

# ***AS TALLINNA VESI***

*Annual report  
Financial year ended  
31 December 2004*

# AS TALLINNA VESI

## ANNUAL REPORT

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Start of financial year	1 January 2004
End of financial year	31 December 2004
Name of Company	AS TALLINNA VESI
Legal form of Company	Public limited company
Commercial register number	10257326
Address	Ädala St.10, Tallinn, Estonia
Chairman of the Board	Robert John Gallienne
Telephone	+ 372 6 262 202
Fax	+372 6 262 300
E-mail	tvesi@tvesi.ee
Web-page	www.tallinnavesi.ee
Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditor	AS Deloitte & Touche Audit



Chairman of the Management Board:

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**ADDRESS BY THE CHAIRMAN OF THE MANAGEMENT BOARD**

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During 2004 the Company has moved forward on a wide range of fronts. We have continued to improve on the already high standards achieved in the previous year and are totally focused on our target of becoming a world-class water utility company. The independent customer satisfaction survey carried out in November 2004 showed that the overall number of customers who are satisfied with our service has risen to 77%. Even more impressively the proportion of customers who are satisfied with the quality of our drinking water has risen by 22%, clearly demonstrating the positive impact of the operational improvements we have made in the water treatment process and operation of the network.

Once again the Company has complied with or exceeded all the Levels of Service set for us by the City of Tallinn. These are wide ranging in scope and in total cover over 90 individual service levels. There are a number of these in which the Company's performance has been extraordinary and four particular areas, which deserve particular mention. The Company was required to reduce the leakage level in the water network to 26% by the end of September 2005, in fact this target has already been exceeded and leakage as at the end of 2004 stands at just over 21%. We are well on target to achieve the 2007 EC Directive for Drinking Water Quality. Our level of compliance in 2004 was 92%, an improvement over the last two years of over 100%. On the wastewater side the level of performance at Paljassaare WWTP was within the legal compliance levels required despite the major reconstruction work being carried out to upgrade the nitrogen treatment process. All the sludge generated at Paljassaare WWTP was disposed of by means of composting with zero disposal to the waste disposal tip.

During 2004 the Company finalised its detailed business continuity and disaster management plans. The benefit of this advanced planning and preparation was fully brought home when we had to deal with the effects of the extreme weather conditions, which occurred in July and August 2004 and again in January 2005. In both these instances the level of Lake Ülemiste rose to critical levels, which were higher than ever previously experienced. Also in July and August 2004 localised storm water flooding occurred in parts of Tallinn. In each situation the Company Crisis Management team, working in partnership with the City of Tallinn effectively managed the situation. The commitment and attitudes of all staff involved in resolving the situation was exceptional and reflects very highly on their professionalism in very difficult circumstances. In the light of the apparently changing weather patterns the Company is working closely with the City of Tallinn and the City Rescue Board to further improve the protective measures, which are required.

The results of the independent customer satisfaction survey held in November 2004 show that we are moving in the right direction, but clearly we have more to do to meet the targets to which we aspire. Whilst we have a high proportion of our customers who are satisfied, our aim is to increase their level of satisfaction still further. During 2004 we have decreased the number of unanswered calls from 15% to 6%. In addition we have started work on the replacement of our customer information and billing system and the construction of a new customer service centre. Both of these initiatives will significantly improve the level and range of services we can provide for our customers in 2005.

A major objective of the Company is the expansion of our service area and maximising the use of the excess capacity we have at the Ülemiste WTP and Paljassaare WWTP. Over the last 12 months we have actively pursued a number of opportunities and also physically enhanced the water and wastewater network in order to be able to expand our service area within and around Tallinn. This strategy has paid off and in 2004 we have been successful in signing contracts to provide services with Harku Municipality for Apametsa area, Rae Municipality and Mähe 1 as well as winning competition and starting activities in Raku and Mõigu areas. There are other opportunities which we are still pursuing and this strategy has and will provide long-term benefits to all our stakeholders.

The sales revenue for 2004 was in line with the budget, this coupled with strong cost control and reduced borrowing costs due to effective cash management has resulted in an excellent financial performance for the year. Profit before tax has risen to 199 million kroons, 24% ahead of target.

Chairman of the Management Board:

**ADDRESS BY THE CHAIRMAN OF THE MANAGEMENT BOARD**

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The process of privatisation of the land at our key operational sites is now in its final stages and it is anticipated that it will be completed by the end of March 2005. The final costs for Ülemiste WTP and Paljassaare WWTP will be of the order of 20 million kroons.

In September 2004 the City of Tallinn approved the tariff increase for 2005 which will underpin the repayment of the EBRD loan which starts in May 2005 and also the Company's ongoing investment programme.

Once again at the core of our success in 2004 has been the drive and commitment of our employees, without their support the Company would not have been able to make the significant progress it has in delivering the improved service levels and excellent financial performance. My thanks goes out to all of them. During 2004 we carried out another annual Staff Satisfaction Survey and the results were extremely positive with increased satisfaction levels across virtually all categories. The results have been discussed with all employees and action plans agreed to address areas of concern.

United Utilities, our major shareholder, makes awards each quarter and each year to teams and individuals who deliver outstanding performance for their company. In 2004 the Estonian managers of AS Tallinna Vesi were put forward as a contender for these awards along with a large number of other individuals and teams from within United Utilities worldwide. I am delighted to be able to announce that the team from AS Tallinna Vesi was awarded both Team of the Quarter and Team of the Year 2004 for the whole of United Utilities. This is a very real achievement and demonstrates both the quality of the performance and the level of their expertise. It is an award of which the whole Company is very proud.

2005 will present us with probably a greater number of challenges and opportunities than ever before, but we are well prepared for them and will improve the performance of the Company still further. The new nitrogen process at Paljassaare WWTP will be commissioned and tested throughout 2005 and as a result there will be a major reduction in the nitrogen discharged to the Baltic Sea. There will be significant improvements in Customer Service through the provision of a wider range of services as a result of the implementation of the new Customer Information and Billing System, and also through the opening of our new customer friendly service centre at Ädala 10. Later in the year we plan to be the first utility in the Baltics to introduce a Guaranteed Standards Scheme for all our customers for the key customer services we provide.

In 2005 we will be delivering the largest capital programme since privatisation totalling some 220 million kroons with a major focus on raising water quality levels still higher towards our 2007 target. We will also aim to further improve our environmental management systems and acquire EMAS accreditation for the Company.

Clearly 2004 has been a successful year and I believe we have put in place for 2005 the necessary steps for improving still further the services we deliver. I would like to thank all our staff for their unwavering desire to continue to improve and the City of Tallinn and the Ministry of Environment for their positive and constructive support throughout the year. It is this that makes the Company the undoubted success that it is.



Robert John Gallienne  
Chairman of the Management Board

Chairman of the Management Board:

## AS TALLINNA VESI

### **DECLARATION OF MANAGEMENT FOR THE YEAR ENDED 31 DECEMBER 2004**

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The Management Board of AS Tallinna Vesi has prepared the annual accounts for the financial year ended 31 December 2004.

The annual accounts have been prepared according to International Financial Reporting Standards, and give a true and fair view of the financial position, results of operations and cash flows of AS Tallinna Vesi.

The preparation of the annual accounts according to International Financial Reporting Standards involves estimates made by the Management Board of the Company's assets and liabilities as at 31 December 2004, and of income and expenses during the financial year. These estimates are based on current information about AS Tallinna Vesi and consider all plans and risks as at 31 December 2004. The actual results of these business transactions recorded may differ from such estimates.

Any subsequent events that materially affect the valuation of assets and liabilities until the preparation of the annual accounts as at 10 February 2005 have been assessed as part of this review.

The Management Board considers AS Tallinna Vesi to be a going concern entity.

