



# **AS Merko Ehitus**

## **Group**

### **Consolidated Annual Report**

Translation of the Estonian original

Beginning of financial year: 01.01.2011

End of financial year: 31.12.2011

Business name: AS Merko Ehitus

Main activity: general contracting of construction

Commercial

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Auditor: AS PricewaterhouseCoopers

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

Management Board: Andres Trink, Alar Lagus, Viktor Mõisja

## TABLE OF CONTENTS

MANAGEMENT REPORT.....	3
MANAGEMENT BOARD'S CONFIRMATION.....	24
FINANCIAL STATEMENTS.....	25
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME.....	25
CONSOLIDATED STATEMENT OF FINANCIAL POSITION .....	26
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY .....	27
CONSOLIDATED CASH FLOW STATEMENT .....	28
NOTES .....	29
Note 1 Summary of significant accounting policies.....	29
Note 2 Management estimates .....	39
Note 3 Operating segments .....	41
Note 4 Cost of goods sold .....	43
Note 5 Marketing expenses.....	43
Note 6 General and administrative expenses.....	43
Note 7 Other operating income .....	44
Note 8 Other operating expenses.....	44
Note 9 Finance income.....	44
Note 10 Finance costs .....	44
Note 11 Corporate income tax.....	45
Note 12 Earnings per share.....	46
Note 13 Dividends per share.....	46
Note 14 Cash and cash equivalents.....	46
Note 15 Short-term deposits.....	46
Note 16 Trade and other receivables.....	46
Note 17 Loans granted.....	47
Note 18 Inventories.....	49
Note 19 Shares in subsidiaries .....	50
Note 20 Investment in associates and joint ventures.....	51
Note 21 Other long-term loans and receivables .....	53
Note 22 Deferred income tax assets and liabilities .....	54
Note 23 Investment property .....	55
Note 24 Property, plant and equipment .....	56
Note 25 Intangible assets .....	57
Note 26 Leased assets .....	57
Note 27 Borrowings .....	58
Note 28 Payables and prepayments .....	60
Note 29 Short-term provisions .....	61
Note 30 Other long-term payables.....	61
Note 31 Loan collaterals and pledged assets .....	62
Note 32 Share capital.....	62
Note 33 Construction contracts in progress.....	63
Note 34 Related party transactions .....	63
Note 35 Contingent liabilities .....	66
Note 36 Risk management.....	66
Note 37 Supplementary disclosures on the parent .....	72
SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2011 ANNUAL REPORT.....	76
INDEPENDENT AUDITOR'S REPORT.....	77
PROFIT ALLOCATION PROPOSAL .....	79
CONTACT DATA OF ANALYSTS FOR MERKO EHITUS GROUP.....	80
REVENUE BREAK-DOWN OF THE PARENT PRESENTED ACCORDING TO THE ESTONIAN CLASSIFICATIONS OF ECONOMIC ACTIVITIES .....	81

## MANAGEMENT REPORT

### General information

AS Merko Ehitus is a leading construction and real estate 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 35 subsidiaries, and 5 associates and joint ventures, the largest of which are SIA Merks (100%), UAB Merko Statyba (100%), AS Merko Infra (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 TMB (25%).

### Structure

The key changes which occurred in the group in 2011:

- On the 28<sup>th</sup> November 2011, AS Merko Ehitus set up a wholly-owned subsidiary AS Merko Ehitus Eesti, where the entire construction business in Estonia will be transferred.
- On the 6<sup>th</sup> December 2011, AS Merko Ehitus set up a wholly-owned subsidiary OÜ Merko Property.
- On the 20<sup>th</sup> December 2011, AS Merko Ehitus sold its wholly-owned subsidiary OÜ Pallasti Kinnisvara for EUR 3.2 million, which owned a recently completed Lasnamäe District Government office building.

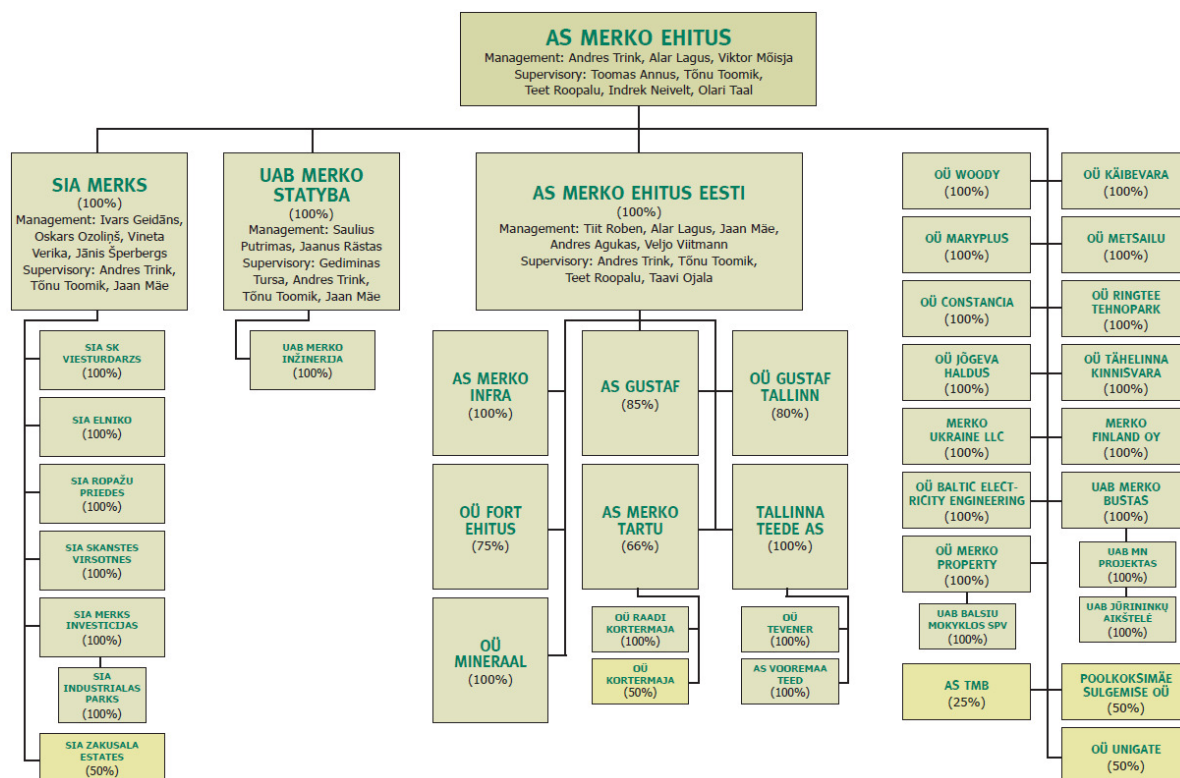
After the balance sheet date, at 13 March 2012, AS Merko Ehitus set up a wholly-owned Finnish subsidiary Merko Finland OY (registration no. 2463604-6). This represented a technical transaction, the goal of which was to set up a legal platform for activities outside the Baltic States, including the Russian market.

At the meeting of the Supervisory Board held on the 2<sup>nd</sup> of December 2011, the Management and Supervisory Boards of AS Merko Ehitus decided to change the group's management structure and according to the resolution of the Supervisory Board of AS Merko Ehitus from 30 December 2011, the group's entire construction business in Estonia was transferred to AS Merko Ehitus Eesti starting from 1<sup>st</sup> of January 2012. The technical completion of the transaction will take place gradually in the first half of 2012. The objective of the changes is to separate the group management from its Estonian production management and to allocate resources to the group's operating areas more efficiently.

After this change, AS Merko Ehitus will operate as a holding company without independent production activities, with 100% ownership interests in construction companies AS Merko Ehitus Eesti, SIA Merks and UAB Merko Statyba and ownership in the group's real estate development unit together with companies holding real estate properties (incl. OÜ Woody, OÜ Constancia, OÜ Metsailu). The main activity of the holding company will be development and implementation of the strategies of Merko Ehitus group's separate business areas primarily through long-term planning of resources.

From 1 January 2012, the Chairman of the Management board of AS Merko Ehitus is Andres Trink. Viktor Möisja and Alar Lagus will continue as the members of the Management Board of AS Merko Ehitus. There are no changes in the composition of the Company's Supervisory Board: Toomas Annus will continue as the Chairman of the Supervisory Board, and its members will be Tõnu Toomik, Teet Roopalu, Indrek Neivelt and Olari Taal.

Structure of AS Merko Ehitus group after the technical completion of the structural change:



## Goals

In 2011, AS Merko Ehitus followed in its activities the strategic goals approved in 2010:

- 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 the city of St. Petersburg in Russia to be promising markets.
- Outside the 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.

The strategic goals will be reviewed annually, based on the changes in the economic and business environment.

Long-term financial goals of AS Merko Ehitus:

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

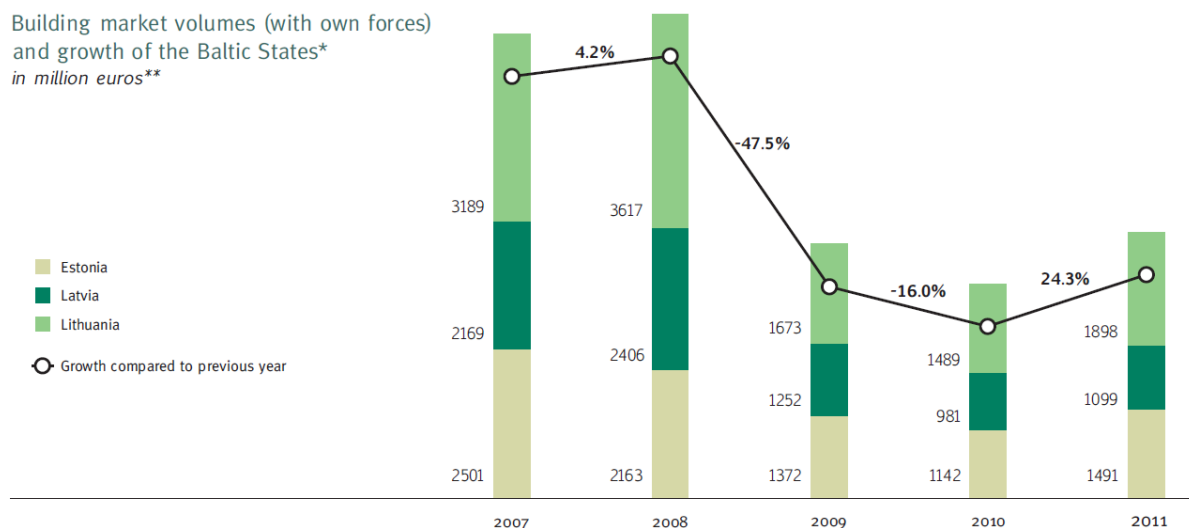
## Baltic construction market

The slight improvement of the economic environment in the Baltic States in 2010 gave a positive impetus for the growth in the construction sector in 2011.

In 2011, construction works with own resources were performed in the Baltic region for EUR 4,488 million which is EUR 876 million higher than in 2010. While in 2010 the entire Baltic construction market declined by 16.0%, it grew by 24.3% in 2011, the volumes of construction works increased in all Baltic States. Estonia experienced the highest growth where the construction market in current prices increased by 30.6% (2010: -16.8%), to EUR 1,491 million and made up 33.2% of the total Baltic construction market. The Lithuanian construction market increased by almost the same percentage (+27.4%), but as a considerably larger market, the Lithuanian construction market made up 42.3% i.e. EUR 1,898 million of the total Baltic construction market. The Latvian construction market which fell the most in 2010 (-21.4%) increased by 11.4% in 2011. According to information of the Statistical Department, construction works with own resources were performed for EUR 1,099 in Latvia in 2011, which made up the smallest share of the Baltic construction market, i.e. 24.5%. Along with an increase in construction works, the construction works per capita also increased. In 2011, construction works per capita were performed for EUR 1,113 in Estonia, EUR 537 in Latvia and EUR 589 in Lithuania.

Due to the low value of the reference base, the volumes of the construction markets in the Baltic States have demonstrated up to 40% growth in the last quarters of the year. As compared to the 4<sup>th</sup> quarter of 2010, construction works performed with own resources increased by 46.0% in Estonia, 40.1% in Lithuania and 28.1 in Latvia. In addition to the improved domestic market situation, the growth of construction volumes also increased in export markets. In a year, the volume of works completed by Estonian companies in foreign countries increased by 32.8% (contributing 11% to total volume of construction services completed with own resources), the exports of Latvian companies increased by 79.8% (contributing 9% to the volume of construction services) and the exports of Lithuania increased by 25.6% (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.

While the data by Statistics Estonia reflect a modest appreciation of construction prices in all Baltic States as compared to 2010 (+3.1%, incl. labour costs +7.6% in Estonia, +2.1%, incl. labour costs -1.0% in Latvia and

+3.9%, incl. labour costs +5.6% in Lithuania), the actual annual increase in construction prices was 20-25% according to construction companies. Due to the high volatility of input prices, the budgeting of projects and their completion with the budgeted costs continues to be difficult and will lead to additional risks when performing construction contracts with fixed prices. While in the first half of the year it were the contractors which had to bear the cost of the fast appreciation of construction prices, the problem reached the contracting entities in the second half of the year, accompanied by cancellation of several invitations to tender that had been announced because the bids did not correspond to the budgets prepared in 2009/2010 and the funds allocated for the projects were insufficient.

The construction of new apartments which picked up in Tallinn and Vilnius in the first half of the year stalled in the second half. The fast appreciation of construction input prices as compared to the sales prices of apartments will significantly curb the launch of new residential construction projects in the near future and will have a negative impact on the supply of residential premises. Due to the higher uncertainty of the economic environment in the entire eurozone in the second half of the year, buyers are less willing to invest in new apartments and are in no hurry to make decisions in this regard. The willingness of banks to finance development activities and end users of residential premises in 2011 was good in Lithuania and Estonia, and satisfactory in Latvia.

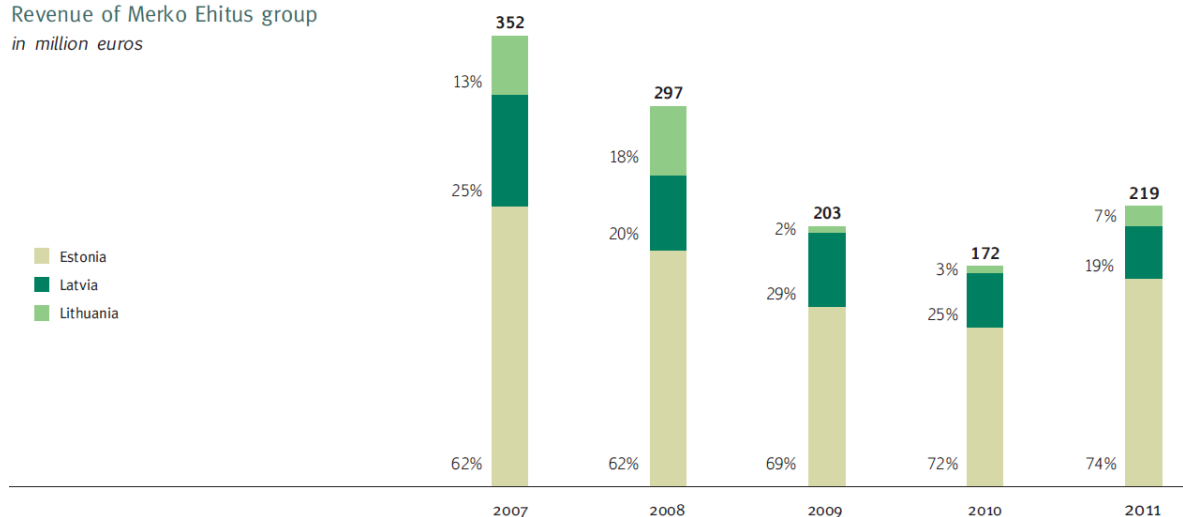
The number of authorisations for use issued for new residential premises has changed in 2007-2011 by country as follows:

Estonia	7073 -> 5300 -> 3026 -> 2324 -> 1918
Latvia	9319 -> 8084 -> 4187 -> 1918 -> 2662
Lithuania	9286 -> 11829 -> 9400 -> 3667 -> 5066

## Operating results

In 2011, the revenue of the construction group was EUR 219.3 million, of which Estonia contributed 74.0%, Latvia 19.0% and Lithuania 7.0%. As compared to 2010, the group's revenue increased by 27.6%, including increases by 30.5% in Estonia and 242.0% in Lithuania, and decrease by 3.3% in Latvia. Considering the growth of the Baltic construction market by 24.3%, it should be noted that the group's revenue also increased in line with the market but since the group ended the financial year with a loss for the first time, the result may be considered unsatisfactory.

Revenue of Merko Ehitus group  
in million euros

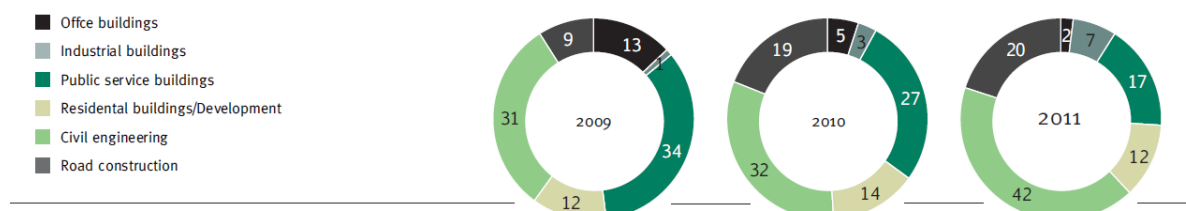


The consolidated revenue of the group's largest entities:

<i>in thousands of euros</i>			
	2011	2010	2009
<b>Estonian entities</b>			
AS Merko Ehitus (parent)	104,118	89,780	107,968
Tallinna Teede AS (100% ownership)	21,614	20,792	17,603
AS Merko Infra (100% ownership)	20,199	549	-
AS Gustaf (85% ownership)	3,243	2,598	2,820
OÜ Gustaf Tallinn (80% ownership)	5,013	3,451	3,907
AS Merko Tartu (66% ownership)	6,765	2,485	4,606
OÜ Woody (100% ownership)	1,577	3,941	1,598
<b>Latvian entity</b>			
SIA Merks (100% ownership)	41,754	43,169	59,181
<b>Lithuanian entity</b>			
UAB Merko Statyba (100% ownership)	13,340	4,432	4,532
<b>Total group</b>	<b>219,322</b>	<b>171,919</b>	<b>203,316</b>

Engineering construction contributed 42%, residential construction/development 12%, service buildings 17%, office buildings 2%, industrial buildings 7% and road construction 20% to the group's revenue. New buildings made up 59%, and renovation and reconstruction works made up 41% of construction activities.

Distribution of construction activities of the group  
per cent



In 2011, the group concluded new construction contracts in the total amount of EUR 185 million. The largest construction contracts entered into in 2011 included the maintenance facilities for aircraft at Tallinn Airport (EUR 10.6 million), construction of Aruküla 330/110 kV substation (EUR 7.2 million), reconstruction and expansion works of public water supply and sewerage systems of the town of Kehra and its vicinity (EUR 5.6 million), stage II of the reconstruction of pipelines and bore wells of the town of Sillamäe (EUR 5.4 million) and partial reconstruction of the insulation, ventilation and heating of the library of Tartu University (EUR 4.0 million). As at 31 December 2011, group's portfolio on unfinished construction contracts totalled EUR 166 million.

The contract portfolio does not include residential projects developed by the group and the works related to construction of investment properties (incl. the contract for the construction and leasing of Jõgeva police and court building).

## The largest projects completed in 2011

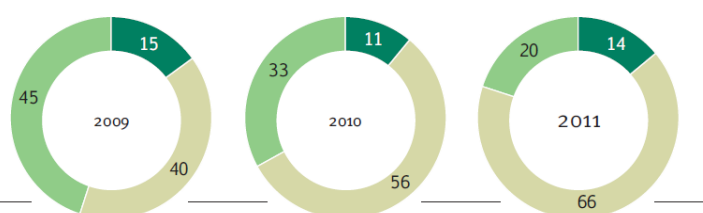
Volta 110kv substation Põlva 110kv substation	reconstruction	Tööstuse 52a, Tallinn Põlva		AS Merko Ehitus
Reinforcement of the sides of Pärnu moat and the park area	reconstruction	Pärnu		AS Merko Ehitus
Porkuni school	new facility	Porkuni, Lääne-Virumaa	7,153 m <sup>2</sup>	AS Merko Ehitus
Library of Tallinn University of Technology	reconstruction	Ehitajate tee 5, Tallinn	4,470 m <sup>2</sup>	AS Merko Ehitus
Apartment building at Kristiina 12	new facility	Kristiina 12, Tallinn	1,695 m <sup>2</sup>	AS Merko Ehitus
Office building of Lasnamäe District Government	new facility	Pallasti 54, Tallinn	3,130 m <sup>2</sup>	AS Merko Ehitus
Office building at Ehitajate Road 120	new facility	Ehitajate Road 120, Tallinn	2,063 m <sup>2</sup>	AS Merko Ehitus
Tõdva-Saku; Tõdva-Hageri	reconstruction	National road 11240 Tõdva- Hageri (km-s 0-3.6 section) and 11342 Saku-Tõdva (km-s 3.4-7.4 section)	68,352 m <sup>2</sup>	Tallinna Teede AS
Steel melting plant	reconstruction	Brīvības 94, Liepāja	24,481 m <sup>2</sup>	SIA Merks
Prisma hypermarket	reconstruction	Kurzemes 3, Rīga	9,313 m <sup>2</sup>	SIA Merks
Balsiu schoolhouse	new facility	Bubilu 8, Vilnius	11,236 m <sup>2</sup>	UAB Merko Statyba
Nursing and care service facilities of Kuressaare Hospital	reconstruction	Aia 25, Kuressaare	3,102 m <sup>2</sup>	AS Gustaf
Annex of the production facility of Meteci Valduse OÜ	new facility	Ringtee 6, Tartu	3,226 m <sup>2</sup>	AS Merko Tartu

The confidence and investing prowess of the private sector in the areas of real estate and infrastructure development 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 revenue according to customers

per cent

- Development projects
- State and municipality
- Private customers



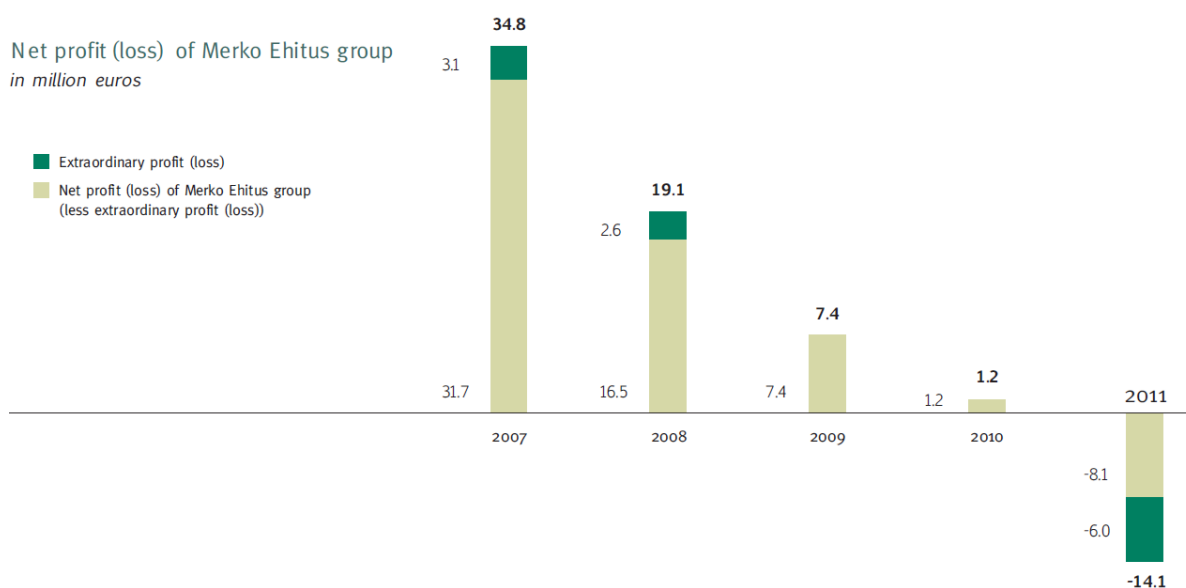
In 2011, the group's gross profit from development and construction activities totalled EUR 0.7 million, including EUR 0.4 million in the 4<sup>th</sup> quarter. The group's gross loss including allowances for impairment losses totalled EUR -3.6 million, including EUR -4.0 million in the 4<sup>th</sup> quarter and the gross margin fell from 7.5% to -1.6% in a year. In 2011, the group's marketing, and general and administrative expenses fell by 8.3%, amounting to 4.6% of the group's revenue (2010: 6.4%). The reduction in marketing, general and administrative expenses was aided by cost-savings measures implemented in prior years, of which the cuts of



other expenses totalled EUR 0.4 million, of staff costs EUR 0.3 million, and of advertising and sponsorship expenses EUR 0.1 million.

In 2011, the group's pre-tax loss totalled EUR 14.0 million and net loss was EUR 14.1 million as compared to the pre-tax profit of EUR 1.8 million and net profit of EUR 1.2 million in 2010. The main reason for the group's loss for 2011 was faster than expected appreciation of construction prices, as a result of which the construction contracts entered into in 2009/2010 and several development projects became unprofitable. The reason for the loss was faster than expected appreciation of construction prices with regard to the contracts entered into in 2009/2010 and the impairment losses for development projects in the 4<sup>th</sup> quarter due to the slow recovery of the Baltic real estate market and appreciation of construction prices. In 2011, the group incurred a loss of EUR 5.98 million due to the recognition of impairment losses for development projects (incl. properties for sale of EUR 2.54 million (incl. impairment losses of inventories of EUR 1.12 million and those at a joint venture of EUR 1.42 million), prepayments for registered immovables of EUR 1.14 million, construction in progress of EUR 2.30 million).

In addition, the group wrote off irrecoverable receivables in the amount of EUR 0.08 million. Based on the results of impairment testing, impairment losses recognised in previous periods for properties for sale were reversed in the amount of EUR 0.10 million and impairment losses of finished projects were reversed in the amount of EUR 0.15 million. The group's pre-tax loss before extraordinary write-downs was EUR 8.0 million. As at 31.12.2011, the group had recognised provisions in the amount of EUR 3.5 million to cover the costs related to completion of unprofitable projects. A higher share of construction of infrastructure facilities in 2011 has considerably increased the seasonal impact on the group's quarterly results of operations (revenue in 2011: EUR 26.2 million in Q1, EUR 48.9 million in Q2, EUR 78.3 million in Q3 as compared to EUR 65.9 million in Q4). Warmer than normal winter alleviated the seasonal impact on the Company's revenue in the 4<sup>th</sup> quarter of 2011. The cyclical nature of the development activities was impacted by the sale of apartments in the amount of EUR 5.9 million in the 4<sup>th</sup> quarter which made up 32.6% of the total annual revenue from the sale of apartments. The impact of the seasonal nature of the construction activity and the cyclical nature of the development activity was insignificant for the results of the financial year.



In 2011, the change in short-term investments, and cash and cash equivalents of Merko Ehitus group was EUR +8.5 million and as at 31 December 2011, the cash and cash equivalents in the bank accounts and term deposits of the group were in the amount of EUR 18.6 million. The cash flows from operating activities totalled

EUR -12.3 million, cash flows from investing activities totalled EUR +8.7 million and cash flows from financing activities totalled EUR +12.1 million. The cash flows from operating activities in the reporting period were mostly affected by the change in receivables and prepayments of EUR -30.3 million, change in liabilities and prepayments related to operating activities of EUR +15.8 million and the operating loss of EUR -13.3 million. Of the cash flows from investing activities, the balance of issued and repaid loans totalled EUR +5.3 million and interest received totalled EUR +0.8 million. Of the cash flows from financing activities, the balance of loans received and repaid totalled EUR +15.5 million, dividends paid totalled EUR -1.8 million and finance lease payments totalled EUR -1.7 million.

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

	2011	2010	2009
Net profit margin	-6.4%	0.7%	3.7%
EBT margin	-6.4%	1.0%	3.8%
Operating profit margin	-6.1%	1.4%	4.2%
Gross margin	-1.6%	7.5%	10.9%
EBITDA margin	-5.0%	2.8%	5.3%
Return on equity per annum	-12.0%	0.9%	5.5%
Return on assets per annum	-6.8%	0.6%	3.2%
Equity ratio	49.6%	63.8%	60.5%
Current ratio	2.0	2.7	2.3
Quick ratio	1.0	1.1	1.1
General expense ratio	4.6%	6.4%	6.3%
Personnel expense ratio	7.6%	9.3%	8.8%
Debt to equity ratio	36.9%	20.6%	24.6%
Accounts receivable turnover (in days)	59	44	44
Accounts payable turnover (in days)	56	35	29
Sales revenue per employee (in thousand EUR)	238	213	256
Average number of full-time employees at the group	920	809	794

Net profit margin: Net profit / Revenue

EBT margin: Profit before tax / Revenue

Operating profit margin: Operating profit / Revenue

Gross margin: Gross profit / Revenue

EBITDA margin : (Operating profit + Depreciation) / 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 suppliers / 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 is a long-term process, 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 factors – stricter credit terms, a decline in demand and the general uncertainty of economic agents about the future have reduced the value of real estate. The residential development area is one of the main sources of market risk arising from the value of real estate for Merko Ehitus group. In 2011, the group sold 159 apartments for EUR 18.2 million (excl. VAT). As at 31.12.2011, the inventories included 33 finished apartments (28 apartments in Tartu and 5 in Riga) with the total cost of EUR 2.7 million and 600 apartments in the stage of construction with the total cost of EUR 29.3 million as at the balance sheet date. Due to the weak demand, the construction of 311 apartments in the amount of EUR 9.3 million has been halted and the construction of 289 apartments is underway, including two apartment buildings with 21 apartments in Hane Street, Tallinn (time of completion: summer 2012), three apartment buildings with 13 apartments in Pallasti Street, Tallinn (time of completion: summer 2012) and an apartment building with 115 apartments in Skanstes Street, Riga (time of completion: autumn 2012). An apartment building with 93 apartments at Tartu Road 50A, Tallinn was in the stage of finalisation as at the balance sheet date. In order to minimise risks, 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 or an insurance contract at own expense is concluded, covering the damage arising from design, erroneous measurement, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2011, indemnity applications submitted to insurance companies totalled EUR 0.58 million, and insurance benefits were received in the amount of EUR 0.02 million and those in processing totalled EUR 0.02 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. Unpredictability and more intense competition put a serious pressure on the profitability of the construction sector, significantly reducing the margin for erring when submitting bids and presenting a serious threat for sustainable development of the sector.

A warranty provision has been set up at the Company to cover for the construction errors which have become evident during the warranty period. In 2011, warranty provisions were set up at the group in the total amount of EUR 1.06 million and disbursements amounted to EUR 0.82 million. As at the year-end, the Company's warranty provision amounted to EUR 1.37 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 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 six of the largest group entities and the occupational health and safety system OHSAS 18001 has been set up at the parent, Merko Infra, Merko Tartu as well as Latvian and Lithuanian subsidiaries. Fifteen 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 uncertainty in 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. The following figures are a proof of the group's active management of credit risk: the amount of doubtful receivables decreased by EUR 1.16 million to EUR 0.54 million in a year, the amount of doubtful receivables written off decreased by 26.1%, i.e. from EUR 0.11 million EUR 0.08 million. During the period, the amount of invoices past due 30 and more days decreased from EUR 3.15 million to EUR 1.21 million. As at 31.12.2011, the group had receivables past due in the amount of EUR 5.89 million, of which EUR 4.82 million was collected by 15 March 2012. The management monitors closely the pattern of receivables and is of opinion that the receivables at the year-end do not carry 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 and Nordea group. While the figures above reflect a positive trend, the payment discipline of customers deteriorated because the average collection period of trade receivables increased from 44 days to 59 days in a year, which in turn led to a longer payment period of trade payables, i.e. 56 days.

**Interest rate risk.** As at 31.12.2011, the group's interest-bearing liabilities totalled EUR 40.34 million, of which short-term loans and the repayments of long-term debt in 2012 totalled EUR 16.57 million, and long-term loans and finance lease liabilities totalled EUR 23.77 million. The volume of interest-bearing liabilities increased by EUR 14.60 million in a year and as at the year-end, these liabilities made up 18.3% of the Company's balance sheet total. Of the liabilities assumed, the liabilities with floating base interest rates and exposed to changes in Euribor totalled EUR 39.18 million and liabilities with fixed interest rates totalled EUR 1.16 million. As at 31.12.2011, the 12-month Euribor was 1.947% and management estimates that it can fall by 50 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 the financial institutions may increase their lending rates by 50-100 basis points in 2012, depending on the previous time of fixing of interest. As at 31.12.2011, the balance of liabilities exposed to a change in the risk margin was EUR 23.90 million. Of current liabilities, the loan received during the demerger of AS Järvevana in the amount of EUR 6.94 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 is preservation of liquidity. As at 31.12.2011, the group's current ratio was 2.0 (31.12.2010: 2.7) and the quick ratio was 1.0 (31.12.2010: 1.1). To ensure liquidity and manage the cash flows better, group entities have

concluded overdraft contracts with banks in the total amount of EUR 7.5 million. In addition to overdraft contracts, the Company has a working capital loan facility with the limit of EUR 3.5 million from AS Riverito. The management considers that the group's capital structure – high equity ratio (49.6% of balance sheet total) and a moderate share of borrowings (18.3% of the balance sheet total) – will create good prerequisites for the extension of existing financial liabilities and, if necessary, obtaining additional working capital, as well as ensuring the company's credibility in the eyes of creditors. Preservation of liquidity continues to be the group's priority in 2012.

**Foreign currency risk.** The group's construction contracts are mostly concluded in the currencies of the country of location of the entities: Estonian euros, Latvian lats and Lithuanian litas. The Latvian lats and Lithuanian litas are pegged to the euro. The exchange rate of the Latvian lats is EUR 1 = LVL 0.702804 LVL +/-1%. To eliminate foreign currency risks, the structure of the Company's assets and liabilities by currency is monitored, and the euro is the preferred currency in conclusion of long-term construction contracts. As at the balance sheet date, 72.0% of the group's assets were in denominated in EUR, 24.2% in LVL, 3.7% in LTL and 0.1% in USD. Of the total liabilities, 86.2% were in EUR, 13.0% in LVL and 0.8% in LTL.

If as at the year-end, the Latvian and Lithuanian national currencies had been simultaneously devalued by 25%, the group would have incurred additional finance costs in the amount of EUR 7.81 million, including from LVL position in the amount of EUR 6.22 million and LTL position in the amount of EUR 1.59 million. As Estonia adopted the euro at 1.01.2011, the management estimates that the possibility of and need for devaluation of national currencies of Latvia and Lithuania has significantly decreased and the situation has stabilised in the Baltic States.

**Legal risks.** 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 December 2011, a provision has been set up at the group in the amount of EUR 1.33 million for covering potential claims and legal costs. The provision for legal claims and costs was not used in 2011, but additional provision in amount of EUR 1.06 million was set up.

An overview of the key legal disputes of group entities as at 31 December 2011 is presented below.

On 13 September 2011, AS Merko Ehitus and Tallinna Teede AS filed a statement of claim with Viru County Court against AS Rakvere Vesi. In the statement of claim, AS Merko Ehitus and Tallinna Teede AS asked the court to establish, among other things, that by their declaration of cancellation submitted to Rakvere Vesi AS at 11 July 2011, AS Merko Ehitus and Tallinna Teede AS have validly cancelled the contract for construction no 114289 (hereinafter: Contract) concluded between AS Merko Ehitus and Tallinna Teede AS and AS Rakvere Vesi as a result of the public procurement "Procurement for designing and construction of piping in the area of the city of Rakvere". AS Merko Ehitus and Tallinna Teede AS also asked the court to order from AS Rakvere Vesi the payment of the amount of EUR 0.22 million and accrued fines for delay, and to establish that AS Rakvere Vesi is not entitled to claim payment of the performance guarantee (in the amount of EUR 0.76 million) provided by AS Merko Ehitus and Tallinna Teede AS on the basis of the Contract. AS Merko Ehitus and Tallinna Teede AS were forced to file a statement of claim with Viru County Court, because AS Rakvere Vesi did not accept the declaration of cancellation of the Contract submitted by AS Merko Ehitus and Tallinna Teede AS at 11 July 2011 due to material breach of the Contract by AS Rakvere Vesi and referred to a possibility to claim payment of the performance guarantee provided under the Contract. AS Rakvere Vesi has not specified the amount of its possible claim for damages. The management of the group is of opinion that

cancellation of the Contract by the contractor's declaration of cancellation of 11 July 2011 was substantiated due to material breach of the Contract by AS Rakvere Vesi.

On 9 January 2011, a court case opened at Harju County Court which among other issues dealt with the claim filed against AS Merko Ehitus and its subsidiaries OÜ Metsailu, OÜ Woody, OÜ Constancia in relation to the giving of the bribe to the former Tallinn city official Ivo Parbus. The Prosecutor's Office has charged Merko Ehitus and its subsidiaries with the giving of the bribe by the then member of management board Tõnu Korts – Estravel's gift coupon of 25,000 kroons (EUR 1,597.80) and the book with the list price of 400 kroons (EUR 26.20) titled "Eesti Talurahva Arhitektuur" (Estonian Vernacular Architecture) - in order to accelerate real estate business related proceedings in Tallinn City authorities. According to section 44 subsection 8 of the Penal Code, a court can, upon conviction, impose a pecuniary punishment from EUR 3,200 to EUR 16,000,000 on a legal person. Pecuniary punishment may be imposed as supplementary punishment in addition to forced liquidation.

On 30 March 2012 Harju County Court proclaimed the judgment in criminal case 1-09-20251. According to the judgment of Harju County Court AS Merko Ehitus, OÜ Metsailu, OÜ Woody, OÜ Constancia were convicted based on Penal Code section 297 subsection 3 (granting or promising a gratuity by a legal person). According to the judgment AS Merko Ehitus will be punished by pecuniary punishment in the amount of EUR 0.3 million OÜ Woody and OÜ Constancia each by pecuniary punishment in the amount of EUR 0.2 million and OÜ Metsailu by pecuniary punishment in the amount of EUR 0.1 million. According to the Income Tax Act, a pecuniary punishment is subject to income tax and upon the enforcement of the pecuniary punishment the group companies will have to pay EUR 0.21 million of income tax in addition to the amount of the pecuniary punishment. To reflect the judgment of Harju County Court after the balance sheet date, an additional provision in the amount of EUR 1.01 million was set up to cover the possible pecuniary punishment and associated tax liability. Pursuant to § 38 subsection 1 clause 1 of Public Procurement Act, a contracting authority shall not award a public contract to a person and shall exclude from a procurement procedure a tenderer or candidate who or whose legal representative has been convicted of committing offences relating to professional misconduct in a criminal procedure, and whose data concerning punishment have not been deleted from the penal register in accordance with the Penal Register Act. Accordingly, AS Merko Ehitus, OÜ Metsailu, OÜ Woody, OÜ Constancia cannot participate in the public procurement in case of criminal conviction. The respective limitation does not concern other companies of the group.

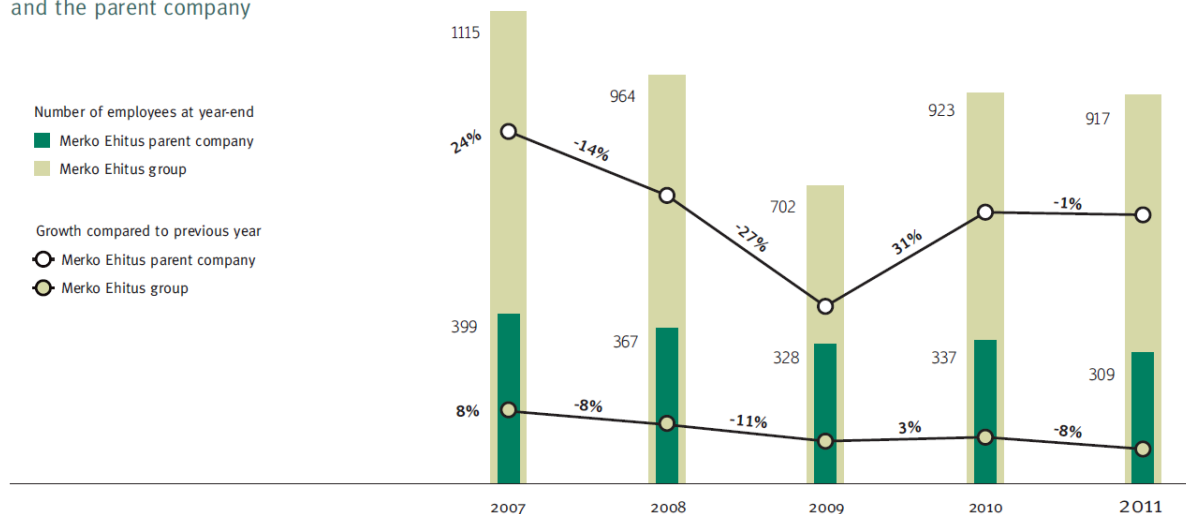
The judgment has not entered into force. The management of the group is of opinion that the company has not granted a gratuity and has conducted its activities in conformity with the laws of the Republic of Estonia and will appeal to the circuit court.

## **The Company and its people**

The number of the group's employees remained almost unchanged during the year and as at 31.12.2011, the group had 917 employees.

The gross wages and salaries of the group's employees totalled EUR 16.7 million, of which base wages and salaries made up 84.6% and bonuses made up 15.4%, i.e. 4.4% more than in 2010. As compared to 2010, the number of the group's employees increased by 0.7% and the average gross wages decreased by 7.8% per employee. The number of employees of the parent AS Merko Ehitus was 309 at the year-end 2011, decreasing by 28 employees in a year. Gross wages and salaries paid to employees totalled EUR 6.37 million, the annual decline was 3.9%, including base wages and salaries increased by 16.3% and bonuses decreased by 40.5%.

#### 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 the most economically purposeful manner.

As at 31.12.2011, the Management Board of AS Merko Ehitus had 6 members. Until the year-end 2011, all members of the Management Board worked full-time at AS Merko Ehitus and their gross remuneration in 2011 totalled EUR 0.32 million, including base remuneration of EUR 0.31 million and bonuses of EUR 0.01 million. After the structural change which became effective at 1 January 2012, five members of the Management Board of AS Merko Ehitus started to work as members of the Management Board of AS Merko Ehitus Eesti and no compensation was paid to them.

From 01.01.2012, the Management Board of AS Merko Ehitus has 3 members: the Chairman of the Management Board is Andres Trink, the members of the Management Board are Viktor Mõisja and Alar Lagus. All three members of the Management Board of AS Merko Ehitus are entitled to receive differing termination benefits ranging from 3.5 – 24 month remuneration.

**Andres Trink** – Born at 1 February 1967. Finished the English-biased class of Pärnu Secondary School no. 1 with honours and graduated cum laude with Master of Science degree from Tallinn University of Technology in automated management systems engineering. He has studied international business administration at the Estonian Business School and completed the Advanced Management Program for senior executives at INSEAD University in France. He has worked in various senior executive positions in the private as well as public sector. He has been working in the financial sector for the last 15 years, including as a member of the management board of Hansabank Baltic banking.

From 1 January 2012, he is the Chairman of the Management Board of AS Merko Ehitus, being responsible for the launch and strategic development of the structure of the new holding company. He is also the Chairman of the Supervisory Boards of AS Merko Ehitus Eesti, SIA Merks and UAB Merko Statyba.

**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, he works as a manager in the finance area and is responsible for the Company's financial and managerial accounting and investor relations.

**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, he 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 five members.

At the general meeting of shareholders held at 28 June 2011, it was decided to extend the term of office of the members of the Supervisory Board Tõnu Toomik, Teet Roopalu, Indrek Neivelt and Olari Taal until 28 June 2014, i.e. for three years from the time of extension and to elect Toomas Annus as a new member of the Supervisory Board whose term of office will also expire at 28 June 2014. In 2011, the remuneration of the members of the Supervisory Board totalled EUR 0.18 million.

**Toomas Annus** - Born at 5 October 1960. Finished Tallinn Technical School of Building and Mechanics (TEMT) and graduated from Tallinn University of Technology in the specialty of industrial and civil engineering of the civil engineering faculty. From 1987, he was the Chairman of the Management Board of EKE MRK (predecessor of Merko Ehitus), from 1991, the Chairman of the Management Board of AS Merko Ehitus. In 1997 – 2008, and from June 2011, he is the Chairman of the Supervisory Board of AS Merko Ehitus.

**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, he was a member of the Management Board of AS Merko Ehitus, being responsible for the management and development of the Company. From August 2008, he was the Chairman of the Supervisory Board of AS Merko Ehitus.

**Teet Roopalu** - Born at 30 August 1949. Finished Nõmme Gymnasium (former Tallinn Secondary School no. 10) and graduated from the Faculty of Economics of Tallinn University of Technology, majoring in construction economics and organisation. He 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, he works at AS Merko Ehitus and is responsible for the Company's financial and legal areas. He is a member of the Supervisory Boards of several subsidiaries and associates of AS Riverito and of AS Merko Ehitus.

**Indrek Neivelt** - Born at 17 March 1967. Finished a mathematics and physics - biased class at Tallinn 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, he 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, he is a Chairman of the Supervisory Board of Bank Saint Petersburg and is a member of supervisory boards of several entities. From October 2008, he 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*). He 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 10<sup>th</sup> Riigikogu (Parliament of Estonia). From October 2008, he 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.

## **Sponsorship**

In 2011, the group sponsored sports, culture and education and donated to charity in total EUR 0.29 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*), 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, our cooperation with the Art Museum of Estonia continued. In the area of education, the group's priority is construction-related education and research work. In 2011, 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 Merko Ehitus scholarship to a student of civil engineering faculty and the scholarship bearing the name of professor Heinrich Laul for young lecturer/scientist with a doctoral degree in construction science.

In the social field, cooperation with our partner Tilsi Children's Home continued.

## **Share and shareholders**

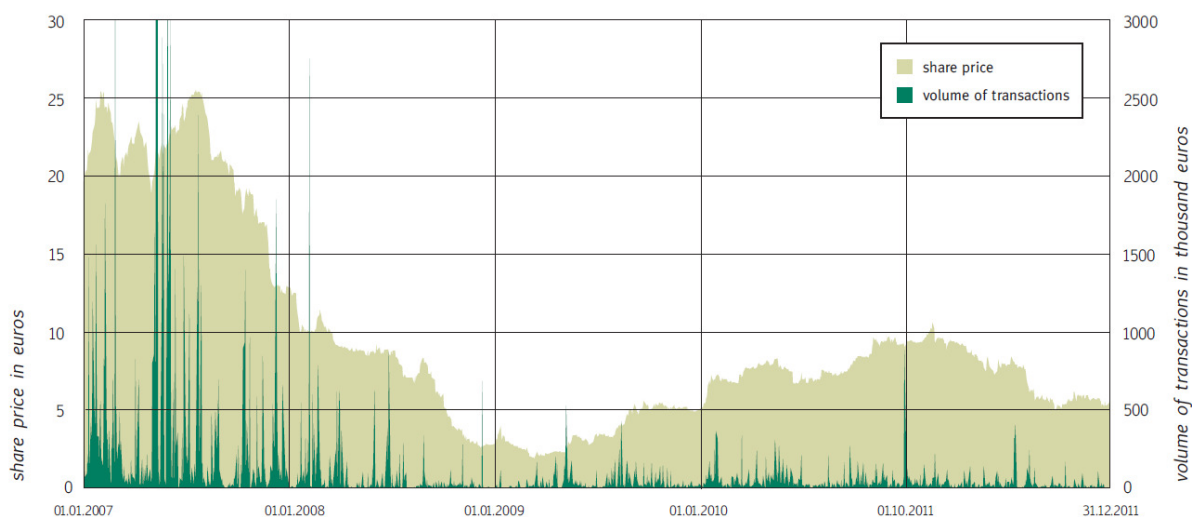
### **Information on security**

Name of security	Share of Merko Ehitus
ISIN	EE3100098328
Type of security	share
Issuer	AS Merko Ehitus
Activity of issuer	Construction
Residency of issuer	Estonia
Nominal value	without nominal value
Number of securities	17,700,000
Number of votes per share	1 vote
Registration at ECSD	08.07.2008
Stock Exchange List	Main List

	31.12.2011	31.12.2010	31.12.2009
Basic earnings per share (EPS), EUR	-0.80	0.07	0.42
Equity per share, EUR	6.17	7.05	7.68
P/B (price to book ratio)	0.87	1.28	0.65
P/E (price / earnings ratio)	-6.79	130.32	11.97

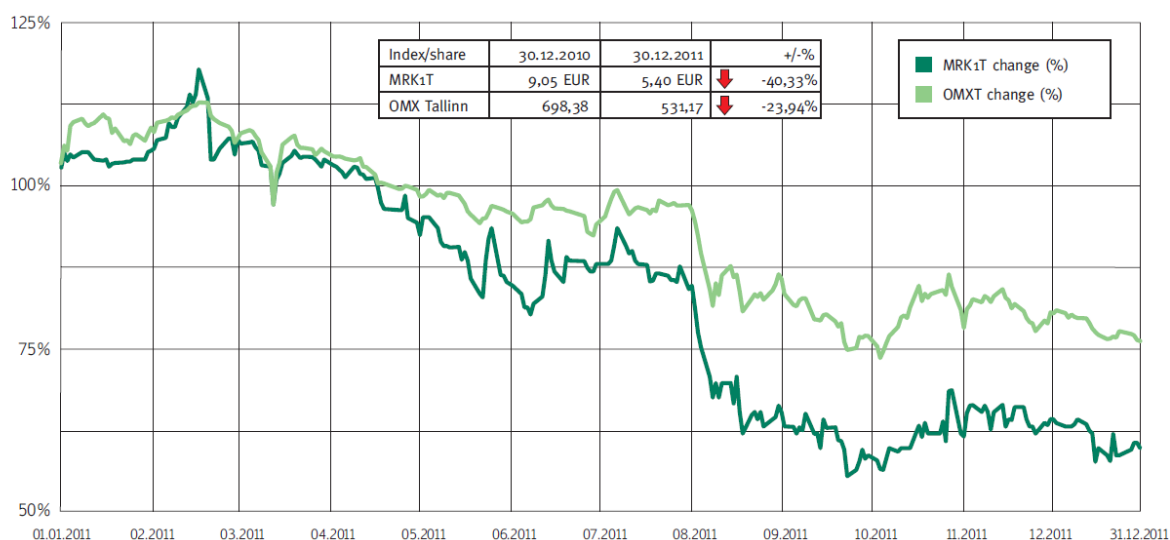
The shares of Merko Ehitus are listed in the Main List of NASDAQ OMX Tallinn. In 2011, 3,719 transactions with the shares of Merko Ehitus were performed, in the course of which 1.1 million shares were traded and the total monetary value of transactions was EUR 8.0 million. The lowest share price was EUR 4.90 and the highest share price was EUR 10.65. The closing price of the shares as at 31.12.2011 was EUR 5.40. As at 31.12.2011, the market capitalisation of AS Merko Ehitus was EUR 96 million.

Performance of Merko Ehitus share at NASDAQ OMX Tallinn Stock Exchange



Trading history of securities, EUR	2009	2010	2011
Highest	5.780	9.890	10.649
Lowest	1.850	5.050	4.899
Closing	5.020	9.050	5.400
Average	3.711	7.718	7.494
Change, %	+79.30	+80.30	-40.33
Traded shares	2,782,150	1,696,902	1,057,616
Turnover, EUR million	9.38	13.09	8.02
Market value, EUR million, as at the year-end	88.85	160.19	95.58

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



Main shareholders of AS Merko Ehitus as at 31.12.2011

	Number of shares	Percentage of total
AS Riverito	12,742,686	71.99%
ING Luxembourg S.A., clients	974,126	5.50%
Skandinaviska Enskilda Banken Ab, clients	777,718	4.39%
Ergo Pension Fund 2P2	171,679	0.97%
State Street Bank and Trust Omnibus Account a Fund No OM01	156,718	0.89%
Firebird Republics Fund Ltd	139,054	0.79%
Gamma Holding OÜ	137,957	0.78%
SEB Elu- and Pensionikindlustus AS	125,520	0.71%
Clearstream Banking Luxembourg S.A. clients	107,330	0.61%
AS Midas Invest	102,805	0.58%

Structure of shareholders as at 31.12.2011

Number of shares	Number of shareholders	% of shareholders	Number of shares	% of shareholders
1-100	424	26.90%	23,017	0.13%
101-1000	825	52.35%	349,721	1.98%
1001-10 000	285	18.09%	837,344	4.73%
10 001 – 100 000	32	2.03%	1,054,325	5.96%
100 001 – 1 000 000	9	0.57%	2,692,907	15.21%
1 000 001 - ...	1	0.06%	12,742,686	71.99%
Total	1576	100%	17,700,000	100%

Shares held by members of the Supervisory Board of AS Merko Ehitus at 31.12.2011

		Number of shares	Percentage of total
Toomas Annus (AS Riverito)	Chairman of the Supervisory Board	8,322,914	47.02%
Tõnu Toomik (AS Riverito)	Member of the Supervisory Board	1,607,185	9.08%
Indrek Neivelt (OU 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 31.12.2011

		Number of shares	Percentage of total
Andres Trink	Chairman of the Management Board	0	0.00%
Alar Lagus	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 its 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:

	2007	2008	2009	2010	2011*
Dividend per share, EUR	0	0.2237	0.7030	0.1	0
Dividend rate	0%	21%	168%	144%	0%

\* according to proposal of the Management Board

### Outlook for 2012

In 2012, the efforts to stabilise the credit crisis of the eurozone and the strengthening of the sustainability of the budgetary policy of the Member States will continue. The low growth rate of the eurozone economy will not support domestic demand growth and a fast improvement of a sense of security. Over the longer term, inflationary risks will still prevail.

We expect moderate growth in construction volumes in all Baltic States in 2012. We expect the nominal growth rate of the construction market to exceed the nominal GDP growth rate.

The profitability of the construction market of the Baltic States will remain low in 2012. Profitability could be expected to improve somewhat due to the experience gained by construction companies in 2010-2011 and

the lessons learned from the movements of input prices and management of risks arising from longer payment terms of customers.

As regards input prices, we expect labour costs and fuel prices to continue to increase, albeit at a more moderate pace than in 2010-2011. Due to the increase in the CPI, the pressure on wages and salaries will increase, as a result of which the preservation of an efficient cost base continues to be the focus of construction companies.

Although the improved economic situation in the Baltic States has created better conditions for the increase of the volume of commercial and business real estate investments, most of the largest construction projects in 2012 will be launched in the areas of infrastructure, roads and environmental facilities funded by the public sector and the EU structural funds. The disputes between the state contracting entities and construction companies will continue as to the allocation of risks arising from input prices. In the long term, the current ambiguities relating to the EU financial framework for 2014-2020, which deals with the scope and areas of the EU co-financing, will create uncertainty as to the decision-making regarding construction volumes and investments.

There is no reason to expect fast improvement of demand in the market of residential premises or a sharp increase in the number of purchase and sales transactions, despite the low Euribor base interest rate and a limited supply of new residential premises over the last three years. The reasons behind low demand continue to be low consumer confidence regarding future cash flows and pressure caused by the appreciation of construction prices on real estate prices. In the market of residential premises, the differentiation is still ongoing, depending on the location, quality and the overall living environment of the real estate property. When choosing a place to live in, there is an increasing trend to prefer smaller apartment buildings which blend in with their surroundings and have good construction quality. Also, in light of the continued internationalisation of the Baltic States, we can expect an increased interest of foreigners in buying residential premises.

The competition among large construction companies in construction procurements will continue to be intense in 2012. Considering the fact that most of the largest construction companies have been unprofitable over the last several years, loss-making bids are expected to be somewhat reduced because the capital base of construction companies does not enable them to include loss-making contracts into the contract portfolio. The construction companies with a stronger capital base have advantages to strengthen their market position in the segment of larger and more complex construction contracts and to improve profitability. Based on aforesaid, we can estimate that strategies will be reviewed and the competitive situation may change in several sectors of construction activity.

### **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 authorities of which are 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**

Until the end of 2011 the Management Board of AS Merko Ehitus had six members, and it represented the Company and managed its daily operations. The activities of the members of the Management Board were 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. Starting from changes in structure effective since 1<sup>st</sup> of January 2012 the Management Board of AS Merko Ehitus has three members: the Chairman of the Management Board is Andres Trink and other members are Viktor Mõisja and Alar Lagus.

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. All three members of the Management Board of AS Merko Ehitus are entitled to receive differing termination benefits ranging from 3.5 – 24 month remuneration.

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. Fifty 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. On 28 June 2011, the Annual meeting of Shareholders decided to prolong the assignments of Supervisory Board members Tõnu Toomik, Teet Roopalu, Indrek Neivelt and Olari Taal until 28 June 2014, i.e. for three years from decision date and, in addition, to elect Toomas Annus as Supervisory Board member, also until 28 June 2014.

The General Meeting of Shareholders shall approve the remuneration of the members of the Supervisory Board. The procedure for paying remuneration to 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.

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 in 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 an 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.

## MANAGEMENT BOARD'S CONFIRMATION

**The members of the Management confirm that according to their best knowledge, the financial statements, prepared in accordance with the accounting standards in force, give a true and fair view of the assets, liabilities, financial position and profit or loss of AS Merko Ehitus and the group entities involved in the consolidation as a whole, and the management report gives a true and fair view of the development and results of the business activities and financial position of AS Merko Ehitus and the group entities involved in the consolidation as a whole and contains a description of the main risks and doubts.**

Andres Trink

Chairman of the  
Management Board



30.03.2012

Alar Lagus

Member of the  
Management Board



30.03.2012

Viktor Mõisja

Member of the  
Management Board



30.03.2012



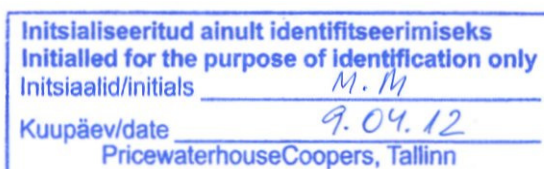
## FINANCIAL STATEMENTS

### CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

*in thousands of euros*

	Note	2011	2010
Revenue	3	219,322	171,919
Cost of goods sold	4	(222,928)	(159,105)
<b>Gross profit (-loss)</b>		(3,606)	12,814
Marketing expenses	5	(2,104)	(2,193)
General and administrative expenses	6	(7,910)	(8,724)
Other operating income	7	1,611	961
Other operating expenses	8	(1,308)	(478)
<b>Operating profit (-loss)</b>		(12,317)	2,380
Finance income	9	1,563	696
Finance costs	10	(1,161)	(908)
Loss from associates and joint ventures	20	(1,120)	(398)
<b>Profit (-loss) before tax</b>		(14,035)	1,770
Corporate income tax expense	11	(121)	(710)
<b>Net profit (-loss) for financial year</b>		(14,156)	1,060
incl. net profit (-loss) attributable to equity holders of the parent		(14,084)	1,229
net profit (-loss) attributable to non-controlling interest		(72)	(169)
<b>Other comprehensive income</b>			
Currency translation differences of foreign entities		354	23
<b>Comprehensive income (-loss) for the period</b>		(13,802)	1,083
incl. net profit (-loss) attributable to equity holders of the parent		(13,730)	1,252
net profit (-loss) attributable to non-controlling interest		(72)	(169)
Earnings per share for profit (-loss) attributable to equity holders of the parent (basic and diluted, in EUR)	12	(0.80)	0.07

The notes set out on pages 29-75 are an integral part of these consolidated financial statements.



## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

in thousands of euros

	Note	31.12.2011	31.12.2010
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	14	18,510	9,856
Short-term deposits	15	140	2,651
Trade and other receivables	16	64,449	44,938
Prepaid corporate income tax		686	1,366
Inventories	18	87,834	93,048
		<u>171,619</u>	<u>151,859</u>
<b>Non-current assets</b>			
Investments in associates and joint ventures	20	9,986	11,053
Other long-term loans and receivables	21	17,065	8,258
Deferred income tax assets	22	1,870	1,571
Investment property	23	2,313	3,585
Property, plant and equipment	24	16,057	17,747
Intangible assets	25	1,427	1,508
		<u>48,718</u>	<u>43,722</u>
<b>TOTAL ASSETS</b>		<u>220,337</u>	<u>195,581</u>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Borrowings	27	16,574	12,554
Payables and prepayments	28	61,635	39,154
Short-term provisions	29	6,781	3,674
		<u>84,990</u>	<u>55,382</u>
<b>Non-current liabilities</b>			
Long-term borrowings	27	23,764	13,185
Deferred income tax liability	22	131	-
Other long-term payables	30	856	846
		<u>24,751</u>	<u>14,031</u>
<b>TOTAL LIABILITIES</b>		<u>109,741</u>	<u>69,413</u>
<b>EQUITY</b>			
Non-controlling interests		1,356	1,428
Equity attributable to equity holders of the parent			
Share capital	32	12,000	11,312
Statutory reserve capital		1,131	1,131
Currency translation differences		(570)	(924)
Retained earnings		96,679	113,221
		<u>109,240</u>	<u>124,740</u>
<b>TOTAL EQUITY</b>		<u>110,596</u>	<u>126,168</u>
<b>TOTAL LIABILITIES AND EQUITY</b>		<u>220,337</u>	<u>195,581</u>

The notes set out on pages 29-75 are an integral part of these consolidated financial statements.



## CONSOLIDATED CASH FLOW STATEMENT

in thousands of euros

	Note	2011	2010
<b>Cash flows used in operating activities</b>			
Operating profit		(13,317)	2,380
Adjustments:			
Depreciation	23-25	2,242	2,427
(Profit)/loss from sale of non-current assets	7	(722)	(76)
Change in receivables and liabilities related to construction contracts recognised under the stage of completion method	33	3,979	(23,355)
Interest income from business activities	7	(450)	(627)
Change in provisions	29,30	2,931	644
Change in trade and other receivables related to operat. activities		(30,296)	1,878
Change in inventories	18	8,146	5,593
Change in trade and other payables related to operat. activities		15,755	6,261
Interest paid	10,28	(1,208)	(857)
Other finance income	9,10	(18)	(4)
Corporate income tax (paid)/reclaimed		688	(1,501)
<b>Total cash flows used in operating activities</b>		<b>(12,270)</b>	<b>(7,237)</b>
<b>Cash flows from investing activities</b>			
Investment in subsidiaries	19	-	(71)
Investments in associates and joint ventures		-	(1)
Proceeds from sale of associates and joint ventures		-	2
Purchase/proceeds from deposits with maturities greater than 3 months	15	2,511	22,972
Purchase of investment property	23	(3,648)	(2,619)
Proceeds from sale of investment property	7,23	3,334	-
Purchase of property, plant and equipment	24,28	(1,008)	(806)
Proceeds from sale of property, plant and equipment	7,24	1,426	181
Purchase of intangible assets	25	(64)	(91)
Proceeds from sale of intangible assets	7,25	3	52
Loans granted	17	(310)	(8,096)
Loan repayments received	17	5,613	4,129
Interest received	9,16	780	804
Dividends received	20	59	14
<b>Total cash flows from investing activities</b>		<b>8,696</b>	<b>16,470</b>
<b>Cash flows from (used in) financing activities</b>			
Proceeds from borrowings	27	20,995	2,115
Repayments of borrowings	27	(5,484)	(10,750)
Sale-leaseback under finance lease terms		65	-
Finance lease principal payments	27	(1,747)	(1,447)
Dividends paid	13	(1,770)	(12,444)
<b>Cash flows from (used in) financing activities</b>		<b>12,059</b>	<b>(22,526)</b>
<b>Net increase/decrease in cash and cash equivalents</b>		<b>8,485</b>	<b>(13,293)</b>
Change in deposits with maturities greater than 3 months	15	(2,511)	(22,972)
Total change		5,974	(36,265)
<b>Cash and cash equivalents at the beginning of the period</b>	14	<b>9,856</b>	<b>22,991</b>
Deposits with maturities greater than 3 months at the beginning of the period	15	2,651	25,623
Total at the beginning of the period		12,507	48,614
<b>Effect of exchange rate changes</b>		<b>169</b>	<b>158</b>
<b>Cash and cash equivalents at the end of the period</b>	14	<b>18,510</b>	<b>9,856</b>
Deposits with maturities greater than 3 months at the end of period	15	140	2,651
Total at the end of the period		18,650	12,507

The notes set out on pages 29-75 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 2011 were signed by the Management Board at 30 March 2012.

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 NASDAQ OMX Tallinn Stock Exchange. As at 31 December 2011, 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.

From 1 January 2012, the group's construction operations in Estonia will be transferred to AS Merko Ehitus Eesti. Thereafter, AS Merko Ehitus will operate as a holding entity with no independent production activities. It will have 100% ownership interests in construction entities in Estonia, Latvia and Lithuania and a real estate development unit consisting of entities holding real estate properties.

#### 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.

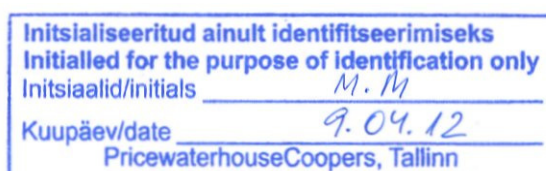
The consolidated financial statements have been prepared under the historical cost convention.

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.

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 the AS Merko Ehitus is the euro from 1 January 2011. The change in the functional currency has been accounted for prospectively. As at 1 January



2011, the parent company and its subsidiaries located in Estonia have translated the balances on their account into euros using the conversion rate of 15,6466 kroon/euro.

Items included in the financial statements of Merko Ehitus group entities are measured using the currency of their primary economic environment (the functional currency): the euro, Latvian lats and the Lithuanian litas. The consolidated financial statements are presented in euros. The primary financial statements and notes are presented in thousands of euros. In the financial statements, the comparatives have been translated from the Estonian kroons into euros using the changeover exchange rate of 15,6466 kroon/euro. As this exchange rate was also the fixed exchange rate prevailing in previous periods, no currency translation differences arose.

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

#### **a. Adoption of New or Revised Standards and Interpretations**

New or revised standards or interpretations that are effective for the first time for the group for the financial year beginning on or after 1 January 2011 are not expected to have a material impact to the group.

#### **b. New Accounting Pronouncements**

The issued new or revised standards and interpretations that are mandatory for the group's annual periods beginning on or after 1 January 2012, and which the group has not adopted early.

**IFRS 12, Disclosure of Interest in Other Entities**, effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU. The standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including (i) significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, (ii) extended disclosures on the share of non-controlling interests in group activities and cash flows, (iii) summarised financial information of subsidiaries with material non-controlling interests, and (iv) detailed disclosures of interests in unconsolidated structured entities. The group is currently assessing the impact of the standard on its financial statements.

**IFRS 11, Joint Arrangements**. The standard replaces IAS 31 "Interests in Joint Ventures" and SIC-13 "Jointly Controlled Entities—Non-Monetary Contributions by Venturers". Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. The group is currently assessing the impact of the standard on its financial statements.

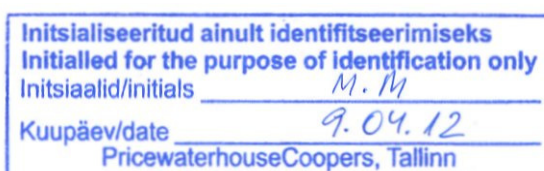
The other new or amended standards or interpretations, which are not yet effective, are not expected to have a material impact on the group.

### **1.4. Consolidation**

Subsidiaries, i.e. entities that are either directly or indirectly controlled by the parent AS Merko Ehitus through fellow subsidiaries, 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 initially measured at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the group makes an election whether to recognise any non-controlling interest in the acquiree 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 interests 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.

### 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 in 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 for the post-acquisition changes that have occurred in 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 jointly controlled operation.

### 1.9. Foreign currency

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank (until 31.12.2010 the 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 euros based on the foreign currency exchange rates of the European Central Bank (until 31.12.2010 the 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 euros for consolidation purposes; the asset and liability items are translated using the foreign exchange rates of the European Central Bank (until 31.12.2010 the currency 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* and in the consolidated comprehensive income item *Currency translation differences of foreign entities*.

### 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 about 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

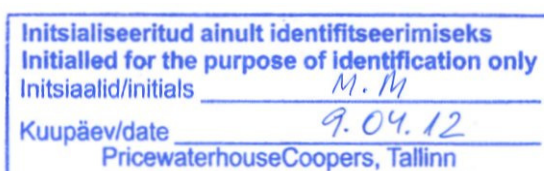
Assets that have indefinite useful lives are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate 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 incurred 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 authenticated 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, i.e. 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.

An item of property, plant and equipment is carried in the statement of financial position at its cost less any accumulated depreciation. The cost consists of the purchase price and other costs directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. 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. Items of property, plant and equipment leased under the finance lease terms are accounted for similarly to purchased property, plant and equipment.

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 of the group belong to the category "other financial liabilities at amortised cost".

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 at 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 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 01.01.2011, the tax rate on dividends payable is 21/79 (in 2010: 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 amounts. Deferred tax assets are recognised in the group's statement of financial position if their future realisation is probable.

Legal entities in Latvia, Lithuania and Ukraine that are part of the group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia, the Republic of Lithuania and the Republic of Ukraine. The profits of entities located in the Republic of Latvia are taxed at the rate of 15% (2010: 15%), the profits of entities located in the Republic of Lithuania are taxed at the rate of 15% (2010: 15%) and the profits of entities located in the Republic of Ukraine are taxed at the rate of 23% (2010: 25%).

### 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 owners after certain adjustments. The group recognises a provision where contractually obliged or when there is past practice that has created a constructive obligation.

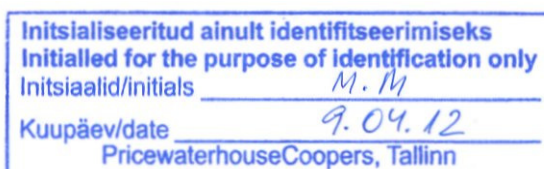
### 1.20. Provisions

Provisions are 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 an 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 acts, 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 yet been completed (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*. Proceeds from the sale of 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. Cash and cash equivalents

In the statement of financial position 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 3 months or less. Management regards deposits with maturities greater than 3 months as investments and hence does not include them 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.

#### 1.24. 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.

#### 1.25. 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.

#### 1.26. 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.

#### 1.27. 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.

#### 1.28. Segment reporting

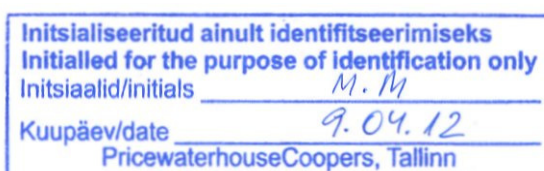
According to IFRS 8 *Operating Segments*, segment reporting is applicable to operating segments whose results are regularly reviewed by the entity's chief operating decision maker to make business-related decisions. Operating segments are components of the entity for which it is possible to obtain discrete 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 services, security services, etc.) are immaterial from the group's viewpoint 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. However, it can be stated 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

For valuation of receivables, each receivable is analysed separately. For 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

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

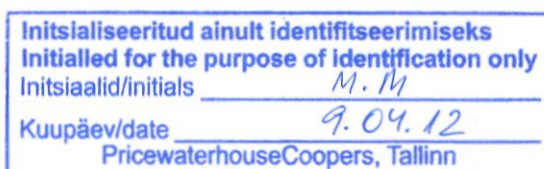
### Inventory write-down

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 from 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 of inventories 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 EUR 6,477 thousand higher in 2011 (2010: EUR 6,856 thousand higher), incl. land for sale in the amount of EUR 1,776 thousand (2010: EUR 1,727 thousand), construction in progress in the amount of EUR 3,224 thousand (2010: EUR 3,183 thousand), finished buildings in the amount of EUR 987 thousand (2010: EUR 1,282 thousand) and prepayments related to acquisition of real estate properties in the amount of EUR 490 thousand (2010: EUR 664 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 2011 would have been EUR 2,502 thousand lower (2010: 1,729 thousand lower), incl. land for sale in the amount of EUR 453 thousand (2010: EUR 227 thousand), construction in progress in the amount of EUR 831 thousand (2010: EUR 270 thousand), finished buildings in the amount of EUR 728 thousand (2010: EUR 758 thousand) and prepayments related to acquisition of real estate properties in the amount of EUR 490 thousand (2010: EUR 474 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 EUR 1,308 thousand (2010: EUR 1,420 thousand) would have been incurred for financial investments stated under equity method and vice versa, had management's estimate been 10% more optimistic, the increase would have been EUR 1,128 thousand (2010: EUR 9 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 31.12.2011, the amount of the provision for onerous contracts was EUR 3,526 thousand (2010: EUR 2,226 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 EUR -22,419/ +11,287 thousand (2010: EUR -17,035/ +7,262 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 revenue, 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.

Valuation of investment property

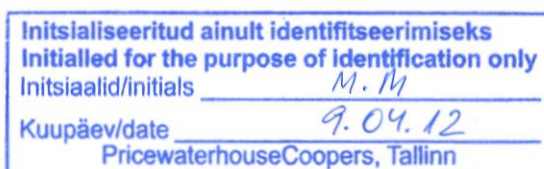
Investment properties are recognised at cost, less any accumulated depreciation and any impairment losses. Management estimates that the carrying amount of investment properties as at 31.12.2011 does not significantly differ from their fair value. Management's estimate regarding the fair value of investment 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. The 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.

In 2011, a total of EUR 94 thousand (2010: EUR 3 thousand) of the borrowing costs was capitalised (Note 27).





**Note 3 Operating segments**  
*in thousands of euros*

The chief operating decision-maker, i.e. the Management Board of parent 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. Pre-tax profit of the segments comprises in substance 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 they 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.

<b>2011</b>	<b>Buildings</b>	<b>Facilities</b>	<b>Roads</b>	<b>Develop- ment of real estate</b>	<b>Other</b>	<b>Total segments</b>
Segment revenue	68,837	109,928	52,019	24,014	2,588	257,386
Inter-segment revenue	(4,089)	(19,177)	(8,718)	(5,107)	(973)	(38,064)
Revenue from external clients	64,748	90,751	43,301	18,907	1,615	219,322
Depreciation (Note 4)	(72)	(212)	(1,161)	(90)	(302)	(1,837)
Inventory write-downs (Notes 4, 18)	-	-	-	(4,562)	-	(4,562)
Reversal of inventory write-downs (Notes 4, 18)	-	-	-	252	-	252
Setting up of provisions (Notes 29, 30)	(860)	(536)	(2,878)	(338)	(278)	(4,890)
Profit (loss) from associates and joint ventures (Note 20)	-	17	-	(1,457)	320	(1,120)
Other finance income/costs (Notes 9, 10)	430	(12)	-	(190)	(30)	198
incl. interest income	971	-	-	-	-	971
interest expense	(541)	(12)	-	(179)	(29)	(761)
Profit (loss) before tax	5,010	1,922	(5,736)	(4,906)	(72)	(3,782)
Segment assets	21,704	31,448	25,171	108,002	5,843	192,168
incl. associates and joint ventures (Note 20)	-	18	-	7,367	2,601	9,986
<b>2010</b>	<b>Buildings</b>	<b>Facilities</b>	<b>Roads</b>	<b>Develop- ment of real estate</b>	<b>Other</b>	<b>Total segments</b>
Segment revenue	70,630	61,296	36,403	23,507	1,801	193,637
Inter-segment revenue	(5,498)	(7,609)	(3,892)	(3,665)	(1,054)	(21,718)
Revenue from external clients	65,132	53,687	32,511	19,842	747	171,919
Depreciation (Note 4)	(106)	(668)	(1,042)	(36)	(84)	(1,936)
Inventory write-downs (Notes 4, 18)	-	-	-	(1,591)	-	(1,591)
Reversal of inventory write-downs (Notes 4, 18)	-	-	-	572	-	572
Setting up of provisions (Notes 29, 30)	(669)	(1,026)	(1,418)	(78)	-	(3,191)
Profit (loss) from associates and joint ventures (Note 20)	-	-	-	(96)	(302)	(398)

Other finance income/costs (Note 10)	-	(6)	-	(179)	-	(185)
Profit(loss) before tax	5,919	5,002	(420)	1,860	(27)	12,334
Segment assets	14,259	12,150	22,314	117,374	3,530	169,627
incl. associates and joint ventures (Note 20)	-	2	-	8,770	2,281	11,053

In addition to the segment assets, the group holds assets in the amount of EUR 28,169 thousand (2010: EUR 25,954 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.

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

	2011	2010
Profit (loss) from reporting segments	(3,782)	12,334
Unallocated expense (income)		
marketing expenses (Note 5)	(2,104)	(2,193)
general and administrative expenses (Note 6)	(7,910)	(8,724)
incl. setting up of provisions (Note 29)	(20)	(107)
other operating income (expense)	(443)	380
incl. setting up of provisions (Note 8, 29)	(1,013)	-
finance income (costs) (Note 9, 10)	204	(27)
incl. interest income	91	592
interest expense	(388)	(723)
<b>Profit before tax</b>	<b>(14,035)</b>	<b>1,770</b>

Unallocated finance costs and income include income from bank deposits, foreign exchange gains (losses), uncapitalised loan interest expenses and other finance income and costs.

#### Revenue by client location

	2011	2010
Estonia	162,217	124,262
Latvia	41,754	43,168
Lithuania	15,351	4,489
<b>Total</b>	<b>219,322</b>	<b>171,919</b>

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

	31.12.2011	31.12.2010
Estonia	19,154	19,760
Latvia	532	746
Lithuania	111	2,334
<b>Total</b>	<b>19,797</b>	<b>22,840</b>

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**Note 4 Cost of goods sold**

*in thousands of euros*

	2011	2010
Construction services	113,632	82,481
Materials	45,956	30,405
Properties purchased for resale	17,941	10,659
Staff costs	16,448	14,961
Construction mechanisms and transport	11,244	7,849
Design	1,964	1,571
Allowance for inventories (Note 18)	4,562	1,591
Reversal of the allowance for write-down of inventories (Note 18)	(252)	(572)
Real estate management costs	313	276
Depreciation	1,837	1,936
Other expenses	9,283	7,948
<b>Total cost of goods sold</b>	<b>222,928</b>	<b>159,105</b>

**Note 5 Marketing expenses**

*in thousands of euros*

	2011	2010
Staff costs	1,186	1,143
Construction tenders	109	146
Advertising, sponsorship	293	361
Transport	155	128
Depreciation	16	26
Other expenses	345	389
<b>Total marketing costs</b>	<b>2,104</b>	<b>2,193</b>

**Note 6 General and administrative expenses**

*in thousands of euros*

	2011	2010
Staff costs	4,838	5,190
Office expenses, communication services	508	442
Transport	506	529
Consulting, legal, auditing	686	756
Depreciation	389	464
Computer equipment and software	309	351
Other expenses	674	992
<b>Total general and administrative expenses</b>	<b>7,910</b>	<b>8,724</b>

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**Note 7 Other operating income**

*in thousands of euros*

	2011	2010
Fines and penalties for delay received	57	98
Collection of doubtful receivables	66	83
Interest income from operating activities	450	627
Profit from sale of non-current assets	722	76
Other income	316	77
<b>Total other operating income</b>	<b>1,611</b>	<b>961</b>

**Note 8 Other operating expenses**

*in thousands of euros*

	2011	2010
Fines, penalties	29	75
Setting up of provision for fines (Note 36)	1,013	-
Gifts, donations	146	250
Doubtful receivables expense (Note 36)	83	112
Other expenses	37	41
<b>Total other operating expenses</b>	<b>1,308</b>	<b>478</b>

**Note 9 Finance income**

*in thousands of euros*

	2011	2010
Interest income	1,062	592
Foreign exchange gains	501	102
Other finance income	0	2
<b>Total finance income</b>	<b>1,563</b>	<b>696</b>

**Note 10 Finance costs**

*in thousands of euros*

	2011	2010
Interest expense	1,149	908
Other finance costs	12	0
<b>Total finance costs</b>	<b>1,161</b>	<b>908</b>

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**Note 11 Corporate income tax**  
*in thousands of euros*

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

**2011**

	<b>Latvia</b>	<b>Lithuania</b>	<b>Ukraine</b>	<b>Estonia</b>	<b>Total</b>
Loss before tax	(5,422)	(1,456)	(29)	(7,128)	(14,035)
Tax rate applicable to profits	15%	15%	23%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	813	218	7	-	1,038
Tax calculated on expenses not deductible for tax purposes	28	68	-	-	96
Tax calculated on income not subject to tax	(24)	(85)	-	-	(109)
Tax losses of previous periods recognised in the reporting period	-	(4)	-	-	(4)
Tax losses not recognised in the reporting period	(533)	(328)	(7)	-	(868)
Deferred income tax on dividends	-	-	-	(274)	(274)
<b>Total income tax expense</b>	<b>284</b>	<b>(131)</b>	<b>-</b>	<b>(274)</b>	<b>(121)</b>
incl. deferred income tax expense (Note 22)	284	(131)	-	-	153
income tax withheld on intra-group transactions	-	-	-	(274)	(274)

**2010**

	<b>Latvia</b>	<b>Lithuania</b>	<b>Estonia</b>	<b>Total</b>
Profit (loss) before tax	3,108	(3,685)	2,347	1,770
Tax rate applicable to profits	15%	15%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(466)	553	-	87
Tax calculated on expenses not deductible for tax purposes	(115)	(625)	-	(740)
Tax calculated on income not subject to tax	65	2	-	67
Tax losses not recognised in the reporting period	-	(5)	-	(5)
Corporate income tax on dividends	-	-	(119)	(119)
<b>Total income tax expense</b>	<b>(516)</b>	<b>(75)</b>	<b>(119)</b>	<b>(710)</b>
incl. income tax expense	(113)	-	(119)	(232)
deferred income tax expense (Note 22)	(403)	(75)	-	(478)

As at 31.12.2011, it is possible to pay out dividends to shareholders from retained earnings (taking into account the obligation to increase statutory reserve capital from net profit of the period to the amount required by law) in the amount of EUR 75,872 thousand and the corresponding income tax would amount to EUR 20,168 thousand. As at 31.12.2010, it would have been possible to pay out EUR 88,715 thousand as dividends, and the corresponding income tax would have amounted to EUR 23,582 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.

	2011	2010
Net profit(-loss) attributable to shareholders ( <i>in thousand EUR</i> )	(14,084)	1,229
Weighted average number of ordinary shares ( <i>thousand pcs</i> )	17,700	17,700
<b>Earnings (loss) per share (<i>in euros</i>)</b>	(0.80)	0.07

In 2010 and 2011, 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, no dividends will be distributed in 2012.

In 2011 the parent company AS Merko Ehitus distributed dividends in the amount of EUR 1,770 thousand, i.e. EUR 0.10 per share and in 2010, EUR 12,444 thousand, i.e. EUR 0.70 per share. 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 euros*

	31.12.2011	31.12.2010
Cash on hand	10	8
Bank accounts	9,173	937
Overnight deposits	9,327	8,911
<b>Total cash and cash equivalents (Note 36)</b>	18,510	9,856

As at 31.12.2011, the weighted average interest on overnight deposits was 0.12% (31.12.2010: 0.2%).

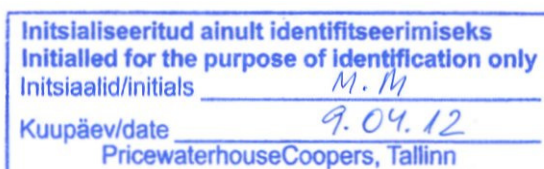
## Note 15 Short-term deposits

*in thousands of euros*

	31.12.2011	31.12.2010
Bank deposits with maturities greater than 3 months (Note 36)	140	2,651

The weighted average interest on bank deposits with maturities greater than 3 months was 1.3% (2010: 1.6%) and the average maturity as at 31.12.2011 was 177 days (2010: 106 days).

## Note 16 Trade and other receivables



in thousands of euros

	31.12.2011	31.12.2010
Trade receivables (Note 36)		
Accounts receivable	36,151	21,748
incl. from related parties (Note 34)	239	32
Allowance for doubtful receivables	(544)	(1,159)
	35,607	20,589
Tax prepayments excluding corporate income tax		
Value added tax	618	1,184
Other taxes	5	17
	623	1,201
Amounts due from customers of contract works (Notes 33, 36)	16,016	13,557
Other short-term receivables		
Short-term loans (Notes 17, 36)	7,673	6,500
incl. from related parties (Note 34)	1,343	1,557
Interest receivables (Note 36)	881	808
incl. from related parties (Note 34)	784	558
Other short-term receivables (Note 36)	1,444	190
incl. from related parties (Note 34)	4	4
	9,998	7,498
Prepayments for services (Note 36)		
Prepayments for construction services	1,499	1,364
Prepaid insurance	296	254
Other prepaid expenses	410	475
	2,205	2,093
<b>Total trade and other receivables</b>	<b>64,449</b>	<b>44,938</b>

#### Trade receivables by due date

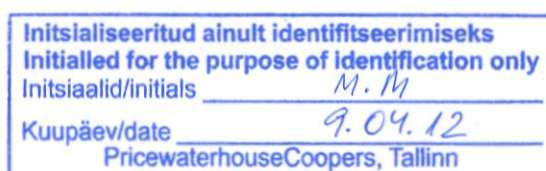
in thousands of euros

	31.12.2011		31.12.2010	
Not overdue	29,714	83.4%	15,751	76.5%
1-30 days overdue	4,686	13.2%	1,688	8.2%
31-60 days overdue	120	0.3%	261	1.3%
61-90 days overdue	232	0.7%	312	1.5%
91-120 days overdue	376	1.0%	278	1.4%
121-180 days overdue	380	1.1%	274	1.3%
More than 180 days overdue	99	0.3%	2,025	9.8%
<b>Total trade receivables (Note 36)</b>	<b>35,607</b>	<b>100.0%</b>	<b>20,589</b>	<b>100.0%</b>

In 2011, the customer payment discipline deteriorated. Although the share of overdue receivables in total receivables decreased from 23.5% to 16.6%, the average trade receivable increased in days from 44 days to 59 days. In 2011, the group's doubtful receivables totalled EUR 544 thousand in the balance sheet (2010: EUR 1,159 thousand) and it wrote off uncollectible receivables in the amount of EUR 82 thousand (2010: EUR 112 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 EUR 5,893 thousand.

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

#### Note 17 Loans granted



in thousands of euros

	2011	2010
<b>Loans granted to joint ventures</b>		
Loan balance at beginning of the year	4,755	2,262
Granted	122	2,503
Collected	-	(6)
Exchange rate difference	53	(4)
Loan balance at end of the year (Notes 34, 36)	4,930	4,755
incl. current portion	1,343	-
non-current portion 1...5 years	3,587	4,755
Average effective interest rate 6.0% (2010: 5.6%)		
<b>Loans granted to entities under common control</b>		
Loan balance at beginning of the year	1,557	2,936
Granted	-	-
Collected	(1,557)	(929)
Reclassification of loan as prepayment for the registered immovable	-	(450)
Exchange rate difference	-	-
Loan balance at end of the year (Notes 34, 36)	-	1,557
incl. current portion	-	1,557
Average effective interest rate 6.3% (2010: 6.3%)		
<b>Loans granted to unrelated legal entities</b>		
Loan balance at beginning of the year	6,400	2,385
Granted	188	5,482
Reclassification of receivable as loan granted	5,183	1,727
Collected	(4,052)	(3,194)
Write-down (Note 36)	(1)	-
Exchange rate difference	14	-
Loan balance at end of the year	7,732	6,400
incl. current portion	6,223	4,932
non-current portion 1...5 years	1,509	1,468
Average effective interest rate 7.7% (2010: 7.0%)		
<b>Loans granted to unrelated individuals</b>		
Loan balance at beginning of the year	111	-
Granted	-	111
Collected	(4)	-
Loan balance at end of the year	107	111
incl. current portion	107	11
non-current portion 1...5 years	-	100
Average effective interest rate 4.8% (2010: 3.5%)		
<b>Total loans granted</b>		
Loan balance at beginning of the year	12,823	7,583
Granted	310	8,096
Reclassification of receivable as loan granted	5,183	1,727

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Collected	(5,613)	(4,129)
Reclassification of loan as prepayment for the registered immovable	-	(450)
Write-down	(1)	-
Exchange difference	67	(4)
<b>Loan balance at end of the year</b>	<b>12,769</b>	<b>12,823</b>
incl. current portion (Notes 16, 36)	7,673	6,500
non-current portion 1...5 years (Notes 21, 36)	5,096	6,323

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

## Note 18 Inventories

*in thousands of euros*

	31.12.2011	31.12.2010
Materials	807	962
Work-in-progress	33,056	31,826
Finished goods	10,549	12,834
Goods for resale		
Registered immovables purchased for resale	36,570	39,513
incl. registered immovables located		
on nature preserve areas*	3,163	3,813
Other goods purchased for resale	1,062	1,173
	37,632	40,686
Prepayments for inventories		
Prepayments for real estate properties	5,560	6,641
incl. from related parties (Note 34)	3,810	4,741
Prepayments for other inventories	230	99
	5,790	6,740
<b>Total inventories</b>	<b>87,834</b>	<b>93,048</b>

\* 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.

As at 31.12.2011, inventories have been written down to their net realisable value by EUR 4,562 thousand (2010: EUR 1,591 thousand) and earlier write-downs have been reversed in the amount of EUR 252 thousand (2010: EUR 572 thousand) (Notes 2, 4, 36):

The inventory pledged as collateral as at 31.12.2011 for loans total EUR 38,286 thousand (2010: EUR 42,810 thousand) (Note 31).

	Carrying amount before write-down	Write-down	Reversal of write-down	Carrying amount after write-down
<b>31.12.2011</b>				
Finished goods	10,402	-	147	10,549
Work-in-progress	35,356	(2,300)	-	33,056
Land purchased for resale	37,586	(1,121)	105	36,570
Prepayments for real estate	6,701	(1,141)	-	5,560
<b>Total</b>	<b>90,045</b>	<b>(4,562)</b>	<b>252</b>	<b>85,735</b>
<b>31.12.2010</b>				
Finished goods	12,826	-	8	12,834
Work-in-progress	32,075	(813)	564	31,826
Land purchased for resale	39,797	(284)	-	39,513
Prepayments for real estate	7,135	(494)	-	6,641
<b>Total</b>	<b>91,833</b>	<b>(1,591)</b>	<b>572</b>	<b>90,814</b>

## Note 19 Shares in subsidiaries

*in thousands of euros*

	Ownership and voting rights %		Location	Area of operation
	31.12.2011	31.12.2010		
Subsidiaries of AS Merko Ehitus				
AS Gustaf	85	85	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 Jõgeva Haldus (former 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	Harju County, 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
AS Merko Ehitus Eesti	100	-	Tallinn	construction
OÜ Merko Property	100	-	Tallinn	real estate
Merko Ukraine LLC	100	100	Republic of Ukraine, Kharkiv	construction

Additional contributions were made into the share capital of AS Merko Infra in the amount of EUR 6,395 thousand in September 2011, and into the share capital of Tallinna Teede AS in the amount of EUR 1,500 thousand in December.

At 28 November 2011, AS Merko Ehitus established a subsidiary AS Merko Ehitus Eesti, where the Estonian construction activities were transferred at 1 January 2012 during the internal restructuring of AS Merko Ehitus. According to the restructuring plan, the ownership interests of another seven Estonian subsidiaries will be transferred after the balance sheet date. These entities are: AS Merko Infra, AS Gustaf, AS Merko Tartu, Tallinna Teede AS, OÜ Gustaf Tallinn, OÜ Fort Ehitus and OÜ Mineraal.

At 6 December 2011, AS Merko Ehitus established a subsidiary OÜ Merko Property for the purpose of real estate development which had not yet launched its operations by the date of preparation of the financial statements.

At 15 August 2011, a subsidiary OÜ Pallasti Kinnisvara was established which acquired an office building as an investment property from the group. At 20 December 2011, OÜ Pallasti Kinnisvara was disposed of. As it represented a single-asset entity, its acquisition and disposal was not treated as a business combination.

#### Acquisition of subsidiaries in 2010

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** *in thousand EUR*

Acquired ownership	10%
Value of non-controlling interest acquired	137
Cost	137

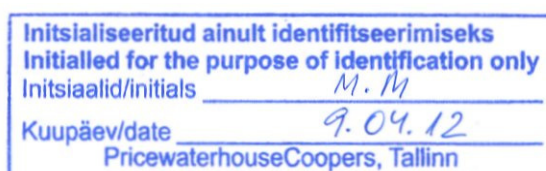
#### **Cash flows from acquisition of a subsidiary**

Cost of acquisition of shares of AS Gustaf	137
Amount due from the seller for the acquisition of the shares of AS Gustaf in 2006	(64)
Interest calculated on amount due	(2)
Cash flows from acquisition of subsidiaries	71

#### **Note 20 Investment in associates and joint ventures**

	<b>Ownership and voting rights %</b>		<b>Location</b>	<b>Area of operation</b>
	<b>31.12.2011</b>	<b>31.12.2010</b>		
<b>Associate of AS Merko Ehitus</b>				
AS TMB (former AS Tartu Maja Betoontooted)	25	25	Tartu	concrete elements
<b>Joint ventures of AS Merko Ehitus</b>				
OÜ Unigate	50	50	Tallinn	real estate
Poolkoksimäe Sulgemise OÜ	50	50	Tallinn	construction
<b>Joint venture of SIA Merks</b>				
SIA Zakusala Estates	50	50	Republic of Latvia, Riga	real estate
<b>Joint venture of AS Merko Tartu</b>				
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 euros

in thousands of euros	Investment at 31.12.2010	Changes in 2011			Investment at 31.12.2011
		Profit/loss from entities	Dividends	Currency translation adjustments	
<b>Associate of AS Merko Ehitus</b>					
AS TMB	2,281	320	-	-	2,601
<b>Joint ventures of AS Merko Ehitus</b>					
OÜ Unigate	61	(1)	-	-	60
Poolkoksimäe Sulgemise OÜ	2	16	-	-	18
<b>Joint venture of SIA Merks</b>					
SIA Zakusala Estates	8,616	(1,448)	-	112	7,280
<b>Joint venture of AS Merko Tartu</b>					
OÜ Kortermaja	93	(7)	(59)	-	27
<b>Total joint ventures</b>	8,772	(1,440)	(59)	112	7,385
<b>Total associates and joint ventures</b>	11,053	(1,120)	(59)	112	9,986

in thousands of euros

in thousands of euros	Investment at 31.12.2009	Establish- ment and liquidation	Changes in 2010			Investment at 31.12.2010
			Profit/loss from entities	Dividends	Currency translation adjustments	
<b>Associate of AS Merko Ehitus</b>						
AS TMB	2,583	-	(302)	-	-	2,281
<b>Joint ventures of AS Merko Ehitus</b>						
OÜ Unigate	62	-	(1)	-	-	61
Poolkoksimäe Sulgemise OÜ	-	2	-	-	-	2
<b>Joint ventures of SIA Merks</b>						
PS Merks Terbe Lat	2	(2)	-	-	-	-
SIA Zakusala Estates	8,688	-	(70)	-	(2)	8,616
<b>Joint venture of AS Merko Tartu</b>						
OÜ Kortermaja	132	-	(25)	(14)	-	93
<b>Total joint ventures</b>	<b>8,884</b>	<b>-</b>	<b>(96)</b>	<b>(14)</b>	<b>(2)</b>	<b>8,772</b>
<b>Total associates and joint ventures</b>	<b>11,467</b>	<b>-</b>	<b>(398)</b>	<b>(14)</b>	<b>(2)</b>	<b>11,053</b>

As at 31.12.2010, the difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee totalling EUR 17 thousand is due to the effect from the unrealised gains of mutual transactions.

As at 31.12.2011, the difference between the value of the investment in SIA Zakusala Estates and the equity of the investee in the amount of EUR 7,376 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 31.12.2010, this difference was EUR 8,678 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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**Associate**  
*in thousands of euros*

**2011**

	<b>Assets 31.12.</b>	<b>Liabilities 31.12.</b>	<b>Revenue</b>	<b>Net profit/ (loss)</b>
AS TMB	14,477	4,073	21,897	1,297

**2010**

AS TMB	12,506	3,380	15,535	(1,008)
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**Joint ventures**  
*in thousands of euros*

	<b>Assets 31.12.</b>		<b>Liabilities 31.12.</b>		<b>Equity 31.12.</b>	<b>Income</b>	<b>Expenses</b>	<b>Net profit/ (loss)</b>
	<b>Current assets</b>	<b>Non- cur- rent assets</b>	<b>Current liabili- ties</b>	<b>Non- current liabili- ties</b>				
<b>2011</b>								
OÜ Unigate	3,637	-	3,517	-	120	-	1	(1)
Poolkoksimeä Sulgemise OÜ	596	161	721	-	36	4,103	4,070	33
SIA Zakusala Estates	70	4,054	462	3,854	(192)	-	67	(67)
OÜ Kortermaja	68	-	14	-	54	140	188	(48)
<b>Total</b>	<b>4,371</b>	<b>4,215</b>	<b>4,714</b>	<b>3,854</b>	<b>18</b>	<b>4,243</b>	<b>4,326</b>	<b>(83)</b>
<b>2010</b>								
OÜ Unigate	3,402	-	40	3,240	122	0	3	(3)
PS Merks Terbe Lat	93	6	96	-	3	768	768	-
SIA Zakusala Estates	4,055	-	472	3,706	(123)	2	142	(140)
OÜ Kortermaja	241	-	20	-	221	292	389	(97)
<b>Total</b>	<b>7,791</b>	<b>6</b>	<b>628</b>	<b>6,946</b>	<b>223</b>	<b>1,062</b>	<b>1,302</b>	<b>(240)</b>

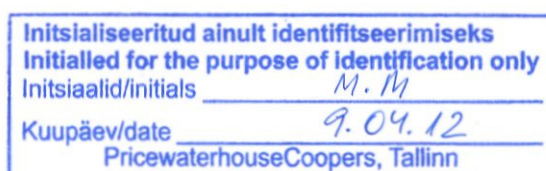
**Note 21 Other long-term loans and receivables**

*in thousands of euros*

	<b>31.12.2011</b>	<b>31.12.2010</b>
Long-term loans (Notes 17, 36)	5,096	6,323
incl. from related parties (Note 34)	3,587	4,755
Long-term interest receivables (Note 36)	17	308
incl. from related parties (Note 34)	-	288
Long-term bank deposit (Note 36)*	180	319
Long-term receivable from buyer of subsidiary (Note 36)**	96	96
Long-term receivables from customers of construction services (Note 36)	11,676	1,212
<b>Total other long-term loans and receivables</b>	<b>17,065</b>	<b>8,258</b>

\* The long-term bank deposit in the amount of EUR 145 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 deposit is in the amount of EUR 35 thousand with the due date of 27 June 2018 and interest rate of 5.35%.

\*\* In 2006, AS Merko Ehitus sold 25% of the shares of its 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 euros*

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

**31.12.2011**

	<b>Latvia</b>	<b>Lithuania</b>	<b>Total</b>
Deferred income tax liability			
effect of other payables	-	(1,764)	(1,764)
other effects	-	(15)	(15)
offsetting of deferred income tax assets and liabilities	-	1,648	1,648
<b>Deferred income tax liability</b>	-	(131)	(131)

Deferred income tax assets			
incl. tax loss carryforwards	-	629	629
effect of carrying amount of property, plant and equipment	(12)	-	(12)
effect of stage of completion method	47	46	93
effect of write-down of receivables	32	17	49
effect of write-down of inventories	804	198	1,002
effect of provisions	-	17	17
effect of other payables	-	1,509	1,509
other effects	231	-	231
offsetting of deferred income tax assets and liabilities	-	(1,648)	(1,648)

<b>Deferred income tax assets</b>	<b>1,102</b>	<b>768</b>	<b>1,870</b>
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Deferred income tax expense of the financial year (Note 11)	(284)	131	(153)
-------------------------------------------------------------	-------	-----	-------

**31.12.2010**

	<b>Latvia</b>	<b>Lithuania</b>	<b>Total</b>
Deferred income tax liability	-	-	-

Deferred income tax assets			
incl. tax loss carryforwards	-	487	487
effect of carrying amount of property, plant and equipment	(6)	-	(6)
effect of stage of completion method	42	240	282
effect of write-down of receivables	67	20	87
effect of write-down of inventories	306	-	306
effect of provisions	-	21	21
effect of changes in income tax rate	-	-	-
other effects	394	-	394

<b>Deferred income tax assets</b>	<b>803</b>	<b>768</b>	<b>1 571</b>
-----------------------------------	------------	------------	--------------

Deferred income tax charge of the financial year (Note 11)	403	75	478
------------------------------------------------------------	-----	----	-----

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

**Note 23 Investment property**  
*in thousands of euros*

	Land	Right of superficies	Buildings	Construction in progress	Total
Cost at 31.12.2009	134	-	1,000	-	1,134
Accumulated depreciation 31.12.2009	-	-	(76)	-	(76)
<b>Carrying amount at 31.12.2009</b>	134	-	924	-	1,058
Acquisition	-	-	152	2,418	2,570
Depreciation	-	-	(43)	-	(43)
<b>Carrying amount at 31.12.2010</b>	134	-	1,033	2,418	3,585
Cost at 31.12.2010	134	-	1,152	2,418	3,704
Accumulated depreciation 31.12.2010	-	-	(119)	-	(119)
<b>Carrying amount at 31.12.2010</b>	134	-	1,033	2,418	3,585
Exchange rate difference	2	-	3	-	5
Acquisition	-	-	2,536	1,112	3,648
Disposals	-	-	(2,460)	-	(2,460)
Reclassification	-	21	14	(2,418)	(2,383)
Depreciation	-	-	(82)	-	(82)
<b>Carrying amount at 31.12.2011</b>	136	21	1,044	1,112	2,313
Cost at 31.12.2011	136	29	1,215	1,112	2,492
Accumulated depreciation at 31.12.2011	-	(8)	(171)	-	(179)
<b>Carrying amount at 31.12.2011</b>	136	21	1,044	1,112	2,313

As at 31.12.2011, the carrying amounts of investment properties do not significantly differ from their fair values (31.12.2010: 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.

Investment properties pledged as collateral as at 31.12.2011 for the loan total EUR 642 thousand (2010: EUR 611 thousand) (Note 31).



**Note 24 Property, plant and equipment**  
*in thousands of euros*

	Land	Buildings	Right of super- ficies	Machi- nery and equip- ment	Other fixtures	Construc- tion in progress and prepay- ments	Total
Cost at 31.12.2009	825	5,690	29	15,143	5,023	55	26,765
Accumulated depreciation at 31.12.2009	-	(710)	(7)	(6,441)	(2,589)	-	(9,747)
<b>Carrying amount at 31.12.2009</b>	<b>825</b>	<b>4,980</b>	<b>22</b>	<b>8,702</b>	<b>2,434</b>	<b>55</b>	<b>17,018</b>
Acquisition	-	2	-	2,857	232	46	3,137
Disposals	-	-	-	(90)	(62)	-	(152)
Reclassification	-	-	-	64	39	(101)	2
Write-offs	-	-	-	(1)	(2)	-	(3)
Depreciation	-	(185)	(1)	(1,752)	(317)	-	(2,255)
<b>Carrying amount at 31.12.2010</b>	<b>825</b>	<b>4,797</b>	<b>21</b>	<b>9,780</b>	<b>2,324</b>	<b>-</b>	<b>17,747</b>
Cost at 31.12.2010	825	5,692	29	17,608	4,986	-	29,140
Accumulated depreciation at 31.12.2010	-	(895)	(8)	(7,828)	(2,662)	-	(11,393)
<b>Carrying amount at 31.12.2010</b>	<b>825</b>	<b>4,797</b>	<b>21</b>	<b>9,780</b>	<b>2,324</b>	<b>-</b>	<b>17,747</b>
Currency translation differences	-	-	-	2	-	-	2
Acquisition	-	34	-	1,220	421	14	1,689
Disposals	-	-	-	(1,288)	(18)	-	(1,306)
Reclassification	-	-	(21)	9	4	(14)	(22)
Write-offs	-	-	-	(2)	(6)	-	(8)
Depreciation	-	(185)	-	(1,507)	(353)	-	(2,045)
<b>Carrying amount at 31.12.2010</b>	<b>825</b>	<b>4,646</b>	<b>-</b>	<b>8,214</b>	<b>2,372</b>	<b>-</b>	<b>16,057</b>
Cost at 31.12.2011	825	5,726	-	16,947	5,169	-	28,667
Accumulated depreciation at 31.12.2011	-	(1,080)	-	(8,733)	(2,797)	-	(12,610)
<b>Carrying amount at 31.12.2011</b>	<b>825</b>	<b>4,646</b>	<b>-</b>	<b>8,214</b>	<b>2,372</b>	<b>-</b>	<b>16,057</b>

Information on leased assets is provided in Note 26 and on lease payments in Note 27.

Property, plant and equipment pledged as collateral as at 31.12.2011 for the loan total EUR 5,328 thousand (2010: EUR 1,762 thousand) (Note 31).



**Note 25 Intangible assets**  
*in thousands of euros*

	Goodwill*	Software	Prepayments	Total
Cost at 31.12.2009	891	1,108	87	2,086
Accumulated amortisation at 31.12.2009	-	(537)	-	(537)
<b>Carrying amount at 31.12.2009</b>	<b>891</b>	<b>571</b>	<b>87</b>	<b>1,549</b>
Acquisitions	-	91	-	91
Disposals	-	(6)	-	(6)
Amortisation	-	(126)	-	(126)
<b>Carrying amount at 31.12.2010</b>	<b>891</b>	<b>530</b>	<b>87</b>	<b>1,508</b>
Cost at 31.12.2010	891	1,160	87	2,138
Accumulated amortisation at 31.12.2010	-	(630)	-	(630)
<b>Carrying amount at 31.12.2010</b>	<b>891</b>	<b>530</b>	<b>87</b>	<b>1,508</b>
Acquisitions	-	64	-	64
Disposals	-	(3)	-	(3)
Reclassification	-	-	(35)	(35)
Amortisation	-	(107)	-	(107)
<b>Carrying amount at 31.12.2011</b>	<b>891</b>	<b>484</b>	<b>52</b>	<b>1,427</b>
Cost at 31.12.2011	891	1,209	52	2,152
Accumulated amortisation at 31.12.2011	-	(725)	-	(725)
<b>Carrying amount at 31.12.2011</b>	<b>891</b>	<b>484</b>	<b>52</b>	<b>1,427</b>

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

\* As at the balance sheet date, impairment 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. Post-projection period 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. During the pojection period the average estimated revenue growth rate is 21% (2010: 21%) and average EBITA margin is 12% (2010: 12%). 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. The impairment test has low sensitivity to revenue growth, the unit would not be impaired if 2011 actual revenue and EBITA margin were retained.

**Note 26 Leased assets**  
*in thousands of euros*

	31.12.2011	31.12.2010
<b>Assets acquired under finance lease terms</b>		
<b>Machinery and equipment</b>		
Cost	9,004	10,641
Accumulated depreciation	(2,854)	(3,351)
incl. depreciation charge of the period	(716)	(783)
<b>Carrying amount</b>	<b>6,150</b>	<b>7,290</b>

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### Assets leased under non-cancellable operating lease terms

Land lease agreements	2011	2010
Payments in the reporting period	2	-
Payments in subsequent periods:	21	4
Payable next year	2	1
Payable in 1...5 years	8	1
Payables after 5 years	11	2

On the basis of cancellable lease agreements, operating lease payments totalling EUR 879 thousand were paid for passenger cars in 2011 (2010: EUR 795 thousand). The Company does not intend to use a bargain purchase option for the assets leased under the operating lease terms in the reporting period.

Lease agreements does not set any limits to groups' dividend or financing policies. Rented assets are not re-rented.

### Note 27 Borrowings

*in thousands of euros*

	2011	2010
<b>Finance lease payables</b>		
Present value of lease payments at beginning of the year	3,948	3,064
Received	773	2,331
Paid	(1,747)	(1,447)
Minimum future lease payments	2,974	3,948
incl. current portion	825	1,054
non-current portion 1...4 years	2,149	2,894
Interest expense for the reporting period	159	109
Minimum future lease payments	3,254	4,291
incl. current portion	941	1,180
non-current portion 1...4 years	2,313	3,111
Average effective interest rate 3.1% (2010: 3.1%)		
Base currencies EUR and LVL		
<b>Bank loans</b>		
Loan balance at beginning of the year	14,489	23,117
Received	20,798	2,115
Paid	(5,484)	(10,750)
Exchange rate difference	106	7
Loan balance at end of the year	29,909	14,489
incl. current portion	8,294	4,374
non-current portion 1...5 years	21,615	10,115
Interest cost of reporting period	771	555
incl. capitalised interest cost	94	3
Average effective interest rate 3.2% (2010: 4.9%)		
Base currencies EUR, LTL and LVL		

**Loans from entities under common control**

Loan balance at beginning of the year	6,989	6,989
Offset with a receivable	(44)	-
Loan balance at end of the year (Note 34)	6,945	6,989
incl. current portion	6,945	6,989
Interest cost of reporting period	193	169
Average effective interest rate 3.2% (2010: 2.4%)		

**Loans from other entities**

Loan balance at beginning of the year	313	313
Received	197	-
Loan balance at end of the year	510	313
incl. current portion	510	137
non-current portion 1...5 years	-	176
Interest cost of reporting period	18	18
Average effective interest rate 5.5% (2010: 5.5%)		

**Total loans**

Loan balance at beginning of year	21,791	30,419
Received	20,995	2,115
Paid	(5,484)	(10,750)
Offset with a receivable	(44)	
Exchange rate difference	106	7
Loan balance at end of year	37,364	21,791
incl. current portion	15,749	11,500
non-current portion 1...5 years	21,615	10,291

**Total borrowings**

	40,338	25,739
incl. current portion (Note 36)	16,574	12,554
non-current portion 1...5 years (Note 36)	23,764	13,185

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:

	2011	2010
<b>Finance lease liabilities</b>		
6-12 months	2,320	2,408
<b>Bank loans</b>		
up to 6 months	8,825	2,269
6-12 months	21,084	12,220
<b>Loans from entities under common control</b>		
6-12 months	6,945	6,989
<b>Total</b>	39,174	23,886

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

	2011	2010
Finance lease liabilities	654	1,540
Loans from other entities	510	313
<b>Total</b>	1,164	1,853

The year 2011 brought certain stability to the global financial markets. 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 fair value of loans refinanced in 2011 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 Payables and prepayments**

*in thousands of euros*

	31.12.2011	31.12.2010
Trade payables (Note 36)	34,206	15,362
incl. to related parties (Note 34)	668	15
Payables to employees	2,835	2,701
Tax liabilities, except for corporate income tax		
value added tax	837	730
personal income tax	458	442
social security tax	871	758
land tax	118	-
unemployment insurance tax	86	78
contributions to mandatory funded pension	28	18
other taxes	106	25
	2,504	2,051
Amounts due to customers for contract works (Notes 33, 36)	10,314	3,876
Other liabilities (Note 36)		
interest liabilities	111	88
incl. to related parties (Note 34)	34	31
payable for registered immovables from demerger	6,391	6,391
incl. to related parties (Note 34)	6,391	6,391
other liabilities	402	301
	6,904	6,780
Prepayments received	4,872	8,384
<b>Total payables and prepayments</b>	61,635	39,154

## Note 29 Short-term provisions

*in thousands of euros*

	2011	2010
<b>Provision for warranty obligation for construction</b>		
Residual value at beginning of the year	1,112	1,184
Set up	1,063	966
Used during the year	(815)	(1,038)
Exchange rate difference	7	-
Balance at end of the year	1,367	1,112
<b>Provision for onerous construction contracts</b>		
Residual value at beginning of the year	2,226	258
Set up	2,914	2,172
Used during the year	(1,616)	(204)
Exchange rate difference	2	-
Balance at end of the year	3,526	2,226
<b>Provision for legal costs and claims filed</b>		
Residual value at beginning of the year	262	926
Set up	1,063	70
Used during the year	-	(734)
Exchange rate difference	1	-
Balance at end of the year (Note 36)	1,326	262
<b>Other provisions</b>		
Residual value at beginning of the year	74	42
Set up	817	90
Used during the year	(330)	(58)
Exchange rate difference	1	-
Balance at end of the year	562	74
<b>Total short-term provisions</b>	6,781	3,674

## Note 30 Other long-term payables

*in thousands of euros*

	31.12.2011	31.12.2010
Trade payables (Note 36)	790	845
Prepayments received	-	1
Long-term provision	66	-
incl. recognised	66	-
<b>Total other long-term payables</b>	856	846

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### Note 31 Loan collaterals and pledged assets

The group has entered into commercial pledge contracts to secure loans and other liabilities, set mortgages on assets and pledged the shares of its subsidiaries:

#### Commercial pledges

	31.12.2011	31.12.2010
Movable property	34,320	49,038
Term deposit (Note 21)	145	145
<b>Total</b>	<b>34,465</b>	<b>49,183</b>

#### Mortgages

	31.12.2011	31.12.2010
Inventories (Note 18)	38,286	42,810
Land and buildings (Note 24)	3,704	72
Other non-current assets (Note 24)	1,624	1,690
Investment properties (Note 23)	642	611
Financial assets*	11,759	-
<b>Total</b>	<b>56,015</b>	<b>45,183</b>

#### Pledges of shares

UAB Merko Statyba has pledged the shares of its (wholly-owned) subsidiary UAB Balsiu mokyklos SPV for the benefit of Nordea Bank Finland Plc. An investment loan in the sum of EUR 7,801 thousand is secured by this pledge.

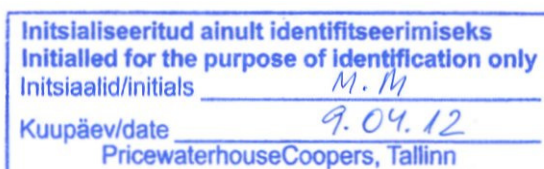
In addition to the the shares of its subsidiary UAB Merko Statyba has pledged as a collateral for investment loan the short-and long-term receivables from the the buyer of Balsiu schoolhouse in the amount of EUR 11,759 thousand.

### Note 32 Share capital

In conjunction with the accession of the Republic of Estonia to the eurozone at 1 January 2011 and pursuant to the amendments to the Commercial Code entered into force at 1 July 2010, the share capital of AS Merko Ehitus was translated from EEK 177,000 thousand into EUR 11,312 thousand and shares without nominal value were taken into use. The share capital of AS Merko Ehitus consists of 17,700 thousand shares without nominal value. In addition, the share capital was increased by means of a bonus issue from retained earnings in the amount of EUR 688 thousand through increasing the book value of shares so that the new size of the share capital is EUR 12,000 thousand. The new book value of the share is EUR 0.67797.

In 2010, no changes were made to the share capital. As at 31.12.2010, the share capital in the amount of EUR 11,312 thousand (EEK 177,000 thousand) consisted of 17,700 thousand registered shares with the nominal value of EUR 0.639 (EEK 10) each.

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



**Note 33 Construction contracts in progress**  
*in thousands of euros*

	31.12.2011	31.12.2010
Costs incurred for construction contracts in progress and corresponding profit*	395,877	381,198
Progress billings submitted	(390,175)	(371,517)
Revenue recorded from construction services during the period	198,294	151,201
Amounts due from customers for contract works (Notes 16, 36)	16,016	13,557
Amounts due to customers for contract works (Notes 28, 36)	(10,314)	(3,876)
Advance payments received for contract works	3,522	8,384

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 2010 and 2009.

**Note 34 Related party transactions**  
*in thousands of euros*

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

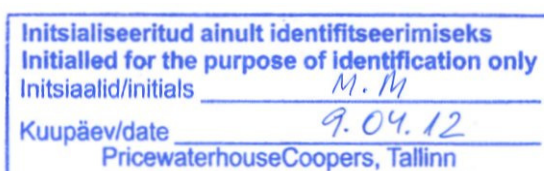
- parent company AS Riverito;
- shareholders of AS Riverito with significant influence over AS Merko Ehitus through AS Riverito;
- other shareholders with significant influence;
- other subsidiaries of AS Riverito, so-called 'entities controlled by the parent';
- associates and joint ventures;
- key members of the management (supervisory and management board), their close relatives and entities under their control or significant influence.

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 31.12.2011 and 31.12.2010, AS Riverito owned 71,99% of the shares of AS Merko Ehitus. The ultimate controlling party of the group is Mr Toomas Annus.

**Goods and services**  
*in thousands of euros*

	2011	2010
<b>Construction services rendered</b>		
Parent company	-	48
Associates and joint ventures	159	128
Entities under common control	1,462	756
Members of the management	27	835
Other related parties	2	5
<b>Total construction services provided</b>	1,650	1,772
<b>Purchased construction services</b>		
Entities under common control	137	143
<b>Other services purchased</b>		
Parent company	115	1,086



**Construction materials purchased**

Parent company	-	76
Associates and joint ventures	74	-
Other related parties	204	6
<b>Total construction materials purchased</b>	<b>278</b>	<b>82</b>

**Interest income**

Associates and joint ventures	108	86
Entities under common control	44	160
<b>Total interest income</b>	<b>152</b>	<b>246</b>

**Interest expense**

Parent company	122	54
Entities under common control	193	169
<b>Total interest expense</b>	<b>315</b>	<b>223</b>

**Balances with related parties**

	<b>31.12.2011</b>	<b>31.12.2010</b>
<b>Trade and other receivables</b>		
Trade receivables (Note 16)		
Parent company	3	5
Associates and joint ventures	23	18
Entities under common control	187	4
Members of the management	25	-
Other related parties	1	5
Total trade receivables	239	32
Short-term loans (Note 17)		
Associates and joint ventures	1,343	-
Entities under common control	-	1,557
Interest receivables (Note 16)		
Associates and joint ventures	784	383
Entities under common control	-	175
Total interest receivables	784	558
Other short-term receivables (Note 16)		
Entities under common control	4	4
Prepayments for inventories (Note 18)		
Entities under common control	3,810	4,741
<b>Total trade and other receivables</b>	<b>6,180</b>	<b>6,892</b>
<b>Other long-term loans and receivables</b>		
Long-term loans (Note 17)		
Associates and joint ventures	3,587	4,755
Interest receivables (Note 21)		
Associates and joint ventures	-	288
<b>Total other long-term loans and receivables</b>	<b>3,587</b>	<b>5,043</b>

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## Borrowings

Short-term loans and bonds (Note 27)		
Entities under common control	6,945	6,989

## Payables and prepayments

Trade payables (Note 28)		
Parent company	12	12
Entities under common control	553	3
Associates and joint ventures	51	-
Other related parties	52	-
Total trade payables	668	15
Interest liabilities (Note 28)		
Parent company	15	16
Entities under common control	19	15
Total interest liabilities	34	31
Other liabilities (Note 28)		
Entities under common control	6,391	6,391
<b>Total payables and prepayments</b>	<b>7,093</b>	<b>6,437</b>

In 2011, allowances for the receivables from entities under common control have been recognised in the amount of EUR 991 thousand (2010: EUR 494 thousand), the amount written down in 2010 is included within inventories as a prepayment in the consolidated financial statements. Allowances made in 2011 and 2010 express the decrease of the value of assets to be acquired under contractual obligation.

## Remuneration of the members of the Supervisory and Management Boards

In 2011, the members of the Supervisory and Management Boards of AS Merko Ehitus and Management Boards of its significant subsidiaries were paid remuneration totalling EUR 1,269 thousand (2010: EUR 1,772 thousand). In 2010, the management structure was reformed, during the course of which the directorate was liquidated and its functions were returned to the Supervisory Board.

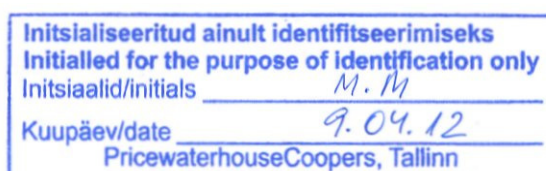
## Termination benefits of members of the Supervisory and Management Boards

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 EUR 406 thousand (2010: EUR 406 thousand). In 2011, no compensation was paid to the members of the Management Board (2010: EUR 50 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 Liising AS in the amount of EUR 35 thousand (31.12.2010: EUR 43 thousand).

The fair value of group's surety contracts is immaterial, therefore no liability has been recorded in the balance sheet as at 31.12.2011 as well as at 31.12.2010.



**Note 35 Contingent liabilities**  
*in thousands of euros*

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.

	31.12.2011	31.12.2010
Performance period's warranty to the customer	22,276	19,339
Tender warranty	3,309	3,276
Guarantee warranty period	9,347	9,771
Prepayment guarantee	12,270	10,295
Contracts of surety	1,248	53
Payment guarantee	1,255	171
<b>Total contingent liabilities</b>	<b>49,705</b>	<b>42,905</b>

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.

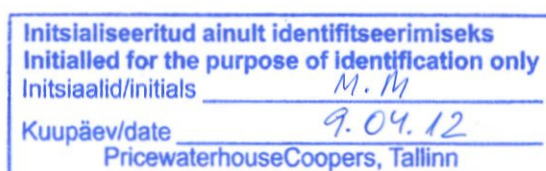
For legal risks, please refer to the respective paragraph of Note 36.

**Note 36 Risk management**

**Financial risks management**

**1. Credit risk**

Credit risk relates to a potential damage 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. Free cash is mostly held in overnight deposits or term deposits at Swedbank, SEB and Nordea bank groups. Swedbank AS and SEB Pank AS do not have separate ratings by Moody's. The parent company of Swedbank AS - Swedbank AB has rating A2 by Moody, the parent company of SEB Pank AS - Skandinaviska Enskilda Banken AB has rating A1 by Moody. Nordea Bank Finland has rating Aa2. The management estimates that the group is not exposed to significant credit risk.



Financial assets exposed to credit risk in thousands of euros	Allocation by due dates		Carrying amount	Collateral
	1-12 months	2-5 years		
<b>31.12.2011</b>				
Cash and cash equivalents (Note 14)	18,510	-	18,510	-
Term deposits (Notes 15, 21)	140	180	320	-
Trade receivables (Notes 16, 21)	35,607	11,772	47,379	-
Amounts due from customers for contract works (Notes 16, 33)	16,016	-	16,016	-
Loans granted (Notes 16, 17, 21)	7,673	5,096	12,769	11,152
Interest receivables (Notes 16, 21)	881	17	898	-
Other short-term receivables (Note 16)	1,444	-	1,444	-
<b>Total</b>	<b>80,271</b>	<b>17,065</b>	<b>97,336</b>	<b>11,152</b>
<b>31.12.2010</b>				
Cash and cash equivalents (Note 14)	9,856	-	9,856	-
Term deposits (Notes 15, 21)	2,651	319	2,970	-
Trade receivables (Notes 16, 21)	20,589	1,308	21,897	-
Amounts due from customers for contract works (Notes 16, 33)	13,557	-	13,557	-
Loans granted (Notes 16, 17, 21)	6,500	6,323	12,823	1,598
Interest receivables (Notes 16, 21)	808	308	1,116	-
Other short-term receivables (Note 16)	190	-	190	-
<b>Total</b>	<b>54,151</b>	<b>8,258</b>	<b>62,409</b>	<b>1,598</b>

The group's customers are primarily large local entities or public sector entities (as at 31.12.2011, the public sector proportion in accounts receivable amounted to 58.3% (as at 31.12.2010: 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.

In 2011, the group recognised doubtful receivables in the amount of EUR 544 thousand (2010: EUR 1,159 thousand) and wrote off uncollectible receivables in the amount of EEK 82 thousand (2010: EUR 112 thousand) in its balance sheet. Management estimates that there are sufficient grounds to assume that the amounts carried in the financial statements will be paid off 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, EUR 4,930 thousand (31.12.2010: EUR 6,312 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. Due to the violation of some of the terms of the loan agreement, the Company recognised an allowance in 2011 for loans granted to unrelated legal entities in the amount of EUR 1 thousand. The loans granted to unrelated legal entities include two loans in the total amount of EUR 4,407 thousand (31.12.2010: EUR 4,598 thousand), the borrowers of which have not been able to meet their obligations arising from the loan contract by their due date but which have been secured by a mortgage or by the parent company's guarantee. The 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. Other loans granted to unrelated legal persons do not carry significant credit risk.

## 2. Market 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. Although the share of interest-bearing liabilities in the group's capital structure increased in 2011, the management considers it moderate (as at 31.12.2011: 18.3% and 31.12.2010: 13.2% of the balance sheet total), and the effect of changes in the interest rate environment in 12 month perspective insignificant for the operating results of the group.

Effect of changes in interest risks on finance costs

As at 31.12.2011, the group's interest-bearing liabilities totalled EUR 40,338 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 31.12.2011, the group's maximum need for payment/refinancing of liabilities in 2012 was EUR 16,574 thousand. Of the liabilities assumed, those with fixed interest rates total EUR 1,164 thousand, including non-current liabilities of EUR 400 thousand. Liabilities in the amount of EUR 39,174 thousand have floating base interest rates, all of which are exposed to changes in Euribor. As at 31.12.2011, 12-month Euribor was 1.947% and the management estimates that the average Euribor rate over the next 12 months may be 50 basis points lower than at the beginning of the year. A change of +/- 50 basis points in Euribor rate at the current level of liabilities would increase/decrease the group's interest expenses by EUR 196 thousand. In addition to Euribor risk, the refinancing of liabilities also carries a risk due to changes in risk margins attributable to the changes in the economic environment. The management estimates that in 2012, the financing institutions may increase their loan rates by 50-100 basis points, depending on the time of prior fixing of the interest rate. The balance of liabilities exposed to the changes in the risk margin as at 31.12.2011 was EUR 23,901 thousand and a change of +/- 100 basis points in the risk margin would increase/decrease the group's interest expenses by EUR +/- 239 thousand.

### Foreign exchange risk

The group's economic activities are conducted mainly in the currencies of the countries of location of the companies: euros in Estonia, Latvian lats in Latvia and Lithuanian litas in Lithuania. 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 the preferred currency for conclusion of long-term loan contracts is the euro. As at the balance sheet date, 72.0% of the assets were denominated in EUR, 24.2% in LVL, 3.7% in LTL and 0.1% in USD and 86.6% of the liabilities were in EUR, 12.9% in LVL and 0.5% in LTL of the balance sheet total.

### 3. Liquidity risk

The Company's liquidity or solvency represents its ability to settle its liabilities to creditors on time. As at 31.12.2011, the group's current ratio was 2.0 (31.12.2010: 2.7) and the quick ratio 1.0 (31.12.2010: 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 EUR 7,495 thousand. In addition to the overdraft facility, the Company has a current loan facility with the limit of EUR 3,500 thousand from AS Riverito, which has not been used.

The management estimates that the group's capital structure – a solid proportion of equity at 49,6% of the balance sheet total and a moderate proportion of interest bearing liabilities at 18.3% 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.

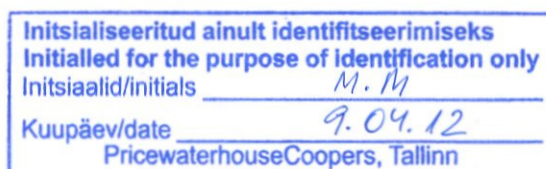
#### Financial assets/liabilities

*in thousands of euros*

**31.12.2011**

#### Assets

	Allocation by due date			Total	Carrying amount
	1-3 months	4-12 months	2-5 years		
Cash and overnight deposits (Note 14)	18,510	-	-	18,510	18,510
Term deposits (Notes 15, 21)	-	140	180	320	320
Trade receivables (Notes 16, 21)	31,261	4,346	11,772	47,379	47,379
Receivables recorded based on the stage of completion of construction contracts (Notes 16, 33)	16,016	-	-	16,016	16,016
Loans and interest (Notes 16, 17, 21)	6,297	2,257	5,113	13,667	13,667
Other short-term receivables (Note 16)	202	1,242	-	1,444	1,444
<b>Total</b>	<b>72,286</b>	<b>7,985</b>	<b>17,065</b>	<b>97,336</b>	<b>97,336</b>



**Liabilities**

Trade payables (Notes 28, 30)	32,978	1,228	790	34,996	34,996
Due to customers of construction works (Notes 28, 33)	10,314	-	-	10,314	10,314
Loan and finance lease liabilities (Note 27)*	356	16,218	23,764	40,338	40,338
Other liabilities (Note 28)	6,724	180	-	6,904	6,904
<b>Total</b>	<b>50,372</b>	<b>17,626</b>	<b>24,554</b>	<b>92,552</b>	<b>92,552</b>

**31.12.2010**

**Assets**

Cash and overnight deposits (Note 14)	9,856	-	-	9,856	9,856
Term deposits (Notes 14, 15, 21)	-	2,651	319	2,970	2,970
Trade receivables (Notes 16, 21)	19,031	1,558	1,308	21,897	21,897
Due from customers of construction works (Notes 16, 33)	13,557	-	-	13,557	13,557
Loans and interest (Notes 16, 17, 21)	-	7,308	6,631	13,939	13,939
Other short-term receivables (Note 16)	57	133	-	190	190
<b>Total</b>	<b>42,501</b>	<b>11,650</b>	<b>8,258</b>	<b>62,409</b>	<b>62,409</b>

**Liabilities**

Trade payables (Notes 28, 30)	13,280	2,082	845	16,207	16,207
Due to customers of construction works (Notes 28, 33)	3,876	-	-	3,876	3,876
Loan and finance lease liabilities (Note 27)*	1,053	11,501	13,185	25,739	25,739
Other liabilities (Note 28)	6,463	317	-	6,780	6,780
<b>Total</b>	<b>24,672</b>	<b>13,900</b>	<b>14,030</b>	<b>52,602</b>	<b>52,602</b>

\* The schedule of expected interest payments cannot be determined with reasonable accuracy. In line with the best 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, the management is of 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 EUR 25 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 EUR 25 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 registered ordinary shares without nominal value which have been fully paid for 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 EUR 6,000 – 24,000 thousand. As at 31.12.2011, the share capital of AS Merko Ehitus was EUR 12,000 thousand and the net assets were EUR 109,240 thousand, therefore 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% (31.12.2011: 49.6%, 31.12.2010: 63.8%) at any given time and

interest bearing debt to assets ratio would not exceed 25% (31.12.2010: 18.3%, 31.12.2010: 13.2%). 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%.

## Other risks management

### 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.

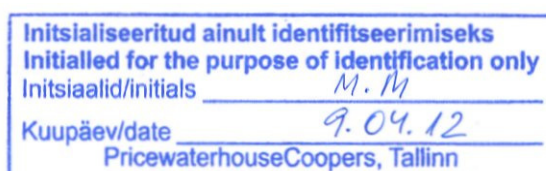
As at 31 December 2011, a provision has been set up at the group in the amount of EUR 1,326 thousand for covering potential claims and legal costs (31 December 2010: EUR 262 thousand), (Note 29).

An overview of the key legal disputes of group entities as at 31 December 2011 is presented below.

On 13 September 2011, AS Merko Ehitus and Tallinna Teede AS filed a statement of claim with Viru County Court against AS Rakvere Vesi. In the statement of claim, AS Merko Ehitus and Tallinna Teede AS asked the court to establish, among other things, that by their declaration of cancellation submitted to Rakvere Vesi AS at 11 July 2011, AS Merko Ehitus and Tallinna Teede AS have validly cancelled the contract for construction no 114289 (hereinafter: Contract) concluded between AS Merko Ehitus and Tallinna Teede AS and AS Rakvere Vesi as a result of the public procurement "Procurement for designing and construction of piping in the area of the city of Rakvere". AS Merko Ehitus and Tallinna Teede AS also asked the court to order from AS Rakvere Vesi the payment of the amount of EUR 220 thousand and accrued fines for delay, and to establish that AS Rakvere Vesi is not entitled to claim payment of the performance guarantee (in the amount of EUR 760 thousand) provided by AS Merko Ehitus and Tallinna Teede AS on the basis of the Contract. AS Merko Ehitus and Tallinna Teede AS were forced to file a statement of claim with Viru County Court, because AS Rakvere Vesi did not accept the declaration of cancellation of the Contract submitted by AS Merko Ehitus and Tallinna Teede AS at 11 July 2011 due to material breach of the Contract by AS Rakvere Vesi and referred to a possibility to claim payment of the performance guarantee provided under the Contract. AS Rakvere Vesi has not specified the amount of its possible claim for damages. The management of the group is of opinion that cancellation of the Contract by the contractor's declaration of cancellation of 11 July 2011 was substantiated due to material breach of the Contract by AS Rakvere Vesi.

On 9 January 2011, a court case opened at Harju County Court which among other issues dealt with the claim filed against AS Merko Ehitus and its subsidiaries OÜ Metsailu, OÜ Woody, OÜ Constancia in relation to the giving of the bribe to the former Tallinn city official Ivo Parbus. The Prosecutor's Offices has charged Merko Ehitus and its subsidiaries with the giving of the bribe by the then member of management board Tõnu Korts – Estravel's gift coupon of EUR 1,597.80 and the book with the list price of EUR 26.20 titled "Eesti Talurahva Arhitektuur" (*Estonian Vernacular Architecture*) - in order to accelerate real estate business related proceedings in Tallinn City authorities. According to section 44 subsection 8 of the Penal Code, a court can, upon conviction, impose a pecuniary punishment from EUR 3,2 thousand to EUR 16,000 thousand on a legal person. Pecuniary punishment may be imposed as supplementary punishment in addition to forced liquidation.

On 30 March 2012 Harju County Court proclaimed the judgment in criminal case 1-09-20251. According to the judgment of Harju County Court AS Merko Ehitus, OÜ Metsailu, OÜ Woody, OÜ Constancia were convicted based on Penal Code section 297 subsection 3 (granting or promising a gratuity by a legal person). According to the judgment AS Merko Ehitus will be punished by pecuniary punishment in the amount of EUR 300,000, OÜ Woody and OÜ Constancia each by pecuniary punishment in the amount of EUR 200,000 and OÜ Metsailu by pecuniary punishment in the amount of EUR 100,000. According to the Income Tax Act, a pecuniary punishment is subject to income tax and upon the enforcement of the pecuniary punishment the group companies will have to pay EUR 213 thousand of income tax in addition to the amount of the pecuniary punishment. To reflect the judgment of Harju County Court after the balance sheet date, an additional provision in the amount of EUR 1,013 thousand was set up to cover the possible pecuniary punishment and associated tax liability. Pursuant to § 38 subsection 1 clause 1 of Public Procurement Act, a contracting authority shall not award a public contract to a person and shall exclude from a procurement procedure a





tenderer or candidate who or whose legal representative has been convicted of committing offences relating to professional misconduct in a criminal procedure, and whose data concerning punishment have not been deleted from the penal register in accordance with the Penal Register Act. Accordingly, AS Merko Ehitus, OÜ Metsailu, OÜ Woody, OÜ Constanica cannot participate in the public procurement in case of criminal conviction. The respective limitation does not concern other companies of the group.

The judgment has not entered into force. The management of the group is of opinion that the company has not granted a gratuity and has conducted its activities in conformity with the laws of the Republic of Estonia and will appeal to the circuit court.

#### Asset valuation

Despite a certain improvement of the economic environment in 2011, the effect of real estate market risk was still significant when evaluating the activities of the Company. Due to the faster than forecast appreciation of construction prices as compared to the prices used in contracts entered into in 2009/2010 and the slow recovery of the Baltic real estate market, in 2011 the group incurred a loss from impairment of development projects in the amount of EUR 5,978 thousand, including from registered immovables for resale of EUR 1,121 thousand, from prepayment for registered immovable of EUR 1,141 thousand, from construction in progress of EUR 2,300 thousand and write-down of immovables of joint venture in the amount of EUR 1,456 thousand. Based on the results of the impairment test, the previous write-downs of registered immovables for sale were reversed in the amount of EUR 106 thousand and write-downs of finished goods were reversed in the amount of EUR 146 thousand. In addition, irrecoverable receivables were written off in the amount of EUR 83 thousand.

In 2011, market risk arose primarily as a result of changes in input prices. Due to strong demand in Scandinavia, the construction sector inputs continued to appreciate in 2011; the prices of all materials, the rent of equipment and the cost of labour have increased. As compared to the bottom of the construction market in 2009, construction prices have increased by 30-40%. 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 2011.

## 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 euros*

	2011	2010
Revenue	111,489	93,835
Cost of goods sold	(111,969)	(87,984)
<b>Gross profit (loss)</b>	(480)	5,851
Marketing expenses	(1,229)	(1,527)
General and administrative expenses	(3,313)	(3,390)
Other operating income	8,451	2,891
Other operating expenses	(519)	(249)
<b>Operating profit (loss)</b>	2,910	3,576
Finance income/costs	(519)	189
Finance income/costs from investments in subsidiaries	-	17,991
<b>Profit (loss) before tax</b>	2,391	21,756
Deferred income tax expense	(275)	-
<b>Net profit for the year</b>	2,116	21,756



## Statement of financial position

in thousands of euros

	31.12.2011	31.12.2010
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	5,665	2,477
Short-term deposits	-	1,500
Trade and other receivables	100,836	36,257
Prepaid corporate income tax	406	406
Inventories	21,265	13,108
Non-current assets held for sale	-	54
	<u>128,172</u>	<u>53,802</u>
<b>Non-current assets</b>		
Investments in subsidiaries	41,867	33,870
Investments in associates and joint ventures	258	258
Other long-term financial assets	3,147	55,246
Investment property	21	-
Property, plant and equipment	1,098	1,156
Intangible assets	390	420
	<u>46,781</u>	<u>90,950</u>
<b>TOTAL ASSETS</b>	<u>174,953</u>	<u>144,752</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Borrowings	15,810	9,417
Trade and other payables	39,017	26,140
Short-term provisions	2,752	1,585
	<u>57,579</u>	<u>37,142</u>
<b>Non-current liabilities</b>		
Other long-term trade payables	10,009	591
	<u>67,588</u>	<u>37,733</u>
<b>TOTAL LIABILITIES</b>	<u>67,588</u>	<u>37,733</u>
<b>EQUITY</b>		
Share capital	12,000	11,312
Statutory reserve capital	1,131	1,131
Retained earnings	94,234	94,576
<b>TOTAL EQUITY</b>	<u>107,365</u>	<u>107,019</u>
<b>TOTAL LIABILITIES AND EQUITY</b>	<u>174,953</u>	<u>144,752</u>

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## Statement of changes in equity

in thousands of euros

Parent	Share capital	Statutory reserve capital	Retained earnings	Total
<b>Balance as at 31.12.2009</b>	11,312	1,131	85,264	97,707
Net profit for financial year	-	-	21,756	21,756
Dividends	-	-	(12,444)	(12,444)
<b>Balance as at 31.12.2010</b>	11,312	1,131	94,576	107,019
Carrying amount of holdings under dominant or significant influence				(34,129)
Value of holdings under dominant or significant influence under the equity method				51,850
<b>Adjusted unconsolidated equity 31.12.2010</b>				<b>124,740</b>
Net profit for financial year	-	-	2,116	2,116
Bonus issue	688	-	(688)	-
Dividends	-	-	(1,770)	(1,770)
<b>Balance as at 31.12.2011</b>	12,000	1,131	94,234	107,365
Carrying amount of holdings under dominant or significant influence				(42,126)
Value of holdings under dominant or significant influence under the equity method				44,001
<b>Adjusted unconsolidated equity 31.12.2011</b>				<b>109,240</b>

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

## Cash flow statement

in thousands of euros

	2011	2010
<b>Cash flows from operating activities</b>		
Operating profit	2,910	3,576
Adjustments:		
depreciation and impairment charge	283	570
(profit) loss from sale of non-current assets	-	(1)
(profit) loss from sale of a business unit	(4,591)	-
adjustment of revenue from construction contracts under stage of completion method	(279)	(15,362)
interest income from business activities	(3,921)	(2,789)
change in provisions	936	(496)
Change in trade and other receivables related to operating activities	(15,910)	(901)
Change in inventories	(8,092)	(144)
Change in trade and other payables related to operating activities	10,943	3,270
Interest paid	(519)	(276)
Corporate income tax reimbursed	-	1
	(18,240)	(12,552)
<b>Cash flows from investing activities</b>		
Investments in subsidiaries	(8,000)	(6,430)
Sale of subsidiaries	14	-
Acquisition of associates and joint ventures	-	(1)
Purchase of/ proceeds from short-term deposits with maturities greater than 3 months	1,500	24,123
Purchase of property, plant and equipment	(183)	(131)
Proceeds from sale of property, plant and equipment	51	117
Purchase of intangible assets	(35)	(13)
Proceeds from sale of intangible assets	3	-
Sale of a business unit	4,515	-
Loans granted	(13,309)	(25,441)
Loan repayments received	19,533	6,567
Interest received	3,131	2,742
Dividends received	-	19,077
	7,220	20,610
<b>Cash flows from financing activities</b>		
Proceeds from borrowings	16,037	414
Loan repayments received	(22)	(4,853)
Finance lease principal payments	(46)	(44)
Dividends paid	(1,770)	(12,444)
	14,199	(16,927)
<b>Net increase/decrease in cash and cash equivalents</b>	3,179	(8,869)
Change in deposits with maturities greater than 3 months	(1,500)	(24,123)
Total change	1,679	(32,992)
<b>Cash and cash equivalents in the beginning of period</b>	2,477	11,258
Deposits with maturities greater than 3 m at the beginning of period	1,500	25,623
Total in the beginning of period	3,977	36,881
<b>Effects of changes in foreign exchange rates</b>	9	88
<b>Cash and cash equivalents at end of the period</b>	5,665	2,477
Deposits with maturities greater than 3 months at the end of period	-	1,500
Total at the end of period	5,665	3,977


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## **SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2011 ANNUAL REPORT**

The Management Board of AS Merko Ehitus has prepared the management report, the consolidated financial statements and the profit allocation proposal for 2011.

Andres Trink	Chairman of the Management Board		30.03.2012
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Alar Lagus	Member of the Management Board		30.03.2012
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Viktor Mõisja	Member of the Management Board		30.03.2012
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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.

Toomas Annus	Chairman of the Supervisory Board		09.04.2012
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Tõnu Toomik	Member of the Supervisory Board		09.04.2012
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Teet Roopalu	Member of the Supervisory Board		09.04.2012
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Indrek Neivelt	Member of the Supervisory Board		09.04.2012
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Olari Taal	Member of the Supervisory Board		09.04.2012
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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 2011 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 2011, 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", written over a light blue horizontal line.

Tiit Raimla  
Auditor's Certificate No.287

A handwritten signature in blue ink, appearing to read "Märten Padu", written over a light blue horizontal line.

Märten Padu  
Auditor's Certificate No.513

9 April 2012

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\* 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 euros*

Retained earnings	EUR 110,763,733
Net profit (loss) for 2011	EUR (14,084,939)

<b>Total retained earnings as at 31.12.2011</b>	<b>EUR 96,678,794</b>
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The Management Board proposes profit allocation as follows:

Transfer to statutory reserve capital	EUR 68,764
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<b>Retained earnings after profit allocation</b>	<b>EUR 96,610,030</b>
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Andres Trink      Chairman of the Management Board

30.03.2012

Alar Lagus      Member of the Management Board

30.03.2012

Viktor Mõisja      Member of the Management Board

30.03.2012

## 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 parent of AS Merko Ehitus for the year 2011 is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), as required under the Commercial Code § 4 p.6:

		<i>in thousands of euros</i>	
<b>EMTAK code</b>		<b>2011</b>	<b>2010</b>
	Rendering of construction services		
4120	construction of residential and non-residential buildings	18,918	33,653
4110	development of building projects	5,632	7,134
4211	construction of roads and railways	21,182	26,855
4221	construction of utility projects for fluids	43,136	14,122
	construction of utility projects for electricity and telecommunications	434	4,187
4222			
4291	construction of water projects	133	3,060
4213	construction of bridges and tunnels	792	174
4299	construction of other civil engineering projects n.e.c.	20,841	4,035
		<u>111,068</u>	<u>93,220</u>
	Real estate activities		
6810	sales of own real estate	335	601
6820	renting and operating of own or leased real estate	86	14
		<u>421</u>	<u>615</u>
	<b>Total revenue</b>	<u>111,489</u>	<u>93,835</u>