

Offering of 34,450,000 Offer Shares

ARCO VARA AS

(Incorporated with limited liability in the Republic of Estonia)

Offer Price Range EEK 37 – 44 per Offer Share

A proposed 34,450,000 shares with a nominal value of EEK 10 each (the "Offer Shares") of Arco Vara AS (the "Company", together with its subsidiaries, the "Group" or "Arco Vara") are being offered in a combined offering (the "Combined Offering"), which consists of (i) an offering of up to 6,950,000 existing Offer Shares by Osaihing Toletum and Osaihing HM Investeeringud (the "Selling Shareholders") and (ii) an offering of 27,500,000 new Offer Shares by the Company. The Combined Offering is made to (i) institutional investors in and outside Estonia and Latvia and outside the United States in reliance on Regulation S ("Regulation S") under the United States Securities Act of 1933, as amended (the "Securities Act") and in the United States to qualified institutional buyers ("QIBs"), as defined in and in reliance on Rule 144A ("Rule 144A") under the Securities Act, and to certain employees of the Group and its joint ventures in Lithuania, Romania and Bulgaria (the "International Offering"); (ii) the public in Estonia and Latvia, including employees and certain managers of the Group and its joint ventures in Estonia and Latvia (the "Retail Offering") and (iii) certain key managers of the Group and its joint ventures in reliance on applicable private placement rules (the "Management Incentive Offering"). The offer price per Offer Share (the "Offer Price") will be determined through a book building process and shall be the same for all investors in the Combined Offering. The offer price range for the Offer Shares is EEK 37 – 44 (the "Offer Price Range"). See "Underwriting - General" for a discussion of certain factors affecting the Offer Price. The Company reserves an option to increase the number of new Offer Shares to be offered in the Combined Offering by up to 8,000,000 Offer Shares prior to the determination of the Offer Price (the "Upsizing Option"). The Selling Shareholders have granted the Global Coordinator an option (the "Over-Allotment Option"), exercisable within 30 days of the date of commencement of trading in the shares of the Company on the Tallinn Stock Exchange, to require the Selling Shareholders to sell up to an additional 5,400,000 existing shares of the Company (the "Additional Shares") for purposes of covering possible over-allotments.

Prior to the Combined Offering, there has been no public market for the Offer Shares or the existing shares of the Company (together, the "Shares"). The Company has made an application to list the Shares on the Main List of the Tallinn Stock Exchange. Trading in the Shares is expected to commence on the Tallinn Stock Exchange on or about 21 June 2007. See "Listing".

The existing Offer Shares and, once the increase of share capital relating to the issue of new Offer Shares is registered with the Estonian Commercial Register, the new Offer Shares will rank *pari passu* with all the remaining existing shares of the Company and will be eligible for any dividends declared and paid on the Shares for the financial period starting on 1 January 2007, and for any dividends declared and paid thereafter. Possible dividends paid by the Company to shareholders who are not generally subject to taxation in Estonia may be subject to Estonian taxes as described in "Taxation."

See "Risk Factors" for a discussion of certain factors that should be considered by prospective investors.

THE OFFER SHARES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT AND MAY NOT BE OFFERED OR SOLD IN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S) EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. ACCORDINGLY, THE OFFER SHARES ARE BEING OFFERED AND SOLD IN THE UNITED STATES ONLY TO QIBs IN RELIANCE ON THE EXEMPTION PROVIDED BY RULE 144A AND ARE BEING OFFERED OUTSIDE THE UNITED STATES IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT. YOU ARE HEREBY NOTIFIED THAT THE SELLERS OF THE OFFERED SHARES MAY BE RELYING ON THE EXCEPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A. THE SHARES ARE SUBJECT TO CERTAIN SELLING RESTRICTIONS. SEE "UNDERWRITING - SELLING RESTRICTIONS."

Advisor to the Company, Global Coordinator and Lead Manager:

SEB ENSKILDA

The date of this Offering Circular is 1 June 2007.

This Offering Circular has been prepared by the Company in connection with the Retail Offering and the listing of the Shares on the Tallinn Stock Exchange in accordance with the Estonian laws implementing Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (the “Prospectus Directive”) and in accordance with the Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing the Prospectus Directive.

This Offering Circular constitutes a prospectus in the form of a single document within the meaning of the Prospectus Directive and the Securities Market Act of Estonia and has been approved as such by the Estonian Financial Supervisory Authority (*Finantsinspeksioon*) (the “EFSA”), in its capacity as the competent authority in the Republic of Estonia. The approval of this Offering Circular referred to above will be notified to the Latvian Financial and Capital Market Commission by the EFSA pursuant to Article 39¹ (2) of the Securities Market Act of Estonia, for the purposes of ensuring the Retail Offering to the public in Latvia.

The information contained in this Offering Circular has been provided by the Company and other sources identified herein. It is prohibited to copy or distribute the Offering Circular or to reveal or use the information contained herein for any other purpose than considering an investment in the Offer Shares.

The Company accepts responsibility for the information contained in this Offering Circular. To the best of the knowledge and belief of the Company, having taken all reasonable care to ensure that such is the case, the information contained in this Offering Circular is in accordance with the facts and contains no omission likely to affect its import.

The Selling Shareholders accept responsibility for the information in the subsections “Shareholders of the Company”, “Selling Shareholders” and “Shareholders’ Agreements” in the section “Company, Share Capital and Ownership Structure”. To the best of the knowledge and belief of the Selling Shareholders, having taken all reasonable care to ensure that such is the case, the information contained in the said subsections is in accordance with the facts and contains no omission likely to affect its import.

Tallinn, 1 June 2007

*Arco Vara AS
Management Board*

*Osühing Toletum
Management Board*

*Osühing HM Investeeringud
Management Board*

Viljar Arakas

Arti Arakas

Hillar-Peeter Luitsalu

Sulev Luiga

Richard Tomingas

Ivar Siimar

Veiko Pedosk

Ahto Altjõe

The Combined Offering will be governed by and construed in accordance with Estonian law. Any disputes relating to the Combined Offering will be settled in a competent court of law, having its jurisdiction in Estonia.

No person has been authorized to give any information or to make any representation in connection with the Combined Offering other than as contained in this Offering Circular and, if given or made, such information or representation must not be relied upon as having been authorized by the Company or by Skandinaviska Enskilda Banken AB (publ), London Branch (the “Global Coordinator”). This Offering Circular does not constitute an offer to sell or a solicitation of an offer to buy any of the Offer Shares in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The distribution of this Offering Circular and the offering or sale of the Offer Shares in certain jurisdictions is restricted by law. Persons into whose possession this Offering Circular may come are required by the Company and the Global Coordinator to inform themselves about and to observe such restrictions. Further information with regard to restrictions on offering and sale of the Offer Shares and the distribution of this Offering Circular is set out in “Underwriting – Selling Restrictions”. Neither the delivery of this Offering Circular nor any sale made in connection with the Combined Offering shall, under any circumstances, create any implication that the information contained herein is correct as of any time subsequent to the date hereof or that the affairs of the Company have not since changed. The Company will update any information presented in this Offering Circular in accordance with the applicable provisions of the Securities Market Act of Estonia.

The Offer Shares have not been approved or disapproved by the United States Securities and Exchange Commission (the “SEC”), any state securities commission in the United States or any other regulatory authority in the United States, nor have any of the foregoing authorities passed upon or endorsed the merits of the Combined Offering or the accuracy or adequacy of this document. Any representation to the contrary is a criminal offence in the United States.

THE OFFER SHARES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT AND MAY NOT BE OFFERED OR SOLD IN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S) EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.

ACCORDINGLY, THE OFFER SHARES ARE BEING OFFERED AND SOLD IN THE UNITED STATES ONLY TO QIBS IN RELIANCE ON THE EXEMPTION PROVIDED BY RULE 144A AND ARE BEING OFFERED OUTSIDE THE UNITED STATES IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT. SEE “UNDERWRITING — SELLING RESTRICTIONS.”

INTERNAL REVENUE SERVICE CIRCULAR 230 DISCLOSURE

PURSUANT TO INTERNAL REVENUE SERVICE CIRCULAR 230, THE COMPANY HEREBY INFORMS INVESTORS THAT THE DISCLOSURE SET FORTH HEREIN WITH RESPECT TO US FEDERAL TAX ISSUES WAS NOT INTENDED OR WRITTEN TO BE USED, AND SUCH DISCLOSURE CANNOT BE USED, BY ANY TAXPAYER FOR THE PURPOSE OF AVOIDING ANY PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER UNDER THE US INTERNAL REVENUE CODE. SUCH DISCLOSURE WAS WRITTEN TO SUPPORT THE MARKETING OF THE OFFER SHARES. TAXPAYERS SHOULD SEEK ADVICE BASED ON THE TAXPAYER’S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

The Offer Shares may not be lawfully offered or sold to persons in the United Kingdom except in circumstances which do not constitute an offer to the public in the United Kingdom within the definition of the Financial Services and Markets Act 2000 (the “FSMA”) as amended or otherwise in compliance with all applicable provisions of the FSMA. Neither this nor any other document issued in

connection with the offer of the Offer Shares has been approved by an authorized person for the purposes of section 21 of the FSMA and hence may not be passed on to any person in the United Kingdom unless that person is entitled to receive this document by virtue of him falling into one of the categories of exemptions under the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 or is a person to whom the document may otherwise lawfully be issued or passed on.

Each prospective purchaser and subscriber of the Offer Shares must comply with all applicable laws and regulations in force in any jurisdiction in which it purchases, subscribes, offers or sells the Offer Shares or possesses or distributes this Offering Circular and must obtain any consent, approval or permission required by it for the purchase, offer or sale by it of the Offer Shares under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, subscriptions, offers or sales, and none of the Company and the Global Coordinator shall have any responsibility for these obligations.

The contents of this Offering Circular are not to be construed as legal, business or tax advice. Each prospective investor should consult with its own legal adviser, business adviser or tax adviser as to legal, business and tax advice.

IN CONNECTION WITH THE COMBINED OFFERING, THE GLOBAL COORDINATOR MAY EFFECT TRANSACTIONS INTENDED TO STABILIZE OR MAINTAIN THE MARKET PRICE OF THE OFFER SHARES AND/OR THE OTHER SHARES OF THE COMPANY AT A LEVEL WHICH MIGHT NOT OTHERWISE PREVAIL. SUCH ACTIVITY MAY BE CONDUCTED ON THE TALLINN STOCK EXCHANGE WITHIN 30 DAYS FROM THE COMMENCEMENT OF THE TRADING IN THE SHARES OF THE COMPANY ON THE TALLINN STOCK EXCHANGE. SUCH ACTIVITIES, IF ANY, MAY BE DISCONTINUED AT ANY TIME. IN CONNECTION WITH SUCH ACTIVITIES, THE GLOBAL COORDINATOR MAY PURCHASE UP TO 5,700,000 SHARES. AFTER THE TIME RESERVED FOR THESE ACTIVITIES, THE GLOBAL COORDINATOR WILL PUBLISH INFORMATION ON WHETHER OR NOT STABILISATION WAS UNDERTAKEN, THE DATE AT WHICH THESE ACTIVITIES STARTED AND THE DATE AT WHICH THEY LAST OCCURRED, AND THE PRICE RANGE WITHIN WHICH STABILISATION WAS CARRIED OUT, FOR EACH OF THE DATES DURING WHICH STABILISATION TRANSACTIONS WERE CARRIED OUT.

AVAILABLE INFORMATION

This Offering Circular has been published in an electronic form on the website of the EFSA (www.fi.ee) and on the website of the Latvian Financial and Capital Market Commission (www.fktk.lv). A paper copy of this Offering Circular can be obtained from larger branches of AS SEB Eesti Ühispank in Estonia and AS SEB Latvijas Unibanka in Latvia until the end of the offer period, i.e. until 4 p.m. on 14 June 2007.

The Articles of Association of the Company, the annual reports of the Company for the financial years ended 31 December 2004, 2005 and 2006 and the unaudited consolidated condensed interim financial statements for the three month period ended 31 March 2007 are available at its head office located at Jõe 2b, 10151 Tallinn, Estonia and on the Company's website (www.arcorealestate.com). Any interested party may obtain a copy of these items from the Company without charge. The annual reports of the Company have been prepared both in the Estonian language and in kroons, and in the English language and in euros. However, in case of any discrepancies between the Estonian and English language versions, the originals in Estonian shall prevail.

References to the Company's website in this Offering Circular should not be deemed to incorporate the information on the Company's website by reference.

The Company is not required to file periodic reports under Sections 13 or 15(d) of the United States Securities Exchange Act of 1934, as amended (the "Exchange Act"). In the event the Company is

neither subject to Section 13 or 15(d) of the Exchange Act nor exempt from reporting under the Exchange Act pursuant to Rule 12g3-2(b) thereunder, in order to preserve the exemption for resales and transfers under Rule 144A, the Company will provide upon request to the holder of any Offer Share, and to each prospective purchaser designated by any such holder, the information specified in, and meeting the requirements of, Rule 144A(d)(4).

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in “Summary”, “Risk Factors”, “Business”, “Management’s Discussion and Analysis of the Group’s Financial Condition and Results of Operations” and elsewhere in this Offering Circular are forward-looking. Such forward-looking statements and information are based on the beliefs of the Company’s management board (the “Management”) or are assumptions based on information available to the Company. When used in this document, the words “anticipate,” “believe,” “estimate” and “expect” and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such forward-looking statements reflect the current views of the Company or its management with respect to future events and are subject to certain risks, uncertainties and assumptions. Many factors could cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including, among others, risks or uncertainties associated with the Company’s technological development, growth management, relations with customers and suppliers and, more generally, general economic and business conditions, changes in domestic and foreign laws and regulations (including those of the European Union), taxes, changes in competition and pricing environments, and other factors referenced in this document. Some of these factors are discussed in more detail under “Risk Factors.” Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this document as anticipated, believed, estimated or expected.

The Company does not intend, and does not assume any obligation, to update the forward-looking statements included in this Offering Circular as at the date set forth on the cover.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

This Offering Circular presents the Company’s (i) unaudited consolidated condensed interim financial statements for the three-month period ended 31 March 2007 prepared in accordance with IAS 34 Interim Financial Statements as adopted by the EU, its (ii) audited consolidated financial statements for the financial year ended 31 December 2006 (with comparative information for the financial year ended 31 December 2005) prepared in accordance with International Financial Reporting Standards as adopted by the EU (“IFRS as adopted by the EU”) and its (iii) audited consolidated financial statements for the financial year ended 31 December 2005 (with comparative information for the financial year ended 31 December 2004) prepared in accordance with International Financial Reporting Standards (“IFRS”) (the “IFRS Financial Statements”).

The IFRS Financial Statements are presented in thousands of kroons. IFRS comprise standards issued by the International Accounting Standards Board (the “IASB”) and interpretations as developed by the International Financial Reporting Interpretations Committee, approved for issue by the IASB. IFRS as adopted by the EU comprise standards issued by the IASB and interpretations as developed by the International Financial Reporting Interpretations Committee, approved for issue by the IASB and adopted by the EU.

Certain financial and other information set forth in this Offering Circular has been rounded off, for the convenience of readers. Accordingly, in certain tables, the sum of the numbers in a column may not conform exactly to the total figure given.

All references in this Offering Circular to (i) “kroon” or “EEK” refer to the currency of Estonia, (ii) “U.S. dollars”, “U.S.\$” or “USD” refer to the currency of the United States of America, (iii) “LVL” or “lats” refer to the currency of Latvia, (iv) “LTL” or “litas” refer to the currency of Lithuania, (v) “UAH” or “hryvnia” refer to the currency of Ukraine, (vi) “RON” or “leu” refer to the currency of Romania, (vii) “BGN” or “lev” refer to the currency of Bulgaria and (viii) “euro” or “EUR” refer to the single currency of the European Union Member States participating in the European Monetary Union (“EMU”).

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT SO FILED IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT ANY EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY, OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER, OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

ENFORCEABILITY OF JUDGMENTS

The Company is a public limited company incorporated under the laws of Estonia. All of the directors and executive officers of the Company are citizens or residents of countries other than the United States. All or a substantial portion of the assets of such persons and substantially all the assets of the Company are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon such persons or the Company, or to enforce or collect judgments of U.S. courts against them, including judgments predicated upon civil liabilities under the securities laws of the United States or any State or territory of the United States.

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SUMMARY

This summary should be read as an introduction to this Offering Circular. The summary information set out below is based on, should be read in conjunction with, and is qualified in its entirety by, the full text of this Offering Circular, including the financial information presented herein. Any consideration to invest in the Offer Shares should be based on consideration of this Offering Circular as a whole by the investor. Where a claim relating to the information contained in this Offering Circular is brought before an Estonian or Latvian court, the plaintiff investor might, under Estonian law or Latvian law, respectively, have to bear the costs of translating this Offering Circular in the course of the legal proceedings or before such proceedings are initiated. No person assumes civil liability in respect of this summary, unless it is misleading, inaccurate or inconsistent when read together with the other parts of this Offering Circular.

OVERVIEW

The Group is a Central and Eastern European real estate developer with an integrated business model that also encompasses real estate services and construction. Arco Vara is one of the leading real estate developers in Estonia and Latvia and it is in the progress of extending its operations in Romania, Bulgaria, Lithuania and Ukraine. Arco Vara has already established real estate agency service in capitals of all its current target markets, providing the technical capability, recruiting base and market understanding required for local expansion into development and construction. On 27 April 2007, Arco Vara acquired rights to what it expects to be the Group's first residential development project in Sofia, Bulgaria.

The Group focuses on developing high-quality residential living environments for the upper-middle class in the capital cities of its target markets. The Group also undertakes the development of commercial properties with an aim to sell the latter prior to or at completion. The Group does not intend to build a portfolio of cash flow generating commercial properties, although it currently owns several such properties for future development purposes.

The Group was founded in 1992 in Estonia with the establishment of its first real estate agency. With an operating history exceeding 15 years, the Group is one of the oldest real estate groups in Estonia. Arco Vara started real estate development operations in 1995 and entered the construction services in 2001. The Group's real estate development division is central to the Group's value generation; however, it utilizes the expertise and capacity of its services and construction divisions to ensure profitable and timely completion of its development projects. Management has set limits for intra-group services as a percentage of the revenue of each division and intra-group transactions are conducted at arm's length basis.

A summary table of the Group's current material development projects and cash-flow generating properties is provided below:

Project	Consolidated project book value as at 31/12/2006, EEK m	Group legal ownership as at 01/06/2007 %	Project total book value as at 31/12/2006, EEK m ¹⁾	Appraised value by Colliers at 16/04/2007, EEK m ²⁾	Expected number of apartments / land units developed	Estimated sellable / leasable space, m ²	Estimated development period
Residential development projects							
Tivoli	300.0	100	300.0	712.2	732 / -	46,872	2008-2011
TOP	137.2	50	274.4	359.5	360 / -	27,086	2008-2011
Kolde	81.3	89	81.3	145.6	372 / -	22,168	2005-2009
Pärtli	4.2	50 ³⁾	8.4	55.7	- / 93	-	2007-2008
Tooma	4.0	50 ⁴⁾	8.0	32.0	- / 101	-	2007-2008
Vahi	2.9	100	2.9	26.1	- / 21	-	2007
Bišumuiža 1	31.4	80	31.4	47.8	238 / -	18,652	2006-2009

Project	Consolidated project book value as at 31/12/2006, EEK m	Group legal ownership as at 01/06/2007 %	Project total book value as at 31/12/2006, EEK m ¹⁾	Appraised value by Colliers at 16/04/2007, EEK m ²⁾	Expected number of apartments / land units developed	Estimated sellable / leasable space, m ²	Estimated development period
Baltezers	31.1	80	31.1	69.7	- / 53	-	2007-2008
Bišumuiža 2	14.0	80 ⁵⁾	14.0	341.8	1,085 / -	81,826	2007-2014
Office and retail development projects							
Ahtri 3	385.0	50	385.0	698.6	n.a.	36,300	2008-2011
Ilmarine	150.8	50	301.5	811.3	n.a.	60,000	2008-2011
Laeva	41.7	100	41.8	112.6	n.a.	6,006	2008-2009
Paldiski road	34.6	100	34.6	218.8	n.a.	21,600	2009-2011
Kipsala	57.4	50 ⁶⁾	114.8	95.7	n.a.	36,000	2008-2011
Cash flow generating properties							
TOP	116.4	50	232.8	267.9	n.a.	23,292	n.a.
Melon	75.0	50	150.0	187.8	n.a.	7,567	n.a.
Kerberon	72.4	83	72.4	78.6	n.a.	8,111	n.a.
AVSK							
<i>Raekoja 10</i>	10.7	50	21.4	39.7	n.a.	1,493	n.a.
<i>Rüütli 16/18</i>	18.5	50	37.0	37.2	n.a.	1,030	n.a.
<i>Kotzebue 18</i>	1.6	50	3.2	4.0	n.a.	415	n.a.
Pärnu market	30.0	100	30.0	40.2	n.a.	2,529	n.a.
STÜ	29.9	100	29.9	26.6	n.a.	1,692	n.a.
Enerpoint	12.7	100	12.7	13.3	n.a.	2,208	n.a.
TOTAL	1,642.8		2,218.6	4,422.7			

¹⁾ Consolidated project book value adjusted with the assumption of 100 per cent being owned by the Group on 31 December 2006.

²⁾ The Appraisal Report was prepared by Colliers International separately from the preparation of the Group's IFRS Financial Statements. In producing the Appraisal Report, Colliers International used certain assumptions, techniques and methodologies specified in the Appraisal Report, which may differ from the assumptions used by the Group when preparing its IFRS Financial Statements. Therefore, the values indicated in the Appraisal Report differ from the values for the same properties used in Group's IFRS Financial Statements. Whereas the values indicated by Colliers International aim to reflect market prices of the properties as at the valuation date, those real estate projects that are classified in accordance with IFRS as Inventories or Construction In Progress are carried at their acquisition cost in the balance sheet of the Company. Only those properties that are classified as Investment Property are carried in the balance sheet of the Company in their fair value. The fair values of investment properties in the interim condensed consolidated financial statements of the Company for the three-month period ended 31 March 2007 have not been based on the Appraisal Report. This is due to the requirement of IFRS that future capital expenditure and the related future benefits from such expenditure are not to be reflected in the fair value of Investment Property.

³⁾ The project encompasses three land plots, one owned by OÜ Koduküla and two other owned by individuals who have entered into agreements for selling these land plots to OÜ Koduküla.

⁴⁾ The land plot is owned by a private individual who has entered into an agreement for selling this plot to OÜ Koduküla, a 50-50 per cent joint venture with VWF Kinnisvara OÜ.

⁵⁾ The land plot is owned by SIA Sportings Riga, the wholly-owned subsidiary of SIA Bišumuižas Nami. As at the date of the Offering Circular, Arco Investeeringud owns 80 per cent and Mr. Viktors Savins owns 20 per cent of the shares of SIA Bišumuižas Nami. On 18 May 2007, Arco Investeeringud and Mr. Viktors Savins entered into a conditional Share Purchase Agreement with SIA Linstow Baltic regarding the sale of 50 per cent of the shares of SIA Bišumuižas Nami. Following the closing Arco Investeeringud will own 40 per cent of the shares in SIA Bišumuižas Nami, with Mr. Viktors Savins owning 10 per cent and SIA Linstow Baltic owning 50 per cent. See - "Management's Discussion and Analysis of the Group's Financial Condition and Results of Operations – Recent Developments".

⁶⁾ OÜ Floriston Grupp, a joint venture with AS Ārimaja, has made an advanced payment for the acquisition of 100 per cent of the shares of SIA "Euroline", the company holding the property for the Kipsala project. See - "Business - Material Contracts - Acquisition of shareholdings in subsidiaries and joint ventures."

GROUP STRUCTURE

Arco Vara AS, a company with limited liability incorporated under the laws of the Republic of Estonia, is the operating parent company of the Group.

As at the date of this Offering Circular, the Company had 32 subsidiaries, 23 joint ventures (“Joint Ventures”) and one associated company.

The Group has been organised into three principal divisions: services, development and construction. Each of Arco Real Estate AS (“Arco Real Estate”), Arco Investeeringute AS (“Arco Investeeringud”) and Arco Ehitus OÜ (“Arco Ehitus”), all wholly-owned direct subsidiaries of the Company, is the parent company of its division. Most of the subsidiaries and interests in Joint Ventures in each division are directly or indirectly owned by the respective divisional parent company.

STRATEGY

The business strategy of the Group is summarised as follows:

- Focus on large-scale residential development projects in the capitals of the Group’s target markets
- Balance the residential development pipeline with selected commercial development projects, which are either pre-sold or have a clear exit strategy
- Enter new target markets with real estate services operations and expand into real estate development thereafter
- In new target markets initially focus on development projects with obtained building rights due to lower risks and faster project completion
- Increase real estate services office network across all target markets to 46 offices by 2009
- Add construction capacity via acquisitions in Estonia and Latvia.

COMPETITIVE STRENGTHS

The competitive strengths of the Group include:

- Vertically integrated business model
- Strong track record in the Baltics combined with local market expertise
- Experience in residential development
- Major development projects in Tallinn and Riga, with future opportunities in Sofia, Bucharest, Vilnius and Kiev
- Unique sales-driven approach to development
- Established business platforms for geographic expansion.

RISK FACTORS

Before purchasing Offer Shares, prospective investors should carefully consider the risks described in “Risk Factors” in addition to the other information contained in this Offering Circular. The risks described in “Risk Factors” are not the only risks that the Group and investors in the Offer Shares will face. Additional risks not currently known to the Group or that the Group currently believes are immaterial may also adversely affect its business, financial condition and results of operation.

The trading price of the Offer Shares could decline due to any of these risks and investors could lose all or part of their investment. For a more detailed description of the risks, see “Risk Factors”.

CAPITALIZATION AND INDEBTEDNESS

For information on capitalization and indebtedness of the Group see “Capitalization and Indebtedness”.

MANAGEMENT AND EMPLOYEES

The control and management of the Company is divided among the general meeting of shareholders (the “General Meeting of Shareholders”), the supervisory council (the “Supervisory Council”) and the management board (the “Management Board”). The current members of the Supervisory Council are Arti Arakas, Richard Tomingas, Hillar-Peeter Luitsalu, Aare Tark and Kalev Tanner. The current members of the Management Board are Viljar Arakas, Sulev Luiga, Ivar Siimar, Veiko Pedosk and Ahto Altjõe.

On 10 May 2007 Mr. Sulev Luiga was recalled from the Management Board with effect on 30 June 2007 and Mr. Aare Tammemäe was elected as a new member of the Management Board with his appointment taking effect as of 1 July 2007.

As at 31 March 2007, the Company and its subsidiaries and associated companies as well as the Joint Ventures employed 546 people.

SHARES AND SHAREHOLDERS

As of the date of this Offering Circular, the Company’s registered share capital is EEK 677,841,500 divided into 67,784,150 authorised, fully paid and issued Shares with a nominal value of EEK 10 each. Each Share entitles its holder to one vote at the General Meeting of Shareholders. The Company has only one class of shares and all existing Shares rank *pari passu* in all respects.

As of the date of this Offering Circular, the Company has two shareholders. Osaühing Toletum owns approximately 66.67 per cent of the Shares and Osaühing HM Investeeringud owns approximately 33.33 per cent of the Shares. Osaühing Toletum is controlled by Messrs. Arti Arakas and Richard Tomingas, each of whom owns 50 per cent of the shares of that company. Osaühing HM Investeeringud is controlled by Mr. Hillar-Peeter Luitsalu, who owns the sole share of that company.

For the description of transactions entered into between the Group companies with related parties, see “Business—Related Party Transactions”.

DIVIDENDS

The existing Offer Shares and, once the increase of share capital relating to the issue of new Offer Shares is registered with the Estonian Commercial Register, the new Offer Shares will be eligible for dividends, if any, declared in respect of the financial year commencing 1 January 2007, and for subsequent periods. See “Dividends and Dividend Policy.”

COMBINED OFFERING

The Combined Offering consists of up to 6,950,000 existing and 27,500,000 new Offer Shares. The Combined Offering consists of (i) the International Offering to institutional investors in and outside Estonia and Latvia and to certain employees of the Group in Lithuania, Romania and Bulgaria; (ii) the Retail Offering to the public in Estonia and Latvia, including the employees and certain managers of the Group and its joint ventures in Estonia and Latvia and (iii) the Management Incentive Offering to certain key managers of the Group and its joint ventures. The Company reserves an option

to increase the number of new Offer Shares to be offered in the Combined Offering by up to 8,000,000 Offer Shares prior to the determination of the Offer Price (the Upsizing Option). In addition, the Selling Shareholders have granted the Global Coordinator an option (the Over-Allotment Option) to require the Selling Shareholders to sell up to an additional 5,400,000 existing Shares for purposes of covering possible over-allotments.

The Offer Shares represent approximately 70.59 per cent of the Company's share capital immediately prior to the Combined Offering and approximately 46.33 per cent of the Company's share capital following the completion of the Combined Offering assuming that the Upsizing Option and the Over-Allotment Option are exercised in full.

The purpose of the Combined Offering is to provide financing for expansion of the Group's operations, create a new source of finance to support the Group's development and broaden the Company's shareholder base. The Combined Offering provides the prerequisites for the Company's listing.

OFFER PRICE

The Offer Price will be decided by the Company and the Selling Shareholders in consultation with the Global Coordinator after the completion of the book-building process directed to the institutional investors. The Offer Price will be in the Offer Price Range of EEK 37 – 44.

DISTRIBUTION AND ALLOCATION

In the event that the demand for the Offer Shares exceeds the number of Offer Shares available, the allocation will be decided by the Company and the Selling Shareholders in consultation with the Global Coordinator.

In the Retail Offering the Offer Shares will be allocated to investors by using the stepped allocation methodology.

USE OF PROCEEDS

The aggregate net proceeds to the Company are estimated to amount to approximately EEK 1,372 million, after deducting the fees and expenses of the Combined Offering, based on the mid-point of the Offer Price Range and assuming that the Upsizing Option is exercised in full. The fees and expenses payable by the Company in connection with the Combined Offering are estimated to amount to approximately EEK 66 million, based on the mid-point of the Offer Price Range and assuming that the Upsizing Option is exercised in full.

The Company will not receive any of the proceeds from the sale of Offer Shares by the Selling Shareholders.

The Company intends to use the net proceeds of the Combined Offering to finance new real estate development projects, primarily focusing on Bulgaria, Romania and Ukraine. The Company also expects to use some of the funds for the development of its existing residential and commercial development projects in Estonia and Latvia. Some of the funds may also be used to fund other areas of the Group's future growth, towards the repayment of any outstanding liabilities and for other general corporate purposes.

LOCK-UP

The Company and the Selling Shareholders have agreed not to issue or sell Shares or securities convertible into Shares for 12 months subsequent to signing the Underwriting Agreement (as defined hereafter) without the prior written consent of the Global Coordinator. All members of the Supervisory Council and Management Board have agreed not to sell or otherwise transfer Shares for 12 months

subsequent to signing the Underwriting Agreement without the prior written consent of the Global Coordinator.

SETTLEMENT

The Offer Shares allocated to the investors will be transferred to their securities accounts on or about 20 June 2007 simultaneously with the transfer of payment for such Offer Shares.

In order to facilitate settlement, some Offer Shares to be transferred to investors (corresponding to the number of new Offer Shares) will be temporarily borrowed from Selling Shareholders so that all investors in the Combined Offering will receive existing Shares only.

LISTING AND TRADING

In connection with the Combined Offering, the Company has applied for listing of its Shares on the Main List of the Tallinn Stock Exchange.

Trading in the existing Shares is expected to commence on or about 21 June 2007.

The international securities identification number (ISIN code) for the Shares is EE3100034653 and the trading code in the Tallinn Stock Exchange trading system is ARC1T.

AUDITORS AND LEGAL ADVISERS

The auditor of the Company is Ernst & Young Baltic AS, address Rävala 4, 10143 Tallinn, Estonia. The Estonian legal adviser to the Global Coordinator is Raidla & Partners, Attorneys at Law, Roosikrantsi 2, 10119 Tallinn, Estonia. The international legal adviser to the Global Coordinator is Curtis, Mallet-Prevost, Colt & Mosle LLP, 53 New Broad Street, London EC2M 1BB, United Kingdom.

ARTICLES OF ASSOCIATION AND OTHER AVAILABLE INFORMATION

The Articles of Association of the Company, the annual reports of the Company for the financial years ended 31 December 2004, 2005 and 2006 and the unaudited consolidated condensed interim financial statements for the three month period ended 31 March 2007 are available at its head office located at Jõe 2b, 10151 Tallinn, Estonia and on the Company's website (www.arcorealestate.com). Any interested party may obtain a copy of these items from the Company without charge. The annual reports of the Company have been prepared both in the Estonian language and in kroons, and in the English language and in euros. However, in case of any discrepancies between the Estonian and English language versions, the originals in Estonian shall prevail.

KEY DATES

	4 June 2007	– Start of the Offer Period
	14 June 2007	– End of the Offer Period
On or about	15 June 2007	– Publication of the Offer Price
On or about	20 June 2007	– Settlement and delivery of Offer Shares
On or about	21 June 2007	– Opening of trading in the Shares on the Tallinn Stock Exchange

SUMMARY OF THE CONSOLIDATED FINANCIAL STATEMENTS OF THE COMPANY

The financial information included below sets out certain summary consolidated financial information and operating data of the Group for the periods indicated. The information has been extracted or calculated based on the IFRS Financial Statements, which are included elsewhere in this Offering Circular. Potential investors should also read the following information in conjunction with the section “Management’s discussion and analysis of the Group’s financial condition and results of operations” and the IFRS Financial Statements and the notes thereto, in each case included elsewhere in this Offering Circular.

Profit or loss account data (EEK, million)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
		(audited)		(unaudited)
Total revenue	349.9	475.9	483.6	291.2
Operating profit	129.6	153.5	260.4	72.4
Profit before income tax	108.7	120.6	226.9	69.4
Net profit attributable to the owners of the Parent ¹⁾	100.1	101.2	207.9	63.5

¹⁾ The term Parent refers to the Company.

Balance sheet data (EEK, million)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
		(audited)		(unaudited)
Cash and cash equivalents	23.3	144.0	58.3	115.4
Receivables, prepaid expenses and short term financial investments ¹⁾	50.2	99.0	106.9	261.2
Inventories and biological assets	152.9	159.9	438.0	606.9
Total current assets	226.4	402.8	603.2	983.6
Long term receivables and investments into financial assets	49.1	20.0	76.4	76.6
Investment property	681.6	851.1	1,479.3	994.0
Property, plant and equipment	36.9	174.4	81.7	78.6
Intangible assets	14.5	13.6	16.7	20.3
Total assets	1,008.5	1,461.9	2,257.4	2,153.0
Borrowings	217.8	316.9	699.6	681.3
Other current liabilities	76.8	159.7	314.6	255.9
Long-term borrowings	338.7	392.3	457.3	408.1
Other non-current liabilities	22.2	12.2	44.0	6.9
Total liabilities	655.4	881.2	1,515.5	1,352.3
Total equity attributable to the owners of the Parent ²⁾	281.3	529.3	724.9	777.9
Minority interest	71.8	51.4	17.0	22.9
Total equity	353.1	580.7	741.9	800.8
Total liabilities and equity	1,008.5	1,461.9	2,257.4	2,153.0

¹⁾ Short term financial investments only relate to 31 December 2004.

²⁾ The term Parent refers to the Company.

Cash flow data (EEK, million)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
		(audited)		(unaudited)
Cash flow from operating activities	90.9	55.8	-117.5	31.5
Cash flow from investing activities	-104.5	-299.3	-341.9	89.1
Cash flow from financing activities	18.6	364.5	374.9	-63.5

Ratios and indicators	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
	(derived from audited information)			(unaudited)
Number of shares, end of the year	8,400	30,453,037	30,453,037	30,453,037
Earnings per share (EPS), EEK ¹⁾	3.67	3.68	6.83	0.94 ^{*)}
Operating profit margin, % ²⁾	37.0	32.3	53.8	24.9
Net profit margin, % ³⁾	28.6	21.3	43.0	21.8
Return on assets (ROA), % ⁴⁾	11.0	8.2	11.2	2.9
Return on equity (ROE), % ⁵⁾	43.2	24.9	33.2	8.5
Equity ratio, % ⁶⁾	35.0	39.7	32.9	37.2

^{*)} Earnings per share of EEK 0.94 is derived by using the number of shares after bonus issue carried out on 4 May 2007, with a resulting total number of shares being 67,784,150.

CALCULATION OF FINANCIAL RATIOS

- 1) Earnings per Share (EPS) Earnings per Share has been calculated in accordance with IAS 33, pursuant to which the net profit attributable to the shareholders of the Company is divided by weighted average number of common shares outstanding during the period. Effect of the bonus issues and share splits is adjusted also for earlier periods, while the effect of a new share issues is adjusted only for the period when it takes place.
- 2) Operating profit margin Operating profit / Total revenue. Operating profit margin measures the relationship between different measures of profitability and revenue providing information about a company's profitability from the operations of its business and is independent of both the company's financing and tax position.
- 3) Net profit margin Net profit attributable to the owners of the Parent/ Total revenue. Net profit margin measures the relationship between different measures of profitability and revenue providing information about a company's profitability.
- 4) Return on assets (ROA) Net profit attributable to the owners of the Parent/ Average total assets. Return on assets compares income with total assets measuring management's ability and efficiency in using the firm's assets to generate profits
- 5) Return on equity (ROE) Net profit attributable to the owners of the Parent/ Average Equity without minority interest. Return on equity compares income with the equity capital measuring management's ability and efficiency in generating return to the shareholders of the company.
- 6) Equity ratio Total equity / Total assets. Equity ratio is a measure of financial leverage providing analysis of a company's capital structure.

RISK FACTORS

An investment in the Offer Shares involves a high degree of risk. Prospective investors in the Offer Shares should consider carefully, among other things, the risks set forth below and the other information contained in this document prior to making a decision to invest in the Offer Shares. Any of the risks highlighted below could have a material adverse effect on the Group's business, financial condition and result of operations, in which case the trading price of the Shares could decline, resulting in the loss of all or part of their investment in the Shares. A potential investor who is in any doubt about the action it should take should consult a professional adviser who specialises in advising on the acquisition of shares and other securities.

Prospective investors should note that the risk factors described below are not intended to be exhaustive and are not intended to be presented in any assumed order of priority. Additional risks and uncertainties not currently known to the Group or that the Group currently considers immaterial may also have the effect set forth above.

RISKS RELATING TO THE GROUP'S BUSINESS

Ability to successfully identify, acquire, develop, operate and dispose property development projects

Real estate development is one of the main operations of the Group. The Group holds a significant portfolio of development projects in different countries, which can be at various stages of development, from the identification of a potential project to the disposal of developed property. The process may last several years. Accordingly, the Group's acquisition and development activities are subject to significant risks of non-completion and loss due to:

- changing market conditions, which may result in diminished opportunities for acquiring desired properties, higher than expected development costs, lower than expected rental rates and lower than expected disposal prices;
- competition from other market participants, which may diminish the Group's opportunities for acquiring desired properties on favourable terms or at all. Even if the Group or the Joint Ventures enter into agreements for the acquisition of properties, these agreements are subject to customary conditions to closing, including completion of due diligence investigations to the Group's satisfaction;
- the Group's inability to acquire land at commercially acceptable terms or obtain detail planning, including construction rights to the acquired land;
- budget overruns and completion delays;
- the Group's potential inability to obtain financing on favourable terms or at all for individual projects or in the context of multiple projects being developed at the same time;
- failure to meet the covenants in the financing agreements which may result in the lenders accelerating the repayments of the loans under the cross-default provisions;
- defects in the legal title to land acquired by the Group or Joint Ventures, or defects in approvals or other authorisations relating to land held by the Group or the Joint Ventures;
- defects in acquired or developed properties, including latent defects in construction work that may not reveal themselves until many years after the Group or any of the Joint Ventures has put a property in service; and

- potential liabilities relating to the acquired land, properties or entities owning properties for which the Group or the Joint Ventures may have limited or no recourse.

Although many of these risks are beyond the Group's control, any negative change in one or more of the factors listed above could adversely affect the Group's business, results of operations and financial condition.

Ability to acquire appropriate real estate on commercially acceptable terms

The Group's ability to continue to develop projects is heavily dependent on identifying and acquiring title or long-term leases on commercially attracting conditions to sites that are suitable for its projects. The property markets in the Baltic States and also in Ukraine, Bulgaria and Romania are highly competitive, particularly in and around the capital cities. Intense competition tends to put pressure on real estate prices and therefore the cost of high-quality sites may increase. To date, the Group has relied on a team of experienced real estate specialists to identify and secure sites. However, if the Group fails to identify or secure sites on a timely basis for any reason, including competition from third parties seeking similar sites, the Group's anticipated growth may be adversely affected. Consequently, there can be no assurance that the Group will successfully identify, lease and/or purchase suitable properties on acceptable terms, and a failure to do so could have a material adverse effect on the Group's business, results of operations and financial condition.

The Company's subsidiary Arco Investeeringud has entered into certain agreements with SIA Linstow Baltic, a Latvian subsidiary of the Norwegian based Linstow AS, a leading investor, developer and operator of shopping centres in the Baltics. The agreements detail the terms of the acquisition by SIA Linstow Baltic of 50 per cent in the Bišumiža 2 project in Riga, Latvia, currently owned by the Group and Viktors Savins. These agreements are subject to conditions, including the Group curing a certain default in relation to its agreement with the City of Riga regarding part of the land intended for this project. For further details, see "Management's Discussion and Analysis of the Group's Financial Condition and Results of Operations – Recent Developments".

In the event that the Group fails to cure this default or fails to negotiate a settlement with the City of Riga or if any other condition is not fulfilled, SIA Linstow Baltic may refuse to close its transaction with the Group or rescind it after closing, which could have a material adverse effect on the Group's business, results of operations and financial condition.

Ability to obtain construction rights, construction and environmental permits and other approvals

In order to secure development projects, the Group must often acquire land for which no detail planning has been prepared or adopted or for which the existing detail planning does not provide construction rights suitable for development. In order to commence development on the site, the Group commissions detail planning for the envisaged project and submits it to the planning authorities of the municipality. Detail planning normally details the division of land units, determines the construction rights attaching to each unit, delineates the area that can be occupied by buildings and determines the areas reserved for streets and other infrastructure.

The planning approval process by municipalities is an administrative process and is subject to strict statutory requirements. The approval process of the detail planning has several stages. The draft detail planning is subject to several analyses and surveys, and is made public and subject to a public hearing. The process may last several years and require the Group to prepare additional documentation or analyses. Depending on the results of the process, the intended use of the land, the maximum number of buildings on the land, the maximum height of the buildings or other details of the plan could be restricted by the authorities.

In addition, the government and municipal authorities may declare that the acquired land or part of it is protected as a nature or heritage conservation area. Any such decision affects the detail planning, and as a consequence, may lead to development and construction activities being prevented or restricted. In Estonia and Latvia, the Group is entitled to exchange such land with the state or municipal authority for another land unit elsewhere. Such exchanges are, however, subject to an individual decision by the relevant governmental or municipal authority. In Latvia, the Group may alternatively demand compensation from the state or municipal authority.

In Latvia, the Group has entered into long-term lease contracts with the local municipalities under which the Group is required to build community developments such as nurseries and recreation zones, as part of the development on the land. The Group's projects also frequently include constructing streets and infrastructure which may eventually be passed on to the municipality.

When the detail planning has been approved or the lease agreement signed, the Group still needs to apply for a building permit from the municipal authorities before construction can commence. The process for obtaining building permits is designed to ensure that the proposed building meets the requirements of the detail planning or a lease agreement, as well as statutory and municipal building regulations and that the design of the building is acceptable to the authorities. Accordingly, even when the Group can acquire suitable sites, it may experience difficulties or delays in obtaining requisite planning and building approvals from the various governmental or municipal authorities required to undertake the planned development and construction. Should the Group fail to obtain approvals and permits on reasonable terms, it may have to give up the project and sell the land at a sale price which may be lower than the purchase price. Any material delays in the process may result in additional costs or even abandoning of the project following changes in the real estate market. No assurance can be given that the Group will be able to obtain the planning approvals and building permits and commence construction as planned, which could have a material adverse effect on the Group's business, results of operations and financial condition.

Increased cost of complying with government regulations

The cost of complying with government regulations can be substantial. The Group's operations and properties, belonging to the Group or the Joint Ventures, are subject to regulation by various government entities and authorities in different countries. Governmental authorities in the European Union regulate various aspects of the Group's business and operations. The regulations applicable to the Group's existing and future operations may change and/or increase substantially. Management believes that the Group's current legal and regulatory compliance systems adequately address all applicable regulatory requirements and that the Group and Joint Ventures are in compliance in all material respects with applicable laws and regulations.

In addition, no assurance can be given that the governments in the Group's core markets will not implement new regulations or fiscal or monetary policies, or amend existing regulations, including regulations or policies relating to or affecting taxation, the environment, health and safety, public procurement, or exchange controls. Any significant amendment to the existing regulations or a new regulation could result in significant additional costs which it may not be possible to pass onto the purchasers of the property, or impose restrictions on the operations of the Group or Joint Ventures, which could have material adverse effect on the Group's business, results of operations and financial condition.

Risk attaching to large property development projects

A relatively small number of large projects in or near the capital cities of Estonia and Latvia form substantially all of the Group's development business. This offers the Group economies of scale and enables it to control the projects more efficiently than if it had a big number of small projects in a wide-spread geographic area. At the same time, concentration of large projects may increase the volatility of the Group's results and increase its exposure to risks attaching to individual projects.

Larger projects may also lead to proportionally larger cost overruns, which may negatively affect the Group's operating margins. Whilst the Group has generally been successful in managing its exposure to cost overruns in the past, it has also had projects where costs have exceeded the projects' budgets. Geographic focus on two capital cities makes the Group vulnerable in case of a downturn in the property market in either city.

Management believes that relatively few major projects in a limited number of geographic locations will continue representing a major part of the Group's business in the foreseeable future. If the Group fails to achieve the expected margins or suffers losses on one or more of these large projects or if the property markets significantly deteriorate in Tallinn or Riga, this could have a material adverse effect on the Group's results of operations or financial condition.

Inaccuracy of the forecasts of property values and market prices

The Group's profitability depends on its ability to forecast market prices, rents, property related costs and property values. In connection with the Group's acquisition of property for its development business, the Group bases the purchase prices it agrees for the property in part on projections of development costs, property values at the time of sale and future market rents. If the Group's projections are inaccurate, it could experience lower profits, which could have a material adverse effect on its results of operations and financial condition.

Potential inaccuracy of the appraised value of the Group's real estate portfolio

Colliers International has valued 21 projects, buildings and sites in the Group's portfolio at 16 April 2007 at EUR 282,816,000 (EUR 247 million for projects in Estonia and EUR 35 million for projects in Latvia). See "Annex A: Colliers International Appraisal Report" (the "Appraisal Report"). The Appraisal Report was prepared separately from the preparation of the Group's IFRS Financial Statements. In producing the Appraisal Report, Colliers International used certain assumptions, techniques and methodologies specified in the Appraisal Report, which may differ from the assumptions used by the Group when preparing its IFRS Financial Statements. Therefore, the values indicated in the Appraisal Report differ from the values for the same properties used in Group's IFRS Financial Statements.

In addition, the assumptions used by Colliers International may not reflect the true position of the Group's portfolio. The valuation of property is inherently subjective due to the individual nature of each property and is based on a number of unconfirmed assumptions. The Baltic real estate markets have a limited amount of publicly available data and research as compared to more mature real estate markets. Relevant property values may have changed since the dates on which the data were applicable. As a result, there can be no assurance that a valuation at a more recent date would not produce a different value for the appraised portfolio.

Market values of properties in the countries in which the Group invests may decline in the future. Furthermore, the appraised value of any or all of the properties covered by the Appraisal Report may decline significantly in the future for other reasons, such as those discussed in this section and elsewhere in this Offering Circular, among others. The appraised value of the property cannot, therefore, be construed as either an estimate or an indication of the prices which could be obtained should the Group or Joint Ventures seek to sell these assets in the open market or as either an estimate or an indication of any price at which the Company's shares may trade.

Changes in customer preferences in the residential housing market

Residential housing markets are subject to changing customer trends, demands and preferences. In particular, customer trends, demands and preferences may vary depending on economic factors, as well as customer preferences for the style of developments. The Group reassesses different risks, including potential changes in customer preferences, at different phases of a project. Should the Group

find changes in customer preferences or other potential threats to the profitability of a project, the Group tries to adjust the project outline to meet the changed market expectations. However, there can be no assurance that the Group will be able to recognise such changes and adapt its existing developments or planned developments in timely fashion to suit such changes in customer preferences. If customer preferences in the markets where the Group operates cease to favour the Group's developments, this could have an adverse effect on the Group's business, results of operations and financial condition.

Damage to property

The property belonging to the Group or the Joint Ventures could suffer physical damage caused by natural disasters, fire or other causes, resulting in losses which may not be fully compensated by insurance. Although the Group and the Joint Ventures do maintain insurance in respect of natural disasters, fire and other damage to its properties, the Group does not maintain separate funds nor does it set aside reserves for these types of events. In addition, certain types of risks (such as certain natural disasters and terrorist acts) may be uninsurable or the cost of insurance may be prohibitively high when compared to risk. Should an uninsured loss or a loss in excess of insured limits occur, the Group could lose capital invested in the affected property as well as anticipated future lease income or sale proceeds from that property. Furthermore, the Group could be held liable to repair damage caused by the event. The Group may also remain liable for any debt or other financial obligation related to that property.

Dependence on subcontractors and supply and price of the construction materials

The Group has acquired and will acquire real estate upon which it develops and constructs properties, or which have existing buildings that require renovation. The Group and Joint Ventures rely mainly on third party constructors or subcontractors and to some extent on its own construction division for its construction and development operations. If the Group or Joint Venture cannot enter into subcontracting arrangements with third party service providers at acceptable terms or at all, the Group / Joint Venture will incur additional costs which will have an adverse effect on its business. The competition for the services of quality contractors and subcontractors may cause delays in construction, therefore exposing the Group to a loss of its competitive advantage.

The Group mainly uses fixed price agreements in its construction operations, both with the customers and subcontractors. When the Group is acting as a contractor it will be subject to risks relating to the subcontractors' financial solidity and ability to meet their obligations. In the development business, the contractor's or subcontractor's failure to perform may result in legal action by the Group to rescind the construction agreement or to enforce the contractor's obligations, which may result in a delay of the project. Furthermore, any delay in the completion of construction may result in an additional cost which the Group may not be able to pass on to the purchaser of the property.

In addition, the Group's development and construction operations may face fluctuations in the supply and market price of some construction materials. The Group's construction operations require various bulk construction materials such as steel and cement. The availability of supply, and the market price for construction materials have varied significantly in Estonia and Latvia in recent years. Due to the recent growth in the construction industry, there have been shortages in the supply of construction materials which in turn has increased prices. Management believes that the Group will confront similar risks in Ukraine, Romania and Bulgaria or in any other country in which the real estate market is rapidly growing.

If the completion of construction is delayed for any reason and the prices of construction materials increase, the Group may need to incur additional costs. The Group's construction division normally has fixed-price agreements with its customers which limits the Group's ability to pass on any of the additional costs incurred as a result of the increase in the construction material prices.

Any delays in the completion of construction operations and consequently, of development projects, and increases in the cost of construction materials may have a material adverse affect on the Group's results of operations and financial condition. See – "Lack of qualified workforce and construction materials."

Growth and its control

Over the past decade the Group has grown relatively rapidly. In recent years, the Group has gradually entered new markets as well as undertaken or acquired new operations such as construction. Management believes that it will continue growing through organic expansion of its business, through acquisitions and through geographical expansion. Whereas the Group is well-established in Estonia and Latvia, expansion into new markets requires further investments and the successful implementation of its business model. The Group faces numerous risks characteristic of international businesses, such as the need to adapt to a large number of different rules and regulations, tax practice or foreign exchange rate fluctuations and general difficulties in operating in a new market such as enforcing contracts. The Group's business strategy is to enter a new market by first establishing real estate agency operations and then gradually taking up other operations. This strategy allows the Group to familiarise itself with specific markets with relatively low initial investments and then to increase its investments as it becomes more familiar with local market conditions.

Growth through acquisitions may cause separate risks, partly because of risks inherent in acquiring businesses and partly because of the difficulty of integrating the acquired businesses into the Group. The Group may fail to integrate the acquired business in accordance with its business strategy and the target may have undiscovered contingent liabilities.

In order to control its investments and assess and manage the potential internal risks, the Group is in the process of implementing a balanced scorecard management system in Estonia and has already adopted other administrative systems across its divisions. The Group needs to continually improve its financial and management controls, reporting systems and procedures, implement new systems when necessary and support, train and manage its personnel. If the Group fails to control its growth and development successfully, this may have an adverse effect on its business, results of operations and financial condition.

Indebtedness

Although Management believes that the Group's current leverage ratio is not higher than what is typical for a real estate investment and development company, the Group and the Joint Ventures have substantial indebtedness. As at 31 December 2006, the Group had EEK 476 million of consolidated long-term borrowings and EEK 700 million of consolidated short-term borrowings. In order to secure these financings, the relevant Group companies have mortgaged most of the real estate acquired by such financing.

Among other things, the Group's indebtedness could potentially (i) limit its ability to obtain additional financing, (ii) limit its flexibility in planning for, or reacting to, changes in the markets in which it competes, (iii) place it at a competitive disadvantage relative to its competitors with less indebtedness, (iv) lead to a partial or complete loss of control over its key subsidiaries or properties, (v) render it more vulnerable to general adverse economic and industry conditions, or (vi) require it to dedicate all or a substantial part of its cash flow to service its debt.

Furthermore, fluctuation in interest rates can increase the Group's financing costs and thus have negative impact on its consolidated net profit. Furthermore, high interest rates tend to reduce the demand for real estate, which in turn can adversely affect the value of Group's and the Joint Ventures' properties and, as a result, the Group's revaluation gains. The Group regularly compares potential losses arising from interest rate fluctuation against the cost of hedging. In a majority of instances, no hedging has taken place, since the hedging expenses would have exceeded the potential losses arising

from interest rate fluctuations. See “Management Discussion and Analysis of the Group’s Financial Condition and Results of Operations – Factors Affecting Results of Operations – Interest Rates.”

The Group’s ability to make payments on its indebtedness depends upon its ability to maintain its operating performance at a certain level, which is subject to general economic and market conditions and to financial, business and other factors, many of which the Group cannot control. If the Group’s cash flow from operating activities becomes insufficient, the Group may take certain action, including delaying or reducing capital or other expenditures in an attempt to restructure or refinance its indebtedness, selling its investment properties or other assets or seeking additional equity capital. The Group may be unable to take any of such action at favourable terms or in a timely manner. Furthermore, such action may not be sufficient to allow the Group to service its debt obligations in full. A failure by the Group or the Company to service its debt may have a material adverse effect on its business, results of operations and financial condition.

Financing and loan agreements

The financing agreements entered into by the Group and Joint Ventures include several negative and positive covenants and requirements to obtain the lender’s consent for, among other things, further financing, changes in the Group’s corporate structure, paying out dividends, consolidating or merging with another corporation, changes in its share capital or creating charges over its assets.

Most of the financing agreements of the Group and Joint Ventures with financial institutions contain customary events of default, including cross-default provisions. These cross-default clauses expose the Group to default risks based on contract performance under other agreements with the financial institutions in question. In addition, under most loan agreements, it is an event of default if the borrower incurs significant additional financial obligations or if there is a change of control in the borrower without the prior consent of the lender.

In addition, most of the Group’s financing agreements require it or any of the Joint Ventures to pledge their assets for the benefit of the relevant lender. A failure to comply with the financing agreements could result in the Group losing its rights or ownership interest in the pledged property.

Any failure to comply with the financing agreements or any demand for early repayment made by the banks could have a material adverse effect on the Group’s business, results of operations and financial condition.

Availability of external financing

The Group operates in a capital intensive industry. The Group needs free cash flow to finance its land acquisitions, initiate development projects, purchase materials and perform construction work on projects before payment is received from customers. Therefore, the Group needs to finance its daily operations, whether from internally generated funds or from external credit providers. Shortage in available funds may increase the Group’s receivables and short-term borrowings. If the Group cannot obtain adequate capital on favourable terms or at all, this could have a material adverse effect on the Group’s business, results of operations and financial condition.

Dependency on cash flows from subsidiaries, associates and joint ventures

The Company is a holding company that runs its operations through 32 subsidiaries, 23 joint ventures and one associated company. The Company holds no significant assets other than its investments into its operating companies and its real property investment. Therefore, the Company is dependent upon receipt of sufficient dividend income, payments for intra-group services and other funds advanced to it by these companies to meet its own obligations.

Under Estonian law and Latvian law, a company is not allowed to pay dividends or make other distributions to shareholders unless current or retained profits are available for such distributions. In addition to the statutory restrictions on dividend payments, the Group companies are contractually bound to retain certain financial levels and ratios, which effectively may reduce the amount of funds available for dividend payments. Certain Group companies are contractually restricted from paying dividends without the prior consent of the lender. Furthermore, most of the shareholder agreements that the Group has entered into in relation to management of certain Group companies and Joint Ventures provide for an agreed dividend that must be distributed to the shareholders. The shareholders' agreement relating to Arco & Koger Investeeringute OÜ, a 50-50 joint venture with OÜ Koger Kinnisvara, prohibits any distributions during the first three years of operation, i.e. until the end of 2009. See "Business – Material Contracts – Shareholders' Agreements."

The Company's financial position is dependent on the contractual and legal ability of subsidiaries, joint ventures and associate companies to pay for the intra-group services, and to declare and pay dividends. A decrease in cash flow from the Group companies and Joint Ventures may have an adverse effect on the Company's financial condition.

Joint control over joint ventures

The Group holds interests in 23 joint ventures, which are mainly established as special purpose vehicles to develop specific real estate development projects together with one or more partners. As at 31 March 2007, such joint ventures held land units with an aggregate book value of approximately EEK 773.7 million. The Group and the other shareholders hold joint control over these companies and no assurance can be given that the Group could follow its strategic interests in these joint ventures.

In addition, the Group has contractually relinquished its controlling interests in certain matters in SIA Arco Real Estate, SIA Arco Development, Arco Ukraina Valduste OÜ and SIA Arco Construction where it holds 80 per cent, 80 per cent, 75 per cent and 55 per cent, respectively. Under the shareholders agreements relating to these companies, certain corporate resolutions require the consent of minority shareholders – see "Business – Material Contracts – Shareholders' Agreements".

These investments involve risks that are not present with assets in which the Group owns a controlling interest. There is a risk that the co-investors might at any time have economic or other business interests or goals that are inconsistent with the Group's business interests or goals. The co-investors may be in a position to take action contrary to the Group's instructions or requests, or contrary to the Group's policies or objectives. No assurance can be given that the co-investors have same objectives as the Group regarding the appropriate timing and pricing of any sale or refinancing of properties. Furthermore, there is a possibility that the co-investors would become insolvent and would not be able to meet their obligation.

The Group has entered into shareholder agreements with its co-investors in respect of six joint ventures. Most of the shareholder agreements of the joint ventures provide for a mechanism for solving a deadlock in the decision-making of the company. Usually the parties to these agreements are provided a put or call option to solve the deadlock situation. In case there is no shareholder agreement between the investors or the agreement does not provide any solution for deadlock, the Group may need to seek for a third party investor to buy the shares or the joint venture may need to be dissolved if no agreement is reached. See "Business – Material agreements – Shareholders' agreements." Such mechanisms however, have never been invoked in any of the joint ventures of the Group, but should a serious deadlock situation arise, it could have a material adverse effect on the Group's business, results of operations and financial condition.

Contractual risks

A dispute may arise between the Group and its contractual counterpart on the interpretation or the validity of a contract or fulfilling of contractual obligations, which can lead to arbitration or litigation with an unfavourable outcome for the Group. Contractual claims and other demands may also have an adverse effect on the Group's profits or financial position. See "Business - Legal Proceedings."

Construction and development liability

The Group's construction business inherently exposes itself to potential liability for defects in design, construction, materials or workmanship. The Group may be subject to claims resulting from defects arising out of construction services within the warranty period. Under Estonian and Latvian law, the construction contractor is subject to a statutory warranty obligation for a period of two years, commencing from the completion of construction, for the conformity of the workmanship to the contract and to the anticipated use of the construction, as well as for the safety of the completed construction. The statutory warranty obligation of a construction contractor cannot be reduced by contract. Accordingly, most of the Group's construction contracts provide for a warranty that covers defects appearing within two years from the delivery of the works to the customer. Due to competitive pressure, the Group has occasionally granted warranties for a longer period than the statutory minimum warranty.

Under Estonian and Latvian law, the Group and the Joint Ventures may be held liable as real estate developers towards their customers for, among other things, legal or construction defects in the property sold to the customer. Such defects may include faults in construction as well as legal defects, such as undisclosed rights of third parties, restrictions associated with nature preservation or heritage protection, planning issues, exercise of statutory right of pre-emption by the state or the local government in case of conservation areas or protected buildings or a prohibition against transfers of rural land to persons not engaged in agriculture or forestry.

Estonian law allows claims connected to the deficiencies in buildings to be made against the construction contractor or the seller of a land unit under general rules of statute of limitations for an extended period of 5-10 years (the general limitation period for contractual claims is 3 years). The law provides for the possibility of agreeing upon a shorter claims period in a construction or sales contract.

The Group seeks to cover its exposure for warranty claims mainly through creating reserves and also through limited insurance, which is designed to cover claims during the contractual warranty period. However, these measures may not always be sufficient. The Group passes the warranty liability on to its contractor and subcontractors, but they may not have adequate financial resources to fully indemnify the Group. Losses may arise from risks not addressed in the Group's indemnity agreements or insurance policies, or it may no longer be possible to obtain adequate insurance coverage against some risks on commercially reasonable terms. Failure to effectively cover the Group's exposure to risks arising from engineering and construction liabilities could expose the Group to substantial costs and potentially lead to substantial losses. Additionally, liabilities relating to defects in design and construction may also adversely affect public perception about the operations of the Group and the perception of customers, suppliers and employees, leading to an adverse effect on the Group's business, results of operations and financial condition.

Furthermore, any claim brought against the Group or any of the Joint Ventures, and the surrounding negative publicity concerning the quality of the properties or projects of the Group or Joint Ventures, irrespective of whether the claim is proven, could also have a material adverse effect on the perception of the Group and its property and projects by its target customers, tenants or investors, and as a result its ability to market, lease or sell its properties and projects successfully in the future. In turn, this could have a material adverse effect on the Group's business, results of operations and financial condition.

Environmental issues

The Group's activities are and will continue to be subject to laws and regulations relating to environmental protection. See "Business – Environmental Issues." Such laws and regulations typically cover a wide range of matters, including, among other things, waste handling, protection of ambient air and use of water. Management believes that the Group complies in all material aspects with the environmental legislation currently in force in all countries in which it operates. However, as Estonia and Latvia, as well as most of the other countries in which the Group operates, are Member States of the European Union, there is a risk that the laws and regulations applicable to real estate development and construction companies may become more stringent and require an increased level of investment by the Group to comply with such standards of environmental safety. The Group has introduced internal procedures, which Management believes to be appropriate to ensure reasonable compliance with applicable laws, regulations, permits and contractual terms and conditions. However, failure to comply with these laws, regulations, permits and contractual terms and conditions could result in substantial costs and liabilities, which could adversely affect the Group's business, its financial condition and results of operations.

The Group, from time to time, acquires land which has subsequently been found to be contaminated. Such land must be cleaned up before the development or construction can commence. Environmental laws and regulations often impose liability on the current property owner whether or not the owner knew of, or was responsible for, the presence of such contamination. Environmental laws may also impose restrictions on the manner in which property may be used or businesses may be operated on the property, and these restrictions may require substantial expenditures or prevent the Group from selling or leasing the property. When purchasing land in Estonia, the Group usually requires the seller to warrant that there is no contamination on the land. However, no assurances can be given that the Group can always detect contamination prior to the acquisition of the land, in which case it may have to incur unexpected clean-up costs. In addition, should the Group or Joint Venture fail to detect or remedy contamination, this may adversely affect the Group's or Joint Venture's ability to sell or lease property and expose the Group to claims from its customers or third parties for personal injury or property damage associated with exposure to contamination.

The cost of complying with environmental regulations or of decontamination of any land by the Group and Joint Ventures or the cost associated with a successful claim for damages could have a material adverse effect on Group's financial condition and results of operations.

Dependence on key personnel

The Group's performance is reliant upon the efforts, diligence, skill and network of business contacts of its senior management team. Well-connected local managers with knowledge of the relevant local market are essential for the Group's property development business. The Group may not always be able to impose competition covenants or other contractual restrictions on a key manager and the Group have to give additional remuneration incentives in order to secure the loyalty and continued employment of such managers. Should the Group lose one or more key managers and fail to find a replacement quickly enough, or should such key manager or managers join a competing business, this could adversely affect the business and results of operations of the Group.

In particular, the Group's Latvian operations have historically been dependent on the services of one of its principal real estate developers, Mr. Viktors Savins. While the Group is in the process of increasing the incentives provided to its other Latvian managers, the departure of Mr. Savins could have a material adverse effect on the Group's Latvian operations.

In addition, the Group depends to a significant extent on its ability to attract and retain highly qualified engineering, technical, sales and business personnel experienced in both acquiring and executing property development projects. The Group anticipates that demands on management and professional

staff will increase. Future success depends on the continuing ability of the Group to identify, hire, train and retain such personnel in the future. See “Business - Employees” and “Management.”

Health and safety

The construction industry generally engages in inherently dangerous operations, which may result in work accidents, equipment failures, fires or explosions, including hazards that may cause injury and loss of life, severe damage to and destruction of property and equipment, and environmental damage. The Group has adopted appropriate health and safety regulations, except for two Group companies where such regulations are in the process of being adopted. Health and safety procedures are assessed on an on-going basis on all of its construction sites. However, no assurance can be given that employees or former employees would not file claims against the Group in the future in respect of injury or illness suffered as a result of working conditions. Such claims, if successful, could have an adverse effect on the Group’s business and results of operations.

Dependence on IT systems

Whilst property advisory services, property development and construction are not generally considered high-tech or technology-intensive industries, rapidly developing technology is nevertheless one of the determining factors of success in the real estate and construction business. Advanced technology and sophisticated IT solutions for project management are particularly critical in large and complex development projects.

The Group has developed and uses a variety of IT systems and web-based solutions for its operations, including on-line agency services, internal accounting and management information systems, the handling of customer and tenant information, project designs and specifications, and general administrative functions. Failures or significant disruptions to the Group’s IT systems could prevent it from conducting its operations efficiently. Furthermore, should the Group experience a significant security breakdown or other disruption to its IT systems, sensitive information could be compromised and its operations could be disrupted which in turn could harm its relationship with its customers and suppliers, or otherwise have a material adverse effect on the Group’s business, results of operations and financial condition.

Inability to keep pace with technical and technological developments

To meet customer demand, the Group must continuously update existing, and develop new technology for its property services and property development and construction operations. In addition, rapid and frequent developments in technology and market demand can often render existing technologies and equipment obsolete, requiring substantial capital expenditure and/or write downs of assets. The Group has made significant investments in new equipment and updating its expertise, but failure to anticipate or to respond adequately to changing technical, market demands and/or customer requirements could adversely affect the Group’s business and results of operations.

Relationship with the principal shareholder

Prior to the Combined Offering, OÜ Toletum owns 66.67 per cent of the Shares. Following the completion of the Combined Offering, this shareholder will continue to own or control approximately 35.78 per cent of the Shares, assuming that the Upsizing Option and the Over-Allotment Option are exercised in full and that this shareholder will not acquire any Offer Shares in the Combined Offering. As a result, OÜ Toletum will be able to exercise significant control over certain matters requiring shareholder approval, including amending the Articles of Association and making changes to the share capital, which could delay or prevent an outside party from acquiring control of the Company. The ability of insiders to prevent or delay these transactions could cause the price of the Shares to decline.

Currency exchange risks

During the financial year ended 31 December 2006, seven per cent of the Group's revenues were generated in Latvian lats. During the same period, 1.1 per cent of the Group's revenues were generated in Ukrainian hryvnia, and 0.05 per cent in Bulgarian levs. In addition, the dividends received from the Group's subsidiaries, affiliates and joint ventures are paid in the currencies of the country of incorporation of these companies. Fluctuations in foreign exchange rates can have a significant impact on the valuation gain accounted for in the income statement year by year. In order to hedge the currency risk of the Group companies, the majority of transactions and contracts are in euros or currencies pegged to the euro. Thus the main currency risk for the Group is that the rate at which these currencies are pegged to the euro changes or that any of these currencies ceases to be pegged to the euro. However, the Group is not engaged in exchange rate hedging activities, and thus is exposed to currency exchange risk. See "Management Discussion and Analysis of the Group's Financial Condition and Results of Operations – Factors Affecting Results of Operations – Exchange Rates."

RISKS RELATING TO THE GROUP'S INDUSTRY

Economic cycles

The property development and construction businesses are cyclical in nature and their profitability tends to fluctuate due to changes in the property markets, general economic conditions, rental yields, interest rates and level of fixed capital investment. Rental levels and the market value of properties are generally affected by overall conditions in the economy, such as growth and absolute levels of GDP, employment trends, inflation and changes in the interest rates. Revenues from property development and construction may be adversely affected if economic development slows down or one or more countries in which the Group or the Joint Ventures operate enters into recession or property prices decrease or cease to increase. Furthermore, a downturn in general economic conditions in one or more of the countries in which the Group chooses to invest may have a negative impact on the demand for its development projects, which in turn could lead to the Group experiencing a loss on such projects or needing to find an alternative use for its development sites. No assurance can be made that the Group's business may not be materially and adversely affected if the economy in Estonia, Latvia, Lithuania, Ukraine, Bulgaria or in any other country in which the Group chooses to invest slows down or the property values or housing prices go in decline.

Competition

The Group operates in a highly competitive business environment. The participants in the Central and Eastern European real estate development and construction industry experience intense competition from a number of local, national and international real estate development firms, real estate investment funds, commercial real estate management companies, construction companies, individual investors and sellers. The barriers to entry are usually low, which gives a competitive advantage to those companies with better access to financing and expertise on the market conditions.

Competition in the real estate development market may lead to an oversupply of residential or commercial real estate through over-development and a resulting decline in the value or average sale price of the properties of the Group or Joint Ventures. Competition may also lead to a significant increase in prices of land available for development or commercial real estate available for sale, impeding the acquisition of new assets, any of which could have a material adverse effect on the Group's business, results of operations and financial condition.

The construction industry is subject to intense price competition. While quality of design and workmanship, technological expertise, past performance, health and safety records and quality of personnel, as well as reputation and experience do impact the customer decisions, price ultimately remains the decisive factor. Although the Group's Estonian construction subsidiaries have been issued ISO qualifications for certain construction management aspects and the Group seeks to maintain its

existing competitive advantages, no assurance can be given that the construction division of the Group will be able to increase or maintain its volume of order intake and operating revenues.

Some of the Group's current and potential competitors in different markets are major international real estate and construction companies or subsidiaries of such companies, which have greater financial resources, know-how and marketing capabilities than the Group. They may also benefit from greater economies of scale and operating efficiencies. Competitors may, whether through consolidation or growth, present more credible integrated and/or lower cost solutions than the Group does.

Any negative change in the Group's competitive position may have adverse effect on the Group's business, results of operations and financial condition. See "Business – Operations – Services division – Competition; Business – Operations –Development division – Competition; Business – Operations - Construction division – Competition".

Illiquidity of real estate investments

Investments in real estate are relatively illiquid and the selling process of real property may take time. As part of its strategy, the Group mainly invests into properties located in the capital cities and preferably in the city centres, which Management considers to be more liquid. However, illiquidity of real estate investments may affect the Group's ability to vary its portfolio or dispose of or liquidate part of its portfolio in a timely fashion and at satisfactory prices. In addition, the Group's property portfolio is subject to restrictive covenants under financing agreements which may further restrict their transferability. This could have material adverse effects on the Group's results of operations and financial condition.

Lack of qualified workforce and construction materials

The Estonian and Latvian construction markets have grown very rapidly during the recent years. At the same time, following the Estonian and Latvian accession to the European Union, a significant number of the Estonian and Latvian construction workers have chosen to work in other Member States, where wages are currently higher than in their home country. As a consequence, Estonian and Latvian contractors often face a shortage of qualified staff and are forced to raise wages and salaries in order to retain their workforce or attract new employees.

Also, the Estonian and Latvian production capacity for construction materials remains lower than demand created by the market growth, which can cause delays in procurement of materials. Whilst the Group has made an effort to strengthen its relationships with key material suppliers and the Group has not faced major disruptions to its materials procurement to date, no assurance can be given that the Group or its subcontractors will have uninterrupted access to the necessary construction materials.

Should the Group face serious shortages of workers or disruptions of materials supply, it could result in the Group failing to meet project timetables or actual costs exceeding budgeted costs, which could have a material adverse effect on the Group's business, results of operations and financial condition.

RISKS ASSOCIATED WITH THE COMBINED OFFERING

Volatility of share prices

There can be no assurances regarding the future development of a market for the Shares or the ability of holders of the Shares to sell their Shares or the price of any such sale. Prior to this Combined Offering, there has been no public market for the Shares. The Offer Price for the Shares will be determined through negotiations among the Global Coordinator, Selling Shareholders and the Company. This initial Offer Price may vary from the market price of the Shares after the Combined Offering. Investors, who purchase Shares in connection with the Combined Offering, may not be able to resell those Shares at or above the Offer Price.

Prevailing market prices from time to time will depend on large number of factors, including the Group's operating results or financial condition or cash flows. Furthermore, the market price of the Shares could be adversely affected by developments unrelated to the Group's operating performance such as strategic actions by competitors, changes in market conditions or the regulatory environment, the operating and share price performance of other companies that investors may consider comparable to the Group. Any of these events could result in a decline in the market price of the Shares.

Liquidity

An application has been made to the Tallinn Stock Exchange for the Shares to be listed on the Main List of the Tallinn Stock Exchange. However, no assurance can be given that the Shares will be listed or that, following the listing, an active trading market for the Shares will emerge, develop or be sustained after completion of the Combined Offering.

The average daily trading turnover on the Tallinn Stock Exchange from 1 January to 30 April 2007 was EUR 5,367,876. A total of 16 companies were listed on the Tallinn Stock Exchange as of 30 April 2007. As of 30 April 2007, the three largest companies in terms of market capitalization, AS Eesti Telekom, AS Tallink Grupp and AS Olympic Entertainment Group represented approximately 59 per cent of the Tallinn Stock Exchange's aggregate market capitalization of approximately EUR 4.8 billion. Consequently, the Tallinn Stock Exchange is substantially less liquid and more volatile than established markets such as those in other countries with highly developed securities markets. The relatively small market capitalization and low liquidity of the Tallinn Stock Exchange may impair the ability of shareholders to sell the Shares on the Tallinn Stock Exchange, which could increase the volatility of the price of the Shares. De-listing of any of the large companies listed on the Tallinn Stock Exchange would be likely to have a negative effect on the market capitalization and liquidity of the Tallinn Stock Exchange.

Prices on the Tallinn Stock Exchange may also be affected by external factors, such as the performance of world markets generally, or other emerging markets in particular, or the imposition of or changes in trading or capital gains taxes.

Share price fluctuations caused by offer for sale of substantial number of additional shares

Sales or issuance of additional Shares into the public market following the Combined Offering could adversely affect the market price of the Shares. The Company and all its current shareholders have agreed to a lock-up commitment for a period of 12 months in connection with the Combined Offering (see "Underwriting - Lock-up"). These shareholders together own or control approximately 53.67 per cent of all the Shares issued and outstanding immediately following the Combined Offering assuming that the Upsizing Option and the Over-Allotment Option are exercised in full and none of the current shareholders acquires any Offer Shares in the Combined Offering.

In addition, as of the date of this Offering Circular, approximately 51 per cent of the Shares are pledged for the benefit of AS SEB Eesti Ühispank. The Selling Shareholders and SEB Eesti Ühispank have agreed that the Selling Shareholders must use the proceeds from the sale of Offer Shares to repay the loans granted by AS SEB Eesti Ühispank and consequently, the bank shall release the Shares from the pledge. Nevertheless, certain number of Shares remain pledged for the benefit of AS Hansapank after the Combined Offering. Should the shareholders fail under any of the financial agreements underlying the pledge arrangements, the pledge holder has a right to realise the pledge and consequently, to sell the Shares. Any such sale in a significant amount may have an adverse effect on the market price of the Shares.

Future payments of dividends on the Shares

There is no assurance that the Company will pay dividends on the Shares, nor is there any assurance as to the amount of any dividend it might pay. The payment and the amount of any dividend will be

subject to the discretion of the Company's Management Board, Supervisory Council and, ultimately, the General Meeting of Shareholders and will depend on available cash balances, anticipated cash needs, results of operations and financial condition of the Group and any financing agreement restrictions binding the Company as well as other relevant factors. See "Dividends and Dividend Policy."

Continued analyst cover

The trading market for the Shares will depend on the research and reports that industry or securities analysts may publish about the Group or its business. The Group has no control over these analysts. If one or more of the analysts who cover the Group downgrade their ratings of the Shares, the price of the Shares may decline. If one or more of these analysts cease coverage of the Group or fail to publish regular reports on it, the Company could lose visibility in the financial markets, which in turn could cause the price of the Shares or trading volume to decline.

Restrictions on transfers of Offer Shares and no public market in the United States for resales of the Shares

The Offer Shares have not been registered in the United States under the Securities Act or under any other applicable securities laws and are subject to restrictions on transfer contained in such laws. The Company does not intend to list the Shares on an established securities exchange in the United States, have them quoted on an automated inter-dealer quotation system in the United States or otherwise create a public market in the United States for resales of the Shares. The Shares constitute "restricted securities" as defined in Rule 144(a)(3) under the Securities Act and, accordingly, are not freely tradable in the United States. There are additional restrictions on the resale of Offer Shares by shareholders who are located in the United States and on the resale of Offer Shares by shareholders to any person who is located in the United States. See "Underwriting - Selling restrictions".

Restrictions on United States shareholders to participate in future rights offerings

Under Estonian law, existing shareholders of shares of Estonian limited liability companies are entitled to statutory pre-emption rights, except where shareholders have waived this right. See "Company, Share capital and Ownership structure – Shareholder rights – Right to acquire own shares". If such rights are not waived, United States holders of Shares may not be able to exercise statutory pre-emption rights in the future unless a registration statement under the Securities Act is effective with respect to those rights, or an exemption from the registration requirement thereunder is available. The Company is unlikely to file any such registration statement in the future, and no assurance can be given that an exemption from the registration requirements of the Securities Act would be available to enable such United States holders to exercise such statutory pre-emption rights or, if available, that the Company will utilize any such exemption. Furthermore, if United States shareholders are not able to exercise statutory pre-emption rights, they may face dilution as a result.

Certain potentially adverse United States federal income tax consequences to United States investors

The Company believes that it was not a passive foreign investment company ("PFIC") for United States federal income tax purposes for its most recent taxable year and does not expect to be considered a PFIC in the foreseeable future. The Company does, however, intend to expand the Group's portfolio of rental properties in the coming years, which may increase the percentage of the Company's assets and income that is classified as passive for PFIC purposes. As a result, there can be no assurance that the Company will not be considered a PFIC for any taxable year. If the Company were treated as a PFIC for any taxable year during which a United States investor held shares, certain adverse United States federal income tax consequences could apply to such investor. For information on the potential consequences to United States investors, please see "Taxation - United States Federal Income Taxation - Passive Foreign Investment Company Considerations."

Limitations on enforcing US judgments against Arco Vara

The Company is incorporated in Estonia. The judgments of the courts of the member states of the European Union (except for Denmark) must be recognized and enforced in Estonia either under Council Regulation (EC) No 44/2001 or Regulation (EC) No 805/2004 of the European Parliament and of the Council without any special procedure being required.

Estonia is not a party to the Brussels Convention or the Lugano Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. However, pursuant to Article 620(1) of the Estonian Code of Civil Procedure, judgments of the courts of foreign states other than the member states of the European Union (i.e. including the United States) must be recognized in Estonia, subject to certain exceptions, such as judgements contrary to Estonian ordre public or earlier judgement involving the same cause of action and between the same parties, judgements where the defendant was not able to reasonably defend its rights and judgements given by a non-authorized court. In such exceptional situations the judgements of United State courts are not enforceable in Estonia without re-litigation of the subject matter of such judgements on its merit.

In addition, substantially all of the assets of the Company and its subsidiaries and affiliates are located outside the United States. As a result, it may be difficult or impossible for an investor to serve process within the United States upon Arco Vara, or to enforce judgment upon Arco Vara for civil liabilities in United States courts.

POLITICAL ECONOMIC AND LEGAL RISKS

Risks relating to doing business in the Baltic States

Investors investing in emerging markets such as Estonia, Latvia and Lithuania should recognize that these markets are subject to greater risks than more mature markets, including legal, economic and political risks. Estonia, Latvia and Lithuania have experienced significant political, legal and economic changes and liberalization during the last two decades of transition from the Soviet rule and a planned economy to independence and a market economy.

For purposes of its accession to the European Union, Estonia, Latvia and Lithuania implemented significant social and economic changes, as well as reforms of their legal and regulatory framework. As a result, the volume of Estonian, Latvian and Lithuanian legislation and other regulations has increased and is expected to increase further pursuant to the obligation to apply European Community law.

The Estonian, Latvian and Lithuanian civil codes and corporate, competition, securities, environmental and other laws have been substantially revised during the last two decades as part of Estonia's, Latvia's and Lithuania's transition to a market economy and to meet EU requirements and standards. The new legislation remains in part largely untested in courts and no clear administrative or judicial practice has evolved.

Estonian, Latvian and Lithuanian businesses are in the process of adopting the business standards and practices of the European Union. Many companies in the Baltic States, including Arco Vara, are still adopting and developing management tools for corporate governance, internal controls and risk management.

Risks of doing business in Ukraine, Romania and Bulgaria

The Group has business operations in Ukraine, Romania and Bulgaria. Investors investing in emerging markets such as Ukraine, Romania and Bulgaria should recognize that these markets are subject to significantly greater legal, economic and political risks than those in more mature markets.

Romania and Bulgaria acceded to the European Union only very recently, in 2007. Whilst these countries have begun the transition required to meet the requirements for a membership in the EU,

their transition process is far from complete. Both countries have been given lengthy transitory periods of time to bring their legislation in line with the EU directives and requirements. The full opening of the borders between the new entrants and the EU has also been made subject to transitory periods, and the movement of labour from Bulgaria and Romania is expected to remain restricted until 2014.

Although some progress has been made since independence in 1991 to reform Ukraine's economy and its political and judicial systems, Ukraine still lacks the necessary legal infrastructure and regulatory framework which are essential to support market institutions, the effective transition to a market economy and broad-based social and economic reforms.

Political instability

Historically, a lack of political consensus has made it consistently difficult for the Ukrainian, Romanian and Bulgarian governments to secure the support necessary to implement a series of policies intended to foster liberalisation, privatisation and financial stability.

Since the independence in 1991, governmental instability has been a feature of the Ukrainian political scene and, as a result, Ukraine has had thirteen prime-ministers and three acting prime-ministers during this period. In light of the events at the beginning of April 2007 when the Ukrainian parliament was dissolved, new parliamentary elections were announced and the political disorder subsequently ensued, the political situation in Ukraine appears to be unstable. As of the date of this Offering Circular, it is still not clear how and when the political situation will stabilize.

Legal system

The Ukrainian, Bulgarian and Romanian legal systems have been developing since the 1990s to support a market-based economy. The legal systems in these countries remain, however, in transition and are therefore subject to greater risks and uncertainties than those in a more mature legal system. As member states of the EU, Romania and Bulgaria are under an obligation to bring their legislation and legal system into conformity with EU standards. Bulgaria has a transition period in relation to certain areas of legislation which extends until 2014.

The uncertainties in the legal system pose significant risks to the Group's and the Joint Ventures' operations and growth potential in Ukraine, Romania and Bulgaria particularly with respect to its ability to enforce contracts, defend its land rights and defend itself against unfair competition or arbitrary action by authorities.

Economic instability

In recent years, the Ukrainian, Bulgarian and Romanian economies have been characterised by a number of features which contribute to economic instability, including limited liquidity caused by a relatively weak banking system, tax evasion, significant capital flight and low wages. Although the governments in these countries have generally been committed to economic reform, the implementation of reform has consistently been impeded by a lack of political consensus, controversies over privatisation, the restructuring of the energy sector, the removal of exemptions and privileges for certain state-owned enterprises or for certain industry sectors and the limited extent of cooperation with international financial institutions. No assurance can be given that current reform policies favouring privatisation, industrial restructuring and tax reform will continue to be implemented and, even if implemented, that those policies will be successful, or that the economy in Ukraine will continue to improve. The Bulgarian and Romanian governments are committed to the reform policies in connection with their accession to the EU, but the implementation of these reform policies is subject to lengthy transition periods.

Currency exchange risks

An investment in shares denominated in kroons by a foreign currency investor exposes the investor to a foreign currency risk. Any depreciation or appreciation of the kroon in relation to such foreign currency will correspondingly reduce or increase the value of the investment in foreign currency terms.

Due to the accession of Estonia to the European Union on 1 May 2004, the operating results and the financial position of the Group are expected to be reported in euros at some point in the future. The exact date on which the euro will be adopted, however, has yet to be determined.

The official and only legal tender in Estonia is the kroon. The kroon is pegged to the euro at fixed rate of EEK 15.6466 for 1 EUR. Although the Bank of Estonia has expressed its intention to maintain the current fixed exchange rate and the currency board system, there can be no guarantee that the Estonian Parliament will not amend the relevant laws and that the fixed exchange rate will be maintained in the coming years. Foreign investors can open both kroon and foreign currency accounts in banks registered in Estonia. Any foreign currency may be freely purchased and sold at market exchange rates. There are no capital movement restrictions. Any devaluation or revaluation of the kroon may have negative consequences for the Estonian economy as a whole and may have a material adverse effect on the Group's financial condition and results of operations.

Potential tax liabilities

Estonia currently enjoys a corporate income tax regime under which income tax is deferred until profits are distributed. Although Estonian companies are currently subject to income tax of 22 per cent, the effective rate is approximately 28.20 per cent of dividends and other distributions paid (22/78 of the net amount of distributed profits), which rate is due to decrease over the next two years. In addition, an Estonian dividend withholding tax of 22 per cent, which rate is due to decrease to 20 per cent by 2009, is currently imposed on dividends paid by the Company to non-resident legal persons, holding less than 20 per cent of the shares or votes of the Company.

The European Union has granted Estonia a transition period expiring on 31 December 2008 following which time Estonia may be required to at least partly adjust its current tax regime. The possibility that Estonia may change its corporate taxation policy has periodically been subject to political discussion but it is currently not possible to assess whether or when any such change may occur. Any change in Estonian corporate taxation policy could have a material adverse effect on the Group's business, results of operations and financial condition. See "Taxation".

Estonian tax laws and regulations have not been in force for significant periods, in contrast to more developed market economies; therefore, implemented laws and regulations may be unclear or nonexistent. Accordingly, there is limited case law on the application and interpretation of these laws. Differing opinions regarding legal interpretations exist both among and within tax authorities, thus creating uncertainties and areas of conflict. Due to the nature of the industry the Group is operating in, complex transactions have been entered into which might expose the Group to potential tax risks as a result of such differing opinions on interpretations of tax legislation.

Dependence on relatively low labour costs

As Member States of the European Union, Estonia, Latvia, Lithuania, Romania and Bulgaria are becoming increasingly integrated in the European markets, and price levels and salaries in these countries are gradually becoming aligned with those in the other member countries. Whilst the wages and salaries in Estonia, Latvia and Lithuania generally remain lower than in the older Member States, further integration with the European Union, coupled with economic and legislative developments, is expected to result in a gradual erosion of this competitive advantage of businesses in the new Member States. The same process can be expected to take place eventually also in Romania and Bulgaria. If the

Group fails to achieve new competitive advantages to off-set the impact of the rising labour costs, this could have a material adverse effect on the Group's results of operations or financial condition.

TERMS AND CONDITIONS OF THE RETAIL OFFERING

These terms and conditions (“Terms”) relate only to the Retail Offering.

THE COMBINED OFFERING

The Combined Offering consists of 34,450,000 existing and new Shares (the Offer Shares) and consists of a private placement to institutional investors in and outside Estonia and Latvia and to certain employees of the Group in Lithuania, Romania and Bulgaria (the International Offering), a public offering to other investors in Estonia and Latvia including the employees and certain managers of the Group and Joint Ventures in Estonia and Latvia (the Retail Offering) and a private placement in reliance on applicable private placement rules to certain key managers of the Group and the Joint Ventures (the Management Incentive Offering). Up to 6,950,000 existing Offer Shares will be offered and sold by the Selling Shareholders and 27,500,000 new Offer Shares will be issued by the Company. The Company reserves an option to increase the number of new Offer Shares to be offered in the Combined Offering by up to 8,000,000 Offer Shares prior to the determination of the Offer Price (the Upsizing Option). The Selling Shareholders have granted the Global Coordinator an option (the Over-Allotment Option), exercisable within 30 days of the date of the commencement of trading in the Shares on the Tallinn Stock Exchange, to require the Selling Shareholders to sell up to an additional 5,400,000 existing Shares for purposes of covering possible over-allotments.

The division of Offer Shares between the International Offering and the Retail Offering has not been pre-determined. 1,550,000 Offer Shares will be allocated in the Management Incentive Offering. The number of Offer Shares included in the International Offering and in the Retail Offering will be decided by the Company and the Selling Shareholders in consultation with the Global Coordinator. This decision will be taken in conjunction with the allocation process, which will take place after the expiry of the Offer Period.

When deciding the division of Offer Shares between the International Offering and the Retail Offering, the Company and the Selling Shareholders will consider mainly (i) the overall demand for the Offer Shares, (ii) the demand for the Offer Shares in the Retail Offering and (iii) the variance in the size of orders in the Retail Offering and the distribution of orders of different sizes in the Retail Offering. When deciding such division the Company and the Selling Shareholders aim to determine a proportion between the International Offering and the Retail Offering which (i) gives the Company a wide shareholder base, (ii) emphasises the long-term investment in the Company and (iii) can be expected to contribute to a stable and favourable development of the share price in the aftermarket.

Until the determination of the Offer Price and completion of the allocation process the Company has the right to exercise the Upsizing Option or the Company and the Selling Shareholders have the right to decrease the total number of Offer Shares included in the Combined Offering, taking into consideration the total demand in the International Offering and the price level and quality of such demand. The total number of Offer Shares included in the Combined Offering may also decrease in case any part of the Combined Offering is cancelled – see “Cancellation of Combined Offering”.

The Company expects to announce the Offer Price and the results of the allocation process, including the final number of Offer Shares and the division of Offer Shares between the International Offering and the Retail Offering and the Management Incentive Offering on or about 15 June 2007 on the website of the Estonian Financial Supervision Authority (www.fi.ee) and through the Tallinn Stock Exchange (www.omxgroup.com/tallinn).

OFFER PERIOD

Investors may submit purchase orders for the Offer Shares (a “Purchase Order”) during the offer period, which commences at **9 a.m. on 4 June 2007** and terminates at **4 p.m. on 14 June 2007** (the “Offer Period”).

CANCELLATION OF COMBINED OFFERING

The Company and the Selling Shareholders have reserved the right to jointly cancel the Combined Offering in part or in its entirety at any time until they have received the full payment for all the Offer Shares, if (i) the General Meeting of Shareholders fails to decide the issue of new Offer Shares prior to settlement and/or (ii) the Underwriting Agreement (as defined hereafter) among the Company, the Selling Shareholders and the Global Coordinator has not been entered into on or before 15 June 2007 or (iii) the obligations of the Global Coordinator under the Underwriting Agreement (a) have not become unconditional or (b) terminate prior to settlement. Any cancellation of the Combined Offering or any part thereof will be announced on the website of the Estonian Financial Supervision Authority (www.fi.ee) and through the Tallinn Stock Exchange (www.omxgroup.com/tallinn). All rights and obligations of the parties in relation to the cancelled part of the Combined Offering will be considered terminated at the moment when such announcement is made public.

OFFER PRICE

The Company and the Selling Shareholders will decide the Offer Price in consultation with the Global Coordinator after the completion of the book-building process directed to the institutional investors. The Offer Price will be based on the tenders for the Offer Shares obtained from institutional investors, taking also into account the factors related to Group's business and financial condition, and Group's industry (see "Underwriting – General"), the total demand in the International Offering, the price sensitivity of such demand and the quality of the demand. The Offer Price will be in the Offer Price Range of EEK 37 – 44.

The Offer Price will be same in the International Offering and in the Retail Offering.

The Offer Price will be expressed in Estonian kroons only. However, investors in Latvia will pay for the Offer Shares in Latvian lats (see – "Payment and returning of funds").

RIGHT TO PARTICIPATE IN THE RETAIL OFFERING

The Retail Offering is directed to all natural and legal persons who have a securities account with Estonian Central Register of Securities (the "ECRS") and whose address recorded in ECRS records in connection with such securities account is located in Estonia and/or, in case of legal persons, whose registration code recorded in ECRS records in connection with such securities account is the registration code of the Estonian Commercial Register. These persons are referred to as "investors in Estonia" in these Terms.

The Retail Offering is directed also to all natural and legal persons who have a securities account with AS SEB Latvijas Unibanka and whose address recorded in the records of AS SEB Latvijas Unibanka in connection with such securities account is located in Latvia and/or, in case of legal persons, whose registration code recorded in the records of AS SEB Latvijas Unibanka in connection with such securities account is the registration code of the Latvian Commercial Register. These persons are referred to as "investors in Latvia" in these Terms.

However, the Retail Offering is not directed to the following categories of institutional investors:

- (i) credit institutions, investment firms, collective investment schemes and their management companies, pension funds and their management companies, insurance companies and other authorised or regulated financial institutions;
- (ii) the Republic of Estonia and the Republic of Latvia and other national, regional and local government entities, central banks and international organisations;
- (iii) natural persons and small and medium-sized enterprises who have been registered as institutional or qualified investors in the respective list maintained by the Estonian Financial

Supervision Authority in accordance with Article 237 of the Securities Market Act (*väärtpaberituruseadus*) or in the respective list maintained by the Latvian Financial and Capital Market Commission in accordance with Article 3²(3) of the Financial Instruments Market Law;

- (iv) natural persons and small and medium-sized enterprises of a Member State of the European Economic Area (other than Estonia and Latvia) who have been registered as institutional or qualified investors in such Member State;
- (v) companies which are not small and medium-sized enterprises; and
- (vi) financial institutions, whose sole corporate purpose is to invest in securities.

A legal person will qualify as an institutional investor under paragraph (v) above only if it provides its latest annual financial statements to the Global Coordinator and such financial statements evidence, to the satisfaction of the Global Coordinator, that it does not fall under the definition of “small and medium-sized enterprises” as set forth in the Securities Market Act of Estonia and the definition of “small and medium-sized enterprises” as set forth in Article 1(33) of the Financial Instruments Market Law of Latvia.

A legal person will qualify as an institutional investor under paragraph (vi) above only if it provides to the Global Coordinator documents and information evidencing, to the satisfaction of the Global Coordinator, that its sole corporate purpose is to invest in securities.

The Global Coordinator is entitled, but not obliged, to request appropriate documentary evidence from any person who claims to be an institutional or qualified investor or denies being an institutional or qualified investor.

All investors that wish to acquire any of the Offer Shares should acquaint themselves with the relevant laws of their countries of residence prior to making a decision to participate in the Combined Offering.

SUBMISSION OF PURCHASE ORDERS

The Company and Selling Shareholders invite investors to submit Purchase Orders in accordance with these Terms. Purchase Orders may be submitted during the Offer Period.

An investor may submit a Purchase Order only at the upper limit of the Offer Price Range, which is EEK 44 for investors in Estonia and LVL 1.9575 for investors in Latvia (“Maximum Price”). The upper limit of the Offer Price Range has been converted from Estonian kroons to Latvian lats on the basis of the official daily exchange rate as most recently published on the web page of *Eesti Pank* (www.eestipank.info) prior to the date of this Offering Circular.

Should an investor submit more than one Purchase Order, all Purchase Orders by the same investor will be added together and considered one single Purchase Order for the purposes of the allocation.

An investor must ensure that all information contained in the Purchase Order is correct, complete and readable. The Company and the Selling Shareholders reserve the right to reject any Purchase Orders which are incomplete, incorrect or unclear.

An investor may submit a Purchase Order either personally or through a representative whom the investor has authorized (in the form required by law) to submit the Purchase Order and make the payments related to such Purchase Order.

Investors in Estonia may submit Purchase Orders through any custodians of the ECRS (see - “Instructions to Investors in Estonia”). Investors in Latvia may submit Purchase Orders only through AS SEB Latvijas Unibanka (see - “Instructions to Investors In Latvia”). AS SEB Latvijas Unibanka and the custodians of the ECRS are hereinafter referred to as the Custodians.

By submitting a Purchase Order an investor:

- confirms that it has read this Offering Circular, accepts these Terms and agrees with the Company and the Selling Shareholders that these Terms will be applicable to the investor's acquisition of any Offer Shares;
- acknowledges that the Retail Offering does not constitute an offer of the Offer Shares by the Company or the Selling Shareholders in legal terms or otherwise and that the submission of a Purchase Order does not itself entitle the investor to acquire the Offer Shares nor result in a contract for the sale of Offer Shares;
- accepts that the number of Offer Shares indicated by the investor in the Purchase Order will be regarded as the maximum number of Offer Shares which the investor wishes to acquire (the "Maximum Amount") and that the investor may receive less (but not more) Offer Shares than the Maximum Amount and that he/she/it may receive no Offer Shares at all;
- undertakes to acquire and pay for any number of Offer Shares allocated to it/him/her in accordance with these Terms.

AMENDMENT OR CANCELLATION OF PURCHASE ORDERS

An investor may amend or cancel a Purchase Order at any time before the expiry of the Offer Period. To do so the investor must contact the relevant Custodian through whom the Purchase Order in question has been made, and carry out the procedures required by the respective Custodian for amending or cancelling a Purchase Order (such procedures may differ between different Custodians). All fees payable in connection with an amendment and/or cancellation of a Purchase Order will be borne by the investor.

PAYMENT AND RETURNING OF FUNDS

Investors in Estonia

By submitting a Purchase Order, an investor in Estonia authorises and instructs the credit institution operating the investor's cash bank account connected to its/his/her securities account (which may or may not be also the investor's Custodian) to immediately block the amount equalling the product of the Maximum Price (EEK 44) and the Maximum Amount on the investor's cash account. Such amount will remain blocked until the settlement is completed or funds are released in accordance with these Terms. An investor may submit a Purchase Order only when there are sufficient funds on the cash account connected to its/his/her respective securities account to cover the amount specified above.

The final amount payable by an investor for the Offer Shares will be calculated by multiplying the number of Offer Shares allocated to such investor with the Offer Price. The amount in excess of what the investor is required to pay for the allocated Offer Shares will be released to the investor by the relevant Custodian on or about 20 June 2007.

Should the Combined Offering be cancelled or in the event that an investor's Purchase Order is rejected, the funds blocked on the investor's cash account will be released in full by the relevant Custodian on or about 20 June 2007.

Investors in Latvia

Investors in Latvia will pay for the Offer Shares in Latvian lats.

By submitting a Purchase Order, an investor in Latvia authorises and instructs AS SEB Latvijas Unibanka to immediately block an amount equalling the product of the Maximum Price (LVL 1.9575) and the Maximum Amount on the investor's cash account. Such amount will remain blocked until the

settlement is completed or funds are released in accordance with these Terms. An investor may submit a Purchase Order only when there are sufficient funds on the cash account connected to its/his/her respective securities account to cover the amount specified above.

For the purposes of determining the final amount payable for the Offer Shares, the Offer Price established in Estonian kroons will be converted to Latvian lats on the basis of the official daily exchange rate as most recently published on the web page of *Eesti Pank* (www.eestipank.info) prior to the fixing the Offer Price.

The final amount payable by an investor for the Offer Shares will be calculated by multiplying the number of Offer Shares allocated to such investor with the Offer Price converted to Latvian lats in accordance with the above. Should the amount so calculated exceed the amount blocked on the investor's cash account as a result of changes in the exchange rates occurring between the date of this Offering Circular and the date of fixing the Offer Price, then the number of Offer Shares allocated to such investor will be decreased to the closest number of Offer Shares for which there are sufficient funds for payment blocked on the investor's cash account. Any Offer Shares which remain unallocated due to such decreasing of allocation will be allocated to other investors at random.

The amount in excess of what the investor is required to pay for the allocated Offer Shares will be released to the investor by AS SEB Latvijas Unibanka on or about 20 June 2007.

Should the Combined Offering be cancelled or in the event that an investor's Purchase Order is rejected, the funds blocked on the investor's cash account will be released in full by AS SEB Latvijas Unibanka on or about 20 June 2007.

DISTRIBUTION AND ALLOCATION

The Company and the Selling Shareholders reserve the right to reject any Purchase Order, which has not been completed and submitted during the Offer Period in accordance with all the requirements set out in these Terms.

The Offer Shares will be allocated to investors by using the stepped allocation methodology. Under the stepped allocation methodology, the Company and the Selling Shareholders, together with the Global Coordinator, will determine one or more allocation bands (in number of shares) and the allocation percentages to be applied in each band. This determination will take place as part of the allocation procedures after the expiry of the Offer Period. For example, assuming three allocation bands, that part of each Purchase Order which is within allocation band A (up to and including X Offer Shares) will be allocated α per cent, whilst that part of each Purchase Order which is within allocation band B (more than X Offer Shares up to and including Y Offer Shares) will be allocated β per cent and that part of each Purchase Order which is within allocation band C (more than Y Offer Shares) will be allocated γ per cent.

The principal criteria to be used in the determination of the bands and the allocation percentages are as follows: (i) total number of Offer Shares to be allocated in the Retail Offering, (ii) the total demand for the Offer Shares in the Retail Offering, (iii) the size of Purchase Orders in the Retail Offering and (iv) the number of investors who have submitted Purchase Orders in the Retail Offering.

An indicative minimum individual allotment (amount up to which Purchase Orders will be fully accepted) will be 750 Offer Shares. The final minimum individual allotment will be determined by the Company and the Selling Shareholders, together with the Global Coordinator, after the expiry of the Offer Period and it may differ from the indicative amount provided above.

Each investor will be allocated a full number of Offer Shares without fractions. If necessary, the number of allocated Offer Shares will be rounded down to the closest full number of Offer Shares.

Any remaining Offer Shares that cannot be allocated using the process described above will be allocated to investors at random.

The table below illustrates the application of the allocation principles set forth above. The calculations in the table have been made on the following basis:

- four investors have submitted Purchase Orders – Martin, Dace, AS Y and Sven;
- the total number of Offer Shares to be allocated in the Retail Offering is 3 750;
- there are three allocation bands A, B and C with respective allocation percentages of 100 per cent, 75 per cent and 7 per cent;
- the Offer Price Range is EEK 37 - 44 and the Offer Price equals EEK 40.50.

The information above has been used merely for the purposes of exemplifying the application of the allocation principles. Under no circumstances should an investor base its investment decision upon such information or consider such information as an indication of the actual allocation bands and percentages or the actual Offer Price and size of the Retail Offering.

		Martin	Dace	AS Y	Sven	Total
Maximum Amount¹⁾		340	715	4,535	11,725	
Maximum Price (EEK)		EEK 44	EEK 44	EEK 44	EEK 44	
Transaction amount blocked (EEK)		EEK 14,960	EEK 31,460	EEK 199,540	EEK 515,900	
Total Shares in Retail Offering						3,750
Allocation bands	Alloc. %					
Band A - 0 to 500 shares	100% (α)					
Part of Subscription Order within Band A		340	500	500	500	
Calculation		340 x 100%	500 x 100%	500 x 100%	500 x 100%	
Shares allocated to investor within Band A		340	500	500	500	1,840
Band B - 501 to 1,000 shares	75% (β)					
Part of Subscription Order within Band B		-	215	500	500	
Calculation		-	215 x 75%	500 x 75%	500 x 75%	
Shares allocated to investor within Band B		-	161	375	375	911
Band C – 1,001 - ... shares	7% (γ)					
Part of Subscription Order within Band C		-	-	3,535	10,725	
Calculation		-	-	3,535 x 7%	10,725 x 7%	
Shares allocated to investor within Band C		-	-	247	751	998
Shares allocated within Bands						3,749
Unallocated shares						1
Random allocation		-	-	-	1	1
Shares allocated to investors		340	661	1,122	1,627	3,750
Offer Price (EEK)		EEK 40.50	EEK 40.50	EEK 40.50	EEK 40.50	
Final (recalculated) transaction amount (EEK)		EEK 13,770	EEK 26,770.50	EEK 45,441	EEK 65,893.50	
Funds to be returned to the investor (EEK)		EEK 1,190	EEK 4,689.50	EEK 154,099	EEK 450,006.50	

¹⁾ Number of shares which investor wishes to subscribe, i.e. number inserted in "number of securities" in the Purchase Order.

The Company and the Selling Shareholders will decide the allocation after deciding the Offer Price after the expiry of Offer Period, and no later than on 15 June 2007.

An investor may obtain information about the number of Offer Shares allocated to it/him/her after the settlement has been completed by submitting an inquiry to the Custodian operating its/his/her respective securities account in accordance with the terms and conditions applied by that Custodian.

PREFERENTIAL ALLOCATION TO MANAGEMENT AND EMPLOYEES

A preferential allocation may be given in the Retail Offering to the following persons:

- certain members of the management and supervisory bodies of the Company, its subsidiaries and joint ventures, who have been included in the list of preferred managers and employees prepared by the Company, dated 4 June 2007 (“Preferred Managers”);
- employees of the Company, its subsidiaries and joint ventures, who have been included in the list of preferred managers and employees prepared by the Company, dated 4 June 2007 (“Employees”).

The allocation bands to be applied in the stepped allocation for the Preferred Managers and the Employees may be different than those used for other investors and/or the allocation percentages to be applied in the stepped allocation for the Preferred Managers and the Employees may be higher than those used for other investors in the Retail Offering.

