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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 NASDAQ OMX Tallinn Stock Exchange from the year 1997. At the end of 2010 the group provided work for more than 900 persons.

We are a leading actor on the Estonian market today, by building about 7% 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 ONES 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

Dear shareholders,

It was a difficult and controversial year on the Baltic construction market in 2010. The profitability of most companies was non-existent and the ability to continue in their present form was often questionable. The revenue for AS Merko Ehitus decreased year-on-year, but we managed to end the financial year with a profit.

As usual, Merko will continue dividend payments to shareholders while maintaining the required liquidity buffer. Conservative management is what has helped us to survive the most difficult periods without resorting to deliberate underbidding on orders.

On domestic markets, there has been a slight recovery in the area of residential construction, where Merko has been involved as a constructor as well as a co-financier for partners. In the coming years, residential construction will remain the only field in which the private sector will participate as a contractor. In order to manage risks, Merko has reinforced the position of its engineering construction, which is based on a strong team of engineers and site managers.

One of the project managers at Merko won the title, Constructor of the Year, for the

second year running. Last year, we established a subsidiary in Ukraine in order to prepare for strategic expansion, and hope to participate in the launch of the first construction projects there in the near future.

The confidence of the banks towards the sector has increased slightly, but many potential contractors are still affected by liquidity problems. Merko's strong financial base will enable it to continue providing co-financing to both private and public contractors in the coming years.

Despite the drastic changes in the economic environment, the company has fulfilled its obligations to cooperation partners. Merko meets all the conditions necessary to strengthen its position as a leading construction company in the Baltic States. This is based on mutual trust between the company's customers, employees and shareholders.



Yours sincerely,

Tõnu Toomik

Chairman of the Supervisory Board



AS MERKO EHITUS GROUP

CONSOLIDATED ANNUAL REPORT

Translation of the Estonian original
Beginning of financial year: 01.01.2010
End of financial year: 31.12.2010

| | |
|--------------------------|---|
| Main activity: | general contracting of construction |
| Commercial Register no.: | 11520257 |
| Address: | Järvevana tee 9G, 11314 Tallinn |
| Phone: | +372 680 5105 |
| Fax: | +372 680 5106 |
| E-mail: | merko@merko.ee |
| Web site: | www.merko.ee |
| Auditor: | AS PricewaterhouseCoopers |
| | |
| Supervisory Board: | Tõnu Toomik, Teet Roopalu, Indrek Neivelt, Olari Taal |
| Management Board: | Tiit Roben, Alar Lagus, Veljo Viitmann, Andres Agukas, Jaan Mäe, Viktor Mõisja |

MANAGEMENT REPORT

General information

AS Merko Ehitus is a leading construction group offering complete solutions. AS Merko Ehitus was set up in 1990 and the Company's home markets are Estonia, Latvia and Lithuania. The group consists of 32 subsidiaries and 5 associates and joint ventures, the largest of which are SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (85%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%), OÜ Fort Ehitus (75%) and AS Tartu Maja Betoontooted (25%).

Key changes which occurred at the group in 2010:

- At 22 December 2010, Merko Ehitus set up its 100% subsidiary LLC Merko Ukraine (registration code 37458687) in Ukraine. This represented a formal act, the goal of which was creation of a legal platform for subsequent activities in a new market. With this step Merko Ehitus confirmed its strategic interest in launching activities in the Ukrainian market. The main activity of the new company is going to be project management of construction works in Ukraine. (http://www.nasdaqomxbaltic.com/market/?pg=details&instrument=EE3100098328&list=2&tab=news&news_id=246079).
- At 3 February 2010, 10% of shares of AS Gustaf were repurchased. The statement of financial position of AS Gustaf as at 31.12.2009 was used as the basis for the purchase transaction.

At 21 December 2010, the Supervisory Board of AS Merko Ehitus decided to elect an additional member to the Management Board of the public limited company – Viktor Mõisja, former manager of the department of concrete works. Viktor Mõisja started to work in the new position at 21 December 2010 and his area of responsibility will include quality management and supervision. In addition, Viktor Mõisja will represent AS Merko Ehitus in the court case commenced at Harju County Court at 10 January 2011 where alongside others AS Merko Ehitus and its subsidiaries are charged with giving a bribe (gift cards of an Estonian tourist company worth EUR 2,556 and a book "Eesti talurahva arhitektuur"/*Estonian Vernacular Architecture*). A member of the Management Board must represent a legal person at criminal proceedings.

Due to the restructuring of the Company's Management structure, Jaan Mäe was removed from the position of a member of the Supervisory Board at the general meeting of shareholders held at 3 June 2010 in conjunction with his election as a member of the Management Board of AS Merko Ehitus.

Due to the changes in the economic environment and the construction market, the Supervisory and Management Boards of AS Merko Ehitus reviewed the group's strategy and approved its strategic goals for the years 2010 - 2015.

The strategy covers the time period from the current year until the end of 2015. All principles and some financial goals, such as the minimum equity to assets ratio to be ensured, are mandatory during the whole period.

The following assumptions regarding the economies of the Baltic States have been used as the basis for the strategy:

- economic growth is not expected in 2010, the construction sector is expected to decline by up to ten per cent;
- according to different experts, economic growth in the upcoming years (2011 – 2012) will not be higher than 3%;
- the key customer in the upcoming years will be the public sector with the main emphasis on infrastructure projects co-financed by EU funds;
- PPP (public private partnership) models will be used more frequently than previously, because the public sector does not have sufficient funds to make investments;
- the number of projects related to improvement of energy efficiency will increase;
- the apartment market will pick up as compared to the recession of the last couple of years;
- a need for industrial buildings will increase;
- credit availability will improve;
- a reduction in unemployment and recovery of the retail trade will occur in 2011.

Strategic goals of AS Merko Ehitus:

- The vision of AS Merko Ehitus is to offer a high-quality construction service to its customers in various fields.
- The goal of AS Merko Ehitus is to be leading construction company in its home market – the Baltic States.
- In addition to the home market, AS Merko Ehitus considers Ukraine, primarily Kiev, and St. Petersburg in Russia to have a good outlook.
- Outside aforementioned markets, the Company builds/develops only for those clients with whom it has prior collaboration experience with, or objects similar to those which it has previously successfully built/developed.
- In 2015, Estonia would contribute ca. 35%, Latvia ca. 30%, Lithuania ca. 25% and other markets ca. 10% to the total sales of the group. The distribution of profit earned at the group should also be of similar proportions.

- In addition to the current construction and design service, the Company would offer an even more integrated service, encompassing the complete process, from help with finding appropriate land plots until arrangement of financing.

Long-term financial goals of AS Merko Ehitus:

- attain a minimum ROE ratio of 15% for the years 2011 – 2015;
- ensure at least 40% equity to assets ratio during the whole period.

To attain these goals, we will:

1. search for opportunities to acquire ownership interests in successful companies, especially in Lithuania and Latvia.
2. rearrange the group's management structure which entails the following:
 - add an additional member to the Management Board, whose area of responsibility will initially include both foreign markets as well as development activities;
 - use several new activities to improve the horizontal cooperation between various group entities and integration of engineering-technical know-how and management experience obtained in various foreign countries into different structures at the group;
 - the ultimate goal of changing the group's structure is the creation of a holding company listed on the stock exchange and production activities in all countries with permanent operations carried out through the structures registered in those countries.
3. preserve the key foundation of the motivational system which has successfully operated until now and improve it in accordance with the set goals.

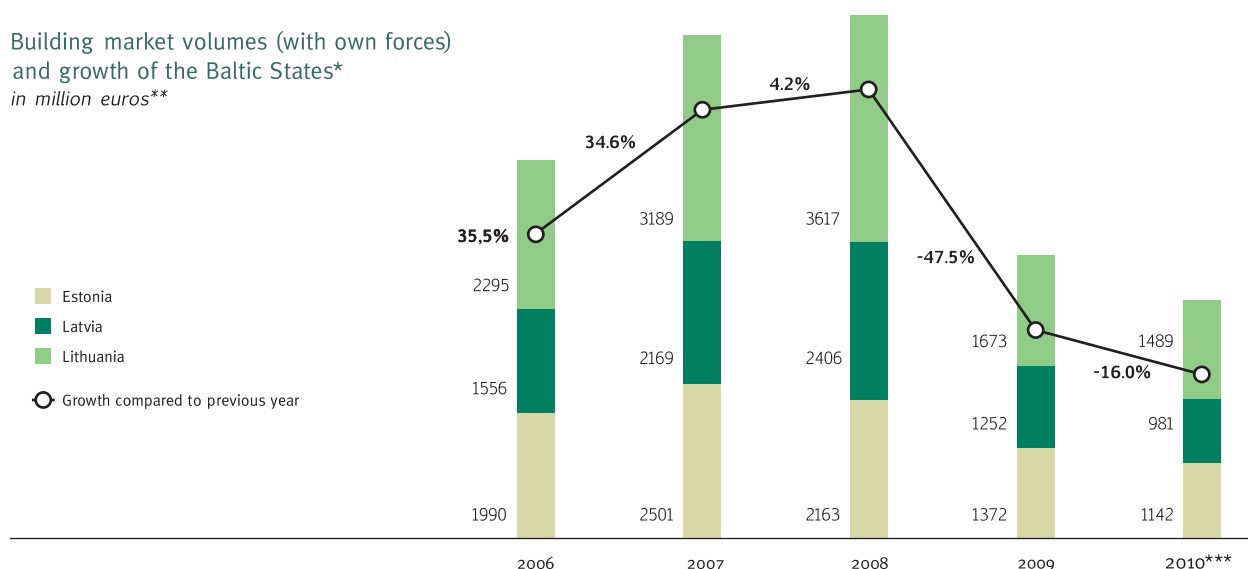
Baltic construction market

In 2010, the construction market was characterised by three keywords: low demand, intense competition and fast appreciation of input prices.

In 2010, construction works with own resources were performed in the Baltic region for EUR 3,612 million (EEK 56.5 billion), which is EUR 686 million (EEK 10.7 billion) less than in 2009. While in 2009 the Baltic construction market as a whole declined by 47.5%, it then fell by another 16.0% in 2010. Latvia experienced the biggest drop, where the construction market in current prices fell by 21.4% (2009: 47.7%) and declined to EUR 981 million (EEK 15.3 billion). Estonia did not fare much better, where the construction market fell by 16.8% in a year, contributing 31.6% to the total Baltic construction market in 2010 equal to EUR 1,141 million (EEK 17.9 billion). While Lithuania fell the most in 2009 (53.7%), the decline was only 11% in 2010. According to the data of statistical office, construction works with own resources were performed in Lithuania for EUR 1,489 million (EEK 23.3 billion) which made up the largest share of the total Baltic construction market at 41.2%. Along with a decline in construction works, the construction works per capita also fell. Construction works per capita were performed for EUR 852 in Estonia, EUR 443 in Latvia and EUR 453 in Lithuania.

Although negative trends continued, the market showed signs of improvement in the 4th quarter on a quarter-over-quarter basis. As compared to the 4th quarter of 2009, construction works performed with own forces increased by 17.8% in Lithuania and 0.6% in Latvia. Despite the weak domestic market situation, demand and the related construction volume continued to grow in export markets in 2010. In a year, the volume of work completed by Estonian companies in foreign countries increased by 8.5% (contributing 11% to total volume of construction services completed with own forces), the exports of Latvian companies increased by 10.4% (contributing 6% to the volume of construction services) and the exports of Lithuania increased by 53.3% (contributing 5% to the volume of the construction services).

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



* Based on the data of local statistical offices.

** According to the unofficial central exchange rate of Eesti Pank.

*** Data of 2010 tentative, based on short-term statistics.

Although the data by Statistics Estonia still reflect depreciation of construction prices as compared to 2009 (-2.8% in Estonia, including labour costs -5.8%, -2.7% in Latvia, including labour costs +1.0%, and -4.3% in Lithuania, including labour costs -5.4%), then strong global demand has led to significant appreciation of the input price in the construction sector from the beginning of 2010, both the prices of materials as well as the rent of equipment have appreciated. Strong demand in the construction sectors of Central Europe and Scandinavia has created a real alternative for local firms and workforce to sell their services to foreign countries and has led to appreciation of labour costs. Appreciation of input prices and orientation of many subcontracting entities towards foreign markets has led to significant appreciation of construction services over the last 9 months. As compared to the bottom of the construction market in 2009, construction prices have increased by 20-25%. Great volatility of prices will complicate the budgeting of new projects and completion of construction of projects with the budgeted costs and will lead to additional risk when performing construction contracts with fixed prices and will put price pressure on profitability of projects. This reason was of significant importance for the formation of weaker than expected results of the group in the 4th quarter. As at 31.12.2010, a provision for unprofitable projects had been set up in the amount of EUR 2.2 million (EEK 34.8 million).

In the market of general contracting, the trend of submitting proposals priced below break-even level continued in order to win the contract, accompanied by withdrawals from tenders and cancellation of contracts. In such a situation, the customer generally loses out due to additional time and resources needed to arrange a new procurement. Such tenders have often been arranged in such a way that the preparatory work at a high price is completed, a decent profit is earned and then the project is abandoned. When arranging a new procurement, it turns out that the actual cost to complete unfinished work exceeds the cost agreed for work unperformed by the previous contractor manyfold. Indifference of customers and fear to attract public attention due to unsuccessful tenders favours unhealthy competition. Merko Ehitus does not approve of such a practice and intends to adhere to its agreements also in the future.

The year 2010 demonstrated the signs of a recovery of housing market in Estonia and Lithuania, the number of transactions as well as average prices increased. The increase in the price level of residential premises and the signs of economic stabilisation have given an impetus for people who for a long time have postponed their purchases to be more active. The improvement of the market situation has been helped by the improved financing environment, primarily lower degree of own financing required and interest margins for end users. Temporary sales success in the area of residential premises has encouraged developers to review their frozen projects and draw up new business plans and loan applications. Despite nascent optimism among developers, the launching of new projects is currently very risky – the speed of appreciation of construction prices clearly exceeds the growth of sales prices and makes profitable development of projects very unpredictable, as a result of which we estimate that the volume of new development projects will remain modest in the near future and the supply of residential premises will drop. Derived from the supply contraction and appreciation of construction prices, we forecast further appreciation of the prices of residential premises over the next 12 months.

