

**ERG CAPITAL - 3 ADSIP**

**FINANCIAL STATEMENTS,  
PREPARED IN ACCORDANCE WITH  
INTERNATIONAL FINANCIAL  
REPORTING STANDARDS  
31 DECEMBER 2013**

**TOGETHER WITH  
INDEPENDENT AUDITORS' REPORT**

**AND**

**ANNUAL MANAGEMENT REPORT ON  
THE ACTIVITY**



**ANNUAL REPORT  
ON THE ACTIVITIES FOR 2013**



## ANNUAL MANAGEMENT REPORT ON THE ACTIVITY OF ERG CAPITAL – 3 ADSIP FOR 2013

7 March 2014

"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 (four as at the date of this report) 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.

Following a decision voted on 26 September 2011 by the Extraordinary General Meeting of the Shareholders (EGM) for reduction of the registered capital of the Company from BGN 21,000,000 to BGN 2,100,000 by reduction of the par value of the outstanding shares from BGN 10 to BGN 1, the registered capital of the Company was reduced and the reduction was recorded in the Commercial Register on 9 February 2012.

On 23 January 2012 another EGM was held at which the shareholders voted to extend the term of existence of the Company until 31 December 2020.

During 2013 the Company sold one of its investments in Sofia - "Gerena property", whereas with the bulk of the sale proceeds it prepaid half of the three-year bond with par value of EUR 6,800 thousand issued in 2012, along with the interest accrued on the prepaid principal. Also, during the year the lease agreement with one of the tenants of "Zagora property" was terminated, for which the Company received the agreed with the tenant compensation (*Please refer to Note 3 to the Financial statements*). With part of it the Company partially prepaid the bank loan used for the development of "Zagora property".

In the following discussion we present some comments regarding important aspects of the activity of the Company during 2013:

#### 1. Liquidity

As of 31 December 2013 the Company's cash and cash equivalents are in the amount of BGN 2,553 thousand and other current assets are in the amount of BGN 165 thousand. The current liabilities are in the amount of BGN 13,001 thousand, of which EUR 6,142 thousand is the principal of the bank loan used for the development of "Zagora property", the main part of which the Company owes on 25 November 2014. The management considers different options for refinancing and/or repaying this loan prior to maturity.

On 21 February 2013 the Company prepaid half of its second three-year bond issued on 21 February 2012 with par value of EUR 6,800 thousand along with the interest accrued on the prepaid principal. (Note: The interest on the bond is due at maturity – 21 February 2015, or at any prepayment date when

the Company shall pay the interest accrued on the prepaid principal). For that purpose the Company used sale proceeds from the sale of "Gerena property" (Please refer to *Acquisitions and disposals of real estate investments* below.).

On 6 August 2013 the Company prepaid EUR 1,559 thousand from the bank loan used for the development of "Zagora property". For that purpose the Company used part of the proceeds from the compensation received for the termination of the lease agreement for part of the "Zagora property".

## **2. Capital resources**

As of 31 December 2013 ERG-3's shareholders' equity is BGN 23,688 thousand. The capital of the Company was paid in full and despite the accumulated losses for 2013, 2012, 2011, 2010, 2009 and 2008, it is currently sufficient to support the Company's business activity. At this stage, ERG-3 does not plan any future capital increases.

For each of the properties described below and in Note 5 to the Financial statements, the Company considers two alternatives: a/ to develop it as commercial property and lease it or sell it and b/ to sell it without development in its current condition. In the cases when the Company decides to develop a property, because the management deems this alternative better for the shareholders, the Company will have significant capital outlays for construction, which it is planning to finance with bank loans.

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

**Share of leased properties in 2013: 50.9 % as a share of the net book value of the properties.**

### **Acquisitions or sales of real estate investments**

As of 31 December 2013 the Company owned four real estate investments: "Yavor property", "Zagora property", "Sofia Ring property" and "Bourgas retail property".

Yavor property represents a 14,483 sq.m. land plot (the cadastre measured area is 14,724 sq.m.) and buildings, located in Varna, with administrative address 2 Oreh St. 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 2013 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 2013, 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), of which 15,370.3 sq.m. are leased to the related companies AIKO Multi Concept EOOD and Mobbo EOOD that sell furniture. Until the third quarter of 2013 the remaining part was leased to Mercator-B EOOD, the Bulgarian subsidiary of the Slovenian FMG retailer – Mercator. Due to the latter leaving Bulgaria, the lease agreement was terminated, for which the Company received agreed upon with the tenant compensation (*Please refer to Note 3 to the Financial Statements*).

