

# ***AS TALLINNA VESI***

*Annual report*  
*Financial year ended*  
*31. December 2005*

# AS TALLINNA VESI

## ANNUAL REPORT

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Beginning of financial year	1 January 2005
End of financial year	31 December 2005
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
Auditors	AS Deloitte Audit Eesti
Documents attached to the Annual Accounts	Proposal for the profit distribution Independent auditor's report

  
Chairman of the Management Board:

AS TALLINNA VESI

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Chairman of the Management Board:

**MANAGEMENT REPORT**

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2005 has been an outstanding year for the Company and all its stakeholders. Significant steps have been taken on all fronts and major improvements delivered across all spheres of our activity.

Successful listing in Tallinn Stock Exchange

In February 2005 the decision was taken by our shareholders to list the Company on the Tallinn Stock Exchange and to sell down 30% of their shareholding creating a free float of 6 million shares. This was the first new listing on the Tallinn Stock Exchange for 6 years and we were committed to carrying it out in the most professional manner and to ensure its success. The Company, with its key advisers, prepared a prospectus of the highest quality and met our target timetable to the day. Significant interest was shown by both institutional and retail investors and the offering was 6 times oversubscribed.

The IPO share price was finalized at 9.25 euros and trading in our shares on the TSE commenced on 1<sup>st</sup> June 2005. The shares have consistently been one of the most traded shares on the TSE and indeed the Baltic Exchange. By the end of the year the share price had risen to 13.50 euro an increase of 46% placing an equity value on the Company of 270 million euro or 4.2 billion kroons. The IPO was a true success both for the Company and its shareholders, but also for the Tallinn Stock Exchange, this is an achievement of which all those involved should be very proud.

Outperformance of Services Agreement

During 2005 the Company continued to outperform the service levels set within its contract with the City. Drinking water quality reached its highest level yet with 99.9% microbiological compliance and 99.7% chemical compliance. These levels demonstrate that we are already delivering the standards required from 1<sup>st</sup> January 2007 twelve months ahead of schedule. We are continuing to reduce leakage levels and we are now at a level of leakage below 18.0%, this is 50% lower than five years ago and over 8% below our contractual target. In 2005 a new and challenging level of service was introduced where no unplanned interruptions to supply should last more than 12 hours. Once again by additional investment and using all the skills and expertise available we have been able in 2005 to reduce the number of occurrences by 90% to just 3, and we will continue to look for ways to eliminate those failures completely.

Improved Environment

Our focus on the environment is unwavering and in 2005 we have continued to invest heavily in schemes and methods of operation which protect the world we live in. The first phase of the composting fields at Paljassaare has been completed and 100% of sewage sludge is being converted into fertiliser and recycled. In addition the construction of the upgrade of the nitrogen removal process at Paljassaare WWTP was completed during the year. The commissioning process is ongoing and will not be completed until the middle of 2006. At present we are on target to deliver the 25% reduction in nitrogen discharged into Tallinn Bay. Compliance with these higher waste water quality requirements will also help to protect the Baltic Sea in line with the HELCOM recommendations.

First EMAS Awarded Company

The Company is extremely proud to have been recognized by the Ministry of Environment as the first in Estonia and in the Baltics to be considered capable of achieving the EU Eco Management and Audit Scheme (EMAS) certification. Following close co-operation within the project managed by the Ministry and the Dutch Ministry of Economics and a very testing external audit I am delighted that the Company received full EMAS certificate on 14th October 2005. This recognition is a clear sign of our understanding and management of our environmental responsibilities. In addition we were also successful in June 2005, the renewal of our ISO 14001 based Environmental Management System certificate.



Chairman of the Management Board:

**MANAGEMENT REPORT**

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Excellent Financial Performance

The financial results for 2005 have once again shown solid improvement. Our managers and their staff are continuously looking to reduce our cost of delivery and also identifying opportunities for growth in our service. As a result the Profit Before Tax (PBT) earned in 2005, was 13.4 million euros, an increase of 5% compared with 2004, and this is after absorbing the one off costs incurred during the year.

Following the successful listing of the Company on the Tallinn Stock Exchange the decision was taken to review the long term loan structure of the Company. As a result of this approximately 50% of the EBRD loan facility was prepaid and the terms and conditions of the remaining 37.5 million euro loan renegotiated and significantly improved. In addition the prepaid proportion of the EBRD loan was replaced with a 37.5 million euro loan from Nordea Bank, again with much improved terms and conditions. The Company has now put in place a loan financing structure, which has reduced our interest costs going forward by approximately 25% per annum and also provides enhanced terms and conditions and greater flexibility in the use of our cash reserves. This provides a strong platform for the future.

Launch of Key IT Projects Supporting the Business

During 2005 the Company completed the implementation of two major IT system implementations which will deliver improved cost efficiency and customer service in 2006 and beyond. The Maximo asset management and work planning system which went live in early 2005 will enable us to analyse and understand the maintenance costs of our assets and plan the work more effectively. In the latter part of 2005 our new Customer Information and Billing System went live, initially running in parallel with the existing system, and following successful testing the old system was switched off in November. This project was a highly complex project and a huge effort was put in to deliver it on time and to budget. Due to the implementation of this system we will be able to provide a wide range of payment options, including direct debits, and also provide a full web-based access for all our customers.

Employees – Our Key Asset

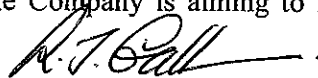
The people who work for us are our most important asset and once again in 2005 they have all responded magnificently to the challenges they have been presented with. I thank them wholeheartedly personally and on behalf of the Management Board as a whole. We have once again carried out an independent staff opinion survey to which over 50% of our staff responded. I am very pleased to be able to report that staff satisfaction increased again in 2005 to the highest level ever. The level of response and the degree of satisfaction indicates that we are on the right track, but we will continue to strive for further improvement and we have already developed the necessary action plans to address the issues which were raised by the staff in the survey.