MANAGEMENT INCENTIVE OFFERING

The Management Incentive Offering consists of 1,550,000 existing Shares that will be offered by the Selling Shareholders to certain key managers of the Group and Joint Ventures (the “Key Managers”). 1,033,333 Shares will be offered and sold by Osühing Toletum and 516,667 Shares will be offered and sold by Osühing HM Investeeringud. The purpose of the Management Incentive Offering is to provide a motivation scheme for the Key Managers.

The table below sets out the names of Key Managers to whom the Management Incentive Offering is made and the number of Shares offered to each Key Manager:

<u>Name</u>	<u>Number of Shares</u>
Viljar Arakas	387,500
Ivar Siimar	155,000
Veiko Pedosk	108,500
Aare Tammemäe	77,500
Ahto Altjõe	77,500
Kaido Kangur	77,500
Urmas Lind	62,000
Maie Kütt	54,250
Aigars Šmits	54,250
Rauni Tillisoo	54,250
Marilyn Hein	46,500
Kadri Lindpere	46,500
Heigo Metsoja	46,500
Veiko Taevere	31,000
Lehar Lindre	31,000
Kristjan Kivipalu	31,000
Martin Otsa	31,000
Indre Augulyte	31,000
Urmas Tehver	23,250
Priit Ojari	23,250
Tarmo Loog	23,250
Tõnu Luts	23,250
Avo Rõõmussaar	23,250
Ergo Tars	15,500

Priit Hainoja	15,500
Total	1,550,000

The offer price in the Management Incentive Offering will be equal to the Offer Price. The payment of the Offer Price will be deferred and will become payable on the third anniversary of the completion of the Combined Offering. Interest will accrue on the deferred Offer Price at the rate of 6 per cent per annum. Interest is payable together with the Offer Price. The Key Manager and the Selling Shareholder may agree on the extension of the term of payment.

Each Key Manager, who acquires Shares in the Management Incentive Offering, will be bound by the following terms and conditions:

- The Key Manager is not allowed to sell or otherwise transfer the Shares acquired in the Management Incentive Offering prior to the third anniversary of the completion of the Combined Offering. If his/her employment or service relationship with the Group or relevant Joint Venture terminates prior to such term, the Selling Shareholder has a call option to repurchase the Shares sold to the Key Manager in the Management Incentive Offering at the Offer Price less the interest accrued on the Offer Price at the rate of 6 per cent per annum.
- After the end of the lock-up period, the Key Manager has the put option to sell the Shares acquired in the Management Incentive Offering to the relevant Selling Shareholder at the Offer Price plus the interest accrued on the Offer Price at the rate of 6 per cent per annum.
- Until the full payment of the Offer Price and interest, the Shares acquired by the Key Manager will be pledged for the benefit of the relevant Selling Shareholder in order to secure the obligations of the Key Manager under the terms of the Management Incentive Offering.

In order to acquire the Shares in the Management Incentive Offering, the Key Manager must enter into respective share purchase agreement and share pledge agreement with the relevant Selling Shareholder during the Offer Period.

To the extent the Key Managers do not wish to purchase the Shares offered to them in the Management Incentive Offering, the unsold Shares may be allocated to other investors participating in the Combined Offering at the discretion of the Selling Shareholders, acting in consultation with the Global Coordinator.

The Offer Shares sold to the Key Managers in the Management Incentive Offering will be transferred to their securities accounts on or about 20 June 2007. In no event will the date of settlement be later than 27 June 2007.

The Selling Shareholders have the right to cancel the Management Incentive Offering together with the cancellation of the Combined Offering. See – “Cancellation Combined Offering”.

The Key Managers in Estonia and Latvia are also entitled to participate in the Retail Offering in accordance with its terms and conditions.

SETTLEMENT AND TRADING

The Offer Shares allocated to the investors in the Retail Offering will be transferred to their securities accounts on or about 20 June 2007 simultaneously with the transfer of payment for such Offer Shares. In no event will the date of settlement be later than 27 June 2007.

In the event that an investor has submitted more than one Purchase Order through more than one securities account, the Offer Shares allocated to such investor will be transferred to his securities accounts proportionally. The number of Offer Shares to be transferred to each securities account may be rounded up or down, as necessary, in order to ensure that a full number of Offer Shares is

transferred to each securities account. In the event that the settlement cannot be completed due to lack of sufficient funds on the investor's cash account, the Purchase Order which was made through the securities account connected to such cash account will be rejected and the investor will lose all rights to the respective Offer Shares covered by such Purchase Order.

In order to facilitate settlement, some Offer Shares to be transferred to investors (corresponding to the number of new Offer Shares) will be temporarily borrowed from the Selling Shareholders so that all investors in the Combined Offering will receive only existing Offer Shares.

Trading in the Shares is expected to commence on the Tallinn Stock Exchange on or about 21 June 2007.

APPLICABLE LAW AND DISPUTE RESOLUTION

The Retail Offering and the Management Incentive Offering shall be governed by the laws of Estonia, except to the extent the rules of private international law applied by the competent court provide for the mandatory application of the laws of any other jurisdiction. Any disputes arising in connection with the Retail Offering and the Management Incentive Offering shall be settled by the competent court in Estonia, unless the exclusive jurisdiction of any other court is provided for by the provisions of law which can not be derogated from by an agreement of the parties.

INSTRUCTIONS TO INVESTORS IN ESTONIA

In order to submit a Purchase Order an investor must have a securities account with the ECRS. Such securities account may be opened through any custodian of the ECRS (the Custodian). As at 1 June 2007 the following banks and investment firms operated as Custodians:

- Aktsiaselts SEB Eesti Ühispank
- Aktsiaselts Hansapank
- Nordea Bank Finland Plc Estonian branch
- AS Sampo Pank
- Aktsiaselts Lõhmus Haavel & Viisemann
- Aktsiaselts Eesti Krediidipank
- AS SBM Pank
- Tallinna Äripanga AS
- AS Parex banka

An investor wishing to submit a Purchase Order should contact the Custodian operating its/his/her ECRS securities account and register a transaction instruction for the purchase of securities in the form set out below. The Purchase Order can be submitted by any means accepted by its/his/her Custodian (such as through personal visit to a branch office, via letter or internet).

Owner of the securities account:	name of the investor
Securities account:	number of the investor's securities account
Custodian:	name of the investor's Custodian
Security:	share of Arco Vara
ISIN code:	EE3100034653
Number of securities:	maximum number of Offer Shares which the investor wishes to acquire
Price (per share):	Maximum Price = EEK 44
Transaction amount:	maximum number of Offer Shares which the investor wishes to acquire multiplied by the Maximum Price
Counterparty:	AS SEB Eesti Ühispank
Securities account of counterparty:	99101157834
Custodian of the counterparty:	AS SEB Eesti Ühispank
Value date of the transaction:	20 June 2007
Type of transaction:	"purchase"
Type of settlement:	"delivery against payment"

An investor may submit a Purchase Order through a nominee account only if it/he/she authorizes and instructs the owner of the nominee account in writing to disclose its/his/her identity to the registrar of

the ECRS (AS Eesti Väärtpaberikeskus). A Purchase Order submitted by an investor through the nominee account will be taken into consideration in the allocation only if the owner of the nominee account has disclosed the identity of such investor in writing to the registrar of the ECRS.

A Purchase Order will be deemed submitted and binding on the investor from the moment the registrar of the ECRS receives a duly completed transaction instruction from the investor's Custodian.

An investor bears all costs and fees charged by the Custodian in connection with the submission of a Purchase Order.

By submitting a Purchase Order an investor authorizes the Custodian and the registrar of the ECRS to amend the information contained in the investor's transaction instruction, including (a) to specify the value date of the transaction and (b) to insert in the transaction instruction (i) the number of Offer Shares allocated to the investor as the number of securities, (ii) the Offer Price (as determined after the Offer Period) as the price per share and (iii) the amount reached by multiplying the Offer Price with the number of Offer Shares allocated to the investor as the transaction amount.

An investor may amend or cancel a Purchase Order at any time before the expiry of the Offer Period in accordance with the procedure described in section "Amendment or cancellation of Purchase Orders". A cancellation of a Purchase Order becomes effective at the moment when the transaction instruction of the investor in question has been cancelled in the ECRS on the basis of the cancellation order received from the investor's Custodian.

INSTRUCTIONS TO INVESTORS IN LATVIA

SUBMISSION OF PURCHASE ORDERS

In order to submit a Purchase Order an investor in Latvia must have a securities account with AS SEB Latvijas Unibanka (the Custodian). Such securities account may be opened at any branch office of AS SEB Latvijas Unibanka.

An investor in Latvia wishing to submit a Purchase Order should contact AS SEB Latvijas Unibanka and register a transaction instruction for the purchase of securities in the form set out below. The Purchase Order can be submitted by any means offered by AS SEB Latvijas Unibanka (such as through personal visit to a branch office, via letter or internet).

Owner of the securities account:	name of the investor
Securities account:	number of the investor's securities account
Custodian:	AS SEB Latvijas Unibanka
Security:	share of Arco Vara
ISIN code:	EE3100034653
Number of securities:	maximum number of Offer Shares which the investor wishes to acquire
Price (per share):	Maximum Price = LVL 1.9575
Transaction amount:	maximum number of Offer Shares which the investor wishes to acquire multiplied by the Maximum Price
Counterparty:	AS SEB Latvijas Unibanka
Securities account of counterparty:	0010 2101 00002
Custodian of the counterparty:	AS SEB Latvijas Unibanka
Value date of the transaction:	20 June 2007
Type of transaction:	"purchase"
Type of settlement:	"delivery against payment"

An investor may submit a Purchase Order through a nominee account only if it/he/she authorizes and instructs the owner of the nominee account in writing to disclose its/his/her identity to AS SEB Latvijas Unibanka. A Purchase Order submitted by an investor through the nominee account will be taken into consideration in the allocation only if the owner of the nominee account has disclosed the identity of such investor in writing to AS SEB Latvijas Unibanka.

A Purchase Order will be deemed submitted and binding on the investor from the moment AS SEB Latvijas Unibanka receives a duly completed transaction instruction from the investor.

An investor bears all costs and fees charged by AS SEB Latvijas Unibanka in connection with the submission of a Purchase Order.

By submitting a Purchase Order an investor authorizes AS SEB Latvijas Unibanka to amend the information contained in the investor's transaction instruction, including (a) to specify the value date of the transaction and (b) to insert in the transaction instruction (i) the number of Offer Shares allocated to the investor as the number of securities, (ii) the Offer Price (as determined after the Offer Period and converted to Latvian lats on the basis of the official daily exchange rate of *Eesti Pank* applicable on the date of fixing the Offer Price) as the price per share and (iii) the amount reached by

multiplying the Offer Price (converted to Latvian lats as specified above) with the number of Offer Shares allocated to the investor as the transaction amount.

An investor may amend or cancel a Purchase Order at any time before the expiry of the Offer Period in accordance with the procedure described in section “Amendment or cancellation of Purchase Orders”.

CUSTODY OF AND TRADING IN THE SHARES

The Shares are registered in the Estonian Central Register of Securities. After the settlement the Offer Shares allocated to investors in Latvia will be held in custody on the nominee account of the Latvian Central Depository with the Estonian Central Register of Securities. At the Latvian Central Depository level, the Shares will initially be recorded in the correspondent account of AS SEB Latvijas Unibanka, which will in turn record the Shares in the investors’ custody accounts with AS SEB Latvijas Unibanka. The investors in Latvia will have an option, at any time after the settlement, to transfer the Shares to their accounts with other custodians eligible to hold the Shares.

The relevant custodian will forward to the investor any information regarding the shareholding and requiring action by the investor when such information is received by the custodian. The investor is responsible for giving instructions to the custodian with regard to such required action. Under certain circumstances, if so agreed, the custodian may, however, take action on behalf of the investor.

To trade in the Shares, the investors shall give instructions to purchase or sell the Shares to the custodians or other providers of financial services eligible to execute such instructions.

EXERCISE OF SHAREHOLDER RIGHTS BY INVESTORS IN LATVIA

Dividends and other distributions

Any dividends paid out by the Company will be distributed to the Latvian investors through the Latvian Central Depository and the relevant custodians. The Latvian Central Depository, upon receipt of the total amount of the dividends to be distributed to the Latvian investors, will credit it to the accounts of the relevant custodians holding the Shares. The relevant custodians will, in turn, distribute the amount of the dividends credited to their accounts to the investors.

Participation in General Meetings of Shareholders

To participate at a General Meeting of Shareholders in person, an investor in Latvia must, as a general rule, request his/her/its custodian to provide him/her/it a written power of attorney to represent the custodian or the Latvian Central Depository in the General Meeting of Shareholders. Although the investor acts in the General Meeting of Shareholders as a representative of the custodian or the Latvian Central Depository, the use of shareholder rights in the meeting is at the sole discretion of the shareholder. Alternative procedures may be available for the participation at General Meetings of Shareholders. To obtain information about such procedures, investors in Latvia should contact their respective custodians.

Taxation of dividends

Please see “Taxation – Latvian Taxation”.

BACKGROUND TO THE COMBINED OFFERING

The purpose of the Combined Offering is to provide financing for expansion of the Group's operations, create a new source of finance to support the Company's development and broaden the Group's shareholder base. The Combined Offering provides the prerequisites for the Company's listing. The listing is expected to enhance the Group's profile among current and prospective customers, co-operation partners and prospective future employees to be recruited by the Group as well as eventually provide liquidity to the Company's existing shareholders.

For a discussion of the Group's plans concerning the use of proceeds from the Combined Offering, see "Use of Proceeds."

LISTING

In connection with the Combined Offering, the Company has applied for listing of its Shares on the Main List of the Tallinn Stock Exchange.

On or about 8 June 2007, the Listing and Surveillance Committee of the Tallinn Stock Exchange is expected to make a decision to list the Shares conditionally on the Main List of the Tallinn Stock Exchange. According to the expected decision, the following conditions must be met for the Shares to be listed:

- the Retail Offering must have been completed in accordance with its terms and conditions and its results announced to the public and the Offer Shares transferred to the investors' securities accounts in the ECRS;
- as a result of the Combined Offering, at least twenty five per cent of the Shares must be held by the public;
- a market making agreement must have been entered into in compliance with the requirements of the Tallinn Stock Exchange; and
- the Company must have submitted to the Tallinn Stock Exchange a report confirming the fulfilment of the above conditions.

Trading in the existing Shares is expected to commence on or about 21 June 2007.

In connection with the listing, the Company and AS SEB Eesti Ühispank intend to enter into a market-making agreement.

USE OF PROCEEDS

The aggregate net proceeds to the Company are estimated to amount to approximately EEK 1,372 million, after deducting the fees and expenses of the Combined Offering, based on the mid-point of the Offer Price Range set forth in the cover of this Offering Circular and assuming that the Upsizing Option is exercised in full. The fees and expenses incurred in connection with the Combined Offering and payable by the Company are estimated to amount to approximately EEK 66 million, based on the mid-point of the Offer Price Range and assuming that the Upsizing Option is exercised in full.

The Company intends to use the net proceeds of the Combined Offering to finance new real estate development projects, primarily focusing on Bulgaria, Romania and Ukraine. The Company also expects to use some of the funds for the development of its existing residential and commercial development projects in Estonia and Latvia. Some of the funds may also be used to fund other areas of the Group's future growth, towards the repayment of any outstanding liabilities and for other general corporate purposes.

The aggregate net proceeds payable to the Selling Shareholders from the sale of Offer Shares and Additional Shares in the Combined Offering, after deduction of the fees and assuming exercise of the Over-allotment Option in full, are expected to be approximately EEK 485 million, based on the mid-point of the Offer Price Range. The Company will not receive any of the proceeds from the sale of Offer Shares by the Selling Shareholders.

DIVIDENDS AND DIVIDEND POLICY

The Offer Shares will be eligible for dividends, if any, declared in respect of the financial year commencing on 1 January 2007, and for subsequent periods. Once the share capital increase relating to the issue of new Offer Shares has been registered with Estonian Commercial Register, the new Offer Shares will rank equally with the outstanding Shares for any dividends.

The Company has paid dividends in the past and for the results in 2005 and 2006 approximately 15 per cent of net profit of the Group was allocated for gross dividends that include the corporate tax on profit distributions. The table below shows the dividends on Shares that the Company has declared for the last three financial years:

	<u>2004</u>	<u>2004</u> <u>(adjusted)²⁾</u>	<u>2005</u>	<u>2006</u>	<u>2006</u> <u>(adjusted)³⁾</u>
Aggregate amount of dividend declared ¹⁾ , EEK	7,792,000	7,792,000	11,692,161	25,430,000	25,430,000
Number of Shares	8,400	27,255,468	30,453,037	30,453,037	67,784,150
Dividend per Share, EEK	927.62	0.29	0.38	0.84	0.38

¹⁾ Net dividends paid to the shareholders of the Company.

²⁾ Adjusted to reflect the bonus issues carried out in 2005.

³⁾ Adjusted to reflect the bonus issue carried out in 2007.

The Company expects to continue paying dividends in the future and to maintain the aggregate amount of gross dividends at the level of 15 per cent of the annual net profit of the Group. However, the Company cannot assure that dividends will be paid in the future or if dividends are paid, how much they will amount to. The declaration and payment by the Company of any future dividends and the amount thereof will depend on the Company's results of operations, financial condition, cash requirements, future prospects, profits available for distribution and other factors considered by the Management Board to be relevant at the time. Therefore, dividends paid historically are not representative of dividends to be paid in the future.

Moreover, certain Group companies and Joint Ventures have entered into loan agreements with financial institutions, which prohibit or restrict the relevant Group company or Joint Venture to pay dividends without the prior consent of the respective lenders. Certain loan agreements of the Group and Joint Ventures also set forth the obligation of the relevant Group company or Joint Venture to retain certain financial levels and ratios throughout the term of such agreements. The shareholders' agreement relating to Arco & Koger Investeeringute OÜ, a 50-50 joint venture with OÜ Koger Kinnisvara, prohibits the distribution of dividends during the first three years of operation. Such restrictions and obligations may effectively reduce the amount of funds available for dividend payments.

As to the tax considerations applicable to dividends, see "Taxation". As to the procedure and regulatory restrictions relating to the payment of dividends, see "Company, Share Capital and Ownership Structure – Shareholder Rights – Dividends and other distributions".

CAPITALIZATION AND INDEBTEDNESS

The following table sets forth the capitalization and indebtedness of the Group based on consolidated figures as of 31 March 2007. The table should be interpreted in conjunction with the financial statements presented elsewhere in this Offering Circular. For further information on the Group's capitalization and indebtedness, see the Notes to the Financial Statements for the three months ended 31 March 2007.

In EEK thousand	31 March 2007
CAPITALIZATION AND INDEBTEDNESS	
Share capital ¹⁾	304,530
Share premium ¹⁾	123,083
Legal mandatory reserve	5,486
Other reserves	-188
Retained earnings ¹⁾	344,999
Minority interest	22,865
Total equity	800,775
Borrowings²⁾	681,313
Long-term financial debt²⁾	408,140
Total capitalization and indebtedness	1,890,228
 NET INDEBTEDNESS	
Cash and cash equivalents	115,436
Total liquidity	115,436
Borrowings²⁾	681,313
Net current financial indebtedness²⁾	565,877
Long term borrowings²⁾	408,140
Net financial indebtedness	974,017

¹⁾ On 26 April 2007, the General Meeting of Shareholders decided to increase the share capital of the Company from EEK 304,530,370 to EEK 677,841,500 by issuing 37,331,113 new Shares with a nominal value of EEK 10 each by means of a bonus issue. The new Shares were issued against reduction in share premium in the amount of EEK 123,082,516 and retained earnings in the amount of EEK 250,228,614.

²⁾ The Group's financial liabilities consist of bank overdrafts, financial leases, bonds and bank loans, some of which are secured by the Group's assets. For additional information please refer to the Index to Financial Statements.

INDUSTRY OVERVIEW

The following information includes extracts from and references to data, statistical information and studies publicly released by officials or by third parties and has been extracted from public or other sources the Group believes to be reliable. The Group accepts responsibility for extracting and reproducing accurately such information, data and statistics. Such information, data and statistics may be approximations or use rounded numbers. As far as the Group is aware no facts have been omitted that would render such information, data and statistics misleading, but the Group accepts no further responsibility in respect of such information, data and statistics. It should be noted that it is difficult to obtain comprehensive and reliable information about the Central and Eastern European real estate markets due to the fact the participants in the real estate markets are mostly closely held companies that rarely share information about their business and operating results.

MACROECONOMIC OVERVIEW OF THE CENTRAL AND EASTERN EUROPE

In the last decade and a half, the former Communist nations of Central and Eastern Europe (CEE) have made considerable progress in their economic and political transition. The pace and degree of reforms have differed from one country to another.

The Baltic States, Poland, Czech Republic and Hungary introduced wide-ranging reforms from the very beginning, opened up for trade and capital flows and combined liberal macroeconomic policies with business-friendly legislation. Other countries, including Romania and Bulgaria, opted for a slower approach. At the moment, there is a significant variation in the standard of living between countries as well as among different society segments in each country.

Foreign investors' interest in the region initially focused in the progressive Central European countries of Poland, Czech Republic and Hungary, but since 2001, their interest has moved increasingly to the Eastern European countries. As a result, the growth rates in Central and Eastern Europe have begun to converge.

Eight CEE countries, including the Baltic States, joined the European Union in May 2004. Improved access to credit and increased productivity have contributed to growing domestic demand across the region. On the other hand, fast growth has also led to inflationary pressure and imbalances in the external balance of payments.

Slovenia was the first ex-Communist country to change its currency into the Euro in 2007. No other CEE country is expected to join the Euro within the next two years. Since a large portion of the growing domestic demand in the CEE countries is satisfied with imports and funded with loans denominated in foreign currencies, addressing external balances is essential for sustainable development.

The International Monetary Fund (IMF) projects the economic growth in the CEE region to reach 4.7 per cent in 2007, which is slightly below the three-year average of 5 per cent in 2004-06. The table below summarizes main economical indicators of selected CEE countries in 2006:

Indicator	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania
Population, million	1.3	2.3	3.4	46.7	7.7	22.3
GDP growth, %	11.4	11.9	7.5	7.1	6.1	7.7
GDP, EUR billion*	13.1	16.0	23.9	84.6	25.1	100.7
GDP per capita, EUR*	9,740	6,980	7,000	1,810	3,250	4,520
Gross monthly wage, EUR	597	394	430	164	181	344
HICP inflation, %	4.4	6.6	3.8	11.6	7.4	6.6
Unemployment rate, %	5.7	6.5	5.7	6.8	9.0	5.2
Current account as % of GDP	-14.8	-21.1	-10.8	-1.5	-15.9	-9.9
Fiscal balance as % of GDP	1.2	-0.9	1.3	-0.9	-3.5	-2.6
Central govt debt as % GDP	3.8	10.2	16.3	17.0	24.7	15.2

*At market rates

Source: Eurostat, national statistical offices of the featured countries

The Baltic States

Since the restoration of independence from the Soviet Union in 1991, all three Baltic countries have pursued bold economic reforms including price and trade liberalization and quick privatization. Having endured the Russian loans crisis of 1998, the Baltic States began re-orienting their exports towards the European Union. The EU now accounts for 66-75 per cent of these countries' trade turnover as well as for most of the foreign direct investment (FDI) to them (source: the national statistical agencies of Estonia, Latvia and Lithuania). Estonia and Latvia joined the World Trade Organization (WTO) in 1999 and Lithuania in 2001. All three countries acceded to the European Union and joined NATO in 2004. Estonia is now the wealthiest of the three Baltic States with the GDP per capita amounting to 65 per cent of EU-25 average in 2006 (on purchasing power parity basis), followed by Lithuania (55 per cent) and Latvia (52 per cent) (source: Eurostat).

Commentators have expressed concerns about overheating economy in both Estonia and Latvia, where the growth rate has averaged 10 per cent in 2004-2006, compared to Lithuania's more moderate 7.5 per cent. Unrestrained credit expansion and the growing shortage of labour have fuelled inflation in all three countries, resulting in a postponement of their joining the Euro. In 2004-2006, the HICP (Harmonised Index of Consumer Prices) inflation averaged 6.6 per cent in Latvia, 3.8 per cent in Estonia, and 2.6 per cent in Lithuania. The central banks of all three countries have nevertheless reiterated their commitment to eventually adopt the Euro. The current target dates for joining the Euro are 2010 for Estonia and Lithuania and 2012 for Latvia.

Ukraine

Economic reforms in Ukraine remained relatively limited in the 1990s, and the Ukrainian economy was in decline for most of the decade. GDP growth turned positive in 2000 after the economy had gradually stabilized after the Russian financial crisis of 1998. Since then, Ukraine has enjoyed strong growth and rising levels of foreign investment, supported by export demand and sound macroeconomic policy. Industries such as mining, steelworks, manufacturing of chemicals and heavy machinery as well as agriculture underpin the Ukrainian economy. Rising energy prices and less favourable terms of trade for key Ukrainian exports have slowed down economic growth in the last two years. According to the State Statistics Committee of Ukraine, GDP grew by 12.1 per cent in 2004, 2.7 per cent in 2005, and 7.1 per cent in 2006.

Rising hydrocarbon prices represent a major threat to sustained economic development in the Ukraine, which similar to other CIS countries, is highly inefficient in using energy. Prices of gas imports from

Russia rose by 66 per cent in 2006 and are set to increase gradually to the level charged from EU countries. The IMF projects that largely as a result of energy prices, the Ukrainian economic growth will fall to 2.8 per cent in 2007 and inflation will climb from single digits to 13.5 per cent.

Romania and Bulgaria

Romania and Bulgaria also chose to pursue gradual economic transition policies in the early 1990s. These policies resulted in but a brief period of economic growth in the mid-1990s, later interrupted by financial crises and a sharp rise in poverty. Since 2000, the governments in both countries have implemented important structural reforms and pursued coherent fiscal and monetary policies. In recent years, foreign investment has increased, encouraged by a low corporate tax rate (15 per cent in Bulgaria and 16 per cent in Romania) and cheap labour. Both countries joined the European Union in 2007. Both countries face major challenges in the areas of reduction of poverty, overhaul of the public sector, improvement of business climate (Bulgaria) and further privatization (Romania).

According to the Bulgarian National Statistics Institute, Bulgarian GDP growth averaged 5.7 per cent from 2004-2006, whilst inflation rose from the 6 per cent recorded in 2004-2005 to 7.4 per cent last year. The Romanian National Institute of Statistics reports that the country has had faster economic growth (6.8 per cent on average in 2004-2006), while its inflation rate has decreased from 11.9 per cent in 2004 to 9.1 in 2005, and to 6.6 per cent in 2006.

REAL ESTATE MARKETS IN CENTRAL AND EASTERN EUROPE

The presentation in this section is mostly based on the methodology used by the Group. The property locations are grouped into the following categories: Centre, Centre Periphery, Cluster of Apartment Blocks (major housing estates usually in the city periphery, "CAB"), Rest of the City ("ROC"), and Suburbs. Management believes that this reflects the market in the Group's five core markets, the capital cities of Tallinn, Riga, Vilnius, Kiev, Sofia and Bucharest.

For presentational purposes, residential properties completed prior to the late 1990s are referred to in this section as "*existing*", while properties completed since 2000 are referred to as "*new*".

The following classification of office properties is based on the industry standards and regional specifics:

- **Class A:** highest quality office space available, constructed or refurbished no more than 5-7 years ago, centrally located in the central business district or generally in the city centre, easily accessible (in terms of transport infrastructure and indoor parking), and with security and catering services. Class A premises are professionally managed and usually attract high profile tenants, such as financial institutions, professional services firms and large multinational companies. The physical depreciation of such premises is below 20 per cent, and virtually no moral depreciation, which relates to relative rather than absolute technical obsolescence of maintenance (surveillance, climate control, energy saving) and communications systems. New premises with exceptional level of specification are sometimes referred to as Class A+.
- **Class B:** mostly Communist era buildings that are in good a state of repair with an economic value depreciation of approximately 20-40 per cent. Recently completed buildings that do not conform to Class A norms due to one or several reasons, such as peripheral location, are often classified as B+ category. Class B offices usually have open-air parking.
- **Class C:** inferior quality premises, often in buildings poorly suited for office use, such as residential or former industrial properties. The physical depreciation of such premises is high (usually above 40 per cent); part of maintenance systems (electricity, sewerage, water supply) may be in a poor state.

- **Class D:** Lowest quality office space with dilapidated interiors or lacking basic office features, such as an Internet connection.

The property price information in this section has been based on the consensus estimates of major real estate developers in each market.

Residential property

As illustrated in the table, the living area per capita in the CEE capitals remains significantly lower than in the Central European and Scandinavia capitals:

City ¹⁾	Living area per resident, m ²
Copenhagen	44.1
Vienna	41.7
Stockholm	39.0
Berlin	39.0
Helsinki	33.0
Prague	28.1
Warsaw	25.0
Vilnius	23.8
Tallinn	23.4
Riga	23.3
Kiev	20.5
Sofia	17.0
Bucharest	15.9

¹⁾ Data is for 2005, except for Vienna (2001, latest available)

Source: statistical agencies of the featured countries, OberHaus, InvestitionBank Berlin

There is an even more important gap in the average quality of building stock. Many residents in the CEE capitals live in obsolete, low-quality housing estates built during the Communist era. This situation is improving due to economic growth, low interest rates and intense competition in the banking sector. Central banks report that during 2001-2005, interest rates have decreased by more than one half in most of CEE countries, resulting in rapidly rising levels of indebtedness. In 2003-2006, mortgage lending has expanded at an average rate above 70 per cent in South-eastern Europe, Ukraine and the Baltic states, compared to 50-60 per cent in Central Europe.

As interest rates are already low, the CEE housing market will be driven in the short to medium term by other factors such as the deteriorating condition of Soviet-era prefabricated housing, growth in purchasing power, and inflation in the construction costs, fuelled by the growing labour shortage. As illustrated in the table below, most CEE countries have similar housing replacement rates. These rates do not appear unsustainable, compared to other European countries with above-average economic growth. Furthermore, the housing replacement rates in the CEE reflect a relatively small building stock, a large part of which is in poor condition.

Country	Stock of housing loans to GDP, % ¹⁾	2006 housing replacement rate, % ²⁾	Average interest rates on new housing loans, % ³⁾	
			local currency	EUR
Denmark	94.0	1.11	4.9	4.0
United Kingdom	80.0	0.82	5.7	n/a
Sweden	55.2	0.52	3.6	n/a
Germany	51.7	0.56	-	4.4
Finland	42.5	0.80	-	3.8
Estonia	32.6	0.81	4.2	4.1
Latvia	30.7	0.75	6.8	5.0
Austria	23.7	1.39	-	3.8
Lithuania	12.6	0.55	4.5	4.6
Czech Republic	11.7	0.79	4.5	4.8
Hungary	11.5	0.80	9.5	4.3

Poland	9.4	n/a	6.4	5.2
Bulgaria	7.4	0.36	7.6	7.9
Ukraine	3.6	0.43	15.4	11.3
Romania	2.3	0.47	12.2	8.5

¹⁾ Data for 2006, except for Germany, Finland, Sweden and the United Kingdom (data as of 2005)

²⁾ Ratio of dwellings completed in 2006 (units) to the 2005 (end-year) housing stock (units); data for Denmark and Austria as of 2005

³⁾ New loans, average of Jan-Dec 2006

Source: European Mortgage Federation, statistical agencies and central banks of the featured countries

Office property

Reflecting the rapid economic growth and persistent shortage of office space, the vacancy rates are abnormally low in the capitals of the Baltic States, Ukraine, Romania and Bulgaria. These vacancy rates range between 2 and 4 per cent, compared to the European average of 8.2 per cent in the fourth quarter of 2006. At the same time, rental yields have steeply dropped from double digits to 7-9 per cent. According to Jones Lang LaSalle, the situation is reminiscent of that observed in Poland, Czech Republic and Hungary ten years ago. However, rental rates are rapidly converging between the CEE capitals. According to the real estate consultancy Re&Solution, there has been a constant shortage of high-quality office premises across Tallinn, Riga and Vilnius since 2005, especially for properties in excess of 1,000 m². This trend can be explained by the organic growth of local businesses, which seek to centralize operations in one location instead of several scattered across the city. The shortage of construction workforce adds to the shortage of high-quality office premises, particularly, as office development in these cities tends to be less profitable than residential construction, since the latter offers higher margins due to rapid asset appreciation and shorter payback periods.

The office property market in Kiev is currently experiencing both high (and rising) rents and rapid growth in property stock. Kiev is the third largest city in Eastern Europe, and some large-scale office development has taken place there recently.

The office property markets in both Sofia and Bucharest have also grown following the increase in investments fuelled by the recent EU accession and economic growth. Several new quality office buildings have been constructed in both cities in the recent years. Supply remains tight in Bucharest, while extensive suburban office developments in Sofia have reduced the pressure on rents.

The table below compares prime office market conditions in major European cities in the fourth quarter of 2006:

City	Prime rent, EUR/m ² p.a.	Prime yield, per cent	Prime vacancy rate, per cent
London (City)	963	3.9	7.5
Moscow	913	9.3	3.6
Paris	730	4.1	5.1
Dublin	646	3.9	12.4
Kiev	520	10.0	2.0
Milan	500	4.6	7.7
Stockholm	431	4.5	14.6
Frankfurt Main	420	4.8	16.2
Madrid	414	4.0	4.3
Oslo	359	4.1	7.0
Amsterdam	325	5.0	14.8
Warsaw	264	5.5	7.8
Berlin	246	5.3	10.0
Prague	240	5.3	5.4
Bucharest	230	7.0	3.0
Budapest	222	6.0	10.6
Riga	220	7.0	2.0
Vilnius	200	7.0	3.0
Tallinn	190	7.0	4.0
Sofia	180	9.5	5.2

Source: Jones Lang LaSalle, Arco Vara, Colliers Int

REAL ESTATE MARKET IN THE GROUP'S KEY MARKETS

Estonia - Tallinn

According to Statistics Estonia, approximately 530,000 people live in the Greater Tallinn region, representing about 40 per cent of the total population of Estonia. The Greater Tallinn region comprises the city itself (400,000) and the surrounding Harju county (130,000).

The city of Tallinn is Estonia's economic centre contributing approximately 50 per cent of the country's GDP in 2006. The population of Tallinn city centre has dropped by 21 per cent since 1990 due to emigration, migration towards the suburbs and the aging of the remaining population. The 2006 New Residential Areas Survey indicates that since 1991 some 17,000 people have moved from the city centre to the suburbs.

The following table summarises the development in statistics relating to the property market in Estonia in 2003-06:

	2003	2004	2005	2006
Mortgages-to-GDP ratio, %	11.2	16.0	23.7	32.6
Outstanding housing loan balance, EUR million	954	1,500	2,618	4,278
Average interest rate on new housing loans in EEK, %	5.2	4.1	3.8	4.1
Average interest rate on new housing loans in EUR, %	5.7	4.5	3.3	4.2
Average gross monthly wage in the City of Tallinn, EUR	529	566	605	698
Construction cost index, y-on-y change in %	3.7	6.5	7.3	10.3
Residential construction in Tallinn, '000 m ²	107	118	138	144
Housing stock in Tallinn, '000 m ²	9,472	9,725	10,035	10,285
Number of transactions with dwellings in Tallinn	9,326	13,337	20,624	20,770

Source: Statistics Estonia, Bank of Estonia

Supply and demand for residential property

After a prolonged hiatus in the 1990s, residential construction in Tallinn resumed in 2000 as a result of low mortgage rates, growth in prosperity and the worsening condition of Soviet-era housing. According to Statistics Estonia, apartment blocks comprise 93 per cent of Tallinn's residential inventory, and two thirds being clusters of apartment blocks (CABs) from the Soviet-era. A large part of new construction tends to take place either in the city centre or in these clusters, which offer both well-developed infrastructure and suitable land for new buildings.

Almost 2,000 new residential units were completed in Tallinn in 2006, which represents an increase of 18 per cent from 2005. The real estate developer OberHaus estimates that another 1,400 units were built in the immediate suburbs. The Estonian Construction Register reports that over 5,000 building permits for residential construction were issued in 2006 in Harjumaa (of which approximately were in 3,900 Tallinn), representing an increase of 40 per cent from 2005. In total, these building permits cover 337,000 m² of floor space.

The suburban belt is emerging in Tallinn much faster than in Riga or Vilnius. This may be partially due to the higher standards of living, as well as Tallinn's size being smaller both by area and population than the other two Baltic capitals, which means less traffic congestion and fewer constraints on the infrastructure. New suburban areas are stretched along the coastal areas west and east of the city; most of them have emerged as extensions to satellite towns or areas of summer cottages rather than new standalone communities.

A brief summary of the recent and ongoing residential development in Tallinn is presented below.

Project	Description	Developer	Location	Apts	Completion	EUR/ m²
Astangu 50a	Two ABs	Rendal Arendus	CAB	108	2006	>1,300
Twin Towers (I)	Hotel/AB	Merko	Centre	184	2006	>3,800
Astangu 21	Two ABs	Noran	CAB	176	2Q 2007	>1,600
Läänemere 70	Two ABs	Eurokinnisvara	CAB	216	2Q 2007	>1,600
Kodukolde	Twelve ABs	Arco Vara	ROC	372	2009 ¹⁾	>2,000
Sipelgapesa	High-rise district	Koger	CAB	97 ¹⁾	3Q 2007	>1,800
Luther	Resid. complex	Grove Invest	Centre	180	3Q 2007	>2,300
Mäepealse Project	High-rise district	YIT Kodu	CAB	600	2007-...	>1,800
Pirita Project	Low-rise district	TTP	ROC	100 ²⁾	2005-2009	n/a
Tivoli	Low-rise district	Arco Vara	ROC	732	2011	n/a

¹⁾ First stage

²⁾ Second stage to be completed in September 2007

Abbreviations: Apts – apartments, AB – apartment block, CAB – cluster of apartment buildings, ROC – rest of the city

Source: Arco Vara, OberHaus, Uus Maa

Residential property prices

According to major real estate consultancies, the sales prices of new housing rose in Tallinn by some 20-30 per cent in 2006, following an even more substantial (30-50 per cent) rise in 2005. Due to the decreasing pace of price growth, the average sales cycles and apartment inventories are increasing. The same trend was mirrored in the secondary market, where slower price growth contrasted with the previous year's surge of 60-70 per cent. At the same time, a steady stream of buyers continues to compress the price differential between new and existing mass-market CAB apartments. This price differential now stands at 30-35 per cent.

The construction index in Tallinn rose by 10.3 per cent in 2006, at its fastest pace in a decade, largely due to a surge in labour costs (up by 18.7 per cent) caused by the deepening shortage in the workforce. Scientists in Tallinn Technical University have even suggested that the actual increase of expenses may be larger due to index calculation methodology. The increased costs put price pressure primarily

on apartments. Developers increasingly delay their announcements of sales prices until construction is largely completed, in order to minimize losses associated with cost and schedule overruns.

The table below summarizes the prices of new and existing apartments (EUR/m²) in districts of Tallinn in December 2006:

<u>District</u>	<u>Existing</u>	<u>New</u>
Old Town	2,500-3,200	n/a
Centre	1,600-5,500	2500-4,000
Centre periphery	>2,000	1,900-2,500
Major CAB areas	1,200-1,500	1,600-2,000
Suburbs	>1,100	>1,500

Source: Arco Vara, Uus Maa

Office property market

According to Colliers, over 60,000 m² (double compared to 2005) of new Class A and B office-space was completed in the city of Tallinn in 2006, bringing the total inventory to ca. 320,000 m². The increase in Class A stock (19,000 m², to 144,000 m²) was quickly absorbed by the strong demand. Vacancy rates continued to decline throughout the year, reaching three per cent at the end of the year for Class A offices (2005 average 5 per cent), 5 per cent for Class B (2005 average 7 per cent).

Several large-scale office projects were completed in the Tallinn central business district and new business clusters are emerging close to major transport arteries, the largest residential areas and the harbour area. Conversion of former industrial facilities into residential/office development (brownfield development) is becoming more common in Tallinn, where the industrial production has largely withdrawn from the city centre to the surrounding areas.

According to Colliers, based on the confirmed project pipeline, up to 100,000 m² of Class A and B office space is expected to come on the market in 2007-2008. In 2006, on average some 70 per cent of the new office supply had been leased before completion, and overall rent levels increased by 10-15 per cent.

The table below summarizes monthly office rental rates (EUR/m²) in December 2006 across the major business districts of Tallinn:

<u>District</u>	<u>Class A+</u>	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>
Central business district	15-18	11-13	9-11	n/a
Rest of the city centre	n/a	10-12	8-10	6-9
Major transport arteries	n/a	9-11	6-8	5-7
CABs	n/a	10-12	7-10	5-6

Source: Arco Vara, OberHaus, UusMaa

OberHaus estimates that office yields fell slightly in the second half of 2006 to 7-8 per cent due to the high price expectations of sellers. The real estate agency Uus Maa believes that a further decline is unlikely due to the recent increase in interest rates. In 2005, Admirali Maja became the first office building developed exclusively as a sale property. Because the loan instalments and rental payments have largely converged since that time, demand for sale properties has increased substantially. According to Uus Maa, all of the new supply of sale properties in 2006 (approximately 12,000 m²) was quickly absorbed, with prices rising from EUR 1,100-1,300/ m² for properties completed in autumn 2006 (Fahle Maja) to an estimated EUR 1,800-2,200/ m² for those scheduled for completion in 2007 (Kadaka Maja, Katusepapi 8).

The table below summarises the recent and pending office development in Tallinn:

<u>Project</u>	<u>Class</u>	<u>Developer</u>	<u>Location</u>	<u>Area</u>	<u>Completion</u>	<u>EUR/ m²</u>
Pärnu road 139	B	n/a	Central business district	5,500	2006	11-12
Fahle Maja	B	Koger & Partnerid	Central business district	3,300	2006	1,100-1,300 ¹⁾
Rävala 4	A	Norber Grupp	Central business district	8,000	2006	13-16

Foorum, Hobujaama	A	Foorum Kinnisvara	Central business district	2,400	2006	14-16
Tornimäe Towers	A	ELL Kinnisvara	Central business district	7,300	2006	14-16
Katusepapi 8	A	KC Kinnisvara	Central business district	2,900	2007	1,900 ¹⁾
Sõpruse 145	B	ELL Kinnisvara	CAB	12,500	2Q 2007	n/a
Kadaka Ärimaja	A	ATM Haldus	Centre periphery	4,000	2007	over 1,900 ¹⁾
Ülemiste City	A, B	Ülemiste City/Mainor	Rest of town	160000	2007-...	9-12

¹⁾ Sales price

Source: Arco Vara, OberHaus, Uus Maa

Latvia - Riga

The Greater Riga area has a population of close to one million people, which represents 44 per cent of the total population in Latvia. Riga is the largest metropolitan area in the Baltics and a major regional logistics and financial centre. The Greater Riga area encompasses Riga (population 725,000), the resort town Jurmala (56,000) and the surrounding Riga and Ogre districts (222,000). According to the Central Statistics Bureau of Latvia, it contributed two-thirds of Latvian GDP in 2004. In 2004-06, an estimated 75 per cent of the residential construction in Latvia concentrated in the Greater Riga region.

The following table summarises the development in statistics relating to the property market in Latvia in 2003-06:

	2003	2004	2005	2006
Mortgages-to-GDP ratio, %	7.6	12.0	19.6	30.7
Outstanding housing loan balance, EUR million	693	1,264	2,486	4,636
Average interest rate on new housing loans in LVL, %		8.3	5.9	6.8
Average interest rate on new housing loans in EUR, %		5.6	4.5	5.0
Average gross monthly wage in the City of Riga, EUR	316	338	398	494
Construction cost index, y-on-y change in %	-1.3	6.4	11.4	20.9
Residential inventory in Greater Riga, '000 m ²	16,517	16,731	17,042	17,650
Residential construction in Greater Riga, '000 m ²	123	333	420	610
Transactions with apartments in Greater Riga, '000	39.9	36.4	31.1	35.9

Source: Central Statistics Bureau of Latvia, Bank of Latvia

Supply and demand for residential property

According to the 2000 Population Census, 74 per cent of Riga's population lived in Soviet-era apartment blocks within the densely populated CABs. The three most common types of residential development include (i) high-rise structures within existing built-up areas (CABs or low-cost housing in satellite towns), (ii) upscale apartments in central Riga and at the seashore, and (iii) single-family, semi-detached or low-rise housing in the emerging suburban belt. The latter segment is expected to gain popularity after the completion of several large-scale infrastructure improvement projects, most notably the Southern Bridge (due in 2008).

More than 5,600 apartments were completed in Riga in 2006, representing a sevenfold increase from 2000-2003. This was less than the 12,000 units announced at the beginning of the year 2006, according to OberHaus, due to the fact that many large-scale projects were delayed. Based on the industry outlook, a further 18,000 units are expected to be completed in 2007. Some 1,170 social housing units were completed in 2004-2006, and the Riga City Council has voiced plans for "thousands more" to accommodate the 13,000 families on the waiting list. In addition to this, a local subsidiary of the Swiss property investor Renova Management is planning a very large mixed type development with the total floor space of 450,000 m², of up to 60 per cent residential.

The table below summarises the recent and pending residential development in Riga.

Project	Description	Developer	Location	Apartments	Completion	EUR/ m²
Metropolia	New district	BR Holdings	CAB	550	2006-2008	>1,700
Bišumuiža-1	New district	Arco Vara	Rest of town	238	2006-2008	>2,000
Duntes Ozoli	High-rise AB	Duntes Ozoli	CAB	217	2006	>2,200
Solaris	High-rise ABs	Parkhaus	CAB	320	2006	>1,600
Astra Lux	High-rise ABs	PBLC	CAB	158	Mid-2007	>1,800
Purvciems Project	High-rise ABs	Hanner	CAB	336	June 2007	>1,400
Panorama Plaza	Mixed type	Latmes	CAB	660	End 2007	>2,400
Skanstes Virsotnes	New district	Merks	Centre periphery	2,500	2008-2009	>2,500

Abbreviation: AB – apartment block, CAB – cluster of apartment buildings

Source: Arco Vara, OberHaus, Latio, JaunieProjekti.lv

Residential property prices

Major local real estate agencies estimate that on average the sale prices in Soviet-era CAB dwellings rose by 50-60 per cent in 2006, slightly more than 45-50 per cent in 2005. The prices in the city centre increased as well, albeit to a much smaller extent. OberHaus estimates that the prices of Old Town properties rose by 5 per cent, whilst prices for properties in other parts of the city centre increased by 8-25 per cent. The price increases in the centre periphery ranged from 30 to 40 per cent. The price differential between new and existing apartments remains small in the mass market, at approximately 20 per cent.

The table below summarizes prices of new and existing apartments (EUR/m²) in different districts of Riga:

District	Existing	New
Old Town	4,200-5,000	n/a
Boulevard Rim	3,500-4,700	n/a
Rest of the city centre	2,600-3,300	n/a
Centre periphery	1,800-2,500	2,000-3,300
Major CAB areas	1,300-1,700	1,600-2,100
Jūrmala	1,100-1,500	2,500-5,000
Suburbs	850-1,200	1,000-1,600

Source: Arco Vara, OberHaus, Latio

Office property market

According to Re&Solution, during 2006, Class A and B office stock grew in Riga by approximately 80,000 m² to approximately 250,000 m². No new Class A properties were completed in 2006, exacerbating the shortage of prime premises in Riga. At present, only two properties, Saules Akmens (85 per cent of which is permanently occupied by Hansabanka) and the Valdemāra Centre, can be considered Class A buildings. The quality of the remaining stock is affected, among other things, by congestion, lack of parking space and limited expansion possibilities. Led by financial institutions such as Hansabanka, SEB Unibanka, GE Money, many major employers are gradually relocating to tailored premises outside the historic centre. According to the real estate agency Colliers International, the new project pipeline predicts a substantial increase in Class A and B properties, with the total supply potentially doubling by the end of 2008. Nonetheless, the same source believes that the continuous shortage of labour and construction materials is likely to delay many projects by 6-8 months.

Riga does not have a distinct business district akin to the high-rise clusters in Tallinn, Vilnius and Warsaw. New development continues to be dispersed across the city, although several areas within the proximity of the Broad Centre are emerging as destinations of choice. Particularly popular are Skanstes/Hanzas, Lucavsala, Krasta Street, and Ķīpsala/Left Bank areas.

The table below summarizes the monthly office rental rates (EUR/ m²) in December 2006 across the districts of Riga:

<u>District</u>	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>
Centre	16-26	9-18	n/a
Centre periphery	15-20	6-13	n/a
Rest of the city	n/a	6-10	3-6

Source: Arco Vara, OberHaus, KOBA

Re&Solution reports that office property yields were around 7 per cent at the end of 2006.

The table below summarises the recent and pending office development in Riga:

<u>Project</u>	<u>Class</u>	<u>Developer</u>	<u>Location</u>	<u>Area</u>	<u>Completion</u>	<u>EUR/m2</u>
Ziemeļu Vārti	B	Ariel Baltic	City centre	10,000	2006	12-15
Barona kvartāls	B	Ivo Zonne	City centre	30,000	2006	8-10
Duntes House	B	Merks	CAB	7,800	2006	18-23
RBS Skals Centre	A	RBS Skals	City centre	9,000	2Q 2007	19-20
Rietumu Capital Centre*	A	Rietumu Bank	City centre	3,600	3Q 2007	20
Krājbanka House*	B	Merks	City centre	6,000	2007	n/a
Magnat Business Centre	B	Magnat	Rest of town	4,000	3Q 2007	12
Alojas Business Centre	A	LNK	Rest of town	10,600	2008	>18
DaVinci complex	A	CG	City centre	n/a	2008	n/a
Z-Towers	A	SPI Group	City centre	95,000	2008	n/a
Ķīpsala Business Centre	A	Arco Vara	City centre	36,000	2010	n/a

*Developed by the respective banks primarily as corporate headquarters

Source: Arco, Koba, OberHaus, Latio

Lithuania - Vilnius

According to Statistics Lithuania, the Greater Vilnius area has a population 646,000, which represents some 18 per cent of the total population of Lithuania. The Greater Vilnius area is comprised of the city itself (population 553,000) and the surrounding Vilnius district (93,000). Average gross wages in the City of Vilnius have been consistently the highest in the country, some 16 per cent above average in the last four years, and the city generates almost one-third of the Lithuanian GDP. In 2003-2005, 49 per cent of the new residential construction in Lithuania took place in the Greater Vilnius area.

The following table summarises the development in statistics relating to the property market in Lithuania 2003-06:

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Mortgages-to-GDP ratio, %	3.4	5.6	9.0	12.6
Outstanding housing loan balance, EUR million	553	1,009	1,857	2,988
Average interest rate on new housing loans in LTL, %	5.0	4.5	4.5	4.5
Average interest rate on new housing loans in EUR, %	4.6	4.1	3.8	4.1
Average gross monthly wage in the City of Vilnius, EUR	362	385	431	n/a
Construction cost index, y-on-y change in %	1.0	6.1	7.6	9.8
Residential inventory in Greater Vilnius, '000 m ²	14,332	14,833	15,315	n/a
Residential construction in Greater Vilnius, '000 m ²	251	349	303	n/a

Source: Statistics Lithuania, Bank of Lithuania

Residential property supply and demand

Soviet-era CABs account for approximately 60 per cent of the total residential property inventory in Vilnius. A large part of new construction tends to take place in these clusters, which combine a well-developed infrastructure with a favourable location. Fewer residential units are built in the more

prestigious districts, such as the city centre, although these apartments tend to be larger than in the CABs. Also, dozens of areas with detached and semi-detached houses are emerging in the suburbs.

According to Statistics Lithuania, more than 4,600 residential units were completed in Greater Vilnius in 2006 (including ca. 4,200 units in the city itself), compared to approximately 3,400 in 2005. Based on plans published by developers, up to 7,000 new apartments and 400-500 detached houses are expected to come to market in 2007.

The table below summarises the recent and pending residential developments in Vilnius:

Project	Description	Developer	Location	Apartments	Completion	EUR m²
Santariškės	Low-rise	Eika	ROC	260	Mid-2007	>1,600
Strazdėlio Namai	Resid. complex	Leidybos centras	Centre	100	4Q 2007	>3,700
Nida	Resid. complex	In Real	Centre periphery	100	4Q 2007	>2,800
Helios City	Mixed type AB	Helios Group	Centre periphery	110	2007	>1,900
Perkūnkiemis	High-rise	SVG/In Real	CAB	~4,000	2008	>1,200
Barjoru kalvos	High-rise	Hanner	ROC	1,100	2007-2010	1,100-

Abbreviation: AB – apartment block, ROC – rest of the city, CAB – clusters of apartment buildings

Source: Arco, OberHaus, Eika

Residential property prices

After substantial increases in prices for both new and existing housing in the CABs of Vilnius in 2004-2005, prices of new residential property prices largely stagnated throughout 2006, while those of existing CAB apartments rose extremely rapidly in the beginning of 2006 before entering a period of stabilization. The property developer In Real attributes the price adjustment largely to the profusion of new developments combined with psychological factors such as disillusionment following the postponement of Lithuania's joining the Euro. According to the real estate agency Re&Solution, until early 2006 up to 90 per cent of new apartments used to be pre-sold before the start of construction, which reduced developers' commitment towards their customers. When property prices stagnated in the spring of 2006, the sales period became longer and buyers gained bargaining power. Notwithstanding the price stagnation, construction costs have continued growing at an accelerating pace for several years and seem likely to continue doing so in 2007.

The table below summarizes prices of new and existing apartments (EUR/m²) in different districts of Vilnius:

District	Existing	New
Old Town, Centre	2,300-3,200	2,300-5,200
Naujamiestis, Žvėrynas	1,500-2,400	1,700-3,500
Major CAB areas	1,200-1,500	1,000-1,700
Suburbs	900-1,200	1,000-1,500

Source: Arco Vara, Burbulas, OberHaus

The price differential between new and existing apartments has been consistently in the range of 30-35 per cent, which is much more than in Tallinn or Riga.

Office property market

Major real estate consultancies estimate that ca 20,000 m² of Class A and B office space came to the market in Vilnius in 2006, bringing the total to 160,000 m². The corresponding figure was 47,000 m² for 2004 and 37,000 m² for 2005. Similarly to Tallinn and Riga, the slow down in office construction is attributed to the shortage of resources, especially labour. The office property sector has to compete for the same resources with residential projects, which are more profitable and have shorter payback times.

According to OberHaus, the vacancy rates for Class A properties in Vilnius dropped from 5 per cent to 2 per cent in the second half of 2006. Meanwhile, vacancy rates of Class B properties remained virtually unchanged. OberHaus expect this trend to reverse in 2007, when up to 70,800-80,000 m² of office inventory is expected to come to the market.

The table below summarizes monthly office rental rates (EUR/m²) at the end of 2006 across major business districts in Vilnius:

<u>District</u>	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>
BTP or Naujamiestis	14-18	n/a	n/a
Saltoniškių/Geležinio Vilko	15-17	11-14	n/a
Rest of the Centre	n/a	10-12	3-6

Source: KOBA, OberHaus

Since Lithuania's first modern office complex was inaugurated in 1999, a strong demand for quality office premises has led to the emergence of two distinctive business districts in Vilnius. The first one is the Business Triangle Park (BTP) just outside the city centre. With the total leasable area of approximately 45,000 m², BTP is now close to saturation. The newer and larger site is being developed on the Right Bank of River Nėris, where Europa Tower and the new Vilnius Municipality building have already been completed. Several large enterprises including Hansabankas and TEO have announced plans to build new headquarters there.

The following table summarises the recent and pending office development in Vilnius:

<u>Offices</u>	<u>Class</u>	<u>Developer</u>	<u>Location</u>	<u>Area</u>	<u>Completion</u>	<u>EUR/</u>
BCC2	A	Eika	Centre	6,200	1Q 2006	n/a
Kernavė	A, B	Atkirta	Centre	5,400	4Q 2006	14
Saltoniškių Street	A	Vilmesta	Centre	6,500	1H 2007	n/a
Vilnius Vartai	A	Ranga IV	Centre	12,500	1H 2007	19
Skraidėnis	B	Skaridenis	Centre periphery	3,700	2H 2007	12-15
Registru centras	A	Vetrūna	Centre	30,000	4Q 2007	17-20
Indeco	A	Indeco	Centre periphery	10,500	2008	n/a

Source: Arco Vara, Koba, OberHaus

Ukraine - Kiev

Kiev is the capital of Ukraine with a population of 2.7 million in the city itself and 1.7 million in the agglomeration around it. In total, the population of 4.4 million in the Kiev metropolitan agglomeration represents some 9 per cent of the total population in Ukraine. Kiev is the major destination for intra-country migration at all income levels. According to the State Statistics Service of Ukraine, the population in the city of Kiev has increased by approximately 4 per cent since 2001, while the total population of Ukraine has declined by 3.7 per cent. Kiev accounts for 18 per cent of Ukrainian GDP and one-third of foreign direct investments. The City of Kiev and the adjacent Kiev oblast together accounted on average for 23 per cent of all residential construction in the Ukraine in 2003-2006.

The following table summarises the development in statistics relating to the property market in the Ukraine metropolitan agglomeration in 2003-06:

	2003	2004	2005	2006
Mortgages-to-GDP ratio, %	0.9	0.9	2.5	3.6
Outstanding housing loan balance, EUR million	380	487	1,674	3,208
Average interest rate on new long-term loans in UAH, %	18.5	20.0	19.3	17.4
Average interest rate on new long-term loans in USD*, %	13.6	14.3	13.4	12.1
Average gross monthly annual in the City of Kiev, EUR	127	147	199	274
Construction cost index, y-on-y change in %	7.4	20.2	25.6	23.5
Residential inventory in the City of Kiev, '000 m ²	n/a	n/a	53,915	n/a
Residential construction in the City of Kiev, '000 m ²	1,001	1,050	1,200	896*

*US Dollar is the major currency in real estate transactions in Ukraine

Source: State Statistics Committee of Ukraine, National Bank of Ukraine

Supply and demand for residential property

Activity in the Kiev residential construction market was limited prior to 2001. According to the real estate agency Planeta Obolon, new residential units completed since 1992 account for just 9.4 per cent of the total housing stock, with the marketable supply heavily concentrated at the opposite extremes of the quality range. The Group estimates that middle class housing accounts for some 60 per cent of the pipeline for new apartment projects, with the rest targeted at the high-earning segment (30 per cent) and high net worth individuals (10 per cent) buyers. There is a serious shortage of housing in Kiev at the present, with unsatisfied demand for 5-8 million m², based on an assessment by Global Solutions, the real estate developer. Furthermore, the construction company Konti-Bud-Ukraina estimates that nine million m² of residential properties in Kiev one-eighth of the total, is in a dilapidated state.

The Kiev suburban belt is expanding rapidly. The suburban residential property consultancy SV Development projects that by 2008 the suburban region will have 80 suburbs of detached houses with a total of 4,000 residential units. This development is likely to result in a total living floor space of 1.8 million m², a five-fold increase from 2006.

Residential property prices

According to a survey published by the Ukrainian Realtors' Association, the average prices of existing housing units within the CABs increased by 60-70 per cent last year. Apartments on the Kiev Left Bank continue to sell at a discount of 5-15 per cent, compared to those on the more prestigious Right Bank. Reflecting the shortage in affordable housing, the prices for suburban housing increased in 2006 by approximately 50 per cent. Property prices in those communities that are conveniently located close to Kiev are now at level with those in some of the capital's neighbourhoods. According to SV Development, the average house price in the Kiev Oblast is USD 1,600/m², with upmarket properties accounting for 70 per cent of the new supply.

The following table summarizes the prices of new and existing apartments (USD/m²) in different districts of Kiev at the end of 2006:

District	Existing	New
Centre	3,800-4,000	3,000-6,000
Centre periphery	2,500-2,700	2,000-4,000
Major CAB areas	2,000-2,600	1,300-2,300
Close suburbs (Vishnevoe, Vishgorod)	n/a	1,200-1,400
Other suburbs	n/a	800-1,000

Source: Arco Vara, Planeta Obolon, Kyiv Zhitlo-Invest

Office property market

The first large-scale office development projects in Kiev came onto the market in 2003. Since that time, the Kiev office market has grown rapidly, fuelled by growing economic activity and shortage for modern office space. Colliers International estimates that at the end of 2006 the total stock of modern office space in Kiev was approximately 177,000 m², and total office space approximately 613,000 m². No new Class A office buildings were completed in 2006, partly due to delays in projects that failed to complete on schedule.

Overall, the office market in Kiev remains seriously undersupplied. The commercial property consultancy Astera Group estimates the unsatisfied demand to amount to as much as 400,000 m². Based on plans announced by developers, approximately 520,000 m² of new office space is expected to come to the market in 2007-2008. Hitherto non-existent, large business centres (30,000-40,000 m²) are emerging in response to demand from foreign companies seeking to build up presence in the Ukrainian market. Major commercial property consultants estimate that the vacancy rates in both Class A and B premises have remained low, between 1.5-3 per cent, for several years. Colliers International estimates that rental rates grew on average by 30-40 per cent in 2006, while prime yields fell from 12.5 per cent in 2005 to 9.5-10 per cent in 2006.

The following table summarizes monthly office rental rates (USD/m²) in Kiev at the end of 2006.

<u>District</u>	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>
Centre	50-70	40-50	n/a
Rest of the city	40-50	30-40	15-30

Source: Astera, Colliers Int.

Bulgaria - Sofia

Sofia is the capital and the largest city in Bulgaria with a population of 1.2 million people, which represents some 16 per cent of the total population of Bulgaria. According to the National Statistics Institute (NSI), the South-Western region, which includes the Sofia area and where a quarter of Bulgaria's population lives, generated 40 per cent of the national GDP in 2004. The Global Property Guide estimates that in 2005 Sofia had the second lowest average residential property prices among the European capitals, the lowest being in Chisinau in Moldova.

The following table summarises the development in statistics relating to the property market in Bulgaria in 2003-06:

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Mortgages-to-GDP ratio, %	1.2	2.6	4.8	7.4
Outstanding housing loan balance, EUR million	209	516	1,037	1,799
Average interest rate on new housing loans in BGN, %	13.2	11.0	8.5	7.6
Average interest rate on new housing loans in EUR, %	13.0	12.0	8.8	7.9
Average gross monthly wage in the City of Sofia, EUR	184	197	219	n/a
Residential inventory in the City of Sofia, '000 m ²	33,87	34,018	34,173	34,280
Residential construction in the City of Sofia, '000 m ²	148	151	161	115

Source: National Statistical Institute of Bulgaria, National Bank of Bulgaria

Supply and demand for residential property

According to the UBS 2006 World's Richest Cities Survey, average wages in Sofia are the lowest among the EU capitals, and the middle class forms a relatively small part of the population. High-paying IT-outsourcing jobs are only beginning to appear in this region which has historically been dominated by metal and pharmaceutical industries. Despite the increasing affordability of bank financing and improving economic conditions, the supply of housing in Sofia has increased only modestly until very recently. According to NSI, residential inventory increased by approximately

570,000 m² between 2003 and 2006, less than 2 per cent of the total residential inventory. Balkan Consultancy Centre estimates that building permits for 1.4 million m² of residential space were issued in 2006, an increase of 40 per cent from 2005. The living area per person in Sofia was 17 m² in 2005, less than half than in the major Western European cities.

The middle class segment of the market is the most active, with the emerging middle class moving out of prefabricated housing into more spacious two-to-three bedroom accommodation in the vicinity of the city centre. At the low end of the market, people relocating from other parts of Bulgaria sustain the demand for apartments within CABs on the city fringe. Some of these estates have good infrastructure and are undergoing gradual gentrification. Finally, there is a limited suburban development concentrated in the southern part of the city, which is largely driven by rental demand from expatriates.

Residential property prices

NSI reported that the average apartment prices increased by 9.8 per cent in Sofia in 2006. The real estate agency Imot estimates that the increase was more pronounced in the prime segment, which increased by 20-30 per cent with average prices at EUR 1,000-1,500/m². According to Arco Vara, the asking prices for new projects in the most prestigious locations were EUR 1,200-2,000/m². Prices at the middle class market segment were EUR 700-900/m². Prices for apartments in the least appealing CABs even dropped slightly, selling at EUR 550-700/m² (up to EUR 800/m² for new projects) at the end 2006.

According to Propertywise Bulgaria magazine, the Sofia property market prices have not yet benefited from the positive effects of Bulgaria's EU membership, such as increasing foreign direct investment, the potential inflow of emigrant remittances or the recent decision announced by the government in November 2006 to allow foreign investors to purchase full property ownership. Foreign investors have only recently discovered Bulgarian properties as an asset class in its own right, and their attention is primarily focused on seaside resorts like Varna and Burgas, rather than the landlocked Sofia region. NSI estimates that in the fourth quarter of 2006, average housing prices in Varna were just 2 per cent lower than in Sofia. The average housing prices in Burgas 10 per cent lower than in Sofia.

Office property market

Colliers International estimates that the Sofia Class A and B office property stock reached a total of 550,000 m² in 2006, representing an increase of 27 per cent since 2005. Declining employment and rising levels of foreign investment have been the key drivers behind demand for quality office space in recent years. Following the completion of several office projects outside the city centre (Business Park Sofia, Belissimo Business Centre), up to the half of the growth in rentable area has taken place in the suburbs of Sofia, which account for almost half of the total office property stock. The Broad Centre accounts for 30 per cent of the stock, and the central business district for 23 per cent. Colliers International expects approximately 300,000 m² of quality office space to be completed during 2007-2009, but does not expect that to have any major effect on rent levels because of Bulgaria's strong economic growth and its emerging profile as a nearshoring destination.

Due to the simultaneous completion of several large-scale projects, the vacancy rates for Class A and B premises rose slightly in the second half of 2006, to 5.2 per cent on average. The first recorded sale in Sofia of office properties to financial investors took place in 2005, followed by more transactions in 2006. In the second half of 2006, office yields in Sofia ranged between 7.2-9 per cent.

The following table summarizes the monthly office rental rates (EUR/m²) in Sofia at the end of 2006:

<u>District</u>	<u>Class A</u>	<u>Class B</u>
Central Business District	15-22	13-14
Broad Centre	11-16	7-10
Suburbs	13-15	5-9

Source: Arco Vara, Colliers Int.

Romania - Bucharest

Bucharest is the capital city and the largest metropolitan area in Romania. In 2005, the city itself had a population of 1.9 million; a total of 2.6 million people lived in the Greater Bucharest area. According to the National Institute of Statistics, the Bucharest-Ilfov region contributes around one-fifth of Romania's GDP and one-quarter of the industrial production. In 2005, its GDP per capita was more than twice the national average and some 60 per cent of the EU-25 level.

The following table summarises the development in statistics relating to the property market in Romania in 2003-06:

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Mortgages-to-GDP ratio, %	1.0	1.4	1.8	2.3
Outstanding housing loan balance, EUR million	535	823	1,448	2,277
Average interest rate on new housing loans in RON, %	24.2	23.5	17.1	12.2
Average interest rate on new housing loans in EUR, %	9.2	9.4	9.1	8.5
Average net monthly wage in the City of Bucharest, EUR	158	190	273	n/a
Residential inventory in Bucharest-Ilfov region, '000 m ²	34,711	35,023	35,820	n/a
Residential construction in Bucharest-Ilfov region, '000 m ²	623	689	824	n/a

Source: National Institute of Statistics of Romania, National Bank of Romania

Supply and demand for residential property

The city outside the Bucharest historic centre consists largely of sprawling housing estates clustered in densely populated CABs. Such areas have good infrastructure, and are sought after by developers for new high-rise middle-class apartment blocks with units of 80-120 m². King Sturge estimates that the middle-income purchases account for three-quarters of the demand, buy-to-let investors 15 per cent, high net worth individuals 7 per cent, and expatriates for the remaining 3 per cent. Upscale property developers are increasingly targeting suburbs on the northern fringe of the city, which are close to the rapidly developing business district and can be easily accessed by both public and private transport. King Sturge estimates Bucharest housing demand at 10,000-15,000 units per annum, which is considerably more than the actual supply of approximately 6,000 units in 2006. Colliers International reports that 19 new projects with 100 units or more were announced in 2006, when then corresponding figure in 2005 was just three. These 22 projects started in 2005-06 comprise approximately 11,000 housing units, half of which were delivered in 2006, the rest being expected to complete in 2007.

Residential property prices

Leading Romanian real estate agencies agree that residential prices grew in Bucharest on average by 10-15 per cent in 2006, at the same rate as in the year before. Colliers International reports that the strong demand enables the developers to increase their prices on a quarterly basis. In the second half of 2006, middle class apartments in multi-storey apartment blocks in the CABs commanded prices in the range of EUR 850-1,500/m², new low-cost properties in peripheral locations between 900-1,000/m², high-quality units in the central and northern parts of Bucharest EUR 1,500-1,900/m². The prices for upmarket properties in central locations start at EUR 2,500/m².

Office property market

King Sturge indicates that Bucharest Class A office stock reached 400,000 m² in 2006, representing an increase of approximately 120,000 m² from 2005; Class B additions totalled 175,000 m², with the total stock rising to 700,000 m². Although Bucharest has no established central business district, the development of new offices is gradually re-orienting from the city centre to the northern part of the city, which offers better transport infrastructure, green areas and proximity to high-quality residential areas. According to CB Richard Ellis, out of the total 350,000 m² of Class A and B office space to be delivered in 2007, more than half will be in Bucharest North.

Reflecting the serious imbalance between demand and supply, in the overall vacancy rates dropped below 4 per cent in the second half of 2006 and below 2 per cent for Class A premises, according to the CB Richard Ellis. However, Colliers International expects prime rents in non-central locations and Class B premises to have room for adjustment because of the growing supply of better-quality space in the more popular locations. Prime office yields have fallen substantially in recent years and are now at 7 per cent, according to the major property consultancies, down from 12 per cent in 2004, and 9-10 per cent in 2005.

The following table summarizes the monthly office rental rates (EUR/m²) in Bucharest at the end of 2006:

District	Class A	Class B
Central business district	19-22	12-15
Central North	19-20	10-15
Other North	15-18	n/a
Rest of the city	n/a	n/a

Source: CB Richard Ellis, Colliers Int.

CONSTRUCTION MARKET IN ESTONIA AND LATVIA

Underpinned by strong economies, the construction industries in both Estonia and Latvia have been growing at double-digit rates since 2004. The construction boom gained momentum in the early 2000s because of a combination of factors, such as growing economic prosperity, low interest rates, and the generally poor state of housing, office inventory and transport infrastructure.

In Estonia, the ratio of the construction sector turnover to GDP is already quite high compared to the rest of Europe, while Latvia is on a par with most CEE countries. Both countries are considered still to have considerable potential for growth in terms of construction output. The table below compares the construction output volume in selected European countries (figures are for 2006, unless stated otherwise).

Country	Construction output	
	As % of GDP	Per capita, EUR
Spain*	23.0	4,653
Ireland*	19.9	7,556
Estonia	15.3	1,495
Czech Rep	14.5	1,600
Finland*	14.0	4,170
Italy*	12.9	6,332
Norway	10.7	6,058
Latvia	9.8	681
Lithuania	9.5	653
Hungary	9.2	855
Germany*	8.7	2,369
Russia	8.4	458
Austria*	8.4	2,509
Slovenia	8.1	1,194

*Data for 2005

Source: Eurostat, national statistical agencies of the respective countries, Euroconstruct

At the present, however, the industry is adjusting to the deepening shortage of workforce and materials, which has caused construction costs to grow at an accelerating pace. Efficient absorption of the EU funds is a serious challenge for Estonia and Latvia on the way to maintaining sustainable growth. According to the European Commission, the two countries together received approximately EUR 1.65 billion of convergence assistance in 2004-2006, including approximately EUR 0.8 billion of Cohesion Funds allocated for improvements in environment and transport infrastructure. Another 8.8 billion has been allocated for 2007-2013, of which Cohesion Funds account for approximately EUR 2.4 billion.

Construction market in Estonia

According to the Statistical Office of Estonia, the construction output in Estonia exceeded EUR 2 billion in 2006, up from EUR 1.5 billion in 2005. The industry employs some 36,300 people, or 6 per cent of the labour force. In 2005, 56 per cent of the total construction volume was carried out in the Harju county, of which the city of Tallinn contributed two-thirds.

The following table outlines general information on the Estonian construction market:

Figures in EUR million, unless indicated otherwise	2003	2004	2005	2006
Civil engineering total	347	447	559	665
Non-residential buildings total	491	513	601	n/a
Residential buildings total	159	218	353	n/a
Construction total	997	1,178	1,514	2,005
Annual change in construction volume, %	6.0	11.0	23.0	22.0
Annual change in construction cost index, %	3.7	6.5	7.3	10.3

Source: Statistical Office of Estonia

As in previous years, growth in residential construction is on an upward trend: according to the Construction Works Register of Estonia, approximately 5,070 housing units were completed in 2006, which is 30 per cent more than in 2005. The volume of civil engineering works has almost doubled since 2003, and is expected to grow strongly in the next several years, largely due to the EUR 3 billion of EU assistance approved for 2007-2013, of which Cohesion Funds account for one-third.

The Commercial Register of Estonia reports that there were over 5,200 construction companies in Estonia at the end of 2005, most of these being small niche players acting as subcontractors to the larger enterprises. Leading construction companies in Estonia are Merko Ehitus, Skanska EMV, Eesti Ehitus and YIT Ehitus, which jointly control substantial share of the market in 2006.

Construction market in Latvia

According to the Central Statistics Bureau of Latvia, construction volume in Latvia reached EUR 1.58 billion in 2006, up from EUR 1.16 billion in 2005. With the progressive absorption of EU funding, the volume of civil engineering works grew by 50 per cent to almost EUR 0.7 billion. Residential construction accounts for a relatively low proportionate share of the total construction volume (17 per cent in 2006), but it is nevertheless a major source of growth for the industry, with approximately 813,000 m² of residential floor space completed in 2006, which is 47 per cent higher than in 2005. As in Estonia, the Latvian construction industry has benefited from the first portion of EU funding. According to the European Commission, in total EUR 1 billion were disbursed in 2003-2006, half of it in Cohesion Funds; another EUR 4.1 billion have been allocated for 2007-2013 (Cohesion Funds accounting for one-third of it).

The following table outlines general information on the Latvian construction market:

<u>Figures in EUR million, unless indicated otherwise</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Civil engineering total*	289	360	456	688
Non-residential buildings*	349	382	466	592
Residential buildings total*	74	116	186	268
Total construction on own account*	712	859	1,108	1,548
Total construction output	747	905	1,164	1,585
Annual change in construction volume index, %	13.3	13.9	15.5	14.4
Annual change in construction cost index, %	-1.3	6.4	11.4	20.9

*Based on the Construction Survey data

Source: Central Statistics Bureau of Latvia

At the end of 2006, the Latvian construction industry employed 117,000 people, or 10.6 per cent of the total workforce. Construction costs have been rising at an accelerating pace since 2004. They increased by some 21 per cent in 2006, more than in any other year in a decade. Although the construction industry headcount has roughly doubled since 2002, the labour shortage has become the major constraint for growth: construction workers' wages increased by 44 per cent in 2006 (up 16 per cent from 2005).

According to the Central Statistics Bureau of Latvia, there are more than 4,000 construction companies in Latvia; a vast majority of these are small and medium-sized enterprises. Over the past few years, the sector has become more concentrated, since the rising construction costs favour economies of scale. The largest players in the market are general constructors, who outsource most of the work to the smaller companies. According to the Latvian Builders' Association, the top five of these (Skonto Buve, Merks, Re&Re, PBLC and BMGS) had a combined market share of some 21 per cent in 2006.

BUSINESS

SUMMARY

The Group is a Central and Eastern European real estate developer with an integrated business model encompassing also real estate services and construction business areas. Arco Vara is one of the leading real estate developers in Estonia and Latvia and it is in the progress of extending its operations in Romania, Bulgaria, Lithuania and Ukraine. Arco Vara's expertise derived from the development of the Baltic real estate market over the last 15 years is expected to provide valuable experience when the Group enters the new target markets.

The Group focuses on developing high-quality residential living environments for the upper-middle class in the capital cities of its target markets. The Group also undertakes the development of commercial properties with an aim to sell the latter prior to or at completion. The Group does not intend to build a portfolio of cash flow generating commercial properties, although it currently owns several such properties for future development purposes.

The Group was founded in 1992 in Estonia with the establishment of its first real estate agency. With an operating history exceeding 15 years, the Group is one of the oldest real estate companies in Estonia. Arco Vara started real estate development operations in 1995 and entered the construction services market in 2001. The Group is organised into three principal divisions: services, development and construction. Each of Arco Real Estate, Arco Investeeringud and Arco Ehitus, all wholly-owned direct subsidiaries of the Company, is the parent company of its division.

The real estate development division is central to the Group's value generation; however, it utilizes the expertise and capacity of the construction and services divisions to ensure profitable and timely completion of its development projects. Management has set limits for intra-group services as a percentage of the revenue of each division and intra-group transactions are generally conducted at arm's length.

The Group's revenue has increased from EEK 349.9 million in 2004 to EEK 483.6 million in 2006, with the largest revenue source being the development division. As of end of 2006, the Group and the Joint Ventures employed 478 people.

Arco Vara has already established real estate agency service in the capitals of all its current target markets, providing the technical capability, recruiting base and market understanding required for the local expansion into development and construction. On 27 April 2007, Arco Vara acquired rights to what it expects to be the Group's first residential development project in Sofia, Bulgaria.

A summary table of the Group's current material development projects and cash-flow generating properties is provided below:

Project	Consolidated project book value at 31/12/2006, EEK m	Group owner -ship, % ¹⁾	Project total book value at 31/12/2006, EEK m ²⁾	Appraised value by Colliers at 16/04/2007, EEK m ³⁾	Expected number of apartments/land units developed	Estimated sellable / leasable space, m ²	Estimated development period
Residential development projects							
Tivoli	300.0	100	300.0	712.2	732 / -	46,872	2008-2011
TOP	137.2	50	274.4	359.5	360 / -	27,086	2008-2011
Kolde	81.3	89	81.3	145.6	372 / -	22,168	2005-2009
Pärtli	4.2	50 ⁴⁾	8.4	55.7	- / 93	-	2007-2008
Tooma	4.0	50 ⁵⁾	8.0	32.0	- / 101	-	2007-2008
Vahi	2.9	100	2.9	26.1	- / 21	-	2007
Bišumuiža 1	31.4	80	31.4	47.8	238 / -	18,652	2006-2009

Project	Consolidated project book value at 31/12/2006, EEK m	Group owner -ship, % ¹⁾	Project total book value at 31/12/2006, EEK m ²⁾	Appraised value by Colliers at 16/04/2007, EEK m ³⁾	Expected number of apartments/ land units developed	Estimated sellable / leasable space, m ²	Estimated development period
Baltezers	31.1	80	31.1	69.7	- / 53	-	2007-2008
Bišumuiža 2	14.0	40 ⁶⁾	14.0	341.8	1,085 / -	81,826	2007-2014
Office and retail development projects							
Ahtri 3	385.0	50	385.0	698.6	n.a.	36,300	2008-2011
Ilmarine	150.8	50	301.5	811.3	n.a.	60,000	2008-2011
Laeva	41.7	100	41.8	112.6	n.a.	6,006	2008-2009
Paldiski road	34.6	100	34.6	218.8	n.a.	21,600	2009-2011
Kipsala	57.4	50 ⁷⁾	114.8	95.7	n.a.	36,000	2008-2011
Cash flow generating properties							
TOP	116.4	50	232.8	267.9	n.a.	23,292	n.a.
Melon	75.0	50	150.0	187.8	n.a.	7,567	n.a.
Kerberon	72.4	83	72.4	78.6	n.a.	8,111	n.a.
AVSK							
<i>Raekoja 10</i>	10.7	50	21.4	39.7	n.a.	1,493	n.a.
<i>Rüütli 16/18</i>	18.5	50	37.0	37.2	n.a.	1,030	n.a.
<i>Kotzebue 18</i>	1.6	50	3.2	4.0	n.a.	415	n.a.
Pärnu market	30.0	100	30.0	40.2	n.a.	2,529	n.a.
STÜ	29.9	100	29.9	26.6	n.a.	1,692	n.a.
Enerpoint	12.7	100	12.7	13.3	n.a.	2,208	n.a.
TOTAL	1,642.8		2,218.6	4,422.7			

¹⁾ Group legal ownership as at the date of this Offering Circular.

²⁾ Consolidated project book value adjusted with the assumption of 100 per cent being owned by the Group on 31 December 2006.

³⁾ The Appraisal Report was prepared by Colliers International separately from the preparation of the Group's IFRS Financial Statements. In producing the Appraisal Report, Colliers International used certain assumptions, techniques and methodologies specified in the Appraisal Report, which may differ from the assumptions used by the Group when preparing its IFRS Financial Statements. Therefore, the values indicated in the Appraisal Report differ from the values for the same properties used in Group's IFRS Financial Statements. Whereas the values indicated by Colliers International aim to reflect market prices of the properties as at the valuation date, those real estate projects that are classified in accordance with IFRS as Inventories or Construction In Progress are carried at their acquisition cost in the balance sheet of the Company. Only those properties that are classified as Investment Property are carried in the balance sheet of the Company in their fair value. The fair values of investment properties in the interim condensed consolidated financial statements of the Company for the three-month period ended 31 March 2007 have not been based on the Appraisal Report. This is due to the requirement of IFRS that future capital expenditure and the related future benefits from such expenditure are not to be reflected in the fair value of Investment Property.

⁴⁾ The project encompasses three land plots, one owned by OÜ Koduküla and two other owned by individuals who have entered into agreements for selling these land plots to OÜ Koduküla.

⁵⁾ The land plot is owned by a private individual who has entered into an agreement for selling this plot to OÜ Koduküla, a 50-50 per cent joint venture with VWF Kinnisvara OÜ.

⁶⁾ The land plot is owned by SIA Sportings Riga, the wholly-owned subsidiary of SIA Bišumuižas Nami. As at the date of the Offering Circular, Arco Investeeringud owns 80 per cent and Mr. Viktors Savins owns 20 per cent of the shares of SIA Bišumuižas Nami. On 18 May 2007, Arco Investeeringud and Mr. Viktors Savins entered into a conditional Share Purchase Agreement with SIA Linstow Baltic regarding the sale of 50 per cent of the shares of SIA Bišumuižas Nami. Following the closing Arco Investeeringud will own 40 per cent of the shares in SIA Bišumuižas Nami, with Mr. Viktors Savins owning 10 per cent and SIA Linstow Baltic owning 50 per cent. See - "Management's Discussion and Analysis of the Group's Financial Condition and Results of Operations – Recent Developments".

⁷⁾ OÜ Floriston Grupp, a joint venture with AS Ärimaja, has made an advanced payment for the acquisition of 100 per cent of the shares of SIA "Euroline", the company holding the property for Kipsala project. See - "Business - Material Contracts - Acquisition of shareholdings in subsidiaries and joint ventures."

COMPETITIVE STRENGTHS

- **Vertically integrated business model.** The Group's vertically integrated operation model in Estonia and Latvia extends from construction and development to marketing, sales, valuation, and property investment advisory services. This model reduces dependence on third parties, reduces third-party fees and enhances the Group's understanding of the market. In-house construction capability helps to secure the Group's development projects in the Estonian and Latvian property markets, where the demand for construction services currently exceeds the supply, without erosion to its profit margins.
- **Strong track record combined with local market expertise.** Management believes that Arco Vara's past history in the Baltic States and its understanding of the real estate markets in Central and Eastern Europe gives the Group a competitive advantage with respect to market trends and investment opportunities in new markets. The Group normally enters a new market through the property agency business, which enables it to develop an in-depth understanding of the market and recruit local professionals prior to expanding operations to other businesses. As a result, Arco Vara's team in the Baltic countries is one of the largest and most experienced professional teams in the local real estate sector.
- **Experience in residential development.** The Group has experience in planning, design and execution of high-quality residential projects. The Group has completed residential projects in Estonia, including Veskimõldre and Merivälja2. These projects give the Group a basis for launching new projects, preparing project documentation and negotiating with project parties, construction companies and material suppliers. Management believes that the Group's performance history, branding, reputation for quality and reliability are important factors in its business operations such as acquiring land and in the marketing efforts towards potential buyers in the Baltic States as well as in Ukraine, Bulgaria and Romania, where the Group has established a presence recently.
- **Significant development projects in Tallinn and Riga, with future opportunities in Sofia, Bucharest, Vilnius, and Kiev.** The Group has a portfolio of current and planned development projects; involving the development of over 2,700 apartments and approximately 160,000 square metres of office and retail property expected to reach the construction phase in the next three years.
- **Unique approach to development.** During 15 years of operations the Group has developed from a real estate agency into a truly integrated real estate development company. Having its roots in the sales-oriented real estate agency allows the Group to develop living spaces most geared towards clients' preferences, which Management believes to be more advantageous than a construction-driven approach.
- **Established business platforms being rolled out in neighbouring markets.** The Group has developed an efficient back-office system with an electronic platform and management systems incorporating a marketing function and standard reporting. The system is operational in the Group's Estonian operations and Management believes it to be a significant advantage in setting up and growing operations in other markets.

STRATEGY

Arco Vara's strategy is to become a leading residential property developer and real estate agent in the Baltic States and selected countries of Central and Eastern Europe. The Group has already achieved this in Estonia and Latvia and it is in the progress of developing its operations in Lithuania, and has recently entered the Romanian, Bulgarian and Ukrainian markets. In the longer run, the Group aims to generate approximately half of the revenues in the Baltics while the rest of the revenues are to

originate from the new target markets. The business strategy of the Group is shortly summarised as follows:

- Focus on large-scale residential development projects in the capitals of the Group's target markets
- Balance the residential development pipeline with selected commercial development projects, which are either pre-sold or have a clear exit strategy
- Enter new target markets with real estate services operations and expand into real estate development thereafter
- In new target markets initially focus on development projects with obtained building rights due to lower risks and faster project completion
- Increase real estate services office network across all target markets to 46 offices by 2009
- Add construction capacity via acquisitions in Estonia and Latvia

Arco Vara is in the process of implementing the balanced scorecard management system in Estonia during 2007 to continuously improve its strategic performance and results. If it proves successful in Estonia, the Group intends to expand this strategic management system to other geographical markets in order to facilitate management and control of the performance of each business.

Arco Vara's business strategy is to enter a new market by establishing real estate agency operations, in the capital city. This advisory platform provides the technical capability, recruiting base and market understanding required for local expansion into development and construction. Real estate agency operations help the Group to gather information about the local property market, its participants, trends and characteristics. The agency also introduces the Group's brand name to the market and builds a client base. Only when Management is satisfied with the Group's understanding of and presence in a new market, will it expand into property development. Following sections detail the business strategy followed by different divisions of the Group.

Real estate agency

The Group considers the real estate agency business as an integral part of its product. In addition to Estonia and Latvia, where the Group is one of the leading providers of real estate agency services, it aims to become a leading agent in each of the countries where it currently has operations. Arco Vara intends to replicate its Baltic operating model in other markets, complete with a similar product offering and web-based solutions, while customising its approach in each individual market. Similar to what the Group has done in Estonia and Latvia, it intends to develop a network of physical offices throughout major cities and regional centres in its target countries. By 2009, the Group expects to have 12 offices in Estonia, 15 offices in Latvia, four offices in Lithuania and three offices in each of Ukraine, Romania and Bulgaria.

Property development

Baltic States

The Group's strategy in property development is to focus primarily on building high-quality residential environments for the upper-middle class in capital cities. Management believes that this customer segment is a particularly attractive and active part of the Central and Eastern European property markets. The Group's target demographic is sensitive to product quality but is less concerned with price, and places a high value on new residential complexes built to high specification.

The Group's strategy is to focus on relatively large projects located in city centre areas or close to them. As the Group has its own construction resources, it can more efficiently scrutinise development

costs, construction quality and timing issues as opposed to exclusively relying on contracting external builders. Management believes this enables Arco Vara to offer a compelling value proposition without sacrificing the profit margins of its development activities.

Arco Vara aims to be an efficient developer and does not intend to build a portfolio of commercial properties. Its strategy in commercial property development is focused solely on development, and the Group usually engages in close-ended commercial development projects that either have a visible exit strategy or have already been pre-sold. Management plans to keep the cash flow generating properties of the Group and the Joint Ventures for their future development potential.

The Group's current Baltic development portfolio consists of development projects in Estonia and Latvia. Arco Vara and the Joint Ventures have secured a number of sites for development in recent years, including 7 cash flow generating projects and 14 projects currently under development or expected to reach their construction phase between 2007 and 2009. Management estimates that these 14 development projects will require investment of approximately EEK 8,135 million, and believes that the successful completion of these projects will form the platform for the Arco Vara's growth in the short to medium term.

Arco Vara expects to focus on fewer large-scale developments by selling some of its smaller sites. In 2007, the Group expects to sell such residual properties for an aggregate consolidated amount of approximately EEK 200 million. Such properties are currently classified under property investment or inventories. In addition, the Group expects to continue looking for opportunities for property development in Lithuania, where thus far it has not been active.

Ukraine, Romania and Bulgaria

Arco Vara believes that new markets in the Ukraine, Romania and Bulgaria present attractive development opportunities and yields, both in the residential and commercial property segments. The Group expects these countries to experience robust growth in property development similar to that of the Baltic countries with the emergence of favourable mortgage loans and the accession to European Union. The Group's development strategy will focus only on capital cities, where purchasing power tends to be higher than in the regional centres. Unlike in the Baltic countries, the Group will initially only consider projects which already have received building and other permits for development. While this conservative approach may imply lower profit margins, it also lowers the risks associated with bureaucracy such as a failure to obtain zoning and building permits.

Similar to its approach in the Baltic region, the Group's long-term goal is to focus on large-scale residential development, which it considers its core competence. However, particularly in the initial stage, it will also consider opportunities for commercial property development for leisure, office and retail use. On 27 April 2007, Arco Vara acquired rights to what it expects to be the Group's first residential development project in Sofia, Bulgaria – see "Management's Discussion and Analysis of the Group's Financial Condition and Results of Operations – Recent Developments". In addition, the Group is currently considering several other potential development projects in the capital cities of its new markets and may initiate a number of them during 2007.

Construction services

The Group considers its own construction capacity vital for continual business development and a key factor to success given the Group's focus on large-scale development projects. Arco Vara's construction activity currently focuses on project management and engineering. However, the Group aims to expand its construction services business vertically by hiring construction employees or acquiring smaller construction companies, with a focus on Estonia and Latvia. The Group has no plans to expand its construction operations into Lithuania, Ukraine, Bulgaria or Romania as Management does not consider launching construction activities necessary to compete in those markets.

HISTORY

The Group was founded in 1992 in Estonia with the establishment of its first real estate agency. With an operating history exceeding 15 years, the Group is one of the oldest companies of its kind in Estonia. Mr. Arti Arakas was the founder of the Company, and Mr. Richard Tomingas and Mr. Hillar-Peeter Luitsalu joined the team shortly after. All of these three individuals have maintained their shareholding in the Group through its 15 years of operations and currently act as members of the Supervisory Council of the Company.

Concurrent with the expansion of its offices in Estonia, the Group also established a real estate development company, Arco Investeeringud, which in 1996 launched the Group's first large-scale residential development project Veskimõldre in Estonia.

The following years marked a substantial development in the Group's Estonian operations. The Group grew into one of country's leading real estate groups which encouraged it to move its experience, know-how, business concept and trademark into other Baltic markets in order to satisfy the Group's growth aspirations, which otherwise would have been restricted to the relatively limited Estonian market. Expansion to neighbouring markets commenced in 1997 with the establishment of a real estate agency office in Riga, Latvia, followed by the launch of the Vilnius office in Lithuania in 2000.

During the following years, Arco Vara identified the possibility of adding more value by incorporating construction services to the Group to support its growing development activities. In 2001, Arco Vara complemented its service portfolio with construction services in Estonia. The Group acquired the construction supervision company Tallinna Linnaehituse AS (founded in 1957), followed by the acquisition of the construction company Deena Ehituse OÜ (current business name Arco Ehitus OÜ) in 2003.

The Group launched its first Latvian residential development project in the Baltezers suburbs of Riga, Latvia in 2002, though more active development activities in Latvia did not begin until 2003.

In 2003, the Group began providing management service for Arco Balti Kinnisvarafond AS (whose business name is proposed to be changed to Arco Balti Kinnisvaraportfell AS), a company with EUR 19.8 million of assets under management as of 31 March 2007. Followed by the successful launch of the first investment vehicle, the Group joined forces with East Capital to initiate and manage the *Explorer Property Fund – Baltic States* in 2005 to invest in cash-flow generating Baltic properties, the latter having EUR 65.7 million of assets under management as of 31 March 2007.

After extensive market research, sight visits and finding local partners, the Group expanded its real estate agency activities, supported by the management systems and back-office in Estonia, to Kiev, Ukraine in 2005, followed by Sofia, Bulgaria in 2006 and Bucharest, Romania at the beginning of 2007.

At the beginning of 2007, the Group acquired a majority shareholding in a construction company in Latvia, SIA Arco Construction, thus having all three of its operational divisions present also in Latvia.

Having more than 15 years of operating history and currently employing more than 500 employees, the Group has developed into a leading real estate group operating in all Baltic countries with an additional presence in Ukraine, Bulgaria and Romania. In Estonia and Latvia the Group combines the activities of property services, property development and construction. In the other countries of operations it has established property services and aims to undertake property development activities once suitable projects have been found.

The Company is the founding member of the Association of Estonian Real Estate Companies, the Latvian Association of Real Estate Transactions, the Estonian Association of Appraisers and the Latvian Association of Property Appraisers.

The table below lists the main development projects undertaken by the Group, already completed or initiated.

Year of launch	Project
1996	Residential development project Veskimõldre in Tallinn, Estonia
1998	Residential development project Merivälja2 in Tallinn, Estonia
1999	Commercial redevelopment of Ristiku shopping centre in Tartu, Estonia
2001	Commercial redevelopment of Rimi shopping centre at Põhja pst, Tallinn, Estonia
2002	Acquisition of Pirita Olympic Yachting Centre (Pirita TOP)
2002	Residential development project in Baltezers, Riga, Latvia
2003	Commercial development project Raekeskus in Kuressaare, island of Saaremaa, Estonia
2003	Residential area of Mārsili in Riga, Latvia
2005	Residential development project Kolde in Tallinn, Estonia
2005	Residential area Bišumuiža in Riga, Latvia

OPERATIONS

The Group has organized its operating structure into three main divisions which reflect its principal areas of business, namely:

- **The services division** is organized under Arco Real Estate in Estonia and its offices in all six real estate markets – Estonia, Latvia, Lithuania, Ukraine, Bulgaria and Romania – are owned by subsidiary companies. The division uses the brand name of “Arco Real Estate” internationally. The main services of the division include real estate agency services, valuation services, real estate investment management, short-term proprietary real estate investments, and small-scale development as well as property management;
- **The development division** is organized under Arco Investeeringud, which is the parent company for all development subsidiaries of the Group and holds interests in joint ventures, with the focus on Estonia and Latvia. The division operates internationally under the brand name “Arco Invest”. The division invests in real estate and is the developer of residential and non-residential environments;
- **The construction division** is organized under Arco Ehitus, which currently has operations in Estonia and a subsidiary in Latvia. Though the division is mainly engaged in project management as a general contractor, it also has subcontracting capacity in Estonia and Latvia and environmental construction capability in Estonia.

The Group is currently actively involved in offering the following services, although Management continuously evaluates possible new development projects in all markets where the Group operates:

Services	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania
Services	x	x	x	x	x	x
Development	x	x	-	-	-	-
Construction	x	x	-	-	-	-

The table below presents the break-down of the Group’s revenues by geographical markets:

Revenues

	2004 audited		2005 audited		2006 audited		1Q 2007 unaudited	
	EEK million	%	EEK million	%	EEK million	%	EEK million	%
Estonia	340.3	97.2	451.9	95.0	439.7	90.9	219.6	75.4
Latvia	9.8	2.8	13.1	2.7	33.7	7.0	67.5	23.2
Other ¹⁾	0.8	0.2	12.4	2.6	11.6	2.4	4.2	1.4
Eliminations	-1.0	-0.2	-1.5	-0.3	-1.3	-0.3	-0.2	-0.1
Total	349.9	100	475.9	100	483.6	100	291.2	100

¹⁾ This figure comprises the revenue from the operations in Lithuania, Ukraine, Bulgaria and Romania.

Although it is more common for companies to expand from construction to development, the Group is an example of a successful transition from traditional real estate agency services to development and construction.

All three divisions, although independent and separate in their operations, function as one organization with the divisions complementing each other. The services division, being the initial operation in a new market and employing the majority of the Group's workforce, moulds the "public face" of the Group and is responsible for providing Group companies with adequate market information, analysis and agency support. The development division, being the principal revenue source of the Group with the most growth potential, uses the expertise and capacities of the construction division as well as the agency offices to ensure smooth completion and successful sales of its projects. The construction division provides quality construction capacity for projects generated by the development division in times of scarcity of human and material resources in the construction sector. This has become especially important for the Group as many major construction companies have expanded into development, resulting in further strain on the already limited construction resources in the Baltic States.

The table below indicates the break-down of revenues and other operating income between the three principal divisions of the Group:

	Revenues and Other Operating Income							
	2004		2005		2006		1Q 2007 unaudited	
	EEK million	%	EEK million	%	EEK million	%	EEK million	%
Services before eliminations	80.0		79.6		119.4		33.3	
Services after eliminations	71.8	16.7	67.7	11.1	107.9	11.9	28.6	8.4
Development before eliminations	316.1		369.3		626.6		294.8	
Development after eliminations	308.4	71.9	367.2	60.1	621.4	68.6	293.5	86.2
Construction before eliminations	137.5		233.5		359.3		57.2	
Construction after eliminations	48.8	11.4	176.2	28.8	177.1	19.5	18.3	5.4
Total	429.0	100	611.2	100	906.5	100	340.4	100

The Group's total revenue has increased from EEK 349.9 million in 2004 to EEK 483.6 million in 2006 with the largest revenue source being the investment and development division. Sales in a given year are largely dependent on the completion schedule of development projects. When the completion of certain projects was postponed in 2006, the increase in sales in that year remained modest, but this was compensated by strong sales growth in the first three months of 2007. Unconsolidated revenue and other operating income of the construction division has historically included substantial volumes of income from other divisions: 64.6 per cent in 2004, 24.5 per cent in 2005 and 50.7 per cent in 2006 of the sales of the construction division related to services provided to the development division.

Despite interaction between the divisions, Management has set limits for the intra-group services as a percentage of the revenue of each division. This is designed to prevent any division from becoming over-dependent on the services of others and to motivate the divisions to be competitive both in quality and price. Intra-group services are always offered at a market price reached after a survey of offers from competitors.

Since the combination of three divisions is functioning already in Estonia and Latvia, Management envisages importing the same model, experience and credibility of process management to new markets.

Services division

The Group's services division activities have been organized under Arco Real Estate in Estonia with local subsidiary companies in each country of operations. See "Organisational Structure". The scale of the service portfolio varies from country to country depending on the strength of the Group's market presence and experience. The division comprises approximately 63 per cent of Group employees and generated 11.9 per cent of its total revenue and other operating income in the financial year 2006. Volume of real estate transactions does exhibit an element of seasonality, but given the small share of the services division of the Group's revenues and the underlying volatility of revenues of the development division, the former is not expected to have a significant impact on the Group's revenues' volatility.

The services division is the best-known part of the Group to the general public and responsible for much of the Group's image and brand name in the market. Years of experience and a reputation have made Arco Vara an often quoted source of opinion in the Baltic market. The Group's services division has also been chosen to represent the global real estate consultancy Cushman & Wakefield Healey & Baker in the Baltic countries, which Management considers an indication of Arco Vara's professional reputation.

The role of the services division in the Group as a whole is to provide other divisions and functions with market information and to support other divisions with agency services when necessary. The share of agency services offered directly to the Group development projects has been limited to approximately 10 per cent of total division revenue to ensure the competitiveness of the division and to motivate the Group's real estate brokers to compete for selling externally developed real estate projects.

The services division is the first operation to enter a new market. This allows the Group to limit its initial capital expenditure, gauge the local real estate market, obtain business contacts and prepare for the entry of other Group divisions provided that the market is considered favourable. The Group's strategy is to open its first office in the capital city of a new country. When the Group is more familiar in the capital and has a solid position there, it expands to other cities, either to attain geographical coverage or to be present in cities with a certain threshold population.

The table below presents the number of agency offices at the end of each of the financial years 2004, 2005 and 2006 and at 31 March 2007 in each country of operations:

<u>Country</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>31 March 2007</u>
Estonia	9	9	10	11
Latvia	1	4	8	8
Lithuania	1	1	2	2
Ukraine	-	1	1	1
Bulgaria	-	-	1	1
Romania	-	-	1	1

Arco Vara currently has agency offices in all six countries where it operates. The services division is represented in 11 cities in Estonia, eight cities in Latvia and two cities in Lithuania. The Group's services division in the well-developed Baltic real estate markets, where it has already achieved a strong position, is still expanding through establishing agencies in smaller towns in all three Baltic countries. As the markets vary in size in each country where the Group operates, the criteria for entering new cities differ greatly. For example, in Estonia the Group tries to establish a presence in cities with populations in excess of 15,000, while in the Ukraine the Group only targets cities that have population in excess of one million inhabitants.

Description of business process and services

The traditional services offered by the division cover agency services and property valuation. In Estonia, the Group's service portfolio also includes other real estate services, which have not yet been introduced to the other markets.

The Group's service portfolio includes also publishing regular market research regarding major market segments and trends of Baltic countries and Ukraine.

Agency service

Agency service is a traditional intermediation service, bringing together willing buyers and sellers for either new development projects or in the secondary real estate market. In a developing real estate market, the agency service is largely vendor-centric, while the market tends to be more buyer-centric in an established environment.

Arco Vara's agency services are divided between residential properties, accounting for approximately three-fourths of the service revenue, and commercial properties, which account for one-fourth of the revenue. Commercial properties include office, retail and other business-related real estate.

The fees in the agency service are calculated as a percentage of transaction value. Fees vary from one to five per cent depending on the competitive situation, geographical location, costs and the size of the property or project sold. In addition to Group's own development projects, other developers without a professional agency of their own are also increasingly using the Group's services in selling their projects.

The agency service is personnel sensitive, because customers appreciate personal qualities like honesty, loyalty and initiative. Certification of brokers is not compulsory in any of the markets where the Group operates, although certified brokers tend to command higher salaries. The brokers receive a relatively low fixed monthly salary and the majority of their total income is derived as a percentage of the service fee from completed transactions. In Latvia, most of the brokers of the Group are not employees of the Group, but act as independent contractors or through their companies under service agreements with SIA Arco Real Estate.

As the business is highly dependent on the quality of its personnel and reputation, the Group has always preferred to grow organically rather than make acquisitions. The standards of business traditions and ethics in Eastern European countries differ greatly and may at times be lower those of Arco Real Estate in Estonia, which can increase the risks of expanding through acquisitions.

The Group has currently its most developed agency service operations in Estonia, closely followed by Latvia. The Estonian business model, brand name, marketing activities, web-page solutions and other back-office support are also used in other markets. Management expects that the Group's agency operations in Latvia, Lithuania and Ukraine will grow faster than its Estonian operations in the coming years, as the real estate markets in these countries are bigger and the Group thus has a great opportunity to strengthen its position.

Valuation service

The valuation service comprises the preparation or review of and supervision over expert opinions regarding the value of real property on the basis of International Valuation Standards and European Valuation Standards. The valuations are prepared by professional valuers or appraisers, who must comply with the laws and regulations of the countries or areas where they practice. National associations certify appraisers, who must have economic, technical or other secondary education (Bachelor's level degree), at least three years of professional experience in real property valuation and a good reputation and must be in compliance with the rules of professional ethics of professional appraisers. While the exact standards of certification may vary, valuation service is nevertheless a certified activity in the markets in which the Group operates. The Group encourages its junior appraisers to obtain a certification, and certified valuers command a higher level of salary than those without it.

The national societies or associations of appraisers in the Baltic States, Ukraine and Romania cooperate and comply with the harmonized standards and procedural guidance formulated and published by the International Valuation Standards Committee. Latvia has implemented its own National Valuation Standards.

Giving an expert opinion on the value of a property services requires familiarity with the local real estate market and business environment, so the Group does not introduce valuation services in a new market before it has operated the agency business there for some time.

The fees for valuation services are fixed, and vary depending on the type of property. Though not all of the Group's valuers are certified, its expert opinions are always signed by a certified valuer.

Management considers it important that the market and financial institutions respect the opinions given by the Group's valuers and that both existing and referral customers to use these services. It is not uncommon that a valuation client eventually uses the Group also for agency services.

The Group currently offers valuation services in all Baltic countries. It is in the process of recruiting suitable qualified specialists in the Ukraine while the Group's offices in Bulgaria and Romania are expected to be ready to introduce valuation services in the second half of 2007.

Short-term investments and small scale development

The Group is currently involved in short-term investments and small scale development services only in Estonia. It considers opportunities for short-term investments in new markets only when the agency service has established itself and the structures for project management are in place.

Management considers it beneficial to attach small-scale development activity to the agency. This allows the Group to take advantage of smaller projects outside Tallinn that do not fit into the large-scale business of the development division. Moreover, the local real estate know-how possessed by well-functioning real estate agencies is a critical factor for success in the small-scale development segment. Management is considering expanding the small scale development operations to Latvia, but has currently no plans to introduce it in other markets.

Any small scale development project or short-term investment in excess of EEK 1,500,000 requires the approval of the Supervisory Council of Arco Real Estate.

Small scale development involves the developing of land and residential projects outside Tallinn. The process covers the purchase of land, upgrading it and selling it to the end-users. The maximum investment horizon is 36 months. The Group has established *OÜ Koduküla*, a 50-50 percent joint venture with VWF Kinnisvara OÜ to develop these projects.

The Group's short-term investments include speculative investments in residential properties outside Harju county, intended for sale within 12 months. This business originates from a period of fast development in the Estonian real estate market, when Arco Vara often identified properties with the potential for short-term value appreciation. Arco Vara always notified the seller of the identity of the buyer and of its intention not to hold the asset for a longer time period. In order to mitigate risks attaching to speculative assets, a single investment is normally limited to EEK 3,000,000. The properties are normally not upgraded during the investment period.

As at year end 2006, the real estate portfolio of the services division, consisting of both short-term investments and small scale development projects, amounted to EEK 11,192,079.

In the Company's financial statements, small scale development projects are accounted under its development segment.

Real estate investment management

The Group holds a 50 per cent interest in a joint venture, AVEC Asset Management AS (whose former business name was Arco Varavalitsemise AS), which provides management services to two investment vehicles, Arco Balti Kinnisvarafond AS (which business name is proposed to be changed to Arco Balti Kinnisvaraportfell AS) and Explorer Property Fund – Baltic States AB. These investment vehicles were launched in order to take advantage of yield rates above European standards, in the Baltic markets where rent levels, property prices and the availability of commercial space are below the European equivalents. As of 31 March 2007, these two investment vehicles had approximately EEK 1.3 billion under management, which establishes them as leading investors in real estate in the Baltic markets. These investment vehicles are not regulated “investment funds” or regulated “collective investment schemes” for the purposes of applicable laws and regulations.

AVEC Asset Management AS provides the investment vehicles with market knowledge, relationships and development expertise in order to access attractive properties in the less competitive segments of the market. AVEC Asset Management AS, a 50-50 per cent joint venture with *East Capital AB*, is a leading independent asset manager specializing in the Eastern European financial markets. AVEC Asset Management AS is not a fund manager in terms of the Investment Funds Act of Estonia.

New investments are proposed by AVEC Asset Management AS for approval by the supervisory boards of the investment vehicles in question. Investors in Arco Balti Kinnisvarafond AS are private banking clients and institutional investors, while Explorer Property Fund – Baltic States is intended only for qualified investors and it has a minimum investment size of EUR 35,000.

Clients

According to Management, approximately 80 per cent of the Group's service division clientele are one-time property buyers or sellers. With this type of client base, it is essential that clients recommend the Group's services to other potential clients, which requires a high quality of service, positive image and brand name recognition.

The Group has three main categories of clients, (i) private upper middle class individuals either buying or selling their personal residence, (ii) investors and developers wishing to buy or develop properties

for business purposes or wanting to sell their development projects and (iii) companies wishing to buy, sell or rent their business premises.

The Group strives to maintain its own client base in each market but it also encourages cross-selling of properties across geographic markets. While the cross selling activity is not material for the services division's current operations, the Group expects it to increase in importance in the coming years.

Competition

The Group's services division operates in a highly competitive market in all of its countries of operation. Availability of information on competition in agency and valuation services varies greatly from one country to another. None of the markets where the Group operates has any organisation that regularly analyses or publishes information about market volumes and players. The Group collects itself thorough information on the Estonian market, but such information is not verified by any official authority. It also has a general overview of the competitive situation in its other markets. According to the management of Arco Real Estate, more important than actual market share in Ukraine, Bulgaria and Romania is the ability to offer high-quality services and having a sufficient property portfolio to satisfy the needs of the client base.

The Estonian market is very competitive and fragmented with approximately 250 companies engaged in the real estate agency business. Management believes that the Group holds an estimated 12 per cent share in the agency and valuation services market segment in Estonia and that it is among the largest market players. The Group and its four largest competitors *Kinnisvarabüroo Uus Maa OÜ*, *Ober Hausi Kinnisvara AS*, *Pindi Kinnisvara AS* and *Eri Kinnisvara OÜ* jointly account for an estimated 55 per cent of total revenue in the market segment, and they are continuously gaining market share from the smaller players.

The following table outlines the revenues from the Estonian agency services and valuation services by the Group and its selected competitors, the latter based on the information reported in the audited annual statements of these companies. Information for competitors for 2006 has been extracted from publicly available source:

Name of the company¹⁾	2004 (EEK m)	2005 (EEK m)	2006 (EEK m)
The Group	26.4	37.4	46.9
Kinnisvarabüroo Uus Maa OÜ, Uus Maa Kinnisvarakonsultantide OÜ, Uus Maa Tartu Büroo OÜ, Uus Maa Kinnisvarabüroo Virumaa OÜ	21.8	61.2	n.a
Ober Hausi Kinnisvara AS, Ober Haus Hindamisteenuste OÜ	24.1	31.1	n.a
Pindi Kinnisvara AS ²⁾	23.0	30.4	n.a
Eri Kinnisvara OÜ, ERI Kommertskinnisvara Lahenduste OÜ, ERI Elamispindade Kinnisvara OÜ, ERI Lõuna-Eesti Kinnisvara OÜ	13.3	19.5	n.a

¹⁾ Some companies perform agency and valuation services through separate legal entities

²⁾ Contains revenues from Latvian operations, which are not separated in the audited annual statements

The Latvian real estate agency market is less fragmented than in Estonia. The Group is among the three largest real estate agencies in Latvia, together with the market leader, the Latvian-owned *Latio*, and the Estonian-based *Ober Hausi Kinnisvara*. Latio has been operating since 1991 and currently has over 250 employees in all of Latvia.

The following table outlines the revenues from the Latvian agency services and valuation services by the Group and its selected competitors, the latter based on the information reported in the audited annual statements of these companies. Information for competitors for 2006 has been extracted from publicly available sources.

<u>Name of the company</u>	<u>2004 (EEK m)</u>	<u>2005 (EEK m)</u>	<u>2006 (EEK m)</u>
The Group	9.7	12.9	23.1
SIA Latio, SIA "Latio Vertetaji & konsultanti Vidzeme"	34.3	62.3	n.a.
SIA "Ober Haus Real Estate Latvia", SIA "Ober Haus Vērtēšanas serviss"	7.2	19.9	27.5

Despite having entered the Lithuanian market already in 2000, the Group has not been able to gain as strong of a market position in Lithuania as it has in Estonia and Latvia. Since 2006, the Group's Lithuanian operations have been given additional support by the Latvian agency office. *Ober Hausi Kinnisvara* is the market leader in Lithuania, followed by the Lithuanian-owned *Inreal*, which is involved both in agency services and property development.

The Ukrainian real estate market, with a population of 48 million, is significantly larger than the Baltic markets, with a combined population of seven million. The Group operates only in Kiev with 36 employees and thus has no substantial market strength. However it differentiates itself by the quality of its agency service and has good prospects to compete with existing local companies. The Kiev market is dominated by local companies, *Blagovest*, with more than 10 years market experience and 600 brokers, *Planeta Abalon*, *Aliancebrok* and *Zalatoi Kljuts*.

With no long-term track record in Sofia and Bucharest, the Group is still building its reputation in these markets. *Address Real Estate* is a pioneer in the Bulgarian real estate business and market leader with 60 offices. *Mirela*, *Yavlena Real Estate Agency* and *Elta Consult* (associated partner of *CB Richard Ellis* since 2003) have had been operating since the early 90s and also have extensive market coverage. The Romanian real estate agency sector has been penetrated by branches of international leading real estate firms such as *Colliers International* and *CB Richard Ellis*, who compete with local firms such as *Eurisko Consulting* and *Regatta*.

Development division

Arco Investeeringud is the parent company of the Group's development division. It owns most of the existing development subsidiaries and interests in respective joint ventures and will establish any future companies that may be required in new markets. See "Business - Organisational Structure".

The division is actively extending its project portfolio in Estonia and Latvia and looking for suitable new projects in Lithuania, Ukraine, Bulgaria and Romania. The division comprises approximately 8 per cent of Group employees and generated 68.6 per cent of its total revenue and other operating income in the financial year 2006.

With limited long-term market experience and contacts in Ukraine, Bulgaria and Romania, the Group currently only considers development projects in capital cities where the services division is already present, and which involves co-operation with a partner that has more experience in the local market. In the Ukraine, the Group is co-operating with a local partner Mr. Juri Nikitin (through his wholly-owned Estonian company *OÜ Bagatini*) whilst in Romania it is partnering with the Estonian-based *IPC Romania OÜ* that has been present in the market for a number of years. In Bulgaria, the Group is partnering with Estonian-based *Koger & Partnerid*, through a jointly owned local company *Arco & Koger EOOD*.

The main objective of the division is to act as project manager investing in and developing large residential and non-residential projects. The process starts with choosing a location and ends with well-organized and effective sales of the completed project.

Developing residential areas is a key strength of the division. The Group's target in the coming years is to reach a division where the residential development projects account for approximately 70 per cent

and non-residential projects for approximately 30 per cent of all development projects in terms of book value. The Group's aim is to reach a market position where it develops approximately 10 per cent of the annual new apartment production in every capital city where it operates.

Non-residential projects are intended for sale to either investors or businesses. As a rule, Arco Investeeringud sells all its projects prior to or upon completion (closed position development) and it does not develop rental properties for its own account.

The development division is linked to the Group's services and construction divisions. It often uses agency services to sell completed projects, although such own-account sales do not account for more than 10 to 15 per cent of Group's total agency revenue. Similarly, the development division uses the services of the construction division, provided that the price is competitive. The intra-group construction services account for approximately 50 per cent of the construction division's revenues.

Description of business process

The development process begins with initial market analysis and *identification of potential projects*. Group's project managers co-operate with the services division, which has the best understanding of the overall market situation and demand, and which understands the characteristics of the region where a proposed project is located. The project manager studies the local building regulations, identifies the general principles for the planning and building in the region, and studies the urban development plan for the area (when available), which provides the framework for the spatial development of the rural municipality or city. When a suitable location is found and the project type determined, the project manager prepares an investment memorandum which is presented to the Supervisory Council of the division for approval. Analysis process also contains stress testing of the project's profitability for a possible stagnation or correction in real estate prices.

Once the project is approved, the division commissions the *detail planning* of the project, which is required for obtaining approvals for building activities from the local government authorities. Arco Investeeringud solicits bids from the pre-selected architectural bureaus and chooses one to prepare a proposal for the detail planning for the project.

The detail planning forms the basis for land use and building activity on a given parcel of land in a rural municipality or city. It details the division of land units, determines the construction rights attaching to each unit, delineates the area that can be occupied by buildings and determines the areas reserved for streets and other infrastructure. The construction rights for each land unit specify its intended use, maximum number of buildings, maximum built area and maximum height of the buildings.

The procedure for the preparation and adoption of detail planning involves several procedural steps and stages, the length and outcome of which may sometimes be difficult to predict. Planning is the responsibility of the city or municipal administration both in Estonia and Latvia, and commencing detail planning requires a formal decision by the city or municipal council or another municipal authority. The developer normally commissions the detail planning for a project it proposes to develop. Working drafts of the detail planning proposal need be coordinated with various administrative agencies, such as the heritage and environmental protection authorities, and must be made publicly available for comments and objections. Also, public hearings must be held in the course of the procedure. Comments and objections of interested parties are to be taken into account to the extent possible. In some cases a strategic environmental impact assessment must be prepared as part of the preparation for detail planning. Detail planning may also require an approval of the governor of the county. The municipal authorities can adopt the detail planning only after all these steps and procedures have been successfully completed.

According to the Group, the detail planning approval can take up to three years, and sometimes even longer. The process is less time-consuming in municipalities outside Tallinn and overall the process

tends to be smoother in Latvia than in Estonia. Given the complexity of the local governmental approval process and its critical importance to the implementation of the project, successful completion of the detail planning phase is crucial for any development project.

After the detail planning approval has been obtained, the next step is to prepare the *building design documentation* within the limits prescribed by the detail planning and additional architectural and construction requirements that the local authorities may prescribe for the project. Arco Investeeringud usually commissions the designs by the same architectural bureau that prepared the proposal for the detail planning. The building design documentation details the exact location of each building, floor plans and division of space and facades. The design documentation is needed for applying for a *building permit* for the project. The building permit issued by the local municipalities is needed before construction can be commenced, and it is granted on the basis of the design documentation. According to the management of Arco Investeeringud, the average time from the completion of the design documentation to obtaining a building permit is approximately six months.

The building permit enables the Group to proceed to the *construction phase*. The Group's key supplier in this project phase is the main contractor, which is selected through a tender process. The Group's own construction division participates in the tendering alongside third-party contractors, and Arco Investeeringud will not choose it unless the offered price is competitive. On its recent larger development projects (e.g. Kolde) the Group has used Arco Ehitus as the main contractor and has not had to depend on external main contractors. After the tendering, the construction contract is finalised and signed, and the Group appoints its own supervisor for the project. Arco Investeeringud regularly supervises the project development and building documentation in the Group's development projects. The general contractor prepares the records of the construction work and other documentation required by the relevant building acts and a draft for the construction contract.

When the building work has been completed, the Group files an application with the local authorities for a *permit for use*, if the building is located in Estonia or for an *act for commissioning of the building*, if it is in Latvia. The building cannot be taken into use before the local government authorities have inspected it and issued the permit for use or executed the act for commissioning of the building.

The time required by the construction phase has increased become longer over the last few years due to supply constraints in the construction market. The average building time for residential projects is currently approximately 12 months, and hotel projects take as long as 26 months.

Under the terms of the construction contract, the main contractor gives a *guarantee of construction works* as to the quality of the workmanship and materials, the guarantee indicates, that the construction complies with the contract and that the construction is safe and fit for use. The guarantee is granted for a period of at least two years as of the date on which building is completed. The contractor must correct at his expense and within a reasonable period of time any construction faults or deficiencies that become evident during that period.

The *sales process* is initiated when the building is substantially completed. Arco Investeeringud does not retain or manage the building itself unless it can see the potential to develop the property further. Both residential and non-residential development projects are sold either to investors or end-users at completion. A real estate agent is usually appointed at a relatively early stage and a marketing campaign is prepared and conducted concurrently with the construction phase. Arco Investeeringud often uses the services of Group's own agency division because it is comfortable with its sales capability and familiar with its practices resulting in a professional and faster solution intra-group. Sales costs constitute up to two per cent of the total development project expenses. When willing buyers have been found, sales contracts concluded and completed, this concludes the development process.

Financing development projects

The Group's development projects are usually owned by a special-purpose company (the project vehicle) established at the inception of the project. The project vehicle acquires the land and starts the process for detail planning and obtaining building permit. The project vehicle finances 50-90 per cent of the land acquisition and initial project stages with short-term bank lending, which is either non-recourse financing secured on the acquired asset or recourse financing guaranteed by the Group. The balance of the funding is provided by the Group as equity. By providing a guarantee, the Group can limit its equity investment in the project vehicle. The Management believes that its use of various financing techniques for its development projects, including its joint ventures, is prudent.

When the detail planning has been approved, the short-term debt is refinanced as part of the overall financing package for the project. This financing is secured by a mortgage on the land owned by the project vehicle and repayable after the project is completed and the developed property has been sold. According to a Management estimate, approximately 70 per cent of the Group's current development projects (including Joint Ventures) are financed at a non-recourse basis, without guarantees from the Company or the Group.

The Group may decide to sell part of the project to another developer or a cooperation partner, who acquires an interest in the project vehicle. In most of the Group's current joint venture projects, the other shareholder owns a 50 per cent interest of the project vehicle, and has committed to provide equity financing in proportion to its ownership interest.

Clients

In residential development, Arco Investeeringud focuses in developing high quality mass products located in central areas of cities, aimed for upper middle class buyers. Its clients tend to be urban professionals who appreciate high standards of building specifications and proximity to city centre.

In non-residential development, Arco Investeeringud prefers to develop properties for real estate funds with a closed position; the sales agreement with the fund is usually signed at the beginning of the development process.

Description of development projects

The Group's current investment and development project portfolio comprises 21 larger projects in total, including 14 development projects and 7 cash flow generating projects. According to IFRS requirements, some of the projects are accounted for as inventory, some as investment property and some as fixed assets, whilst projects that are already generating cash flow are classified as investment property. These 21 projects were included in the Group's IFRS Financial Statements with consolidated book value of EEK 1,643 million as of 31 December 2006, while the consolidated book value was EEK 1,510 million as of 31 March 2007, the difference resulting from the sale of 50 per cent of Ahtri property and revaluation gains. The Group commissioned Colliers International to provide an independent valuation as of 16 April 2007 on these 21 projects, which the Management believes to be the most significant real estate assets of the Group and the Joint Ventures – see "Annex A: Colliers International Appraisal Report."

These 21 investment and development projects represent approximately 73 per cent of the total book value of the Group's assets as at 31 December 2006 and approximately 71 per cent of the Group's assets as at 31 March 2007. Of these, 14 projects are development projects in respect of which the Management has established more detailed future development plan and which are already in the development phase or estimated to reach the development phase within the next three years. The remaining 7 projects are cash flow generating. These projects are located in Estonia and Latvia and include residential, office as well as retail projects. Each of these projects is described briefly below.

In addition to 21 projects specified, the Group owns additional real estate assets with a consolidated book value of approximately EEK 187 million as of 31 March 2007 with respect to which the future development plan is not yet determined. Management believes that the value of these properties is fairly reflected in the IFRS Financial Statements.

The progress and success of the property development projects of the Group and the Joint Ventures are largely dependent on factors outside the Group's control, and in particular on obtaining the requisite detail planning approvals and building permits from the regional and/or municipal planning authorities. The details of the projects described below, including the estimated timetable, the size and number of buildings and apartments, the division between residential and other space and other aspects of the development and land use, are subject to change in the approvals and permitting process.

The realisation of the projects described below is also subject to changes in the market conditions and competition. It also depends on how well Management has been able to anticipate trends and estimate costs associated with any given project. The Group continuously evaluates its project portfolio, and is prepared to sell the whole or part of any property at any time when, in Management's estimation, the sale can be achieved for an advantageous price which can then be invested in other, more attractive opportunities.

Residential development projects

Tivoli residential area in Tallinn, Estonia

The business plan for the Tivoli residential area foresees a series of apartment buildings located in an area formerly occupied by an amusement park in the Kadriorg suburb of Tallinn, near the city centre. The location is attractive for a residential area: it is close to parkland, sea and the city centre and at distance from main roads.

The Group purchased the land for this project in 2005 for EEK 251,000,000. Detailed planning for the project has been initiated by the Tallinn municipal authorities and is currently in progress. The planning process has been delayed due to complexities in interpreting the urban plan for the area, which has given rise to different interpretations about what types of buildings are allowed on the land. Arco Investeeringud expects to obtain a building permit in six months after planning approval and expects to start construction in 2008.

The project is expected to involve the construction of apartment buildings in parallel rows to allow a maximum number of apartments to have a view of the seaside. The project expects to use approximately a quarter of the total land area for construction, which leaves substantial room for greenery and trees. The buildings will comprise 732 apartments in total, with an average size of 65 square meters. The project will be constructed in four phases of 183 apartments each. Approximately 720 parking lots are sold in conjunction with the apartments. The project is targeted to upper middle class individual buyers who prefer to live in the city centre and appreciate a spacious green environment.

TOP residential area in Tallinn, Estonia

The TOP residential area is located in the Pirita suburb of Tallinn. Pirita is a prestigious residential area by the seaside beach six kilometres from the city centre. The planned TOP residential area lies between Pirita TOP's yachting centre and the main road to the city centre. Arco Vara owns 50 per cent of this project. The project company is AS Tallinna Olümpiapurjespordikeskus, a 50-50 per cent joint venture with *Regati Valduste OÜ*, an investment company involved in the development of the TOP yachting centre.

The project company has commissioned detail planning for this project, which is being prepared with an aim to submit it to the Tallinn municipal planning authorities by 2008. Key advantages of the project under consideration are its location and the scattered positioning of its buildings. Every apartment is expected to have a view over the seafront. Depending on the results of detail planning, the Group's business plan currently foresees constructing 360 apartments in seven two- and five-storey buildings in one construction phase. The average size of the apartments will be approximately 72 square meters. Target clients for this project are upper-middle class families who appreciate the proximity to both city centre and sandy beaches.

Kolde residential area in Tallinn, Estonia

The Kolde residential area project comprises a total of 3.9 hectares of land with construction rights and 12 residential apartment buildings located on Helme Street in the Pelgulinna suburb of Tallinn, near the Stroomi beaches. The area is close to the city, seaside, parks and greenery. The project is currently in the construction phase: the first phase of two apartment buildings was completed in March 2007 and the other five phases are to be completed by 2009.

Each building has five storeys and 31 apartments, which take up 76 per cent of the useable floor space. The average apartment size is 60 square meters, ranging from simple two room flats to large penthouse apartments with views on forest and sea-side.

Prices of the apartments currently on the market start from EUR 2,010 per square metre, including customised equipment and decoration according to the buyer's wishes. The customised equipment decoration includes sanitary equipment and painted walls, ceilings and tiled floors. Alternatively, the apartment can be bought as "shell-and-core", where costs relating to interior decoration are born by the buyer.

The project is being constructed by Group's own construction division. The first phase was supported by strong market demand and all apartments were sold in the early development stage. Early sales were followed by substantial rises in construction costs during the construction period, and these additional costs were carried by Arco Vara. To avoid similar situations in the future, Arco Vara changed its sales strategy to putting the apartments up for sale in the later stages of development when the final construction cost, deadlines and quality of construction are more predictable.

Pärtli, Tooma and Vahi residential projects close to Tallinn, Estonia

The Pärtli, Tooma and Vahi residential projects are based on the same concept: the project company acquires a parcel of land, commissions detail planning, divides the land into several land units, constructs the infrastructure including communications, roads, street lighting, water and sewerage systems, electricity and gas connections. The land is then sold to customers, who can construct a house on the land according to the design of their own.

While the Group has undertaken the Vahi residential project on his own, Arco Vara owns 50 per cent of the Pärtli and Tooma projects. The project company for those two projects is OÜ Koduküla, where the remaining 50 per cent is held by OÜ VWF Kinnisvara. The project area is located near Saue town, 18 kilometres south-west from Tallinn.

The land intended for the Pärtli project currently consists of three real estate units, one owned by OÜ Koduküla and two other owned by private individuals who have entered into respective agreements for the sale of these real estate units to OÜ Koduküla. The planning approval for the Pärtli project is expected in 2007, after which land will be divided into 93 land plots with an average size of 1,500 square meters. The plots are expected to be sold in two years during 2007 to 2008.

The land intended for the Tooma project is currently owned by a private individual who has entered into an agreement for the sale of this land to OÜ Koduküla. The planning approval for the Tooma

project is also expected in 2007. The land in Tooma will be divided into 101 land units, and expected to be sold by the end of 2008. The average size of the land unit will be 1,909 square meters.

The Vahi residential area is located in Harku rural municipality at the coast in the western part of Harju county, 13 kilometres from Tallinn City border. Arco Vara owns 100 per cent of this project. The planning approval for this project was issued in August 2006. The Vahi project comprises approximately 8.3 ha of land, which has been divided into 21 land plots with an average size of 3,316 square meters. The land plots are expected to be sold during 2007.

Bišumuiža 1 residential area (BM-1) in Riga, Latvia

The Bišumuiža residential area is located in prestigious Zemgales District in the Riga city. It is a green neighbourhood in the south-eastern corner of the Riga's Left Bank, the area south of the Daugava river, next to the new Southern Bridge currently under construction, and close to the emerging retail and office area in Mūkusalas Street.

The project is currently in the construction phase. The Group envisages building 17 apartment buildings on the area with 238 apartments in total. The first phase of four buildings and 56 apartments is expected to be completed in 2007. The second phase of five buildings and 70 apartments is expected to be completed in 2008 and third with eight buildings and 112 apartments in 2009.

Each building is expected to have only 14 apartments and the average size of an apartment is 78 square meters. The ground, first and second floors all have two two-room and two three-room apartments. The third floor is divided between two four-room penthouse apartments with a balcony and terrace. All apartments are sold with fully completed interior decoration.

Target buyers for this project are young upper middle class families who want to live close to the city centre. The penthouses are intended for families with higher than average income as an alternative for living in a detached house.

Baltezers area (MB-5) in Riga, Latvia

Baltezers area is one of the most prestigious suburban neighbourhoods in the Riga region. It has a direct access to the Riga city centre via the Via Baltika highway. It is located at the proximity of several lakes and close to the seaside. The project is next to the Mārsili village, also developed by the Group, comprising detached houses.

The planning approval for the project was received in 2006. The land in the Baltezers residential project will be divided into 53 land units with an average size of 1,883 square meters each. The Group will construct the infrastructure including communications, roads, street lighting, water and sewerage systems, electricity and gas connections. The Group expects to sell a total of 23 land units in 2007 and a further 30 plots in 2008. The design of each house will be subject to an approval by the architect appointed by Arco Vara to ensure the overall architectural unity and quality of the area.

Target buyers for the project are upper middle class families who appreciate the attractions offered by the lakeside residential area.

Bišumuiža 2 residential area (BM-2) in Riga, Latvia

The Bišumuiža 2 residential area is located in the vicinity of Bišumuiža 1 residential area in Riga. The area has good access to the city centre, the airport as well as famous Jurmala resort. The project concept is similar to the one realized for Bišumuiža 1 residential area and targets also the same client group.

The planning is in place and the Group is currently finalising the infrastructural plan specifying the location of houses and roads. The construction is projected to commence by the end of 2007.

Gross construction volume is estimated at 95,970 m², or 113,365 m² if underground parking facilities are also considered. The project is envisaged to comprise 35 five-storey buildings with 1,085 apartments in total, with average apartment size of 75 square meters, to be built between 2007 and 2014. The project company is SIA Sportings Riga, the wholly owned subsidiary of SIA Bišumuižas Nami As at the date of the Offering Circular, Arco Investeeringud owns 80 per cent and Mr. Viktors Savins owns 20 per cent of the shares of SIA Bišumuižas Nami. On 18 May 2007, Arco Investeeringud and Mr. Viktors Savins entered into a conditional Share Purchase Agreement with SIA Linstow Baltic regarding the sale of 50 per cent of the shares of SIA Bišumuižas Nami. Following the closing Arco Investeeringud will own 40 per cent of the shares in SIA Bišumuižas Nami, with Mr. Viktors Savins owning 10 per cent and SIA Linstow Baltic owning 50 per cent. See - “Management’s Discussion and Analysis of the Group’s Financial Condition and Results of Operations – Recent Developments”.

The chart on the next page summaries the key elements of each residential project discussed above

RESIDENTIAL DEVELOPMENT PROJECTS

	Tivoli	TOP	Kolde	Pärtli	Tooma	Vahi	Bīšumuiža 1	Baltezers 5	Bīšumuiža 2
Expected development period	2008-2011	2008-2011	2005-2009	2007-2008	2007-2008	2007	2006-2009	2007-2008	2007-2014
Expected future investment, EEK, mln	1,006	608	390	38	74	9	364	24	1,674
Expected number of apartments	732	360	372	-	-	-	238	-	1,085
Expected number of land units	-	-	-	93	101	21	-	53	-
Land area, m2	48,698	46,200 ³⁾	39,565	200,000	281,000	83,480	36,419	118,400	111,596
Gross construction volume, m2	60,000	34,725	31,467	N.a.	N.a.	N.a.	22,273	N.a.	95,970
Estimated sellable floor, m2	46,872	27,086	22,168	-	-	-	18,652	-	81,826
Consolidated project book value as at 31/12/2006, EEK m	300.0	137.2	81.3	4.2	4.0	2.9	31.4	31.1	14.0
Group legal ownership as at 01/06/2007, %	100%	50%	89%	50% ⁴⁾	50% ⁵⁾	100%	80% ⁶⁾	80%	80% ⁷⁾
Project total book value as at 31/12/2006, EEK m¹⁾	300.0	274.4	81.3	8.4	8.0	2.9	31.4	31.1	14.0
Appraised value by Colliers at 16/04/2007, EEK m²⁾	712.2	359.5	145.6	55.7	32.0	26.1	47.8	69.7	341.8
Project status	Planning	Planning	Construction	Planning	Planning	Planning	Construction	Planning	Planning

¹⁾ Consolidated project book value is adjusted with the assumption of 100 per cent being owned by the Group on 31 December 2006.

²⁾ The Appraisal Report was prepared by Colliers International separately from the preparation of the Group's IFRS Financial Statements. In producing the Appraisal Report, Colliers International used certain assumptions, techniques and methodologies specified in the Appraisal Report, which may differ from the assumptions used by the Group when preparing its IFRS Financial Statements. Therefore, the values indicated in the Appraisal Report differ from the values for the same properties used in Group's IFRS Financial Statements. Whereas the values indicated by Colliers International aim to reflect market prices of the properties as at the valuation date, those real estate projects that are classified in accordance with IFRS as Inventories or Construction In Progress are carried at their acquisition cost in the balance sheet of the Company. Only those properties that are classified as Investment Property are carried in the balance sheet of the Company in their fair value. The fair values of investment properties in the interim condensed consolidated financial statements of the Company for the three-month period ended 31 March 2007 have not been based on the Appraisal Report. This is due to the requirement of IFRS that future capital expenditure and the related future benefits from such expenditure are not to be reflected in the fair value of Investment Property.

³⁾ 46,200 m² of the total land plot of 154,563 m² (entire TOP property) is proposed to be used for residential development.

⁴⁾ The project encompasses three land plots, one owned by OÜ Kodukūla and two other owned by individuals who have entered into agreements for selling these land plots to OÜ Kodukūla.

⁵⁾ The land plot is owned by a private individual who has entered into an agreement for selling this plot to OÜ Kodukūla, a 50-50 per cent joint venture with Ārimāja AS.

⁶⁾ The real estate unit is leased from the Riga City Council.

⁷⁾ The land plot is owned by SIA Sportings Rīga, the wholly-owned subsidiary of SIA Bīšumuižas Nami. As at the date of the Offering Circular, Arco Investeeringu owns 80 per cent and Mr. Viktors Savins owns 20 per cent of the shares of SIA Bīšumuižas Nami. On 18 May 2007, Arco Investeeringu and Mr. Viktors Savins entered into a conditional Share Purchase Agreement with SIA Linstow Baltic regarding the sale of 50 per cent of the shares of SIA Bīšumuižas Nami. Following the closing Arco Investeeringu will own 40 per cent of the shares in SIA Bīšumuižas Nami, with Mr. Viktors Savins owning 10 per cent and SIA Linstow Baltic owning 50 per cent. See - "Management's Discussion and Analysis of the Group's Financial Condition and Results of Operations – Recent Developments".

Office and retail development projects

Ahtri 3 business centre in Tallinn, Estonia

The property is located in the port area of the Tallinn city centre next to the admiralty pool. The neighbouring buildings include the port passenger terminals, other business and office buildings as well as the newly developed Rotermanni residential area.

The project company is proposing to build a business centre on the property, with retail space in the ground floor and office space in the first floor plus some 300 parking places in an underground parking area. The building design proposes that a pedestrian street should go through the building, giving direct access for pedestrians from the port to the city centre, and providing customers for the retail space in the ground floor.

The detail planning of the project is being processed by the Tallinn municipal authorities, which will determine the final details of the project. Management expects the construction to start in 2008 and be completed in 2011.

The Group envisages the project to involve a total gross construction volume of 70,754 square meters, divided into 48,400 square meters of above ground commercial gross space and 22,354 square meters of underground parking.

Arco Vara owns 50 per cent of the Ahtri 3 project. The project company is Arco HCE OÜ. The Group sold a 50 per cent interest in this company to *Rotermann Eesti OÜ* in the beginning of 2007. Rotermann Eesti OÜ is responsible for developing residential and commercial properties in the same area.

Ilmarine office building project in Tallinn, Estonia

The Ilmarine property is located at the edge of the Tallinn city centre close to the Mustamäe suburb, at the corner of Mustamäe road, Endla street and Paldiski road

The property comprises 13 separate land units side by side, in a densely built area on a total of 39,503 square metres of land. The neighbouring properties have outdated production, office and residential buildings but the property has a good access connections to the centre. The property is currently occupied by the former Ilmarine factory complex, though its condition is poor. Some of the existing buildings were built in early 20th century and some in the 1960s. Management expects that this property will not be used as production facility, as modern industrial space in Tallinn tends to be located in technological parks outside of city centre where transport logistics are better.

The project company managing the project has not yet commissioned detail planning for the project, as it is awaiting for the adoption of a more general urban plan for the area, which will determine the main characteristics for the buildings to be erected in the area. In the current drafts the property has been designated for high-rise buildings. The urban plan is expected to be adopted by the Tallinn municipal authorities in the summer of 2007. After that, the project company intends to commission detail planning based on the urban plan. The current factory premises will not be demolished before the new detail planning has been approved. Management estimates that the planning approval can be obtained in 2008 and that the construction phase will take place between 2008 and 2011.

The project company plans to develop the property as office space with gross construction volume of approximately 80,000 square meters. The building is planned to comprise 60,000 square meters of net office space. Arco Vara owns 50 per cent of the Ilmarine project. The project company is OÜ Floriston Grupp, a 50-50 per cent joint venture with *Ärimaja AS*.

Laeva office building project in Tallinn, Estonia

The Laeva property is located in the port area, next to the Ahtri 3 property, 700 meters away from Viru square in central Tallinn. The property has already received a planning approval for a six-storey building. The construction is planned start in 2008 and end in 2009 with the sale of the property to a real estate fund.

The Laeva office building is designed to be triangular in shape with reflecting glass indents in the facades to allow natural light into the building. Management has reserved the two upper floors of the Laeva building for the new head office of the Group, to replace the current Jõe street property which no longer can accommodate the increasing staff of the Group. The lower floors of the Laeva building will be leased out to other tenants.

Paldiski road office and retail building project (PM 80) in Tallinn, Estonia

The Paldiski road property comprises 8,200 square meters of land in the Haabersti district of Tallinn, approximately five kilometres from the city centre. The property is currently empty without any permanent buildings. The property is easily accessible by car and public transport and surrounded by residential areas and several office and retail buildings.

The Group envisages constructing several six-storey and ten-storey office complexes, all interconnected through a glass-roofed atrium, with a shopping mall extending the full length of the second floor with retail and business premises on both sides. The building is expected to have 28,800 square meters of total construction volume of which 75 per cent can be leased out, the rest including common areas such as lobbies, hallways, parking and sanitary spaces.

The Group has commissioned detail planning for the property, which is expected to be completed and submitted to the Tallinn municipal authorities in 2007. The Group estimates that planning approval will not be achieved before the second half of 2007 and the building permit before 2008. Construction is expected to start in 2009 and be completed in 2011.

Kipsala office building project in Latvia

The Kipsala land is located in the prime central district of Riga on the north side of River Daugava. The property is close to the Vansu Bridge and opposite the Hansabank building, the first modern high-rise office tower in Latvia. Kipsala is one of the fastest developing areas in Riga with several new high-profile developments in the pipeline. Kipsala is conveniently located at a short distance from the Old Town and one of the main roads to the airport.

The project company SIA EUROLINE has leased the project's land from Riga City Municipality and the Republic of Latvia under a long-term lease agreement and the draft plans have been presented to local authorities for review. The project company envisages constructing yachting marina on the Kipsala land together with office building. The building will be of contemporary design and be located by the river shore with the boat docks jutting out to the river. The construction volume and its distribution between office, leisure and residential use may be subject to change in the planning process with the Riga municipal authorities.

Management expects construction to commence in 2008 and be completed in 2011. It is expected that the business property will be sold to funds investing in commercial real estate, whilst the apartments will be sold to end-users.

Arco Vara has made a prepayment for the acquisition of 100 per cent of the shares of SIA "EUROLINE", the project company for the Kipsala project. See "Business - Material Contracts – Acquisition of shareholdings in subsidiaries and joint ventures". The project is run through OÜ Floriston Grupp, a 50-50 per cent joint venture with AS Ärimaja.

The chart below summaries the key elements of each office and retail development residential project discussed above:

OFFICE AND RETAIL DEVELOPMENT PROJECTS

	Ahtri 3	Ilmarine	Laeva	Paldiski road	Kipsala
Expected development period	2008-2011	2008-2011	2008-2009	2009-2011	2008-2011
Expected future investment, EEK mln	927	1,302	166	461	1,101
Land area, m2	13,911	39,503	2,698	8,200	53,038
Gross construction volume, m2	48,400	80,000	7,800	28,800	50,000
Net area, m2	36,300	60,000	6,006	21,600	36,000
Expected annual rental NOI, EEK mln	112	130	25	48	Not applicable
Consolidated project book value as at 31/12 2006, EEK mln	385.0	150.8	41.7	34.6	57.4
Group legal ownership as at 01/06/2007, %	50%	50%	100%	100%	50% ³⁾
Project total book value as at 31/12/2006, EEK mln¹⁾	385.0	301.5	41.8	34.6	114.8
Colliers appraised value, at 16/04 2007, EEK mln²⁾	698.6	811.3	112.6	218.8	95.7
Project Status	Planning	Planning	Planning	Planning	Planning

¹⁾ Consolidated project book value is adjusted with the assumption of 100 per cent being owned by the Group on 31 December 2006.

²⁾ The Appraisal Report was prepared by Colliers International separately from the preparation of the Group's IFRS Financial Statements. In producing the Appraisal Report, Colliers International used certain assumptions, techniques and methodologies specified in the Appraisal Report, which may differ from the assumptions used by the Group when preparing its IFRS Financial Statements. Therefore, the values indicated in the Appraisal Report differ from the values for the same properties used in Group's IFRS Financial Statements. Whereas the values indicated by Colliers International aim to reflect market prices of the properties as at the valuation date, those real estate projects that are classified in accordance with IFRS as Inventories or Construction In Progress are carried at their acquisition cost in the balance sheet of the Company. Only those properties that are classified as Investment Property are carried in the balance sheet of the Company in their fair value. The fair values of investment properties in the interim condensed consolidated financial statements of the Company for the three-month period ended 31 March 2007 have not been based on the Appraisal Report. This is due to the requirement of IFRS that future capital expenditure and the related future benefits from such expenditure are not to be reflected in the fair value of Investment Property.

³⁾ OÜ Floriston Grupp, a joint venture with AS Ärimaja, has made an advanced payment for the acquisition of 100 per cent of the shares of SIA "Euroline", the company holding the property for Kipsala project. See – "Business - Material Contracts - Acquisition of shareholdings in subsidiaries and joint ventures."

Cash flow generating properties

The following nine properties are the Group's material cash-flow generating properties.

TOP office property in Tallinn, Estonia

The TOP office property is located at the coast in the Pirita suburb, Tallinn, approximately six kilometres from the city centre. The Pirita TOP complex was originally built for the yachting event of the 1980 Moscow Olympic Games, held in Tallinn and is considered a landmark building. The complex is protected as an object of architectural heritage. The complex comprises several buildings and currently serves mainly as offices. Pirita TOP is the only yachting marina in the city of Tallinn and accordingly valued by the local sailing community. The atmosphere in the complex is somewhat nostalgic and in little use outside the summer sailing season. The Pirita TOP complex also includes a spa owned by the Explorer Property Fund - Baltic States.

The property in TOP Pirita includes several buildings constructed in 1988, including (i) a three-storey technical centre with net floor space of 698.4 square meters, which houses the technical services for entire complex; (ii) a two-storey building with a net floor space of 8,787 square meters used as production facility, with indoor tennis courts and offices in the second floor; (iii) a three-storey former press centre currently used as an office building with net floor space of 6,064 square meters; (iv) the former yacht club reconstructed as a six-storey office with a net floor space of 3,788 square meters and (v) a three-storey office and production building with a net floor space of 3,955 square meters.

The complex has very low vacancy rates and is thus generating stable rental cashflow. The expected annual rental revenue of this property amounts to approximately EEK 16.6 million, including income from the port administration.

The project company for TOP office complex is AS Tallinna Olümpiapurjespordikeskus. Arco Vara owns 50 per cent of the company, with the remaining 50 per cent held by *Regati Valduste OÜ*.

Melon office and retail property in Tallinn, Estonia

The Melon retail property is located in Estonia Avenue in the Tallinn city centre, close to two other popular shopping malls, Viru Centre and Tallinn Department Store (Kaubamaja). The Melon shopping centre is surrounded by businesses and retail properties.

The five-storey office and shopping centre has 7,461 square meters of net floor space plus 46 parking spaces and an auxiliary building in the inside courtyard with a net space of 1,230 square meters. The building was constructed in the late 1950s and refurbished as a shopping centre in the 1990s. Currently, the ground and first floors are used as a shopping centre with glass façade facing the street. The upper three floors are used as offices. The auxiliary building is used as a substation for AS Eesti Energia with sporting facilities in the two upper floors.

The property has approximately 1 per cent vacancy of the total space that is rented out. The property's expected annual rental income amounts to approximately EEK 11.4 million.

Arco Vara owns 50 per cent of Arco Ärikeskuse OÜ, the project company for the Melon property. Another 50 per cent of the joint venture is held by *Aberdeen OÜ*.

Kerberon retail and office property on Kadaka road in Tallinn, Estonia

The Kerberon retail and office property is located in the Mustamäe suburb of Tallinn on 24,176 square metres, surrounded by production, warehouse and commercial properties.

The Kerberon property comprises three buildings, five large halls and a warehouse. The three buildings include (i) a two-storey warehouse and office building built about 5 years ago with a net floor space of 1,862 square meters, (ii) a two-storey retail building built in the 1970s with 2,604 square meters of sales area, technical facilities, warehousing and offices as well as a car wash and (iii) a two-storey office and garage building built in the 1980s with a net floor space of 1,321 square meters, used as offices and sales space and garage. Five additional halls (2,324 square metres of net space in total) are used for warehousing purposes. The retail and office buildings are in a good condition and currently produce expected annual rental revenue of approximately EEK 7.0 million.

Arco Investeeringud is planning to replace the two halls with a new modern warehouse with a net floor space of 1,122 square meters. The demolition of the two halls is scheduled for March 2007 and the construction will start in April 2007.

Arco Investeeringud owns 83 per cent of the project company OÜ Kerberon (17 per cent balance is held by *OÜ ISA Group*), who in turn has a building title established with respect to the property.

Arco Vara Saare Kinnistud (AVSK) office and retail properties in Tallinn and Kuressaare, Estonia

The AVSK properties comprises three different cash flow buildings, one located in Kuressaare, on the island of Saaremaa and two in Tallinn.

Raekoja 10 is a modern retail property in the centre of Kuressaare, the largest city on the island of Saaremaa, surrounded by other retail and residential properties. The two-storey building was constructed in 2004 with a net space of 1,884 square metres, of which 1,493 square metres can be rented out. The building is currently fully rented out, with a supermarket as the largest tenant, alongside with other services and a bank branch. Most of the leases are long-term (three to eight years) and allow annual rent increases of 2.5 per cent. The expected annual rental revenue of the property is approximately EEK 2,7 million.

Rüütli 16/18 is three-storey building in the historical old town area of Tallinn. The building dates back to 1850, and it is protected as an object of national heritage. The building has a net space of 992 square meters is fully occupied by one tenant, who has sublet it for offices. The current lease expires in 2009 and generates an expected annual rental revenue of approximately EEK 0.5 million for the property

Kotzebue 18C is located slightly to the north of the Tallinn city centre. The property was privatized only in January 2007. Property comprises three small, outdated buildings from the 1950s, two of them used as warehouses (net floor space 333 and 17.5 square meters respectively) and one as an office space with a net floor space of 64.9 square meters. The AVSK has commissioned detail planning for the property, which is expected to change the purpose of use of the land. Management expects that this project will ultimately be disposed of as too small for the Group's project portfolio. The disposal may take place either before or after the planning approval.

Arco Vara owns 50 per cent of the AVSK properties. The project company is *Arco Vara Saare Kinnistud OÜ* which is a 50-50 per cent joint venture with *Saare Finants AS*.

Pärnu market retail property on Suur-Sepa street in Pärnu city, Estonia

This property is located in the city centre of Pärnu with the size of the property of 7,663 square metres. The building, which is situated in the centre of Pärnu, was built four years ago and is in a good condition. Although the property is located the part of the town with parking restrictions, the access to the property is convenient.

The one-storey building consists of a sales area, retail space, offices and sanitary rooms. There is also outside market sales space outside the building, which is used mainly during the summer season. The expected annual rental revenue from the property is approximately EEK 3.1 million and the Group owns 100 per cent of the property.

Retail project (STÜ) on the island of Saaremaa, Estonia

The property is located in city of Kuressaare on the island of Saaremaa, Estonia. The property consists of two land units. One land unit (4,337 square meters) currently has a two-storey department store constructed in 2005-2006, and the other serves as a parking lot (6,716 square meters).

Currently, 1,507 square meters of the existing building have been rented out, with 184.7 square meters remaining vacant space. The expected annual rental income from this property currently amounts to approximately EEK 2.26 million and the rental agreements allow for an annual rent increase of two per cent. Arco Investeeringud plans to sell the property during 2007.

Enerpoint office property in Kuressaare on the island of Saaremaa, Estonia

The Enerpoint property is located in the outskirts of Kuressaare, on the island of Saaremaa and consists of 5,251 square metres of land. The land is in a retail area but also close to apartment buildings and some vacant land that may be developed in the short to medium-term.

The property includes an office building, a production facility and a warehouse. The two-storey office building was completely renovated in 2005 and has 195 square meters of net space. The production facility was renovated in 2004, has a net space of 2,012.5 square meters and is in good condition.

The property is fully rented out. The expected annual rental income from this property amounts to approximately EEK 1.2 million.

The chart below summaries the key elements of each cash flow generating property discussed above:

CASH FLOW GENERATING PROPERTIES									
	TOP	Melon	Kerberon	Raekoja 10	Rüütli 16/18	Kotzebue 18	Pärnu market	STÜ	Enerpoint
Expected Annual Rental Revenue, EEK mln	16.6	11.4	7.0	2.7	0.5	0.3	3.1	2.26	1.2
Land, m2	154,563	4,409	24,176	2,382	687	980	7,663	11,053	5,251
Net floor space, m2	23,292	7,567	8,111	1,493	1,030	415	2,529	1,692	2,208
Consolidated project book value 31/12/2006, EEK m	116.4	75.0	72.4	10.7	18.5	1.6	30.0	29.9	12.7
Group share of the project, %	50	50	83	50	50	50	100	100	100
Project total book value as at 31/12/2006, EEK m¹⁾	232.8	150.0	72.4	21.4	37.0	3.2	30.0	29.9	12.7
Colliers appraised Project value, at 16/04/2007, EEK m²⁾	267.9	187.8	78.6	39.7	37.2	4.0	40.2	26.6	13.3

¹⁾ Consolidated project book value is adjusted with the assumption of 100 per cent being owned by the Group on 31 December 2006.

²⁾ The Appraisal Report was prepared by Colliers International separately from the preparation of the Group's IFRS Financial Statements. In producing the Appraisal Report, Colliers International used certain assumptions, techniques and methodologies specified in the Appraisal Report, which may differ from the assumptions used by the Group when preparing its IFRS Financial Statements. Therefore, the values indicated in the Appraisal Report differ from the values for the same properties used in Group's IFRS Financial Statements. Whereas the values indicated by Colliers International aim to reflect market prices of the properties as at the valuation date, those real estate projects that are classified in accordance with IFRS as Inventories or Construction In Progress are carried at their acquisition cost in the balance sheet of the Company. Only those properties that are classified as Investment Property are carried in the balance sheet of the Company in their fair value. The fair values of investment properties in the interim condensed consolidated financial statements of the Company for the three-month period ended 31 March 2007 have not been based on the Appraisal Report. This is due to the requirement of IFRS that future capital expenditure and the related future benefits from such expenditure are not to be reflected in the fair value of Investment Property.

Competition

Rapid real estate market development in Estonia and Latvia has resulted in development projects being executed by companies from a variety of business sectors. Residential and commercial projects developed by the Group compete with the projects developed by specialised real estate developers, construction companies or smaller developers. An overview of selected recent and upcoming projects in Estonia and Latvia is provided in “Industry Overview – Real estate market in the Group’s key markets”.

The following specialised property developers are deemed the Group’s principal competitors, although the strategy of some competitors is a hybrid of property development and investment and their reported numbers may consist of additional activities not performed by the Group. The following table summarizes the revenue and other operating income of major competitors of the Group in Estonia and Latvia:

Name of the Company	Revenue and other Operating income in 2004, EEK m	Revenue and other Operating income in 2005, EEK m	Revenue and other Operating income in 2006, EEK m
<i>The Group</i> ¹⁾	308.4	367.3	621.4
<i>AS TTP</i>	178.2	300.5	n.a
<i>E.L.L. Kinnisvara AS</i>	142.4	177.0	n.a
<i>Q Vara OÜ</i>	22.5	256.8	227.6
<i>OÜ Manutent</i>	54.1	593.4	n.a
<i>SIA Pilsētņēmju Institūts Urban Art</i> ²⁾³⁾	63.7	49.5	202.5
<i>AS Kolonna</i> ²⁾³⁾	91.3	92.0	143.8
<i>SIA PBLC nekustamie īpašumi</i> ²⁾³⁾	n.a	69.2	n.a

Source: Estonian Commercial Registry, Latvian Enterprise Register, publicly available sources for competitors in 2006.

¹⁾ Only external revenue for Development Division of Arco Vara considered.

²⁾ Figures in LVL converted into EEK with annual average exchange rates calculated by the Bank of Estonia, available at www.eestipank.info.

³⁾ Change in fair value of investment properties is included to provide comparability with numbers reported by the Group.

Construction division

The construction division is the most recent addition to the Group’s activities. Arco Ehitus is the parent company of the division and it owns all current subsidiaries involved in construction-related services (except Tallinna Linnaehituse AS held directly by the Company). See “Business - Organisational Structure”. The Group has been involved with construction business in Estonia since 2001 and since the beginning of 2007 also in Latvia. Management expects Estonia and Latvia to remain the Group’s main construction markets in the coming years. The division comprises approximately 25 per cent of Group employees and generated 19.5 per cent of its total revenue and other operating income in the financial year 2006.

Arco Ehitus was formed in early 2007 as a result of a merger between a general contracting company, Deena Ehituse OÜ, and an environmental construction company, OÜ Veemaailm Inc. The latter brings strong sanitary and environmental construction expertise into the newly formed Arco Ehitus, as OÜ Veemaailm Inc. is a leading company in the sanitary and environmental construction sub-segment in Estonia. Its subsidiary, SIA Arco Construction, operates in Latvia and offers both residential and non-residential construction services. It has also historically acted as a subcontractor.

Tallinna Linnaehituse AS specializes in construction supervision. As it is not involved in any other construction activity, is not part of the construction division but remains as direct subsidiary of Arco Vara AS. This ownership arrangement is designed to mitigate potential conflicts of interest between Arco Ehitus and Tallinna Linnaehituse AS.

The construction division has a supporting role in the Group. It mainly contributes to the success of the development division because of the shortage of qualified construction labour and resources in the Baltic market. Although the priority of the construction division is to satisfy intra-group demand for construction services, Management estimates that approximately 50 per cent of its total revenue is generated from projects with third-party employers.

The Group is currently in the process reorganizing and expanding the construction division. The division is growing and gaining reputation but lacks substantial market power. Management expects the division to grow considerably in the coming years either through organic growth or acquisitions, bearing in mind the strong project pipeline of the Group itself and the real estate market in general. The construction division focuses on the quality of construction and the ability to meet deadlines as Management believes these to be the key characteristics appreciated by customers.

Description of business process

The management of a general contracting operation typical starts with a **tendering process**. Project owners circulate the information required in order to participate in a tender process either directly or by publishing announcements in the press.

As preparing a bid involves significant cost and management resources, the Group bids only for selected projects. Arco Ehitus prefers variable price contracts rather than fixed price contracts, as they leave the risk of cost increases with the customers. In fixed price contracts, Arco Ehitus prefers projects with a timeline of no longer than 10 months, which allows relative control on price increases. The rising costs of personnel and materials are currently the main risks for a construction company in the Baltic States, where there is scarcity for both labour and materials. Every bid must be submitted to the approval of the management before it is submitted to the customer.

When the tender has been won and the construction agreement signed, the division starts the **process of procuring** outsourced services and subcontractors. Procurement of subcontractors is crucial for the timely and successful completion of any project at the budget. When choosing subcontractors, Arco Ehitus always assesses their past experience and work patterns, quality of work and reference projects. Provided that the price is suitable and timeframe acceptable, Arco Ehitus uses the services of the subcontractors such as *AS Betoneks* and *OÜ Betoneks Ehitus* for producing and mounting concrete and reinforced concrete products, *AS Savi* for piling works for building cast-in-place piles, *OÜ Penope* for sanitary works and *AS Welander* for electricity works.

Arco Vara procures building materials either directly from the producers or from a building material wholesalers. Arco Ehitus has some ten supply contracts with building material wholesalers with discounts varying between 5 and 40 per cent, and the selection of a supplier to an individual project depends on the terms of supply terms and characteristics of each project.

After the detailed subcontracting agreements have been concluded, the Group prepares **project planning**. The project plan covers various aspects of the construction project such as schedules, project accounting, design works, procurements, general construction site planning, environmental planning, safety and health planning and project reporting.

Each construction project has a project manager who is responsible for **project implementation**. He ensures that the construction work advances smoothly, coordinates communication between the customer, subcontractors and suppliers, oversees the documentation and ensures that the safety requirements are met.

The general contractor is responsible for keeping a project on timetable and reducing costs. Keeping deadlines is highly dependent on the amount of additional work required, changes in the project, the quality of subcontractors' work and experience. Arco Ehitus aims to mitigate these risks in its

construction agreements. After the construction work have been completed, the customer and the general contractor inspect the project and hold the **project finalization meetings**.

The construction supervision operations of Tallinna Linnaehituse AS are performed separately from the rest of the construction division. To avoid conflicts of interest, the company does not supervise any projects constructed by Arco Ehitus.

General contracting does not generally involve environmental construction services. These involve slightly different processes of subcontracting, which are supervised by the contracts concluded with the general contractor.

Customers

Arco Vara construction division has both one-time and repeat customers. Approximately half of the division's revenue is generated from intra-group contracts with the development division (including the construction of Kolde residential area and the Kerese centre in Narva, which was sold in 2007). Furthermore, SIA Arco Construction is the main contractor for the Group's Bišumuiža 1 development project in Latvia.

Due to OÜ Veemaailm Inc's expertise within sanitary and environmental construction, Arco Ehitus has a good reputation for undertaking projects in that construction market sub-segment. Current projects in progress include the renovation of waste water treatment plant in Toila and the planning and construction of the water and sewage project in Matsalu National Park.

Competition

Estonian and Latvian construction markets are growing rapidly, mainly driven by the increasing costs of labour and materials. The construction markets are highly fragmented and competitive with numerous construction companies competing for the same projects.

According to the Commercial Register of Estonia, there were 5,200 construction companies operated in Estonia as at year end 2005. Arco Ehitus is a medium-sized construction company and not among the largest market players in Estonia. Although it lacks a substantial market position, it nevertheless frequently competes against major local and international companies in the tendering processes. Market leaders *AS Merko Ehitus*, *Skanska EMV AS*, *AS Eesti Ehitus* and *AS YIT Ehitus* all have strong positions in the construction of residential and non-residential properties, collectively accounting for a substantial share of the construction market.

The competition in the Latvian construction market is similar to the Estonian market, lead by a group of four or five of the largest companies, such as *Skonto Buve*, *PBLC*, *RE&RE*, *SIA Merks* (part of Estonian *Merko Ehitus Group*) and *BMGS*.

According to the management of Arco Ehitus, the Group's construction supervision company Tallinna Linnaehituse AS is one of Estonia's leading supervision service providers, the other two being *AS Telora-E* and *AS TSM*.

Environmental construction services in the construction division also possess a strong market position and their know-how, engineering skills and cleaning equipment are highly valued in the market.

INVESTMENTS

Capital expenditure and investments into land and properties

In the normal course of business, the Group's principal investments are acquiring land and buildings for and in connection with real estate development. In accordance with the accounting treatment

prescribed by IFRS, such investments are reported either as part of Inventory, Investment Property or Property, Plant and Equipment.

The following table outlines the investments in and additions in the Group's Investment Property and Property, Plant and Equipment during 2004-2006:

EEK, thousand	2004	2005	2006
Acquisitions of Investment Property (including capitalised borrowing costs)	89,726	64,408	13,825
Additions of Investment Property from business combinations	104,620	0	14,031
Property, plant and equipment purchases (including capitalised borrowing costs)	9,222	163,471	322,875
Additions of property, plant and equipment from business combinations	394	11,188	0

This section describes the Group's investments in excess of EUR 1 million (EEK 15.6466 million) in the last three years. Management believes that this is a reasonable threshold for material investments, given the scope and magnitude of the Group's current operations.

The Group's additions to Investment property in 2006 amounted to EEK 27.9 million and consisted of investments in several smaller properties. The additions to Investment property in 2005 amounted to EEK 64.4 million, including an investment of approximately EEK 24.4 million in a property located at Paldiski road 80 (Tallinn, Estonia). The additions to Investment property in 2004 amounted to EEK 194.3 million, consisting of the following major transactions: investment in the Nurmenuku shopping centre (Tallinn, Estonia) of approximately EEK 50.8 million, investment in a property on Narva road 3/9 (Tallinn, Estonia) of approximately EEK 47 million, investment in Ahtri 3 property (Tallinn, Estonia) of approximately EEK 38 million, investment in the Kerberon retail and office property at Kadaka road 131 (Tallinn, Estonia) property for approximately EEK 19.6 million, investment in the Pärnu market property for approximately EEK 16.7 million (Suur-Sepa street 18, Pärnu, Estonia).

The Group's investments into Property, plant and equipment amounted to EEK 322.9 million in 2006 and primarily consisted of additions of real estate into Construction in progress and prepayments. The principal such investments include the following projects: approximately EEK 114.3 million was invested into the Laeva 2 (Tallinn, Estonia) project; approximately EEK 90.1 million was invested into the Kerese shopping centre development project (Narva, Estonia), while approximately EEK 83.6 million was invested into the Ahtri 3 (Tallinn, Estonia) development project. In 2005, additions to property, plant and equipment amounted to approximately EEK 174.7 million, including the following major projects: approximately EEK 125.6 million was invested into the Ahtri 3 (Tallinn, Estonia) property, while approximately EEK 20.3 million was invested into the Liimi 1b property (Tallinn, Estonia). In 2004, the additions to property, plant and equipment reached EEK 9.6 million, which comprised several small-scale investments.

In addition, the Group has invested in land and buildings in 2004-2006, which have been recorded as the inventory in the Group's accounts. The largest investments in this category in 2006 include an investment of approximately EEK 37.7 million into a property on Ulmana gatve (Riga, Latvia) and an investment of approximately EEK 27.6 million into the Bišumuiža 1 development project (Riga, Latvia). In 2005, the major inventory investments were the acquisition (including additional investments) the Tivoli development project (Narva road 67, Tallinn, Estonia) for approximately EEK 259.2 million; the Koondise residential development project (Saue Parish, Tallinn) of approximately EEK 128.7 million, the Ubalehe residential development project (Tallinn, Estonia) for approximately EEK 54 million, the Mazais Baltezers residential development project (Riga district, Latvia) for approximately EEK 17.5 million and the Merivälja2 residential development project (Tallinn, Estonia) for approximately EEK 16.5 million. In 2004, the major investments into inventory included an investment of approximately EEK 194.5 million into the Veskimöldre residential development project (Tallinn, Estonia), an investment of approximately EEK 20.5 million into the Ubalehe residential

development project (Tallinn, Estonia) and an investment of approximately EEK 18.5 million into the Koondise residential development project (Saue Parish, Estonia).

In the first 3 months of 2007, the Group made significant investments only into the projects classified as inventories. The major investments in this category were made into the Kolde residential project (approximately EEK 31.9 million) and the Bišumuiža 1 residential development project (approximately EEK 11.7 million).

EMPLOYEES

General overview

As at 31 March 2007, the Company and its subsidiaries and associated companies as well as the Joint Ventures employed 546 people. The following table presents the number of employees for the end of the financial years 2004, 2005, 2006 and first quarter of financial year 2007, broken down by geographical coverage and main divisions:

Country	2004	2005	2006	31 March 2007
Estonia				
Services division	81	93	128	119
Development division	49	14	30	31
Construction division	46	47	90	83
General management	10	22	24	25
Latvia				
Services division	34	71	108	113
Development division	5	6	8	8
Construction division	-	-	-	51
General management	-	-	-	-
Lithuania				
Services division	5	13	34	31
Development division	-	1	2	2
Construction division	-	-	-	-
General management	-	-	-	-
Ukraine				
Services division	-	16	31	56
Development division	-	1	-	-
Construction division	-	-	-	-
General management	-	-	-	-
Bulgaria				
Services division	-	-	16	21
Development division	-	-	-	-
Construction division	-	-	-	-
General management	-	-	-	-
Romania				
Services division	-	-	7	6
Development division	-	-	-	-
Construction division	-	-	-	-
General management	-	-	-	-
Total	230	284	478	546

Human resource management principles

The Group has three different operating divisions in six different geographical regions. Whilst general characteristics like independence and initiative are appreciated in all employees, each division needs employees with varying qualifications, background and skills. The Group organizes its human resource management at the division level. Management believes that imposing common principles for human resource management at the Group level would make them less effective and overly general.

Some personnel-related services have been organized at the Group, whilst the majority of issues in the human resources (HR) management are at the discretion of division management. The chairman of the Management Board is responsible of personnel issues on the Group management level. Some divisions have HR directors in their management teams whilst in some cases the heads of the divisions perform the HR role themselves.

Human resource management at the Group level includes implementing motivating remuneration schemes, diversified training programs, personnel valuation systems, a social atmosphere boosting teamwork and high quality working environment.

Remuneration schemes differ based on the position and division specific features. In addition to their monthly salaries, employees receive annual bonuses. On the management level, bonuses are directly dependent on the financial results of the year. However for the majority of the employees bonuses are distributed from the Group's bonus pool following the proposal of the division head and approval of the Supervisory Council.

The direct superior of each employee is responsible for conducting a personnel valuation and development assessment interview at least once per year. The interview process is designed to encourage feedback from the employee to the employer as well as vice-versa. The training plans, remuneration and professional targets for the following year are set on the basis of the interview. For management, a 360 degree assessment programme is used; each member of the management provides feedback on all management members at different scales and the results are used to evaluate the effectiveness and performance of each member of the management.

To promote teamwork and social intercourse, the Group periodically organises intra Group social events.

Recruitment and training

In the course of preparation of annual budgets, the head of each division proposes its requirements for personnel growth and related costs as well as plans for training. Each division head as well as the heads of the subsidiary companies are personally responsible for identifying the need for additional positions to be filled and to organise the necessary recruitment process. The means of recruiting vary depending on the position to be filled; in general the Group prefers to advertise publicly for open positions, although recruiting companies are usually engaged for senior managerial positions.

Each employee's training requirements are assessed after development assessment interviews. In addition to specific professional training, the Group organises training courses to develop the overall social, time-management, sales related or other skills. The Group has in-house induction programmes for new employees. The Group also co-operates with selected external training suppliers.

At management level, quarterly management meetings are held for approximately 25 people at a time. These meetings combine training programs, updates on the quarterly performance as well as team-building activities. The members of the Management Board are also subject of the so called "runner-up" training programme. The programme requires that each member of the Management Board appoints two replacements for himself, who are trained and kept up to date with latest developments in the area. This program is designed to ensure the continuity of managerial skills, availability of

informed employees and to mitigate the risks of information losses in case of persons changing in managerial positions.

Labour Union and Collective Agreements

The Group is not subject to any collective agreements nor do any of the employees belong to labour unions.

LAND OWNERSHIP

The table below summarises the material land and buildings which the Company and its subsidiaries as well as joint ventures either own or have agreed to purchase from third parties under a sales agreement or hold under a long-term lease as at the date of this Offering Circular. According to the IFRS requirements, some of these properties are accounted for in the Group accounts as inventory, some as property investments and some as fixed assets.

RESIDENTIAL DEVELOPMENT

Name / Location	Description	Intended use
“Tivoli” Narva rd 67 Tallinn, Estonia	48,698 m ² of land, registered purpose of use: social. Owned by Arco Investeeringud. Encumbered with a mortgage in favour of AS SEB Eesti Ühispank.	Proposed to be developed into apartment buildings together with parking lots, infrastructure and public areas. The detail planning for the project is being processed.
“TOP residential area” Regati pst 1,3,5 Tallinn, Estonia	175,937 m ² of land, registered purpose of use: commercial and social. AS Tallinna Olümpiapurjespordikeskus owns 154 564/175 937 of the property, the rest is owned by OÜ TopSpa Kinnisvara. The co-owners have entered into an agreement which determines the land areas and properties being in the common use of both owners, land areas and properties being in the exclusive use of each owner and the terms of possession and use of the co-owned property. Under the agreement, the ultimate goal is to terminate the co-ownership and divide the land. The ownership interest of AS Tallinna Olümpiapurjespordikeskus is encumbered with a mortgage in favour of AS Hansapank.	46,200 m ² of the land area proposed to be developed into apartments in the vicinity of the Tallinn Olympic Yacht Centre in Pirita. Existing buildings leased out– see “TOP office property” below. The “Pirita TOP SPA” hotel located on the land is in the exclusive use of OÜ TopSpa Kinnisvara under the agreement entered into between the co-owners. The detail planning for the project has been commissioned.

Name / Location	Description	Intended use
<p>“Kolde” Helme st 5,7,9,11,13,16, 16b, 18 Tallinn, Estonia</p>	<p>A 50-year building title encumbering 39,565 m² of land in nine adjacent real estate units owned by the City of Tallinn.</p> <p>The building title encumbering land at Helme st 13 has been further divided into individual apartment building titles, most of which have been sold to end clients. The rest are owned by AS Kolde.</p> <p>The building titles encumbering other real estate units are owned by AS Kolde and are proposed to be divided into individual apartment building titles for the purposes of sale to end clients.</p>	<p>To be developed into apartment buildings together with parking spaces and related infrastructure.</p> <p>Two apartment buildings have been completed and two apartment buildings are currently under construction.</p>
<p>“Pärtli” Vanamõisa village Saue parish Harjumaa, Estonia</p>	<p>Approx. 33.74 ha of land in three real estate units, registered purpose of use: profit yielding.</p> <p>One real estate unit of 8.65 ha owned by OÜ Koduküla and encumbered with a mortgage in favour of Sampo Pank AS. Two other real estate units of 14.64 ha and 10.45 ha, respectively, are currently owned by private individuals who have entered into respective agreements for the sale of these real estate units to OÜ Koduküla.</p>	<p>Residential area infrastructure to be developed and sold as 93 real estate units ready for construction, with an area of approximately 1,500 m² each.</p> <p>The detail planning for the project is being processed.</p>
<p>“Tooma” Tooma 1, Jõgisoo village Saue parish Harjumaa, Estonia</p>	<p>Approx. 31.66 ha of land, registered purpose of use: profit yielding.</p> <p>Currently owned by a private individual who has entered into an agreement for the sale to OÜ Koduküla.</p>	<p>Residential area infrastructure to be developed and sold as 101 real estate units ready for construction, with an area of approximately 1,909 m² each.</p> <p>The detail planning for the project is being processed.</p>
<p>“Vahi” Puiestiku I, Vääna village Harku parish Harjumaa, Estonia</p>	<p>83,480 m² of land, registered purpose of use: profit yielding and residential.</p> <p>Owned by Arco Investeeringud. Encumbered with mortgage in favour of AS Hansapank.</p>	<p>Residential area infrastructure to be developed and sold as 21 real estate units ready for construction, with an area of approximately 3,316 m² each.</p> <p>Detail planning was effected in August 2006</p>
<p>“Bišumuiža 1 (BM-1)” Komētas street 8,10,12,14 Riga, Latvia</p>	<p>Leasehold of 36,419 m² of land.</p>	<p>To be developed into apartment buildings.</p>

Name / Location	Description	Intended use
	<p>Land is leased by SIA Arco Development from Riga City Council under a long-term lease. Four buildings under construction are owned by SIA Arco Development.</p> <p>Encumbered with mortgages in favour of AS DnB NORD Banka.</p> <p>It is prohibited to alienate, dispossess, donate, split, lease, rent and encumber the land with rights <i>in rem</i> without the written consent of AS DnB NORD Banka.</p>	<p>Four buildings (56 apartments) are expected to be completed in 2007 and five buildings (70 apartments) and eight buildings (112 apartments) are expected to be completed in 2008 and 2009 respectively.</p>
<p>“Baltezers (MB-5)” “Dumpji”, Garkalnes parish, Riga district, Latvia</p>	<p>Approx. 11.8 ha of land.</p> <p>Owned by SIA Arco Development. Encumbered with mortgage in favour of AS HANSABANKA. It is prohibited to alienate, dispossess, donate, split and encumber the land with rights <i>in rem</i> without the written consent of AS HANSABANKA.</p>	<p>Proposed to be divided and developed into 53 residential land units with roads and utility services, with an average area of 1,883 m² each.</p> <p>Planning approval for the project has been obtained.</p>
<p>“Bišumuiža 2 (BM-2)” Zāļu street 8 Riga, Latvia</p>	<p>Approx. 11.2 ha of land in two real estate units.</p> <p>Owned by SIA Sportings Riga.</p> <p>Part of the land (9.49 ha) is subject to prohibition to alienate, donate, split and encumber with rights <i>in rem</i> without consent of Riga City Municipality until certain conditions have been complied with.</p>	<p>Proposed to be developed into apartment buildings.</p> <p>Planning for the project is in place. Start of construction activities is planned for the end of 2007.</p>

OFFICE AND RETAIL DEVELOPMENT

Name / Location	Description	Intended use
<p>Ahtri 3 Tallinn, Estonia</p>	<p>13,911 m² of land, registered purpose of use: commercial.</p> <p>Owned by Arco HCE OÜ. Encumbered with mortgages in favour of AS SEB Eesti Ühispank.</p>	<p>Proposed to be developed into business center with apartments, office and retail space together with accompanying parking area and public space.</p> <p>A new detail planning for the project is being processed.</p>
<p>“Ilmarine” Metalli 15 and 23, Mustamäe rd 5B, 5C, 5D, 5E, 5F, 5G, 5H, 5I, 5J, 5K, 5L Tallinn, Estonia</p>	<p>39,503 m² of land in 13 adjacent real estate units, registered purpose of use: industrial and commercial.</p>	<p>Part of the area proposed to be developed into commercial space, the rest to be sold undeveloped.</p>

Name / Location	Description	Intended use
	Owned by OÜ Floriston Grupp. Encumbered with mortgages in favour of AS Hansapank.	The detail planning for the project to be initiated once the thematic plan of high-rise buildings has been effected.
Laeva 2 Tallinn, Estonia	2,698 m ² of land, registered purpose of use: residential and commercial. Owned by Arco Investeeringud. Encumbered with mortgages in favour of AS SEB Eesti Ühispank.	Proposed to be developed into office building, including the new head office for the Group. A new detail planning for the project is being processed.
Paldiski mnt 80 Tallinn, Estonia	8,200 m ² of land, registered purpose of use: commercial. Owned by OÜ Wilson Kinnisvara. Encumbered with a mortgage in favour of AS Hansapank.	Proposed to be developed into office and retail building. The detail planning for the project is being processed.

CASH FLOW GENERATING PROPERTIES

Name / Location	Description	Intended use
“TOP office property” Regati 1,3,5 Tallinn, Estonia	175,937 m ² of land, registered purpose of use: commercial and social. For ownership and encumbrances - see “TOP residential area” above.	Buildings with leasable space of 23,292 m ² and yacht piers.
“Melon” Estonia avenue 1/3 Tallinn, Estonia	4,409 m ² of land, registered purpose of use: commercial and production. Owned by Arco Ärikeskuse OÜ. Encumbered with mortgages in favour of AS NORD/LB Latvija and AS DnB NORD banka.	Renovated office and retail buildings with leasable space of 7,567 m ² .
“Kerberon “ Kadaka rd 131 Tallinn, Estonia	50-year building title encumbering 24,176 m ² of land, registered purpose of use: production. Six years of the term of the building title have expired. The building title is held by Kerberon OÜ and encumbered with a mortgage in favour of AS SEB Eesti Ühispank. The land is owned by the City of Tallinn.	Buildings with leasable space of 8,111 m ² . The Group proposes to replace some of the buildings with a modern warehouse.
Raekoja 10, Kuressaare, Estonia	2,382 m ² of land, registered purpose of use: commercial. Owned by Arco Vara Saare Kinnistud OÜ. Encumbered with a mortgage in favour of AS Hansapank and building title in favour of Arco Vara Saare Kinnistud OÜ.	A retail building completed in 2004 with leasable space of 1,493 m ² .

Name / Location	Description	Intended use
Rüütli 16/18, Tallinn, Estonia	The office building (in two apartment units). Owned by Arco Vara Saare Kinnistud OÜ. Encumbered with mortgages in favour of AS Hansapank.	A historic building in Tallinn old town area with leasable space of 1,030 m ² .
Kotzebue 18C Tallinn, Estonia	980 m ² of land, registered purpose of use: commercial. Owned by Arco Vara Saare Kinnistud OÜ. Encumbered with a mortgage in favour of the Republic of Estonia	Two outdated warehouses and one office building in the Kalamaja historic residential area in Tallinn with leasable space of 415 m ² . The Group intends to dispose of the property either before or after new detail plan is effected.
“Pärnu market” Suur-Sepa 18 Pärnu, Estonia	7,663 m ² of land, registered purpose of use: commercial. Owned by OÜ Pärnu Turg. Encumbered with mortgages in favour of AS SEB Eesti Ühispank.	An upgraded Pärnu market building with leasable space of 2,529 m ² .
“STÜ” Tallinna rd 77 and 79 Kuressaare, Estonia	Tallinn rd 77: 4,337 m ² of land, registered purpose of use: residential Tallinn rd 79: a 50-year building title encumbering 6,716 m ² of land, registered purpose of use: transport Owned by Arco Vara Kinnistute AS. The land at Tallinn rd 79 is owned by the Republic of Estonia. Encumbered with mortgages in favour of Sampo Pank AS.	A retail store completed in 2006 with leasable space of 1,692 m ² , car park.
“Enerpoint” Kalevi põik 7, 7A, 7B Kuressaare, Estonia	5,251 m ² of land, registered purpose of use: production. Owned by Arco Vara Kinnistute AS. Encumbered with a mortgage in favour of Nordea Bank Finland Plc.	An office building and a production facility with a warehouse with leasable space of 2,208 m ² .

OTHER PROPERTIES

Name / Location	Description	Intended use
Kaarli pst 2 Tallinn, Estonia	4,791 m ² of land, registered purpose of use: commercial. Owned by Varamaad Kinnisvara OÜ. Encumbered with a mortgage in favour of the Republic of Estonia.	To be developed into underground parking house in co-operation with the City of Tallinn.

Name / Location	Description	Intended use
Liimi 1B Tallinn, Estonia	4,847 m ² of land, registered purpose of use: commercial. Arco Investeeringud owns 2463/4847 share of the property, the rest is owned by Arco Balti Kinnisvarafond AS. The co-owners have entered into an agreement which determines the land areas and properties being in the common use of both owners and land areas and properties being in the exclusive use of each owner. Under the agreement, the ultimate goal is to terminate the co-ownership and divide the land. Encumbered with mortgage in favour of AS SEB Eesti Ühispank.	Proposed to be divided into two separate real estate units and the real estate unit acquired by Arco Investeeringud to be sold.
Jaunpils street Riga, Latvia	5,227 m ² of land. Owned by SIA Ulmana Gatves Nami. Encumbered with a mortgage in favour of AS HANSABANKA. It is prohibited to alienate, dispossess, donate, split and encumber the land with rights <i>in rem</i> without consent of AS HANSABANKA.	Proposed to be sold.
“Mārsili” Ādažu parish, Riga district, Latvia	13,095 m ² of land in two real estate units relating to residential development project “Mārsili”. Owned by SIA Arco Development. Encumbered with mortgages in favour of AS DnB NORD Banka. It is prohibited to alienate, dispossess, donate, split, lease, rent and encumber the land with rights <i>in rem</i> without consent of AS DnB NORD Banka.	Proposed to be sold.
Kase 52 and 54, Tallinn, Estonia	Four apartments of 130.7 m ² each and one apartment of 132.9 m ² . Owned by Tallinna Linnaehituse AS under a 50-year building title in apartments encumbering the land at Kase 52 and 54. The land is owned by the City of Tallinn. Encumbered with mortgage in favour of AS SEB Eesti Ühispank.	Proposed to be sold to end clients.
“Merivälja 2” Tallinn, Estonia	Approx. 10 ha of land relating to the residential development project “Merivälja 2”; registered purpose of use: transport, social and residential.	The land used for streets, infrastructure and public areas proposed to be transferred to the City of Tallinn.

<u>Name / Location</u>	<u>Description</u>	<u>Intended use</u>
	Owned by Arco Investeeringud.	Residential land proposed to be sold. Certain land proposed to be exchanged with the City of Tallinn.
Palusambla 1 Tallinn, Estonia	55,466 m ² of land; registered purpose of use: social. Owned by Arco Investeeringud. Encumbered with mortgages in favour of AS Hansapank and AS Sampo Pank.	Proposed to be developed into residential area.
Jõe 2B, Tallinn, Estonia	273 m ² of land with on office building with a net area of 922.5 m ² . Owned by the Company. Encumbered with mortgage in favour of AS Hansapank	Used as office premises for the Group.
Forest land	Approximately 620 ha of land, registered purpose of use: forest and profit yielding. Owned by Arco Maadehalduse OÜ.	Proposed to be sold.

INTELLECTUAL PROPERTY

The Group companies or the Joint Ventures have registered in Estonia the combined trademarks “ARCO VARA”, “ARCO VARA KINNISVARABÜROO REAL ESTATE COMPANY”, “KODU PIRITAL”, “ARCO INVEST”, “TOPCity”, the wordmark “MELON” and the trademark depicting a triumphal arc.

The Company filed an application on 25 August 2006 for the registration of the trademark “ARCO REAL ESTATE” in Estonia. The registration application is pending.

The Company registered the same trademark under the Madrid Protocol. On 28 December 2006, the World Intellectual Property Organization registered the trademark and forwarded it to the following designated countries Armenia, Austria, Bulgaria, Benelux, Belarus, Cyprus, Czech, Germany, Denmark, Spain, Finland, France, United Kingdom, Georgia, Greece, Croatia, Hungary, Ireland, Italy, Kyrgyzstan, Lithuania, Latvia, Moldova, Macedonia, Norway, Poland, Portugal, Romania, Russia, Sweden, Slovenia, Slovakia, Turkmenistan, Turkey, Ukraine, Serbia and Montenegro. Each of the designated countries is entitled to refuse trademark protection by notifying World Intellectual Property Organization no later than 27 June 2008.

In addition, the Group companies have registered in Latvia the trademarks “ARCO REAL ESTATE”, “ARCO DEVELOPMENT” and the trademark for project “Marsili”.

The Group does not have exclusive rights to the word “Arco”. This word is used in the corporate names and trademarks of other businesses, including Arco Color AS, an Estonian company 35 per cent owned by Mr. Arti Arakas, a member of the Company’s Supervisory Council. Arco Color AS is acting in the business of powder painting and Management does not consider Arco Color AS a competitor of

the Group nor does it consider it likely that third parties would confuse Arco Color AS with the Group or its businesses.

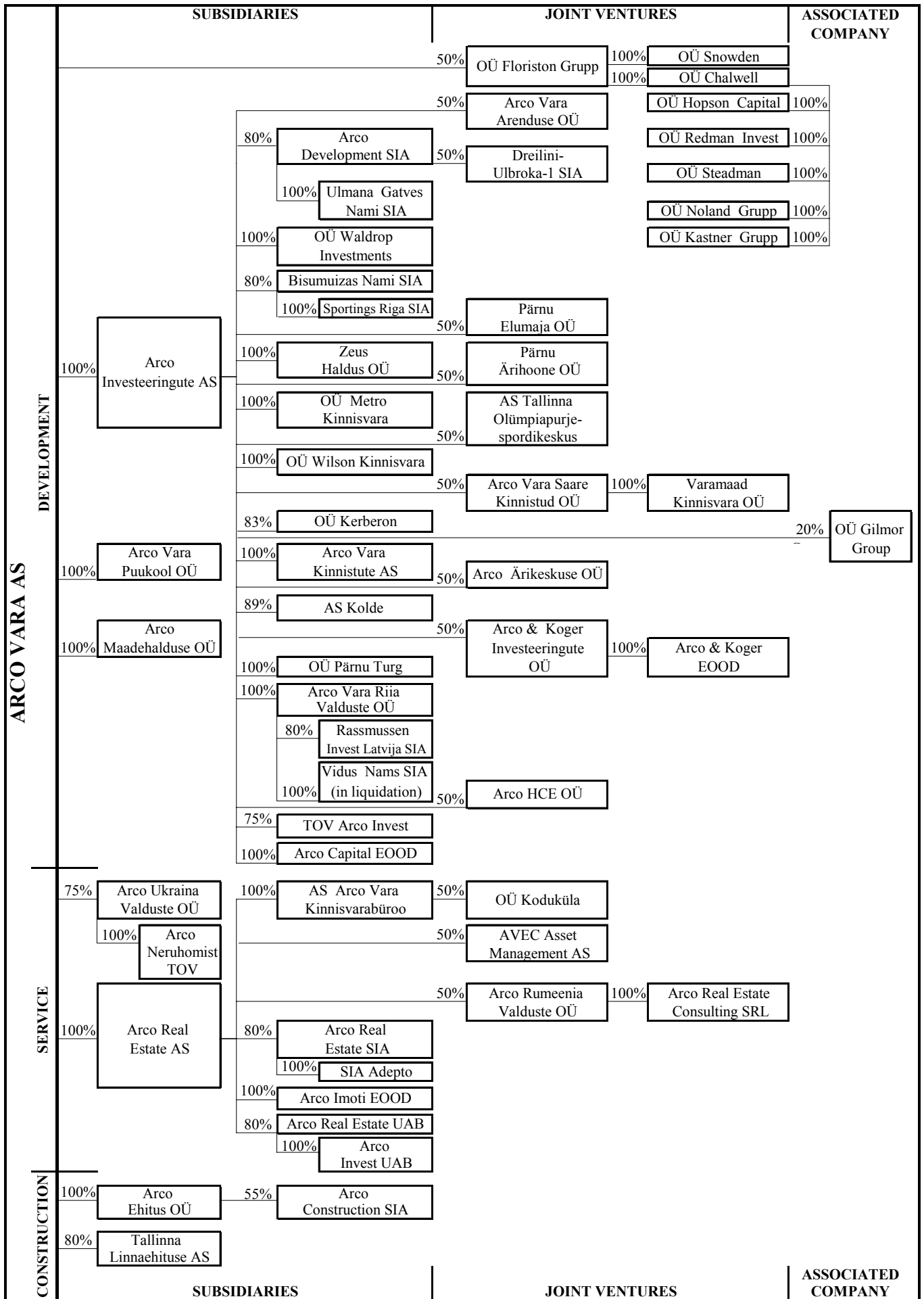
Arti Arakas and Richard Tomingas, the shareholders of Osühing Toletum, also control Arco Kinnisvaraholduse AS, a company involved in the real estate business, but the shareholders of this company have undertaken to delete the word "Arco" from its corporate name before the Combined Offering is completed.

ORGANISATIONAL STRUCTURE

The Group has been organised into three principal divisions: services, development and construction. Each of Arco Real Estate, Arco Investeeringud and Arco Ehitus, all wholly-owned direct subsidiaries of the Company, is the parent company of its division. In the course of restructuring started in 2007 most of the subsidiaries and joint ventures in each division have been transferred under the direct or indirect ownership of the respective divisional parent company.

Tallinna Linnaehituse AS is a direct subsidiary of the Company in order to avoid potential conflicts of interest between Arco Ehitus and Tallinna Linnaehituse AS in situations where the latter performs construction supervision over Arco Ehitus. Management proposes that OÜ Floriston Grupp and Arco Invest UAB will be reorganised under the parent company Arco Investeeringud and Arco Ukraina Valduste OÜ will be reorganised under the parent company Arco Real Estate. The shareholders of the following Group companies have decided that Zeus Haldus OÜ and Osühing Metro Kinnisvara will be merged into Arco Investeeringud and that Pärnu Elumaja OÜ will be merged into Pärnu Ärihoone OÜ. The shareholders of Arco Maadehalduse OÜ and Arco Vara Puukool OÜ have decided that these companies will be merged. Management proposes that Arco Vara Puukool OÜ, as the surviving company, will be reorganised under the parent company Arco Investeeringud. Management expects that such restructuring procedures will be completed later in 2007. Management proposes that Arco Kinnisvaraholduse AS will be liquidated later in 2007.

The chart below illustrates the organisational structure of the Group as at the date of this Offering Circular. See "Company, Share Capital and Ownership Structure – Subsidiaries, Joint Ventures and Associated Companies" for more detailed information about the Group.



ENVIRONMENTAL ISSUES

As a result of environmental surveys some contamination of oil products and heavy metals has been found on the land plot located at Ahtri 3, Tallinn that is owned by Arco HCE OÜ as well as on the land plot located at Narva rd 67, Tallinn that is owned by Arco Investeeringud. The contamination found at Ahtri 3, Tallinn has been removed. The contaminated soil at Narva rd 67, Tallinn is to be excavated before or during the construction phase and transferred for handling to special companies. Cleaning up costs have been included in the budget of the project.

Except as described above, the Management is not aware of any material contamination on the properties owned by the Group companies or joint ventures. However, the environmental condition of each of the Group's or Joint Ventures' properties has not been thoroughly investigated. In the event that residual pollution is found on the land owned by the Group or the Joint Ventures, the Group or the relevant Joint Venture may be liable for such pollution as the landowner. A number of laws in Estonia and Latvia directly or indirectly apply to the residual pollution that may be located on the land owned by the Group. In general, the landowner may be required to clean up pollution located on its land and/or to compensate the damage caused by flammable, radiation, combustible, toxic, caustic or environmentally hazardous substances on the land. When purchasing land in Estonia, the Group usually requires the seller to warrant that there is no contamination on the land. A breach of such warranty may entitle the Group to demand compensation from the seller within a limited period of time.

Under Estonian and Latvian law, the landowner is, as a rule, liable for the damage caused by buildings collapse or items falling off the building. The Group holds insurance policies to mitigate the potential effect of such liability – see “Business - Insurance”. During the construction period of a property development, the liability and risks related to the building and the construction site are usually borne by the construction company under the terms and conditions of the construction agreements.

INSURANCE

The Group's construction subsidiaries in Estonia and Latvia are subject to potential liability for defects in design, construction, materials or workmanship. The minimum statutory warranty period for construction is two years in Estonia and Latvia. The Group's construction subsidiaries obtain specialized insurance cover against all construction risks (Contractor's All Risks or CAR) for each project for the duration of the project. Under Latvian law, the contractors of construction works are required to hold mandatory civil liability insurance policies with certain minimum coverage. Such mandatory liability insurance requirements have been met by the Group's construction subsidiaries.

Construction supervision, real estate brokerage and valuation as well as real estate maintenance and management where the Group companies are also active may bring about additional civil liability towards third parties. Most of the Group companies operating in these fields have specific insurance policies covering such liability. Under Latvian law, certified real estate appraisers are required to hold professional liability insurance with certain minimum coverage. Such mandatory liability insurance requirements have been met.

The Group also holds policies covering the building owner's liability in relation to most of its material buildings. All motor vehicles used by the Group are covered by the mandatory third party liability insurance.

Management believes that the Group's insurance policies correspond to the standard industry practices in Estonia and Latvia and meet the requirements imposed by the covenants in the Group's financing agreements.

MATERIAL CONTRACTS

Shareholders' Agreements

The Group has entered into a number of shareholders' agreements in relation to those Group companies and joint ventures that have third party shareholders. These agreements provide the main principles for the operation and management of the company, principles of corporate governance, rules for adopting corporate decisions, resolution of deadlock situations, restrictions on the transfers of shares and other similar matters. Unless otherwise stated, the agreements summarised below are governed by Estonian law.

Shareholders' agreement in relation to AVEC Asset Management AS

This shareholders' agreement was entered into on 15 February 2005 between Arco Real Estate and East Capital Holding AB, each of whom owns 50 per cent of the shares in AVEC Asset Management AS. The agreement is governed by Swedish law.

The agreement provides that the supervisory council of this company consists of four members, each shareholder being entitled to nominate two members. The chairman of the supervisory council, who has the deciding vote, is appointed from the nominees of East Capital Holding AB. The management board of the company comprises two members, each shareholder being entitled to nominate one member.

Material decisions, such as amending the articles of associations, alteration of the share capital, issuing shares or entering into any obligations for issuance, disposition or acquisition of the shares of the company, winding up the company, adoption of the annual report, require at least two-thirds of the votes, whether the decision is to be taken by the supervisory council, management board or the general meeting of the shareholders.

Each shareholder has a right of first refusal and tag-along right upon the transfer of shares by the other shareholder.

In case of a material breach of the agreement by a shareholder remaining unremedied for more than 30 days after a written request of the other shareholder, the non-breaching shareholder is entitled to buy out the breaching shareholder for market value. Similarly, each shareholder is entitled to acquire the shares held by the other if the latter is insolvent or becomes subject to statutory restructuring.

Shareholders' agreement in relation to Arco Rumeenia Valduste OÜ

This shareholders' agreement was entered into on 18 August 2006 between Arco Real Estate and IPC Romania OÜ, each owning 50 per cent of the shares in Arco Rumeenia Valduste OÜ.

The agreement provides the principles for the cooperation between the parties in jointly launching real estate mediation, evaluation and consultancy operations in the Romanian real estate market, for which purpose the parties will establish a subsidiary in Romania.

Under the agreement, the management board of the company consists of four members, each shareholder being entitled to nominate two members. The chairman of the management board, who has the deciding vote, is appointed from the nominees of the Company. All transactions with a value exceeding EUR 25,000 require a joint signature of three members of the management board.

Under the agreement, at least 15 per cent of the profits of the company or its subsidiary earned in a financial year is to be distributed as dividends. Any departure from this principle requires the consent of both shareholders.

The shareholders' meeting can pass resolutions only when all shareholders are present, and all decisions must be made unanimously. In the event of a deadlock, either shareholder has the option to buy the other out at a fair market price determined by an audit firm acceptable to both shareholders. Should both shareholders wish to acquire the other shareholder's shares, the price of the shares is gradually increased until one shareholder agrees to sell its shares.

Each shareholder has a right of first refusal and tag-along right upon the transfer of shares by the other shareholder.

Should the Company transfers its shares in the company, IPC Romania OÜ must delete the word "Arco" from the names of the company and its subsidiaries.

The agreement provides contractual penalties payable by a party in the event of a breach of contract.

Shareholders' agreement in relation to Arco Ukraina Valduste OÜ

This shareholders' agreement was entered into on 8 March 2005 between the Company, owning 75 per cent of the votes represented by shares of the company, and Bagatini OÜ, owning 25 per cent of the votes represented by the shares of the company. The agreement does not specify the governing law.

The agreement provides the principles for the cooperation between the parties in jointly launching real estate mediation and development operations in the Ukrainian real estate market, for which purpose the parties have agreed to establish a subsidiary "Arco Neruhomist" TOV in Ukraine.

Under the agreement, the management board of the company consists of three members, the Company being entitled to nominate two members and Bagatini OÜ being entitled to nominate one member of the board. The members of the management boards of the subsidiaries of the company are to be nominated in accordance with the shareholdings of the parties in Arco Ukraina Valduste OÜ.

The consent of the shareholders is required for certain transactions outside the normal course of business, whether conducted by Arco Ukraina Valduste OÜ or its subsidiary. Resolutions of the general meeting of shareholder on material issues, such as, approval of the annual report, election of members of management board, amending the articles of associations, alteration of the share capital, real estate investments, issuing of convertible bonds or loan options, granting of options, foundation of subsidiaries, acquisition and transfer of shares in other companies, and winding up the company require the agreement of both shareholders.

Under the agreement, 50 per cent of the profits of the company earned in a financial year are to be distributed as dividends. Any departure from this principle requires the consent of both shareholders.

In the event of deadlock, each shareholder has a put option to sell its shares to the other party at a fair market price agreed by the parties or determined by an audit firm acceptable to both shareholders. If both parties wish to buy the share of other party, the price of the shareholding shall be gradually increased until either shareholder agrees to sell its shares. If neither shareholder wishes to purchase the shares of the other party, all shares are to be sold by auction, or, at the shareholders' option, the price of the shares is gradually decreased until either shareholder decides to acquire the shares of the other party.

According to the agreement, the shareholders are not allowed to encumber their shares in the company. Each shareholder has a right of first refusal, which is applicable upon the transfer of shares as well as derivative instruments relating to shares. However, if the share purchase price offered is unreasonably high for investment purposes, the shareholder has the right to acquire the share at a fair market price determined by an audit firm acceptable to both shareholders.

The agreement also provides for drag-along right.

Should the Company transfer its share in Arco Ukraina Valduste OÜ, Bagatini OÜ must delete the word “Arco” from the names of the company and its subsidiaries.

The agreement does not set forth any contractual penalties for the breach of the agreement.

Shareholders’ agreement in relation to Arco HCE OÜ

Arco HCE OÜ is a special purpose vehicle established to develop the land at Ahtri 3, Tallinn. The shareholders’ agreement was entered into on 11 January 2007 between Arco Investeeringud and Rotermann Eesti OÜ, each of whom owns 50 per cent of the shares of the target company.

Under the agreement, the supervisory council of the company consists of four members, each shareholder being entitled to nominate two members. Each shareholder has the right to appoint the chairman of the supervisory council in alternate years. The chairman, however, does not have the deciding vote. The resolutions of the supervisory council require that at least one member representing each party be in favour.

The shareholders’ meeting can pass resolutions only when all shareholders are present, and all decisions must be made unanimously. In the event of a deadlock, either shareholder may issue a call offer the other party, requesting it to sell its shares to the first shareholder. The shareholder receiving the call offer may either accept the call offer or request that the first shareholder sells its shares at the price indicated in the call offer.

The shareholders are not allowed to transfer their shares during one year after signing, i.e. until 11 January 2008. After that, each shareholder has a right of first refusal as well as tag-along and drag-along rights upon the transfer of shares by the other shareholder. Shares in the company may be pledged or encumbered only with the prior consent of the other shareholders.

Should Arco Investeeringud transfer its share in the company, Rotermann Eesti OÜ must delete the word “Arco” from the names of the company and its subsidiaries.

The agreement provides contractual penalties payable by a party in the event of a breach of contract.

Shareholders’ agreement in relation to Osühing Koduküla

The shareholders’ agreement was entered into on 2 August 2006 between AS Arco Vara Kinnisvarabüroo and OÜ VWF Kinnisvara, each of whom own 50 per cent of the shares in the company.

Under the agreement, the management board of the company consists of two members, each shareholder being entitled to nominate one member.

Resolutions of the general meeting of shareholder on material issues, such as, amending the articles of associations, alteration of the share capital, issuing of convertible bonds or loan options, granting of options, election and removal of members of management board or supervisory council and winding up the company require the agreement of both shareholders.

Under the agreement, at least 30 per cent of the profits of the company earned in a financial year is to be distributed as dividends. Any departure from this principle requires the consent of both shareholders.

The transfers of shares in the company require a resolution of the shareholders adopted with a 2/3 majority. Each shareholder has a right of first refusal upon the transfer of shares by the other shareholder.

If a party breaches its obligations regarding the transfer of shares and the right of first refusal, it must pay contractual penalty to the other party.

Shareholders' agreement in relation to Arco & Koger Investeeringute OÜ

This shareholders' agreement was entered into on 6 October 2006 between Arco Investeeringud and OÜ Koger Kinnisvara, each of whom owns 50 per cent of the shares in the joint venture Arco & Koger Investeeringute OÜ.

According to the agreement, the company does not have a supervisory council. The management board of the company consists of two members, each shareholder being entitled to nominate one member. The same principle is applied to any subsidiaries of the company.

The consent of the shareholders is required for transactions outside normal course of business and for certain specific types of transactions. Under the agreement, the shareholders are not to distribute profits of the company or its subsidiaries during first three years of operations, i.e until the end of 2009.

In case of a deadlock, each shareholder has a put option to sell its shares to the other party at a fair market price agreed by the parties or determined by the auditor specified in the agreement. If both parties wish to buy the share of other party, the price of the shareholding is to be gradually increased until either shareholder agrees to sell its shares. If neither shareholder wishes to purchase the shares of the other party, all shares are to be sold by auction, or, at the shareholders' option, the price of the shares is to be gradually decreased until either shareholder decides to acquire the shares of the other party.

Each shareholder has a tag-along right upon the transfer of shares by the other shareholder.

Should either shareholder transfers its shares in the company, the other shareholder must delete the word "Arco" or "Koger", as the case may be, from the names of the company and its subsidiaries.

The agreement provides contractual penalties payable by a party in the event of a breach of contract.

Shareholders' agreement in relation to Arco Real Estate SIA

This shareholders' agreement was entered into on 17 May 2007 between Arco Real Estate AS, owning 80 per cent of the votes represented by shares of the company, and Viktors Savins, owning 20 per cent of the votes represented by the shares of the company. The agreement does not specify the governing law.

The agreement contains no provisions about quorum or qualified majority in the meeting of shareholders, except that 15 per cent of the profit of the company earned in a financial year shall be distributed as dividends unless both shareholders decide otherwise.

Under the agreement, each shareholder agrees not to engage in a business directly competitive with that of Arco Real Estate SIA without the consent of other shareholder, except that Mr. Viktors Savins has consented to Arco Real Estate AS operating directly and indirectly in the real estate business without him.

Any shareholder owning at least 20 per cent of the share capital is entitled to appoint one member of the supervisory council.

The agreement prohibits Mr. Viktors Savins from transferring his shares without the consent of Arco Real Estate SIA during a lock-up period of 2.5 years from the date of the agreement. Each shareholder has the right of first refusal upon a transfer of shares by the other shareholders.

Mr. Viktors Savins has a put option for an unspecified term to require Arco Real Estate AS to purchase his shares at the price based on the net asset value of Arco Real Estate SIA and payable within three years as of the signing of the share purchase agreement giving effect to the exercise of the put option. In order to exercise the option, Mr. Savins must submit a notice indicating the price and all other relevant terms no later than one year before the proposed date of transfer.

Arco Real Estate AS has a drag-along right upon the transfer of its shares to any third party.

Should Arco Real Estate AS transfer its shares in the company, Mr. Viktors Savins must delete the word “Arco” from the names of the company and its subsidiaries within six months as of the transfer.

The agreement provides contractual penalties payable by a party in the event of a breach of contract.

Shareholders’ agreement in relation to Arco Development SIA

This shareholders’ agreement was entered into on 27 March 2007 between Arco Investeeringud, owning 80 per cent of the votes represented by shares of the company, and Viktors Savins, owning 20 per cent of the votes represented by the shares of the company. The agreement does not specify the governing law.

Under the agreement, the general meeting of shareholders has a quorum when more than 50 per cent of the votes represented by shares are present. Resolutions regarding alteration of share capital, division of the shares and selling subsidiaries require the consent of both shareholders.

Under the agreement, 15 per cent of the profit of the company earned in a financial year is to be distributed as dividends. Any departure from this principle requires the consent of both shareholders.

Any shareholder owning more than 10 per cent of the share capital is entitled to appoint one member of the supervisory council. The management board of the company consists of up to two members. According to the agreement, Mr. Viktors Savins is to be a member of the management board until 25 May 2010 and has the right to be re-elected, provided that the company meets its economical targets.

The agreement prohibits Mr. Viktors Savins from transferring his shares without the consent of Arco Investeeringud during a lock-up period expiring on 25 September 2009. Each shareholder has the right first refusal upon the transfer of shares by the other shareholders.

Mr. Viktors Savins has a put option for an unspecified term to require Arco Investeeringud to purchase his shares at the price based on the net asset value of Arco Development SIA payable within two years as of the signing of the share purchase agreement giving effect to the exercise of the put option. In order to exercise the option, Mr. Savins must submit a notice indicating the market price and all other relevant terms no later than one year before the proposed date of transfer.

Arco Investeeringud has a drag-along right upon the transfer of its shares to any third party. Neither shareholder may encumber its shares in the company during the validity of the agreement. In case of a deadlock, Arco Investeeringud has a call option to acquire the shares held by Mr. Savins at the market price agreed between parties or determined jointly by two different auditors from well-known international audit firms, with the redemption price becoming payable within two years after the signing of the share purchase agreement giving effect to the redemption.

Should the Group transfer its shares in the company, Mr. Savins must delete the word “Arco” from the names of the company and its subsidiaries within six months as of the transfer.

The agreement provides contractual penalties payable by a party in the event of a breach of contract.

Shareholders' agreement in relation to SIA Arco Construction

This shareholders' agreement was entered into on 28 December 2006 between Arco Ehitus, owning 55 per cent of the shares of SIA Arco Construction, and the minority shareholders Messrs. Viktors Savins, Martins Bubens and Aivars Kacars, each owning 15 per cent of the shares. The agreement does not specify the governing law.

Under the agreement, the general meeting of shareholders has a quorum when more than 50 per cent of the votes represented by shares are present. The resolutions of the shareholders require that at least 75 per cent of the votes represented by shares be in favour. However, the resolutions on alteration of share capital, division of shares, granting option rights, issuance of option loans or convertible bonds, merger, division, reorganisation or winding up of the company are deemed adopted if 100 per cent of the votes represented by shares are in favour.

Under the agreement, 15 per cent of the profits of the company earned in a financial year is to be distributed as dividends. Any departure from this principle requires the consent of both shareholders.

According to the agreement, the management board of the company consists of up to three members. Messrs. Martins Bubens and Aivars Kacars are to be members of the management board until 28 December 2009 and have the right to be re-elected, provided that the company meets certain economical targets.

According to the agreement, the shareholders may not transfer their shares without the consent of the company during a lock-up period expiring on 28 December 2009. Each shareholder has a right first refusal upon the transfer of shares by the other shareholders.

Each of Messrs. Viktors Savins, Martins Bubens and Aivars Kacars has a put option for an unspecified term to require Arco Ehitus to purchase his shares at the market price payable within two years as of the signing of the share purchase agreement giving effect to the exercise of the put option. The party wishing to exercise the option must submit a notice indicating the market price and all other relevant terms no later than 12 months before the proposed date of transfer. Should the parties fail to agree on the market price, it is to be determined as the average between valuations prepared by two different auditors from well-known international audit firms. The costs of determining the market price are to be borne by Arco Ehitus.

Arco Ehitus has a drag-along option upon the transfer of all shares by the other shareholders. The agreement provides no mechanisms for a dead-lock situation.

Should Arco Ehitus transfer its shares in the company, the other shareholders must delete the word "Arco" from the names of the company and its subsidiaries.

The agreement provides contractual penalties payable by a party in the event of a breach of contract.

Shareholders' agreement in relation to Bišumuižas Nami SIA

Bišumuižas Nami SIA is a special purpose vehicle established to develop the land "Bišumuiža 2" located at Zalu street 8, Riga, Latvia. The land is owned by SIA Sportings Riga which is a wholly-owned subsidiary of Bišumuižas Nami SIA.

In connection with the pending sale of 50 per cent of the shares in Bišumuižas Nami SIA to Linstow Baltic SIA, Arco Investeeringud, Mr. Viktors Savins, SIA Linstow Baltic and SIA Bišumuižas Nami entered into a shareholders agreement relating to SIA Bišumuižas Nami on 18 May 2007. Whilst this agreement is technically in force, it will become operative in practice only upon the closing of the share sale, currently expected to take place before 30 June 2007. For further details see

“Management’s Discussion and Analysis of the Group’s Financial Condition and Results of Operations – Recent Developments”.

Acquisition and transfer of shareholdings in material subsidiaries and joint ventures

Share purchase agreement in relation to SIA “EUROLINE”

On 8 June 2006, OÜ Floriston Grupp entered into a share purchase agreement with Urban Development Group AS and Askolds Berzinš for the acquisition of 100 per cent of the shares in the Latvian company SIA “EUROLINE”. The agreement is governed by Latvian law.

SIA “EUROLINE” is a Latvian company which holds a long-term lease of the properties that are proposed to be used for the Kipsala office building project in Latvia. See “Business – Operations - Office and retail development projects”.

Under the agreement, the total purchase price payable by OÜ Floriston Grupp amounts to EUR 11,000,000. The purchase price is payable in three parts. The first payment of EUR 7,000,000 (advance payment) was paid by OÜ Floriston Grupp. The second payment of EUR 2,500,000 is payable upon the closing of the transaction which is expected to take place after the fulfilment of certain conditions precedent, such as the adoption of certain decisions by the Municipality of Riga required for the commencement of the contemplated real estate development activities. The third payment in the amount of EUR 1,500,000 is payable within two years as of the signing of the agreement, the exact time of payment being subject to issuing of the building permit to SIA “EUROLINE”.

LITIGATION

The Group companies and joint ventures are party to a number of legal proceedings that have arisen in the ordinary course of their business. For additional information about court cases pending as at 31 March 2007, see Note 32 to the financial statements for the financial year ended 31 December 2006. In the court case relating to a claim filed against AS Tallinna Olümpiapurjespordikeskus by Regati Valduste OÜ and Urmast Uustal, the Tallinn Circuit Court dismissed the appeal of Urmast Uustal and Regati Valduste OÜ by its decision of 17 April 2007. However, on 15 May 2007 Urmast Uustal and Regati Valduste OÜ filed an appeal in cassation to the Supreme Court of Estonia. By the date of this Offering Circular the Supreme Court of Estonia has not decided whether to accept or refuse to accept the appeal in cassation.

In addition, OÜ Ehitus Service has initiated an action against OÜ Floriston Grupp in order to have a notation made in the Land Register regarding a lease contract between the parties whereby OÜ Floriston Group as a lessor was to build and lease to OÜ Ehitus Service 14,080 m² of commercial premises at Mustamäe tee 5B, Tallinn. However, OÜ Floriston Grupp has challenged the making of such a notation in the court since OÜ Floriston Grupp has already terminated the lease contract unilaterally on the basis that due to the unforeseeable circumstances OÜ Floriston Grupp has not been able to receive a necessary building permit for the renovation of the building at Mustamäe tee 5B, Tallinn and is therefore unable to fulfil the obligations resulting from the lease contract.

None of the Group companies are involved or have been involved during the 12 months preceding the date of this Offering Circular in any governmental, legal or arbitration proceedings that has had or may have a material adverse effect on the Group’s financial position or profitability. Nor is Management aware of any circumstances that could reasonably be expected to lead to any such proceedings in the foreseeable future.

RELATED PARTY TRANSACTIONS

The Group has entered into certain agreements with related parties. All material and on-going related party transactions are described below. For additional information about other related party

transactions of the Group, see Note 38 to the financial statements for the financial year ended 31 December 2006 and Note 35 to the financial statements for the financial year ended 31 December 2005.

Transactions with Joint Ventures and the other shareholders of Joint Ventures

This section describes all material and on-going agreements with a value in excess EEK 1 million, either as the total value of the agreement or as a sum of more than one agreements between the same parties or as an outstanding balance between the same parties (after the Group's share has been eliminated).

- Sales agreement between Arco Investeeringud (as the seller) and OÜ Snowden (as the purchaser), dated 5 September 2006, whereby Arco Investeeringud sold to OÜ Snowden a land parcel at Kõrkja tee 10a, Tallinn for total consideration of EEK 16,000,000. The purchase price has been paid in full. OÜ Snowden is a subsidiary of Floriston Grupp OÜ. Floriston Grupp OÜ is a joint venture between the Group and Ärimaja AS.
- Loan agreement between the Company and Arco HCE OÜ, dated 19 January 2007 regarding a loan of EEK 106,187,584 by the Company to Arco HCE OÜ for a term expiring on 31 March 2008. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. Arco HCE OÜ is a joint venture between the Group and Rotermann Eesti OÜ. As at 31 March 2007, the outstanding capital amount of this loan was EEK 54,140,920 (after the elimination of the Group's share).
- Loan agreement between Rotermann Eesti OÜ and Arco HCE OÜ, dated 19 January 2007 regarding a loan of EEK 106,187,584 by Rotermann Eesti OÜ to Arco HCE OÜ for a term expiring on 31 March 2008. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. Arco HCE OÜ is a joint venture between the Group and Rotermann Eesti OÜ. As at 31 March 2007, the outstanding capital amount of this loan was EEK 53,093,792 (after the elimination of the Group's share).
- Loan agreement between Ärimaja AS and Floriston Grupp OÜ, dated 24 May 2006 regarding a loan of EEK 23,000,000 by Ärimaja AS to Floriston Grupp OÜ for a term expiring on 23 May 2011. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 11,500,000 (after the elimination of the Group's share). Ärimaja AS is a shareholder in Floriston Grupp OÜ, a joint venture between the Group and Ärimaja AS.
- Loan agreement between Ärimaja AS and Floriston Grupp OÜ, dated 27 November 2001 regarding an interest-free loan of EEK 1,214,900 by Ärimaja AS to Floriston Grupp OÜ for a term expiring on 30 November 2007. As at 31 March 2007, the outstanding capital amount of this loan was EEK 590,273 (after the elimination of the Group's share). Ärimaja AS is a shareholder in Floriston Grupp OÜ, a joint venture between the Group and Ärimaja AS.
- Loan agreement between OÜ VWF Kinnisvara and OÜ Koduküla, dated 27 November 2006 regarding a loan of EEK 800,000 by OÜ VWF Kinnisvara to OÜ Koduküla for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 400,000 (after the elimination of the Group's share). OÜ VWF Kinnisvara is a shareholder in OÜ Koduküla, a joint venture between the Group and OÜ VWF Kinnisvara.
- Loan agreement between OÜ VWF Kinnisvara and OÜ Koduküla, dated 12 December 2006 regarding a loan of EEK 4,500,000 by OÜ VWF Kinnisvara to OÜ Koduküla for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan

was EEK 2,250,000 (after the elimination of the Group's share). OÜ VWF Kinnisvara is a shareholder in OÜ Koduküla, a joint venture between the Group and OÜ VWF Kinnisvara.

- Loan agreement between OÜ VWF Kinnisvara and OÜ Koduküla, dated 31 July 2006 regarding a loan of EEK 1,250,000 by OÜ VWF Kinnisvara to OÜ Koduküla for a term expiring on 30 September 2008. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 625,000 (after the elimination of the Group's share). OÜ VWF Kinnisvara is a shareholder in OÜ Koduküla, a joint venture between the Group and OÜ VWF Kinnisvara.
- Loan agreement between OÜ VWF Kinnisvara and OÜ Koduküla, dated 12 March 2007 regarding a loan of EEK 3,750,000 by OÜ VWF Kinnisvara to OÜ Koduküla for a term expiring on 12 January 2008. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 1,750,000 (after the elimination of the Group's share). OÜ VWF Kinnisvara is a shareholder in OÜ Koduküla, a joint venture between the Group and OÜ VWF Kinnisvara.
- Loan agreement between AS Arco Vara Kinnisvarabüroo and OÜ Koduküla dated 3 August 2006 regarding a loan of EEK 1,250,000 by AS Arco Vara Kinnisvarabüroo to OÜ Koduküla for a term expiring on 1 September 2008. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 625,000 (after the elimination of the Group's share). OÜ Koduküla is a joint venture between the Group and OÜ VWF Kinnisvara.
- Loan agreement between AS Arco Vara Kinnisvarabüroo and OÜ Koduküla dated 24 November 2006 regarding a loan of EEK 800,000 by AS Arco Vara Kinnisvarabüroo to OÜ Koduküla for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 400,000 (after the elimination of the Group's share). OÜ Koduküla is a joint venture between the Group and OÜ VWF Kinnisvara.
- Loan agreement between AS Arco Vara Kinnisvarabüroo and OÜ Koduküla dated 12 December 2006 regarding a loan of EEK 4,500,000 by AS Arco Vara Kinnisvarabüroo to OÜ Koduküla for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 2,250,000 (after the elimination of the Group's share). OÜ Koduküla is a joint venture between the Group and OÜ VWF Kinnisvara.
- Loan agreement between AS Arco Vara Kinnisvarabüroo and OÜ Koduküla dated 12 March 2007 regarding a loan of EEK 3,750,000 by AS Arco Vara Kinnisvarabüroo to OÜ Koduküla for a term expiring on 12 January 2008. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 1,875,000 (after the elimination of the Group's share). OÜ Koduküla is a joint venture between the Group and OÜ VWF Kinnisvara.
- Loan agreement between OÜ Saarte Investeering and Pärnu Elumaja OÜ dated 1 January 2007 regarding a loan of EEK 9,440,000 by OÜ Saarte Investeering to Pärnu Elumaja OÜ for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 4,720,000 (after the elimination of the Group's share). Saarte Investeeringud OÜ is a shareholder in Pärnu Elumaja OÜ, a joint venture between the Group and OÜ Saarte Investeering. The loan was fully repaid on 19 April 2007.
- Loan agreement between Arco Investeeringud and Pärnu Elumaja OÜ dated 1 January 2007 regarding a loan of EEK 9,440,000 by Arco Investeeringud to Pärnu Elumaja OÜ for a term

expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 4,720,000 (after the elimination of the Group's share). Pärnu Elumaja OÜ is a joint venture between the Group and Saarte Investeeringud OÜ. The loan was fully repaid on 19 April 2007.

- Loan agreement between Arco Investeeringud and Pärnu Elumaja OÜ dated 25 August 2006 regarding a loan of EEK 350,000 by Arco Investeeringud to Pärnu Elumaja OÜ for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 175,000 (after the elimination of the Group's share). Pärnu Elumaja OÜ is a joint venture between the Group and Saarte Investeeringud OÜ. The loan was fully repaid on 19 April 2007.
- Loan agreement between the Company and Arco Vara Saare Kinnistud OÜ dated 9 August 2006 regarding a loan of EEK 10,500,000 by the Company to Arco Vara Saare Kinnistud OÜ for a term expiring on 30 September 2007. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 1,250,000 (after the elimination of the Group's share). Arco Vara Saare Kinnistud OÜ is a joint venture between the Group and Saare Finants AS.

All the loans discussed above are unsecured.

For the shareholders' agreements between the Group and the other shareholders of the Joint Ventures see "Business – Material Contracts".

Transactions with key management personnel and other related parties

This section describes all material and on-going agreements with a value in excess EEK 1 million, either as the total value of the agreement or as a sum of more than one agreements between the same parties or as an outstanding balance between the same parties (after the Group's share has been eliminated).

- Agreement between the Company and Mr. Indrek Porila dated 15 March 2007 regarding bonuses payable to Mr. Porila in connection with the real estate projects of Floriston Grupp OÜ. Subject to the terms and conditions of the agreement, Mr. Porila is entitled to a bonus in the gross amount (including taxes) equal to up to 12.5 per cent of the total consolidated undistributed retained earnings of Floriston Grupp OÜ, subject to the completion of real estate projects of Floriston Grupp OÜ. Floriston Grupp OÜ is a joint venture between Arco Investeeringud and AS Ärimaja and Mr. Porila is a member of the management board of Floriston Grupp OÜ. As at 31 March 2007, the liabilities of the Group under this agreement were reflected in the Group's IFRS Financial Statements in the amount of EEK 37,943,987. The bonus in respect of each project becomes payable when the project is completed. The Company granted this bonus to Mr. Porila in recognition of his exceptional performance in the early years of the Group's Latvian operations, and the agreement of 15 March 2007 reduced to writing an oral agreement that had been applied between the Company and Mr. Porila for several years.
- Loan agreement between Bagatini OÜ and Arco Ukraina Valduste OÜ, dated 12 July 2006, regarding a loan of EUR 188,478 (EEK 2,949,040) by Bagatini OÜ to Arco Ukraina Valduste for a term expiring on 30 June 2010. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 2,332,529. Bagatini OÜ is a company controlled by Juri Nikitin, one of the key executives of the Group. The loan is unsecured.
- Loan agreement between Arco Vara Saare Kinnistud OÜ and Reedik Aavik, dated 7 April 2006,

regarding a loan of EEK 2,200,000 by Arco Vara Saare Kinnistud OÜ to Reedik Aavik for a term expiring on 1 September 2007. Interest on the outstanding amount of the loan accrues at the rate of 6 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 1,100,000 (after the elimination of the Group's share). Mr. Reedik Aavik is a relative of a member of the Supervisory Council. The loan is unsecured.

- Loan agreement between the Company and Arco Kinnisvaraholduse AS, dated 2 January 2007, regarding a loan of EEK 9,162,805 by the Company to Arco Kinnisvaraholduse AS for a term expiring on 31 December 2007. This loan relates to certain claims under earlier loan agreements and other past business transactions between the Group and Arco Kinnisvaraholduse AS. These claims were consolidated on 2 January 2007 into one loan from the Company to Arco Kinnisvaraholduse AS. Interest on the outstanding amount of the loan accrues at the rate of 6 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 9,162,805. Arco Kinnisvaraholduse AS is a company controlled the members of the Supervisory Council Arti Arakas and Richard Tomingas. The loan is unsecured.
- Share purchase agreement between Arco Investeeringud and ISA Group OÜ dated 29 August 2003 whereby Arco Investeeringud sold 20 per cent of the shares of Tallinna Linnaehituse AS to ISA Group OÜ for the total consideration of EEK 900,000. The purchase price is payable in five instalments by 29 August 2008. As at 31 March 2007, the total amount of the unpaid purchase price was EEK 867,633. ISA Group OÜ is a company controlled by Vladimir Issakov, member of the Management Board of the Group companies Tallinna Linnaehituse AS and AS Kolde.
- Share purchase agreement between Tallinna Linnaehituse AS and ISA Group OÜ dated 1 September 2003 whereby Tallinna Linnaehituse AS sold 17 per cent of the shares of OÜ Kerberon to ISA Group OÜ for the total consideration of EEK 399,000. The purchase price is payable by 1 September 2008. An interest on the outstanding amount of the purchase price accrues at the rate of 3 per cent per annum. As at 31 March 2007, the total amount of the unpaid purchase price was EEK 367,062. ISA Group OÜ is a company controlled by Vladimir Issakov, member of the Management Board of the Group companies Tallinna Linnaehituse AS and AS Kolde.
- Construction agreement between Arco Ehitus OÜ (as the contractor) and Euro Houses Development OÜ (as the customer), dated 8 January 2007, regarding the performance of construction work in the building located at Lossi 27, Kuressaare, Estonia. The total contract price payable by Euro Houses Development OÜ under the agreement was EEK 5,000,000 plus VAT. As at 31 March 2007, the outstanding amount under the agreement was EEK 787,593.
- Assignment agreement between SIA Mazais Baltezers and SIA Arco Development, dated 21 September 2005. Pursuant to the agreement SIA Mazais Baltezers transferred to SIA Arco Development its claim against Arco Vara Ärijuhtimise OÜ arising from eight real estate purchase agreements entered on 25 January 2005 and 26 January 2005 respectively. In consideration for this assignment, SIA Arco Development agreed to pay to SIA Mazais Baltezers an amount of EUR 574,670. As at 31 March 2007 the amount outstanding under the agreement was EEK 2,107,136. The parties have agreed that SIA Arco Development must pay this outstanding amount by 31 December 2007.
- Loan agreement between the Company and Euro Houses Development OÜ, dated 29 May 2007, regarding a loan of EEK 408,514 by the Company to Euro Houses Development OÜ for a term expiring on 31 December 2007. This loan relates to Company's outstanding claims against Euro Houses Development OÜ under past business transactions. On 29 May 2007, these claims were reorganised into a loan from the Company to Euro Houses Development OÜ. Interest on the outstanding amount of the loan accrues at the rate of 6 per cent per annum. Euro Houses Development OÜ is a company controlled by the members of the Supervisory Council Arti Arakas and Richard Tomingas. The loan is unsecured.

- Loan agreement between Arco Investeeringud and Euro Houses Development OÜ, dated 29 May 2007, regarding a loan of EEK 3,860,165 by the Company to Euro Houses Development OÜ for a term expiring on 31 December 2007. This loan relates to outstanding claims of Arco Investeeringud against Euro Houses Development OÜ under past business transactions. On 29 May 2007, these claims were reorganized into a loan from Arco Investeeringud to Euro Houses Development OÜ. Interest on the outstanding amount of the loan accrues at the rate of 10 per cent per annum. Euro Houses Development OÜ is a company controlled by the members of the Supervisory Council Arti Arakas and Richard Tomingas. The loan is unsecured.
- Loan agreement between AS Arco Vara Kinnisvarabüroo and Euro Houses Development OÜ, dated 6 August 2004, regarding a loan of EEK 1,900,000 by AS Arco Vara Kinnisvarabüroo to Euro Houses Development OÜ for a term expiring on 30 June 2007. Interest on the outstanding amount of the loan accrues at the rate of 6 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 1,900,000. Euro Houses Development OÜ is a company controlled by the members of the Supervisory Council Arti Arakas and Richard Tomingas. The loan is unsecured.
- Loan agreement between Arco Ehitus OÜ and Euro Houses Development OÜ, dated 20 October 2003, regarding a loan of EEK 4,000,000 by Arco Ehitus OÜ to Euro Houses Development OÜ for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 4 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 971,870. Euro Houses Development OÜ is a company controlled by the members of the Supervisory Council Arti Arakas and Richard Tomingas. The loan is unsecured.
- Loan agreement between Euro Houses Development OÜ and Arco Maadehalduse OÜ, dated 27 October 2003, regarding a loan of EEK 150,000 by Euro Houses Development OÜ to Arco Maadehalduse OÜ for a term expiring on 31 December 2007. Interest on the outstanding amount of the loan accrues at the rate of 6 per cent per annum. As at 31 March 2007, the outstanding capital amount of this loan was EEK 150,000. Euro Houses Development OÜ is a company controlled by the members of the Supervisory Council Arti Arakas and Richard Tomingas. The loan is unsecured.

In addition, the Company has entered into service agreements under which the Company provides (i) accounting services to OÜ HM Investeeringud, OÜ Toletum, Euro Houses Development OÜ, Arco Kinnisvarahoiduse AS, Euro Shipping OÜ and CGI Project OÜ and (ii) legal services to Euro Houses Development OÜ. OÜ HM Investeeringud is a shareholder of the Company controlled by Hillar-Peeter Luutsalu, the member of the Supervisory Council. OÜ Toletum, Euro Houses Development OÜ, Arco Kinnisvarahoiduse AS and Euro Shipping OÜ are companies controlled by Arti Arakas and Richard Tomingas, the members of the Supervisory Council. CGI Project OÜ is a company controlled by Ivar Siimar, the member of the Management Board. Under the terms of these service agreements, each company pays a flat monthly fee of EEK 33,281, notwithstanding the quantity of services delivered. In 2006, aggregate fees received by the Company pursuant to these agreements amounted to approximately EEK 250,000.

In addition, Group companies have granted loans to certain members of the Supervisory Council and certain legal entities and private individuals related to the members of the Supervisory Council. As at 31 March 2007, the outstanding capital amounts of these loans were as follows:

- Loans granted by the Group companies to Richard Tomingas, a member of the Supervisory Council - EEK 1,480,000;
- Loans granted by the Group companies to Osauhing Toletum, a shareholder of the Company controlled by the members of the Supervisory Council Arti Arakas and Richard Tomingas – EEK 113,000.

- Loans granted by the Group companies to Arnet Arakas, a relative of the member of the Supervisory Council - EEK 1,240,000;
- Loans granted by the Group companies to Hillar-Peeter Luitsalu, a member of the Supervisory Council - EEK 3,537,316.

On 15 May 2007, the Company acquired from other Group companies all rights and obligations relating to the loans listed above and transferred an aggregate amount of EEK 2,833,000 of the remaining loans to Osühing Toletum for a consideration of EEK 3,166,992 and an aggregate amount of EEK 3,537,316 to Osühing HM Investeeringud for a consideration of EEK 4,172,814. The purchase price of these loans equals the aggregate outstanding capital amount of the respective loans and interest accrued on them. Osühing Toletum and Osühing HM Investeeringud are the current shareholders of the Company. The consideration for the loans was set off against the payment of dividend to the shareholders for the financial year ended on 31 December 2006.

The Group has also entered into several agreements regarding intra-group transactions, such as management services agreements (regarding the provision of one or several of the following services, depending on the nature of the activities of the relevant Group company: management of the service group, accounting and financial services, legal services, marketing and communication services and/or asset management services), loan agreements, construction agreements, subcontracting agreements, lease agreements, guarantees.

Management believes all the above agreements were entered into on arm's length terms.

SELECTED FINANCIAL DATA

The following tables set forth selected financial data as at the end of each of the three financial years ended 31 December 2004, 2005 and 2006, and the three-month period ended 31 March 2007. Results for the interim period are not necessarily indicative of results for the full financial year. The financial information for the years ended 31 December 2004, 2005 and 2006 has been derived from the audited consolidated financial statements of Arco Vara and the financial information for the three months ended 31 March 2007 has been derived from the unaudited consolidated condensed financial statements of Arco Vara. The unaudited consolidated condensed interim financial statements for the three-month period ended 31 March 2007 have been prepared in accordance with IAS 34 Interim Financial Statements as adopted by the EU. The audited consolidated financial statements for the financial year ended 31 December 2006 have been prepared in accordance with IFRS as adopted by the EU. The audited consolidated financial statements for the financial year ended 31 December 2005 have been prepared in accordance with IFRS. The selected financial data set forth below should be read in conjunction with “Management’s Discussion and Analysis of the Group’s Financial Condition and Results of Operations” and the financial statements including Notes thereto included elsewhere in this Offering Circular.

The ratios and indicators set forth in the table below are provided to illustrate certain aspects of Group’s business and financial performance. Certain of these ratios and indicators are used by the Company’s management to evaluate the Group’s performance, while others are provided for the benefit of investors considering an investment in the Offer Shares. Although certain of these ratios and indicators are not calculated in accordance with IFRS, the Company believes that the ratios and indicators set forth below are customary and often used by public companies to illustrate their business and financial performance.

Profit or loss account data (EEK thousand)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
		(audited)		(unaudited)
Total revenue	349,941	475,938	483,586	291,181
Cost of sales	-240,701	-358,416	-349,067	-226,397
Gross profit	109,240	117,522	134,519	64,784
Other operating income	79,018	135,286	422,928	49,256
Marketing, general and administrative expenses	-53,113	-86,035	-134,308	-38,955
Other operating expenses	-5,552	-13,251	-162,788	-2,699
Operating profit	129,593	153,532	260,351	72,386
Financial and investment activity income and expenses	-20,856	-32,973	-33,439	-2,998
Profit before income tax	108,737	120,559	226,912	69,388
Income tax expenses	-2,102	-4,116	-9,563	-288
Minority interest	6,580	15,212	9,404	-5,601
Net profit attributable to the owners of the Parent ^{*)}	100,055	101,231	207,945	63,499

^{*)} The term Parent refers to the Company.

Balance sheet data (EEK thousand)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
		(audited)		(unaudited)
Cash and cash equivalents	23,344	143,985	58,345	115,436
Receivables, prepaid expenses and short term financial investments ¹⁾	50,202	98,964	106,927	261,200
Inventories	147,567	153,874	431,817	600,803
Biological assets	5,289	6,020	6,141	6,142
Total current assets	226,402	402,843	603,230	983,581
Long term receivables and investments into financial assets	49,137	19,970	76,442	76,552
Investment property	681,564	851,104	1,479,281	994,037
Property, plant and equipment	36,905	174,401	81,713	78,554
Intangible assets	14,523	13,584	16,705	20,307
Total non-current assets	782,129	1,059,059	1,654,141	1,169,450
Total assets	1,008,531	1,461,902	2,257,371	2,153,031
Borrowings	217,784	316,853	699,568	681,313
Payables	57,604	117,742	249,275	217,538
Prepayments and provisions	19,163	42,003	65,380	38,407
Current liabilities	294,551	476,598	1,014,223	937,258
Long-term borrowings	338,689	392,346	457,258	408,140
Other long-term payables	21,074	11,113	41,561	4,111
Deferred income taxes and long term provisions	1,100	1,100	2,448	2,747
Non-current liabilities	360,863	404,559	501,267	414,998
Total liabilities	655,414	881,157	1,515,490	1,352,256
Share capital	4,200	304,530	304,530	304,530
Share premium	8,841	123,083	123,083	123,083
Legal mandatory reserve	420	420	5,486	5,486
Other reserves	5,702	474	-184	-188
Retained earnings	262,120	100,811	292,002	344,999
Total equity attributable to the owners of the Parent²⁾	281,283	529,318	724,917	777,910
Minority interest	71,834	51,427	16,964	22,865
Total equity	353,117	580,745	741,881	800,775
Total liabilities and equity	1,008,531	1,461,902	2,257,371	2,153,031

¹⁾ Short term financial investments only relate to 31 December 2004.

²⁾ The term Parent refers to the Company.

Cash flow data (EEK thousand)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
		(audited)		(unaudited)
Cash flow from operating activities	90,945	55,750	-117,460	31,499
Cash flow from investing activities	-104,512	-299,332	-341,918	89,131
Cash flow from financing activities	18,561	364,520	374,876	-63,483

Ratios and indicators	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
	(derived from audited information)			(unaudited)
Number of shares, end of the year	8,400	30,453,037	30,453,037	30,453,037
Earnings per share (EPS), EEK ¹⁾	3.67	3.68	6.83	0.94 ^{*)}
Operating profit margin, % ²⁾	37.0	32.3	53.8	24.9
Net profit margin, % ³⁾	28.6	21.3	43.0	21.8
Return on assets (ROA), % ⁴⁾	11.0	8.2	11.2	2.9
Return on equity (ROE), % ⁵⁾	43.2	24.9	33.2	8.5
Equity ratio, % ⁶⁾	35.0	39.7	32.9	37.2

^{*)} Earnings per share of EEK 0.94 is derived by using the number of shares after bonus issue carried out on 4 May 2007, with a resulting total number of shares being 67,784,150.

CALCULATION OF FINANCIAL RATIOS

- 1) Earnings per Share (EPS) Earnings per Share has been calculated in accordance with IAS 33, pursuant to which the net profit attributable to the shareholders of the Company is divided by weighted average number of common shares outstanding during the period. Effect of the bonus issues and share splits is adjusted also for earlier periods, while the effect of a new share issues is adjusted only for the period when it takes place.
- 2) Operating profit margin Operating profit / Total revenue. Operating profit margin measures the relationship between different measures of profitability and revenue providing information about a company's profitability from the operations of its business and is independent of both the company's financing and tax position.
- 3) Net profit margin Net profit attributable to the owners of the Parent / Total revenue. Net profit margin measures the relationship between different measures of profitability and revenue providing information about a company's profitability.
- 4) Return on assets (ROA) Net profit attributable to the owners of the Parent / Average total assets. Return on assets compares income with total assets measuring management's ability and efficiency in using the firm's assets to generate profits
- 5) Return on equity (ROE) Net profit attributable to the owners of the Parent / Average Equity without minority interest. Return on equity compares income with the equity capital measuring management's ability and efficiency in generating return to the shareholders of the company.
- 6) Equity ratio Total equity / Total assets. Equity ratio is a measure of financial leverage providing analysis of a company's capital structure.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE GROUP'S FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the IFRS Financial Statements, including the notes thereto (see the Company's audited consolidated financial statements prepared as at and for the years ended 31 December 2005 and 2006 beginning on page F-16 and the unaudited information for the interim period ended 31 March 2007 beginning on page F-2). The financial information for the three-month period ended 31 March 2007 was prepared in accordance with IAS 34 Interim Financial Statements as adopted by the EU. The financial information for the year ended 31 December 2006 was prepared in accordance with IFRS as adopted by the EU and the financial information for the years ended 31 December 2004 and 2005 was prepared in accordance with IFRS.

The discussion below is based on an analysis of revenues of the business segments of the Group which is more detailed than the revenue segmentation used in the Group's financial statements. This detailed revenue segmentation is based on a revenue analysis prepared by Management for business development purposes. The detailed revenue segmentation and the financial statements are derived from the same accounting information.

OVERVIEW

Set forth below is a discussion of the primary sources of revenue and operational expenses of the Group for the financial years ended 31 December 2004, 2005, 2006 and for the three-month period ended 31 March 2006 and 2007 respectively. In accordance with IFRS, the Group consolidates its subsidiaries line by line and Joint Ventures by using proportionate consolidation and includes the revenues, costs and financial information of each such affiliate in proportion to the Group's holding in such an affiliate. Accordingly, references to the financial information of the Group in this section include a proportion of financial information on the affiliates. For the ownership structure of the Group and its subsidiaries and joint ventures, see "Business – Organisational Structure".

BASIS OF PRESENTATION

For the purposes of this section, the Group is defined as a consolidated group as defined by IFRS. Please refer to the condensed consolidated unaudited interim financial information and the consolidated audited financial statements of the Group on beginning on page F-2 and F-16, respectively, for further clarification.

The Group operates primarily in three divisions. The analysis of those divisions is provided in the notes to the consolidated annual report for the period of 2004-2006 and in the condensed interim financial information for the three months ended 31 March 2007.

The information provided in the above mentioned reports may differ somewhat from the categorization of the business areas as described in this Offering Circular. In the audited annual and the unaudited interim financial reports the Group presents business segmentation information based on business activity of the Group and thus does not give any recognition of different revenue types across the legal entities.

For the purposes of this discussion, Management has recognised and compiled information on different revenue types across the three divisions provided in audited annual reports and unaudited condensed interim financial report. This information is supplementary to the information provided in above mentioned financial statements and is unaudited in nature.

The discussion in the current section should be read in conjunction with audited and unaudited financial reports. The Group structure has been changing throughout the reporting period and thus special attention should be paid to mergers and acquisitions, establishments of new entities, changes in

ownership structures and disposals of ownerships in subsidiary and joint-venture companies which have an effect on consolidated results of the Group.

RECENT DEVELOPMENTS AND OUTLOOK

Manastirski Project, Bulgaria

On 27 April 2007, the Group acquired rights to a development project in the prestigious Manastirski Livadi district in Sofia, Bulgaria, pursuant to an agreement between the Company's Bulgarian subsidiary Arco Capital Ltd and MIKS PS OOD. Under the terms of this agreement, Arco Capital EOOD will acquire a land unit of 0.889 ha designated for residential and commercial development for the total consideration of EUR 7.95 million. The Group has already made a down payment on EUR 1 million and the remaining part of the purchase price is to be paid upon closing. The closing will take place no later than 20 July 2007. The seller's obligations between signing and closing are secured by a bank guarantee in the amount of EUR 1 million issued by United Bulgarian Bank.

The property in Manastirski has a planning permission and building permit for a 7-storey combined commercial and residential building with a useable floor area of 26 239 square meters.

According to Management, 3 024 square meters of the building is intended for commercial use, and the rest will comprise in total 222 apartments with an average size of 105 square meters, plus indoor parking for 210 cars. The construction is expected to commence in August 2007 and be completed in 24 months. The sales period of the project will start in December 2007.

Sale of shares in SIA Bišumuižas Nami and SIA Sportings Riga

Arco Investeeringud and Mr. Viktors Savins entered into a conditional Share Purchase Agreement on 18 May 2007 with SIA Linstow Baltic regarding the sale of 50 per cent of the shares of SIA Bišumuižas Nami. The nominal consideration for the shares is LVL 1,000, but together with related agreements, the transaction, if completed, is expected to provide approximately EUR 7.5 million income for the Group from financial and investment activity. The closing of the transaction is subject a number conditions such as a filing to the Latvian competition authorities, satisfactory due diligence review by the purchaser and certain further agreements being negotiated and entered into in a form acceptable to the purchaser. If these conditions are not met by 30 June 2007, any party may withdraw from the agreement without any liability. Further, the transaction is conditional on the payment of consideration of EUR 19,220,000 for the purchase by SIA Bišumuižas Nami of 100 per cent of the shares of SIA Sportings Riga by 30 November 2007. The sellers are entitled to buy back the shares of SIA Bišumuižas Nami for the same price (LVL 1,000) in the event that SIA Bišumuižas Nami fails to pay in full the purchase price for the shares of SIA Sportings Riga within four months after the closing.

Following the closing, Arco Investeeringud will own 40 per cent of the shares in SIA Bišumuižas Nami, with Mr. Viktors Savins owning 10 per cent and SIA Linstow Baltic owning 50 per cent.

SIA Linstow Baltic has agreed to issue a loan to SIA Bišumuižas Nami following the closing in the amount of EUR 6,000,000 for the purposes of financing a part of the purchase price for the shares of SIA Sportings Riga. Further, Arco Investeeringud, Viktors Savins and SIA Linstow Baltic have agreed to increase the share capital of SIA Bišumuižas Nami by LVL 698,000 by subscribing for new shares in proportion to their existing shareholdings.

Arco Investeeringud has agreed to issue a shareholder loan to SIA Bišumuižas Nami in the amount of EUR 4,000,000 to finance the project development as soon as SIA Bišumuižas Nami has secured bank lending for EUR 14,000,000 and paid in full the purchase price for the shares in SIA Sportings Riga. Half of the shareholder loan will be used to repay part of the loan from SIA Linstow Baltic to SIA Bišumuižas Nami.

The entire transaction with SIA Linstow Baltic is dependent on SIA Sportings Riga fully complying with certain commitments in its Land Purchase Agreement No. RD-06-128-li dated 15 May 2006 with the municipality of Riga City. Under this agreement, Sportings Riga acquired a property of 94,974 square meters at Zalu iela 8 in Riga. This property accounts for approximately 85 per cent of the land proposed to be used for the Bišumuiža 2 project (see “Business - Operations – Development division – Description of development projects – Residential development projects - Bišumuiža 2 2 residential area (BM-2) in Riga, Latvia”). Under the terms of the agreement, SIA Sportings Riga was required, among other things, to separate and to hand over a parcel of land back to the City of Riga no later than 15 November 2006. As at the date of this Offering Circular, SIA Sportings Riga has not fulfilled this condition. Under the terms of the agreement, the City of Riga is entitled to contractual penalty at the rate of 0.1 per cent of the purchase price for each day SIA Sportings Riga is in default, and if the aggregate amount of such contractual penalty reaches 100 per cent of the purchase price, the City of Riga is entitled to rescind the land purchase agreement and re-assume title to the property without further compensation.

Under the terms of the transaction with SIA Listow Baltic, SIA Linstow Baltic may, at its discretion, decide not to proceed with the transaction if, inter alia, SIA Sportings Riga fails to comply with the terms of its agreement with the City of Riga by 30 September 2007. If SIA Linstow Baltic chooses to close the the transaction before 30 June 2007 notwithstanding that SIA Sportings Riga has not complied with the terms of its agreement with the City of Riga, and the default has not been cured by 30 September 2007, SIA Listow Baltic is entitled to withdraw from its financing obligations, in which case the Group may repurchase the shares in SIA Bišumuižas Nami.

Shareholders Agreement in relation to SIA Bišumuižas Nami

Arco Investeeringud, Mr. Viktors Savins, SIA Linstow Baltic and SIA Bišumuižas Nami in relation to SIA entered into a Shareholders Agreement relating to SIA Bišumuižas Nami on 18 May 2007. The agreement is governed by Latvian law.

Under this agreement, the management board of SIA Bišumuižas Nami consists of two members, one to be appointed by Arco Investeeringud and one by SIA Linstow Baltic. All decisions of the management board require the consent of both members.

All decisions at meetings of shareholders require the consent of both Arco Investeeringud and SIA Linstow Baltic, except for the approval of the annual accounts (apart from declaring dividends) and the election of auditors.

In the event of deadlock or material breach of contract within 24 months after the date of the agreement, each of Arco Investeeringud and SIA Linstow Baltic may offer to sell all of its shares to the other shareholder, who can either accept the offer or sell its shares to the offering shareholder on the same terms and conditions. All shareholders have tag-along rights during the development phase of the project, and encumbering shares is subject to strict limitations.

In event of a material breach of contract, the defaulting party must pay a penalty of EUR 1,000,000 per breach, except for transfers of shares in breach of the agreement, which are subject to penalties ranging from EUR 3,000,000 – EUR 5,000,000.

Whilst this agreement is technically in force, it will become operative in practice only upon the closing of the share sale, currently expected to take place before 30 June 2007.

Plavnieku centrs residential project in Riga, Latvia

Supervisory Council of Arco Investeeringud decided on 29 March 2007 to authorise the Group's participation in a residential development project in a joint venture with SIA Rigas Pilsetbuvnieks,

a company owned by City of Riga. A decision of SIA Rīgas Pilsetbūvnieks giving a formal go-ahead to the project is expected shortly.

The project involves developing a residential property at Saharova Street in the City of Riga (cadastral number 01001211096). The project is expected to involve constructing 193 apartments with a total gross construction volume of approximately 15,600 square metres.

The technical planning of the project has been completed, and the Group expects to obtain permission to start the construction before the end of 2007. The acquisition cost of the project for the Group is approximately EUR 1.6 million, while total construction costs for the project are estimated at EUR 16.7 million. The approximate development period for the project is estimated at 3-4 years.

Sale of two properties by the Group's joint venture OÜ Pärnu Elumaja

OÜ Pärnu Elumaja, a joint venture of the Group with OÜ Saarte Investeering, sold two properties located in Pärnu, Estonia to *Neli Investorit Osaiühing* on 18 April 2007.

The property located at Lai 5, Pärnu, previously classified in the Group's accounts under inventories, was sold for a consideration EEK 22.6 million. The property located at Aida 8, Pärnu, previously classified in the Group's accounts under property investments, was sold for a consideration of EEK 24 million.

Other developments

On 29 May 2007, Mr. Gerdas Jankeliunas resigned from his position as the Head of Development Division in Lithuania upon the agreement with the Group. In connection with his resignation, the Group and Mr. Jankeliunas agreed that Mr. Jankeliunas will sell his 20 per cent interest in Arco Real Estate UAB to Arco Real Estate AS for EUR 125,000.

Outlook

Management believes that the Estonian and Latvian real estate markets have entered a phase of stabilization, following rapid price increases in 2004-06. In 2007, residential real estate market in Estonia is characterised by lengthening sale periods and more supply, which is also evident from the lower number of transactions in the first quarter of 2007 compared to the first quarter of the previous year. The total value of real estate transactions in the first quarter of 2007 was nevertheless slightly higher than in the same period a year before, which indicates a continuing upward trend in real estate prices. The residential demand in Riga is yet to exhibit similar characteristics, but Management expects trends in Estonia to be replicated in Latvia. Management expects that this market sentiment will reduce the banks' willingness to lend money to smaller real estate development companies both in Estonia and Latvia, which in consequence, may lead into a consolidation in the sector. Management believes that such a sector consolidation would be beneficial to the Group because, in Management's opinion, it is in position to take advantage of attractive opportunities for acquiring land that may become available in connection with such consolidation.

Management also expects that customers in Estonia and Latvia will increasingly value the high-quality residential living environments in central locations, in which the Group has particular experience and which the Group plans to continue developing also in the future.

While commercial real estate market in Estonia and Latvia has seen compression of yields towards the Western European levels, Management believes that recent transactions indicate a continuing appetite of the real estate investors to include Baltic properties in their portfolios. Most recently, Baltic Property Trust acquired a commercial property with approximately 35,000 m² leasable space in Tallinn and SEB Group sold a portfolio of 63 properties in the Baltics to Homburg Invest Inc. Furthermore, KanAm Grundinvest Fonds acquired a 40,000 m² retail centre in Riga for a reported

consideration of EEK 2.4 billion. Management expects the Group's commercial development projects to further benefit from the current low vacancy levels for office space in Tallinn and Riga.

Management expects the new markets under consideration, primarily Bulgaria and Romania, to undergo similar macroeconomic development that has been characteristic for new EU-members. The main trends include rapid economic development, substantial income growth and increase in demand for new housing encouraged by an increased availability of mortgage lending. Management expects these trends to benefit the Group's new residential and development projects in Bulgaria and Romania.

The Group is actively identifying new projects and business opportunities in all of its core markets, and in particular opportunities for quality residential development in Bucharest, Vilnius, Kiev, Sofia and Riga. The Group constantly evaluates possible targets for land acquisition in these and other markets as well as possible targets for acquiring interests in already existing projects that have not yet reached the construction stage. In addition, the Group is also considering targets for acquisition in order to expand certain of its critical businesses, in particular in the construction sector. Existence of such targets is dependent largely on the development of the property market and thus there is no assurance as to the success of any potential acquisitions.

FACTORS AFFECTING RESULTS OF OPERATIONS

The following is a discussion of the principal factors affecting the Group's results of operations and financial condition. These factors are, in turn, influenced by general economic conditions in the real estate markets in which the Group operates.

General Conditions Affecting Real Estate Related Items

In general, demand for real estate tends to increase when economic indicators improve, which can in turn increase the valuation of the Group's existing real estate portfolio. Conversely, an economic downturn can decrease the valuation of the Group's existing real estate portfolio, which can result in an impairment charge that can have a negative effect on the Group's income. Gross domestic product of countries in which the Group has operations, inflation and interest rates, levels of foreign investment and population growth in the cities in which the Group and the Joint Ventures hold property and development of disposable incomes of potential customers are among the key economic indicators that affect the demand for real estate.

These factors affect local market trends in the rental market, which can—in addition to the location and condition of the rental property—have a strong influence on vacancy levels and the Group's ability to effect rental increases and, therefore, on the Group's rental income. Real estate values and vacancy rates are also affected by the levels of growth in real estate stock in the respective sectors (commercial, residential and office), which, relative to the levels of demand and take-up, can increase or decrease the valuation of the property and rental rates of the Group and Joint Ventures. For a further discussion of these factors in the markets in which the Group operates, see "Industry Overview". For a discussion of the risks related to these factors, see "Risk Factors".

Ability to Invest and Execute Projects

The success of the Group depend on it being able to acquire land or properties for development at competitive prices, develop them efficiently and sell or lease out the developments in timely fashion and with a good profit margin. Thus the Group depends on the state of the property market in the countries in which the Group and the Joint Ventures choose to invest. The negative developments in respective markets can result in prolonged sale periods of properties and negative developments in property prices can have an adverse effect on profit margins and negative effect on the Group's liquidity.

The Group's future development depends on its ability to identify and execute new development projects. Land for such projects can be difficult to obtain for reasons such as competition in the real estate market, the lengthy process of obtaining permits and the limited availability of land with appropriate infrastructure. Furthermore, there is no certainty that the land for the projects currently under negotiations will be finally purchased.

Revaluation Gains

A significant portion of the Group's net operating profit is derived from the periodic revaluation of its investment properties, which may result in significant fluctuations in the Group's results of operations from period to period.

The Group properties purchased with intention to earn income from rent or capital appreciation or held for long-term perspective with several possible intentions are classified as "investment property". At each reporting date, investment properties are measured at their fair value. Management of the Group decided to rely mostly on external certified appraisers when determining the fair values of investment properties as at year ended 2006.

Possible gains and losses from change in value or from derecognition of investment properties are charged to "Other operating expenses" or "Other operating income" in income statements.

Property Sales

The timing of the sale of a particular property will depend on a number of factors, such as the development schedule of the project and the prevailing market conditions. Property sales may not occur on a regular or predictable basis and, as a result, the Group's results of operations may not necessarily reflect a consistent trend.

Rental Income

Approximately 8 per cent of the total consolidated revenue of the Group in 2006 was derived from rental income from investment properties. The amount of contracted gross rent per square metre is an important indicator in Management's analysis of the Group's performance and for predicting trends, as is the average remaining length of the current rental agreements.

The development schedule and occupancy rates of its commercial properties are also important factors in assessing the Group's performance, as the additional recurring revenues recognised upon the completion and occupancy of a project can have a significant impact on the Group's results of operations.

Construction Market Conditions

The revenues derived from construction activities makes up significant part of total revenues of the Group. The Group's construction activities as at the end of 2006 were concentrated in the Estonian market, which has grown considerably in recent years. The overall strength of the construction market determines the level of construction activity in the market and the number of tenders carried out. This in turn has a direct effect on the Group's revenues. As a result, market conditions cause inherent instability in the Group's revenues, which fluctuate with the overall construction.

Exchange Rates

Items included in the financial statements of each of the Group companies are measured using the currency of the primary economic market in which such entity operates (the "functional currency"). All currencies, except Estonian kroon are considered to be foreign currencies.

Fluctuations in foreign exchange rates can have a significant impact on the valuation gain accounted for in the income statement year by year. When the functional currency of subsidiaries and joint ventures differs from the Company's functional currency (e.g. functional currency of Latvian subsidiaries is Latvian lats), the Group uses: a) the exchange rate prevailing at the balance sheet date to translate values of all assets and liabilities of foreign subsidiaries and joint ventures and b) the weighted average exchange rate for the period to restate the income, expenses and changes in equity of the subsidiaries and joint ventures. The exchange difference arising on the foreign currency translation, i.e. between balance sheet date and weighted average rates, are presented in the balance sheet row "other reserves".

In order to hedge the currency risk of the Group companies, the majority of transactions and contracts are in euros or currencies pegged to the euro. Thus the main currency risk for the Group derives from the risk that with adoption of the euro the exchange rates between local currencies and the euro will change significantly.

Furthermore, the Group has a natural hedge to reduce its exposure to currency fluctuations since the Group tries to keep its revenues and borrowings either in Euro or in currencies pegged to euro.

Interest Rates

Fluctuations in interest rates can increase the Group's financing costs and thus have a negative impact on consolidated net profit. Furthermore, business environments with high interest rates tend to decrease demand for real estate properties, which in turn adversely affects the fair value of properties and, as a result, the Group's revaluation gains.

As most of the Group's borrowings are tied to EURIBOR, the Group is exposed to events in international financial markets. The Group regularly compares potential losses arising from interest rate changes against risk hedging expenses. In a majority of instances, no transactions have been concluded with financial instruments for interest rate hedging purposes, since the hedging expenses have exceeded the potential losses arising from interest rate fluctuations. The Group has concluded an interest rate swap agreement with maturity on 1 December 2008. The fair value of the hedging transaction as of 31 December 2006 was EEK 1.6 million.

RESULTS OF OPERATIONS

Annual and interim consolidated financial information

The following table sets forth certain income and expense items as a percentage of total revenues for the periods indicated:

Profit or loss account data (EEK, '000)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
Total revenue from external customers	349,941	475,938	483,586	291,181
Development	236,830	235,899	199,655	244,429
Construction	46,820	175,535	176,667	18,254
Services	66,291	64,504	107,264	28,498
Cost of sales	-68.8%	-75.3%	-72.2%	-77.8%
Gross profit	31.2%	24.7%	27.8%	22.2%
Marketing expenses	-2.7%	-2.6%	-3.8%	-2.6%
General and administrative expenses	-12.5%	-15.5%	-23.9%	-10.8%
Other operating income	22.6%	28.4%	87.5%	16.9%
Other operating expenses	-1.6%	-2.8%	-33.7%	-0.9%
Operating profit	37.0%	32.3%	53.8%	24.9%
Financial items and investment activity income and expenses	-6.0%	-6.9%	-6.9%	-1.0%
Profit before income tax	31.1%	25.3%	46.9%	23.8%
Income tax expense	-0.6%	-0.9%	-2.0%	-0.1%
Net profit	30.5%	24.5%	44.9%	23.7%
Attributable to:				
Equity holders of the Group	28.6%	21.3%	43.0%	21.8%
Minority interest	1.9%	3.2%	1.9%	1.9%

Division analysis

Revenue to external customers by divisions (EEK '000)	Year ended 31 December			Three months ended 31 March
	2004	2005	2006	2007
Revenue segmentation by business activity				
Construction	46,820	175,535	176,667	18,254
Construction services	46,820	175,111	172,234	18,020
Rental and property management services	0,000	293	768	76
Sale of properties	0,000	0,000	3,420	0,000
Other revenues	0,000	131	245	158
Services	66,291	64,504	107,264	28,498
Brokerage and appraisal services	37,555	47,780	81,107	20,380
Sale of properties	22,225	600	4,965	2,050
Geodesy services	1,203	1,003	0,000	0,000
Property management services	3,596	3,821	6,417	1,842
Asset management services	0,000	9,448	11,487	3,058
Management services	958	611	1,622	0,000
Other revenues	754	1,241	1,666	1,168
Development	236,830	235,899	199,655	244,429
Sale of properties	173,433	174,899	150,545	235,293
Rental and property management services	56,344	51,592	37,871	8,430
Management services	1,171	8,150	9,571	618
Other revenues	5,882	1,258	1,668	88
Total consolidated revenues	349,941	475,938	483,586	291,181

Revenue segmentation by type of revenue

Revenue from rendering services	154,283	300,439	324,656	53,838
Revenue from sale of goods	195,658	175,499	158,930	237,343
Total consolidated revenues	349,941	475,938	483,586	291,181
Revenue from sale of goods	195,658	175,499	158,930	237,343
Construction services	46,820	175,111	172,234	18,0
Brokerage and appraisal services	37,555	47,780	81,107	20,4
Rental and property management services	59,940	55,706	45,056	10,3
Asset management services	0,000	9,448	11,487	3,1
Management services	2,129	8,761	11,193	618
Geodesy services	1,203	1,003	0,000	0,0
Other revenues	6,636	2,630	3,579	1,414
Total consolidated revenues	349,941	475,938	483,586	291,181

THREE MONTHS ENDED 31 MARCH 2007 COMPARED TO THREE MONTHS ENDED 31 MARCH 2006

The Group did not perform a revaluation of its investment property as of 31 March, 2006. Due to uncertainties in the valuation of the investment property as of 31 March, 2006 and possible gains or losses associated with it, the figures for this period are not fully comparable to those for the three-month period ended 31 March 2007. As the revaluation gains do not affect revenues, this section is restricted to analysing revenues of each division, excluding expense items. The unaudited condensed consolidated interim report for the three-month period ended 31 March 2007 (including comparatives for the three-month period ended 31 March 2006) is provided on F-pages of this Offering Circular.

Revenue

The consolidated revenue for the Group for the first three months of 2007 amounted to EEK 291.2 million, which is EEK 190.5 million or 2.9 times more than then corresponding amount for the same period in the previous year.

Division analysis

Revenues of the development division increased in three months ended 31 March 2007 more than six times compared to the same period in the previous year. This increase of EEK 206.3 million contributed most of the total revenue growth of the Group. Revenues of the services division to external customers increased by EEK 6.1 million or 27.2 per cent compared to first three months of the previous year whilst revenues of the construction division to external customers decreased by EEK 21.9 million. The growth in the development division changed the revenue structure of the Group considerably. For the three-month period ended 31 March 2007, the development division accounted for 83.9 per cent of the Group's total consolidated revenues, whilst the services division accounted for 9.8 per cent and the construction division for 6.3 per cent.

Total consolidated revenue of the construction division for the first three months of 2007 amounted to EEK 18.3 million, compared to EEK 40.2 million for the same period in 2006. Construction services contributed most of revenues (EEK 18.0 million or 98.7 per cent). The decrease in the overall revenue was caused mainly by a shift from third-party services to providing construction services to the other divisions of the Group. Revenues and other operating income from intra-group transactions increased from EEK 12.2 million in the first quarter of 2006 to EEK 39.0 million in the first quarter of 2007. Rental revenues and revenues from property management and other revenues contributed EEK 0.2 million to the total revenues of the construction division.

Revenues of the services division increased by 27.2 per cent or EEK 6.1 million in the three months ended 31 March 2007 compared to the same period in the previous year. The total consolidated

revenue of the division for the first quarter of 2007 was EEK 28.5 million. Most of the growth in the division's revenues (EEK 3.7 million) was derived from the organic growth in the existing offices providing brokerage and appraisal services. The Group opened one new office in Riga in the first of quarter of 2007. Revenues from property management services and revenues associated to selling properties increased in aggregate by EEK 1.7 million in the first quarter of 2007 when compared to the same period in the previous year. Revenues from property management services increased by 28.1 per cent and revenues associated to selling properties multiplied by more than 2.5 times.

The Group's revenues from property development totalled EEK 244.4 million in the first three months of 2007. Selling properties accounted for approximately 96.3 per cent and rental and property management services 3.4 per cent of the development revenues. In absolute terms, the revenues from the sale of developed properties across all divisions amounted to EEK 237.3 million or 81.5 per cent, including, among others, the sale of the Kolde and Kase projects in Tallinn and the sale of Ulmana Gatves in Riga.

When analysed by revenue type, the Group's revenues for the first quarters of 2006 and 2007 show a significant shift towards revenues from sale of goods, primarily revenue from the sale of properties. While in the first three months of 2006, approximately 75.3 per cent of the Group revenue originated from rendering services, a year later the revenue structure was essentially reverse, with revenues from sale of goods contributing 81.5 per cent or EEK 237.3 million of the total consolidated revenues of the Group.

The sale of properties, construction services, brokerage services, appraisal services and rental and property management services in aggregate accounted for approximately 97.6 per cent of the total consolidated revenues of the Group in the first quarter of 2007, and 81.5 per cent of this originated from sale of properties. Brokerage and appraisal services and construction services contributed EEK 20.4 million and EEK 18.0 million, respectively. Revenues from rental and property management services and asset management remained relatively stable in the first quarter of 2007 compared to 2006, contributing EEK 10.3 million and EEK 3.1 million, respectively.

YEAR ENDED 31 DECEMBER 2006 COMPARED TO YEAR ENDED 31 DECEMBER 2005

Revenue

The consolidated revenue for the Group remained relatively stable in 2006 as compared to the previous financial year, posting an increase of 1.6 per cent. Total revenue in 2006 reached EEK 483.6 million.

Division analysis

The revenue structure of the Group changed considerably in 2006 as compared to 2005. The biggest changes were in services and the real estate development division. Revenue from the service division increased by EEK 42.8 million or 66.3 per cent as compared to the same period in 2005, reaching EEK 107.3 million. Real estate development accounted for EEK 199.7 million of total consolidated sales in 2006, a decline of EEK 36.2 million resulting mostly from decline in the sale of properties. As a percentage of total consolidated revenue, the construction division accounted for 36.5 per cent, the services and real estate development divisions accounted for 22.2 per cent and 41.3 per cent respectively in 2006.

Total consolidated revenue from the construction division increased from EEK 175.5 million in 2005 to EEK 176.7 million in 2006. Approximately EEK 172.2 million or 97.5 per cent of the division revenue resulted from construction services. In 2006, the construction services revenues remained relatively stable, with a decline of approximately 1.6 per cent as compared to the year 2005. The construction division accounted for EEK 3.4 million non-recurring revenue from sale of properties in

2006, offsetting the minor decline in construction services. Furthermore, rental and property management services and revenues from other services contributed to the division revenue.

The services division experienced the most rapid growth in 2006 as compared to the other divisions. Total consolidated revenue from the division increased by 66.3 per cent, from EEK 64.5 million in 2005 to EEK 107.3 million in 2006. Most of the growth was derived from brokerage and appraisal services from the Estonian, Latvian and Ukrainian markets, accounting for approximately 78 per cent of the division revenue growth in absolute terms. Revenues from sale of properties multiplied by more than seven times in 2006, from EEK 0.6 million in 2005 to EEK 5.0 million as compared to the previous period, contributing EEK 4.4 million to the division revenue growth. Property management services and management services were important lines of revenues in the services division, contributing approximately 6 and 10 per cent of the division revenues respectively.

Approximately EEK 199.7 million of revenues were derived from real estate development in 2006. As compared to the prior year, revenue declined from EEK 235.9 million or by approximately 15.4 per cent. Sale of properties made up approximately 63.6 per cent and rental and property management services 16.0 per cent of the division revenues in 2006. Both of the latter mentioned revenue items experienced negative developments in 2006. Sale of properties decreased from EEK 174.9 million in 2005 to EEK 150.5 million in 2006 due to the timing of sales of the Kodukolde residential development. Revenues from rental and property management services decreased by EEK 13.7 million or 26.6 per cent, mainly due to sale of AS Tallinna Olümpiapurjespordikeskus in the fourth quarter of 2005. Management services made up EEK 9.6 million from the division revenues in 2006 with an increase of 17.4 per cent as compared to the previous year. Approximately EEK 1.7 million or 0.7 per cent of the division revenue was derived from other revenues, resulting mostly from sale of cutting rights of growing forest.

An alternative analysis of revenues, by revenue type, shows a slight shift towards revenues from rendering services. In 2005, approximately 63.1 per cent of revenue originated from rendering services. The weight of the latter revenue reached 67.1 per cent in 2006, increasing by EEK 24.2 million in absolute terms to total EEK 324.7 million. Revenues from sale of goods decreased by 9.4 per cent, from EEK 175.5 million in 2005 to EEK 158.9 million in 2006.

The sale of properties, construction services, brokerage services, appraisal services and rental and property management services constituted approximately 95-97 per cent of total consolidated revenues of the Group over the last three full financial years and are thus the most important items affecting results of the Group's operations. Approximately 3-5 per cent of the revenues for the last three financial years were derived mostly from asset management and management services rendered and from other revenues.

Construction services was the most important line of revenue in 2006, accounting for EEK 172.2 million or 35.6 per cent of consolidated sales of the Group in 2006. Please refer to the analyses of construction divisions above in the sections above as the construction services revenue is derived solely from construction.

Sale of goods accounts for 32.9 per cent or EEK 158.9 million of the total consolidated revenue of the Group in 2006. The vast majority of the revenues originate from the real estate development division. The construction division reported a one-time sale of property in an amount of EEK 3.4 million for the Kase residential project. The services division accounted for EEK 5.0 million worth of revenues from the sale of properties held for short term capital appreciation purposes.

Around EEK 81.1 million worth of revenues of the total revenues of the Group was generated by brokerage and appraisal services in 2006. In absolute terms, the revenue from brokerage and appraisal services increased by EEK 33.3 million, or approximately 69.8 per cent as compared to the previous period. Please see sections above for further analysis.

Total revenue from rental and property management services in 2006 was EEK 45.1 million, a decrease of EEK 10.7 million as compared to 2005. The main factor attributing to the decrease in revenue was the sale of AS Tallinna Olümpiapurjespordikeskus in the fourth quarter of 2005.

Asset management services and management services related revenues in 2006 totalled EEK 11.5 million and EEK 11.2 million, respectively. Both revenue lines increased over 20.0 per cent when compared to 2005. The revenue increase was directly connected to amount of assets under management.

Other revenues accounted for EEK 3.6 million or 0.7 per cent from total consolidated revenues. The Group records the sale of cutting rights to growing forests, common utility services and consultation services under other revenues.

Cost of sales

Cost of sales for the financial year ended 31 December 2006 totalled EEK 349.1 million making up 72.2 per cent of total consolidated sales or approximately 3.1 per cent less than in the same period in the previous year. Thus the Group improved its gross margin by 14.5 per cent, from 24.7 per cent in 2005 to 27.8 per cent in 2006. In absolute terms the Group earned EEK 134.5 million in gross profits in 2006, approximately 17.0 million more than in the previous year.

The biggest cost items for the Group were: the carrying value of real estate sold, construction services purchased and personnel expenses which made up an aggregate of 89.7 per cent of the cost of sales account. Carrying value of real estate sold as a per cent of revenue made up 20.4 per cent or EEK 98.8 million of cost of sales in 2006, an approximately 10.3 per cent decrease as compared to previous year. Construction services purchased amounted to 30.7 per cent of total revenue in 2006 totalling EEK 148.5 million, a decrease of approximately 16.6 per cent in absolute terms when compared to 2005. As construction services purchased made up 37.4 per cent of total revenue in 2005 the Group realised an approximately 6.7 per cent improvement in gross margin. Personnel expenses, the third largest expense account under cost of sales, increased considerably in 2006 both in absolute terms and as a percentage of revenue. Salary expense increased 5.6 per cent as a percentage of revenues as compared to the prior year, reaching EEK 65.9 million in 2006. The increase resulted from an increase in average salaries in the Group as well as an increase in the total number of personnel. As at the end of 2006 the Group employed a total of 478 employees, up from 284 as at the end of 2005. The Group initiated operations in Romania and Bulgaria and considerably increased the number of existing personnel throughout its established operations.

Operating expenses

During the last financial years ended 31 December 2004, 2005 and 2006, combined gains from change in the fair value and derecognition of investment property recorded under other operating income account have exceeded marketing, general and administrative and other operating expenses for the corresponding periods. Thus, the operating profit for the Group for the last three years has exceeded gross profits.

Marketing expenses grew from EEK 12.3 million in 2005 to EEK 18.6 million in 2006. Most of the increase is attributable to brokerage fees which increased by EEK 4.4 million. Other marketing expenses and advertising expenses increased by EEK 1.2 million and EEK 0.9 million respectively. In general terms the cost structure of marketing expenses remained unchanged. Total marketing expenses as a percentage of total revenue increased from 2.6 per cent in 2005 to 3.8 per cent in 2006. As stated above, the major contributing factor to such increases was brokerage fees expenses, which increased 0.9 per cent as a percentage of total revenue in 2006.

General and administrative expenses increased as a percentage of total revenue by 8.7 per cent or EEK 41.9 million reaching EEK 115.7 million in the 2006 financial year. The largest expense account

in 2006 was personnel expenses. The expense account increased by EEK 20.6 million in 2006 increasing the expenses as a percentage of total revenue by 4.1 per cent. Most of the increase is attributable to an increase in personnel. Legal and consulting services increased from EEK 17.4 million in 2005 to EEK 36.7 million in 2006 mostly due to real estate related advisory services rendered to the Group. Office expenses for 2006 totalled EEK 18.1 million in 2006, approximately EEK 10.0 million higher as compared to the previous period. Increase in expense items is attributable mainly to the opening of new offices in Romania and Bulgaria. Depreciation, amortisation and impairments expense decreased by EEK 8.8 million in 2006 as compared to 2005, principally as a result of the recognition of negative goodwill as income in an amount of EEK 14.7 million and accounting for impairment loss on goodwill of EEK 12.6 million. Allowance expenses for doubtful receivables decreased in 2006 as a percentage of revenue by 0.6 per cent as compared to 2005, totalling EEK 2.1 million. Other expenses increased by EEK 3.3 million in 2006 totalling EEK 12.4 million.

The Group recorded operating profits of EEK 260.4 million in 2006, an increase of approximately 69.6 per cent as compared to the 2005 financial year. Due to considerable gain on fair value of investment property and despite certain exceptional fines and penalties and a write-down loss of property, plant and equipment, the Group increased its operating profit margin from 32.2 per cent in 2005 to 53.8 per cent in 2006.

Other operating income and expenses

Other operating income grew from EEK 135.3 million in 2005 to EEK 422.9 million in 2006. Most of the other operating income balance is derived from a gain on the change in the fair value of investment property, accounting for EEK 389.0 million in 2006 and increasing by EEK 274.2 million as compared to the previous financial year. Gain on disposal of investment property increased more than 100 per cent in 2006 as compared to 2005 reaching EEK 25.2 million in 2006. These two operating income items constituted approximately 97.9 per cent of the total other operating income balance. The Group also recognised EEK 6.4 million as gain from disposal of property, plant and equipment, EEK 1.4 million as other income and approximately EEK 1.0 million as a gain on the change in the fair value of biological assets during financial year ended 31 December 2006.

The Group recorded EEK 162.8 million as other operating expenses in 2006. Approximately 90.8 per cent of the balance was attributable to EEK 75.0 million in fines and penalties and EEK 72.8 million to loss from write-down and impairments of property, plant and equipment. A total of EEK 75.0 million in fines and penalties were reported for 2006 including the contractual penalty for withdrawal from the contract related to the construction/development project of a Holiday Club Estonia. Loss from write-down is derived from the write-down of real estate recorded as construction-in-progress to its recoverable value. The Group also accounted for EEK 14.0 million as a loss on change in fair value of investment property in 2006.

Financial and investment activities income and expenses

Net financial and investment activities and related income and expense items totalled negative EEK 33.4 million in 2006, a slight increase of 1.4 per cent as compared to 2005. As a percentage of total revenue the net account balance remained at 6.9 per cent in 2005 and 2006.

Interest expense is the largest expense item under the current heading and totalled EEK 30.8 million in 2006, an increase of EEK 6.9 million as compared to financial year 2005. The increase is attributable to the increase of average interest rates (except for other long term bank loans) and an increase of borrowings and long-term borrowings, which grew from EEK 709.2 million in 2005 to EEK 1,156.8 million in 2006. Other expenses accounting for negative EEK 11.7 million in 2006 resulted from the write-down of receivables from associated companies in an amount of EEK 8.9 million and a write-down of other long-term financial investments in the amount of EEK 2.8 million.

The Group recognised an EEK 7.5 million gain from disposal of shares of subsidiary Sportings Riga SIA by Arco Development SIA to a minority shareholder. As a result of the transaction, the Group's stake in Sportings SIA was not changed. Furthermore the Group accounted for EEK 3.4 million interest income in 2006.

All the other income and expense accounts are relatively immaterial in nature.

Corporate income tax

The Group incurred a total of EEK 9.6 million worth of income tax in 2006. The majority of the tax expense or EEK 6.0 million was attributable to income tax on the profit of Latvian and Bulgarian subsidiaries. Furthermore EEK 3.6 million was recognised as tax on dividends.

Net profit

Net profit before minority interests for the financial year ended 31 December 2006 was EEK 217.3 million, an increase of EEK 100.9 million as compared to the previous financial year. The minority interest from net profit in 2006 was EEK 9.4 million.

YEAR ENDED 31 DECEMBER 2005 COMPARED TO YEAR ENDED 31 DECEMBER 2004

Revenue

Consolidated revenue of the Group increased in 2005 by 36.0 per cent, EEK 126.0 million on a year-on-year basis, reaching EEK 475.9 million. Major factors contributing to such growth were positive developments in the construction division, considerable increase in brokerage and appraisal services and the addition of revenues from asset management services.

There were noteworthy changes in the revenue structure of the Group in 2005. As all of the revenue growth for 2005 originated from the construction division with absolute growth of EEK 128.7 million, the corresponding percent of total revenue deriving from services and real estate development divisions showed a relative decrease as a percentage of revenue. In 2005, the construction division revenues reached EEK 175.5 million. On a year-on-year basis the weight as a percentage of revenue increased in construction division by 23.5 per cent reaching 36.9 per cent. The services division declined to 13.6 per cent and real estate development to 49.6 per cent as percentage of revenue in 2005, contributing EEK 64.5 million and EEK 235.9 million respectively.

The revenue growth in construction stemmed both from organic growth of existing Deena Ehituse OÜ and Tallinna Linnaehituse AS operations and the acquisition of the environmental construction company OÜ Veemaailm Inc. The total consolidated revenue of Deena Ehituse OÜ and OÜ Veemaailm Inc reached EEK 168.0 million in 2005, twice the revenue generated by Deena Ehituse in 2004. The Group accounted for rental and property management services revenue for the first time in the construction division in the amount of EEK 0.3 million in 2005.

A total of EEK 64.5 million worth of revenues were generated by the services division in 2005, a decline of 2.7 per cent as compared to the previous financial year. The relative decline in revenue does not adequately reflect the development of the division revenues. The decline was a result of accounting for exceptional revenues from the sale of properties in 2004 for EEK 22.2 million (EEK 0.6 million in 2005). The majority or 74.1 per cent of the division revenues are attributable to brokerage and appraisal services with sales of EEK 47.8 million and asset management services with revenues of EEK 9.4 million. Brokerage and appraisal services experienced considerable revenue increases in Estonia, Latvia and Lithuania. The most aggressive growth was in Lithuania where revenue multiplied by 3.4 times as compared to 2005. In 2005, the Explorer Property Fund – Baltic States AB, managed by AVEC Asset Management AS (former name Arco Varavalitsemise AS), commenced its investing activities. The new asset management service line generated a total of EEK 9.4 million in revenues in 2005. In addition to major revenue items, the Group accounted for EEK 3.8

million of revenues from property management services and approximately EEK 1.0 million in geodesy services, the service line discontinued at the end of 2005.

The real estate development division revenues maintained the level recorded in 2004 and totalled EEK 235.9 million in 2005. The sale of properties contributed EEK 174.9 million, increasing by 0.8 per cent on a year-on-year basis. Rental and property management services declined from EEK 56.3 million in 2004 to EEK 51.6 million in 2005. In addition, other revenues declined by EEK 4.6 million reaching EEK 1.3 million in 2005, mostly as a result of a decrease in revenues from the sale of cutting rights of growing forest. The decline in the above mentioned service lines were partially offset by positive developments in management services related revenues, contributing EEK 7.0 million to revenues of the division and reaching EEK 8.2 million in financial year 2005.

Alternative analyses of revenues by revenue types shows a considerable shift towards revenues from rendering services principally as a result of revenue multiplying in construction by approximately 3.7 times. The weight of the latter mentioned division reached 63.1 per cent in 2005, increasing by EEK 146.2 million in absolute terms reaching EEK 300.4 million. The revenues from sale of goods decreased by 10.3 per cent, from EEK 195.7 million in 2004 to EEK 175.5 million.

Similar to the financial year ended 31 December 2006, revenues from sale of properties, construction services, brokerage services, appraisal services and rental and property management services constituted 95.4 per cent or substantially all of total consolidated revenue in 2005.

The structure of the Group's revenues changed significantly in 2005 as compared to the previous financial year. On a year-on-year basis only construction revenues increased its weight in total revenues rising from 13.4 per cent in 2004 to 36.8 per cent in 2005. All other revenue types experienced declines as a percentage of revenue compared to the 2004 financial year, except for asset management services which was recognised for the first time in 2005 (EEK 9.4 million). As a percentage of total consolidated revenue the sale of properties declined by 19.0 per cent from 55.9 per cent in 2004 to 36.9 per cent, rental and property management services by 5.4 per cent to 11.7 per cent and brokerage and appraisal services revenues by 0.7 per cent to 10.0 per cent from 2005 total Group revenues.

Management services revenues increased from EEK 2.1 million in 2004 to EEK 8.8 million in 2005, an increase of approximately 311.5 per cent on year-on-year basis.

Geodesy and other revenues aggregately made up 0.8 per cent of revenues or EEK 3.6 million in 2005.

Cost of sales

The Group's gross profit margin declined approximately 6.5 per cent, to 24.7 per cent, due to the increase in the direct costs of construction services purchased and personnel expenses at a rate higher than the 36.0 per cent annual growth rate in revenue in 2005. Construction services purchased as a percentage of revenue increased from 28.7 per cent in 2004 to 37.4 per cent for the period ended 31 December 2005. A total of EEK 178.1 million worth of construction services were purchased in 2005, an increase of EEK 77.7 million as compared to the previous financial year, which was mainly attributed to an increase in construction prices. Personnel expenses increased as a percentage of revenue from 6.1 per cent to 8.0 per cent, a total of EEK 16.7 million and reached EEK 37.9 million in 2005. The growth in personnel costs is attributable mostly to the increase in personnel from 220 employees as at 31 December 2004 to 284 as at year end 2005. The carrying value of real estate sold contributed EEK 17.4 million to the total increase of EEK 117.7 million in cost of sales. As a percentage of revenue, the cost decreased from 26.5 per cent in 2004 to 23.1 per cent, thus having a positive effect on gross margin. Other expenses and depreciation, amortisation and impairment made up approximately 11.0 per cent and 9.0 per cent of cost of sales in 2004 and 2005 respectively.

Operating expenses

Marketing expenses as a percentage of sales have remained relatively stable. Total marketing expense of EEK 9.4 million made up 2.7 per cent of 2004 total revenues and in 2005 the corresponding figures were EEK 12.3 million and 2.6 per cent. Approximately 80.0 per cent of marketing expenses or EEK 9.8 million in 2005 was related to advertising. Brokerage fees declined from EEK 1.7 million to EEK 1.3 million. Market research expenses, personnel expenses and other marketing expenses made up approximately 0.3 per cent of total revenue in 2004 and 2005 financial years.

General and administrative expenses increased by 3.0 per cent as a percentage of revenue, from 12.5 per cent in 2004 to 15.5 per cent in 2005. The financial years are not directly comparable in this matter as the Group recognised negative goodwill in income on amortisation caption in the total amount of EEK 19.9 million in 2004, which decreased general and administrative expenses in 2004. The increase in general and administrative expenses in 2005 was EEK 30.0 million or 68.6 per cent on year-on-year basis. The increase was mainly attributable to an increase in legal and consulting services of EEK 9.4 million, and allowance for doubtful receivables of EEK 4.0 million in 2005. Personnel expenses increased by EEK 4.5 million in 2005 reaching EEK 26.0 million in 2005, but as a percentage of sales decreased from 6.2 per cent in 2004 to 5.5 per cent in 2005. Other expenses incurred totalled EEK 9.1 million in 2005, a decrease from EEK 20.5 million as compared to the 2004 financial year. Office expenses decreased in absolute terms from EEK 9.3 million in 2004 to EEK 8.1 million in 2005.

The Group recorded operating profits of EEK 153.5 million in 2005, an increase of approximately 18.5 per cent as compared to the 2004 financial year. Despite a considerable gain of EEK 114.8 million from the change of the fair value of investment property, it was not sufficient to offset the decrease in gross profit margin of 6.5 per cent. Operating profit margin for the Group fell from 37.0 per cent in 2004 to 32.3 per cent in 2005.

Other operating income and expenses

Other operating income grew from EEK 79.0 million in 2004 to EEK 135.3 million in 2005, an increase of 71.2 per cent or EEK 56.3 million on a year-on-year basis. Gain on change in fair value of investment property contributed approximately 84.9 per cent or EEK 114.8 million from the other operating income balance in 2005, an increase of 91.4 per cent or EEK 54.8 million as compared to the previous financial year. The other material income items for 2005 were gains from disposal of investment property and other income, contributing EEK 12.4 million and EEK 5.6 million respectively. Biological asset revaluations resulted in a gain of EEK 1.9 million and the disposal of property, plant and equipment resulted in a gain of EEK 0.7 million.

Other operating expenses increased from EEK 5.6 million in 2004 to EEK 13.3 million in 2005 mainly due to a loss in the change in the fair value of investment property in an amount of EEK 11.9 million in 2005. The Group also recognised slight losses from the change in the fair value of biological assets of EEK 0.6 million, fines and penalties of EEK 0.3 million and other expenses of EEK 0.5 million.

Financial and investment activities income and expenses

Net financial investment activities expenses increased by EEK 12.1 million to approximately EEK 33.0 million in 2005. The increase is principally attributable to losses from the disposal of shares of subsidiaries which increased by an amount of EEK 6.0 million. The Group also accounted for expenses related to other long-term financial investments of EEK 2.7 million, net of other income and expenses of EEK 3.7 million. Interest expenses incurred by the Group decreased as a percentage of revenue from 7.7 per cent in 2004 to 5.0 per cent in 2005. In absolute terms interest expenses decreased by EEK 3.0 million. The increase is attributable principally to an increase in borrowings of approximately EEK 152.7 million.

For the financial year ended 31 December 2005 the Group accounted for EEK 3.9 million as interest income.

Corporate income tax

The Group incurred total of EEK 4.1 million worth of income tax in 2005. The majority of the tax expense or EEK 3.6 million was attributable to income tax on dividends. Approximately EEK 0.5 million was recognised as income tax on profit of Latvian subsidiaries.

Net profit

Net profit before minority interests for the financial year ended 31 December 2005 was EEK 116.4 million, an increase of EEK 9.8 million as compared to the previous financial year. The minority interests from net profit in 2005 were EEK 15.2 million.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Resources

The following table outlines the Group's equity and balances of interest-bearing obligations as at 31 December 2004, 2005 and 2006 and 31 March 2007:

(EEK, '000)	Year ended 31 December			Three months ended
	2004	2005	2006	31 March 2007
Equity	353,117	580,745	741,881	800,775
Interest-bearing liabilities	556,473	709,199	1,156,826	1,089,453

Operating cash flows

The Company calculates its cash flows by applying the indirect method. Accordingly, cash flows from operating activities consist of cash flows related to the sales of services and real estate inventories, and of costs related to such sales and the overhead expenses of the Group.

The Group finances its operations and investments partly from cash flows from operations and partly with loan facilities from third-party lenders. The Group's operating cash flow before changes in balance sheet items (such as changes in receivables and payables related to operating activities and changes in inventories and prepayments) was positive in 2004 and 2005 and in the first quarter of 2007. The negative operating cash flow before changes in balance sheet items in 2006 resulted from recognition of fines and penalties in an amount of EEK 75.0 million which reduced operating profit. As the penalty was not paid during the period, the amount of these fines should be eliminated in order to make the cash flow comparable to the previous periods. While taking this into consideration, the Group operating cash flows before changes in balance sheet items in positive. Currently the effect of these fines and penalties were eliminated from net operating cash flows through changes in liabilities related to operations.

There has been significant variance in the Group's total cash flows from operations in the recent three financial years. In 2004, the operating cash flows of the Group reached EEK 90.9 million, before dropping to EEK 55.8 million in 2005 and to negative EEK 117.5 million for the period ended 31 December 2006.

During the first three months of 2007, the Group's cash flows from operating activities totalled EEK 31.5 million, representing an increase of EEK 39.9 million compared to the negative cash flow of EEK 8.4 million in the same period of the previous year. The major contributors to this development

were an increase in operating profits and a decrease in inventories, the latter resulting in positive cash flow of EEK 114.6 million. In the same period in 2006, the Group recorded negative cash flow from the change in inventories of EEK 29.3 million. Change in receivables, liabilities and prepayments relating to the operating activities had a negative impact of EEK 110.2 million on operating cash flows during the three months ended 31 March 2007.

Because the Group records its residential development projects, houses and land as inventories, its operating cash flows are largely dependent on the level of sales, expenditures, liabilities and prepayments from such real estate projects. During the financial year ended 31 December 2006, the Group expenditures related to development projects in Riga and Tallinn (including city proximity) totalled 126.7 million and 99.4 million, respectively. The aggregate inventories and receivables related to operations increased in total by EEK 208.9 million in 2006, the highest level during the last three financial years. The corresponding change in inventories and receivables amounted to EEK 16.3 million in 2005 and EEK 20.8 million in 2004.

Apart from the expenditures of ordinary business operations and development expenditures recorded in inventories, the Group uses its funds primarily for purchases of property, plant, equipment and intangible assets, acquiring property and biological assets, acquiring other businesses, repaying indebtedness and interest payments.

In three months ended 31 March 2007, the Group made no significant investments into property, plant, equipment or intangible assets. The Group recorded significant cash flows of EEK 93.2 million from investing activities during the period, derived from disposals of subsidiaries and joint ventures. Cash flows from financing activities were negative by EEK 63.5 million in the first quarter of 2007, mainly because of repayments of loans, leases and overdrafts. During the same period, total cash flows of the Group were EEK 57.1 million, compared to the negative EEK 19.5 million in the first quarter of 2006.

In 2006, the Group paid a total of EEK 294.4 million for property, plant and equipment, which represents an increase of EEK 155.5 million compared to the previous period. The Group acquired real estate in the port area of Tallinn for a total amount of EEK 187.7 million, properties in Kuressaare and Narva for EEK 87.9 million and real estate in Kiev, Ukraine, for EEK 6.8 million. Acquisitions of subsidiaries and joint ventures accounted for EEK 91.3 million of negative cashflows and the Group made a total of EEK 292.3 million in loan and lease repayments (including refinancing of loans in the amount of EEK 91.4 million). The Group's interest payments accounted for EEK 45.4 million in 2006.

In 2005, by far the most important use of funds was the acquisition of investment property by the Group. In terms of cash flows, the Group invested a total of EEK 318.2 million in investment property and biological assets that year, including the purchase of land for the Tivoli residential area development for EEK 256 million. The Group also repaid loans (including refinancing of loans in the amount of EEK 116.5 million) and financial lease obligations of EEK 466.9 million and invested a total of EEK 138.9 million into property, plant, equipment and intangible assets.

In 2004, the Group's most important use of funds was repayments of loan and financial lease obligations in the total amount of EEK 293.1 million, and purchases of investment property for EEK 89.4 million.

Equity

The Company has had one new share issue in the last three financial years. Arco Vara AS increased its share capital in 2005 by issuing approximately 3.2 million new shares with a nominal value of EEK 10 each through a private placement to AS Hansapank. The increase in share capital amounted to EEK 32 million with a share premium of EEK 124.5 million, and net proceeds to the Company amounted to EEK 155.1 million. The proceeds of the share issue were used for financing several real estate development projects in Latvia and Estonia and for partial repayment of bonds.

Working capital

Management believes that, taking into account the Group's existing assets and financial condition, the Group's working capital is sufficient to meet all liabilities as they fall due for at least the 12-month period following the date of this Offering Circular.

Bank loans

(EEK, '000)	Year ended 31 December (audited)			Three months ended 31 March (unaudited)
	2004	2005	2006	2007
Bank loans outstanding	439,968	496,025	905,367	789,621
Bonds	30,784	175,469	183 551	180,993
Other interest bearing liabilities	61,494	31,102	63 933	114,417
Financial leasing liabilities	24,227	6,603	3 975	4,422
Total	556,473	709,199	1,156,826	1,089,453
total short term liabilities	217,784	316,853	699,568	681,313
total long term liabilities	338,689	392,346	457,258	408,140

The repayment obligations of the Group's bank loans outstanding as at 31 December 2006 divide between future periods as follows:

(EEK, '000)	Within one year	1-5 years	over 5 years	Total
Bank loans	699,568	270,075	187,183	1,156,826

The Group uses operating cash flows and borrowings to finance its operations. Major part of the borrowings throughout the last three financial years relates to acquisition of investment property and investments to real estate development projects. Acquisition of investment property is done via setting up a separate business entity or through acquisition of already existing entities owning the property. Due to specific group structure of separate companies owning the development properties, the loans taken to finance either property acquisitions or real estate development are taken in most cases by the relevant subsidiary or joint venture company. Some of the real estate development projects have been financed through bond issues on the parent company level. Such proceeds have been given out as a loans to subsidiary or joint venture companies.

As at 31 March 2007 the Group had a total of EEK 1,082 million of interest-bearing obligations outstanding, EEK 82.3 million less than at 31 December 2006. The short term obligations accounted for 62.5 per cent of the total balance outstanding representing an increase of 2.1 per cent compared to 31 December 2006.

The general financing structure of the Group remained relative stable during the first three months on 2007. Compared to 31 December 2006, the Group's bank loans balance (including overdrafts) had decreased by EEK 115 million. Large part of the decrease is attributable to the sale of 50 per cent of the shares in Arco HCE OÜ, which resulted in a reclassification of a long term bank loan to other short term loans. Also, the overdraft balances decreased by EEK 15.6 million in the first quarter of 2007, reaching EEK 2.9 million. Furthermore, the Group completed two bond issues in the first three months of 2007 which enabled the Group to decrease its short term bond obligation balance by EEK 30.5 million. The total balance of the bonds as of 31 March 2007 was EEK 181.0 million, a decrease of EEK 2.5 million compared to the year-end balance of 31 December 2006. There were no significant changes in financial lease liabilities during the three-month period ended 31 March 2007.

As at 31 December 2006, Arco Vara AS had in total three outstanding interest bearing debt obligations and one overdraft balance. The Company had arranged these facilities as the parent company of the Group in order to fund the general corporate purposes of the Group. The Company has conducted several bond issues during the last three financial years, rising over EEK 200 million in aggregate. In 2006, the Company successfully completed two bond issues raising total of EEK 97.0 million to refinance bond outstanding from previous periods.

The Group increased its short-term bank loans balance considerably in 2006. As at the year-end, the outstanding balance was EEK 458.0 million, which represents an increase of EEK 381.0 million from the balance as at 31 December 2005. This increase was partially caused by reclassification of long terms borrowings.

As at 31 December 2006, the Group companies had a total of EEK 1,157 million of interest-bearing obligations outstanding. Most of these borrowings carry an interest based on EURIBOR. Approximately 75 per cent of the Group's interest-bearing liabilities are obligations with a floating interest rate. For financial year 2006 the average interest rates for short-term bank loans and for long-term bank loans were 5.9 per cent and 5.7 per cent, respectively. The effective interest rate for bonds in 2006 was 5.2 per cent. The Group intends to fix the interest rates of its long-term borrowings.

The financing agreements entered into by the Group companies contain several negative and positive covenants and requirements to obtain the lender's consent. Most of the Group's financing agreements with financial institutions contain customary provisions on events of default, including cross-default. In addition, under most loan agreements, it is an event of default if the borrower takes significant additional financial obligations or if there is a change of control in the borrower without the prior consent of the lender. In addition, most of the financing agreements require the Group or any of the Joint Ventures to pledge their assets for the benefit of the lender. See "Risk factors - Risks relating to the Group's business - Financing and loan agreements" for further information.

Financial leasing liabilities

The Group has used financial leasing facilities over the last three years mainly for financing acquisitions of investment property. Significance of capital lease as source of financing has decreased considerably over the last three financial year, from EEK 24.2 million in 2004 to EEK 4.0 million as of year end 2006.

Off-Balance Sheet Arrangements

As of 31 December 2006, the Group companies had been provided an overdraft facility in an amount of EEK 35.6 million. The overdraft balance outstanding as at the year-end 2006 was EEK 18.5 million.

The operating lease commitments of the Group totalled EEK 26.3 million as at 31 December 2006, a decrease of EEK 3.0 million compared to the end of previous financial year. The operating lease agreements are used for financing investment property items.

The Group had no other off-balance sheet liabilities as of 31 December 2006.

CRITICAL ACCOUNTING POLICIES

Classification of real estate

The classification of real estate items into classes as inventories, investment property or property, plant and equipment (construction-in-progress) is both on the initial classification as well as on later reclassification based on the intention of the management on the future use of the real estate. The accomplishment of the management's plans depends also on the decisions not controlled by the Group

(i.e., changing registered intended use of land, approving detailed plans, issuing licence for construction etc), which reduces the accuracy of classification of real estate.

The real estate items with the intention on the future use for development and sale of living environments, individual house or plot of land have been classified as inventories. Real estate items purchased for sale in the course of ordinary business have also been recognised as inventories.

The aim of the purchase of an investment property is to earn income from rent or capital appreciation. The real estate items held for long-term perspective and with several possible intentions on future use are also considered to be investment properties.

The property being developed for the future use as commercial spaces leased out under operating lease terms or purchased commercial property with extensive ongoing reconstruction, is recorded as investment property only after completion of the work (after obtaining the permit for use). These properties have been recorded as constructions-in-progress under property, plant and equipment until completion.

Existing investment property that is being re-developed for continued future use as investment property is not temporarily re-classified to construction-in-progress.

Revenue recognition

Revenue is recognised at the fair value of the consideration received/receivable. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

Proceeds from disposals of real estate

Sales of real estate are recognised when all material risks and rewards related to the real estate have been transferred to the purchaser and the seller has no further substantial acts to complete under the contract. In general, the sale is deemed completed when the real right contract (the contract, agreeing the transfer of the ownership of real estate), is concluded. Payments received from customers before concluding the contract are recorded under “prepayments”.

Revenue from long-term service agreements

The stage of completion method is used for recording revenue and expenses of long-term service contracts, incl. construction contracts. The stage of completion of the rendered service is estimated based on the proportion of expenses actually incurred on the project until the balance sheet date compared to the estimated total expenses of the project. If, by the balance sheet date, the invoice issued by the service provider to the customer differs from the amount of revenue calculated based on the stage of completion method, the difference will be recorded in the balance sheet under liabilities or receivables, respectively.

If it has become evident that the anticipated costs of the project exceed the total revenue, the loss will be recorded immediately and fully in the income statement.

Revenue from rendering of other services

Revenue from the sales of services is recorded upon rendering of the service. Revenues from brokerage services are recognised when the mediated operation has been concluded. Rental income arising on investment properties is accounted for on a straight-line basis over the lease term. Revenue and expenses related to utility services (i.e. electricity, heat, water, etc.) are offset.

Revenue from sales of other goods

Revenue from sales of other goods is recognised when all material risks and benefits related to the ownership of the asset have been transferred to the purchaser, and the amount of revenue can be reliably measured.

Financial income

Interest income is recorded on an accrual basis in the income statement, based on the effective interest rate method. Dividend income is recognised when the respective right of claim arises.

Income tax

Income tax assets and liabilities and income tax expense and income are recognised as current and deferred income tax. Current income tax is recorded as short-term asset or liability and deferred income tax as long-term asset or liability.

Parent company, subsidiaries and joint ventures registered in Estonia

Pursuant to the Income Tax Act, Estonian companies are not subjected to pay income tax on the profit. Rather, they are subjected to income tax on the disbursed dividends. The established tax rate was 23/77 of the net dividend disbursed until 31.12.2006 and 22/78 of the net dividend disbursed from 01.01.2007 onwards. The Income Tax Act establishes further decrease of applicable income tax rate by one point until 20/80 on net dividends paid out after 01.01.2009. Income tax from disbursement of dividends is recorded under expenses in the income statement at the moment of declaring the dividends (upon incurring the payment obligation).

Since pursuant to the Income Tax Act, Estonian companies are not subjected to pay income tax on the profit thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise. A Group's potential tax liability related to the distribution of its retained earnings as dividends is not recorded in the balance sheet. The maximum amount of potential income tax liability has been disclosed in Note 32.

Latvian, Lithuanian, Ukrainian, Bulgarian and Romanian subsidiaries and joint ventures

The company's net profit is subject to income tax in Latvia, Lithuania, Ukraine, Bulgaria and Romania. The tax rate is 15 per cent in Latvia and Lithuania, 25 per cent in Ukraine, 15 per cent in Bulgaria (10 per cent starting from 01.01.2007) and 16 per cent in Romania. The chargeable tax is calculated on the profit before income tax, and temporarily or permanently adjusted with additional income and expense items in accordance with the requirements of the local income tax laws.

In case of foreign subsidiaries, the deferred income tax assets or liabilities are calculated on the temporary differences between the tax basis and carrying values of assets and liabilities. The deferred income tax assets will be presented in the balance sheet only if the company is likely to incur, in the foreseeable future, an income tax liability in a comparable amount to the deferred income tax assets and which can be used for offsetting.

CURRENCY FLUCTUATION IMPACT

In order to hedge the currency risk of the Group companies, the majority of transactions and contracts are in euros or currencies pegged to the euro. The main currency risk therefore stems from the risk that, with the adoption of the euro, the exchange rates between local currencies and the euro will significantly change.

INTEREST RATE RISK

The Group's long-term borrowings are for the most part tied to EURIBOR. Therefore, the Group is exposed to the events on the international financial markets. The long-term EURIBOR decrease has been brought to a halt, and the interest rate is showing initial signs of a moderate rise. Therefore, the primary purpose of interest risk management in the Group is to fix the floating interest rate of long-term borrowings.

CREDIT RISK

Credit risk involves the potential losses arising from the counterparties' inability to perform their liabilities to Arco Vara Group, as well as the ability of subsidiaries and joint ventures to fulfil their obligations to the Parent. Considering the amounts involved, credit risk constitutes the biggest risk for the Group. Credit risk management mostly involves the monitoring of accumulated credit risk concentration in the Group.

MANAGEMENT

Pursuant to the provisions of the Estonian Commercial Code and the Company's Articles of Association, the control and management of the Company is divided among the General Meeting of Shareholders, the Supervisory Council and the Management Board. See "Estonian Securities Market – Corporate Governance" for further information.

SUPERVISORY COUNCIL

The Supervisory Council is responsible for planning the business activities of the Company, organizing the management of the Company and supervising the activities of the Management Board. The Supervisory Council reports to the General Meeting of Shareholders. According to Company's Articles of Association, the Supervisory Council's functions also include the following:

- approval of the Company's business strategy and of any changes to such strategy;
- approval of the Company's yearly budget;
- approval of principles of risk management;
- appointment and recalling of procurators of the Company; and
- deciding on the conclusion of and the terms of transactions and on the conduct of legal disputes with members of the Management Board and appointment of the representative of the Company for such purposes.

In addition, according to the Company's Articles of Association, the Supervisory Council's approval is required for the following transactions:

- acquisition or disposal of holdings in other companies;
- establishment and winding up of subsidiaries; and
- material changes in the activities of the Company or involvement by the Company in any business which is not related to the objectives of Company's existing business.

According to the Company's Articles of Association, the Supervisory Council consists of five to seven members elected by the General Meeting of Shareholders for a term of five years. The members of the Supervisory Council elect the chairman among themselves. The chairman is responsible for organizing the activities of the Supervisory Council. The Supervisory Council is required to hold meetings at least once every three months. The meeting of the Supervisory Council has a quorum when more than half of members of the Supervisory Council are present. The resolutions of the Supervisory Council adopted at the meeting require that more than half of the members present be in favour. The resolutions of the Supervisory Council adopted without convening a meeting require that all members of the Supervisory Council be in favour.

As of the date of this Offering Circular, the Supervisory Council of the Company is as follows:

Name	Year of birth	Member since	Position	Current term expires
Arti Arakas	1968	1997	Chairman	2011
Hillar-Peeter Luitsalu	1959	2004	Member	2011
Richard Tomingas	1969	1997	Member	2011
Aare Tark	1959	2007	Member	2012
Kalev Tanner	1965	2007	Member	2012

Arti Arakas. Mr. Arti Arakas, born 1968, is the Chairman of the Supervisory Council. He is the founder of the Group and acted as a Chairman of the Management Board of Aktsiaselts Arco Vara (currently AS Arco Vara Kinnisvarabüroo) from 1992-1996. From 1988 to 1992 he worked for Harju KEK where he held the positions of the Economics Department Manager and Economics Department Acting Manager. Mr. Arakas graduated in 1987 from the Tallinn Polytechnic Institute, where he specialized in Electrical Installation in Industrial Enterprises. From 1987-1992, he studied in University of Technology (TTÜ) specializing in Automatic Equipment and Telemechanics. His additional education includes several courses in Economics. Currently he is continuing his studies at the University of Tartu at the Faculty of Social Sciences to obtain a Degree in Psychology.

Richard Tomingas. Mr. Richard Tomingas, born 1969, has been a Member of the Supervisory Council since 1997. Since joining the Group in 1993, he has been actively involved in the management of several Group companies. From 1993 to 1997, he served as the Member of the Management Board of Aktsiaselts Arco Vara (currently AS Arco Vara Kinnisvarabüroo). Mr. Tomingas has a Bachelor's Degree in Business Administration from the Estonian Business School. From 1987-1990, he studied in Tallinn Polytechnic Institute, where he specialized in Civil Engineering.

Hillar-Peeter Luitsalu. Mr. Hillar-Peeter Luitsalu, born 1959, has been a Member of the Supervisory Council since 2004. Since joining the Group in 1994, he has been actively involved in the management of several Group companies. He was the Member of the Management Board of the Company from 1999-2004 and a Member of the Supervisory Council of AS Arco Vara Kinnisvarabüroo in 1996-2005. Mr. Luitsalu graduated in 1994 from the University of Tartu, where he specialized in Law. He has additionally acquired a degree in Physical Training at the Tallinn Pedagogic Institute. His additional education includes several courses in Law.

Aare Tark. Mr. Aare Tark, born 1959, has been a Member of the Supervisory Council since 2007. He has been the Senior Partner at Law Office Tark & Co since 1991. He was the President of the Estonian Bar of Association in 1994, 1995 and from 1998 to 2001. Since 2003 he has been the Member of the Legal Ethics and Practice Committee of the Estonian Bar of Association. Mr. Tark graduated in 1993 from the University of Tartu, where he specialized in Law.

Kalev Tanner. Mr. Kalev Tanner, born 1965, has been a Member of the Supervisory Council since 2007. Mr. Tanner is also the Chairman of the Supervisory Council of AS E-Kindlustus Kindlustusmaakler, the largest insurance brokerage company in Estonia. Since 2003, he has served as a Senior Adviser of the private equity company BaltCap. Mr. Tanner is the founder and Chairman of the Management Board of OÜ Sparkling Group, an Estonian based company operating luxury hotels and restaurants. He is also the Managing Director of OÜ IG Partners, an Estonian based venture capital and advisory services company. Before founding IG Partners OÜ, Mr. Tanner was the Managing Director of Balti Cresco Investeerimisgrupi AS (current business name AS Cresco) from 1998 to 2001. During the same period he also served as the member of the Supervisory Council of AS Tallinna Börs (Tallinn Stock Exchange). From 1994 to 1998, Mr. Tanner worked as a Corporate Finance specialist in Goldman Sachs in New York and London. Mr. Tanner obtained MBA from the J.L. Kellogg Graduate School of Management, Northwestern University in 1994.

The business address of all of the above persons is: c/o AS Arco Vara Jõe 2b, 10151 Tallinn, Estonia.

MANAGEMENT BOARD

The Management Board manages the Company's daily business operations. See "Estonian Securities Market – Corporate Governance" for further information on the tasks of the Management Board.

According to Company's Articles of Association, the Management Board consists of three to five members elected by the Supervisory Council for a term of three years. If the Management Board has

more than two members, the Supervisory Council shall appoint a Chairman for the Management Board.

As of the date of this Offering Circular, the Management Board is as follows:

<u>Name</u>	<u>Year of birth</u>	<u>Member since</u>	<u>Position</u>	<u>Current term expires</u>
Viljar Arakas	1979	2004	Chairman, CEO	2010
Sulev Luiga	1971	2005	Member, CFO	2007
Ivar Siimar	1969	2003	Member, Head of Services Division	2010
Veiko Pedosk	1965	2007	Member, Head of Development Division	2010
Ahto Altjõe	1961	2007	Member, Head of Construction Division	2010

Pursuant to the resolution of the Supervisory Council dated 10 May 2007, Mr. Sulev Luiga was recalled from the Management Board with effect on 30 June 2007 and Mr. Aare Tammemäe was elected as a new member of the Management Board with his appointment taking effect as of 1 July 2007.

Viljar Arakas. Mr. Viljar Arakas, born 1979, is the Chief Executive Officer of the Group and the Chairman of the Management Board. Before joining the firm in 2002, he was the founder and a Member of the Board of OÜ Haagisekeskus since 2000. He was Chairman of the Management Board of AS Arco Transport from 1999-2002, and a Sales Manager in AS Arco Transport from 1998-2001. In 1997-1999, he worked for AS Arco Trans where he held the position of a Sales Manager. Mr. Arakas graduated in 1999 from the Tallinn Polytechnic Institute, where he specialized in Telecommunication Equipment. He also has an International Bachelor's Degree in Business Administration (BBA) from the Estonian Business School in 2003. From 2002-2003, he studied at the Hogeschool Novi in Netherlands where he graduated Double Degree Program. He is continuing his studies at the Estonian Business School to obtain a Masters Degree. Messrs. Viljar Arakas and Arti Arakas are brothers.

Sulev Luiga. Mr. Sulev Luiga, born 1971, has been a Member of the Management Board and CFO of the Group since 2005. From 1992-2005, he worked for KPMG Estonia AS where he held the following positions: from 2001-2005, a Senior Partner and a Chairman of the Management Board; in 1998-2001, a Partner and a Member of the Management Board; from 1995-1998, he was a Partner and a Member of the Supervisory Council; from 1992-2005, he was an Auditor and Head of Department. He was a Chairman of the Estonian Auditing Board from 1999-2005. Currently, Mr. Luiga is a Member of the Estonian Auditing Board. Mr. Luiga graduated in 1993 from the Tallinn University of Technology (TTÜ), where he specialized in Accounting and Business Analysis. In 2006, he obtained his EMBA cum laude at the Estonian Business School. His additional education includes Economics in Lappeenranta University of Technology and Business Management at the Paris Graduate School of Management.

Ivar Siimar. Mr. Ivar Siimar, born 1969, has been a Member of the Management Board and Head of the Services Division since 2003. He joined the firm in 1994 and worked as a real estate broker until 1996. From 1996-1998, he held the position of an office manager. He served as the Chairman of the Management Board of Arco Vara Tallinna Büroo AS (later merged with AS Arco Vara Kinnisvarabüroo) from 1998 to 2001. From 1997 to 1999, he also served as the Member of the Management Board of the Company. He has been the manager of Arco Vara Service Division from 2001 until today. He was a member of the Supervisory Council of AS Kinnisvaraportaal, the company operating the first real estate portal "City 24 Baltics" and a member of the Management Board of the Association of Estonian Real Estate Companies from 1996 until 2002. Mr. Siimar graduated in 1992 from the Tallinn Pedagogic Institute, where he specialized in Physical Culture. He has additionally acquired a Graduate Diploma at the Estonian Higher Commerce School (formerly the Estonian Business School), where he attended the Masters Program in International Business Administration

Veiko Pedosk. Mr. Veiko Pedosk, born 1965, has been a Member of the Management Board since 2007 and is the Head of Group's Development Division. Before joining Arco Vara he was Chairman of the Management Board of AS Sampo Liising from 1997 to 2002, Member and Chairman of the Management Board of Estonian Leasing Association from 1998 to 2002, and a Deputy Director of the EU Round Table for small enterprise financing in 2001. From 1994 -1996 he worked for the Estonian Innovation Bank as a Treasurer, Equity Trader, Certified Exchange Trader and CEO of the bank's leasing company. Until 1994 he worked for the car-company Baltmotors where he held the position of a Service Manager. Mr. Pedosk has cooperated with the Leasing Unions of Russia, CIS and Baltics since 1998, in the work of administrative, legislative and accounting teams of the Estonian Leasing Union since 1996, and as an invited speaker in leasing seminars and workshops across CIS. He has consulted and provided training for the EBRD in establishing the first leasing company in Moldova. In 1997 Mr. Pedosk graduated from Tallinn University of Technology, where he specialized in Business Administration. His additional education includes several training courses and seminars in leadership and management, Euromoney training courses, courses in leasing, small enterprise financing, environmental due diligence, modern accounting and financial administration, capital markets and treasury risk management.

Ahto Altjõe. Mr. Ahto Altjõe, born 1961, has been a Member of the Management Board since 2007. He is the Head of the Construction Division of the Group. From 2001-2006, he served as the Chairman of the Management Board of AS Tallinna Olümpiapurjespordikeskus. From 2000-2001, he worked for AS Eesti Raudtee where he held the position of a Manager of Rolling Stock Services. From 1996-2000, he served as Chairman of the Management Board and a Managing Director of AS Reval Auto. From 1994-1996, he was the Chairman of Raasiku Municipal Council and Marketing Manager of AS Fakto. He has also worked as a Chief Engineer in the Riigi Kooliamet (State School Board). Mr. Altjõe graduated from Tallinn Pedagogic University as a School Manager and a Development Consultant. He is continuing his studies at the Estonian Business School to obtain a degree in International Business Administration.

Aare Tammemäe. Mr. Aare Tammemäe, born 1971, was elected as a Member of the Management Board and Chief Financial Officer of the Group on 10 May 2007 with his appointment taking effect as of 1 July 2007. Mr. Tammemäe has been the Head of Corporate Banking and Member of the Management Board of Nordea Bank Finland, Estonian branch since 2005. From 2001-2005, he served as the Chief Financial Officer of AS Tallinna Sadam (the Port of Tallinn) where he was a Member of the Management Board from 2004-2005. From 1998 to 2004 he acted as the Chairman of the Management Board of State Compensation Fund (*Hüvitusfond*). From 1996 to 1998 he worked for Talinvest Suprema Securities (today AS Suprema Securities), where he lead the Sales and Trading unit and performed the duties of the Managing Director. From 1995-1996 he worked as an information advisor for State Street Bank in United States of America and from 1992-1995 he worked as a financial analyst in SIAR-Bossard. Mr. Tammemäe graduated in 1993 from the Tallinn University of Technology, where he obtained a Degree of Master of Science in Economics. In 1996 he obtained a Degree of Master of Business Administration from Bentley Graduate School of Business, Boston USA. He has also attended several Euromoney seminars. In 2002, he participated in executive education program in London Business School.

The business address of all of the above persons is: c/o AS Arco Vara Jõe 2b, 10151 Tallinn, Estonia.

OTHER KEY EXECUTIVES

Name	Year of birth	Position
Maie Kütt	1974	Head of Legal Department
Marilin Hein	1971	Chief Accountant
Heigo Metsoja	1977	Head of Asset Management
Ergo Tars	1978	Head of IT
Kadri Lindpere	1981	Marketing and Communications Manager

Kaido Kangur	1968	Head of Services Division in Estonia
Aigars Šmits	1975	Head of Services Division in Latvia
Viktors Savins	1976	Head of Development Division in Latvia
Indrė Augulytė	1981	Head of Services Division in Lithuania
Juri Nikitin	1966	Managing Director of Arco Vara's Ukrainian operations
Rauni Tillisoo	1972	Managing Director of Arco Vara's Bulgarian operations
Ciprian Marius Lopata	1964	Managing Director of Arco Vara's Romanian operations

Maie Kütt. Ms. Maie Kütt, born 1974, is the Legal Counsel to the Supervisory Council and the Head of Legal Department of the Group. She worked as a lawyer in Arco Kinnisvarahooduse AS from 1998 to 2006 and in the Arco Vara Tallinn Office from 1996 to 1998. Before joining the Group she worked for AS Laine as an Assistant to a Real Estate Broker in 1995. She was Member of the Ethics Committee of the Association of Real Estate Companies of Estonia in 1997-2000. Ms. Kütt is a graduate of University of Tartu Faculty of Law. She is continuing her studies at the University of Tartu at the Faculty of Social Sciences to obtain a Degree in Psychology. Her additional education includes training courses and seminars in civil rights, team management and teamwork.

Marilin Hein. Ms. Marilin Hein, born 1971, has been the Chief Accountant of the Group since 2003. Before joining the firm, she worked as the chief accountant of Luiga Mody Hääl Borenius, Attorneys at Law in 2003, chief account of Reval Rent OÜ from 2001-2003 and accountant of State Compensation Fund (*Hüvitusfond*) from 1997-2002. Ms. Hein is the graduate of Audentes University where she obtained a diploma in International Finance.

Heigo Metsoja. Mr. Heigo Metsoja, born 1977, has been the Head of Asset Management of the Group since 2005. Before joining the Group, he was the CEO of AS Eesti Eine from 2003 to 2005. He worked as a credit analyst for AS Hansapank from 2001-2003, and as a financial analyst for Fortum Energia AS from 1999-2001. Mr. Metsoja graduated from the Estonian Business School in 1999, where he obtained a BBA degree, specializing in Money and Banking. He is currently continuing his studies at the Estonian Business School to obtain an Executive MBA degree with specialization in Accounting and Finance.

Ergo Tars. Mr. Ergo Tars, born 1978, has been the Head of IT of the Group since 2007. Before joining the Group, he worked for Skype Technologies where he held the position of Release Manager from July 2006 to December 2006. From 2001-2006, he worked as a Configuration Manager for the Estonian Tax and Customs Board. Mr. Tars graduated from the Tallinn University of Technology in 2004, where he specialized in Mechanical Engineering.

Kadri Lindpere. Ms. Kadri Lindpere, born 1981, has been the Marketing and Communications Manager of the Group since 2004. From 2003-2004 she worked for AS Arco Vara Ärijuhtimise OÜ where she held the position of a Communication Manager. Ms. Lindpere graduated from the Estonian Business School in 2003, where she obtained a Bachelor's Degree in International Business Administration, specializing in Marketing and PR.

Kaido Kangur. Mr. Kaido Kangur, born 1968, leads the Group's Services Division in Estonia. Until 2004, he was a Member of the Supervisory Council of AS Põlluvara, a Member of the Management Board of AS Vestman Kinnisvaraarendus, and a Real Estate Manager of AS Kinnisvarabüroo Maa ja Talu / Vestman Kinnisvara. From 2000-2001, he worked as a Development Director in AS Kinnisvarabüroo Maa ja Talu. From 1998-2000, he was a Member of the Management Board and a Manager of Merchant Banking in Optiva Bank. From 1993-1998, he worked for Foreksbank (Foreks Bank) where he held the positions of Head of Credit, Head of the Loan Department, and a Merchant Banking Customer Relation Manager. In 1993, Mr. Kangur graduated from Tallinn University of Technology where he specialized in Construction Economics. His additional education includes training courses and seminars in sales, management, teamwork and motivation, and real estate development.

Aigars Šmits. Mr. Aigars Šmits, born 1975, has headed the Group's Services Division in Latvia since 2004. He joined the Group in 2003 as a Residential Broker. He worked for SIA Lido as a Marketing Manager in 2003 and for Baltic Transport Insurance as an Assistant Manager of the Bank Insurance Department in 2001. He has been an Assistant to the Manager of the Centre Subsidiary, a lawyer in the Latvian Mortgage and Land Bank since 2000 and a Manager of the Legal Department, Personnel Manager, and a Lawyer in Latvijas Tirdzniecības Banka (Latvian Trade Bank) since 1999. Mr. Šmits graduated from Latvian Police Academy in 1998, where he obtained a Diploma in Law. His additional education includes training courses and seminars in team building and personnel management.

Viktors Savins. Mr. Viktors Savins, born 1976, has been head of the Group's Development Division in Latvia since 2004. He has been Chairman of the Board of SIA Arco Development since 2004, and a Chairman of the Council of SIA Arco Real Estate since 2003. From 1998-2003, he was Chairman of the Board of SIA Arco Real Estate. Before joining the Group he worked for Interinfo Latvia as a Marketing and Sales Senior Consultant since 1996. He has been a Member of the Board and Chairman of the Committee of the Standards of Latvian Real Estate Association since 2004. Mr. Savins is currently studying at the School of Business Administrations "Turība" to obtain a Bachelor's Degree. His additional education includes training courses in consultative selling and principles of professional sales team management.

Indrė Augulytė. Ms. Indrė Augulytė, born 1981, has been the head of Group's Services Division in Lithuania and the Director of UAB Arco Real Estate since 2007. She was the manager of the residential department of UAB Arco Real Estate from 2005 to 2007 and a real estate broker in the same company from 2003 to 2005. Ms. Augulytė graduated from the Vilnius Technics University in 2003, where she specialized in Real Estate Management.

Juri Nikitin. Mr. Juri Nikitin, born 1966, has been the Managing Director of Arco Vara's Ukrainian operations and member of the Board of Arco Ukraina Valduste OÜ since 2005. Before joining Arco Vara, he was the manager of several companies. Mr. Nikitin has established a wide range of contacts in Ukrainian real estate market.

Rauni Tillisoo. Ms. Rauni Tillisoo, born 1972, is the Managing Director of Arco Vara's Bulgarian operations. She has five years of work experience in the real estate sector. Ms. Rauni Tillisoo has been studying Law at the Akadeemia Nord since 2002. Her additional education includes training courses in loan management, foreign trade and banking, real estate market, sales, and accounting.

Ciprian Marius Lopata. Mr. Ciprian Marius Lopata, born 1964, has been the Managing Director of Arco Vara's Romanian operations since 2007. Before joining the Group he worked for Partner IPC Investment. From 2003-2005, he was the CEO of Cleanaway in Eastern Europe and Russia. From 1996-2002, he worked for Colgate Palmolive in Romania and the Baltic countries where he held the positions of a Sales Director and a General Manager. In 1993, he worked as Sales Director for Western Romania in Procter & Gamble. Mr. Lopata has an Engineering Degree in Electronics and Telecommunications.

The business address of Ms. Maie Kütt, Ms. Marilin Hein, Mr. Heigo Metsoja, Mr. Ergo Tars, Ms. Kadri Lindpere and Mr. Kaido Kangur is: c/o AS Arco Vara Jõe 2b, 10151 Tallinn, Estonia.

The business address of Mr. Aigars Šmits and Mr. Viktors Savins is Lāčplēša iela 20a, Riga - LV1011, Latvia. The business address of Mr. Gerdas Jankeliunas and Ms. Indrė Augulytė is Konstitucijos ave 7, Vilnius, Lithuania. The business address of Mr. Juri Nikitin is 15, Turgenevskay str., 01054 Kiev, Ukraine. The business address of Ms. Rauni Tillisoo is Buzludja str. 74 - III, Sofia, Bulgaria and the business address of Mr. Ciprian Marius Lopata is 65 Teodosie Rudeanu St, Bucharest 1, 011259, Romania.

CORPORATE GOVERNANCE

The Estonian Financial Supervision Authority (the EFSA) has approved the Corporate Governance Recommendations, which entered into force as of 1 January 2006.

Following the listing of the Shares on the Tallinn Stock Exchange, the Company is required to either comply with the recommendations or explain reasons for its non-compliance ('comply or explain'). The recommendations regulate, among others matters, the calling of and the procedure in the general meetings of shareholders, requirements for the composition, duties and activities of the supervisory council and the management board, continuous disclosure requirements and financial reporting.

The Corporate Governance Recommendations require that at least half of the members of the supervisory council must be independent. If the supervisory council has an odd number of members, then there may be one independent member less than the number of dependent members. According to the recommendations, an independent member is a person, who has no such business, family or other ties with the issuer, a company controlled by the issuer, a controlling shareholder of the issuer, a company belonging to the issuer's group or a member of a governing body of these companies, that can affect their decisions by the existence of conflict of interests.

The Supervisory Council of the Company is currently composed of five members, of whom Kalev Tanner can be considered independent under the Corporate Governance Recommendations. Arti Arakas and Richard Tomingas cannot be considered independent as they are the shareholders and members of the Management Board of Osühing Toetum which, immediately after the Combined Offering is expected to control approximately 35.78 per cent of the votes that can be cast in the General Meeting of Shareholders, assuming that the Upsizing Option and the Over-Allotment Option are exercised in full. Nor can Hillar-Peeter Luitsalu be considered independent, as he has been a member of governing bodies of several Group companies in the previous three years and has had several business relationships with the Group companies through OÜ HM Investeeringud, a company controlled by him. Aare Tark cannot be considered independent as he has provided legal services to the Group companies in the previous year through a company controlled by him.

Although the Supervisory Council of the Company does not meet the independence requirements set out in the recommendations, the Company does not plan to make any changes in the composition of the Supervisory Council. Arco Vara believes that the present composition of the Supervisory Council is in the best interests of the Company and all of its shareholders.

The Corporate Governance Recommendations also require the disclosure of the remuneration of each member of the Management Board on the Company's website and in the Corporate Governance Report, including the details about his/her base salary, performance related bonuses, severance packages, other financial benefits and bonuses. The Company has not decided whether it will publish such information in the manner contemplated in the Corporate Governance Recommendations, considering that publishing such personal information may seriously damage the privacy of the members of the Management Board.

In other respects, the Company will consider its compliance with the requirements of the Corporate Governance Recommendations on a case-by-case basis with the aim of achieving a compliance to the maximum extent practicable. The Company will annually report to the shareholders as to the status of its compliance with the recommendations in the Corporate Governance Report. Such report will be included in the annual report of the Company for the first time for the financial year ending on 31 December 2007.

MEMBERSHIPS IN THE ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES

The table below lists the names of the companies and partnerships, apart from Group companies and joint ventures, in which the members of the Supervisory Council, Management Board and other key

executives have held positions as members of the administrative, management or supervisory bodies or partners at any time in the previous five years:

Supervisory Council		
Name	Former positions	Current positions
Arti Arakas	AS Ilmarine, Supervisory Council Barona Ärikeskuse AS (dissolved), Supervisory Council Metro Capital Management AS, Supervisory Council OÜ Canopus, Management Board OÜ Ranhard, Supervisory Council OÜ Oldplus, Management Board OÜ Burford, Management Board	E-Kinnistute OÜ, Management Board Euro Houses Development OÜ, Management Board Euro Shipping OÜ, Management Board OÜ Carlyte Capital, Management Board Arco Kinnisvaraholduse AS, Management Board OÜ Tarlton Capital, Management Board OÜ Toletum, Management Board OÜ Woolard Capital, Management Board OÜ Elwell Capital, Management Board
Richard Tomingas	AS Ilmarine, Supervisory council AS Kuressaare Golf, Supervisory Council Barona Ärikeskuse AS (dissolved), Supervisory Council Metro Capital Management AS, Supervisory Council OÜ Canopus, Management Board OÜ Dorsy Trade, Management Board OÜ Ranhard, Supervisory Council OÜ Burford, Management Board	Euro Houses Development OÜ, Management Board Euro Shipping OÜ, Management Board OÜ Carlyte Capital, Management Board OÜ Tarlton Capital, Management Board OÜ Toletum, Management Board OÜ Woolard Capital, Management Board OÜ Elwell Capital, Management Board Arco Kinnisvaraholduse AS, Supervisory Council
Hillar-Peeter Luitsalu	Barona Ärikeskuse AS (dissolved), Supervisory Council OÜ Canopus, Management Board OÜ Dorsy Trade, Management Board	Arco Kinnisvaraholduse AS, Supervisory Council OÜ HM Investeeringud, Management Board OÜ TIK Spordimaja, Management Board
Aare Tark	AS Flora Vara, Supervisory Council AS ESP, Supervisory Council AS Sampo Pank, Supervisory Council	AS Advokaadibüroo Tark & Ko, Management Board AS Eesti Telekom, Supervisory Council AS Norma, Supervisory Council AS Saku Metall, Supervisory Council Amserv Grupi AS, Supervisory Council
Kalev Tanner	AS Intergate (merged with OÜ IG Partners), Management Board AS Kinnisvaraportal, Supervisory Council AS WebMedia, Supervisory Council AS Erel Group, Management Board Est Holding OÜ, Management Board OÜ Tallinna Pesumaja, Supervisory Council	OÜ Sparkling Group, Management Board AS E-Kindlustus Kindlustusmaakler, Supervisory Council AS Neoqi, Supervisory Council AS Vene Posti Operaator, Supervisory Council NutriTech Baltics OÜ, Supervisory Council OÜ E-KINDLUSTUS ONLINE, Supervisory Council OÜ Licom Trade, Management Board OÜ Spirit, Management Board OÜ T-Capital, Management Board OÜ Veglio, Management Board OÜ Axtell Grupp, Management Board SIA Axtell Latvia, Management Board OÜ Boom Juhtimine, Management Board OÜ Caresun, Management Board OÜ Chedi, Management Board OÜ IG Partners, Management Board OÜ Longfield, Management Board OÜ Mirabilli, Management Board OÜ Postramar, Management Board

Privador AS, Supervisory Council

Management Board

Name	Former positions	Current positions
Viljar Arakas	Arco Transport AS, Management Board Haagiserent AS, Management Board OÜ Haagisekeskus, Management Board OÜ Celleman, Management Board	AS Norbert, Supervisory Council Explorer Property Fund – Baltic States AB, Board of Directors Explorer Property Fund Investors – Baltic States AB (publ), Board of Directors Arco Balti Kinnisvarafond AS, Supervisory Council
Sulev Luiga	KPMG Estonia AS, Management Board	AS Norbert, Supervisory Council OÜ ES Gaap Arco Balti Kinnisvarafond AS, Supervisory Council
Ivar Siimar	AS Kinnisvaraportaali, Supervisory Council	CGI PROJECT OÜ, Management Board OÜ Stonemill, Management Board
Veiko Pedosk	AS Sampo Liising, Management Board	Kvaliteks OÜ, Management Board
Ahto Altjõe	AS GoRail, Supervisory Council Reval Rent OÜ, Supervisory Council Noil Group AS, Management Board Antigone OÜ (dissolved), Management Board	OÜ Infotrade, Management Board
Aare Tammemäe	AS EDI VEKTOR (dissolved), Supervisory Council AS IT Grupp, Supervisory Council AS Tallinna Sadam, Management Board OÜ Tallinna Sadama Elektrivõrk, Supervisory Council HF Investeeringu AS (dissolved), Supervisory Council HF KAPITAL AS (dissolved), Supervisory Council OÜ Tallinna Sadama Elektrivõrk, Supervisory Council	OÜ Brandeis Grupp, Management Board Nordea Bank Finland Plc Estonian Branch, Management Board

Other Key Executives

Name	Former positions	Current positions
Maie Kütt	-	OÜ Loogika, Management Board
Marilyn Hein	-	-
Heigo Metsoja	AS EEMG, Supervisory Council AS Eesti Eine, Management Board	-
Ergo Tars	-	-
Kadri Lindpere	-	-
Kaido Kangur	AS Vestman Kinnisvaraarendus, Management Board AS Põlluvara, Supervisory Council	-
Aigars Šmits	SIA Euro Real Estate, Management Board	SIA Jagr Investicijas, Management Board SIA Siguldās mājas JS, Management Board
Viktors Savins	-	-

Indrė Augulytė	-	-
Juri Nikitin	-	OÜ Tarteks Trading, Management Board OÜ Bagatini, Management Board
Rauni Tillisoo	Delta Brokers EOOD, Management Board	-
Ciprian Marius Lopata	AS Cleanaway, Management Board AS Cleanaway Tartu (in liquidation), Supervisory Council Cleanaway Viljandi AS, Supervisory Council AS Heakorastus, Supervisory Council Cleanaway Hiiumaa OÜ, Supervisory Council Cleanaway Konteinerveod AS, Supervisory Council Cleanaway Tallinn AS, Supervisory Council Harko Keila OÜ, Supervisory Council Tallinna Prügila AS, Supervisory Council	AS IPC Real Estate, Management Board IPC Romania OÜ, Management Board Pensby OÜ, Management Board IPC Real Estate Business SRL, Management Board Tartu SRL, Management Board Otepaa SRL, Management Board Paide SRL, Management Board Jaagupi SRL, Management Board Teletell SRL, Management Board

In addition, Mr. Viljar Arakas has granted his consent to be elected as a Member of the Supervisory Council of Tallinna Lennujaama AS (Tallinn Airport). As at the date of this Offering Circular, the resolution regarding his election to this position has not been adopted yet.

REMUNERATION AND BENEFITS

The following table sets forth the aggregate gross amounts of salaries and other remuneration paid by the Group to the members of its Supervisory Council, Management Board and other key executives for the financial year ended 31 December 2006:

	Salary (EEK)	Bonuses (EEK)	Total remuneration (EEK)
Supervisory Council	-	-	-
Management Board	4,632,124	2,740,000	7,372,124
Other key executives	2,787,693	577,574	3,365,267

On 29 May 2007, the General Meeting of Shareholders decided that the Company will pay a monthly remuneration in the gross amount of EEK 7,500 to each member of the Supervisory Council as of 1 June 2007. No remuneration has been paid to the members of the Supervisory Council prior to 1 June 2007.

No benefits have been granted by the Group to the members of the Supervisory Council, except that the Company provides a company car to certain members of the Supervisory Council, who are also entitled to reimbursement of mobile phone costs, fuel costs and parking costs.

The Company has not entered into service agreements with the members of the Supervisory Council.

Arco Vara operates a bonus system for the key employees and members of the management of the Group. This bonus system is effective for the three-year period starting from 1 January 2007 and applies to the following persons: (i) the members of the Management Board of the Company; (ii) the managers of the Company's direct and indirect subsidiaries, other than the special purpose vehicles established for specific projects; (iii) the heads of the Group's back-office functions, such as the Head of Legal Department, Chief Accountant, Head of IT, Head of Asset Management, Marketing and Communications Manager and Head of Administration. Management regularly updates the list of positions in categories (ii) and (iii), when changes take place in the Group's structure and organization.

Each member of the Management Board is entitled to an annual bonus in the maximum amount of EUR 250,000 per year, based on the financial results of the years 2007, 2008 and 2009. The exact amount of bonus depends on to what extent certain financial targets have been reached. These targets have been set individually for each member of the Management Board in relation to his areas of responsibility and for each financial year. For Mr. Viljar Arakas, Mr. Sulev Luiga and Mr. Aare Tammemäe, the financial targets are based on the consolidated revenue and profit of the entire Group. For Mr. Ivar Siimar, Veiko Pedosk and Ahto Altjõe, the financial targets are based on the consolidated revenue and profit of the services division, development division and the construction division, respectively. Mr. Tammemäe is entitled to a certain fixed bonus each year, regardless whether the financial targets are reached.

Each manager of the Company's subsidiaries participating in the bonus system is entitled to an annual bonus in the maximum amount of his/her three months' salary. The exact amount of bonus depends on to what extent the profit target, revenue target and operational targets set for the subsidiary have been reached. The Management Board determines these targets in consultation with the relevant manager for each of the years 2007, 2008 and 2009 as well as for the whole three-year period. When the targets for the whole three-year period are reached, the manager is entitled to an additional bonus in the amount of his/her one-month salary for every year in the period 2007-2009, provided that the annual target of that year is met.

Each head of the back-office functions participating in the bonus system is entitled to an annual bonus in the maximum amount of his/her three months' salary. The exact amount of bonus depends on the following criteria: (i) the amount of Group's annual revenue (ii) the amount of Group's annual profit and (iii) achievement of annual operational targets set for the employee. The operational targets are determined for each of the years 2007, 2008 and 2009 by the employee's direct superior in consultation with the employee.

Under their service agreements with the Company, Mr. Viljar Arakas, Mr. Sulev Luiga and Mr. Aare Tammemäe are entitled to a compensation equal to six months' remuneration in the event of their dismissal from the Management Board without cause. Mr. Aare Tammemäe is entitled to such compensation also in case he resigns from the Management Board for the reason that the Company has breached his service agreement. Mr. Veiko Pedosk is also entitled to compensation equal to six months' remuneration upon his dismissal from the management board of Arco Investeeringud without cause. Similarly, each of Mr. Ivar Siimar and Mr. Ahto Altjõe are entitled to compensation equal to six months' remuneration upon his dismissal from the management boards of Arco Real Estate, Arco Ehitus, respectively, without cause. According to the service agreements of Messrs. Arakas, Luiga, Pedosk, Siimar and Altjõe, the above compensation is not payable in the event that the member of the Management Board is recalled from his office during the first six months of his service or for the reason that he has breached his service agreement or caused damages to the company or its co-operation partners in any other way. According to the service agreement of Mr. Tammemäe, the compensation is not payable if he is recalled from his office with cause, including for the reason that he has committed a material breach of his service agreement which results in damages to the Company or its shareholders or creditors.

Other benefits granted to members of the Management Board and certain other key executives include company cars or reimbursement of costs of personal cars, compensation of travel expenses, mobile phone costs, fuel costs, parking costs, health check-up costs and training costs. The Group also covers the costs of health insurance of certain key executives.

None of the members of the Supervisory Council, Management Board or other key executives is entitled to any pension benefits from the Group.

Certain individual key members of the management are entitled to personal incentive remuneration outside the Group's general remuneration programmes. Such incentives are decided by the Company case by case. The Group currently operates the following personal incentive schemes:

- Mr. Sulev Luiga is entitled to receive a one-off bonus in the maximum amount of EEK 500,000 in connection with the Combined Offering. The first part of the bonus in the amount of EEK 250,000 will be paid upon the public announcement of the Combined Offering and the commencement of book-building. The payment of the remaining part of the bonus in the amount up to EEK 250,000 will be paid no later than on 10 July 2007, depending on the results of the Combined Offering and amount of the bonus will be subject to an adjustment on the basis of the ratio between the total number of Offer Shares offered in the Combined Offering and the total number of Offer Shares purchased or subscribed.
- Mr. Indrek Porila, the member of the management board of OÜ Floriston Grupp, is entitled to a bonus in the gross amount (including taxes) equal to up to 12.5 per cent of the total consolidated undistributed retained earnings of Floriston Grupp OÜ, a joint venture between Arco Investeeringud and AS Ärimaja. The bonus in respect of each project becomes payable when the project is completed. The Company granted this bonus to Mr. Porila in recognition of his exceptional performance in the early years of the Group's Latvian operations.
- The Group has given shares in certain local subsidiaries to the local senior managers. In Latvia, Mr Viktors Savins owns a 20 per cent interest in Arco Real Estate SIA and Arco Development SIA, 20 per cent of Bišumuižas Nami SIA and 15 per cent of Arco Construction SIA. After the closing of the sale of 50 per cent of the shares in Bišumuižas Nami SIA to Linstow Baltic SIA, Mr. Savins's shareholding in Bišumuižas Nami SIA will decrease to 10 per cent. Similarly, Mr Martins Bubens and Mr Aivars Kacars, each holds 15 per cent of the shares in Arco Construction SIA. These persons were the former majority shareholders of Arco Construction SIA and retained their minority holdings after the transfer of majority of the shares to the Group. These minority shareholders have no free-carry rights, but are expected to participate in the financing of these companies in proportion to his ownership interest. The Group expects to continue giving minority interests to key managers on a case-by-case basis, in new geographic areas that are new to the Group.

SHARE OWNERSHIP AND PARTICIPATION IN THE COMBINED OFFERING

As of the date of this Offering Circular, the members of the Supervisory Council, Messrs. Arti Arakas, Richard Tomingas and Hillar-Peeter Luitsalu, hold together indirectly 100 per cent of the Shares, entitling them to 100 per cent of the votes that can be cast in the General Meeting of Shareholders. See "Company, Share Capital and Ownership Structure – Shareholders of the Company."

Except as provided above, none of the members of the Supervisory Council, Management Board or other key executives holds any Shares or options over the Shares as of the date of this Offering Circular.

The members of the Supervisory Council and Management Board and other key executives may participate in the Combined Offering subject to the terms and conditions of the Combined Offering as set forth in this Offering Circular. Some of these persons have indicated to the Company that they may participate in the Combined Offering. However, to the extent that the Company is informed, none of such persons intends to subscribe individually for more than five per cent of the Offer Shares.

TRANSACTIONS WITH ARCO VARA, LEGAL ISSUES

The Company is not aware that any of the members of its Supervisory Council or Management Board or other key executives has been disqualified by any court from acting as a member of the administrative, management or supervisory bodies of an issuer or from acting in the management or conduct of the affairs of any issuer.

The members of the Supervisory Council, Messrs. Arti Arakas, Richard Tomingas and Hillar-Peeter Luitsalu have all acted as members of the Supervisory Council of Barona Ārikeskuse AS which is

currently under compulsory liquidation. The company had no business activities and it was decided to dissolve the company by way of compulsory liquidation proceedings, which were initiated on the formal ground that the company failed to register its shares in the Estonian Central Register of Securities.

A member of the Management Board, Mr. Ahto Altjõe, has served as a member of the Management Board of Antigone OÜ. This company has been compulsorily dissolved on the ground that it has failed to submit its annual report to the Commercial Register.

Except as provided above, the Company is not aware of any compulsory liquidations of companies in which any of the members of its Supervisory Council, Management Board or other key executives has acted as a member of the administrative, management or supervisory body or as a senior manager.

The Company is not aware of any convictions in relation to fraudulent offences, bankruptcies, receiverships or any official public incrimination and/or sanctions with respect to the members of its Supervisory Council or Management Board or other key executives.

The Company is not aware of any potential conflicts of interest between the duties of the members of its Supervisory Council or Management Board or other key executives to the Company and their private interests or other duties.

COMPANY, SHARE CAPITAL AND OWNERSHIP STRUCTURE

GENERAL INFORMATION ON THE COMPANY

Name, place of registration, legal form

The legal (business) name of the Company is Arco Vara AS. The Company is a public limited company (*aktsiaselts*) incorporated pursuant to the laws of the Republic of Estonia. The Company is registered with the Estonian Commercial Register (*Äriregister*) under registration code 10261718.

The Company was registered in the Estonian Enterprises Register (*Ettevõttere register*) on 4 July 1994 under the business name Arco Kinnisvara AS. On 12 September 1997 the Company was re-registered in the Estonian Commercial Register. In August 1998, the business name of the Company was changed to Arco Vara AS.

The origins of the Group, however, date back to 10 February 1992 when Mr. Arti Arakas founded the company named “aktsiaselts Arco Vara” with the purpose of starting a real estate agency business in Tallinn. This company, being the oldest member of the Group, is currently a subsidiary of the Company with the business name of AS Arco Vara Kinnisvarabüroo.

The Company has been established for an indefinite term.

Registered office

The Company’s registered office is in Tallinn, Estonia at the address Jõe 2b, 10151 Tallinn, Estonia, telephone (+372) 6 144 630.

Fields of activities

As of 1 January 2007, public limited companies established under Estonian law are not required to list their fields of activities in their Articles of Association. Instead, when preparing their annual reports, they must indicate in the report their fields of activities for the previous financial year and contemplated fields of activities for the next financial year, using the Estonian Classificatory of Economic Activities.

According to Company’s annual report for the financial year 2006, the Company’s fields of activities in 2006 were real estate development and investment, real estate related services and construction. The Company does not contemplate introducing any changes in its fields of activities in the financial year 2007.

Financial year

The financial year of the Company runs from 1 January to 31 December.

SUBSIDIARIES, JOINT VENTURES AND ASSOCIATED COMPANIES

The Company is the operating parent company of the Group. The table below shows the Company’s subsidiaries, joint ventures and associated companies, as at the date of this Offering Circular. The percentage in the table indicates the proportion of ownership held directly or indirectly by the Company in the respective company.

DEVELOPMENT

Name	%	Registered office	Share capital	Other shareholders
Arco Investeeringute AS	100	Tallinn	EEK 400,000	
Zeus Haldus OÜ	100	Tallinn	EEK 60,000	
OÜ Metro Kinnisvara	100	Tallinn	EEK 40,000	
Arco Vara Kinnistute AS	100	Tallinn	EEK 686,000	
OÜ Wilson Kinnisvara	100	Tallinn	EEK 40,000	
OÜ Pärnu Turg	100	Tallinn	EEK 40,000	
Arco Capital EOOD	100	Sofia	BGN 100,000	
Arco Vara Riia Valduste OÜ	100	Tallinn	EEK 40,000	
Vidus Nams SIA (in liquidation)	100	Riga	LVL 2,000	
Rasmussen Invest Latvija SIA	80	Riga	LVL 2,000	Kingstone Invest OÜ 20%
OÜ Waldrop Investments	100	Tallinn	EEK 40,000	
AS Kolde	89	Tallinn	EEK 420,000	OÜ ISA Group 11%
OÜ Kerberon	83	Tallinn	EEK 80,000	OÜ ISA Group 17%
Arco Development SIA	80	Riga	LVL 2,000	Viktors Savins 20%
Ulmana Gatves Nami SIA	80	Riga	LVL 2,000	
Dreilini-Ulbroka-1 SIA	40	Riga	LVL 2,000	B&S Finance B.V 50%
Bisumuizas Nami SIA	80 ¹⁾	Riga	LVL 2,000	Viktors Savins 20% ¹⁾
Sportings Riga SIA	80 ¹⁾	Riga	LVL 31,800	
TOV Arco Invest	75	Kiev	UAH 40,000	OÜ Bagatini 25%
AS Tallinna Olümpiapurjespordikeskus	50	Tallinn	EEK 166,192,000	Regati Valduse OÜ 50%
Arco Ärikeskuse OÜ	50	Tallinn	EEK 90,000	Aberdeen OÜ 50%
Arco HCE OÜ	50	Tallinn	EEK 40,000	Rotermann Eesti OÜ 50%
Arco & Koger Investeeringute OÜ	50	Tallinn	EEK 40,000	OÜ Koger Kinnisvara 50%
Arco & Koger EOOD	50	Sofia	BGN 5,000	
Arco Vara Saare Kinnistud OÜ	50	Tallinn	EEK 150,400	Saare Finants AS 50%
Varamaad Kinnisvara OÜ	50	Tallinn	EEK 33,000,000	
OÜ Floriston Grupp	50	Tallinn	EEK 40,000	AS Ärimaja 50%
OÜ Snowden	50	Tallinn	EEK 40,000	
OÜ Chalwell	50	Tallinn	EEK 40,000	
OÜ Hopson Capital	50	Tallinn	EEK 40,000	
OÜ Redman Invest	50	Tallinn	EEK 40,000	
OÜ Steadman	50	Tallinn	EEK 40,000	
OÜ Noland Grupp	50	Tallinn	EEK 40,000	
OÜ Kastner Grupp	50	Tallinn	EEK 40,000	
Arco Vara Arenduse OÜ	50	Tallinn	EEK 80,000	GGI Projekt OÜ 50%
Pärnu Elumaja OÜ	50	Tallinn	EEK 40,000	OÜ Saarte Investeering 50%
Pärnu Ärihoone OÜ	50	Tallinn	EEK 40,000	OÜ Saarte Investeering 50%
OÜ Gilmor Group	20	Tallinn	EEK 200,000	Linstow AS 80%
Arco Maadehalduse OÜ	100	Tallinn	EEK 330,000	
Arco Vara Puukool OÜ	100	Tallinn	EEK 40,000	

SERVICES

Name	%	Registered office	Share capital	Other shareholders
Arco Real Estate AS	100	Tallinn	EEK 400,000	
AS Arco Vara Kinnisvarabüroo	100	Tallinn	EEK 952,000	
OÜ Koduküla	50	Tallinn	EEK 200,000	VWF Kinnisvara OÜ 50%
Arco Imoti EOOD	100	Sofia	BGN 5,000	
Arco Real Estate SIA	80	Riga	LVL 54,000	Viktors Savins 20%
SIA Adepto	80	Riga	LVL 2,000	
Arco Real Estate UAB	80	Vilnius	LTL 20,000	G. Jankeliunas 20%
Arco Invest UAB	80	Vilnius	LTL 1,000	
AVEC Asset Management AS	50	Tallinn	EEK 4,400,000	East Capital Holding AB 50%
Arco Rumeenia Valduste OÜ	50	Tallinn	EEK 40,000	IPC Romania OÜ 50%
Arco Real Estate Consulting SRL	50	Bucharest	RON 30,000	
Arco Ukraina Valduste OÜ	75	Tallinn	EEK 40,000	OÜ Bagatini 25%
Arco Neruhomist TOV	75	Kiev	UAH 26,200	

CONSTRUCTION

Name	%	Registered office	Share capital	Other shareholders
Arco Ehitus OÜ	100	Tallinn	EEK 740,000	
Arco Construction SIA	55		LVL 4,000	V. Savins 15%, M. Bubens 15%, A. Kacars 15%
Tallinna Linnaehituse AS	80	Tallinn	EEK 6,300,000	OÜ ISA Group 20%

¹⁾ As at the date of the Offering Circular, Arco Investeeringud owns 80 per cent and Mr. Viktors Savins owns 20 per cent of the shares of SIA Bišumuižas Nami. On 18 May 2007, Arco Investeeringud and Mr. Viktors Savins entered into a conditional Share Purchase Agreement with SIA Linstow Baltic regarding the sale of 50 per cent of the shares of SIA Bišumuižas Nami. Following the closing Arco Investeeringud will own 40 per cent of the shares in SIA Bišumuižas Nami, with Mr. Viktors Savins owning 10 per cent and SIA Linstow Baltic owning 50 per cent. See - "Management's Discussion and Analysis of the Group's Financial Condition and Results of Operations – Recent Developments".

Management proposes that OÜ Floriston Grupp and Arco Invest UAB will be reorganised under the parent company Arco Investeeringud and Arco Ukraina Valduste OÜ will be reorganised under the parent company Arco Real Estate. The shareholders of the following Group companies have decided that Zeus Haldus OÜ and Osühing Metro Kinnisvara will be merged into Arco Investeeringud and that Pärnu Elumaja OÜ will be merged into Pärnu Ärihoone OÜ. The shareholders of Arco Maadehalduse OÜ and Arco Vara Puukool OÜ have decided that these companies will be merged. Management proposes that Arco Vara Puukool OÜ, as the surviving company, will be reorganised under the parent company Arco Investeeringud. Management expects that such restructuring procedures will be completed later in 2007. The proposed reorganization will not affect the Company's ultimate ownership of the assets as described herein.

INFORMATION ON SHARE CAPITAL AND SHARES

As of 31 March 2007, the Company's registered share capital was EEK 304,530,370 divided into 30,453,037 authorised, fully paid and issued Shares with a nominal (par) value of EEK 10 each.

As of the date of this Offering Circular, the Company's registered share capital is EEK 677,841,500 divided into 67,784,150 authorised, fully paid and issued Shares with a nominal value of EEK 10 each. See "Changes in the Share Capital".

After the completion of the Combined Offering, the share capital of the Company will be EEK 1,032,841,500 divided into 103,284,150 Shares with a nominal (par) value of EEK 10 each, assuming that the Upsizing Option is exercised in full.

The existing Offer Shares have been issued, and the new Offer Shares will be issued, under the laws of the Republic of Estonia. All existing Offer Shares are fully paid up. All existing Offer Shares and, once the increase of share capital relating to the issue of new Offer Shares is registered with the Estonian Commercial Register, the new Offer Shares will rank *pari passu* in all respects with all the remaining existing Shares.

The Shares are registered in book-entry form in the Estonian Central Register of Securities (as maintained by AS Eesti Väärtpaberikeskus, address Tartu mnt 2, Tallinn, 10145) under the identification number (ISIN code) EE3100034653. The trading code of the Shares in the Tallinn Stock Exchange trading system is ARC1T.

Free transferability of the Shares has not been restricted in the Company's Articles of Association, nor are the Shares subject to any transfer restrictions other than those described in this Offering Circular regarding particular shareholders. See "Underwriting — Lock-up".

CHANGES IN THE SHARE CAPITAL

Since the registration of the Company in the Commercial Register on 12 September 1997, the amount of the share capital has changed as follows:

	<u>Change in share capital (EEK)</u>	<u>New share capital (EEK)</u>	<u>Registered in Commercial Register</u>
Registration of Company in Commercial Register		100,000	12 September 1997
Share capital increase (new issue)	+ 300,000	400,000	20 May 1999
Share capital increase (new issue)	+ 607,000	1,007,000	1 September 1999
Share capital increase (new issue)	+ 2,034,000	3,041,000	30 December 1999
Share capital increase (new issue)	+ 1,159,000	4,200,000	27 November 2002
Share capital increase (bonus issue)	+ 268,354,680	272,554,680	16 August 2005
Share capital increase (new issue)	+ 31,975,690	304,530,370	19 December 2005
Share capital increase (bonus issue)	+373,311,130	677,841,500	4 May 2007

On 27 July 2005, the General Meeting of Shareholders decided to execute a share split by reducing the nominal value of the shares of the Company from EEK 500 to EEK 10 and converting each share of the Company into 50 shares. In conjunction with the share split the General Meeting of Shareholders also decided to increase the share capital from EEK 4,200,000 to EEK 272,554,680 by means of a bonus issue. The increase of share capital was registered in the Commercial Register on 16 August 2005.

On 18 November 2005, the General Meeting of Shareholders decided to increase the share capital of the Company from EEK 272,554,680 to EEK 304,530,370 by issuing 3,197,569 new Shares with a nominal value of EEK 10 each. The Share issue was executed as a private placement directed to AS Hansapank. The Shares were issued at a premium with the total issue price of the Shares being EEK 156,466,400, which was fully paid by AS Hansapank in cash. The increase of share capital was registered in the Commercial Register on 19 December 2005.

On 26 April 2007, the General Meeting of Shareholders decided to increase the share capital of the Company from EEK 304,530,370 to EEK 677,841,500 by issuing 37,331,113 new Shares with a nominal value of EEK 10 each by means of a bonus issue. The new Shares were issued against reduction in the share premium in the amount of EEK 123,082,516 and retained earnings in the amount of EEK 250,228,614. The increase of share capital was registered in the Commercial Register on 4 May 2007.

ISSUE OF NEW OFFER SHARES AND DILUTION

In connection with the Combined Offering the Company will issue 27,500,000 new Offer Shares. The Company reserves an option to increase the number of new Offer Shares to be offered in the Combined Offering by up to 8,000,000 Offer Shares prior to the determination of the Offer Price. The General Meeting of Shareholders is expected to approve the issue of new Offer Shares on or about 14 June 2007. The Management Board will propose that the General Meeting of Shareholders waive the pre-emptive right of shareholders to subscribe for the new Offer Shares in connection with the Combined Offering in order to widen the shareholder base of the Company. The decisions of the General Meeting of Shareholders will be published through the Tallinn Stock Exchange on or about 15 June 2007.

The Offer Shares represent approximately 70.59 per cent of the Company's share capital immediately prior to the Combined Offering and approximately 46.33 per cent of the Company's share capital following the completion of the Combined Offering assuming that the Upsizing Option and the Over-Allotment Option are exercised in full.

OPTION RIGHTS, CONVERTIBLE SECURITIES AND SECURITIES WITH WARRANTS

In absence of express authorisation in the Articles of Association, any decision which alters the share capital or number of shares in an Estonian public limited company must be passed by the general meeting of shareholders. Under Estonian law, convertible bonds are the only debt instruments granting a conversion right into the company's shares. The general meeting of shareholders can decide on the issuance of convertible bonds, if such right has been provided for in the Articles of Association.

In addition, upon the decision of the general meeting of shareholders, share subscription rights may be granted to the employees and members of governing bodies of the company or related undertakings. Such subscription rights may be granted also in connection with the preparation for a merger.

The Company's Articles of Association allow the Company to issue convertible bonds upon the decision of the General Meeting of Shareholders. However, the Company has not issued any convertible bonds or option rights, securities with warrants, capital loans or other securities or instruments convertible into or exchangeable for Shares.

SHAREHOLDERS OF THE COMPANY

According to the shareholder register of the Company as maintained in the ECRS, the Company had two shareholders as at the date of this Offering Circular, whose shareholdings were as follows:

<u>Name</u>	<u>Number of Shares</u>	<u>%</u>
Osäühing Toletum	45,189,434	66.67
Osäühing HM Investeeringud	22,594,716	33.33
Total	67,784,150	100

None of the shareholders have any different voting rights compared to other shareholders.

As of the date of this Offering Circular, neither the Company nor any of its subsidiaries owns any of the Shares.

Osäühing Toletum, which owns 45,189,434 Shares entitling it to approximately 66.67 per cent of the votes that can be cast in the General Meeting of Shareholders, is a private limited company registered in the Estonian Commercial Register under registration code 11011219. The registered address of Osäühing Toletum is Jõe 2b, Tallinn 10151, Estonia. Osäühing Toletum is controlled by Messrs. Arti Arakas and Richard Tomingas, each of whom own 50 per cent of the shares of that company.

Osäühing HM Investeeringud, which owns 22,594,716 Shares entitling it to approximately 33.33 per cent of the votes that can be cast in the General Meeting of Shareholders, is a private limited company registered in the Estonian Commercial Register under registration code 10963165. The registered address of Osäühing HM Investeeringud is Hämariku 2A, Tallinn 11211, Estonia. Osäühing HM Investeeringud is controlled by Mr. Hillar-Peeter Luitsalu, who owns the sole share of that company.

In November 2005, the Company carried out a private placement by issuing 3,197,569 new Shares to AS Hansapank. In conjunction with the private placement, the shareholders of the Company entered into a shareholders' agreement on 29 November 2005. The agreement provided the majority shareholders of the Company with an option to repurchase the Shares issued to AS Hansapank at the price based on the issue price plus an agreed premium of 16.5 per cent per year. This option could be exercised at any time from the first anniversary until the third anniversary of the completion of the private placement. On 22 December 2006, the majority shareholders Osäühing Toletum and Osäühing HM Investeeringud exercised the option in full and acquired all Shares owned by AS Hansapank for the total consideration of EEK 181,259,826 (EEK 56.6867 per Share). The repurchase was completed in February 2007.

For the description of transactions entered into between the Group companies with related parties, see “Business—Related Party Transactions”.

SELLING SHAREHOLDERS

In the Combined Offering Osühing Toletum is offering up to 4,633,333 Offer Shares for sale and Osühing HM Investeeringud is offering up to 2,316,667 Offer Shares for sale.

In addition, Osühing Toletum has granted the Global Coordinator an option to require Osühing Toletum to sell up to 3,600,000 Additional Shares and Osühing HM Investeeringud has granted the Global Coordinator an option to require Osühing HM Investeeringud to sell up to 1,800,000 Additional Shares. Such options have been granted for purposes of covering possible over-allotments (the Over-Allotment Option).

Assuming that neither of the Selling Shareholders will acquire any Offer Shares in the Combined Offering and that the Selling Shareholders sell all the Additional Shares covered by the Over-Allotment Option and assuming that the Upsizing Option is exercised in full, it is expected that immediately after the Combined Offering Osühing Toletum will control approximately 35.78 per cent of the votes that can be cast in the General Meeting of Shareholders and Osühing HM Investeeringud will control approximately 17.89 per cent of the votes that can be cast in the General Meeting of Shareholders.

As of the date of this Offering Circular, the Selling Shareholders have pledged the total of 34,603,104 Shares for the benefit of AS SEB Eesti Ühispank in order to secure the loans granted to them by AS SEB Eesti Ühispank. The Selling Shareholders and AS SEB Eesti Ühispank have an agreement that the Selling Shareholders shall use the proceeds from the sale of Offer Shares to repay the loans granted by SEB Eesti Ühispank and consequently, the bank shall release the Shares from the pledge.

In addition, Osühing Toletum has pledged 2,100,000 Shares for the benefit of AS Hansapank in order to secure an overdraft facility granted by AS Hansapank to Mr. Arti Arakas, the shareholder and Member of the Management Board of Osühing Toletum. These Shares remain pledged for the benefit of AS Hansapank after the Combined Offering.

SHAREHOLDERS’ AGREEMENTS

No shareholders’ agreements exist between shareholders in relation to their holdings of shares in the Company.

In connection with the Combined Offering, certain restrictions on sale and transfer of Shares have been agreed between the relevant parties. See “Underwriting — Lock-up.”

SHAREHOLDER RIGHTS

General meetings of shareholders

Under the Estonian Commercial Code, shareholders exercise their power to decide on corporate matters at general meetings of shareholders. The general meeting of shareholders considers, among other things, the annual report and the distribution of profits. Resolutions may be adopted at either annual or extraordinary general meetings.

In accordance with the Commercial Code, an annual general meeting of shareholders must be held within six months after the end of a financial year. An extraordinary general meeting of shareholders may be convened whenever the management board deems it appropriate. However, the management board is obliged to convene an extraordinary general meeting in cases set forth by the Commercial Code, for example, if the equity capital decreases below the legally required minimum equity, if the supervisory council, the auditor of the company or shareholders whose shares represent at least one-

tenth of the share capital of the company make such a request to the management board, or if this is clearly in the interests of the company. If the management board does not convene an extraordinary general meeting within one month following the receipt of a request of one or more shareholders, the supervisory council, the auditor, or the person or the persons who have submitted the respective request are entitled to convene an extraordinary general meeting themselves. The articles of association of the company may set forth additional cases in which the management board is required to convene an extraordinary general meeting.

Notices to convene annual general meetings of shareholders must be given at least three weeks prior to the meeting, and notices to convene extraordinary general meetings of shareholders must be given at least one week prior to the meeting. Notices must be sent in such way that, under normal conditions of delivery, they would reach the addressees within the term specified above. Notices to convene a general meeting of shareholders must be sent to shareholders by registered mail to their registered addresses (being the address of the shareholder entered in the shareholders' register of the company as maintained in the ECRS). If the company is aware or should be aware that the address of a shareholder is different from the one entered in the share register, the notice must be sent also to such address. Notices may be sent also by unregistered mail or fax provided that the letter or fax is accompanied by a notice requesting the recipient to immediately return the confirmation of receipt to the management board. However, if the company has more than 50 shareholders, notices need not be sent to shareholders, but may be published in at least one national daily newspaper in Estonia.

The supervisory council of the company usually determines the agenda of the general meeting of shareholders. If, however, the shareholders or the auditor convene a general meeting of shareholders, they also determine the agenda of that meeting. The management board or one or more shareholders whose shares represent at least one-tenth of the share capital of the company are entitled to request that items be included on the agenda of a general meeting of shareholders. If, upon convening a general meeting of shareholders, the requirements of law or the articles of association have been breached, no decision may be adopted at the meeting unless all shareholders participate or are represented at the meeting.

In order to have the right to attend and vote at a general meeting of shareholders, a shareholder must be registered in the shareholders' register on the cut-off date which is ten days before the meeting. Voting rights may not be exercised by a shareholder whose shares are registered in the name of a nominee unless the nominee account holder has given a power of attorney to the shareholder.

A general meeting of shareholders is capable of passing resolutions if more than one-half of the votes represented by shares held by the shareholders are present at the meeting. If the meeting has no quorum, the management board must call a new general meeting of shareholders for a date not later than within three weeks but not earlier than seven days after the date of the original meeting. There are no quorum requirements for the newly called general meeting.

Voting rights

The Company has one class of shares with a nominal value of EEK 10 each. Each share entitles the holder to one vote. A shareholder may attend and vote at a general meeting of shareholders in person or by proxy. At a general meeting of shareholders, resolutions generally require the approval of a majority of the votes represented at the meeting. However, certain resolutions, such as amending the Articles of Association, increasing or decreasing the share capital and, in certain cases, resolutions relating to a merger, division, reorganisation or liquidation of the company, require a majority of two-thirds of the votes represented at the general meeting of shareholders.

Any issuance of new shares on terms other than in accordance with the existing shareholders' preemptive subscription rights requires a majority of at least three quarters of the votes represented at the general meeting. Issuing a different class of shares requires amendment of the Articles of Association by a two-thirds majority of votes represented at the general meeting.

The rights attaching to any class of shares may be amended only by a decision of the general meeting of shareholders which is supported by a qualified majority of four-fifths of all votes and nine-tenths of the shareholders whose rights are proposed to be amended.

Dividends and other distributions

Under the Estonian Commercial Code, a general meeting of shareholders may authorize the payment of dividends on the terms and conditions set out in the profit distribution proposal presented by the management board. The supervisory council has the right to make changes to the proposal of the management board before submission to the general meeting.

Dividends, if any, should be paid in cash or, if the shareholders consent, in kind. The shareholders decide annually the dividend amount and procedure of payment on the basis of the approved annual report (the decision may, however, stipulate that the dividends are to be paid out in several instalments). As a general rule, no interim dividends may be paid in respect of a financial period for which an annual report (together with the audited financial statements) has not yet been approved by the general meeting of shareholders. However, the articles of association may provide that the management board has the right, upon the consent of the supervisory council, to make advance payments to the shareholders on account of the estimated profit after the end of a financial year but before the approval of the annual report, provided that such advance payments do not exceed one-half of the amount that may be distributed among shareholders. The Company's Articles of Association provide for such right of the Management Board.

Dividends may only be paid out from net profit or undistributed profit from previous financial years, and from which uncovered losses from previous years have been deducted. Dividends may not be paid to the shareholders if the net assets of the company, as recorded in the approved annual report of the previous financial year, are less than or would be less than the total of share capital and reserves, which, pursuant to applicable law or the Articles of Association, may not be distributed to the shareholders.

Dividends of companies listed on the Tallinn Stock Exchange are paid only to those shareholders (or their nominees) who are entered on the list of shareholders (shareholders' register) as maintained in the ECRS on the respective record date. The Tallinn Stock Exchange Rules and Regulations provide that a listed company is required to disclose information about closing the list of shareholders (fixing the record date) at least nine trading days before the record date. If a general meeting of shareholders adopts a resolution that relates to rights attached to the shares (for example, the declaration of payment of dividends), the record date may not be earlier than the tenth trading day after the date of the relevant general meeting of shareholders.

All existing Shares and, once the increase of share capital relating to the issue of new Offer Shares is registered with the Estonian Commercial Register, the new Offer Shares, rank *pari passu* with regard to dividends and other distributions of the Company (including distribution of assets in the event of dissolution).

For a description of restrictions on payment of dividends, see "*Dividends and Dividend Policy*".

Pre-emptive subscription rights

Under Estonian law, existing shareholders of a public limited company have pre-emptive rights to subscribe for new shares in the company, in proportion to their existing shareholding. A resolution waiving pre-emptive rights must be approved by at least three-fourths of all votes represented at the general meeting of shareholders.

Right to acquire own shares

A public limited company is entitled to acquire its own shares only if all the following conditions are met:

- (i) the acquisition occurs within one year after the adoption of a resolution of the general meeting of shareholders which specifies the conditions and term for the acquisition and the amounts to be paid for the shares;
- (ii) the sum of the nominal value of the shares held by the company does not exceed one-tenth of its share capital; and
- (iii) the shares are paid for from assets excluding the share capital, reserve capital and premium.

However, a public limited company may acquire its shares by inheritance. A public limited company may also acquire its shares by a resolution of the supervisory council without requiring a resolution of the general meeting of shareholders if the acquisition of the shares is necessary to prevent significant damage to the company. In such case, the shareholders must be informed of the circumstances and details of the acquisition of the company's own shares at the next general meeting of shareholders.

In any event, a public limited company, which has acquired its own shares, must transfer or cancel those shares within one year from the date on which they were acquired. In the event that the public limited company acquires its own shares in violation of the law, such shares must be disposed of or cancelled (by decreasing the share capital) within three months of acquisition. In the event that the shares acquired contribute to more than one-tenth of the share capital, such excess shares must be disposed of within six months of their acquisition.

The rules regarding the acquisition of a company's own shares are also applied to the acquisition of a parent company's shares by the subsidiaries. In the event that a subsidiary acquires the shares of its parent company, the parent company shall be regarded as the acquiring party.

Disclosure of shareholdings

Pursuant to the Estonian Commercial Code, the management board is required to submit to the Estonian Commercial Register, together with the approved annual report, a proposal for profit distribution, an auditors' report and a list of shareholders holding more than ten per cent of the votes as of the date of the approval of the annual report by the general meeting of shareholders. See "Estonian Securities Market—Estonian Company Law— The Estonian Central Registry of Securities and registration of shares" for a description of other instances when information concerning the shareholders is accessible to the public.

Squeeze-out rules

The Commercial Code provides that a shareholder whose shares, together with the shares of its parent undertaking and its subsidiaries, represent at least 90 per cent of the share capital of a public limited company, is entitled to make an offer to acquire the remaining outstanding shares of the company for fair monetary compensation. Such an offer must be presented to the general meeting of shareholders and, if at least 95 per cent of the votes represented by the shares of the Company are cast in favour, the offer will be binding on all shareholders.

Mandatory takeover bid rules

A person who has gained, either directly or together with other persons acting in concert, a dominant influence over a company whose shares are listed on the Tallinn Stock Exchange, is required to make within 20 days a takeover bid for all the outstanding shares of such issuer. Exemptions from the

obligation to make the mandatory take-over bid may be granted by the EFSA in case of certain specific circumstances provided by law.

For these purposes, a “dominant influence” is a situation where a person: (i) owns the majority of votes represented by the issuer’s shares; or (ii) being a shareholder of the company, has the right to appoint or remove a majority of the members of the supervisory council or management board of the company; or (iii) being a shareholder of the company, controls a simple majority of the votes represented by the company’s shares on the basis of an agreement entered into with other shareholders.

The Securities Market Act requires that the purchase price payable for the shares which are the object of the mandatory takeover bid must be fair.

Taxation of dividends

See “Taxation.”

ESTONIAN SECURITIES MARKET

ESTONIAN COMPANY LAW

The following describes certain provisions of Estonian legislation regulating the legal status and management of public limited companies. The following description does not constitute an exhaustive description of the subject matter. It is based on the laws of Estonia as in force on the date of this Offering Circular, and is subject to changes as a result of any future amendments to Estonian legislation.

Introduction

Under Estonian law, limited liability companies are divided into two main categories—private limited companies (*osajühing*, abbreviated as OÜ) and public limited companies (*aktsiaselts*, abbreviated as AS). Shareholders of private limited companies and public limited companies are generally not personally liable for the obligations of the companies. The two types of companies mainly differ in their requirements for capital and management structures. Public limited companies have greater capital requirements and can issue more classes of shares than private limited companies, and are required to register their shares with the ECRS. See “The Tallinn Stock Exchange and the Estonian Securities Market” below for details regarding the functions of the ECRS.

A public limited company organized under Estonian law must be registered with the Commercial Register and it acquires legal capacity upon its registration in the Commercial Register. The Commercial Register is maintained by the registration departments of the courts of first instance.

Public limited companies must have a minimum share capital of EEK 400,000. A public limited company's share capital must be fully paid-up as a condition of registration in the Commercial Register. Shares must be paid up in cash, unless the company's Articles of Association allows payment by means of a non-monetary contribution. The valuation of non-monetary contributions must be confirmed by the auditor.

The shares of public limited companies must have a nominal value of EEK 10 each or a full multiple thereof. Shares are freely transferable, but the company's Articles of Association may confer a preemptive right on shareholders. Dividends must be distributed to shareholders pro rata, based upon the nominal value of the shares held by each shareholder. A public limited company may issue different classes of shares, whose owners enjoy different rights upon distribution of profits and upon distribution of remaining assets in case of liquidation of the company. A public limited company may issue non-voting shares, which grant a preferential right to receive dividends and to participate in the distribution of the remaining assets of the company upon dissolution (preferred shares). The Articles of Association may prescribe that a preferred share shall grant the right to vote on the adoption of certain resolutions (restricted voting right). The sum of the nominal values of preferred shares may not be greater than one-third of the share capital.

Corporate governance

Under Estonian law, the control and management of a public limited company is divided among the general meeting of shareholders, the supervisory council and the management board.

General meeting of shareholders is the highest authority in a public limited company and makes the most important decisions in the company, such as amending the articles of association, increasing and reducing share capital, approving the annual report and distributing profit. See “Company, Share Capital and Ownership Structure - General meetings of shareholders” for further information on the tasks and procedures related to the general meeting of shareholders.

The supervisory council engages in oversight and longer-term management activities, such as supervising the management board and devising business plans. The supervisory council must have at least three members, who are elected by the general meeting for a period of five years, unless a shorter period is prescribed in the Articles of Association. The supervisory council reports to the general meeting. No residency or nationality requirements apply to the members of the supervisory council. A member of the supervisory council may not simultaneously serve as a member of the management board of the same company, or any of its subsidiaries.

The management board is an executive body charged with the day-to-day management of the company, and it represents the company in relations with third parties, for example, in entering into contracts on behalf of the company. The management board is elected by the supervisory council for a term of three years, unless the Articles of Association prescribe another term, which, however, may not be longer than five years. The management board must adhere to the lawful orders of the supervisory council. At least one-half of the management board members of a public limited company must be residents of Member States of the European Economic Area or Switzerland. Members of the management board may not simultaneously serve as the members of the supervisory council of the same company.

Members of the supervisory council and management board have a number of general obligations towards the company, such as a fiduciary duty of loyalty, the obligation to act with due diligence and sufficient skills and to the maximum benefit of the company. They must inform the company about any material facts related to the performance of their duties. Members of the supervisory council and management board are subject to a strict confidentiality obligation that applies to any information that they learn in connection with the discharge of their duties that the company has a legitimate interest to keep confidential, and above all, information relating to the trade and business secrets of the company. The confidentiality obligation continues after the management board or supervisory council member's term of service expires, to the extent necessary to protect the company's justified interests. Exceptions to the confidentiality obligation arise where the company authorizes disclosure, or where the law requires disclosure. Unauthorized disclosure of business secrets may result in criminal sanctions.

The Rules of Tallinn Stock Exchange impose a number of additional restrictions and limitations on the supervisory council and management board of a company listed on the Tallinn Stock Exchange. Most of these restrictions apply to a company from the moment when it submits the application for listing of its shares on the Tallinn Stock Exchange.

Under the Estonian Commercial Code, a public limited company is required to engage an auditor who must be appointed by the general meeting of shareholders. The general meeting of shareholders also determines the principles of remuneration of the company's auditors. The auditors may be appointed for a specified term or for a single audit.

A public limited company is required to have its annual report audited. After the end of the financial year, the management board must prepare the annual accounts and activity report and present them to the auditor for review. The management board presents the annual report (comprising the annual accounts and management report), the auditor's report and a proposal regarding the distribution of profit to the general meeting of shareholders for approval. The supervisory council has the right to make amendments to the profit distribution proposal before it is presented to the general meeting of shareholders. In addition, the supervisory council must review the annual report and prepare a written report thereon, which must, among other things, indicate whether or not the supervisory council approves the annual report. This report must be presented to the general meeting of shareholders together with the annual report.

Shareholders whose shares represent at least one tenth of the share capital of the company may demand from the company that the auditor who prepared the auditor's report participate in the making of the decision regarding the approval of the annual report, and provide explanations concerning the

auditor's report. Such a request must be submitted to the company in writing at least five days before the general meeting of shareholders.

THE TALLINN STOCK EXCHANGE AND THE ESTONIAN SECURITIES MARKET

Set out below is a summary of certain information concerning the Estonian regulated securities market and certain provisions of Estonian law and Estonian securities market regulations in effect on the date of this Offering Circular. The summary is based on Estonian laws and securities market regulations and publicly available information on OMX AB group, the principal shareholder of the company operating the Tallinn Stock Exchange, and on NOREX.

The Tallinn Stock Exchange

The Tallinn Stock Exchange is the only stock exchange operating in Estonia. It is operated by AS Tallinna Börs, a public limited company whose principal shareholder is the Swedish company OMX AB, through its Finnish subsidiary. OMX AB group companies also operate the Copenhagen Stock Exchange, the Helsinki Stock Exchange, the Iceland Stock Exchange, the Stockholm Stock Exchange, the Riga Stock Exchange and the Vilnius Stock Exchange. The Tallinn Stock Exchange is also a member of NOREX, an alliance of Nordic and Baltic stock exchanges all using the SAXESS trading system.

The activities of, and trading on, the Tallinn Stock Exchange are subject to two tiers of regulation. Laws and government regulations comprise the basic regulatory framework, which is supplemented by the Tallinn Stock Exchange Rules and Regulations. The principal laws governing the activities of, and trading on, the Tallinn Stock Exchange are the Estonian Securities Market Act and the Estonian Central Registry of Securities Act. The Tallinn Stock Exchange Rules and Regulations are established by the operator of the Tallinn Stock Exchange (AS Tallinna Börs) to ensure the regular and lawful operation of the stock exchange. The operator may unilaterally amend the Tallinn Stock Exchange Rules and Regulations, though the EFSA must approve such amendments. The Tallinn Stock Exchange Rules and Regulations are binding on the members of the Tallinn Stock Exchange and the issuers whose securities are listed on the Tallinn Stock Exchange or admitted to trading on the Secondary List which is a separate market regulated by the Tallinn Stock Exchange.

The Estonian Central Registry of Securities and registration of shares

The Estonian Central Registry of Securities (*Eesti väärtpaberite keskreister*, the ECRS) is a public register established, among other matters, for the registration of shares and other securities stipulated in the Estonian Central Registry of Securities Act and transactions executed with such securities (including pledges). The ECRS is operated by the Estonian Central Securities Depository (*AS Eesti Väärtpaberikeskus*, the "ECSD"). The ECSD is organized as a public limited company, and its shares are fully owned by AS Tallinna Börs. The ECSD's primary functions include clearing and settling securities transactions, maintaining records of share ownership and pledges, and providing securities-related services to issuers and investors. The ECSD is the responsible body for the only securities settlement system (SSS) in Estonia, which settles stock exchanges and over-the-counter trades. The Estonian Central Bank acts as a settlement bank of the netted cash position of the participants in the SSS.

All shares listed and traded on the Tallinn Stock Exchange must be registered in the ECRS or another register of securities that is approved by the TSE. No share certificates are issued with respect to shares registered in the ECRS. Shares are registered in the ECRS in book-entry form and are held in dematerialized form in the respective shareholders' electronic securities accounts opened in the ECRS. Therefore, all transactions involving shares listed on the Tallinn Stock Exchange must be recorded on the ECRS' electronic database by account operators and are cleared and settled through the ECSD. The rights attached to the shares belong to the persons who are registered as the shareholders in the share register of the issuer maintained by the ECSD.

The public has access to certain information, and has the right to obtain extracts and transcripts of documents from the ECRS, concerning the issuer (its name, seat and registry code) and the securities (the type, nominal value and amount of securities) registered with the ECRS. If shares are quoted on the stock exchange, the information concerning the shareholders is also accessible to the public. The Estonian Central Registry of Securities Act stipulates further circumstances when additional information registered with the ECRS is accessible to third parties.

A securities account can be opened in the ECRS by any Estonian or foreign person. The opening of the account takes place through an account operator (custodian). Account operators are institutions that qualify under Estonian law as professional participants in the securities market, such as credit institutions, investment firms, and other persons specified by law. In certain cases, foreign persons may act as account operators. Under certain conditions, a nominee account can be opened in the ECRS, in which case a notation is made in the ECRS indicating the nominee status of the relevant account. Shares held in the nominee account are deemed to be the client's shares, and not the shares of the account owner, and thus cannot be brought into the bankruptcy estate of the owner of the nominee account. The person who is entitled to exercise the rights arising from shares held in the nominee account is the account owner. In the exercise of voting rights and other rights arising from a share, the owner of a nominee account must follow the instructions of the client. At the request of the client, the owner of a nominee account must grant authorization in the required format to the client for the client to represent the owner in the exercise of rights arising from the shares.

Listing on the Tallinn Stock Exchange

Application has been made to list the Shares on the main list of the Tallinn Stock Exchange. In order to list shares on the main list of the Tallinn Stock Exchange, among other requirements, a sufficient number of such shares must be held by the public. As a general rule, this condition is fulfilled if at least 25 per cent of the share capital represented by the shares to be listed is held by the public, or taking into consideration the number of shares and their distribution among the public, the market would also operate properly at a lower percentage of shares held by the public, or such level of distribution is expected to be achieved shortly after listing. The Tallinn Stock Exchange Rules and Regulations set out certain specific requirements when the shares are not deemed to be held by the public.

Trading on the Tallinn Stock Exchange

The trading system of the Tallinn Stock Exchange is open for trading to its members. Trading on the Tallinn Stock Exchange takes place on each business day from 10:00 a.m. to 2:00 p.m. (Estonian time). From 2:05 p.m. to 2:30 p.m. the TSE carries out after-market trading. The Tallinn Stock Exchange uses the Nordic-Baltic trading system SAXESS, which in addition to Estonia is used by exchanges in Sweden, Finland, Denmark, Norway, Iceland, Latvia and Lithuania. The official trading currency of the Tallinn Stock Exchange trading system is the euro.

Transactions can be concluded on the Tallinn Stock Exchange either through automatic matching or through negotiated deals. In the case of automatic matching, the buy and sell orders are matched by the trading system automatically according to price and time priorities. Automatically matched transactions are settled on the third day after the transaction (T+3), unless agreed otherwise. Negotiated trades can be concluded during the Tallinn Stock Exchange trading period at a price between the best bid and offer prices quoted at the time of concluding the transaction. Negotiated deals concluded after the Tallinn Stock Exchange's trading period must be concluded at a price at or between the closing prices of that day or prices of transactions made during the trading period of that day. Negotiated deals are negotiated between stock exchange members outside the system and brokers must enter the deal in the trading system as soon as possible, and in any event not later than five minutes, after its conclusion. Negotiated deals may have a settlement day between T+1 (inclusive) and T+6 (inclusive) if agreed between the relevant stock exchange members.

The operator of the Tallinn Stock Exchange is required to ensure constant access on its website to information on the securities traded on the market, including the acquisition and transfer prices of the securities, recent prices, price changes, the highest and lowest prices and the volume and number of transactions. According to the Estonian Securities Market Act, such information must be accurate, clear, precise and complete. The Tallinn Stock Exchange operates an electronic trading system that provides real-time stock quotes, distributes issuer announcements and displays information regarding executed transactions, statistics and other such data. The operator of the Tallinn Stock Exchange must record at least the following regarding transactions concluded on the exchange: (i) the time at which the transaction is concluded; (ii) information regarding the market participant who concluded the transaction; (iii) the securities which served as the object of the transaction; and (iv) their number, nominal value and price. In accordance with the Tallinn Stock Exchange Rules and Regulations, the operator of the Tallinn Stock Exchange has the right to request additional information regarding a transaction for the purposes of recording the transaction.

The Listing and Surveillance Committee of the Tallinn Stock Exchange has the right, for the purpose of ensuring sufficient liquidity of a security, to demand from the issuer applying for listing the conclusion of a market-making agreement with a member of the Tallinn Stock Exchange in respect of the securities to be listed.

Supervision over the Tallinn Stock Exchange

Activities of the Tallinn Stock Exchange are supervised by the EFSA. Compliance with the Tallinn Stock Exchange Rules and Regulations by its members is monitored by the Listing and Surveillance Committee of the Tallinn Stock Exchange. The operator of the Tallinn Stock Exchange exercises supervision over the exchange with respect to the prices of securities traded on the exchange and the conducting and execution of transactions for the purpose of detecting and reducing transactions conducted on the basis of inside information, market manipulation and other violations of law. The operator is under an obligation to notify the EFSA immediately of any violation of law. The EFSA also has specific supervisory obligations for monitoring transactions concluded on the exchange.

Disclosure of transactions and ownership

A person who has acquired in an issuer, either directly or indirectly, individually or together with persons operating in concert, a qualifying holding and in connection therewith or thereafter has acquired or increased the number of votes owned by such person over 10 per cent, 20 per cent, one-third, 50 per cent or two-thirds of all votes represented by the shares of the issuer, must immediately, and in any event by no later than four business days thereafter, notify the issuer and the EFSA of the number of votes owned by such person. The same notification requirements also apply in case the holding falls below the prescribed levels. The EFSA has the right to make exemptions from such notification requirements in certain circumstances. In the case of a company whose shares are listed on the Tallinn Stock Exchange, the disclosure obligations described above also apply in the case of the acquisition or reduction of a holding of five per cent.

The issuer is also required to ensure that shareholders holding more than 5 per cent of the shares of the issuer disclose, through the issuer, all the significant provisions of all the agreements made with other shareholders or third parties which are aimed at restricting the free transferability of the shares or which may have a significant effect on the price of the shares.

In order to ensure that disclosure obligations established by law are also fulfilled in respect of shareholdings held by nominee accounts, the operator of a nominee account is required to enter into written agreements with the clients on whose behalf the operator holds securities. These agreements must, among other requirements, require the client to notify the issuer and/or the competent supervisory body (the exact person to whom the notification must be submitted may vary depending on a particular transaction) if a holding in a company exceeds the threshold established by law or to obtain the permission of the competent supervisory body for the holding to exceed the threshold

established by law (such permission is required, for example, in the case of the acquisition of a holding above a certain level in financial institutions, or in the case of an acquisition subject to concentration control by competition authorities).

The Tallinn Stock Exchange Rules and Regulations also regulate the disclosure of the issuer's dealings in its own shares.

Market abuse

Estonian law prohibits market abuse, which, within the meaning of the Estonian Securities Market Act, is misuse of inside information and market manipulation. Restrictions established for the misuse of inside information also apply to financial instruments that are not admitted to trading in Estonia or in a Member State of the European Economic Area (the "EEA") but the value of which depends on a financial instrument that is admitted to trading in Estonia or in an EEA Member State.

Inside information is precise information which has not been made public, relating, directly or indirectly, to the financial instrument or its issuer and which, if it were made public, would be likely to have a significant effect on the price of the financial instrument or on the price of related derivative financial instruments. The law establishes additional conditions under which information may qualify as inside information.

An insider is a person who possesses inside information by virtue of being a partner in the issuer, or by virtue of his membership in the management or supervisory bodies of the issuer, or by virtue of his shareholding in the issuer, or by virtue of having access to the information through the exercise of his employment, profession or duties, or by virtue of his criminal activities. Third parties who possess inside information are also treated as insiders if they knew or should have known that the information is inside information. The Tallinn Stock Exchange Rules and Regulations stipulate that, among other persons, persons who hold or control at least 10 per cent of shares in an issuer, the subsidiaries of the issuer and certain officials of such shareholders and subsidiaries and persons associated with them are deemed to be insiders for the purpose of the Tallinn Stock Exchange Rules and Regulations.

Misuse of inside information comprises, among other actions, the trading on the basis of inside information, unauthorized disclosure of inside information, and the making of recommendations on the basis of inside information for the acquisition or disposal of financial instruments to which that information relates.

An insider who, directly or indirectly, on its own account or on the account of a third party, acquires or transfers a financial instrument to which the inside information relates or a derivative security related to such financial instrument or who makes recommendations to third parties or influences third parties to acquire or transfer such financial instrument or derivative security, commits a criminal offence, and may be subject to fines or imprisonment up to three years. The Securities Market Act also provides under certain circumstances the right to demand directly from the issuer of the financial instrument traded on the Estonian market compensation of damages arising from the failure to disclose the information.

Issuers of publicly-traded securities and other individuals or entities that have regular access to inside information are required to establish internal rules and procedures to prevent the disclosure of such information.

The Estonian Securities Market Act contains a non-exhaustive list of actions that are deemed to constitute market manipulation. Under the Estonian Securities Market Act, market manipulation may be punishable by a fine. Under the Estonian Penal Code, certain actions of market manipulation conducted by shareholders of the issuer or persons related to the issuer due to their employment or work duties may be subject to fines or imprisonment up to three years.

The Tallinn Stock Exchange Rules and Regulations also restrict transactions involving an issuer's securities by certain officials of the issuer and by persons connected with such officials, to avoid profiting from short-term price fluctuations of the issuer's securities and during restricted periods (in particular, after the end of a financial period but when the financial results of the issuer have not yet been made public). The Listing and Surveillance Committee of the Tallinn Stock Exchange has the right to make exemptions from the requirement to abstain from trading during a restricted period if the Committee is of the opinion that the transaction will not be executed on the basis of confidential information.

TAXATION

The following summary is based on the tax laws of Estonia, Latvia and the United States as in effect on the date of this Offering Circular, and is subject to changes in such laws, including changes that could have a retroactive effect. The following summary is not exhaustive and does not take into account or discuss the tax laws of any country other than Estonia, Latvia and the United States. You are advised to consult your own professional tax advisors as to the Estonian, the Latvian, the United States and other tax consequences of the Combined Offering and the purchase, ownership and disposition of Offer Shares. Prospective investors who may be affected by the tax laws of other jurisdictions should consult their own tax advisors with respect to the tax consequences applicable to their particular circumstances.

ESTONIAN TAXATION

Corporate Income Tax

The Estonian Income Tax Act (*Tulumaksuseadus*) provides that the accrued profit of a legal entity resident in Estonia, such as the Company, is not subject to corporate income tax at the moment the profits are generated, but corporate income tax is charged on dividend distributions or other profit distributions and other payments considered as not related to the business of the legal entity by law.

In particular, pursuant to the Income Tax Act, corporate income tax is charged on:

- dividends and other profit distributions;
- expenses and payments not related to the business of the Company;
- fringe benefits granted to employees and the management;
- loans and advances to natural persons related to the Company, exceeding 50 per cent of the expenses of the Company which are subject to Estonian social tax;
- costs of entertaining, catering, accommodation and transportation of guests of the Company, which exceed 2 per cent of the expenses of the Company which are subject to Estonian social tax; and
- gifts and donations.

The rate of income tax is 22 per cent of the gross amount distributed, although the income tax is calculated on the amount of the distributed dividends or other profit distributions by applying the tax rate of 22/78 of the net amount meaning that the effective rate is approximately 28.2 per cent of the net amount of the distribution. The relevant amount of income tax due is required to be paid by the tenth day of the month following the month in which the payment was made. Estonian taxation laws and regulations provide that this currently applicable rate of income tax will be reduced to 21 per cent (21/79) on 1 January 2008 and to 20 per cent (20/80) on 1 January 2009.

The Income Tax Act provides exemptions from the corporate income tax. An Estonian resident company receiving dividends does not have to pay corporate income tax upon redistributing the part of dividends from which the tax has been paid either in Estonia or abroad, if it owned at least 15 per cent of the shares of the distributing company at the time of distribution.

Dividends

No Estonian dividend withholding tax is imposed on dividends paid to Estonian residents (whether legal persons or individuals) or to non-resident individuals.

However, an Estonian dividend withholding tax of 22 per cent is currently imposed on dividends paid by the Company to non-resident legal persons. A limited exemption from this dividend withholding tax applies where the non-resident legal person owns at least 15 per cent of the share capital or votes of the Company. However, the exemption does not apply where the relevant non-resident legal person is located in a “low tax rate territory” for the purposes of Estonian taxation laws and regulations.

Estonian taxation laws and regulations provide that the currently applicable rate of dividend withholding tax of 22 per cent referred to above will be reduced to 21 per cent on 1 January 2008 and to 20 per cent on 1 January 2009.

Non-resident individual investors whose Shares are held in nominee accounts may be required to undertake certain action to avoid imposition of the Estonian dividend withholding tax. Non-resident individual investors are encouraged to contact their custodians or their own professional tax advisors for any further information on taxation of dividends.

Additional exemptions or more favorable tax rates available to non-resident legal persons may be enjoyed under international treaties in effect between Estonia and certain other states, including European Union Member States. For applying the more favorable tax rates under the treaties, the non-resident legal person subject to Estonian withholding tax has to provide the Company with a document claiming the benefits of the applicable tax treaty from the non-resident’s competent taxing authority confirming that the non-resident is a resident of the applicable jurisdiction for treaty purposes. Such document should correspond to the form provided by the Estonian Ministry of Finance.

For example, Article 10 of the Convention between the Republic of Estonia and the Republic of Latvia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (Double Taxation Treaty between Latvia and Estonia) provides that the withholding tax imposed in Estonia may not exceed 15 per cent of the gross amount of the dividends (5 per cent if the beneficial owner of the dividends is a company holding at least 25 per cent of the Company’s share capital).

Non-resident legal persons who may benefit from lower tax rates under the double taxation treaties and whose Shares are held in nominee accounts are encouraged to contact their custodians or their own professional tax advisors for any further information on the application of the relevant double taxation treaties.

Capital Gains

In general, income tax is not charged on gains realized by non-residents (whether legal persons or individuals) from the sale or exchange of shares of Estonian companies.

As an exception, Estonian income tax is charged on the capital gain realized from the sale or exchange of shares of a “real estate company” in case the transferor of the shares is a non-resident who at the time of transfer of shares has the holding of at least 10 per cent in the real estate company. A “real estate company” for these purposes is a company, common fund (*lepinguline investeerimisfond*) or other pool of assets, of the assets of which, at the time of transfer or at some period during two years immediately preceding the transfer, immovables or structures as movables located in Estonia constituted directly or indirectly more than 50 per cent.

As at 31 March 2007, immovables or structures as movables located in Estonia constituted directly or indirectly more than 50 per cent of the assets of the Company.

In addition, as the current income tax system applicable in Estonia provides that the profits of Estonian legal persons are not taxed upon their generation but are only taxed upon their distribution to shareholders, income tax is not charged on capital gains realized by Estonian legal persons from the sale or exchange of Shares upon their generation.

Income tax is, however, charged on gains realized by Estonian individuals from the sale or exchange of Shares.

If income tax is due to be paid as described in the previous paragraphs, it is charged on the gains realized from the sale or exchange of a shareholding, with the gains being deemed to be equal to the difference between the acquisition costs and the sale/exchange price of the relevant shareholding. Capital gains realized are currently subject to income tax of 22 per cent, and are required to be declared annually by the relevant person by 31 March in each year following the sale or exchange of the Shares.

Payments made by the Company as a result of any redemption of its Shares or any repurchase of its Shares or the proceeds of any liquidations of the Company which are paid to Estonian individuals or non-residents (whether legal persons or individuals) are also treated as capital gains which are chargeable as described above (even if such non-residents' capital gains are not chargeable upon a sale or exchange of the Shares).

Estonian taxation laws and regulations provide that the currently applicable income tax rate of 22 per cent chargeable on capital gains referred to above will be reduced to 21 per cent on 1 January 2008 and to 20 per cent on 1 January 2009.

Exemptions or more favorable tax rates available to non-residents may be enjoyed under international treaties in effect between Estonia and certain other states.

In general, the international treaties provide that capital gains from the alienation of immovable property located in Estonia or shares in a company the assets of which consist mainly of such property may be taxed in Estonia. For instance, such provision is provided in Article 13 of the Double Taxation Treaty between Latvia and Estonia.

Possible Changes in Corporate Taxation in Estonia

As described above, Estonia currently enjoys a corporate income tax regime under which income tax is deferred until profits are distributed. It is the opinion of the EU authorities that the Estonian corporate income tax payable on profit distributions is a withholding tax and is in contradiction with the Council Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (the EC parent-subsidiary directive, 90/435/EEC). Upon Estonia's accession to the European Union on 1 May 2004, Estonia was granted a transitional period to harmonize its income tax regime with the EC parent-subsidiary directive by 31 December 2008. Thus, Estonia has to adjust or change its corporate income tax regime. There is, however, still no political agreement whether Estonia should implement a classical corporate income tax system or adjust its current regime partly.

Stamp Duty and Other Transfer Taxes

There are currently no stamp duties or other transfer taxes payable on the transfer of Shares. However, fees and charges are generally levied by the operators of securities accounts in the ECRS on transactions in the Shares which are cleared and settled through the ECSD.

LATVIAN TAXATION

Dividends

Pursuant to the Latvian Law on Corporate Income Tax (*likums "Par uzņēmumu ienākuma nodokli"*), dividends paid by the Company to Latvian resident companies are currently exempt from Latvian corporate income tax. Dividends paid by the Company to permanent establishments in Latvia of Latvian non-resident companies are currently also exempt from Latvian corporate income tax provided that the relevant non-resident company is:

- (i) a company which (i) takes one of the forms listed in Annex 1 to the Law on Corporate Income Tax, (ii) according to the tax laws of another Member State of the European Union is considered to be resident in that State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the European Union, and (iii) is subject to one of the taxes listed in Annex 2 to the Law on Corporate Income Tax, without the possibility of an option or of being exempt; or
- (ii) a company which (i) according to the tax laws of another State of the European Economic Area (other than Member States of the European Union) is considered to be resident in that State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the European Economic Area, and (ii) is subject to tax equivalent to the Latvian corporate income tax in the country of its residence, without the possibility of an option or of being exempt.

The application of the exemption from Latvian corporate income tax is subject to submission to the Latvian State Revenue Service of a document confirming that the Company is a resident of Estonia for tax purposes. Where the exemption does not apply, the dividends paid by the Company are subject to Latvian corporate income tax at the rate of 15 per cent.

Pursuant to the Latvian Law on Personal Income Tax (*likums "Par iedzīvotāju ienākuma nodokli"*), dividends paid by the Company to Latvian resident individuals are currently exempt from personal income tax. The exemption will not however apply if the Company will be benefiting in Estonia in the year when the dividends are declared or the previous year from tax reliefs or allowances equivalent to those available under Latvian law other than the Law on Corporate Income Tax.

Capital Gains

Pursuant to the Law on Corporate Income Tax, income obtained by Latvian resident companies from the sale of the Shares is not subject to the Latvian corporate income tax provided that the Shares at the time of the sale remain listed on the Tallinn Stock Exchange or another regulated market of a Member State of the European Union or the European Economic Area.

Pursuant to the Law on Personal Income Tax, income obtained by Latvian resident individuals from the sale of the Shares is not subject to the Latvian personal income tax if the Shares sold are the individual's personal assets. However, the income obtained by a Latvian resident individual from the sale of Shares is subject to Latvian personal income tax at the rate of 25 per cent if the Shares were acquired by the Latvian resident individual for the purpose of their subsequent resale or if the acquisition and subsequent sale of the Shares is considered part of the Latvian resident individual's personal business.

Stamp Duty and Other Transfer Taxes

There are currently no Latvian stamp duties or other transfer taxes payable on the transfer of Shares. However, fees and charges may be levied by financial intermediaries involved in custody or transfer of the Shares.

FEDERAL TAX CONSIDERATIONS IN UNITED STATES

TO ENSURE COMPLIANCE WITH INTERNAL REVENUE SERVICE CIRCULAR 230, YOU ARE HEREBY NOTIFIED THAT THE DISCUSSION OF THE U.S. FEDERAL AND STATE TAX MATTERS SET FORTH IN THIS OFFERING CIRCULAR WAS WRITTEN IN CONNECTION WITH THE PROMOTION OR MARKETING OF THIS COMBINED OFFERING AND WAS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY ANY PROSPECTIVE INVESTOR, FOR THE PURPOSES OF AVOIDING TAX-RELATED PENALTIES UNDER U.S. FEDERAL OR STATE TAX LAW. EACH PROSPECTIVE INVESTOR SHOULD SEEK ADVICE BASED ON ITS PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR

The following is a summary of certain U.S. federal income tax consequences that may be relevant with respect to the acquisition, ownership and disposition of Shares. This summary addresses only the U.S. federal income tax considerations of holders that are initial purchasers of Shares and that will hold Shares as capital assets. Unless otherwise stated, this summary does not address tax considerations applicable to holders that may be subject to special tax rules, such as banks, insurance companies, traders or dealers in securities or currencies, tax-exempt entities, persons that will hold Shares as a position in a “straddle” or as part of a “hedging” or “conversion” transaction for U.S. federal income tax purposes, persons that have a functional currency other than the U.S. dollar or holders of 10 per cent or more by voting power of the stock of the Company. This summary is based on the tax laws of the United States, U.S. Treasury Department regulations and judicial and administrative interpretations thereof, and relevant U.S. tax treaties, each as in effect as of the date of this Offering Circular. The foregoing authorities are subject to change, which change could apply retroactively and could affect the tax consequences described below.

For the purposes of this discussion, a “United States Holder” is a beneficial owner of Shares that is, for U.S. federal income tax purposes, (i) a citizen or resident of the United States, (ii) a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States or any state thereof (including the District of Columbia), (iii) an estate, the income of which is subject to U.S. federal income taxation regardless of its source, or (iv) a trust, the administration of which is subject to the primary supervision of a court in the United States and for which one or more U.S. persons have the authority to control all substantial decisions. Notwithstanding the preceding sentence, certain trusts in existence on August 20, 1996, and treated as U.S. persons prior to such date, that elect to continue to be treated as U.S. persons also will be United States Holders. If a partnership holds Shares, the U.S. federal income tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. Partners of partnerships holding Shares should consult their tax advisors. A “Non-United States Holder” is a beneficial owner of Shares other than a United States Holder.

EACH PROSPECTIVE PURCHASER OF SHARES SHOULD CONSULT ITS OWN TAX ADVISOR WITH RESPECT TO THE U.S. FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES OF ACQUIRING, OWNING AND DISPOSING OF SHARES.

Dividends

Under Article 10(1) of the 1998 Income Tax Treaty Between Estonia and the United States (the Treaty), as in force as of the date of this Offering Circular, dividends paid by the Company to a United States Holder may be taxed in the United States. Accordingly, subject to the discussion headed “PFIC Considerations” below, distributions of cash or property (other than Shares, if any, distributed pro rata to all shareholders of the Company) with respect to the Shares will be included in income by a United States Holder as foreign source dividend income at the time of receipt, to the extent such distributions are made from the current or accumulated earnings and profits of the Company, as determined under U.S. federal income tax principles. For tax years ending on or before December 31, 2010, and subject to the discussion of PFICs, below, distributions with respect to the Shares taken into income as dividends by United States Holders that are individuals, trusts or estates may qualify for the 15 per

cent U.S. federal maximum capital gains rate, provided that certain holding period requirements are met. Distributions with respect to the Shares taken into income as dividends by corporate United States Holders will not be eligible for the 15 per cent rate or the dividends received deduction generally allowed to corporate shareholders.

To the extent, if any, that the amount of any distribution by the Company exceeds the Company's current and accumulated earnings and profits as determined under U.S. federal income tax principles, it will be treated first as a tax-free return of the United States Holder's tax basis in the Shares and thereafter as capital gain. Notwithstanding the foregoing, the Company does not intend to maintain calculations of its earnings and profits as determined under U.S. federal income tax principles.

Any dividend paid in Estonian kroon or euros will be included in the gross income of a United States Holder in an amount equal to the U.S. Dollar value of the kroon or euros (including the amount of any Estonian withholding tax thereon), calculated by reference to the exchange rate in effect on the date of receipt by the United States Holder. United States Holders should consult their tax advisors regarding the U.S. federal income tax treatment of any foreign currency exchange gain or loss recognized on a subsequent conversion of Estonian kroon or Euros received as dividends into U.S. Dollars.

Under Article 10(2) of the Treaty, dividends paid by the Company to a United States Holder may also be subject to a withholding tax in Estonia. Under Article 10(2)(b) of the Treaty, this withholding tax cannot exceed 15 per cent of the gross amount of the dividend (and, under Article 10(2)(a) of the Treaty, cannot exceed 5 per cent of the gross amount of the dividend if the United States Holder owns 10 per cent or more of the voting shares of the Company). See the discussion under the heading "*Estonian Taxation*" for details regarding Estonian tax law and the implications as to withholding taxes. United States Holders should consult their tax advisor regarding the Estonian withholding taxes that would apply to dividend payments received from the Company in their specific situation.

In the event that a United States Holder receives dividends from the Company with respect to the Shares, the United States Holder may be entitled to certain credits against United States income taxes otherwise due. To the extent Estonian withholding tax is payable in respect of a distribution or payment to a United States Holder, the United States Holder may be eligible for a foreign tax credit or deduction. Dividends received with respect to the Shares generally will be treated as foreign source income. Foreign source income has an effect on a United States Holder's ability to absorb foreign tax credits. The rules relating to United States foreign tax credits are complex. United States Holders should consult their tax advisors regarding the application of the United States foreign tax credit rules to their particular situations.

Taxation on sale or disposition of the Shares

Under Article 13(6) of the Treaty, gain from sale or disposition of the Shares by a United States Holder may be taxed in the United States. Subject to the discussion headed "PFIC Considerations" below, upon a sale or other disposition of Shares, a United States Holder generally will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the U.S. dollar value of the amount realized and the United States Holder's tax basis in the Shares (generally, the amount paid by the United States Holder for the shares, determined in U.S. Dollars). Generally, such gain or loss will be a capital gain or loss. For tax years ending on or before December 31, 2010, capital gains realized by a United States Holder that is an individual, estate or trust are generally subject to U.S. federal income tax at a maximum rate of 15 per cent if the United States Holder's holding period for the Shares exceeds one year. Limitations apply to the deductibility of capital losses by corporate and non-corporate United States Holders. Any gain or loss recognized by a United States Holder on the sale or other disposition of the Shares generally will be treated as U.S. source income or loss.

Because a substantial amount of the Company's assets consists of real property located in Estonia, income from the disposition of Shares also may be subject to tax in Estonia, under Article 13(2) of the

Treaty. For Estonian taxation on gain from the sale or other disposition of Shares, see the discussion under the heading “*Estonian Taxation*”. United States Holders should consult their tax advisor regarding the Estonian taxes that would apply to the sale or other disposition of Shares in their specific situation.

PFIC considerations

A corporation organized outside the United States generally will be classified as a “passive foreign investment company” (a “PFIC”) for U.S. federal income tax purposes in any taxable year in which either (i) 75 per cent or more of its gross income is “passive income” or (ii) 50 per cent or more of the average gross value of its assets are attributable to assets that produce “passive income” or are held for the production of passive income. In arriving at this calculation, the Company must also include a pro rata portion of the income and assets of each corporation in which it owns, directly or indirectly, at least a 25 per cent interest. Passive income for this purpose generally includes dividends, interest, royalties, rents and gains from commodities and securities transactions.

The Company has not evaluated whether it is, or is likely to be, a PFIC. Further, because the tests for determining passive foreign investment company status are applied as of the end of each taxable year and are dependent upon a number of factors, some of which are beyond the Company’s control, including the value of its assets, the market price of its ordinary shares, and the amount and type of its gross income, the Company cannot state with certainty that it is not a PFIC or will not be a PFIC in the future.

If the Company is treated as a PFIC, United States Holders will be subject to the PFIC provisions of the United States federal income tax law. The PFIC provisions impose interest charges on gains from the sale of, and “excess distributions” with respect to, shares of a PFIC owned directly (or deemed to be owned directly or indirectly under certain attribution rules) by a United States Holder. In general, an excess distribution is any distribution to a United States Holder that is greater than 125 per cent of the average annual distributions received by the United States Holder (including return of capital distributions) during the three preceding taxable years or, if shorter, the United States Holder’s holding period for the shares and gains on the disposition of shares.

Under these rules (i) the gain or excess distribution would be allocated ratably over a United States Holder’s holding period for the Shares, (ii) the amount allocated to the taxable year in which the gain or excess distribution was realized would be taxable as ordinary income, (iii) the amount allocated to each prior year, with certain exceptions, would be subject to tax at the highest rate in effect for that year, and (iv) the interest charge generally applicable to underpayments of tax would be imposed in respect of the tax attributable to each such year.

United States Holders can avoid the interest charge by making a “mark to market” election with respect to the Shares, provided that the Shares are “marketable” within the meaning of U.S. Treasury Regulations during each calendar quarter. Such election cannot be revoked without the consent of the U.S. Internal Revenue Service unless the Shares cease to be marketable. A United States Holder that makes a mark to market election generally would be required to take into account the difference, if any, between the fair market value and the adjusted tax basis of the Shares at the end of a taxable year as ordinary income (or, subject to certain limitations, ordinary loss) in calculating its income for such year, subject to certain limitations. In the case of a mark to market election, gains from an actual sale or other disposition of the Shares will be treated as ordinary income. Any losses incurred on a sale or other disposition of the Shares will be treated as an ordinary loss to the extent of any net mark to market gains for prior years.

If the Company were to agree to provide the necessary information, United States Holders could also avoid the interest charge imposed by the PFIC rules by making a qualified electing fund election (a “QEF election”). A United States Holder making a QEF election generally would be required to include in income on a current basis its pro rata share of the ordinary income and net capital gains of

the Company. However, the Company does not expect to provide United States Holders the information that would be necessary in order for a United States Holder to make a QEF election with respect to the Shares.

Information reporting and backup withholding tax

United States information reporting requirements will generally apply to payments of dividends on, and to proceeds from the sale or redemption of, the Shares by a payor to a holder of the Shares (other than an “exempt recipient”, which includes a corporation, a Non-United States Holder that provides an appropriate certification and certain other persons). Dividends or payments from sources outside the United States that are actually paid outside the United States by a non-United States payor are not subject to the information reporting requirements. Further, information reporting is not required in connection with payments (including proceeds from a sale of the Shares) that a payor can, prior to the payment, associate with documentation upon which it can rely to treat the payment as made to a foreign beneficial owner or as made to a foreign payee.

Unless a United States Holder provides its taxpayer identification number and certifies under penalties of perjury that it is exempt from backup withholding requirements, or otherwise establishes an exemption, backup withholding will apply to payments of dividends on, and proceeds from the sale of, Shares within the United States. In the case of a payment to a foreign partnership (other than one that qualifies as a “withholding foreign partnership”), the partners of such partnership will be required to provide the information and certification discussed above in order to establish an exemption from information reporting and backup withholding. Under United States Treasury Regulations, a payor may rely on a certification only if it is received prior to the payment in question, and the payor does not know, or have reason to know, that the certification is incorrect.

During tax years ending on or before December 31, 2010, a payor within the United States will be required to withhold a 28 per cent “backup withholding tax” on any payment of proceeds from the sale or redemption of Shares within the United States to a holder (other than an exempt recipient) if such holder fails to furnish its correct taxpayer identification number or otherwise fails to comply with applicable backup withholding requirements. Any amounts withheld under the backup withholding rules from a payment to a United States Holder generally will be refunded (or credited against such holder’s U.S. federal income tax liability, if any), provided that the required information is furnished to the U.S. Internal Revenue Service.

THE ABOVE SUMMARY IS NOT INTENDED TO CONSTITUTE A COMPLETE ANALYSIS OF ALL THE TAX CONSEQUENCES RELATING TO THE ACQUISITION, OWNERSHIP OR DISPOSITION OF SHARES. PROSPECTIVE INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISERS CONCERNING THE TAX CONSEQUENCES TO THEM IN LIGHT OF THEIR PARTICULAR SITUATIONS.

UNDERWRITING

GENERAL

The Company and the Selling Shareholders are expected to sign an underwriting agreement (the "Underwriting Agreement") with the Skandinaviska Enskilda Banken AB (publ), London Branch (the "Global Coordinator") and AS SEB Enskilda (jointly with the Global Coordinator, the "Managers") on or about 14 June 2007.

According to the Underwriting Agreement, the Company will agree to issue and the Selling Shareholders will agree to sell the Offer Shares and, subject to the terms and conditions of the Underwriting Agreement, the Global Coordinator will agree to purchase or procure purchasers for and in case of new Shares issued by the Company, subscribe or obtain subscribers for Offer Shares, except for the Offer Shares in the Management Incentive Offering, at a price equal to the Offer Price.

According to the Underwriting Agreement, the Company and the Selling Shareholders will pay to the Managers an underwriting commission equal to 3.5 per cent of the Offer Price per Offer Share. Therefore, in connection with the Combined Offering, the Managers will receive total commissions of approximately EEK 65.63 million. The calculation is based on the Offer Price of EEK 40.50 assuming that the Upsizing Option and the Over-Allotment Option are exercised in full. The Company and the Selling Shareholders have agreed in the Underwriting Agreement to indemnify the Managers against certain liabilities, including among others liabilities under the Estonian Securities Market Act. In addition, the Company has agreed to reimburse the Managers for certain expenses.

The obligations of the Managers under the Underwriting Agreement are subject to certain conditions precedent, including compliance by the Selling Shareholders and the Company with the representations and warranties set forth in the Underwriting Agreement and the non-occurrence of certain adverse changes as described in the Underwriting Agreement. The Global Coordinator may terminate the Underwriting Agreement at any time before the Offer Shares have been issued and paid, if in its opinion, there shall have been a change in national or international financial, political, economic or market conditions or currency exchange rates or exchange controls, as would in its reasonable view, be likely to prejudice materially the success of the Combined Offering and distribution of, or dealings in, the Offer Shares in the secondary market.

The Offer Price will be determined by negotiation between the Company, the Selling Shareholders and the Managers. Prior to the Combined Offering, there has been no public market for the Shares. Factors relevant to the determination of the Offer Price include results of operations, the current financial condition of the Group, future prospects, markets, the economic conditions in and future prospects for the industry in which the Group competes, its management, and currently prevailing general conditions in the equity securities markets, including current market valuations of publicly-traded companies considered comparable to the Company, and the total demand in the International Offering, the price sensitivity of such demand and the quality of the demand.

AS SEB Eesti Ühispank and AS SEB Latvijas Unibanka will act as retail managers in the Retail Offering in Estonia and Latvia, respectively. Both AS SEB Eesti Ühispank and AS SEB Latvijas Unibanka are affiliates of the Global Coordinator and in relation to the Combined Offering act as agents of the Global Coordinator.

OVER-ALLOTMENT, OVER-ALLOTMENT OPTION AND STABILIZATION

In connection with the Combined Offering, the Global Coordinator may purchase and sell Shares in the open market. These transactions may include, among others, over-allotments which involve sales of Shares in excess of the principal amount of Offer Shares being offered in the Combined Offering.

Subject to the terms and conditions of the Underwriting Agreement, the Selling Shareholders have granted the Global Coordinator an Over-Allotment Option, exercisable within 30 days from the

commencement of trading in the Shares on the Tallinn Stock Exchange, to purchase up to an aggregate of 5,400,000 Additional Shares at the Offer Price. The Additional Shares are intended to cover possible over-allotments. If all Additional Shares are purchased, they will represent approximately 5.23 per cent of all the shares in the Company and votes that can be cast in the Company's General Meeting of Shareholders, assuming that the Upsizing Option is exercised in full.

The Global Coordinator may effect transactions that stabilize or maintain the market price of the Offer Shares, in accordance with applicable laws, during a 30-day period starting from the commencement of trading in the Shares on the Tallinn Stock Exchange. Any such stabilization activity will be decided by the Global Coordinator at its sole discretion and there is no obligation on the Global Coordinator to do this. Such stabilization transactions may result in a market price of the Shares that is higher than would otherwise prevail. Such stabilization, if commenced, may be discontinued at any time.

In connection with settlement and stabilization, the Managers have entered into a share lending arrangement with the Selling Shareholders as part of the Underwriting Agreement. In accordance with the share lending provisions of the Underwriting Agreement, the Managers may borrow a number of Shares equal to the number of Additional Shares subject to the Over-Allotment Option that will allow it to settle over-allotments made, if any, in connection with the Combined Offering. In addition, the Managers will borrow from the Selling Shareholders a number of Shares corresponding to the number of new Shares issued in connection with the Combined Offering in order to facilitate settlement. To the extent the Managers borrow Shares under these provisions, it will be required to return an equivalent number of Shares or rights representing such number of Shares to the Selling Shareholders in accordance with the provisions of the Underwriting Agreement.

LOCK-UP

The Company and the Selling Shareholders have agreed not to issue or sell shares of the Company or securities convertible into shares of the Company for 12 months subsequent to signing the Underwriting Agreement without the prior written consent of the Global Coordinator.

In addition, each member of the Company's Supervisory Council and Management Board has agreed not to sell or otherwise transfer shares of the Company without the prior written consent of the Global Coordinator for 12 months subsequent to signing the Underwriting Agreement.

SELLING RESTRICTIONS

Because of the following restrictions, purchasers of the Offer Shares are advised to consult legal counsel prior to making any offer for, resale, pledge or other transfer of the Offer Shares.

General

No action has been taken or will be taken in any jurisdiction other than Estonia and Latvia by the Global Coordinator or the Company that would permit a public offering of the Offer Shares, or the possession or distribution of any documents relating to the Combined Offering, or any amendment or supplement thereto, in any country or jurisdiction where specific action for that purpose is required. The Global Coordinator will comply with all applicable laws and regulations in each jurisdiction concerning acquiring, offering or selling of Offer Shares or possession or distribution of any offering documents or any amendment or supplement thereto. No offer or sale of Offer Shares may be made in any jurisdiction except under circumstances that will result in compliance with the applicable laws of such jurisdiction. Persons receiving a copy of this Offering Circular are required by the Company and the Global Coordinator to inform themselves about and to observe any restrictions as to the offering of Offer Shares and the distribution of this Offering Circular.

Each purchaser of Offer Shares will be deemed to have acknowledged, by its purchase of Offer Shares, that the Company, the Global Coordinator, their respective affiliates, and other persons will

rely upon the truth and accuracy of the acknowledgements, representations and agreements set forth below.

Buyers of Offer Shares sold by the Global Coordinator may be required to pay stamp taxes and other charges in accordance with the laws and practice of the country of purchase in addition to the Offer Price.

European Economic Area

In relation to each Member State of the European Economic Area that has implemented the Prospectus Directive (each, a relevant Member State), with effect from and including the date on which the Prospectus Directive is implemented in that relevant Member State (the relevant implementation date), an offer of the Offer Shares described in this Offering Circular may not be made to the public in that relevant Member State prior to the publication of a prospectus in relation to the Offer Shares that has been approved by the competent authority in that relevant Member State or, where appropriate, approved in another relevant Member State and notified to the competent authority in that relevant Member State, all in accordance with the Prospectus Directive, except that, with effect from and including the relevant implementation date, an offer of securities may be offered to the public in that relevant Member State at any time:

- to any legal entity that is authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities; or
- to any legal entity that has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than EUR 43,000,000 and (3) an annual net revenues of more than EUR 50,000,000, as shown in its last annual or consolidated accounts; or
- in any other circumstances that do not require the publication of a prospectus pursuant to Article 3 of the Prospectus Directive.

Each purchaser of the Offer Shares located within a relevant Member State (other than Estonia and Latvia) will be deemed to have represented, acknowledged and agreed that it is a “qualified investor” within the meaning of Article 2(1)(e) of the Prospectus Directive. For purposes of this provision, the expression an “offer to the public” in any relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the securities to be offered so as to enable an investor to decide to purchase or subscribe for the securities, as the expression may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, and the expression “Prospectus Directive” means Directive 2003/71/EC and includes any relevant implementing measure in each relevant Member State.

The sellers of the Offer Shares have not authorized and do not authorize the making of any offer of the Offer Shares through any financial intermediary on their behalf, other than offers made by the Global Coordinator with a view to the final offering of the Offer Shares as contemplated in this Offering Circular. Accordingly, no purchaser of the Offer Shares, other than the Global Coordinator, is authorized to make any further offer of the Offer Shares on behalf of the sellers or the Global Coordinator.

United States

The Offer Shares have not been and will not be registered under the Securities Act or with any securities authority of any state of the United States. The Offer Shares in the Offer may not be offered, sold or delivered within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state laws. Accordingly, the Offer Shares are being offered and sold in the Combined Offering:

- in the United States only to QIBs in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A; and
- outside the United States in accordance with Regulation S under the Securities Act.

Within the United States

Each purchaser of Offer Shares offered in reliance on Rule 144A under the Securities Act who is located in the United States will be deemed to have represented, acknowledged and agreed that it has received a copy of this document and such other information as it deems necessary to make an investment decision and that (terms used herein that are defined in Rule 144A are used herein as defined therein):

- (i) it is (a) a QIB, (b) acquiring such Offer Shares for its own account or for the account of one or more QIBs for which it is acting as a duly authorised fiduciary or agent with sole investment discretion to each such account and with full authority to make the acknowledgments, representations and agreements in an investment letter with respect to such account (in which case it makes, the representations and warranties set forth herein on behalf of such QIB), (c) is not acquiring the Offer Shares with a view to further distribution of such Offer Shares and (d) is aware and each beneficial owner of such Offer Shares has been advised that the sale of Offer Shares to it may be made in reliance on Rule 144A;
- (ii) it understands and acknowledges that the Offer Shares have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be reoffered, resold, pledged or otherwise transferred except (a) (i) to a person whom the purchaser and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or for the account of a QIB in a transaction meeting the requirements of Rule 144A, (ii) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (no representation is made as to the availability of the exemption provided by Rule 144 for such resales) or (iii) in an “offshore transaction” in compliance with Rule 903 or Rule 904 of Regulation S, in each case notifying the subsequent purchaser of the resale restrictions described herein, and (b) in accordance with all applicable securities laws of the states of the United States;
- (iii) it acknowledges that the Offer Shares (whether in physical, certificated form or in uncertificated form held in CREST) offered and sold hereby are “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act, are being offered and sold in a transaction not involving any public offering in the United States within the meaning of the Securities Act and that no representation is made as to the availability of the exemption provided by Rule 144 for resales of Offer Shares. The purchaser understands that the Offer Shares may not be deposited into any unrestricted depositary receipt facility in respect of Offer Shares established or maintained by a depositary bank, unless and until such time as such Offer Shares are no longer restricted securities within the meaning of Rule 144(a)(3) under the Securities Act;
- (iv) such person has received a copy of this document and has had access to such financial and other information concerning the Company as it has deemed necessary in connection with making its own investment decision to purchase the Offer Shares. Such person has made its own independent investigation and appraisal of without limitation, the business, financial condition, prospects, creditworthiness, status and affairs of the Company and the Offer Shares. It understands that there may be certain consequences under U.S. and other tax laws resulting from an investment in the Offer Shares and it has made such investigation and has consulted such tax and other advisers with respect thereto as it deems appropriate. Such person acknowledges that neither the Company nor the Global Coordinator named herein nor any person representing the Company or the Global Coordinator has made any representation, express or implied, to it with respect to the Company or offering or sale of any Offer Shares other than as set forth in this

document in respect of the Offer, upon which it is relying solely in making its investment decision with respect to the Offer Shares. It has held and will hold any offering materials, including this document, it receives directly or indirectly from the Company in confidence, and it understands that any such information received by it is solely for it and not to be redistributed or duplicated by it. It acknowledges that it has read and agreed to the matters stated in this section “Transfer and Selling Restrictions”;

- (v) such person, and each other QIB, if any, for whose account it is acquiring Offer Shares, in the normal course of business, invests in or purchases securities similar to the Offer Shares, has such knowledge and experience in financial and business matters that it is capable of evaluation the merits and risks of purchasing Offer Shares and is aware that it must bear the economic risk of an investment in any Offer Shares for an indefinite period of time and it is able to bear such risk for an indefinite period of time and is able to sustain a complete loss of investment in the Offer Shares;
- (vi) it is not an affiliate (as defined in Rule 501(b) under the Securities Act) of the Company, and is not acting on behalf of the Company or any of its affiliates;
- (vii) such person understands that these representations, warranties, undertakings and acknowledgements are required in connection with U.S. securities laws and that the Company, its affiliates and the Global Coordinator will be relying thereon and it irrevocably authorises the Global Coordinator on its own behalf and on behalf of each beneficial owner of the Offer Shares being purchased by it, to rely on the truth and accuracy of these representations, acknowledgements and agreements;
- (viii) it understands that any offer, sale, pledge or other transfer of the Offer Shares made other than in compliance with the above-stated restrictions may not be recognised by the Company; and
- (ix) the Offer Shares (to the extent they are in certificated form), unless otherwise determined by the Company in accordance with applicable law, will bear a legend substantially to the following effect:

THE SECURITY EVIDENCED HEREBY HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (A) (1) TO A PERSON WHOM THE SELLER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER (WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT) PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (2) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER (IF AVAILABLE) AND (B) IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND ANY OTHER RELEVANT JURISDICTION. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR THE RESALE OF THIS SECURITY. NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THE FOREGOING, THIS SECURITY MAY NOT BE DEPOSITED INTO ANY UNRESTRICTED DEPOSITARY RECEIPT FACILITY IN RESPECT OF ORDINARY SHARES OF THE COMPANY ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK. EACH HOLDER, BY ITS ACCEPTANCE OF THIS SECURITY, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS.

THE SECURITY EVIDENCED HEREBY MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED TO AN EMPLOYEE BENEFIT PLAN, AS DEFINED IN SECTION 3(3) OF ERISA, THAT IS SUBJECT TO THE PROVISIONS OF PART 4 OF SUBTITLE B OF TITLE I OF ERISA, A PLAN TO WHICH SECTION 4975 OF THE CODE, APPLIES, OR AN ENTITY WHOSE UNDERLYING ASSETS INCLUDE PLAN ASSETS BY REASON OF SUCH AN EMPLOYEE BENEFIT PLAN'S OR PLAN'S INVESTMENT IN SUCH ENTITY, OR A GOVERNMENTAL, CHURCH OR NON-US PLAN WHICH IS SUBJECT TO ANY SIMILAR LAW, BUT MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED TO A GOVERNMENTAL, CHURCH OR NON-U.S. PLAN, PROVIDED SUCH ACQUISITION, HOLDING AND/OR DISPOSITION DOES NOT AND WILL NOT VIOLATE ANY SIMILAR LAW.

In addition, until 40 days after the commencement of the Combined Offering, any offer or sale of the Offer Shares that is made within the United States by any dealer (whether or not participating in the Combined Offering) may violate the registration requirements of the Securities Act unless made pursuant to Rule 144A or another exemption from the registration requirements of the Securities Act.

Prospective purchasers are hereby notified that sellers of the Offer Shares may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

Outside the United States

Each purchaser of the Offer Shares offered in reliance on Regulation S will be deemed to have represented and agreed as follows (terms used in this paragraph that are defined in Rule 144A or Regulation S are used herein as defined therein):

- (i) the purchaser is and the person, if any, for whose account or benefit the purchaser is acquiring the shares is, at the time of the offer to it of Offer Shares and at the time the buy order originated, outside the United States and continues to be located outside the United States and the person, if any, for whose account or benefit the purchaser is acquiring the Offer Shares reasonably believes that the purchaser is outside the United States; and neither the purchaser nor any person acting on its behalf knows that the transaction has been pre-arranged with a buyer in the United States;
- (ii) the purchaser acknowledges that the Offer Shares have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state of the United States and are being offered outside the United States in reliance on Regulation S;
- (iii) the purchaser is aware of the restrictions on the offer, exercise and sale of the Offer Shares pursuant to Regulation S described in this document;
- (iv) any offer, sale, pledge or other transfer made other than in compliance with the above-stated restrictions shall not be recognised by the Company in respect of the Offer Shares;
- (v) it is not an affiliate (as defined in Rule 501(b) under the Securities Act) of the Company or a person acting on behalf of the Company or any of its affiliates;
- (vi) either (A) it is not, and it is not acting on behalf of (and for so long as it holds the share or any interest therein will not be, and will not be acting on behalf of), an employee benefit plan, as defined in Section 3(3) of ERISA, that is subject to the provisions of part 4 of subtitle B of Title I of ERISA, a plan to which subject to Section 4975 of the Code, applies, or an entity whose underlying assets include plan assets by reason of such an employee benefit plan's or plan's investment in such entity (each, a "Benefit Plan Investor"), or a governmental, church or non-U.S. plan which is subject to any Similar Law, and no part of the assets to be used by it to purchase or hold such shares or any interest therein constitutes the assets of any Benefit Plan Investor or such a plan, or (B) it is, or is acting on behalf of, such a governmental, church or

non-U.S. plan, and such acquisition, holding and/or disposition of such shares does not and will not violate any Similar Law, and (ii) it understands and agrees that no purchase by or transfer to any Benefit Plan Investor of such shares, or any interest therein, will be effective, and none of the Company, the Registrar or any Transfer Agent will recognise any such purchase or transfer; and (b) it will not sell or otherwise transfer such shares or any interest therein otherwise than to a purchaser or transferee that makes or is deemed to make these same representations, warranties and agreements with respect to its purchase, holding and disposition of such shares; and

- (vii) such person understands that these representations, warranties, undertakings and acknowledgements are required in connection with U.S. securities laws and that the Company, its affiliates and the Global Coordinator will be relying thereon and it irrevocably authorises the Global Coordinator on its own behalf and on behalf of each beneficial owner of the Offer Shares being purchased by it, to rely on the truth and accuracy of these representations, acknowledgements and agreements.

United Kingdom

The Global Coordinator has represented and agreed that:

- (i) it has not offered or sold, and will not offer or sell, prior to the expiry of a period of six months from the date of the Combined Offering, and will not offer or sell any Shares to persons in the United Kingdom except when the offer is made to or directed at qualified investors only (as defined in the FSMA) or the offer is made to or directed at fewer than 100 persons, other than qualified investors, per EEA State and will not constitute an offer to the public in the United Kingdom within the definition of the FSMA (as amended);
- (ii) it has complied with and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Offer Shares, in, from or otherwise involving or capable of having an effect in the United Kingdom; and
- (iii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) in connection with the offering of the Offer Shares in circumstances in which section 21(1) of the FSMA does not or would not otherwise apply to the Company.

This document (i) is directed only at persons who fall within the definition of “qualified investors” as that term is defined in Section 86(1) of the FSMA or otherwise in circumstances which do not result in an offer of transferable securities to the public in the United Kingdom within the meaning of the FSMA, and (ii) is being communicated or caused to be communicated only to investment professionals and to such other persons to whom communications of this nature may be made without the financial promotion restriction in Section 21(1) of the FSMA applying.

LEGAL MATTERS

In respect of Estonian law, certain legal matters will be passed upon for the Global Coordinator by Raidla & Partners, Roosikrantsi 2, Tallinn 10119, Estonia.

In respect of English and United States federal law, certain legal matters will be passed upon for the Global Coordinator by Curtis, Mallet-Prevost, Colt & Mosle LLP, 53 New Broad Street, London EC2M 1BB, United Kingdom.

INDEPENDENT AUDITORS

Pursuant to the Estonian Commercial Code, the General Meeting of Shareholders decides the number of auditors and elects the auditors.

The auditors of the Company until 22 February 2007 were Hanno Lindpere and Marju Põldniit, certified auditors from the auditor company Ernst & Young Baltic AS, Rävåla 4, 10143 Tallinn, Estonia. In view of the fact that Marju Põldniit left Ernst & Young Baltic AS and that the Estonian Commercial Code allows the election of an auditor company as the auditor of the Company, the General Meeting of Shareholders held on 22 February 2007 decided to elect Ernst & Young Baltic AS as the auditor of the Company.

The consolidated financial statements of Arco Vara for the financial years ended 31 December 2006, 31 December 2005 and 31 December 2004 appearing in this Offering Circular have been audited by the Company's auditors, as stated in their report appearing herein. The financial information of Arco Vara for the three months ended 31 March 2007 appearing in this Offering Circular has not been audited.

Certain financial information presented in this Offering Circular has been obtained directly from the audited financial statements of the Company, while certain other financial information presented herein has been recomputed by Management from amounts contained in the audited financial statements. This financial information is presented in the following sections: Summary, Selected Financial Information, Management's Discussion and Analysis of the Group's Financial Condition and Results of Operations, Business and Management. All other financial information contained in this Offering Circular, including certain information in the aforementioned sections and all information concerning the quarter ended 31 March 2007, has been derived by the Management from the Company's unaudited records.

DEFINITIONS AND GLOSSARY

“CAB”	Cluster of apartment blocks
“Company”	Arco Vara AS, incorporated in Estonia with registration code 10261718
“EFSA”	the Estonian Financial Supervisory Authority
“EU”	the European Union
“Group”	the Company and its subsidiaries
“IFRS”	International Financial Reporting Standards
“IFRS as adopted by the EU”	International Financial Reporting Standards as adopted by the EU
“IFRS Financial Statements”	the Company’s unaudited consolidated condensed interim financial statements for the three-month period ended 31 March 2007 prepared in accordance with IAS 34 Interim Financial Statements as adopted by the EU, its (ii) audited consolidated financial statements for the financial year ended 31 December 2006 (with comparative information for the financial year ended 31 December 2005) prepared in accordance with IFRS as adopted by the EU and its (iii) audited consolidated financial statements for the financial year ended 31 December 2005 (with comparative information for the financial year ended 31 December 2004) prepared in accordance with IFRS
“Joint Ventures”	Dreilini-Ulbroka-1 SIA AS Tallinna Olümpiaspordikeskus Arco Ärikeskuse OÜ Arco HCE OÜ Arco & Koger Investeeringsgute OÜ Arco & Koger EOOD Arco Vara Saare Kinnistud OÜ Varamaad Kinnisvara OÜ OÜ Floriston Grupp OÜ Snowden OÜ Chalwell OÜ Hopson Capital OÜ Redman Invest OÜ Steadman OÜ Noland Grupp OÜ Kastner Grupp Arco Vara Arenduse OÜ Pärnu Elumaja OÜ Pärnu Ärihoone OÜ OÜ Koduküla AVEC Asset Management AS Arco Rumeenia Valduste OÜ

	Arco Real Estate Consulting SRL
“Management”	the Management Board of the Company
“NOI”	Net operating income
“Prospectus Directive”	Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC

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**CONSOLIDATED UNAUDITED INTERIM CONDENSED FINANCIAL STATEMENTS OF
ARCO VARA AS FOR THE THREE MONTHS ENDED 31 MARCH 2007**

MANAGEMENT REPRESENTATION TO THE CONSOLIDATED INTERIM CONDENSED FINANCIAL
STATEMENTS

Hereby we declare our responsibility for the Consolidated Interim Condensed Financial Statements of Arco Vara AS (hereafter also the “Parent”) and its subsidiaries (hereinafter also collectively the “Group”) prepared for the 3 months ended 31 March 2007. These Consolidated Interim Condensed Financial Statements set out on pages F-2 to F-15 have been prepared in accordance with IAS 34 as adopted by EU and give a true and fair view of the financial position of the Group, as well as the results of its operations and cash flows.

The Group and the Parent are able to continue as a going concern.

Viljar Arakas

Chairman of the Management Board

Sulev Luiga

Member of the Management Board

Ivar Siimar

Member of the Management Board

Veiko Pedosk

Member of the Management Board

Ahto Altjõe

Member of the Management Board

CONSOLIDATED INCOME STATEMENT

in thousands of kroons

	Note	1 st Quarter 2007	1st Quarter 2006
Revenue from rendering services		53,838	75,872
Revenue from sale of goods		237,343	24,844
Total revenue	5	291,181	100,716
Cost of sales		-226,397	-67,021
Gross profit		64,784	33,695
Other operating income	5	49,256	2,551
Marketing expenses		-7,565	-3,671
General and administrative expenses		-31,390	-2,877
Other operating expenses		-2,699	-114
Operating profit		72,386	29,584
Financial and investment activity income		10,170	1,860
Financial and investment activity expenses		-13,168	-4,428
Profit before income tax		69,388	27,016
Income tax expense		-288	80
Net profit		69,100	27,096
attributable to minority interests		5,601	-66
attributable to owners of Arco Vara AS		63,499	27,162
Profit attributable to owners of the Parent per share (in kroons)			
- basic		2.09	0.99
- diluted		2.09	0.99

CONSOLIDATED BALANCE SHEET

in thousands of kroons

	Note	31.03.2007	31.12.2006
ASSETS			
<i>Current assets</i>			
Cash and cash equivalents		115,436	58,345
Receivables	7	252,092	102,498
Prepaid expenses		9,108	4,429
Inventories	8	600,803	431,817
Biological assets		6,142	6,141
Total current assets		983,581	603,230
<i>Non-current assets</i>			
Long-term receivables		9,063	10,673
Long-term investments into financial assets		67,489	65,769
Investment property	9	994,037	1,479,281
Property, plant and equipment	10	78,554	81,713
Intangible assets	11	20,307	16,705
Total non-current assets		1,169,450	1,654,141
TOTAL ASSETS		2,153,031	2,257,371
LIABILITIES AND EQUITY			
<i>Current liabilities</i>			
Borrowings		681,313	699,568
Payables		217,538	249,275
Prepayments		36,481	63,427
Provisions		1,926	1,953
Total current liabilities		937,258	1,014,223
<i>Non-current liabilities</i>			
Long-term borrowings		408,140	457,258
Other long-term payables		4,111	41,561
Deferred income taxes		1,647	1,353
Long-term provisions		1,100	1,095
Total non-current liabilities		414,998	501,267
Total liabilities		1,352,256	1,515,490
Equity			
<i>Equity attributable to the owners of the Parent</i>			
Share capital		304,530	304,530
Share premium		123,083	123,083
Legal mandatory reserve		5,486	5,486
Other reserves		-188	-184
Retained earnings		344,999	292,002
Total equity attributable to the owners of the Parent		777,910	724,917
Minority interest		22,865	16,964
Total equity		800,775	741,881
TOTAL LIABILITIES AND EQUITY		2,153,031	2,257,371

CONSOLIDATED CASH FLOW STATEMENT

in thousands of kroons

	Note	1st Quarter 2007	1st Quarter 2006
Cash flow from operating activities			
Operating profit		72,386	29,584
Adjustment of operating profit, incl.		-45,331	-14,987
<i>Depreciation of property, plant and equipment and amortisation of</i>		1,103	-12,594
<i>Gains or losses from disposals of property, plant and equipment and</i>		-36	-8
<i>Gains or losses from disposals of investment property</i>		2,272	-2,385
<i>Gains or losses from changes in fair value of investment property</i>		-48,670	0
Change in receivables related to operating activities		-59,867	-1,444
Change in inventories		114,622	-29,267
Change in biological assets		-1	108
Change in liabilities and prepayments related to operating activities		-50,310	7,627
Total cash flow from operating activities		31,499	-8,379
Cash flow from investing activities			
Purchase of property, plant and equipment, and intangible assets		-3,589	-35,027
Proceeds from disposals of property, plant and equipment		19	12
Acquisition of investment property		-6,128	-7,639
Proceeds from disposals of investment property		9,418	5,051
Acquisition of subsidiaries and joint ventures		-6,203	-4,036
Proceeds from disposals of subsidiaries and joint ventures		93,215	0
Loans granted		-9,426	-165
Repayments of loans granted		10,620	2,235
Interest received		1,205	1,060
Total cash flow from investing activities		89,131	-38,509
Cash flow from financing activities			
Loans received		160,928	59,831
Loan and finance lease repayments		-196,491	-19,216
Change in overdraft		-15,598	-80
Change in group account		-376	0
Interest paid		-9,288	-6,590
Issue of shares		0	-1,408
Dividends paid		-1,990	-4,079
Paid income tax on dividends		-668	-1,106
Total cash flow from financing activities		-63,483	27,352
TOTAL CASH FLOW		57,147	-19,536
Cash and cash equivalents at the beginning of the period		58,345	143,985
Change in cash and cash equivalents		57,147	-19,536
Effect of changes in currency exchange rates on cash and cash equivalents		-56	-42
Cash and cash equivalents at the end of the period		115,436	124,407

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

in thousands of kroons

	Attributable to the equity holders of the Parent						Minority interest	Total owner's equity
	Share capital	Share premium	Legal mandatory reserve	Other reserves	Retained earnings	Total		
Balance as of 31.12.2005	304,530	123,083	420	474	100,811	529,318	51,427	580,745
Unrealised currency exchange rate differences	0	0	0	12	0	12	0	12
Change in minority interest caused by changes in the Parent's ownership in subsidiaries	0	0	0	0	0	0	-43,585	-43,585
Net profit for period	0	0	0	0	27,162	27,162	-66	27,096
Balance as of 31.03.2006	304,530	123,083	420	486	127,973	556,492	7,776	564,268
Balance as of 31.12.2006	304,530	123,083	5,486	-184	292,002	724,917	16,964	741,881
Unrealised currency exchange rate differences	0	0	0	-4	0	-4	0	-4
Change in minority interest caused by changes in the Parent's ownership in subsidiaries	0	0	0	0	0	0	300	300
Initially recorded put options on minority	0	0	0	0	-10,502	-10,502	0	-10,502
Net profit for the period	0	0	0	0	63,499	63,499	5,601	69,100
Balance as of 31.03.2007	304,530	123,083	5,486	-188	344,999	777,910	22,865	800,775

NOTES TO THE CONSOLIDATED INTERIM CONDENSED FINANCIAL STATEMENTS

1 Accounting policies

The non-audited condensed consolidated interim financial statements of Arco Vara AS for the first quarter of 2007 are prepared in accordance with the requirements provided by International Accounting Standard (IAS) 34 Interim Financial Reporting, making use of the same accounting methods and principles which were applied in preparing the consolidated financial statement for 2006.

The interim condensed consolidated financial statements for the three months ended 31 March 2007 do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements as at 31 December 2006.

In addition, the following new or revised standards and interpretations have been applied which did not have any influence on the financial results of the first quarter of 2007:

- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Presentation of Financial Statements (revised)
- IFRIC 8 Scope of IFRS 2
- IFRIC 9 Reassessment of Embedded Derivatives
- IFRIC 10 Interim Financial Reporting and Impairment

New or revised standards and interpretations adopted by the balance sheet date of this financial statement, but not yet entered into force, do not have a significant effect on the material accounting principles applied by the Group. The requirements of these standards and requirements will be followed as of the date of their entry into force which will be either 1 January 2008 (IFRIC 11) or 1 January 2009 (IFRS 8) in the case of standards and interpretations applicable to the Group:

- IFRS 8 Operating Segments
- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions

Financial instruments – supplemented accounting principles

Based on two shareholder agreements, four minority shareholders of the Group have put options which give the minority shareholders the right to sell and give the Group the obligation to purchase the shares held by the minority shareholders. In the case of one shareholders' agreement, the exercise price of the put option is the established amount which corresponds to the market value of those shares. In case of the other shareholders' agreement, the exercise price of the put option is the minority's proportional part of the book value of the company's equity, calculated according to IFRS.

Based on IAS 32 paragraph 23, the Group has recognised, in connection with the given put options held by the minority, a financial liability in the present value of the amount payable upon exercising the options. The amount of the given liability is calculated either on the basis of the market value of the minority interest or the book value of the equity of the company on each reporting date. Upon initial recognition the minority put options are recognised as a short-term liability and as an adjustment to retained earnings. Any subsequent changes in the carrying value of financial liability will be recognised in financial income or financial expenses in the income statement.

2 Scope of consolidation

	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	Total
Parent and subsidiaries							
As of 31.12.2006	20	7	2	2	1	-	32
Additions	1	1	1	0	-	-	3
Disposals and mergers	-6	-	-	-1	-	-	-7

As of 31.03.2007	15	8	3	1	1	-	28
Joint ventures							
As of 31.12.2006	22	2	-	-	-	1	25
Additions	1	-	-	-	-	-	1
Disposals	-2	-	-	-	-	-	-2
As of 31.03.2007	21	2	-	-	-	1	24
Associated companies (not consolidated)							
As of 31.12.2006	1	0	0	0	0	0	1
Additions	-	-	-	-	-	-	0
Disposals	0	-	-	-	-	-	0
As of 31.03.2007	1	0	0	0	0	0	1

In the first quarter of 2007, the number of consolidated companies of the Group decreased by five, including five companies that were merged with other companies of the Group, two subsidiaries were founded, one was acquired by way of business combination (Note 4), one subsidiary and two joint companies (Note 3) were sold, and one company was reclassified to a joint venture as a result of selling a shareholding in a subsidiary (Note 3).

3 Transfers of Group holdings in subsidiaries and joint ventures

At the beginning of 2007, Arco Vara AS transferred a 50% shareholding in subsidiary Arco HCE OÜ. The sales price in transferring the shareholding was 22,711 thousand kroons, in addition to which the purchaser paid 50% of the claim of Arco Vara AS against the subsidiary in the amount of 106,188 thousand kroons.

The impact of the sale the shareholding in the subsidiary and subsequent changes to a joint venture had the following influence on the Group:

in thousands of kroons	1st Quarter 2007
Cash and cash equivalents ¹	121,356
Other current assets	-2,423
Long-term receivables	49,322
Investment property (Note 9)	-192,500
Short-term borrowings	-62,509
Other short-term payables	-46,351
Long-term borrowings	49,322

¹ The sales price of the share received from transferring the ownership of the share of Arco HCE OÜ and the receivable of the Group from Arco HCE OÜ as of 31.12.2006 paid by the purchaser to the Group have been shown as a change in cash and cash equivalents in the above table.

After the transfer of the shareholding, the share capital of Arco HCE OÜ was increased by 20 thousand kroons, while the nominal value of the share of both owners of Arco HCE OÜ was increased in proportion to their shareholding. A total of 73,829 thousand kroons was paid in as a share premium, of which the premium paid by the Group comprised 72,839 thousand kroons.

The costs directly related to the transfer of the 50% shareholding in Arco HCE OÜ reached 2,000 thousand kroons.

In March 2007, the Group transferred a shareholding in the Ukrainian company Arco Capital TOV, receiving 2,649 thousand kroons from the sale of the subsidiary. The influence of transfer of the shareholding in Arco Capital TOV on the assets and liabilities of the Group was as follows:

in thousands of kroons	1st Quarter 2007
Cash and cash equivalents	-403
Other current assets	-66

Property, plant and equipment (note 10)	-6,802
Liabilities	-44

In March 2007, the Group transferred its shareholding in joint venture Kramer Kinnisvara OÜ. As of 31 March 2007, the Group has a claim in the amount of 2,311 thousand kroons from selling the joint venture. The influence of transferring Kramer Kinnisvara OÜ on the financial results of the Group in the first quarter was as follows:

in thousands of kroons	1st Quarter 2007
Cash and cash equivalents	-53
Short-term receivables	-481
Inventories (note 8)	-14,624
Short-term borrowings	-2,385
Other short-term payables	-303
Long-term borrowings	-11,213

In January 2007, the Group transferred its holding in joint venture Cromer Trade OÜ, receiving 2,400 thousand kroons from the sale. Cromer Trade OÜ was a project company, holding the real estate recognised as inventories and therefore the sale of the joint venture is recognised as sales revenue in the income statement and as a change in operating cash flows in the cash flows statement.

4 Business combinations and acquisitions of minority shareholdings

On 11 January 2007, the Group acquired a 55% shareholding in Latvian building company Arco Construction SIA. The acquisition cost was 4 303 thousand kroons, of which 1 291 thousand kroons was paid in cash in the first quarter of 2007 and the remaining amount will be paid within three years. The acquisition cost does not bear any interest and therefore it has been discounted as a result of which the acquisition cost comprises 4 070 thousand kroons. The acquired net assets and created goodwill are presented in the following table.

The acquisition cost is divided to the assets and liabilities of Arco Construction SIA at fair value as follows

in thousands of kroons	11.01.2007
Acquisition cost	4,070
Fair value of acquired net assets	710
Goodwill	3,360

The income and expenditure of Arco Construction SIA within three months as well as the liabilities as of 31 March 2007 are consolidated to the Group's financial statement for the first quarter of 2007. The sales revenue of Arco Construction SIA outside the Group in the first quarter of 2007 was 4,286 thousand kroons.

In early 2007 the Group acquired an additional 25% shareholding in the subsidiary Riia Valduste OÜ. After the acquisition of the minority Riia Valduste OÜ became a wholly owned subsidiary of the Group. The Group paid 10 thousand kroons for the minority interest acquired. The transaction had no material effect on the financial position and financial performance of the Group.

5 Segment information - business segments

in thousands of kroons

Revenue and other operating income by business segments	1st Quarter 2007	1st Quarter 2006	Part from consolidated income (%)
Service	33,253	24,276	10
Revenue from external customers	28,498	22,406	8

Other operating income from external customers	131	4	0
Revenue and other operating income to other segments	4,624	1,866	1
Development	294,777	43,110	87
Revenue from external customers	244,429	38,128	72
Other operating income from external customers	49,118	2,446	14
Revenue and other operating income to other segments	1,230	2,536	0
Construction	57,219	52,476	17
Revenue from external customers	18,254	40,182	5
Other operating income from external customers	7	101	0
Revenue and other operating income to other segments	38,958	12,193	11
Eliminations	-44,812	-16,595	-13
Total revenue and operating income	340,437	103,267	100

Operating profit by business segments	1st Quarter 2007	1st Quarter 2006
Service	-1,650	4,141
incl. amortisation and depreciation	-297	-181
incl. goodwill recorded as income and impairment loss on goodwill	0	0
Development	86,138	38,906
incl. amortisation and depreciation	-208	-137
incl. goodwill recorded as income and impairment loss on goodwill	0	13,404
Construction	-6,334	-8,410
incl. amortisation and depreciation	-369	-281
incl. goodwill recorded as income and impairment loss on goodwill	0	-90
Eliminations	5,648	862
Unallocated operating expenses	-11,416	-5,915
incl. amortisation and depreciation	-224	-100
incl. goodwill recorded as income and impairment loss on goodwill	0	0
Total operating profit	72,386	29,584
incl. amortisation and depreciation	-1,098	-699
incl. negative goodwill recorded as income and impairment loss on goodwill	0	13,314

Investments into non-current assets by business segments	1st Quarter 2007	1st Quarter 2006
Service	1,488	604
Development	3,093	43,000
Construction	3,783	3,968
Unallocated investments	160	53
Total investments into non-current assets	8,524	47,625

Assets by business segments	31.03.2007	31.12.2006
Service	36,941	31,900
Development	1,819,842	2,054,015
Construction	90,506	92,240
Eliminations	-42,510	-20,665
Unallocated assets	248,252	99,881
Total assets	2,153,031	2,257,371

The decrease in the volume of the assets of the development segment as compared to 31 December 2006 is caused in part by the sale of a 50% shareholding in Arco HCE OÜ, the subsequent change of a subsidiary to a joint venture (Note 3) and selling the real estate properties recognised as inventories (Note 8).

6 Earnings per share

in thousands of kroons

	1st Quarter 2007	1st Quarter 2006
Weighted average number of common shares	67,784,150	67,784,150
Net profit attributable to the owners of the Parent	63,499	27,162
EPS (in kroons per share)	0.94	0.40

In May 2007 the Group conducted a bonus issue, increasing the share capital in the amount of 373,311 thousand kroons at the expense of the company's equity without any additional inflow of resources to the Group. With the bonus issue, 37,331,113 new shares were issued at a nominal value of 10 kroons per share. For this reason, the weighted average number of shares during the first quarter of 2007 and first quarter of 2006 was retroactively changed to 67,784,150 shares.

7 Receivables

in thousands of kroons

	31.03.2007	31.12.2006
Accounts receivable, net	131,222	45,147
Total other receivables	98,465	34,057
Total accrued income	22,405	23,294
Total receivables	252,092	102,498

The significant increase in the caption of accounts receivable is related to the sale of real estate properties Kerese Keskus in Narva and Suur-Sõjamäe 40 in Tallinn. The total unpaid amount as of 31.03.2007 from these transactions was 96,648 thousand kroons.

The increase in the caption other receivables is related to receivables from Arco HCE OÜ in the total amount of 54,141 thousand kroons. Arco HCE OÜ was reclassified from subsidiary to joint venture as the result of the 50% sale of Arco HCE OÜ at the beginning of 2007 (Note 3).

8 Inventories

in thousands of kroons

	31.03.2007	31.12.2006
Real estate purchased for resale or development	581,555	415,567
Other goods purchased for resale	5,464	6,580
Materials and finished goods	1,204	0
Prepayments to suppliers	12,580	9,670
Total inventories	600,803	431,817

A significant increase in the caption of real estate purchased for resale or development is related to the reclassification of the Tivoli project from investment properties to inventories (Note 9). The reclassification at the beginning of 2007 in the amount of 300,000 thousand kroons was caused by the assessment of the development segment management on the future intended purpose of the real estate and positive developments in the process of establishing a detailed plan for the project.

In addition to the foregoing, real estate Ulmana Gatves in Riga, Keres Centre in Narva, apartments in Kolde residential district and the most important part of Kase project in Tallinn were sold, as a result of which the inventories decreased by a total amount 173,828 thousand kroons.

Through the sale of the joint venture Kramer Kinnisvara OÜ in March 2007, the real estate objects recognised as inventories decreased in value by 14,624 thousand kroons (Note 3).

Other changes in the stocks are related to investments in development objects in progress in Estonia and Latvia.

9 Investment property

in thousands of kroons

Balance as of 31.12.2005	851,104
Acquisitions	4,274
Capitalised borrowing costs	69
Sales	-2,574
Balance as of 31.03.2006	852,873
Balance as of 31.12.2006	1,479,281
Acquisitions	433
Sales	-41,847
Disposals related to sale of subsidiaries and reclassification into joint venture (note 3)	-192,500
Reclassification into inventories (Note 8)	-300,000
Gain or loss from change in fair value	48,670
Balance as of 31.03.2007	994,037

10 Property, plant and equipment

in thousands of kroons

	Land and buildings	Machinery and equipment	Other property, plant and equipment	Construction -in-progress and prepayments	Total property, plant and equipment
Balance as of 31.12.2005	16,956	1,464	2,938	153,043	174,401
Purchases	0	40	687	25,406	26,133
Capitalised borrowing costs	0	0	0	2,295	2,295
Disposals	0	-5	0	0	-5
Depreciation charge	-186	-138	-298	0	-622
Balance as of 31.03.2006	16,770	1,361	3,327	180,744	202,202
<i>Incl Acquisition cost</i>	<i>24,860</i>	<i>4,946</i>	<i>7,812</i>	<i>180,744</i>	<i>218,362</i>
<i>Incl Accumulated depreciation</i>	<i>-8,090</i>	<i>-3,585</i>	<i>-4,485</i>	<i>0</i>	<i>-16,160</i>
<i>Incl Acquisition cost</i>	<i>30,052</i>	<i>5,553</i>	<i>8,256</i>	<i>53,799</i>	<i>97,660</i>
<i>Incl Accumulated depreciation</i>	<i>-8,723</i>	<i>-3,292</i>	<i>-3,932</i>	<i>0</i>	<i>-15,947</i>
Balance as of 31.12.2006	21,329	2,261	4,324	53,799	81,713
Purchases	0	1,016	724	2,655	4,395
Capitalised borrowing costs	0	0	0	20	20
Additions from business combinations (note 4)	0	0	695	0	695
Disposals	0	-436	-29	0	-465

Disposals related to sale of subsidiary (note 3)	0	0	0	-6,802	-6,802
Depreciation charge (Note 9)	-339	-152	-511	0	-1,002
Balance as of 31.03.2007	20,990	2,689	5,203	49,672	78,554
<i>Incl Acquisition cost</i>	<i>30,046</i>	<i>5,391</i>	<i>9,220</i>	<i>49,672</i>	<i>94,329</i>
<i>Incl Accumulated depreciation</i>	<i>-9,056</i>	<i>-2,702</i>	<i>-4,017</i>	<i>0</i>	<i>-15,775</i>

11 Intangible assets

in thousands of kroons

	Goodwill	Negative goodwill	Computer software	Total
Balance as at 31.12.2005	13,071	0	513	13,584
Purchases	0	0	36	36
Additions from business combinations	3,873	13,314	0	17,187
Disposals	0	-13,314	0	-13,314
Amortisation charge	0	0	-77	-77
Balance as at 31.03.2006	16,944	0	472	17,416
<i>Incl Acquisition cost</i>	<i>16,944</i>	<i>0</i>	<i>1,119</i>	<i>18,063</i>
<i>Incl Accumulated amortisation</i>	<i>0</i>	<i>0</i>	<i>-647</i>	<i>-647</i>
Balance as at 31.12.2006	15,558	0	1,147	16,705
Purchases	0	0	327	327
Additions from business combinations (Note 4)	3,360	0	11	3,371
Amortisation charge	0	0	-96	-96
Balance as at 31.03.2007	18,918	0	1,389	20,307
<i>Incl Acquisition cost</i>	<i>18,919</i>	<i>0</i>	<i>2,176</i>	<i>21,095</i>
<i>Incl Accumulated amortisation</i>	<i>0</i>	<i>0</i>	<i>-788</i>	<i>-788</i>

The goodwill created through the business combination in the first quarter of 2007 is related to the client relations of Arco Construction SIA and concluded building contracts. The concluded construction contracts and client relations cannot be assessed as separate intangible assets.

12 Transactions with related parties

in thousands of kroons

Transactions with joint ventures:

	For the 1st Quarter 2007 or as of 31.03.2007	For the 1st Quarter 2006 or as of 31.12.2006
Sales revenue	183	236
Services purchased	12	40
Short-term loan receivables	64,811	4,075
Long-term loan receivables	1,158	2,215
Accounts receivables	133	4,846
Other short-term receivables	353	121
Short-term payables	21	1

In January 2007, the Group transferred a 50% holding in subsidiary Arco HCE OÜ. Through selling half of the shareholding, Arco HCE OÜ changed to a joint venture and 50% of the Group's claims against the joint venture are hereafter recognised in the consolidated balance sheet. As of 31 March 2007, short-term loan receivables from joint ventures included claims against Arco HCE OÜ in the amount of 54,141 thousand kroons. The interest on this loan is 10% a year.

Transactions with companies with joint control over the Group or the Group companies:

	For the 1st Quarter 2007 or as of 31.03.2007	For the 1st Quarter 2006 or as of 31.12.2006
Sales revenue	135	0
Short-term loan receivables	113	113
Short-term borrowings	63,529	3,240
Long-term borrowings	12,438	12,438

Short-term liabilities as of 31 March 2007 included liabilities towards the other joint venturer of Arco HCE OÜ in the amount of 53,094 thousand kroons. The interest rate of loan liability is 10% a year.

Transactions with key management personnel of the Group companies

	For the 1st Quarter 2007 or as of 31.03.2007	For the 1st Quarter 2006 or as of 31.12.2006
Sales revenue	788	0
Short-term loan receivables	5,017	5,017
Other short-term receivables	104	104
Short-term borrowings	268	268

Transactions with other related parties

	For the 1st Quarter 2007 or as of 31.03.2007	For the 1st Quarter 2006 or as of 31.12.2006
Sales revenue	1,353	91
Purchased services	1,378	60
Short-term loan receivables	14,661	8,196
Other short-term receivables	1,279	5,089
Accounts receivables	815	0
Long-term loan receivables	1,255	5,197
Trade Payables	95	0
Short-term borrowings	150	552
Other short-term payables	40,051	39,616
Long-term borrowings	2,344	2,960

Other short-term receivables as of 31 December 2006 comprised a receivable from Arco Kinnisvaraholduse AS in the amount of 3 810 thousand kroons that was converted into a loan receivable in early 2007. Short-term loans receivable as of 31 March 2007 include a total of 9 163 thousand kroons (including the above mentioned converted receivable) outstanding from Arco Kinnisvaraholduse AS. The loan bears an interest of 6% per annum.

13 Events after the balance sheet date

Transfer of a shareholding in subsidiaries Bišumuižas Nami SIA and Sportings Riga SIA

Arco Investeeringud and the minority shareholder of Bišumuižas Nami SIA entered into a conditional Share Purchase Agreement on 18 May 2007 with SIA Linstow Baltic regarding the sale of 50 per cent of the shares of SIA Bišumuižas Nami. The nominal consideration for the shares is LVL 1,000. The closing of the transaction is subject a number conditions such as a filing to the Latvian competition authorities, satisfactory due diligence review by the purchaser and certain further agreements being negotiated and entered into in a form acceptable to the purchaser. If these conditions are not met by 30 June 2007, any party may withdraw from the agreement without any liability. Further, the transaction is conditional on the payment of consideration of EUR 19,220,000 for the purchase by SIA Bišumuižas Nami of 100 per cent of the shares of SIA Sportings Riga by 30 November 2007. The sellers are entitled to buy back the shares of SIA Bišumuižas Nami for the same price (LVL 1,000) in the event that SIA Bišumuižas Nami fails to pay in full the purchase price for the shares of SIA Sportings Riga within four months after the closing.

Following the closing, Arco Investeeringud will own 40 per cent of the shares in SIA Bišumuižas Nami, with Mr. Viktors Savins owning 10 per cent and SIA Linstow Baltic owning 50 per cent.

Transfer of the Group's holding in joint ventures Castleberry OÜ and Barrow Investments OÜ

In May 2007, the Group transferred its holding in joint venture Castleberry OÜ and in April, 2007, its holding in joint venture Barrow Investments. Castleberry OÜ and Barrow Investments OÜ were a project companies, holding the real estate recognised as inventories and therefore the sales of the joint ventures are recognised as sales revenue in the income statement and as a change in operating cash flows in the cash flows statement.

Bonus issue

In May 2007, the Group increased the share capital by way of bonus issue in the amount of 373,311 thousand kroons on account of the company's equity without making any additional contributions. During the bonus issue 37,331,113 new shares with a nominal value of EEK 10 were issued.

Acquisitions of minority interests

In May 2007 the Group acquired additional shareholdings of 25% and 20% in the subsidiaries Arco Vara Puukool OÜ and Arco Real Estate UAB respectively. After the acquisition both companies became wholly owned subsidiaries of the Group. The transactions had no material effect on the financial position and financial performance of the Group.

**CONSOLIDATED AUDITED FINANCIAL STATEMENTS OF ARCO VARA AS FOR THE
FINANCIAL YEAR ENDED 31 DECEMBER 2006 WITH COMPARATIVE INFORMATION
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2005**

MANAGEMENT REPRESENTATION TO THE CONSOLIDATED FINANCIAL STATEMENTS

We hereby take responsibility for preparation of the financial statements set out on pages F-16 to F-79, and confirm that:

1. the accounting principles used in preparing the financial statements of Arco Vara AS (hereinafter also the "Parent") and its subsidiaries and joint ventures (hereinafter also the "Group") are in compliance with the International Financial Reporting Standards (IFRS) as adopted by the EU;
2. the consolidated financial statements give a true and fair view of the financial position of the Group, as well as the results of its operations and cash flows;
3. the Group and the Parent are able to continue as a going concern.

Viljar Arakas
Chairman of the Management Board

Sulev Luiga
Member of the Management Board

Ivar Siimar
Member of the Management Board

Veiko Pedosk
Member of the Management Board

Ahto Altjõe
Member of the Management Board

31 March 2007

CONSOLIDATED INCOME STATEMENT

in thousands of kroons

	Note	2006	2005
Revenue from rendering services		324 656	300 439
Revenue from sale of goods		158 930	175 499
Total revenue	5,6	483 586	475 938
Cost of sales	8	-349 067	-358 416
Gross profit		134 519	117 522
Other operating income	9	422 928	135 286
Marketing expenses	9	-18 595	-12 259
General and administrative expenses	9	-115 713	-73 766
Other operating expenses	9	-162 788	-13 251
Operating profit		260 351	153 532
Financial and investment activity income	10	16 215	13 065
Financial and investment activity expenses	10	-49 654	-46 038
Profit before income tax		226 912	120 559
Income tax expense	11	-9 563	-4 116
Net profit		217 349	116 443
attributable to:			
owners of the parent		207 945	101 231
minority interests		9 404	15 212
Profit attributable to owners of the Parent per share (in kroons)	13		
- basic		6,83	3,68
- diluted		6,83	3,68

CONSOLIDATED BALANCE SHEET

in thousands of kroons

	Note	31.12.2006	31.12.2005
ASSETS			
<i>Current assets</i>			
Cash and cash equivalents	37	58 345	143 985
Receivables	14	102 498	96 370
Prepaid expenses	15	4 429	2 594
Inventories	16	431 817	153 874
Biological assets	17	6 141	6 020
Total current assets		603 230	402 843
<i>Non-current assets</i>			
Long-term receivables	18	10 673	16 967
Long-term investments into financial assets	20	65 769	3 003
Investment property	21	1 479 281	851 104
Property, plant and equipment	22	81 713	174 401
Intangible assets	23	16 705	13 584
Total non-current assets		1 654 141	1 059 059
TOTAL ASSETS		2 257 371	1 461 902
LIABILITIES AND EQUITY			
<i>Current liabilities</i>			
Borrowings	24	699 568	316 853
Payables	26	249 275	117 742
Prepayments	27	63 427	41 361
Provisions	28	1 953	642
Total current liabilities		1 014 223	476 598
<i>Non-current liabilities</i>			
Long-term borrowings	24	457 258	392 346
Other long-term payables	29	41 561	11 113
Deferred income taxes	11	1 353	0
Long-term provisions	28	1 095	1 100
Total non-current liabilities		501 267	404 559
Total liabilities		1 515 490	881 157
Equity			
<i>Equity attributable to the owners of the Parent</i>			
Share capital	31	304 530	304 530
Share premium	31	123 083	123 083
Legal mandatory reserve		5 486	420
Other reserves		-184	474
Retained earnings	32	292 002	100 811
Total equity attributable to the owners of the Parent		724 917	529 318
Minority interest		16 964	51 427
Total equity		741 881	580 745
TOTAL LIABILITIES AND EQUITY		2 257 371	1 461 902

CONSOLIDATED CASH FLOW STATEMENT

in thousands of kroons

	Note	2006	2005
Cash flow from operating activities			
Operating profit		260 351	153 532
Adjustment of operating profit, incl.		-333 738	-107 453
Depreciation of property, plant and equipment and amortisation of		921	9 771
Impairment of plant, property and equipment (Note 9)		72 823	0
Gains/losses from disposals of property, plant and equipment and		-6 346	-661
Gains/losses from disposals of investment property (Note 9)		-25 224	-12 353
Gains/losses from changes in fair value of investment property and		-375 912	-104 227
Other adjustments		0	17
Change in receivables related to operating activities and inventories		-208 908	-16 344
Change in liabilities and prepayments related to operating activities		164 835	26 015
Total cash flow from operating activities	35	-117 460	55 750
Cash flow from investing activities			
Purchase of property, plant and equipment, and intangible assets		-294 375	-138 894
Proceeds from disposals of property, plant and equipment		11 944	472
Acquisition of investment property and biological assets		-17 616	-318 187
Sale of investment property and biological assets		57 087	144 113
Acquisition of subsidiaries and joint ventures (net of cash acquired)		-91 251	-21 713
Proceeds from disposals of subsidiaries and joint ventures		0	-5 187
Acquisition of other investments		0	-516
Proceeds from disposals of other investments		0	5 965
Loans granted		-22 338	-15 293
Repayments of loans granted and finance lease		12 690	45 362
Interest received		1 941	4 546
Total cash flow from investing activities	36	-341 918	-299 332
Cash flow from financing activities			
Loans received		723 267	719 842
Loan and finance lease repayments		-292 312	-466 883
Change in overdraft		10 116	-8 791
Interest paid		-45 412	-24 243
Issue of shares ¹		-1 223	157 026
Dividends paid		-13 263	-9 720
Paid income tax on dividends		-6 297	-2 711
Total cash flow from financing activities		374 876	364 520
TOTAL CASH FLOW		-84 502	120 938
Cash and cash equivalents at the beginning of the period		143 985	23 344
Change in cash and cash equivalents		-84 502	120 938
Effect of changes in currency exchange rates on cash and cash equivalents		-1 138	-297
Cash and cash equivalents at the end of the period	37	58 345	143 985

¹ The negative cashflows from the issuance of shares in 2006 relate to transaction costs payable in 2006 incurred in connection with the 2005 issuance.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

in thousands of kroons

	Share capital	Share premium	Legal mandatory reserve	Other reserves	Retained earnings	Total	Minority interest	Total owner's equity
Balance as of 31.12.2004	4 200	8 841	420	5 702	262 120	281 283	71 834	353 117
Bonus issuance	268 355	-8 841	0	-5 186	-254 328	0	0	0
Issued share capital	31 975	123 083	0	0	0	155 058	0	155 058
Distribution of dividends ¹	0	0	0	0	-7 792	-7 792	0	-7 792
Dividends of subsidiaries	0	0	0	0	0	0	-823	-823
Adjustments of retained earnings	0	0	0	0	-420	-420	0	-420
Unrealised currency exchange rate differences	0	0	0	-42	0	-42		-42
Change in minority interest caused by changes in the Parent's ownership in subsidiaries (Note 7.2)	0	0	0	0	0	0	-34 796	-34 796
Net profit for the financial year	0	0	0	0	101 231	101 231	15 212	116 443
Balance as of 31.12.2005	304 530	123 083	420	474	100 811	529 318	51 427	580 745
Distribution of dividends ¹	0	0	0	0	-11 692	-11 692	-200	-11 892
Unrealised currency exchange rate differences	0	0	0	-658	0	-658	0	-658
Transfer to mandatory reserve	0	0	5 062	0	-5 062	0	0	0
Change in legal mandatory reserve due to merger with subsidiary	0	0	4	0	0	4	0	4
Change in minority interest caused by changes in the Parent's ownership in subsidiaries (Note 7.2)	0	0	0	0	0	0	-43 667	-43 667
Net profit for the financial year	0	0	0	0	207 945	207 945	9 404	217 349
Balance as of 31.12.2006	304 530	123 083	5 486	-184	292 002	724 917	16 964	741 881

Additional information on the share capital and share premium has been disclosed in Note 31.

¹ Dividends per share were announced in the reporting period as follows:

	2006	2005
Dividends announced	11 692	7 792
Number of shares at the announcement date	30 453 037	8 400
Dividends per share (in kroons)	0,38	927,62

1 General information

The consolidated financial statements of Arco Vara AS and its subsidiaries and joint ventures for the financial year ended 31.12.2006 were authorised for issue on 31.03.2007. According to the Commercial Code of the Republic of Estonia, the annual report, prepared by the Management Board and approved by the Supervisory Board, is authorised by the General Meeting of Shareholders. These consolidated financial statements form a part of the annual report to be approved by the shareholders, and basis for profit allocation. The shareholders shall have the right not to approve the annual report prepared by the management board and approved by the supervisory board, and demand preparation of a new annual report.

The annual report to be approved by the shareholders will be presented in the Estonian language. Current financial statements are a translation of the statutory Estonian originals. In case of differences arising on translation between the Estonian original and the current set of financial statements the statutory Estonian original shall prevail.

Arco Vara AS (the Parent) is a limited liability company incorporated and domiciled in Estonia. In 2006, the Group employed approximately 480 employees (2005: 280 employees). The main activities of the Group have been described in Note 4 “Segment reporting” and the Group operates through its subsidiaries and joint ventures in Estonia, Latvia, Lithuania, Ukraine, Bulgaria and Romania.

The structure of Arco Vara Group as at 31.12.2006 has been disclosed in Note 40.

2 Statement of compliance and basis for preparation

The consolidated financial statements of Arco Vara AS and its subsidiaries and joint ventures have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU. These consolidated financial statements have been prepared and presented for approval in accordance with and in order to meet the requirements of the Estonian Accounting Act and the Commercial Code.

Due to the mandatory requirement arising from the anticipated IPO in 2007 Arco Vara AS has changed the basis of preparation from IFRS to IFRS as adopted by the European Union starting from 01.01.2006. The effect of the change in the basis of preparation has had no material effect on the financial results and disclosures of 2006 or the corresponding financial information for 2005.

Both the functional currency of Arco Vara AS and the presentation currency of these financial statements is the Estonian kroon (EEK). Unless otherwise noted, these financial statements have been prepared in thousands of kroons.

The consolidated financial statements of the Group have been prepared on a historical cost basis, unless indicated otherwise in the accounting policies described in Note 4 “Summary of significant accounting policies” (e.g., certain financial investments, derivative financial instruments, investment property and biological assets have been measured at fair value).

Basis of consolidation

The consolidated financial statements comprise the financial statements of Arco Vara AS and its subsidiaries consolidated line by line as well as joint ventures using proportionate consolidation. The reporting years of the financial statements of the Group companies coincide with the calendar year. The companies use consistent accounting policies and estimates to a material extent (or accounting policies and estimates used by certain foreign entities have been adjusted, if necessary).

A subsidiary is an entity that is controlled by the Parent. Generally, a subsidiary is considered to be under the control of the Parent, when the Parent owns, directly or indirectly (through other subsidiaries), more than half of the voting power of an entity or the Parent has otherwise power to govern the financial and operating policies of a subsidiary under a contractual agreement or otherwise.

Joint ventures are companies whose economic activities are jointly controlled under a contractual agreement by two or more parties (incl. the Parent company). Joint control means sharing of control, where in order to determine the strategic financial and operating decisions of an investment object require unanimous consensus of the parties sharing control.

Assets, liabilities, income, expenses and cash flow of subsidiaries and joint ventures are consolidated from the date on which control or joint control (respectively) is transferred to the group, and cease to be consolidated from the date on which the control or joint control over the investment object is transferred out of the group.

The group's share in the joint ventures is consolidated under proportionate consolidation—the group's share of the joint ventures' assets, liabilities, income and expenses are combined with similar items in the consolidated financial statements.

Any receivables, liabilities, income, expenses, cash flow and unrealised profit and loss arising from transactions between the Parent company and its subsidiaries have been fully eliminated in the consolidated financial statements. When eliminating the effect of transactions with joint ventures, the amount of holding of the Group is assessed. Unrealised losses are eliminated unless the loss is generated by decrease in the value of assets.

Minority interest – the share of the subsidiary's profit, loss and net assets which does not belong to the group, is recorded under a separate caption in the consolidated income statement and balance sheet (under owner's equity).

The acquisition of subsidiaries and joint ventures is recorded on the basis of the purchase method of accounting - the acquired assets and liabilities as well as contingent liabilities (hereinafter jointly also referred to as "net assets") of the subsidiary and joint venture are recognised at fair value. Any positive difference between the cost of the business combination and the fair value of the net assets of the investment object is recorded as goodwill. If as a result of the purchase price allocation the Group's share of the fair value of the net assets of the investment object exceed the cost of the business combination then the Group reassesses the fair values of the subsidiary's or joint venture's assets, liabilities and contingent liabilities and then recognises any differences (negative goodwill) immediately as income (see Note 4 "Goodwill" for the subsequent measurement of positive goodwill).

When the Company increases its share in a subsidiary by means of acquiring minority then the difference between the acquisition cost of the minority and the acquired minority's share of the net assets of the subsidiary is recorded as either positive or negative goodwill, whereas the net assets of the subsidiary are not revalued to fair value (the purchase method described in IFRS 3 „Business Combinations” does not apply to the acquisition of minority) in these cases.

When an interest in a subsidiary or joint venture is disposed of, the difference between the proceeds from the disposal and the carrying amount of the parent's interest in the subsidiary's or joint venture's assets and liabilities plus the carrying amount of goodwill related to the subsidiary or joint venture is recognised in the income statement as a gain or loss on disposal.

If control ceases, but only part of the subsidiary is disposed of, depending on the level of influence still held by the investor, the remaining interest in the carrying amounts of the subsidiary's or joint ventures assets and liabilities and of goodwill is accounted for either as an associate, as a joint venture or as a financial asset.

3 Changes in the presentation and accounting principles

The accounting policies and presentation adopted in preparation of the current financial statements are consistent with those of the previous financial year. In addition, the following new/revised standards have been adopted, which had no material effect on the financial results and disclosures of 2006:

- IAS 1 Presentation of Financial Statements (revised);
- IAS 19 Employee Benefits (revised);
- IAS 21 Effect of Changes in Foreign Exchange Rates (revised);
- IAS 39 Financial Instruments: Recognition and Measurement (revised);
- IFRS 4 Insurance Contracts (revised);
- IFRS 6 Exploration for and Evaluation of Mineral Resources¹;
- IFRIC 4 Determining whether an Arrangement Contains a Lease;
- IFRIC 5 Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds¹;
- IFRIC 6 Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment¹.

According to management, the new or revised standards and interpretations that have been approved but have not yet entered into force as of the balance sheet date have no significant effect on the material accounting principles used by the group. The requirements of the below standards and interpretations will be adopted as of their date of entry into force, which for the standards and interpretations, applicable to the Group, is 01.01.2007 (IFRS 7, IAS 1, IFRIC 7, IFRIC 8, IFRIC 9, IFRIC 10), 01.01.2008 (IFRIC 11, IFRIC 12) or 01.01.2009 (IFRS 8, IAS 23):

- IAS 1 Presentation of financial statements (revised);
- IFRS 7 Financial Instruments: Disclosures;
- IFRS 8 Operating segments²;
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies¹;
- IFRIC 8 Scope of IFRS 2;
- IFRIC 9 Reassessment of Embedded Derivatives;
- IFRIC 10 Interim Financial Reporting and Impairment;
- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions²;
- IFRIC 12 Service Concession Arrangements²;
- IAS 23 Borrowing costs (revised)²

¹ The amendments are not relevant to the Group's operating activities.

² The standard or interpretation has not yet been endorsed by the EU.

4 Summary of significant accounting policies

Significant accounting assumptions and judgements of the Management

The preparation of consolidated financial statements in conformity with International Financial Reporting Standards requires the management of the Group to make estimates and decisions that affect the reported amounts and accounting policies of assets, liabilities, income and expenses and disclosure of contingencies.

Although the estimates and decisions are reviewed by management consistently and these are based on the previous experiences and the best knowledge on future trends, the actual outcomes may differ from the current estimates.

The more important judgements, which have effect on the information recognised in the financial statements, concern the following areas of accounting:

Classification of real estate

The classification of real estate items into classes as inventories, investment property or property, plant and equipment (construction-in-progress) is both on the initial classification as well as on later reclassification based on the intention of the management on the future use of the real estate. The accomplishment of the management's plans depends also on the decisions not controlled by the Group (i.e., changing registered intended use of land, approving detailed plans, issuing licence for construction etc), which reduces the accuracy of classification of real estate.

The real estate items with the intention on the future use for development and sale of living environments, individual house or plot of land have been classified as inventories. Real estate items purchased for sale in the course of ordinary business have also been recognised as inventories.

The aim of the purchase of an investment property is to earn income from rent or capital appreciation. The real estate items held for long-term perspective and with several possible intentions on future use are also considered to be investment properties.

The property being developed for the future use as commercial spaces leased out under operating lease terms or purchased commercial property with extensive ongoing reconstruction, is recorded as investment property only after completion of the work (after obtaining the permit for use). These properties have been recorded as constructions-in-progress under property, plant and equipment until completion.

Existing investment property that is being re-developed for continued future use as investment property is not temporarily re-classified to construction-in-progress.

Operating leases: Group as the lessor

Detailed examination of the lease agreements of several real estate objects has indicated that the material risks and rewards from ownership of the leased assets have not been transferred to the lessee. Therefore these leases are treated as operating leases.

Real estate funds managed by the Group: subsidiaries or other financial assets

The Group owns more than half of the voting power of the fund *Explorer Property Fund - Baltic States AB* managed by the Group. In the shareholder agreement of the fund and the management agreement of the fund, such managing and governing principles, which do not give control of the fund's financial and operating policies to the Group, have been established. Hence the fund is accounted for as a special purpose entity and the investment in the fund has been classified as financial asset at fair value through profit or loss.

Estimation uncertainty

The estimates made by the management of the Group are based on the previous experiences and all information available by the date of completing the financial statements. There is a risk that the estimates reported at the balance sheet date and related to value of assets, liabilities, revenue and expenses will be adjusted in the future. Areas, where due to uncertainty of estimates there is a heightened risk of adjustment, are described below:

Goodwill – impairment test

The Group determines whether goodwill arisen on acquisition of subsidiaries and joint ventures is impaired at least on an annual basis. This requires an estimate of fair value (less costs to sell) or value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the management to make an estimate of the expected future net cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill as at 31.12.2006 was 15 558 thousand kroons (2005: 13 071 thousand kroons). More details about the impairment test principles and results have been laid out in Notes 4 and 23.

Investment property: determining the fair value

At each reporting date, investment properties are measured at their fair value. The management of the Group decided to rely mostly on external certified appraisers when determining the fair values of investment properties as at year end 2006. For properties where an internal certified appraiser is used, the discounted cash flow method is the valuation techniques used in most cases for determining fair value. Estimating the discounted cash flows requires an appraiser to forecast rental income generated by the real estate (incl. rent prices per 1 m² and vacancy of premises under lease) and the related operating expenses. In order to calculate the present value of those net cash flows an appraiser has to choose also a suitable discount rate, which reflects the time value of money and specific risks related to the assets in the best possible way. The carrying amount of the investment properties with the fair value determined by the Group's internal appraisers using the discounted cash flow method as at 31.12.2006 amounted to 41 007 thousand kroons (2005: 249 984 thousand kroons). Carrying amount of the investment properties with the fair value determined by the external certified appraisers using the discounted cash flow method as at 31.12.2006 amounted to 341 255 thousand kroons. More details about determining the fair value of investment properties, using the discounted cash flow method have been disclosed in Note 21.

For investment properties where as at 31.12.2006 the valuation technique used was the discounted cash flow method the following can be said regarding the sensitivity of the fair values to changes in key assumptions:

- an average 1% increase in the discount rate would have resulted in a 40 259 thousand kroons decrease in the fair value of investment property recorded as at 31.12.2006;
- an average 1% decrease in the discount rate would have resulted in a 51 352 thousand kroons increase in the fair value of investment property recorded as at 31.12.2006;
- an average 5% decrease in the forecasted net operating income would have resulted in a 19 120 thousand kroons decrease in the fair value of investment property recorded as at 31.12.2006;
- an average 5% increase in the forecasted net operating income would have resulted in a 19 120 thousand kroons increase in the fair value of investment property recorded as at 31.12.2006.

Receivable from local municipalities: probability of the receipt

Paragraph 30 of the Planning Act requires local municipalities to acquire the real estate or a part of it from the Group, if it is intended for public use already in the approved detailed plan. Although the act requires local municipalities to purchase such real estate or a part hereof immediately and for a fair price, there are no explicit bases for determining the compensatory amount and payment schedule. The estimates on the likelihood of receipt from local municipalities have been taken as basis for the

recognition of the receivables in the balance sheet. The carrying amount of such receivables as at 31.12.2006 amounted to 0 kroons (2005: 6 408 thousand kroons). More information on the amount and maturity of the receivable has been disclosed in Note 18.

Segment reporting

The segment reporting is based on the segmentation principles of structural units, used in the internal accounting and reporting (i.e., management reporting and budgeting) of the Group. The primary basis for segmentation is the type of business activity, whereby a segment has been disclosed as a separate reportable segment, if its products and services distinctly differ from the products and services offered by other segments, and it operates as an independent profit centre.

The business segments of the Group are the following:

- real estate development: development projects of living and business environments, investments into real estate with long-term perspective;
- services related to real estate: real estate brokerage and appraisal services, real estate management and real estate fund management, investment into real estate with short-term perspective;
- construction: provision of main and sub- construction contractor services, building inspection services.

Segment revenue is the revenue that is directly attributable to a segment and the relevant portion of other revenue that can be allocated on a reasonable basis to a segment. These are revenues from the sales to external customers or from transactions with other segments of the Group. Revenue from the transactions between the companies belonging to same segment has been eliminated.

Segment expense is the expense resulting from the operating activities of a segment that is directly attributable to a segment and the relevant portion of other expense that can be allocated on reasonable basis to a segment. These are expenses relating to sales to external customers and expenses relating to transactions with other segments of the Group. Segment expense does not include financial expenses, general and administrative expenses and other expenses that are related to the Group as a whole. Expenses incurred at the Group level are allocated to the segment, if these expenses relate to the segment's operating activities and they can be directly attributed or allocated to the segment on reasonable basis. Expenses related to the transactions between the Group companies belonging to same segment have been eliminated.

Segment operating profit is the segment revenue less segment expenses.

Unrealised profit and loss, arising from the transactions between one Group segment with another, are not allocated to any of the segments, but are indicated as elimination between segments. Unrealised profit and loss, arising from transactions between Parent and the segments which can, on a reasonable basis, be allocated to the segment, is included in the operating profit of segment. Such profit or loss can be e.g. interest expenses previously capitalised in the Group, which upon reclassification of assets, initially recorded at cost, into fair value, are presented as an adjustment of fair value gain/loss during reclassification period of assets.

Segment assets are those assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets include current assets, investment property, property, plant and equipment (PPE) and intangible assets related to the operating activities of the segment. If a particular item of depreciation or amortisation is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general Group purposes or which cannot be allocated directly to the segment. Segment assets shared by two or more segments are allocated between these segments, if a reasonable basis for allocation exists.

Segment liabilities are these liabilities related to the operating activities, which either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities include, for example, accounts payable and other payable, accrued expenses, customers' prepayments,

warranty provisions and other product and service related liabilities. Segment liabilities do not include loans, financial leases, bonds and other liabilities related to financing activities. Income tax liability is also not included in segment liabilities.

Revenue and expenses, assets and liabilities, which are not directly related to the segment and cannot be allocated to the segment, are presented as unallocated revenue and expenses, assets and liabilities of the Group.

The secondary basis of segmentation is geographical location. As at 31.12.2006 the geographical segments include Estonian, Latvian, Lithuanian, Ukrainian and Bulgarian segments. Romanian companies are considered as a separate segment starting from 2007.

Foreign currency transactions

All currencies, except Estonian kroon (the functional currency of the Parent) are considered to be foreign currencies. Transactions denominated in foreign currency are initially recorded on the basis of the foreign currency exchange rates of the Bank of Estonia officially valid on the transaction date. Monetary assets (cash, cash equivalents and receivables) and liabilities (loans received and payables) denominated in foreign currency have been translated into Estonian kroons on the basis of the currency exchange rates of the Bank of Estonia officially valid on the balance sheet date. Foreign exchange gains and losses resulting from revaluation are recorded in the income statement of the reporting period as “Financial and investment activity income” or “Financial and investment activity expenses”. Non-monetary items that are measured at historical cost in a foreign currency are translated using the currency exchange rates of the Bank of Estonia officially valid on the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated into the functional currency using the currency exchange rates of the bank of Estonia, officially valid on the date when the fair value was determined.

When the functional currency of subsidiaries and joint ventures differs from the Parent’s functional currency (e.g. functional currency of Latvian subsidiaries is Latvian lats, functional currency of Lithuanian subsidiary is Lithuanian litas and functional currency of Ukrainian subsidiaries is US dollar), the following exchange rates are used for translation of financial statements of subsidiaries and joint ventures for the purpose of consolidation:

- all of the assets and liabilities of foreign subsidiaries and joint ventures (incl. goodwill and fair value adjustments arising from acquisitions of these companies) are translated at the rate of exchange ruling at the balance sheet date;
- the income, expenses and changes in equity of the subsidiaries and joint ventures are restated on the basis of the weighed average exchange rate of the period.

The exchange differences arising on the translation i.e. between balance sheet date and weighted average rates, are presented in the balance sheet row “other reserves”. On disposal or partial disposal of foreign subsidiaries and joint ventures as well as on capital re-contributions, the amounts presented in the equity row “other reserves” relating to that particular disposed entity are recognised in the income statement as profit or loss for the year.

Revenue recognition

Revenue is recognised at the fair value of the consideration received/receivable. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

Proceeds from disposals of real estate

Sales of real estate are recognised when all material risks and rewards related to the real estate have been transferred to the purchaser and the seller has no further substantial acts to complete under the contract. In general, the sale is deemed completed when the real right contract (the contract, agreeing

the transfer of the ownership of real estate), is concluded. Payments received from customers before concluding the contract are recorded under “prepayments”.

Revenue from long-term service agreements

The stage of completion method is used for recording revenue and expenses of long-term service contracts, incl. construction contracts. The stage of completion of the rendered service is estimated based on the proportion of expenses actually incurred on the project until the balance sheet date compared to the estimated total expenses of the project. If, by the balance sheet date, the invoice issued by the service provider to the customer differs from the amount of revenue calculated based on the stage of completion method, the difference will be recorded in the balance sheet under liabilities or receivables, respectively.

If it has become evident that the anticipated costs of the project exceed the total revenue, the loss will be recorded immediately and fully in the income statement.

Revenue from rendering of other services

Revenue from the sales of services is recorded upon rendering of the service. Revenues from brokerage services are recognised when the mediated operation has been concluded. Rental income arising on investment properties is accounted for on a straight-line basis over the lease term. Revenue and expenses related to utility services (i.e. electricity, heat, water, etc.) are offset.

Revenue from sales of other goods

Revenue from sales of other goods is recognised when all material risks and benefits related to the ownership of the asset have been transferred to the purchaser, and the amount of revenue can be reliably measured.

Financial income

Interest income is recorded on an accrual basis in the income statement, based on the effective interest rate method. Dividend income is recognised when the respective right of claim arises.

Cash and cash equivalents

Cash equivalents are short-term (with a term of up to 3 months from the date of acquisition) highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in market value. Such assets are cash in hand and current bank accounts, term deposits with an original maturity of three months or less and money market fund shares.

Financial assets

All financial assets are initially recognised at cost, being the fair value of the consideration given. The acquisition cost includes all expenditures directly related to the purchase of the financial asset, including service charges payable to brokers and advisors, non-refundable taxes and other similar expenditures. As an exception to this rule - transaction costs directly attributable to the purchases of financial assets at fair value through profit or loss are recognised as expenses when incurred.

Regular way purchases and disposals of financial assets are recorded on the transaction/trade date. A transaction date is the date when the Group commits (e.g. concludes an agreement) to purchase or sell the financial asset. Regular way purchases or sales are purchases or sales of financial assets, where the seller has delivered the assets to the buyer within the period generally established by conventions in the marketplace or regulations.

After initial recognition the financial assets are divided into groups (see below). The Group re-evaluates designation of the financial asset at each financial year-end and, if necessary, makes respective adjustments. The classification of financial assets, which according to the International

Financial Reporting Standards may not be reclassified, is not changed. The following measurement bases are used for financial assets:

- 1) financial assets at fair value through profit or loss - fair value;
- 2) held-to-maturity investments - measured at amortised cost;
- 3) receivables - measured at amortised cost;
- 4) available-for-sale financial assets – measured at fair value, except investments in equity instruments whose fair value cannot be reliably measured, which are measured at cost.

Financial assets measured at fair value

Financial assets that are measured at fair value are revaluated on each balance sheet date, with no deduction for possible transaction costs related to the disposal of the asset. The fair value of listed securities is based on the closing price of the security, as well as the official exchange rate of the Bank of Estonia on the balance sheet date. For securities, which are not listed on a stock exchange, fair value is determined based on all available information and using the fair value of another instrument, which is substantially the same, at the reporting date and/or discounted cash flow analysis as valuation techniques.

A gain and loss arising from changes in the fair value of a financial asset is recognised in profit or loss (under “Financial and investment activity income” or “Financial and investment activity expenses”). An exception is available-for-sale financial assets, measured at fair value, with gains or losses being recognised directly in equity (as “other reserves”). After the investment is derecognised or is determined to be impaired, the balance of revaluation reserves is transferred to the income statement. The impairment loss recycled from owner's equity to the income statement is the difference between the acquisition cost (less any principal repaid, and amortisation) and the current fair value of the financial asset, less any impairment losses relating to the financial asset previously recorded in the income statement.

A gain and loss arising from disposal of financial assets measured at fair value as well as interests and dividends from these assets are recognised in profit or loss (under “Financial and investment activity income” or “Financial and investment activity expenses”).

Receivables held-to-maturity investments

Receivables, except those that the Group intends to sell in the near term, and held-to-maturity investments are measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on acquisition, as well as expenses directly related to the transaction, over the useful life of the asset.

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the difference between the asset's carrying amount and the recoverable amount is recorded in the income statement. The recoverable amount of a financial asset is the net present value of future cash flows from the financial asset, discounted with the effective interest rate determined upon the assets initial recognition. The impairment loss of financial assets related to operating activities is charged to operating expenses in the income statement (under "Administrative and general expenses") while the impairment loss of financial assets related to investing activities is charged to financial expenses in the income statement.

The impairment loss is determined separately for financial assets that are individually significant. Receivables overdue more than 180 days are considered to be fully impaired and are expensed. If impairment in the value of the assets becomes known sooner, the receivables are considered as impaired earlier.

If a receivable previously written down is collected or any other event occurs, which cancels the impairment, the reversal of the previously recognised impairment loss is recognised in the income statement as a reduction of the expense where the impairment was initially recognised.

Interest income from receivables and held-to-maturity investments is recognised under “Financial and investment activity income” and “Financial and investment activity expenses” in the income statement.

Financial assets measured at acquisition cost

A financial asset, measured at acquisition cost is written down to its recoverable amount if the recoverable amount is less than the carrying amount of the financial asset. The recoverable amount of financial assets measured at cost consists of the estimated future cash flows from the financial asset, discounted with the average rate of return from similar financial assets on the market. The impairment loss is recognised under “Financial and investment activity expenses” in income statement and shall not be reversed.

The derecognition of financial assets will take place when the Group no longer controls the rights to receive cash flows arising from the financial assets, or when the Group is obliged to, without a material delay, transfer to a third party all cash flows attributable to the asset, and the majority of the risks and rewards related to the financial asset.

Derivative financial instruments

The Group uses derivative instruments such as interest rate swap to hedge the risk associated with interest rate fluctuations. Such derivative instruments are initially stated at fair value on the contract conclusion date. Subsequent to initial recognition, the instrument will be revaluated in accordance with the change in its fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The fair value of the currently operational interest rate swap contract is determined by reference to discounted future cash flows based on estimates on fluctuation of 6-month EURIBOR (from Reuters).

Gains and losses arising from changes in the fair value of the derivative instrument are charged to the “Financial and investment activity income” and “Financial and investment activity expenses” of the period except for derivative instruments that qualify for hedge accounting. The Group had no instruments that qualified for hedge accounting in the reporting period, or in the comparative period.

Inventories

Finished products and work-in-progress are recorded at production cost, consisting of the direct and indirect production costs incurred upon bringing the inventories to their present condition and amount. General production expenses are allocated to work-in-progress and finished goods, based on a normal production volume. Other inventories are recorded at acquisition cost consisting of all the direct and indirect expenditures necessary for converting inventories into ready for sale. Indirect costs, which are included in the cost of the real estate recorded as inventory, are also borrowing costs (interest, amortisation of contract fees, etc) related to the financing of construction of real estate items. Borrowing costs are capitalised into the acquisition cost of inventory until completion of the construction. Borrowing costs related to registered immovable and apartments treated as movables are included in the acquisition cost until a permit for use has been issued.

Generally, inventories are accounted for by using weighted average cost method. An exception to this rule is registered immovable and apartments, treated as movables, where individual cost method is used.

Inventories are valued in the balance sheet at whichever is lower, acquisition cost or the net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale. The amount of write-down of inventories to their net realisable value is recorded as expenses of the reporting period, under “cost of sales” in the income statement.

Investment property

Investment property is property, land or a building held to earn rentals or for capital appreciation, and which is not used for the business activities of the Group. Real estate items held with long-term perspective and with several possible intentions on future use are also considered to be investment properties. Land and buildings purchased for development of living environment have been recognised as inventories. Properties being developed for future use as investment properties (construction of commercial buildings) and buildings treated as movables (reconstruction of commercial buildings) are recorded as PPE until completion of the development work.

Investment properties are initially recognised in the balance sheet at cost, including the transaction costs directly related to the acquisition (i.e. notary's fees, state duty, consulting fees and other expenses incurred for the purpose of concluding the transaction). Thereafter, investment properties are stated at fair value at each reporting date, which reflects market conditions at the balance sheet date.

Expert opinion of certified valuers is used to determine the fair value of the investment property. For more significant investment properties, an independent appraiser's valuation is used in parallel. The following methods are used for determining the fair value:

- Discounted cash flow method. Estimating the discounted cash flows requires an appraiser to forecast rental income generated by the real estate (incl. rent prices per m² and vacancy) and related operating expenses. Depending on the termination possibilities of the lease agreement, appraiser chooses between existing cash flows or market average cash flows. In order to calculate the present value of the net cash flows an appraiser has to estimate also a suitable discount rate, which reflects the time value of money and specific risks related to the assets in the best way. For discount rate calculations market average capital structure is used, not asset specific structure. Discounted cash flow method is used for determining the value of properties with stable rental flows.
- Comparable prices method. For comparable prices method transactions concluded on comparable conditions with the valued property are examined and the market value of the property is derived through the price per m² of the concluded transactions. Comparable prices method is used for real estate with no rental flow and which are held for future development potential or capital appreciation. By nature it's almost impossible to find exactly the same property or deal to compare with, therefore appraiser adjusts the property by transaction time, district, location, size and detail plan.
- Sale contract under the law of obligations concluded as at the balance sheet date. For real estate, which has been disposed of as at the balance sheet date on the basis of a contract under the law of obligations, but for which the real right contract has not been signed yet, the basis for determining the fair value is the sales price in the sales contract under the law of obligations. The sales price is used as the basis for determining the fair value of the investment property only when the Group has sufficient certainty that a real right contract under the same terms will be concluded (for example the buyer has made a considerable prepayment for the acquisition of the property as at the balance sheet date or the real right contract has been concluded after the balance sheet date but before the financial statements are approved for issue).

Gain/loss from the change in value is recorded under "Other operating expenses"/"Other operating income" in the income statement.

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses arising from derecognition of investment property are charged to "Other operating income" or "Other operating expenses" in the income statement of the period when the investment property was derecognised.

Investment property is reclassified in the balance sheet when there is a change in use. From the date of the change in use, the Group uses the accounting principles applicable to the group of assets, into which the property was re-classified. For a transfer from investment property to inventories or

property, plant and equipment, the new deemed cost of property for subsequent accounting is its fair value as at the date of reclassification.

For a transfer from PPE to investment property, the positive difference between fair value at that date and its previous carrying amount is recognised in revaluation reserve. The negative difference is recognised in the income statement under depreciation expense. An exception to this rule is transfer from construction-in-progress, where both positive and negative difference is recognised in profit or loss, under "other operating income" or "other operating expenses". If a property previously recognised as inventories is reclassified to investment property, both the positive and negative differences between the fair value on the day of reclassification and carrying amount will be recorded, under "Other operating income"/"Other operating expenses" in the income statement.

Biological assets

A living animal or plant is recognised as a biological asset, if it is held for the purpose of future economic benefit and its fair value or cost can be measured reliably. Upon both their initial and subsequent recognition, biological assets are recorded at their fair value, less the estimated sales expenses. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. If an active market exists, the market price is considered to be the fair value of a biological asset. If an active market does not exist, the fair value of an asset is determined using the discounted cash flow method.

When determining the number of plants 15 sample areas are used per each 100 m², the size of a sample area being 77cm x 77cm (2 planting boxes x 2 planting boxes) or 0.593 m². All living plants are counted on the sample area and the average result of sample areas is calculated. Based on this information the number of plants per 1 m² is calculated, which is multiplied with the area of all planting boxes.

Biological assets are divided into consumable and productive assets. All biological assets recognised on the Group's balance sheet are consumable assets and these assets have been distinguished between mature and immature biological assets, as appropriate (see Note 17). For the purpose of determining the fair value, the assets were divided into groups based on their characteristic (age, sort and level of maturity). For each group the estimated sales period, sales revenue, based on current market prices and estimated sales costs were determined. The fair value is determined based on the discounted cash flow method.

Gain/loss from the change in value is recorded under "Other operating expenses"/"Other operating income" in the income statement.

Property, plant and equipment

Assets with an acquisition cost of over 20 000 kroons and a useful life of over 1 year are considered to be property, plant and equipment. Assets with an acquisition cost of less than 20 000 kroons and estimated useful life over 1 year, are recorded as low-value items (under inventories) and are fully expensed when the asset is taken into use.

PPE are initially recorded at cost, consisting of the purchase price and expenditures directly related to the acquisition. Costs, which are included in the cost of the real estate recorded as PPE, are also borrowing costs (interest, amortisation of contract fees, etc) related to the financing of construction of properties. Borrowing costs are capitalised into the acquisition cost of PPE from the start of the construction until completion hereof.

Subsequent to initial recognition, an item of PPE is carried in the balance sheet at cost less accumulated depreciation and any accumulated impairment losses.

If an item in the PPE consists of clearly separable components with different useful lives, each such component is accounted for separately in the accounting of the Group. Depreciation rates are determined for each component individually, depending on its estimated useful life.

Expenses incurred on PPE after their recognition (e.g. replacement of a part of the asset) are added to the carrying value of the asset, provided they meet the following criteria: (a) it is probable that future economic benefits associated with the item will flow to the Group; and (b) the acquisition cost of the item can be reliably measured. Replaced parts are derecognized from the balance sheet. All other expenditures are recognised as an expense in the period in which they have been incurred.

Depreciation of PPE is calculated on a straight-line basis. Depreciation rates are determined for each tangible asset item individually, depending on its estimated useful life. The following annual depreciation rates are applied for PPE groups:

- Buildings and facilities 2–18%
- Machinery and equipment 8–20%
- Transport vehicles 15–25%
- Fixtures, fittings and tools 20–40%

Depreciation is calculated until the moment the residual value of the asset exceeds its carrying value. The residual value is the amount that the Group would currently obtain from disposal of the asset, if the asset was already of the age and in condition expected at the end of its useful life.

The depreciation rates, depreciation methods and the residual value of items of PPE are reviewed at the end of each financial year, and changed, where necessary. If the methods of valuation change, the changes are accounted for prospectively.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. The impairment test has been described in more detail below (see the accounting principles for impairment of asset).

PPE is derecognised upon disposal of the asset, or when no future economic benefits are expected from the use or disposal of the asset. Any profits and losses arising from derecognition of an item of PPE are charged to "Other operating income" or "Other operating expenses" in the income statement of the period when the PPE item was derecognised.

PPE items which are very likely to be sold within 12 months are reclassified into non-current assets held for sale. Non-current assets held for sale are presented separately from current and non-current assets in the balance sheet, and are no longer depreciated. Non-current assets held for sale are valued at whichever is lower, net carrying amount or fair value less costs to sell.

Goodwill

Goodwill acquired in a business combination is initially measured at cost. Goodwill is the positive difference of the acquisition cost of the acquired holding and the Group’s interest in the fair value of the net assets of the subsidiary or joint venture as at the date of acquisition. Net assets of the subsidiary or joint venture as at the acquisition date are the net value of the identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. In order to determine the impairment, any goodwill acquired is allocated to each cash-generating units expected to benefit from the combination's synergies, or groups of such units. An independent cash-generating unit (set of units) is the smallest identifiable group of assets, which is not larger than a primary segment based on the Group's segment reporting.

Goodwill is reviewed for impairment annually, as at the end of the financial year or more frequently if events or changes in assessments indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Impairment loss is recognised in profit and loss, under “general and administrative expenses”.

Other intangible assets

Other acquired intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are measured at cost, less accumulated amortisation and any accumulated impairment losses.

The intangible assets are divided into assets with either finite or indefinite useful lives.

Intangible assets with finite lives are amortised on a straight-line basis, over the useful economic life (generally 3 to 6 years). The amortisation expense on the assets is recognised in the income statement in the expense category consistent with the function of the intangible asset. The amortisation period and amortisation methods of intangible assets with finite useful life are reviewed at the end of each financial year. Changes in the expected useful life and the expected time structure of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method prospectively.

Intangible assets with indefinite useful lives are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, calculation of amortisation is started on the asset and necessary changes are made on a prospective basis.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. The carrying values of intangible assets with finite useful lives are reviewed for impairment when circumstances indicate that the carrying value may not be recoverable. If the impairment test reveals that the recoverable amount of the asset item is lower than its carrying amount, the item will be written down to its recoverable amount. The amounts of impairment are recorded likewise to amortisation costs in income statement, i.e. grouped by the purpose of use of the assets. The accounting principle for impairment of assets has been described in section “Impairment of assets”.

Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If such an indication exists or at least once a year (if so required by IFRS), the Group makes an estimate of the asset’s recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down, either individually or as part of a cash-generating unit², to its recoverable amount. An asset’s recoverable amount is either the present value of an asset’s estimated future cash flows (value in use) or its fair value less costs to sell, whichever is higher. In assessing value in use, the estimated cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Independent experts are used for determining the fair value of the asset. Impairment losses, incl. impairment of the asset as a part of a cash-generating unit, are recognised in the income statement in the depreciation/amortisation costs of the reporting period.

If there is an indication that the reason for the impairment no longer exists, the previously recognised impairment is reversed. An assessment about the change of circumstances is made at least at each reporting date. The previously recognised impairment loss is reversed and the value of the asset is increased to its carrying value, which the asset would have had, had no impairment loss been recognised. Cancellation of the write-down is recorded in the income statement— as a reduction of expenses under the same caption previously used for the write-down. As an exception to this rule, impairment loss of goodwill is not reversed.

Financial liabilities

All financial liabilities (accounts payable, loans taken, accrued expenses, bonds issued, other short-term and long-term payables) are initially accounted for at their acquisition cost, which includes all expenses directly related to the acquisition. After initial recognition, financial liabilities are

² The Group views segments as cash generating units

subsequently measured at amortised cost (except financial liabilities held for trading, which are measured at their fair value).

The amortised cost of short-term financial liabilities equals to their nominal value. Therefore, short-term financial liabilities are recorded in the balance sheet at the amount payable. In order to calculate the amortised cost of a long-term liability, the liability is initially recorded at the fair value of the amount to be received (less transaction costs), by charging interest on the liability in future periods based on the effective interest rate method. Interest expenses related to the financial liability are charged to the expenses of the period on accrual basis under “Financial and investment activity income” and “Financial and investment activity expenses” in the income statement. Interests related to financing the development of assets (real estate projects under inventories, investment property and PPE) that have been incurred from the launch of the development until completion of the work are, as an exception, capitalised as part of the cost of the asset.

A financial liability is classified as short-term, if it is payable within 12 months as of the reporting date or if the Group has no unconditional right to postpone the payment of the liability for more than 12 months as of the reporting date. Borrowings, which are payable within 12 months as of the reporting date, however which are refinanced into a long-term liability after the reporting date, but before approval of the annual report, are recognised as short-term liabilities. Borrowings which are due upon demand due to the violation of a provision of the loan agreement are also recorded under short-term borrowings.

Government grants

Government grants are recorded under income during the period the company incurs the expenses for which the grant was allocated. Government grants, which are allocated for covering expenses incurred in previous periods or which do not incur deferred liabilities, are charged to income during the period the grant was allocated. Government grants are not recorded as income before the Group has sufficient reason to believe that the Group meets the conditions established for the government grant, and the grant will be awarded. Contingent government grant related liabilities are recorded as provisions or contingent liabilities.

Assets acquired with government grants are recorded at acquisition cost, less the amount of government grant (the net method). The acquired assets are depreciated to expenses over the useful life of the asset.

Provisions and contingent liabilities

Provisions are recognised only if the Group has a present obligation (legal or constructive) as a result of a past event, the performance of which most likely requires future outflow of resources and a reliable estimate can be made about the amount of the obligation.

Promises, guarantees and other commitments that in certain circumstances (which have not yet occurred) may become liabilities are disclosed as contingent liabilities in the notes to the financial statements.

Present obligations that arise from past events, which according to the judgement of the management of the Group will not realise or which can not be reliably measured, are also disclosed as contingent liabilities.

Accounting for lease

Lease transactions, where all material risks and rewards from ownership of the leased asset are transferred to the lessee, are treated as finance lease. All other lease transactions are treated as operating lease.

Assets acquired under the terms of finance leases are recognised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Thereafter leased assets are depreciated over the shorter of the following: the estimated useful life of

the asset and the agreed lease term. Assets sold under finance lease terms are recorded in the balance sheet as a receivable in the amount of the net investment in the lease. Lease payments are apportioned between the financial expense or income and lease liability or receivable, using a constant rate of interest throughout the lease term.

In case of operating lease, the assets are recorded in the lessor's balance sheet. Operating lease receipts and payments are recognised as an income or expense in the income statement on a straight-line basis over the lease term.

Legal mandatory reserve

According to the Commercial Code, the mandatory reserve has to be at least 10% of the share capital of the Parent. Accordingly, the Parent transfers at least 5% of the net profit at profit distribution to the mandatory reserve each financial year. When the reserve capital has reached the prescribed amount, the net profit transfers are terminated. The mandatory reserve cannot be paid out as dividends. It can be used for covering accumulated loss, if loss cannot be covered from the free shareholder's equity. Mandatory reserve can also be used for increasing the share capital of the company by way of a bonus issue.

Income tax

Income tax assets and liabilities and income tax expense and income are recognised as current and deferred income tax. Current income tax is recorded as short-term asset or liability and deferred income tax as long-term asset or liability.

Parent company, subsidiaries and joint ventures registered in Estonia

Pursuant to the Income Tax Act, Estonian companies are not subjected to pay income tax on the profit. Rather, they are subjected to income tax on the disbursed dividends. The established tax rate was 23/77 of the net dividend disbursed until 31.12.2006 and 22/78 of the net dividend disbursed from 01.01.2007 onwards. The Income Tax Act establishes further decrease of applicable income tax rate by one point until 20/80 on net dividends paid out after 01.01.2009. Income tax from disbursement of dividends is recorded under expenses in the income statement at the moment of declaring the dividends (upon incurring the payment obligation).

Since pursuant to the Income Tax Act, Estonian companies are not subjected to pay income tax on the profit thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise. A Group's potential tax liability related to the distribution of its retained earnings as dividends is not recorded in the balance sheet. The maximum amount of potential income tax liability has been disclosed in Note 32.

Latvian, Lithuanian, Ukrainian, Bulgarian and Romanian subsidiaries and joint ventures

The company's net profit is subject to income tax in Latvia, Lithuania, Ukraine, Bulgaria and Romania. The tax rate is 15% in Latvia and Lithuania, 25% in Ukraine, 15% in Bulgaria (10% starting from 01.01.2007) and 16% in Romania. The chargeable tax is calculated on the profit before income tax, and temporarily or permanently adjusted with additional income and expense items in accordance with the requirements of the local income tax laws.

In case of foreign subsidiaries, the deferred income tax assets or liabilities are calculated on the temporary differences between the tax basis and carrying values of assets and liabilities. The deferred income tax assets will be presented in the balance sheet only if the company is likely to incur, in the foreseeable future, an income tax liability in a comparable amount to the deferred income tax assets and which can be used for offsetting.

Accounting for investments in subsidiaries and joint ventures in the parent company's unconsolidated main statements as required by Estonian Accounting Act

The Parent's non-consolidated main statements (presented in Note 41) represent supplemental information in line with the Estonian Accounting Act and they are not deemed to present separate financial statements of the Parent in accordance with IAS 27.

In the Parent's non-consolidated main statements investments in its subsidiaries and joint ventures are carried at cost. This means that the investment is initially recognised at acquisition cost, consisting of the fair value of the consideration given, adjusted thereafter by the impairment losses arising from impairment in the value of the investment.

If events or changes in circumstances indicate that the carrying value of an investment may be impaired then such investments are tested for impairment at each reporting date or more frequently, (accounting principle "Impairment of assets"). Impairment losses are recognised under "Financial and investment activity income" and "Financial and investment activity expenses" in the income statement.

Dividends receivable/received from subsidiaries and joint ventures are recognised as financial and investment activity income, when the right to receive the payment is established. The part of dividends paid out on account of the retained earnings generated by the subsidiary or joint venture before the acquisition of the entity are not considered as income. The respective portion of the dividends is recorded as a reduction of the investment.

5 Segment information - business segments

in thousands of kroons

As of 31.12.2006 or for the year 2006, respectively	Service	Development	Construction	Eliminations	Total
Revenue from external customers	107 264	199 655	176 667	0	483 586
Other operating income from external customers	702	421 764	462	0	422 928
Revenue and other operating income to other segments	11 471	5 195	182 216	-198 882	0
Total revenue & other operating income	119 437	626 614	359 345	-198 882	906 514
Segment results	8 624	278 185	959	1 408	289 176
Unallocated operating expenses					-28 825
Total operating profit					260 351
Financial and investment activity income					16 215
Financial and investment activity expenses					-49 654
Income tax expenses					-9 563
Net profit for the financial year					217 349
	Service	Development	Construction	Eliminations	Total
Segment assets	31 900	2 054 015	92 240	-20 665	2 157 490
Unallocated assets					99 881
Total assets					2 257 371
Segment liabilities	22 610	264 591	47 635	-20 665	314 171
Unallocated liabilities					1 201 319
Total liabilities					1 515 490

Segment investments into non-current assets	9 449	333 718	5 349	0	348 516
Unallocated investments					3 488
Total investments into non-current assets					352 004

As of 31.12.2006 or for the year 2006, respectively	Service	Development	Construction	Eliminations	Total
Depreciation and amortisation included in segment results (Note 9, 22, 23)	-966	-536	-1 031	0	-2 533
Impairment loss on goodwill included in segment results (note 9, 23)	0	-12 599	0	0	-12 599
Goodwill charged to income, included in segment results (Note 9, 23)	0	14 467	281	0	14 748
Unallocated depreciation and amortisation (Note 9, 22, 23)					-537
Total depreciation, amortisation and impairment loss					-921

Non-monetary income and expenses (except depreciation and amortisation)

Gains and losses from change in the fair value of investment property and biological assets (Note 9, 21)	170	375 742	0	0	375 912
Write-down and liquidation of PPE (Note 22)	0	-72 805	-18	0	-72 823
Allowance for receivables and write-off of liabilities (Note 9)	-1 657	-440	-13	0	-2 110
Total non-monetary income and expenses					300 979

As of 31.12.2005 or for the year 2005, respectively	Service	Development	Construction	Eliminations	Total
Revenue to external customers	64 504	235 899	175 535	0	475 938
Other operating income to external customers	3 238	131 384	664	0	135 286
Revenue and other income to other segments	11 865	2 053	57 294	-71 212	0
Total revenue & other operating income	79 607	369 336	233 493	-71 212	611 224
Segment results	13 230	147 697	3 366	4 820	169 113
Unallocated operating expenses					-15 581
Total operating profit					153 532

Financial and investment activity income					13 065
Financial and investment activity expenses					-46 038
Income tax					-4 116
Net profit for the financial year 2005					116 443

	Service	Development	Construction	Eliminations	Total
Segment assets	31 923	1 214 569	80 540	-67 437	1 259 595
Unallocated assets					202 307
Total assets					1 461 902
Segment liabilities	14 652	397 985	58 451	-336 263	134 825
Unallocated liabilities					746 332
Total liabilities					881 157

Segment investments into non-current assets	498	231 914	14 279	0	246 691
Unallocated investments					88
Total investments into non-current assets					246 779
Depreciation and amortisation included in segment results (Note 9, 22, 23)	-828	-341	-1 064	0	-2 233
Impairment loss included in segment results (note 9, 23)	0	-7 109	0	0	-7 109
Unallocated depreciation and amortisation (Note 9, 22, 23)					-429
Total depreciation, amortisation and impairment loss					-9 771
Non-monetary income and expenses (except depreciation and amortisation)					
Gains and losses from change in the fair value of investment property and biological assets	2 909	100 009	2 040	-731	104 227
Allowance for receivables and write-off of liabilities	-173	-1 613	0	0	-1 786
Total non-monetary income and expenses					102 441

6 Segment information - geographical segments

in thousands of kroons

Revenue by geographical location of customer	2006	2005
Estonia	439 653	451 904
Latvia	33 697	13 069
Lithuania	5 977	2 737
Sweden	0	8 768
Ukraine	5 313	934
Bulgaria	266	0
Inter-segment eliminations	-1 320	-1 474
Total	483 586	475 938

Segment assets by geographical location of assets	31.12.2006	31.12.2005
Estonia	1 985 251	1 234 114
Latvia	171 048	51 378
Lithuania	862	360
Ukraine	7 500	529
Bulgaria	415	0
Inter-segment eliminations	-1 671	-26 786
Unallocated assets	93 966	202 307
Total segment assets by geographical location of assets	2 257 371	1 461 902

Non-current assets acquired in 2006 by type of assets	Estonia	Latvia	Lithuania	Bulgaria	Ukraine	Total
Investment property	27 856	0	0		0	27 856
Property, plant and equipment	320 541	1 395	287	237	415	322 875
Intangible assets	1 082	17	24	72	78	1 273
Total acquired non-current assets	349 479	1 412	311	309	493	352 004

Non-current assets acquired in 2005 by type of assets	Estonia	Latvia	Lithuania	Ukraine	Total
Investment property	54 838	9 570	0	0	64 408
Property, plant and equipment	173 745	374	268	272	174 659
Intangible assets	7 631	81	0	0	7 712
Total acquired non-current assets	236 214	10 025	268	272	246 779

7 Changes in the Arco Vara Group structure

7.1 Scope of consolidation

	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	Total
Parent and subsidiaries							
As of 01.01.2006	21	7	1	2	-	-	31
Additions	1	1	1	-	1	-	4
Disposals	-2	-1	-	-	-	-	-3
As of 31.12.2006	20	7	2	2	1	-	32
Joint ventures							
As of 01.01.2006	10	1	-	-	-	-	11
Additions	14	1	-	-	-	1	16
Disposals	-2	-	-	-	-	-	-2
As of 31.12.2006	22	2	-	-	-	1	25
Associated companies (not consolidated)							
As of 01.01.2006	-	-	-	-	-	-	-
Additions	1	-	-	-	-	-	1
As of 31.12.2006	1	-	-	-	-	-	1

As of 31.12.2006, 42 Estonian, 9 Latvian, 2 Lithuanian, 2 Ukrainian, 1 Bulgarian and 1 Romanian company had been consolidated under the Arco Vara Group. In 2006, the Group acquired 4 subsidiaries, consolidation of three companies was stopped. 16 proportionally consolidated joint ventures were added to the Group.

The effect of joint ventures on the consolidated balance sheet and income statement (in thousands of kroons):

	2006	2005
Operating income	279 718	93 336
Operating expenses	-52 390	-19 551
Financial income and expenses	-1 425	-10 377
Current assets	98 992	28 806
Non-current assets	599 910	296 653
Current liabilities	85 780	22 485
Non-current liabilities	172 217	61 475

The most significant joint ventures from the Group's perspective are Tallinna Olümpiapurjespordikeskus AS (owns the Regati pst 1 property) and Floriston Grupp OÜ (owns several development properties in Tallinn).

Companies belonging to the Arco Vara consolidation group:

Service segment companies

Group's subsidiaries in the service segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country	The Group's joint ventures in the service segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Arco Neruhomist TOVI	75%	75%	Ukraine	Arco Varavalitsemise AS	50%	50%	Estonia
Arco Real Estate EOOD	100%	0%	Bulgaria	Arco Rumeenia Valdused OÜ	50%	0%	Estonia
Arco Real Estate SIA	80%	80%	Latvia	Arco Real Estate Consulting SRL1	50%	0%	Romania
Arco Real Estate UAB	80%	80%	Lithuania	Lehe Elamud OÜ	sold	50%	Estonia
Arco Ukraina Valdused OÜ	75%	75%	Estonia	Home Service SIA1,3	40%	40%	Latvia
Arco Vara Halduse OÜ	merged	100%	Estonia				
Arco Vara Kinnisvarabüroo AS	100%	100%	Estonia				

Development segment companies

The Group's subsidiaries in the development segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country	The Group's joint ventures in the development segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Arco Capital TOV ¹	75%	75%	Ukraine	Arco & Koger Investeeringute AS ¹	50%	0%	Estonia
Arco Development SIA	80%	80%	Latvia	Arco Vara Arenduse OÜ	50%	50%	Estonia
Arco HCE OÜ	100%	100%	Estonia	Arco Vara Saare Kinnistud OÜ	50%	50%	Estonia
Arco Invest UAB ¹	80%	0%	Lithuania	Arco Ärikeskuse OÜ ²	50%	50%	Estonia
Arco Investeeringute AS	100%	84%	Estonia	Barrow Investments OÜ ¹	50%	0%	Estonia
Arco Maadehaldus OÜ	100%	100%	Estonia	Castleberry OÜ ¹	50%	0%	Estonia
Arco Management SIA ¹	liquidated	100%	Latvia	Chalwell OÜ ¹	50%	50%	Estonia
Arco Vara Kinnistute AS	100%	100%	Estonia	Cromer Trade OÜ ¹	50%	0%	Estonia
Arco Vara Puukool OÜ	75%	75%	Estonia	Dreilini-Ulbroka-1 SIA ^{1,3}	40%	0%	Latvia
Arco Vara Riia Valdused OÜ	75%	75%	Estonia	Floriston Grupp OÜ	50%	50%	Estonia
Arcofond OÜ	100%	84%	Estonia	Hopson Capital OÜ ¹	50%	0%	Estonia
Bisumuiza Nami SIA ¹	80%	0%	Latvia	Kastner Grupp OÜ ¹	50%	0%	Estonia
Kerberon OÜ	83,4%	67%	Estonia	Koduküla OÜ ¹	50%	0%	Estonia
Kolde AS	89,3%	73%	Estonia	Kramer Kinnisvara OÜ	50%	0%	Estonia
Metro Kinnisvara OÜ	100%	100%	Estonia	Noland Grupp OÜ ¹	50%	0%	Estonia
Pärnu Turg OÜ	100%	84%	Estonia	Pärnu Elumaja OÜ ^{1,3}	50%	42%	Estonia
Rasmussen Invest SIA ¹	60%	60%	Latvia	Pärnu Ärihoone OÜ ^{1,3}	merged	42%	Estonia
Sportings Riga SIA	80%	80% ¹	Latvia	Redman Invest OÜ ¹	50%	0%	Estonia

Zeus Haldus OÜ	100%	100%	Estonia	Snowden OÜ ¹	50%	0%	Estonia
Ulmana Gatves Nami SIA ¹	80%	80%	Latvia	Steadman OÜ ¹	50%	0%	Estonia
Waldrop Investments OÜ ¹	100%	0%	Estonia	Tallinna Olümpiapurjespordikeskus AS ^{1,3}	50%	42%	Estonia
Vidus Nams SIA (under liquidation) ¹	75%	75%	Latvia	Varamaad Kinnisvara OÜ ¹	50%	0%	Estonia
Wilson Kinnisvara OÜ	100%	100%	Estonia				

The Group's associated companies in the development segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Gilmor Grupp OÜ ¹	20%	0%	Estonia

Construction segment companies

The Group's subsidiaries in the construction segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Arco Ehitus OÜ (formerly known as Deena Ehituse OÜ)	100%	84%	Estonia
Fimaier OÜ	100%	80%	Estonia
Tallinna Linnaehituse AS1	80%	80%	Estonia
Veemaailm Inc OÜ1	100%	84%	Estonia

¹ The Group has a stake in the company through a subsidiary or joint venture

² Arco Ärikeskus OÜ bought back its shares, proportionally from all shareholders, in 2006. The Group's participation in Arco Ärikeskuse OÜ's share capital thus decreased in 2006, while the voting right remained the same.

³ The Group has or had the specified ownership through its not fully owned subsidiary. The subsidiary owns or owned directly 50% shares in mentioned joint venture, whereas the Group's ultimate participation is or was lower.

7.2 Changes in the Group's ownership in subsidiaries

In March 2006, the Group purchased from a minority shareholder the following shares in subsidiaries belonging to the Group:

Company	Segment	Share of Arco Vara AS before the transaction	Share acquired	Share of Arco Vara AS after the transaction	Purchase price	Goodwill on acquisition (Note 23)	Negative goodwill on acquisition (Note 23)
Arco Investeeringute AS	Development	84.0%	16.0%	100.00%	27 419	0	10 653
Kolde AS	Development	73.4%	15.9%	89.30%	4 322	0	0
Kerberon OÜ	Development	67.4%	16.0%	83.35%	2 230	0	3 809
Arcofond OÜ	Development	84.0%	16.0%	100.00%	2	0	5
Pärnu Turg OÜ	Development	84.0%	16.0%	100.00%	1 588	159	0
Deena Ehituse OÜ	Construction	84.0%	16.0%	100.00%	4 438	3 609	0
Fimaier OÜ	Construction	80.0%	20.0%	100.00%	1 965	0	281
Total					41 964	3 768	14 748

The purchase price is subject to payment in March 2008 at the latest.

A share exchange transaction was concluded at the beginning of 2005, with the Group acquiring and transferring the following shares:

	Before the transaction	Share acquired	Share transferred	After the transaction
Arco Vara Korter AS (merged with Arco Investeeringute AS)	80.0%	+4.0%		84.0%
Kolde AS	71.4%	+2.0%		73.4%
Kerberon AS	66.8%	+0.6%		67.4%
Arcofond OÜ	80.0%	+4.0%		84.0%
Arco Vara Ehitus AS (merged with Arco Investeeringute AS)	95.0%		-11.0%	84.0%
Pärnu Turg OÜ	100.0%		-16.0%	84.0%
Deena Ehitus OÜ	100.0%		-16.0%	84.0%

The exchange transaction generated a profit of 1 806 thousand kroons (the net book value of the minority interest was decreased in the same amount).

Acquisitions (establishment) of subsidiaries

In 2006, the Group established the following new subsidiaries:

Company	Segment	The Group's share in the acquired company	Share capital contribution (in thousands of kroons)
Arco Invest UAB	Development	80%	45
Bisuimuiza Nami SIA	Development	80%	36
Waldrop Investments OÜ	Development	100%	50
Arco Real Estate EOOD	Service	100%	36
Total			167

In 2005, the Group established the following new subsidiaries:

Company	Segment	The Group's share in the acquired company	Share capital contribution (in thousands of kroons)
Arco Capital TOV	Development	75%	91
Arco Neruhomist TOV	Service	75%	87
Arco Ukraina Valdused OÜ	Service	75%	30
Ulmana Gatves Nami SIA	Development	80%	45
Total			253

Mergers of subsidiaries

At the beginning of 2006 Arco Vara Ärijuhtimise OÜ, which was involved with the management of the Group, was merged into the Parent.

In October 2006, the Group merged Arco Vara Kinnisvarabüroo AS (the surviving company) and Arco Vara Halduse OÜ, both 100% subsidiaries of the Group.

With the merger, the surviving companies became the legal successors of the merged companies. The activities of the merged companies as an independent legal entity were terminated. No shares were issued or nominal value of shares changed in the course of the merger. Mergers of companies under common control have had no effect on the results or financial position of the Group.

Disposal of subsidiaries

In 2005, the Group disposed of shares in the following subsidiaries:

Company	Transferred share in the Group	Sales price	Profit/loss from transfer
Arco Development SIA	20%	0	-10
Arco Kinnisvarahoolduse AS	100%	0	-5 419
Arco Vara Geodeesia OÜ	100%	250	-788
Arco Real Estate SIA	20%	0	-1
Arco Real Estate UAB	20%	0	-18
Arco Varavalitsemise AS	50%	1 100	1 684
Nurmenuku Kaubanduskeskus OÜ	100%	4 956	-3 339

The effect of the disposal of subsidiaries on the Group's assets and liabilities in 2005:

in thousands of kroons	2005
Cash and cash equivalents	-9 683
Other current assets	-3 690
Investment property (Note 21)	-56 170
Property, plant and equipment (Note 22)	-465
Intangible assets (Note 23)	-75
Borrowings	-32 751
Other payables	-23 163

In 2005 the Group's stake in the subsidiary which owned the preference share in Arco Balti Kinnisvarafond AS decreased to 50%. The decrease in influence conditioned the reclassification of Arco Balti Kinnisvarafond AS in 2005 to a long-term financial investment which is measured at fair value through profit or loss. As a result of the change in estimates, the Group's assets, liabilities and owner's equity (minority interest) decreased in 2005 as follows:

	1.01.2005
Cash and cash equivalents	-1 810
Other current assets	-978
Investment property (Note 21)	-83 845
Intangible assets (Note 23)	-1 204
Borrowings	-56 517
Other payables	-1 034
Minority interest	-30 286

No shares in subsidiaries were disposed of the Group in 2006.

7.3 Changes in the Group's ownership in joint ventures

Acquisitions (establishment) of joint ventures

In 2006, the Group established the following joint ventures:

Company	Segment	The Group's share in the acquired joint venture	Share capital contribution (in thousands of kroons)
Arco & Koger Investeeringute OÜ	Development	50%	20
Barrow Investments OÜ	Development	50%	20
Castleberry OÜ	Development	50%	20
Cromer Trade OÜ	Development	50%	20
Dreilini-Ulbroka-1 SIA	Development	40%	22
Hopson Capital OÜ	Development	50%	20
Kastner Grupp OÜ	Development	50%	20
Koduküla OÜ	Development	50%	100
Noland Grupp OÜ	Development	50%	20
Redman Invest OÜ	Development	50%	20
Snowden OÜ	Development	50%	20
Steadman OÜ	Development	50%	20
Arco Rumeenia Valduse OÜ	Service	50%	20
Arco Real Estate Consulting SRL	Service	50%	22
Total			364

Disposals of joint ventures

In 2006, the Group disposed of a 50% stake in the joint venture Lehe Elamud OÜ. The company's sales price was 1 343 thousand kroons, subject to payment before the end of 2007. The Group posted 42 thousand kroons profit from the transaction.

The effect of the disposal of Lehe Elamud OÜ on the Group's assets and liabilities:

in thousands of kroons	
Receivable related to the cash pooling account	-383
Receivables and prepayments	-728
Inventories	-1 812
Property, plant and equipment (Note 22)	-5
Short-term payables and prepayments	-377
Long-term borrowings	-1 250

7.4 Business combinations

Business combinations in 2006

Total revenue generated by entities acquired through business combinations in 2006 amounted to 3 773 thousand kroons of the Group's revenue for 2006, with the effect on the Group's net profit amounting to -11 446 thousand kroons. The negative effect on the Group's net profit was, above all, conditioned by the goodwill impairment arising from the business combination at the end of the year (see Note 23). Had the business combinations happened on 1 January 2006, the effect of the revenue and net profit of the business combinations on the Group's result would not have significantly differed from the effect of business combinations from the moment of the acquisition until the end of 2006.

In August 10, 2006, the Group acquired Varamaad Kinnisvara OÜ, a joint venture which owns investment property in Tallinn.

Net assets of the acquired company and the generated goodwill were as follows:

in thousands of kroons	2006
Acquisition cost	25 974
Fair value of the net assets acquired	14 657
Goodwill	11 318

Acquisition cost of Varamaad Kinnisvara OÜ in 25 974 thousand kroons was paid in cash.

The goodwill was related to the net present value of the estimated future cash flows of the object recognised as investment property. This amount is estimated on the basis of the detailed plan to be established for the real estate.

As of the date of acquisition of Varamaad Kinnisvara OÜ, the acquisition cost was allocated to the assets and liabilities as follows:

in thousands of kroons	Varamaad Kinnisvara OÜ's assets and liabilities before acquisition	Adjustment into fair value	Varamaad Kinnisvara OÜ's assets and liabilities after acquisition
Cash	626	0	626
Investment property (Note 21)	14 031	0	14 031
Goodwill (Note 23)	0	11 318	11 318
Liabilities	-1	0	-1
Acquisition cost			25 974

In June 1, 2006, the Group acquired Pennington Kinnisvara OÜ (a joint venture involved in land development in Saaremaa), together with its 100% subsidiaries Kramer Kinnisvara OÜ and Merise Arenduse OÜ. A monetary payment of 40 thousand kroons was made for the group of joint ventures. On the date of acquisition, the acquisition cost was allocated to the assets and liabilities of the acquired companies as follows:

in thousands of kroons	Pennington Kinnisvara's assets and liabilities before acquisition	Adjustment into fair value	Pennington Kinnisvara's assets and liabilities after acquisition
Cash	190	0	190
Receivables and prepayments	152	0	152
Inventories	12 838	1 353	14 191
Current liabilities	-4 493	0	-4 493
Non-current liabilities	-10 000	0	-10 000
Acquisition cost			40

In the autumn of 2006, Pennington Kinnisvara OÜ and its subsidiaries were merged, with Kramer Kinnisvara OÜ being the surviving entity. Mergers of companies under joint control have had no effect on the results of operations or financial position of the Group.

Business combinations in 2005

The net profit of business combinations in 2005 had no significant effect on the Group, making up 1 231 thousand kroons of the Group's net profit. The net profit of the 2005 business combinations for the whole year 2005 amounted to 148 thousand kroons, and turnover to 86 718 thousand kroons in 2005.

In March 23, 2005, Deena Ehituse OÜ acquired a 100% share in OÜ Thornhill. In March 24, 2005, Thornhill acquired a 100% stake in Veemaailm Inc OÜ, a company involved in environmental construction. Net assets of the acquired company and the generated goodwill were as follows:

in thousands of kroons	2006
Acquisition cost paid in 2005	8 050
Conditional acquisition cost ¹	3 465
Acquisition cost	11 515
Fair value of the net assets acquired	3 979
Goodwill	7 536

¹ The conditional part of the acquisition cost will be paid before the end of 2009 at the latest, in the amount of 4 000 thousand kroons. No interest is charged on the unpaid amount. The unpaid amount is thus discounted with a 6% discount rate. The discounted acquisition cost amounted to 3 465 thousand kroons.

On the date of acquisition, the acquisition cost was allocated to the assets and liabilities of Veemaailm Inc OÜ as follows:

in thousands of kroons	Veemaailm Inc OÜ's assets and liabilities before acquisition	Adjustment into fair value	Veemaailm Inc OÜ's assets and liabilities after acquisition
Cash	164	0	164
Other current assets	6 611	0	6 611
Property, plant and equipment (Note 22)	6 188	0	6 188
Goodwill (Note 23)	0	7 535	7 535
Liabilities	-8 983	0	-8 983
Acquisition cost			11 515

The generated goodwill is mainly associated with Veemaailm Inc OÜ's customer base as well as the relationship between the company and its potential customers which allow concluding more beneficial sales agreements in the future than the Group could have concluded without acquiring Veemaailm Inc OÜ. The above customer base and customer relations have not been recorded separately as intangible assets, since there were no existing long-term sales contracts, but good relations and therefore they could not be identified as separate assets.

In June 15, 2005, the Group acquired Agnetha OÜ, a company involved in investment property management, by paying 5 040 thousand kroons for the subsidiary. Agnetha OÜ and Arco HCE OÜ were merged after the acquisition.

On the date of acquisition, the acquisition cost was allocated to the assets and liabilities of Agnetha OÜ as follows:

in thousands of kroons	Agnetha OÜ's assets and liabilities before acquisition	Adjustment into fair value	Agnetha OÜ's assets and liabilities after acquisition
Cash	40	0	40
Property, plant and equipment (Note 22)	5 000	0	5 000

Liabilities	0	0	0
Acquisition cost			5 040

NOTES TO THE INCOME STATEMENT

8 Cost of sales

in thousands of kroons

Cost of sales	2006	2005
Carrying value of real estate sold	-98 754	-110 076
Construction services purchased	-148 501	-178 104
Administrative expenses	-16 365	-9 470
Personnel expenses	-65 940	-37 853
Depreciation, amortisation and impairments (Note 22, 23)	-1 127	-1 208
Other expenses	-18 380	-21 705
Total cost of sales	-349 067	-358 416

9 Other income and expenses related to other operating activities

in thousands of kroons

Other operating income	2006	2005
Gain on change in fair value of investment property (Note 21)	388 950	114 798
Gain on disposals of investment property	25 224	12 353
Gain on change in the fair value of biological assets (Note 17)	993	1 908
Gain on disposals of PPE	6 375	661
Other income	1 386	5 566
Total other operating income	422 928	135 286

Marketing expenses	2006	2005
Advertising expenses	-10 701	-9 808
Brokerage fees	-5 493	-1 136
Market research expenses	-105	-226
Personnel expenses	-803	-798
Other marketing expenses	-1 493	-291
Total marketing expenses	-18 595	-12 259

General and administrative expenses	2006	2005
Personnel expenses	-46 636	-26 022
Office expenses	-18 067	-8 097
Legal services; consulting	-36 695	-17 350
Depreciation, amortisation and impairments (Note 22, 23) ¹	206	-8 563
Allowance for doubtful receivables	-2 110	-4 624
Other expenses	-12 411	-9 110
Total general and administrative expenses	-115 713	-73 766

¹ Depreciation, amortization and impairment includes negative goodwill charged to income in the amount of 14 748 thousand kroons (2005: 24 thousand kroons) and an impairment loss on goodwill in the amount of 12 599 thousand kroons (2005: 7 109 thousand kroons). For additional information on goodwill, see Note 7.2 and 7.4.

Other operating expenses	2006	2005
Losses on change in the fair value of investment property (Note 21)	-14 031	-11 923
Loss on change in the fair value of biological assets (Note 17)	0	-556
Loss on disposals of PPE	-29	0
Loss from write-down and impairments of PPE ¹ (Note 5 and Note 22)	-72 823	0
Fines and penalties ²	-74 975	-253
Other expenses	-930	-519
Total other operating expenses	-162 788	-13 251

¹ Loss from write-down of PPE includes write-down in the amount of 72 805 thousand kroons of a real estate object recorded as construction-in-progress to its recoverable value. The recoverable amount of the property was determined as the fair value less cost to sell. The write-down is based on the expert opinion of an external certified appraiser, given on the basis of the comparative price method, as well as the management's estimates on the sales expenses.

² Fines and penalties for 2006 include the contractual penalty for withdrawal from the contract related to the Holiday Club Estonia project in the amount of 73 539 thousand kroons.

10 Financial and investment activity income and financial and investment activity expenses

in thousands of kroons

Financial and investment activity income	2006	2005
Gains from disposal of shares of subsidiaries ¹	7 463	6 758
Gains from disposals of shares of joint ventures (Note 7.3)	42	0
Interest income	3 367	3 895
Income related to other long-term financial investments ³	5 343	2 412
Total financial and investment activity income	16 215	13 065

Financial and investment activity expenses	2006	2005
Losses from disposal of shares of subsidiaries ¹	0	-12 843
Loss from associates based on the equity method (Note 19)	-40	0
Interest expense ²	-30 800	-23 887
Expenses related to other long-term financial investments ⁴	-6 411	-5 067
Foreign exchange loss	-682	-499
Other financial expenses ⁵	-11 721	-3 742
Total financial and investment activity expenses	-49 654	-46 038

¹ Gain and losses from disposal of shares of subsidiaries includes the profit from disposal of Sportings Riga SIA by Arco Development SIA to a minority shareholder in the amount of 7 463 thousand kroons in 2006. As a result of the transaction, the stake held by the minority shareholder was not increased; that is, the Group's stake in Sportings Riga SIA was not decreased. See Note 7.2 for information on gains/losses generated from disposals of the shares of subsidiaries in 2005.

² Interest expenses consist, to a material extent, of the interest charged on loans and bonds taken/issued for financing purchase of investment property. Interest expenses arising from loans taken for financing development projects in progress have been capitalised. In 2006, total capitalised interest amounted to 16 783 thousand kroons (2005: 15 941 thousand kroons).

³ Among other things, income from other long-term financial investments in 2006 includes change in the fair value of financial assets measured at fair value in the amount of 5 343 thousand kroons (2005: 2 290 thousand kroons). Additional information on financial assets measured at fair value has been disclosed in Note 20;

⁴ Among other things, expenses from other long-term financial investments in 2006 include Write-down of the receivable from local governments in the amount of 6 408 thousand kroons (2005: 5 067 thousand kroons). Additional information on the receivable from local governments has been disclosed in Note 18.

⁵ Among other things, other financial expenses for 2006 include.

write-down of receivables from associated companies in the amount of 8 900 thousand kroons (Note 19);

write-downs of other long-term financial investments in the amount of 2 821 thousand kroons (2005: 3 742 thousand kroons).

11 Income tax expense

in thousands of kroons

	2006	2005
Income tax on dividends	-3 570	-3 645
Income tax on the profit of Latvian and Bulgarian subsidiaries ¹	-5 993	-471
Total income tax expenses	-9 563	-4 116

¹ Income tax expenses on the profit of Latvian and Bulgarian subsidiaries in 2006 includes the income tax expenses calculated on the fair value gain of an object recognised as investment property in the Latvian subsidiary in the amount of 1 353 thousand kroons. The Group has recognised a deferred long-term income tax liability in this amount.

12 Operating lease

in thousands of kroons

Operating lease: Group as the lessor

Lease payments to be received from non-cancellable operating lease contracts	31.12.2006	31.12.2005
up to 1 year	4 582	6 699
2-5 years	9 329	8 790
over 5 years	12 466	13 844
Total	26 377	29 333

The operating lease contracts involve lease of investment property. See also Note 21 for information on rental income for the reporting period.

Operating lease: Group as the lessee

Rental expenses	2006	2005
Premises	-5 711	-3 883
Vehicles	-3 680	-2 529
Office equipment	-1 867	-523
Total rental expenses	-11 258	-6 935

13 Earnings per share

in thousands of kroons

In order to calculate basic EPS, the net profit attributable to the Parent's shareholders is divided by the weighted average number of common shares outstanding during the period. Since the Parent has no contingently issuable common shares, diluted EPS is equal to basic EPS.

	2006	2005
Weighted average number of common shares ¹	30 453 037	27 521 932
Net profit attributable to the owners of the Parent	207 945	101 231
EPS (in kroons per share)	6,83	3,68

¹In 2005, the Group conducted a bonus issue, increasing the share capital in the amount of 268 355 thousand kroons at the expense of the company's equity without making any additional contributions. With the bonus issue, 26 835 468 new shares were issued at a nominal value of 10 kroons. For this reason, the average number of shares in 2004 was retroactively changed to 27 255 468 shares.

14 Receivables

in thousands of kroons

	31.12.2006	31.12.2005
<i>Accounts receivable</i>		
Accounts receivable, gross	45 436	38 151
Allowance for doubtful receivables	-289	-801
Accounts receivable, net	45 147	37 350
<i>Other receivables</i>		
Receivables from joint ventures (Note 38)	9 042	6 575
Loans granted ¹	15 071	21 985
Other short-term receivables ²	9 944	7 660
Total other receivables	34 057	36 220
<i>Accrued income</i>		
Interest	3 028	2 240
Accrued income from long-term construction contracts ³	4 537	8 043
Prepaid and refundable value added tax	15 695	12 475
Other accrued income	34	42
Total accrued income	23 294	22 800
Total receivables	102 498	96 370

¹The unsecured loans granted had an average annual interest rate of 5% (2005: 5.4%). Loans granted include balances due from related parties in the amount of 13 326 thousand kroons (2005: 20 524 thousand kroons). See Note 38 for information on loans granted to related parties.

² As of 31.12.2006, other short-term receivables include:

- receivable for encumbering real estate with a personal right of use in the amount of 2 321 thousand kroons (2005: 2 321 thousand kroons);
- receivables from related parties in the amount of 5 193 thousand kroons (2005: 1 723 thousand kroons). See Note 38 for additional information on related parties;
- receivable from interest rate swap agreement recorded at fair value in the amount of 1 560 thousand kroons (2005: 0 kroons). Additional information on interest swap agreement has been presented in Note 34.
- other smaller receivables in the amount of 870 thousand kroons (2005: 2 116 thousand kroons).
- as of 31.12.2005, other short-term receivables included a refundable prepayment in the amount of 1 500 thousand kroons. This receivable was deemed doubtful in 2006, and has been recorded under general and administrative expenses, under "Allowance for doubtful receivables" in the income statement (Note 9).

³ Accrued income from long-term construction contracts in the amount of 4 537 thousand kroons (2005: 8 043 thousand kroons) include receivables from customers, calculated based on the stage of completion method (see Note 27).

15 Prepaid expenses

in thousands of kroons

As of 31.12.2006, prepaid expenses consist of the following future expenses:

- prepayments for the advertising events to be held in 2007 in the amount of 2 000 thousand kroons (2005: prepayments for advertising events in 2006: 400 thousand kroons);
- expenses on analysis of the real estate fund portfolio with respect to transactions in 2007 in the amount of 1 222 thousand kroons (2005: 0 kroons);
- other prepaid expenses in the amount of 1 207 thousand kroons (2005: 848 thousand kroons);
- as of 31.12.2005, prepaid expenses included prepayments for purchase of real estate in the amount of 1 346 thousand kroons.

16 Inventories

in thousands of kroons

	31.12.2006	31.12.2005
Real estate purchased for resale or development	415 567	144 974
Other goods purchased for resale	6 580	4 137
Materials and finished goods	0	524
Prepayments to suppliers	9 670	4 239
Total inventories	431 817	153 874

In connection with the decrease in the net realisable value of real estate purchased for resale below their carrying amount, inventories were written down in the amount of 7 613 thousand kroons in 2005. As of 31.12.2005, the carrying amount of written-down inventories amounted to 355 thousand kroons.

The net realizable value of inventory was measured through the fair value of real estate less cost sell. No inventories were written down in 2006.

Real estate purchased for resale and development have been pledged in collateral to the Group's borrowings in the total amount of 272 473 thousand kroons (2005: 99 225 thousand kroons).

17 Biological assets

in thousands of kroons

Balance as of 31.12.2004	5 289
Acquisitions	217
Disposals	-610
Gain/loss from change in fair value	1 352
Reclassifications into PPE (Note 22)	-228
Balance as of 31.12.2005	6 020
Acquisitions	339
Government grants (Note 33)	-232
Disposals	-979
Gain/loss from change in fair value	993
Balance as of 31.12.2006	6 141

The balance of biological assets, by level of maturity, as of 31.12.2006:

	31.12.2006	31.12.2005
Mature (ready for sale) plants	464	658
Immature (not ready for sale) plants	819	771
Forest ready for felling	486	1 400
Growing forest for which the Group has not yet received the cutting permit	4 372	3 191
Total biological assets, categorised by their stage of completion:	6 141	6 020

The Group owns a total of 443 ha of growing forest (2005: 366 ha).

Biological asset management expenses amounted to 732 thousand kroons in 2006 (2005: 843 thousand kroons).

A total of 3 175 thousand kroons worth of biological assets recorded in the balance sheet had been set as collateral to the Group's borrowings as of 31.12.2005. No biological assets served as collateral to the Group's borrowings as of 31.12.2006.

18 Long-term receivables

in thousands of kroons

	31.12.2006	31.12.2005
Receivables from joint ventures (Note 38)	2 215	850
Long-term loan receivables ¹	5 564	5 380
Prepayments for long-term financial investments ²	2 781	2 716
Other long-term receivables ³	113	8 021
Total long-term receivables	10 673	16 967

¹ As of 31.12.2006, long-term loan receivables included receivables from related parties in the amount of 5 197 thousand kroons (2005: 5 380 thousand kroons). The due dates for repayment range up to 31.12.2008. The receivables have not been secured (2005: the same). Receivables bear an annual interest of 4-6% (2005: 4-4.5%). See Note 38 for information on related parties.

² As of 31.12.2006, prepayments for long-term financial investments consisted of:

- prepayment for establishment of a joint venture in the Republic of Latvia in the amount of 2 716 thousand kroons (2005: the same);
- other smaller prepayments in the amount of 65 thousand kroons (2005: 0).

³ As of 31.12.2005, other long-term receivables included, among other things, a receivable from the local government in the nominal amount of 11 475 thousand kroons. In connection with the estimation of the probability of receipt of the receivable, the receivable was written down in 2006 in the amount of 6 408 thousand kroons (2005: 5 067 thousand kroons). Starting from 31.12.2006, the receivable is in full amount recorded off-balance sheet. The write-down had been recorded as "Income and expenses related to other long-term financial investments" under financial items and investment activity income (expenses) in the income statement (Note 10).

19 Associates

in thousands of kroons

In April 2006, the Group established the associated company Gilmore Group OÜ. On 12 April 2006, Gilmore Group OÜ concluded a contract under the law of obligations, providing the company with the right to acquire real estate in Tallinn. Under the contract, the company made a prepayment to the seller of the real estate in the amount of 15 000 thousand kroons. The purchase contract stipulated the obligation to pay a contractual penalty in the amount of 15 000 thousand kroons in case of cancellation of the contract. As of the balance sheet date, the management of Gilmore Group OÜ deems it unlikely that the right to acquire the real estate, arising from the contract under the law of obligations, will be exercised. The company has therefore charged the contractual penalty to the expenses of 2006. As of 31.12.2006, the Group's share in the equity of Gilmore Group OÜ amounted to -3 003 thousand kroons, of which -40 thousand kroons was charged to loss from equity method under financial items and investment activity income (expenses) in the Group's income statement, and the remainder was recorded off-balance sheet.

The Group gave Gilmore Group OÜ a 8 900 thousand kroon loan for acquiring real estate in Tallinn in 2006. Deeming the project completion unlikely, the Group recorded a 100% allowance for the granted loan. The allowance has been charged to "Other financial expenses" under financial and investment activity expenses in the income statement.

The Group holds a 20% stake in the company. As of 31.12.2006, the Group has a 40 thousand kroons payable for the Gilmore Group OÜ share capital contribution to non-related parties.

20 Long-term investments into financial assets

in thousands of kroons

	31.12.2006	31.12.2005
Long-term investments in unquoted shares - measured at acquisition cost	131	132
Long-term investments in unquoted shares - measured at fair value ¹	8 215	2 871
Prepayments for shares ²	57 423	0
Total other long-term securities	65 769	3 003

¹ Investments measured at fair value belong to the asset group "Financial assets measured at fair value through profit or loss".

² As of 31.12.2006, prepayments for shares included a prepayment for acquisition of the shares of the Latvian company Euroline SIA.

21 Investment property

in thousands of kroons

Balance as of 31.12.2004	681 564
Acquisitions, except for capitalised borrowing costs	56 593
Capitalised borrowing costs	7 815
Sales	-131 150
Disposals related to sale of subsidiaries (Note 7.2)	-140 015
Reclassification from/into inventories	254 852
Reclassification from/into PPE (Note 22)	18 570
Gain/loss from change in fair value (Note 9)	102 875
Balance as of 31.12.2005	851 104
Acquisitions, except for capitalised borrowing costs	13 274
Capitalised borrowing costs	551
Sales	-26 559
Additions from business combinations (Note 7.4)	14 031
Gain/loss from change in fair value (Note 9)	374 919
Reclassification from PPE	251 961
Balance as of 31.12.2006	1 479 281

The fair value of material investment property items was established in 2006 on the basis of the expert opinions of independent appraisers. On the basis of the above expert opinions, the Group has recorded a change in the fair value of 42 real estate objects with the carrying amount of 1 011 435 thousand kroons (2005: 11 objects in the carrying amount of 710 394 thousand kroons). The fair value of three investment properties has been established on the basis of the sales price stipulated in the contract under the law of obligations in the amount of 426 839 thousand kroons.

The fair value of other investment property was established on the basis of the analyses of in-house analysts and authorised appraisers.

The fair value of investment property was established on the basis of the following estimates:

	2006	2005
Annual increase in rental revenue	1-5%	2%
Annual increase in expenses	2-3%	2-3%
Vacancy rate of the lease space	3-25%	3%
Exit yield	7-10%	10-11.5%

The Group earned 37 747 thousand kroons (2005: 49 204 thousand kroons) of rental revenue from investment property in 2006. Expenses directly related to investment property management amounted to 10 959 thousand kroons (2005: 11 102 thousand kroons).

A total of 8 694 thousand kroons (2005: 14 168 thousand kroons) was invested in the improvement of existing investment property.

The Group has made a total of 5 000 thousand kroons (2005: 0) of prepayments for investment property in accordance with the sales contracts under the law of obligations, and 675 thousand kroons (2005: 0) are still to be received from sale of investment property.

As of 31.12.2005, the Group had a 4 003 thousand kroon payable for purchase of investment property. The debt was paid in 2006.

As of 31.12.2006, finance lease payable for the purchase of investment property amounted to 1 961 thousand kroons (2005: 1 450 thousand kroons).

As of 31.12.2006, the Group had pledged total of 1 202 542 thousand kroons (31.12.2005: 694 280 thousand kroons) worth of investment property in collateral to its borrowings.

22 Property, plant and equipment

in thousands of kroons

	Land and buildings	Machinery and equipment	Other property, plant and equipment	Construction -in-progress and prepayments	Total property, plant and equipment
<i>Acquisition cost 31.12.2004</i>	17 112	4 349	7 360	21 259	50 080
<i>Accumulated depreciation 31.12.2004</i>	-3 504	-3 184	-6 487	0	-13 175
Balance as at 31.12.2004	13 608	1 165	873	21 259	36 905
Additions	171	650	1 763	157 271	159 855
Capitalised borrowing costs	0	0	0	3 616	3 616
Additions from business combinations (Note 7.4)	3 616	1 022	635	5 915	11 188
Disposals	0	-234	-166	0	-400
Disposals related to sale of subsidiaries (Note 7.2)	0	-387	-78	0	-465
Depreciation charge (Note 9)	-679	-566	-1 178	0	-2 423
Reclassification ¹	240	-186	1 089	-35 018	-33 875
Balance as at 31.12.2005	16 956	1 464	2 938	153 043	174 401
<i>Acquisition cost 31.12.2005</i>	24 860	4 911	7 125	153 043	189 939
<i>Accumulated depreciation 31.12.2005</i>	-7 904	-3 447	-4 187	0	-15 538
Additions	5 662	1 580	3 242	296 159	306 643
Capitalised borrowing costs	0	0	0	16 232	16 232
Government grants (Note 33)	-723	-242	-315	-104	-1 384
Write-down(Note 9)	0	-10	-8	-72 805	-72 823
Sales	-30	0	-98	-5 470	-5 598
Disposals related to sale of joint venture (Note 7.3)	0	0	-5	0	-5
Depreciation charge (Note 9)	-833	-531	-1 420	0	-2 784
Reclassification ¹	297	0	-10	-333 256	-332 969
Balance as at 31.12.2006	21 329	2 261	4 324	53 799	81 713
<i>Acquisition cost 31.12.2006</i>	30 052	5 553	8 256	53 799	97 660
<i>Accumulated depreciation 31.12.2006</i>	-8 723	-3 292	-3 932	0	-15 947

¹ Reclassifications in 2006 and 2005:

	Land and buildings	Machinery and equipment	Other property, plant and equipment	Construction -in-progress and prepayments	Total property, plant and equipment
Reclassification of facilities constructed for resale into inventories	0	0	0	-15 533	-15 533
Reclassification of commercial	0	0	0	-20 621	-20 621

properties into investment property upon completion of development

Reclassification from investment property	0	0	0	2 051	2 051
Reclassification from biological assets	0	0	0	228	228
Reclassification between PPE groups	240	-186	1 089	-1 143	0
Total reclassifications in 2005	240	-186	1 089	-35 018	-33 875
Reclassification of commercial properties into investment property upon completion of development	0	0	0	-251 961	-251 961
Reclassification into inventories ^{1.1}	0	0	0	-81 008	-81 008
Reclassification between PPE groups	297	0	-10	-287	0
Total reclassifications in 2006	297	0	-10	-333 256	-332 969

^{1.1} In the summer of 2006, the Group signed a letter of intent regarding the sale of a real estate object located in Narva recorded as construction-in-progress. Under the above letter of intent, the Group undertook to complete construction work on the real estate object by the spring of 2007 at the latest, and to conclude rental contracts with tenants to occupy at least 50% of the rental space. Due to the change in the intended use of the property, the object was reclassified into inventories in 2006 in the amount of 81 008 thousand kroons.

	31.12.2006	31.12.2005
Net book value of PPE pledged as collateral	64 639	167 651
Accounts payable for purchase of PPE	20 277	860
Capital commitments related to construction contracts of real estate objects recorded as construction-in-progress	0	79 103

23 Intangible assets

in thousands of kroons

	Goodwill	Negative goodwill	Computer software	Total
Balance as at 31.12.2004	13 849	0	674	14 523
Purchases	0	0	177	177
Additions from business combinations (Note 7.4)	7 535	-24	0	7 511
Negative goodwill recorded as income	0	24	0	24
Disposals related to sale of subsidiaries (Note 7.2)	-1 204	0	-75	-1 279
Impairment loss (Note 9)	-7 109	0	0	-7 109
Amortisation charge (see Note 9)	0	0	-263	-263
Balance as at 31.12.2005	13 071	0	513	13 584
<i>Acquisition cost 31.12.2005</i>	<i>13 071</i>	<i>0</i>	<i>1 083</i>	<i>14 154</i>
<i>Accumulated amortisation 31.12.2005</i>	<i>0</i>	<i>0</i>	<i>-570</i>	<i>-570</i>
Purchases	0	0	935	935
Additions from acquisition of minority interest (Note 7.2)	3 768	-14 748	0	-10 980
Additions from business combinations (Note 7.4)	11 318	0	0	11 318
Disposals	0	0	-15	-15
Impairment loss (Note 9)	-12 599	0	0	-12 599
Goodwill recorded as income (Note 9)	0	14 748	0	14 748

Amortisation charge (see Note 9)	0	0	-286	-286
Balance as at 31.12.2006	15 558	0	1 147	16 705
<i>Acquisition cost 31.12.2006</i>	<i>15 558</i>	<i>0</i>	<i>1 840</i>	<i>17 398</i>
<i>Accumulated amortisation 31.12.2006</i>	<i>0</i>	<i>0</i>	<i>-693</i>	<i>-693</i>

The balance of goodwill by segments has been disclosed in the below table:

	Service segment	Development segment	Construction segment	Total
Balance as at 31.12.2004	1 204	8 232	4 413	13 849
Additions from business combinations (Note 7.4)	0	0	7 535	7 535
Disposals related to sale of subsidiaries (Note 7.2)	-1 204	0	0	-1 204
Impairment loss (see Note 9)	0	-7 109	0	-7 109
Balance as at 31.12.2005	0	1 123	11 948	13 071
Additions from acquisition of minority interest (Note 7.2)	0	158	3 610	3 768
Additions from business combinations (Note 7.4)	0	11 318	0	11 318
Impairment loss (see Note 9)	0	-12 599	0	-12 599
Balance as at 31.12.2006	0	0	15 558	15 558

A goodwill impairment test was conducted at the end of the year 2006. As a result, goodwill arising from two objects in the development segment was written down. The write-down of one object in the amount of 11 318 thousand kroons was conditioned by the fact that, as of the end of the year, neither the fair value nor the future cash flows of the investment property associated with the goodwill could be measured/estimated reliably. The write-down of the other object in the amount of 1 123 thousand kroons was conditioned by the sales of the investment property associated with the goodwill in 2006.

A goodwill impairment test was conducted at the end of the year 2005. As a result, goodwill was written down by 7 109 thousand kroons. The write-down was caused by determining the fair value of the investment property associated with the goodwill on the basis of discounted cash flows. The value of the investment property was determined on the basis of the analysis of the cash flows of the real estate object for the next five years, with an estimated annual 2% increase in revenue and expenses, a 3% annual vacancy rate of the lease premises, and a 10% annual discount rate. The investment property was adjusted to its fair value after the above analysis. Since goodwill associated with the object was based on the previously estimated future cash flows from the investment property, the recoverable amount test revealed that the cash flows from the real estate object no longer exceeded the amount of investment property and goodwill recorded in the balance sheet before the write-down.

Judgements used upon measuring the recoverable amount of goodwill of the construction segment:

- recoverable amount was determined based on the value-in-use;
- basis for the management's forecast on cash flows:
 - Forecasted growth in the volume of environmental construction projects in Estonia (arising from the EU requirements), and the related opportunities to participate, in the next five years, in public procurements worth 880 million kroons. The Group has forecasted an annual 20-30% increase in environmental construction revenue, and an increase in gross profit from an annual 3.5% to 7.7%. Due to the higher quality indicators of the environmental construction company of the Group, and the efficiency of the technology developed in Estonia, the forecasted revenue increase is a bit higher than that of companies operating in the same branch.

- Forecasted aggressive growth in real estate market, and the market demand for residential and commercial buildings. The revenue forecast is based on the number of square metres to be constructed, the average sales price per square metre, and the growth in these indicators, compared to the previous period. The number of square meters to be constructed is forecasted to increase by 26% in 2006, 51% in 2007, 46% in 2008 and an annual 14-20% thereafter. The price of the average square metre of construction is forecasted to increase by 21% in 2006, 10% in 2007 and an annual 5% thereafter. The cost of sales forecasted by construction companies makes up 92% of the revenue.
- Free cash flows associated with the construction companies are discounted by using an annual 13.65% weighed average cost of capital. A 10% specific risk is added upon calculation of the continuing cash flow (CCF). CCF is thus calculated based on a 23.65% cost of capital.
- Cash flow forecasts are based on the budgets approved by the Management Board for the next five years.

Judgements used upon measuring the recoverable amount of goodwill of the development segment:

- recoverable amount was determined based on the value-in-use;
- the management uses previous experience regarding leased-out business space upon forecasting cash flows:
 - an annual 2% increase in rental revenue;
 - an annual 2-3% increase in expenses;
 - an annual 3% vacancy rate of the lease space;
 - the forecasted discount rate of 11.5% upon exiting the project;
 - cash flow forecasts are based on the budgets approved by the Management Board for the next five years.

The balance of negative goodwill by segments has been disclosed in the below table:

	Development segment	Construction segment	Total
Balance as at 31.12.2004	0	0	0
Additions from business combinations (Note 7.4)	-24		-24
Negative goodwill recorded as income (Note 9)	24	0	24
Balance as at 31.12.2005	0	0	0
Additions from acquisition of minority interest (Note 7.2)	-14 467	-281	-14 748
Negative goodwill recorded as income (Note 9)	14 467	281	14 748
Balance as at 31.12.2006	0	0	0

The part of the fair value of assets, liabilities and contingent liabilities acquired from business combinations, which exceeds the acquisition cost of the business combination or acquisition of minority, is recorded as negative goodwill.

24 Borrowings

in thousands of kroons

Short-term borrowings

	31.12.2006	31.12.2005
Overdraft ¹	18 530	8 415
Current portion of long-term borrowings, incl.	18 822	41 160
Bank loans	17 751	37 029
Other loans	67	2 976
Finance lease liabilities (Note 25)	1 004	1 155
Short-term bank loans and bonds	640 457	253 294
Other short-term loans ²	21 759	13 984
Total short-term borrowings	699 568	316 853

¹ An overdraft facility has been provided to the Group companies in the amount of 35 600 thousand kroons as of 31.12.2006 (2005: 37 500 thousand kroons).

Long-term borrowings

	31.12.2006	31.12.2005
Total long-term borrowings	476 080	433 506
incl. current portion	18 822	41 160
incl. long-term portion, incl.	457 258	392 346
Bank loans (Note 34)	412 180	372 756
Other loans (Note 34) ²	42 107	14 142
Finance lease liabilities (Notes 25, 34)	2 971	5 448

In 2006, the Group issued short-term and long-term commercial papers in the total amount of 96 960 thousand kroons (2005: 285 300 thousand kroons). The average effective interest rate was 5.16% (2005: 4.6%). The commercial papers have been recorded under short-term and long-term bank loans.

Average loan interest rates	2006	2005
Overdrafts	5.3%	5,0%
Short-term bank loans	5.9%	4,7%
Other short-term loans	6.8%	6,6%
Long-term bank loans	5.7%	4,9%
Other long-term loans	7.2%	7,8%

Interest terms of most significant bank loans	Interest rate		
	Loan balance as at 31.12.06 (thousand kroons)	2006	2005
Short-term bank loan	145 000	5,65%	4,25%
Short-term bank loan	87 017	5,75%	4,95%
Short-term bank loan	83 200	5,50%	-
Short-term bank loan	78 240	4,63%	-
Long-term bank loan	64 581	5,45%	-

² Other short-term and long-term loans as of 31.12.2006 include liabilities to related parties in the amount of 19 458 thousand kroons (2005: 0). See Note 38 for additional information on related parties.

See Note 30 for additional information on assets pledged as collaterals to loans.

All loan liabilities are denominated in either Estonian kroons, Latvian lats or euros.

25 Finance lease liabilities

in thousands of kroons

Finance lease liability, by term of payment	31.12.2006		31.12.2005	
	Minimum lease payments	Present value of minimum lease payments	Minimum lease payments	Present value of minimum lease payments
up to 1 year	1 083	1 004	1 751	1 155
2-5 years	2 892	2 803	5 804	5 117
over 5 years	170	168	359	331
Lessor's total gross investment	4 145	3 975	7 914	6 603
Future interest expenses	-170		-1 311	
Lessor's total net investment	3 975	3 975	6 603	6 603

Assets acquired on finance lease terms	31.12.2006	31.12.2005
Investment property	3 207	58 150
Property, plant and equipment	1 905	799
Intangible assets	0	95
Total book value of leased assets	5 112	59 044

26 Short-term payables

in thousands of kroons

	31.12.2006	31.12.2005
Payables to suppliers¹	68 021	53 808
<i>Other payables</i>		
Payables to joint ventures (Note 38)	1	192
Payables related to transactions with securities ²	9 540	7 821
Payables related to transactions with non-current assets ³	5 000	6 214
Other payables ⁴	114 768	17 350
Total other payables	129 309	31 577
<i>Taxes payable</i>		
Value added tax	9 459	1 669
Income tax on dividends	1 785	3 195
Personal income tax	2 054	1 686
Social tax	3 936	2 701
Other taxes payable	5 175	1 769
Total taxes payable	22 409	11 020
<i>Accrued expenses</i>		
Interest payable	4 223	2 463
Payables to employees	10 440	5 936

Dividends payable	3 897	6 134
Other accrued expenses ⁵	10 976	6 804
Total accrued expenses	29 536	21 337
Total payables	249 275	117 742

¹ As of 31.12.2006, payables to suppliers included, among other things, payables related to acquisitions of PPE in the amount of 21 146 thousand kroons (2005: 860 thousand kroons).

² As of 31.12.2006, payables related to transactions with securities included the liability arising from the increase in the Group's share in subsidiaries in 2004 in the amount of 9 500 thousand kroons (2005: 7 821 thousand kroons) and a payable for the associated company acquired in 2006 in the amount of 40 thousand kroons.

³ As of 31.12.2006, payables related to transactions with non-current assets included a deposit received in accordance with the contract under the law of obligations concluded for the sale of an investment property in the amount of 5 000 thousand kroons. As of 31.12.2005, payables related to transactions with non-current assets included a payable arising from acquisition of investment property in the amount of 6 214 thousand kroons.

⁴ As of 31.12.2006, other payables include:

- Contractual penalty for cancellation of the contract associated with the Holiday Club Estonia project in the amount of 73 539 thousand kroons;
- Payables to related parties in the amount of 39 616 thousand kroons (2005: 15 894 thousand kroons). See Note 38 for additional information on related parties;
- Other smaller payables in the amount of 1 613 thousand kroons (2005: 1 456 thousand kroons).

⁵ As of 31.12.2006, other accrued expenses included the following liabilities:

- Accrued expenses related to the sale of development projects, calculated on accrual basis, in the amount of 9 205 thousand kroons (2005: 1 893 thousand kroons);
- Payables related to real estate fund management, calculated on accrual basis, in the amount of 1 060 thousand kroons (2005: 0);
- Other accrued expenses in the amount of 711 thousand kroons (2005: 3 503 thousand kroons);
- As of 31.12.2005, other accrued expenses included, among other things, a payable for arrangement of the issue of the shares of Arco Vara AS in the amount of 1 408 thousand kroons.

27 Prepayments

in thousands of kroons

	31.12.2006	31.12.2005
Prepayments received from sales of real estate	59 001	29 876
Prepayments received from long-term service agreements ¹	634	8 051
Other prepayments	3 792	3 434
Total prepayments	63 427	41 361

¹ Adjustment of revenue from long-term service agreements

	31.12.2006	31.12.2005
Costs incurred and recognised profits of long-term service agreements	108 614	144 268
Invoices issued	-104 711	-144 276

Total adjustment of revenue	3 903	-8
incl. increasing revenue (Note 14)	4 537	8 043
incl. decreasing revenue	-634	-8 051

28 Short-term and long-term provisions

in thousands of kroons

	Guarantee provision	Provision for profit of the client	Other provisions related to business	Total provision
Provision as at 31.12.2004	233	0	1 238	1 471
Additional provision	58	351	0	409
Provision used during the year	0	0	-138	-138
Provision as at 31.12.2005	291	351	1 100	1 742
Additional provision	154	0	1 515	1 669
Provision used during the year	-12	-351	0	-363
Provision as at 31.12.2006	433	0	2 615	3 048
incl. long-term provision			1 095	1 095

The guarantee provision related to construction is based on previous years' experiences, i.e. the actual guarantee expenses incurred in 2005 to 2006 and the amount of projects with guarantee periods as of 31.12.2006. The guarantee provision is established for covering the expenses that are expected to occur during the guarantee period. The guarantee period is 2 years from completion of the work.

According to one construction agreement, the client has a right to receive 80% of the difference between the contract price and the actual cost of the project under the contract. Due to this clause the Group has recorded a provision on the profit to be paid to the client based on the stage of completion of the project. The project was completed in 2006.

Under the resolution of the Supervisory Board of one of the joint ventures of the Group, the Group has established a provision for management and staff bonuses in the amount of 1 515 thousand kroons as of 31.12.2006, with the provision expected to be used in March 2007.

As of 31.12.2006, the Group has established a provision in the amount of 1 095 thousand kroons for covering any additional expenses which may arise from transactions that took place in previous periods. The risk of these expenses is expected to expire within 3 to 5 years.

29 Other long-term payables

in thousands of kroons

	31.12.2006	31.12.2005
Payables related to transactions with securities ¹	39 562	8 817
Payables related to transactions with non-current assets	0	327
Deposits ²	1 499	1 905
Other long-term payables	500	64
Total other long-term payables	41 561	11 113

¹ As of 31.12.2006, payables related to transactions with securities consisted of the acquisition cost of the minorities acquired by the Group in March 2006 in the amount of 41 964 thousand kroons, payable in March 2008. The liability bears no interest and has been discounted with the rate of 5%. The

discount for 2006 amounted to 1 449 thousand kroons, and has been recorded as "Interest expense" under financial items and investment activity expenses in the income statement.

² Deposits consist of amounts deposited by tenants as security to rental contracts. As of 31.12.2006, the contracts associated with the deposits will remain in force until 2014. The deposits bear no interest.

30 Pledged assets

in thousands of kroons

The Group has pledged the following assets as collateral to its borrowings, i.e. finance lease liabilities:

	31.12.2006	31.12.2005
Real estate recorded under inventories (Note 16)	272 473	99 225
Investment property (Note 21)	1 202 542	694 280
Property, plant and equipment (Note 22)	64 639	167 651
Intangible assets (Note 23)	0	95
Biological assets (Note 17)	0	3 175
Commercial pledge	3 552	1 287
Total pledged assets	1 543 206	965 713

The parent has given a 130 000 thousand kroon guarantee (2005: 60 000 thousand kroons) as collateral to the bank loan taken by the Group's subsidiary Arco HCE OÜ. The guarantee contract has been concluded for the refinancing period and will expire on 28 August 2007 at the latest. As of 31.12.2006, one of the terms of the guarantee contract was a restriction on dividend payment without the bank's previous written consent.

31 Share capital

in thousands of kroons

	31.12.2006	31.12.2005
Issued and fully paid-in-capital (no. of shares)	30,453,037	30,453,037
Share capital	304 530	304 530
Share premium per share (in kroons)	4,04	4,04
Total share premium	123 083	123 083

In 2005, Arco Vara AS split the shares by reducing the nominal value of a share from 500 kroons to 10 kroons. With the split, the number of shares was increased by 411 600 from 8 400 (as of 01.01.2005) to 420 000 shares. Thereafter, 268 355 thousand kroons were transferred to the Parent's share capital through bonus issue at the expense of equity without making additional contributions. With the bonus issue, 26 835 468 new shares were issued at a nominal value of 10 kroons.

In December 2005, the Parent increased the share capital by 3 197 569 shares through private placement. The nominal value of new shares was 10 kroons per share. The shares were issued with a share premium amounting to 124 491 thousand kroons. The service charges related to the arrangement of the issue, which have been recorded as a reduction of the share premium, and which amounted to 1 408 thousand kroons, were paid in 2006. A monetary contribution was made for the shares issued and share premium.

32 Contingent liabilities

in thousands of kroons

Income tax on dividends

	2006	2005
Retained earnings as at 31.12	292 002	100 811
Potential income tax liability	64 240	23 187
Available dividends	227 762	77 624

The maximum possible income tax liability has been calculated based on the assumption that the net dividends to be paid and the related total income tax expenses would not exceed the distributable profit as of 31.12.2006.

The Group's management has decided to propose to the Group's Supervisory Board and shareholders to distribute dividends from the net profit for 2006 in the amount of 16 953 thousand kroons (2005: 11 692 thousand kroons), which is 0.56 kroons per share (2005: 0.38 kroons per share). Should the proposal be approved by the Supervisory Board and shareholders, the dividend payment would incur income tax in the amount of 4 782 thousand kroons (2005: 3 492 thousand kroons).

Pending court cases

Claim filed against the joint venture AS Tallinna Olümpiapurjespordikeskus (hereinafter AS TOP)

Regati Valduste OÜ (the other shareholder of AS TOP) and Urmas Uustal, member of the Supervisory Board of AS TOP, have filed a petition against the joint venture AS TOP, demanding nullification of the resolution of the Supervisory Board of AS TOP on the sale of 21374/175937 legal share of the real estate; as well as an application for prohibition of the transaction and an application for securing the petition. Harju County Court dismissed the petition with its ruling of 19 October 2006.

In November 2006, Urmas Uustal and Regati Valduste OÜ appealed the case in the Tallinn Circuit Court. AS TOP has already filed its objections. The court case was still pending at the time of preparation of this Annual Report.

According to the Group's management, the claim is unfounded—no breach of procedure for passing resolutions has occurred in the joint venture AS TOP. In these financial statements, the contested transaction has been recorded as disposal of investment property in 2005. No provision was established for contingent liabilities arising from the court case. The management of the Group does not consider it probable that any penalties or other liabilities will arise in connection with this transaction.

Claim filed against the subsidiary Arco Investeeringute AS

In December 2006, Profitor Group OÜ filed a petition against Arco Investeeringute AS for an outstanding invoice in the amount of 1 377 thousand kroons and the accumulated default interest in the amount of 225 thousand kroons.

In January 2007, Arco Investeeringute AS filed a counterclaim against Profitor Group OÜ for payment without basis of 4 368 thousand kroons for unreceived services. The proceedings had not yet commenced at the time of preparation of this Annual Report.

The Group's management believes the claim to be unfounded - Profitor Group OÜ has not rendered the agreed service.

Claim filed against the subsidiary Arco Vara Kinnistute AS

At the beginning of 2006, OÜ Faalanks (bankrupt) filed a petition against Arco Vara Kinnistute AS for a receivable for failure to fulfil the obligations arising from the construction contract concluded between the parties in the amount of 3 305 thousand kroons, incl. default interest in the amount of 2 218 thousand kroons and a claim against unjustified enrichment in the amount of 4 650 thousand kroons. In July, OÜ Faalanks filed an application for reduction of the claim, reducing the claim against Arco Vara Kinnistute AS by 4 237 thousand kroons, and asking the court to order payment of 3 718 thousand kroons to OÜ Faalanks.

According to the Group's management, the claim is unfounded as: 1) 1 087 thousand kroons of the claim were offset with Arco Vara Kinnistute OÜ's receivables from OÜ Faalanks in 2004; 2) since there is no claim on the principal, the claim for default interest in the amount of 2 218 thousand kroons is unfounded; 3) the parties regulated their mutual relations with a contract and a signed document regarding the acceptance of the work, according to which OÜ Faalanks completed work on the site, and Arco Vara Kinnistute AS has no other liabilities besides payments of the amounts specified on the invoices.

The court case was still pending at the time of preparation of this Annual Report.

33 Government grants

in thousands of kroons

In 2006, the Group received a government grant for production of potted forest plants in the amount of 1 384 thousand kroons and establishment of forest plantation on arable land in the amount of 347 thousand kroons. The government grant received for potted forest plants has been deducted from the acquisition cost of property, plant and equipment (Note 22). The amount received for the forest plantation was deducted from the acquisition cost of biological assets in the amount of 232 thousand kroons (Note 17) and from the cost of sales in the amount of 115 thousand kroons.

34 Financial instruments and financial risk management

in thousands of kroons

Arco Vara AS is an international real estate Group active in 3 main fields of activity (real estate services, real estate development and construction) and 6 countries:

	Real estate services	Real estate development	Construction
Estonia	Started in 1992	Started in 1995	Started in 2001
Latvia	Started in 1997	Started in 2003	Started in 2007
Lithuania	Started in 2000	Started in 2006	-
Ukraine	Started in 2005	Started in 2005	
Bulgaria	Started in 2006	Will be started in 2007	-
Romania	Started in 2006	Will be started in 2007	-

From the viewpoint of managing financial risks, business activities in the real estate market are primarily related to the adequate evaluation of the investment period and profitability and the systematic hedging of risks arising from potential inaccuracies. The pace of internationalisation is another source of risk. Success in financial risk management is manifested in the actual changes in the liquidity, interest rates, exchange rates, creditworthiness and fair value positions compared to the maximum possible changes.

Risk management in Arco Vara Group is based on the notion that corporate success depends on continual risk monitoring, accurate risk evaluation and skilful risk hedging. The Financial Service of the Group takes care of centralised financial risk management. The main purpose of risk management is to prevent any damage that could endanger the sustainability of Arco Vara Group's equity or operations. In order to hedge risks, the Group develops policies and implements various activities so as to evaluate and ascertain the risks, and disperse the risks over time, fields of activity, and geographical areas. The activities developed and necessary for risk hedging are implemented by the managers of the Group companies.

Liquidity risk

Liquidity risk arises from the potential change in the financial position, reducing the Group's ability to generate sufficient positive cash flows for the prompt settlement of obligations assumed. Above all, the following factors have an effect on the Group's liquidity risk:

- The ability of the Group companies to independently generate positive net cash flows; and the seasonality of these cash flows;
- The terms of receipt/payment of assets/liabilities; flexibility in changing these terms;
- Marketability of long-term assets;
- Volume and speed of real estate development activities;
- Volume and speed of acquisitions of new investments;
- Volume and speed of expansion of operations into new countries;
- Financing proportions/gearing.

Liquidity management in the Financial Service is based on a strategy adjusted in accordance with the changes in the Group's investment plan. Any such changes are approved by the Supervisory Board of the Parent.

Above all, short-term liquidity management is based on the annual budgets approved for the Group companies. The purpose of short-term liquidity management is to guarantee the sufficient availability of highly liquid assets (i.e. cash and cash equivalents, quickly disposable real estate). Short-term liquidity management is mostly conducted through the cash pooling account of the Group companies. Depending on the season, the estimated amount of cash and cash equivalents needed to ensure the continuity of the regular business activities (short-term liquidity) of the Group companies is 15-40 million kroons. In order to guarantee the availability of the relevant resources, the Parent has concluded overdraft agreements with banks and linked these to the cash pooling account.

Long-term liquidity is primarily influenced by investment decisions. Investments are made on the principle that the net cash flows from the business operations of the companies together with the net cash flows from investment activities have to cover the financing expenses of the entire Group. Thus the purpose of long-term liquidity management is to ensure the sufficient liquidity of the investment(property) portfolio, harmonize the timing of cash flows from investing and financing activities more regular, and to find a suitable financing proportion. Long-term projects are monitored to ensure that the timing and amounts of cash flows from investing activities do not considerably differ from the terms and amounts of the cash flows from financing activities. And as a rule, the Group does not accept investment projects where the required equity financing exceeds 30% of the total cost of the project. The table below characterises Arco Vara Group's open position in financing short-term borrowings and thus the liquidity requirements for the real estate portfolio:

The maturity of financial assets and financial liabilities as of 31.12.2006

	< 1 year	1-5 years	>5 years	Total
ASSETS				
Cash and cash equivalents	58 345	0	0	58 345
Receivables	102 498	10 673	0	113 171

Financial investments into securities	0	65 769	0	65 769
Total assets	160 843	76 442	0	237 285

LIABILITIES

Borrowings	699 568	270 075	187 183	1 156 826
Payables	249 275	41 561	0	290 836
Total liabilities	948 843	311 636	187 183	1 447 662

The maturity of financial assets and financial liabilities as of 31.12.2005

	< 1 year	1-5 years	>5 years	Total
ASSETS				
Cash and cash equivalents	143 985	0	0	143 985
Receivables	96 370	10 559	6 408	113 337
Financial investments into securities	0	3 003	0	3 003
Total assets	240 355	13 562	6 408	260 325
LIABILITIES				
Borrowings	316 853	332 322	60 024	709 199
Payables	117 742	11 113	0	128 855
Total liabilities	434 595	343 435	60 024	838 054

Interest risk

Interest risk constitutes a danger that changes in the interest rate and/or payment period could significantly affect the profitability of the Group's operations.

The Group's long-term borrowings are for the most part tied to EURIBOR. Therefore, the Group is exposed to the events on the international financial markets. The long-term EURIBOR decrease has been brought to a halt, and the interest rate is showing initial signs of a moderate rise. Therefore, the primary purpose of interest risk management in the Group is to fix the floating interest rate of long-term borrowings.

In managing short-term interest risks, the Group regularly compares potential losses arising from interest changes against risk hedging expenses. So far, no transactions have been concluded with financial instruments for the purposes of hedging short-term interest risk, since the Group believes hedging expenses would exceed the potential losses arising from interest rate fluctuations.

Interest-bearing receivables and liabilities of the Group as of 31.12.2006

	Maturity dates			Total
Fixed interest rates	< 1 year	1-5 years	>5 years	
Interest-bearing receivables	14 966	5 669	0	20 635
Interest-bearing liabilities	226 868	42 567	2 383	271 818
Net position	-211 902	-36 898	-2 383	-251 183

	Re-pricing date			Total
Floating interest rates	< 1 year	1-5 years	>5 years	
Interest-bearing receivables	0	0	0	0
Interest-bearing liabilities	876 129	0	0	876 129
Net position	-876 129	0	0	-876 129

Interest-bearing receivables and liabilities of the Group as of 31.12.2005

Fixed interest rates	Maturity dates			Total
	< 1 year	1-5 years	>5 years	
Interest-bearing receivables	23 878	7 385	0	31 263
Interest-bearing liabilities	117 041	98 281	2 480	217 802
Net position	-93 163	-90 896	-2 480	-186 539

Floating interest rates	Re-pricing date			Total
	< 1 year	1-5 years	>5 years	
Interest-bearing receivables	0	0	0	0
Interest-bearing liabilities	484 224	0	0	484 224
Net position	-484 224	0	0	-484 224

The above table does not contain long-term receivables and payables with a contractual 0% interest, which have been discounted at the rate of 5-6%. Bonds which have a contractual interest rate of 0%, but which were issued with a discount (discount bonds), constitute an exception to the rule and are included in the above table.

The return on projects financed with external capital is reduced upon the extension of the interest payment period primarily in case the realisation value of the project does not increase. The length of the interest payment period is linked to the detailed plan approval and building permit issuance timetable. The mentioned decisions are in the competence of state or local municipality and beyond the Group's control. Therefore there is a risk that as sales prices stabilise and the originally planned implementation period of the project is extended, the profitability of the projects and thus the entire Group may decrease. This kind of risk is primarily hedged: a) with the sales of projects not generating the expected return and b) the selection of projects acquired into the investment property portfolio on the basis of geographical regions and implementation periods. The estimated amount of interest the Group pays its creditors a year is 44 million kroons.

Currency risk

Currency risk involves the potential losses arising from unfavourable changes in currency exchange rates with respect to the Estonian kroon. The Bank of Estonia has pegged the rate of kroon to euro (1 EUR=15.6466 EEK). Arco Vara Group is operating in another 5 countries, the currencies of which are fixed to the euro as follows:

Country	Currency	1 euro (EUR) 31.12.2006	Status
Latvia	lats (LVL)	0.6975	Fixed rate
Lithuania	litas (LTL)	3.4528	Fixed rate
Ukraine	hryvnia (UAH)	6.6572	Floating rate
Bulgaria	lev (BGN)	1.95583	Fixed rate
Romania	leu (RON)	3.3817	Floating rate

As of 31.12.2006 or per 2006 (%)	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	Eliminations
Proportion of Group companies in the consolidated balance sheet	92.1	7.6	0.0	0.3	0.1	0	-0.1
Proportion of Group companies in the consolidated income	90.9	7.0	1.2	1.1	0.1	0	-0.3

In order to hedge the currency risk of the Group companies, the majority of transactions and contracts are in euros or currencies pegged to the euro. The main currency risk therefore stems from the risk that, with the adoption of the euro, the exchange rates between local currencies and the euro will

significantly change. Considering the low probability of devaluation of local currencies, and the share of the Baltic countries in the Group's activities, the exposure to the currency risk is thus considered modest.

Any currency risks arising from open positions are hedged with euro-based transactions between countries, as well as local harmonization of the timing of receipt and payment.

Credit risk

Credit risk involves the potential losses arising from the counterparties' inability to perform their liabilities to Arco Vara Group, as well as the ability of subsidiaries and joint ventures to fulfil their obligations to the Parent. Considering the amounts involved, credit risk constitutes the biggest risk for the Group. Credit risk management mostly involves the monitoring of accumulated credit risk concentration in the Group. Credit risk prevention and minimization involves the daily monitoring and directing of the customers' payment behaviour. This allows the operative application of the necessary measures. In addition, sales and construction activities are partly financed by repayments from customers. In order to hedge the risks involved, the Group also co-operates with various banks, since many real estate transactions are financed through credit institutions. Consequently, the company deems the overall credit risk exposure to be hedged.

Allowances are made for covering known potential losses. Evaluation of potential losses is carried out on the basis of previous experience as well as the current outlook of the counterparty and the overall economic environment.

The Group companies conclude transactions only with counterparties previously deemed creditworthy. Immediate payment is demanded for transactions, or additional collaterals that cover the risks involved. Consequently, the management deems the need for additional credit risk hedging to be minimal. The maximum potential credit risk equals the total book value of receivables, cash and cash equivalents and other financial investments.

Fair value

The principal financial assets and liabilities of the Group companies are recorded in the balance sheet – i.e. the Group has no known off-balance sheet financial assets and liabilities not recorded in these financial statements. As a result of the accounting and reporting principles applied, the book value of the financial assets and liabilities of the Group companies does not significantly differ from their fair value, which has been determined using the discounted cash flow method for practically all the financial assets and liabilities. The fair value of receivables and payables with fixed interest rates is not considered different from their book value, since the fixed interest rate does not significantly differ from the prevalent interest rates on the market.

Risk hedging

All derivative instruments are recorded either as assets or liabilities. Regardless of their purpose, they are initially recognised at fair value. Changes in the fair value of such derivative instruments are recognised in the income statement on line "Interest expenses" under financial and investment activity expenses.

The fair value of risk hedging transactions as of 31.12.2006 was 1 560 thousand kroons (2005: -169 thousand kroons). The interest swap contract matures on 01.12.2008. The fair value of the interest swap contract is recognised on the balance sheet either under other short-term receivables (2006, Note 14) or other short-term payables (2005, Note 26).

35 Cash flows from operating activities

in thousands of kroons

The Group's cash flows from operating activities consist of cash flows related to the sales of services and real estate as inventories, and of the costs related to the mentioned sales and the overhead expenses of the company. In 2006, the cash flow from real estate objects recorded as inventories mostly consisted of expenditure related to development projects in Riga in the amount of 126 671 thousand kroons, income and expenditure related to the Kolde development project in Tallinn in the amount of -77 235 thousand kroons, expenditure related to the Merivälja and Viimsi development projects in the amount of 22 117 thousand kroons, and the expenditure of minor development projects in the rural areas of Estonia in the amount of 9 629 thousand kroons.

Non-cash adjustments of operating profit in the cash flow statement for the year 2006 totalled -333 738 thousand kroons (2005: -107 453 thousand kroons).

36 Cash flows from investing activities

in thousands of kroons

The Group's cash flows from investment activities consist of the acquisition and sales of plant, property and equipment, cash flows related to granted loans and received interest amounts.

In 2006, the acquisition of plant, property and equipment and intangible assets mainly included the acquisition of real estate objects in the port area in Tallinn in the amount of 187 711 thousand kroons, the acquisition of real estate objects in Narva and Kuressaare in the amount of 87 878 thousand kroons and the acquisition of a real estate object in Kyiv in the amount of 6 802 thousand kroons.

Amounts received for real estate objects in Tallinn, Rakvere and Kuressaare have been recognised under the sale of investment property in the cash flow statement.

In addition to the items described in Note 7, the acquisition of subsidiaries and joint ventures includes a prepayment for the foundation of a Latvian joint venture in the amount of 58 054 thousand kroons.

37 Cash and cash equivalents

in thousands of kroons

	31.12.2006	31.12.2005
Cash on hand and demand deposits	35 031	17 786
Term deposits	23 314	126 199
Total cash and cash equivalents	58 345	143 985

As of 31.12.2006, term deposits consist of a 1-month deposit in the amount of 18 173 thousand kroons and an overnight deposits in the amount of 5 141 thousand kroons (2005: 113 919 thousand kroons). The interest rates of term deposits were between 2.46% and 3.69% in 2006.

As of 31.12.2005, term deposits consisted of deposits with maturity up to 3 months in the amount of 12 280 thousand kroons. The interest rates of term deposits were between 0.2% and 2.38% in 2005.

The interest rates of demand deposits were 0.25% to 0.5% per annum (2005: the same).

38 Transactions with related parties

in thousands of kroons

The Group considers the following as related parties:

- joint ventures;
- associated companies;

- companies and other persons with joint control over or significant influence on the Group or the Group companies. Besides joint venturers these include owners of the Parent;
- key management personnel of the Group. These include members of Supervisory Board as well Management Board members of Group companies;
- other related parties, mainly companies with which members of the Supervisory Board members are associated.

Transactions with joint ventures¹:

As of 31.12 or per year	2006	2005
Sales revenue	9 937	7 254
Services purchased	72	60
Short-term loan receivables (Note 14)	4 075	1 758
Short-term interest receivable (Note 14)	121	63
Accounts receivable (Note 14)	4 846	4 754
Long-term loan receivables (Note 18)	2 215	850
Short-term payables (Note 26)	1	192

¹ The above figures do not include the sales, purchases, receivables and payables eliminated in the Group's financial statements in accordance with the Group's holding in the joint ventures.

Sales to joint ventures in 2006 mainly comprised sale of properties in the amount of 7 995 thousand kroons. In 2005 sales to joint ventures comprised mainly sale of construction services in the amount of 6 384 thousand kroons.

Loans granted to joint ventures as of 31.12.2006 earn an interest of 10% p.a. (2005: 6%-15% p.a.) and the maturity dates of these loans are from 2007 to 2008. The granted loans are unsecured.

Transactions with companies with joint control over the Group or the Group companies:

	2006	2005
Purchased services	103	0
Short-term loan receivables (Note 14)	113	113
Short-term borrowings (Note 24)	3 240	0
Long-term borrowings (Note 24)	12 438	0

Short-term loan receivables as of 31.12.2006 earn an interest of 4% p.a. (2005: the same).

Short-term and long-term borrowings from companies with joint control over the Group companies have been received at the interest rate of 10% per annum and have to be repaid by 2011 at the latest.

Transactions with key management personnel of the Group companies

	2006	2005
Short-term loan receivables (Note 14)	5 017	4 779
Other short-term receivables (Note 14)	104	0
Short-term borrowings (Note 24)	268	0

Short-term loan receivables as of 31.12.2006 earn an interest of 4% to 9% p.a. (2005: the same).

Transactions with other related parties

Other related parties are companies over which the key management personnel of the Group companies have dominating or significant influence, and close relatives of owners.

	2006	2005
Sales revenue	249	1 829
Purchased services	27 756	21 490
Short-term loan receivables (Note 14)	8 196	15 632
Other short-term receivables (Note 14)	5 089	1 723
Long-term loan receivables (Note 18)	5 197	5 380
Other long-term receivables (Note 18)	0	699
Short-term borrowings (Note 24)	552	0
Long-term borrowings (Note 24)	2 960	0
Short-term payables (Note 26)	39 616	15 894

Purchased services from other related parties mainly comprised different fees from real-estate transactions as well management fees.

Short-term and long-term loans have been granted at the interest rate of 4% to 6% p.a. (2005: 4% to 4,5% p.a.) with maturity dates falling due in 2007 and 2008.

Transactions with associated companies

In 2006, the Group granted a loan to its associated company in the amount of 8 900 thousand kroons, which was considered as an doubtful receivable at the end of the year. Further information on the said transaction is provided in Note 19.

Remuneration to the management

In 2006, the Group's remuneration to the Management Board of the Parent and the division managers amounted to a total of 8 688 thousand kroons, incl. taxes (2005: 4 273 thousand kroons, incl. the compensation for the termination of the employment relationship to a member of the Management Board calculated in 2005 in the amount of 510 thousand kroons).

39 Events after the balance sheet date

in thousands of kroons

Transfer of the Group's holdings in subsidiary Arco HCE OÜ

In December 2006 Arco Vara AS concluded a conditional sales contract with for the transfer of the 50% stake in Arco HCE OÜ. The conditions deriving from the sales contract were fulfilled at the beginning of 2007 and the holding was sold by the time of preparing these financial statements. The sales price of Arco HCE OÜ was 22 711 thousand kroons, in addition to which the buyer paid 50% of the Parent's claim against the subsidiary, which as of 31.12.2006 amounted to 98 645 thousand kroons. The sales of the holding in the subsidiary and its consequent transformation into a joint venture had the following effect on the Group as of 31.12.2006:

In thousands of kroons	
Cash and cash equivalents	121 356
Other current assets	-2 423
Long-term receivables	49 322
Investment property	-192 500
Short-term borrowings	-62 509
Other short-term payables	-46 351
Long-term borrowings	49 322

Total	-83 783
--------------	----------------

After the transfer of the holding the share capital of Arco HCE OÜ was increased by 20 thousand kroons, whereas the nominal value of the share of each owner of Arco HCE OÜ was increased in proportion to their holding. The increase in the holdings was paid for at a premium in the total amount of 73 819 thousand kroons, of which the share premium paid by the Group formed 72 839 thousand kroons.

Acquisition of a construction company in the Republic of Latvia

At the beginning of 2007 the Group acquired a 55% stake in the Latvian construction company Arco Construction SIA. The acquisition cost was 4 303 thousand kroons, of which 1 291 thousand kroons was paid in the first quarter of 2007 and the rest will be paid over three years. The acquisition cost does not bear interest and therefore it was discounted, as a result of which the net present value of the acquisition cost amounts to 4 070 thousand kroons. The acquired net assets and the created goodwill according to preliminary purchase price allocation is presented in the table below (in thousands of kroons):

Acquisition cost	4 070
Fair value of acquired net assets	742
Goodwill	3 328

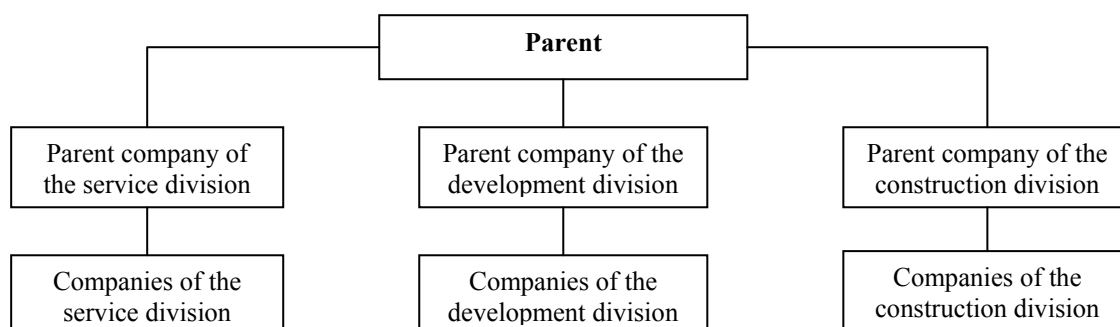
The acquisition cost is allocated to the assets and liabilities of Arco Construction SIA as follows (in thousands of kroons):

Cash and cash equivalents	187
Receivables and prepayments	3 379
Inventories	584
Property, plant and equipment	406
Goodwill	3 328
Liabilities	-3 814
Acquisition cost	4 070

Changes in the Group structure

At the beginning of 2007 the Group will carry out a restructuring, as a result of which every Group division will have a parent company and the companies in the division will be legally owned by the parent company of the division.

The following drawing illustrates the Group structure after the restructuring:



As a part of the restructuring, the Group's management has decided to merge the following subsidiaries on 1 January 2007:

Merging (surviving) company	Companies merged
Arco Vara AS	Fimaier OÜ, Arcofond OÜ
Arco Ehitus OÜ (formerly Deena Ehituse OÜ)	Veemaailm Inc OÜ
Arco Investeeringute AS	Metro Kinnisvara OÜ, Zeus Haldus OÜ

The restructuring of Arco Vara Group will have no effect of the Group's financial position or results.

Incorporation of a subsidiary of the development division

In March 2007 the Group incorporated a development company, Arco Investments TOV, in Ukraine, paying 71 thousand kroons into the share capital of the company. The Group's stake in the said company is 75%.

Issue of Arco Vara bonds

At the beginning of 2007 Arco Vara AS issued short-term and long-term bonds as follows:

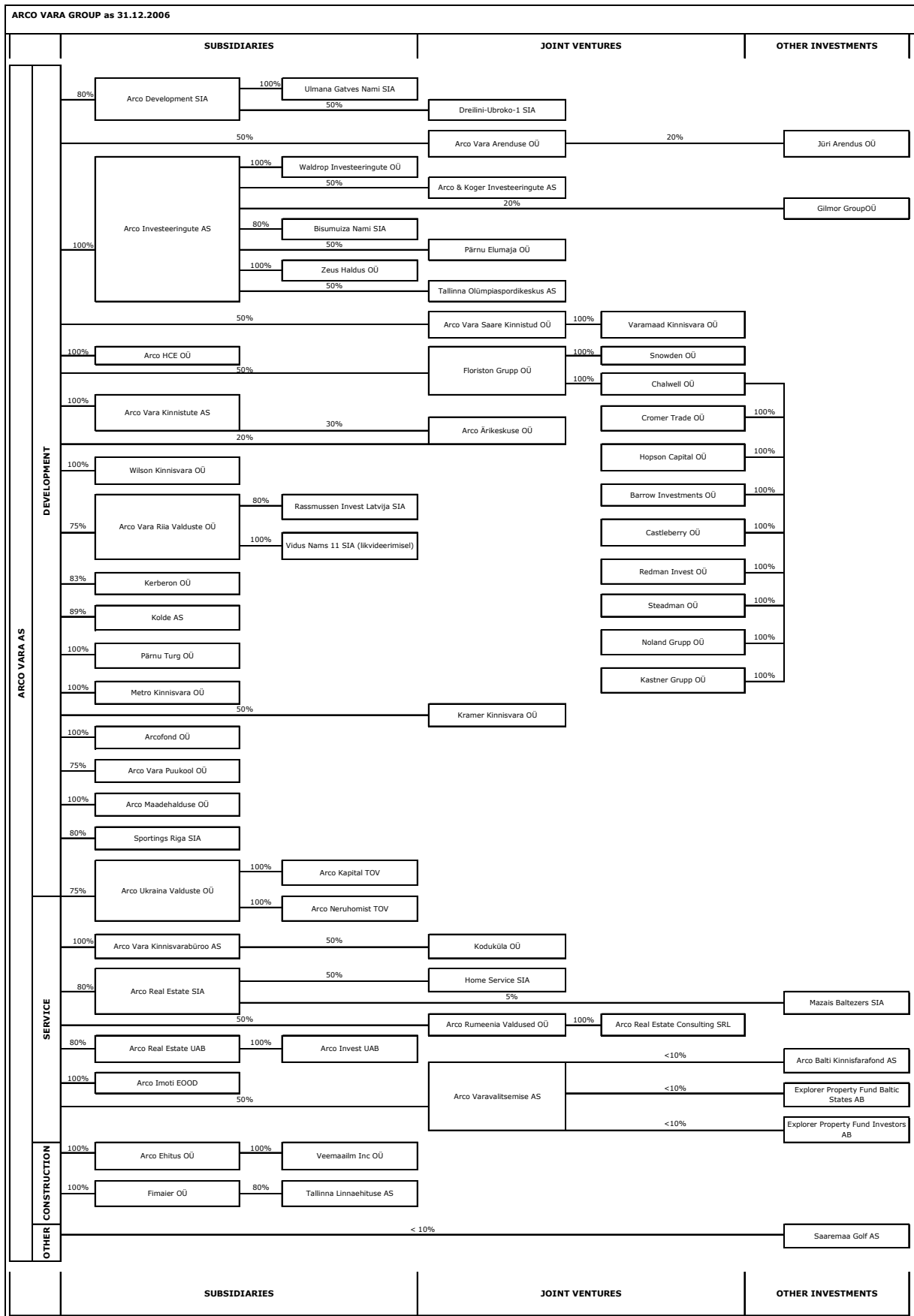
Name of security	Type of bond	Issue volume (in thousands of kroons)	Currency	Interest rate
Arco Vara Kommertspaber 21.09.2007	Discount bonds	60 450	EEK	6.46%
Arco Vara Kommertspaber 21.01.2011	Coupon bonds	27 929	EUR	6 month Euribor +4%

Sale of real estate

In March 2007 the Group sold real estate in Narva which was accounted as inventories, generating sales revenue of 102 300 thousand kroons.

Real Estate objects accounted as investment property were sold in the beginning of Year 2007 in the total amount of 41 839 thousand kroons. As those properties were accounted in fair value as of 31.12.2006 with the fair value having been determined according to sales contracts under the law of obligations then those transactions have had no impact on the Group's equity in 2007.

40 Group structure of Arco Vara AS



41 Main statements of the Parent as required by Estonian Accounting Act

in thousands of kroons

The main statements of the Parent as required by the Estonian Accounting Act are not prepared as separate financial statements of the Parent as described in IAS 27.

Income Statement

	2006	2005
Sales revenue	15 511	4
Cost of Sales	-12 130	0
Gross profit	3 381	4
Other operating income	2 326	0
Marketing expenses	-1 692	
General and administrative expenses	-19 608	-2 920
Other operating expenses	-165	0
Operating profit	-15 758	-2 916
Gain or loss from shares in subsidiaries and joint ventures	7 127	9 900
Other financial income	41 893	24 498
Other financial expenses	-20 526	-20 214
Profit before income tax	12 736	11 268
Income tax expense	-3 307	0
Net profit	9 429	11 268

Balance Sheet

	31.12.2006	31.12.2005
ASSETS		
<i>Current assets</i>		
Cash	14 142	422
Receivables	245 096	327 891
Prepaid expenses	1 323	0
Inventories	1	0
Total current assets	260 562	328 313
<i>Non-current assets</i>		
Long-term financial investments	292 613	94 110
Investment property	17 040	0
Property, plant and equipment	3 655	0
Intangible assets	251	0
Total non-current assets	313 559	94 110
TOTAL ASSETS	574 121	422 423
LIABILITIES AND EQUITY		
<i>Current liabilities</i>		
Borrowings	105 439	90 488
Payables	90 299	20 300

Total current liabilities	195 738	110 788
<i>Non-current liabilities</i>		
Long-term borrowings	94 423	85 000
Other long-term payables	40 061	9 292
Total non-current liabilities	134 484	94 292
Total liabilities	330 222	205 080
<i>Equity</i>		
Share capital	304 530	304 530
Share premium	123 083	123 083
Legal mandatory reserve	5 486	420
Retained earnings	-189 200	-210 690
Total equity	243 899	217 343
TOTAL LIABILITIES AND EQUITY	574 121	422 423

Statement of Changes in Equity

	Share capital	Share premium	Legal mandatory reserve	Retained earnings	Total
Balance at 31.12.2004	4 200	8 841	420	45 348	58 809
Bonus issue (Note 31)	268 355	-8 841	0	-259 514	0
Issue of new shares	31 975	123 083	0	0	155 058
Dividends	0	0	0	-7 792	-7 792
Net profit for the year	0	0	0	11 268	11 268
Balance at 31.12.2005	304 530	123 083	420	-210 690	217 343
Change in retained earnings due to merger with subsidiary	0	0	0	28 821	28 821
Increase in legal mandatory reserve	0	0	5 062	-5 062	0
Change in legal mandatory reserve due to merger with subsidiary	0	0	4	0	4
Dividends	0	0	0	-11 692	-11 692
Net profit for the year	0	0	0	9 423	9 423
Balance at 31.12.2006	304 530	123 083	5 486	-189 200	243 899

Adjusted Statement of Equity

	31.12.2006	31.12.2005
Unconsolidated equity of the Parent	243 899	217 343
Deducting the carrying value of subsidiaries and joint ventures in the Parents unconsolidated balance sheet	-120 442	-45 639
Adding the carrying value of subsidiaries and joint ventures according to equity method	601 460	357 614
Adjusted equity of the Parent	724 917	529 318

Cash Flow Statement

	2006	2005
Cash flows from operating activities		
Operating profit	-15 758	-2 916
Adjustments to operating profit	-2 178	0
Change in receivables and prepayments related to operating activities	-3 569	-447
Change in payables and prepayments related to operating activities	3 704	313
Other financial income and expenses	0	0
Total cash flows from operating activities	-17 801	-3 050
Cash flows from investing activities		
Acquisition of property plant and equipment and intangible assets	-532	0
Acquisition of investment property	-9 170	0
Acquisition of subsidiaries and joint ventures	-10 301	-8 893
Sales of subsidiaries and joint ventures	7 128	250
Acquisition of other investments	0	-34
Sales of other investments	0	50
Loans granted	-89 509	-61 709
Repayments of loans granted	195 227	5 774
Interest received	29 010	1 522
Change in cash pool receivable	-227 120	-229 748
Dividends received	2 401	9 003
Total cash flows from investing activities	-102 866	-283 785
Cash flows from financing activities		
Loans received	94 178	283 362
Repayments of loans and finance lease obligations	-97 093	-142 693
Change in cash pooling liabilities	33 745	0
Change in overdraft credit	15 901	8
Interest paid	-8 620	-885
Issue of shares	-1 408	156 466
Dividends paid	-12 584	-9 003
Income tax on paid dividends	-3 745	0
Total cash flows from financing activities	20 374	287 255
TOTAL CASH FLOWS	-100 293	420
Cash and cash equivalents at the beginning of the period	114 473	3
Change in cash and cash equivalents	-100 293	420
Effect of changes in exchange rates on cash and cash equivalents	-38	-1
Cash and cash equivalents at the end of the period	14 142	422

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Arco Vara AS

We have audited the consolidated financial statements of Arco Vara AS and its subsidiaries (hereafter "the Group"), set out on pages F-16 through F-79 of the Offering Circular, which comprise the consolidated balance sheet as of December 31, 2006, the consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Report on Other Legal and Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The financial information of Arco Vara AS as a parent company in Note 41 is presented because it is required by the Estonian Accounting Law and is not a required part of the consolidated financial statements prepared under International Financial Reporting Standards as adopted by the European Union. Such financial information has been subject to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is prepared in all material respects in accordance with the requirements of the Estonian generally accepted accounting principles and in relation to the consolidated financial statements taken as whole.

Tallinn, May 28, 2007

Hanno Lindpere
Ernst & Young Baltic AS

Indrek Luuk
Authorised Auditor

The audit of the consolidated financial statements for the financial year ended December 31, 2006 was completed on April 16, 2007, except for the minor financial statements presentational amendment done in 2007 (Note 2), as to which the date is May 28, 2007.

**CONSOLIDATED AUDITED FINANCIAL STATEMENTS OF ARCO VARA AS FOR THE
FINANCIAL YEAR ENDED 31 DECEMBER 2005 WITH COMPARATIVE INFORMATION
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2004**

MANAGEMENT REPRESENTATION TO THE CONSOLIDATED FINANCIAL STATEMENTS

We hereby take responsibility for the preparation of the consolidated financial statements set out on pages F-81 to F-137 and confirm that:

1. accounting principles used in preparing the consolidated financial statements of Arco Vara AS (hereinafter referred as to "the Parent") and its subsidiaries and joint ventures (hereinafter together referred as to "the Group") are in compliance with International Financial Reporting Standards (IFRS);
2. the consolidated financial statements give a true and fair view of the financial position of the Group and the results of its operations and cash flows;
3. the Group and the Parent are able to continue as a going concern.

Viljar Arakas

Chairman of the Management Board

Sulev Luiga

Member of the Management Board

Ivar Siimar

Member of the Management Board

31 March 2006

CONSOLIDATED INCOME STATEMENT

for the financial year ended 31 December 2005, in thousands of EEK

	Notes	2005	2004
Revenue from rendering services		300 439	154 283
Revenue from sale of goods		175 499	195 658
Total revenue	6,7	475 938	349 941
Cost of sales	8	-358 416	-240 701
Gross profit		117 522	109 240
Marketing expenses	9	-12 259	-9 354
General and administrative expenses	9	-73 766	-43 759
Other operating income	6,9	135 286	79 018
Other operating expenses	9	-13 251	-5 552
Operating profit	6	153 532	129 593
Financial items and investment activity income (expenses)	10	-32 973	-20 856
Profit before income tax		120 559	108 737
Income tax expense	11	-4 116	-2 102
Net profit		116 443	106 635
attributable to:			
- owners of the Parent		101 231	100 055
- minority interests		15 212	6 580
Profit attributable to owners of the Parent per share (in kroons)	12		
-basic		3,68	3,67
-diluted		3,68	3,67

CONSOLIDATED BALANCE SHEET

for the financial year ended 31 December 2005, in thousands of EEK

	Notes	31.12.2005	31.12.2004
ASSETS			
<i>Current assets</i>			
Cash and cash equivalents	13	143 985	23 344
Short-term financial investments		0	500
Receivables	14	96 370	47 647
Prepaid expenses		2 594	2 055
Inventories	15	153 874	147 567
Biological assets	21	6 020	5 289
Total current assets		402 843	226 402
<i>Non-current assets</i>			
Long-term receivables	19	16 967	47 728
Long-term investments into securities	20	3 003	1 409
Investment property	22	851 104	681 564
Property, plant and equipment	23	174 401	36 905
Intangible assets	24	13 584	14 523
Total non-current assets		1 059 059	782 129
TOTAL ASSETS		1 461 902	1 008 531
LIABILITIES AND EQUITY			
<i>Current liabilities</i>			
Borrowings	25	316 853	217 784
Payables	26	117 742	57 604
Prepayments	27	41 361	18 792
Provisions	28	642	371
Total current liabilities		476 598	294 551
<i>Non-current liabilities</i>			
Long-term borrowings	25	392 346	338 689
Other long-term payables	29	11 113	21 074
Long-term provisions	28	1 100	1 100
Total non-current liabilities		404 559	360 863
Total liabilities		881 157	655 414
Equity			
<i>Equity attributable to the owners of the Parent</i>			
Share capital	32	304 530	4 200
Share premium	32	123 083	8 841
Legal mandatory reserve		420	420
Other reserves		474	5 702
Retained earnings	33	100 811	262 120
Total equity attributable to the owners of the Parent		529 318	281 283
Minority interests		51 427	71 834
Total equity		580 745	353 117
TOTAL LIABILITIES AND EQUITY		1 461 902	1 008 531

CONSOLIDATED CASH FLOW STATEMENT

for the financial year ended 31 December 2005, in thousands of EEK

	Notes	2005	2004
Cash flows from operating activities			
Operating profit		153 532	129 593
Adjustments of operating profit, incl.		-107 453	-83 545
Depreciation of property, plant and equipment and amortization of intangible assets (Notes 23, 24)		9 771	-15 719
Gains (-) or losses (+) from disposals of property, plant and equipment and intangible assets (Note 9)		-661	1 153
Gains (-) or losses (+) from disposals of investment property (Note 9)		-12 353	-10 660
Gains (-) or losses (+) from changes in fair value of investment property and biological assets (Note 9)		-104 227	-58 084
Other adjustments		17	-235
Increase in receivables related to operating activities and inventories		-16 344	-20 787
Increase in payables and prepayments related to operating activities		26 015	65 684
Total cash flows from operating activities		55 750	90 945
Cash flows used in investing activities			
Purchase of property, plant and equipment and intangible assets	23,24	-138 894	-9 659
Proceeds from sale of property, plant and equipment and intangible assets		472	819
Acquisition of investment property ^{1,2}	22	-318 187	-89 427
Proceeds from sale of investment property and biological assets	9,21,22	144 113	45 763
Acquisition of subsidiaries and joint ventures	16,18,26,29	-21 713	-58 935
Proceeds from disposal of subsidiaries and joint ventures	16	-5 187	17 462
Acquisition of other investments		-516	-569
Proceeds from disposal of other investments		5 965	1 057
Loans granted		-15 293	-29 529
Repayments of loans granted and finance lease		45 362	14 633
Interests received		4 546	3 873
Total cash flows used in investing activities		-299 332	-104 512
Cash flows from financing activities			
Loans received		719 842	325 878
Loan and financial lease repayments		-466 883	-293 118
Change in overdraft		-8 791	-3 842
Interests paid		-24 243	-24 682
Proceeds from issue of shares ³	32	157 026	14 733
Dividends paid		-9 720	-339
Income tax on dividends paid		-2 711	-69
Total cash flows from financing activities		364 520	18 561
NET CASH FLOWS		120 938	4 994
Cash and cash equivalents at the beginning of the year		23 344	18 467
Change in cash and cash equivalents		120 938	4 994
Effect of changes in currency exchange rates on cash and cash equivalents		-297	-117
Cash and cash equivalents at the end of the year		143 985	23 344

¹ In 2005, purchase of investment property in cash flow statement includes also expenditures in the total amount of 20 561 thousand kroons for the items presented as property, plant and equipment within the year and reclassified from property, plant and equipment (construction-in-progress) to investment property at the end of year.

² The real estate item purchased in 2005 and initially recorded as an inventory but later reclassified to investment property in the amount of 256 056 thousand kroons has been presented as a purchase of investment property in the cash flow statement. Purchase of investment property does not include capitalised interests in the total amount of 7 815 thousand kroons (2004: zero). The specified amount has been presented under “Interests paid” in cash flow statement.

³ In 2004, proceeds from issue of shares consist contributions made by the minority interests of subsidiaries (2005: 560 thousand kroons).

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the financial year ended 31 December 2005, in thousands of EEK

	Equity attributable to the owners of the Parent					Total	Minority interest	Total equity
	Share capital	Share premium	Legal mandatory reserve	Other reserves ¹	Retained earnings			
Balance at 31.12.2003	4 200	8 841	400	308	168 085	181 834	73 798	255 632
Reclassification from property, plant and equipment to investment property	0	0	0	5 186	0	5 186	0	5 186
Dividends to owners of the Parent ²	0	0	0	0	-6 000	-6 000	0	-6 000
Foreign currency translation	0	0	0	208	0	208	0	208
Dividends of subsidiaries	0	0	0	0	0	0	-704	-704
Changes in minority interests caused by changes in the Parent's ownership in subsidiaries	0	0	0	0	0	0	-7 840	-7 840
Increase in legal mandatory reserve	0	0	20	0	-20	0	0	0
Net profit for the year	0	0	0	0	100 055	100 055	6 580	106 635
Balance at 31.12.2004	4 200	8 841	420	5 702	262 120	281 283	71 834	353 117
Bonus issue	268 355	-8 841	0	-5 186	-254 328	0	0	0
Issue of new shares	31 975	123 083	0	0	0	155 058	0	155 058
Dividends to owners of the Parent ²	0	0	0	0	-7 792	-7 792	0	-7 792
Adjustments of retained earnings	0	0	0	0	-420	-420	0	-420
Foreign currency translation	0	0	0	-42	0	-42	0	-42
Dividends of subsidiaries	0	0	0	0	0	0	-823	-823
Changes in minority interests caused by changes in the Parent's ownership in subsidiaries (Note 16)	0	0	0	0	0	0	-34 796	-34 796
Net profit for the year	0	0	0	0	101 231	101 231	15 212	116 443
Balance at 31.12.2005	304 530	123 083	420	474	100 811	529 318	51 427	580 745

¹ Other reserves consist of the translation difference of foreign subsidiaries' financial statements from their functional currency to the presentation currency of the consolidated financial statements and gains from the revaluation of real estate arose at its reclassification from property, plant and equipment to investment property. More detail information on these reserves as well as the legal mandatory reserve has been disclosed in Note 5 "Summary of the significant accounting policies".

² Dividends per share have been announced in the reporting period as follows:

	2005	2004
Total dividends announced	7 792	6 000
Number of shares at the announcement date	8 400	8 400
Dividends per share (kroons)	928	714

Additional information on share capital and share premium has been disclosed in Note 32.

1 Corporate information

The consolidated financial statements of Arco Vara AS and its subsidiaries and joint ventures for the financial year ended 31.12.2005 were authorised for issue on 31.03.2006. According to the Estonian Business Code, the annual report prepared by the Management Board and approved by the Supervisory Board, is authorized by the Shareholders' General Meeting. The current consolidated financial statements are one part of the annual report and the basis of the profit allocation decision. The shareholders hold the power not to approve the annual report prepared by the Management Board and approved by the Supervisory Board and the right to request a new annual report to be prepared. The annual report to be approved by the shareholders will be presented in the Estonian language. Current financial statements are a translation of the statutory Estonian originals. In case of differences arising on translation between the Estonian original and the current set of financial statements the statutory Estonian original shall prevail.

Arco Vara AS (the Parent) is a limited company incorporated and domiciled in Estonia. In 2005, the Group employed approximately 280 employees (2004: 220 employees). The main activities of the Group have been described in Note 5 (under the policy of segment reporting) and the Group operates through its subsidiaries and joint ventures in Estonia, Latvia, Lithuania and Ukraine.

The structure of the Group as of 31.12.2005 has been disclosed in Note 37.

2 Statement of compliance and basis of preparation

The consolidated financial statements of Arco Vara AS and its subsidiaries and joint ventures have been prepared in accordance with International Financial Reporting Standards (IFRS). The consolidated financial statements have been prepared and approved in accordance with and in order to meet the requirements of the Estonian Accounting Act and the Business Code.

Both the functional currency of Arco Vara AS and the presentation currency of these financial statements is the Estonian kroon (EEK). Unless otherwise noted, these financial statements have been prepared in thousands of kroons.

The consolidated financial statements of the Group have been prepared on a historical cost basis, unless indicated otherwise in the accounting policies described in Note 5 (e.g., certain financial investments, derivative financial instruments, investment property and biological assets that have been measured at fair value).

Basis of consolidation

The consolidated financial statements comprise the financial statements of Arco Vara AS and its subsidiaries consolidated line by line as well as joint ventures using proportionate consolidation. The financial statements of subsidiaries and joint ventures are prepared for the same reporting year (calendar year) as the Parent, using consistent accounting policies and estimates (or accounting policies and estimates used by the certain foreign entities have been adjusted, if necessary).

A subsidiary is an entity that is controlled by the Parent. Generally, a subsidiary is considered to be under the control of the Parent, when the Parent owns, directly or indirectly, more than half of the voting power of an entity or the Parent has otherwise power to govern the financial and operating policies of a subsidiary. A joint venture is an entity whose economic activities are jointly controlled under a contractual agreement by two or more parties (incl. the Parent).

More detailed information of subsidiaries and joint ventures of the Group has been disclosed in Notes 16, 17 and 18 on pages F-110 to F-116.

Subsidiaries and joint ventures' assets, liabilities, revenue, expenses and cash flows are consolidated from the date, on which the Group obtains control and joint control and continue to be consolidated until the date that such control and joint control, respectively, ceases.

The Group recognises its interest in the joint venture using proportionate consolidation. The Group combines its share of each of the assets, liabilities, income and expenses of the joint venture with the similar items, line by line, in its consolidated financial statements.

All intra-group balances, income, expenses and cash flows and profits resulting from intra-group transactions that are recognised as assets, are eliminated in full, except profits resulting from transactions with a joint venture that are already eliminated from the Group's interest in the joint venture. Unrealised losses are eliminated unless costs cannot be recovered.

Minority interests represent the portion of the profit or loss and net assets of subsidiaries, not held by the Group and are presented separately in the income statement and within equity in the consolidated balance sheet.

New subsidiaries and joint ventures (business combinations) have been included in the consolidated financials statements using the purchase method of accounting. Accordingly, the consolidated income statement and consolidated cash flow statement include the results and cash flows of new subsidiaries and joint ventures for the period starting from their acquisition date. The cost of business combination is allocated to the fair value of assets acquired and liabilities and contingent liabilities assumed at the date of acquisition. Any positive difference between the cost of the business combination and the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities is considered to be goodwill (see Note 5, "Goodwill" for the subsequent measurement of goodwill); any negative difference (so-called negative goodwill) is recognized immediately as income.

3 Changes in accounting policies and presentation

The accounting policies and presentation adopted in preparation of the current financial statements are consistent with those of the previous financial year, except that the Group has adopted the following new / revised standards mandatory for the financial year beginning on or after January 1, 2005. The financial position of the Group and the results of its operations are influenced by the following standards:

- IFRS 3 Business Combinations;
- IAS 1 Presentation of Financial Statements;
- IAS 27 Consolidated and Separate Financial Statements;
- IAS 31 Interests in Joint Ventures;
- IAS 36 Impairment of Assets.

The principal effects of these changes in policies are stipulated below.

Business combinations and goodwill

In accordance with standards IFRS 3 and IAS 36 (revised 2004), goodwill arose the business combinations with agreement date before 31.03.2004 was amortised until 31.12.2004. Goodwill, which arose from the business combinations with the agreement date on or after 31.03.2004 has not been amortised, but tested for impairment. The adoption of IFRS 3 and IAS 36 (revised 2004) has resulted in the Group discontinuing annual goodwill amortisation of all goodwill and testing for

impairments annually at the cash generating unit level (unless an event occurs during the year which requires the goodwill to be tested more frequently) from 01.01.2005. The transitional provisions of IFRS 3 required the Group to eliminate the accumulated amortisation in the amount of 4 967 thousand kroons with a corresponding entry to gross carrying amount of goodwill.

Subsidiaries and joint ventures in non-consolidated financial statements of the Parent

The investments into subsidiaries and joint ventures were accounted for under the equity method in the previous year separate financial statements of the Parent. IAS 27 (revised 2004) and IAS 31 (revised 2004) prohibit to use the equity method of accounting for investments into subsidiaries and joint ventures in the separate financial statements of the parent from 01.01.2005. Instead, the investments have to be measured at cost or at fair value. In the non-consolidated financial statements of the Parent presented in Note 38 of the current consolidated financial statements, the investments into subsidiaries and joint ventures are measured at cost (incl. comparatives).

As a result of the specified change, the Parent's retained earnings as of 01.01.2004 decreased by 172 959 thousand kroons, net profit for 2004 decreased by 50 094 thousand kroons, revaluation reserve, translation difference and investments into subsidiaries and joint ventures as of 31.12.2004 decreased by 5 186 thousand kroons, 516 thousand kroons and 229 683 thousand kroons respectively, and short-term and long-term receivables from subsidiaries and joint ventures as of 31.12.2004 increased by 344 thousand kroons and 584 thousand kroons, respectively.

Presentation of minority interests

The minority interests were presented separately from liabilities and equity in the balance sheet of the previous year consolidated financial statements. According to IAS 1 (revised 2004) and IAS 27 (revised 2004), the minority interests have to be presented as equity from 01.01.2005 (incl. comparatives). As a result of the specified change, the Group's equity as of 01.01.2004 increased by 71 834 thousand kroons (the change does not have any effect on the equity attributable to shareholders of the Parent).

Other standards and interpretations

Additionally to those specified above, the Group has adopted the following revised standards during the financial year. Comparative figures have been amended as required. Adoption of revised standards does not have any effect on equity as of 01.01.2004 and net profit for 2004.

- IAS 2 Inventories;
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;
- IAS 10 Events after Balance Sheet Date;
- IAS 16 Property, Plant and Equipment;
- IAS 17 Leases;
- IAS 21 The Effect of Changes in Foreign Exchange Rate;
- IAS 24 Related Party Disclosures;
- IAS 32 Financial Instruments: Disclosure and Presentation;
- IAS 33 Earnings per Share;
- IAS 38 Intangible Assets;
- IAS 39 Financial Instruments: Recognition and Measurement;
- IAS 40 Investment Property;
- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

The Group has not applied the following new / revised standards and interpretations that have been issued but are not yet effective. The new / revised standards and interpretations do not have any effect on accounting policies used by the Group. According to the current plans, the Group will not apply

these new / revised standards and interpretations before effective date, i.e. 01.01.2006 (IFRIC 4) or 01.01.2007 (others) for the standards applicable for the Group.

- IFRS 4 Insurance Contracts - Financial Guarantee Contracts (amendments)¹;
- IFRS 6 Exploration for and Evaluation of Mineral Resources¹;
- IFRS 7 Financial instruments: Disclosures;
- IAS 1 Presentation of Financial Statements (amendments);
- IAS 19 Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures (amendments)¹;
- IAS 39 Financial Instruments: Recognition and Measurement (amendments);
- IFRIC 4 Determining whether an Arrangement contains a Lease;
- IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds¹;
- IFRIC 6 Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment¹.

¹ does not apply to the activities of the Group.

4 Significant accounting judgements and estimates

The preparation of consolidated financial statements in conformity with International Financial Reporting Standards requires the management of the Group to make estimates and decisions that affect the reported amounts and accounting policies of assets, liabilities, income and expenses and disclosure of contingencies.

Although the estimations and decisions are reviewed by the management consistently and these are based on the previous experiences and the best knowledge on future trends, the actual outcomes may differ from the current estimates.

Judgements

In the process of applying the Group's accounting policies, the management of the Group has made the following judgements, which have the significant effect on the amounts recognised in the financial statements:

Classification of real estate

The classification of real estate items into classes as inventories, investment property or property, plant and equipment (construction-in-progress) is based on the intention of the management on the future use of the real estate. The accomplishment of the management's plans depends also on the decisions not controlled by the Group (i.e., changing registered intended use of land, approving architectural drawings, licence for construction etc), which may affect the final classification of real estate.

The real estate items with the intention on the future use for development and sale of living environments, individual house or plot of land have been classified as inventories. Real estate items purchased for sale have also been recognised as inventories.

The aim of the purchase of an investment property is to earn rental income or income from capital appreciation. The real estate items held for long-term perspective and with several possible intentions on future use are also considered to be investment properties.

The property being constructed or developed or improved for the future use as commercial spaces leased out under operating lease terms (except these items being re-developed for continued future use as investment property) have been recorded as constructions-in-progress under property, plant and

equipment and after the completion of work (i.e., after receiving a use permit) have been re-classified to investment property.

Existing investment property that is being re-developed for continued future use as investment property is not temporarily re-classified to construction-in-progress.

Operating lease commitments – the Group as a lessor

The Group has entered into lease agreements of properties of its investment property portfolio. As a result of the detailed examination of the lease agreements, the Group has determined that it retains all the significant risks and rewards of ownership of these properties and therefore these leases have been treated as operating leases.

Real estate funds managed by the Group – subsidiaries or other financial assets

The joint venture Arco Varavalitsemise AS owns more than half of the shares of voting power of the fund (Explorer Property Fund - Baltic States AB) managed by Arco Varavalitsemise AS. In the shareholder agreement of the fund and the management agreement of the fund, such managing and governing principles, which do not give control of the fund's financial and operating policies to the Group, have been agreed. Therefore the investment into the fund has been classified as financial asset at fair value through profit or loss.

Estimation uncertainty

The estimates made by the management of the Group are based on the previous experiences and all information available by the date of the financial statements authorised for issue. There is either lower or higher risk that the estimates reported at the balance sheet date and related to value of assets, liabilities, revenue and expenses will change in the future. The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Goodwill – impairment test

The Group determines whether goodwill arisen from business combinations is impaired at least on an annual basis. This requires an estimation of fair value (less costs to sell) or value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill as of 31.12.2005 was 13 071 thousand kroons (2004: 13 849 thousand kroons). More details have been laid out in Notes 5 and 24.

Investment property – determining the fair value

At each balance sheet date, investment properties have been measured at their fair value. The discounted cash flow method has been used as a valuation technique for determining fair value. Estimating the discounted cash flows requires an appraiser to forecast rental income generated by the real estate (incl. rent prices per 1 m² and vacancy of premises under lease) and related expenses. In order to calculate the present value of those cash flows an appraiser has to choose a suitable discount rate, which reflects the time value of money and specific risks related to the assets in the best way. The carrying amount of the investment properties with the fair value determined using the discounted cash flow method as of 31.12.2005 amounted to 249 984 thousand kroons (2004: 507 783 thousand kroons). More details have been disclosed in Note 22.

Receivable from local municipalities – probability of the receipt

Paragraph 30 of the Planning Act requires local municipalities to acquire the real estate or a part of it of the Group, if it is intended for public use already in the architectural drawings. Although the act requires local municipalities to purchase such real estate items immediately and for fair price, there are no explicit basis for determining the purchase price and payment schedule. The estimates on the receipt from local municipalities have been made by the management of the Group for the recognition of the receivables in the balance sheet. The carrying amount of such receivables as of 31.12.2005 amounted to 6 407 thousand kroons (2004: 11 475 thousand kroons). More information on the amount and maturity of the receivable has been disclosed in Note 19.

5 Summary of significant accounting policies

Segment reporting

The segment reporting is based on the segmentation of the Group companies used in the internal reporting (i.e., management accounting and budgeting). The primary segment reporting format is determined to be business segments. A segment has been disclosed as a separate reportable segment, if its products and services distinctly differ from the products and services offered by other segments and it operates as an independent profit centre.

The business segments of the Group are the following:

- development: development of complete living environments as well as office buildings and commercial space, investments into real estate;
- services related to real estate: real estate brokerage and appraisal services, real estate management and real estate fund management;
- construction: provision of main and sub- construction contractor services, building inspection services.

Segment revenue is revenue reported in the Group's income statement that is directly attributable to a segment and the relevant portion of the Group's revenue that can be allocated on reasonable basis to a segment, whether from sales to external customers or from transactions with other segments of the Group. Revenue from the transactions between the Group companies belong to same segment has been eliminated.

Segment expenses is expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to sales to external customers and expenses relating to transactions with other segments of the Group. Segment expense does not include financial expenses, general and administrative expenses and other expenses that arise at the Group level and related to the Group as a whole. Expenses incurred at the Group level are allocated on a reasonable basis to the segment, if these expenses relate to the segment's operating activities and they can be directly attributed or allocated to the segment. Expenses related to the transactions between the Group companies belong to same segment has been eliminated.

Segment result is segment revenue less segment expenses.

Segment assets are those assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets include current assets, investment property, biological assets, property, plant and equipment and intangible assets related to the operating activities of the segment. If a particular item of depreciation or amortization is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general Group or head-office purposes

or which cannot be allocated directly to the segment. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists.

Segment liabilities are those liabilities that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities include, for example, accounts payables and other payables, accrued expenses, customers' prepayments, warranty provisions and other provisions. Segment liabilities do not include loans, finance leases, bonds and other liabilities related to financing activities. Income tax liability is not also included in segment liabilities.

Expenses, assets and liabilities which are not directly related to the segment or cannot be allocated to the segment are presented as unallocated expenses, assets and liabilities of the Group.

The secondary segment reporting format is determined to be geographical segments based on the location of the Group's assets. Geographical segments include Estonian, Latvian, Lithuanian and Ukrainian segments.

Foreign currency translation

All currencies, except Estonian kroon are considered to be foreign currencies. Transactions in foreign currencies are initially recorded in the functional currency rate of the Bank of Estonia officially valid at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to profit or loss (as financial items). Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

When the functional currency of subsidiary differs from the Parent's functional currency (e.g. functional currency of Latvian subsidiaries is Latvian lats, functional currency of Lithuanian subsidiary is Lithuanian litas and functional currency of Ukrainian subsidiary is US dollar), the following principles on exchange rates are used for translation of financial statements of subsidiaries and joint ventures into the presentation currency of the Parent:

- the assets and liabilities of these subsidiaries and joint ventures (incl. goodwill and fair value adjustments arising from acquisitions of these companies) are translated at the rate of exchange ruling at the balance sheet date;
- income, expenses and changes in equity of subsidiaries and joint ventures are translated at the weighted average exchange rates for the year.

The exchange differences arising on the translation are taken directly to a separate component of equity (in the balance sheet row "other reserves"). On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable.

Sales of real estate items

Sales of real estate is recognised when all material risks related to the real estate have been transferred to the purchaser and the seller has no further substantial acts to complete under the contract. In general, revenue is recognised when the contract, where the transfer of the ownership of real estate is

agreed, is concluded. Payments received before the concluding contract are shown under “prepayments”.

Revenue from long-term service agreements

The stage of completion method is used for recording revenue and expenses of long-term service contracts, incl. construction contracts. The stage of completion of the rendered service is estimated based on the proportion of expenses incurred on the project until the balance sheet date compared to the estimated total expenses of the project. If, by the balance sheet date, the invoice issued by the service provider to the customer exceeds or is smaller than the amount of revenue calculated based on the stage of completion method, the difference will be recorded in the balance sheet under liabilities or receivables, respectively.

If it has become evident that the anticipated costs of the project exceed the total revenue, the loss will be recorded immediately and fully in the income statement.

Revenue from providing other services

Revenue from the sales of services is recorded upon rendering of the service. Revenues from brokerage services are normally recognised when the mediated operation has been concluded. Rental income arising on investment properties is accounted for on a straight-line basis over the lease terms on ongoing leases. Revenue and expenses related to utility services (i.e. electricity, heat, water, etc.) are offset - the Group does not consider rendering of utility services its main activity.

Sales of other goods

Revenue from the sales of other goods is recognised when all material risks related to the asset have been transferred to the purchaser, and the amount of revenue related to the transaction can be reliably measured.

Financial income recognition

Interest income is recognised as interest accrues (using the effective interest method). Revenue from dividends is recognised when the Group’s right to receive the payment is established.

Cash and cash equivalents

Cash equivalents are short-term (up to 3 months from the date of acquisition) highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, including cash in hand and current bank accounts, time deposits with an original maturity of three months or less and money market shares.

Financial assets

Financial assets are initially recognised at cost, being the fair value of the consideration given. In the case of investments not at fair value through profit or loss, the cost includes also directly attributable transaction costs, including service charges payable to brokers and advisors, non-refundable taxes and other similar expenditures. Transaction costs directly attributable to the purchases of the financial assets at fair value through profit or loss are recognised as expenses when incurred.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Group commits (e.g. concludes an agreement) to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

The financial assets are divided into the following groups. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end. The following measurement bases are used for financial assets:

- financial assets at fair value through profit or loss – measured at fair value;
- held-to-maturity investments – measured at amortised cost;
- receivables - measured at amortised cost;
- available-for-sale financial assets – measured at fair value, except investments in equity instruments whose fair value cannot be reliably measured, which are measured at cost.

Financial assets at fair value

At each balance sheet date, the financial assets measured at fair value are revalued to their fair values, without any deduction for transaction costs it may incur on sale or other disposal. The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date and rates of exchange of the Bank of Estonia. For investments where there is no active market, fair value is determined using all available information on the value of the investment (reference to the current market value of another instrument, which is substantially the same and discounted cash flow analysis are used as valuation techniques).

A gain and loss arising from changes in the fair value of a financial asset is recognised in profit or loss (under “financial items and investment activity income (expenses)”), except regarding available-for-sale financial assets. Available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity (as “other reserves”) until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement. If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to the income statement.

A gain and loss arising from disposal of financial assets measured at fair value as well as interests and dividends from these assets are recognised in profit or loss (under “financial items and investment activity income (expenses)”).

Receivables and held-to-maturity investments

Receivables, except those that the Group intends to sell in the near term, and held-to-maturity investments are measured at amortised cost using the effective interest method. This cost is computed for the whole term of financial assets considering any discounts or premiums and expenditures directly related to the acquisition.

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows discounted at the financial asset’s original effective interest rate. The impairment loss of financial assets related to operating activities is recognised under operating expenses (in the group of “general and administrative expenses”) and impairment loss of financial assets related to investing activities is recognised under “financial items and investment activity income (expenses)”.

The impairment loss is determined separately for financial assets that are individually significant. Based on the previous experiences, the receivables overdue more than 180 days are considered to be fully impaired. If there are any other indications that the book value of assets may be lower than their recoverable amounts, the receivables are considered as impaired earlier.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement as a reduction of the expense where the impairment was initially recognised.

Interest income from receivables and held-to-maturity investments are recognised under “financial items and investment activity income (expenses)” in income statements.

Financial assets at cost

If there is objective evidence that an impairment loss on financial assets measured at cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. The impairment loss is recognised under “financial items and investment activity income (expenses)” in income statement. Such impairment losses shall not be reversed.

A financial asset is derecognised where the rights to receive cash flows from the asset have expired or the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a “pass-through” arrangement and the Group has transferred substantially all the risks and rewards of the asset.

Derivative financial instruments

The Group uses derivative financial instruments such as interest rate swaps to hedge its risks associated with interest rate fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The fair value of interest rate swap contracts is determined by reference to discounted future cash flows based on estimations on fluctuation of 6-months EURIBOR (from Reuters).

Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to net profit or loss for the year. In the reporting period and comparative period, the Group did not have any derivatives that qualify for hedge accounting.

Inventories

Finished products and work-in-progress are recorded at production cost, consisting of the direct and indirect production costs incurred upon bringing the inventories to their present condition and amount. Indirect production costs are allocated to the work-in-progress and finished goods on normal operating capacity. Other inventories are recorded at acquisition cost consisting of the direct and indirect expenditures necessary for converting inventories into ready for sale. Borrowing costs (interests, amortisation of arrangement fee, etc) related to the financing of construction of real estate items are included in the cost of the constructed real estate. Borrowing costs are capitalised until the completion of the works (i.e., receiving an use permit for).

Inventories are accounted for by using weighted average cost method, except regarding real estate and apartments, where individual cost method is used.

Inventories are valued at the lower of cost and net realisable value. Estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale is considered to be net realisable value. The amount of write-down of inventories to their net realisable value is recorded as expenses of the reporting period, under “cost of sales” of the income statement.

Investment property

Investment property is property, land or a buildings, held to earn rentals or for capital appreciation, and which is not used for the business activities (production of goods, supply of services and administrative activities) of the Group. Land and buildings purchased for development of living

environment have been recognised as inventories. The property being constructed or developed or improved for the future use as commercial spaces leased out under operating lease terms (except these items being re-developed for continued future use as investment property) have been recorded as constructions-in-progress under property, plant and. The real estate items held with long-term perspective and with several possible intentions on future use.

Investment properties are measured initially at cost, including directly related transaction costs (i.e. notary fees, state duty, fees paid to advisers, and other expenses in order to complete the transaction). Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the balance sheet date.

Professional experts are used to determine the fair value of the investment property. For more significant investment property, the independent appraiser's valuation has also been used. The comparable prices method and discounted cash flow method are used for determining the fair value of investment property. Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the year in which they arise (under "other operating income" or "other operating expenses").

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal (under "other operating income" or "other operating expenses").

Transfers are made to, or from, investment property when, and only when, there is a change in use. From the date of the change in use, the Group uses the accounting principles applicable to the group of assets, into which the property was re-classified. For a transfer from investment property to owner-occupied property or inventories, the deemed cost of property for subsequent accounting is its fair value at the date of change in use.

For a transfer from property, plant and equipment to investments property, the positive difference between fair value at that date and its previous carrying amount is recognised in revaluation reserve. The negative difference is recognised in profit or loss, except for construction-in-progress, where both positive and negative difference is recognised in profit or loss, under "other operating income" or "other operating expenses". For a transfer from inventories to investment property, any difference between the fair value of the property at that date and its previous carrying amount is recognised in profit or loss (under "other operating income" or "other operating expenses").

Biological assets

A living animal or plant which is recognised as a biological asset, if it is controlled by the Group, it is held for the purpose of future economic benefits and its fair value or cost can be measured reliably. Biological assets are recorded on initial recognition and at each balance sheet date at their fair value less estimated point-of-sale costs. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. If an active market exists, the market price is considered to be the fair value of a biological asset; if an active market does not exist, the fair value of an asset is determined using the discounted cash flow method.

The following technique was used for determining the number of plants. 15 sample areas were used per each 100 m². The size of a sample area was 77cm x 77cm (2 planting boxes x 2 planting boxes) or 0.593 m². All living plants were counted. Based on this information the average result of sample areas was calculated and used for determining the number of plants per 1 m². The number of plants per 1 m² was multiplied with area of all planting boxes.

All biological assets recognised in the Group's balance sheet are consumable assets and these assets have been distinguished between mature and immature biological assets, as appropriate (see Note 21). For the purpose of determining the fair value the assets were divided into groups based on their

characteristic (age, sort and level of mature); fair value was determined for each group based on current market prices less estimated point-of-sale costs. The discounted cash flow method was used as a fair value of biological assets.

Changes in the fair value are recorded in the income statement under “other operating income” or “other operating expense”.

Property, plant and equipment (PPE)

Assets with a useful life of over 1 year and an acquisition cost of over 20 000 kroons are considered to be property, plant and equipment. Assets with a useful life of over 1 year, but an acquisition cost of less than 20 000 kroons, are recorded as low-value items (under inventories) and are fully expensed when the asset is taken into use.

PPE items are initially recognised at cost, consisting of the purchase price and expenditures directly related to the acquisition. Borrowing costs related to the financing of construction of assets (incl. amortisation of arrangement fees, interests, etc) are capitalised as a part of the acquisition cost of an asset (incurred up to the completion of the work).

Following initial recognition property, plant and equipment are measured at cost less any accumulated depreciation and accumulated impairment losses.

If an asset consists of separable components with different useful lives, each such component are accounted for and depreciated separately in the book-keeping of the Group.

Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised (e.g. replacements of part of some items) are added to the carrying amount of the assets, if the recognition criteria are met, i.e. (a) it is probable that future economic benefits associated with the item will flow to the Group, and (b) the cost of the item can be measured reliably. The replaced items are derecognised. All other expenditures are recognised as an expense in the period in which it is incurred.

Depreciation is calculated on a straight-line basis. Depreciation rates are determined for each tangible asset item individually, depending on its estimated useful life. The following annual depreciation rates apply for PPE groups:

- | | |
|--------------------------------|---------|
| • Buildings and facilities | 2-18 % |
| • Machinery and equipment | 8-20 % |
| • Transport vehicles | 15-25 % |
| • Fixtures, fittings and tools | 20-40 % |

Depreciation is stopped when the carrying value of an asset equals with its residual value. The residual value is the estimated amount that the Group would currently obtain from disposal of the asset, after deducting the estimated cost of disposal, if the asset was already of the age and in condition expected at the end of its useful life.

The residual values, useful lives and depreciation methods of items of property, plant and equipment are reviewed at each year-end and, if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimation, i.e. prospectively.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. The accounting principle for impairment of assets has been described below.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset is

included in the income statement (under “other operating income” or “other operating expenses”) in the year the asset is derecognised.

Items of PPE are re-classified as non-current assets held for sales, if it is highly probable, that these assets will be sold within one year. Non-current assets held for sale are presented separately from current and non-current assets in the Group’s balance sheet. Non-current assets held for sale are valued at the lower of net carrying amount and fair value less costs to sell. Non-current assets are not depreciated.

Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Net assets of the subsidiary or joint venture as at the acquisition date are the net value of the identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is so allocated (1) represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and (2) is not larger than a segment based on either the Group's primary reporting format.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Impairment loss is recognised in profit and loss, under “general and administrative expenses”.

Other intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The intangible assets acquired in a business combination are recognised separately, if their fair values can be measured reliably. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life (in most cases 3 to 6 years). Amortisation is calculated on a straight-line basis. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

Intangible assets with indefinite useful lives are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. The carrying values of intangible assets with finite lives are

reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. The accounting principle for impairment of assets has been described below.

Research and development costs

Research costs are expensed as incurred.

An intangible asset arising from development expenditure on an individual project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the ability of resources to complete and the availability to measure reliably the expenditure during the development.

Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use (i.e. present value of estimated future cash flows). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If necessary, the external experts are used for determining the fair value. Impairment losses are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. The previously recognised impairment loss, except for impairment loss of goodwill, is reversed and the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised as a reduction of expenses in income statement when incurred.

Financial liabilities

Financial liabilities are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, financial liabilities are subsequently measured at amortised cost using the effective interest method. Transaction costs are taken into consideration upon calculating the effective interest rate, and charged to expenses over the term of the financial liability.

Borrowing costs are recognised as an expense when incurred (under "financial items and investment activity income (expenses)"), except for interest expenses related to the financing of construction of assets (real estate project under inventories, investment property and PPE items), where they are included into the acquisition cost during the period from the launch of construction until the completion of the works.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Promises, guarantees and other commitments that in certain circumstances may become liabilities as a result of one or more uncertain future events are disclosed as contingent liabilities in the notes to the consolidated financial statements. Present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources of the Group will be required (according to the judgement of the management of the Group), are also disclosed as contingent liabilities in the notes to the consolidated financial statements.

Leases

A finance lease is a lease that transfers substantially all the risks and benefits incidental to ownership of the leased item. All other lease transactions are treated as operating lease.

Finance leases are capitalised by a lessee at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term. Assets sold under finance lease terms are recorded in the lessor's balance sheet as a receivable in the amount of the net investment in the lease. Lease payments are apportioned between the finance expense or income and reduction of the lease liability or receivable so as to achieve a constant rate of interest on the remaining balance of the liability / receivable.

In case of operating lease, the leased assets are recorded in the lessor's balance sheet. Operating lease payments are recognised as an income (by lessor) or expense (by lessee) in the income statement on a straight-line basis over the lease term.

Mandatory legal reserve

Pursuant to the Commercial Code of the Republic of Estonia and the Articles of the Parent, at least 5% of the net profit attributable to the shareholders of the Parent must be transferred to the reserve capital each financial year, until the reserve capital amounts to at least 10% of the share capital. The mandatory reserve cannot be paid out as dividends. It can be used for covering the loss, if loss cannot be covered from the distributable shareholder's equity. Mandatory reserve can also be used for increasing the share capital of the company.

Income tax

Income tax consists of current income tax and deferred income tax. The current income tax is recognised as a current asset / liability and deferred income tax is recognised as a non-current asset / liability.

The Parent and Estonian subsidiaries and joint ventures

Pursuant to the Income Tax Act, Estonian companies are not subjected to pay income tax on the profit, but all dividends paid by the company are subject to income tax (24/76 of net dividend paid out before December 31, 2005; 23/77 of net dividend paid out during the calendar year 2006 and after that the rate will decrease every year by one point until 20/80 of net dividends paid out after January 1, 2009). Income tax from payment of dividends is recorded under expenses in the income statement at the moment of declaring the dividends.

Since income tax is paid on the dividends rather than profit, there are no temporary differences between the tax bases and carrying values of assets and liabilities that may cause the deferred income

tax. A Group's potential tax liability related to the distribution of its retained earnings as dividends is not recorded in the balance sheet. The maximum amount of potential tax liability has been disclosed in Note 33.

Latvian, Lithuanian and Ukrainian subsidiaries

In accordance with income tax acts, the company's net profit adjusted by temporary and permanent differences determined in income tax acts is subject to income tax in Latvia, Lithuania and Ukraine (tax rate is 15% in Latvia and Lithuania and 25% in Ukraine).

Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are recognised only when it is probable that profit will be available against which the deferred tax assets can be utilised.

Accounting for investments in subsidiaries and joint ventures in the Parent's non-consolidated main statements as required by Estonian Accounting Act

The Parent's non-consolidated main statements (presented in Note 38) represent supplemental information in line with the Estonian Accounting Act and they are not deemed to present separate financial statements of the Parent in accordance with IAS 27.

In the Parent's non-consolidated financial statements investments in its subsidiaries and joint ventures are carried at cost. It means that investments in subsidiaries are initially recognised at cost, being the fair value of the consideration given. After initial recognition the cost is adjusted by any losses arise from impairment in value.

The Group assesses at each balance sheet date whether there is an indication that an investment may be impaired and if any such indication exists, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an investment exceeds its recoverable amount, the asset is written down to its recoverable amount (higher of the value in use and fair value less costs to sell). Impairment losses are recognised under "financial items and investment activity income (expenses)" in the income statement.

Dividends receivable/received from subsidiaries and joint ventures are recognised as financial income, when the Parent's right to receive the payment is established, except a part of dividends paid out on account of the retained earnings generated by the subsidiary / joint venture before the acquisition of the entity. Such dividends are recognised as a reduction of investments.

6 Segment information – business segments

in thousands of kroons

As of 31.12.2005 or for the year 2005, respectively	Service	Development	Construction	Eliminations	Total
Revenue to external customers	64 504	235 899	175 535	0	475 938
Other operating income to external customers	3 238	131 384	664	0	135 286
Revenue and other operating income to other segments	11 865	2 053	57 294	-71 212	0
Total revenue & other operating income	79 607	369 336	233 493	-71 212	611 224
Segment results	13 230	147 697	3 366	4 820	169 113
Unallocated operating expenses					-15 581
Total operating profit					153 532
Financial items and investment activity income (expenses)					-32 973
Income tax					-4 116
Net profit					116 443
	Service	Development	Construction	Eliminations	Total
Segment assets	31 923	1 214 569	80 540	-67 437	1 259 595
Unallocated assets					202 307
Total assets					1 461 902
Segment liabilities	14 652	397 985	58 451	-336 263	134 825
Unallocated liabilities					746 332
Total liabilities					881 157
Segment investments into non-current assets	498	228 314	14 279	0	243 091
Unallocated investments					72
Total investments into non-current assets					243 163
Depreciation and amortisation included in segment results	-828	-341	-1 064	0	-2 233
Impairment loss included in segment results	0	-7 109	0	0	-7 109
Unallocated depreciation and amortisation					-429
Total depreciation, amortisation and impairment loss					-9 771
Non-monetary income and expenses (except depreciation and amortisation)					
Gains and losses from change in fair value of investment property and biological assets	2 909	100 009	2 040	-731	104 227
Allowance of receivables and write-off of liabilities	-173	-1 613	0	0	-1 786
Total non-monetary income and expenses					102 441

As of 31.12.2004 or for the year 2004, respectively	Service	Development	Construction	Eliminations	Total
Revenue to external customers	66 291	236 830	46 820	0	349 941
Other operating income to external customers	5 491	71 595	1 932	0	79 018
Revenue and other operating income to other segments	8 200	7 692	88 796	-104 688	0
Total revenue & other operating income	79 982	316 117	137 548	-104 688	428 959
Segment results	5 822	126 201	-1 646	6 548	136 925
Unallocated operating expenses					-7 332
Total operating profit					129 593
Financial items and investment activity income (expenses)					
Income tax					-20 856
					-2 102
Net profit					
Segment results					106 635
	Service	Development	Construction	Eliminations	Total
Segment assets	35 237	883 432	48 568	-61 060	906 177
Unallocated assets					102 354
Total assets					1 008 531
Segment liabilities	19 589	192 455	34 008	-179 334	66 718
Unallocated liabilities					588 696
Total liabilities					655 414
Segment investments into non-current assets	3 283	187 827	281	0	191 391
Unallocated investments					275
Total investments into non-current assets					191 666
Depreciation and amortisation included in segment results	-670	15 013	1 832	0	16 175
Unallocated depreciation and amortisation					-456
Total depreciation amortisation and impairment loss					15 719
Non-monetary income and expenses (except depreciation and amortisation)					
Gains and losses from change in fair value of investment property and biological assets	2 359	57 625	0	-1 900	58 084
Total non-monetary income and expenses					58 084

Transfer prices between business segments are set on arm's length basis in a manner similar to transactions with third parties.

7 Segment information - geographical segments

in thousands of kroons

Revenue by geographical location of customers	2005	2004
Estonia	451 904	340 334
Latvia	13 069	9 820
Lithuania	2 737	809
Sweden	8 768	0
Ukraine	934	0
Revenue to other segments	-1 474	-1 022
Total revenue by location of customers	475 938	349 941

Segment assets by geographical location of assets	31.12.2005	31.12.2004
Estonia	1 234 114	908 812
Latvia	51 378	7 908
Lithuania	360	226
Ukraine	529	0
Inter-segment eliminations	-26 786	-10 769
Unallocated assets	202 307	102 354
Total segment assets by geographical location of assets	1 461 902	1 008 531

Assets acquired in 2005 by type of assets	Estonia	Latvia	Lithuania	Ukraine	Total
Investment property	54 838	9 570	0	0	64 408
Property, plant and equipment	170 129	374	268	272	171 043
Intangible assets	7 631	81	0	0	7 712
Total acquired assets	232 598	10 025	268	272	243 163

Assets acquired in 2004 by type of assets	Estonia	Latvia	Lithuania	Ukraine	Total
Investment property	194 346	0	0	0	194 346
Property, plant and equipment	9 141	475	0	0	9 616
Intangible assets	-12 296	0	0	0	-12 296
Total acquired assets	191 191	475	0	0	191 666

8 Cost of sales
in thousands of kroons

	2005	2004
Carrying value of real estate sold	-110 076	-92 713
Construction services purchased	-178 104	-100 396
Personnel expenses	-37 854	-21 202
Depreciation, amortisation and impairments (see Notes 23, 24)	-1 207	-373
Other expenses	-31 175	-26 017
Total cost of sales	-358 416	-240 701

9 Other operating income and expenses
in thousands of kroons

Marketing expenses	2005	2004
Advertising expenses	-9 808	-6 621
Brokerage fees	-1 136	-1 720
Market research expenses	-226	0
Personnel expenses	-797	-100
Depreciation, amortisation and impairments (see Notes 23, 24)	-1	-1
Other marketing expenses	-291	-912
Total marketing expenses	-12 259	-9 354

General and administrative expenses	2005	2004
Personnel expenses	-26 022	-21 530
Office expenses	-8 097	-9 276
Legal services and consultations	-17 350	-7 943
Depreciation, amortisation and impairments ¹ (see Notes 23, 24)	-8 563	16 093
Allowance for doubtful receivables	-4 624	-586
Other expenses	-9 110	-20 517
Total general and administrative expenses	-73 766	-43 759

¹ The amount of depreciation, amortisation and impairment loss includes, among other, so-called negative goodwill recorded as income in the amount of 24 thousand kroons (2004: 19 916 thousand kroons). See Notes 18 and 24 for additional information on goodwill.

Other operating income	2005	2004
Gain on change in fair value of investment property (see Note 22)	114 798	59 984
Gain on disposals of investment property	12 353	10 660
Gain on change in fair value of biological assets (see Note 21)	1 908	1 078
Gain on disposals of property, plant and equipment	661	153
Other income	5 566	7 143
Total other operating income	135 286	79 018

Other operating expenses	2005	2004
Loss on change in fair value of investment property (see Note 22)	-11 923	-2 802
Loss on change in fair value of biological assets (see Note 21)	-556	-176
Fines and penalties	-253	-471
Loss on disposals of property, plant and equipment	0	-1 306
Other expenses	-519	-797
Total other operating expenses	-13 251	-5 552

10 Financial items and investment activity income (expenses)

in thousands of kroons

	2005	2004
Interest expenses	-23 887	-26 931
Interest income	3 895	1 010
Gains and losses from sale of subsidiaries (see Note 16)	-6 085	0
Gains and losses from sale of joint ventures (see Note 17)	0	4 319
Income and expenses from non-current financial investments	-2 655	1 097
Net foreign exchange loss	-499	-465
Other income and expenses	-3 742	114
Total financial items and investment activity income (expenses)	-32 973	-20 856

¹ The amount of income and expenses from non-current financial investments includes, among other, gain from change in fair value of financial assets carried at fair value in the amount of 2 290 thousand kroons (2004: zero).

11 Income tax expense

in thousands of kroons

	2005	2004
Income tax on dividends	-3 645	-2 099
Income tax on profit of Latvian subsidiaries	-471	-3
Total income tax expense	-4 116	-2 102

The foreign subsidiaries have deferred income tax assets (in insignificant amount for the Group perspective), which have been recorded as off-balance sheet items, as it is not probable that future taxable profit will be available against which the unused tax losses can be utilised.

12 Earnings per share

in thousands of kroons

Basic earnings per share are calculated by dividing the net profit for the financial year attributable to the owners of the Parent by the weighted average number of ordinary shares outstanding during the financial year. As the Parent does not have any potential ordinary shares, then the diluted earnings per share are equal to basic earnings per share.

	2005	2004 restated	2004 previously stated

Weighted average number of ordinary shares	27 521 932	27 255 468	8 400
Net profit attributable to the owners of the Parent	101 231	100 055	100 055
Earnings per share (in kroons)	3,68	3,67	11 911

In 2005, share split and bonus issue were carried out (see Note 32). Therefore the weighted average number of ordinary shares for comparative year has been adjusted – the number of shares after share split and bonus issue (i.e., 27 255 468 shares) has been used for calculation of weighted average number of shares.

In addition to the increases in share capital specified above, Arco Vara AS issued 3 197 569 new shares for monetary contribution (see Note 32). The number of ordinary shares after the second increase of share capital amounts to 30 453 037 shares. The calculation of weighted average number (i.e. 27 521 932) of ordinary shares for the year 2005 is the following:

- January to November (11 months): 27 255 468 shares;
- December (1 month): 30 453 037 shares.

13 Cash and cash equivalents

in thousands of kroons

	31.12.2005	31.12.2004
Cash on hand and bank demand deposits	17 786	16 569
Term deposits	126 199	6 423
Money Market Fund shares	0	352
Total cash and cash equivalents	143 985	23 344

As of 31.12.2005 term deposits consist of over-night deposits in the total amount of 113 919 thousand kroons (2004: zero) and time deposits with maturity up to 3 months in the total amount of 12 280 thousand kroons (2004: 6 423 thousand kroons).

The interest rates of demand deposits and time deposits were in the range of 0.25% to 0.5% p.a (2004: same) and 0.2% to 2.38% p.a (2004: 0.25% to 0.5%), respectively.

14 Receivables

in thousands of kroons

	31.12.2005	31.12.2004
<i>Accounts receivable</i>		
Accounts receivable, gross	38 151	15 453
Allowance for doubtful receivables	-801	-1 000
Accounts receivable, net	37 350	14 453
<i>Other receivables</i>		
Receivables from joint ventures (see Note 35)	6 575	2 408
Loans granted ¹	21 985	19 555
Other short-term receivables ²	7 660	4 582
Total other receivables	36 220	26 545
<i>Accrued income</i>		
Interests	2 240	313
Accrued income from long-term service contracts ³	8 043	1 647

VAT refundable	12 475	4 130
Other accruals	42	559
Total accrued income	22 800	6 649
Total receivables	96 370	47 647

¹ The average interest rate of unsecured loans granted were 5.4% p.a (2004: 5% p.a). The amount of loans granted includes, among other things, loans granted to related parties in the total amount of 20 524 thousand kroons (2004: 12 970 thousand kroons). See Note 35 for information of these loans.

² Other short-term receivables as of 31.12.2005 include the following:

- receivable for encumbering the real estate with the personal right of use in the amount 2 321 thousand kroons (2004: 10 704 thousand kroons, recorded as a long-term receivable);
- receivables from related parties in the total amount of 1 723 thousand kroons (2004: 1 507 thousand kroons) – see also Note 35;
- refund of the prepayment in the amount of 1 500 thousand kroons (2004: zero);
- other receivables in the total amount of 2 116 thousand kroons (2004: 3 075 thousand kroons).

³ Accrued income from long-term service contracts in the amount of 8 043 thousand kroons (2004: 1 647 thousand kroons) is related to long-term construction contracts (see also Note 27).

15 Inventories

in thousands of kroons

	31.12.2005	31.12.2004
Real estate purchased or developed for sale	144 974	143 698
Other goods purchased for resale	4 137	760
Raw materials and finished goods	524	0
Prepayments to suppliers	4 239	3 109
Total inventories	153 874	147 567

Due to decrease in net realisable value of real estate purchased for sale below their book value, the inventories have been written down by 7 613 thousand kroons (2004: zero). As of 31.12.2005 the book value of real estate items written down in 2005 amounted to 355 thousand kroons (2004: no inventories written down).

As of 31.12.2005 real estate purchased or developed for sale in the amount of 99 225 thousand kroons (2004: 134 839 thousand kroons) were pledged as a collateral for borrowings of the Group.

16 Subsidiaries of the Group

in thousands of kroons

Name of subsidiaries	Country of incorporation	Segment	Ownership as of 31.12.2004	Ownership as of 31.12.2005
A.M.L. AS ¹	Estonia	Development	100% ⁷	merged to other financial investments
Arco Balti Kinnisvarafond AS ³	Estonia	Development	0% ⁷	100% ⁷
Arco Capital TOV	Ukraine	Development	-	100% ⁷
Arco Neruhomist TOV	Ukraine	Service	-	100% ⁷
Arco Development SIA ⁵	Latvia	Development	100%	80%
Arco HCE OÜ	Estonia	Development	100%	100%
Arco Investeeringute AS	Estonia	Development	100% ⁷	84%
Arco Kinnisvarahoolduse AS ⁵	Estonia	Development	100%	sold

Arco Maadehalduse OÜ	Estonia	Development	100%	100%
Arco Management SIA (under liquidation)	Latvia	Development	100% ⁷	100% ⁷
Arco Merivälja AS ¹	Estonia	Development	100% ⁷	merged
Arco Real Estate SIA ⁵	Latvia	Service	100%	80%
Arco Real Estate UAB ⁵	Lithuania	Service	100%	80%
Arco Ukraina Valduste OÜ	Estonia	Service	-	75%
Arco Vara Ehitus AS ^{1,2}	Estonia	Development	95%	merged
Arco Vara Geodeesia OÜ ⁵	Estonia	Service	100%	sold
Arco Vara Halduse OÜ	Estonia	Service	100%	100%
Arco Vara Kinnistute AS	Estonia	Development	100%	100%
Arco Vara Konsultatsioonid OÜ ¹	Estonia	Service	100%	merged
Arco Vara Korteri AS ^{1,2}	Estonia	Development	80%	merged
Arco Vara Kuressaare Kinnistute OÜ ¹	Estonia	Development	100%	merged
Arco Vara Majade AS ^{1,4}	Estonia	Development	64%	merged
Arco Vara Puukool OÜ	Estonia	Development	75%	75%
Arco Vara Pärnu Büroo AS ¹	Estonia	Service	100%	merged
Arco Vara Riia Valduste OÜ	Estonia	Service	75%	75%
Arco Vara Saare Büroo AS ¹	Estonia	Service	100%	merged
Arco Vara Kinnisvarabüroo AS (formerly known as Arco Vara Tallinna Büroo AS)	Estonia	Service	100%	100%
Arco Vara Tartu Büroo AS ¹	Estonia	Service	100%	merged
Arco Vara Virumaa Büroo OÜ ¹	Estonia	Service	100%	merged
Arco Vara Ärijuhtimise OÜ (in merger process, see Note 37)	Estonia	Group management	100%	100%
Arco Varavalitsemise AS ⁵	Estonia	Service	100% ⁷	to joint ventures
Arcofond OÜ ²	Estonia	Development	80%	84%
Deena Ehituse OÜ ²	Estonia	Construction	100%	84%
Fimaier OÜ	Estonia	Construction	80%	80%
Kerberon OÜ ²	Estonia	Development	67%	67%
Kolde AS ²	Estonia	Development	71%	73%
Kuressaare Vaekoda OÜ ¹	Estonia	Service	100%	merged to other financial investments
Maltifor OÜ ¹	Estonia	Development	100% ⁷	merged
Metro Kinnisvara OÜ ¹	Estonia	Development	100%	merged
Metro Kinnisvara OÜ (formerly known as Vesteros Kaubanduse OÜ)	Estonia	Development	100%	100%
Nurmenuku Kaubanduskeskuse OÜ ⁵	Estonia	Development	100% ⁷	sold
Oma Korteri AS ¹	Estonia	Development	100% ⁷	merged
Pärnu Turg OÜ ²	Estonia	Development	100%	84%
Rasmussen Invest SIA (under liquidation)	Latvia	Development	80% ⁷	80% ⁷
Sportings Riga SIA	Latvia	Development	100% ⁷	100% ⁷
Tallinna Linnaehitus AS	Estonia	Construction	80% ⁷	80% ⁷
Tähetorni 21c Kinnisvara OÜ ¹	Estonia	Development	100% ⁷	to other financial investments
Zeus Haldus OÜ	Estonia	Development	100% ⁷	100% ⁷
Ulmana Gatves Nami SIA	Latvia	Development	-	100% ⁷
Veemaailm Inc. OÜ	Estonia	Construction	-	100% ⁷
Vidus Nams SIA (under liquidation)	Latvia	Development	100% ⁷	100% ⁷
Wilson Kinnisvara OÜ	Estonia	Development	100%	100%

¹The following mergers were completed in 2005:

Acquiring company	Companies being acquired	Date of merger
Arco Balti Kinnisvarafond AS	Maltifor OÜ, Tähetorni 21c Kinnisvara OÜ	January 2005
Arco Investeeringute AS	Arco Merivälja AS, Oma Korter AS	January 2005
Arco Investeeringute AS	Arco Vara Ehituse AS, Arco Vara Majade AS, Arco Vara Korter AS	July 2005
Arco Vara Kinnisvarabüroo AS (formerly known as Arco Vara Tallinna Büroo AS)	Arco Vara Saare Büroo AS, Arco Vara Tartu Büroo AS, Arco Vara Pärnu Büroo AS, Arco Vara Virumaa Büroo OÜ, Arco Vara Konsultatsioonid OÜ, Kuressaare Vaekoda OÜ	January 2005
Metro Kinnisvara OÜ (formerly known as Vesteros Kaubanduse OÜ)	Metro Kinnisvara OÜ (former), Arco Vara Kuressaare Kinnistute AS, Wilandor OÜ	October 2005
Arcofond OÜ	A.M.L. AS	July 2005
Arco HCE OÜ	Agnetha OÜ (see Note 18)	July 2005
Veemaailm Inc. OÜ	Thornhill OÜ (see Note 18)	September 2005

As a result of mergers the acquiring companies became the legal successors of the companies being acquired. As a separate legal entities, the operations of companies being acquired were discontinued. During the merger no new shares were issued nor nominal amount of existing shares changed. The merger of companies under common control did not influence the results of the Group and its financial position.

²The barter transaction with following sales and purchases of shares was completed in 2005:

	Before transaction	Acquired ownerships	Sold ownerships	After transaction
Arco Vara Korter AS (merged with Arco Investeeringute AS)	80.0%	+4.0%		84.0%
Kolde AS	71.4%	+2.0%		73.4%
Kerberon AS	66.8%	+0.6%		67.4%
Arcofond OÜ	80.0%	+4.0%		84.0%
Arco Vara Ehitus AS (merged with Arco Investeeringute AS)	95.0%		-11.0%	84.0%
Pärnu Turg OÜ	100.0%		-16.0%	84.0%
Deena Ehitus OÜ	100.0%		-16.0%	84.0%

The gain of 1 806 thousand kroons arose from this transaction (the minority interest decreased by the same amount).

³ In 2004 the Group owned through subsidiaries a preferred share of Arco Balti Kinnisvarafond AS. The preferred share gave the owner rights which were treated as a control. Therefore Arco Balti Kinnisvarafond AS was considered to be a subsidiary and was consolidated line-by-line. In 2005, the ownership of the Group in the entity, which owns the preferred share, decreased to 50%. Due to decrease in the Group's control over Arco Balti Kinnisvarafond AS, the investment was reclassified to long-term financial investments measured at fair value through profit or loss. As a result of the change in estimates, the Group's assets, liabilities and equity (minority interests) decreased as follows:

	01.01.2005
Cash and cash equivalents	-1 810
Other current assets	-978
Investment property	-83 845
Intangible assets	-1 204
Borrowings	-56 517
Other payables	-1 034
Minority interests	-30 286

⁴ In 2005, the Group purchased 20% of shares of Arco Vara Majade AS for 3 336 thousand kroons, which was offset with the group's liabilities. As a result of the transaction, the minority interests decreased by 2 704 thousand kroons.

⁵ In 2005, the Group sold the ownership in the following subsidiaries:

Subsidiaries	Ownership sold	Sale price	Gain or loss from sale
Arco Development SIA	20%	0	-10
Arco Kinnisvaraholduse AS	100%	0	-5 419
Arco Vara Geodeesia OÜ	100%	250	-788
Arco Real Estate SIA	20%	0	-1
Arco Real Estate UAB	20%	0	-18
Arco Varavalitsemise AS	50%	1 100	1 684
Nurmenuku Kaubanduskeskuse OÜ	100%	4 956	-3 339
TOTAL		6 306	-7 891

The effect of disposal of subsidiaries on the Group's assets and liabilities were the following:

Cash and cash equivalents	-9 683
Other current assets	-3 690
Investment property	-56 170
Property, plant and equipment	-464
Intangible assets	-75
Borrowings	-32 751
Other payables	-23 163

At the beginning of 2005, the fully owned subsidiary sold 1/3 of shares of Arco Varavalitsemise AS. After the sale of shares, Arco Varavalitsemise AS issued 11 000 new shares, which were acquired by the minority shareholder of Arco Varavalitsemise AS. As a result of these transactions, there are two shareholders with joint control over Arco Varavalitsemise AS. The Group earned a gain of 1 684 thousand kroons from the disposal of its ownership in Arco Varavalitsemise AS. As Arco Varavalitsemise AS started with its business activities after the transactions specified above, the reclassification of the investment from subsidiary to joint venture had no significant effect on the Group's financial position and results of operations.

⁶ In 2004, the Group increased its ownership in the following subsidiaries and joint ventures:

Subsidiaries	Ownership acquired	Acquisition cost	Negative goodwill arose from the transaction
Arcofond OÜ	20%	18 049	5 089
Arco Vara Ehitus AS	25%	6 371	570
Arco Vara Korter AS	20%	0	0
Arco Vara Majade AS	16%	2 070	186
Deena Ehituse OÜ	46%	1 200	1 822
Fimaier OÜ	20%	1 101	294
Kolde AS	17%	0	0
Kerberon OÜ	17%	828	2 724
Metro Kinnisvara OÜ	50%	37 109	1 794
TOTAL		66 728	12 479

The effect of the reclassification of investments from joint ventures to subsidiaries on the Group's assets, liabilities and equity was the following:

Cash and cash equivalents	416
Other current assets	11 560
Investment property	57 620
Borrowings	12 760
Minority interests	-22 371

⁷ The Parent has the specified ownerships through its other subsidiaries. See Note 37 for additional information on the structure of the Group as of 31.12.2005.

17 Joint ventures of the Group

in thousands of kroons

Name of joint ventures	Country of incorporation	Segment	Ownership as of 31.12.2004	Ownership as of 31.12.2005
Arco Vara Arenduse OÜ	Estonia	Development	50% ²	50%
Arco Vara Saare Kinnistud OÜ	Estonia	Development	50%	50%
Arco Varavalitsemise AS (see Note 16)	Estonia	Service	-	50% ²
Arco Ärikeskuse OÜ	Estonia	Development	50% ³	50% ³
Chalwell OÜ ¹	Estonia	Development	-	100% ²
Floriston Grupp OÜ	Estonia	Development	50%	50%
Home Service SIA (see Note 18)	Latvia	Development	-	50% ²
Lehe Elamud OÜ	Estonia	Development	50% ²	50% ²
Pärnu Elumaja OÜ (see Note 18)	Estonia	Development	-	50% ²
Pärnu Ärihoone OÜ (see Note 18)	Estonia	Development	-	50% ²
Tallinna Olümpiapurjespordikeskus AS	Estonia	Development	50% ²	50% ²

¹ In 2004, there were no business activities in Chalwell OÜ and the ownership of 100% was held for resale and recorded under "Short-term financial investments". In 2005, the shares of Chalwell were sold to the joint venture Floriston Grupp OÜ, and reclassified as a joint venture, as well. The reclassification had no significant effect on the Group financial indicators.

² The Parent has the specified ownerships through its subsidiaries or other joint ventures. See Note 42 for additional information on the structure of the Group as of 31.12.2005.

³ Arco Vara AS owns directly 19.8% of shares of Arco Ärikeskuse OÜ and 30.2% of shares through its subsidiaries.

In 2004, the Group sold the following ownerships in joint ventures:

Joint ventures	Ownership sold	Sale price	Gain or loss from sale
Arco Kapitalijuhtimise AS	50%	4 100	2 999
Wolks AS	33%	13 603	428
Fortuuna Elamu AS	31%	11	187
Masinaehitus AS	50%	1	705
TOTAL		17 715	4 319

The effect of disposal of joint venture in 2004 on the Group's assets and liabilities are the following:

Cash and cash equivalents	-253
Other current assets	-4 100
Long-term financial investments	-3 400
Property, plant and equipment	-907
Investment property	-19 469
Borrowings	-12 262
Other payables	-2 602
Total net assets	-13 396

The financial indicators of joint ventures recognised in the Group's financial statements using proportionate consolidation

	2005	2004
Operating income	93 336	52 424
Operating expenses	-19 551	-16 736
Financial items and investment activity income (expenses)	-10 377	-11 394
	31.12.2005	31.12.2004
Current assets	28 806	4 766
Non-current assets	296 653	372 260
Short-term liabilities	-22 485	17 261
Long-term liabilities	-61 475	185 980

18 Business combinations and establishing subsidiaries
in thousands of kroons

In 2005, the Group established the following subsidiaries and joint ventures:

Subsidiaries and joint ventures	Ownership acquired	Segment	Contribution into share capital
Arco Capital TOV	100%	Development	91
Arco Neruhomist TOV	100%	Service	87
Arco Ukraina Valduste OÜ	75%	Service	30
Home Service SIA	50%	Development	22
Pärnu Elumaja OÜ	50%	Development	20
Pärnu Ärihoone OÜ	50%	Development	20
Ulmana Gatves Nami SIA	100%	Development	45

In 2004, the Group established the following subsidiaries:

Subsidiaries	Ownership acquired	Segment	Contribution into share capital
Zeus Haldus OÜ	100%	Development	40
Arco Varavalitsemise AS	100%	Service	3 300
Wilson Kinnisvara OÜ	100%	Development	40

At the beginning of 2005, Deena Ehituse OÜ acquired 100% of ownership in OÜ Thornhill paying for that 50 thousand kroons. In March 2005, OÜ Thornhill acquired 100% of ownership in Veemaailm Inc. OÜ – a main contractor of environmental construction. The acquisition cost amounted to 11 465 thousand kroons and consisted of purchase price of 8 000 thousand kroons paid at once and

conditional purchase price of 4 000 thousand kroons payable during next four years. The part of purchase price payable in future was discounted by the discount rate of 6% p.a and the discounted value of this part amounted to 3 465 thousand kroons. Subsequently to these acquisitions, Veemaailm Inc. OÜ and Thornhill OÜ were merged (see also Note 16).

As of the acquisition date, the fair value of assets, liabilities and contingent liabilities of Veemaailm Inc. OÜ were the following:

	Fair value
Cash and cash equivalents	164
Other current assets	6 611
Property, plant and equipment (see Note 23)	6 188
Borrowings	-1 687
Other payables and prepayments	-7 297
Net assets	3 979
Acquisition cost	11 514
Goodwill (see Note 24)	7 535

The goodwill arising from the acquisition of Veemaailm Inc. OÜ is mostly related to the clientele and relationships with potential clients helping the Group to enter into more profitable agreements, than without acquiring in Veemaailm Inc. OÜ. These clientele and relationships have not been recorded as separate intangible assets, as fair value of these assets can not be determined reliably.

The net profit for 2005 of Veemaailm Inc. OÜ amounted to 148 thousand kroons, incl. net profit for 9-month period included in the Group's income statement in the amount of 1 231 thousand kroons. In 2005, revenue of Veemaailm Inc. OÜ amounted to 86 718 thousand kroons.

On 15.06.2005 the Group acquired the real estate company - Agnetha OÜ paying for that 5 040 thousand kroons. Subsequently to the acquisition, Agnetha OÜ and Arco HCE OÜ were merged (see Note 16).

As of the acquisition date, the fair value of assets, liabilities and contingent liabilities of Agnetha OÜ were the following:

	Fair value
Cash and cash equivalents	40
Property, plant and equipment (see Note 23)	5 000
Net assets	5 040
Acquisition cost	5 040
Goodwill	0

In 2004, the Group acquired the subsidiaries Maltifor OÜ, Arco HCE OÜ, Arco Development SIA and Pärnu Turg OÜ. As of the acquisition dates, the fair value of assets, liabilities and contingent liabilities of the companies acquired were the following:

Cash and cash equivalents	45
Other current assets	453
Investment property	47 000
Borrowings	-30 356
Net assets	17 142
Acquisition cost	16 888
Goodwill (see Note 24)	102
Negative goodwill (see Note 24)	-356

19 Long-term receivables

in thousands of kroons

	31.12.2005	31.12.2004
Receivables from joint venture (Note 35)	850	19 825
Long-term loan receivables ¹	5 380	213
Other long-term receivables ²	10 737	27 690
Total long-term receivables	16 967	47 728

¹ Long-term loan receivables as of 31.12.2005 include receivables from related parties with interest rate of 4%-4.5% (see also Note 35). Maturity dates have been determined up to 31.12.2008 and these loans are unsecured.

² Other long-term receivables as of 31.12.2005 consist of the following receivables:

- receivables from local municipalities in nominal amount of 11 475 thousand kroons (2004: 11 475 thousand kroons). Due to changes in estimates the receivable was written down by 5 067 thousand kroons (in 2004, the Group estimated to collect the money by 2009; in accordance with current estimates the year 2015 has been considered as a final maturity date). The discount rate of 6% was used in the calculation of the recoverable amount of the specified receivable. The impairment loss of the receivable from local municipalities has been recorded under "Financial items and investment activity income (expenses)".
- Receivable arisen from sales of shares of subsidiaries in the total amount of 1 542 thousand kroons (2004: 1 922 thousand kroons). The maturity date of the receivable is the year 2008. The receivable has been discounted with the rate of 6%.
- prepayment related to purchase of a joint venture in Latvia in the amount of 2 716 thousand kroons (2004: 2 736 thousand kroons).
- other receivables of 71 thousand kroons (2004: 853 thousand kroons).
- 2004: other long-term receivables included also receivable for encumbering the real estate with the personal right of use in the amount 10 704 thousand kroons. In the opinion of the management, the receivable will be repaid in 2006 and therefore it has been reclassified to short-term receivables in 2005 (see also Note 14).

Note 20 Long-term investments into securities

in thousands of kroons

	31.12.2005	31.12.2004
Long-term investments into shares – measured at cost	132	129
Long-term investments into shares – measured at fair value ¹	2 871	1 280
Total long-term investments into securities	3 003	1 409

¹ Long-term investments into shares – measured at fair value belong to the group of "financial assets at fair value through profit or loss".

21 Biological assets

in thousands of kroons

Balance at 31.12.2003	6 332
Purchases	1 001
Sales	-2 946
Gains and losses from changes in fair value (Note 9)	902
Balance at 31.12.2004	5 289
Purchases	217
Sales	-610
Gains and losses from changes in fair value (Note 9)	1 352
Reclassifications to property, plant and equipment (Note 23)	-228
Balance at 31.12.2005	6 020

As of 31.12.2005 biological assets can be divided by maturity level as follows:

- mature (ready for sale) plants in the book value of 658 thousand kroons (2004: 17 thousand kroons);
- immature (not ready for sale) plants in the book value of 771 thousand kroons (2004: 711 thousand kroons);
- forest ready for felling in the book value of 1 400 thousand kroons (2004: 1 706 thousand kroons);
- growing forest, for which the Group has not received the cutting allowance yet in the book value of 3 191 thousand kroons (2004: 2 855 thousand kroons).

The growing forest owned by the Group amounted to 55 thousand cubic meters (2004: 60 thousand cubic meters).

In 2005, the expenses related to the management of biological assets amounted to 843 thousand kroons (2004: 376 thousand kroons).

As of 31.12.2005 the biological assets in the amount of 3 175 thousand kroons (2004: 3 042 thousand kroons) were pledged as a collateral for borrowings of the Group.

22 Investment property

in thousands of kroons

Balance at 31.12.2003	469 143
Purchases	89 726
Sales	-33 324
Reclassifications from inventories	2 349
Reclassifications from property, plant and equipment (Note 23)	6 151
Additions from business combinations (Notes 16, 18)	104 620
Disposals related to sales of joint ventures (Note 17)	-19 469
Net gain on changes in fair value recorded into equity	5 186
Gains and losses from changes in fair value (Note 9)	57 182
Balance at 31.12.2004	681 564
Purchases	64 408
Sales	-131 150
Disposals related to sales of subsidiaries (Note 16)	-140 015
Gains and losses from changes in fair value (Note 9)	102 875

Reclassifications from and to property, plant and equipment (Note 23)	18 570
Reclassifications from and to inventories	254 852
Balance at 31.12.2005	851 104

At the end of 2005, the company reclassified a real estate item acquired in the summer of 2005 for the purpose of developing a complete living environment. The reclassification of the object from inventories to investment property in the amount of 259 205 thousand kroons was conditioned by problems occurring in the course of preparation of the architectural drawings, and requirements which could not be taken into consideration upon passing of the initial resolution.

As a real estate company, the Group employs professional certified appraisers. Intra-group appraisers are thus, as a rule, used for determining the fair value of investment property. Additionally, the Group's Management Board has used independent appraisers for determining the fair value of 11 real estate objects with a book value of 710 394 thousand kroons (2004: three objects worth 344 645 thousand kroons).

Assessment of the fair value of investment property to be leased out is based on the estimated annual 2% increase in rental income and 2-3% increase in expenditures. The annual vacancy rate of the leased-out premises was an average of 3%. The discount rate for project termination falls between 10% and 11.5%. As regards land lots recognised as investment property, the fair value was determined based on comparable market transactions, as well as the volume and price of the potential building right.

Total rentals earned from investment property amounted to 49 204 thousand kroons (2004: 58 960 thousand kroons). Expenses directly related to the management of investment property (incl. repairs and improvements) amounted to 11 102 thousand kroons (2004: 25 545 thousand kroons).

The Group made capitalised improvements in existing investment property in the amount of 14 168 thousand kroons in 2005 (2004: zero).

In order to secure its borrowings, the Group has pledged, as of the end of 2005, real estate objects recognised as investment property in the total amount of 694 280 thousand kroons (2004: 353 189 thousand kroons).

As of 31.12.2005, the Group had incurred a total of 5 453 thousand kroons of payables related to acquisitions of investment property (2004: 1 300 thousand kroons), incl. finance lease liability for investment properties acquired in 2005 in the amount of 1 450 thousand kroons. The payable for the investment property acquired in 2005 was offset with the Group's previous receivable from the same company in the amount of 9 570 thousand kroons.

Borrowing costs in the amount of 7 815 thousand kroons were capitalised under investment property in 2005 (2004: zero).

23 Property, plant and equipment

in thousands of kroons

	Land and buildings	Machinery and equipment	Other equipment	Construction in progress & prepayments	Total
Balance at 31.12.2003	18 539	2 205	1 895	16 191	38 830
Purchases	1 873	277	347	6 725	9 222
Additions from business combinations	0	0	0	394	394
Disposals	-706	-39	-60	0	-805
Disposals related to sales of joint ventures (Note 17)	0	-735	-172	0	-907
Depreciation charge	-470	-488	-818	0	-1 776
Reclassifications ¹	-5 628	-55	-319	-2 051	-8 053
Balance at 31.12.2004	13 608	1 165	873	21 259	36 905
<i>Cost at 31.12.2004</i>	<i>17 112</i>	<i>4 349</i>	<i>7 360</i>	<i>21 259</i>	<i>50 080</i>

<i>Accumulated depreciation at 31.12.2004</i>	-3 504	-3 184	-6 487	0	-13 175
Purchases	171	650	1 763	157 271	159 855
Additions from business combinations	3 616	1 022	635	5 915	11 188
Capitalised borrowing costs	0	0	0	3 616	3 616
Disposals	0	-234	-166	0	-400
Disposals related to sales of subsidiaries (Note 16)	0	-387	-78	0	-465
Depreciation charge	-679	-566	-1 178	0	-2 423
Reclassifications ¹	240	-186	1 089	-35 018	-33 875
Balance at 31.12.2005	16 956	1 464	2 938	153 043	174 401
<i>Cost at 31.12.2005</i>	<i>24 860</i>	<i>4 911</i>	<i>7 125</i>	<i>153 043</i>	<i>189 939</i>
<i>Accumulated depreciation at 31.12.2005</i>	<i>-7 904</i>	<i>-3 447</i>	<i>-4 187</i>	<i>0</i>	<i>-15 538</i>

¹In 2005, the Group purchased a real estate with an unfinished office building. The purchase was made with the aim of reconstructing and developing the existing office building for future lease-out or sales. Upon its completion, the object was reclassified from PPE into investment property in the amount of 20 621 thousand kroons (incl. capitalised borrowing costs in the amount of 343 thousand kroons). In 2004, a total of 6 151 thousand kroons worth of real estate objects were reclassified into investment property.

As of 31.12.2005, the Group has capital commitments in the total amount of 79 103 thousand kroons (2004: zero) related to contracts of construction of real estate objects recorded under construction-in-progress.

The book value of capitalised improvements reclassified from PPE into inventories in 2005, amounts to 15 533 thousand kroons (2004: 902 thousand kroons). The value of real estate objects which were purchased for business premises development purposes and reclassified from investment property into PPE in 2005, amounts to 2 051 thousand kroons (2004: zero). 228 thousand kroons (2004: zero) of plant boxes were reclassified from biological assets into PPE in connection with the change in their purpose of use.

As of 31.12.2005, total payables for purchases of PPE amount to 860 thousand kroons (2004: zero).

The Group has pledged 167 651 thousand kroons of PPE as collateral to its borrowings (2004: 13 417 thousand kroons).

24 Intangible assets

in thousands of kroons

	Goodwill ¹	Negative goodwill ²	Software	Total
Balance at 31.12.2003	15 893	-7 081	513	9 325
Purchases	0	0	437	437
Additions from business combinations (Notes 16, 18)	102	-12 835	0	-12 733
Amortisation charge	-2 146	0	-276	-2 422
Negative goodwill recorded as income	0	19 916	0	19 916
Balance at 31.12.2004	13 849	0	674	14 523
<i>Cost at 31.12.2004</i>	<i>18 816</i>	<i>0</i>	<i>921</i>	<i>19 737</i>
<i>Accumulated amortisation at 31.12.2004</i>	<i>-4 967</i>	<i>0</i>	<i>-247</i>	<i>-5 214</i>
Purchases	0	0	177	177
Additions from business combinations (Note 18)	7 535	-24	0	7 511
Disposals related to sales of subsidiaries (Note 16)	-1 204	0	-75	-1 279
Negative goodwill recorded as income	0	24	0	24

Amortisation charge	0	0	-263	-263
Impairment loss	-7 109	0	0	-7 109
Balance at 31.12.2005	13 071	0	513	13 584
<i>Cost at 31.12.2004</i>	<i>13 071</i>	<i>0</i>	<i>1 083</i>	<i>14 154</i>
<i>Accumulated amortisation and impairments at 31.12.2004</i>	<i>0</i>	<i>0</i>	<i>-570</i>	<i>-570</i>

¹A goodwill impairment test was conducted at the end of the year. As a result, goodwill was written down by 7 109 thousand kroons. The write-down was caused by determining the fair value of an investment property associated with the goodwill on the basis of discounted cash flows. The value of the investment property was determined by analysing the cash flow from the real estate object in the next five years, with an estimated annual 2% increase in revenue and expenses, a 3% annual vacancy rate of the lease premises, and a 10% annual discount rate. The investment property was revalued to its fair value after the above analysis. Since goodwill associated with the object was based on previously estimated future cash flow from the investment property, the test of recoverable amount revealed that the cash flows from the real estate object no longer exceeded the amount of investment property and goodwill recorded in the balance sheet before the write-down.

As of 31.12.2005, goodwill is divided between the construction segment (11 948 thousand kroons) and development segment (1 123 thousand kroons).

Judgements and estimates used upon measuring the recoverable amount of goodwill of the construction division

- recoverable amount was determined based on the value-in-use;
- basis for the management's forecast on cash flows:
 - forecasted growth in the volume of environmental construction projects in Estonia (arising from the EU requirements), and the related opportunities to participate, in the next five years, in public procurements worth 880 million kroons. The Group forecasts an annual 20-30% increase in environmental construction revenue, and an increase in gross profit from 3.5% p.a to 7.7% p.a. Due to the higher quality indicators of the environmental construction company of the Group and efficiency of the technology developed in Estonia, the revenue increase of the Group companies has forecasted a bit higher than that of other companies operating in the same branch.
 - forecast of aggressive growth of the real estate market, and the market demand for residential and commercial buildings. The revenue forecast is based on the number of square metres to be constructed, the average sales price per square metre, and growth in these indicators, compared to the previous period. The number of square meters to be constructed is forecasted to increase by 26% in 2006, 51% in 2007, 46% in 2008 and an annual 14-20% thereafter. The price of the average square metre of construction is forecasted to increase by 21% in 2006, 10% in 2007 and an annual 5% thereafter. The cost of sales forecasted by construction companies makes up 92% of the revenue.
 - an weighted average cost of capital (WACC) of 13.65% used for discounting free cash flow associated with construction companies. A specific risk of 10% is added upon calculation of the continuing cash flow (CCF). CCF is thus calculated based on the WACC of 23.65%.
- Cash flow forecasts are based on the budgets approved by the Management Board for the next five years.

Judgements and estimates used upon measuring the recoverable amount of goodwill of the Development Division:

- recoverable amount was determined based on the value-in-use;
- the management uses previous experience regarding leased-out business space upon forecasting cash flows:
 - an annual 2% increase in rental revenue and an annual 2-3% increase in expenses;

- an annual 3% vacancy rate of the lease space;
- the forecasted discount rate of 11.5% upon exiting the project;
- cash flow forecasts are based on the budgets approved by the Management Board for the next five years.

² The part of the fair value of assets, liabilities and contingent liabilities acquired from business combinations, which exceeds the acquisition cost of the business combination, is recorded as negative goodwill.

The Group has pledged intangible assets of 95 thousand kroons (2004: 182 thousand kroons) as collateral to finance lease contracts (see also Note 30).

25 Borrowings

in thousands of kroons

	31.12.2005	31.12.2004
Overdraft ¹	8 415	22 646
Portion of long-term borrowings payable within next financial year, incl.:	41 160	47 226
Bank loans	37 029	43 407
Other loans	2 976	472
Finance leases (Note 30)	1 155	3 347
Short-term bank loans and bonds	253 294	135 575
Other short-term loans	13 984	12 337
Total short-term borrowings	316 853	217 784

¹ The Group has been provided with an overdraft facility, with a credit limit of 37 500 thousand kroons as of 31.12.2005 (2004: 35 000 thousand kroons). Bank overdraft has been guaranteed with the Group's assets with a total carrying amount of 24 727 thousand kroons (2004: 20 884 thousand kroons).

	31.12.2005	31.12.2004
Total long-term borrowings	433 452	385 915
incl. portion payable within next financial year	41 106	47 226
incl. portion payable after 1 year, incl.:	392 346	338 689
Bank loans	372 756	269 124
Other loans	14 142	48 685
Finance leases (Note 30)	5 448	20 880

In 2005, short- and long-term bonds were issued in the total nominal amount of 285 300 thousand kroons (2004: 31 500 thousand kroons). The average effective interest rate of issues was 4.6% (2004: 4.8%). The short- and long-term bonds have been presented under short- and long-term bank loans, respectively.

Interest rates of borrowings	2005	2004
Overdraft	5.0%	5.9%
Short-term bank loans	4.7%	4.9%
Other short-term loans	6.6%	4.0%
Long-term bank loans	4.9%	5.1%
Other long-term loans	7.8%	5.8%

Additional information on borrowing collaterals has been presented in Notes 31.

All borrowings of the Group has been fixed in Estonian kroons or euros.

26 Other payables

in thousands of kroons

	31.12.2005	31.12.2004
Accounts payable	53 808	18 487
<i>Other payables</i>		
Payables to joint ventures (Note 35)	192	209
Payables related to transactions with securities ¹	7 821	8 554
Payables related to transactions with non-current assets, except financial assets ²	6 214	0
Other payables ³	17 350	6 730
Total other payables	31 577	15 493
<i>Taxes payable</i>		
Value added tax (VAT)	1 669	1 528
Income tax from dividends	3 195	2 102
With-holding income tax	1 686	1 139
Social tax	2 701	1 809
Other taxes payable	1 769	115
Total taxes payable	11 020	6 693
<i>Accrued expenses</i>		
Interests	2 463	833
Payables to employees	5 936	4 445
Dividends payable	6 134	6 781
Other accruals ⁴	6 804	4 872
Total accrued expenses	21 337	16 931
Total payables	117 742	57 604

¹ Payables related to transactions with securities as of 31.12.2005 and 31.12.2004 consist of current portion of liabilities from increasing the interests in the equity of subsidiaries in 2004. The non-current portion of the specified liability has been presented under other long-term payables (see Note 29).

² Payables relate to transactions with non-current assets as of 31.12.2005 include payables to related parties arose from purchase of real estate (see Note 35). The payable with interest of 0% will be settled in 2006. Payables to non-related parties arose from purchases of non-current assets in the total amount of 4 863 thousand kroons (2004: 1 300 thousand kroons) have been presented under "accounts payable".

³ Other payables as of 31.12.2005 include payables to related parties in the total amount of 15 894 thousand kroons (2004: 6 384 thousand kroons). See also Note 35 "Related parties transactions".

⁴ Other accruals as of 31.12.2005 include, among other, the arrangement fee in the amount of 1 408 thousand kroons payable for the issue of shares of Arco Vara AS.

27 Prepayments

in thousands of kroons

	31.12.2005	31.12.2004
Prepayments received from sales of real estate	29 876	10 604
Prepayments received from long-term service agreements ¹	8 051	6 739
Other prepayments	3 434	1 449
Total prepayments	41 361	18 792

¹ Long-term service agreements	31.12.2005	31.12.2004
Costs incurred and recognised profits of long-term service agreements	144 268	22 681
Invoices issued	-144 276	-17 589
Total adjustment of revenue	-8	5 092
incl. increasing revenue (accrued income) – see Note 14	8 043	1 647
incl. decreasing revenue (prepaid income)	-8 051	-6 739

28 Short- and long-term provisions

in thousands of kroons

	Guarantee provision ¹	Provision for profit of the client ²	Other provisions related to business ³	Total provision
Balance at 31.12.2003	176	0	1 111	1 287
Additional provision recorded during the year	57	0	127	184
Balance at 31.12.2004	233	0	1 238	1 471
Additional provision recorded during the year	58	351	0	409
Provision used during the year	0	0	-138	-138
Balance at 31.12.2005	291	351	1 100	1 742
incl. long-term provision	0	0	1 100	1 100

¹ The guarantee provision related to construction is based on previous years experiences, i.e., the actual guarantee expenses incurred in 2004 to 2005 and the amount of projects with guarantee periods as of 31.12.2005. The guarantee provision is established for covering the expenses that are expected to occur during the guarantee period. The guarantee period is 2 years.

² According to one construction agreement, the client has a right to receive 80% of the difference between the contract price and the actual cost of the project under the contract. Due to this clause the Group has a recorded provision on the profit to be paid to the client based on the stage of completion of the project. The project will be completed in 2006.

³ With references to various transactions that have taken place before the balance sheet date, the Group has recorded provisions in the total amount of 1 100 thousand kroons for covering possible expenses associated with these transactions, that are expected to occur in future periods. In the opinion of the management the risk related to the specified transactions passes in 4 to 6 years.

29 Other long-term payables

in thousands of kroons

	31.12.2005	31.12.2004
Payables to joint ventures (Note 35)	0	76
Payables related to transactions with securities ¹	8 817	15 666
Payables related to transactions with non-current assets, except financial assets	327	0
Other payables	1 969	5 332
Total other long-term payables	11 113	21 074

¹ Payables related to transactions with securities as of 31.12.2005 and 31.12.2004 consist of liabilities from increasing the ownership in the equity of subsidiaries in 2004. The liability has been discounted with the rate of 6% p.a and the interest expenses for 2005 amounted to 1 245 thousand kroons. The current portion of the liability has been presented under other short-term payables (see Note 26).

30 Finance and operating leases

in thousands of kroons

Finance lease: the Group as a lessee

in thousands of kroons	31.12.2005		31.12.2004	
	Minimum lease payments	Net present value of minimum lease payments	Minimum lease payments	Net present value of minimum lease payments
Within 1 year	1 751	1 155	4 672	3 347
After 1 year, but not more than 5 years	5 804	5 117	17 027	12 910
Over 5 years	359	331	9 630	7 970
Total minimum lease payments	7 914		31 329	
Future financial expenses	-1 311		-7 102	
Net present value of minimum lease payments	6 603	6 603	24 227	24 227

	31.12.2005	31.12.2004
Book value of leased assets:		
Investment property	58 150	45 582
Property, plant and equipment	799	299
Intangible assets	95	182
Inventories	0	2 406
Total book value of leased assets	59 044	48 469

Operating leases: the Group as a lessor

Future minimum lease payments under non-cancellable lease agreements:	31.12.2005	31.12.2004
Within 1 year	6 669	8 723
After 1 year, but not more than 5 years	8 790	35 580
Over 5 years	13 844	69 604
Total	29 303	113 907

Operating leases are leases of investment property items. Annual minimum lease payment of operating leases have been disclosed in Note 22.

Operating leases: the Group as a lessee

In 2005, the Group used premises, cars and office equipment under operating lease agreements. The total operating lease expenses amounted to 6 935 thousand kroons (2004: 5 839 thousand kroons).

31 Assets pledged

in thousands of kroons

The Group has pledged the following assets as a collateral for the borrowings of the Group:

	31.12.2005	31.12.2004
Real estate recorded under inventories	99 225	134 839
Property, plant and equipment	167 651	13 417
Intangible assets	95	182
Investment property	694 280	353 189
Biological assets	3 175	3 042
Floating charge	1 287	0
Total pledged assets	965 713	504 669

32 Share capital

in thousands of kroons

	31.12.2005	31.12.2004
Issued and fully paid-in-capital (pcs.)	30 453 037	8 400
Share capital	304 530	4 200
Share premium per share (in kroons)	4,04	1 052,5
Total share premium	123 083	8 841

As of 31.12.2005, the maximum number of common shares allowed by the Articles of Association of the Parent is 109 021 872 (2004: 33 600).

In 2005, Arco Vara AS split the shares by reducing the nominal value of the share from 500 kroons to 10 kroons. With the split, the number of shares was increased by 411 600. Thereafter, 268 355 thousand kroons were transferred to the Parent's share capital through bonus issue at the expense of equity without making additional contributions. With the bonus issue, 26 835 468 new shares were issued at a nominal value of 10 kroons.

In December 2005, the Parent increased the share capital by 3 197 569 shares through private placement. The nominal value of new shares is 10 kroons. The shares were issued with a share premium amounting to 124 491 thousand kroons. The service charges related to the arrangement of the issue, which have been recorded as reduction of the share premium, amount to 1 408 thousand kroons and are payable in 2006 (see Note 26). A monetary contribution was made for the shares issued and share premium.

The Parent has a conditional redemption obligation with respect to certain shares, which may realise at the end of 2008. According to the Group's management, realisation of the conditions required for the

counterparty to be able to use the resale option is unlikely. The contractual shares have thus been recorded under equity. Due to confidentiality of the terms and conditions of the contract, no detailed information is provided on the above transaction in these consolidated financial statements.

33 Contingent liabilities

in thousands of kroons

Income tax on dividends

The Group's retained earnings as of 31.12.2005 amounted to 100 811 thousand kroons (2004: 262 120 thousand kroons). The maximum possible tax liability related to the payment of the Group's retained earnings as dividends amounts to 23 187 thousand kroons (2004: 62 909 thousand kroons). Thus, the Group can pay dividends in the total amount of 77 624 thousand kroons (2004: 199 211 thousand kroons).

The maximum possible tax liability has been calculated based on the assumption that the net dividends and the related income tax together do not exceed the retained earnings as of 31.12.2005.

Legal claims

Claim filed against the joint venture AS Tallinna Olümpiapurjespordikeskus (hereinafter AS TOP)

Regati Valduste OÜ (the other shareholder of AS TOP) and Urmas Uustal, member of the Supervisory Board of AS TOP, filed an action against the joint venture AS TOP, demanding nullification of the resolution of the Supervisory Board of AS TOP on the sale of a 21374/175937 legal share of the company's real estate; as well as an application for prohibition of the transaction and an application for securing the action. Harju County Court (the former Tallinn City Court) satisfied the application for securing the claim, and made a notation concerning prohibition of disposal of the share of the real estate owned by AS TOP in the land register.

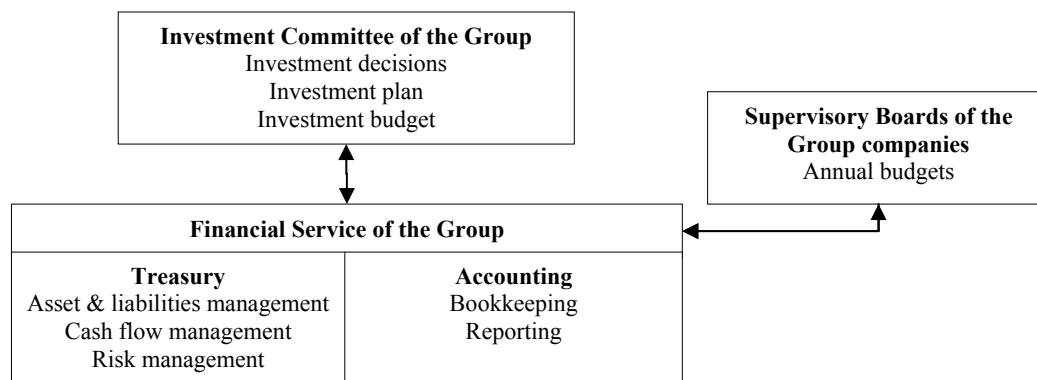
The joint venture contested the decision of the Tallinn City Court in the Tallinn Circuit Court, which satisfied the appeal. The notation concerning prohibition was thus cancelled.

The court case is still pending at the time of preparation of these financial statements. According to the Group's management, the claim is unfounded — no breach of procedure for passing resolutions has occurred in the joint venture AS TOP. In the current financial statements, the contested transaction has been recorded as disposal of investment property. In 2005, no provision was established for liabilities may arise from the court case. If the transaction was cancelled, the Group's investment property and liabilities would increase in the amount of the proportional share (50%) of the fair value of the sold real estate (i.e. 141 250 thousand kroons).

34 Financial instruments and financial risk management

in thousands of kroons

Risk management in Arco Vara Group is based on the notion that corporate success depends on continual risk monitoring, accurate risk evaluation and skilful risk hedging. In order to hedge risks, the Group has developed several policies and implemented various activities so as to ascertain the risks, and disperse the risks over time, fields of activity, and geographical areas. The main purpose of risk management is to prevent any damage that could endanger sustainability of the Arco Vara Group's equity or operations. The Group's risk management structure has been brought out below:



In order to improve risk management in the Group, a risk forecast and asset management unit was established under the Financial Service of the Group in 2005. The main substantial changes in the Group's risk evaluation and management were conditioned by the halt in EURIBOR decrease on the loan market. During the EURIBOR decrease, long-term investment projects were partially financed by short-term loans. This incurred temporary open positions upon project liquidity management (temporal differences between cash inflows and cash outflows). Now that the EURIBOR is rising, the time of a project completion and financing terms will be matched. The Group has also, for the first time in its history, concluded interest rate swap agreements in order to fix the floating interest rates of long-term liabilities, and thus hedge the interest risks involved.

Liquidity risk

Liquidity risk arises from the potential change in the financial position, reducing the Group's ability to generate sufficient positive cash flows for settlement the obligations assumed in time.

Above all, the following factors have an effect on the Group's liquidity risk:

- The ability of the Group companies to independently generate positive net cash flows; and the seasonality of these cash flows;
- the terms of receipt/payment of assets/liabilities;
- marketability of long-term assets;
- volume and speed of real estate development activities;
- volume and speed of acquisitions of new investment property;
- financing proportions.

Liquidity management in the Financial Service is based on a strategy which is adjusted in accordance with the changes in the Group's investment plan. Any such changes are approved by the Investment Committee consisting of the Parent's Supervisory Board and Management Board members.

Short-term liquidity management is based, above all, on the annual budgets approved for the Group companies. The purpose of short-term liquidity management is to guarantee sufficient availability of highly liquid assets (i.e. cash and cash equivalents, quickly disposable real estate). Short-term liquidity management is mostly conducted through the cash pool account of the Group companies.

Long-term liquidity management is effected, above all, by the decision of the Investment Committee. The purpose of long-term liquidity management is to match the time of cash flows from investing and financing activities, and to find a suitable financing proportion.

The amount of cash and cash equivalents required for ensuring sustainability of the usual business activities of the Group companies (i.e. short-term liquidity) depends on the season, and amounts to 10-30 mln kroons.

As regards long-term projects, the Group makes sure that the term and amount of cash flow from investing activities would not significantly differ from the term and amount of cash flow from financing activities. As a rule, the Group does not accept investment projects where the required equity financing exceeds 30% of the total cost of the project.

The maturity of financial assets and financial liabilities as of 31.12.2005:

	< 1 year	1-5 years	>5 years	Total
ASSETS				
Cash and cash equivalents	143 985	0	0	143 985
Receivables	96 370	10 559	6 408	113 337
Financial investments into securities	0	3 003	0	3 003
Total assets	240 355	13 562	6 408	260 325
LIABILITIES				
Borrowings	316 853	332 322	60 024	709 199
Payables	117 742	11 113	0	128 855
Total liabilities	434 595	343 435	60 024	838 054

As a result of reclassification of real estate from inventories into investment property (see also Note 22), the Group's current ratio was less than 1 at the end of the year. Quickly disposable assets worth at least 300 000 thousand kroons have been recorded under non-current assets (long-term financial investments, investment property, PPE and intangible assets) in accordance with the purpose of their acquisition. If we take into account the above liquid non-current assets, the actual current solvency of the Group has significantly improved from last year. As a result of the activities undertaken for matching the duration of the above projects and the terms of financing, liquidity improvement is also starting to be reflected in the financial ratios calculated on the basis of the balance sheet.

The EURIBOR decrease of previous years favoured short-term loans. In 2006, the Group aims at bringing the terms of repayment of the loans to be refinanced and new loans into accordance with the duration of the investment projects (an average of 3-5 years). See also "Interest risk" below.

Currency risk

Currency risk involves the potential losses arising from unfavourable changes in currency exchange rates with respect to the Estonian kroon. On the Group's home markets (Estonia, Latvia and Lithuania), local currencies have been fixed against the euro. In order to hedge the currency risk of the Group companies, a majority of the transactions is made and contracts concluded in euros, or currencies tied with the euro. The main currency risk therefore has to do with the risk that, with the adoption of the euro, the exchange rates between local currencies and the euro will be significantly changed compared to the current rates. Considering the low probability of devaluation of local currencies, and the share of the Baltic countries in the Group's activities, the exposure to the currency risk is thus considered modest.

The Group launched its operations in Ukraine in 2005. The Ukrainian hryvnia (UAH) has not been fixed against the euro. Unlike on the home market, operations in Ukraine therefore result in open currency positions. Any currency risk arising from open positions is hedged with euro-based transactions between countries, as well as local standardisation of the terms of receipt and payment. Consequently, and considering that the share of Ukrainian-based activities is very small in the Group, the Group estimates the present need for hedging currency risks, as well as the risks arising from currency exchange rate fluctuations, to be small.

Interest risk

Interest risk involves the risk of changes in interest rates, and the consequent effect on the results of the Group's operations. The Group's long-term borrowings have, for the most part, been associated with EURIBOR. Therefore, the Group is exposed to the events on the international financial markets. The long-term EURIBOR decrease has been brought to a halt, and the interest rate is showing initial signs of a moderate rise. Therefore, the primary purpose of interest risk management in the Group is to fix the floating interest rate of long-term borrowings. The Group plans to fix these rates upon assuming long-term interest-bearing liabilities. The first steps were taken in the second half of 2005, with the interest rates of EURIBOR-based three-year bonds fixed with the interest rate swap agreement:

Nominal amount of hedged transaction	5.43 million euros
Maturity date	01.12.2008
Interest payments	twice a year
First interest payment	01.06.2006
Basis of interest calculation	30/360 days
Fixed interest rate of swap agreement	3.05% p.a
Floating interest rate fixed for first settlement (6-M Euribor)	Fixed on 01.12.2005 at 2.597% p.a
Fair value of swap as of 31.12.2005	-169 thousand kroons

Upon managing short-term interest risks, the Group regularly compares potential losses arising from interest rate changes against risk hedging expenses. No transactions have, so far, been concluded with financial instruments for purposes of hedging the short-term interest risk, since the Group believes the hedging expenses to exceed potential losses arising from interest rate fluctuations.

Interest-bearing receivables and liabilities of the Group as of 31.12.2005

Fixed interest rates	According to maturity date			
	< 1 year	1-5 years	>5 years	Total
Interest-bearing receivables	23 878	7 385	0	31 263
Interest-bearing liabilities	117 041	98 281	2 480	217 802
Net position	-93 163	-90 896	-2 480	-186 539

Floating interest rates	According to repricing date			
	< 1 year	1-5 years	>5 years	Total
Interest-bearing receivables	0	0	0	0
Interest-bearing liabilities	484 224	0	0	484 224
Net position	-484 224	0	0	-484 224

The above table does not contain long-term receivables and liabilities with a contractual 0% interest, which have been discounted at a rate of 5-6%. Bonds which have a contractual interest rate of 0% but which were issued with discount, constitute an exception to the rule and is included in the above table.

Credit risk

Credit risk involves the potential losses arising from the counterparty's inability to perform his liabilities to Arco Vara Group. Considering the amounts involved, credit risk constitutes the biggest risk for the Group. Credit risk management mostly involves monitoring of accumulated credit risk concentration in the Group. Credit risk prevention and minimizing involves daily monitoring and directing of the clients' payment behaviour. This allows operative application of the necessary measures. In addition, sales and construction activities are partially financed by prepayments from customers. In order to hedge the risks involved, the Group also co-operates with various banks, since

many real estate transactions are financed through credit institutions. Consequently, the company deems overall credit risk exposure to be hedged.

Allowances are made for covering known potential losses. Evaluation of potential losses is carried out on the basis of previous experience as well as the current outlook of the counterparty and the overall economic environment.

The Group companies conclude transactions only with counterparties previously deemed creditworthy. Immediate payment is demanded for transactions, or additional collaterals that cover the risks involved. Consequently, the management deems the need for additional credit risk hedging to be minimal. The maximum potential credit risk equals to the total book value of receivables, cash and cash equivalents and other financial investments.

Fair value

The principal financial assets and liabilities of the Group companies are recorded in the balance sheet — i.e. the Group has no known off-balance sheet financial assets and liabilities not recorded in these financial statements. As a result of the accounting and reporting principles applied, the book value of the financial assets and liabilities of the Group companies does not significantly differ from their fair value, which has been determined based on the discounted cash flow method. The fair value of receivables and payables with fixed interest rates is not considered different from their book value, since the fixed interest rate does not significantly differ from the prevalent interest rates on the market.

35 Related parties transactions

in thousands of kroons

Transactions with joint ventures:

The Group companies purchased and sold goods and services from/to the following Arco Vara Group joint ventures. The amounts below do not include the part of transactions and balances eliminated in the consolidated financial statements of the Group.

	2005	2004
Sales	7 254	6 057
Purchases	60	303
Balances:	31.12.2005	31.12.2004
Short-term receivables (Note 14)	6 575	2 408
incl. loans granted	1 758	2 303
incl. interests receivable	63	42
incl. accounts receivable	4 754	63
Long-term receivables (Note 19)	850	19 825
incl. loans granted	850	19 825
Total receivables from joint ventures	7 425	22 233

Loans granted to joint ventures (unsecured) as of 31.12.2005 earn an interest of 6-15% p.a (2004: 4-7% p.a) and the maturity dates of these loans are range of 2006 to 2008 (2004: 2005 to 2017).

	31.12.2005	31.12.2004
Short-term liabilities (Note 26)	192	209
Long-term, liabilities (Note 29)	0	76
Total payables to joint ventures	192	285

Transactions with other related parties

Sales	2005	2004
Companies related through the owners of the Group	435	500
Companies related through the management of the Group	1 394	0

Purchases	2005	2004
Owners of the Group and companies related through the owners of the Group	18 917	500
Companies related through the management of the Group	2 573	2 192

Short-term loans granted	31.12.2005	31.12.2004
Owners of the Group and companies related through the owners of the Group	19 284	12 970
Close relatives of the owners of the Group	1 240	0
Total short-term loans (Note 14)	20 524	12 970

Other short-term receivables	31.12.2005	31.12.2004
Companies related through the owners of the Group (Note 14)	1 723	1 507

Long-term loans granted	31.12.2005	31.12.2004
Owners of the Group and companies related through the owners of the Group (Note 19)	5 380	0

Other long-term receivables	31.12.2005	31.12.2004
Companies related through the management of the Group	699	741

Loans granted to other related parties (unsecured) as of 31.12.2005 earn an interest of 4-15% p.a (2004: 4-6% p.a) and the maturity dates of these loans are range of 2006 to 2008.

As of 31.12.2005 the Group owed to companies related through the owners of the Group for the purchase of real estate under property, plant and equipment 6 214 thousand kroons (see Note 26). The liability will be settled in 2006.

As of 31.12.2005 the Group owed to companies related through the management of the Group for the purchases of investment property during 2005 and 2004 the total amount of 12 068 thousand kroons (2004: 6 384 thousand kroons).

The Group has received interest-free and unsecured loans from the companies related through its management in the total amount of 3 826 thousand kroons (2004: 3 305 thousand kroons – presented under borrowings). These loans will be repaid in 2006.

In 2005, the remuneration paid to the members of the management of the Group amounted to 5 809 thousand kroons. The members of the Management Board of the Parent have the right to termination benefits. The maximum amount of such benefits as of 31.12.2005 is 1 440 thousand kroons.

36 Events after the balance sheet date

in thousands of kroons

Mergers

In January 2006, the fully owned subsidiary - Arco Vara Ärijuhtimise OÜ – was merged with Arco Vara AS. The merger had no effect on the financial position and the result of operation of the Group.

The acquisition of ownership in the Group companies from minority interests

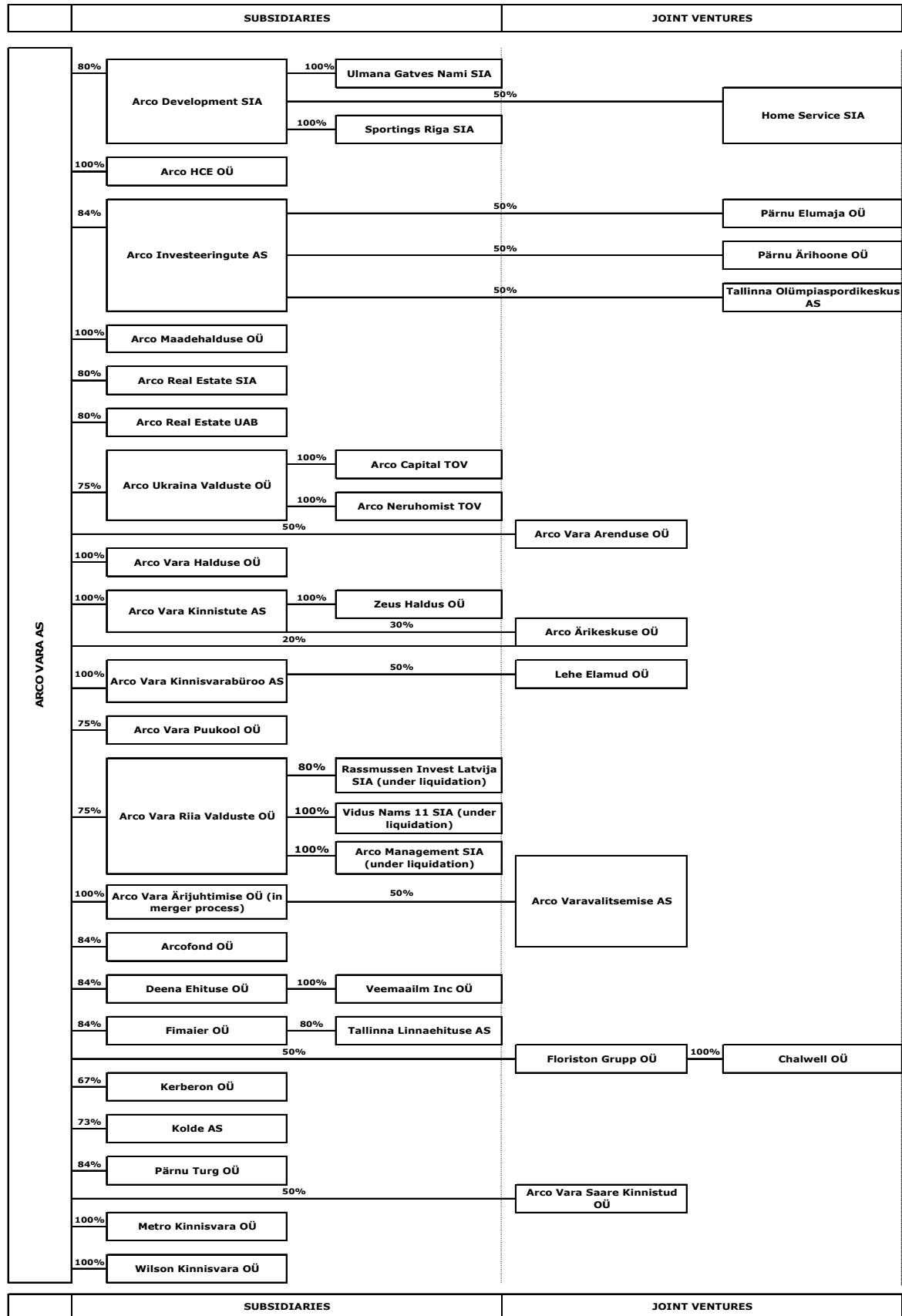
In March 2006, the Group purchased the following minority interests:

Companies	Ownership before transaction	Ownership acquired	Ownership after transaction
Arco Investeeringute AS	84.0%	16.0%	100.0%
Kolde AS	73.4%	15.5%	88.9%
Kerberon OÜ	67.35%	16%	83.4%
Arcofond OÜ	84%	16%	100.0%
Pärnu Turg OÜ	84%	16%	100.0%
Deena Ehituse OÜ	84%	16%	100.0%
Fimaier OÜ	80%	20%	100.0%

The total purchase price of the specified ownerships was 41 964 thousand kroons to be paid within the next two years. No interest on the payable amount has been agreed in the contract.

37 Group structure of Arco Vara AS

As of 31.12.2005



38 Main statements of the Parent as required by Estonian Accounting Act

in thousands of kroons

The main statements of the Parent as required by the Estonian Accounting Act are not prepared as separate financial statements of the Parent as described in IAS 27.

Income Statement

	2005	2004 ¹
Sales revenue	4	0
Cost of Sales	0	0
Gross profit	4	0
General and administrative expenses	-2 920	-170
Operating loss	-2 916	-170
Gain or loss from shares in subsidiaries and joint ventures	9 900	53 370
Other financial items and investment activity income (expenses)	4 284	293
Profit before income tax	11 268	53 493
Income tax expense	0	-259
Net profit	11 268	53 234

¹ Comparative data has been restated – see additional information in Note 3.

Balance Sheet

	31.12.2005	31.12.2004 ¹
ASSETS		
Cash and cash equivalents	422	3
Short-term financial investments	0	49
Receivables	327 891	81 079
Prepaid expenses	0	1
Total current assets	328 313	81 132
Long-term financial investments	94 110	47 138
Total non-current assets	94 110	47 138
TOTAL ASSETS	422 423	128 270
LIABILITIES AND EQUITY		
Borrowings	90 488	34 298
Payables	20 300	19 497
Total current liabilities	110 788	53 795
Long-term borrowings	85 000	0
Other long-term payables	9 292	15 666
Total non-current liabilities	94 292	15 666
Total liabilities	205 080	69 461

Share capital	304 530	4 200
Share premium	123 083	8 841
Legal mandatory reserve	420	420
Retained earnings	-210 690	45 348
Total equity	217 343	58 809
TOTAL LIABILITIES AND EQUITY	422 423	128 270

¹ Comparative data has been restated – see additional information in Note 3.

Statement of Changes in Equity

	Share capital	Share premium	Legal mandatory reserve	Other reserves	Retained earnings	Total
Balance at 31.12.2003 (previously stated)	4 200	8 841	400	308	171 093	184 842
Effect of change in accounting policy (see Note 3)	0	0	0	-308	-172 959	-173 267
Balance at 31.12.2003 (restated)	4 200	8 841	400	0	-1 866	11 575
Dividends	0	0	0	0	-6 000	-6 000
Increase in legal mandatory reserve	0	0	20	0	-20	0
Net profit for the year	0	0	0	0	53 234	53 234
Balance at 31.12.2004	4 200	8 841	420	0	45 348	58 809
Bonus issue (Note 32)	268 355	-8 841	0	0	-259 514	0
Issue of new shares (Note 32)	31 975	123 083	0	0	0	155 058
Dividends	0	0	0	0	-7 792	-7 792
Net profit for the year	0	0	0	0	11 268	11 268
Balance at 31.12.2005	304 530	123 083	420	0	-210 690	217 343

Cash Flow Statement

	2005	2004
Operating loss	-2 916	-170
Increase in receivables and prepayments related to operating activities	-447	-658
Increase in payables and prepayments related to operating activities	313	12
Other financial items	0	29
Total cash flows from operating activities	-3 050	-787
Acquisition of subsidiaries and joint ventures	-8 893	-43 702
Proceeds from sale of subsidiaries and joint ventures	250	86 877
Acquisition of other investments	-34	-179
Proceeds from sale of other investments	50	40
Loans granted	-61 709	-38 624
Repayments of loans granted	5 774	6 669
Interests received	1 522	0
Change in receivable related to the cash pooling agreement of the Group	-229 748	-33 984
Dividends received	9 003	0
Total cash flows used in investing activities	-283 785	-22 903
Loans received	283 362	31 693

Repayments of borrowings	-142 693	-8 000
Change in overdraft	8	0
Interests paid	-885	0
Proceeds from issue of share (see Note 32)	156 466	0
Dividends paid	-9 003	0
Total cash flows from financing activities	287 255	23 693
<hr/>		
NET CASH FLOWS	420	3
<hr/>		
Cash and cash equivalents at the beginning of the year	3	0
Change in cash and cash equivalents	420	3
Effect of changes in exchange rates on cash and cash equivalents	-1	0
Cash and cash equivalents at the end of the year	422	3

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Arco Vara AS

We have audited the consolidated financial statements of Arco Vara AS and its subsidiaries (hereafter “the Group”), set out on pages F-81 through F-137 of the Offering Circular, which comprise the consolidated balance sheet as of December 31, 2005, the consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2005, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The financial information of Arco Vara AS as a parent company in Note 38 is presented because it is required by the Estonian Accounting Law and is not a required part of the consolidated financial statements prepared under International Financial Reporting Standards. Such financial information has been subject to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is prepared in all material respects in accordance with the requirements of the Estonian generally accepted accounting principles and in relation to the consolidated financial statements taken as whole.

Tallinn, May 28, 2007

Hanno Lindpere
Ernst & Young Baltic AS

The audit of the consolidated financial statements for the financial year ended December 31, 2005 was completed on March 31, 2006, except for the minor financial statements presentational amendments done in 2007 (the Cash Flow statement and Notes 2, 38), as to which the date is May 28, 2007.

AUDITORS' REPORT TO THE SHAREHOLDERS OF ARCO VARA AS

(Translation of the Estonian original)

We have audited the financial statements of Arco Vara AS (hereafter "the Company") for the financial year ended December 31, 2004 and the consolidated financial statements of Arco Vara AS and its subsidiaries and joint ventures (hereafter "the Group") for the financial year ended December 31, 2004, which are set out on pages 7 through 48 of the Annual Report. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company and the Group as of December 31, 2004, and the results of their operations and their cash flows for the financial year then ended in accordance with International Financial Reporting Standards.

Tallinn, April 4, 2005

(Signature)

Hanno Lindpere
Ernst & Young Baltic AS

(Signature)

Marju Põldniit
Authorised Auditor

ANNEX A: COLLIERS INTERNATIONAL APPRAISAL REPORT



**APPRAISAL REPORT
ARCO VARA PORTFOLIO**

TALLINN

07 May 2007

COLLIERS INTERNATIONAL TALLINN

Pärnu rd 102C

Tallinn 11312

Estonia

Ph. +372 6622 777

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INSTRUCTIONS

Pursuant to the agreement for real estate valuation from March 09, 2007 (hereinafter referred to as Contract) between Arco Vara AS (hereinafter referred to as Client) and Colliers International OÜ (hereinafter referred to as Appraiser), the latter has performed the appraisal of the Market Value of the projects/buildings/sites, listed in Proposal. Those 21 projects are assets, which Client considers to be material and make up significant part of development portfolio.

PURPOSE OF APPRAISAL

We understand that this Appraisal Report is required in connection with the proposed listing on Tallinn Stock Exchange and combined offering of the shares of the Client to a) the public in Estonia and Latvia and b) to institutional investors in and outside Estonia and Latvia and in the United States.

Colliers International OÜ hereby gives its consent to the issue of Prospectus and International Offering Circular of Arco Vara AS with its name included in it and with inclusion of its Appraisal Report and references hereto.

Purpose of Appraisal Report is to provide independent Market Values to the Client as of April 16, 2007. Colliers International OÜ has taken reasonable care that information contained in Appraisal Report is in accordance with the facts and does not omit anything likely to affect the import of such information.

ASSUMPTIONS

The Client has provided us with such information as sizes, details of tenure, use, net operating incomes (NOI's) and the like. We have assumed that the information and documentation supplied is correct and that our understanding of the situation is also correct.

We have not calculated nor measured areas and have relied upon areas provided to us, which we assume to have been calculated in accordance with market practice. We take no responsibilities for any inaccuracies.

Past purchase price of the land is disregarded in the calculations.

We have not carried out structural surveys nor have inspected those parts of the properties, which are covered, unexposed or inaccessible and such parts have been assumed to be in good repair and condition. We cannot express an opinion about or advice upon the condition of un inspected parts and this report should be taken as making any implied representation or statement about such parts. We have had regard to the general condition of the properties as observed in the course of our inspection for valuation purposes.

The Appraiser's opinion on the market value of the Object is valid as of the date of the appraisal. The Appraiser shall not be held responsible for any subsequent social, economic, legislative or environmental changes which may affect the value of the Object appraised.

The market value of the Object is determined on the assumption that the Object is free and clear of any lien, is not used to secure a debt obligation and is not under arrest.

Neither Client, nor the Appraiser can use this Report (or any part of it) otherwise than it is stipulated by the Contract between the Client and the Appraiser.

The Appraiser will not be responsible for losses the Client or the third party may incur in the event of dissemination, publication or use of this Report for purposes inconsistent with provisions of this section.

The Appraiser would like to emphasize that in accordance with the Contract between Client and Appraiser the latter is responsible only to Client and is free from any obligations to other parties.

COMPLIANCE WITH STANDARDS AND STATUS OF APPRAISERS

This report has been prepared by Mrs Mare Pavelts and Mr Mairis Zerbelis a Certified Appraisers as defined in the International Valuation Standards (IVS), qualified to give valuation advice on this type of properties and in these locations. The market value is determined in accordance with the International Valuation Standards Committee (IVSC) International Valuation Standards IVS 1 4, European Valuation Standards (EVS).

Colliers International is acting as External Appraisers. An External Appraiser is defined in the Standards as „A valuer that, together with any associates, has no material links with the client, an agent acting on behalf of the client, or the subject of the assignment.”

We confirm that Colliers International has no direct interest in the properties or the parties associated with the latter, and are able to provide independent advice.

EXECUTIVE SUMMARY

Estimated Market Value on April 16, 2007 of the 21 projects/buildings/sites located as indicated in Proposal determined with the discounted cash flow approach or with comparable transactions approach is:

EUR 282'816'000 (two hundred eighty two million eight hundred sixteen thousand euros)

Ardi Roosimaa

Managing Director

Head of Capital Advisory, Baltic States and Belarus

Mare Pavelts

Certified Appraiser, attestation AKH 171203 (Association of Estonian Real Property Valuers)

Eugen Aarna

Assistant of the appraiser

Mairis Zerbelis

Certified Appraiser, attestation 73 (Latvian Association of Property Appraisers)

Ilze Krievina

Assistant of the appraiser

VALUATION METHODOLOGIES

Discounted Cash Flow (DCF) Approach

We have adopted a Discounted Cash Flow approach to best reflect the income characteristics of the investment properties.

The Discounted Cash Flow (DCF) approach is widely used mainly for valuing income-producing properties for investment purposes. Investment properties such as the subject premises are normally valued based on their ability to generate income and on anticipated change in market sentiment. Analysis of properties in terms of their ability to provide sufficient net annual return on investment capital is an important means of developing a value indication.

Projected net incomes over a given period together with the terminal value are discounted back to their present value in line with the cash-flow methodology at a rate commensurate in our estimation with the investment risks inherent to the ownership of the property. Such a conversion of income considers competitive returns offered by alternative investment opportunities.

The discount rate is based upon the return expectation an investor would be willing to accept for such a property. The subsequent sums of each discounted cash flows provides the capital value of the building plus the terminal value, which is discounted back.

Appraisal methodology, which encompasses terminal value, is used in the following projects: Laeva, Ahtri, Tivoli, Ilmarine, PM 80, STÜ Kauplus, AVSK, Enerpoint, Kerberon, Melon, Pärnu Market and TOP Business.

Sales Comparison Approach

The Sales Comparison Approach involves a search for recent sales of comparable property and an analysis of the data as it relates to the subject property. This approach utilizes the price paid in actual market transactions of similar properties to estimate the market value of the subject. This appraisal technique is dependent upon utilizing truly comparable sales data which have occurred near enough in time to reflect market conditions relative to the subject. A correlation of data provides a value estimate for the subject via the Sales Comparison Approach, in light of adjustments based on physical and economic characteristics.

VALUATION SUMMARY BY COUNTRIES

A summary of values is presented below with each property described in more detail onwards in this Report.

Properties in Estonia

Project Name	Town/ Parish	Location	Description	Land, m ²	GLA * or GSA ** sqm	Appraised value of the project, EUR
Tooma	Saue parish	Jõgisoo village	Land plot to be divided into parcels for private house construction	281'000	192'802	2'046'000
Kolde	Tallinn	Helme Str	Land plots for development of residential project	39'565	20'545	9'307'000
Pärtli	Saue parish	Vanamõisa village	Land plot to be divided into parcels for private house construction	200'000	139'500	3'562'000
Vahi	Harku parish	Vääna village	Land plot to be divided into parcels for private house construction	83'480	69'630	1'670'000

Laeva 2	Tallinn	Laeva Str 2	Land plot for development of commercial project	2'698	6'006	7'195'000
Ahtri 3	Tallinn	Ahtri Str 3	Land plot for development of business building	13'911	36'300	44'650'000
Tivoli	Tallinn	Narva Rd 67	Land plots for development of residential and business project	48'698	45'000	45'516'000
TOP arendus	Tallinn	Regati Ave	Land plots for development of residential project	154'563/ 175'937	26'000	22'976'000
Ilmarine	Tallinn	Mustamäe tee Str	Land plots for development of residential and business project	39'503	60'000	51'851'000
Paldiski road	Tallinn	Paldiski Rd	Land plot for development of business building	8'200	21'600	13'983'000
STÜ	Kuressaare	Tallinna Str	Cash flow generating project	4'337	1'692	1'698'000
AVSK	Tallinn, Kuressaare	Rüütli Str, Kotzebue Str-Tln; Raekoja Str-Kuressaare	Cash flow generating project	687; 687; 981; 2'382	992; 38; 415; 1'493	5'316'000
Enerpoint	Kuressaare	Kalevi põik Str	Cash flow generating project	5'251	195; 2'013; 1'321;	852'000
Kerberon	Tallinn	Kadaka tee Str	Cash flow generating project	24'176	1'862; 2'604; 2'324	5'027'000
Melon	Tallinn	Estonia Ave	Cash flow generating project	4'409	6'337; 1'230	12'004'000
Pärnu turg	Pärnu	Suur-Sepa Str	Cash flow generating project	7'663	2'529	2'571'000
TOP Business	Tallinn	Regati Ave	Cash flow generating project	154'563 out of 175'937	23'292	17'123'000
Total						247'347'000

*GLA - (Gross Lettable Area) is a building's total rentable area;

**GSA – (Gross Sellable Area)

Properties in Latvia

Project Name	Town	Location	Description	Land m ²	GSA m ²	Appraised value of the project, EUR
Bišumuiža 1	Riga	Komētas Street	Land plot for development of residential project	36'419	15'753	3'056'000
Baltezers	Riga Region	“Dumpji”, Garkalne District	Land plot to be divided into parcels for private house construction	118'400	97'533	4'456'000
Bišumuiža 2	Riga	Zāļu Street 8	Land plots for development of residential project	111'596	86'388	21'842'000
Ķīpsala	Riga	Balasta dambis	Land plot for development project	53'038	-	6'115'000
Total						35'469'000

SUMMARY

All information gathered has been compiled by the Colliers International local office respectively.

Active demand for investment properties compresses the yield levels towards Central European levels. As most of the deals still happen off market, the yields are to some extent emotionally formed. Levels indicated are taking account market conditions but also reflect our position in where the complete offers could stand.

The actual sales price might rely more to the gross portfolio volume than separate local properties potential.

Disclaimer

The reflected market data is based on Colliers International market data and overviews. In smaller cities it has to be noted the slow market and low liquidity can make predictions very broad.

Confidentiality and Disclosure

The report will be disclosed as stated in the reliance section and the instruction letter.

Before this Valuation Report, or any part of thereof, is reproduced or referred to, in any document, circular or statement, and before its contents, or any part thereof, are disclosed orally or otherwise to a third party, the valuer's written approval as to the form and context of such publication or disclosure must first be obtained. Such publication or disclosure will not be permitted unless, where relevant, it incorporates the Assumptions referred to herein. For the avoidance of doubt such approval is required whether or not Colliers International have been referred to by name.

Yours faithfully,

Colliers International

07 May 2007

DETAILED OVERVIEW OF DEVELOPMENT PROJECTS

Project	Address	Cadastral number	Size, sqm	Description, and tenure	Gross Income from the sales	Purpose of land usage	Appraised value of the project
Tooma	Tooma l. Jõgisoo village, Saue parish, Harju County	72703:002:0101	281'000	Land plot will be divided into 101 small house land plots and sold. Minimum size of the plot is 1'500 sqm. Detailed planning is in process and as it is in compliance with the general plan of the parish, we expect no material obstacles to the validation of this plan. The site is relatively close to Tallinn's satellite town Saue, which provides infrastructure like shops, school, and kindergarten. The developer will sell the plots with communications, namely: water, sewage, electricity, drainage, asphalted inner road, street illumination.	Potential cash flow expected over three years is EUR 3'205'000	Agricultural	EUR 2'046'000
Kolde	Helme 5, Tallinn	78408:803:0091	3'536	Building rights-ground lease from Tallinn city until 2049. There are apartment buildings (5-storeys high), where apartments are being sold starting from EUR 2'045 sqm. 25% of the construction of the whole project is completed. Presently the two houses are sold; apartments in the third house are on sale and fourth house is being built.	Potential cash flow expected within four years is EUR 12'141'000	Residential	EUR 9'307'000
	Helme 7, Tallinn	78408:803:0092	4'081			Residential	
	Helme 9, Tallinn	78408:803:0093	4'559			Residential	
	Helme 11, Tallinn	78408:803:0094	4'191			Residential	
	Helme 13, Tallinn	78408:803:6501	4'562			Residential	
	Helme 16, Tallinn	78408:803:0095	3'105			Residential	
	Helme 16b, Tallinn	78408:803:0096	45			Production	
	Helme 18, Tallinn	78408:803:0097	5'713			Residential and Social	
	Helme Str., Tallinn	78408:803:0098	9'773			Transport	
	TOTAL AREA		39'565				
Bišumuiža 1	Komētas Street, Riga	0100 052 0096	36'419	Building rights-ground lease from Riga City Municipality until 2054, it is planned to purchase land at the end of 2007. Construction of 17 four-storey residential buildings in progress, apartments are being sold for average EUR 1'750 per sqm (net of VAT). First 4 buildings are planned to be completed in December 2007, the project is planned to be completed in March 2009.	Perspective gross income from the sales over the three years is EUR 33'300'000	Dwelling territory	EUR 3'056'000

Project	Address	Cadastral number	Size, sqm	Description, and tenure	Gross Income from the sales	Purpose of land usage	Appraised value of the project
Baltezers	"Dumpji" Riga Region Garkalne District	8060 004 0062	118'400	Land plot will be divided into 53 parcels for private house construction and sold. Average assumed size of the plot is 1'883 sqm. Land parcels are being sold for 75 EUR per sqm (net of VAT). Development plan of Garkalne District has not been accepted yet but as the project is in compliance with the previous version of Garkalne District Development plan, we expect that there won't be any changes except we assume that realization term of the project will be longer.	Perspective gross income from the sales over the three years is EUR 7'315'000	Agricultural	EUR 4'456'000
Bišumuiža 2	Zāļu Street 8, Riga	0100 073 2107	94'974	Owner of the land plots is SPORTINGS RĪGA, Ltd. It is expected to privatize, purchase land out from municipality within 2007. Planned gross construction area is 113'365 sqm, incl. underground parking, outside parking- 700 lots. Construction of residential buildings, apartments are planned to be sold for average EUR 1'780 per sqm (net of VAT). It is assumed that Project will be started in 2007 and will be completed in 2014.	Planned gross income from the sales over the eight years is EUR 153'770'000	Dwelling territory Green territory with low rise buildings	EUR 21'842'000
Pärtli	Pärtli ja Uue-Pärtli 1, Vanamõisa village, Saue parish Harju County	72701:002:0357 72701:002:0359	200'000	Land plot will be divided into 93 small house land plots and sold. Minimum size of the plot is 1'500 sqm. Detailed planning is in progress and as it is in compliance with the general plan, we expect no material obstacles to the validation of this plan. Closeness to Tallinn's satellite town of Saue is an advantage due to infrastructure like shops, school, and kindergarten. The developer will sell the plots with communications, namely: water, sewage, electricity, gas, drainage, asphalted inner road, street illumination.	Potential cash flow expected over three years is EUR 4'639'000	Agricultural	EUR 3'562'000
Vahi	Puistiku I, Vääna village, Harju parish, Harju County	19801:012:0128	83'480	Sellable 69'630 sqm, which consists of 21 land plots for residential purposes. Land plots will be sold with communication networks provided. An average size of the plot is 3'316 sqm, which is larger than average. Hence, the unit price is lower. There is lack of close-by infrastructure as shops, school, and kindergarten.	Potential cash flow expected over three years is EUR 2'071'000	Agricultural	EUR 1'670'000

Project	Address	Cadastral number	Size, sqm	Description, and tenure	Gross Income from the sales	Purpose of land usage	Appraised value of the project
Tivoli	Narva Rd 67, Tallinn	78401:115:2690	48'698	Detailed planning process was initiated in January 2007. Developer expects to obtain construction volume as much as 60'000 sqm, which is very large volume. Density 1,23 at the seashore's plot might not be realisable, particularly in a light of change from social purpose to residential and commercial use. 90% of the volume will be residential purpose and 10% of the volume will be for business use.	Gross income from sales (residential) and net operating income (rent+terminal value): Potential cash flow expected over ten years is EUR 67'008'000	Social	EUR 45'516'000
TOP Development	Regati Avenue 1, 3, (5), Tallinn	78402:202:2990	175'937 (100%) 154'563 (88%)	Under evaluation is imaginary part (88%) of the freehold. Out of this 88% only development part is being evaluated. There are planned 360 apartments for residential use. Average size of the apartments is 72 sqm. The part of town is called Pirita, which is the most highly valued part of town in Tallinn for residences. Current Floor area ratio (FAR) is 0,15 for imaginary part under evaluation. Planned FAR is 0,38.	Potential cash flow expected over five years is EUR 32'621'000	Business and social	EUR 22'976'000
Kippsala	Balasta dambis, Riga	0100 062 0148	24'212	Owner of the land plot with cadastre No.0100 062 2016 is Republic of Latvia, Ministry of Transport, signed land lease with Euroline, Ltd. until 2047 and owner of land plot with cadastre No.0100 062 0148 is Riga City Municipality. Land plot with cadastre No 0100 062 2016 is situated in the territory of Free Port of Riga. According to the Development Plan of Riga, allowed maximal construction intensity is 100% and free territory is 15%, allowed number of storeys is 2 – 3. Construction should be shipping object or object for yachts. Currently ~15'000 sqm from site area to be developed is land and the rest is under the water.	N/a	Commercial territory, nature	EUR 6'115'000
Site area to be developed according to the current Development plan of Kipsala							
			53'038 31'670			Commercial territory	
Laeva 2	Laeva Str 2, Tallinn	78401:114:2510	2'698	Construction right volume validated is 7'800 m2. GI.A ca 6'000 sqm. Footprint size of the building will be 1'300 sqm. There is requested to be built	Upper two floors will be occupied by Arco Vara AS	Potential cash flow expected over ten years is	Residential and business EUR 7'195'000

six-storey high 100% office building, EUR 23'769'000								
Project	Address	Cadastral number	Size, sqm	Description, and tenure	Tenancies	Net Operating Income	Purpose of land usage	Appraised value of the project
Ahtri 3	Ahtri Str 3, Tallinn	78401:114:0051	13'911	Validated above ground construction volume is 48'400 sqm as closed gross area, which means 36'300 sqm as GLA. There is planned retail component together with office premises in the building.	N/a, but as location is excellent we foresee no problems with future occupancy.	Potential cash flow expected over ten years is EUR 147'160'000	Business	EUR 44'650'000
Ilmarine	Mustamäe 5f	78407:701:2450	1'040	FAR expected reasonably to be validated by the city authorities is 2,7.		Potential cash flow expected over ten years is EUR 181'345'000	Production	EUR 51'851'000
	Mustamäe 5b	78407:701:2400	12'710	Land plots at address Mustamäe tee Str 5 have got total area of 33'815 sqm. In total, the ground based construction volume expected by the Client is 80'000 sqm for business use (100%).			Production	
	Mustamäe 5c	78407:701:2350	2'385				Production-business	
	Metalli 15	78407:701:6080	3'671				Production	
	Mustamäe 5d	78407:701:2410	396				Production	
	Metalli 23	78407:701:3300	2'017				Production	
	Mustamäe 5e	78407:701:2420	2'088				Production	
	Mustamäe 5g	78407:701:2390	3'175				Production	
	Mustamäe 5h	78407:701:2380	7'163				Production	
	Mustamäe 5i	78407:701:2360	1'587				Production	
	Mustamäe 5j	78407:701:2430	797				Production	
	Mustamäe 5k	78407:701:2440	1'572				Production	
	Mustamäe 5l	78407:701:2460	902				Production	
	Paldiski road	Paldiski Rd 80, Tallinn	78406:601:0010	8'200	Detail planning process initializing is being requested. Volume requested is relatively high 28'800. FAR is 3,51, which may not be achievable	N/a	Potential cash flow expected over ten years is EUR 54'739'000	Business

DETAILED OVERVIEW OF CASH FLOW GENERATING PROJECTS

Project	Address	Cadastral number	Size, sqm	Description and tenure	Tenancies	Net Operating Income	Purpose of land usage	Appraised value of the project
STÜ	Tallinna Str 77, Kuressaare, Saare County	34901:003:0094	1'623	Building rights, ground lease. Cash flow generating project, as business and retail centre together with servicing plot as parking area.	N/a	First year EUR 138'000	Residential (actual use is retail)	EUR 1'698'000
	Kalevi põik 6, Kuressaare, Saare County	34901:003:0072	2'714				Residential (actual use is retail)	
	Tallinna Str 79, Kuressaare, Saare County	34901:003:0171	6'716	servicing plot as parking area.			Transport, parking	
AVSK	Rüütli 16 / 18, Tallinn, Harju County	78401:101:3700	687	Leasable area size is 992 sqm, which consists of 72% office premises and 28% catering premises.	AS Inrestaator, office and catering	First year EUR 28'000	Residential / business	EUR 2'378'000
	Rüütli Str 16 / 18-2, Tallinn, Harju County	78401:101:3700	687	Size of the apartment property is 38,2 sqm.	Formerly apartment contract currently.	First year EUR 0	Residential/ business	EUR 146'000
	Raekoja Str 10, Kuressaare, Saare County	34901:011:0055	2'382	Called Rae Centre located in the very centre of town Kuressaare in the island of Saaremaa. GLA is 1'493 sqm.	Anchor tenant is Saaremaa Consumer's Association, which occupies 85% of the building. Lid ABC Saare OÜ occupies 7% of the building. The other minor tenants are: Lid HM Grupp Saare OÜ, Lid Lillekoda OÜ, Lid Eurex Capital OÜ, Lid OÜ M.S.I. Loto, SEB Eesti Ühispank.	First year EUR 172'000	Business	EUR 2'538'000
	Kotzebue Str 18c, Tallinn, Harju County	78408:801:0118	980	Leasable area size is 415,4 sqm, of which 84% is storage premises and 16% is office premises.	Lid OÜ Elkerg 100%	First year EUR 17'000	Business	EUR 254'000

Project	Address	Cadastral number	Size, sqm	Description and tenure	Tenancies	Net Operating Income	Purpose of land usage	Appraised value of the project
Enerpoint	Kalevi põik 7, Kuressaare, Saare County Kalevi põik 7a, Kuressaare, Saare County Kalevi põik 7b, Kuressaare, Saare County	34901:003:0030 34901:003:0053 34901:003:0054	3 647 678 926	Closed gross area is 2208 sqm. Usufruct fee is received, while amount is being fixed, indexation 2% in a year and back purchase price is also fixed.	Ltd Enerpoint OÜ	First year EUR 80'000	Production Production Production	EUR 852'000
Kerberon	Kadaka tee 131, Tallinn	78405:502:1290	24 176	Building rights-ground lease until 2051. Usufruct fee yearly payable to City of Tallinn is EUR 14'416.	Main tenants are Prategli Invest OÜ (57% of the areas), AS Industek (20%), Ltd Küttemaailm OÜ (9%). Owner is Ltd OÜ Kerberon, which also belongs (2/3) to Arco Investeeringute AS.	First year EUR 405'000	Production	EUR 5'027'000
Melon	Estonia Avenue 1/3, Tallinn	78401:102:0080	4 409	Footprint size is 1'979 sqm and GLA is 6'337 sqm (main building).	The main tenants are Ltd Atko Halduse OÜ, A&G Kaubanduse AS, Hewlett Packard, Ltd IMG Numeri OÜ. All in all, 47 different tenants. Lessees tend to rotate quite often due to insufficient parking capacity and uncomfortable planning of the building.	EUR 732'000	Business-production	EUR 12'004'000
Pärnu marketplace	Suur-Sepa Str 18, Pärnu	62511:084:1670	7 663	City of Pärnu marketplace. One-storey building located at the edge of the city centre, where sellers trade with their merchandise. Market place has been there for a number of years and is frequently used mostly by price sensitive people.	Ca 124 tenants	EUR 203'000		EUR 2'571'000
TOP Business	Regati Avenue 1, 3, (5), Tallinn	78402:202:2990	175'937 (100%) 154'563 (88%)	Under evaluation is imaginary part (88%) of the total freehold. Out of mentioned 88%, here, the cash flow producing part of it is being evaluated. Income from existing buildings and from the port administration is reflected here.	N/a	First year EUR 1'074'000 0	Business and social	EUR 17'123'000

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