<b>Name</b>	<b>Position</b>	<b>Signature</b>	<b>Date</b>
Robert John Gallienne	Chairman of the Management Board		<u>10.02.2005.</u>
Roch Jean Guy Antoine Cheroux	Member of the Management Board		<u>10.02.2005a</u>
Ian John Alexander Plenderleith	Member of the Management Board	<u>I.J.A. Plenderleith</u>	<u>10.02.2005</u>

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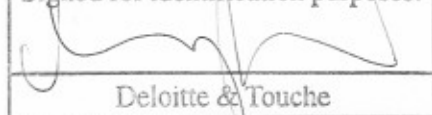
## AS TALLINNA VESI

## BALANCE SHEET AT 31 DECEMBER 2004, 2003 AND 2002

(thousand EEK)

ASSETS	Note	2004	2003	2002
<b>CURRENT ASSETS</b>				
Cash at bank and in hand	2	101 000	84 153	188 211
Customer receivables	3	51 644	53 837	86 701
Other receivables	4	66	2 551	332
Accrued income and prepaid expenses	5	3 886	4 171	3 049
Inventories	6	3 266	5 544	11 625
Assets for sale	7	1 621	2 789	5 559
<b>TOTAL CURRENT ASSETS</b>		<b>161 483</b>	<b>153 045</b>	<b>295 477</b>
<b>NON-CURRENT ASSETS</b>				
Shares of associated companies	8	0	6 126	8 504
Long-term deposit	9	77 538	31 448	0
Other long-term investment assets	10	1 330	2 576	4 320
Tangible assets	11	1 779 897	1 785 139	1 778 319
Intangible assets	11	18 460	21 361	11 826
Construction in progress	11	102 634	62 797	51 168
Unfinished pipelines - new connections	11	79 675	93 176	99 254
Prepayments for fixed assets	11	3 648	8 565	18 934
<b>TOTAL NON-CURRENT ASSETS</b>		<b>2 063 182</b>	<b>2 011 188</b>	<b>1 972 325</b>
<b>TOTAL ASSETS</b>		<b>2 224 665</b>	<b>2 164 233</b>	<b>2 267 802</b>
<b>LIABILITIES</b>				
<b>CURRENT LIABILITIES</b>				
Current portion of long-term finance lease	12	1 777	2 632	3 007
Current portion of long-term bank loans	12	87 086	17 477	74 486
Trade and other payables	13	55 707	78 459	172 979
Taxes payable	14	20 534	15 827	18 471
Short-term provisions	15	912	13 668	1 708
Deferred income	16	18 582	36 495	26 120
<b>TOTAL CURRENT LIABILITIES</b>		<b>184 598</b>	<b>164 558</b>	<b>296 771</b>
<b>NON-CURRENT LIABILITIES</b>				
Finance lease	12	1 685	3 462	5 587
Bank loans	12	1 039 192	1 094 984	1 112 601
Other payables	13	100	100	11 255
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>1 040 977</b>	<b>1 098 546</b>	<b>1 129 443</b>
<b>TOTAL LIABILITIES</b>		<b>1 225 575</b>	<b>1 263 104</b>	<b>1 426 214</b>
<b>EQUITY CAPITAL</b>				
Share capital	17	200 001	200 001	200 001
Share premium		387 000	387 000	387 000
Statutory legal reserve	17	93 394	93 394	93 394
Accumulated profit		145 734	116 193	15 000
Net profit for the financial year		172 961	104 541	146 193
<b>TOTAL EQUITY CAPITAL</b>		<b>999 090</b>	<b>901 129</b>	<b>841 588</b>
<b>TOTAL LIABILITIES AND EQUITY CAPITAL</b>		<b>2 224 665</b>	<b>2 164 233</b>	<b>2 267 802</b>

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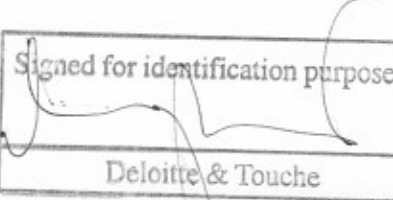
## AS TALLINNA VESI

## INCOME STATEMENT FOR THE YEARS 2004, 2003 AND 2002

(thousand EEK)

	Note	2004	2003	2002
Sales from main operating activities	18	478 814	434 794	432 947
Revenues from other operating activities	18	69 715	69 223	79 577
<b>Net sales</b>	<b>18</b>	<b>548 529</b>	<b>504 017</b>	<b>512 524</b>
Cost of goods sold main operating activities	19, 20	-195 486	-193 157	-202 219
Cost of goods sold other operating activities	19, 20	-64 410	-61 608	-69 963
<b>GROSS PROFIT</b>		<b>288 633</b>	<b>249 252</b>	<b>240 342</b>
Marketing expenses	19, 20	-6 134	-6 342	-6 602
General administration expenses	19, 20	-40 739	-56 440	-42 143
Other income/ expenses (-)	19	13 158	-16 635	-16 701
<b>OPERATING PROFIT</b>		<b>254 918</b>	<b>169 835</b>	<b>174 896</b>
Financial income / expenses (-)	21	-55 680	-50 013	-5 344
<b>PROFIT BEFORE TAXES</b>		<b>199 238</b>	<b>119 822</b>	<b>169 552</b>
Income tax on dividends	22	-26 277	-15 281	-23 359
<b>NET PROFIT FOR THE FINANCIAL YEAR</b>		<b>172 961</b>	<b>104 541</b>	<b>146 193</b>
Attributable to:				
Equity holders of A-shares		172 951	104 531	146 183
B-share holder		10	10	10
<b>Earnings per share in kroons</b>	<b>23</b>	<b>8,65</b>	<b>5,23</b>	<b>1,75</b>

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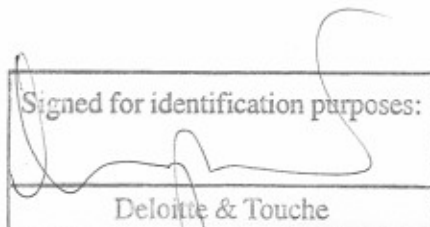
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## CASH FLOW STATEMENT FOR THE YEARS 2004, 2003 AND 2002

(thousand EEK)

	Note	2004	2003	2002
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Profit before taxes		199 238	119 822	169 552
Adjustment for depreciation		77 736	73 458	69 385
Adjustment for income and expenses from constructions	24A	-5 306	-7 616	-9 311
Adjustment for shares and finance income and expenses		51 845	38 265	3 684
Profit/loss(+) from privatization vouchers (EVP)		0	-5 066	7
Profit from sale of fixed assets		-2 844	-1 595	-21
Write off of fixed assets		2 470	683	4 712
Write off of financial assets	10	1 200	0	0
Capitalization of operating expenses		-38 974	-60 144	-37 615
Change in current assets involved in operating activities	24B	-48 978	-17 245	-1 132
Change in liabilities involved in operating activities	24B	-11 045	21 731	-1 605
Interest paid		-57 513	-56 654	-20 311
<b>Total cash flow from operating activities</b>		<b>167 829</b>	<b>105 639</b>	<b>177 345</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Proceeds from sale of shares of associated company	8	6 259	0	0
Sale of EVP		0	18 930	0
Acquisition of fixed assets	24C	-72 957	-62 583	-112 080
Payment of pipelines financed by construction income	24A	-60 750	-50 568	-64 380
Proceeds from pipelines financed by construction income	24A	59 371	109 172	51 441
Repayments of loans to third parties		2	25	52
Proceeds from sale of fixed assets		3 799	11 332	167
Proceeds from sale of inventories/goods for sale		2 250	9 500	0
Received dividends		0	1 717	0
Interest received		2 661	4 170	11 804
<b>Total cash flow from investing activities</b>		<b>-59 365</b>	<b>41 695</b>	<b>-112 996</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Decrease in share capital		0	-112 083	-837 917
Received long-term loans	12	31 293	0	1 110 864
Repayment of long-term loans	12	-19 001	-76 004	-318 412
Finance lease payments	12	-2 632	-3 024	-3 574
Dividends paid	22	-75 000	-45 000	-131 828
Income tax on dividends	22	-26 277	-15 281	-23 359
<b>Total cash flow from financing activities</b>		<b>-91 617</b>	<b>-251 392</b>	<b>-204 226</b>
<b>Change in cash and bank accounts</b>		<b>16 847</b>	<b>-104 058</b>	<b>-139 877</b>
<b>CASH AND EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>		<b>84 153</b>	<b>188 211</b>	<b>328 088</b>
<b>CASH AND EQUIVALENTS AT THE END OF THE YEAR</b>	2	<b>101 000</b>	<b>84 153</b>	<b>188 211</b>

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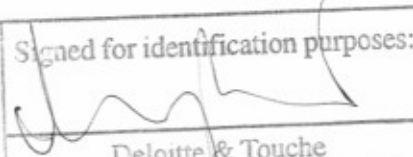
AS TALLINNA VESI

STATEMENT OF CHANGES IN EQUITY  
FOR THE YEARS ENDED 31 DECEMBER 2004, 2003 AND 2002

(thousand EEK)

	Share capital	Share premium	Statutory legal reserve*	Accumulated profit*	Net profit	Total equity
<b>31 December 2001</b>	<b>1 150 001</b>	<b>387 000</b>	<b>85 000</b>	<b>-12 660</b>	<b>167 882</b>	<b>1 777 223</b>
Transfer of financial year profit to the accumulated profit	0	0	0	167 882	-167 882	0
Increase of reserves	0	0	8 394	-8 394	0	0
Declared dividends	0	0	0	-131 828	0	-131 828
Reduction of shares	-950 000	0	0	0	0	-950 000
Net profit of the financial year	0	0	0	0	146 193	146 193
<b>31 December 2002</b>	<b>200 001</b>	<b>387 000</b>	<b>93 394</b>	<b>15 000</b>	<b>146 193</b>	<b>841 588</b>
Transfer of financial year profit to the accumulated profit	0	0	0	146 193	-146 193	0
Dividends	0	0	0	-45 000	0	-45 000
Net profit of the financial year	0	0	0	0	104 541	104 541
<b>31 December 2003</b>	<b>200 001</b>	<b>387 000</b>	<b>93 394</b>	<b>116 193</b>	<b>104 541</b>	<b>901 129</b>
Transfer of financial year profit to the accumulated profit	0	0	0	104 541	-104 541	0
Dividends	0	0	0	-75 000	0	-75 000
Net profit of the financial year	0	0	0	0	172 961	172 961
<b>31 December 2004</b>	<b>200 001</b>	<b>387 000</b>	<b>93 394</b>	<b>145 734</b>	<b>172 961</b>	<b>999 090</b>

\* As a subsequent event 73 394 kroons were transferred from the Statutory legal reserve to the Accumulated profit on 3 February 2005 (see note 17).

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**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004**

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**NOTE 1. ACCOUNTING PRINCIPLES**

The financial statements for the financial year 2004 have been prepared according to International Financial Reporting Standards (IFRS) for the first time. All IFRS standards valid and effective from 1 January 2005, and applicable to the company have been adopted before their effective date. The implementation of IFRS did not cause any material changes to the existing accounting principles and had no influence on the profit of the company. As a consequence of the reporting of IFRS's the presentation of the information has changed slightly with the additional information published in the notes to the accounts. The disclosures required by IFRS 1 concerning the transition from Estonian GAAP to IFRS are presented in note 29.

Functional currency is Estonian kroon. The annual accounts are prepared in Estonian kroons (EEK) rounded to the nearest thousand, unless otherwise indicated. The financial statements have been prepared on historical cost accounting basis, unless specified otherwise. Initial acquisition cost includes all costs directly related to the asset or liability.

The main accounting principles applied in the preparation of the financial statements are detailed below.

**Foreign currency transactions**

Foreign currency transactions are recorded on the basis of the foreign currency exchange rates of the Bank of Estonia at the date of the transaction. Assets and liabilities recorded in foreign currencies in the financial statements have been converted into Estonian kroons based on foreign currency exchange rates valid at the Balance Sheet date. Profits and losses due to exchange rate changes are aggregated and shown in the Income Statement.

**Financial assets and liabilities**

Financial assets are cash, customer receivables, accrued income, other current and long-term receivables. Financial liabilities are accounts payable, accrued expenses, other current and long-term liabilities.

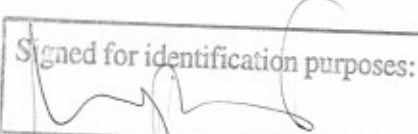
Financial assets and liabilities are recognized at acquisition cost, which is assumed to be a fair value paid for or gained from that asset or liability.

Financial assets and liabilities are recorded in the Balance Sheet when the company acquires the ownership according to financial asset or liability contract conditions.

Loans are recorded at the value of the proceeds received, net of direct transaction costs, which are accounted for on an accrual basis proportionally to the income statement during the loan agreement validity period. As the transaction cost has been considered immaterial compared to the loan received, no effective interest method is implemented.

**Cash and cash equivalents**

Cash and cash equivalents within the Balance Sheet and the Cash Flow Statement comprise of cash held on premises, cash in bank accounts and short-term, risk free, liquid bank deposits convertible into cash within a three months period without penalty.

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**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004**

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**Receivables**

Receivables are presented using the amortized cost method. Provisions for accounts receivable that are considered to be doubtful, are recorded in the Income Statement under "Other expenses" during the financial year, and a respective reserve on the Balance Sheet line "Allowance for doubtful debts" is recorded. Receivables which cannot be collected, or the collection is considered to be economically not justified, are evaluated as un-collectible and written-off from the Balance Sheet. Accounts receivable from previous periods that were recorded as doubtful, but that were received during the year, are recorded on the same expense account as a reverse entry.

Until 2004 the likelihood of receipt of all receivables was evaluated individually. In 2004 the principle was revised to simplify the procedure and to be in accordance with the parent company's accounting principles. Individual debts are now grouped by age and the following percentages are applied in the doubtful debt calculation:

61 to 90 days 10%;  
91 to 180 days 30%;  
181 to 360 days 70%;  
over 360 days 100%.

The change in principle did not cause any material difference to the 2004 accounts and cause no need to revise the 2003 and 2002 accounts.

**Accounting for inventories**

Raw materials and spare parts are recorded at acquisition price, which consists of purchase price, non-recoverable taxes, freight costs and other direct costs, less discounts and subsidies received.

Inventories are recorded on the Balance Sheet at the lower of acquisition cost and net realizable value with any impairment recorded in the Income Statement to "Other expenses". The acquisition cost of inventories is accounted for by using weighted average acquisition cost method. Any inventories received at nil cost are recorded at zero value.

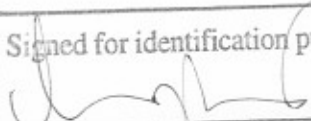
**Long-term financial investments**

Shares of associates, subsidiaries and other securities and financial assets acquired for periods more than one year are recorded as long-term financial investments.

In 2002 and 2003 the Company had one fully owned subsidiary which was accounted for using the equity method in the accounts. During 2004 the subsidiary was merged into the Company and the accounts of the subsidiary were merged row by row into the accounts of the Company. The assets, liabilities, revenues and expenses arising from the transactions between the subsidiary and the parent have been eliminated. The accounts for 2002 and 2003 have been consolidated retrospectively. The effects of consolidation are shown in note 29.

Until 2003 investments in an associated company were accounted using the equity method, whereby the investment balance was adjusted each year by the share of the associated company's profit or loss less any dividends received. In 2004 the share of the associated company was sold. The earlier share and result of the sale are indicated in note 8.

As at 31 December 2004 the company does not own any subsidiary or own any shares in an associated company.

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Deloitte & Touche

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004**

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**Tangible and intangible fixed assets**

Assets with useful life more than one year and with a minimum value of 2 000 EEK are capitalised as fixed assets. Fixed assets are recorded at acquisition cost, which comprises of purchase price, non-recoverable taxes and all other direct costs to take the fixed asset object into operation including internal labour costs. Capitalisation of internal labour costs is based on hours worked on the acquisition of asset. In addition to salary costs all other employee related costs are capitalized in the same proportion.

The interest cost of company debt during the acquisition period of any fixed assets is capitalized during the construction process, incl. unfinished pipelines – new connections, which are calculated as the proportion of the amount of construction in progress compared to the balance of the corresponding debt.

Unfinished pipelines – new connections include the costs of acquiring water or sewerage pipelines. After completion of construction and the concluding of the connection contracts with customers the costs related to the acquisition of these pipelines are recorded within costs of goods sold to ensure the correct matching of revenues and expenses in the same accounting period. Remaining expenses relating to the construction, that are not directly compensated to the company, are recorded within the Balance Sheet as "Facilities" within fixed assets.

Depreciation is calculated on a straight-line method. The depreciation rate of each fixed asset is based on the fixed asset's useful life, using the following rates:

- buildings 1,25-2,0 % per annum;
- facilities 1,0-8,33 % per annum;
- machinery and equipment 3,33-50 % per annum;
- instruments, facilities etc. 10-20 % per annum;
- intangible assets 20-33 % per annum.

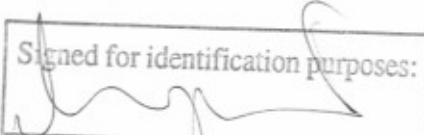
Land is not depreciated.

In exceptional circumstances rates may differ from the above rates if it is evident that the useful lifetime of the asset varies materially from the rate assigned to the respective category.

Prepayments for fixed assets and construction-in-process, including unfinished pipelines – new connections, are recorded as fixed assets and are not depreciated.

Improvements to fixed assets are capitalised if the properties of that asset are improved substantially or, as a result of the improvement, the useful life of the asset will be extended, or it is foreseen that additional future revenues will result. Maintenance and repair works are expensed in the period incurred.

All costs of identifiable and controllable development projects which are likely to earn future revenues, and the acquisition costs of computer software are capitalised as intangible assets on the Balance Sheet and amortised on a straight-line basis for a period of up to 5 years. If the software is necessary to take computer hardware into use, the acquisition cost of such software is capitalised in the acquisition cost of the hardware and depreciated according to the useful life of the hardware. Research costs are expensed.

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**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004**

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**Impairment of tangible and intangible assets**

At each balance sheet date, the Company reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. Individual assets with no realization value are removed from operations and the net balance sheet value is recorded in the Income Statement to "Other expenses".

**Investment property and Assets for sale**

The property held by the company to earn rentals is classified as investment property. The revenues and costs related to the property are disclosed in note 10.

The land and buildings held for sale in the ordinary course of business are classified as inventory as management has decided to sell and will endeavour to make every effort to do so during the next accounting year.

Investment property and assets for sale are measured at cost. The investment property is continuously depreciated using the same principles as applied to tangible fixed assets. For assets for sale the depreciation is stopped after the decision is taken to move the assets to the inventory. Management has evaluated the fair value of all items listed within both investment property and inventory and is confident that the fair value is at least equal to the net balance sheet value.

**Liabilities**

Liabilities with payment terms more than one year after the balance sheet date are considered to be long-term liabilities. All other liabilities are considered to be short-term liabilities.

No long-term employee benefit schemes are applicable to the company. The company has made an internal decision to pay bonuses to the employees based on the accounting year results of the company and other individual performance criteria. The expected cost is recorded on the Income Statement as an expense and on the Balance Sheet as a short-term liability.

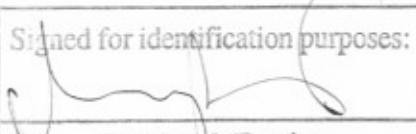
As profits are not taxable in Estonia no deferred tax liabilities are applicable. Taxation is described more thoroughly in notes 26 and 14.

**Provisions**

Legal or contractual liabilities which have arisen during the financial year or previous periods, which are reasonably expected to result in abandoning the asset and result in costs that can be reliably measured at any point in the future, but final cost or term of payment is not firmly fixed, are accounted for as provisions.

Financial statements include short-term provisions from ongoing court cases, potential insolvencies of high risk customers, contractual obligations other than accruals and the expected loss from the liquidation of financial assets existing independently of the company's future actions. Provisions for losses are recorded using the best evaluation by the management of AS Tallinna Vesi. The final costs of such transactions may differ from these estimates.

Contingent liabilities are excluded from recognition in the balance sheet. The company had no known contingent liabilities at the time of the preparation of the reports.

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**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004**

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**Reserves**

Statutory legal reserve is recorded based upon the requirements of the Commercial Code and comprises of the allocations made from net profits. The annual allocation must be at least 5% of the approved net profit of the financial year until achieving the statutory legal reserve equal to 10% of share capital.

**Accounting for leases**

Lease contracts are considered as finance leases if all relevant risks and benefits with reference to the ownership of the asset are borne by the lessee, otherwise the lease contract is considered as operating lease.

Operating lease payments are recorded as expense during the period incurred i.e. the asset is not recorded as a fixed asset nor is depreciated.

Assets acquired under a finance lease and finance lease liabilities are recognised on the balance sheet of the lessee. If ownership is expected to be transferred to the lessee, depreciation is calculated in the usual manner.

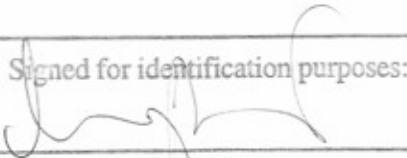
**Revenues**

Sales revenue is recorded on an accruals basis based upon the revenue principle if the sales revenue and the costs related to transaction are reliably defined. Net sales comprise the income received from goods and services sold after the deduction of sales discounts and all applicable taxes. Sales income from services is recorded in the period when the service has been provided.

Connections revenue is recorded when construction is completed and the connection contract is concluded ensuring the correct matching of revenues and expenses in the same accounting period. If the construction works of new connections is not compensated by the property owner and takes place in a different accounting period from the connection contract completion date, then the revenue and costs are booked in the accounting period when compensation confirmation is received.

**Subsequent events**

During the preparation of the annual accounts management considers the materiality of all subsequent events that occurred between the balance sheet date and the preparation date of the report. Subsequent events, which could in the opinion of the management have a material impact on the disclosure of the assets, liability and equity capital, are disclosed in the notes if they do exist.

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AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

NOTE 2. CASH AND CASH EQUIVALENTS

	2004	2003	2002
Cash and bank accounts	85 253	77 053	25 494
Short-term deposits	15 747	7 100	162 717
<b>Total cash and cash equivalents</b>	<b>101 000</b>	<b>84 153</b>	<b>188 211</b>

NOTE 3. CUSTOMER RECEIVABLES

	2004	2003	2002
Accounts receivable	59 383	65 849	101 484
Allowance for doubtful debts	-7 739	-12 012	-14 783
<b>Total customer receivables</b>	<b>51 644</b>	<b>53 837</b>	<b>86 701</b>

Change in customer receivables includes the following movements:

Write off of uncollectible receivables	-1 723	-1 100	-100
Change in allowance for doubtful debts	4 273	2 770	-8 298

NOTE 4. OTHER RECEIVABLES

	2004	2003	2002
Receivables from parent company	0	23	0
Other receivables	66	2 528	332
<b>Total other receivables</b>	<b>66</b>	<b>2 551</b>	<b>332</b>

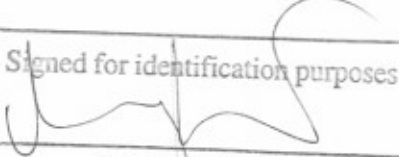
NOTE 5. ACCRUED INCOME AND PREPAID EXPENSES

	2004	2003	2002
Accrued interest	274	156	0
Other accrued income	26	27	107
Prepaid taxes	3	180	10
Other prepaid expenses	3 583	3 808	2 932
<b>Total accrued income and prepaid expenses</b>	<b>3 886</b>	<b>4 171</b>	<b>3 049</b>

NOTE 6. INVENTORIES

Inventories consist of raw materials and are shown net of provisions for obsolete assets.

Old raw materials with a nature and value only specific to the Company are considered obsolete, subject to the assumption that management has made all reasonable efforts to sell the unnecessary assets during the year. The most likely outcome for the majority of these assets is treatment as scrap with no material revenue to the Company. These items have been fully provided in the accounts, 1 508 th kroons and 4 631 th kroons as of 31 December 2004 and 2003 respectively. Any subsequent revenues received on the sale of these assets has been immaterial in value and has been offset against the value written off. In 2002 no provisions were recorded for aged stock.

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AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

NOTE 7. ASSETS FOR SALE

	2004	2003	2002
Assets for sale	693	1 919	4 631
Prepayments for land in assets for sale	928	870	928
<b>Total assets for sale</b>	<b>1 621</b>	<b>2 789</b>	<b>5 559</b>

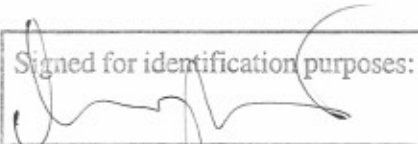
NOTE 8. INVESTMENT IN ASSOCIATED COMPANY

The Company had the long-term investment in AS Kemivesi with the following participation:

Number of shares at 31 December 2002	6 900
Number of shares at 31 December 2003	6 900
Number of shares at 31 December 2004	0
<b>Book value of shares at 31 December 2001</b>	<b>7 837</b>
Income calculated using equity method	667
<b>Book value of shares at 31 December 2002</b>	<b>8 504</b>
Income calculated using equity method	-661
Decrease in investment value by dividends announced	-1 717
<b>Book value of shares at 31 December 2003</b>	<b>6 126</b>
<b>Share ownership % 31 December 2003</b>	<b>33,25%</b>

In 2004 the company sold the participation in AS Kemivesi with the following result to the accounts:

Revenue from sale of shares	6 259
Carrying value of the investment	-6 126
<b>Profit from the transaction</b>	<b>133</b>

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## NOTE 9. LONG-TERM DEPOSITS

The Company has opened a Debt Service Reserve (hereinafter the DSR) deposit in accordance with the EBRD loan agreement (see note 12). The company is required to maintain the DSR to an amount equal to not less than the sum of the payments of principal and interest on the loan that become due and payable at the next interest payment date throughout the whole loan agreement period. The withdrawal of amounts from the DSR is restricted to payments of the loan obligations, and can only be used for any other purpose with the prior written consent of the bank. The approximate amount of the obligation is to maintain 80 000 th kroons in DSR account until 2015.

## NOTE 10. OTHER LONG-TERM INVESTMENT ASSETS

	2004	2003	2002
Long term loans	0	1	2
Other Shares*	0	1 200	1 200
Investment Property (acquisition value)**	1786	1 786	3 596
Accumulated depreciation of investment property (-)	-456	-411	-478
<b>Total other long-term investment assets</b>	<b>1 330</b>	<b>2 576</b>	<b>4 320</b>

\* Other Shares

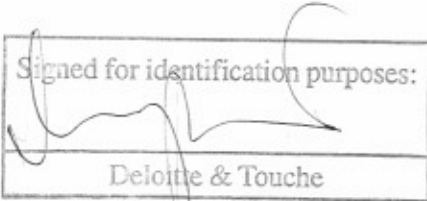
In 2001 AS Tallinna Vesi acquired 8 B - shares of AS Rocca al Mare Suurhall with a nominal value of 100 kroons and in a total amount of 1 200 000 kroons, based on a contract signed between AS Tallinna Vesi and AS Rocca al Mare Suurhall during the financial year ended 31 December 2000. As the financial situation of AS Rocca al Mare Suurhall is weak and there's plan to cancel all ordinary shares, the value of the shares is written off and recorded in Income Statement within financial expenses in 2004.

\*\* Real Estate Investment

The real estate investment includes one property at address Järvevana Street 3, Tallinn.

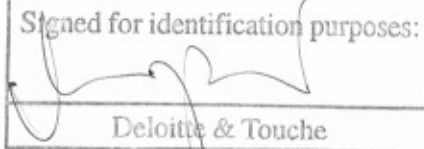
No movements other than depreciation have happened to the balance sheet value of the property during the reporting year.