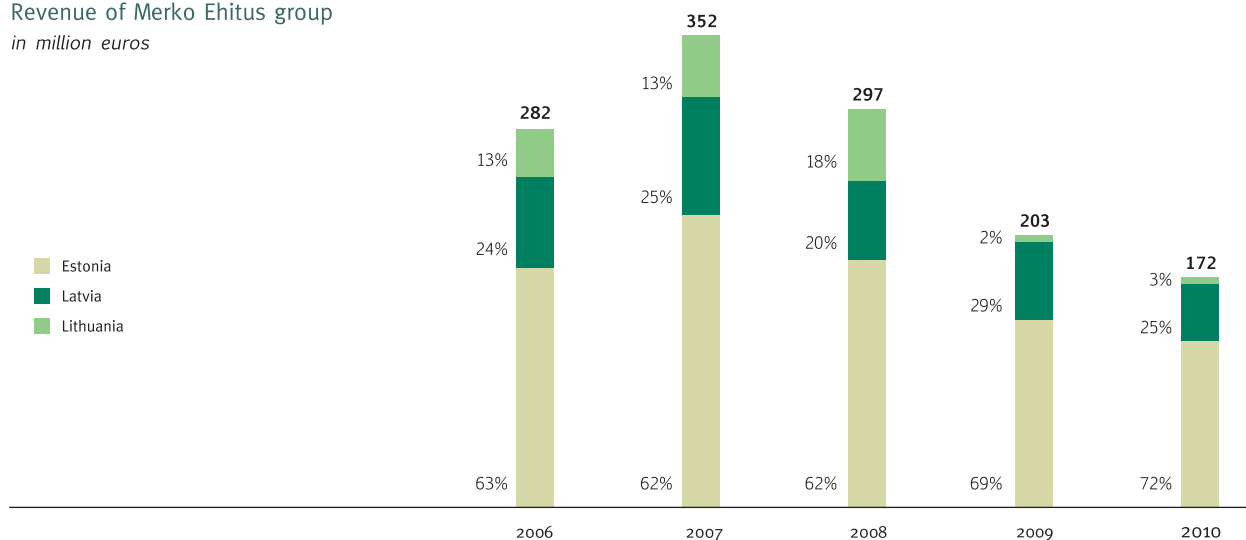
During the year, a total of 2324 (2009: 3026) permits of use were issued for new residential premises in Estonia, 1905 (2009: 4187) in Latvia and 3667 (2009: 9400) in Lithuania.

Operating results

In 2010, the revenue of the construction group was EUR 171.9 million (EEK 2,689.9 million). In 2010, Estonia contributed 72.3%, Latvia 25.1% and Lithuania 2.6% to the group's sales. As compared to 2009, the group's revenue decreased by 15.4%, including 10.9% in Estonia, 27.1% in Latvia and 5.1% in Lithuania. Considering the 16.0% drop in the Baltic construction market, it should be noted that the group's revenue also decreased along with the drop in the market. The fact that the group earned a profit in the financial year should rather be considered a positive result considering the market situation.

Revenue of Merko Ehitus group

in million euros



The consolidated sales revenue of the group's largest entities:

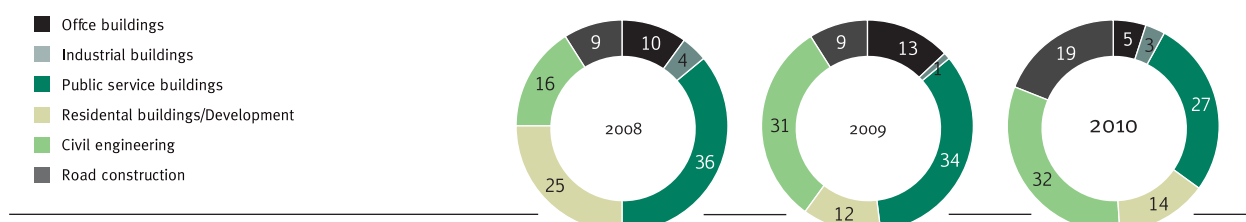
in thousands of euros and kroons

| | 2010 | | 2009 | |
|------------------------------------|--------|-----------|---------|-----------|
| | EUR | EEK | EUR | EEK |
| Estonian entities | | | | |
| AS Merko Ehitus (parent) | 89,780 | 1,404,744 | 107,968 | 1,689,327 |
| AS Gustaf (85% ownership) | 2,598 | 40,647 | 2,820 | 44,131 |
| OÜ Gustaf Tallinn (80% ownership) | 3,451 | 53,997 | 3,907 | 61,126 |
| AS Merko Tartu (66% ownership) | 2,485 | 38,885 | 4,606 | 72,073 |
| Tallinna Teede AS (100% ownership) | 20,792 | 325,330 | 17,603 | 275,423 |
| OÜ Woody (100% ownership) | 3,941 | 61,663 | 1,598 | 25,000 |
| Latvian entity | | | | |
| SIA Merks (100% ownership) | 43,169 | 675,440 | 59,181 | 925,985 |
| Lithuanian entity | | | | |
| UAB Merko Statyba (100% ownership) | 4,432 | 69,352 | 4,532 | 70,915 |

Engineering construction contributed 32%, residential construction/development 14%, service buildings 27%, office buildings 5%, industrial buildings 3% and road construction 19% to the group's revenue. New buildings made up 57%, and renovation and reconstruction works made up 43% of construction activities.

Distribution of construction activities of the group

per cent



In 2010, the group concluded new construction contracts in the total amount of EUR 290 million (EEK 4.54 billion), incl. EUR 79 million (EEK 1.24 billion) in the 4th quarter. The largest construction contracts entered into in 2010 included reconstruction of Ülemiste traffic junction (EUR 41.4 million), construction of Loo-Maardu section of E20 highway (EUR 18.5 million), construction of water and sewage pipelines and facilities of the water economy project of the town of Maardu (EUR 13.3 million), construction of Iru waste-to-energy plant (EUR 12.6 million) and renovation of the public water supply of the region of Kohtla-Järve (EUR 7.8 million). As at 31 December, the group's portfolio on unfinished construction contracts totalled EUR 200 million (EEK 3.13 billion).

The contract portfolio does not include residential development projects developed by the Company and the works related to construction of investment properties. At 13.07.2010, the subsidiary of AS Merko Ehitus, UAB Merko Statyba, signed a contract for the construction of Balsiu schoolhouse and its subsequent leasing for 25 years with the real estate company of the City of Vilnius. The estimated investment into the project is EUR 10 million and the school-house should be completed to receive students at 1 September 2011. In August 2010, a contract was concluded with the City District Government of Lasnamäe district, pursuant to which the Company will lease out 2405 m² office space in Lasnamäe to the latter in August 2011.

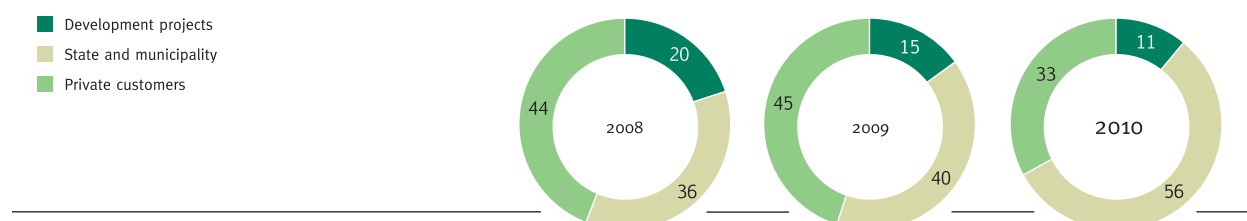
The largest project completed in 2010

| | | | | |
|--|----------------|--|------------------------|-------------------|
| Facilities of Ämari air base | new facility | Ämari, Vasalemma rural municipality, Harju county | | AS Merko Ehitus |
| Extension of Kristiine shopping centre | new facility | Endla 45, Tallinn | 20,764 m ² | AS Merko Ehitus |
| Piirissaare Port | reconstruction | Tooni village, Piirissaare rural municipality | quay 108 m | AS Merko Ehitus |
| Water and sewerage facilities of the town of Elva | new facility | town of Elva | 34.7 km | AS Merko Ehitus |
| Avinurme recreational centre | reconstruction | Avinurme rural municipality, Ida-Virumaa | 580 m ² | AS Merko Ehitus |
| Stage II of apartment buildings at Pärnu mnt 129c and Räägu-Vuti | new facility | Pärnu road 129c, Tallinn Räägu street 10, Tallinn | 9332 m ² | AS Merko Ehitus |
| Northern greenhouse of Tallinn Botanical Garden | new facility | Kloostrimetsa road 52, Tallinn | 1310 m ² | AS Merko Ehitus |
| Section of Rannaküla-Haapsalu highway T9 | reconstruction | Ääsmäe-Haapsalu-Rohuküla km 64,460-70,416 | 257,276 m ² | Tallinna Teede AS |
| DnB NORD Bank office building | new facility | Skanstes 12, Riga | 15,146 m ² | SIA Merks |
| Hotel Tallink | new facility | Elizabetes 24/26, Riga | 10,837 m ² | SIA Merks |
| Jõgeva kindergarten Rohutirts | reconstruction | Rohu 8, Jõgeva | 2585 m ² | AS Gustaf |
| Kindergarten of Haanja rural municipality | new facility | Haanja village, Võrumaa | 1259 m ² | AS Merko Tartu |

The confidence and courage to investment of the private sector exiting from the economic crisis continue to be low. The majority of new construction projects are initiated in the area of infrastructure and environmental facilities funded by the public sector and the EU structural funds.

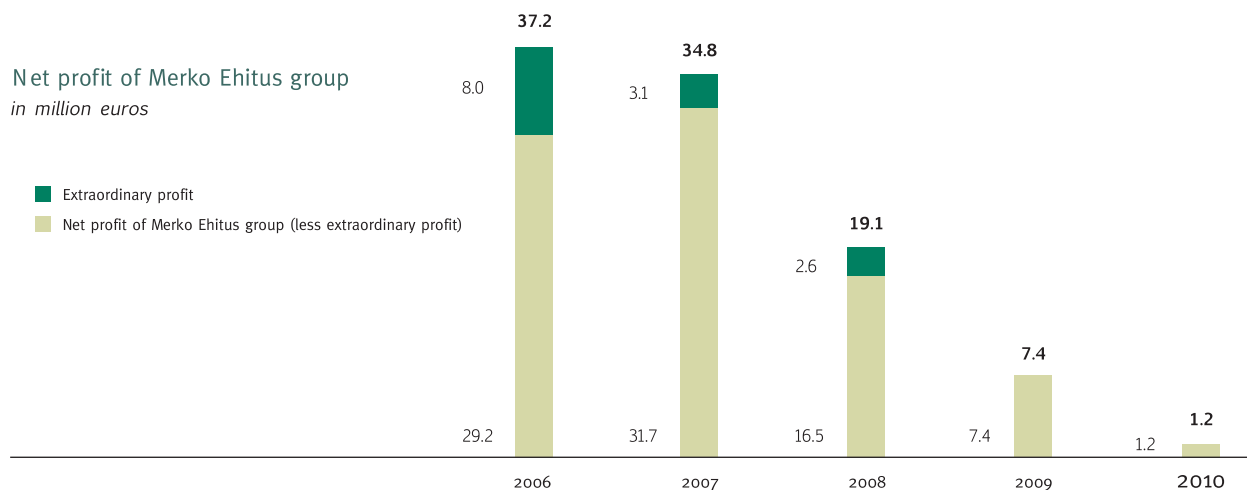
Distribution of revenue according to customers

per cent



Due to the lower volumes and significant appreciation of input prices (several projects were unprofitable), the ratio of cost of goods sold to revenue increased, as a result of which the gross margin fell from 10.9% to 7.5% in a year. In 2010, the group's marketing, and general and administrative expenses fell by 15.1%. The reduction in marketing, general and administrative expenses was aided by cost-savings measures implemented, of which the decline in staff costs contributed EUR 1.1 million (EEK 16.4 million), office and communication expenses EUR 0.6 million (EEK 9.1 million), construction tenders EUR 0.6 million (EEK 8.6 million) and advertising and sponsorships cuts EUR 0.3 million (EEK 4.7 million). Despite the overall decline in marketing, and general and administrative expenses, the consulting and legal expenses increased by EUR 0.3 million (EEK 5.0 million) in a year, largely attributable to the legal disputes related to procurement proceedings.

In 2010, the group's pre-tax profit totalled EUR 1.8 million (EEK 27.7 million), decreasing by EUR 5.9 million (EEK 92.2 million) in a year and the net profit totalled EUR 1.2 million (EEK 19.2 million), decreasing by EUR 6.2 million (EEK 96.9 million) or 83.4%. The decline in profits was influenced by a drop in sales revenue, and in the profitability of the construction and development area. Due to faster than expected appreciation of construction prices, the Company had to make major adjustments to the cost forecasts and this was also the major reason for the loss of EUR 4.0 million (EEK 62.4 million) incurred in the 4th quarter of 2010. In 2010, the group incurred a loss of EEK 1.02 million (EEK 15.9 million) on the write-down of development projects (including properties for sale of EUR 0.28 million (EEK 4.4 million), a prepayment for a registered immovable of EUR 0.49 million (EEK 7.7 million), construction in progress of EUR 0.25 million (EEK 3.9 million) (incl. impairment of construction in progress of EUR 0.81 million (EEK 12.7 million) and a reversal of the impairment loss of construction in progress of EUR 0.56 million (EEK 8.8 million)) and a reversal of the impairment loss of finished goods recognised in the previous year of EUR 0.01 million (EEK 0.1 million). In addition, it incurred a loss of EUR 0.11 million (EEK 1.8 million) from the write-down of irrecoverable receivables. The group's pre-tax profit before extraordinary write-downs was EUR 2.90 million (EEK 45.4 million). The impact of the seasonal nature of the construction activity and the cyclical nature of the development activity was insignificant for results.



In 2010, the change in short-term investments, and cash and cash equivalents of Merko Ehitus group was EUR -36.3 million (EEK -567.6 million) and as at 31 December 2010, the cash and cash equivalents in the bank accounts and term deposits of the group were in the amount of EUR 12.5 million (EEK 195.7 million). The cash flows from operating activities totalled EUR -7.3 million (EEK -113.4 million), cash flows from investing activities totalled EUR -6.5 million (EEK -101.7 million) and cash flows from financing activities totalled EUR -22.5 million (EEK -352.5 million). The cash flows from operating activities in the reporting period were mostly affected by the change in liabilities and prepayments related to operating activities of EUR +6.3 million (EEK +98.0 million), the change in inventories of EUR +5.6 million (EEK +87.5 million) and restatement of the revenue from construction projects recognised under the stage of completion method of EUR -23.4 million (EEK -365.5 million). Of the cash flows from investing activities, the balance of issued and repaid loans totalled EUR -4.0 million (EEK -62.1 million), acquisition of investment properties totalled EUR -2.6 million (EEK -41.0 million) and investments in property, plant and equipment totalled EUR -0.8 million (EEK -12.6 million). Of the cash flows from financing activities, EUR -12.4 million (EEK -194.7 million) was spent on dividend payments, EUR -10.8 million (EEK -168.2 million) on loans assumed and EUR -1.4 million (EEK -22.6 million) on finance lease principal payments.

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

| | 2008 | 2009 | 2010 |
|---|-------|-------|-------|
| Net profit margin | 6.4% | 3.7% | 0.7% |
| Net profit margin before write-downs (excluding extraordinary profit) | 9.3% | 7.2% | 0.7% |
| EBT margin | 7.1% | 3.8% | 1.0% |
| Operating profit margin | 7.0% | 4.2% | 1.4% |
| Gross margin | 16.3% | 10.9% | 7.5% |
| Return on equity per annum | 14.6% | 5.5% | 0.9% |
| Return on assets per annum | 7.7% | 3.1% | 0.6% |
| Equity ratio | 53.7% | 60.5% | 63.8% |
| Current ratio | 2.8 | 2.3 | 2.7 |
| Quick ratio | 1.3 | 1.1 | 1.1 |

| | | | |
|--|-------|-------|-------|
| General expense ratio | 5.8% | 6.3% | 6.4% |
| Personnel expense ratio | 8.8% | 8.8% | 9.3% |
| Debt to equity ratio | 35.6% | 24.6% | 20.6% |
| Accounts receivable turnover (in days) | 42 | 44 | 44 |
| Accounts payable turnover (in days) | 33 | 29 | 35 |
| Sales revenue per employee (in EUR thousand) | 291 | 256 | 186 |
| Average number of full-time employees at the group | 1023 | 794 | 809 |

Definition of key indicators:

Net profit margin: Net profit / Revenue

EBT margin: Profit before tax / Revenue

Operating profit margin: Operating profit / Revenue

Gross margin: Gross 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: Owners' equity / Total assets*

Current ratio: Current assets / Current liabilities

Quick ratio: (Current assets – Inventories) / Current liabilities

General expense ratio: General expenses / Revenue

Personnel expense ratio: Personnel expenses / Revenue

*Debt to equity ratio: Interest-bearing liabilities / Owners' equity**

Accounts receivable turnover: Trade receivables / 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

* attributable to equity holders of the parent

Business risks

Market risk. One of the peculiarities of construction activities is the fact that the execution of the contracts concluded will take months, making the sector inert to changes in the economic environment. Due to this, both positive and negative changes in the economic environment reach the construction industry with a lag of approximately 12-18 months. This time lag enables the sector to arrange its activities to be prepared for potential setbacks as well as booms.

Several unfavourable factors – appreciation of credit, a decline in demand and general uncertainty about the future have significantly reduced the value of real estate. The housing development area is one of the main sources of market risk arising from the value of real estate for Merko Ehitus group. In 2010, the group sold 233 apartments for EUR 17.9 million (EEK 280.7 million), (exclusive of VAT), which can be considered a decent result in light of the market situation. As at 31.12.2010, the inventories included 63 unsold apartments with a total cost of EUR 4.9 million (EEK 77.1 million) and 424 apartments in the stage of construction with a total cost of EUR 16.3 million (EEK 255.7 million) as at the balance sheet date. The group's stock of apartments varies by regions, of the finished buildings 44 apartments are located in Tartu, 18 in Riga and 1 in Tallinn. As the stock in Tallinn reached a critical level, the Company launched construction of a new apartment building with 93 apartments at Tartu road 50 in Tallinn in the 3rd quarter and an apartment building with 15 apartments at Kristiina 12, Tallinn in the 4th quarter of 2010. The apartments will be completed in the 4th quarter of 2011. SIA Merks relaunched a development project with 116 apartments in the district of Skanstes, Riga. The construction works of the property are planned to be completed in the 2nd quarter of 2011. In order to minimise risks, the new projects are generally small-scaled and regionally dispersed.

Operating risk. The group concludes total risk insurance contracts with insurance companies in order to hedge the risk of unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to EUR 10 million. The risks of the projects whose cost exceeds EUR 10 million or which the annual policy does not cover (water construction, rail-road construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding contracts for services involving design work, an insurance contract for professional liability is required from subcontractors covering the damage arising from design, erroneous measurement, advice and instructions, or such a contract is concluded at own expense. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2010, indemnity applications totalled EUR 0.26 million (EEK 4.0

million), and insurance benefits were received in the amount of EUR 0.20 million (EEK 3.2 million) and those in processing totalled EUR 0.01 million (EEK 0.1 million).

The prices of construction services and materials which move quickly have made the budgeting of projects more difficult, increasing the risk of inadequate pricing of bids. Unpredictably and more intense competition put serious pressure on the profitability of the construction sector, significantly reducing the margin for erring when submitting tenders and presenting a serious threat for sustainable development of the sector.

A warranty reserve has been set up at the Company to cover the construction errors which have become evident during the warranty period. In 2010, warranty provisions were set up at the group in the total amount of EUR 0.97 million (EEK 15.1 million) and disbursements amounted to EUR 1.04 million (EEK 16.2 million). As at the year-end, the Company's warranty provision amounted to EUR 1.11 million (EEK 17.4 million). With regard to work performed by subcontractors, the subcontractor is responsible for elimination of errors that became evident during the warranty period. With regard to critically significant contracts, the performance of contractual obligations of the contractor arising from contracts of services is guaranteed with bank guarantees to be paid upon the first demand.

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 five largest group entities and the occupational health and safety system OHSAS 18001 has been set up at the parent, Merko Tartu as well as Latvian and Lithuanian subsidiaries. Twelve full-time quality control specialists work at the group whose work responsibilities include ensuring the development and functioning of quality, occupational safety and management systems.

Credit risk. In connection with the overall weakness of the economic environment, the share of credit risk in the group's risk matrix continues to be high. In managing credit risk, close attention is paid to the payment behaviour of business partners, their financial position is analysed and if necessary, third parties are involved as guarantors in transactions. Upon prepayments to suppliers, a bank guarantee by suppliers is required. In 2010, the payment discipline of customers improved slightly. Although the amount of doubtful receivables remained virtually unchanged, decreasing from EUR 1.27 million (EEK 19.9 million) to EUR 1.16 million (EEK 18.1 million), the ratio of write-downs to sales decreased 6.7 times from EUR 0.89 million (EEK 13.9 million) to EUR 0.11 million (EEK 1.8 million). During the period, the amount of invoices past due 30 and more days decreased from EUR 7.2 million (EEK 113.7 million) to EUR 3.15 million (EEK 49.3 million). As at 31.12.2010, the group had receivables past due in the amount of EUR 4.84 million (EEK 75.7 million), of which EUR 1.27 million (EEK 19.9 million) were collected after the balance sheet date. Management monitors closely the pattern of receivables and is of opinion that the receivables at the year-end do not contain major credit risks posing a threat for the Company's sustainability of operations. The Company's available funds are primarily held in overnight deposits or term deposits at the banks of Swedbank, SEB, Nordea and Unicredit group.

Interest rate risk. As at 31.12.2010, the group's interest-bearing liabilities totalled EUR 25.7 million (EEK 402.7 million), of which short-term loans and the current portion of long-term debt totalled EUR 12.5 million (EEK 196.4 million) and long-term loans and finance lease liabilities totalled EUR 13.2 million (EEK 206.3 million). The volume of interest-bearing liabilities decreased by EUR 7.75 million (EEK 121.2 million) in a year and as at the year-end, these liabilities made up 13.2% of the Company's balance sheet total. Of the liabilities assumed, the liabilities with floating base interest rates totalled EUR 25.13 million (EEK 393.3 million), of which EUR 24.96 million (EEK 390.5 million) are exposed to the risk of changes in Euribor and EUR 0.18 million (EEK 2.8 million) in Rigibor, and EUR 0.60 million (EEK 9.4 million) have fixed interest rates. As at 31.12.2010, 12-month Euribor was 1.507% and management estimates that it can increase by 100 basis points over the next 12 months. In addition to the risk of Euribor, the refinancing of liabilities poses a threat of a change in the risk margin due to the changes in the economic environment. The management estimates that it may lower interest rates by 50-100 basis points in 2011, depending on the previous time of fixing of interest. As at 31.12.2010, the balance of liabilities exposed to a change in the risk margin was EUR 5.51 million (EEK 86.2 million). Of current liabilities, the loan received during the demerger of AS Järvevana in the amount of EUR 6.99 million (EEK 109.4 million) is not subject to the margin risk, where the interest on the loan has been fixed at the level of 12-month Euribor + 100 basis points.

Liquidity risk. Due to the decrease in money supply, lower turnover speed of development projects and potential negative scenarios with regard to the payment discipline, one of the group's main priorities will be the ensuring of liquidity. As at 31.12.2010, the group's current ratio was 2.7 (31.12.2009: 2.3) and quick ratio was 1.1 (31.12.2009: 1.1). To ensure liquidity and better management of the cash flows, the group entities have concluded overdraft contracts with banks in the total amount of EUR 5.96 million (EEK 93.2 million). In addition to overdraft contracts, the Company has a working capital loan facility with the limit of EUR 5.0 (EEK 78.3 million) from AS Riverito. The majority of the group's loans have been taken for implementation of short-term development projects and due to the improvement of the residential real estate market and the financing environment, management does not see any problems with the repayment or refinancing of these loans. Management considers that the group's capital structure – high equity ratio of 63.8% of the balance sheet total and a moderate proportion of borrowings of 13.2% of the balance sheet total – ensures both the feasibility of the extension of existing financial liabilities and, if necessary, obtaining additional working capital, as well as the company's trustworthiness in the eyes of creditors. The group's priority in 2011 continues to be preservation of liquidity.

Foreign currency risk. The group's construction contracts are mostly concluded in the currencies of the country of location of the entities: Estonian kroons, Latvian lats and Lithuanian litas. From 1 January 2011, EUR was adopted in Estonia. The Latvian lats and Lithuanian litas are pegged to the euro. The exchange rate of the Latvian lats is EUR 1 = LVL 0.702804 +/-1%. To eliminate foreign currency risks, the structure of the Company's assets and liabilities by currencies is monitored, and the euro is the preferred currency in conclusion of long-term construction contracts. As at the balance sheet date, EUR 188.05 million (EEK 2942.4 million) or 96.2% of the group's assets were denominated in local currencies, including the assets in EEK 55.1%, LVL 34.7% and LTL 6.4% of the balance sheet total and the liabilities in local currencies totalled EUR 168.96 million (EEK 2,643.6 million) or 86.4%, including liabilities in EEK 67.3%, LVL 17.1% and LTL 2.0% of the balance sheet total.

If as at the year-end, all national currencies had been simultaneously devalued by 25%, the group would have incurred additional finance costs in the amount of EUR 4.77 million (EEK 74.7 million), including from EEK position EUR 5.97 million (EEK 93.3 million), from LVL position EUR 8.60 million (EEK 134.6 million) and from LTL position EUR 2.14 million (EEK 33.5 million). As Estonia adopted the euro at 1.01.2011, management estimates that the possibility of and need for devaluation of national currencies of LVL and LTL have significantly decreased and the situation has stabilised in the Baltic States.

Legal risks. Due to the possibility of differing interpretations of contracts, regulations and laws, there is a risk that some buyers, contractors or supervisory authorities consider the Company's activities from the perspective of laws or contracts from a different position, and dispute the legality of the Company's activities. As at 31.12.2010, the Company had set up provisions for potential claims and legal costs in the amount of EUR 0.26 million (EEK 4.1 million). In 2010, legal costs in the total amount of EUR 0.73 million (EEK 11.5 million) were covered from the provisions and new provisions were set up in the amount of EUR 0.07 million (EEK 1.1 million).

An overview of the main legal disputes of group entities as at 31.12.2010 is presented below.

At 8 November 2010, Lithuanian company UAB Olinda filed a claim with the Arbitration Court of Helsinki Chamber of Commerce and Industry against UAB Merko Statyba in the amount of LTL 17.3 million (EEK 78.4 million). UAB Olinda's losses were allegedly incurred in conjunction with the refusal of UAB Merko Statyba to launch work pursuant to the construction contract. UAB Merko Statyba is of opinion that the project submitted by the customer and the building permit were not in compliance with Lithuanian laws as well as the detailed plan of the registered immovable intended for the purpose of construction, and Merko Statyba was under the obligation to refuse performance of illegal construction activities. The Lithuanian Planning and Construction Inspectorate is also of opinion that the launch of construction activities on the property is illegal until the documentation of the construction project and building permit has been brought into compliance with Lithuanian legislation. At the request of the Inspectorate, Vilnius Administrative Court has also suspended the validity of the building permit. The session at the court of arbitration in the disputed matter will take place at 14-15 June 2011. The group's management is opinion that UAB Merko Statyba's refusal to launch construction activities on the grounds of an invalid building permit was justified and the claim will be dismissed.

At 31 December 2010, customer UAB Neringos Vanduo filed a claim against the Lithuanian branch of AS Merko Ehitus in the amount of LTL 2 million (EUR 0.58 million/EEK 9.1 million) related to the alleged improper fulfilment of the contract for services concerning Neringa wastewater treatment plant and enforced the performance warranty issued by the bank to the customer in the amount of LTL 1 million (EUR 0.29 million/EEK 4.5 million). Merko Ehitus is of opinion that the goals laid down in the contract have been attained – the wastewater treatment plant has received authorisation for use, incl. permit by the Lithuanian Health Board in accordance with the contract for services and Lithuanian laws, the customer has no legal grounds to demand payment of contractual penalties and it intends to prove its right in court.

At 9 January 2011, a court case was commenced at Harju County Court which among other issues deals with the claim filed against AS Merko Ehitus in relation to the giving of bribe to the former Tallinn city official Ivo Parbus. The Prosecutor's Offices has charged Merko Ehitus with the giving of a bribe – Estravel's gift coupon of EEK 25,000 (EUR 1,598) and the book with the list price of EEK 410 (EUR 26) titled "Eesti Talurahva Arhitektuur" (Estonian Vernacular Architecture) in order to accelerate the proceedings with the plans of three registered immovables located in Tallinn. The group's management is of opinion that the company has not given a bribe and has conducted its activities in conformity with the laws of the Republic of Estonia.

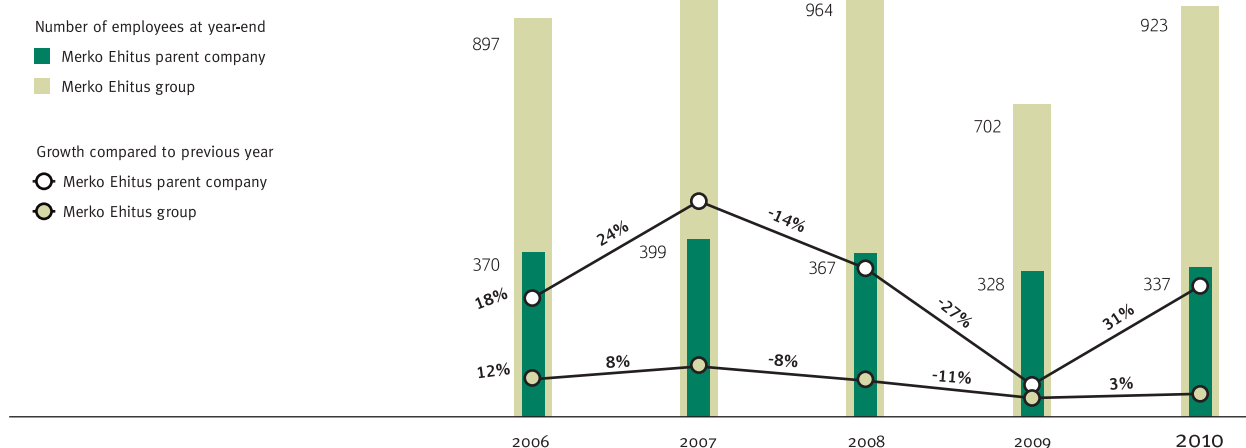
AS Solaris Keskus has declined payment of EUR 2.13 million (EEK 33.4 million) to the general contractors (AS Merko Ehitus ja AS Skanska EMV) for the work performed at Solaris recreational centre. AS Solaris Keskus delays the payment of invoices, referring to the erroneous overpayment made to the builders in the amount of EUR 0.33 million (EEK 5.1 million) and additional expenses incurred during the opening and subsequent use of the centre due to the alleged low quality of construction work performed. This lawsuit will be settled by the parties in court. The group's management is of opinion that the refusal of Solaris Keskus to pay the invoice is not justified.

