



# AS MERKO EHITUS

SOCIAL RESPONSIBILITY REPORT





# AS MERKO EHITUS GROUP

## SOCIAL RESPONSIBILITY REPORT

<b>Business name:</b>	AS Merko Ehitus
<b>Main activities:</b>	Holding companies General contracting of construction Real estate development
<b>Commercial Register No.:</b>	11520257
<b>Address:</b>	Järvevana tee 9G, 11314 Tallinn
<b>Postal address:</b>	Pärnu mnt 141, 11314 Tallinn
<b>Phone:</b>	+372 650 1250
<b>Fax:</b>	+372 650 1251
<b>E-mail:</b>	merko@merko.ee
<b>Web site:</b>	www.merko.ee
<b>Auditor:</b>	AS PricewaterhouseCoopers
<b>Supervisory Board:</b>	Toomas Annus, Teet Roopalu, Indrek Neivelt, Olari Taal
<b>Management Board:</b>	Andres Trink, Tõnu Toomik





# TABLE OF CONTENTS

BRIEF OVERVIEW OF THE GROUP	4
STATEMENT OF THE CHAIRMAN OF THE MANAGEMENT BOARD	17
MANAGEMENT REPORT	21
REPORT ON GOOD CORPORATE GOVERNANCE	29
RISK MANAGEMENT	42





Merko Ehitus focuses on general contracting of construction and on providing complete solutions in professional construction and real estate development. Long-term experience in various countries, a wide scope of construction services, flexibility, reliability and meeting the deadlines and primarily quality have helped group companies to achieve a strong position in the Baltics.

Wide scope of construction services: general construction, civil engineering, road construction and real estate project



Operates in Estonia (**81%** of revenue), Latvia (**17%**) and Lithuania (**2%**)



Revenue 2013: **€262.7** mln



The largest listed construction company in the Baltics



Share quoted on NASDAQ OMX Tallinn since 1997

#### MERKO'S COMPETITIVE ADVANTAGES:

- Broad range of construction services and products, and comprehensive solutions offered to clients
- Experienced project managers and engineers
- Longstanding experience on the subcontractors and suppliers market
- Innovative technological approaches and construction solutions
- Strong financial capability
- Inventory of residential development projects



EBITDA 2013: **€15.1** mln,  
Net Profit 2013 **€10.4** mln



31.12.2013: **860** employees



2013: new contracts in the amount of **€254.4** mln

#### OUR VALUE OFFERING

AS PRIME CONTRACTOR, WE OVERSEE THE ENTIRE CONSTRUCTION PROCESS AND ARE RESPONSIBLE FOR THE COMPLETION OF THE CONSTRUCTION PROJECT AS A WHOLE:

- Integrated project management and construction service and provision of strategic consultation to the contracting entity throughout the process
- As needed, combined use of subcontractors and Merko workforce (concrete works, road construction, electrical constructions both indoor and outdoor)
- Real estate investments and development, managing the entire apartment development process: development, construction and sales
- Co-investing, risk distribution and participation in PPP (public-private partnership) projects



## MAIN EVENTS IN 2013

### FEBRUARY

- AS Merko Ehitus Eesti Eesti enters into an agreement for construction work on the Noorus spa hotel and recreational aquatic centre in Narva-Jõesuu, Estonia (10.6 million euros). In Latvia, SIA Merks enters into an agreement for the construction of two three-storey apartment buildings (41 apartments total) in Jurmala (7.9 million euros).



- On 24 February, National Independence Day, the recreational trails foundation SA Eesti Terviserajad established by Merko Ehitus, Swedbank and Eesti Energia launch a countrywide action "Let's make trail story together" where 11,249 participants covered 112,040 kilometres, which would circle the Earth over two times. The goal of the undertaking is to provide advice for the development of a nationwide Estonian recreational and sports trail system, coordinate the development activities and contribute to the financing.



### APRIL

- AS Merko Infra enters into an agreement for construction work on the Tondiraba ice rink in the Lasnamäe district of Tallinn (22.5 million euros), and AS Merko Ehitus Eesti enters into an agreement for construction work on the 24,000 m<sup>2</sup> Nurmevälja logistics centre in Jõelähtme municipality (7 to 8 million euros). In April, AS Merko Ehitus Eesti continues constructing an exclusive 14-storey commercial and apartment building on one of Tallinn's marquee plots of land, Kentmanni 6. The building, designed by architect Indrek Allmann, will be finished in late 2014.



- At a meeting held in April, AS Merko Ehitus Eesti's management board and supervisory board review the company's strategic development areas and approve the long-range financial goals up to 2018. The goals are reviewed annually based on the market situation, the company's financial status and strategy. An average ROE of at least 10% from 2013-2018, dividend rate: 50-70% of annual profit, equity ratio: at least 40%.
- The Corporate Band 2013 competition held at Rock Cafe club is won by AS Merko Ehitus Eesti employees' band "Ma Sulle Ehitan" (I'll Build for You).

### MAY

- A change is made to SIA Merks's supervisory board – Ivars Geidāns is recalled and the supervisory board becomes a three-member board: Andres Trink (chairman), Tõnu Toomik and Jaan Mäe.
- AS Merko Ehitus releases its financial results for Q1: sales revenue of 47.9 million euros and net profit of 1.8 million euros.

### JUNE

- At an annual general shareholders' meeting of AS Merko Ehitus Eesti, the consolidated annual report for FY2012 is approved. Resolutions are taken on distribution of earnings and recalling a supervisory board member. The management board delivers the keynote on the company's economic results and outlook.
- In Estonia, a waste to energy (WTE) unit is opened at Eesti Energia's Iru power plant; the general construction and specialized work is performed by AS Merko Ehitus Eesti on the basis of a contract from a French company considered an expert in the area of WTE plants, CNIM. The waste incineration plant's boiler unit – with a three-dimensional steel structure consisting of over 10,000 components and weighing nearly 1,000 tonnes – was designed in cooperation between companies from three countries and assembled to the precision of a millimetre amidst mammoth



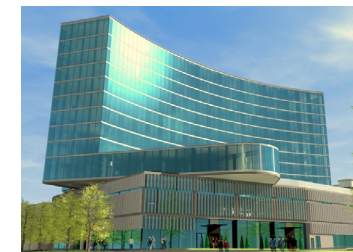
equipment.

- AS Merko Ehitus Eesti supervisory board member Tõnu Toomik is elected management board member. Toomik's area of responsibility is managing the real estate portfolio and coordinating the development activity in the construction field across all of the Group's companies. Management board chairman Andres Trink is responsible for corporate strategy, business development and finances.



### JULY

- Shareholders are paid dividends totalling 5.3 million euros (0.30 euros per share). The dividend payment made in 2013 meant that the dividend rate was 70% in 2012 and the dividend yield was 5.1%.
- AS Merko Ehitus Eesti Eesti enters into an agreement on construction of a hotel and entertainment complex in Tallinn, which will be operated by the international hotel chain Hilton Worldwide. The contract is valued at 31 million euros.



- One of Estonia's few energy class A apartment buildings is finished at Räägu 9 in Tallinn, developed and built by AS Merko Ehitus Eesti Eesti.



## MAIN EVENTS IN 2013

### AUGUST

- SIA Merks enters into three agreements in Latvia: for the construction of a 10-storey, multifunctional centre called Lielais Dzintars accommodating 1,000 visitors, in Liepāja (28.3 million euros); construction of a manufacturing and logistics centre and office building in Mārupe (17.8 million euros); and finishing work in a 45-apartment building in Riga (5.3 million euros).
- AS Merko Ehitus Eesti releases financial results for Q2: sales revenue was 65.9 million for the quarter and, for 6 months, 113.7 million euros. Net profit in the second quarter was 2.3 million and 6-month net profit was 4.0 million euros.
- In August, renovation of Riga's Spīķeri quarter and Daugava's riverside promenade are finished. As a result, SIA Merks developed a modern public space that is appealing both for locals and for tourists.



### SEPTEMBER

- In Estonia, Narva water treatment plant gets a cornerstone, with 63,000 Narva residents assured of quality drinking water by spring 2015. Besides construction of the new water treatment plant, the Mustajõe water intake will be renovated and brought into conformity with contemporary requirements. Construction work is being performed at the behest of AS Narva Vesi utility by AS Merko Ehitus Eesti, in cooperation with the Danish company Krüger A/S.
- The Merko Ehitus supported exhibition "When the Artist Met Clio. Historical Scenes from the 19th Century" is opened at the Kadriorg Art Museum of Estonia, which brought together for the first time historical scenes created and collected in Estonia and Latvia in the 18th and 19th century.
- The renovation and addition to Tallegg's Tabasalu plant in Estonia are completed by AS Merko Infra.



- Work on the Laurenč recreational and sport complex winds up in Riga – SIA Merks established a 1,480-metre ski trail that allows snow making machines to be used. It also built the sport sand recreational centre's main building, renovated an outbuilding and established and landscaped a 3.75-hectare area including parking lot. A four-lane, 100-metre running track was also built.

### OCTOBER

- The supervisory board of UAB Merko Statyba implements membership changes. Gediminas Tursa is recalled and the supervisory board continues as a three-member board: Andres Trink (chairman), Tõnu Toomik and Jaan Mäe.
- Estonia's most competitive enterprises for 2013 are announced, with AS Merko Ehitus Eesti earns top place in the category of construction companies for the second year in a row.
- The AS Merko Ehitus Eesti led consortium delivers one of Estonia's most complex infrastructure projects, Ülemiste junction traffic interchange in Tallinn. The junction includes a 680-metre-long dual-carriageway tunnel, three tunnels for bike paths and a 150-metre flyover, 8.7 km of roadways and 7 km of bicycle paths. In the deepest spot, construction was performed 16 metres below the surface of Lake Ülemiste.
- AS Merko Infra wins recognition from the Labour Inspectorate's occupational environment best practices competition for conceiving and using the idea of an excavation trough in the construction of the city of Tõrva's water and sewerage mains.

### NOVEMBER

- AS Merko Ehitus Eesti releases its financial results for Q3: sales revenue was 84.1 million for the third quarter and, for nine months, 197.8 million euros. Net profit in the third quarter was 3.9 million and the nine-month figure was 7.9 million euros.
- AS Merko Ehitus Eesti and Tallinn University of Technology's Development Fund sign a new cooperation agreement under which Merko will provide eponymous scholarships for Tallinn University of Technology students and stipends for faculty.
- The Peetri shopping centre with Selver supermarket as the anchor tenant is opened. Construction was performed by AS Merko Ehitus Eesti.



### DECEMBER

- Tallinna Teede AS signs an agreement to continue performing maintenance repair for the streets of Tallinn in the new contract period from 2014–2018. The contract is valued at 17.5 million euros. The winner of the contract was chosen at a public procurement organized by the contracting authority, entitled "Performing maintenance repair of Tallinn streets and infrastructure."
- SIA Merks enters into an agreement for construction work on the Valmiera Vocational School (5.9 million euros) and four apartment buildings at Dzintaru 28 (93 units total; 13.7 million euros).
- AS Merko Ehitus Eesti wins honours from the city of Tallinn for the Tedre 55 apartment building/commercial building construction site: the construction company with the best and most orderly construction lot.



# ÜLEMISTE TRAFFIC JUNCTION

Client: Tallinn Municipal Engineering Services Department

Construction period: 2010-2013

Address: Tallinn, Estonia

Construction cost: 37.93 million euros

Project manager: Tiit Joosti

The construction of the Ülemiste junction was carried out by the consortium consisting of AS Merko Ehitus Eesti, AS Merko Infra, Tallinna Teede AS and AS Ehitusfirma Rand & Tuulberg.

Ülemiste traffic junction is one of Estonia's most complex integrated infrastructure projects. The junction consists of a 680-metre-long tunnel for automotive traffic, three tunnels for cyclist and pedestrian use, and a 150-metre overpass. The large-scale construction project was made more complicated by the high water table in the vicinity of Lake Ülemiste and the fact that work took place in an area with heavy traffic flow, an operating train service and live utility lines. The junction has 8.7 km of carriageway and 7 km of non-motorised cycle and pedestrian track, with a total of 155,000 square metres paved with asphalt. At its deepest point, the construction work took place 16 metres below the surface of Lake Ülemiste.







As part of the procurement for the preliminary work for the junction back in 2010-2011, AS Merko Ehitus Eesti established a storm drain system with a total length of 2.5 kilometres, situated up to 16 metres below ground. These lines route runoff from Järvevana road, Tehnika street and Filtri road from underneath Zelluloosi street via Lasnamäe street into open concrete channels running through Kadriorg Park. In addition, in the same period and likewise as part of the procurement, AS Merko Infra established a transition between 110 kV overhead electrical lines to buried cable. This was required for building the Tartu highway overpass and the cycle and pedestrian paths.

From a construction aspect, the most complicated part of the junction was the 680-metre tunnel segment of the project, of which the actual underground tunnel section makes up 320 metres. The tunnel construction required constant work in a high water-table zone and the deepest part was 16 metres below the surface of Lake Ülemiste. The second important part of the junction is the 150-metre overpass that routes the flow of traffic from Peterburi road over Tartu highway to Järvevana road. Each direction of traffic uses a separate span structure. The bridge was erected on variable height reinforced concrete beams with a rectangular cross-section, with post-tension reinforcement.

The tunnels for the carriageways in either direction are 8 metres wide and 4.6 metres high and connect Järvevana road with Peterburi road, passing underneath the railway. Each direction has its own structure – two reinforced concrete structures have been built for the tunnels, connected to each other by emergency exit routes. The tunnel is anchored to the ground; the ramps have anchors for the upward force exerted by water.