Our Health and Safety performance continues to be at the highest level. During 2005 there were only 2 work accidents, the same as in 2004, but the number of lost work hours and the severity of the accidents has significantly decreased. Our close co-operation with our contractors has also shown benefits and there were no accidents with contractors' employees on AS Tallinna Vesi sites during 2005.

Extensive Investments

2005 has been a major year for investments in our assets with over 14 million euro of work being carried out, an increase of 41% over 2004. The major investments were in the network forreplacement and rehabilitation, of 3.4 million; network extensions 4.7 million; the nitrogen upgrade and extension of the compost fields at Paljassaare Wastewater treatment Plant 1.9 million euro; the ongoing improvement of the raw water facilities and biomanipulation project at Ülemiste Water Treatment Plant 767 thousand euros; the delivery of the new work management and customer service IT systems 831 thousand euros, and the costs of privatising land at Ülemiste and Paljassaare 1.3 million euros.

During 2005 major changes and developments have occurred. These have set a firm foundation for future progress in 2006 and looking forward once again the Company is aiming to further improve

  
Chairman of the Management Board:

**MANAGEMENT REPORT**

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across a wide range of activities. Our 2006 capital investment programme will be larger at just under 16 million euros. Once again the key areas of focus will be on network extension and rehabilitation, with particular emphasis on drinking water quality, with forecast investments of around 9.6 million euros. A further 959 thousand euros will be spent at Ülemiste, again concentrating on raw water quality. At Paljassaare WWTP over 3.2 million euros will be invested on improving our sludge handling process and a further extension to the compost fields. These investments clearly indicate our ongoing commitment to meeting and exceeding our levels of service.

Focus on Customers

We will launch in 2006 a Guaranteed Standards Scheme for our customers, which we believe is the first of its kind and scope in the Baltics. Through this scheme the Company will declare over 20 levels of service and if we fail to meet the levels of service a monetary compensation will be paid to the customer. By operating a scheme of this kind the Company is demonstrating very powerfully, its commitment to the customer and its belief that we can deliver the service that is required. This scheme will also be supported by the improved customer service capability of the new customer information and billing system implemented in late 2005, the full year benefits of which will be received by all our customers in 2006.

Strengthening of the Governance of the Company

During 2005 there have been a number of changes in the membership of our Supervisory Council and I would like to thank all those Council members for their support during a very challenging year. As a result of the Company's listing on the Tallinn Stock Exchange we have two additional independent directors, Helo Meigas and Valdur Laid, I very much welcome both of them to the Council and look forward to working with them in the future.

The recruitment of the two new independent Supervisory Council members will only serve to strengthen still further the Corporate Governance of the Company. This is something we have continued to improve throughout 2005 by working closely with the Financial Supervision Authority on the clarity and quality of our reporting. In September 2005 the Tallinn Stock Exchange issued an expanded set of Corporate Governance recommendations. These come into effect from the financial reporting period 1 January 2006 for Tallinna Vesi, it is our intention to comply with these recommendations as required. For this reporting period all information required to be reported by the Tallinn Stock Exchange or by Estonian Accounting law not contained within this text is included in the annual accounts and notes.

Clearly we have come a long way in the year and none of this could have been achieved without all the support and total commitment of our staff who have once again been outstanding. The support and guidance we receive from our parties the City of Tallinn and the Ministry of Environment has been invaluable. During 2005 we achieved outstanding success in our quality of product, service and financial targets and I believe can now be very proud of being a world class water company.



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 2005**

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The Management Board of AS Tallinna Vesi (hereinafter the Company) hereby declares its responsibility for the preparation of the annual accounts for the financial year ended 31 December 2005.

The annual accounts have been prepared according to International Financial Reporting Standards as adopted by the EU, 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 2005, 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 2005. 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 2006 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>10/2/2006</u>
Roch Jean Guy Antoine Cheroux	Member of the Management Board		<u>10/2/2006</u>
Ian John Alexander Plenderleith	Member of the Management Board	<u>I.J.A. Plenderleith</u>	<u>10/2/2006</u>

  
Chairman of the Management Board:

## AS TALLINNA VESI

BALANCE SHEET  
AT 31 DECEMBER 2005 AND 2004

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(thousand EUR)

ASSETS	Note	2005	2004
<b>CURRENT ASSETS</b>			
Cash at bank and in hand	2	13 234	6 455
Customer receivables	3	4 265	3 301
Accrued income and prepaid expenses	4	338	253
Inventories	5	202	209
Assets for sale	6	89	104
<b>TOTAL CURRENT ASSETS</b>		<b>18 128</b>	<b>10 321</b>
<b>NON-CURRENT ASSETS</b>			
Long-term investment assets	7	0	5 041
Tangible assets	8	117 503	113 756
Intangible assets	8	2 811	1 180
Unfinished assets - non connections	8	6 058	6 560
Unfinished pipelines - new connections	8	6 979	5 092
Prepayments for fixed assets	8	222	233
<b>TOTAL NON-CURRENT ASSETS</b>		<b>133 573</b>	<b>131 861</b>
<b>TOTAL ASSETS</b>		<b>151 701</b>	<b>142 182</b>
<b>LIABILITIES</b>			
<b>CURRENT LIABILITIES</b>			
Current portion of long-term borrowings	9	86	5 679
Trade and other payables, incl. dividends	10	3 420	3 560
Taxes payable	11	1 452	1 312
Short-term provisions	12	18	58
Deferred income	13	4 382	1 188
<b>TOTAL CURRENT LIABILITIES</b>		<b>9 359</b>	<b>11 798</b>
<b>NON-CURRENT LIABILITIES</b>			
Finance lease	9	27	108
Bank loans	9	74 471	66 416
Other payables	10	6	6
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>74 504</b>	<b>66 531</b>
<b>TOTAL LIABILITIES</b>		<b>83 863</b>	<b>78 329</b>
<b>EQUITY CAPITAL</b>			
Share capital	14	12 782	12 782
Share premium		24 734	24 734
Statutory legal reserve	14	1 278	5 969
Accumulated profit		17 901	9 314
Net profit for the period		11 143	11 054
<b>TOTAL EQUITY CAPITAL</b>		<b>67 839</b>	<b>63 853</b>
<b>TOTAL LIABILITIES AND EQUITY CAPITAL</b>		<b>151 701</b>	<b>142 182</b>