The Company and its people

One of the main values of Merko Ehitus is its people. Due to the growth of the contract portfolio and the increase in the share of facilities in the structure of contracts, the number of group's employees increased by 221 employees and as at 31.12.2010, the group had 923 employees.

The gross wages and salaries of the group's employees totalled EUR 16.0 million (EEK 250.4 million), of which base wages and salaries made up 73.6% and bonuses made up 26.4%, or 10.2% less than in 2009. As compared to 2009, the number of the group's employees increased by 31.5% and the average gross wages decreased by 12.4%. The number of employees of the parent AS Merko Ehitus was 337 at the year-end 2010, increasing by 9 employees in a year. Gross wages and salaries paid to employees totalled EUR 6.6 million (EEK 103.7 million), the annual decline was 24.1%, including base wages and salaries by 21.5% and bonuses by 28.4%.

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



Management Board

The Management Board is the Company's governing body, which represents and manages the Company. The Management Board shall adhere to the lawful regulations of the Supervisory Board. The Management Board is under the obligation to act in most economically purposeful manner.

As at 31.12.2010, the Management Board of AS Merko Ehitus had 6 members. At the general meeting of shareholders held at 3 June 2010, in conjunction with the restructuring of the Company's management structure, Jaan Mäe was removed from the position of a member of the Supervisory Board due to his election as a member of the Management Board of AS Merko Ehitus and at 21 December 2010, the Supervisory Board of AS Merko Ehitus decided to elect former manager of the department of concrete works Viktor Mõisja as an additional member of the Management Board. The members of the Management Board are all full-time employed for AS Merko Ehitus and their gross remuneration in 2010 totalled EUR 0.47 million (EEK 7.4 million), including base remuneration of EUR 0.23 million (EEK 3.6 million) and bonuses of EUR 0.24 million (EEK 3.8 million). All members of the Management Board currently work on the basis of service contracts. Upon the premature removal of a member of the Management Board or non-extension of their service contracts, the members are paid severance pay which equals their last 24 months' remuneration.

Tiit Roben – Born at 5 January 1966. Finished Mustamäe Gymnasium (former name: Tallinn Secondary School no. 44) in Tallinn and graduated from Tallinn University of Technology, majoring in industrial and civil engineering. Worked as a project manager at AS Merko Ehitus between 1998-2002. Between 2002-2008, worked at AS Riverito's entity E.L.L.Kinnisvara AS, from 2005, is a member of the Company's Management Board. From August 2008, is the Chairman of the Management Board of AS Merko Ehitus, being responsible for the management and development of the Company.

Jaan Mäe – Born at 26 September 1964. Finished Viljandi Secondary School no. 5. and graduated from Tallinn University of Technology, majoring in industrial and civil engineering. From December 1997, works at AS Merko Ehitus, has been project manager, division manager and member of the Management Board. Between 2006-2010, was a member of the Supervisory Board of AS Merko Ehitus and several group entities. From June 2010, is a member of the Management Board of AS Merko Ehitus, being responsible for attainment of goals in the area of development and is the Chairman of the Supervisory Board of Latvian and Lithuanian subsidiaries.

Alar Lagus – Born at 15 February 1969. Finished Rapla Secondary School and graduated from the Faculty of Chemistry of Tallinn University of Technology, majoring in organisation and technology of public catering. After graduation, worked in various positions at Hansapank. From 2004, works as a manager in the finance area and is responsible for the Company's financial and managerial accounting and investor relations.

Veljo Viitmann – Born at 13 March 1962. Finished Türi Secondary School and graduated from Tallinn University of Technology, majoring in road engineering and bridges. From 1994, works at AS Merko Ehitus and is responsible for preparation of tenders for new projects.

Andres Agukas – Born at 15 July 1965. Finished Pärnu-Jaagupi Secondary School and graduated from Tallinn University of Technology, majoring in road engineering. At 2 February 1998, started to work at AS Merko Ehitus as the first employee in the area of civil engineering. From October 2005, as a member of the Management Board is responsible for the whole area of the construction service.

Viktor Mõisja – Born at 6 January 1951. Graduated as a civil engineer from Tallinn University of Technology in 1976. Viktor Mõisja has worked at AS Merko Ehitus since the foundation of the Company and most of the time as a manager of the department of concrete works. From 21 December 2010, is a member of the Company's Management Board and his area of responsibility is quality management and supervision.

Supervisory Board

The general meeting of shareholders elects the Company's Supervisory Board. The Supervisory Board plans the Company's activities and arranges its management as well as performs supervision over the Management Board. The Supervisory Board of AS Merko Ehitus has four members.

At the general meeting of shareholders held at 3 June 2010, due to the restructuring of the Company's management structure, Jaan Mäe was removed from the position of the Supervisory Board member due to his election as a member of the Management Board. During the restructuring the management structure, the 3-member Directorate was eliminated and the functions previously partially granted to the Directorate were returned to the Supervisory Board. The gross remuneration of the members of the group's Directorate totalled EUR 0.08 million (EEK 1.3 million), including base remuneration of EUR 0.05 million (EEK 0.7 million) and bonuses of EUR 0.03 million (EEK 0.6 million). In 2010, the remuneration of the members of the Supervisory Board totalled EUR 0.17 million (EEK 2.7 million).

Tõnu Toomik – Born at 8 March 1961. Finished Raatuse Gymnasium in Tartu (former Tartu Secondary School no. 3) and graduated from Tallinn University of Technology, majoring in industrial and civil engineering. From 1993, started to work as a project manager at AS Merko Ehitus. Between 1997-2008, was a member of the Management Board of AS Merko Ehitus, being responsible for the management and development of the Company. From August 2008, is the Chairman of the Supervisory Board of AS Merko Ehitus.

Teet Roopalu – Born at 30 August 1949. Finished Tallinn Secondary School no. 10 (current Nõmme Gymnasium) and graduated from the Faculty of Economics of Tallinn University of Technology, majoring in construction economics and organisation. Has worked at construction companies, including as a director of finance, managed the economic activities in EKE (Estonian Collective Farm Construction) system as a chief economist, as a bank director and has also been involved in design work. Since November 2002, works at AS Merko Ehitus and is responsible for the Company's financial and legal areas. Is a member of the Supervisory Board of AS Riverito and those of several subsidiaries and associates of AS Merko Ehitus.

Indrek Neivelt – Born at 17 March 1967. Finished a mathematics and physics - biased class at Tallinna Secondary School no. 1 (current Gustav Adolf Gymnasium), graduated from Tallinn University of technology, majoring in civil engineering economics and management, and received his MBA in banking and finance from Stockholm University. Between 1991-2005, worked in various positions at Hansapank, over the last six years as the general director of the group and chairman of the Management Board. From 2005, is a Chairman of the Supervisory Board of Bank Saint Petersburg and is a member of supervisory boards of several entities. From October 2008, is member of the Supervisory Board of AS Merko Ehitus.

Olari Taal – Born at 7 August 1953. In 1971, finished Varstu Secondary School and in 1976, graduated as a civil engineer from Tallinn University of Technology. Has managed Tartu Elamuehituskombinaat (Tartu Housing Plant; Tartu Maja) and Eesti Hoiupank (Estonian Savings Bank). Has served the Republic of Estonia as the Minister of Construction, Minister of Economic Affairs, Minister of Internal Affairs and as a member of the 10th Riigikogu (Parliament of Estonia). From October 2008, Olari Taal is a member of the Supervisory Board of AS Merko Ehitus.

Information about the shares held by the members of the Supervisory and management Boards is disclosed in chapter "Share and shareholders" of the report.

In 2010, the group sponsored sports, culture and education with EUR 0.40 million (EEK 6.2 million).

In the area of sports, we foster the development and projects of sports aimed at young people, enabling to create opportunities for engagement in athletic activities and active vacationing. The group's largest sponsorship project continued to be the initiative launched in collaboration with Swedbank, Eesti Energia and the Ministry of Culture of the Republic of Estonia as well as the Estonian Ski Association, called the Eesti Terviserajad (Estonian Hiking Tracks). We also supported the recreational sports series called Merko Talverajad (Merko Winter Paths) that was launched by Eesti Terviserajad SA and organised by Stamina Sports Club, by which, in addition to creation of well-maintained sports areas, we try to vigorously contribute to the development of regular exercising habits of Estonians. We also support Estonian tennis players. We continue to support the Estonian national cross-country skiing team and the youth team Merko Team.

In the area of culture and education, collaboration with the Estonian Art Museum and Drama Theatre continued. In the area of education, the group's priority is construction-related education and research work. In 2010, cooperation continued with Tallinn University of Technology 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 doctoral degree in construction science. Merko Ehitus pays scholarships to 7 Master's degree students at Tallinn University of Technology and 4 Master's degree students at Tallinn University of Applied Sciences.

In the social field, cooperation with our partner Tilsi Children's Home continued. By midsummer's night 2010, an outdoor basketball field was completed at the children's home with the help of Merko. In December, Santa's elves sent gifts to the children.

Share and shareholders

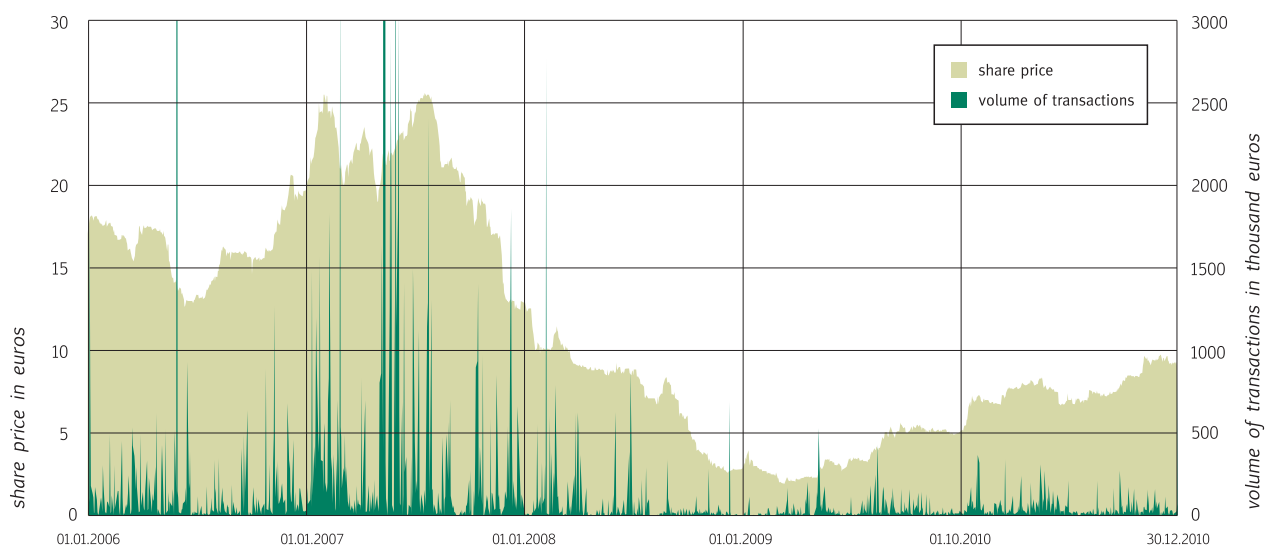
Information on securities

| Name of security | Share of Merko Ehitus |
|---------------------------|-------------------------------------|
| ISIN | EE3100098328 |
| Type of security | Freely transferable ordinary shares |
| Issuer | AS Merko Ehitus |
| Activity of issuer | Construction |
| Residency of issuer | Estonia |
| Nominal value | EEK 10.00 (EUR 0.6391) |
| Number of securities | 17,700,000 |
| Number of votes per share | 1 vote |
| Registration at ECSD | 08.07.2008 |
| Stock Exchange List | Main List |

| | 31.12.2008 | 31.12.2009 | 31.12.2010 |
|-------------------------------------|------------|------------|------------|
| Basic earnings per share (EPS), EUR | 1.08 | 0.42 | 0.07 |
| Equity per share, EUR | 7.49 | 7.68 | 7.05 |
| P/B (price to book ratio) | 0.37 | 0.65 | 1.28 |
| P/E (price / earnings ratio) | 2.59 | 11.97 | 130.32 |

The shares of Merko Ehitus are listed in the Main List of NASDAQ OMX Tallinn. In 2010, 4490 transactions with the shares of Merko Ehitus were performed, in the course of which 1.7 million shares were traded and the total monetary value of transactions was EUR 13.1 million (EEK 204.8 million). The lowest share price was EUR 5.05 (EEK 79.0) and the highest price was EUR 9.89 (EEK 154.7) per share. The closing price of the shares as at 30.12.2010 was EUR 9.05 (EEK 141.6). As at 31.12.2010, the market capitalisation of AS Merko Ehitus was EUR 160 million (EEK 2.5 billion).

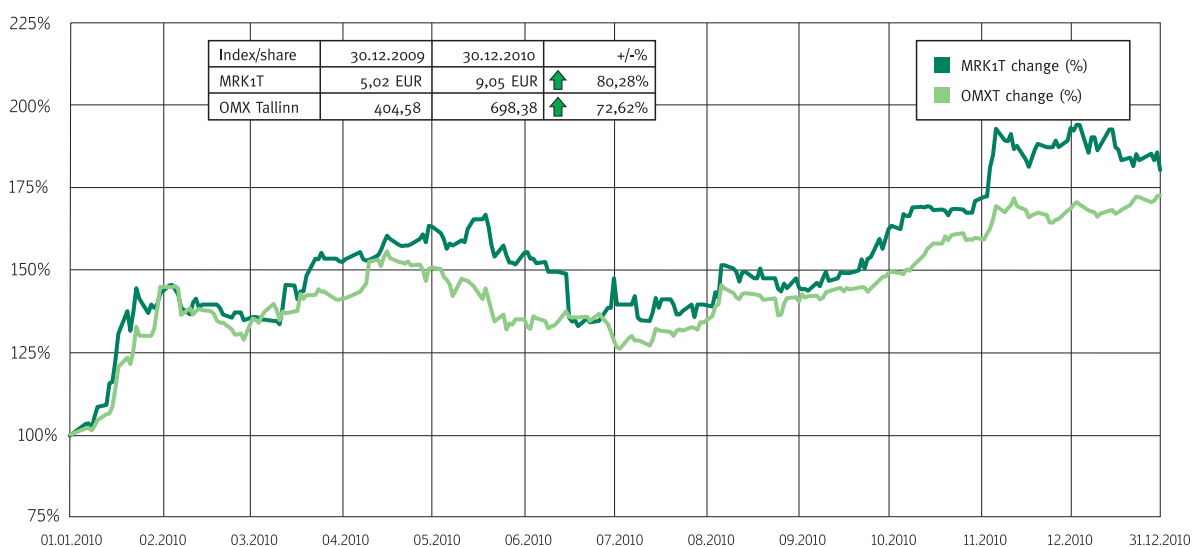
Performance of Merko Ehitus share at NASDAQ OMX Tallinn Stock Exchange



Trading history of securities

| <i>in euros</i> | 2008 | 2009 | 2010 |
|---|-----------|-----------|-----------|
| Highest | 12.95 | 5.78 | 9.89 |
| Lowest | 2.58 | 1.85 | 5.05 |
| Closing | 2.80 | 5.02 | 9.05 |
| Average | 7.59 | 3.71 | 7.72 |
| Change, % | -78.46 | +79.30 | +80.30 |
| Traded shares | 2,367,089 | 2,782,150 | 1,696,902 |
| Turnover, EUR million | 18.22 | 9.38 | 13.09 |
| Market value, EUR million, as at the year-end | 49.56 | 88.85 | 160.19 |

Performance of the share of Merko Ehitus and comparison index OMX Tallinn



Structure of shareholders as at 31.12.2010

| Number of shares | Number of shareholders | % of shareholders | Number of shares | % of shareholders |
|---------------------|------------------------|-------------------|------------------|-------------------|
| 1-100 | 379 | 26.30% | 20,565 | 0.12% |
| 101-1000 | 701 | 48.65% | 305,923 | 1.73% |
| 1001-10 000 | 315 | 21.86% | 889,826 | 5.03% |
| 10 001 – 100 000 | 35 | 2.43% | 954,947 | 5.39% |
| 100 001 – 1 000 000 | 10 | 0.69% | 2,786,053 | 15.74% |
| 1 000 001 - ... | 1 | 0.07% | 12,742,686 | 71.99% |
| Total | 1441 | 100% | 17,700,000 | 100% |

The main shareholders of AS Merko Ehitus as at 31.12.2010

| | Number of shares | Percentage of total |
|--|------------------|---------------------|
| AS Riverito | 12,742,686 | 71.99% |
| ING Luxembourg S.A., clients | 963,376 | 5.44% |
| Skandinaviska Enskilda Banken Ab, clients | 856,581 | 4.84% |
| State Street Bank and Trust Omnibus Account a Fund No OM01 | 169,587 | 0.96% |
| Gamma Holding OÜ | 142,821 | 0.81% |
| SEB Elu- ja Pensionikindlustus AS | 125,520 | 0.71% |
| Skandinaviska Enskilda Banken Finnish, clients | 108,999 | 0.62% |
| Clearstream Banking Luxembourg S.A. clients | 106,239 | 0.60% |
| Nordea Bank Finland Plc/Non-resident legal entities | 106,180 | 0.60% |
| Firebird Aurora Fund, Ltd. | 103,910 | 0.59% |
| AS Midas Invest | 102,840 | 0.58% |

Shares held by members of the Supervisory Board of AS Merko Ehitus at 31.12.2010

| | | Number of shares | Percentage of total |
|------------------------------|-----------------------------------|------------------|---------------------|
| Tõnu Toomik (AS Riverito) | Chairman of the Supervisory Board | 1,607,184 | 9.08% |
| Indrek Neivelt (OÜ Trust IN) | Member of the Supervisory Board | 31,635 | 0.18% |
| Olari Taal (OÜ Eggera) | Member of the Supervisory Board | 2,500 | 0.01% |
| Teet Roopalü | Member of the Supervisory Board | 0 | 0.00% |

Shares held by members of the Management Board of AS Merko Ehitus at 31.12.2010

| | | Number of shares | Percentage of total |
|--|----------------------------------|------------------|---------------------|
| Tiit Roben (OÜ Amistad Invest) | Chairman of the Management Board | 1,500 | 0.01% |
| Alar Lagus | Member of the Management Board | 0 | 0.00% |
| Veljo Viitmann | Member of the Management Board | 0 | 0.00% |
| Andres Agukas | Member of the Management Board | 0 | 0.00% |
| Jaan Mäe | Member of the Management Board | 0 | 0.00% |
| Viktor Mõisja (AS Riverito / private person) | Member of the Management Board | 1,103,734 | 6.23% |

Dividend policy

Distribution of dividends to the Company's shareholders is recognised as a liability in the financial statements at the time when the payment of dividends is approved by the Company's shareholders. Throughout the years, Merko Ehitus has attempted to distribute approximately 20% of the year's net profit as dividends to the shareholders. The possibility and amount of payment of dividends is considered annually, taking into consideration various factors and thereafter, a proposal is made at the general meeting of shareholders in respect of the amount and payment of dividends. Over the last five years, the dividends have been paid to the shareholders for the respective periods as follows:

| | 2006 | 2007 | 2008 | 2009 | 2010* |
|-------------------------|--------|------|--------|--------|-------|
| Dividend per share, EUR | 0.4474 | 0 | 0.2237 | 0.7030 | 0,1 |
| Dividend rate | 21% | 0% | 21% | 168% | 144% |

* according to proposal of the Management Board

Outlook for 2011

Construction market and its developments

Three consecutive crisis years have significantly ravaged the construction sector. The financial position of companies is weak and internal reserves have been depleted. While the volumes and profitability of the sector in 2008 and 2009 were maintained by the portfolio put together in previous periods, and depreciation of the cost of materials and labour, the situation changed in 2010. Input prices have started to increase and profits were replaced by losses. Despite some positive expectations in respect of volumes, we expect the aforementioned negative trends to continue and worsen in 2011.

We expect moderate growth in construction volumes in 2011. Growth rates may differ country-by-country, but should remain between 10% and 15%. Although volumes are increasing, intense competition still prevails in the market. The profitability of the sector continues to be low and margins earned are not sufficient to ensure sustainable development of the sector. Customers enjoy their supremacy due to low demand, accompanied by their request of unreasonable guarantees and lengthening of payment terms. The ability of companies to adhere to the guarantees given to the customers and raising of additional working capital due to lengthening of payment terms will become a critical factor. It is not enough to be flexible and adaptable in order to fulfil contractual obligations, financial capability is becoming the key factor for staying competitive. Despite intense competition, the construction prices will continue to climb due to global appreciation of materials prices and limited labour supply. Appreciation of prices is expected to be definitely lower than in 2010, but it may still reach 10-15%. Therefore, the number of bankruptcies is expected to increase due to the projects left unfinished by the contractors as well as aggressive supply.

Most of the new construction projects continue to be launched in the areas of infrastructure and environmental facilities funded by the public sector and EU structural funds. The key question here is the ability of the state and local governments to prepare the projects and financial capability to provide public sector funds. With regard to the latter, the year 2011 should be favourable – growing exports, the recovery of domestic consumption and overall improved economic environment will considerably strengthen the revenue base of the public sector and financial capability to launch new projects.

Liberalisation of financing terms will continue, and the number of projects and companies in compliance with the requirements of credit institutions will increase. Preference is still given to production companies with an export potential, and to real estate and construction, provided the projects are related to the aforementioned areas. The sector of trade and commercial real estate shows signs of stabilisation. Vacancy of rental premises will decline and rental prices may increase slightly in the second half of the year. The cash flows as well as lending capacity of projects will improve. However, the aforementioned changes are not sufficient to create demand for additional premises and new projects in the sector. The situation is somewhat different in respect of rental projects related to public sector needs, where we see a clear growth potential. In 2010, the group won two such PPP tenders and we plan to continue in this direction in 2011. The Group's strategy does not foresee inclusion of long-term rental projects in its balance sheet and our goal is the sale of projects after these become functional to long-term investors. In 2011, we expect the interest of financial investors in functional real estate projects to increase and several large-scale sales transactions to be concluded in this area. Although such sales have no direct impact on the construction sector, it is still quite probable that some of the capital that becomes available will be reinvested in real estate at some point in time and new projects will be launched with the help of available funds.

There is no reason to expect fast improvement of demand in the market of residential premises, the confidence of people and their incomes are still low and the debt burden is high. However, the supply of residential premises is decreasing and there are conditions underway in the market for undersupply. In Estonia and Lithuania, the interest of banks in residential real estate both in respect of end consumers (apartment buyers) as well as developers was already evident in 2010. This year, we also expect positive changes in the Latvian market. Stabilisation of the economic environment and a favourable price level of residential premises will lure foreign capital back to the market, both apartments as well as registered immovables with a development potential will be acquired. Due to the demand growth, we expect appreciation of the prices of residential premises by 10-15% in 2011.

The year 2011 should be a break-through year for the construction sector - negative trends prevailing in the previous period should continue in the first half of the year, but the market should stabilise by the end of the year. The companies which have survived the crisis enter a new economic cycle and the profitability of the sector will improve. Although the golden period of the ending economic cycle with its extensive investments in the construction and real estate sector remained in the first half of 2010, the year 2011 may also offer interesting investment opportunities.

Corporate Governance Code (CGC)

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

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 authority of which is 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 web site 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 reliable 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 has six members, and it represents the Company and manages its daily operations. The activities of the members of the Management Board are divided by areas of operation: general management – Tiit Roben, construction – Andres Agukas, technology – Veljo Viitmann, finance – Alar Lagus, development – Jaan Mäe, quality management and supervision – Viktor Mõisja. The Chairman of the Management Board, Tiit Roben, oversees 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 paid to the members of the Management Board in the annual report, as it believes that the disclosure of personalised remuneration does not create additional value but 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 twenty-four 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 group and entities governed by the Management Board shall be considered. On reviewing the quarterly results of operations, the Supervisory Board of the Company 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 four members: Teet Roopalu, Indrek Neivelt, Olari Taal and Chairman of the Supervisory Board, Tõnu Toomik.

The General Meeting of Shareholders shall approve the remuneration of the members of the Supervisory Board. The order of remuneration of the current Supervisory Board was approved by the General Meeting of Shareholders held at 31 October 2008.

Upon premature termination or non-extension of the powers, no severance pay is paid to the members of the Supervisory Board.

IV Collaboration of the Management and Supervisory Boards

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

V Disclosure of information

In disclosing information, AS Merko Ehitus shall follow the rules and regulations of NASDAQ OMX 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. In respect of construction contracts entered into, contracts with the volume of EUR 10 million and higher shall be disclosed separately in stock exchange releases. Important information shall be disclosed through the stock exchange system and on the Company's Web site.

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 shall generally publish important information regarding the Company after the end of the trading day and shall inform its 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 presentations 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 Web site or other public sources. We believe that the publication of the schedule for meetings does not provide any valuable 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 by the European Union.

In electing the auditor, the Company shall consider auditor's independence, competence, reliability and the price of the service. 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 to the General Meeting of Shareholders. In extending the contract with the auditor who audited the Company in the previous financial year, the Supervisory Board shall acknowledge 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.

Audit committee

The responsibility of the audit committee is advising the Supervisory Board in supervision related issues. The Committee executes supervision in the areas of : a) arrangement of accounting, b) preparation and approval of the financial budget and reports, c) management of financial risks, d) performance of external audit, e) functioning of the internal control system and f) legality of the activities.

The Company's Supervisory Board set up a 3-member audit committee and appointed Indrek Neivelt and Olari Taal as its members and Teet Roopalu as its Chairman. A member of the committee is elected for a term of three years, but at the decision of the Supervisory Board, a member of the committee may be removed before the expiration of his term of office.

The meetings of the audit committee are held not less frequently than once every three months.

The Management Board of AS Merko Ehitus acknowledges and confirms that to the best of management's knowledge, the management report for the 2010 financial year presents a true and fair view of the business development and results, and the financial position of the Issuer and the consolidation group entities, and it includes a description of the main risks and uncertainties.

| | | | |
|----------------|----------------------------------|--|------------|
| Tiit Roben | Chairman of the Management Board |  | 12.04.2011 |
| Alar Lagus | Member of the Management Board |  | 12.04.2011 |
| Veljo Viitmann | Member of the Management Board |  | 12.04.2011 |
| Andres Agukas | Member of the Management Board |  | 12.04.2011 |
| Jaan Mäe | Member of the Management Board |  | 12.04.2011 |
| Viktor Mõisja | Member of the Management Board |  | 12.04.2011 |

FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| <i>In thousands of</i> | | EEK | | EUR | |
|---|------|----------------|----------------|---------------|---------------|
| | Note | 2010 | 2009 | 2010 | 2009 |
| Revenue | 3 | 2,689,947 | 3,181,209 | 171,919 | 203,316 |
| Cost of goods sold | 4 | (2,489,455) | (2,835,169) | (159,105) | (181,200) |
| Gross profit | | 200,492 | 346,040 | 12,814 | 22,116 |
| Marketing expenses | 5 | (34,312) | (47,094) | (2,193) | (3,009) |
| General and administrative expenses | 6 | (136,505) | (154,000) | (8,724) | (9,842) |
| Other operating income | 7 | 15,041 | 14,408 | 961 | 921 |
| Other operating expenses | 8 | (7,480) | (27,326) | (478) | (1,746) |
| Operating profit | | 37,236 | 132,028 | 2,380 | 8,440 |
| Finance income | 9 | 10,900 | 39,517 | 696 | 2,525 |
| Finance costs | 10 | (14,214) | (24,597) | (908) | (1,573) |
| Profit/loss from associates and joint ventures | 20 | (6,220) | (27,090) | (398) | (1,731) |
| Profit before tax | | 27,702 | 119,858 | 1,770 | 7,661 |
| Corporate income tax expense | 11 | (11,108) | (8,496) | (710) | (543) |
| Net profit for financial year | | 16,594 | 111,362 | 1,060 | 7,118 |
| incl. net profit attributable to equity holders of the parent | | 19,232 | 116,166 | 1,229 | 7,424 |
| net profit attributable to non-controlling interest | | (2,638) | (4,804) | (169) | (306) |
| Other comprehensive income | | 364 | (2 266) | 23 | (145) |
| Currency translation differences of foreign entities | | 364 | (2,266) | 23 | (145) |
| Comprehensive income for the period | | 16,958 | 109,096 | 1,083 | 6,973 |
| incl. net profit attributable to equity holders of the parent | | 19,596 | 113,900 | 1,252 | 7,279 |
| net profit attributable to non-controlling interest | | (2,638) | (4,804) | (169) | (306) |
| Earnings per share for profit attributable to equity holders of the parent (basic and diluted, in EEK/ EUR) | 12 | 1.09 | 6.56 | 0.07 | 0.42 |

The notes set out on pages 30-75 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| <i>In thousands of</i> | | EEK | | EUR | |
|--|------|------------------|------------------|----------------|----------------|
| | Note | 31.12.2010 | 31.12.2009 | 31.12.2010 | 31.12.2009 |
| ASSETS | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | 14 | 154,211 | 359,732 | 9,856 | 22,991 |
| Short-term deposits | 15 | 41,475 | 400,916 | 2,651 | 25,623 |
| Trade and other receivables | 16 | 703,141 | 661,954 | 44,938 | 42,306 |
| Prepaid corporate income tax | | 21,377 | 3,885 | 1,366 | 248 |
| Inventories | 18 | 1,455,872 | 1,536,463 | 93,048 | 98,199 |
| Total current assets | | 2,376,076 | 2,962,950 | 151,859 | 189,367 |
| Non-current assets | | | | | |
| Investments in associates and joint ventures | 20 | 172,939 | 179,421 | 11,053 | 11,467 |
| Other long-term loans and receivables | 21 | 129,207 | 32,468 | 8,258 | 2,075 |
| Deferred income tax assets | 22 | 24,587 | 32,069 | 1,571 | 2,050 |
| Investment property | 23 | 56,086 | 16,552 | 3,585 | 1,058 |
| Property, plant and equipment | 24 | 277,681 | 266,276 | 17,747 | 17,018 |
| Intangible assets | 25 | 23,596 | 24,238 | 1,508 | 1,549 |
| Total non-current assets | | 684,096 | 551,024 | 43,722 | 35,217 |
| TOTAL ASSETS | | 3,060,172 | 3,513,974 | 195,581 | 224,584 |
| LIABILITIES | | | | | |
| Current liabilities | | | | | |
| Borrowings | 27 | 196,430 | 447,569 | 12,554 | 28,605 |
| Trade and other payables | 28 | 612,609 | 782,470 | 39,154 | 50,009 |
| Corporate income tax liability | | - | 5,249 | - | 335 |
| Provisions | 29 | 57,484 | 37,702 | 3,674 | 2,410 |
| Total current liabilities | | 866,523 | 1,272,990 | 55,382 | 81,359 |
| Non-current liabilities | | | | | |
| Long-term borrowings | 27 | 206,294 | 76,316 | 13,185 | 4,878 |
| Other long-term trade payables | 30 | 13,235 | 10,658 | 846 | 681 |
| Total non-current liabilities | | 219,529 | 86,974 | 14,031 | 5,559 |
| TOTAL LIABILITIES | | 1,086,052 | 1,359,964 | 69,413 | 86,918 |
| EQUITY | | | | | |
| Non-controlling interest | | 22,343 | 27,129 | 1,428 | 1,734 |
| Equity attributable to equity holders of the parent | | | | | |
| 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 | | (14,452) | (14,816) | (924) | (947) |
| Retained earnings | | 1,771,529 | 1,946,997 | 113,221 | 124,436 |
| Total equity attributable to equity holders of the parent | | 1,951,777 | 2,126,881 | 124,740 | 135,932 |
| TOTAL EQUITY | | 1,974,120 | 2,154,010 | 126,168 | 137,666 |
| TOTAL LIABILITIES AND EQUITY | | 3,060,172 | 3,513,974 | 195,581 | 224,584 |

The notes set out on pages 30-75 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| <i>In thousands of EEK</i> | Note | Equity attributable to equity holders of the parent | | | | | Non-controlling interest | Total |
|---|------|---|---------------------------|----------------------------------|-------------------|-----------|--------------------------|-----------|
| | | Share capital | Statutory reserve capital | Currency translation differences | Retained earnings | Total | | |
| Balance as at 31.12.2008 | | 177,000 | 17,700 | (12,550) | 1,892,781 | 2,074,931 | 34,633 | 2,109,564 |
| Comprehensive income for the financial year | | - | - | (2,266) | 116,166 | 113,900 | (4,804) | 109,096 |
| Dividends | 13 | - | - | - | (61,950) | (61,950) | (2,700) | (64,650) |
| Balance as at 31.12.2009 | | 177,000 | 17,700 | (14,816) | 1,946,997 | 2,126,881 | 27,129 | 2,154,010 |
| Comprehensive income for the financial year | | - | - | 364 | 19,232 | 19,596 | (2,638) | 16,958 |
| Dividends | 13 | - | - | - | (194,700) | (194,700) | - | (194,700) |
| Acquisition of non-controlling interest | | - | - | - | - | - | (2,148) | (2,148) |
| Balance as at 31.12.2010 | | 177,000 | 17,700 | (14,452) | 1,771,529 | 1,951,777 | 22,343 | 1,974,120 |

| <i>In thousands of EUR</i> | Note | Equity attributable to equity holders of the parent | | | | | Non-controlling interest | Total |
|---|------|---|---------------------------|----------------------------------|-------------------|----------|--------------------------|----------|
| | | Share capital | Statutory reserve capital | Currency translation differences | Retained earnings | Total | | |
| Balance as at 31.12.2008 | | 11,312 | 1,131 | (802) | 120,971 | 132,612 | 2,213 | 134,825 |
| Comprehensive income for the financial year | | - | - | (145) | 7,424 | 7,279 | (306) | 6,973 |
| Dividends | 13 | - | - | - | (3,959) | (3,959) | (173) | (4,132) |
| Balance as at 31.12.2009 | | 11,312 | 1,131 | (947) | 124,436 | 135,932 | 1,734 | 137,666 |
| Comprehensive income for the financial year | | - | - | 23 | 1,229 | 1,252 | (169) | 1,083 |
| Dividends | 13 | - | - | - | (12,444) | (12,444) | - | (12,444) |
| Acquisition of non-controlling interest | | - | - | - | - | - | (137) | (137) |
| Balance as at 31.12.2010 | | 11,312 | 1,131 | (924) | 113,221 | 124,740 | 1,428 | 126,168 |

The notes set out on pages 30-75 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

| <i>In thousands of</i> | | EEK | | EUR | |
|---|-----------|------------------|------------------|-----------------|-----------------|
| | Note | 2010 | 2009 | 2010 | 2009 |
| Cash flows from operating activities | | | | | |
| Operating profit | | 37,236 | 132,028 | 2,380 | 8,440 |
| Adjustments: | | | | | |
| Depreciation and impairment charge | 23-25 | 37,969 | 37,471 | 2,427 | 2,395 |
| Profit/loss from sales of non-current assets | 7 | (1,185) | (519) | (76) | (33) |
| Change in receivables and liabilities related to construction contracts recognised under the stage of completion method | | (365,425) | 56,548 | (23,355) | 3,614 |
| Interest income from business activities | | (9,817) | (4,476) | (627) | (286) |
| Change in provisions | | 10,069 | (2,327) | 644 | (149) |
| Change in trade and other receivables related to operating activities | | 29,381 | 223,055 | 1,878 | 14,256 |
| Change in inventories | | 87,528 | 281,116 | 5,593 | 17,966 |
| Change in trade and other payables related to operating activities | | 97,986 | (306,272) | 6,261 | (19,574) |
| Interest paid | | (13,415) | (28,157) | (857) | (1,800) |
| Other finance income | | (66) | (62) | (4) | (5) |
| Corporate income tax paid | | (23,491) | (19,971) | (1,501) | (1,276) |
| Total cash flows from operating activities | | (113,230) | 368,434 | (7,237) | 23,548 |
| Cash flows from investing activities | | | | | |
| Investment in subsidiaries | 19 | (1,110) | (62,069) | (71) | (3,967) |
| Proceeds from sale of subsidiaries | | - | 1,125 | - | 71 |
| Investments in associates and joint ventures | | (22) | - | (1) | - |
| Proceeds from sale of associates and joint ventures | | 24 | - | 2 | - |
| Purchase/proceeds of/from deposits with maturities greater than 3 months | | 359,441 | (138,157) | 22,972 | (8,830) |
| Purchase of investment property | | (40,977) | - | (2,619) | - |
| Proceeds from sale of investment property | | - | 1,250 | - | 80 |
| Purchase of property, plant and equipment | | (12,613) | (13,222) | (806) | (845) |
| Proceeds from sale of property, plant and equipment | | 2,830 | 1,298 | 181 | 83 |
| Purchase of intangible assets | | (1,420) | (985) | (91) | (63) |
| Proceeds from sale of intangible assets | | 816 | 134 | 52 | 9 |
| Loans granted | 17 | (126,681) | (65,885) | (8,096) | (4,211) |
| Loan repayments received | 17 | 64,610 | 45,793 | 4,129 | 2,927 |
| Interest received | | 12,579 | 31,968 | 804 | 2,043 |
| Dividends received | | 220 | - | 14 | - |
| Total cash flows from investing activities | 20 | 257,697 | (198,750) | 16,470 | (12,703) |
| Cash flows from financing activities | | | | | |
| Proceeds from borrowings | 27 | 33,088 | 56,841 | 2,115 | 3,633 |
| Repayments of borrowings | 27 | (168,208) | (300,698) | (10,750) | (19,218) |
| Finance lease principal payments | 27 | (22,647) | (17,476) | (1,447) | (1,118) |
| Dividends paid | 13 | (194,700) | (64,650) | (12,444) | (4,132) |
| Cash flows from financing activities | | (352,467) | (325,983) | (22,526) | (20,835) |
| Net increase/decrease in cash and cash equivalents | | (208,000) | (156,299) | (13,293) | (9,990) |
| Change in deposits with maturities greater than 3 months | | (359,441) | 138,157 | (22,972) | 8,830 |
| Total change | | (567,441) | (18,142) | (36,265) | (1,160) |
| Cash and cash equivalents at the beginning of the period | 14 | 359,732 | 515,191 | 22,991 | 32,927 |
| Deposits with maturities greater than 3 months at the beginning of the period | | 400,916 | 262,759 | 25,623 | 16,793 |
| Total at the beginning of the period | | 760,648 | 777,950 | 48,614 | 49,720 |
| Effect of exchange rate changes | | 2,479 | 840 | 158 | 54 |
| Cash and cash equivalents at the end of the period | 14 | 154,211 | 359,732 | 9,856 | 22,991 |
| Deposits with maturities greater than 3 months at the end of period | | 41,475 | 400,916 | 2,651 | 25,623 |
| Total at the end of the period | | 195,686 | 760,648 | 12,507 | 48,614 |

The notes set out on pages 30-75 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) and its subsidiaries (hereinafter the group) for the financial year ended 31 December 2010 were signed by the Management Board at 12 April 2011.

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 require preparation of a new annual report.

AS Merko Ehitus is a corporation registered in the Republic of Estonia (Commercial Register no.: 11520257, 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 NASDAQ OMX Tallinn Stock Exchange. As at 31 December 2010, the majority shareholder AS Riverito owned 71.99% of the Company's shares through which the ultimate controlling person is Toomas Annus.

AS Merko Ehitus was established in the demerger of the former AS Merko Ehitus, currently AS Järvevana, as a result of which all operating areas, i.e. all assets and liabilities other than the liabilities related to the criminal proceeding, were transferred to the new entity.

1.2. Bases for preparation of the consolidated financial statements

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 using the stage of completion method, assessment of the useful lives of items of property, plant and equipment, estimation of allowances for 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 statement of financial position. 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 entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency): the Estonian kroon, Latvian lats and the 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 NASDAQ OMX Tallinn Stock Exchange, the primary financial statements are also presented in thousands of euros. As at 31.12.2010 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. From 01.01.2011, Estonia is part of the Eurozone (Note 1.27).

1.3. New International Financial Reporting Standards, amendments to published standards and interpretations of the International Financial Reporting Interpretations Committee (IFRIC)

a) Standards, amendments to standards and interpretations effective for group's financial year beginning on 1 January 2010.

IFRIC 12, Service Concession Arrangements (as adopted by the EU, effective for annual periods beginning on or after 30 March 2009). The interpretation contains guidance on applying the existing standards by service providers in public-to-private service concession arrangements. Application of the interpretation did not have any impact on the group's financial statements because its accounting policies were in compliance with the interpretation.

IFRIC 15, Agreements for the Construction of Real Estate (as adopted by the EU, effective for annual periods beginning after 31 December 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. Application of IFRIC 15 did not have any impact on the group's financial statements because its accounting policies were in compliance with the interpretation.

Improvements to International Financial Reporting Standards, issued in April 2009 (amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The amendments did not have a material impact on the group's financial statements.

Amendment to IFRS 5, Non-current Assets Held for Sale and Discontinued Operations (and consequential amendments to IFRS 1) (effective for annual periods beginning on or after 1 July 2009). This amendment to IFRS 5 is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that an entity committed to a sale plan involving loss of control of a subsidiary would classify the subsidiary's assets and liabilities as held for sale. The revised guidance should be applied prospectively from the date at which the entity first applied IFRS 5. The amendment did not have a material impact on the group's financial statements.

Standards, amendments to standards and interpretations which became effective in 2010 but which are not relevant to the group's operations.

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009

IFRIC 16, Hedges of a Net Investment in a Foreign Operation

IFRIC 17, Distributions of Non-Cash Assets to Owners

IFRIC 18, Transfers of Assets from Customers

IFRS 1, First-time Adoption of International Financial Reporting Standards, revised in December 2008

Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2

Additional Exemptions for First-time Adopters - Amendments to IFRS 1

Eligible Hedged Items—Amendment to IAS 39

b) New standards, amendments to standards and interpretations effective for annual periods beginning on or after 1 January 2011 and which the group has not early adopted.

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 on or after 1 January 2011 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 interpretations to the financial statements in the period of their first-time adoption:

IFRS 9, Financial Instruments Part 1: Classification and Measurement, issued in November 2009 (effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU). IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2009 to address the classification and measurement of financial liabilities. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated as at fair value through profit or loss in other comprehensive income.

The group is considering the implications of the standard, the impact on the group and the timing of its adoption by the group.

Amendment to IAS 24, Related Party Disclosures, (issued in November 2009, effective for annual periods beginning on or after 1 January 2011). The amended standard simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. The group is currently assessing the impact of the amended standard on disclosures in its financial statements.

Improvements to International Financial Reporting Standards, issued in May 2010 (effective dates vary standard by standard, most improvements are effective for annual periods beginning on or after 1 January 2011). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous GAAP carrying amount to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period; IAS 1 was amended to clarify that the components of the statement of changes in equity include profit or loss, other comprehensive income, total comprehensive income and transactions with owners and that an analysis of other comprehensive income by item may be presented in the notes; IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2008); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of a fair value hierarchy, changes in classification of financial assets or changes in a business or economic environment that affect the fair values of the entity's financial instruments; and IFRIC 13 was amended to clarify measurement of fair value of award credits. The group is currently assessing the impact of the amended standards on its consolidated financial statements.

Disclosures—Transfers of Financial Assets – Amendment to IFRS 7 (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party yet remain in the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the

relationship between the financial assets and associated liabilities. Where financial assets have been derecognised but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The group is currently assessing the impact of the amended standard on disclosures in its financial statements.

c) New standards, amendments to standards and interpretations effective for annual periods beginning on or after 1 January 2011 that the group has not adopted early and that are not relevant to the group's operations:

IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments (effective for annual periods beginning on or after 1 July 2010).

Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14 (effective for annual periods beginning on or after 1 January 2011).

Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters – Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2010).

Classification of Rights Issues - Amendment to IAS 32, issued in October 2009 (effective for annual periods beginning on or after 1 February 2010).

Deferred Tax: Recovery of Underlying Assets – Amendment to IAS 12 (effective for annual periods beginning on or after 1 January 2012; not yet adopted by the EU). The amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value.

Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters – Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU). The amendments will provide relief for first-time adopters of IFRSs from having to reconstruct transactions that occurred before their date of transition to IFRSs, and guidance for entities emerging from severe hyperinflation either to resume presenting IFRS financial statements or to present IFRS financial statements for the first time.

1.4. Consolidation

Subsidiaries or entities that are either directly or indirectly through fellow subsidiaries controlled by the parent AS Merko Ehitus, have been consolidated on a line-by-line basis in the consolidated financial statements. Control exists when the parent 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 fully consolidated in the financial statements of the group from the date of acquiring control until the date at which control ceases.

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 unless a loss is caused by impairment.

Group entities use uniform accounting policies.

1.5. Business combinations

The group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. 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 statement of financial position of the group.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the identifiable net assets

acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the statement of comprehensive income.

Goodwill is subsequently measured at its 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 1.11).

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 non-controlling interests

The group treats transactions with non-controlling interests as transactions with equity owners of the group starting from 1 January 2010. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying amount of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity. Until 31 December 2009, the transactions with the shareholders or owners of non-controlling interests were treated as transactions with non-group third parties. Gains and losses from the transfer of non-controlling interests were taken to profit or loss. At the acquisition of a non-controlling interest, the difference between the purchase price and the carrying amount of the net assets corresponding to the acquired interest was recognised as goodwill.

1.6. Associates

Associates are all entities in which the group has significant influence but not control over 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. Investments in associates include goodwill identified on acquisition.

The group's share of its associates' post-acquisition profits or losses is recognised at the group's income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. 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 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.

1.7. Joint ventures

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to common control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at cost and subsequently adjusted by the post-acquisition changes that have occurred at 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. Unrealised gains and losses from transactions between the group and its joint ventures are eliminated similarly to transactions with associates (Note 1.6).

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 entity 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 statement of financial position. 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 that 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 reporting 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*.

1.10. 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
- held-to-maturity investments;
- available-for-sale financial assets.

Management determines the classification of its financial assets at initial recognition.

The Company does not have any held-to-maturity investments, financial assets at fair value through profit or loss and available-for-sale financial assets. The group does not have any derivatives either.

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 the transaction. Receivables whose collection is improbable are written down during the reporting period (see also 1.11).

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 a 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 a group of financial assets that can be reliably estimated. Objective evidence that a financial asset or a group of financial 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;
- probability that the debtor will enter bankruptcy;
- 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 objectively be related to an event occurring after 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 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 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 that suffered an impairment loss are reviewed at each reporting date and if necessary, the impairment loss is reversed except for impairment of goodwill.

1.12. Inventories

Inventories are recorded in the statement of financial position at 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 statement of financial position at the lower of 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 either as work-in-progress or finished goods, depending on the stage of completion in the line *Inventories* in the statement of financial position. When the development of property is financed with a loan, the borrowing costs incurred during development are included in the cost of the property. Borrowing costs during the period of construction are capitalised until a permit for use is obtained for the project. Expenses associated with maintenance or usage of the property are not capitalised.

A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Revenue is recognised as income from the sale of goods (Note 1.21). Upon the sale of real estate properties, the group and the acquirer enter into a notarially certified agreement for transferring the property, and a respective entry is made in the land register.

1.13. Investment property

Investment property is a 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, administrative purposes or sale in the ordinary course of business. Investment property is measured using the cost method, that is at 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 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 statement of financial position at its cost less any accumulated depreciation. Subsequent expenditure incurred for items of property, plant and equipment is recognised as non-current assets when it is probable that future economic benefits associated with the asset will flow to the Company and the cost of the asset can be measured reliably. Other repair 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 2-20 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.

If an item of property, plant and equipment consists of separately identifiable components with different useful lives, these components are accounted for as separate assets and accordingly, separate depreciation rates are set for them depending on their useful lives.

Items of property, plant and equipment are derecognised on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition of items of property, plant and equipment are included either within other operating income or other operating expenses in the income statement.

Non-current assets are written down to their recoverable amount if the latter is lower than their carrying amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

1.15. Intangible assets

Intangible assets are recognised in the statement of financial position 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 cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Intangible assets are carried in the statement of financial position at cost less any accumulated amortisation and any accumulated impairment losses. Goodwill is not amortised.

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).

1.16. 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 statement of financial position 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 finance costs in the income statement. Finance costs are allocated to the rental period so as to achieve a constant periodic rate of interest on the remaining balance of the liability.

Operating lease payments are reported in the income statement as expenses on a straight-line basis over the lease term.

1.17. Financial liabilities

All financial liabilities (trade payables, borrowings, 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 current financial liabilities normally equals their nominal value; therefore current financial liabilities are stated in the statement of financial

position 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 a contractual right at the balance sheet date to demand immediate repayment of the borrowing due to the breach of conditions set forth in the agreement.

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.

1.18. 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, in Estonia there are no differences between the tax bases and the carrying amounts of assets which would give rise to a deferred income tax asset or liability. From 01.01.2010, the tax rate on dividends payable is 21/79 (in 2009 and 2008: 21/79) 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 entities 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 amount. Deferred tax assets are recognised at the group's statement of financial position if their future realisation is probable.

Legal entities in Latvia and Lithuania that are part of 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% (2009: 15%) and the profits of entities located in the Republic of Lithuania are taxed at the rate of 15% (2009: 20%).

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 a detailed formal plan without a possibility of withdrawal; or providing termination benefits as a result of another offer made to encourage voluntary redundancy. Termination benefits are discounted to their present value.

Profit-sharing and bonus plans

The Company recognises a liability and an expense for bonuses and profit-sharing plans, based on a formula that takes into consideration the profit attributable to the parent'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 probable 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 reporting period.

Provisions are recognised in the statement of financial position based on the best estimate of the management board at the present value of the expenditure expected to be sufficient to settle the obligation. A pre-tax rate of discount is used, which reflects current market valuations of the time value of money and the risks associated with liabilities that are not already included in the best estimate of the related expenses.

Pursuant to respective building regulations, 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 the provision of construction services 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 (private 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. 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, 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 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 overhead costs of the construction contract.

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 statement of financial position.

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. The gross method is used for recognition of government grants.

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 and term deposits with maturities of three months or less. Management regards deposits with maturities greater than 3 months as investments and hence does not include these in cash and cash equivalents. In addition to changes in cash and its equivalents, the consolidated cash flow statement also includes changes in short-term

bank deposits with maturities greater than 3 months due to the possibility of using these deposits immediately as the need arises without a significant effect on the group's financial position.

The indirect method has been used for the preparation of the cash flow statement.

1.25. 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 statement of financial position, 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 reporting period or previous periods. Material events after the balance sheet date not related to transactions in the reporting period or previous periods are not reported in the statement of financial position but they are disclosed in the notes to the financial statements.

At 1 January 2011, the Republic of Estonia joined the euro area and adopted the euro as a national currency, replacing the Estonian kroon. Consequently, the functional currency of AS Merko Ehitus is the euro from 2011 and the annual reports for 2011 and subsequent years to be submitted to the Commercial Register will be presented in euros. Comparative figures will be recalculated to euros using the conversion rate of EUR 1 = EEK 15.6466, which is the fixed exchange rate that was applicable also in earlier periods.

1.28. 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.

1.29. Segment reporting

According to IFRS 8 Operating Segments, segment reporting is applicable to operating segments whose results are regularly reviewed by the entity's chief operating decision maker to make business-related decisions. Operating segments are components of the entity for which it is possible to obtain discrete financial information to make decisions about resources to be allocated to the segment and assess its performance.

The group's Management Board classifies its operations into the following segments based on internal management information:

- construction of buildings,
- construction of facilities,
- road construction,
- real estate,
- other.

The first three segments relate to the provision of construction services. The real estate segment is primarily based on its own real estate development – construction and sale, and to a lesser degree, maintenance and leasing of real estate. Other activities (management related service, security services, etc.) are immaterial from the group's standpoint and they are not reported as separate operating segments in the financial statements. For the purpose of segment reporting, each cost item to be disclosed is the amount which is presented to the Company's management for making decisions regarding allocation of funds to the segment and evaluation of segment results. The costs reported after the profit of reportable segments are accounted for in segment

reporting using the same principles as those used in the financial statements and the Company's management does not use them to evaluate segment results.

For the purpose of segment reporting, intra-group transactions involving income, expenses and assets as well as unrealised profits and losses other than those due to impairment of assets have been eliminated between all reportable segments.

Note 2. Management estimates

The preparation of the 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 may ultimately differ from those estimates. At the same time it can be confirmed that seasonality and cyclicity do not have a significant effect on the group's activities within a year. The areas involving a higher degree of judgement or complexity, or the areas where assumptions and estimates are relevant to the consolidated financial statements of Merko Ehitus group, are disclosed below. Changes in management's estimates are reported in the income statement of the period of the change.

Valuation of receivables

In valuation of receivables, each receivable is analysed separately. In determining the need for a complete or partial write-down of receivables, the debtor's financial position, the guarantees provided, the solutions offered to pay off the loan and the previous payment behaviour of the debtor are considered.

Provision for warranty obligations

In determining the provision for warranty obligations, the statistical cost of the Company's warranty works is considered.

Inventory write-down

Inventories are valued separately by individual properties (registered immovable or building). A business plan is prepared for each property based on its nature (intended use and building rights currently effective or being effected) and the project's costs are compared with expected income. If the property's costs exceed the expected revenue to be generated by the realisation of the project (net realisable value), the group shall write down assets in the amount by which the costs exceed income. Due to the volatility of the construction market and low liquidity of the real estate market, determination of the net realisable value of the assets depends largely on management estimates. The sensitivity analysis showed that had the net realisable value been overestimated by 10% (income would be 10% lower upon the disposal of assets), the Company's write-down of inventories would have been EEK 107,277 thousand higher in 2010 (2009: EEK 121,848 higher), incl. land for sale in the amount of EEK 27,028 thousand (2009: EEK 43,657 thousand), construction in progress in the amount of EEK 49,797 thousand (2009: EEK 46,156 thousand), finished buildings in the amount of EEK 20,061 thousand (2009: EEK 22,277 thousand) and prepayments related to acquisition of real estate properties in the amount of EEK 10,391 thousand (2009: EEK 9,758 thousand). Had the value been underestimated by 10% (income would be 10% higher upon the disposal of assets), the write-down of inventories for the year 2010 would have been EEK 27,052 thousand lower (2009: EEK 55,121 thousand lower), incl. land for sale in the amount of EEK 3,554 thousand (2009: EEK 13,428 thousand), construction in progress in the amount of EEK 4,215 thousand (2009: EEK 15,868 thousand), finished buildings in the amount of EEK 11,865 thousand (2009: EEK 19,035 thousand) and prepayments related to acquisition of real estate properties in the amount of EEK 7,418 thousand (2009: EEK 6,790 thousand).

In addition to the cost of inventories, determination of the value of real estate properties also impacts the real estate related financial investments through a change in the value of the joint ventures. Had management's estimate regarding the real estate properties located at joint ventures been 10% more conservative, i.e. the expected return on disposal of assets had been 10% lower, an additional impairment loss in the amount of EEK 22,213 thousand would have been incurred for financial assets and vice versa, had management's estimate been 10% more optimistic, the increase in value would have been EEK 146 thousand.

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, forecasting and reporting of income and expenses has been introduced for determining 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 31.12.2010, the amount of the provision for onerous contracts was EEK 34,833 thousand (2009: EEK 4,035 thousand) which was determined after the evaluation of the stage of completion of construction contracts (Note 29). The risk analysis showed that a change in the estimated costs of construction projects in the range of +/-5% would result in a change in the net profit between EEK -266,534/ +113,610 thousand (2009: EEK -225,340/ +149,531 thousand).

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 the purpose of 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.

Valuation of property, plant and equipment and intangibles

At each balance sheet date, an impairment test is performed for the intangible assets with indefinite useful lives including goodwill, and the carrying amount is written down to its recoverable amount if it is lower than the carrying amount. An impairment test is also carried out for property, plant and equipment and intangibles when an event or change in circumstances indicates that impairment may have occurred.

The recoverable amount is the higher of the fair value of an asset less costs to sell and its value in use. Evaluation of fair value is based on reliable information regarding the proceeds from a sale to an informed, interested and independent party, less costs of disposal. The test is used both for single assets and for a cash-generating unit. Assets, intangible assets included, which have no autonomous (independent from other assets) capacity to earn revenues, are treated as cash-generating units and valuation of their recoverable amount is based on their value in use.

For the purpose of the test, in order to assess the value in use, management prepares a realistic forecast for the cash flows to be earned in subsequent periods by the business unit and calculates the present value of these cash flows. For determining the present value, the discount rate is used which according to management objectively reflects the risk level of the respective business unit and its expected rate of return. If the recoverable amount determined in such a way exceeds the carrying amount of non-current assets and goodwill of the business unit subject to testing, goodwill is not written down (Note 19).

Valuation of investment property

Investment properties are recognised at cost, less any accumulated depreciation and any impairment losses. Management estimates that the carrying amount of investment properties as at 31.12.2010 does not significantly differ from their fair value. Management's estimate regarding the fair value of investment properties is based on the existing market value of the assets. The estimated amount for which the asset can be exchanged in a transaction between independent parties at the date of estimation is considered to be its market value. External experts were not involved in the estimation of the fair value of investment properties. Market value estimates are mostly based on market transactions.

Borrowing costs

Borrowing costs that are related to a qualifying asset (one that necessarily takes a substantial period of time to get ready for its intended use or sale) are recognised in the cost of inventory. Interest expenses related to holding and later use of assets are recorded under finance costs as period costs. Most of the interest expense incurred at the group is related to the acquisition of immovables and construction of residential properties. The decision regarding capitalisation or expensing of borrowing costs is made by the management. Management uses the following considerations for decision-making purposes:

- Upon acquisition of immovables which are ready for intended use or sale the borrowing costs related to holding such assets are not capitalised;
- Borrowing costs related to a specific development project are capitalised during the construction period until obtaining the permit for use. If, depending on the market situation, the management temporarily suspends the construction of an object, the capitalisation of borrowing costs is ceased at the same time and the borrowing costs incurred during the period of suspended development are expensed.

According to the management's estimate, the borrowing costs incurred in 2009 and 2010 were not related to the preparation of assets for use or sale as development projects had mostly been suspended during the year and therefore all borrowing costs were expensed under finance expenses.

Note 3. Operating segments

The chief operating decision-maker, i.e. the directorate and management of AS Merko Ehitus, monitors the business of the group by operating segments. The performance of the segments is assessed by the chief operating decision maker based on segment revenue derived from outside the group and pre-tax profit. Profit before taxes of the segments comprises in substance of their revenue and cost of goods sold; other expenses and income are not allocated to segments as these are monitored for the group as a whole and are not directly related to operating segments.

