the Board of Directors of the Company is an advantage for the Company.
 - The Company does not foresee payment of additional incentives to fixed remuneration of the Directors. According to the adopted policy for the remuneration of members of the Board of Directors, the Company does not pay variable remuneration or provide such in the form of shares, stock options or other rights to acquire shares. The amount of remuneration of the Board of Directors of the Company is determined so that: (i) the Directors are not encouraged to take risks exceeding the normal acceptable level of risk in carrying out their activities; (ii) it will meet not only the short-term, but also the medium-term and long-term goals and interests of the Company; (iii) the Company will be able to hire professionals, who will participate in the management of the Company while avoiding possible conflicts of interest between the Company and its Directors.
 - Currently the Company has not applied a rotational basis in the selection of external auditor, as till now the ratio between the due remuneration, the quality of work and the reputation of Deloitte Audit OOD have not required the selection of another audit company.
4. As for the description of the main features of the internal control system and the risk management system of the issuer in relation to the financial reporting process: as stated below in this report the Company has no separate unit for internal control. This function is performed by the Board of Directors who are also members of the Audit Committee. Part of the control activities of the Audit Committee include review of quarterly financial statements and the accompanying notes to the financial statements, for the accuracy, completeness and compliance with appropriate accounting principles prior to their publication; review of the financial policy of the Company; review the adequacy of accounting and financial services; overseeing the work of the registered independent auditor and others. An exemplary result of the effectiveness of the internal control system is the timely preparation, disclosure and publication of financial statements of the Company before the Financial Supervision Commission, a trustee bank, Bulgarian stock exchange and the public. The company has a set of internal policies and rules for risk management - including its accounting policies presented in the notes to the financial statements. Part of the internal control and risk management systems are also the meetings conducted with the experts engaged by the servicing company. Risk management is also linked to the efforts and the early actions carried out, as far as it is possible, in order to forecast, identify and control the risks
5. As for the information under Article 10, para 1, letter "c", "d", "f", "h" and "i" of the Directive 2004/25 /EU of the European Parliament and of the Council of 21 April 2004 on take-over bids: such information, as far as it is applicable to the Company, could be found below in item 4 Controlling shareholders, item 9 Voting rights restrictions, item 11 Appointment of the Board of Directors and amendments and supplements of Bylaws and item 12 Powers of the Board of Directors. In addition to the above, during the period January 1, 2016 - December 31, 2016 the Company has not received notifications, from individuals or legal entities, reporting an acquisition or a sale of shares of the Company, as a result of which the voting right of an individual or a legal entity reached, exceed or fell below one of the following threshold: 10%, 20%, 1/3, 50% and 2/3.
6. With respect to the composition and functioning of the administrative, management and supervisory bodies and their committees: The Company has one-tier management system and it is managed by a Board of Directors whereas its members are as follows: Boyan Ikonov, Kostadin Petkov and Yordan Chompalov. The members of the Board of Directors are also members of the Audit Committee of the Company. The powers of Board of Directors are described in item 12 below.

SHARES OF THE COMPANY

1. Capital structure

Share Capital (item 1, Appendix 11 to Ordinance 2 of FSC)

At 31 December 2016, the Company has outstanding share capital of BGN 2,100 thousand comprising of 2,100,000 shares, each with a nominal value of BGN 1. All the issued and outstanding shares are fully paid-up. During 2016 there were no changes in the number of shares outstanding.

ERG-3 has a single class of ordinary shares, representing 100% of its registered capital. Each of the shares ranks pari passu amongst themselves, with no preferential rights attached to any of the shares. Each share entitles its holder to one vote at a general meeting of shareholders, to dividends when declared and to participate in a liquidation of the Company in proportion to the nominal value of the share. The Company does not have non-listed shares.

The following table shows the issued and outstanding share capital of the Company at the dates indicated:

	Number of issued shares	Paid-up share capital (thousand BGN)
31 December 2015	2,100,000	2,100
31 December 2016	2,100,000	2,100

Pre-emption Rights

Each holder of shares has pre-emptive rights to subscribe for any new shares or convertible bonds issued by the Company pro rata to its existing holding of shares. The number of shares required to subscribe for one new share or convertible bond must be specified in the shareholder resolution approving the share capital increase. Under Bulgarian law, pre-emption rights may not be removed in any way, unless those pre-emption rights are automatically removed by operation of Bulgarian law, which occurs whenever shares are issued for the following purposes: (i) to be allotted to holders of interests in another company as part of a merger or a non-cash tender offer for the shares in that company; (ii) to be allotted to holders of convertible bonds or warrants due to the conversion of those instruments.

If the capital increase is authorized by a shareholder resolution, the pre-emption rights accrue to those persons registered as shareholders at the Central Depository on the ex-dividend date, i.e. 14 days following the date of the shareholders' resolution. If the capital increase is authorized by a resolution of the Board of Directors, the pre-emption rights accrue to those persons registered as shareholders at the Central Depository on the seventh day after the publication of the announcement of the rights issue pursuant to the terms and conditions of the Public Offering of Securities Act. On the business day following the ex-dividend date (or the seventh day after the announcement, as appropriate) the Central Depository opens rights accounts in the name of the relevant shareholders based on the register at the Central Depository at such date.

The first date on which pre-emption rights may either be: (1) exercised to subscribe for new shares or convertible bonds; or (2) traded on the BSE is required to be specified in the announcement of the rights issue. The final date for the exercise of pre-emption rights must be between fourteen and thirty days from the date set for the first exercise of such rights. All rights not exercised within this time must be offered to the public by means of an auction organized by the BSE five business days after the final date on which rights may be traded. This auction is open for a period of one day. Any right acquired pursuant to the auction could be exercised within ten business days of the auction.

2. Restrictions on Share Transfers (item 2, Appendix 11 to Ordinance 2 of FSC)

In general there are no limitations on the transfer of the shares and shareholders do not need the approval of the Company or of any other shareholder in order to do so.

3. Principal Shareholders (item 3, Appendix 11 to Ordinance 2 of FSC)

The following table sets out details, insofar as they are known to the Company, of the interests in shares held by persons who are directly or indirectly interested in five per cent or more of the Company's issued share capital at the date of this document.

At 31 December 2016

Shareholder	Number of shares Owned at 31.12.2016	% of Voting shares at 31.12.2016
America for Bulgaria Foundation ("ABF") as the receiver of the assets of the Bulgarian American Enterprise Fund ("BAEF" or the "Fund")	1,036,700	49.37
Frank Louis Bauer	165,509	7.88
Michael David Hunsberger	124,500	5.93

Save as disclosed in the table above, the Company is not aware of any person who is holding directly or indirectly 5% or more of the Company's registered share capital.

None of the Company's shareholders have different voting rights from any other holder of shares in respect of any shares held by them.

4. Controlling Shareholders (item 4, Appendix 11 to Ordinance 2 of FSC)

No shareholders of the Company exercise any special controlling rights.

By virtue of the Company's bylaws the general meeting of the shareholders has a quorum if at least 50% of the voting shares are presented. Pursuant to the provisions of the Company's bylaws certain decisions of the shareholders' meeting are taken with majority of ¾ of the shares represented at the general meeting. Unless otherwise provided by law or by the Company's bylaws the decisions of the general meeting are taken with a 50% majority of the shares represented at the general meeting. These provisions set forth higher majorities than those generally required in the Commercial Act.

5. Remuneration of the Members of the Board of Directors

In 2016 Directors received gross remuneration from ERG-3 in the amount of BGN 18,000 (excluding VAT) based on the decisions of the AGM. According to these decisions each member of the Board of Directors receives gross remuneration in the amount of BGN 500 per month. Save for these payments the Company has not made any other payments to its directors in whatever form.

6. Employees and Directors as Shareholders

Company's directors (Boyan Ikonov and Kostadin Petkov) hold certain interest in the Company's shares, which is equal to 1.16% of its share capital at 31 December 2016. The single employee of the Company does not own any shares. Each director and employee votes his shares on his/her own and the Company is not aware of the existence of any control system imposing voting limitations. (item 5, Appendix 11 to Ordinance 2)

The Company is not aware of any shareholder agreement, restriction or limitation being imposed on directors or employees in voting their shares. Each shareholder exercises his/her voting right or may choose to authorize a third party of its own choice to vote by proxy. The Company is not aware of any directors' or employees' shares being blocked or restricted. The table below provides information on director's and their respective representatives' dealings with Company's shares in 2016:

Director	Shares owned on 31 December 2015	Net purchases (sales) of Company shares	Shares owned on 31 December 2016
Anna Boneva - member of the Board of Directors till 8 December 2016	7,500	-	7,500
Kostadin Petkov	17,000	-	17,000
Yordan Chompalov	-	-	-
Boyan Ikonov – member of the the Board of Director from 8 December 2016	-	-	7,450

Directors do not have any special rights or privileges to acquire securities issued by the Company.

7. Directors as owners of beneficial interest in other legal entities or as Directors

7.1. Yordan Compalov (as of the date of this report)

7.1.1. Does not participate in any trade company as a general partner with unlimited liability;

7.1.2. Owns more than 25% of the capital in the following companies:

- "DTT" OOD;

7.1.3. Does not serve as director in other companies.

7.2. Anna Boneva (as of the date of this report)

7.2.1. Does not participate in any trade company as a general partner with unlimited liability;

7.2.2. Owns more than 25% of the capital in the following company:

- "Fine Line" OOD;

7.2.3. Serves as director/member of the board in other entities:

- Tokuda Bank AD, Board member and Executive director.

7.3. Kostadin Petkov (as of the date of this report)

7.3.1. Does not participate in any trade company as a general partner with unlimited liability;

7.3.2. Owns more than 25% of the capital of the following companies:

- MMTT Petkov Engineering EOOD;

7.3.3. Serves as director/member of board in the following companies:

- MMTT Petkov Engineering EOOD;
- Association "Institute for interdisciplinary researches and technologies";
- Foundation "Center for economic strategy and competitiveness";
- Association "Red hearts";
- Association "Basketball club Sofia".

7.4. Boyan Ikononov (as of the date of this report)

- 7.4.1. Does not participate in any trade company as a general partner with unlimited liability;
- 7.4.2. Owns more than 25% of the capital of the following companies:
 - KMN Consult EOOD;
- 7.4.3. Serves as director/member of board in the following companies:
 - KMN Consult EOOD;

8. Conflicts of interest

In 2016 none of the Directors has entered into any agreements with the Company outside of its scope of activity or on terms and conditions different from those prevailing on the market.

9. Voting Rights Restrictions (item 6, Appendix 11 to Ordinance 2 of FSC)

The Company is not aware of any restrictions or limitations on voting rights on any grounds. A limitation may arise by law regarding voting on certain deals with interested parties as stipulated in article 114 of POSA.

10. Restrictive Shareholder Agreements (item 7, Appendix 11 to Ordinance 2 of FSC)

The Company is not aware of any agreements between any of its shareholders that might lead to restrictions in transferring the Company's shares or in exercising voting rights.

11. Appointment of the Board of Directors and amendments and supplements of Bylaws (item 8, Appendix 11 to Ordinance 2 of FSC)

The by-laws of the Company provide for a one-tier management system consisting of a Board of Directors. Members of the Board of Directors may be either individuals or legal entities.

Board of Directors

Bulgarian law and the Company's bylaws provide that the Board of Directors must consist of at least three and not more than seven persons. The members of the Board of Directors may be appointed and dismissed by a resolution passed by a majority of ¾ of the shareholders in general meeting. Under Bulgarian law at least one third of the members of the Board of Directors should be independent (i.e. (i) not being an employee of the Company, (ii) not being a majority shareholder or a person related to the Company, (iii) not being in a long-term commercial relationship with the Company, (iv) not being a board member, procurator or employee of an entity under (ii) and (iii) or (v) being related to another member of board of the Company).

The Company's by-laws provide that a quorum of at least half of all Board members is necessary for a valid meeting and for passing of resolutions. Unless otherwise provided by law or by the Company's bylaws the decisions of the Board are taken with simple majority of Board members.

The Board has authorized the Executive Director to represent the Company and to take responsibility for its daily operations.

Board members may be re-elected without limitation and may be dismissed at any time by the Shareholders meeting. A board member may resign and require to be deregistered as a Board member in the commercial register with notice in writing addressed to the Company.

Amendments or supplements to the bylaws

The Company's by-laws provide that the shareholder resolution to amend or supplement the by-laws requires the approval of ¾ of the voting shares present at the meeting. The Financial Supervision Commission has the power to issue a "stop order" or a compulsory instruction or injunction to the Company if any resolution of the shareholders in general meeting or resolution of the Board of Directors is found to be illegal. The Financial Supervision Commission alone may make such an order if a resolution of the Board would be detrimental to the interests of shareholders or other investors.

Amendments and supplements to the by-laws of the Company are only effective at the date of the registration of the resolution at the Bulgarian commercial register.

12. Powers of the Board of Directors (item 9, Appendix 11 to Ordinance 2 of FSC)

The Board of Directors is responsible for securing the lawful and viable operation of the Company. It resolves on all issues that are not of the exclusive competence of the General meeting of the shareholders. The Board of Directors reports on its activities to the General Meeting of the Shareholders.

The most important resolutions of the Board of Directors are listed below:

- conclude, terminate and rescind agreements with the Depository Bank;
- control the execution and performance of the agreements with the Servicing Company/ies and with the Depository Bank;
- take decisions to invest the Company's free funds in accordance with the requirements and the restrictions set forth by the Law on Companies with Special Investment Purpose, the By-laws and the current legislation;
- take decisions to take bank credits and conclude loan agreements with banks:
 - (a) for acquisition or completion of real estate for securitization including loans which for the current year amount to more than 1/2 of the total assets of the Company according to the certified financial report, and
 - (b) in the amount of up to 20% of the book value of the total assets of the Company which loans shall be used for payment of interest and only if the term of the loan is not exceeding 12 months;
- take decisions for providing collateral to the loan agreements under the above item including the case when the amount of the collateral for the current year exceeds ½ of the total assets of the Company as per the certified financial report;
- take decisions to invest up to 10% of the registered capital of the Company in a servicing company;
- elect and dismiss an executive director/s;
- take decisions for issue of bonds under the terms and conditions of Art. 13, para. (3) and (4) of the by-laws.
- Based on proposals from the Servicing Company/ies decides on acquisitions and sales of real estate investments within the limitations of the Law and the By-laws.

The Board of Directors resolves on all issues that are not of the sole competence of the General Meeting.

Unlike the other public companies the companies with special investment purpose are not allowed by law to buy-back their own shares under the conditions of art.111, (5) of POSA.

13. Agreements Representing a Takeover Defense (item 10, Appendix 11 to Ordinance 2 of FSC)

The Company is not aware of any agreements that shall become in effect, supplemented or cancelled in the event of change in control or a takeover bid.

14. Agreements on Severance Packages in Case of Termination of Employment (item 11, Appendix 11 to Ordinance 2 of FSC)

The Company is not aware of any arrangements between the company and its directors or employees that may result in extra payments, bonuses or other compensation in case of termination of employment, dismissal or cancellation of employment without any legal grounds or due to a takeover bid.

ADDITIONAL INFORMATION (APPENDIX 10 TO ORDINANCE 2 OF FSC)

1. Main goods and services

ERG-3's main activity is managing and/or developing and leasing and/or sale of the properties it owns.

2. Revenue by type of activity, geography and main service providers

In 2016, there is no revenue from sales of investment properties.

The revenue of the Company for 2016 is mainly from renting Varna property under short-term lease agreement with a lease term up to August 31, 2017 – BGN 106 thousand.

During 2016 the total amount of expenses of the Company are at the amount of BGN 853 thousand, of which 72.7 % represent interest and expenses related to the bond issue maturing on 21 February 2018 and 5.5% represent expenses for the servicing company.

3. Significant deals in 2016

Please refer to Acquisitions and disposals of real estate investments in 2016 and Lease agreements executed in 2016 above.

Except for the deals described in these paragraphs, during 2016 the Company has not executed other deals that are significant to its operations.

4. Deals or proposals for deals with related parties

There were no such new deals in 2016.

5. Unusual events with significant impact on the activities

In 2016 there were no unusual events that could have a material impact on the activity of the Company, its financials and results from operations safe for the ones disclosed in this document.

6. Off-balance sheet commitments

All off-balance sheet assets or liabilities are disclosed in the Notes 5, 8 and 9 to the financial statements.

7. Ownership of other legal entities

ERG-3 does not own shares or any other ownership interest in other companies.

8. Loans of the Company, extended guarantees or other assumed obligations

At 31 December 2016 ERG-3 has one listed bond issue with details provided in this report and in Note 7 to the Financial statements.

The Company is prohibited by law to and it has not extended any guarantees to any third party.

9. Loans by the Company

By law ERG-3 is not allowed to provide loans to any party and in 2016 the Company has not entered in such deals.

10. Use of funds from a new issue of securities

In 2016 the company did not issue any new securities.

11. Comparison of financial results with prior earnings forecasts

ERG-3 does not publish earnings forecasts.

12. Capital budgeting, liability management, threats and measures

ERG-3's policy in managing its financial resources is adequate and the Company has sufficient resources to service its obligations and to fund its activities. For details, please see above the sections on Liquidity and Capital Resources.

13. Planned investments and their funding

The information is in section 7. *Expected developments and plans for 2017* above.

14. Change in governance principles and in the group companies under the Accountancy Act of the Company

There were no changes to ERG-3's governance principles.

15. Internal control and risk management

ERG-3 does not have a separate internal control unit, rather this function is exercised by the Board of Directors. The Company has an internal set of policies and rules for risk management, including its accounting policy, presented in the notes to the Financial Statements.

16. Changes of the Board of Directors

During 2016 the following changes are made in the Board of Directors of the Company: With a resolution of the General Meeting of Shareholders held on 08.12.2016, Anna Petrova Tsankova - Boneva was discharged as member of the Board of Directors of the Company and on her position was elected Boyan Nikolov Ikonov. Boyan Ikonov was also elected as a member of the Audit Committee and as an Executive Director of the Company. Those changes were filed and recorded in the Commercial Register as of the Registry Agency during the same month.

17. Remuneration of the Board of Directors

During 2016 the members of the Board of Directors received gross remuneration from ERG-3 in the amount of BGN 18,000 (net of VAT). For more details, please see the section on Corporate Governance above.

18. Shares owned by Directors

The Company has a single class of shares and it has not issued any options. For more details on Director's ownership of shares, please see the section on Corporate Governance above.

19. Possible change in control

The Company is not aware of any negotiations or agreements that may result in change of ownership of its shares.

20. Court, administrative or arbitrage procedures

The Company is not a party to any pending, court, administrative or arbitration proceedings, regarding receivables or obligations exceeding 10% of its shareholders' equity.

21. Investor relations officer

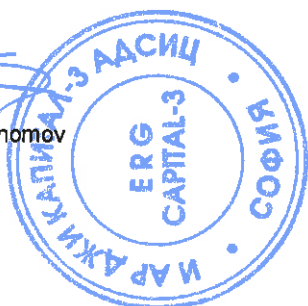
Svetozara Stoyanova-Tavityan
3 Shipka Str.
Sofia, 1504

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E: ergcapital3@baefinvest.com

CHANGES IN THE PRICE OF THE SHARES

According to infostock.bg between 1 January 2016 and 31 December 2016, 650 shares of the Company were traded at BSE-Sofia for a total value of BGN 3,187 thousand at prices ranging between BGN 4.70 and 6.50 per share. During the period there has been some increase in the price of the Company's shares, but under lower traded volume. The last deal at BSE-Sofia for 2016 was executed on 30 December 2016 for 10 shares at BGN 6.50 per share.

.....
Boyan Nikolov Ikonov
Executive Director



*This document is a translation of the original in Bulgarian text,
in case of divergence the Bulgarian text shall prevail*

INDEPENDENT AUDITOR'S REPORT

To the shareholders of ERG Capital - 3 ADSIP

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the accompanying financial statements of ERG Capital - 3 ADSIP (the "Company"), which comprise the statement of financial position as at December 31, 2016, and the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union ("EU").

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 Financial Statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Independent Financial Audit Act (IFAA) that are relevant to our audit of the financial statements in Bulgaria, and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the requirements of IFAA. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

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

<i>Key audit matter</i>	<i>How our audit addressed the key audit matter</i>
<p>1) Valuation of investment properties carried at the amount of BGN 24,244 thousands as disclosed in Note 4</p> <p>The applicable accounting policy for subsequent measurement of investment properties is at cost less accumulated depreciation and impairment losses. According to the Special Purpose Investment Companies Act (SPIC) the Company should perform appraisal of its investment properties at least once a year. The Board of Directors engaged licensed independent appraiser for assessment of the investment properties fair value as of 31 December 2016. The appraiser report is also used for disclosure of the fair value of the investment properties in the financial statements as required by IAS 40.</p> <p>The Company uses the appraiser report for impairment review. Based on the estimated fair value by the licensed independent appraiser as of December 31, 2016 the Board of Directors concluded that there is no impairment with respect to the investment properties.</p> <p>The valuation of Company's investment properties is key audit matter as it requires significant management judgement and in the same time, the investment properties are significant part of the Company assets. The valuations of the properties contain certain key assumptions such as information for the market transactions, assumptions for the market, expected rental income, discount factors, risks related to the development of the properties.</p>	<p>During our audit we performed the following procedures in relation to valuation of investment properties:</p> <ul style="list-style-type: none"> • Evaluation of the external valuers' objectivity, independence and expertise ; • Assessment of the methodology used and the key assumptions made based on our knowledge of the industry and using our in-house valuation experts; • Check, on a sample basis, of the accuracy of the input data used; <p>We found the disclosures in note 2 and 4 to be appropriate.</p>
<p>2) Liquidity position as disclosed in Note 2, Basis for preparation and Note 8</p> <p>The Board of Directors has assessed the liquidity position of the Company and the up-coming maturity of the bond emission. The maturity date is February 21, 2018. The undiscounted amount of the bond liability is BGN 9.1 mln. and the Company does not currently have enough available liquid resources to meet the up-coming payment. The bond is secured with mortgage over one of the investment properties – Sofia Ring.</p> <p>The Board of Directors considers several options for settlement of the bond liability, namely:</p>	<p>During our audit we performed the following procedures with regard to the assessment of the Company's liquidity position:</p> <ul style="list-style-type: none"> • Evaluated the Board of Directors' assessment of the Company's ability to continue as a going concern ; • Checked whether the bond is secured with Sofia Ring property; • Evaluated the significance and likelihood of occurrence of certain events and conditions;

<i>Key audit matter</i>	<i>How our audit addressed the key audit matter</i>
<ul style="list-style-type: none"> • Sale of investment property; and • Extension of the maturity date. <p>As a consequence of the Company's liquidity position as of December 31, 2016 the Board of Directors assessed the going concern assumption. Based on the different settlement options and the fact that the security covers the undiscounted liability the Board of Directors considered that the going concern assumption is appropriate and there is no material uncertainty in this regard.</p> <p>The settlement options of the bond emission are subject to significant judgement and assessment of future events, as well as the significance of the liability to the Company's statement of financial position, it is considered as key audit matter.</p>	<ul style="list-style-type: none"> • Evaluated the Board of Directors assessment of alternatives for settlement of the liability. <p>We found the disclosures in note 2, Basis for preparation and note 8, to be appropriate.</p>

Information Other than the Financial Statements and Auditor's Report Thereon

The Board of Directors (the Management) is responsible for the other information. The other information comprises the annual report on activities and the corporate governance statement, prepared by the Management in accordance with Chapter Seven of the Accountancy Act, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, unless it is not specifically stated in our auditor's report and to the extent it is specifically stated.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the 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 Those Charged with Governance for the Financial Statements

The Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS as adopted by the EU, and for such internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Management is responsible for assessing the Company'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 either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Audit Committee (Those charged with governance) are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the 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 Independent Financial Audit Act and 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 financial statements.

As part of an audit in accordance with Independent Financial Audit Act and ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

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

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 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

Additional matters, required to be reported by the Accountancy Act and Public Offering of Securities Act

In addition to our reporting responsibilities according to ISAs described in section "Information Other than the Financial Statements and Auditor's Report Thereon", with respect to the annual report on activities and the corporate governance statement, we have also performed the procedures required by the Guidelines of the Professional Organization of Chartered Accountants and Registered Auditors in Bulgaria - Institute of Certified Public Accountants (ICPA), issued on November 29, 2016. These procedures include tests over the form and content of the other information in order to assist us in forming an opinion as to whether the other information includes the disclosures and reporting as required by Chapter Seven of the Accountancy Act and the Public Offering of Securities Act (art. 100m, para 10 of POSA in relation to art. 100m, para 4, p. 3 and 4 of POSA), applicable in Bulgaria.

Opinion under Article 37, paragraph 6 of the Accountancy Act

Based on the procedures performed, in our opinion:

- The information included in the annual report on the activities for the financial year for which the financial statements have been prepared, is consistent with the financial statements.
- The annual report on the activities has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act and of Art. 100m, paragraph 7 of the Public Offering of Securities Act.
- The information required by Chapter Seven of the Accountancy Act and Art. 100m, para 8 of the Public Offering of Securities Act is presented in the corporate governance statement covering the financial year for which the financial statements have been prepared.

Opinion under Art. 100m, para 10 in relation to art. 100m, para 8, p. 3 and 4 of the Public Offering of Securities Act

Based on the procedures performed during our audit and as a result of the acquired knowledge and understanding of the Company and the environment in which it operates, acquired during our audit, in our opinion, the description of the main features of the Company's internal control and risk management systems in relation to the financial reporting process as part of the annual report on activities (as element of the content of the corporate governance statement) and the information under Article 10, paragraph 1, letter "c", "d", "e", "h" and "i" of the Directive 2004/25/EC of the European Parliament and of the EU Council of April 21, 2004 related to takeover bids, included in the corporate governance statement do not contain cases of material misrepresentations.

Additional reporting in relation to the audit of the financial statements under Art 100m, para 4, p. 3 of the Public Offering of Securities Act

Reporting in relation to Art 100m, para 4, p. 3, l. "b" of the Public Offering of Securities Act

Information on related party transactions is disclosed in Note 11 to the accompanying financial statements. Based on the procedures performed on related party transactions in the context of our audit of the financial statements as a whole, nothing has come to our attention indicating that the related party transactions are not disclosed in the accompanying financial statements for the year ended December 31, 2016, in all material respects, in accordance with the requirements of IAS 24 Related Party Disclosures. We have considered the results of our audit procedures on related party transactions in forming our opinion on the financial statements as a whole and not for the purpose of providing a separate opinion on the related party transactions.

Reporting in relation to Art 100m, para 4, p. 3, l. "c" of the Public Offering of Securities Act

Our responsibilities for the audit of the financial statements described in section "Auditor's Responsibilities for the Audit of the Financial Statements" include evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. Based on the procedures performed on the material transactions underlying the financial statements for the year ended December 31, 2016, nothing has come to our attention indicating any instances of material unfair presentation and disclosure under the applicable IFRS as adopted by the European Union. We have considered the results of our audit procedures on the material transactions underlying the financial statements in forming our opinion on the financial statements as a whole and not for the purpose of providing a separate opinion on these material transactions.

Deloitte Audit OOD

Deloitte Audit OOD



Assen Dimov
Statutory manager
Registered Auditor



Sofia
March 29, 2017

ERG CAPITAL – 3 ADSIP
 STATEMENT OF COMPREHENSIVE INCOME
 YEAR ENDED 31 DECEMBER 2016


BGN in thousands except per share amounts or unless otherwise stated


	Notes	2016	2015
Revenue			
Other income	4	106	106
Interest income		1	2
Net revenue		107	108
Expenses			
Operating expenses	3	(233)	(237)
Interest expense	8	(620)	(574)
Impairment loss on investment property	4	-	(1,873)
Total expenses		(853)	(2,684)
Loss for the year		(746)	(2,576)
Loss per share - basic and diluted	10	(0.36)	(1.23)

These financial statements have been approved by the Board of Directors on 28 March 2017


 Boyan Nikolov Ikonomov
 Executive Director




 Penka Georgieva-Higgins
 Manager of PSG-98 EOOD
 Compiler of the financial report




 29.03.2017



ERG CAPITAL - 3 ADSIP
STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2016

BGN in thousands except per share amounts or unless otherwise stated

	Notes	2016	2015
ASSETS			
Cash and cash equivalents	5	694	943
Other assets	6	9	12
Investment property (net)	4	24,244	24,130
TOTAL ASSETS		24,947	25,085
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES			
Other liabilities	7	35	32
Interest payable on debt securities	8	2,885	2,291
Debt securities	8	5,591	5,580
Total liabilities		8,511	7,903
SHAREHOLDERS' EQUITY			
Share capital	9	2,100	2,100
Share premium		8,941	8,941
Reserve fund	9	18,937	18,937
Retained earnings		(13,542)	(12,796)
Total shareholders' equity		16,436	17,182
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		24,947	25,085

These financial statements have been approved by the Board of Directors on 28 March 2017.

Boyan Nikolov Ikononov
Executive Director

Penka Georgieva-Higgins
Manager of PSG-98 EODS
Compiler of the financial report

Boyan Nikolov Ikononov
29.03.2017



ERG CAPITAL - 3 ADSIP
 STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
 YEAR ENDED 31 DECEMBER 2016


BGN in thousands except per share amounts or unless otherwise stated


	Share capital	Share premium	Reserve fund	Retained earnings	Total
31 December 2014	2,100	8,941	18,937	(10,220)	19,758
Loss for the year	-	-	-	(2,576)	(2,576)
31 December 2015	2,100	8,941	18,937	(12,796)	17,182
Loss for the year	-	-	-	(746)	(746)
31 December 2016	2,100	8,941	18,937	(13,542)	16,436

These financial statements have been approved by the Board of Directors on 28 March 2017.


 Boyan Nikolov Ikononov
 Executive Director




 Penka Georgieva-Higgins
 Manager of PSG 98 EOOD
 Compiler of the financial report




 29.03.2017



ERG CAPITAL - 3 ADSIP
STATEMENT OF CASH FLOW
YEAR ENDED 31 DECEMBER 2016

BGN in thousands except per share amounts or unless otherwise stated

	Notes	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Loss for the year		(746)	(2,576)
Adjustments to reconcile loss for the year to net cash provided by operating activities			
Investment in properties		(114)	-
Impairment loss on investment property	4	-	1,873
Increase in interest payable on debt securities		594	593
Decrease in other assets		3	1
(Decrease) increase in other liabilities		3	(1)
Net cash used in operating activities		(260)	(110)
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of debt securities, net of amortization of transaction cost	8	11	(34)
Net cash from/(used in) financing activities		11	(34)
Net (decrease) in cash and cash equivalents		(249)	(144)
Cash and cash equivalents at the beginning of the year		943	1,087
Cash and cash equivalents at the end of the year		694	943
Supplemental cash flow information:			
Interest and transaction cost paid		15	15

These financial statements have been approved by the Board of Directors on 28 March 2017.

Boyan Nikolov Ikononov
Executive Director

Penka Georgieva-Higgins
Manager of PSG-98 EOOD
Compiler of the financial report



Boyan Nikolov Ikononov
28.03.2017



BGN in thousands except per share amounts or unless otherwise stated

1 Organization and operations

ERG Capital - 3 ADSIP ("the Company" or "ERG"), PIC 175113002, was registered on 13 July 2006 as a Bulgarian joint stock company with special investment purpose with the sole purpose to invest the funds raised in real estate. As at 31 December 2016, America for Bulgaria Foundation ("ABF") as the receiver of the assets of the Bulgarian-American Enterprise Fund ("BAEF"), following the principles, policies and controls of BAEF owns directly 49.37% of the share capital of the Company. Under the Company's by-laws, ERG has a fixed term of existence that ends on 31 December 2020.

ERG activities and operations are governed by the provisions of the Special Investment Purpose Companies Act ("SIPCA"), the Public Offering of Securities Act ("POSA") and related secondary legislative acts. The Financial Supervision Commission is responsible for supervision of the Company's compliance with the laws and regulations. The SIPCA requires the Company's cash and securities to be held at a custodian bank, which is United Bulgarian Bank AD. In 2016 Bulgarian American Management Company EOOD ("BAMC") replaced Serdika Capital Advisors Permanent Establishment ("SCA") as the servicing company for ERG.

On 25 April 2007 the Company received its license to operate as a company with special investment purpose from the Financial Supervision Commission.

The Company's registered office is located at 3 Shipka Str., Sofia, Bulgaria.

2 Summary of significant accounting policies

Basis of Preparation

The Company prepares and presents its financial statements in accordance with International Financial Reporting Standards ("IFRS"), issued by the International Accounting Standards Board ("IASB") and the interpretations, issued by the International Financial Reporting Interpretations Committee ("IFRIC"), as approved by the European Union ("the EU") and applicable in the Republic of Bulgaria. IFRS, as adopted by the EU do not differ from IFRS, issued by the IASB, and are effective for reporting periods ended as of 31 December 2016, except for certain IFRS, amendments to IFRS and interpretations, which have not been adopted by the EU. The management believes that if those have been approved by the EU it would have no influence on these financial statements.

During 2016 the Company has adopted all new and revised IFRS by IASB, as approved by the EU, effective for 2016, which refer to the Company's business. The adoption of these amendments and interpretations has not resulted in changes in the accounting policies of the Company.

Certain IFRS, amendments to IFRS and interpretations have been adopted by IASB and IFRIC as of the date of the financial statements, but are effective for annual periods beginning on or after 1 January 2016. The Company has not elected earlier application of those IFRS and IFRS revisions.

These financial statements have been prepared on the historical cost basis. The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results may differ from those estimates.

The Company prepares these financial statements on the going concern basis, which assumes that the Company will continue to operate in the foreseeable future. In making its assessment of the entities ability to continue as a going concern the Board of directors has assessed the upcoming at 21 February 2018 maturity of the bond emission. The expected cash outflow at maturity date is BGN 9.1 mln, of which principal at the amount of BGN 5.6 mln. and interest at the amount of BGN 3.5 mln. The bond liability as of 31 December 2016 is BGN 8.5 mln. The Board of Directors considers several different options for settlement of the liability. Based on these options, the Board of directors assessed that the going concern principal is applicable and there is no material uncertainty with this respect.

BGN in thousands except per share amounts or unless otherwise stated

The statement of financial position presents assets and liabilities in decreasing order of liquidity and does not distinguish between current and non-current items. These financial statements are prepared for general purposes and provide information for the financial position, operations and cash flows of the Company for the year ended 31 December 2016.

Functional and reporting currency

The functional currency of the Company is the national currency of Bulgaria - BGN. The financial statements are presented in thousand BGN.

Foreign currency

Foreign currency transactions, i.e. transactions denominated in currencies other than BGN, the Company's functional currency, are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of comprehensive income.

Cash and cash equivalents

For the purposes of the financial statements, the Company considers all highly liquid financial instruments and other financial instruments with maturity of three months or less to be cash equivalents.

Investment property

Investment property is property (land or a building-or part of a building-or both) held to be leased under long term operating leases or for capital appreciation or both in accordance with the Improvements to IFRS issued in May 2008 and effective 1 January 2009. An investment property is measured initially at its cost. Cost comprises its purchase price and any directly attributable expenditures, including taxes and fees directly related to the purchase and other transaction costs. For all new investments started after 1 January 2009 borrowing costs that are directly attributable to the acquisition, construction and development are capitalised as part of the cost of the investment property, in accordance with the amendments to IAS 23 "Borrowing costs". Construction cost is recorded based upon stages of completion. Development cost is recorded at the time the services are performed. After the initial recognition the investment property is accounted for in accordance with the cost model - cost less accumulated depreciation and accumulated impairment losses as determined by management. The SIPCA requires that ERG's investment property is appraised at the end of each fiscal year. Depreciation of the buildings starts when they are available for use and is based on the straight-line method.

Debt securities

Debt securities represent an issue of secured bonds, which is recognized initially at fair value less transaction costs. Subsequently, the issue is valued at amortized cost with any difference between net proceeds and the redemption value is recognized in the statement of comprehensive income using the effective interest rate for the term of the liability.

Fair Value Measurement

Some of the accounting policies of the Company require fair value estimates for both financial and non-financial assets and liabilities. The measurement of fair value is done from a position of assumptions and estimates, which would be made by potential market participants when they determined the price of the respective asset or liability, assuming that they would operate to achieve the best economic benefits of it for them. When measuring of the fair value, the Company applies observable data, if possible. The fair values are categorized into different levels of the fair value hierarchy based on the inputs to valuation techniques as follows:

- Level 1: quoted prices (unadjusted) in active markets for similar assets or liabilities.
- Level 2: inputs data other than quoted prices included in Level 1 that directly (i.e. as prices) or indirectly (i.e. derived from prices) are available for observation for the asset or liability.
- Level 3: inputs data for the asset or liability that are not based on observable market data (unobservable inputs).

BGN in thousands except per share amounts or unless otherwise stated

Borrowings

Borrowings are recognized initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method.

Rental income recognition

Rents from operating leases are recorded as rental income proportionately to the term of the lease agreement.

Interest income and expense recognition

Interest income and expense are recognised in the statement of comprehensive income for all interest bearing instruments using the effective interest method. Interest income includes interest on bank deposits. Interest expense includes interest and transaction costs on borrowings, debt securities and payables.

Tax status and dividend requirement

The Company was formed under the SIPCA and is exempt from Bulgarian corporate income taxes as long as it distributes to shareholders 90% of its profit for the year or 90% of its retained earnings if retained earnings is less than the profit for the year. Considering the SIPCA requirement, the Company accrues the required dividend as of the end of each fiscal year and recognizes this dividend as a liability at the statement of financial position date, meeting the criteria of a present obligation as defined in IAS 37.

Reclassification

As of 01.01.2016, the Company presented a correction in cash flow statement, related to the Interest expenses/increase of interest payables on debt securities in cash flows from financial activities. As of 31.12.2016 the interest expenses are presented in adjustment to cash flows from operating activities. The comparative information in these financial statements has been reclassified. The effect of the reclassification results in increase in the cash flows from operating activities by BGN 593 thousand in 2015 and decrease in the cash flows from financing activities by the same amount.

3 Operating expenses

	<u>2016</u>	<u>2015</u>
Professional fees	205	208
Board of Directors fees	18	18
General and administrative expenses	11	11
Total	<u>233</u>	<u>237</u>

Professional fees for 2015 include asset management and servicing fee to SCA of BGN 30 (Note 11).

4 Investment property (net)

At 31 December 2016 and 2015 the Company owned three properties.

- "Yavor property" at 31 December 2016 (2015) represents a 14,724 sq. m. (the cadastre measured area) land plot and buildings, located in Varna – 2, Oreh Str. During 2016 and 2015, the Company generated immaterial amount of rental income of BGN 106 thousand and BGN 106 thousand, respectively from Varna property under a short term operating lease contract that was renewed until 31 August 2017.

ERG CAPITAL - 3 ADSIP
 NOTES TO THE FINANCIAL STATEMENTS
 31 DECEMBER 2016

BGN in thousands except per share amounts or unless otherwise stated

- "Sofia Ring property" at 31 December 2016 (2015) represents a 131,284 sq. m. (the cadastre measured area) land plot located in Sofia, at the Ring road and Botevgradsko shose junction. In February 2012 the property was pledged in favor of TB Victoria EAD (previously Credit Agricole Bulgaria EAD and Emporiki Bank – Bulgaria EAD) as trustee bank to secure holders of the Second bond issue. In November 2014 the pledge was transferred to Allianz Bank Bulgaria AD as a new trustee bank to secure holders of the Second bond issue (Note 8).

- "Burgas retail property" at 31 December 2016 (2015) represents a 24,959 sq. m. (the cadastre measured area) land plot, located in Burgas between Todor Alexandrov Blvd. and the Burgas port.

	<u>Investment property under development</u>
	<u>Land & Buildings</u>
<i>Cost</i>	
31 December 2014	27,424
Disposals	-
31 December 2015	27,424
Acquired	114
31 December 2016	27,538
<i>Accumulated depreciation and impairment loss</i>	
31 December 2014	1,421
Impairment loss for 2015	1,873
31 December 2015	3,294
Impairment loss for 2016	-
31 December 2016	3,294
<i>Net book value</i>	
31 December 2016	24,244
31 December 2015	24,130
31 December 2014	26,003

In 2015, management devalued two of its investment properties to their recoverable amount by recognizing an impairment loss in the statement of comprehensive income.

Based upon the result of the required annual appraisal (prepared by an independent appraiser with recognized and relevant professional qualification), the fair value of the investment property at 31 December 2016 and 2015 was BGN 24,561 thousand and BGN 24,294 thousand, respectively. The investment property is classified within Level 3 of the fair value hierarchy and has been determined based on combination of generally accepted valuation methods. In estimating the fair value of the investment property, the highest and best use of the property is its current use. There has been no change to the valuation technique during the year.

5 Cash and cash equivalents

	<u>2016</u>	<u>2015</u>
Cash at bank accounts, including	8	11
<i>Bank accounts in BGN</i>	5	8
<i>Bank accounts in foreign currency</i>	3	3
Bank deposits, including	686	932
<i>In BGN</i>	99	345
<i>In foreign currency</i>	587	587
Total	694	943

BGN in thousands except per share amounts or unless otherwise stated

6 Other assets

	<u>2016</u>	<u>2015</u>
Prepaid expenses	6	6
Other	3	6
Total	<u>9</u>	<u>12</u>

7 Other liabilities

	<u>2016</u>	<u>2015</u>
Guarantee deposit	24	24
Other	11	8
Total	<u>35</u>	<u>32</u>

8 Debt securities

Second bond issue

In February 2012, the Company issued fixed rate (10.5%) secured bonds in the amount of EUR 6.8 million with a term of 36 months. In November 2014 the term of the Second bond issue was extended by 36 months, effective February 2015. Both interest and principal are due in full amount at maturity. In case the Company decides to repay partially or in full the principal, the Company should pay the accrued interest on the repaid principal. This bond issue is secured by mortgages on Sofia Ring property, Yavor property (mortgage on Yavor property was fully repaid in October 2014), Burgas retail property (mortgage on Burgas retail property was released in October 2014) and a pledge on a bank account to be credited with the proceeds of the future sale of the pledged properties. In October 2014 TB Victoria EAD (previously Credit Agricole Bulgaria EAD and Emporiki Bank – Bulgaria EAD) was replaced by Allianz Bank Bulgaria AD as the trustee bank under this bond issue. The Second bond issue is listed on the BSE for secondary trading and trades under BSE code 5ERB. Through the years and using part of the revenues from sold properties, the Company has paid in advance partially the bond issue, whereas as a result of this the mortgages recorded over properties Yavor and Burgas Retail were released. The unpaid part of the principal, net of deferred transaction costs, as of December 31, 2016 and in 2015 is EUR 2,86 million (BGN 5,591 thousand) and EUR 2,85 million (BGN 5,580 thousand), respectively, and obligations for interest EUR 1,48 million (BGN 2,885 thousand) and EUR 1,17 million (BGN 2,291 thousand), respectively (Note 11).

The fair value of this bond issue approximates its carrying amount and is classified within Level 3 of the fair value hierarchy. The fair value has been determined in accordance with generally accepted pricing models based on a discounted cash flows analysis, with the most significant input being the discount rate that reflects the credit risk of counterparties.

With respect to the maturity date of the bond in February 2018, the Board of Directors of the Company are considering several different options to settle the bond's obligations - which are related to extension of the term or payment of part or of the entire outstanding principal, together with interest accrued through possible sale of an investment property.

9 Share capital

After receiving a license for special investment purpose company ERG was required to increase its outstanding shares by at least 30% through a public offering. On 25 April 2007 the Company received its license and subsequently completed a 50% capital increase within the prescribed period.

The capital of the Company is BGN 2,100 thousand distributed in 2,100,000 common shares with a face value of BGN 1 per share, each with equal voting rights.

BGN in thousands except per share amounts or unless otherwise stated

The Company's by-laws were amended at the December 2014 General Meeting of shareholders to confirm that the Company should maintain its Reserve fund in the minimum amount of BGN 18,900 thousand (accumulated from the reduction of the face value of the common shares of the Company in 2012), but not less than 1/10 of the capital of the Company.

Since January 2015, as a result of several transactions with ERG shares, the Bulgarian-American Enterprise Fund ("BAEF" or the "Fund") holds indirectly 49.37% of the share capital through ABF, related to BAEF entity (pursuant to the Supplementary provisions of the Public Offering of Securities Act) and does not hold direct ownership in ERG. Following BAEF's Board of Directors decision from September 30, 2015 BAEF was dissolved without being liquidated. ABF as receiver of BAEF's assets, following the principles, policies and controls of BAEF owns directly 49.37% of the share capital of the Company. Majority of ABF Directors are former directors of BAEF.

The owners of BAEF, as set forth in BAEF Certificate of Incorporation, are its Members, who do not own any personal stake in the equity of BAEF, but they manage the assets of the Fund acting as fiduciaries for the ultimate beneficiaries of the BAEF's charitable activities. The Members of BAEF are the Directors of BAEF who established the ABF to receive the assets of the Fund, subject to the Fund's principles, policies and controls. The Directors of BAEF are also Directors of ABF.

The remaining shares are owned by other companies and individuals.

The Company's shares are traded on the Bulgarian Stock Exchange under BSE code 5ER.

10 Earnings per share

Earnings per share is computed by dividing profit or loss for the year available to common shareholders by the weighted average number of common shares outstanding for the period. The Company does not have any diluted shares thus basic and diluted earnings per share are equal. The weighted average number of common shares used in the calculations for 2016 and 2015 is 2,100,000.

11 Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions or if it is under common control. The Company has entered into transactions with related parties in the normal course of business.

The balances due to/from related companies and the related expense and income at 31 December 2016 and 2015, respectively were as follows:

<u>Related company</u>	<u>2016</u>	<u>2015</u>
Debt securities, net from deferred expenses – ABF*	5,591	5,580
Interest payable on debt securities – ABF*	2,885	2,291
Bond interest expense - ABF	620	574
Asset management and servicing fee to SCA		30
Expenses for remuneration of the BOD	18	18

* As of December 31, 2016 ABF is the only bondholder. The bond issue is with maturity date on 21 February 2018 and it is registered for secondary trading on the Bulgarian Stock Exchange.

12 Financial Risk Factors

The Company's activities expose it to a variety of financial risks: credit risk, interest rate risk, liquidity risk and market risk (including currency and price risk).

BGN in thousands except per share amounts or unless otherwise stated

Credit risk

The Company is exposed to credit risk in its investment activities. Credit risk is the risk that counterparty will be unable to pay amounts in full when they become due. ERG limits the credit risk by ensuring that rental contracts are made with customers with an appropriate credit history and also by having in place bank guarantees and/or company guarantees from the lessees' parent companies for prompt and accurate performance of the obligations under the rental contracts.

Interest rate risk

The interest rate risk relates to the potentially adverse impact of interest rate fluctuations to the Company's profit for the year and equity value. It is the Company's policy to reduce the interest rate risk on floating rate loans through the use of interest rate swaps if necessary. This reduces to a large extent the overall interest rate risk. As of December 31, 2016 the Company has an interest-bearing liability only on the bond issue, which has a fixed interest rate.

Liquidity Risk

The liquidity risk refers to the risk that the Company might not have sufficient cash to meet its obligations and arises from mismatch in cash flows. For the Company, the primary liquidity risk relates to its dependence on the payments of rents and property sales in order to service the debenture loan. The Company aims to maintain positive balance between the incoming and outgoing cash flows on its rents, while its ability to make large one-time outflows depends on its ability to sell properties and/or refinance maturing borrowings.

Market risk

Currency Risk

The Company is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Rent receivables, debt securities and a significant amount of interest and operating expenses are denominated in EUR. The Company does not maintain positions in currency other than EUR and BGN. The BGN/EUR exchange rate of BGN 1.95583 for EUR 1 is fixed under a Currency Board arrangement.

Price risk

The Company is exposed to property price and market rental risks. This risk has increased as a result of the global financial crisis that limited the credit availability worldwide and affected negatively the real estate prices and the rental rates. The crisis affected Bulgarian real estate market in the second half of 2008. There was some recovery in the Bulgarian real estate market in 2016, which is expected to continue in 2017, but there is no guarantee that this will lead to increase in the prices of properties owned by the Company. Company's policy is to decrease the price risk by investing in high quality and good location properties.

Capital management

The Company manages its capital so as to operate as a going concern company, while seeking to maximize the returns to the shareholders through optimization of the ratio between debt and equity (return of invested capital). The goal of the management is to maintain the confidence of the investors, creditors and the market and to ensure the future development of the Company.

Management of the Company monitors the capital structure based on the ratio of net debt to the equity. Net debt includes long and short term interest bearing loans less cash. The share capital, share premium, reserve fund, accumulated loss/profit represent equity of the Company.

ERG CAPITAL - 3 ADSIP
NOTES TO THE FINANCIAL STATEMENTS
31 DECEMBER 2016

BGN in thousands except per share amounts or unless otherwise stated

The ratios of net debt to equity as of December 31, 2016 and in 2015 are as follows:

	31 December 2016	31 December 2015
Bond issue	8,476	7,871
Cash	(694)	(943)
Net debt	7,782	6,928
Share capital	16,436	17,182
Debt - capital ratio	0.47	0.40

ERG - 3 does not have a separate unit for internal control. This function is performed by the Board of Directors. The company has a set of internal policies and rules for risk management - including its accounting policy presented in the notes to the financial statements.

13. Events after the date of the statement of financial position

There are no significant events after the date of the statement of financial position that require adjustments or disclosure in the financial statements as of and for the year ending December 31, 2016.