## AS TALLINNA VESI

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**INCOME STATEMENT  
FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004**

(thousand EUR)

	Note	2005	2004
Sales from main operating activities	15	35 146	30 602
Revenues from other operating activities	15	2 691	4 456
<b>Net sales</b>		<b>37 838</b>	<b>35 057</b>
Costs of goods sold (main operating activities)	16,17	-12 914	-12 607
Costs of goods sold (other operating activities)	17	-2 450	-4 117
<b>GROSS PROFIT</b>		<b>22 474</b>	<b>18 334</b>
Marketing expenses	16,17	-433	-392
General administration expenses	16,17	-4 107	-2 604
Other income/ expenses (-)	17	125	954
<b>OPERATING PROFIT</b>		<b>18 059</b>	<b>16 292</b>
Financial income / expenses (-)	18	-4 655	-3 559
<b>PROFIT BEFORE TAXES</b>		<b>13 404</b>	<b>12 734</b>
Income tax on dividends	19	-2 260	-1 679
<b>NET PROFIT FOR THE PERIOD</b>		<b>11 143</b>	<b>11 054</b>
Attributable to:			
Equity holders of A-shares		11 143	11 054
B-share holder		0,64	0,64
<b>Earnings per share in euros</b>	20	<b>0,56</b>	<b>0,55</b>

AS TALLINNA VESI

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CASH FLOW STATEMENT

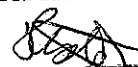
FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004

(thousand EUR)

	Note	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Operating profit		18 059	16 292
Adjustment for depreciation	17	5 032	5 081
Adjustment for income and expenses from constructions	21A	-241	-339
Other financial income and expenses		-1 279	-245
Profit from sale of fixed assets		-759	-182
Expensed fixed assets		25	121
Capitalization of operating expenses		-1 488	-2 491
Movement in current assets involved in operating activities	21B	3 691	-3 130
Movement in liabilities involved in operating activities	21B	410	-706
Interest paid		-3 825	-3 676
<b>Total cash flow from operating activities</b>		<b>19 626</b>	<b>10 726</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from sale of shares of associated company		0	400
Acquisition of fixed assets (incl pipelines construction)	21C	-12 774	-8 545
Proceeds from pipelines financed by construction income	21A	3 355	3 794
Proceeds from sale of and prepayments received for fixed assets		3 026	243
Proceeds from sale of real estate investments		748	144
Interest received		324	170
<b>Total cash flow from investing activities</b>		<b>-5 322</b>	<b>-3 794</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Received long-term loans	9	44 503	2 000
Repayment of long-term loans	9	-42 500	-1 214
Finance lease payments	9	-109	-168
Dividends paid	19	-7 158	-4 793
Income tax on dividends	19	-2 260	-1 679
<b>Total cash flow from financing activities</b>		<b>-7 525</b>	<b>-5 855</b>
<b>Change in cash and bank accounts</b>		<b>6 779</b>	<b>1 077</b>
<b>CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD</b>		<b>6 455</b>	<b>5 378</b>
<b>CASH AND EQUIVALENTS AT THE END OF THE PERIOD</b>	2	<b>13 234</b>	<b>6 455</b>

AS TALLINNA VESI

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**STATEMENT OF CHANGES IN EQUITY  
FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004**

(thousand EUR)

	Share capital	Share premium	Statutory legal reserve	Accumulated profit	Net profit	Total equity
<b>31 December 2003</b>	<b>12 782</b>	<b>24 734</b>	<b>5 969</b>	<b>7 426</b>	<b>6 681</b>	<b>57 593</b>
Transfer of financial year profit to the accumulated profit	0	0	0	6 681	-6 681	0
Dividends	0	0	0	-4 793	0	-4 793
Net profit of the financial year	0	0	0	0	11 054	11 054
<b>31 December 2004</b>	<b>12 782</b>	<b>24 734</b>	<b>5 969</b>	<b>9 314</b>	<b>11 054</b>	<b>63 853</b>
Transfer of financial year profit to the accumulated profit	0	0	0	11 054	-11 054	0
Transfer of statutory legal reserve to the accumulated profit	0	0	-4 691	4 691	0	0
Dividends	0	0	0	-7 158	0	-7 158
Net profit of the financial year	0	0	0	0	11 143	11 143
<b>31 December 2005</b>	<b>12 782</b>	<b>24 734</b>	<b>1 278</b>	<b>17 901</b>	<b>11 143</b>	<b>67 839</b>

  
Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTE 1. ACCOUNTING PRINCIPLES**

The annual accounts for the financial year 2005 (hereinafter financial statements) have been prepared according to International Financial Reporting Standards (hereinafter IFRS) as adopted by the European Union. All IFRS standards effective from 1 January 2005, and applicable to the Company have been adopted in the preparation of the statements. The IFRS 7 "Financial Instruments: Disclosures", which is not effective yet, is not adopted in the preparation of the statements and the Company considers the possible impact from the adaptation of the standard to be immaterial.

The functional currency of the Company is the Estonian kroon, the original annual accounts were prepared in Estonian kroons (EEK) rounded to the nearest thousand. In accordance with the requirements of the Tallinn Stock Exchange the accounts are also disclosed in euros, rounded to the nearest thousand, for informative purposes.

The financial statements in euros are converted using the Bank of Estonian official fixed exchange rate of 15.6466 EEK per EUR from the original accounts prepared in kroons for the same period.

The financial statements do not include the segment reporting as there are no geographical segments and no clearly distinguished business segments related to the activities of the Company.