	2004	2003	2002
Rental revenue from the investment, excluding VAT	1 064	1 257	1 254
Direct operating expenses that generated rental income	456	624	612
The occupation rate of the property (average of the reporting year)	93%	99%	99%

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NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

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(thousand EEK)

## NOTE 11. TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS

	Tangible assets in usage				Assets in progress			Intangible assets		Total tangible and intangible non-current assets
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Unfinished pipelines - new connections	Prepayment for fixed assets	Development costs	Acquired licenses and software	
<b>Acquisition cost at</b>										
<b>31.12.2002</b>	<b>314 452</b>	<b>1 819 172</b>	<b>441 806</b>	<b>14 539</b>	<b>51 168</b>	<b>99 254</b>	<b>18 934</b>	<b>8 201</b>	<b>12 195</b>	<b>2 779 721</b>
Acquisition	0	0	1 601	540	106 065	59 502	4 761	0	1 099	173 568
Sale of fixed assets	-12 518	-846	-2 334	-334	-63	0	-489	0	0	-16 584
Write-off of fixed assets	-285	-5 704	-1 908	-365	0	0	0	0	0	-8 262
Reclassification within balance sheet	0	0	-463	0	597	0	-13 835	0	0	-13 701
Reclassification to expenses	0	0	0	0	-221	0	0	0	0	-221
Expensed pipelines	0	0	0	0	0	-61 608	0	0	0	-61 608
Reclassification from assets in progress	2 153	51 063	33 485	525	-94 749	-3 972	-806	174	12 127	0
<b>31.12.2003</b>	<b>303 802</b>	<b>1 863 685</b>	<b>472 187</b>	<b>14 905</b>	<b>62 797</b>	<b>93 176</b>	<b>8 565</b>	<b>8 375</b>	<b>25 421</b>	<b>2 852 913</b>
Acquisition	0	0	0	0	104 254	54 125	0	0	0	158 379
Sale of fixed assets	-1 462	0	-2 204	-6	0	0	0	0	0	-3 672
Write-off of fixed assets	-205	-2 885	-4 504	-412	0	0	0	0	0	-8 006
Reclassification within balance sheet	331	0	0	0	173	0	-81	0	0	423
Reclassification to expenses	0	0	0	0	-495	-1	0	0	0	-496
Expensed pipelines	0	0	0	0	0	-64 410	0	0	0	-64 410
Reclassification from assets in progress	9 004	38 719	19 416	1 848	-64 095	-3 215	-4 836	1 223	1 936	0
<b>31.12.2004</b>	<b>311 470</b>	<b>1 899 519</b>	<b>484 895</b>	<b>16 335</b>	<b>102 634</b>	<b>79 675</b>	<b>3 648</b>	<b>9 598</b>	<b>27 357</b>	<b>2 935 131</b>
<b>Accumulated depreciation</b>										
<b>31.12.2002</b>	<b>47 189</b>	<b>540 618</b>	<b>214 604</b>	<b>9 239</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>5 255</b>	<b>3 315</b>	<b>820 220</b>
Depreciation	4 160	26 219	38 050	1 064	0	0	0	916	2 984	73 393
Depreciation of fixed assets sold and written-off (-)	-1 659	-6 147	-3 298	-634	0	0	0	0	0	-11 738
Reclassification	-224	1 034	-775	0	0	0	0	-35	0	0
<b>31.12.2003</b>	<b>49 466</b>	<b>561 724</b>	<b>248 581</b>	<b>9 669</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>6 136</b>	<b>6 299</b>	<b>881 875</b>
Depreciation	4 061	27 624	38 874	1 073	0	0	0	905	5 155	77 692
Depreciation of fixed assets sold and written-off (-)	-638	-2 598	-5 129	-385	0	0	0	0	0	-8 750
Reclassification	0	-3	3	0	0	0	0	0	0	0
<b>31.12.2004</b>	<b>52 889</b>	<b>586 747</b>	<b>282 329</b>	<b>10 357</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>7 041</b>	<b>11 454</b>	<b>950 817</b>
<b>Net book value</b>										
<b>30.12.2002</b>	<b>267 263</b>	<b>1 278 554</b>	<b>227 202</b>	<b>5 300</b>	<b>51 168</b>	<b>99 254</b>	<b>18 934</b>	<b>2 946</b>	<b>8 880</b>	<b>1 959 501</b>
<b>31.12.2003</b>	<b>254 336</b>	<b>1 301 961</b>	<b>223 606</b>	<b>5 236</b>	<b>62 797</b>	<b>93 176</b>	<b>8 565</b>	<b>2 239</b>	<b>19 122</b>	<b>1 971 038</b>
<b>31.12.2004</b>	<b>258 581</b>	<b>1 312 772</b>	<b>202 566</b>	<b>5 978</b>	<b>102 634</b>	<b>79 675</b>	<b>3 648</b>	<b>2 557</b>	<b>15 903</b>	<b>1 984 314</b>

Fixed assets are written off if the condition of the asset does not enable further usage for production purposes.

Net balance sheet value of finance leases was 9 434 thousand kroons, 11 197 thousand kroons and 14236 thousand kroons in 2004, 2003 and 2002 respectively.

Interest capitalised to fixed assets was 2 689 thousand kroons, 3 815 thousand kroons and 8 750 thousand kroons in 2004, 2003 and 2002 respectively.

Chairman of the Management Board:

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

## NOTE 12. SHORT-TERM AND LONG-TERM DEBT OBLIGATIONS

The Company's long-term obligations are as follows:

Bank loans	Loan date	Loan received	Residual amount 31.12.2002	Residual amount 31.12.2003	Residual amount 31.12.2004	Short-term portion 31.12.2004	Long-term portion 31.12.2004	Interest rate %	Maturity date
DePfa bank	04.1999	304 013	95 005	19 001	0	0	0	3 months Euribor +3	04.2004
EBRD incl. A loan	12.2002	1 251 731	1 110 864	1 110 864	1 142 157	88 610	1 053 547	5,69	05.2015
incl. B loan		860 565	763 719	763 719	785 233	60 920	724 313	Euribor + 1,5	
Loan costs	12.2002	391 166	347 145	347 145	356 924	27 690	329 234		
<b>Total bank loans</b>		-18 782	-18 782	-17 404	-15 879	-1 524	-14 355		05.2015
<b>Total bank loans</b>		<b>1 536 962</b>	<b>1 187 087</b>	<b>1 112 461</b>	<b>1 126 278</b>	<b>87 086</b>	<b>1 039 192</b>		
<b>Finance lease</b>		<b>15 332</b>	<b>8 594</b>	<b>6 094</b>	<b>3 462</b>	<b>1 777</b>	<b>1 685</b>	3,56-9,28	06.2007
<b>Total long-term debt obligations</b>		<b>1 552 294</b>	<b>1 195 681</b>	<b>1 118 555</b>	<b>1 129 740</b>	<b>88 863</b>	<b>1 040 877</b>		

The amount not drawn from EBRD loan as of 31.12.2004 is 109 574 thousand kroons, all of which is intended to be drawdown by May 2005.

The short-term portion of the finance lease in the amount of 1 777 thousand kroons is recorded on the Balance Sheet line "Current portion of long-term finance lease".

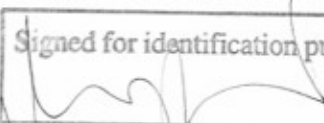
The long-term portion of finance lease in the amount of 1 685 thousand kroons is recorded on the Balance Sheet line "Finance lease".

The underwriting of the loan from EBRD is indicated in Note 27.

Name	Repayments period
EBRD	Loan repayments start in 2005. The repayments will be made twice a year in May and November in accordance with the repayment factors agreed in the loan agreement.
Finance lease	Repayments on a monthly or quarterly basis in accordance with the contracts.

The repayments, including the amount of EBRD loan to be drawdown in 2005, are as follows:

	Less than 1 year	1-5 years	Over 5 years	Total	Repayment period
EBRD	88 610	530 874	632 247	1 251 731	9 years
Finance leases	1 777	1 685	0	3 462	2 years
<b>Total</b>	<b>90 387</b>	<b>532 559</b>	<b>632 247</b>	<b>1 255 193</b>	

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AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

NOTE 13. TRADE AND OTHER PAYABLES

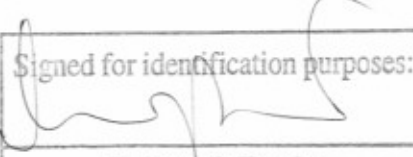
Short-term payables	2004	2003	2002	Maturity date
Accounts payable - operating expenditures	15 025	15 270	13 840	
Accounts payable - capital expenditures	20 855	36 871	28 696	
Factoring	282	1 255	4 354	
Payables to parent company	1 523	5 734	42 683	
Payables to associated company	0	957	412	
Payables to Tallinn City for shares	0	0	71 738	
Payables to employees	12 865	13 154	8 782	
Interest payable	5 120	5 185	2 429	
Other accrued expenses	37	33	45	
<b>Total short-term trade and other payables</b>	<b>55 707</b>	<b>78 459</b>	<b>172 979</b>	
<b>Long-term payables</b>				
Accounts payable - capital expenditures	0	0	10 000	06.2004
Factoring	0	0	1 255	04.2004
Long-term guarantee deposit*	100	100	0	04.2102
<b>Total long-term trade and other payables</b>	<b>100</b>	<b>100</b>	<b>11 255</b>	

\* Long-term deposit is in acquisition value.

