AS Merko Ehitus

Listing and Trading Prospectus

AS MERKO EHITUS (the "Company" or "MERKO EHITUS" and together with its subsidiaries the "Group"), registry code 11520257, a limited liability company incorporated in Estonia, has been established as a result of division of AS Järvevana (former business name AS MERKO EHITUS) (the "Division"). AS Järvevana, registry code 10068022, a limited liability company incorporated in Estonia, is currently listed on the Main List of the Tallinn Stock Exchange. On 30 April 2008 AS Järvevana announced through the Tallinn Stock Exchange the conclusion of a notarized division plan (the "Division Plan"), setting forth the terms and conditions of the Division. The General Meeting of shareholders of AS Järvevana approved the Division Plan on 3 June 2008 and the Division was registered in the Estonian Commercial Register on 1 August 2008, which is also the date of incorporation of the Company. According to the Division Plan, AS Järvevana was divided by separation, such that all of its assets and business, including all movables and property, rights and obligations (the "Business") were transferred to the Company, except for the obligations arising from the criminal case No 05913000055 ("Criminal Proceedings"), including damages, penalties and other claims along with legal costs and corresponding assets to cover possible obligations related to the criminal case. No assets were transferred to any other party in the course of the Division. For more details on the Division see "Information about the Company - Division of AS Järvevana and Establishment of the Company".

In connection with the Division the Company has applied for the listing of all its shares (the "Shares") on the Main List of the Tallinn Stock Exchange (the "Listing") (for general information on the Tallinn Stock Exchange, see "Estonian Securities Market – Tallinn Stock Exchange and the Estonian Securities Market"). The Listing and Surveillance Committee of the Tallinn Stock Exchange is expected to decide upon the Company's listing application on or about 5 August 2008, and in case the decision is positive, trading in the Shares is expected to commence on or about 11 August 2008. This listing and trading prospectus (the "Prospectus") is prepared merely in connection with the Listing of the Shares on the Main List of the Tallinn Stock Exchange. The Prospectus has been prepared by the Company in accordance with the Estonian laws implementing the 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 (the "Prospectus Directive") and in accordance with the Commission Regulation (EC) 809/2004 of 29 April 2004 implementing the Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (the "Prospectus Regulation") and its subsequent amendments. This Prospectus and the Listing does not constitute an offer to sell, or a solicitation of an offer to buy, any of the Shares in any jurisdiction to any person by the Company or any of its shareholders.

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

NEITHER THE SHARES NOR THEIR DISTRIBUTION HAS BEEN OR WILL BE REGISTERED UNDER THE U.S. SECURITIES ACT OR WITH ANY SECURITIES AUTHORITY OF THE UNITED STATES OR ANY STATE OF THE UNITED STATES, AND THE SHARES MAY NOT BE RE-OFFERED OR RE-SOLD WITHIN THE UNITED STATES OR FOR THE ACCOUNT OF U.S. PERSONS (AS DEFINED IN REGULATION S OF THE U.S. SECURITIES ACT OF 1933) EXCEPT PURSUANT TO REGISTRATION UNDER THE U.S. SECURITIES ACT OF 1933 OR PURSUANT TO AN APPLICABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF U.S. SECURITIES ACT OF 1933. SEE "SELLING RESTRICTIONS".

1 August 2008

The information contained in this Prospectus has been provided by the Company and other sources identified herein. It is prohibited to copy or distribute the Prospectus or to reveal or use the information contained therein for any other purpose than for making a decision to conduct trading with Shares on the Tallinn Stock Exchange.

Persons Responsible

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

Management Board of AS MERKO EHITUS

Tiit Roben	Veljo Viitmann	Alar Lagus	Andres Agukas	Tõnu Korts

Legal Notice

The Listing and this Prospectus will be governed by and construed in accordance with Estonian law. Any disputes relating to the Listing and this Prospectus 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 Listing other than set out in this Prospectus and, if given or made, such information or representation may not be relied upon as having been authorized by the Company.

The distribution of this Prospectus and the offering or sale of the Shares in certain jurisdictions is restricted by law (see “Selling Restrictions”). Persons into whose possession this Prospectus may come are required by the Company to acquaint themselves with and observe such restrictions. Neither the delivery of this Prospectus nor any sale made in connection with the Listing 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 Prospectus in accordance with the applicable provisions of the Estonian Securities Market Act.

NEITHER THE SHARES NOR THEIR DISTRIBUTION HAS BEEN OR WILL BE REGISTERED UNDER THE U.S. SECURITIES ACT OR WITH ANY SECURITIES AUTHORITY OF THE UNITED STATES OR ANY STATE OF THE UNITED STATES, AND THE SHARES MAY NOT BE RE-OFFERED OR RE-SOLD WITHIN THE UNITED STATES OR FOR THE ACCOUNT OF U.S. PERSONS (AS DEFINED IN REGULATION S OF THE U.S. SECURITIES ACT OF 1933) EXCEPT PURSUANT TO REGISTRATION UNDER THE U.S. SECURITIES ACT OF 1933 OR PURSUANT TO AN APPLICABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF U.S. SECURITIES ACT OF 1933.

Each owner or prospective purchaser of Shares must comply with all applicable laws and regulations in force in any jurisdiction in which it purchases, subscribes, offers or sells the Shares or possesses or distributes this Prospectus and must obtain any consent, approval or permission required by it for the purchase, offer or sale by it of the 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 the Company shall bear no responsibility for these obligations.

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

Cautionary Note Regarding Forward-Looking Statements

Certain statements in this Prospectus are forward-looking. Such forward-looking statements and information are based on the beliefs of the Company's management (the "Management"), or are assumptions based on information available to the Company. Whenever used in this document, the words "anticipate", "believe", "estimate", "expect" and similar expressions, as they relate to the Company or its management, are intended to mark the forward-looking statements. Such forward-looking statements reflect the current views of the Company or the 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 contained in this Prospectus as of the date set forth on the cover page.

Presentation of Financial Information and Definition of Terms

As the Company was formed in the course of the Division only recently and lacks itself historical financial information, the annual reports of AS Järvevana for the financial years ended 31 December 2005, 2006 and 2007 and the un-audited condensed consolidated interim financial information for the three months ended 31 March 2008 have been included in this Prospectus. Additionally, the un-audited *pro forma* financial information for the interim period ended 31 March 2008 has been attached to this Prospectus. Such un-audited *pro forma* financial information is intended to give prospective investors a better understanding of what the Company's financial position and results would have been, had the Division taken place and had the Company been registered at the commencement of the period being reported on or at the date reported.

The financial statements of AS Järvevana Group attached to this Prospectus have been prepared in accordance with the International Financial Reporting Standards as adopted by the European Union ("IFRS").

Certain financial information presented in this Prospectus has been obtained directly from the audited financial statements of AS Järvevana Group, while certain other financial information presented herein have been recomputed by the Management from amounts contained in the audited financial statements or have been derived by the Management from un-audited records. Financial information obtained from or recomputed on the basis of the audited financial statements should be viewed only together with the respective audited financial statements as a whole. Certain financial information contained in the audited financial statements attached to this Prospectus have been amended by subsequent financial statements (see Note 1.3. and 1.4. to the financial statement of AS Järvevana for the financial year ended on 31 December 2005). In such cases the amended figures have been used in the Prospectus. Certain financial and other information set forth in a number of tables in this Prospectus has been rounded off for the readers' convenience. Accordingly, in certain instances, the sum of the numbers in a column may not conform exactly to the total figure given.

All references in this Prospectus to (i) "kroon" or "EEK" refer to the official currency of Estonia, (ii) "LTL" or "litas" refer to the official currency of Lithuania, (iii) "LVL" or "lats" refer to the official currency of Latvia and (iv) "euro" or "EUR" refer to the single currency of the EU Member States participating in the European Monetary Union. Solely for the purpose of convenience, this Prospectus contains translations of certain Estonian kroon amounts into litas at the specified rate of EEK 4.53=LTL 1.00, into lats at the rate of EEK 22.19=LVL 1.00 (official exchange rate of the Central Bank of Estonia as of 1 July 2008) and into euros at the specified rate of EEK 15.65=EUR 1.00.

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SUMMARY

This summary should be read as an introduction to this Prospectus. 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 Prospectus, including the financial information presented herein. Any consideration to invest in the Shares should be based on consideration of this Prospectus as a whole by the investor. Where a claim relating to the information contained in this Prospectus is brought before an Estonian court, the plaintiff investor might, under Estonian law, have to bear the costs of translating this Prospectus in the course of the legal proceedings or before such proceedings are initiated. The Company assumes civil liability in respect of this summary only if it is misleading, inaccurate or inconsistent when read in concert with the other parts of this Prospectus.

Overview

The Company has been established as a result of the Division of AS Järvevana (formerly AS Merko Ehitus), a company listed in the Tallinn Stock Exchange since 1997.

On 15 October 2007, the Prosecutors' Office launched Criminal Proceedings against AS Järvevana and its Chairman of the Supervisory Board Mr. Toomas Annus, suspected of bribery and misuse of trust. In the opinion of the management of AS Järvevana the substance of suspicions is incomprehensible to the management of AS Järvevana and AS Järvevana has followed the effective laws of the Republic of Estonia and good industry practices. At a joint meeting held on 14 March 2008, the Management Board and the Supervisory Board of AS Järvevana adopted a resolution to restructure the company and separate operating activities from the Criminal Proceedings related to the land swap transactions, as the filing of suspicions may impact the company's competitiveness as well as the competitive position of the Estonian construction market in general. According to the management of AS Järvevana the restructuring of AS Järvevana was the best way to ensure its sustainable development and to protect the interests of shareholders and employees in the long-lasting Criminal Proceedings related to the land swap transactions.

On 30 April 2008 AS Järvevana concluded the notarized Division Plan, setting forth the terms and conditions of the Division of AS Järvevana. The aim of the Division was to transfer all of the assets and business operations, including all movables and property, rights and obligations of AS Järvevana to the Company, except for the assets and obligations set forth in Annex No. 3 to the Division Plan that were to be retained by AS Järvevana. The Division was approved by the resolution of the General Meeting of shareholders of AS Järvevana on 3 June 2008 and registered in the Estonian Commercial Register on 1 August 2008, which is also the date of incorporation of the Company. Each person who was a shareholder of AS Järvevana on 31 July 2008 at 23:59 received upon the registration of the Division and the establishment of the Company in the Estonian Commercial Register one share of the Company per each share of AS Järvevana held by him/her/it as of the time indicated above. For a more detailed description of the Division see "Information about the Company – Division of AS Järvevana and establishment of the Company".

The principal business activities of the Group are general construction (the construction of office buildings, industrial buildings, public service buildings, residential buildings including development thereof), civil engineering and road construction. In the course of these business activities, the Group carries out and renders the services of general construction, civil engineering, road construction, external networks construction, electrical construction and concrete works.

<u>General Construction</u>
The amplitude of the services of general construction is wide and includes everything that covers the keywords "real estate" and "construction". The general construction service starts with mapping the aims and wishes of the client, includes planning and offering the optimum solution for the client and results in designing, building and delivering the project to the client with a warranty. The general

construction services are rendered especially in the course of construction of office buildings, industrial buildings, public service buildings and residential buildings.

The Management and employees of the Group have specialized education and long-term experience, having worked on general construction for more than 15 years.

Civil Engineering

The civil engineering division builds facilities, if necessary together with designing. The Group builds port structures, landfills, bridges, overpasses, water and sewerage pipelines, water and sewage treatment plants and structures related to environmental protection.

The Group's objective is to maintain high professional level of work and the Management and employees of the Group have long-term experience and professional education. Generally, the projects undertaken by the Group are complicated and unique and require specific skills and knowledge. The Group values cooperation with the contracting entity and the local municipality.

Road Construction

Road construction works are mainly performed by the subsidiary company Tallinna Teede AS, which carries out road maintenance works all over Estonia, both as a project manager and independently. This includes building of road structures, performing road repairs and supervising excavation works and the condition of roads in Tallinn, as well as production of traffic signs and providing machinery repair services.

External Networks Construction

The Company builds external networks of water, sewerage and gas pipelines, installs sewage pumping stations and constructs and renovates storm water systems. The Company carries out works with high quality and in line with the generally recognised building practice; solves water supply and sewerage problems of the clients. External network construction services are rendered in the course of civil engineering activities.

Electrical Construction

The electrical works department of the Company is involved in the design, installation and construction of medium- and high-voltage substations and lines. In addition, subsidiary OÜ Baltic Electricity Engineering is active in planning medium- and high-voltage substations and lines. The Company has an experienced professional project management team.

Concrete Work

The main task of the concrete works department is to offer solutions for buildings and structures made of precast or cast-in-situ concrete, which are built by other units of the Company as well as external contractors. The Company manages, carries out and delivers to the clients the concrete structures of a building.

Development Activities

The development division deals with commercial real estate development activities, including both the preparation of the construction (preparation, planning of detailed plans) and performance of the construction works. The client can order the construction of the required commercial building with the preparation on his property (offices, hotels, trade centres, production buildings etc.), and also to purchase the property in the area developed by the Company, including the planning of the building and construction work on it. With experience in detailed planning and organisation of construction works the objective of the Company is to provide quality service to the clients.

In 2007, the revenue of AS Järvevana Group was EEK 5,510.8 billion, increasing by 24.8% on the previous year. In 2007, Estonia contributed 61.4%, Latvia 25.2% and Lithuania 13.4% to the revenue growth. As compared to 2006, revenue increased by 31.3% in Latvia, 30.9% in Lithuania and 21.2% in Estonia. Engineering construction contributed 10%, residential construction/development 22%, administrative buildings 43%, office buildings 14%, industrial buildings 2% and road construction 9% to AS Järvevana Group's revenue. Of construction activities, 83% accounted for new structure and 17% for renovation and reconstruction works. In 2007, AS Järvevana Group entered into construction contracts with the total volume of EEK 4,351 million and as at 31 December 2007, the AS Järvevana Group's contract backlog totalled EEK 4,136 million.

AS Järvevana Group's revenue for the 3 months ended 31 March 2008 was EEK 1,119.6 million, which constitutes an annual increase of 10.3% on the respective period in 2007. 55.2% of the revenue originated from Estonia, 26.7% from Latvia and 18.1% from Lithuania. As compared with the respective period in 2007, group's sales in Latvia increased by 94.1%, in Lithuania by 19.7% and decreased in Estonia by 10.7%.

Group Structure
AS Merko Ehitus, a limited liability company incorporated under the laws of the Republic of Estonia, is the operating parent company of the Group.

As at the date of the Prospectus, the Company has 34 subsidiaries. In addition, the Company owned directly or indirectly through its subsidiaries shares in 6 companies. 19 of the subsidiaries are companies incorporated under the laws of the Republic of Estonia and 14 are companies incorporated under the laws of Republic of Latvia. UAB Merko Statyba is the only Lithuanian subsidiary of the Company. Most important subsidiaries of the Company are SIA Merks in Latvia, UAB Merko Statyba in Lithuania and Tallinna Teed AS, AS Merko Tartu, AS Gustaf, Gustaf Tallinn OÜ, OÜ Baltic Electricity Engineering, OÜ Fort Ehitus, OÜ Woody and OÜ Rae Tehnopark in Estonia. For further information about the Group see "Organizational Structure".

Risk Factors
Prospective investors should carefully consider the risks described under "Risk Factors" in addition to the other information contained in this Prospectus. The risks described under "Risk Factors" are not the only risks that the Group and investors in the Shares will face. Additional risks, which are not currently known to the Group or which the Group currently considers immaterial, may also adversely affect its business, financial condition and the results of its operation. The trading price of the 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".

Management and Employees
The control and management of the Company is divided among the General Meeting of Shareholders, the Supervisory Board and the Management Board. The current members of the Supervisory Board are Teet Roopalu, Jaan Mäe and Tõnu Toomik. The current members of the Management Board are Tiit Roben, Veljo Viitmann, Alar Lagus, Andres Agukas, Tõnu Korts. For further information about the members of the Management Board and Supervisory Board see "Administrative, Management, and Supervisory Bodies and Senior Management".

As of 31 December 2007, AS Järvevana Group had 1,115 employees compared to 897 employees at 31 December 2006. As compared to 2006, the number of AS Järvevana Group's employees increased by 24.3%. All the employment contracts of AS Järvevana were transferred to the Company in the course of the Division. For further information see "Employees".

Articles of Association and Share Capital
The Articles of Association of the Company are in all material aspects in accordance with the requirements of the Estonian law. The Articles of Association were appended to the Division Plan of AS Järvevana (formerly AS Merko Ehitus) signed on 30 April 2008 and were approved as a part of the Division Plan by the General Meeting of shareholders of AS Järvevana on 3 June 2008.

As of the date of this Prospectus, the share capital of the Company is EEK 177,000,000 divided into 17,700,000 ordinary shares with a par value of EEK 10. Each Share entitles its holder to one vote at the General Meeting of Shareholders. The Company has only one class of shares and all the existing Shares rank *pari passu* in all respects. See "Additional Information".

Shareholders and Related Party Transactions
As of the date of this Prospectus, the controlling shareholder of the Company is, according to the share register of the Company maintained at the ECSD, AS Merko Grupp with 71.99% shares of the Company. Other major shareholders with more than 5% shareholdings in the Company as of 1 August 2008 are the clients of Skandinaviska Enskilda Banken Ab (5.88%) and the clients of ING Luxembourg S.A. (5.44%).

AS Merko Grupp is a public limited company registered in the Estonian Commercial Register under registry code 10068039. With the proportion of 65.32% of the holdings of AS Merko Grupp, the ultimate controlling party of the Company is Mr. Toomas Annus. Other shares of AS Merko Grupp are ultimately controlled by Mr. Tõnu Toomik, member of the Supervisory Board of the Company, who controls 12.61% of the shares of AS Merko Grupp; Mr. Viktor Mõisja, who controls 8.56% of the shares of AS Merko Grupp; Mr. Ott Kikkas, who controls 7.2% of the shares of AS Merko Grupp and Mr. Ülo Metsaots, who controls 6.31% of the shares of AS Merko Grupp.

The Group companies have entered into certain agreements with related parties. For the most relevant and material of the recent and on-going agreements see “Related Party Transactions”.

Dividends
The shares of the Company will grant the right to a share of profit of the Company as of entry of the Division in the commercial register of the seat of the Company, and for subsequent periods. See “Financial Information Concerning the Issuer’s Assets and Liabilities, Financial Position and Profit and Losses – Dividends and Dividend Policy”.

Listing and Trading
In connection with the Division, the Company has applied for listing of its Shares on the Main List of the Tallinn Stock Exchange. The Listing and Surveillance Committee of the Tallinn Stock Exchange is expected to decide upon the Company’s listing application on or about 5 August 2008, and in case the decision is positive, trading in the Shares is expected to commence on or about 11 August 2008.

The international securities identification number (ISIN) for the Shares is EE3100098328, the trading code in the Tallinn Stock Exchange trading system is expected to be MRK.

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

Auditors and Legal Advisors
The Company’s auditor for the financial year 2008 is AS PricewaterhouseCoopers, address Pärnu mnt 15, Tallinn 10141, Estonia. The consolidated financial statements of AS Järvevana for the financial years ended 31 December 2005, 2006 and 2007 included in this Prospectus have been audited by AS PricewaterhouseCoopers.

The legal advisor to the Company is AS Advokaadibüroo Tark & Ko, address Roosikrantsi 2, Tallinn 10119, Estonia.

Information Available for Inspection
For the period of validity of this Prospectus, the annual reports of AS Järvevana (formerly AS Merko Ehitus) for the financial years ended 31 December 2005, 2006 and 2007; the un-audited consolidated condensed interim financial information of AS Järvevana for the three month period ended 31 March 2008 and the Articles of Association of the Company are available at its head office located at Järvevana tee 9G, Tallinn, Estonia and on the Company’s website (www.merko.ee). Any interested party may obtain a copy of these items from the Company without charge. References to the Company’s website in this Prospectus should not be deemed to incorporate the information on the Company’s website by reference.

Summary of the Consolidated Financial Statements

As the Company was established only recently and therefore lacks historical financial information, the following tables set forth certain selected financial data in regard to AS Järvevana. As the Company was formed in the course of the Division of AS Järvevana and on the basis of the Business operated previously by AS Järvevana and transferred from AS Järvevana to the Company, the below financial information also illustrates the business and financial condition of the Company. For the effects of the Division on the financial information, see the un-audited pro forma financial information included elsewhere in this Prospectus.

The financial information presented below has been extracted or calculated based on the audited consolidated financial statements of AS Järvevana for the financial years ended 31 December 2005, 2006, 2007, prepared in accordance with IFRS and from the un-audited consolidated condensed interim financial information of AS Järvevana for the three months ended 31 March 2008, prepared in accordance with the IAS 34 Interim Financial Reporting, included elsewhere in this Prospectus.

CONSOLIDATED INCOME STATEMENT DATA

In thousands of EEK	**Three months ended 31 March (un-audited)**		**Year ended 31 December (audited)**		
	2008	**2007**	**2007**	**2006**	**2005**
Revenue	1,119,572	1,014,864	5,510,760	4,414,361	3,232,392
Costs of goods sold	(884,377)	(886,352)	(4,731,752)	(3,727,561)	(2,738,714)
Gross profit	235,195	128,512	779,008	686,800	493,678
Marketing expenses	(7,888)	(5,605)	(32,472)	(23,390)	(22,595)
Administrative and general expenses	(49,373)	(35,610)	(213,806)	(148,792)	(127,632)
Other operating income	1,704	2,102	6,424	148,205	185,052
Other operating expenses	(1,738)	(1,038)	(18,109)	(29,952)	(93,452)
Operating profit	177,900	88,361	521,045	632,871	435,051
Financial income and expenses	(1,762)	3,907	69,694	7,737	28,673
Profit before tax	176,138	92,268	590,739	640,608	463,724
Corporate income tax expense	(20,138)	(881)	(30,830)	(49,917)	(18,437)
Net profit for financial period	156,000	91,387	559,909	590,691	445,287
Incl. net profit attributable to equity holders of the parent company	154,881	88,450	545,049	581,738	438,638
Minority interest	1,119	2,937	14,860	8,953	6,649

CONSOLIDATED BALANCE SHEET DATA

In thousands of EEK					
	31.03.2008 (un-audited)	**31.03.2007 (un-audited)**	**31.12.2007 (audited)**	**31.12.2006 (audited)**	**31.12.2005 (audited)**
ASSETS					
Current assets					
Cash and cash equivalents	356,863	321,903	205,564	676,143	268,446
Trade and other receivables	1,003,458	1,150,910	1,199,566	854,103	542,110
Prepaid corporate income tax	941	1,433	2,376	6,428	2,471

Inventories	2,047,829	1,480,273	2,025,426	1,356,734	964,088
Assets held for sale	-	-	-	733	-
	3,409,091	2,954,519	3,432,932	2,894,141	1,777,115
Non-current assets					
Investments in associates and joint ventures	275,983	204,979	272,964	200,798	179,609
Other long-term loans and receivables	24,214	8,666	14,492	8,476	8,524
Deferred income tax assets	3,392	6,547	3,396	6,592	8,753
Investment property	12,946	3,840	7,361	3,900	42,506
Property, plant and equipment	172,134	99,795	172,912	90,445	199,004
Intangible assets	12,675	10,901	12,574	10,177	4,365
	501,344	334,728	483,699	320,388	442,761
TOTAL ASSETS	3,910,435	3,289,247	3,916,631	3,214,529	2,219,876
LIABILITIES					
Current liabilities					
Borrowings	192,924	223,605	304,879	283,792	114,841
Trade and other payables	939,593	1,076,977	1,015,492	1,081,396	711,236
Corporate and other income tax liability	36,159	19,423	16,718	18,868	950
Government grants	1,498	1,472	1,498	1,498	22,225
Short-term provisions	81,495	80,580	73,212	33,517	21,741
	1,251,669	1,402,057	1,411,799	1,419,071	870,993
Non-current liabilities					
Long-term borrowings	399,165	149,814	397,713	159,335	202,824
Other long-term trade payables and prepayments	54,796	39,470	57,423	23,277	22,726
Deferred income tax liabilities	-	-	-	-	11,385
	453,961	189,284	455,136	182,612	236,935
TOTAL LIABILITIES	1,705,630	1,591,341	1,866,935	1,601,683	1,107,928
EQUITY					
Minority interest	35,058	21,840	33,939	18,904	10,552
Equity attributable to equity holders of the parent company					
Share capital	177,000	177,000	177,000	177,000	177,000
Statutory reserve capital	17,700	17,700	17,700	17,700	8,850
Currency translation differences	(5,976)	(12,077)	(5,085)	(5,751)	(5,059)
Retained earnings	1,981,023	1,493,443	1,826,142	1,404,993	920,605
	2,169,747	1,676,066	2,015,757	1,593,942	1,101,396
TOTAL EQUITY	2,204,805	1,697,906	2,049,696	1,612,846	1,111,948
TOTAL LIABILITIES AND EQUITY	3,910,435	3,289,247	3,916,631	3,214,529	2,219,876

CONSOLIDATED CASH FLOW STATEMENT DATA

In thousands of EEK	**Three months ended 31 March (un-audited)**		**Year ended 31 December (audited)**		
	2008	**2007**	**2007**	**2006**	**2005**
Cash flows from operating activities	276,498	(193,310)	(488,904)	155,687	264,667
Cash flows from investing activities	(10,840)	(90,276)	(73,366)	234,394	(378,115)
Cash flows from financing activities	(113,001)	(68,692)	93,319	21,646	243,108

Change in cash and cash equivalents	152,657	(352,278)	(468,951)	411,727	129,660
Cash and cash equivalents at end of the period	356,863	321,903	205,564	676,143	268,446

THE FINANCIAL RATIOS DESCRIBING THE COMPANY'S MAIN OPERATIONS:*

	Three months ended 31 March (un-audited)		**Year ended 31 December (un-audited)**		
	2008	**2007**	**2007**	**2006**	**2005**
Net profit margin	13.8%	8.7%	9.9%	13.2%	13.6%
Profit before tax margin	15.7%	9.1%	10.7%	14.5%	14.3%
Operating profit margin	15.9%	8.7%	9.5%	14.3%	13.5%
Return on equity per annum	29.6%	21.6%	30.2%	43.2%	48.2%
Return on assets per annum	15.8%	10.9%	15.3%	21.4%	24.9%
Equity ratio	55.5%	51.0%	51.5%	49.6%	49.6%
Current ratio	2.7	2.1	2.4	2.0	2.0
General expense ratio	5.1%	4.1%	4.5%	3.9%	4.6%
Personnel expense ratio	10.9%	12.8%	9.3%	8.0%	7.3%
Debt to equity ratio	27.3%	22.3%	34.9%	27.8%	28.8%
Debt to assets ratio	15.1%	11.4%	17.9%	13.8%	14.3%
Accounts receivable turnover (in days)	60	68	59	46	33
Accounts payable turnover (in days)	40	46	41	45	38
Sales revenue per employee (in million EEK)	1.036	1.119	5.376	5.193	4.651
Average number of full-time employees	1081	907	1025	850	695
Number of shares, thousands	17,700	17,700	17,700	17,700	17,700
Earings per share, in EEK	8.75	5.00	30.79	32.87	24.78

** See "Selected Financial Information" for the explanation of the formulas used.*

RISK FACTORS

Prospective investors should carefully consider the following risk factors in addition to the other information contained in this Prospectus. Any of the risks described below could have material adverse effect on the Company's business, financial condition and results 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.

Prospective investors should note that the risks described below are not the only risks associated with the investment in the Shares. Additional risks not currently known to the Company or that the Company currently believes are immaterial may also have the effect set forth above.

Risks Related to the Company's Business

Growth Management

The Company's operations have grown significantly over the recent years, which has exerted pressure on management capacity. Management expects that in the mid-term it will continue growing, both through organic expansion of its business and through potential acquisitions. The Company 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 Company fails to control its growth and development successfully, this may have an adverse effect on its profits and financial position. The continuing growth requires investments in non-current assets and additional working capital. The availability of additional financing on advantageous terms cannot be assured.

High Working Capital Requirements

Certain business segments, such as road construction, real estate development and construction of environmental structures, require significant working capital. The Company needs to invest in large amounts of working capital to purchase materials and perform engineering, construction and other work on projects before payment is received from the customers. According to the Management, the most working capital intensive projects of the Group are the ones financed by EU related funds where the Company has in the past been forced to accept lengthy payment terms and has effectively funded to greater or lesser extent the working capital requirements of the projects. Management envisages that lengthy payment terms in such projects will be necessary also in the future, and that the Company may need to incur additional indebtedness to satisfy its working capital requirements.

Shortage in working capital may increase the Company's receivables and short-term borrowings. Sustained increase in working capital requirements may have an adverse effect on the Company's financial condition and results of operations.

Management expects the ongoing economic slowdown to negatively impact the construction industry in the short-term. This may intensify the competition and result in more favourable contract terms for the customers including lengthier payment terms, which might further increase the Company's working capital needs.

Increasing Cost of Labour

The rapid economic growth and accession to the European Union have created tensions in the Baltic labour market. Rising demand has created an incentive to increase production, but there is a shortage of labour, which has put pressure on wage rates. Accession to the European Union has increased competition among employers. A large number of construction workers have chosen to work in other member countries where income level is higher. As a consequence, local construction companies have been forced to raise wages and salaries in order to attract qualified workforce and maintain growth. Therefore, the Company may experience rising labour costs and shortage of workers, which can lead to lower profitability and difficulties in meeting deadlines.

Dependence on Key Personnel

The Company relies heavily on the highly qualified engineering, technical and management level personnel. The leaving of several project managers, technicians or business personnel may cause serious damage to Company's business. The future of the Company is dependent on the ability to hire, train and retain such personnel in the future. Should the Company lose one or more key personnel and fail to find a replacement quickly enough, or should such key personnel join a competing business, this could also affect the business and results of operations of the Company. Loss of key personnel may also result in increased risk of unauthorised disclosure or use of the Company's procedures, practices, customer lists and other confidential information.

Under Estonian law, confidentiality and non-competition covenants are enforceable after termination of the contract only when employee has received a special remuneration or other compensation to that effect. In accordance with the Estonian Penal Code it is prohibited and punishable to disclose or use a business secret of which the person became aware in connection with his or her official duties without the permission of the relevant undertaking, for commercial purposes or with the aim to cause damage.

The employment contracts of the Company do not include the confidentiality and non-competition covenants applicable beyond the term of the contract. With a view to the limitations to the enforceability of confidentiality covenants and non-competition covenants, the Company relies largely on other measures designed to encourage loyalty of the workforce, such as competitive compensation and benefits packages.

Dependence on Suppliers and Subcontractors

The Company is not directly dependent on any one of its subcontractors. The main risks associated with suppliers and subcontractors are present on the individual project level. The replacement process of a key subcontractor in a particular project may not be cost-efficient and may result in delays, which in turn may negatively impact the overall profitability and reputation of the Company.

Dependence on Cost of Equipment, Materials and Fuel

The cost of materials make up a large part of the Company's operating expenses. Depending on particular contracts, a significant rise in the price of materials cannot always be passed to the customers, which creates additional risk for the Company. The Company needs various types of construction equipment to carry out its operations. If the prices of the equipment (rent) or the fuel for operating the machinery rises significantly, the Company may experience a notable increase in operating expenses, which may result in lower profitability and worsened financial condition.

Real Estate Development

Residential real estate has been an important source of revenues over the past three years, but it is also the most vulnerable to economic cycles. The management expects the revenues of this segment to decline in the short term. The Company has invested significant amounts in acquiring land plots without a guarantee that it can develop these plots successfully and profitably. Some plots lack detailed planning and no assurance can be given that detailed plans suitable for development can be obtained.

Competition

The Baltic construction market is fragmented and highly competitive. The Company faces competition from both local and international companies, some of which are significantly larger. Some of the largest competitors in the Baltic States are Skanska EMV AS, AS YIT Ehitus, Panevėžio statybos trestas SC, Skonto buve Ltd, SIA PBLC and Ranga Group, AS Eesti Ehitus.

The price is the main factor deciding most tenders. Other factors, such as references, technological expertise, personnel, health and safety records and reputation are important for being accepted as a bidder, but generally do not decide the contractor. Intense price competition favours companies that achieve economies of scale and/or other operating efficiencies. Competitors, some of which are affiliated with large international companies, may benefit from such efficiencies. They may also have more financial resources and marketing capabilities that help them to counterbalance the effects of economic cycles. If the Company fails to survive such price competition and is forced to accept unprofitable projects, it may face difficulties in increasing or maintaining the level of operating revenues.

Dependence on Government Entities or Municipalities as Customers

In the years 2005-2007, customers in the public sector accounted for approximately 30 % of the revenue of AS Järvevana Group. Such projects are often related to European Union initiatives and financed through the European Union structural and other funds subject to extensive bureaucratic requirements. Complications in these projects can delay their completion or result in delays in collection of receivables from the customer. Certain operations of the Company require significant working capital and delayed collection of receivables could significantly adversely affect the Company's liquidity and results of operations. The general consumption slowdown is expected to cut the revenue base of the public sector, weaken the budgets of central and local governments and significantly impair their investment capacities.

Financing and Loan Agreements

The loan and lease agreements entered into by the Company may include several restrictive covenants and requirements to obtain the lender's consent for, among other things, further financing, changes in the Company's corporate structure or the nature of its business, and consolidating or merging with another corporation.

Some of the Company's loan agreements with financial institutions contain customary events of default, including cross-default provisions. These cross-default clauses expose the Company to default risks based on performance under other agreements with the financial institutions in question or other creditors.

Majority of the Company's financial agreements have floating interest rates. Changes in applicable interest rates affect the Company's interest expenses. No financial instruments are used to hedge interest rate risks.

Operations Outside Estonia

In addition to Estonia, the Company operates in Latvia and Lithuania. Due to smaller market share in these countries as compared to Estonia, the Company experiences more competition and is more vulnerable to business cycles. In order to expand its operations and capture market share in Latvia and Lithuania the Company may need to use a significant amount of financial resources. These actions may reflect in the Company's operating results and financial position in the following years.

Contractual Risks

A dispute may arise between the Company and its contractual counterparties on the interpretation or the validity of a contract or fulfilling of contractual obligations, which can lead to arbitration or litigation with an unfavorable outcome for the Company. Contractual claims and other demands may have an adverse effect on the Company's profits and financial position. Most of the contracts concluded in Latvia and Lithuania are governed by the local law and subject to the jurisdiction of local courts, which may impose a risk of foreign law. The Company seeks to cover its exposure for contractual risks mainly through creating provisions for potential claims and legal costs. However, this measure may not always be sufficient.

Credit Risk

The potential inability of customers and suppliers to satisfy their obligations opens the Company to credit risk. Despite the efforts to monitor the financial condition of Company's debtors, defaults may occur. Such events, especially when involving some major partner, may have serious consequences to the Company's financial condition and operating results as well as increase many other risks.

Construction Liability

The Company's construction business inherently exposes itself to potential liability for defects in design, construction, materials or workmanship. The Company may be subject to claims resulting from defects arising out of construction services within the warranty period. Under Estonian 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 cannot be reduced by contract. Claims can be made under the general rules of the statute of limitations for 5-10 years unless the parties have agreed on a shorter claims period in the construction contract. Accordingly, most of the Company'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 extended the statutory warranty coverage.

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

Environmental Issues

The Company's activities are and will continue to be subject to laws and regulations relating to environmental protection. 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 Company complies in all material aspects with the Estonian environmental legislation currently in force. However, as Estonia is a Member State of the European Union, there is a risk that the laws and regulations applicable to construction companies may become more stringent and require an increased level of investment by the Company to comply with such standards of environmental safety.

The Company has been involved in the construction of complex infrastructure projects which generally are subject to numerous, extensive and evolving laws, regulations and permits, including those related to the environmental protection. The Company's construction contracts with its customers also contain terms and conditions related to the environmental matters. Failure to comply with these laws, regulations, permits and contractual terms and conditions could result in substantial cost and liabilities, which could have an adverse effect on the Company's business, its financial condition and results of operations.

The Company, from time to time, acquires land which has been found substantially contaminated. Such land must be cleaned up before the construction can commence. Environmental laws often impose liability on the current property owner whether or not the owner knew of, or was responsible for, the presence of such contamination. On purchase of the land the Company usually requires the seller to warrant that there is no contamination on the land. However, no assurance can be given that the Company can always detect contamination prior to the acquisition of the land, in which case it may have to incur unexpected clean-up costs.

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

Health and Safety

The construction industry generally engages in inherently hazardous 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. On the average five to ten incidents per year have occurred with the employees of AS Järvevana. The Company has adopted appropriate health and safety regulations which 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 Company 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 Company's business and results of its operations. In order to protect itself against this risk the Company has concluded a liability insurance contract covering its operations in Estonia.

Inability to Keep Up with Technical and Technological Developments in Engineering Construction Industry

Pre-qualification is the key for the Company's winning major civil engineering projects. The Company's ability to bid for and win large engineering construction projects is dependent on gaining experience from large engineering, procurement and construction contracts and technically complex integrated projects.

Most of the large international competitors are pre-qualified contractors with strong technical background. If the Company fails to keep up with major developments in engineering construction industry, it may eventually lack qualifications and efficiency to undertake major projects.

Government Regulations May Lead to Increasing Compliance Costs

The cost of complying with government regulations can be substantial. Governmental authorities in the European Union regulate various aspects of the Company's business and operations. The regulations applicable to the Company's existing and future services may change and/or increase substantially. In addition, no assurance can be given that the governments of the Company's core markets would not implement regulations or fiscal or monetary policies, 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 be unable to pass on to third parties, or impose restrictions on the operations of the Company, which could have material adverse effect on the Company's business, results of its operations and financial condition.

Ability to Qualify for, Win and Execute Large Engineering Construction Projects

In selecting contractors for major projects, customers usually only accept tenders from pre-qualified contractors. The selection among pre-qualified contractors relies mainly on price. The Company must keep up with technical and technological developments in the engineering construction industry to qualify for tenders. Furthermore, the Company has to improve its efficiency to be competitive in bidding. If the Company fails to achieve these targets, it may not be able to participate in major projects, which has adverse effect on its market position and, ultimately, on the operating results.

Relationship with the Principal Shareholder

AS Merko Grupp owns and controls 71.99 % of the Shares. As a result, AS Merko Grupp will be able to exercise significant control over most matters requiring shareholder approval, including the election of members of the Supervisory Board and approval of significant corporate transactions, amending the Articles of Association and making changes to the share capital, which could delay or prevent a third party from acquiring control of the Company. The ability of a major shareholder to prevent or delay such transactions could cause a decline in the price of the Shares.

Currency Exchange Risks

The Company is active in Estonia, Latvia and Lithuania where the local currencies are pegged to the euro. There is no guarantee that the central banks of these countries will maintain the current exchange rate in the future. Any devaluation or revaluation of local currencies (EEK, LVL, LTL) may have negative effects on the economy as a whole and on the Company's financial condition and operating results. The Company has covered the local currency and euro risk in the contracts, but this may not prove sufficient in case of devaluation when customers are not able to honor their commitments (currency exchange risk becomes credit risk).

Risks relating to the Division of AS Järvevana

On 15 October 2007, the Prosecutors' Office launched Criminal Proceedings against AS Järvevana and its Chairman of the Supervisory Board Mr. Toomas Annus, suspected of bribery and misuse of trust. In the opinion of the management of AS Järvevana the substance of suspicions is incomprehensible to the management of AS Järvevana and AS Järvevana has followed the effective laws of the Republic of Estonia and good industry practices.

At a joint meeting held on 14 March 2008, the Management Board and the Supervisory Board of AS Järvevana adopted a resolution to restructure the company and separate operating activities from the Criminal Proceedings related to the land swap transactions, as the filing of suspicions may impact the company's competitiveness and the competitive position of the Estonian construction market in general. The delay in the process of Criminal Proceedings related to the land swap transactions launched in 2005 and the accompanying ambiguity and speculation in the media have started to take a toll on the operations of AS Järvevana and thus, harming the interests of AS Järvevana and its shareholders.

The management of AS Järvevana estimated that the restructuring of AS Järvevana was the best way to ensure its sustainable development and to protect the interests of shareholders and employees in the long-lasting Criminal Proceedings related to the land swap transactions. However there is a risk that the ongoing Criminal Proceeding will affect also the reputation of the Company.

According to the Estonian Commercial Code, the companies participating in a division (in the present case AS Järvevana and the Company) will remain jointly and severally liable before creditors for the obligations of the company being divided having arisen before the entry of the division in the Estonian Commercial Register. Therefore, there is a risk that a claim may be submitted against the Company for the obligations of AS Järvavana. However, if such obligations were designated in the Division Plan as obligations remaining with AS Järvevana, the Company could have recourse against AS Järvevana if it would be forced to satisfy the claim of a third party relating to such obligations.

Risks Related to the Industry

Industry is Susceptible to Economic Cycles

The operations of all business lines of the Company are subject to economic cycles, which may either improve or have a negative effect on the financial results of the Company. The construction market and the companies are influenced by a wide range of factors, which are related to economic cycles. Among these are the costs of financing, operational expenses and the demand for the services of construction companies.

In 2008 there has been a slowdown of the economic growth in all the three Baltic States. As against the first quarter of 2007, the rate of growth of GDP in Estonia was as low as 1.4%, in Latvia 3.6% and in Lithuania 6.4%. As regards the development projects of residential buildings and commercial premises, the market will evidently remain passive and is expected to recover not before 2009. For the time being, the largest challenge in the sector is to cope with the narrowing financing opportunities and liquidity problems. The year 2008 will be challenging for the real estate and construction areas. It will be important to adapt to the changing environment and cope with the risks related to theses changes.

Lack of Qualified Personnel and Certain Construction Materials

Accession to the European Union has made it easier for people to work abroad. Because of higher income, a lot of qualified workforce has left to work in other member states. Local companies may not be financially competitive to offer similar working conditions and are therefore exposed to the risk that they cannot increase production even if there is a rising demand for their services. Rather, it is possible that they have to decline new projects in order to meet the deadlines of ongoing projects.

The industry may face lack of certain construction materials, for example when there is a sudden rise in demand. This kind of situation may considerably increase the price of these construction materials and also the operational expenses of the whole industry, which may have an adverse effect on the financial results of the Company.

Risks Related to the Shares

Volatility and Liquidity of Share Prices

There is a vast amount of factors that influence the share prices and trading volumes. The fluctuations in the share prices are often not related to the operating performance of the underlying companies, but dependent on other factors, such as interest rates, the state of the economy, market conditions (including world market), operating results of companies in the same or similar industries, investor confidence, etc. Therefore, there is no certainty in the ability of the shareholders to sell their shares or the price of any such sale.

In 2007, the average daily turnover of Tallinn Stock Exchange was EEK 95.4 million. The average daily turnover of the shares of AS Järvevana was EEK 7.2 million. In the first quarter of 2008, the average daily turnover of Tallinn Stock Exchange was EEK 39.1 million and the average daily turnover of the shares of AS Järvevana for the same period was EEK 2.5 million.

Offer for Sale of Substantial Number of Additional Shares May Depress the Share Price

Sales or issuance of additional Shares into the public market following the Listing could adversely affect the market price of the Shares.

Future Payments of Dividends

There is no certainty whether or how much dividends will be paid in the future by the Company. Among many other factors, including general economic environment, dividend payments are dependent on the financial condition, required investments and operating results of the Company. The payment and amount of any dividend will be subject to discretion of the Company's Management Board, Supervisory Board and, ultimately, the General Meeting of Shareholders. With the holding representing 71.99% of the voting rights in the General Meeting of Shareholders of the Company, AS Merko Grupp is in the position to decide on the payment of the dividends and the amount thereof.

Continued Analyst Coverage

The price and liquidity of Company shares are partly influenced by analyst coverage. If one or many analysts lower their ratings on Company shares, it may result in lower share price and liquidity. If one or many analysts end their coverage of Company shares, it may result in smaller attention to the Company by investors, which again may bring along lower share price and liquidity. There cannot be any assurance, which kind of analyst coverage the Company receives in the future.

Political, Economic and Legal Risks

Risks Related 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 plan economy to independence and a market economy. For purposes of their 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 the European Community law.

The civil code and corporate, competition, securities, environmental and other laws in Estonia, Latvia and Lithuania have been substantially revised during the last decade as part of these countries' 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 court interpretation practice has evolved.

Estonian, Latvian and Lithuanian businesses are in the process of adopting the business standards and practices of the European Union. Many Estonian companies are still adopting and developing management tools for competition law related risks, corporate governance, internal controls and risk management.

Potential Tax Liabilities

Estonia currently enjoys a corporate income tax regime under which the corporate income tax is deferred until profits are distributed. Estonian companies are currently subject to income tax of 21/79 of the net amount of distributed profits. As the law currently stands, the above-mentioned rate is due to decrease gradually over the following years (down to 20/80 as from 1 January 2009, 19/81 as from 1 January 2010 and 18/82 as from 1 January 2011).

In addition, Estonian dividend withholding tax of 21% is currently imposed on dividends paid by the Company to non-resident legal persons, holding at the moment of announcement and payment of dividends less than 15% of the shares or votes of the Company. The withholding tax on dividends will be entirely abolished as from 1 January 2009.

Upon its accession to the European Union in 2004, Estonia was granted a transitional period until the end of 2008 to modify its corporate income tax system, since corporate income tax payable on profit distributions, according to the European Commission, constituted a withholding tax on dividends prohibited under the Parent-Subsidiary Directive (EC Council Directive 90/435/EEC).

On 26 March 2008, the Estonian Parliament adopted amendments to the Estonian Income Tax Act, the purpose of which is to align the Income Tax Act with the Parent-Subsidiary Directive. The amendments will enter into force as from 1 January 2009. Despite the above-described position of the European Commission, the key principle of the Estonian corporate income tax system will remain unchanged: retained (i.e. undistributed) earnings will remain untaxed until distribution.

The new law contains several amendments, such as the new taxable period being a financial year as opposed to a calendar month. Notably, Estonian resident companies will be required to make advance income tax payments calculated on the average actual taxable payments. Also, dividends received from other EU states will be exempt from income tax, irrespective of the holding period or shareholding percentage. As mentioned above, the dividend withholding tax will be entirely abolished as from 1 January 2009. See „Taxation" for more details.

It is currently unclear whether or not the European Commission will challenge the recent amendments and bring the case before the European Court of Justice. In addition, the amendments may be challenged by local businesses wishing to optimize the distribution of retained earnings. Such possibilities create significant uncertainties with regard to the Company's future tax position.

Moreover, it should be noted that 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. Often, differing opinions regarding legal interpretations exist both among and within tax authorities, thus creating uncertainties and areas of conflict. The Company's tax position may be subject to possible review and investigation by tax authorities. If for any reason the Company's tax position were to be disputed by the tax authorities, the possible tax liabilities of the Company could have a substantial adverse impact on the Company's operating results, and therefore could have a material adverse impact on the market price for the Shares.

CAPITALIZATION AND INDEBTEDNESS

The following table sets forth the un-audited capitalization and indebtedness of the AS Merko Ehitus Group as of 31 March 2008. As the Company was established only recently and therefore lacks historical financial information, the following table is based on the Un-audited Pro Forma Financial Information of AS Merko Ehitus included elsewhere in this Prospectus. This information should be analysed in conjunction with the un-audited consolidated codensed interim financial statements of AS Järvevana for the three months ended 31 March 2008 included elsewhere in this Prospectus.

in thousands of EEK (un-audited)	**31 March 2008**
CAPITALIZATION	
Total current debt	**317,924**
- secured	*142,924*
- unguaranteed/unsecured	*175,000*
Total non-current debt (excluding current portion of long-term debt)	**399,165**
- secured	*399,165*
Shareholders' equity	**1,937,247**
Share capital	*177,000*
Statutory reserve capital	*17,700*
Currency translation adjustment	*(5,976)*
Retained earnings	*1,748,523*
TOTAL CAPITALIZATION	**2,654,336**
NET INDEBTEDNESS	
A. Cash and cash equivalents	331,863
B. Trading securities	-
C. Liquidity (A+B)	**331,863**
D. Current financial receivable	**41,127**
E. Current bank debt	129,043
F. Current portion of non-current debt	13,881
G. Other current financial debt	175,000
H. Current Financial Debt (E+F+G)	**317,924**
I. Net current financial indebtedness (H-D-C)	**(80,068)**
J. Non-current bank loans	399,165
K. Other non-current loans	-
L. Non current financial indebtedness (J+K)	399,165

F. Net financial indebtedness (I+L)	**319,087**

AS Järvevana had no other current financial debt as of 31 March 2008.

The Company does not have any contingent liablities, which might impact the Company's indebtedness.

No material changes in capitalization and indebtedness have incurred since 31 March 2008.

INFORMATION ABOUT THE COMPANY

General Information

The Company was established on 1 August 2008 as a result of the Division. The Company's registration data are the following:

Legal and commercial name	AS Merko Ehitus
Country of incorporation	The Republic of Estonia
Registration number	11520257
Date of incorporation	1 August 2008
Legal form	public limited liability company (in Estonian - *aktsiaselts*)
Legislation under which the Company operates	legislation of the Republic of Estonia
Country on incorporation	The Republic of Estonia
Registered address	Järvevana tee 9G, 11314 Tallinn, Estonia
Contact details	Tel.: +372 6 805 105 Fax: +372 6 805 106 E-mail: merko@merko.ee

Division of AS Järvevana and Establishment of the Company

The Company has been established as a result of the Division of AS Järvevana (formerly AS Merko Ehitus). AS Järvevana is currently listed on the Main List of the Tallinn Stock Exchange. On 30 April 2008 AS Järvevana concluded the notarized Division Plan, setting forth the terms and conditions of the Division of AS Järvevana. The Division Plan was published on 30 April 2008 through the information system of the Tallinn Stock Exchange and is available on the web page of the Tallinn Stock Exchange and the below web page of the Company: http://www.merko.ee/eng/investor/generalmeeting/2008.

The aim of the Division was to transfer all of the assets and operations, including all movables and immovables, rights and obligations (the "Business") of AS Järvevana to the Company, except for the assets and obligations that have been set forth in Annex No. 3 to the Division Plan, which are retained by AS Järvevana. AS Järvevana retained EEK 25,000,000 in cash and the following immovable property with the total book value of EEK 36,957,763 as of 31 March 2008:

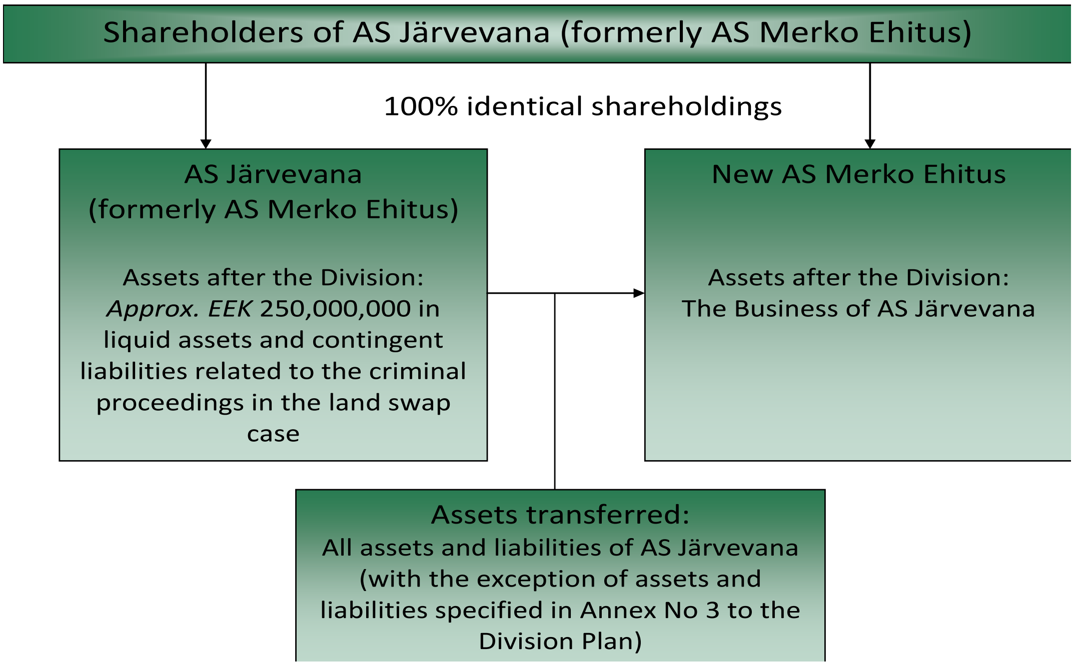
Number of immovable in the Estonian Land Register	Cadastral reference number	Address
152502	19801:002:0962	Harku municipality, Tiskre Village, Kallaste II, Estonia
13290401	78403:315:2670	Tallinn, Valukoja Str 26, Estonia
13290501	78403:315:2680	Tallinn, Valukoja Str 24, Estonia
13291001	78403:315:2730	Tallinn, Valukoja Str 35, Estonia
18460801	78407:701:0177	Tallinn, Tendre Str 55, Estonia

Additionally, AS Järvevana has certain claims and obligations arising from the transactions described in Section "Related Party Transactions". Liabilities related to the criminal case No 05913000055, including the provision reported on the balance sheet of AS Järvevana in the amount of EEK 17,500,000 in connection with the estimated legal costs and off-balance sheet contingent liabilities, including the maximum contingent penalty of EEK 250,000,000, are also retained by AS Järvevana.

The Division was approved by the resolution of the General Meeting of shareholders of AS Järvevana on 3 June 2008. Pursuant to the shareholders' resolution approving the Division Plan and an announcement published by the Management Board of AS Järvevana on 17 July 2008, each person who was a shareholder of AS Järvevana on 31 July 2008 at 23:59 received upon the registration of the Division and the establishment of the Company in the Estonian Commercial Register one share of the Company per each share of AS Järvevana held by him/her/it as of the time indicated. The share capital of both the Company and AS Järvevana amount to EEK 177,000,000 and divides into 17,700,000 shares, each with the par value of EEK 10. The share capital of the Company was deemed paid in by the assets of AS Järvevana, transferred to the Company in the course of the Division. On 18 July 2008 the Management Board of the Company has performed a valuation of the transferable assets, in order to determine that the assets were sufficient to pay in the share capital of the Company. The independent auditors AS PricewaterhouseCoopers have verified the valuation of the assets performed by the Management Board and have issued a report confirming the correctness of the valuation on 18 July 2008. The Division was registered in the Estonian Commercial Register on 1 August 2008, which is also the date of incorporation of the Company. Pursuant to the Estonian Commercial Code, assets to be transferred in the course of the division are deemed transferred to the recipient company and the shareholders of the company being divided are deemed shareholders of the recipient company pursuant to the division plan as of the entry of the division in the Estonian Commercial Register.

According to the Commercial Code, AS Järvevana and the Company shall remain jointly and severally liable for the obligations of AS Järvevana having arisen before the entry of the Division in the Estonian Commercial Register. In relations between themselves only a person to whom obligations are designated by the Division Plan, would be an obligated person. Therefore, even if third parties may require the Company to perform an obligation of AS Järvevana that has arisen before the entry of the division in the Estonian Commercial Register and which was designated in the Division Plan as an obligation remaining with AS Järvevana, the Company may, upon fulfillment of such obligation, have recourse against AS Järvevana.

The following chart provides an additional illustration of the Division:



History and Development of the Company

Even though the Company itself was established only recently and formally lacks corporate history, a summary of the history of AS Järvevana (the company from whom the Company acquired the Business in the course of the Division) is as follows:

- The foundation meeting of AS Järvevana (then AS EKE Merko) was held on 5 November 1990. AS Järvevana (then AS EKE Merko) purchased the assets and liabilities of EKE MRK in 1990.

- In 1992 the company moved to the new head office and production buildings in Saue, Harjumaa.

- In 1995 the company constructs the new head office of Hansabank as the largest project in Tallinn. The company became one of the largest construction companies in Estonia.

- In 1996 all activities not related to construction were separated from the company. The business name of the company was changed to AS Merko Ehitus.

- In 1997 the first public issue of shares of the company was organized. The shares of the company were listed in the main list of the Tallinn Stock Exchange on 22 July 1997. The shares of the company were also traded at the stock exchanges of Munich and Frankfurt.

- In 1998 the company acquired the majority holdings in the subsidiaries OÜ Matek, AS Merko Tartu, UAB Merko Statyba (100%) in Lithuania and SIA Merks (100%) in Latvia. The company became the largest construction company in Estonia and also in the Baltics with consolidated revenue of EEK 843 million.

- In 1999 the head office of AS Eesti Ühispank and Kristiine shopping centre were completed, the business activities were expanded in Latvia and Lithuania. E.L.L Kinnisvara AS was separated from AS Järvevana Group and transferred to AS Merko Grupp, the parent company of AS Järvevana, with the aim to separate the real estate development from the construction. The company focused on the development of main contracting and project management of construction and creating of necessary jobs. The activities were started by the civil engineering division, the fields of activity of which were ports, waste management projects, roads, bridges, water and sewerage utility lines etc. The international quality certificate ISO 9001 was attributed to the company.

- In 2000 Sikupilli shopping centre and Radisson SAS Hotel in Estonia were completed, Grand Palace Hotel in Riga was reconstructed, the production buildings of the brewery Cēsu Alus in Latvia and the head office of Lietuvos Telekomas in Lithuania were built. In the sector of civil engineering in Estonia the landfill of Väätsa was completed and the water supply system of Jõhvi-Ahtme and the water treatment plants of Kuressaare, Valga and Pärnu were also reconstructed. The revenue of the company exceeded EEK 1 billion.

- Related to the growth in demand of the market regarding the single-family houses and apartments the residential construction division of the company was established in 2001. In 2001 the apartment buildings of Tuvi street, family-houses of Teelahkme were among the largest projects completed. The company acquired 100 % of the shares in Tallinna Teede AS, thus expanding into the spheres of road construction and maintenance.

- The largest projects in 2002 included among other things the extension of Kristiine shopping centre and construction of Haabersti Citymarket and Norde Centrum. The construction of Mustakivi trade centre and trade and business centre of Viru square and the head office of Hansabank in Riga were started.

- In 2003 a subsidiary company named OÜ Gustaf Tallinn was founded. The sole share in OÜ Woody was also acquired. The subsidiaries of SIA Merks and UAB Merko Statyba were founded. The new large-scale construction contracts were concluded for the construction of Muuga coal terminal and Estonian Art Museum in Estonia. The former landmark hotel Lietuva of Vilnius was reconstructed.

- In 2004 Viru Centre in Tallinn and the new head office of AS Hansabanka in Riga were completed. SIA Merks started the construction of one of the most complicated development project, multifunctional entertainment centre Arena Riga in Riga. In Estonia, the larger projects completed included Pärnu spa centre and the Tallink City Hotel.

- In 2005 the subsidiary OÜ Merko Kaevandused was transferred to AS Merko Grupp, the parent company of AS Järvevana. As to the large-scale construction projects, the Estonian Art Museum (KUMU), Rävala apartment building, Wendre production building, Muuga coal terminal and the residential and commercial building Admirali house in Estonia were completed. The construction contracts were concluded for the expansion and reconstruction of Tartu water and sewerage network and establishing of Saaremaa deep port with AS Tallinna Sadam (Port of Tallinn). The Second stage of Spice Trade Centre was completed in Riga, capital of Latvia. The construction of the trade centre in Šiauliai city centre was started in Lithuania.

- In 2006 a multifunctional entertainment centre with 12,000 seats was completed in the area of Skanstes street as a result of the joint efforts of SIA Merks and AS Järvevana and the development project of four 24-storeyed apartment buildings was started. As to the large-scale projects, Viimsi school building, Saaremaa deep port, office building of the Bank of Estonia, apartment buildings in the centre of Tabasalu, second stage of the Tallinn Landfill, the set of Iru municipal buildings and water and sewerage utility lines of the City of Valga were completed. The construction of Skulte port and Murjan bridge was started. The cornerstone of the AS Järevana Group's all-time largest construction project - Panorama trade centre – in Vilnius, Lithuania was laid.

- In 2007 Sõpruse Ärimaja, Tornimäe apartment building, Hotel Tallink SPA and Nordic Hotel Forum were completed. In housing construction the new apartment building on Sõpruse pst was completed and second stage of the construction of row houses and apartment buildings in Räägu-Kännu district was finished. In the sector of civil engineering, the extension of Smuuli tee and Puurmani crossing were completed. The arch bridge of Puurmani crossing was announced the winner of "Concrete Building of the Year 2007" by the Estonian Concrete Union. In Latvia, the South Mole of Skulte Port was reconstructed in the first stage. As to the large-scale projects, the house of furniture next to the SPICE trade centre, a modern set of office buildings at the crossing of Duntes/Upes streets, a set of apartment buildings on Kaivase street, trade centre in Valmiera and the representative building of Krajbanka in Skanstese quarter will be completed in Latvia. In Lithuania, the Šiauliai trade centre, industrial building of ELINTA and business and apartment building on Gabijose Street in Vilnius, as own development, were completed.

- In 2007, suspicions on bribe-offering and breach of trust were presented in the criminal case No 05913000055 to AS Järvevana (then AS Merko Ehitus) and its Chairman of the Supervisory Board, Mr. Toomas Annus.

- On 13 March 2008 Latvian government agency, Jaunie tris Brani, made a decision whereby AS Järvevana (then AS Merko Ehitus) and SIA Merks were excluded from the construction tender for the Latvian National Library because of the suspicion in the criminal case No. 05913000055.

- On 1 August 2008, AS Järvevana (then AS Merko Ehitus) was divided. In the process of the Division, the Company was established and the Business was transferred to the Company.

Investments

As the Company was established only recently, hereby information on investments of AS Järvevana in non-current assets during the financial years 2005 – 2007 and the first quarter of financial year 2007 and 2008 is presented. As the Company was formed in the course of the Division of AS Järvevana and on the basis of the Business operated previously by AS Järvevana and transferred from AS Järvevana to the Company, the below information also illustrates the investments of the Company.

Extract from the consolidated balance sheets of AS Järvevana:

in thousands of EEK	31.03.2008 (un-audited)	31.03.2007 (un-audited)	31.12.2007 (audited)	31.12.2006 (audited)	31.12.2005 (audited)
Inventories	2,047,829	1,480,273	2,025,426	1,356,734	964,088
Non-current Assets					
Investments in associates and joint ventures	275,983	204,979	272,964	200,798	179,609
Other long-term loans and receivables	24,214	8,666	14,492	8,476	8,524
Investment property	12,946	3,840	7,361	3,900	42,506
Property, plant and equipment	172,134	99,795	172,912	90,445	199,004
Intangible assets	12,675	10,901	12,574	10,177	4,365
Total investments into non-current assets	**497,952**	**328,181**	**480,303**	**313,796**	**434,008**
Total investments into non-current assets and inventories	**2,545,781**	**1,808,454**	**2,505,729**	**1,670,530**	**1,398,096**

Following is an excerpt from the consolidated cash flow statements of AS Järvevana:

in thousands of EEK	Three months ended 31 March (un-audited)		Year ended 31 December (audited)		
	2008	2007	2007	2006	2005
Change in inventories	(13,433)	(137,643)	(665,436)	(363,595)	(464,906)
Cash flow from investing activities					
Investments into subsidiaries	-	-	(29,575)	(3,029)	(23,985)
Proceeds from sale of subsidiaries	-	6,891	500	(2)	3,376
Subsidiary liquidation	-	-	-	(20)	(694)

proceeds to minority shareholders					
Investments into associates and joint ventures	(1,000)	(3,343)	(3,352)	(7,866)	(136,228)
Proceeds from sale of associates and joint ventures	-	-	-	1,847	8,306
Proceeds from sale of other financial investments	-	-	-	3,004	3
Purchase of investment property	(112)	-	-	-	(63)
Purchase of property, plant and equipment	(3,734)	(11,169)	(48,757)	(76,264)	(226,960)
Proceeds from sale of property, plant and equipment	867	1,267	2,718	290,753	2,143
Purchase of intangible assets	(606)	(1,086)	(4,413)	(6,739)	(2,917)
Sales of a business unit	-	-	-	9,717	2,752
Loans granted	(9,737)	(110,757)	(145,692)	(275,353)	(190,123)
Loan repayments received	-	21,573	134,599	286,953	176,311
Interest received	3,482	6,348	16,226	8,393	6,641
Dividends received	-	-	4,380	3,000	3,323
Total cash flow from investing activities	**(10,840)**	**(90,276)**	**(73,366)**	**234,394**	**(378,115)**

According to the Division Plan, AS Järvevana was divided so that all of its assets and business, including all assets, rights and obligations, except for the assets and obligations referred to above in Section "Division of AS Järvevana and establishment of the Company", were transferred to the Company.

Following is an overview of the investments made by AS Järvevana. The information below is based on the information previously disclosed by AS Järvevana through the Tallinn Stock Exchange. As AS Järvevana has been a listed company on the Tallinn Stock Exchange since 1997, the Management of the Company deems it appropriate to highlight only such information on the investments of AS Järvevana, which AS Järvevana has assessed to be significant enough to be disclosed through the Tallinn Stock Exchange.

Financial Assets

Following is a short overview of main investments of AS Järvevana Group into financial assets (including shares in subsidiaries, associates and joint ventures):

- **2005**

  In December 2005, AS Järvevana acquired the sole share in OÜ Käibevara (purchase price EEK 2,428 thousand) from E.L.L. Kinnisvara AS. OÜ Käibevara was acquired for the purpose of real estate development. In April 2005, AS Järvevana acquired 50% of shares in OÜ Pire Projekt (purchase price EEK 6,150 thousand) and OÜ Constancia (purchase price EEK 2,144 thousand). As a result of these transactions AS Järvevana became the sole shareholder in these companies. In April 2005, AS Järvevana increased the share capital of its Latvian subsidiary SIA Merks. The share capital of SIA Merks was increased by LVL 1,500 thousand (EEK 33,285 thousand). AS Järvevana also made contributions to its subsidiaries, OÜ Maryplus, OÜ Rannamõisa Kinnisvara, OÜ Merko Ehitustööd, OÜ Maavõlur and OÜ Metsailu (each contribution was equal to EEK 40 thousand). AS Järvevana also established OÜ Baltic Electricity Engineering for the purpose of building power systems. OÜ Baltic Electricity Engineering was established with the share capital of EEK 40 thousand. In addition, SIA Merks, a subsidiary of the Company, acquired 50 % share in SIA Zakusala Estates (purchase price EEK 148,319 thousand). SIA Merks also established SIA Arena Riga on 26 January 2005 (please see "Exceptional factors" here below in relation to establishment and activities of SIA Arena Riga).

On July 8 in 2005, AS Järvevana sold its 100% shareholding in the subsidiary OÜ Merko Kaevandused to AS Merko Grupp, the parent company of AS Järvevana, (sale price EEK 4,600 thousand). UAB Merko Statyba, a subsidiary of AS Järvevana, sold its shareholding in UAB Upes Centras to E.L.L. Kinnisvara AS, which is a subsidiary of AS Merko Grupp (sale price EEK 150 thousand). AS Järvevana also sold 14% of the shares in AS Telegrupp, an associate of AS Järvevana (sale price EEK 4,100 thousand). OÜ Talbit, a subsidiary of Tallinna Teede AS, also disposed of its shareholding in AS Bituumen (sale price EEK 5,600 thousand). In addition, AS Insenervõrgud, a joint venture of AS Järvevana, and OÜ Talbit, a subsidiary of Tallinna Teede AS, were dissolved during 2005.

- **2006**

In 2006, AS Järvevana did not acquire any shareholdings. SIA Merks, a Latvian subsidiary of AS Järvevana, sold its 100% shareholding in SIA Arena Riga on December 11, 2006 for EEK 275,500 thousand. In July 2006, AS Järvevana sold 25% of shares in AS Gustaf (sale price EEK 5,100 thousand). AS Järvevana also disposed of its 100% shareholding in subsidiaries OÜ Rannamõisa Kinnisvara (sale price EEK 31,900 thousand) and OÜ Merko Kinnisvara (sale price EEK 40 thousand) and remaining shares of an associate AS Telegrupp (sale price EEK 3,200 thousand).

- **2007**

In 2007, AS Järvevana acquired a 75% share in OÜ Fort Ehitus (purchase price EEK 15,000 thousand). AS Merko Tartu, a subsidiary of AS Järvevana, set up a private limited company named Raadi Kortermaja OÜ with the share capital of EEK 40 thousand. Tallinna Teede AS also acquired 100% shareholding in OÜ Tenever (purchase price EEK 15,000 thousand).

- **2008**

AS Järvevana has not acquired any shareholdings in 2008. On 2 May 2008, AS Järvevana sold the 100% shareholding in OÜ Karulaugu Kinnisvara to AS E.L.L. Kinnisvara. The sale price of the company was EEK 42,000 thousand; of this amount, EEK 4,120 thousand, the balance of the company's financial obligations and current assets, were deducted.

On 21 May 2008, AS Merko Ehitus sold a 50% holding (with the nominal value EEK 20 thousand) in the company OÜ Tornimäe Apartments (registry code 11016607) to the copartner AS EKE Invest. The sale price of the 50% holding was EEK 58,000 thousand.

Fixed Assets and Inventory

For investments in inventories, investment property and property, plant and equipment see notes 17, 22 and 23 to the financial statements of AS Järvevana for the years ended 31 December 2005, 2006 and 2007 included elsewhere in this Prospectus.

The table below illustrates the changes in the inventories, investment property and property, plant and equipment of AS Järvevana Group during the financial years ended 31 December 2005, 2006 and 2007 and during the three months ended 31 March 2007 and 2008.

in thousands of EEK	**31.03.2008 (un-audited)**	**31.03.2007 (un-audited)**	**31.12.2007 (audited)**	**31.12.2006 (audited)**	**31.12.2005 (audited)**
Inventories	2,047,829	1,480,273	2,025,426	1,356,734	964,088
Investment property	12,946	3,840	7,361	3,900	42,506
Property, plant and equipment	172,134	99,795	172,912	90,445	199,004
Total	**2,232,909**	**1,583,908**	**2,205,699**	**1,451,079**	**1,205,598**

Intangible Assets

The balances of intangible assets during the financial years 2005 – 2007 were immaterial. The intangible assets of AS Järvevana Group consisted of software and prepayments. The prepayments were made in relation to update of the software. See also note 24 to the consolidated financial statement of AS Järvevana for the year ended 31 December 2007 included elsewhere in this Prospectus.

Future Investments

In the Division Plan a put option and a call option were agreed. According to the put option the Company has an obligation to acquire from AS Järvevana certain properties for the total consideration of EEK 100 million. According to the call option the company is entitled to acquire from AS Järvevana the same properties for the total consideration of EEK 100 million.The transaction is intended to be financed on account of the Company's own funds and external funds. For further information see "Related Party Transactions".

The Management of the Company has approved the construction of a new warehouse facility in Rae Tehnopark. The total investment, including purchase of the land and the construction of the closed warehouse complex is budgeted to be EEK 16 million. The facility is intended to be used by the Group companies to accommodate construction materials, equipment and machinery. The investment is intended to be financed on account of the Company's own funds.

BUSINESS OVERVIEW

Principal Activities

As upon the Division, the Company acquired the Business (see “Division of AS Järvevana and Establishment of the Company” above), we will refer to the history and activities of AS Järvevana Group as to the history and activities of the Group in this business overview.

The main business activities of the Group are general construction (the construction of office buildings, industrial buildings, public service buildings, residential buildings including development thereof), civil engineering and road construction. In the course of these business activities, the Group carries out and renders the services of general construction, civil engineering, road construction, external networks construction, electrical construction and concrete works.

Following is an overview of the services offered and carried out in relation to the business activities of the Group.

General Construction

The range of the general construction services is wide and includes everything that covers the keywords "real estate" and "construction". The services of general construction starts from mapping the aims and wishes of the client, includes planning and offering the optimum solution for the client and results in designing, building and delivering the project to the client with warranty.

The Management and employees of the Group have specialized education and long-term experience, having worked on general construction for more than 15 years.

The general construction services are rendered primarily in the course of construction of office buildings, industrial buildings, public service buildings and residential buildings.

Out of the works performed the Company would like to set forth most of the new buildings in the downtown of Tallinn - hotel SAS Radisson, SEB Eesti Ühispank, Viru Keskus, Coca-Cola Plaza cinema complex, Tallink City Hotel, Nordic Hotel Forum and Admiral House as well as Tallink Spa & Conference Hotel and the Art Museum (KUMU). In addition to that, the Company has international experience, for example Hotel Lietuva and Lietuvos Telekomas in Lithuania and the head-office of Hansabank and Arena Riga in Latvia.

Civil Engineering

The civil engineering division builds facilities, if necessary together with designing. Port structures, landfills, bridges, overpasses, water and sewerage pipelines, water and sewage treatment plants and structures related to environmental protection are built by the Group.

The objective of the Group is to maintain high professional level of work and the Management and employees of the Group have long-term experience and professional education. Generally, the projects undertaken by the Group are complicated and unique and require specific knowledge. For the Group, it is important to maintain cooperation with the contracting entity and the local municipality.

The Company would distinguish as significant projects the construction of the Muuga coal terminal due to its size and the construction of Puurmani crossing carried out upon the order of the Road Administration, as well as the construction of the Smuuli Road viaduct and water and sewage utility lines of Tartu and Valga. All of the said projects were carried out in Estonia.

Road Construction

Road construction works are mainly performed by the subsidiary company, Tallinna Teede AS, which carries out road maintenance works throughout Estonia, both as a project manager and independently. This includes building of road structures, road repairs and exercise of supervision over excavation works and the condition of roads in Tallinn, production of traffic signs and providing machinery repair services.

External Networks Construction

The Company is building external networks of water, sewerage and gas pipelines, installing sewerage pumping stations and constructing and renovating storm water systems.

The Company carries out works with high quality and according to the good building practice; solves the water supply and sewerage problems of the clients. External networks construction services are rendered in the course of civil engineering activities.

Out of the completed projects the Company would like to set forth installment of pipelines by the closed or directional drilling. A good example is construction of the Pärnu siphons on the Raba, Vingi and Lai street. Furthermore, the important projects are the construction of the external networks of the Rae industrial park, technically complicated extensions of the water and sewage network in Tartu Ropka district and Valga town. All of the said projects are located in Estonia.

Electrical Construction

The electrical works department of the Company is involved in designing, installment and construction of medium- and high-voltage substations and lines. In addition, OÜ Baltic Electricity Engineering is active in planning medium- and high-voltage substations and lines.

The Company has a competent and experienced professional project management team with knowledge in the field of electricity.

Out of the completed projects the Company would like to set forth the reconstruction of the Ülejõe 110 kV substation in Tartu, Estonia and the projects of Tõnismäe substation 110 kV cables in Tallinn, Estonia.

Concrete Work

The main task of the concrete works department is to offer solutions for buildings and structures made of pre-cast or cast-in-situ concrete, which are built by other units of the Company as well as external contractors. The Company manages, carries out and delivers to the clients the concrete structures of a building.

The most important works the Company would like to set forth are the headquarters of SEB Eesti Ühispank, the Postimees building on Maakri Street, Sampo bank building on Narva Road, extension of the Stockmann department store with a parking lot, of Põhjaranna Road viaduct and Radisson SAS Hotel. All of the said works have been conducted in Tallinn, Estonia.

Development Activities

The development division deals with commercial real estate development activities, including both the preparation of the construction (preparation, planning of detailed plans) and performance of the construction works. The client can order the construction of the required commercial building with the preparation on his property (offices, hotels, trade centres, production buildings etc.), or to purchase the property in the area developed by the Company, including the planning of the building and construction work on it. With long experience in detailed planning and organisation of construction works the objective of the Company is to provide quality service to the clients.

Principal Markets

Distribution of Activities

The table below illustrates the division of construction activities of AS Järvevana Group in the years ended 31 December 2005, 2006 and 2007.

per cent	2007 (un-audited)	2006 (un-audited)	2005 (un-audited)
Office buildings	14	15	9
Industrial buildings	2	7	10
Public service buildings	43	31	37
Residential buildings/Development	22	24	17
Civil engineering	10	16	21
Road construction	9	7	6

Over the said period the construction of public service buildings and residential buildings (together with development activities) has contributed the majority of the revenues of the AS Järvevana Group.

Geographical Markets

The geographical markets of the Group are Estonia, Latvia and Lithuania. The geographical distribution of turnover of AS Järvevana Group in the years ended 31 December 2005, 2006 and 2007.

per cent	2007 (un-audited)	2006 (un-audited)	2005 (un-audited)
Estonia	62	63	76
Latvia	25	24	17
Lithuania	13	13	7

Market Overview

To the best of the Company's knowledge, no current, independent, reliable and comprehensive reviews of the competitive situation in the markets in which the Company operates were publicly available prior to the date hereof. As a consequence, in presenting the overview below of the competitive position of the Company in the relevant markets, the management of the Company has relied principally on its own assessment and analysis of such competitive position. In doing so, the management of the Company has used the market information collected by its own staff and advisors for such purpose, either available on the basis of public information or derivable from the same.

The table below illustrates the market share of AS Järvevana Group in the years ended 31 December 2005, 2006 and 2007 on the Estonian construction market.

per cent	2007	2006	2005
AS Järvevana	6.1	6.1	7.0
AS Eesti Ehitus	5.9	5.0	4.5
AS Skanska EMV	3.2	3.9	5.1
AS YIT Ehitus	2.0	2.0	3.4
others	82.8	83.0	80.0

The table below illustrates the market share of AS Järvevana Group in the years ended 31 December 2005, 2006 and 2007 in the construction market of the Baltic States (Estonia, Latvia and Lithuania).

per cent	**2007**	**2006**	**2005**
AS Järvevana Group	3.4	3.7	3.6
Skanska	1.1	1.6	2.0
AS Eesti Ehitus Group	2.1	1.9	1.7
AS YIT Ehitus Group	2.1	0.8	1.6
Panavežio statybos trestas	1.4	1.2	0.9
Others	93.1	90.8	90.2

Exceptional Factors

In 2004, SIA Merks, a Latvian subsidiary of the Company (then of AS Järvevana) engaged in the project of Arena Riga. SIA Merks took the obligation to construct a multifunctional centre in Riga known as the Arena Riga and to finance the construction thereof from its own funds. The construction of Arena Riga had to be completed by 1 February 2006 as the Ice-hockey World Championship games were planned to take place in Arena Riga in spring 2006. As the timely construction of Arena Riga entailed major risks and the construction costs thereof were significantly higher than the recoverable amount of Arena Riga at the completion of its construction, the project was considered financially unfeasible.

The City of Riga decided to offer government grant for the potential developer. As a government grant, a number of immovables were sold to SIA Merks in 2004 and 2005. The purchase price paid for the said immovables was lower than the market price thereof. The difference of the purchase price of the said immovables and the market price thereof was reported as government grant on the accounts of AS Järvevana. The government grant was recognised as revenue in the same period as the impairment loss on the unfinished construction of Arena Riga was recognised. The amount by which the government grant exceeded the impairment loss of Arena Riga was recognised as the revenue of financial year 2005, since it was reasonably certain that SIA Merks would be eligible to the government grant.

In connection with the Arena Riga project, SIA Arena Riga was established on 26 January 2005. The principal activities of SIA Arena Riga were real estate administration and event management. On 30 November 2006, SIA Arena Riga acquired from SIA Merks the 12 thousand seat multifunctional entertainment center Arena Riga and commenced with actual economic activity. In the first eleven months of 2006, while the administration of Arena Riga was carried out by SIA Merks, 126 events (including Ice-Hockey World Championships) were held in Arena Riga with a total of 520 thousand visitors. The total revenue of the period was LVL 2,533 thousand (approx. EEK 56,207 thousand) and operating profit was EEK 9,516 thousand (approx. LVL 429 thousand).

In spite of the above financial results, the management of AS Järvevana Group assessed the risks related to Arena Riga as high and as the business of SIA Arena Riga was not in line with the core business of the group of AS Järvevana Group, the shareholding in SIA Arena Riga was disposed of. SIA Merks sold its 100 % shareholding in SIA Arena Riga on 11 December 2006 for EUR 17,610 thousand (EEK 275,597 thousand). See also “Material Contracts”.

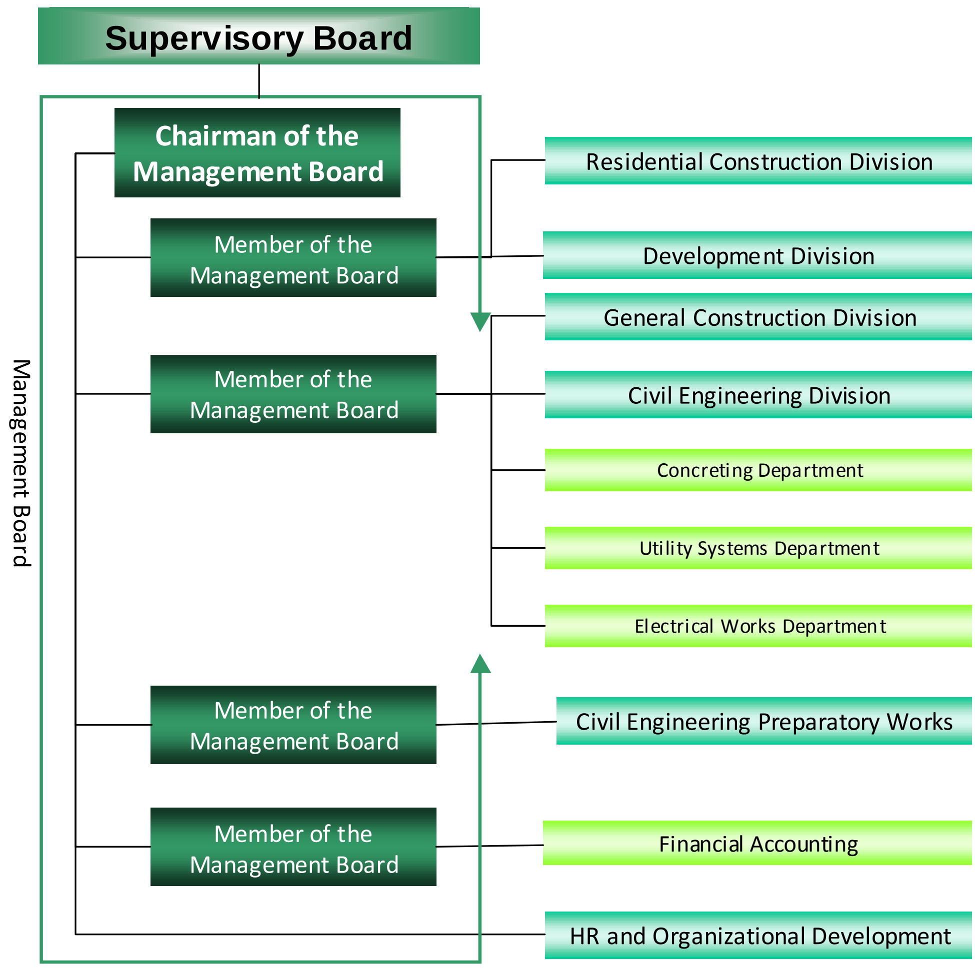
ORGANIZATIONAL STRUCTURE

The Company is a subsidiary of AS Merko Grupp, holding company controlled by Mr. Toomas Annus, who owns 65.32% of shares in AS Merko Grupp. AS Merko Grupp owns 71.99% of shares in the Company. AS Merko Grupp is also the sole shareholder in AS E.L.L. Kinnisvara and OÜ Merko Kaevandused. AS Merko Grupp owns 71.99% of shares in AS Järvevana, the company during the division of which the Company was established.

The Management Structure of the Company

The Management Board of AS Merko Ehitus has five members. The activities of the members are divided by areas of operation: general management, construction, development, technology, and finance. The Chairman of the Management Board leads the work of the Management Board.

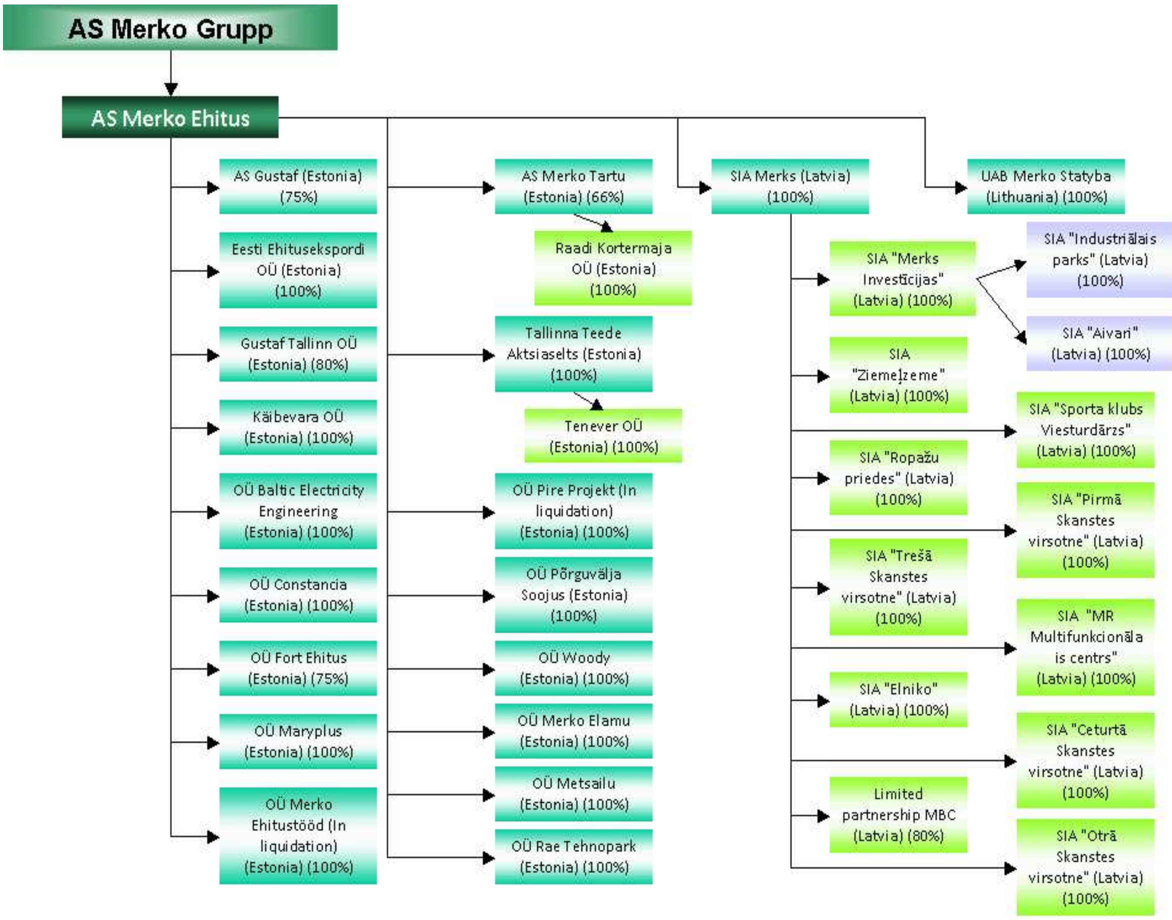
The following chart illustrates the management structure of the Company:



The Structure of the Group

The Company has 34 subsidiaries. In addition, the Company owns directly or indirectly through its subsidiaries shares in 6 companies. 19 of the subsidiaries are Estonian companies and 14 are Latvian companies. UAB Merko Statyba is the only Lithuanian subsidiary of the Company.

The following chart illustrates the structure of the Group:



Most important subsidiaries of the Company are SIA Merks in Latvia, UAB Merko Statyba in Lithuania and Tallinna Teede AS, AS Merko Tartu, AS Gustaf, Gustaf Tallinn OÜ, OÜ Baltic Electricity Engineering, OÜ Fort Ehitus, OÜ Woody and OÜ Rae Tehnopark in Estonia.

SIA Merks, established in 1997, has grown into one of the most outstanding construction companies in Latvia. The prominent works like Hansabank's head office and the Arena Riga have earned the company a lot of recognition.

The Lithuanian subsidiary UAB Merko Statyba was established in 1998. UAB Merko Statyba provides construction project management services and offers compact solutions in all the areas of construction.

Tallinna Teede AS, which was acquired by AS Järvevana in 2002, performs road maintenance works all over Estonia, both as a project manager and independently. This includes building of road structures, performing road repairs and exercise of supervision over excavation works and the condition of roads in Tallinn, production of traffic signs and supply of machinery repair services.

AS Merko Tartu is specialized in project management, intermediation of services of subcontractors to clients, bearing ultimate liability before the clients for the timely and proper completion of construction projects.

AS Gustaf works on the principle of project management and operates as the main contractor in construction projects mainly in Pärnu County.

Gustaf Tallinn OÜ, a company established in 2003, provides main contractor services in small scale reconstruction and repair works.

OÜ Baltic Electricity Engineering performs design works for medium- and high-voltage substations and the low-, medium- and high-voltage overhead and cable lines.

OÜ Fort Ehitus is a construction company carrying out the water construction and pile works. The construction works include the sheeting of different profiles, quay walls of pipe piles and Jet-type quays, dredging works, construction of bank protections, sinking of concrete piles in every size and CFA piles.

The main areas of activity of OÜ Woody and of OÜ Rae Tehnopark are the development and sale of their own real estate projects.

For holdings of the Company in other undertakings please see “Information on Holdings”

PROPERTY, PLANT AND EQUIPMENT

Property

Below an overview of the property owned by the Company and its subsidiaries is given.

In accordance with the Law of Property Act, a person entered into the Estonian Land Register as an owner of an immovable is deemed to be the owner of that immovable. The same principle applies also in respect of building rights and other restricted real rights. Although certain properties (immovables), building rights and other restricted real rights in the tables below and related footnotes are referred to as owned by the Company, according to the entries in the Estonian Land Register the legal owner thereof is AS Järvevana until the entries in respect of the transfer of the properties, building rights and other restricted real rights are made in the Estonian Land Register. The properties, building rights and other restricted real rights are agreed to be transferred to the Company upon the Division in accordance with the Division Plan. Therefore, such property, building rights and other restricted real rights are provided below as Company's property, building rights and other restricted real rights.

The Property of the Company

Property owned by the Company:[1]

No.	Location	Type of property	Area
1.	Järvevana tee 9d, Tallinn, Harju County, Estonia[2]	Immovable, land designated for transport	5,929 m^2
2.	Mõisa tn 7, Tallinn, Harju County, Estonia[3]	Immovable, land designated for transport	1,218 m^2
3.	Järvetipu development area (including properties in Kubu, Sagari, Rõugu and Vihu Streets)	Most of the land plots are residential land	96,022 m^2
4.	Suur-Patarei 20, Tallinn, Harju County, Estonia	Immovable, commercial land	3,533 m^2
5.	Masti tn 16, Tallinn, Harju County, Estonia[4]	Immovable, public land	2,818 m^2
6.	Trummi tn 25, Tallinn, Harju County, Estonia	Immovable, commercial land	5,933 m^2
7.	Hommiku tee 1A, Tabasalu, Harku municipality, Estonia	Immovable, production land	28 m^2
8.	Lossi tn 18/Soone tn 3, apartment No. B9, Tallinn, Harju County, Estonia[5]	Apartment ownership, residential land	3,316 m^2
9.	Pärnu mnt 129c, Tallinn, Harju County, Estonia	Immovable, residential land	6,126 m^2
10.	Pärnu mnt 129d, Tallinn, Harju County, Estonia	Immovable, land designated for transport	1,495 m^2
11.	Vabaõhumuuseumi tee 5, apartment no. 86p, Tallinn, Harju County, Estonia[6]	Apartment ownership, commercial land	3,754 m^2

[1] The Company has entered into agreements whereby it will purchase and acquire three properties in Vabaõhukooli Road and Narva Road, Tallinn Estonia, which are currently in the possession of OÜ Woody under usufruct (please see properties no. 21 – 23 in the list below on the property of OÜ Woody).

[2] The Company owns 1075/5929 of common ownership, encumbered with personal right of use for 10 years for E.L.L. Kinnisvara AS starting from 14 May 2007.

[3] AS Merko Ehitus owns 12/35 of the co-ownership.

[4] The property is encumbered with the building right in favour of Eesti Ehitusekspordi OÜ (a subsidiary of the Company).

[5] The Company owns 63/30760 of the co-ownership in the property.

12.	Roostiku tn 47, Tallinn, Harju County, Estonia	Immovable, residential land	800 m^2
13.	Rannaniidu tn 1/Roostiku 49, Tallinn, Harju County, Estonia	Immovable, residential land	598 m^2
14.	Roostiku tn 45, Tallinn, Harju County, Estonia	Immovable, residential land	722 m^2
15.	Roostiku tn 43, Tallinn, Harju County, Estonia	Immovable, residential land	845 m^2
16.	Tartu mnt 52/Lastekodu tn 23, Tallinn, Harju County, Estonia[7]	Immovable, 85% residential land, 15% commercial land	5,955 m^2
17.	Tartu mnt 50a, Tallinn, Harju County, Estonia	Immovable, 90% residential land, 10% commercial land	3,190 m^2

Property owned by AS Gustaf:

No.	Location	Type of property	Area
1.	Kellukese, Paikuse, Paikuse municipality, Pärnu County, Estonia	Immovable, profit yielding land	2.2 ha

Property owned by OÜ Käibevara:

No.	Location	Type of property	Area
1.	Kostiranna Village, Jõelähtme municipality, Harju County, Estonia	Immovable, profit yielding land	1.28 ha

Property owned by OÜ Fort Ehitus:

No.	Location	Type of property	Area
1.	Liukivi 3, apartment No. 28, Kostivere, Jõelähtme municipality, Harju County, Estonia[8]	Apartment ownership	3,072 m^2
2.	Vibeliku tee 21B, Loo, Jõelähtme municipality, Harju County	Immovable, commercial land	2,645 m^2

Property owned by AS Merko Tartu:

No.	Location	Type of property	Area
1.	Mõisaplatsi 4, Tila Village, Tartu municipality, Tartu County, Estonia	Immovable, general purpose land	12,705 m^2
2.	Kaupmehe 5, Vahi Village, Tartu municipality, Tartu County, Estonia[9]	Immovable, 70% multi-storey housing land, 30% commercial land	4,041 m^2

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[6] The apartment ownership is equal to 431/90055 of legal share of the respective property.
[7] The Company owns 5234/5955 and OÜ Woody (AS Merko Ehitus subsidiary) owns 721/5955 of legal share of the registered immovable, encumbered with following mortgages: 1) mortgage in amount of EEK 12,000,000 for the benefit of Eesti Spordiselts Põhjakotkas and 2) mortgage in amount of EEK 4,000,000 for the benefit of OÜ Vana Villem. The Company owns 5234/5955 and OÜ Woody (AS Merko Ehitus subsidiary) owns 721/5955 of legal share of the property.
[8] The apartment ownership is equal to 527/30410 of legal share of respective property.
[9] The property has been encumbered with a mortgage to the amount of EEK 24,200,000 for the benefit of AS Sampo Pank.

3.	Kaupmehe 7, Tila Village, Tartu municipality, Tartu County, Estonia[10]	Immovable, 70% multi-storey housing land, 30% commercial land	3,901 m^2
4.	Kaupmehe 9, Tila Village, Tartu municipality, Tartu County, Estonia[11]	Immovable, 70% multi-storey housing land, 30% commercial land	3,987 m^2
5.	Kaupmehe 11, Tila Village, Tartu municipality, Tartu County, Estonia[12]	Immovable, 70% multi-storey housing land, 30% commercial land	3,916 m^2
6.	Kaupmehe 13, Tila Village, Tartu municipality, Tartu County, Estonia	Immovable, 70% multi-storey housing land, 30% commercial land	3,785 m^2
7.	Kaupmehe 15, Tila Village, Tartu municipality, Tartu County, Estonia	Immovable, 70% multi-storey housing land, 30% commercial land	3,229 m^2
8.	Pärna allee 8, Tila Village, Tartu municipality, Tartu County, Estonia[13]	Immovable, multi-storey housing land	3,375 m^2
9.	Pärna allee 10, Tila Village, Tartu municipality, Tartu County, Estonia	Immovable, multi-storey housing land	3,230 m^2
10.	Pärna allee 12, Tila Village, Tartu municipality, Tartu County, Estonia	Immovable, multi-storey housing land	2,793 m^2
11.	Vahi Village, Tartu municipality, Tartu County, Estonia	Immovable, profit yielding land	7.34 ha
12.	Pärna allee 7, Vahi Village, Tartu municipality, Tartu County, Estonia[14]	Immovable, small housing land	3,360 m^2
13.	Pärna allee 9, Tila Village, Tartu municipality, Tartu County, Estonia	Immovable, small housing land	3,220 m^2
14.	Pärna allee 11, Tila Village, Tartu municipality, Tartu County, Estonia	Immovable, small housing land	2,958 m^2
15.	Tähe 10, Tartu, Tartu County, Estonia	Immovable, 85% public housing land, 15% small housing land	8,239 m^2

Property owned by Raadi Kortermaja OÜ:

No.	Location	Type of property	Area
1.	Pärna allee 5, Vahi Village, Tartu municipality, Tartu County, Estonia[15]	Apartment ownerships, an apartment building consisting of apartments no. 1 – 28	3,389 m2
2.	Pärna allee 6, Vahi Village, Tartu municipality, Tartu County, Estonia[16]	Apartment ownerships, an apartment building consisting of apartments no. 1 – 42	3,311 m2

[10] The property has been encumbered with a mortgage to the amount of EEK 24,200,000 for the benefit of AS Sampo Pank.
[11] The property has been encumbered with a mortgage to the amount of EEK 24,200,000 for the benefit of AS Sampo Pank.
[12] The property has been encumbered with a mortgage to the amount of EEK 24,200,000 for the benefit of AS Sampo Pank.
[13] The property has been encumbered with a mortgage to the amount of EEK 19,800,000 for the benefit of AS Sampo Pank.
[14] The property has been encumbered with a mortgage to the amount of EEK 19,800,000 for the benefit of AS Sampo Pank.
[15] The property has been encumbered with the following mortgages: 1) mortgage to the amount of EEK 11,000,000 for the benefit of AS Sampo Pank; 2) mortgage to the amount of EEK 33,000,000 for the benefit of AS Sampo Pank.

Property owned by OÜ Tenever:

No.	Location	Type of property	Area
1.	Väike-Kõrnomaa, Kirdalu Village, Saku municipality, Harju County, Estonia[17]	Immovable, profit yielding land	15.86 ha

Property owned by OÜ Woody:

No.	Location	Type of property	Area
1.	Räägu tn 10A, Tallinn, Harju County, Estonia	Immovable, 75% residential land, 25% commercial land	1,500 m^2
2.	Räägu tn 10/Vuti tn 89/ Varese tn 10a, Tallinn, Harju County, Estonia	Immovable, residential land	4,611 m^2
3.	Kiviaia tee 10, Tallinn, Harju County, Estonia	Immovable, production land	5,417 m^2
4.	Kiviaia tee 10A, Tallinn, Harju County, Estonia	Immovable, production land	66 m^2
5.	Tartu mnt 52/Lastekodu tn 23, Tallinn, Harju County, Estonia[18]	Immovable, 85% residential land, 15% commercial land	5,955 m^2
6.	Kiviaia tee 11, Tallinn, Harju County, Estonia	Immovable, production land	20,857 m^2
7.	Kristiina tn 12, Tallinn, Harju County, Estonia	Immovable, residential land	1,246 m^2
8.	Sõpruse pst 33, Tallinn, Harju County, Estonia	Immovable, 85% residential land, 15% commercial land	6,000 m^2
9.	Kiviaia tee 11B, Tallinn, Harju County, Estonia	Immovable, public land	21,366 m^2
10.	Kiviaia tee 16, Tallinn, Harju County, Estonia	Immovable, public land	7,411 m^2
11.	Kiviaia tee 9a, Tallinn, Harju County, Estonia	Immovable, public land	2,535 m^2
12.	Riigimaa 40, Tallinn, Harju County, Estonia	Immovable, residential land	6.22 ha
13.	Kentmanni tn 8A, Tallinn, Harju County, Estonia	Immovable, residential and commercial land	346 m^2
14.	Sõpruse pst. 29A, Tallinn, Harju County, Estonia	Immovable, land designated for transport	665 m^2
15.	Kolde pst 67, apartment No. 7, Tallinn, Harju County, Estonia[19]	apartment ownership, residential land	5,500 m^2
16.	Kolde pst 67, apartment No. 30, Tallinn, Harju County,	apartment ownership, residential land	5,500 m^2

[16] The property has been encumbered with the following mortgages: 1) mortgage to the amount of EEK 11,000,000 for the benefit of AS Sampo Pank; 2) mortgage to the amount of EEK 33,000,000 for the benefit of AS Sampo Pank.

[17] The property has been encumbered with the mortgage to the amount of EEK 23,400,000 for the benefit of AS Hansapank.

[18] OÜ Woody owns 721/5955 of the co-ownership. AS Merko Ehitus owns 5234/5955 of the co-ownership

[19] The apartment ownerships of OÜ Woody are equal to 847/31941 of legal share of respective property.

	Estonia[20]		
17.	Apartment ownerships at Räägu tn 12B/Kännu tn 30, Tallinn, Harju County, Estonia (4 apartments)[21]	apartment ownership, residential land	2,830 m^2
18.	Apartment ownerships at Räägu tn 12/Lehe tn 29, apartment No. 5, Tallinn, Harju County, Estonia (10 apartment ownerships)[22]	apartment ownership, residential land	3,228 m^2
19.	Lehe tn 31, apartment No. 4, Tallinn, Harju County, Estonia[23]	apartment ownership, residential land	3,162 m^2
20.	Apartement ownerships at Sõpruse pst 29, Estonia (30 apartment ownerships)[24]	apartment ownership, 90% residential land, 10% commercial land	3,292 m^2

Property owned by OÜ Metsailu:

No.	Location	Type of property	Area
1.	Kentmanni tn 8, Tallinn, Harju County, Estonia	Immovable, land designated for transport	558 m^2

Property owned by Eesti Ehituseksspordi OÜ[25]:

No.	Location	Type of property	Area
1.	Tilluvälja II, Vaela Village, Kiili municipality, Harju County, Estonia	Immovable, profit yielding land	9.82 ha

Property owned by OÜ Rae Tehnopark:

No.	Location	Type of property	Area
1.	Immovables of Rae Tehnopark at Lehmja Village, Rae municipality, Harju County, Estonia (19 immovables)	Mostly production land but includes also commercial land	Total area 183,027 m^2

Property owned by SIA Merks:

No.	Location	Type of property	Area
1.	Grostonas 15, Riga, Latvia	Ownership, residential land	19,090 m^2
2.	J. Dikmaņa 8, Riga, Latvia	Ownership, commercial land	11,898 m^2
3.	Skanstes 16, Riga, Latvia	Ownership, commercial land	4,140 m^2
4.	Skanstes 18, Riga, Latvia	Ownership, commercial land	4,130 m^2
5.	Skanstes 20, Riga, Latvia	Ownership, commercial land	5,107 m^2

[20] The apartment ownerships of OÜ Woody are equal to 874/31941 of legal share of respective property.
[21] The apartment ownerships of OÜ Woody are equal to 3012/23430 of legal share of respective property.
[22] The apartment ownerships of OÜ Woody are equal to 7638/26843 of legal share of respective property.
[23] The apartment ownerships of OÜ Woody are equal to 1670/16303 of legal share of respective property.
[24] The apartment ownerships of OÜ Woody are equal to 14242/25662 of legal share of respective property.
[25] Eesti Ehituseksspordi OÜ has also entered into an agreement whereby it will purchase Tilluvälja III property (12.77 ha) after the detailed plan has been prescribed.

6.	Arēnas 12, Riga, Latvia	Ownership, commercial land	4,015 m^2
7.	Arēnas 6, Riga, Latvia	Ownership, residential land	3,545 m^2
8.	Arēnas 4, Riga, Latvia	Ownership, residential land	3,657 m^2
9.	Arēnas 2, Riga, Latvia	Ownership, residential land	3,625 m^2
10.	Arēnas 8, Riga, Latvia	Ownership, commercial land	5,457 m^2
11.	Skanstes St., Riga, Latvia (block 16)	Ownership, mixed use	18,496 m^2
12.	Skanstes St., Riga, Latvia (block 17)	Ownership, mixed use	36,076 m^2
13.	Skanstes St., Riga, Latvia (block 18)	Ownership, mixed use	12,804 m^2
14.	Ķemerejas St. 3, Riga, Latvia	Ownership	322 m^2
15.	J.Daliņa 8, Riga, Latvia	Ownership, residential land	5,653 m^2
16.	Grostonas 25, Riga, Latvia	Ownership, residential land	5,380 m^2

Property owned by SIA Elniko:

No.	Location	Type of property	Area
1.	Gaiļezera str., Riga, Latvia	Ownership, residential land	52,326 m^2

Property owned by SIA Industrialais Parks:

No.	Location	Type of property	Area
1.	Salaspils, Latvia	Ownership	199,000 m^2

Property owned by SIA SPORTA KLUBS VIESTURDĀRZS:

No.	Location	Type of property	Area
1.	Rūpniecības 21, k-1, Riga, Latvia	Ownership, commercial land	3,813 m^2

Property owned by SIA ROPAŽU PRIEDES:

No.	Location	Type of property	Area
1.	Mucenieki, Ropažu parish, Latvia	Ownership, residential land	198,320 m^2

Property owned by UAB Merko Statyba:

No.	Location	Type of property	Area
1.	3004 Virsuliskiu skg. 56, Vilnius, Lithuania	Ownership, 51% commercial, 49% residential land	4,000 m^2
2.	30101 Ežero str 1D, Kaunas /Raudondvario/ Lithuania	Ownership, commercial/residential land	3,223 m^2
3.	30102 Batniavos str 57, 57A, 57B Kaunas /Raudondvario/ Lithuania	Ownership, commercial/residential land	3,306 m^2
4.	3014 Kernavės str, Vilnius, Lithuania	Ownership, land designated for transportation	4,453 m^2
5.	3015 Mokslininkų str, Vilnius, Lithuania	Ownership, residential land	11,700 m^2

Rights of Superficies of the Group

According to the Estonian Law of Property Act, the right of superficies is a limited real right attaching to immovable property and the right of superficies in apartments is a derivative thereof. According to the Law of Property Act, an immovable may be encumbered such that the person for whose benefit a right of superficies has been established has a transferable and inheritable right for a specified term to own a construction permanently attached to the immovable.

The below table provides an overview of the building rights and building rights in apartments belonging to the Company:

Right of Superficies of the Company:

No.	Location	Type	Area
1.	Tartu mnt 87f, Tallinn, Harju County, Estonia	Building right, land designated for transport	2,762 m^2
2.	Mirta tn 38, Tallinn, Harju County, Estonia	Building right, residential land	852 m^2
3.	Mirta tn 20, apartment No. 3, Tallinn, Harju County, Estonia[26]	Building right in apartments, residential land	1,157 m^2
4.	Mirta tn 27, apartment No. 8, Tallinn, Harju County, Estonia[27]	Building right in apartments, residential land	866 m^2
5.	Veerise tn 8, apartment No. 2, Tallinn, Harju County, Estonia[28]	Building right in apartments, residential land	909 m^2
6.	Building rights in apartments at Veerise tn 10, Tallinn, Harju County, Estonia (2 building rights in apartments)[29]	Building right in apartments, residential land	1,042 m^2
7.	Building rights in apartments at Mirta tn 37, Tallinn, Harju County, Estonia (3 building rights in apartments)[30]	Building right in apartments, residential land	983 m^2
8.	Building rights in apartments at Veerise tn 12, Tallinn, Harju County, Estonia (3 building rights in apartments)[31]	Building right in apartments, residential land	694 m^2
9.	Building rights in apartments at Mirta tn 41, Tallinn, Harju County, Estonia (14 building rights in apartments)	Building right in apartments, residential land	940 m^2

[26] The right of superficies in apartment is equal to 541/8559 of legal share of respective right of superficies.
[27] The right of superficies in apartment is equal to 593/8559 of legal share of respective right of superficies.
[28] The right of superficies in apartment is equal to 366/8559 of legal share of respective right of superficies.
[29] The right of superficies in apartment of the Company is equal to 959/8559 of legal share of respective right of superficies.
[30] The right of superficies in apartment of the Company is equal to 1652/8559 of legal share of respective right of superficies.
[31] The right of superficies in apartment of the Company is equal to 1766/8559 of legal share of respective right of superficies.

10.	Building rights in apartments at Veerise tn 16, Tallinn, Harju County, Estonia (14 building rights in apartments)	Building right in apartments, residential land	917 m^2
11.	Building rights in apartments at Veerise tn 22, Tallinn, Harju County, Estonia (14 building rights in apartments)	Building right in apartments, residential land	590 m^2
12.	Building rights in apartments at Veerise tn 20, Tallinn, Harju County, Estonia (14 building rights in apartments)	Building right in apartments, residential land	770 m^2
13.	Building rights in apartments at Veerise tn 14, Tallinn, Harju County, Estonia (2 building rights in apartments)[32]	Building right in apartments, residential land	932 m^2

Building rights of Eesti Ehituseкspordi OÜ:

No.	Location	Type	Area
1.	Masti tn 16, Tallinn, Harju County, Estonia	Building right, public land	2,818 m^2
2.	Kiviaia tee 10, Tallinn, Harju County, Estonia	Building right, production land	5,417 m^2
3.	Kiviaia tee 10A, Tallinn, Harju County, Estonia	Building right, production land	66 m^2

Building right of Tallinna Teede AS:

No.	Location	Type	Area
1.	Betooni tn 24, Tallinn, Harju County, Estonia	Building right, production land	37,502 m^2

Building right of OÜ Põrguvälja Soojus:

No.	Location	Type	Area
1.	Kentmanni tn 8, Tallinn, Harju County, Estonia [33]	Building right, land designated for transport	558 m^2

In addition, OÜ Constancia has entered into an agreement whereby the right of superficies will be entered in the Land Register encumbering the immovable at Võidujooksu 12/Pae 7A (325,194 m2) owned by the City of Tallinn.

Leaseholds and usufructs

Below is an overview of the immovable property leased by the Group (whether under a lease agreement or by way of registered usufruct):

a. the immovable property at Pärnu mnt 143, Tallinn, Estonia, consisting 100 % of social land (with area of 191,975m2) is in the possession of the Company under an usufruct[34];

[32] The right of superficies in apartment of the Company is equal to 1310/8559 of legal share of respective right of superficies.

[33] The right of superficies has been encumbered with a mortgage to the amount of EEK 10,000,000 for the benefit of the Company.

b. OÜ Woody is entitled to use the following property under usufruct: immovable at Vabaõhukooli tee 17, Tallinn, Estonia (with the area of 5.99 ha), immovable at Vabaõhukooli tee 18, Tallinn, Estonia (with the area of 8,957 m^2) and immovable at Narva mnt 180, Tallinn, Estonia (with the area of 29,087 m^2);

c. SIA Merks leases residential land (to be privatized) at Grostonas 6, Riga (block 8 with the area of 39,037 m2), office and parking premises at 13 Skanstes St., Riga (with the area of 1,245 m2) and archive room at 6 Duntes St., Riga (with the area of 41.6 m2);

d. SIA Polyster is leasing a plot of residential land at Lucavsala, Riga (with the area of 26,560 m^2);

e. UAB Merko Statyba leases two flats from private persons for accommodation of our employees (at Siauliu St. 22 – 3, Klaipeda and at S. Neries St. 83 – 58, Vilnius, Lithuania).

In addition, SIA Zakusala Estate[35] leases the following property:

No.	Location	Type of property	Area
1.	Zaķusalas krastmala 2, Riga	mixed use, land to be privatized	8,792 m2
2.	Zaķusalas krastmala 34, Riga	mixed use, land to be privatized	44,602 m2
3.	Zaķusalas krastmala 16, Riga	mixed use, land to be privatized	72,668 m2

Plant and Equipment

AS Järvevana has neither acquired nor disposed of any material items of plant and equipment since the end of financial year ended 31 December 2007. See notes 17 and 23 to the consolidated financial statement of AS Järvevana for the financial year ended 31 December 2007 in relation to the plant and equipment of the Company and its subsidiaries.

See the annual reports of AS Järvevana for the financial years ended 31 December 2005, 2006 and 2007 and the interim report of AS Järvevana for three months ended 31 March 2008 included elsewhere in this Prospectus.

See note 25 to the annual reports of AS Järvevana for the financial years ended 31 December 2005, 2006 and 2007 in relation to the leased items of plant and equipment. The Company and its subsidiaries have leased certain items of plant and equipment, which they require for their operations. According to the management's assessment the most important leased property is an MBA 200 asphalt factory leased by Tallinna Teede AS (EUR 1,502,691 + VAT; equalling approx. EEK 23,517,114).

[34] According to the Estonian Law of Property Act a usufruct encumbers an immovable in such a way that the person for whose benefit the usufruct has been established is entitled to use the immovable and to acquire the fruits thereof.

[35] SIA Zakusala Estate is not a subsidiary of the Company but a joint venture of SIA Merks. SIA Merks owns 50 % of shares in SIA Zakusala Estate. The properties of SIA Zakusala Estate are provided herein due to the size of those properties.

SELECTED FINANCIAL INFORMATION

As the Company was established only recently and therefore lacks historical financial information, the following tables set forth certain selected financial data in regard to AS Järvevana. As the Company was formed in the course of the Division of AS Järvevana and on the basis of the Business operated previously by AS Järvevana and transferred from AS Järvevana to the Company, the below financial information also illustrates the business and financial condition of the Company. For the effects of the Division on the financial information, see the un-audited pro forma financial information of AS Merko Ehitus included elsewhere in this Prospectus.

The financial information presented below has been extracted or calculated based on the audited consolidated financial statements of AS Järvevana for the financial years ended 31 December 2005, 2006, 2007, prepared in accordance with IFRS and from the un-audited consolidated condensed interim financial information of AS Järvevana for the three months ended 31 March 2008, prepared in accordance with the IAS 34 Interim Financial Reporting, included elsewhere in this Prospectus.

The ratios and indicators set forth in the table below are provided to illustrate certain aspects of the business and financial performance of AS Järvevana. Certain of these ratios and indicators are used by the Management to evaluate the performance of AS Järvevana while others are provided for the benefit of investors holding the shares. These ratios and indicators are not IFRS measures and should not be considered as alternatives to IFRS measures of profit/(loss) or as indicators of operating performance or as measures of cash flow from operations under IFRS or as indicators of liquidity. However, 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.

CONSOLIDATED INCOME STATEMENT DATA

In thousands of EEK	**Three months ended 31 March (un-audited)**		**Year ended 31 December (audited)**		
	2008	**2007**	**2007**	**2006**	**2005**
Revenue	1,119,572	1,014,864	5,510,760	4,414,361	3,232,392
Costs of goods sold	(884,377)	(886,352)	(4,731,752)	(3,727,561)	(2,738,714)
Gross profit	235,195	128,512	779,008	686,800	493,678
Marketing expenses	(7,888)	(5,605)	(32,472)	(23,390)	(22,595)
Administrative and general expenses	(49,373)	(35,610)	(213,806)	(148,792)	(127,632)
Other operating income	1,704	2,102	6,424	148,205	185,052
Other operating expenses	(1,738)	(1,038)	(18,109)	(29,952)	(93,452)
Operating profit	177,900	88,361	521,045	632,871	435,051
Financial income and expenses	(1,762)	3,907	69,694	7,737	28,673
Profit before tax	176,138	92,268	590,739	640,608	463,724
Corporate income tax expense	(20,138)	(881)	(30,830)	(49,917)	(18,437)
Net profit for financial period	156,000	91,387	559,909	590,691	445,287
Incl. net profit attributable to equity holders of the parent company	154,881	88,450	545,049	581,738	438,638
Minority interest	1,119	2,937	14,860	8,953	6,649

CONSOLIDATED BALANCE SHEET DATA

In thousands of EEK					
	31.03.2008 (un-audited)	**31.03.2007 (un-audited)**	**31.12.2007 (audited)**	**31.12.2006 (audited)**	**31.12.2005 (audited)**
ASSETS					
Current assets					
Cash and cash equivalents	356,863	321,903	205,564	676,143	268,446
Trade and other receivables	1,003,458	1,150,910	1,199,566	854,103	542,110
Prepaid corporate income tax	941	1,433	2,376	6,428	2,471
Inventories	2,047,829	1,480,273	2,025,426	1,356,734	964,088
Assets held for sale	-	-	-	733	-
	3,409,091	2,954,519	3,432,932	2,894,141	1,777,115
Non-current assets					
Investments in associates and joint ventures	275,983	204,979	272,964	200,798	179,609
Other long-term loans and receivables	24,214	8,666	14,492	8,476	8,524
Deferred income tax assets	3,392	6,547	3,396	6,592	8,753
Investment property	12,946	3,840	7,361	3,900	42,506
Property, plant and equipment	172,134	99,795	172,912	90,445	199,004
Intangible assets	12,675	10,901	12,574	10,177	4,365
	501,344	334,728	483,699	320,388	442,761
TOTAL ASSETS	3,910,435	3,289,247	3,916,631	3,214,529	2,219,876
LIABILITIES					
Current liabilities					
Borrowings	192,924	223,605	304,879	283,792	114,841
Trade and other payables	939,593	1,076,977	1,015,492	1,081,396	711,236
Corporate and other income tax liability	36,159	19,423	16,718	18,868	950
Government grants	1,498	1,472	1,498	1,498	22,225
Short-term provisions	81,495	80,580	73,212	33,517	21,741
	1,251,669	1,402,057	1,411,799	1,419,071	870,993
Non-current liabilities					
Long-term borrowings	399,165	149,814	397,713	159,335	202,824
Other long-term trade payables and prepayments	54,796	39,470	57,423	23,277	22,726
Deferred income tax liabilities	-	-	-	-	11,385
	453,961	189,284	455,136	182,612	236,935
TOTAL LIABILITIES	1,705,630	1,591,341	1,866,935	1,601,683	1,107,928
EQUITY					
Minority interest	35,058	21,840	33,939	18,904	10,552
Equity attributable to equity holders of the parent company					
Share capital	177,000	177,000	177,000	177,000	177,000
Statutory reserve capital	17,700	17,700	17,700	17,700	8,850
Currency translation differences	(5,976)	(12,077)	(5,085)	(5,751)	(5,059)
Retained earnings	1,981,023	1,493,443	1,826,142	1,404,993	920,605
	2,169,747	1,676,066	2,015,757	1,593,942	1,101,396
TOTAL EQUITY	2,204,805	1,697,906	2,049,696	1,612,846	1,111,948
TOTAL LIABILITIES AND EQUITY	3,910,435	3,289,247	3,916,631	3,214,529	2,219,876

CONSOLIDATED CASH FLOW STATEMENT DATA

In thousands of EEK	**Three months ended 31 March (un-audited)**		**Year ended 31 December (audited)**		
	2008	**2007**	**2007**	**2006**	**2005**
Cash flows from operating activities	276,498	(193,310)	(488,904)	155,687	264,667
Cash flows from investing activities	(10,840)	(90,276)	(73,366)	234,394	(378,115)
Cash flows from financing activities	(113,001)	(68,692)	93,319	21,646	243,108
Change in cash and cash equivalents	152,657	(352,278)	(468,951)	411,727	129,660
Cash and cash equivalents at end of the period	356,863	321,903	205,564	676,143	268,446

THE RATIOS AND METHODOLOGY OF CALCULATING THE FINANCIAL RATIOS DESCRIBING THE COMPANY'S MAIN OPERATIONS:

	Three months ended 31 March (un-audited)		**Year ended 31 December (un-audited)**		
	2008	**2007**	**2007**	**2006**	**2005**
Net profit margin	13.8%	8.7%	9.9%	13.2%	13.6%
Profit before tax margin	15.7%	9.1%	10.7%	14.5%	14.3%
Operating profit margin	15.9%	8.7%	9.5%	14.3%	13.5%
Return on equity per annum	29.6%	21.6%	30.2%	43.2%	48.2%
Return on assets per annum	15.8%	10.9%	15.3%	21.4%	24.9%
Equity ratio	55.5%	51.0%	51.5%	49.6%	49.6%
Current ratio	2.7	2.1	2.4	2.0	2.0
General expense ratio	5.1%	4.1%	4.5%	3.9%	4.6%
Staff costs ratio	10.9%	12.8%	9.3%	8.0%	7.3%
Debt to assets ratio	15.1%	11.4%	17.9%	13.8%	14.3%
Debt to equity ratio	27.3%	22.3%	34.9%	27.8%	28.8%
Accounts receivable turnover (in days)	60	68	59	46	33
Accounts payable turnover (in days)	40	46	41	45	38
Revenue per employee (in million EEK)	1.036	1.119	5.376	5.193	4.651
Average number of full-time employees	1081	907	1025	850	695
Number of shares, thousands	17,700	17,700	17,700	17,700	17,700
Earnings per share, in EEK	8.75	5.00	30.79	32.87	24.78

Net profit margin: Net profit* / Revenue
Profit before tax margin: Profit before tax / Revenue
Operating profit margin: Operating profit / Revenue
Return on equity per annum: Net profit* / Average equity of the period**
Return on assets per annum: Net profit* / Average assets of the period
Equity ratio: Shareholders' equity** / Total assets
Current ratio: Current assets / Current liabilities
General expense ratio: Administrative and general expenses and marketing expenses/ Revenue
Staff costs ratio: Staff costs/ Revenue
Debt to equity ratio: Interest-bearing liabilities / Shareholders' equity**
Debt to assets ratio: Interest-bearing liabilities / Total assets

Accounts receivable turnover: Trade receivables / Revenue x 365
Accounts payable turnover: Payables to supplies / Cost of goods sold x 365
Revenue per employee: Revenue / Average number of full-time employees
Earning per share: Net profit* / Weighted avarega number of ordinary shares

** Calculated based on net profit attributable to equity holders of the parent company*
*** Calculated based on equity attributable to the equity holders of the parent company*

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE GROUP'S FINANCIAL CONDITION AND RESULTS OF OPERATIONS

As the Company was established only recently and therefore lacks historical financial information, the following discussion as well as in sections "Capital Resources" and "Trend Information" is based on the financial information of AS Järvevana. As the Company was formed in the course of the Division of AS Järvevana and on the basis of the Business operated previously by AS Järvevana and transferred from AS Järvevana to the Company, the financial information below also illustrates the business and financial condition of the Company. For the effects of the Division on the financial information of AS Järvevana, see the un-audited pro forma financial information of AS Merko Ehitus included elsewhere in this Prospectus.

The following discussion should be read in conjunction with the consolidated audited financial statements of AS Järvevana, including the notes thereto, and the un-audited pro forma financial information of AS Merko Ehitus, included elsewhere in this Prospectus. The consolidated financial statements for the years ended 31 December 2005, 2006 and 2007 were prepared in accordance with IFRS, while un-audited consolidated condensed interim financial information of AS Järvevana for the three months ended 31 March 2008 was prepared in accordance with IAS 34 Interim Financial Reporting.

In thousands of EEK	**Three months ended 31 March (un-audited)**		**Year ended 31 December (audited)**		
	2008	**2007**	**2007**	**2006**	**2005**
Revenue (note 1)	1,119,572	1,014,864	5,510,760	4,414,361	3,232,392
Administrative and general expenses (note 2)	(49,373)	(35,610)	(213,806)	(148,792)	(127,632)
Other operating income (note 3)	1,704	2,102	6,424	148,205	185,052
Other operating expenses (note 4)	(1,738)	(1,038)	(18,109)	(29,952)	(93,452)
Total financial income/(expenses) (note 4)	(1,762)	3,907	69,694	7,737	28,673
Profit before tax	176,138	92,268	590,739	640,608	463,724
Corporate income tax expense	(20,138)	(881)	(30,830)	(49,917)	(18,437)
Net profit for financial year (note 5)	156,000	91,387	559,909	590,691	445,287
incl. net profit attributable to equity holders of the parent company	154,881	88,450	545,049	581,738	438,638
Cash flows from operating activities (note 6)	276,498	(193,310)	(488,904)	155,687	264,667
Cash flows from investing activities (note 7)	(10,840)	(90,276)	(73,366)	234,394	(378,115)
Cash flows from financing activities	(113,001)	(68,692)	93,319	21,646	243,108
FINANCIAL CONDITIONS					
In thousands of EEK	**31.03.2008**	**31.03.2007**	**31.12.2007**	**31.12.2006**	**31.12.2005**
	(un-audited)	**(un-audited)**	**(audited)**	**(audited)**	**(audited)**
Cash and cash equivalents (note 6, 7)	356,863	321,903	205,564	676,143	268,446
Trade and other receivables (note 8)	1,003,458	1,150,910	1,199,566	854,103	542,110
Inventories (note 9)	2,047,829	1,480,273	2,025,426	1,356,734	964,088
Investments in associates and joint ventures	275,983	204,979	272,964	200,798	179,609
Property, plant and equipment(note 10)	172,134	99,795	172,912	90,445	199,004
Total assets	3,910,435	3,289,247	3,916,631	3,214,529	2,219,876
Borrowings (note 11)	192,924	223,605	304,879	283,792	114,841

Trade and other payables	939,593	1,076,977	1,015,492	1,081,396	711,236
Long-term borrowings (note 11)	399,165	149,814	397,713	159,335	202,824
Total equity (note 12)	2,204,805	1,697,906	2,049,696	1,612,846	1,111,948

Note 1: Revenue

Revenue from construction in progress is recognised under the stage of completion method, which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, forecasting and reporting of income and expenses has been introduced to determine the stage of completion. The estimated final result to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the profit estimate is adjusted.

Revenue from real estate development projects is recognised as revenue in accordance with IAS 18 "Revenue", i.e. revenue is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer. Therefore, the cyclical revenue stream from real estate development projects influenced AS Järvevana Group's first quarter results in 2008 as well as in 2007.

Note 2: Administrative and general expenses

The fast growth in administrative and general expenses was due to an increase in salaries and legal expenses related to the criminal case No. 05913000055 in 2007. For further information about the Criminal Proceedings see "Financial Information Concerning the Issuer's Assets and Liabilities, Financial Position and Profits and Losses – Legal and Arbitration Proceedings".

Note 3: Other operating income

In autumn 2004, the AS Järvevana Group accepted its biggest project thus far - SIA Merks entered into a contract with Riga's City Government committing itself to build a multifunctional hall in Riga accommodating 12,500 visitors by the time of the Ice-Hockey World Championships in 2006. The project involved huge risks related to the short construction period and losses arising from the difference between the market value and the construction and usage costs of the hall. Hence, to encourage the potential developer to undertake the constriction completion and further hall's operating risks, Riga's City Government supported the project by government grants of EEK 177.3 million in 2005 and EEK 20.7 million in 2006. On 11 December 2006, SIA Merks, a Latvian subsidiary of AS Järvevana, sold its 100% holding in SIA Arena Riga for EUR 17,610 thousand (approx. EEK 275,597 thousand). The sum was paid to SIA Merks at the transfer of ownership. SIA Arena Riga was sold as it was not in line with the core business of AS Järvevana Group.

Note 4: Other operating expenses

High operating expenses in 2005 and 2006 were mostly influenced by impairment. In 2005, impairment charge of EEK 89.3 million related to multifunctional hall Arena Riga was recognised. Considering the experience in the neighbouring countries, where the recoverable amount of multifunctional halls established has been lower than the constructions cost, the management carried out an impairment test of the Arena Riga in order to assess the recoverable amount of the hall as at 31 December 2005. The cash-flows for the following 10 years and the present value of these cash-flows were generated based on the model. As a result of the impairment test and the recoverable amount determined, the value of the hall was written down by EEK 89.3 million. In 2006, the Järvevana Group incurred EEK 22.5 million expenses related to carrying out of the Ice-Hockey World Championships in Arena Riga. The arrangement was agreed in autumn 2004 between SIA Merks and Riga City Government and the expenditures were partially reimbursed by government grants.

Note 5: Net profit for financial year

In 2005 the net profit attributable to equity holders of the parent company totalled EEK 438.6 million, representing an increase of 48.9% in comparison with 2004. Net profit from construction and development activities totalled EEK 289.3 million, one-off transactions contributed EEK 149.3 million to net profit, of which EEK 84.7 million were earned on the transfer of registered property, EEK 53.7 million from government grants and EEK 10.9 million from the transfer of ownerships and rights. High profitability was ensured by the AS Järvevana Group's own residential housing developments and the sales of registered property, which were not critical for the attainment of the company's strategic goals.

In 2006, the Järvevana Group's net profit attributable to equity holders of the parent company totalled EEK 581.7 million. Income from the sale of shareholdings contributed EEK 125.1 million, development activities EEK 284.7 million, construction activities EEK 164.2 million and financial activities EEK 7.7 million of net profit. The material outcome was provided from the sales of Arena Riga. SIA Merks sold its shareholding in multipurpose hall for EEK 275.4 million and earned extra profit of EEK 122.1 million.

In 2007, the net profit attributable to equity holders of the parent company totalled EEK 545.0 million, of which EEK 48.7 million was earned as extraordinary income from the sale of registered property, EEK 337.5 million from development activities, EEK 147.8 million from construction activities and EEK 11.0 million from financing activities. Profit from main operations increased from EEK 456.6 million to EEK 496.4 million or 8.7%

The net profit attributable to equity holders of the parent company in the first three months of 2008 was EEK 154.9 million, having increased by 75.1% compared with the three months ended 31 March 2007. The warm winter jointly with the cyclic nature of residential construction and real estate development had a positive effect on the profit.

Note 6: Cash and cash equivalents. Cash flows from operating activities

The AS Järvevana Group's first quarter 2008 cash position was strongly impacted by cash flow from operating activities which amounted to EEK 276.5 million. The operating cash flow was mostly influenced by the change in trade and other receivables of EEK 162.6 million, adjustments to revenue from construction contracts under stage of completion method of EEK 113,7 million, change in trade and other payables **-** EEK (154.4) million and operating profit **-** EEK 177.9 million.

In 2007, the AS Järvevana Group's total cash flows amounted to EEK (468.0) million, which was strongly distressed by the cash flows from operating activities totalling to EEK (488.9) million. Despite of the good positive flows from the operating profit EEK 521.0 million, the cash was drained due to an increase in own developments and related growth of inventories in the sum of EEK (665.4) million, a change in receivables and prepayments in the sum of EEK (108.4) million, a change in liabilities and prepayments in the sum of EEK (127.7) million, and adjustment of revenue from construction contracts in the sum of EEK (130.9) million as a result of increasing business activities and unfavourable payment terms. Management considers the situation as temporary, since the expected sales of residential property and completion of contracts with unfavourable payment schedules should improve the net cash position in 2008.

In 2005, AS Järvevana Group's total cash flow from operations amounted to EEK 129.7 million. The cash flow for the accounting period was mostly affected by the operating profit of EEK 435.1 million, a change in inventories of EEK (464.9) million resulting from acquisition of land, a change in liabilities and prepayments of EEK 186.6 million, depreciation and amortisation of EEK 109.6 million mainly related to impairment of Arena Riga.

Note 7: Cash and cash equivalents. Cash flows from investing activities

In 2005 AS Järvevana Group's cash flow from investing activities was EEK (378.1) million, of which EEK (227.0) million was investments into property and EEK (148.5) million investments into subsidiaries and associates. The investments were mainly related to the construction of Riga Arena and strengthening capital structure of Latvian and Lithuanian subsidiaries and the acquisition of 50% shares by SIA Merks in a company engaged in real estate development, SIA Zakusala Real Estates.

On 1 December 2005, SIA Merks, a subsidiary of AS Järvevana, acquired 50% shares in SIA Zakusala Estates. The transaction's value was EUR 9.39 million (approx. EEK 146.95 million) of which EUR 8.45 million (approx. EEK 132.24 million) was settled with a loan previously granted to the shareholders of SIA Zakusala Estates, and with a further monetary payment of EUR 0.94 million (approx. EEK 14.71 million). This share purchase was a prospective and long-term investment which does not affect financial performance of AS Järvevana Group in the nearest future. As at 31 December 2007, the investment into the joint venture SIA Zakusala Estates includes intangible assets in the amount of EEK 147.3 million (2006: EEK 147.2 million) which are not recognized on the balance sheet of the investee. The intangible asset represents the lease agreement with the City of Riga expiring at 2 June 2051 which gives it a right to use the 126 thousand m2 registered property on Zakusala island in the centre of Riga.

Note 8: Trade and other receivables

Compared to 2005 and 2006, in 2007 trade and other receivables growth in relation to revenue growth was relatively high, which was affected mostly by the participation in several large public procurements. The accounts receivable turnover increased from 46 days to 59 days and the receivables totalled to EEK 1,199.57 milllion at 31 December 2007. Management estimates that the receivables as at the year-end do not contain significant credit risk and the receivables amount should drop and the cash flow enhance in 2008, when those contracts will be completed.

Note 9: Inventories

Inventories are recorded in the balance sheet at their acquisition cost, which consists of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition. In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishable from each other, then the weighted average cost method is used. Inventories are recognised in the balance sheet at the lower of acquisition cost and net realisable value. The net realisable value is the sales price less estimated sales costs.

Expenditure incurred for real estate development is reported in the balance sheet line Inventories either as work-in-progress or finished goods, depending on the stage of completion. A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Revenue on real estate development is recognised as income from the sale of goods. Upon the sale of real estate properties, a notarially certified agreement is entered into between the Group and the acquirer for transferring the property and the respective entry is made in the land register.

During the last three years, the AS Järvevana Group experienced steady growth of inventories and particularly in work-in-progress and finished goods, which is mainly initiated from the growth of residential and commercial development. In 2007, real estate development made up 16.6% of the sales revenue of AS Järvevana Group, including residential construction of 12.2%. As of 31.12.2007, 58 completed apartments with the cost price of EEK 79.4 million and 1287 unfinished apartments with the cost price of EEK 1,022.5 million, of which 556 apartments had been sold to buyers under preliminary contracts, had not been sold by AS Järvevana Group.

In thousands of EEK	**31.03.2008 (un-audited)**	**31.03.2007 (un-audited)**	**31.12.2007 (audited)**	**31.12.2006 (audted)**	**31.12.2005 (audited)**
Materials	7,791	4,484	3,501	4,579	1,845
Work-in-progress	1,123,410	700,771	1,209,117	567,868	200,482
Finished goods	164,260	27,914	72,434	18,121	4,461
Goods for resale	713,741	703,596	704,124	723,441	752,800
Land purchased for resale*	713,729	703,488	704,111	723,334	752,789
Other goods purchased for resale	12	108	13	107	11
Prepayments for inventories	38,627	43,508	36,250	42,725	4,500
Total inventories	2,047,829	1,480,273	2,025,426	1,356,734	964,088

* AS Järvevana’s inventory also contains land located on nature preserve areas with a total value of EEK 61,098 thousand. There are strict building restrictions on the land located in nature reserves. In accordance with the amendments to the Nature Conservation Act adopted by the Estonian Parliament on 19 June 2008 land owners can claim a compensation from the state for property, the use of which for its intended purposes is significantly hindered by the protection procedure, only in the form of the purchase of the registered property by the state for its usual market price (i.e. the

possibility of exchange has been removed). If a property is not located, as a whole, within the territory of a protected area, the part of the land located within the protected area may be purchased by the state upon agreement with the owner. If the part of the land located within the territory of a protected area is larger than two-thirds of the total area of the property, or if the land encompasses the protected category species protection site or limited management zone of an individual protected natural object, the whole property may be purchased by state based on an agreement. The above amendments shall take effect in 10 days from their publication in the official gazette entitled “Riigi Teataja” (i.e. 1 August 2008) and, thereafter, applications for exchange of land shall be treated by the state as offers to acquire the land. The procedure and bases for evaluation of the property shall be established by a government regulation.

The management of AS Järvevana is of an opinion that the Estonian legislation at the date of this Prospectus allows selling of the land to the state of Estonia for its usual market price, and consequently the management is not aware of any circumstances implying to an impairment of the aforementioned land. For further details please follow consolidated financial statements of AS Järvevana for the year ended 31 December 2007, Note 17.

Note 10: Property, plant and equipment

In 2006, the property of AS Järvevana Group decreased due to the sales of Arena Riga and in 2007 the balance increased due to acqusition of OÜ Fort Ehitus - the pile works and aqua construction entity.

Note 11: Borrowings

Due to intensive development activites and increase of working capital of AS Järvevana Group interest bearing debt has grown steadily during last three years.

In thousands of EEK	31.03.2008 (un-audited)	31.03.2007 (un-audited)	31.12.2007 (audited)	31.12.2006 (audited)	31.12.2005 (audited)
Total borrowings, of which	592,089	373,419	702,592	443,127	317,665
incl. current portion	192,924	223,605	304,879	283,792	114,841
non-current portion 2...5 years	399,165	149,814	397,713	159,335	202,824

Most of AS Järvevana Group’s loans are related to short-term development projects, the duration of which does not exceed 36 months. Due to the short-term nature of the loans, the effect of interest rate increases on the final results of projects is immaterial, and therefore, hedging against interest risks of these obligations is not considered reasonable.

Note 12: Total equity

The equity of AS Järvevana Group in recent years has been influenced by dividend payments and annual profits.

In capital management, the Company follows the principle of maintaining its trustworthiness, sustainable development and the assets of shareholders through economic cycle pursuant to which it monitors that its equity to assets ratio would at any given time be at least 45% (31.12.2007: 52%, 31.12.2006: 50%) and interest bearing debt to assets ratio would not exceed 25% (31.12.2007: 18%, 31.12.2006: 14%).

The practice of AS Järvevana Group has been that 20% of annual profit is disbursed for dividend payment. The actual dividend payment may be adjusted depending on the market situation and the company’s financial standing.

CAPITAL RESOURCES

The following table outlines the consolidated equity and balances of interest bearing liabilities of AS Järvevana as of 31 December 2005, 2006 and 2007 and 31 March 2007 and 2008:

In thousands of EEK	31.03.2008 (un-audited)	31.03.2007 (un-audited)	31.12.2007 (audited)	31.12.2006 (audited)	31.12.2005 (audited)
Interest bearing liabilities	592,089	373,419	702,592	443,127	317,665
Equity	2,204,805	1,697,906	2,049,696	1,612,846	1,111,948

Operating Cash Flow

In 2007, AS Järvevana Group's total cash flows amounted to EEK (468,951) thousand, of which the cash flows from operating activities totalled EEK (488,904) thousand. In 2006, AS Järvevana Group's cash flow from operating activities totalled EEK 155,687 thousand and in 2005 EEK 264,667 thousand. The cash flows from operating activities in 2007 were mostly affected by the operating profit EEK 521,045 thousand, a change in inventories EEK (665,436) thousand, a change in receivables and prepayments related to operating activities EEK (108,379) thousand, a change in liabilities and prepayments (127,742) thousand, adjustment of revenue from construction contracts under the stage of completion method EEK (130,927) thousand and corporate income tax paid EEK (34,597) thousand. AS Järvevana Group's cash flows from investing activities totalled EEK (73,366) thousand, of which EEK 150,824 thousand were loan repayments received and interest, EEK (145,692) thousand loans granted during the period, EEK (48,757) thousand investments into property, plant and equipment and EEK (32,927) thousand investments in subsidiaries and associates. AS Järvevana Group's cash flows from financing activities totalled EEK 93,319 thousand, of which the net balance of credit liabilities assumed and repaid was EEK 222,284 thousand and dividends paid EEK (128,965) thousand.

The period's negative cash flow was covered through additional loans (period's net cash flows from borrowings EEK 236,544 thousand) and through AS Järvevana Group's liquid assets.

To ensure liquidity and better management of the cash flows, AS Järvevana Group companies have concluded overdraft contracts with banks to the total amount of EEK 90 million. In addition to overdraft credits, AS Järvevana has a working capital loan with the limit of EEK 150 million from AS Merko Grupp. Management estimates that AS Järvevana Group's capital structure – high equity rate of 52% of the total assets and a low share of borrowings of 18% of the total assets – ensures the trustworthiness in the eyes of creditors also in difficult times and significantly improves the ability to extend existing financial liabilities and raising additional debt. In 2008, AS Järvevana Group's liquidity will be positively impacted by the completion of several projects with unusually long accounts receivable turnover and the transfer of apartments included in inventories to buyers.

AS Järvevana Group's net cash flow of the three months ended 31 March 2008 was EEK 152,657 thousand, including cash flow from operating activities EEK 276,498 thousand. The cash flow from operating activities was mostly influenced by the change in trade and other receivables related to operating activities (EEK 162,644 thousand), change in trade and other payables (EEK (154,437) thousand) and operating profit EEK 177,900 thousand. Cash flows from financing activities of the three months ended 31 March 2008 totalled EEK (113,001) thousand which consisted of the net balance of credit liabilities assumed and repaid.

Equity

The total amount of shares issued has not changed during the period covered in this Prospectus, the number of shares being 17,700,000 with the par value of EEK 10 each.

Working Capital

Management believes that, considering the current state of the AS Järvevana Group's assets and financial resources, the working capital is sufficient to meet all the liabilities arising as a result of ongoing operations in the next 12 months after the date of this Prospectus.

Borrowings

In thousands of EEK	31.03.2008 (un-audited)	31.03.2007 (un-audited)	31.12.2007 (audited)	31.12.2006 (audited)	31.12.2005 (audited)
Total borrowings, of which	592,089	373,419	702,592	443,127	317,665
incl. current portion	192,924	223,605	304,879	283,792	114,841
non-current portion 2...5 years	399,165	149,814	397,713	159,335	202,824

Out of the interest-bearing liabilities as at 31 December 2007, EEK 10.6 thousand was denominated in Estonian kroons, EEK 79,624 thousand in Lithuanian litas, EEK 382,231 thousand in Latvian lats and EEK 240,727 thousand in euros. The volume of interest-bearing liabilities increased by EEK 260 million in a year end as at the year-end, these liabilities made up 17.9% of the total assets of AS Järvevana Group. Loan interest depended on the base interest of 3-12 month interbank money market loans of the respective country of incorporation. Management expects the European Central Bank to lower the euro base rates over the following 12 months as a result of which Euribor will fall by approximately 50 basis points. However, the management expects the increase of base rates on loans denominated in national currencies of the Baltic States by approximately 75 basis points. Assuming that the volume and structure of borrowings does not change during the year, the following will occur: 1) a decrease/increase of Euribor by (50)/50 basis points will change the Company's interest costs by EEK (1,196)/1,196 thousand; 2) an increase/decrease of base rate on loans denominated in national currencies by 75/(75) basis points will increase/decrease financing costs by EEK (3,476)/3,476 thousand.

Most of AS Järvevana Group's loans relate to short-term development projects, the duration of which does not exceed 36 months. Due to the short-term nature of loans, the effect of interest rate increases is immaterial to the final results of those projects and, therefore, hedging against the interest risks of these obligations is not considered reasonable by the management.

The repayment obligation of AS Järvevana Group's outstanding loan and finance lease as at 31 December 2007 is split between future periods as follows:

In thousands EEK (audited)	**Allocation by due dates**			**Total**
	1-3 months	4-12 months	Over 12 months	
Loan and finance lease liabilities	91,535	213,344	397,713	702,592

The schedule of expected interest payments cannot be determined with reasonable certainty. In line with the best property development practice, the loan obligations to acquire land plots have been assumed with open-end maturities. The repayment of those loan obligations is dependent on the progress of related development projects and on the timing of cash-flows generated from those projects upon completion. Consequently, the management is of the opinion that even their best estimate on the timing of expected interest payments would not be of reliable accuracy for the users of this financial information and, therefore, has not been presented.

The financing agreements entered into by AS Järvevana Group companies contain several negative and positive covenants and requirements to obtain the lender's consent. Most of the financing agreements with financial institutions contain customary provisions on events of default, including cross-default. For further information, see "Risk Factors-Risks Relating to the Company-Financing and Loan Agreements".

TREND INFORMATION

Revenue and Gross Profit

In 2007, the revenue of AS Järvevana Group was EEK 5,510,760 thousand, increasing by 24.8% on the previous year. In 2007, Estonia contributed 61.4%, Latvia 25.2% and Lithuania 13.4% to the revenue growth. As compared to 2006, revenue increased by 31.3% in Latvia, 30.9% in Lithuania and 21.2% in Estonia. Engineering construction contributed 10%, residential construction/development 22%, administrative buildings 43%, office buildings 14%, industrial buildings 2% and road construction 9% to AS Järvevana Group's revenue. Of construction activities, 83% was new structure and 17% was renovation and reconstruction works. In 2007, AS Järvevana Group entered into construction contracts with the total volume of EEK 4,351 million and as at 31 December 2007, AS Järvevana Group's contract backlog totalled EEK 4,136 million.

In 2007, the cost of goods sold of AS Järvevana Group increased by 26.9% and distribution and administrative expenses increased by 43.0%, representing 85.9% and 4.5%, respectively, of revenue. Due to fast growth of service and labour costs, the gross margin decreased from 15.6% to 14.1% in a year, and the operating margin decreased from 14.3% to 9.5% in a year.

AS Järvevana Group's revenue for the three months ended 31 March 2008 was EEK 1,119,572 thousand, which constitutes an annual increase of 10.3% on the respective period in 2007. 55.2% of the revenue originated from Estonia, 26.7% from Latvia and 18.1% from Lithuania. As compared with the respective period in 2007, AS Järvevana Group's sales in Latvia increased by 94.1%, in Lithuania by 19.7% and decreased in Estonia by 10.7%.

Construction Market and its Developments

Warm winter jointly with the cyclic nature of residential construction and real estate development had a positive effect on the revenue in the fist quarter of 2008. In general, the first quarter witnessed the slowing down of the economic growth in all the three Baltic States. As against the first quarter of 2007, the rate of growth of GDP in Estonia was as low as 1.4%, in Latvia 3.6% and in Lithuania 6.4%. Retardation of the economic growth poses a serious challenge to budgets of local-governments and national governments in all the three Baltic States and generates doubts as to the feasibility of projects funded by the public sector.

The three months ended 31 March 2008 did not involve any significant changes in the construction sector. According to the information provided by the Statistical Offices, the building prices continued growing. In the year, the building service became more expensive in Latvia by 20.7%, in Lithuania by 15.4% and in Estonia by 6.0%, while labour costs climbed up in Latvia by 41.3% and in Estonia by 9.5%. For the most part, however, the appreciation occurred in 2007. As against the 4th quarter of 2007, the building service appreciated in Estonia by 1.1%, in Lithuania by 2.0% and in Latvia by 5.1%. By reference to decreasing demand and tighter competition the following quarters of the year may witness stabilization of prices, and in respect of certain types of work, also a certain decline in expenses. When planning the projects, though, one should not reckon with steep decline in prices, because the labour price in the market will continue to depend on demand for building service in the neighbouring countries, and a significant part of building materials is imported into the Baltic States at the prices applicable in the world market.

The market of residential premises picked up, to a certain extent, at the end of the first quarter 2008. However, it is rather a seasonal trend than a breaking point in the buyer's confidence and readiness to buy. As regards the development projects of residential buildings and commercial premises, the market will evidently remain passive and is not expected to recover before 2009. For the time being the largest challenge in the sector is to cope with the narrowing financing opportunities and liquidity problems.

Analysis of comparative indicators in the construction sector, construction works per capita EUR 1,751 (approx. EEK 27,403) in Estonia, EUR 953 (approx. EEK 14,914) in Latvia and EUR 922 (approx. EEK 14,426) in Lithuania, and growth rates for 2007 allow expecting regional segregation of growth rates: fast growth will continue in Latvia and Lithuania, activity will be lower in Estonia and volumes will stall. The growth rates attained in 2007 will be unattainable in 2008 and the market growth will remain between 0 - 15%.

The year 2008 will be challenging for the real estate and construction areas. It will be important to adapt to the changing environment and cope with the risks related to theses changes. The year 2008 will not be able to repeat the success of the previous year, but it will offer new opportunities and lay a good foundation for future success.

ADMINISTRATIVE, MANAGEMENT, AND SUPERVISORY BODIES AND SENIOR 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 Board and the Management Board. See "Additional Information – The Company's Articles of Association" for further information.

Supervisory Board

The Supervisory Board 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 Board reports to the General Meeting of Shareholders.

Pursuant to the Division Plan of AS Järvevana, signed on 30 April 2008 and approved by the General Meeting of Shareholders on 3 June 2008, the Supervisory Board of the Company consists of three members, whose authorization is valid for three years as of the date of their appointment.

The Supervisory Board consists of the following members:

Name	Position in the Company	Business address
Teet Roopalu	Member	Järvevana tee 9G, 11314 Tallinn, Estonia
Jaan Mäe	Member	Järvevana tee 9G, 11314 Tallinn, Estonia
Tõnu Toomik	Member	Järvevana tee 9G, 11314 Tallinn, Estonia

Teet Roopalu

Mr. Teet Roopalu (born in 1949) has graduated from the Faculty of Economics of Tallinn University of Technology, his major being construction economics and organization. Mr. Roopalu has worked in construction companies, incl. as a financial director; has managed economic activities in EKE group of companies as chief economist; has acted as a bank director; and has also been active in the sphere of design. Since November 2002 up until the Division Mr. Roopalu was responsible for the financial and legal sector in AS Järvevana.

Information about the participation of Mr. Roopalu in management bodies during the last five years (since July 2003) is presented in the table below. The positions listed exclude the participation in the management and supervisory bodies of the Company and its subsidiaries.

Entity	Position	Date of the Start	Date of the End
AS Merko Grupp	Member of the Supervisory Board Member of the Management Board	June 2007 April 2004	 July 2007
AS Tartu Maja Betoontooted	Member of the Supervisory Board	November 2003	
E.L.L. Kinnisvara AS	Member of the Supervisory Board	May 2003	
OÜ Vara HTG	Member of the Supervisory Board	March 2003	
OÜ Tornimäe Apartments	Member of the Supervisory Board	May 2004	May 2008
OÜ Evans Holding	Member of the Management Board	March 2005	
OÜ Teet Konsult	Member of the Management Board	February 2007	
Frans Maas Estonia OÜ (deleted from the register)	Member of the Management Board	November 1996	February 2005
OÜ Merko Kaevandused	Member of the Management Board	January 2004	August 2007
OÜ EE Ressursid	Member of the Management Board	January 1998	July 2003

Jaan Mäe

Mr. Jaan Mäe (born in 1964) has graduated from Tallinn University of Technology, his major being industrial and civil engineering. Since 1997 up until the Division Mr. Mäe has worked for AS Järvevana as a site manager, project manager and division manager; he has also served as a member of the Management Board and, as of April 2006, as a member of the Supervisory Board of AS Järvevana.

Information about the participation of Mr. Mäe in management bodies during the last five years (since July 2003) is presented in the table below. The positions listed exclude the participation in the management bodies of the Company and the Subsidiaries.

Entity	Position	Date of the Start	Date of the End
AS Merko Grupp	Chairman of the Supervisory Board	June 2007	
E.L.L. Kinnisvara AS	Member of the Supervisory Board	April 2006	
OÜ Tornimäe Apartments	Member of the Management Board	May 2004	May 2008
Admirali Korterid OÜ	Member of the Management Board	May 2002	January 2004
OÜ Unigate	Member of the Management Board	March 2002	August 2006

Tõnu Toomik

Mr. Tõnu Toomik (born in 1961) has graduated from Tallinn University of Technology, his major being industrial and civil engineering. Mr. Toomik started working for AS Järvevana in 1993 as a project manager and since 1997 up until the Division served as the chairman of the Management Board, responsible for the management and development of the activities of AS Järvevana.

Information about the participation of Mr. Toomik in management bodies during the last five years (since July 2003) is presented in the table below. The positions listed exclude the participation in the management bodies of the Company and the Subsidiaries.

Entity	Position	Date of the Start	Date of the End
E.L.L. Kinnisvara AS	Member of the Supervisory Board	August 1997	
AS Unigate	Member of the Supervisory Board	May 2003	
OÜ Tornimäe Apartments	Member of the Supervisory Board	May 2004	May 2008
AS K&P Ehitus	Member of the Supervisory Board	December 1997	August 2004
AS Remoluft	Member of the Supervisory Board	May 2004	June 2007
AS Telegrupp	Member of the Supervisory Board	July 2002	January 2006
Saue Auto AS	member of the Supervisory Board	May 2004	June 2005
AS Merko Grupp	Member of the Management Board	September 1996	
Normanni Linnagrupi AS	Member of the Management Board	February 1998	

Management Board

The Management Board manages the Company's daily business operations. Pursuant to the Division Plan of AS Järvevana, signed on 30.04.2008 and approved by the General Meeting of Shareholders on 03.06.2008, the Management Board consists of five members whose authorization is valid for three years as of the date of their appointment.

Mr. Tiit Roben is planned to be elected as the Chairman of the Management Board of the Company and is expected to assume the position in September 2008 after his resignation from the management board of E.L.L. Kinnisvara AS.

Name	Position in the Company	Business address
Tiit Roben	Chairman, responsible for the management and development of the activities of the Company	Järvevana tee 9G, 11314 Tallinn, Estonia
Veljo Viitmann	Member, responsible for the preparation and budgeting of tenders for new projects	Järvevana tee 9G, 11314 Tallinn, Estonia
Alar Lagus	Member, responsible for the Company's financial and managerial accounting and investor relations	Järvevana tee 9G, 11314 Tallinn, Estonia
Andres Agukas	Member, responsible for the execution of construction services	Järvevana tee 9G, 11314 Tallinn, Estonia
Tõnu Korts	Member, responsible for the development sector of residential and commercial areas	Järvevana tee 9G, 11314 Tallinn, Estonia

Tiit Roben

Mr. Tiit Roben (born in 1966) has graduated from Tallinn University of Technology, his major being industrial and civil engineering. Since 2005 up until the Division Mr. Roben served as a member of the Management Board of AS E.L.L. Kinnisvara being responsible for the development of the company. Mr. Roben has also previous experience working for several construction companies, including AS Järvevana.

Information about the participation of Mr. Roben in management bodies during the last five years (since July 2003) is presented in the table below. The positions listed exclude the participation in the management bodies of the Company and the Subsidiaries.

Entity	Position	Date of the Start	Date of the End
Viru Väljaku Arenduse AS	Member of the Supervisory Board	October 2003	
E.L.L. Kinnisvara AS	Member of the Management Board	June 2005	
Amistad Invest OÜ	Member of the Management Board	February 2006	
OÜ Sõpruse Investeeringud	Member of the Management Board	September 2006	
Sõpruse Ärimaja OÜ	Member of the Management Board	September 2006	
OÜ Smuuli Kinnisvara	Member of the Management Board	November 2000	
SIA Tirdzniecibas Centras Plesdkodale	Member of the Management Board	January 2006	
SIA MKEE	Member of the Management Board	January 2006	
UAB Nekilnojamas Turtas	Member of the Management Board	December 2005	
UAB Saltesta	Member of the Management Board	December 2005	
UAB Tivesta	Member of the Management Board	October 2005	
AS Viru Keskus	Member of the Management Board	February 2003	October 2003

Veljo Viitmann

Mr. Veljo Viitmann (born in 1962) has graduated from the Civil Engineering Faculty of Tallinn University of Technology, his major being transport engineering and bridges. Mr. Viitmann has worked for AS Järvevana since 1994 up until the Division.

Alar Lagus

Mr. Alar Lagus (born in 1969) has graduated from the Tallinn University of Technology, his major being public catering organization and technology. After graduation Mr. Lagus worked for ten years in different positions in Hansabank. Since 2004 up until the Division Mr. Lagus was responsible for the financial and managerial accounting and investor relations of AS Järvevana.

Information about the participation of Mr. Lagus in management bodies during the last five years (since July 2003) is presented in the table below. The positions listed exclude the participation in the management bodies of the Company and the Subsidiaries.

Entity	Position	Date of the Start	Date of the End
AS Insenerivõrgud	Member of the Supervisory Board	May 2004	April 2005
AS Telegrupp	Member of the Supervisory Board	March 2004	June 2006
AS Merko Grupp	Member of the Management Board	July 2007	
OÜ Sõpruse Investeeringud	Member of the Management Board	September 2006	

Andres Agukas
Mr. Andres Agukas (born in 1965) has graduated from Tallinn University of Technology, his major being transport engineering. Mr. Agukas started in AS Järvevana in 1998 as the first employee of the civil engineering sector and served since 2005 up until the Division as a member of the Management Board of AS Järvevana.

Tõnu Korts
Mr. Tõnu Korts (born in 1974) has graduated from Tallinn University of Technology, his major being construction economy and management. Mr. Korts worked for AS Järvevana since 1997 as a site manager, project manager, project director and division director, and since 2006 up until the Division served as a member of the Management Board of AS Järvevana.

Information about the participation of Mr. Korts in management bodies during the last five years (since July 2003) is presented in the table below. The positions listed exclude the participation in the management bodies of the Company and the Subsidiaries.

Entity	Position	Date of the Start	Date of the End
OÜ Unigate	Member of the Supervisory Board	May 2006	
Graali Vara OÜ	Member of the Management Board	August 2005	August 2007

Declarations in Respect of the Management

To the best of the Company's knowledge, none of the members of the Supervisory Board or Management Board of the Company have been convicted in relation to fraudulent offences for the previous five years, nor were any of these persons in the same period associated with bankruptcies, receiverships or liquidations in their capacity as members of the management or supervisory bodies, partners with unlimited liability, founders or senior manager. To the best of the Company's knowledge, no such persons were subject to any official public incriminations and/or sanctions by statutory or regulatory authorities (including designated professional bodies), nor have they been disqualified by a court from acting as a member of the administrative, management or supervisory bodies of the Company or from acting in the management or conduct of the affairs of the Company for the previous five years.

Conflict of Interest

Some members of the Management of the Company also belong to the management bodies of E.L.L. Kinnisvara AS, as presented above. E.L.L. Kinnisvara AS and the Company are controlled by the same person, AS Merko Grupp. From time to time the Company enters into transactions with E.L.L. Kinnisvara AS, which might be a source for potential conflicts of interest. The Company is of the opinion that this risk of conflicts of interest is sufficiently handled as every transaction has to be entered into on an arm's-length basis. See "Related Party Transactions" for further information. The Company is not aware of any other potential conflicts of interest between the duties of the members of its Supervisory Board or Management Board and their private interests or other duties.

REMUNERATION AND BENEFITS

As the Company was established only recently, no remuneration and benefits were paid by the Company to the members of its Supervisory Board and Management Board in 2007. As the Company was formed in the course of the Division of AS Järvevana and on the basis of the Business operated previously by AS Järvevana and transferred from AS Järvevana to the Company, the following table provides the aggregate gross amount of salary and bonuses paid to the members of the Management Board and Supervisory Board by AS Järvevana for the financial year ended 31 December 2007:

In millions of EEK	Total remuneration	Salary	Bonuses
Supervisory Board	7.0	1.8	5.2
Management Board	14.8	3.2	11.6

The remuneration for the Supervisory Board includes remuneration paid for 2007 to Mr. Toomas Annus, Mr. Jaan Mäe and Mr. Teet Roopalu who were the members of the Supervisory Board of AS Järvevana in 2007.

The remuneration for the Management Board includes remuneration paid for 2007 to Mr. Tõnu Toomik, Mr. Veljo Viitmann, Mr. Alar Lagus, Mr. Andres Agukas and Mr. Tõnu Korts who were the members of the Management Board of AS Järvevana in 2007.

The Company believes that the disclosure of personalized remuneration does not create additional value and disturbs the privacy of the members of the Management.

Upon premature termination or non-extension of the service contract and on the condition that the members of the Management or Supervisory Board shall not compete with the Company, severance pay shall be paid to the members of the Management and Supervisory Board equaling their twelve-month basic remuneration. The Company does not provide any other pension, retirement or similar benefits.

BOARD PRACTICES

The Tenures

	Position	Start Date	End Date	Start Date in the same position in AS Järvevana
Teet Roopalu	Member of the Supervisory Board	30 April 2008	30 April 2011	12 April 2003
Jaan Mäe	Member of the Supervisory Board	30 April 2008	30 April 2011	19 May 2006
Tõnu Toomik	Member of the Supervisory Board	30 April 2008	30 April 2011	2 January 1997*
Tiit Roben	Member of the Management Board	30 April 2008	30 April 2011	
Veljo Viitmann	Member of the Management Board	30 April 2008	30 April 2011	27 May 1997
Alar Lagus	Member of the Management Board	30 April 2008	30 April 2011	5 January 2004
Andres Agukas	Member of the Management Board	30 April 2008	30 April 2011	1 October 2005
Tõnu Korts	Member of the Management Board	30 April 2008	30 April 2011	25 May 2006

* The starting date on the Management Board of AS Järvevana.

Upon premature termination or non-extension of the service contract and on the condition that the members of the Management or Supervisory Board shall not compete with the Company, severance pay shall be paid to the members of the Management and Supervisory Board equaling the person's twelve-month salary.

The Company does not have any audit or remuneration committees.

Corporate Governance

From 2006, the Corporate Governance Recommendations, which lay down the general principles of managing companies and treating of shareholders, apply to the issuers of equity securities listed on the Tallinn Stock Exchange. The application of the Corporate Governance Recommendations is recommended for publicly traded companies, and companies are free to decide whether to follow the main recommendations or not. The Corporate Governance Recommendations are based on the principle of *comply or explain* according to which a company must explain its standpoints and activities with regard to those provisions which it does not follow.

The Company places great value on the equal treatment of its shareholders, the transparency of the Company's management processes as well as the reliability of its activities. The following is based on the activities of AS Järvevana, as the Company does not have sufficient corporate history as of the date of the Prospectus. However, the practices of AS Järvevana will be applied also by the Company. For technical, economic or other reasons the Company does not intend to follow some of the principles of the Corporate Governance Recommendations.

The Company's highest governing body is the General Meeting of Shareholders, the powers of which are regulated by legislation and the articles of association of the Company.

The Corporate Governance Recommendations require that members of the management board, the chairman of the supervisory board and, if possible, members of the supervisory board and at least one of the auditors should participate in the General Meeting.

On behalf of the Company, the Chairman of the Management Board and Chairman of the Supervisory Board participate in the General Meeting of AS Merko Ehitus, and if necessary, other members of the Management and Supervisory Boards are involved. The Company does not consider the participation of all members of the Management and Supervisory Boards in the General Meeting to be necessary.

The Corporate Governance Recommendations require that at least one-half of the members of the supervisory board must be independent. If the supervisory board has an odd number of members, 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 interest.

The Supervisory Board of AS Merko Ehitus has three members. Merko Ehitus does not have any independent members of the Supervisory Board meeting the definition of the Corporate Governance Recommendations, as the members also participate in the work of the companies controlled by the Company and in the Supervisory Boards of the Company's controlling shareholder. The members of the Supervisory Board are elected on the basis of their knowledge and experience in the field of construction and real estate development. A peculiar feature of the work procedures of the Supervisory Board of Merko Ehitus is the fact that the members work full-time on the basis of service contracts. Such a work procedure adds responsiveness to the activities of the Group, ensures better informativeness of the Supervisory Board and altogether enables more efficient supervision over the activities of business units, which are dispersed geographically and have diverse operations.

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, and other financial benefits and bonuses.

The Management Board of AS Merko Ehitus has five members. The activities of the members are divided by areas of operation: general management, construction, development, technology, and finance. The Chairman of the Management Board leads the work of the Management Board. The members of the Management Board have entered into three-year service contracts with the Company. The Company discloses the total amount of remuneration and bonuses of the members of the Management Board in the annual report, as it believes that the disclosure of personalised remuneration does not create additional value and disturbs the privacy of the members of the Management Board.

In accordance with the Corporate Governance Recommendations, the issuer must publish the disclosure dates of information subject to disclosure throughout the year at the beginning of the fiscal year in a separate notice, called the financial calendar.

In disclosing information, AS Merko Ehitus follows the rules and regulations of the Tallinn Stock Exchange and immediately discloses important information regarding the Company's activities to the shareholders after obtaining reasonable assurance as to its correctness and making sure that the disclosure of such information does not harm the interests of the Company and its business partners. Important information will be disclosed through the stock exchange system and on the Company's website. During the year, Merko Ehitus will not publish the dates for disclosing information, the so-called financial calendar, because the disclosure of reliable dates would incorporate an additional time factor into the dates and endanger the timeliness of disclosures. Merko Ehitus publishes important information regarding the Company after the end of the trading day and informs shareholders about publishing interim financial statements and the annual report at least two days prior to their disclosure.

Corporate Governance Recommendations require that the issuer disclose the amount of remuneration the issuer has paid or will pay to the auditor.

In electing the auditor, the Company considers his/her independence, competence, reliability and the price of the service offered by him/her. The Company will not publish the fees paid for the provision of auditing and consulting services, because such activities may significantly impair the Company's ability to obtain the service for a competitive price in the future.

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 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.

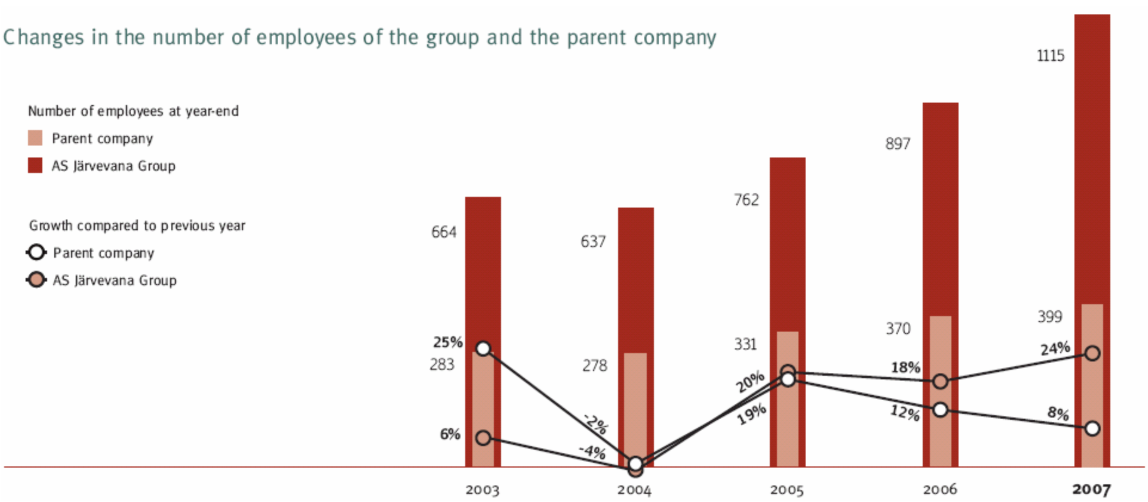
EMPLOYEES

Number of Employees

Employees are one of the main assets of the Company. All the employment contracts of AS Järvevana were transferred to the Company in the course of the Division, and therefore the following is based on the information of AS Järvevana Group.

In 2007, the number of AS Järvevana Group's employees increased by 218 people and, as at 31 December 2007, AS Järvevana Group had 1,115 employees. The gross wages and salaries of AS Järvevana Group's employees totaled EEK 406.6 million, of which basic wages and salaries made up 70.5% and bonuses 29.5%, or 46.3% more than in 2006. As compared to 2006, the number of AS Järvevana Group's employees increased by 24.3% and the average wages per employee grew by 17.7%. The number of employees of the parent company AS Järvevana was 399 at the year-end 2007, increasing by 29 people in a year. Gross wages and salaries paid to employees totaled EEK 177.3 million, for the annual growth of 40.6%, including the growth of base wages of 36.2% and that of bonuses of 48.3%.

The change in the number of employees is represented in the chart below:



The following table represents the breakdown of employees by geographic location as of the specified dates:

Location	31 December 2007	31 December 2006	31 December 2005
Estonia	679	603	537
Latvia	281	186	155
Lithuania	155	108	70
TOTAL	**1,115**	**897**	**762**

Most of the employment contracts have been concluded for an indefinite term. As a rule the AS Järvevana Group companies do not employ temporary employees.

Share Ownership and Acquisition of Shares

The member of the Supervisory Board of the Company, Mr. Tõnu Toomik, has an indirect holding in the Company through AS Merko Grupp, which owns 71.99% of the share capital of the Company. Mr. Toomik owns 12.61% of the shares of AS Merko Grupp.

The member of the Management Board, Mr. Tiit Roben, has an indirect holding in the Company through Amistad Invest OÜ, which ownes 0.0085% of the share capital of the Company. Mr. Roben has a 50% holding of Amistad Invest OÜ.

To the best of the Company's knowledge, no other members of the Supervisory Board and Management Board or their close relatives own any shares of the Company.

Employee Participation Schemes

The Company does not have in place any arrangement for involving the employees in its equity.

MAJOR SHAREHOLDERS

The shareholders of public limited companies whose shares are admitted to trading on an Estonian or European Economic Area Member State regulated market must notify about certain percentage thresholds in their shareholdings according to the Estonian Securities Market Act. In accordance with § 185(1) of the Estonian Securities Market Act, the minimum threshold which requires the notification is five percent of the interest in the capital or voting rights of the issuer, exercised either directly or indirectly, individually or together with persons acting in concert. The list of the Company's major shareholders, as of 1 August 2008, together with the amount of each such person's interest is provided in the table below.

Name of the shareholder	Number of shares	Proportion
AS Merko Grupp	12,742,686	71.99%
Skandinaviska Enskilda Banken Ab, clients	1,040,334	5.88%
ING Luxembourg S.A., clients	963,376	5.44%

The Company is being controlled by AS Merko Grupp. AS Merko Grupp is a public limited company registered in the Estonian Commercial Register under registration code 10068039. The registered office of AS Merko Grupp is Järvevana tee 9G, 11314 Tallinn. With the proportion of 65.32% of the holdings of AS Merko Grupp, the ultimate controlling party is Mr. Toomas Annus. Other shares of AS Merko Grupp are ultimately controlled by Mr. Tõnu Toomik, a member of the Supervisory Board of the Company, who controls 12.61% of the shares of AS Merko Grupp; Mr. Viktor Mõisja, who controls 8.56% of the shares of AS Merko Grupp; Mr. Ott Kikkas, who controls 7.2% of the shares of AS Merko Grupp, and Mr. Ülo Metsaots, who controls 6.31% of the shares of AS Merko Grupp.

None of the major shareholders of the Company have different voting rights compared to other shareholders of the Company.

All transactions of the Company are concluded on an arms' length basis, which is in the opinion of the Company sufficient to prevent transactions harmful to the interests of the Company. Further, in accordance with the Articles of Association of the Company the consent of the Supervisory Board is required for the conclusion of certain transactions exceeding specified thresholds. For transactions and limits thereof requiring consent of the Supervisory Board see further "Additional Information – The Company's Articles of Association – Supervisory Board".

As of the date of the Prospectus, the Company is not aware of any existing agreements between the shareholders of the Company the operation of which may at a subsequent date result in a change in control over the Company.

RELATED PARTY TRANSACTIONS

The Company and its subsidiaries are parties to certain agreements with related parties. The following entities have been considered as related parties:

- parent company AS Merko Grupp;
- shareholders of AS Merko Grupp with significant influence through AS Merko Grupp;
- other shareholders of the Company with significant influence;
- other subsidiaries of AS Merko Grupp, so-called "entities controlled by the parent company";
- associates and joint ventures;
- key managers and their close relatives;
- entities under control of persons mentioned above.

Significant influence, as referred to above, is presumed to exist when the person has more than 20% of the voting power.

The most relevant and material of the recent and on-going agreements with related parties are the following:

1. In the Division Plan, a loan in the amount of EUR 7,989,000 (approx. EEK 125,027,850) was agreed upon between the Company and AS Järvevana. The interest for the first twelve months has been fixed at 6%, henceforth the interest rate is twelve months' EURIBOR + one percent. The lender, AS Järvevana, is entitled to declare the loan principal or any portion thereof rounded to EUR 500,000 (five hundred thousand) integer along with the interest accumulated thereon immediately due and repayable upon at least 30 (thirty) days' advance notice. The terms and conditions of the loan agreed upon under the Division Plan were specified in the cooperation agreement between the Company and AS Järvevana, dated 31 July 2008 (the "Cooperation Agreement"). According to the Cooperation Agreement it is further agreed that (a) AS Järvevana is entitled to demand repayment of the principal of the loan partially in the amount of EUR 500,000 during each year and in a higher amount if AS Järvevana fails to perform its obligations arising from or related to the criminal case No 05913000055 and (b) the Company is entitled to repay the loan by giving at least 6 months' advance notice.

2. In the Division Plan a put option and a call option were agreed upon. According to the put option the Company has an obligation to acquire from AS Järvevana certain properties for the total consideration of EEK 100 million. According to the call option the company is entitled to acquire from AS Järvevana the same properties for the total consideration of EEK 100 million. The terms and conditions of the put and call options agreed upon in the Division Plan were specified by the Cooperation Agreement. The Cooperation Agreement specifies the term for the exercise of the call and put option, which is 3 years from the execution of the Division Plan. The term for the exercise of the options has been agreed to renew itself automatically for one year at a time after passage of the initial 3-year term. The automatic renewal of the term for the exercise of the options will terminate as of termination of the criminal proceedings in the criminal case No 05913000055 by a court order or other ruling that has entered into force. According to the Cooperation Agreement AS Järvevana has the right to sell to the Company all or any of the properties at the negotiated price by notifying the Company of its wish to exercise the put option at least thirty days in advance. However, AS Järvevana is entitled to exercise its put option only if it has requested repayment of the loan provided to AS Merko Ehitus and referred to in the Division Plan. Further, the Company is entitled under the Cooperation Agreement to buy at any time from AS Järvevana all or any of the properties by notifying AS Järvevana of its wish to exercise the call option at least thirty days in advance. The properties subject to the agreement and the option exercise prices have been presented in the following table:

New property No.	Cadastral reference	Address	Option exercise price per property (in EEK)
152502	19801:002:0962	Harku municipality, Tiskre Village, Kallaste II	9,500,000
13290401	78403:315:2670	Tallinn, Valukoja Str 26	21,000,000
13290501	78403:315:2680	Tallinn, Valukoja Str 24	28,000,000
13291001	78403:315:2730	Tallinn, Valukoja Str 35	4,500,000
18460801	78407:701:0177	Tallinn, Tendre Str 55	37,000,000
Total exercise price of options (in EEK):			**100,000,000**

3. On 2 May 2008, AS Järvevana transferred the 100% shareholding in the company OÜ Karulaugu Kinnisvara (registry code 11034491) to E.L.L. Kinnisvara AS, a subsidiary of AS Merko Grupp. The sale price of the transaction was EEK 42 million, from which EEK 4.12 million, the balance of the company's financial obligations and current assets, were deducted. The entire sales price was paid to the seller upon transfer of the shares.

4. On 17 March 2008, AS Järvevana sold the properties in Riga, at Skantes Street 25 (gross area 6,028 m^2), Skantes Street 26 (gross area 6,593 m^2) and Skantes Street 27 (gross area 7,084 m^2), to E.L.L. Kinnisvara AS, a subsidiary of AS Merko Grupp. The total sales price was EEK 142,457,646 (EUR 9,102,725) without VAT.

5. On 28 December 2007, AS Järvevana sold the property in Tallinn, Põhja pst. 37, to E.L.L. Kinnisvara AS, a subsidiary of AS Merko Grupp. The sales price of the transaction was EEK 58.5 million without VAT. Subject to the total construction capacity to be established by the detailed plan for the property as well as the expenses related to the liquidation of the environmental pollution, an additional sales price shall be paid up to the amount of EEK 6.5 million.

6. On 12 March 2007, AS Järvevana and OÜ Linnamaa Kinnisvara, a subsidiary of AS Merko Grupp, concluded an appendix to a construction contract, and as a result an office building (gross area 15,761 m^2) and a multi-storey car park (gross area 10,214 m^2) in Tallinn, at Pärnu road 141 will be built. The price of the contract is EEK 321,600,460 without VAT, and the completion time for the work is set for November 2008.

7. On 29 December 2006, AS Järvevana sold its 100% shareholding in the company OÜ Rannamõisa Kinnisvara (registry code 10677241) to E.L.L. Kinnisvara AS, a subsidiary of AS Merko Grupp. The sales price was established at EEK 35 million, from which the balance of company's financial obligations and current assets was deducted. AS Järvevana made a profit in the amount of EEK 23.75 million as a result of the transaction. Additionally, according to the contract, the buyer was obligated to order the construction on the plot from AS Järvevana. At the date of the transaction OÜ Rannamõisa Kinnisvara and AS Järvevana had a valid loan agreement, according to which OÜ Rannamõisa Kinnisvara owed to AS Järvevana EEK 2.76 million.

8. On 13 November 2006, AS Järvevana and OÜ Sõpruse Ärimaja, a subsidiary of AS Merko Grupp, concluded an appendix to a construction contract for the construction of an office building in Tallinn, at Sõpruse pst. 145. The price of the contract was EEK 253,919,553 without VAT.

9. On 29 September 2006, SIA Merks, a subsidiary of AS Järvevana, and SIA MKEE, a subsidiary of AS Merko Grupp, concluded a construction contract for the building of furniture store in Riga, at Jaunmoku Street 12 (gross area 28,000 m^2). The price of the contract was EEK 266,441,000 (LVL 12,007,256) without VAT.

10. On 23 March 2006, UAB Merko Statyba, a subsidiary of AS Järvevana, and UAB Saltesta, a subsidiary of AS Merko Grupp, concluded a construction contract for the building of a shopping centre in Vilnius, at Saltoniškiu 9. The price of the contract was EEK 1,055,490,000 (LTL 233,000,000) without VAT.

11. On 30 January 2006 a construction contract concluded between SIA Merks, a subsidiary of AS Järvevana, and SIA Zeltini M, a subsidiary of AS Merko Grupp, was enforced for the construction of a seven-storey office building in Riga, at Hospitalu' street. The price of the contract was approx. EEK 216,037,259 (LVL 9,735,794).

12. On 18 November 2005, AS Järvevana and OÜ Veeilu, a subsidiary of AS Merko Grupp, concluded a contract for design and construction works of the Nordic Hotel Forum in Tallinn, at Narva street 1A/ Viru väljak 2A. The price of the contract was EEK 237,651,091 without VAT.

13. On 8 July 2005, AS Järvevana transferred its 100% shareholding in OÜ Merko Kaevandused (registry code 10540989) to AS Merko Grupp. The sale price of the transaction was EEK 5.1 million.

The Company and its subsidiaries have also executed several other intra-group transactions, such as for the purchase or rendering of construction services, real estate transactions, loan agreements, guarantees and other agreements. For additional information regarding related party transactions and balances concerning the Business transferred from AS Järvevana to the Company in the course of the Division, see Note 6 to the un-audited consolidated condensed interim financial information of AS Järvevana Group for the three months ended 31 March 2008, Note 34 to the consolidated financial statements of AS Järvevana Group for the year ended 31 December 2007, Note 34 to the consolidated financial statements of AS Järvevana Group for the year ended 31 December 2006 and Note 35 to the consolidated financial statements of AS Järvevana Group for the year ended 31 December 2005. The Management believes that all of the above agreements have been entered into on an arm's length basis.

FINANCIAL INFORMATION CONCERNING THE ISSUER'S ASSETS AND LIABILITIES, FINANCIAL POSITION AND PROFITS AND LOSSES

Historical Financial Information

The un-audited pro forma financial information and historical financial information of the Company is presented in the Annexes to this Prospectus. Please see "Index to Financial Information" on page 102. There has not been any significant change in the Group's financial or trading position since the end of the financial period for which the audited financial information and interim financial information has been published.

Dividends and Dividend Policy

The shares of the Company will grant the right to a share of the Company's profit as of entry of the Division in the commercial register of the seat of the Company.

The Company does not have an official dividend policy, but the practice of AS Järvevana has been that 20% of annual profits is disbursed for dividend payment.

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 deemed by the Management Board to be relevant at the time. Moreover, the Management Board merely makes a proposal for the amount of dividends to be distributed. The Supervisory Board has the right to amend such proposal and the proposal is ultimately to be approved by the General Meeting of Shareholders. For more details on the procedure and regulatory restrictions relating to the payment of dividends, see "Additional Information- Shareholders Rights- Dividends and Other Distributions".

Due to the fact that the Company was established only recently, it has not yet paid dividends. As the Company was formed in the course of the Division of AS Järvevana and on the basis of the Business operated previously by AS Järvevana and transferred from AS Järvevana to the Company, an overview of the dividends paid by AS Järvevana is hereby given.

The table below shows dividends on shares that AS Järvevana has declared and paid since 2005. The General Meeting of the Shareholders of AS Järvevana approved the proposal not to pay dividends for the financial year 2007. Dividends paid historically are not representative of dividends to be paid in the future:

	2007	2006	2005
Total amount of dividends paid out (in EEK thousand)	123,900	88,500	57,525
Number of shares	17,700,000	17,700,000	8,850,000
Dividend per share (in EEK)	7.0	5.0	6.5

As to the tax considerations applicable to dividends, see "Taxation – Taxation of Dividends".

Legal and Arbitration Proceedings

On 15 October 2007, the Prosecutors' Office launched Criminal Proceedings (criminal case No. 05913000055) against AS Järvevana and Chairman of AS Järvevana's Supervisory Board Mr Toomas Annus, suspected of bribery and misuse of trust regarding the land swap transactions. The substance of suspicions is incomprehensible to the management of AS Järvevana, as the activities of

AS Järvevana and its governing bodies have always been appropriate and in compliance with the laws of the Republic of Estonia. The management of AS Järvevana estimated that the restructuring of AS Järvevana by means of division was the best way to ensure its sustainable development and to protect the interests of shareholders and employees in the long-lasting Criminal Proceedings related to the land swap transactions. See further “Risk Factors – Risks Related to the Company’s Business – Risk Relating to the Division of AS Järvevana”

ADDITIONAL INFORMATION

Share Capital

The current registered share capital of the Company is EEK 177,000,000. It is divided into 17,700,000 ordinary shares with a par value of EEK 10. The Company does not have any classes of shares other than ordinary shares and does not contemplate the issue of any shares of such other classes. Upon Division the share capital of the Company has been fully paid by a non-monetary contribution (i.e. the Business).

The Shares have been issued under the laws of the Republic of Estonia and registered in book-entry form in the Estonian Central Registry of Securities (as maintained by AS Eesti Väärtpaberikeskus, address Tartu mnt 2, 10145 Tallinn) under ISIN EE3100098328.

No shares are held by or on behalf of the Company itself or by subsidiaries of the Company. No convertible securities, exchangeable securities or securities with warrants are outstanding; likewise, there are no outstanding acquisition rights or undertakings to increase share capital. No put or call options are outstanding with respect to the shares of any Group company.

The share capital of the Company has not been increased or decreased since the incorporation of the Company in the course of the Division.

The Company's Articles of Association

The main objective of the Company is to gain profit from its business activities (i.e. construction of commercial and other buildings). The principal activity of the Company is entered into the Commercial Register on the basis of the information provided by the Company.

Pursuant to the Estonian Commercial Code of 1995 (the "CC"), the Articles of Association must above all include provisions regarding the number of members in the Management Board and Supervisory Board and if necessary, also the specifications for the right of representation of the members of the Management Board. In addition, the Articles of Association may specify the specific work procedure of the Management Board, term of election of the Management and Supervisory Board members, transactions for conclusion of which the consent of the Supervisory Board is required and such other issues which are not in conflict with the law.

To summarize, the Articles of Association include the following provisions with respect to the Supervisory Board and Management Board:

Supervisory Board

According to the Articles of Association of the Company, the Supervisory Board plans the activities of the Company, organizes the management of the Company and supervises the activities of the Management Board. The Supervisory Board reports to the General Meeting of Shareholders. According to the Articles of Association and the Commercial Code, the Supervisory Board's functions also include the following:

- appointment and removal of members of the Management Board and procurators;
- approving and amending the Company's overall strategy;
- approval of the annual budget;
- review of the annual report prepared by the Management Board;
- determination of agendas of general meetings;
- approval of transactions between the Company and members of its Management Board and decisions regarding taking action against members of the Management Board, and appointing a representative for the Company in such action or transaction;
- approval of transactions outside the ordinary course of business of the Company.

Consent of the Supervisory Board is required by the Management Board for conclusion of transactions which bring about:

- conclusion of a transaction, including signing of a contract or agreement and placement of an offer, if the total value of the transaction or simultaneous transactions exceeds EUR 10,000,000 (ten million); or
- assumption of a loan or signing of a leasing agreement in the sum exceeding EUR 1,000,000 (one million); or
- granting of a loan, securing of a debt, acquisition of a claim or taking over of a debt in the sum exceeding EUR 200,000 (two hundred thousand); or
- making of an investment in, or acquisition or disposal of, fixed assets beyond the annual budget, if the total value of the transaction or simultaneous transactions exceeds EUR 200,000 (two hundred thousand); or
- acquisition or transfer of an immovable or registered immovable, if conclusion of such a transaction has not been prescribed by a business plan or if the value of the transaction exceeds EUR 200,000 (two hundred thousand); or
- the acquisition, transfer or dissolution of a company; or
- the foundation or closure of foreign branches

The Supervisory Board has three to five members elected for a term of three years. The members of the Supervisory Board elect a chairman from among themselves, who organizes the activities of the Supervisory Board.

Management Board

According to the Articles of Association, the Management Board is a directing body of the Company, which represents and directs the Company in accordance with the lawful orders of the Supervisory Board. *See* "Estonian Securities Market - Estonian Company Law - Corporate Governance" for further information on the duties of the Management Board.

The Management Board has three to six members, the Chairman being elected by the Supervisory Board. The members of the Management Board are elected for a term of three years.

Shareholders Rights

General Meetings of Shareholders

Shareholders exercise their power to decide on corporate matters at the 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, at the latest. Annual general meetings are held once a year. The Management Board can convene an extraordinary general meeting of shareholders whenever it deems it appropriate. In addition, the Management Board must convene an extraordinary general meeting when it is required by the Commercial Code (for example, if the company's equity capital falls below the minimum level required by law) and when the Supervisory Board, the auditor or shareholders representing at least one-tenth of the share capital of the company request so). If the Management Board fails to convene an extraordinary general meeting within one month after the receipt of such a request, the shareholders, the Supervisory Board or the auditor are entitled to convene an extraordinary general meeting themselves.

Notices to convene an annual general meeting of shareholders must be given no later than three weeks prior to the meeting, and notices to convene extraordinary general meetings of shareholders must be given no later than one week before the meeting. The Management Board will send the notice calling a general meeting by registered or regular post, facsimile transmission or email to all shareholders holding registered shares. The notice must be sent to the address specified in the share 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. 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. General meetings must be held at the seat of the Company (i.e. within the administrative territory of the Tallinn city).

The Supervisory Board normally sets the agenda for the general meeting of shareholders. If, however, the shareholders or the auditor call a general meeting of shareholders, they also set the agenda for it. 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 items be included on the agenda for 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 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.

The General Meeting may adopt resolutions if over one-half of the votes represented by shares are present. If the votes specified in this article are not represented at the general meeting, the Management Board will, within three weeks but not earlier than in seven days, call another meeting with the same agenda. The new general meeting is competent to adopt resolutions regardless of the votes represented at the 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 disapplying the existing shareholders' pre-emptive subscription rights requires a majority of at least three-quarters of the votes represented at the meeting. Creating a new class of shares requires an amendment of the articles of association with a two-thirds majority of votes represented at the meeting. According to Estonian law, 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 attaching to the shares of the Company and nineteenths of all the shareholders who own shares affected by the amendment.

Dividends and Other Distributions

The General Meeting of Shareholders authorizes the payment of dividends on the terms and conditions set out in the profit distribution proposal presented by the Management Board. The Supervisory Board 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. Dividends may only be paid out from net profit or undistributed profit from previous financial years 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, 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 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 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 fixed at an earlier date than ten trading days after the date of the relevant general meeting. All the shares of the Company are registered with the Estonian Commercial Register and grant the same rights with regard to dividends and other distributions of the Company (including distribution of assets in the event of dissolution).

Pre-emptive Subscription Rights

Under Estonian law, existing shareholders of limited liability companies 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 the following conditions are met:
(i) the acquisition occurs within one year after the adoption of a resolution of the general meeting which specifies the conditions and term for the acquisition and the price 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 or by a resolution of the supervisory board without requiring a resolution of the general meeting if the acquisition of the shares is necessary to prevent significant damage to the company. The shareholders must be informed of the circumstances 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 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 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.

Pledge of Shares

A registered share may be pledged. A share encumbrance transaction must be in writing.

Transfer of Shares

The registered shares are freely transferable. Upon transfer of shares to third parties the shareholders have no right of pre-emption.

Disclosure of Shareholdings

Pursuant to the 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 and an auditors' report, a list of shareholders holding more than 10% of the votes as of the date of the approval of the annual report by the general meeting of shareholders.

See "Estonian Securities Market - Tallinn Stock Exchange and the Estonian Securities Market-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.

MATERIAL CONTRACTS

The following provides a summary of material contracts, other than contracts entered into in the ordinary course of business, to which the Company or any member of the Group is a party, for the two years preceding the publication of the Prospectus.

In the Division Plan a put option and a call option were agreed. According to the put option the Company has an obligation to acquire from AS Järvevana certain properties for the total consideration of EEK 100,000,000. According to the call option the company is entitled to acquire from AS Järvevana the same properties for the total consideration of EEK 100,000,000. For more information see “Related Party Transactions”.

On 11 December 2006 SIA Merks, a Latvian subsidiary of the Company (then the subsidiary of AS Järvevana) disposed of the shareholding in SIA Arena Riga for EUR 17,610 thousand (EEK 275,597 thousand). For a more precise overview of the SIA Arena Riga contract please see “Business Overview-Exceptional Factors”.

DOCUMENTS ON DISPLAY

For the period of validity of this Prospectus, the annual reports of AS Järvevana (formerly AS Merko Ehitus) for the financial years ended 31 December 2005, 2006 and 2007; the un-audited consolidated condensed interim financial report of AS Järvevana for the three month period ended 31 March 2008 and the Articles of Association of the Company are available at its head office located at Järvevana tee 9G, Tallinn, Estonia and on the Company's website (www.merko.ee) as well as on the website of the Tallinn Stock Exchange. Any interested party may obtain a copy of these items from the Company without charge. References to the Company's website in this Prospectus should not be deemed to incorporate the information on the Company's website by reference.

INFORMATION ON HOLDINGS

In addition to the entities described in section "Organizational Structure" the Company also has holdings in other undertakings as presented below:

	Shareholding and voting rights as of 31.12.2007 %	**Location**	**Area of operation**
Associate of AS Merko Ehitus			
AS Tartu Maja Betoontooted	25	Tartu	concrete elements
Joint ventures of AS Merko Ehitus			
Normanni Linnagrupi AS	50	Tallinn	construction
OÜ Unigate	50	Tallinn	real estate
Joint ventures of SIA Merks			
PS Merks Terbe Lat	50	Republic of Latvia, Riga	construction
SIA Zakusala Estates	50	Republic of Latvia, Riga	real estate
Joint venture of AS Merko Tartu			
OÜ Kortermaja	50	Tartu	real estate

ESTONIAN SECURITIES MARKET

Estonian Company Law

The following is a brief overview of the provisions of Estonian legislation regulating the legal status and management of public limited companies. The following summary 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 Prospectus and is subject to changes as a result of any future amendments to Estonian legislation.

Introduction

Estonian law recognizes two basic forms of limited liability companies; (i) a private limited company (*osaühing*, abbreviation *OÜ*) and (ii) a public limited company (*aktsiaselts*, abbreviation AS). Shareholders in either form are generally not personally liable for the obligations of the companies. The two company forms 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 Estonian Central Registry of Securities (*Eesti väärtpaberite keskregister*) ("ECRS"). ECRS maintains the share registers of companies and records all the share transactions.

Under Estonian law, essential details about commercial undertakings must be entered in the Commercial Register, and a company acquires legal capacity when it has been entered in the Register. Accordingly, a company organized under Estonian law must be registered with the Commercial Register. Commercial Registers are kept by the courts of first instance and they are attached to the Real Estate Registers. The registers are kept in Estonian and all documents in other languages must be submitted with a certified translation.

The minimum share capital required for incorporating a public limited company is EEK 400,000. A public limited company's share capital must be fully paid up when it is registered in the Commercial Register. Shares must be paid up in cash unless the company's articles of association allow payment by means of a non-monetary contribution. An auditor must audit the valuation of a non-monetary contribution and must present an opinion on whether the contribution meets the requirements specified by law. An opinion of an auditor must *inter alia* include an assessment whether the value of the non-monetary contribution corresponds to the nominal value and issue premium of the share paid for by the non-monetary contribution. 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 grant the shareholders a right of first refusal. Dividends must be distributed to the holders of shares of the same class *pro rata*, based upon the nominal value of the shares held by each shareholder. Public limited companies may also 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 sum of the nominal values of preferred shares must not be greater than one-third of the share capital.

Corporate Governance

The management board, supervisory board and general meeting of shareholders are responsible for the corporate governance and management of a public limited company. The 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, electing members of the supervisory board, approving the annual report and distributing profit.

A public limited company incorporated in Estonia must have a two-tier management structure, with a supervisory board and a management board. The management board is an executive body responsible for the day-to-day management of the company, and it represents the company towards third parties, such as entering into contracts on its behalf. A member of the management board must be elected for a specified term of three years unless the articles of association prescribe another term which must not be longer than five years. Members of the management board have a fiduciary duty of loyalty and due diligence, and must preserve the business secrets of the company. Members of the management board may not serve as members of a directing body of another company which operates in the same area of activity as the public limited company, without the consent of the supervisory board, unless the companies belong to the same group of companies. The management board must follow the instructions of the supervisory board, provided that they do not breach the law. At least one-half of the management board members in 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 members of the supervisory board of the same company.

Whilst most Estonian listed companies have a management board comprising several members, the law also allows a management board comprising only one person who acts as the chief executive officer of the company.

The supervisory board is responsible for supervising the activities of the management board, devising business plans and generally organizing the management of the company. The supervisory board must have at least three members. The general meeting of shareholders elects and appoints the supervisory board for a period of five years, unless a shorter period is prescribed in the articles of association. The supervisory board reports to the general meeting of shareholders. There are no residency or nationality requirements for the members of the supervisory board. A member of the supervisory board may not simultaneously serve as a member of the management board of the same company or any of its subsidiaries.

Members of the management board and supervisory board have a number of general obligations towards the company, including a fiduciary duty of loyalty, acting with due diligence, performing their duties with sufficient skill and in a manner commensurate with their knowledge and abilities, and acting to maximize the benefit of the company and prevent losses in the company. Members of the supervisory board and management board must inform the company about any conflicts of interest and other material facts related to the performance of their duties. Members of the supervisory board and management board are subject to a strict confidentiality obligation for any information that they may learn in connection with the discharge of their duties. This confidentiality applies to the company’s business and trade secrets and any other information that the company has a legitimate interest to keep confidential. To the extent necessary to protect the company’s interests, the confidentiality obligation continues even after the member of the management board or supervisory board no longer serves in that position. Exceptions to the confidentiality obligation arise where the company authorizes the disclosure or where it is required by law. Unauthorized disclosure of business secrets may result in criminal sanctions.

Pursuant to the Estonian Commercial Code, a public limited company is required to engage an auditor who is appointed by the general meeting of shareholders. The general meeting of shareholders must also determine 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 financial statements audited.

After the end of the financial year, the management board prepares the financial statements and management report and presents them to the auditor for audit. The management board presents the annual report (comprising the financial statements and management report) and the auditor’s report and a proposal regarding distribution of profit to the general meeting of shareholders for approval. The shareholders whose shares represent at least one tenth of the share capital may demand that the auditor who prepared the auditor's report participate in the making of the decision to approve the annual report, and provide explanations concerning the auditor's report. Such request must be submitted to the company in writing at least five days before the general meeting of shareholders. No later than six months after the end of the financial year, the approved annual report, the auditor’s report and the proposal regarding distribution of profit (if any) must be filed with the Commercial Register. The Rules of the Tallinn Stock Exchange (“TSE”) provide that the audited annual report has to be made public immediately after its approval by the supervisory board but not later than four months after the end of the accounting period. Minority shareholders in a public limited company have the right to require an extraordinary audit, but they are not entitled to investigate the company's books or records. Every shareholder has the right to receive information in regard to the activities of the company from the management board at the general meeting of shareholders. However, the management board may refuse to disclose information if such disclosure might seriously harm the interests of the company.

The protection of minority shareholders includes, among other things, the right of shareholders with shares representing at least one-tenth of the share capital to (i) demand the convening of an extraordinary meeting of the shareholders, (ii) submit an application to the court demanding a dismissal of a member of the supervisory board, (iii) request an extraordinary audit (which would have to be approved by the simple majority of votes at a duly convened general meeting of shareholders), (iv) require certain issues to be included in the agenda of the general meeting of shareholders, (v) demand a meeting of the supervisory board, and (vi) prevent modifications to the rights of certain types of shares.

The Commercial Code provides that a shareholder whose shares, together with the shares of its parent undertaking and its subsidiaries, represent at least 90 % of the share capital of a public limited company, can make an offer to acquire the shares held by the minority shareholders for a fair monetary compensation. Such an offer will be presented to the general meeting of shareholders, and if at least 95% of all the votes attaching to the company's shares vote in favor, it will be binding on all shareholders.

The Rules of the TSE impose a number of additional restrictions and limitations on the supervisory board and management board of a company listed on the TSE. Most of these restrictions apply to a company from the moment when it submits its application for listing of its shares on the TSE.

Tallinn Stock Exchange and the Estonian Securities Market

The TSE and the Estonian Central Securities Depository (*AS Eesti Väärtpaberikeskus*) ("ECSD") are the two leading securities market infrastructure operators in Estonia. Set out below is a brief overview of the information concerning the Estonian regulated securities market and certain provisions of Estonian law and current securities market regulations in effect on the date of this Prospectus. The summary is based on Estonian laws and securities market regulations and publicly available information on NASDAQ OMX Group, the principal shareholder of the company operating the TSE.

Tallinn Stock Exchange

The TSE is the only stock exchange operating in Estonia. It is operated by AS Tallinna Börs, a public limited company whose principal shareholder is NASDAQ OMX Group through the OMX Nordic Exchanges Group OY. The latter is also the controlling owner of the operators of the Copenhagen Stock Exchange, the Stockholm Stock Exchange, the Helsinki Stock Exchange, the Iceland Stock Exchange, the Riga Stock Exchange and the Vilnius Stock Exchange. The TSE is also a member of NOREX, an alliance of Nordic and Baltic stock exchanges all using the SAXESS trading system.

The TSE is a self-regulated organization, issuing and enforcing its own rules and regulations consistent with standard exchange operating procedures, but is licensed and supervised by the Estonian Financial Supervision Authority ("EFSA"). The TSE Rules are established by AS Tallinna Börs, the operator of the TSE, in order to ensure the regular and lawful operation of the stock exchange. The operator may unilaterally amend the TSE Rules, though the EFSA must approve such amendments. The rules and regulations of the TSE regulate the listing of securities and trading in them on the TSE and the performance of the obligations arising from securities transactions performed on the TSE. The TSE Rules are established by the Management Board of the TSE. The Rules are binding on the members of the TSE, and the issuers whose securities are listed on the TSE or admitted to trading on the Secondary List which is a separate market regulated by the TSE.

The activities of, and trading on, the TSE are subject to two tiers of regulation. Laws and government regulations comprise the basic regulatory framework, which is then supplemented by the TSE Rules. The principal laws governing the activities of, and trading on, the TSE are the Estonian Securities Market Act and the Estonian Central Registry of Securities Act.

Estonian Central Registry of Securities and Registration of Shares

The Estonian Central Registry of Securities ("ECRS") is a public register established, *inter alia* for the registration and maintenance of shares, debt obligations 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 ECSD. The ECSD is organized as a public limited company, and all of its shares are fully owned by the TSE's operator 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. Eesti Pank acts as a settlement bank of the netted cash position of the participants in the SSS.

All shares listed and traded on the TSE must be registered in the ECRS or another register of securities if it is approved by the TSE. No share certificates are issued with respect to the registered shares. 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 TSE 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 are deemed to 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 basic 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 available 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 administrator (custodian). Account administrators are institutions that qualify under Estonian law as professional participants in the securities market, such as investment firms, credit institutions and other persons specified by law. Foreign companies that hold an activity license of a professional securities market participant and are registered in a Member State of the EU, or with which the Republic of Estonia has a legal agreement may also qualify as account administrators.

Professional participants in the Estonian securities market and foreign legal entities meeting certain criteria are entitled to open a nominee account in the ECRS. A notation is made and maintained 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, not the shares of the account owner, and thus cannot be brought into the bankruptcy estate of the owner of the nominee account. 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 so that the client can represent the owner of the nominee account in the exercise of rights arising from the shares.

Listing on the Tallinn Stock Exchange

An application has been made to list the Shares on the main list. In order to list shares on the main list of the TSE, 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% 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 TSE Rules set out certain specific criteria as to determining whether shares are held by the public.

Trading on the Tallinn Stock Exchange

The trading system of the TSE is open for trading to its members. Trading on the TSE takes place on each business day from 10:00 a.m. to 1:50 p.m. (Estonian time). From 2:05 p.m. to 2:30 p.m. the TSE carries out after-market trading. The TSE 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 EUR. Investors of the TSE instruments can place transaction orders and pay for transactions also in EEK without extra charge; stock exchange members use the official Bank of Estonia central rate (EUR 1 = EEK 15,6466) for the calculations needed to fulfill customer's orders.

Transactions can be concluded on the TSE either through automatic matching in the Order Book (Automatic Order Matching) or between pre-determined persons outside the Order Book (Manual Trade). Automatic order matching is a process in the Order Book by which Sell and Buy Orders are matched automatically when the price, volume and other specifications for a given order correspond with Order(s) previously entered in the Order Book. In case of automatic order matching, the settlement date of the transaction is the third exchange day (T+3) following the transaction date (T). Member firms of TSE can agree upon a settlement date that differs from that by filing a relevant application with the exchange according to the procedure prescribed by the exchange. In case of manual trade, the member firms may determine that the settlement date of the transaction is from T+1 until T+6. Member firms may agree on a different settlement date of the transaction than the one provided in the previous sentence only on the consent of the TSE. A member firm must notify the exchange immediately, but not later than three minutes from the time of the trade, of any Manual trade in which it has participated. A manual trade shall be concluded by specifying one of the trade types, which are:

- Standard trade concluded on standard market terms during the trading session;
- Exchange granted trade concluded pursuant to an individual or general authorization from the exchange. Joint authorization of the exchange may be granted to all members for conclusions of a particular type of transactions.

The operator of the TSE 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 TSE 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 TSE 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 TSE Rules, the operator of the TSE has the right to request additional information regarding a transaction for the purposes of recording the transaction.

The Listing and Surveillance Committee of the TSE has the right, for the purpose of ensuring sufficient liquidity of a security, to demand that the issuer concludes a market-making agreement with a member of the TSE with respect to the securities to be listed. Market makers have the obligation with respect to a specific security to display the buy and sell prices in the order book throughout the trading period.

Supervision of the Tallinn Stock Exchange

Activities of the TSE are supervised by the EFSA, which is a body carrying out the supervision of all Estonian financial institutions including banks, insurance companies, investment and pension funds and the securities market. Compliance with the TSE Rules by its members is monitored by the

Listing and Surveillance Committee of the TSE. The operator of the TSE exercises supervision over the exchange with respect to the prices of securities traded on the exchange and the conduct 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 the law. The operator of the TSE also supervises the disclosure of adequate information to the investors, protection of the interests of the investors as well as their fair and equal treatment. The operator of the TSE can apply contractual penalties, full or partial suspension of the rights accompanying the status of a participant or member of the exchange for up to six months, suspension of the listing of or trading in the security for up to six months, termination of membership of the exchange, or permanent termination of the listing or trading in the security. The operator is under an obligation to notify the EFSA immediately of any violation of law. The EFSA also has specific supervisory obligations to monitor transactions concluded on the exchange.

Disclosure of Transactions and Ownership

A person who has acquired, either directly or indirectly, individually or together with persons operating in concert, a qualifying holding in a public limited company, and thus acquires or increases the number of votes owned thereby to more than 5%, 10%, 15%, 20%, 25% and 50% or one-third or two-thirds of all votes represented by the shares of the public limited company, must immediately, but not later than within four business days, notify the public limited company and the securities market supervisory agency of the state where the public limited company is founded or registered, disclosing the number of votes owned by such person. The same notification requirements also apply if the holding falls below the prescribed levels.

The EFSA has the right to make exemptions from such notification requirements in certain circumstances. The issuer is also required to ensure that shareholders holding more than five 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 things, 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 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 TSE Rules also regulate the disclosure of the issuer’s dealings in its own shares.

Market Abuse

The Estonian Securities Market Act prohibits market abuse, which (within the meaning of the said Act) is misuse of inside information and market manipulation. The Act also requires all persons providing investment services as a permanent activity to immediately notify the EFSA of a reasonable suspicion of market abuse.

Restrictions established for the misuse of inside information apply to all financial instruments admitted to trading on the market of Estonia or in a Member State of the EEA, but also to instruments not admitted to trading, 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 probably have a significant effect on the price of the financial instrument or a derivative linked to the financial instrument. 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 or member of 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 as a result of an offence committed by him or her. 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 TSE Rules stipulate that, among other persons, persons who hold or control at least 10% 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 TSE Rules.

Misuse of inside information comprises, among other things, 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. Misuse of inside information is a criminal offence and may result in fines or imprisonment.

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 monitor access to inside information and prevent the disclosure of such information.

The Estonian Securities Market Act contains a non-exhaustive list of activities including price fixing, dissemination of rumors and false news and other methods that are deemed to constitute market manipulation. Under the Estonian Securities Market Act, market manipulation may be punishable by a fine. Credit institutions, investment firms and others providing investment recommendations must disclose any conflicts of interest they may have when providing investment advice. On 15 March 2007, amendments to the Estonian Penal Code took effect, creating a new criminal offense based on market manipulation of market prices of financial instruments in regulated markets or regulated trading systems. The amendment prohibits shareholders of the issuer and individuals related to the issuer through employment or their work duties from carrying out transactions or distributing information that is misleading or could be misleading. The penalty for such activities ranges from a pecuniary penalty up to three years in prison.

The TSE Rules 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 TSE 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.

Mandatory Takeover Bid

A person, who has gained dominant influence over the target issuer, either directly or together with other persons acting in concert, is required within twenty days as of gaining that dominant influence to make a takeover bid for all the remaining shares of the target issuer. This does not apply if a takeover bid has been done before gaining the dominant influence.

For the purposes of the mandatory takeover bid, a "dominant influence" is a situation where a person:
(i) holds the majority of votes represented by the issuer's shares or holds the majority of the votes as a general partner or limited partner; or (ii) person who is the general or limited partner of the company and has the right to appoint or remove the majority of the members of the supervisory board or management board of the company; or (iii) person being a shareholder or general or limited partner of the company controls alone the majority of the votes pursuant to an agreement with other partners or shareholders. The Securities Market Act requires that the offeror must obtain approval for the takeover bid from the EFSA, and that the purchase price in a takeover bid must be fair and in proportion to the rights and obligations deriving from the shares being acquired. A fair price is deemed to be the highest price paid for this share within the last six months before the takeover bid

by the offeror or persons acting in concert. If the offeror or persons acting in concert have acquired shares after the disclosure of the takeover bid and before the disclosure of the result of the takeover bid, the fair price is deemed to be the highest price paid for the share by them during this period.

After the EFSA has approved the takeover bid, a target person or other person connected with the takeover bid, may not demand cancellation of the takeover bid or modification of the conditions thereof. They may demand compensation of damage caused by the takeover bid within one year as of approval of the takeover bid by the Supervision Authority.

If the offeror has acquired at least nine-tenths of the share capital of the target issuer through a takeover bid, then upon the application of the offeror, the general meeting of shareholders of the target issuer may decide to take over the rest of the shares belonging to the target persons for a fair price. The fair price may be paid in cash or in marketable instruments which are traded and the price may not be smaller than the purchase price of the takeover bid.

The general meeting of shareholders of the target issuer may decide this within three months since the due date of the takeover period. The quorum for this decision is nine-tenths of the votes represented by shares.

Those target offerees who did not make a bid to the offeror for the transfer of their shares in the course of the takeover bid have the sell-out right if the offeror owns at least 90% of the target issuer’s voting stock and the general meeting of the target issuer has not adopted a resolution for the squeeze-out described above.

TAXATION

The following summary is based on the tax laws of Estonia as in effect on the date of this Prospectus and is subject to changes in such laws, including changes that could have a retroactive effect. The following summary is in no way exhaustive and does not take into account or discuss the tax laws of any jurisdiction other than Estonia. Investors are encouraged to seek specialist assistance as to the Estonian and other tax consequences of the Listing and the purchase, ownership and disposition of 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.

Corporate Income Tax

The Estonian corporate income tax system currently in force in Estonia is a unique system that shifts the point of corporate taxation from the moment of earning the profits to the moment of their distribution. Corporate income tax is charged on profit distributions and implicit distributions (such as fringe benefits, gifts and donations, transfer pricing adjustments and expenditures not related to the business activities of the company).

All of the above distributions are taxed at the rate of 21/79 of the net amount of distribution, which amounts to 21% of the gross amount distributed. As the Estonian Income Tax Act currently stands, the rate of the corporate income tax will decrease gradually within the following years (down to 20/80 as from 1 January 2009, 19/81 as from 1 January 2010 and 18/82 as from 1 January 2011).

Departing from the general rule described above, some profit distributions are exempted from the distribution tax. In particular, an Estonian resident company is not subject to the distribution tax in case of re-distribution of dividends received from a company subject to income tax and residing in an EEA member state or Switzerland (except for entities located at a low tax rate territory), provided that the Estonian company owned at least 15% of the share capital or votes in the distributing company at the moment of receiving the dividends.

Taxation of Dividends

In addition to the corporate income tax upon profit distributions, dividends payable to Estonian residents and non-resident individuals are not subject to any withholding in Estonia (the above distribution tax nevertheless applies). A withholding tax at the rate of 21% is, however, charged on dividends payable to non-resident legal persons. Note that such withholding tax may be reduced under the applicable conventions for avoidance of double taxation. Such conventions concluded by Estonia typically reduce the applicable rate of withholding tax down to 15%. The withholding tax on dividends will be entirely abolished as from 1 January 2009.

No withholding tax is levied on dividends payable to a non-resident legal person if the non-resident legal person is, at the moment of announcement or payment of dividends, holding at least 15% of the share capital or votes in the distributing company. Such exemption does not apply when the shareholder is situated in a low tax rate territory for the purposes of Estonian tax laws.

Taxation of Sale and Exchange of Shares

Income tax at the rate of 21% (subject to reduction down to 20% as from 1 January 2009, 19% as from 1 January 2010 and 18% as from 1 January 2011) is charged on gains realized by Estonian resident individuals upon the sale or exchange of shares. Since earnings of resident legal persons, including capital gains, are taxed only upon distribution, capital gains realized by resident legal persons are not subject to taxation.

Income tax is charged on capital gains realized by non-residents from the sale or exchange of shares in an Estonian company only in very specific circumstances. Namely, in cases where at least 10% of the shares of a real estate company are being held at the time of the transfer. Pursuant to the Income Tax Act, a real estate company for these purposes is a company, a contractual investment fund or other pool of assets, of whose assets property (immovables) or structures as movables situated in Estonia constitute at the moment of transfer or have constituted at any moment within two years prior to transfer directly or indirectly more than 50%.

If the income tax on capital gains as described above in previous paragraphs is to be charged, the taxable amount is considered to be the difference between the acquisition cost and the sale price or exchange value of the shares. A shareholder is entitled to deduct certified expenses directly related to the sale or exchange of shares from the shareholder’s gain.

Any payments made by the company to its shareholders as a result of the decrease of share capital or purchase of its own shares are treated as capital gains for tax purposes and will be taxed accordingly.

Acquisition Cost of the Shares

It is important to establish the acquisition cost of the Shares issued to the shareholders in the course of the Division. Although the applicable laws provide no clear guidance in this respect, in the view of the Company, the acquisition cost of each share of AS Järvevana (formerly AS Merko Ehitus) should be split between the remaining share of AS Järvevana and the newly issued Share of the Company according to the proportion between the net assets of AS Järvevana and the Company.

According to the response to AS Järvevana’s (formerly AS Merko Ehitus) query issued by the Northern Tax Center of Tax and Customs Board on 29 May 2008, the tax authority agrees with the above interpretation. Note, however, that such response is not legally binding upon the tax authority, the Company or the shareholders.

Moreover, AS Järvevana (formerly AS Merko Ehitus) has filed an additional query with the tax authority to confirm that the above-mentioned proportion may be determined based on the net assets of AS Järvevana as on 31 December 2007. AS Järvevana intends to publish more detailed information on calculation of the acquisition cost of the Shares once additional clarification from the tax authority is received.

Upcoming Changes in Corporate Taxation in Estonia

Upon its accession to the European Union in 2004, Estonia was granted a transitional period until the end of 2008 to modify its corporate income tax system, since corporate income tax payable on profit distributions, according to the European Commission, constituted a withholding tax on dividends prohibited under the Parent-Subsidiary Directive (EC Council Directive 90/435/EEC).

On 26 March 2008, the Estonian Parliament adopted amendments to the Income Tax Act, the purpose of which was to align the Income Tax Act with the Parent-Subsidiary Directive. The amendments will enter into force as from 1 January 2009. Despite the above-described position of the European Commission, the key principle of the Estonian corporate income tax system will remain unchanged: retained (i.e. undistributed) earnings will remain untaxed until distribution.

The new law contains several amendments, the most important of which are the following: (i) the new taxable period will be a financial year as opposed to a calendar month; (ii) Estonian resident companies will be required to make advance income tax payments calculated based on the average actual taxable payments; (iii) extended possibilities for double taxation relief with respect to dividend income received from abroad (in particular, dividends received from other EU states will be exempt from income tax, irrespective of the holding period or shareholding percentage); (iv) the dividend withholding tax will be entirely abolished; (v) proceeds from acquisitions of own shares and share capital reductions will be taxed at the level of the company making the payments to the extent the respective proceeds exceed the actual monetary or non-monetary contributions to the equity capital of the company.

Stamp Duty and Other Transfer Taxes

Currently there are no stamp duties or transfer taxes payable upon the transfer of shares, except for the service fees of the custodians and/or the ECRS which maintains the stock register.

SELLING RESTRICTIONS

Because of the following restrictions, persons receiving the Shares in connection with the Division and persons purchasing the Shares after the Division are advised to consult legal counsel prior to making any offer for resale, pledge or other transfer of the Shares.

General

No action has been taken or will be taken in any jurisdiction other than Estonia by the Company or any party on behalf of the Company that would permit a public offering of the Shares, or the possession or distribution of this Prospectus or any other documents relating to the Listing, or any amendment or supplement thereto, in any country or jurisdiction where specific action for that purpose is required. Persons receiving a copy of this Prospectus are required by the Company to inform themselves about and to observe any restrictions as to the acquiring or resale of the Shares.

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), the Shares may not be offered to the public in that relevant Member State prior to the publication of a prospectus in relation to the 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. For the 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.

United States

Neither the Shares nor their distribution has been or will be registered under the United States Securities Act of 1933 (as amended) (the "Securities Act") or with any securities authority of the United States or any state of the United States, and the Shares may not be re-offered or re-sold within the United States or for the account of U.S. persons (as defined in Regulation S of the U.S. Securities Act of 1933) except pursuant to registration under the U.S. Securities Act of 1933 or pursuant to an applicable exemption from the registration requirements of the U.S. Securities Act 1933.

LEGAL MATTERS

In respect of Estonian law, certain legal matters will be passed upon for the Company by AS Advokaadibüroo Tark & Ko, 2 Roosikrantsi St., Tallinn 10119, Estonia.

INDEPENDENT AUDITORS

The auditor of the Company for the year 2008 is AS PricewaterhouseCoopers, Pärnu mnt 15, Tallinn, Estonia. AS PricewaterhouseCoopers is a member of the Estonian Auditing Board.

The auditor of AS Järvevana for the financial years ended 31 December 2005, 2006 and 2007 was AS PricewaterhouseCoopers.

The consolidated financial statements of AS Järvevana for the financial years ended 31 December 2005, 2006 and 2007 included in this Prospectus have been audited by AS PricewaterhouseCoopers. The consolidated condensed interim financial information of AS Järvevana for the three months ended 31 March 2008 included in this Prospectus has not been audited.

AS PricewaterhouseCoopers conducted an examination of the un-audited pro forma financial information of AS Merko Ehitus for the three months ended 31 March 2008, prepared for the purposes of this Prospectus, and issued a report, included elsewhere in this Prospectus. The responsibility of AS PricewaterhouseCoopers for the content of this Prospectus is limited to this report and the respective responsibility statement of AS PricewaterhouseCoopers has been included within this report. AS PricewaterhouseCoopers expressed its written consent, which has not been withdrawn, for the inclusion of its report in this Prospectus in the form and context in which it is included.

DEFINITIONS AND GLOSSARY

AS Järvevana Group	AS Järvevana together with its subsidiaries before the Division
Business	The assets and business, including all movables and immovables, rights and obligations of AS Järvevana, except for the assets and obligations that have been set forth in Annex No. 3 to the Division Plan, which were transferred to the Company in accordance with the Division Plan
Company or Merko Ehitus or Issuer	AS Merko Ehitus
Criminal Proceedings	Criminal case No. 05913000055 launched against AS Järvevana and its chairman of the Supervisory Board Mr. Toomas Annus, suspected of bribery and misuse of trust in relation to the land swap transactions
Division	The division of AS Järvevana (formerly AS Merko Ehitus) in accordance with the Division Plan
Division Plan	The notarized division plan of AS Merko Ehitus (currently AS Järvevana) concluded on 30 April 2008 approved by the general meeting of shareholders on 3 June 2008
ECRS	Estonian Central Registry of Securities
ECSD	Estonian Central Securities Depository
EEA	European Economic Area
EEK	kroon, the currency of Estonia
EFSA	Estonian Financial Supervision Authority
EU	European Union
EUR	euro, the single currency of the European Union Member States participating in the European Monetary Union
Group	AS Merko Ehitus together with its subsidiaries
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards as adopted by the European Union
Listing	Listing of the Shares of AS Merko Ehitus on the main list of Tallinn Stock Exchange

LTL	litas, the currency of Lithuania
LVL	lats, the currency of Latvia
Management	The management of AS Merko Ehitus
Management Board	The management board of AS Merko Ehitus
Prospectus	The listing and trading prospectus of AS Merko Ehitus
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
Prospectus Regulation	Commission Regulation (EC) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements
Shares	The shares of AS Merko Ehitus
Supervisory Board	The Supervisory Board of AS Merko Ehitus
TSE	Tallinn Stock Exchange

INDEX TO FINANCIAL INFORMATION

ISSUER

AS Merko Ehitus
Järvevana tee 9G
11314 Tallinn
Estonia

LEGAL ADVISER TO THE ISSUER

AS Advokaadibüroo Tark & Ko
Roosikrantsi 2
10119 Tallinn
Estonia

INDEPENDENT AUDITORS

AS PricewaterhouseCoopers
Pärnu mnt. 15
10141 Tallinn
Estonia

UN-AUDITED PRO FORMA FINANCIAL INFORMATION FOR AS MERKO EHITUS

August 1, 2008

Introduction

The Un-audited Pro Forma Financial Information for AS Merko Ehitus set forth below comprising the un-audited pro forma consolidated balance sheet as of 31 March 2008 and the explanatory notes thereto, has been prepared for the Prospectus, solely for illustrative purposes and presents a hypothetical situation. Therefore, it does not present the actual consolidated financial position of the Group. The Un-audited Pro Forma Financial Information should be read in conjunction with the information included in the consolidated financial statements of AS Järvevana (formerly AS Merko Ehitus), included elsewhere in this Prospectus.

The Un-audited Pro Forma Financial Information was prepared to present the division of AS Järvevana, described in detail in chapter "Division of AS Järvevana and Establishment of the Company" of the Prospectus, and the impact it could have on the consolidated financial statements of the AS Järvevana Group, had this transaction taken place as at the balance sheet date. The assumptions underlying the pro forma adjustments and the sources of information are described in the accompanying explanatory notes. The un-audited pro forma adjustments were based upon the information available and certain assumptions which, in the opinion of the Management, are reasonable given the circumstances.

No pro forma income statement was prepared, as substantially all income generating business operations have been transferred to the Company upon the Division. There were no significant revenues or expenses associated with the assets that have not been transferred to the Company. It is however expected that the costs relating to the criminal case No 05913000055 (which amounted to EEK 22.5 million in 2007 and EEK 2 million for the three months ended 31 March 2008) will be incurred by AS Järvevana rather than by the Company, but the involvement of the Company in defending its de facto owned assets may be significant. As explained in the explanatory notes to the pro forma consolidated balance sheet as of 31 March 2008, on the Division an intercompany loan of EEK 125 million between AS Järvevana and the Company has been set up. Subject to conditions set out in the explanatory notes to the pro forma consolidated balance sheet as of 31 March 2008 the loan is payable on demand and carries interest at 6% pa. for the first 12 months and henceforth a variable interest rate of 12 months' EURIBOR + 1%. As it is uncertain when and how the loan balance will be settled, it is impossible to assess reliably the impact of this loan on the business performance and results of the Company.

The Un-audited Pro Forma Financial Information was prepared in accordance with the accounting principles applied by the Group and described in the consolidated financial statements of AS Järvevana included elsewhere in this Prospectus. It has been provided solely for illustrative purposes and does not purport to present what the consolidated position of the Group would actually have been had the Division taken place on the date assumed.

Un-audited Pro Forma Consolidated Balance Sheet as at 31 March 2008

in thousands of EEK

	Unadjusted historical data of AS Järvevana (formerly Merko Ehitus AS)	Pro forma adjustments (Division)	Pro forma data of AS Merko Ehitus
	Un-audited	Un-audited	Un-audited
	Note 1	**Note 2**	
ASSETS			
Current assets			
Cash and cash equivalents	356 863	-25 000	331 863
Trade and other receivables	1 003 458	-	1 003 458
Prepaid corporate income tax	941	-	941
Inventories	2 047 829	-	2 047 829
	3 409 091	-25 000	3 384 091
Non-current assets			
Investments in associates and joint ventures	275 983	-	275 983
Other long-term loans and receivables	24 214	-	24 214
Deferred income tax assets	3 392	-	3 392
Investment property	12 946	-	12 946
Property, plant and equipment	172 134	-	172 134
Intangible assets	12 675	-	12 675
	501 344	-	501 344
TOTAL ASSETS	3 910 435	-25 000	3 885 435
LIABILITIES			
Current liabilities			
Borrowings	192 924	125 000	317 924
Trade and other payables	939 593	100 000	1 039 593
Corporate income tax liability	36 159	-	36 159
Government grants	1 498	-	1 498
Short-term provisions	81 495	-17 500	63 995
	1 251 669	207 500	1 459 169
Non-current liabilities			
Long-term borrowings	399 165	-	399 165
Other long-term trade payables	54 796	-	54 796
	453 961	-	453 961
TOTAL LIABILITIES	1 705 630	207 500	1 913 130
EQUITY			
Minority interest	35 058	-	35 058
Equity attributable to equity holders of the parent company			
Share capital	177 000	-	177 000
Statutory reserve capital	17 700	-	17 700
Currency translation differences	-5 976	-	-5 976
Retained earnings	1 981 023	-232 500	1 748 523
	2 169 747	-232 500	1 937 247
TOTAL EQUITY	2 204 805	-232 500	1 972 305
TOTAL LIABILITIES AND EQUITY	3 910 435	-25 000	3 885 435

1. AS Järvevana (formerly Merko Ehitus AS) financial information used to prepare the Un-audited Pro Forma Financial Information was extracted from the un-audited consolidated condensed interim financial information of AS Järvevana for the three months ended 31 March 2008 included elsewhere in this Prospectus.

2. As at the date of the pro forma balance sheet, data referring to the operations not transferred to the Company as a result of the Division were included in the financial information of AS Järvevana. The adjustment reflects the elimination of assets and liabilities that were not transferred to the Company.

The adjustment to cash and cash equivalents reflects cash in the amount of EEK 25 mln that according to Section 5.1 of the Division Plan (the Division Plan has been published through the information system of the Tallinn Stock Exchange and is available at the following web page: http://www.merko.ee/eng/investor/generalmeeting/2008) was not transferred to the Company.

The adjustment to borrowings reflects the loan liability in the amount of EEK 125 mln to AS Järvevana. According to the terms set in the Annex No 3 to the Division Plan the loan is unsecured. Interest for the first 12 months has been fixed at 6% pa and henceforth the interest rate is 12 months' EURIBOR + 1% pa. According to the cooperation agreement between AS Järvevana and the Company, dated 31. July 2008, the loan is repayable at 30 days period of notice by AS Järvevana, but not more than EUR 500,000 per year, unless a larger amount is needed to settle the obligations of AS Järvevana arising from or related to the criminal case No 05913000055.

The adjustment to trade and other payables reflects the short-term liability to AS Järvevana in the amount of EEK 100 mln for land plots as described in Annex No 3 of the Division Plan, according to which the Company is entitled to purchase (call option) and also AS Järvevana is entitled to sell (put option) five land plots retained in AS Järvevana for a fixed price of EEK 100 mln at 30 days period of notice by either party. As according to the terms set in the Annex No 3 of the Division Plan the significant risks and rewards of ownership of the land plots were transferred to the Company, the land plots (book value EEK 39 mln) have been recorded as assets transferred to the Company as a result of the Division.

According to the cooperation agreement between AS Järvevana and the Company, dated 31. July 2008, the value of the call option of the Company is EEK 27.3 mln, the value of the put option of AS Järvevana is EEK 5.9 mln and the net value of the put option and call option is EEK 24.3 mln. According to the cooperation agreement the net value of the put option and the call option was deemed to be paid by the Company to AS Järvevana concurrently with execution of the Division Plan (i.e. the assets transferred from AS Järvevana to the Company as a result of the Division were reduced by the the net value of the put option and the call option).

The cooperation agreement further specifies that the call option and put option are exercisable at any time during 3 years period from the date of the execution of the Division Plan. The exercise period of the options will be automatically extended for one more year unless the criminal proceeding in the criminal case No 05913000055 has been terminated. Since the put and call options are exercisable at any time with 30 days period of notice, the obligation is classified as current.

The adjustment to short-term provisions in amount of EEK 17.5 mln reflects the provision for estimated legal costs related to the criminal case No 05913000055 that according to Section 5.1 of the Division Plan was not transferred to the Company as such costs are expected to be settled by AS Järvevana.

The adjustment to retained earnings reflects the net assets that according to the Annex 3 of the Division Plan were not transferred to the Company.

AS PricewaterhouseCoopers
Pärnu mnt. 15
10141 Tallinn
Estonia

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To the Management Board of AS Merko Ehitus

INDEPENDENT ASSURANCE REPORT ON EXAMINATION OF PRO FORMA FINANCIAL INFORMATION

We have examined the accompanying pro forma financial information for AS Merko Ehitus set out in the Prospectus of AS Merko Ehitus (the "Company" and together with its subsidiaries the "Group") comprising the un-audited pro forma consolidated balance sheet as at 31 March 2008, and the explanatory notes thereto (the "Pro Forma Financial Information").

The Pro Forma Financial Information has been prepared on the basis stated therein, for illustrative purposes only, to provide information on how the Group's consolidated financial information prepared on the basis of its accounting policies might have been affected had the transaction described in the introduction to the Pro Forma Financial Information occurred at an earlier date.

This report is required by item 20.2 of Annex I to the Commission Regulation (EC) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (the "EU Prospectus Regulation") and is given for the purposes of complying with these regulations and for no other purposes.

Preparation of the Pro Forma Financial Information in accordance with item 20.2 of Annex I to the EU Prospectus Regulation and guidance issued by the Committee of European Securities Regulators is the responsibility of the Management Board of the Company. It is our responsibility to form an opinion, as required by item 7 of Annex II of the EU Prospectus Regulation, as to the proper compilation of the Pro Forma Financial Information. We are not responsible for expressing and do not express any other opinion on the Pro Forma Financial Information or on any of its constituent elements. In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro Forma Financial Information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

We conducted our examination in accordance with International Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information". Our work, which involved no independent examination of any of the underlying financial information, on which the Pro Forma Financial Information is based, consisted primarily of comparing the unadjusted financial information with the source documents, considering evidence supporting the adjustments and discussing the Pro Forma Financial Information with the management of the Company.

We have planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro Forma Financial Information has been properly compiled on the basis stated therein and that such basis is consistent with the accounting policies of the Group.

Based on our examination, in our opinion:

a) the Pro Forma Financial Information for AS Merko Ehitus has been properly compiled on the basis stated therein;

b) such basis is consistent with the accounting policies of the Group described in the consolidated financial statements of AS Järvevana (formerly AS Merko Ehitus) for the year ended 31 December 2007.

Without qualifying our opinion, we draw attention to the fact that, as outlined in the introduction to the Pro Forma Financial Information, this Pro Forma Financial Information has been prepared by using management's assumptions. It is not necessarily indicative of the effects on the financial position that would have been attained had the transaction described in the introduction to the Pro Forma Financial Information actually occurred earlier. Moreover, this accompanying Pro Forma Financial Information is not intended to, and does not, provide all the information and disclosures necessary to present a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union.

For the purpose of item 1.2 of Annex I and item 1.2 of Annex III of the EU Prospectus Regulation we are responsible for this report as part of the Prospectus and we declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with item 1.2 of Annex I and item 1.2 of Annex III of the EU Prospectus Regulation.

On behalf of AS PricewaterhouseCoopers:

Urmas Kaarlep
AS PricewaterhouseCoopers

1 August 2008

AS MERKO EHITUS
GROUP

Consolidated interim report 3M 2008

Commercial Registry No: 10068022

Address:	9G Järvevana road, 11314 Tallinn
Telephone:	+372 680 5105
Fax:	+372 680 5106
E-mail:	merko@merko.ee
Homepage:	www.merko.ee

Primary activity:	General contracting in construction sector
Auditor:	AS PricewaterhouseCoopers
Beginning of financial year:	01.01.2008
End of financial year:	31.12.2008

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MANAGEMENT REPORT

General information

Merko Ehitus is a leading building corporation offering integrated solutions since 1990, with branches currently in Estonia, Latvia and Lithuania. Largest companies of the Group are SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (75%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%) and AS Tartu Maja Betoontooted (25%).

At a joint meeting held at 14 March 2008, the Management Board and the Supervisory Board of AS Merko Ehitus adopted a resolution to restructure the Company and separate operating activities from the criminal proceedings related to the land swap. The Company's management estimates that the restructuring of the Company is the best way to ensure its sustainable development and protect the interests of shareholders and employees in the long-lasting criminal proceedings related to the land swap.

The delay in the process of criminal proceedings related to the land swap launched in 2005 and the accompanying ambiguity and speculation in the media have started to take a toll on the Company's operations and thus harming the interests of the Company and its shareholders.

At 15 April 2008, the management of AS Merko Ehitus presented the Company's restructuring plan (http://www.baltic.omxgroup.com/market/?pg=details&instrument=EE3100003559&list=2&tab=news&news_id=222602), according to which AS Merko Ehitus will be split up/demerged so that AS Merko Ehitus, e.g. assets (other than liquid assets in the amount of 250 million kroons), liabilities and contracts as well as the business name will be separated and transferred to the new company being set up (hereinafter AS Uus Merko). The exact description of assets and the division plan have been published in the materials announcing the general meeting of shareholders http://www.merko.ee/eng/investor/generalmeeting/2008. As a result of the demerger, each shareholder will receive one share of AS Uus Merko for each share of AS Merko Ehitus and the shares of AS Uus Merko will be listed on the Tallinn Stock Exchange as soon as possible. The business name of AS Merko Ehitus will also be changed and the Company's shares will continue to be listed on the Tallinn Stock Exchange. The sole member of the Management Board of the new company will be Toomas Annus.

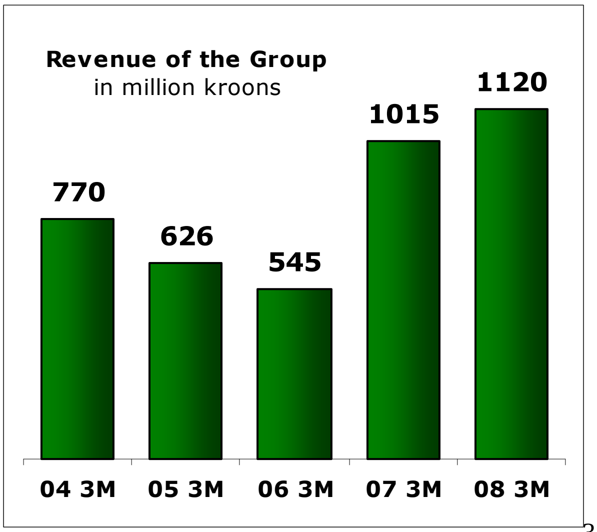
At May 2 2008 AS Merko Ehitus transferred the 100-percent holding in the company OÜ Karulaugu Kinnisvara (registry code 11034491) to AS E.L.L. Kinnisvara. The sale price of the company was 42 million kroons; from this amount, 4.12 million kroons, the balance of company's financial obligations and current assets, were deducted. (http://www.baltic.omxnordicexchange.com/market/?pg=details&instrument=EE3100003559&list=2&tab=news&news_id=223284)

At May 21 2008 AS Merko Ehitus transferred the 50-percent holding in the company OÜ Tornimäe Apartments (registry code 11016607) to the copartner AS EKE Invest. The sale price of the company was 58 million kroons. (http://www.baltic.omxnordicexchange.com/market/?pg=news&news_id=223709).

Business operations

Group's revenue for the 3 months in 2008 was 1119.6 million kroons, which constitutes an annual increase of 10.3%. 55.2% of the sales originated from Estonia, 26.7% from Latvia and 18.1% from Lithuania. As compared with the respective period in 2007, company's sales in Latvia increased by 94.1%, in Lithuania by 19,7% and decreased in Estonia by -10,7%.

The warm winter jointly with the cyclic nature of residential construction and real estate development had a positive effect on the revenue.

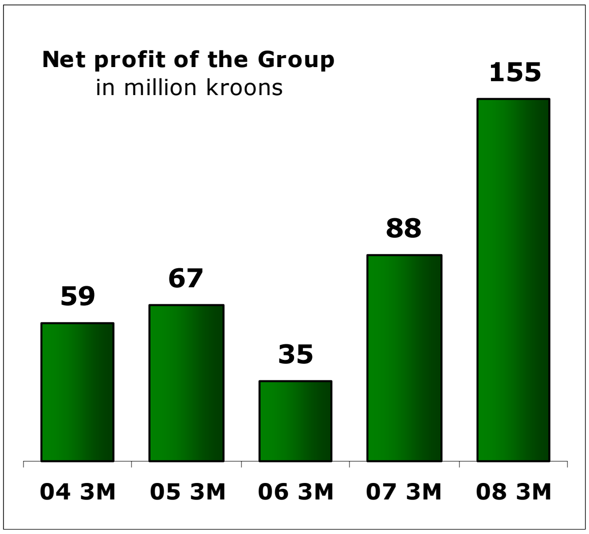


Most important companies of the Group 3 months 2008 consolidated revenue (sales outside the Group)

				in thousand kroons and euros
	2008 3 months		**2007 3 months**	
	EEK	EUR	EEK	EUR
Estonian companies				
AS Merko Ehitus (parent company)	458 331	29 293	464 357	29 678
AS Gustaf (75% partnership)	44 746	2 860	22 411	1 432
OÜ Gustaf Tallinn (80% partnership)	40 188	2 568	34 221	2 187
AS Merko Tartu (66% partnership)	39 940	2 553	40 030	2 558
Tallinna Teede AS (100% partnership)	33 244	2 125	20 650	1 320
OÜ Woody (100% partnership)	16 805	1 074	123 227	7 876
Latvian company				
SIA Merks (100% partnership)	287 354	18 365	127 341	8 139
Lithuanian company				
UAB Merko Statyba (100% partnership)	195 203	12 476	156 893	10 027

In one year, the Group's cost of goods sold decreased by –0.2%, whereas the marketing and general administrative expenses increased by 38.9%, constituting 79.0% and 5.1% of the revenue respectively. The successful development activities enabled the company to compensate the impact of the rapid growth of the costs of services and labour and as a result Group's net profit margin increased from 8.7% to 13.8%.

The Group's net profit in the first three months of 2008 was 154.9 million kroons, having increased by 75.1% compared to the last year.



Group's net cash flow of the 3 months of the year was +152.7 million kroons, including cash flow from operating activities +276.5 million kroons, from investing activities –10.8 million kroons and financing activities –113.0 million kroons. The cash flow from operating activities were mostly influenced by the change in trade and other receivables related to operating activities (+379.8 million kroons), change in trade and other payables (–371.6 million kroons) and operating profit +177,9 million kroons.

Construction market

The 1st quarter witnessed the slowing down of the economic growth in all three Baltic States. As against the 1st quarter of 2007, the rate of growth of GDP in Estonia was as low as 0.4%, in Latvia 3.6% and in Lithuania 6.4%. Retardation of the economic growth poses a serious challenge to budgets of self-governments and national governments in all three Baltic States and generates doubts as to feasibility of projects funded by the public sector.

The past quarter did not bring about significant changes in the construction sector. According to information provided by the Statistical Offices, the building prices continued appreciation. In the year, the building service became more expensive in Latvia by 20.7%, in Lithuania by 15.4% and in Estonia by 6.0%, while labour costs climbed up in Latvia by 41.3% and in Estonia by 9.5%. For the most part however, the appreciation occurred in 2007. As against the 4th quarter of 2007 the building service appreciated in Estonia by 1.1%, in Lithuania by 2.0% and in Latvia by 5.1%. By reference to decreasing demand and tighter competition the following quarters of the year may witness stabilization of prices, and in respect of certain types of work, also a certain lowering of expenses. When planning the projects however one should not reckon with steep decline in prices, because the labour price in the market will continue to be dependent on demand of building service in the neighbouring countries, and a significant part of building materials is imported into the Baltic States at the prices applicable in the world market.

The market of residential premises picked up, to a certain extent at the end of the 1st quarter. However, it is rather a seasonal trend that a breaking point in the feeling of security and alertness to buy of the buyers. With regard to development projects of residential building and commercial premises the market will evidently remain passive and recovery may be expected as late as in 2009. For the time being the largest challenge in the sector is how to cope with the narrowing financing opportunities and liquidity problems.

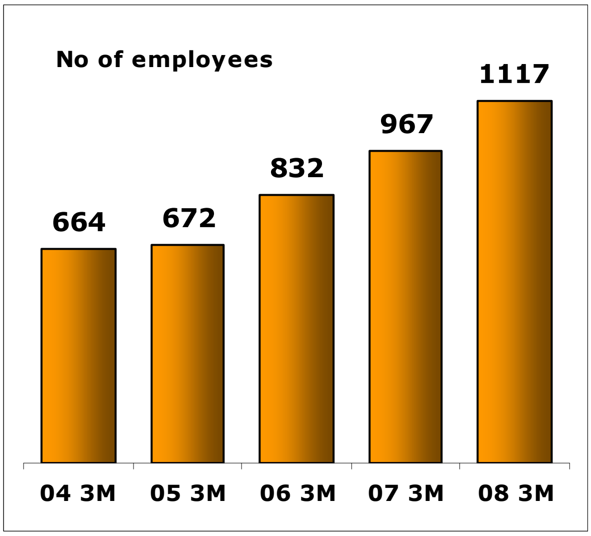
The ratios and calculation methods characterizing the operating activities of the Group

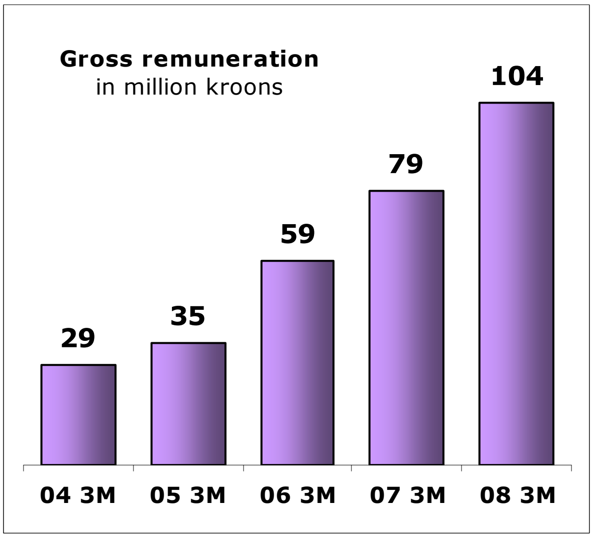
	2008 3 months	2007 3 months
Net profit margin	13,8 %	8,7 %
Operating profit margin	15,9 %	8,7 %
Return on equity per annum	29,6 %	21,6 %
Return on assets per annum	15,8 %	10,9 %
Current ratio	2,7	2,1
Equity ratio	55,5 %	51,0 %
General expense ratio	5,1 %	4,1 %
Personnel expense ratio	10,9 %	12,8 %
Average number of full-time employees	1081	907

Net profit margin: Net profit* / Revenue
Operating profit margin: Operating profit / Revenue
Return on equity: Net profit x 4* / Average equity during the period*
Return on assets: Net profit x 4* / Average assets during the period
Current ratio: Current assets / Current liabilities
Equity ratio: Owners equity* / Total assets
General expense ratio: General expenses / Revenue
Personnel expense ratio: Personnel expenses / Revenue

* calculated as attributable to the equity holders of the parent company

In 31.03.2008, the number of employees in the Group's service was 1117, including 1082 full-time employees. The number of the Group's employees increased by 15.5% (150 new employees were recruited). The gross remuneration paid to full-time personnel in 3 months 2008 amounted to 104.2 million kroons an increase of 31.4% compared to previous year.





Shares and shareholders

AS Merko Ehitus biggest shareholders as of 31.03.2008

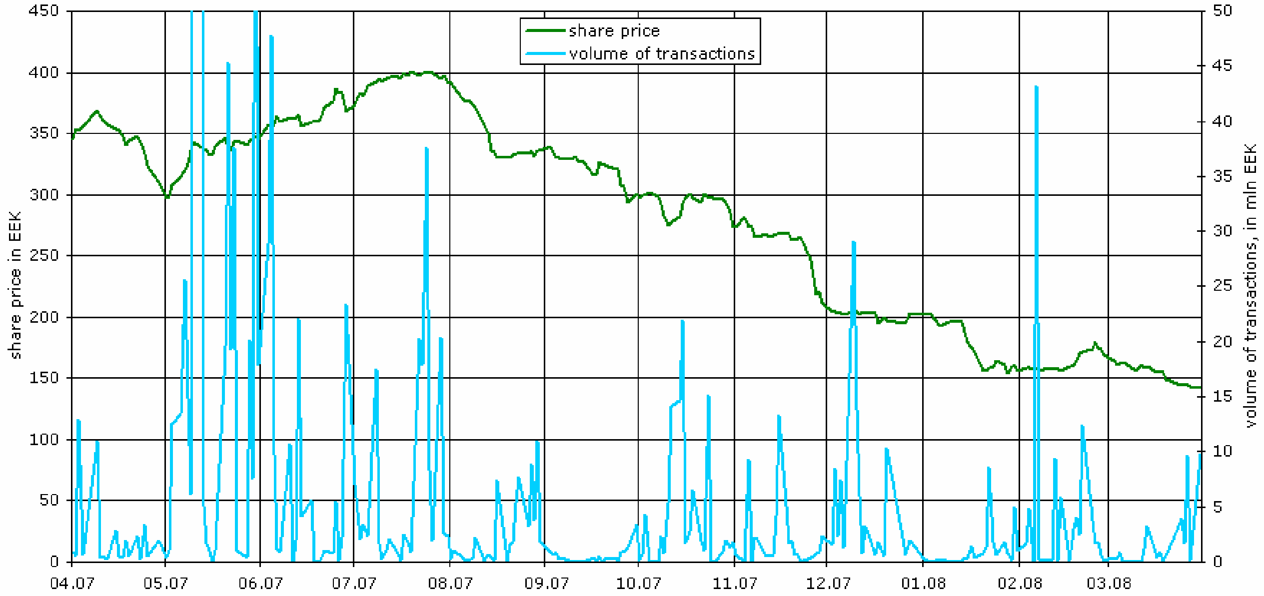
	No. of shares	Ownership
AS Merko Grupp	12 742 686	71,99%
Skandinaviska Enskilda Banken Ab, clients	1 160 427	6,56%
ING Luxembourg S.A., clients	909 500	5,14%
State Str. Munich Care of SSB Boston/DWS Invest. S.A. for DWS Osteuropa	265 904	1,50%
Mellon Treaty Omnibus	198 478	1,12%
The Bank of New York/ING Bank Slaski A/C ING Parasol	189 683	1,07%
Danske Bank clients	183 512	1,04%
Bank Austria Creditanstalt AG clients	177 831	1,00%

Breakdown os shareholders as of 31.03.2008

No. of shares	No. of shareholders	% of shareholders	No. of shares	% of shares
1-100	304	39,28%	15 041	0,09%
101-1000	346	44,70%	140 241	0,79%
1001-10 000	84	10,85%	270 795	1,53%
10 001 – 100 000	27	3,49%	820 248	4,63%
100 001 – 1 000 000	11	1,42%	2 550 562	14,41%
1 000 001 - …	2	0,26%	13 903 113	78,55%
Total	774	100%	17 700 000	100%

The shares of Merko Ehitus are listed in the main list of Tallinn Stock Exchange. In 2008 3 months the number of transactions with Merko Ehitus' shares was 737, during which 1.0 million shares changed ownership and the turnover of the transactions was 154.9 million kroons. The cheapest bargain with a share was 141.60 kroons and highest 202.62 kroons per share. The closing share price with a state of 31.03.2008 was 142.38 kroons.

Performance of Merko Ehitus share at Tallinn Stock Exchange (last 12 months)



	31.03.2008	31.03.2007	+/-
No. of shares, thousand pcs	17 700	17 700	
Earnings per share (EPS), in kroons	8,75	5,00	+75,0%
Equity per share, in kroons	122,58	94,69	+29,5%
P/B (share price to equity per share)	1,16	3,66	-68,3%

in thousand kroons and euros

INCOME STATEMENT
consolidated, unaudited

		EEK		EUR	
	note	**2008 3 months**	**2007 3 months**	**2008 3 months**	**2007 3 months**
Revenue	1,2	1 119 572	1 014 864	71 554	64 862
Cost of goods sold	3	(884 377)	(886 352)	(56 522)	(56 648)
Gross profit		235 195	128 512	15 032	8 214
Marketing expenses		(7 888)	(5 605)	(504)	(358)
Administrative and general expenses		(49 373)	(35 610)	(3 156)	(2 276)
Other operating income		1 704	2 102	109	134
Other operating expenses		(1 738)	(1 038)	(111)	(66)
Operating profit		177 900	88 361	11 370	5 648
Financial income and expenses		(1 762)	3 907	(113)	250
incl. financial income (expenses) from investments in associate companies and joint ventures		2 280	6 831	145	437
interest expense		(5 584)	(2 733)	(357)	(175)
foreign exchange gain		(1 692)	(3 447)	(108)	(220)
other financial income and expenses		3 234	3 256	207	208
Profit before tax		176 138	92 268	11 257	5 898
Corporate income tax expense		(20 138)	(881)	(1 287)	(57)
Net profit for current period		156 000	91 387	9 970	5 841
incl. net profit attributable to equity holders of the parent company		154 881	88 450	9 898	5 653
minority interest		1 119	2 937	72	188
Earnings per share for profit attributable to the equity holders of the parent company (basic and diluted, in EEK and EUR)	4	8,75	5,00	0,56	0,32

in thousand kroons and euros

BALANCE SHEET
consolidated, unaudited

		EEK		EUR	
	note	**31.03.2008**	**31.12.2007**	**31.03.2008**	**31.12.2007**
ASSETS					
Current assets					
Cash and cash equivalents	5	356 863	205 564	22 808	13 138
Trade and other receivables	6	1 000 831	1 199 566	63 963	76 666
Prepaid corporate income tax		3 568	2 376	228	152
Inventories	7	2 047 829	2 025 426	130 880	129 448
Total current assets		3 409 091	3 432 932	217 879	219 404
Non-current assets					
Long-term financial investments	8	300 197	287 456	19 186	18 372
Deferred income tax assets		3 392	3 396	217	217
Investment property	9	12 946	7 361	828	470
Property, plant and equipment	10	172 134	172 912	11 001	11 051
Intangible assets	11	12 675	12 574	810	804
Total non-current assets		501 344	483 699	32 042	30 914
TOTAL ASSETS		3 910 435	3 916 631	249 921	250 318
LIABILITIES AND EQUITY					
Current liabilities					
Borrowings	12	192 924	304 879	12 330	19 485
Trade and other payables	13	939 593	1 015 492	60 050	64 902
Corporate income tax liability		36 159	16 718	2 311	1 068
Government grants		1 498	1 498	96	96
Short-term provisions	14	81 495	73 212	5 208	4 680
Total current liabilities		1 251 669	1 411 799	79 995	90 231
Non-current liabilities					
Long-term borrowings	12	399 165	397 713	25 512	25 418
Other long-term trade payables	15	54 796	57 423	3 502	3 670
Total non-current liabilities		453 961	455 136	29 014	29 088
Total liabilities		1 705 630	1 866 935	109 009	119 319
Equity					
Minority interests		35 058	33 939	2 241	2 169
Equity attributable to equity holders of the parent company					
Share capital		177 000	177 000	11 312	11 312
Statutory reserve capital		17 700	17 700	1 131	1 131
Currency translation adjustment		(5 976)	(5 085)	(382)	(325)
Retained earnings		1 981 023	1 826 142	126 610	116 712
		2 169 747	2 015 757	138 671	128 830
Total equity		2 204 805	2 049 696	140 912	130 999
TOTAL LIABILITIES AND EQUITY		3 910 435	3 916 631	249 921	250 318

in thousand kroons and euros

STATEMENT OF CHANGES IN EQUITY
unaudited

EEK	Equity attributable to equity holders of the parent company					Minority interest	Total
	Share capital	Statu-tory reserve capital	Currency translation adjust-ment	Retained earnings	Total		
Balance as at 31.12.2006	177 000	17 700	(5 751)	1 404 993	1 593 942	18 904	1 612 846
Effect of exchange rate changes	-	-	(6 326)	-	(6 326)	-	(6 326)
Net profit for current period	-	-	-	88 450	88 450	2 937	91 387
Balance as at 31.03.2007	177 000	17 700	(12 077)	1 493 443	1 676 066	21 841	1 697 907
Balance as at 31.12.2007	177 000	17 700	(5 085)	1 826 142	2 015 757	33 939	2 049 696
Effect of exchange rate changes	-	-	(891)	-	(891)	-	(891)
Net profit for current period	-	-	-	154 881	154 881	1 119	156 000
Balance as at 31.03.2008	177 000	17 700	(5 976)	1 981 023	2 169 747	35 058	2 204 805

EUR	Equity attributable to equity holders of the parent company					Minority interest	Total
	Share capital	Statu-tory reserve capital	Currency translation adjust-ment	Retained earnings	Total		
Balance as at 31.12.2006	11 312	1 131	(368)	89 796	101 871	1 208	103 079
Effect of exchange rate changes	-	-	(403)	-	(403)	-	(403)
Net profit for current period	-	-	-	5 653	5 653	188	5 841
Balance as at 31.03.2007	11 312	1 131	(771)	95 449	107 121	1 396	108 517
Balance as at 31.12.2007	11 312	1 131	(325)	116 712	128 830	2 169	130 999
Effect of exchange rate changes	-	-	(57)	-	(57)	-	(57)
Net profit for current period	-	-	-	9 898	9 898	72	9 970
Balance as at 31.03.2008	11 312	1 131	(382)	126 610	138 671	2 241	140 912

The share capital of AS Merko Ehitus consists of 17 700 000 common shares with a nominal value of EEK 10 i.e. EUR 0.64.

in thousand kroons and euros

CASH FLOW STATEMENT
consolidated, unaudited

	EEK		EUR	
	2008 3 months	**2007 3 months**	**2008 3 months**	**2007 3 months**
Cash flows from operating activities				
Operating profit	177 900	88 361	11 370	5 648
Adjustments:				
depreciation and impairment charge	7 024	5 519	449	353
(profit) loss from sale of non-current assets	(327)	(214)	(21)	(14)
adjustments of revenue from construction contracts under stage of completion method	113 684	41 366	7 266	2 644
interest income from business activities	(1 028)	(1 094)	(66)	(70)
government grant and change in other provisions	(6 095)	26 160	(390)	1 672
Change in trade and other receivables related to operating activities	162 644	(24 215)	10 395	(1 548)
Change in inventories	(13 433)	(137 643)	(859)	(8 797)
Change in trade and other payables related to operating activities	(154 437)	(186 530)	(9 870)	(11 922)
Interests paid	(8 790)	(4 348)	(562)	(278)
Other financial expenses (income)	(5)	(3)	0	0
Corporate income tax paid	(639)	(669)	(41)	(43)
	276 498	(193 310)	17 671	(12 355)
Cash flows from investing activities				
Proceeds from sale of subsidiaries	-	6 891	-	440
Investments into associates and joint ventures	(1 000)	(3 343)	(64)	(214)
Purchase of investment property	(112)	-	(7)	-
Purchase of property, plant and equipment	(3 734)	(11 169)	(239)	(714)
Proceeds from sale of property, plant and equipment	867	1 267	55	81
Purchase of intangible assets	(606)	(1 086)	(39)	(69)
Loans granted	(9 737)	(110 757)	(622)	(7 079)
Loan repayments received	-	21 573	-	1 379
Interest received	3 482	6 348	223	406
	(10 840)	(90 276)	(693)	(5 770)
Cash flows from financing activities				
Proceeds from borrowings	28 113	60 693	1 797	3 879
Repayments of borrowings	(137 211)	(127 144)	(8 769)	(8 126)
Finance lease principal payments	(3 903)	(2 241)	(249)	(143)
	(113 001)	(68 692)	(7 221)	(4 390)
Change in cash and cash equivalents	152 657	(352 278)	9 757	(22 515)
Cash and cash equivalent at beginning of period	205 564	676 143	13 138	43 213
Exchange gains/(losses) on cash and cash equivalents	(1 358)	(1 962)	(87)	(125)
Cash and cash equivalent at end of period	356 863	321 903	22 808	20 573

NOTES

Note 1 Business and geographical segments

in thousand kroons

Business segments

2008 3 months	**Construc-tion**	**Road construction**	**Concrete elements**	**Group**
Consolidated revenue	1 086 328	33 244	-	1 119 572
Inter-segmental revenue	-	101	-	101
Segment revenue	1 086 328	33 345	-	1 119 673
Segment operating profit	175 676	2 224	-	177 900
Financial income/expenses				(1 762)
incl. profit/loss from associates and joint ventures	1 223	-	1 057	2 280
Profit before tax				176 138
Corporate income tax				(20 138)
Net profit of the Group				156 000
incl. attributable to equity owners of the parent company				154 881
minority interest				1 119
Segment assets	3 403 766	172 907	-	3 576 673
Associates and joint ventures	217 884	-	58 099	275 983
Unallocated assets				57 779
Total consolidated assets				3 910 435
Segment liabilities	1 012 166	60 008	-	1 072 174
Unallocated liabilities				633 456
Total consolidated liabilities				1 705 630
Purchase of investment property	112			112
Purchase of property, plant and equipment and intangible assets	3 853	486		4 339
Depreciation and impairment	4 801	2 223		7 024

2007 3 months	**Construc-tion**	**Road construction**	**Concrete elements**	**Group**
Consolidated revenue	994 762	20 102	-	1 014 864
Inter-segmental revenue	-	23 431	-	23 431
Segment revenue	994 762	43 533	-	1 038 295
Segment operating profit	88 148	213	-	88 361
Financial income/expenses				3 907
incl. profit/loss from associates and joint ventures	2 336	-	4 495	6 831
Profit before tax				92 268
Corporate income tax				(881)
Net profit of the Group				91 387
incl. attributable to equity owners of the parent company				88 450
minority interest				2 937
Segment assets	2 873 109	152 517	-	3 025 626
Associates and joint ventures	160 305	-	44 674	204 979
Unallocated assets				58 642
Total consolidated assets				3 289 247
Segment liabilities	1 117 986	33 382	-	1 151 368
Unallocated liabilities				439 973
Total consolidated liabilities				1 591 341
Purchase of property, plant and equipment and intangible assets	13 013	2 887	-	15 900
Depreciation and impairment	3 310	2 209	-	5 519

Costs, assets and liabilities that cannot be related to a specific asset or it is not practical to do so are considered as unallocated.

Geographical segments

	Revenue		Total assets		Purchase of property, plant and equipment and intangible assets	
	2008 3 months	2007 3 months	31.03.2008	31.03.2007	2008 3 months	2007 3 months
Estonia	617 618	691 303	1 976 274	1 704 099	2 410	11 311
Latvia	299 087	154 112	1 567 214	1 268 175	1 803	4 589
Lithuania	202 867	169 449	366 947	316 973	126	-
Total	1 119 572	1 014 864	3 910 435	3 289 247	4 339	15 900

Revenue is based on the country in which the customer is located; the assets are reported basing on the geographic location of the assets.

Note 2 Revenue

in thousand kroons

	2008 3 months	2007 3 months
Rendering of services	703 705	852 676
Sale of real estate and real estate development projects	415 389	161 620
Rental income	236	393
Sale of goods	242	175
Total revenue	1 119 572	1 014 864

Note 3 Cost of goods sold

in thousand kroons

	2008 3 months	2007 3 months
Materials	83 266	86 020
Construction services	511 129	621 412
Properties purchased for resale	128 519	17 564
Staff costs	89 210	103 140
Depreciation and impairment charge	4 567	3 888
Design	18 669	19 994
Construction mechanisms and transport	21 424	12 722
Other expenses	27 593	21 612
Total cost of goods sold	884 377	886 352

Note 4 Earnings per share

Basic earnings per share for profit attributable to equity holders of the parent company has been derived by dividing the net profit attributable to shareholders by the weighted average number of shares.

	2008 3 months	2007 3 months
Net profit attributable to shareholders *(in thousand kroons)*	154 881	88 450
Weighted average number of ordinary shares *(thousand pcs)*	17 700	17 700
Earnings per share *(in kroons)*	8,75	5,00

The Group did not have any potential ordinary shares to be issued; therefore the diluted earnings per share equal the basic earnings per share.

Note 5 Cash and cash equivalents

in thousand kroons

	31.03.2008	31.12.2007
Cash on hand	158	116
Bank accounts	193 977	53 722
Short-term deposits	162 728	151 726
Total cash and bank	356 863	205 564

Note 6 Trade and other receivables

in thousand kroons

	31.03.2008	31.12.2007
Trade receivables		
accounts receivable	732 392	886 967
allowance for doubtful receivables	(2 105)	(2 111)
	730 827	884 856
Tax prepayments excluding corporate income tax		
value added tax	26 592	38 139
social security tax	12	12
other taxes	1	1
	26 605	38 152
Amounts due from customers for contract works	113 664	151 119
Other short-term receivables		
short-term loans	41 128	41 135
interest receivables	4 053	2 075
receivable from sale of subsidiary	1 000	1 000
other short-term receivables	920	2 662
	47 101	46 872
Prepayments for services		
prepayments for construction services	72 076	64 864
prepaid insurance	2 699	2 339
other prepaid expenses	7 859	11 364
	82 634	78 567
Total trade and other receivables	1 000 831	1 199 566

Note 7 Inventories

in thousand kroons

	31.03.2008	31.12.2007
Materials	7 791	3 501
Work-in-progress	1 123 410	1 209 117
Finished goods	164 260	72 434
Goods for resale		
land purchased for resale	713 728	704 111
other goods purchased for resale	13	13
	713 741	704 124
Prepayments for inventories		
prepayments for real estate properties	33 257	35 653
prepayments for other inventories	5 370	597
	38 627	36 250
Total inventories	2 047 829	2 025 426

Note 8 Long-term financial assets
in thousand kroons

	31.03.2008	31.12.2007
Investments in associates and joint ventures	275 983	272 964
Long-term loans	18 389	8 667
Long-term receivable from buyer of subsidiary	3 625	3 625
Long-term receivables from customers of construction services	2 200	2 200
Total long-term financial assets	300 197	287 456

Note 9 Investment property
in thousand kroons

	31.03.2008	31.12.2007
Land	7 676	2 136
Buildings at carrying amount		
cost	5 706	5 600
accumulated depreciation	(436)	(375)
	5 270	5 225
Total investment property	12 946	7 361

Note 10 Property, plant and equipment
in thousand kroons

	31.03.2008	31.12.2007
Land	15 943	15 943
Buildings at carrying amount		
cost	24 619	24 627
accumulated depreciation	(4 454)	(4 246)
	20 165	20 381
Right of superficies at carrying amount		
cost	458	458
accumulated depreciation	(97)	(95)
	361	363
Machinery and equipment at carrying amount		
cost	158 874	153 587
accumulated depreciation	(58 281)	(55 100)
	100 593	98 487
Other fixtures at carrying amount		
cost	65 930	64 970
accumulated depreciation	(38 124)	(35 996)
	27 806	28 974
Construction in progress	132	36
Prepayments for property, plant and equipment	7 134	8 728
Total property, plant and equipment	172 134	172 912

Note 11 Intangible assets

in thousand kroons

	31.03.2008	31.12.2007
Software at carrying amount		
cost	15 118	14 443
accumulated depreciation	(4 255)	(3 682)
	10 863	10 761
Prepayments for intangible assets	1 812	1 813
Total intangible assets	12 675	12 574

Note 12 Borrowings

in thousand kroons

	31.03.2008	31.12.2007
Finance lease payables		
Present value of lease payments	47 400	48 114
incl. current portion	13 881	11 879
non-current portion 2...4 years	33 519	36 235
Interest expense of reporting period	547	3 272
Minimum future lease payments	50 718	51 404
incl. current portion	13 263	13 441
non-current portion 2...4 years	37 455	37 963
Base currencies EEK, EUR and LVL		
Loans		
Loan balance	539 789	630 543
incl. current portion	176 893	273 965
non-current portion 2...5 years	362 896	356 578
Interest cost of reporting period	14 366	28 714
incl. capitalised interest cost	3 293	20 975
Base currencies LVL and EUR		
Loans from parent company		
Loan balance	-	19 035
incl. current portion	-	19 035
Loans from other companies		
Loan balance	4 900	4 900
incl. current portion	2 150	-
non-current portion 2...5 years	2 750	4 900
Total loans		
Loans balance	544 689	654 478
incl. current portion	179 043	293 000
non-current portion 2...5 years	365 646	361 478
Total borrowings	592 089	702 592
incl. current portion	192 924	304 879
non-current portion 2...5 years	399 165	397 713

Note 13 Trade and other payables

in thousand kroons

	31.03.2008	31.12.2007
Payables to suppliers	391 281	528 857
Payables to employees	77 812	74 892
Tax liabilities, except for corporate income tax		
value added tax	18 797	26 979
personal income tax	11 347	10 720
social security tax	20 292	17 654
land tax	60	46
unemployment insurance tax	337	319
contributions to mandatory funded pension	756	527
other taxes	1 018	570
	52 607	56 815
Amounts due to customers for contract works	253 404	161 725
Other payables		
interest liabilities	1 049	465
other payables	7 343	21 503
	8 392	21 968
Advance payments received	156 097	171 235
Total trade and other payables	939 593	1 015 492

Note 14 Short-term provisions

in thousand kroons

	31.03.2008	31.12.2007
Provision for warranty obligation for construction	16 147	15 625
Provision for onerous construction contracts	27 785	32 512
Provision for potential cancellation of construction projects	14 624	1 934
Provision for legal costs and claims filed	21 776	22 786
Other provisions	1 163	355
Total short-term provisions	81 495	73 212

Note 15 Other long-term trade payables

in thousand kroons

	31.03.2008	31.12.2007
Payables to suppliers	7 655	11 091
Advance payments received	47 141	46 332
Total long-term trade payables	54 796	57 423

Note 16 Related party transactions

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

- parent company AS Merko Grupp;
- shareholders of AS Merko Grupp with significant influence through AS Merko Grupp;
- other shareholders with significant influence;
- other subsidiaries of AS Merko Grupp, so-called 'entities controlled by the parent company';
- associates and joint ventures;
- key managers and their close relatives;
- entities under control of persons mentioned above;

Significant influence is presumed to exist when the person has more than 20% of the voting power.

The parent company of AS Merko Ehitus is AS Merko Grupp. As at 31.03.2008 and 31.12.2007, AS Merko Grupp owned 72% of the shares of AS Merko Ehitus. The ultimate controlling party of the Group is Mr Toomas Annus.

Goods and services

in thousand kroons

	2008 3 months	2007 3 months
Purchased construction services		
Associates and joint ventures	12 891	18 720
Entities controlled by the parent company	2 842	3 825
Total purchased construction services	15 733	22 545
Construction services rendered		
Associates and joint ventures	-	9 169
Entities controlled by the parent company	191 810	292 009
Management members	795	3 830
Total construction services rendered	192 605	305 008
Construction materials purchased		
Other related parties	31	19
Real estate sold		
Entities controlled by the parent company	99 644	-

Balances with the related parties

in thousand kroons

	30.03.2008	31.12.2007
Trade and other receivables		
Trade receivables		
Associates and joint ventures	6 704	16 046
Entities controlled by the parent company	234 130	182 802
Short-term loans		
Associates and joint ventures	7 000	7 000
Entities controlled by the parent company	4 228	4 236
Interest receivables		
Associates and joint ventures	979	649
Entities controlled by the parent company	961	-

Other short-term receivables		
Other related parties	-	2
Other long-term loans and receivables		
Long-term loans		
Associates and joint ventures	15 451	5 725
Entities controlled by the parent company	2 937	2 942
Borrowings		
Short-term loans and bonds		
Parent company	-	19 035
Trade and other payables		
Payables to suppliers		
Associates and joint ventures	8 437	11 098
Entities controlled by the parent company	-	326
Prepayments received		
Entities controlled by the parent company	19 071	16 094
Interest liabilities		
Parent company	-	272

Note 17 Contingent liabilities

The Group has purchased the following guarantees in the following maximum amounts from financial institutions to cover Group's maximum exposure to third parties if the Group would not be able to fulfil its contractual obligations. The management believes that the likelyhood of additional expenses due to these guarantees is remote.

in thousand kroons	**31.03.2008**	**31.12.2007**
Performance period's warranty to the customer	306 538	309 904
Tender warranty	33 663	23 761
Guarantee warranty period	84 843	55 500
Prepayment guarantee	76 501	68 756
Sureties	5 158	9 999
Payment guarantee	7 681	5 176
Letter of credit	-	11 218
Total contingent liabilities	514 384	484 314

Performance period's warranty to the customer – warranty provider grants to customer that contractor's obligations arising from construction contract will be adequately completed.
Tender warranty – warranty provider grants to customer arranging the tender process that the tenderer will sign a contract as per tender conditions.
Guarantee for warranty period - warranty provider grants to customer that construction defects discovered during the warranty period will be repaired.
Prepayment guarantee - warranty provider grants to customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.
Payment guarantee – warranty provider grants to customer payment for goods or services.

MANAGEMENT DECLARATION

The Management Board of Merko Ehitus has prepared the consolidated 3 months interim report 2008 as presented on pages 3 to 18.

The Management Board confirms to the best of its knowledge:

- the accounting methods used for preparing the interim financial statements are in compliance with International Financial Reporting Standards as adopted by the European Union;
- the interim financial statements give a true and fair view of the financial position, the results of operations and the cash flows of the Group;
- the parent company and all Group companies are going concerns.

The consolidated interim financial statements of AS Merko Ehitus for the 3 months period ending 31.03.2008 have been prepared in accordance with IAS 34 "Interim Financial Reporting" for condensed interim financial statements. Company applies the same accounting policies in its interim financial statements as applied in its annual financial statement of 2007.

Tõnu Toomik	Chairman of the Board	23.05.2008
Alar Lagus	Member of the Board	23.05.2008
Veljo Viitmann	Member of the Board	23.05.2008
Andres Agukas	Member of the Board	23.05.2008
Tõnu Korts	Member of the Board	23.05.2008

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TORNIMÄE ÄRIKESKUS

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ABOUT THE COMPANY

Merko Ehitus is the construction company established at the beginning of 1990 which operates in Estonia, Latvia and Lithuania and which shares are quoted at Tallinn Stock Exchange from the year 1997. As at the end of the last year the group provided work for more than 1100 persons.

We are a market leader today in Estonia, by building about 6% of all objects to be built in Estonia. The company continues the development of its activities in Latvia and Lithuania with the requirement to get among the leaders of the construction market of these countries through its subsidiaries SIA Merks and UAB Merko Statyba.

Long-term experience from different markets, wide scope of construction services, flexibility, reliability and meeting of deadlines and foremost quality have helped Merko Ehitus to achieve and maintain during the years the position of market leader in the Baltics. Depending on the expectations of the clients, the group companies perform both small-scale construction works as well as large scale, complicated and innovative projects.

International quality, environmental protection and occupational safety certificates ISO 9001, ISO 14001 and OHSAS 18001 have been assigned to the company.

We operate on the wide scale in the construction sector: we build hotels, museums, cultural centres, business centres, service institutions, schools, kindergartens, dwellings, offices, production buildings, sport complexes. In the engineering sector we build the port facilities, waste management facilities, bridges, viaducts, water and sewerage networks, wastewater purifiers and other environmental protection facilities. In the road construction we perform all road maintenance works, we build roads, carry out maintenance repairs of roads and supervision of the extracting works and road status, produce the traffic signs and provide the repair services for the machinery. In the sector of electrical works we foremost deal with planning, adjustment and construction of the medium and high voltage substations and cable lines.

VISION

Our vision is the reliable solutions and quality performance for your ideas.

VALUES

LIABILITY
We decide based on business thinking/awareness and ethical beliefs. We offer continuous and environment-friendly solutions.

KEEPING OF ONE'S PROMISES
We give realistic promises to the shareholders, clients, cooperation partners, employees and we keep our promises. Good solutions are born in cooperation, the keeping of one's promises is mutual.

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

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

CREATIVITY
We are open, innovative and creative in working out and implementing the solutions. We are willing to carry out our thoughts.

ADDRESS OF THE CHAIRMAN OF THE SUPERVISORY BOARD

The year 2007 was the most successful one in the 17-year history of Merko Ehitus's operations. Sales revenues of 5.5 billion kroons at a growth rate of almost 25 percent and net profit of 545 million kroons were the most important financial indicators of the past year. It is also worth pointing out that the number of company's employees in Estonia, Latvia and Lithuania altogether exceeded the margin of 1000 people. The AS Merko Ehitus Group affirmed its position as a leading construction company in the Baltic States. It is fitting to thank the entire team of Merko Ehitus!

On the other hand, the company faced the biggest challenges ever which were induced by the general cooling down of the economic climate in the Baltic States as well as by the criminal case related to the company. All of this has left a mark and will undoubtedly influence not only Merko Ehitus's economic activities but almost all companies in the region.

The year 2007 in the Estonian economy will be characterized by the growth retardation of the so far rapidly growing economy and since the pacemaker of the growth was the construction and property sector, the first corrections resulting in the slowdown in growth reached this market first. Clearly, the general economic climate has also cooled down – we have done mistakes and have not taken up opportunities to correct them. Even though having a market share of just 6 percent, Merko Ehitus is still the largest construction company in the region and we cannot totally detach ourselves from the strategic direction and decisions that the state authorities have chosen or left unchosen. In 2007, the Baltic construction market grew 33.2 percent as a whole and according to the data of the Statistics Estonia the annual growth rate in Estonia was 22.4 percent. Growth rates in absolute numbers remained strong but this related primarily to the first half of the year. For ensuring sustainable growth, the management of Merko Ehitus has started to rearrange company's activities the aim of which is to preserve company's competitiveness and the Group's leading position on the Baltic construction market.

It is quite clear that the company management did not have experience in dealing with a criminal case initiated against a publicly listed company and that it is also a peculiarly novel and hopefully last experience of its kind for the Tallinn Stock Exchange, law-enforcement bodies and many other interest groups. In the given situation, Merko Ehitus has primarily proceeded from the company's status as a member of the exchange, our priorities have been open and transparent communication and correct relations with investors which mainly aims at maintaining relations with our shareholders that are based on trust. This has been acknowledged both by the investors as well as by experts.

Among the largest construction projects were the termination of construction works of several shopping centres in Latvia and Lithuania, the opening of the Nordic Hotel Forum and the construction of one of the most prominent buildings in Tallinn forming part of Tallinn City in the area of the Tartu street. In 2008, we proceed with several large-scale and complex objects.

Changes in the economic environment and among decision-makers will lead to changes in the company management. According to results of 2008, Tõnu Toomik, today's Merko Ehitus's Chairman of the Management Board addresses you in the name of the entire Supervisory Board.

In the name of the Supervisory Board, I would like to express my gratitude to all shareholders and our partners for their trust and support which you have always shown to Merko Ehitus and especially in this contradictory year 2007!

Toomas Annus
Chairman of the Supervisory Board

AS MERKO EHITUS

GROUP

CONSOLIDATED ANNUAL REPORT

Beginning of financial year: 01.01.2007

End of financial year: 31.12.2007

Commercial Register no:	10068022
Address:	Järvevana tee 9G, 11314 Tallinn
Phone:	+372 680 5105
Fax:	+372 680 5106
E-mail:	merko@merko.ee
Web site:	www.merko.ee
Main activity:	general contracting of construction
Auditor:	AS PricewaterhouseCoopers

MANAGEMENT REPORT

General information

Merko Ehitus is a leading construction group offering complete solutions, with companies located in Estonia, Latvia and Lithuania. Merko Ehitus was set up in 1990. The Group consists of 36 subsidiaries and 7 associates and joint ventures, the largest of which are SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (75%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%), OÜ Fort Ehitus (75%) and AS Tartu Maja Betoontooted (25%).

Key changes occurred at the Group in 2007:

- At 5 April 2007, AS Merko Ehitus acquired a 75% holding in OÜ Fort Ehitus (registration no. 10722444). The main activity of OÜ Fort Ehitus is piling and hydrotechnical works. The goal of the acquisition of the holding was to strengthen the competencies of the Group in the area of piling works and hydrotechnical construction.
- Due to the need to simplify the Group's structure, AS Merko Ehitus launched the liquidation of its subsidiaries AS Merko Insenerehitus, OÜ Merko Ehitustööd and OÜ Pire Projekt in 2007.

At 15 October 2007, the Prosecutors' Office launched criminal proceedings against AS Merko Ehitus and Chairman of the Company's Supervisory Board Toomas Annus, suspected of giving bribes and misuse of trust. The substance of suspicions is incomprehensible to the management of AS Merko Ehitus, as the activities of the Company and its governing bodies have always been appropriate and in compliance with the laws of the Republic of Estonia. The substance of suspicions was published in the stock exchange announcement at 22.10.2007 (http://www.baltic.omxgroup.com/market/?pg=details&instrument=EE3100003559&list=2&tab=news&news_id=218499). The effect of the suspicions on the Company's results of operations for the year 2007 is negligible. However, the Management Board considers it necessary to note that the filing of suspicions may impact the Company's competitiveness and the competitive position of the Estonian construction market as a whole.

At a joint meeting held at 14 March 2008, the Management Board and the Supervisory Board of AS Merko Ehitus adopted a resolution to restructure the Company and separate operating activities from the criminal proceedings related to the land swap. The Company's management estimates that the restructuring of the Company is the best way to ensure its sustainable development and protect the interests of shareholders and employees in the long-lasting criminal proceedings related to the land swap.

The delay in the process of criminal proceedings related to the land swap launched in 2005 and the accompanying ambiguity and speculation in the media have started to take a toll on the Company's operations and thus harming the interests of the Company and its shareholders. The Company has entered into advisory agreements with the investment bank GildBankers and the law office Tark & CO for the implementation of the process and evaluating the related legal and economic impact.

At 15 April 2008, the management of AS Merko Ehitus presented the Company's restructuring plan (http://www.baltic.omxgroup.com/market/?pg=details&instrument=EE3100003559&list=2&tab=news&news_id=222602), according to which AS Merko Ehitus will be split up/demerged so that AS Merko Ehitus, e.g. assets (other than liquid assets in the amount of EEK 300 million), liabilities and contracts as well as the business name will be separated and transferred to the new company being set up (hereinafter AS Uus Merko). As a result of the demerger, each shareholder will receive one share of AS Uus Merko for each share of AS Merko Ehitus and the shares of AS Uus Merko will be listed on the Tallinn Stock Exchange as soon as possible. The business name of AS Merko Ehitus will also be changed and the Company's shares will continue to be listed on the Tallinn Stock Exchange. The sole member of the Management Board of the new company will be Toomas Annus.

The Management Board of AS Merko Ehitus will prepare the demerger plan outlining the details of the demerger, incl. size of share capital of AS Uus Merko, members of the Management Board and Supervisory Board, distribution and exchange ratio of the shares of AS Uus Merko to be transferred to shareholders, terms of transferring shares, a list of assets and liabilities to be transferred to AS Uus Merko. In addition, the Management Board will prepare the demerger report explaining the demerger from the legal and economic point of view.

The demerger plan will be presented for approval at the General Meeting of Shareholders of AS Merko Ehitus. At least 2/3 of the voting power represented at the meeting is required to adopt the resolution.

Baltic construction market

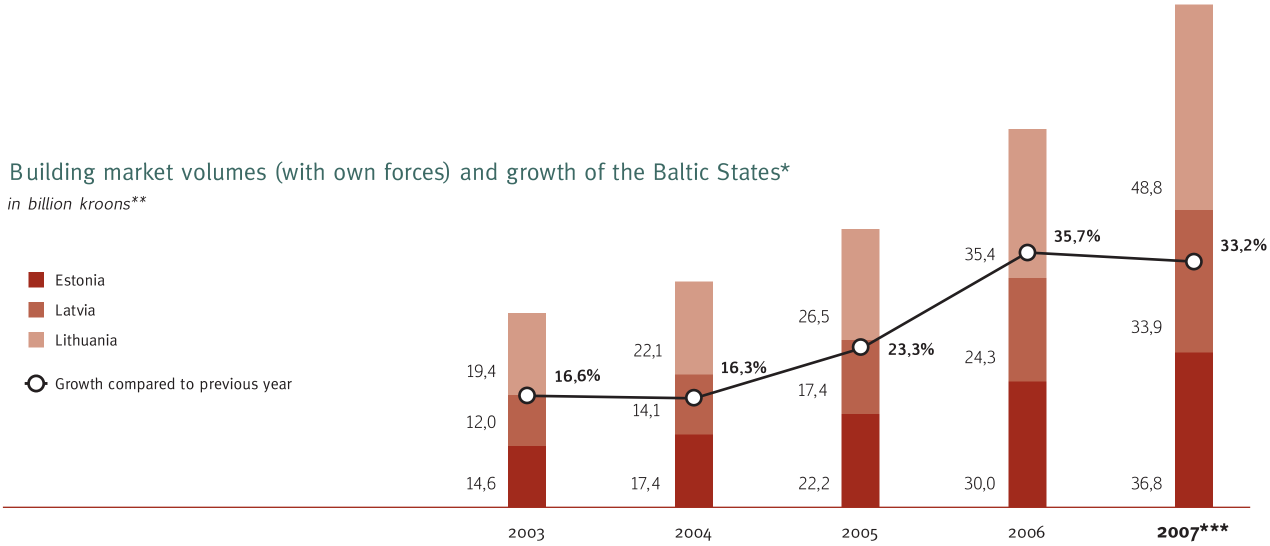
In 2007, the Baltic construction market as a whole grew by 33.2%. In 2007, construction works with own resources were performed in the Baltic region for EEK 119.6 billion which is EEK 29.8 billion more than in 2006.

The year was characterised by the regional polarisation of markets – the fast growth of the last couple of years continued in Latvia and Lithuania, whereas the construction market stabilised in Estonia. The fastest growth occurred in Latvia, where the construction market grew by 40.2% in current prices (2006: 39.7%) and reached EEK 33.9 billion. Lithuania's growth of 38.0% fell short of the respective figure of Latvia, but exceeded its own last year's growth rate of 33.4% by EEK 13.5 billion. The Estonian market was the only one not to reach the growth rate of previous years. According to the data by Estonian Statistics Board construction works with own resources were performed for EEK 36.8 billion in 2007. As compared to 2006, the Estonian construction companies performed construction works for EEK 6.7 billion or 22.4% more than last year. Despite their faster growth rates, Latvia and Lithuania could not surpass Estonia with regard to construction production per capita. Construction works per capita were performed for EUR 1751 in Estonia, EUR 953 in Latvia and EUR 922 in Lithuania.

The year 2007 was characterised by moderate growth in the residential housing market in Lithuania and stagnation in Latvia and Estonia. High prices of residential housing, lower sense of security of consumers and higher cost of financing significantly reduced the demand for residential housing. However, the provision of new dwellings increased significantly. A total of 7232 operating permits were issued in Estonia, 9319 in Latvia and 9286 in Lithuania for new dwellings, the selling periods of apartments got longer and a moderate correction of prices occurred in less liquid development projects.

Building market volumes (with own forces) and growth of the Baltic States*

*in billion kroons***



** Based on the data of local statistical offices.*
*** According to the unofficial central exchange rate of Eesti Pank.*
**** Data of 2007 tenative, based on short-term statistics.*

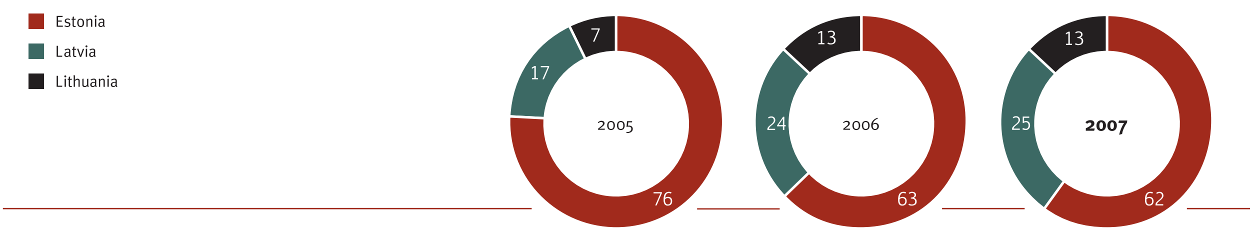
Similarly to the growth of construction volumes, the construction prices continued to appreciate in 2007. For the second consecutive year, the fastest growth occurred in Latvia, and Estonia and Lithuania swapped their places. As compared to 2006, construction services appreciated by 26.2% in Latvia, 13.7% in Lithuania and 12.7% in Estonia, including appreciation of labour costs by 45.5% in Latvia, 22.1% in Estonia and 20.6% in Lithuania.

Operating results

The year 2007 turned out to be an extraordinary one for the Group in many respects. In 2007, the sales revenue of the Merko Ehituse Group was EEK 5510.8 billion, increasing by 24.8% in a year. In 2007, Estonia contributed 61.4%, Latvia 25.2% and Lithuania 13.4% to sales growth. As compared to 2006, sales revenue increased by 31.3% in Latvia, 30.9% in Lithuania and 21.2% in Estonia.

Geographical distribution of turnover of Merko Ehitus group

per cent



The consolidated sales revenue of the Group's largest companies:

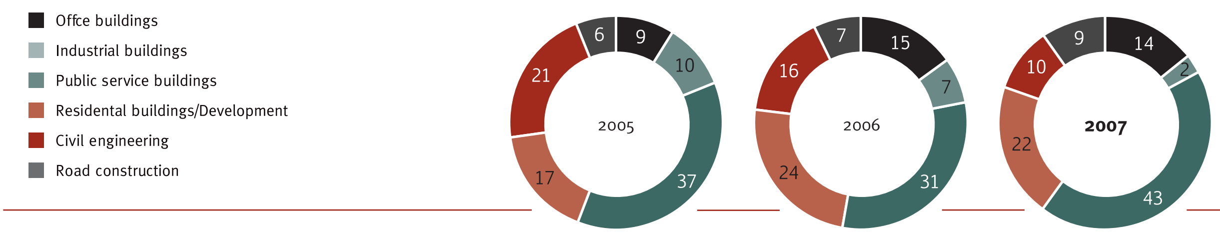
in thousand EEK and EUR

	2007		2006	
	EEK	EUR	EEK	EUR
Estonian companies				
AS Merko Ehitus (parent company)	2 221 823	142 000	1 864 882	119 188
AS Gustaf (75% ownership)	153 123	9 786	97 049	6 203
OÜ Gustaf Tallinn (80% ownership)	146 568	9 367	124 068	7 929
AS Merko Tartu (66% ownership)	309 282	19 767	255 769	16 347
Tallinna Teede AS (100% ownership)	363 272	23 217	317 591	20 298
OÜ Woody (100% ownership)	218 642	13 974	306 354	19 580
Latvian company				
SIA Merks (100% ownership)	1 225 816	78 344	973 636	62 227
Lithuanian company				
UAB Merko Statyba (100% ownership)	696 010	44 483	507 309	32 423

Engineering construction contributed 10%, residential construction/development 22%, administrative buildings 43%, office buildings 14%, industrial buildings 2% and road construction 9% to the Group's revenue. Of construction activities, 83% was new structure and 17% was renovation and reconstruction works. In 2007, the Group entered into construction contracts with the total volume of EEK 4351 million and as at 31.12.2007, the Group's contract portfolio totalled EEK 4136 million.

Distribution of construction activities of the group

per cent

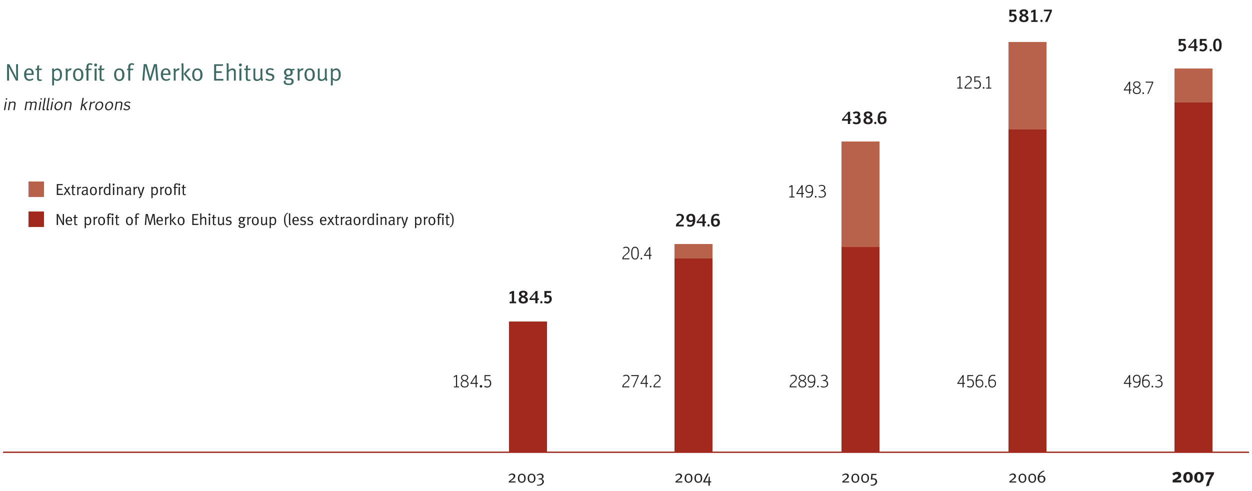


The largest completed projects in 2007

Sõpruse Ärimaja	new facility	Sõpruse 145, Tallinn	25 055 m²	AS Merko Ehitus
Tallink Spa & Conference Hotel	new facility	Sadama 11a, Tallinn	33 318 m²	AS Merko Ehitus
Nordic Hotel Forum	new facility	Narva mnt 1a/ Viru Väljak 2a, Tallinn	16 849 m²	AS Merko Ehitus
Tornimäe multi-functional skyscraper, residential building	new facility	Tornimäe 3, Tallinn	14 885 m²	AS Merko Ehitus
Extension of Smuuli Road (overpass)	new facility	Smuuli Road in the section of St. Petersburg Highway – Suur-Sõjamäe St, Tallinn	370 m	AS Merko Ehitus
Puurmani road intersection	new facility	Tallinn-Tartu-Võru-Luhamaa Highway 147,6-149,4 km		AS Merko Ehitus
Residential and office building	new facility	Sõpruse 29, Tallinn	4 078 m²	OÜ Woody
Furniture centre of Spice	new facility	Jaunmoku 12, Riga	28 156 m²	SIA Merks
Production facilities of Valmiera fibre class plant	new facility	Cempu 13, Valmiera	21 485 m²	SIA Merks
Office building	new facility	Hospitalu 55, Riga	19 450 m²	SIA Merks
Business centre and bus station	new facility	Tilžes 109, Šiauliai	51 938 m²	UAB Merko Statyba
Production facility of Glaskek	new facility	Tähtvere rural municipality,Tartumaa	11 405 m²	AS Merko Tartu

In a year, the cost of goods sold of the Group increased by 26.9% and distribution and administrative expenses increased by 43.0%, representing 85.9% and 4.5%, respectively, of sales revenue. Due to fast growth of service and labour costs, the gross margin decreased from 15.6% to 14.1% in a year, and the operating margin decreased from 14.3% to 9.5% in a year.

In 2006, the Group's net profit totalled EEK 545.0 million, of which EEK 48.7 million was earned as extraordinary income from the sale of registered immovables, EEK 337.5 million from development activities, EEK 147.8 million from construction activities and EEK 11.0 million from financing activities. Profit from main operations increased from EEK 456.6 million to EEK 496.4 million or 8.7%. Similarly to a decline in gross and operating margins, the net margin also decreased, from 13.2% in the comparable period to 9.9%. The Group's net profit margin before extraordinary income was 9.0% and the profit margin from construction activities was 3.2%.



In 2007, the Group's total cash flows amounted to EEK –469.0 million, of which the cash flows from operating activities totalled EEK –488.9 million. The cash flows from operating activities of the reporting period were mostly affected by the operating profit EEK +521.0 million, a change in inventories EEK –665.4 million, a change in receivables and prepayments related to operating activities EEK –108.4 million, a change in liabilities and prepayments –127.7 million, adjustment of revenue from construction contracts EEK –130.9 million and corporate income tax paid EEK –34.6 million. The Group's cash flows from investing activities totalled EEK –73.4 million, of which EEK +150.8 million were loan repayments received and interest, EEK –145.7 million loans granted during the period, EEK –48.8 million investments into property, plant and equipment and EEK –32,9 million investments in subsidiaries and associates. The Company's cash flows from financing activities totalled EEK +93,3 million, of which the balance of credit liabilities assumed/repaid was EEK +222.3 million and dividends paid EEK –129.0 million.
The period's negative cash flow was covered through additional loans (period's net cash flows from borrowing EEK +236.5 million) and the Group's liquid assets.

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

	2005	2006	2007
Net profit margin	13.6%	13.2%	9.9%
Net profit margin (excluding extraordinary profit)	9.0%	10.3%	9.0%
EBITDA margin	14.3%	14.5%	10.7%
Operating profit margin	13.5%	14.3%	9.5%
Return on equity per annum	48.2%	43.2%	30.2%
Return on assets per annum	24.9%	21.4%	15.3%
Equity ratio	49.6%	49.6%	51.5%
Current ratio	2.0	2.0	2.4
General expense ratio	4.6%	3.9%	4.5%
Personnel expense ratio	7.3%	8.0%	9.3%
Debt ratio	28.8%	27.8%	34.9%
Accounts receivable turnover (in days)	33	46	59
Accounts payable turnover (in days)	38	45	41
Sales revenue per employee (in million EEK)	4.651	5.193	5.376
Average number of full-time employees at the Group	695	850	1025

Definition of key indicators:
Net profit margin: Net profit / Sales revenue
EBITDA margin: Profit before tax / Sales revenue
Operating profit margin: Operating profit / Sales revenue
*Return on equity per annum: Net profit / Average equity of the period**
Return on assets per annum: Net profit / Average assets of the period
Equity ratio: Owners' equity / Total assets*
Current ratio: Current assets / Current liabilities
General expense ratio: General expenses / Sales revenue
Personnel expense ratio: Personnel expenses / Sales revenue
*Debt to equity ratio: Interest-bearing liabilities / Owners' equity**
Accounts receivable turnover: Trade receivables / Sales revenue x 365
Accounts payable turnover: Payables to supplies / Cost of goods sold x 365
Sales revenue per employee: Sales revenue / Average number of full-time employees

** Calculated as attributable to the equity holders of the parent company*

Business risks

Market risk. One of the peculiarities of construction activities is the fact that the execution of the contracts entered into will take months, making the sector immune to changes in the economic environment. Due to this the changes having both a negative and positive effect on the demand for construction services will reach construction industry with a lag of approximately 12 months. This time lag enables the sector to arrange its activities to be prepared for potential setbacks as well as booms.

It is much more difficult to estimate the changes in the demand for residential housing development. The concurrent occurrence of several risks described in previous years – fast price appreciation, appreciation of loan interest, lack of investing interest due to stabilisation of dwelling prices led to a significant decline in the demand for new residential housing in Estonia and Latvia. The situation was further aggravated by the explosive growth of apartments available for sale. The Lithuanian market clearly stood out in the Baltic market with its demand and supply in balance and where most of the completed apartments were sold. In order to anticipate potential problems, we closely follow the changes in sales figures, the process of selling apartments is launched in the early stages of construction, preliminary contracts are entered into with the buyer at the first opportunity and a deposit is collected from them to ensure the execution of contractual obligations. The largest projects are divided into stages so that they can be frozen quickly and with few expenses. In 2007, real estate development made up 16.6% of the sales revenue of Merko Ehitus, including residential construction of 12.2%. As at 31.12.2007, 58 completed apartments with the cost price of EEK 79.4 million and 1287 unfinished apartments with the cost price of EEK 1022.5 million, of which 556 apartments had been sold to buyers under preliminary contracts, had not been sold by the Group.

Operating risk. The Group concludes complete risk insurance contracts with insurance companies in order to hedge unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to EUR 10 million. The risks of projects which cost exceeds 10 million euros or which the annual policy does not cover (water construction, railroad construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding employment contracts for design work, an insurance contract for professional liability is required from subcontractors covering the losses arising from design, erroneous measuring, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2007, indemnity applications totalling EEK 7.1 million and insurance benefits were received in the amount of EEK 4.5 million.

A warranty reserve has been set up at the Company to eliminate the construction errors which have become evident during the warranty period. In 2007, warranty provisions were set up in the total amount of EEK 13.3 million and disbursements amounted to EEK 7.4 million. As at the year-end, the Company's warranty provision amounted to EEK 15.6 million. With regard to work performed by subcontractors, the subcontractor shall eliminate the errors that became evident during the warranty period. With regard to significant contracts, the performance of contractual obligations of the contractor arising from contracts of services is guaranteed with bank guarantees.

One important part of managing operating risks is the mapping out of the situation and anticipation of risks. ISO 9001/14001 management systems have been set up at the four largest group companies and the occupational health and safety system OHSAS 18001 has been set up at the parent company. Sixteen full-time quality control specialists work at the Group whose work responsibilities include ensuring the development and functioning of quality, work safety and management systems.

Credit risk is an inevitable part of business. In managing credit risk, close attention is paid to the payment behaviour of partners, their financial position is analysed and if necessary, third parties are involved as guarantors. With regard to prepayments to suppliers, a bank guarantee by suppliers is required. In 2007, the payment discipline of customers somewhat improved, the amount of invoices exceeding 30 and more days decreased from EEK 22.4 million to EEK 10.0 million and at the same time the amount of doubtful receivables collected increased from EEK 1.6 million to EEK 2.1 million. Due to participation in several large public procurements, the accounts receivable turnover increased from 46 days to 59 days in a year. Management estimates that the liabilities as at the year-end do not contain significant credit risk. The Company's available funds are held in short-term deposits at the banks with a high credit rating (Moody's rating of A3/P-2 and higher).

Interest rate risk. As at 31.12.2007, the Group's interest-bearing liabilities totalled EEK 702.6 million, of which short-term loans and the current portion of long-term debt totalled EEK 304.9 million and long-term loans and finance lease liabilities totalled 397.7 million. The volume of interest-bearing liabilities increased by 259.5 million kroons in a year end as at the year-end, these liabilities made up 17.9% of the Company's balance sheet total. Most of the Group's loans relate to short-term development projects the duration of which does not exceed 36 months. Due to the short-term nature of loans, the effect of interest rate increases is immaterial on the final results of projects and therefore, the hedging of interest risks of these obligations is not considered reasonable.

Liquidity risk. Due to stricter control over money supply, lower turnover speed of development projects and potential negative scenarios with regard to the payment discipline, one of the major challenges in the field in the near future will be liquidity risk. As at 31.12.2007, the Group's current ratio was 2.4 (2006: 2.0) and quick ratio was 1.0 (2006: 1.1). To ensure liquidity and better management of the cash flows, the group companies have concluded overdraft contracts with banks in the total amount of EEK 90 million. In addition to overdraft credits, the Company has a working capital loan with the limit of EEK 150 million from AS Merko Grupp. Management estimates that the Group's capital structure – high equity rate of 52% of the balance sheet total and a low share of borrowings of 18% of the balance sheet total – ensures the Company's trustworthiness in the eyes of creditors also during difficult times and significantly improves the feasibility of the extension of existing financial liabilities and raising additional debt. In 2008, the Group's liquidity will be positively impacted by the expiration of several projects with unusually long accounts receivable turnover and the transfer of dwellings included in inventories to buyers.

Foreign currency risk. The Group's construction contracts are mostly concluded in a foreign currency of the country of location and open foreign currency positions in daily activities are being avoided. The most significant foreign contracts are concluded in euros. The Latvian lats (exchange rate on EUR 1 = LVL 0.702804 +/- 1%), the Lithuanian litas and the Estonian kroons are pegged to the Euro and hence the foreign currency risks of intra-group transactions have been eliminated.

Legal risks. Due to different interpretation of contracts, regulations and laws, there is a risk that some buyers, contractors or supervisory authorities consider the Company's activities to be in conflict with the laws or contracts. As at 31.12.2007, the Company had set up provisions for potential claims and legal costs in the amount of EEK 22.7 million. In 2007, legal costs in the amount of EEK 3.1 million were covered from the provisions and new reserves were set up in the amount of EEK 21.8 million.

At 15 October 2007, the Prosecutors' Office launched criminal proceedings against AS Merko Ehitus and Chairman of the Company's Supervisory Board Toomas Annus, suspected of giving bribes and misuse of trust. The suspicion filed is arbitrary and is grounded to a great extent on an impracticable interpretation of risks related to industry practices and business as well as inability to estimate the effect of time on events and real estate prices. Management estimates that the Company has followed the prevailing laws of the Republic of Estonia and good industry practices.

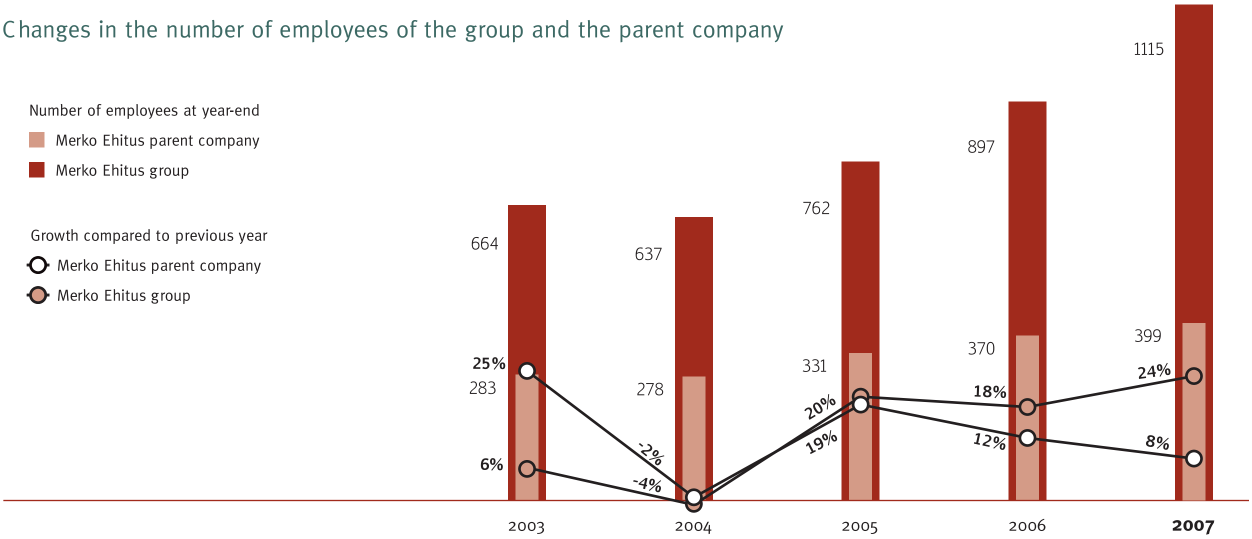
The substance of suspicions is disclosed in the Company's stock exchange announcement from 22.10.2007 (http://www.baltic.omxgroup.com/market/?pg=details&instrument=EE3100003559&list=2&tab=news&news_id=218499). The analysis of the substance of suspicions prepared by the law office of Teder, Glikman & Partnerid defending Merko Ehitus were presented to the shareholders at the Extraordinary Meeting of Shareholders at 19 February 2008 and the document is available on the website of Merko Ehitus (http://www.merko.ee/eng/investor/generalmeeting/2008).

The theoretical maximum penalty in case of criminal conviction is EEK 250 million and the Company's compulsory liquidation. Management estimates that no *de facto* basis exists for convicting the Company. However, it should be taken into account that a prolonged investigation, a potential court case and the related agiotage will hinder the Company's competitiveness regardless of the outcome of the process.

The Company and its people

One of the main values of Merko Ehitus is its people. In a year, the number of the Group's employees increased by 218 people and at 31.12.2007, the Group had 1115 employees. The gross wages and salaries of the Group's employees totalled EEK 406.6 million, of which basic wages and salaries made up 70.5% and bonuses made up 29.5%, or 46.3% more than in 2006. As compared to 2006, the number of Group's employees increased by 24.3% and the average wages per employee grew by 17.7%. The number of employees of the parent company of AS Merko Ehitus was 399 at the year-end 2007, increasing by 29 people in a year. Gross wages and salaries paid to employees totalled EEK 177.3 million, for the annual growth of 40.6%, including the growth of basic wages of 36.2% and that of bonuses of 48.3%.

Changes in the number of employees of the group and the parent company



The Management Board of AS Merko Ehitus has five members. The members of the Management Board are all full-time employees of AS Merko Ehitus and their gross remuneration in 2007 totalled EEK 14.8 million, incl. basic remuneration of EEK 3.2 million and bonuses of EEK 11.6 million. The Supervisory Board of AS Merko Ehitus has three members and their gross remuneration in 2007 totalled EEK 7.0 million, incl. basic remuneration of EEK 1.8 million and bonuses of EEK 5.2 million. All members of the Supervisory and Management Boards currently work on the basis of service contracts. Upon the premature removal of a member of the Supervisory and Management Boards or non-extension of their service contracts, members are paid severance pay which equals their last 12 months' remuneration.

In 2007, the Group sponsored sports, culture and education with EEK 9.4 million. The Group's largest sponsorship project was the initiative launched in collaboration with Hansabank, Eesti Energia and the Ministry of Culture of the Republic of Estonia as well as the Estonian Ski Association called the Estonian hiking tracks.

In sports, we sponsored the youth cross-country skiing team Merko Team in Estonia and the ice-hockey club Riga 2000 in Latvia. In culture, we supported the awarding of music prizes of the Estonian Music Council, the Latvian choral song festival, arrangement of the exhibition Landscapes of Joan Miro at the KUMU museum of fine arts and we concluded a three-year sponsorship agreement with the Estonian Drama Theatre. In 2007, we signed two important collaboration agreements in the administration field – a contract was signed with Tallinn University of Technology for long-term collaboration in the fields of development, research and studies and with the Development Fund of Tallinn University of Technology for granting the scholarship bearing the name of professor Heinrich Laul for young lecturers/scientists with a Doctor's degree in construction science. We continued to sponsor the granting of master's degree scholarships at Tallinn University of Technology and paid Merko Scholarship to 14 students.

Shares and shareholders

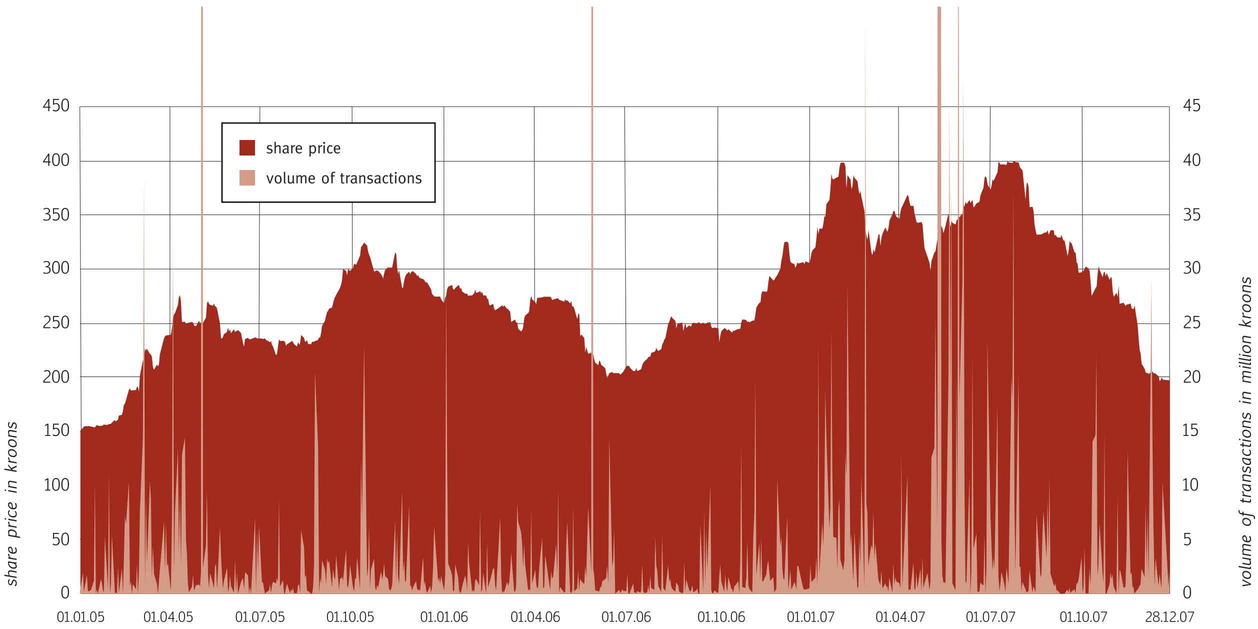
Information on securities

Name of security	Shares of Merko Ehitus
ISIN	EE3100003559
Type of security	Freely transferable ordinary shares
Issuer	AS Merko Ehitus
Activity of issuer	Construction
Residency of issuer	Estonia
Nominal value	10.00
Currency	EEK
Number of securities	17 700 000
Number of votes per share	1 vote
Registration at ECSD	09.05.1997
Stock Exchange List	Main List

	31.12.2005	31.12.2006	31.12.2007
Basic earnings per share (EPS), EEK	24.78	32.87	30.79
Owners' equity per share, EEK	62.23	90.05	113.88
P/B (price to book ratio)	4.34	3.41	1.79
P/E (price / earnings ratio)	10.89	9.35	6.61

In 2007, 4899 transactions with the shares of Merko Ehitus were performed in the course of which 5.5 million shares were traded and the total monetary value of transactions was EEK 1830.7 million. The lowest share price was EEK 191.67 and the highest price was EEK 402.12 per share. The closing price of the shares as at 28.12.2008 was EEK 203.41.

Performance of Merko Ehitus share at Tallinn Stock Exchange



The share prices preceding the bonus share issue have been adjusted to the number of shares which resulted from the bonus share issue carried out in 2005.

Trading history of securities	2005	2006	2007
Highest	327.01	326.23	402.12
Lowest	150.21	197.46	191.67
Closing	269.90	307.46	203.41
Change, %	+77.47	+13.92	-33.84
Traded shares	2 847 923	3 434 847	5 532 018
Turnover, million EEK	1 052.38	832.59	1 830.68
Market value, in million EEK, as at the year-end	4 777.23	5 442.04	3 600.35

Structure of shareholders as at 31.12.2007

Number of shares	Number of shareholders	% of shareholders	Number of shares	% of shares
1-100	294	40.83%	14 908	0.09%
101-1000	309	42.92%	120 371	0.68%
1001-10 000	79	10.97%	246 741	1.39%
10 001 – 100 000	25	3.47%	776 407	4.39%
100 001 – 1 000 000	11	1.53%	2 784 637	15.73%
1 000 001 - ...	2	0.28%	13 756 936	77.72%
Total	720	100%	17 700 000	100%

The main shareholders of AS Merko Ehitus as at 31.12.2007

	Number of shares	Proportion
AS Merko Grupp	12 742 686	71.99%
Skandinaviska Enskilda Banken Ab, clients	1 014 250	5.73%
ING Luxembourg S.A., clients	909 500	5.14%
J.P. Morgan Bank Luxembourg S.A., clients	387 900	2.19%
State Str. Munich Care of SSB Boston/DWS Invest. S.A. for DWS Osteuropa	215 904	1.22%
Danske Bank, clients	191 709	1.08%
The Bank of New York/ING Bank Slaksi A/C ING Parasol	189 683	1.07%
Mellon Treaty Omnibus	179 678	1.02%

Outlook for 2008

Construction market and its developments

The overall global negative background to the real estate and financial sector, current account deficit in the Baltic States, extremely fast economic growth and accompanying inflation have led to negative assessment of future economic growth in the Baltic States. Appreciation of interest, stricter control over money supply and negative expectations have undermined the sense of security of consumers and investment activities of investors due to which the domestic consumption which has been the driving force behind the economic growth in the Baltic States is expected to decrease. Most of the changes described above will have a direct impact on the real estate and construction sector in 2008.

We believe that the appreciation of construction prices will slow down in 2008 and as supply exceeds demand, prices will stabilise. However, with regard to certain materials and construction stages, moderate price declines can be expected in 2008. Under the circumstances of intensifying competition, efficiency and quality will become more important, as a result of which the providers of unprofessional services will be impacted the most.

In 2008, a number of structural changes are expected to take place in the construction sector. The share of infrastructure and environmental projects funded from the Structural Funds of the European Union and by the public sector will increase in construction. At the same time, it can be expected that the general slowdown of consumption will lower the revenue base of the public sector, weaken the budgets of central and local governments and clearly hinder their investment capacities. In 2007/2008, the developers will be engaged in launching completed rental projects and sale of residential housing and therefore, their interest in new projects will be low. Serious interest in new projects may arise in the second half of 2009, when the market will have absorbed the existing supply and reached a balance between supply and demand. Until then, the biggest challenge facing the sector will be coping with scarcer funding opportunities and skilful management of liquidity risks related to lengthening of the sales period of apartments.

Analysis of comparative indicators in the construction sector, construction works per capita of EUR 1751 in Estonia, EUR 953 in Latvia and EUR 922 in Lithuania and growth rates for 2007 allow expecting regional segregation of growth rates: fast growth will continue in Latvia and Lithuania, activity will be lower in Estonia and volumes will stall. The growth rates attained in 2007 will be unattainable in 2008 and the market growth will remain between 0 - 15%.

The year 2008 will be challenging for real estate and construction areas. It will be important to adapt to the changing environment and cope with the risks related to theses changes. The year 2008 will not be able to repeat the success of the previous year, but it will offer new opportunities and lay a good foundation for success in the future. Merko Ehitus is ready for it.

Corporate Governance Code (CGC)

From 2006, the Corporate Governance Code (CGC) which lays down the general principles of managing companies and treating shareholders applies to the issuers of equity securities which are listed on the Tallinn Stock Exchange. The application of the CGC principles is recommended to the publicly traded companies and the companies are free to decide whether to follow the main CGC principles or not. The Corporate Governance Code is based on the principle of follow or explain according to which a company shall explain its standpoints and activities with regard to those CGC provisions which it does not follow.

Merko Ehitus places great value on the equal treatment of its shareholders, the transparency of the Company's management processes as well as the reliability of its activities. This report deals with those CGC principles which AS Merko Ehitus does not follow for technical, economic or other reasons.

I General Meeting of Shareholders

The Company's highest governing body is the General Meeting of Shareholders, the authorities of which are regulated by legislation and the articles of association of the Company.

The Company shall announce the time, place, and agenda of the General Meeting as well as the recommendations of the Supervisory Board with regard to the items on the agenda in a national daily newspaper, on the Company's website and through the stock exchange system. The General Meeting shall be held at the place shown in the notice, on a working day and between 9 a.m. and 6 p.m. enabling most of the shareholders to participate in the General Meeting of Shareholders. Any shareholder or his authorised representative may participate in the General Meeting. No picture taking or filming is allowed at the General Meeting, because it may disturb the privacy of shareholders. Participation in the General Meeting cannot be accomplished through the means of communication because there are no reliably ways to identify shareholders and to ensure the privacy of participating shareholders.

On behalf of the Company, the Chairman of the Management Board and the Chairman of the Supervisory Board shall participate in the General Meeting of AS Merko Ehitus, and if necessary, other members of the Management and Supervisory Boards shall be involved. The Company does not consider the participation of all members of the Management and Supervisory Boards in the General Meeting relevant.

II Management Board

The Management Board of AS Merko Ehitus represents the Company and manages its daily operations. The Management Board of AS Merko Ehitus has five members and the activities of the members are divided by areas of operation: general management – Tõnu Toomik, construction – Andres Agukas, development – Tõnu Korts, technology – Veljo Viitmann, finance – Alar Lagus. The Chairman of the Management Board, Tõnu Toomik, leads the work of the Management Board.

The members of the Management Board have entered into three-year service contracts with the Company. The Company discloses the total amount of remuneration and bonuses of the members of the Management Board in the annual report, as it believes that the disclosure of personalised remuneration does not create additional value and disturbs the privacy of the members of the Management Board. Upon premature termination or non-extension of the service contract and under the condition that the members of the Management Board shall not compete with the Company, severance pay shall be paid to the members of the Management Board equalling twelve-month basic remuneration of the member of the Management Board.

In paying bonuses to the members of the Management Board, the financial performance of the companies managed by the Group and the Management Board shall be considered. Besides reviewing the quarterly results of operations, the Supervisory Board shall review and approve the bonuses payable to the Management Board. Twenty-five per cent of the bonuses payable on the basis of interim financial statements shall be withheld and paid after the approval of the annual report by the General Meeting of Shareholders. No share options have been used to motivate the members of the Management Board.

III Supervisory Board

The General Meeting of Shareholders shall elect the Supervisory Board. The Supervisory Board shall determine the Company's operating strategy, endorse the transactions as authorised by the articles of association, elect the members of the Management Board and monitor the performance of the Management Board during the time the General Meetings are not held. The Supervisory Board of AS Merko Ehitus has three members: Teet Roopalu, Jaan Mäe and Chairman of the Supervisory Board, Toomas Annus.

Merko Ehitus does not have any independent members of the Supervisory Board meeting the definition of the CGC, as the members also participate in the work of the companies controlled by the Company and in the Supervisory Boards of the Company's controlling shareholder. The members of the Supervisory Board shall be elected on the basis of their knowledge and experience in the field of construction and real estate development. The peculiarity of the work procedures of the Supervisory Board of Merko Ehitus is the fact that the members work full-time on the basis of service contracts. Such a work procedure adds responsiveness to the activities of the Group, ensures better informativeness of the Supervisory Board and altogether enables more efficient supervision over the activities of business units which are dispersed geographically and have diverse operations.

The General Meeting of Shareholders shall approve the remuneration of the members of the Supervisory Board. The terms and conditions of the service contracts in force, including the procedures for paying remuneration to the members of the Supervisory Board were approved by the General Meeting of Shareholders in May 2006.

The performance-based pay of the members of the Supervisory Board shall be determined on the basis of the financial performance of the Group. The payment of bonuses occurs on a quarterly basis after the publication of the issuer's interim financial statements. Twenty-five per cent of the bonuses payable on the basis of interim financial statements shall be paid after the approval of the annual report by the General Meeting of Shareholders.
Upon the premature termination or non-extension of the service contract and under the condition that the members of the Supervisory Board shall not compete with the Company, severance pay shall be paid to the members of the Supervisory Board equalling their twelve month basic remuneration.

IV Collaboration of the Management and Supervisory Boards

To ensure that the Company's interests are met as best as possible, the Management and Supervisory Boards shall collaborate extensively. At least once a month, a meeting between the members of the Supervisory and Management Boards shall take place, at which the Management Board shall inform the Supervisory Board of significant issues regarding the Company's business operations, the fulfilment of the Company's short and long-term goals and the risks impacting them.

V Disclosure of information

In disclosing information, AS Merko Ehitus shall follow the rules and regulations of the Tallinn Stock Exchange and immediately disclose important information regarding the Company's activities to the shareholders after obtaining reasonable assurance as to its correctness and that the disclosure of such information shall not harm the interests of the Company and its business partners. The conclusion of building contracts will be announced in a separate stock exchange annoucement release if the contract volume is at least 150 million kroons. Important information shall be disclosed through the stock exchange system and on the Company's website.

During the year, Merko Ehitus shall not publish the dates for disclosing information, the so-called financial calendar, because the disclosure of reliable dates would incorporate additional time factor into the dates and endanger the timeliness of disclosures. Merko Ehitus publishes important information regarding the Company after the end of the trading day and from 2007, informs shareholders about publishing interim financial statements and the annual report at least two days prior to their disclosure.

If possible, the Company shall participate in the presentation and press conferences arranged by analysts and investors. The information made available at the meetings is public, i.e. available in the reports of the Company, on its website or other public sources. We believe that the publication of the schedule for meetings does not provide any additional information for the shareholders and therefore, such information shall not be published.

VI Election of an auditor and auditing the financial statements

The Company's financial statements are prepared in accordance with International Financial Reporting Standards as adopted in the European Union.

In electing the auditor, the Company shall consider his/her independence, competence, reliability and the price of the service offered by him/her. The Company shall not publish the fees paid for the provision of auditing and consulting services, because such activities may significantly impair the Company's ability to obtain the service for a competitive price in the future.

When proposing to elect a new auditor, the Supervisory Board shall also present its rationale for the change. In extending the contract with the auditor who audited the Company in the previous financial year, the Supervisory Board acknowledges with its choice that the auditor has fulfilled the expectations laid on him/her and the Supervisory Board is content with the quality of the service provided.

FINANCIAL STATEMENTS

Management declaration

The Management Board confirms the correctness and completeness of AS Merko Ehitus consolidated financial statements as presented on pages 21-66.

The Management Board confirms that to the best of its knowledge:

1. the accounting methods used for preparing the financial statements are in compliance with International Financial Reporting Standards as adopted by the European Union;
2. the financial statements give a true and fair view of the financial position, the results of operations and the cash flows of the Group;
3. the parent company and all group companies are going concerns.

Tõnu Toomik	Chairman of the Management Board	15.04.2008
Alar Lagus	Member of the Management Board	15.04.2008
Veljo Viitmann	Member of the Management Board	15.04.2008
Andres Agukas	Member of the Management Board	15.04.2008
Tõnu Korts	Member of the Management Board	15.04.2008

Consolidated income statement

in thousands of	*Note*	EEK 2007	EEK 2006	EUR 2007	EUR 2006
Revenue	2,3	5 510 760	4 414 361	352 202	282 129
Cost of goods sold	4	(4 731 752)	(3 727 561)	(302 415)	(238 234)
Gross profit		**779 008**	**686 800**	**49 787**	**43 895**
Marketing expenses	5	(32 472)	(23 390)	(2 075)	(1 495)
Administrative and general expenses	6	(213 806)	(148 792)	(13 665)	(9 501)
Other operating income	7	6 424	148 205	411	9 463
Other operating expenses	8	(18 109)	(29 952)	(1 157)	(1 914)
Operating profit		**521 045**	**632 871**	**33 301**	**40 448**
Financial income	9	11 016	8 303	704	530
Financial expenses	10	(17 762)	(20 353)	(1 135)	(1 301)
Profit from sale of subsidiaries		-	2 326	-	149
Profit from associates and joint ventures	19	76 440	17 461	4 885	1 116
Profit before tax		**590 739**	**640 608**	**37 755**	**40 942**
Corporate income tax expense	11	(30 830)	(49 917)	(1 970)	(3 190)
Net profit for financial year		**559 909**	**590 691**	**35 785**	**37 752**
incl. net profit attributable to equity holders of the parent company		545 049	581 738	34 835	37 180
minority interest		14 860	8 953	950	572
Earnings per share for profit attributable to equity holders of the parent company (basic and diluted, in kroons/ euros)	12	30,79	32,87	1,97	2,10

The notes set out on pages 26-66 are an integral part of these consolidated financial statements.

Consolidated balance sheet

in thousands of	Note	EEK 31.12.2007	EEK 31.12.2006	EUR 31.12.2007	EUR 31.12.2006
ASSETS					
Current assets					
Cash and cash equivalents	14	205 564	676 143	13 138	43 213
Trade and other receivables	15	1 199 566	854 103	76 666	54 587
Prepaid corporate income tax		2 376	6 428	152	411
Inventories	17	2 025 426	1 356 734	129 448	86 712
Assets held for sale		-	733	-	47
Total current assets		**3 432 932**	**2 894 141**	**219 404**	**184 970**
Non-current assets					
Investments in associates and joint ventures	19	272 964	200 798	17 446	12 833
Other long-term loans and receivables	20	14 492	8 476	926	542
Deferred income tax assets	21	3 396	6 592	217	421
Investment property	22	7 361	3 900	470	249
Property, plant and equipment	23	172 912	90 445	11 051	5 781
Intangible assets	24	12 574	10 177	804	650
Total non-current assets		**483 699**	**320 388**	**30 914**	**20 476**
TOTAL ASSETS		**3 916 631**	**3 214 529**	**250 318**	**205 446**
LIABILITIES					
Current liabilities					
Borrowings	26	304 879	283 792	19 485	18 138
Trade and other payables	27	1 015 492	1 081 396	64 902	69 114
Corporate income tax liability		16 718	18 868	1 068	1 206
Government grants	28	1 498	1 498	96	96
Short-term provisions	29	73 212	33 517	4 680	2 142
Total current liabilities		**1 411 799**	**1 419 071**	**90 231**	**90 696**
Non-current liabilities					
Long-term borrowings	26	397 713	159 335	25 418	10 183
Other long-term trade payables	30	57 423	23 277	3 670	1 488
Total non-current liabilities		**455 136**	**182 612**	**29 088**	**11 671**
TOTAL LIABILITIES		**1 866 935**	**1 601 683**	**119 319**	**102 367**
EQUITY					
Minority interest		33 939	18 904	2 169	1 208
Equity attributable to equity holders of the parent company					
Share capital	32	177 000	177 000	11 312	11 312
Statutory reserve capital		17 700	17 700	1 131	1 131
Currency translation differences		(5 085)	(5 751)	(325)	(368)
Retained earnings		1 826 142	1 404 993	116 712	89 796
Total equity attributable to equity holders of the parent company		**2 015 757**	**1 593 942**	**128 830**	**101 871**
TOTAL EQUITY		**2 049 696**	**1 612 846**	**130 999**	**103 079**
TOTAL LIABILITIES AND EQUITY		**3 916 631**	**3 214 529**	**250 318**	**205 446**

The notes set out on pages 26-66 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

in thousands of EEK	*Note*	Equity attributable to equity holders of the parent company: Share capital	Statutory reserve capital	Currency translation differences	Retained earnings	Total	Minority interest	Total
Balance as at 31.12.2005		**177 000**	**8 850**	**(5 059)**	**920 605**	**1 101 396**	**10 552**	**1 111 948**
Currency translation differences		-	-	(692)	-	(692)	-	(692)
Net profit for financial year		-	-	-	581 738	581 738	8 953	590 691
Total recognised income for 2006		**-**	**-**	**(692)**	**581 738**	**581 046**	**8 953**	**589 999**
Minority interest sold		-	-	-	-	-	2 799	2 799
Dividends	13	-	-	-	(88 500)	(88 500)	(3 400)	(91 900)
Transfer to statutory reserve capital		-	8 850	-	(8 850)	-	-	-
Balance as at 31.12.2006		**177 000**	**17 700**	**(5 751)**	**1 404 993**	**1 593 942**	**18 904**	**1 612 846**
Currency translation differences		-	-	666	-	666	-	666
Net profit for financial year		-	-	-	545 049	545 049	14 860	559 909
Total recognised income for 2007		**-**	**-**	**666**	**545 049**	**545 715**	**14 860**	**560 575**
Minority interest of acquired subsidiary		-	-	-	-	-	5 240	5 240
Dividends	13	-	-	-	(123 900)	(123 900)	(5 065)	(128 965)
Balance as at 31.12.2007		**177 000**	**17 700**	**(5 085)**	**1 826 142**	**2 015 757**	**33 939**	**2 049 696**

in thousands of EUR	Equity attributable to equity holders of the parent company: Share capital	Statutory reserve capital	Currency translation differences	Retained earnings	Total	Minority interest	Total
Balance as at 31.12.2005	**11 312**	**566**	**(323)**	**58 837**	**70 392**	**674**	**71 066**
Currency translation differences	-	-	(45)	-	(45)	-	(45)
Net profit for financial year	-	-	-	37 180	37 180	572	37 752
Total recognised income for 2006	**-**	**-**	**(45)**	**37 180**	**37 135**	**572**	**37 707**
Minority interest sold	-	-	-	-	-	179	179
Dividends	-	-	-	(5 656)	(5 656)	(217)	(5 873)
Transfer to statutory reserve capital	-	565	-	(565)	-	-	-
Balance as at 31.12.2006	**11 312**	**1 131**	**(368)**	**89 796**	**101 871**	**1 208**	**103 079**
Currency translation differences	-	-	43	-	43	-	43
Net profit for financial year	-	-	-	34 835	34 835	950	35 785
Total recognised income for 2007	**-**	**-**	**43**	**34 835**	**34 878**	**950**	**35 828**
Minority interest of acquired subsidiary	-	-	-	-	-	335	335
Dividends	-	-	-	(7 919)	(7 919)	(324)	(8 243)
Balance as at 31.12.2007	**11 312**	**1 131**	**(325)**	**116 712**	**128 830**	**2 169**	**130 999**

The notes set out on pages 26-66 are an integral part of these consolidated financial statements.

Consolidated cash flow statement

in thousands of	Note	EEK 2007	EEK 2006	EUR 2007	EUR 2006
Cash flows from operating activities					
Operating profit		521 045	632 871	33 301	40 448
Adjustments:					
depreciation and impairment charge	2,22-24	28 670	30 747	1 832	1 965
profit/loss from sale of non-current assets	7,23	(275)	(122 403)	(18)	(7 823)
adjustment of revenue from construction contracts under stage of completion method		(130 927)	38 109	(8 368)	2 436
interest income from business activities		(2 844)	(2 335)	(182)	(149)
change in government grants and other provisions		49 456	5 455	3 161	349
profit on acquisition of subsidiary	18	(720)	-	(46)	-
Change in trade and other receivables related to operating activities		(108 379)	(189 193)	(6 927)	(12 092)
Change in inventories		(665 436)	(363 595)	(42 529)	(23 238)
Change in trade and other payables related to operating activities		(127 742)	186 197	(8 164)	11 900
Interest paid		(17 144)	(16 168)	(1 096)	(1 033)
Other financial income		(11)	(7)	(1)	(1)
Corporate income tax paid		(34 597)	(43 991)	(2 211)	(2 812)
Total cash flows from operating activities		**(488 904)**	**155 687**	**(31 248)**	**9 950**
Cash flows from investing activities					
Investment into subsidiaries	18	(29 575)	(3 029)	(1 890)	(195)
Proceeds from sale of subsidiaries	18	500	(2)	32	0
Subsidiary liquidation proceeds to minority shareholders		-	(20)	-	(1)
Investments into associates and joint ventures	19	(3 352)	(7 866)	(214)	(503)
Proceeds from sale of associates and joint ventures		-	1 847	-	118
Proceeds from sale of other financial assets		-	3 004	-	192
Purchase of property, plant and equipment		(48 757)	(76 264)	(3 116)	(4 874)
Proceeds from sale of property, plant and equipment		2 718	290 753	174	18 583
Purchase of intangible assets		(4 413)	(6 739)	(282)	(431)
Sale of a business unit		-	9 717	-	621
Loans granted	16	(145 692)	(275 353)	(9 311)	(17 598)
Loan repayments received	16	134 599	286 953	8 602	18 340
Interest received		16 226	8 393	1 037	536
Dividends received		4 380	3 000	280	192
Total cash flows from investing activities		**(73 366)**	**234 394**	**(4 688)**	**14 980**
Cash flows from financing activities					
Proceeds from borrowings	26	582 283	268 726	37 215	17 175
Repayments of borrowings	26	(345 739)	(144 017)	(22 097)	(9 204)
Finance lease principal payments	26	(14 260)	(11 163)	(911)	(714)
Dividends paid		(128 965)	(91 900)	(8 242)	(5 873)
Total cash flows from financing activities		**93 319**	**21 646**	**5 965**	**1 384**
Net increase/decrease in cash and cash equivalents		**(468 951)**	**411 727**	**(29 971)**	**26 314**
Cash and cash equivalents at beginning of the period	14	676 143	268 446	43 213	17 157
Exchange losses on cash and cash equivalents		(1 628)	(4 030)	(104)	(258)
Cash and cash equivalents at end of the period	14	**205 564**	**676 143**	**13 138**	**43 213**

The notes set out on pages 26-66 are an integral part of these consolidated financial statements.

NOTES

Note 1 Summary of significant accounting policies

1.1. General information

The consolidated financial statements of AS Merko Ehitus (hereinafter the parent company) and its subsidiaries (hereinafter the Group) for the year ended 31 December 2007 were signed by the Management Board on 15 April 2008.

Pursuant to the Commercial Code of the Republic of Estonia, the annual report prepared by the Management Board and approved by the Supervisory Board and which also includes the consolidated financial statements shall be approved at the General Meeting of Shareholders. Shareholders have the right not to approve the annual report prepared and presented by the Management Board and demand preparation of a new annual report.

AS Merko Ehitus is a company registered in the Republic of Estonia (Commercial Register no: 10068022, address: Järvevana tee 9G, Tallinn) and it operates in Estonia, Latvia and Lithuania. Its main activities are construction and real estate development.

From 22 July 1997, the shares of AS Merko Ehitus are listed on the Tallinn Stock Exchange. As at 31 December 2007, the majority shareholder AS Merko Grupp owned 71.99% of the shares of the company.

1.2. Basis of preparation

The consolidated financial statements of Merko Ehitus Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

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

Several financial figures are based on management's estimates, including for example, assessment of profitability of construction contracts upon the application of the stage of completion method, assessment of useful lives of items of property, plant and equipment, assessment of impairment losses of receivables and inventories, recognition of provisions for warranty obligations. Management's estimates have been made to the best of its knowledge, but they may not be accurate. The effect of changes in accounting estimates is reported in the financial statements of the period in which the change occurred.

Assets and liabilities are classified as current and non-current in the balance sheet. Current assets include assets that are expected to be used within the next financial year. Current liabilities include liabilities the due date of which is within 12 months after the balance sheet date. The remaining assets and liabilities are classified as non-current.

Expenses are classified according to their function in the income statement.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency): Estonian kroons, Latvian lats and Lithuanian litas. The consolidated financial statements are presented in Estonian kroons. The primary financial statements and notes are presented in thousands of kroons. Pursuant to the requirements of the Tallinn Stock Exchange, the primary financial statements are also presented in thousands of euros. As the Estonian kroon is pegged to the Euro (EUR 1=EEK 15.6466), no exchange rate differences arise in the translation of the financial statements.

1.3. New International Financial Reporting Standards, amendments and International Financial Reporting Interpretations Committee (IFRIC) interpretations

a) Standards, amendments and interpretations effective from 1 January 2007

IAS 1 (amendment) – Presentation of Financial Statements: Capital Disclosures. The standard requires additional disclosures in the financial statements regarding capital and its management. The adoption of amended IAS 1 did not have an effect on the existing evaluation and recognition principles.

IFRS 7 – Financial Instruments: Disclosures. IFRS 7 requires additional disclosures in the financial statements in order to improve the quality of information related to financial instruments. It requires disclosure of qualitative and quantitative information with regard to the risks arising from financial instruments, containing specific minimum requirements for credit risk, liquidity risk and market risk (including sensitivity analysis). The standard does not have an effect on the classification and value of existing financial instruments. The Group made certain amendments to the presentation of financial information and supplementary information (including comparatives) is disclosed in these consolidated financial statements.

IFRIC 10 – Interim Financial Reporting and Impairment. According to this interpretation, an impairment loss recognised in an interim period in respect of goodwill or an investment in either an equity instrument or financial asset carried at cost shall not be reversed. The adoption of this standard did not have an effect on the Group's consolidated financial statements.

IFRS 4 – Insurance Contracts (effective 1 January 2007);

IFRIC 7 – Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Environments (effective for periods beginning on or after 1 March 2006);

IFRIC 8 – Scope of IFRS 2. This interpretation requires evaluation of whether such transactions under which the consideration received for equity instruments issued is less than the fair value of these instruments are within the scope of IFRS 2 or not.

IFRIC 9 – Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006);

b) Standards, revisions and interpretations issued but not yet in force in 2007 and that the Group has not adopted early

By the time of preparing these financial statements, new International Financial Reporting Standards and their interpretations have been issued which are effective for the Group's annual periods beginning at or after 1 January 2008 but that the group has not adopted early. Below is an estimate of the Group's management on the potential effect of new standards and interpretation in the period of their first-time adoption:

IFRS 8 – Operating Segments (effective for annual periods beginning at or after 1 January 2009). IFRS 8 supersedes IAS 14 – Segment Reporting. The new standard specifies new requirements in respect of the disclosure of information on business segments, as well as information on products and services, geographical areas where the business is conducted and major customers. IFRS 8 requires a "managerial approach" to reporting the performance of business segments. The Group is evaluating the effect of the new standard on segment reporting in the consolidated financial statements.

IAS 23 revised – Borrowings Costs (effective for annual periods beginning at or after 1 January 2009). The main amendment relates to the elimination of an option to immediately expense borrowing costs attributable to assets that necessarily take a substantial period of time to get ready for their intended use or sale. Entities need to capitalise such borrowing costs within the acquisition cost of the asset. The amended standard is applied prospectively to borrowing costs attributable to specific assets that need to be capitalised from 1 January 2009. The Group estimates that the adoption of the amended standard will not have an effect on the consolidated financial statements.

IAS 1 revised – Presentation of Financial Statements (effective for annual periods beginning at or after 1 January 2009). The main amendment to IAS 1 is the replacement of the income statement with the statement of comprehensive income which also includes non-owner changes in equity, such as changes in the revaluation surplus of available-for-sale financial assets. Two statements are allowed to be presented as an alternative: a separate income statement and a statement of comprehensive income. The amended IAS requires also the disclosure of the financial position (balance sheet) for the opening balances of the comparable period when comparative information has been adjusted due to reclassifications, changes in accounting policies or correction of errors. The Group estimates that the amended IAS 1 will have an effect on the presentation of financial information but it is not relevant to the recognition and measurement principles used until now in the consolidated financial statements.

IAS 27 revised – Consolidated and Separate Financial Statements (is effective for annual periods beginning at or after 1 July 2009). The standard requires that the effects of transactions with minority shareholders be recognised directly in equity, on the condition that control over the entity is retained by the parent company. In addition, the standard elaborates on the accounting treatment of the loss of control over a subsidiary, i.e. it requires that the remaining shares be restated to fair value, with the resulting differences recognised in the income statement. The Group is evaluating the effect of the amended standard on the consolidated financial statements.

IFRS 3 revised – Business Combinations (effective for business combinations the acquisition date of which is in the first annual period beginning at or after 1 July 2009). The amendments introduced include the choice to disclose minority interests either at fair value or their share in the fair value of the net assets identified, a restatement of shares already held in an acquired entity to fair value, with the resulting differences to be recognised in the income statement, and additional guidance on the application of the purchase method, including the recognition of transaction costs as an expense in the period in which they were incurred, measurement of goodwill in acquiring additional shares and rules of recognition when the fair value of the consideration contingent upon additional conditions changes due to a change in the estimate after the business combination. The Group is evaluating the effect of the amended standard on the consolidated financial statements.

Amendment to IFRS 2 – Share-based Payment – Vesting Conditions and Cancellations (effective for annual periods beginning at or after 1 July 2008). The amendment explains that the transfer of ownership may be conditional upon satisfying vesting conditions and performance conditions. Other conditions of share-based payments are not vesting conditions. The amendment explains that all cancellations whether by the Group or other parties shall be accounted for in a similar manner. The Group will evaluate the effect of the amended standard on the consolidated financial statements.

IFRIC 13 – Customer Loyalty Programmes (effective for annual periods beginning at or after 1 July 2008). IFRIC 13 includes guidance on the accounting treatment of transactions resulting from loyalty programmes implemented by an entity for its customers, such as loyalty cards or awarding of points. In particular, IFRIC 13 indicates the correct accounting for the entity's obligation to provide free or discounted goods or services if and when customers redeem points. The amendment to the standard is not relevant to the Group's operations and management estimates that it does not have a major impact on the Group's consolidated financial statements.

IAS 32 and amendment to IAS 1 amendment – Puttable Instruments and Obligations Arising on Liquidation (effective for annual periods beginning at or after 1 January 2009). The amendment requires the classification of some financial instruments which meet the definition of financial liabilities as equity instruments. The Group estimates that the adoption of the amended standard will not have an effect on the consolidated financial statements.

IFRIC 11 IFRS 2 – Group and Treasury Share Transactions (effective for annual periods beginning at or after 1 March 2007). The interpretation contains guidelines on the following issues: applying IFRS 2 Share-based Payment for transactions of payment with shares which are entered into by two or more related entities; and adopting an accounting approach in the following instances: an entity grants its employees rights to its equity instruments that may or must be repurchased from a third party in order to settle obligations towards the employees; or an entity or its owner grants the entity's employees rights to the entity's equity instruments, and the provider of those instruments is the owner of the entity. The Group estimates that the adoption of this interpretation will not have an effect on the consolidated financial statements because the Group does not have any transactions enabling employees to acquire equity instruments through third parties.

IFRIC 12 – Service Concession Arrangements (effective for annual periods beginning at or after 1 January 2008). The interpretation contains guidelines on applying the existing standards by entities being parties to service concessions between the public and the private sector. IFRIC 12 pertains to arrangements where the ordering party controls what services are provided by the operator using the infrastructure, to whom it provides the services and at what price. The Group estimates that the adoption of the interpretation will not have an effect on the consolidated financial statements.

IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual periods beginning at or after 1 January 2008). The Interpretation contains general guidance on how to assess the limit of the surplus of fair value of a defined benefit plan over the present value of its liabilities which can be recognised as an asset, in accordance with IAS 19. In addition, IFRIC 14 explains how the statutory or contractual requirements of the minimum funding may affect the values of assets and liabilities of a defined benefit plan. The Group estimates that the adoption of the interpretation will not have an effect on the consolidated financial statements because it does not have any such assets.

1.4. Critical accounting estimates and judgments

The preparation of financial statements in conformity with International Financial Reporting Standards requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are relevant to the consolidated financial statements of Merko Ehitus Group, are disclosed below. Changes in management's estimate are reported in the income statement of the period of the change.

The most significant management estimates are as follows:

Revenue under the stage of completion method

Revenue from construction in progress is recognised under the stage of completion method (Note 1.24), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, forecasting and reporting of income and expenses has been introduced to determine the stage of completion. The estimated final result to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the profit estimate is adjusted. As at 31.12.2007, after evaluating the stage of completion of construction in progress, a provision for onerous construction contracts in the amount of 31 512 thousand kroons (Note 29) was recognised. Risk analysis showed that a change in the stage of completion of construction projects in the range of +/-10% will result in a change in the net profit between an increase of 307 419 thousand kroons and a decrease of 397 293 thousand kroons.

Determination of the useful lives of items of property, plant and equipment

Management has estimated the useful lives of items of property, plant and equipment, taking into consideration conditions and volumes of business activities, historical experience in this area and future outlook. Management estimates that the useful lives of buildings and facilities are between 10 and 33.3 years depending on their structure and use. The average useful lives of machinery and equipment are on average between 3 and 5 years and those of other fixtures between 2.5 to 5 years depending on the purpose of use of the asset.

1.5. Consolidation

Subsidiaries or entities that are either directly or indirectly through fellow subsidiaries controlled by the parent company AS Merko Ehitus, have been consolidated on a line-by-line basis in the consolidated financial statements. Control exists when the parent company owns more than one half of the voting power of the subsidiary or otherwise has power to govern the operating and financial policies of the other entity. Subsidiaries are reported in the financial statements of the Group from the date of acquiring control until the date at which control ceases.

The parent company and its subsidiaries are treated as one economic entity in the consolidated financial statements. Upon consolidation, intra-group receivables and liabilities, income and expenses as well as unrealised profits and losses arising from intragroup transactions have been eliminated unless the asset is not recoverable. Minority interest is reported separately.

Group companies use uniform accounting policies for similar transactions occurred under similar circumstances.

1.6. Business combinations

Business combinations are accounted for under the purchase method. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. From the date of acquisition, the revenue and expenses of the acquired entity are reported in the income statement of the Group and goodwill is reported in the balance sheet of the Group.

Goodwill is the excess of the cost of acquisition over the fair value of assets acquired, reflecting the portion of the acquisition cost which was paid for such assets of the acquired entity that cannot be separated and recognised separately. Goodwill is recognised at its acquisition cost as an intangible asset at the date of acquisition.

Goodwill is subsequently measured at its acquisition cost less any impairment losses. Goodwill arising in a business combination is not amortised. Instead, an impairment test is carried out once a year. Goodwill is written down to its recoverable amount if the carrying amount is not recoverable (Note 1.12).

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Goodwill is subject to impairment test at least once a year or whenever an indication of impairment arises.

Transactions with minority interests

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

1.7. Associates

Associates are all entities over which the Group has significant influence but does not control their operating and financial policies. Significant influence is presumed to exist when the parent owns between 20% and 50% of the voting rights. Investments in associates are initially recognised at cost and subsequently measured using the equity method of accounting. The Group's investments in associates include goodwill identified on acquisition, net of any accumulated impairment losses.

The Group's share of its associates' post-acquisition profits or losses is recognised in the Group's income statement, and its share of post-acquisition movements in equity is recognised directly in the Group's equity items. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

1.8. Joint ventures

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at acquisition cost and subsequently adjusted by the changes that have occurred in the Group's share of the net assets under common control. The income statement of the Group includes the Group's share in the profits or losses of the entity under common control.

1.9. Jointly controlled operations

Under IAS 31 *Interests in Joint Ventures*, jointly controlled operations are joint operations with third parties, whereby the assets and other resources of venturers are used without the establishment of a new company or another unit or creation of a separate financial structure. Each venturer uses its own property, plant and equipment and carries its own inventories in the balance sheet. The venturer also incurs its own expenses and liabilities and raises its own funds which represent its own obligations. In respect of its interest in jointly controlled operations, a venturer recognises in its financial statements:
- the assets that it controls and the liabilities it incurs;
- the expenses that it incurs and its share of revenue that it earns from the sale of goods or services of the joint venture.

1.10. Foreign currency

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia prevailing at the dates of the transactions. Monetary financial assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing at the balance sheet date. Exchange rate differences from translation are reported in the income statement of the accounting period.

The functional currency of subsidiaries located abroad is the currency of their business environment; therefore the financial statements of such subsidiaries are translated into Estonian kroons for consolidation purposes. The asset and liability items are translated using the foreign exchange rates of the Bank of Estonia prevailing at the balance sheet date, income and expenses using the weighted average foreign exchange rates for the year and other changes in equity using the foreign exchange rates at the date at which they arose. Exchange rate differences arising from translation are reported in the equity item *Currency translation differences*.

1.11. Financial assets

The purchases and sales of financial assets are recognised at the trade date.
Depending on the purpose for which financial assets were acquired, financial assets are classified into the following categories at the Group:
- financial assets at fair value through profit or loss;
- loans and receivables not held for trading purposes;

• held-to-maturity investments;
• available-for-sale financial assets.

Management determines the classification of its financial assets at initial recognition.

Financial assets at fair value through profit or loss include financial assets held for trading purposes (i.e. assets acquired or created principally for the purpose of selling or repurchasing in the short term; or a derivative financial instrument which is not a hedging instrument) and other financial assets that have been designated by management at their initial recognition as at fair value through profit or loss. Assets in this category are classified as current assets if they are principally held for trading purposes or are expected to be sold within 12 months after the balance sheet date. After initial recognition, financial assets in this category are carried at fair value.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are included within current assets except for maturities greater than 12 months after the balance sheet date. Such assets are classified as non-current assets. Loans and receivables are initially recognised at their fair value less transaction costs. After initial recognition, the Group carries loans and receivables at amortised cost (less any impairment losses), calculating interest income on the receivable in the following periods using the effective interest rate method.

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information on the solvency of the party to transaction. Receivables whose collection is improbable are written down during the accounting period.

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months after the balance sheet date. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement as part of other income. Dividends on available-for-sale equity instruments are recognised in the income statement as part of other income when the Group's right to receive payments is established.

The Group does not have any held-to-maturity financial assets. The Group does not have any derivatives.

1.12. Impairment of assets

Financial assets at amortised cost

The Group assesses at each balance sheet date whether there is any indication that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (loss events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that is available to the Group regarding the following events:

• significant financial difficulties of the debtor;
• a breach of contract, such as a default or delinquency in payments;
• it is probable that the debtor will enter bankruptcy;
• the disappearance of an active market for that financial asset because of financial difficulties; or
• observable data indicating that there is a measurable decrease in the estimated future cash flows from a financial asset or a group of financial assets, although the decrease cannot yet be measured reliably.

If there is objective evidence that an impairment loss has incurred for loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have already been recognised), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Non-financial assets

Assets that have indefinite useful lives (including goodwill) are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and is compared with the carrying amount. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit). Non-financial assets other than goodwill that suffered an impairment loss are reviewed for possible reversal of impairment at each reporting date and if necessary, the impairment loss is reversed.

1.13. Inventories

Inventories are recorded in the balance sheet at their acquisition cost, which consists of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition.

In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishable from each other, then the weighted average cost method is used.

Inventories are recognised in the balance sheet at the lower of acquisition cost and net realisable value. The net realisable value is the sales price less estimated costs to sell.

Expenditure incurred for real estate development is reported in the balance sheet line *Inventories* either as work-in-progress or finished goods, depending on the stage of completion. A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Sales revenue on real estate development is recognised as income from the sale of goods (Note 1.23). Upon the sale of real estate properties, a notarially certified agreement is entered into between the Group and the acquirer for transferring the property and the respective entry is made in the land register.

1.14. Investment property

Investment property is real estate property which is primarily held for the purpose of earning rental income or for capital appreciation or for both, but not for the production of goods or services, for administrative purposes or for sale in the ordinary course of business. Investment property is measured under the acquisition cost method, that is at acquisition cost less any accumulated depreciation and any accumulated impairment losses.

Buildings included in investment properties are depreciated on a straight-line basis over the period of 12.5 to 33.3 years. Land is not depreciated.

1.15. Property, plant and equipment

An item of property, plant and equipment is an asset used for production, provision of services or administrative purposes over a period longer than one year. The acquisition cost consists of the purchase price of the asset and other expenditure incurred in bringing the asset to its operating condition and location.

An item of property, plant and equipment is carried in the balance sheet at its acquisition cost less any accumulated depreciation. Subsequent expenditure incurred for items of property, plant and equipment are recognised as non-current assets when it is probable that future economic benefits associated with the asset will flow to the Group and the cost of the asset can be measured reliably. Other repairs and maintenance costs are recognised as expenses at the time they are incurred.
Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years;
- machinery and equipment 3-5 years:
- other items of property, plant and equipment 2.5-5 years;
- right of superficies 50 years.

Land is not depreciated.

At each balance sheet date, the validity of applied depreciation rates, the depreciation method and the residual values applicable to assets is assessed.

Non-current assets are written down to their recoverable amount if the latter is below its carrying amount. The recoverable amount is the higher of the asset's net selling price and its value in use.

1.16. Intangible assets

Intangible assets are recognised in the balance sheet when the asset can be controlled by the company, the expected future benefits attributable to the asset will flow to the company and the cost of the asset can be measured reliably. The acquisition cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Intangible assets are carried in the balance sheet at acquisition cost less any accumulated amortisation and any accumulated impairment losses.

Software and information systems
The costs related to the development of information systems and software which are reported as intangible assets, are depreciated under a straight-line method over their estimated useful lives (2-10 years).

1.17. Finance and operating leases

Leases of property, plant and equipment which transfer all significant risks and rewards of ownership to the lessee are classified as finance leases. All other leases are recognised as operating leases.

Assets and liabilities leased under the finance lease terms are reported in the balance sheet at the lower of fair value of the leased asset and the present value of minimum rental payments. Items of property, plant and equipment leased under the finance lease terms are depreciated over the shorter of the lease term and the useful life.

Finance lease liabilities are reduced by principal payments; interest expenses on lease payments are included within financial expenses in the income statement.

Operating lease payments are reported in the income statement as expenses on an accrual basis over the lease term.

1.18. Financial liabilities

All financial liabilities (supplier payables, borrowings, accrued expenses, bonds issued and other short and long-term borrowings) are initially recorded at their fair value and are subsequently stated at amortised cost, using the effective interest rate method. The amortised cost of the current financial liabilities normally equals their nominal value; therefore current financial liabilities are stated in the balance sheet in their redemption value. To calculate the amortised cost of non-current financial liabilities, they are initially recognised at fair value of the proceeds received (net of transaction costs incurred) and an interest cost is calculated on the liability in subsequent periods using the effective interest rate method.

Financial liabilities are classified as current when they are due to be settled within twelve months after the balance sheet date; or the Group does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Borrowings that are due within 12 months after the balance sheet date, but which are refinanced after the balance sheet date as non-current, are recognised as current ones. Also, borrowings are classified as current if the lender had on the balance sheet date the contractual right to demand immediate repayment of the borrowing due to the breach of conditions set forth in the agreement.

1.19. Corporate income tax

According to the Income Tax Act of the Republic of Estonia, legal entities are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, costs of entertaining guests, dividends and payments not related to business operations. Thus there are no differences between the tax bases and the carrying values of assets which would give rise to a deferred income tax asset or liability. Starting from 01.01.2008 the tax rate on dividends payable is 21/79 (in 2007: 22/78; 2006: 23/77) of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared.

Corporate income tax on profits and deferred income tax expense or income of the subsidiaries located in Latvia and Lithuania as well as corporate income tax on dividends of Estonian companies are reported in the consolidated income statement.

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the balance sheet. Deferred tax assets are recognised in the Group's balance sheet if their future realisation is probable.

Legal entities in Latvia and Lithuania that belong to the Group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia and the Republic of Lithuania. The profits of entities located in the Republic of Latvia are taxed at the rate of 15%, the profits of entities located in the Republic of Lithuania are taxed at the rate of 15%+3% in 2007 and 15% in 2008 (2006: 15%+4%).

1.20. Borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost, calculating interest income on the borrowing in subsequent periods using the effective interest rate method.

Borrowings are classified as current when the borrower does not have a right to pay off the loan later than 12 months after the balance sheet date.

Borrowing costs directly related to the acquisition and construction of a real estate property until the property is ready for use or sale, are capitalised. In other cases, borrowing costs are recognised as an expense in the period in which they are incurred.

1.21. Employee benefits

<u>Termination benefits</u> – Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of another offer made to encourage voluntary redundancy. Benefits due more than 12 months after the balance sheet date are discounted to present value.

<u>Profit-sharing and bonus plans</u> – The Company recognises a liability and an expense for bonuses and profit-sharing, based on formula that takes into consideration the profit attributable to the parent company's shareholders after certain adjustments. The Group recognises a provision where contractually obliged or when there is past practice that has created a constructive obligation.

1.22. Provisions

Provisions are constructive or legal obligations which arise as a result of events occurring before the balance sheet date. Setting up of provisions or increasing existing provisions is recognised as expense in the income statement of the accounting period.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation which are not included already in the best esimate of the related expenses.

Pursuant to respective building acts, the construction companies of the Group provide 2-year warranties on their buildings. The calculation of warranty provisions is based on management estimates and previous periods' experience with regard to actual warranty expenses.

The expected loss arising from construction contracts is immediately recognised as an expense. A provision is recognised for onerous construction contracts which have not been completed yet (Note 1.24).

1.23. Revenue

Revenue is recognised at the fair value of the consideration received or receivable.
Revenue from construction service is recognised as revenue by reference to the stage of completion of the contract (see Note 1.24)

in accordance with IAS 11 *Construction Contracts*. Revenue from own real estate development projects (private dwelling houses, apartments, office premises, etc. that have been built on the registered immovables owned by entities of Merko Ehitus Group) is recognised as revenue in accordance with IAS 18 *Revenue* when significant risks and rewards of ownership of the goods are transferred to the buyer, the receipt of payment is probable and the costs incurred in respect of the transaction can be measured reliably.

When goods are sold or swapped in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents received or paid. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents received or paid.

Revenue from the provision of services is recognised based on the stage of completion of the service at the balance sheet date.

Revenue arising from interest and dividends is recognised when it is probable that future economic benefits associated with the transaction will flow to the entity and the amount of the revenue can be measured reliably.

1.24. Construction contracts in progress

Income and expenses of construction contracts in progress have been matched under the stage of completion method. The stage of completion is determined on the basis of the relationship between the actual costs incurred by the balance sheet date and the estimated costs of the contract. The actual costs of the contract consist of direct and certain overhead costs of the construction contact.

If invoices submitted to the customer by the balance sheet date are either higher or lower than the income calculated under the stage of completion method, then the difference is recognised as a liability or as a receivable in the balance sheet.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately and in full.

1.25. Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs, which they are intended to compensate. Government grants received to compensate the operating expenses of the previous period or where there are no additional conditions attached to grants to be addressed in the future, are accounted for as income when the grant is received. Government grants are recognised when there is reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

1.26. Cash and cash equivalents

In the balance sheet and the cash flow statement, cash and cash equivalents comprise highly liquid funds with low variation in value, such as cash on hand, cash in bank accounts and term deposits with maturities of three months or less.
The indirect method has been used for the preparation of the cash flow statement.

1.27. Contingent liabilities

Contingent liabilities are those liabilities the realisation of which is less probable than non-realisation and the amount of which cannot be determined reliably. Contingent liabilities are not recognised in the balance sheet, but they are disclosed in the notes to the financial statements.

1.28. Statutory reserve capital

Reserve capital is formed to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be entered in reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

1.29. Events after the balance sheet date

The financial statements of the reporting period include material circumstances affecting the assessment of assets and liabilities which became evident between the balance sheet date and the date of preparing the financial statements but that are related to transactions in the accounting period or previous periods. Material events after the balance sheet date not related to transactions in the accounting period or previous periods are not reported in the balance sheet but they are disclosed in the notes to the financial statements.

1.30. Dividends

The distribution of dividends to the Company's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

1.31. Segment reporting

A business segment is a part of the Group engaged in making similar products or providing similar services and whose profitability and risks differ from those of other parts of the Group. The business segments at the Group comprise construction, road construction, construction of communication networks and production of concrete elements. Segment expenses are those which are incurred in the segment's main operations and which can be allocated to the segment reliably and objectively. Such expenses, assets and liabilities have not been allocated to segments that cannot be or are not suitable to be associated with a specific segment. In preparing the financial statements, business segments have been considered as primary segments.

A geographical segment is a part of the Group where operating activities occur in an economic environment in which returns and risks differ from those of other parts of the Group. The main geographical segments at the Group are Estonia, Latvia and Lithuania. In preparing the financial statements, geographical segments have been considered as secondary segments.

The main operating environment of the parent company is Estonia. All business segments of the Group are represented in Estonia. Construction is the main business segment in Latvia and Lithuania. Segment revenue is shown according to geographical segments of markets and segment assets, according to geographical locations of assets.

Note 2 Business and geographical segments

Business segments

2007 *in thousands of kroons*	General construction	Road construction	Concrete elements	Group
Consolidated revenue	**5 004 039**	**506 721**	**-**	**5 510 760**
Inter-segmental revenue	191	199	-	390
Segment revenue	5 004 230	506 920	-	5 511 150
Segment operating profit	**487 697**	**33 348**	**-**	**521 045**
Financial income/expenses				69 694
incl. profit/loss from associates and joint ventures (Note 19)	55 577	-	20 863	76 440
Profit before tax				590 739
Corporate income tax				(30 830)
Net profit of the Group				**559 909**
incl. attributable to equity owners of the parent company				545 049
minority interest				14 860
Segment assets	3 406 435	178 816	-	3 585 251
Associates and joint ventures	215 922	-	57 042	272 964
Unallocated assets				58 416
Total consolidated assets				**3 916 631**
Segment liabilities	(1 083 479)	(82 223)	-	(1 165 702)
Unallocated liabilities				(701 232)
Total consolidated liabilities				**(1 866 934)**
Purchase of property, plant and equipment and intangible assets	52 129	21 822	-	73 951
Depreciation and impairment (Notes 22-24)	(18 654)	(10 014)	-	(28 668)

2006 *in thousands of kroons*	General construction	Road construction	Concrete elements	Group
Consolidated revenue	**4 097 263**	**317 098**	**-**	**4 414 361**
Inter-segmental revenue	377 656	104 117	-	481 773
Segment revenue	4 474 919	421 215	-	4 896 134
Segment operating profit	**596 374**	**36 497**	**-**	**632 871**
Financial income/expenses				7 733
incl. profit/loss from associates and joint ventures (Note 19)	(416)	-	17 877	17 461
Profit before tax				640 604
Corporate income tax				(49 913)
Net profit of the Group				590 691
incl. attributable to equity owners of the parent company				581 738
minority interest				8 953
Segment assets	2 772 635	187 047	-	2 959 682
Associates and joint ventures	160 619	-	40 179	200 798
Unallocated assets				54 049
Total consolidated assets				**3 214 529**
Segment liabilities	(1 033 996)	(63 825)	-	(1 097 821)
Unallocated liabilities				(503 862)
Total consolidated liabilities				**(1 601 683)**
Purchase of property, plant and equipment and intangible assets	80 654	12 510	-	93 164
Depreciation and impairment (Notes 22-24)	(22 377)	(8 370)	-	(30 747)

Costs, assets and liabilities that cannot be related to a specific asset or it is not practical to do so are considered as unallocated.

Geographical segments

Revenue	Group	
in thousands of kroons	2007	2006
Estonia	3 385 635	2 794 317
Latvia	1 386 332	1 055 632
Lithuania	738 793	564 412
Total	**5 510 760**	**4 414 361**

	Total assets		Purchase of property, plant and equipment	
in thousands of kroons	31.12.2007	31.12.2006	2007	2006
Estonia	2 022 549	1 700 964	59 117	27 018
Latvia	1 486 220	1 244 312	14 741	65 699
Lithuania	407 862	269 253	93	447
Total	**3 916 631**	**3 214 529**	**73 951**	**93 164**

Note 3 Revenue

Revenue break-down is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), information which is required under Business Code § 4 p.6.

in thousands of kroons		Group	
EMTAK code		2007	2006
	Rendering of construction services		
4120	incl. construction of residential and non-residential buildings	3 565 675	2 551 995
4110	development of building projects	668 913	729 193
4211	construction of roads and railways	468 864	317 098
4221	construction of utility projects for fluids	392 612	308 563
4222	construction of utility projects for electricity and telecommunications	72 992	62 190
4291	construction of water projects	37 863	241 687
4213	construction of bridges and tunnels	37 857	-
4299	construction of other civil engineering projects n.e.c.	16 993	55 956
	Total rendering of construction services	**5 261 769**	**4 266 682**
	Real estate activities		
6810	incl. sales of own real estate	246 828	102 407
6820	renting and operating of own or leased real estate	2 163	45 272
	Total real estate activities	**248 991**	**147 679**
	Total revenue	**5 510 760**	**4 414 361**

Note 4 Cost of goods sold

in thousands of kroons	Group 2007	2006
Construction services	3 191 237	2 592 026
Materials	419 679	369 094
Properties purchased for resale	398 825	215 889
Staff costs	373 901	247 902
Construction mechanisms and transport	106 955	108 629
Design	92 772	72 851
Depreciation and impairment charge	20 596	25 098
Other expenses	127 787	96 072
Total cost of goods sold	**4 731 752**	**3 727 561**

Note 5 Marketing costs

in thousands of kroons	Group 2007	2006
Advertising, sponsorship	12 379	9 015
Staff costs	10 674	9 407
Construction tenders	1 754	900
Transport	1 226	1 268
Depreciation and impairment charge	434	356
Other expenses	6 005	2 444
Total marketing costs	**32 472**	**23 390**

Note 6 General and administrative expenses

in thousands of kroons	Group 2007	2006
Staff costs	127 856	95 827
Computer equipment and impairment charge	30 977	7 080
Office expenses, communication services	15 494	16 701
Depreciation and impairment charge	7 638	5 293
Transport	8 114	6 820
Other expenses	23 727	17 071
Total general and administrative expenses	**213 806**	**148 792**

Note 7 Other operating income

in thousands of kroons	Group 2007	2006
Interest income from operating activities	2 844	2 335
Fines and amounts for delay received	723	1 223
Profit from sale of non-current assets	488	122 403
Revenue from government grants (Note 28)	-	20 727
Other income	2 369	1 517
Total other operating income	**6 424**	**148 205**

Profit from sale of non-current assets in 2006 include the profit from the sale of multifunctional hall Arena Riga by subsidiary SIA Merks in the amount of 122 053 thousand kroons (Note 23).

Note 8 Other operating expenses

in thousands of kroons	Group 2007	2006
Fines, penalties	13 307	1 339
Gifts, donations	3 851	4 674
Foreign exchange loss	325	10
Loss from sales of investment property	212	-
Expenses of arranging ice-hockey world championship	-	22 522
Other expenses	414	1 407
Total other operating expenses	**18 109**	**29 952**

Note 9 Financial income

in thousands of kroons	Group 2007	2006
Interest income	11 016	6 462
Gains from available-for-sale assets	-	618
Financial income from other long-term loans and receivables	-	7
Other financial income	-	1 216
Total financial income	**11 016**	**8 303**

Note 10 Financial expenses

in thousands of kroons	Group 2007	2006
Interest expenses	16 948	14 288
Foreign exchange loss	809	6 064
Other financial expenses	5	1
Total financial expenses	**17 762**	**20 353**

Note 11 Corporate income tax

The income tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate applicable to profits of the consolidated entities as follows:

2007

in thousands of kroons	Latvia	Lithuania	Estonia	Total
Profit before tax	134 848	24 592	431 299	590 739
Tax rate applicable to profits	15%	18%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(20 227)	(4 427)	-	(24 654)
Tax calculated on expenses not deductible for tax purposes	(4 594)	(680)	-	(5 274)
Tax calculated on income not subject to tax	8 672	295	-	8 967
Corporate income tax on dividends	-	-	(9 869)	(9 869)
Tax charge	**(16 149)**	**(4 812)**	**(9 869)**	**(30 830)**
incl. current tax	(15 978)	(1 787)	(9 869)	(27 634)
deferred tax charge (Note 21)	(171)	(3 025)	-	(3 196)

2006

in thousands of kroons	Latvia	Lithuania	Estonia	Total
Profit before tax	271 450	25 031	344 127	640 608
Tax rate applicable to profits	15%	19%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(40 717)	(4 756)	-	(45 473)
Tax calculated on expenses not deductible for tax purposes	(49)	(91)	-	(140)
Tax calculated on income not subject to tax	1 295	17	-	1 312
Corporate income tax on dividends	-	-	(5 616)	(5 616)
Tax charge	**(39 471)**	**(4 830)**	**(5 616)**	**(49 917)**
incl. current tax	(18 925)	-	(5 616)	(24 541)
deferred tax charge (Note 21)	(20 546)	(4 830)	-	(25 376)

As at 31.12.2007, it is possible to pay out dividends to shareholders from retained earnings in the amount of 1 438 635 thousand kroons and the corresponding income tax would amount to 382 422 thousand kroons. As at 31 December 2006 (taking into account the statutory requirement to increase the statutory reserve capital), it would have been possible to pay out 1 091 409 thousand kroons as dividends, and the corresponding income tax would have amounted to 307 833 thousand kroons.

Note 12 Earnings per share

Basic earnings per share for profit attributable to equity holders of the parent company have been derived by dividing the net profit attributable to shareholders by the weighted average number of shares.

	2007	2006
Net profit attributable to shareholders *(in thousands of kroons)*	545 049	581 738
Weighted average number of ordinary shares *(thousand pcs)*	17 700	17 700
Earnings per share *(in kroons)*	**30,79**	**32,87**

In 2006 and 2007, the Group did not have any potential ordinary shares to be issued; therefore the diluted earnings per share equal the basic earnings per share.

Note 13 Dividends per share

Dividends payable are recognised after the approval of profit allocation at the General Meeting of Shareholders. According to the profit allocation proposal, in 2008 dividends are not paid.

In 2007, 123 900 thousand kroons, i.e. 7.0 kroons per share, were paid as dividends and in 2006, 88 500 thousand kroons, i.e. 5.0 kroons per share were paid out as dividends. In both years, AS Merko Ehitus did not need to pay corporate income tax due to the dividends received from subsidiaries (and which were taxable at foreign subsidiary level in prior periods).

Note 14 Cash and cash equivalents

	Group	
in thousands of kroons	**31.12.2007**	**31.12.2006**
Cash on hand	116	155
Bank accounts	53 722	437 456
Short-term deposits	151 726	238 532
Total cash and bank	**205 564**	**676 143**

As at 31.12.2007, the interest on short-term overnight bank deposits was 4.63% (31.12.2006: 3.37%) and the weighted average interest on term deposits was 4.11% (2006: 3.85%). As at 31.12.2007, the average maturity of bank deposits was 6 days (31.12.2006: 25.6 days).

Note 15 Trade and other receivables

	Group	
in thousands of kroons	**31.12.2007**	**31.12.2006**
Trade receivables		
accounts receivable	886 967	552 732
allowance for doubtful receivables	(2 111)	(1 370)
Total trade receivables	**884 856**	**551 362**
Tax prepayments excluding corporate income tax		
value added tax	38 139	32 183
social security tax	12	171
other taxes	1	199
Total tax prepayments excluding corporate income tax	**38 152**	**32 553**
Amounts due from customers for contract works (Note 33)	**151 119**	**135 408**
Other short-term receivables		
short-term loans (Note 16)	41 135	34 883
interest receivables	2 075	2 913
receivable from sale of subsidiary	1 000	500
other short-term receivables	2 662	1 049
Total other short-term receivables	**46 872**	**39 345**
Prepayments for services		
prepayments for construction services	64 864	86 326
prepaid insurance	2 339	2 245
other prepaid expenses	11 364	6 864
Total prepayments for services	**78 567**	**95 435**
Total trade and other receivables	**1 199 566**	**854 103**

Trade receivables by due dates

in thousands of kroons	Group			
	31.12.2007		31.12.2006	
Not overdue	833 330	94.2%	481 231	87.3%
1-30 days overdue	41 505	4.7%	48 006	8.7%
31-60 days overdue	1 000	0.1%	4 047	0.7%
61-90 days overdue	1 180	0.1%	11 433	2.1%
91-120 days overdue	719	0.1%	1 073	0.2%
121-180 days overdue	3 846	0.4%	4 902	0.9%
More than 180 days overdue	3 276	0.4%	670	0.1%
Total trade receivables	**884 856**	**100,0%**	**551 362**	**100,0%**

Note 16 Loans granted

in thousands of kroons	Group	
	2007	2006
Loans granted to joint ventures		
Loan balance at beginning of the year	24 750	21 325
Granted	6 725	10 950
Collected	(18 750)	(7 525)
Loan balance at end of the year	12 725	24 750
incl. current portion	7 000	24 750
non-current portion 1...5 years	5 725	-
Average effective interest rate 6.0% (2006: 6.5%)		
Loans granted to entities controlled by the parent company		
Loan balance at beginning of the year	12 700	6 565
Granted	110 230	264 286
Reclassification of loan after sale of majority stake in subsidiary	-	2 046
Reclassification of loan granted to related party	-	1 473
Collected	(115 774)	(261 670)
Exchange difference	22	-
Loan balance at end of the year	7 178	12 700
incl. current portion	4 236	8 896
non-current portion 1...5 years	2 942	3 804
Average effective interest rate 4.5% (2006: 4.5%)		
Loans granted to entities controlled by the parent company		
Loan balance at beginning of the year	-	1 973
Collected	-	(500)
Reclassification to loan granted to jointly controlled entities	-	(1 473)
Loan balance at end of the year	-	-
Loans granted to non-related legal entities		
Loan balance at beginning of the year	1 177	20 930
Granted	28 737	117
Reclassification from other receivables	-	1 009
Collected	(15)	(16 906)
Reclassification to other receivables	-	(3 973)
Loan balance at end of the year	29 899	1 177
incl. current portion	29 899	1 177
Average effective interest rate 6.0% (2006: 4.0%)		

Loans to non-related individuals		
Loan balance at beginning of the year	60	412
Collected	(60)	(352)
Loan balance at end of the year	-	60
incl. current portion	-	60
Average effective interest rate 3.7% 2006: 3.7%		

Total loans granted		
Loan balance at beginning of the year	38 687	51 205
Granted	145 692	275 353
Reclassification of loan granted to subsidiary	-	2 046
Reclassification from other receivables	-	1 009
Collected	(134 599)	(286 953)
Exchange difference	22	-
Reclassification from other receivables	-	(3 973)
Loan balance at end of the year	49 802	38 687
incl. current portion (Note 15)	41 135	34 883
non-current portion 1...5 years (Note 20)	8 667	3 804

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

The management believes that the credit quality of financial assets which are neither past due nor impaired is very good. The clients of the Group are normally either large local companies or public sector entities with sufficient and known creditworthiness. The Group closely monitors the payment discipline of its customers and monitors the data publicly available on companies' credit discipline.

Note 17 Inventories

	Group	
in thousands of kroons	**31.12.2007**	**31.12.2006**
Materials	3 501	4 579
Work-in-progress	1 209 117	567 868
Finished goods	72 434	18 121
Goods for resale		
land purchased for resale	704 111	723 334
incl. immovables located on nature preserve areas*	61 098	61 098
other goods purchased for resale	13	107
Total goods for resale	**704 124**	**723 441**
Prepayments for inventories		
prepayments for real estate properties	35 653	34 767
prepayments for other inventories	597	7 958
Total prepayments for inventories	**36 250**	**42 725**
Total inventories	**2 025 426**	**1 356 734**

** There are strict building restrictions on immovables located on nature preserve areas. These immovables can be used for real estate development only by exchanging these with the Government of the Republic of Estonia. According to the Nature Conservation Act, an immovable which is located within the territory of a protected area, special conservation area or species protection site and whose use for its intended purposes is significantly hindered by the protection procedure may be exchanged for an immovable owned by the state based on an agreement between the state and the owner of the immovable, or may be transferred to the state for a consideration equivalent to the usual value of the immovable (§ 19 and 20 of Nature Conservation Act).*

The management of the Group is on the opinion that Estonian legislation at the date of signing this annual report allows to exchange those immovables for other, unrestricted immovables (with at least similar value) with the state of Estonia, and consequently the Group's management is not aware of any circumstances refer to impairment of the aforementioned immovables.

The regulation concerning exchanging immovables in the Nature Conservation Act is currently being revised by Riigikogu (the parliament). Proposed changes would create a situation where land owner can require compensation from the state for an immovable whose use for its intended purposes is significantly hindered by the protection procedure only in the form of the purchase of the registered immovable for its usual market price (i.e. the possibility of exchange is removed). If an immovable is not is located, as a whole, within the territory of a protected area, the part of the immovable located within the protected area may be purchased by the state upon agreement with the owner. If the part of the immovable located within the territory of a protected area is larger than two thirds of the total area of the immovable, or if the immovable encompasses the I protected category species protection site or limited management zone of an individual protected natural object, the whole immovable may be purchased by state based on an agreement.

The procedure and bases for evaluating the immovables are planned to be established by a regulation of the Government of the Republic. Therefore it is currently not possible to estimate the effect of amendments to the Nature Conservation Act on the valuation of relevant immovables.

No write-downs were recorded to inventories in the financial year 2007 as well as in the previous period.

Note 18 Shares in subsidiaries

	Participation and voting rights %		Location	Area of
in thousands of kroons	**31.12.2007**	**31.12.2006**		**operation**
Subsidiaries of AS Merko Ehitus				
AS Gustaf	75	75	Pärnu	construction
AS Merko Tartu	66	66	Tartu	construction
AS Merko Insenerehitus	100	100	Tallinn	construction
OÜ Merko Ehitustööd	100	100	Tallinn	construction
Eesti Ehitusekspordi OÜ	100	100	Tallinn	construction
Tallinna Teede AS	100	100	Tallinn	road construction
SIA Merks	100	100	Rep. of Latvia, Riga	construction
UAB Merko Statyba	100	100	Rep. of Lithuania, Vilnius	construction
OÜ Merko Elamu	100	100	Tallinn	real estate
OÜ Põrguvälja Soojus (previous name OÜ Merko Maja)	100	100	Tallinn	real estate
OÜ Woody	100	100	Tallinn	real estate
OÜ Gustaf Tallinn	80	80	Tallinn	construction
OÜ Karulaugu Kinnisvara (previous name OÜ Maavõlur)	100	100	Tallinn	real estate
OÜ Rae Tehnopark	100	100	Tallinn	real estate
OÜ Maryplus	100	100	Tallinn	real estate
OÜ Metsailu	100	100	Tallinn	real estate
OÜ Pire Projekt	100	100	Tallinn	real estate
OÜ Constancia	100	100	Tallinn	real estate
OÜ Käibevara	100	100	Tallinn	real estate
OÜ Baltic Electricity Engineering	100	100	Tallinn	electricity systems
OÜ Fort Ehitus	75	-	Harjumaa, Viimsi County	construction

In April 2007, AS Merko Ehitus acquired a 75% holding in the private limited company Fort Ehitus for carrying out pole and hydrotechnical works. In August 2007, AS Merko Tartu founded Raadi Kortermaja OÜ (with the share capital of 40 thousand kroons) for real estate development. In September, Tallinna Teede AS acquired the private limited company Tevener, a one-asset-company, the asset of which is land recognised as a non-current asset, and its main activity is extraction of natural resources.

In 2007, the Company received a partial instalment payment in the amount of 500 thousand kroons for the 25% shares of the subsidiary AS Gustaf which was disposed of in 2006.

Acquisition of subsidiaries

	OÜ Fort Ehitus		OÜ Tevener	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and bank	385	385	40	40
Trade receivables	415	415	-	-
Non-current assets	33 003	33 003	1 387	14 960
Current liabilities	(1 177)	(1 177)	-	-
Non-current liabilities	(11 666)	(11 666)	-	-
Net assets	20 960	20 960	1 427	15 000
Acquired holding	75%		100%	
Value of net assets acquired	15 720	15 720	1 427	15 000
Cost	15 000		15 000	
Gain on acquisition	720			
Profit/loss in post-acquisition financial year	(108)			

Cash flows from acquisition of subsidiaries	OÜ Fort Ehitus	OÜ Tevener	Total
Cost	15 000	15 000	30 000
Paid in acquisition in 2007	(15 000)	(15 000)	(30 000)
Cash and cash equivalents in acquisition of subsidiary	385	40	425
Cash flows from acquisition of subsidiaries	(14 615)	(14 960)	(29 575)

As AS Tenever was a one-asset company holding just land, the acquisition of that company was not accounted for as a business combination. The fair value of land included within non-current assets of the subsidiary OÜ Tevener is based on the market value. Before acquisition of OÜ Tevener, there were no economic activities.

At 5 April 2007, AS Merko Ehitus acquired a 75% holding in OÜ Fort Ehitus. From the beginning of the period till acquisition date entity had a revenue in amount 3269 thousands kroons and profit 604 thousand kroons. Total revenue contributed by acquired entity for the financial period is 21 450 thousand kroons. The gain from the acquisition of the subsidiary Oü Fort Ehitus in the amount of 720 thousand kroons is reported in the line *Other operating income*.

Note 19 Investments into associates and joint ventures

	Participation and voting rights %		Location	Area of
in thousands of kroons	31.12.2007	31.12.2006		operation
Associate of AS Merko Ehitus				
AS Tartu Maja Betoontooted	25	25	Tartu	concrete elements
Joint ventures of AS Merko Ehitus				
Normanni Linnagrupi AS	50	50	Tallinn	construction
OÜ Unigate	50	50	Tallinn	real estate
OÜ Tornimäe Apartments	50	50	Tallinn	real estate
Joint ventures of SIA Merks				
PS Merks Terbe Lat	50	50	Rep. of Latvia, Riga	construction
SIA Zakusala Estates	50	50	Rep. of Latvia, Riga	real estate
Joint venture of AS Merko Tartu				
OÜ Kortermaja	50	50	Tartu	real estate

In 2007, the final instalment payment in the amount of 3352 thousand kroons was paid for the joint venture SIA Zakusala Estates acquired in 2005.

in thousands of kroons	Investment at 31.12.2006	Changes occurred in 2007: profit/loss from associates and joint ventures	dividends	currency translation adjustments	Investment 31.12.2007
Associate of AS Merko Ehitus					
AS Tartu Maja Betoontooted	40 179	20 863	(4 000)	-	57 042
Total associates	**40 179**	**20 863**	**(4 000)**	**-**	**57 042**
Joint ventures of AS Merko Ehitus					
Normanni Linnagrupi AS	413	(3)	-	-	410
OÜ Unigate	22	(6)	-	-	16
OÜ Tornimäe Apartments	122	56 133	-	-	56 255
Joint ventures of SIA Merks					
PS Merks Terbe Lat	406	-	(382)	1	25
SIA Zakusala Estates	157 343	(2 749)	-	107	154 701
Joint venture of AS Merko Tartu					
OÜ Kortermaja	2 313	2 202	-	-	4 515
Total joint ventures	**160 619**	**55 577**	**(382)**	**108**	**215 922**
Total associates and joint ventures	**200 798**	**76 440**	**(4 382)**	**108**	**272 964**

in thousands of kroons	Investment at 31.12.2005	Changes in 2006: acquisition, sale and liquidation	profit/loss from associates and joint ventures	dividendid	currency translation adjustments	Investment 31.12.2006
Associates of AS Merko Ehitus						
AS Tartu Maja Betoontooted	25 302	-	17 877	(3 000)	-	40 179
AS Telegrupp	3 534	(4 233)	699	-	-	-
Total associates	**28 836**	**(4 233)**	**18 576**	**(3 000)**	**-**	**40 179**
Joint ventures of AS Merko Ehitus						
Normanni Linnagrupi AS	422	-	(9)	-	-	413
OÜ Unigate	92	-	(70)	-	-	22
OÜ Tornimäe Apartments	24	-	98	-	-	122
Joint ventures of SIA Merks						
PS Merks Terbe Lat	12	-	396	-	(2)	406
SIA Zakusala Estates	148 319	11 238	(1 939)	-	(275)	157 343
Joint venture of AS Merko Tartu						
OÜ Kortermaja	1 904	-	409	-	-	2 313
Total joint ventures	**150 773**	**11 238**	**(1 115)**	**-**	**(277)**	**160 619**
Total associates and joint ventures	**179 609**	**7 005**	**17 461**	**(3 000)**	**(277)**	**200 798**

As at 31.12.2007, the difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee totalling 2265 thousand kroons (2006: 1847 thousand kroons) is due to the effect from the unrealised gains of mutual transactions.

As at 31.12.2007, the investment into the joint venture SIA Zakusala Estates includes intangible assets in the amount of 147 263 thousand kroons (2006: 147 152 thousand kroons) which are not recognized on the balance sheet of the investee. The intangible asset represents the lease agreement with the City of Riga expiring at 2 June 2051 which gives it a right to use the 126 thousand m2 registered immovable on Zakusala island in the centre of Riga.

Associates

in thousand kroons	Assets 31.12.	Liabilities 31.12.	Revenue	Net profit
2007				
AS Tartu Maja Betoontooted	308 168	80 000	520 146	83 452
2006				
AS Tartu Maja Betoontooted	272 892	112 176	442 962	71 508

Joint ventures

	Assets 31.12.		Liabilities 31.12.		Equity 31.12	Income	Expenses	Net profit/ loss
in thousand kroons	current assets	non-current assets	current liabilities	non-current liabilities				
2007								
Normanni Linnagrupi AS	819	-	-	-	819	2	9	(7)
OÜ Unigate	45 996	-	43 497	2 468	31	3	15	(12)
OÜ Tornimäe Apartments	114 163	-	1 654	-	112 509	331 711	219 446	112 265
PS Merks Terbe Lat	50		-	-	50	-	-	-
SIA Zakusala Estates	4 978	24 648	7 222	7 528	14 876	-	5 498	(5 498)
OÜ Kortermaja	27 316	-	13 756	-	13 560	39 121	33 883	5 238
2006								
Normanni Linnagrupi AS	826	-	-	-	826	56	73	(17)
OÜ Unigate	25 488	-	13 260	12 184	44	-	139	(139)
OÜ Tornimäe Apartments	204 795	-	204 568	-	227	195	17	178
PS Merks Terbe Lat	811	-	9	-	802	884	73	811
SIA Zakusala Estates	11 810	8 870	299	-	20 381	187	4 063	(3 876)
OÜ Kortermaja	54 084	-	14 124	31 638	8 322	27 772	23 474	4 298

Note 20 Other long-term loans and receivables

	Group	
in thousand kroons	31.12.2007	31.12.2006
Long-term loans (Note 16)	8 667	3 804
Long-term receivable from buyer of subsidiary*	3 625	4 624
Long-term receivables from customers of construction services	2 200	48
Total other long-term loans and receivables	**14 492**	**8 476**

*** In 2006, AS Merko Ehitus sold 25% of the shares of the subsidiary AS Gustaf. The receivable is discounted at a 5% interest rate.*

Note 21 Deferred income tax assets and liabilities

Income tax assets and liabilities arisen at the subsidiaries SIA Merks and UAB Merko Statyba:

31.12.2007

in thousand kroons	Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	2 498	898	3 396
incl. tax loss carryforwards	68	-	68
effect of carrying amount of property, plant and equipment	(613)	-	(613)
effect of stage of completion method	3 043	191	3 234
other	-	707	707
Net deferred income tax assets /liabilities	**2 498**	**898**	**3 396**
Deferred income tax charge of the financial year (Note 11)	171	3 025	3 196

31.12.2006

in thousand kroons	Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	2 669	3 923	6 592
incl. tax loss carryforwards	-	3 062	3 062
effect of carrying amount of property, plant and equipment	2 669	-	2 669
effect of stage of completion method	-	443	443
other	-	418	418
Net deferred income tax assets /liabilities	**2 669**	**3 923**	**6 592**
Deferred income tax charge of the financial year (Note 11)	20 546	4 830	25 376
Reclassification*	(34 600)	-	(34 600)
Net change in deferred tax balance	(14 054)	4 830	(9 224)

** The effect of difference between fair value and carrying amount of real estate inventories (in 2005, in the amount of 34 600 thousand kroons in Latvia) was reclassified from deferred tax liability to actual tax liability in 2006 due to changes in management estimates, and the amount was paid to the State Revenue Service in Latvia in 2006.*

In Lithuania, unused tax losses carried forward expire in 4 years and the management considers it likely that the respective tax losses can be utilised against future profits.

Note 22 Investment property

in thousand kroons	Land	Buildings	Total
Cost at 31.12.2005	35 634	8 959	44 593
Accumulated depreciation at 31.12.2005	-	(2 087)	(2 087)
Carrying amount at 31.12.2005	**35 634**	**6 872**	**42 506**
Write-off	-	(2 331)	(2 331)
Reclassification	(33 500)	(2 432)	(35 932)
Depreciation charge	-	(343)	(343)
Carrying amount at 31.12.2006	**2 134**	**1 766**	**3 900**
Cost at 31.12.2006	2 134	2 589	4 723
Accumulated depreciation 31.12.2006	-	(823)	(823)
Carrying amount at 31.12.2006	**2 134**	**1 766**	**3 900**

Exchange difference	2	15	17
Sale	-	(212)	(212)
Reclassification	-	3 733	3 733
Depreciation charge	-	(77)	(77)
Carrying amount at 31.12.2007	**2 136**	**5 225**	**7 361**
Cost at 31.12.2007	2 136	5 600	7 736
Accumulated depreciation at 31.12.2007	-	(375)	(375)
Carrying amount at 31.12.2007	**2 136**	**5 225**	**7 361**

As at 31.12.2007, the carrying amount of the investment property does not significantly differ from their fair values (31.12.2006: the carrying amount of the investment property did not significantly differ from their fair values).

In 2007, items of property, plant and equipment were reclassified from construction in progress to investment property in the amount of 3733 thousand kroons.

In 2006, the Group reclassified land in the amount of 33 500 thousand kroons from investment property into inventories, and reclassified buildings to property, plant and equipment in the amount of 2432 thousand kroons. Write-offs in the amount of 2331 thousand kroons relate to the pulling down of useless buildings.

Investment property has not been acquired for the purpose of earning rental income but for capital appreciation or development in the future. Buildings located on the plot of land have been temporarily leased out under the operating lease terms. Rental income receivable, maintenance costs incurred and improvement expenses are immaterial.

Note 23 Property, plant and equipment

in thousands of kroons	Land	Buildings	Right of superficies	Machinery and equipment	Other fixtures	Construction in progress	Prepay-ments	Total
Cost at 31.12.2005	145	14 872	458	88 070	42 794	260 100	1 270	407 709
Accumulated depreciation at 31.12.2005	-	(2 464)	(76)	(39 188)	(24 276)	(142 701)	-	(208 705)
Carrying amount at 31.12.2005	**145**	**12 408**	**382**	**48 882**	**18 518**	**117 399**	**1 270**	**199 004**
Foreign exchange rate changes	-	-	-	-	20	4	-	24
Acquisitions	-	8 042	-	12 893	34 151	29 841	1 510	86 437
Sales	-	(142 592)	-	(586)	(25 137)	-	-	(168 315)
Reclassification	-	143 670	-	(440)	6 740	(146 691)	(2 780)	499
incl. non-current assets held for sale	-	-	-	(733)	-	-	-	(733)
Depreciation charge	-	-	-	(3)	(165)	-	-	(168)
Impairment charge	-	(6 282)	(10)	(9 476)	(11 268)	-	-	(27 036)
Carrying amount at 31.12.2006	**145**	**15 246**	**372**	**51 270**	**22 859**	**553**	**-**	**90 445**
Cost at 31.12.2006	145	18 682	458	92 430	51 257	553	-	163 525
Accumulated depreciation at 31.12.2006	-	(3 436)	(86)	(41 160)	(28 398)	-	-	(73 080)
Carrying amount at 31.12.2006	**145**	**15 246**	**372**	**51 270**	**22 859**	**553**	**-**	**90 445**
Foreign exchange rate changes	-	-	-	-	57	-	-	57
Acquisitions	15 798	4 695	-	33 766	16 543	5 465	8 230	84 497
Acquisition in business combinations	-	1 106	-	28 757	-	-	1 278	13 141
Sales	-	-	-	(2 181)	(738)	-	-	(2 919)
Reclassification	-	-	-	1 915	1 114	(5 982)	(780)	(3 733)
Write-offs	-	-	-	(250)	(136)	-	-	(386)
Deprecation in income statement	-	(666)	(9)	(14 790)	(10 725)	-	-	(26 190)
Carrying amount at 31.12.2007	**15 943**	**20 381**	**363**	**98 487**	**28 974**	**36**	**8 728**	**172 912**

Cost at 31.12.2007	15 943	24 627	458	153 587	64 970	36	8 728	268 349
Accumulated depreciation at 31.12.2007	-	(4 246)	(95)	(55 100)	(35 996)	-	-	(95 437)
Carrying amount at 31.12.2007	**15 943**	**20 381**	**363**	**98 487**	**28 974**	**36**	**8 728**	**172 912**

In 2006, the multifunctional hall Arena Riga was sold by the subsidiary SIA Merks which is accounted for in the table above as a sale of buildings. Profit from the sale totalled 122 053 thousand kroons (Note 7).

Information on leased assets is provided in Note 25 and on lease payments in Note 26.

No Property, plant and equipment are pledged as collateral for borrowings.

Note 24 Intangible assets

in thousands of kroons	Software	Prepayments	Total
Cost at 31.12.2005	2 371	2 847	5 218
Accumulated amortisation at 31.12.2005	(853)	-	(853)
Carrying amount at 31.12.2005	**1 518**	**2 847**	**4 365**
Acquisition	2 059	4 668	6 727
Sale	(46)	-	(46)
Amortisation	(869)	-	(869)
Carrying amount at 31.12.2006	**2 662**	**7 515**	**10 177**
Cost at 31.12.2006	4 368	7 515	11 883
Accumulated amortisation at 31.12.2006	(1 706)	-	(1 706)
Carrying amount at 31.12.2006	**2 662**	**7 515**	**10 177**
Cost	2 004	2 410	4 414
Reclassification	8 112	(8 112)	-
Amortisation	(2 017)	-	(2 017)
Carrying amount at 31.12.2007	**10 761**	**1 813**	**12 574**
Cost at 31.12.2007	14 443	1 813	16 256
Accumulated amortisation at 31.12.2007	(3 682)	-	(3 682)
Carrying amount at 31.12.2007	**10 761**	**1 813**	**12 574**

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

Note 25 Leased assets

	Group	
in thousands of kroons	**2007**	**2006**
Assets acquired under finance lease terms		
Machinery and equipment		
Cost	90 195	49 324
Accumulated depreciation	(20 871)	(12 076)
incl. depreciation charge	(8 291)	(4 606)
Carrying amount	69 324	37 248

Assets leased under non-cancellable operating lease terms

Right of superficies		
Payments made in financial year	-	93
Future lease payments:		
payments in next financial year	475	93
payments in 1...5 years	950	372
payments after year 5	9 482	3 806

On the basis of cancellable lease agreements, operating lease payments totalling 11 675 thousand kroons (2006: 8028 thousand kroons) were paid for passenger cars in 2007.

Note 26 Borrowings

	Group	
in thousands of kroons	**2007**	**2006**
Finance lease payables		
Present value of lease payments at beginning of the year	25 851	25 098
Received	36 523	11 916
Paid	(14 260)	(11 163)
Present value of lease payments at end of the year	48 114	25 851
incl. current portion	11 879	8 367
non-current portion 2...4 years	36 235	17 484
Interest expense of financial year	3 272	1 316
Minimum future lease payments	51 404	27 402
incl. current portion	13 441	9 868
non-current portion 2...4 years	37 963	17 534
Average effective interest rate 5.7% (2006: 5.0%)		
Base currencies EEK, EUR and LVL		
Loans		
Loan balance at beginning of the year	417 276	292 567
Received	558 348	268 726
Paid	(345 739)	(144 017)
Exchange difference	658	-
Loan balance at end of the year	630 543	417 276
incl. current portion	273 965	275 425
non-current portion 2...5 years	356 578	141 851
Interest cost of reporting period	28 714	12 474
incl. capitalised interest cost	20 975	-
Average effective interest rate 7.0% (2006: 4.5%)		
Base currencies LVL and EUR		
Loans from entities controlled by the parent company		
Loan balance at beginning of the year	-	-
Received	19 035	-
Loan balance at end of the year	19 035	-
incl. current portion	19 035	-
Average effective interest rate 4.9%		

Loans from associates and joint ventures		
Loan balance at beginning of the year	-	-
Received	4 900	-
Loan balance at end of the year	4 900	-
incl. non-current portion 2..5 years	4 900	-
Average effective interest rate 6.0%		

Total loans		
Loan balance at beginning of the year	417 276	292 567
Received	582 283	268 726
Paid	(345 739)	(144 017)
Exchange difference	658	-
Loan balance at end of the year	654 478	417 276
incl. current portion	293 000	275 425
non-current portion 2...5 years	361 478	141 851
Total borrowings	**702 592**	**443 127**
incl. current portion	304 879	283 792
non-current portion 2...5 years	397 713	159 335

Long-term bank loans have floating rates related to EURIBOR or RIGIBOR (Riga Interbank Offered Rate - the index of Latvian interbank credit interest rates). The exposure of the Group's bank borrowings to interest rate changes and the contractual repricing dates at the balance sheet dates are as follows:

	Group	
in thousands of kroons	**2007**	**2006**
6 months or less	354 423	271 458
6-12 months	276 120	145 818
Total bank loans	**630 543**	**417 276**

The fair value of borrowings does not differ materially from their carrying amount.
Loan collaterals and pledged assets are presented in Note 31.

Note 27 Trade and other payables

	Group	
in thousands of kroons	**31.12.2007**	**31.12.2006**
Payables to suppliers	**528 856**	**464 199**
Payables to employees	**74 892**	**64 218**
Tax liabilities, except for corporate income tax		
value added tax	26 979	19 998
personal income tax	10 720	5 884
social security tax	17 654	13 654
land tax	46	130
unemployment insurance tax	319	206
contributions to mandatory funded pension	527	307
other taxes	570	1 687
Total tax liabilities, except for corporate income tax	**56 815**	**41 866**

Amounts due to customers for contract works (Note 33)	**161 725**	**276 940**
Other payables		
interest liabilities	465	-
other payables	21 503	27 290
advance payments received	171 235	206 883
Total other payables	**193 203**	**234 173**
Total trade and other payables	**1 015 491**	**1 081 396**

Note 28 Government grants

In 2006, the world championships in ice-hockey took place in the multifunctional hall Arena Riga the owner of which was a subsidiary of SIA Merks. The City of Riga supported the raising of funds for the arrangement of the world championship and the carrying out of competitions with 22 225 thousand kroons in 2005. The grant was used to arrange the world championships in ice-hockey in 2006. The cost of the ice-cleaning machine included within inventories to be given over to the City of Riga equals to the remaining balance of government grant in the amount of 1498 thousand kroons.

	Group	
in thousands of kroons	**31.12.2007**	**31.12.2006**
Carrying amount at beginning of the year	1 498	22 225
Utilised portion	-	(20 727)
Balance at end of the year	1 498	1 498

Note 29 Short-term provisions

	Group	
in thousands of kroons	**2007**	**2006**
Provision for warranty obligation for construction		
Carrying amount at beginning of the year	9 662	8 463
Accrued during the year	13 325	10 692
Utilised during the year	(7 362)	(9 493)
Balance at end of the year	15 625	9 662
Provision for onerous construction contracts		
Residual value at beginning of the year	17 848	-
Accrued during the year	20 541	17 848
Utilised during the year	(5 877)	-
Balance at end of the year	32 512	17 848
Provision for potential cancellation of construction projects		
Residual value at beginning of the year	-	6 664
Utilised during the year	-	(6 664)
Balance at end of the year	-	-
Provision for legal costs and claims filed		
Residual value at beginning of the year	4 054	6 090
Accrued during the year	21 878	1 000
Utilised during the year	(3 146)	(3 036)
Balance at end of the year (Note 36)	22 786	4 054

Other provisions		
Residual value at beginning of the year	1 953	524
Set up	2 480	1 953
Utilised during the year	(2 144)	(524)
Balance at end of the year	2 289	1 953
Total short-term provisions	**73 212**	**33 517**

Note 30 Other long-term trade payables

	Group	
in thousands of kroons	**31.12.2007**	**31.12.2006**
Payables to suppliers	11 091	10 352
Advance payments received	46 332	12 925
Total long-term trade payables	**57 423**	**23 277**

In 2007, SIA Merks received initial payment and advance payments for apartments in Skanstes Street, Riga in the amount of 33 407 thousand kroons (2006: 12 925 thousand kroons). The apartments will be completed in 2009.

Note 31 Loan collaterals and pledged assets

The following agreements have been entered into for guaranteeing loans and other obligations:

Between AS Merko Ehitus and Hansabank:
A commercial pledge agreement on movable property in the amount of 140 million kroons (registered under the first, second and fifth orders in the register of commercial pledges). The obligations arising from guarantee contracts and overdraft contracts are guaranteed by the pledge.
In addition, a deposit pledge contract in the amount of 2.5 million kroons has been entered into for guaranteeing the guarantee contract concerning stage I of construction works of Puurmanni traffic network.

Between AS Merko Ehitus and SEB Bank:
A commercial pledge agreement on movable property in the amount of 60 million kroons (registered under the third, fourth and sixth orders in the register of commercial pledges). The obligations arising from the guarantee contract are guaranteed by the pledge.

Between Tallinna Teede AS, Hansabank and SEB Bank:
A commercial pledge agreement on movable property in the amount of 25 million kroons (registered under the first order in the register of commercial pledges), whereby the 14/25 legal share of the commercial pledge belongs to Hansabank and 11/25 to SEB Bank.

Between Tallinna Teede AS and Hansabank:
A commercial pledge agreement on movable property in the amount of 2 million kroons (registered under the second order in the register of commercial pledges). All claims of the banks arising from contracts under the law of obligations have been guaranteed by the pledges.

Between AS Gustaf and Hansabank:
A commercial pledge agreement on movable property in the amount of 6 million kroons for guaranteeing guarantee contracts.

Between OÜ Gustaf Tallinn and Hansabank:
A commercial pledge agreement on movable property in the amount of 3.9 million kroons for guaranteeing guarantee contracts.

Between AS Merko Tartu and SEB Bank:
A commercial pledge agreement on movable property in the amount of 20.0 million kroons. Guarantee contracts entered into are guaranteed by the pledge.

Between SIA Merks and Hansabanka:
A commercial pledge agreement on assets in the amount of 3.0 million Latvian lats (67.3 million kroons). Obligations arising from the guarantee contracts and the loan agreements are guaranteed by the pledge.
Mortgages in the amount of 17.36 million Latvian lats (389.4 million kroons) for 7 registered immovables in Riga have been set as collateral for a loan contract totalling 17.5 million euros (268.3 million kroons).

Between SIA Merks and Nordea Banka:
Mortgages in the amount of 40.5 million Latvian lats (909.2 million kroons) for registered immovables in Riga have been set as collateral for a loan contract totalling 35.0 million euros (785.8 million kroons).

Between UAB Statyba and Hansabankas:
A commercial pledge agreement on movable property in the amount of 6.0 million Lithuanian litas (27.2 million kroons). The obligations arising from overdraft contracts and guarantee contracts are guaranteed by the pledge.

Note 32 Share capital

In 2006 and 2007, no changes occurred in share capital.

As at 31.12.2007, the share capital in the amount of 177 000 thousand kroons consisted of 17 700 thousand registered shares with the nominal value of 10 kroons each.

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

Note 33 Construction contracts in progress

	Group	
in thousands of kroons	**31.12.2007**	**31.12.2006**
Costs incurred for construction contracts in progress and corresponding profit	5 570 285	4 016 033
Progress billings submitted	(5 580 891)	(4 157 565)
Amounts due from customers for contract works (Note 15)	151 119	135 408
Amounts due to customers for contract works (Note 27)	(161 725)	(276 940)
Advance payments received for contract works	171 235	86 326

Amounts due from customers for contract works are included in the balance sheet line *Trade and other receivables*. Amounts due to customers for contract work are included in the balance sheet line *Trade and other payables*.

Note 34 Related party transactions

In compiling the Annual Report, the following entities have been considered as related parties:
- parent company AS Merko Grupp;
- shareholders of AS Merko Grupp with significant influence through AS Merko Grupp;
- other shareholders with significant influence;
- other subsidiaries of AS Merko Grupp, so-called 'entities controlled by the parent company';
- associates and joint ventures;
- key managers and their close relatives;
- entities under control of persons mentioned above;

Significant influence is presumed to exist when the person has more than 20% of the voting power.

The parent company of AS Merko Ehitus is AS Merko Grupp. As at 31.12.2007 and 31.12.2006, AS Merko Grupp owned 72% of the shares of AS Merko Ehitus. The ultimate controlling party of the Group is Mr Toomas Annus.

Goods and services

in thousands of kroons	Group 2007	2006
Purchased construction services		
Associates and joint ventures	86 123	91 732
Entities controlled by the parent company	8 425	7 858
Total purchased construction services	**94 548**	**99 590**
Construction services rendered		
Associates and joint ventures	33 642	118 667
Entities controlled by the parent company	1 576 911	986 301
Management members	10 027	5 970
Total construction services provided	**1 620 580**	**1 110 938**
Construction materials purchased		
Other related parties	211	208
Real estate sold		
Entities controlled by the parent company	81 583	31 890

Loans granted to related parties are disclosed in Note 16 *Loans granted*.

Balances with the related parties

in thousands of kroons	Group 31.12.2007	31.12.2006
Trade and other receivables		
Trade receivables		
Associates and joint ventures	16 046	13 678
Entities controlled by the parent company	182 802	141 050
Other related parties	-	18
Short-term loans		
Associates and joint ventures	7 000	24 750
Entities controlled by the parent company	4 236	8 896
Interest receivables		
Associates and joint ventures	649	2 656
Entities controlled by the parent company	-	32
Other short-term receivables		
Entities controlled by the parent company	-	6 890
Other related parties	2	-
Prepayments for services		
Associates and joint ventures	-	1 068
Other long-term loans and receivables		
Long-term loans		
Associates and joint ventures	5 725	-
Entities controlled by the parent company	2 942	3 804

Borrowings

Short-term loans and bonds		
Entities controlled by the parent company	19 035	-

Trade and other payables

Payables to suppliers		
Associates and joint ventures	11 098	9 414
Entities controlled by the parent company	326	272
Other related parties	6	7
Prepayments received		
Entities controlled by the parent company	16 094	16 551
Interest liabilities		
Entities controlled by the parent company	272	-
Other payables		
Associates and joint ventures	-	3 365

No allowances for impairment losses have been set up for receivables from related parties in 2007

Remuneration of the members of the Supervisory and Management Boards and senior executives

In 2007, the members of the Supervisory and Management Boards as well as senior executives of AS Merko Ehitus were paid remuneration totalling 25 355 thousand kroons (2006: 15 171 thousand kroons).

Termination benefits of members of the Supervisory and Management Boards

Upon premature removal or termination of authority of the members of the Supervisory and Management Boards, the Group has the obligation to pay compensation totalling 4410 thousand kroons (2006: 4392 thousand kroons).

Contracts of surety

AS Merko Ehitus provides surety for:

- obligations arising from the loan agreement of the subsidiary AS Merko Tartu to Sampo Bank in the amount of 4841 thousand kroons.
- obligations arising from lease agreements of subsidiaries and consolidation group companies to Balti Autoliisingu AS in the amount of 4158 thousand kroons (31.12.2006: 9883 kroons);
- obligations arising from loan agreements of the joint venture OÜ Unigate to Hansabank in the amount of 1000 thousand kroons (31.12.2006: 1000 thousand kroons).

The fair value of Group's surety contracts is immaterial, therefore no liability has been recorded in the balance sheet as at 31.12.2007 as well as at 31.12.2006.

Note 35 Contingent liabilities

The Group has purchased the following guarantees in the following maximum amounts from financial institutions to cover Group's maximum exposure to third parties if the Group would not be able to fulfil its contractual obligations. The management believes that the likelyhood of additional expenses due to these guarantees is remote.

in thousands of kroons	Group 31.12.2007	Group 31.12.2006
Performance period's warranty to the customer	309 904	180 617
Tender warranty	23 761	72 352
Guarantee warranty period	55 500	73 295
Prepayment guarantee	68 756	105 478
Sureties (Note 34)*	9 999	26 483
Payment guarantee	5 176	3 743
Letter of credit	11 218	-
Total contingent liabilities	**484 314**	**461 968**

** In addition to sureties disclosed in Note 34, the Group has not issued sureties covering the obligations of third parties (31.12.2006: the amount was 8100 thousand kroons).*

Performance period's warranty to the customer – warranty provider grants to customer that contractor's obligations arising from construction contract will be adequately completed.
Tender warranty – warranty provider grants to customer arranging the tender process that the tenderer will sign a contract as per tender conditions.
Guarantee for warranty period - warranty provider grants to customer that construction defects discovered during the warranty period will be repaired.
Prepayment guarantee - warranty provider grants to customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.
Payment guarantee – warranty provider grants to customer payment for goods or services.

On 29 February 2008 a penalty claim was issued against Merko Ehitus branch in Latvia in the amount of 7,5 million kroons. The Group's management believes that this claim is not justified and no provision has been made. The first court hearings will take place in the summer of 2008.

Tax authorities have the right to review the Group's tax records within 6 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines. The Group's management estimates that there are not any circumstances which might lead the tax authorities to impose additional significant taxes on the Group.

Note 36 Risks

Credit risk

Credit risk relates to a potential damage which would occur if the parties to the contract are unable to fulfil their contractual obligations. In order to lower credit risks, the payment discipline of customers is constantly monitored; construction activities are partly funded by customer prepayments. The company's cash is held in short-term deposits at banks with a high credit rating (Moody's rating A3/P-2 and higher). Cash is mostly held in overnight deposits or term deposits at Hansabank and the banks of the SEB Group. The management estimates that the Group does not have any major credit risks.

Financial assets *in thousands of kroons*	Allocation by due dates 1-12 months	Allocation by due dates 2-5 years	Carrying amount	Collateral
31.12.2007				
Cash and overnight deposits	53 838	-	53 838	-
Term deposits	151 726	-	151 726	-
Trade receivables	884 856	5 825	890 681	-
Receivables recorded based on the stage of completion of construction contracts	151 119	-	151 119	-
Loans granted	41 135	8 667	49 802	30 000
Total	**1 282 674**	**14 492**	**1 297 166**	**30 000**

31.12.2006				
Cash and overnight deposits	437 611	-	437 611	-
Term deposits	238 532	-	238 532	-
Trade receivables	551 362	4 672	556 034	-
Receivables recorded based on the stage of completion of construction contracts	135 408	-	135 408	-
Loans granted	34 883	3 804	38 687	-
Total	**1 397 796**	**8 476**	**1 406 272**	**-**

Of financial assets, an allowance has been set up for doubtful receivables. Receivables in the amount of EEK 2111 thousand (2006: EEK 1370 thousand) have been written down in full.

According to the industry practice, trade receivables and receivables recorded based on the stage of completion of construction contracts have no collateral.

Of the loans granted, EEK 19 903 thousand (31.12.2006: EEK 37 450 thousand) are loans to companies under joint control and associates of whose economic activities the Company has a good overview and therefore, no collateral is required.

Interest risk

Interest risk arises from interest rate changes in the financial markets as a result of which it may be necessary to revalue the company's financial assets and take into consideration higher financing costs in the future. Most of the Group's bank loans have floating interest rates based on either EURIBOR or the interbank rates of the countries of incorporation of the companies. As the share of interest-bearing liabilities in the Group's capital structure is low (as at 31.12.2007: 18% of the balance sheet total), management considers the effect of changes in the interest rate environment insignificant for the operating results of the Group.

Effect of changes in interest risks on financial expenses.

As at 31.12.2007, the Group's interest-bearing liabilities totalled EEK 702 592.6 thousand, including EEK 10.6 thousand denominated in Estonian kroons, EEK 79 624.0 thousand in Lithuanian litas, EEK 382 230.8 thousand in Latvian lats and EEK 240 727.3 thousand in euros. Loan interest depended on the base interest of 3-12 month interbank money market loans of the respective country of incorporation.

Management expects the European Central Bank to lower the euro base rates over the following 12 months as a result of which Euribor will fall by approximately 50 basis points. However, we expect the increase of base rates on loans denominated in national currencies of the Baltic States by approximately 75 basis points.

Assuming that the volume and structure of borrowings does not change during the year, the following will occur: 1) a decrease/increase of Euribor by -50/+50 basis points will change the Company's interest costs by -/+1195.6 thousand kroons; 2) an increase/decrease of base rate on loans denominated in national currencies by +75/-75 basis points will increase/decrease financing costs by +/-3 476.1 thousand kroons.

Foreign exchange risk

The Group's transactions are carried out in Estonian kroons, Latvian lats and Lithuanian litas. The Estonian kroon, as well as the Latvian lats and Lithuanian litas are pegged to the Euro. The exchange rate of the Latvian lat is 1 EUR=0.702804 LVL +/-1%. In order to eliminate foreign exchange risk, material foreign contracts and long-term loan agreements are concluded in euros.

Liquidity risk

The Company's solvency represents its ability to settle its liabilities to creditors on time. As at 31.12.2007, the Group's current ratio was 2.4 (2006: 2.0) and quick ratio was 1.0 (2006: 1.1). To complement available current assets and to ensure liquidity and better management of cash flows, the group companies have concluded overdraft agreements with banks for a total facility of EEK 90 million. In addition to overdraft facility, the Company has a current loan facility with the limit of EEK 150 million available from AS Merko Grupp. Management estimates that the Group's capital structure – a high proportion of equity at 52% of the balance sheet total and a low proportion of interest bearing liabilities of 18% of the balance sheet total – ensures the Company's trustworthiness for creditors also during difficult times and significantly improves the feasibility of the extension of existing financial liabilities and raising additional debt.

Financial assets/liabilities *in thousands of kroons*	Allocation by due dates 1-3 months	 4-12 months	 2-5 years	Total	Carrying amount
31.12.2007					
Assets					
Cash and overnight deposits	53 838	-	-	53 838	53 838
Term deposits	151 726	-	-	151 726	151 726
Trade receivables	884 856	-	5 825	890 681	890 681
Prepaid taxes *	40 528	-	-	40 528	40 528
Receivables recorded based on the stage of completion of construction contracts	151 119	-	-	151 119	151 119
Loans and interest	779	42 431	8 667	51 877	51 877
Other short-term receivables	3 662	-	-	3 662	3 662
Total	**1 286 508**	**42 431**	**14 492**	**1 343 431**	**1 343 431**
Liabilities					
Trade payables	528 856	-	11 091	539 947	539 947
Payables to employees	74 892	-	-	74 892	74 892
Tax liabilities	73 533	-	-	73 533	73 533
Loan and finance lease liabilities**	91 535	213 344	397 713	702 592	702 592
Other liabilities	7 991	13 977	-	21 968	21 968
Total	**776 807**	**227 321**	**408 804**	**1 412 932**	**1 412 932**
31.12.2006					
Assets					
Cash and overnight deposits	437 611	-	-	437 611	437 611
Term deposits	238 532	-	-	238 532	238 532
Trade receivables	551 362	-	4 672	556 034	556 034
Prepaid taxes *	38 981	-	-	38 981	38 981
Receivables recorded based on the stage of completion of construction contracts	135 408	-	-	135 408	135 408
Loans and interest	583	37 213	3 804	41 600	41 600
Other short-term receivables	1 549	-	-	1 549	1 549
Total	**1 404 026**	**37 213**	**8 476**	**1 449 715**	**1 449 715**
Liabilities					
Trade payables	464 199	-	10 352	474 551	474 551
Payables to employees	64 218	-	-	64 218	64 218
Tax liabilities	60 734	-	-	60 734	60 734
Loan and finance lease liabilities**	56 758	227 034	159 335	443 127	443 127
Other liabilities	5 458	21 832	-	27 290	27 290
Total	**651 367**	**248 866**	**169 687**	**1 069 920**	**1 069 920**

** Although prepaid taxes do not meet the definition of financial assets, they will offset the amount of negative cash flows from tax liabilities.*

*** The schedule of expected interest payments cannot be determined with reasonable certainty. In line with property development best practice, the loan obligations to acquire land plots have been assumed with open-end maturities. The repayment of those loan obligations is dependent on the progress of related development projects and on the timing of cashflows generated from those projects upon completion. Consequently the management is on the opinion that even their best estimate on the timing of expected interest payments would not be of reliable accuracy for the users of this financial information and have been omitted.*

Capital management

The Commercial Code of the Republic of Estonia specifies the following requirements for the share capital of the companies registered in Estonia:

• the minimum share capital of a public limited company shall be at least EEK 400 000;

• the net assets of a public limited company shall be at least one half of the Company's share capital but not less than EEK 400 000.

The size of share capital or its minimum and maximum are set out in the articles of association of a public limited company whereas the minimum share capital shall equal at least ¼ of maximum share capital.

According to the current articles of association of AS Merko Ehitus, the Company's share capital consists of 17 700 thousand ordinary shares with the nominal value of 10 kroons each and without amending the articles of association of the public limited company, changes can be made to the Company's share capital within the range of EEK 85 - 340 million. As at 31.12.2007, the share capital of AS Merko Ehitus was EEK 177 000 thousand and the consolidated net assets were EEK 2 049 696 thousand, so the Company's equity and share capital were in compliance with the requirements established in the Republic of Estonia.
In capital management, the Company follows the principle of maintaining its trustworthiness, sustainable development and the assets of shareholders through economic cycle pursuant to which it monitors that its equity to assets ratio would at any given time be at least 45% (31.12.2007: 52%, 31.12.2006: 50%) and interest bearing debt to assets ratio would not exceed 25% (31.12.2007: 18%, 31.12.2006: 14%).

Legal risk

At 15 October 2007, the Prosecutors' Office submitted a suspicion of bribery and breach of trust against AS Merko Ehitus and the Chairman of the Company's Supervisory Board Toomas Annus. The suspicion filed is arbitrary and is largely based on incompetent interpretation of risks related to business and industry practices as well as on inability to estimate the effect of time on events and real estate prices. Management estimates that the Company has followed the effective laws of the Republic of Estonia and good industry practice. The theoretical maximum penalty in case of criminal conviction is EEK 250 million and the Company's compulsory liquidation. Management estimates that no *de facto* basis exists for convicting the Company and no provision has been made in this respect (excl provision for lawyers' costs).
Due to different interpretation of contracts, regulations and laws related to Group's principal activities, there is a risk that some buyers, contractors or supervisory authorities evaluate the Company's activities in abiding by a law or a contract on different grounds and dispute the legitimacy of the Company's activities.
As at 31.12.2007, a provision has been set up in the Group in the amount of EEK 22 786 thousand for covering potential claims and legal costs (31.12.2006: EEK 4054 thousand), (Note 29).

Fair value

The carrying amounts of the Group's financial assets and financial liabilities do not significantly differ from their fair values.

Note 37 Number of shares owned by the members of the Supervisory and Management Board and their close relatives

As at 31.12.2007, neither members of the Supervisory Board and Management Board of AS Merko Ehitus nor their close relatives owned shares of Merko Ehitus.

Note 38 Shareholders with more than 5% ownership

	Shares	Ownership %
AS Merko Grupp	12 742 686	71.99
Clients of ING Luxembourg S.A.	909 500	5.14

Note 39 Events after the balance sheet date

At a joint meeting held at 14 March 2008, the Management Board and the Supervisory Board of AS Merko Ehitus adopted a resolution to restructure the Company and separate operating activities from the criminal proceedings related to the land swap. The Company's management estimates that the restructuring the Company is the best way to ensure its sustainable development and protect the interests of shareholders and employees in the long-lasting criminal proceedings related to the land swap.
The delay of the criminal proceedings related to the land swap launched in 2005, the accompanying ambiguity and speculation in the media have started to take a toll on the Company's operations and thus harming the interests of the Company and its shareholders. The Company has entered into advisory agreements with the investment bank GildBankers and law office Tark & CO to evaluate the legal and economic impact related to the adoption and implementation of the process.
At 15 April 2008, the management of AS Merko Ehitus presented the Company's restructuring plan according to which AS Merko Ehitus will be demerged so that core business (e.g. all assets, liabilities and contracts as well as the business name) will be separated and transferred to the new company being set up, except for liquid assets and equity totalling 300 million kroons and contingent liability related to criminal proceedings. As a result of the demerger, each shareholder will receive one share of New Merko for each share of AS Merko Ehitus and the shares of New Merko will be listed on the Tallinn Stock Exchange as soon as possible. The business name of AS Merko Ehitus will also be changed and the Company's shares will continue to be listed on the Tallinn Stock Exchange. The sole member of the Management Board of the company will be Toomas Annus.

The Management Board of AS Merko Ehitus will prepare the demerger plan outlining the details of the demerger, incl. size of share capital of New Merko, members of the Management Board and Supervisory Board, distribution and exchange ratio of the shares of New Merko to be transferred to shareholders, terms of transferring shares, list of assets to be transferred to New Merko and allocation of liabilities accompanying the assets between the companies. In addition, the Management Board will prepare the demerger report explaining the demerger from the legal and economic point of view.
The demerger plan will be presented for approval at the General Meeting of Shareholders of AS Merko Ehitus. At least 2/3 of the voting power represented at the meeting is required to adopt the resolution.

Note 40 Supplementary disclosures on the parent company

The financial information of the parent company comprises separate primary statements of the parent company (income statement, balance sheet, cash flow statement and statement of changes in equity), the disclosure of which is required by the Estonian Accounting Act. The primary financial statements of the parent company have been prepared using the same accounting methods and measurement bases as for the preparation of the consolidated financial statements, except for subsidiaries, associates and joint ventures which are reported at cost in the separate primary financial statements of the parent company.

INCOME STATEMENT

	Parent company	
in thousands of kroons	**2007**	**2006**
Revenue	2 466 908	2 111 887
Cost of goods sold	(2 194 892)	(1 834 444)
Gross profit	**272 016**	**277 443**
Marketing expenses	(16 439)	(12 591)
Administrative and general expenses	(121 424)	(63 775)
Other operating income	24 683	19 323
Other operating expenses	(14 413)	(4 782)
Operating profit	**144 423**	**215 618**
Financial income/expenses	(861)	2 226
Financial income/expenses from investments into subsidiaries	124 079	113 488
Financial income/expenses from investments into associates and joint ventures	4 000	2 499
Net profit for the year	**271 641**	**333 831**

Revenue break-down of the parent company is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), information which is required under Business Code § 4 p.6.

EMTAK		Parent company	
code		**2007**	**2006**
	Rendering of construction services		
4120	incl. construction of residential and non-residential buildings	1 577 180	980 529
4110	development of building projects	205 982	451 609
4211	construction of roads and railways	107 501	99 693
4221	construction of utility projects for fluids	388 160	318 441
4222	construction of utility projects for electricity and telecommunications	53 113	62 327
4291	construction of water projects	29 845	141 372
4213	construction of bridges and tunnels	28 787	-
4299	construction of other civil engineering projects n.e.c.	16 994	55 999
	Total rendering of construction services	**2 407 562**	**2 109 970**
	Real estate activities		
6810	incl. sales of own real estate	58 500	-
6820	renting and operating of own or leased real estate	846	1 917
	Total real estate activities	**59 346**	**1 917**
	Total revenue	**2 466 908**	**2 111 887**

in thousands of kroons	Parent company 31.12.2007	Parent company 31.12.2006
ASSETS		
Current assets		
Cash and cash equivalents	107 000	311 059
Trade and other receivables	964 874	948 507
Prepaid corporate income tax	1 433	1 451
Inventories	373 734	154 132
Total current assets	**1 447 041**	**1 415 149**
Non-current assets		
Investments in subsidiaries	318 069	229 604
Investments in associates and joint ventures	3 540	3 540
Other long-term financial assets	338 763	129 326
Property, plant and equipment	15 681	12 653
Intangible assets	8 801	6 197
Total non-current assets	**684 854**	**381 320**
TOTAL ASSETS	**2 131 895**	**1 796 469**
LIABILITIES		
Current liabilities		
Borrowings	262 391	32 463
Trade and other payables	534 169	617 514
Corporate income tax liability	9	-
Short-term provisions	59 380	18 727
Total current liabilities	**855 949**	**668 704**
Non-current liabilities		
Other long-term payables	5 690	5 250
TOTAL LIABILITIES	**861 639**	**673 954**
EQUITY		
Share capital	177 000	177 000
Statutory reserve capital	17 700	17 700
Retained earnings	1 075 556	927 815
TOTAL EQUITY	**1 270 256**	**1 122 515**
TOTAL LIABILITIES AND EQUITY	**2 131 895**	**1 796 469**

STATEMENT OF CHANGES IN EQUITY

Parent company *in thousands of kroons*	Share capital	Statutory reserve capital	Retained earnings	Total
Balance as at 31.12.2005	**177 000**	**8 850**	**691 334**	**877 184**
Net profit for the year	-	-	333 831	333 831
Transfers to reserve capital	-	8 850	(8 850)	-
Dividends	-	-	(88 500)	(88 500)
Balance as at 31.12.2006	**177 000**	**17 700**	**927 815**	**1 122 515**
Carrying amount of holdings under dominant or significant influence				(233 144)
Carrying amount of holdings under dominant or significant influence under the equity method				704 571
Adjusted unconsolidated equity at 31.12.2006				**1 593 942**
Net profit for the year	-	-	271 641	271 641
Dividends	-	-	(123 900)	(123 900)
Balance as at 31.12.2007	**177 000**	**17 700**	**1 075 556**	**1 270 256**
Carrying amount of holdings under dominant or significant influence				(321 609)
Carrying amount of holdings under dominant or significant influence if the equity method had been applied				1 067 110
Adjusted unconsolidated equity at 31.12.2007				**2 015 757**

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

in thousands of kroons	Parent company 2007	2006
Cash flows from operating activities		
Operating profit	144 423	215 618
Adjustments:		
depreciation and impairment	6 462	7 648
gain/loss from sale of non-current assets	57	(107)
adjustment of revenue from construction contracts under stage of completion method	19 786	(102 843)
interest income from operating activities	(24 585)	(17 913)
change in provisions	49 203	9 697
Change in trade receivables related to operating activities	(220 877)	(214 673)
Change in inventories	(219 603)	(60 913)
Change in trade payables related to operating activities	(6 242)	147 513
Interest paid	(7 513)	(931)
Total cash flows from operating activities	**(258 889)**	**(16 904)**
Cash flows from investing activities		
Investments into subsidiaries	(65 807)	(69 834)
Proceeds from sale of subsidiaries	500	25 039
Proceeds from sales of associates	-	1 847
Proceeds from sale of other financial assets	-	3 004
Purchase of property, plant anda equipment	(5 459)	(7 501)
Proceeds from sale of property, plant and equipment	151	155
Purchase of intangible assets	(3 332)	(4 570)
Loans granted	(283 278)	(303 095)
Loan repayments received	161 502	510 324
Interest received	18 223	20 379
Dividends received	128 079	88 579
Total cash flows from investing activities	**(49 421)**	**264 327**
Cash flows from financing activities		
Borrowings	259 651	33 242
Repayments of borrowings	(30 436)	(5 165)
Finance lease principal payments	(1 063)	-
Dividends paid	(123 900)	(88 500)
Total cash flows from financing activities	**104 252**	**(60 423)**
Net increase/decrease in cash and cash equivalents	**(204 058)**	**187 000**
Cash and cash equivalents at beginning of the period	311 059	124 033
Currency translation adjustment	(1)	26
Cash and cash equivalents at end of the period	**107 000**	**311 059**

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INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS Merko Ehitus

We have audited the accompanying consolidated financial statements of AS Merko Ehitus and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2007 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2007, and of 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.

Urmas Kaarlep
AS PricewaterhouseCoopers

Tiit Raimla
Authorised Auditor

30 April 2008

**This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

PROFIT ALLOCATION PROPOSAL

in kroons	
Retained earnings	1 281 092 636
Net profit for 2007	545 049 316
Total retained earnings as at 31.12.2007	**1 826 141 952**

Due to the need to ensure the liquidity of the company and maintain the investment ability in deteriorating economic environment, the Management Board proposes that no dividends would be distributed.

Tõnu Toomik	Chairman of the Management Board	15.04.2008
Alar Lagus	Member of the Management Board	15.04.2008
Veljo Viitmann	Member of the Management Board	15.04.2008
Andres Agukas	Member of the Management Board	15.04.2008
Tõnu Korts	Member of the Management Board	15.04.2008

SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2007 ANNUAL REPORT

The Management Board of AS Merko Ehitus has prepared the management report, consolidated financial statements and the profit allocation proposal for 2007.

Tõnu Toomik	Chairman of the Management Board	15.04.2008
Alar Lagus	Member of the Management Board	15.04.2008
Veljo Viitmann	Member of the Management Board	15.04.2008
Andres Agukas	Member of the Management Board	15.04.2008
Tõnu Korts	Member of the Management Board	15.04.2008

The Supervisory Board has reviewed the Annual Report which consists of the management report and the financial statements prepared by the Management Board and which also includes the auditor's report and the profit allocation proposal, and approved it for presentation at the General Meeting of Shareholders.

Toomas Annus	Chairman of the Supervisory Board	30.04.2008
Teet Roopalu	Member of the Supervisory Board	30.04.2008
Jaan Mäe	Member of the Supervisory Board	30.04.2008

CONTACT DATA OF ANALYSTS FOR MERKO EHITUS GROUP

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about the company

Merko Ehitus is a leading building corporation offering integral solutions, with branches currently in Estonia, Latvia and Lithuania. Merko Ehitus has been in business since 1990.

Long experience gained from various markets, wide range of building services, flexibility and quality have helped Merko Ehitus to achieve and hold the position of the market leader for years.

In keeping with customer expectations, depending on the region and the size of objects the enterprises of the corporation carry out both small and large scale building projects, both on land and in water environments.

mission

Based on long-term experience, a strong team and continuous learning, Merko Ehitus offers sustainable and working integral solutions, providing satisfaction and security in the area of real estate development, architectural design and building.

vision

The goal of Merko Ehitus is to become in three years, one of the five strongest building companies in the Baltic States, to develop one tenth of the residential premises of Estonia and Latvia and to achieve, in the Baltic region, 5% of market share.

address of the chairman of the supervisory board

The year 2006 was special for Merko Ehitus above all because for the first time in the history of our company the net profit of our Latvian and Lithuanian companies together exceeded the profit of their parent company Merko Ehitus.

The share of the construction work carried out outside Estonia raised in the corporation's net sales from 24.5% to 36.7% in a year. Compared to 2005 the sales revenue raised 14.5% in Estonia, 88.5% in Latvia and 144.4% in Lithuania.

Merko Ehitus entered the Latvian and Lithuanian markets about ten years ago. There is a saying that the early bird catches the worm. For that exact reason we haven't been surprised that our Latvian and Lithuanian companies have achieved such results by today. It highlights the years of hard work by people that are willing and able to do their jobs well.

The described achievements have enabled us to spread the risks around and to keep up the speed of growth. In 2006 the net sales of Merko Ehitus corporation was 4.4 billion kroons, growing 36.6% in a year. We believe that operating on the three markets with comparable volumes we have an advantage over the competition in both, securing larger projects and balancing the risks in countries that are still growing very quickly. We have room for growth, but also for stumbling.

The speed of growth, especially occurring in the construction and real estate has brought a lot of attention to the sector. The popularity of construction and real estate makes it appear that almost everybody would like to be part of building a power plant with cost of billions of kroons and many have assumed an expert status in assessing the fair price of real estate. Last year Merko Ehitus was thus also drawn into speculations concerning the three legal exchanges of land under building restrictions with the state. The fact that our employees, stakeholders and partners continue to have faith gives us strength. It helped overcome the small crisis and move on to new perspectives.

It makes us happy that good construction workers are returning to their homeland. The rapid growth of salaries has narrowed the gap between incomes in different markets. Prices of some piecework are already higher in Estonia than in some of the older European Union member countries. Still, the demand for good professionals exceeds the number of available workers. Also, the construction market will be on-goingly affected by the deficiency and raising prices of construction materials.

One of the highlights of the year is that one of our buildings, the headquarters of Hansabanka in Riga won the first award of the international real estate federation FIABCI in the category of business and industrial spaces. Such worldwide known buildings as Petronas Twin Towers in Malaysia, Prudential Tower in Singapore, Guggenheim Museum in Spain and Disneyland in Paris have gained the same award before. It was the first time such an honour has come to Baltic States and it concerns both the team of Merko and also our client, Hansapank.

Toomas Annus
Chairman of the Supervisory Board

AS MERKO EHITUS

GROUP

CONSOLIDATED ANNUAL REPORT

Beginning of financial year: 01.01.2006

End of financial year: 31.12.2006

(Translation of the Estonian original)

Commercial Registry no:	**10068022**
Address:	**Järvevana tee 9G, 11314 Tallinn**
Phone:	**+372 680 5105**
Fax:	**+372 680 5106**
E-mail:	**merko@merko.ee**
Web site:	**www.merko.ee**
Main activities:	**general contracting of construction**
Auditor:	**AS PricewaterhouseCoopers**

MANAGEMENT REPORT

general information

Merko Ehitus is a leading construction group which offers complete solutions and whose companies are located in Estonia, Latvia and Lithuania. Merko Ehitus was set up in 1990. The Group consists of 32 subsidiaries and 7 associates and joint ventures, the largest ones of which are SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (75%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%) and AS Tartu Maja Betoontooted (25%).

In 2006, the following changes took place in the Group's structure:

- In February, AS Merko Ehitus sold its 12% holding in the associate AS Telegrupp for 1.85 million kroons and in June, the remaining 19% shares of AS Telegrupp for 3.0 million kroons.
- In June, AS Merko Ehitus sold its 25% holding in the subsidiary AS Gustaf for 5.13 million kroons.
- In December, the Latvian subsidiary of AS Merko Ehitus, SIA Merks, sold its 100% holding in the company SIA Arena Riga as a non-core business for 17.61 million euros (275.5 million kroons).
- In December, AS Merko Ehitus sold its 100% holding in OÜ Rannamõisa Kinnisvara for 31.89 million kroons. The sale transaction was recorded as a sale of real estate property in the Group accounting.

overview of the construction market and its developments

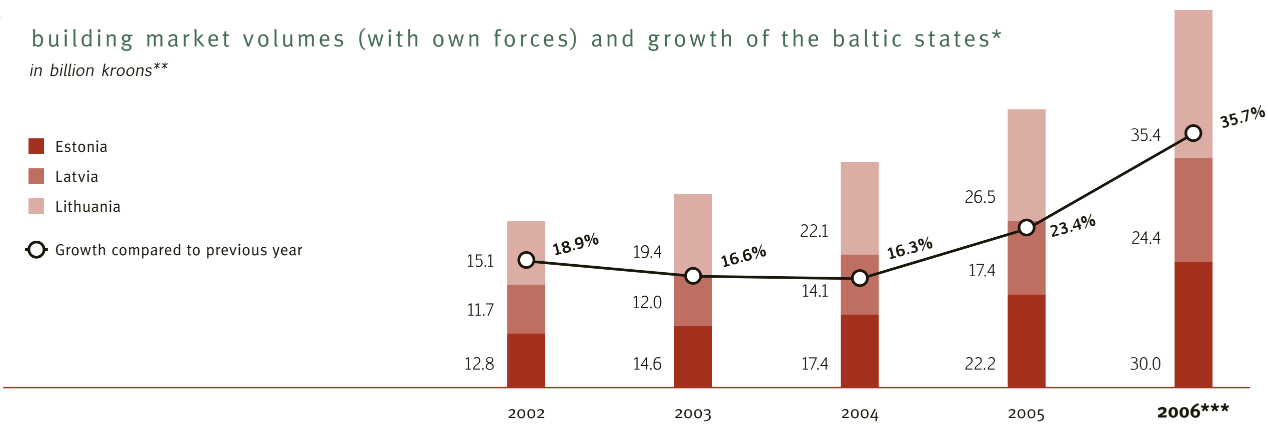
The availability of unlimited funds and strong domestic consumption determined the development of the construction market in 2006. The demand was strong in the sector and the Baltic construction market as a whole grew by 35.7% in a year. In 2006, construction works were performed in the Baltic region for 89.8 billion kroons which is 23.6 billion kroons more than in 2005. Continuing appreciation of construction prices contributed significantly to this growth.

The sector's growth was the fastest in Latvia, where the market grew in current prices by 39.7% in a year and reached 24.5 billion kroons. According to the data by the Estonian Statistical Office, the Estonian construction companies performed construction works with their own forces in Estonia and foreign countries for 31.4 billion kroons, which is 35.2% more than a year ago. In Estonia, construction works were performed for 30.1 billion kroons and in foreign countries, for 1.3 billion kroons. Fast growth also continued in the Lithuanian construction market which increased by 33.1% and was 35.7 billion kroons. Despite fast growth in Latvia and Lithuania, the ratios characterising construction production stayed relatively low as compared with Estonia: construction works per capita were performed for 1493 euros in Estonia, 675 euros in Latvia and 668 euros in Lithuania.

A major part of the growth of the construction market has come from residential construction over the last several years. The year 2006 was characterised by stabilisation of the residential market in Lithuania and Estonia, and as a result, interest towards real estate properties available for development decreased and their prices stabilised. In Latvia, the prices for residential housing continued to climb, appreciating by 30-40% in a year. Other main reason for the price appreciation was inadequate supply due to limited construction capacity and growing demand arising from speculative interest and availability of funds. In 2006, 5068 dwellings were completed in Estonia, 5865 in Latvia and 7292 in Lithuania.

building market volumes (with own forces) and growth of the baltic states*

*in billion kroons***



** Based on the data of local statistival offices.*

*** According to the unofficial central exchange rate of Eesti Pank.*

**** Data of 2006 tenative, based on short-term statistics.*

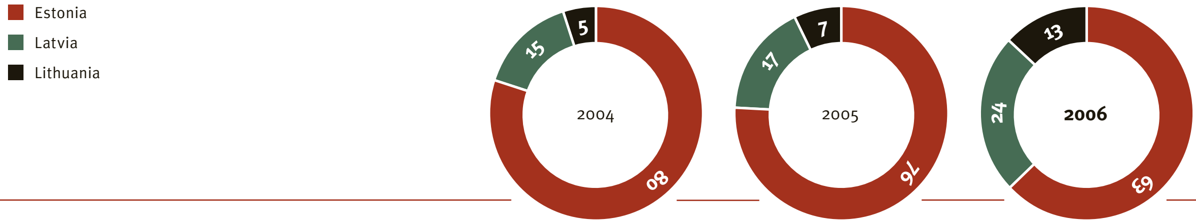
Fast volume growth had an effect on the supply of labour and construction materials and was the driving force behind continuing appreciation of construction prices, which exceeded the growth of the consumer price index several times. The most critical situation occurred in respect of qualified labour, as simultaneously with volume growth, skilled labour left en masse to the EU countries with higher standards of living. The construction services appreciated by 20.9% in Latvia, 10.3% in Estonia and 9.8% in Lithuania, and labour costs appreciated by 44.2% in Latvia, 18.7% in Estonia and 17.5% in Lithuania.

results of operations

The year 2006 was a challenging one for the Group and ended with the highest ever sales revenue and net profit. In 2006, the sales revenue of Merko Ehitus totalled 4414 million kroons, increasing by 36.6% in a year. The volume of construction works performed outside of Estonia increased from 24.5% to 36.7% of the total sales revenue of the Group. In 2006, Estonia contributed 63.3%, Latvia 23.9% and Lithuania 12.8% to sales growth. As compared with 2005, sales revenue increased by 14.5% in Estonia, 88.5% in Latvia and 144.4% in Lithuania.

geographical distribution of turnover of merko ehitus group

per cent



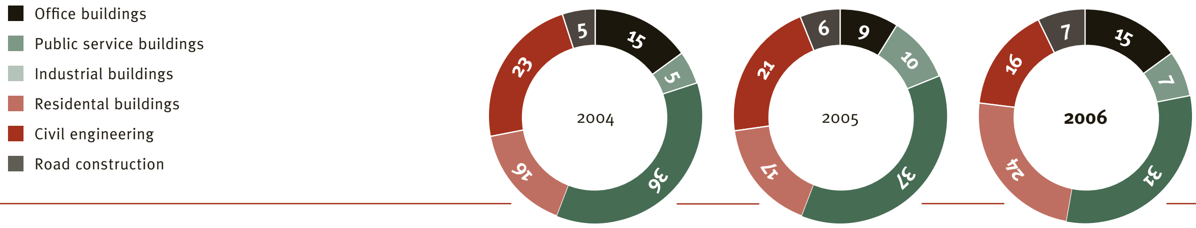
the consolidated sales revenue of the group's largest companies

	2006 EEK	2006 EUR	2005 EEK	2005 EUR
Estonian companies				
AS Merko Ehitus (parent company)	1,864,882	119,188	1,779,827	113,752
AS Gustaf (75% ownership)	97,049	6,203	60,922	3,894
OÜ Gustaf Tallinn (80% ownership)	124,068	7,929	77,555	4,957
AS Merko Tartu (66% ownership)	255,769	16,347	232,972	14,890
Tallinna Teede AS (100% ownership)	317,591	20,298	204,005	13,038
OÜ Woody (100% ownership)	306,354	19,580	106,080	6,780
Latvian companies				
SIA Merks (100% ownership)	973,636	62,227	545,068	34,836
Lithuanian companies				
UAB Merko Statyba (100% ownership)	507,309	32,423	208,850	13,348

Engineering construction contributed 16%, residential construction/development 24%, administrative buildings 31%, office buildings 15%, industrial buildings 7% and road construction 7% to the Group's revenue. Of construction activities, 83% was new structure and 17% was renovation and reconstruction works. In 2006, the Group entered into construction contracts with the total volume of 6754 million kroons and as at 31.12.2006, the Group's contract portfolio totalled 5245 million kroons.

distribution of construction activities of the group

per cent



The Group's key events in the year 2006 were related to the Latvian subsidiary SIA Merks which turned 10 last year. At the beginning of the year, a multifunctional recreational centre accommodating 12 thousand people was opened in the district of Skanstes Street which was built by SIA Merks in co-operation with Merko Ehitus. During its first eleven months of operation under the management of SIA Merks, 126 events (including 33 ice-hockey world championships games) were arranged there, 520 000 people visited the complex, the revenue from operating the complex totalled LVL 2 533 000 and operating profit amounted to LVL 425 000. Despite initial success, management considered the risks of operating the complex high and irrelevant for the attainment of the Group's strategic goals; therefore the recreational unit was divested. At 11.12.2006, SIA Merks entered into a sales agreement to divest its holding in the company SIA Arena Riga for 17.61 million euros.

An important acknowledgement of the activities of SIA Merks during the year 2006 was the second prize awarded at the Competition of the Best Building of 2006 by the Latvian Construction Companies Association for the building of Riga Arena built by SIA Merks and the title of the best building of the year for the residential complex of Rūpniecības.

the largest completed projects of 2006

Viimsi schoolhouse	new facility	Randvere tee 8, Viimsi, Harjumaa	18 197 m²	AS Merko Ehitus
Shopping centre	new facility	Mustakivi tee 17, Tallinn	11 279 m²	AS Merko Ehitus
Port of Saaremaa	new facility	Ninase village, Mustjala rural municipality, Saaremaa	11 200 m²	AS Merko Ehitus
Iru social welfare buildings	new facility	Hooldekodu tee 21 ja 23, Tallinn	10 387 m²	AS Merko Ehitus
Stage 2 of residential buildings at Tabasalu	new facility	Sarapuu põik, Tabasalu, Harjumaa	9080 m²	AS Merko Ehitus
Apartment buildings and terraced houses	new facility	Mooni 89b, Räägu 10c, Räägu 10b, Tallinn Kännu 32 / Lehe 31, Tallinn Räägu 12b / Kännu 30, Tallinn Räägu 12 / Lehe 29, Tallinn Kolde pst 67, Tallinn	14 789 m²	OÜ Woody
Stage 3 of shopping centre Spice	new facility	Lielirbes 29a, Riga	27 378 m²	SIA Merks
Apartment building	new facility	Rūpniecības 21, Riga	13 962 m²	SIA Merks
Administrative building of UAB Univesa	new facility	Taikos pst 88A, Vilnius	4028 m²	UAB Merko Statyba
Section of Jõhvi-Tartu-Valga Highway no. 209, section 209.2-217.4 and Transport Street in Valga	reconstruction	Section of Jõhvi-Tartu-Valga Highway no. 209, section 209.2-217.4 and Transport Street in Valga	100 000 m²	Tallinna Teede AS
Road construction of Mustakivi Road (Tähesaju - Laagna Road)	reconstruction	Mustakivi tee, Tallinn	14 935 m²	Tallinna Teede AS
Logistics Centre of A. Le Coq Tartu Beer Factory	new facility	Tähtvere village, Tartumaa	15 692 m²	AS Merko Tartu

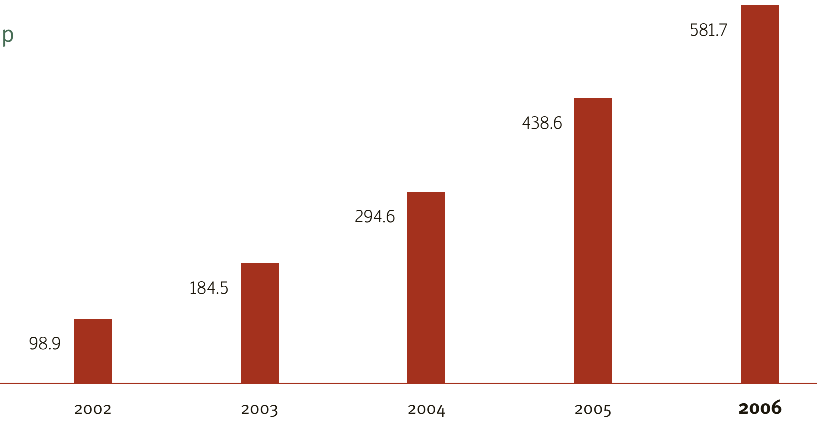
Due to the volume growth and appreciation of labour and material costs, the cost of goods sold increased by 36.1% and the distribution and administrative expenses increased by 14.6%, contributing 84.4% and 3.9%, respectively, to sales revenue. Despite fast appreciation of costs related to construction activities and tense situation with regard to labour supply, the Company was able to retain its gross margin at 15.6% and increase its operating margin from 13.5% to 14.3%.

In 2006, the Group's net profit totalled 581.7 million kroons. Extraordinary income from the sale of holdings contributed 125.1 million kroons, development activities 284.7 million kroons, construction activities 164.2 million kroons and financial activities 7.7 million kroons to net profit. The Group's net profit margin before extraordinary income was 10.3% and the profit margin from construction activities was 4.6%.

In a year, the Group's net profit increased by 32.6% and the net profit from other countries increased by 155.4%. For the first time, the net profit earned by the Latvian and Lithuanian business units (252.2 million kroons) exceeded that of the parent company AS Merko Ehitus of 218.1 million kroons.

net profit of merko ehitus group

in million kroons



In 2006, the Group's total cash flows totalled +411.7 million kroons, of which the cash flows from operating activities totalled +155.7 million kroons. The cash flows from operating activities of the reporting period were mostly affected by the operating profit of +632.9 million kroons, a change in inventories –363.6 million kroons, a change in receivables and prepayments related to operating activities -189.2 million kroons, a change in liabilities and prepayments +165.3 million kroons, loss from the sale of non-current assets -122.4 million kroons and prepaid corporate income tax paid -44.0 million kroons. The Group's cash flows from investing activities totalled +234.4 million kroons, of this amount the proceeds from sale of property, plant and equipment totalled +290.8 million kroons, loan repayments received totalled +287.0 million kroons, loans granted in the reporting period -275.4 million kroons, investments into property, plant and equipment -76.3 million kroons and other income from investing activities +8.3 million kroons. The Company's cash flows from financing activities totalled +21.6 million kroons, of which the balance of credit liabilities assumed/repaid totalled +113.5 million kroons and dividends paid –91.9 million kroons.

the ratios and methodology of calculating the financial ratios describing the company's main operations

	2004	2005	2006
Net profit margin	9.5%	13.6%	13.2%
Net profit margin (excluding extraordinary profit)	8.8%	9.0%	10.3%
Operating profit margin	10.3%	13.5%	14.3%
Return on equity per annum	49.9%	48.2%	43.2%
Return on assets per annum	24.1%	24.9%	21.4%
Equity ratio	55.3%	49.6%	49.6%
Current ratio	2.0	2.0	2.0
General expense ratio	3.4%	4.6%	3.9%
Personnel expense ratio	6.3%	7.3%	8.0%
Debt ratio	3.7%	28.8%	27.8%
Accounts receivable turnover (in days)	30	33	46
Accounts payable turnover (in days)	29	38	45
Sales revenue per employee (in million kroons)	4.891	4.651	5.193

Definition of key indicators

Net profit margin: Net profit / Sales revenue
Operating profit margin: Operating profit / Sales revenue
*Return on equity per annum: Net profit / Average equity of the period**
Return on assets per annum: Net profit / Average assets of the period
Current ratio: Owners' equity / Total assets*
Current ratio: Current assets / Current liabilities
General expense ratio: General expenses / Sales revenue
Personnel expense ratio: Personnel expenses / Sales revenue
*Debt to equity ratio: Interest-bearing liabilities / Owners' equity**
Accounts receivable turnover: Trade receivables / Sales revenue x 365
Accounts payable turnover: Payables to supplies / Cost of goods sold x 365
Sales revenue per employee: Sales revenue / Average number of full-time employees

* *Calculated as attributable to the equity holders of the parent company.*

business risks

Market risks. One of the peculiarities of construction activities is the fact that the execution of the contracts entered into will take months and it ensures relatively long-term revenue stream for the companies which in turn makes the sector immune to changes in the economic environment. Due to this the changes having both a negative and positive effect on the demand for construction services will reach construction with a lag of approximately 12 months. This time is long enough to take necessary measures and avoid the worst or be prepared for the best.

It is much more difficult to estimate the changes in the demand for housing development. In 2006, the housing development differed among the Baltic countries, the prices stabilised and the sales period of apartments lengthened in Estonia and Lithuania and price appreciation continued in Latvia. How will the market be able to absorb the price appreciation of previous years? What will happen to apartments purchased as investments if housing prices no longer increase? How will the lending market adjust to interest rate hikes? Concurrent interaction between different factors in the dwelling space market is complicated and represents a significant risk for the developer. In order to anticipate potential problems, we closely follow the changes in sales numbers, the process of selling apartments is launched before the construction of the building, a preliminary contract is entered into with the buyer at the first opportunity and a deposit is collected to ensure the execution of the contract. The largest projects are divided into stages so that they can be frozen quickly and with few expenses. Development activities made up 19.2% of the sales revenue of Merko Ehitus in 2006. As at 31.12.2006, 32 completed apartments with the cost price of 18.1 million kroons had not been sold by the Group and 839 apartments with the cost price of 428.1 million kroons were not completed, of which 404 apartments had been sold to buyers under preliminary contracts.

The accession of the Baltic countries to the European Union opened new markets for construction companies, a large gap between the new and old countries led to a massive migration of construction workers into old EU countries. Labour migration and growth of construction market volumes led to shortages of skilled labour in all Baltic countries and fast appreciation of labour costs. Developments in the labour market, convergence of prices of construction services and materials with the prices of the European Union and longer delivery dates of construction materials need to be considered when assessing the risks for long-term projects lasting longer than 12 months. In order to hedge risks we have stepped up international cooperation; in the absence of necessary skills, knowledge or work is purchased from other Baltic countries, Finland and Sweden.

Operating risks. The Group concludes complete risk insurance contracts with insurance companies in order to hedge unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to 10 million euros. The risks of projects whose cost exceeds 10 million euros or which the annual policy does not cover (water construction, railroad construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding employment contracts for design work, an insurance contract of professional liability is required from subcontractors covering the losses arising from design, erroneous measuring, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2006, indemnity applications totalling 2.6 million kroons were submitted to insurance companies and disbursements in the amount of 0.4 million kroons were received from insurance companies and 1.9 million kroons are being processed.

The appropriate fulfilment of contractual obligations arising from employment agreements is guaranteed with bank guarantees payable on first demand. A warranty reserve has been set up at the Company to eliminate the construction errors which became evident during the warranty period. In 2006, warranty provisions were set up in the total amount of 10.7 million kroons and disbursements amounted to 9.5 million kroons. As at the year-end, the Company's warranty reserve amounted to 9.7 million kroons. With regard to work performed by subcontractors, the subcontractor shall eliminate the errors that became evident during the warranty period and the fulfilment of these obligations is guaranteed with bank guarantees.

One important part of managing operating risks is the mapping out of the situation and anticipation of risks. ISO 9001/14001 management systems have been set up at the four largest companies of the Group and the occupational health and safety system OHSAS 18001 has been set up at the parent company. Fifteen full-time quality control specialists work in the Group whose work responsibilities include ensuring the functioning of quality, work safety and management systems.

Credit risk is an inevitable part of the Company's activities. In managing credit risk, close attention is paid to the payment behaviour of partners, their financial position is analysed and if necessary, third parties are involved as guarantors. With regard to prepayments to suppliers, a bank guarantee by suppliers is required. In 2006, the payment discipline of customers somewhat deteriorated, the amount of invoices exceeding 30 and more days increased from 2.4 million kroons to 22.4 million kroons and the amount of doubtful receivables increased from 0.4 million kroons to 1.6 million kroons. Due to participation in several large public procurements, the accounts receivable turnover increased from 33 days to 46 days in a year.

The Company's available funds are held in short-term deposits at the banks with high credit ratings (Moody's rating of A3/P-2 and higher). In order to ensure liquidity, the group companies have concluded overdraft contracts with the total value of 148 million kroons.

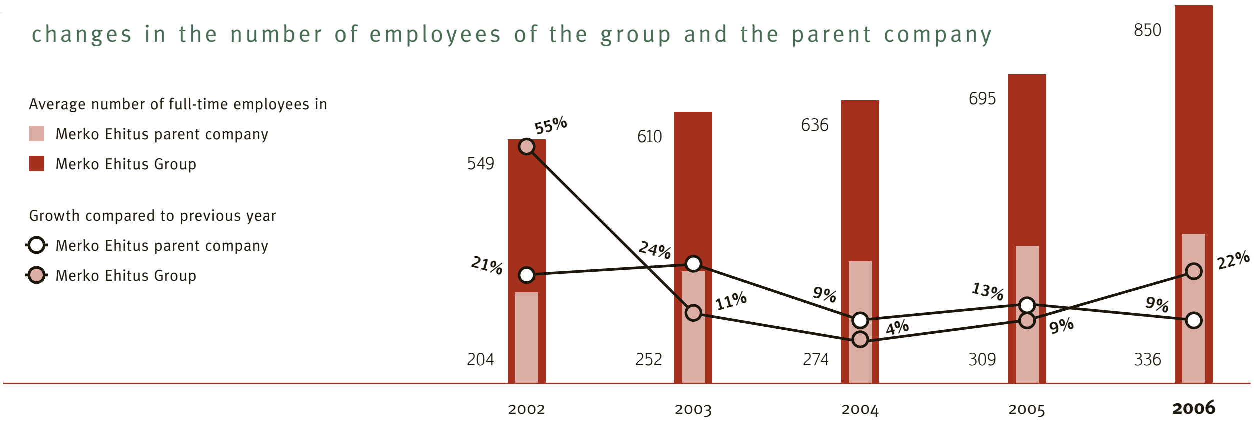
Interest rate risks. As at 31.12.2006, the Group's interest-bearing liabilities totalled 443.1 million kroons, of which short-term loans and the current portion of long-term debt totalled 283.8 million kroons and long-term loans and finance lease liabilities totalled 159.3 million kroons. The volume of interest-bearing liabilities increased by 125.5 million kroons in a year and as at the year-end, these liabilities made up 13.8% of the Company's balance sheet total. Most of the Group's loans relate to short-term development projects the duration of which exceeds 24 months. Due to the short-term nature of loans, the effect of interest rate increases is immaterial on the final results of projects and therefore, the hedging of interest risks of these obligations is not considered appropriate.

Foreign currency risk. The Group's construction contracts are mostly concluded in a foreign currency of the country of location and open foreign currency positions in daily activities are being avoided. The most significant foreign contracts are concluded in euros. The Estonian kroons, as well as the Lithuanian litas and Latvian lats (exchange rate is 1 EUR = 0.702804 LVL +/-1%) are pegged to the Euro.

the company and its people

One of the main values of Merko Ehitus is its people. In a year, the number of the Group's employees increased by 155 people and at 31.12.2006, the Group had 850 full-time employees. The gross wages and salaries of the Group's full-time employees totalled 276.5 million kroons, of which the basic wages and salaries made up 68.0% and bonuses made up 32.0%, and that is 59.0% more than in 2005. In 2006, the average number of full-time employees at the parent company AS Merko Ehitus was 336, increasing by 27 employees in a year. Gross wages and salaries paid to full-time employees totalled 125.2 million kroons, the annual growth was 21.2%, incl. the growth of basic wages and salaries of 30.2% and that of bonuses of 8.0%. As compared to 2005, the average number of employees grew by 22.3% at the Group and the average gross wages and salaries grew by 29.8%.

changes in the number of employees of the group and the parent company



The Management Board of AS Merko Ehitus has 5 members. The members of the Management Board were all full-time employees of AS Merko Ehitus and their gross remuneration totalled 7.1 million kroons in 2006, incl. basic remuneration of 2.8 million kroons and bonuses of 4.3 million kroons. The Supervisory Board of AS Merko Ehitus has three members and their gross remuneration in 2006 totalled 5.5 million kroons, incl. basic remuneration of 1.6 million kroons and bonuses of 3.9 million kroons. All members of the Supervisory and Management Boards work on the basis of service contracts. Upon the premature removal of a member of the Supervisory and Management Boards or non-extension of the service contract, the member is paid severance pay which equals the last 12 months' remuneration.

In 2006, the Group sponsored sports, culture and science with 8.6 million kroons. The Group's largest sponsorship project was the initiative launched in collaboration with Hansabank, Eesti Energia and the Ministry of Culture of the Republic of Estonia as well as the Estonian Ski Association called 'Estonian hiking tracks'. The goal of the project is to help develop the Estonian athletic tracks in order to ensure availability of year-round and free athletic opportunities to all interested people and to promote athletic lifestyles. SA Eesti Terviserajad was set up to implement this project. Over the last two years, the private sector has invested 20 million kroons into the hiking tracks, has cleaned 15 hiking tracks and design works have been launched with regard to 9 centres.

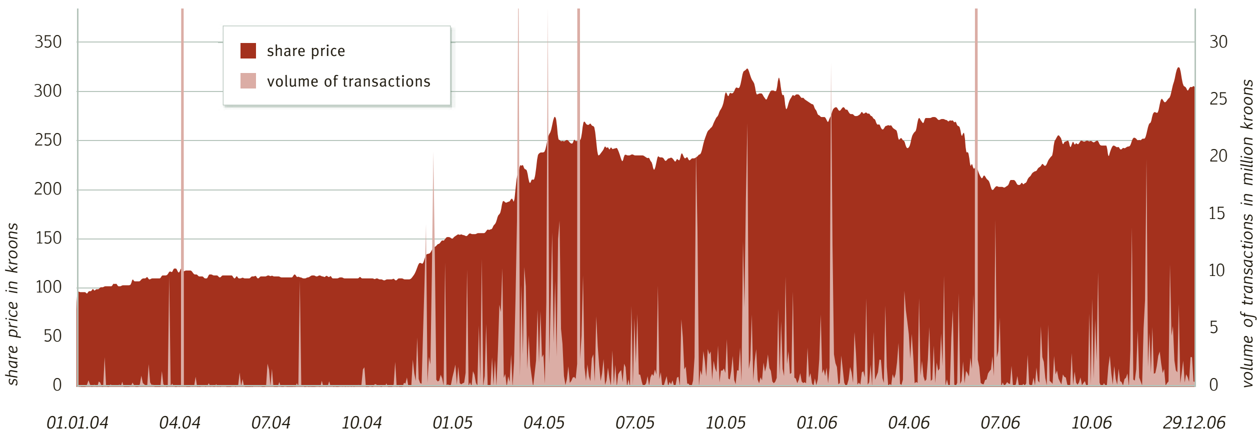
shares and shareholders

The shares of Merko Ehitus are listed in the main list of Tallinn Stock Exchange.

	31.12.2004	31.12.2005	31.12.2006
Basic earnings per share (EPS), kroons	16.64	24.78	32.87
Owners' equity per share, kroons	40.56	62.23	90.05
P/B (price to book ratio)	3.75	4.34	3.41
P/E (price / earnings ratio)	9.14	10.89	9.35

In 2006, 3589 transactions with the shares of Merko Ehitus were performed in the course of which 3.4 million shares were traded and the total monetary value of transactions was 832.6 million kroons. The lowest share price was 197.46 kroons and the highest price was 326.23 kroons per share. The closing price of the share as at 29.12.2006 was 307.46 kroons.

performance of merko ehitus share at tallinn stock exchange



The share prices preceding the equity financing have been corrected to the number of shares which resulted from the equity financing carried out in 2005.

trading history of securities

	2004	2005	2006
Highest	152.16	327.01	326.23
Lowest	93.88	150.21	197.46
Closing	152.09	269.90	307.46
Change, %	+61.86	+77.47	+13.92
Traded shares	1,465,632	2,847,923	3,434,847
Turnover, million kroons	355.98	1 052.38	832.59
Market value, in million kroons, as at the year-end	2,691.90	4,777.23	5,442.04

structure of shareholders as at 31.12.2006

Number of shares	Number of shareholders	% of shareholders	Number of shares	% of shares
1-100	398	39.80%	21,918	0.12%
101-1000	451	45.10%	173,912	0.98%
1001-10 000	116	11.60%	346,672	1.96%
10 001 – 100 000	24	2.40%	889,761	5.03%
100 001 – 1 000 000	9	0.90%	2,310,351	13.05%
1 000 001 - ...	2	0.20%	13,957,386	78.86%
Total	**1000**	**100%**	**17,700,000**	**100%**

the main shareholders of as merko ehitus as at 31.12.2006

	Number of shares	Proportion
AS Merko Grupp	12,742,686	71.99%
ING Luxembourg S.A., clients	1,214,700	6.86%
Skandinaviska Enskilda Banken Ab, clients	789,365	4.46%
Nordea Bank Finland Plc, clients	503,172	2.84%
OKO Bank Plc, clients	248,594	1.40%
J.P. Morgan Bank Luxembourg S.A.	189,306	1.07%

outlook for 2007

The overall condition of the construction sector is primarily affected by the country's economic development, general investment climate and availability of funds. Lately, international rating agencies and independent analysts have drawn attention to the current account deficit in the Baltic countries, extremely fast economic growth and accompanying inflation. Analysts think that the economy is showing signs of overheating and requires state intervention. In February 2007, the Government of Latvia announced its programme of measures to balance the economy. The foundation of the programme is the curbing of domestic consumption through reducing the availability of funds and public procurements as well as fiscal policy restrictions. Most of the planned measures would also have a direct effect on the development of the construction sector.

The tightness of the supply of labour and construction materials and fast price acceleration will remain the largest challenges for the sector's further development. The year 2007 may bring some alleviation to the problems of construction materials and labour. The supply of construction materials should improve when the investments made into production in 2005/06 are launched. Positive changes may also be seen in the supply of the labour market. Fast salary acceleration in the domestic market over the last several years has made the domestic market attractive for construction workers migrating to foreign countries and brought new employees to the market from other sectors of the economy. The above changes are unlikely to solve these problems; therefore the appreciation of the prices of construction services will continue.

The year 2007 will not bring along any structural changes in the construction sector, the construction of infrastructure and environmental facilities financed in collaboration of the public sector and the Structural Funds of the European Union will continue. The private sector will continue to invest in the renovation and construction of hotels, commercial and office buildings and industrial parks.

Besides general and engineering construction, housing construction has played an important role over the last several years. Due to stricter requirements set for the borrowers by banks and lower demand due to higher inflation, the growth of housing loans will slow and as a result, the housing market will stabilise, the sales periods of residential properties will lengthen and the regional differentiation of real estate prices will take place. The renewal pace of the housing fund of 2.1-3.8 new housing spaces per thousand people attained by today is not expected to change significantly over the next several years. The market needs time to get used to the fast price acceleration of the last several years and the purchasing power of people is expected to catch up.

We believe that despite the deterioration of the borrowing environment and the measures taken by the central banks and governments of the Baltic countries to balance the economy, the economic growth rate of the region will maintain its 6-7% growth rate which the construction sector will also benefit from. In the short term, the demand for construction services distinctly exceeds the supply and the growth of volumes and prices is expected to continue. In the medium term, the fast acceleration of the construction services and the forecast deceleration of economic growth will have a negative effect on demand and the growth of the construction sector may slow down.

Although the growth rates of the construction markets of all Baltic countries were similar in 2006, in the future, faster growth is expected to take place in Latvia and Lithuania where the construction volumes do not reflect the size and the number of people in these countries. In 2006, construction works were performed for 1493 euros in Estonia, 675 euros in Latvia and 668 euros in Lithuania. These numbers demonstrate that the growth of construction market is still ahead.

Merko Ehitus continues to expand its operations in Latvia and Lithuania where it aims at becoming one of the leaders of the Latvian and Lithuanian construction markets with the help and the branch offices of Merko Ehitus and subsidiaries SIA Merks and UAB Merko Statyba. We are optimistic regarding the developments in Latvia and Lithuania and believe that over the next 3 years, the share of their operations will grow to 50% of the Group's revenue.

Our experience, knowledge, and people are a value which has brought success for Merko Ehitus over the years. We believe that we will be able to turn the year 2007 into another successful year for the Company's business partners, clients, employees and shareholders.

corporate governance code

From 2006, the Corporate Governance Code (CGC) which lays down the general principles of managing companies and treating shareholders, applies to the issuers of equity securities which are listed on Tallinn Stock Exchange. The application of the CGC principles is recommended to the listed companies and the companies are free to decide whether to follow the main CGC principles or not. The Corporate Governance Code is based on the principle of follow or explain according to which a company shall explain its standpoints and activities with regard to those CGC provisions which it does not follow.

Merko Ehitus places great value on the equal treatment of its shareholders, the transparency of the Company's management processes as well as the reliability of its activities. This report deals with those CGC principles which AS Merko Ehitus does not follow for technical, economic or other reasons.

I general meeting of shareholders

The Company's highest governing body is the General Meeting of Shareholders, the authorities of which are regulated by legislation and the articles of association of the Company.

The Company shall announce the time, place, and agenda of the General Meeting as well as the recommendations of the Supervisory Board with regard to the items on the agenda in a national daily newspaper, on the Company's website and through the stock exchange system. The General Meeting shall be conducted at the place shown on the notice, on a working day and between 9 a.m. and 6 p.m. enabling most of the shareholders to participate in the General Meeting of Shareholders. Any shareholder or his authorised representative may participate in the General Meeting. No picture taking or filming is allowed at the General Meeting, because it may disturb the privacy of shareholders. Participation in the General Meeting cannot be accomplished through the means of communication because there are no reliably way to identify shareholders and to ensure the privacy of participating shareholders.

On behalf of the Company, the Chairman of the Management Board and the Chairman of the Supervisory Board shall participate in the General Meeting of AS Marko Ehitus, and if necessary, other members of the Management and Supervisory Boards shall be involved. The Company does not consider the participation of all members of the Management and Supervisory Boards in the General Meeting relevant.

II management board

The Management Board of AS Merko Ehitus represents the Company and manages its daily operations. The Management Board of AS Merko Ehitus has five members and the activities of the members are divided by areas of operation: general management – Tõnu Toomik, construction – Andres Agukas, development – Tõnu Korts, technology – Veljo Viitmann, finance – Alar Lagus. The Chairman of the Management Board, Tõnu Toomik presides over the work of the Management Board.

The members of the Management Board have entered into three-year service contracts with the Company. The Company discloses the total amount of remuneration and bonuses of the members of the Management Board in the annual report, as it believes that the disclosure of personalised remuneration does not create additional value and disturbs the privacy of the members of the Management Board. Upon premature termination or non-extension of the service contract and under the condition that the members of the Management Board shall not compete with the Company, severance pay shall be paid to the members of the Management Board equalling twelve-month basic remuneration of the member of the Management Board.

In paying bonuses to the members of the Management Board, the financial performance of the companies managed by the Group and the Management Board shall be considered. Besides reviewing the quarterly results of operations, the Supervisory Board shall review and approve the bonuses payable to the Management Board. Twenty-five per cent of the bonuses payable on the basis of interim financial statements shall be withheld and paid after the approval of the annual report by the General Meeting of Shareholders. No share options have been used to motivate the members of the Management Board.

III supervisory board

The General Meeting of Shareholders shall elect the Supervisory Board. The Supervisory Board shall determine the Company's operating strategy, endorse the transactions as authorised by the articles of association, elect the members of the Management Board and monitor the performance of the Management Board during the time the General Meetings are not held. The Supervisory Board of AS Merko Ehitus has three members: Teet Roopalu, Jaan Mäe and Chairman of the Supervisory Board, Toomas Annus.

Merko Ehitus does not have any independent members of the Supervisory Board meeting the definition of the CGC, as the members also participate in the work of the companies controlled by the Company and in the Supervisory Boards of the Company's controlling shareholder. The members of the Supervisory Board shall be elected on the basis of their knowledge and experience in the field of construction and real estate development. The peculiarity of the work procedures of the Supervisory Board of Merko Ehitus is the fact that the members work full-time on the basis of service contracts. Such a work procedure adds responsiveness to the activities of the Group, ensures better informativeness of the Supervisory Board and altogether enables more efficient supervision over the activities of business units which are dispersed geographically and have diverse operations.

The General Meeting of Shareholders shall approve the remuneration of the members of the Supervisory Board. The terms and conditions of the service contracts in force, including the procedures for paying remuneration to the members of the Supervisory Board were approved by the General Meeting of Shareholders in May 2006.

The performance-based pay of the members of the Supervisory Board shall be determined on the basis of the financial performance of the Group. The payment of bonuses occurs on a quarterly basis after the publication of the issuer's interim financial statements. Twenty-five per cent of the bonuses payable on the basis of interim financial statements shall be paid after the approval of the annual report by the General Meeting of Shareholders.

Upon the premature termination or non-extension of the service contract and under the condition that the members of the Supervisory Board shall not compete with the Company, severance pay shall be paid to the members of the Supervisory Board equalling twelve month basic remuneration.

IV collaboration of the management and supervisory boards

To ensure that the Company's interests are met as best as possible, the Management and Supervisory Boards shall collaborate extensively. At least once a month, a meeting between the members of the Supervisory and Management Boards shall take place, at which the Management Board shall inform the Supervisory Board of significant issues regarding the Company's business operations, the fulfilment of the Company's short and long-term goals and the risks affecting them.

V disclosure of information

In disclosing information, AS Merko Ehitus shall follow the rules and regulations of Tallinn Stock Exchange and immediately disclose important information regarding the Company's activities to the shareholders after obtaining reasonable assurance as to its correctness and that the disclosure of such information shall not harm the interests of the Company and its partners. Important information shall be disclosed through the stock exchange system and on the Company's website.

During the year, Merko Ehitus shall not publish the dates for disclosing information, the so-called financial calendar, because the disclosure of reliable dates would incorporate additional time factor into the dates and endanger the timeliness of disclosures. Merko Ehitus publishes important information regarding the Company after the end of the trading day and from 2007, informs shareholders about publishing interim financial statements and the annual report at least two days prior to their disclosure.

If possible, the Company shall participate in the presentation and press conferences arranged by analysts and investors. The information made available at the meetings is public, i.e. available in the reports of the Company, on its website or other public sources. We believe that the publication of the schedule for meetings does not provide any additional information for the shareholders and therefore, such information shall not be published.

VI election of an auditor and auditing the financial statements

The Company's financial statements are prepared in accordance with International Financial Reporting Standards as adopted in the European Union.

In electing the auditor, the Company shall consider his/her independence, competence, reliability and the price of the service offered by him/her. The Company shall not publish the fees paid for the provision of auditing and consulting services, because such activities may significantly impair the Company's ability to obtain the service for a competitive price in the future.

When proposing to elect a new auditor, the Supervisory Board shall also present its rationale for the change. In extending the contract with the auditor who audited the Company in the previous financial year, the Supervisory Board acknowledges with its choice that the auditor has fulfilled the expectations laid on him/her and the Supervisory Board is content with the quality of the service provided.

FINANCIAL STATEMENTS

management declaration

The Management Board confirms the correctness and completeness of AS Merko Ehitus consolidated financial statements as presented on pages 21-58.

The Management Board confirms that to the best of its knowledge:

- the accounting methods used for preparing the financial statements are in compliance with International Financial Reporting Standards as adopted by the European Union;
- the financial statements give a true and fair view of the financial position, the results of operations and the cash flows of the Group,
- the parent company and all group companies are going concerns.

Tõnu Toomik	Chairman of the Management Board	29.03.2007
Alar Lagus	Member of the Management Board	29.03.2007
Veljo Viitmann	Member of the Management Board	29.03.2007
Andres Agukas	Member of the Management Board	29.03.2007
Tõnu Korts	Member of the Management Board	29.03.2007

consolidated income statement

in thousands	Note	EEK 2006	EEK 2005	EUR 2006	EUR 2005
Revenue	2, 3	4,414,361	3,232,392	282,129	206,588
Cost of goods sold	4	(3,727,561)	(2,738,714)	(238,234)	(175,036)
Gross profit		**686,800**	**493,678**	**43,895**	**31,552**
Marketing expenses	5	(23,390)	(22,595)	(1,495)	(1,444)
Administrative and general expenses	6	(148,792)	(127,632)	(9,501)	(8,157)
Other operating income	7	148,205	185,052	9,463	11,827
Other operating expenses	8	(29,952)	(93,452)	(1,914)	(5,973)
Operating profit		**632,871**	**435,051**	**40,448**	**27,805**
Financial income	9	8,303	6,253	530	400
Financial expenses	10	(20,353)	(4,710)	(1,301)	(301)
Profit from sale of subsidiaries	18	2,326	7,498	149	479
Profit from associates and joint ventures	19	17,461	19,632	1,116	1,255
incl. profit from equity participation		17,038	17,065	1,089	1,091
Profit before tax		**640,608**	**463,724**	**40,942**	**29,638**
Corporate income tax expense	11	(49,917)	(18,437)	(3,190)	(1,178)
Net profit for financial year		**590,691**	**445,287**	**37,752**	**28,460**
incl. net profit attributable to equity holders of the parent company		581,738	438,638	37,180	28,034
minority interest		8,953	6,649	572	426
Earnings per share for profit attributable to equity holders of the parent company (basic and diluted, in kroons / euros)	12	32.87	24.78	2.10	1.58

The notes set out on pages 26-58 are an integral part of these consolidated financial statements.

consolidated balance sheet

in thousands	Note	EEK 31.12.2006	EEK 31.12.2005	EUR 31.12.2006	EUR 31.12.2005
ASSETS					
Current assets					
Cash and cash equivalents	14	676,143	268,446	43,123	17,157
Trade and other receivables	15	854,103	542,110	54,587	34,648
Prepaid corporate income tax		6,428	2,471	411	158
Inventories	17	1,356,734	964,088	86,712	61,617
Assets held for sale		733	-	47	-
Total current assets		**2,894,141**	**1,777,115**	**184,970**	**113,580**
Non-current assets					
Investments in associates and joint ventures	19	200,798	179,609	12,833	11,479
Other long-term loans and receivables	20	8,476	8,524	542	545
Deferred income tax assets	21	6,592	8,753	421	559
Investment property	22	3,900	42,506	249	2,716
Property, plant and equipment	23	90,445	199,004	5,781	12,718
Intangible assets	24	10,177	4,365	650	279
Total non-current assets		**320,388**	**442,761**	**20,476**	**28,296**
TOTAL ASSETS		**3,214,529**	**2,219,876**	**205,446**	**141,876**
LIABILITIES					
Current liabilities					
Borrowings	26	283,792	114,841	18,138	7,340
Trade and other payables	27	1,081,396	711,236	69,114	45,456
Corporate income tax liability		18,868	950	1,206	61
Government grants	28	1,498	22,225	96	1,420
Short-term provisions	29	33,517	21,741	2,142	1,390
Total current liabilities		**1,419,071**	**870,993**	**90,696**	**55,667**
Non-current liabilities					
Long-term borrowings	26	159,335	202,824	10,183	12,963
Other long-term trade payables	30	23,277	22,726	1,488	1,452
Deferred income tax liability	21	-	11,385	-	728
Total non-current liabilities		**182,612**	**236,935**	**11,671**	**15,143**
TOTAL LIABILITIES		**1,601,683**	**1,107,928**	**102,367**	**70,810**
EQUITY					
Minority interest		18,904	10,552	1,208	674
Equity attributable to equity holders of the parent company					
Share capital	32	177,000	177,000	11,312	11,312
Statutory reserve capital		17,700	8,850	1,131	566
Currency translation differences		(5,751)	(5,059)	(368)	(323)
Retained earnings		1,404,993	920,605	89,796	58,837
Total equity attributable to equity holders of the parent company		**1,593,942**	**1,101,396**	**101,871**	**70,392**
TOTAL EQUITY		**1,612,846**	**1,111,948**	**103,079**	**71,066**
TOTAL LIABILITIES AND EQUITY		**3,214,529**	**2,219,876**	**205,446**	**141,876**

The notes set out on pages 26-58 are an integral part of these consolidated financial statements.

consolidated statement of changes in equity

in thousands of EEK	Note	Share capital	Share premium	Statutory reserve capital	Currency translation differences	Retained earnings	Total	Minority interest	Total
		Equity attributable to equity holders of the parent company							
Balance as at 31.12.2004		**88,500**	**2,950**	**8,850**	**(4,663)**	**622,333**	**717,970**	**7,200**	**725,170**
Derecognition of negative goodwill	24	-	-	-	-	2,709	2,709	-	2,709
Balance as at 01.01.2005		**88,500**	**2,950**	**8,850**	**(4,663)**	**625,042**	**720,679**	**7,200**	**727,879**
Currency translation differences		-	-	-	(396)	-	(396)	-	(396)
Net profit for financial year		-	-	-	-	438,638	438,638	6,649	445,287
Total recognised income for 2005		**-**	**-**	**-**	**(396)**	**438,638**	**438,242**	**6,649**	**444,891**
Liquidation proceeds to minority shareholders		-	-	-	-	-	-	(697)	(697)
Fund issue	32	88,500	(2,950)	-	-	(85,550)	-	-	-
Dividends	13	-	-	-	-	(57,525)	(57,525)	(2,600)	(60,125)
Balance as at 31.12.2005		**177,000**	**-**	**8,850**	**(5,059)**	**920,605**	**1,101,396**	**10,552**	**1,111,948**
Currency translation differences		-	-	-	(692)	-	(692)	-	(692)
Net profit for financial year		-	-	-	-	581,738	581,738	8,953	590,691
Total recognised income for 2006		**-**	**-**	**-**	**(692)**	**581,738**	**581,046**	**8,953**	**589,999**
Minority interest sold	18	-	-	-	-	-	-	2,799	2,799
Dividends	13	-	-	-	-	(88,500)	(88,500)	(3,400)	(91,900)
Transfers to statutory reserve capital		-	-	8,850	-	(8,850)	-	-	-
Balance as at 31.12.2006		**177,000**	**-**	**17,700**	**(5,751)**	**1,404,993**	**1,593,942**	**18,904**	**1,612,846**

in thousands of EUR	Share capital	Share premium	Statutory reserve capital	Currency translation differences	Retained earnings	Total	Minority interest	Total
	Equity attributable to equity holders of the parent company							
Balance as at 31.12.2004	5,656	189	566	(298)	39,774	45,887	460	46,347
Derecognition of negative goodwill	-	-	-	-	173	173	-	173
Balance as at 01.01.2005	5,656	189	566	(298)	39,947	46,060	460	46,520
Currency translation differences	-	-	-	(25)	-	(25)	-	(25)
Net profit for financial year	-	-	-	-	28,034	28,034	426	28,460
Total recognised income for 2005	**-**	**-**	**-**	**(25)**	**28,034**	**28,009**	**426**	**28,435**
Liquidation proceeds to minority shareholders	-	-	-	-	-	-	(46)	(46)
Fund issue	5,656	(189)	-	-	(5,467)	-	-	-
Dividends	-	-	-	-	(3,677)	(3,677)	(166)	(3,843)
Balance as at 31.12.2005	**11,312**	**-**	**566**	**(323)**	**58,837**	**70,392**	**674**	**71,066**
Currency translation differences	-	-	-	(45)	-	(45)	-	(45)
Net profit for financial year	-	-	-	-	37,180	37,180	572	37,752
Total recognised income for 2006	**-**	**-**	**-**	**(45)**	**37,180**	**37,135**	**572**	**37,707**
Minority interest sold	-	-	-	-	-	-	179	179
Dividends	-	-	-	-	(5,656)	(5,656)	(217)	(5,873)
Transfers to statutory reserve capital	-	-	565	-	(565)	-	-	-
Balance as at 31.12.2006	**11,312**	**-**	**1,131**	**(368)**	**89,796**	**101,871**	**1,208**	**103,079**

The notes set out on pages 26-58 are an integral part of these consolidated financial statements.

consolidated cash flow statements

in thousands	*Note*	EEK 2006	EEK 2005	EUR 2006	EUR 2005
Cash flows from operating activities					
Operating profit		632,871	435,051	40,448	27,805
Adjustments:					
depreciation and impairment charge	*2, 22-24*	30,747	109,637	1,965	7,007
profit/loss from sale of non-current assets	*7, 23*	(122,403)	(535)	(7,823)	(34)
adjustment of revenue from construction contracts under stage of completion method		38,109	66,630	2,436	4,258
interest income from business activities		(2,335)	(5,590)	(149)	(357)
change in government grants and other provisions		5,455	(22,973)	349	(1,468)
Change in trade and other receivables related to operating activities		(189,193)	(27,321)	(12,092)	(1,746)
Change in inventories		(363,595)	(464,906)	(23,238)	(29,713)
Change in trade and other payables related to operating activities		186,197	186,556	11,900	11,923
Interest paid		(16,168)	(2,811)	(1,033)	(180)
Other financial income (expense)		(7)	3,857	(1)	247
Corporate income tax paid		(43,991)	(12,928)	(2,812)	(826)
Total cash flows from operating activities		**155,687**	**264,667**	**9,950**	**16,916**
Cash flows from investing activities					
Investments into subsidiaries	*18*	(3,029)	(23,985)	(195)	(1,533)
Proceeds from sale of subsidiaries	*18*	(2)	3,376	-	216
Subsidiary liquidation proceeds to minority shareholders	*18*	(20)	(694)	(1)	(44)
Investments into associates and joint ventures	*19*	(7,866)	(136,228)	(503)	(8,707)
Proceeds from sale of associates and joint ventures		1,847	8,306	118	531
Proceeds from sale of other financial assets		3,004	3	192	-
Purchase of investment property	*22*	-	(63)	-	(4)
Purchase of property, plant and equipment	*23*	(76,264)	(226,960)	(4,874)	(14,505)
Proceeds from sale of property, plant and equipment	*23*	290,753	2,143	18,583	137
Purchase of intangible assets		(6,739)	(2,917)	(431)	(186)
Sale of a business unit		9,717	2,752	621	176
Loans granted	*16*	(275,353)	(190,123)	(17,598)	(12,151)
Loan repayments received	*16*	286,953	176,311	18,340	11,268
Interest received		8,393	6,641	536	424
Dividends received		3,000	3,323	192	212
Total cash flows from investing activities		**234,394**	**(378,115)**	**14,980**	**(24,166)**
Cash flows from financing activities					
Proceeds from borrowings	*26*	268,726	293,567	17,175	18,762
Repayments of borrowings	*26*	(144,017)	(6,724)	(9,204)	(430)
Finance lease principal payments	*26*	(11,163)	(5,832)	(714)	(373)
Government grants received	*28*	-	22,225	-	1,421
Dividends paid		(91,900)	(60,128)	(5,873)	(3,843)
Total cash flows from financing activities		**21,646**	**243,108**	**1,384**	**15,537**
Change in cash and cash equivalents		**411,727**	**129,660**	**26,314**	**8,287**
Cash and cash equivalents at beginning of the period	*14*	268,446	141,812	17,157	9,063
Exchange gains/(losses) on cash and cash equivalents		(4,030)	(3,026)	(258)	(193)
Cash and cash equivalents at end of the period	**14**	**676,143**	**268,446**	**43,213**	**17,157**

The principal non-cash is the exchange of inventories discussed in Note 3.
The notes set out on pages 26-58 are an integral part of these consolidated financial statements.

NOTES

note 1 summary of significant accounting policies

1.1. basis of preparation

The consolidated financial statements of Merko Ehitus Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

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

Several financial figures are based on management's estimates, including for example, assessment of profitability of construction contracts upon the application of the stage of completion method, assessment of useful lives of items of property, plant and equipment, assessment of impairment losses of receivables and inventories, recognising provisions for warranty obligations. Management's estimates have been made to the best of its knowledge, but they may not be accurate. The effect of changes in accounting estimates is reported in the financial statements of the period in which the change occurred.

Assets and liabilities are classified as current and non-current in the balance sheet. Current assets include assets that are expected to be used within the next financial year. Current liabilities include liabilities the due date of which is within 12 months after the balance sheet date. The remaining assets and liabilities are classified as non-current.

Expenses are classified according to their function in the income statement.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency): Estonian kroons, Latvian lats and Lithuanian litas. The consolidated financial statements of Merko Ehitus Group are presented in Estonian kroons, which is the Group's presentation currency. The primary financial statements and notes are presented in thousands of kroons. Pursuant to the requirements of Tallinn Stock Exchange, the primary financial statements are also presented in thousands of euros. As the Estonian kroon is pegged to the Euro (EUR 1=EEK 15.6466), no exchange rate differences arise in the translation of the financial statements.

1.2. new international financial reporting standards, amendments and international financial reporting interpretations committee (IFRIC) interpretations

Standards, amendments and interpretations effective in 2006
From 1 January 2006, several amendments to the text of existing standards as well as new IFRS standards, which became mandatory for the Group for the financial year beginning at 1 January 2006, became effective.

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but have no material impact on the Group financial statements:

- **IAS 19** (amendment) – Employee Benefits.
- **IAS 21** (amendment) – Net Investment in a Foreign Operation.
- **IAS 39** (amendment) – Cash Flow Hedge Accounting of Forecast Intragroup Transactions.
- **IAS 39** (amendment) – The Fair Value Option.
- **IAS 39** and **IFRS 4** (Amendment) – Financial Guarantee Contracts.
- **IFRS 1** (amendment) – First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources.
- **IFRIC 4** – Determining whether an Arrangement contains a Lease.
- **IFRIC 5** – Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds.
- **IFRIC 6** – Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

Amendments in IAS 19, IAS 21, IFRS 1, new standard of IFRS 6 and interpretations in IFRIC 4, IFRIC 5 and IFRIC 6 are not relevant to the Group's operations and therefore have no substantial effect on the Group's accounting policies. Amendments to IAS 39 are relevant to the Group's operating activities, but they did not affect the accounting policies used by the Group that already comply with the requirements established.

New standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group
Certain new International Financial Reporting Standards, amendments to existing standards and the interpretations of the standards have been published by the time of compiling these financial statements which became mandatory for the Group's accounting periods beginning on or after 1 January 2007 and have not been early adopted by the Group. The overview of these standards and the Group management estimate of the potential impact of applying the new standards and interpretations is given below:

- **IAS 1** (amendment) – *Presentation of Financial Statements:* Capital Disclosures. The amendment to IAS 1 is effective for accounting periods beginning at or after 1 January 2007. The standard requires additional disclosures in the financial statements and presents additional requirements for the parent company's capital and capital management.

- **IFRS 7** *Financial instruments:* Disclosures. IFRS 7 is effective for accounting periods beginning at or after 1 January 2007. The standard requires additional disclosures in the financial statements. This standard does not have any impact on the classification and valuation of the Group's financial instruments.
- **IFRS 8** *Operating Segments* – is effective from 1 January 2009. The management is considering the impact on Group's financial statements.
- **IAS 23** (revised) *Borrowing costs* – is effective from 1 January 2009. Revised standard requires capitalisation of borrowing costs.

The management is of opinion that the following new standards, their amendments and interpretations do not have a significant effect on the financial statements of the Group:

- **IFRIC 7** *Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Environments* (effective 1 March 2006),
- **IFRIC 8** *Share-based Compensations as defined in IFRS 2* (effective 1 May 2006),
- **IFRIC 9** *Reassessment of Embedded Derivatives* (effective 1 June 2006),
- **IFRIC 10** *Interim Financial Reporting and Impairment* (effective 1 November 2006),
- **IFRIC 11** *IFRS 2 – Group Treasury Share Transactions* (effective 1 March 2007),
- **IFRIC 12** *Service Concession Arrangements* (effective 1 January 2008).

Standard IFRS 8, IAS 23 (revised) and interpretations IFRIC 10, IFRIC 11 and IFRIC 12 have not yet been endorsed by European Union.

1.3. management estimates

The preparation of financial statements in conformity with International Financial Reporting Standards requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Although these estimates are based on management's best knowledge of current event and actions, actual results ultimately may differ from those estimates. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements of AS Merko Ehitus, are disclosed below. The effect of changes in an accounting estimate is recognised prospectively by including it in profit or loss in the period of the change.

The most significant management estimates are as follows:

Revenue under the stage of completion method
Revenue from construction in progress is recognised under the stage of completion method (Note 1.22), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, and reporting of income and expenses has been introduced to determine the stage of completion. The estimated final result to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the profit estimate is adjusted. In the financial year, after evaluating the stage of completion of construction in progress, a provision for onerous construction contracts in the amount of 17 848 thousand kroons (Note 29) was recognised. Risk analysis showed that a change in the stage of completion of construction projects in the range of +/-10% will result in a change in the net profit between an increase of 257 594 thousand kroons and a decrease of 291 769 thousand kroons.

Determination of the useful lives of items of property, plant and equipment
Management has estimated the useful lives of items of property, plant and equipment, taking into consideration conditions and volumes of business activities, historical experience in this area and future outlook. Management estimates that the useful lives of buildings and facilities are between 10 and 33.3 years depending on their structure and use. The average useful lives of machinery and equipment are on average between 3 and 5 years and those of other fixtures between 2.5 to 5 years depending on the purpose of use of the asset.

1.4. consolidation

Subsidiaries or entities that are either directly or indirectly through fellow subsidiaries controlled by the parent company AS Merko Ehitus, have been consolidated on a line-by-line basis. Control exists when the parent company owns more than one half of the voting rights of the subsidiary or otherwise has power to govern the operating and financial policies of the other entity. Subsidiaries are reported in the financial statements of the Group from the date of acquiring control until the date at which the control ceases.

The parent company and its subsidiaries are treated as one economic entity in the consolidated financial statements. Upon consolidation, intra-group receivables and liabilities, income and expenses as well as unrealised profits and losses arising from intra-group transactions have been eliminated in full. Minority interest is reported separately.

Group companies use uniform accounting policies for similar transactions occurred under similar circumstances.

1.5. business combinations

Business combinations between independent parties are accounted for under the purchase method. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. From the date of acquisition, revenue and expenses of the acquired entity are reported in the income statement of the Group and goodwill is reported in the balance sheet of the Group.

Goodwill is the excess of the cost of acquisition over the fair value of assets acquired, reflecting the portion of the acquisition cost which was paid for such assets of the acquired entity that cannot be separated and recognised separately. Goodwill is recognised at its acquisition cost as an intangible asset at the date of acquisition.

Goodwill is subsequently measured at its acquisition cost less any impairment losses. Goodwill arising in a business combination is not amortised. Instead, an impairment test is carried out once a year. Goodwill is written down to its recoverable amount if the latter is below its carrying amount (Note 1.11).

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Transactions with minority interests
The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

1.6. associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

1.7. joint ventures

Joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at acquisition cost and subsequently adjusted by the changes that have occurred in the Group's share of the net assets under common control. The income statement of the Group includes the Group's share in the profits or losses of the entity under common control.

1.8. jointly controlled operations

Under IAS 31 "Interests in Joint Ventures", jointly controlled operations are joint operations with third parties, whereby the assets and other resources of venturers are used without the establishment of a new company or another unit or creation of a separate financial structure. Each venturer uses its own property, plant and equipment and carries its own inventories in the balance sheet. The venturer also incurs its own expenses and liabilities and raises its own funds which represent its own obligations. In respect of its interest in jointly controlled operations, a venturer recognises in its financial statements:

- the assets that it controls and the liabilities it incurs,
- the expenses that it incurs and its share of revenue that it earns from the sale of goods or services of the joint venture.

1.9. foreign currency

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia prevailing at the dates of the transactions. Monetary financial assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing at the balance sheet date. Exchange rate differences from translation are reported in the income statement of the accounting period.

The functional currency of subsidiaries located abroad is the currency of their business environment; therefore the financial statements of such subsidiaries are translated into Estonian kroons for consolidation purposes. The asset and liability items are translated using the foreign exchange rates of the Bank of Estonia, income and expenses using the weighted average foreign exchange rates for the year and other changes in equity using the foreign exchange rates at the date at which they arose. Exchange rate differences arising from translation are reported in the equity item *Currency translation differences*.

1.10. financial assets

The purchases and sales of financial assets are recognised at the trade date.

Depending on the purpose for which financial assets were acquired, financial assets are classified into the following categories at the Group:

- financial assets at fair value through profit or loss,
- loans and receivables not held for trading purposes,
- held-to-maturity investments,
- available-for-sale financial assets.

Management determines the classification of its financial assets at initial recognition.

Financial assets at fair value through profit or loss include financial assets held for trading purposes (i.e. assets acquired or created principally for the purpose of selling or repurchasing in the short term; a part of a jointly managed portfolio of financial instruments; or a derivative financial instrument which is not a hedging instrument) and other financial assets that have been designated by management at their initial recognition as at fair value through profit or loss. Assets in this category are classified as current assets if they are principally held for trading purposes or are expected to be sold within 12 months after the balance sheet date. After initial recognition, financial assets in this category are carried at fair value.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are included within current assets except for maturities greater than 12 months after the balance sheet date. Such assets are classified as non-current assets. Loans and receivables are initially recognised at their fair value less transaction costs. After initial recognition, the Group carries loans and receivables at amortised cost (less any impairment losses), calculating interest income on the receivable in the following periods using the effective interest rate method.

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information on the solvency of the party to transaction. Receivables whose collection is improbable are written down during the accounting period.

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement as part of other income. Dividends on available-for-sale equity instruments are recognised in the income statement as part of other income when the Group's right to receive payments is established.

The Group does not have any held-to-maturity financial assets. The Group does not have any derivatives.

1.11. impairment of assets

Financial assets at amortised cost
The Group assesses at each balance sheet date whether there is any indication that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (loss events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that is available to the Group regarding the following events:

- significant financial difficulties of the debtor,
- a breach of contract, such as a default or delinquency in payments,
- it is probable that the debtor will enter bankruptcy,
- the disappearance of an active market for that financial asset because of financial difficulties,
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a financial asset or a group of financial assets, although the decrease cannot yet be measured reliably.

If there is objective evidence that an impairment loss has incurred for loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have already been recognised), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Non-financial assets
Assets that have indefinite useful lives (including goodwill) are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and is compared with the carrying amount. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit). Non-financial assets other than goodwill that suffered an impairment loss are reviewed for possible reversal of impairment at each reporting date and if necessary, the impairment loss is reversed.

1.12. inventories

Inventories are recorded in the balance sheet at their acquisition cost, which consists of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition.

In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishably from each other, then the weighted average cost method is used.

Inventories are recognised in the balance sheet at the lower of acquisition cost and net realisable value. The net realisable value is the sales price less estimated costs to sell.

Expenditure incurred for real estate development is reported in the balance sheet line *Inventories* either as work-in-progress or finished goods, depending on the stage of completion. A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Sales revenue on real estate development is recognised as income from the sale of goods (Note 1.21). Upon the sale of real estate properties, a notary certified agreement is entered into between the Group and the acquirer for transferring the property and the respective entry is made in the land register.

1.13. investment property

Investment property is real estate property which is primarily held for the purpose of earning rental income or for capital appreciation or for both, but not for the production of goods or services, for administrative purposes or for sale in the ordinary course of business. Investment property is measured under the acquisition cost method, that is at acquisition cost less any accumulated depreciation and any accumulated impairment losses.

Buildings included in investment properties are depreciated on a straight-line basis over the period of 12.5 to 33.3 years. Land is not depreciated.

1.14. property, plant and equipment

An item of property, plant and equipment is an asset used for production, provision of services or administrative purposes over a period longer than one year. The acquisition cost consists of the purchase price of the asset and other expenditure incurred in bringing the asset to its operating condition and location.

An item of property, plant and equipment is carried in the balance sheet at its acquisition cost less any accumulated depreciation. Subsequent expenditure incurred for items of property, plant and equipment are recognised as non-current assets when it is probable that future economic benefits associated with the asset will flow to the Group and the cost of the asset can be measured reliably. Other repairs and maintenance costs are recognised as expenses at the time they are incurred.

Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years,
- machinery and equipment 3-5 years,
- other items of property, plant and equipment 2.5-5 years,
- right of superficies 50 years.
  Land is not depreciated.

At each balance sheet date, the validity of applied depreciation rates, the depreciation method and the residual values applicable to assets is assessed.

Non-current assets are written down to their recoverable amount if the latter is below its carrying amount. The recoverable amount is the higher of the asset's net selling price and its value in use.

1.15. other intangible assets

Other intangible assets (development costs, patents, licenses, trademarks, software) are recognised in the balance sheet when the asset is controlled by the Group, it gives rise to future economic benefits and the cost of the asset can be measured reliably. The acquisition cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Other intangible assets are carried in the balance sheet at acquisition cost less any accumulated amortisation. Amortisation is calculated on a straight-line basis over the estimated useful lives of assets, which is a maximum of 5 years.

1.16. finance and operating leases

Leases of property, plant and equipment which transfer all significant risks and rewards of ownership to the lessee are classified as finance leases. All other leases are recognised as operating leases.

Assets and liabilities leased under the finance lease terms are reported in the balance sheet at the lower of fair value of the leased asset and the present value of minimum rental payments. Items of property, plant and equipment leased under the finance lease terms are depreciated over the shorter of the lease term and the useful life.

Finance lease liabilities are reduced by principal payments; interest expenses on lease payments are included within financial expenses in the income statement.

Operating lease payments are reported in the income statement as expenses on an accrual basis over the lease term.

1.17. corporate income tax

According to the Income Tax Act of the Republic of Estonia, legal entities are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, reception costs, dividends and payments not related to business operations. Thus there are no differences between the tax bases and the carrying values of assets which would give rise to a deferred income tax asset or liability. Starting from 01.01.2007 the tax rate on dividends payable is 22/78 (in 2006: 23/77; 2005: 24/76) of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared.

Corporate income tax on profits and deferred income tax expense or income of the subsidiaries located in Latvia and Lithuania as well as corporate income tax on dividends of Estonian companies are reported in the consolidated income statement.

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the balance sheet. Deferred tax assets are recognised in the Group's balance sheet if their future realisation is probable.

Legal entities in Latvia and Lithuania that belong to the Group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia and the Republic of Lithuania. The profits of entities located in the Republic of Latvia are taxed at the rate of 15%, the profits of entities located in the Republic of Lithuania are taxed at the rate of 15%+4% in 2006 and 15%+3% in 2007.

1.18. borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost, calculating interest income on the borrowing in subsequent periods using the effective interest rate method.

Borrowings are classified as current when the borrower does not have a right to pay off the loan later than 12 months after the balance sheet date.

Borrowing costs are recognised as an expense in the period in which they are incurred.

1.19. employee benefits

Termination benefits. Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of another offer made to encourage voluntary redundancy. Benefits due more than 12 months after the balance sheet date are discounted to present value.

Profit-sharing and bonus plans. The Group recognises a liability and an expense for bonuses and profit-sharing, based on formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a provision where contractually obliged or when there is past practice that has created a constructive obligation.

1.20. provisions

Provisions are constructive or legal obligations which arise as a result of events occurring before the balance sheet date. Setting up of provisions or increasing existing provisions is recognised as expenses in the income statement of the accounting period.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

Pursuant to respective building acts, the construction companies of the Group provide 2-year warranties on their buildings. The calculation of warranty provisions is based on management estimates and previous periods' experience with regard to actual warranty expenses.

The expected loss arising from construction contracts is immediately recognised as an expense. A provision is recognised for onerous construction contracts which have not been completed yet (Note 1.22).

1.21. revenue

Revenue is recognised at the fair value of the consideration received or receivable.

Revenue from construction service is recognised as revenue by reference to the stage of completion of the contract (see Note 1.22) in accordance with IAS 11 "Construction Contracts". Revenue from own real estate development projects (developed on immovables belonging to Merko Ehitus group) is recognised as revenue in accordance with IAS 18 "Revenue" when significant risks and rewards of ownership of the goods are transferred to the buyer, the receipt of payment is probable and the costs incurred in respect of the transaction can be measured reliably and it is probable that future economic benefits associated with the transaction will flow to the entity.

When goods are sold or swapped in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Revenue from the provision of services is recognised based on the stage of completion of the service at the balance sheet date.

Revenue arising from interest and dividends is recognised when it is probable that future economic benefits associated with the transaction will flow to the entity and the amount of the revenue can be measured reliably.

1.22. construction contracts in progress

Income and expenses of construction contracts in progress have been matched under the stage of completion method. The stage of completion is determined on the basis of the relationship between the actual costs incurred by the balance sheet date and the estimated costs of the contract. The actual costs of the contract consist of direct and certain overhead costs of the construction contact.

If invoices submitted to the customer by the balance sheet date are either higher or lower than the income calculated under the stage of completion method, then the difference is recognised as a liability or as a receivable in the balance sheet.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately and in full.

1.23. government grants

Government grants are recognised as income over the periods necessary to match them with the related costs, which they are intended to compensate. Government grants received to compensate the operating expenses of the previous period or where there are no additional conditions attached to grants to be addressed in the future, are accounted for as income when the grant is received. Government grants are recognised when there is reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

1.24. cash and cash equivalents

In the balance sheet and the cash flow statement, cash and cash equivalents comprise highly liquid funds with low variation in value, such as cash on hand, cash in bank accounts, highly liquid securities such as money market funds and term deposits with maturities of three months or less.

The indirect method has been used for the preparation of the cash flow statement.

1.25. contingent liabilities

Contingent liabilities are those liabilities which realisation is less probable than non-realisation and the amount of which cannot be determined reliably. Contingent liabilities are not recognised in the balance sheet, but they are disclosed in the notes to the financial statements.

1.26. statutory reserve capital

Reserve capital is formed to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be entered in reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

1.27. events after the balance sheet date

The financial statements of the reporting period include material circumstances affecting the assessment of assets and liabilities which became evident between the balance sheet date and the date of preparing the financial statements but that are related to transactions in the accounting period or previous periods. Material events after the balance sheet date not related to transactions in the accounting period or previous periods are not reported in the balance sheet but they are disclosed in the notes to the financial statements.

1.28. dividend distribution

The distribution of dividends to the Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

1.29. segment reporting

A business segment is a part of the Group engaged in making similar products or providing similar services and whose profitability and risks differ from those of other parts of the Group. The business segments at the Group comprise construction, road construction, construction of communication networks and production of concrete elements. Segment expenses are those which are incurred in the segment's main operations and which can be allocated to the segment reliably and objectively. Such expenses, assets and liabilities have not been allocated to segments that cannot be or are not suitable to be associated with a specific segment. In preparing the financial statements, business segments have been considered as primary segments.

A geographical segment is a part of the Group where operating activities occur in an economic environment in which returns and risks differ from those of other parts of the Group. The main geographical segments at the Group are Estonia, Latvia and Lithuania. In preparing the financial statements, geographical segments have been considered as secondary segments.

The main operating environment of the parent company is Estonia. All business segments of the Group are represented in Estonia. Construction is the main business segment in Latvia and Lithuania. Segment revenue is shown according to geographical segments of markets and segment assets, according to geographical locations of assets.

note 2 business and geographical segments

business segments

2006 *in thousands of kroons*	General construction	Road construction	Concrete elements	Group
Consolidated revenue	**4,097,263**	**317,098**	**-**	**4,414,361**
Inter-segmental revenue	377,656	104,117	-	481,773
Segment revenue	4,474,919	421,215	-	4,896,134
Segment operating profit	**596,374**	**36,497**	**-**	**632,871**
Financial income/expenses				7,733
incl. profit/loss from associates and joint ventures (Note 19)	(416)	-	17,877	17,461
Profit before tax				640,604
Corporate income tax				(49,913)
Net profit of the Group				**590,691**
incl. attributable to equity owners of the parent company				581,738
minority interest				8,953
Segment assets	2,772,635	187,047	-	2,959,682
Associates and joint ventures	160,619	-	40,179	200,798
Unallocated assets				54,049
Total consolidated assets				**3,214,529**
Segment liabilities	1,033,996	63,825	-	1,097,821
Unallocated liabilities				503,862
Total consolidated liabilities				**1,601,683**
Purchase of property, plant and equipment and intangible assets	80,654	12,510	-	93,164
Depreciation and impairment (Notes 22-24)	22,377	8,370	-	30,747

2005 *in thousands of kroons*	General construction	Road construction	Concrete elements	Construction of communication networks	Group
Consolidated revenue	**3,028,386**	**204,006**	**-**	**-**	**3,232,392**
Inter-segmental revenue	4,773	34,338	-	-	39,111
Segment revenue	3,033,159	238,344	-	-	3,271,503
Segment operating profit	**416,770**	**18,281**	**-**	**-**	**435,051**
Financial income/expenses					28,673
incl. profit/loss from associates and joint ventures (Note 19)	5,839	1,924	10,660	1,209	19,632
Profit before tax					463,724
Corporate income tax					(18,437)
Net profit of the Group					**445,287**
incl. attributable to equity owners of the parent company					438,638
minority interest					6,649
Segment assets	1,856,012	121,555	-	-	1,977,567
Associates and joint ventures	150,773	-	25,302	3,534	179,609
Unallocated assets					62,700
Total consolidated assets					**2,219,876**
Segment liabilities	715,238	37,671	-	-	752,909
Unallocated liabilities					355,019
Total consolidated liabilities					**1,107,928**
Purchase of investment property	63	-	-	-	63
Purchase of property, plant and equipment and intangible assets	227,228	9,015	-	-	236,243
Depreciation and impairment (Notes 22-24)	99,525	10,112	-	-	109,637

Costs, assets and liabilities that cannot be related to a specific asset or it is not practical to do so are considered as unallocated.

note 2 business and geographical segments (continued)

geographical segments

Revenue

in thousands of kroons	**2006**	**2005**
Estonia	2,794,317	2,441,325
Latvia	1,055,632	560,107
Lithuania	564,412	230,960
Total	**4,414,361**	**3,232,392**

	Total assets		**Purchase of investment property**		**Purchase of property, plant and equipment**	
in thousands of kroons	**31.12.2006**	**31.12.2005**	**2006**	**2005**	**2006**	**2005**
Estonia	1,700,964	1,033,085	-	39	27,018	20,440
Latvia	1,244,312	991,929	-	24	65,699	215,356
Lithuania	269,253	194,862	-	-	447	447
Total	**3,214,529**	**2,219,876**	**-**	**63**	**93,164**	**236,243**

note 3 revenue

in thousands of kroons	**2006**	**2005**
Rendering of services	3,535,810	2,751,778
Sale of real estate and real estate development projects	831,490	475,748
Rental income	45,272	2,354
Sale of goods	1,789	2,512
Total revenue	**4,414,361**	**3,232,392**

In 2005, revenue included 86.3 million kroons generated by non-cash inventory exchange transactions (immovables located on nature preserve areas were exchanged with the Government of the Republic of Estonia for non-restricted immovables owned by the state). In 2006, there were no non-cash transactions with inventories.

note 4 cost of goods sold

in thousands of kroons	**2006**	**2005**
Materials	369,094	367,736
Construction services	2,592,026	1,934,926
Properties purchased for resale	215,889	78,303
Staff costs	247,902	152,619
Depreciation and impairment charge	25,098	15,253
Design	72,851	72,115
Construction mechanisms and transport	108,629	82,951
Other expenses	96,072	34,811
Total cost of goods sold	**3,727,561**	**2,738,714**

note 5 marketing costs

in thousands of kroons	**2006**	**2005**
Staff costs	9,407	11,651
Depreciation and impairment charge	356	253
Advertising, sponsorship	9,015	5,017
Transport	1,268	1,256
Construction tenders	900	918
Other expenses	2,444	3,500
Total marketing costs	**23,390**	**22,595**

note 6 general and administrative expenses

in thousands of kroons	**2006**	**2005**
Staff costs	95,827	72,967
Depreciation and impairment charge	5,293	4,793
Computer equipment and information services	7,080	10,413
Transport	6,820	5,677
Offices expenses, communications services	16,701	14,638
Other expenses	17,071	19,144
Total general and administrative expenses	**148,792**	**127,632**

note 7 other operating income

in thousands of kroons	**2006**	**2005**
Profit from sale of non-current assets	122,403	535
Fines and amounts for delay received	1,223	971
Foreign exchange gains	-	16
Interest income from operating activities	2,335	5,590
Revenue from government grants (Note 28)	20,727	177,333
Other income	1,517	607
Total other operating income	**148,205**	**185,052**

Profit from sale of non-current assets in 2006 include the profit from the sale of multifunctional hall Arena Riga by subsidiary SIA Merks in the amount of 122 053 thousand kroons (Note 23).

note 8 other operating expenses

in thousands of kroons	**2006**	**2005**
Fines, penalties	1,339	2,790
Foreign exchange loss	10	-
Gifts, donations	4,674	904
Impairment charge (Note 23)	-	89,338
Expenses of arranging ice-hockey world championship	22,522	-
Other expenses	1,407	420
Total other operating expenses	**29,952**	**93,452**

note 9 financial income

in thousands of kroons	**2006**	**2005**
Financial income from other long-term loans and receivables	7	11
Interest income	6,462	1,470
Gains from available-for-sale financial assets	618	3
Other financial income	1,216	4,769
Total financial income	**8,303**	**6,253**

note 10 financial expenses

in thousands of kroons	**2006**	**2005**
Interest expenses	14,288	2,418
Foreign exchange loss	6,064	2,277
Other financial expenses	1	15
Total financial expenses	**20,353**	**4,710**

note 11 corporate income tax

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate applicable to profits of the consolidated entities as follows:

2006

in thousands of kroons	Latvia	Lithuania	Estonia	Total
Profit before tax	271,450	25,031	344,127	640,608
Tax rate applicable to profits	15%	19%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(40,717)	(4,756)	-	(45,473)
Tax calculated on expenses not deductible for tax purposes	(49)	(91)	-	(140)
Tax calculated on income not subject to tax	1,295	17	-	1,312
Corporate income tax on dividends	-	-	(5,616)	(5,616)
Tax charge	**(39,471)**	**(4,830)**	**(5,616)**	**(49,917)**
incl. current tax	(18,925)	-	(5,616)	(24,541)
deferred tax charged/(credited) to the income statement (Note 21)	(20,546)	(4,830)	-	(25,376)

2005

in thousands of kroons	Latvia	Lithuania	Estonia	Total
Profit before tax	91,113	17,252	355,359	463,724
Tax rate applicable to profits	15%	19%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(13,667)	(2,588)	-	(16,255)
Tax calculated on expenses not deductible for tax purposes	(570)	(477)	-	(1,047)
Tax calculated on income not subject to tax	-	1,243	-	1,243
Tax losses for which no deferred income tax asset was recognised	-	6,452		6,452
Corporate income tax on dividends	-	-	(8,830)	(8,830)
Tax charge	**(14,237)**	**4,630**	**(8,830)**	**(18,437)**
incl. current tax	(2,852)	-	(8,830)	(11,682)
deferred tax charged/(credited) to the income statement	(11,385)	4,630	-	(6,755)

As at 31.12.2006, it is possible to pay out dividends to shareholders from retained earnings in the amount of 1 091 409 thousand kroons and the corresponding income tax would amount to 307 833 thousand kroons. As at 31 December 2005 (taking into account the statutory requirement to increase the statutory reserve capital), it would have been possible to pay out 698 156 thousand kroons as dividends, and the corresponding income tax would have amounted to 208 540 thousand kroons.

note 12 earnings per share

Basic earnings per share for profit attributable to equity holders of the parent company has been derived by dividing the net profit attributable to shareholders by the weighted average number of shares.

	2006	2005
Net profit attributable to shareholders (in thousands of kroons)	581,738	438,638
Weighted average number of ordinary shares (thousand pcs)	17,700	17,700
Earnings per share (in kroons)	**32.87**	**24.78**

In 2005 and 2006, the Group did not have any potential ordinary shares to be issued; therefore the diluted earnings per share equal the basic earnings per share.

note 13 dividends per sharea

Dividends payable are recognised after the approval of profit allocation at the General Meeting of Shareholders. According to the profit allocation proposal 123 900 thousand kroons will be distributed as dividends in 2007, i.e. 7.00 kroons per share and the accompanying maximum income tax expense will amount to 22/78 of the amount payable, i.e. 34 946 thousand kroons.

In 2006, 88 500 thousand kroons, i.e. 5.0 kroons per share were paid, on which AS Merko Ehitus did not need to pay corporate income tax due to the taxable dividends received from subsidiaries. In 2005, dividends paid amounted to 57 525 thousand kroons, i.e. 6.50 kroons per share, on which income tax amounted to 4446 thousand kroons.

note 14 cash and cash equivalents

in thousands of kroons	**31.12.2006**	**31.12.2005**
Cash on hand	155	97
Bank accounts	437,456	135,577
Short-term deposits	238,532	121,258
Units of Estonian money market funds	-	11,514
Total cash and bank	**676,143**	**268,446**

As at 31.12.2006, the interest on short-term overnight bank deposits was 3.37% (31.12.2005: 2.15%) and the weighted average interest on term deposits was 3.85% (2005: 2.5%). As at 31.12.2006, the average maturity of bank deposits was 25.6 days (31.12.2005: 7.6 days).

note 15 trade and other receivables

in thousands of kroons	**31.12.2006**	**31.12.2005**
Trade receivables		
accounts receivable	552,732	296,626
allowance for doubtful receivables	(1,370)	(345)
Total trade receivables	**551,362**	**296,281**
Corporate income tax paid		
value added tax	32,183	34,193
social security tax	171	6
other taxes	199	-
Total corporate income tax paid	**32,553**	**34,199**
Amounts due from customers for contract work (Note 33)	**135,408**	**82,224**
Other short-term receivables		
short-term loans (Note 16)	34,883	49,481
interest receivables	2,913	1,846
other short-term receivables	1,549	6,026
Total other short-term receivables	**39,345**	**57,353**
Prepayments for services		
prepayments for construction services	86,326	68,357
prepaid insurance	2,245	1,062
other prepaid expenses	6,864	2,634
Total prepayments for services	**95,435**	**72,053**
Total trade and other receivables	**854,103**	**542,110**

note 16 loans granted

in thousands of kroons	**2006**	**2005**
Loans granted to associates		
Loan balance at beginning of the year	21,325	49,155
Granted	10,950	28,005
Collected	(7,525)	(37,440)
Reclassification to loan granted to subsidiary	-	(18,395)
Loan balance at end of the year	24,750	21,325
incl. current portion	24,750	21,325
Average effective interest rate 6.5% (2005: 6.2%).		
Loans granted to entities controlled by the parent company		
Loan balance at beginning of the year	6,565	5,991
Granted	264,286	83,243
Reclassification of loan granted to subsidiary	2,046	31,183
Reclassification of loan granted to related party	1,473	-
Collected	(261,670)	(66,183)
Loan balance at beginning of the year	-	(47,669)
Loan balance at end of the year	12,700	6,565
incl. current portion	8,896	6,565
non-current portion 2...5 years	3,804	-
Average effective interest rate 4.5% (2005: 4.0%).		
Loans granted to other related parties		
Loan balance at beginning of the year	1,973	380
Granted	-	1,593
Collected	(500)	-
Reclassification to loan granted to entities controlled by the parent company	(1,473)	-
Loan balance at end of the year	-	1,973
incl. current portion	-	500
non-current portion 2...5 years	-	1,473
Average effective interest rate 4.5% (2005: 1.0%).		
Loans granted to non-related legal entities		
Loan balance at beginning of the year	20,930	17,754
Granted	117	76,860
Reclassification from other receivables	1,009	-
Collected	(16,906)	(72,678)
Reclassification to other receivables	(3,973)	(1,006)
Loan balance at end of the year	1,177	20,930
incl. current portion	1,177	20,679
non-current portion 2...5 years	-	251
Average effective interest rate 4.0% (2005: 3.5%).		
Loans to other non-related private individuals		
Loan balance at beginning of the year	412	-
Granted	-	422
Collected	(352)	(10)
Loan balance at end of the year	60	412
incl. current portion	60	412
Average effective interest rate 3.7% (2005: 3.7%).		

note 16 loans granted (continued)

in thousands of kroons	2006	2005
Total loans granted		
Loan balance at beginning of the year	51,205	73,280
Granted	275,353	190,123
Reclassification of loan granted to subsidiary	2,046	31,183
Reclassification from other receivables	1,009	-
Collected	(286,953)	(176,311)
Reclassification to loan granted to subsidiary	-	(66,064)
Reclassification to other receivables	(3,973)	(1,006)
Loan balance at end of the year	**38,687**	**51,205**
incl. current portion (Note 15)	34,883	49,481
non-current portion 2...5 years (Note 20)	3,804	1,724

note 17 inventories

in thousands of kroons	31.12.2006	31.12.2005
Materials	4,579	1,845
Work-in-progress	567,868	200,482
Finished goods	18,121	4,461
Goods for resale		
Land purchased for resale	723,334	752,789
incl. immovables located on nature preserve areas*	61,098	53,625
Other goods purchased for resale	107	11
Total goods for resale	**723,441**	**752,800**
Prepayments for inventories		
Prepayments for real estate properties	34,767	4,500
Prepayments for other inventories	7,958	-
Total prepayments for inventories	42,725	4,500
Total inventories	**1,356,734**	**964,088**

** There are strict building restrictions on immovables located on nature preserve areas. These immovables can be used for real estate development only by exchanging these with the Government of the Republic of Estonia. According to Nature Conservation Act an immovable which is located within the territory of a protected area, special conservation area or species protection site and whose use for its intended purposes is significantly hindered by the protection procedure may be exchanged for an immovable owned by the state based on an agreement between the state and the owner of the immovable, or may be acquired (based on a decision of the Government of the Republic of Estonia) by the state for a charge equivalent to the usual value of the immovable if the owner of the immovable agrees (§ 19 and 20 of Nature Conservation Act).*

The management of the Group is on the opinion that Estonian legislation at the date of signing this annual report allows to exchange those immovables for other, unrestricted immovables (with at least similar value) with the Republic of Estonia, and consequently the Group has not assumed any significant risks which would trigger the need for impairment of the immovables referred to above.

note 18 shares in subsidiaries

subsidiaries of as merko ehitus

	Participation and voting rights %			
	31.12.2006	31.12.2005	Location	Area of operation
AS Gustaf	75	100	Pärnu	construction
AS Merko Tartu	66	66	Tartu	construction
AS Merko Insenerehitus	100	100	Tallinn	construction
OÜ Merko Ehitustööd	100	100	Tallinn	construction
Eesti Ehitusekspordi OÜ	100	100	Tallinn	construction
Tallinna Teede AS	100	100	Tallinn	road construction
SIA Merks	100	100	Republic of Latvia, Riga	construction
UAB Merko Statyba	100	100	Republic of Lithuania, Vilnius	construction
OÜ Merko Elamu	100	100	Tallinn	real estate
OÜ Merko Maja	100	100	Tallinn	real estate
OÜ Merko Kinnisvara	-	100	Saue	real estate
OÜ Woody	100	100	Tallinn	real estate
OÜ Gustaf Tallinn	80	80	Tallinn	construction
OÜ Rannamõisa Kinnisvara	-	100	Tallinn	real estate
OÜ Maavõlur	100	100	Tallinn	real estate
OÜ Rae Tehnopark	100	100	Tallinn	real estate
OÜ Maryplus	100	100	Tallinn	real estate
OÜ Metsailu	100	100	Tallinn	real estate
OÜ Pire Projekt	100	100	Tallinn	real estate
OÜ Constancia	100	100	Tallinn	real estate
OÜ Käibevara	100	100	Tallinn	real estate
OÜ Baltic Electricity Engineering	100	100	Tallinn	electricity systems

In May 2006, AS Merko Ehitus sold its subsidiary OÜ Merko Kinnisvara which had not started its operating activities yet. In July 2006, AS Merko Ehitus sold 25% of the shares of its subsidiary AS Gustaf.

In December 2006, AS Merko Ehitus sold its subsidiary OÜ Rannamõisa Kinnisvara to a related party (see Note 34). In accordance with the substance and economic reality (subsidiary was a one-asset-company; assets comprised of land purchased for resale), the sales transaction was recognised as a sale of land included within inventories at the Group.

In 2006, Merko Ehitus group companies paid 3029 thousand kroons for shares in subsidiaries acquired during previous years.

proceeds from sales of subsidiaries

in thousands of kroons	OÜ Merko Kinnisvara	AS Gustaf	Total
Participations sold	100%	25%	
Carrying amount of participations sold	42	2,801	2,843
Sales price	40	5,125	5,165
Profit from sale	**2**	**2,324**	**2,326**
Cash received	40	-	40
Cash and cash equivalents of subsidiary from sale	(42)	-	(42)
Cash flows from sale at the Group	(2)	-	(2)
Sales consideration receivable (Note 20)	-	4,624	4,624

note 19 investments into associates and joint ventures

	Participation and voting rights % 31.12.2006	31.12.2005	Location	Area of operation
Associates of AS Merko Ehitus				
AS Tartu Maja Betoontooted	25	25	Tartu	concrete elements
AS Telegrupp	-	31	Tallinn	telecommunications
Joint ventures of AS Merko Ehitus				
Normanni Linnagrupi AS	50	50	Tallinn	construction
OÜ Unigate	50	50	Tallinn	real estate
OÜ Tornimäe Apartments	50	50	Tallinn	real estate
Joint ventures of SIA Merks				
PS Merks Terbe Lat	50	50	Republic of Latvia, Riga	construction
SIA Zakusala Estates	50	50	Republic of Latvia, Riga	real estate
Associate of AS Merko Tartu				
OÜ Kortermaja	50	50	Tartu	real estate

In February 2006, AS Merko Ehitus sold a 12% holding in its associate AS Telegrupp. The remaining 19% holding was recognised as available-for-sale financial assets and the total holding was sold in July of the same year.

in thousands of kroons	Investment at 31.12.2005	Changes occurred in 2006: Acquisition, sale and liquidation	Profit (loss) from acsociates and jointventures	Dividends	Currency translation adjustment	Investment 31.12.2006	Participation in equity of investee
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	25,302	-	17,877	(3,000)	-	40,179	40,179
AS Telegrupp	3,534	(4,233)	699	-	-	-	-
Total associates	**28,836**	**(4,233)**	**18,576**	**(3,000)**	**-**	**40,179**	**40,179**
Joint ventures of AS Merko Ehitus							
Normanni Linnagrupi AS	422	-	(9)	-	-	413	413
OÜ Unigate	92	-	(70)	-	-	22	22
OÜ Tornimäe Apartments	24	-	98	-	-	122	122
Joint ventures of SIA Merks							
PS Merks Terbe Lat	12	-	396	-	(2)	406	406
SIA Zakusala Estates	148,319	11,238	(1,939)	-	(275)	157,343	10,191
Joint venture of AS Merko Tartu							
OÜ Kortermaja	1,904	-	409	-	-	2,313	4,160
Total joint ventures	**150,773**	**11,238**	**(1,115)**	**-**	**(277)**	**160,619**	**15,314**
Total associates and joint ventures	**179,609**	**7,005**	**17,461**	**(3,000)**	**(277)**	**200,798**	**55,493**

note 19 investments into associates and joint ventures (continued)

in thousands of kroons	Investment at 31.12.2004	Changes in 2005: Acquisition, sale and liquidation	Changes in 2005: Profit (loss) from associates and joint venture	Changes in 2005: Dividends	Changes in 2005: Currency translation adjustment	Investment 31.12.2005	Participation in equity of investee
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	16,142	-	10,660	(1,500)	-	25,302	25,302
AS Telegrupp	6,292	(2,257)	1,209	(1,710)	-	3,534	3,534
Associate of OÜ Talbit							
AS Bituumen	3,627	(5,550)	1,923	-	-	-	-
Total associates	**26,061**	**(7,807)**	**13,792**	**(3,210)**	**-**	**28,836**	**28,836**
Joint ventures of AS Merko Ehitus							
Normanni Linnagrupi AS	389	-	33	-	-	422	422
AS Insenervõrgud	623	(499)	(124)	-	-	-	-
OÜ Pire Projekt	849	(5,800)	4,951	-	-	-	-
OÜ Constancia	760	(1,384)	624	-	-	-	-
OÜ Unigate	412	-	(320)	-	-	92	92
OÜ Tornimäe Apartments	19	-	5	-	-	24	24
Joint ventures of SIA Merks							
PS Merks Terbe Lat	5,100	-	-	(5,099)	11	12	(4)
SIA Zakusala Estates	-	148,319	-	-	-	148,319	910
Joint venture of AS Merko Tartu							
OÜ Kortermaja	1,233	-	671	-	-	1,904	2,012
Total joint ventures	**9,385**	**140,636**	**5,840**	**(5,099)**	**11**	**150,773**	**3,456**
Total associates and joint ventures	**35,446**	**132,829**	**19,632**	**(8,309)**	**11**	**179,609,**	**32,292**

As at 31.12.2006, the difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee totalling 1847 thousand kroons (2005: 108 thousand kroons) is due to the effect from the unrealised gains of mutual transactions.

As at 31.12.2006, the investment into the joint venture SIA Zakusala Estates includes intangible assets in the amount of 147 152 thousand kroons (2005: 147 409 thousand kroons). The assets and liabilities of the joint venture are immaterial, but it has a signed a lease agreement with the City of Riga expiring at 2 June 2051 which gives it a right to use the 126 thousand m^2 registered immovable on Zakusala island in the centre of Riga. This intangible asset represents a payment for future economic benefits that arise from the aforementioned right to use the property.

note 19 investments into associates and joint ventures (continued)

Associates

in thousands of kroons	Assets 31.12.	Liabilities 31.12.	Revenue	Net profit
2006				
AS Tartu Maja Betoontooted	272,892	112,176	442,962	71,508
2005				
AS Tartu Maja Betoontooted	244,556	143,348	249,750	42,629
AS Telegrupp	25,139	13,700	76,923	1,257

Joint ventures	Assets 31.12.		Liabilities 31.12.					
in thousands of kroons	Current assets	Non-current assets	Current	Non-current	Equity 31.12.	Income	Expenses	Net profit/ loss
2006								
Normanni Linnagrupi AS	826	-	-	-	826	56	73	(17)
OÜ Unigate	25,488	-	13,260	12,184	44	-	139	(139)
OÜ Tornimäe Apartments	204,795	-	204,568	-	227	195	17	178
PS Merks Terbe Lat	811	-	8	-	802	884	73	811
SIA Zakusala Estates	11,810	8,870	299	-	20,381	187	4,063	3,876
OÜ Kortermaja	54,084	-	14,124	31,638	8,322	27,772	23,474	4,298
2005								
Normanni Linnagrupi AS	1,399	-	-	555	844	11,084	11,018	66
AS Insenervõrgud	-	-	-	-	-	6	252	(246)
OÜ Pire Projekt	-	-	-	-	-	25,367	15,465	9,902
OÜ Constancia	-	-	-	-	-	14,502	13,254	1,248
OÜ Unigate	18,940	-	15,055	3,701	184	6	647	(641)
OÜ Tornimäe Apartments	158,184	-	105,617	52,518	49	21	11	10
PS Merks Terbe Lat	921	-	928	-	(7)	5	34	(29)
SIA Zakusala Estates	1,524	1,122	825	-	1,821	3,151	5,159	(2,008)
OÜ Kortermaja	16,635	-	12,611	-	4,024	17,804	16,543	1,261

note 20 other long-term loans and receivables

in thousands of kroons	31.12.2006	31.12.2005
Long-term loans (Note 16)	3,804	1,724
Long-term receivable from buyer of business unit*	-	6,800
Long-term receivable from the acquirer of a subsidiary (Note 18)**	4,624	-
Long-term receivables from customers of construction services	48	-
Total other long-term loans and receivables	**8,476**	**8,524**

** In 2004, Tallinna Teede AS sold a project management and supervision unit of related road maintenance works. As at 31.12.2006, the payable had been paid by the buyers.*
*** In 2006, AS Merko Ehitus sold 25% of the shares of the subsidiary AS Gustaf. The receivable is discounted at a 5% interest rate.*

note 21 deferred income tax assets and liabilities

Income tax assets and liabilities arisen at the subsidiaries SIA Merks and UAB Merko Statyba:

in thousands of kroons	31.12.2006 Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	2,669	3,923	6,592
incl. tax loss carryforwards	-	3,062	3,062
effect of carrying amount of property, plant and equipment	2,669	-	2,669
effect of stage of completion method	-	443	443
other	-	418	418
Net deferred income tax assets /(liabilities)	**2,669**	**3,923**	**6,592**
Deferred income tax charge of the financial year (Note 11)	20,546	4,830	25,376
Reclassification*	(34,600)	-	(34,600)
Net change in deferred tax balance	**(14,054)**	**4,830**	**(9,224)**

	31.12.2005 Latvia	Lithuania	Total
Deferred income tax liability*	34,600	-	34,600
incl. effect of difference between fair value and carrying amount of real estate inventories	34,600	-	34,600
Deferred income tax assets	23,215	8,753	31,968
incl tax loss carryforwards	-	8,351	8,351
effect of carrying amount of property, plant and equipment	20,608	-	20,608
effect of other provisions	1,682	-	1,682
other	925	402	1,327
Net deferred income tax assets /(liabilities)	**(11,385)**	**8,753**	**(2,632)**

** The effect of difference between fair value and carrying amount of real estate inventories (in 2005 in Latvia in the amount of 34 600 thousand kroons) was reclassified from deferred tax liability to actual tax liability in 2006 due to changes in management estimates, and the amount was paid to State Revenue Service in Latvia in 2006.*

In Lithuania tax losses can be carried forward for 5 years and the management considers it likely that respective tax losses will be utilized against future profits.

note 22 investment property

in thousands of kroons	Land	Buildings	Prepayments	Total
Cost at 31.12.2004	56,919	4,172	1,427	62,518
Accumulated depreciation at 31.12.2004	-	(1,129)	-	(1,129)
Carrying amount at 31.12.2004	**56,919**	**3,043**	**1,427**	**61,389**
Acquisitions	63	-	-	63
Reclassification	(21,348)	4,254	(1,427)	(18,521)
Depreciation charge	-	(425)	-	(425)
Carrying amount at 31.12.2005	**35,634**	**6,872**	**-**	**42,506**
Cost at 31.12.2005	35,634	8,959	-	44,593
Accumulated depreciation at 31.12.2005	-	(2,087)	-	(2,087)
Carrying amount at 31.12.2005	**35,634**	**6,872**	**-**	**42,506**
Write-offs	-	(2,331)	-	(2,331)
Reclassification	(33,500)	(2,432)	-	(35,932)
Depreciation charge	-	(343)	-	(343)
Carrying amount at 31.12.2006	**2,134**	**1,766**	**-**	**3,900**
Cost at 31.12.2006	2,134	2,589	-	4,723
Accumulated depreciation at 31.12.2006	-	(823)	-	(823)
Carrying amount at 31.12.2006	**2,134**	**1,766**	**-**	**3,900**

note 22 investment property (continued)

At 31.12.2006, the carrying amount of the investment property does not significantly differ from their fair values (31.12.2005: the fair value was 110 442 thousand kroons).

In 2006, the Group reclassified land in the amount of 33 500 thousand kroons from investment property into inventories, and reclassified buildings to property, plant and equipment in the amount of 2432 thousand kroons. Write-offs in the amount of 2331 thousand kroons relate to the pulling down of useless buildings.

In 2005 the Group reclassified a land in the amount of 21 348 thousand kroons and a prepayment in the amount of 1427 thousand kroons into inventory. Also a part of a building being leased out was reclassified from property, plant and equipment (PPE) to Investment Property, the reclassification amounted to 4254 thousand kroons.

Investment property has not been acquired for the purpose of earning rental income but for capital appreciation or development in the future. Buildings located on the plot of land have been temporarily leased out under the operating lease terms. Rental income receivable, maintenance costs incurred and improvement expenses are immaterial.

note 23 property, plant and equipment

in thousands of kroons	Land	Buildings	Right of superficies	Machinery and equipment	Other	Construction in progress	Prepayments	Total
Cost at 31.12.2004	145	7,020	458	81,389	35,090	65,027	872	190,001
Accumulated depreciation at 31.12.2004	-	(2,549)	(67)	(33,503)	(19,501)	(54,993)	(872)	(111,485)
Carrying amount at 31.12.2004	**145**	**4,471**	**391**	**47,886**	**15,589**	**10,034**	**-**	**78,516**
Foreign exchange rate changes	-	-	-	-	(2)	(8)	-	(10)
Acquisitions	-	-	-	10,968	10,504	209,350	1,394	232,216
Sales	-	-	-	(1,102)	(506)	-	-	(1,608)
Reclassification	-	8,384	-	-	-	(12,639)	(124)	(4,379)
Write-offs	-	-	-	(76)	(201)	-	-	(277)
Depreciation charge	-	(447)	(9)	(8,794)	(6,866)	-	-	(16,116)
Impairment charge	-	-	-	-	-	(89,338)	-	(89,338)
Carrying amount at 31.12.2005	**145**	**12,408**	**382**	**48,882**	**18,518**	**117,399**	**1,270**	**199,004**
Cost at 31.12.2005	145	14,872	458	88,070	42,794	260,100	1,270	407,709
Accumulated depreciation at 31.12.2005	-	(2,464)	(76)	(39,188)	(24,276)	(142,701)	-	(208,705)
Carrying amount at 31.12.2005	**145**	**12,408**	**382**	**48,882**	**18,518**	**117,399**	**1,270**	**199,004**
Foreign exchange rate changes	-	-	-	-	20	4	-	24
Acquisitions	-	8,042	-	12,893	34,151	29,841	1,510	86,437
Sales	-	(142,592)	-	(586)	(25,137)	-	-	(168,315)
Reclassification	-	143,670	-	(440)	6,740	(146,691)	(2,780)	499
incl. to non-current assets available for sale	-	-	-	(733)	-	-	-	(733)
Write-offs	-	-	-	(3)	(165)	-	-	(168)
Depreciation charge	-	(6,282)	(10)	(9,476)	(11,268)	-	-	(27,036)
Carrying amount at 31.12.2006	**145**	**15,246**	**372**	**51,270**	**22,859**	**553**	**-**	**90,445**
Cost at 31.12.2006	145	18,682	458	92,430	51,257	553	-	163,525
Accumulated depreciation at 31.12.2006	-	(3,436)	(86)	(41,160)	(28,398)	-	-	(73,080)
Carrying amount at 31.12.2006	**145**	**15,246**	**372**	**51,270**	**22,859**	**553**	**-**	**90,445**

Impairment charge during 2005 in the amount of 89 338 thousand kroons related to multifunctional hall Arena Riga. Considering the experience in neighbouring countries, where the recoverable amount of multifunctional halls established has been lower than the constructions cost, the management carried out the impairment test of the Arena Riga in order to assess the recoverable amount of the hall as at 31.12.2005. Taking into account the specifics of the hall, lack of active market and absence of a sales offer, determining the fair value of the hall through comparative sales arrangements was not feasible. Therefore the recoverable value was determined via value in use.

In order to determine the value in use, the management analysed the indices of similar multifunctional halls in Estonia and Lithuania (number of events per year, average number of visitors per event day, average revenue/expense per event and visitor, expenses per halls usable area and visitor, etc.) and composed a business plan of the hall based on these indices. The cash-flows for the following 10 years and the present value of these cash-flows were generated based on the model. As a result of the impairment test and the recoverable amount determined, the hall was written down by 89 338 thousand kroons. As the Group had no experience in this field, it was not feasible to compare the cash-flow prognosis and assumptions with historical data.

In 2006, the Arena Riga was sold by subsidiary SIA Merks and reported as the sale of buildings in the table above. The profit from the sale amounted to 122 053 thousand kroons.

Information on leased assets is provided in Note 25 and on lease payments in Note 26.

note 24 intangible assets

in thousands of kroons	Goodwill	Negative goodwill	Other	Prepayments	Total
Cost at 31.12.2004	3,163	(6,773)	1,098	1,224	(1,288)
Accumulated amortisation at 31.12.2004	(1,160)	4,064	(506)	-	2,398
Carrying amount at 31.12.2004	**2,003**	**(2,709)**	**592**	**1,224**	**1,110**
Derecognition of negative goodwill according to IFRS 3 as at 01.01.2005	-	2,709	-	-	2,709
Acquisitions	1,110	-	1,294	1,623	4,027
Write-offs	(3,113)	-	(21)	-	(3,134)
Amortisation charge	-	-	(347)	-	(347)
Carrying amount at 31.12.2005	**-**	**-**	**1,518**	**2,847**	**4,365**
Cost at 31.12.2005	-	-	2,371	2,847	5,218
Accumulated amortisation at 31.12.2005	-	-	(853)	-	(853)
Carrying amount at 31.12.2005	**-**	**-**	**1,518**	**2,847**	**4,365**
Acquisitions	-	-	2,059	4,668	6,727
Sales	-	-	(46)	-	(46)
Amortisation charge	-	-	(869)	-	(869)
Carrying amount at 31.12.2006	**-**	**-**	**2,662**	**7,515**	**10,177**
Cost at 31.12.2006	-	-	4,368	7,515	11,883
Accumulated amortisation at 31.12.2006	-	-	(1,706)	-	(1,706)
Carrying amount at 31.12.2006	**-**	**-**	**2,662**	**7,515**	**10,177**

Prepayments for intangible assets relate to prospective replacement of Group's accounting software. As at 01.01.2005 the carrying amount of negative goodwill was charged to retained earnings.

note 25 leased assets

in thousands of kroons	2006	2005
ASSETS ACQUIRED UNDER FINANCE LEASE TERMS		
Machinery and equipment		
Cost	49,324	38,144
Accumulated depreciation	(12,076)	(7,470)
incl. depreciation charge	(4,606)	(3,077)
Carrying amount	**37,248**	**30,674**
ASSETS ACQUIRED UNDER OPERATING LEASE TERMS		
Right of superficies		
Payments made in financial year	93	93
Future lease payments		
payments in next financial year	93	238
payments in 2...5 years	372	1,188
payments after year 5	3,806	9,720

On the basis of cancellable lease agreements, operating lease payments totalling to 8028 thousand kroons (2005: 5489 thousand kroons) were paid for passenger cars in 2006.

note 26 borrowings

in thousands of kroons	2006	2005
FINANCE LEASE PAYABLES		
Present value of lease payments at beginning of the year	25,098	16,959
Received	11,916	13,971
Paid	(11,163)	(5,832)
Present value of lease payments at end of the year	**25,851**	**25,098**
incl. current portion	8,367	9,697
non-current portion 2...4 years	17,484	15,401
Interest expense of financial year	1,316	955
Minimum future lease payments	26,000	30,118

Average effective interest rate 5.0% (2005: 5.0%). Base currencies EEK, EUR and LVL.

LOANS

Bank loans	2006	2005
Loan balance at beginning of the year	292,567	5,202
Received	268,726	293,567
Paid	(144,017)	(6,202)
Loan balance at end of the year	**417,276**	**292,567**
incl. current portion	275,425	105,144
non-current portion 2...5 years	141,851	187,423
Interest expense of financial year	12,474	3,356

Average effective interest rate 4,5% (2005: 4,0%). Base currency EUR.

Loans from associates and joint ventures	2006	2005
Loan balance at beginning of the year	-	3,941
Paid	-	(3,941)*
Loan balance at end of the year	-	-
Loans from entities controlled by the parent company		
Loan balance at beginning of the year	-	522
Paid	-	(522)
Loan balance at end of the year	**-**	**-**
Total loans		
Loan balance at beginning of the year	292,567	9,665
Received	268,726	293,567
Paid	(144,017)	(10,665)*
Loan balance at end of year	**417,276**	**292,567**
incl. current portion	275,425	105,144
non-current portion 2...5 years	141,851	187,423
Total borrowings	**443,127**	**317,665**
incl. current portion	283,792	114,841
non-current portion 2...5 years	159,335	202,824

** Includes a non-monetary transaction, a net settlement against dividends receivable in amount of 3941 thousand kroons.*

Long-term bank loans have floating rates related to EURIBOR or RIGIBOR (Riga Interbank Offered Rate - the index of Latvian interbank credit interest rates). The exposure of the Group's bank borrowings to interest rate changes and the contractual repricing dates at the balance sheet dates are as follows:

	2006	2005
6 months or less	271,458	275,712
6-12 months	145,818	16,855
Total bank loans	**417,276**	**292,567**

The fair value of borrowings equals their carrying amount. Loan collaterals and pledged assets are presented in Note 31.

note 27 trade and other payables

in thousands of kroons	31.12.2006	31.12.2005
Payables to suppliers	464,199	282,087
Payables to employees	64,218	37,688
Tax liabilities, except for corporate income tax		
value added tax	19,998	11,919
personal income tax	5,884	3,032
social security tax	13,654	9,269
land tax	130	166
unemployment insurance tax	206	201
contributions to mandatory funded pension	307	173
other taxes	1,687	260
Total tax liabilities, except for corporate income tax	**41,866**	**25,020**
Amounts due to customers for contract work (Note 33)	**276,940**	**185,648**
Other payables		
interest liabilities	-	65
payables for shares of subsidiaries	-	14,735
other payables	27,290	4,837
advance payments received	206,883	161,156
Total other payables	**234,173**	**180,793**
Total trade and other payables	**1,081,396**	**711,236**

note 28 government grants

The Company's Latvian subsidiary SIA Merks was engaged (in 2004) in a project according to which SIA Merks took the responsibility to build a multifunctional hall (known as Arena Riga) at its own expense in the city of Riga, Latvia. It also took the responsibility to complete the hall by 1 February 2006 so that it would be possible to host 2006 World Championship in ice-hockey in Riga. As the due completion of the building involved major risks (see note 35) and the aggregate expected construction costs of (to build) the hall (Arena Riga) were considerably higher than the recoverable amount of the arena when completed, the project was not feasible on commercial ground. Therefore, to encourage the possible developer (before Merks two developers had rejected the project) the Riga Municipality provided a government grant to the project by selling some land plots (in Riga) at a price below their fair value to SIA Merks in 2004 and 2005. The difference between the purchase price actually paid and the fair value of the land plots on the date of acquisition was accounted for as a government grant. This government grant was accounted as a revenue in the same periods as the impairment losses on unfinished construction of the arena were recognised. The excess amount of government grant, i.e. the amount by which the government grant finally appeared to be higher than impairment loss (see Note 8 and 23 for impairment losses recognised) on the arena, was also recognised as a revenue in 2005, as it was reasonably certain that the Group was able to comply with the conditions attaching to the conditions of the grant.

In 2006, the world championships in ice-hockey took place in the multifunctional hall Arena Riga. The City of Riga supported the raising of funds for the arrangement of the world championship and the carrying out of competitions with 22 225 thousand kroons in 2005. The grant was used to arrange the world championships in ice-hockey in 2006. The cost of the ice-cleaning machine included within inventories to be given over to the City of Riga equals to the remaining balance of government grant in the amount of 1498 thousand kroons as at 31.12.2006.

in thousands of kroons	31.12.2006	31.12.2005
Carrying amount at beginning of the year	22,225	44,818
Received during the year	-	154,740
Recognised in income during the year	(20,727)	(177,333)
Balance at end of the year	**1,498**	**22,225**

note 29 short-term provisions

in thousands of kroons	2006	2005
Provision for warranty obligation for construction		
Carrying amount at beginning of the year	8,463	5,784
Accrued during the year	10,692	5,567
Utilized during the year	(9,493)	(2,888)
Balance at end of the year	**9,662**	**8,463**
Provision for covering unprofitable construction contracts		
Residual value at beginning of the year	-	-
Accrued during the year	17,848	-
Utilized during the year	-	-
Balance at end of the year	**17,848**	**-**
Provision for potential cancellation of construction project		
Residual value at beginning of the year	6,664	-
Accrued during the year	-	6,664
Utilized during the year	(6,664)	-
Balance at end of the year	**-**	**6,664**
Provision for covering court fees and claims		
Residual value at beginning of the year	6,090	-
Accrued during the year	1,000	6,090
Utilized during the year	(3,036)	-
Balance at end of the year	**4,054**	**6,090**
Other provisions		
Residual value at beginning of the year	524	-
Accrued during the year	1,953	524
Utilized during the year	(524)	-
Balance at end of the year	**1,953**	**524**
Total short-term provisions	**33,517**	**21,741**

note 30 other long-term trade payables

in thousands of kroons	31.12.2006	31.12.2005
Payables to suppliers	10,352	9,884
Advance payments received	12,925	12,842
Total long-term trade payables	**23,277**	**22,726**

In 2005, the subsidiary SIA Merks received advance payments in the amount of 12 842 thousand kroons for renting the space of Arena Riga from 2007 (lease agreements were entered into for 5-7 years). In 2006, Arena Riga was sold.

In 2006, SIA Merks received initial payment and advance payments for apartments in Skanste Street, Riga in the amount of 12 925 thousand kroons. The apartments will be completed in 2009.

note 31 loan collaterals and pledged assets

The following agreements have been entered into for guaranteeing loans and other obligations:

Between AS Merko Ehitus and Hansabank:
A commercial pledge agreement on movable property in the amount of 140 million kroons (registered under the first, second and fifth orders in the registry of commercial pledges). The obligations arising from guarantee contracts and overdraft contracts are guaranteed by the pledge.

Between AS Merko Ehitus and SEB Eesti Ühispank:
A commercial pledge agreement on movable property in the amount of 60 million kroons (registered under the third, fourth and sixth orders in the registry of commercial pledges). The obligations arising from guarantee contract are guaranteed by the pledge.

Between Tallinna Teede AS, Hansabank and SEB Eesti Ühispank:
A commercial pledge agreement on movable property in the amount of 25 million kroons (registered under the first order in the registry of commercial pledges), whereby the 14/25 legal share of the commercial pledge belongs to Hansabank and 11/25 to SEB Eesti Ühispank.

Between Tallinna Teede AS and Hansabank:
A commercial pledge agreement on movable property in the amount of 2 million kroons (registered under the second order in the registry of commercial pledges). All claims of the banks arising from contracts under the law of obligations have been guaranteed by the pledges.

Between AS Gustaf and Hansabank:
A commercial pledge agreement on movable property in the amount of 6 million kroons for guaranteeing guarantee contracts.

Between OÜ Gustaf Tallinn and Hansabank:
A commercial pledge agreement on movable property in the amount of 3.9 million kroons for guaranteeing guarantee contracts.

Between AS Merko Tartu and SEB Eesti Ühispank:
A commercial pledge agreement on movable property in the amount of 12.0 million kroons. Guarantee contracts entered into are guaranteed by the pledge.

Between SIA Merks and Hansabanka:
A commercial pledge agreement on assets in the amount of 3.0 million Latvian lats (67,3 million kroons). Obligations arising from the guarantee contracts and the loan agreements are guaranteed by the pledge.

Mortgages in the amount of 17.36 million Latvian lats (389,4 million kroons) for 7 registered immovables in Riga have been set as collateral for a loan contract totalling 17.5 million euros (268,3 million kroons).

Between SIA Merks and SEB Unibanka:
A commercial pledge agreement on assets in the amount of 1.9 million Latvian lats (42,6 million kroons). Obligations arising from the loan agreement have been guaranteed by the pledge.

Between SIA Merks and Nordea Banka:
Mortgages in the amount of 11.07 million Latvian lats (248,3 million kroons) for registered immovables in Riga have been set as collateral for a loan contract totalling 17.5 million euros (273,8 million kroons).

Between UAB Statyba and Hansabankas:
A commercial pledge agreement on movable property in the amount of 6.0 million Lithuanian litas (27.2 million kroons). The obligations arising from guarantee contracts and overdraft contracts are guaranteed by the pledge.

note 32 share capital

In accordance with the resolution of the General Meeting of Shareholders from 28.04.2005, the share capital was increased in May of the same year by transferring the share premium paid during previous share issues (2950 thousand kroons) and retained earnings (85 550 thousand kroons) by the amount of 88 500 thousand kroons by means of equity capitalisation, by issuing 8850 thousand new ordinary shares with the nominal value of 10 kroons each. As at 31.12.2005, the share capital in the amount of 177 000 thousand kroons consisted of 17 700 thousand registered shares with the nominal value of 10 kroons each.

In 2006, no changes occurred in share capital.

According to the articles of association, the maximum number of ordinary is 18 000 thousand shares. All issued shares have been paid for.

note 33 construction contracts in progress

in thousands of kroons	2006	2005
Costs incurred for construction contracts in progress and corresponding profit	4,016,033	2,312,322
Progress billings submitted	(4,157,565)	(2,415,746)

	31.12.2006	31.12.2005
Amounts due from customers for contract work (Note 15)	135,408	82,224
Amounts due to customers for contract work (Note 27)	(276,940)	(185,648)
Advance payments received for contract work	86,326	68,357

Amounts due from customers for contract work are included in the balance sheet line *Trade and other receivables*. Amounts due to customers for contract work are included in the balance sheet line *Trade and other payables*.

note 34 related party transactions

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

- parent company AS Merko Grupp,
- shareholders of AS Merko Grupp with significant influence through AS Merko Grupp,
- other shareholders with significant influence,
- other subsidiaries of AS Merko Grupp, so-called 'entities controlled by the parent company',
- subsidiaries,
- other controllable entities,
- associates,
- close relatives of persons with significant influence,
- key managers and their close relatives,
- entities under control of persons mentioned above,
- entities sharing key management with AS Merko Ehitus.

Significant influence is presumed to exist when the person has more than 20% of the voting power.

As at 31.12.2006 and 31.12.2005, AS Merko Grupp owned 72% of the shares of AS Merko Ehitus. The ultimate controlling party of the Group is Mr Toomas Annus.

GOODS AND SERVICES

in thousands of kroons	2006	2005
Purchased construction services		
Associates and joint ventures	91,732	45,202
Entities controlled by the parent company	7,858	5,444
Total purchased construction services	**99,590**	**50,646**
Construction services rendered		
Associates and joint ventures	118,667	136,160
Entities controlled by the parent company	986,301	425,568
Management members	5,970	1,526
Total construction services provided	**1,110,938**	**563,254**
Construction materials purchased		
Other related parties	208	2,008
Real estate sold		
Entities controlled by the parent company (Note 18)	31,890	-

Loans granted to related parties are disclosed in Note 16 *Loans granted* and **loans received** from related parties are disclosed in note 26 *Borrowings*.

note 34 related party transactions (continued)

BALANCES WITH THE RELATED PARTIES

in thousands of kroons	31.12.2006	31.12.2005
TRADE RECEIVABLES		
Trade receivables		
Associates and joint ventures	13,678	39,044
Entities controlled by the parent company	141,050	56,946
Other related parties	18	-
Short-term loans		
Associates and joint ventures	24,750	21,325
Entities controlled by the parent company	8,896	6,565
Other related parties	-	500
Interest receivables		
Associates and joint ventures	2,656	1,541
Entities controlled by the parent company	32	-
Other related parties	-	8
Other short-term receivables		
Entities controlled by the parent company	6,890	-
Other related parties	-	2,917
Prepayments for services		
Associates and joint ventures	1,068	7,698
Entities controlled by the parent company	-	562
OTHER SHORT AND LONG-TERM INVESTMENTS		
Long-term loans		
Entities controlled by the parent company	3,804	1,473
Other long-term receivables		
Other related parties	-	6,800
TRADE PAYABLES		
Payables to suppliers		
Associates and joint ventures	9,414	19,179
Entities controlled by the parent company	272	223
Other related parties	7	116
Prepayments received		
Entities controlled by the parent company	16,551	16,847
Interest liabilities		
Entities controlled by the parent company	-	21
Management members	-	18
Other payables		
Management members	-	307
Associates and joint ventures	3,365	-
Entities controlled by the parent company	-	2,419

note 34 related party transactions (continued)

remuneration of the members of the supervisory and management boards and senior executives

In 2006, the members of the Supervisory and Management Boards as well as senior executives of AS Merko Ehitus were paid remuneration totalling 15 171 thousand kroons (2005: 15 743 thousand kroons).

termination benefits of members of the supervisory and management boards

Upon premature removal or termination of authority of the members of the Supervisory and Management Boards, the Group has the obligation to pay compensation totalling to 4392 thousand kroons (2005: 3108 thousand kroons).

contracts of surety

AS Merko Ehitus provides surety for:

- obligations arising from lease agreements of subsidiaries and consolidation group companies to Balti Autoliisingu AS in the amount of 9883 thousand kroons (31.12.2005: 0 kroons),
- obligations arising from loan agreements of the joint venture OÜ Tornimäe Apartments to SEB Eesti Ühispank in the amount of 7500 thousand kroons (31.12.2005: amount was 5000 thousand kroons),
- obligations arising from loan agreements of the joint venture OÜ Unigate to Hansabank in the amount of 1000 thousand kroons (31.12.2005: same amount).

The fair value of Group's surety contracts is immaterial, therefore no liability has been recorded in the balance sheet as at 31.12.2006 as well as at 31.12.2005.

note 35 contingent liabilities

The Group has issued guarantees to cover Group's obligations to third parties:

in thousands of kroons	**31.12.2006**	**31.12.2005**
Performance period's warranty to the customer	180,617	108,448
Tender warranty	72,352	15,355
Guarantee for warranty period	73,295	107,042
Prepayment guarantee	105,478	87,215
Sureties (Note 34)*	26,483	13,000
Investment obligation**	-	67,409
Payment guarantee	3,743	-
Total contingent liabilities	**461,968**	**398,469**

** In addition to sureties disclosed in Note 34, the Group has issued in the extent of 8100 thousand kroons sureties covering obligations of third parties (31.12.2005: amount was 7000 thousand kroons).*

*** At 25 May, the Riga City Council and SIA Merks concluded the investment agreement whereby SIA Merks assumed the responsibility to build the multifunctional hall Arena Riga. The contract included the following terms and conditions:*

- SIA Merks shall pay penalty fees totalling 67.4 million kroons to Riga City Council if hall fails to obtain a permit for use by February 1, 2006;

- Riga City Council has the right to demand a refund for the grant if the hall fails to obtain a permit for use by 31 December 2006.

At 31 January 2006, the hall obtained the permit for and consequently SIA Merks was released of the contingent investment liability.

Performance period's warranty to the customer – warranty provider grants to customer that contractor's obligations arising from construction contract will be adequately completed.
Tender warranty – warranty provider grants to customer arranging the tender process that tenderer will sign a contract as per tender conditions.
Guarantee for warranty period – warranty provider grants to customer that construction defects discovered during the warranty period will be repaired.
Prepayment guarantee – warranty provider grants to customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.
Payment guarantee – warranty provider grants to customer payment for goods or services.

Tax authorities have the right to review the Group's tax records within 6 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines. The Group's management estimates that there are not any circumstances which might lead the tax authorities to impose additional significant taxes on the Group.

note 36 risks

Credit risk

Credit risk relates to potential damage which would occur if the parties to the contract are unable to fulfil their contractual obligations. In order to lower credit risks, the payment discipline of customers is constantly being monitored; construction activities are partly funded by customer prepayments. Available funds are mostly held at Hansabank and SEB Eesti Ühispank. The management estimates that the Group does not have any major credit risks.

Interest risk

Interest risk arises from floating rate borrowings. Interest on bank loans is related to EURIBOR. Changes in EURIBOR and changes in average market interest rates affect the Group's interest expenses. The Group's management estimates that the Group does not have any major interest risks.

Foreign exchange risk

The Group's transactions are carried out in Estonian kroons, Latvian lats and Lithuanian litas. The Estonian kroons, as well as the Lithuanian litas and Latvian lats (exchange rate is 1 EUR = 0.702804 LVL +/-1%) are pegged to the Euro.

In order to hedge foreign exchange risk, key foreign contracts are concluded in euros. All long-term loan agreements of the Group have been concluded in euros.

Fair value

The carrying amounts of the Group's financial assets and financial liabilities do not significantly differ from their fair values.

note 37 number of shares belonging to the members of the supervisory and management board and their close relatives

Member of the Management Board	Shares	Ownership %
Tõnu Toomik	18,000	0.10

note 38 shareholders with more than 5% ownership

	Shares	Ownership %
AS Merko Grupp	12,742,686	71.99
ING Luxembourg S.A. clients	1,214,700	6.86

note 39 supplementary disclosures on the parent company

The financial information of the parent company comprises separate primary statements of the Parent Company (income statement, statement of changes in equity, balance sheet and cash flow statement), the disclosure of which is required by the Estonian Accounting Act. The primary financial statements of the parent company have been prepared using the same accounting methods and measurement bases as for the preparation of the consolidated financial statements, except for subsidiaries, associates and joint ventures which are reported at cost in the separate primary financial statements of the parent company.

income statement

in thousands of kroons	**2006**	**2005**
Revenue	2,111,887	1,860,068
Cost of goods sold	(1,834,444)	(1,575,816)
Gross profit	**277,443**	**284,252**
Marketing expenses	(12,591)	(15,743)
Administrative and general expenses	(63,775)	(55,278)
Other operating income	19,323	9,399
Other operating expenses	(4,782)	(3,608)
Operating profit	**215,618**	**219,022**
Financial income	2,226	3,876
Financial income from investments into subsidiaries	113,488	43,157
Financial income/expenses from investments into associates and joint ventures	2,499	(3,166)
Profit before tax	**333,831**	**262,889**
Corporate income tax	-	(4,446)
Net profit for the financial year	**333,831**	**258,443**

statement of changes in equity

in thousands of kroons	Share capital	Share premium	Statutory reserve capital	Retained earnings	Total
Balance as at 31.12.2004	88,500	2,950	8,850	575,966	676,266
Net profit for the financial year	-	-	-	258,443	258,443
Fund issue	88,500	(2,950)	-	(85,550)	-
Dividends	-	-	-	(57,525)	(57,525)
Balance as at 31.12.2005	**177,000**	**-**	**8,850**	**691,334**	**877,184**
Carrying amount of holdings under dominant or significant influence					(181,157)
Carrying amount of holdings under dominant or significant influence under the equity method					405,369
Adjusted unconsolidated equity at 31.12.2005					**1,101,396**
Net profit for the financial year	-	-	-	333,831	333,831
Transfers to statutory reserve capital	-	-	8,850	(8,850)	-
Dividends	-	-	-	(88,500)	(88,500)
Balance as at 31.12.2006	**177,000**	**-**	**17,700**	**927,815**	**1,122,515**
Carrying amount of holdings under dominant or significant influence					(233,144)
Carrying amount of holdings under dominant or significant influence under the equity method					704,571
Adjusted unconsolidated equity at 31.12.2006					**1,593,942**

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

note 39 supplementary disclosures on the parent company (continued)

balance sheet

in thousands of kroons	31.12.2006	31.12.2005
ASSETS		
Current assets		
Cash and cash equivalents	311,059	124,033
Trade receivables	948,507	850,188
Prepaid corporate income tax	1,451	272
Inventories	154,132	79,299
Total current assets	**1,415,149**	**1,053,792**
Non-current assets		
Investments in subsidiaries	229,604	171,333
Investments in associates and joint ventures	3,540	9,824
Long-term financial assets	129,326	82,145
Investment property	-	16,460
Property, plant and equipment	12,653	10,193
Intangible assets	6,197	1,743
Total non-current assets	**381,320**	**291,698**
TOTAL ASSETS	**1,796,469**	**1,345,490**
LIABILITIES		
Current liabilities		
Borrowings	32,463	29,431
Trade payables	617,514	421,136
Short-term provisions	18,727	11,856
Total current liabilities	**668,704**	**462,423**
Non-current liabilities		
Other long-term payables	5,250	5,883
TOTAL LIABILITIES	**673,954**	**468,306**
EQUITY		
Share capital	177,000	177,000
Statutory reserve capital	17,700	8,850
Retained earnings	927,815	691,334
TOTAL EQUITY	**1,122,515**	**877,184**
TOTAL LIABILITIES AND EQUITY	**1,796,469**	**1,345,490**

cash flow statement

in thousands of kroons	2006	2005
Cash flows from operating activities		
Operating profit	215,618	219,022
Adjustments:		
depreciation and impairment	7,648	4,517
gain/loss from sale of non-current assets	(107)	(139)
adjustment of revenue from construction contracts under stage of completion method	(102,843)	38,601
interest income from operating activities	(17,913)	(9,017)
change in provisions	9,697	10,940
Change in trade receivables related to operating activities	(214,673)	(38,516)
Change in inventories	(60,913)	8,773
Change in trade payables related to operating activities	147,513	51,307
Interest paid	(931)	(632)
Other financial income received	-	3,857
Corporate income tax paid	-	(4,446)
Total cash flows from operating activities	**(16,904)**	**284,267**
Cash flows from investing activities		
Investments into subsidiaries	(69,834)	(43,095)
Proceeds from sale of subsidiaries	25,039	4,600
Proceeds from sale of associates	1,847	2,756
Proceeds from sale of other financial assets	3,004	-
Purchase of property, plant and equipment	(7,501)	(7,275)
Proceeds from sale of property, plant and equipment	155	610
Purchase of intangible assets	(4,570)	(1,279)
Loans granted	(303,095)	(411,744)
Loan repayments received	510,324	170,640
Interest received	20,379	8,971
Dividends received	88,579	43,446
Total cash flows from investing activities	**264,327**	**(232,370)**
Cash flows from financing activities		
Borrowings	33,242	28,529
Repayments of borrowings	(5,165)	-
Dividends paid	(88,500)	(57,525)
Total cash flows from financing activities	**(60,423)**	**(28,996)**
Change in cash and cash equivalents	187,000	22,901
Cash and cash equivalents at beginning of the period	124,033	101,143
Currency translation adjustment	26	(11)
Cash and cash equivalents at end of the period	**311,059**	**124,033**

PRICEWATERHOUSECOOPERS

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www.pwc.ee

independent auditor's report

(Translation of the Estonian original)

To the Shareholders of AS Merko Ehitus

We have audited the accompanying consolidated financial statements of AS Merko Ehitus and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2006, and of 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.

Urmas Kaarlep
AS PricewaterhouseCoopers

Tiit Raimla
Authorised Auditor

12. April 2007

profit allocation proposal

in kroons

Retained earnings	823,254,549
Net profit for 2006	581,738,087
Total retained earnings as at 31.12.2006	**1,404,992,636**

The Management Board proposes to allocate the net profit as follows:

As dividends (7.00 kroons per share)	123,900,000
Retained earnings after the allocation of net profit	**1,281,092,636**

Tõnu Toomik	Chairman of the Management Board	29.03.2007
Alar Lagus	Member of the Management Board	29.03.2007
Veljo Viitmann	Member of the Management Board	29.03.2007
Andres Agukas	Member of the Management Board	29.03.2007
Tõnu Korts	Member of the Management Board	29.03.2007

signatures of the management board and supervisory board to the 2006 annual report

The Management Board of AS Merko Ehitus has prepared the management report, consolidated financial statements and the profit allocation proposal for 2006.

Tõnu Toomik	Chairman of the Management Board	29.03.2007
Alar Lagus	Member of the Management Board	29.03.2007
Veljo Viitmann	Member of the Management Board	29.03.2007
Andres Agukas	Member of the Management Board	29.03.2007
Tõnu Korts	Member of the Management Board	29.03.2007

The Supervisory Board has reviewed the Annual Report which consists of the management report and the financial statements prepared by the Management Board and which also includes the auditor's report and the profit allocation proposal, and approved it for presentation at the General Meeting of Shareholders.

Toomas Annus	Chairman of the Supervisory Board	12.04.2007
Teet Roopalu	Member of the Supervisory Board	12.04.2007
Jaan Mäe	Member of the Supervisory Board	12.04.2007

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merko

2005

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AS MERKO EHITUS
GROUP

Consolidated Annual Report

Beginning of financial year: 01.01.2005
End of financial year: 31.12.2005

Commercial Registry no:	10068022
Address:	Järvevana Rd 9G 11314 Tallinn Estonia
Phone:	+372 680 5105
Fax:	+372 680 5106
E-mail:	merko@merko.ee
Web site:	www.merko.ee
Main activities:	general contracting of construction
Auditor:	AS PricewaterhouseCoopers

Management report

General information

The Group Merko Ehitus is engaged in construction and related activities in Estonia, Latvia and Lithuania. The Group consists of 32 subsidiaries and 8 associates and joint ventures the largest of which are: SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (100%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%) and AS Tartu Maja Betoontooted (25%).

In 2005, the following important changes took place in the Group's structure.

- The holding of Merko Ehitus in OÜ Constancia and OÜ Pire Projekt increased from 50% to 100%.
- Subsidiary OÜ Merko Kaevandused was sold.
- Baltic Electricity Engineering OÜ was established; the company designs and installs medium and high voltage electrical networks and substations.
- Joint venture AS Insenervõrgud was liquidated.
- Merko Ehitus decreased its holding of AS Telegrupp from 45% to 31%.
- SIA Merks acquired a 50% holding in a company engaged in real estate development, SIA Zakusala Real Estates.

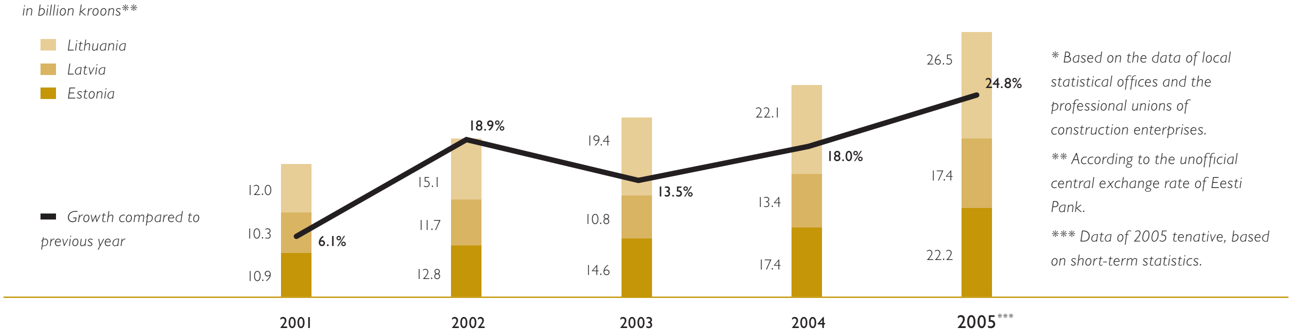
Overview of the construction market and its developments

The Baltic construction market grew by 24.8% in a year under the conditions of a favourable loan environment and fast economic growth. In 2005, construction work in the Baltic region was performed for 66.1 billion kroons which is 13.1 billion kroons higher than in 2004.

The sector's fastest growth occurred in Latvia, where the market grew in current prices by 29.0 per cent in a year and reached 17.5 billion kroons. Despite fast growth, the ratios describing the Latvian construction market were relatively modest: construction work per capita was performed for 485 euros and construction output per one GDP euro was 9 cents. According to the data by the Estonian Statistical Office, Estonian construction companies performed construction work with their own forces in Estonia and foreign countries for 23.2 billion kroons which is 28.3% more than last year. In Estonia, construction work was completed for 22.2 billion kroons and in foreign countries for 1.0 billion kroons. Growth also continued in the Lithuanian construction market which increased by 19.3% in a year and totalled 26.8 billion kroons. Similarly to Estonia and Latvia, construction activities in Lithuania also centred around the largest cities (Vilnius, Klaipeda, Kaunas).

Building market volumes (with own forces) and growth of the Baltic states*

*in billion kroons***



* Based on the data of local statistical offices and the professional unions of construction enterprises.

** According to the unofficial central exchange rate of Eesti Pank.

*** Data of 2005 tenative, based on short-term statistics.

Simultaneously with the fast growth of the construction market, the construction prices appreciated uncontrollably. The manufacturers of construction materials could not keep pace with the growth of construction volumes, the delivery periods of ordered materials increased and there was deficit with regard to shelf goods at the stores. However, the most critical situation occurred in respect of qualified labour, as simultaneously with volume growth, skilled labour left en masse to the EU countries with higher standards of living. The prices of construction services increased by 11.4% in Latvia, 7.6% in Lithuania and 7.3% in Estonia.

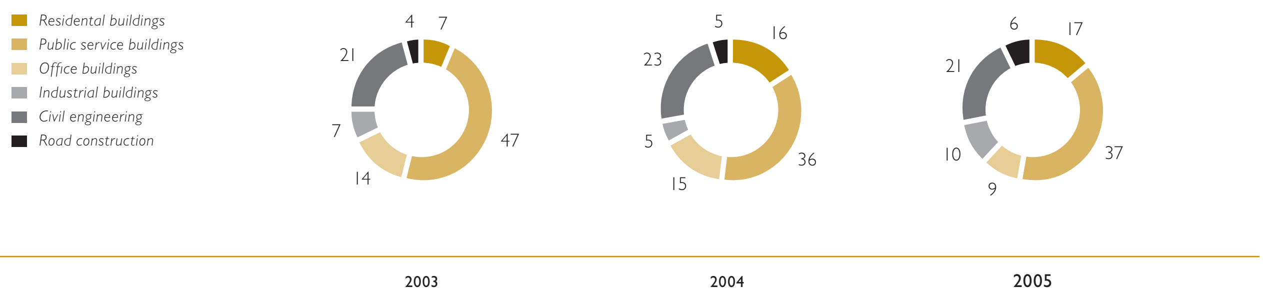
Residential housing development has been the main profitability driver in the construction sector over the last several years. In 2005, the sales prices of new housing increased by 40-50 percent which guaranteed continuous good profitability in this area. The prices of registered immovables suitable for development increased by 150-200% in a year and reached a level where the profit to be derived from development activities was discounted into the price of land by land owners, allowing the developers to make a profit on the project only on account of additional price increases of new housing.

Business operations

The year 2005 was a good one for Merko Ehitus. The Group's net sales increased by 3.9% in a year and totalled 3,232 million kroons. Construction activities contributed 93.8% and other activities 6.2% to the Group's revenue.

Distribution of construction activities of the Group

per cent



Of the Group's construction activities, 86% was new structures and 14% renovation and reconstruction work. In 2005, the largest construction projects worth mentioning were the Estonian Art Museum, the residential building at Rävala Blvd, Wendre's production facility, Muuga coal terminal, trade centre Spice and the business and residential building Admirali maja (Admiral's House).

The largest projects completed in 2005

Muuga coal terminal	new facility	Muuga, Harjumaa	573,500 m²	AS Merko Ehitus
Road construction of Sõpruse Blvd (Endla St - Linnu Rd)	reconstruction	Sõpruse Blvd, Tallinn	45,000 m²	Tallinna Teede AS
3 apartment buildings	new facility	Rävala Blvd 19, Tallinn Pärnu Rd 131B, Tallinn Uus-Tatari 23, Tallinn	26,647 m²	AS Merko Ehitus
Wendre's production facility	new facility	Lina 31, Pärnu	24,957 m²	AS Merko Ehitus
Stage 2 of shopping centre Spice	new facility	Leilirbes 29a, Riga	24,000 m²	SIA Merks
Estonian Art Museum	new facility	Weizenbergi 34/Valge 1, Tallinn	23,910 m²	AS Merko Ehitus
Business and residential building Admiral's House	new facility	Ahtri 6, Tallinn	23,424 m²	AS Merko Ehitus
Shopping centre Rimi	new facility	On the corner of Ateities and Žadeikos Streets, Vilnius	9,300 m²	UAB Merko Statyba
Administrative building of the Ministry of Social Affairs	reconstruction	Gonsiori 29, Tallinn	8,560 m²	AS Merko Tartu
Shopping centre K-Rauta	new facility	Lucavsalas 3, Riga	8,528 m²	SIA Merks
Business centre L3	new facility	Laisvės 3, Vilnius	6,499 m²	UAB Merko Statyba

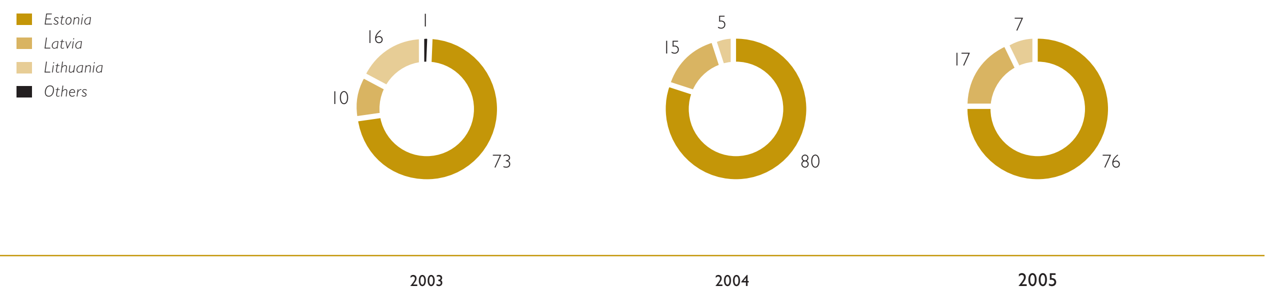
In autumn 2004, the Group accepted its biggest challenge ever - SIA Merks entered into a contract with Riga's City Government committing itself to build a multifunctional hall in Riga accommodating 12,500 visitors by the time of the Ice Hockey World

Championships in 2006. A limited timetable, a complex engineering-technical solution of the structure and the failure of two developers to complete the project presented a real challenge for the Company. Arena Riga was not only a challenge from the construction point of view, but SIA Merks was also the developer, builder and investor of the building. Being aware of the problems of building and operating such complexes in neighbouring countries, it was not easy to find investors and financiers ready to join the project. We are obliged to the fans of culture and sports who acquired personal chairs or boxes in the complex and to Hansapank which believed in us and financed the project with 17.5 million euros. Despite all issues encountered, the building was completed on time, at 31.01.2006 the hall was granted authorisation for use and the inhabitants of Riga gained a complex that the city badly needed.

The home market of AS Merko Ehitus is the Baltic countries. Due to growth of construction volumes in Latvia and Lithuania, the share of exported goods and services provided outside Estonia increased from 20% in 2004 to 24% in 2005.

Geographical distribution of turnover of Merko Ehitus Group

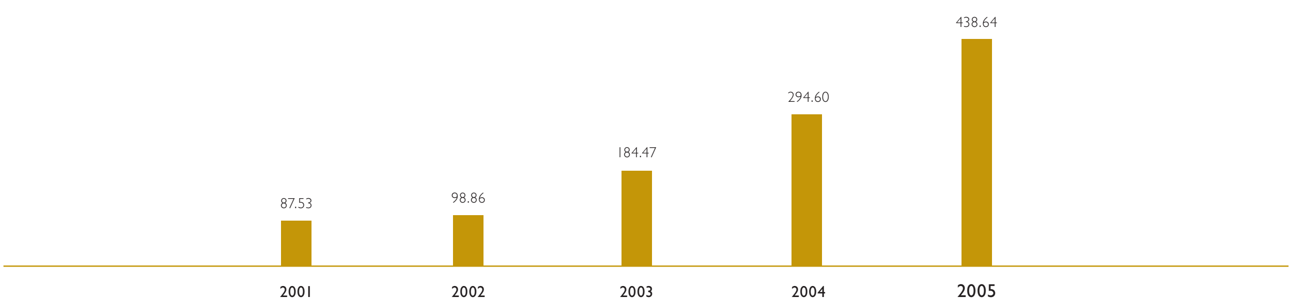
per cent



The net profit of the Group in 2005 totalled 438.6 million kroons, an increase of 48.9% over the net profit of 294.6 million kroons in 2004. Net profit from construction and development activities totalled 289.3 million kroons, one-time transactions contributed 149.3 million kroons to net profit, of which 84.7 million kroons was earned in the transfer of registered immovables, 53.7 million kroons from government grants and 10.9 million from the transfer of ownerships and rights. Decent profitability was ensured by the Company's own residential housing projects, better sales of subsidiaries and the transfer of registered immovables unimportant for the attainment of the Company's strategic goals.

Net profit of Merko Ehitus Group

in million kroons



In 2005, the Group's total cash flow from operations amounted to +129.7 million kroons, of which cash flow from operating activities was +264.7 million kroons. The cash flow of the accounting period was mostly affected by the operating profit of +435.1 million kroons, a change in inventories -464.9 million kroons, a change in liabilities and prepayments +186.6 million kroons, depreciation and amortisation +109.6 million kroons, adjustment of revenue from construction contracts under the stage of completion method +66.6 million kroons. The Group's cash flow from investing activities was -378.1 million kroons, of which -227.0 million kroons was investments into property -148.5 million kroons investments into subsidiaries and associates, -190.1 million kroons loans granted, +176.3 million kroons loan repayments received and +11.2 million kroons other income from investing activities. Investments were made from own funds as well as borrowed funds in the amount of 293.6 million kroons. The Company's cash flow from financing activities totalled +243.1 million kroons, of which the balance of credit liabilities assumed/repaid in the amount +281.0 million kroons, dividends paid -60.1 million kroons and government grants received +22.2 million kroons.

The ratios and the methodology for calculating the Group's main activities were as follows

	2003	2004	2005
Net profit margin	6.8%	9.5%	13.6%
Net profit margin *	6.8%	8.8%	9.0%
Operating profit margin	7.5%	10.3%	13.5%
Return on equity per annum	48.3%	49.9%	48.2%
Return on assets per annum	19.9%	24.1%	24.9%
Equity ratio	40.4%	55.3%	49.6%
Current ratio	1.5	2.0	2.0
General expenses to net sales	3.3%	3.4%	4.6%
Staff costs to net sales	5.7%	6.3%	7.3%

** Less extraordinary profit.*

Net profit margin : Net profit / Net sales
Operating profit margin : Operating profit / Net sales
Return on equity : Net profit / Average equity of the period
Return on assets : Net profit/ Average total assets of the period
Equity ratio : Equity / Total assets
Current ratio : Current assets / Current liabilities
General expenses to net sales : General expenses / Net sales
Staff costs to net sales : Staff costs / Net sales

Business risks

Market risk. One of the peculiarities of construction activities is the fact that carrying out contracts entered into will take months and it ensures relatively long-term revenue stream for the companies which in turn makes the sector immune to changes in the economic environment. Based on the above, the changes having both a negative and positive effect on the demand for construction services will reach construction with a lag of approximately 12 months. This time is long enough to adopt necessary measures and avoid the worst or be prepared for the best.

It is much more difficult to estimate changes in demand in residential housing development where many apartments have been purchased as investments in a hope to make a profit from continuing appreciation of apartment prices and where under strong demand, the prices of new apartments increased by up to 50% in 2005. Will the market be able to absorb the price appreciation? What will happen to apartments purchased as investments if housing prices no longer increase? What will happen to interest rates? How will the bankers in Helsinki and Stockholm view our market if the loan race continues? These and many other issues will make this sector vulnerable and will become a major source of risk for the investor. In order to identify potential issues and manage risk, we closely follow changes in sales numbers, the process of selling apartments is launched before the construction of the building, a preliminary contract is entered into with the buyer at the first opportunity and a deposit is collected to ensure the carrying out of the contract. The largest projects are divided into stages so that they can be frozen quickly and with few expenses. Development activities made up 14.7% of the net sales of the Merko Ehitus Group in 2005.

The accession of the Baltic countries to the European Union opened new markets for construction companies, accompanied by a massive inflow of construction workers into the EU countries. Free movement of labour and growth of construction market volumes led to a deficit of skilled labour in all Baltic countries and fast appreciation of labour costs. Developments in the labour market, convergence of prices for construction services and materials with the prices of the European Union and longer delivery dates of construction materials shall be considered when assessing risks for long-term projects lasting for longer than 12 months. In order to hedge risks we have stepped up international cooperation, in the absence of required competencies, knowledge or work is purchased from other Baltic countries. Frequently, services of Finnish and Swedish colleagues are used.

Operating risk. The Group concludes complete risk insurance contracts with insurance companies in order to hedge unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to 10 million euros. The risks of projects whose cost exceeds 10 million euros or which the annual policy does not cover (water construction, railroad construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding employment contracts for design work, an insurance contract of professional liability is required from subcontractors covering the losses arising from designing, erroneous measuring, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2005, applications for compensation in the amount of 0.8 million kroons were submitted to insurance companies and indemnifications in the amount of 0.6 million kroons were received from insurance companies.

The appropriate fulfilment of contractual obligations arising from employment agreements is guaranteed at first demand payable bank guarantees. A reserve for guarantee provisions has been set up at the Company to eliminate the construction errors which become evident during the warranty period. In 2005, warranty provisions were set up in the total amount of 5.6 million kroons and indemnifications amounted to 2.9 million kroons. As at the end of the year, the Company's guarantee reserve amounted to 8.5 million kroons. With regard to work performed by subcontractors, the subcontractor shall eliminate the errors that became evident during the warranty period and the fulfilment of these obligations is guaranteed by bank guarantees.

One important part of managing operating risks is the mapping out of the situation and anticipation of risks. ISO 9001/14001 management systems have been set up at the four largest companies of the Group and the occupational health and safety system OHSAS 18001 has been set up at the parent company. Twenty-one full-time quality specialists work in the Group whose work responsibilities include ensuring quality, work safety and management systems.

Credit risk is an inevitable part of the Company's activities. In managing credit risk, close attention is paid to the payment behaviour of partners, their financial position is analysed and if necessary, third parties are involved as guarantors. With regard to prepayments to suppliers, a bank guarantee by suppliers is required. In 2005, the customers of Merko demonstrated good payment discipline, despite the average collection period increasing from 30 to 33 days, the amount of invoices exceeding the due date fell from 16.1 million kroons to 2.4 million kroons and the amount of doubtful receivables decreased from 1.2 million kroons to 0.4 million kroons.

Company's free monetary resources are held as short-term deposits in banks with high credit-ratings (Moody's A3/P-2 and higher). In order to guarantee liquidity and better management of cash flows, Group's companies have concluded overdraft contracts with a total value of 112 million kroons.

Interest rate risk. As at 31.12.2005, the Group's interest-bearing liabilities amounted to 307.8 million kroons, of which 105.1 million were short-term loans and the current portion of long-term liabilities in 2006 and 202.7 million were non-current liabilities and finance lease liabilities. The volume of interest-bearing liabilities increased by 285.6 million kroons in a year and as at the end of the year, these liabilities amounted to 13.9% of the balance sheet total of the Company. As the Group intends to transfer most the assets financed through long-term loans within 12-24 months, then the hedging of interest risks of these obligations is not considered appropriate.

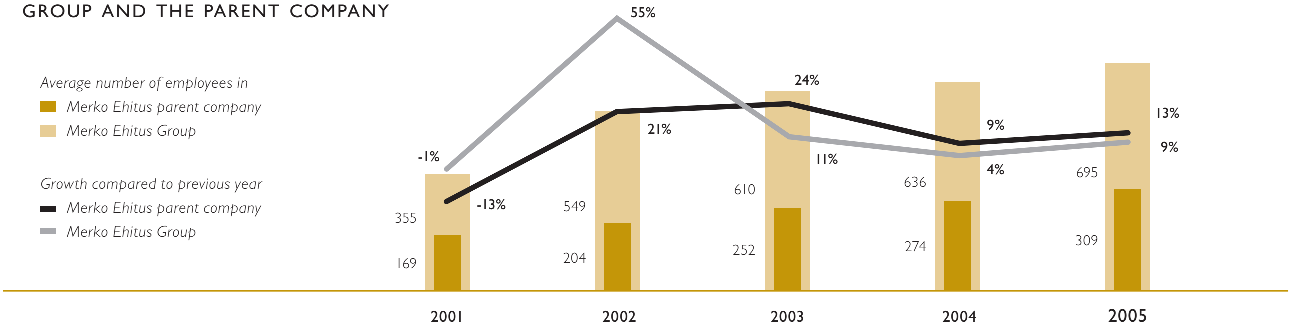
Foreign exchange risk. The Group's construction contracts are mostly concluded in a foreign currency of the country of location and open foreign currency positions in arranging daily activities are tried to be avoided. The most significant foreign contracts are concluded in euros. The Latvian lats, the Lithuanian litas and the Estonian kroons have been pegged to the euro and hence the foreign currency risks of intra-group transactions have been eliminated.

The company and the people

The key to the success of a modern entity is a knowledgeable, motivated team oriented at teamwork. Merko Ehitus appreciates professional behaviour highly and invests into its people.

In 2005, the average number of full-time employees at the parent company was 309, increasing by 35 people in a year. The gross wages and salaries paid to full-time employees amounted to 95.0 million kroons, the annual growth was 7.8%, incl. base salary of 7.4% and bonuses of 8.2%. The average number of full-time employees at the Group was 695 and their gross wages and salaries amounted to 173.9 million kroons, of which base salaries amounted to 70.3% and bonuses 29.7%. As compared to 2004, the number of employees at the Group increased by 9% and the average gross wages and salaries increased by 16.7%.

Changes in the number of employees of the group and the parent company



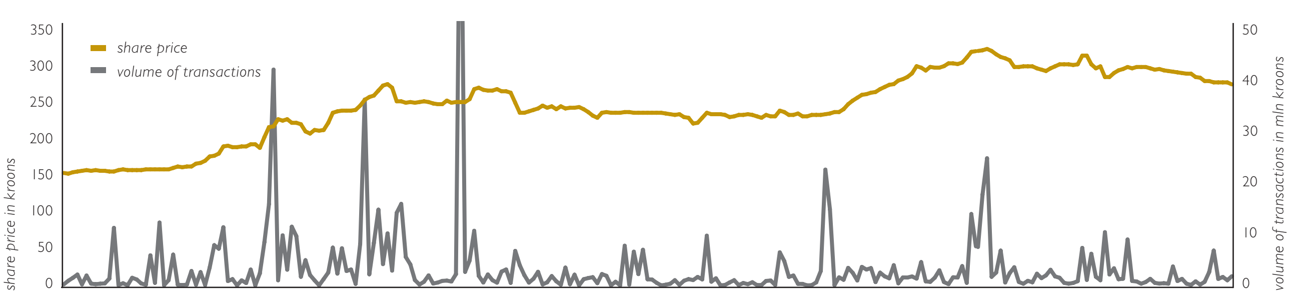
From October 2005, the Management Board of AS Merko Ehitus consists of 5 members. All members of the Management Board work full-time at AS Merko Ehitus and their gross remuneration in 2005 was 7.3 million kroons, incl. base salaries of 1.8 million kroons and bonuses of 5.5 million kroons. The Supervisory Board of AS Merko Ehitus consists of 3 members and their gross remuneration amounted to 5.2 million kroons in 2005, of which base salaries amounted to 1.3 million kroons and bonuses to 3.9 million kroons. All members of the Supervisory and Management Boards currently work on the basis of contracts for services. Members are paid a termination fee upon the early removal of a member of the Supervisory Board and the Management Board or non-extension of the service contract equalling the last 12 month base salary.

One of the largest joys is the joy of giving. At the end of 2004, Hansapank, Eesti Energia and Merko together with the Ministry of Culture signed a cooperation project to build 'Estonian hiking tracks''. The goal of the project was to bring together nature and healthy lifestyles, promote athletic lifestyles and set up a network of hiking tracks in cooperation with private and state structures which would be available to all interested persons regardless of their age or financial position. SA Eesti Terviserajad was set up to implement this project. The private sector assumed the responsibility of investing 30 million kroons into hiking tracks over the following 3 years as well as to maintain them; the responsibility of the public sector was to arrange ongoing management of the facilities. Today, a total of 8 health tracks have been equipped with the necessary technology, established or fixed up and in respect of 4 centres, the design work is still underway. We see success and it encourages us to continue on the path chosen.

Shares and shareholders

The shares of Merko Ehitus are listed in the main list of Tallinn Stock Exchange and as at 31.12.2005, the closing price of the share on Tallinn Stock Exchange was 269.90 kroons, increasing by 77.5% in a year.

Performance of Merko Ehitus share at Tallinn Stock Exchange



The earnings per share in 2005 were 24.78 kroons, increasing by 48.9% in a year. Pursuant to the current dividend policy of the Company, a proposal is made at the General Meeting of Shareholders to pay out 20% of the net profit for the year as net dividends, i.e. 5 kroons per share.

Structure of Merko Ehitus at the end of 2005

Shareholders	*Shares*	*Participation*
Merko Grupp	12,742,686	72.0%
ING Luxembourg S.A., clients	1,135,900	6.4%
SEB, clients	992,310	5.6%
Nordea Pank, clients	608,683	3.4%
Okobank, clients	262,600	1.5%
Clearstream Banking Luxembourg S.A., clients	245,007	1.4%
J.P. Morgan Bank Luxembourg S.A.	194,200	1.1%
Other shareholders	1,518,614	8.6%
Total	**17,700,000**	**100.0%**

Outlook for 2006

The overall condition of the construction sector is primarily affected by the country's economic development, general investment climate and availability of funds. We believe that despite slight appreciation of interest rates, the economic growth of 6-7% is sustainable in the Baltic countries in the near term and the construction market will participate in it.

In 2006, the construction of infrastructure and environmental facilities in cooperation with the public sector and the EU Structural Funds will continue. A decent year is expected in general construction, where hotels, trade and office buildings and industrial parks near cities are planned to be built.

Along with general and engineering construction, residential housing development has played an important role over the last several years. The year 2006 will present serious challenges to residential developers. The renewal pace of the housing fund of 1.8-2.9 new housing spaces per 1000 people reached by now is significantly lower than the respective figures in the neighbouring countries: 6.5 in Norway, 5.8 in Finland, 5.0 in Denmark and 3.5 in Sweden and thus to call the volumes of residential housing construction the peak is not justified. On the other hand, how will the market cope with the price increase of 2005, how sustainable are prices in a situation in which the square meter of new residential housing space costs 4-6 average salaries, will the inflow of borrowed funds compensate for the price increase of apartments? We believe that the prices of housing spaces will stabilise and a more distinct regional differentiation will take place. In a stable price environment, demand for housing acquired for the purpose of investment will decrease and a number of families buying new homes will increase. The work of those developers will be difficult, who in anticipation of price increases in 2005 purchased properties, whose disposal in a stable price environment may turn out to be a challenge.

Although the growth of construction activities in Latvia and Lithuania in 2005 was impressive, considering the size of these countries and their populations it can be stated that rapid development is still coming. In 2005, construction projects per capita were completed for 1,001 euros in Estonia, 485 euros in Latvia and 502 euros in Lithuania and construction output was generated for GDP euro of 14 cents in Estonia, 9 cents in Latvia and 8 cents on Lithuania. The modest numbers of Latvia and Lithuania best characterise the hidden potential of construction activities of these countries and allow forecasting faster than average growth in the near term. The Estonian construction market which has experienced fast growth over the last years should reach a stage of stable growth in the upcoming year.

Merko Ehitus will continue to expand its activities in Latvia and Lithuania, where it intends to become one of the largest construction companies through its subsidiaries SIA Merks and UAB Merko Statyba. We maintain our positive stance towards the development of Latvia and Lithuania and believe that in the near term the share of revenue of the subsidiaries located there will reach 50% and Merko will achieve 5% market share in the Baltic construction market.

In 2006, deficit of locally manufactured construction materials and labour will deepen and the price appreciation of construction services will continue. The companies committed to long-term offers will be hit the hardest.

Our experience, knowledge, and people dedicated to their work is value which has brought success for Merko Ehitus and enabled us to continue to be successful in a changing environment. We believe that we will be able to shape the year 2006 so that is will be a successful one for our business partners, customers, the Company's employees and shareholders.

Financial statements

Management declaration

The Management Board confirms the correctness and completeness of AS Merko Ehitus consolidated financial statements as presented on pages 9-52.

The Management Board confirms that to the best of its knowledge:

- the accounting methods used for preparing the financial statements are in compliance with International Financial Reporting Standards as adopted by the European Union;
- the financial statements give a true and fair view of the financial position, the results of operations and the cash flows of the parent company and the Group;
- the parent company and all group companies are going concerns.

Tõnu Toomik	Chairman of the Management Board	29.03.2006
Alar Lagus	Member of the Management Board	29.03.2006
Veljo Viitmann	Member of the Management Board	29.03.2006
Jaan Mäe	Member of the Management Board	29.03.2006
Andres Agukas	Member of the Management Board	29.03.2006

CONSOLIDATED INCOME STATEMENT

in thousands of		EEK		EUR	
	Note	**2005**	**2004**	**2005**	**2004**
Sales	*2*	**3,232,392**	3,110,399	**206,588**	198,791
Cost of goods sold	*3*	**(2,738,714)**	(2,695,989)	**(175,036)**	(172,305)
Gross porfit		**493,678**	414,410	**31,552**	26,486
Marketing expenses	*4*	**(22,595)**	(18,138)	**(1,444)**	(1,159)
Administrative and general expenses	*5*	**(127,632)**	(89,089)	**(8,157)**	(5,694)
Other operating income	*6*	**185,052**	72,063	**11,827**	4,605
Other operating expenses	*7*	**(93,452)**	(59,542)	**(5,973)**	(3,805)
Operating profit		**435,051**	319,704	**27,805**	20,433
Financial income	*8*	**6,253**	5,743	**400**	367
Finance cost	*9*	**(4,710)**	(26,919)	**(301)**	(1,721)
Profit (loss) from sale of subsidiary	*18*	**7,498**	(299)	**479**	(19)
Profit (loss) from associates and joint ventures	*19*	**19,632**	9,950	**1,255**	636
incl. profit (loss) from equity participation		**17,065**	9,950	**1,091**	636
Profit before tax		**463,724**	308,179	**29,638**	19,696
Corporate income tax expense	*10*	**(18,437)**	(9,997)	**(1,178)**	(639)
Net profit for financial year		**445,287**	298,182	**28,460**	19,057
incl. net profit attributable to equity holders of the parent company		**438,638**	294,600	**28,034**	18,828
minority interest		**6,649**	3,582	**426**	229
Earnings per share for profit attributable to the equity holders of the parent company (basic and diluted, in kroons/euros)	*11*	**24.78**	16.64	**1.58**	1.06

The notes on pages 15-52 are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

in thousands of		EEK		EUR	
	Note	**31.12.2005**	**31.12.2004**	**31.12.2005**	**31.12.2004**
ASSETS					
Current assets					
Cash and cash equivalents	*13*	**268,446**	141,812	**17,157**	9,063
Financial assets at fair value through profit or loss	*14*	**-**	11,775	**-**	753
Trade receivables	*15*	**542,110**	496,943	**34,648**	31,761
Prepaid corporate income tax		**2,471**	2,222	**158**	142
Inventories	*17*	**964,088**	449,399	**61,617**	28,722
Total current assets		**1,777,115**	1,102,151	**113,580**	70,441
Non-current assets					
Investments in associates and joint ventures	*19*	**179,609**	35,446	**11,479**	2,265
Other long-term loans and receivables	*20*	**8,524**	15,868	**545**	1,014
Deferred income tax assets	*21*	**8,753**	4,124	**559**	264
Investment property	*22*	**42,506**	61,389	**2,716**	3,924
Property, plant and equipment	*23*	**199,004**	78,516	**12,718**	5,018
Intangible assets	*24*	**4,365**	1,110	**279**	71
Total non-currents assets		**442,761**	196,453	**28,296**	12,556
TOTAL ASSETS		**2,219,876**	1,298,604	**141,876**	82,997
LIABILITIES					
Current liabilities					
Borrowings	*26*	**114,841**	12,578	**7,340**	804
Trade payables	*27*	**711,236**	486,857	**45,456**	31,116
Corporate income tax liability		**950**	1,313	**61**	84
Government grants	*28*	**22,225**	44,818	**1,420**	2,865
Short-term provisions	*29*	**21,741**	5,784	**1,390**	369
Total current liabilities		**870,993**	551,350	**55,667**	35,238
Non-current liabilities					
Long-term borrowings	*26*	**202,824**	14,046	**12,963**	898
Other long-term trade payables	*30*	**22,726**	8,038	**1,452**	514
Deferred income tax liability	*31*	**11,385**	-	**728**	-
Total non-current liabilities		**236,935**	22,084	**15,143**	1,412
TOTAL LIABILITIES		**1,107,928**	573,434	**70,810**	36,650
EQUITY					
Minority interest		**10,552**	7,200	**674**	460
Equity attributable to equity holders of the parent company					
Share capital	*33*	**177,000**	88,500	**11,312**	5,656
Share premium		**-**	2,950	**-**	189
Statutory reserve capital		**8,850**	8,850	**566**	566
Currency translation adjustment		**(5,059)**	(4,663)	**(323)**	(298)
Retained earnings		**920,605**	622,333	**58,837**	39,774
Total equity attributable to equity holders of the parent company		**1,101,396**	717,970	**70,392**	45,887
TOTAL EQUITY		**1,111,948**	725,170	**71,066**	46,347
TOTAL LIABILITIES AND EQUITY		**2,219,876**	1,298,604	**141,876**	82,997

The notes on pages 15-52 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

in thousands of EEK	*Note*	Equity attributable to equity holders of the parent company						Minority interest	Total
		Share capital	Share premium	Statutory reserve capital	Currency translation adjustment	Retained earnings	Total		
Balance as at 31.12.2003		88,500	2,950	8,850	(1,380)	364,903	463,823	4,809	468,632
Effect of exchange rate changes		-	-	-	(3,283)	-	(3,283)	-	(3,283)
Net profit for financial year		-	-	-	-	294,600	294,600	3,582	298,182
Business combinations		-	-	-	-	-	-	409	409
Total recognized income for 2004		**-**	**-**	**-**	**(3,283)**	**294,600**	**291,317**	**3,991**	**295,308**
Dividends	*33*	-	-	-	-	(37,170)	(37,170)	(1,600)	(38,770)
Balance as at 31.12.2004		**88,500**	**2,950**	**8,850**	**(4,663)**	**622,333**	**717,970**	**7,200**	**725,170**
Effect of changes in accounting policies 01.01.2005	*1.3.2*	-	-	-	-	2,709	2,709	-	2,709
Effect of exchange rate changes		-	-	-	(396)	-	(396)	-	(396)
Net profit for financial year		-	-	-	-	438,638	438,638	6,649	445,287
Business combinations		-	-	-	-	-	-	(697)	(697)
Total recognized income for 2005		**-**	**-**	**-**	**(396)**	**441,347**	**440,951**	**5,952**	**446,903**
Equity capitalization	*33*	88,500	(2,950)	-	-	(85,550)	-	-	-
Dividends	*33*	-	-	-	-	(57,525)	(57,525)	(2,600)	(60,125)
Balance as at 31.12.2005		**177,000**	**-**	**8,850**	**(5,059)**	**920,605**	**1,101,396**	**10,552**	**1,111,948**

Consolidated statement of changes in equity (continued)

in thousand of EUR	Equity attributable to equity holders of the parent company							
	Share capital	Share premium	Statutory reserve capital	Currency translation adjustment	Retained earnings	Total	Minority interest	Total
Balance as at 31.12.2003	5,656	189	566	(88)	23,321	29,644	307	29,951
Effect of exchange rate changes	-	-	-	(210)	-	(210)	-	(210)
Net profit for financial year	-	-	-	-	18,828	18,828	229	19,057
Business combinations	-	-	-	-	-	-	26	26
Total recognized income for 2004	**-**	**-**	**-**	**(210)**	**18,828**	**18,618**	**255**	**18,873**
Dividends	-	-	-	-	(2,375)	(2,375)	(102)	(2,477)
Balance as at 31.12.2004	**5,656**	**189**	**566**	**(298)**	**39,774**	**45,887**	**460**	**46,347**
Effect of changes in accounting policies 01.01.2005	-	-	-	-	173	173	-	173
Effect of exchange rate changes	-	-	-	(25)	-	(25)	-	(25)
Net profit for financial year	-	-	-	-	28,034	28,034	426	28,460
Business combinations	-	-	-	-	-	-	(46)	(46)
Total recognized income for 2005	**-**	**-**	**-**	**(25)**	**28,207**	**28,182**	**380**	**28,562**
Equity capitalization	5,656	(189)	-	-	(5,467)	-	-	-
Dividends	-	-	-	-	(3,677)	(3,677)	(166)	(3,843)
Balance as at 31.12.2005	**11,312**	**-**	**566**	**(323)**	**58,837**	**70,392**	**674**	**71,066**

The notes on pages 15-52 are an integral part of these consolidated financial statements.

Consolidated cash flow statement

in thousands of		EEK		EUR	
	Note	**2005**	**2004**	**2005**	**2004**
CASH FLOWS FROM OPERATING ACTIVITIES					
Operating profit		**435,051**	319,704	**27,805**	20,433
Adjustments:					
depreciation and amortisation	*2, 22-24*	**109,637**	70,903	**7,007**	4,532
(profit) loss from sale of non-current assets	*6, 23*	**(535)**	(545)	**(34)**	(35)
(profit) loss from sale of a unit	*6*	**-**	(11,651)	**-**	(745)
adjustment of revenue from construction contracts under stage of completion method		**66,630**	(173,460)	**4,258**	(11,086)
interest income from business activities		**(5,590)**	(2,591)	**(357)**	(166)
change in government grants and other provisions		**(22,973)**	7,650	**(1,468)**	489
Change in trade receivables related to operating activities		**(27,321)**	157,969	**(1,746)**	10,096
Change in inventories		**(464,906)**	(280,660)	**(29,713)**	(17,937)
Change in trade payables related to operating activities		**186,556**	28,092	**11,923**	1,795
Interest paid		**(2,811)**	(1,692)	**(180)**	(108)
Other financial income		**3,857**	-	**247**	-
Corporate income tax paid		**(12,928)**	(15,359)	**(826)**	(982)
Total cash flows from operating activities		**264,667**	98,360	**16,916**	6,286
CASH FLOWS FROM INVESTING ACTIVITIES					
Investments into subsidiaries	*18*	**(23,985)**	(5,950)	**(1,533)**	(380)
Proceeds from sale of subsidiaries	*18*	**3,376**	700	**216**	45
Liquidation proceeds of subsidiary to minority shareholders	*18*	**(694)**	-	**(44)**	-
Investments into associates and joint ventures	*19*	**(136,228)**	(2,393)	**(8,707)**	(153)
Proceeds from sale of associates and joint ventures		**8,306**	-	**531**	-
Proceeds from sale of other financial investments		**3**	141	**0**	9
Purchase of investment property	*22*	**(63)**	(17,018)	**(4)**	(1,088)
Purchase of property, plant and equipment	*23*	**(226,960)**	(79,996)	**(14,505)**	(5,113)
Proceeds from sale of property, plant and equipment	*23*	**2,143**	985	**137**	63
Purchase of intangible assets		**(2,917)**	(1,699)	**(186)**	(108)
Sales of a unit		**2,752**	(776)	**176**	(49)
Loans granted	*16*	**(190,123)**	(108,961)	**(12,151)**	(6,964)
Loan repayments received	*16*	**176,311**	51,121	**11,268**	3,267
Interest received		**6,641**	6,751	**424**	431
Dividends received		**3,323**	1,679	**212**	107
Total cash flows from investing activities		**(378,115)**	(155,416)	**(24,166)**	(9,933)
CASH FLOWS FROM FINANCING ACTIVITIES					
Proceeds from borrowings	*26*	**293,567**	9,143	**18,762**	584
Repayments of borrowings	*26*	**(6,724)**	(9,063)	**(430)**	(579)
Finance lease principal payments	*26*	**(5,832)**	(3,373)	**(373)**	(216)
Proceeds from issue of ordinary shares in subsidiary		**-**	105	**-**	7
Government grants received	*28*	**22,225**	-	**1,421**	-
Dividends paid		**(60,128)**	(38,770)	**(3,843)**	(2,478)
Total cash flows from financing activities		**243,108**	(41,958)	**15,537**	(2,682)
Change in cash and cash equivalents		**129,660**	(99,014)	**8,287**	(6,329)
Cash and cash equivalents at beginning of year	*13*	**141,812**	240,152	**9,063**	15,349
Effect of exchange rate changes		**(3,026)**	674	**(193)**	43
Cash and cash equivalents at end of year	*13*	**268,446**	141,812	**17,157**	9,063

The notes on pages 15-52 are an integral part of these consolidated financial statements.

Notes

Note 1 Accounting principles

1.1 General bases

The consolidated financial statements of the Merko Ehitus Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The financial statements have been prepared under the historical cost convention, except for financial assets at fair value through profit or loss.

Several financial figures are based on management's estimates, including for example, assessment of profitability of construction contracts upon the application of the stage of completion method, assessment of the useful life of property, plant and equipment, assessment of the impairment losses of receivables and inventories, setting up provisions for warranty obligations. Management's estimates have been made to the best of its knowledge, but they may not be accurate. The effect of changes in accounting estimates is reported in the financial statements of the period in which the change occurred.

Assets and liabilities have been classified as current and non-current in the balance sheet. Current assets include assets that are expected to be exchanged or used within the next financial year (except deferred tax asset that is classified as non-current asset). Current liabilities include liabilities which due date is within 12 months after the balance sheet date (except deferred tax liability that is classified as non-current liability). The remaining assets and liabilities have been classified as non-current.

Expenses have been classified according to their function in the income statement.

The functional and presentation currency in the consolidated financial statements of Merko Ehitus Group is the Estonian kroon. The financial statements are presented in thousands of kroons. Pursuant to the requirements of Tallinn Stock Exchange, the principal financial statements have also been presented in thousands of euros. As the Estonian kroon is pegged to the euro (EUR 1=EEK 15.6466), then no exchange rate differences arise in the translation of the financial statements.

1.2. New IFRS standards and interpretations

New IFRS standards and several changes in existing standards were implemented since 1 January 2005. The adoption of these changes became obligatory for the Group from the financial year started on 1 January 2005.

In 2005 the Group adopted all new and revised standards that are effective from or before 1 January 2005. The amended standards, which are applied from 1 January 2005 are the following:

- IAS 2 (revised 2003), Inventories
- IAS 10 (revised 2003), Events After Balance Sheet Date
- IAS 17 (revised 2003), Leases
- IAS 21 (revised 2003), The Effects of Changes in Foreign Exchange Rates
- IAS 27 (revised 2003), Consolidated and Separate Financial Statements
- IAS 32 (revised 2003), Financial Instruments: Disclosure and Presentation
- IAS 33 (revised 2003), Earnings per Share
- IAS 39 (revised 2003), Financial Instruments: Recognition and Measurement
- IAS 40 (revised 2004), Investment Property

The issued new standards and interpretations, which get into force for the period starting from 1 January 2005 and are applied respectively, are the following:

- IFRS 2, Share-based Payments
- IFRS 3, Business Combinations, which get into force for the period starting from 31 March 2004
- IFRS 4, Insurance Contracts
- IFRS 5, Non-current Assets Held for Sale and Discontinued Operations
- IFRIC 1, Changes in Existing Decommissioning, Restoration and Similar Liabilities
- IFRIC 2, Members' Shares in Co-operative Entities and Similar Instruments

The adoption of these amendments and interpretations to standards caused no significant changes to the existing recognition and measurement policies and had no impact to the profit of the Group. However, the adoption of the changed standards has resulted in certain changes in presentation of the financial information and in need to disclose additional information in the financial statements. Previous period's comparative figures have been presented in accordance with the new requirements.

1.3. Change in accounting policies

In preparing the consolidated financial statements for the year 2005, the following accounting policies have been changed:

1.3.1. In 2004, sales revenue from real estate development projects was recognised after the conclusion of a notarial preliminary contract, under the stage of completion method in accordance with International Financial Reporting Standard IAS 11 "Construction Contracts". As a result of the change, revenue from real estate development projects is recognised as sales revenue in accordance with Standard IAS 18 "Revenue", i.e. sales revenue is recognised after transferring the real estate property to the buyer. The effect of the change on comparative information for 2004 is immaterial.

1.3.2. In accordance with International Financial Reporting Standard IFRS 3 "Business Combinations", the carrying amount of negative goodwill which arose in business combinations before 31.03.2004 is taken off the balance sheet as an adjustment of the opening balance of retained earnings. As result, the opening balance of retained earnings and intangible assets as at 01.01.2005 has been adjusted by the carrying amount of negative goodwill which arose in the acquisition of the subsidiary Tallinna Teede AS in 2001 in the amount of 2,709 thousand kroons (Note 24).

1.3.3. In 2005, the subsidiary SIA Merks changed its accounting policy to account for its real estate project Arena Riga. This project has been undertaken in cooperation with Riga's City Government and the Ice Hockey World Championships are planned to be held in this hall in 2006. To cover the incidental expenses related to the short construction period, losses arising from the difference between the market value of this multi-functional hall built by SIA Merks (as the Company's own asset) and the construction and usage costs, plots of land whose fair value exceeded the purchase price were sold to SIA Merks in 2004. In the financial statements for 2004, the construction of the hall as well as the acquired plots of land were reported at acquisition cost. In the financial statements for 2005, these grants are reported under the gross method in accordance with IAS 20 "Government Grants". In conjunction with the change of accounting policies, the comparative information for 2004 has been adjusted, as result of which the acquisition cost of plots was increased to their fair value at the time of acquisition (recognised in inventories) and the liability was increased (deferred income from government grants), both in the amount of 98,067 thousand kroons. Capitalized construction costs of the hall were written down at the end of 2004 to reflect its fair value, according to IAS 36. The impairment loss arising from revaluation in the amount of 55,865 thousand kroons was covered by the income from the government grant. As at 31.12.2004, the amount of the grant was 44,818 thousand kroons, which will be used for covering the costs arising from further write-downs of the hall.

Balance sheet for 2004

in thousands of kroons	reported in 2004	change	adjusted in 2004
Inventories	351,332	98,067	449,399
Total current assets	1,004,084	98,067	1,102,151
Property, plant and equipment	131,765	(53,249)	78,516
Total assets	1,253,786	44,818	1,298,604
Government grants	-	44,818	44,818
Total current liabilities	506,532	44,818	551,350
Total liabilities	528,616	44,818	573,434
Total liabilities and equity	1,253,786	44,818	1,298,604

Income statement for 2004

in thousands of kroons	reported in 2004	change	adjusted in 2004
Other operating income	16,198	55,865	72,063
Other operating expenses	(3,677)	(55,865)	(59,542)

The changes in balance sheet items are translated from Latvian lat to Estonian kroon on the basis of foreign exchange rates of the Bank of Estonia at the balance sheet date, income and expenses on the basis of the weighted average foreign exchange rates for the year.

These adjustments did not affect the net profit, the cash flows and the statement of changes in equity for 2004.

The impact of the changes in the accounting principles to earnings per share (both basic and diluted) is immaterial.

1.4. Amendments to the presentation format

The following amendment has been made to the presentation format as compared to the previous year:

- interest income received on loans granted for business purposes has been reported in the income statement line *Other operating income*, last year it was included in *Financial income*.

Comparative information of the previous financial year has been changed in the financial statements to correspond to the new format. The effect of the amendment is immaterial.

1.5. Critical accounting estimates, and judgments in applying accounting policies

In accordance with International Financial Reporting Standards, certain decisions and estimates shall be made which may affect the assets and liabilities reported in the financial statements of the next financial year. In addition to estimates, the management will provide their estimates with regard to the application of accounting policies used.

The most significant management estimates are as follows:

1.5.1. Revenue under the stage of completion method

Revenue from construction in progress is recognised under the stage of completion method (Note 1.25), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, and reporting of income and expenses has been introduced to determine the stage of completion. The estimated final revenue to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the revenue estimate is adjusted. In the financial year, revenue was decreased by 103,424 thousand kroons (Note 34) as a result of determining the stage of completion of construction services in progress. Risk analysis showed that a change in the estimate of the stage of completion of construction projects in the range of +/- 10% will result in a change in the net profit in a range between an increase of 97,627 thousand kroons and the decrease of 207,960 thousand kroons.

1.5.2. Determination of the useful life of property, plant and equipment

Management has estimated the useful lives of property, plant and equipment, taking into consideration conditions and volumes of business activities, historical experience in this area and future outlook. Management estimates that the useful lives of buildings and facilities are between 10 and 33.3 years depending on their structure and use. The average useful lives of machinery and equipment are on average between 3 and 5 years and those of other fixtures between 2.5 to 5 years depending on the use of asset.

1.5.3. Assessing the recoverable amount of Arena Riga

Considering the experience in nabouring countries, where the recoverable amount of multifunctional halls established has been lower than the constructions cost, the management has carried out the impairment test of the Arena Riga in order to assess the recoverable amount of the hall. Taking into account the specifics of the hall, lack of active market and absence of a sales offer, determining the fair value of the hall through comparative sales arrangements was not feasible, which is why the recoverable value was determined via value in use.

In order to determine the value in use, the management analysed the indices of similar multifunctional halls in Estonia and Lithuania (number of events per year, average number of visitors per event day, average revenue/expense per event and visitor, expenses per halls usable area and visitor, etc.) and composed a business plan of the hall based on these indices. The cash-flows for the following 10 years and the present value of these cash-flows were generated based on the model. As a result of the impairment test and the recoverable amount determined, the hall was written down by 145,100 thousand kroons. As the Group has no experience in this field, it was not feasible to compare the cash-flow prognosis and assumptions with historical data.

1.6. Consolidation

Subsidiaries or entities that are either directly or indirectly through other subsidiaries controlled by the parent company AS Merko Ehitus have been combined on a line-by-line basis. Control exists when the parent company owns more than one half of the voting power of the subsidiary or otherwise has power to govern the operating and financial policies of the other entity. Subsidiaries are reported in the financial statements of the Group from the time of acquiring control until it is transferred.

The parent company and its subsidiaries are treated as one economic entity in the consolidated financial statements. Upon consolidation, intra-group receivables and liabilities, income and expenses as well as unrealised profits and losses arising from intragroup transactions have been eliminated in full. Minority interest is reported separately.

Group companies use uniform accounting policies for similar transactions occurred under similar circumstances.

1.7. Recognition of subsidiaries, associates and joint ventures in the financial statements of the parent company

In accordance with the Estonian Accounting Act, separate principal financial statements (of the parent company) shall be disclosed in the notes. The principal financial statements of the parent company are disclosed in Note 41. The principal financial statements of the parent company have been prepared using the same accounting methods and measurement bases that were used for the preparation of the consolidated financial statements.

Amendments to accounting policies in separate financial statements.

In conjunction with the amendment to IAS 27 "Consolidated and Separate Financial Statements" and IAS 31 "Joint ventures", the accounting policy for reporting subsidiaries, associates and joint ventures has been changed in the separate financial statements disclosed in the notes to the financial statements (Note 41) – instead of the previous equity method, subsidiaries, associates and joint ventures are accounted for at their acquisition cost in the separate financial statements. The effect of the change in the accounting policy was recorded as at 31 December 2004; the balance of retained earnings was reduced by 46,367 thousand kroons and currency translation adjustment reserve has increased by 4,663 thousand kroons. Accordingly, the cost of investments into subsidiaries has also been reduced.

1.8. Business combinations

Business combinations between independent parties are accounted for under the purchase method. The difference between the cost of an acquisition and the fair value of the acquired net assets is recorded as goodwill. From the date of acquisition, the revenue and expenses of the acquired entity are reported in the income statement of the Group and the resulting goodwill in the balance sheet of the Group.

Goodwill is the difference between cost of acquisition and the fair value of assets, liabilities and contingent liabilities acquired in a business combination, reflecting the portion of the acquisition cost which was paid for such assets of the acquired entity that cannot be separated and recognised separately. Goodwill is recognised at its acquisition cost as an intangible asset at the date of the acquisition.

Goodwill is subsequently measured at its acquisition cost less any impairment losses. Goodwill arising in a business combination is not amortised. Instead, an impairment test is carried out once a year. Goodwill is written down to its recoverable value if it is below its carrying amount.

With regard to goodwill which arose in business combinations set up before 31.03.2004, amortisation of goodwill has been terminated as at 01.01.2005, an impairment test has been carried out at the balance sheet date and if necessary, goodwill has been written down.

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement. Such differences that arose before 01.01.2005 has been included in retained earnings as at 01.01.2005 (see also Note 1.3.2).

1.9. Associates

Associates are entities over which the Group has significant influence but whose operating and financial policies it does not control. Significant influence is generally presumed to exist when the Group holds between 20 and 50% of the voting power of the investee. Investments into associates are accounted for under the equity method. Under the equity method, the amount of the investment is adjusted to recognise the share of the Group in the profits or losses of the associate and unrealised profits and losses arsing from mutual transactions have been eliminated based on the Group's share in the associate.

Investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

1.10. Joint ventures

Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at acquisition cost and subsequently adjusted by the changes that have occurred in the venturer's share of the net assets under common control. The income statement of the venturer includes the share of the venturer in the profits or losses of the entity under common control.

1.11. Jointly controlled operations

Under IAS 31 "Interests in Joint Ventures", jointly controlled operations are joint operations with third parties, whereby the assets and other resources of venturers are used without the establishment of a new company or another unit or creation of a separate financial structure. Each venturer uses its own property, plant and equipment and carries its own inventories in the balance sheet. The venturer also incurs its own expenses and liabilities and raises its own funds which represent its own obligations. In respect of its interest in jointly controlled operations, a venturer recognises in its financial statements:

- the assets that it controls and the liabilities it incurs;
- the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

1.12. Foreign currency

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia prevailing at the dates of the transactions. Monetary financial assets and liabilities denominated in foreign currencies as the balance sheet date are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing at the balance sheet date. Exchange rate differences from revaluation are reported in the income statement of the accounting period.

The functional currency of subsidiaries located abroad is the currency of their business environment; therefore the financial statements of such subsidiaries have been translated into Estonian kroons for consolidation purposes. The asset and liability items have been translated on the basis of foreign exchange rates of the Bank of Estonia, income and expenses on the basis of the weighted average foreign exchange rates for the year and other changes in equity have been translated using the foreign exchange rates at the date on which they arose. Exchange rate differences arising from translation are reported in the equity item *Currency translation adjustment*.

1.13. Financial assets

The purchases and sales of financial assets are recognised at the transaction date.

Depending on the purpose for which financial assets were acquired, investments are classified in the following categories at the Group:

- financial assets at fair value through profit or loss;
- loans and receivables not held for trading purposes;
- held-to-maturity investments;
- available-for-sale financial assets.

Financial assets at fair value through profit or loss include financial assets held for trading purposes (i.e. assets acquired or created principally for the purpose of selling or repurchasing in the short term; a part of a jointly managed portfolio of financial instruments; or a derivative financial instrument which is not a hedging instrument) and other financial assets that have not been designated by management at their initial recognition as at fair value through profit or loss. Assets in this category are classified as current assets if they are principally held for trading purposes or are expected to be realised within 12 months after the balance sheet date. After initial recognition, financial assets in this category are carried at fair value.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are included in current assets except for maturities greater than 12 months after the balance sheet date. Such assets are classified as non-current assets. Loans and receivables are initially recognised at their fair value less transaction costs. After initial recognition, the Group carries loans and receivables at amortised cost (less any impairment losses), calculating interest income on the receivable in the following periods using the effective interest rate method.

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information on the solvency of the party to transaction. Receivables whose collection is improbable are expensed during the accounting period.

The Company does not have any held-to-maturity and available-for-sale financial assets. The Company does not have any derivative transactions either.

1.14. Impairment of assets

Financial assets at amortised cost

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Company about the following events:

- significant financial difficulty of the issuer or debtor;
- a breach of contract, such as a default or delinquency in payments;

- it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

If there is objective evidence that an impairment loss has been incurred on loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Non-financial asset

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of impairment at each reporting date.

1.15. Inventories

Inventories are recorded in the balance sheet at their acquisition cost, consisting of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition.

In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishably from each other, then the weighted average cost method is used.

Inventories are accounted for in the balance sheet at the lower of acquisition cost and net realisable value. The net realisable value is the sales price less estimated costs to sell.

Expenditure incurred for real estate development is reported in the balance sheet line *Inventories* either as work in progress or finished goods depending on the stage of completion. A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Sales revenue is recognised as income from the sale of goods. Upon the sale of real estate properties, a notary certified agreement is entered into between the transferor and the acquirer for transferring the property and the respective entry is made in the land register.

1.16. Investment property

Investment property is real estate property which is primarily held for the purpose of earning rental income or for capital appreciation or for both, but not for the production of goods or services, for administrative purposes or for sale in the ordinary course of business. Investment property is measured under the acquisition cost method, that is at acquisition cost less any accumulated depreciation and any accumulated impairment losses.

Buildings included in investment properties are depreciated on a straight-line basis over the period of 12.5 to 33.3 years. Land is not depreciated.

1.17. Property, plant and equipment

An item of property, plant and equipment is an asset used for production, provision of services or administrative purposes over a period longer than one year. The acquisition cost consists of the purchase price of the asset and other expenditure incurred in bringing the asset to its operating condition and location.

An item of property, plant and equipment is carried in the balance sheet at acquisition cost less any accumulated depreciation. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years;
- machinery and equipment 3-5 years:
- other property, plant and equipment 2.5-5 years;
- right of superficies 50 years;
- land is not depreciated.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Non-current assets are written down to their recoverable value if the recoverable value is below the carrying amount. The recoverable value is the higher of the asset's net selling price and its value in use.

1.18. Other intangible assets

Other intangible assets (development costs, patents, licenses, trademarks, software) are recognised in the balance sheet when the asset is controlled by the Company, it gives rise to future economic benefits and the cost of the asset can be measured reliably. The acquisition cost of an intangible asset consist of its purchase price and other expenditure directly related to the purchase. Other intangible assets are carried in the balance sheet at acquisition cost less any accumulated amortisation. Amortisation is calculated on a straight-line basis over the estimated useful lives of assets, which is 5 years maximum.

1.19. Finance and operating leases

Leases of property, plant and equipment where the company has substantially all the risks and rewards of ownership are classified as finance leases. All other leases are recognised as operating leases.

Assets and liabilities leased under the finance lease terms are reported in the balance sheet at the lower of fair value of the leased asset and the present value of minimum rental payments. Items of property, plant and equipment leased under the finance lease terms are depreciated over the shorter of the lease term and the useful life.

Finance lease liabilities are reduced by principal payments; interest expenses on rental payments are included in financial expenses in the income statement.

Operating lease payments are reported in the income statement as expenses on an accrual basis over the lease term.

1.20. Corporate income tax

According to the Income Tax Act of the Republic of Estonia, legal persons are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, reception costs, dividends and payments not related to business operations. Thus there are no differences between the tax bases and the carrying values of assets which would give rise to a deferred income tax liability.

The tax rate on dividends payable is 23/77 (until 31.12.2005: 24/76 and until 31.12.2004: 26/74) of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared.

Corporate income tax on profits earned by subsidiaries located in Latvia and Lithuania and the deferred income tax expenses or income as well as the corporate income tax on dividends of Estonian companies are reported in the consolidated income statement.

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the balance sheet. Deferred tax assets are recognised in the company's balance sheet if their future realisation is probable.

Legal persons in Latvia and Lithuania that belong to the Group calculate taxable income and the corporate income tax in accordance with the legislation of the Republic of Latvia and the Republic of Lithuania. The profits of entities located in the Republic of Latvia and the Republic of Lithuania are taxed at the rate of 15%.

1.21. Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest rate method.

Borrowings are classified as current liabilities unless the borrower has an unconditional right to defer the settlement of the liability for at least 12 months after the balance sheet date.

1.22. Employee benefits

1.22.1. Termination benefits – Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an other offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

1.22.2. Profit-sharing and bonus plans – The Group recognizes a liability and an expense for bonuses and profit-sharing, based on formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognizes a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

1.23. Provisions

Provisions are constructive or legal obligations which arise as a result of events occurring before the balance sheet date. Setting up of provisions or increasing existing provisions is recognised as expenses in the income statement of the accounting period.

Pursuant to the Building Act, the construction companies of the Group provide 2-year warranties on their buildings. The calculation of warranty provisions is based on the management estimates and actual experience of previous periods with regard to actual warranty expenses.

1.24. Revenue

Revenue is recognised at the fair value of the consideration received or receivable.

Revenue from the sale of goods (incl. sale of a real-estate development projects) is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer, the amount of revenue and the costs incurred in respect of the transaction can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the enterprise.

Revenue from the provision of services is recognised based on the stage of completion of the service at the balance sheet date.

Revenue arising from interest and dividends is recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of the revenue can be measured reliably.

1.25. Construction contracts

Income and expenses of unfinished construction services have been matched under the stage of completion method. The stage of completion is determined on the basis of the relationship between the actual costs incurred by the balance sheet date and the estimated costs of the contract. The actual costs of the contract consist of direct and general costs of the construction contact.

If invoices submitted to the customer by the balance sheet date are either higher or lower than the income calculated under the stage of completion method, then the difference is recognised as a liability or as a receivable in the balance sheet.

When it is probable that total contract costs exceed total contract revenue, the expected loss is recognised as an expense immediately.

1.26. Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs, which they are intended to compensate. Government grants received to compensate the operating expenses of the previous period or where there are no additional conditions attached to grants to be addressed in the future, are accounted for as income when the grant is received. Government grants are recognised where there is reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

1.27. Cash and cash equivalents

In the balance sheet and the cash flow statement, cash and cash equivalents are highly liquid funds with low variation in value, such as cash on hand, cash in bank accounts, highly liquid securities such as money market funds and term deposits of three months or less.

The indirect method has been used for the preparation of the cash flow statement.

1.28. Contingent liabilities

Contingent liabilities are those liabilities whose realisation is less probable than non-realisation and whose amount cannot be determined reliably. Potential liabilities are not recognised in the balance sheet, they are disclosed in the notes to the financial statements.

1.29. Statutory reserve capital

Reserve capital is formed to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be entered in reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

1.30. Events after the balance sheet date

The financial statements of the reporting period include material circumstances affecting the assessment of assets and liabilities which became evident between the balance sheet date and the date of preparing the financial statements but that are related to transactions in the accounting period or previous periods. Material events after the balance sheet date not related to transactions in the accounting period or previous periods are not reported in the balance sheet but they are disclosed in the notes to the financial statements.

1.31. Related parties

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

- parent company AS Merko Grupp;
- shareholders of AS Merko Grupp with significant influence through AS Merko Grupp;
- other shareholders with significant influence;
- other subsidiaries of AS Merko Grupp;
- subsidiaries;
- other controllable subsidiaries;
- joint ventures;
- associates;
- close relatives of persons with significant influence;
- key managers and their close relatives;
- entities under control of persons mentioned above;
- companies sharing key managers with AS Merko Ehitus.

Significant influence is presumed to exist when the person has more than 20% of the voting power.

1.32. Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

1.33. Segment reporting

A business segment is a part of the Group engaged in making similar products or providing similar services and whose profitability and risks differ from those of other parts of the Group. The business segments at the Group are construction from which road construction has been separated, construction of communication networks and production of concrete elements. Segment expenses are those which are incurred in the segment's main operations and which can be allocated to the segment reliably and objectively. Such expenses, assets and liabilities have not been allocated to segments cannot be or are not suitable to be associated with a specific segment. Business segments have been considered as primary segments when preparing the financial statements.

A geographical segment is a part of the Group whose operating activities occur in an economic environment whose returns and risks differ from the respective figures of other parts of the Group. The main geographical segments at the Group are Estonia, Latvia and Lithuania. When preparing the financial statements, geographical segments have been considered as secondary segments.

The main operating environment of the parent company is Estonia. All business segments of the Group are represented in Estonia. Construction is the main business segment in Latvia and Lithuania. The segment's sales revenue is shown on the basis of geographical segments of markets and segment's assets, based on the geographical location of assets.

1.34. New International Financial Reporting Standards and International Financial Reporting Interpretations Committee (IFRIC) interpretations

By the time of preparing these financial statements, new International Financial Reporting Standards and their interpretations have been issued which shall become mandatory for the Company's financial statements prepared for accounting periods beginning at or after 1 January 2006. Below is the Company's estimate on the potential effect of new standards and interpretations on the financial statements upon their first-time application.

Amendment to **IAS 1** – *Presentation of Financial Statements:* Capital disclosures. The amendment to IAS 1 shall be applied to accounting periods beginning at or after 1 January 2007. The Company has decided not to apply the amendments to the standards early. The standard requires additional disclosures in the financial statements.

Amendments to **IAS 39** – *Financial Instruments: Recognition and Measurement* (Recognition of cash flow hedges for forecasting intra-group transactions; Fair value option). The amendments to the standards shall be applied to accounting periods beginning at or after 1 January 2006. The Company has decided not to apply the amendments to the standards early. The management estimates that the application of the amendments will not lead to any changes in the recognition of existing assets and liabilities at the time of preparing the financial statements.

Amendment to **IAS 39** *Financial Instruments: Recognition and Measurement* and **IFRS 4** *Insurance Contracts – Financial guarantee contracts*. The amendments to the standards shall be applied to accounting periods beginning at or after 1 January 2006. The Group has decided not to apply the amendments to the standards early. The management estimates that the application of the amendments will not lead to any changes in the recognition of existing assets and liabilities at the time of preparing the financial statements.

IFRS 7 – *Financial instruments:* Disclosures. IFRS 7 shall be applied to accounting periods beginning at or after 1 January 2007. The Company has decided not to apply the amendments to the standards early. The standard requires additional disclosures in the financial statements.

IFRIC 4 – *Determining Whether an Arrangement Contains a Lease*. IFRIC 4 shall be applied to accounting periods beginning at or after 1 January 2006. The Company has decided not to apply IFRIC 4 early. The management estimates that the application of IFRIC 4 will not lead to any changes in the recognition of existing agreements at the time of preparing the financial statements.

Amendment to **IAS 19** – *Concerning Reporting Actuarial Gains and Losses and disclosures* (effective from 1 January 2006)

Amendment to **IAS 21** – *The Effects of Changes in Foreign Exchange Rates* (effective from 1 January 2006).

Amendment to **IFRS 1** – *First-time Application of IFRS and amendment* to **IFRS 6** – *Exploration for and Evaluation of Mineral Resource* (effective from 1 January 2006)

IFRIC 5 – *Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (effective from 1 January 2006)

IFRIC 6 – *Liabilities Arising from Participating in a Specific Market: Waste Electrical and Electronic Equipment* (applicable for periods beginning at or after 1 December 2005 and effective from 1 January 2006)

IFRIC 7 – *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Environments* (applicable for periods beginning at or after 1 March 2006 and effective from 1 January 2007)

IFRIC 8 – *Scope of IFRS 2* (applicable for periods beginning at or after 1 May 2006 and effective from 1 January 2007)

IFRIC 9 – *Reassessment of Embedded Derivatives* (effective from 1 June 2006)

IFRS 6 – *Exploration for and Evaluation of Mineral Resources* (effective from 1 January 2006)

IFRS 7, IAS 21, IFRS 6 and IFRS 1 have not yet been endorsed by the European Union. Despite that, the Company's management has decided to refer to these standards above, as the European Union may require their application retrospectively. For example, IFRIC 2 was officially issued at 7 July 2005, but is application is mandatory for periods beginning at or after 1 January 2005. Thus, the standard was entered into force and applied retrospectively before the date of endorsement.

Note 2 Business and geographical segments

Business segments

2005 *in thousands of kroons*	Construc-tion	Road construction	Concrete elements	Construction of communication networks	Group
Sales	3,028,386	204,006	-	-	**3,232,392**
Sales between segments	4,773	34,338	-	-	**(39,111)**
Sales of the segment	3,033,159	238,344	-	-	**3,271,503**
Segment's operating profit	416,770	18,281	-	-	**435,051**
Financial income (expenses)					**28,673**
incl. profit (loss) from associates and joint ventures (Note 19)	5,839	1,924	10,660	1,209	**19,632**
Profit before tax					**463,724**
Corporate income tax					**(18,437)**
Net profit of the Group					**445,287**
incl. attributable to equity owners of the parent company					**438,638**
minority interest					**6,649**
Segment's assets	1,856,012	121,555	-	-	**1,977,567**
Associates and joint ventures	150,773	-	25,302	3,534	**179,609**
Unallocated assets					**62,700**
Total consolidated assets					**2,219,876**
Segment's liabilities	715,238	37,671	-	-	**752,909**
Unallocated liabilities					**355,019**
Total consolidated liabilities					**1,107,928**
Purchase of investment property	63	-	-	-	**63**
Purchase of property, plant and equipment and intangible assets	227,228	9,015	-	-	**236,243**
Depreciation and amortisation (Notes 22-24)	99,525	10,112	-	-	**109,637**

2004 *in thousands of kroons*	Construc-tion	Road construction	Concrete elements	Construction of communication networks	Group
Sales	2,962,857	147,542	-	-	**3,110,399**
Sales between segments	483	13,819	-	-	**(14,302)**
Sales of the segment	2,963,340	161,361	-	-	**3,124,701**
Segment's operating profit	297,432	22,272	-	-	**319,704**
Financial income (expenses)					**(11,525)**
incl. profit (loss) from associates and joint ventures (Note 19)	6,107	531	5,243	(1,931)	**9,950**
Profit before tax					**308,179**
Corporate income tax					**(9,997)**
Net profit of the Group					**298,182**
incl. attributable to equity owners of the parent company					**294,600**
minority interest					**3,582**
Segment's assets	1,138,264	87,043	-	-	**1,225,307**
Associates and joint ventures	20,284	3,627	5,243	6,292	**35,446**
Unallocated assets					**37,851**
Total consolidated assets					**1,298,604**
Segment's liabilities	520,263	15,119	-	-	**535,382**
Unallocated liabilities					**38,052**
Total consolidated liabilities					**573,434**
Purchase of investment property	6,468	-	-	-	**6,468**
Purchase of property, plant and equipment and intangible assets	63,579	15,673	-	-	**79,252**
Depreciation and amortisation (Notes 22-24)	61,934	8,969	-	-	**70,903**

Costs, assets and liabilities that cannot be related to a specific asset or it is not practical to do so are considered as unallocated.

Note 2 Business and geographical segments (continued)

Geographical segments

in thousands of kroons		
Sales	2005	2004
Estonia	2,441,325	2,489,027
Latvia	560,107	460,510
Lithuania	230,960	160,862
Total	**3,232,392**	**3,110,399**

	Total assets		Purchase of investment property		Purchase of property, plant and equipment	
in thousands of kroons	**31.12.2005**	**31.12.2004**	**2005**	**2004**	**2005**	**2004**
Estonia	1,033,085	849,690	39	6,468	20,440	21,119
Latvia	991,929	321,926	24	-	215,356	57,861
Lithuania	194,862	126,988	-	-	447	272
Total	**2,219,876**	**1,298,604**	**63**	**6,468**	**236,243**	**79,252**

Note 3 Cost of goods sold

in thousands of kroons	**2005**	**2004**
Materials	367,736	369,727
Construction services	1,934,926	1,931,422
Sale of investment property	78,303	68,972
Staff costs	152,619	135,464
Depreciation and amortisation	15,253	12,293
Design	72,115	45,799
Construction mechanisms and transportation	82,951	77,886
Other expenses	34,811	54,426
Total cost of goods sold	**2,738,714**	**2,695,989**

Note 4 Marketing costs

in thousands of kroons	**2005**	**2004**
Staff costs	11,651	7,255
Depreciation and amortisation	253	168
Advertising costs, sponsorship	5,017	4,514
Transportation	1,256	1,060
Construction tenders	918	1,576
Other expenses	3,500	3,565
Total marketing costs	**22,595**	**18,138**

Note 5 General and administrative expenses

in thousands of kroons	**2005**	**2004**
Staff costs	72,967	54,373
Depreciation and amortisation	4,793	2,577
Computer equipment and information services	10,413	5,446
Transportation	5,677	4,489
Offices expenses, communications services	14,638	10,965
Other expenses	19,144	11,239
Total general and administrative expenses	**127,632**	**89,089**

Note 6 Other operating income

in thousands of kroons	2005	2004
Proceeds from sale of non-current assets	535	545
Fines and amounts for delay received	971	657
Foreign exchange gains	16	-
Proceeds from sales of a unit	-	11,651
Interest income from operating activities	5,590	2,591
Revenue from government grants	177,333	55,865
Other income	607	754
Total other operating income	**185,052**	**72,063**

Note 7 Other operating expenses

in thousands of kroons	2005	2004
Fines, penalties	2,790	1,213
Foreign exchange loss	-	673
Gifts, donations	904	872
Depreciation and impairments	89,338	55,865
Other expenses	420	919
Total other operating expenses	**93,452**	**59,542**

Note 8 Financial income

in thousands of kroons	2005	2004
Financial income from other long-term loans and receivables	11	-
Interest income	1,470	5,607
Gains of financial assets at fair value through profit or loss	3	-
Other financial income	4,769	136
Total financial income	**6,253**	**5,743**

Note 9 Finance cost

in thousands of kroons	2005	2004
Interest expenses	2,418	3,395
Foreign exchange losses	2,277	5,254
Losses of financial assets at fair value through profit or loss	-	14,557
Loss from revaluation of financial assets at fair value through profit or loss	-	2,949
Other financial expenses	15	764
Total finance cost	**4,710**	**26,919**

NOTE 10 CORPORATE INCOME TAX

in thousands of kroons	**2005**	**2004**
Profit before tax	463,724	308,179
Corporate income tax on dividends	8,830	6,672
Corporate income tax	2,851	3,325
Deferred income tax expense	6,756	-
incl. deferred income tax gain (Note 21)	(4,629)	-
deferred income tax expense (Note 31)	11,385	-
Total corporate income tax	**18,437**	**9,997**

NOTE 11 EARNINGS PER SHARE

Basic earnings per share for profit attributable to the equity holders of the parent company has been derived by dividing the net profit attributable to the shareholders by the weighted average number of shares, without considering treasury shares (in 2004 and 2005, AS Merko Ehitus did not hold any treasury shares).

	2005	**2004**
Net profit attributable to shareholders (in thousands of kroons)	438,638	294,600
Weighted average number of ordinary shares (thousand pcs)	17,700	17,700
Earnings per share (in kroons)	**24.78**	**16.64**

The figures for 2004 have been calculated taking into consideration the equity capitalization which took place in the accounting period (Note 33).

In 2004 and 2005, the Group did not have any potential ordinary shares to be issued, therefore the diluted earnings per share equal the basic earnings per share.

NOTE 12 DIVIDENDS PER SHARE

Dividends payable are recognised after the approval of profit allocation at the General Meeting of Shareholders. According to the profit allocation proposal, 88,500 thousand kroons will be distributed in 2006, i.e. 5.00 kroons per share and the accompanying income tax expense will amount to 23/77 of the amount payable, i.e. 26,435 thousand kroons.

In 2005, 57,525 thousand kroons i.e. 6.50 kroons per share were paid out, and the accompanying income tax amounted to 4,446 thousand kroons.

NOTE 13 CASH AND CASH EQUIVALENTS

in thousands of kroons	**31.12.2005**	**31.12.2004**
Cash on hand	97	137
Bank accounts	135,577	36,763
Short-term deposits	121,258	95,206
Units of Estonian money market funds	11,514	9,706
Total cash and cash equivalents	**268,446**	**141,812**

As at 31.12.2005, the interest on short-term bank overnight deposits was 2.15% (31.12.2004: 2.0%) and the weighted average interest on term deposits was 2.5% (2004: 2.41%). As at 31.12.2005 the weighted average maturity of the bank deposits is 7.6 days (2004: 10.6 days). The average rate of return on the units of Estonian money market funds over the last 12 months was 1.87% (2004: 2.04%).

NOTE 14 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

in thousands of kroons	**31.12.2005**	**31.12.2004**
Financial assets at fair value through profit or loss	-	11,775
Total financial assets at fair value through profit or loss	**-**	**11,775**

As at 31.12.2004, shares in the amount 11,755 thousand kroons that belonged to the subsidiary SIA Merks, and that were sold in 2005 have been recognised at the Group. The expense related to the revaluation to fair value amounted to 1,149 thousand kroons.

NOTE 15 TRADE RECEIVABLES

in thousands of kroons	**31.12.2005**	**31.12.2004**
Trade receivables		
accounts receivable	296,626	257,992
allowance for doubtful receivables	(345)	(1,158)
Total trade receivables	**296,281**	**256,834**
Prepaid expenses, except for corporate income tax		
value added tax	34,193	15,637
social security tax	6	-
Total prepaid expenses, except for corporate income tax	**34,199**	**15,637**
Receivables from the customers of construction works (Note 34)	**82,224**	**117,180**
Other short-term receivables		
short-term loans (Note 16)	49,481	72,637
interest receivable	1,846	2,004
uncollected dividends	-	224
other short-term receivables	6,026	3,252
Total other short-term receivables	**57,353**	**78,117**
Prepayments for services		
prepayments for construction services	68,357	25,992
prepaid insurance	1,062	1,727
other receivables and prepaid expenses	2,634	1,456
Total prepayments for services	**72,053**	**29,175**
Total trade receivables	**542,110**	**496,943**

NOTE 16 LOANS GRANTED

in thousands of kroons	**2005**	**2004**
Loans granted to associates		
Loan balance at beginning of year	**49,155**	5,909
Granted	**28,005**	45,047
Collected	**(37,440)**	(1,275)
Reclassification to a loan granted to subsidiary	**(18,395)**	(526)
Loan balance at end of year	**21,325**	49,155
incl. current portion	**21,325**	49,155

Average interest rate 6.2% (2004: 4.5%).

Loans granted to entities under common control		
Loan balance at beginning of year	**5,991**	4,265
Granted	**83,243**	21,726
Reclassification from a loan granted to subsidiary	**31,183**	-
Collected	**(66,183)**	(20,000)
Reclassification to a loan granted to subsidiary	**(47,669)**	-
Loan balance at end of year	**6,565**	5,991
incl. current portion	**6,565**	5,991

Average interest rate 4.0% (2004: 4.0%).

Loans to other related parties		
Loan balance at beginning of year	**380**	5,740
Granted	**1,593**	-
Collected	**-**	-
Reclassification to a loan granted to subsidiary	**-**	(5,360)
Loan balance at end of year	**1,973**	380
incl. current portion	**500**	-
non-current portion 2...5 years	**1,473**	380

Average interest rate 1.0% (2004: 0.0%).

Loans granted to non-related legal persons		
Loan balance at beginning of year	**17,754**	5,791
Granted	**76,860**	42,188
Collected	**(72,678)**	(29,846)
Reclassification to a loan granted to subsidiary	**-**	(379)
Reclassification to a other receivables	**(1,006)**	-
Loan balance at end of year	**20,930**	17,754
incl. current portion	**20,679**	17,491
non-current portion 2…5 years	**251**	263

Average interest rate 3.5% (2004: 4.0%).

Note 16 Loans granted (continued)

in thousands of kroons	2005	2004
Loans granted to non-related physical persons		
Loan balance at beginning of year	**-**	-
Granted	**422**	-
Collected	**(10)**	-
Loan balance at end of year	**412**	-
incl. current portion	**412**	-

Average interest rate 3.7%.

in thousands of kroons	2005	2004
Total loans		
Loan balance at beginning of year	**73,280**	21,705
Granted	**190,123**	108,961
Reclassification from a loan granted to subsidiary	**31,183**	-
Collected	**(176,311)**	(51,121)
Reclassification to a loan granted to subsidiary	**(66,064)**	(6,265)
Reclassification to a receivables	**(1,006)**	-
Loan balance at end of year	**51,205**	**73,280**
incl. current portion (Note 15)	**49,481**	72,637
non-current portion 2…5 years (Note 20)	**1,724**	643

Note 17 Inventories

in thousands of kroons	31.12.2005	31.12.2004
Raw materials and materials	**1,845**	1,506
Work-in-progress	**200,482**	29,738
Finished goods	**4,461**	1,209
Goods purchased for resale		
Registered immovables purchased for resale	**752,789**	377,951
Other goods purchased for resale	**11**	12
Total goods purchased for resale	**752,800**	377,963
Prepayments for inventories		
Prepayments for real estate properties	**4,500**	35,842
Prepayments for other inventories	**-**	3,141
Total prepayments for inventories	**4,500**	38,983
Total inventories	**964,088**	449,399

Note 18 Investments in subsidiaries

	Participation and voting rights %		Location	Area of operation
	31.12.2005	**31.12.2004**		
Subsidiaries of AS Merko Ehitus				
AS Gustaf	**100**	100	Pärnu	construction
AS Merko Tartu	**66**	66	Tartu	construction
AS Merko Inseneriehitus	**100**	100	Tallinn	construction
OÜ Merko Ehitustööd	**100**	100	Tallinn	construction
OÜ Merko Kaevandused	**-**	100	Tallinn	construction
Eesti Ehituseekspordi OÜ	**100**	100	Tallinn	construction
Tallinna Teede AS	**100**	100	Tallinn	road construction
SIA Merks	**100**	100	Republic of Latvia, Riga	construction
UAB Merko Statyba	**100**	100	Republic of Lithuania, Vilnius	construction
OÜ Merko Elamu	**100**	100	Tallinn	real estate
OÜ Merko Maja	**100**	100	Tallinn	real estate
OÜ Merko Kinnisvara	**100**	100	Saue	real estate
OÜ Woody	**100**	100	Tallinn	real estate
OÜ Gustaf Tallinn	**80**	80	Tallinn	construction
OÜ Rannamõisa Kinnisvara	**100**	100	Tallinn	real estate
OÜ Maavõlur	**100**	100	Tallinn	real estate
OÜ Rae Tehnopark (previous name OÜ Teistest Ees)	**100**	100	Tallinn	real estate
OÜ Maryplus	**100**	100	Tallinn	real estate
OÜ Metsailu	**100**	100	Tallinn	real estate
OÜ Pire Projekt	**100**	50	Tallinn	real estate
OÜ Constancia	**100**	50	Tallinn	real estate
OÜ Käibevara	**100**	-	Tallinn	real estate
OÜ Baltic Electricity Engineering	**100**	-	Tallinn	electricity systems

In December 2005, AS Merko Ehitus acquired a private limited company OÜ Käibevara from AS Merko Grupp's subsidiary E.L.L. Kinnisvara AS for real estate development and set up a private limited company Baltic Electricity Engineering (share capital 40 thousand kroons), whose main activity is the construction of electricity networks. In April 2005, a 50% participation was acquired in OÜ Pire Projekt and OÜ Constancia, as a result of which these joint ventures became subsidiaries. In July 2005, a subsidiary OÜ Merko Kaevandused was sold to the parent company AS Merko Grupp.

In April 2005, AS Merko Ehitus increased share capital in its subsidiary SIA Merks by 1,500 thousand Latvian lats. In order to restore equity at its subsidiaries OÜ Maryplus, OÜ Rannamõisa Kinnisvara, OÜ Merko Ehitustööd, OÜ Maavõlur and OÜ Metsailu, additional contributions of 40 thousand kroons were made into equity during 2005.

In September 2005, UAB Merko Statyba sold its subsidiary UAB Upes Centras to AS Merko Grupp subsidiary E.L.L. Kinnisvara AS.

In October 2005, Tallinna Teede AS liquidated its subsidiary OÜ Talbit. In December, liquidation proceeds were paid from the distribution plan to Tallinna Teede AS in the amount of 4,857 thousand kroons and to minority shareholders in the amount of 694 thousand kroons.

Note 18 Investments in subsidiaries (continued)

Investments into subsidiaries

in thousands of kroons	OÜ Käibevara	OÜ Pire Projekt	OÜ Constancia	Total
Cash and cash equivalents	24	4,932	5	4,961
Trade receivables	-	3,147	18,238	21,385
Inventories	54,185	120	-	54,305
Current liabilities	51,781	2,399	16,859	71,039
Fair value of net assets acquired	2,428	5,800	1,384	9,612
Participation acquired	100%	50%	50%	
Revenues at the time of purchase	-	25,363	14,502	39,865
Profit at the time of purchase	(512)	4,951	624	5,063
Goodwill (Note 24)	-	350	760	1,110
Acquisition cost	**2,428**	**6,150**	**2,144**	**10,722**
Paid upon acquisition in 2005	-	(6,150)	(2,144)	(8,299)
Cash and cash equivalents of subsidiary upon acquisition	24	9,864	9	9,897
Cash flows from investments into subsidiaries	24	3,714	(2,135)	1,603
Cash flow from investment into subsidiary SIA Merks				(20,227)
Payable of Tallinna Teede AS for subsidiary acquired in 2003				(1,830)
Payable of SIA Merks for subsidiary acquired in 2004				(3,528)
Paid for other expenses related to setting up subsidiaries				(3)
Total cash flows from investments				**(23,985)**

As the subsidiaries acquired prepared their financial statements (until the acquisition) in accordance with the local GAAP, disclosing the carrying values (determined in accordance with IFRS, immediately before the combination) of the assets acquired during the business combination is considered impracticable.

Proceeds from sale of subsidiaries

in thousands of kroons	OÜ Merko Kaevandused	Sale of UAB Merko Statyba's subsidiary UAB Upes Centras	Total
Participation sold	100%	100%	
Sales price	4,600	150	4,750
Profit from sale	**5,143**	**2,355**	**7,498**
Cash received	4,600	150	4,750
Cash and cash equivalents of subsidiary upon the sale	(66)	(1,308)	(1,374)
Cash flows at Group from sale	4,534	(1,158)	3,376

Note 19 Investments in associates and joint ventures

	Participation and voting rights %		Location	Area of operation
	31.12.2005	**31.12.2004**		
Associates of AS Merko Ehitus				
AS Tartu Maja Betoontooted	**25**	25	Tartu	concrete elements
AS Telegrupp	**31**	45	Tallinn	telecommunications
Associate of OÜ Talbit				
AS Bituumen	**-**	24,2	Tallinn	real estate management
Joint ventures of AS Merko Ehitus				
Normanni Linnagrupi AS	**50**	50	Tallinn	construction
AS Insenervõrgud	**-**	50	Tallinn	construction
OÜ Pire Projekt	**-**	50	Tallinn	real estate
OÜ Constancia	**-**	50	Tallinn	real estate
OÜ Unigate	**50**	50	Tallinn	real estate
OÜ Tornimäe Apartments	**50**	50	Tallinn	real estate
Joint ventures of SIA Merks				
PS Merks-Terbe Lat	**50**	50	Republic of Latvia, Riga	construction
SIA Zakusala Estates	**50**	-	Republic of Latvia, Riga	real estate
Joint venture of AS Merko Tartu				
OÜ Kortermaja	**50**	50	Tartu	real estate

In 2005, the remaining 50% participation was acquired in joint ventures OÜ Pire Projekt and OÜ Constancia, after which they were accounted for as subsidiaries. During the same year a 14% share in AS Telegrupp (associate) was sold and a joint venture AS Insenervõrgud was liquidated.

Before the liquidation of OÜ Talbit, a subsidiary of Tallinna Teede AS, OÜ Talbit sold its participation in OÜ Bituumen.

In December 2005, SIA Merks acquired a subsidiary SIA Zakusala Estates for real estate development with the acquisition cost of 148,319 thousand kroons, of which 136,228 thousand kroons was paid in 2005.

Note 19 Investments in associates and joint ventures (continued)

in thousands of kroons	Investment 31.12. 2004	Changes in 2005: Acquisition, sale and liquidation	Profit (loss) on associated	Dividends	Currency translation adjustment	Investment 31.12. 2005	Participation in equity of investee
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	16,142	-	10,660	(1,500)	-	25,302	25,302
AS Telegrupp	6,292	(2,257)	1,209	(1,710)	-	3,534	3,534
Associate of OÜ Talbit							
AS Bituumen	3,627	(5,550)	1,923	-	-	-	-
Total associates	26,061	(7,807)	13,792	(3,210)	-	28,836	28,836
Joint ventures of AS Merko Ehitus							
Normanni Linnagrupi AS	389	-	33	-	-	422	422
AS Insenervõrgud	623	(499)	(124)	-	-	-	-
OÜ Pire Projekt	849	(5,800)	4,951	-	-	-	-
OÜ Constancia	760	(1,384)	624	-	-	-	-
OÜ Unigate	412	-	(320)	-	-	92	92
OÜ Tornimäe Apartments	19	-	5	-	-	24	24
Joint ventures of SIA Merks							
PS Merks Terbe Lat	5,100	-	-	(5,099)	11	12	(4)
SIA Zakusala Estates	-	148,319	-	-	-	148,319	910
Joint venture of AS Merko Tartu							
OÜ Kortermaja	1,233	-	671	-	-	1,904	2,012
Total joint ventures	9,385	140,636	5,840	(5,099)	11	150,773	3,456
Total associates and joint ventures	35,446	132,829	19,632	(8,309)	11	179,609	32,292

in thousands of kroons	Investment 31.12. 2003	Changes in 2004: Acquisition, sale and liquidation	Profit (loss) on associated	Dividends	Currency translation adjustment	Investment 31.12. 2004	Participation in equity of investee
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	10,899	-	5,243	-	-	16,142	16,142
AS Telegrupp	9,901	-	(1,930)	(1,679)	-	6,292	6,292
OÜ Maryplus	-	366	(366)	-	-	-	-
Associate of OÜ Talbit							
AS Bituumen	3,096	-	531	-	-	3,627	3,627
Total associates	23,896	366	3,478	(1,679)	-	26,061	26,061
Joint ventures of AS Merko Ehitus							
Normanni Linnagrupi AS	388	-	1	-	-	389	389
AS Insenervõrgud	736	-	(113)	-	-	623	623
OÜ Pire Projekt	20	-	829	-	-	849	849
OÜ Constancia	-	-	760	-	-	760	760
OÜ Unigate	-	2,000	(1,588)	-	-	412	412
OÜ Tornimäe Apartments	-	20	(1)	-	-	19	19
Joint ventures of SIA Merks							
PS Merks Terbe Lat	-	-	5,351	-	(251)	5,100	5,100
Joint venture of AS Merko Tartu							
OÜ Kortermaja	-	-	1,233	-	-	1,233	1,381
Total joint ventures	1,144	2,020	6,472	-	(251)	9,385	9,533
Total associates and joint ventures	25,040	2,386	9,950	(1,679)	(251)	35,446	35,594

NOTE 19 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES (CONTINUED)

The difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee in the amount of 108 thousand kroons (2004: 148 thousand kroons) is due to the loss from the unrealised gains of the mutual transaction.

As at 31.12.2005, the investment into the joint venture SIA Zakusala Estates includes intangible assets in the amount of 147,409 thousand kroons. The assets and liabilities of the joint venture are immaterial, but the company has a signed agreement with Riga city that gives them a right to use the 126 thousand m² land-plot on Zakusala island in the center of Riga, until 2 June 2051. The intangible assets recognized reflects the future economic benefits that arise from the use of the right described.

Associates *in thousands of kroons*	Assets 31.12.	Liabilities 31.12.	Sales	Net profit
2005				
AS Tartu Maja Betoontooted	244,556	143,348	249,750	42,629
AS Telegrupp	25,139	13,700	76,923	1,257
2004				
AS Tartu Maja Betoontooted	133,733	69,165	165,829	21,110
AS Telegrupp	22,073	8,092	65,953	2,302
AS Bituumen	14,999	-	-	2,195

Joint ventures *in thousands of kroons*	Assets 31.12.		Liabilities 31.12.		Equity 31.12.	Revenue	Expenses	Net profit (loss)
	Current assets	Non-current assets	Current	Non-current				
2005								
Normanni Linnagrupi AS	1,399	-	-	555	844	11,084	11,018	66
AS Insenervõrgud	-	-	-	-	-	6	252	(246)
OÜ Pire Projekt	-	-	-	-	-	25,367	15,465	9,902
OÜ Constancia	-	-	-	-	-	14,502	13,254	1,248
OÜ Unigate	18,940	-	15,055	3,701	184	6	647	(641)
OÜ Tornimäe Apartments	158,184	-	105,617	52,518	49	21	11	10
PS Merks Terbe Lat	921	-	928	-	(7)	5	34	(29)
SIA Zakusala Estates	1,524	1,122	825	-	1,821	3,151	5,159	(2,008)
OÜ Kortermaja	16,635	-	12,611	-	4,024	17,804	16,543	1,261
2004								
Normanni Linnagrupi AS	5,505	-	4,105	623	777	128,420	128,418	2
AS Insenervõrgud	481	767	2	-	1,246	8	235	(227)
OÜ Pire Projekt	34,239	-	32,540	-	1,699	30,398	28,739	1,659
OÜ Constancia	24,459	-	22,939	-	1,520	21,975	20,189	1,786
OÜ Unigate	16,812	-	11,712	4,275	825	-	1,037	(1,037)
OÜ Tornimäe Apartments	31,386	-	5,565	25,782	39	2	3	(1)
PS Merks Terbe Lat	12,506	-	1,518	788	10,200	47,821	37,037	10,783
OÜ Kortermaja	13,937	-	11,175	-	2,762	23,555	20,909	2,646

NOTE 20 OTHER LONG-TERM LOANS AND RECEIVABLES

in thousands of kroons	**31.12.2005**	**31.12.2004**
Long-term loans (Note 16)	1,724	643
Long-term receivable from the buyer of a subsidiary*	6,800	9,717
Long-term receivables from customers of construction services	-	5,508
Total long-term loans and receivables	**8,524**	**15,868**

* The long-term receivable from the buyer of subsidiary's business unit has been discounted at an interest rate of 6 per cent.

Note 21 Deferred income tax assets

Income tax assets arisen at the subsidiary UAB Merko Statyba:

in thousands of kroons	**2005**	**2004**
Effect of stage of completion method	**153**	984
Warranty provision	**20**	126
Vacation pay provision	**57**	131
Provision for allowance for doubtful receivables	**172**	170
Tax loss carryforwards	**8,351**	2,713
Deferred income tax assets at end of year	**8,753**	4,124
Deferred income tax assets at beginning of year	**4,124**	4,124
Gain on deferred income tax for the financial year (Note 10)	**4,629**	**-**

Note 22 Investment property

in thousands of kroons	Land	Buildings	Prepayments	Total
Cost at 31.12.2003	26,180	3,496	23,588	53,264
Accumulated depreciation at 31.12.2003	-	(396)	-	(396)
Residual value at 31.12.2003	**26,180**	**3,100**	**23,588**	**52,868**
Acquisitions	28,629	-	(22,161)	6,468
Reclassification	2,110	249	-	2,359
Depreciation	-	(306)	-	(306)
Residual value at 31.12.2004	**56,919**	**3,043**	**1,427**	**61,389**
Cost at 31.12.2004	56,919	4,172	1,427	62,518
Accumulated depreciation at 31.12.2004	-	(1,129)	-	(1,129)
Residual value at 31.12.2004	**56,919**	**3,043**	**1,427**	**61,389**
Acquisitions	63	-	-	63
Reclassification	(21,348)	4,254	(1,427)	(18,521)
Depreciation	-	(425)	-	(425)
Residual value at 31.12.2005	**35,634**	**6,872**	**-**	**42,506**
Cost at 31.12.2005	35,634	8,959	-	44,593
Accumulated depreciation at 31.12.2005	-	(2,087)	-	(2,087)
Residual value at 31.12.2005	**35,634**	**6,872**	**-**	**42,506**

At 31.12.2005, the fair value of investment property was 110,442 thousand kroons (31.12.2004: 107,844 thousand kroons).

In 2005 the Group reclassified a land in amount of 21,348 thousand kroons and a prepayment in amount of 1,427 thousand kroons into an Inventory. Also a part of a building being rented out was reclassified from property, plant and equipment (PPE) to Investment property, the reclassification amounted to 4,254 thousand kroons (2004: 2,359 thousand kroons was reclassified from PPE to Investment property).

Investment property have not been acquired for the purpose of earning rental income but for capital appreciation or development in the future. Buildings located on the plot of land have been temporarily leased out under the operating lease terms. Rental income receivable, maintenance costs incurred and improvement expenses are immaterial.

Note 23 Property, plant and equipment

in thousands of kroons	Land	Buildings	Right of superficies	Machinery and equipment	Other	Construction in progress	Pre-payments	Total
Acquisition cost at 31.12.2003	2,189	7,720	458	84,038	25,180	95	145	119,825
Accumulated depreciation at 31.12.2003	-	(2,735)	(58)	(30,046)	(13,935)	-	-	(46,774)
Residual value at 31.12.2003	**2,189**	**4,985**	**400**	**53,992**	**11,245**	**95**	**145**	**73,051**
Foreign exchange rate changes	(79)	(32)	-	-	(85)	2,575	41	2,420
Acquisitions	-	-	-	6,684	7,705	62,357	831	77,577
Sales	-	-	-	(460)	(113)	-	-	(573)
Reclassification	(1,965)	(225)	-	(1,999)	1,999	-	(145)	(2,335)
Write-offs	-	-	-	(581)	(262)	-	-	(843)
Depreciation/impairment	-	(257)	(9)	(9,750)	(4,900)	(54,993)*	(872)	(70,781)
Residual value at 31.12.2004	**145**	**4,471**	**391**	**47,886**	**15,589**	**10,034**	**-**	**78,516**
Acquisition cost at 31.12.2004	145	7,020	458	81,389	35,090	65,027	872	190,001
Accumulated depreciation at 31.12.2004	-	(2,549)	(67)	(33,503)	(19,501)	(54,993)	(872)	(111,485)
Residual value at 31.12.2004	**145**	**4,471**	**391**	**47,886**	**15,589**	**10,034**	**-**	**78,516**
Foreign exchange rate changes	-	-	-	-	(2)	(8)	-	(10)
Acquisitions	-	-	-	10,968	10,504	209,350	1,394	232,216
Sales	-	-	-	(1,102)	(506)	-	-	(1,608)
Reclassification	-	8,384	-	-	-	(12,639)	(124)	(4,379)
Write-offs	-	-	-	(76)	(201)	-	-	(277)
Depreciation/impairment	-	(447)	(9)	(8,794)	(6,866)	(89,338)	-	(105,454)
Residual value at 31.12.2005	**145**	**12,408**	**382**	**48,882**	**18,518**	**117,399**	**1,270**	**199,004**
Acquisition cost at 31.12.2005	145	14,872	458	88,070	42,794	260,100	1,270	407,709
Accumulated depreciation at 31.12.2005	-	(2,464)	(76)	(39,188)	(24,276)	(142,701)	-	(208,705)
Residual value at 31.12.2005	**145**	**12,408**	**382**	**48,882**	**18,518**	**117,399**	**1,270**	**199,004**

* Refer to note 1.3.3 and note 28.

Information on leased assets is provided in Note 25 and on lease payments in Note 26.

Acquisition of non-current assets differs from acquisition of non-current assets in the cash flow statement due to the periodical payments of non-current assets under the finance lease.

The sale of non-current assets is stated at the residual value. Sales are stated at the sales price and net sales as an adjustment of operating profit in the cash flow statement.

Note 24 Intangible assets

in thousands of kroons	Goodwill	Other	Prepayments	Total
Acquisition cost at 31.12.2003	(4,144)	652	-	(3,492)
Accumulated amortisation at 31.12.2003	2,221	(321)	-	1,900
Residual value at 31.12.2003	**(1,923)**	**331**	**-**	**(1,592)**
Additions	5	446	1,224	1,675
Write-offs	529	-	-	529
Amortisation	683	(185)	-	498
Residual value at 31.12.2004	**(706)**	**592**	**1,224**	**1,110**
Acquisition cost at 31.12.2004	(3,610)	1,098	1,224	(1,288)
Accumulated amortisation at 31.12.2004	2,904	(506)	-	2,398
Residual value at 31.12.2004	**(706)**	**592**	**1,224**	**1,110**
Effect of change in accounting policies (Note 1.3.2)	2,709	-	-	2,709
Additions	1,110	1,294	1,623	4,027
Write-offs	(3,113)	(21)	-	(3,134)
Amortisation	-	(347)	-	(347)
Residual value at 31.12.2005	**-**	**1,518**	**2,847**	**4,365**
Acquisition cost at 31.12.2005	-	2,371	2,847	5,218
Accumulated depreciation at 31.12.2005	-	(853)	-	(853)
Residual value at 31.12.2005	**-**	**1,518**	**2,847**	**4,365**

Note 25 Leased assets

in thousands of kroons	**2005**	**2004**
Assets acquired under finance lease terms		
Machinery and equipment		
Acquisition cost	38,144	28,714
Accumulated depreciation	(26,827)	(4,342)
depreciation charge of the accounting period	(3,077)	(2,762)
Residual value	**11,317**	**24,372**
Assets acquired under operating lease terms		
Right of superficies		
Payments made in financial year	93	93
Future lease payments		
incl. payments in next financial year	238	93
payments in 2…5 years	1,188	1,188
payments after year 5	9,720	9,957

On the basis of cancellable lease agreements, operating lease payments totalling 5,489 thousand kroons (2004: 4,005 thousand kroons) were paid for passenger cars in 2005.

Note 26 Borrowings

in thousands of kroons	2005	2004
FINANCE LEASE PAYABLES		
Present value of lease payments at beginning of year	16,959	19,783
Received	13,971	549
Paid	(5,832)	(3,373)
Present value of lease payments at end of year	**25,098**	**16,959**
incl. payments in next financial year	9,697	3,560
payments in 2…4 years	15,401	13,399
Interest expense of financial year	955	882
Minimum future lease payments	30,118	19,040

Average interest rate 5.0% (2004: 5.0%). Underlying currencies EEK, EUR and LVL.

	2005	2004
LOANS		
Bank loans		
Loan balance at beginning of year	5,202	9,063
Received	293,567	5,202
Paid	(6,202)	(9,063)
Loan balance at end of year	**292,567**	**5,202**
incl. payments in next financial year	105,144	4,555
payments in 2…5 years	187,423	647
Interest expense of financial year	3,356	152

Average interest rate 4.0% (2004: 2.3%). Underlying currency EUR.

	2005	2004
Loans from associates and joint ventures		
Loan balance at beginning of year	3,941	-
Received	-	3,941
Paid	(3,941)*	-
Loan balance at the end of year	**-**	**3,941**
incl. payments in next financial year	-	3,941
Loans from entities under common control		
Loan balance at beginning of year	522	-
Reclassification to loans from subsidiaries	-	522
Paid	(522)	-
Loan balance at end of year	**-**	**522**
incl. payments in next financial year	-	522
Total loans		
Loan balance at beginning of year	9,665	9,063
Received	293,567	9,143
Reclassification to loans from subsidiaries	-	522
Paid	(10,665)*	(9,063)
Loan balance at end of year	**292,567**	**9,665**
incl. payments in next financial year	105,144	9,018
payments in 2…5 years	187,423	647
TOTAL BORROWINGS	**317,665**	**26,624**
incl. payments in next financial year	114,841	12,578
payments in 2…5 years	202,824	14,046

* Includes a non-monetary transaction, a net settlement against dividends receivable in amount 3,941 thousand kroons.

Loan collaterals and pledged assets have been provided in Note 32.

Note 27 Trade payables

in thousands of kroons	**31.12.2005**	**31.12.2004**
Payables to suppliers	282,087	211,034
Payables to employees	37,688	30,630
Tax liabilities, except for corporate income tax		
value added tax	11,919	281
personal income tax	3,032	2,230
social security tax	9,269	7,296
land tax	166	34
unemployment insurance tax	201	111
contributions to mandatory funded pension	173	121
other taxes	260	43
Total tax liabilities, except for corporate income tax	**25,020**	**10,116**
Receivables from customers of construction works (Note 34)	185,648	153,974
Other payables		
interest liabilities	65	112
dividends payable	-	3
payables for shares of subsidiaries	14,735	10,844
other payables	4,837	3,339
prepayments received	161,156	66,805
Total other payables	**180,793**	**81,103**
Total trade liabilities	**711,236**	**486,857**

Note 28 Government grants

The Company's Latvian subsidiary SIA Merks was engaged (in 2004) in a project according to which Merko took the responsibility to build a multifunctional hall (known as Arena Riga) at its own expense in the city of Riga, Latvia. It also took the responsibility to complete the hall by 1 February 2006 so that it would be possible to host 2006 Ice Hockey World Championships in Riga, the competition being due in spring 2006. As the due completion of the building involved major risks (see note 36) and the aggregate expected construction costs of (to build) the hall (Arena) were considerably higher than the recoverable amount of the Arena when completed, the project was not feasible on commercial ground. Therefore, to encourage the possible developer (before Merks two developers had rejected the project) the Riga Municipality provided a government grant to the project by selling some land plots (in Riga) at a price below their fair value to Merks in 2004 and 2005. The difference between the purchase price actually paid and the fair value of the land plots on the date of acquisition was accounted for as a government grant. This government grant has been accounted as a revenue in the same periods as the impairment losses on unfinished construction of the Arena were recognised. The excess amount of government grant, i.e. the amount by which the government grant finally appeared to be higher than impairment loss (see Note 7 and 23 for impairment losses recognised) on the Arena, was also recognised as a revenue in 2005, as it was reasonably certain that the Company was able to comply with the conditions attaching to the conditions of the grant.

in thousands of kroons	**31.12.2005**	**31.12.2004**
Residual value at beginning of year	44,818	-
Received	154,740*	98,067
Used	177,333	53,249
Balance at the end of year	**22,225**	**44,818**

* Includes an additional government grant received in 2005 in cash in the amount of 22,225 thousand kroons for the purpose of acquiring specific equipment for hosting 2006 Ice Hockey World Championships.

Note 29 Short-term provisions

in thousands of kroons	2005	2004
Provision for warranty obligation for construction		
Residual value at beginning of year	5,784	5,191
Set up	5,567	3,965
Used	(2,888)	(3,372)
Balance at end of year	**8,463**	**5,784**
In addition, the following short-term provisions were set up:		
provision for the potential losses regarding discontinuing of a construction project	6,664	-
provision for covering court fees	6,090	-
other provisions	524	-
Total short-term provisions	**21,741**	**5,784**

Note 30 Long-term trade payables

in thousands of kroons	31.12.2005	31.12.2004
Supplier payables	9,884	7,421
Prepayments received	12,842	-
Other long-term payables	-	617
Total long-term trade payables	**22,726**	**8,038**

The subsidiary SIA Merks has received prepayments in the amount of 12,842 thousand kroons for renting the space of Arena Riga beginning in 2007 (lease agreements entered into for 5-7 years).

Note 31 Deferred income tax liability

A deferred income tax liability was incurred at the subsidiary SIA Merks:

in thousands of kroons	2005	2004
Effect of difference between fair value and carrying amount of real estate inventories	34,600	-
Effect of tax amortisation of non-current assets	(20,608)	-
Unrealised profit upon consolidation	(925)	-
Effect of provisions	(1,682)	-
Deferred income tax expense of the financial year (Note 10)	11,385	-

Note 32 Loan collateral and pledged assets

The following agreements have been entered into for guaranteeing loans and other obligations:

Between AS Merko Ehitus and Hansapank:

A commercial pledge agreement on movable property in the amount of 140 million kroons (registered under the first, second and fifth orders in the registry of commercial pledges). The obligations arising from guarantee contracts and overdraft contract are guaranteed by the pledge.

Note 32 Loan collateral and pledged assets (continued)

Between AS Merko Ehitus and SEB Eesti Ühispank:

A commercial pledge agreement on movable property in the amount of 60 million kroons (registered under the third, fourth and sixth orders in the registry of commercial pledges). The obligations arising from guarantee contracts are guaranteed by the pledge.

Between Tallinna Teede AS, Hansapank and SEB Eesti Ühispank:

A commercial pledge agreement on movable property in the amount of 25 million kroons (registered under the first order in the registry of commercial pledges), whereby the 14/25 legal share of the commercial pledge belongs to Hansapank and 11/25 to SEB Eesti Ühispank.

Between Tallinna Teede AS and Hansapank:

A commercial pledge agreement on movable property in the amount of 2 million kroons (registered under the second order in the registry of commercial pledges). All claims of the banks arising from contracts under the law of obligations have been guaranteed by the pledges.

Between AS Gustaf and Hansapank:

A commercial pledge agreement on movable property in the amount of 6 million kroons for guaranteeing guarantee contracts.

Between OÜ Gustaf Tallinn and Hansapank:

A commercial pledge agreement on movable property in the amount of 3.9 million kroons for guaranteeing guarantee contracts.

Between AS Merko Tartu and SEB Eesti Ühispank:

A commercial pledge agreement on movable property in the amount of 8.5 million kroons (registered under the first order in the registry of commercial pledges). Guarantee contracts entered have been guaranteed by the pledge.

Between SIA Merks and Hansabanka:

A commercial pledge agreement on assets in the amount of 3.0 million Latvian lats. Obligations arising from the guarantee contracts and the loan agreements have been guaranteed by the pledge.

Mortgage in the amount of 17.15 million Latvian lats (7 real properties in Riga, Latvia) to guarantee the loan commitments in amount of 17.5 million euros.

Mortgage in the amount of 8.4 million Latvian lats (a real property in Riga, Latvia) to guarantee the loan commitments in amount of 8.52 million euros.

Between SIA Merks and SEB Unibanka:

A commercial pledge agreement on assets in the amount of 3.9 million Latvian lats. Obligations arising from the loan agreement have been guaranteed by the pledge.

Note 33 Share capital

There were no changes in share capital in 2004. As at 31.12.2004, the share capital in the amount of 88,500 thousand kroons consisted of 8,850 thousand registered shares with the nominal value of 10 kroons each.

In accordance with the resolution of the General Meeting of Shareholders from 28.04.2005, share capital was increased in May by transferring the share premium paid during previous share issues (2,950 thousand kroons) and retained earnings (85,550 thousand kroons) by the amount of 88,500 thousand kroons by means of a equity capitalization, via issuing 8,850 new ordinary shares with the nominal value of 10 kroons. Share capital after the equity capitalization consists of 17,700 thousand ordinary shares with the nominal value of 10 kroons each.

According to the articles of association, the maximum number of shares is 18,000 thousand. All issued shares have been paid for.

In 2005, dividends in the amount of 57,525 thousand kroons have been declared and distributed to the shareholders (in 2004, dividends in the amount of 37,170 thousand kroons were declared and distributed).

Note 34 Construction contracts

in thousands of kroons	2005	2004
Costs incurred for construction in progress and corresponding revenue	2,312,322	2,433,813
Progress billings submitted	(2,415,746)	(2,470,607)
Total adjustment of revenue	**(103,424)**	**(36,794)**

in thousands of kroons	31.12.2005	31.12.2004
Receivables from customers for construction works (Note 15)	82,224	117,180
Payables to customers of construction works (Note 27)	(185,648)	(153,974)
Total adjustment of revenue	**(103,424)**	**(36,794)**

Revenue increase is shown for all those contracts in progress for which revenue corresponding to the costs incurred exceeds than the progress billing submitted to the customers. The increase of revenue is included in the balance sheet line *Receivables and prepayments*.

A decrease of revenue is shown for all those unfinished contracts for which the revenue corresponding to the costs incurred are lower than the progress billings submitted to the customers. The decrease of revenue is included in the balance sheet line *Liabilities and prepayments*.

Note 35 Related party transactions

The parent company of AS Merko Ehitus is AS Merko Grupp, as at 31.12.2005 and 31.12.2004, AS Merko Grupp (who is also the ultimate controlling party) owned 72% of the shares of AS Merko Ehitus.

Goods and services

in thousands of kroons	2005	2004
Purchased construction services		
Associates and joint ventures	45,202	136,641
Affiliates	5,444	5,155
Total purchased construction services	**50,646**	**141,796**
Construction services rendered		
Associates and joint ventures	136,160	39,233
Affiliates	425,568	86,915
Management members	1,526	1,804
Total construction services provided	**563,254**	**127,952**
Construction materials purchased		
Other related parties	2,008	1,864

Loans granted to related parties are provided in Note 16 *Loans granted* and **loans received** from related parties are provided in Note 26 *Borrowings*.

Note 35 Related party transactions (continued)

Balances with the related parties

in thousands of kroons	**31.12.2005**	**31.12.2004**
Trade receivables		
Trade receivables		
Associates and joint ventures	39,044	3,972
Affiliates	56,946	17,955
Short-term loans		
Associates and joint ventures	21,325	49,155
Affiliates	6,565	5,991
Other related parties	500	-
Interest receivables		
Associates and joint ventures	1,541	900
Other related parties	8	-
Dividends receivable		
Associates and joint ventures	-	224
Other short-term receivables		
Other related parties	2,917	-
Prepayments for services		
Associates and joint ventures	7,698	-
Affiliates	562	-
Long-term financial investments		
Long-term loans		
Other related parties	1,473	380
Non-current receivables		
Other related parties	6,800	-
Borrowings		
Short-term loans		
Affiliates	-	522
Trade payables		
Payables to suppliers		
Associates and joint ventures	19,179	2,577
Affiliates	223	212
Other related parties	116	-
Prepayments received		
Affiliates	16,847	10,850
Interest liabilities		
Affiliates	21	-
Management members	18	74
Other payables		
Management members	307	915
Affiliates	2,419	2,242
Non-current liabilities		
Other long-term payables		
Management members	-	305

Note 35 Related party transactions (continued)

Remuneration of the members of the Supervisory and Management Boards and senior executives

In 2005, the members of the Supervisory and Management Boards as well as senior executives of AS Merko Ehitus were paid remuneration in the amount of 15,743.1 thousand kroons (2004: 11,989.6 thousand kroons).

Benefits of the members of the Supervisory and Management Boards

Upon premature removal or expiry of duties of the members of the Supervisory and Management Board, compensation totalling 3,108 thousand kroons (2004: 2,748 thousand kroons) has to be paid in case the contract for services is not extended.

Contracts of suretyship

AS Merko Ehitus provides surety for:

- obligations arising from limits of loan-, construction- and guarantee contracts of the subsidiary SIA Merks to Hansabanka in the amount of 344,892 thousand kroons;
- obligations arising from guarantee contracts of the subsidiary UAB Statyba to UAB Lindra in the amount of 1,262 thousand kroons and obligations arising from construction contracts to Hansabankas in the amount of 10,738 thousand kroons;
- obligations arising from guarantee contracts of the subsidiary AS Merko Tartu to Sampo Pank in the amount of 5,000 thousand kroons;
- obligations arising from loan agreements of the joint venture OÜ Tornimäe Apartments to SEB Eesti Ühispank in the amount of 5,000 thousand kroons;
- obligations arising from loan agreements of the joint venture OÜ Unigate to Hansapank in the amount of 1,000 thousand kroons;
- obligations arising from loan agreements of the joint venture AS Uus Sakala to Hansapank in the amount of 7,000 thousand kroons.

Note 36 Contingent liabilities

in thousands of kroons	**31.12.2005**	**31.12.2004**
Performance period's warranty to the customer	108,448	72,604
Bid warranty	15,355	15,158
Guarantee for warranty period	107,042	75,005
Prepayment guarantee	87,215	23,352
Suretyships	376,892	43,433
Investment obligation*	67,409	67,409
Payment guarantee	-	15,150
Credits established	-	6,723
Total contingent liabilities	**762,361**	**318,834**

* On 25 May 2004 the Riga City Council and SIA Merks concluded the investment agreement whereby SIA Merks obliged to build in the Skanstes street the multifunctional hall Arena Riga (including necessary investment). The contracts included the following conditions:

- Penalties in the amount of 67.4 million kroons in favour of the Riga City Council, if hall construction will not be completed due to Company's fault latest at 1 February 2006;
- The Riga City Council has rights to request the return of government grant if the hall will be not put into operation by 31 December 2006.

On 31.12.2006 the hall was officially commissioned by city authorities and consequently SIA Merks was released of the contingent investment liability.

As at 31.12.2005 (taking into account the statutory requirement to increase the statutory reserve capital), it would be possible to pay out dividends to shareholders from retained earnings in the amount of 698,156 thousand kroons and the corresponding income tax would amount to 208,540 thousand kroons. As at 31 December 2004, it would have been possible to pay out 471,671 thousand kroons as dividends, and the corresponding income tax would have amounted to 148,949 thousand kroons.

Tax authorities have the right to review the Company's tax records within 6 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines.

The Company's management estimates that there are not any circumstances which might lead the tax authorities to impose additional significant taxes to the Company.

Note 37 Risks

Credit risk

Credit risk relates to potential damage which would occur if the parties to the contract cannot fulfill their contractual obligations. In order to lower credit risks, the payment discipline of customers is constantly being monitored; construction activities are partly funded by customer prepayments. Available funds are mostly held at Hansapank and SEB Eesti Ühispank. The management estimates that the Group does not have any major credit risks.

Interest risk

Interest risk arises from floating rate borrowings. Interest on bank loans is related to EURIBOR. Changes in EURIBOR and changes in average market interest rates affect the Group's interest expenses. The Company's management estimates that the Group does not have any major interest risks.

Foreign exchange risk

The Company's transactions are carried out in Estonian kroons, Latvian lats and Lithuanian litas. The Lithuanian litas was pegged to the euro at the beginning of 2002. Risks to the Group's income and expenses were related to the exchange rate changes of the Latvian lats. From 01.01.2005, the Latvian lats is tied to the euro.

In order to hedge foreign exchange risk, key foreign contracts are concluded in euros. All long-term loan agreements of the Group have been concluded in euros.

Fair value

The carrying amounts of the company's financial assets and financial liabilities does not significantly differ from their fair values.

Note 38 Events after the balance sheet date

As at 31.12.2005, AS Merko Ehitus had a 31% participation in AS Telegrupp. In February 2006, shares in the total amount of 1,847 thousand kroons were sold, after which AS Merko Ehitus owns 19% of the shares of AS Telegrupp.

Note 39 Number of shares belonging to the members of the Supervisor and Management Board and their close relatives

	Shares	Ownership %
Member of the Management Board		
Tõnu Toomik	9,000	0.10

Note 40 Shareholders with more than 5% ownership

	Shares	Ownership %
AS Merko Grupp	12,742,686	71.99
Clients of ING Luxembourg S.A.	1,135,900	6.42
Clients of Skandinaviska Enskilda Banken	992,310	5.61

NOTE 41 SEPARATE BALANCE SHEET, INCOME STATEMENT, STATEMENT OF CHANGES IN EQUITY AND CASH FLOW STATEMENT OF THE PARENT COMPANY

Balance sheet		
in thousands of kroons	**31.12.2005**	**31.12.2004**
ASSETS		
Current assets		
Cash and cash equivalents	124,033	101,143
Trade receivables	850,188	602,774
Prepaid corporate income tax	272	18
Inventories	79,299	76,908
Total current assets	**1,053,792**	**780,843**
Non-current assets		
Investments in subsidiaries	171,333	127,706
Investments in associates and joint ventures	9,824	19,000
Other long-term loans and receivables	82,145	43,029
Investment property	16,460	27,903
Property, plant and equipment	10,193	7,587
Intangible assets	1,743	504
Total non-current assets	**291,698**	**225,729**
Total assets	**1,345,490**	**1,006,572**
LIABILITIES		
Current liabilities		
Borrowings	29,431	902
Trade payables	421,136	320,820
Short-term provisions	11,856	3,235
Total current liabilities	**462,423**	**324,957**
Non-current liabilities		
Other long-term liabilities	5,883	5,349
Total liabilities	**468,306**	**330,306**
EQUITY		
Share capital	177,000	88,500
Share premium	-	2,950
Statutory reserve capital	8,850	8,850
Retained earnings	691,334	575,966
Total equity	**877,184**	**676,266**
Total liabilities and equity	**1,345,490**	**1,006,572**

Note 41 Separate balance sheet, income statement, statement of changes in equity and cash flow statement of the parent company (continued)

Income statement		
in thousands of kroons	**2005**	**2004**
Sales	1,860,068	2,110,292
Cost of goods sold	(1,575,816)	(1,819,097)
Gross profit	**284,252**	**291,195**
Marketing expenses	(15,743)	(13,136)
Administrative and general expenses	(55,278)	(47,503)
Other operating income	9,399	2,418
Other operating expenses	(3,608)	(2,056)
Operating profit	**219,022**	**230,918**
Financial income (expenses)	3,876	572
Financial income (expenses) from investments into subsidiaries	43,157	18,975
Financial income (expenses) from investments into associates and joint ventures	(3,166)	1,679
Profit before tax	**262,889**	**252,144**
Corporate income tax	(4,446)	(3,588)
Net profit for financial year	**258,443**	**248,556**

Statement of changes in equity						
in thousands of kroons	Share capital	Share premium	Statutory reserve capital	Currency translation adjustment	Retained earnings	Total
Balance as at 31.12.2003	88,500	2,950	8,850	(1,380)	364,903	463,823
Currency translation adjustment	-	-	-	(3,283)	-	(3,283)
Net profit for financial year	-	-	-	-	294,600	294,600
Dividends	-	-	-	-	(37,170)	(37,170)
Balance as at 31.12.2004	88,500	2,950	8,850	(4,663)	622,333	717,970
Effect of recognising subsidiaries and associates at cost	-	-	-	4,663	(46,367)	(41,704)
incl. for previous periods	-	-	-	1,380	(323)	1,057
for accounting period	-	-	-	3,283	(46,044)	(42,761)
Balance at 31.12.2004 adjusted	**88,500**	**2,950**	**8,850**	**-**	**575,966**	**676,266**
The book value of shareholdings under dominant or significant influence						(146,706)
The value of shareholdings under dominant or significant influence accounted by the equity method						188,410
Adjusted unconsolidated equity 31.12.2004						**717,970**
Net profit for financial year	-	-	-	-	258,443	258,443
Equity capitalization	88,500	(2,950)	-	-	(85,550)	-
Dividends	-	-	-	-	(57,525)	(57,525)
Balance as at 31.12.2005	**177,000**	**-**	**8,850**	**-**	**691,334**	**877,184**
The book value of shareholdings under dominant or significant influence						(181,157)
The value of shareholdings under dominant or significant influence accounted by the equity method						405,369
Adjusted unconsolidated equity 31.12.2005						**1,101,396**

Note 41 Separate balance sheet, income statement, statement of changes in equity and cash flow statement of the parent company (continued)

Cash flow statement

in thousands of kroons	**2005**	**2004**
Cash flows from operating activities		
Operating profit	219,022	230,918
Adjustments		
depreciation and amortisation	4,517	4,314
(profit) loss from sale of non-current assets	(139)	(10)
adjustment of revenue from construction contracts under stage of completion method	38,601	(151,427)
interest income from operating activities	(9,017)	(2,242)
change in provisions	10,940	6,045
Change in trade receivables related to operating activities	(38,516)	159,757
Change in inventories	8,773	20,785
Change in trade payables related to operating activities	51,307	(37,921)
Interest paid	(632)	(184)
Other financial income received	3,857	-
Corporate income tax paid	(4,446)	(2,992)
Total cash flows from operating activities	**284,267**	**227,043**
Cash flow from investing activities		
Investments into subsidiaries	(43,095)	(4,489)
Proceeds from sale of subsidiaries	4,600	700
Investments into associates and joint ventures	-	(2,393)
Proceeds from sale of associates and joint ventures	2,756	-
Purchase of property, plant and equipment	(7,275)	(2,725)
Proceeds from sale of property, plant and equipment	610	50
Purchase of intangible assets	(1,279)	(504)
Loans granted	(411,744)	(372,103)
Loan repayments received	170,640	55,463
Interest received	8,971	5,934
Dividends received	43,446	20,222
Total cash flow from investing activities	**(232,370)**	**(299,845)**
Cash flows from financing activities		
Interest received	28,529	-
Dividends paid	(57,525)	(37,170)
Total cash flows from financing activities	**(28,996)**	**(37,170)**
Change in cash and cash equivalents	22,901	(109,972)
Cash and cash equivalents at the beginning of the period	101,143	211,116
Currency translation adjustment	(11)	(1)
Cash and cash equivalents at end of period	**124,033**	**101,143**

Signatures of the Management Board and Supervisory Board to the 2005 Annual Report

The Management Board of AS Merko Ehitus has prepared the management report, consolidated financial statements and the profit allocation proposal for 2005.

Tõnu Toomik	Chairman of the Management Board	29.03.2006
Alar Lagus	Member of the Management Board	29.03.2006
Veljo Viitmann	Member of the Management Board	29.03.2006
Jaan Mäe	Member of the Management Board	29.03.2006
Andres Agukas	Member of the Management Board	29.03.2006

The Supervisory Board has reviewed the Annual Report which consists of the management report and the financial statements prepared by the Management Board and which also includes the auditor's report and the profit allocation proposal, and approved it for presentation at the General Meeting of Shareholders.

Toomas Annus	Chairman of the Supervisory Board	6.04.2006
Ott Kikkas	Member of the Supervisory Board	6.04.2006
Teet Roopalu	Member of the Supervisory Board	6.04.2006

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Auditor's report

To the shareholders of AS Merko Ehitus

We have audited the accompanying consolidated balance sheet of AS Merko Ehitus and its subsidiaries (the Group) as of 31 December 2005 and the related consolidated statements of income, cash flows and changes in shareholders' equity for the year then ended. These financial statements as set out on pages 9 to 52 are the responsibility of the Management Board of AS Merko Ehitus. 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, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2005 and of the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Urmas Kaarlep
AS PricewaterhouseCoopers

Tiit Raimla
Authorised Auditor

5 April 2006

Profit allocation proposal

in kroons	
Retained earnings	481,967,065
Net profit for 2005	438,637,484
Total retained earnings as at 31.12.2005	**920,604,549**

The Management Board proposes to allocate the net profit as follows:

As dividends (5.00 kroons per share)	88,500,000
Transfers to statutory reserve capital	8,850,000
Retained earnings after the allocation of net profit	**823,254,549**

Tõnu Toomik	Chairman of the Management Board	29.03.2006
Alar Lagus	Member of the Management Board	29.03.2006
Veljo Viitmann	Member of the Management Board	29.03.2006
Jaan Mäe	Member of the Management Board	29.03.2006
Andres Agukas	Member of the Management Board	29.03.2006

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