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 land 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 plot consisted of two regulated land plots: LI - 265 and L – 636, which in 2009 were united in one regulated land plot L-

265,636 and has cadastre identification number 07079.659.505. The property is cleared from buildings and construction scrap. According to the effective regulation and the city plan the property is in the 3/СмФ1 zone, which, according to the existing standards allows maximum building development intensity up to 2.5 and respectively the possible construction of buildings with total built-up area up to 62,397.5 sq.m.

#### Acquisitions and disposals of real estate investments in 2013

In 2013 the Company did not acquire new properties.

In February 2013 the Company closed the sale of "Gerena property" - 25,208 sq.m. land plot (sketch measured area - 25,036.9 sq.m.) located on Vladimir Vazov Blvd. in Sofia for EUR 4,184 thousand, net of sale expenses (Please refer to Note 5 to the Financial Statements).

#### **Lease agreements executed in 2013**

In 2013 the Company did not execute new lease agreements.

In 2013 the Company agreed to terminate the lease agreement for part of "Zagora property" after it received the compensation agreed with the tenant – Mercator-B EOOD within the agreed upon term (Please refer to Note 3 to the Financial statements).

In 2013 the Company executed an agreement with the other tenants of "Zagora property" with which it agreed to decrease the monthly rent by 14.5% for six months, whereas this term was subsequently extended with another nine months.

#### **Construction works, repairs and improvements made in 2013:**

During 2013 ERG-3 did not make any significant constructions works, repairs and improvements to the properties it owns.

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

The Company ended 2013 with a loss for the year of BGN 840 thousand as a result from impairment of investment property.

Out of BGN 14,301 thousand total revenue for the period, net of property sale expenses, BGN 8,183 thousand (57.2%) is revenue from the sale of the "Gerena property", net of the sale expenses. The rest is mostly revenue from "Zagora property" - rental income and other income (in total BGN 6,056 thousand or 42.4%) and interest income (BGN 62 thousand or 0.4%). Other income from investment property generating rental income includes the compensation received for the termination of the lease agreement with one of the tenants of the Zagora property.

The major expenses for the period are operating expenses – BGN 1,231 thousand and interest expense – BGN 1,366 thousand. The direct rental expenses and depreciation are BGN 930 thousand, of which BGN 714 thousand is depreciation expense for "Zagora property".

As at 31 December 2013, based on the prevailing market conditions and the latest property appraisals of an independent appraiser the Company impaired its investment properties with the amount of BGN 4,178 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

In 2013 the Bulgarian real estate sector remained depressed, which will likely continue during 2014. 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**

No important events have occurred after the date of the Financial Statements until the date of this report that might have significant impact to the financial position and the operating results of the Company.

#### **7. Expected developments and plans for 2014**

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/ to develop it as a commercial property and lease it or sell it or b/ to sell it without development in its current condition. In the cases when the Company decides to develop a property, because the management deems this alternative better for the shareholders, the Company will have significant capital outlays for construction, which it is planning to finance with bank loans.

#### **8. Research and development**

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

#### **9. Use of financial instruments**

As at 31 December 2013 the Company has outstanding bond in the amount of EUR 3,400 thousand (out of issued EUR 6,800 thousand) maturing on 21 February 2015. The bond has coupon of 10.5% and it is secured by mortgages on properties of the Company. The interest is due at the bond's maturity (*Please refer also to Part 1 Liquidity above*).

#### **10. Branches**

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

#### **11. Share buy backs**

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



## CORPORATE GOVERNANCE

The Company adopted its Good Corporate Governance Program (GCGP) in 2007. During 2013 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 2013, the Company has outstanding share capital of BGN 2,100 thousand comprising of 2,100,000 shares, each with a nominal value of BGN 1. All the issued and outstanding shares are fully paid-up. During 2013 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<br>issued shares | Paid-up share<br>capital<br>(thousand BGN) |
|------------------|----------------------------|--|
| 31 December 2012 | 2,100,000                  | 2,100                                      |
| 31 December 2013 | 2,100,000                  | 2,100                                      |

#### Pre-emption Rights

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

If the capital increase is authorized by a shareholder resolution, the pre-emption rights accrue to those persons registered as shareholders at the Central Depository on the ex-dividend date, i.e. 14 days following the date of the shareholders' resolution. If the capital increase is authorized by a resolution of the Board of Directors, the pre-emption rights accrue to those persons registered as shareholders at the Central Depository on the seventh day after the publication of the announcement of the rights issue 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 2013

| Shareholder   | Number of shares Owned at 31.12.2013 | % of Voting shares at 31.12.2013 |
|---|--------------------------------------|----------------------------------|
| Bulgarian-American Enterprise Fund (BAEF)                   | 980,000                              | 46.67                            |
| Frank Louis Bauer   | 158,009                              | 7.52                             |
| 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 ¾ of the shares represented at the general meeting. Unless otherwise provided by law or by the Company's bylaws the decisions of the general meeting are taken with a 50% majority of the shares represented at the general meeting. These provisions set forth higher majorities than those generally required in the Commercial Act.

**5. Remuneration of the Members of the Board of Directors**

In 2013 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 is equal to 7.87% of its share capital at 31 December 2013. 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 2013:

| Director   | Shares owned on 31 December 2012 | Net purchases (sales) of Company shares | Shares owned on 31 December 2013 |
|--|----------------------------------|---|----------------------------------|
| 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                            |
| Kostadin Petkov representative of Sredetz Enterprise EOOD as per art. 234 par. 1 of the Commercial Act | 17,000                           | -                                       | 17,000                           |
| 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 (as of the date of this report)

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. Does not serve as director in other companies;

### 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 2013 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 to another member of board of the Company).

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

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

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

##### **Amendments or supplements to the bylaws**

The Company's by-laws provide that the shareholder resolution to amend or supplement the by-laws requires the approval of  $\frac{3}{4}$  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 1/2 of the total assets of the Company according to the certified financial report, and
  - (b) in the amount of up to 20% of the book value of the total assets of the Company which loans shall be used for payment of interest and only if the term of the loan is not exceeding 12 months;
- take decisions for providing collateral to the loan agreements under the above item including the case when the amount of the collateral for the current year exceeds ½ of the total assets of the Company as per the certified financial report;
- take decisions to invest up to 10% of the registered capital of the Company in a servicing company;
- elect and dismiss an executive director/s;
- take decisions for issue of bonds under the terms and conditions of Art. 13, para. (3) and (4) of the by-laws.
- **Based** on proposals from the Servicing Company/ies decides on acquisitions and sales of real estate investments within the limitations of the Law and the By-laws.

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

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

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

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

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

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

## **ADDITIONAL INFORMATION (APPENDIX 10 TO ORDINANCE 2 OF FSC)**

### **1. Main goods and services**

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

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

During 2013 the revenue from sale of investment property, net of sale expenses amounts to 57.2% of Company's revenue, net of property sale expenses. The other income from investment property generating rental income amounts to 32.4% of Company's revenue, net of property sale expenses and is related to the compensation that the Company received for the termination of the lease agreement for part of "Zagora property". The rental income amounts to 10.0% of the Company's revenue, net of property sale expenses.

During 2013 the total amount of expenses of the Company, including direct rental expenses and

depreciation, but net of impairment loss, property sale expenses and net book value of investment property sold is BGN 3,527 thousand, of which 9.9% represent expenses related to Raiffeisenbank (Bulgaria) EAD for interest and loan related expenses (Raiffeisenbank (Bulgaria) EAD is not a related party to the Company), 28.8% represent interest and expenses related to the bond issue maturing on 21 February 2015 and 31.8% represent expenses for the servicing company.

The Company has not made expenses exceeding 10% of the total amount of expenses, including direct rental expenses and depreciation, but net of impairment loss, property sale expenses and net book value of investment property sold, to other counterparties save for those stated above.

### **3. Large or important deals in 2013**

Please refer to *Acquisitions and disposals of real estate investments in 2013* and *Lease agreements executed in 2013* above.

Except for the deals described in these paragraphs, during 2013 the Company has not executed other deals that are significant to its operations.

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

There were no such new deals in 2013.

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

In 2013 there were no unusual events that could have a material impact on the activity of the Company, its financials and results from operations save for the ones disclosed in this document.

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

All off-balance sheet assets or liabilities are disclosed in the Notes 3, 5, 8 and 9 to the Financial statements.

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

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

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

At 31 December 2013 ERG-3 has one bank loan outstanding with details provided in this report and in Note 8 to the Financial statements and one listed bond issue with details provided in this report and in Note 9 to the Financial statements.

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

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

By law ERG-3 is not allowed to provide loans to any party and in 2013 the Company has not entered in such deals.

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

In 2013 the company did not issue any new securities.

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

ERG-3 does not publish earnings forecasts.

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



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

### **13. Planned investments and their funding**

The information is in section 7. *Expected developments and plans for 2014* 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 were no changes to the Board of Directors in 2013 **except** for the change of the representative under art. 234, par. 1 of the Commercial Law of the board member – Sredetz Enterprise, in which Mrs. Daniela Handjieva was replaced by Mr. Kostadin Petkov.

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

In 2013 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 shareholders' equity. 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-Tavityan  
3 Shipka Str.  
Sofia, 1504

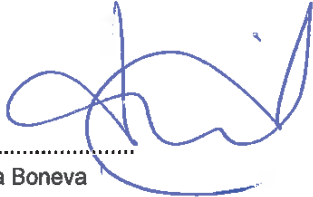
T: +359 2 948 92 11

F: +359 2 943 36 90

E: [ergcapital3@baefinvest.com](mailto:ergcapital3@baefinvest.com)

## CHANGES IN THE PRICE OF THE SHARES

According to infostock.bg between 1 January 2013 and 31 December 2013, 1,954 shares of the Company were traded at BSE-Sofia for a total value of BGN 9.0 thousand at prices ranging between BGN 3.50 and 5.00 per share. For the period the shares of the Company remained approximately flat. The last deal at BSE-Sofia for 2013 was executed on 28 December 2013 for 53 shares at BGN 4.70 per share.



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



**INDEPENDENT AUDITOR'S REPORT AND  
ANNUAL FINANCIAL STATEMENTS  
DECEMBER 31, 2013**



*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, 2013, and the statement of comprehensive income, statement of changes in shareholders' 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.

Делойт се отнася към едно или повече дружества - членове на Делойт Туш Томацу Лимитид, частно дружество с ограничена отговорност (private company limited by guarantee), регистрирано в Обединеното кралство, както и към директата от дружества - членове, всяко от които е юридически самостоятелно и независимо лице. За детайлна информация относно правната структура на Делойт Туш Томацу Лимитид и дружествата - членове, гледайте посетете [www.deloitte.com/bg/za\\_nas](http://www.deloitte.com/bg/za_nas).

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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, 2013, 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 of 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.

We draw attention to note 8 of the accompanying financial statements where the maturity of the loan on 25 November 2014 is disclosed, as well as the management consideration of various options to refinance or repay this loan until maturity. 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, 2013, 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 March 7, 2014.

*Deloitte Audit OOD*

Deloitte Audit OOD

*Assen Dimov*

Assen Dimov  
Statutory Manager  
Registered Auditor



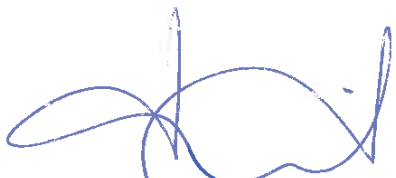
March 7, 2014  
Sofia

ERG CAPITAL – 3 ADSIP  
STATEMENT OF COMPREHENSIVE INCOME  
YEAR ENDED 31 DECEMBER 2013


BGN in thousands except per share amounts or unless otherwise stated

|   | Notes | 2013                  | 2012                  |
|---|-------|-----------------------|-----------------------|
| <b>Revenue</b>  |       |                       |                       |
| Sale of investment property                                     | 5     | 8,814                 | -                     |
| Net book value of investment property                           | 5     | (7,436)               | -                     |
| Sale expenses   |       | (631)                 | -                     |
|   |       | <u>747</u>            | <u>-</u>              |
| Rental income   | 3     | 1,429                 | 2,229                 |
| Other income from investment property generating rental income  | 3     | 4,627                 | -                     |
| Direct rental expenses and depreciation                         |       | (930)                 | (877)                 |
| Impairment loss on investment property generating rental income | 5     | (2,757)               | -                     |
|   |       | <u>2,369</u>          | <u>1,352</u>          |
| Interest income   |       | 62                    | 17                    |
| <b>Net revenue</b>  |       | <u><b>3,178</b></u>   | <u><b>1,369</b></u>   |
| <b>Expenses</b>   |       |                       |                       |
| Operating expenses  | 4     | (1,231)               | (254)                 |
| Interest expense  | 8, 9  | (1,366)               | (1,914)               |
| Impairment loss on investment property                          | 5     | (1,421)               | -                     |
| <b>Total expenses</b>   |       | <u><b>(4,018)</b></u> | <u><b>(2,168)</b></u> |
| <b>Loss for the year</b>  |       | <u><b>(840)</b></u>   | <u><b>(799)</b></u>   |
| <b>Loss per share - basic and diluted</b>                       | 11    | <b>(0.40)</b>         | <b>(0.38)</b>         |

These financial statements have been approved by the Board of Directors on 7 March 2014.

  
Anna Boneva  
Representative of the Executive Director  
BAPM EOOD

  
Emilia Karadocheva  
Chief Financial Officer

  
07.03.2014

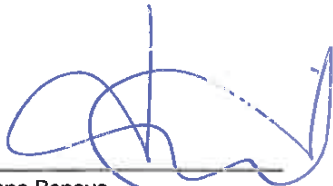


ERG CAPITAL - 3 ADSIP  
STATEMENT OF FINANCIAL POSITION  
31 DECEMBER 2013

BGN in thousands except per share amounts or unless otherwise stated

|   | Notes | 2013                 | 2012                 |
|---|-------|----------------------|----------------------|
| <b>ASSETS</b>                                     |       |                      |                      |
| Cash and cash equivalents                         |       | 2,553                | 914                  |
| Other assets                                      | 6     | 315                  | 351                  |
| Investment property (net)                         | 5     | <u>41,650</u>        | <u>53,636</u>        |
| <b>TOTAL ASSETS</b>                               |       | <b><u>44,518</u></b> | <b><u>54,901</u></b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>       |       |                      |                      |
| <b>LIABILITIES</b>                                |       |                      |                      |
| Other liabilities                                 | 7     | 1,015                | 473                  |
| Borrowings  | 8     | 11,986               | 15,717               |
| Interest payable on debt securities               | 9     | 1,299                | 1,202                |
| Debt securities                                   | 9     | <u>6,530</u>         | <u>12,981</u>        |
| <b>Total liabilities</b>                          |       | <b><u>20,830</u></b> | <b><u>30,373</u></b> |
| <b>SHAREHOLDERS' EQUITY</b>                       |       |                      |                      |
| Share capital                                     | 10    | 2,100                | 2,100                |
| Share premium                                     |       | 8,941                | 8,941                |
| Reserve fund                                      |       | 18,937               | 18,937               |
| Retained earnings                                 |       | <u>(6,290)</u>       | <u>(5,450)</u>       |
| <b>Total shareholders' equity</b>                 |       | <b><u>23,688</u></b> | <b><u>24,528</u></b> |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> |       | <b><u>44,518</u></b> | <b><u>54,901</u></b> |

These financial statements have been approved by the Board of Directors on 7 March 2014.

  
Anna Boneva  
Representative of the Executive Director  
BAPM EOOD

  
Emilia Karadocheva  
Chief Financial Officer

  
07.03.2014



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 2013

BGN in thousands except per share amounts or unless otherwise stated

|                   | Share<br>capital | Share<br>premium | Reserve<br>fund | Retained<br>earnings | Total         |
|-------------------|------------------|------------------|-----------------|----------------------|---------------|
| 31 December 2011  | 21,000           | 8,941            | 37              | (4,651)              | 25,327        |
| Reserve fund      | (18,900)         | -                | 18,900          | -                    | -             |
| Loss for the year | -                | -                | -               | (799)                | (799)         |
| 31 December 2012  | 2,100            | 8,941            | 18,937          | (5,450)              | 24,528        |
| Loss for the year | -                | -                | -               | (840)                | (840)         |
| 31 December 2013  | <u>2,100</u>     | <u>8,941</u>     | <u>18,937</u>   | <u>(6,290)</u>       | <u>23,688</u> |

These financial statements have been approved by the Board of Directors on 7 March 2014.



Anna Boneva  
 Representative of the Executive Director  
 BAPM EOOD



Emilia Karadocheva  
 Chief Financial Officer





ERG CAPITAL - 3 ADSIP  
STATEMENT OF CASH FLOW  
YEAR ENDED 31 DECEMBER 2013

BGN in thousands except per share amounts or unless otherwise stated

|  | <u>Notes</u> | <u>2013</u>     | <u>2012</u> |
|--|--------------|-----------------|-------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |              |                 |             |
| Loss for the year  |              | (840)           | (799)       |
| <b>Adjustments to reconcile loss for the year to net cash provided by (used in) operating activities</b> |              |                 |             |
| Investment in investment property  | 5            | (342)           | -           |
| Proceeds from sale of investment property, net of realized gain and sale expenses                        | 5            | 7,436           | -           |
| Depreciation   | 5            | 714             | 699         |
| Impairment loss on investment property generating rental income  | 5            | 2,757           | -           |
| Impairment loss on investment property   | 5            | 1,421           | -           |
| Decrease (increase) in other assets  |              | 36              | (77)        |
| Increase in other liabilities  |              | 542             | 96          |
| <b>Net cash provided by (used in) operating activities</b>   |              | <b>11,724</b>   | <b>(81)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |              |                 |             |
| Repayment of borrowings, net of amortization of transaction cost   | 8            | (3,731)         | (681)       |
| Repayment of debt securities, net of amortization of transaction cost                                    | 9            | (6,451)         | (12,727)    |
| Increase in interest payable on debt securities  |              | 97              | 1,135       |
| Proceeds from debt securities, net of transaction cost   | 9            | -               | 12,981      |
| <b>Net cash (used in) provided by financing activities</b>   |              | <b>(10,085)</b> | <b>708</b>  |
| <b>Net increase in cash and cash equivalents</b>   |              | <b>1,639</b>    | <b>627</b>  |
| <b>Cash and cash equivalents at the beginning of the year</b>  |              | <b>914</b>      | <b>287</b>  |
| <b>Cash and cash equivalents at the end of the year</b>  |              | <b>2,553</b>    | <b>914</b>  |
| <b>Supplemental cash flow information:</b>   |              |                 |             |
| Interest and transaction cost paid   | 8, 9         | 1,042           | 1,057       |

These financial statements have been approved by the Board of Directors on 7 March 2014.

  
Anna Boneva  
Representative of the Executive Director  
BAPM EOOD

  
Emilia Karadocheva  
Chief Financial Officer



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

07.03.2014



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. The Company's by-laws were amended at the January 2012 Extraordinary General Meeting of shareholders ("EGM") in order to extend ERG's term of existence to 31 December 2020.

ERG activities and operations are governed by the provisions of the Special Investment Purpose Companies Act ("SIPCA"), the Public Offering of Securities Act 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 2013, 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 2013 the Company has adopted all new and revised IFRS by IASB, as approved by the EU, effective for 2013, 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 2014. 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 - 3 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2013

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 2013.

**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.

**Investment property**

Investment property is property (land or a building-or part of a building-or both) held to be leased under long term operating leases or for capital appreciation or both in accordance with the Improvements to IFRS issued in May 2008 and effective 1 January 2009. An investment property is measured initially at its cost. Cost comprises its purchase price and any directly attributable expenditures, including taxes and fees directly related to the purchase and other transaction costs. For all new investments started after 1 January 2009 borrowing costs that are directly attributable to the acquisition, construction and development are capitalised as part of the cost of the investment property, in accordance with the amendments to IAS 23 "Borrowing costs". Construction cost is recorded based upon stages of completion. Development cost is recorded at the time the services are performed. After the initial recognition the investment property is accounted for in accordance with the cost model - cost less accumulated depreciation and accumulated impairment losses as determined by management. The SIPCA requires that ERG's investment property is appraised at the end of each fiscal year. Depreciation of the buildings starts when they are available for use and is based on the straight-line method over their estimated useful lives of 25 years.

**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.

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 and transaction costs on borrowings, debt securities and payables.

**Tax status and dividend requirement**

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

**3 Rental income**

The Zagora property contains two commercial buildings which were fully leased until August 2013. 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. During 2012 (following the amendment in February 2010), the lease contract was amended whereby the fixed amount of rent was lowered but the provision that provides additional rent if annual net turnover for AIKO and Mobbo exceeds a certain amount was retained. During 2013 the fixed amount of rent was additionally lowered for a period of six months which period was subsequently extended with another nine months. These changes acknowledge the effect of the economic crisis but at the same time provide an upside potential when the economy rebounds. As a result of the amendments, the Company expects to receive in the future approximately the same rental income from AIKO and Mobbo as the one in 2013.

The second building was leased to Mercator-B EOOD under an operating lease contract which was terminated in August 2013. ERG received a contractual termination compensation and recorded it as other income from investment property generating rental income in the statement of comprehensive income.

During 2013 the Company generated immaterial amount of rental income from Yavor property under a short term operating lease contract that was renewed until November 2014.

**4 Operating expenses**

|                                     | <u>2013</u>  | <u>2012</u> |
|-------------------------------------|--------------|-------------|
| Professional fees                   | 1,194        | 225         |
| Board of Directors fees             | 17           | 17          |
| General and administrative expenses | 20           | 12          |
| Total                               | <u>1,231</u> | <u>254</u>  |

Professional fees for 2013 and 2012 include asset management fee to SCA of BGN 1,039 and BGN 0, respectively (Note 12).

BGN in thousands except per share amounts or unless otherwise stated

**5 Investment property (net)**

At 31 December 2013 and 2012 the Company owned four and five properties, respectively.

- "Yavor property" at 31 December 2013 represents a 14,724 sq.m. (the cadastre measured area) land plot and buildings, located in Varna – 2, Oreh Str. During 2013 the property generated immaterial amount of rental income as discussed in Note 3. In February 2012 the property was pledged in favor of Credit Agricole Bulgaria EAD (previously Emporiki Bank – Bulgaria EAD) as trustee bank to secure holders of the Second bond issue (Note 9).

- "Zagora property" at 31 December 2013 represents a 22,768 sq.m. (the cadastre measured area) land plot with two commercial buildings located in Stara Zagora - 50 Patriarh Evtimii blvd. The buildings were fully leased until August 2013 as discussed in Note 3. The property is pledged in favor of Raiffeisenbank Bulgaria under a loan agreement (Note 8).

- "Sofia Ring property" at 31 December 2013 represents a 131,284 sq.m. (the cadastre measured area) land plot located in Sofia, at the Ring road and Botevgradsko shosse junction. The property was pledged in favor of United Bulgarian Bank AD as trustee bank to secure holders of the First bond issue. In February 2012 the property was pledged in favor of Credit Agricole Bulgaria EAD (previously Emporiki Bank – Bulgaria EAD) as trustee bank to secure holders of the Second bond issue. In March 2012 the pledge in favor of United Bulgarian Bank AD was released (Note 9).

- "Bourgas retail property" at 31 December 2013 represents a 24,959 sq.m. (the cadastre measured area) land plot, located in Bourgas between Todor Alexandrov blvd. and the Bourgas port. In February 2012 the property was pledged in favor of Credit Agricole Bulgaria EAD (previously Emporiki Bank – Bulgaria EAD) as trustee bank to secure holders of the Second bond issue (Note 9).

- "Gerena property" at 31 December 2012 represented a 25,036.9 sq.m. (a sketch measured area) land plot located in Sofia, at the intersection of Vladimir Vazov blvd and Vitinya str. In December 2012 the property was pledged in favor of Credit Agricole Bulgaria EAD as trustee bank to secure holders of the Second bond issue (Note 9). In February 2013 the Gerena property was sold and the pledge was released.

ERG CAPITAL - 3 ADSIP  
NOTES TO THE FINANCIAL STATEMENTS  
31 DECEMBER 2013

BGN in thousands except per share amounts or unless otherwise stated

|   | Investment<br>property under<br>development | Investment property generating<br>rental income |           | Total               |
|---|---|---|-----------|---------------------|
|   | Land &<br>Buildings                         | Land  | Buildings | Land &<br>Buildings |
| <i>Cost</i>   |   |   |           |                     |
| 31 December 2011  | 34,860                                      | 3,856   | 17,496    | 56,212              |
| 31 December 2012  | 34,860                                      | 3,856   | 17,496    | 56,212              |
| Additions   | -   | -   | 342       | 342                 |
| Disposals   | (7,436)                                     | -   | -         | (7,436)             |
| 31 December 2013  | 27,424                                      | 3,856   | 17,838    | 49,118              |
| <i>Accumulated depreciation<br/>and impairment loss</i> |   |   |           |                     |
| 31 December 2011  | -   | -   | 1,877     | 1,877               |
| Depreciation for 2012                                   | -   | -   | 699       | 699                 |
| 31 December 2012  | -   | -   | 2,576     | 2,576               |
| Depreciation for 2013                                   | -   | -   | 714       | 714                 |
| Impairment loss for 2013                                | 1,421                                       | 551   | 2,206     | 4,178               |
| 31 December 2013  | 1,421                                       | 551   | 5,496     | 7,468               |
| <i>Net book value</i>                                   |   |   |           |                     |
| 31 December 2013  | 26,003                                      | 3,305   | 12,342    | 41,650              |
| 31 December 2012  | 34,860                                      | 3,856   | 14,920    | 53,636              |
| 31 December 2011  | 34,860                                      | 3,856   | 15,619    | 54,335              |

In 2013 management wrote-down two of its investment properties to their recoverable amount by recognizing an impairment loss in the statement of comprehensive income.

Based upon the result of the required annual appraisal (prepared by an independent appraiser with recognized and relevant professional qualification), the fair value of the investment property at 31 December 2013 and 2012 was BGN 46,876 and BGN 73,053, respectively. The investment property is classified within Level 3 of the fair value hierarchy and has been determined based on combination of generally accepted valuation methods. In estimating the fair value of the investment property, the highest and best use of the property is its current use. There has been no change to the valuation technique during the year.

**6 Other assets**

|   | 2013 | 2012 |
|---|------|------|
| Interest receivable                             | 7    | 8    |
| VAT receivable                                  | 109  | -    |
| Deferred brokerage fee & other prepaid expenses | 199  | 343  |
| Total   | 315  | 351  |

BGN in thousands except per share amounts or unless otherwise stated

**7 Other liabilities**

|  | <u>2013</u>  | <u>2012</u> |
|--|--------------|-------------|
| VAT payable                            | -            | 3           |
| Deferred rental income                 | 106          | 151         |
| Other                                  | 38           | 42          |
| Asset management fee payable (Note 12) | <u>871</u>   | <u>277</u>  |
| Total                                  | <u>1,015</u> | <u>473</u>  |

**8 Borrowings**

**Raiffeisenbank Bulgaria**

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. In August 2013, with the termination compensation received from Mercator-B EOOD, the Company partially repaid this loan. The outstanding principal balance, net of deferred transaction cost incurred, at 31 December 2013 and 2012 was EUR 6.13 million (BGN 11,986) and EUR 8.04 million (BGN 15,717), respectively.

The management of the Company is considering various options to refinance or repay this loan until maturity.

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

**9 Debt securities**

**First bond issue**

In March 2009, the Company issued fixed rate (10%) secured bonds in the amount of EUR 6.514 million with a term of 36 months. This bond issue was 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 was the trustee bank under this bond issue. The First bond issue was repaid at maturity in March 2012 with the proceeds from the Second bond issue.

**Second bond issue**

In February 2012, the Company issued fixed rate (10.5%) secured bonds in the amount of EUR 6.8 million with a term of 36 months. 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. This bond issue is secured with mortgages on Sofia Ring property, Yavor property, Bourgas retail property, Gerena property (mortgage on Gerena property was released in February 2013) and a pledge on a bank account to be credited with the proceeds of the future sale of the pledged properties. Credit Agricole Bulgaria EAD



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(previously Emporiki Bank – Bulgaria EAD) is the trustee bank under this bond issue. The Company used the proceeds to repay the First bond issue. This bond issue is listed on the BSE for secondary trading and trades under BSE code 5ERB. In February 2013, with the proceeds from the sale of Gerena property, the Company partially repaid this bond issue. The outstanding principal balance, net of deferred transaction cost incurred, at 31 December 2013 and 2012 was EUR 3.34 million (BGN 6,530) and EUR 6.64 million (BGN 12,981), respectively and the interest payable was EUR 0.66 million (BGN 1,299) and EUR 0.61 million (BGN 1,202), respectively.

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

#### 10 Share capital

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

In February 2012 in accordance with the shareholders' decision of the EGM held in September 2011, the capital of the Company was reduced 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.

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 2013 and 2012 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 2013 and 2012, respectively were as follows:

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| <b>Related company</b>   | <b>2013</b> | <b>2012</b> |
|--|-------------|-------------|
| Asset management fee payable to SCA                                    | 871         | 277         |
| Asset management fee - SCA   | 1,039       | -           |
| Servicing fee - SCA  | 48          | 67          |
| 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 Bulgarian American Property Management EOOD | 5           | 5           |

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

#### **Interest rate risk**

The interest rate risk relates to the potentially adverse impact of interest rate fluctuations to the Company's profit for the year and equity value. It is the Company's policy to reduce the interest rate risk on floating rate loans through the use of interest rate swaps if necessary. This reduces to a large extent the overall interest rate risk.

#### **Liquidity Risk**

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

#### **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, debt securities and a significant amount of interest and operating expenses are denominated in EUR. The Company does not maintain positions in currency other than EUR and BGN. The BGN/EUR exchange rate of BGN 1.95583 for EUR 1 is fixed under a Currency Board arrangement.



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**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 2014 although it is not expected for the prices and rental rates to decrease further. 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.