NOTE 14. TAXES PAYABLE

	2004	2003	2002
Income tax	1 593	1 581	1 888
VAT	4 147	4 396	10 287
Water usage tax	2 289	2 369	2 653
Pollution taxes*	9 274	4 497	564
Social security tax	2 815	2 708	2 929
Other	416	276	150
<b>Total</b>	<b>20 534</b>	<b>15 827</b>	<b>18 471</b>

\* Within pollution taxes is an accrual for 7.5 mln kroons. This accrual is to cover the full value of the taxes that the Company has been exempted from up to 31 December 2004 relating to tax on Nitrogen waived by the Ministry of the Environment in return for the upgrade of the Waste Water Treatment Works the Company has undertaken. At this moment in time the Company is unable to predict with any degree of certainty the results of measurements to be taken at the end of the first quarter 2006 that will determine if these taxes have to be re-paid, therefore a liability has been recorded.

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# AS TALLINNA VESI

## NOTES TO THE ANNUAL ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

### NOTE 15. PROVISIONS

Provisions include expected losses from the following:

	2004	2003	2002
Contractual obligations	912	8 028	0
Ongoing Court Cases	0	5 640	1 708
<b>Total provisions</b>	<b>912</b>	<b>13 668</b>	<b>1 708</b>

### NOTE 16. DEFERRED INCOME

	2004	2003	2002
Water and sewerage services revenues	4 027	2 852	269
Connection revenues	14 555	33 643	25 851
<b>Total deferred income</b>	<b>18 582</b>	<b>36 495</b>	<b>26 120</b>

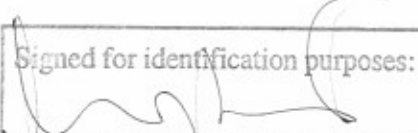
### NOTE 17. SHARE CAPITAL AND STATUTORY LEGAL RESERVE

At 31 December 2004 the nominal value of the share capital is 200 001 000 (two hundred million one thousand) kroons, composed of 20 000 000 shares with nominal value of 10 kroons per share (A-share) and one preferred share (B-share) with a nominal value of 1 000 kroons.

One B-share has been issued giving the right of veto to the shareholder when voting on the following issues: change in statute, increase and decrease of share capital, issuance of replacement bonds, termination of company activities, joining, sharing and rearrangements, acquisition of own shares, and on demand of management or supervisory board, deciding other issues related to the activities of the Company that have not been placed in the sole competence of the General meeting by law. B-share grants the holder the preferential right to receive dividend in an agreed sum of 10 thousand kroons.

At 31 December of year ends 2002, 2003 and 2004 International Water UU (Tallinn) B.V. owned 10 086 957 AS Tallinna Vesi A-shares and Tallinn City 9 913 043 A-shares and 1 B-share.

The shareholders reduced the statutory legal reserve from 93 394 thousand kroons to 20 000 thousand kroons on 3 February 2005. The share capital was reduced in 2002, but the statutory legal reserve, which has to be 10% of the share capital, was not revised at this time.

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AS TALLINNA VESI

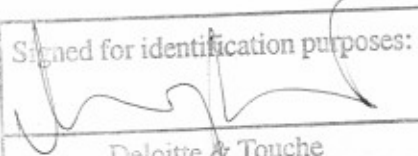
NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

NOTE 18. NET SALES

	2004	2003	2002
<b>Sales from main operating activities</b>			
Water supply service	220 688	200 889	201 245
Waste water disposal service	204 494	180 739	178 026
Stormwater treatment and disposal service	44 731	44 311	42 682
Fire hydrants service	1 959	1 941	1 869
Other work and services	6 942	6 914	9 125
<b>Total sales from main operating activities</b>	<b>478 814</b>	<b>434 794</b>	<b>432 947</b>
<b>Revenues from other operating activities</b>			
Water, sewerage and storm water connections construction income	69 715	69 223	79 577
<b>TOTAL NET SALES</b>	<b>548 529</b>	<b>504 017</b>	<b>512 524</b>

100 % of AS Tallinna Vesi revenue was transacted within the Estonian Republic.

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**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004**

(thousand EEK)

**NOTE 19. COSTS AND EXPENSES****Cost of goods sold main operating activities**

	2004	2003	2002
Tax on special use of water	-9 272	-9 929	-10 124
Chemicals	-9 387	-10 113	-12 173
Electricity	-26 151	-26 484	-26 094
Pollution tax	-8 380	-7 557	-2 516
Staff costs	-44 643	-44 657	-55 350
Research & development	-85	-211	-70
Depreciation and amortization	-73 104	-69 642	-66 540
Other costs of goods sold	-24 464	-24 564	-29 352

<b>Total cost of goods sold main operating activities</b>	<b>-195 486</b>	<b>-193 157</b>	<b>-202 219</b>
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**Cost of goods sold other operating activities**

	2004	2003	2002
Water, sewerage and storm water connections construction cost	-64 410	-61 608	-69 963

**Marketing Expenses**

	2004	2003	2002
Staff costs	-4 240	-4 280	-4 540
Depreciation and amortization	-113	-114	-71
Other marketing expenses	-1 781	-1 948	-1 991

<b>Total cost of marketing expenses</b>	<b>-6 134</b>	<b>-6 342</b>	<b>-6 602</b>
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**General Administration Expenses**

	2004	2003	2002
Staff costs	-15 813	-16 913	-17 744
Depreciation and amortization	-4 520	-3 702	-2 774
Other general administration expenses	-20 406	-35 825	-21 625

<b>Total cost of general administration expenses</b>	<b>-40 739</b>	<b>-56 440</b>	<b>-42 143</b>
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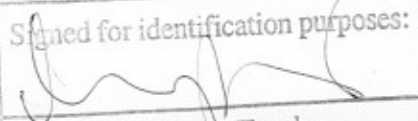
**Other income/expenses** includes the profits recognised on the sale of fixed assets during the year, the movement of the bad debt provision during the year and provisions recognised and released throughout the financial year.

**NOTE 20. STAFF INFORMATION**

	2004	2003	2002
Salaries and wages	-48 461	-49 326	-58 153
Social security taxation	-16 235	-16 524	-19 481

<b>Staff costs total</b>	<b>-64 696</b>	<b>-65 850</b>	<b>-77 634</b>
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<b>No of employees at end of reporting period</b>	<b>351</b>	<b>348</b>	<b>370</b>
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AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

NOTE 21. FINANCIAL INCOME AND EXPENSES

	2004	2003	2002
Financial income/expenses (-) from associated company	133	-661	667
Interest income	2 780	4 326	8 889
Interest expense	-54 757	-55 595	-13 241
Other financial income / expenses (-)	-3 637	2 224	-1 421
Foreign exchange loss	-199	-307	-238
<b>Total financial income / expenses</b>	<b>-55 680</b>	<b>-50 013</b>	<b>-5 344</b>

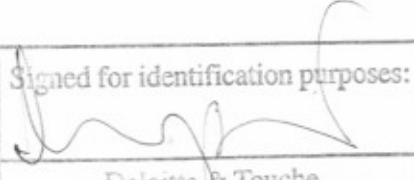
NOTE 22. DIVIDENDS

	2004	2003	2002
Dividend distributed and paid during the year	75 000	45 000	131 828
Income tax on dividends distributed and paid (26/74)	-26 351	-15 811	-23 359
The income tax paid on dividends received	74	530	0
<b>The income tax accounted</b>	<b>-26 277</b>	<b>-15 281</b>	<b>-23 359</b>

The income tax accounting principles are explained in Note 26.

