



AS Merko Ehitus

Group

Consolidated Annual Report

Translation of the Estonian original

Beginning of financial year: 01.01.2010

End of financial year: 31.12.2010

Business name: AS Merko Ehitus

Main activity: general contracting of construction

Commercial

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Auditor: AS PricewaterhouseCoopers

Supervisory Board: Tõnu Toomik, Teet Roopalu, Indrek Neivelt, Olari Taal

Management Board: Tiit Roben, Alar Lagus, Veljo Viitmann, Andres Agukas,
Jaan Mäe, Viktor Mõisja

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MANAGEMENT REPORT

General information

AS Merko Ehitus is a leading construction group offering complete solutions. AS Merko Ehitus was set up in 1990 and the Company's home markets are Estonia, Latvia and Lithuania. The group consists of 32 subsidiaries and 5 associates and joint ventures, the largest of which are SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (85%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%), OÜ Fort Ehitus (75%) and AS Tartu Maja Betoontooted (25%).

Key changes which occurred at the group in 2010:

- At 22 December 2010, Merko Ehitus set up its 100% subsidiary LLC Merko Ukraine (registration code 37458687) in Ukraine. This represented a formal act, the goal of which was creation of a legal platform for subsequent activities in a new market. With this step Merko Ehitus confirmed its strategic interest in launching activities in the Ukrainian market. The main activity of the new company is going to be project management of construction works in Ukraine. (http://www.nasdaqomxbaltic.com/market/?pg=details&instrument=EE3100098328&list=2&tab=news&news_id=246079).
- At 3 February 2010, 10% of shares of AS Gustaf were repurchased. The statement of financial position of AS Gustaf as at 31.12.2009 was used as the basis for the purchase transaction.

At 21 December 2010, the Supervisory Board of AS Merko Ehitus decided to elect an additional member to the Management Board of the public limited company – Viktor Mõisja, former manager of the department of concrete works. Viktor Mõisja started to work in the new position at 21 December 2010 and his area of responsibility will include quality management and supervision. In addition, Viktor Mõisja will represent AS Merko Ehitus in the court case commenced at Harju County Court at 10 January 2011 where alongside others AS Merko Ehitus and its subsidiaries are charged with giving a bribe (gift cards of an Estonian tourist company worth EUR 2,556 and a book "Eesti talurahva arhitektuur"/*Estonian Vernacular Architecture*). A member of the Management Board must represent a legal person at criminal proceedings.

Due to the restructuring of the Company's Management structure, Jaan Mäe was removed from the position of a member of the Supervisory Board at the general meeting of shareholders held at 3 June 2010 in conjunction with his election as a member of the Management Board of AS Merko Ehitus.

Due to the changes in the economic environment and the construction market, the Supervisory and Management Boards of AS Merko Ehitus reviewed the group's strategy and approved its strategic goals for the years 2010 - 2015.

The strategy covers the time period from the current year until the end of 2015. All principles and some financial goals, such as the minimum equity to assets ratio to be ensured, are mandatory during the whole period.

The following assumptions regarding the economies of the Baltic States have been used as the basis for the strategy:

- economic growth is not expected in 2010, the construction sector is expected to decline by up to ten per cent;
- according to different experts, economic growth in the upcoming years (2011 – 2012) will not be higher than 3%;
- the key customer in the upcoming years will be the public sector with the main emphasis on infrastructure projects co-financed by EU funds;

- PPP (public private partnership) models will be used more frequently than previously, because the public sector does not have sufficient funds to make investments;
- the number of projects related to improvement of energy efficiency will increase;
- the apartment market will pick up as compared to the recession of the last couple of years;
- a need for industrial buildings will increase;
- credit availability will improve;
- a reduction in unemployment and recovery of the retail trade will occur in 2011.

Strategic goals of AS Merko Ehitus:

- The vision of AS Merko Ehitus is to offer a high-quality construction service to its customers in various fields.
- The goal of AS Merko Ehitus is to be leading construction company in its home market – the Baltic States.
- In addition to the home market, AS Merko Ehitus considers Ukraine, primarily Kiev, and St. Petersburg in Russia to have a good outlook.
- Outside aforementioned markets, the Company builds/develops only for those clients with whom it has prior collaboration experience with, or objects similar to those which it has previously successfully built/developed.
- In 2015, Estonia would contribute ca. 35%, Latvia ca. 30%, Lithuania ca. 25% and other markets ca. 10% to the total sales of the group. The distribution of profit earned at the group should also be of similar proportions.
- In addition to the current construction and design service, the Company would offer an even more integrated service, encompassing the complete process, from help with finding appropriate land plots until arrangement of financing.

Long-term financial goals of AS Merko Ehitus:

- attain a minimum ROE ratio of 15% for the years 2011 – 2015;
- ensure at least 40% equity to assets ratio during the whole period.

To attain these goals, we will:

1. search for opportunities to acquire ownership interests in successful companies, especially in Lithuania and Latvia.
2. rearrange the group's management structure which entails the following:
 - add an additional member to the Management Board, whose area of responsibility will initially include both foreign markets as well as development activities;
 - use several new activities to improve the horizontal cooperation between various group entities and integration of engineering-technical know-how and management experience obtained in various foreign countries into different structures at the group;
 - the ultimate goal of changing the group's structure is the creation of a holding company listed on the stock exchange and production activities in all countries with permanent operations carried out through the structures registered in those countries.
3. preserve the key foundation of the motivational system which has successfully operated until now and improve it in accordance with the set goals.

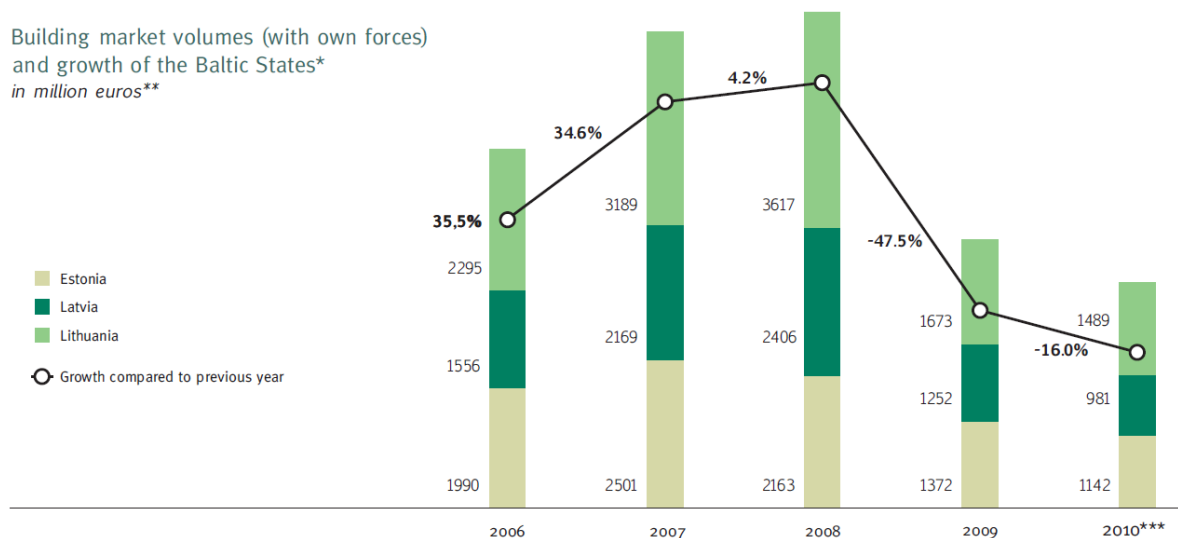
Baltic construction market

In 2010, the construction market was characterised by three keywords: low demand, intense competition and fast appreciation of input prices.

In 2010, construction works with own resources were performed in the Baltic region for EUR 3,612 million (EEK 56.5 billion), which is EUR 686 million (EEK 10.7 billion) less than in 2009. While in 2009 the Baltic construction market as a whole declined by 47.5%, it then fell by another 16.0% in 2010. Latvia experienced the biggest drop, where the construction market in current prices fell by 21.4% (2009: 47.7%) and declined to EUR 981 million (EEK 15.3 billion). Estonia did not fare much better, where the construction market fell by 16.8% in a year, contributing 31.6% to the total Baltic construction market in 2010 equal to EUR 1,141 million (EEK 17.9 billion). While Lithuania fell the most in 2009 (53.7%), the decline was only 11% in 2010. According to the data of statistical office, construction works with own resources were performed in Lithuania for EUR 1,489 million (EEK 23.3 billion) which made up the largest share of the total Baltic construction market at 41.2%. Along with a decline in construction works, the construction works per capita also fell. Construction works per capita were performed for EUR 852 in Estonia, EUR 443 in Latvia and EUR 453 in Lithuania.

Although negative trends continued, the market showed signs of improvement in the 4th quarter on a quarter-over-quarter basis. As compared to the 4th quarter of 2009, construction works performed with own forces increased by 17.8% in Lithuania and 0.6% in Latvia. Despite the weak domestic market situation, demand and the related construction volume continued to grow in export markets in 2010. In a year, the volume of work completed by Estonian companies in foreign countries increased by 8.5% (contributing 11% to total volume of construction services completed with own forces), the exports of Latvian companies increased by 10.4% (contributing 6% to the volume of construction services) and the exports of Lithuania increased by 53.3% (contributing 5% to the volume of the construction services).

Building market volumes (with own forces)
and growth of the Baltic States*
in million euros**



* Based on the data of local statistical offices.

** According to the unofficial central exchange rate of Eesti Pank.

*** Data of 2010 tentative, based on short-term statistics.

Although the data by Statistic Estonia still reflect depreciation of construction prices as compared to 2009 (-2.8% in Estonia, including labour costs -5.8%, -2.7% in Latvia, including labour costs +1.0%, and -4.3% in Lithuania, including labour costs -5.4%), then strong global demand has led to significant appreciation of the input price in the construction sector from the beginning of 2010, both the prices of materials as well as the rent of equipment have appreciated. Strong demand in the construction sectors of Central Europe and Scandinavia has created a real alternative for local firms and workforce to sell their services to foreign countries and has led to appreciation of labour costs. Appreciation of input prices and orientation of many

subcontracting entities towards foreign markets has led to significant appreciation of construction services over the last 9 months. As compared to the bottom of the construction market in 2009, construction prices have increased by 20-25%. Great volatility of prices will complicate the budgeting of new projects and completion of construction of projects with the budgeted costs and will lead to additional risk when performing construction contracts with fixed prices and will put price pressure on profitability of projects. This reason was of significant importance for the formation of weaker than expected results of the group in the 4th quarter. As at 31.12.2010, a provision for unprofitable projects had been set up in the amount of EUR 2.2 million (EEK 34.8 million).

In the market of general contracting, the trend of submitting proposals priced below break-even level continued in order to win the contract, accompanied by withdrawals from tenders and cancellation of contracts. In such a situation, the customer generally loses out due to additional time and resources needed to arrange a new procurement. Such tenders have often been arranged in such a way that the preparatory work at a high price is completed, a decent profit is earned and then the project is abandoned. When arranging a new procurement, it turns out that the actual cost to complete unfinished work exceeds the cost agreed for work unperformed by the previous contractor manyfold. Indifference of customers and fear to attract public attention due to unsuccessful tenders favours unhealthy competition. Merko Ehitus does not approve of such a practice and intends to adhere to its agreements also in the future.

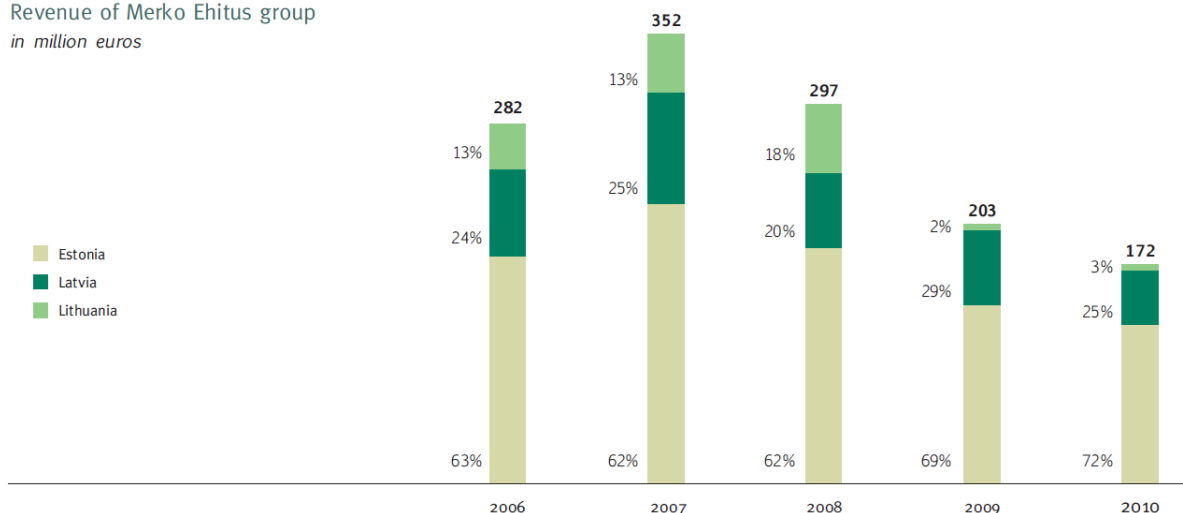
The year 2010 demonstrated the signs of a recovery of housing market in Estonia and Lithuania, the number of transactions as well as average prices increased. The increase in the price level of residential premises and the signs of economic stabilisation have given an impetus for people who for a long time have postponed their purchases to be more active. The improvement of the market situation has been helped by the improved financing environment, primarily lower degree of own financing required and interest margins for end users. Temporary sales success in the area of residential premises has encouraged developers to review their frozen projects and draw up new business plans and loan applications. Despite nascent optimism among developers, the launching of new projects is currently very risky – the speed of appreciation of construction prices clearly exceeds the growth of sales prices and makes profitable development of projects very unpredictable, as a result of which we estimate that the volume of new development projects will remain modest in the near future and the supply of residential premises will drop. Derived from the supply contraction and appreciation of construction prices, we forecast further appreciation of the prices of residential premises over the next 12 months.

During the year, a total of 2324 (2009: 3026) permits of use were issued for new residential premises in Estonia, 1905 (2009: 4187) in Latvia and 3667 (2009: 9400) in Lithuania.

Operating results

In 2010, the revenue of the construction group was EUR 171.9 million (EEK 2,689.9 million). In 2010, Estonia contributed 72.3%, Latvia 25.1% and Lithuania 2.6% to the group's sales. As compared to 2009, the group's revenue decreased by 15.4%, including 10.9% in Estonia, 27.1% in Latvia and 5.1% in Lithuania. Considering the 16.0% drop in the Baltic construction market, it should be noted that the group's revenue also decreased along with the drop in the market. The fact that the group earned a profit in the financial year should rather be considered a positive result considering the market situation.

Revenue of Merko Ehitus group
in million euros



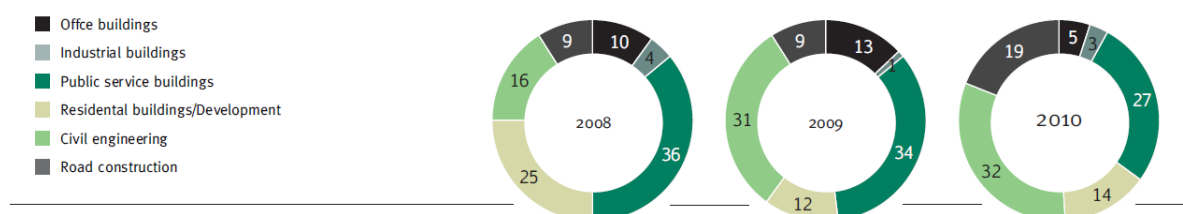
The consolidated sales revenue of the group's largest entities:

in thousands of euros and kroons

	2010		2009	
	EUR	EEK	EUR	EEK
Estonian entities				
AS Merko Ehitus (parent)	89,780	1,404,744	107,968	1,689,327
AS Gustaf (85% ownership)	2,598	40,647	2,820	44,131
OU Gustaf Tallinn (80% ownership)	3,451	53,997	3,907	61,126
AS Merko Tartu (66% ownership)	2,485	38,885	4,606	72,073
Tallinna Teede AS (100% ownership)	20,792	325,330	17,603	275,423
OU Woody (100% ownership)	3,941	61,663	1,598	25,000
Latvian entity				
SIA Merks (100% ownership)	43,169	675,440	59,181	925,985
Lithuanian entity				
UAB Merko Statyba (100% ownership)	4,432	69,352	4,532	70,915

Engineering construction contributed 32%, residential construction/development 14%, service buildings 27%, office buildings 5%, industrial buildings 3% and road construction 19% to the group's revenue. New buildings made up 57%, and renovation and reconstruction works made up 43% of construction activities.

Distribution of construction activities of the group
per cent



In 2010, the group concluded new construction contracts in the total amount of EUR 290 million (EEK 4.54 billion), incl. EUR 79 million (EEK 1.24 billion) in the 4th quarter. The largest construction contracts entered into in 2010 included reconstruction of Ülemiste traffic junction (EUR 41.4 million), construction of Loo-Maardu section of E20 highway (EEK 18.5 million), construction of water and sewage pipelines and facilities of the water economy project of the town of Maardu (EUR 13.3 million), construction of Iru waste-to-energy plant (EUR 12.6 million) and renovation of the public water supply of the region of Kohtla-Järve (EUR 7.8 million). As at 31 December, the group's portfolio on unfinished construction contracts totalled EUR 200 million (EEK 3.13 billion).

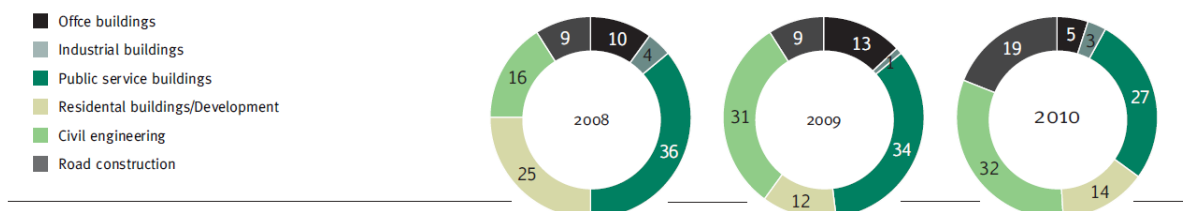
The contract portfolio does not include residential development projects developed by the Company and the works related to construction of investment properties. At 13.07.2010, the subsidiary of AS Merko Ehitus, UAB Merko Statyba, signed a contract for the construction of Balsiu schoolhouse and its subsequent leasing for 25 years with the real estate company of the City of Vilnius. The estimated investment into the project is EUR 10 million and the school-house should be completed to receive students at 1 September 2011. In August 2010, a contract was concluded with the City District Government of Lasnamäe district, pursuant to which the Company will lease out 2405 m² office space in Lasnamäe to the latter in August 2011.

The largest project completed in 2010

Facilities of Ämari air base	new facility	Ämari, Vasalemma rural municipality, Harju county		AS Merko Ehitus
Extension of Kristiine shopping centre	new facility	Endla 45, Tallinn	20,764 m ²	AS Merko Ehitus
Piirissaare Port	reconstruction	Tooni village, Piirissaare rural municipality	quay 108 m	AS Merko Ehitus
Water and sewerage facilities of the town of Elva	new facility	town of Elva	34.7 km	AS Merko Ehitus
Avinurme recreational centre	reconstruction	Avinurme rural municipality, Ida-Virumaa	580 m ²	AS Merko Ehitus
Stage II of apartment buildings at Pärnu mnt 129c and Räägu-Vuti	new facility	Pärnu road 129c, Tallinn Räägu street 10, Tallinn	9332 m ²	AS Merko Ehitus
Northern greenhouse of Tallinn Botanical Garden	new facility	Kloostrimetsa road 52, Tallinn	1310 m ²	AS Merko Ehitus
Section of Rannaküla-Haapsalu highway T9	reconstruction	Ääsmäe-Haapsalu-Rohuküla km 64,460-70,416	257,276 m ²	Tallinna Teede AS
DnB NORD Bank office building	new facility	Skanstes 12, Riga	15,146 m ²	SIA Merks
Hotel Tallink	new facility	Elizabetes 24/26, Riga	10,837 m ²	SIA Merks
Jõgeva kindergarten Rohutirts	reconstruction	Rohu 8, Jõgeva	2585 m ²	AS Gustaf
Kindergarten of Haanja rural municipality	new facility	Haanja village, Võrumaa	1259 m ²	AS Merko Tartu

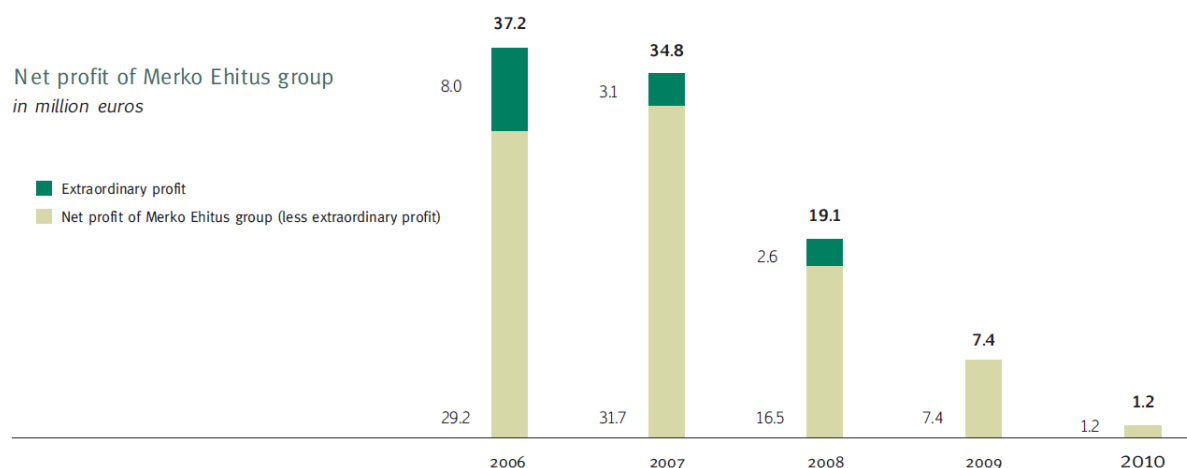
The confidence and courage to investment of the private sector exiting from the economic crisis continue to be low. The majority of new construction projects are initiated in the area of infrastructure and environmental facilities funded by the public sector and the EU structural funds.

Distribution of construction activities of the group
per cent



Due to the lower volumes and significant appreciation of input prices (several projects were unprofitable), the share of cost of goods of sold to total costs increased, as a result of which the gross margin fell from 10.9% to 7.3% in a year. In 2010, the group's marketing, and general and administrative expenses fell by 15.1%. The reduction in marketing, general and administrative expenses was aided by cost-savings measures implemented, of which the decline in staff costs contributed EUR 1.1 million (EEK 16.4 million), office and communication expenses EUR 0.6 million (EEK 9.1 million), construction tenders EUR 0.6 million (EEK 8.6 million) and advertising and sponsorships cuts EUR 0.3 million (EEK 4.7 million). Despite the overall decline in marketing, and general and administrative expenses, the consulting and legal expenses increased by EUR 0.3 million (EEK 5.0 million) in a year, largely attributable to the legal disputes related to procurement proceedings.

In 2010, the group's pre-tax profit totalled EUR 1.8 million (EEK 27.7 million), decreasing by EUR 5.9 million (EEK 92.2 million) in a year and the net profit totalled EUR 1.2 million (EEK 19.2 million), decreasing by EUR 6.2 million (EEK 96.9 million) or 83.4%. The decline in profits was influenced by a drop in sales revenue, and in the profitability of the construction and development area. Due to faster than expected appreciation of construction prices, the Company had to make major adjustments to the cost forecasts and this was also the major reason for the loss of EUR 4.0 million (EEK 62.4 million) incurred in the 4th quarter of 2010. In 2010, the group incurred a loss of EEK 1.02 million (EEK 15.9 million) on the write-down of development projects (including properties for sale of EUR 0.28 million (EEK 4.4 million), a prepayment for a registered immovable of EUR 0.49 million (EEK 7.7 million), construction in progress of EUR 0.25 million (EEK 3.9 million) (incl. impairment of construction in progress of EUR 0.81 million (EUR 12.7 million) and a reversal of the impairment loss of construction in progress of EUR 0.56 million (EEK 8.8 million)) and a reversal of the impairment loss of finished goods recognised in the previous year of EUR 0.01 million (EEK 0.1 million). In addition, it incurred a loss of EUR 0.11 million (EEK 1.8 million) from the write-down of irrecoverable receivables. The group's pre-tax profit before extraordinary write-downs was EUR 2.90 million (EEK 45.4 million). The impact of the seasonal nature of the construction activity and the cyclical nature of the development activity was insignificant for results.



In 2010, the change in short-term investments, and cash and cash equivalents of Merko Ehitus group was EUR -36.3 million (EEK -567.6 million) and as at 31 December 2010, the cash and cash equivalents in the bank accounts and term deposits of the group were in the amount of EUR 12.5 million (EEK 195.7 million). The cash flows from operating activities totalled EUR -7.3 million (EEK -113.4 million), cash flows from investing activities totalled EUR -6.5 million (EEK -101.7 million) and cash flows from financing activities totalled EUR -22.5 million (EEK -352.5 million). The cash flows from operating activities in the reporting period were mostly affected by the change in liabilities and prepayments related to operating activities of EUR +6.3 million (EEK +98.0 million), the change in inventories of EUR +5.6 million (EEK +87.5 million) and restatement of the revenue from construction projects recognised under the stage of completion method of EUR -23.4 million (EEK -365.5 million). Of the cash flows from investing activities, the balance of issued and repaid loans totalled EUR -4.0 million (EEK -62.1 million), acquisition of investment properties totalled EUR -2.6 million (EEK -41.0 million) and investments in property, plant and equipment totalled EUR -0.8 million (EEK -12.6 million). Of the cash flows from financing activities, EUR -12.4 million (EEK -194.7 million) was spent on dividend payments, EUR -10.8 million (EEK -168.2 million) on loans assumed and EUR -1.4 million (EEK -22.6 million) on finance lease principal payments.

The ratios and methodology for calculating the financial ratios describing the Company's main operations:

	2008	2009	2010
Net profit margin	6.4%	3.7%	0.7%
Net profit margin before write-downs (excluding extraordinary profit)	9.3%	7.2%	0.7%
EBT margin	7.1%	3.8%	1.0%
Operating profit margin	7.0%	4.2%	1.4%
Gross margin	16.3%	10.9%	7.5%
Return on equity per annum	14.6%	5.5%	0.9%
Return on assets per annum	7.7%	3.1%	0.6%
Equity ratio	53.7%	60.5%	63.8%
Current ratio	2.8	2.3	2.7
Quick ratio	1.3	1.1	1.1
General expense ratio	5.8%	6.3%	6.4%

Personnel expense ratio	8.8%	8.8%	9.3%
Debt to equity ratio	35.6%	24.6%	20.6%
Accounts receivable turnover (in days)	42	44	44
Accounts payable turnover (in days)	33	29	35
Sales revenue per employee (in EUR thousand)	291	256	186
Average number of full-time employees at the group	1023	794	809

Net profit margin: Net profit / Revenue

EBT margin: Profit before tax / Revenue

Operating profit margin: Operating profit / Revenue

Gross margin: Gross profit / Revenue

Return on equity per annum: Net profit / Average equity of the period*

Return on assets per annum: Net profit / Average assets of the period

Equity ratio: Owners' equity* / Total assets

Current ratio: Current assets / Current liabilities

Quick ratio: (Current assets – Inventories) / Current liabilities

General expense ratio: General expenses / Revenue

Personnel expense ratio: Personnel expenses / Revenue

Debt to equity ratio: Interest-bearing liabilities / Owners' equity*

Accounts receivable turnover: Trade receivables / Revenue x 365

Accounts payable turnover: Payables to supplies / Cost of goods sold x 365

Sales revenue per employee: Sales revenue / Average number of full-time employees

* *attributable to equity holders of the parent*

Business risks

Market risk. One of the peculiarities of construction activities is the fact that the execution of the contracts concluded will take months, making the sector inert to changes in the economic environment. Due to this, both positive and negative changes in the economic environment reach the construction industry with a lag of approximately 12-18 months. This time lag enables the sector to arrange its activities to be prepared for potential setbacks as well as booms.

Several unfavourable factors – appreciation of credit, a decline in demand and general uncertainty about the future have significantly reduced the value of real estate. The housing development area is one of the main sources of market risk arising from the value of real estate for Merko Ehitus group. In 2010, the group sold 233 apartments for EUR 17.9 million (EEK 280.7 million), (exclusive of VAT), which can be considered a decent result in light of the market situation. As at 31.12.2010, the inventories included 63 unsold apartments with a total cost of EUR 4.9 million (EEK 77.1 million) and 424 apartments in the stage of construction with a total cost of EUR 16.3 million (EEK 255.7 million) as at the balance sheet date. The group's stock of apartments varies by regions, of the finished buildings 44 apartments are located in Tartu, 18 in Riga and 1 in Tallinn. As the stock in Tallinn reached a critical level, the Company launched construction of a new apartment building with 93 apartments at Tartu road 50 in Tallinn in the 3rd quarter and an apartment building with 15 apartments at Kristiina 12, Tallinn in the 4th quarter of 2010. The apartments will be completed in the 4th quarter of 2011. SIA Merks relaunched a development project with 116 apartments in the district of Skanstes, Riga. The construction works of the property are planned to be completed in the 2nd quarter of 2011. In order to minimise risks, the new projects are generally small-scaled and regionally dispersed.

Operating risk. The group concludes total risk insurance contracts with insurance companies in order to hedge the risk of unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to EUR 10 million. The risks of the projects whose cost exceeds EUR 10 million or which the annual policy does not cover (water construction, railroad construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding contracts for services involving design work, an insurance contract for professional liability is required from subcontractors covering the damage arising from design, erroneous measurement, advice and instructions, or such a contract is concluded at own expense. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2010, indemnity applications totalled EUR 0.26 million (EEK 4.0 million), and insurance benefits were received in the amount of EUR 0.20 million (EEK 3.2 million) and those in processing totalled EUR 0.01 million (EEK 0.1 million).

The prices of construction services and materials which move quickly have made the budgeting of projects more difficult, increasing the risk of inadequate pricing of bids. Unpredictably and more intense competition put serious pressure on the profitability of the construction sector, significantly reducing the margin for erring when submitting tenders and presenting a serious threat for sustainable development of the sector.

A warranty reserve has been set up at the Company to cover the construction errors which have become evident during the warranty period. In 2010, warranty provisions were set up at the group in the total amount of EUR 0.97 million (EEK 15.1 million) and disbursements amounted to EUR 1.04 million (EEK 16.2 million). As at the year-end, the Company's warranty provision amounted to EUR 1.11 million (EEK 17.4 million). With regard to work performed by subcontractors, the subcontractor is responsible for elimination of errors that became evident during the warranty period. With regard to critically significant contracts, the performance of contractual obligations of the contractor arising from contracts of services is guaranteed with bank guarantees to be paid upon the first demand.

One important part of managing operating risks is the mapping out of the situation and anticipation of risks. ISO 9001/14001 management systems have been set up at five largest group entities and the occupational health and safety system OHSAS 18001 has been set up at the parent, Merko Tartu as well as Latvian and Lithuanian subsidiaries. Twelve full-time quality control specialists work at the group whose work responsibilities include ensuring the development and functioning of quality, occupational safety and management systems.

Credit risk. In connection with the overall weakness of the economic environment, the share of credit risk in the group's risk matrix continues to be high. In managing credit risk, close attention is paid to the payment behaviour of business partners, their financial position is analysed and if necessary, third parties are involved as guarantors in transactions. Upon prepayments to suppliers, a bank guarantee by suppliers is required. In 2010, the payment discipline of customers improved slightly. Although the amount of doubtful receivables remained virtually unchanged, decreasing from EUR 1.27 million (EEK 19.9 million) to EUR 1.16 million (EEK 18.1 million), the ratio of write-downs to sales decreased 6.7 times from EUR 0.89 million (EEK 13.9 million) to EUR 0.11 million (EEK 1.8 million). During the period, the amount of invoices past due 30 and more days decreased from EUR 7.2 million (EEK 113.7 million) to EUR 3.15 million (EEK 49.3 million). As at 31.12.2010, the group had receivables past due in the amount of EUR 4.84 million (EEK 75.7 million), of which EUR 1.27 million (EEK 19.9 million) were collected after the balance sheet date. Management monitors closely the

pattern of receivables and is of opinion that the receivables at the year-end do not contain major credit risks posing a threat for the Company's sustainability of operations. The Company's available funds are primarily held in overnight deposits or term deposits at the banks of Swedbank, SEB, Nordea and Unicredit group.

Interest rate risk. As at 31.12.2010, the group's interest-bearing liabilities totalled EUR 25.7 million (EEK 402.7 million), of which short-term loans and the current portion of long-term debt totalled EUR 12.5 million (EEK 196.4 million) and long-term loans and finance lease liabilities totalled EUR 13.2 million (EEK 206.3 million). The volume of interest-bearing liabilities decreased by EUR 7.75 million (EEK 121.2 million) in a year and as at the year-end, these liabilities made up 13.2% of the Company's balance sheet total. Of the liabilities assumed, the liabilities with floating base interest rates totalled EUR 25.13 million (EEK 393.3 million), of which EUR 24.96 million (EEK 390.5 million) are exposed to the risk of changes in Euribor and EUR 0.18 million (EEK 2.8 million) in Rigibor, and EUR 0.60 million (EEK 9.4 million) have fixed interest rates. As at 31.12.2010, 12-month Euribor was 1.507% and management estimates that it can increase by 100 basis points over the next 12 months. In addition to the risk of Euribor, the refinancing of liabilities poses a threat of a change in the risk margin due to the changes in the economic environment. The management estimates that it may lower interest rates by 50-100 basis points in 2011, depending on the previous time of fixing of interest. As at 31.12.2010, the balance of liabilities exposed to a change in the risk margin was EUR 5.51 million (EEK 86.2 million). Of current liabilities, the loan received during the demerger of AS Järvevana in the amount of EUR 6.99 million (EEK 109.4 million) is not subject to the margin risk, where the interest on the loan has been fixed at the level of 12-month Euribor + 100 basis points.

Liquidity risk. Due to the decrease in money supply, lower turnover speed of development projects and potential negative scenarios with regard to the payment discipline, one of the group's main priorities will be the ensuring of liquidity. As at 31.12.2010, the group's current ratio was 2.7 (31.12.2009: 2.3) and quick ratio was 1.1 (31.12.2009: 1.1). To ensure liquidity and better management of the cash flows, the group entities have concluded overdraft contracts with banks in the total amount of EUR 5.96 million (EEK 93.2 million). In addition to overdraft contracts, the Company has a working capital loan facility with the limit of EUR 5.0 (EEK 78.3 million) from AS Riverito. The majority of the group's loans have been taken for implementation of short-term development projects and due to the improvement of the residential real estate market and the financing environment, management does not see any problems with the repayment or refinancing of these loans. Management considers that the group's capital structure – high equity ratio of 63.8% of the balance sheet total and a moderate proportion of borrowings of 13.2% of the balance sheet total – ensures both the feasibility of the extension of existing financial liabilities and, if necessary, obtaining additional working capital, as well as the company's trustworthiness in the eyes of creditors. The group's priority in 2011 continues to be preservation of liquidity.

Foreign currency risk. The group's construction contracts are mostly concluded in the currencies of the country of location of the entities: Estonian kroons, Latvian lats and Lithuanian litas. From 1 January 2011, EUR was adopted in Estonia. The Latvian lats and Lithuanian litas are pegged to the euro. The exchange rate of the Latvian lats is EUR 1 = LVL 0.702804 +/-1%. To eliminate foreign currency risks, the structure of the Company's assets and liabilities by currencies is monitored, and the euro is the preferred currency in conclusion of long-term construction contracts. As at the balance sheet date, EUR 188.05 million (EEK 2942.4 million) or 96.2% of the group's assets were denominated in local currencies, including the assets in EEK 55.1%, LVL 34.7% and LTL 6.4% of the balance sheet total and the liabilities in local currencies totalled EUR 168.96 million (EEK 2,643.6 million) or 86.4%, including liabilities in EEK 67.3%, LVL 17.1% and LTL 2.0% of the balance sheet total.

If as at the year-end, all national currencies had been simultaneously devalued by 25%, the group would have incurred additional finance costs in the amount of EUR 4.77 million (EEK 74.7 million), including from EEK position EUR 5.97 million (EEK 93.3 million), from LVL position EUR 8.60 million (EEK 134.6 million) and from LTL position EUR 2.14 million (EEK 33.5 million). As Estonia adopted the euro at 1.01.2011, management estimates that the possibility of and need for devaluation of national currencies of LVL and LTL have significantly decreased and the situation has stabilised in the Baltic States.

Legal risks. Due to the possibility of differing interpretations of contracts, regulations and laws, there is a risk that some buyers, contractors or supervisory authorities consider the Company's activities from the perspective of laws or contracts from a different position, and dispute the legality of the Company's activities. As at 31.12.2010, the Company had set up provisions for potential claims and legal costs in the amount of EUR 0.26 million (EEK 4.1 million). In 2010, legal costs in the total amount of EUR 0.73 million (EEK 11.5 million) were covered from the provisions and new provisions were set up in the amount of EUR 0.07 million (EEK 1.1 million).

An overview of the main legal disputes of group entities as at 31.12.2010 is presented below.

At 8 November 2010, Lithuanian company UAB Olinda filed a claim with the Arbitration Court of Helsinki Chamber of Commerce and Industry against UAB Merko Statyba in the amount of LTL 17.3 million (EEK 78.4 million). UAB Olinda's losses were allegedly incurred in conjunction with the refusal of UAB Merko Statyba to launch work pursuant to the construction contract. UAB Merko Statyba is of opinion that the project submitted by the customer and the building permit were not in compliance with Lithuanian laws as well as the detailed plan of the registered immovable intended for the purpose of construction, and Merko Statyba was under the obligation to refuse performance of illegal construction activities. The Lithuanian Planning and Construction Inspectorate is also of opinion that the launch of construction activities on the property is illegal until the documentation of the construction project and building permit has been brought into compliance with Lithuanian legislation. At the request of the Inspectorate, Vilnius Administrative Court has also suspended the validity of the building permit. The session at the court of arbitration in the disputed matter will take place at 14-15 June 2011. The group's management is opinion that UAB Merko Statyba's refusal to launch construction activities on the grounds of an invalid building permit was justified and the claim will be dismissed.

At 31 December 2010, customer UAB Neringos Vanduo filed a claim against the Lithuanian branch of AS Merko Ehitus in the amount of LTL 2 million (EUR 0.58 million/EEK 9.1 million) related to the alleged improper fulfilment of the contract for services concerning Neringa wastewater treatment plant and enforced the performance warranty issued by the bank to the customer in the amount of LTL 1 million (EUR 0.29 million/EEK 4.5 million). Merko Ehitus is of opinion that the goals laid down in the contract have been attained – the wastewater treatment plant has received authorisation for use, incl. permit by the Lithuanian Health Board in accordance with the contract for services and Lithuanian laws, the customer has no legal grounds to demand payment of contractual penalties and it intends to prove its right in court.

At 9 January 2011, a court case was commenced at Harju County Court which among other issues deals with the claim filed against AS Merko Ehitus in relation to the giving of bribe to the former Tallinn city official Ivo Parbus. The Prosecutor's Offices has charged Merko Ehitus with the giving of a bribe – Estravel's gift coupon of EEK 25,000 (EUR 1,598) and the book with the list price of EEK 410 (EUR 26) titled "Eesti Talurahva Arhitektuur" (*Estonian Vernacular Architecture*) in order to accelerate the proceedings with the plans of three

registered immovables located in Tallinn. The group's management is of opinion that the company has not given a bribe and has conducted its activities in conformity with the laws of the Republic of Estonia.

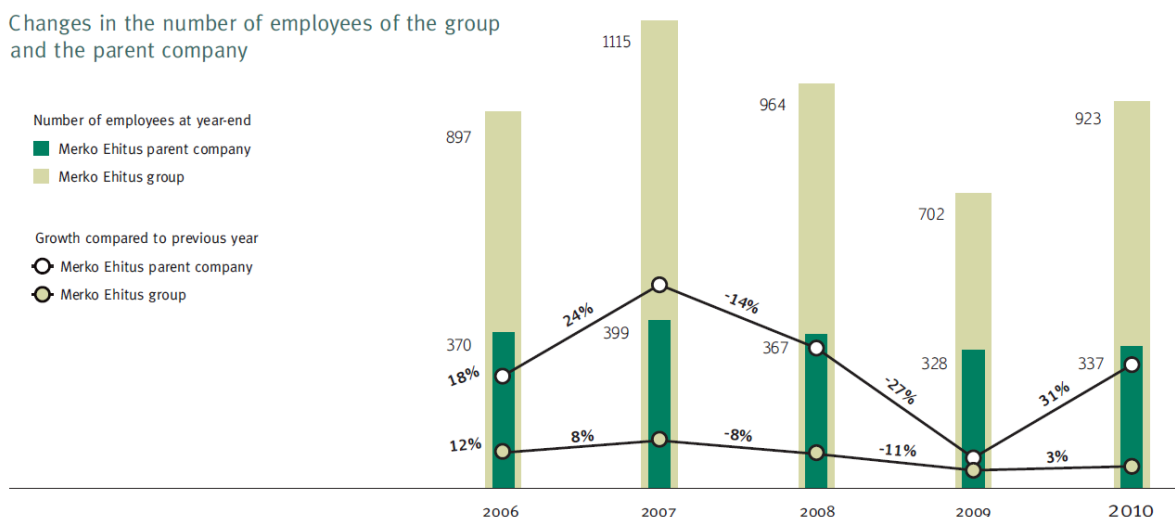
AS Solaris Keskus has declined payment of EUR 2.13 million (EEK 33.4 million) to the general contractors (AS Merko Ehitus ja AS Skanska EMV) for the work performed at Solaris recreational centre. AS Solaris Keskus delays the payment of invoices, referring to the erroneous overpayment made to the builders in the amount of EUR 0.33 million (EEK 5.1 million) and additional expenses incurred during the opening and subsequent use of the centre due to the alleged low quality of construction work performed. This lawsuit will be settled by the parties in court. The group's management is of opinion that the refusal of Solaris Keskus to pay the invoice is not justified.

The Company and its people

One of the main values of Merko Ehitus is its people. Due to the growth of the contract portfolio and the increase in the share of facilities in the structure of contracts, the number of group's employees increased by 221 employees and as at 31.12.2010, the group had 923 employees.

The gross wages and salaries of the group's employees totalled EUR 16.0 million (EEK 250.4 million), of which base wages and salaries made up 73.6% and bonuses made up 26.4%, or 10.2% less than in 2009. As compared to 2009, the number of the group's employees increased by 31.5% and the average gross wages decreased by 12.4%. The number of employees of the parent AS Merko Ehitus was 337 at the year-end 2010, increasing by 9 employees in a year. Gross wages and salaries paid to employees totalled EUR 6.6 million (EEK 103.7 million), the annual decline was 24.1%, including base wages and salaries by 21.5% and bonuses by 28.4%.

Changes in the number of employees of the group and the parent company



Management Board

The Management Board is the Company's governing body, which represents and manages the Company. The Management Board shall adhere to the lawful regulations of the Supervisory Board. The Management Board is under the obligation to act in most economically purposeful manner.

As at 31.12.2010, the Management Board of AS Merko Ehitus had 6 members. At the general meeting of shareholders held at 3 June 2010, in conjunction with the restructuring of the Company's management structure, Jaan Mäe was removed from the position of a member of the Supervisory Board due to his election as a member of the Management Board of AS Merko Ehitus and at 21 December 2010, the Supervisory Board of AS Merko Ehitus decided to elect former manager of the department of concrete works Viktor Mõisja as an additional member of the Management Board. The members of the Management Board are all full-time employed for AS Merko Ehitus and their gross remuneration in 2010 totalled EUR 0.47 million (EEK 7.4 million), including base remuneration of EUR 0.23 million (EEK 3.6 million) and bonuses of EUR 0.24 million (EEK 3.8 million). All members of the Management Board currently work on the basis of service contracts. Upon the premature removal of a member of the Management Board or non-extension of their service contracts, the members are paid severance pay which equals their last 24 months' remuneration.

Tiit Roben – Born at 5 January 1966. Finished Mustamäe Gymnasium (former name: Tallinn Secondary School no. 44) in Tallinn and graduated from Tallinn University of Technology, majoring in industrial and civil engineering. Worked as a project manager at AS Merko Ehitus between 1998-2002. Between 2002-2008, worked at AS Riverito's entity E.L.L.Kinnisvara AS, from 2005, is a member of the Company's Management Board. From August 2008, is the Chairman of the Management Board of AS Merko Ehitus, being responsible for the management and development of the Company.

Jaan Mäe – Born at 26 September 1964. Finished Viljandi Secondary School no. 5. and graduated from Tallinn University of Technology, majoring in industrial and civil engineering. From December 1997, works at AS Merko Ehitus, has been project manager, division manager and member of the Management Board. Between 2006-2010, was a member of the Supervisory Board of AS Merko Ehitus and several group entities. From June 2010, is a member of the Management Board of AS Merko Ehitus, being responsible for attainment of goals in the area of development and is the Chairman of the Supervisory Board of Latvian and Lithuanian subsidiaries.

Alar Lagus – Born at 15 February 1969. Finished Rapla Secondary School and graduated from the Faculty of Chemistry of Tallinn University of Technology, majoring in organisation and technology of public catering. After graduation, worked in various positions at Hansapank. From 2004, works as a manager in the finance area and is responsible for the Company's financial and managerial accounting and investor relations.

Veljo Viitmann – Born at 13 March 1962. Finished Türi Secondary School and graduated from Tallinn University of Technology, majoring in road engineering and bridges. From 1994, works at AS Merko Ehitus and is responsible for preparation of tenders for new projects.

Andres Agukas – Born at 15 July 1965. Finished Pärnu-Jaagupi Secondary School and graduated from Tallinn University of Technology, majoring in road engineering. At 2 February 1998, started to work at AS Merko Ehitus as the first employee in the area of civil engineering. From October 2005, as a member of the Management Board is responsible for the whole area of the construction service.

Viktor Mõisja – Born at 6 January 1951. Graduated as a civil engineer from Tallinn University of Technology in 1976. Viktor Mõisja has worked at AS Merko Ehitus since the foundation of the Company and most of the time as a manager of the department of concrete works. From 21 December 2010, is a member of the Company's Management Board and his area of responsibility is quality management and supervision.

Supervisory Board

The general meeting of shareholders elects the Company's Supervisory Board. The Supervisory Board plans the Company's activities and arranges its management as well as performs supervision over the Management Board. The Supervisory Board of AS Merko Ehitus has four members.

At the general meeting of shareholders held at 3 June 2010, due to the restructuring of the Company's management structure, Jaan Mäe was removed from the position of the Supervisory Board member due to his election as a member of the Management Board. During the restructuring the management structure, the 3-member Directorate was eliminated and the functions previously partially granted to the Directorate were returned to the Supervisory Board. The gross remuneration of the members of the group's Directorate totalled EUR 0.08 million (EEK 1.3 million), including base remuneration of EUR 0.05 million (EEK 0.7 million) and bonuses of EUR 0.03 million (EEK 0.6 million). In 2010, the remuneration of the members of the Supervisory Board totalled EUR 0.17 million (EEK 2.7 million).

Tõnu Toomik – Born at 8 March 1961. Finished Raatuse Gymnasium in Tartu (former Tartu Secondary School no. 3) and graduated from Tallinn University of Technology, majoring in industrial and civil engineering. From 1993, started to work as a project manager at AS Merko Ehitus. Between 1997-2008, was a member of the Management Board of AS Merko Ehitus, being responsible for the management and development of the Company. From August 2008, is the Chairman of the Supervisory Board of AS Merko Ehitus.

Teet Roopalu – Born at 30 August 1949. Finished Tallinn Secondary School no. 10 (current Nõmme Gymnasium) and graduated from the Faculty of Economics of Tallinn University of Technology, majoring in construction economics and organisation. Has worked at construction companies, including as a director of finance, managed the economic activities in EKE (*Estonian Collective Farm Construction*) system as a chief economist, as a bank director and has also been involved in design work. Since November 2002, works at AS Merko Ehitus and is responsible for the Company's financial and legal areas. Is a member of the Supervisory Board of AS Riverito and those of several subsidiaries and associates of AS Merko Ehitus.

Indrek Neivelt – Born at 17 March 1967. Finished a mathematics and physics - biased class at Tallinna Secondary School no. 1 (current Gustav Adolf Gymnasium), graduated from Tallinn University of technology, majoring in civil engineering economics and management, and received his MBA in banking and finance from Stockholm University. Between 1991-2005, worked in various positions at Hansapank, over the last six years as the general director of the group and chairman of the Management Board. From 2005, is a Chairman of the Supervisory Board of Bank Saint Petersburg and is a member of supervisory boards of several entities. From October 2008, is member of the Supervisory Board of AS Merko Ehitus.

Olari Taal – Born at 7 August 1953. In 1971, finished Varstu Secondary School and in 1976, graduated as a civil engineer from Tallinn University of Technology. Has managed Tartu Elamuehituskombinaat (*Tartu Housing Plant*; Tartu Maja) and Eesti Hoiupank (*Estonian Savings Bank*). Has served the Republic of Estonia as the Minister of Construction, Minister of Economic Affairs, Minister of Internal Affairs and as a member of the 10th Riigikogu (Parliament of Estonia). From October 2008, Olari Taal is a member of the Supervisory Board of AS Merko Ehitus.

Information about the shares held by the members of the Supervisory and management Boards is disclosed in chapter "Share and shareholders" of the report.

In 2010, the group sponsored sports, culture and education with EUR 0.40 million (EEK 6.2 million).

In the area of sports, we foster the development and projects of sports aimed at young people, enabling to create opportunities for engagement in athletic activities and active vacationing. The group's largest sponsorship project continued to be the initiative launched in collaboration with Swedbank, Eesti Energia and the Ministry of Culture of the Republic of Estonia as well as the Estonian Ski Association, called the Eesti Terviserajad (Estonian Hiking Tracks). We also supported the recreational sports series called Merko Talverajad (Merko Winter Paths) that was launched by Eesti Terviserajad SA and organised by Stamina Sports Club, by which, in addition to creation of well-maintained sports areas, we try to vigorously contribute to the development of regular exercising habits of Estonians. We also support Estonian tennis players. We continue to support the Estonian national cross-country skiing team and the youth team Merko Team.

In the area of culture and education, collaboration with the Estonian Art Museum and Drama Theatre continued. In the area of education, the group's priority is construction-related education and research work. In 2010, cooperation continued with Tallinn University of Technology in the fields of development, research and studies, and with the Development Fund of Tallinn University of Technology for granting the scholarship bearing the name of professor Heinrich Laul for young lecturers/scientists with a doctoral degree in construction science. Merko Ehitus pays scholarships to 7 Master's degree students at Tallinn University of Technology and 4 Master's degree students at Tallinn University of Applied Sciences.

In the social field, cooperation with our partner Tilsi Children's Home continued. By midsummer's night 2010, an outdoor basketball field was completed at the children's home with the help of Merko. In December, Santa's elves sent gifts to the children.

Shares and shareholders

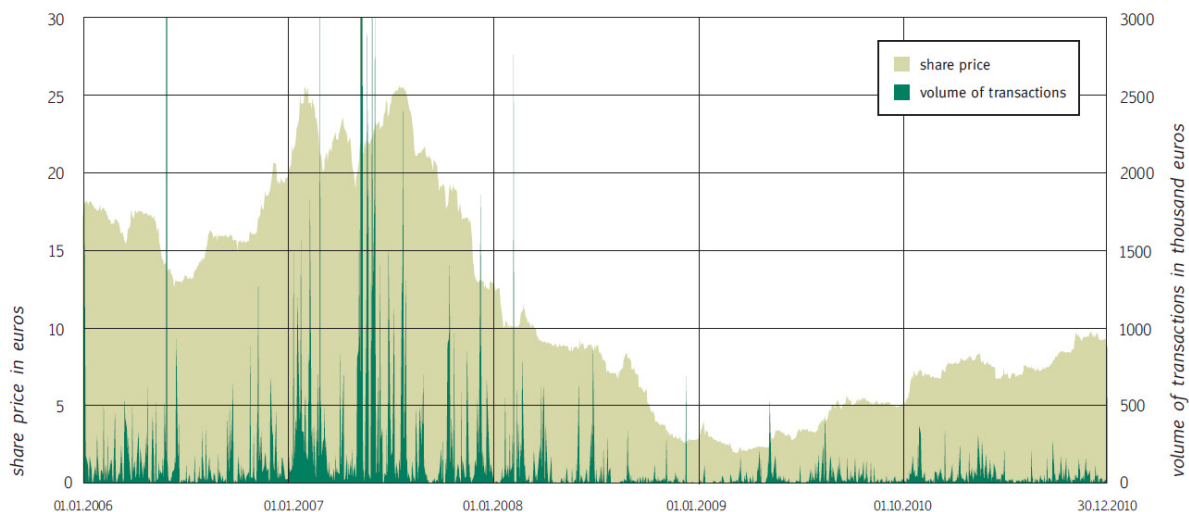
Information on securities

Name of security	Share of Merko Ehitus
ISIN	EE3100098328
Type of security	Freely transferable ordinary shares
Issuer	AS Merko Ehitus
Activity of issuer	Construction
Residency of issuer	Estonia
Nominal value	EEK 10.00 (EUR 0.6391)
Number of securities	17,700,000
Number of votes per share	1 vote
Registration at ECSD	08.07.2008
Stock Exchange List	Main List

	31.12.2008	31.12.2009	31.12.2010
Basic earnings per share (EPS), EUR	1.08	0.42	0.07
Earnings per share, EUR	7.49	7.68	7.05
P/B (price to book ratio)	0.37	0.65	1.28
P/E (price / earnings ratio)	2.59	11.97	130.32

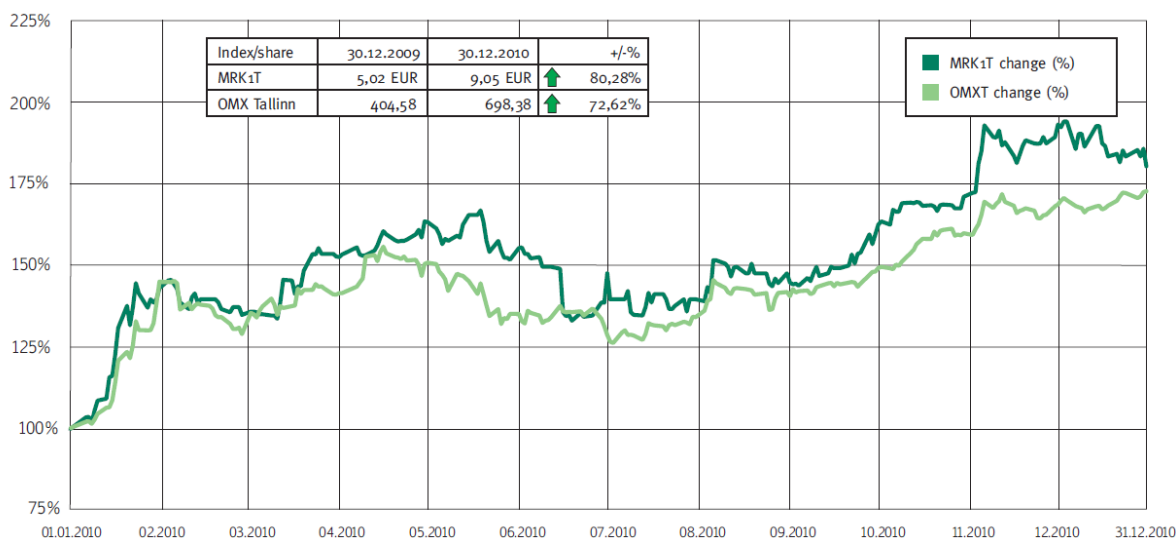
The shares of Merko Ehitus are listed in the Main List of NASDAQ OMX Tallinn. In 2010, 4490 transactions with the shares of Merko Ehitus were performed, in the course of which 1.7 million shares were traded and the total monetary value of transactions was EUR 13.1 million (EEK 204.8 million). The lowest share price was EUR 5.05 (EEK 79.0) and the highest price was EUR 9.89 (EEK 154.7) per share. The closing price of the shares as at 30.12.2010 was EUR 9.05 (EEK 141.6). As at 31.12.2010, the market capitalisation of AS Merko Ehitus was EUR 160 million (EEK 2.5 billion).

Performance of Merko Ehitus share at NASDAQ OMX Tallinn Stock Exchange



Trading history of securities, EUR	2008	2009	2010
Highest	12.95	5.78	9.89
Lowest	2.58	1.85	5.05
Closing	2.80	5.02	9.05
Average	7.59	3.71	7.72
Change, %	-78.46	+79.30	+80.30
Traded shares	2,367,089	2,782,150	1,696,902
Turnover, EUR million	18.22	9.38	13.09
Market value, EUR million, as at the year-end	49.56	88.85	160.19

Performance of the share of Merko Ehitus and comparison index OMX Tallinn



Structure of shareholders as at 31.12.2010

Number of shares	Number of shareholders	% of shareholders	Number of shares	% of shareholders
1-100	379	26.30%	20,565	0.12%
101-1000	701	48.65%	305,923	1.73%
1001-10 000	315	21.86%	889,826	5.03%
10 001 – 100 000	35	2.43%	954,947	5.39%
100 001 – 1 000 000	10	0.69%	2,786,053	15.74%
1 000 001 - ...	1	0.07%	12,742,686	71.99%
Total	1441	100%	17,700,000	100%

The main shareholders of AS Merko Ehitus as at 31.12.2010

	Number of shares	Percentage of total
AS Riverito	12,742,686	71.99%
ING Luxembourg S.A., clients	963,376	5.44%
Skandinaviska Enskilda Banken Ab, clients	856,581	4.84%
State Street Bank and Trust Omnibus Account a Fund No OM01	169,587	0.96%
Gamma Holding OÜ	142,821	0.81%
SEB Elu- ja Pensioniäriä AS	125,520	0.71%
Skandinaviska Enskilda Banken Finnish, clients	108,999	0.62%
Clearstream Banking Luxembourg S.A. clients	106,239	0.60%
Nordea Bank Finland Plc/Non-resident legal entities	106,180	0.60%
Firebird Aurora Fund, Ltd.	103,910	0.59%
AS Midas Invest	102,840	0.58%

Shares held by members of the Supervisory Board of AS Merko Ehitus at 31.12.2010

		Number of shares	Percentage of total
Tõnu Toomik (AS Riverito)	Chairman of the Supervisory Board	1,607,184	9.08%
Indrek Neivelt (OÜ Trust IN)	Member of the Supervisory Board	31,635	0.18%
Olari Taal (OÜ Eggera)	Member of the Supervisory Board	2,500	0.01%
Teet Roopalu	Member of the Supervisory Board	0	0.00%

Shares held by members of the Management Board of AS Merko Ehitus at 31.12.2010

		Number of shares	Percentage of total
Tiit Roben (OÜ Amistad Invest)	Chairman of the Management Board	1,500	0.01%
Alar Lagus	Member of the Management Board	0	0.00%
Veljo Viitmann	Member of the Management Board	0	0.00%
Andres Agukas	Member of the Management Board	0	0.00%

Jaan Mäe	Member of the Management Board	0	0.00%
Viktor Mõisja (AS Riverito / private person)	Member of the Management Board	1,103,734	6.23%

Dividend policy

Distribution of dividends to the Company's shareholders is recognised as a liability in the financial statements at the time when the payment of dividends is approved by the Company's shareholders. Throughout the years, Merko Ehitus has attempted to distribute approximately 20% of the year's net profit as dividends to the shareholders. The possibility and amount of payment of dividends is considered annually, taking into consideration various factors and thereafter, a proposal is made at the general meeting of shareholders in respect of the amount and payment of dividends. Over the last five years, the dividends have been paid to the shareholders for the respective periods as follows:

	2006	2007	2008	2009	2010*
Dividend per share, EUR	0.4474	0	0.2237	0.7030	0,1
Dividend rate	21%	0%	21%	168%	144%

* according to proposal of the Management Board

Outlook for 2011

Construction market and its developments

Three consecutive crisis years have significantly ravaged the construction sector. The financial position of companies is weak and internal reserves have been depleted. While the volumes and profitability of the sector in 2008 and 2009 were maintained by the portfolio put together in previous periods, and depreciation of the cost of materials and labour, the situation changed in 2010. Input prices have started to increase and profits were replaced by losses. Despite some positive expectations in respect of volumes, we expect the aforementioned negative trends to continue and worsen in 2011.

We expect moderate growth in construction volumes in 2011. Growth rates may differ country-by-country, but should remain between 10% and 15%. Although volumes are increasing, intense competition still prevails in the market. The profitability of the sector continues to be low and margins earned are not sufficient to ensure sustainable development of the sector. Customers enjoy their supremacy due to low demand, accompanied by their request of unreasonable guarantees and lengthening of payment terms. The ability of companies to adhere to the guarantees given to the customers and raising of additional working capital due to lengthening of payment terms will become a critical factor. It is not enough to be flexible and adaptable in order to fulfil contractual obligations, financial capability is becoming the key factor for staying competitive. Despite intense competition, the construction prices will continue to climb due to global appreciation of materials prices and limited labour supply. Appreciation of prices is expected to be definitely lower than in 2010, but it may still reach 10-15%. Therefore, the number of bankruptcies is expected to increase due to the projects left unfinished by the contractors as well as aggressive supply.

Most of the new construction projects continue to be launched in the areas of infrastructure and environmental facilities funded by the public sector and EU structural funds. The key question here is the

ability of the state and local governments to prepare the projects and financial capability to provide public sector funds. With regard to the latter, the year 2011 should be favourable – growing exports, the recovery of domestic consumption and overall improved economic environment will considerably strengthen the revenue base of the public sector and financial capability to launch new projects.

Liberalisation of financing terms will continue, and the number of projects and companies in compliance with the requirements of credit institutions will increase. Preference is still given to production companies with an export potential, and to real estate and construction, provided the projects are related to the aforementioned areas. The sector of trade and commercial real estate shows signs of stabilisation. Vacancy of rental premises will decline and rental prices may increase slightly in the second half of the year. The cash flows as well as lending capacity of projects will improve. However, the aforementioned changes are not sufficient to create demand for additional premises and new projects in the sector. The situation is somewhat different in respect of rental projects related to public sector needs, where we see a clear growth potential. In 2010, the group won two such PPP tenders and we plan to continue in this direction in 2011. The Group's strategy does not foresee inclusion of long-term rental projects in its balance sheet and our goal is the sale of projects after these become functional to long-term investors. In 2011, we expect the interest of financial investors in functional real estate projects to increase and several large-scale sales transactions to be concluded in this area. Although such sales have no direct impact on the construction sector, it is still quite probable that some of the capital that becomes available will be reinvested in real estate at some point in time and new projects will be launched with the help of available funds.

There is no reason to expect fast improvement of demand in the market of residential premises, the confidence of people and their incomes are still low and the debt burden is high. However, the supply of residential premises is decreasing and there are conditions underway in the market for undersupply. In Estonia and Lithuania, the interest of banks in residential real estate both in respect of end consumers (apartment buyers) as well as developers was already evident in 2010. This year, we also expect positive changes in the Latvian market. Stabilisation of the economic environment and a favourable price level of residential premises will lure foreign capital back to the market, both apartments as well as registered immovables with a development potential will be acquired. Due to the demand growth, we expect appreciation of the prices of residential premises by 10-15% in 2011.

The year 2011 should be a break-through year for the construction sector - negative trends prevailing in the previous period should continue in the first half of the year, but the market should stabilise by the end of the year. The companies which have survived the crisis enter a new economic cycle and the profitability of the sector will improve. Although the golden period of the ending economic cycle with its extensive investments in the construction and real estate sector remained in the first half of 2010, the year 2011 may also offer interesting investment opportunities.

Corporate Governance Code (CGC)

From 2006, the Corporate Governance Code (CGC) which lays down the general principles for managing entities and treating shareholders applies to the issuers of equity securities which are listed on NASDAQ OMX Tallinn Stock Exchange. The CGC principles are recommended to the publicly traded companies and the entities are free to decide whether to follow the main CGC principles or not. The Corporate Governance Code is based on the principle of *follow or explain* according to which an entity shall explain its standpoints and activities with regard to those CGC provisions which it does not follow.

Merko Ehitus places great value on the equal treatment of its shareholders, the transparency of the Company's management processes as well as the reliability of its activities. This report deals with those CGC principles which AS Merko Ehitus does not follow for technical, economic or other reasons.

I General Meeting of Shareholders

The Company's highest governing body is the General Meeting of Shareholders, the authority of which is regulated by legislation and the articles of association of the Company.

The Company shall announce the time, place, and agenda of the General Meeting as well as the recommendations of the Supervisory Board with regard to the items on the agenda in a national daily newspaper, on the Company's web site and through the stock exchange system. The General Meeting shall be held at the place shown in the notice, on a working day and between 9 a.m. and 6 p.m., enabling most of the shareholders to participate in the General Meeting of Shareholders. Any shareholder or his authorised representative may participate in the General Meeting. No picture taking or filming is allowed at the General Meeting, because it may disturb the privacy of shareholders. Participation in the General Meeting cannot be accomplished through the means of communication because there are no reliable ways to identify shareholders and to ensure the privacy of participating shareholders.

On behalf of the Company, the Chairman of the Management Board and the Chairman of the Supervisory Board shall participate in the General Meeting of AS Merko Ehitus, and if necessary, other members of the Management and Supervisory Boards shall be involved. The Company does not consider the participation of all members of the Management and Supervisory Boards in the General Meeting relevant.

II Management Board

The Management Board of AS Merko Ehitus has six members, and it represents the Company and manages its daily operations. The activities of the members of the Management Board are divided by areas of operation: general management – Tiit Roben, construction – Andres Agukas, technology – Veljo Viitmann, finance – Alar Lagus, development – Jaan Mäe, quality management and supervision – Viktor Mõisja. The Chairman of the Management Board, Tiit Roben, oversees the work of the Management Board.

The members of the Management Board have entered into three-year service contracts with the Company. The Company discloses the total amount of remuneration and bonuses paid to the members of the Management Board in the annual report, as it believes that the disclosure of personalised remuneration does not create additional value but disturbs the privacy of the members of the Management Board. Upon premature termination or non-extension of the service contract and under the condition that the members of the Management Board shall not compete with the Company, severance pay shall be paid to the members of

the Management Board equalling twenty-four month basic remuneration of the member of the Management Board.

In paying bonuses to the members of the Management Board, the financial performance of the group and entities governed by the Management Board shall be considered. On reviewing the quarterly results of operations, the Supervisory Board of the Company shall review and approve the bonuses payable to the Management Board. Twenty-five per cent of the bonuses payable on the basis of interim financial statements shall be withheld and paid after the approval of the annual report by the General Meeting of Shareholders. No share options have been used to motivate the members of the Management Board.

III Supervisory Board

The General Meeting of Shareholders shall elect the Supervisory Board. The Supervisory Board shall determine the Company's operating strategy, endorse the transactions as authorised by the articles of association, elect the members of the Management Board and monitor the performance of the Management Board during the time the General Meetings are not held. The Supervisory Board of AS Merko Ehitus has four members: Teet Roopalu, Indrek Neivelt, Olari Taal and Chairman of the Supervisory Board, Tõnu Toomik.

The General Meeting of Shareholders shall approve the remuneration of the members of the Supervisory Board. The order of remuneration of the current Supervisory Board was approved by the General Meeting of Shareholders held at 31 October 2008.

Upon premature termination or non-extension of the powers, no severance pay is paid to the members of the Supervisory Board.

IV Collaboration of the Management and Supervisory Boards

To ensure that the Company's interests are met in the best way possible, the Management and Supervisory Boards shall extensively collaborate. At least once a month, a joint meeting of the members of the Supervisory and Management Boards shall take place, in which the Management Board shall inform the Supervisory Board of significant issues regarding the Company's business operations, the fulfilment of the Company's short and long-term goals and the risks impacting them.

V Disclosure of information

In disclosing information, AS Merko Ehitus shall follow the rules and regulations of NASDAQ OMX Tallinn Stock Exchange and immediately disclose important information regarding the Company's activities to the shareholders after obtaining reasonable assurance as to its correctness and that the disclosure of such information shall not harm the interests of the Company and its business partners. In respect of construction contracts entered into, contracts with the volume of EUR 10 million and higher shall be disclosed separately in stock exchange releases. Important information shall be disclosed through the stock exchange system and on the Company's Web site.

During the year, Merko Ehitus shall not publish the dates for disclosing information, the so-called financial calendar, because the disclosure of reliable dates would incorporate additional time factor into the dates and endanger the timeliness of disclosures. Merko Ehitus shall generally publish important information regarding

the Company after the end of the trading day and shall inform its shareholders about publishing interim financial statements and the annual report at least two days prior to their disclosure.

If possible, the Company shall participate in the presentations and press conferences arranged by analysts and investors. The information made available at the meetings is public, i.e. available in the reports of the Company, on its Web site or other public sources. We believe that the publication of the schedule for meetings does not provide any valuable additional information for the shareholders and therefore, such information shall not be published.

VI Election of an auditor and auditing the financial statements

The Company's financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

In electing the auditor, the Company shall consider auditor's independence, competence, reliability and the price of the service. The Company shall not publish the fees paid for the provision of auditing and consulting services, because such activities may significantly impair the Company's ability to obtain the service for a competitive price in the future.

When proposing to elect a new auditor, the Supervisory Board shall also present its rationale for the change to the General Meeting of Shareholders. In extending the contract with the auditor who audited the Company in the previous financial year, the Supervisory Board shall acknowledge with its choice that the auditor has fulfilled the expectations laid on him/her and the Supervisory Board is content with the quality of the service provided.

Audit committee

The responsibility of the audit committee is advising the Supervisory Board in supervision related issues. The Committee executes supervision in the areas of : a) arrangement of accounting, b) preparation and approval of the financial budget and reports, c) management of financial risks, d) performance of external audit, e) functioning of the internal control system and f) legality of the activities.

The Company's Supervisory Board set up a 3-member audit committee and appointed Indrek Neivelt and Olari Taal as its members and Teet Roopalu as its Chairman. A member of the committee is elected for a term of three years, but at the decision of the Supervisory Board, a member of the committee may be removed before the expiration of his term of office.

The meetings of the audit committee are held not less frequently than once every three months.

The Management Board of AS Merko Ehitus acknowledges and confirms that to the best of management's knowledge, the management report for the 2010 financial year presents a true and fair view of the business development and results, and the financial position of the Issuer and the consolidation group entities, and it includes a description of the main risks and uncertainties.

Tiit Roben Chairman of the Management Board



12.04.2011

Alar Lagus Member of the Management Board



12.04.2011

Veljo Viitmann Member of the Management Board



12.04.2011

Andres Agukas Member of the Management Board



12.04.2011

Jaan Mäe Member of the Management Board



12.04.2011

Viktor Mõisja Member of the Management Board



12.04.2011

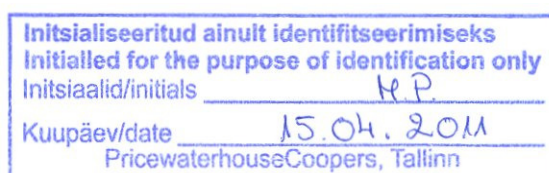
FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

In thousands of

		EEK		EUR	
	Note	2010	2009	2010	2009
Revenue	3	2,689,947	3,181,209	171,919	203,316
Cost of goods sold	4	(2,489,455)	(2,835,169)	(159,105)	(181,200)
Gross profit		200,492	346,040	12,814	22,116
Marketing expenses	5	(34,312)	(47,094)	(2,193)	(3,009)
General and administrative expenses	6	(136,505)	(154,000)	(8,724)	(9,842)
Other operating income	7	15,041	14,408	961	921
Other operating expenses	8	(7,480)	(27,326)	(478)	(1,746)
Operating profit		37,236	132,028	2,380	8,440
Finance income	9	10,900	39,517	696	2,525
Finance costs	10	(14,214)	(24,597)	(908)	(1,573)
Profit/loss from associates and joint ventures	20	(6,220)	(27,090)	(398)	(1,731)
Profit before tax		27,702	119,858	1,770	7,661
Corporate income tax expense	11	(11,108)	(8,496)	(710)	(543)
Net profit for financial year		16,594	111,362	1,060	7,118
incl. net profit attributable to equity holders of the parent		19,232	116,166	1,229	7,424
net profit attributable to non-controlling interest		(2,638)	(4,804)	(169)	(306)
Other comprehensive income					
Currency translation differences of foreign entities		364	(2,266)	23	(145)
Comprehensive income for the period		16,958	109,096	1,083	6,973
incl. net profit attributable to equity holders of the parent		19,596	113,900	1,252	7,279
net profit attributable to non-controlling interest		(2,638)	(4,804)	(169)	(306)
Earnings per share for profit attributable to equity holders of the parent (basic and diluted, in EEK/EUR)	12	1.09	6.56	0.07	0.42

The notes set out on pages 31-80 are an integral part of these consolidated financial statements.



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

In thousands of

		EEK		EUR	
	Note	31.12.2010	31.12.2009	31.12.2010	31.12.2009
ASSETS					
Current assets					
Cash and cash equivalents	14	154,211	359,732	9,856	22,991
Short-term deposits	15	41,475	400,916	2,651	25,623
Trade and other receivables	16	703,141	661,954	44,938	42,306
Prepaid corporate income tax		21,377	3,885	1,366	248
Inventories	18	1,455,872	1,536,463	93,048	98,199
		<u>2,376,076</u>	<u>2,962,950</u>	<u>151,859</u>	<u>189,367</u>
Non-current assets					
Investments in associates and joint ventures	20	172,939	179,421	11,053	11,467
Other long-term loans and receivables	21	129,207	32,468	8,258	2,075
Deferred income tax assets	22	24,587	32,069	1,571	2,050
Investment property	23	56,086	16,552	3,585	1,058
Property, plant and equipment	24	277,681	266,276	17,747	17,018
Intangible assets	25	23,596	24,238	1,508	1,549
		<u>684,096</u>	<u>551,024</u>	<u>43,722</u>	<u>35,217</u>
TOTAL ASSETS		<u>3,060,172</u>	<u>3,513,974</u>	<u>195,581</u>	<u>224,584</u>
LIABILITIES					
Current liabilities					
Borrowings	27	196,430	447,569	12,554	28,605
Trade and other payables	28	612,609	782,470	39,154	50,009
Corporate income tax liability		-	5,249	-	335
Provisions	29	57,484	37,702	3,674	2,410
		<u>866,523</u>	<u>1,272,990</u>	<u>55,382</u>	<u>81,359</u>
Non-current liabilities					
Long-term borrowings	27	206,294	76,316	13,185	4,878
Other long-term trade payables	30	13,235	10,658	846	681
		<u>219,529</u>	<u>86,974</u>	<u>14,031</u>	<u>5,559</u>
TOTAL LIABILITIES		<u>1,086,052</u>	<u>1,359,964</u>	<u>69,413</u>	<u>86,918</u>
EQUITY					
Non-controlling interest		22,343	27,129	1,428	1,734
Equity attributable to equity holders of the parent					
Share capital	32	177,000	177,000	11,312	11,312
Statutory reserve capital		17,700	17,700	1,131	1,131
Currency translation differences		(14,452)	(14,816)	(924)	(947)
Retained earnings		1,771,529	1,946,997	113,221	124,436
		<u>1,951,777</u>	<u>2,126,881</u>	<u>124,740</u>	<u>135,932</u>
TOTAL EQUITY		<u>1,974,120</u>	<u>2,154,010</u>	<u>126,168</u>	<u>137,666</u>
TOTAL LIABILITIES AND EQUITY		<u>3,060,172</u>	<u>3,513,974</u>	<u>195,581</u>	<u>224,584</u>

The notes set out on pages 31-80 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

In thousands of EEK	Note	Equity attributable to equity holders of the parent					Non-controlling interest	Total
		Share capital	Statutory reserve capital	Currency translation differences	Retained earnings	Total		
Balance as at 31.12.2008		177,000	17,700	(12,550)	1,892,781	2,074,931	34,633	2,109,564
Comprehensive income for the financial year		-	-	(2,266)	116,166	113,900	(4,804)	109,096
Dividends	13	-	-	-	(61,950)	(61,950)	(2,700)	(64,650)
Balance as at 31.12.2009		177,000	17,700	(14,816)	1,946,997	2,126,881	27,129	2,154,010
Comprehensive income for the financial year		-	-	364	19,232	19,596	(2,638)	16,958
Dividends	13	-	-	-	(194,700)	(194,700)	-	(194,700)
Acquisition of non-controlling interest		-	-	-	-	-	(2,148)	(2,148)
Balance as at 31.12.2010		177,000	17,700	(14,452)	1,771,529	1,951,777	22,343	1,974,120

In thousands of EUR	Note	Equity attributable to equity holders of the parent					Non-controlling interest	Total
		Share capital	Statutory reserve capital	Currency translation differences	Retained earnings	Total		
Balance as at 31.12.2008		11,312	1,131	(802)	120,971	132,612	2,213	134,825
Comprehensive income for the financial year		-	-	(145)	7,424	7,279	(306)	6,973
Dividends	13	-	-	-	(3,959)	(3,959)	(173)	(4,132)
Balance as at 31.12.2009		11,312	1,131	(947)	124,436	135,932	1,734	137,666
Comprehensive income for the financial year		-	-	23	1,229	1,252	(169)	1,083
Dividends	13	-	-	-	(12,444)	(12,444)	-	(12,444)
Acquisition of non-controlling interest		-	-	-	-	-	(137)	(137)
Balance as at 31.12.2010		11,312	1,131	(924)	113,221	124,740	1,428	126,168

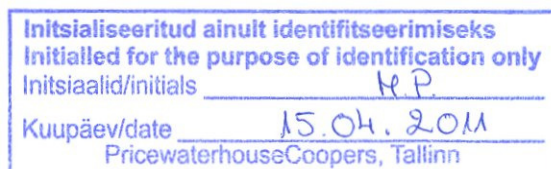
The notes set out on pages 31-80 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

In thousands of

		EEK		EUR	
	Note	2010	2009	2010	2009
Cash flows from operating activities					
Operating profit		37,236	132,028	2,380	8,440
Adjustments:					
Depreciation and impairment charge	23-25	37,969	37,471	2,427	2,395
Profit/loss from sales of non-current assets	7	(1,185)	(519)	(76)	(33)
Change in receivables and liabilities related to construction contracts recognised under the stage of completion method		(365,425)	56,548	(23,355)	3,614
Interest income from business activities		(9,817)	(4,476)	(627)	(286)
Change in provisions		10,069	(2,327)	644	(149)
Change in trade and other receivables related to operat. activities		29,381	223,055	1,878	14,256
Change in inventories		87,528	281,116	5,593	17,966
Change in trade and other payables related to operat. activities		97,986	(306,272)	6,261	(19,574)
Interest paid		(13,415)	(28,157)	(857)	(1,800)
Other finance income		(66)	(62)	(4)	(5)
Corporate income tax paid		(23,491)	(19,971)	(1,501)	(1,276)
Total cash flows from operating activities		(113,230)	368,434	(7,237)	23,548
Cash flows from investing activities					
Investment in subsidiaries	19	(1,110)	(62,069)	(71)	(3,967)
Proceeds from sale of subsidiaries		-	1,125	-	71
Investments in associates and joint ventures		(22)	-	(1)	-
Proceeds from sale of associates and joint ventures		24	-	2	-
Purchase/proceeds of/from deposits with maturities greater than 3 months		359,441	(138,157)	22,972	(8,830)
Purchase of investment property		(40,977)	-	(2,619)	-
Proceeds from sale of investment property		-	1,250	-	80
Purchase of property, plant and equipment		(12,613)	(13,222)	(806)	(845)
Proceeds from sale of property, plant and equipment		2,830	1,298	181	83
Purchase of intangible assets		(1,420)	(985)	(91)	(63)
Proceeds from sale of intangible assets		816	134	52	9
Loans granted	17	(126,681)	(65,885)	(8,096)	(4,211)
Loan repayments received	17	64,610	45,793	4,129	2,927
Interest received		12,579	31,968	804	2,043
Dividends received		220	-	14	-
Total cash flows from investing activities	20	257,697	(198,750)	16,470	(12,703)
Cash flows from financing activities					
Proceeds from borrowings	27	33,088	56,841	2,115	3,633
Repayments of borrowings	27	(168,208)	(300,698)	(10,750)	(19,218)
Finance lease principal payments	27	(22,647)	(17,476)	(1,447)	(1,118)
Dividends paid	13	(194,700)	(64,650)	(12,444)	(4,132)
Cash flows from financing activities		(352,467)	(325,983)	(22,526)	(20,835)
Net increase/decrease in cash and cash equivalents		(208,000)	(156,299)	(13,293)	(9,990)
Change in deposits with maturities greater than 3 months		(359,441)	138,157	(22,972)	8,830
Total change		(567,441)	(18,142)	(36,265)	(1,160)
Cash and cash equivalents at the beginning of the period	14	359,732	515,191	22,991	32,927
Deposits with maturities greater than 3 months at the beginning of the period		400,916	262,759	25,623	16,793
Total at the beginning of the period		760,648	777,950	48,614	49,720
Effect of exchange rate changes		2,479	840	158	54
Cash and cash equivalents at the end of the period	14	154,211	359,732	9,856	22,991
Deposits with maturities greater than 3m at the end of period		41,475	400,916	2,651	25,623
Total at the end of the period		195,686	760,648	12,507	48,614

The notes set out on pages 31-80 are an integral part of these consolidated financial statements.



NOTES

Note 1 Summary of significant accounting policies

1.1. General information

The consolidated financial statements of AS Merko Ehitus (hereinafter the parent) and its subsidiaries (hereinafter the group) for the financial year ended 31 December 2010 were signed by the Management Board at 12 April 2011.

Pursuant to the Commercial Code of the Republic of Estonia, the annual report prepared by the Management Board and approved by the Supervisory Board and which also includes the consolidated financial statements shall be approved at the General Meeting of Shareholders. Shareholders have the right not to approve the annual report prepared and presented by the Management Board and require preparation of a new annual report.

AS Merko Ehitus is a corporation registered in the Republic of Estonia (Commercial Register no.: 11520257, address: Järvevana tee 9G, Tallinn) and it operates in Estonia, Latvia and Lithuania. Its main activities are construction and real estate development.

From 22 July 1997, the shares of AS Merko Ehitus are listed on the Tallinn Stock Exchange. As at 31 December 2010, the majority shareholder AS Riverito owned 71.99% of the Company's shares through which the ultimate controlling person is Toomas Annus.

AS Merko Ehitus was established in the demerger of the former AS Merko Ehitus, currently AS Järvevana, as a result of which all operating areas, i.e. all assets and liabilities other than the liabilities related to the criminal proceeding, were transferred to the new entity.

1.2. Bases for preparation of the consolidated financial statements

The consolidated financial statements of Merko Ehitus group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

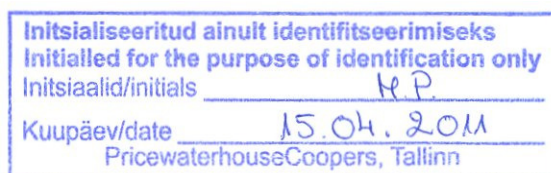
The consolidated financial statements have been prepared under the historical cost convention.

Several financial figures are based on management's estimates, including for example, assessment of profitability of construction contracts using the stage of completion method, assessment of the useful lives of items of property, plant and equipment, estimation of allowances for receivables and inventories, recognition of provisions for warranty obligations. Management's estimates have been made to the best of its knowledge, but they may not be accurate. The effect of changes in accounting estimates is reported in the financial statements of the period in which the change occurred.

Assets and liabilities are classified as current and non-current in statement of financial position. Current assets include assets that are expected to be used within the next financial year. Current liabilities include liabilities the due date of which is within 12 months after the balance sheet date. The remaining assets and liabilities are classified as non-current.

Expenses are classified according to their function in the income statement.

Items included in the financial statements of each of the group entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency): the Estonian kroon, Latvian lats and the Lithuanian litas. The consolidated financial statements are presented in Estonian kroons. The primary financial statements and notes are presented in thousands of kroons. Pursuant to the requirements of the NASDAQ OMX Tallinn Stock Exchange, the primary financial statements are also presented in thousands of euros. As at 31.12.2010 the Estonian kroon is pegged to the Euro (EUR 1=EEK 15.6466), no exchange rate differences arise in the translation of the financial statements. From 01.01.2011, Estonia is part of the Eurozone (Note 1.27).



1.3. New International Financial Reporting Standards, amendments to published standards and interpretations of the International Financial Reporting Interpretations Committee (IFRIC)

a) Standards, amendments to standards and interpretations effective for group's financial year beginning on 1 January 2010.

IFRIC 12, Service Concession Arrangements (as adopted by the EU, effective for annual periods beginning on or after 30 March 2009). The interpretation contains guidance on applying the existing standards by service providers in public-to-private service concession arrangements. Application of the interpretation did not have any impact on the group's financial statements because its accounting policies were in compliance with the interpretation.

IFRIC 15, Agreements for the Construction of Real Estate (as adopted by the EU, effective for annual periods beginning after 31 December 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. Application of IFRIC 15 did not have any impact on the group's financial statements because its accounting policies were in compliance with the interpretation.

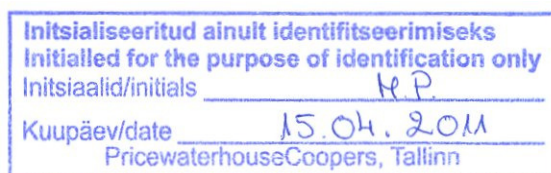
Improvements to International Financial Reporting Standards, issued in April 2009 (amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The amendments did not have a material impact on the group's financial statements.

Amendment to IFRS 5, Non-current Assets Held for Sale and Discontinued Operations (and consequential amendments to IFRS 1) (effective for annual periods beginning on or after 1 July 2009). This amendment to IFRS 5 is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that an entity committed to a sale plan involving loss of control of a subsidiary would classify the subsidiary's assets and liabilities as held for sale. The revised guidance should be applied prospectively from the date at which the entity first applied IFRS 5. The amendment did not have a material impact on the group's financial statements.

Standards, amendments to standards and interpretations which became effective in 2010 but which are not relevant to the group's operations.

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009

IFRIC 16, Hedges of a Net Investment in a Foreign Operation



IFRIC 17, Distributions of Non-Cash Assets to Owners

IFRIC 18, Transfers of Assets from Customers

IFRS 1, First-time Adoption of International Financial Reporting Standards, revised in December 2008

Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2

Additional Exemptions for First-time Adopters - Amendments to IFRS 1

Eligible Hedged Items—Amendment to IAS 39

b) New standards, amendments to standards and interpretations effective for annual periods beginning on or after 1 January 2011 and which the group has not early adopted.

By the time of preparing these financial statements, new International Financial Reporting Standards and their interpretations have been issued which are effective for the group's annual periods beginning on or after 1 January 2011 but that the group has not adopted early. Below is an estimate of the group's management on the potential effect of new standards and interpretations to the financial statements in the period of their first-time adoption:

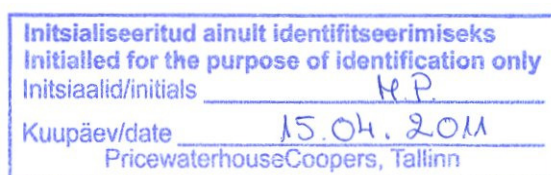
IFRS 9, Financial Instruments Part 1: Classification and Measurement, issued in November 2009 (effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU). IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2009 to address the classification and measurement of financial liabilities. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated as at fair value through profit or loss in other comprehensive income.

The group is considering the implications of the standard, the impact on the group and the timing of its adoption by the group.

Amendment to IAS 24, Related Party Disclosures, (issued in November 2009, effective for annual periods beginning on or after 1 January 2011). The amended standard simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. The group is currently assessing the impact of the amended standard on disclosures in its financial statements.

Improvements to International Financial Reporting Standards, issued in May 2010 (effective dates vary standard by standard, most improvements are effective for annual periods beginning on or after 1 January 2011). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous GAAP carrying amount to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS



financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period; IAS 1 was amended to clarify that the components of the statement of changes in equity include profit or loss, other comprehensive income, total comprehensive income and transactions with owners and that an analysis of other comprehensive income by item may be presented in the notes; IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2008); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of a fair value hierarchy, changes in classification of financial assets or changes in a business or economic environment that affect the fair values of the entity's financial instruments; and IFRIC 13 was amended to clarify measurement of fair value of award credits. The group is currently assessing the impact of the amended standards on its consolidated financial statements.

Disclosures—Transfers of Financial Assets – Amendment to IFRS 7 (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party yet remain in the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The group is currently assessing the impact of the amended standard on disclosures in its financial statements.

c) New standards, amendments to standards and interpretations effective for annual periods beginning on or after 1 January 2011 that the group has not adopted early and that are not relevant to the group's operations:

IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments (effective for annual periods beginning on or after 1 July 2010).

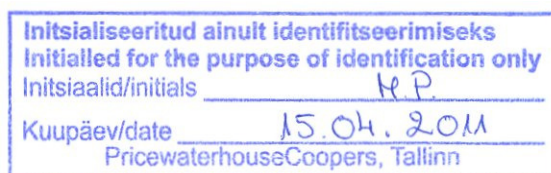
Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14 (effective for annual periods beginning on or after 1 January 2011).

Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters – Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2010).

Classification of Rights Issues – Amendment to IAS 32, issued in October 2009 (effective for annual periods beginning on or after 1 February 2010).

Deferred Tax: Recovery of Underlying Assets – Amendment to IAS 12 (effective for annual periods beginning on or after 1 January 2012; not yet adopted by the EU). The amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value.

Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters – Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU). The amendments will provide relief for first-time adopters of IFRSs from having to reconstruct transactions that occurred before



their date of transition to IFRSs, and guidance for entities emerging from severe hyperinflation either to resume presenting IFRS financial statements or to present IFRS financial statements for the first time.

1.4. Consolidation

Subsidiaries or entities that are either directly or indirectly through fellow subsidiaries controlled by the parent AS Merko Ehitus, have been consolidated on a line-by-line basis in the consolidated financial statements. Control exists when the parent owns more than one half of the voting power of the subsidiary or otherwise has power to govern the operating and financial policies of the other entity. Subsidiaries are fully consolidated in the financial statements of the group from the date of acquiring control until the date at which control ceases.

Upon consolidation, intra-group receivables and liabilities, income and expenses as well as unrealised profits and losses arising from intra-group transactions have been eliminated unless a loss is caused by impairment.

Group entities use uniform accounting policies.

1.5. Business combinations

The group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. From the date of acquisition, the revenue and expenses of the acquired entity are reported in the income statement of the group and goodwill is reported in the statement of financial position of the group.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the statement of comprehensive income.

Goodwill is subsequently measured at its cost less any impairment losses. Goodwill arising in a business combination is not amortised. Instead, an impairment test is carried out once a year. Goodwill is written down to its recoverable amount if the carrying amount is not recoverable (Note 1.11).

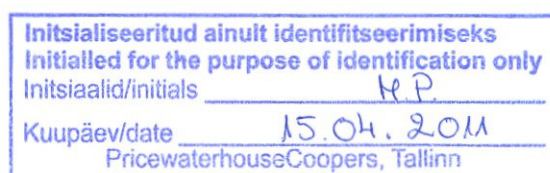
If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Transactions with non-controlling interests

The group treats transactions with non-controlling interests as transactions with equity owners of the group starting from 1 January 2010. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying amount of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity. Until 31 December 2009, the transactions with the shareholders or owners of non-controlling interests were treated as transactions with non-group third parties. Gains and losses from the transfer of non-controlling interests were taken to profit or loss. At the acquisition of a non-controlling interest, the difference between the purchase price and the carrying amount of the net assets corresponding to the acquired interest was recognised as goodwill.

1.6. Associates

Associates are all entities in which the group has significant influence but not control over their operating and financial policies. Significant influence is presumed to exist when the parent owns between 20% and 50% of



the voting rights. Investments in associates are initially recognised at cost and subsequently measured using the equity method of accounting. Investments in associates include goodwill identified on acquisition.

The group's share of its associates' post-acquisition profits or losses is recognised at the group's income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the group's share of losses in an associate equals or exceeds its interest in the associate, the group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the group and its associates are eliminated to the extent of the group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. The accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the group.

1.7. Joint ventures

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to common control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at cost and subsequently adjusted by the post-acquisition changes that have occurred at the group's share of the net assets under common control. The income statement of the group includes the group's share in the profits or losses of the entity under common control. Unrealised gains and losses from transactions between the group and its joint ventures are eliminated similarly to transactions with associates (Note 1.6).

1.8. Jointly controlled operations

Under IAS 31 *Interests in Joint Ventures*, jointly controlled operations are joint operations with third parties, whereby the assets and other resources of venturers are used without the establishment of a new entity or another unit or creation of a separate financial structure. Each venturer uses its own property, plant and equipment and carries its own inventories in the statement of financial position. The venturer also incurs its own expenses and liabilities and raises its own funds which represent its own obligations. In respect of its interest in jointly controlled operations, a venturer recognises in its financial statements:

- the assets that it controls and the liabilities that it incurs;
- the expenses that it incurs and its share of revenue that it earns from the sale of goods or services of the joint venture.

1.9. Foreign currency

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia prevailing at the dates of the transactions. Monetary financial assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing at the balance sheet date. Exchange rate differences from translation are reported in the income statement of the reporting period.

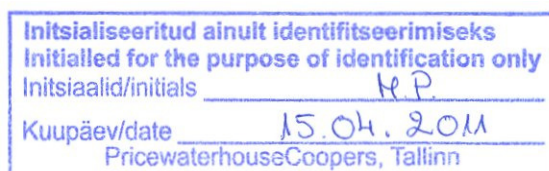
The functional currency of subsidiaries located abroad is the currency of their business environment; therefore the financial statements of such subsidiaries are translated into Estonian kroons for consolidation purposes; the asset and liability items are translated using the foreign exchange rates of the Bank of Estonia prevailing at the balance sheet date, income and expenses using the weighted average foreign exchange rates for the year and other changes in equity using the foreign exchange rates at the date at which they arose. Exchange rate differences arising from translation are reported in the equity item *Currency translation differences*.

1.10. Financial assets

The purchases and sales of financial assets are recognised at the trade date.

Depending on the purpose for which financial assets were acquired, financial assets are classified into the following categories at the group:

- financial assets at fair value through profit or loss;
- loans and receivables



- held-to-maturity investments;
- available-for-sale financial assets.

Management determines the classification of its financial assets at initial recognition.

The Company does not have any held-to-maturity investments, financial assets at fair value through profit or loss and available-for-sale financial assets. The group does not have any derivatives either.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are included within current assets except for maturities greater than 12 months after the balance sheet date. Such assets are classified as non-current assets. Loans and receivables are initially recognised at their fair value less transaction costs. After initial recognition, the group carries loans and receivables at amortised cost (less any impairment losses), calculating interest income on the receivable in the following periods using the effective interest rate method.

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information on the solvency of the party to the transaction. Receivables whose collection is improbable are written down during the reporting period (see also 1.11).

1.11. Impairment of assets

Financial assets at amortised cost

The group assesses at each balance sheet date whether there is any indication that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (loss events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated. Objective evidence that a financial asset or a group of financial assets is impaired includes observable data that is available to the group regarding the following events:

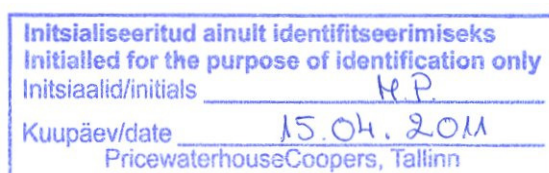
- significant financial difficulties of the debtor;
- a breach of contract, such as a default or delinquency in payments;
- probability that the debtor will enter bankruptcy;
- disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a financial asset or a group of financial assets, although the decrease cannot yet be measured reliably.

If there is objective evidence that an impairment loss has incurred for loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have already been recognised), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can objectively be related to an event occurring after impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Non-financial assets

Assets that have indefinite useful lives are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and 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 its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit). Non-financial assets that suffered an impairment loss are reviewed at each reporting date and if necessary, the impairment loss is reversed except for impairment of goodwill.



1.12. Inventories

Inventories are recorded in the statement of financial position at cost, which consists of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition.

In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishable from each other, then the weighted average cost method is used.

Inventories are recognised in the statement of financial position at the lower of cost and net realisable value. The net realisable value is the sales price less estimated costs to sell.

Expenditure incurred for real estate development is reported either as work-in-progress or finished goods, depending on the stage of completion in the line *Inventories* in the statement of financial position. When the development of property is financed with a loan, the borrowing costs incurred during development are included in the cost of the property. Borrowing costs during the period of construction are capitalised until a permit for use is obtained for the project. Expenses associated with maintenance or usage of the property are not capitalised.

A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Revenue is recognised as income from the sale of goods (Note 1.21). Upon the sale of real estate properties, the group and the acquirer enter into a notarially certified agreement for transferring the property, and a respective entry is made in the land register.

1.13. Investment property

Investment property is a real estate property which is primarily held for the purpose of earning rental income or for capital appreciation or for both, but not for the production of goods or services, administrative purposes or sale in the ordinary course of business. Investment property is measured using the cost method, that is at cost less any accumulated depreciation and any accumulated impairment losses.

Buildings included in investment properties are depreciated on a straight-line basis over the period of 12.5 to 33.3 years. Land is not depreciated.

1.14. Property, plant and equipment

An item of property, plant and equipment is an asset used for production, provision of services or administrative purposes over a period longer than one year. The cost consists of the purchase price of the asset and other expenditure incurred in bringing the asset to its operating condition and location.

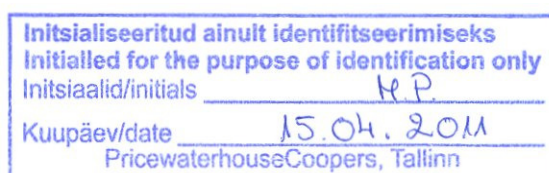
An item of property, plant and equipment is carried in the statement of financial position at its cost less any accumulated depreciation. Subsequent expenditure incurred for items of property, plant and equipment is recognised as non-current assets when it is probable that future economic benefits associated with the asset will flow to the Company and the cost of the asset can be measured reliably. Other repair and maintenance costs are recognised as expenses at the time they are incurred. Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years;
- machinery and equipment 2-20 years;
- other items of property, plant and equipment 2.5-5 years;
- right of superficies 50 years.

Land is not depreciated.

At each balance sheet date, the validity of applied depreciation rates, the depreciation method and the residual values applicable to assets is assessed.

If an item of property, plant and equipment consists of separately identifiable components with different useful lives, these components are accounted for as separate assets and accordingly, separate depreciation rates are set for them depending on their useful lives.



Items of property, plant and equipment are derecognised on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition of items of property, plant and equipment are included either within other operating income or other operating expenses in the income statement.

Non-current assets are written down to their recoverable amount if the latter is lower than their carrying amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

1.15. Intangible assets

Intangible assets are recognised in the statement of financial position when the asset can be controlled by the Company, the expected future benefits attributable to the asset will flow to the Company and the cost of the asset can be measured reliably. The cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Intangible assets are carried in the statement of financial position at cost less any accumulated amortisation and any accumulated impairment losses. Goodwill is not amortised.

Software and information systems

The costs related to the development of information systems and software which are reported as intangible assets, are depreciated under a straight-line method over their estimated useful lives (2-10 years).

1.16. Finance and operating leases

Leases of property, plant and equipment which transfer all significant risks and rewards of ownership to the lessee are classified as finance leases. All other leases are recognised as operating leases.

Assets and liabilities leased under the finance lease terms are reported in the statement of financial position at the lower of fair value of the leased asset and the present value of minimum rental payments. Items of property, plant and equipment leased under the finance lease terms are depreciated over the shorter of the lease term and the useful life.

Finance lease liabilities are reduced by principal payments; interest expenses on lease payments are included within finance costs in the income statement. Finance costs are allocated to the rental period so as to achieve a constant periodic rate of interest on the remaining balance of the liability.

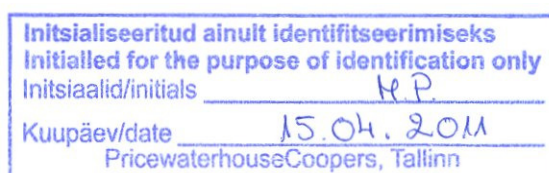
Operating lease payments are reported in the income statement as expenses on a straight-line basis over the lease term.

1.17. Financial liabilities

All financial liabilities (trade payables, borrowings, and other short and long-term borrowings) are initially recorded at their fair value and are subsequently stated at amortised cost, using the effective interest rate method. The amortised cost of current financial liabilities normally equals their nominal value; therefore current financial liabilities are stated in the statement of financial position in their redemption value. To calculate the amortised cost of non-current financial liabilities, they are initially recognised at fair value of the proceeds received (net of transaction costs incurred) and an interest cost is calculated on the liability in subsequent periods using the effective interest rate method.

Financial liabilities are classified as current when they are due to be settled within twelve months after the balance sheet date; or the group does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Borrowings that are due within 12 months after the balance sheet date, but which are refinanced after the balance sheet date as non-current, are recognised as current ones. Also, borrowings are classified as current if the lender had a contractual right at the balance sheet date to demand immediate repayment of the borrowing due to the breach of conditions set forth in the agreement.

Borrowing costs directly related to the acquisition and construction of a real estate property until the property is ready for use or sale, are capitalised. In other cases, borrowing costs are recognised as an expense in the period in which they are incurred.



1.18. Corporate income tax

According to the Income Tax Act of the Republic of Estonia, legal entities are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, costs of entertaining guests, dividends and payments not related to business operations. Thus, in Estonia there are no differences between the tax bases and the carrying amounts of assets which would give rise to a deferred income tax asset or liability. From 01.01.2010, the tax rate on dividends payable is 21/79 (in 2009 and 2008: 21/79) of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared.

Corporate income tax on profits and deferred income tax expense or income of the subsidiaries located in Latvia and Lithuania as well as corporate income tax on dividends of Estonian entities are reported in the consolidated income statement.

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying amount. Deferred tax assets are recognised at the group's statement of financial position if their future realisation is probable.

Legal entities in Latvia and Lithuania that are part of the group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia and the Republic of Lithuania. The profits of entities located in the Republic of Latvia are taxed at the rate of 15% (2009: 15%) and the profits of entities located in the Republic of Lithuania are taxed at the rate of 15% (2009: 20%).

1.19. Employee benefits

Termination benefits

Termination benefits are payable when employment is terminated by the group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without a possibility of withdrawal; or providing termination benefits as a result of another offer made to encourage voluntary redundancy. Termination benefits are discounted to their present value.

Profit-sharing and bonus plans

The Company recognises a liability and an expense for bonuses and profit-sharing plans, based on a formula that takes into consideration the profit attributable to the parent's shareholders after certain adjustments. The group recognises a provision where contractually obliged or when there is past practice that has created a constructive obligation.

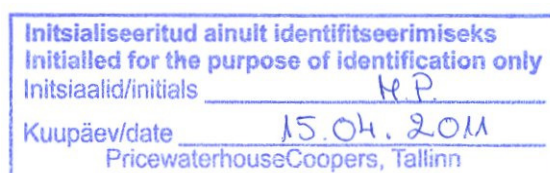
1.20. Provisions

Provisions are probable constructive or legal obligations which arise as a result of events occurring before the balance sheet date. Setting up of provisions or increasing existing provisions is recognised as expense in the income statement of the reporting period.

Provisions are recognised in the statement of financial position based on the best estimate of the management board at the present value of the expenditure expected to be sufficient to settle the obligation. A pre-tax rate of discount is used, which reflects current market valuations of the time value of money and the risks associated with liabilities that are not already included in the best estimate of the related expenses.

Pursuant to respective building regulations, the construction companies of the group provide 2-year warranties on their buildings. The calculation of warranty provisions is based on management estimates and previous periods' experience with regard to actual warranty expenses.

The expected loss arising from construction contracts is immediately recognised as an expense. A provision is recognised for onerous construction contracts which have not been completed yet (Note 1.22).



1.21. Revenue

Revenue is recognised at the fair value of the consideration received or receivable.

Revenue from the provision of construction services is recognised as revenue by reference to the stage of completion of the contract (see Note 1.22) in accordance with IAS 11 *Construction Contracts*. Revenue from own real estate development projects (private houses, apartments, office premises, etc. that have been built on the registered immovables owned by entities of Merko Ehitus group) is recognised as revenue in accordance with IAS 18 *Revenue* when significant risks and rewards of ownership of the goods are transferred to the buyer, the receipt of payment is probable and the costs incurred in respect of the transaction can be measured reliably.

When goods are sold or swapped in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. Revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents received or paid. When the fair value of the goods or services received cannot be measured reliably, revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents received or paid.

Revenue from the provision of services is recognised based on the stage of completion of the service at the balance sheet date.

Revenue arising from interest and dividends is recognised when it is probable that future economic benefits associated with the transaction will flow to the entity and the amount of revenue can be measured reliably.

1.22. Construction contracts in progress

Income and expenses of construction contracts in progress have been matched under the stage of completion method. The stage of completion is determined on the basis of the relationship between the actual costs incurred by the balance sheet date and the estimated costs of the contract. The actual costs of the contract consist of direct and overhead costs of the construction contract.

If invoices submitted to the customer by the balance sheet date are either higher or lower than the income calculated under the stage of completion method, then the difference is recognised as a liability or as a receivable in the statement of financial position.

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

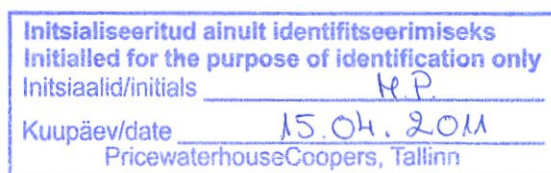
1.23. Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs, which they are intended to compensate. Government grants received to compensate the operating expenses of the previous period or where there are no additional conditions attached to grants to be addressed in the future, are accounted for as income when the grant is received. Government grants are recognised when there is reasonable assurance that the grant will be received and the group will comply with all attached conditions. The gross method is used for recognition of government grants.

1.24. Cash and cash equivalents

In the balance sheet and the cash flow statement, cash and cash equivalents comprise highly liquid funds with low variation in value, such as cash on hand, cash in bank accounts and term deposits with maturities of three months or less. Management regards deposits with maturities greater than 3 months as investments and hence does not include these in cash and cash equivalents. In addition to changes in cash and its equivalents, the consolidated cash flow statement also includes changes in short-term bank deposits with maturities greater than 3 months due to the possibility of using these deposits immediately as the need arises without a significant effect on the group's financial position.

The indirect method has been used for the preparation of the cash flow statement.



1.25. Contingent liabilities

Contingent liabilities are those liabilities the realisation of which is less probable than non-realisation and the amount of which cannot be determined reliably. Contingent liabilities are not recognised in the statement of financial position, but they are disclosed in the notes to the financial statements.

1.26. Statutory reserve capital

Reserve capital is formed to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be entered in 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.

1.27. Events after the balance sheet date

The financial statements of the reporting period include material circumstances affecting the assessment of assets and liabilities which became evident between the balance sheet date and the date of preparing the financial statements but that are related to transactions in the reporting period or previous periods. Material events after the balance sheet date not related to transactions in the reporting period or previous periods are not reported in the statement of financial position but they are disclosed in the notes to the financial statements.

At 1 January 2011, the Republic of Estonia joined the euro area and adopted the euro as a national currency, replacing the Estonian kroon. Consequently, the functional currency of AS Merko Ehitus is the euro from 2011 and the annual reports for 2011 and subsequent years to be submitted to the Commercial Register will be presented in euros. Comparative figures will be recalculated to euros using the conversion rate of EUR 1 = EEK 15.6466, which is the fixed exchange rate that was applicable also in earlier periods.

1.28. Dividends

The distribution of dividends to the Company's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

1.29. Segment reporting

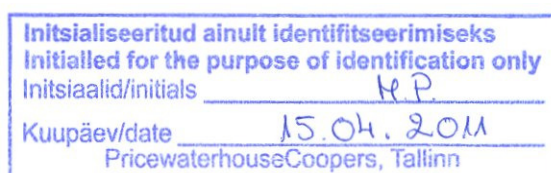
According to IFRS 8 *Operating Segments*, segment reporting is applicable to operating segments whose results are regularly reviewed by the entity's chief operating decision maker to make business-related decisions. Operating segments are components of the entity for which it is possible to obtain discrete financial information to make decisions about resources to be allocated to the segment and assess its performance.

The group's Management Board classifies its operations into the following segments based on internal management information:

- construction of buildings,
- construction of facilities,
- road construction,
- real estate,
- other

The first three segments relate to the provision of construction services. The real estate segment is primarily based on its own real estate development – construction and sale, and to a lesser degree, maintenance and leasing of real estate. Other activities (management related service, security services, etc.) are immaterial from the group's standpoint and they are not reported as separate operating segments in the financial statements. For the purpose of segment reporting, each cost item to be disclosed is the amount which is presented to the Company's management for making decisions regarding allocation of funds to the segment and evaluation of segment results. The costs reported after the profit of reportable segments are accounted for in segment reporting using the same principles as those used in the financial statements and the Company's management does not use them to evaluate segment results.

For the purpose of segment reporting, intra-group transactions involving income, expenses and assets as well as unrealised profits and losses other than those due to impairment of assets have been eliminated between all reportable segments.



Note 2 Management estimates

The preparation of the financial statements in conformity with International Financial Reporting Standards requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates. At the same time it can be confirmed that seasonality and cyclicity do not have a significant effect on the group's activities within a year. The areas involving a higher degree of judgement or complexity, or the areas where assumptions and estimates are relevant to the consolidated financial statements of Merko Ehitus group, are disclosed below. Changes in management's estimates are reported in the income statement of the period of the change.

Valuation of receivables

In valuation of receivables, each receivable is analysed separately. In determining the need for a complete or partial write-down of receivables, the debtor's financial position, the guarantees provided, the solutions offered to pay off the loan and the previous payment behaviour of the debtor are considered.

Provision for warranty obligations

In determining the provision for warranty obligations, the statistical cost of the Company's warranty works is considered.

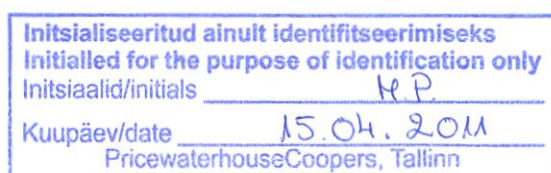
Inventory write-down

Inventories are valued separately by individual properties (registered immovable or building). A business plan is prepared for each property based on its nature (intended use and building rights currently effective or being effected) and the project's costs are compared with expected income. If the property's costs exceed the expected revenue to be generated by the realisation of the project (net realisable value), the group shall write down assets in the amount by which the costs exceed income. Due to the volatility of the construction market and low liquidity of the real estate market, determination of the net realisable value of the assets depends largely on management estimates. The sensitivity analysis showed that had the net realisable value been overestimated by 10% (income would be 10% lower upon the disposal of assets), the Company's write-down of inventories would have been EEK 107,277 thousand higher in 2010 (2009: EEK 121,848 higher), incl. land for sale in the amount of EEK 27,028 thousand (2009: EEK 43,657 thousand), construction in progress in the amount of EEK 49,797 thousand (2009: EEK 46,156 thousand), finished buildings in the amount of EEK 20,061 thousand (2009: EEK 22,277 thousand) and prepayments related to acquisition of real estate properties in the amount of EEK 10,391 thousand (2009: EEK 9,758 thousand). Had the value been underestimated by 10% (income would be 10% higher upon the disposal of assets), the write-down of inventories for the year 2010 would have been EEK 27,052 thousand lower (2009: EEK 55,121 thousand lower), incl. land for sale in the amount of EEK 3,554 thousand (2009: EEK 13,428 thousand), construction in progress in the amount of EEK 4,215 thousand (2009: EEK 15,868 thousand), finished buildings in the amount of EEK 11,865 thousand (2009: EEK 19,035 thousand) and prepayments related to acquisition of real estate properties in the amount of EEK 7,418 thousand (2009: EEK 6,790 thousand).

In addition to the cost of inventories, determination of the value of real estate properties also impacts the real estate related financial investments through a change in the value of the joint ventures. Had management's estimate regarding the real estate properties located at joint ventures been 10% more conservative, i.e. the expected return on disposal of assets had been 10% lower, an additional impairment loss in the amount of EEK 22,213 thousand would have been incurred for financial assets and vice versa, had management's estimate been 10% more optimistic, the increase in value would have been EEK 146 thousand.

Revenue under the stage of completion method

Revenue from construction in progress is recognised under the stage of completion method (Note 1.22), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, forecasting and reporting of income and expenses has been introduced for determining the stage of completion. The estimated final result to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the profit estimate is adjusted. As at 31.12.2010, the amount of the provision for onerous contracts was EEK 34,833 thousand (2009: EEK 4,035 thousand) which was determined after the evaluation of the stage of completion of construction contracts (Note 29). The risk analysis showed that a change in the estimated costs



of construction projects in the range of +/-5% would result in a change in the net profit between EEK -266,534/ +113,610 thousand (2009: EEK -225,340/ +149,531 thousand).

Determination of the useful lives of items of property, plant and equipment

Management has estimated the useful lives of items of property, plant and equipment, taking into consideration conditions and volumes of business activities, historical experience in this area and future outlook. Management estimates that the useful lives of buildings and facilities are between 10 and 33.3 years depending on their structure and the purpose of use. The average useful lives of machinery and equipment are on average between 3 and 5 years and those of other fixtures between 2.5 to 5 years depending on the purpose of use of the asset.

Valuation of property, plant and equipment and intangibles

At each balance sheet date, an impairment test is performed for the intangible assets with indefinite useful lives including goodwill, and the carrying amount is written down to its recoverable amount if it is lower than the carrying amount. An impairment test is also carried out for property, plant and equipment and intangibles when an event or change in circumstances indicates that impairment may have occurred.

The recoverable amount is the higher of the fair value of an asset less costs to sell and its value in use. Evaluation of fair value is based on reliable information regarding the proceeds from a sale to an informed, interested and independent party, less costs of disposal. The test is used both for single assets and for a cash-generating unit. Assets, intangible assets included, which have no autonomous (independent from other assets) capacity to earn revenues, are treated as cash-generating units and valuation of their recoverable amount is based on their value in use.

For the purpose of the test, in order to assess the value in use, management prepares a realistic forecast for the cash flows to be earned in subsequent periods by the business unit and calculates the present value of these cash flows. For determining the present value, the discount rate is used which according to management objectively reflects the risk level of the respective business unit and its expected rate of return. If the recoverable amount determined in such a way exceeds the carrying amount of non-current assets and goodwill of the business unit subject to testing, goodwill is not written down (Note 19).

Valuation of investment property

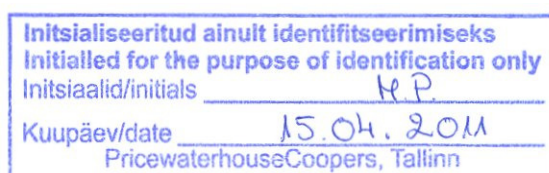
Investment properties are recognised at cost, less any accumulated depreciation and any impairment losses. Management estimates that the carrying amount of investment properties as at 31.12.2010 does not significantly differ from their fair value. Management's estimate regarding the fair value of investment properties is based on the existing market value of the assets. The estimated amount for which the asset can be exchanged in a transaction between independent parties at the date of estimation is considered to be its market value. External experts were not involved in the estimation of the fair value of investment properties. Market value estimates are mostly based on market transactions.

Borrowing costs

Borrowing costs that are related to a qualifying asset (one that necessarily takes a substantial period of time to get ready for its intended use or sale) are recognised in the cost of inventory. Interest expenses related to holding and later use of assets are recorded under finance costs as period costs. Most of the interest expense incurred at the group is related to the acquisition of immovables and construction of residential properties. The decision regarding capitalisation or expensing of borrowing costs is made by the management. Management uses the following considerations for decision-making purposes:

- Upon acquisition of immovables which are ready for intended use or sale the borrowing costs related to holding such assets are not capitalised;
- Borrowing costs related to a specific development project are capitalised during the construction period until obtaining the permit for use. If, depending on the market situation, the management temporarily suspends the construction of an object, the capitalisation of borrowing costs is ceased at the same time and the borrowing costs incurred during the period of suspended development are expensed.

According to the management's estimate, the borrowing costs incurred in 2009 and 2010 were not related to the preparation of assets for use or sale as development projects had mostly been suspended during the year and therefore all borrowing costs were expensed under finance expenses.



Note 3 Operating segments

in thousands of kroons

The chief operating decision-maker, i.e. the directorate and management of AS Merko Ehitus, monitors the business of the group by operating segments. The performance of the segments is assessed by the chief operating decision maker based on segment revenue derived from outside the group and pre-tax profit. Profit before taxes of the segments comprises in substance of their revenue and cost of goods sold; other expenses and income are not allocated to segments as these are monitored for the group as a whole and are not directly related to operating segments.

The profit and loss account information and assets of reportable segments have been reported in accordance with the accounting principles used in preparation of these financial statements. All segments are involved in the sale of construction services with the exception of the real estate development segment whose revenue is derived from the sale of apartments in development projects.

2010	Buildings	Facilities	Roads	Development of real estate	Other	Total segments
Segment revenue	1,105,124	959,066	569,583	367,813	28,180	3,029,766
Inter-segment revenue	(86,029)	(119,050)	(60,903)	(57,347)	(16,490)	(339,819)
Revenue from external clients	1,019,095	840,016	508,680	310,466	11,690	2,689,947
Depreciation (Note 4)	(1,659)	(10,455)	(16,311)	(561)	(1,307)	(30,293)
Inventory write-downs (Notes 4, 18)	-	-	-	(24,895)	-	(24,895)
Reversal of inventory write-downs (Notes 4, 18)	-	-	-	8,951	-	8,951
Setting up of provisions	(10,461)	(16,055)	(22,182)	(1,229)	-	(49,927)
Profit (loss) from associates and joint ventures (Note 20)	-	(2)	-	(1,495)	(4,723)	(6,220)
Other finance income/costs	-	(93)	-	(2,804)	-	(2,897)
Profit before tax	92,616	78,270	(6,567)	29,100	(423)	192,996
Segment assets	223,103	190,100	349,145	1,836,498	55,232	2,654,078,
2009	Buildings	Facilities	Roads	Development of real estate	Other	Total segments
Segment revenue	1,809,728	955,780	439,444	405,915	8,480	3,619,347
Inter-segment revenue	(262,646)	(15,776)	(142,295)	(13,560)	(3,861)	(438,138)
Revenue from external clients	1,547,082	940,004	297,149	392,355	4,619	3,181,209
incl. client, whose revenue is at least 10% of consolidated revenue	-	344,522	-	-	-	344,522
Depreciation and impairment charge (Note 4)	(2,506)	(13,106)	(9,543)	(793)	(4,456)	(30,404)
Inventory write-downs (Notes 4, 18)	-	-	-	(81,752)	-	(81,752)
Setting up of provisions	(9,327)	(12,982)	(690)	(151)	(21)	(23,171)
Profit (loss) from associates and joint ventures (Note 20)	-	-	-	(13,634)	(13,456)	(27,090)
Other finance income/costs	51	(792)	(1,459)	(2,614)	1,181	(3,633)
Profit before tax	241,185	82,912	31,038	(24,040)	(23,308)	307,787
Segment assets	362,921	170,564	189,153	1,452,735	71,862	2,247,235

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In addition to the segment assets, the group holds assets of EEK 406,094 thousand (2009: EEK 1,266,739 thousand) that cannot be associated with a specific segment or the allocation of which to segments would be impracticable. The unallocated assets of the group comprise cash and cash equivalents, deposits, loans receivable excluding loans to associates and joint ventures, tax prepayments, other receivables and an unallocated portion of property, plant and equipment. A significant part of the unallocated property, plant and equipment is made up by the office building of AS Merko Ehitus acquired in 2009 for EEK 56,544 thousand.

Reconciliation of the pre-tax profit of segments and the group

	2010	2009
Profit (loss) from reporting segments	192,996	307,787
Unallocated expense (income)		
marketing expenses	(34,312)	(47,094)
General and administrative expenses	(136,505)	(154,000)
incl. setting up of provisions	(1,682)	(309)
other operating income (expense)	5,940	(5,388)
finance income (costs)	(417)	18,553
incl. interest income	9,267	37,828
interest expense	(11,313)	(16,725)
Profit before tax	27,702	119,858

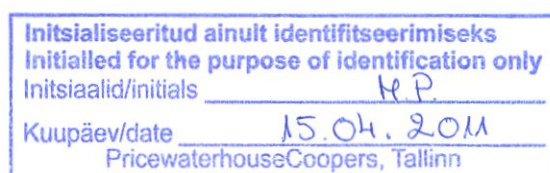
Unallocated finance costs and income mostly include income from deposits but also interest expense not capitalised and other immaterial finance costs.

Revenue by client location

	2010	2009
Estonia	1,944,272	2,181,197
Latvia	675,440	925,985
Lithuania	70,235	74,027
Total	2,689,947	3,181,209

Non-current assets (except for financial assets and deferred income tax assets) by location of assets:

	31.12.2010	31.12.2009
Estonia	309,180	290,429
Latvia	11,657	15,825
Lithuania	36,526	812
Total	357,363	307,066



Note 4 Cost of goods sold

in thousands of kroons

	2010	2009
Construction services	1,290,546	1,533,504
Materials	475,731	455,124
Properties purchased for resale	166,779	270,884
Staff costs	234,091	247,018
Construction mechanisms and transport	122,804	93,412
Design	24,578	26,229
Allowance for inventories (Note 18)	24,895	81,752
Reversal of the allowance for write-down of inventories (Note 18)	(8,951)	-
Real estate management costs	4,318	3,934
Depreciation and impairment charge	30,293	30,404
Other expenses	124,371	92,908
Total cost of goods sold	2,489,455	2,835,169

Note 5 Marketing expenses

in thousands of kroons

	2010	2009
Staff costs	17,889	17,177
Construction tenders	2,290	10,592
Advertising, sponsorship	5,641	10,378
Transport	1,996	1,758
Depreciation and impairment charge	408	489
Other expenses	6,088	6,700
Total marketing costs	34,312	47,094

Note 6 General and administrative expenses

in thousands of kroons

	2010	2009
Staff costs	81,206	98,364
Office expenses, communication services	6,909	16,044
Transport	8,281	7,692
Consulting, legal, auditing	11,833	6,826
Depreciation and impairment charge	7,258	6,572
Computer equipment and software	5,494	4,993
Other expenses	15,524	13,509
Total general and administrative expenses	136,505	154,000

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Note 7 Other operating income

in thousands of kroons

	2010	2009
Fines and penalties for delay received	1,536	2,492
Collection of doubtful receivables	1,305	4,745
Interest income from operating activities	9,817	4,476
Profit from sale of non-current assets	1,185	519
Other income	1,198	2,176
Total other operating income	15,041	14,408

Note 8 Other operating expenses

in thousands of kroons

	2010	2009
Fines, penalties	1,179	7,832
Gifts, donations	3,919	4,250
Doubtful receivables expense (Note 36)	1,758	13,854
Other expenses	624	1,390
Total other operating expenses	7,480	27,326

Note 9 Finance income

in thousands of kroons

	2010	2009
Interest income	9,267	37,828
Foreign exchange gains	1,600	1,209
Other finance income	33	480
Total finance income	10,900	39,517

Note 10 Finance costs

in thousands of kroons

	2010	2009
Interest expense	14,212	23,478
Other finance costs	2	1,119
Total finance costs	14,214	24,597

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Note 11 Corporate income tax

in thousands of kroons

The income tax on the group's profit before tax differs from the theoretical amount that would arise using the tax rate applicable to profits of the consolidated entities for the following reasons:

2010

	Latvia	Lithuania	Estonia	Total
Profit before tax	48,630	(57,653)	36,725	27,702
Tax rate applicable to profits	15%	15%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(7,295)	8,648	-	1,353
Tax calculated on expenses not deductible for tax purposes	(1,807)	(9,774)	-	(11,581)
Tax calculated on income not subject to tax	1,022	37	-	1,059
Tax loss not recognised in the reporting period	-	(78)	-	(78)
Corporate income tax on dividends	-	-	(1,861)	(1,861)
Tax charge	(8,080)	(1,167)	(1,861)	(11,108)
incl. current tax	(1,761)	-	(1,861)	(3,622)
deferred tax charge (Note 22)	(6,319)	(1,167)	-	(7,486)

2009

	Latvia	Lithuania	Estonia	Total
Profit before tax	106,172	(77,402)	91,088	119,858
Tax rate applicable to profits	15%	20%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(15,926)	15,480	-	(446)
Tax calculated on expenses not deductible for tax purposes	(456)	(2,965)	-	(3,421)
Tax calculated on income not subject to tax	943	382	-	1,325
Effect of change in income tax rate	-	(763)	-	(763)
Tax loss not recognised in the reporting period	-	(2,001)	-	(2,001)
Corporate income tax on dividends	-	-	(3,190)	(3,190)
Total income tax expense	(15,439)	10,133	(3,190)	(8,496)
incl. current tax	(13,182)	-	(3,190)	(16,372)
deferred tax charge (Note 22)	(2,257)	10,133	-	7,876

Income tax on dividends was incurred at the group due to the distribution of the subsidiaries' profits as dividends.

As at 31.12.2010, it is possible to pay out dividends to shareholders from retained earnings in the amount of EEK 1,388,091 thousand and the corresponding income tax would amount to EEK 368,986 thousand. As at 31.12.2009, it would have been possible to pay out EEK 1,526,423 thousand, and the corresponding income tax would have amounted to EEK 405,758 thousand.

Note 12 Earnings per share

Basic earnings per share for profit attributable to equity holders of the parent have been derived by dividing the net profit attributable to shareholders by the weighted average number of shares.

	2010	2009
Net profit attributable to shareholders (<i>in EEK thousand</i>)	19,232	116,166
Weighted average number of ordinary shares (<i>thousand pcs</i>)	17,700	17,700
Earnings per share (<i>in EEK</i>)	1.09	6.56

In 2009 and 2010, the group did not have any potential ordinary shares to be issued; therefore the diluted earnings per share equal the basic earnings per share.

Note 13 Dividends per share

Dividends payable are recognised after the approval of profit allocation at the General Meeting of Shareholders. According to the profit allocation proposal, EUR 1,770 thousand (EEK 27,694 thousand), i.e. EUR 0.10 (EEK 1.56) per share, will be distributed as net dividends in 2011, incurring a maximum corporate income tax charge of 21/79 of the amount paid i.e. EUR 470.5 thousand (EEK 7,362 thousand).

In 2010, EEK 194,700 thousand, i.e. EEK 11 per share and in 2009, EEK 61,950 thousand, i.e. EEK 3.50 per share were paid out as dividends. In both years, AS Merko Ehitus did not have to pay corporate income tax due to the dividends received from subsidiaries and taxed in prior periods.

Note 14 Cash and cash equivalents

in thousands of kroons

	31.12.2010	31.12.2009
Cash on hand	125	270
Bank accounts	14,663	40,787
Overnight deposits	139,423	93,961
Term deposits with maturities of 3 months and less	-	224,714
Total cash and cash equivalents (Note 36)	154,211	359,732

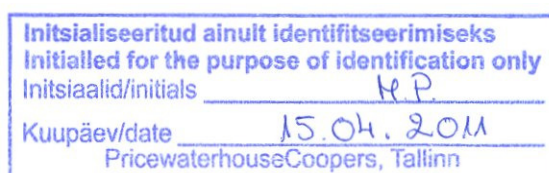
As at 31.12.2010, the weighted average interest on overnight deposits was 0.2% (31.12.2009: 1.4%).

Note 15 Short-term deposits

in thousands of kroons

	31.12.2010	31.12.2009
Bank deposits with maturities greater than 3 months (Note 36)	41,475	400,916

The weighted average interest on bank deposits with maturities greater than 3 months was 1.6% (2009: 3.5%) and the average maturity as at 31.12.2010 was 106 days (2009: 117 days).



Note 16 Trade and other receivables

in thousands of kroons

	31.12.2010	31.12.2009
Trade receivables (Note 36)		
Accounts receivable	340,276	405,030
incl. from related parties (Note 34)	510	3,178
Allowance for doubtful receivables	(18,130)	(19,921)
	322,146	385,109
Tax prepayments excluding corporate income tax (Note 36)		
Value added tax	18,524	7,823
Social security tax	-	7
Other taxes	288	922
	18,812	8,752
Amounts due from customers of contract works (Notes 33, 36)	212,122	102,144
Other short-term receivables		
Short-term loans (Notes 17, 36)	101,704	96,874
incl. from related parties (Note 34)	24,359	59,556
Interest receivables (Note 36)	12,642	13,524
incl. from related parties (Note 34)	8,718	10,771
Receivable from buyer of subsidiary (Note 36)	-	7,125
Other short-term receivables (Note 36)	2,973	2,253
incl. from related parties (Note 34)	70	1
	117,319	119,776
Prepayments for services (Note 36)		
Prepayments for construction services	21,349	38,197
Prepaid insurance	3,967	1,764
Other prepaid expenses	7,426	6,212
	32,742	46,173
Total trade and other receivables	703,141	661,954

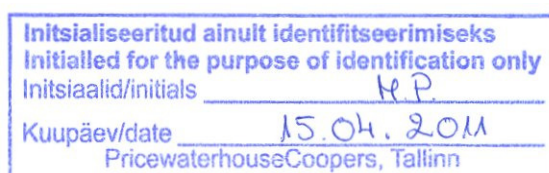
Trade receivables by due date

in thousands of kroons

	31.12.2010		31.12.2009	
Not overdue	246,450	76.5%	235,389	61.1%
1-30 days overdue	26,417	8.2%	36,021	9.4%
31-60 days overdue	4,084	1.3%	5,536	1.4%
61-90 days overdue	4,882	1.5%	54,343	14.1%
91-120 days overdue	4,351	1.4%	8,535	2.2%
121-180 days overdue	4,280	1.3%	39,317	10.2%
More than 180 days overdue	31,682	9.8%	5,968	1.6%
Total trade receivables (lisa 36)	322,146	100.0%	385,109	100.0%

In 2010, the payment discipline of customers improved slightly. In a year, the share of overdue receivables in total receivables decreased from 38.9% to 23.5%. In 2010, the group's doubtful receivables amounted to EEK 18,130 thousand (2009: EEK 19,921 thousand) and a write-down of uncollectible receivables in the amount of EEK 1,758 thousand was recorded (2009: EEK 13,854 thousand). Management considers it likely that the receivables carried in the financial statements will be paid by customers. As at the balance sheet date, the amount of overdue receivables was EEK 75,695 thousand, including EEK 21,568 thousand held as security by customers, which will be released at the completion of the project upon presentation of a guarantee. By the date of approval of the financial statements, EEK 19,872 thousand of overdue debt had been collected.

A more detailed overview of the Company's credit risk is provided in Note 36.



Note 17 Loans granted

in thousand kroons

	2010	2009
Loans granted to joint ventures		
Loan balance at beginning of the year	35,396	34,667
Granted	39,171	3,925
Collected	(100)	(3,153)
Exchange rate difference	(59)	(43)
Loan balance at end of the year (Notes 34, 36)	74,408	35,396
incl. current portion	-	16,500
non-current portion 1...5 years	74,408	18,896
Average effective interest rate 5.6% (2009: 12.4%)		
Loans granted to entities under common control		
Loan balance at beginning of the year	45,945	7,065
Granted	-	61,178
Reclassification of receivable as loan granted	-	19,962
Collected	(14,535)	(42,246)
Reclassification of loan as prepayment for the registered immovable	(7,048)	-
Exchange rate difference	(3)	(14)
Loan balance at end of the year (Notes 34, 36)	24,359	45,945
incl. current portion	24,359	43,056
non-current portion 1...5 years	-	2,889
Average effective interest rate 6.3% (2009: 3.2%)		
Loans granted to unrelated legal entities		
Loan balance at beginning of the year	37,318	26,885
Granted	85,775	782
Reclassification of receivable as loan granted	27,017	10,045
Collected	(49,975)	(394)
Loan balance at end of the year	100,135	37,318
incl. current portion	77,175	37,318
non-current portion 1...5 years	22,960	-
Average effective interest rate 7.0% (2009: 7.7%)		
Loans granted to unrelated individuals		
Loan balance at beginning of the year	-	-
Granted	1,735	-
Loan balance at end of the year	1,735	-
incl. current portion	170	-
non-current portion 1...5 years	1,565	-
Average effective interest rate 3.5%		
Total loans granted		
Loan balance at beginning of the year	118,659	68,617
Granted	126,681	65,885
Reclassification of receivable as loan granted	27,017	30,007
Collected	(64,610)	(45,793)
Reclassification of loan as prepayment for the registered immovable	(7,048)	-

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Exchange difference	(62)	(57)
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Loan balance at end of the year	200,637	118,659
incl. current portion (Notes 16, 36)	101,704	96,874
Non-current portion 1...5 years (Notes 21, 36)	98,933	21,785

All loans granted are fully performing at the balance sheet date.

Note 18 Inventories

in thousands of kroons

	31.12.2010	31.12.2009
Raw materials and materials	15,046	6,752
Work-in-progress	497,970	470,428
Finished goods	200,801	268,242
Goods for resale		
Registered immovables purchased for resale	618,241	686,543
incl. registered immovables located on nature preserve areas*	59,653	59,653
Other goods purchased for resale	18,360	2,543
	636,601	689,086
Prepayments for inventories		
Prepayments for real estate properties	103,907	87,192
incl. from related parties (Note 34)	74,177	57,462
Prepayments for other inventories	1,547	14,763
	105,454	101,955
Total inventories	1,455,872	1,536,463

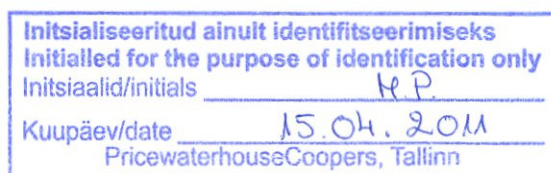
* There are strict building restrictions on immovables located on nature preserve areas and their use for development purposes, either directly or indirectly, is not permitted. According to the Nature Conservation Act of the Republic of Estonia, an immovable which is located within the territory of a protected area, special conservation area or species protection site and the use of which for intended purposes is significantly hindered by the protection procedure, may be transferred to the state by an agreement between the state and the owner of land for a consideration equivalent to the usual value of the immovable (§20 of Nature Conservation Act). Until the entry into force of the new version of the Act, an older version was in force until 01.08.2008 which laid down the exchange of nature preserve areas with the state.

The value of an immovable, other than a forest immovable, is determined using the transaction comparison method. In determining the value of an immovable, the real rights which due to their nature cannot be deleted from the land register are considered (e.g. servitudes, neighbourhood rights) as well as those arising from laws other than the restrictions on an immovable property arising from the protection procedure which forms a basis for the acquisition of an immovable.

Due to the overall economic environment and a tense state budget situation, the transfer of the registered immovables is unlikely in the near term. Management is of opinion that in the long term, the state is required to purchase these registered immovables or annul the restrictions set for them as a result of which they have been treated as land without restrictions for valuation purposes and the value of registered immovables have not been written down.

As at 31.12.2010, inventories have been written down to their net realisable value by EEK 24,895 thousand (2009: EEK 81,752 thousand) and earlier write-downs have been reversed in the amount of EEK 8,951 thousand (Notes 2, 4, 36):

The assets pledged as collateral for loans total EEK 669.8 million.



	Carrying amount before write-down	Write-down	Reversal of write-down	Carrying amount after write-down
31.12.20010				
Finished goods	200,681	-	120	200,801
Work-in-progress	501,861	12,722	8,831	497,970
Land purchased for resale	622,687	4,446	-	618,241
Prepayments for real estate	111,634	7,727	-	103,907
31.12.2009				
Finished goods	288,232	19,990	-	268,242
Work-in-progress	474,144	3,716	-	470,428
Land purchased for resale	726,854	40,311	-	686,543
Prepayments for real estate	104,927	17,735	-	87,192

Note 19 Shares in subsidiaries

in thousands of kroons

	Ownership and voting rights %		Location	Area of operation
	31.12.2010	31.12.2009		
Subsidiaries of AS Merko Ehitus				
AS Gustaf	85	75	Pärnu	construction
AS Merko Tartu	66	66	Tartu	construction
Ringtee Tehnopark OÜ	100	100	Tallinn	construction
Tallinna Teede AS	100	100	Tallinn	road construction
SIA Merks	100	100	Republic of Latvia, Riga	construction
UAB Merko Statyba	100	100	Republic of Lithuania, Vilnius	construction
OÜ Merko Elamu	100	100	Tallinn	real estate
OÜ Woody	100	100	Tallinn	real estate
OÜ Gustaf Tallinn	80	80	Tallinn	construction
OÜ Maryplus	100	100	Tallinn	real estate
OÜ Metsailu	100	100	Tallinn	real estate
OÜ Constancia	100	100	Tallinn	real estate
OÜ Käibevara	100	100	Tallinn	real estate
OÜ Baltic Electricity Engineering	100	100	Tallinn	electricity systems
OÜ Fort Ehitus	75	75	Harjumaa, Viimsi rural municipality	construction
OÜ Tähelinna Kinnisvara	100	100	Tallinn	real estate
OÜ Mineraal	100	100	Tallinn	other mining
AS Merko Infra	100	100	Tallinn	construction
Merko Ukraine LLC	100	-	Republic of Ukraine, Kharkiv	construction

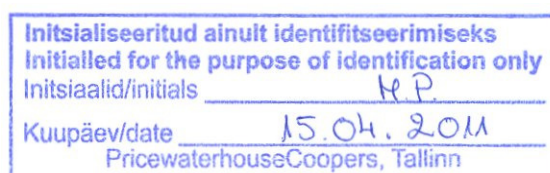
At 8 December 2010, AS Merko Ehitus established a subsidiary Merko Ukraine LLC, the main activity of which is construction.

At 3 February 2010, the Company purchased 10% of the shares of AS Gustaf from a non-controlling interest.

Acquisition of a 10% additional ownership in the subsidiary AS Gustaf

EEK thousand

Acquired ownership	10%	10%
Value of non-controlling interest acquired	2,148	2,148
Cost	2,148	2,148



Cash flows from acquisition of a subsidiary

Cost of acquisition of shares of AS Gustaf	2,148
Amount due from the seller for the acquisition of the shares of AS Gustaf in 2006	(1,000)
Interest calculated on amount due	(38)
Cash flows from acquisition of subsidiaries	1,110

Acquisition of subsidiaries in 2009

At 2nd of April 2009, AS Merko Ehitus merged with its wholly-owned subsidiary OÜ Rae Tehnopark that is engaged in real estate development.

At 18th of December 2009, AS Merko Ehitus acquired full ownership of OÜ Tähelinna Kinnisvara, which is the subsidiary of AS Riverito's subsidiary E.L.L. Kinnisvara, the main activity of which is the leasing of the head office building of AS Merko Ehitus.

At 18th of May 2009, AS Merko Ehitus acquired a subsidiary OÜ Mineraal involved in sand and gravel extraction and which had not yet launched its operations, and in November 2009, it set up a subsidiary AS Merko Infra, in which the former department of outdoor utility lines launched its operations.

At 2nd of December 2009, the wholly-owned subsidiary of AS Merko Ehitus, Tallinna Teede AS, acquired 100% ownership in a subsidiary AS Vooremaa Teed, the main activity of which is also road construction.

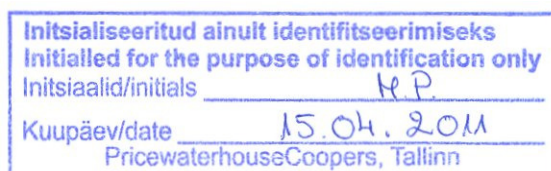
Acquisition of subsidiaries

in thousands of kroons

	AS Vooremaa Teed		OÜ Tähelinna Kinnisvara		OÜ Mineraal	
	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value
Cash	6,552	6,552	30,763	30,763	40	40
Receivables	6,455	6,455	32	32	-	-
Inventories	3,120	3,120	-	-	-	-
Property, plant and equipment	21,180	35,182	31,059	56,544	-	-
Current liabilities	(6,151)	(6,151)	(217)	(217)	-	-
Non-current liabilities	(10,639)	(10,639)	(36,196)	(36,196)	-	-
Net assets	20,517	34,519	25,441	50,926	40	40
Acquired ownership interest	100%		100%		100%	
Value of acquired net assets	20,517	34,519	25,441	50,926		40
Cost		48,458		50,926		40
Goodwill (Note 25)		13,939		-		-
Sales revenue						
- from the beginning of the year	54,179		8,511		873	
- post acquisition	4,484		180		873	
Net profit (loss)						
- from beginning of the year	8,830		4,993		320	
- post acquisition	541		(59)		320	

As at the balance sheet date, a goodwill test was performed for the cash-generating unit AS Vooremaa Teed which goodwill is attributable to. In the reporting period, goodwill was not written down because the recoverable amount of the cash-generating unit exceeded the carrying amount of the non-current assets and goodwill of the cash-generating unit.

The recoverable amount of the assets is determined as its value in use, using management-approved cash flow projections for the next 5 years. According the development plan, the purpose for the acquisition of the entity was expansion into the road maintenance market and development of a road construction unit in Central Estonia. The acquisition of AS Vooremaa Teed also enables better use of the existing resources and



finding of synergies for product development. Post-projection period's cash flows are extrapolated using reasonable growth rates. The long-term growth rate of 2.5% for revenue and expenses is not higher than the estimated long-term GDP growth rate in Estonia.

The weighted average cost of capital is used as the discount rate, taking into consideration the Company's activities and risk level. For determining the gross margin, management uses previous periods' business experience.

Assumptions used for determining value in use:

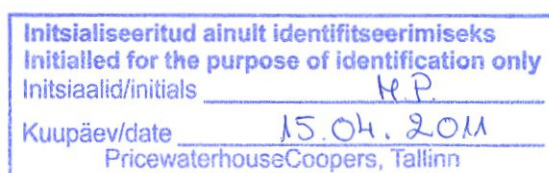
	31.12.2010	31.12.2009
Budget period, years	5	5
Average revenue growth in budget period, %	24%	26%
Average expense growth in budget period, %	23%	26%
Discount rate for cash flows, %	14%	14%
Post-budget period's growth rate, %	2,5%	2.5%
EBITDA margin of the budget period, %	12%	13%

Cash flows from acquisition of subsidiaries	AS Vooremaa Teed	OÜ Tähelinna Kinnisvara	OÜ Mineraal	Total
Cost	48,458	50,926	40	99,424
Paid on acquisition in 2009	(48,458)	(50,926)	(40)	(99,424)
Cash and cash equivalents on acquisition of subsidiaries	6,552	30,763	40	37,355
Cash flows on acquisition of subsidiaries	(41,906)	(20,163)	-	(62,069)

Note 20 Investment in associates and joint ventures

	Ownership and voting rights %		Location	Area of operation
	31.12.2010	31.12.2009		
Associate of AS Merko Ehitus				
AS Tartu Maja Betoontooted	25	25	Tartu	concrete elements
Joint ventures of AS Merko Ehitus				
OÜ Unigate	50	50	Tallinn	real estate
Poolkoksimeä Sulgemise OÜ	50	-	Tallinn	construction
Joint ventures of SIA Merks				
PS Merks Terbe Lat	-	50	Republic of Latvia, Riga	construction
SIA Zakusala Estates	50	50	Republic of Latvia, Riga	real estate
Joint venture of AS Merko Tartu				
OÜ Kortermaja	50	50	Tartu	real estate

In July 2010, AS Merko Ehitus liquidated its 50% joint venture SIA Merks Terbe Lat.



in thousands of kroons

	Investment at 31.12.2009	establish- ment and liquidation	Profit/loss from entities	Dividends	Currency translation adjustments	Investment at 31.12.2010
Associate of AS Merko Ehitus						
AS Tartu Maja Betoontooted	40,419	-	(4,723)	-	-	35,696
Joint ventures of AS Merko Ehitus						
OÜ Unigate	972	-	(23)	-	-	949
Poolkoksimaie Sulgemise OÜ	-	22	(2)	-	-	20
Joint ventures of SIA Merks						
PS Merks Terbe Lat	24	(24)	-	-	-	-
SIA Zakusala Estates	135,943	-	(1,090)	-	(40)	134,813
Joint venture of AS Merko Tartu						
OÜ Kortermaja	2,063	-	(382)	(220)	-	1,461
Total joint ventures	139,002	(2)	(1,497)	(220)	(40)	137,243
Total associates and joint ventures	179,421	(2)	(6,220)	(220)	(40)	172,939

in thousands of kroons

	Investment at 31.12.2008	Changes in 2009 Profit/loss from entities	Currency translation adjustments	Investment at 31.12.2009
Associate of AS Merko Ehitus				
AS Tartu Maja Betoontooted	53,875	(13,456)	-	40,419
Joint venture of AS Merko Ehitus				
OÜ Unigate	984	(12)	-	972
Joint ventures of SIA Merks				
PS Merks Terbe Lat	24	-	-	24
SIA Zakusala Estates	149,154	(12,961)	(250)	135,943
Joint venture of AS Merko Tartu				
OÜ Kortermaja	2,724	(661)	-	2,063
Total joint ventures	152,886	(13,634)	(250)	139,002
Total associates and joint ventures	206,761	(27,090)	(250)	179,421

As at 31.12.2010, the difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee totalling EEK 266 thousand (2009: EEK 647 thousand) is due to the effect from the unrealised gains of mutual transactions.

As at 31.12.2010, the difference between the value of the investment in SIA Zakusala Estates and the equity of the investee in the amount of EEK 135,778 thousand is attributable to the difference between the cost and market value of the 126 thousand square meter registered immovable located on Zakusala island in the centre of Riga that was privatised in December 2010 by the joint venture. As at 31.12.2009, this difference was EEK 135,819 thousand attributable to the lease agreement concerning the aforementioned registered immovable entered into with the City of Riga until 2 June 2051, pursuant to which SIA Zakusala Estates had the right to use the land and which was not included in the statement of financial position of the joint venture.

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Associates

in thousands of kroons

	Assets 31.12.	Liabilities 31.12.	Revenue	Net profit/loss
2010				
AS Tartu Maja Betoontooted	195,679	52,893	243,075	(15,769)

2009

AS Tartu Maja Betoontooted	239,191	77,513	186,523	(52,699)
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Joint ventures

in thousands of kroons

	Assets 31.12.		Liabilities 31.12.		Equity 31.12.	Income	Expenses	Net profit/loss
	Current assets	Non-current assets	Current liabilities	Non-current liabilities				
2010								
OÜ Unigate	53,225	-	627	50,701	1,897	1	47	(46)
Poolkoksimeä Sulgemise OÜ	1,450	95	1,505	-	40	12,016	12,016	0
SIA Zakusala Estates	63,451	-	7,386	57,994	(1,929)	36	2,217	(2,181)
OÜ Kortermaja	3,770	-	316	-	3,454	4,565	6,092	(1,527)
Total	121,896	95	9,834	108,695	3,462	16,618	20,372	(3,754)

2009

OÜ Unigate	49,681	-	46,504	1,234	1,943	6	31	(25)
PS Merks Terbe Lat	17	-	-	-	17	-	-	-
SIA Zakusala Estates	1,853	28,663	7,250	23,018	248	48	8,235	(8,187)
OÜ Kortermaja	7,607	-	2,187	-	5,420	10,380	14,694	(4,314)
Total	59,158	28,663	55,941	24,252	7,628	10,434	22,960	(12,526)

Note 21 Other long-term loans and receivables

in thousands of kroons

	31.12.2010	31.12.2009
Long-term loans (Notes 17, 36)	98,933	21,785
incl. from related parties (Note 34)	74,408	21,785
Long-term interest receivables (Note 36)	4,823	-
incl. from related parties (Note 34)	4,506	-
Long-term bank deposit (Note 36)*	4,994	2,809
Long-term receivable from buyer of subsidiary (Note 36)**	1,500	1,375
Long-term receivables from customers of construction services (Note 36)	18,957	6,499
Total other long-term loans and receivables	129,207	32,468

* The long-term bank deposit in the amount of EEK 2,259 thousand with the maturity of 28 December 2012 and interest rate of 4.63% has been pledged as collateral for the warranty granted to a customer of a construction contract. The interest rate on the deposit in the amount of EEK 2,185 thousand and the due date of 25 June 2012 is 1.6% and that of the deposit in the amount of EEK 550 thousand and the due date of 27 June 2018 is 5.35%.

** In 2006, AS Merko Ehitus sold 25% of the shares of the subsidiary AS Gustaf. The receivable is discounted at a 5% interest rate and its due date is 1 May 2013.

Note 22 Deferred income tax assets and liabilities

in thousands of kroons

Formation of deferred income tax assets and liabilities at the subsidiaries SIA Merks and UAB Merko Statyba:

31.12.2010

	Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	12,567	12,020	24,587
incl. tax loss carryforwards			
effect of carrying amount of property, plant and equipment	(93)	-	(93)
effect of stage of completion method	657	3,751	4,408
effect of write-down of receivables	1,042	307	1,349
effect of write-down of inventories	4,794	-	4,794
effect of provisions	-	321	321
effect of changes in income tax rate	-	7,641	7,641
other effects	6,167	-	6,167
Deferred income tax assets	12,567	12,020	24,587
Deferred income tax charge of the financial year (Note 11)	6,319	1,167	7,486

31.12.2009

	Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	18,882	13,187	32,069
incl. tax loss carryforwards	-	6,002	6,002
effect of carrying amount of property, plant and equipment	(565)	-	(565)
effect of stage of completion method	817	97	914
effect of write-down of receivables	127	531	658
effect of write-down of inventories	10,915	6,316	17,231
effect of provisions	-	(122)	(122)
effect of changes in income tax rate	-	(464)	(464)
other effects	7,588	827	8,415
Deferred income tax assets	18,882	13,187	32,069
Deferred income tax charge of the financial year (Note 11)	2,257	(10,133)	(7,876)

The management considers it likely that the unused tax losses carried forward can be utilised against future profits, although the financial results of the Lithuanian subsidiary were negative in the reporting period.

Note 23 Investment property

in thousands of kroons

	Land	Buildings	Construction in progress	Total
Cost at 31.12.2008	2,103	10,600	-	12,703
Accumulated depreciation at 31.12.2008	-	(701)	-	(701)
Carrying amount at 31.12.2008	2,103	9,899	-	12,002
Exchange rate difference	(5)	(8)	-	(13)
Disposals	-	(1,048)	-	(1,048)
Reclassification	-	6,118	-	6,118
Depreciation	-	(507)	-	(507)
Carrying amount at 31.12.2009	2,098	14,454	-	16,552
Cost at 31.12.2009	2,098	15,650	-	17,748
Accumulated depreciation 31.12.2009	-	(1,196)	-	(1,196)
Carrying amount at 31.12.2009	2,098	14,454	-	16,552
Exchange rate difference	(1)	(1)	-	(2)
Acquisition	-	2,371	37,831	40,202
Depreciation	-	(666)	-	(666)
Carrying amount at 31.12.2010	2,097	16,158	37,831	56,086
Cost at 31.12.2010	2,097	18,020	37,831	57,948
Accumulated depreciation 31.12.2010	-	(1,862)	-	(1,862)
Carrying amount at 31.12.2010	2,097	16,158	37,831	56,086

As at 31.12.2010, the carrying amounts of investment properties do not significantly differ from their fair values (31.12.2009: the carrying amounts of investment properties did not significantly differ from their fair values). Fair values have mainly been estimated based on market transactions.

Investment properties have been acquired for the purpose of earning rental income as well as for capital appreciation or development in the future. Buildings located on the plot of land have temporarily been leased out under the operating lease terms. Rental income receivable, maintenance costs incurred and improvement expenses are immaterial.

Note 24 Property, plant and equipment
in thousands of kroons

	Land	Buildings	Right of super- ficies	Machi- nery and equip- ment	Other fixtures	Construc- tion in progress and prepay- ments	Total
Cost at 31.12.2008	9,697	20,008	458	181,732	97,274	5,721	314,890
Accumulated depreciation and impairment losses at 31.12.2008	-	(4,909)	(104)	(67,761)	(45,022)	-	(117,796)
Carrying amount at 31.12.2008	9,697	15,099	354	113,971	52,252	5,721	197,094
Currency translation differences	-	-	-	24	(16)	-	8
Acquisition	-	837	-	9,094	1,363	1,918	13,212
Acquisition in business combinations	3,208	57,462	-	31,056	-	-	91,726
Disposals	-	-	-	(882)	(25)	-	(907)
Reclassification	-	5,539	-	8,937	(8,090)	(6,773)	(387)
Write-offs	-	-	-	(60)	(76)	-	(136)
Depreciation	-	(1,018)	(9)	(25,975)	(7,332)	-	(34,334)
Carrying amount at 31.12.2009	12,905	77,919	345	136,165	38,076	866	266,276
Cost at 31.12.2009	12,905	89,030	458	236,939	78,588	866	418,786
Accumulated depreciation and impairment losses at 31.12.2009	-	(11,111)	(113)	(100,774)	(40,512)	-	(152,510)
Carrying amount at 31.12.2009	12,905	77,919	345	136,165	38,076	866	266,276
Currency translation differences	-	-	-	2	3	-	5
Acquisition	-	38	-	44,705	3,633	725	49,101
Disposals	-	-	-	(1,408)	(963)	-	(2,371)
Reclassification	-	-	-	995	596	(1,591)	-
Write-offs	-	-	-	(26)	(37)	-	(63)
Depreciation	-	(2,890)	(9)	(27,411)	(4,957)	-	(35,267)
Carrying amount at 31.12.2010	12,905	75,067	336	153,022	36,351	-	277,681
Cost at 31.12.2010	12,905	89,068	458	275,504	78,004	-	455,939
Accumulated depreciation and impairment losses at 31.12.2010	-	(14,001)	(122)	(122,482)	(41,653)	-	(178,258)
Carrying amount at 31.12.2010	12,905	75,067	336	153,022	36,351	-	277,681

Information on leased assets is provided in Note 26 and on lease payments in Note 27.
No property, plant and equipment are pledged as collateral for borrowings.

Note 25 Intangible assets

in thousands of kroons

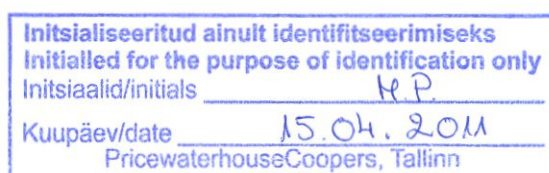
	Goodwill (Note 19)	Software	Prepayments	Total
Cost at 31.12.2008	-	16,377	1,362	17,739
Accumulated amortisation at 31.12.2008	-	(5,932)	-	(5,932)
Carrying amount at 31.12.2008	-	10,445	1,362	11,807
Currency translation differences	-	2	-	2
Acquisitions	13,939	984	-	14,923
Amortisation	-	(2,494)	-	(2,494)
Carrying amount at 31.12.2009	13,939	8,937	1,362	24,238
Cost at 31.12.2009	13,939	17,346	1,362	32,647
Accumulated amortisation at 31.12.2009	-	(8,409)	-	(8,409)
Carrying amount at 31.12.2009	13,939	8,937	1,362	24,238
Currency translation differences	-	1	-	1
Acquisitions	-	1,419	-	1,419
Disposals	-	(89)	-	(89)
Write-offs	-	(1)	-	(1)
Amortisation	-	(1,972)	-	(1,972)
Carrying amount at 31.12.2010	13,939	8,295	1,362	23,596
Cost at 31.12.2010	13,939	18,144	1,362	33,445
Accumulated amortisation at 31.12.2010	-	(9,849)	-	(9,849)
Carrying amount at 31.12.2010	13,939	8,295	1,362	23,596

Prepayments for intangible assets relate to prospective replacement of the group's accounting software.

Note 26 Leased assets

in thousands of kroons

	2010	2009
Assets acquired under finance lease terms		
Machinery and equipment		
Cost	166,494	130,007
Accumulated depreciation	(52,426)	(42,391)
incl. depreciation charge of the period	(12,247)	(10,205)
Carrying amount	114,068	87,616
Assets leased under non-cancellable operating lease terms		
Land lease agreements		
Payments in the reporting period	1	-



Payments in subsequent periods:	57	
Payable next year	5	-
Payable in 1...5 years	19	-
Payables after 5 years	33	-

On the basis of cancellable lease agreements, operating lease payments totalling EEK 12,441 thousand (2009: EEK 12,606 thousand) were paid for passenger cars in 2010. The Company does not intend to use a bargain purchase option for the assets leased under the operating lease terms in the reporting period.

Note 27 Borrowings

in thousands of kroons

	2010	2009
Finance lease payables		
Present value of lease payments at beginning of the year	47,934	54,541
Received	36,489	10,869
Paid	(22,647)	(17,476)
Exchange rate difference	2	-
Minimum future lease payments	61,778	47,934
incl. current portion	16,498	16,170
non-current portion 1...4 years	45,280	31,764
Interest expense for the reporting period	1,713	1,800
Minimum future lease payments	67,136	50,619
incl. current portion	18,459	17,303
non-current portion 1...4 years	48,677	33,316
Average effective interest rate 3.1% (2009: 5.3%)		
Base currencies EEK, EUR and LVL		
Bank loans		
Loan balance at beginning of the year	361,697	553,611
Received	33,088	56,841
Borrowing related to acquisition of subsidiary	-	36,196
Paid	(168,208)	(285,051)
Exchange difference	115	100
Loan balance at end of the year	226,692	361,697
incl. current portion	68,428	319,895
non-current portion 1...5 years	158,264	41,802
Interest cost of reporting period	8,687	14,721
incl. capitalised interest cost	53	-
Average effective interest rate 4.9% (2009: 4.5%)		
Base currencies LVL and EUR		
Loans from entities under common control		
Loan balance at beginning of the year	109,354	125,001
Paid	-	(15,647)
Loan balance at end of the year (Note 34)	109,354	109,354
incl. current portion	109,354	109,354

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Interest cost of reporting period	2,640	5,589
Average effective interest rate 2.4% (2009: 4.5%)		

Loans from other entities

Loan balance at beginning of the year	4,900	4,900
Loan balance at end of the year	4,900	4,900
incl. current portion	2,150	2,150
non-current portion 1...5 years	2,750	2,750

Interest cost of reporting period	276	273
Average effective interest rate 5.5% (2009: 5.5%)		

Total loans

Loan balance at beginning of year	475,951	683,512
Received	33,088	56,841
Borrowing related to acquisition of subsidiary	-	36,196
Paid	(168,208)	(300,698)
Exchange rate difference	115	100
Loan balance at end of year	340,946	475,951
incl. current portion	179,932	431,399
non-current portion 1...5 years	161,014	44,552

Total borrowings

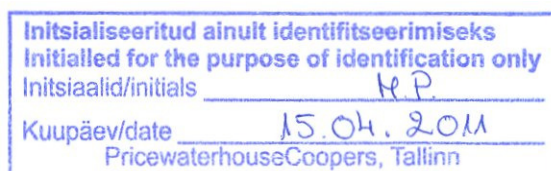
	402,724	523,885
incl. current portion (Note 36)	196,430	447,569
non-current portion 1...5 years (Note 36)	206,294	76,316

Borrowings with floating interest rates related to Euribor or Rigibor (Riga Interbank Offered Rate - the index of Latvian interbank credit interest rates) are divided by the interest rate changes and the contractual repricing dates as follows:

	2010	2009
Finance lease liabilities		
6-12 months	37,683	29,597
Bank loans		
up to 6 months	35,489	180,712
6-12 months	191,203	180,985
Loans from entities under common control		
6-12 months	109,354	109,354
Total	373,729	500,648

Borrowings with the contractual fixed interest rate are divided as follows:

	2010	2009
Finance lease liabilities	24,095	18,337
Loans from other entities	4,900	4,900
Total	28,995	23,237



The global financial markets returned to stability in 2010. The risk margins of loans continued to increase. As most of the group's loan contracts have been concluded prior to the increase in risk margins, we can assert that the fair value of bank loans is lower than their carrying amount. The carrying amount of loans refinanced in 2010 is equal to their carrying amount. Among the loans from entities under common control, there is a loan from AS Järvevana originating from the demerger, the interest of which after the first 12 months is 12 month Euribor + 1%.

Loan collaterals and pledged assets are presented in Note 31.

Note 28 Trade and other payables

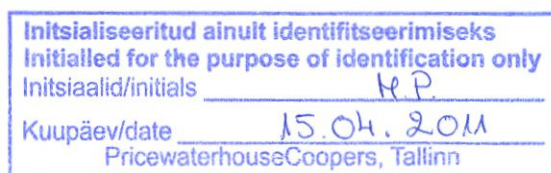
in thousands of kroons

	31.12.2010	31.12.2009
Trade payables (Note 36)	240,357	223,149
incl. to related parties (Note 34)	231	94
Payables to employees	42,262	55,364
Tax liabilities, except for corporate income tax		
value added tax	11,422	22,625
personal income tax	6,913	6,783
social security tax	11,854	13,045
land tax	-	80
unemployment insurance tax	1,218	1,171
contributions to mandatory funded pension	274	107
other taxes	403	604
	<u>32,084</u>	<u>44,415</u>
Amounts due to customers for contract works (Notes 33, 36)	60,649	316,095
Other liabilities (Note 36)		
interest liabilities	1,378	1,105
incl. to related parties (Note 34)	482	233
payable for registered immovables from demerger	100,000	100,000
incl. to related parties (Note 34)	100,000	100,000
other liabilities	4,697	4,274
	<u>106,075</u>	<u>105,379</u>
Prepayments received	131,182	38,068
incl. from related parties (Note 34)	5	-
Total trade and other payables	<u>612,609</u>	<u>782,470</u>

Note 29 Short-term provisions

in thousands of kroons

	2010	2009
Provision for warranty obligation for construction		
Residual value at beginning of the year	18,518	19,916
Set up	15,109	13,620
Used during the year	(16,234)	(15,018)
Exchange difference	(1)	-
Balance at end of the year	<u>17,392</u>	<u>18,518</u>



Provision for onerous construction contracts

Residual value at beginning of the year	4,035	3,525
Set up	33,983	2,014
Used during the year	(3,185)	(1,504)
Balance at end of the year	34,833	4,035

Provision for legal costs and claims filed

Residual value at beginning of the year	14,492	7,882
Set up	1,102	7,518
Used during the year	(11,492)	(908)
Balance at end of the year (Note 36)	4,102	14,492

Other provisions

Residual value at beginning of the year	657	994
Set up	1,415	328
Used during the year	(915)	(665)
Balance at end of the year	1,157	657

Total short-term provisions

57,484 37,702

Note 30 Other long-term trade payables

in thousands of kroons

	31.12.2010	31.12.2009
Trade payables (Note 36)	13,223	10,653
Prepayments received	12	5
Total long-term trade payables	13,235	10,658

Note 31 Loan collaterals and pledged assets

The following agreements have been entered into for guaranteeing loans and other obligations:

Between AS Merko Ehitus and Swedbank AS:

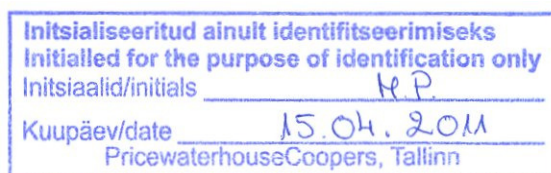
A commercial pledge agreement on movable property in the amount of EEK 200 million (registered under the first, second, fifth and seventh orders in the register of commercial pledges). The obligations arising from guarantee contracts and overdraft contracts are guaranteed by the pledge. In addition, a deposit pledge contract in the amount of EEK 2.3 million has been entered into for guaranteeing the guarantee contract concerning stage I of construction works of Puurmanni traffic network.

Between AS Merko Ehitus and Nordea Bank Finland Plc Estonia branch:

A joint mortgage under the first available order in the amount of EEK 100 million on the registered immovables recognised in the inventories of AS Merko Ehitus. The contractual obligations arising from the overdraft facility are secured by the mortgage.

Between AS Merko Ehitus and AS SEB Pank:

A commercial pledge agreement on movable property in the amount of EEK 60 million (registered under the third, fourth and sixth orders in the register of commercial pledges). The obligations arising from the guarantee contract are secured by the pledge.



Between Tallinna Teede AS, Swedbank AS and AS SEB Pank:

A commercial pledge agreement on movable property in the amount of EEK 25 million (registered under the first order in the register of commercial pledges), whereby Swedbank AS has a 14/25 legal share and AS SEB Pank has a 11/25 legal share.

Between Tallinna Teede AS and Swedbank AS:

A commercial pledge agreement on movable property in the amount of EEK 2 million (registered under the second order in the register of commercial pledges). All claims of the banks arising from contracts under the law of obligations have been secured by the pledges.

Between Tallinna Teede AS, OÜ Tevener and Swedbank AS:

A mortgage in the amount of EEK 23.4 million on the registered immovable included within the non-current assets of OÜ Tevener, located in Kirdalu village, Saku rural municipality, Harjumaa up to its carrying amount of EEK 26.7 million, for guaranteeing the obligations arising from the loan contract entered into between Swedbank AS and Tallinna Teede AS.

Between AS Vooremaa Teed and Swedbank AS:

A mortgage on the registered immovable with the carrying amount of EEK 1.1 million located in Jõgeva that is carried within the non-current assets has been set as collateral for the limit agreement of off-balance sheet products with the limit of EEK 1 million.

Between AS Gustaf and Swedbank AS:

A commercial pledge agreement on movable property in the amount of EEK 9.1 million (registered under the first and second orders in the register of commercial pledges). Guarantee contracts entered into are guaranteed by the pledge.

Between OÜ Gustaf Tallinn and Swedbank AS:

A commercial pledge agreement on movable property in the amount of EEK 3.9 million for guaranteeing guarantee contracts.

Between AS Merko Tartu and AS SEB Pank:

A commercial pledge agreement on movable property in the amount of EEK 22.0 million. Guarantee contracts entered into are guaranteed by the pledge.

Between AS Merko Tartu and AS SEB Pank:

A mortgage has been set as collateral for the loan contract in the amount of EEK 5.0 million concerning 9 apartment ownerships in Tartumaa (investment property with the carrying amount of EEK 9.6 million in the statement of financial position), for guaranteeing the obligations arising from the loan contract.

Between AS Merko Tartu and Danske Bank AS Estonia branch:

Joint mortgages on 13 registered immovables in Tartumaa up to their carrying amount of EEK 38.7 have been set as collateral for the loan contract with the limit of EEK 5.0 million and for the loan contract in the amount of EEK 25 million, for guaranteeing the obligations arising from the loan contract.

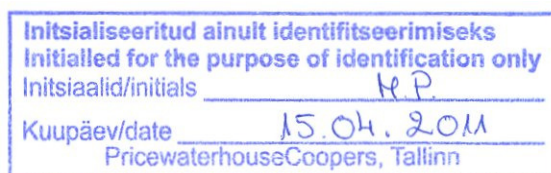
Between OÜ Raadi Kortermaja and Danske Bank AS:

Mortgages have been set on two registered immovables in Tartumaa (finished goods with the carrying amount of EEK 31.9 million in the statement of financial position) as collateral for the loan contract in the amount of EEK 30.4 million, for guaranteeing the obligations arising from the loan contract. In addition, the same loan contract is guaranteed by the contract of surety of AS Merko Tartu.

Between SIA Merks and AS Swedbank:

A commercial pledge agreement on assets in the amount of LVL 20.2 million (EEK 444.4 million). The obligations arising from overdraft contracts and guarantee contracts are guaranteed by the pledge.

Mortgages on 19 registered immovables in Riga (property purchased for resale in the statement of financial position) have been pledged as collateral for the loan contract in the amount of EUR 6.3 million (EEK 98.1 million) up to their carrying amount of LVL 11.6 million (EEK 256.6 million). The obligations arising from guarantee contracts have also been guaranteed by the mortgages on 19 registered immovables in Riga in the amount of LVL 5.2 million (EEK 114.6 million).



Between SIA Merks and Nordea Bank Finland Plc branch:

A mortgage on a registered immovable consisting of apartment ownerships and apartments in the stage of construction (construction in progress in the statement of financial position) up to its carrying amount of LVL 11.0 million (EEK 242.6 million) has been set as collateral for the loan contract with the limit of EUR 3.7 million (EEK 57.9 million).

The group's assets have been pledged in the total amount of EEK 1,475.9 million (incl. movable property in the amount of EEK 768,7 million, inventories in the amount of EEK 669.8 million and items of property, plant and equipment in the amount of EEK 37.4 million).

Note 32 Share capital

In 2010 and 2009, no changes occurred in share capital.

As at 31.12.2010, the share capital in the amount of EEK 177,000 thousand consisted of 17,700 thousand registered shares with the nominal value of 10 kroons each.

Additional information is disclosed in Note 36 under *Capital management*.

Note 33 Construction contracts in progress

in thousands of kroons

	31.12.2010	31.12.2009
Costs incurred for construction contracts in progress and corresponding profit*	5,964,456	6,277,655
Progress billings submitted	(5,812,983)	(6,491,606)
Revenue recorded from construction services during the period	2,365,782	2,772,962
Amounts due from customers for contract works (Notes 16, 36)	212,122	102,144
Amounts due to customers for contract works (Notes 28, 36)	(60,649)	(316,095)
Advance payments received for contract works	131,182	38,068

Amounts due from customers for contract works are included in the statement of financial position line *Trade and other receivables*. Amounts due to customers for contract work are included in the statement of financial position line *Trade and other payables*.

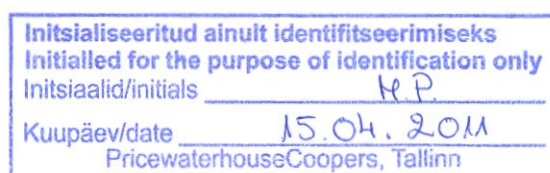
* Costs incurred for construction contracts in progress and corresponding profit have been presented for contracts in effect, including those entered into in 2009 and 2008.

Note 34 Related party transactions

in thousands of kroons

In compiling the Annual Report, the following entities have been considered as related parties:

- parent company AS Riverito;
- shareholders of AS Riverito with significant influence over AS Merko Ehitus through AS Riverito;
- other shareholders with significant influence;
- other subsidiaries of AS Riverito, so-called 'entities controlled by the parent';
- associates and joint ventures;



- key members of the management, their close relatives and entities under their control or significant influence
- entities sharing key personnel with AS Merko Ehitus.

Significant influence is presumed to exist when the person has more than 20% of the voting power.

The parent of AS Merko Ehitus is AS Riverito. As at 31.12.2010 and 31.12.2009, AS Riverito owned 72% of the shares of AS Merko Ehitus. The ultimate controlling party of the group is Mr Toomas Annus.

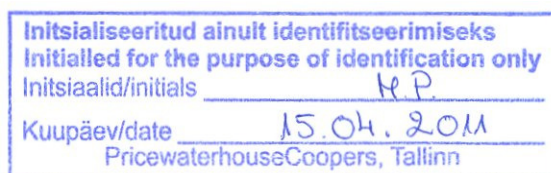
Goods and services

	2010	2009
Purchased construction services		
Associates and joint ventures	1	2,435
Entities under common control	2,232	10,972
Total purchased construction services	<u>2,233</u>	<u>13,407</u>
Other services purchased		
Parent company	<u>17,000</u>	<u>-</u>
Construction services rendered		
Parent company	752	-
Associates and joint ventures	2,007	67
Entities under common control	11,825	133,434
Management members	13,058	15,237
Other related parties	74	896
Total construction services provided	<u>27,716</u>	<u>149,634</u>
Construction materials purchased		
Parent company	1,182	-
Other related parties	87	82
	<u>1,269</u>	<u>82</u>
Real estate purchased		
Entities under common control	<u>-</u>	<u>50,926</u>

Loans granted to related parties are disclosed in Note 17 *Loans granted*.

Balances with related parties

	31.12.2010	31.12.2009
Trade and other receivables		
Trade receivables (Note 16)		
Parent company	85	190
Associates and joint ventures	285	74
Entities under common control	63	483
Other related parties	77	2,431

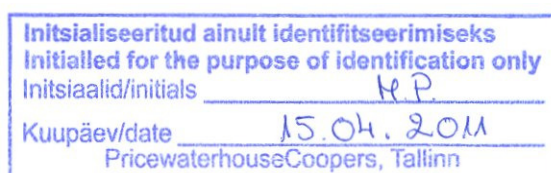


Short-term loans (Note 17)		
Associates and joint ventures	-	16,500
Entities under common control	24,359	43,056
Interest receivables (Note 16)		
Associates and joint ventures	5,987	9,147
Entities under common control	2,731	1,624
Other short-term receivables (Note 16)		
Associates and joint ventures	-	1
Entities under common control	70	-
Prepayments for inventories (Note 18)		
Entities under common control	74,177	57,462
Other long-term loans and receivables		
Long-term loans (Note 17)		
Associates and joint ventures	74,408	18,896
Entities under common control	-	2,889
Interest receivables (Note 21)		
Associates and joint ventures	4,506	-
Borrowings		
Short-term loans and bonds (Note 27)		
Entities under common control	109,354	109,354
Trade and other payables		
Trade payables (Note 28)		
Parent company	180	2
Entities under common control	46	90
Other related parties	5	2
Interest liabilities (Note 28)		
Parent company	254	-
Entities under common control	228	233
Other liabilities (Note 28)		
Entities under common control	100,000	100,000
Prepayments received (Note 28)		
Entities under common control	5	-

In 2010, an allowance for the receivables from entities under common control has been recognised in the amount of EEK 7,727 thousand (2009: EEK 17,735 thousand), the balance written down in 2010 had been included under prepayments for inventory in the consolidated financial statements.

Remuneration of the members of the Supervisory and Management Boards, and senior executives

In 2010, the members of the Supervisory and Management Boards as well as senior executives (directorates) of AS Merko Ehitus were paid remuneration totalling EEK 11,434 thousand (2009: EEK 14,529 thousand). In 2010, the management structure was changed, during the course of which the directorate was liquidated and its functions were returned to the Supervisory Board.



Termination benefits of members of the Supervisory and Management Boards

Authorisation agreements have been entered into with the members of the Supervisory Board according to which no termination benefits are paid to them upon the termination of the contract. Upon premature removal or termination of authority of the members of the Supervisory and Management Boards, the group has the obligation to pay compensation totalling EEK 6,348 thousand (2009: EEK 5,556 thousand). In 2010, compensation totalled EEK 780 thousand (2009: EEK 360 thousand).

Contracts of surety

AS Merko Ehitus provides surety for the liabilities arising from the lease agreements of its subsidiaries and consolidation group entities to Swedbank Autopargi Juhtimise AS in the amount of EEK 679 thousand (31.12.2009: EEK 1,555 thousand).

The fair value of group's surety contracts is immaterial, therefore no liability has been recorded in the balance sheet as at 31.12.2010 as well as at 31.12.2009.

Note 35 Contingent liabilities

in thousands of kroons

The group has purchased the following guarantees from financial institutions to guarantee the group's obligations to third parties. These amounts represent the maximum right of claim by third persons against the group in case the group is unable to meet its contractual obligations. Management estimates that additional expenses related to these guarantees are unlikely.

	31.12.2010	31.12.2009
Performance period's warranty to the customer	302,593	262,573
Tender warranty	51,261	59,254
Guarantee warranty period	152,890	152,114
Prepayment guarantee	161,078	81,296
Contracts of surety	829	9,705
Payment guarantee	2,678	3,318
Letter of credit	-	6,404
Total contingent liabilities	671,329	574,664

Performance period's warranty to the customer – warranty provider guarantees to the customer that the contractor's obligations arising from construction contract will be adequately completed.

Tender warranty – warranty provider guarantees to the customer arranging the tender process that the tenderer will sign a contract as per tender conditions.

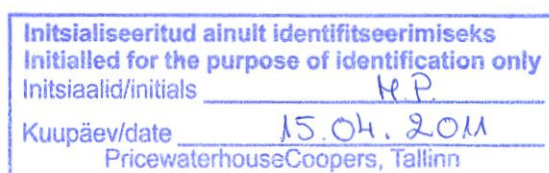
Guarantee for warranty period – warranty provider guarantees to the customer that the construction defects discovered during the warranty period will be repaired.

Prepayment guarantee – warranty provider guarantees to the customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.

Payment guarantee – warranty provider guarantees to the customer payment for goods or services.

Tax authorities have the right to review the group's tax records within 6 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines. The group's management estimates that there are not any circumstances which might lead the tax authorities to impose additional significant taxes on the group.

For legal risks, please refer to the respective paragraph of Note 36.



Note 36 Risk management

Credit risk

Credit risk relates to potential losses which would occur if the parties to the contract are unable to fulfil their contractual obligations. In order to lower credit risks, the payment discipline of customers is constantly monitored; construction activities are partly funded by customer prepayments. Cash is mostly held in overnight deposits or term deposits at Swedbank, SEB, Nordea and Unicredit group. Management estimates that the group is not exposed to significant credit risk.

Financial assets exposed to credit risk <i>in thousands of kroons</i>	Allocation by due dates		Carrying amount	Collateral
	1-12 months	2-5 years		
31.12.2010				
Cash and cash equivalents (Note 14)	154,211	-	154,211	-
Term deposits (Notes 15, 21)	41,475	4,994	46,469	-
Trade receivables (Notes 16, 21)	322,146	20,457	342,603	-
Amounts due from customers for contract works (Notes 16, 33)	212,122	-	212,122	-
Loans granted (Notes 16, 17)	101,704	98,933	200,637	25,000
Interest receivables (Notes 16, 21)	12,642	4,823	17,465	-
Other short-term receivables (Note 16)	2,973	-	2,973	-
Total	847,273	129,207	976,480	25,000
31.12.2008				
Cash and cash equivalents (Note 14)	135,018	-	135,018	-
Term deposits (Notes 14, 15, 21)	625,630	2,809	628,439	-
Trade receivables (Notes 16, 21)	385,109	7,874	392,983	-
Amounts due from customers for contract works (Notes 16, 33)	102,144	-	102,144	-
Loans granted (Notes 16, 17)	96,874	21,785	118,659	25,000
Interest receivables (Notes 16, 21)	13,524	-	13,524	-
Other short-term receivables (Note 16)	9,378	-	9,378	-
Total	1,367,677	32,468	1,400,145	25,000

The group's customers are primarily large local companies or public sector entities (as of 31.12.2010 the public sector proportion in accounts receivable amounted to 46,6%) with well-known and sufficient creditworthiness. The group carefully monitors the payment behaviour of its customers and publicly available information on the payment discipline of entities.

Of the financial assets, an allowance has been set up for doubtful receivables. In 2010, the group's doubtful receivables amounted to EEK 18,130 thousand (2009: EEK 19,921 thousand) and a write-down of uncollectible receivables in the amount of EEK 1,758 thousand was recorded (2009: EEK 13,854 thousand). Management estimates that there are sufficient grounds to assume that the amounts carried in the financial statements will be paid by the customers.

According to the industry practice, trade receivables and receivables recorded based on the stage of completion of construction contracts have no collateral.

Of the loans granted, EEK 98,767 thousand (31.12.2009: EEK 81,341 thousand) are loans to entities under common control and associates of whose economic activities the group has a good overview and therefore, no additional collateral is required. The loans granted to unrelated legal entities include two loans in the amount of EEK 71,939 thousand, the borrowers of which have not been able to timely meet the obligations arising from the loan contract but which have been secured by a mortgage or by parent company guarantee. Management estimates that the collateral covers the balance of the loan principal and there is no need for recognising an allowance for these financial assets. The loans granted to other unrelated legal persons do not carry significant credit risk.

Interest risk

Interest risk arises from interest rate changes in the financial markets as a result of which it may be necessary to revalue the group's financial assets and take into consideration higher financing costs in the future. Most of the group's bank loans have floating interest rates based on either Euribor or the interbank rates of the countries of incorporation of the entities. As the share of interest-bearing liabilities at the group's capital structure is low (as at 31.12.2010: 13.2% and 31.12.2009: 14.9% of the balance sheet total), management considers the effect of changes in the interest rate environment insignificant for the operating results of the group.

Effect of changes in interest risks on finance costs

As at 31.12.2010, the group's interest-bearing liabilities totalled EEK 402,724 thousand. Loan interest depended on the base interest of 3-12 month interbank money market loans of the respective country of incorporation and Euribor.

As at 31.12.2010, the group's maximum need to repay/refinance liabilities in 2011 was EEK 196,430 thousand. The need may decrease, because of the total amount, EEK 27,102 thousand is related to housing development and, depending on the selling success of apartments, the loan is repaid on a continuous basis. Of the liabilities assumed, those with fixed interest rates total EEK 9,447 thousand, including non-current liabilities of EEK 6,405. Liabilities in the amount of EEK 393,277 thousand have floating base interest rates, of which EEK 390,518 thousand is exposed to changes in Euribor and EEK 2,759 thousand to changes in Rigibor. As at 31.12.2010, 12-month Euribor was 1.507% and management estimates that it may increase by 100 basis points over the next 12 months. A change of +/- 100 basis points in Euribor rate at the current level of liabilities would increase/decrease the group's interest expenses by EEK 3,905 thousand. In addition to Euribor risk, the refinancing of liabilities also carries a risk due changes in risk margins attributable to the changes in the economic environment. Management estimates that it may reduce interest rates by 50-100 basis points in 2011, depending on the time of prior fixing of the interest rate. The change in interest rates of loans taken in local currencies by +/- 100 would increase/decrease the group's interest expenses by EEK +/- 77 thousand. The balance of liabilities exposed to the changes in the risk margin as at 31.12.2010 was EEK 86,184 thousand and a change of +/- 100 basis points in the risk margin would increase/decrease the group's interest expenses by EEK +/- 862 thousand.

Foreign exchange risk

The group's economic activities are conducted mainly in the currencies of the countries of location of the companies: Estonian kroons, Latvian lats and Lithuanian litas. From 1 January 2011, Estonia adopted the euro as its national currency. Latvian lats and Lithuanian litas are pegged to the euro. The exchange rate of the Latvian lats is 1 EUR= LVL 0.702804 +/-1%. In order to eliminate foreign exchange risk, the proportions of assets and liabilities denominated in different currencies are monitored and key foreign contracts and long-term loan contracts are preferentially concluded in euros. As at the balance sheet date, EEK 2,942,420 thousand or 96.2% of the assets were denominated in local currencies, including the assets in EEK which made up 55.1%, assets in LVL 34.7% and assets in LTL 6.4% of the balance sheet total, and EEK 2,643,585 thousand or 86.4% of the liabilities were denominated in local currencies, including liabilities in EEK which made up 67.3%, in LVL 17.1% and in LTL 2.0% of the balance sheet total.

Liquidity risk

The Company's liquidity or solvency represents its ability to settle its liabilities to creditors on time. As at 31.12.2010, the group's current ratio was 2.7 (31.12.2009: 2.3) and the quick ratio was 1.1 (31.12.2009: 1.1). To complement available current assets and to ensure liquidity and better management of cash flows, the group has concluded overdraft agreements with banks. As at end of the year, the group entities had concluded overdraft contracts with banks in the total amount of EEK 93,226 thousand. In addition to the overdraft facility, the Company has a current loan facility with the limit of EEK 78,233 thousand from AS Riverito.

In 2010, the group's liquidity was mostly impacted by the negative cash flows from financing activities in the amount of EEK 352,467 thousand, including dividends paid in the amount of EEK 194,700 thousand and repayment of borrowings in the amount of EEK 190,855 thousand. Also, the extension of payment / acceptance deadlines arising from the structural change of customers (higher share of the state and local governments) had an effect of EEK 238,058 thousand.

Management estimates that the group's capital structure – a high proportion of equity at 63.8% of the balance sheet total and a low proportion of interest bearing liabilities at 13.2% of the balance sheet total – ensures the Company's trustworthiness for creditors in the changing economic climate and significantly improves the feasibility of the extension of existing financial liabilities and raising of additional debt.

Financial assets/liabilities <i>in thousands of kroons</i>	Allocation by due date			Total	Carrying amount
	1-3 months	4-12 months	2-5 years		
31.12.2010					
Assets					
Cash and overnight deposits (Note 14)	154,211	-	-	154,211	154,211
Term deposits (Notes 15, 21)	-	41,475	4,994	46,469	46,469
Trade receivables (Notes 16, 21)	297,764	24,382	20,457	342,603	342,603
Receivables recorded based on the stage of completion of construction contracts (Notes 16, 33)	212,122	-	-	212,122	212,122
Loans and interest (Notes 16, 17, 21)	-	114,346	103,756	218,102	218,102
Other short-term receivables (Note 16)	894	2,079	-	2,973	2,973
Total	664,991	182,282	129,207	976,480	976,480
Liabilities					
Trade payables (Notes 28, 30)	207,787	32,570	13,223	253,580	253,580
Due from customers of construction works (Notes 28, 33)	60,649	-	-	60,649	60,649
Loan and finance lease liabilities (Note 27)*	16,483	179,947	206,294	402,724	402,724
Other liabilities (Note 28)	101,133	4,942	-	106,075	106,075
Total	386,052	217,459	219,517	823,028	823,028
31.12.2009					
Assets					
Cash and overnight deposits (Note 14)	135,018	-	-	135,018	135,018
Term deposits (Notes 14, 15, 21)	224,714	400,916	2,809	628,439	628,439
Trade receivables (Notes 16, 21)	358,791	26,318	7,874	392,983	392,983
Due from customers of construction works (Notes 16, 33)	102,144	-	-	102,144	102,144
Loans and interest (Notes 16, 17, 21)	523	109,875	21,785	132,183	132,183
Other short-term receivables (Note 16)	198	9,180	-	9,378	9,378
Total	821,388	546,289	32,468	1,400,145	1,400,145
Liabilities					
Trade payables (Notes 28, 30)	217,408	5,741	10,653	233,802	233,802
Due from customers of construction works (Notes 28, 33)	316,095	-	-	316,095	316,095
Loan and finance lease liabilities (Note 27)*	7,932	439,637	76,316	523,885	523,885
Other liabilities (Note 28)	103,947	1,432	-	105,379	105,379
Total	645,382	446,810	86,974	1,179,161,	1,179,161

* The schedule of expected interest payments cannot be determined with reasonable accuracy. In line with the industry practice of property development, the loan obligations to acquire land plots have been assumed with open-end maturities.

The repayment of these loan obligations depends on the progress of related development projects and on the timing of cash flows generated from those projects after their completion. Consequently, management is of

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opinion that even its best estimate of the timing of expected interest payments would not be sufficiently accurate for the users of these financial statements and this information has not been disclosed.

Capital management

The Commercial Code of the Republic of Estonia specifies the following requirements for the share capital of the entities registered in Estonia:

- the minimum share capital of a public limited company shall be at least EEK 400 thousand;
- the net assets of a public limited company shall be at least one half of the Company's share capital but not less than EEK 400 thousand.

The size of share capital or its minimum and maximum limits are set out in the articles of association of a public limited company whereas the minimum share capital shall equal at least ¼ of maximum share capital.

According to the current articles of association of AS Merko Ehitus, the Company's share capital consists of 17,700 thousand ordinary shares with the nominal value of 10 kroons each and without amending the articles of association of the public limited company, changes can be made to the Company's share capital within the range of EEK 85,000 – 340,000 thousand. As at 31.12.2010, the share capital of AS Merko Ehitus was EEK 177,000 thousand and the net assets were EEK 1,951,700 thousand, so the Company's equity and share capital were in compliance with the requirements established in the Republic of Estonia.

In capital management, the Company follows the principle of maintaining its trustworthiness, sustainable development and the assets of shareholders through an economic cycle and hence it monitors that its equity to assets ratio should be at least 40% (31.12.2010: 63.8%, 31.12.2009: 60.5%) at any given time and interest bearing debt to assets ratio would not exceed 25% (31.12.2010: 13.2%, 31.12.2009: 14.9%). The overdraft contract with Nordea Bank Finland Plc Estonia branch sets a requirement that the share of the Company's consolidated equity of total assets would not fall below 35%.

Legal risk

Due to different interpretations of contracts, regulations and laws related to group's principal activities, there is a risk that some buyers, contractors or supervisory authorities evaluate the Company's activities from the perspective of laws or contracts from a different position and dispute the legitimacy of the Company's activities.

As at 31.12.2010, a provision has been set up at the group in the amount of EEK 4,102 thousand for covering potential claims and legal costs (31.12.2009: EEK 14,492 thousand), (Note 29).

An overview of the key legal disputes of group entities as at 31.12.2010 is presented below.

At 8 November 2010, Lithuanian company UAB Olinda filed a claim with the Arbitration Court of Helsinki Chamber of Commerce and Industry against UAB Merko Statyba in the amount of LTL 17,300 thousand (EEK 78,396 thousand). UAB Olinda's losses were allegedly incurred in conjunction with the refusal of UAB Merko Statyba to launch work pursuant to the construction contract. UAB Merko Statyba is of opinion that the project submitted by the customer and the building permit were not in compliance with Lithuanian laws as well as the detailed plan of the registered immovable intended for the purpose of construction, and Merko Statyba was under the obligation to refuse performance of illegal construction activities. The Lithuanian Planning and Construction Inspectorate is also of opinion that the launch of construction activities on the property is illegal until the documentation of the construction project and building permit has been brought into compliance with Lithuanian legislation. At the request of the Inspectorate, Vilnius Administrative Court has also suspended the validity of the building permit. The session at the court of arbitration in the disputed matter will take place at 14-15 June 2011. The group's management is of the opinion that UAB Merko Statyba's refusal to launch construction activities on the grounds of an invalid building permit was justified and the claim will be dismissed.

At 31 December 2010, customer UAB Neringos Vanduo filed a claim against the Lithuanian branch of AS Merko Ehitus in the amount of LTL 2,000 thousand (EEK 9,063 thousand) related to the alleged improper fulfilment of the contract for services concerning Neringa wastewater treatment plant and effected the performance warranty issued by the bank to the customer in the amount of LTL 1,000 thousand (EEK 4,532 thousand). Merko Ehitus is of opinion that the goals laid down in the contract have been attained – the wastewater treatment plant has received authorisation for use, incl. permit by the Lithuanian Health Board in

accordance with the contract for services and Lithuanian laws, the customer has no legal grounds to demand payment of contractual penalties and it intends to prove its right in court.

At 9 January 2011, a court case opened at Harju County Court which among other issues deals with the claim filed against AS Merko Ehitus in relation to the giving of bribe to the former Tallinn city official Ivo Parbus. The Prosecutor's Office has charged Merko Ehitus with the giving of the bribe – Estravel's gift coupon of EEK 25,000 and the book with the list price of EEK 410 titled "Eesti Talurahva Arhitektuur" (*Estonian Vernacular Architecture*) in order to accelerate the proceedings with the plans of three registered immovables located in Tallinn. The group's management is of opinion that the Company has not given a bribe and has conducted its activities in conformity with the laws of the Republic of Estonia. According to section 44 of the Penal Code, a court can, upon conviction, impose a pecuniary punishment from EEK 50 thousand to EEK 250 000 thousand. Pecuniary punishment may be imposed as supplementary punishment in addition to forced liquidation.

AS Solaris Keskus has not paid EEK 33,385 to the general contractors (AS Merko Ehitus ja AS Skanska EMV) for the work performed at Solaris recreational centre. AS Solaris Keskus delays with the payment of invoices, referring to the erroneous overpayment made to the builders in the amount of EEK 5,085 thousand and additional expenses incurred for the opening and subsequent use of the centre due to the alleged low quality of construction work performed. This lawsuit will be settled by the parties in court. The group's management is of opinion that the refusal of Solaris Keskus to pay the invoice is not justified.

Asset valuation

Despite the stabilisation of the economic environment in 2010, the effect of real estate market risk was still significant when evaluating the activities of the Company. In 2010, the group made significantly less write-downs of inventories and assets as due to the stabilisation of the economic environment, their net realisable value exceeded the costs incurred for their acquisition. The group incurred a loss in the amount of EEK 17,702 due to the write-down of the value of assets, including EEK 15,944 thousand due to the write-down of inventories (incl. registered immovables for resale of EEK 4,446 thousand, prepayment for registered immovable of EEK 7,727 thousand, construction in progress of EEK 3,891 thousand (incl. write-down of construction in progress of EEK 12,722 thousand and reversal of the write-down of construction in progress of EEK 8,831 thousand) and reversal of the write-down of finished goods of EEK 120 thousand) and a loss of EEK 1,758 thousand on the write-down of irrecoverable receivables.

In 2010, market risk arose primarily as a result of changes in input prices. Due to strong global demand, the construction sector inputs have appreciated, the prices of all materials and the rent of equipment have increased. Strong demand in the construction sectors of Central Europe and Scandinavia has created a real alternative for local workforce to sell their labour to foreign countries and has led to appreciation of labour costs. Appreciation of inputs and orientation of many subcontracting entities towards foreign markets has led to significant appreciation of construction services over the last 9 months. As compared to the bottom of the construction market in 2009, construction prices have increased by 20-25%. Great volatility of prices will complicate the budgeting of new projects and completion of construction of projects with the budgeted costs and will lead to additional risk when performing construction contracts with fixed prices and put price pressure on profitability of projects. This reason was of significant importance for the formation of weaker than expected results of the group in the 4th quarter.

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Note 37 Supplementary disclosures on the parent

The financial information of the parent comprises separate primary statements of the parent (income statement, statement of financial position, cash flow statement and statement of changes in equity), the disclosure of which is required by the Estonian Accounting Act. The primary financial statements of the parent have been prepared using the same accounting methods and measurement bases as those used for the preparation of the consolidated financial statements, except for subsidiaries, associates and joint ventures which are reported at cost in the separate primary financial statements of the parent.

Income statement

in thousands of kroons

	2010	2009
Revenue	1,468,193	1,941,232
Cost of goods sold	(1,376,653)	(1,770,366)
Gross profit	91,540	170,866
Marketing expenses	(23,886)	(24,105)
General and administrative expenses	(53,044)	(64,997)
Other operating income	45,234	34,157
Other operating expenses	(3,897)	(9,117)
Operating profit	55,947	106,804
Finance income/costs	2,961	15,911
Finance income/costs from investments in subsidiaries	281,497	176,760
Finance income/costs from investments in associates and joint ventures	(3)	-
Net profit for the year	340,402	299,475

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Statement of financial position

in thousands of kroons

	31.12.2010	31.12.2009
ASSETS		
Current assets		
Cash and cash equivalents	38,754	176,152
Short-term deposits	23,475	400,916
Trade and other receivables	567,300	680,160
Prepaid corporate income tax	6,354	3,438
Inventories	205,093	202,844
Non-current assets held for sale	840	1,750
	<u>841,816</u>	<u>1,465,260</u>
Non-current assets		
Investments in subsidiaries	529,955	445,301
Investments in associates and joint ventures	4,040	4,020
Other long-term financial assets	864,409	357,391
Property, plant and equipment	18,096	24,620
Intangible assets	6,563	7,605
	<u>1,423,063</u>	<u>838,937</u>
TOTAL ASSETS	<u>2,264,879</u>	<u>2,304,197</u>
LIABILITIES		
Current liabilities		
Borrowings	147,348	216,763
Trade and other payables	409,009	525,834
Short-term provisions	24,798	24,526
	<u>581,155</u>	<u>767,123</u>
Non-current liabilities		
Other long-term trade payables	9,237	8,289
	<u>590,392</u>	<u>775,412</u>
TOTAL LIABILITIES	<u>590,392</u>	<u>775,412</u>
EQUITY		
Share capital	177,000	177,000
Statutory reserve capital	17,700	17,700
Retained earnings	1,479,787	1,334,085
	<u>1,674,487</u>	<u>1,528,785</u>
TOTAL EQUITY	<u>1,674,487</u>	<u>1,528,785</u>
TOTAL LIABILITIES AND EQUITY	<u>2,264,879</u>	<u>2,304,197</u>

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Statement of changes in equity

in thousands of kroons

Parent	Share capital	Statutory reserve capital	Retained earnings	Total
Balance as at 31.12.2008	177,000	17,700	1,096,560	1,291,260
Net profit for financial year	-	-	299,475	299,475
Dividends	-	-	(61,950)	(61,950)
Balance as at 31.12.2009	177,000	17,700	1,334,085	1,528,785
Carrying amount of holdings under dominant or significant influence				(449,321)
Value of holdings under dominant or significant influence under the equity method				1,047,417
Adjusted unconsolidated equity 31.12.2009				2,126,881
Net profit for financial year	-	-	340,402	340,402
Dividends	-	-	(194,700)	(194,700)
Balance as at 31.12.2010	177,000	17,700	1,479,787	1,479,787
Carrying amount of holdings under dominant or significant influence				(533,995)
Value of holdings under dominant or significant influence under the equity method				811,285
Adjusted unconsolidated equity 31.12.2010				1,951,777

Adjusted unconsolidated retained earnings represent the amount that is available for distribution to the shareholders according to the Estonian Accounting Act.

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Cash flow statement


in thousands of kroons

	2010	2009
Cash flows from operating activities		
Operating profit	55,947	106,804
Adjustments:		
depreciation and impairment charge	8,918	7,957
profit/loss from sale of non-current assets	(15)	(26)
adjustment of revenue from construction contracts under stage of completion method	(240,366)	73,172
interest income from business activities	(43,641)	(33,927)
change in provisions	(7,757)	8,426
Change in trade and other receivables related to operating activities	(14,101)	(19,801)
Change in inventories	(2,249)	34,035
Change in trade and other payables related to operating activities	51,170	(60,172)
Interest paid	(4,324)	(16,659)
Corporate income tax reimbursed	8	-
	(196,410)	99,809
Cash flows from investing activities		
Investments in subsidiaries	(100,615)	(114,008)
Proceeds from sale and liquidation of subsidiaries	-	1,125
Merger with subsidiary	-	72,950
Acquisition of associates and joint ventures	(22)	-
Purchase of/ proceeds from short-term deposits with maturities greater than 3 months	377,441	(138,157)
Purchase of property, plant and equipment	(2,052)	(10,422)
Proceeds from sale of property, plant and equipment	1,834	584
Purchase of intangible assets	(209)	(886)
Loans granted	(398,063)	(176,750)
Loan repayments received	102,752	87,364
Interest received	42,910	30,061
Dividends received	298,497	60,461
	322,473	(187,678)
Cash flows from financing activities		
Proceeds from borrowings	6,480	62,916
Loan repayments received	(75,928)	(132,142)
Finance lease principal payments	(685)	(712)
Dividends paid	(194,700)	(61,950)
	(264,833)	(131,888)
Net increase/decrease in cash and cash equivalents	(138,770)	(219,757)
Change in deposits with maturities greater than 3 months	(377,441)	138,157
Total change	(516,211)	(81,600)
Cash and cash equivalents in the beginning of period	176,152	394,877
Deposits with maturities greater than 3 months at the beginning of period	400,916	262,759
Total in the beginning of period	577,068	657,636
Effects of changes in foreign exchange rates	1,372	1,032
Cash and cash equivalents at end of the period	38,754	176,152
Deposits with maturities greater than 3 months at the end of period	23,475	400,916
Total at the end of period	62,229	577,068

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SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2010 ANNUAL REPORT


The Management Board of AS Merko Ehitus has prepared the management report, the consolidated financial statements and the profit allocation proposal for 2010.

Tiit Roben	Chairman of the Management Board		12.04.2011
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Alar Lagus	Member of the Management Board		12.04.2011
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Veljo Viitmann	Member of the Management Board		12.04.2011
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Andres Agukas	Member of the Management Board		12.04.2011
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Jaan Mäe	Member of the Management Board		12.04.2011
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Viktor Mõisja	Member of the Management Board		12.04.2011
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The Supervisory Board has reviewed the Annual Report which consists of the management report and the financial statements prepared by the Management Board, and which also includes the auditor's report and the profit allocation proposal, and approved it for presentation at the General Meeting of Shareholders.

Tõnu Toomik	Chairman of the Supervisory Board		18.04.2011
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Indrek Neivelt	Member of the Supervisory Board		18.04.2011
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Teet Roopalu	Member of the Supervisory Board		18.04.2011
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Olari Taal	Member of the Supervisory Board		18.04.2011
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INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS Merko Ehitus

We have audited the accompanying consolidated financial statements of AS Merko Ehitus and its subsidiaries, which comprise the consolidated statement of financial position as of 31 December 2010 and the consolidated statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

Management Board is responsible for the preparation, and true and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 true and fair presentation of the consolidated 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 consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of AS Merko Ehitus and its subsidiaries as of 31 December 2010, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Tiit Raimla'.

Tiit Raimla
Auditor's Certificate No.287

A handwritten signature in blue ink, appearing to read 'Märten Padu'.

Märten Padu
Auditor's Certificate No.513

15 April 2011

** This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

PROFIT ALLOCATION PROPOSAL

in EUR

Retained earnings	111,992,184	(EEK 1,752,296,911)
Net profit for 2010	1,229,186	(EEK 19,232,573)

Total retained earnings as at 31.12.2010 113,221,370 (EEK 1,771,529,484)

The Management Board proposes profit allocation as follows:

As dividend (0.10 EUR per share)	1,770,000	(EEK 27,694,482)
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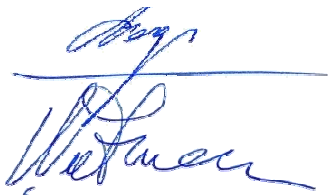
Retained earnings after distribution of dividend s 111,451,370 (EEK 1,743,835,002)

Tiit Roben Chairman of the Management Board



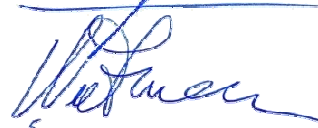
12.04.2011

Alar Lagus Member of the Management Board



12.04.2011

Veljo Viitmann Member of the Management Board



12.04.2011

Andres Agukas Member of the Management Board



12.04.2011

Jaan Mäe Member of the Management Board



12.04.2011

Viktor Mõisja Member of the Management Board



12.04.2011

CONTACT DATA OF ANALYSTS FOR MERKO EHITUS GROUP

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REVENUE BREAK-DOWN OF THE PARENT PRESENTED ACCORDING TO THE ESTONIAN CLASSIFICATIONS OF ECONOMIC ACTIVITIES

Revenue break-down of the standalone parent of the group AS Merko Ehitus is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), as required under the Commercial Code § 4 p.6:

		<i>in thousands of kroons</i>	
EMTAK code		2010	2009
	Rendering of construction services		
4120	construction of residential and non-residential buildings	526,549	1,022,873
4110	development of building projects	111,623	64,173
4211	construction of roads and railways	420,191	408,564
4221	construction of utility projects for fluids	220,965	221,260
	construction of utility projects for electricity and		
4222	telecommunications	65,513	90,734
4291	construction of water projects	47,878	32,980
4213	construction of bridges and tunnels	2,717	54,472
4299	construction of other civil engineering projects n.e.c.	63,132	37,138
		<u>1,458,568</u>	<u>1,932,194</u>
	Real estate activities		
6810	sales of own real estate	9,400	8,500
6820	renting and operating of own or leased real estate	225	538
		<u>9,625</u>	<u>9,038</u>
	Total revenue	<u>1,468,193</u>	<u>1,941,232</u>