

**ERG CAPITAL - 3 ADSIP**

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

**TOGETHER WITH  
INDEPENDENT AUDITORS' REPORT**

**AND**

**ANNUAL MANAGEMENT REPORT ON  
THE ACTIVITY**

**ANNUAL REPORT  
ON THE ACTIVITIES FOR 2011**

## ANNUAL MANAGEMENT REPORT ON THE ACTIVITY OF ERG CAPITAL – 3 ADSIP FOR 2011

23 February 2012

“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 five real estate investments in the cities of Sofia, Varna, Stara Zagora and Bourgas and described below and in Note 5 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. The Company increased its capital by 50%. The Company sold 700,000 rights, against which 700,000 shares were subscribed at issue price of BGN 20 per share. As a result the Company received a total of BGN 15,941 thousand and used the proceeds to pay amounts due for a real estate investment acquired in 2006 and to purchase new real estate investments.

The Annual General Meeting of the Shareholders (AGM) was on 12 May 2011. Apart from the usual AGM agenda items it confirmed the decision of the Board of Directors (BoD) of the Company for the sale of Zagora property for EUR 11 million (net of VAT) for which a preliminary sale agreement had been executed in September 2010.

In July 2011 the sale was cancelled with an annex to the preliminary sale agreement upon request by the buyer.

On 26 September 2011 an Extraordinary General Meeting of the Shareholders (EGM) voted for:

- (1) the registered capital of the Company to be decreased from BGN 21,000,000 to BGN 2,100,000 by decrease of the par value of the outstanding shares from BGN 10 to BGN 1 and
- (2) upon completion of the decrease of the registered capital, the capital of the Company to be increased from BGN 2,100,000 to BGN 6,300,000 by issuing 4,200,000 new shares with par value of BGN 1 and issue price of BGN 3.35.

Agenda items (1) and (2) above were proposed by the BoD of the Company. The purpose of the capital increase in item (2) was the Company to attract additional funding to repay the EUR 6.514 million bond maturing on 12 March 2012. The preceding registered capital decrease was necessary in order to reduce the par value of the registered shares, which was necessary for the capital increase to be successful. Under the Commercial Act the Company could not sell new shares below their par value. In order for the capital increase to be successful the issue price of the new shares had to be close, or slightly below, the market price of the existing shares while the latter was substantially below the par value of BGN 10.

After the end of the reporting period another EGM was held on 23 January 2012 at which the shareholders voted to:

- (1) extend the term of existence of the Company to 31 December 2020;
- (2) stop the capital increase approved on the 26 September 2011 EGM; and
- (3) the Company to issue a 3-year secured accrual-only bond with which to repay the one maturing on 12 March 2012.

The agenda items above were proposed by the BoD after the market sounding showed that there was not enough interest for the new shares from the planned capital increase while there was interest for a 3-year

secured bond that would accrue interest, but pay it only at the maturity, with the proceeds of which the Company could repay the bond maturing on 12 March 2012.

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

### 1. Liquidity

As of 31 December 2011 the Company's cash and cash equivalents are in the amount of BGN 287 thousand. The other current assets are in the amount of BGN 52 thousand. The current liabilities are in the amount of BGN 13,852 thousand, of which EUR 351 thousand is the current portion of the bank loan used for financing the development of the Zagora property.

During 2011 ERG – 3 made 4 scheduled coupon payments under its listed 3-year fixed rate EUR 6,514 thousand bond issue. It also serviced regularly the bank loan used for the development of the Zagora property and all its other liabilities.

The available cash and the proceeds from the planned new 3-year secured accrual-only bond discussed above would be sufficient for the Company at this stage to cover its liquidity needs.

### 2. Capital resources

As of 31 December 2011 ERG – 3's shareholders' equity is BGN 25,327 thousand. The capital of the Company was paid in full and despite the accumulated losses for 2011, 2010, 2009 and 2008, it is currently sufficient to support the Company's business activity. After the EGM from 23 January 2012, ERG – 3 does not plan any further capital increases.

For each of the properties described below and in Note 5 to the Financial statements, the Company has two alternatives: a/ to develop it as a commercial property and lease it out or sell it and b/ to sell it without development with a premium. In the case of developing a property, if this is considered to be more beneficial to the shareholders by the management, the Company will have significant capital expenses for construction works, which will be financed with bank loans.

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

**Share of leased properties in 2011, based on land square meters: 10.41%**

#### Acquisitions or sales of real estate investments

As of 31 December 2011 the Company owned five real estate investments: "Yavor property", "Zagora property", "Gerena property", "Sofia Ring property" and "Bourgas retail property".

Yavor property represents a 14,483 sq.m. land plot (the cadastre measured area is 14,724sq.m.) and buildings, located in Varna, with administrative address 2, Oreh Street. 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 26<sup>th</sup> 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 2011 was 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. **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.**

Zagora property at 31 December 2011, represented a 22,817 sq.m. land plot (the cadastre measured area is 22,768 sq.m.) and fully developed retail complex with total built-up area of 18,530.3 sq.m. (the cadastre measured area) leased to the companies Aiko Multi Concept EOOD, Mobbo EOOD (related to Aiko Multi Concept EOOD) and Merkator-B EOOD. The first two are furniture retailers, leasing 15,370.3sq.m. and the third is a food retailer, a subsidiary of the Slovenian Merkator, leasing 3,160sq.m.

Gerena property represents 25,208 sq.m. land plot (a sketch measured area is 25,036.9sq.m.) located on Vladimir Vazov Blvd, which is one of the main boulevards in Sofia. It is easily accessible from the city centre and the airport. The property consists of three regulated plots. The property is cleared from buildings and construction scrap. The process of optimization of the plot boundaries through regulation was finalized in 2010. **After the completion of the procedure for changing the regulation and building development plan, the maximum building development intensity for that property is 1.5, which means that there could be constructed buildings with total built-up area of up to 37,555.35 sq. m.**

Sofia Ring property represents 131,284 sq.m. land plot 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 land consists of two regulated plots with **maximum building development intensity 1.5 and 1.5 respectively, which means possible construction of buildings with total built-up area of up to 196,926 sq.m. There are two construction permits issued for the plots (based on conceptual designs) with less than the allowed construction.**

Bourgas 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 Bourgas. The land consisted of two regulated plots: LI - 265 and L – 636, which in 2009 were united in one regulated 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/CMφ1 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 sales of real estate investments in 2011

In 2011 the Company did not acquire new properties, nor it sold any of its real estate investments.

#### **Lease agreements executed in 2011**

In 2011 the Company did not execute new lease agreements.

#### **Construction works, repairs and improvements made in 2011:**

ERG-3 did not make any significant constructions works, repairs and improvements during 2011.

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

The Company ended 2011 with a loss for the year of BGN 934 thousand. In the year, due to the worsening market situation, the Company did not sell any property.

The Company generated rental income in the amount of BGN 2,170 thousand. It was solely from the Zagora property. The net rental income, after direct rental expenses and depreciation, amounted to BGN 1,296 thousand.

In the meantime the Company incurred expenses, the most significant of which was the interest expense in the amount of BGN 1,967 thousand comprising mainly the interest paid on the bond used to refinance the line for the acquisition of the Sofia Ring property and on the loan used to finance the development of the Zagora property.

The Company incurred operating expenses in the amount of BGN 294 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

During 2011 the real estate market in Bulgaria worsened significantly and this trend is expected to continue at least in the first half of 2012. This and the worsening macroeconomic situation could significantly adversely affect the Company's financial condition and results of operations. It could have negative effect on the tenants' financial position and/or result in reduction of the prices of the real estate properties owned by the Company.

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

After the end of the reporting period, in January 2012 the Company agreed not to increase the minimum rents of some of the tenants of the Zagora property as scheduled in the respective lease agreements. As a result management expects that the property will be generating approximately the same rental income over the coming years as in 2011. The Company retained the option to receive additional rental income from the property should the turnover of the respective tenants exceeds a certain threshold.

On 9 February 2012 the Commercial Registry registered the decrease of the registered capital of the Company and the corresponding change of its by-laws, voted by the Extraordinary General Meeting of the Shareholders, held on 26 September 2011. Registered capital was decreased from BGN 21 million to BGN 2.1 million by decreasing the par value of the shares from BGN 10 to BGN 1 per share. The number of shares outstanding is unchanged and is 2,100,000.