First an underlying drainage layer was built, then technical concrete, on top of which was established hydro insulation and concrete structures. The tunnel itself is completely covered by hydro insulation underneath, on top and on the sides, and the sides have drainage mats so that the tunnel would not disrupt normal water circulation in the area – water moves to the tunnel, passes through the mat, goes underneath the tunnel and, based on the principle of communicating vessels, rises up on the other side. To lower the water table during tunnel construction, an up to 17 metre long trench surrounded by sealed wall elements was established and submersible pumps and needle filters were used to remove the water, which constantly sucked up the water from the sand.



The influx of water from below and above continues in the case of the finished tunnel; and in order to collect rain and snowmelt into storm drains, the pavement is built at a lateral and longitudinal angle toward drains connected to storm sewers. From there, the water flows downhill to the sea via underground storm sewers and the open concrete canals through Kadriorg Park.

To ensure safety, the situation in the tunnel is monitored by an electronic safety system, which detects any hazardous situations - fire, accidents, or other problems and regulates the situation using traffic signs with an electronic readout. The human supervisor then checks the real situation on the video recording and decides whether to close the tunnel. The tunnel has emergency exits – at intervals of less than 90 metres and equipped with fire doors – for the purpose of ensuring human safety. In addition, the tunnel also has a smoke exhaust system. The tunnels have smoke removal fans, which are switched on by the arriving rescue teams manager at the scene in case of accident. There are also evacuation routes for people, which have illuminated markings and lead people out of one structure to the other and then out of the tunnel.

The safety of pedestrians and other non-motorised road users is ensured by the Ülemiste junction bicycle/footpaths and tunnels, which connect to the rest of the Tallinn bicycle path system. They can be used to get between Järvevana road – Veerenni street and Järvevana road – Filtri road and Tehnika street without crossing a road used by motorised traffic. The Järvevana bicycle/footpath connects Järve recreational path and the Haabersti bicycle path network with the Tartu highway area. The Tehnika street bicycle/footpaths provide a connection to the city centre from Veerenni street and the bus station.







## FACTS ABOUT ÜLEMISTE JUNCTION:

- 7.5 km of new roads and paths, and 1.2 km of rebuilt roads and paths, total area of asphalt pavement laid – 155,000 m<sup>2</sup>
- Two 680-meter road tunnels for motorised traffic, of which the underground section makes up 320-meters
- 150-metre-long overpass
- Three tunnels for bicycle and foot traffic, built using a technical design similar to the one for the carriageways
- 5.35 km of new non-motorised routes for bicycles and pedestrians, 1.65 km rebuilt, width ranging from 2m to 4.5 m
- The dedicated site crew was 20 strong. There were also many pipe layers, utility line and concrete pouring crews, with 250 workers on site on peak days.
- 12 hectares of green space established as part of the project, with hundreds of trees and thousands of shrubs planted
- As part of the procurement for the groundwork for the junction project, the following was built:
  - a storm drain system and close to 2.5 km of underground water drainage canals and mains ranging up to 16 metres below ground in places, leading from Ülemiste to Kadriorg
  - a 110 kV overhead line was connected to buried line, which was required for building the Tartu highway overpass and cycle and pedestrian paths
- Concrete Construction of the Year 2013





MERKO  
EMPLOYEES  
ON SITE

## BRIEF OVERVIEW OF THE GROUP

Merko Ehitus focuses on general contracting of construction and on providing complete solutions in professional construction and real estate development. Long-term experience in various countries, a wide scope of construction services, flexibility, reliability and meeting the deadlines and primarily quality have helped group companies to achieve a strong position in the Baltics. Depending on the requirements of the contracting entities, the group companies perform both small-scale construction works as well as large scale, complicated and innovative projects, with a focus on general contracting and project management. Merko Ehitus is among the leading residential construction companies in the Baltic States.

AS Merko Ehitus is responsible for the development and implementation of the strategies of various group companies primarily through allocation and long-term planning of resources. The shares of Merko have been listed on the Tallinn Stock Exchange since 1997. The group employs more than 850 people.

The group comprises construction and property development companies providing complete construction solutions in Estonia, Latvia and Lithuania, among which the

group's largest construction sector companies are AS Merko Ehitus Eesti (100%), SIA Merks (100%), UAB Merko Statyba (100%) and the companies belonging to the AS Merko Ehitus Eesti group: Tallinna Teede AS (100%) and AS Merko Infra (100%).

Merko Ehitus is the company with the highest owners' equity in the Estonian construction sector and is able to finance projects by itself in long-term. We are conservative in involving debt capital. We ensure that we would have sufficient necessary resources for continuously investing in attractive projects.

Merko Ehitus Eesti group is the market leader of the Estonian construction sector with about 6% of the total volume of the Estonian construction market as of the end of year 2013. In Latvia and Lithuania, Merko Ehitus operates through its subsidiaries SIA Merks and UAB Merko Statyba, focusing selectively on projects where the competitive advantage is perceivable as compared to other market players.

International quality, environmental protection and occupational safety certificates ISO 9001, ISO 14001 and OHSAS 18001 have been assigned to the group's larger construction companies.





## VISION

**“ OUR VISION IS RELIABLE  
SOLUTIONS AND QUALITY  
PERFORMANCE FOR YOUR IDEAS.**

## VALUES

### RESPONSIBILITY

We decide based on business thinking, awareness and ethical beliefs. We offer enduring and environmentally friendly solutions.

### KEEPING PROMISES

We give realistic promises to the shareholders, contracting entities, cooperation partners, employees and we keep our promises. Good solutions are born in cooperation, the keeping of one's promises is mutual.

### COMPETENCE

We value quality and professionalism. We constantly develop our professional knowledge and skills.

### INITIATIVE

We manage processes and we are result-oriented. We accept the challenges which presume more.

### CREATIVITY

We are open, innovative and creative in working out and implementing the solutions. We have a will to carry out forward-looking ideas.





A LARGE PROJECT IN PROGRESS, DUE TO BE COMPLETED IN 2014: CONSTRUCTION OF POWER SYSTEMS WITH NECESSARY EQUIPMENT FOR OIL SHALE AND BIOFUEL HANDLING SYSTEMS IN THE TERRITORY OF ESTONIAN POWER PLANT.

## STRATEGY



The business strategy of AS Merko Ehitus subsidiaries is focussed on improving profitability and enhancing the efficiency of the cost base, offering general contracting services in the field of construction of buildings and infrastructure facilities and developing residential real estate in its home markets Estonia, Latvia and Lithuania.

## LONG-TERM FINANCIAL OBJECTIVES UNTIL 2018

At the meeting held on 8 April 2013, the Management Board and Supervisory Board reviewed the company's strategic development directions and approved long-term financial objectives until 2018.

Considering the weak growth prospects of the Baltic construction and real estate market in the coming few years, the overall low interest rate environment, as

well as the company's high equity base, the strategy and financial objectives are focused towards improving return on invested capital and on increasing the efficiency of the balance sheet.

The confirmed objectives were set based on the following assumptions regarding the external environment during the next five years:

- There will be no significant growth in the Baltic States during next two years.
- The high proportion of public procurements in construction orders will remain, however their volume from the second half of 2013 will temporarily decline with the current European Union (EU) financial framework period ending. The funding channelled into the economy as a whole will remain at the previous level in the new EU financial framework period (2014–2020), however their structure will change. The activity of private contracting entities developing and launching larger projects will recover slowly.
- Supply exceeds demand in the construction sector and excess capacity of fixed assets will continue. Increasing competition in the construction market will put the profit margins of construction companies under pressure.
- Moderate growth in the number of transactions and rise in prices in the apartment market of the Baltic States will continue, especially in capital cities.





COMPLICATED CONSTRUCTION PROCESS OF THE TUNNEL OF ÜLEMISTE TRAFFIC JUNCTION

The long-term financial objectives of AS Merko Ehitus relate to the period until 2018 and are reviewed annually based on the market situation, the financial condition and strategy of the company.

- average return on equity of the period of at least 10%
- dividend rate: 50-70% of annual profit
- equity ratio: at least 40%

average return on  
equity of the period  
2013-2018  
of at least **10%**

dividend rate  
**50-70%** of  
annual profit

equity ratio  
at least  
**40%**

The group's return on equity was 8.8% in 2013. The objective of return on equity achieved was lower than the long-term goal due to project management risks that materialized on one general construction segment project in the last quarter of the year, thus the profit from that segment was below the target. At the same time, the profitability and the return on equity were better than in the previous year in 2013.

The rest of the financial goals were achieved: the dividend rate was 70% and the equity ratio was 50.9%.



# SPIKERI QUARTER AND DAUGAVA EMBANKMENT RECONSTRUCTION

Address: **territory between Maskavas, Krasta, Turgeņeva Streets, Riga**

Client: **Riga City Council City Development Department**

Designer: **SIA Arplan**

Architect: **Rolands Bruzgulis**

Total area: **36 350 m<sup>2</sup>**

Construction period: **September 2012 – August 2013**

Construction cost: **3.7 million LVL (5.26 million EUR)**

Project manager: **Jānis Doniņš**

The aim of the project "Revitalization of the degraded territory between Maskava, Krasta and Turgeņeva streets" was to turn the street block into a publicly accessible, cultural and educational quarter, of interest to both locals and tourists. The territory is attractive for both locals and tourists as the warehouse block is located in the historical centre, which is included on the Unesco World Cultural Heritage list.





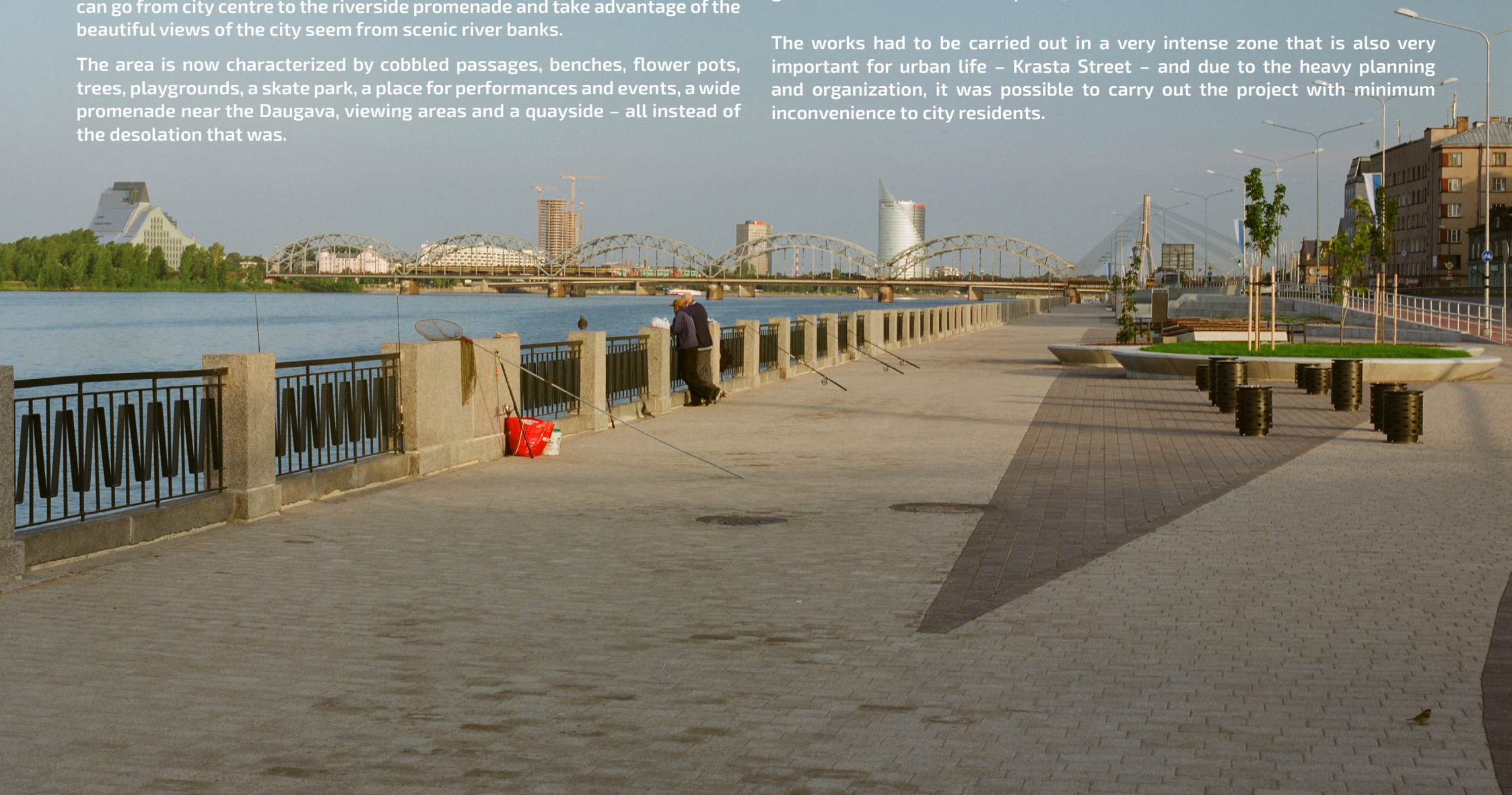
Previously the area was characterized by old garages, cracked asphalt covered in scattered garbage, a widely spaced plank fence, graffiti on old concrete slabs, a rusty handrail on the embankment, and a littered pedestrian tunnel, closed with a grid on one end.