NOTE 23. EARNINGS PER SHARE

	2004	2003	2002
Earnings per share from continuing operations:			
Earnings for the purposes of basic earnings per share (net profit for the year minus B-share preference rights)	172 951	104 531	146 183
Weighted average number of ordinary shares for the purposes of basic earnings per share	20 000 000	20 000 000	83 333 333
Earnings per share in kroons	8,65	5,23	1,75

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NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

NOTE 24. NOTES TO THE CASH FLOW STATEMENT

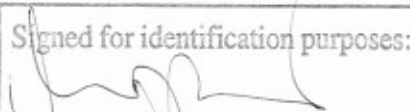
NOTE 24A. PIPELINES FINANCED BY CONNECTION FEES

	2004	2003	2002
<b>Revenue</b>			
Connection fees from pipelines taken into use	69 715	69 223	79 273
Increase in prepayments for pipelines	-19 088	7 792	790
Decrease in accounts receivable from pipelines	8 744	34 268	-28 104
Offset with liabilities	0	-2 111	-518
<b>Connection fees received</b>	<b>59 371</b>	<b>109 172</b>	<b>51 441</b>
<b>Expenses</b>			
Acquisition cost of pipelines taken into use	-64 410	-61 607	-69 963
Decrease in pipelines not in use	13 502	6 078	27 129
Increase in payables to suppliers for pipelines	-9 842	4 961	-21 546
<b>Payment for pipelines</b>	<b>-60 750</b>	<b>-50 568</b>	<b>-64 380</b>

NOTE 24B. CHANGE IN CURRENT ASSETS AND LIABILITIES

Addition to changes in balance sheet, current assets and liabilities are changed as follows:

	2004	2003	2002
<b>Current assets</b>			
Change in balance sheet	-8 438	142 432	108 473
<u>Adjustments:</u>			
Change in money and equivalents	16 847	-104 058	-139 877
Changes between fixed assets and current assets	-423	11 998	5 094
Assets sold from inventory	-2 250	-2 053	0
Change in securities, deferred interests and loans	119	151	-2 927
Change in construction income debt	-8 743	-34 267	28 105
Cash to long-term deposit	-46 090	-31 448	0
<b>Total change in current assets</b>	<b>-48 978</b>	<b>-17 245</b>	<b>-1 132</b>
<b>Liabilities</b>			
Change in balance sheet	20 040	-132 213	51 231
<u>Adjustments:</u>			
Change in finance lease and loan costs	-67 163	166 712	32 300
Liability due to share capital reduction	0	0	-112 083
Change in debt for connection constructions	9 842	-4 961	21 546
Change in payables for capital investments	7 148	-115	5 673
Change in construction income prepayments	19 088	-7 792	-790
Change in deposit	0	100	0
Offset related to operating expenditures	0	0	518
<b>Total change in liabilities</b>	<b>-11 045</b>	<b>21 731</b>	<b>-1 605</b>

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NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

NOTE 24. NOTES TO THE CASH FLOW STATEMENT (continued)

NOTE 24C. PAYMENTS FOR FIXED ASSETS

	2004	2003	2002
Acquisition of fixed assets	-158 379	-173 568	-182 614
<u>Adjustments:</u>			
Acquisition cost of connection pipelines taken into use	64 410	61 607	69 963
Decrease in connection pipelines not taken into use	-13 502	-6 078	-27 129
Additional finance lease	0	525	4 221
Additional factoring	282	0	467
Payment for factoring	-1 255	-4 353	-5 286
Payments for facilities	-10 000	-13 091	-13 113
Increase in other accounts payable related to investments	3 824	6 305	-4 954
Interest capitalization	2 689	3 815	8 750
Capitalization of operating expenses	38 974	60 144	37 615
Offsetting of payments for investments	0	2 111	0
<b>Total payments for fixed assets</b>	<b>-72 957</b>	<b>-62 583</b>	<b>-112 080</b>

NOTE 25. COMMITMENTS


Leased assets

	2004	2003	2002
Total operating lease expense for computers and vehicles	4 077	5 532	6 075

Minimum operating lease payments are as follows:

Less than 1 year	4 230
1-5 years	7 091
<b>Total minimum lease payments</b>	<b>11 321</b>

As of 31.12.2004 the Company had taken commitments for capital investments, i.e. concluded contracts and requested works with purchase requisitions in the amount of 49 610 thousand kroons.

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**NOTE 26. INCOME TAX ON DIVIDENDS**

According to the Estonian Income Tax Act the accrued profit of a resident legal entity is not subject to tax, as tax is charged only on dividend distributions. Pursuant to the Income Tax Act Section 50, effective since 1 January 2003, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The tax rate applicable is 24/76 on the amount of the dividends paid in 2005; in 2002, 2003 and 2004 the rate was 26/74. In 2002 the dividends paid to resident corporate bodies were not taxable.

The potential tax liability that may occur if all distributable retained earnings should be paid out as dividends is not reported on the Balance Sheet. The income tax due on dividend distribution is recorded as a tax cost within the Income Statement during the same period as the dividend is paid.

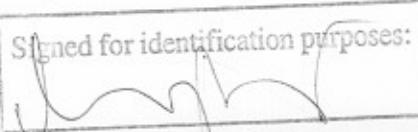
The Company's distributable retained earnings as at 31 December 2004 amounted to 318 695 thousand kroons. Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 100 641 thousand kroons.

Tax due on dividend distribution is reduced by up to 26/74 of the total dividends received from subsidiaries and associated companies.

**NOTE 27. COLLATERAL OF LOANS AND PLEDGED ASSETS**

In connection with the loan agreement concluded between the European Bank for Reconstruction and Development (hereafter EBRD) and AS Tallinna Vesi on 8 November 2002, the following guarantee contracts were concluded, which concern the assets of the Company and/or the assets of shareholders of the Company:

- a) Account Pledge Agreement, which was concluded between EBRD, the Company and AS Hansapank on 11 November 2002. All the open accounts and accounts to be opened in Hansapank have been pledged as security in favour of EBRD within the contract;
- b) Account Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002. All the open accounts and accounts to be opened in Nordea Bank have been pledged as security in favour of EBRD within the contract;
- c) Commercial Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002 in favour of EBRD in the amount of 1 877 592 thousand kroons;
- d) Buildings Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002. All buildings and facilities at address Järvevana tee 3, which are in possession of the Company, have been pledged in favour of EBRD within the contract in net balance value 165 618 thousand kroons;
- e) Insurance Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002. According to the contract, EBRD has been established as the beneficiary in the Company's asset contracts, business interruption contracts, and liability insurance contracts.

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NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

(thousand EEK)

## NOTE 28. RELATED PARTIES

Transactions with related parties are considered to be transactions with parent, subsidiary and associated companies, members of the Supervisory Board and Management Board, their relatives and the companies in which they hold majority interest. Dividend payments are indicated in Statements of Changes in Equity.

Those companies that were related to the Company as of 31.12.2004 had recorded transactions in 2002, 2003 and 2004 and balances as of 31.12.2002, 31.12.2003 and 31.12.2004 as follows:

	Tallinn City Government and related boards	United Utilities (Tallinn) B.V.* and United Utilities International Ltd**
<b>2002</b>		
<b>Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet</b>		
Accounts receivable - customer and other receivables	38 005	0
Payables to shareholders for shares	71 737	40 346
Accounts payable - short term trade and other payables	10 000	2 337
Accounts payable - long term trade and other payables	10 000	0
<b>Transactions recorded to AS Tallinna Vesi Income Statement</b>		
Net sales	104 976	0
General administration cost	0	3 557
Financial cost	0	1 297
<b>Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet</b>		
Tangible non-current assets incl unfinished constructions and new connections	0	12 189
Deferred income - connection revenue	3 285	0
<b>2003</b>		
<b>Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet</b>		
Accounts receivable - customer and other receivables	4 348	23
Accounts payable - short term trade and other payables	10 000	5 734
<b>Transactions recorded to AS Tallinna Vesi Income Statement</b>		
Net sales	97 370	0
General administration cost	0	19 462
<b>Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet</b>		
Tangible non-current assets incl unfinished constructions and new connections	0	34 831
Other deferred income	727	0
<b>2004</b>		
<b>Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet</b>		
Accounts receivable - customer and other receivables	1 551	0
Accounts payable - short term trade and other payables	0	1 523
<b>Transactions recorded to AS Tallinna Vesi Income Statement</b>		
Net sales	99 216	40
General administration cost	0	7 663
<b>Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet</b>		
Tangible non-current assets incl unfinished constructions and new connections	0	14 306

The agreed market prices were implemented in transactions with related parties.

\*International Water UU (Tallinn) B.V. was transformed to United Utilities (Tallinn) B.V. on 5 January 2004.

\*\*United Utilities (Tallinn) B.V. holds 50.4% of the Company. The ultimate controlling parties of United Utilities (Tallinn) B.V. are EBRD and United Utilities Plc. United Utilities International Ltd is owned by United Utilities Plc.

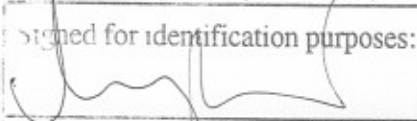
The fees paid to management board members excluding social tax

2004	2003	2002
2 059	2 470	507

The fees paid to supervisory board members excluding social tax

18	41	39
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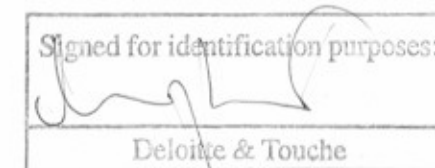


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Chairman of the Management Board:

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004



(thousand EEK)

NOTE 29. CONSOLIDATION AND RECLASSIFICATION

In 2003 and 2002 accounts the following rows of the Balance Sheet were changed as result of consolidation of the 100% owned subsidiary, AS Vesimer's results, and the reclassifications made, follow the format of IFRS reports.