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. Monetary 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, trade receivables, accrued income, other current and long-term receivables including the derivatives with positive value. Financial liabilities are accounts payable, accrued expenses, other current and long-term liabilities including the derivatives with negative value.

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 ownership according to the 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 accruals basis proportionally to the income statement during the loan agreement validity period. As the transaction costs have been considered immaterial compared to the loans received, no effective interest method is implemented.



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**AS TALLINNA VESI****NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005****Cash and cash equivalents**

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

**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" and a respective allowance is recorded on the Balance Sheet line "Customer receivables". 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. Receivables which cannot be collected, or the collection is considered to be economically not justified, are evaluated as uncollectible and written-off from the Balance Sheet.

For evaluation of the doubtful debts the individual debts are 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%.

**Inventories**

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

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.

**Assets for sale**

The land and buildings held for sale in the ordinary course of business are classified as assets for sale, as management has made the sale decision and will endeavour to make every effort to do so during the next financial year.

Assets for sale are measured at cost. For assets for sale the depreciation is stopped after the decision is taken to move the assets to the assets for sale group.

**Tangible and intangible fixed assets**

Assets with useful life more than one year and with a minimum value of 128 EUR 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 required 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.

  
Chairman of the Management Board:



**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005**

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 "Tangible 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.

**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 the lines "Costs of goods sold – main operating activities", "Marketing expenses" or "General administration expenses" depending on purpose of asset usage before the impairment.



Chairman of the Management Board:

### **Liabilities**

Liabilities with payment terms of 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 11 and 23.

### **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 the final cost or term of payment is not firmly fixed, and the expected loss from the liquidation of financial assets existing independently of the Company's future actions, are accounted for as provisions. Provisions for losses are recorded using the best evaluations made by the management of the Company. 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 financial statements.

### **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 the statutory legal reserve is 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 an operating lease.


Operating lease payments are recorded as an expense during the period incurred i.e. the asset is neither recorded as a fixed asset nor is it 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 at the fair value received or receivable. Sales comprises of the income received from goods and services sold after the deduction of sales discounts.

  
Chairman of the Management Board:

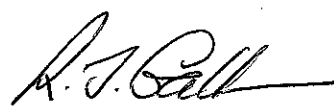
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**NOTES TO THE ANNUAL ACCOUNTS  
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Sales income from goods is recorded in the period when all material risks and benefits related to the ownership have been delivered to the purchaser, the proceeds from the sale of goods is probable and the revenue and the costs related to the goods are reliably identified. Sales income from services is recorded in the period when the service has been provided, the proceeds from the provision of the service is probable and the revenue and the costs related to the provision of the service are reliably identified.

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.

  
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## AS TALLINNA VESI

**NOTES TO THE ANNUAL ACCOUNTS  
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(thousand EUR)

**NOTE 2. CASH AND CASH EQUIVALENTS**

	2005	2004
Cash and bank accounts	2 992	5 449
Short-term deposits	10 242	1 006
<b>Total cash and cash equivalents</b>	<b>13 234</b>	<b>6 455</b>

**NOTE 3. CUSTOMER RECEIVABLES**

	2005	2004
Accounts receivable	4 738	3 795
Allowance for doubtful debts	-473	-495
<b>Total customer receivables</b>	<b>4 265</b>	<b>3 301</b>

Impairment costs of receivables:

Write off of uncollectible receivables	-69	-110
Proceeds from uncollectible receivables	14	12
Change in allowance for doubtful debts	22	273

**NOTE 4. ACCRUED INCOME AND PREPAID EXPENSES**

	2005	2004
Accrued interest	11	18
Other accrued income	1	6
Prepaid taxes	71	0
Other prepaid expenses	255	229
<b>Total accrued income and prepaid expenses</b>	<b>338</b>	<b>253</b>

**NOTE 5. 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, 14 thousand euros and 96 thousand euros as of 31 December 2005 and 2004 respectively. Any subsequent revenues received on the sale of these assets have been immaterial in value and have been offset against the value written off.



**NOTES TO THE ANNUAL ACCOUNTS  
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(thousand EUR)

**NOTE 6. ASSETS FOR SALE**

	2005	2004
Land and buildings for sale	32	44
Prepayments for the land related to the assets for sale	57	59
<b>Total assets for sale</b>	<b>89</b>	<b>104</b>

**NOTE 7. LONG-TERM INVESTMENT ASSETS**

	2005	2004
Long-term deposit	0	4 956
Investment property (acquisition value)	0	114
Accumulated depreciation of investment property (-)	0	-29
<b>Total other long-term investment assets</b>	<b>0</b>	<b>5 041</b>

Long-term investment assets included the long-term deposit and the real estate investment at address Järvevana Street 3, Tallinn in years 2004 and 2005. The obligation to hold on long-term deposit an amount of approximately 5,1 million euros was a requirement of the terms and conditions of the original European Bank for Reconstruction and Development (hereinafter EBRD) loan concluded in 2002. This obligation was removed when the company refinanced and made amendments to the loan agreement in 2005 (see note 9). The property was sold in the 1st quarter of 2005 with the sales profit of 665 thousand euros recorded in the row "Other income/expenses" of the income statement.

	2005*	2004
Rental revenue from the investment, excluding VAT	17	68
Direct operating expenses that generated rental income	6	29
The occupation rate of the property (average of the reporting year)	84%	93%

\* Data recorded for the first quarter only when the asset was sold by the company.


NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005

## NOTE 8. TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS

(thousand EUR)

	Tangible assets in use			Assets in progress			Intangible assets			Total tangible and intangible non-current assets
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Unfinished assets - non connections	Unfinished pipelines - new connections	Prepayment for fixed assets	Development costs	Acquired licenses and other intangible assets	
<b>Acquisition cost at</b>										
31.12.2003	19 416	119 111	30 178	953	4 013	5 955	547	535	1 625	182 334
Acquisition	0	0	0	0	6 663	3 459	0	0	0	10 122
Sale of fixed assets	-93	0	-141	0	0	0	0	0	0	-235
Write-off of fixed assets	-13	-184	-288	-26	0	0	0	0	0	-512
Reclassification within balance sheet	21	0	0	0	11	0	-5	0	0	27
Reclassification to expenses	0	0	0	0	-32	0	0	0	0	-32
Expensed pipelines	0	0	0	0	-4 117	0	0	0	0	-4 117
Reclassification from assets in progress	575	2 475	1 241	118	-4 096	-205	-309	1 223	1 936	0
31.12.2004	19 907	121 401	30 990	1 044	6 560	5 092	233	1 758	3 561	187 589
Acquisition	0	0	0	0	8 243	4 753	1 266	0	0	14 262
Sale of fixed assets	-5	-8	-191	0	0	0	0	0	0	-205
Write-off of fixed assets	-65	-205	-1 019	-12	0	0	0	0	-12	-1 312
Reclassification within balance sheet	0	15	0	0	0	0	0	0	0	15
Reclassification to expenses	0	0	0	0	-4	0	-11	0	0	-15
Expensed pipelines	0	0	0	0	0	-2 450	0	0	0	-2 450
Reclassification from assets in progress	2 529	3 177	2 405	191	-8 741	-416	-1 266	271	1 849	0
31.12.2005	22 365	124 380	32 185	1 223	6 058	6 979	222	2 029	5 398	197 883
<b>Accumulated depreciation</b>										
31.12.2003	3 161	35 901	15 887	618	0	0	0	392	403	56 362
Depreciation	265	1 782	2 574	70	0	0	0	58	329	5 078
Depreciation of fixed assets sold and written-off (-)	-46	-183	-417	-26	0	0	0	0	0	-672
Reclassification	0	0	0	0	0	0	0	0	0	0
31.12.2004	3 380	37 500	18 044	662	0	0	0	450	732	60 768
Depreciation	248	1 911	2 297	87	0	0	0	153	336	5 032
Depreciation of fixed assets sold and written-off (-)	-70	-213	-1 184	-12	0	0	0	0	-12	-1 491
31.12.2005	3 559	39 198	19 156	737	0	0	0	603	1 056	64 309
<b>Net book value</b>										
31.12.2003	16 255	83 210	14 291	335	4 013	5 955	547	143	1 222	125 972
31.12.2004	16 526	83 901	12 946	382	6 560	5 092	233	1 308	2 829	129 778
31.12.2005	18 807	85 182	13 029	486	6 058	6 979	222	1 427	4 341	133 573

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 274 thousand euros and 607 thousand euros in 2005 and 2004 respectively.  
Interest capitalised to fixed assets was 69 thousand euros and 172 thousand euros in 2005 and 2004 respectively.

  
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NOTES TO THE ANNUAL ACCOUNTS  
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(thousand EUR)

## NOTE 9. SHORT-TERM AND LONG-TERM DEBT OBLIGATIONS

The Company's short-term and long-term debt obligations as of 31.12.2005 and the changes during 2005 in respective debts were as follows:

	Loan date	Loan received	Residual amount 31.12.2004	Repayments during 2005	Drawdowns in 2005	Residual amount 31.12.2005	Short-term portion	Long-term portion	Interest rate %	Maturity date
Panglaenuud										
EBRD	12.2002	80 000	72 997	-42 500	7 003	37 500	0	37 500		05.2015
incl. A loan		55 000	50 186	-17 500	4 815	37 500	0	37 500	4,67	
incl. B loan		25 000	22 812	-25 000	2 188	0	0	0	0 6 kuu Euribor + 1,5	
EBRD loan costs	12.2002	-1 112	-1 015	0	0	-510	0	-510		05.2015
Nordea Bank	11.2005	37 500	0	0	37 500	37 500	0	37 500	6 kuu Euribor + 0,24	05.2015
Nordea Banga loan costs	11.2005	-19	0	0	0	-19	0	-19		05.2015
<b>Total bank loans</b>		<b>116 369</b>	<b>71 982</b>	<b>-42 500</b>	<b>44 503</b>	<b>74 471</b>	<b>0</b>	<b>74 471</b>		
Finance lease		1 017	221	109	0	112	86	27	3,56-9,28	06.2007
<b>Total debt obligations</b>		<b>117 386</b>	<b>72 204</b>	<b>-42 391</b>	<b>44 503</b>	<b>74 583</b>	<b>86</b>	<b>74 498</b>		

In November 2005 took place the restructuring of the EBRD loan - the whole amount of B loan and part of A loan were repaid and the interest rate of A loan was agreed to a more favourable rate from 5,69% to 4,67%. All short-term debts are recorded on Balance sheet line current portion of long term borrowings.

The long-term part of the finance lease and loans is respectively recorded on Balance sheet lines Finance lease and Bank loans. The underwriting of the loans are indicated in Note 24.

## Name Repayments period

EBRD	Loan repayments start in 2008. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.
Nordea Bank	Loan repayments start in 2011. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.
Finance lease	Repayments on a monthly or quarterly basis in accordance with the contracts.

The repayments are as follows by due dates:

	Less than 1 year	1-5 years	Over 5 years	Total	Repayment period from
EBRD	0	21 429	16 071	37 500	9 years
Nordea Bank	0	7 500	30 000	37 500	9 years
Finance lease	86	27	0	112	2 years
<b>Total</b>	<b>86</b>	<b>28 955</b>	<b>46 071</b>	<b>75 112</b>	

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**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005**

(thousand EUR)

**NOTE 10. TRADE AND OTHER PAYABLES**

	Balance amount 31.12.2004	Balance amount 31.12.2005	Short-term portion 31.12.2005	Long-term portion 31.12.2005	Maturity date
<b>Liabilities</b>					
Accounts payable - operating expenditures	960	1 022	1 022	0	until 31.12.2006
Accounts payable - capital expenditures	1 333	1 235	1 235	0	until 31.12.2006
Factoring	18	0	0	0	until 31.12.2006
Payables to parent company	97	155	155	0	until 31.12.2006
Payables to employees	822	741	741	0	until 31.12.2006
Interest payable	327	264	264	0	until 31.12.2006
Other accrued expenses	2	3	3	0	until 31.12.2006
Long-term guarantee deposit*	6	6	0	6	04.2102
<b>Total trade and other payables</b>	<b>3 567</b>	<b>3 426</b>	<b>3 420</b>	<b>6</b>	

\* Long-term deposit is presented in acquisition value.

**NOTE 11. TAXES PAYABLE**

	31.12.2005	31.12.2004
Income tax	97	102
VAT	293	265
Water usage tax	149	146
Pollution taxes*	720	593
Social security tax	183	180
Other	11	27
<b>Total</b>	<b>1 452</b>	<b>1 312</b>

\* Within pollution taxes is an accrual for 671 thousand euros. This accrual is recorded in order to cover the full value of the taxes that the Company has been exempted from up to 31 December 2005 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 second 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 2005**

(thousand EUR)

**NOTE 12. PROVISIONS**

Provisions include expected losses from the following:

	2005	2004
Contractual obligations	0	58
Servitudes	18	0
<b>Total provisions</b>	<b>18</b>	<b>58</b>

According to the management estimate there are no ongoing courtcases which will cause any extra cost that would need to be recorded as a provision or off-balance sheet liability. The provision recorded for servitudes is the management estimate of the expected cost of potential future payments to private land owners whose use of land has been restricted as a result of the Company's pipelines laid on their land.

**NOTE 13. DEFERRED INCOME**

	2005	2004
Operating revenues incl connection revenues	1 468	1 188
Prepayments for sale of fixed assets*	2 914	0
<b>Total deferred income</b>	<b>4 382</b>	<b>1 188</b>

\*The Company received prepayments based on pre-agreements concluded for the sale of fixed assets including the properties. The actual revenue from the sale may vary depending upon the final agreements.

**NOTE 14. SHARE CAPITAL AND STATUTORY LEGAL RESERVE**

At 31 December 2005 the nominal value of the share capital is about 12 782 394 euro (200 001 000 kroons), composed of 20 000 000 shares with nominal value about of 0,64 euro (10 kroons) per share and one preferred share with a nominal value about of 64 euro (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. The B-share grants the holder the preferential right to receive a dividend in an agreed sum about of 640 euro (10 thousand kroons).

In 2004 United Utilities (Tallinn) B.V. owned 10 086 957 (50,4%) A- shares and the City of Tallinn owned 9 913 043 A- shares (49,6%) and 1 B- share. In May 2005 an initial public offering (hereinafter IPO) took place, with the existing shareholders selling down total 6 000 000 shares in direct proportion to their original shareholding. The shares of the Company were listed on the Tallinn Stock Exchange on 1 June 2005. As result United Utilities (Tallinn) B.V. owns 7 060 870 (35,3%) A- shares, the City of Tallinn owns 6 939 130 (34,7%) A- shares, with 6 000 000 shares in free float.

Nordea Bank Finland Plc customers owned 2 312 667 (11,6%) shares as of 31.12.2005. Other shareholders owned less than 5% of the shares as of 31.12.2005.

From Supervisory and Management Board members only Ian John Alexander Plenderleith and Roch Jean Guy Antoine Cheroux owned 110 and 262 shares respectively, both proportion in shareholding was approximately 0 as of 31.12.2005.

The shareholders reduced the statutory legal reserve from 5 969 thousand euros to 1 278 thousand euros 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.

  
Chairman of the Management Board

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005

(thousand EUR)


NOTE 15. NET SALES

	2005	2004
<b>Revenues from main operating activities</b>		
Water supply service	16 789	14 105
Waste water disposal service	14 882	13 070
Stormwater treatment and disposal service	2 977	2 859
Fire hydrants service	130	125
Other works and services	368	444
<b>Total revenues from main operating activities</b>	<b>35 146</b>	<b>30 602</b>
<b>Revenues from other operating activities</b>		
Water, sewerage and storm water connections construction income	2 691	4 456
<b>TOTAL NET SALES</b>	<b>37 838</b>	<b>35 057</b>

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

NOTE 16. PERSONNEL EXPENSES

	2005	2004
Salaries and wages	-3 384	-3 097
Social security taxation	-1 134	-1 038
<b>Staff costs total</b>	<b>-4 518</b>	<b>-4 135</b>
<b>Average number of employees during the reporting pe</b>	<b>337</b>	<b>343</b>

  
Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
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(thousand EUR)

**NOTE 17. COSTS AND EXPENSES****Cost of goods sold (main operating activities)**

	2005	2004
Tax on special use of water	-578	-593
Chemicals	-861	-600
Electricity	-1 510	-1 671
Pollution tax	-441	-536
Staff costs	-2 920	-2 853
Research & development	-12	-5
Depreciation and amortization	-4 703	-4 785
Other costs of goods sold	-1 888	-1 564

<b>Total cost of goods sold (main operating activities)</b>	<b>-12 914</b>	<b>-12 607</b>
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**Cost of goods sold (other operating activities)**

Water, sewerage and storm water connections construction cost	-2 450	-4 117
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**Marketing Expenses**

Staff costs	-305	-271
Depreciation and amortization	-12	-7
Other marketing expenses	-116	-114

<b>Total cost of marketing expenses</b>	<b>-433</b>	<b>-392</b>
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**General Administration Expenses**

Staff costs	-904	-1 011
IPO bonus to employees	-388	0
IPO services	-731	0
Depreciation and amortization	-317	-289
Other general administration expenses	-1 766	-1 304

<b>Total cost of general administration expenses</b>	<b>-4 107</b>	<b>-2 604</b>
--	---------------	---------------

**Other income/expenses** include 543 thousand euros of IPO costs in 2005, in years 2004 and 2005 the profits recognised on the sale of fixed assets during the period, the movement of the bad debt provision during the year and provisions recognised and released throughout the financial period. It also includes income and costs generated from a consultancy project in Republic of Tajikistan.

In total, the costs for the period ended 31 December 2005 include IPO costs of 1 662 thousand euros, being made up of 1 274 thousand euros for services and 388 thousand euros for staff bonus costs as referred to above.

Chairman of the Management Board:





**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005**

(thousand EUR)

**NOTE 18. FINANCIAL INCOME AND EXPENSES**

	2005	2004
Interest income	317	178
Interest expense	-3 694	-3 500
Loans restructuring costs	-1 246	0
Other financial income / expenses (-)	-52	-224
Foreign exchange gain/loss (-)	19	-13
<b>Total financial income / expenses</b>	<b>-4 655</b>	<b>-3 559</b>

**NOTE 19. DIVIDENDS**

	2005	2004
Dividends declared during the period	7 158	4 793
Dividends paid during the period	7 158	4 793
Income tax on dividends declared	-2 260	-1 684
Income tax paid on dividends received	0	5
<b>Income tax accounted</b>	<b>-2 260</b>	<b>-1 679</b>

The income tax rates were 26/74 and 24/76 respectively in 2004 and 2005.

**NOTE 20. EARNINGS AND DIVIDENDS PER SHARE**

	2005	2004
Earnings per share from continuing operations:		
Earnings for the purposes of basic earnings per share (net profit for the period minus B-share preference rights)	11 143	11 054
Weighted average number of ordinary shares for the purposes of basic earnings per share	20 000 000	20 000 000
Earnings per share in euros	0,56	0,55
Dividends per A-share in euros	0,36	0,24
Dividends per B-share in euros	639	639

Diluted earnings per share for the periods ended 31 December 2005 and 31 December 2004 are equal to the earnings per share figures stated above.

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005**

(thousand EUR)

**NOTE 21. NOTES TO THE CASH FLOW STATEMENT****NOTE 21A. PIPELINES FINANCED BY CONNECTION FEES**

	2005	2004
<b>Revenue</b>		
Connection fees from pipelines taken into use	2 691	4 456
Increase/decrease (-) in prepayments for pipelines	495	-1 220
Decrease in accounts receivable from pipelines	213	559
Offset with liabilities	-45	0
<b>Connection fees received</b>	<b>3 355</b>	<b>3 794</b>
 Acquisition cost of pipelines taken into use	 -2 450	 -4 117

The connection fees from and the acquisition costs of pipelines taken into use are eliminated from "Cash flows of operating activities" as these are recorded within "Cashflows from investing activities". The net amounts eliminated were respectively -241 thousand and -339 thousand euros in 2005 and in 2004.

**NOTE 21B. CHANGE IN CURRENT ASSETS AND LIABILITIES**

In addition to changes in the balance sheet, current assets and liabilities are changed as follows:

	2005	2004
<b>Current assets</b>		
Change in balance sheet	-7 807	-539
<u>Adjustments:</u>		
Change in money balance	6 779	1 077
Changes between fixed assets and current assets	-15	-27
Assets sold from assets for sale	0	-144
Change in deferred interests and long-term loans	-6	8
Offset of debts	-2	0
Change in construction income debt	-213	-559
Cash from/to long-term deposit	4 956	-2 946
<b>Total change in current assets</b>	<b>3 691</b>	<b>-3 130</b>
 <b>Liabilities</b>		
Change in balance sheet	-2 496	1 281
<u>Adjustments:</u>		
Change in finance lease and loan costs	6 199	-4 292
Change in payables for capital investments	116	1 086
Prepayments for the sale of fixed assets	-2 914	0
Change in construction income prepayments	-495	1 220
<b>Total change in liabilities</b>	<b>410</b>	<b>-706</b>

## AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005

(thousand EUR)

## NOTE 21. NOTES TO THE CASH FLOW STATEMENT (continued)

NOTE 21C. PAYMENTS FOR FIXED ASSETS

	2005	2004
Acquisition of fixed assets	-223 145	-158 379
<u>Adjustments:</u>		
Decrease in accounts payable related to investments	-1 818	-16 990
Offsetting of payments for investments	733	0
Interest capitalization	1 075	2 690
Capitalization of operating expenses	23 280	38 974
<b>Total payments for fixed assets</b>	<b>-199 875</b>	<b>-133 705</b>

## NOTE 22. COMMITMENTS

## Leased assets

	2005	2004
Total operating lease expense for computers and vehicles	307	261

Minimum operating lease payments are as follows:

Less than 1 year	320
1-5 years	390
<b>Total minimum lease payments</b>	<b>710</b>

As of 31.12.2005 the Company had taken commitments for capital investments, i.e. concluded contracts and requested works with purchase orders in the amount of 4 944 thousand euros.



AS TALLINNA VESI

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005**

(thousand EUR)

**NOTE 23. 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 23/77 on the amount of the dividends payable in 2006; in 2005 the rate was 24/76.

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 2005 amounted to 29 044 thousand euros. Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 8 676 thousand euros.

**NOTES 24. COLLATERAL OF LOANS AND PLEDGED ASSETS**

In connection with the loan agreements concluded between the EBRD the Company and between and the Estonian affiliate of Nordea Bank Plc (hereinafter Nordea Bank) and the Company, the following guarantee contracts were concluded, which concern the assets of the Company :

- a) Commercial Pledge Agreement in favour of EBRD to the value of 120 000 thousand euros;
- b) Separate Mortgage Agreements in favour of EBRD regarding the properties of Ülemiste water treatment plant and Paljassaare waste water treatment plant whereby both pledges are to the value of 18 750 thousand euros;
- c) Combined Mortgage Agreement in favour of Nordea Bank regarding the properties of Ulemiste water treatment plant and Paljassaare waste water treatment plant to the value of 37 500 thousand euros.

The pledges in favour of Nordea Bank and EBRD have the same ranking.

- d) A Security Agreement is concluded between EBRD and Nordea Bank.

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005

(thousand EUR)

## NOTE 25. RELATED PARTIES

Transactions with related parties are considered to be transactions with members of the Supervisory Board and Management Board, their relatives and the companies in which they hold majority interest and transactions with shareholder having the significant influence. Dividend payments are indicated in the Statement of Changes in Equity.

The transactions with related parties in 2004 and 2005 and respective balances as of 31.12.2004 and 31.12.2005 are recorded as follows:

	Tallinn City Government and related boards	The companies belonging to the same group with the United Utilities (Tallinn) B.V.
<b>2004</b>		
<b>Transactions recorded in Working Capital on the Balance Sheet of AS Tallinna Vesi</b>		
Customer receivables	99	0
Accounts payable - short-term trade and other payables	0	97
<b>Transactions recorded to the Income Statement of AS Tallinna Vesi</b>		
Net sales	6 341	3
General administration expenses	0	490
<b>Transactions recorded to other accounts on the Balance Sheet of AS Tallinna Vesi</b>		
Non-current assets incl unfinished assets and new connections	0	914
<b>2005</b>		
<b>Transactions recorded in Working Capital on the Balance Sheet of AS Tallinna Vesi</b>		
Deferred income	5	0
Accounts payable - short-term trade and other payables, incl. dividends	0	155
<b>Transactions recorded to the Income Statement of AS Tallinna Vesi</b>		
Net sales	4 951	0
General administration expenses	0	830
Other income (-)/ expenses	0	32
<b>Transactions recorded to other accounts on the Balance Sheet of AS Tallinna Vesi</b>		
Non-current assets incl unfinished assets and new connections	0	862
	<b>2005</b>	<b>2004</b>
Management Board fees excluding social tax	136	132
Supervisory Board fees excluding social tax	4	1

The fees disclosed above are contractual payments made by the Company to the management board members. In addition to this the board members have also received direct compensations from the companies belonging to the group of United Utilities (Tallinn) B.V. as overseas secondees.

## NOTE 26. RECLASSIFICATION

Due to the reclassification of impairment loss the following reclassifications are recorded in the Income Statement of 2004:

Line of Income Statement	Opening balance	Reclassification	Closing balance
Costs of goods sold (main operating activities)	-12 494	-113	-12 607
Other income/ expenses (-)	841	113	954

The net sales and the cost of goods sold, both recorded in one line of the Income Statement of 2004, are both split between main operating and other operating activities as recorded in the Income Statement of the financial reports.



**NOTE 27. 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 two loans, from which the first is at a fixed interest rate, the second loan is split into two parts: the first part is calculated by reference to the Euribor 6 Months rate with an upper and lower cap to limit exposure, the rest of the balance, 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. The debt management group participates in the determination of payment terms and schedules to facilitate the collection of debt and controls the payment discipline of customers as part of a daily routine, for example by sending out invoice reminders, making debt follow up phone calls and other debt management tools.

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 accidents, theft, vandalism etc.



Chairman of the Management Board:



## AS TALLINNA VESI

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2005****NOTE 28. FINANCIAL INDICATORS**

	2005	2004
Operating Margin <sup>(1)</sup>	47,7%	46,5%
Net profit margin <sup>(2)</sup>	29,5%	31,5%
Return on equity <sup>(3)</sup>	16,9%	18,2%
Return on assets <sup>(4)</sup>	8%	8%
Debt to equity ratio <sup>(5)</sup>	1,2	1,2
Current ratio <sup>(6)</sup>	1,9	0,9

## Notes:

- <sup>(1)</sup> Operating profit as a percentage of net sales  
<sup>(2)</sup> Net profit as a percentage of net sales  
<sup>(3)</sup> Net profit as a percentage of average total equity capital  
<sup>(4)</sup> Net profit as a percentage of average total assets  
<sup>(5)</sup> Total liabilities divided by total equity capital  
<sup>(6)</sup> Total current assets divided by total current liabilities

AS TALLINNA VESI

**PROFIT DISTRIBUTION PROPOSAL**

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The distributable equity capital of AS Tallinna Vesi as of 31 December 2005 is as follows:

Accumulated profit	17 901 thousand euros
Net profit for the financial year	11 143 thousand euros
<b>Total</b>	<b>29 044 thousand euros</b>

The Management Board of AS Tallinna Vesi proposes to distribute 10 034 thousand euros to shareholders as dividends from the available equity capital accumulated by end of the year 2005.

10 February 2006



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 year ended 31 December 2005. 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 2005, 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 as adopted by the EU.



Sander Kallasmaa  
Certified Auditor  
10 February 2006



AS Deloitte Audit Eesti



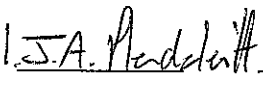


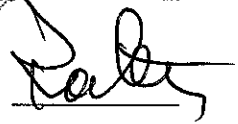
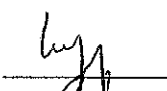



**AS TALLINNA VESI**

**CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS TO THE ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2005**

The Management Board has prepared the management report and the annual accounts of AS Tallinna Vesi on 10 February 2006.

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		10/2/2006
Roch Jean Guy Antoine Chèroux	Member of the Management Board		10/2/2006
Ian John Alexander Plenderleith	Member of the Management Board		10/2/2006
Michael James Southworth	Head of the Supervisory Board	_____	_____
Karl Olof Joakim Forsberg	Member of the Supervisory Board	_____	_____
David John Kilgour	Member of the Supervisory Board	_____	_____
Marion Elaine Price	Member of the Supervisory Board		14/3/06
Toivo Tootsen	Member of the Supervisory Board		14.03.06
Rein Ratas	Member of the Supervisory Board		14.03.06
Elmar Sepp	Member of the Supervisory Board		14.03.2006
Helo Meigas	Member of the Supervisory Board		14.03.06
Valdur Laid	Member of the Supervisory Board		14/3/06
			

Chairman of the Management Board: