

**ERG CAPITAL - 2 ADSIP**

FINANCIAL STATEMENTS,  
PREPARED IN ACCORDANCE WITH  
INTERNATIONAL FINANCIAL  
REPORTING STANDARDS  
31 DECEMBER 2011

TOGETHER WITH  
INDEPENDENT AUDITOR'S REPORT

AND

ANNUAL MANAGEMENT REPORT ON  
THE ACTIVITY

**ANNUAL REPORT  
ON THE ACTIVITIES FOR 2011**

## ANNUAL MANAGEMENT REPORT ON THE ACTIVITY OF ERG CAPITAL – 2 ADSIP FOR 2011

5 January 2012

"ERG Capital – 2" ADSIP ("the Company" or "ERG – 2") 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 ("investment property") securitization.

In 2005, ERG - 2 acquired the investment property specified in the Company's by-laws together with the rights and obligations under the associated lease agreements and was licensed as a Special Investment Purpose Company by the Financial Supervision Commission ("FSC"). In 2006 The Company increased its capital by 50%. The shares outstanding increased from 2,300,000 to 3,450,000 with nominal value of BGN 1 each. As a result ERG - 2 received a total of BGN 3,562 thousand: BGN 1,262 thousand from the sale of 1,150,000 rights, against which 1,150,000 shares were subscribed at issue price of BGN 2.00 per share.

Since its listing as a public company ERG -2 complies with its obligations under the agreements to which it is a party. Its activity is oriented towards managing its existing properties and tenant relationships, working on optimizing the Company's expenses, including its debt financing to the extent possible, and investment of temporarily free funds in accordance with the rules set in its by-laws.

### ACTIVITY REVIEW

On 29 March 2011 the Company sold its two investment properties for EUR 14 700 000, net of VAT.

As at the date of this report the Company has received the sale proceeds, part of which were applied to prepay the bank loans used to finance the acquisition of the properties. As at the date of this report the Company does not have bank loans outstanding.

On 11 May 2011 was held the annual shareholders' meeting of the Company on which the shareholders decided to distribute BGN 1,025 thousand from the profit as at 31 December 2010 as dividend. As a result in June 2011 the Company paid BGN 0.297 gross dividend per share.

The management of the Company intends to offer to the shareholders to take the following decisions at their annual meeting in 2012:

1. Substantially the entire retained earnings of the Company in the amount of BGN 11,711 thousand to be distributed to the shareholders as dividend (BGN 3.394 gross dividend per share) and
2. The Company to be liquidated based on that the by-laws limit its investments to the two properties described in them that were sold in 2011.

In the following discussion we present some comments regarding important aspects of the activity of the Company during 2011.

#### 1. Liquidity

As at 31 December 2011 the Company has BGN 17,126 thousand in current and deposit accounts with banks, which is 97% percent of total assets.

#### 2. Capital resources

The capital of the Company has been paid in full. Based on that the management intends to offer to the shareholders the Company to be liquidated, no capital increases, nor acquisition of new properties, significant capital expenditures and assumption of long-term liabilities are planned.

As at 31 December 2011 the ratio of shareholders' equity to total assets is 40.12% compared to 37.11% as at 31 December 2010.

### **3. Information about the properties, owned by ERG - 2 (Art. 41. (2). (5). Ordinance 2 of FSC)**

As at the date of this report the Company does not own investment properties. Of the period from 01 January 2011 till their sale the Company has received all rents due for its investment properties in accordance with the lease agreement to which it was a party.

### **4. Results from operations**

The Company's profit for the year 2011 is BGN 11,620 thousand (or BGN 3.37 per share) compared to BGN 1,026 thousand (or BGN 0.30 per share) for 2010 whereas it does not include any gains or losses from asset or liability revaluations.

The substantial increase of the profit for the period 01 January – 31 December 2011 compared to the same period of the prior year is due to the sale of the two investment properties of the Company.

The realized gain on sale of the two investment properties amount to BGN 13,874 thousand.

The rental income for the period 01 January – 31 December 2011 amount to BGN 677 thousand compared to BGN 2,738 thousand for the same period of the prior year. The decline is due to the sale of the two investment properties during the year.

The operating expenses and the depreciation expense for the period are BGN 3,104 thousand and BGN 129 thousand compared to BGN 737 thousand and BGN 531 thousand for the same period of the prior year. The decline in the depreciation expenses and the increase in the operating expenses is due to the sale of the properties of the Company, whereas the increase of the operating expenses is due to the paid under the agreement with Serdika Capital Advisors remuneration in the amount of 20% from the realized gain on the sale of the properties, according the agreement dated 09 June 2005 for consulting services.

### **5. Risks**

As long as at the date of this report the Company has sold its investment properties, has received the sale proceeds and has prepaid its loans and it does not plan to invest in new properties, the main risks and uncertainties are related to the creditworthiness of the banks with which it placed its cash.

### **6. Important events after the date of the Financial statements**

No important events that could have material effect on the operating and financial results of the Company have happened after the date of the Financial statements - 31 December 2011.

### **7. Expected developments and plans for 2012**

The management of the Company intends to offer to the shareholders to take the following decisions at their annual meeting in 2012:

1. Substantially the entire retained earnings of the Company in the amount of BGN 11,711 thousand to be distributed to the shareholders as dividend (BGN 3.394 gross dividend per share) and
2. The Company to be liquidated based on that the by-laws limit its investments to the two properties described in them that were sold in 2011.

The Company does not intend to hire any new employees.

## 8. Research and development

ERG - 2 is operating in the real estate sector and is not involved in any research and development activities.

## 9. Use of financial instruments

The Company has not issued any new securities (bonds or shares) in 2011 and has not taken any new loans. In 2011 the Company prepaid the bank loans outstanding and terminated the interest rate swap used to fix their interest rates.

## 10. Branches

ERG - 2 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 POSA. Therefore, by virtue of the law, ERG - 2 is not allowed to purchase or own any of its shares and the Company has never traded in its own shares.

## CORPORATE GOVERNANCE

During 2011 the activities of the Company and of the Board of Directors have been in compliance with its Good Corporate Governance Program, which is published on its web site.

The discussion in the following sections provides additional information on the Company's share capital and disclosures related to its corporate governance.

## SHARES OF THE COMPANY

### 1. Capital structure

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

At 31 December 2011, the Company's issued and outstanding share capital was BGN 3,450 thousand comprising 3,450,000 shares, each with a nominal value of BGN 1. All the issued and outstanding shares are fully paid-up. There have not been any changes in the Company's share capital during 2011.

ERG - 2 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. ERG - 2 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 (BGN in thousand)
31 December 2010	3,450,000	3,450
31 December 2011	3,450,000	3,450

### **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 in the Bulgarian State Gazette. 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 must 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 December 31, 2011**

<b>Shareholder</b>	<b>Number of shares owned at 31.12.2011</b>	<b>% of Voting shares at 31.12.2011</b>
Bulgarian-American Enterprise Fund (BAEF)	1,268,450	36.77%
Bulgarian-American Credit Bank	344,650	9.99%
Frank Louis Bauer	324,637	9.41%
Doverie UPF	241,465	7.00%
Michael David Hunsberger	178,500	5.17%
Stoyan Nikolov Dinchiiski (directly and indirectly through Fan Consult EOOD)	178,321	5.17%

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 by-laws 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 90% 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 2/3 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

For their services in 2011 Directors received gross remuneration from ERG-2 in the amount of BGN 18,000 based on the decisions of the Annual General Meeting. 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 hold certain interest in the Company's shares, which are equal to 0.47% of its share capital at 31 December 2011. 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 dealings with Company's shares in 2011:

Director	Shares owned on December 31, 2010	Net purchases (sales) of Company shares	Shares owned on December 31, 2011
Krassen Stanchev	0	0	0
Emilia Karadocheva	9,310	0	9,310
Veneta Ilieva	6,900	0	6,900

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, as of the date of this report

##### 7.1. . Krassen Stanchev

7.1.1. Does not participate in any legal entity as a general partner with unlimited liability.

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

- Europartners OOD, Sofia;
- KC2 EOOD.
- 7.1.3. Participates in the management of other companies or co-operations (as a procurator, manager or member of board):
  - Member of the Supervisory board of Vinprom "Svishtov" and Vinarna "Svishtov";
  - Chairman of the Management Board of the Institute for Market Economics;
  - Member of the Management Board of the Bulgarian Chamber of Commerce and industry;
  - Member of the Management Board of Association "Global Bulgaria Initiative";
  - Member of the Management Board of Association "Priroda Nazaem";
  - Member of the Management Board of Association "Ecoglasnost";
  - Member of the Management Board of Bulgarian Association of Consultants of European Projects.

#### 7.2 Emilia Karadocheva

- 7.2.1. Does not participate in any legal entity as a general partner with unlimited liability.
- 7.2.2. Owns more than 25% of the capital in the following companies:
  - Owns 100% of the capital of EK Advisor EOOD.
- 7.2.3. Participates in the management of some other companies (as a procurator, manager or member of board):
  - Manager of Sredetz Enterprise EOOD, Sofia;
  - Liquidator of Preslav Enterprise EOOD, Sofia;

#### 7.3 Veneta Ilieva

- 7.3.1. Does not participate in any legal entity as a general partner with unlimited liability.
- 7.3.2. Owns more than 25% of the capital in the following companies:
  - Owns 100% of the capital of BRK Solutions EOOD;
  - Owns 50% of the capital of Club 50 Plus AD;
  - Club 50 Plus AD owns 100% of the capital of Motivi Tours EOOD;
  - Owns 35% of the capital of Gela OOD – in liquidation.
- 7.3.3. Participates in the management of some other companies (as a procurator, manager or member of board):
  - Manager of BRK Solutions EOOD;
  - Executive director of Club 50 Plus AD;
  - Manager of Motivi Tours EOOD;
  - Member of the board of the Bulgarian CFA Society;
  - Member of the board of the Bulgarian Investor Relations Society;
  - Member of the board of Empower United.

## 8. Conflicts of interest

In 2011 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 et sec. 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 by-laws 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 90% 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 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. Pursuant to the provisions of the Company's bylaws certain decisions of the Board are taken with unanimity or majority of ¾ of the Board members. Unless otherwise provided by law or by the Company's bylaws the decisions of the Board are taken with 2/3 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 90% 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 before 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 SIPCA, these By-laws and 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.

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 - 2's main activity is renting the properties it owns.

### **2. Revenues by type of activity, geography and main service providers**

In 2011 96% of the Company revenues are from property sales. The other revenue sources are from rents - 2% and from interest 2%. The two properties, owned by ERG-2 until their sale on 29 March 2011 are located in Varna. The Company does not operate in other regions.

In 2011 16% from the expenses, including net book value of investment property sold represent remuneration to Serdika Capital Advisors ("SCA"). SCA is a related party to the Company and received its remuneration based on an agreement dated 09 June 2005 for consulting services, approved by the Constitutive Meeting of the Shareholders, held on 25 May 2005.

No contractor, other than SCA has accounted for more than 10% of total expenses, including net book value of investment property sold.

### **3. Large or important deals in 2011**

Save for the execution of the final agreements for the sale of the properties of the Company on 29 March 2011, the Company has not executed any large or important deals in 2011.

### **4. Deals or proposals for deals with related parties**

The Company has not executed any large or significant deals with related parties in 2011. The Company does not have any subsidiaries.

In 2011 the Company has not entered into any agreements with related parties outside of its scope of activity or on terms and conditions different from those prevailing on the market. Deals, balances, expenses and income are disclosed in Note 12 to the Financial statements.

#### **5. Unusual events with significant impact on the activities**

Save for the sale of the properties of the Company that has one-time effect on the financial results of the Company, in 2011 there were no any unusual events that could have a material impact on the activity of the Company, its financial results and its performance

#### **6. Off-balance sheet commitments**

All off-balance sheet assets or liabilities are disclosed in the Notes 3, 5, 6 and 7 to the Financial statements.

#### **7. Ownership of other legal entities**

ERG - 2 does not own shares or any other ownership interest in other companies.

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

In 2011 the Company has not received any new loans, extended any guarantees or assumed any other material obligations.

In 2011, after the sale of its properties ERG-2 prepaid the bank loans used for their financing.

By law the Company is not allowed to and has not extended any guarantees to any third party.

#### **9. Loans by the Company**

By law ERG - 2 is not allowed to provide loans to any party and in 2011 the Company has not entered in such deals.

#### **10. Use of funds from a new issue of securities**

ERG - 2 has not issued any securities in 2011.

#### **11. Comparison of financial results with prior earnings forecasts**

ERG - 2 does not publish earnings forecasts.

#### **12. Capital budgeting, liability management, threats and measures**

ERG - 2'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**

ERG - 2 does not plan to acquire new assets or to make any other significant capital expenditures in 2012.

ERG - 2 does not plan to issue any new securities or take any new loans in 2012.

#### **14. Change in governance principles and in the economic group of the Company**

There were no changes to ERG - 2's governance principles. With 37% of the shares, BAEF is the main shareholder. The Company does not have an economic group.

#### **15. Internal control and risk management**

ERG - 2 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 2011 there were no changes to the Board of Directors of the Company.

#### **17. Remuneration of the Board of Directors**

In 2011 Directors received gross remuneration from ERG-2 in the amount of BGN 18,000.

#### **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. The Company has not issued any bonds.

#### **20. Court, administrative or arbitration procedures**

The Company is not a party to any court, administrative or arbitration procedure.

#### **21. Investor relations officer**

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#### **CHANGES IN THE PRICE OF THE SHARES**

According to the statistics at Investor.bg, in 2011, 22,054 shares of the Company were traded at BSE-Sofia for a total value of BGN 96 thousand at prices ranging between BGN 3.75 and BGN 4.50 per share. The last deal at BSE-Sofia for the year was executed on 29.12.2011 for 20 shares at BGN 4.50 per share.

  
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Veneta Ilieva  
Executive Director

**INDEPENDENT AUDITOR'S REPORT AND  
FINANCIAL STATEMENTS  
DECEMBER 31, 2011**



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*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 - 2 ADSIP**

### **Report on the financial statements**

We have audited the accompanying financial statements of ERG Capital - 2 ADSIP (the "Company"), which comprise the statement of financial position as of December 31, 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### *Management's responsibility for the financial statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, 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.

#### *Auditor's responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparations and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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### *Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2011, and of its financial performance and its cash flows for the year then ended in accordance with IFRS, as adopted by the European Union.

### *Emphasis of matter*

In note 2 to the accompanying financial statements is disclosed that on January 5, 2012 the Board of Directors of the Company decided to hold the Annual General Meeting of shareholders in February 2012. The agenda for the meeting will include a proposal for liquidation of the Company. If approved the liquidation would most likely be completed by the end of 2012. During the liquidation period the financial statements will be prepared on another relevant basis. These financial statements do not include any adjustments that might be considered necessary in case that the going concern assumption appears inappropriate. Our opinion is not modified in respect to this matter.

### **Report on other legal and regulatory requirements - Annual report on the activities of the Company according to article 33 of the Accountancy Act**

Pursuant to the requirements of the Bulgarian Accountancy Act, article 38, paragraph 4 we have read the accompanying Annual report on the activities of the Company. The Annual report on the activities of the Company, prepared by the Company's management, is not a part of the financial statements. The historical financial information presented in the Annual report on the activities of the Company, prepared by the management is consistent, in all material respects, with the annual financial information disclosed in the financial statements of the Company as of December 31, 2011, prepared in accordance with IFRS, as adopted by the European Union. Management is responsible for the preparation of the Annual report on the activities of the Company dated January 5, 2012.

*Deloitte Audit*  
Deloitte Audit OOD

*S. Peneva*  
Sylvia Peneva  
Managing Director  
Registered Auditor



January 5, 2012  
Sofia


ERG CAPITAL - 2 ADSIP  
STATEMENT OF COMPREHENSIVE INCOME  
YEAR ENDED 31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

	Notes	2011	2010
Sale of investment property	3	28,751	-
Net book value of investment property	6	(13,799)	-
Sale expenses		(1,078)	-
Realized gain on sale of investment property		13,874	-
Rental income	3	677	2,738
Interest income		657	56
Depreciation expense	6	(129)	(531)
Operating expenses	4	(3,104)	(737)
Interest expense		(355)	(500)
<b>Profit for the year</b>		<b>11,620</b>	<b>1,026</b>
<b>Other comprehensive income</b>			
Cash flow hedges	7	358	(26)
<b>Total comprehensive income for the year</b>		<b>11,978</b>	<b>1,000</b>
Earnings per share - basic and diluted	10	3.37	0.30

These financial statements have been approved by the Board of Directors on 5 January 2012.

  
Veneta Ilieva  
Executive Director

  
Eleonora Popovska  
Senior Accountant



The accompanying notes to financial statements are an integral part of these statements.

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05.01.2012



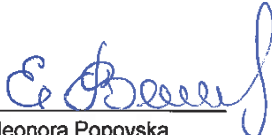
ERG CAPITAL - 2 ADSIP  
STATEMENT OF FINANCIAL POSITION  
AT 31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

	<u>Notes</u>	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>			
Cash and cash equivalents	5	17,126	1,388
Other receivables and prepaid expenses		609	37
Investment property (net)	6	-	13,928
<b>TOTAL ASSETS</b>		<b><u>17,735</u></b>	<b><u>15,353</u></b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>LIABILITIES</b>			
Dividend payable	11	10,458	923
Other liabilities	8,12	162	322
Derivative financial instruments	7	-	358
Borrowings	7	-	8,053
<b>Total liabilities</b>		<b><u>10,620</u></b>	<b><u>9,656</u></b>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	9	3,450	3,450
Share premium		2,412	2,412
Hedge reserve		-	(358)
Retained earnings		1,253	193
<b>Total shareholders' equity</b>		<b><u>7,115</u></b>	<b><u>5,697</u></b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b><u>17,735</u></b>	<b><u>15,353</u></b>

These financial statements have been approved by the Board of Directors on 5 January 2012.

  
\_\_\_\_\_  
Veneta Ilieva  
Executive Director

  
\_\_\_\_\_  
Eleonora Popovska  
Senior Accountant



2 The accompanying notes to financial statements are an integral part of these statements.

05.01.2012

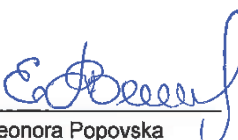
ERG CAPITAL - 2 ADSIP  
 STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
 YEAR ENDED 31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

	Share capital	Share premium	Hedge reserve	Retained earnings	Total
31 December 2009	3,450	2,412	(332)	93	5,623
Cash flow hedges	-	-	(26)	-	(26)
Profit for the year	-	-	-	1,026	1,026
Dividend				(926)	(926)
31 December 2010	3,450	2,412	(358)	193	5,697
Cash flow hedges	-	-	358	-	358
Profit for the year	-	-	-	11,620	11,620
Dividend	-	-	-	(10,560)	(10,560)
31 December 2011	3,450	2,412	-	1,253	7,115

These financial statements have been approved by the Board of Directors on 5 January 2012.

  
 Veneta Ilieva  
 Executive Director

  
 Eleonora Popovska  
 Senior Accountant



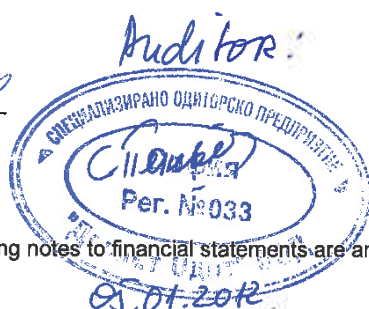
ERG CAPITAL - 2 ADSIP  
STATEMENT OF CASH FLOW  
YEAR ENDED 31 DECEMBER 2011

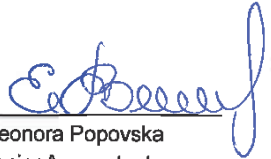
BGN in thousands except per share amounts or unless otherwise stated

	<u>Notes</u>	<u>2011</u>	<u>2010</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit for the year		11,620	1,026
<b>Adjustments to reconcile profit for the year to net cash provided by operating activities</b>			
Proceeds from sale of investment property, net of realized gain and sale expenses	3, 6	13,799	-
Depreciation	6	129	531
(Increase) decrease in other receivables and prepaid expenses		(572)	14
Decrease in other liabilities	8,12	(160)	(80)
<b>Net cash provided by operating activities</b>		<u><b>24,816</b></u>	<u><b>1,491</b></u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Repayment of borrowings	7	(8,053)	(587)
Dividend paid	11	(1,025)	(835)
<b>Net cash used in financing activities</b>		<u><b>(9,078)</b></u>	<u><b>(1,422)</b></u>
<b>Net increase in cash and cash equivalents</b>		<b>15,738</b>	<b>69</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<u><b>1,388</b></u>	<u><b>1,319</b></u>
<b>Cash and cash equivalents at the end of the year</b>	5	<u><u><b>17,126</b></u></u>	<u><u><b>1,388</b></u></u>
<b>Supplemental cash flow information:</b>			
Interest paid		<u><u>355</u></u>	<u><u>500</u></u>

These financial statements have been approved by the Board of Directors on 5 January 2012.

  
Veneta Ilieva  
Executive Director



  
Eleonora Popovska  
Senior Accountant

4 The accompanying notes to financial statements are an integral part of these statements.

BGN in thousands except per share amounts or unless otherwise stated

## **1 Organization and operations**

ERG Capital - 2 ADSIP ("the Company" or "ERG") was registered on 9 June 2005 as a Bulgarian joint stock company with special investment purpose with the sole purpose to invest the funds raised in real estate. The main shareholder of the Company is the Bulgarian-American Enterprise Fund ("BAEF"), which holds 37% of the share capital. The Company's by-laws were amended at the May, 2010 Annual General Meeting of shareholders in order to extend ERG's term of existence to 31 December 2018.

ERG activities and operations are governed by the provisions of the Special Investment Purpose Companies Act ("SIPCA"), the Public Offering of Securities Act 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. Bulgarian American Property Management EOOD ("BAPM") is the servicing company for ERG and the asset management consulting company for ERG is Serdika Capital Advisors Permanent Establishment ("SCA").

On 22 December 2005 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 2011, except for the adoption of IFRS 9 Financial instruments, which uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the many different rules in IAS 39, which has not been adopted by the EU. The management believes that if the IFRS 9 Financial instruments has been approved by the EU it would have no influence on these financial statements.

During 2011 the Company has adopted all new and revised IFRS by IASB, as approved by the EU, effective for 2011, 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 2012. 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.

ERG CAPITAL - 2 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2011

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 2011.

On 5 January 2012 the Board of Directors of the Company decided to hold the Annual General Meeting of shareholders in February 2012. The agenda for the meeting will include a proposal for liquidation of the Company. If approved the liquidation would most likely be completed by the end of 2012. During the liquidation period the financial statements will be prepared on another relevant basis. However, the use of another relevant basis would not lead to significantly different results.

#### **Functional and reporting currency**

The functional currency of the Company is the national currency of Bulgaria, the Lev ("BGN"). The financial statements are presented in 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 held to be leased under long term operating leases. After the initial recognition the investment property is accounted for in accordance with the Cost model - cost less accumulated depreciation and less 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 is based on the straight-line method over the estimated useful life of the asset. The annual rate of depreciation used for the buildings is 4%.

#### **Borrowings**

Borrowings are recognized initially at 'cost', being their issue proceeds (fair value of consideration received) 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 as they become due in accordance with the lease contracts.

ERG CAPITAL - 2 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

**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 on borrowings and payables.

**Derivatives**

Derivative financial instruments, including interest rate swaps are initially recognised in the statement of financial position at cost (including transaction costs) and subsequently are remeasured at their fair value. Fair values are obtained from quoted market prices or discounted cash flow models. The derivatives designated as effective cash flow hedges are carried as assets when fair value is positive and as liabilities when fair value is negative. The changes in their fair value are recognized in the statement of comprehensive income.

**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 are less than 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.

**3 Rental income**

Until March 2011 the Company owned property at two locations in Varna – 55, Republica Blvd. and 268, Vladislav Varnenchik Blvd. The first property, except for the basement area was leased to Praktiker EOOD under an operating lease contract. The second property, along with the basement area of the first property, was leased to Piccadilly EAD under an operating lease contract. Operating lease contracts were multiyear and included cancellation penalties and guarantee requirements. In addition, the Company leased a billboard to the Bulgarian American Credit Bank AD and a portion of the parking area to Mobilitel EAD.

In March 2011 the Company completed the sale of this property to a real estate company.

**4 Operating expenses**

	<u>2011</u>	<u>2010</u>
Professional fees	3,071	708
Board of Directors fees	18	18
General and administrative expenses	15	11
Total	<u>3,104</u>	<u>737</u>

Professional fees for 2011 and 2010 include asset management fee to SCA of BGN 2,968 and BGN 420, respectively (Note 12).

BGN in thousands except per share amounts or unless otherwise stated

**5 Cash and cash equivalents**

At 31 December 2010 cash and cash equivalents of BGN 411 were pledged under loan agreements (Note 7).

**6 Investment property**

	<u>Land</u>	<u>Buildings</u>	<u>Total</u>
<i>Cost</i>			
31 December 2009	3,419	13,285	16,704
31 December 2010	3,419	13,285	16,704
Disposal	(3,419)	(13,285)	(16,704)
31 December 2011	-	-	-
<i>Accumulated depreciation</i>			
31 December 2009	-	2,245	2,245
Charge	-	531	531
31 December 2010	-	2,776	2,776
Charge	-	129	129
Disposal	-	(2,905)	(2,905)
31 December 2011	-	-	-
<i>Net book value</i>			
31 December 2011	-	-	-
31 December 2010	3,419	10,509	13,928
31 December 2009	3,419	11,040	14,459

Investment property was sold in March 2011.

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 2010 was BGN 28,610.

The investment property was pledged in favor of UniCredit Bulbank under the loan agreements (Note 7).

**7 Borrowings**

**Loans from UniCredit Bulbank**

**Loan № 1**

On 15 August 2005 (and as subsequently amended) the Company and UniCredit Bulbank executed a floating rate (3 month EURIBOR + 3%, reduced to 3 month EURIBOR + 2% at 31 August 2006) loan agreement whereby the Company could borrow up to EUR 3.45 million for financing the purchase of investment property located in Varna at 55, Republica Blvd. Principal payments were due monthly through 20 November 2012 according to a fixed repayment schedule. The Company pledged the property and the related rental income, as well as certain bank accounts. The outstanding principal balance at 31 December 2010 was EUR 2.17 million (BGN 4,239). The fair value of the loan approximated its carrying

ERG CAPITAL - 2 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

amount. In March 2011 the pledged property was sold and subsequently the loan was repaid in accordance with the loan agreement.

**Loan № 2**

On 8 November 2005 (and as subsequently amended) the Company and UniCredit Bulbank executed a floating rate (3 month EURIBOR + 3%, reduced to 3 month EURIBOR + 2% at 31 August 2006) loan agreement whereby the Company could borrow up to EUR 2.6 million for financing the purchase of investment property located in Varna at 268, Vladislav Varnenchik Blvd. Principal payments were due monthly through 20 November 2012 according to a fixed repayment schedule. The Company pledged the property and the related rental income, as well as certain bank accounts. The outstanding principal balance at 31 December 2010 was EUR 1.95 million (BGN 3,814). The fair value of the loan approximated its carrying amount. In March 2011 the pledged property was sold and subsequently the loan was repaid in accordance with the loan agreement.

On 3 November 2005 the Company and UniCredit Bulbank executed an interest rate swap agreement with a notional principal of EUR 5.97 million and amortization schedule matching the amortization schedules of the two loans from UniCredit Bulbank in order to fix the interest rate on both loans. Under the agreement the Company paid to UniCredit Bulbank interest of 3.45 % on the notional principal over the term of the swap and UniCredit Bulbank paid to ERG interest equal to the corresponding 1 month EURIBOR. The maturity of the swap was 30 November 2012. The outstanding notional balance at 31 December 2010 was EUR 4.47 million (BGN 8,738). Change in the fair value at 31 December 2011 and 2010 of EUR 0.18 million (BGN 358) and EUR (0.01) million (BGN (26)), respectively is recognized in the statement of comprehensive income. In accordance with IFRS 7, fair value hierarchy Level 2, the swap agreement fair value was derived using market interest rates at 31 December 2010. Interest income and expense are recognized in the statement of comprehensive income in the period they incur. In April 2011, following the sale of the investment property and repayment of the loans, the interest rate swap agreement was cancelled.

**8 Other liabilities**

	<u>2011</u>	<u>2010</u>
Asset management fee payable (Note 12)	162	308
Other	-	14
Total	<u>162</u>	<u>322</u>

**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 22 December 2005 the Company received its license and subsequently completed a 50% capital increase within the prescribed period.

The capital of the Company is BGN 3,450 distributed in 3,450,000 common shares with a face value of BGN 1 per share, each with equal voting rights.

BAEF as a significant minority shareholder owns 37% of the shares. It is a U.S. corporation established pursuant to the Support for East European Democracy Act of 1989 (the "SEED Act") for the primary purpose of promoting the development of the Bulgarian private sector and policies and practices conducive to such development.



BGN in thousands except per share amounts or unless otherwise stated

The remaining shares are owned by other companies and individuals.

The Company's shares are traded on the Bulgarian Stock Exchange under the ticker 6ER.

#### 10 Earnings per share

Earnings per share is computed by dividing the 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 2011 and 2010 is 3,450,000.

#### 11 Dividend per share

At 31 December 2011 and 2010 a dividend of BGN 10,458 (BGN 3.03 per share) and BGN 923 (BGN 0.27 per share), respectively were accrued. The 2010 dividend was increased to BGN 1,025 (BGN 0.297 per share) at the May, 2011 Annual General Meeting of shareholders and the difference was recorded in 2011.

#### 12 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 2011 and 2010, respectively are as follows:

<u>Related company</u>	<u>2011</u>	<u>2010</u>
Asset management fee payable to SCA	162	308
Asset management fee - SCA	2,968	420
Servicing fee - BAPM	62	82
Board of Directors fees - Preslav Enterprise EOOD	-	3

#### 13 Financial Risk Factors

As of 31 December 2011 the Company has sold its investment property, has received the sale proceeds and has repaid its loans. The Company does not plan to acquire new investment property. Considering these factors, it faces the following financial risks.

##### **Credit risk**

The Company is exposed to credit risk related to the creditworthiness of the banks at which it placed the proceeds from the sale of the investment property, net of the repaid bank loans and sale related expenses, until it distributes them to the shareholders. ERG strives to minimize this risk by not keeping all funds with just one counterparty bank and by keeping the bulk of the funds with banks that are among the top five in Bulgaria or have investment grade credit rating.

ERG CAPITAL - 2 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

**Currency Risk**

Some of the deposits placed with local banks 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.