On 21 February 2012 the Company issued a second secured corporate bond through a private placement. The bond is a fixed rate (10.5%) secured bond in the amount of EUR 6.8 million with a term of 36 months. Coupon and principal are due at maturity. In case the Company decides to make early repayments, the Company should pay the accrued interest on the repaid principal. The Company will use the proceeds to refinance its first secured corporate bond, which matures on 12 March 2012, and to fund operations. Please, refer also to Note 9 to the Financial Statements for additional information.

Please refer also to the discussion about the 23 January 2012 EGM of the Company in *ACTIVITY REVIEW* above.

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

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 5 to the Financial statements, the Company is currently exploring the following alternatives: a/ develop a commercial property and lease it out or sell it or b/ sell without development. In the case of developing a property, if this is more beneficial to the shareholders, the Company will have significant capital expenses for construction works, which will be financed 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

In 2009 the Company issued a secured bond in the amount of EUR 6,514 thousand to refinance existing bank loan. The Company plans to repay it by the newly issued 3-year secured, accrual-only bond in the amount from EUR 6.8 million as described in item 6 Important events after the date of the Financial Statements 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 2011 the activities of the Company and of the Board of Directors have been in compliance with the GCGP.

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 has outstanding share capital of BGN 21,000 thousand comprising of 2,100,000 shares, each with a nominal value of BGN 10. All the issued and outstanding shares are fully paid-up. During 2011 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 2010	2,100,000	21,000
31 December 2011	2,100,000	21,000



On 9 February 2012 the Commercial Registry registered the decrease of the registered capital of the Company, voted by the Extraordinary General Meeting of the Shareholders, held on 26 September 2011. Registered capital was decreased from BGN 21 million to BGN 2.1 million by decreasing the nominal value of the shares from BGN 10 to BGN 1 per share. The number of shares outstanding is unchanged and is 2,100,000.

#### **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 the date of this document.

**At 31 December 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)	980,000	46.67
Frank Louis Bauer	165,509	7.88
Bulgarian-American Property Management (100% owned by BAEF)	140,700	6.70
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  $\frac{3}{4}$  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 2011 Directors received gross remuneration from ERG-3 in the amount of BGN 17,000 (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 hold certain interest in the Company's shares, which are equal to 6.70% 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 and their respective representatives' dealings with Company's shares in 2011:

Director	Shares owned on 31 December 2010	Net purchases (sales) of Company shares	Shares owned on 31 December 2011
BAPM EOOD	140,700	-	140,700
Sredetz Enterprise EOOD	-	-	-
Anna Boneva, representative of BAPM EOOD as per art. 234 par. 1 of the Commercial Act	7,500	-	7,500
Daniela Handjieva representative of Sredetz Enterprise EOOD as per art. 234 par. 1 of the Commercial Act	1,226	-	1,226
Yordan Chompalov	-	-	-

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**

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:

- "DTT" OOD;

7.1.3. Participates in the management of other companies (as a procurator, manager or member of board):

- "Imoti Direct" ADSIP;

### **7.2. Sredetz Enterprise EOOD (as of the date of this report)**

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

7.2.2. Does not own more than 25% of the capital of any company;

7.2.3. Does not serve as director in other companies.

### **7.3. Bulgarian American Property Management EOOD (BAPM EOOD) (as of the date of this report)**

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 of the following companies:

- Owns 100% of the capital of Sredetz Enterprise EOOD.

7.3.3. Does not serve as director in other companies

## **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 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  $\frac{3}{4}$  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. 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  $\frac{3}{4}$  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  $\frac{1}{2}$  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  $\frac{1}{2}$  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 the properties it owns.

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

In 2011 the rental revenues accounted for 98.6% of the Company's revenues.

In 2011 interest and loan related expenses to Raiffeisenbank (Bulgaria) AD accounted for 19% of total expenses including direct rental expenses and depreciation. Raiffeisenbank (Bulgaria) is not a related party to the Company. The interest on the bond issued in March 2009 and subsequent listed for trading on the BSE-Sofia and bond related expenses accounted for 43% of the total expenses including direct rental expenses and depreciation.

No contractor, other than Raiffeisenbank (Bulgaria) has accounted for more than 10% of the total expenses including direct rental expenses and depreciation of the Company.

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

No large or important deals were executed by the Company in 2011.

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

There were no such deals in 2011

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

In 2011 there were no unusual events that could have a material impact on the activity of the Company, its financials and results from operations.