Now Riga has a new and progressively arranged recreation place at the very shoreline, providing many opportunities. Within the framework of the project, the entire block of buildings and the Daugava embankment were revitalised and the underground pedestrian tunnel reconstructed, through which one can go from city centre to the riverside promenade and take advantage of the beautiful views of the city seen from scenic river banks.

The area is now characterized by cobbled passages, benches, flower pots, trees, playgrounds, a skate park, a place for performances and events, a wide promenade near the Daugava, viewing areas and a quayside – all instead of the desolation that was.

During the project, three buildings and 43 used garages were demolished, 6.5 kilometres of power cables and more than a kilometre of water piping were replaced, 94 lampposts and 75 benches were installed and a children's playground was built. A 1.3 km long bikeway and a square on the Daugava embankment, including a special support structure for a Christmas tree, were created. An area of around 30,000 square metres was paved; car and bicycle parking lots were established and a completely new lighting system as well as underground waste containers, equipped with above-ground chutes for waste disposal, was installed.

The works had to be carried out in a very intense zone that is also very important for urban life – Krasta Street – and due to the heavy planning and organization, it was possible to carry out the project with minimum inconvenience to city residents.





# STATEMENT OF THE CHAIRMAN OF THE MANAGEMENT BOARD



ANDRES TRINK  
AS MERKO EHITUS  
CHAIRMAN OF THE  
MANAGEMENT BOARD

Dear reader,

Our years of experience in different countries, a wide range of construction services, trustworthiness and on-time record, and above all, our quality, have helped the AS Merko Ehitus group of companies become the leading construction enterprise in the Baltics.

We're confident that our long-term success hinges on socially responsible management practices and sustainable operations. Like Estonian society and most local companies, we are only at the beginning of a long road when it comes to articulating and implementing the principles of corporate social responsibility. In planning our activity, we try to find a balance between short-term goals and business results and long-term perspective – growing the value of the company. The goal of the group is to increase its value in both the economic and the societal terms, taking responsibility for its decisions and activities, understanding how they affect employees, customers and partners as well as local communities, the environment and all of society.

**“ THE AWARD OF ESTONIA'S MOST COMPETITIVE CONSTRUCTION COMPANY WAS THE RESULT OF OUR EMPLOYEES' DEVOTION AND WORK, AS WELL AS OUR GOOD RELATIONSHIP WITH CUSTOMERS.**

broad decision-making powers; we support their skills and abilities in every way we can. To ensure that the best in the profession work for Merko, we offer a fair and competitive wage commensurate with employees' contributions as well as an attractive package of benefits.

We employ 860 people in the Baltics – office workers, project managers and site crew members. Indeed, one of our key assets is our employees – professionals in their field – whom we see as partners and who have

In 2013, the companies in our group developed many different buildings and infrastructure in the fields of general construction, engineering and road construction. Merko buildings aren't just houses – they can be high-quality, cosy homes, relaxing hotels, public service providers, inspirational educational buildings, rewarding, comfortable places to work, and logistical centres that support our customers' business. Since 1992, Merko has built a home for thousands of families in the Baltics. Our goal – always – is to create a high-quality and energy efficient home that is well-suited to its neighbourhood, boasts a good living environment, design and retains its value for many years to come.

2013's big project – the Ülemiste junction in Tallinn – is a notable infrastructure project on the nationwide scale, ensuring a smoother, faster commute for thousands every day. The second waste-to-energy incineration plant in the Baltics, at Iru, allows over 200,000 tonnes of waste to be used each year, recovering 85% of the energy in the waste in the form of electricity and heat for consumers. The road infrastructure projects we have handled ensure that people spend less time in traffic while the water and sewerage system projects improve the quality of life for residents. As a result of the construction, the Spīķeri area on the Daugava waterfront became an appealing recreational area and cultural and educational centre for tourists and Riga residents alike.



As the market leader in the Baltic states' construction sector, we consider it important to do what we can to contribute to society. Our sponsorship activities focus on three areas: sport and recreational opportunities; education and youth outreach; and culture and art heritage. Our largest project is Eesti Terviserajad (Estonian Recreational Trails), which in ten years has developed 100 maintained and mostly illuminated trails all over Estonia. The goal of the project is to ensure that Estonians enjoy free access to such trails year-round. We also support the Estonian Ski Association, young Estonian motor sport athletes and Latvia's RSU/Merks women's basketball team.

For the purpose of developing specialized education and training the rising generation of specialists, we have had a partnership with Tallinn University of Technology since 2007. In November 2013, we signed a new agreement on the basis of which we will award a Merko scholarship to a young researcher or faculty member and to an engineering student in the field of civil engineering and construction. In the field of culture, our longstanding relationship with the Art Museum of Estonia helps us put a premium on art heritage.

In 2013, Merko Ehitus was for the second time declared Estonia's most competitive construction company. It isn't something we take for granted, as we are cognizant it was made possible by our employees' dedication and everyday work and our efforts bearing in mind the long-term perspective. This was also made possible by our good cooperation with customers, for whom we want to continue to be trustworthy and professional partners. Construction and sustainable functioning of buildings or other infrastructure is a process that requires commitment from many parties. We pledge that as a construction company we will invest our maximum effort into this process.



Sincerely,  
Andres Trink





# RECREATION AND SPORTS COMPLEX „LAURENČI”

Address: **Sigulda district, Laurenči**

Client: **Sigulda District Council**

Designer: **SIA Arhitektes I. Kalveles birojs**

Architect: **Ilze Kalvele**

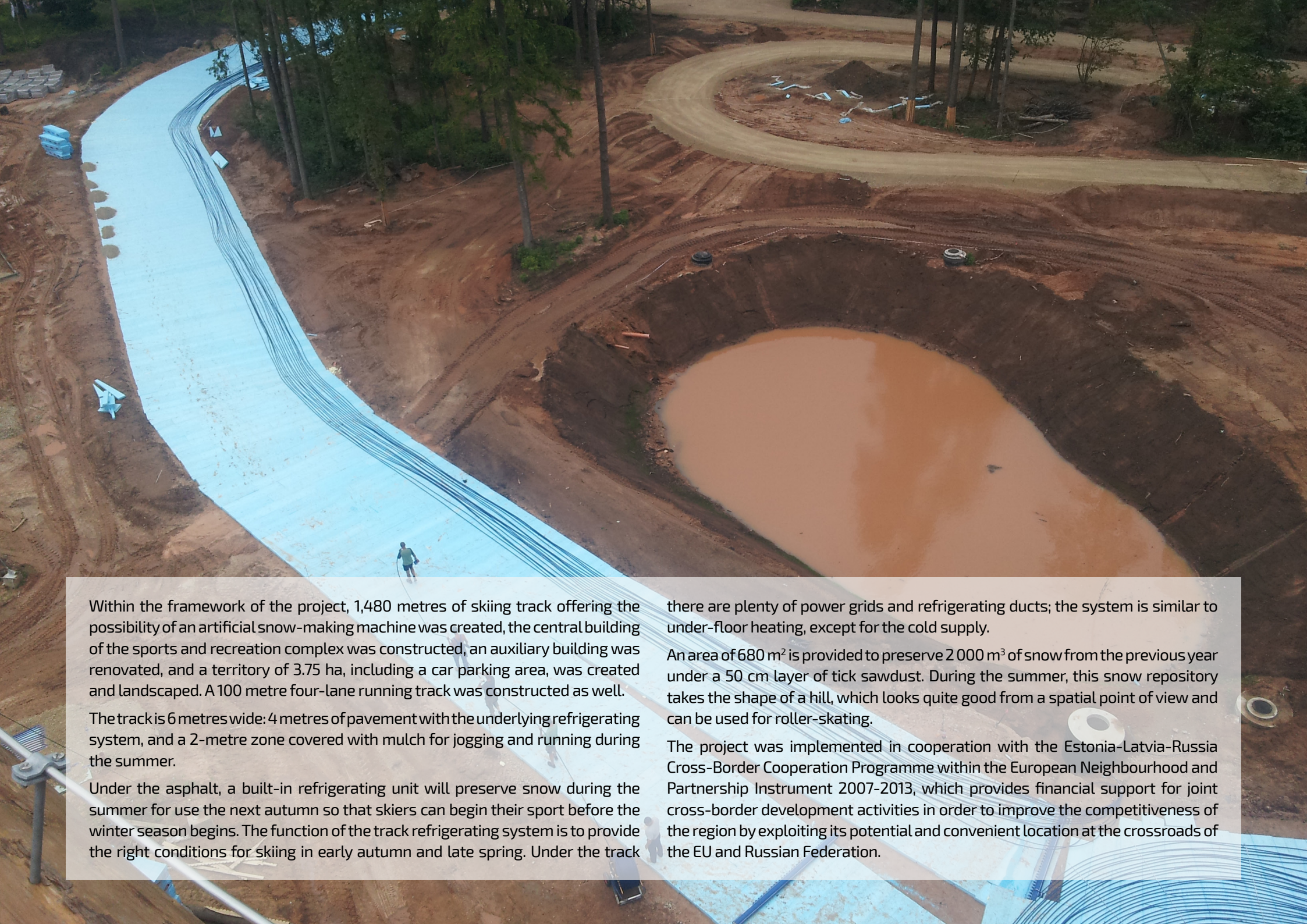
Total construction area: **443.2 m<sup>2</sup>**

Construction period: **September 2012 – September 2013**

Construction cost: **approx. 1.13 million LVL. (1.6 million EUR)**

Project manager: **Zigmunds Urtāns**





Within the framework of the project, 1,480 metres of skiing track offering the possibility of an artificial snow-making machine was created, the central building of the sports and recreation complex was constructed, an auxiliary building was renovated, and a territory of 3.75 ha, including a car parking area, was created and landscaped. A 100 metre four-lane running track was constructed as well.

The track is 6 metres wide: 4 metres of pavement with the underlying refrigerating system, and a 2-metre zone covered with mulch for jogging and running during the summer.

Under the asphalt, a built-in refrigerating unit will preserve snow during the summer for use the next autumn so that skiers can begin their sport before the winter season begins. The function of the track refrigerating system is to provide the right conditions for skiing in early autumn and late spring. Under the track

there are plenty of power grids and refrigerating ducts; the system is similar to under-floor heating, except for the cold supply.

An area of 680 m<sup>2</sup> is provided to preserve 2 000 m<sup>3</sup> of snow from the previous year under a 50 cm layer of tick sawdust. During the summer, this snow repository takes the shape of a hill, which looks quite good from a spatial point of view and can be used for roller-skating.

The project was implemented in cooperation with the Estonia-Latvia-Russia Cross-Border Cooperation Programme within the European Neighbourhood and Partnership Instrument 2007-2013, which provides financial support for joint cross-border development activities in order to improve the competitiveness of the region by exploiting its potential and convenient location at the crossroads of the EU and Russian Federation.



# MANAGEMENT REPORT

## BRIEF OVERVIEW OF 2013

### PROFITABILITY

Net profit was EUR 10.4 million (2012: EUR 7.6 million), up 36.3% from the previous year in 2013.

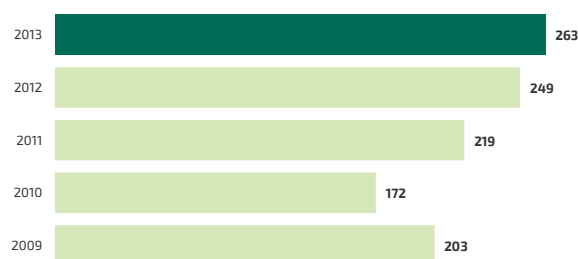
### REVENUE IS UP

In 2013, the revenue was EUR 262.7 million (2012: EUR 249.1 million), up 5.5% from the previous year.

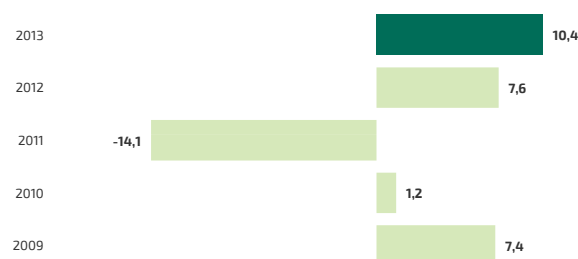
### STRONG CASH POSITION

At the end of the period, the group had cash equivalents of EUR 46.6 million and equity of EUR 121.9 million (50.9% of the balance sheet total). Comparative data at the end of 2012 were EUR 35.3 million and EUR 116.9 million (52.0% of the balance sheet total), respectively.

REVENUE  
in million euros



NET PROFIT  
in million euros



### ORDER BOOK

In 2013, group companies signed new contracts in the amount of EUR 254.4 million (2012: EUR 247.4 million) and as at 31 December 2013, the group's order book stood at EUR 213.7 million (31 December 2012: EUR 189.9 million).

### GROUP STRUCTURE

Streamlining of the corporate structure for the purposes of more effective management and lower administrative expenses. First changes are under way and the implementation of the action plan will continue in 2014. The action plan does not concern material subsidiaries and does not have a material near-term effect on the group's financial results.

		2013	2012	CHANGE
Revenue	million EUR	262.7	249.1	+5.5%
Gross profit	million EUR	22.7	17.9	+26.9%
Gross margin	%	8.6	7.2	+20.3%
Parent company's net profit	million EUR	10.4	7.6	+36.3%
Net margin	%	4.0	3.1	+29.3%
Earnings per share	EUR	0.59	0.43	+36.3%
Dividends per share	EUR	0.41*	0.30	+36.7%

\* pursuant to the Management Board's proposal

**2013 DIVIDEND RATE 70%  
OR 0.41 EUROS PER SHARE**

### DIVIDEND PROPOSAL

The Management Board proposes to distribute to shareholders EUR 7.3 million (EUR 0.41 per share) in dividends from retained earnings in 2014. This is equivalent to a 70% dividend rate for 2013.

		31/12/2013	31/12/2012	CHANGE
Return on equity (annual)	%	8.8	6.8	+28.7%
Equity ratio	%	50.9	52.0	-2.0%
Order book	million EUR	213.7	189.9	+12.5%
Total assets	million EUR	239.2	225.0	+6.3%
Number of employees	people	860	915	-6.0%

Calculation of ratios is provided on page 127 of the report.





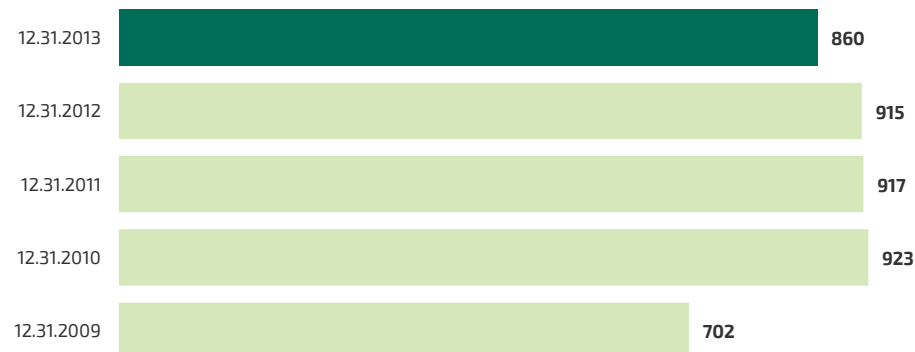
THE 860 EMPLOYEES OF MERKO EHITUS IN THE BALTICS INCLUDE OFFICE STAFF, PROJECT MANAGERS AND ON-SITE TEAM MEMBERS. EXPERIENCED PROFESSIONALS ARE THE COMPANY'S KEY STRENGTH.

## EMPLOYEES

Compared to the same period last year, the number of the group's employees decreased by 55 (-6.0%) and as at 31 December 2013, the group had a total of 860 employees (including fixed-term and part-time employees).

In 2013, the number of employees mainly declined because the proportion of the civil engineering segment declined within the volumes of the group. In 2014, the reduction in the number of employees will continue due to the streamlining of the group corporate structure and the decrease in ownership interest in immaterial subsidiaries, however not materially.

### NO OF EMPLOYEES people



## PERSONNEL POLICY

Merko Ehitus employs a total of 860 people in Estonia, Latvia and Lithuania, including office staff, project managers and on-site team members. Experienced professionals are the company's key strength.

The group's personnel policy supports achievement of the company's goals, ensuring sustainability of the organisation and management, staying competitive, maintaining and increasing the value of the organisation and constant development of competence.

We develop responsible management throughout the organisation, guided by company strategy, management system, applicable law, ethical values and good organisation management practice. We treat employees as partners, involving them in the decision-making process and perceiving that the right to make decisions includes responsibility. We support people's achievement of their professional goals and the advancement of their career in the company by encouraging existing employees to apply for vacant or new positions within the company. We ensure an adequate, fair and competitive salary that complies with the contribution of the employee and a motivation package.

We provide employees with conditions for professional development and career opportunities by supporting studies and acquisition of professional knowledge and experience. We support our employees for developing their competence and skills.



## HEALTH AND SAFETY

Creating a safe working environment for well trained, healthy and motivated employees, both in offices and on construction sites, has always been an important aspect in the operations of the group's construction companies. Pre-construction risk analysis remains constantly in focus, aimed at identifying common protection needs of site workers, measures and requirements for use of personal protection equipment. Basic and supplementary training in the field of occupational health and safety forms part of our personnel policy. Training provides knowhow and skills that enables to prevent risks, analyse them and find the most suitable technical and economic solutions. The management system for occupational health and safety that was certified in 2004 and complies with the OHSAS 18001 standard allows to effectively monitor working environment in construction sites and offices. Basic and supplementary training has always been available for inspectors to guarantee their competence.



Periodic health inspection provided by the occupational health partner to assess work-related risk factors helps to prevent employee health problems, plan safer working environments or, with the partial support of the company, to allow employees to use the necessary health rehabilitation measures. Additionally, the company organises for its employees free vaccinations and, naturally, provides its on-site personnel with comfortable compliant work clothes and footwear

A balanced personal life and a healthy way of living provide a counterbalance to stressful work. In order to promote recreational sports and to maintain working ability we pay our employees sports and health allowance. Additionally, Merko has for more than ten years contributed to the development of Estonian health trails - today a hundred health trails all across Estonia are available for use free of charge for all Merko employees as well as everyone else.

## PERSONNEL DEVELOPMENT AND RECOGNITION

Work at Merko demands great responsibility but also offers variety, new challenges and opportunities for study and development. We value and support employees' personal development, offer various training courses internally and externally both as team training and individual study.

We fully support employees' studies and recognise graduation and completion of a diploma.

In order to recognise the most prominent employees of the company and the best business partners, employees annually elect AS Merko Ehitus Eesti Achievers of the Year. In 2013, the following employees and business partner were elected as Achievers of the Year:

Site Operator of the Year or "The Bull"	Siim Õispalu	Project manager, department of electrical works
Site Team Member of the Year or "Little Bull"	Reet Hein	Site engineer, residential construction division
Manager of the Year or "The Ram"	Tiit Joosti	Project director, civil engineering division
Office Employee of the Year or "The Rat"	Holger Tilk	lawyer
Newcomer of the Year or "The Fox"	Karit Roolaan	accountant
Business Partner of the Year or "The Horse"	Peetri Puit OÜ	Partnership in the construction of Tondiraba Ice Arena

We celebrate together with our employees their personal events and company events welcome the employees together with their spouses or guests and family events welcome the whole family. We offer additional benefits in the form of holiday days to our long-time employees. We highly value teamwork and a strong sense of team identity. In 2013, AS Merko Ehitus Eesti employees successfully represented the company at the "Corporate Band 2013" contest. In April, Merko employee band "Ma sulle ehitan" was chosen as the best of the best. The winners competed with eight groups, including Sorainen Law Firm, Tele2, Skype, Microsoft and Saarionen. The contest is primarily for those who are not employed in music.

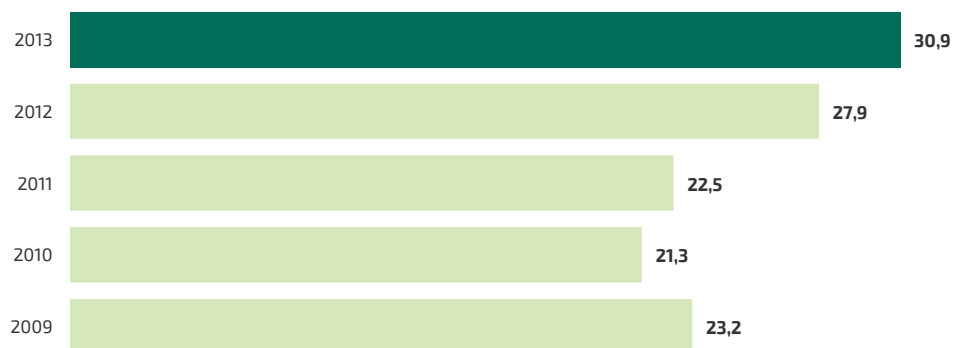


## REMUNERATION

The group's objective is to pay its employees competitive salary. The interests of employees and the company are balanced by performance-based remuneration.

The group defines labour cost as salary (incl. fixed salary, additional pay (night work, overtime and public holidays), holiday pay and bonus), taxes based on salary, fringe benefits and taxes based on fringe benefits. In 2013, the labour cost was EUR 30.9 million (2012: EUR 27.9 million), up 10.8% from the previous year. This increase is mainly caused by the bonuses triggered by the higher profitability environment and to a smaller extent selective increases in fixed salaries.

LABOUR COST  
in million euros



## ETHICAL BUSINESS PRACTICES

Ethical business is the cornerstone of our success. By following highly ethical policies, we promote profitable growth, gain the trust of our stakeholders and support fair competition and equal treatment. Unethical business practices, however, carry serious consequences - including hindering the functioning of a fair market and distorting competition.

The AS Merko Ehitus group does not tolerate any form of corruption. We have undertaken the obligation to engage in honest business, which means avoiding all forms of corruption, incl. bribery, and compliance with anti-corruption laws in each country where we operate. The group has undertaken the obligation to do business and act so as not to be involved in any form of corruption or to contribute to it in any manner.

In each country and in the entire organisation we are guided by ethical principles in our actions. We require that our employees know these principles and guidelines and adhere to them in their work. In order to facilitate this, the group has enacted a Code of Business Ethics that each group employee must review and comply with. The code of business ethics includes, among other things, guidelines on the following matters:

- conflicts of interests;
- confidentiality obligation;
- handling of insider information and insider transactions;
- bribery and corruption;
- hospitality and gifts;
- competition rules;
- equal treatment;
- protection and proper use of assets.

If an employee observes any misconduct, then he/she should first report it to a management board member of the relevant entity, who has the responsibility to report the misconduct to the AS Merko Ehitus Audit Committee. If a management board member has engaged in misconduct, the employee must directly notify the AS Merko Ehitus Audit Committee.

Each suspected misconduct will be investigated carefully and without delay, and will lead to appropriate action.

## ENVIRONMENT

The environmental management system that complies with ISO 14001 standard continues to focus on waste handling issues of construction sites, highlighting the need to sort waste in the most appropriate location and handing waste over only to such service providers that are licensed to handle such waste. In cooperating with such companies we have often discovered polluted soil and waste containing hazardous substances. For years, the company has been recording the quantities of waste created in construction sites and submitted respective annual reports to the Environmental Authority.

In environmentally sensitive tenders, we have always considered the requirements to the environmental impact assessment of projects, carried out preliminary research if necessary or conducted replacement planting, if it has been inevitable to fell trees when preparing the construction site.



# FACULTY OF POWER AND ELECTRICAL ENGINEERING (FPEE) OF RIGA TECHNICAL UNIVERSITY

---

Address: Āzenes street 12/1, Riga

Client: Riga Technical University

Designer: SIA Valeinis un Stepe

Architect: Ģirts Valeinis

Total area: 7750 m<sup>2</sup>

Construction period: November 2012 – October 2013

Construction cost: 5.8 million LVL (8.25 million EUR)

Project managers: Ivo Brālēns, Andris Bišmeistars

---







The new Faculty of Power and Electrical Engineering (FPEE) of Riga Technical University is hosted in a modern and energy-efficient building. It is a six-storey building with 250 rooms intended for lectures, practical work and studies. The roof structure was made in the form of a reverse roof to accommodate laboratory works.

The new FPEE building is unique as it is a fully automated so-called electronic building in which ventilation, heating and lighting systems are controlled through a single control panel. The FPEE is fully adapted for people with special needs; it has specific door widths, adapted elevators and built-in ramps.

The construction of the Faculty was carried out within the framework of the project "RTU – A City within the City". The design of the building provided for a completely new, contemporary concept. It includes measures to increase the energy efficiency of the building, such as heat recovery from refrigeration unit compressors for heating the water and motorised outer window-blinds on the southern and western sides of the building to block out the direct sunlight, which operate fully automatically depending on weather conditions.



## SOCIAL RESPONSIBILITY

The group is responsible for its decisions and activities that have an impact on our employees, customers and partners and, more broadly, on local communities.

In 2013, Merko Ehitus continued its long-term sponsorship projects in the same fields: we invest in sports and create recreational sports opportunities, promote education and the next generation, value culture and arts and continued our long-term social project. During the year, the group supported sports, culture and education and made charitable donations total in the amount of EUR 0.34 million (2012: EUR 0.27 million).

The company's largest sponsored project is the Estonian Health Trails project founded in 2004 in collaboration with Swedbank and Eesti Energia. The aim of the project is to adjust and develop the exercise and sports tracks of Estonia to ensure the availability of the year-round and free possibility for active exercise in nature for all interested people and popularise the sporty lifestyle. Across Estonia, pro and amateur sportsmen and - women have today a hundred trails – over 950 kilometres worth of maintained and mostly illuminated trails.

In the field of sports, the company continued to work with Estonian Ski Association, sponsoring both the adults, as well as the youth team. In 2013, Merko sponsored Estonian racing driver Kevin Korjus who is participating in the GP3 Series and the Kalev Yacht Club with over 500 members. In Latvia, SIA Merks sponsored the "Baltic Grand Prix 2013" sports dance competition and the women's basketball team of the Rīga Stradiņš university.

In the field of culture, Merko Ehitus has sponsored Estonian Art Museum since the year 2005 and in 2013 the partnership focused on the exhibition "When an Artist Met Kleio. Historical Scenes from the 19th Century". It is the first art event that brought together historical photographs created in Estonia and Latvia in the 18th to 19th centuries.

Merko has a successful partnership since 2007 with Tallinn University of Technology for the objective of developing education in the field and train the next generation. In November, AS Merko Ehitus Eesti signed a new cooperation agreement with the Development Fund of Tallinn University of Technology until 2016 for sponsoring TUT students and academic staff with eponymous scholarships. A EUR 3,200 scholarship is awarded in construction specialities to a young lecturer/scientist up to 40 years of age, possessing a Doctoral level degree, in TUT and there is also another scholarship for EUR 1,920 to a

successful TUT construction faculty third, fourth or fifth year student. The first young scientist's scholarship was awarded to Andrus Räämet, Ph.D. in civil and environmental engineering at TUT and the engineering scholarship was awarded to Alan Väli, a construction economics and management student. In addition, Merko sponsored the interdisciplinary innovation centre MEKTORY of Tallinn University of Technology, opened in the autumn. In Latvia, the company in 2013 sponsored the Development Fund of the Riga Technical University, helping organise a scholarship contest.

In the sphere of social affairs, the company has for years sponsored the Tilsi Children's Home, located in Põlvamaa. The home provides shelter for 65 children primarily from Southern Estonia.



MERKO EHITUS HAS CONTRIBUTED TO THE RECREATIONAL TRAILS FOUNDATION EESTI TERVISERAJAD FOR A LONG TIME. CURRENTLY THERE ARE MORE THAN 100 MAINTAINED AND ILLUMINATED HEALTH TRAILS OVER ESTONIA.



## RECOGNITIONS 2013

In 2013, the activities of AS Merko Ehitus were recognised in the form of the following prizes:

### THE ENTREPRENEURSHIP AWARD 2013

AS Merko Ehitus was granted the most competitive company's award in the field of construction for the second year in a row at the annual Entrepreneurship Award competition organised by Enterprise Estonia, the Estonian Chamber of Commerce and the Estonian Employers' Confederation.

### CONSTRUCTION COMPANY WITH THE FINEST AND TIDIEST CONSTRUCTION SITE IN TALLINN

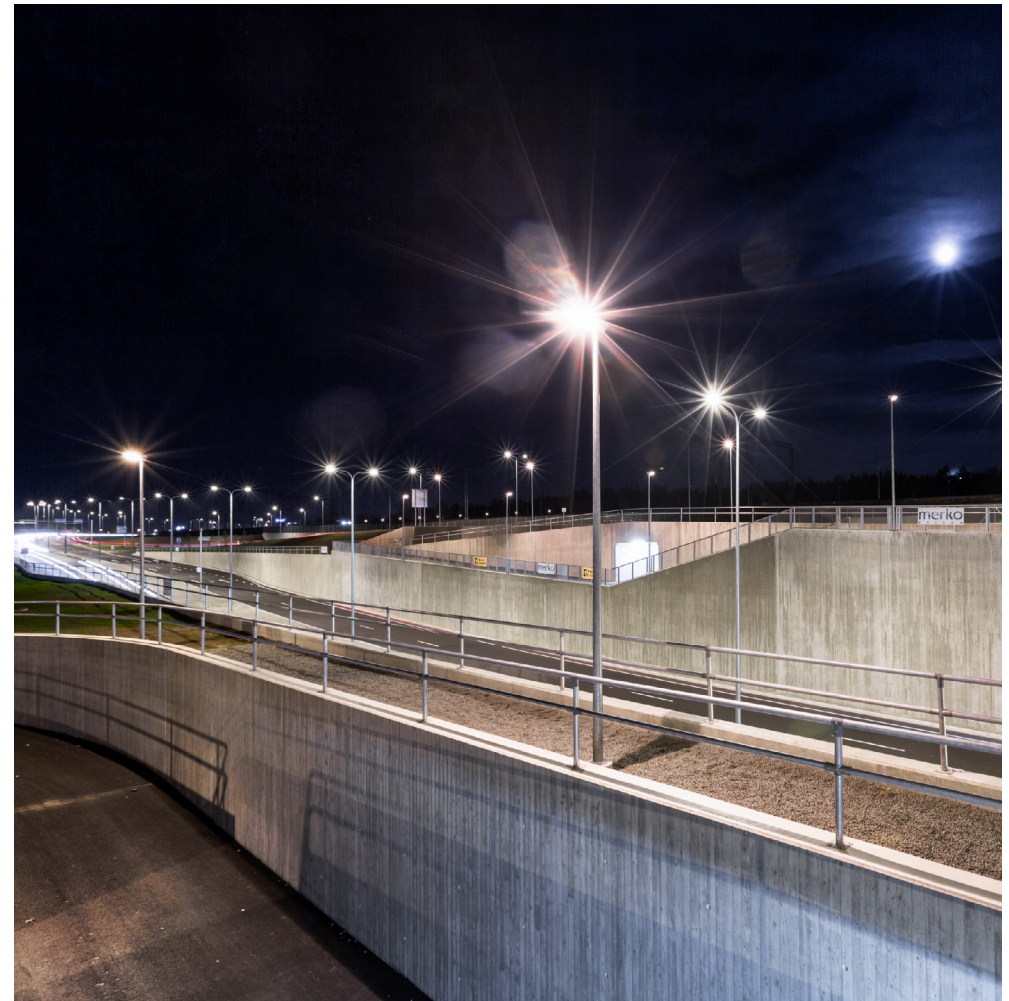
In December, AS Merko Ehitus Eesti was recognised for its construction site of the Tedre tn 55 apartment/commercial building by the city of Tallinn as the company with the finest and tidiest construction site. The purpose of the evaluation committee in determining the finest and tidiest construction site is to inspect the condition of construction sites, draw builders' attention on violations of laws and regulations for the goal of ensuring citizens have a secure and well-maintained living environment. The committee comprises specialists from Municipal Engineering Services Department, Tallinn Municipal Police Department and Northern Police Prefecture.

### LABOUR INSPECTORATE'S BEST PRACTICES AWARD FOR WORKING ENVIRONMENT

AS Merko Infra was recognised by the Labour Inspectorate, within the framework of the best working environment practice competition, for the design and implementation of the excavation trough during construction of the Tõrva municipal water and sewerage pipeline. The special-purpose troughs were designed and built with the aim of enhancing the safety and quality of work in the installation of pipes in limited drainage conditions. A total of 57 examples of best working environment practice participated in the competition.

### BUILDER OF THE YEAR COMPETITION

One of the nominees for the title of the Builder of the Year 2013 was Siim Õispalu, project manager with the electrical works department of AS Merko



IN THE CONSTRUCTION OF THE CONCRETE CONSTRUCTION OF THE YEAR 2013, THE ÜLEMISTE JUNCTION, 42,000 M<sup>3</sup> OF CONCRETE WAS USED.

Ehitus Eesti, who has successfully managed the complicated construction of the Aruküla substation and, previously, the construction of the runway lighting of the NATO airfield in Ämari, and the electrical works on the Puurmani multi-level interchange on the Tallinn-Tartu road. The Builder of the Year competition is organised by the Estonian Association of Construction Entrepreneurs with the purpose of promoting the profession of a builder and recognising the best specialists in the field.



# REPORT ON GOOD CORPORATE GOVERNANCE

## CORPORATE GOVERNANCE AND STRUCTURE

Adherence to the principles of Good Corporate Governance is part of the management of AS Merko Ehitus. Generally, this system is regulated by relevant legislation, the company's articles of association and the company's internal policies. Starting from 1 January 2006, issuers of shares listed on the NASDAX OMX Tallinn Stock Exchange are recommended to adhere to the principles of Good Corporate Governance approved by the Financial Supervisory Authority that covers good practices of enterprise management and treatment of shareholders. AS Merko Ehitus has followed these principles throughout 2013.

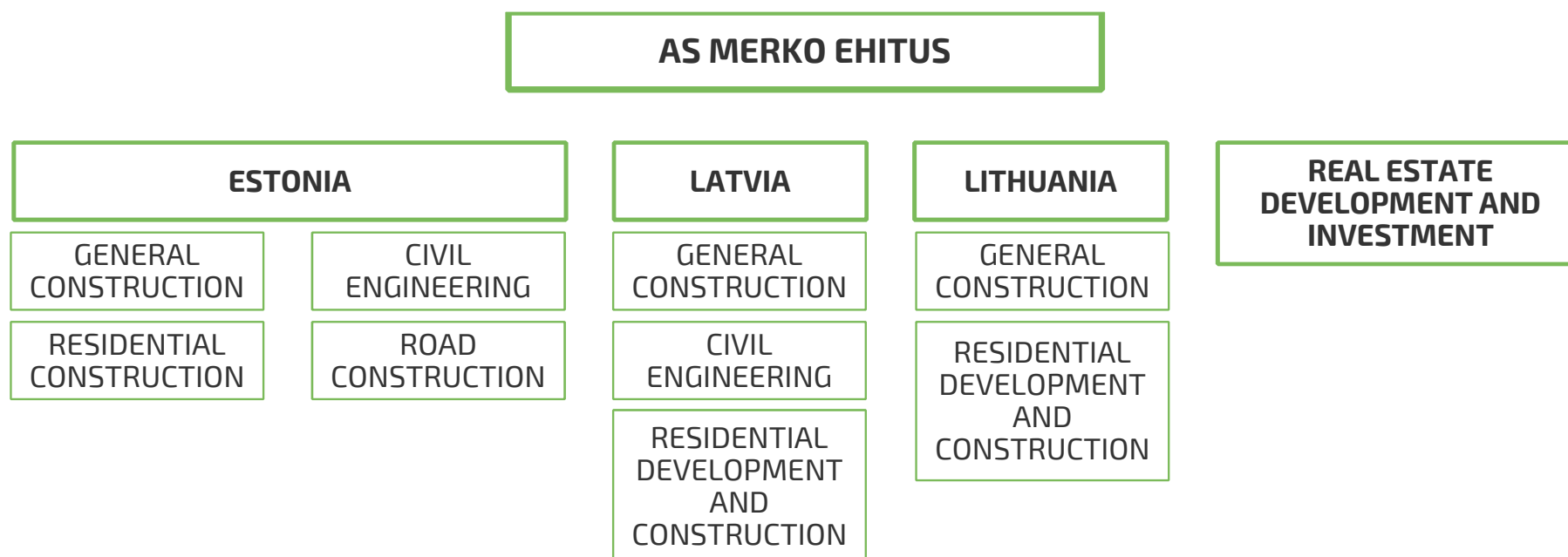
AS Merko Ehitus is dedicated to following high standards of corporate governance, for the implementation of which the Management Board and the Supervisory Board are responsible for shareholders. Our objective is to be transparent in our economic activity, in disclosing information and in relations with shareholders.

AS Merko Ehitus operates as a holding company whose companies in Estonia, Latvia and Lithuania offer complete solutions in the field of construction

and real estate development. In the construction sector, the group's largest companies are AS Merko Ehitus Eesti (100%), SIA Merks (100%), UAB Merko Statyba (100%) and the companies belonging to the AS Merko Ehitus Eesti group: Tallinna Teede AS (100%) and AS Merko Infra (100%).

The main activity of the holding company is development and implementation of the strategies of Merko Ehitus group's separate business areas primarily through long-term planning of resources. The holding company AS Merko Ehitus has a two-member Management Board: Andres Trink and Tõnu Toomik.

It is important to maintain a simple organisational structure in the group and in management to be guided primarily by the group's objectives and requirements. For the purposes of maximum effectiveness in group management, we in some cases differentiate the management structure and legal structure. Management structure of group's business areas as at 31 December 2013 is the following:





## GROUP'S LEGAL STRUCTURE

As at 31 December 2013, the group comprises 47 companies (31.12.2012: 46). The group's legal structure is predominantly based on tax efficiency and there is not in all cases a direct linear relationship with the group's effective management structure. The detailed list of group companies is provided in Notes 18 and 19 of the financial statements.

### CHANGES IN THE LEGAL STRUCTURE OF THE GROUP

On 16 January 2013, AS Merko Ehitus' fully owned subsidiary AS Merko Ehitus Eesti acquired a 7.5% ownership interest in its subsidiary AS Gustaf from its minority shareholders for the price of EUR 98,260.

In the first quarter of 2013, the AS Merko Ehitus group formed a fully owned subsidiary OÜ Paepargi 57. The share capital of the company is EUR 2,500. The company was formed to ensure the accounting of a company-based development project.

In the second quarter of 2013, OÜ Baltic Electricity Engineering, fully owned subsidiary of AS Merko Ehitus was renamed as OÜ Merko Investments. The share capital of the company is EUR 10,000.

On 22 May 2013, as an internal transaction, AS Merko Ehitus sold its full ownership of SIA Merks, a subsidiary engaging in construction, to its fully owned subsidiary OÜ Merko Investments. Said transaction was of a technical nature and done for the purposes of streamlining the group's legal structure.

On 4 July 2013, the liquidation of Merko Ukraine LLC finished, which began in the autumn of 2012 and the company has been deregistered.

On 10 June 2013, shareholders of the 50% joint venture of AS Merko Ehitus, OÜ Unigate, decided to increase the nominal value of shares of the joint venture by EUR 887.07 to EUR 6,000 for the purposes of achieving compliance with the Commercial Code. Both shareholders paid in a monetary contribution of EUR 350,000, of which EUR 444 corresponded to the share capital at nominal value and EUR 349,556 was share premium.

On 17 July 2013, fully owned subsidiary of AS Merko Ehitus, UAB Merko Bustas, formed a fully owned subsidiary in Lithuania, UAB Kražiu Projektas with a share capital of LTL 10,000 (EUR 2,896). The subsidiary was formed to acquire properties for development in Lithuania.



**MERKO EHITUS MAKES CHANGES IN THE STRUCTURE OF THE GROUP COMPANIES IN 2014 FOR THE PURPOSE OF MORE EFFECTIVE MANAGEMENT AND SAVING ON ADMINISTRATIVE COSTS.**

On 16 August 2013, OÜ Paepargi 57, fully owned subsidiary of OÜ Constancia, a fully owned subsidiary of AS Merko Ehitus, was sold to Capital Mill OÜ for the price of EUR 2,500.

On 10 September 2013, a branch office of AS Merko Infra was registered in Latvia in order to participate in large-scale infrastructure construction procurements and electrical construction procurements in order to supplement the competences and references of SIA Merks.

On 3 October 2013, AS Merko Ehitus Eesti, fully owned subsidiary of AS Merko Ehitus, formed a 51%-owned subsidiary OÜ Heamaja. The company was formed to participate in the construction concession contract procurement for Suur-Ameerika 1, Tallinn, organised by AS Riigi Kinnisvara.

In 2014, AS Merko Ehitus has decided to streamline its group companies' structure to improve management effectiveness and produce administrative cost savings. As part of the action plan, ownership interests of insignificant subsidiaries are reviewed and potential mergers or disposals are decided. The action plan does not concern material subsidiaries of the group and does not have a material near-term effect on the group's financial results. First changes are under way and the implementation of the action plan will continue in 2014.

On 20 December 2013, AS Merko Ehitus initiated a process to merge its fully owned subsidiaries OÜ Woody, OÜ Metsailu and OÜ Käibevara, all engaged in real estate development, in order to produce administrative cost savings related to company management. The acquiring company is OÜ Metsailu. The companies being acquired will be merged into OÜ Metsailu and as a result of the merger the companies being acquired will wind up without liquidation proceedings and OÜ Metsailu will become the legal successor of the companies being acquired. As a result of the merger, AS Merko Ehitus will remain the sole shareholder in OÜ Metsailu, the acquiring company.





The closing date of the merger is 1 January 2014 after which all transactions of the acquirees will have been deemed to have been made on account of the acquirer. The final merger entry will be made in the Commercial Register during the first half of 2014.

On 15 January 2014, a subsidiary of AS Merko Ehitus group, AS Merko Ehitus Eesti, signed an agreement for the transfer of its entire 80% holding in the subsidiary Gustaf Tallinn OÜ to the current co-shareholder and member of the management board Tiit Pomerants. The share capital of Gustaf Tallinn OÜ is EUR 23,967 of which the holding of AS Merko Ehitus Eesti with a nominal value of EUR 19,174 comprises 80% and the holding of Tiit Pomerants with a nominal value of EUR 4,793 made up 20%. The holding was transferred with the purpose of re-arranging the structure of the group companies and reducing holdings in non-significant subsidiaries. The principal area of activity of the construction company Gustaf Tallinn OÜ is construction and finishing work and the company offers prime contractor service for smaller renovations and repair jobs, which are not one of the strategically significant principal areas of activity of the AS Merko Ehitus group. On 15 January 2014, the buyer paid the seller EUR 20,000. The final sales price will be calculated in accordance with the audited 2013 annual report of Gustaf Tallinn OÜ on the basis of the share of equity held by AS Merko Ehitus Eesti, adjusted by dividend payment of EUR 960 thousand paid to the seller before transfer of the share as well as by the income tax expense of EUR 255 thousand related to the paid dividend. AS Merko Ehitus Group considers the additional influence of adjustments of sales price to be immaterial. The buyer is obliged to pay the adjusted part of the sales price to the seller's bank account by 1 May 2014.

As a result of the sale of the ownership interest and the subsequent deconsolidation of Gustaf Tallinn OÜ, the estimated impact on the consolidated profit of AS Merko Ehitus group is EUR 0, the negative impact on assets and liabilities is EUR 967 thousand and EUR 945 thousand, respectively.

On 22 January 2014, fully owned subsidiary of AS Merko Ehitus, UAB Merko Bustas, formed a fully owned subsidiary in Lithuania, UAB VPSP 1 with a share capital of LTL 10,000 (EUR 2,896). The subsidiary was formed to participate in public-private partnership (PPP) procurements organised by the Lithuanian government.



## CHANGES IN AS MERKO EHITUS MANAGEMENT STRUCTURE

The annual general meeting of shareholders was held on 5 June 2013. The general meeting of shareholders decided to recall Tõnu Toomik from the Supervisory Board with the objective to appoint Tõnu Toomik as a member of the Management Board of AS Merko Ehitus. The Supervisory Board of AS Merko Ehitus resolved to recall Member of the Management Board Viktor Mõisja from 5 June 2013, with Mr Mõisja continuing to serve in the engineering division of the company's subsidiary AS Merko Ehitus Eesti, and to appoint the former member of the Supervisory Board Tõnu Toomik as a new member of the Management Board. The company continues to have a two-member Management Board: Andres Trink and Tõnu Toomik. The members of the Supervisory Board of the company are Toomas Annus as Chairman of the Supervisory Board and Teet Roopalü, Indrek Neivelt and Olari Taal as members.

## 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 general meeting of shareholders decides, among others, the appointment and recall of members of the Supervisory Board, appointment of the auditor and approval of the results of the financial year, the payment of dividends. The annual general meeting of shareholders is held at least once a year and shall approve the annual report within six months of the end of the financial year.

In the general meeting of the shareholders of 5 June 2013, the consolidated annual report of 2012 was approved and the profit allocation and recall of a Supervisory Board member was decided. The Management Board made a presentation on the company's financial results and future prospects.

In accordance with the Commercial Code, its Articles of Association and Good Governance Code, AS Merko Ehitus calls the annual and extraordinary general meeting of shareholders by notifying the shareholders through the Tallinn Stock Exchange and by publishing a meeting call in one national daily newspaper at least 3 weeks in advance. 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.

Before their publication, agendas at annual and extraordinary general meetings of the company's shareholders are approved by the Supervisory Board that shall also present to the general meeting subjects for discussion and voting. Agenda items of the general meeting, recommendations of the Supervisory Board with relevant explanations, procedural guidance for participation in the general meeting and how and when new agenda items can be proposed are published together with the notice on calling the general meeting.

General meetings can be attended by any shareholder or his or her authorised representative. AS Merko Ehitus does not allow participation in general meetings by electronic means of communication equipment since the deployment of reliable solutions for the identification of shareholders some of whom live abroad, while ensuring the privacy of participating shareholders, would be too complicated and costly. No picture taking or filming is allowed at the general meeting, because it may disturb the privacy of shareholders.

Annual and extraordinary general meeting of shareholders shall be chaired by an independent person. In 2013, the general meeting was chaired by attorney-at-law Vesse Võhma who introduced the procedure for conducting the general meeting and the procedure of asking questions from the Management Board and Supervisory Board about the company's activities.

On behalf of the company, usually 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. If necessary, the company's auditor shall participate.

The annual general meeting of shareholders of AS Merko Ehitus held in 2013 was attended by Andres Trink (Chairman of the Management Board), Toomas Annus (Chairman of the Supervisory Board) and Ago Vilu (Auditor).





# IRU WASTE-TO-ENERGY POWER UNIT

---

**Client:** Constructions industrielles de la Méditerranée (CNIM)

**Construction period:** 2010-2013

**Address:** Peterburi road 105, Maardu

**Construction cost:** 16.42 million euros

**Project manager:** Priit Pullerits

---

The general construction and specialized work on Eesti Energia's Iru WTE unit, which opened today, was performed by AS Merko Ehitus Eesti on the basis of a contract with the international waste incineration plant expert, the French firm CNIM. The Iru waste-to-energy unit's boiler plant facility's nearly 1,000-tonne three-dimensional steel structure made up of over 10,000 parts was engineered in cooperation between companies from three countries and assembled to a millimetre's precision in a space occupied by large-scale machinery.

The entirety of the technology needed for WTE operations was designed, supplied and installed by the prime contractor, the French company Constructions industrielles de la Méditerranée (CNIM), which is a valued expert in the field of waste incineration and one of the largest builders of waste incineration plants worldwide. Merko performed the general construction and specialised work along with all of the necessary design work.





In total, it took 7,000 cubic metres of reinforced concrete and over 3,000 tonnes of construction steel to complete the plant. Besides jobs Merko is accustomed to doing, a number of specific systems auxiliary to equipment and technology were built, such as pressurized air system and an industrial wastewater cleaning system. Merko's contract also included design of the high- and medium-voltage parts and installation work. Among other things, Merko also built a truck scale and access system, all fire alarm systems and an access road from the brand-new road interchange on Saha-Loo road.

Iru waste-to-energy plant is a complicated and extraordinary project from the construction aspect already for the fact alone that it is only the second waste-to-energy plant in the three Baltic states. As the heart of the plant is its waste incineration and energy production buildings, the design and construction of the buildings stemmed mainly from the technological needs, measurements, loads and the schedule for installation. The building's bulk is densely filled with various industrial machinery that made the 3D design – carried out in collaboration with CNIM – critical.



One of the most complicated challenges was the design and assembly of the steel frame of the boiler plant, which had to fit between and around massive pieces of machinery with literally only a millimetre to spare in many places. The design of the ventilation systems required special attention, as an unusually high amount of heat is emitted into the building, occasioning the need for large amount of air exchange. Ventilation of the Merko-designed waste hopper and the Merko-installed active air filters are extremely important for normal functioning of the building, ensuring that the air released into the atmosphere is at the required level of cleanliness.

The biggest challenge, technologically speaking, was the construction of the base for the steam turbine, where the permissible amount of deviation was extraordinarily small. The geometric shape was also very complicated and a number of assembled components had to be encased in concrete within it.



## SUPERVISORY BOARD

The Supervisory Board shall plan the activities of the company, organise the management of the company and supervise the activities of the Management Board. The Supervisory Board shall notify the general meeting of shareholders of the results of a review. The Chairman of the Supervisory Board organises the work of the Supervisory Board. The main duties of the Supervisory Board are to approve the group's material strategic and tactical decisions and to supervise the activities of the group's Management Board. The Supervisory Board's actions are guided by the company's articles of association, guidelines of the general meeting and law.

According to the Articles of Association of Merko Ehitus, the Supervisory Board has 3 to 5 members who shall be elected for the term of three years.

At the annual general meeting of shareholders held at 28 June 2011, it was decided to

extend the term of office of Supervisory Board members Tõnu Toomik, Teet Roopalu, Indrek Neivelt and Olari Taal until 28 June 2014, i.e. for three years and, in addition, to elect Toomas Annus as the additional member of the Supervisory Board of AS Merko Ehitus with a term of office until 28 June 2014.

The general meeting of shareholders held on 5 June 2013 decided to recall Tõnu Toomik from the Supervisory Board with the objective to appoint Tõnu Toomik as a member of the Management Board of AS Merko Ehitus. The mandate of Tõnu Toomik as a member of the Supervisory Board of AS Merko Ehitus expired on 5 June 2013.

The Supervisory Board of AS Merko Ehitus has four members of whom, in accordance with the requirements of the Good Governance Code, two - Indrek Neivelt and Olari Taal - are independent members:



**TOOMAS ANNUS** (53)  
CHAIRMAN OF THE  
SUPERVISORY BOARD

### Positions held:

2011-... Merko Ehitus AS, Chairman of the Supervisory Board  
2009-... E.L.L. Kinnisvara AS, Member of the Management Board  
2008-... Järvevana AS, Chairman of the Management Board  
1999-2009 E.L.L. Kinnisvara AS, Chairman of the Supervisory Board  
1997-2008 Merko Ehitus AS, Chairman of the Supervisory Board  
1996-... Riverito AS, Chairman of the Management Board  
1991-1996 EKE Merko, Chairman of the Management Board  
1989-1991 EKE MRK, director of the company

### Education:

Tallinn University of Technology, industrial and civil engineering  
Tallinn Technical School of Building and Mechanics, industrial and civil engineering

**Number of shares:** 8,322,914 (AS Riverito)



**TEET ROOPALU** (64)  
MEMBER OF THE  
SUPERVISORY BOARD

### Positions held:

2004-... Merko Ehitus AS, Member of the Supervisory Board  
2010-... Riverito AS, Member of the Management Board  
2002-2004 Merko Ehitus AS, Adviser to the Management Board

Has worked for different construction companies, including as a director of finance. Has been in charge of economic activities in the EKE system as a chief economist; worked as a bank director; and has also worked in building design.

Member of Supervisory Boards of subsidiaries and associated companies.

### Education:

Tallinn University of Technology, construction economics and organisation

**Number of shares:** -



**INDREK NEIVELT** (46)  
MEMBER OF THE  
SUPERVISORY BOARD

### Positions held:

2008-... Merko Ehitus AS, Member of the Supervisory Board  
2005-... Bank Saint Petersburg, Chairman of the Supervisory Board  
1999-2005 Hansapank, Director General of the Group, Chairman of the Management Board  
1991-1999 Hansapank, various positions  
Belongs to Supervisory Boards of various companies.

### Education:

Tallinn University of Technology, civil engineering economics and management.

Stockholm University, banking and finance, MBA

**Number of shares:** 31,635 (Trust IN OÜ)



**OLARI TAAL** (60)  
MEMBER OF THE  
SUPERVISORY BOARD

### Positions held:

2008-... Merko Ehitus AS, Member of the Supervisory Board

Has been the head of the Tartu Elamuehituskombinaat (Tartu Housing Plant; Tartu Maja) and Eesti Hoiupank (Estonian Savings Bank).

Has served the Republic of Estonia as Minister of Construction, Minister of Economic Affairs, Minister of the Interior and as a Member of the 10th Riigikogu (Parliament of Estonia).

Belongs to Supervisory Boards of various companies.

### Education:

Tallinn University of Technology, civil engineering.

**Number of shares:** 2,500 (Eggers OÜ)





IN 2013, MERKO CONTINUED THE WORKS OF CLOSING THE INDUSTRIAL WASTE AND SEMI-COKE LANDFILL IN KOHTLA-JÄRVE, WHICH INCLUDES TRANSFER OF MOUNTAIN MASS 6 MILLION M<sup>3</sup>.

The meetings of the Supervisory Board generally take place once a month, except in summer months. In 2013, the Supervisory Board held 11 regular meetings. No extraordinary Supervisory Board meetings were held. Participation of members of the Supervisory Board at meetings:

NAME	PARTICIPATION IN MEETINGS	PARTICIPATION %
Toomas Annus	11	100%
Teet Roopalu	11	100%
Tõnu Toomik*	5	100%
Indrek Neivelt	11	100%
Olari Taal	11	100%

\* Tõnu Toomik was a member of the Supervisory Board until 5 June 2013.

The Supervisory Board fulfilled all its obligations laid down in legal acts. The Supervisory Board has set up an audit committee as its work body. The Supervisory Board has not considered it necessary to set up a remuneration committee or appointment committee. Remuneration of the members of the Supervisory Board is approved by the general meeting of shareholders. The valid procedure

for remuneration of Supervisory Board members was approved by the general meeting of shareholders held at 31 October 2008.

No termination benefits are paid to the members of the Supervisory Board upon the termination or non-extension of the contract. In the 2013 and 2012 financial years, the members of the Supervisory Board were remunerated as follows (in euros):

NAME	2013	2012
Toomas Annus	42,182	42,182
Teet Roopalu	38,347	38,347
Tõnu Toomik*	15,978	38,347
Indrek Neivelt	38,347	38,347
Olari Taal	38,347	38,347
<b>TOTAL</b>	<b>173,201</b>	<b>195,570</b>

\* Tõnu Toomik was a member of the Supervisory Board until 5 June 2013.

Remuneration, less the statutory taxes, to the members of the Supervisory Board is paid on a monthly basis.



## MANAGEMENT BOARD

The Management Board is a governing body which represents and manages AS Merko Ehitus in its daily activities in accordance with the law and the Articles of Association. The Management Board has to act in the most economically purposeful manner, taking into consideration the best interests of all shareholders and ensures the company's sustainable development in accordance with set objectives and strategy. 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. For every meeting of the Supervisory Board, the Management Board shall prepare a management report and submit it well in advance of the meeting so that the Supervisory Board can study it. The Management Board prepares reports for the Supervisory Board also in between the meetings, if it is considered necessary by the Supervisory Board or its Chairman.

Pursuant to the Articles of Association approved at the general meeting of shareholders in 2012, the Management Board may have up to three members. The Supervisory Board of AS Merko Ehitus resolved to recall Member of the Management Board Viktor Mõisja from 5 June 2013, with Mr Mõisja continuing to serve in the engineering division of the company's subsidiary AS Merko Ehitus Eesti, and to appoint the former member of the Supervisory Board Tõnu Toomik as a new member of the Management Board. AS Merko Ehitus continues with a two-member Management Board: Andres Trink (Chairman of the Management Board) and Tõnu Toomik (Member of the Management Board).

The responsibilities of Andres Trink, Chairman of the Management Board, include, among others, fulfilling daily obligations of the CEO of AS Merko Ehitus, managing and representing the company, ensuring compliance with the Articles of Association, legal acts, organising the work of the Management Board and supervisory boards of the more important subsidiaries, coordinating the development of strategies and providing for their implementation, being responsible for business development and finance. Tõnu Toomik is responsible for the management of the portfolio of properties and coordination of construction segment development activities across the whole group.

Members of the Management Board have entered into three-year contracts of service with the company. The procedure and principles of remuneration of Management Board members are approved by the Supervisory Board. The members of the Management Board are paid a fee for fulfilling their official duties. Bonuses payable to the Management Board depend on the fulfilment of the targets of the given financial year by the group and the Management Board. The members of the Management Board are paid bonuses once a year based on the fulfilment of the targets of the previous financial year.

Gross fees paid to the members of the Management Board in the financial year 2013 totalled EUR 285 thousand (financial year 2012: EUR 186 thousand). Pursuant to agreement, AS Merko Ehitus did not pay any compensation upon termination of employment to Viktor Mõisja who left during the financial year.



**ANDRES TRINK** (46) CHAIRMAN  
OF THE MANAGEMENT BOARD  
APPOINTED: 1 JANUARY 2012  
TERM ENDS: 31 DECEMBER 2014

### Positions held:

2012-... Merko Ehitus AS,  
Chairman of the Management Board  
Chairman of the Supervisory Board of Merko Ehitus Eesti AS, SIA Merks and UAB Merko Statyba  
Has held various executive positions in the private and public sector. Before being hired at Merko Ehitus, worked for 15 years in the financial sector, including as a Member of the Management Board of Baltic banking at Hansapank (now Swedbank).

### Education:

Tallinn University of Technology, automated management systems engineering (summa cum laude).

Estonian Business School, international business administration.

Graduate of the INSEAD University (France), executive management programme.

**Number of shares:** -



**TÕNU TOOMIK** (52) MEMBER  
OF THE MANAGEMENT BOARD  
APPOINTED: 6 JUNE 2013  
TERM ENDS: 5 JUNE 2016

### Positions held:

2013-... Merko Ehitus AS,  
Member of the Management Board  
2011-2013 Merko Ehitus AS,  
Member of the Supervisory Board  
2008-2011 Merko Ehitus AS,  
Chairman of the Supervisory Board  
1997-2008 Merko Ehitus AS,  
Chairman of the Management Board  
1993-1997 Merko Ehitus AS, Project Manager  
Member of Supervisory Boards of subsidiaries and associated companies.

### Education:

Tallinn University of Technology, industrial and civil engineering

**Number of shares:** 1,607,185 (AS Riverito)



## SUPERVISORY AND MANAGEMENT BOARDS OF SUBSIDIARIES

Authorisation and responsibility of supervisory boards of subsidiaries of AS Merko Ehitus are based on their Articles of Association and intergroup rules. Generally, Supervisory Boards of subsidiaries consist of members of the Management Board and Supervisory Board of the company that is the main shareholder of the specific subsidiary. Supervisory Board meetings of the most significant subsidiaries are held usually once a month, otherwise according to the group's needs, Articles of Association of subsidiaries and legal provisions. Generally, no separate fee is paid to members of the Supervisory Board of subsidiaries. Members of the Supervisory Board will also receive no termination benefit in case their contract of service is terminated before due date or not extended.

The chairman or member of the Management Board of the subsidiary shall be named by the subsidiary's Supervisory Board. Below are the supervisory boards and management boards of the most significant subsidiaries that are wholly-owned by AS Merko Ehitus as at 31 December 2013:

COMPANY	SUPERVISORY BOARD	MANAGEMENT BOARD
AS Merko Ehitus Eesti	Andres Trink (Chairman), Teet Roopalu, Tõnu Toomik, Taavi Ojala	Tiit Roben (Chairman), Andres Agukas, Jaan Mäe, Alar Lagus, Veljo Viitmann
AS Merko Infra	Andres Agukas (Chairman), Veljo Viitmann, Mihkel Mugur	Tarmo Pohlak, Arno Elias
Tallinna Teede AS	Tiit Roben (Chairman), Andres Agukas, Alar Lagus, Veljo Viitmann	Jüri Läll (Chairman), Jüri Helila
OÜ Merko Investments	-	Andres Trink, Signe Kukin
SIA Merks	Andres Trink (Chairman), Tõnu Toomik, Jaan Mäe	Oskars Ozoliņš (Chairman), Jānis Šperbergs
UAB Merko Statyba	Andres Trink (Chairman), Tõnu Toomik, Jaan Mäe	Saulius Putrimas (Chairman), Jaanus Rästas

The mandate of the Management Board Member of Tallinna Teede AS, Richard Viies, expired from 5 January 2013 as a result of the expiry of a fixed-term contract of service. The mandate of Richard Viies as Management Board Member was not extended. Tallinna Teede AS continues with a two-member Management Board: Jüri Läll (Chairman) and Jüri Helila.

On 22 May 2013, the Supervisory Board of OÜ Merko Investments resolved to recall members of the Management Board Jaanus Ojangu and Boris Tehnikov, and appoint Andres Trink and Signe Kukin as new members of the Management Board from 23 May 2013 onwards.

In conjunction with a review of the management structure, there was a change on 1 October 2013 in the composition of the Supervisory Board of UAB Merko Statyba, a 100% subsidiary of AS Merko Ehitus. Gediminas Tursa, the Chairman of the Supervisory Board was recalled. The Supervisory Board will continue with three members: Andres Trink (Chairman), Tõnu Toomik and Jaan Mäe.

In conjunction with a streamlining of the management structure, there was a change on 7 March 2014 in the composition of the Management Board of AS Merko Ehitus Eesti, a 100% subsidiary of AS Merko Ehitus. Andres Agukas, the Member of the Management Board was recalled. The Management Board will continue with four members: Tiit Roben (Chairman), Jaan Mäe, Veljo Viitmann and Alar Lagus.

As a result of the departure of Andres Agukas, the composition of the Supervisory Boards of AS Merko Infra and Tallinna Teede AS, subsidiaries of the AS Merko Ehitus Eesti group, will change. Effective 7 March 2014, Tiit Roben was appointed as Chairman of the Supervisory Board of AS Merko Infra to replace Andres Agukas. The Supervisory Board will continue with three members: Tiit Roben (Chairman), Veljo Viitmann and Mihkel Mugur. The Supervisory Board of Tallinna Teede AS will continue with three members after the departure of Andres Agukas: Tiit Roben (Chairman), Alar Lagus and Veljo Viitmann.

Remuneration paid to the members of the Management Boards of significant subsidiaries is provided in Note 33 of the financial statements.

## AUDIT COMMITTEE

The Supervisory Board of AS Merko Ehitus has formed an audit committee as its work body. The responsibility of the audit committee is advising the Supervisory Board in supervision related issues. The Committee executes supervision over the whole group (incl. subsidiaries): 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.

As at 10 January 2011, 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 recalled before the expiration of their term of office.

Members of the auditing committee are not separately remunerated.



## CONFLICT OF INTERESTS AND HANDLING OF INSIDER INFORMATION

It is important to appropriately handle insider information in order to protect shareholders' interest and ensure honest and fair trading of shares. Significant information about AS Merko Ehitus and its subsidiaries must be available in a timely, consistent and equal manner for all shareholders and potential new shareholders. It is inevitable that persons related to AS Merko Ehitus and its subsidiaries have, because of their job, at certain times and in certain cases more information about the group than investors and the public. To prevent the misuse of such information, we have adopted internal rules in the group's companies on maintaining and publication of insider information and on making transactions on the basis of insider information (hereinafter: insider information rules). Insider information rules include a reporting system under which employees who may develop a conflict of interest when fulfilling their job duties are required to disclose their economic interests and confirm their independence by self-assessment.

The members of the Management and Supervisory Board of AS Merko Ehitus are users of insider information (so-called insiders). They have signed a relevant statement, are aware of insider information rules of AS Merko Ehitus and together with people connected with them are registered in the list of the company's insiders. Moreover, the list of insiders includes the financial employees of the parent company who have access to the group's consolidated operating results as well as members of the Management and Supervisory Boards of the more important subsidiaries together with the employees who are responsible for preparing and presenting accounting information.

To the best of our knowledge, in the financial year 2013 there were no cases of any misuse of insider information or conflicts of interest. No transactions with related parties were made at other than market terms.

### OWNERSHIP INTERESTS OF AS MERKO EHITUS MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARD (OVER 5%) IN OTHER COMPANIES

NAME	RELATED COMPANY
Toomas Annus	AS Riverito, Kardispordi Arendamise OÜ, Kental OÜ
Teet Roopalu	Teet Konsult OÜ
Indrek Neivelt	Trust IN OÜ, Admiral Investeeringute OÜ
Olari Taal	Eggera OÜ
Andres Trink	None
Tõnu Toomik	AS Riverito

No members of the company's supervisory or management board hold shares in an entity that operates in the core business area of AS Merko Ehitus – construction sector.

An overview of transactions with related parties in 2013 is provided in Note 33 of the financial statements.

### DISCLOSURE OF INFORMATION

In disclosing information, AS Merko Ehitus shall follow Estonian law, the rules and regulations of NASDAQ OMX Tallinn Stock Exchange and guidelines of the Financial Supervision Authority of Estonia 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.

The group has adopted an information disclosure procedure that describes the main policies in communication with investors and the public. The objective of the information disclosure procedure is to ensure access to adequate and yet accurate information about the group and its operations that will form the basis for the price of the securities issued by the company. Information will be disclosed without undue delay and impartially. The main principles of information disclosure of Merko Ehitus are consistency, impartiality, transparency, truthfulness and preventive approach.

The group discloses information about its financial condition and strategy in its financial statements, annual report and interim reports pursuant to the schedule that has been set. The disclosure dates of each next financial year will be announced before the end of the previous financial year.

Merko immediately discloses all decisions, issues and events that in the company's view may significantly change the price of the securities issued by the company and that are to be disclosed pursuant to laws and regulations. Stock exchange releases are published in Estonian and English.

Stock exchange releases are always published regarding the following subjects:

- financial statements, interim reports;
- amendment to previously published strategies and financial objectives;
- profit warnings;



- major projects and construction contracts;
- major investments and financial arrangements;
- significant corporate reorganisations and partnership agreements;
- significant reorganization, streamlining or discontinuation of functions or operations;
- management board's proposals to the annual general meeting and resolutions adopted in the annual meeting;
- significant legal actions, legal proceedings or actions of the authorities.

From 13 March 2014, information about projects is disclosed in the form of stock exchange notice if contract value exceeds EUR 3 million excluding VAT (until 12.03.2014: for contracts valued over EUR 5 million) and in case of public procurements without the customer's reserve (price limit subjected to construction contracts by Merko). Generally, Merko will only make disclosures about awarded contracts, i.e. information is disclosed after the contract is signed.

Important information shall be disclosed through the stock exchange system and on the company's website. In 2013, we published 34 stock exchange releases through the stock exchange system.

NUMBER OF RELEASES	CONTENT OF RELEASE
11	New construction contracts
6	Operating results
4	Changes in structure and management
2	General meeting
2	Releases about the court judgment in criminal matter No. 1-09-20251
4	Preliminary notices regarding time of publication of financial results
5	Other releases

We will publish 2014 consolidated interim reports as follows:

DATE	EVENT
08/05/2014	2014 3 months and I quarter unaudited interim report
07/08/2014	2014 6 months and II quarter unaudited interim report
06/11/2014	2014 9 months and III quarter unaudited interim report
12/02/2015	2014 12 months and IV quarter unaudited interim report

Reports are published after the end of the trading day. Annual accounts of subsidiaries are not generally published, but they can be obtained, if necessary, from AS Merko Ehitus or the local Commercial Registries.

Our objective is to support fair pricing of Merko shares through constant and continued distribution of information to all market operators. Moreover, our objective is to maintain the loyalty of existing shareholders towards the company and to create interest in new shareholders and analysts.

It is our responsibility to prepare quarterly and annual reports, stock exchange releases and presentation and to plan and organise investor meetings with shareholders and analysts. We also collect and analyse feedback from investors and analysts in order to increase the value of information to be disclosed.

The company shall not hold meetings with analysts or presentations for investors immediately before the dates of disclosure of financial reporting (interim reports, annual report). AS Merko Ehitus communicates regularly with its larger shareholders and potential investors and, if requested, holds meetings. The information presented in these meetings is public, i.e. available from the company's reports, website or other public sources. We carefully monitor insider information rules during these meetings.

For informing the company's shareholders an annual general meeting of shareholders is called at least once a year where all shareholders can ask questions from members of the company's Management Board and Supervisory Board.

The main analysts who cover AS Merko Ehitus are:

SWEDBANK AS	SEB ENSKILDA	AS LHV PANK
Liivalaia 8, 15040 Tallinn, Estonia	Tornimäe 2, 15010 Tallinn, Estonia	Tartu mnt 2, 10145 Tallinn, Estonia
phone +372 631 0310	phone +372 665 5100	phone +372 680 0457
e-mail info@swedbank.ee	e-mail info@seb.ee	e-mail research@lhv.ee
www.swedbank.ee	www.seb.ee	www.lhv.ee

Information on investor relations of AS Merko Ehitus is available from:

ANDRES TRINK	SIGNE KUKIN	AS MERKO EHITUS
Chairman of the Management Board	Group Chief Financial Officer	Delta Plaza, 7th Floor
phone +372 650 1250	phone +372 650 1250	Pärnu mnt 141, 11314 Tallinn, Estonia
fax +372 650 1251	fax +372 650 1251	phone +372 650 1250
e-mail andres.trink@merko.ee	e-mail signe.kukin@merko.ee	www.merko.ee



## REPORTING AND FINANCIAL AUDIT

Availability of adequate and timely information is the basis for obtaining quality management decisions. It is important to ensure that reporting is factual, but also forward-looking. This will enable to manage, to the best of one's knowledge, risks and, in competition with other market operators, turn them into opportunities. The company's reporting can be roughly divided into: a) financial reporting and b) management reporting.

Financial reporting consists of interim reports of consolidated economic indicators and annual reports of companies that belong to the AS Merko Ehitus group, that are made public through the stock exchange system of NASDAQ OMX Tallinn and that are available to all shareholders, potential investors and analysts covering the company.

On the other hand, management reporting is meant for the company's internal use. It is appropriate to separate reporting on various operating indicators that focuses on the performance of business segments and different group companies as well as return on equity. The refinement of reporting is a continuous process during which indicators affecting the achievement of agreed objectives are reviewed. Management reporting includes budgets and forecasts that AS Merko Ehitus does not disclose.

Financial audits are conducted on the basis of International Standards on Auditing. The auditor of AS Merko Ehitus is approved by the general meeting of shareholders. The selection process is managed by the Supervisory Board and its findings are presented to the general meeting for approval. As a result of the tender and with the resolution made by the general meeting in 2012, the financial auditor for annual reports 2012-2013 is AS PricewaterhouseCoopers (PwC). Auditors authorised to sign the report differ, depending on the country of residence of the group company. Chartered auditor Ago Vilu is responsible for the consolidated audit report.

AS Merko Ehitus considers it important to ensure independence of the financial auditor and to avoid of conflicts of interest. In 2013, PwC did not perform to AS Merko Ehitus services that could have affected the independence of the auditor. We find that the financial audit was conducted in 2013 in compliance with regulative acts, international standards and expectations. PwC presented the results in two stages: a) as part of an interim audit and b) with regard to the final audit before the opinion is issued.

AS Merko Ehitus does not disclose the financial audit fee because in our estimation it may harm the results of future tenders.

## DECLARATION OF CONFORMITY TO RECOMMENDATIONS OF GOOD CORPORATE GOVERNANCE CODE

The Corporate Governance Code 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.

We have assessed the structure and functions of the management of AS Merko Ehitus on the basis of Good Governance Code. Above we have described significant components of corporate governance. Having assessed the compliance of the structure and functioning of the company's management system, we find that our organisation and activities are in significant part in compliance with the Good Governance Code. Also, our activities comply with the Estonian legislation that regulates several principles provided in the code in more detail. AS Merko Ehitus has not followed some recommendations that are provided below with the explanation why the company is not following them at the present:

CORPORATE GOVERNANCE RECOMMENDATIONS	EXPLANATIONS BY MANAGEMENT AND SUPERVISORY BOARDS
2.2.7 Basic wages, performance pay, severance packages, other benefits payable and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on the website of the issuer and in the Corporate Governance Recommendations report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the issuer or the amount of foreseeable expense as of the day of disclosure.	AS Merko Ehitus publishes in its annual report the total amount of remuneration and bonuses paid to member of the Management Board, as it believes that public disclosure of personal income does not create value added for shareholders but does violate the privacy of members of the Management Board.
6.2.1 The Supervisory Board shall describe in its evaluation report regarding the auditor's activity, inter alia, the services (including advisory services) that the auditor has provided to the issuer during the preceding year or shall provide during the next year. Also the remuneration that the issuer has paid or shall pay to the auditor shall be disclosed.	AS Merko Ehitus does not publicly disclose the fee for performing financial audits, as we believe it could impair the results of tenders for audit services in future periods and thereby result in economic harm for the company.



## RISK MANAGEMENT

Risk management is part of strategic management and is inseparable from daily operations of the company. In managing risks, the main objective of the company is to determine larger and more significant risks and to optimally manage these risks so that the company achieves its strategic and financial objectives. The company considers it important to assess aggregate group's risks, instead of the impact factors of individual risks. Turning constant attention to risk management enables to exclude or minimise a possible financial loss. The following are deemed by the company to be the most significant risks: market risk, operational risk and financial risk, including interest rate risk, foreign currency risk, credit risk, liquidity risk, equity risk and legal risks. Detailed description of financial risks is provided in Note 35 of the financial statements.

Because of the group's balance sheet structure and the market position, none of these risks has a significant impact as at the date of this report.

Group risk management is coordinated by the management board who

**“ THE COMPANY MANAGES RISKS SO AS TO ACHIEVE ITS STRATEGIC AND FINANCIAL OBJECTIVES.**

develops, implements and maintains processes covering group activities for the management of all material risks impacting the activity and results of Merko Ehitus. Each group company and business unit must ensure that risks are managed on an ongoing basis with reference to the objectives it has been assigned. Risk-taking is a normal part of business but in doing so, one must be convinced that if the risk materializes, purposeful and sustainable activity is maintained with reference to the strategy of the company and business unit. The group assesses ongoing business risks and risks affecting development projects in a calculated manner.

### MERKO EHITUS DIVIDES RISKS INTO FOUR MAIN CATEGORIES:





## BUSINESS RISK

The group takes calculated risks for the purpose of increasing revenue. The biggest business risks relate to the entry of Merko Ehitus to new markets and segments, the management of existing inventories and investments and the execution of awarded construction contracts. 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.

Operating in several different markets requires orientation in the environments of various countries. The main areas of attention are the different cyclicity attributes of different economies and legal, cultural and political differences. The main objective of Merko Ehitus is to expand into new segments in existing markets. When entering new markets, the company thoroughly studies local customs and peculiarities before making final investment decisions and makes sure that the environment is sufficiently stable and a competent team is assembled.

From the investments point of view, the main risks relate to the portfolio of properties and implementation of property development projects. Merko Ehitus carries out real estate development projects as an integrated process, comprising all activities from the acquisition of the property, proceedings related to the detailed plan, handling design and construction and finally sale of finished apartments to the customer and warranty service. The group uses standard policies for implementing real estate development projects in order to ensure the use of best practices that the entire group has accumulated over years. Merko Ehitus continuously analyses its existing inventory of land with development potential to ensure that the portfolio contains a sufficient number of properties to carry out developments suitable to the market. Investments in new properties of up to EUR 3 million are decided on the supervisory board level of subsidiaries and then further approved by the supervisory board of the group.

## MARKET RISK

Significantly more attention is being paid to potentially major volatility of input prices in the construction sector that could complicate the budgeting process, completion of projects at planned costs, cause additional risks in carrying out fixed-price construction contracts and weaken projects' profitability. Therefore, the overall economic development is being closely monitored and taking excessive price risks already in the bidding phase is avoided.

The residential development area is one of the main sources of market risk arising from the value of real estate for Merko Ehitus group. The real estate market has become more selective and in pre-launch risk assessment, consideration is given to such important aspects as the project's location, development volume, planning solutions and the target group. Taking into account low interest rates on loans and limited supply on the market of new apartments, in the last three years the demand and transaction activity on the apartment market has grown moderately. Due to the selectiveness of the real estate market, setting the right sale price for new development projects in the given region have become very important. For hedging the area's price risk, price statistics collected by the group and available from other public sources is being constantly analysed.

Market risk that is partially related to financial risks also includes **currency risk and interest rate risk**. The analysis of these risks is provided in Note 35 of the financial statements.

## FINANCIAL RISK

Financial risks include risks related to adequate capitalisation level and financing, currency, interest rate and credit risk. Financial risks are managed through accounting and finance rules, as well as audit. The group's finance department is ultimately responsible for forecasting the cash flows of Merko Ehitus, continuously monitoring various subsidiaries' cash positions and forecasts. The group has enacted a regular budgeting procedure whereby the group's annual forecasts are updated as a minimum four times per year.

The analysis on **credit, liquidity and legal risks** is provided in Note 35 of the financial statements.

## OPERATIONAL RISK

Operational risks are risks caused by inadequate or ineffective processes, people, equipment, systems or external events. The main goal of operational risk management is to reduce the effect of unwanted events. In order to meet the objective, the group is developing internal processes and control systems. Development of processes and control systems is a significant area of focus for the group, particularly because of the materialization of unforeseen project management risks in the general construction segment in 2013 and the goal is to apply measures to avoid similar project management risks in the future. In order to ensure the group's high level of project management, project teams are continuously trained, business processes are improved and results are monitored.



Considering the group's field of business, it is essential in operational risk management that the improvement and application of safety standards and regulations continues and that supervision of compliance with environmental requirements is increased. One measure for managing operational risks is the implementation of quality and environmental management systems. Risks related to occupational health and safety in construction are assessed and managed in all units and process stages of the group. The largest construction companies of the group have implemented ISO 9001/14001 management systems and Merko Ehitus Eesti, Merko Infra, Merko Tartu and Latvian and Lithuanian subsidiaries have implemented the occupational health and safety management system OHSAS 18001. The group employs 10 (2012: 16) full-time quality specialists who are responsible for developing quality, safety and management systems and ensuring their functioning.

Insurance is used as additional mitigation of operational risks, especially for risks that cannot otherwise be mitigated. 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 customers, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to EUR 9.6 million. The risks of the projects which cost exceeds EUR 9.6 million or 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 2013, indemnity applications submitted to insurance companies totalled EUR 0.90 million (2012: EUR 0.98 million), and insurance benefits were received in the amount of EUR 0.08 million (2012: EUR 0.17 million).

A warranty provision has been provided at the company to cover for the construction errors which have become evident during the warranty period. In 2013, warranty

provisions were set up at the group in the total amount of EUR 0.82 million (2012: EUR 0.81 million) and disbursements amounted to EUR 0.62 million (2012: EUR 0.56 million). As at the year-end, the company's warranty provision amounted to EUR 1.8 million (31.12.2012: EUR 1.62 million). With regard to work performed by subcontractors, the subcontractors are responsible for elimination of defects 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.



