

Annual report

ARCO VARA AS

Beginning of financial year:	1 January 2007
End of financial year:	31 December 2007
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Core activities:	Real estate development and investment (EMTAK 701) Real estate related services (EMTAK 702, 703) Construction (EMTAK 45)
Supervisory board:	Richard Tomingas, Hillar-Peeter Luitsalu, Arti Arakas, Kalev Tanner, Aare Tark
Management board:	Aare Tammemäe, Avo Rõõmussaar, Veiko Taevere, Ahto Altjõe
Auditor:	Ernst & Young Baltic AS

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Management report

Arco Group and its business

Arco Vara AS and other companies of Arco Group are engaged in various aspects of the real estate business. The Group's three business lines – services, development and construction have been organised into corresponding divisions which provide a comprehensive range of real estate services. At the end of 2007, Arco Group comprised the parent Arco Vara AS and its 34 subsidiaries (2006: 32), 20 joint ventures (2006: 25) and one associate (2006: same).

The performance of all divisions is subject to seasonal fluctuations. The transaction volumes of the Service division expand in autumn and spring while the Construction division's turnover and Development division's investment activities subside in the winter.

The Service division is engaged in real estate brokerage, valuation, management, consulting and portfolio management, and short-term investment in residential real estate.

The Development division develops integrated residential environments and commercial real estate. Fully developed housing solutions are sold to end-consumers. Commercial properties are developed until they start generating cash flow after which they are sold to a real estate fund or another developer. Despite the strategy, the Group holds some income-yielding commercial properties because they have not been developed to their full potential.

The Construction division provides general construction, environmental engineering and construction supervision services, operating as a general contractor and construction manager.

Arco Group's domestic markets include Estonia, Latvia and Lithuania. According to the Group's strategy, the Service and Development divisions will expand to Bulgaria, Ukraine, Romania and other East European countries.

Mission, vision and values

The mission of Arco Group is **to be a valued provider of comprehensive real estate solutions.**

The vision of Arco Group is **to become a symbol of real estate.**

Arco Group's core values:

Partnership – our client is our partner

Reliability – we are reliable, open and honest

Professionalism – we deliver quality

Respect – we respect our client's personality

Responsibility – we keep our promises

Letter by chairman of the management board

- To date, the Estonian and Latvian real estate markets which began experiencing difficulties in spring 2007 have stabilised. The decline in transaction volumes has evened out and steadied at the level of three years ago. In the housing market, offering of new residential properties is going to decrease because many developers have suspended their projects, focusing on the adoption of detailed plans and making preparations for new projects. Banks in both Estonia and Latvia have become considerably less enthusiastic about real estate projects that do not generate cash flow and financing terms have become more inflexible and less favourable for developers. In the face of this, Arco is well placed, having sufficient liquidity thanks to the funds involved through the initial public offering arranged in 2007. Moreover, the Group's focus is shifting on Eastern and Central Europe, especially Ukraine and the Balkans. We are building our first 112 apartments in Bulgaria and have invested in our first shopping centre in Ukraine. In the new markets, we will invest, above all, in office and business properties so as to reduce the proportion of residential property development in our business portfolio.
- Demand for centrally located commercial real estate in large Baltic and Balkan cities has not diminished. For example, in Tallinn vacancies of centrally located category A office and commercial premises are almost down to zero. The situation is no different in Vilnius, Kiev and Bucharest. This enhances the value of the Group's existing cash generating properties and creates a sound basis for launching the construction of Ahtri 3 and Laeva 2 projects in Tallinn in 2008. In addition, we see positive developments in the commercial property markets of Ukraine and other East European countries where the ratios of commercial space per population are substantially lower than Europe's average.
- We are pleased about the strong results of the Construction division which indicate that the recovery processes launched in 2006 were effective. Operating profit for the year improved by almost 15.0 million kroons (0.9 million euros). New contracts include provisions which share the construction price risk with the customer. Construction prices in the Baltics are following a downward trend which may affect the Construction division's profitability in 2008. On the other hand, lower construction prices have a positive impact on the profitability of new development projects (Ahtri 3, Laeva 2).

- Although the Service division's overall result for 2007 fell short of the one achieved in 2006, the year-end was extremely strong. Fourth quarter results were significantly better than in 2006 and the number of brokerage transactions stabilised. New products such as real estate consulting and focus on the business client are yielding their first positive results.
- Milestones of the period include progress with major plans - Tivoli, Ahtri 3, Laeva 2, Baltezers-3, and the expansion of development operations to the Balkans and Ukraine in the first quarter of 2008.
- Already in the third quarter, the capital of the two-year old Explorer Property Fund – Baltic States AB, a real estate investment company managed by AVEC Asset Management AS, was fully invested. The assets of the fund have grown to 3,129 million kroons (200 million euros) and the average entrance yield is 8.35%.

Arco Group's key financials for 2007

- Revenue and other income totalled 867.3 million kroons (55.4 million euros), 4.3% down from 2006.
- Operating profit amounted to 103.1 million kroons (6.6 million euros), a 60.4% decrease year-over-year.
- Net profit grew to 235.5 million kroons (15.1 million euros), 10.3% up on 2006.
- Equity to assets ratio rose to 54.1 % (2006: 32.8%) while return on equity equalled 14.2% (2006: 31.5%) and return on invested capital was 10.0% (2006: 15.7%).
- In the construction business, the year-end order backlog was 331.4 million kroons (21.2 million euros).
- During the year, 110 apartments and plots were sold or reserved.

	EEK					EUR				
	2007	2006	2005	2004	2003	2007	2006	2005	2004	2003
In millions										
Revenue and other income	727	484	476	350	280	46	31	30	22	18
Gross profit	185	135	118	109	93	12	9	8	7	6
Operating profit	103	260	154	130	168	7	17	10	8	11
Profit before tax	250	227	121	109	141	16	15	8	7	9
Net profit	236	217	116	107	141	15	14	7	7	9
Net revaluation gains	77	375	104	58	1	5	24	7	4	0
Net loans	517	1,143	578	555	482	33	73	37	35	31
Gross margin, %	25%	28%	25%	31%	33%	25.4%	27.8%	24.7%	31.2%	33.2%
Operating margin, %	14%	54%	32%	37%	60%	14.2%	53.8%	32.3%	37.0%	60.0%
Net margin, %	32%	45%	24%	30%	50%	32.4%	44.9%	24.5%	30.5%	50.4%
ROE, %	14.2%	31.5%	26.9%	n/a	n/a	14.2%	31.5%	26.9%	n/a	n/a
ROA, %	7.5%	11.7%	8.5%	n/a	n/a	7.5%	11.7%	8.5%	n/a	n/a
ROIC, %	10.0%	15.7%	12.3%	n/a	n/a	10.0%	15.7%	12.3%	n/a	n/a
Quick Ratio	1.1	0.2	0.5	0.2	0.2	1.1	0.2	0.5	0.2	0.2
Current Ratio	2.2	0.6	0.8	0.8	1.0	2.2	0.6	0.8	0.8	1.0
EPS, in kroons and euros	2.8	3.1	1.6	1.6	1.4	0.18	0.20	0.10	0.10	0.09
P/E	8.1					8.1				
Lowest share price, in kroons and euros	20.5					1.3				
Average share price, in kroons and euros	28.4					1.8				
Highest share price, in kroons and euros	38.8					2.5				
Number of staff	664	478	280	220	180	664	478	280	220	180

Economic environment and outlook for 2008

In macroeconomic terms, the past financial year was one of the toughest. In the winter, rising defaults on sub-prime mortgages in the US triggered a global crisis for the money markets. In addition, Latvia and Estonia posted double-digit inflation figures and reported escalating current account deficit. If in the first half of the year Baltic investors were worried about local macroeconomic risk, in the second half of the year their main concern was a global liquidity crisis. Owing to all this, investors and consumers have started placing their funds in risk-free instruments and postponing consumption and real estate acquisitions. Financing real estate projects with commercial paper has become more expensive as investors scrutinise the issuer's credit risk meticulously and banks have adopted a stricter lending policy.

Arco's results for the second half-year reflect the changes in consumer behaviour. The number of brokerage and valuation transactions plummeted and growth in asset values was times smaller than in 2006.

The liquidity crisis affects all sectors of the real estate business. Although the cost of external financing has increased on account of rising margins and leverage levels are dropping, the Group has not been directly hit. In 2007, our debt margins remained stable but in 2008 interest expense will probably increase and borrowing terms will become tougher also for Arco Group.

Plots without a detailed plan can no longer be financed with bank loans and in the construction business creditors demand preliminary reservations. We believe that the global liquidity crisis will change the development market significantly. Development operations will become more equity consuming, leaving no room for small developers. Volumes will shrink, especially in housing development. On the other hand, the situation involves the opportunity of launching new housing and commercial real estate solutions in two to three year's time when supply has decreased.

The commercial market includes sectors where in the medium term demand will still surpass supply (e.g. centrally located office and commercial premises). Arco intends to take advantage of the almost 20% plunge in construction prices and launch its Laeva and Ahtri projects - commercial properties with a gross enclosed area of 60 thousand square metres in prime locations in the Estonian capital Tallinn.

Revenue and profit

	EEK		EUR	
	2007	2006	2007	2006
In millions				
Revenue and other income				
Service	139.6	119.4	8.9	7.6
Development	566.3	626.6	36.2	40.0
Construction	425.5	359.3	27.2	23.0
Eliminations	-264.1	-198.9	-16.9	-12.7
Total revenue and other income	867.3	906.5	55.4	57.9
Operating profit				
Service	-16.5	8.6	-1.1	0.6
Development	162.0	278.2	10.4	17.8
Construction	16.9	1.0	1.1	0.1
Eliminations	-16.5	1.4	-1.1	0.1
Unallocated expenses	-42.9	-28.8	-2.7	-1.8
Total operating profit	103.1	260.4	6.6	16.6
Interest income and interest expense	-3.7	-27.4	-0.2	-1.8
Other financial income and expense	150.9	-6.0	9.6	-0.4
Income tax expense	-14.8	-9.6	-0.9	-0.6
Net profit	235.5	217.3	15.1	13.9

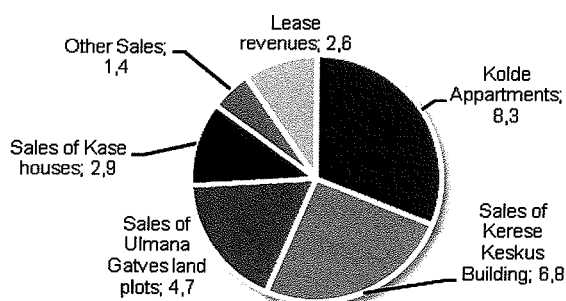
The largest revenue was earned by the Development division where sales of apartments and registered properties totalled 381.3 million kroons (24.4 million euros). Sales of Kolde community apartments contributed 130.0 million kroons (8.3 million euros), the divestment of the retail and office building Kereses Keskus yielded 106 million kroons (6.8 million euros), and sales of the Ulmana Gaves property and Kase project generated 74.0 million kroons (4.7 million euros) and 46.0 million kroons (2.9 million euros) respectively.

Consolidated net profit for 2007 was significantly improved by finance income of 118.4 million kroons (7.6 million euros) generated by the divestment of the Group's interest in Sportings Riga SIA, net gain of 76.6 million kroons (4.5 million euros) on fair value adjustments to investment property and property, plant and equipment, net gain of 27.6 million kroons (1.8 million euros) on the realisation of the Kolde project, finance income of 42.6 million kroons (2.7 million euros) contributed by AVEC Asset Management AS and income of 8.4 million kroons (0.5 million euros) derived from the divestment of a stake in Varamaad Kinnisvara OÜ and.

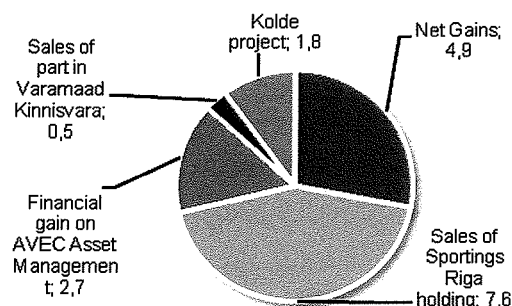
The Group's profit was adversely affected by the loss of the Service division of 16.5 million kroons (1.0 million euros), triggered mainly by rapid expansion. Despite the difficulties, expansion to new markets will remain a priority.

The Construction division's results surpassed all expectations. The improvement in profitability may be attributed to structural changes in the division's order backlog where many unfavourable contracts were replaced with more profitable ones.

Main sources of revenues in development division, mEUR



Main sources of Group profit, mEUR



Cash flows

	EEK		EUR	
	2007	2006	2007	2006
In millions				
Cash flows from operating activities	-548	-118	-35	-8
Cash flows from investing activities	137	-342	9	-22
Cash flows from financing activities	1,118	376	71	24
Net cash flow	707.2	-84.5	45.2	-5.4
Cash and cash equivalents at beginning of period	58.3	144.0	3.7	9.2
Effect of exchange rate fluctuations	-0.5	-1.1	0.0	-0.1
Cash and cash equivalents at end of period	765.0	58.3	48.9	3.7

Operating cash flows were strongly affected by expenditures on the acquisition of properties in Bulgaria and Lithuania (348.3 million kroons or 22.2 million euros), investment in projects in progress (266.4 million kroons or 17.0 million euros) and an increase in VAT receivables (91 million kroons or 5.9 million euros).

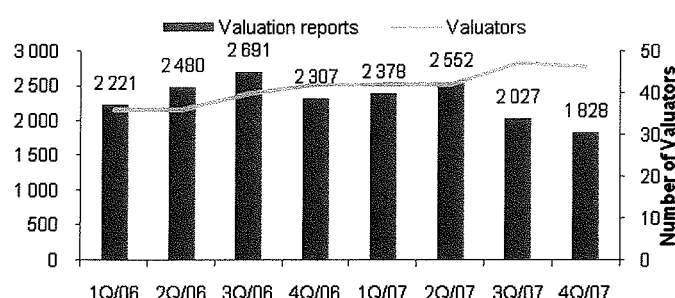
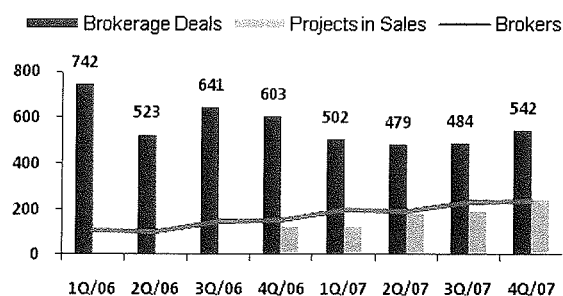
The main investing cash flows resulted from the divestment of holdings in Sportings Riga SIA and Arco HCE OÜ for 218 million kroons (13.9 million euros) and the investment of 74 million kroons (4.7 million euros) in short-term bonds.

Cash flows from financing activities were boosted by IPO proceeds of 987 million kroons (63.1 million euros).

Service division

Developments in the Lithuanian, Bulgarian and Romanian markets correspond to expectations and the Ukrainian market is perking up. The cooling of the Latvian and Estonian markets continues to exert a strongly adverse effect although the brokerage markets have stabilised. A decline in brokerage transactions affects the provision of valuation services - in the second half of 2007 the growth in valuation services followed a downward trend. However, the situation has stabilised and the decline has been replaced with a slight rise, especially in the commercial sector. To adjust to the new situation, we are optimising our operating expenses and right-sizing the staff. The measures should yield a positive effect in 2008. Although foreign investors' interest in Romania and Bulgaria is decreasing, local demand is still strong and we intend to sustain vigorous growth, especially outside the capitals.

In 2007, the number of valuation reports issued decreased by 9%. Although the figures posted by the Lithuanian office are improving steadily, the overall result is weakened by the nosedive in the Latvian market. In 2007, our appraisers issued 8,785 valuation reports in six countries (2006: 9,699). On the positive side, the results for the fourth quarter were better than those for the third. The division is putting a lot of effort in introducing valuation services in the new markets and promoting real estate consulting services in the Baltics.



	2007	2006	Change, %
Number of properties brokered	2,007	2,509	-20
Number of projects on sale	240	124	94
Number of valuation reports issued	8,785	9,699	-9
Number of appraisers	45	38	18
Number of real estate brokers	215	126	71
Average number of staff	363	224	62

Project sales contracts totalled 240, 94% up on 2006. The number of brokerage transactions was 2,007, a 20% decrease year-over-year.

In 2007, the real estate investment companies managed by the Group's joint venture AVEC Asset Management AS acquired the retail and office building Kereses Keskus in Narva, three shopping malls in Jõhvi, the Laracija office block in Lithuania, Hotel Portus in Tallinn, AS Favor's production complex in Maardu, Jeruzalemes Centrs in Riga and the first phase in the office and commercial building Papiniidu Keskus in Pärnu. After the acquisition of Papiniidu Keskus, the capital of AVEC Baltic Property Fund AB was fully invested. In addition, in the third quarter of 2007 56.5 million kroons (3.6 million euros) was raised through the issue of shares in Arco Balti Kinnisvaraportfell AS. Through the transactions, the assets of the real estate investment companies managed by AVEC Asset Management AS have grown to 3,442 million kroons (220 million euros).

Development division

Developments in the new markets do not outweigh the cooling in the Baltics. The developers' main concern is the deterioration in financing opportunities triggered by global turbulence in the capital markets. The situation has unnerved market participants who are postponing their real estate acquisitions in Estonia and Latvia in fear of a general economic slump. Under the circumstances, Arco Group has been able to maintain its liquidity and to reinvest its profits. New investments have been made in Bulgaria and to date, also in Ukraine. The stabilisation in the number of brokerage transactions indicates that the situation is improving and market participants have more confidence in the future.

In the Baltic market, the priorities of the Development division are to continue the development of projects in progress, to launch the construction of Ahtri and Laeva properties, and to mitigate the risk exposures through the adoption of detailed plans. In the Balkans, the Group is already developing the Madrid project in Sofia (112 apartments) and will soon launch the Manastirski project. Further expansion of the land bank will be characterized by the assumption of greater planning risk in the Balkans and realisation of opportunities in Ukraine.

The Development division ended 2007 with sales of 585.0 million kroons (37.4 million euros), 6.5% down from 2006, and an operating profit of 162.0 million kroons (10.4 million euros), a 41.7% decrease year-over-year. Major fluctuations in quarterly sales and profit figures are common in real estate development. However, the period was set apart by the recognition of net revaluation gains (fair value adjustments to investment properties and property, plant and equipment) of 79.4 million kroons (5 million euros) which allowed the division to end the year with positive operating cash flows (EBITDA) of 84.5 million kroons (5.4 million euros).

In 2007, 110 apartments and plots were sold or reserved, most of them in the Kolde community in Estonia and Bishumizhas -1 community in Latvia. In the current stages of the projects, 139 plots and apartments remain to be sold.

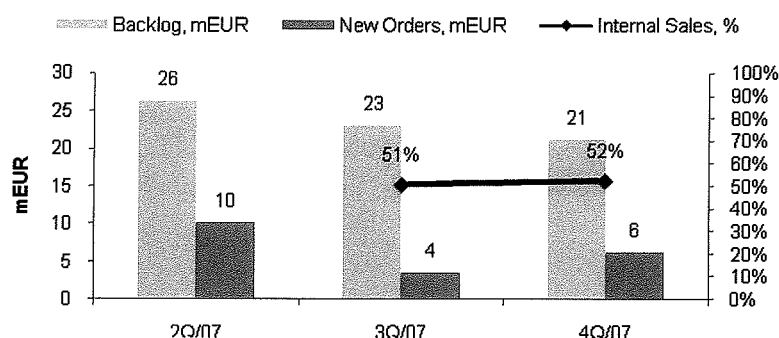
Construction division

In the near future, a reduction of orders in the residential sector is going to exert downward pressure on residential construction prices. The commercial and industrial sectors are still stable – there is no visible decline in orders. In connection with allocations from the EU Structural Funds, the number of environmental engineering projects is going to increase. Accordingly, we are going to focus on developing our environmental engineering capabilities. The number of public procurement tenders for the construction and rehabilitation of local government facilities remains large as well.

The Construction division ended 2007 with revenue of 425.5 million kroons (27.2 million euros), an 18.4% rise year-over-year, and an operating profit of 16.9 million kroons (1.1 million euros), an exceptional 17-fold improvement on the prior year. Significant profit growth was achieved in the second half-year because a number of unfavourable fixed-price environmental engineering contracts in Saaremaa and commercial construction contracts in Tallinn expired in the first half-year (the contracts were concluded two years ago). The current market situation provides better opportunities for sharing the price risk.

A major transaction of 2007 was the acquisition of a 55% stake in the Latvian construction company Dinamo Buve SIA. With this, the division completed implementation of the Group's full business model in Latvia. Consolidation in the construction sector will continue. The division's future profitability will be affected by the decrease in construction prices in Estonia and Latvia.

At the year-end, the Construction division's order backlog stood at 331.4 million kroons (21.2 million euros). The largest contracts comprised the rehabilitation of Matsalu water and wastewater systems (67.5 million kroons or 4.31 million euros) and the construction of the Bishumuizhas apartment houses (63.0 million kroons or 4.0 million euros). Intra-group sales accounted for 57.2% of the division's sales for 2007. At 31 December 2007, the Construction division employed 173 people, 50.3% of them in Latvia.



Summary table of major projects

Project type	Project name	Country	Legal holding	Building rights according to business plan	Current state	Classification in the balance sheet
Commercial	Ahtri 3	Estonia, Tallinn	50%	47,075 m ²	The old plan and building permit are in effect. A new detailed plan has been initiated to obtain more extensive building rights. The planning process is in the final phase. In the new plan, above-ground building rights extend to ca 51,110 m ² .	Investment property
Commercial	Ilmarine	Estonia, Tallinn	50%	Ca 80,000 m ²	The City is preparing a general plan for the high rise area. Partial demolition of existing buildings is under way.	Investment property
Commercial	Kipsala	Latvia, Riga	50%	50,000 m ²	No building rights. The project is in the planning stage.	Receivables
Commercial	Laeva 2	Estonia, Tallinn	100%	7,697 m ²	Building rights. Re-planning is in the final stage.	Assets under construction
Commercial	Marsili, Vizni	Latvia, Riga	80%	n/a	No building rights. Project suspended.	Investment property
Commercial	Paldiski mnt 80	Estonia, Tallinn	100%	23,600 m ²	No building rights. Planning is in the initial stage.	Investment property
Apartments	Bishumuizhas 1	Latvia, Riga	80%	Building rights to unsold part 7,768 m ²	Building rights. Construction and sale of apartments is under way.	Inventories
Apartments	Bishumuizhas 2	Latvia, Riga	40%	95,970 m ²	Intended purpose is provided in the general plan. Preparation of architectural drawings is under way.	Inventories
Apartments	Hills	Lithuania, Vilnius	100%	6,500 m ²	Building rights.	Inventories
Apartments	Kolde	Estonia, Tallinn	89%	Building rights to unsold part 21,539 m ²	Right of superficies. Building rights. Construction and sale of apartments is under way.	Inventories
Apartments	Madrid	Bulgaria, Sofia	100%	24,700 m ²	Building rights. Construction is under way.	Inventories
Apartments	Manastirski	Bulgaria, Sofia	100%	26,239 m ²	Building rights. Changing of architecture is under way.	Inventories

Apartments	Plavnieku centrs	Latvia, Riga	40%	13,243 m2	Building rights. We are preparing a joint business plan with the City.	Inventories
Apartments	Tivoli	Estonia, Tallinn	100%	58,470 m2	No building rights. Planning is in the final stage.	Inventories
Apartments	TOP Residential premises	Estonia, Tallinn	50%	33,770 m2	No building rights. Planning is in the initial stage	Investment property
Plots	Baltezers-3	Latvia, Riga	80%	n/a, land area 860,000 m2	Awaits privatisation. The right of superficies. No building rights. General plan has been adopted. Intended purpose residential land. A detailed plan will be adopted in the near future for construction of ca 120 000 m2 of detached houses.	Inventories
Plots	Baltezers-5	Latvia, Riga	80%	53 plots	Building rights. Construction and sale are under way.	Inventories
Plots	Merivälja 2	Estonia, Merivälja	100%	n/a	Negotiations with the City of Tallinn regarding exchange of land are under way.	Inventories
Plots	Pärtli	Estonia, Saue	50%	84 plots, average plot 1,500 m2	No building rights. Draft plans have been approved. Suspended until improvement in market situation.	Inventories
Plots	Tooma	Estonia, Saue	50%	107 plots, average plot 1,802 m2	No building rights. Draft plans have been approved. Suspended until improvement in market situation.	Inventories
Plots	Vahi	Estonia, Vääna	100%	21 plots, average plot 3,363 m2	Building rights. Suspended until improvement in market situation.	Inventories
Cash flow	Enerpoint	Estonia, Kuressaare	100%	3,201 m2	Building rights. Generates cash flow.	Investment property
Cash flow	Kerberon	Estonia, Tallinn	83%	2,391 m2	Building rights. The right to superficies. Generates cash flow. We are building additional space for a specific client.	Investment property
Cash flow	Melon	Estonia, Tallinn	50%	7,461 m2	Building rights. Generates cash flow. We have applied for additional building rights to ca 12,000m2.	Investment property
Cash flow	Pärnu market	Estonia, Pärnu	100%	9,745 m2	Building rights. Generates cash flow.	Investment property
Cash flow	Rüütli 16/18	Estonia, Tallinn	50%	980 m2	Building rights. Generates cash flow.	Investment property
Cash flow	Tallinna 77/79	Estonia, Kuressaare	100%	2,500 m2	Building rights. Generates cash flow.	Investment property
Cash flow	TOP Commercial premises	Estonia, Tallinn	50%	We are dealing with the adoption of a new plan for at least 74,675 m2.	Building rights correspond to currently built-up area. Generates cash flow. Current total area 17,000 m2. We have initiated a new plan whose adoption is in its initial phase.	Investment property

Note: The development and success of the Group's development projects depend largely on external factors, such as the adoption of plans and the issuance of building permits by the local government or planning authorities. The information presented in the tables, such as building rights according to business plan, the current state, project type and classification of the project in the balance sheet, has been recorded based on management's best estimates and judgment and may change in line with changes in the planning process.

Expectations of the projects' realisation may also change over time in connection with changes in the market and the competition environment. Management estimates the value of the project portfolio on an ongoing basis and is prepared to sell any project or part of a project at any time, depending on the results of the cost-benefit analysis.

The carrying amounts of the projects presented in the summary table account for the following portions of the Group's assets

Balance sheet item	EEK		EUR	
	Balance sheet item at 31 December 2007	Carrying amount of projects presented in the summary table at 31 December 2007	Balance sheet item at 31 December 2007	Carrying amount of projects presented in the summary table at 31 December 2007
In millions				
Total assets	3,564.0	2,097.6	227.8	134.1
Short-term receivables	297.2	33.7	19.0	2.2
Inventories	1,148.4	1,059.3	73.4	67.7
Investment property	1,000.0	930.4	63.9	59.5
Assets under construction	101.8	74.2	6.5	4.7

Adjusted NAV

During the IPO, Colliers International estimated the values of the Group's major projects by reference to the discounted cash flow (DCF) method. Although the Group's investment properties are measured in the financial statements by applying the fair value model, IFRS provides that it is not always possible to estimate the book values of all properties using the DCF method because the DCF method takes into account the future capital expenditures and cash flows forecast in the business plan which may not be included in the fair value computations for properties that do not generate cash flow. The Group upholds the tradition that an independent international property valuation company appraises all major projects once a year using the sales comparison method and the discounted cash flow method.

If at the year-end all assets had been measured using the DCF method, the carrying amounts of the Group's properties would have been 864 million kroons (55.2 million euros) larger – assets under construction by 76.0 million kroons (4.8 million euros), inventories by 335.8 million kroons (21.5 million euros) and investment property by 452.9 million kroons (28.9 million euros).

The values of the following projects were estimated using DCF: Ahtri 3, Laeva 2, Narva mnt 67 (Tivoli), the potential of TOP Residential premises, Ilmarine, Kaarli 2 and Hills. The adjusted NAV does not include the cost of the Construction, Service and Asset Management divisions as during the IPO. It should be noted that Colliers International has not appraised Baltezers-3 for which a general plan was adopted in December and whose carrying amount is 0.6 million kroons (0.04 million euros). Nor has the valuation company appraised the whole volume of TOP's detailed plan of ca 110,000 m².

Significant changes in detailed plans in 2007

Tivoli: Tallinn City government approved the plan and referred it for public display. Two challenges were submitted (by an apartment owner in an adjacent residential area and by Eesti Energia). The challenge by Eesti Energia has already been resolved. According to management's assessment, the remaining challenge will not put the building right at risk but may postpone the adoption of the plan by a quarter. The works submitted to the architectural competition were published on 23 November. The best solution has been selected and design work will commence. Tallinn City government referred the plan to Harju County Governor for supervision proceedings. In January 2008, the County Governor approved the plan and returned it for adoption.

Ahtri: The plot has a detailed plan with building rights. However, we have submitted to the City government a draft of a new detailed plan. Until the new plan is adopted, the building rights provided in the previous plan apply. The Planning Department has approved the draft of the new detailed plan and will prepare resolutions for the initiation of a detailed plan at a session of the City government. The new plan includes above-ground building rights to 51,110 square metres. We are negotiating financing for the first phase of the project with a syndicate of banks. Hopefully the negotiations will be completed by the end of the first quarter.

Laeva 2: The plot has a detailed plan. Still, we have initiated the adoption of a new detailed plan which maintains the construction volume but changes the boundaries of the construction area. We hope that in March 2008 the City government will approve the plan and refer it for public display.

PM80: City government has approved the draft of the detailed plan. The Planning Department will prepare resolutions for the initiation of a detailed plan at a session of the City government

Baltezers-3: A general plan has been adopted for the area according to which its intended purpose is residential land.

Changes in the Group's structure

In 2007, the Group continued streamlining its legal structure by selling investments previously held by the parent to the divisions' parent companies: Arco Real Estate AS in the Service division, Arco Investeeringute AS in the Development division and Arco Ehitus OÜ in the Construction division. The process is aimed at harmonising the Group's legal structure with the segment reporting structure used for financial accounting purposes.

In addition to legal restructuring, the Group disposed of and acquired numerous ownership interests. The transactions involved the following companies: Arco HCE OÜ, Arco Capital TOV, Kramer Kinnisvara OÜ, Cromer Trade OÜ, Barrow Investments OÜ, Castleberry OÜ, Bishumuizhas Nami SIA, Dreilini-Ulbroko-1 SIA, Varamaad Kinnisvara OÜ, Arco Construction SIA, Arco Vara Riia Valdused OÜ, Arco Vara Puukool OÜ, Arco Real Estate UAB and Arco Rumeenia Valduste OÜ. The effect of the transactions on the Group's financial position and results of operation is described in note 7 to the consolidated interim financial statements. The Group's structure as at 31 December 2007 is presented in note 41 to the consolidated interim financial statements

People

At the end of 2007, Arco Group employed 664 people (2006: 478) whose annual remuneration including associated taxes totalled 164 million kroons (10.5 million euros).

The distribution of staff by regions and business lines as at 31 December:

2007	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	TOTAL
Service	123	101	52	65	34	27	402
Development	36	8	3	0	5	3	55
Construction	84	99	0	0	0	0	183
Head office	24	0	0	0	0	0	24
TOTAL	267	208	55	65	39	30	664
2006							
Service	128	108	34	31	16	7	324
Development	30	8	2	0	0	0	40
Construction	90	0	0	0	0	0	90
Head office	24	0	0	0	0	0	24
TOTAL	272	116	36	31	16	7	478

The remuneration of the members of the management board for 2007 including associated taxes amounted to 24.3 million kroons (1.5 million euros) and the remuneration of the members of the supervisory board including associated taxes totalled 0.3 million kroons (0.02 million euros).

The bonuses of the members of the management board whose service ended totalled 4.3 million kroons (0.3 million euros) (including associated taxes).

Share info

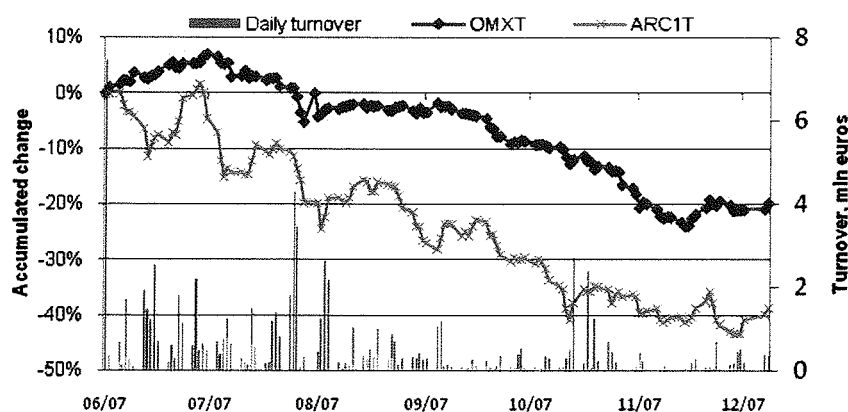
At 31 December 2007, the share capital of Arco Vara AS amounted to 952,841,500 kroons. The company has issued registered shares of one type whose par value is 10 (ten) Estonian kroons. Each share carries 1 (one) vote at meetings of the company. No share certificates are issued. Each share grants the holder the right to participate in shareholders' general meetings, distribution of profit and, upon dissolution of the company, the allocation of residual assets, as well as other rights provided for by the law and the company's Articles of Association. All shares are listed in the main list of Tallinn Stock Exchange. There are no restraints or agreements concerning voting rights and the company has not issued any preference shares.

Under the Articles of Association, all shares are freely transferable. There are no rights of first refusal or other restraints which might restrict the transfer of shares to third parties.

According to the information of Arco Vara AS, under the Underwriting Agreement signed by Skandinaviska Enskilda Banken AB (publ), London Branch and AS SEB Enskilda on 15 June 2007, during 1 (one) year after the listing of the shares on Tallinn Stock Exchange the shareholders OÜ HM Investeeringud and OÜ Toletum may transfer their shares only subject to the underwriter's consent.

On 20 December 2007, OÜ Toletum and OÜ Greatway signed an agreement on the division of OÜ Toletum by way of separation. Under the agreement OÜ Greatway, who acquired, among other things, 50% of the shares in AS Arco Vara which were in the ownership of OÜ Toletum, assumed also the restriction attaching to the transfer of the shares.

At 31 December 2007, the company had a total of 1,489 shareholders, 81.2% of them holding less than 1,000 shares.



Major shareholders at 31 December 2007	Number of shares	Ownership interest %
OÜ Toletum	40,711,100	42.7%
HM Investeeringud OÜ	20,301,300	21.3%
JPMORGAN CHASE BANK, UK RESIDENTS	8,895,666	9.3%
DEUTSCHE BANK AG LONDON PRIME BROKERAGE	3,578,865	3.8%
Central Securities Depository of Lithuania	3,172,584	3.3%
J.P. MORGAN BANK LUXEMBOURG S.A.	2,550,000	2.7%
Skandinaviska Enskilda Banken Ab Clients	2,223,350	2.3%
INVESTORS BANK & TRUST COMPANY	1,994,329	2.1%
MORGAN STANLEY & CO	1,550,000	1.6%
PICTET & CIE CLIENT ACCOUNT	879,465	0.9%

Dividend policy

During the years 2005 to 2007, Arco Group declared dividends of up to 15% of its consolidated net profit for the year. The Group intends to continue distributing dividends in the same proportion to net profit. Regardless, the Group cannot guarantee that dividend distributions will continue at the same rate because the ultimate amount of a dividend distribution depends on the Group's results of operation for a specific financial year and expected medium term liquidity position.

Financial risk management

The Group's financial risk management policy and risk exposures as at 31 December 2007 are discussed in note 35 to the consolidated financial statements.

Corporate governance and compliance with the Corporate Governance Recommendations promulgated by Tallinn Stock Exchange

The shares of Arco Vara AS were listed in the main list of Tallinn Stock Exchange on 21 June 2007.

As a public limited company, Arco Vara AS adheres to the legislation effective in the Republic of Estonia, including the regulations and recommendations of Tallinn Stock Exchange and its own corporate values outlined on page one of the management report.

As part of its annual report, Arco Vara AS submits a corporate governance report in which management confirms compliance with the requirements of the Corporate Governance Recommendations (CGR) of Tallinn Stock Exchange or explains the reasons for any non-compliance.

The annual report has been prepared in accordance with the provisions of CGR. The corporate governance report constitutes a separate chapter of the management report, which is part of the company's annual report.

General meeting

The company's highest governing body is the general meeting of its shareholders.

The powers of the general meeting and the procedure for calling general meetings and passing resolutions are set out in the company's Articles of Association.

In 2007, no general meetings were held subsequent to the flotation of the company on Tallinn Stock Exchange. The general meetings which convened before the flotation of the company were called and conducted in accordance with effective legislation and the company's Articles of Association.

Management board

At the date this annual report is authorised for issue, the management board of Arco Vara AS has four members:

- Aare Tammemäe – chairman of the management board, in charge of the board and financial management of the company
- Avo Rõõmussaar – member of the management board, in charge of the Service division
- Veiko Taevere – member of the management board, in charge of the Development division
- Ahto Altjõe – member of the management board, in charge of the Construction division

From 1 January 2007 to 30 June 2007, the management board had five members: Viljar Arakas (chairman of the management board), Ahto Altjõe (member of the management board, head of the Construction division), Sulev Luiga (member of the management board, chief financial officer), Veiko Pedosk (member of the management board, head of the Development division) and Ivar Siimar (member of the management board, head of the Service division).

From 1 July 2007 to 3 September 2007, the management board had five members: Viljar Arakas (chairman of the management board), Ahto Altjõe (member of the management board, head of the Construction division), Aare Tammemäe (member of the management board, chief financial officer), Veiko Pedosk (member of the management board, head of the Development division) and Ivar Siimar (member of the management board, head of the Service division).

From 1 October 2007 to 31 December 2007, the management board had five members: Viljar Arakas (chairman of the management board), Ahto Altjõe (member of the management board, head of the Construction division), Aare Tammemäe (member of the management board, chief financial officer), Veiko Pedosk (member of the management board, head of the Development division) and Avo Rõõmussaar (member of the management board, head of the Service division).

On 12 December 2007, the supervisory board decided to recall from the management board the chairman of the management board Viljar Arakas who had submitted a resignation request. The powers of Viljar Arakas expired on 21 January 2008.

In 2007, when Viljar Arakas was the chairman of the management board of Arco Vara AS, the supervisory board approved his request to establish OÜ Miemmma Holding and be the entity's management board member. OÜ Miemmma Holding and Arco Vara AS have signed an accounting services contract under which Arco Vara AS provides OÜ Miemmma Holding with accounting services. The contract was concluded on market terms.

In 2007, OÜ CGI Project and Arco Vara AS had an accounting services contract under which Arco Vara AS provided OÜ CGI Project with accounting services. The contract was concluded on market terms.

Members of the management board serve the company on the basis of service agreements which outline their rights, obligations and liability as well as basic remuneration and entitlement to bonuses.

Members of the management board have notified the company of their participation in other companies and governing bodies which are not part of Arco Group:

- Ahto Altjõe – member of the management board and sole shareholder of OÜ Infotrade
- Veiko Pedosk – member of the management board and sole shareholder of Kvaliteks OÜ
- Avo Rõõmussaar – member of the management board and shareholder of Strateg Consulting OÜ
- Aare Tammemäe – member of the management board and sole shareholder of OÜ Brandeis Grupp
- Viljar Arakas – shareholder of OÜ Küttemaailm, member of the management board of the Estonian Property Owners' Association (Eesti Omanike Keskkliit) and member of the management board and sole shareholder of OÜ Miemmma Holding established in 2007
- Ivar Siimar – member of the management board and sole shareholder of OÜ CGI Project
- Sulev Luiga – member of the management board and sole shareholder of OÜ ES GAAP

Management board members' ownership of interests and participation in the governing bodies of certain companies does not constitute breach of the prohibition on competition. On signing the service agreement, management board members undertake not to breach the prohibition on competition.

In 2007, the supervisory board granted its consent to chairman of the management board Viljar Arakas becoming a member of the supervisory board of AS Tallinna Lennujaam (Tallinn Airport).

In 2007, the company supplemented its internal procedure rules with the regulation of Article 2.3.4 of CGR according to which the company's management board member or employee may not demand money or other benefits from third parties in connection with their work and may not provide unlawful or baseless advantages to third parties on behalf of the company.

The management board members' service agreements are effective for three years.

The remuneration of management board members and the bonuses paid to Viljar Arakas and Sulev Luiga on the termination of their service agreements have been disclosed in the consolidated financial statements in their respective aggregate amounts. The company is of the opinion that presenting such information separately for each management board member would constitute the disclosure of sensitive personal information that would not add value to the report.

Members of the management board are entitled to termination benefits equal to their six months' basic remuneration if they are recalled without just cause.

To motivate members of the management board on the flotation of the company on Tallinn Stock Exchange, OÜ Toletum and OÜ HM Investeeringud sold members of the management board shares in Arco Vara AS:

- Aare Tammemäe – 77,500 shares
- Ahto Altjõe – 77,500 shares
- Veiko Pedosk – 108,500 shares
- Veiko Taevere – 31,000 shares

- Ivar Siimar – 155,000 shares
- Viljar Arakas – 387,500 shares

Management board members whose service agreements have been terminated have sold their shares in the company back to the seller.

Management board members do not have any share options.

Supervisory board

The supervisory board plans and organises the activity of the company and oversees the activities of the management board. Members of the supervisory board are elected by the general meeting.

In accordance with CGR, half of the supervisory board members should be independent. If the supervisory board has an uneven number of members, the number of independent members may be smaller by one.

On 31 May 2007, the general meeting decided that the supervisory board should have five members. In addition to former members Arti Arakas, Hillar-Peeter Luitsalu and Richard Tomingas, shareholders elected to the supervisory board Aare Tark and Kalev Tanner.

Only Kalev Tanner complies with CGR's definition of an independent board member. Arti Arakas and Richard Tomingas cannot be regarded as independent because in 2007 they were members of the governing bodies and shareholders of the company's shareholder OÜ Toletum who held 36.78% of the company's shares. In addition, OÜ Toletum and Arco Vara AS have business relations.

Hillar-Peeter Luitsalu does not comply with CGR's definition of independence because during three preceding years he has been a member of the governing bodies of several companies belonging to Arco Group and he has business relations with Arco Vara AS through OÜ HM Investeeringud in which he is a shareholder.

Aare Tark does not qualify as an independent member of the supervisory board because he provides Arco Vara AS with legal services through law office Tark&Co, which is under his control.

Despite non-compliance with CGR, the management of Arco Vara AS believes that the current membership of the supervisory board is the best for the company and its shareholders.

Members of the supervisory board elect a chairman from among themselves.

From 1997 the chairman of the company's supervisory board was Arti Arakas. On 12 December 2007, he submitted to the supervisory board a request for stepping down as chairman of the supervisory board. The supervisory board satisfied his request and from 21 January 2008 the chairman of the supervisory board has been Richard Tomingas.

The general meeting approved the remuneration of the members of the supervisory board on 31 May 2007. According to the resolution of the general meeting, the annual remuneration of a member of the supervisory board is 90 thousand kroons excluding social charges. Until 1 June 2007 members of the supervisory board were not remunerated.

The company does not deem it necessary to disclose the procedure of remunerating each member of the supervisory board because this would constitute the disclosure of sensitive personal information that would not add value to the report.

Members of the supervisory board may receive additional remuneration according to their contribution to the development of the company. The rates of additional remuneration are decided based on the company's results for the financial year. In 2007, no additional remuneration was paid.

The chairman of the supervisory board does not receive any extra remuneration.

Members of the supervisory board are not eligible to termination benefits.

In addition to their regular duties, Arti Arakas, Hillar-Peeter Luitsalu and Richard Tomingas participate actively in the work of the supervisory boards of companies controlled by Arco Vara AS. Therefore, based on a resolution of the general meeting, the company has placed at their disposal cars, computers and mobile phones whose costs are covered by the company.

The supervisory board has not formed any committees.

In 2007, the supervisory board convened 18 times. Five of the meetings took place after the company's flotation on Tallinn Stock Exchange. All members of the supervisory board have attended more than half of the meetings of the supervisory board which have taken place after the flotation.

Cooperation of the management and supervisory boards

The company's management and supervisory boards cooperate closely as provided in the company's Articles of Association.

Members of the supervisory board Arti Arakas, Hillar-Peeter Luitsalu and Richard Tomingas are actively involved in the supervisory boards of companies controlled by Arco Vara AS in all the three business lines (Arco Ehitus OÜ, Arco Investeeringute AS and Arco Real Estate AS).

The management and supervisory boards have joint strategy meetings and exchange information regarding the company's strategic development on an ongoing basis.

The chairman of the management board and the chairman of the supervisory board meet weekly. On exchange information, all board members observe the rules governing the possession and disclosure of inside information and performance of transactions with the shares of Arco Vara AS.

On 12 December 2007, the chairman of the management board Viljar Arakas submitted to the supervisory board a resignation request because the changes in the real estate market had caused differences of opinion between the management and supervisory boards in matters concerning the selection of strategies and the supervisory board's interference in the company's daily management. Since 21 January 2008, the chairman of the management board has been Aare Tammemäe.

According to the member of the supervisory board Richard Tomingas, the management board should have been more active in new rising markets such as the Balkans and Ukraine.

On 12 December 2007, chairman of the supervisory board Arti Arakas, who had been supportive of the activities of the management board, submitted to the supervisory board an application for stepping down as chairman of the supervisory board.

Disclosure of information

Since the listing of its shares on Tallinn Stock Exchange, Arco Vara AS has complied with the information disclosure requirements of Tallinn Stock Exchange and the rule that all shareholders should be treated equally.

The corporate website of Arco Vara AS is at www.arcorealestate.com and information for shareholders is available in the subdivision <http://www.arcorealestate.com/en/investor-info/general> both in Estonian and in English. Since 4 October 2007, the latter page includes the company's information disclosure policy.

Financial reporting and auditing

The consolidated financial statements of Arco Vara AS have been prepared in accordance with International Financial Reporting Standards (IFRS).

Arco Vara AS does not disclose the auditors' fee because the company is of the opinion that non-disclosure of that information does not affect the reliability of the auditor's report.

Formulas used in the calculation of ratios

Invested capital = current interest-bearing liabilities plus non-current liabilities plus equity

Net loans = current interest-bearing liabilities at end of period plus non-current liabilities at end of period less cash and cash equivalents at end of period less short-term investments in financial assets

Equity to assets ratio = equity at end of period / total assets at end of period

Average equity = the past four quarters' closing equity / 4

Return on equity (ROE) = net profit for the period / the period's average equity

Average invested capital = the past four quarters' current interest bearing liabilities plus non-current liabilities plus equity / 4

Return on invested capital (ROIC) = the past four quarters' profit before tax plus interest expense / average invested capital

EPS 1 = net profit attributable to equity holders of the parent / weighted average number of ordinary shares outstanding during the period

Confirmation


The Group's management board confirms that the management report presents fairly the development, performance and financial position of the company and the Group and provides an overview of the main risks and uncertainties.



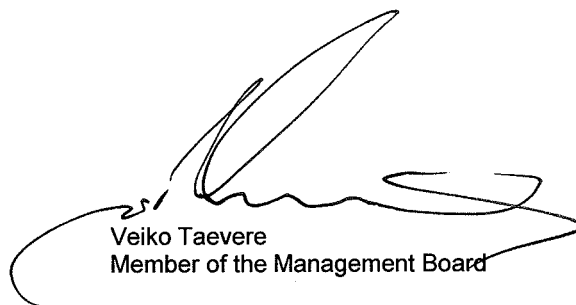
Aare Tammemäe
Chairman of the Management Board



Avo Rõõmussaar
Member of the Management Board



Ahto Altjõe
Member of the Management Board



Veiko Taevere
Member of the Management Board

Consolidated financial statements

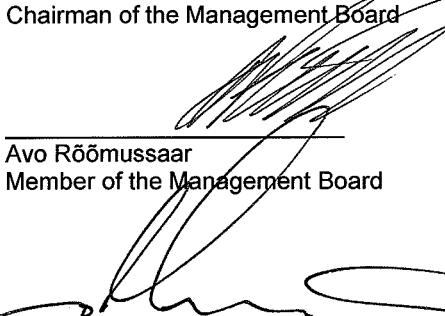
Statement of management's responsibility

We acknowledge our responsibility for the preparation of the consolidated financial statements on pages 17 to 85 of this report and confirm that:

1. the accounting policies applied on the preparation of the consolidated financial statements of Arco Vara AS (the "Parent") and its subsidiaries and interests in jointly controlled entities (together referred to as the "Group") comply with International Financial Reporting Standards as adopted by the European Union;
2. the consolidated financial statements give a true and fair view of the financial position of the Group and of the results of its operations and its cash flows;
3. the Group and the Parent are going concerns.



Aare Tammemäe
Chairman of the Management Board


Avo Rõõmussaar
Member of the Management Board
Ahto Altjõe
Member of the Management Board
Veiko Taevere
Member of the Management Board

31. March 2008

Consolidated income statement

		EEK		EUR	
	Note	2007	2006	2007	2006
In thousands					
Rendering of services		345,856	324,656	22,104	20,749
Sale of goods		381,332	158,930	24,372	10,157
Total revenue	5, 6	727,188	483,586	46,476	30,906
Cost of sales	8	-542,135	-349,067	-34,649	-22,309
Gross profit		185,053	134,519	11,827	8,597
Other income	11	140,090	422,928	8,953	27,030
Selling and distribution expenses	9	-22,534	-18,595	-1,440	-1,188
Administrative expenses	10	-136,053	-115,713	-8,695	-7,395
Other expenses	11	-63,498	-162,788	-4,058	-10,404
Operating profit	5	103,058	260,351	6,587	16,640
Finance income	12	215,005	16,215	13,741	1,036
Finance expenses	13	-67,744	-49,654	-4,330	-3,173
Profit before tax		250,319	226,912	15,998	14,503
Income tax expense	14	-14,808	-9,563	-946	-611
Profit for the year		235,511	217,349	15,052	13,892
Attributable to minority interests		7,924	9,404	507	601
Attributable to equity holders of the Parent		227,587	207,945	14,546	13,291
Earnings per share (in kroons and in euros) ¹	16				
- Basic		2.76	3.07	0.18	0.20
- Diluted		2.76	3.07	0.18	0.20

¹ In May 2007, Arco Vara AS increased its share capital by 373,331 thousand kroons (23,860 thousand euros) through a bonus issue. The issue was arranged using the company's equity; no additional contributions were made. The company issued 37,331,113 new shares with a par value of 10 kroons each. Because of this, the average number of shares outstanding in 2006 has been retrospectively adjusted to 67,784,150.

Consolidated balance sheet

As at 31 December	Note	EEK		EUR	
		2007	2006	2007	2006
In thousands					
Cash and cash equivalents	38	765,008	58,345	48,893	3,729
Other financial assets	17	78,595	0	5,023	0
Receivables	18	297,189	102,498	18,994	6,551
Prepayments	19	10,450	4,429	668	283
Inventories	20	1,148,433	431,817	73,398	27,598
Biological assets	21	8,360	6,141	534	393
Total current assets		2,308,035	603,230	147,510	38,554
Other financial assets	17	48,515	65,769	3,101	4,203
Receivables	18	40,124	10,673	2,564	682
Investment property	23	999,999	1,479,281	63,912	94,543
Property, plant and equipment	24	141,863	81,713	9,067	5,222
Intangible assets	25	25,505	16,705	1,630	1,068
Total non-current assets		1,256,006	1,654,141	80,274	105,718
TOTAL ASSETS		3,564,041	2,257,371	227,784	144,272
Loans and borrowings	26	753,077	699,568	48,130	44,711
Payables	28	223,591	249,275	14,290	15,932
Deferred income	29	47,216	63,427	3,018	4,054
Provisions	30	3,468	1,953	222	125
Total current liabilities		1,027,352	1,014,223	65,660	64,822
Loans and borrowings	26	600,938	457,258	38,407	29,224
Other liabilities	28	4,607	41,561	294	2,656
Deferred income tax liability	14	1,321	1,353	84	86
Provisions	30	251	1,095	16	70
Total non-current liabilities		607,117	501,267	38,801	32,036
TOTAL LIABILITIES		1,634,469	1,515,490	104,461	96,858
Share capital	32	952,842	304,530	60,898	19,463
Share premium	32	712,514	123,083	45,538	7,866
Statutory capital reserve		20,084	5,486	1,284	351
Other reserves		37	-184	2	-12
Retained earnings	33	218,830	292,002	13,986	18,662
Total equity attributable to equity holders of the parent		1,904,307	724,917	121,708	46,330
Minority interests		25,265	16,964	1,615	1,084
Total equity		1,929,572	741,881	123,323	47,414
TOTAL LIABILITIES AND EQUITY		3,564,041	2,257,371	227,784	144,272

Consolidated cash flow statement

		EEK		EUR	
	Note	2007	2006	2007	2006
In thousands					
Net profit		235,511	217,349	15,052	13,892
Interest income and interest expense	12, 13	3,663	27,433	234	1,753
Gains and losses on sale of investments in subsidiaries and interests in jointly controlled entities	12, 13	-131,083	-7,505	-8,378	-480
Gains and losses on other non-current financial assets	12, 13	-47,861	1,068	-3,059	68
Impairment losses on financial assets	13	25,768	11,721	1,647	749
Depreciation, amortisation and impairment losses	8, 10	-13,645	88,492	-872	5,655
Recognition of negative goodwill as income	10	-283	-14,748	-18	-943
Gain / loss on sale of property, plant and equipment	11	-18	-6,346	-2	-405
Gain / loss on sale of investment property	11	1,633	-25,224	105	-1,612
Change in fair value of investment property and biological assets	11	-59,874	-375,912	-3,827	-24,025
Losses on equity-accounted investments (associates)	13	0	40	0	3
Foreign exchange gains and losses	12, 13	2,252	682	144	44
Corporate income tax expense		14,591	8,807	933	563
Net cash used in operating activities before changes in working capital		30,654	-74,143	1,959	-4,738
Change in receivables and prepayments		-80,085	-18,255	-5,118	-1,166
Change in inventories		-424,728	-190,857	-27,145	-12,198
Change in biological assets		-174	204	-11	13
Change in payables and deferred income		-73,596	164,835	-4,704	10,535
NET CASH USED IN OPERATING ACTIVITIES	36	-547,929	-118,216	-35,019	-7,554
Acquisition of property, plant and equipment and intangible assets		-47,204	-294,375	-3,017	-18,814
Proceeds from sale of property, plant and equipment and intangible assets		8,436	11,944	539	763
Acquisition of investment property		-12,000	-17,616	-767	-1,126
Proceeds from sale of investment property		51,834	57,087	3,313	3,649
Acquisition of subsidiaries and interests in jointly controlled entities		-20,176	-91,251	-1,289	-5,832
Proceeds from disposal of subsidiaries and interests in jointly controlled entities		222,650	0	14,230	0
Acquisition of other financial assets		-92,529	0	-5,914	0
Proceeds from sale of other financial assets		14,639		936	
Loans granted		-52,681	-22,338	-3,367	-1,428
Repayment of loans granted		40,878	12,690	2,613	811
Interest received		19,684	1,941	1,258	124
Dividends received		3,147	0	201	0
NET CASH FROM / USED IN INVESTING ACTIVITIES	37	136,678	-341,918	8,736	-21,853

	Note	EEK		EUR	
		2007	2006	2007	2006
Proceeds from loans received		800,488	723,267	51,161	46,225
Repayment of loans and payment of finance lease liabilities		-572,650	-292,312	-36,599	-18,682
Change in overdraft		-18,516	10,116	-1,183	647
Change in group account liability		382	0	24	0
Interest paid		-55,486	-45,412	-3,546	-2,902
Proceeds from issue of share capital	32	987,514	-1,223	63,114	-78
Dividends paid		-16,006	-13,263	-1,023	-848
Income tax paid on dividends		-7,324	-5,541	-468	-354
NET CASH FROM FINANCING ACTIVITIES	37	1,118,402	375,632	71,480	24,008
NET CASH FLOW		707,151	-84,502	45,197	-5,399
Cash and cash equivalents at beginning of period		58,345	143,985	3,729	9,202
Increase / decrease		707,151	-84,502	45,195	-5,399
Effect of exchange rate fluctuations		-488	-1,138	-32	-73
Cash and cash equivalents at end of period	38	765,008	58,345	48,893	3,729

Consolidated statement of changes in equity

In thousands EEK	Equity attributable to equity holders of the parent						Minority interests	Total equity
	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total		
At 31 December 2005	304,530	123,083	420	474	100,811	529,318	51,427	580,745
Change in unrealised exchange differences	0	0	0	-658	0	-658	0	-658
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	-43,667	-43,667
Dividend distribution ¹	0	0	0	0	-11,692	-11,692	-200	-11,892
Transfer to capital reserve	0	0	5,062	0	-5,062	0	0	0
Change in capital reserve from merger with a subsidiary	0	0	4	0	0	4	0	4
Profit for the year	0	0	0	0	207,945	207,945	9,404	217,349
At 31 December 2006	304,530	123,083	5,486	-184	292,002	724,917	16,964	741,881
Change in unrealised exchange differences	0	0	0	221	0	221	0	221
Bonus issue	373,312	-123,083	0	0	-250,229	0	0	0
Issue of share capital	275,000	770,000	0	0	0	1,045,000	0	1,045,000
Transfer to capital reserve	0	0	14,598	0	-14,598	0	0	0
Dividend distribution ¹	0	0	0	0	-25,430	-25,430	-200	-25,630
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	577	577
Initial recognition of the put options of minority shareholders	0	0	0	0	-10,502	-10,502	0	-10,502
Total expense for the year recognised directly in equity ²	0	-57,486	0	0	0	-57,486	0	-57,486
Profit for the year	0	0	0	0	227,587	227,587	7,924	235,511
Total income and expense for the year	0	-57,486	0	0	227,587	170,101	7,924	178,025
At 31 December 2007	952,842	712,514	20,084	37	218,830	1,904,307	25,265	1,929,572

In thousands EUR	Equity attributable to equity holders of the parent						Minority interests	Total equity
	Share capital	Share premium	Statutory capital reserve	Other reserves	Retained earnings	Total		
At 31 December 2005	19,463	7,866	27	30	6,443	33,829	3,287	37,116
Change in unrealised exchange differences	0	0	0	-42	0	-42	0	-42
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	-2,791	-2,791
Dividend distribution ¹	0	0	0	0	-747	-747	-13	-760
Transfer to capital reserve	0	0	324	0	-324	0	0	0
Change in capital reserve from merger with a subsidiary	0	0	0	0	0	0	0	0
Profit for the year	0	0	0	0	13,290	13,290	601	13,891
At 31 December 2006	19,463	7,866	351	-12	18,662	46,330	1,084	47,414
Change in unrealised exchange differences	0	0	0	14	0	14	0	14
Bonus issue	23,859	-7,866	0	0	-15,993	0	0	0
Issue of share capital	17,576	49,212	0	0	0	66,788	0	66,788
Transfer to capital reserve	0	0	933	0	-933	0	0	0
Dividend distribution ¹	0	0	0	0	-1,625	-1,625	-13	-1,638
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	37	37
Initial recognition of the put options of minority shareholders	0	0	0	0	-671	-671	0	-671
Total expense for the year recognised directly in equity ²	0	-3,674	0	0	0	-3,674	0	-3,674
Profit for the year	0	0	0	0	14,546	14,546	507	15,053
Total income and expense for the year	0	-3,674	0	0	14,546	10,872	507	11,379
At 31 December 2007	60,898	45,538	1,284	2	13,986	121,708	1,615	123,323

Further information on share capital and share premium is presented in note 32.

¹ Dividends per share were declared as follows:

In thousands	EEK		EUR	
	2007	2006	2007	2006
Dividends declared	25,430	11,692	1,625	747
Number of shares outstanding on declaration on dividends	67,784,150	30,453,037	67,784,150	30,453,037
Dividends per share (in kroons and in euros)	0.38	0.38	0.02	0.02

² Total expense for the year recognised directly in equity include direct issue cost of the initial public offering (note 32).

Notes to the consolidated financial statements

1 Corporate information

These consolidated financial statements of Arco Vara AS and its subsidiaries and interests in jointly controlled entities as at and for the year ended 31 December 2007 were authorised for issue by the management board on 31 March 2008. Under the Commercial Code of the Republic of Estonia, the final approval of the annual report prepared by the management board and approved by the supervisory board rests with the shareholders' general meeting. The consolidated financial statements are part of the annual report, which is subject to approval by the shareholders, and they serve as a basis for adopting the profit allocation resolution. Shareholders may decide not to approve the annual report, which has been prepared by the management board and approved by the supervisory board, and may demand that a new annual report be prepared.

Arco Vara AS (the "Parent") is a limited company incorporated and domiciled in Estonia. At the end of 2007, Arco Vara AS, its subsidiaries and jointly controlled entities (the "Group") employed 664 people (2006: 480 people). The principal activities of the Group are described in note 4 "Segment reporting". In addition to Estonia, the Group operates in Latvia, Lithuania, Ukraine, Bulgaria and Romania.

The structure of Arco Vara Group as at 31 December 2007 is presented in note 41.

2 Statement of compliance and basis of preparation

The consolidated financial statements of Arco Vara AS and its subsidiaries and interests in jointly controlled entities have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The consolidated financial statements have been presented and submitted for approval in conformity with the requirements of the Estonian Accounting Act and the Commercial Code.

The functional and presentation currency of Arco Vara AS is the Estonian kroon (kroon, EEK). In compliance with the rules of Tallinn Stock Exchange, the financial statements are also presented in euro (EUR). The Estonian kroon is pegged to the euro at the rate of 15.6466 kroons to 1 euro. Therefore, the presentation of the financial statements in euros does not give rise to any exchange differences. All financial information has been rounded to the nearest thousand, except where otherwise indicated.

The consolidated financial statements have been prepared on a historical cost basis, unless otherwise indicated in note 4 "Summary of significant accounting policies" (e.g. certain investments, derivative financial instruments, investment properties and biological assets have been measured at fair value).

Basis of consolidation

The consolidated financial statements comprise the financial statements of Arco Vara AS and its subsidiaries, combined line by line, and the Group's interests in jointly controlled entities (joint ventures), recognised using proportionate consolidation. The financial statements of all Group entities coincide with the calendar year and are prepared using, in all material respects, uniform accounting policies and measurement basis. The accounting policies of foreign Group entities have been adjusted, where necessary, to ensure consistency with the policies adopted by the Group.

A subsidiary is an entity that is controlled by the Parent. Control is the power to govern the financial and operating policies of an entity under a statute or an agreement or by some other means. Control is presumed to exist when the Parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity.

A joint venture is a contractual arrangement whereby two or more parties (including the Parent) undertake an economic activity that is subject to joint control. Joint control exists when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

The assets, liabilities, income, expenses and cash flows of subsidiaries and interests in joint ventures are consolidated from the date the control or joint control commences until the control or joint control ceases.

The Group's interest in a jointly controlled entity is recognised using proportionate consolidation — the Group's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is combined with similar items in the consolidated financial statements.

In preparing the consolidated financial statements, all receivables, liabilities, income, expenses, cash flows and unrealised gains and losses arising from transactions between the Parent and its subsidiaries are eliminated in full. The effect of transactions with jointly controlled entities is eliminated to the extent of the Group's share. Unrealised losses are eliminated only to the extent that there is no evidence of impairment.

A minority interest, i.e. the portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, is separately presented in the consolidated balance sheet (within equity) and the consolidated income statement.

Acquisitions of subsidiaries and interests in jointly controlled entities are accounted for by applying the purchase method. Under the purchase method, the acquiree's assets, liabilities and contingent liabilities ("net assets") are recognised at their fair values. The excess of the cost of the business combination over the Group's interest in the fair value of the acquiree's net assets is recognised as goodwill. If the Group's interest in the fair value of the acquiree's net assets exceeds the cost of the business combination, the Group reassesses the identification and measurement of the acquiree's assets, liabilities and contingent liabilities and recognises any excess remaining after that reassessment (negative goodwill) immediately as income in the income statement. For subsequent measurement of goodwill, see policy "Goodwill" in note 4.

Acquisitions of minority interests are accounted for by recognising the difference between the book value of the share of the net assets acquired and the cost of the interest acquired as (positive or negative) goodwill. The net assets acquired are not previously re-measured to fair value (acquisitions of minority interests are not accounted for by applying the purchase method described in IFRS 3 *Business Combinations*). In case that the Group acquires a group of assets or net assets that does constitute a business, it allocates the cost of the group assets between the individual identifiable assets and liabilities in the group based their relative fair values at the acquisition date.

When an interest in a subsidiary or a jointly controlled entity is disposed of, the difference between the sum of the consideration received and the carrying amount of the Group's share in the subsidiary's or jointly controlled entity's assets, liabilities and goodwill is recognised immediately in the income statement, either as a gain in "Finance income" or a loss in "Finance expenses". If control ceases (e.g. the Group's interest decreases below half of the voting power) but influence does not cease, the remaining interest in the carrying amounts of the subsidiary's assets, liabilities and goodwill is classified either as an investment in an associate, an interest in a jointly controlled entity, or an investment in other financial assets.

3 **Changes in accounting policies and presentation practice**

The accounting policies and presentation practice adopted are consistent with those of the previous financial year. In addition, the following new and revised standards and interpretations have been adopted which did not have any effect on the Group's results for 2007:

- IAS 1 *Amendment – Presentation of Financial statements*
- IFRS 7 *Financial Instruments: Disclosures*
- IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*¹
- IFRIC 8 *Scope of IFRS 2*
- IFRIC 9 *Reassessment of Embedded Derivatives*
- IFRIC 10 *Interim Financial Reporting and Impairment*

According to management's assessment, the new and revised standards and interpretations issued but not yet effective as at the balance sheet date have no material impact on the significant accounting policies applied by the Group. The Group will adopt the new requirements when they become mandatory. The new and revised standards and interpretations applicable to the Group become effective for annual periods beginning on or after 1 January 2009 (IFRS 8, IAS 1, IAS 23), 1 March 2007 (IFRIC 11 - IFRS 2), 1 January 2008 (IFRIC 12, IFRIC 14 - IAS 19) and 1 July 2008 (IFRIC 13):

- IAS 1 *Presentation of Financial Statements (revised)*
- IAS 23 *Borrowing Costs (revised)*
- IFRS 8 *Operating Segments*
- IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions*¹
- IFRIC 12 *Service Concession Agreements*¹
- IFRIC 13 *Customer Loyalty Programmes*¹
- IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interactions*¹

¹ The interpretation has no direct impact on the Group's operations.

The principal effects of these changes are as follows:

IAS 1 *Amendment – Presentation of Financial statements*

This amendment requires the Group to make new disclosures that enable users of the financial statements to evaluate the Group's objectives, policies and processes for managing capital.

IAS 23 *Borrowing Costs (revised)*

This revised standard requires the capitalization of interests on borrowings made to acquire, construct or produce a qualifying asset. The previous option of immediately recognizing such borrowing costs in income has been withdrawn. Since interest on borrowed capital directly attributable to qualifying assets was already capitalized in the past, the amendments will have no impact on the consolidated financial statements of the Group.

IFRS 7 *Financial Instruments: Disclosures*

This amendment requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial positions or results, comparative information has been revised where needed.

IFRS 8 *Operating Segments*

This standard requires disclosure of information about the Group's operating segments and replaced the requirements to determine primary (business) and secondary (geographical) reporting segments of the Group. The Group determined that the operating segments were the same as the business segments previously identified under IAS 14 Segment reporting. Group does not believe that the application of this standard will have a significant impact on the presentation of its segment reporting.

IFRIC 8 *Scope of IFRS 2*

This interpretation requires IFRS 2 to be applied to any arrangements in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. This interpretation had no impact on the financial position or performance of the Group.

IFRIC 9 *Reassessment of Embedded Derivatives*

IFRIC 9 states that the date to assess the existence of an embedded derivative is the date that an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. As the Group has no embedded derivative requiring separation from the host contract, the interpretation had no impact on the financial position or performance of the Group.

IFRIC 10 *Interim Financial Reporting and Impairment*

The Group adopted IFRIC interpretation 10 as of 1 January 2007, which requires that an entity must not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. As the Group had no impairment losses previously reversed, the interpretation had no impact on the financial position or performance of the Group.

4 Summary of significant accounting policies

Significant accounting judgements, estimates and assumptions

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses, and the disclosure of contingent assets and contingent liabilities.

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

In applying the Group's accounting policies, management has made the following judgements that have the most significant effect on the financial statements:

Classification of properties

Properties are classified as inventories, investment properties and items of property, plant and equipment (assets under construction) both on initial recognition and on any subsequent reclassification based on management's intentions regarding their further use. Realization of management's plans depends, among other factors, on resolutions adopted by other parties (e.g. changes in the intended purpose of land, approval of detailed plans, issuance of construction permits, etc). This lessens the accuracy of the classification.

Properties which are acquired for the development and subsequent sale of living environments, single residential buildings, or residential plots, and properties which are acquired for resale in the ordinary course of business are classified as inventories.

Properties which are held to earn operating lease rentals or for capital appreciation and properties which are held over an extended period for an undetermined future use are classified as investment property.

Properties which are being developed for future use as commercial or business environments that will be let under operating lease and commercial and business properties which are being extensively renovated are classified as investment properties only after the development or renovation is complete (the permit for use has been obtained). Until the development or renovation is complete, the properties are classified as items of property, plant and equipment (assets under construction).

Investment properties that are being redeveloped for continued use as investment properties are not temporarily transferred to property, plant and equipment (assets under construction).

Operating leases: the Group as a lessor

A critical analysis of the leases of several properties included in the Group's real estate portfolio indicates that the leases do not transfer substantially all the risks and rewards incidental to ownership to the lessee. Therefore, the leases are classified as operating leases.

Real estate funds managed by the Group: subsidiaries or other financial assets

A Group's jointly controlled entity owns more than half of the ordinary shares in Explorer Property Fund - Baltic States AB, a fund managed by the jointly controlled entity. According to management's assessment, the operating and management policies of the fund have been agreed in the shareholder agreement in such a manner which precludes the Group from controlling the financial and operating policies of the fund. Accordingly, Explorer Property Fund - Baltic States AB is treated as a special purpose entity and the investment is classified as a financial asset at fair value through profit or loss since this investment is monitored by the Group's management on its fair value basis which is also in line with the investment strategy of the Group.

Estimation uncertainty

The estimates made by management are based on historical experience and the information available at the date the financial statements are authorised for issue. There is a risk that the estimates applied at the balance sheet date in respect of assets and liabilities and associated income and expenses need to be revised in the future. The key sources of estimation uncertainty that have a significant risk of causing material adjustments to the consolidated financial statements are discussed below.

Impairment of goodwill

The Group assesses whether goodwill arisen on the acquisition of subsidiaries and interests in jointly controlled entities may be impaired (i.e. whether the carrying amount of the goodwill exceeds its recoverable amount) at least annually. This assumes estimating the fair value (less costs to sell) or value in use of the cash-generating unit to which the goodwill has been allocated. Value in use is determined by estimating the future net cash flows to be derived from the cash-generating unit and by applying an appropriate discount rate to calculate the present value of those cash flows. At 31 December 2007, the carrying amount of goodwill was 23,957 thousand kroons (2006: 15,558 thousand kroons). Further information on the principles and results of impairment testing is provided in notes 4 and 25.

Fair value of investment property

At each reporting date, investment properties are measured at their fair values. In 2007, the fair values of investment properties were determined based on the valuations performed by qualified independent appraisers. Fair value is determined by reference to two basic techniques - the discounted cash flow method and the sales comparison method. In order to estimate a property's discounted cash flows, an appraiser has to forecast the property's future rental income (including rental per 1 m² and the occupancy rate) and operating expenses. In addition, to determine the present value of the future net cash flow, the appraiser has to apply a discount rate, which best reflects the time value of money and the risks specific to the asset. At 31 December 2007, the carrying amount of investment properties whose fair value was determined using the discounted cash flow method was 468,377 thousand kroons (2006: 382,262 thousand kroons). Further information on measuring the fair value of investment property is provided in note 23.

At 31 December 2007, the sensitivity of the carrying amounts of investment properties measured using the discounted cash flow method to the key valuation assumptions applied was as follows (on average):

- a 1 percentage point increase in the discount rate would have caused a 28,828 thousand kroon (1,842 thousand euro) decrease in the fair value of investment property (31 December 2006: a 40,259 thousand kroon (2,573 thousand euro) decrease)
- a 1 percentage point decrease in the discount rate would have caused a 31,560 thousand kroon (2,017 thousand euro) increase in the fair value of investment property (31 December 2006: a 51,352 thousand kroon (3,293 thousand euro) increase)
- a 5% decrease in the forecasted net operating cash flows would have caused a 21,983 thousand kroon (1,405 thousand euro) decrease in the fair value of investment property (31 December 2006: a 19,120 thousand kroon (1,222 thousand euro) decrease)
- a 5% increase in the forecasted net operating cash flows would have caused a 21,983 thousand kroon (1,405 thousand euro) increase in the fair value of investment property (31 December 2006: a 19,120 thousand kroon (1,222 thousand euro) increase)

Segment reporting

Segment reporting is based on the grouping of structural units for the Group's internal accounting and reporting purposes (management accounting and budgeting). The Group's primary reporting format is business segments. A business segment is a distinguishable component of the Group that is engaged in providing products or services that are different from those of other business segments, and which operates as an independent profit centre.

The Group's business segments comprise:

- Development. The development of residential and commercial environments and long-term investment in real estate.
- Service. Real estate brokerage, valuation and management, management of real estate funds and short-term investment in real estate.
- Construction. General and sub-contracting in the field of general construction and environmental engineering, and construction supervision.

Segment revenue is revenue that is directly attributable to a segment and the relevant portion of the Group's revenue that can be allocated to the segment on a reasonable basis, whether from sales to external customers or from transactions with other segments of the Group. Revenue arising from transactions with companies belonging to the same segment is eliminated.

Segment expense is expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of the Group's expense that can be allocated to the segment on a reasonable basis, including expenses relating to sales to external customers and expenses relating to transactions with other segments of the Group. Segment expense does not include finance expenses, the Group's general administrative expenses and other expenses that arise at the Group level. The costs incurred at the Group level are allocated to a segment only if they relate to the segment's operating activities and they can be directly attributed to the segment on a reasonable basis. Expenses arising from transactions with companies belonging to the same segment are eliminated.

Segment result is segment revenue less segment expenses.

Unrealised gains and losses arising from transactions between the Group's segments are not allocated to any segment but are presented in inter-segment eliminations. Unrealised gains and losses arising from transactions between the Parent and a segment which can be allocated to the segment on a reasonable basis are included in the segment result. Such gains and losses may include previously capitalised interest expense which upon the reclassification of assets accounted for under the cost model to assets accounted for under the fair value model is recognised as a fair value adjustment in the period in which the assets are reclassified.

Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on reasonable basis. Segment assets include, for example, current assets, investment properties, property, plant and equipment and intangible assets used in a segment's operating activities. If an asset's depreciation or amortisation expense is included in segment expenses, the asset is included in segment assets. Segment assets do not include assets used for the Group's general needs or which cannot be directly allocated to the segment. Assets shared by two or more segments are allocated to those segments if a reasonable basis for allocation exists.

Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities include, for example, trade and other payables, accrued expenses, advances received from customers, warranty provisions and other liabilities related to the segment's products and services. Segment liabilities do not include loans, finance leases, debt securities and other liabilities related to financing activities. Income tax liabilities are not included in segment liabilities either.

Unallocated items comprise revenue and expenses and assets and liabilities which are not directly related to any segment and therefore cannot be allocated to any segment.

The Group's secondary reporting format is geographical segments. At 31 December 2007, geographical segments comprised Estonia, Latvia, Lithuania, Ukraine, Bulgaria and Romania. Romania has been a separate segment since 2007.

Foreign currency

All currencies other than the Estonian kroon (the functional currency of the Parent) are treated as foreign currencies. Transactions in foreign currencies are initially recorded at the foreign exchange rates of the Bank of Estonia ruling at the date of the transaction. Monetary assets (cash, cash equivalents and receivables) and monetary liabilities (loans and borrowings, payables and other liabilities) denominated in foreign currencies at the reporting date are retranslated to Estonian kroons at the Bank of Estonia exchange rates ruling at the balance sheet date. Foreign exchange gains and losses are recognised in the income statement in finance income and finance expenses respectively in the period in which they arise. Non-monetary items denominated in foreign currencies that are measured in terms of historical cost are translated using the Bank of Estonia exchange rates ruling at the dates of the initial transactions. Non-monetary items denominated in foreign currencies that are measured at fair value are translated using the Bank of Estonia exchange rates ruling at the date when the fair value was determined.

When the functional currency of a subsidiary or a jointly controlled entity differs from the Parent's functional currency (e.g. the functional currency of the Latvian entities is the Latvian lats, the functional currency of the Lithuanian subsidiary is the Lithuanian litas and the functional currency of the Ukrainian entities is the US dollar), the financial statements of the subsidiary or jointly controlled entity are translated for consolidation purposes using following exchange rates:

- the assets and liabilities of foreign subsidiaries and jointly controlled entities (including goodwill and fair value adjustments arising on acquisition) are translated at the exchange rates ruling at the balance sheet date
- the income and expenses, other changes in equity, and cash flows of foreign subsidiaries and jointly controlled entities are translated at the weighted average exchange rates for the period.

The exchange differences arising on translation, i.e. the differences between the rates ruling at the balance sheet date and the weighted average exchange rates are taken directly to equity and reported in "Other reserves". On the divestment of a foreign entity, the relevant amounts in "Other reserves" are transferred to profit or loss.

Revenue

Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be measured reliably.

Revenue from the sale of properties (real estate)

Sales of properties are recognised when all significant risks and rewards related to the properties have been transferred to the buyer and the Group has no obligation to perform significant additional work. In general, a sale is deemed to have occurred when the real right contract has been signed. Payments made by customers before the signature of the real right contract are recognised as deferred income.

Revenue from long-term service contracts

The revenue and expenses arising from long-term service contracts (including construction contracts) are recognised by reference to the stage of completion method. The stage of completion of a service is determined as the proportion that the costs incurred until the balance sheet date bear to the estimated total costs of the transaction. If the amount of progress billings as at the balance sheet date differs from the revenue determined by reference to the stage of completion method, the difference is recognised as a payable or a receivable.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Revenue from other services

Revenue from the rendering of other services arises on the rendering of the service. Revenue from brokerage services is recognised when the transaction has been completed. Rental income from investment properties is recognised on a straight-line basis over the lease term. Revenue and expenses from intermediation of utilities services (electricity, heat, water, etc. charges) are offset against the costs of purchasing those services.

Revenue from the sale of other goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer and the amount of revenue can be measured reliably.

Finance income

Interest income is recognised on an accrual basis using the effective interest rate method. Dividend income is recognised when the Group's right to receive payment is established.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, current accounts, demand deposits and short-term highly liquid investments which are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value, such as term deposits with a maturity of up to three months and shares in money market funds.

Financial assets

When a financial asset is recognised initially, it is measured at cost, which is the fair value of the consideration given for it plus any costs that are directly attributable to the acquisition of the asset, including fees and commissions paid to agents, advisers, brokers and dealers, as well as any non-recoverable levies, taxes and duties. Exceptions include transaction costs directly attributable to the acquisition of a financial asset at fair value through profit or loss which are recognised as an expense when incurred.

A regular way purchase or sale of financial assets is recognised using trade date accounting. The trade date is the date on which the Group commits itself to purchase or sell a financial asset (e.g. the date on which the agreement is signed). A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established by regulation or convention in the marketplace concerned.

Subsequent to initial recognition, financial assets are classified into different categories (see below) and the designation is re-evaluated at each financial year end. Financial assets whose reclassification is not permitted by IFRS are not reclassified. After initial recognition, financial assets are measured as follows:

- 1) financial assets at fair value through profit or loss – at their fair values;
- 2) held-to-maturity investments – at their amortised cost;
- 3) loans and receivables – at their amortised cost; and
- 4) available-for-sale financial assets – at their fair values or, in the case of equity instruments whose fair value cannot be measured reliably, at cost.

Financial assets measured at fair value

Financial assets that are measured at fair value are re-measured to fair value at each balance sheet date without any deduction for transaction costs that may be incurred on the sale or disposal of the asset. The fair values of listed securities are based on the closing prices of the securities and the official exchange rates of the Bank of Estonia ruling at the balance sheet date. The fair values of unlisted securities are determined based on all available information and by reference to comparison with the fair values of other instruments which are substantially the same and/or the discounted cash flow analysis.

A gain or loss arising from a change in the fair value of a financial asset is recognised in profit or loss (in "Finance income" and "Finance expenses" respectively), except for a gain or loss arising from a change in the fair value of an available-for-sale financial asset which is recognised directly in the revaluation reserve in equity. When an available-for-sale financial asset is derecognised or determined to be impaired, the cumulative gain or loss previously recognised in the revaluation reserve is removed from equity and recognised in profit or loss. In the case of impaired items, the amount of the cumulative loss that is removed from equity and recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

A gain and loss arising on the disposal of financial assets measured at fair value as well as the interest and dividends on these assets are recognised in the income statement (in "Finance income" and "Finance expenses").

Loans and receivables and held-to-maturity investments

Loans and receivables, except those that the Group intends to sell in the near term, and held-to-maturity investments are measured at amortised cost using the effective interest method. The amortised cost is calculated taking into account any discount or premium on acquisition and any directly attributable transaction costs.

If there is objective evidence that an impairment loss on a financial asset carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised in the income statement. Impairment losses on financial assets related to operating activities are charged to administrative expenses and impairment losses on financial assets related to investing activities are charged to finance expenses.

Financial assets that are individually significant are assessed for impairment individually. Receivables overdue for 180 days or more are considered impaired and are expensed in full. If impairment becomes evident sooner, the asset is written down earlier.

If a receivable which has been written down is collected or any other event occurs which reverses an impairment loss which has been recognised, the reversal is recognised by reducing the expense item in which the impairment loss was initially recognised.

Interest income on loans and receivables and held-to-maturity investments is recognised in the income statement in "Finance income".

Financial assets measured at cost

A financial asset measured at cost is written down to its recoverable amount when the latter decreases below the asset's carrying amount. The recoverable amount of a financial asset measured at cost is the present value of its estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are recognised in "Finance expenses" and are not reversed.

A financial asset is derecognised when the Group's contractual rights to the cash flows from the financial asset expire or when the Group assumes the obligation to remit the cash flows from the financial asset without material delay to a third party to whom most of the risks and rewards associated with the financial asset are transferred.

Derivative financial instruments

The Group uses derivative financial instruments such as interest rate swaps to hedge the interest rate risk. Such derivative instruments are initially recognised at fair value at the date the contract is signed. Subsequent to initial recognition, the instrument is restated to fair value at each balance sheet date. Derivatives with a positive fair value are carried as assets and derivatives with a negative fair value are carried as liabilities. The fair value of the Group's existing interest rate swaps is determined by reference to the discounted cash flow method based on Reuters' estimates of 6-month EURIBOR.

Gains and losses arising from changes in the fair value of derivative financial instruments are recognised in "Finance income" and "Finance expenses" respectively except for the gains and losses on derivative instruments that qualify for hedge accounting. In the reporting and prior periods, the Group had no instruments that qualified for hedge accounting.

Inventories

Finished goods and work in progress are initially recognised at their cost of conversion. The cost of conversion includes all direct and indirect production costs incurred in bringing the inventories to their present location and condition. Production overheads are allocated to the costs of conversion based on the normal capacity of the production facilities. Other inventories are initially recognised at cost. The cost of inventories includes all direct and indirect costs incurred in bringing the inventories to their present location and condition. The cost of properties carried as inventories includes, among other items, the borrowing costs (interest charges, amortisation of contract fees, etc) incurred in financing the construction of the properties. Borrowing costs are capitalised until the construction of the underlying asset is complete. Borrowing costs related to registered immovable properties and apartments treated as movable properties are added to the carrying amounts of the assets until a permit of use has been issued.

The cost of inventories is assigned using the weighted average cost formula except that the cost of registered immovable properties and apartments treated as movable properties is assigned by specific identification of their individual costs.

In the balance sheet, inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Inventory write-downs to net realisable value are recognised in the "Cost of sales" in the income statement.

Investment property

Investment property is property (land or a building or both) held to earn rentals or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes. In addition, investment property includes properties which are held over an extended period for an undetermined future use. Land and buildings acquired for development and resale are carried as inventories. Properties being constructed or developed for future use as investment properties (commercial buildings) and buildings treated as movable properties (commercial buildings under renovation) are carried as items of property, plant and equipment until their construction or development is complete.

An investment property is measured initially at its cost. Transaction costs are included in the initial measurement. Transaction costs that are directly attributable to acquisition include notary's fees, stamp duties, advisors' fees and other transaction costs. After initial recognition, investment properties are measured using the fair value model. The fair value of investment property reflects market conditions at the balance sheet date.

The fair value of investment property is determined based on the valuations performed by qualified independent appraisers. The following valuation methods are applied:

- Discounted cash flow analysis. In order to calculate the present value of a property's future cash flows, the appraiser has to forecast the property's future rental income (including rental per 1 m² and the occupancy rate) and operating expenses. Depending on the terms of the lease (whether and how easily the lease can be terminated by the lessee), the appraiser will base the projections on either the property's existing cash flows or the market's current average cash flows for similar properties. The present value of the future net cash flow should be found by applying a discount rate which best reflects the current market assessments of the time value of money and the risks specific to the asset. The discount rate should be selected based on the market's average capital structure, not asset structure. The discounted cash flow method is used to determine the value of properties that generate stable rental income.

- Sales comparison method. Under this method, the market value of a property is determined by reference to the price per square metre agreed in transactions performed with similar properties. This method is used to determine the value of properties which do not generate rental income but are held for development or capital appreciation. As the transactions selected for comparison are practically never identical with the property being valued, their prices are adjusted to reflect differences in time, location, size and detailed plan.
- Sales contract under the law of obligations. In the case of properties which at the balance sheet date have been sold based on a contract under the law of obligations but in respect of which the real right contract has not been signed, fair value is determined by reference to the sales price of the property in the contract under the law of obligations. The sales price agreed in the contract under the law of obligations is used for determining the fair value of a property only when the Group has reasonable assurance that the related real right contract will be concluded under the same terms and conditions (e.g. the buyer has made a substantial prepayment for the property by the balance sheet date or the real right contract is concluded after the balance sheet date but before the date management approves the financial statements for issue).

Gains and losses arising from changes in the fair value of investment property are recognised in the income statement in the period in which they arise (in "Other income" and "Other expenses" respectively).

An investment property is derecognised on disposal or when the property is permanently withdrawn from use and no future economic benefits are expected from its disposal. Gains and losses arising from the retirement or disposal of investment property are recognised in the income statement in the period of the retirement or disposal (in "Other income" or "Other expenses" respectively).

Transfers to and from investment property are made when there is a change in use (IAS 40.57). From the date of transfer, an asset is accounted for using the policies applied to the group of assets to which it has been transferred. For a transfer from investment property to inventories or property, plant and equipment, the property's deemed cost for subsequent accounting is its fair value at the date of transfer.

When an item of property, plant and equipment is transferred to investment property, any positive difference between the fair value and carrying amount of the property at the date of transfer is recognised in the revaluation reserve in equity. Any negative difference is recognised in the income statement in depreciation expense. Exceptions include assets under construction. When they are transferred to investment property, any difference (positive or negative) between fair value and carrying amount is recognised in the income statement in "Other income" or "Other expense" as appropriate. When a property is transferred from inventories to investment property, any difference between fair value and carrying amount is recognised in the income statement in "Other income" or "Other expense" as appropriate.

Biological assets

A living animal or plant is recognised as a biological asset when it is held to obtain economic benefits and its fair value or cost can be measured reliably. A biological asset is measured on initial recognition and at each balance sheet date at its fair value less estimated point-of-sale costs. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. If an active market exists for a biological asset, the quoted price in that market is used as a basis for determining the fair value of that asset. If an active market does not exist, the fair value of an asset is determined using the discounted cash flow method.

On measuring the quantity of plant production, the Group uses 15 sample areas of 77 cm x 77 cm (2 times 2 planting boxes) or 0.593 m² per each 100 m². All living plants on those areas are counted and the average of the sample areas calculated. Based on this information, the number of plants per 1 m² is identified and multiplied with the area of all planting boxes.

Biological assets are classified into consumable and bearer biological assets. All biological assets in the consolidated balance sheet are consumable biological assets which have been classified into mature and immature biological assets (see note 21). For the determination of fair value, biological assets are grouped according to significant attributes (age, species, and degree of maturity). For each group, a period of sale, sales revenue (based on the market prices prevailing during the season) and sales costs are estimated. Fair value is determined using the discounted cash flow method.

A gain or loss arising from a change in the fair value of a biological asset is recognised in the income statement in operating profit in the period in which it arises.

Property, plant and equipment

Assets are recognised as items of property, plant and equipment when their cost exceeds 20,000 kroons and useful life extends beyond one year. Assets with a lower cost but an estimated useful life that extends beyond one year are accounted for as items of small value and carried in inventories. Assets of small value are expensed as of implementation. Expensed items of small value are accounted for off the balance sheet.

An item of property, plant and equipment is initially recognised at cost. The cost of an item of property, plant and equipment comprises its purchase price and any costs directly attributable to its acquisition. The cost of properties which are carried as items of property, plant and equipment includes borrowing costs (interest charges, amortisation of contract fees, etc) incurred in financing the construction of the properties. Capitalisation of borrowing costs commences at the date the construction of the asset begins and ceases when the asset is complete.

After recognition, an item of property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses.

If an item of property, plant and equipment consists of significant parts that have different useful lives, the parts are accounted for separately and assigned depreciation rates that correspond to their useful lives.

Subsequent expenditure on an item of property, plant and equipment (e.g. the costs of replacing a part of an item) is added to the carrying amount of the item, provided that it meets the following criteria: (a) it is probable that future economic benefits associated with the item will flow to the Group; and (b) the cost of the item can be measured reliably. The carrying amounts of the parts that are replaced are derecognised. All other subsequent expenditures related to property, plant and equipment are recognised as an expense in the period in which they are incurred.

Items of property, plant and equipment are depreciated on a straight-line basis. Each part of an item of property, plant and equipment is assigned a depreciation rate that corresponds to its useful life. The following annual depreciation rates are applied:

• Buildings and structures	2–18%
• Plant and equipment	8–20%
• Vehicles	15–25%
• Other equipment and fixtures	20–40%

Items of property, plant and equipment are depreciated until their residual value exceeds their carrying amount. The residual value is the estimated amount that the Group would currently obtain from the disposal of the asset if the asset were already of the age and in the condition expected at the end of its useful life.

Depreciation methods, depreciation rates and residual values are reviewed at each reporting date. When measurement bases are revised, the revisions are applied prospectively.

The carrying amounts of items of property, plant and equipment are reviewed for impairment when there is evidence that the carrying amount of an asset may exceed its recoverable amount. Impairment testing is described in more detail below (see the policy "Impairment of assets").

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of property, plant and equipment is recognised in the income statement in "Other income" or "Other expenses", as appropriate, in the period in which the item is derecognised.

Items of property, plant and equipment whose sale within the next 12 months is highly probable, are reclassified to non-current assets held for sale. Non-current assets held for sale are presented separately from other assets in the balance sheet and their depreciation is discontinued. A non-current asset held for sale is measured at the lower of its carrying amount and fair value less costs to sell.

Goodwill

Goodwill acquired in a business combination is initially measured at cost. Goodwill is the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities (net assets) recognised at the date of acquisition.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash-generating units or groups of cash-generating units that are expected to benefit from the synergies of the combination. Each cash-generating unit or group of units to which goodwill is allocated is not larger than a segment in the Group's primary reporting format.

Goodwill is assessed for impairment at least annually, at the end of the financial year, or more frequently if events or changes in estimates indicate that the carrying amount of goodwill may be impaired. Impairment is determined by measuring the recoverable amount of the cash-generating unit to which the goodwill has been allocated. An impairment loss is recognised when the recoverable amount of the cash-generating unit to which goodwill has been allocated is less than the carrying amount of the unit. Impairment losses on goodwill are recognised in "Administrative expenses" in the income statement.

Other intangible assets

Other acquired intangible assets are initially measured at cost. Following initial recognition, intangible assets are measured at cost less any accumulated amortisation and any accumulated impairment losses.

Intangible assets are divided into assets with finite and indefinite useful lives. Intangible assets with finite useful lives are amortised on a straight-line basis over their estimated useful lives (generally three to six years). Amortisation expense is recognised in the income statement in the expense category consistent with the function of the underlying asset. The amortisation periods and amortisation methods of intangible assets with finite useful life are reviewed at each financial year end. Changes in the expected useful life of an asset and the pattern in which the asset's future economic benefits are expected to be consumed are accounted for as changes in accounting estimates and are applied prospectively.

Intangible assets with indefinite useful lives are not amortised. The useful life of an intangible asset with an indefinite useful life is reviewed annually to determine whether events and circumstances continue to support the indefinite life assessment for that asset. If not, the change is accounted for as a change in an accounting estimate on a prospective basis and the asset is subjected to amortisation.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the level of the cash-generating unit. The carrying values of intangible assets with finite useful lives are reviewed for impairment when there is evidence that the carrying value may not be recoverable. If an impairment test indicates that the recoverable amount of an intangible asset is lower than its carrying amount, the asset is written down to its recoverable amount. Impairment losses are recognised in the income statement similarly to amortisation expenses, i.e. they are grouped according to the use of the underlying assets. Impairment testing is described in greater detail in the section "Impairment of assets".

Impairment of assets

The Group assesses at each reporting date whether there is any indication that an asset may be impaired. If such an indication exists or at least once a year (if so required by IFRS), the Group measures the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down, either individually or as part of a cash-generating unit, to its recoverable amount. An asset's recoverable amount is the higher of the present value of its estimated future cash flows (value in use) and its fair value less costs to sell. In measuring value in use, the estimated cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where necessary, the assistance of independent experts is used. Impairment losses, including impairment losses for cash-generating units are recognised in the income statement in depreciation and amortisation expense in the period in which they are incurred.

If there is evidence that an impairment loss recognised in prior years no longer exists or has decreased, the impairment loss is reversed. Impairment losses and prevailing circumstances are reviewed at least annually at each reporting date. The increased carrying amount of an asset attributable to a reversal of an impairment loss may not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised. As an exception, an impairment loss recognised for goodwill is not reversed in a subsequent period.

Minority shareholders' put options

Based on two shareholder agreements, in the first half of 2007 four minority shareholders of Group entities had put options which granted them the right to sell and obligated the Group to purchase the shares held by the minority shareholders. In the case of one shareholder agreement, the option exercise price was the market value of the shares. In the case of the other shareholder agreement, the option exercise price was a proportionate share of the book value of the company's equity.

In compliance with IAS 32 paragraph 23, the Group recognised financial liabilities for the present values of the redemption amounts of the options. The liabilities are measured based on the market value (i.e. adjusted equity) or book value of the entities in which the minority shareholders have an interest at the balance sheet date, as appropriate. Upon initial recognition, the minority shareholders' interests in the adjusted or book equity are recorded as current liabilities and adjustments to retained earnings. Subsequent gains and losses arising from changes in the carrying amounts of the financial liabilities are recognised in the income statement in "Finance income" and "Finance expenses" respectively.

In the third quarter of 2007, the put options whose exercise price was a proportionate share of the book value of the company's equity were cancelled. The option provided by the second shareholder agreement was effective at 31 December 2007.

Financial liabilities

All financial liabilities (trade and other payables, loans and borrowings, accrued expenses, bonds, and other short and long-term liabilities) are initially recognised at cost. The cost of a financial liability includes all transaction costs that are directly attributable to its acquisition. After initial recognition, financial liabilities are measured at amortised cost (except for financial liabilities held for trading which are measured at their fair value).

As a rule, the amortised cost of a short-term financial liability equals its nominal value. Therefore, short-term financial liabilities are stated in the balance sheet at the amount payable. Long-term financial liabilities are initially recognised at the fair value of the consideration received (less the transaction charges). Thereafter, they are measured at amortised cost using the effective interest rate method. Interest expenses on financial liabilities are recognised in "Finance expenses" in the income statement on an accrual basis except that interest expenses on financing the development of assets (properties carried as inventories, investment properties, and items of property, plant and equipment) are capitalised and added to the carrying amount of the asset from the date the development of the asset commences to the date the development is complete.

A financial liability is classified as current when it is due to be settled within 12 months after the balance sheet date or the Group does not have an unconditional right to defer settlement of the liability for more than 12 months after the balance sheet date. Financial liabilities which are due to be settled within 12 months after the balance sheet date are classified as current even if an agreement to refinance on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue. When a contract is breached on or before the balance sheet date with the effect that the liability becomes payable on demand, the liability is classified as current.

Financial liabilities are derecognised when the obligation under the liability is discharged, cancelled or expired.

Government grants

Government grants related to income are recognised as income over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. A government grant that becomes receivable as compensation for expenses or losses already incurred with no future related costs is recognised as income of the period in which it becomes receivable. Government grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attaching to them and the grants will be received. Potential obligations related to government grants are recognised as provisions or disclosed as contingent liabilities.

An asset acquired with a government grant is recognised at cost less the amount of the grant received (the net method). An asset acquired with a government grant is depreciated over the useful life of the asset.

Provisions and contingent liabilities

A provision is recognised only when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Promises, guarantees and other commitments that may transform into obligations under certain circumstances (which have not yet occurred) are disclosed as contingent liabilities in the notes to the financial statements.

Present obligations arising from past events which according to management's judgement will not realise or cannot be measured reliably are also disclosed as contingent liabilities.

Leases

A lease that transfers substantially all the risks and rewards incidental to ownership of the leased asset to the lessee is classified as a finance lease. All other leases are classified as operating leases.

Finance leases related to assets acquired are recognised as assets and liabilities at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Assets acquired with finance lease are depreciated over the shorter of the lease term and the useful life of the asset. Assets leased out under a finance lease are recognised in the balance sheet and presented as a receivable at an amount equal to the net investment in the lease. Lease payments made are apportioned between finance expense and the reduction of the outstanding liability and lease payments received are apportioned between finance income and repayment of the principal. A constant periodic rate of interest is applied throughout the lease term.

Assets subject to operating leases are recognised in the lessor's balance sheet. Operating lease receipts and payments are recognised as income and expense respectively on a straight-line basis over the lease term.

Statutory capital reserve

According to the Commercial Code, the statutory capital reserve has to amount to at least 10% of the Parent's share capital and the Parent has to transfer at least 5% of its net profit for the financial year to the capital reserve until the required level has been achieved. The capital reserve may not be distributed as dividends but it may be used for covering accumulated losses if the latter cannot be covered with unrestricted equity, and for increasing share capital through a bonus issue.

Income tax

Income tax assets and liabilities and income tax expense and income comprise current and deferred items. Current tax is recognised as a short-term asset or liability and deferred tax is recognised as a long-term asset or liability.

Parent company and subsidiaries and jointly controlled entities registered in Estonia

Pursuant to the Estonian Income Tax Act, companies do not have to pay income tax on their earnings (profit for the financial year). Instead, income tax is levied on profit distributions (dividends). Until 31 December 2007, the tax rate was 22/78 and from 1 January 2008 the tax rate is 21/79 of the amount distributed as the net dividend. The Income Tax Act provides that the tax rate will decrease at the rate of 1 percentage point per year to 20/80, which will be effective for dividends distributed after 1 January 2009. The income tax payable on a dividend distribution is recognised as the income tax expense of the period in which the dividends are declared (the payment obligation arises).

Because of the specific nature of the taxation system, deferred income tax liabilities and assets do not arise. The income tax liability which would arise on the distribution of retained earnings as dividends is not recognised in the balance sheet. Instead, the income tax liability which would arise if all of the unrestricted equity were distributed as dividends is disclosed in the notes to the consolidated financial statements (note 33).

Latvian, Lithuanian, Ukrainian, Bulgarian and Romanian subsidiaries and jointly controlled entities

In Latvia, Lithuania, Ukraine, Bulgaria and Romania the profit earned by companies is subject to income tax. The tax rate is 15% in Latvia and Lithuania, 25% in Ukraine, 10% in Bulgaria (until 31 December 2006: 15%) and 16% in Romania. Taxable income is identified by adjusting profit before tax for the temporary and permanent differences permitted by the local tax laws.

In the case of foreign subsidiaries, deferred income tax assets and deferred income tax liabilities are recognised for all temporary differences between the carrying amounts and tax bases of assets and liabilities. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Investments in subsidiaries and jointly controlled entities in the Parent's unconsolidated financial statements presented in accordance with the Estonian Accounting Act

The Parent's unconsolidated primary financial statements (note 42) represent supplementary information which is presented in accordance with the Estonian Accounting Act and they do not constitute separate financial statements as defined in IAS 27.

In the Parent's unconsolidated primary financial statements, investments in subsidiaries and jointly controlled entities are measured using the cost model. This means that the investment is initially recognised at cost, which is considered equal to the fair value of the consideration given for it, and thereafter measured at cost less any impairment losses.

Investments are tested for impairment at each financial year end or whenever there is any indication that an investment may be impaired (see policy "Impairment of assets"). Impairment losses are recognised in "Finance expenses" in the income statement.

Dividends received and receivable from subsidiaries and jointly controlled entities are recognised in "Finance income" when the right to receive payment has been established. The dividends distributed from the retained earnings accumulated by a subsidiary or jointly controlled entity before the date of acquisition are not recognised as income. Instead, such dividends are recognised as a reduction of the investment.

5 Segment reporting by business segments

The Group's business segments comprise:

Service - real estate brokerage, valuation and management, management of real estate funds and short-term investment in real estate

Development - development of residential and commercial environments and long-term investment in real estate

Construction - general and sub-contracting in the field of general construction and environmental engineering, and construction supervision

Inter-segment transactions are performed on an arm's length basis and priced similarly to external transactions. A major portion of inter-segment transactions is performed by the Construction segment and the Service segment who supply the Development segment with construction and brokerage services. On the supply of construction services, the Construction segment adds a 2.5-7.2% profit margin in Estonia and a 12% profit margin in Latvia. The price of brokerage services is 1-3% of the cost of the brokered property in all markets.

Revenue and other income	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Service	139,621	119,437	8,924	7,633
External revenue	115,184	107,264	7,362	6,855
Other external income	8,588	702	549	45
Inter-segment revenue and other income	15,849	11,471	1,013	733
Development	566,260	626,614	36,191	40,048
External revenue	418,372	199,655	26,739	12,760
Other external income	133,746	421,764	8,548	26,956
Inter-segment revenue and other income	14,142	5,195	904	332
Construction	425,484	359,345	27,193	22,967
External revenue	193,631	176,667	12,375	11,291
Other external income	44	462	3	30
Inter-segment revenue and other income	231,809	182,216	14,815	11,646
Eliminations	-264,087	-198,882	-16,879	-12,711
Total revenue and other income	867,278	906,514	55,429	57,937

	EEK		EUR	
	2007	2006	2007	2006
Operating profit				
In thousands				
Service	-16,540	8,624	-1,057	551
Including depreciation, amortisation and impairment losses	-1,575	-966	-101	-62
Including change in fair value of investment property	7,000	170	447	11
Development	161,988	278,185	10,353	17,779
Including depreciation, amortisation and impairment losses	-948	-536	-61	-34
Including recognition of negative goodwill as income and impairment losses on goodwill	283	1,868	18	119
Including impairment losses on property, plant and equipment	18,778	-72,805	1,200	-4,653
Including change in fair value of investment property and biological assets	52,874	375,742	3,379	24,014
Construction	16,926	959	1,082	61
Including depreciation, amortisation and impairment losses	-1,789	-1,031	-114	-66
Including recognition of negative goodwill as income and impairment losses on goodwill	0	281	0	18
Including impairment losses on property, plant and equipment	0	-18	0	-1
Eliminations	-16,455	1,408	-1,052	90
Unallocated expenses	-42,861	-28,825	-2,739	-1,842
Including depreciation and amortisation	-821	-537	-52	-34
Total operating profit	103,058	260,351	6,587	16,639
Including depreciation, amortisation and impairment losses (notes 8, 10)	-5,133	-3,070	-328	-196
Including recognition of negative goodwill as income and impairment losses on goodwill (note 10)	283	2,149	18	137
Including impairment losses on property, plant and equipment (note 11)	18,778	-72,823	1,200	-4,654
Including change in fair value of investment property and biological assets (note 11)	59,874	375,912	3,826	24,025

	EEK		EUR	
	2007	2006	2007	2006
Assets				
As at 31 December				
In thousands				
Service	63,600	31,900	4,065	2,039
Development	2,395,424	2,054,015	153,095	131,275
Construction	126,767	92,240	8,102	5,895
Eliminations	-83,558	-20,665	-5,340	-1,321
Unallocated assets	1,061,808	99,881	67,862	6,384
Total assets	3,564,041	2,257,371	227,784	144,272

The Group's capital expenditures (investments in investment property, property, plant and equipment and intangible assets) break down as follows:

Capital expenditures	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Service	14,220	9,449	909	604
Development	59,233	333,718	3,786	21,327
Construction	7,546	5,349	482	342
Unallocated expenditures	491	3,488	31	223
Total capital expenditures	81,490	352,004	5,208	22,496

Liabilities As at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Service	25,260	22,610	1,614	1,445
Development	122,195	264,591	7,810	16,910
Construction	102,153	47,635	6,529	3,044
Eliminations	-63,555	-20,665	-4,062	-1,321
Unallocated liabilities	1,448,416	1,201,319	92,570	76,780
Total liabilities	1,634,469	1,515,490	104,461	96,858

6 Segment reporting by geographical segments

Revenue by customer's location and business segments	Service		Development		Construction		Eliminations		Total	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
In thousands EEK										
Estonia	74,218	80,216	317,422	194,246	364,422	357,883	-187,651	-193,530	568,411	438,815
Latvia	31,097	27,148	73,443	9,964	102,437	0	-67,522	-3,904	139,455	33,208
Lithuania	6,374	5,958	200	0	0	0	-49	0	6,525	5,958
Ukraine	8,182	5,605	0	0	0	0	0	-294	8,182	5,605
Bulgaria	9,160	266	26	0	0	0	-6,636	0	2,550	0
Romania	2,332	0	0	0	0	0	0	0	2,332	0
Eliminations	-267	-458	0	0	0	0	0	0	-267	0
Total revenue	131,096	118,735	391,091	204,210	466,859	357,883	-261,858	-197,728	727,188	483,586

Revenue by customer's location and business segments	Service		Development		Construction		Eliminations		Total	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
In thousands EUR										
Estonia	4,743	5,127	20,287	12,415	23,291	22,873	-11,993	-12,369	36,328	28,045
Latvia	1,987	1,735	4,694	637	6,547	0	-4,315	-250	8,913	2,122
Lithuania	407	381	13	0	0	0	-3	0	417	381
Ukraine	523	358	0	0	0	0	0	-19	523	358
Bulgaria	585	17	2	0	0	0	-424	0	163	0
Romania	149	0	0	0	0	0	0	0	149	0
Eliminations	-17	-29	0	0	0	0	0	0	-17	0
Total revenue	8,377	7,589	24,996	13,052	29,838	22,873	-16,735	-12,638	46,476	30,906

Assets by geographical location AS at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Estonia	1,771,908	1,985,251	113,246	126,881
Latvia	274,834	171,048	17,565	10,932
Lithuania	39,705	862	2,538	55
Ukraine	727	7,500	46	479
Bulgaria	413,797	415	26,446	27
Romania	7,188	0	459	0
Eliminations	-5,926	-1,671	-379	-107
Unallocated assets	1,061,808	93,966	67,863	6,005
Total assets	3,564,041	2,257,371	227,784	144,272

Capital expenditures by asset type	Investment property		Property, plant and equipment		Intangible assets	
	2007	2006	2007	2006	2007	2006
In thousands EEK						
Estonia	3,016	27,856	55,242	320,541	942	1,082
Latvia	0	0	7,046	1,395	3,361	17
Lithuania	0	0	64	287	2,129	24
Ukraine	0	0	121	415	6	78
Bulgaria	0	0	3,452	237	56	72
Romania	0	0	3,597	0	2,458	0
Total capital expenditures	3,016	27,856	69,522	322,875	8,952	1,273

Capital expenditures by asset type	Investment property		Property, plant and equipment		Intangible assets	
	2007	2006	2007	2006	2007	2006
In thousands EUR						
Estonia	194	1,780	3,531	20,486	60	69
Latvia	0	0	450	89	215	1
Lithuania	0	0	4	18	136	2
Ukraine	0	0	8	27	0	5
Bulgaria	0	0	221	15	4	5
Romania	0	0	230	0	157	0
Total capital expenditures	194	1,780	4,444	20,635	572	81

7 Changes in Arco Vara Group

7.1 Scope of consolidation

	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	Total
Subsidiaries							
At 31 December 2006	20	7	2	2	1	-	32
Acquisitions	3	3	1	1	2	2	12
Disposals	-7	-2	-	-1	-	-	-10
At 31 December 2007	16	8	3	2	3	2	34
Interests in jointly controlled entities							
At 31 December 2006	22	2	-	-	-	1	25
Acquisitions	1	3	-	-	1	-	5
Disposals	-6	-2	-	-	-1	-1	-10
At 31 December 2007	17	3	-	-	-	-	20
Associates (not consolidated)							
At 31 December 2006	1	-	-	-	-	-	1
Acquisitions	-	-	-	-	-	-	-
Disposals	-	-	-	-	-	-	-
At 31 December 2007	1	-	-	-	-	-	1

At 31 December 2007, the Group's consolidated entities broke down between countries as follows: 33 in Estonia (2006: 42), 11 in Latvia (2006: 9), 3 in Lithuania (2006: 2), 2 in Ukraine (2006: 2), 3 in Bulgaria (2006: 1) and 2 in Romania (2006: 1).

In 2007, the number of consolidated entities decreased by three: six subsidiaries were merged with other Group companies, seven subsidiaries and two jointly controlled entities were founded, one subsidiary was acquired through a business combination (note 7.3), and one subsidiary and interests in six jointly controlled entities were sold (note 7.2).

The structure of Arco Vara Group is presented in note 41.

The effect of interests in jointly controlled entities on the consolidated income statement and balance sheet

As at 31 December or for the year	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Revenue and other income	140,540	279,718	8,982	17,877
Expenses	-69,278	-52,390	-4,428	-3,348
Finance income	9,149		585	0
Finance expenses	-45,802		-2,927	0
Current assets	228,814	98,992	14,624	6,327
Non-current assets	769,323	599,910	49,169	38,341
Current liabilities	150,908	85,780	9,645	5,482
Non-current liabilities	337,916	172,217	21,597	11,007

The most significant jointly controlled entities include Tallinna Olümpiapurjespordikeskus OÜ (owns a property at Regati pst 1, Tallinn), Arco HCE OÜ (owns the Ahtri 3 development project in Tallinn) and Floriston Grupp OÜ (owns a number of development projects in Tallinn).

Companies belonging to Arco Vara Group

		Group's ownership interest	
The company	Domicile	31 December 2007	31 December 2006
%			
Service segment			
Subsidiaries			
Arco Real Estate EOOD	Bulgaria	100	100
Arco Real Estate AS	Estonia	100	-
Arco Rumeenia Valdused OÜ	Estonia	100	was a joint venture
Arco Ukraina Valdused OÜ	Estonia	75	75
Arco Vara Kinnisvarabüroo	Estonia	100	100
Adepto SIA ¹	Latvia	80	-
Arco Real Estate SIA	Latvia	80	80
Arco Real Estate UAB	Lithuania	80	80
Arco Real Estate Consulting SRL ¹	Romania	100	was a joint venture
Arco Neruhomist TOV ¹	Ukraine	75	75
Interests in jointly controlled entities			
AVEC Asset Management OÜ	Estonia	50	50
Arco Rumeenia Valdused OÜ	Estonia	reclassified	50
Home Service SIA ¹	Latvia	sold	40
Arco Real Estate Consulting SRL ¹	Romania	reclassified	50
Development segment			
Subsidiaries			
Arco Invest EOOD	Bulgaria	100	-
Arco & Koger EOOD ¹	Bulgaria	100	-
Arco & Koger Investeeringute AS	Estonia	100	was a joint venture
Arco HCE OÜ	Estonia	reclassified	100
Arco Investeeringute AS	Estonia	100	100
Arco Maadehaldus OÜ	Estonia	merged	100
Arco Vara Kinnistute AS	Estonia	100	100
Arco Vara Puukool OÜ	Estonia	100	75
Arco Vara Riia Valdused OÜ	Estonia	100	75
Arcofond OÜ	Estonia	merged	100
Kerberon OÜ	Estonia	83.4	83.4
Kolde AS	Estonia	89.3	89.3
Metro Kinnisvara OÜ	Estonia	merged	100
Pämu Turg OÜ	Estonia	100	100
Zeus Haldus OÜ	Estonia	merged	100
Waldrop Investments OÜ	Estonia	100	100
Wilson Kinnisvara OÜ	Estonia	100	100
AD Saulkrasti SIA ¹	Latvia	50.4	-
Arco Development SIA	Latvia	80	80
Bišumuižas Nami SIA	Latvia	reclassified	80
Rasmussen Invest SIA ¹	Latvia	80	60
Sportings Riga SIA ¹	Latvia	reclassified	80
Ulmana Gatves Nami SIA ¹	Latvia	80	80
Vidus Nams SIA (in liquidation) ¹	Latvia	100	75
Arco Invest UAB	Lithuania	100	80
Arco Capital TOV ¹	Ukraine	sold	75

Company	Domicile	31 December 2007	31 December 2006
Arco Capital Real Estate SRL	Romania	100	-
Arco Investments TOV	Ukraine	75	-
Interests in jointly controlled entities			
Arco & Koger Investeeringute AS	Estonia	reclassified	50
Arco HCE OÜ	Estonia	50	was a subsidiary
Arco Vara Arenduse OÜ	Estonia	50	50
Arco Vara Saare Kinnistud OÜ	Estonia	50	50
Arco Ärikeskus OÜ	Estonia	50	50
Barrow Investments OÜ ¹	Estonia	sold	50
Castleberry OÜ ¹	Estonia	sold	50
Chalwell OÜ ¹	Estonia	50	50
Cromer Trade OÜ ¹	Estonia	sold	50
Floriston Grupp OÜ	Estonia	50	50
Hopson Capital OÜ ¹	Estonia	50	50
Kastner Grupp OÜ ¹	Estonia	50	50
Koduküla OÜ	Estonia	50	50
Kramer Kinnisvara OÜ	Estonia	sold	50
Noland Grupp OÜ ¹	Estonia	50	50
Pärnu Elumaja OÜ	Estonia	50	50
Redman Invest OÜ ¹	Estonia	50	50
Snowden OÜ ¹	Estonia	50	50
Steadman OÜ ¹	Estonia	50	50
Tallinna Olümpiapurjespordikeskus AS	Estonia	50	50
Varamaad Kinnisvara OÜ ¹	Estonia	33.4	50
Bišumuižas Nami SIA	Latvia	40	was a subsidiary
Dreilini-Ulbroka-1 SIA ¹	Latvia	sold	40
Plavnieku Centrs SIA ¹	Latvia	40	-
Sporting Riga SIA ¹	Latvia	40	was a subsidiary
Interests in jointly controlled entities			
Gilmor Grupp OÜ	Estonia	20	20
Construction segment			
Subsidiaries			
Arco Ehitus OÜ	Estonia	100	100
Veemaailm Inc OÜ	Estonia	merged	100
Fimaier OÜ	Estonia	merged	100
Tallinna Linnaehituse AS	Estonia	80	80
Arco Construction SIA	Latvia	55	-

¹ The Group has an interest in the company through a subsidiary or a jointly controlled entity.

7.2 Disposals of interests in subsidiaries and jointly controlled entities

In 2007, the Group disposed of interests in the following companies:

Company	%	EEK		EUR	
	Interest disposed of by the Group	Sales price	Gain or loss on disposal (notes 12, 13)	Sales price	Gain or loss on disposal (notes 12, 13)
In thousands					
Subsidiaries					
Arco HCE OÜ ¹	50	22,711	-2,981	1,451	-191
Arco Capital TOV	75	2,726	4,923	174	315
Bišumuižas Nami SIA and Sportings Riga SIA ²	40	120,291	118,491	7,688	7,573
Jointly controlled entities					
Kramer Kinnisvara OÜ	50	2,311	2,119	148	136
Cromer Trade OÜ ³	50	2,400	0	153	0
Barrow Investments OÜ ³	50	1,214	0	78	0
Castleberry OÜ ³	50	123	0	8	0
Dreilini-Ulbroka-1 SIA	40	22	0	1	0
Varamaad Kinnisvara OÜ ⁴	16.6	8,650	8,531	553	545
Home Service SIA	40	2	0	0	0
Total		160,450	131,083	10,254	8,378

¹ At the beginning of 2007, Arco Vara AS disposed of a 50% stake in the subsidiary Arco HCE OÜ. In addition to the sales price, the buyer settled 50% of Arco Vara AS' receivables from the subsidiary, i.e. 106,188 thousand kroons (6,787 thousand euros). After the disposal of the interest, the share capital of Arco HCE OÜ was increased by 20 thousand kroons (one thousand euros). The par value of the share of either shareholder was increased in proportion to their ownership interest. Shareholders paid for the increase with share premium of 73,829 thousand kroons (4,719 thousand euros) in aggregate. The Group's contribution was 72,839 thousand kroons (4,655 thousand euros).

The direct costs of disposing of the 50% interest in Arco HCE OÜ were 2,360 thousand kroons (150.8 thousand euros).

² On 18 May 2007, the Group entered into an agreement with SIA Linstow Baltic for the disposal of a 40% stake in Bishumuizhas Nami SIA. In compliance with the terms of the transaction, in August 2007 Bishumuizhas Nami SIA paid Arco Vara AS and the minority shareholder of Sportings Riga SIA 19,220 thousand euros (300,728 thousand kroons) for the acquisition of the Group's subsidiary Sportings Riga SIA. After the transaction, the Group's subsidiary Arco Investeeringute AS owns 40% of the shares in Bishumuizhas Nami SIA and the investments in Bishumuizhas Nami SIA and Sportings Riga SIA are classified as interests in jointly controlled entities.

³ In the first half of 2007, the Group disposed of its interests in jointly controlled entities Cromer Trade OÜ, Barrow Investments OÜ and Castleberry OÜ. The entities were project companies which held properties carried as inventories. Therefore, the disposal of the interests has been recognised in revenue in the income statement and in operating cash flows in the cash flow statement.

⁴ The sales price charged for the disposal of a 16.6% interest in Varamaad Kinnisvara OÜ of 8,650 thousand kroons (553 thousand euros) was offset against the Group's liabilities to the acquirer.

In 2006, the Group disposed of interests in the following companies:

Company	Interest disposed of by the Group	Sales price	Gain or loss on disposal (notes 12, 13)	Sales price	Gain or loss on disposal (notes 12, 13)
In thousands					
Subsidiaries					
Sportings Riga RIA ¹	0	7,463	7,463	477	478
Jointly controlled entities					
Lehe Elamud OÜ	50	1,343	42	86	4
Total					
		8,806	7,505	563	482

¹ In 2006, Arco Development SIA transferred a 20% stake in Sportings Riga SIA to the minority shareholder. In the Group, the minority shareholder's 20% stake in Sportings Riga SIA had already previously been recognised through Arco

Development SIA. Therefore, the transaction did not reduce the Group's holding or increase the minority shareholders' holding in Sportings Riga SIA.

The effect of the disposals on the Group's assets, liabilities and equity was as follows:

Effect of the disposal of subsidiaries on the Group's assets and liabilities	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Cash and cash equivalents ¹	120,953	0	7,730	0
Other current assets	-2,489	0	-159	0
Non-current receivables	49,322	0	3,152	0
Investment property (note 23)	-192,500	0	-12,303	0
Property, plant and equipment (note 24)	-6,801	0	-435	0
Current loans and borrowings	-62,509	0	-3,995	0
Other current liabilities	-46,395	0	-2,965	0
Non-current loans and borrowings	49,322	0	3,152	0

¹ Cash and cash equivalents includes, among other items, the sales price received for the interest in Arco HCE OÜ and the Group's receivables from Arco HCE OÜ as at 31 December 2006 which were settled by the acquirer.

Effect of the disposal of interests in jointly controlled entities on the Group's assets and liabilities	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Cash and cash equivalents	-53	-383	-3	-24
Other current assets	-487	-728	-31	-47
Inventories	-22,707	-1,812	-1,451	-116
Property, plant and equipment (note 24)	-96	-5	-6	0
Current loans and borrowings	-2,385	0	-152	0
Other current liabilities	-330	-377	-21	-24
Non-current loans and borrowings	-11,213	-1,250	-717	-80

7.3 Business combinations

Business combinations in 2007

On 11 January 2007, the Group acquired a 55% stake in the Latvian construction company Arco Construction SIA for 4,303 thousand kroons (275 thousand euros); 1,945 thousand kroons (124 thousand euros) of the purchase price was settled in 2007 in cash and the rest will be settled within two years by March 2010. The liability does not bear any interest. Therefore the liability and the cost of the acquisition have been discounted to 4,070 thousand kroons (260 thousand euros). The cost of acquisition was allocated to net assets acquired and goodwill as follows:

	EEK	EUR
In thousands		
Cost of acquisition	4,070	260
Fair value of net assets acquired ¹	710	45
Goodwill (note 25)	3,360	215

¹ At the date of acquisition, the fair values of the assets, liabilities and net assets of Arco Construction SIA equalled their carrying amounts.

The goodwill arisen on acquisition is primarily related to the customer base of Arco Construction SIA and the relations between Arco Construction SIA and potential customers which allow performing more profitable sales transactions in subsequent periods than the Group could have performed without the acquisition of Arco Construction SIA. The customer base and customer relations have not been recognised as separate intangible assets because at the date of acquisition long-term sales contracts had not been signed and, accordingly, the fair value of the relations could not have been measured reliably.

The cost of acquisition was allocated to the assets and liabilities of Arco Construction SIA as follows:

	EEK	EUR
In thousands		
Cash	179	11
Receivables and prepayments	3,239	207
Inventories	559	36
Property, plant and equipment (note 24)	382	24
Goodwill (note 25)	3,360	215
Liabilities	-3,649	-233
Cost of acquisition	4,070	260

The Group's consolidated financial statements for 2007 comprise Arco Construction SIA's revenue and expenses for twelve months of 2007 and assets and liabilities as at 31 December 2007. Arco Construction SIA's revenue for 2007 accounted for 37,664 thousand kroons (2,407 thousand euros) of the Group's consolidated revenue for 2007 and the entity's impact on the Group's net profit for 2007 was negative to the extent of 873 thousand kroons (56 thousand euros). The negative effect on net profit resulted mainly from the elimination of the Latvian entity's intra-group profits arisen in connection with the Bishumuizhas I project.

In October 2007, the Group acquired the remaining 50% of the shares in the jointly controlled entity Arco Rumeenia Valdused OÜ, taking its ownership interest in Arco Rumeenia Valdused OÜ and Arco Real Estate Capital SRL to 100%. The cost of acquisition was allocated to net assets acquired and goodwill as follows:

	EEK	EUR
In thousands		
Cost of acquisition	20	1
Fair value of net assets acquired	-2,438	-156
Goodwill (note 25)	2,458	157

As a result of the transaction, the Group reclassified two interests in jointly controlled entities to subsidiaries. The effect of the reclassification on the Group's assets and liabilities was the following:

	EEK	EUR
In thousands		
Cash	399	26
Other current assets	276	18
Property, plant and equipment (note 24)	576	37
Goodwill (note 25)	2,458	157
Loans and borrowings	1,522	97
Current liabilities	843	54

If the Arco Rumeenia Valdused OÜ would have acquired on 1 January 2007, the impact on the Group's consolidated revenue would have been increased for 1,039 thousand kroons (66 thousand euros) and consolidated net profit would have been decreased for 2,205 thousand kroons (141 thousand euros).

Business combinations in 2006

The revenue of entities acquired in 2006 accounted for 3,773 thousand kroons (241 thousand kroons) of the Group's revenue for 2006 and their impact on the Group's net profit for 2006 was negative to the extent of 11,446 thousand kroons (732 thousand kroons). Above all, consolidated net profit was adversely affected because of the impairment loss recognised at the end of 2006 for goodwill acquired in a business combination (note 25). If the business combinations had occurred on 1 January 2006, their impact on the Group's consolidated revenue and consolidated net profit would not have been significantly different from what it was from the date of the business combinations until the end of 2006.

On 10 August 2006, the Group acquired an interest in Varamaad Kinnisvara OÜ, a jointly controlled entity holding an investment property in Tallinn. The purchase price of 25,974 thousand kroons (1,660 thousand euros) was settled in cash. The cost of acquisition was allocated to net assets acquired and goodwill as follows:

	EEK	EUR
In thousands		
Cost of acquisition	25,974	1,660
Fair value of net assets acquired	14,657	937
Goodwill	11,318	723

Goodwill was measured by reference to the present value of the estimated future cash flows of the investment property held by the entity. In making the calculations, cash flow projections were based on a detailed plan expected to be adopted for the property.

The cost of acquisition was allocated to the entity's assets and liabilities as follows:

	EEK	EUR
In thousands		
Cash	626	40
Investment property (note 23)	14,031	897
Goodwill (note 25)	11,318	723
Liabilities	-1	0
Cost of acquisition	25,974	1,660

On 1 June 2006, the Group acquired an interest in Pennington Kinnisvara OÜ, a jointly controlled entity engaged in land development on the island of Saaremaa, and its wholly-owned subsidiaries Kramer Kinnisvara OÜ and Merise Arenduse OÜ. The cost of acquisition amounted to 40 thousand kroons and was settled in cash. At the acquisition date, the cost of the business combination was allocated to the entity's assets and liabilities as follows:

	EEK	EUR
In thousands		
Cash	190	12
Receivables and prepayments	152	10
Inventories	14,191	907
Current liabilities	-4,493	-287
Non-current liabilities	-10,000	-639
Cost of acquisition	40	3

In autumn 2006, Pennington Kinnisvara OÜ and its subsidiaries were merged. The acquirer was Kramer Kinnisvara OÜ. The combination of entities under common control had no impact on the Group's financial position or results of operation.

7.4 Acquisitions from minority shareholders

At the beginning of 2007, the Group acquired from minority shareholders their interests in the Group's subsidiaries Arco Vara Riia Valdused OÜ (a 25% interest), Arco Vara Puukool OÜ (a 25% interest) and Arco Real Estate UAB (a 20% interest), taking its ownership in the subsidiaries to 100%. Acquisition of the shareholdings cost 2,466 thousand kroons (158 thousand euros) and gave rise to positive goodwill of 2,581 thousand kroons (165 thousand euros).

In March 2006, the Group acquired from a minority shareholder interests in the following Group entities:

Company	Segment	Arco Vara AS' interest before the transaction %	Interest acquired %	Arco Vara AS' interest after the transaction %	EEK			EUR		
					Cost of acquisition	Positive goodwill arising on acquisition (note 25)	Negative goodwill arising on acquisition (note 25)	Cost of acquisition	Positive goodwill arising on acquisition (note 25)	Negative goodwill arising on acquisition (note 25)
In thousands										
Arco Investeeringute AS	Development	84	16	100	27,419	0	10,653	1,752	0	681
Kolde AS	Development	73.4	15.9	89.3	4,322	0	0	276	0	0

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Kerberon OÜ	Development	67.4	16	83.35	2,230	0	3,809	143	0	243
Arcofond OÜ	Development	84	16	100	2	0	5	0	0	0
Pärnu Turg OÜ	Development	84	16	100	1,588	159	0	101	10	0
Deena Ehituse OÜ	Construction	84	16	100	4,438	3,609	0	284	231	0
Firmaier OÜ	Construction	80	20	100	1,965	0	281	126	0	18
Total					41,964	3,768	14,748	2,682	241	943

The purchase price of the interests acquired is to be settled in May 2008 at the latest.

7.5 Establishment of companies

In 2007, the Group established or participated in the establishment of the following companies:

Company	Domicile	Group's interest in the entity, %	Contribution to share capital	
			EEK	EUR
In thousands				
Subsidiaries				
AD Saulkrasti SIA	Latvia	50.4	28	2
Adepto SIA	Latvia	80	45	3
Arco Invest EOOD	Bulgaria	100	800	51
Arco Capital Real Estate SRL	Romania	100	978	63
Arco Investments TOV	Ukraine	75	71	5
Arco Real Estate AS	Estonia	100	400	26
Jointly controlled entities				
Arco & Koger EOOD	Bulgaria	50	20	1
Plavnieku Centrs SIA	Latvia	40	13,180	842
Total			15,522	993

In 2006, the Group established or participated in the establishment of the following companies:

Company	Domicile	Group's interest in the entity, %	Contribution to share capital	
			EEK	EUR
In thousands				
Subsidiaries				
Arco Invest UAB	Lithuania	80	45	3
Bišumuižas Nami SIA	Latvia	80	36	2
Waldrop Investments OÜ	Estonia	100	50	3
Arco Real Estate EOOD	Bulgaria	100	36	2
Jointly controlled entities				
Arco & Koger Investeeringute OÜ	Estonia	50	20	1
Barrow Investments OÜ	Estonia	50	20	1
Castleberry OÜ	Estonia	50	20	1
Cromer Trade OÜ	Estonia	50	20	1
Dreilini-Ubroko-1 SIA	Latvia	40	22	1
Hopson Capital OÜ	Estonia	50	20	1
Kastner Grupp OÜ	Estonia	50	20	1
Koduküla OÜ	Estonia	50	100	6
Noland Grupp OÜ	Estonia	50	20	1
Redman Invest OÜ	Estonia	50	20	1
Snowden OÜ	Estonia	50	20	1
Steadman OÜ	Estonia	50	20	1

Arco Rumeenia Valduste OÜ	Estonia	50	20	1
Arco Real Estate Consulting SRL	Romania	50	22	1
Total			531	29

Notes to the consolidated income statement

8 Cost of sales

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Cost of properties sold	-264,966	-98,754	-16,934	-6,312
Cost of construction services purchased	-159,122	-148,501	-10,170	-9,491
Management and administration costs	-11,398	-16,365	-728	-1,046
Personnel expenses	-84,980	-65,940	-5,431	-4,214
Vehicle expenses	-7,163	-5,683	-458	-363
Depreciation and amortisation (notes 24, 25)	-2,002	-1,127	-128	-72
Other costs	-12,504	-12,697	-800	-811
Total cost of sales	-542,135	-349,067	-34,649	-22,309

9 Selling and distribution expenses

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Advertising expenses	-17,356	-10,701	-1,109	-684
Brokerage and intermediation fees	-421	-5,493	-27	-351
Market research expenses	-444	-105	-28	-7
Personnel expenses	-829	-803	-53	-51
Other selling and distribution expenses	-3,484	-1,493	-223	-95
Total selling and distribution expenses	-22,534	-18,595	-1,440	-1,188

10 Administrative expenses

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Personnel expenses	-85,110	-46,636	-5,440	-2,981
Office expenses	-31,108	-18,067	-1,988	-1,155
Legal and consulting fees ¹	-953	-36,695	-61	-2,345
Depreciation, amortisation and impairment losses ² (notes 24, 25)	-3,131	-14,542	-200	-929
Recognition of negative goodwill as income (note 25)	283	14,748	18	943
Allowance for doubtful receivables	-1,481	-2,110	-95	-135
Vehicle expenses	-9,832	-7,067	-628	-452
Other expenses	-4,721	-5,344	-301	-341
Total administrative expenses	-136,053	-115,713	-8,695	-7,395

¹ Legal and consulting fees for 2007 include the costs arising from a bonus scheme agreed with a member of the board of a jointly controlled entity, which extend to 12.5% of the entity's equity. In 2007, the entity's equity decreased, which reduced the costs arising from the bonus scheme by 11,483 thousand kroons (734 thousand euros). In 2006, the costs arising from the bonus scheme totalled 25,441 thousand kroons (1,626 thousand euros).

² In 2006, depreciation expense included an impairment loss on goodwill of 12,599 thousand kroons (805 thousand euros). For further information on goodwill, please refer to note 25.

11 Other income and other expenses

Other income

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Gains on fair value adjustments to investment property (note 23)	133,029	388,950	8,502	24,858
Gains on sale of investment property	2,620	25,224	167	1,612
Gains on fair value adjustments to biological assets (note 21)	2,756	993	176	63
Gains on sale of property, plant and equipment	57	6,375	4	407
Miscellaneous income	1,628	1,386	104	90
Total other income	140,090	422,928	8,953	27,030

Other expenses

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Losses on fair value adjustments to investment property (note 23)	-75,200	-14,031	-4,806	-897
Losses on sale of investment property	-4,253	0	-272	0
Losses on sale of property, plant and equipment	-39	-29	-2	-2
Impairment losses on property, plant and equipment ¹ (note 24)	18,778	-72,823	1,200	-4,654
Interest on arrears and penalty charges ²	-481	-74,975	-31	-4,792
Miscellaneous expenses	-2,303	-930	-147	-59
Total other expenses	-63,498	-162,788	-4,058	-10,404

¹ Impairment losses on property, plant and equipment for 2007 include a reversal of an impairment loss recognised for a property carried as an asset under construction. The original impairment loss was recognised in 2006 based on a valuation performed by a qualified independent real estate appraiser using the sales comparison method and management's

estimates of probable selling costs. An impairment test performed for the same asset in 2007 indicated that its recoverable amount as at 31 December 2007 was 18,778 thousand kroons (1,200 thousand euros) higher than at 31 December 2006. The recoverable amount was identified by reference to a valuation performed by qualified independent real estate appraisers.

² Interest on arrears and penalty charges for 2006 include a penalty of 73,539 thousand kroons (4,700 thousand euros) charged for withdrawal from a contract related to the Holiday Club Estonia project.

12 Finance income

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Gains on sale of investments in subsidiaries (note 7.2)	123,414	7,463	7,888	477
Gains on sale of interests in jointly controlled entities (note 7.2)	10,650	42	681	3
Interest income	30,177	3,367	1,929	215
Foreign exchange gains	39	0	2	0
Income on other non-current financial assets ¹	50,725	5,343	3,241	341
Total finance income	215,005	16,215	13,741	1,036

¹ Income on other non-current financial assets for 2007 includes, among other items, gains of 41,238 thousand kroons (2,636 thousand euros) yielded by the restatement to fair value of the investment in Explorer Property Fund AB, a fund belonging to a jointly controlled entity, and gains of 1,362 thousand kroons (87 thousand euros) yielded by the restatement to fair value of the preference share in Arco Balti Kinnisvaraportfell AS. The cancellation of the put options of three minority shareholders yielded gains of 3,330 thousand kroons (213 thousand euros).

Income on other non-current financial assets for 2006 includes, among other items, fair value gains of 5,343 thousand kroons (341 thousand euros) on assets carried at fair value. Further information on financial assets carried at fair value is presented in note 17.

13 Finance expenses

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Losses on sale of shares in subsidiaries (note 7.2)	-2,981	0	-191	0
Losses on equity-accounted investments (associates)	0	-40	0	-3
Interest expense ¹	-33,840	-30,800	-2,163	-1,968
Expenses on other non-current financial assets ²	-2,864	-6,411	-183	-410
Foreign exchange losses	-2,291	-682	-146	-44
Impairment losses on financial assets ³	-25,768	-11,721	-1,647	-748
Total finance expenses	-67,744	-49,654	-4,330	-3,173

¹ Interest expense includes mainly the interest expense of loans taken and debt securities issued for the acquisition and construction of properties. Interest expenditures incurred in connection with loans taken to finance development projects in progress are capitalised. In 2007, capitalised interest expenditures totalled 21,646 thousand kroons (1,383 thousand euros). The corresponding figure for 2006 was 16,783 thousand kroons (1,073 thousand euros).

² Expenses on other non-current financial assets for 2007 reflect an increase in the value of a minority shareholder's put option by 2,864 thousand kroons (183 thousand euros). For information on liabilities related to the put option, please refer to note 28.

Expenses on other non-current financial assets for 2006 include impairment losses of 6,408 thousand kroons (410 thousand euros) recognised for receivables from local governments.

³ Impairment losses on financial assets for 2007 include an impairment loss of 25,258 thousand kroons (1,614 thousand euros) recognised for a receivable related to the Kippsala project and minor impairment losses of 510 thousand kroons (33 thousand euros) recognised for various financial assets. The impairment loss for the Kippsala project was recognised based on management's estimates of the time and probability of the collection of the receivable.

Impairment losses on financial assets for 2006 include an impairment loss of 8,900 thousand kroons (569 thousand euros) recognised for a receivable from an associated company (note 22) and impairment losses of 2,821 thousand kroons (180 thousand euros) recognised for various financial assets.

14 Income tax expense

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Income tax expense on dividends	-12,129	-3,570	-775	-228
Income tax expense on the profit of Latvian subsidiaries	-2,569	-6,109	-164	-390
Income tax expense on the profit of Bulgarian subsidiaries	163	5	10	0
Income tax expense on the profit of Lithuanian subsidiaries	0	111	0	7
Income tax expense on the profit of Ukrainian subsidiaries	-273	0	-17	0
Total income tax expense	-14,808	-9,563	-946	-611

Income tax expense on the profit of Latvian subsidiaries for 2006 includes income tax expense of 1,353 thousand kroons (86 thousand euros) calculated on a fair value gain on an investment property. At 31 December 2007, the Group recognised deferred income tax liabilities of 1,321 thousand kroons (84 thousand euros). At 31 December 2006 the corresponding figure was 1,353 thousand kroons (88 thousand euros).

15 Operating lease expenses

The Group uses office premises, vehicles and office equipment under operating lease. Related expenses break down as follows:

Lease expense for	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Premises	10,642	5,711	680	365
Vehicles	4,535	3,680	290	235
Office equipment	2,951	1,867	189	119
Total	18,128	11,258	1,159	720

16 Earnings per share

Basic earnings per share are calculated by dividing the profit attributable to ordinary equity holders of the Parent by the weighted average number of ordinary shares outstanding during the period. The company does not have any potential ordinary shares. Therefore, diluted earnings per share equal basic earnings per share.

	EEK		EUR	
	2007	2006	2007	2006
Weighted average number of ordinary shares outstanding	82,516,293	67,784,150	82,516,293	67,784,150
Profit attributable to equity holders of the parent	227,587	207,945	14,546	13,291
Earnings per share	2.76	3.07	0.18	0.20

In May 2007, Arco Vara AS increased its share capital by 373,331 thousand kroons (23,860 thousand euros) through a bonus issue. The issue was arranged using the company's equity; no additional contributions were made. The company issued 37,331,113 new shares with a par value of 10 kroons each. Because of this, the average number of shares outstanding in 2006 has been retrospectively adjusted to 67,784,150.

Notes to the consolidated balance sheet

17 Other financial assets

At 31 December 2007, other current financial assets included commercial paper issued by Kesko OY. At the end of 2007, the Group had 7,500 pieces of commercial paper issued by Kesko OY with a unit value of 9,854 kroons (630 euros) and a total value of 73,905 thousand kroons (4,723 thousand euros). The redemption date of the commercial paper is 13 March 2008.

In addition to Kesko OY commercial paper, at 31 December 2007 other current financial assets included a deposit of 4,620 thousand kroons (295 thousand euros) put up as financial security for a loan taken by a subsidiary. The deposit will be recovered in the first half of 2008.

Other non-current financial assets break down as follows:

As at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Non-current investments in equity instruments – carried at cost	128	131	8	8
Non-current investments in equity instruments – carried at fair value ¹	48,387	8,215	3,093	525
Prepayments for other financial assets ²	0	57,423	0	3,670
Total other non-current financial assets	48,515	65,769	3,101	4,203

¹ Non-current investments in equity instruments carried at fair value includes mainly investments in Explorer Property Fund AB and Arco Balti Kinnisvaraportfell AS which at 31 December 2007 totalled 48,281 thousand kroons (3,086 thousand euros). At 31 December 2006, investments in those entities totalled 5,680 thousand kroons (363 thousand euros).

In the case of Explorer Property Fund AB, fair value has been determined by reference to the fair values of its subsidiaries which serve as a basis for determining the present value of the success fees attributable to the Group's interest in the jointly controlled entity that owns Explorer Property Fund AB. The assets of the fund's subsidiaries are valued by qualified independent appraisers.

In the case of Arco Balti Kinnisvaraportfell AS, fair value is determined by reference to the discounted values of the management fees attributable to the Group's interest in the jointly controlled entity that owns Arco Balti Kinnisvaraportfell AS.

Investments carried at fair value are classified as financial assets at fair value through profit or loss. Further information on the revaluation of financial assets carried at fair value is presented in note 12.

² At 31 December 2006, prepayments for other financial assets comprised a prepayment for the acquisition of shares in the Latvian company Eurolines SIA. The prepayment was related to the Kippsala project. In 2007, the receivable was reclassified to current receivables. Further information on the reclassification is presented in note 18.

18 Receivables

Current items

As at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Trade receivables				
Receivables from customers	48,236	45,436	3,083	2,903
Allowance for doubtful receivables	-70	-289	-4	-18
Total trade receivables (note 36)	48,166	45,147	3,079	2,885
Other receivables				
Receivables from jointly controlled entities (note 39)	53,719	9,042	3,433	578
Loans granted ¹	12,391	15,071	792	963
Miscellaneous receivables ²	47,449	9,944	3,033	636
Total other receivables	113,559	34,057	7,258	2,177

As at 31 December	EEK		EUR	
	2007	2006	2007	2006
Accrued income				
Interest receivable ³	5,807	3,028	371	194
Due from customers long-term construction contracts ⁴	21,635	4,537	1,383	290
Prepaid and refundable VAT ⁵	107,406	15,695	6,864	1,003
Other accrued income	616	34	39	2
Total accrued income	135,464	23,294	8,657	1,489
Total current receivables	297,189	102,498	18,994	6,551

¹ In 2007, the average interest rate of unsecured loans provided by the Group was 4.8% (2006: 5.0%). Loans granted include receivables from related parties of 12,391 thousand kroons (792 thousand euros). The corresponding figure for 2006 was 13,326 thousand kroons (852 thousand euros).

² At 31 December 2007, miscellaneous receivables included:

- a receivable of 33,675 thousand kroons (2,152 thousand euros) related to the Kippsala project. At 31 December 2006, the investments made in the Kippsala project were carried as prepayments for other financial assets in an amount of 57,423 thousand kroons (3,670 thousand euros). At the end of 2007, the Group decided to exit the project and claimed repayment of the prepayment. At 31 December 2007, the receivable was considered to be impaired and was written down by 25,258 thousand kroons (1,614 thousand euros) (note 13).
- a receivable of 2,321 thousand kroons (148 thousand euros) for the establishment of the right of use to a property. At 31 December 2006, the receivable was recognised in the same amount.
- receivables from related parties of 6,315 thousand kroons (404 thousand euros). At 31 December 2006, receivables from related parties totalled 5,193 thousand kroons (332 thousand euros). Further information on receivables from related parties is presented in note 39.
- a receivable of 1,330 thousand kroons (86 thousand euros) from an interest rate swap measured at fair value. At 31 December 2006, the corresponding figure was 1,560 thousand kroons (100 thousand euros). Further information on the interest rate swap is presented in note 35.
- a receivable of 900 thousand kroons (58 thousand euros) for sale of shares in a subsidiary. At the end of 2006, the receivable was carried at its discounted value of 868 thousand kroons (55 thousand euros).
- a number of individually insignificant receivables of 2,907 thousand kroons (185 thousand euros) in aggregate. At the end of 2006, the corresponding figure was 870 thousand kroons (56 thousand euros).

³ At 31 December 2007, interest receivable included interest receivables from related parties of 1,242 thousand kroons (79 thousand euros). At the end of 2006, interest receivables from related parties totalled 1,566 thousand kroons (100 thousand euros). Further information on related parties is presented in note 39.

⁴ Due from customers under long-term construction contracts comprises receivables under long-term construction contracts measured by reference to the stage of completion method. See also note 28.

⁵ At 31 December 2007, prepaid and refundable VAT included mainly VAT prepayments for development projects in progress in Bulgaria, Latvia and Lithuania which will be recovered in 2008. At 31 December 2007, VAT prepayments related to the Madrid and Manastirski (Bulgaria), Hills (Lithuania) and Bishumizhas I (Latvia) projects totalled 94,009 thousand kroons (6,008 thousand euros).

Non-current items

As at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Receivables from jointly controlled entities (note 39)	38,538	2,215	2,463	142
Long-term loan receivables ¹	907	5,564	58	356
Prepayments for long-term financial assets ²	0	2,781	0	178
Other non-current receivables	679	113	43	6
Total non-current receivables	40,124	10,673	2,564	682

¹ At 31 December 2007, long-term loan receivables included items of 907 thousand kroons (2 thousand euros) due from related parties. At 31 December 2006, long-term loan receivables from related parties totalled 5,197 thousand kroons (332 thousand euros). The receivables have not been secured and bear interest at the rate of 4-6% per year. Further information on related parties is presented in note 39.

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² At 31 December 2006, prepayments for long-term financial assets included:

- a prepayment of 2,716 thousand kroons (174 thousand euros) made for the establishment of a jointly controlled entity in Latvia. The prepayment was returned in 2007.
- individually insignificant prepayments of 65 thousand kroons (4 thousand euros).

19 Prepayments

At 31 December 2007, prepayments comprised:

- prepayments of 7,254 thousand kroons (464 thousand euros) made by the Group's construction companies to suppliers of construction services;
- prepayments of 500 thousand kroons (32 thousand euros) made for advertising services, at 31 December 2006 the corresponding figure was 2,000 thousand kroons (128 thousand euros); and
- miscellaneous prepayments of 2,696 thousand kroons (172 thousand euros), at 31 December 2006 the corresponding figure was 2,429 thousand kroons (155 thousand euros).

20 Inventories

AS at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Properties purchased and developed for resale ¹	1,111,527	415,567	71,040	26,560
Other goods purchased for resale	4,498	6,580	287	421
Materials and finished goods	529	0	34	0
Prepayments to suppliers	31,879	9,670	2,037	617
Total inventories	1,148,433	431,817	73,398	27,598

The line "Properties purchased and developed for resale" includes all residential development projects and properties which have been acquired for resale.

¹ The significant increase results from the transfer of the Tivoli project of 300,000 thousand kroons (19,173 thousand euros) from investment property to inventories (note 23). The project was reclassified at the beginning of 2007 in connection with the Development segment's estimates regarding further use of the property and positive developments in the adoption of the property's detailed plan.

According to management's estimates, properties purchased and developed for resale include items of 908,475 thousand kroons (58,062 thousand euros) which will be sold after 31 December 2008.

At 31 December 2007, the Group had pledged properties purchased and developed for resale of 810,212 thousand kroons (51,782 thousand euros) as collateral for its loan commitments. At 31 December 2006, the corresponding figure was 272,473 thousand kroons (17,414 thousand euros).

21 Biological assets

	EEK	EUR
In thousands		
At 31 December 2005	6,020	385
Increases due to purchases	339	22
Government grant (note 34)	-232	-15
Decreases due to sales	-979	-62
Gain or loss from change in fair value (note 11)	993	63
At 31 December 2006	6,141	393
Increases due to purchases	164	10
Decreases due to sales	-701	-45
Gain or loss from change in fair value (note 11)	2,756	176
At 31 December 2007	8,360	534

Biological assets according to maturity:

As at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Mature, ready for sale plants	696	464	44	30
Immature, not ready for sale plants	724	819	46	52
Mature harvestable forest	0	486	0	31
Growing forest without a cutting permit	6,940	4,372	444	280
Total biological assets	8,360	6,141	534	393

At 31 December 2007, the Group had 448 ha of growing forest (2006: 443 ha).

In 2007, asset management expenses totalled 1,381 thousand kroons (88 thousand euros). The corresponding figure for 2006 was 732 thousand kroons (47 thousand euros).

22 Associates

In thousands

In April 2006, the Group established an associated company Gilmor Group OÜ. On 12 April 2006, Gilmour Group OÜ concluded a purchase contract under the law of obligations which granted it the right to acquire properties located in Tallinn. Based on the contract, the company made a prepayment of 15,000 thousand kroons (958 thousand euros). The contract provided a penalty of 15,000 thousand kroons (958 thousand euros) for withdrawal from the contract. At 31 December 2006, the management of Gilmor Group OÜ decided that it was unlikely that the right to acquire the properties would be exercised and recognised the contractual penalty as an expense of 2006. At 31 December 2007, the Group's share in the equity of Gilmor Group OÜ was negative to the extent of 3,003 thousand kroons (192 thousand euros); 40 thousand kroons of this was recognised as a loss on an equity-accounted investment in finance expenses in the consolidated income statement and the rest was accounted for off the balance sheet.

In 2006, the Group gave Gilmor Group OÜ a loan of 8,900 thousand kroons (569 thousand euros) for acquiring properties in Tallinn. When the completion of the project was deemed unlikely, the Group considered the loan fully impaired. The impairment loss was recognised in "Impairment losses on financial assets" in finance expense in the consolidated income statement.

The Group has a 20% stake in the company. At 31 December 2007 and 31 December 2006, the Group had a liability of 40 thousand kroons (3 thousand euros) to a non-related party for its contribution to the share capital of Gilmor Group OÜ.

At the beginning of 2008, the Group initiated the liquidation of Gilmor Group OÜ.

23 Investment property

Investment properties include commercial buildings which are leased out and properties with development potential whose future use has not been determined.

Movements in investment property:

	EEK	EUR
In thousands		
At 31 December 2005	851,104	54,395
Acquisitions	13,274	848
Capitalised borrowing costs	551	35
Sales	-26,559	-1,696
Acquisitions through business combinations (note 7.3)	14,031	897
Transfer from property, plant and equipment (note 24)	251,961	16,103
Gain or loss on change in fair value (note 11)	374,919	23,961
At 31 December 2006	1,479,281	94,543

	EEK	EUR
Acquisitions	3,016	194
Sales	-58,949	-3,768
Disposals through divestment of interests in subsidiaries and transformation of subsidiaries into jointly controlled entities (note 7.2)	-192,500	-12,303
Transfer to inventories (note 20)	-300,000	-19,173
Transfer from inventories	4,446	284
Transfer from property, plant and equipment (note 24)	6,876	439
Gain or loss on change in fair value (note 11)	57,829	3,696
At 31 December 2007	999,999	63,912

In 2007, the fair values of all investment properties were determined by reference to valuations performed by qualified independent real estate appraisers.

In determining the fair values of investment properties, cash flow projections were based on the following assumptions:

	2007	2006
%		
Annual increase in rental income	1.5-3.0	1-5
Annual increase in operating expenses	0.0-5.0	2-3
Vacancy rate of the premises	0.0-20.0	3-25
Discount rate on exit from project	7.5-9.5	7-10

In 2007, rental income on investment properties amounted to 36,027 thousand kroons (2,303 thousand euros). The corresponding figure for 2006 was 37,747 thousand kroons (2,412 thousand euros). Direct property management expenses totalled 7,906 thousand kroons (505 thousand euros). The corresponding figure for 2006 was 10,959 thousand kroons (700 thousand euros).

Non-cancellable operating lease rentals receivable in subsequent periods break down as follows:

Rental income receivable	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Less than 1 year	14,400	4,582	920	293
Between 1 and 5 years	36,678	9,329	2,344	596
More than 5 years	16,103	12,466	1,029	797
Total	67,181	26,377	4,293	1,686

Improvements to existing investment properties totalled 8,085 thousand kroons (517 thousand euros). The corresponding figure for 2006 was 8,694 thousand kroons (556 thousand euros).

At 31 December 2007, liabilities from acquisition of investment property totalled 798 thousand kroons (51 thousand euros). At the end of 2006, the Group had received prepayments of 5,000 thousand kroons (320 thousand euros) based on contracts under the law of obligations. The items were settled in 2007.

At 31 December 2007, the Group had pledged investment properties of 983,568 thousand kroons (62,861 thousand euros) as collateral for loan commitments. At the end of 2006, the corresponding figure was 1,202,542 thousand kroons (76,856 thousand euros).

Finance lease liabilities related to investment properties acquired totalled 1,162 thousand kroons (74 thousand euros) at 31 December 2007 and 1,961 thousand kroons (125 thousand euros) at 31 December 2006.

24 Property, plant and equipment

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total
In thousands EEK					
Carrying amount at 31 December 2005	16,956	1,464	2,938	153,043	174,401
Additions	5,662	1,580	3,242	296,159	306,643
Capitalised borrowings costs	0	0	0	16,232	16,232
Government grant (note 34)	-723	-242	-315	-104	-1,384
Impairment loss (note 11)	0	-10	-8	-72,805	-72,823
Disposals	-30	0	-98	-5,470	-5,598
Disposals through divestment of interests in jointly controlled entities (note 7.2)	0	0	-5	0	-5
Transfer ¹	297	0	-10	-333,256	-332,969
Depreciation charge (notes 8, 10)	-833	-531	-1,420	0	-2,784
Carrying amount at 31 December 2006	21,329	2,261	4,324	53,799	81,713
<i>Cost at 31 December 2006</i>	<i>30,052</i>	<i>5,553</i>	<i>8,256</i>	<i>53,799</i>	<i>97,660</i>
<i>Accumulated depreciation at 31 December 2006</i>	<i>-8,723</i>	<i>-3,292</i>	<i>-3,932</i>	<i>0</i>	<i>-15,947</i>
Additions	7,207	3,115	5,396	37,341	53,059
Capitalised borrowings costs	0	662	0	14,530	15,192
Additions through business combinations (note 7.3)	0	0	695	0	695
Additions through acquisition of interests from minority shareholders (note 7.4)	0	482	94	0	576
Reversal of impairment loss (note 11)	0	0	0	18,778	18,778
Disposals	0	-569	-79	-8,965	-9,613
Disposals through divestment of subsidiaries (note 7.2)	-96	0	0	-6,801	-6,897
Transfer ¹	-63	300	-300	-6,876	-6,939
Depreciation charge (note 8, 10)	-1,437	-1,117	-2,147	0	-4,701
Carrying amount at 31 December 2007	26,940	5,134	7,983	101,806	141,863
<i>Cost at 31 December 2007</i>	<i>37,083</i>	<i>9,108</i>	<i>13,637</i>	<i>101,806</i>	<i>161,634</i>
<i>Accumulated depreciation at 31 December 2007</i>	<i>-10,143</i>	<i>-3,974</i>	<i>-5,654</i>	<i>0</i>	<i>-19,771</i>

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total
In thousands EUR					
Carrying amount at 31 December 2005	1,084	94	188	9,781	11,147
Additions	362	101	207	18,928	19,598
Capitalised borrowings costs	0	0	0	1,037	1,037
Government grant (note 34)	-46	-15	-20	-7	-88
Impairment loss (note 11)	0	-1	-1	-4,653	-4,655
Disposals	-2	0	-6	-350	-358
Transfer ¹	19	0	-1	-21,299	-21,281
Depreciation charge (notes 8, 10)	-53	-34	-91	0	-178
Carrying amount at 31 December 2006	1,363	145	276	3,438	5,222
<i>Cost at 31 December 2006</i>	<i>1,921</i>	<i>355</i>	<i>528</i>	<i>3,438</i>	<i>6,242</i>
<i>Accumulated depreciation at 31 December 2006</i>	<i>-558</i>	<i>-210</i>	<i>-251</i>	<i>0</i>	<i>-1,019</i>

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total
Additions	461	199	345	2,387	3,392
Capitalised borrowings costs	0	42	0	929	971
Additions through business combinations (note 7.3)	0	0	44	0	44
Additions through acquisition of interests from minority shareholders (note 7.4)	0	31	6	0	37
Reversal of impairment loss (note 11)	0	0	0	1,200	1,200
Disposals	0	-36	-5	-573	-614
Disposals through divestment of subsidiaries (note 7.2)	-6	0	0	-435	-441
Transfer ¹	-4	19	-19	-439	-443
Depreciation charge (note 8, 10)	-92	-71	-138	0	-301
Carrying amount at 31 December 2007	1,722	328	510	6,507	9,067
<i>Cost at 31 December 2007</i>	<i>2,370</i>	<i>582</i>	<i>872</i>	<i>6,507</i>	<i>10,331</i>
<i>Accumulated depreciation at 31 December 2007</i>	<i>-648</i>	<i>-254</i>	<i>-362</i>	<i>0</i>	<i>-1,264</i>

¹ Transfers in 2007 and 2006:

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total
In thousands EEK					
Transfer of commercial properties to investment property on completion of development	0	0	0	-251,961	-251,961
Transfer to inventories ^{1.1}	0	0	0	-81,008	-81,008
Transfer from one category of property, plant and equipment to another	297	0	-10	-287	0
Total transfers in 2006	297	0	-10	-333,256	-332,969
Transfer of commercial properties to investment property on completion of development	0	0	0	-6,876	-6,876
Transfer to inventories	-63	0	0	0	-63
Transfer from one category of property, plant and equipment to another	0	300	-300	0	0
Total transfers in 2007	-63	300	-300	-6,876	-6,939

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total
In thousands EUR					
Transfer of commercial properties to investment property on completion of development	0	0	0	-16,103	-16,103
Transfer to inventories ^{1.1}	0	0	0	-5,177	-5,177
Transfer from one category of property, plant and equipment to another	19	0	-1	-18	0
Total transfers in 2006	19	0	-1	-21,299	-21,280
Transfer of commercial properties to investment property on completion of development	0	0	0	-439	-439
Transfer to inventories	-4	0	0	0	-4
Transfer from one category of property, plant and equipment to another	0	19	-19	0	0
Total transfers in 2007	-4	19	-19	-439	-443

^{1.1} In the summer of 2006, the Group signed a letter of intent regarding the sale in 2007 of a property located in Narva which was carried as an asset under construction. Under the above letter of intent, the Group undertook to complete construction work on the property by the spring of 2007 at the latest, and to sign rental contracts with tenants to the extent of at least 50% of the rental space. Due to a change in its intended use, the property was transferred to inventories in an amount of 81,008 thousand kroons (5,177 thousand euros).

Other information on property, plant and equipment:

As at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Carrying amount of property, plant and equipment pledged as collateral	102,541	64,639	6,554	4,131
Payable for purchase of property, plant and equipment	2,864	20,277	183	1,296
Amounts due under construction contracts for properties carried as assets under construction	2,631	0	168	0

25 Intangible assets

	Goodwill	Software	Total
In thousands EEK			
Carrying amount at 31 December 2005	13,071	513	13,584
Additions	0	935	935
Additions through acquisition of interests from minority shareholders (note 7.4)	3,768	0	3,768
Additions through business combinations (note 7.3)	11,318	0	11,318
Disposals	0	-15	-15
Impairment loss (note 10)	-12,599	0	-12,599
Amortisation charge (note 10)	0	-286	-286
Carrying amount at 31 December 2006	15,558	1,147	16,705
Cost at 31 December 2006	15,558	1,840	17,398
Accumulated amortisation at 31 December 2006	0	-693	-693
Additions	0	825	825
Additions through business combinations (note 7.3)	5,818	0	5,818
Additions through acquisition of interests from minority shareholders (note 7.4)	2,581	11	2,592
Disposals	0	-3	-3
Amortisation charge (note 10)	0	-432	-432
Carrying amount at 31 December 2007	23,957	1,548	25,505
Cost at 31 December 2007	23,957	2,665	26,622
Accumulated amortisation at 31 December 2007	0	-1,117	-1,117

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	Goodwill	Software	Total
In thousands EUR			
Carrying amount at 31 December 2005	835	33	868
Additions	0	60	60
Additions through acquisition of interests from minority shareholders (note 7.4)	241	0	241
Additions through business combinations (note 7.3)	723	0	723
Disposals	0	-1	-1
Impairment loss (note 10)	-805	0	-805
Amortisation charge (note 10)	0	-18	-18
Carrying amount at 31 December 2006	994	73	1,068
<i>Cost at 31 December 2006</i>	<i>994</i>	<i>118</i>	<i>1,112</i>
<i>Accumulated amortisation at 31 December 2006</i>	<i>0</i>	<i>-44</i>	<i>-44</i>
Additions	0	53	53
Additions through business combinations (note 7.3)	375	0	375
Additions through acquisition of interests from minority shareholders (note 7.4)	165	1	166
Amortisation charge (note 10)	0	-28	-28
Carrying amount at 31 December 2007	1,531	99	1,630
<i>Cost at 31 December 2007</i>	<i>1,531</i>	<i>170</i>	<i>1,701</i>
<i>Accumulated amortisation at 31 December 2007</i>	<i>0</i>	<i>-71</i>	<i>-71</i>

Carrying amount of goodwill by segments:

	Service segment	Development segment	Construction segment	Total
In thousands EEK				
Carrying amount at 31 December 2005	0	1,123	11,948	13,071
Additions through acquisition of interests from minority shareholders (note 7.4)	0	158	3,610	3,768
Additions through business combinations (note 7.3)	0	11,318	0	11,318
Impairment loss (note 10)	0	-12,599	0	-12,599
Carrying amount at 31 December 2006	0	0	15,558	15,558
Additions through acquisition of interests from minority shareholders (note 7.4)	4,539	500	0	5,039
Additions through business combinations (note 7.3)	0	0	3,360	3,360
Carrying amount at 31 December 2007	4,538	500	18,919	23,957

	Service segment	Development segment	Construction segment	Total
In thousands EUR				
Carrying amount at 31 December 2005	0	72	764	836
Additions through acquisition of interests from minority shareholders (note 7.4)	0	10	230	240
Additions through business combinations (note 7.3)	0	723	0	723
Impairment loss (note 10)	0	-805	0	-805
Carrying amount at 31 December 2006	0	0	994	994
Additions through acquisition of interests from minority shareholders (note 7.4)	290	32	0	322
Additions through business combinations (note 7.3)	0	0	215	215
Carrying amount at 31 December 2007	290	32	1,209	1,531

Goodwill was tested for impairment at the end of 2007. The tests indicated that goodwill was not impaired.

The impairment tests performed at the end of 2006 indicated that the goodwill allocated to two investment properties in the Development segment was impaired. The Group recognised an impairment loss of 11,318 thousand kroons (723 thousand euros) for goodwill allocated to one property because at the end of the year the property's fair value and future cash flows could not be sufficiently conservatively measured and estimated. The Group recognised an impairment loss of 1,123 thousand kroons (72 thousand euros) for goodwill allocated to the other property in connection with the sale of the property in 2006.

Assumptions applied on estimating the recoverable amount of goodwill allocated to the Service segment

- The recoverable amount was estimated based on value in use.
- Cash flows were projected:
 - based on the Group's prior experience of the growth of service companies in Estonia, Latvia, Bulgaria and Ukraine;
 - assuming that the revenue of the Service segment will increase at the rate of 10% per year;
 - assuming that supply of services will expand outside the capitals and this will increase market share;
 - by discounting free cash flows at the weighted average cost of capital of 14% per year;
 - based on the budgets approved by management for the next five years.

Assumptions applied on estimating the recoverable amount of goodwill allocated to the Construction segment

- The recoverable amount was estimated based on value in use.
- Cash flows were projected as follows:
 - It was assumed that due to EU requirements the volume of environmental engineering projects and the opportunities of participating in relevant public procurement tenders in Estonia will increase in the next five years by up to 1,550 million kroons and that the Group's environmental engineering revenues and gross profit will increase at the rate of 0.8-10% per year.
 - In calculating the value in use of the goodwill allocated to general construction in Estonia, revenue was estimated based on the number of square metres expected to be built, the average sales price per square metre, and the expected annual growth rates of those indicators. It was assumed that the number of square metres built will increase by 59% in 2008, by 1% in 2009, by 1% in 2010 and at the rate of 5% per year thereafter. It was forecast that the price per square metre will increase at the rate of 5% per year and that the ratio of cost of sales to revenue will be 96%.
 - In calculating the value in use of the goodwill allocated to general construction in Latvia, revenue was estimated based on the number of square metres expected to be built, the average sales price per square metre, and the expected annual growth rates of those indicators. It was assumed that the number of square metres built will increase 1.2-fold in 2008, by 8% in 2009 and by 11% in 2010 after which the number of square metres built will remain stable. It was forecast that the price per square metre will increase at the rate of 5% per year and that the ratio of cost of sales to revenue will be 89%.
 - The free cash flows of construction companies were discounted at the weighted average cost of capital of 13.65% per year. Consistent cash flow (CCF) was calculating using a 10% specific risk factor. Accordingly CCF was calculated using a 23.65% cost of capital.
 - The projections were based on the budgets approved by management for the next five years.

Assumptions applied on estimating the recoverable amount of goodwill allocated to the Development segment

- The recoverable amount was estimated based on value in use.
- The goodwill acquired by the Development segment in 2007 was related to plant production at a Group's subsidiary. Therefore, the recoverable amount of the goodwill could not be estimated using assumptions applied by the segment in prior periods. In 2007, cash flows were projected based on the expected growth in plant production which was forecast by reference to budgets approved by management for the next five years and the Group's prior plant production experience. Cash flows were discounted at the weighted average cost of capital of 15% per year.
- In 2006, cash flows were projected based on prior experience regarding the lease of commercial premises and the following assumptions:
 - Rental income will increase at the rate of 2% per year.
 - Expenses will increase at the rate of 2-3% per year.
 - The vacancy rate of rental premises will be 3% per year.
 - The discount rate on exiting the project will be 11.5%.
 - The projections were based on the budgets approved by management for the next five years.

26 Loans and borrowings

	31 December 2007		31 December 2006	
	Total	Including current portion	Total	Including current portion
In thousands EEK				
Overdrafts ¹	0	0	18,530	18,530
Debt securities ²	139,284	124,545	181,551	87,128
Bank loans ³	1,094,580	563,689	888,837	571,080
Finance lease liabilities (note 27)	6,712	2,475	3,975	1,004
Other loans ⁴	113,439	62,368	63,933	21,826
Total (note 35)	1,354,015	753,077	1,156,826	699,568

	31 December 2007		31 December 2006	
	Total	Including current portion	Total	Including current portion
In thousands EUR				
Overdrafts ¹	0	0	1,184	1,184
Debt securities ²	8,902	7,960	11,603	5,568
Bank loans ³	69,956	36,026	56,807	36,499
Finance lease liabilities (note 27)	429	158	254	64
Other loans ⁴	7,250	3,986	4,087	1,396
Total (note 35)	86,537	48,130	73,935	44,711

¹ At 31 December 2007, Group companies had access to overdraft facilities whose limits totalled 8,723 thousand kroons (556 thousand euros). At the end of 2006, the limits of available overdraft facilities totalled 35,600 thousand kroons (2,275 thousand euros).

² In 2007, the Group issued short- and long-term commercial paper with a total par value of 119,379 thousand kroons (7,630 thousand euros) and redeemed commercial paper at the total par value of 73,640 thousand kroons (4,706 thousand euros). In 2006, the Group issued commercial paper with a total par value of 96,960 thousand kroons (6,197 thousand euros) and redeemed commercial paper at the total par value of 91,438 thousand kroons (5,844 thousand euros). The average effective interest rate of the issues was 6.85% (2006: 5.16%).

At 31 December 2007 and 31 December 2006, the following debt securities issues were still redeemable:

			Par value		Interest rate, %	Balance, EEK		Balance, EUR	
Settlement date	Redemption date	Commercial paper	EEK	EUR		2007	2006	2007	2006
In thousands									
1 December 2005	1 December 2008	Arco Vara AS FRN 1.12.2008	85,000	5,432	6.74	0	0	0	0
22 June 2006	22 January 2007	Arco Vara AS CP 22012007	87,400	5,586	5.25	0	87,128	0	5,568
22 June 2006	1 December 2008	Arco Vara AS FRN 1.12.2008 increase	9,560	611	6.74	94,423	94,423	6,035	6,035
22 January 2007	21 January 2011	Arco Vara AS bond 21012011	27,929	1,785	8.38	14,739	0	942	0
22 January 2007	21 September 2007	Arco Vara AS CP 21092007	60,450	3,863	6.462	0	0	0	0
21 September 2007	20 June 2008	Arco Vara AS CP 20062008	31,000	1,981	6.25	30,121	0	1,925	0
Total						139,284	181,551	8,902	11,603

³ In 2007, the weighted average interest rate of loans and borrowings was 6.70% (2006: 5.57%). The weighted average interest rate of bank loans was 6.51% (2006: 5.46%).

The interest rates of major bank loans are as follows:

	Loan balance		Interest rate, %	
	31 December 2007	31 December 2006	2007	2006
In thousands EEK				
Short-term bank loan	145,000	145,000	6.90	5.65
Long-term bank loan	104,308	78,240	5.53	4.63
Long-term bank loan	97,250	87,017	5.99	5.75
Short-term bank loan	83,200	83,200	6.25	5.50
Long-term bank loan	-	64,581	-	5.45

Long-term bank loan	121,960	-	6.29	-
Long-term bank loan	93,880	-	7.80	-
Long-term bank loan	87,621	-	6.16	-

Information on assets pledged as security for bank loans is presented in note 31.

The Group's loan liabilities are denominated in Estonian kroons, Latvian lats or euros.

⁴ At 31 December 2007, other loans included loan liabilities to related parties of 100,484 thousand kroons (6,422 thousand euros). At 31 December 2006, the corresponding figure was 19,458 thousand kroons (1,244 thousand euros). For further information on related parties, please refer to note 39.

27 Finance lease liabilities

Finance lease liabilities by settlement term	31 December 2007		31 December 2006	
	Minimum lease payments	Present value of minimum lease payments	Minimum lease payments	Present value of minimum lease payments
In thousands EEK				
Less than 1 year	2,551	2,272	1,083	1,004
Between 1 and 5 years	4,434	3,896	2,892	2,803
More than 5 years	552	544	170	168
Lessor's gross investment	7,537	6,712	4,145	3,975
Future interest expense	-825		-170	
Lessor's net investment	6,712	6,712	3,975	3,975

Finance lease liabilities by settlement term	31 December 2007		31 December 2006	
	Minimum lease payments	Present value of minimum lease payments	Minimum lease payments	Present value of minimum lease payments
In thousands EUR				
Less than 1 year	163	145	69	64
Between 1 and 5 years	283	249	185	179
More than 5 years	35	35	11	11
Lessor's gross investment	481	429	265	254
Future interest expense	-52		-11	
Lessor's net investment	429	429	254	254

Assets acquired with finance lease	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
Investment property	3,426	3,207	219	205
Property, plant and equipment	6,307	1,905	403	122
Total carrying amount	9,733	5,112	622	327

28 Payables and other liabilities

Payables

Current items

	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
In thousands				
Trade payables¹	60,612	68,021	3,874	4,347
Other payables				
Payables to jointly controlled entities (note 39)	6,386	1	408	0
Payables from securities transactions ²	48,616	9,540	3,107	610
Payables related to non-current asset transactions ³	0	5,000	0	320
Miscellaneous payables ⁴	29,496	114,768	1,885	7,335
Total other payables	84,498	129,309	5,400	8,265
Taxes payable				
Value added tax	1,761	9,459	113	605
Income tax on dividends	3,449	1,785	220	114
Personal income tax	2,535	2,054	162	131
Social tax	4,841	3,936	309	252
Other taxes	4,037	5,175	258	331
Total taxes payable	16,623	22,409	1,062	1,432
Accrued expenses				
Interest payable ⁵	7,164	4,223	458	270
Payables to employees	27,671	10,440	1,769	668
Dividends payable	8,743	3,897	559	249
Other accrued expenses ⁶	18,280	10,976	1,168	701
Total accrued expenses	61,858	29,536	3,954	1,888
Total payables	223,591	249,275	14,290	15,932

¹ At 31 December 2007, trade payables included items of 2,631 thousand kroons (168 thousand euros) payable for the acquisition of property, plant and equipment. At 31 December 2006, the corresponding figure was 21,146 thousand kroons (1,351 thousand euros).

² At 31 December 2007, the amounts payable for securities transactions included the following items:

- an amount of 41,964 thousand kroons (2,682 thousand euros) due to a minority shareholder for the interests acquired in Group entities in March 2006. The liability is non-interest-bearing. Therefore, it is discounted at the rate of 5%. Discounting expense for 2007 amounted to 1,978 thousand kroons (126 thousand euros) and has been recognised in the income statement in finance expense (as an item of interest expense). At 31 December 2007, the carrying amount of the liability was 41,539 thousand kroons (2,655 thousand euros). At 31 December 2006, the liability was carried as a long-term item in "Other liabilities" in an amount of 39,562 thousand kroons.
- a liability of 6,121 thousand kroons (391 thousand euros) arising from a put option granted under a shareholder agreement. Information on the gains and losses from the measurement of the put option is presented in notes 12 and 13.
- a liability of 914 thousand kroons (58 thousand euros) arisen from the acquisition of a Latvian construction company through a business combination. The non-current portion of the liability is carried in "Other liabilities".
- a liability of 40 thousand kroons (3 thousand euros) for the acquisition of an associate. The Group had the liability both at the end of 2006 and 2007.

At 31 December 2006, payables from securities transactions included a liability of 9,500 thousand kroons (607 thousand euros) arisen from acquisition of interests in Group entities in 2004.

³ At 31 December 2006, amounts payable for non-current assets included a deposit of 5,000 thousand kroons (320 thousand euros) received based on a contract under the law of obligations signed for the sale of an investment property.

⁴ At 31 December 2007, miscellaneous payables included:

- payables to related parties of 28,406 thousand kroons (1,815 thousand euros). At the end of 2006 the corresponding figure was 39,616 thousand kroons (2,532 thousand euros). Further information on related parties is presented in note 39.
- individually insignificant payables of 1,179 thousand kroons (753 thousand euros). At the end of 2006, the corresponding figure was 1,613 thousand kroons (103 thousand euros).

At 31 December 2006, miscellaneous payables included a penalty liability of 73,539 thousand kroons (4,700 euros) incurred in connection with withdrawal from a contract related to the Holiday Club Estonia project.

⁵ At 31 December 2007, interest payable included interest liabilities to related parties of 2,474 thousand kroons (158 thousand euros). At the end of 2006 the corresponding figure was 693 thousand kroons (44 thousand euros). Further information on related parties is presented in note 39.

⁶ At 31 December 2007, other accrued expenses included:

- accrued items of 12,495 thousand kroons (799 thousand euros) arisen from the sale of development projects. At the end of 2006, the corresponding figure was 9,205 thousand kroons (588 thousand euros).
- accruals of 1,043 thousand kroons (67 thousand euros) payable for the management of real estate funds. At the end of 2006, the corresponding figure was 1,060 thousand kroons (68 thousand euros).
- accrued expenses of 4,004 thousand kroons (256 thousand euros) related to the intermediation of commercial real estate.
- miscellaneous accrued expenses of 738 thousand kroons (47 thousand euros). At the end of 2006, the corresponding figure was 711 thousand kroons (45 thousand euros).

Other liabilities

Non-current items

	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
In thousands				
Liabilities from securities transactions ¹	1,211	39,562	77	2,528
Deposits received ²	1,461	1,499	93	96
Miscellaneous long-term liabilities ²	1,935	500	124	32
Total other liabilities	4,607	41,561	294	2,656

¹ Liabilities from securities transactions comprise a liability incurred in 2007 in connection with the acquisition of a Latvian construction company. The current portion of the liability is carried in "Other payables".

At 31 December 2006, liabilities from securities transactions comprised the cost of interests acquired in Group entities from a minority shareholder in March 2006. At 31 December 2007, the liability is carried as a current item and presented in "Payables from securities transactions".

² At 31 December 2007, miscellaneous long-term liabilities included liabilities to related parties of 997 thousand kroons (64 thousand euros). At the end of 2006, there were no miscellaneous long-term liabilities to related parties. Further information on related parties is presented in note 39.

29 Deferred income

	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
In thousands				
Advances for sale of real estate	23,758	59,001	1,518	3,771
Deferred income from long-term service contracts ¹	2,114	634	135	41
Other deferred income	21,344	3,792	1,365	242
Total deferred income	47,216	63,427	3,018	4,054

¹ Adjustment of the revenue of long-term service contracts

	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
In thousands				
Costs incurred and recognised profit under the stage of completion	94,664	108,614	6,050	6,942
Progress billings	-75,143	-104,711	-4,802	-6,693
Total revenue adjustment	19,521	3,903	1,248	249
Including due from customers (note 18)	21,635	4,537	1,383	290
Including due to customers	-2,114	-634	-135	-41

30 Provisions

	Warranty provision ¹	Provision for customer's share of profit ²	Other provisions ³	Total
In thousands EEK				
Provision at 31 December 2005	291	351	1,100	1,742
Provisions made during the year	154	0	1,515	1,669
Provisions used during the year	-12	-351	0	-363
Provision at 31 December 2006	433	0	2,615	3,048
Including current portion	433	0	1,520	1,953
Provisions made during the year	1,268	0	1,392	2,660
Provisions used during the year	-398	0	-1,591	-1,989
Provision at 31 December 2007	1,303	0	2,416	3,719
Including current portion	1,303	0	2,165	3,468

	Warranty provision ¹	Provision for customer's share of profit ²	Other provisions ³	Total
In thousands EUR				
Provision at 31 December 2005	19	22	70	111
Provisions made during the year	10	0	97	107
Provisions used during the year	-1	-22	0	-23
Provision at 31 December 2006	28	0	167	195
Including current portion	28	0	97	125
Provisions made during the year	81	0	89	170
Provisions used during the year	-25	0	-102	-127
Provision at 31 December 2007	84	0	154	238
Including current portion	83	0	139	222

¹ Warranty provisions are recognised based on management's best estimates, i.e. by reference to the terms and conditions of each construction contract (whether the Group acts as a general contractor or uses own labour, who the subcontractors are, how complicated the project is, where the project is performed, etc). A provision amounts to up to 1% of the cost of the contract. Warranty provisions are created for covering the costs which may be incurred during the warranty period. A warranty period lasts for two years from the delivery of work performed.

² According to a construction contract, a Group's subsidiary was entitled to 80% of the difference between the contractual price and actual cost of the work performed. Due to this clause, the Group made a provision for the profit attributable to the customer under the stage of completion method in 2005. The project was completed in 2006.

³ Based on a resolution adopted by the supervisory board of a jointly controlled entity at 31 December 2007 a provision of 687 thousand kroons (44 thousand euros) was recognised for the bonuses payable to the entity's management and employees. According to estimates, the provision will be used in the summer of 2008. At the end of 2006, the corresponding figure was 1,515 thousand kroons (97 thousand euros).

At 31 December 2007, provisions for additional expenses which could be incurred from transactions performed in prior periods totalled 1,271 thousand kroons (81 thousand euros). At the end of 2006, the corresponding figure was 1,095 thousand kroons (70 thousand euros). According to estimates, the risk of additional expenses will expire within 2 to 4 years.

At 31 December 2007, the Group's Bulgarian development company had created a builder's warranty provision of 458 thousand kroons (29 thousand euros). This is the amount by which at 31 December 2007 the construction company providing services to the Group had reduced the invoices paid to it on a monthly basis. The provision will be used for covering construction defects and deficiencies. The provision will be recognised for 15 years after the delivery of the work performed.

31 Assets pledged as security

The Group has pledged the following assets as security for its loans and borrowings (including finance lease liabilities):

	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
In thousands				
Properties carried as inventories (note 20)	810,212	272,473	51,782	17,414
Investment property (note 23)	983,568	1,202,542	62,861	76,856
Property, plant and equipment (note 24)	102,541	64,639	6,554	4,131
Shares in Group entities (commercial pledge)	0	3,552	0	227
Total pledged assets	1,896,321	1,543,206	121,197	98,628

32 Share capital

	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
Number of issued shares fully paid up	95,284,150	30,453,037	95,284,150	30,453,037
Share capital (in thousands)	952,842	304,530	60,898	19,463
Share premium per share (in kroons and in euros)	7.48	4.04	0.48	0.26
Total share premium (in thousands)	712,514	123,083	45,538	7,866

In May 2007, Arco Vara AS increased its share capital by 373,331 thousand kroons (23,860 thousand euros) through a bonus issue. The issue was arranged using the company's equity; no additional contributions were made. The company issued 37,331,113 new shares with a par value of 10 kroons each.

In June 2007, the company issued an additional 27,500 thousand shares with a par value of 10 kroons each. The shares were subscribed during the initial public offering (IPO) of the shares of Arco Vara AS on Tallinn Stock Exchange. The subscription price of a share was set to 38 kroons (2.43 euros). As a result of the IPO, the company was paid 1,045,000 thousand kroons (66,788 thousand euros) in cash. Direct issue costs of 57,486 thousand kroons (3,674 thousand euros) have been recognised as a reduction of share premium.

At 31 December 2007, the maximum authorized number of shares was 121,812,148.

33 Contingent liabilities

Income tax on dividends

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Retained earnings at 31 December	218,830	292,002	13,986	18,662
Contingent income tax liability	45,954	64,240	2,937	4,106
Amount	172,876	227,762	11,049	14,556

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The maximum contingent income tax liability has been calculated on the assumption that the net dividend and the associated dividend tax expense may not exceed the distributable profits as of 31 December 2007.

The Group's management board has decided to propose to the Group's supervisory board and shareholders that the company distribute 37,210 thousand kroons (2,378 thousand euros) of the net profit for 2007 as dividends (2006: 16,953 thousand kroons (1,083 thousand euros)), i.e. a dividend of 0.4 kroons per share (2006: 0.56 kroons). If the supervisory board and annual general meeting of the company's shareholders approve the proposal, the distribution will give rise to income tax expense of 9,891 thousand kroons (632 thousand euros) (2006: 4,782 thousand kroons (306 thousand euros)).

Pending litigation

Litigation against the jointly controlled entity AS Tallinna Olümpiapurjespordikeskus (AS TOP)

Regati Valduste OÜ (the other shareholder of AS TOP) and Urmas Uustal, a member of the supervisory board of AS TOP, filed a statement of claim against the Group's jointly controlled entity AS TOP with a view to establishing that the resolution of the supervisory board of AS TOP to sell 21374/175937 of the legal share in the property is null and void and prohibiting the transaction, and submitted an application for securing the action. On 19 October 2006, Harju County Court decided to dismiss the statement of claim.

In November 2006, Urmas Uustal and Regati Valduste OÜ filed an appeal with Tallinn Circuit Court. Following this, AS TOP filed its objections to the appeal.

On 29 February 2008, Tallinn Circuit Court annulled the ruling of Harju County Court of 19 October 2006 regarding the claim of Regati Valduste OÜ and Urmas Uustal against AS TOP and issued a new ruling. The Circuit Court ruled that the resolutions of the supervisory board of AS TOP of 15 November 2005 are void. The court ordered AS TOP to pay the legal costs of 62 thousand kroons (4 thousand euros).

At the date of these annual financial statements are authorised for issue, the ruling has not yet entered into force and AS TOP may file an appeal in cassation within 30 days of the receipt of the ruling.

The Group's management believes that AS TOP has not violated the procedure for the adoption of resolutions and the statement of claim is baseless. Therefore, the Group has not recognised a provision for the claim. The Group's management does not believe that the transaction will result in any penalty or similar costs.

Litigation against the subsidiary Arco Investeeringute AS

In December 2006, Profitor Group OÜ filed a statement of claim against Arco Investeeringute AS for settlement of an invoice of 1,377 thousand kroons (88 thousand euros) and related interest on arrears of 225 thousand kroons (14 thousand euros).

In January 2007, Arco Investeeringute AS filed a counterclaim against Profitor Group OÜ for charging 4,368 thousand kroons (279 thousand euros) for services not delivered. To date, the judicial proceedings have not commenced.

During a preliminary hearing held in autumn 2007, the judge recommended that the parties settle the dispute through compromise. To date, the parties have not reached a compromise.

The Group's management believes Profitor Group OÜ did not deliver the agreed service and consequently the claim is baseless.

Litigation against the subsidiary Arco Vara Kinnistute AS

At the beginning of 2006, OÜ Faalanks (bankrupt) filed a statement of claim against Arco Vara Kinnistute AS in which it claimed settlement of 3,305 thousand kroons (211 thousand euros) for non-performance of contractual obligations arising from a construction contract, including interest on arrears of 2,218 thousand kroons (142 thousand euros), and settlement of 4,650 thousand kroons (297 thousand euros) for unjustified enrichment. In July 2006, OÜ Faalanks filed an application for the reduction of the claim, in which it lowered its claim against Arco Vara Kinnistute AS by 4,237 thousand kroons (271 thousand euros), and asked the court to order payment of 3,718 thousand kroons (238 thousand euros) for the benefit of OÜ Faalanks.

During a preliminary hearing held in 2007, existing documents were reviewed but no substantive developments occurred.

According to the Group's management, the claim against Arco Vara Kinnistute AS is baseless because: 1) 1,087 thousand kroons (69 thousand euros) of the claim was offset against Arco Vara Kinnistute OÜ's receivables from OÜ Faalanks in 2004; 2) since there is no principal claim, the claim for interest on arrears of 2,218 thousand kroons (142 thousand euros) is baseless; 3) the parties regulated their mutual relations with a contract and signed documents verifying the delivery of work performed, according to which OÜ Faalanks completed its work on the site and Arco Vara Kinnistute AS had no other liabilities except the amounts payable on the basis of invoices for work actually performed.

At the date these consolidated financial statements are authorised for issue, the litigation is still pending.

34 Government grant

In 2006, the Group received a government grant of 1,384 thousand kroons (88 thousand euros) in support of the production of forest plants with enclosed root systems (potted forest plants) and a government grant of 347 thousand kroons (22 thousand euros) for the establishment of forest plantations on arable land. The government grant received for the production of forest plants has been deducted from the cost of property, plant and equipment (note 24). The amount received for the establishment of forest plantations has been deducted from the cost of biological assets (232 thousand kroons (15 thousand euros)) (note 21) and from the cost of sales (115 thousand kroons (7 thousand euros)). In 2007, the Group did not receive any government grants.

35 Financial instruments and financial risk management

The Group's activities expose it to various financial risks: market risk (interest rate risk and currency risk), credit risk and liquidity risk.

The Group's risk management programme is based on the assumption that the financial markets are unpredictable and appropriate measures have to be adopted to minimise potential adverse impacts on the Group's financial activities. The Group uses derivative financial instruments to hedge certain risk exposures.

The Group's risk management process is based on the premise that the Group's success depends on constant monitoring, careful analysis and effective management of the risks faced by the Group. Centralised financial risk management is the responsibility of the Group's financial team. The main objective of financial risk management is to prevent any damage or financial loss that could jeopardise the Group's equity and continuous operation. The Group establishes risk management policies and activities which are aimed at identifying, evaluating, monitoring and managing risks and spreading risks across time, activities and geographical areas. Risk management policies and activities are implemented by the managers of Group entities.

By implementing financial risk management process the critical issue is to monitor the Group's risk exposure in development segment due to the concentration of interest rate and liquidity risk in one business segment –development and geographically in Estonia. The main reason is that the property development is very capital intensive and several large development projects in Estonia are under process at the same time.

Information on financial instruments by category

	EEK		EUR	
	31.12.2007	31.12.2006	31.12.2007	31.12.2006
In thousands				
Cash and cash equivalents	765,008	58,345	48,893	3,729
Loans and receivables	765,008	58,345	48,893	3,729
Receivables	337,313	113,171	21,558	7,233
Loans and receivables	335,983	111,611	21,473	7,133
Derivatives	1,330	1,560	85	100
Other financial assets	127,110	65,769	8,124	4,203
Loans and receivables	128	57,554	8	3,678
Non-current investments in equity instruments – carried at fair value ¹	126,982	8,215	8,116	525
Total financial assets	1,229,431	237,285	78,575	15,165
Loans and borrowings	1,354,015	706,533	86,537	45,156
Carried at amortized cost	1,354,015	706,533	86,537	45,156
Payables and other liabilities	228,198	290,836	14,585	18,588
Carried at amortized cost	228,198	290,836	14,585	18,588
Total financial liabilities	1,582,213	997,369	101,122	63,743

Income, expense, gains and losses on financial instruments can be assigned to the following categories:

2007

	Loans and receivables	Derivatives	Non-current investments in equity instruments – carried at fair value	Liabilities carried at amortized cost	Total
In thousands EEK					
Interest income (note 12)	29,472	0	705	0	30,177
Interest expense (note 13)	0	-156	0	-33,684	-33,840
Gains and losses from other non-current financial assets (note 12, 13)	0	0	43,317	4,544	47,861
Impairment losses on financial assets (note 13)	-25,768	0	0	0	-25,768
Net result	3,704	-156	44,022	-29,140	18,430

2007

	Loans and receivables	Derivatives	Non-current investments in equity instruments – carried at fair value	Liabilities carried at amortized cost	Total
In thousands EUR					
Interest income (note 12)	1,884	0	45	0	1,929
Interest expense (note 13)	0	-10	0	-2,153	-2,163
Gains and losses from other non-current financial assets (note 12, 13)	0	0	2,768	290	3,058
Impairment losses on financial assets (note 13)	-1,647	0	0	0	-1,647
Net result	237	-10	2,813	-1,863	1,177

2006

	Loans and receivables	Derivatives	Non-current investments in equity instruments – carried at fair value	Liabilities carried at amortized cost	Total
In thousands EEK					
Interest income (note 12)	1,818	1,549	0	0	3,367
Interest expense (note 13)	0	0	0	-30,800	-30,800
Gains and losses from other non-current financial assets (note 12, 13)	-6,497	0	5,429	0	-1,068
Impairment losses on financial assets (note 13)	-11,721	0	0	0	-11,721
Net result	-16,400	1,549	5,429	-30,800	-40,222

2006

	Loans and receivables	Derivatives	Non-current investments in equity instruments – carried at fair value	Liabilities carried at amortized cost	Total
In thousand euros					
Interest income (note 12)	116	99	0	0	215
Interest expense (note 13)	0	0	0	-1,968	-1,968
Gains and losses from other non-current financial assets (note 12, 13)	-415	0	346	0	-69
Impairment losses on financial assets (note 13)	-748	0	0	0	-748
Net result	-1,047	99	346	-1,968	-2,570

Financial assets overdue

The Group has some trade receivables which are more than three months overdue but for which no impairment allowance has been made. The Group's management has assessed the recoverability of such receivables on an individual basis and has come to the conclusion that the items are not impaired.

The following table provides an overview of overdue receivables:

	EEK		EUR	
	31.12.2007	31.12.2006	31.12.2007	31.12.2006
In thousands				
Until 3 months	38,340	40,863	2,451	2,611
3 - 6 months	1,150	2,986	74	191
6 - 12 months	5,855	721	374	46
More than 12 months	2,821	577	180	37
Total trade receivables (note 18)	48,166	45,147	3,079	2,885

The Group's other financial assets do not include overdue items for which an impairment allowance has not been made.

Liquidity risk

Liquidity risk is the risk that a change in financial position will cause the Group to encounter difficulty in meeting the obligations associated with financial liabilities in a due and timely manner, or that the Group will be unable to dispose of property at market price and within the desired timeframe. Above all, the Group's liquidity is affected by the following factors:

- Group entities' ability to generate independent positive net operating cash flows and the volatility of those cash flows
- Mismatch in the maturities of assets and liabilities and flexibility in adjusting it
- Marketability of long-term assets
- Volume and pace of property development
- Volume and pace of geographical expansion
- Financing structure

The Group's financial team manages the Group's liquidity based on a relevant strategy which is aligned with the Group's investment plan.

Short-term liquidity management is based, first and foremost, on Group entities' approved annual budgets. The purpose of short-term liquidity management is to guarantee the availability of sufficient highly liquid funds (i.e. cash and cash equivalents and highly liquid investments). The main tools for short-term liquidity management are the group account, which pools the funds of Group entities, and, in the case of foreign Group entities, loans from the Parent. According to estimates, the Group has to maintain liquid funds at the level of 20-40 million kroons (1-3 million euros) to ensure the continuity of its regular operations. In order to guarantee the availability of relevant resources, the Parent has arranged overdraft facilities which are linked to the group account and has implemented a commercial paper programme to access the funds of the local capital market.

Long-term liquidity is primarily influenced by investment decisions. The Group observes the principle that Group entities' net cash inflows from operating and investing activities have to cover the Group's cash outflows from financing activities. Accordingly, the purpose of long-term liquidity management is to ensure sufficient liquidity of the investment (property) portfolio, harmonize the timing of cash flows from investing and financing activities, and determine the optimal financing structure. Long-term projects are monitored to ensure that the timing and amounts of investing cash flows do not differ significantly from the timing and amounts of financing cash flows. As a rule, the Group does not accept investment projects where the required equity financing exceeds 30% of the cost of the project. The following table illustrates the Group's open position in refinancing short-term loan liabilities.

Maturity structure of financial assets and financial liabilities

	31.12.2007			
	< 3 months	3-12 months	1-5 years	> 5 years
In thousands				
EEK				
Cash and cash equivalents	685,008	80,000	0	0
Receivables	76,224	220,965	40,124	0
Total				

Investments in financial assets	78,595	0	48,515	0	127,110
Total assets	839,827	300,965	88,639	0	1,229,431
Loans and borrowings	111,888	605,374	500,983	135,770	1,354,015
Payables	139,093	84,498	4,607	0	228,198
Total liabilities	250,981	689,872	505,590	135,770	1,582,213

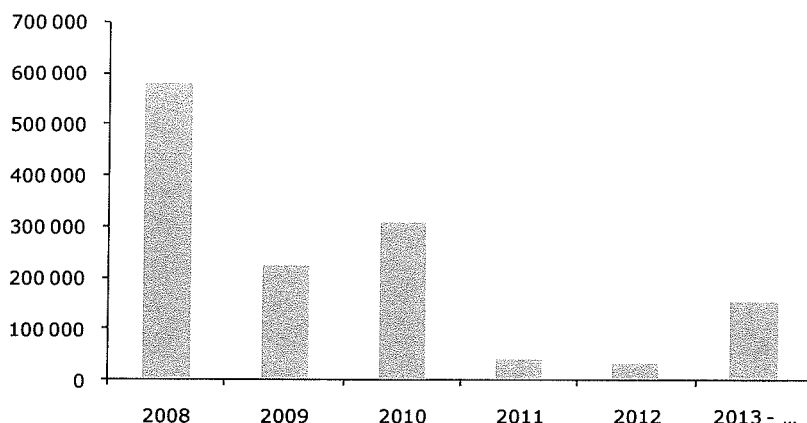
31 December 2006					
	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EEK					
Cash and cash equivalents	58,345	0	0	0	58,345
Receivables	68,441	34,057	10,673	0	113,171
Investments in financial assets	0	0	65,769	0	65,769
Total assets	126,786	34,057	76,442	0	237,285
Loans and borrowings	135,773	389,089	554,331	77,633	1,156,826
Payables	119,966	129,309	41,561	0	290,836
Total liabilities	255,739	518,398	595,892	77,633	1,447,662

31 December 2007					
	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EUR					
Cash and cash equivalents	43,780	5,113	0	0	48,893
Receivables	4,872	14,122	2,564	0	21,558
Investments in financial assets	5,023	0	3,101	0	8,124
Total assets	53,675	19,235	5,665	0	78,575
Loans and borrowings	7,151	38,690	32,019	8,677	86,537
Payables	8,890	5,400	294	0	14,584
Total liabilities	16,041	44,090	32,313	8,677	101,121

31 December 2006					
	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EUR					
Cash and cash equivalents	3,729	0	0	0	3,729
Receivables	4,374	2,177	682	0	7,233
Investments in financial assets	0	0	4,203	0	4,203
Total assets	8,103	2,177	4,885	0	15,165
Loans and borrowings	8,678	24,867	35,428	4,962	73,935
Payables	7,668	8,264	2,656	0	18,588
Total liabilities	16,346	33,131	38,084	4,962	92,523

Based on the maturities of liabilities included in the Group's loan portfolio, at 31 December 2007 the average weighted maturity of loans and borrowings was 2.2 years, a slight decrease from the 2.7 years measured at 31 December 2006. The following graph illustrates the maturity distribution of loans and borrowings.

Breakdown of loans and borrowings by maturity (in thousands of kroons)



Refinancing risk is managed by monitoring the liquidity position on a daily basis and analysing different financing options on a consistent and ongoing basis. In addition, partner banks and professionals qualified in analysing developments in capital markets are involved in the process already in the initial stage.

Interest rate risk and currency risk

Interest rate risk is the risk that a rise in market interest rates will increase interest expense to an extent that will have a significant impact on the Group's operating efficiency. Exposure to interest rate risk results from:

1. use of loans and borrowings with a floating interest rate, and
2. the need for refinancing in connection with the arrival of the due dates of liabilities or the involvement of new loans in connection with the realisation of the investment plan in a situation where the volatility of financial markets is increasing and the economic environment is changing.

Most of the Group's long-term loans and borrowings are linked to EURIBOR. Therefore, the Group is exposed to developments on the international financial markets. Interest rate risk is managed, among other things, by monitoring movements in the money market interest rate curve, which reflects the market participants' expectations of market interest rates and allows estimating a trend for euro-denominated interest rates.

In response to a 1 percentage point rise in EURIBOR in 2007, the Group analysed the sensitivity of its profit before tax and cash flows to a 1 percentage point change in interest rates.

The sensitivity analysis of consolidated cash flows indicated that a 1 percentage point change (rise or decline) in interest rates would affect (increase or reduce) the Group's cash flows for 2007 by 8,281 thousand kroons (529 thousand euros) (2006: 8,153 thousand kroons (521 thousand euros)). The sensitivity analysis of profit before tax demonstrated that a 1 percentage point change (rise or decline) in interest rates would affect (increase or reduce) profit before tax for 2007 by 5,050 thousand kroons (328 thousand euros) (2006: 5,530 thousand kroons (353 thousand euros)). In managing its short-term interest rate risks, the Group regularly compares potential losses from changes in interest rates against corresponding risk hedging expenses. To date, no financial instruments have been used to hedge short-term interest rate risks because according to management's assessment hedging expenses would exceed the losses which might be incurred.

The Group's interest-bearing assets and liabilities

31 December 2007

By maturity	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EEK					
Interest-bearing assets	692,865	145,062	38,578	0	876,505
Interest-bearing liabilities	111,888	605,374	500,983	135,770	1,354,015
Net position	580,977	-460,312	-462,405	-135,770	-477,510

31 December 2006					
By maturity	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EEK					
Interest-bearing assets	23,314	14,966	5,669	0	43,949
Interest-bearing liabilities	135,773	389,089	554,331	77,633	1,156,826
Net position	-112,459	-374,123	-548,662	-77,633	-1,112,877

31 December 2007					
By maturity	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EUR					
Interest-bearing assets	44,282	9,271	2,466	0	56,019
Interest-bearing liabilities	7,151	38,690	32,019	8,677	86,537
Net position	37,131	-29,419	-29,553	-8,677	-30,518

31 December 2006					
By maturity	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EUR					
Interest-bearing assets	1,490	957	362	0	2,809
Interest-bearing liabilities	8,678	24,867	35,428	4,962	73,935
Net position	-7,188	-23,910	-35,066	-4,962	-71,126

Currency risks are hedged by performing most transactions and signing most agreements and contracts in euros or currencies pegged to the euro. The main currency risk is the devaluation of the local currency against the euro. In view of the low probability of the devaluation, the risk is not significant.

Breakdown of loans and borrowings by currency

	EEK		EUR		Proportion, %	
	2007	2006	2007	2006	2007	2006
As at 31 December						
In thousands						
EUR	875,421	466,754	55,950	29,831	65	40
EEK	472,055	686,362	30,170	43,867	35	59
Other currencies	6,539	3,712	418	237	0	0
Total	1,354,015	1,156,828	86,538	73,935	100	100

Breakdown of interest-bearing assets by currency

	EEK		EUR		Proportion, %	
	2007	2006	2007	2006	2007	2006
As at 31 December						
In thousands						
EEK	817,937	20,212	52,276	1,292	93	98
EUR	58,568	0	3,743	0	7	0
Other currencies	0	423	0	27	0	2
Total	876,505	20,635	56,019	1,319	100	100

The Group's liabilities are denominated mainly in the euro or in the Estonian kroon and operating volumes are the largest in countries whose local currency is pegged to the euro. Therefore, the currency risk is insignificant. Currency risks arising from open positions are hedged by euro-denominated transactions between countries and matching the timing of receipts and payments in the country involved.

Credit risk

Credit risk is the risk that the other party to a financial instrument will cause a financial loss to the Group by failing to discharge an obligation.

Credit risk is managed by making sure that there are no major concentrations of credit risk. Group entities prevent and minimize credit risk by monitoring and managing customers' settlement behaviour on a daily basis so that appropriate measures could be applied in due time. In addition, sales and construction activities are partly financed with customer prepayments and in real estate transactions, where the other party is often financed by a credit institution, the Group cooperates with banks. Consequently, the risks arising from customer insolvency are well hedged.

Allowances are made for potential losses. Potential losses are estimated based on historical experience, the other party's ability to meet existing obligations in the short term, and developments in the economic environment.

Group entities perform transactions only with counterparties who are considered creditworthy. As a rule, immediate payment is demanded. Credit is granted against additional collateral only. Accordingly, management believes that the need for additional hedging of credit risk is minimal. The maximum potential credit risk equals the total carrying amount of receivables, cash and cash equivalents and investments in financial assets.

Fair value

The main financial assets and financial liabilities of Group entities are recognised in the balance sheet. The Group does not have any significant off-balance sheet financial assets or liabilities which have not been disclosed in the financial statements. Because of the accounting and reporting principles applied, the carrying amounts of the financial assets and financial liabilities do not differ significantly from their fair values.

The fair values of assets and liabilities with a fixed interest rate are not significantly different from their carrying amounts because the fixed interest rate does not differ significantly from current market interest rates.

Hedging

All derivative financial instruments which are used to hedge risks are recognised as assets or liabilities. Regardless of their purpose, they are initially recognised at their fair values. Changes in the fair values of such derivative instruments are recognised in the income statement in finance income and expenses (in "Interest expense").

At 31 December 2007, the fair value of risk hedging transactions was 1,330 thousand kroons (85 thousand euros) (2006: 1,560 thousand kroons (100 thousand euros)). The interest rate swap matures on 1 December 2008. The fair value of the interest rate swap is recognised in the balance sheet in other receivables or other payables, as appropriate.

Capital management

The objective of capital management is to maintain a capital base which ensures the Group's continuous operation and development and to prevent risks which could jeopardise the Group's equity.

The Group finances its operations with both debt and equity capital. Property development is very capital intensive. Therefore, as a rule, related investment projects are financed on the assumption that equity financing should not exceed 30% of the cost of the project.

In designing the optimal financing structure and identifying and measuring risks, the Group monitors the proportion of equity in the consolidated balance sheet. At 31 December 2007, equity accounted for 54.1% (2006: 32.8%) of the balance sheet total.

Management makes a proposal for the distribution of dividends based on the Group's results of operation and investment plan, and developments in the economic environments of the markets in which the Group operates.

Notes to the cash flow statement

36 Cash flows from operating activities

The Group's operating cash flows result from the sales of services and properties carried as inventories as well as associated costs and the Group's overheads. In 2007, cash flows from properties carried as inventories consisted mainly of expenditures incurred in connection with new residential development projects in Bulgaria and Lithuania of 366,343 thousand kroons (23,414 thousand euros) and existing residential development projects in Estonia and Latvia of 292,968 thousand kroons (18,724 thousand euros). The sale of properties in Estonia and Latvia reduced inventories by 234,583 thousand kroons (14,992 thousand euros).

The change in receivables reflects a 91,711 thousand kroon (5,861 thousand euro) increase in VAT receivables triggered by the acquisition and development of properties in Bulgaria and Lithuania.

37 Cash flows from investing activities

The Group's cash flows from investing activities result from the acquisition and disposal of subsidiaries and interests in jointly controlled entities, the purchase and sales of property, plant and equipment, and loans granted and interest received.

In 2007, the largest cash inflows resulted from the disposal of interests in Sportings Riga SIA and Arco HCE OÜ of 218,176 thousand kroons (13,943 thousand euros) in aggregate. Other disposal proceeds comprised inflows from the divestment of investments in Kramer Kinnisvara OÜ, Varamaad Kinnisvara OÜ and Arco Capital TOV.

38 Cash and cash equivalents

Cash comprises cash on hand, bank cheques and demand deposits. In accordance with IAS 7 *Cash Flow Statements*, cash and cash equivalents also include term deposits with a maturity of less than three months.

	EEK		EUR	
	31 December 2007	31 December 2006	31 December 2007	31 December 2006
In thousands				
Cash and demand deposits	70,738	35,031	4,521	2,239
Term deposits	694,270	23,314	44,372	1,490
Total cash and cash equivalents	765,008	58,345	48,893	3,729

At 31 December 2007, term deposits comprised deposits with a maturity of up to three months of 646,466 thousand kroons (41,317 thousand euros) and overnight deposits of 58,035 thousand kroons (3,709 thousand euros). At the end of 2006, the figures were 18,173 thousand kroons (1,161 thousand euros) for term deposits and 5,141 thousand kroons (329 thousand euros) for overnight deposits.

In 2007, the interest rates for term deposits ranged from 2.64% to 7.9% per year (2006: 2.46% to 3.69%).

The interest rates for demand deposits ranged from 0.25% to 0.5% per year (2006: the same).

Other information

39 Transactions with related parties

For the purposes of these consolidated financial statements related parties comprise:

- jointly controlled entities
- associated companies
- companies and other persons having control, joint control or significant influence over the Group or Group entities (this includes venture partners and shareholders of the Parent);
- key members of the Group's management (this includes members of the Parent's supervisory board and members of the management boards of the Group's subsidiaries and jointly controlled entities)
- other related parties (this includes companies related to members of the Parent's supervisory board)

Transactions and balances with related parties:

As at 31 December or for the year	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Transactions with jointly controlled entities¹				
Sales revenue	5,017	9,937	321	635
Services purchased	-46	-72	-3	-5
Short-term loan receivables ² (note 18)	52,530	4,075	3,357	260
Long-term loan receivables ³ (note 18)	37,688	2,215	2,409	142
Trade receivables (note 18)	963	4,846	62	310
Other current receivables (note 18)	226	4,967	14	317
Other non-current receivables (note 18)	850	0	54	0
Payables (note 28)	6,386	1	408	0
Transactions with companies having joint control over Group companies				
Sales revenue	135	0	9	0
Services purchased	-555	-103	-35	-7
Other current receivables ⁴ (note 18)	3,490	0	223	0
Long-term loan receivables (note 18)	0	113	0	7
Short-term loan liabilities ⁵ (note 26)	51,852	3,240	3,314	207
Dividends payable (note 28)	8,743	3,897	559	249
Trade payables	24	0	2	0
Interest payable (note 28)	2,101	693	134	44
Long-term loan liabilities (note 26)	38,898	12,438	2,486	795
Other long-term liabilities (note 28)	815	0	52	0
Transactions with key staff of the Group and the Group's management				
Sales revenue	5,093	0	326	0
Short-term loan receivables (note 18)	0	5,017	0	321
Trade receivables	1,377	104	88	7
Short-term loan liabilities (note 26)	1,945	268	124	17
Interest payable (note 28)	373	166	24	11

As at 31 December or for the year	EEK		EUR	
	2007	2006	2007	2006
Transactions with other related parties				
Sales revenue	14,395	249	920	16
Services purchased	10,582	-27,756	676	-1,774
Short-term loan receivables ^{6, 7} (note 18)	12,391	8,196	792	524
Interest receivable (note 18)	1,242	1,566	79	100
Other current receivables ⁷ (note 18)	2,825	5,089	181	325
Long-term loan receivables (note 18)	907	5,197	58	332
Short-term loan liabilities (note 26)	298	552	19	35
Trade payables	17	0	1	0
Other payables (note 28)	28,406	39,616	1,815	2,532
Long-term interest liabilities (note 28)	997	0	64	0
Long-term loan liabilities (note 26)	7,491	2,960	479	189

¹ The figures do not include the sales and purchases, and receivables and payables which have been eliminated in the consolidated financial statements based on the Group's interest.

² In January 2007, the Group sold a 50% stake in the subsidiary Arco HCE OÜ. As a result of the transaction, Arco HCE OÜ became a jointly controlled entity and the consolidated financial statements include 50% of the Group's receivables from the jointly controlled entity. At 31 December 2007, short-term loan receivables from jointly controlled entity Arco HCE OÜ totalled 46,975 thousand kroons (3,002 thousand euros). The annual interest rate of the loan is 10%.

³ Long-term loan receivables from jointly controlled entities as at 31 December 2007 include, among other items, a loan of 37,552 thousand kroons (2,400 thousand euros) granted to Bishumuizhas Nami SIA. The annual interest rate of the loan is 7% and the settlement term is 31 December 2014.

⁴ At 31 December 2007, other current receivables from companies with joint control over Group companies included receivables from the Group's related parties which in the second quarter were taken over by companies holding shares in Arco Vara AS. At the date of transfer, the receivables totalled 8,532 thousand kroons (545 thousand euros). On the distribution of dividends the receivables will be offset against the Group's dividend liabilities. At 31 December 2007, the receivables totalled 3,487 thousand kroons (223 thousand euros).

⁵ Short-term loan liabilities include 46,034 thousand kroons (2,942 thousand euros) due to the other venturer of Arco HCE OÜ. The annual interest rate of the loan is 10%.

⁶ At 31 December 2007, short-term loan receivables from other related parties were bearing interest at the rate of 4-6% per year (2006: the same).

⁷ At 31 December 2006, other current receivables from other related parties included items due from Arco Kinnisvaraholduse AS which had arisen on the takeover of liabilities to Group companies in an amount of 3,810 thousand kroons (243 thousand euros). At the beginning of 2007, the receivables were transformed into a loan. At 31 December 2007, short-term loans to Arco Kinnisvaraholduse AS and the receivables which were transformed into a loan totalled 9,163 thousand kroons (586 thousand euros). The annual interest rate of the loans is 6%.

Transactions with associates

In 2006, the Group granted its associate a loan of 8,900 thousand kroons (569 thousand euros), which was considered irrecoverable at the end of the year. Further information on the transaction is presented in note 22.

Management's remuneration

The remuneration of the Parent's management board and division managers for 2007, including associated taxes, totalled 24,313 thousand kroons (1,554 thousand euros). The corresponding figure for 2006 was 8,688 thousand kroons (555 thousand euros). The termination benefits calculated for two members of the management board in 2007 totalled 4,267 thousand kroons (273 thousand euros). In 2006, no termination benefits were calculated or paid.

During the IPO, Toletum OÜ and HM Investeeringud OÜ, the companies of Arco's founding partners, sold 1,550,000 shares to the management of Arco Group at the IPO offer price. The payment for the shares is deferred and will become payable on the third anniversary of the IPO when the management has two options: (1) put option to the same entities at acquisition cost plus accrued interests 6% p.a. on the deferred liability, or (2) the sales of the shares at the market price on stock exchange and payment of the deferred acquisition cost plus accrued interests. Until then the shares are pledged to the relevant selling entity.

The purchase price equalled the IPO price (fair value) and therefore no expense in Group report according to IFRS 2 has been recognised.

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 ERNST & YOUNG

31.03.2008/m

40 Events after the balance sheet date

Preliminary agreement on the sale of apartments in the Madrid development project in Bulgaria

At the beginning of March 2008, the Group's Bulgarian development company signed a preliminary agreement on the sale of apartments in the Madrid development project. Under the agreement, 45 apartments and 60 parking spaces will be sold en bloc. The total value of the transaction is 126.7 million kroons (8.1 million euros). The buyer settled 38 million kroons (2.4 million euros) of this at the beginning of March 2008 and will pay the rest in 2009 when the building has been issued a permit of use.

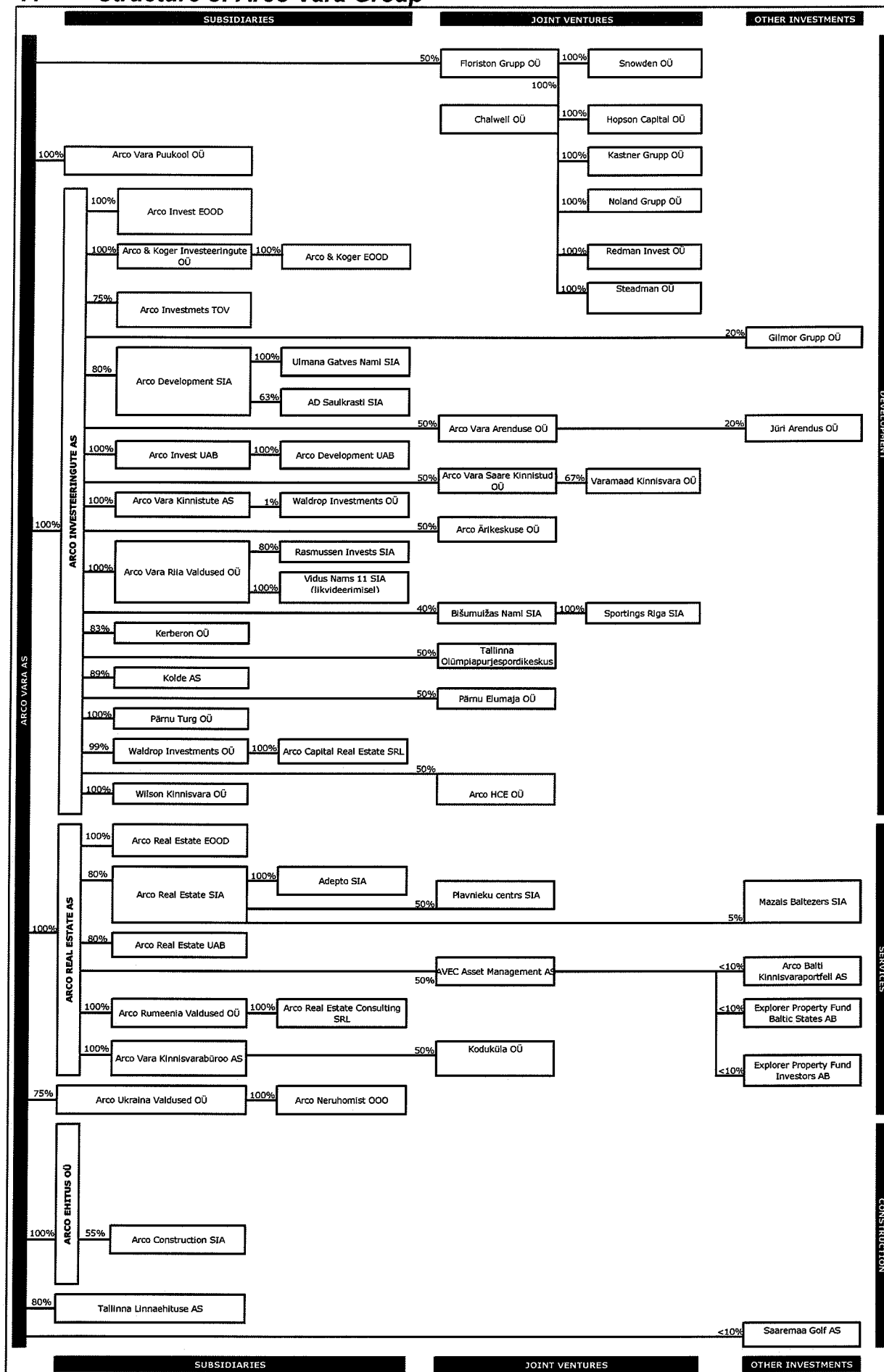
Preliminary agreement on the participation in a shopping centre project in Ukraine

In February 2008, a subsidiary of the Group signed a preliminary agreement on the acquisition of a 50% stake in a shopping centre project in Simferopol, Ukraine. Based on the agreement, the subsidiary made a prepayment of 85.6 million kroons (5.5 million euros) in March 2008. The final price of the stake depends on the results of legal and financial due diligence procedures. The final contract on the purchase and sale of the stake will be signed on 30 September 2008 at the latest.

Loan agreement

In February 2008, a subsidiary of the Group entered into a loan agreement with Piraeus Bank Bulgaria Plc. The loan of 219 million kroons (14 million euros) was taken to finance the construction of the Manastirski project in Sofia, Bulgaria. The loan term is 48 months and base interest rate is 3 months' EURIBOR. The margin which is added to the base rate ranges from 2.25 to 2.75%, depending on how quickly the apartments are sold.

41 Structure of Arco Vara Group



42 The Parent's unconsolidated financial statements presented in accordance with the Estonian Accounting Act

The Parent's unconsolidated primary financial statements have been prepared and presented in accordance with the Estonian Accounting Act and they do not constitute the Parent's separate financial statements as defined in IAS 27 *Consolidated and Separate Financial Statements*.

UNCONSOLIDATED INCOME STATEMENT

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Revenue from rendering of services	10,250	15,511	655	991
Cost of sales	-9,068	-12,130	-580	-775
Gross profit	1,182	3,381	75	216
Other income	8,404	2,326	537	149
Selling and distribution expenses	-4,717	-1,692	-301	-108
Administrative expenses	-38,431	-19,614	-2,456	-1,254
Other expenses	-355	-165	-23	-11
Operating profit	-33,917	-15,764	-2,168	-1,008
Gain / loss on shares in subsidiaries and jointly controlled entities	479,204	7,127	30,627	455
Finance income	26,997	41,893	1,725	2,677
Finance expenses	-14,093	-20,526	-901	-1,312
Profit before tax	458,191	12,730	29,283	812
Income tax expense	-9,230	-3,307	-590	-211
Profit for the year	448,961	9,423	28,693	601

UNCONSOLIDATED BALANCE SHEET

As at 31 December	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Cash and cash equivalents	687,926	14,142	43,966	904
Financial investments	78,595	0	5,023	0
Receivables	638,185	245,096	40,787	15,664
Prepayments	690	1,323	44	85
Inventories	0	1	0	0
Total current assets	1,405,396	260,562	89,820	16,653
Financial investments	489,709	292,613	31,298	18,701
Investment property	16,540	17,040	1,058	1,090
Property, plant and equipment	12,221	3,655	782	234
Intangible assets	610	251	40	16
Total non-current assets	519,080	313,559	33,178	20,041
TOTAL ASSETS	1,924,476	574,121	122,998	36,694
Loans and borrowings	124,558	105,439	7,961	6,739
Payables	131,883	90,299	8,429	5,771
Total current liabilities	256,441	195,738	16,390	12,510
Loans and borrowings	14,739	94,423	942	6,035
Other liabilities	0	40,061	0	2,561
Total non-current liabilities	14,739	134,484	942	8,596
TOTAL LIABILITIES	271,180	330,222	17,332	21,106
Share capital	952,842	304,530	60,898	19,463
Share premium	712,514	123,083	45,538	7,866
Statutory capital reserve	20,084	5,486	1,284	351
Retained earnings	-32,144	-189,200	-2,054	-12,092
Total equity	1,653,296	243,899	105,666	15,588
TOTAL LIABILITIES AND EQUITY	1,924,476	574,121	122,998	36,694

UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory capital reserve	Retained earnings	Total
In thousands EEK					
At 31 December 2005	304,530	123,083	420	-210,690	217,343
Change in retained earnings from merger with a subsidiary	0	0	0	28,821	28,821
Change in capital reserve from merger with a subsidiary	0	0	4	0	4
Dividend distribution	0	0	0	-11,692	-11,692
Transfer to capital reserve	0	0	5,062	-5,062	0
Profit for the period	0	0	0	9,423	9,423
At 31 December 2006	304,530	123,083	5,486	-189,200	243,899
Bonus issue	373,312	-123,083	0	-250,229	0
Issue of share capital	275,000	712,514	0	0	987,514
Transfer to capital reserve	0	0	14,598	-14,598	0
Change in retained earnings from merger with a subsidiary	0	0	0	-1,648	-1,648
Dividend distribution	0	0	0	-25,430	-25,430
Profit for the period	0	0	0	448,961	448,961
At 31 December 2007	952,842	712,514	20,084	-32,144	1,653,296
	Share capital	Share premium	Statutory capital reserve	Retained earnings	Total
In thousands EUR					
At 31 December 2005	19,463	7,866	27	-13,466	13,891
Change in retained earnings from merger with a subsidiary	0	0	0	1,842	1,842
Change in capital reserve from merger with a subsidiary	0	0	0	0	0
Dividend distribution	0	0	0	-747	-747
Transfer to capital reserve	0	0	324	-324	0
Profit for the period	0	0	0	602	602
At 31 December 2006	19,463	7,866	351	-12,093	15,587
Bonus issue	23,859	-7,866	0	-15,993	0
Issue of share capital	17,576	45,538	0	0	63,114
Transfer to capital reserve	0	0	933	-933	0
Change in retained earnings from merger with a subsidiary	0	0	0	-104	-105
Dividend distribution	0	0	0	-1,625	-1,625
Profit for the period	0	0	0	28,694	28,694
At 31 December 2007	60,898	45,538	1,284	-2,054	105,666

ADJUSTED UNCONSOLIDATED EQUITY (for calculating compliance with the requirements of the Commercial Code)

	EEK		EUR	
As at 31 December	2007	2006	2007	2006
In thousands				
The Parent's unconsolidated equity	1,653,296	243,899	105,665	15,588
Carrying amount of interests in subsidiaries and jointly controlled entities in the Parent's unconsolidated balance sheet	-74,508	-120,442	-4,762	-7,698
Carrying amount of interests in subsidiaries and jointly controlled entities under the equity method	325,519	601,460	100,903	38,440
The Parent's adjusted equity	1,904,307	724,917	201,806	46,330

For identification purposes only

UNCONSOLIDATED CASH FLOW STATEMENT

	EEK		EUR	
	2007	2006	2007	2006
In thousands				
Operating profit	-33,917	-15,764	-2,168	-1,008
Adjustments for:	-7,940	-2,178	-507	-140
Depreciation and amortisation	464	148	30	9
Gain / loss on sale of investment property	0	-2,326	0	-149
Change in fair value of investment property	-8,404	0	-537	0
Operating profit after adjustments	-41,857	-17,942	-2,675	-1,148
Change in receivables and prepayments	144	-3,569	9	-228
Change in payables	12,348	3,710	789	237
NET CASH USED IN OPERATING ACTIVITIES	-29,359	-17,801	-1,877	-1,139
Acquisition of property, plant and equipment and intangible assets	-486	-532	-31	-34
Acquisition of investment property	0	-9,170	0	-586
Acquisition of subsidiaries and interests in jointly controlled entities	-10,355	-10,301	-662	-658
Proceeds from disposal of subsidiaries and interests in jointly controlled entities	262,994	7,128	16,808	456
Acquisition of other financial investments	-78,595	0	-5,023	0
Loans granted	-661,560	-89,509	-42,281	-5,721
Repayment of loans granted	220,428	195,227	14,088	12,477
Change in group account receivables	104,906	-227,120	6,705	-14,516
Interest received	28,062	29,010	1,793	1,854
Dividends received	800	2,401	51	153
NET CASH USED IN INVESTING ACTIVITIES	-133,806	-102,866	-8,552	-6,575
Proceeds from loans received	115,029	94,178	7,352	6,019
Repayment of loans	-215,915	-97,093	-13,799	-6,205
Change in overdraft	-15,895	15,901	-1,016	1,016
Change in group account liability	-5,934	33,745	-379	2,157
Interest paid	-7,592	-8,620	-485	-551
Proceeds from issue of share capital	987,514	-1,408	63,114	-90
Dividends paid	-15,807	-12,584	-1,011	-804
Income tax paid on dividends	-4,388	-3,745	-281	-238
NET CASH FROM FINANCING ACTIVITIES	837,012	20,374	53,495	1,304
NET CASH FLOW	673,841	-100,293	43,066	-6,410
Cash and cash equivalents at beginning of period	14,142	114,473	904	7,316
Increase / decrease	673,841	-100,293	43,066	-6,410
Effect of exchange rate fluctuations	-57	-38	-4	-2
Cash and cash equivalents at end of period	687,926	14,142	43,966	904

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Arco Vara AS

Report on the Financial Statements

We have audited the consolidated financial statements of Arco Vara AS and its subsidiaries (hereafter "the Group"), identified by us on the accompanying pages of the Consolidated Annual Report, which comprise the consolidated balance sheet as of 31 December 2007, the consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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 as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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 risks 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 entity's preparation 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 entity'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.

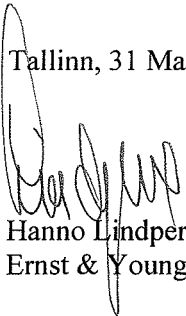
Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.


Report on Other Legal and Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The financial information of Arco Vara AS as a parent company in Note 42 is presented because it is required by the Estonian Accounting Law and is not a required part of the consolidated financial statements prepared under International Financial Reporting Standards as adopted by the European Union. Such financial information has been subject to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is prepared in all material respects in accordance with the requirements of the Estonian generally accepted accounting principles and in relation to the consolidated financial statements taken as whole.

Tallinn, 31 March 2008



Hanno Lindpere
Ernst & Young Baltic AS



Urmo Kallakas
Authorised Auditor

Profit allocation proposal

The management board proposes that the general meeting of the shareholders of Arco Vara AS allocate profit as follows

(In thousands of kroons):

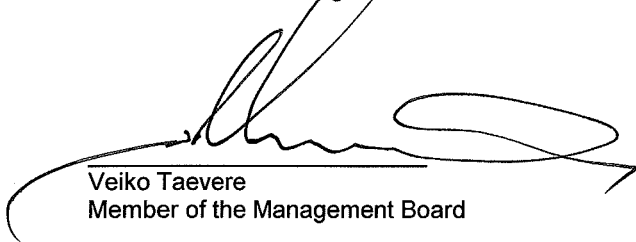
Retained earnings at 31 December 2007	218,830
Transfer to statutory capital reserve	11,379
Dividend distribution (net dividend)	37,210
Retained earnings after allocations	170,241



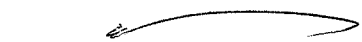
Aare Tammemäe
Chairman of the Management Board



Avo Rõõmussaar
Member of the Management Board



Veiko Taveere
Member of the Management Board



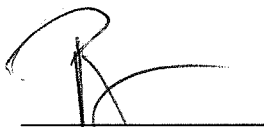

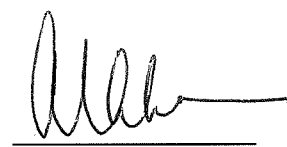
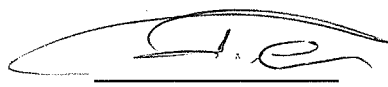
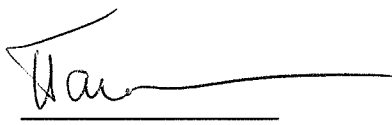
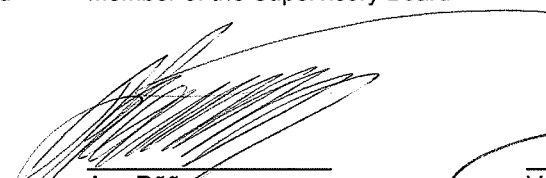
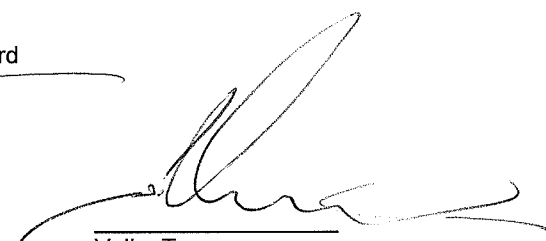
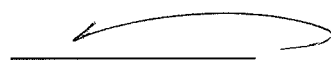
Ahto Altjõe
Member of the Management Board

31. March

2008

Signatures

We hereby confirm that the information presented in the consolidated financial statements of Arco Vara AS for 2007 is true and fair.


Richard Tomingas
Chairman of the Supervisory Board
Hillar-Peeter Luutsalu
Member of the Supervisory Board
Arti Arakas
Member of the Supervisory Board
Aare Tark
Member of the Supervisory Board
Kalev Tanner
Member of the Supervisory Board
Aare Tammemäe
Chairman of the Management Board
Avo Rõõmussaar
Member of the Management Board
Veiko Taevere
Member of the Management Board
Ahto Altjõe
Member of the Management Board

11. April 2008