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

All off-balance sheet assets or liabilities are disclosed in the Notes 3, 5, 8, 9 and 10 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 2011 ERG-3 has one loan outstanding with details provided in Note 8 to the Financial

statements and a listed bond issue with details provided in this report and in Note 9 to the Financial statements. As of the date of this document the Company has issued a second secured corporate bond as described in detail in item 6. Important events after the date of the Financial Statements and in Note 9 to the Financial statements.

The Company is prohibited by law to and 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 2011 the Company has not entered in such deals.

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

In 2009 the Company issued EUR 6,514 thousand 3-year fixed rate secured bond that was listed for trading at the BSE-Sofia. The proceeds were used to refinance a bank line used to finance the acquisition of the Sofia Ring property (EUR 5,000 thousand) and to cover on-going cash needs of the Company. The Company plans to repay it at maturity by using the proceeds of its newly issued 3-year secured, accrual-only bond in the amount from EUR 6.8 million as described in detail in item 6. Important events after the date of the Financial Statements and in Note 9 to the Financial statements.

#### **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**

Please refer to "Expected developments and plans for 2012" discusses above.

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

There were no changes to ERG-3's governance principles. With 46.7% of the shares held directly and 53.4% directly and indirectly, BAEF is the main shareholder. The Company does not have an economic group.

#### **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**

There we no changes in the Board of Directors in 2011

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

In 2011 the members of the Board of Directors received gross remuneration from ERG-3 in the amount of BGN 17,000 (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 arbitration procedures**

The Company is not a party to any pending, court, administrative or arbitration proceedings, regarding receivables or obligations exceeding 10% of its capital.  
It is management's opinion that the resolution of these proceedings will not have a material effect on the Company's financial statements.

**21. Investor relations officer**

Svetozara Stoyanova  
3 Shipka Str.  
Sofia, 1504

T: +359 2 948 92 11  
F: +359 2 946 01 18  
E: [ergcapital3@baefinvest.com](mailto:ergcapital3@baefinvest.com)

**CHANGES IN THE PRICE OF THE SHARES**

According to Investor.bg between February 2011 and January 2012 4,655 shares of the Company were traded at BSE-Sofia for a total value of BGN 19.8 thousand at prices ranging between BGN 3.00 and 5.99 per share. For the period the shares of the company depreciated by approximately 16.8%. The last deal at BSE-Sofia for 2011 was executed on 30 December 2011 for 20 shares at BGN 4.30 per share.



.....  
Anna Boneva  
Representative of the Executive Director  
BAPM EOOD

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





*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 financial statements

We have audited the accompanying financial statements of ERG Capital - 3 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.

*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*

We draw attention to note 5 to the accompanying financial statements where based upon the result of the required annual appraisal, the fair value of the investment properties is disclosed. Due to the inherent uncertainty related to any valuation and especially in the current real estate market conditions, where the real estate market has deteriorated significantly, and very limited number of transactions have taken place, the disclosed fair values may differ significantly from the values that would have been used had an active market for the properties existed, and the differences could be material. Our opinion is not modified in respect to this matter.

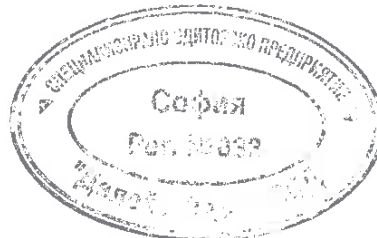
**Report on other legal and regulatory requirements - Annual report on the activities of the Company according to article 33 of the Accountancy Act**

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 February 23, 2012.

*Deloitte Audit*  
Deloitte Audit OOD

*Sylvia Peneva*

Sylvia Peneva  
Managing Director  
Registered Auditor




February 23, 2012  
Sofia


ERG CAPITAL – 3 ADSIP  
 STATEMENT OF COMPREHENSIVE INCOME  
 YEAR ENDED 31 DECEMBER 2011


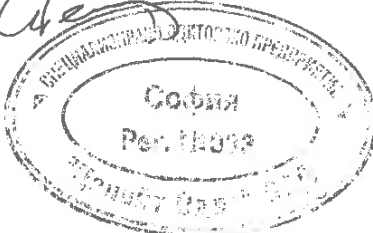
BGN in thousands except per share amounts or unless otherwise stated

	Notes	2011	2010
<b>Revenue</b>			
Rental income	3	2,170	2,110
Direct rental expenses and depreciation		(874)	(871)
		1,296	1,239
Interest income		31	126
<b>Net revenue</b>		<b>1,327</b>	<b>1,365</b>
<b>Expenses</b>			
Operating expenses	4	(294)	(561)
Interest expense	8	(1,967)	(1,881)
<b>Total expenses</b>		<b>(2,261)</b>	<b>(2,442)</b>
<b>Loss for the year</b>		<b>(934)</b>	<b>(1,077)</b>
<b>Loss per share - basic and diluted</b>	11	<b>(0.44)</b>	<b>(0.51)</b>

These financial statements have been approved by the Board of Directors on 23 February 2012.

  
 Anna Boneva  
 Representative of the Executive Director  
 BAPM EOOD

  
 Emilia Karadocheva  
 Chief Financial Officer

Auditor:  
  



23.02.2012

ERG CAPITAL - 3 ADSIP  
STATEMENT OF FINANCIAL POSITION  
31 DECEMBER 2011


BGN in thousands except per share amounts or unless otherwise stated

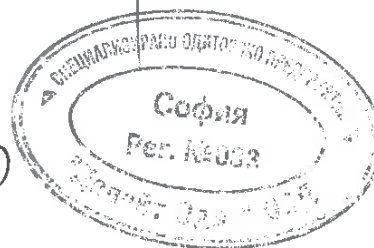
	Notes	2011	2010
<b>ASSETS</b>			
Cash and cash equivalents		287	1,214
Other assets	6	274	329
Investment property (net)	5	<u>54,335</u>	<u>55,033</u>
<b>TOTAL ASSETS</b>		<b><u>54,896</u></b>	<b><u>56,576</u></b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>LIABILITIES</b>			
Other liabilities	7	444	568
Debt securities	9	12,727	12,669
Borrowings	8	<u>16,398</u>	<u>17,078</u>
<b>Total liabilities</b>		<b><u>29,569</u></b>	<b><u>30,315</u></b>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	10	21,000	21,000
Share premium		8,941	8,941
Reserve fund		37	37
Retained earnings		<u>(4,651)</u>	<u>(3,717)</u>
<b>Total shareholders' equity</b>		<b><u>25,327</u></b>	<b><u>26,261</u></b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b><u>54,896</u></b>	<b><u>56,576</u></b>

These financial statements have been approved by the Board of Directors on 23 February 2012.

  
\_\_\_\_\_  
Anna Boneva  
Representative of the Executive Director  
BAPM EOOD

  
\_\_\_\_\_  
Emilia Karadocheva  
Chief Financial Officer

Auditor:  
  
23.02.2012



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

ERG CAPITAL - 3 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	Reserve fund	Retained earnings	Total
31 December 2009	21,000	8,941	37	(2,640)	27,338
Loss for the year	-	-	-	(1,077)	(1,077)
31 December 2010	21,000	8,941	37	(3,717)	26,261
Loss for the year	-	-	-	(934)	(934)
31 December 2011	<u>21,000</u>	<u>8,941</u>	<u>37</u>	<u>(4,651)</u>	<u>25,327</u>

These financial statements have been approved by the Board of Directors on 23 February 2012.

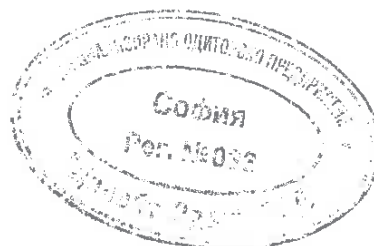


Anna Boneva  
 Representative of the Executive Director  
 BAPM EOOD



Emilia Karadocheva  
 Chief Financial Officer

Auditor:

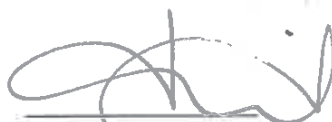
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ERG CAPITAL - 3 ADSIP  
 STATEMENT OF CASH FLOW  
 YEAR ENDED 31 DECEMBER 2011

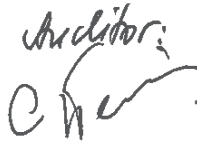
BGN in thousands except per share amounts or unless otherwise stated

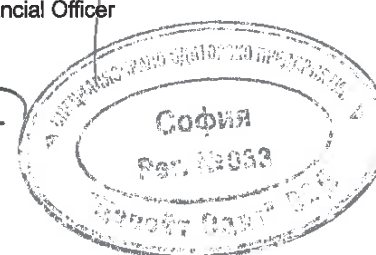
	<u>Notes</u>	<u>2011</u>	<u>2010</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Loss for the year		(934)	(1,077)
<b>Adjustments to reconcile loss for the year to net cash used in operating activities</b>			
Decrease in other assets		55	170
Investment in investment property	5	(2)	(435)
Depreciation	5	700	700
Decrease in other liabilities		(124)	(21)
<b>Net cash used in operating activities</b>		<b>(305)</b>	<b>(663)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Amortization of transaction cost on debt securities	9	58	28
Amortization of transaction cost on borrowings	8	30	29
Repayment of borrowings	8	(710)	(710)
<b>Net cash used in financing activities</b>		<b>(622)</b>	<b>(653)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(927)</b>	<b>(1,316)</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<b>1,214</b>	<b>2,530</b>
<b>Cash and cash equivalents at the end of the year</b>		<b>287</b>	<b>1,214</b>
<b>Supplemental cash flow information:</b>			
Interest paid		1,879	1,822

These financial statements have been approved by the Board of Directors on 23 February 2012.

  
 Anna Boneva  
 Representative of the Executive Director  
 BAPM EOOD

  
 Emilia Karadocheva  
 Chief Financial Officer

Auditor:  
  
 23.02.2012



BGN in thousands except per share amounts or unless otherwise stated

## **1 Organization and operations**

ERG Capital - 3 ADSIP ("the Company" or "ERG") 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. The main shareholder of the Company is the Bulgarian-American Enterprise Fund ("BAEF"), which holds 46.7% of the share capital plus an additional 6.7% through a wholly owned subsidiary. Under the Company's by-laws, ERG has a fixed term of existence that ends on 31 December 2014. In January 2012 the Company's term of existence was extended to 31 December 2020 by an Extraordinary General Meeting of shareholders.

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. Serdika Capital Advisors Permanent Establishment ("SCA") is 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 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.



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.

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

The functional currency of the Company is the national currency of Bulgaria - 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.

#### **Real estate investments for future use as investment property**

Real estate investments for future use as investment property are reported according to the Improvements to IFRS issued in May 2008 and effective 1 January 2009 whereas IAS 40 "Investment property" applies to property that is being constructed or developed for future use as investment property. Until 31 December 2008 IAS 16 "Property, plant and equipment" was applied to property that was acquired with the purpose of being developed for future use as investment property until development was completed. Upon completion the Company applied IAS 40 "Investment property". The Company has not elected earlier application of the amendments to IAS 40 in accordance with paragraph 85B of IAS 40.

#### **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 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 of the buildings starts when they are available for use and is based on the straight-line method over their estimated useful lives. The annual rate of depreciation used for the buildings is 4%.

ERG CAPITAL - 3 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2011

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 as they become due in accordance with the lease contracts.

**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, 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.

**3 Rental income**

The Zagora property contains two commercial buildings which are fully leased. The larger of the two buildings is leased to two related companies, AIKO Multi Concept EOOD ("AIKO") and Mobbo EOOD ("Mobbo") under a single, non-cancellable operating lease contract that expires in March 2019. AIKO and Mobbo provided bank guarantees for a certain number of monthly rent payments and the owner of AIKO and Mobbo provided a personal guarantee. In February 2010 the lease contract was amended whereby the method for determining the rent was changed by lowering the fixed amount of rent and adding a provision that provides additional rent if annual net turnover for AIKO and MOBBO exceeds a certain amount. The rent modification reduces the total contracted fixed rent over the lease period by approximately BGN 3,500. Subsequent to 31 December 2011 the lease contract was further amended whereby the rent modification reduces additionally the total contracted fixed rent, but retains the provision for additional rent if annual turnover exceeds a certain amount. These changes acknowledge the effect of the economic crisis but at the same time provide an upside potential when the economy rebounds.

The second building is leased to Mercator-B EOOD under a non-cancellable operating lease contract that expires in July 2024. The lease contract is guaranteed with a bank guarantee for a certain number of monthly rent payments and a guarantee from Poslovni sistem Mercator d.d., Slovenia, the parent company of Mercator-B EOOD.

In September 2010 the Company signed a preliminary sale agreement with a real estate company for sale of the Zagora property. Completion of the sale was subject to the buyer's due diligence and ability to secure financing, as well as the buyer's and the seller's compliance with terms and conditions specified in the agreement. In July 2011 the buyer cancelled the preliminary sale agreement.

ERG CAPITAL - 3 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

**4 Operating expenses**

	<u>2011</u>	<u>2010</u>
Professional fees	259	525
Board of Directors fees	17	18
General and administrative expenses	<u>18</u>	<u>18</u>
Total	<u>294</u>	<u>561</u>

**5 Investment property**

At 31 December 2011 and 2010 the Company owned five properties:

- "Yavor property" at 31 December 2011 represents a 14,483 sq.m. land plot and buildings, located in Varna – 2, Oreh Str. The property was pledged in favor of Bulgarian-American Credit Bank AD ("BACB") under a loan agreement. Subsequent to 31 December 2011 the pledge was released (Note 8).

- "Zagora property" at 31 December 2011 represents a 22,817 sq.m. land plot with two commercial buildings located in Stara Zagora - 50 Patriarh Evtimii blvd. The buildings are fully leased as discussed in Note 3. The property is pledged in favor of Raiffeisenbank Bulgaria under a loan agreement (Note 8).

- "Gerena property" at 31 December 2011 represents a 25,208 sq.m land plot located in Sofia, at the intersection of Vladimir Vazov blvd and Vitinya str.

- "Sofia Ring property" at 31 December 2011 represents a 131,284 sq.m land plot located in Sofia, at the Ring road and Botevgradsko shosse junction. The property is pledged in favor of United Bulgarian Bank AD as trustee bank to secure holders of the debt securities issued by the Company (Note 9).

- "Bourgas retail property" at 31 December 2011 represents a 24,966 sq.m. land plot, located in Bourgas between Todor Alexandrov blvd. and the Bourgas port.

In 2011 and 2010 the Company increased the cost of its investment property with BGN 2 and BGN 435 respectively, due to development.

ERG CAPITAL - 3 ADSIP  
 NOTES TO THE FINANCIAL STATEMENTS  
 31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

	Investment property under development	Investment property generating rental income		Total
	Land & Buildings	Land	Buildings	Land & Buildings
<i>Cost</i>				
31 December 2009	34,423	3,856	17,496	55,775
Additions	435	-	-	435
31 December 2010	34,858	3,856	17,496	56,210
Additions	2	-	-	2
31 December 2011	34,860	3,856	17,496	56,212
<i>Accumulated depreciation</i>				
31 December 2009	-	-	477	477
Charge for 2010	-	-	700	700
31 December 2010	-	-	1,177	1,177
Charge for 2011	-	-	700	700
31 December 2011	-	-	1,877	1,877
<i>Net book value</i>				
31 December 2011	34,860	3,856	15,619	54,335
31 December 2010	34,858	3,856	16,319	55,033
31 December 2009	34,423	3,856	17,019	55,298

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 2011 and 2010 was BGN 75,224 and BGN 85,167, respectively.

**6 Other assets**

	2011	2010
Interest receivable	-	17
Other	-	1
Deferred brokerage fee & other prepaid expenses	274	311
Total	274	329

**7 Other liabilities**

	2011	2010
VAT payable	9	23
Deferred rental income	70	176
Other	88	92
Asset management fee payable (Note 12)	277	277
Total	444	568

BGN in thousands except per share amounts or unless otherwise stated

## 8 Borrowings

The table below presents the maturities of the Company's borrowings by year:

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>Total</u>
Raiffeisenbank Bulgaria - Loan № 1	<u>681</u>	<u>681</u>	<u>15,036</u>	<u>16,398</u>

### **Raiffeisenbank Bulgaria - Loan № 1**

On 29 May 2008 (and as subsequently amended) the Company and Raiffeisenbank Bulgaria executed a floating rate (3 month EURIBOR + 2.5%, decreased to 3 month EURIBOR + 2% starting 21 August 2009) loan agreement whereby the Company can borrow up to EUR 9.5 million (inclusive of capitalized interest) to finance the development of the Zagora property. Principal payments started in June, 2009 and are due monthly through 25 November 2014 according to a fixed repayment schedule. The Company pledged the Zagora property with all future improvements and related future rental income, as well as certain bank accounts. In addition, the loan agreement requires the BAEF to maintain at least 26% ownership (currently 46.7%) in ERG until repayment of the loan. The outstanding principal balance, net of deferred transaction cost incurred, at 31 December 2011 and 2010 was EUR 8.38 million (BGN 16,398) and EUR 8.73 million (BGN 17,078), respectively. The fair value of the loan approximates its carrying amount.

### **Bulgarian American Credit Bank ("BACB") - Loan № 2 (expired in 2011)**

On 18 December 2008 (and as subsequently amended) the Company and BACB executed a floating rate (1 month EURIBOR + 5.5%) line of credit agreement whereby the Company can borrow up to EUR 1 million for operating needs. The Company pledged the Yavor property. At 31 December 2010 there were no amounts outstanding. The line of credit expired on 20 December 2011 at which time there was no outstanding balance. Subsequent to 31 December 2011 the pledge was released.

## 9 Debt securities

In March 2009, the Company issued fixed rate (10%) secured bonds in the amount of EUR 6.514 million. Coupon payments are due quarterly through 12 March 2012. Principal payment is due at the last coupon payment date unless the Company decides to make early repayments in which case the Company should pay a fee of 2% over the repaid principal. The bond issue is secured with a mortgage on the Sofia Ring Property and a pledge on a bank account to be credited with the proceeds of the future sale of Sofia Ring Property. United Bulgaria Bank AD is the trustee bank under the bond issue. The bond issue is listed on the Bulgarian Stock Exchange (BSE) for secondary trading and trades under BSE code 5ERA. The outstanding principal balance, net of deferred transaction cost incurred, at 31 December 2011 and 2010 was EUR 6.51 million (BGN 12,727) and EUR 6.48 million (BGN 12,669), respectively.

On 21 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. Both coupon and principal are due at maturity. In case the Company decides to make early repayments, the Company should pay the accrued interest on the repaid principal. The bond issue is secured with mortgages on Sofia Ring Property, Yavor property, Bourgas retail property and a pledge on a bank account to be credited with the proceeds of the future sale of the pledged properties. Emporiki Bank – Bulgaria EAD is the trustee bank under the bond issue. The Company will use the proceeds to repay the existing bond maturing on 12 March 2012.

## 10 Share capital

ERG CAPITAL - 3 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2011

BGN in thousands except per share amounts or unless otherwise stated

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 21,000 distributed in 2,100,000 common shares with a face value of BGN 10 per share, each with equal voting rights.

An Extraordinary General Meeting of shareholders was held in September 2011. The shareholders decided to reduce the capital of the Company from BGN 21,000 distributed in 2,100,000 common shares with a face value of BGN 10 per share to BGN 2,100 distributed in 2,100,000 common shares with a face value of BGN 1 per share. Subsequent to 31 December 2011 the capital was reduced in accordance with the shareholders' decision.

BAEF owns 46.7% of the shares plus an additional 6.7% through a wholly owned subsidiary. BAEF 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.

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.

#### 11 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 2011 and 2010 is 2,100,000.

#### 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 were as follows:

<u>Related company</u>	<u>2011</u>	<u>2010</u>
Asset management fee payable to SCA	277	277
Asset management fee - SCA	-	277
Development fee - SCA	-	17
Servicing fee - SCA	65	63
Amortization of brokerage fee paid to SCA in 2009	36	36
Board of Directors fees to Sredetz Enterprise EOOD	6	6
Board of Directors fees to BAPM EOOD*	5	3

BGN in thousands except per share amounts or unless otherwise stated

\*BAPM EOOD became a member of the Board of Directors of ERG on 15 June 2010.

### 13 **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).

#### **Credit risk**

The Company is exposed to credit risk in its investment activities. Credit risk is the risks 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. If the interest rate on Raiffeisenbank Bulgaria loan (Note 8) experience increase/decrease by 0.5% in the next 12 months period, the interest expense for the year would increase/decrease and the profit for the year would decrease/increase with approximately EUR 0.04 million (BGN 81), respectively.

#### **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 in order to service the borrowings. At any point of time the Company maintains a positive balance between the incoming and outgoing cash flows on its rents and 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, borrowings 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 Bulgaria and the local real estate market in the second half of 2008 and is expected to continue in 2012. It is the Company's policy to reduce this risk by only investing in high quality properties and leasing them to good quality tenants with favorable terms and guarantees.