Baltika Grupp

AS BALTIKA

2003 ANNUAL REPORT
(Translation of the Estonian original)

Commercial name	AS Baltika
Commercial Registry No	10144415
Legal Address	Veerenni 24, Tallinn 10135, Estonia
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E-mail	baltika@baltika.ee
Auditor	AS PricewaterhouseCoopers
Reporting Period	01.01.2003-31.12.2003
Main Fields of Activity	Manufacturing of menswear and womenswear, retail and wholesale, and sewing services

Table of Contents

Short Characteristics of AS Baltika group

Baltika Group is an international clothing trade company with AS Baltika as a parent company. The group operates Monton, Baltman, CHR/Evermen and Baltika Factory Shop retail chains in 81 shops at 7 countries – Estonia, Latvia, Lithuania, Poland, the Ukraine, Russia and Sweden. Baltika uses vertically integrated business model. BG's brands are marketed via its own retail chains and wholesalers, the main brands being Baltman, Evermen and Herold (overcoats) for men, and CHR and Mascara (overcoats) for women. Monton, the brand for both men and women, is marketed solely through BG's retail chain Monton.

By now, BG has become a leading clothing trade company in the Baltics, comprising of 7 trade and 3 production enterprises.

As of 31.12.2003, the group had 1,714 employees. The company is located and has been registered at Veerenni 24, Tallinn, Estonia. AS Baltika is listed in Tallinn Stock Exchange.

As of 31.12.2003, the group consists of the following companies:

	Country of location	Participation 31.12.2003	Participation 31.12.2002
AS Baltika (parent)	Estonia		
OÜ Baltman	Estonia	100%	100%
Baltika Lietuva	Lithuania	100%	100%
Baltika Sweden	Sweden	100%	100%
Baltika Ukraina	Ukraine	99%	99%
Baltika Poland	Poland	100%	100%
Baltika Latvija	Latvia	75%	75%
OY Baltinia AB	Finland	100%	100%
AS Virulane	Estonia	79,23%	79,23%
AS Elina STC	Estonia	50,10%	50,10%

MANAGEMENT REPORT OF AS BALTIKA GROUP 2003

1. Implementation of Strategy

The retail strategy implementation plan of AS Baltika prescribes the following main goals for 2003:

-to improve the efficiency of operation of retail sales space;
Results: In 2003 the sales increased on like-for-like sales spaces (comparable spaces by retail brands in 2002) by 8% in comparison with the previous year, whereas the growth took place in all of the BG's retail markets. On the whole the efficiency of sales (sales/m^2) decreased by 18% in comparison with 2002 of which 4% was attributable to the fall in the exchange rate. A major decrease took place during the first half of the year (-31%), retail efficiency was 9% lower in comparison with the last year's results during the second half of 2003, of which 5% was attributable to the fall in the exchange rate. The markets with the highest sales efficiency were Lithuania and Ukraine, and the lowest sales efficiency was observed in Poland.

-to reduce the percentage of old (older than one season) inventories in the system;
Results: The inventories at the end of the fall season of 2003 were 50% lower than at the end of 2002. The volume of the inventories that were either purchased or produced during 2002 and older inventories decreased in 2003 by 6.7 million euros, the vast majority of which was sold through retail systems owned by the Company, which caused longer discount periods and deeper discount rates. Due to the decrease in the level of inventories one of the major activities at the end of the 2003 was insuring a sufficient level of new inventories for 2004/1, which was more successful than the same period of the previous year: In December the new season goods in the warehouse ready to dispatch were in total of 1.4 million euros (in warehouse prices) in comparative period the amount was 0.2 million euros.

-to increase sales (particularly in the retail system);
Results: the 2003 consolidated net sales of Baltika grew in comparison with 2002 by 2,3% (31.7 million euros in 2003 in comparison to 31.0 million euros in 2002). The retail sales grew by 26% (20.5 million euros in 2003 in comparison to 16.3 million euros in 2002).

-to ensure and strengthen positive cash flow;
BG's cash flow from operating activities in 2003 was 1.6 million euros, during the same period last year it was negative –1.9 million euros. The activities through which BG is planning to ensure stronger cash flow are: decreasing the level of investments, additional reduction of costs during the second half of the year, more precise planning of financial activities, improvement of the inventory management system.

2. General Economic Results

Sales

The net sales of the Baltika Group were 31.7 million euros, growing by 2.3% in comparison with the 2002 sales (31.0 million euros).
Five markets had the strongest growth in retail sales, which was one of the strategic goals of BG in 2003. The retail sales were 20.5 million euros in 2003, which was 26% more than in 2002 (16.3 million euros) and retail sales percentage of total net sales was 64,6% in comparison with 52% in year 2002. The wholesale sales of in-house production, which was 7.8 million euros decreased by 29% in comparison with the year 2002 (by 3.2 million euros) and the subcontracted production sales were 3.2 million euros, which also decreased by 4% in comparison with the year 2002.
The volume of exports was 22.9 million euros in 2003, composing 72% of the total sales (in 2002 respectively 22.7 million euros, 73%). The Estonian market had the largest net sales (8.9 million euros, growth of 6.7%), followed by Lithuania (5.2 million euros, growth of 12.9%), Ukraine (3.5 million euros, growth of 1.8%). The largest growth was achieved in Poland (3.1 million euros, growth 38.6%), although the result was weaker than expected.
The main factors that influenced the sales results in 2003 were: the decline in the average foreign exchange rates (Polish zloty -12.5%, Ukrainian grivna -16.7% and Latvian lat -9.4%), deeper discount rates than planned and the continually weaker performance of the Polish market in comparison with other retail markets. Due to the decline in the foreign exchange rates approximately 1.2 million euros worth of sales was lost.
The sales of Monton retail brand, which celebrated its first anniversary in September 2003, formed 73% of the total retail sales of BG, totaling 15.0 million euros.

The CHR/Evermen retail chain launched during the second half of the year 2003 in four markets accounted for 13.2% of the whole BG retail sales, totaling 2.7 million euros.
The Baltman retail chain relaunched in three markets accounted for 8.3% of the total BG retail sales, totaling 1.7 million euros.
The general problem in retailing in 2003 was the extensive length of discount periods (end of season sales) and the insufficient supply of new products at the beginning of the year, due to which both the discount rates and the total sales decreased.

Financial results

The net loss of Baltika considering the circumstances described below was 4.0 million euros in 2003. During the same period in 2002 the enterprise made a profit of 0.4 million euros. Considering large losses from the exchange rate changes, the need for revaluing the investments in the markets associated with exchange rate losses, the need for changing the accounting estimates of inventory valuation arising from the company's restructuring from a manufacturing enterprise into a retail enterprise and change in inventories structure (increase of fashion brands) as well as the situation in the Polish market the company has decided to conservatively reflect the following financial events as expenses:

- To change the accounting estimates of inventory valuation with respect to the end-of-season fashion items according to the international retail business practice and to make allowances in the amount of 1.1 million euros in order to improve inventory turnover and accelerate the marketing opportunities of older than one season products.
- To expense the costs of closing down a store in Poland in January 2004 in the amount of 0.2 million euros.
- To reassess the value of net investments in Poland and Ukraine in the amount of 0.4 million euros.
- Considering the net loss of 0.8 million euros from the Polish market, to take a conservative view of the deferred income tax accounting principle and accordingly expense 0.1 million euros.

The operating profit has been affected by the market specific fluctuation of retail margins and efficiency. The Polish market where 30% of Monton's selling space is located involves the largest degree of risk and consequently the lowest sales efficiency can be achieved there. The margins have also been affected by the situation according to which the purchases of BG are Euro based but the selling currencies in Poland, Ukraine and Latvia are partly influenced by the descending trend of the exchange rate of USD. Although operating expenses on these markets, converted into Estonian euros, were also smaller because of the fall in the exchange rates, the loss of margins outbalanced the savings on expenses.

In 2003 the operating expenses grew by 9% as compared to 2002. The growth of the expenses was mostly associated with the introduction of new selling space. As a result of the saving program that was introduced during the second half of 2003 the operating and personnel expenses decreased as compared to the initial budget by 0.6 million euros.

The depreciation expenses have grown due to the vast investments into retailing, production and IT that were made during the second half of 2002 and during 2003. In 2003 investments were made in the amount of 1.0 million euros, of which developing retailing was 0.5 million euros, renewal of production machinery was 0.1 million euros, introducing IT related programs 0.4 million euros and other investments 0.1 million euros. The downfall of EURIBOR and gaining better conditions for loan agreements have decreased interest expenses as compared to the last year by 0.1 million euros.

Balance Sheet

As of 31.12.2003, the consolidated balance sheet total of Baltika was 21.1 million euros, having decreased by 2.8 million euros over the financial year. The cash balance increased by 0.2 million euros. Inventories have decreased by 1.8 million euros as compared to the beginning of the financial year.
The balance of short-term and long-term liabilities was 0.5 million euros smaller than at the end of 2002, the liabilities accounted for 8.9 million euros in total.
The reason of the decrease in debt liabilities was redemtion of bonds in amount of 3.2 million euros, and repayments of existing loans and lease liabilities. During the year debt liabilities to banks increased by 1.6 million euros.
The major economic indicators of BG for 2003 were as follows:

	31.12.2003	31.12.2002
Growth in sales as compared to previous year	2.3%	17%
Retail sales from total sales	64%	52%
Number of retail outlets	66	55
BG's retail area (m^2)	10 109	8 684
Markets (countries) managed via own retail trade organizations	6	6
Operating profit to net sales	-11.2%	2.8%
Profit margin	-12.7%	1.4%
Return on equity	-42.7%	4.0%
Return on assets	-17.5%	3.7%

3. Development of Retail Trade

An essential activity for BG in 2003 was segmentation of the market, which was also reflected in the restructuring of the BG's retail space. During the first half of 2003 the renewed concepts of two smaller retail brands Baltman and CHR/EM were prepared, which laid the foundation for a significant increase in those brands' retail selling space. Exactly those retail stores saw a relative enlargement during the second half of 2003. A balanced brand portfolio creates better opportunities for competing successfully in different markets and increases the chance of better satisfying larger customer group's needs.
As of 31.12.2003 BG owned stores in six countries – Estonia, Latvia, Lithuania, Ukraine, Poland and Sweden totaling 10 109 m² of sales space and 66 stores: 31 Monton, 9 Baltman, 18 CHR/Evermen, and 8 Baltika factory stores. During the financial year 1 425 m² of new selling space at 11 new stores was added. Altogether with the franchise contracts and shop-in-shop selling space BG operates 11 552 m² of selling space in 81 stores as of 31.12.2003.
In January 2004 three ineffective stores were closed down: two in Estonia and one in Poland. The principle of closing down of ineffective stores will be maintained in the year 2004.

In 2003 emphasis was made on enlarging and strengthening the client base. More than 34 000 new members joined the Monton client program during the year. By the end of the year there were 46 000 members in the Monton client program. CHR/EM had 14 thousand and Baltman 3.5 thousand regular customers by the end of the year.

4. Production

The objective of the BG production divisions is meet its retail and wholesale needs as much as possible in order to ensure high quality and a flexible and quick ordering system to meet the needs of the retail system.
The total output of 2003 was 820,000 products (818,000 in 2002).

5. Organization and Personnel

The transition to the division-based management that started in 2002 was finalized by mid 2003 when Product Division and Retail Division were formed and the Business Processes Division was divided into two: Financial Services and Business Processes Services. An important structural change took place on August 1 when three brand-based subdivisions were formed - Monton, Baltman and CHR/EM brand-teams that were composed of brand manager, designers and trade analysts (merchandisers). As of winter-fall season 2003 the main profit centers of BG are the markets' retail organisations (maximising the profit within the market (country)) and brand-teams (maximising the revenues of sales of the brands).
The new production information system PROTEX that was utilized in 2003 and the sales information system JAFFEX that is still being developed together with retail markets' information systems enable BG to start operating the retail system efficiently from the BG headquarters at the beginning of 2004.
The utilisation of the new BG's retail concept in different markets met different success rates. Although the results of the second half of 2003 of the Baltic markets more or less met the expectations then the results of Ukraine and Poland remained unsatisfactory (although an objective role was played by depreciation of Ukrainian grivna and Polish zloty in comparison to EURO). In order to improve the results in Poland in the fall of 2003 a special task force was formed, the market organisation was downsized and by the beginning of 2004 the most unprofitable store in Poland (In Wola centre, Warsaw) was closed.
Because of the weak results in 2003 the manager of the Polish market was replaced in January 2004.
The Baltika Group employed 1714 people at the end of 2003, including 491 in retail trade divisions and 1062 in production divisions. In total 316 employees worked abroad.

6. Plans for 2004

According to the BG's 4-year retail trade development plan it is planned to achieve the following in 2004:

- Moderate growth of sales.
- Entering the Russian retail market through a joint venture.
- In managing the inventories a significant increase in the inventory turnover rate.
- Continuing readjustments in the Polish market. The goal is to reach the break-even point at the stores and to minimize the market managing expenses. In case the goal is not accomplished BG will consider closing down its operation in the Polish market in 2005.

Moderate investments are planned for 2004 (up to 1.0 million euros). The investments include the purchase of up to 2000 m² of new selling space in the existing markets (excl. Poland) and Russia combined.

Results of January 2004

The unaudited and unconsolidated total net sales of Baltika in January 2004 were 2.6 million euros, which was 10% more than in January 2003 (2,4 million euros). The retail net sales amounted to 1.6 million euros (16.5% growth). The growth in sales took place in all of the markets except for Poland, where the results of 2002 were not met by 0.04 million euros.
The sales on like-for-like sales space (comparable spaces by retail brands in 2002) increased by 6.7%. The net profit of January was 0.3 million euros, which exceeded the 2003 result by 33% (-0.4 million euros). Three ineffective stores were closed down: one in Poland and two in Estonia.

Meelis Milder
Chairman of Management Board

2003 FINANCIAL STATEMENTS

Management Board's Confirmation of the Financial Statements

The Management Board confirms the completeness and correctness of AS Baltika parent company and group 2003 consolidated financial statements which is presented on pages 8-35.

The Management Board confirms that:

1. The accounting principles and methods used in preparing the financial statements are in compliance with International Financial Reporting Standards (IFRS).

2. The financial statements give a true and fair view of the financial position, the results of its operations and the cash flows of the parent company and the group.

3. Baltika group is a going concern.

....
Meelis Milder
Chairman of Management Board

....
Ülle Järv
Member of Management Board

....
James Haylow
Member of Management Board

....
Maire Milder
Member of Management Board

....
Boriss Loifenfeld
Member of Management Board

Tallinn, 22th of March 2004

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Balance Sheet

EUR thousand	Note	Parent		Group	
ASSETS		**31.12.2003**	**31.12.2002**	**31.12.2003**	**31.12.2002**
Current assets					
Cash and bank	1	302	96	820	640
Held for trading investments	2	24	35	24	35
Customer receivables	3	2 685	2 745	2 922	3 043
Other receivables and prepaid expenses	4,5	4 368	7 239	883	1 244
Inventories	6	5 391	5 971	9 449	11 239
Total current assets		**12 771**	**16 085**	**14 099**	**16 200**
Non-current assets					
Investments in subsidiaries	7,8	3 442	2 628	0	0
Other long-term assets	7	20	20	197	210
Deferred tax assets	9	0	0	148	183
Tangible fixed assets	10	2 063	2 915	5 735	6 927
Intangible assets	11	781	213	885	315
Total non-current assets		**6 305**	**5 776**	**6 965**	**7 635**
TOTAL ASSETS		**19 076**	**21 862**	**21 065**	**23 835**
LIABILITIES AND OWNER'S EQUITY					
Current liabilities					
Debt obligations	13	4 256	5 565	4 431	5 792
Customer prepayments		5	4	17	10
Trade payables	14	3 410	2 310	3 447	2 154
Other tax liabilities	5	304	170	680	517
Accrued expenses	16	324	194	672	497
Total current liabilities		**8 299**	**8 243**	**9 247**	**8 970**
Non-current liabilities					
Long-term debt	13	3 857	2 758	4 441	3 545
Other long-term payables		0	0	2	2
Deferred tax liabilities	9	0	0	0	7
Total non-current liabilities		**3 857**	**2 758**	**4 443**	**3 554**
TOTAL LIABILITIES		**12 156**	**11 001**	**13 690**	**12 524**
Minority interest	17	**0**	**0**	**455**	**451**
OWNER'S EQUITY	18	**6 920**	**10 861**	**6 920**	**10 861**
Share capital (par value)		3 515	3 480	3 515	3 480
Share premium		2 716	2 663	2 716	2 663
Statutory legal reserve		1 463	1 463	1 463	1 463
Retained profit		3 255	2 821	3 255	2 821
(Loss)/profit for the year		(4 028)	434	(4 028)	434
TOTAL LIABILITIES AND OWNER'S EQUITY		**19 076**	**21 862**	**21 065**	**23 835**

Accounting principles presented on pages 13-17 and notes to the financial statements presented on pages 18-35 are integral parts of the financial statements.

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Income Statement

EUR thousand	Note	Parent 2003	Parent 2002	Group 2003	Group 2002
Revenue					
Net sales	19	**22 284**	**25 811**	**31 744**	**31 025**
Other income	20	68	462	39	385
Total revenue		**22 352**	**26 273**	**31 782**	**31 410**
Expenses					
Materials, raw materials, and services		(14 452)	(13 931)	(14 323)	(11 472)
Change in inventories		(135)	66	(42)	104
Operationg expenses	21	(3 063)	(3 710)	(8 745)	(8 059)
Personnel expenses	22	(5 144)	(5 088)	(10 494)	(9 653)
Depreciation and amortization	10,11	(659)	(664)	(1 414)	(1 216)
Other expenses	23	(83)	(132)	(288)	(221)
Total expenses		**(23 536)**	**(23 459)**	**(35 306)**	**(30 518)**
Operating profit		**(1 184)**	**2 814**	**(3 524)**	**892**
(Loss)/profit from subsidiaries		(2 425)	(1 933)	0	0
Net other Financial expenses	24	(419)	(446)	(463)	(542)
(Loss)/profit before taxes and minority interest		**(4 028)**	**434**	**(3 987)**	**350**
Income tax expense	25	0	0	(30)	137
(Loss)/profit before minority interest		**(4 028)**	**434**	**(4 016)**	**488**
Minority interest	17	0	0	12	53
Net (loss) profit		**(4 028)**	**434**	**(4 028)**	**434**
Basic earnings per share (EUR)	26	**(0,73)**	**0,09**	**(0,73)**	**0,09**
Diluted earnings per share (EUR)	**26**	**(0,73)**	**0,09**	**(0,73)**	**0,09**

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Cash flow statement
(indirect method)

		Parent		Group	
Operating activities	**Notes**	**2003**	**2002**	**2003**	**2002**
Operating profit		(1 184)	2 814	(3 524)	892
Adjustment for depreciation and amortization	10,11	659	664	1 414	1 216
Profit from sale of fixed assets	10	(2)	(302)	148	(302)
Change in receivables*	3,4	(263)	(5 149)	505	(75)
Change in inventories	6	580	(642)	1 790	(2 858)
Change in payables		1 371	(182)	1 642	(189)
Interest paid	24	(297)	(483)	(348)	(558)
Income tax paid	25	0	0	(6)	(43)
Other financial income/expenses		0	2	0	2
Total cash from (used in) operating activities		**865**	**(3 277)**	**1 622**	**(1 914)**
Investing activities					
Purchase of tangible and intangible assets	10,11,12	(385)	(751)	(939)	(2 933)
Proceeds from sale of fixed assets	10	13	0	24	19
Proceeds from sale of right of pre-emption of real estate	20	0	368	0	368
Acquisition of subsidiaries		0	(120)	0	(23)
Interest received	24	14	53	7	11
Dividends received		1	4	1	4
Proceeds from sales of marketable securities	2	19	6	19	6
Repayments of loans granted		1	1	1	2
Total cash used in investing activities		**(338)**	**(439)**	**(888)**	**(2 547)**
Financing activities					
Loan repayments	13	(432)	(120)	(569)	(257)
Loans received	13	2 126	853	2 126	1 696
Capital lease payments and instalments paid	12,13	0	(60)	(103)	(112)
Dividends paid to minority shareholders	17	0	0	(7)	0
Receipts from contributions into share capital	18	84	1 483	84	1 483
Redemption of bonds	15	(3 196)	(3 518)	(3 196)	(3 518)
Proceeds from sale of bonds	15	1 093	4 992	1 093	4 992
Proceeds from sale of convertible bonds	15	12	12	12	12
Paid for redeemed convertible bonds		(1)	0	(1)	0
Cash from (used in) financing activities		**(313)**	**3 641**	**(560)**	**4 296**
Changes in foreign currency exchange rate		(8)	(25)	7	(1)
Total cash flow		**206**	**(99)**	**181**	**(167)**
Opening cash and equivalents balance	1	**96**	**196**	**640**	**807**
Closing cash and equivalents balance	1	**302**	**96**	**820**	**640**

* Change in receivables includes the nonmonetary contributions made for increasing the subsidiaries share capital and allowances of receivables from subsidiaries.

Accounting principles presented on pages 13-17 and notes to the financial statements presented on pages 18-35 are integral parts of the financial statements.

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Statement of Changes in Shareholders' Equity

	Share capital	Share premium	Statutory legal reserves	Retained earnings	Profit/loss for the financial year	Total
Balance per 31.12.2001	**3 068**	**1 592**	**1 463**	**1 817**	**1 004**	**8 944**
Appropriation of 2001 profit	0	0	0	1 004	(1 004)	0
Net profit for the accounting period	0	0	0	0	434	434
Contribution to share capital	412	1 071	0	0	0	1 483
Balance per 31.12.2002	**3 480**	**2 663**	**1 463**	**2 821**	**434**	**10 861**
Appropriation of 2002 profit	0	0	0	434	(434)	**0**
Contribution to share capital	35	53	0	0	0	**88**
Net profit for the accounting period	0	0	0	0	(4 028)	**(4 028)**
Balance per 31.12.2003	**3 515**	**2 716**	**1 463**	**3 255**	**(4 028)**	**6 920**

More detailed information on owner's equity and changes in equity is provided in Notes 15 and 18.

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Initsiaalid/initials VE
Kuupäev/date 25/03/2004
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Accounting policies and basis of the preparation of the financial statements

The 2003 financial statements of AS Baltika (the Parent) and its subsidiaries (the Group) have been prepared in accordance with International Financial Reporting Standards (IFRS).

The financial statements have been prepared under the historical cost convention, if not indicated otherwise in the accounting policies of a specific item below. The financial statements are prepared in thousands of Estonian kroons, unless specifically referred to another currency.

Presentation of the current set of financial statements

This set of financial statements has been translated from the Estonian original and converted from Estonian kroons (which is the measurement currency of AS Baltika) into Euros for the convenience of users. Because Estonian kroon is bound to Euro with fixed exchange rate 1 Euro = 15,64664 Estonian kroons, no currency translation differences arise from the converting of financial statements. Although, due to rounding of the figures, some differences below 1 th. euros may arise.

Comparability

The financial statements are prepared in accordance with the comparability and consistency principles, the nature and impact of any changes in accounting methods is explained in respective notes. When the presentation or classification of items in the financial statements is amended, comparative amounts for the previous period are also reclassified.

Consolidation

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies, are consolidated.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless cost cannot be recovered.

The 2003 consolidated annual report incorporates the financial reports of AS Baltika, and its subsidiaries AS Baltman, AS Virulane, AS Elina STC, Baltika Lietuva, Baltika Latvija, Baltika Sweden, Baltika Poland, Baltika Ukraina, and OY Baltinia AB. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

All foreign subsidiaries are regarded as foreign operations that are integral to the operations of the parent company. Accordingly, all items in the financial statements of the foreign operations are translated as if all their transactions had been entered into by the parent company (monetary items using the closing rate, non monetary items using the excange rate at the date of transaction and revenues and expenses using the average rate of the period). Foreign exchange gains and losses are recorded in income statement.

Investments in subsidiaries, in the non-consolidated financial statements of a parent company are accounted for using the equity method.

Cash and Cash Equivalents

Cash on hand, bank account balances (excl. overdraft), and short-term deposits are recorded as cash and cash equivalents in the cash flow statement.

Foreign Currency Transactions

All transactions of AS Baltika and the group are recorded in Estonian kroons. Assets and liabilities denominated in foreign currency have been revalued into Estonian kroons based on the foreign currency exchange rates of Bank of Estonia officially valid on the balance sheet date. During the year, transactions in foreign currency are

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recorded in Estonian kroons based on the foreign currency exchange rates of Bank of Estonia officially valid on the transaction date. Foreign exchange profits and losses are recorded in income statement.

Trade receivables

Trade receivables are carried at original invoice amount less provision made for impairment of these receivables. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers.

Held for trading investments

Investments in shares, which are acquired for trading purposes, and securities that mature within one year from the balance sheet date are classified as trading investments and included in current assets. Shares and other securities are recorded at acquisition cost of the transaction date, and subsequently carried at fair value: quoted shares are recorded at the closing price at the end of the reporting period at Tallinn Stock Exchange; other securities at the sales price on financial markets of the transaction date. Unrealized profits and losses from revaluation of the shares are recorded in income statement, at line "Financial income from investments".

Inventories

Cost is measured at the lower of cost and net realisable value. Cost is determined using the First-in-First-out (FIFO) costing method. When necessary, provision is made for obsolete and slow moving inventories.

Change in accounting policy

As a result of the introduction of a new software, the Group changed the cost determination basis of its inventory from average cost to FIFO. The impact of this change was however not significant as the range of products changes quickly and the proportion of products having very different costs is low.

Other long-term Financial Investments

Other long-term investments (long-term receivables) are carried at amortised cost.

Fixed assets

Property, plant and equipment are generally assets held by the company for use in the production or supply of goods or services or for administrative purposes, with a useful life of over 1 year.

Property, plant and equipment are recorded at cost, comprising of purchase price (including import duties and non-refundable purchase taxes) and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Property, plant and equipment are stated at historical cost less accumulated depreciation and any impairment.

Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's net selling price and its value in use), it is written down immediately to its recoverable amount.
Self-constructed assets are recorded at acquisition cost that include actual production expenses. Reconstruction expenses increase the acquisition cost of reconstructed non-current physical assets. Depreciation is calculated based on the straight-line method, depending on the useful life of the fixed asset. Land is not depreciated.

Profits and losses from the sale of fixed assets are recorded in the income statement, in other income or other expenses.

Annual depreciation rates used by the group companies are:

Building, facilities	2,5-9%
Plant equipment	15-30%
Other fixtures	15-40%

Change in management estimate

During 2003, management has reassessed the useful life of the furniture and fixtures in its stores, extending it from 3 to 5 years. The impact of this change in the 2003 financial statements was to reduce the depreciation charge for the year by EEK 2.9 million.

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

Intangible assets

Software licenses and intangible assets arising from development are recorded as intangible assets. Development expenditures are capitalized only if the company is capable of controlling the use of the asset, capable of assessing the profit generated by that asset, and if technical facilities and practical solutions for applying the new project exist.

An intangible asset is measured initially at cost, comprising of its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at cost less any accumulated amortisation and any accumulated impairment losses. Intangible assets are amortized at straight-line method normally over 5 years except for the accounting/business software used by the parent company which is amortised over 10 years period.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is amortized using the straight-line method over their useful lives, not exceeding a period of 5 years.

Leases

Leases of property, plant and equipment where the group has substantially all the risks and rewards of ownership are classified as finance leases. Other leases are classified as operating leases.

The company is the lessee

Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges (interest expense) so as to achieve a constant rate on the finance balance outstanding. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated similar to acquired assets over the shorter of the useful life of the asset or the lease term.

Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease in the line of "other operating expenses".

The company is the lessor

Assets leased out under operating leases are included in property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment. Rental income is recognised on a straight-line basis over the lease term.

Corporate income tax

According to the Income Tax Act of the Republic of Estonia the annual profit earned by enterprises is not taxed. Thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets and liabilities arise. Instead of taxing the net profit, the distribution of retained earnings is subject to income tax (26/74 of net dividend paid). The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared, regardless of the actual payment date or the period for which the dividends are paid for.

Deferred income tax

According to the Estonian Income Tax Law, the permanent and temporary differences between the tax bases of assets and liabilities and their carrying values in Estonian companies of the group do not arise, thus no deferred income tax assets or liabilities arise. Subsidiaries in Latvia, Lithuania, Poland and Ukraine are the subjects of corporate income tax, adjusted with temporary and permanent differences between the tax bases of assets and liabilities and their carrying values in the balance sheet (Income tax rate in Latvia and Lithuania is 15%; Poland 19% and Ukraine 30%).

Deferred tax is provided for all temporary differences between the tax bases of assets and liabilities and their carrying values in the balance sheet. Main temporary differences arise from depreciation of fixed assets and tax

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

loss carry forward. Deferred tax asset in respect of tax loss carry forwards are recognized in the balance sheet only if their realization is probable.

Provisions and contingent liabilities

Provisions are recognised when the company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows.

Minority Interest

Minority interest in income statement indicates the share of net profit for the financial year belonging to non-group shareholders of subsidiaries. Minority shareholding in the balance sheet presents the share of equity belonging to the non-group shareholders of subsidiaries.

Revenue recognition

Revenue from the sales of goods is recognized when all material risks related to the asset have been transferred to the purchaser and the sales revenue and expenses related to the transaction can be determined reliably. Revenue from the sales of services is recorded upon rendering of the service.
Interest income is recognized on a time proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the Group. Dividends are recognized when the right to receive payment is established.
Revenue from the sales of goods is recognized in the income statement as “net sales”, interest and dividend income as “other income”.

Cash Flow Statement

Cash flow statement is compiled based on the indirect method. According to that method, operating cash flow is calculated by adjusting the operating profit by eliminating the non-monetary transactions and changes in the balances of current assets and current liabilities related to operating activities.

Segment Reporting

In segment reporting retail trade segment is distinguished from the wholesale/production segment with the first comprising accordingly the goods and services provided through Group retail chain and the other the wholesale trade, contractor work and other services provided by Group.
All assets and liabilities related to segments are recorded accordingly as segmental assets and liabilities. Unallocated assets and liabilities (corporate income tax, interest receivables and liabilities, dividend receivables and liabilities, shares) are recorded as the assets and liabilities of the Group. The primary segments of the group are the business segments by areas of operation (differentiating retail trade and production/wholesale), and its secondary segments are geographical segments on the basis of the location of the company's sales network.
Retail segment reflects assets, liabilities, revenues and expenses of retail subsidiaries, related to retail trade as well as assets, liabilities, revenues and expenses of factory shops belonging to production companies. Production and wholesale segment reflects assets, liabilities, revenues and expenses related to production, wholesales and other associated operations. Assets and liabilities of segments do not include financial assets and liabilities, and the revenues and expenses of segment do not include the revenues and expenses accruing from these assets and liabilities. In segment reporting, administrative buildings are considered as indivisible asset of the group; long-term loans, dividends and interest liabilities are considered as indivisible liabilities of the group; administrative costs of the centre are considered as non-allocated expenses of the group.
The management is convinced that the prices used in inter segmental transactions do not substantially differ from market prices.

Financial liabilities

Loans, bonds and convertible bonds are considered as financial liabilities. Financial liabilities are initially recognized at the proceeds received, net of transaction cost incurred and subsequently stated at amortized cost using the affective yield method. Borrowing costs and interest costs are not capitalised but expensed on accrual basis.
The financial liabilities value in balance sheet does not materially differ from their fair value.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

Statutory legal reserve

Statutory legal reserve is formed to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be entered in the statutory legal reserve, until the reserve reaches one-tenth of the share capital. The statutory legal reserve can be used to offset losses from the prior periods or to increase share capital. No distributions can be made from the statutory legal reserve.

Earnings Per Share

Basic earnings per share is the amount that the company can pay out to shareholders, based on the weighted average number of shares outstanding during the year. The diluted earnings per share is calculated taking into account the weighted average number of potential ordinary shares (considering the influence of convertible bonds).

Subsequent Events

Material matters that have an effect on the evaluation of assets and liabilities and that became evident between the balance sheet date and the date of approving the financial statements, but are related to transactions that took place in the reporting period or earlier periods, are recorded in the financial statements.

Subsequent events that have not been taken into consideration when evaluating the assets and liabilities but have material effect on the result of the next financial year are disclosed in the Notes to the financial statements.

Fair value estimation

The fair value of publicly traded derivatives and trading and available-for-sale securities is based on quoted market prices at the balance sheet date.

In assessing the fair value of non-traded financial instruments, the Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for the specific or similar instruments are used for long-term debt. Other techniques, such estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

NOTES TO THE FINANCIAL STATEMENTS

Note 1 Cash and Bank

	Parent		Group	
	31.12.2003	31.12.2002	31.12.2003	31.12.2002
Cash and bank - Estonian kroons	11	7	36	82
Cash and bank - foreign currencies	291	89	528	558
Short-term deposits	0	0	257	0
	302	**96**	**820**	**640**

To be more flexible in managing liquid assets, a group account is in use, which enables the subsidiaries to use the group's resources up to a limit established by AS Baltika (see note 27).

As of 31.12.2003, Polish subsidiary had an overnight deposit in the amount of EUR 256 thousand (PLN 1 210 thousand) with interest rate of 4.5%.

Note 2 Held for trading investments

	Parent and Group	
	31.12.2003	31.12.2002
	Fair value	Fair value
Shares of AS Tallinna Kaubamaja	24	18
Shares of AS Hansapank	0	17
Total Short Term Shares and Securities	**24**	**35**

Note 3 Customer Receivables

	Parent		Group	
	31.12.2003	31.12.2002	31.12.2003	31.12.2002
Customer receivables	2 756	2 824	2 999	3 126
Impairment provision	(71)	(80)	(76)	(83)
Total	**2 685**	**2 745**	**2 922**	**3 043**

Note 4 Other Receivables and Prepaid Expenses

	Parent		Group	
	31.12.2003	31.12.2002	31.12.2003	31.12.2002
Receivables from subsidiaries	4 180	7 007	0	0
Other short-term receivables	26	58	82	74
Prepaid and refundable taxes	130	132	625	1 005
Prepaid expenses	30	40	174	162
Interest receivables	2	3	2	3
Total	**4 368**	**7 239**	**883**	**1 244**

More detailed information about prepaid and refundable taxes is disclosed in note 5. Prepaid expenses as at 31.12.2003 include prepaid rental and insurance expenses, prepayments for IT services, subscription costs of periodicals, etc.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Receivables from subsidiaries	Parent 31.12.2003	31.12.2002
For goods		
Baltika Lietuva	1 188	1 779
Baltika Sweden	18	99
Baltika Poland	742	1 921
Baltika Ukraina	1 419	2 061
Baltika Latvija	739	909
Baltinia OY	74	32
Total	**4 180**	**6 801**
Loan		
Baltika Poland	0	206
Total receivables from subsidiaries	**4 180**	**7 007**

The parent company's receivables from subsidiaries have been written down by the amount of negative equity of subsidiaries (as at 31.12.2003 EUR 2 659 thousand; 31.12.2002 EUR 1 412 thousand).

Note 5 Tax Receivables and Liabilities

Tax Receivables (Prepayments)

	Parent		Group	
	31.12.2003	31.12.2002	31.12.2003	31.12.2002
VAT	130	132	611	994
Prepaid income tax	0	0	14	10
Other taxes	0	0	0	1
Total	**130**	**132**	**625**	**1 005**

Tax Liabilities

	Parent		Group	
	31.12.2003	31.12.2002	31.12.2003	31.12.2002
Withheld personal income tax	117	65	200	156
Social tax	172	104	353	258
VAT	0	0	91	85
Other taxes	14	1	35	18
Total	**304**	**170**	**680**	**517**

Information about income tax of the parent company is provided in notes 9 and 25.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

Note 6 Inventories

	Parent		Group	
	31.12.2003	**31.12.2002**	**31.12.2003**	**31.12.2002**
Raw materials	2 723	2 586	3 168	2 940
Provisions for slow moving and obsolete materials	(63)	(19)	(85)	(23)
Work-in progress	737	412	820	468
Finished goods	2 259	3 097	6 569	7 958
Provisions for slow moving and obsolete finished goods	(327)	(110)	(1 089)	(113)
Prepayments to suppliers	62	5	65	9
Total	**5 391**	**5 971**	**9 449**	**11 239**

As at 31.12.2003, the inventories of EUR 1.5 million are carried at their net realizable value, including EUR 1.4 million of finished goods and EUR 0.1 million of materials (as at 31.12.2002 EUR 0.6 million, including EUR 0.5 million of finished goods and EUR 0.1 million of materials).

Change in accounting estimates
In 2003 the accounting estimate of provisions for slow moving and obsolete finished goods was changed to be in accordance with the substantial modifications in the Group's sales structure (increase of retail percentage to 64,6%) and increase of fashion products importance in total product portfolio. Additional provision were made for fashion clothing at the end of the season and previous season's clothing and materials. The amount of provision derives from the product life cycle and is brand based. If the previous estimates had been applied, the provision would have been EUR 1.0 million less in 2003.

See note 13 on pledged inventories.

Note 7 Long-term financial assets

	Parent		Group	
	31.12.2003	**31.12.2002**	**31.12.2003**	**31.12.2002**
Investments in subsidiaries (note 8)	**3 442**	**2 628**	**0**	**0**
Other long-term assets:				
Shares and securities	0	0	0	0
Loan to the manager of a subsidiary (note 27)	0	0	9	9
Long-term lease prepayment	20	20	188	201
Total other long-term assets	**20**	**20**	**197**	**210**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Note 8 Investments in Subsidiaries

					Parent	
Subsidiary	**Location**	**Activity**	**Participation as of 31.12.2003**	**Participation as of 31.12.2002**	**Investment in Subsidiaries 31.12.2003**	**Investment in subsidiaries 31.12.2002**
OÜ Baltman	Estonia	Retail	100%	100%	1 028	1 304
Elina STC AS	Estonia	Production	50,10%	50,10%	75	67
Virulane AS	Estonia	Production	79,23%	79,23%	1 375	1 243
Baltika Latvija	Latvia	Retail	75%	75%	0	7
Baltika Lietuva	Lithuania	Retail	100%	100%	0	0
Baltinia OY	Finland	Wholesale	100%	100%	4	3
Baltika Sweden	Sweden	Retail	100%	100%	8	4
Baltika Poland	Poland	Retail	100%	100%	952	0
Baltika Ukraina	Ukraine	Retail	99%	99%	0	0
TOTAL					**3 442**	**2 628**

Note 9 Deferred Income Tax

	2003				
	Poland	**Latvia**	**Lithuania**	**Ukraine**	**Total**
Deferred income tax liability:					
From fixed assets	0	(19)	0	(7)	**(25)**
Deferred income tax asset:					
From fixed assets	0	0	0	0	**0**
From tax losses carry forward	0	38	58	77	**173**
Net deferred tax asset	**0**	**20**	**58**	**70**	**148**
Deferred tax income (expense) (See note 25)	**(108)**	**1**	**1**	**77**	**(28)**

	2002				
	Poland	**Latvia**	**Lithuania**	**Ukraine**	**Total**
Deferred income tax liability:					
From fixed assets	0	(13)	0	(7)	**(20)**
Deferred income tax asset:					
From fixed assets	7	0	2	0	**8**
From tax losses carry forward	101	31	56	0	**187**
From pension liability	0	0	0	0	**0**
Net deferred tax liability	**0**	**0**	**0**	**(7)**	**(7)**
Net deferred tax asset	**108**	**18**	**57**	**0**	**183**
Deferred tax income (expense) (See note 25)	**108**	**18**	**57**	**(7)**	**176**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials KE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

In addition to the deferred tax loss carry forwards recorded in the balance sheet, the company also has off-balance sheet tax loss carry forwards in amount of EUR 0.1 mln in Poland, EUR 0.2 mln in Ukraine, EUR 0.1 mln in Lithuania and EUR 0.1 mln in Latvia, that according to management estimates will not be realized.

The realization of the deferred assets from tax loss carry forwards is dependent on the future taxable profit in subsidiaries that exceeds the losses carried forward. According to the forecast the tax losses carry forward will realize in Lithuania in 2005, in Latvia within 5 years starting from 2006 and in Ukraine within 3 years starting from 2006. The forecast assumes that the company's strategic goals are achieved and the price policy within the group synchronized.

Note 10 Tangible Assets

Tangible Fixed Assets movement in the Group in 2003

	Land	Buildings, facilities	Plant, equipment	Other fixtures	Facilities under construction	Pre-payments	Total
Acquisition cost 31.12.2002	**192**	**4 721**	**4 669**	**2 642**	**400**	**4**	**12 628**
Accumulated depreciation 31.12.2002	0	(1 010)	(3 612)	(1 079)	0	0	**(5 701)**
Residual value 31.12.2002	**192**	**3 711**	**1 057**	**1 563**	**400**	**4**	**6 927**
Acquired during the period	0	161	187	266	56	14	684
Sold during the period	0	0	(7)	(6)	0	0	(13)
Impairment loss	0	0	0	(162)	0	0	(162)
Reclassified as intangible assets (see note 11)	0	(187)	2	185	0	0	0
Reclassification	0	0	0	0	(400)	0	(400)
Depreciation 2003	0	56	4	0	(56)	(4)	0
Foreign exchange differences	0	(322)	(423)	(556)	0	0	(1 301)
Acquisition cost 31.12.2003	192	4 759	4 507	2 736	0	14	12 209
Accumulated depreciation 31.12.2003	0	1 340	3 686	1 447	0	0	6 473
Residual value 31.12.2003	**192**	**3 419**	**821**	**1 290**	**0**	**14**	**5 735**

The largest investments in the amount of EUR 0.5 million were into retailing. New stores were opened in Latvia, Lithuania, Poland, Ukraine and Estonia. Investments into production equipment were EUR 113 thousand, IT EUR 46 thousand and a car for EUR 30 thousand (using finance lease). See note 12.

Majority of the impairment loss (EUR 0.2 million) relates to the Wola shopping-center in the Polish subsidiary that will be closed in 2004. The assets were written down to zero.

Reclassifying of fixed assets was conducted in Baltika AS and its subsidiary in Ukraine to harmonize the group's fixed assets' grouping principles.

Change in management estimate
During 2003, management has reassessed the useful life of the furniture and fixtures in its stores, extending it from 3 to 5 years. The impact of this change in the 2003 financial statements was to reduce the depreciation charge for the year by EEK 2.9 million.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Tangible Fixed Assets movements in the Parent in 2003

	Land	Buildings, facilities	Plant, equipment	Other fixtures	Facilities under con-struction	Pre-payments	Total
Acquisition cost 31.12.2002	181	1 901	3 480	1 211	400	4	7 177
Accumulated depreciation 31.12.2002	0	(714)	(2 953)	(595)	0	0	(4 262)
Residual value 31.12.2002	**181**	**1 187**	**527**	**616**	**400**	**4**	**2 915**
Acquired during the period	0	4	74	49	0	0	126
Sold during the period	0	0	(4)	0	0	0	(4)
Written off during the period	0	0	0	(6)	0	0	(6)
Reclassified as intangible assets (see note 11)	0	0	0	0	(400)	0	(400)
Reclassification	0	45	6	(47)	0	(4)	0
Depreciation 2003	0	(109)	(241)	(219)	0	0	(568)
Acquisition cost 31.12.2003	181	2 024	3 220	1 048	0	0	6 474
Accumulated depreciation 31.12.2003	0	897	2 859	655	0	0	4 411
Residual value 31.12.2003	**181**	**1 127**	**362**	**393**	**0**	**0**	**2 063**

In 2003 EUR 0.04 million was invested in retail business, EUR 0.07 million to production equipment and EUR 0.01 in other fixed assets at the parent company.

See note 13 concerning pledged assets.

Note 11 Intangible Assets

Intangible Assets movements in the Group in 2003

	Software and other licenses	Prepayments for intangible assets	Goodwill	Negative goodwill	Total
Acquisition cost 31.12.2002	414	63	149	(59)	568
Accumulated amortization 31.12.2002	(168)	0	(114)	29	(253)
Residual value 31.12.2002	**246**	**63**	**35**	**(29)**	**315**
Acquired during the period	284	0	0	0	284
Reclassified from tangible assets (see note 10)	399	0	0	0	399
Reclassification	63	(63)	0	0	0
Amortization 2003	(130)	0	(12)	29	(113)
Acquisition cost 31.12.2003	1 157	0	111	(59)	1 209
Accumulated amortization 31.12.2003	(294)	0	(89)	59	(324)
Residual value 31.12.2003	**862**	**0**	**23**	**0**	**885**

The groups investments into intangible assets formed EUR 284 thousand in 2003, of which majority was spent to implementing new software, Protex and Jaffex, in Baltika. The software includes the company's processes from production to delivering the goods. Large portion of the work for implementing the software was done already in 2002.
The new software was also implemented in Latvian and Lithuanian subsidiaries.

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Intangible Assets movements in the Parent in 2003

	Software and other licenses	Goodwill	Negative goodwill	Total
Acquisition cost 31.12.2002	387	149	(59)	477
Accumulated amortization 31.12.2002	(179)	(114)	29	(264)
Residual value 31.12.2002	**207**	**35**	**(29)**	**213**
Acquired during the period	259	0	0	259
Reclassified from tangible assets (see note 10)	399	0	0	399
Amortization 2003	(108)	(12)	29	(90)
Acquisition cost 31.12.2003	1 024	111	(59)	1 077
Accumulated amortization 31.12.2003	(267)	(89)	59	(296)
Residual value 31.12.2003	**758**	**23**	**0**	**781**

Note 12 Operating and Finance Lease

Operating Lease – the company as a lessee

The future minimum lease payments of non-cancellable operating leases are as follows:

	Parent		**Group**	
	31.12.2003	**31.12.2002**	**31.12.2003**	**31.12.2002**
Up to 1 year	39	47	2 722	2 085
1 to 5 years	18	47	4 233	5 022
Over 5 years	12	0	506	893
	69	**94**	**7 462**	**8 001**

Operating lease expenses include rental expenses of store facilities. The lease contracts of stores are predominantly not binding in the long term in Estonia, Latvia and Lithuania and can be terminated by notifying 2 to 6 months in advance. In Poland and Ukraine the termination of lease agreement mostly requires finding a new lessee for the store facilities.

Termless lease agreements last for 5 years. If canceling the lease agreement requires mutual agreement, the future lease payments of 6 months are considered. If canceling the lease agreement requires notifying in advance, the notifying period's lease payments are considered.

In 2003 and 2002, operating lease payments of the group totaled EUR 3 594 thousand and EUR 2 543 thousand, respectively.

Operating Lease – the company as a lessor

Operating lease income includes income from the renting of rooms.

The future minimum lease receipts of non-cancellable operating leases are as follows:

	31.12.2003	31.12.2002
Up to 1 year	11	12
1 to 5 years	0	0

In 2003 and 2002 the total amount of operating lease payments received were EUR 46 thousand and EUR 60 thousand, respectively.

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Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Finance lease – the Group as lessee

	Equipment and fittings of factory	Car	Total
Acquisition cost 31.12.2002	310	21	331
Accumulated depreciation 31.12.2002	(51)	(8)	(59)
Residual value 31.12.2002	**259**	**13**	**272**
Acquisition in 2003	0	30	30
Depreciation in 2003	(77)	(10)	(86)
Acquisition cost 31.12.2003	310	51	361
Accumulated depreciation 31.12.2003	(128)	(18)	(145)
Residual value 31.12.2003	**182**	**33**	**215**

Minimum lease payments on finance lease:	**31.12.2003**	**31.12.2002**
Short-term – up to 1 year	88	102
Long-term – 1 to 5 years	37	108
Total	**125**	**210**
Future finance charges on finance lease	**(6)**	**(18)**
Present value of minimum lease payments	**119**	**193**
The present value of minimum lease payments is as follows:		
Short-term – up to 1 year (note 13)	83	91
Long-term – 1 to 5 years (note 13)	36	102
Total	**119**	**193**

Parent company has no finance lease liabilities.

Note 13 Debt Obligations

	Parent		**Group**	
Short-term debt	**31.12.2003**	**31.12.2002**	**31.12.2003**	**31.12.2002**
Current portion of long-term debt	851	1 008	988	1 145
Short-term bank loans	2 258	1 461	2 214	1 461
Short-term lease liabilities (note 12)	0	0	83	91
Convertible bonds (note 15)	32	25	32	25
Bonds (note 15)	1 114	3 071	1 114	3 071
Total	**4 256**	**5 565**	**4 431**	**5 792**

	Parent		**Group**	
Long-term debt	**31.12.2003**	**31.12.2002**	**31.12.2003**	**31.12.2002**
Long-term bank loans	3 857	2 758	4 405	3 443
Long-term lease liabilities (note 12)	0	0	36	102
Total	**3 857**	**2 758**	**4 441**	**3 545**

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Bank Loans of the Group as at 31.12.2003

Creditor	Loan debt 31.12.03	Current portion up to 1 year	Long-term portion 1-5 years	Interest
Nordea Bank	575	115	460	3 months' Euribor+2,5%
Nordea Bank	599	240	360	6 months' Euribor+2,5%
Hansapank	3 533	496	3 037	6 months' Euribor+2,25%
Hansapank	703	703	0	4,5%
Hansapank	685	137	548	6 months' Euribor+2,35%
Hansapank (overdraft facility) (see note 27)	1 511	1 511	0	4,5%
Total	**7 606**	**3 202**	**4 405**	

Bank Loans of the Group as at 31.12.2002

Creditor	Loan debt 31.12.02	Current portion up to 1 year	Long-term portion 1-5 years	Interest
Nordea Bank	839	240	599	3 months' Euribor+2,5%
Hansapank	2 927	768	2 159	6,4%
Hansapank	822	137	685	6 months' Euribor+2,75%
Hansapank (overdraft facility) (See note 27)	1 461	1 461	0	6,1%
Total	**6 049**	**2 606**	**3 443**	

In 2003 the parent company AS Baltika obtained a long-term loan of EUR 0.6 million from Nordea Pank and serviced the loan in the amount of EUR 0.2 million. Baltika AS also raised a short-term and long-term loan from Hansapank in the amount of EUR 1.5 million and serviced loans in the amount of EUR 0.2 million. The due date of the short-term loan is 31.05.2004.

AS Virulane has a long-term loan with the limit of EUR 959 thousand from Hansapank for financing the construction of the Ahtme factory. The loan is secured by mortgages on the registered immovable property at Kalda 10A in Rakvere (residual value EUR 0.5 million) and Õpetajate 5 in Ahtme (residual value EUR 1.1 million) as well as by the surety of AS Baltika.
AS Virulane serviced the loan in the amount of EUR 0.1 million.

The loans and overdraft are secured by a commercial pledge of EUR 4.453 thousand and a mortgage on the registered immovable property at Veerenni 24 in the amount of EUR 3.5 million.

See note 24 on interest expenses.

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

Note 14 Trade Payables

	Parent		Group	
	31.12.2003	**31.12.2002**	**31.12.2003**	**31.12.2002**
Trade payables to third parties	2 810	1 705	3 447	2 154
Trade payables to subsidiaries				
AS Elina STC	150	102	0	0
AS Virulane	341	199	0	0
Baltika Ukraina	0	146	0	0
OÜ Baltman	109	158	0	0
Total trade payables to subsidiaries	**600**	**605**	0	0
Total Trade Payables	**3 410**	**2 310**	**3 447**	**2 154**

Note 15 Debt Instruments

Convertible Bonds

According to the resolution of the general meeting of shareholders, held on April 6, 2001, 576 000 (192 000 in a year) convertible bonds were issued to the management with a nominal value of EUR 0.06 each.

3 types of convertible bonds in total number of 576 000 were issued as follows:

	Issue date	Issue price (value) (In EUR thousand)	Bond conversion period	Converted into shares (In EUR thousand)	Redeemed (In EUR thousand)	Convertible bonds 31.12.2003 (In EUR thousand)
A-Bond	01.05.2001	12	01.05.2002-01.05.2004	4	0	9
B-Bond	01.05.2002	12	01.05.2003-01.05.2005	0	0	12
C-Bond	01.05.2003	12	01.05.2004-01.05.2006	0	1	11
Total		**36**		**4**	**1**	**32**

The bonds are convertible into ordinary shares as follows:
A –Bond into one ordinary share for additional cash payment of EUR 1.53.
B –Bond into one ordinary share for additional cash payment of EUR 2.13.
C –Bond into one ordinary share for additional cash payment of EUR 2.34.

If the bonds are neither converted into ordinary shares nor redeemed during the conversion period, they are exchanged into a loan, which will be bear market interest rate. Until that date no interest is paid on the bonds.

In 2003, 55 000 holders of A convertible bond decided to subscribe for the shares. In accordance with owners' permission the management decided to increase the share capital of AS Baltika by 55 000. After the increase, the amount of share capital is going to be EUR 3 514 780, consisting of 5 499 450 shares with the face value of EUR 0.64 (see notes 13 and 18). The issue premium was EUR 52 727.

According to the terms of the bonds, employees leaving the company have to sell back bonds. In 2003, 14 000 bonds were redeemed.

The full amount of convertible Bonds is recorded as financial liability because the equity component is immaterial.

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Initsiaalid/initials KE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

Closed Issue of Bonds

	Quantity	Nominal EUR	Issue price	Balance 31.12.2003	Coupon rate %	Maturity
Bonds	1 750	639	631.04	1.114	7.0	17.03.2006

In October 2002, AS Baltika issued bonds with the term to maturity of 365 days (0% coupon interest), redeemed on October 14, 2003. The volume of the issue was EUR 3.2 million, the effective interest rate was 4.95%.

On September 26, 2003, AS Baltika issued bonds in the amount of EUR 1.1 million: maturity date on March 17, 2006, coupon rate 7.0% and coupon payment dates March 17, 2005 and March 17, 2006. Effective interest rate is about 7.8%. The initial public offering was conducted through direct sale and the offer was arranged by Hansapank. The bonds are to be listed on the Tallinn Stock Exchange within 6 months. The bonds are unsecured.
The funds acquired were used for redeeming bonds on October 14, 2003 (see above).

Note 16 Accrued Expenses

	Parent		**Group**	
	31.12.2003	**31.12.2002**	**31.12.2003**	**31.12.2002**
Payables to employees	305	168	651	469
Dividends payable	18	18	18	18
Interest payable	0	7	0	9
Other accrued expenses	1	1	4	2
Total	**324**	**194**	**672**	**497**

Note 17 Minority interest

	2003	**2002**
Minority interest on 1 January	**451**	**424**
Change in minority interest as a result of increasing the share of parent company	0	(27)
Net profit for the financial year	41	79
Net loss for the financial year	(29)	(26)
Dividends paid	(7)	0
Minority interest on 31 December	**455**	**451**

Note 18 Owners' Equity

<u>**Share Capital**</u>

	31.12.2003	**31.12.2002**
Share capital (in thousand EUR)	3 515	3 480
Number of shares (pc)	5 499 450	5 444 450
Nominal value of shares (EUR)	0.64	0.64
Statutory legal reserve (in thousand EUR)	352	348
Voluntary legal reserve (in thousand EUR)	1 111	1 115

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Under the article of association, the minimum number of shares is 4 000 000 and the maximum number of shares is 16 000 000. All issued shares have been paid for.

In 2003, 55 000 holders of A convertible bond decided to subscribe for the shares. In accordance with the owners' permission the management decided to increase the share capital of AS Baltika by 55 000 shares. After the increase, the amount of share capital is EUR 3 514 780, consisting of 5 499 450 shares with the nominal value of EUR 0.64 (see note 15).

Shareholders as of 31.12.2003

	Number of shares	Participation %
1. Baltic Republics Fund	1 942 400	35.3%
2. OÜ BMIG	1 088 310	19.8%
3. Members of the Management board and their confidants:		
- Meelis Milder	85 239	1.6%
- Maire Milder	18 000	0.3%
- Ülle Järv	1 063	0.02%
4. Others	2 364 438	43.0%

Note 19 Segments

Business segment report by areas of operation for 2003 – primary segment

	Retail trade	Production, wholesale and subcontracting	Intersegmental transactions	TOTAL
Extra-group sales	20 498	11 246		31 744
Intersegmental sales	0	15 550	(15 550)	0
Total sales	20 498	26 796	(15 550)	31 744
Operating profit of the segment	(3 027)	1 520	0	(1 507)
Unallocated expenses				(2 017)
Total operating profit				(3 524)
Other financial income (expenses)				(463)
Income tax				(30)
Profit before minority shareholding				(4 016)
Minority interest				12
Net profit				(4 028)
Assets	7 941	12 706	(109)	20 538
Unallocated assets of the group				527
Total assets				21 065
Liabilities	7 517	4 048	(6 765)	4 800
Unallocated liabilities of the group				8 890
Total liabilities				13 690
Acquisition of tangible and intangible assets	593	375	0	968
Depreciation and amortization	701	713	0	1 414
Other major non-monetary expenses	(976)	(56)	0	(1 031)

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Business segment report by areas of operation for 2002 – primary segment

	Retail trade	Production, wholesale and subcontracting	Intersegmental transactions	TOTAL
Extra-group sales	16 273	14 753		31 025
Intersegmental sales	0	15 764	(15 764)	0
Total sales	16 273	30 517	(15 764)	31 025
Operating profit of the segment	1 122	1 716	0	2 838
Unallocated expenses				(1 946)
Total operating profit				892
Other financial income (expenses)				(542)
Income tax				137
Profit before minority shareholding				488
Minority interest				53
Net profit				434
Assets	10 149	13 249	(305)	23 093
Unallocated assets of the group				742
Total assets				23 835
Liabilities	9 174	2 397	(8 419)	3 153
Unallocated liabilities of the group				9 371
Total liabilities				12 524
Acquisition of tangible and intangible assets	2 028	1 633	0	3 661
Depreciation and amortization	583	633	0	1 216
Other major non-monetary expenses	1	179	0	179

The retail segment includes subsidiaries, related to retail trade as well as factory shops belonging to production companies AS Baltika and AS Virulane. The production and wholesale segment includes production, wholesale, subcontracting and other associated operations.

Assets and liabilities of segments do not include financial assets and liabilities, and the revenues and expenses of the segment do not include the revenues and expenses associated with these assets and liabilities.

In the segment report, administrative building is considered as an unallocated asset of the group; long-term loans, dividends and interest liabilities are considered as unallocated liabilities of the group; administrative costs of the centre are considered as unallocated costs of the group.

Allowances for inventories and doubtful receivables are recorded under other non-monetary expenses.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Sales and assets by Geographical Segment (location of clients) – secondary segment

	Sales		Fixed assets		Capital expenditure	
	2003	**2002**	**31.12.2003**	**31.12.2002**	**2003**	**2002**
Estonia	8 921	8 362	4 799	5 221	440	2 041
Latvia	3 328	3 078	252	221	91	235
Lithuania	5 181	4 597	528	541	170	390
Russia	2 549	3 273	0	0	0	0
Ukraine	3 543	3 477	348	380	67	196
Finland	2 536	3 389	24	0	30	0
Sweden	1 483	1 426	6	9	0	1
Great Britain	1 038	1 092	0	0	0	0
Poland	3 101	2 235	663	869	171	798
Other markets	65	96	0	0	0	0
Total	**31 744**	**31 025**	**6 621**	**7 241**	**968**	**3 661**

The management is of the opinion that the prices used in inter segmental transactions do not substantially differ from market prices.

Note 20 Other Income

	Parent		Group	
	2003	**2002**	**2003**	**2002**
Profit from sales of non-current assets	8	0	15	17
Other income	60	148	24	54
Profit from sales of pre-emption right on real estate	0	314	0	314
Total	**68**	**462**	**39**	**385**

Note 21 Operating Expenses

	Parent		Group	
	2003	**2002**	**2003**	**2002**
Operating lease expenses	298	324	3 595	2 543
Expenses on fuel and energy	241	225	501	441
Transportation expenses	491	509	583	590
Travel expenses	128	195	189	261
Advertising costs	588	804	1 183	1 265
Costs of insurance	75	61	107	91
Costs of utilities	26	26	74	51
Communication costs	161	160	286	257
Personnel recruitment costs	1	4	1	5
Training costs	15	20	38	48
Security costs	45	44	124	123
Consultation fees	103	166	104	173
Agency fees	81	99	86	122
Impairment loss on receivables	2	182	25	192
IT costs	266	282	330	345
Credit card fees	2	0	189	139
Other operating expenses*	540	608	1 329	1 413
Total	**3 063**	**3 710**	**8 745**	**8 059**

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Increase in operating lease expenses results from opening up new shops in different markets.
* Other operating expenses include costs of office supplies, customs services, maintenance, bank services, legal services etc.

Note 22 Personnel Expenses

	Parent		Group	
	2003	**2002**	**2003**	**2002**
Wages and salaries	3 870	3 877	8 029	7 439
Social and other taxes	1 274	1 211	2 464	2 215
Total	**5 144**	**5 088**	**10 494**	**9 653**

The Baltika Group employed 1714 people at the end of 2003 (1 725 at the end of the year 2002).

Note 23 Other Expenses

	Parent		Group	
	2003	**2002**	**2003**	**2002**
Membership fees	5	5	8	7
Loss from sales and write-off of fixed assets	6	12	163	29
Penalties, delay allowances, tax interests	5	0	7	1
Representational costs	59	62	69	87
Foreign exchange losses	2	18	30	24
Other expenses	7	35	11	73
Total	**83**	**132**	**288**	**221**

Note 24 Net Other Financial Expenses

	Parent		Group	
	2003	**2002**	**2003**	**2002**
Interest income	15	52	8	10
Interest expense from loans and leases	(435)	(482)	(485)	(558)
Dividends received	1	4	1	4
Foreign exchange gain (loss)	(8)	(25)	7	(1)
Other financial gain (loss)	8	4	7	4
Total Net Other Financial expenses	**(419)**	**(446)**	**(463)**	**(542)**

Note 25 Income Tax

	2003	**2002**
Current income tax	(2)	(38)
Deferred income tax gain (expense)	(28)	176
Total income tax	**(30)**	**137**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

Income tax divided by countries in 2003

	Poland	Latvia	Lithuania	Ukraine	Finland	Estonia	Elimination	Total
Profit (loss) before income tax	(17)	(506)	(490)	(1 038)	1	(3 991)	2 012	(4 028)
Income tax rate in 2003	27%	19%	15%	30%	29%	0%		
Theoretical income tax	5	96	74	311	(0)	0	0	485
Income tax on intra–group dividends	0	0	0	0	0	(1)	0	(1)
The effect of untaxed income	(4)	(12)	0	0	0	0	0	(16)
The effect of untaxed expenses	58	3	2	0	0	0	0	66
Change in unrecognized deferred tax assets	(166)	(86)	(75)	(234)	0	0	0	(561)
Current income tax expense	**0**	**0**	**0**	**0**	**(0)**	**(1)**	**0**	**(2)**
Deferred income tax gain (expense)	**(108)**	**1**	**1**	**77**	**0**	**0**	**0**	**(28)**

In Latvia the lower tax rate of 15% that will take effect in 2004 is used as a basis of deferred tax calculation.

Income tax prepayment in the amount of EUR 14 thousand was incurred in subsidiaries Baltika Ukraine, Baltinia OY and Baltika Sweden.

Note 26 Earnings Per Share

Basic earnings per share

		2003	2002
Weighted average number of shares	Pcs	5 483 992	5 015 817
Net profit (loss)	EUR '000	**(4 028)**	**434**
Basic earnings per share	**EUR**	**(0.73)**	**0.09**

Diluted earnings per share

		2003	2002
Weighted average number of shares	Pcs	5 990 992	5 090 069
Net profit (loss)	EUR '000	**(4 028)**	**434**
Diluted earnings per share	**EUR**	**(0.73)**	**0.09**

In calculating the diluted earnings per share in 2002, the 384 000 convertible bonds issued within the framework of the top executives' share option program, have been taken into account. The convertible bonds entitle their holders to exchange them for the same amount of shares of AS Baltika (see note 15). As in 2003 group resulted a loss diluted loss per share does not differ from basic loss per share.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

AS Baltika 2003 Annual Report. In EUR thousands. Translation of the Estonian original.

Note 27 Related Parties

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 "Related Party Disclosure". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Following parties are considered as related parties in the AS Baltika annual report:
a) Owners;
b) Members of management, management board and supervisory board;
c) Confidants of the above mentioned; and
d) Companies that are under the control of the members of management board and supervisory board;
e) Subsidiaries.

The director of the subsidiary Baltika Lietuva has been granted a loan in the amount of EUR 8.7 thousand (LTL 30 thousand), due date is May 1, 2006. As long as the current employment contract is effective, no interest is to be calculated on the loan.

In 2003 and 2002, the salaries of members of the Management Board and the Supervisory Board were EUR 0.2 million and EUR 0.2 million in total, respectively.

In April 2003, the members of the Management Board were entitled to subscribe for 98 000 convertible bonds entitling them to subscribe for the shares of Baltika at EUR 2.40 per share starting with May 2004 (see Note 15). In 2002, 124 000 convertible bonds were subscribed for by the members of the Management Board.

OÜ BMIG which is controlled by the members of the Management and Supervisory Board held 19.79% of the shares of AS Baltika as of 31.12.2003 (see note 18).

In 2003, goods in the amount of EUR 295 thousand were purchased from OÜ Maisan, a company that is controlled by a member of the Management Board. The services was rendered in amount of 7.2 thousand EUR. In year 2002 goods in amount of 285 thousand EUR were purchased from OÜ Maisan.

In 2003, sewing services and goods in the amount of EUR 1.0 million were sold to and services in amount of EUR 49.6 thousand purchased from The Major Oak Clothing Co, a company that is controlled by a member of the Supervisory Board. In 2002 the figures were EUR 1.1 million and EUR 2.1 thousand, respectively.

AS Virulane, AS Elina STC and OÜ Baltman are part of the group account agreement of AS Baltika. The group account has an overdraft facility of EUR 1.6 million. As of 31.12.2003, only the parent company was using the overdraft (see note 13). The users of the group account are jointly responsible for fulfilling the terms of the group account agreement.

Liabilities and Receivables of Parent Company to/from Subsidiaries:

	31.12.2003	**31.12.2002**
Liabilities	600	605
Receivables	4 780	7 007

The management is of the opinion that the prices used in transactions with related parties do not substantially differ from market prices.

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
PricewaterhouseCoopers, Tallinn

Note 28 Financial Risks

Foreign Currency Risk

Exports constitute 72% of the group's net sales. Major selling currencies in the group's retail markets are LTL (Lithuanian litas), LVL (Latvian lats), UAH (Ukrainian hryvnia), PLN (Polish zloty); the group's other selling currencies are EUR (Euro) and GBP (Pound sterling).
The majority of direct materials used in production are imported. Major buying currencies are EUR (Euro) and USD (USA dollar). Trading with countries belonging to the European Monetary Union is done solely in EUR.
The group's financial performance was considerably influenced by the decrease of the average foreign currency rates against Estonian euros in countries where AS Baltika has subsidiaries: Polish zloty –12.5%, Ukrainian hryvnia –16.7% and Latvian lats –9.4%.
No financial instruments have been applied in 2003 to hedge the foreign currency risk. If possible, the foreign currency obtained from the sales is used for the payments of the liabilities due in the same currency. See note 24 on net foreign currency gains (losses).

Credit and Liquidity Risk

The group is open to credit risk concerning the solvency of a business partner in Russia. Receivables recorded in the balance sheet are not secured. As the production and sales cycle of the group is seasonal, credit risks are not constant. The maximum credit risk per balance sheet date is EUR 2.9 million, including credit risk of the Russian partner of EUR 1.8 million. Credit risk in Russia is concentrated on a single business partner that Baltika has been trading with for the past 10 years and with whom a franchise and wholesale agreement have been signed. AS Baltika is going to establish a joint venture with the Russian partner in 2004. Receivables from the Russian partner are to be used for buying shares in the joint venture.

Interest Rate Risk

Interest rate risk arises primarily from the possible fluctuation of EURIBOR as well as changes in the average interest rates of banks.

Note 29 Guarantees

As of 31.12.2003, the group has guaranteed future payments of bills of credit to the bank in the amount of EUR 62 thousand. (as at 31.12.2002 EUR 133 thousand).

Note 30 Fair value

As at 31.12.2003, there is no significant difference between the carrying amount of the financial assets and liabilities and their fair value.

Note 31 Subsequent events

Tentative agreements for establishing a joint venture in Russia have been concluded. The company is expected to be established in the 2nd quarter of 2004 (see also note 28 about receivables from Russian partner).

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Initialled for the purpose of identification only
Initsiaalid/initials VE
Kuupäev/date 25/03/2004
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AUDITOR'S REPORT

(Translation of the Estonian original)

To the shareholders of AS Baltika

We have audited the financial statements of AS Baltika (the Parent Company) and the consolidated financial statements of the Parent Company and its subsidiary companies (the Group) for the year ended 31 December 2003 as set out on pages 8 to 35. These financial statements are translated into euros from the original in Estonian kroons. These financial statements are the responsibility of the Parent Company's management board. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements give a true and fair view of the financial position of the Parent Company and the Group as at 31 December 2003 and of the results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Urmas Kaarlep	Ago Vilu
AS PricewaterhouseCoopers	Authorised auditor

25 March 2004

Proposal for covering net loss for the financial year

The Management Board of AS Baltika proposes to the General Meeting of Shareholders to cover the 2003 net loss in the amount of 4 028 thousand euros with retained earnings.

Signatures of the Management Board and Supervisory Board to the 2003 Annual Report

2003 Annual Report of AS Baltika signed on 25 March 2004:

Chairman of the Management Board
Meelis Milder

Member of the Management Board
Ülle Järv

Member of the Management Board
Maire Milder

Member of the Management Board
James Hayhow

Member of the Management Board
Boriss Loifenfeld

Chairman of the Supervisory Board
Miles Warwic Burger

Member of the Supervisory Board
Joakim H. Helenius

Member of the Supervisory Board
Reet Saks