Line of balance	2003				2002			
	Opening balance	Consolidation adjustment	Reclassification adjustment	Revised Balance	Opening balance	Consolidation adjustment	Reclassification adjustment	Revised Balance
Cash at bank and in hand	82 358	1 795	0	84 153	185 305	2 906	0	188 211
Customer receivables	53 837	0	0	53 837	86 474	227	0	86 701
Other receivables	2 251	300	0	2 551	4 083	-3 751	0	332
Accrued income and prepaid expenses	21 563	12	-17 404	4 171	21 823	8	-18 782	3 049
Inventories	1 264	0	4 280	5 544	7 272	1 312	3 041	11 625
Assets for sale	0	2 789	0	2 789	4 689	870	0	5 559
Shares of subsidiaries and associated companies	12 295	-6 169	0	6 126	13 501	-4 996	0	8 505
Other long-term investment assets	1 201	1 375	0	2 576	1 202	3 117	0	4 319
Tangible assets	1 789 419	0	-4 280	1 785 139	1 780 924	436	-3 041	1 778 319
Current portion of long-term bank loans	19 001	0	-1 524	17 477	76 004	0	-1 518	74 486
Trade and other payables	78 385	74	0	78 459	172 933	46	0	172 979
Taxes payable	15 799	28	0	15 827	18 388	83	0	18 471
Bank loans	1 110 864	0	-15 880	1 094 984	1 129 865	0	-17 264	1 112 601

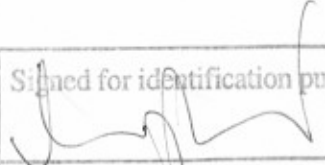
In 2003 and 2002 accounts the following rows of Income Statement were changed as result of consolidation of AS Vesimer results to AS Tallinna Vesi accounts and due to reclassification of currency exchange losses between lines of Income Statement.

Line of income statement	2003				2002			
	Opening results	Consolidation Adjustment	Reclassification adjustment	Revised results	Opening results	Consolidation Adjustment	Reclassification adjustment	Revised results
Net sales	502 972	1 045	0	504 017	509 913	2 611	0	512 524
Cost of goods sold	-254 966	201	0	-254 765	-272 182	0	0	-272 182
General administration expenses	-54 789	-1 651	0	-56 440	-39 710	-2 433	0	-42 143
Other income/ expenses (-)	-18 537	1 839	63	-16 635	-16 799	-5	0	-16 804
Financial income / expenses (-)	-48 590	-1 360	-63	-50 013	-5 069	-172	0	-5 241
Income tax on dividends	-15 207	-74	0	-15 281	-23 359	0	0	-23 359

Chairman of the Management Board:

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004

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(thousand EEK)

NOTE 29. CONSOLIDATION AND RECLASSIFICATION (continued)

In 2003 and 2002 accounts the following rows of Cash Flow Statement were changed as result of consolidation of Vesimer Investeeringute AS to AS Tallinna Vesi accounts.

	2003			2002		
	Opening balance	Consolidation adjustment	Revised balance	Opening balance	Consolidation adjustment	Revised balance
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>						
Profit before taxes	119 748	74	119 822	169 552	0	169 552
Adjustment for depreciation	73 393	65	73 458	69 316	69	69 385
Adjustment for shares and finance income and expenses	36 887	1 378	38 265	3 458	226	3 684
Profit from sale of privatization vouchers (EVP)	-5 039	-27	-5 066	0	7	7
Income from sale of fixed assets	228	-1 823	-1 595	-21	0	-21
Change in current assets involved in operating activities	-13 026	-4 219	-17 245	-2 911	1 779	-1 132
Change in liabilities involved in operating activities	21 756	-25	21 731	-1 989	384	-1 605
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>						
Sale of EVP	18 703	227	18 930	0	0	0
Acquisition of fixed assets	-62 583	0	-62 583	-112 044	-36	-112 080
Repayments of loans to third parties	6	19	25	19	33	52
Proceeds from sale of inventories/goods for sale	6 000	3 500	9 500	0	0	0
Received dividends	1 928	-211	1 717	0	0	0
Interest received	4 165	5	4 170	11 798	6	11 804
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>						
Income tax on dividends	-15 207	-74	-15 281	-23 359	0	-23 359
<b>Change in cash and bank accounts</b>	<b>-102 947</b>	<b>-1 111</b>	<b>-104 058</b>	<b>-142 345</b>	<b>2 468</b>	<b>-139 877</b>
<b>CASH AND EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>	<b>185 305</b>	<b>2 906</b>	<b>188 211</b>	<b>327 649</b>	<b>439</b>	<b>328 088</b>
<b>CASH AND EQUIVALENTS AT THE END OF THE YEAR</b>	<b>82 358</b>	<b>1 795</b>	<b>84 153</b>	<b>185 304</b>	<b>2 907</b>	<b>188 211</b>

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2004**

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**NOTE 30. FINANCIAL RISK MANAGEMENT**

The Company operates only in Estonia and the number of international transactions is limited to specific purchases and loan transactions. The Company still seeks to minimise potential adverse effects on the financial performance of the Company. A Treasury Department under instructions given by the Management Board carries out risk management.

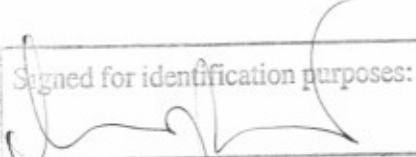
The Company's international transactions are mainly in euros, which rate is fixed against Estonian kroons, all transactions in other currencies may be considered immaterial. Therefore the likelihood of being exposed to foreign risk arising from currency exposures is low and as such no specific activities for foreign exchange management are needed at this moment in time.

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The Company has no significant interest-bearing assets. The Company has one loan split into three parts. The first, and largest, part is at a fixed interest rate. The second part is calculated by reference to the Euribor 6 Months rate, with an upper and lower cap to limit exposure. The balance of the loan, which is immaterial, is at market rates.

The Company has no significant concentrations of credit risk. The Company has procedures in place to ensure that sales of products and services and purchases are only made in accordance with the Company's policies.

In management of liquidity risk the Company has taken a prudent view, maintaining sufficient cash and marketable securities funding availability through an adequate amount of committed credit facilities. Continuous cash flow forecasting and control are essential tools in the day-to-day liquidity risk management of the Company.

The Company is insured against sudden and unexpected physical loss, damage or destruction; business interruption and extra expenses; third party claims against the Company including sudden and unexpected environment pollution damages; Company crime risks; liability of D&O (management board, supervisory board and members of senior management); accident insurance of personnel; motor vehicle insurance against accident, theft, vandalism etc.

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## AS TALLINNA VESI

### PROFIT DISTRIBUTION PROPOSAL

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The distributable equity capital of AS Tallinna Vesi as of 31 December 2004 is as follows\*:

Accumulated profit	145 734 thousand kroons
Net profit for the financial year	172 961 thousand kroons
<b>Total</b>	<b>318 695 thousand kroons</b>

\*As of 10 February 2005 the accumulated profit is 73 394 thousand kroons higher due to the transfer of excess reserve from the Statutory legal reserve to the Accumulated profit (see note 17).

The Management Board of AS Tallinna Vesi proposes to distribute 112 000 thousand kroons to shareholders as dividends from the available equity capital accumulated by end of the year 2004.

10 February 2005

Robert John Gallienne  
Chairman of the Management Board

Chairman of the Management Board:

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of AS Tallinna Vesi:

We have audited the annual accounts of AS Tallinna Vesi ("the Company") for the years ended 31 December 2004, 2003 and 2002. These annual accounts are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on these annual accounts based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the annual accounts. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall presentation of the annual accounts. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the annual accounts present fairly, in all material respects, the financial position of the Company as of 31 December 2004, 2003 and 2002, the results of its operations and its cash flows for the years then ended, in accordance with Estonian Accounting Law and International Financial Reporting Standards.



Sander Kallasmaa  
Certified Auditor  
11 February 2005



AS Deloitte & Touche Audit

**CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS TO  
THE ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2003**

The Management Board has prepared the address by the Chairman of the Management Board and the annual accounts on 10 February 2005.

The Supervisory Board of AS Tallinna Vesi has reviewed the annual report, prepared by the Management Board, consisting of the Address by the Chairman of the Management Board and the annual accounts, the Management Board's proposal for profit distribution and the independent auditors' report, and has approved the annual report for presentation on the Shareholders' General Meeting.

The annual report has been signed by all the members of the Management Board and Supervisory Board.

Name	Position	Signature	Date
Robert John Gallienne	Chairman of the Management Board		<u>10.02.05</u>
Roch Jean Guy Antoine Chèroux	Member of the Management Board		<u>10.02.05</u>
Ian John Alexander Plenderleith	Member of the Management Board		<u>10.02.05</u>
Michael James Southworth	Head of the Supervisory Board		<u>22.03.2005</u>
Karl Olof Joakim Forsberg	Member of the Supervisory Board		<u>22.03.2005</u>
David John Kilgour	Member of the Supervisory Board		<u>22.03.2005</u>
Laurence Kenneth Billett	Member of the Supervisory Board		<u>12-4-05</u>
Igor Gräzin	Member of the Supervisory Board		<u>19.04.05</u>
Siim Roode	Member of the Supervisory Board		<u>27.02.05</u>
Svetlana Baltina	Member of the Supervisory Board		<u>22.03.05</u>

Chairman of the Management Board: