AS BALTIKA

2006 CONSOLIDATED ANNUAL REPORT

(translation of the Estonian original)

Commercial name	AS BALTIKA
Commercial Registry no	10144415
Legal address	Veerenni 24,Tallinn 10135, Estonia
Phone	+372 630 2731
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E-mail	baltika@baltika.ee
Internet homepage:	www.baltikagroup.com
Main activities	Retail and wholesale of clothes
Auditor	AS PricewaterhouseCoopers
Beginning and end of financial year	01.01.2006 - 31.12.2006

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KEY FIGURES AND RATIOS

	2002	2003	2004	2005	2006
Operating results, EEK '000					
Net sales	485,440	497,048	581,878	680,906	899,481
Gross profit*	n/a	n/a	278,404	351,079	490,562
Operating profit	13,962	-57,464	18,786	74,907	97,332
Profit before taxes	5,482	-66,794	14,016	70,960	91,295
Net profit	6,798	-67,447	16,701	72,664	87,376
Balance sheet data, EEK '000					
Total assets	372,937	329,376	317,180	377,099	596,390
Interest-bearing liabilities	146,127	138,818	120,427	92,831	147,413
Shareholders' equity	176,982	115,165	141,470	207,952	304,240
Other data					
Number of directly managed stores	55	66	78	86	112
Sales area, m^2	8,684	10,109	11,668	12,736	19,594
Number of employees (31 Dec)	1,725	1,714	1,704	1,678	1,915
Key ratios					
Net sales growth	17.1%	2.4%	17.1%	17.0%	32.1%
Retail sales growth	66.9%	25.7%	30.9%	30.1%	34.7%
Share of retail sales in net sales	53%	65%	72%	80%	82%
Share of exports in net sales	73%	72%	75%	71%	72%
Gross margin*	n/a	n/a	47.8%	51.6%	54.5%
Operating margin	2.9%	-11.6%	3.2%	11.0%	10.8%
EBT margin	1.1%	-13.4%	2.4%	10.4%	10.1%
Net margin	1.4%	-13.6%	2.9%	10.7%	9.7%
Current ratio	1.8	1.5	1.5	2.1	1.5
Debt to equity ratio	82.6%	120.5%	85.1%	44.6%	48.5%
Net gearing ratio	76.6%	109.1%	75.9%	31.3%	44.3%
Inventory turnover	3.04	3.02	3.89	4.92	5.38
ROE	0.5%	-42.7%	14.6%	44.1%	35.9%
ROA	0.2%	-17.5%	5.1%	22.2%	18.3%
Share data, EEK					
Shares outstanding (31 Dec)	5,444,450	5,499,450	5,633,950	5,822,950	6,214,950
Weighted average number of shares	5,015,817	5,483,992	5,541,721	5,759,950	6,008,783
Share price (31 Dec)	36.77	32.86	29.10	203.40	347.35
Market cap, million (31 Dec)	200	181	164	1,184	2,159
EPS	1.36	-12.30	3.01	12.62	14.54
Change in EPS, %	-58.6%	-1007%	125%	319%	15.3%
P/E	27.1	neg.	9.7	16.1	23.9
Book value per share	32.5	20.9	25.1	35.7	49.0
P/B	1.1	1.6	1.2	5.7	7.1
DPS	0	0	0.75	2.00	2.40**
Dividend yield	0%	0%	2.6%	1.0%	0.7%**
Dividend payout ratio	0%	0%	26.2%	16.6%	17.1%**

*Comparable gross profit figures available after the change in the income statement format (introduced in 2005)
**Proposal to AGM, DPS applied to the number of shares before the fund issue

Definitions of key ratios

Gross margin = (Net sales-Cost of goods sold)/Net sales
Operating margin = Operating profit/Net sales
EBT margin = Profit before corporate income tax/Net sales
Net margin = Net profit (attributable to parent)/Net sales
Current ratio = Current assets/Current liabilities

Debt to equity ratio = Interest-bearing liabilities/Equity
Net gearing ratio = (Interest-bearing liabilities-Cash and bank-Current financial assets)/Equity
Inventory turnover = Net sales/Average inventories*
ROE (Return on equity) = Net profit (attributable to parent)/Average equity*
ROA (Return on assets) = Net profit (attributable to parent)/Average total assets*
Market cap = Share price (31 Dec)xShares outstanding (31 Dec)
EPS = Net profit (attributable to parent)/Weighted average number of shares
P/E = Share price (31 Dec)/EPS
Book value per share = Equity/Shares outstanding (31 Dec)
P/B = Share price (31 Dec)/Book value per share
Dividend yield = DPS/Share price (31 Dec)
Dividend payout ratio = Paid out dividends/Net profit (attributable to parent)

*Based on 12-month average

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BRIEF DESCRIPTION OF BALTIKA GROUP

The Baltika Group, with the parent company AS Baltika, is an international fashion retailer operating in the Baltic States and Eastern Europe. The Group operates four retail concepts: Monton, Mosaic, Baltman and Ivo Nikkolo and is currently represented in six countries: Estonia, Latvia, Lithuania, Poland, Ukraine and Russia. Baltika employs a vertically integrated business model which means that the Group controls all stages of the fashion process: design, manufacturing, supply chain management, distribution/logistics and retail sales. Baltika also sells its collections wholesale.

The shares of AS Baltika are listed on the Tallinn Stock Exchange.

As of 31 December 2006, the Group employed 1,915 people (31 December 2005: 1,678).

The parent company is located and has been registered at Veerenni 24, Tallinn, Estonia.

The Group consists of the following companies:

	Location	Activity	Participation at 31.12.2006	Participation at 31.12.2005
Parent company				
AS Baltika	Estonia			
Subsidiaries				
OÜ Baltman	Estonia	Retail	100%	100%
SIA Baltika Latvija	Latvia	Retail	75%	75%
UAB Baltika Lietuva	Lithuania	Retail	100%	100%
Baltika Ukraina Ltd	Ukraine	Retail	99%	99%
OOO Kompania “Baltman Rus”	Russia	Retail	100%	50.10%
Baltika Poland Sp.z.o.o.	Poland	Retail	100%	100%
OY Baltinia AB	Finland	Distribution	100%	100%
Baltika Sweden AB	Sweden	Distribution	100%	100%
AS Elina STC	Estonia	Production	62.50%	50.10%
AS Virulane	Estonia	Production	82.66%	79.23%
OÜ Baltika TP	Estonia	Real estate management	100%	100%
Joint venture				
OÜ Baltika Tailor	Estonia	Production	50%	50%

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MANAGEMENT REPORT

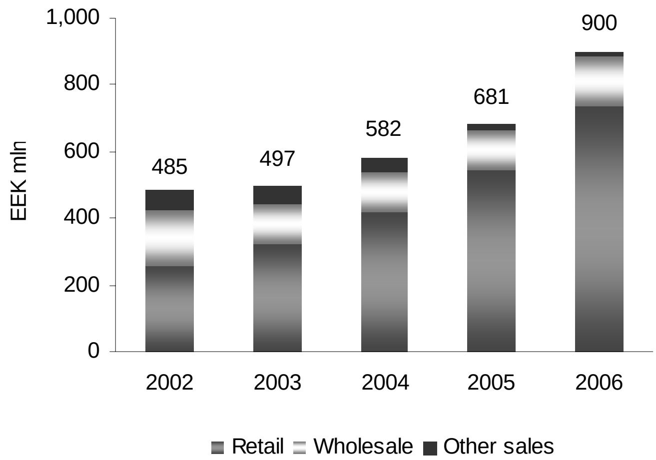
Baltika Group's consolidated net profit in 2006 amounted to 87.4 million kroons and net profit margin reached 9.7% (2005: 10.7%). The Group's net profit grew 20.2% yoy. Baltika's 2006 net sales increased 32.1%, while retail sales posted a growth of 34.7% and wholesale increased 24.6% in comparison with the previous year. The Group's gross margin rose to 54.5%, compared with 51.6% in 2005. Operating margin stood at 10.8% (2005: 11.0%).

SALES

Sales by segment

EEK million	**2006**	**2005**	**+/-**
Retail sales	736.4	546.8	*34.7%*
Wholesale	150.6	120.9	*24.6%*
Subcontracting	0	0.6	*-100.0%*
Other sales	12.5	12.8	*-1.7%*
Total	**899.5**	**680.9**	***32.1%***

Baltika Group's sales in 2002-2006



RETAIL SALES

In 2006, Baltika continued expanding its store network faster than before – the average sales space of the Baltika Group increased by 30% as compared to the 8% growth in 2005. As a result, the growth of retail sales was also faster in 2006 reaching 34.7% (2005: 30.1%). The Group's retail sales totalled 736.4 million kroons in 2006.

Like-for-like sales (sales in comparable stores) increased 13% in 2006. A store is comparable if it has been open and has had an unchanged sales area during the reporting period and during the comparable preceding period.

As a result of fast growth, the share of retail sales also increased in the Group's total sales. In 2006, retail sales represented 82% of Baltika's total sales compared to 80% in 2005.

The Group's sales efficiency (sales/m^2) was up 3% yoy in 2006. The growth of the Group's average sales efficiency has slowed down in 2006 as compared to previous year reflecting initial lower sales density of new stores. In 2006, a lot of new stores were opened in Russia and Ukraine moving from capital cities to major regional cities where it takes time for the new shopping centres to build up customer traffic. Hence, it takes up to 12-18 months for a store to achieve planned sales density at such locations. At the same time, stores opened at high-quality and already established centres achieve planned sales density almost immediately.

Sales density is also affected by enlarging store formats. More than half of the Monton shops opened in 2006 are 300 square metres or larger. In November 2006, Baltika opened the largest Monton store to date – a 500 square metre shop – in Moscow's newest and largest shopping and leisure centre Evropeisky. This shop is a good example of Monton's strategic direction to start operating larger stores.

Baltika also continued to improve stock management in 2006 – the inventory turnover ratio increased 9% over the year from 4.92 to 5.38. A strategically important investment in terms of future expansion and stock management was completed in July when Baltika's new logistics centre started operating. If compared with the old one, the new logistics centre has much higher capacity and enables to handle increasing quantities of merchandise faster, making inventory management more flexible and efficient.

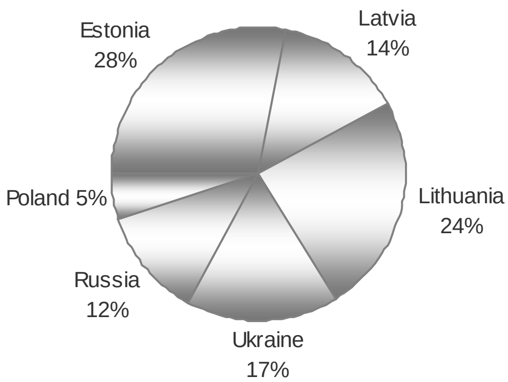
In 2006, investments into customer service were prioritised including implementation of extensive sales and customer service training for staff. In addition, two brands, Monton and Mosaic, received new store formats that are flexible and can be used in stores with different floor space as well as comfortable and attractive shop environments for customers. Consequently, we have seen progress in customer service in our stores and in the number of loyal customers. In 2006, the number of people who visited Baltika's stores in six markets grew 37%.

Bearing in mind the strategic goals and future growth, the Group extended its brand portfolio by the acquisition of Ivo Nikkolo fashion brand. With this acquisition, Baltika entered the premium ladies' fashion market. Also, in the beginning of the year Baltika successfully carried out a name change of one of its brands – CHR/Evermen became Mosaic. The name change was implemented in order to simplify the brand's name and thus enhance the concept's international competitiveness.

OVERVIEW BY MARKETS

The macroeconomic environment in Baltika's markets continued to be favourable throughout 2006. The fastest economic growth occurred in Baltika's home market i.e. the Baltic countries (7-12%). The overall economic growth is carried through into the purchasing power of our customers. In the Baltic countries, retail sales of textiles, clothing, footwear and leather goods in constant prices increased by 35-42% in 2006. The GDP growth in Russia and Ukraine was also strong last year – respectively 6.7% and 7.0% according to preliminary data.

Share of markets in retail sales, 2006



The Baltic countries maintained their 66% share in Baltika's retail sales in 2006. As only a few new stores were opened in these markets in 2006, sales growth in the Baltics was mainly driven by good performance of like-for-like stores. Estonia and Latvia saw especially strong rise in sales per square metre. In Lithuania, sales growth was also supported by eight new openings in 2005.

In terms of individual markets, Estonia was Baltika's largest retail market last year based on sales revenues. With 202.2 million kroons Estonia accounted for 28% of the Group's retail sales. Baltika's retail sales in Estonia increased 32% in 2006. Lithuania where retail sales grew 37% yoy to 178.8 million kroons continued in the second position with its 24% share. Latvia posted the strongest growth in retail sales among the Baltic States – sales were up 42% yoy and totalled 105.7 million kroons.

The largest number of stores in 2006 was opened in Ukraine and Russia. Ten new shops were opened in Ukraine doubling Baltika's sales space to ca 4,000 square metres in that market. Majority of stores were opened outside the capital in other large cities such as Odessa, Donetsk and Dnepropetrovsk. Only one store was opened in Kiev, the capital city, because of the deficit of modern shopping centre developments in Ukraine's capital. The situation in Kiev should improve in 2008.

Due to high inflation caused by the increase in the prices of gas, household expenditures and food, the Ukrainian people tended to be less interested in shopping for fashion clothing in 2006. On average, the prices of goods and services in Ukraine increased by 9.1% in 2006 while the prices of services alone increased by 27.8%. Nevertheless, Baltika's retail sales increased 30% in Ukraine in 2006 and amounted to 128.5 million kroons.

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Though, due to the above mentioned reasons, like-for-like sales growth in Ukraine was twice as low as the Group's average for 2006.

Russia saw the largest number of new openings in 2006 – altogether 15 new stores (including nine stores in 4Q). As a result, Baltika's retail space increased four times in Russia last year to ca 5,000 square metres. Baltika moved into two new cities, Krasnodar and Nizhni Novgorod, and opened two additional stores in Kazan. The largest expansion took place in St. Petersburg where eight new stores were opened taking the total to ten. This has had a positive effect on Baltika's brand awareness among customers in St. Petersburg. In Moscow, Baltika's Monton brand is strengthening its position by opening flagship stores in the two most important shopping centres of the city. In November 2006, a Monton store was opened in Moscow's newest and largest shopping and leisure centre Evropeisky and in January 2007, another Monton store was opened in Moscow's most popular shopping centre Ohotniy Ryad.

Development of shopping centres has accelerated in the two most important cities of Russia – Moscow and St. Petersburg. The trend is expected to continue in the coming years. Shopping centre development is gathering speed also in the other large cities of Russia. Under these circumstances, it is most important for Baltika to choose the best locations and open stores. It has to be noted, though, that the competition in the retail sector is high and in some cases the offering of shopping centres exceeds the demand from customers. These are large cities where it takes time for customer habits to change so that shopping in big centres becomes a common practice. Hence, the starting period of new stores is longer in the Russian market if compared to Baltika's home market and can last up to 12-18 months. Therefore one of the main tasks of Baltika, besides expansion, is to increase the number of loyal customers and strengthen overall brand awareness in the Russian market. The latter is fostered by opening of the flagship stores in Moscow.

In Russia, the Baltika Group's retail sales grew 69% in 2006 to 86.7 million kroons. Although Russia accounted for just 12% of the Group's retail sales in 2006, this market is expected to become more and more important in the future along with continuing expansion. In April 2006, Baltika also became the sole owner of its Russian subsidiary after acquiring an additional 49.9% stake in the company.

Despite decreasing sales in Poland, Baltika saw very positive developments in that market in 2006. Sales in Poland totalled 34.4 million kroons decreasing 12% over the year. Overall sales decreased due to closing of three stores out of Baltika's eight stores in the market. As a result of closings, sales area was cut by 38%, however, sales dropped only 12% because the Polish market achieved a 16% growth in sales efficiency (sales/m^2) and a 9% growth in like-for-like sales in 2006. Positive trends appeared in the second half of 2006 when like-for-like sales growth reached 21% versus the same period last year. Poland is currently the smallest of Baltika's markets, with five stores and sales comprising 5% of the Group's retail sales.

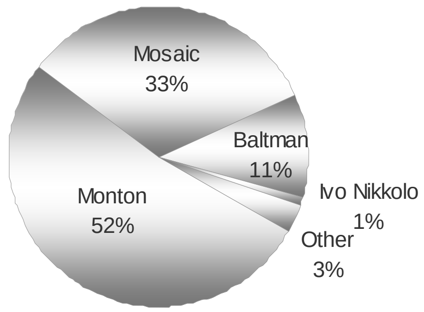
Retail sales by market

EEK million	**2006**	**2005**	**+/-**
Estonia	202.2	153.0	*32%*
Latvia	105.7	74.3	*42%*
Lithuania	178.8	130.5	*37%*
Ukraine	128.5	98.6	*30%*
Russia	86.7	51.3	*69%*
Poland	34.4	39.2	*-12%*
Total	**736.4**	**546.8**	***35%***

OVERVIEW BY BRANDS

In terms of brands Monton accounted for the largest share (52%) of the total retail sales in 2006. The sales of Mosaic were 33% and Baltman 11% of the Group's retail sales. The new brand Ivo Nikkolo – acquired in September 2006 – accounted for only one percent of the retail sales. The rest, 3%, came from factory outlet stores and one multibrand store that sells several brands together.

Share of brands in retail sales, 2006



Monton as the largest brand of Baltika posted a solid growth in 2006, achieving the retail sales of 385 million kroons which is 31% more than in 2005. The sales growth was driven by increasing number of stores, a better coordinated base collection, and successful launch of new product groups. The year 2006 marked expansion both for the whole Baltika Group as well as Monton – 15 new stores were opened taking the total number of stores to 44. In accordance with the set goals Monton started to operate larger stores, opening eight 300-400 square meter shops and one 500 square meter flagship store in Moscow. In future Monton will focus on opening average (300-400 m²) and large (500 m² and larger) stores. In order to become more attractive for the client the base collection choice was expanded, a new lingerie and beachwear collection was launched, and several new product groups were introduced into the collection of accessories. Compared with the growth of the clothing sales, the sales of accessories grew even faster (+47%). This growth was based on very successful launch of sun-glasses, Monton's own stockings and socks collections and a more focussed choice of accessories that better matched the base collection. In addition, Monton men's collection witnessed a higher growth than the average growth of the whole brand.

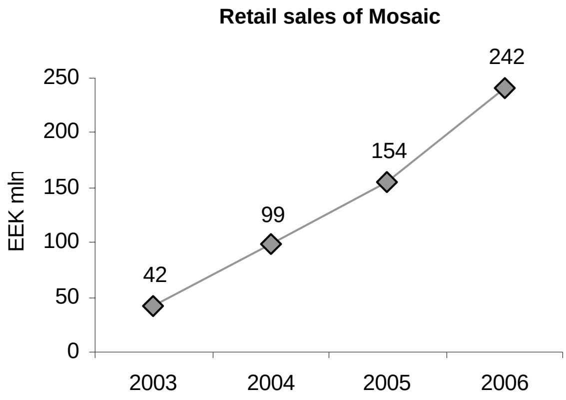
Retail sales of Monton

Last year Monton increased brand awareness by creating the uniforms for the very successful Estonian Olympic Team for the 2006 Torino Olympic Winter Games. The co-operation with the Estonian Olympic Committee will continue in preparation for the 2008 Beijing Summer Olympics. Monton is also chosen by the Olympic Committee of Ukraine as the official partner to dress its sportsmen for the 2008 Beijing Summer Olympics.

The past year showed that Monton is continuously innovative and is able to surprise clients with exciting marketing, to successfully launch new product groups, to wisely develop the base collection, and to productively operate on larger store areas. In 2007 Monton aims to launch its footwear collection and become even more efficient.

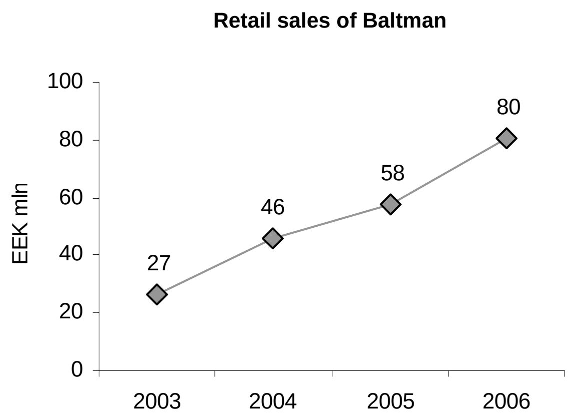
The year 2006 marked the birth of the brand Mosaic – in February Baltika changed the name of one of its concepts and CHR/Evermen stores became Mosaic. The name change was carried out in order to simplify the brand's name and thus enhance the concept's international competitiveness, especially in large markets such as Russia and Ukraine where the brand awareness is currently limited due to the small number of stores. The name change can be definitely regarded successful – with the 56% retail sales growth Mosaic was the fastest growing Baltika brand in 2006. The retail sales of Mosaic amounted to 242 million kroons in 2006. The growth in sales revenue was due to both the growth of sales efficiency in like-for-like stores and opening of new stores. By the end of 2006, the number of Mosaic stores reached 45, out of which 14 were newly opened stores.

Collection-wise the year was good for both Mosaic women's and men's collections. The greatest change in women's collection took place in autumn – the party collections were introduced in stores already in September and new items were added in October and November. In future the Mosaic women's collection will offer festive clothes all year round. The Mosaic men's collection witnessed significant changes becoming more stylish and including more fashionable details. The aim of the change is to increase the sales efficiency of the Mosaic men's collection. In 2006 this goal was already achieved in the Baltic countries and in 2007 the goal is to increase sales efficiency in all other markets. The accessories collection also witnessed a noteworthy development in 2006 as a result of which the sales of accessories increased by 71% compared with the previous year. In 2007 it is planned to increase the relative share of the accessories even more.



The 2007 will be remarkable for Mosaic – in spring the brand will launch its first children's collection in the larger stores. In future Mosaic will become a brand for the whole family. The women's, men's and also accessories' collections will be developed in the direction established with the 2006 name change. The collections will be balanced with each other and develop together with the client who expects the Mosaic products to be new, stylish and fashionable. Also, from the year 2007 onwards the number of collections will be increased from four to seven per year.

The retail sales of Baltman totalled 80 million kroons in 2006, increasing by 39% compared with the previous year. In 2006 three new stores were opened and by the end of the year Baltman had 15 stores in five countries. The year 2006 as a whole was successful for the brand. This was mostly due to offering the target client a collection enabling a more specific choice, also a more fashionable and high-quality product which is characteristic of the brand's core values. New details, innovative materials and finishings, plus additions to the present product ranges have all been most favourably received by the customers. In the range of accessories the results of the year 2006 can also be regarded successful – a more specific and wider choice resulted in a larger than expected sales revenue. The sales were enhanced by timely and successful campaigns, especially the Baltman Travel suit campaign. In addition, last year Baltman and the Estonian national football team signed a sponsorship agreement. As provided by the agreement, the Estonian national football team will wear Baltman Travel suits at public events during the next two years. To dress the national football team is the aim of any serious men's brand. Last year Baltman also renewed the co-operation agreement with the Latvian national football team.



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In September 2006 Baltika acquired a well-known Estonian fashion brand Ivo Nikkolo. The aim of the acquisition was to expand the brand portfolio and to enter the premium fashion market for ladies. Together with the trademark rights Baltika also took over the three Ivo Nikkolo stores in Estonia. Merging the Ivo Nikkolo brand with Baltika has been successful – the brand's turnover after the merger was more than 5.0 million kroons, delivering an estimated sales growth of 40% compared with the same period of the previous year.

Ivo Nikkolo brand has found its own niche in the Baltika Group's brand portfolio – the brand will focus on ladies fashion in future. The aim is to maintain Ivo Nikkolo's specific style and enlarge the assortment. The production facilities of Baltika Group enable to offer the top-level sewing quality vital for premium brand. The assortment of casual clothing will also be broader and as a result the whole collection will become more balanced. In addition, in 2007 the number of collections will be increased to seven collections per year.

In 2006 a new store environment and concept were developed for Ivo Nikkolo brand. The aim of the brand is to offer the client a comfortable and spirited shopping environment with attentive and personal service. In the upcoming years Baltika plans to expand the chain of Ivo Nikkolo stores into the markets presently covered by other Baltika brands. The first new concept stores will be opened in 2007 in Lithuania and Latvia. All in all, 8-12 Ivo Nikkolo stores are planned to be opened in 2007-2008.

SHOPS AND SALES AREA

As of the end of 2006, the Baltika Group operated 112 shops in six countries, with total sales area of 19,594 square metres. As of the end of 2005, Baltika's retail system comprised 86 stores with total sales area of 12,736 square metres. During 2006, 32 new stores were opened, nine closed (including relocated stores) and three stores were added with the acquisition of Ivo Nikkolo. All the new stores were opened in shopping centres. The net growth of the retail system in 2006 was 26 stores and 6,858 square metres as a result of which the sales area operated by Baltika increased by 54% over the year.

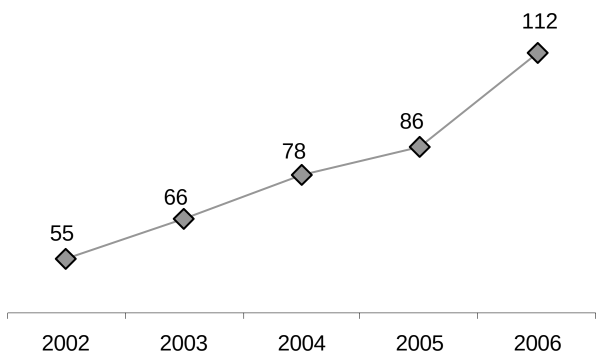
In terms of markets, the largest retail chain expansion took place in Russia and Ukraine last year with 15 and 10 new store openings, respectively. Four stores were opened in Latvia, two in Estonia and one in Lithuania.

Number of shops by market

	31.12.2006	31.12.2005
Estonia	28	24
Latvia	13	10
Lithuania	22	23
Ukraine	21	12
Russia	23	9
Poland	5	8
Total shops	**112**	**86**
Total sales area, m^2	**19,594**	**12,736**

In terms of brands, the largest number of stores were opened under the Monton (15) and Mosaic (14) names. In addition, three multibrand shops in Russia were converted into Mosaic stores. A total of three Baltman stores were opened. As of the end of 2006, the stores were divided between the concepts as follows: 45 Mosaic, 44 Monton, 15 Baltman, 3 Ivo Nikkolo and 4 factory outlet stores. In addition, Baltika still had one multibrand store that sells several brands together.

Number of directly managed stores



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Baltika's retail network by markets and brands, 31.12.2006

	Monton	Mosaic	Baltman	Ivo Nikkolo	Other	**Total**	**m²**
Estonia	6	10	5	3	4	**28**	**3,683**
Latvia	5	5	3			**13**	**2,033**
Lithuania	9	9	4			**22**	**3,676**
Ukraine	11	9	1			**21**	**4,079**
Russia	10	10	2		1	**23**	**5,076**
Poland	3	2				**5**	**1,047**
Total	**44**	**45**	**15**	**3**	**5**	**112**	**19,594**

WHOLESALE

In 2005, wholesale sales of Baltika's brands amounted to 150.6 million kroons and represented 17% of Baltika's net sales. The growth of wholesale sales of almost 25% yoy was stronger than expected. The biggest contributor to growth was Russian wholesale.

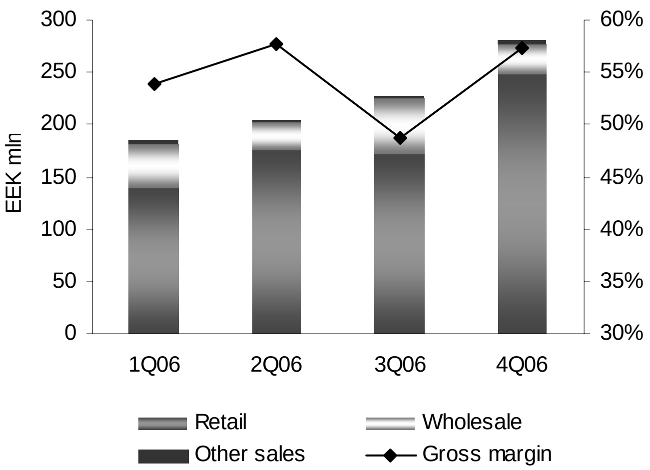
One of Baltika's largest wholesale clients in Russia is a company that operates around 30 stores in the Siberia and Ural region that sell Baltika's brands. The other wholesale partners are mainly department stores in the Baltics and Finland such as Stockmann and Tallinn Department Store Group. Two brands – Mosaic and Baltman – are mostly distributed wholesale whereas Mosaic accounts for almost half of Baltika's wholesale. Monton is sold wholesale only to Baltika's Russian partner.

EARNINGS AND MARGINS

2006 was the first year in Baltika's three-year strategic period during which the Group's goal is to grow profitably. The year was successful – Baltika expanded rapidly as well as prepared several projects that facilitate fast growth in the future (construction of the new logistics centre, acquisition of a new brand, name change of one of the brands, development of shop concepts, development and launch of new product groups). Although Baltika increased its sales space rapidly in more risky markets such as Russia and Ukraine where the starting period of new stores is longer putting pressure upon the profit margins, the Group maintained strong profitability in 2006. Overall, the results were supported by solid growth of retail sales (+35% yoy), including good growth in like-for-like sales (+13%), better sales efficiency (+3%) and more efficient inventory management.

The Group's gross profit margin in 2006 rose to 54.5% from the corresponding figure of 51.6% in 2005. Gross profitability was bolstered by better intake margins and more accurate product pricing on the markets. In 2006, the Group's gross profit amounted to 490.6 million kroons and was up by 39.7% versus 2005.

Quarterly gross margin as per sales structure



Baltika's operating expenses are growing in conjunction with the expansion of the retail network. Despite the fact that the new shops have initially lower sales density while operating costs are reported in full, the Group was able to maintain the operating margin almost unchanged in comparison with 2005. In 2006, operating margin stood at 10.8% compared with 11.0% in 2005 and operating profit increased 29.9% to 97.3 million kroons.

Baltika's operating profit in 2006 includes some one-off revenues from the sale and revaluation of real estate in the amount of 11.89 million kroons. In the third quarter, Baltika received 7.51 million kroons from the sale of a building lease on a plot located in Lasnamäe Industrial Park in Tallinn. A factory will be built on the site by

November 2007 for relocation of the production premises of Baltika's joint venture OÜ Baltika Tailor from Veerenni 24, Tallinn. In the fourth quarter, 4.38 million kroons was recorded as revenue from the revaluation of the Group's real estate investments. In 2005, Baltika's operating profit included one-off revenues from the revaluation of the Group's real estate investments in the amount of 13.74 million kroons.

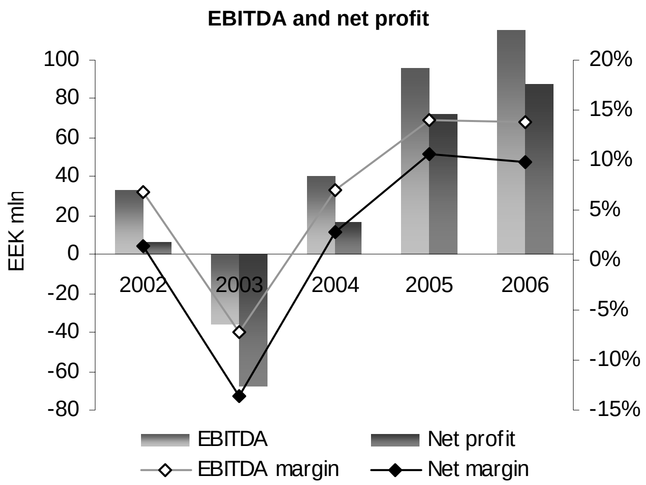
In 2006, fluctuations in foreign exchange rates had a negative impact on the results. Other operating expenses include foreign exchange losses in the amount of 4.71 million kroons in 2006. In 2005, Baltika received foreign exchange gains in the amount of 4.93 million kroons – recorded in other operating income.

The Group's financial expenses totalled 6.0 million kroons increasing by 53.0% over the year. Financial expenses grew mostly as a result of foreign exchange losses. Foreign exchange gains of 645 thousand kroons earned in 2005 were replaced by foreign exchange losses in the amount of 863 thousand kroons in 2006. Interest expenses grew 5.8% yoy to 5.7 million kroons in 2006.

The Group's profit before income tax grew 28.7% over the year and amounted to 91.3 million kroons in 2006.

The Baltika Group's net profit after taxes and minority shareholding amounted to 87.4 million kroons in 2006, up 20.2% versus last year. Net margin reached 9.7% (2005: 10.7%).

The Group's return on equity was 35.9% in 2006 (2005: 44.1%) and return on assets 18.3% (2005: 22.2%).



BALANCE SHEET

As of 31 December 2006, the total assets of the Baltika Group amounted to 596.4 million kroons, up 58% in comparison with the end of the previous year. The growth is attributed to the Group's fast expansion.

Due to the strong growth and the credit terms of the wholesale sales, trade receivables increased by 46.8 million kroons over the year, reaching 86.4 million kroons. Other receivables and prepaid expenses have grown mainly because of increasing prepayments of rent and value-added tax in Russia and Ukraine.

As of the end of the year, the Group's total inventories stood at 200.7 million kroons, up by 56.2 million kroons or 39% since the end of 2005. The growth is mainly due to increasing number of shops in Baltika's retail network. The Group's inventory turnover ratio (net sales/average inventories) increased from 4.92 to 5.38 in 2006, reflecting more efficient stock management.

Likewise, due to major expansion of Baltika's retail business, supplier payables expanded by 51.7 million kroons over the year to 96.5 million kroons by the end of 2006.

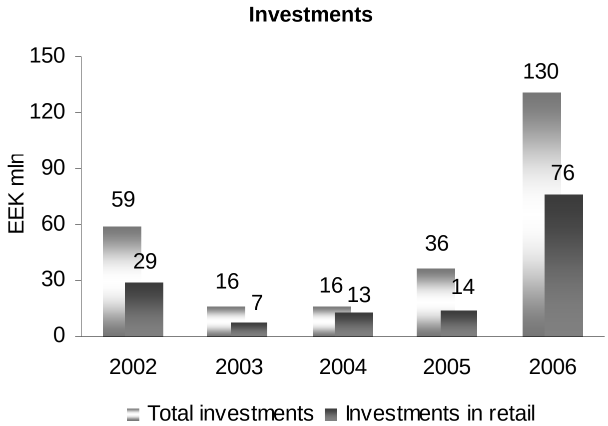
At the end of the year, the Group's borrowings amounted to 147.4 million kroons, including bank loans of 105.0 million kroons. The rest of the debt consists of finance lease liabilities (11.2 million kroons) and bonds (31.2 million kroons). Over the year, the Group's borrowings have increased by 54.6 million kroons, including bank loans by 41.7 million kroons. Bank loans have increased mainly due to the usage of the bank's overdraft in the amount of 31.9 million kroons. As of 31 December 2005, the bank's overdraft was not used. Overall debt level has grown because of the need to finance the expansion of the retail space and the construction of the new logistics centre. In 2006, the Group made loan repayments in the amount of 12.7 million kroons.

As of the end of 2006, the Group's total net debt (Interest-bearing liabilities less Cash and Current financial assets) amounted to 134.8 million kroons, and the net debt to equity ratio stood at 44.3%. A year ago, net debt to equity ratio was 31.3%.

The Group's equity grew by 96.3 million kroons in 2006 to 304.2 million kroons.

INVESTMENTS
The Baltika Group's investments in 2006 totalled 130.4 million kroons. In 2005, investments amounted to 36.2 million kroons.

A total of 75.6 million kroons was invested in the retail system and 33.8 million kroons in the new logistics centre. The acquisition of an additional 49.9% stake in the Russian subsidiary cost 6.3 million kroons. Investments in information technology, software and licences amounted to 10.2 million kroons. The rest of the investments of 4.5 million kroons were made in production equipment and other fixed assets.



CASH FLOW
In connection with the growth of the Group's retail network and increased need for working capital, Baltika's total cash flow from operating activities decreased in 2006 by 44.4 million kroons in comparison with 2005 and amounted to 30.2 million kroons. The Group's inventories, trade receivables and supplier payables grew significantly in 2006.

As a result of a considerable growth of investments, the net cash flow from investing activities totalled -96.8 million kroons, compared with -25.8 million kroons in 2005.

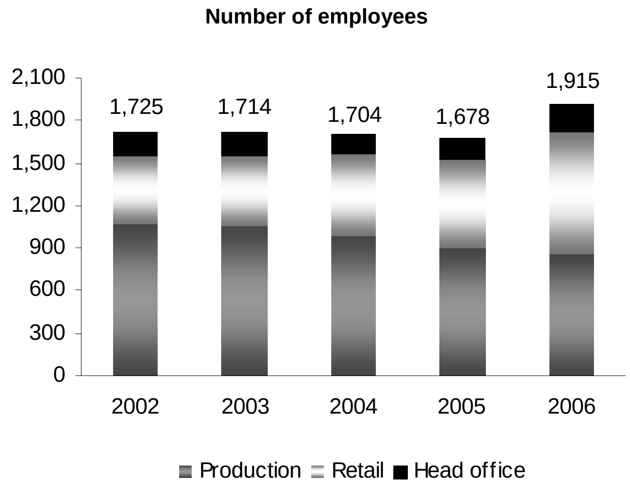
Baltika increased bank loans and issued bonds in order to finance the operations in 2006. In addition, some capital was obtained by increasing the share capital via conversion of the issued convertible bonds into shares. Over the year, the Group repaid bank loans in the amount of 12.7 million kroons. Baltika also paid dividends to shareholders in the amount of 12.0 million kroons. Consequently, total cash flow from financing activities amounted to 54.0 million kroons in 2006.

All in all, in 2006 the cash and cash equivalents of the Baltika Group decreased by 13.4 million kroons. In 2005, the Group's cash and cash equivalents increased by the same amount i.e. 13.4 million kroons.

PRODUCTION
Three production companies, OÜ Baltika Tailor, AS Elina STC and AS Virulane, belong to the Baltika Group. High quality and flexible production with short lead times is an important component in the Group's vertical business model. During the last year, Baltika's retail network increased fast. In order to ensure sufficient production capacity during the continuing expansion, Baltika has increased control in its production companies. In 2006, Baltika increased its ownership in both Elina and Virulane. An additional stake of 12.40% of the share capital of AS Elina STC was acquired, as a result of which Baltika's ownership in the subsidiary increased to 62.50%. In Virulane, Baltika acquired additionally 3.43% of the share capital and increased its participation to 82.66%. In February 2007, Baltika concluded an agreement for repurchasing of a 50% stake in the joint venture

OÜ Baltika Tailor. As a result, Baltika will become the sole owner of the company. In March 2007, Baltika increased its ownership in Elina to 100%.

PERSONNEL
As of the end of 2006, Baltika Group employed 1,915 people (31 December 2005: 1,678), including 857 (630) in retail, 866 (896) in production, and 192 (152) at the head office. During 2006, the number of employees increased by 237 people, while the largest growth occurred in retail (+227) as a result of opening new stores. The number of people employed outside Estonia was 689 (483) representing 36% of the Group’s employees. The average number of personnel stood at 1,777 in 2006 (2005: 1,651).



After joining the European Union in May 2004, the Baltic States have suffered increasing labour outflow, which also has an effect on the retail sector. Competition has increased in hiring of quality labour and top specialists. Baltika has recognized the importance of the image of being an attractive employer on the Group’s sustainable growth in the future. Thus, one of the Group’s goals in the next few years is to position itself as the most attractive employer in the fashion sector in our retail markets. One of the measures here is to use appropriate motivation packages, including convertible bonds, for example.

In 2006, the Baltika Group’s wages and salaries amounted to 137.5 million kroons. The remuneration paid to the members of the Management Board and Supervisory Board totalled 6.1 million kroons.

OUTLOOK AND GOALS FOR 2007
In 2007, Baltika Group will continue implementation of its profitable growth strategy:

- The Group’s goal in 2007 is to increase net sales at least 40%. During the year, 20-25 new stores are planned to be opened taking the Group’s total to 132-137 by the end of the year;
- Continuing expansion into Central and Eastern Europe, Baltika plans to enter one or two new markets (Czech Republic and Romania);
- Gross margin will be improved (54.5% in 2006);
- The brands will launch new product groups: Mosaic will launch childrenswear during the spring-summer season and Monton will present footwear during the fall season;
- Ivo Nikkolo starts expansion into the other Baltic markets (Latvia and Lithuania) in 2007;
- Investments are continuing in information technology related to the management of inventory and overall retail system;
- In the fall of 2007, a new production building will be completed in the suburbs of Tallinn for relocation of the Group’s production company Baltika Tailor that is currently located in the city centre at Veerenni 24. After that, the real estate owned by Baltika at Veerenni 24, Tallinn, is ready for extensive development.

AS Baltika 2006 Consolidated Annual Report (in thousands of Estonian kroons)

KEY FIGURES OF THE GROUP IN 2006

	31.12.2006	31.12.2005	+/-
Net sales (EEK million)	899.5	680.9	*32.1%*
Retail sales (EEK million)	736.4	546.8	*34.7%*
Share of retail sales in net sales	82%	80%	
Share of exports in net sales	73%	71%	
Number of directly managed stores	112	86	*30.2%*
Sales area (m^2)	19,594	12,736	*53.8%*
Number of employees (end of year)	1,915	1,678	*14.1%*
Gross margin	54.5%	51.6%	
Operating margin	10.8%	11.0%	
EBT margin	10.1%	10.4%	
Net margin	9.7%	10.7%	
Current ratio	1.5	2.1	*-28.6%*
Inventory turnover	5.38	4.92	*9.3%*
Debt to equity ratio	48.5%	44.6%	
Return on equity	35.9%	44.1%	
Return on assets	18.3%	22.2%	

Definitions of key ratios

Gross margin = (Net sales-Cost of goods sold)/Net sales
Operating margin = Operating profit/Net sales
EBT margin = Profit before corporate income tax/Net sales
Net margin = Net profit (attributable to parent)/Net sales
Current ratio = Current assets/Current liabilities
Inventory turnover = Net sales/Average inventories*
Debt to equity ratio = Interest-bearing liabilities/Equity
Return on equity = Net profit (attributable to parent)/Average equity*
Return on assets = Net profit (attributable to parent)/Average total assets*

*Based on 12-month average

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THE BALTIKA SHARE

Baltika's share has been quoted on the Tallinn Stock Exchange since 5 June 1997. The Tallinn Stock Exchange belongs to the OMX Group, which also owns and operates stock exchanges in Copenhagen, Stockholm, Helsinki, Riga, and Vilnius.

All of the shares of Baltika are common shares and carry equal rights to votes and dividends.

Basic information on the Baltika share

OMX symbol: BLT1T
ISIN: EE3100003609
Number of shares: 6,214,950
Nominal value of share: EEK 10
Voting rights per share: 1 vote

Share data

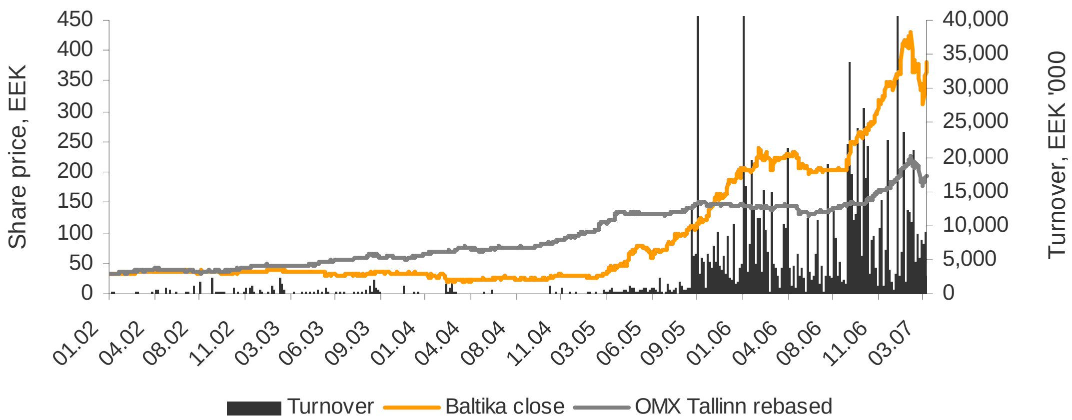
EEK	2002	2003	2004	2005	2006
Shares outstanding	5,444,450	5,499,450	5,633,950	5,822,950	6,214,950
Weighted average number of shares	5,015,817	5,483,992	5,541,721	5,759,950	6,008,783
Share price (31 Dec)	36.77	32.86	29.10	203.40	347.35
EPS	1.36	-12.30	3.01	12.62	14.54
P/E	27.1	neg.	9.7	16.1	23.9
Book value per share	32.5	20.9	25.1	35.7	49.0
P/B	1.1	1.6	1.2	5.7	7.1
DPS	0	0	0.75	2.00	2.40*
Dividend yield	0%	0%	2.6%	1.0%	0.7%*

*Proposal to AGM, DPS applied to the number of shares before the fund issue

SHARE PRICE AND TRADING

Baltika's share price increased by 71% during 2006 to 347.35 kroons and the Group's market capitalisation to 2.2 billion kroons. In the same period, the OMX Tallinn all share index rose by 29%.

Share price and turnover



In 2006, positive development continued in the liquidity and trading activity of the Baltika stock. In connection with the closure of the fund, Baltika's long-term strategic investor the Baltic Republics Fund (BRF) sold its 34.6% holding in the Company in September 2005. The fund's participation was sold through an international bid to institutional investors from eight different countries and as a result, the shareholder structure of Baltika became more diversified and the liquidity of the share increased. After the successful turnaround from clothing manufacturer to retail enterprise, the interest in Baltika's share has increased significantly among both foreign institutional investors as well as local retail investors. In 2006, excluding the transaction for the sale of the BRF stake, the number of Baltika shares traded on the stock exchange rose by more than two times in comparison with 2005, to 4.9 million shares.

AS Baltika 2006 Consolidated Annual Report (in thousands of Estonian kroons)

Security trading history

EEK	2002	2003	2004	2005	2006
High	38.96	39.90	32.86	203.40	350.48
Low	31.20	30.04	18.15	25.03	186.19
Last	36.77	32.86	29.10	203.40	347.35
Change, %	16.7%	-10.6%	-11.4%	598.9%	70.8%
Traded volume	580,595	731,037	666,917	4,403,236*	4,908,804
Turnover, million	20.6	25.7	16.1	486.3*	1,138.3
Market capitalisation, million	200	181	164	1,184	2,159

*Includes block sale of Baltic Republics Fund shareholding of 2.0 million shares in the amount of 216 million kroons

INDICES

OMX uses a common classification of indices for the Nordic and Baltic markets. The OMX Baltic index family includes all share, tradable, benchmark and sector indices. The indices are calculated in euros and as price (PI) and/or gross (GI) indices. All indices are chain-linked, meaning that they are calculated based on the price level of the previous trading day. All OMX Baltic indices have base values of 100 and the base date is 31 December 1999. The base date of the OMX Tallinn index is 3 June 1996. The composition of the tradable and benchmark indices is revised twice a year based on the trading activity of the shares.

As of the end of 2006, the Baltika share was part of ten OMX indices:

Index	Description	Type	Short name
OMX Tallinn GI	OMX Tallinn all share index	Gross index	OMXTGI
OMX Baltic 10 Tradable	Baltic tradable index	Price index	OMXB10
OMX Baltic All-Share PI	Baltic all share index	Price index	OMXBPI
OMX Baltic All-Share GI	Baltic all share index	Gross index	OMXBGI
OMX Baltic Benchmark PI	Baltic benchmark index	Price index	OMXBBPI
OMX Baltic Benchmark GI	Baltic benchmark index	Gross index	OMXBBGI
OMX Baltic Benchmark Cap PI	Capped Baltic benchmark index	Price index	OMXBBCAPPI
OMX Baltic Benchmark Cap GI	Capped Baltic benchmark index	Gross index	OMXBBCAPGI
OMX Baltic Consumer Discretionary PI	Baltic sector index	Price index	B25PI
OMX Baltic Consumer Discretionary GI	Baltic sector index	Gross index	B25GI

STRUCTURE OF SHAREHOLDERS

As of the end of 2006, Baltika had 1,129 shareholders. During the year, the number of shareholders rose by 19% from the 2005 year end number of 946.

The largest shareholder of Baltika is OÜ BMIG, a holding company owned by Baltika's Management Board. As of the end of 2006, OÜ BMIG held 20.84% of the share capital of Baltika. As of the same date, the members of the Management Board owned 27.85% of Baltika, both directly and through companies controlled by them.

Baltika's shareholder list is available at the website of Estonian Central Register of Securities (www.e-register.ee).

Largest shareholders as of 31.12.2006

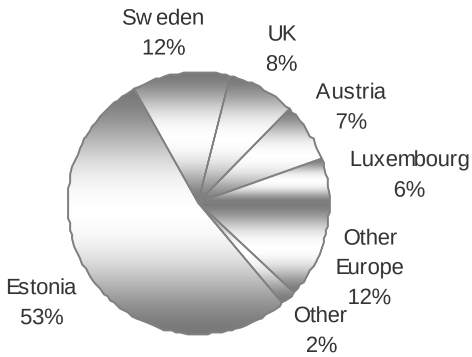
	Number of shares	Holding
BMIG OÜ	1,295,072	20.84%
Skandinaviska Enskilda Banken Ab Clients	417,020	6.71%
Raiffeisen Zentralbank Österreich AG Clients	305,940	4.92%
Morgan Stanley & Co Incorporated Equity Client Account	300,000	4.83%
Svenska Handelsbanken Clients	255,400	4.11%
Clearstream Banking Luxembourg S.A. Clients	254,009	4.09%
Meelis Milder	247,183	3.98%
Tõnis Kotkas	230,000	3.70%
Bank Austria Creditanstalt AG Clients	143,970	2.32%
AS Suprema Client Account	139,811	2.25%
The Bank of New York/ING Bank Slaski	136,982	2.20%
Hansabankas Clients	109,181	1.76%
State Street Bank/Allianz RCM Global Small-Cap Fund	100,000	1.61%
Other	2,280,382	36.69%
Total	**6,214,950**	**100%**

AS Baltika 2006 Consolidated Annual Report (in thousands of Estonian kroons)

Breakdown of shareholders by ownership size, 31.12.2006

Ownership	Number of shareholders	% of shareholders	Number of shares	% of votes
> 10%	1	0.1%	1,295,072	20.8%
1.0 - 10.0%	22	1.9%	3,439,881	55.3%
0.1 - 1.0%	77	6.8%	1,028,344	16.5%
< 0.1%	1,029	91.1%	451,653	7.3%
Total	**1,129**	**100.0%**	**6,214,950**	**100.0%**

Shareholders' structure by country, 31.12.2006



SHARE CAPITAL

As of 31 December 2006, the share capital of Baltika amounted to 62,149,500 kroons, consisting of 6,214,950 common shares. In 2006, the share capital increased by 3,920,000 kroons as a result of converting 392,000 C- and D-bonds into shares.

As of the end of 2006, all the convertible bond programs of Baltika were completed. The new share issues must be approved by 2/3 of the participants at the annual shareholders' meeting. Pursuant to the Company's Articles of Association, its maximum share capital is 160 million kroons.

Share capital movements

Date	Issue type	Issue price EEK	Issue amount	Shares outstanding	Share capital par value EEK '000	Share premium EEK '000
31.12.2001				**4,800,000**	**48,000**	**24,910**
4.10.2002	Directed share issue to OÜ BMIG	36.00	644,450	5,444,450	54,445	41,665
31.12.2002				**5,444,450**	**54,445**	**41,665**
20.02.2003	Conversion of A-bonds into shares	25.00	15,500	5,459,950	54,600	41,898
30.07.2003	Conversion of A-bonds into shares	25.00	39,500	5,499,450	54,995	42,490
31.12.2003				**5,499,450**	**54,995**	**42,490**
15.07.2004	Conversion of A-bonds into shares	25.00	88,000	5,587,450	55,875	43,810
16.12.2004	Conversion of A-bonds into shares	25.00	46,500	5,633,950	56,340	44,508
31.12.2004				**5,633,950**	**56,340**	**44,508**
17.05.2005	Conversion of B-bonds into shares	34.09	189,000	5,822,950	58,230	49,061
31.12.2005				**5,822,950**	**58,230**	**49,690**
30.03.2006	Conversion of C-bonds into shares	37.57	192,000	6,014,950	60,150	55,298
5.10.2006	Conversion of D-bonds into shares	28.95	82,400	6,097,350	60,974	56,860
8.12.2006	Conversion of D-bonds into shares	28.95	117,600	6,214,950	62,150	59,088
31.12.2006				**6,214,950**	**62,150**	**59,088**

DIVIDENDS

Considering the Group’s objectives in the coming years, the limit on the payment of dividends has been set at up to 25% of net profits for the financial year. The dividend proposal will take into account the Group’s cash flows, future expansion plans and the need for financing.

In 2006, Baltika’s consolidated net profit totalled 87.4 million kroons. The Management Board proposes to pay shareholders a dividend of 2.40 kroons per share (applied to the number of shares before the fund issue), i.e. 14.9 million kroons in total. In 2006, Baltika paid dividends in the amount of 12.0 million kroons or 2.00 kroons per share. Dividend payment comprised 16.6% of the net profit of the corresponding financial year.

For information on dividend history and ratios please see table Share data.

CORPORATE GOVERNANCE RECOMMENDATIONS REPORT

Corporate Governance Recommendations (CGR) is a collection of rules and principles that are recommended to be followed by companies whose shares have been admitted to trading on a regulated market in Estonia. As the principles described in the Corporate Governance Recommendations are not compulsory, each company shall decide whether or not it adopts these and shall confirm in a Corporate Governance Recommendations Report its compliance or not with the set recommendations. The "Comply or Explain" principle applies to publicly traded companies starting from 1 January 2006. AS Baltika follows most of the rules enclosed in the Corporate Governance Recommendations. The following report describes Baltika's management practices and explains the reasons for non-compliance of some principles.

AS Baltika is a joint-stock company; the management bodies of AS Baltika are the general meeting of shareholders, supervisory council and management board.

GENERAL MEETING

The General Meeting of shareholders is the highest managing body of the Company. The General Meetings are ordinary and extraordinary. The ordinary General Meeting is held once a year within six months after the end of the financial year. The Management Board will call an extraordinary General Meeting if the net assets of the Company are less than the amount permitted by law or this is demanded by the Council, the auditor or the shareholders whose shares represent at least 1/10 of the share capital. The General Meeting is competent to adopt decisions if at least half of the votes represented by shares are present. The persons authorized to participate at the General Meeting are determined at 08.00 a.m. on the day of the General Meeting.

The 2006 Annual General Meeting of Shareholders of AS Baltika was held on 3 May 2006. A total of 3,394,855 votes that represented 56.44% of the share capital of Baltika were present and the Annual General Meeting was competent to pass resolutions. The 2006 Annual General Meeting approved the 2005 annual report, profit distribution and the new wording of the Articles of Association. It also elected a new Council. The Management Board presented to shareholders the 2006-2008 strategy of Baltika Group.

SUPERVISORY COUNCIL

According to the Articles of Association, the Council may have three to five members. The 2006 Annual General Meeting elected a new Council consisting of five members. The previous Council had four members (Miles Burger, Joakim Helenius, Claire Chabrier, Reet Saks) and one of them was re-elected into the new Council (Reet Saks). The previous Council was recalled due to the change in the Company's ownership structure. In connection with the closure of the fund, Baltika's long-term strategic investor the Baltic Republics Fund sold its holding in September 2005. Two members of the previous Council, Joakim Helenius and Claire Chabrier, represented the interests of the Baltic Republics Fund at the Council.

The Baltic Republics Fund's 34.6% holding was sold through an international bid to institutional investors. During the bidding, the Management Board of Baltika increased its participation through the holding company OÜ BMIG, which became the largest shareholder after the bidding (20.84% holding as of the end of 2006). The second largest shareholder is East Capital (ca 6% holding as of the end of 2006), a leading independent asset manager specialising in Eastern European financial markets.

The new Council includes Tiina Mõis, the Chairman of the Council, and the members of the Council Reet Saks, Gert Tiivas, Allan Remmelkoor and Andres Erm. Mr. Gert Tiivas is the Managing Director of East Capital Estonian branch and represents East Capital at the Council, the rest of the members are independent. Mrs. Reet Saks is an attorney at Raidla & Partners Law Office, a long-term partner of Baltika, and has belonged to the Council since 1997. Mr. Allan Remmelkoor who is the Managing Director of Kristiine Shopping Centre in Tallinn, Estonia, contributes valuable retail experience to the Council. Mr. Andres Erm is the Chairman of the Management Board of OÜ Eurocon, the Ukrainian subsidiary of an Estonian construction company AS Eesti Ehitus, and has gained vast business experience in Eastern Europe, which is the operating region of Baltika. Mrs. Tiina Mõis is the Chairman of the Management Board of AS Genteel and belongs to the councils of several Estonian companies. One Council member, Andres Erm, owns Baltika shares (36,000 shares or 0.58% of the share capital of Baltika as of the end of 2006).

The members of the Council are elected by the General Meeting for three years. The Council plans the activities of the Company, organizes the management of the Company and supervises the activities of the Management Board. Meetings of the Council are held when necessary but not less frequently than once every three months. There were six Council meetings held in 2006, including four meetings with the new Council. A meeting of the

AS Baltika 2006 Consolidated Annual Report (in thousands of Estonian kroons)

Council has a quorum if more than half of the members of the Council are present. A resolution of the Council is adopted if more than half of the members of the Council who participate in the meeting vote in favour. Each member of the Council has one vote.

The 2006 Annual General Meeting resolved to continue the remuneration of the members of the Council in accordance with the resolution adopted by the Extraordinary General Meeting of Shareholders of AS Baltika on 8 December 2004. The fee payable to the Chairman of the Council is ten thousand (10,000) kroons per month and to the members of the Council six thousand (6,000) kroons per month. There are no compensation for termination of contract and other payable benefits for the members of the Council.

MANAGEMENT BOARD

According to the Articles of Association, the Management Board may consist of three to seven members who are elected by the Council for three years. The Management Board of Baltika comprises four members: the Chairman of the Board Meelis Milder and the members of the Board Ülle Järv, Maire Milder and Boriss Loifenfeld. At the meeting held on 28 August 2006, the Council of Baltika decided to extend the term of Management Board members for the next three years. The employment history of the members of the Board reaches 7-22 years.

The Management Board is the largest shareholder of Baltika via a holding company OÜ BMIG. As of the end of 2006, OÜ BMIG held 20.84% of the share capital of Baltika. As of the same date, the members of the Management Board owned 27.85% of Baltika, both directly and through companies controlled by them.

Management shareholdings as of 31.12.2006

	Number of shares	Holding
Baltika share capital	**6,214,950**	**100.00%**
OÜ BMIG	1,295,072	20.84%
Meelis Milder	247,183	3.98%
Maire Milder	115,361	1.86%
Boriss Loifenfeld	50,122	0.81%
Ülle Järv	23,158	0.37%
Total OÜ BMIG and Management Board	**1,730,896**	**27.85%**

The members of the Management Board are heading strategic divisions of the Company and thus, their tasks are not limited solely to the responsibilities of a Management Board member (supervising and representing the Company). As a result, the members of the Management Board have employment contracts with the Company and not the contract of service concluded with the Chairman of the Supervisory Council (CGR Article 2.2.1.). Mr. Meelis Milder, the Chairman of the Management Board, is the CEO of the Baltika Group and the members Mrs. Ülle Järv is the CFO, Mrs. Maire Milder the Director of Retail Division and Mr. Boriss Loifenfeld the Director of Wholesale and CIS Market Projects.

The remuneration and compensation of the Management Board members is determined by the employment contracts concluded with them. The compensation for termination of the contract of a Board member reaches 6-12 monthly salaries.

The Board members as well as other employees of the Company receive bonuses in accordance with the Company’s bonus scheme, which is based on the profits generated by different profit centres. The maximum amount of the bonus payment of the Chairman of the Management Board/Group CEO is 1.5% of the net profit of the Company whereby the actual payout is limited to one year’s salary. The bonus amount of the members of the Board/directors is based on the results of specific profit centres and the actual payouts are limited to 1/2 or 2/3 of annual salary. The bonuses are paid twice in advance during a financial year and the final amount is determined and paid out after the completion of the audited annual results. The bonus payment of the Chairman of the Board is approved by the Supervisory Council. The bonus payments of the members of the Board are approved by the Chairman of the Council based on the proposal of the Chairman of the Board.

The members of the Management Board, as well as all the managers who have a director’s employment contract with the Company, are entitled to one insurance or pension fund payment a year in the amount of one month’s salary after working three years on the respective position. The members of the Board are entitled to a company car and other benefits as per the Company’s internal rules. The members of the Board have participated and may participate in the future in the convertible bond or option programs of Baltika.

Due to the confidential nature of the employment contracts, Baltika does not disclose remuneration payments to each Board member separately (CGR Article 2.2.7.), however, the total amount of remuneration paid to the members of the Management Board and Supervisory Council during a specific period is disclosed in management reports of Baltika's interim and annual reports. In 2006, the remuneration paid to the members of the Management Board and Supervisory Council totalled 6.1 million kroons.

In 2006, the members of the Board also participated in convertible bond schemes for the top and middle management. The change in the shareholdings of the Board members can be followed in Baltika's shareholder list available at the website of Estonian Central Register of Securities (www.e-register.ee) and in the Company's interim and annual reports. As of the end of 2006, all the convertible bond programs of Baltika were completed.

AUDITOR

An auditor or auditors are elected by the General Meeting for a one-time audit or for a definite term. The Annual General Meeting held on 18 May 2005 elected AS PricewaterhouseCoopers as the auditing company in 2005 and 2006. According to the agreement, the leading auditor of Baltika is Urmas Kaarlep and the executive auditor Relika Mell. The auditors' fee is set in the agreement, which is concluded by the Management Board. Baltika assures the independence of the auditors by rotating the leading and executive auditors in every five years.

CGR ARTICLE 5.6.

The Issuer shall disclose the dates and places of meetings with analysts and presentations and press conferences organized for analysts, investors or institutional investors on its website.

According to the rules of the Tallinn Stock Exchange, Baltika discloses all the material and price sensitive information at first via the stock exchange information system. During the meetings and press conferences the previously disclosed information is presented. All the disclosed information is available at the website of Baltika, which also includes contacts for obtaining additional information. Baltika's website also includes the Company's corporative and financial results presentations, which are used during the meetings with analysts and investors. At present, the Company does not consider it important to disclose the schedule of different meetings held.

AS Baltika 2006 Consolidated Annual Report (in thousands of Estonian kroons)

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT BOARD'S CONFIRMATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

The Management Board confirms the correctness and completeness of AS Baltika's 2006 consolidated financial statements as presented on pages 24-69.

The Management Board confirms that:

1. the accounting policies and presentation of information is in compliance with International Financial Reporting Standards as adopted by the European Union;

2. the financial statements present a true and fair view of the financial position, the results of the operations and the cash flows of the Group;

3. all group companies are going concerns.

Meelis Milder Chairman of the Management Board 16 March 2007	Ülle Järv Member of the Management Board 16 March 2007
Boriss Loifenfeld Member of the Management Board 16 March 2007	Maire Milder Member of the Management Board 16 March 2007

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CONSOLIDATED BALANCE SHEET

	Note	31.12.2006	31.12.2005
ASSETS			
Current assets			
Cash and bank	4	12,584	25,961
Current financial assets	5	0	1,808
Trade receivables	6	86,402	39,566
Other receivables and prepaid expenses	7	42,069	14,992
Inventories	8	200,702	144,459
Total current assets		**341,757**	**226,786**
Non-current assets			
Investment in joint venture	9	0	234
Investment property	10	23,572	27,193
Deferred income tax asset	11	4,462	3,598
Other non-current financial assets	12	11,077	4,708
Property, plant and equipment	13,15	166,448	88,089
Intangible assets	14	49,074	26,491
Total non-current assets		**254,633**	**150,313**
TOTAL ASSETS		**596,390**	**377,099**
EQUITY AND LIABILITIES			
Current liabilities			
Borrowings	16,17	88,179	30,278
Supplier payables		96,535	44,782
Tax liabilities	7	23,006	17,563
Accrued expenses	18	18,174	13,505
Other short-term liabilities	18	7,022	466
Total current liabilities		**232,916**	**106,594**
Non-current liabilities			
Long-term borrowings	16	59,234	62,553
Total non-current liabilities		**59,234**	**62,553**
TOTAL LIABILITIES		**292,150**	**169,147**
EQUITY			
Share capital at par value		62,150	58,230
Share premium		59,088	49,690
Reserves		9,721	9,532
Retained earnings		73,521	13,077
Net profit for the period		87,376	72,664
Currency translation reserve		4,319	4,131
Total equity attributable to equity holders of the parent		**296,175**	**207,324**
Minority interest		8,065	628
TOTAL EQUITY	19	**304,240**	**207,952**
TOTAL LIABILITIES AND EQUITY		**596,390**	**377,099**

The Notes to the financial statements presented on pages 29-69 are an integral part of the Annual Report

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CONSOLIDATED INCOME STATEMENT

	Note	2006	2005
Net sales	20,21	899,481	680,906
Cost of goods sold	22	-408,919	-329,827
Gross profit		**490,562**	**351,079**
Distribution costs	23	-300,879	-207,704
Administrative and general expenses	24	-97,926	-85,232
Other operating income	25	12,482	19,817
Other operating expenses	26	-6,907	-3,053
Operating profit		**97,332**	**74,907**
Financial income (expenses)		**-6,037**	**-3,947**
Share of joint venture results		-234	-861
Gains from other investments, net		322	1,205
Interest expenses, net		-5,730	-5,415
Foreign exchange gains (losses), net		-863	645
Other financial income, net		468	479
Profit before corporate income tax		**91,295**	**70,960**
Corporate income tax	27	-3,136	-4,280
Net profit		**88,159**	**66,680**
Net profit (loss) attributable to minority shareholders		783	-5,984
Net profit attributable to equity holders of the parent company		**87,376**	**72,664**
Basic earnings per share, EEK	28	14.54	12.62
Diluted earnings per share, EEK	28	14.12	12.11

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CONSOLIDATED CASH FLOW STATEMENT

	Note	2006	2005
Operating activities			
Operating profit		97,332	74,907
Adjustments:			
Depreciation, amortisation and impairment of property, plant and equipment, intangibles	13,14	26,158	20,713
Profit (loss) from disposal of property, plant and equipment		1,236	1,350
Profit (loss) from sale of investment property	10	-7,513	0
Revaluation of investment property	10	-4,380	-13,738
Other non-monetary expenses	17	315	629
Changes in working capital:			
Change in balance of receivables	6,7	-66,717	-22,956
Change in balance of inventories	8	-56,243	1,001
Change in supplier payables		53,422	20,098
Interest paid	16	-5,537	-4,338
Income tax paid	27	-7,846	-3,043
Total cash flow from operating activities		**30,227**	**74,623**
Investing activities			
Purchase of property, plant and equipment, intangibles	13,14	-104,176	-36,164
Including under the finance lease terms	15	5,804	10,954
Proceeds from disposal of property, plant and equipment	13	435	406
Proceeds from disposal of investment property	10	11,055	0
Investments in subsidiaries	30	-786	0
Investments in other business combinations	30	-11,667	0
Interest received		89	167
Dividends received		15	0
Proceeds from disposal of current financial assets	5	2,131	0
Loans granted	29	0	-1,505
Repayments of loans granted	29	352	305
Total cash flow from investing activities		**-96,748**	**-25,837**
Financing activities			
Repayments of borrowings	16	-12,695	-37,456
Loans received	16	54,428	0
Finance lease and instalment payments made		-1,236	-654
Receipts from contributions into share capital	19	12,791	6,254
Dividends paid	19	-12,020	-4,475
Redemption of bonds	17	-17,500	-6
Proceeds from issue of bonds	17,19	30,239	352
Total cash flow from financing activities		**54,007**	**-35,985**
Effect of exchange rate changes on cash balance		-863	645
Total cash flows		**-13,377**	**13,446**
Cash and cash equivalents at the beginning of the period	4	**25,961**	**12,515**
Cash and cash equivalents at the end of the period	4	**12,584**	**25,961**
Change in cash and cash equivalents		**-13,377**	**13,446**

The Notes to the financial statements presented on pages 29-69 are an integral part of the Annual Report

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share pre-mium	Reser-ves	Re-tained ear-nings	Cur-rency transla-tion reserve	Total attribu-table to equity holders	Mino-rity interest	Total
Balance as of 31.12.2004	**56,340**	**44,508**	**26,783**	**193**	**6,622**	**134,446**	**7,024**	**141,470**
Currency translation differences	0	0	0	0	-2,491	**-2,491**	-413	**-2,904**
Net income (expenses) recognised directly in equity	0	0	0	0	-2,491	**-2,491**	-413	**-2,904**
Net profit for the period	0	0	0	72,664	0	**72,664**	-5,984	**66,680**
Total recognised income (expense)	**0**	**0**	**0**	**72,664**	**-2,491**	**70,173**	**-6,397**	**63,776**
Equity-settled share-based transactions (Note 17,19)	0	629	0	0	0	**629**	0	**629**
Dividends paid (Note 19)	0	0	0	-4,367	**0**	**-4,367**	0	**-4,367**
Transfers to statutory reserve capital (Note 19)	0	0	834	-834	0	**0**	0	**0**
Increase of share capital (Note 17,19)	1,890	4,553	0	0	0	**6,443**	0	**6,443**
Allocations to retained earnings	0	0	-18,085	18,085	0	**0**	0	**0**
Balance as of 31.12.2005	**58,230**	**49,690**	**9,532**	**85,741**	**4,131**	**207,324**	**628**	**207,952**
Balance as of 31.12.2005	**58,230**	**49,690**	**9,532**	**85,741**	**4,131**	**207,324**	**628**	**207,952**
Currency translation differences	0	0	0	0	188	**188**	-7	**181**
Net income (expenses) recognised directly in equity	0	0	0	0	188	**188**	-7	**181**
Net profit for the period	0	0	0	87,376	0	**87,376**	783	**88,159**
Total recognised income (expense)	**0**	**0**	**0**	**87,376**	**188**	**87,564**	**776**	**88,340**
Equity-settled share-based transactions (Note 17,19)	0	315	0	0	0	**315**	0	**315**
Dividends paid (Note 19)	0	0	0	-12,031	0	**-12,031**	0	**-12,031**
Transfers to statutory reserve capital (Note 19)	0	0	189	-189	0	**0**	0	**0**
Increase of share capital (Note 17,19)	3,920	9,083	0	0	0	**13,003**	0	**13,003**
Acquisition of minority interest (Note 30)	0	0	0	0	0	**0**	6,661	**6,661**
Balance as of 31.12.2006	**62,150**	**59,088**	**9,721**	**160,897**	**4,319**	**296,175**	**8,065**	**304,240**

Additional information on share capital and changes in equity is provided in Note 19.

The Notes to the financial statements presented on pages 29-69 are an integral part of the Annual Report

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 Accounting policies and accounting methods used in the preparation of the financial statements

The Group's 2006 consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). The financial statements have been prepared under the historical cost convention, as modified by the revaluations of investment property and financial instruments at fair value through profit or loss, which are presented at fair value as disclosed in the accounting policies below. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

All information in the financial statements is presented in thousands of Estonian kroons, unless otherwise stated. The Estonian kroon is pegged to the euro at the rate of EUR 1 = EEK 15.6466.

Comparability

The financial statements have been prepared in accordance with the consistency and comparability principles, the nature of the changes in methods and their effect is explained in the respective notes. When the presentation of items in the financial statements or their classification method has been amended, then the comparative information of previous periods has also been restated.

New International Financial Reporting Standards, amendments to published standards and interpretations by the International Financial Reporting Interpretations Committee

a) Amendments to published standards and interpretations effective from 1 January 2006
Implementation of amendments to standards or their interpretations did not result in material changes of existing accounting principles and had no significant impact on the Group's financial result.

IAS 19 Amendment – Actuarial Gains and Losses, Group Plans and Disclosures
As the Group has no defined benefit obligations, the amendment has no impact on the Group's financial statements.
IAS 21 Amendment – Net Investment in a Foreign Operation
IAS 39 Amendment – Cash Flow Hedge Accounting of Forecasted Intragroup Transactions
IAS 39 Amendment – The Fair Value Option
The Group meets the criteria in the amendment and therefore continues to designate certain financial assets and financial liabilities at fair value through profit and loss.
IAS 39 and IFRS 4 Amendment – Financial Guarantee Contracts
The measurement and disclosure requirements under IAS 39 have not resulted in a material change to the Group's polices.
IFRS 1 Amendment – First-time Adoption of International Financial Reporting Standards
IFRS 6 Amendment – Exploration for and Evaluation of Mineral Resources
IFRIC 4 Determining whether an Arrangement contains a Lease
IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

IFRS 1, IFRS 4, IFRS 6, IFRIC 4, IFRIC 5 and IFRIC 6 are not relevant to the Group's operating activities and therefore have no substantial effect on the Group's accounting policies.

b) Interpretations issued but not yet effective
The Group has chosen not to early adopt the following standards and interpretations that were issued but are not yet effective for accounting periods beginning on 1 January 2006:

IAS 1 Amendment – Capital Disclosures – effective 1 January 2007
IFRS 7 Financial Instruments: Disclosures – effective 1 January 2007
IFRS 8 Operating Segments – effective 1 January 2008
IFRIC 7 Applying the Restatement Approach under IAS 29 – effective 1 March 2006
IFRIC 8 Scope of IFRS 2 – effective 1 May 2006
IFRIC 9 Reassessment of Embedded Derivative – effective 1 June 2006
IFRIC 10 Interim Financial Reporting and Impairment – effective 1 November 2006

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IFRIC 11, IFRS 2 Group Treasury Share Transactions – effective 1 March 2007
IFRIC 12 Service Concession Arrangements – effective 1 January 2009

The application of these new interpretations will not have material impact on the Group's financial statements in the period of initial application, except for IFRS 7, amendment to IAS 1 and IFRS 8, which will not have an impact on any measurement or recognition principles, but are expected to have an impact on presentation and disclosure.

Principles of consolidation, accounting for business combinations and subsidiaries

A subsidiary is an entity in which the Group, directly or indirectly, has interest of more than one half of the voting rights or otherwise has power to govern the operating and financial policies so as to obtain economic benefits. All subsidiaries have been consolidated in the Group's financial statements. An associate is an entity, in which the Group owns between 20% and 50% of shares with voting rights and over which the Group has significant influence.

A subsidiary is consolidated from the date on which control is transferred to the group and is no longer consolidated from the date on which control ceases. The purchase method of accounting is used to account for the acquisition of a subsidiary. The cost of an acquisition is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The date of exchange is the acquisition date where a business combination is achieved in a single transaction, and is the date of each share purchase where a business combination is achieved in stages by successive share purchases. Under the purchase method, acquired and separately identifiable assets and liabilities as well as contingent liabilities of the acquired subsidiary are recognised at their fair values at the acquisition date.

In the consolidated financial statements, the financial statements of the subsidiaries under the control of the parent company (except for the subsidiaries acquired for the purpose of selling) are combined on a line-by-line basis. Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

The consolidated financial statements include the consolidated financial information of AS Baltika and its subsidiaries OÜ Baltman, AS Virulane, AS Elina STC, UAB Baltika Lietuva, SIA Baltika Latvija, Baltika Poland Sp.z.o.o., Baltika Ukraina Ltd, OY Baltinia AB, Baltika Sweden AB, OOO Kompania "Baltman Rus" and OÜ Baltika TP. Where necessary, the accounting policies of the subsidiaries have been changed to ensure consistency with the policies adopted by the Group. The consolidated financial statements had earlier been prepared for subsidiaries with their own subsidiaries which were then used for consolidation purposes.

Investments into subsidiaries and associates are reported at cost (less any impairment losses) in the separate primary financial statements of the parent company.

Minority interest
Minority interest is that part of the net results and of the net assets of a subsidiary, including the fair value adjustments, which is attributable to interests which are not owned, directly or indirectly, by the Group. Minority interest forms a separate component of the Group's equity.

Purchases of minority interest
Transactions with minorities are treated as transactions with parties external to the Group. Difference, if any, between the carrying amount of a minority interest and the amount paid to acquire it is recorded as goodwill or charged to income statement as negative goodwill, if the carrying amount of minority interest is in excess of the amount paid.

Joint ventures

A joint venture is based on a contractual agreement according to which two parties carry out their jointly controlled economic activities. Joint venture's activities are accounted for under the equity method in the balance sheet of a venturer, according to which the interest in a jointly controlled entity is initially recognised at cost and subsequently adjusted with the changes that have occurred in the venture interest in the net assets of the jointly controlled entity after the acquisition. In the income statement, the venture accounts for its interest in the operating results, financial income and financial expenses in the jointly controlled entity.

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Foreign currency

Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements have been prepared in Estonian kroons, which is the functional and presentation currency of the parent company.

Financial statements of foreign operations

The results and financial position of each Group entity are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised as a separate component of equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. When a subsidiary is disposed of through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity, the exchange differences deferred in equity are reclassified to profit or loss.

Foreign currency transactions

During the year, all foreign currency transactions of AS Baltika and the Group have been recorded in Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing on the transaction date. Receivables and liabilities denominated in a foreign currency have been translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing on the balance sheet date. Profits and losses from foreign currency transactions, including arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition, are recognised in the income statement as income or expenses of that period.

Cash and cash equivalents

For the purposes of the balance sheet and the cash flow statement, cash and cash equivalents comprise cash on hand as well as bank account balances (except for overdraft), term deposits with original maturities of three months or less and money-market funds shares. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet. Cash and cash equivalents are measured at fair value.

Financial assets

The purchases and sales of financial assets are recognised at the trade date – the date on which the Group commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

Depending on the purpose for which financial assets were acquired as well as management's intentions, financial assets are classified into the following categories at initial recognition:

- financial assets at fair value through profit or loss;
- loans and receivables;
- held-to-maturity investments; and
- available-for-sale financial assets.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading purposes (i.e. assets acquired or arisen primarily for the purpose of selling or repurchasing in the near term or a derivative financial instrument that is not a hedging instrument) as well as other financial assets that have been designated at inception as financial assets at fair value through profit or loss. Financial assets belonging to this group are initially recognised at fair value excluding transaction costs. After their initial recognition, the financial assets in this category are measured at fair value with changes in fair value recognised in the income statement.

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The Group has not classified any financial assets as "held-to-maturity investments" or "available-for-sale financial assets".

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables are initially recognised at fair value plus transaction costs. After initial recognition, loans and receivables are accounted for at amortised cost using the effective interest rate method. This method is used for calculating interest income on the receivable in the following periods.

When it is probable that the Group is unable to collect all amounts due according to the original terms of receivables, an allowance is set up for the impairment of these receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount. The recoverable amount is the expected future cash flows discounted at the market rate of interest for similar borrowers. Impairment losses are charged to the income statement.

Other receivables are assessed based on their collectible amounts. The collection of each receivable is assessed separately, taking into consideration all known information on the solvency of the debtor. Doubtful receivables are written down in the balance sheet to the collectible amount. Irrecoverable receivables are derecognised.

Receivables are generally included in current assets when they are due within 12 months after the balance sheet date. Such receivables whose due date is later than 12 months after the balance sheet date are reported as non-current assets.

Inventories

Inventories are recorded in the balance sheet at cost, consisting of the purchase costs, direct and indirect production costs and other costs incurred in bringing the inventories to their present location and condition.

Purchase costs include the purchase price, customs duties and other non-refundable taxes and direct transportation costs related to the purchase, less discounts and subsidies. The production costs of inventories include costs directly related to the units of production (such as direct materials and packing material costs, unavoidable storage costs related to work in progress, direct labour), and also a systematic allocation of fixed and variable production overheads (such as depreciation and maintenance of factory buildings and equipment, overhaul costs, and the labour cost of factory management).

The FIFO method is used to account for the cost of inventories. Inventories are measured in the balance sheet at the lower of acquisition/production cost or net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Investment property

Real estate properties (land, buildings) that the entity owns or leases under finance lease terms to earn rental income or for capital appreciation and which are not occupied by the Group are recorded under investment property. An investment property is initially recognised at its acquisition cost. It is subsequently re-measured at its fair value which is based on the market value determined annually by external valuers and the management's judgement based on the comparable transactions at the same location. Earned rental income is recorded in profit or loss within other operating income. Gains and losses resulting from changes in the fair value of investment property are recorded in profit or loss and presented in "Other operating expenses"/"Other operating income".

If non-current assets used in operating activities are reclassified as investment property, the difference between the carrying amount and the fair value is recognised in an equity reserve unless the difference arising from revaluation reverses an impairment loss recorded in previous periods – in such case the change in fair value is recognised directly in the income statement to the extent it reverses the previous impairment loss. The revaluation surplus included in equity is transferred to retained earnings on the subsequent disposal of investment property.

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Property, plant and equipment

Property, plant and equipment are non-current assets used in the operating activities of the entity with a useful life of over one year. An item of property, plant and equipment is initially recognised at its acquisition cost which consists of the purchase price (including customs duties and other non-refundable taxes) and other expenditures directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. An item of property, plant and equipment is subsequently stated at cost less any accumulated depreciation and any impairment losses. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets.

Subsequent expenditure incurred for an item of property, plant and equipment is recognised as a non-current asset when it is probable that the Group will derive future economic benefits from it and its cost can be measured reliably. The cost of reconstruction carried out on rental spaces of stores is depreciated over the lease term. Other maintenance and repair costs are expensed when incurred.

Land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

- buildings and structures	5-40 years;
- machinery and equipment	2-7 years;
- other fixtures	2-7 years.

At each balance sheet, the appropriateness of depreciation rates, methods and the residual value is assessed. When the residual value of the asset exceeds its carrying amount, the depreciation of the asset is ceased.

At each reporting date the management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, the management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the income statement. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss in the income statement item "Other operating income"/"Other operating expenses".

Non-current assets available for sale

Assets classified as assets held for sale are recognised in the balance sheet at the lower of carrying amount and fair value (less costs to sell). Assets are classified as held for sale, when the carrying amount is principally recovered through a sale transaction rather than through continuing use. Non-current assets available for sale are items of property, plant and equipment and intangible assets which the management intends to sell within the next 12 months and with regard to which the management has started active marketing activities and the assets are offered for sale at a realistic price as compared to their fair value. The depreciation of assets held for sale is ceased. Assets held for sale are reported on the balance sheet as a separate item "Non-current assets available for sale"

For those subsidiaries and associates which already at the time of their acquisition met the criteria for non-current assets held for sale (i.e. will most likely be sold within 12 months after their acquisition), the acquired subsidiaries are recognised at the lower of their fair value less costs to sell and their carrying amount and the acquired associates are recognised at the lower of their fair value less costs to sell and their carrying amount.

Intangible assets (excluding goodwill)

An intangible asset is initially recognised at its acquisition cost, comprising 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 its acquisition cost less any accumulated amortisation and impairment losses.

Trademarks and licences

Acquired trademarks and licences are shown at historical cost. Trademarks and licences have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademarks and licences over their estimated useful lives (5-20 years).

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Computer software
Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include the employee costs incurred as a result of developing software and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised over their estimated useful lives (5-10 years).

Goodwill

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, reflecting the part of acquisition cost which was paid for such assets of the acquired company which cannot be separated and accounted for separately. Goodwill which arose in the acquisition of a subsidiary is recognised as an intangible asset in the consolidated financial statements.

At the transaction date, goodwill is recognised in the balance sheet at its acquisition cost. Goodwill is subsequently carried at its cost less any impairment losses. Goodwill is not amortised. Goodwill is allocated to cash-generating units for the purpose of impairment testing.

At each balance sheet date (or more frequently when an event or change in circumstances indicates that the fair value of goodwill may have become impaired), an impairment test is performed and if necessary, goodwill is written down to its recoverable value (if it is lower than its carrying amount). The excess of the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired over cost ("negative goodwill") is immediately recognised under "Other operating income".

Goodwill which arose in the acquisition of an associate or joint venture is included in the carrying amount of the investment and tested for impairment.

Goodwill which arose in the acquisition of foreign subsidiaries is translated using the foreign exchange rate of the Bank of Estonia prevailing on the balance sheet date.

Impairment of non-current assets

Intangible assets with indefinite useful lives (property, plant and equipment (land) as well as intangible assets (goodwill)) are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amount with the recoverable amount.

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If such circumstances exist, the recoverable amount is compared with the carrying amount.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit).

Assets which were written down are reviewed on each balance sheet date to determine whether their recoverable value has arisen. The reversal of the impairment loss is recorded in the income statement of the financial year as a reduction of the impairment losses. Impairment loss recognised for goodwill is not reversed.

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Finance and operating leases

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

The Group 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 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 term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. Assets leased under finance leases are depreciated similarly to acquired non-current assets whereas the depreciation period is the lower of the asset's expected useful life or the duration of the lease term (when the transfer of ownership is not sufficiently certain).

Payments made under operating leases are charged to the income statement on a straight-line basis over the lease term.

The Group is the lessor

Assets leased out under operating leases are recognised similarly to non-current assets. Operating lease payments are recognised as income on a straight-line basis over the lease term.

Corporate income tax in Estonia

According to the Income Tax Act, the annual profit earned by enterprises is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise. Instead of taxing the net profit, the distribution of retained earnings is subject to income tax of 22/78 from 1 January 2007 (until 31 December 2006: 23/77 and until 31 December 2005: 24/76) of the amount paid out as dividends from which income tax paid before 1 January 2000 can be deducted using a respective coefficient. 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 dividends are paid.

Deferred income tax

In accordance with the current Income Tax Act, no differences arise between the tax bases of assets and liabilities and their carrying amounts for group companies located in Estonia, as a result of which no deferred tax receivables or tax liabilities arise. In accordance with the local income tax laws, the net profit of companies located in Latvia, Lithuania, Poland, Ukraine and Russia that has been adjusted for the permanent and temporary differences as stipulated by law is subject to corporate income tax (the income tax rate is 15% in Latvia and Lithuania, 19% in Poland, 25% in Ukraine and 24% in Russia). There have been no changes in tax rates compared to 2005.

Deferred income tax is provided using the balance sheet liability method. Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the balance sheet. The main temporary differences arise from depreciation and tax loss carry-forwards. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised. Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Provisions and contingent liabilities

Provisions for liabilities and charges resulting from environmental restoration, restructuring costs and legal claims are recognised when: the Group 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 the amount has been reliably estimated. Provisions are not recognised for future operating losses.

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Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

A financial guarantee contract is initially recognised at fair value and is subsequently measured at the higher of (a) the amount determined in accordance with IAS 37 and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18. Consequently, any financial guarantees issued on behalf of parties outside of the Group will result in recognition of a liability, unless the likelihood of occurrence is zero.

Revenue recognition

Revenue from the sale of goods is recognised at the fair value of the consideration received or receivable, taking into consideration all discounts and concessions made. Revenue from the sale of goods is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer and the amount of revenue and costs incurred in respect of the transaction can be measured reliably.

Retail sales
Revenue from the sale of goods is recognised at the time of selling the goods to the customer at the retail store, generally for cash or by card payment. The sales price also includes fees for card transactions recognised as distribution costs. Past experience is used to estimate and provide for such returns at the time of sale.

Wholesale
Revenue from the sale of goods is recognised when the goods have been delivered to the customer, the customer has accepted the goods and the collectibility of the related receivable is reasonably assured. Accumulated experience is used to estimate and provide for such returns at the time of sale.

Other
Revenue from the rendering of services is recorded in the accounting period in which the services are rendered. If a service is rendered over a longer period of time, revenue from the rendering of a service is recorded using the stage of completion method. Revenue arising from interest is recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of revenue can be measured reliably. Dividend income is recognised when the right to receive payment is established. Revenue from the sale of goods and services is included in income statement lines “Net sales” and revenue from the sale of investments in the line “Gains from other investments, net”.

Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

The primary format of segment reporting of the Group is the geographical segment by the area of location of customers and the secondary format of segment reporting is the business segment which distinguishes retail trade from wholesale trade with other activities and production activities.

The allocation of the Group’s subsidiaries and business units into segments is based on the structure of the internal management reporting.

Segment results include revenues and expenses directly attributable to the segment and the relevant part that can be allocated to the particular segment either from external or internal transactions. Unallocated items result from utilisation or disposal of unallocated assets and liabilities as well as from administrative costs taken by the parent company.

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Segment assets and liabilities include those operating assets and liabilities directly attributable to the segment or those that can be allocated to the particular segment. Financial assets, interest bearing borrowings and the administrative facilities of the parent company are disclosed as unallocated assets and liabilities.

Interest income and expenses

Interest income/expenses have been recognised in the income statement for all instruments that are measured at amortised cost using the effective interest rate method. The effective interest rate is a method for calculating the amortised cost of a financial asset or a financial liability or the method for allocating interest expenses to the respective period. The effective interest rate is the rate that exactly discounts the expected future cash receipts/payments over the expected useful life of the financial asset or the financial liability to its carrying amount. In calculating the effective interest rate, the Group assesses all contractual terms of the financial instrument but does not consider future discounts. All contractual major service fees paid or received between the parties that are an integral part of the effective interest rate, transaction costs and other additional taxes or deductions are used in the calculation. If a financial asset or a group of similar financial assets has been written down due to impairment, interest income is calculated on them using the same interest rate as was used for discounting the future estimated cash receipts in order to determine the impairment loss.

Revenue arising from interest is recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of revenue can be measured reliably. When the receipt of interest is uncertain, interest income is recognised on a cash basis.

Financial liabilities

All financial liabilities (supplier payables, borrowings, accrued expenses, bonds and other short and long-term borrowings) are initially recorded at the proceeds received, net of transaction costs incurred. The amortised cost of short-term liabilities normally equals their nominal value; therefore short-term liabilities are stated in the balance sheet in their redemption value. Long-term liabilities are initially recognised at the fair value of the consideration receivable (less transaction costs) and are subsequently measured at amortised cost using the effective interest rate method.

A financial liability is classified as short term when it is due within 12 months after the balance sheet date or the Group does not have an unconditional right to defer the payment for longer than 12 months after the balance sheet date. Borrowings with a due date of 12 months or less after the balance sheet date that are refinanced into long-term borrowings after the balance sheet date but before the approval of the annual report, are classified as current. Borrowings that the lender has the right to recall due to the violation of terms specified in the contract are also classified as current liabilities.

Offsetting

Financial assets and financial liabilities are offset only when there exists a legally enforceable right and these amounts are intended to be settled simultaneously or on a net basis.

Share capital

Shares are included in equity. The Group does not have any preference shares. The costs directly related to the issuance of shares are recognised as a reduction of the equity item "Share premium". Upon the repurchasing of the Company's treasury shares by the Group companies, the payments made for the shares less transaction costs are recognised as a reduction of equity until the issue, sale or recalling of shares. Upon the sale or issue of treasury shares, the consideration received less directly attributable transactions costs is taken to equity.

Statutory reserve capital

In accordance with the Commercial Code, statutory reserve capital is set up from annual net profit allocations. During each financial year, at least one-twentieth of the net profit shall be transferred to reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

Other reserves

Other reserves are set up in accordance with the resolution of the General Meeting of Shareholders and they can be used to offset losses from prior periods as well as to increase share capital. Payments shall not be made to shareholders from other reserves.

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Share-based payments

The fair value of services (work contribution) supplied by the employees to the Group in exchange for the shares is recognised as an expense in the income statement and in share premium in equity during the vesting period (from the grant date of convertible bonds until the vesting date). The fair value of the services received is determined by reference to the fair value (market value) of equity instruments granted to the employees at the grant date. For the employee to receive the right to be able to convert the convertible bond into shares under the share-based payment agreement, there must be an existing employment relationship and therefore at each balance sheet date, the number of estimated convertible bonds expected to vest is assessed and personnel expenses as well as share premium items are adjusted to reflect the change in the number of bonds expected to be converted. The amounts received for shares upon the conversion of a convertible bond less direct transaction costs is recognised in the items “Share capital” and “Share premium” in equity.

Payables to employees

Payables to employees contain the contractual right arising from employment contracts with regard to performance-based pay which is calculated on the basis of the Group's financial results and meeting of objectives set for the employees. Performance-based pay is included in period expenses and as a liability if it is to be paid in the next financial year. In addition to the performance-based pay, this liability also includes accrued social and unemployment taxes calculated on it.

Pursuant to employment contracts and current legislation, payables to employees also include an accrued holiday pay liability as of the balance sheet date. In addition to the holiday pay, this liability also includes accrued social and unemployment taxes.

Earnings per share

Basic earnings per share are determined by dividing the net profit for the financial year by the period’s weighted average number of shares issued. Diluted earnings per share are determined by dividing the net profit for the financial year by the weighted average number of shares taking also into consideration the number of dilutive potential shares.

NOTE 2 Critical accounting estimates, and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management’s experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include: inventory (Note 8), valuation of goodwill (Note 14), determination of the useful life of property, plant and equipment (Note 13), valuation of investment property (Note 10), valuation of intangible assets (Note 30) and valuation of deferred income tax assets (Note 11).

Inventory valuation

Upon valuation of inventories, the management will rely on its best knowledge taking into consideration historical experience, general background information and potential assumptions and conditions of future events. In determining the impairment of inventories, the sales potential as well as the net realisable value of finished goods is considered (carrying amount of 126,528 thousand kroons as of 31 December 2006 and 76,260 thousand kroons as of 31 December 2005), upon valuation of raw materials, their potential as a source of finished goods and generating income is considered (carrying amount of 70,715 thousand kroons as of 31 December 2006 and 63,096 thousand kroons as of 31 December 2005); upon valuation of work in progress, their stage of completion that can reliably be measured is considered (carrying amount of 2,293 thousand kroons as of 31 December 2006 and 1,600 thousand kroons as of 31 December 2005).

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Valuation of goodwill

Goodwill is the excess of the cost of the acquisition over the fair value of the acquired net assets, reflecting the part of cost that was paid for the acquisition of such assets that cannot be separately identified and recognised. Goodwill as an intangible asset with an indefinite useful life is not amortised but it is tested for impairment at least once a year. The management has performed an impairment test for goodwill which arose on the acquisition of the subsidiary Baltman Rus (carrying amount of 20,423 thousand kroons as of 31 December 2006 and 14,129 thousand kroons as of 31 December 2005). Future expected cash flows based on the budgeted retail sales volumes in the Russian market have been taken into consideration in determining the recoverable amount of the investment. The future expected cash flows have been discounted using the expected rate of return in the Russian market within the similar industry. If the recoverable amount of goodwill is lower than its carrying amount, an impairment loss is recognised.

Determination of useful lives of property, plant and equipment

The management has evaluated the economic lives of production equipment and other non-current assets related to production depending on their estimated useful lives. The estimation of economic lives is based on historical experience and takes into consideration production capacity and conditions. The estimation of economic lives of non-current assets used in retail trade is based on the period over which this asset is expected to participate in the generation of revenue as well as the guaranteed duration of lease agreements. The economic life of assets with unlimited use (land) is assessed as indefinite. The total carrying amount of property, plant and equipment with a limited useful life is 155,475 thousand kroons as of 31 December 2006 and 77,116 thousand kroons as of 31 December 2005. The total carrying amount of land is 10,973 thousand kroons as of 31 December 2006 and the same as of 31 December 2005.

Valuation of investment property

Investment property is initially recognised at the acquisition cost and subsequently measured at fair value in the balance sheet. The management uses the estimate of an asset's market value provided by an independent expert as a basis for fair value estimation. In its absence, the Management Board uses alternative measurement methods. In 2006, the management used an independent expert's opinion for evaluating the registered real estate located at Veerenni Street, Tallinn (carrying amount of 23,572 thousand kroons as of 31 December 2006 and 19,192 thousand kroons as of 31 December 2005).

Deferred income tax

Deferred income tax asset has mostly arisen through tax loss carry-forwards from subsidiaries operating in foreign markets and is recoverable through future deductions from taxable profits. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future the management makes judgements and applies estimation based on the future development of the market and its outcomes to evaluate future expected revenue. The profit assumption is based on the attainment of the Group's strategic goals. The carrying amount of net deferred income tax asset as of 31 December 2006 is 4,462 thousand kroons and as of 31 December 2005 3,598 thousand kroons.

NOTE 3 Financial risks

In its daily activities, the Group is exposed to different types of risk management, which is an important and integral part of the business activities of AS Baltika. The organisation's ability to identify, measure and control different risks is a key variable for the Group's profitability. The Group's management defines risk as a potential negative deviation from the expected financial results. The main risk factors are market (including currency risk, fair value interest rate risk, cash flow interest rate risk), credit, operational and liquidity risks.

The basis for risk management at the Group are the requirements set by the Tallinn Stock Exchange, the Financial Supervision Authority and other regulatory bodies, adherence to generally accepted accounting principles, as well as the organisation's internal regulations and risk policies. Overall risk management includes identification, measurement and control of risks. The management of the parent company plays a major role in managing risks and approving risk procedures, but the Supervisory Board of the Group's parent company also plays an important role.

The management of the Group's parent company considers market risk which also includes foreign exchange risk as the most serious risk at the Group.

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Market risk

Baltika's operations are mostly affected by the cyclical nature of economies in target markets and changes in competitive positions, as well as risks related to specific markets (especially non-European Union markets in Russia and Ukraine).

To hedge risks, the Group attempts to increase the flexibility of its operations: the sales volumes and the activities of competitors are also being monitored and if necessary, the Group will make adjustments in price levels, marketing activities and collections offered. In addition to central gathering and assessment of information, an important role in analysing and planning actions is played by a marketing organisation in each target market enabling the Group to obtain fast and direct feedback on market developments on the one hand and adequately consider local condition on the other.

As improvement of flexibility plays an important role in increasing the Group's competitiveness, continuous efforts are being made to shorten the cycles of business processes and minimise potential deviations. This also helps to improve the relative level and structure of inventories and the fashion collections' meeting consumer expectations.

Foreign exchange risk

Exports constitute 72% of the sales of Baltika Group. The major currencies for exports at the Group's retail markets are LTL (Lithuanian lit), LVL (Latvian lat), UAH (Ukrainian hryvnia), PLN (Polish zloty), RUR (Russian rouble); the Group's other currencies are EUR (Euro), GBP (British pound). The majority of raw materials used in production is imported. The major currencies for imports are EUR (euro) and USD (US dollar). Trading with the countries belonging to the European Monetary Union is handled only in euros.

As the Group primarily sells its goods in euros, then as a retail company, the prices of goods in the markets are fixed in a local currency and consequently, foreign currency risk directly affects the Group's revenue through the pricing of goods at the stores in those markets. A change in the economic environment and relative appreciation/depreciation of a local currency may greatly affect the purchasing power of customers in the market of the respective segment.

The weakening of the USD against the euro poses liquidity risk, which affects the Group's collectible amounts from the countries most affected by the changes in the dollar's exchange rate (Ukraine, Russia, Poland). On the other hand, the weakening of the dollar has a positive impact on importing from the countries (China, Japan, Korea) with which accounts are settled in dollars.

The Group's results are open to fluctuations in foreign currency rates against Estonian kroon in those countries where AS Baltika has subsidiaries. The impact of changes in average foreign currency rates against Estonian kroon in the reporting period were the following: Polish zloty +3.3% (2005: +12.3%), Ukrainian hryvnia +0.1% (2005: +4.5%), Russian rouble +3.1% (2005: +1.8%) and Latvian lat +0.0% (2005: -4.5%). The Lithuanian lit is fixed to EUR and has therefore no impact on the Group's results.

No separate instruments were used for hedging foreign currency risks in 2006. The Group mostly uses the euro to settle the accounts with its subsidiaries located in foreign markets; for the Polish subsidiary, accounts are settled in zlotys and since October 2005, accounts are settled in roubles with the Russian subsidiary.

If feasible, foreign currencies collected are used for the settling of liabilities measured in the same currency. For foreign currency profits and losses, please refer to Note 25 and 26.

Credit and liquidity risks

Credit risk is a potential loss that would occur by the balance sheet date if the contract parties did not meet their obligations. The Group is exposed to credit risk to the extent of solvency of its business partner in Russia. There are no collaterals for receivables in the balance sheet. Credit risks arising from the Group's seasonal production and sales cycle are not permanent. As of the balance sheet date, the maximum credit risk is 86,402 thousand kroons (2005: 39,566 thousand kroons) kroons, including credit risk of the Russian wholesale partner of 49,044 thousand kroons (2005: 30,476 thousand kroons). Russia's credit risk is related to one customer, who was also a minority shareholder of Baltman Rus until April 2006.

A Group current account/overdraft facility is in use for more flexible management of liquid assets, enabling the Group companies to use the Group resources up to the limit established by AS Baltika (Note 16).

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Cash flow and fair value interest rate risk

As the Group has no significant interest-bearing assets, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

The Group's interest rate risk arises from long-term borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. Interest rate risk is primarily caused by the potential fluctuations of Euribor and the changing of the average interest rates of banks. During 2006 and 2005, the Group's long-term borrowings at variable rate were denominated in EUR, therefore no currency risk is assumed.

The Group analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and alternative financing. No separate financial instruments have been used to manage the interest rate risk during 2006 and 2005.

Operational risk

The most important operating risk arises from the Group's inability to produce collections which would meet customer expectations and the goods that cannot be sold when expected and as budgeted. Another important risk is that the Group's information technology system is unable to ensure sufficiently fast and accurate transmission of information for decision-making purposes. In 2006, one more risk has been identified resulting from later than planned openings of shopping centres that might lead to excessive inventories.

To ensure good collections, Baltika employs a strong team of designers who monitor and are always aware of fashion trends by using internationally acclaimed channels. Such a structure, procedures and information systems have been set up at the Group which help daily monitoring of sales and balance of inventories and using the information in subsequent activities. In order to upgrade information systems, the transition to the integrated system encompassing several areas of operations has been initiated in 2006. In order to avoid supply problems, cooperation with the world's leading procurement intermediaries as well as fabric manufacturers has been expanded.

The unavoidable risk factor in selling clothes is the weather. Collections are created and sales volumes as well as time is planned under the assumption that regular weather conditions prevail in the target market – in case weather conditions differ significantly from normal conditions, the actual sales results may significantly differ from the budget.

NOTE 4 Cash and bank

	31.12.2006	31.12.2005
Cash in hand	3,879	1,896
Cash at bank	8,705	11,267
Short-term deposits	0	12,798
Total	**12,584**	**25,961**

As of 31 December 2006, the Group has no cash in overnight deposit. As of 31 December 2005, overnight deposits had been deposited by the parent company in the amount of 12,798 thousand kroons, with the following interest rates depending on the currency deposited: 2.05 % for EEK, 1.55% for EUR and 4.00% for USD.

NOTE 5 Financial assets at fair value through profit or loss

	31.12.2006	31.12.2005
Shares of Tallinna Kaubamaja	0	1,808

The shares of Tallinna Kaubamaja, disclosed as current financial assets, were sold in August 2006. The net gain from the transaction amounted to 198 thousand kroons and was included within other financial income.

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NOTE 6 Trade receivables

	31.12.2006	31.12.2005
Accounts receivable	87,710	39,579
Allowance for impairment of trade receivables	-1,308	-13
Total	**86,402**	**39,566**

Trade receivables include the parent's receivable from the joint venture in the amount of 4,659 thousand kroons (31 December 2005: 1,627 thousand kroons). For more information see Note 29.

During 2006, trade receivables of 1,312 thousand kroons (2005: 224 thousand kroons) were impaired and provided for. Impaired receivables in the amount of 17 thousand kroons were written off. Impairment losses were disclosed under distribution costs. No reversals of previously impaired trade receivables occurred in year 2006 whereas, impairment losses of 24 thousand kroons were reversed in 2005.

A certain risk concentration exists regarding a wholesale partner in Russia (see Note 3 – Credit risk). The other receivables are not affected by credit risk concentration.

NOTE 7 Other receivables and prepaid expenses, tax prepayments and liabilities

	31.12.2006	31.12.2005
Other current receivables	9,065	3,578
Tax prepayments and tax reclaims	14,356	5,189
Prepaid expenses	18,648	6,207
Interest receivables	0	18
Total	**42,069**	**14,992**

Prepaid expenses include prepaid rental and insurance expenses, prepayment for information technology services, subscription costs of periodicals, etc. Significant increase in prepaid expenses by the end of 2006 has resulted from a number of new shops opened in Russia and the resulting prepaid rental expense.

Tax receivables (prepayments)

	31.12.2006	31.12.2005
Value added tax	10,596	4,818
Prepaid income tax	3,642	323
Other taxes	118	48
Total	**14,356**	**5,189**

Tax liabilities

	31.12.2006	31.12.2005
Personal income tax	3,895	2,601
Social security tax and unemployment insurance premium	7,444	5,686
Value added tax	10,565	7,958
Corporate income tax liability	406	932
Other taxes	696	386
Total	**23,006**	**17,563**

Additional information on corporate income tax is provided in Notes 11 and 27.

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NOTE 8 Inventories

	31.12.2006	31.12.2005
Raw materials	71,239	65,630
Impairment of raw materials	-524	-2,534
Work-in-progress	2,293	1,600
Finished goods and goods purchased for resale	129,335	77,816
Impairment of finished goods and goods purchased for resale	-2,807	-1,556
Prepayments to suppliers	1,166	3,503
Total	**200,702**	**144,459**

As of 31 December 2006, inventories of the Group with a carrying amount of 3,191 thousand kroons (31 December 2005: 7,501 thousand kroons) were in the custody of third parties.

The acquisition cost of fabric carried at net realizable value as of 31 December 2006 amounted to 2,203 thousand kroons (31 December 2005: 6,594 thousand kroons). The impairment allocation has decreased by 2,366 thousand kroons resulting from disposal of impaired materials with no additional losses and increased by impairment losses recognised in 2006 in the amount of 356 thousand kroons (2005: 1,105 thousand kroons).

The acquisition cost of finished goods carried at net realizable value as of 31 December 2006 amounted to approximately 10,900 thousand kroons (31 December 2005: 7,000 thousand kroons). The impairment allowance of finished goods has increased due to increased number of retail locations and corresponding volumes. The relation of impairments allowance to the total balance of finished goods and goods purchased for resale shows moderate changes compared to the previous reporting period.

The estimated amount of non-current inventories as of the end of the current and previous reporting period equals approximately 1.3% of the total carrying amount of inventories.

Information on pledged assets is provided in Note 16.

NOTE 9 Investments in joint ventures

			Participation		Investment in balance sheet	
Subsidiary	**Location**	**Activity**	**31.12.2006**	**31.12.2005**	**31.12.2006**	**31.12.2005**
OÜ Baltika Tailor	Estonia	Production	50%	50%	0	234

OÜ Baltika Tailor key financial information (100%)

	31.12.2006	31.12.2005
Current assets	9,064	8,266
Non-current assets	4,647	2,864
Current liabilities	13,559	7,999
Non-current liabilities	2,718	2,604

	2006	2005
Revenue	64,957	67,048
Expenses	67,764	68,710

The parent company has issued a comfort letter to the management of the joint venture for continuous financial support.

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NOTE 10 Investment property

As of 31 December 2006, investment property consists of the production facility located at Veerenni 24, Tallinn that is leased to the joint venture OÜ Baltika Tailor carried at fair value of 23,572 thousand kroons.

As of 31 December 2005, following facilities were recognised as investment property:

- a production facility located at Veerenni 24, Tallinn that is leased to the joint venture OÜ Baltika Tailor and is carried at fair value of 19,192 thousand kroons;
- construction rights of the plot located in Lasnamäe Industrial Park, Tallinn carried at fair value of 8,001 thousand kroons.

Balance as of 31.12.2004	**7,500**
Additions	5,955
Revaluation	13,738
Balance as of 31.12.2005	**27,193**
Disposals	-8,001
Revaluation	4,379
Balance as of 31.12.2006	**23,572**

	2006	**2005**
Rental income from investment properties	3,150	3,000
Direct operating expenses from investment properties	3,150	3,000
Net rental income from investment properties	**0**	**0**

In September 2006, the Group concluded the agreement to sell the construction rights of the property located in Lasnamäe Industrial Park. At the same time, the Group has signed a lease agreement with the buyer providing a 15 year lease period of the production premises to be constructed. For details of the agreements see Note 15.

The acquisition cost of the investment property included the discounted net present value of the buy-out option of construction rights that was accounted for as finance lease. As a result of the sale of the investment property, the recognition of a long-term finance lease liability in the amount of 4,459 thousand kroons has been discontinued.

The proceeds from sales amounted to 11,055 thousand kroons. Gain recognised from disposal of the investment property amounted to 7,513 thousand kroons.

The production facility located at Veerenni 24, Tallinn that is leased to the joint venture OÜ Baltika Tailor has been presented at fair value of 23,572 thousand kroons as of 31 December 2006. The revaluation gain of 4,380 thousand kroons has been recognised under other operating income (Note 25).

Upon revaluation of investment property, the valuation of an independent expert of the real estate was used as the basis for fair value determination. The independent expert assessed the total value of the real estate located at Veerenni 24 and the value of the investment property recorded in the balance sheet was separated from the total value of the property.

The Group has no binding obligations to sell or develop the investment property at Veerenni 24. The investment property at Veerenni 24 has been pledged to secure the Group's liabilities (Note 16).

NOTE 11 Deferred income tax

The recovery of the deferred income tax asset arising from tax loss carry-forwards is dependent on future taxable profits at subsidiaries that exceed the existing losses to be carried forward. An analysis of expected future profits was carried out when preparing the financial statements. The profit assumption is based on the attainment of each respective company's strategic goals. The deferred tax asset resulting from losses carried forward is recognised to the extent that the realisation of the related tax benefit through the future profits is probable. For deferred income tax assets carried off-balance sheet see Note 27.

According to the estimate, the tax losses in Poland and Russia will be used within three years from the balance sheet date.

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Deferred income tax 2006

	Poland	Latvia	Lithuania	Ukraine	Russia	Total
Deferred income tax liability						
On property, plant and equipment	0	-288	0	0	0	**-288**
Deferred income tax asset						
On property, plant and equipment	377	0	74	80	255	**786**
On tax loss carry-forwards	2,136	0	525	818	485	**3,964**
Deferred income tax asset, net	**2,513**	**-288**	**599**	**898**	**740**	**4,462**
Incl. current portion (recovered within 12 months)	769	-288	599	898	0	**1,978**
non-current portion	1,744	0	0	0	740	**2,484**
Deferred income tax income (expense) (Note 27)	**904**	**-1,205**	**-472**	**898**	**740**	**865**

Deferred income tax 2005

	Poland	Latvia	Lithuania	Ukraine	Russia	Total
Deferred income tax liability						
On property, plant and equipment	0	-219	0	0	0	**-219**
On vacation payroll accrual	0	-3	0	0	0	**-3**
On finance lease	-16	0	0	0	0	**-16**
Deferred income tax asset						
On property, plant and equipment	167	0	36	0	0	**203**
On tax loss carry-forwards	1,140	1,140	1,035	0	0	**3,315**
On accrued liabilities	318	0	0	0	0	**318**
Deferred income tax asset, net	**1,609**	**918**	**1,071**	**0**	**0**	**3,598**
Incl. current portion (recovered within 12 months)	507	273	651	0	0	**1,431**
non-current portion	1,102	645	420	0	0	**2,167**
Deferred income tax income (expense) (Note 27)	**-73**	**-14**	**-635**	**-29**	**0**	**-751**

NOTE 12 Other non-current financial assets

	31.12.2006	31.12.2005
Loan receivable from joint venture (Note 29)	1,359	1,302
Long-term prepayments for rent	9,718	3,361
Other long-term financial assets	0	45
Total other non-current financial assets	**11,077**	**4,708**

Long-term prepayments for rent arise from lease agreements of the Group's retail subsidiaries operating in Latvian, Lithuanian, Polish and Russian markets. Additional information on loans given to the joint venture is disclosed in Note 29.

NOTE 13 Property, plant and equipment

The Group's investments in property, plant and equipment during the reporting period amounted to 102,385 thousand kroons. The investments during the previous reporting period amounted to 29,034 thousand kroons. Investments in the construction of the new logistics centre amounted to 33,814 thousand kroons (2005: 11,696 thousand kroons). Investments in retail operations totalled 62,163 thousand kroons (2005: 13,825 thousand kroons). Investments in the amount of 4,080 thousand kroons (2005: 1,457 thousand kroons) were made in production related assets, investments in the amount of 1,877 thousand kroons (2005: 762 thousand kroons) in information technology and 451 thousand kroons (2005: 1,294 thousand kroons) was invested in other equipment.

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Changes in property, plant and equipment

	Land	Buildings and structures	Machinery and equipment	Other fixtures	Construc-tion in progress	Pre-payments	Total
31.12.2004							
Acquisition cost	**3,004**	**69,628**	**70,706**	**47,902**	**68**	**0**	**191,308**
Accumulated depreciation and impairment	0	-22,454	-62,353	-29,176	0	0	**-113,983**
Net book amount	**3,004**	**47,174**	**8,353**	**18,726**	**68**	**0**	**77,325**
Additions	7,969	5,960	3,364	6,554	1,892	3,295	**29,034**
Disposals	0	-181	-120	-235	0	0	**-536**
Reclassification	0	0	218	-218	0	0	**0**
Impairment	0	-1,243	0	0	0	0	**-1,243**
Depreciation	0	-5,773	-4,871	-7,175	0	0	**-17,819**
Currency translation differences	0	552	78	639	49	10	**1,328**
31.12.2005							
Acquisition cost	**10,973**	**74,005**	**71,321**	**51,440**	**2,009**	**3,305**	**213,053**
Accumulated depreciation and impairment	0	-27,516	-64,299	-33,149	0	0	**-124,964**
Net book amount	**10,973**	**46,489**	**7,022**	**18,291**	**2,009**	**3,305**	**88,089**
Additions	0	43,104	7,195	48,342	1,448	1,414	**101,503**
Acquired in business combination	0	0	0	882	0	0	**882**
Disposals	0	-615	-236	-822	0	0	**-1,673**
Reclassification	0	3,795	67	1,054	-1,796	-3,120	**0**
Depreciation	0	-7,248	-3,885	-9,634	0	0	**-20,767**
Currency translation differences	0	-484	-80	-919	-56	-47	**-1,586**
31.12.2006							
Acquisition cost	**10,973**	**116,708**	**78,982**	**94,154**	**1,605**	**1,552**	**303,974**
Accumulated depreciation and impairment	0	-31,667	-68,899	-36,960	0	0	**-137,526**
Net book amount	**10,973**	**85,041**	**10,083**	**57,194**	**1,605**	**1,552**	**166,448**

For further information on pledged assets and business combinations see Note 16 and 30, respectively.

Assets acquired during the financial year under finance lease terms recorded in property, plant and equipment amounted to 5,804 thousand kroons (2005: 16,813 thousand kroons) at acquisition cost. The total net book amount of assets acquired through finance lease included in property, plant and equipment is 13,998 thousand kroons (2005: 17,750 thousand kroons). See Note 15 for additional information on finance leases.

NOTE 14 Intangible assets

The investments in development of information systems in 2006 amounted to 3,942 thousand kroons. The cost of investments is amortised over the estimated useful life of 10 years.

Intangible assets acquired in business combinations totalled 19,719 thousand kroons. The cost of trademark and other assets acquired in business combinations are amortised over the respective useful lives of 20 years and 5-10 years. Goodwill carried at 20,423 thousand kroons at 31 December 2006 is carried at cost less impairment losses.

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Changes in intangible assets

	Licences, software and other	Trade-marks	Advances	Goodwill	Total
31.12.2004					
Acquisition cost	**20,070**	**0**	**0**	**13,924**	**33,994**
Accumulated amortisation	-6,011	0	0	0	**-6,011**
Net book amount	**14,059**	**0**	**0**	**13,924**	**27,983**
Additions	1,184	0	0	0	**1,184**
Amortisation	-2,894	0	0	0	**-2,894**
Currency translation differences	13	0	0	205	**218**
31.12.2005					
Acquisition cost	**21,125**	**0**	**0**	**14,129**	**35,254**
Accumulated amortisation	-8,763	0	0	0	**-8,763**
Net book amount	**12,362**	**0**	**0**	**14,129**	**26,491**
Additions	6,871	0	1,459	0	**8,330**
Acquired in business combination (Note 30)	3,333	10,060	0	6,326	**19,719**
Disposal	-26	0	0	0	**-26**
Amortisation	-5,346	-45	0	0	**-5,391**
Currency translation differences	-8	0	-9	-32	**-49**
31.12.2006					
Acquisition cost	**28,045**	**13,129**	**1,450**	**20,423**	**63,047**
Accumulated amortisation	-13,928	-45	0	0	**-13,973**
Net book amount	**14,117**	**13,084**	**1,450**	**20,423**	**49,074**

An impairment test for goodwill that was recognised as a result of the acquisition is performed on each balance sheet date and if necessary, an impairment loss is recognised. As of 31 December 2006, goodwill was carried at the amount of 20,423 thousand kroons (31 December 2005: 14,129 thousand kroons).

An impairment test was performed as of 31 December 2006 to determine the recoverable value of Baltman Rus based on value-in-use calculations. These calculations use pre-tax cash flow projections covering the five-year period. Management determined budgeted cash flows based on past performance and its expectations for the market development. Cash flow projections for the period of five years were calculated based on average growth rate of 6.94%. The average growth rate of 4.35% and 0% was applied on cash flow projections extrapolated beyond year 2011 and year 2019, respectively. From year 2019 the growth rate is estimated to be 0% because from there on no potential growth in efficiency per square metre can be generated by assets existing as of the balance sheet date.

The growth rates used for projections have been derived from the past experience of the growth in respective industry and the management expectations of the respective growth rates in the projected future years in the particular region. The Weighted Average Cost of Capital (WACC) used was pre-tax and reflects specific risks relating to the relevant market and industry sector.

The key assumptions used for value-in-use calculations are as follows:

Sales growth[1]	6.94%
Sales growth[2]	4.35%
Growth rate[3]	0.00%
Discount rate[4]	14.00%

[1] Management determined average annual growth in sales efficiency per square metre (decreasing growth trend over the period of cash flow projections)
[2] Average growth rate used to extrapolate cash flows beyond year 2011

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[3] Growth rate used to extrapolate cash flows beyond year 2019
[4] Pre-tax discount rate applied to the cash flow projections (WACC)

The test showed that the recoverable value exceeded the carrying amount. The carrying amount of goodwill was allocated to one cash-generating unit defined as the whole of Russian market.

Average annual growth in sales efficiency must decrease by 7.8% before the recoverable amount will be equal to the carrying amount.

An impairment test of goodwill has been performed as of 31 December 2005. Key assumptions used for value-in-use calculations were the same as for the current year. No impairment losses were incurred as a result of the impairment test.

NOTE 15 Accounting for leases

Operating lease – the Group as the lessee

Future minimum lease payments under non-cancellable operating leases

	31.12.2006	**31.12.2005**
Up to 1 year	69,831	51,487
1-5 years	163,944	86,530
Over 5 years	71,952	2,668
Total	**305,727**	**140,685**

Operating lease expenses include the rental expenses for leasing the retail outlet spaces. The future minimum lease payments under non-cancellable operating leases are calculated based on the non-cancellable periods of the leases.

The lease agreements for stores are predominantly not binding for long-term in Estonia, Latvia and Lithuania, most of the lease agreements can be terminated with a two to six month notice. In Poland and Ukraine, the lease agreements usually require finding a new lessee when cancelling the lease agreement. Agreements without term are expected to be valid for five years. Should the termination of the agreement require a mutual agreement, lease payments are expected to be paid during the following six-month period. If the termination of the agreement requires an advance notice, lease payments are expected to be paid off during the advance notice period.

The lease agreements concluded for a certain term are subject to renewal on market conditions. The Group has signed certain contingent lease agreements which stipulate the increase in lease within the lease term based on changes in consumer price index or inflation.

In 2006, operating lease payments totalled 124,508 thousand kroons (2005: 86,627 thousand kroons).

Operating lease – the Group as the lessor

Future minimum lease payments receivable from non-cancellable subleases

	31.12.2006	**31.12.2005**
Up to 1 year	5,175	5,659
1-5 years	0	2,725
Total	5,175	8,384

Operating lease income includes rental income on investment property and machinery. In 2006, the Group earned operating lease income in the amount of 5,919 thousand kroons (2005: 5,727 thousand kroons) from assets leased to third parties under operating lease agreements. The respective expenses totalled 3,685 thousand kroons (2005: 3,931 thousand kroons).

AS Baltika has concluded a lease agreement with the joint venture OÜ Baltika Tailor for the production facilities and machinery located at Veerenni 24, Tallinn (see Note 10). The lease agreement for the facility is effective until 31 October 2007 and the lease agreement for machinery is without term.

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In September 2006, the Group concluded the agreement to sell the construction rights of the plot located in Lasnamäe Industrial Park. According to the agreement, the buyer has the obligation to construct a production building by the end of 2007 for relocation of the production premises of OÜ Baltika Tailor from their current location at Veerenni 24, Tallinn. At the same time, the Group has signed a lease agreement with the buyer providing a 15 year lease period of the production premises to be constructed. According to the agreement, the Group has the right to exercise the buy-out option of the construction rights of the plot or the property from the tenth year of the lease period. The transaction price shall be based on arms-length principles. The Group has issued a guarantee letter to the constructor to guarantee all payments arising from the lease contract. For details of disposal of the construction rights see Note 10.

Assets given to operating lease

	Total
31.12.2004	
Acquisition cost	**55,152**
Accumulated depreciation	-39,593
Net book amount	**15,559**
Revaluations	11,692
Disposals (at acquisition cost)	-483
Written off (at acquisition cost)	-2,265
Depreciation	-2,243
31.12.2005	
Acquisition cost	**64,096**
Accumulated depreciation	-34,197
Net book amount	**29,899**
Revaluations	4,380
Disposals (at acquisition cost)	-45
Written off (at acquisition cost)	-2,163
Depreciation	-2,244
31.12.2006	
Acquisition cost	**66,268**
Accumulated depreciation	-40,339
Net book amount	**25,929**

<u>Finance lease – the Group as the lessee</u>

	Construction rights	**Machinery and equipment**	**Passenger cars and equipment**	**Total**
31.12.2004				
Acquisition cost	**0**	**4,853**	**464**	**5,317**
Accumulated depreciation	0	-2,588	-332	**-2,920**
Net book amount	**0**	**2,265**	**132**	**2,397**
Additions	15,970	10	833	**16,813**
Depreciation	0	-728	-143	**-871**
Disposals (at net book amount)	0	0	-117	**-117**
31.12.2005				
Acquisition cost	**15,970**	**3,640**	**951**	**20,561**
Accumulated depreciation	0	-2,669	-142	**-2,811**
Net book amount	**15,970**	**971**	**809**	**17,750**

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Additions	0	5,804	0	**5,804**
Depreciation	0	-1,197	-176	**-1,373**
Disposals (at net book amount)	-8,001	0	-181	**-8,182**
31.12.2006				
Acquisition cost	**7,969**	**9,444**	**674**	**18,087**
Accumulated depreciation	0	-3,866	-223	**-4,089**
Net book amount	**7,969**	**5,578**	**451**	**13,998**

For further information on disposal of construction rights see Note 10.

Minimum lease payments

	31.12.2006	31.12.2005
Short-term – up to 1 year	1,149	243
Long-term – 1-5 years	10,493	12,004
Total	**11,642**	**12,247**
Future interest expense of finance lease	-419	-1,340
Present value of future minimum lease payments	**11,223**	**10,906**

Present value of future minimum lease payments

	31.12.2006	31.12.2005
Short-term – up to 1 year	1,149	194
Long-term – 1-5 years	10,074	10,712
Total	**11,223**	**10,906**

The construction rights of the land located in Lasnamäe Industrial Park where the Group's new logistic centre has been built in 2006, are accounted for as finance lease. The construction rights were acquired for 10 years with a renewal option for another 50 years. The Group has the buy-out option for the land at the price of 450 kroons per square metre with total value of 6,444 thousand kroons that can be exercised from the fourth year of the lease. As the option to purchase the land is at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, the transaction has been recorded as a finance lease.

According to the agreement, the Group has taken obligations to exercise the construction rights according to the business plan to use the land with the purpose of providing for production. The Group is also required to create one job per each 50 square metre within three years from the date of the acquisition at the latest and to ensure this employment level for another 8 years after the initial requirement is met.

NOTE 16 Borrowings

	31.12.2006	31.12.2005
Short-term borrowings		
Current portion of long-term bank loans	13,946	11,443
Short-term bank loans	41,911	0
Short-term finance lease liabilities (Note 15)	1,149	194
Convertible bonds (Note 17)	0	212
Bonds (Note 17)	31,173	18,429
Total	**88,179**	**30,278**
Long-term borrowings		
Long-term bank loans	49,160	51,841
Long-term finance lease liabilities (Note 15)	10,074	10,712
Total	**59,234**	**62,553**

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Bank loans of the Group at 31 December 2006

	Balance at 31.12.2006	Expiring within 1 year	Expiring within 1-5 years	Interest rate
Nordea Pank	4,678	936	3,742	6 month Euribor+2.5%
Nordea Pank	2,084	833	1,251	3 month Euribor+2.5%
Hansapank	40,793	7,531	33,262	6 month Euribor+1.5%
Hansapank	4,286	2,143	2,143	6 month Euribor+2.35%
Hansapank	10,000	10,000	0	4.25%
Nordea Pank	11,265	2,503	8,762	3 month Euribor+1.0%
Hansapank (bank overdraft)	27,805	27,805	0	4.25%
Nordea Pank (bank overdraft)	4,106	4,106	0	5.30%
Total	**105,017**	**55,857**	**49,160**	

All long-term bank loans as of 31 December 2006 are subject to a floating interest rate based on Euribor, which is fixed every three or six months and are repriced within a year. As the loans are subject to the floating interest rate and the interest margin is based on the Group's business risk, the management of the parent company estimates that the loans have been taken under the market conditions with the market rate of interest, thus the fair value of the loans is close to the carrying value.

Short-term borrowings in the amount of 41,911 thousand kroons carrying fixed interest rate are subject to fair value interest risk. Hence, the borrowings are expiring within a year or have been taken without term (overdraft), the exposure of the fair value interest risk according to management's estimate is immaterial.

Long-term bank loans of the Group are denominated in euros, thus no currency risk is assumed.

Bank loans of the Group at 31 December 2005

	Balance at 31.12.2005	Expiring within 1 year	Expiring within 1-5 years	Interest rate
Nordea Pank	5,615	936	4,679	6 month Euribor+2.5%
Nordea Pank	2,917	833	2,084	3 month Euribor+2.5%
Hansapank	48,324	7,531	40,793	6 month Euribor+1.5%
Hansapank	6,428	2,143	4,285	6 month Euribor+2.35%
Total	**63,284**	**11,443**	**51,841**	

In May 2006, the Group received a short-term loan from Hansapank in the amount of 10,000 thousand kroons to finance the investments budgeted in the second half-year of 2006. The loan is due on 30 March 2007.

To finance the construction of the new logistics centre situated in Lasnamäe Industrial Park, the Group received a loan from Nordea Pank in June 2006 in the amount of 12,517 thousand kroons. The loan has to be repaid by June 2011.

In September, the Group signed the agreement for an overdraft facility with Nordea Pank. The maximum exposure of the overdraft is 6,259 thousand kroons. The agreement is without term.

During the financial year, the Group made loan payments in the amount of 3,021 thousand kroons (2005: 4,917 thousand kroons) to Nordea Pank and in the amount of 9,674 thousand kroons (2005: 12,339 thousand kroons) to Hansapank.

The Group has following off balance-sheet liabilities:

- a commercial pledge used as collateral for the overdraft and loans in the amount of 69,700 thousand kroons;
- a mortgage on the real estate at Veerenni 24, Tallinn in the amount of 40,000 thousand kroons;
- a mortgage on the real estate at Lasnamäe Industrial Park, Tallinn in the amount of 24,400 thousand kroons;
- a mortgages on registered real estate located at Kalda 10A, Rakvere in the amount of 7,400 thousand kroons;
- a mortgage on property located at Õpetajate 5, Ahtme in the amount of 12,000 thousand kroons;
- a commercial pledge in the amount of 14,200 thousand kroons and a guarantee of the parent company are registered as the loan collateral for AS Virulane.

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As of 31 December 2006, the carrying amount of non-current assets securing the abovementioned off-balance sheet liabilities was 64,680 thousand kroons.

The Group companies AS Virulane, AS Elina STC, OÜ Baltman, OÜ Baltika TP and OÜ Baltika Tailor share AS Baltika current account/overdraft facility. The maximum exposure of the overdraft facility received from Hansapank was 37,000 thousand kroons at the end of 2006. From 1 January 2007, the maximum exposure has been changed to 32,000 thousand kroons. Users of the Group account are jointly responsible for the fulfilment of obligations arising from the Group account agreement.

Interest expense amounted to 5,858 thousand kroons during the financial year (2005: 5,415 thousand kroons). Interest expenses have been recognised net with the corresponding income under interest expenses.

NOTE 17 Bonds

Convertible bonds

As of 31 December 2005, there were C and D type of convertible bonds outstanding that were issued during the convertible bond program for the executives of Baltika. All C- and D-bonds were converted into shares during 2006.

	Issue date	Bond conversion period	Number of convertible bonds 31.12.2005	Number of convertible bonds 31.12.2006
C-bond	01.05.2003	01.05.2004-01.05.2006	192,000	0
D-bond	21.12.2004	01.07.2006-30.12.2006	200,000	0
Total			**392,000**	**0**

In the first quarter of 2006, C-bonds were converted into shares as a result of which 192,000 registered shares with a nominal value of 10.00 kroons per share were issued. C-bonds were issued with the nominal value of 1.00 kroons per bond and were convertible into ordinary shares for an additional payment of 36.57 kroons per share. Thus, the issue price per share was 37.57 kroons including a premium of 27.57 kroons per share. The issued shares are entitled to receive dividends starting from 2006. After the conversion of C-bonds into shares, the share capital of the Company was 60,149 thousand kroons and consisted of 6,014,950 shares. The total share premium of the issue was 5,293 thousand kroons. The average share price of AS Baltika on the exercise day on the Tallinn Stock Exchange was 223.90 kroons.

The nominal value of D-bonds was 0.10 kroons per bond and these were convertible into ordinary shares at the price of 28.95 kroons, equalling the weighted average share price of AS Baltika on the Tallinn Stock Exchange on the trading date preceding the adoption of the resolution (7 December 2004). The vesting condition for the conversion of bonds into shares was that the market price of AS Baltika's shares equalled at least 45.00 kroons per share. Employees who had left the Company by the time of the conversion, had the obligation to sell the bonds back to the Company.

The accounting policies described in IFRS 2 have been adopted to account for the D-bonds (Note 19). During the first half-year of 2006, 315 thousand kroons (2005: 629 thousand kroons) were expensed as payroll costs and a respective increase of share premium in owner's equity as part of the D-bond cost for the vesting period from 1 January 2006 until 30 June 2006.

The fair value of the services (employee contribution) acquired by the entity from the employees in exchange for the shares was determined by reference to the fair value of the convertible bonds granted and was valued by an independent expert at 4.82 kroons per one convertible bond. The Black-Scholes option pricing model was used in valuing the convertible bond. The following parameters were used in determination of the price of the instrument: share price at the date prior to the grant date, exercise price, weighted average share price, expected volatility by a reference to the history of volatility based on the history of fluctuations of the market prices of the share and the expected life of the option.

In September 2006, D-bonds were converted into 82,400 registered shares with a nominal value of 10.00 kroons per share. The issue price per share was 28.95 kroons including the share premium of 18.95 kroons per share. The issued shares are entitled to dividends starting from the dividend payments made in 2007. After the first stage of the conversion of D-bonds into shares, the share capital of the Company increased to 60,973 thousand

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kroons and consisted of 6,097,350 shares. The total share premium of the issue was 1,561 thousand kroons. The average share price of AS Baltika on the exercise day on the Tallinn Stock Exchange was 233.92 kroons.

In December 2006, the remaining amount of D-bonds was converted into 117,600 registered shares with nominal value of 10.00 kroons per share. The terms of shares issued were the same as for the first stage of the D-bonds conversion. After the second conversion of D-bonds into shares, the share capital of the Company amounted to 62,150 thousand kroons and consisted of 6,214,950 shares. The total share premium of the issue was 2,229 thousand kroons. The average share price on the exercise day on the Tallinn Stock Exchange was 322.56 kroons.

For further information on changes in the share capital see Note 19.

Closed issue of bonds

In March 2006, AS Baltika issued unsecured bonds via a closed issue in the amount of 19,208 thousand kroons. The redemption date of the bonds is 16 March 2007. A total of 2,000 bonds were issued with a nominal value of 10,000 kroons and price of 9,603.81 kroons per bond. The bonds do not carry coupon interest, instead the difference between the nominal value and issue price yields an interest of 4.08% per annum.

The proceeds from the issue were used for the redemption of the previous bond issue on 17 March 2006 in the amount of 17,500 thousand kroons. The rest of proceeds were used for financing investments into the Group's core activities.

In July 2006, AS Baltika issued additional unsecured bonds via a closed issue in the amount of 11,111 thousand kroons. The redemption date of the bonds is 18 April 2007. A total of 1,150 bonds were issued with a nominal value of 10,000 kroons and price of 9,661.73 kroons per bond. The bonds do not carry coupon interest, instead the difference between the nominal value and issue price yields an interest of 4.60% per annum. The proceeds are used for financing investments of the second half-year of 2006.

The fair values of the bonds are considered to be very close to the carrying values, as the maturities are short and the effect of changes in interest rates are immaterial.

	Quantity	Nominal (kroons)	Issue price	Balance at 31.12.2006	Interest rate	Maturity
Bonds	2,000	10,000	19,208	19,835	4.08%	16.03.2007
Bonds	1,150	10,000	11,111	11,338	4.60%	18.04.2007
Total	**3,150**		**30,319**	**31,173**		

NOTE 18 Accrued expenses and other short-term liabilities

All financial liabilities listed below have been designated by the parent company's management as payable within 12 months after the balance sheet date and are therefore recognised as current liabilities.

Other short-term liabilities consist of payable for acquisition of Ivo Nikkolo trademark in 2007.

	31.12.2006	31.12.2005
Payables to employees (accrued wages and salaries, vacation payroll accrual, bonus accrual, etc.)	17,250	12,767
Dividends payable	7	2
Interest payable	43	27
Customer prepayments	392	409
Other accrued expenses	874	710
Other short-term payables	6,630	57
Total	**25,196**	**13,971**

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NOTE 19 Equity

Share capital

	31.12.2006	31.12.2005
Share capital	**62,150**	**58,230**
Number of shares (pcs)	6,214,950	5,822,950
Nominal value of shares (kroons)	10.00	10.00

Change in the number of shares

	Issue	Number of shares
Number of shares 31.12.2002		**5,444,450**
Issued 20.02.2003	Conversion of A-bonds	15,500
Issued 30.07.2003	Conversion of A-bonds	39,500
Number of shares 31.12.2003		**5,499,450**
Issued 15.07.2004	Conversion of A-bonds	88,000
Issued 16.12.2004	Conversion of A-bonds	46,500
Number of shares 31.12.2004		**5,633,950**
Issued 17.05.2005	Conversion of B-bonds	189,000
Number of shares 31.12.2005		**5,822,950**
Issued 30.03.2006 (Note 17)	Conversion of C-bonds	192,000
Issued 05.10.2006 (Note 17)	Conversion of D-bonds	82,400
Issued 08.12.2006 (Note 17)	Conversion of D-bonds	117,600
Number of shares 31.12.2006		**6,214,950**

Under the Articles of Association, the minimum number of shares is 4,000,000 and the maximum number of shares is 16,000,000. All shares have been paid for.

In May 2006, AS Baltika paid dividends to its shareholders at the rate of 2.00 kroons per share in total amount of 12,020 thousand kroons (declared dividends amounted to 12,031 thousand kroons). Corporate income tax on dividends amounted to 1,796 thousand kroons.

In 2005, AS Baltika paid dividends to shareholders at the rate of 0.75 kroons per share, totalling 4,367 thousand kroons. Corporate income tax did not arise on this transaction, as these were paid out from the profits earned during 1994-1999, on which the corporate income tax has already been paid.

Detailed information on changes in equity resulting from the conversion of C- and D-bonds is disclosed in Note 17.

Reserves

	31.12.2006	Change	31.12.2005	Change	31.12.2004
Statutory reserve	5,823	189	5,634	834	4,800
Revaluation reserve	3,898	0	3,898	0	3,898
Other reserves	0	0	0	-18,085	18,085
Total	**9,721**	**189**	**9,532**	**-17,251**	**26,783**

In 2006, the share premium was increased by 9,398 thousand kroons (2005: 5,182 thousand kroons), of which 9,083 thousand kroons (2005: 4,533 thousand kroons) originated from the difference in the exercise price and the nominal value of the converted bonds and remaining 315 thousand kroons (2005: 629 thousand kroons) resulted from the application of IFRS 2 on D-bonds (Note 17).

During the financial year 189 thousand kroons were transferred to the mandatory legal reserve from the net profit.

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Shareholders at 31 December 2006

	Number of shares	Participation
1. BMIG OÜ	1,295,072	20.84%
2. Skandinaviska Enskilda Banken Ab Clients	417,020	6.71%
3. Raiffeisen Zentralbank Österreich AG Clients	305,940	4.92%
4. Members of the Management Board and persons related to them:		
Meelis Milder	247,183	3.98%
Maire Milder	115,361	1.86%
Boriss Loifenfeld	50,122	0.81%
Ülle Järv	23,158	0.37%
5. Other minority shareholders	3,761,094	60.52%
Total	**6,214,950**	**100.00%**

Shareholders at 31 December 2005

	Number of shares	Participation
1. BMIG OÜ	1,284,980	22.07%
2. Skandinaviska Enskilda Banken Ab Clients	451,295	7.75%
3. AS LHV Arbitrage	336,000	5.77%
4. Members of the Management Board and persons related to them:		
Meelis Milder	151,617	2.60%
Maire Milder	82,161	1.41%
Boriss Loifenfeld	12,482	0.21%
Ülle Järv	8,158	0.14%
5. Other minority shareholders	3,496,257	60.04%
Total	**5,822,950**	**100.00%**

The shares of the parent company are listed on the Tallinn Stock Exchange. The parent company does not have a controlling shareholder or any shareholders jointly controlling the entity. The investment company OÜ BMIG is under the control of the Management Board members of AS Baltika.

NOTE 20 Segments

<u>**Geographical segment by client's location – primary segment**</u>

As of 31 December 2006, the Group is active in the following markets:

- Estonia, Latvia, Lithuania, Russia, Ukraine, Poland – defined as separate geographical segments, as each market generates significantly different risks and returns and each market separately is significant enough to form a separate segment;
- other markets (Finland, etc.) – the Group's presence in other markets is small or less strategic and these markets separately do not form a segment for the segment reporting.

Financial information by geographical segments for the year ended 31 December 2006

	Estonia	Latvia	Lithuania	Russia	Ukraine	Poland	Other	Internal trans-actions	Total
Non-group sales	247,741	115,276	180,302	174,670	128,524	34,440	18,528	0	899,481
Inter-segment sales	0	69,789	118,071	37,778	80,342	14,541	0	-320,521	0
Total sales	247,741	185,065	298,373	212,448	208,866	48,981	18,528	-320,521	899,481
Operating profit of the segment	76,000	28,854	30,496	36,630	9,235	-2,548	4,699	0	183,366
Unallocated operating exp. and inc.									-86,034
Total operating profit									97,332
Other financial income (expenses)									-6,037
Corporate income tax									-3,136
Net profit before minority interest									88,159

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Minority interest									783
Net profit for the financial year									87,376
Assets	181,193	37,332	62,965	254,944	87,780	9,873	303	-166,909	467,481
Group's unallocated assets									128,909
Incl. assets used in production									72,092
assets used for administrative use									6,337
other unallocated assets									50,480
Total assets									596,390
Liabilities	33,285	19,889	38,866	102,022	57,647	4,466	0	-190,868	65,307
Group's unallocated liabilities									226,843
Incl. liab. related to production activity									78,885
other unallocated liabilities									147,958
Total liabilities									292,150
Property, plant and equipment acquired	30,921	5,005	2,881	43,840	13,441	63	0	0	96,151
Property, plant and equipment acquired, unallocated									34,283
Depreciation	9,982	1,517	4,262	2,554	2,525	1,864	0	0	22,704
Incl. depreciation of PPE	5,201	1,357	3,978	2,554	2,509	1,794	0	0	17,393
amort. of intangible assets	4,781	160	284	0	16	70	0	0	5,311
Depreciation, unallocated									3,454

Financial information by geographical segments for the year ended 31 December 2005

	Estonia	Latvia	Lithuania	Russia	Ukraine	Poland	Other	Internal trans-actions	Total
Non-group sales	195,359	82,333	132,431	111,480	98,599	39,150	21,554	0	680,906
Inter-segment sales	0	46,898	83,867	17,274	36,685	21,443	3,027	-209,194	0
Total sales	195,359	129,231	216,298	128,754	135,284	60,593	24,581	-209,194	680,906
Operating profit of the segment	54,075	20,275	25,771	23,348	17,487	-692	6,137	0	146,401
Unallocated operating exp. and inc.									-71,494
Total operating profit									74,907
Other financial income (expenses)									-3,947
Corporate income tax									-4,280
Net profit before minority interest									66,680
Minority interest									-5,984
Net profit for the financial year									72,664
Assets	137,248	20,510	51,782	88,197	31,108	16,887	422	-74,969	271,185
Group's unallocated assets									105,914
Incl. assets used in production									91,567
assets used for administrative use									6,719
other unallocated assets									7,628
Total assets									377,099
Liabilities	14,251	17,154	35,627	26,063	16,305	6,365	0	-86,875	28,890
Group's unallocated liabilities									140,257
Incl. liab. related to production activity									20,371
other unallocated liabilities									119,886
Total liabilities									169,147

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Property, plant and equipment acquired	3,076	342	6,941	4,959	899	660	0	0	16,877
Property, plant and equipment acquired, unallocated									13,341
Depreciation	8,520	1,268	2,901	593	1,668	2,918	0	0	17,868
Depreciation, unallocated									2,845

Allocated income and expenses are directly related to the segment – revenue from sales to customers, cost of sales, payroll and rental costs and other costs related to the market. Unallocated operating income and expenses are the general administrative expenses of the Group, such as the central management expenses, marketing expenses, information technology costs, etc.

The assets of the segment mainly consist of inventories and fixtures located at retail outlets, also other necessary working capital (e.g. cash). The liabilities of the segments are related to the payables of the retail outlets, mainly connected to rental agreements, payroll and taxes. Payables for the inventories are mostly to the parent company and have been eliminated in consolidation, thus they are not presented in the segment report. Deferred income tax assets and liabilities are treated as unallocated items.

The unallocated assets of the Group are the administrative building, office equipment used for general administration, other equipment and current assets related to general activities. Additionally, the Group's assets used in production have been presented as unallocated assets, as these assets service all geographical segments and there is no reasonable basis for dividing these assets among the markets. All assets related to production activity are located in Estonia.

The unallocated liabilities of the Group are mainly the borrowings related to the financing of the Group – loans and bonds. In addition to that also production-related liabilities have been classified as unallocated, such as accounts payable for raw materials and payroll liabilities of production personnel.

According to the parent company management's estimate, the inter-segment transactions have been carried out at arm's length and the conditions applied do not differ materially as compared to the transactions with third parties.

From year 2006, the improved management reporting system enabled for more precise allocation of operating profits to individual geographical segments. The operating profit of every individual segment contains relevant part of marketing and distribution expenses incurred by the parent company and the part of operating profit from intra-group transactions attributable to clients located in this particular geographical segment. The unallocated other income and expenses consist of general and administrative expenses recognised by the Group as well as from gains and losses from sales and revaluation of unallocated assets. General and administrative (GA) expenses of the Group include GA expenses recognised by the parent company and the subsidiaries engaged in production. The comparable segment information for 2005 has been adjusted according to the improved and more precise allocation system.

Business segment by area of operations – secondary segment

As of 31 December 2006, the Group operated in the following areas, generating significantly different risks and returns compared to each other and each activity is material enough to form a separate segment:

- retail and managing of retail outlet chains in the markets;
- wholesale and other services;
- production.

Other areas of operations (sewing as a subcontractor, renting of assets, etc.) are less strategic and less material as compared to the main activities and these activities do not form a separate segment.

The Group's assets and investments that relate to more than one business segment and cannot be allocated are recognised as unallocated assets and investments in property, plant and equipment. During the previous periods, additions to tangibles assets in the parent company and investments in the new logistics centre were allocated to wholesale. Those balances have been restated to provide comparable information about the year 2005.

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	Net sales		Assets		Additions to PPE and intangibles	
	2006	**2005**	**31.12.2006**	**31.12.2005**	**2006**	**2005**
Retail	736,366	546,760	250,075	127,724	71,660	15,791
Wholesale and other	150,585	120,845	67,204	31,552	0	0
Production	12,530	13,301	72,092	79,055	5,158	1,577
Unallocated	0	0	207,019	138,768	53,616	12,850
Total	**899,481**	**680,906**	**596,390**	**377,099**	**130,434**	**30,218**

NOTE 21 Sales revenue

	2006	**2005**
Sale of goods	886,951	667,605
Sale of sewing services	0	556
Rental income	7,121	5,676
Other	5,409	7,069
Total	**899,481**	**680,906**

NOTE 22 Cost of goods sold

	2006	**2005**
Materials and supplies	363,874	289,619
Change in allowance for inventories	-699	253
Other production costs	5,530	5,112
Payroll costs in production	39,351	31,302
Depreciation of assets used in production (Note 13)	2,741	2,769
Change in inventories	-1,878	772
Total	**408,919**	**329,827**

NOTE 23 Distribution costs

	2006	**2005**
Rental expenses	119,245	81,345
Payroll expenses	92,322	66,704
Advertising expenses	22,776	13,180
Depreciation and amortisation of assets used in distribution (Note 13,14)	15,919	11,756
Transportation expenses	11,127	4,734
Credit card fees from customer payments	4,988	3,697
Communication expenses	2,252	1,929
Information technology expenses	2,090	1,373
Bank fees	2,042	2,143
Packing expenses	1,708	910
Renovation of retail outlets	1,414	1,097
Expenses for uniforms	1,262	913
Accounting and auditing expenses	911	1,020
Other distribution expenses	22,823	16,903
Total	**300,879**	**207,704**

In 2006, the development costs in the amount of 3,000 thousand kroons were incurred relating to the change in the brand name of CHR/Evermen (new brand Mosaic). In 2005, the respective costs were incurred in the amount of 500 thousand kroons.

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NOTE 24 Administrative expenses

	2006	2005
Payroll costs	60,588	54,579
Depreciation and amortisation (Note 13,14)	7,498	6,187
Business trips	3,809	2,277
Rental expenses	3,529	3,683
Management and consulting fees	2,976	4,164
Information technology expenses	2,902	2,515
Fuel, heating and electricity	1,453	1,400
Sponsorship	1,416	1,069
Bank fees	994	1,020
Communication costs	894	1,208
Other administrative expenses	11,867	7,130
Total	**97,926**	**85,232**

NOTE 25 Other operating income

	2006	2005
Profit from the sale of non-current assets	7,443	217
Gain from revaluations of investment property (Note 10)	4,379	13,738
Other operating income	660	932
Foreign exchange gains	0	4,930
Total	**12,482**	**19,817**

NOTE 26 Other operating expenses

	2006	2005
Foreign exchange losses	4,710	0
Fines, penalties on late payment and interest expenses on tax	626	34
Representation costs	220	963
Losses from the sale and write-offs of non-current assets	0	1,567
Other operating expenses	1,351	489
Total	**6,907**	**3,053**

NOTE 27 Corporate income tax

Accounting for income tax in the Group

	2006	2005
Income tax expense	-4,001	-3,528
Deferred income tax income (expense)	865	-751
Total income tax expense	**-3,136**	**-4,280**

From 2006, both in Baltman Rus and its subsidiaries, the profit is taxable at the rate of 24%. In previous periods, two subsidiaries of Baltman Rus were using the simplified taxation scheme, whereby the taxation of the company was based on the retail space square metres at a rate of 15%.

Deferred income tax assets were recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Group did not recognise deferred income tax assets of 2,994 thousand kroons (2005: 2,251 thousand kroons) in respect of losses amounting to 12,614 thousand kroons (2005: 10,171 thousand kroons) that can be carried forward against future taxable income. Losses amounting to 4,055 thousand kroons (2005: 1,281 thousand kroons) and 8,559 thousand kroons (2005: 8,890 thousand kroons) expire within 12 months after the balance sheet date and within following years respectively.

The income tax calculated on profits of the Group's subsidiaries based on the nominal tax rate differs from effective income tax expense for the reasons presented below.

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Income tax by countries for the year ended 31 December 2006

	Poland	Latvia	Lithuania	Ukraine	Estonia	Russia	Sweden/ Finland	Total
Profit (loss) before tax	-4,232	8,331	2,121	-7,461	103,115	-10,570	-8	**91,296**
Tax rate	19%	15%	15%	25%	0%	24%	28%/29%	
Calculated income tax	804	-1,250	-318	1,865	0	2,537	2	**3,641**
Income tax on dividends	0	0	0	0	-1,797	0	0	**-1,797**
Expenses not deductible for tax purposes	355	43	73	1,807	0	666	0	**2,944**
Changes in deferred tax assets (recognised and off-balance sheet)	-255	-142	-227	-4,481	0	-2,816	-2	**-7,923**
Income tax expense	**0**	**-144**	**0**	**-1,707**	**-1,797**	**-353**	**0**	**-4,001**
Deferred income tax income (expense)	**904**	**-1,205**	**-472**	**898**	**0**	**740**	**0**	**865**

Income tax by countries for the year ended 31 December 2005

	Poland	Latvia	Lithuania	Ukraine	Estonia	Russia	Sweden/ Finland	Total
Profit (loss) before tax	1,105	3,532	3,986	23,842	45,414	-6,907	-11	**70,961**
Tax rate	19%	15%	15%	25%	0%	15%;24%	28%/29%	
Calculated income tax	-210	-530	-598	-5,961	0	-394	-3	**-7,695**
Income tax on dividends	0	0	0	0	-32	0	0	**-32**
Income not subject to tax	-83	0	0	0	0	0	0	**-83**
Expenses not deductible for tax purposes	2,957	-250	285	0	0	11	0	**3,003**
Changes in deferred tax assets (recognised and off-balance sheet)	-2,736	766	-323	2,907	0	-88	3	**529**
Income tax expense	**0**	**0**	**0**	**-3,025**	**-32**	**-472**	**0**	**-3,529**
Deferred income tax expense	**-73**	**-14**	**-635**	**-29**	**0**	**0**	**0**	**-751**

For further information on deferred income tax see Note 11.

NOTE 28 Earnings per share

Basic earnings per share

		2006	2005
Weighted average number of shares	pcs	6,008,783	5,759,950
Net profit attributable to equity holders of the parent	EEK '000	87,376	72,664
Basic earnings per share	**EEK**	**14.54**	**12.62**

Diluted earnings per share

		2006	2005
Weighted average number of shares	pcs	6,186,941	5,998,761
Profit used to determine diluted earnings per share	EEK '000	87,376	72,664
Diluted earnings per share	**EEK**	**14.12**	**12.11**

The weighted average number of shares for diluted earnings per share has been adjusted by convertible bonds issued to senior managers and converted into the registered shares by the end of the reporting period taking into account the actual conversion date and assuming that all outstanding bonds will be converted.

In 2006, the average share price (arithmetic average based on daily closing prices) of AS Baltika on the Tallinn Stock Exchange was 235.17 kroons (2005: 86.75 kroons).

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NOTE 29 Related parties

For the purpose of these financial statements, parties are considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the financial and management decisions of the other one in accordance with IAS 24 “Related Party Disclosures”. Not only the legal form of the transactions and mutual relationships, but also their actual substance has been taken into consideration when defining related parties.

For the reporting purposes in consolidated annual statements of Baltika Group, the following entities have been considered related parties:
- owners, that have either significant influence or control, generally implying an ownership interest of 20% or more (Note 19);
- members of the management, the Management Board and the Supervisory Board;
- close relatives of the persons mentioned above;
- entities under the control or significant influence of the members of the Management Board and the Supervisory Board;
- joint venture (Note 9).

AS Baltika has purchased (sewing services, goods for resale, non-current assets) and sold its goods and rendered services (management services, other services) to related parties.

Transactions with joint venture

	2006		2005	
	Purchases	**Sales**	**Purchases**	**Sales**
Purchases and sales of goods	26	2,641	76	4,267
Purchases and sales of services	32,734	5,163	25,976	7,033

The parent company sold semi-finished goods and services to the joint venture in the amount of 5,801 thousand kroons (2005: 5,570 thousand kroons).

Balances with joint venture

	31.12.2006	31.12.2005
Trade receivables	4,659	1,627
Other current receivables	1,736	97
Non-current receivables	1,359	1,302
Trade payables	3,125	0

A loan of 1,500 thousand kroons has been granted to the joint venture OÜ Baltika Tailor with the annual interest rate of 1% to be used for investments into production. For the reporting purposes the loan has been discounted at 4%. The balance as of 31 December 2006 includes accrued interest expense in the amount of 57 thousand kroons.

Convertible bonds

As of 31 December 2005, 392,000 C- and D-bonds have been issued to and subscribed by the members of the Management Board with the nominal value of 212 thousand kroons (Note 17). All outstanding bonds were converted into ordinary shares by the end of 2006.

Loans to management members

	2006	2005
Balance at beginning of year	352	574
Repayments of loans received	-352	-289
Foreign exchange gains (losses)	0	67
Balance at end of year	**0**	**352**

In 2004, an interest free loan was granted to the Managing Director of Baltika’s subsidiary Baltika Ukraina. The loan has been fully repaid by the end of the reporting period.

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Compensation for key managers (9 members of Management and Supervisory Boards)

	2006	2005
Salaries and remuneration	6,092	4,982

The Company's management estimates that the prices used in related party transactions do not materially differ from the market prices.

NOTE 30 Subsidiaries and business combinations

Subsidiary	Location	Activity	Participation 31.12.2006	Participation 31.12.2005
OÜ Baltman	Estonia	Retail	100%	100%
SIA Baltika Latvija	Latvia	Retail	75%	75%
UAB Baltika Lietuva	Lithuania	Retail	100%	100%
Baltika Ukraina Ltd	Ukraine	Retail	99%	99%
OOO Kompania "Baltman Rus"	Russia	Retail	100%	50.10%
Baltika Poland Sp.z.o.o.	Poland	Retail	100%	100%
OY Baltinia AB	Finland	Distribution	100%	100%
Baltika Sweden AB	Sweden	Distribution	100%	100%
AS Elina STC	Estonia	Production	62.50%	50.10%
AS Virulane	Estonia	Production	82.66%	79.23%
OÜ Baltika TP	Estonia	Real estate management	100%	100%

Acquisition of minority interest in Russia
According to the contract signed on 4 April 2006, AS Baltika acquired an additional stake of 49.9% of the share capital of its subsidiary OOO Kompania "Baltman Rus" and thereby became the 100% owner of the subsidiary. The acquisition cost was 7,714 thousand kroons and the consideration was paid by offsetting trade receivables equalling the transaction price. The transaction was concluded between independent parties under market conditions. At the same time, the Group increased its ownership in the subsidiaries of Baltman Rus to 100%. Baltman Rus has eight subsidiaries engaged in retail business. The subsidiaries are Stelsing, Baltman Klassik, Moda Baltman located in Moscow and Vektra, Olivia, Retail and Klassika located in St. Petersburg.

The difference between the acquisition cost and acquired share in carrying value of subsidiary's net assets was recognised as goodwill.

For further information see Note 14.

Acquisition of minority interest in AS Elina STC
In February 2006, AS Baltika acquired additional 12.40% of the shares of the subsidiary AS Elina STC. The participation of AS Baltika after the transaction increased to 62.50%. The purchase consideration amounted to 353 thousand kroons, which was paid in cash. The goodwill arising from the transactions was immaterial.

Acquisition of minority interest in AS Virulane
In September 2006, AS Baltika acquired additionally 3.43% of the share capital of its subsidiary AS Virulane and as a result, Baltika's ownership in AS Virulane increased to 82.66%. The acquisition cost was 432 thousand kroons paid in cash. Negative goodwill arising from the transaction in the amount of 587 thousand kroons was recognised as operating income.

Acquisition of Ivo Nikkolo trademark
In September 2006, AS Baltika acquired the Ivo Nikkolo fashion trademark and started operating three Ivo Nikkolo stores located in Estonia. The trademark was created in 1994. With the acquisition of the trademark, Baltika entered the premium ladies' fashion market.

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The assets and liabilities arising from the acquisition were as follows:

	Fair value	**Acquiree's carrying amount**
Trademark (Note 14)	10,060	0
Loyal customers' ledger (Note 14)	3,010	0
Product development and design (Note 14)	273	0
Other assets (Note 14)	50	0
Total intangible assets	**13,393**	**0**
Equipment (Note 13)	882	882
Inventories (Note 8)	4,055	4,055
Other liabilities	-33	-33
Total items acquired	**18,297**	**4,904**
Total consideration paid/payable in cash	**18,297**	

The effect of acquired business combination on net sales/net income of the Group has not been disclosed for the following reasons:

- the effect on net sales/net income of the Group for the period as if the acquisition date had been at the beginning of the reporting period is considered to be impracticable as this information was not available;
- the effect on net income of the Group since the acquisition date until the end of the reporting period is immaterial.

NOTE 31 Contingent liabilities

No tax audit has been performed in any subsidiary of the Group by tax authorities during the years 2005-2006.

The tax authorities may at any time inspect the books and records of the Company within six years subsequent to the reported tax year, and may as a result of their inspection impose additional tax assessments and penalties.

The Company's management is not aware of any circumstances which may give rise to a potential material liability in any Group company in this respect.

NOTE 32 Fair value

According to the management, there are no significant differences between the carrying values and fair values of financial assets and liabilities.

NOTE 33 Events after balance sheet date

Baltika acquires 100% ownership in the joint venture

AS Baltika concluded a purchase agreement on 27 February 2007 with the Finnish garment manufacturer Oy Turo Tailor Ab for repurchasing of a 50% stake in the joint venture OÜ Baltika Tailor. As a result, Baltika will become the sole owner of the company. Baltika acquires 100% control in the joint venture due to fast expansion of its retail network and growing need for quality production capacity.

According to the agreement, the transfer of the ownership will take place after the first instalment has been paid to Turo Tailor the latest on 15 April 2007 and subsequent registration of the ownership in the Estonian Central Register of Securities. After the acquisition, Baltika Tailor will be consolidated in the Baltika Group accounts.

Turo Tailor will continue using manufacturing services of Baltika Tailor until 30 September 2007. After the relocation of the production premises of Baltika Tailor from Veerenni 24 to the Lasnamäe Industrial Park, Baltika will become the sole user of the production capacity.

The purchase consideration shall consist of the fixed payment of 3,912 thousand kroons and of 50% of the net assets of the joint venture as of 30 June 2007.

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Acquisition of minority interest in AS Elina STC

AS Baltika concluded a purchase agreement on 15 March 2007 with OÜ Viromena to acquire a 37.50% stake in the garment manufacturer AS Elina STC. As a result, Baltika will become the sole owner of the company. Baltika acquires 100% control in Elina due to fast expansion of its retail network.

The purchase consideration shall be 1,300 thousand kroons and goodwill arising from the transaction 345 thousand kroons.

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Supplementary disclosures on the parent company of the Group

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for reporting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the Annual Report in conjunction with IAS 27 "Consolidated and Separate Financial Statements".

In the parent separate primary financial statements, disclosed to these consolidated financial statements (Supplementary disclosures), the investments into the shares of subsidiaries, joint ventures and associates are accounted for at cost less any impairment recognised.

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AS Baltika
BALANCE SHEET

	31.12.2006	31.12.2005
ASSETS		
Current assets		
Cash and bank	547	16,178
Financial assets at fair value through profit or loss	0	1,808
Trade receivables	73,916	34,874
Other receivables and prepaid expenses	165,311	92,779
Inventories	98,876	78,340
Total current assets	**338,650**	**223,979**
Non-current assets		
Investments in subsidiaries	49,785	63,260
Investments in joint venture	1,000	1,000
Investment property	23,572	19,192
Other non-current assets	51,005	11,025
Property, plant and equipment	19,486	17,125
Intangible assets	25,045	10,866
Total non-current assets	**169,893**	**122,468**
TOTAL ASSETS	**508,543**	**346,447**
EQUITY AND LIABILITIES		
Current liabilities		
Borrowings	83,077	27,941
Supplier payables	73,964	37,278
Tax liabilities	5,050	3,328
Accrued expenses	6,066	5,617
Other short-term liabilities	31,081	12,904
Total current liabilities	**199,238**	**87,068**
Non-current liabilities		
Long-term borrowings	40,764	47,554
Total non-current liabilities	**40,764**	**47,554**
TOTAL LIABILITIES	**240,002**	**134,622**
EQUITY		
Share capital at par value	62,150	58,230
Share premium	59,088	49,690
Statutory reserve	5,823	5,634
Other reserves	3,898	3,898
Retained earnings	137,582	94,373
TOTAL EQUITY	**268,541**	**211,825**
TOTAL LIABILITIES AND EQUITY	**508,543**	**346,447**

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AS Baltika
INCOME STATEMENT

	2006	2005
Net sales	604,053	424,704
Cost of goods sold	420,860	303,903
Gross profit	**183,193**	**120,801**
Distribution costs	-17,678	-12,197
Administrative and general expenses	-91,366	-73,782
Other operating income	10,532	17,763
Other operating expenses	-5,344	-13,686
Operating profit	**79,337**	**38,899**
Dividend income	3,000	284
Financial income from other investments	1,514	1,205
Impairment of investments	-23,863	-5,140
Interest income (expenses)	-2,684	-4,709
Foreign exchange gain (loss)	6	288
Other financial income (expenses)	-85	323
Income tax	-1,796	0
Net profit for the financial year	**55,429**	**31,150**

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AS Baltika
CASH FLOW STATEMENT

	2006	2005
Operating activities		
Operating profit	79,337	38,899
Depreciation	7,950	6,818
Profit from sale of non-current assets	0	-64
Gains on revaluation of investment property	-4,380	-11,692
Other non-monetary expenses	3,810	629
Changes in operating receivables and payables	-72,811	40,094
Changes in inventories	-20,536	-11,838
Interest paid	-4,758	-3,922
Income tax paid	-2,189	0
Total cash flow from operating activities	**-13,577**	**58,924**
Investing activities		
Acquisition of non-current assets and investment property	-17,948	-1,086
Including under the finance lease terms	3,945	10
Proceeds from disposal of non-current assets	39	100
Investment in joint ventures	-785	0
Interest received	100	180
Dividends received	3,015	0
Proceeds from disposal of current financial assets	2,131	0
Loans granted	-51,036	-11,569
Repayments of loans granted	13,100	302
Total cash flow from investing activities	**-47,439**	**-12,063**
Financing activities		
Loans received	41,911	0
Repayments of borrowings	-9,300	-35,920
Finance lease payments made	-742	-12
Dividends paid	-12,020	-4,366
Receipts from contributions into share capital	12,791	6,254
Redemption of bonds	-17,500	-6
Proceeds from issue of bonds	30,239	352
Total cash flow from financing activities	**45,379**	**-33,698**
Effect of exchange rate changes on cash balance	6	288
Total cash flows	**-15,631**	**13,451**
Cash and cash equivalents at the beginning of the period	**16,178**	**2,727**
Cash and cash equivalents at the end of the period	**547**	**16,178**
Change in cash and cash equivalents	**-15,631**	**13,451**

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AS Baltika
STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Reserves	Retained earnings	Total
Balance as of 31.12.2004	**56,340**	**44,508**	**26,783**	**50,339**	**177,970**
Dividends paid	0	0	0	-4,367	**-4,367**
Transfers to statutory reserve	0	0	834	-834	**0**
Share issue	1,890	4,553	0	0	**6,443**
Reclassification of reserves	0	0	-18,085	18,085	**0**
Equity-settled share-based transactions	0	629	0	0	**629**
Net profit for the financial year (adjusted)	0	0	0	31,150	**31,150**
Balance as of 31.12.2005	**58,230**	**49,690**	**9,532**	**94,373**	**211,825**
Book value of holdings under control or significant influence					**-64,260**
Value of holdings under control or significant influence, calculated under equity method					**59,758**
Adjusted unconsolidated equity as of 31.12.2005					**207,323**
Dividends paid	0	0	0	-12,031	**-12,031**
Transfers to statutory reserve	0	0	189	0	**189**
Share issue	3,920	9,083	0	0	**13,003**
Reclassification of reserves	0	0	0	-189	**-189**
Equity-settled share-based transactions	0	315	0	0	**315**
Net profit for the financial year (adjusted)	0	0	0	55,429	**55,429**
Balance as of 31.12.2006	**62,150**	**59,088**	**9,721**	**137,582**	**268,541**
Book value of holdings under control or significant influence					**-50,785**
Value of holdings under control or significant influence, calculated under equity method					**78,419**
Adjusted unconsolidated equity as of 31.12.2006					**296,175**

According to the Estonian Accounting Law, the adjusted unconsolidated retained earnings is the amount which can be distributed to shareholders.

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INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)

To the Shareholders of AS Baltika

We have audited the accompanying consolidated financial statements of AS Baltika and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2006, and of 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.

Urmas Kaarlep
AS PricewaterhouseCoopers

Relika Mell
Authorised Auditor

19 March 2007

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AS BALTIKA PROFIT ALLOCATION PROPOSAL

The Management Board of AS Baltika makes the proposal to:

1. transfer the net profit of the year ended 31 December 2006 in the amount of 87,376 thousand kroons to the retained earnings;

2. increase the share capital by fund issue in the amount of 124,299 thousand kroons on the account of retained earnings and share premium by issuing 2 new shares per each existing share. The share capital after the fund issue shall equal to 186,448 thousand kroons consisting of 18,644,850 ordinary shares;

3. transfer 12,822 thousand kroons from retained earnings to statutory reserve;

4. distribute 14,916 thousand kroons to the shareholders of the company. The dividend per share (applied to the number of shares after the fund issue) shall be 0.80 kroons.

Allocation of retained earnings:

Retained earnings as of 31 December 2005	73,521
Net profit of the current year	87,376
Total retained earnings as of 31 December 2006	160,897
Increase share capital by fund issue	65,211
Transfer to statutory reserve	12,822
To be paid as dividends (0.80 kroons per share)	14,916
Remaining retained earnings	67,949
Share premium as of 31 December 2006	59,088
Increase share capital by fund issue	59,088
Remaining share premium	0

SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2006 ANNUAL REPORT

The signing of AS Baltika 2006 Annual Report on 26 March 2007.

Meelis Milder
Chairman of the Management Board
26 March 2007

Tiina Mõis
Chairman of the Supervisory Board
26 March 2007

Ülle Järv
Member of the Management Board
26 March 2007

Gert Tiivas
Member of the Supervisory Board
26 March 2007

Maire Milder
Member of the Management Board
26 March 2007

Reet Saks
Member of the Supervisory Board
26 March 2007

Boriss Loifenfeld
Member of the Management Board
26 March 2007

Allan Remmelkoor
Member of the Supervisory Board
26 March 2007

Andres Erm
Member of the Supervisory Board
26 March 2007