The profit and loss account information and assets of reportable segments have been reported in accordance with the accounting principles used in preparation of these financial statements. All segments are involved in the sale of construction services with the exception of the real estate development segment whose revenue is derived from the sale of apartments in development projects.

| 2010 <i>in thousands of kroons</i> | Buildings | Facilities | Roads | Develop- ment of real estate | Other | Total seg- ments |
|--|------------------|-------------------|--------------|---|--------------|-----------------------------|
| Segment revenue | 1,105,124 | 959,066 | 569,583 | 367,813 | 28,180 | 3,029,766 |
| Inter-segment revenue | (86,029) | (119,050) | (60,903) | (57,347) | (16,490) | (339,819) |
| Revenue from external clients | 1,019,095 | 840,016 | 508,680 | 310,466 | 11,690 | 2,689,947 |
| Depreciation (Note 4) | (1,659) | (10,455) | (16,311) | (561) | (1,307) | (30,293) |
| Inventory write-downs (Notes 4, 18) | - | - | - | (24,895) | - | (24,895) |
| Reversal of inventory write-downs (Notes 4, 18) | - | - | - | 8,951 | - | 8,951 |
| Setting up of provisions | (10,461) | (16,055) | (22,182) | (1,229) | - | (49,927) |
| Profit (loss) from associates and joint ventures (Note 20) | - | (2) | - | (1,495) | (4,723) | (6,220) |
| Other finance income/costs | - | (93) | - | (2,804) | - | (2,897) |
| Profit before tax | 92,616 | 78,270 | (6,567) | 29,100 | (423) | 192,996 |
| Segment assets | 223,103 | 190,100 | 349,145 | 1,836,498 | 55,232 | 2,654,078 |

| 2009 <i>in thousands of kroons</i> | Buildings | Facilities | Roads | Develop- ment of real estate | Other | Total seg- ments |
|---|------------------|-------------------|--------------|---|--------------|-----------------------------|
| Segment revenue | 1,809,728 | 955,780 | 439,444 | 405,915 | 8,480 | 3,619,347 |
| Inter-segment revenue | (262,646) | (15,776) | (142,295) | (13,560) | (3,861) | (438,138) |
| Revenue from external clients | 1,547,082 | 940,004 | 297,149 | 392,355 | 4,619 | 3,181,209 |
| incl. client, whose revenue is at least 10% of consolidated revenue | - | 344,522 | - | - | - | 344,522 |
| Depreciation and impairment charge (Note 4) | (2,506) | (13,106) | (9,543) | (793) | (4,456) | (30,404) |
| Inventory write-downs (Notes 4, 18) | - | - | - | (81,752) | - | (81,752) |
| Setting up of provisions | (9,327) | (12,982) | (690) | (151) | (21) | (23,171) |
| Profit (loss) from associates and joint ventures (Note 20) | - | - | - | (13,634) | (13,456) | (27,090) |
| Other finance income/costs | 51 | (792) | (1,459) | (2,614) | 1,181 | (3,633) |
| Profit before tax | 241,185 | 82,912 | 31,038 | (24,040) | (23,308) | 307,787 |
| Segment assets | 362,921 | 170,564 | 189,153 | 1,452,735 | 71,862 | 2,247,235 |

In addition to the segment assets, the group holds assets of EEK 406,094 thousand (2009: EEK 1,266,739 thousand) that cannot be associated with a specific segment or the allocation of which to segments would be impracticable. The unallocated assets of the group comprise cash and cash equivalents, deposits, loans receivable excluding loans to associates and joint ventures, tax prepayments, other receivables and an unallocated portion of property, plant and equipment. A significant part of the unallocated property, plant and equipment is made up by the office building of AS Merko Ehitus acquired in 2009 for EEK 56,544 thousand.

Reconciliation of the pre-tax profit of segments and the group

| | 2010 | 2009 |
|---------------------------------------|---------------|----------------|
| Profit (loss) from reporting segments | 192,996 | 307,787 |
| Unallocated expense (income) | | |
| marketing expenses | (34,312) | (47,094) |
| general and administrative expenses | (136,505) | (154,000) |
| incl. setting up of provisions | (1,682) | (309) |
| other operating income (expense) | 5,940 | (5,388) |
| finance income (costs) | (417) | 18,553 |
| incl. interest income | 9,267 | 37,828 |
| interest expense | (11,313) | (16,725) |
| Profit before tax | 27,702 | 119,858 |

Unallocated finance costs and income mostly include income from deposits but also interest expense not capitalised and other immaterial finance costs.

Revenue by client location

| | 2010 | 2009 |
|--------------|------------------|------------------|
| Estonia | 1,944,272 | 2,181,197 |
| Latvia | 675,440 | 925,985 |
| Lithuania | 70,235 | 74,027 |
| Total | 2,689,947 | 3,181,209 |

Non-current assets (except for financial assets and deferred income tax assets) by location of assets:

| | 31.12.2010 | 31.12.2009 |
|--------------|----------------|----------------|
| Estonia | 309,180 | 290,429 |
| Latvia | 11,657 | 15,825 |
| Lithuania | 36,526 | 812 |
| Total | 357,363 | 307,066 |

Note 4. Cost of goods sold

| <i>in thousands of kroons</i> | 2010 | 2009 |
|---|------------------|------------------|
| Construction services | 1,290,546 | 1,533,504 |
| Materials | 475,731 | 455,124 |
| Properties purchased for resale | 166,779 | 270,884 |
| Staff costs | 234,091 | 247,018 |
| Construction mechanisms and transport | 122,804 | 93,412 |
| Design | 24,578 | 26,229 |
| Allowance for inventories (Note 18) | 24,895 | 81,752 |
| Reversal of the allowance for write-down of inventories (Note 18) | (8,951) | - |
| Real estate management costs | 4,318 | 3,934 |
| Depreciation and impairment charge | 30,293 | 30,404 |
| Other expenses | 124,371 | 92,908 |
| Total cost of goods sold | 2,489,455 | 2,835,169 |

Note 5. Marketing expenses

| <i>in thousands of kroons</i> | 2010 | 2009 |
|------------------------------------|---------------|---------------|
| Staff costs | 17,889 | 17,177 |
| Construction tenders | 2,290 | 10,592 |
| Advertising, sponsorship | 5,641 | 10,378 |
| Transport | 1,996 | 1,758 |
| Depreciation and impairment charge | 408 | 489 |
| Other expenses | 6,088 | 6,700 |
| Total marketing costs | 34,312 | 47,094 |

Note 6. General and administrative expenses

| <i>in thousands of kroons</i> | 2010 | 2009 |
|--|----------------|----------------|
| Staff costs | 81,206 | 98,364 |
| Office expenses, communication services | 6,909 | 16,044 |
| Transport | 8,281 | 7,692 |
| Consulting, legal, auditing | 11,833 | 6,826 |
| Depreciation and impairment charge | 7,258 | 6,572 |
| Computer equipment and software | 5,494 | 4,993 |
| Other expenses | 15,524 | 13,509 |
| Total general and administrative expenses | 136,505 | 154,000 |

Note 7. Other operating income

| <i>in thousands of kroons</i> | 2010 | 2009 |
|---|---------------|---------------|
| Fines and penalties for delay received | 1,536 | 2,492 |
| Collection of doubtful receivables | 1,305 | 4,745 |
| Interest income from operating activities | 9,817 | 4,476 |
| Profit from sale of non-current assets | 1,185 | 519 |
| Other income | 1,198 | 2,176 |
| Total other operating income | 15,041 | 14,408 |

Note 8. Other operating expenses

| <i>in thousands of kroons</i> | 2010 | 2009 |
|--|--------------|---------------|
| Fines, penalties | 1,179 | 7,832 |
| Gifts, donations | 3,919 | 4,250 |
| Doubtful receivables expense (Note 36) | 1,758 | 13,854 |
| Other expenses | 624 | 1,390 |
| Total other operating expenses | 7,480 | 27,326 |

Note 9. Finance income

| <i>in thousands of kroons</i> | 2010 | 2009 |
|-------------------------------|---------------|---------------|
| Interest income | 9,267 | 37,828 |
| Foreign exchange gains | 1,600 | 1,209 |
| Other finance income | 33 | 480 |
| Total finance income | 10,900 | 39,517 |

Note 10. Finance costs

| <i>in thousands of kroons</i> | 2010 | 2009 |
|-------------------------------|---------------|---------------|
| Interest expense | 14,212 | 23,478 |
| Other finance costs | 2 | 1,119 |
| Total finance costs | 14,214 | 24,597 |

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 for the following reasons:

| 2010 | | | | |
|--|---------------|------------------|----------------|--------------|
| <i>in thousands of kroons</i> | Latvia | Lithuania | Estonia | Total |
| Profit before tax | 48,630 | (57,653) | 36,725 | 27,702 |
| Tax rate applicable to profits | 15% | 15% | 0% | |
| Tax calculated at domestic tax rates applicable to profits in the respective countries | (7,295) | 8,648 | - | 1,353 |
| Tax calculated on expenses not deductible for tax purposes | (1,807) | (9,774) | - | (11,581) |
| Tax calculated on income not subject to tax | 1,022 | 37 | - | 1,059 |
| Tax loss not recognised in the reporting period | - | (78) | - | (78) |
| Corporate income tax on dividends | - | - | (1,861) | (1,861) |
| | | | | |
| Tax charge | (8,080) | (1,167) | (1,861) | (11,108) |
| incl. current tax | (1,761) | - | (1,861) | (3,622) |
| deferred tax charge (Note 22) | (6,319) | (1,167) | - | (7,486) |
| | | | | |
| 2009 | | | | |
| <i>in thousands of kroons</i> | Latvia | Lithuania | Estonia | Total |
| Profit before tax | 106,172 | (77,402) | 91,088 | 119,858 |
| Tax rate applicable to profits | 15% | 20% | 0% | |
| Tax calculated at domestic tax rates applicable to profits in the respective countries | (15,926) | 15,480 | - | (446) |
| Tax calculated on expenses not deductible for tax purposes | (456) | (2,965) | - | (3,421) |
| Tax calculated on income not subject to tax | 943 | 382 | - | 1,325 |
| Effect of change in income tax rate | - | (763) | - | (763) |
| Tax loss not recognised in the reporting period | - | (2,001) | - | (2,001) |
| Corporate income tax on dividends | - | - | (3,190) | (3,190) |
| | | | | |
| Total income tax expense | (15,439) | 10,133 | (3,190) | (8,496) |
| incl. current tax | (13,182) | - | (3,190) | (16,372) |
| deferred tax charge (Note 22) | (2,257) | 10,133 | - | 7,876 |

Income tax on dividends was incurred at the group due to the distribution of the subsidiaries' profits as dividends.

As at 31.12.2010, it is possible to pay out dividends to shareholders from retained earnings in the amount of EEK 1,388,091 thousand and the corresponding income tax would amount to EEK 368,986 thousand. As at 31.12.2009, it would have been possible to pay out EEK 1,526,423 thousand, and the corresponding income tax would have amounted to EEK 405,758 thousand.

Note 12. Earnings per share

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

| | 2010 | 2009 |
|--|-------------|-------------|
| Net profit attributable to shareholders <i>(in EEK thousand)</i> | 19,232 | 116,166 |
| Weighted average number of ordinary shares <i>(thousand pcs)</i> | 17,700 | 17,700 |
| Earnings per share <i>(in EEK)</i> | 1.09 | 6.56 |

In 2009 and 2010, 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, EUR 1,770 thousand (EEK 27,694 thousand), i.e. EUR 0.10 (EEK 1.56) per share, will be distributed as net dividends in 2011, incurring a maximum corporate income tax charge of 21/79 of the amount paid i.e. EUR 470.5 thousand (EEK 7,362 thousand).

In 2010, EEK 194,700 thousand, i.e. EEK 11 per share and in 2009, EEK 61,950 thousand, i.e. EEK 3.50 per share were paid out as dividends. In both years, AS Merko Ehitus did not have to pay corporate income tax due to the dividends received from subsidiaries and taxed in prior periods.

Note 14. Cash and cash equivalents

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|--|----------------|----------------|
| Cash on hand | 125 | 270 |
| Bank accounts | 14,663 | 40,787 |
| Overnight deposits | 139,423 | 93,961 |
| Term deposits with maturities of 3 months and less | - | 224,714 |
| Total cash and cash equivalents (Note 36) | 154,211 | 359,732 |

As at 31.12.2010, the weighted average interest on overnight deposits was 0.2% (31.12.2009: 1.4%).

Note 15. Short-term deposits

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|---|------------|------------|
| Bank deposits with maturities greater than 3 months (Note 36) | 41,475 | 400,916 |

The weighted average interest on bank deposits with maturities greater than 3 months was 1.6% (2009: 3.5%) and the average maturity as at 31.12.2010 was 106 days (2009: 117 days).

Note 16. Trade and other receivables

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|--|----------------|----------------|
| Trade receivables (Note 36) | | |
| Accounts receivable | 340,276 | 405,030 |
| incl. from related parties (Note 34) | 510 | 3,178 |
| Allowance for doubtful receivables | (18,130) | (19,921) |
| Total trade receivables | 322,146 | 385,109 |
| Tax prepayments excluding corporate income tax (Note 36) | | |
| Value added tax | 18,524 | 7,823 |
| Social security tax | - | 7 |
| Other taxes | 288 | 922 |
| Total tax prepayments excluding corporate income tax | 18,812 | 8,752 |
| Amounts due from customers of contract works (Notes 33, 36) | 212,122 | 102,144 |
| Other short-term receivables | | |
| Short-term loans (Notes 17, 36) | 101,704 | 96,874 |
| incl. from related parties (Note 34) | 24,359 | 59,556 |
| Interest receivables (Note 36) | 12,642 | 13,524 |
| incl. from related parties (Note 34) | 8,718 | 10,771 |
| Receivable from buyer of subsidiary (Note 36) | - | 7,125 |
| Other short-term receivables (Note 36) | 2,973 | 2,253 |
| incl. from related parties (Note 34) | 70 | 1 |
| Total other short-term receivables | 117,319 | 119,776 |
| Prepayments for services (Note 36) | | |
| Prepayments for construction services | 21,349 | 38,197 |
| Prepaid insurance | 3,967 | 1,764 |
| Other prepaid expenses | 7,426 | 6,212 |
| Total prepayments for services | 32,742 | 46,173 |
| Total trade and other receivables | 703,141 | 661,954 |

Trade receivables by due date

| <i>in thousands of kroons</i> | 31.12.2010 | | 31.12.2009 | |
|--|----------------|---------------|----------------|---------------|
| Not overdue | 246,450 | 76.5% | 235,389 | 61.1% |
| 1-30 days overdue | 26,417 | 8.2% | 36,021 | 9.4% |
| 31-60 days overdue | 4,084 | 1.3% | 5,536 | 1.4% |
| 61-90 days overdue | 4,882 | 1.5% | 54,343 | 14.1% |
| 91-120 days overdue | 4,351 | 1.4% | 8,535 | 2.2% |
| 121-180 days overdue | 4,280 | 1.3% | 39,317 | 10.2% |
| More than 180 days overdue | 31,682 | 9.8% | 5,968 | 1.6% |
| Total trade receivables (Note 36) | 322,146 | 100.0% | 385,109 | 100.0% |

In 2010, the payment discipline of customers improved slightly. In a year, the share of overdue receivables in total receivables decreased from 38.9% to 23.5%. In 2010, the group's doubtful receivables amounted to EEK 18,130 thousand (2009: EEK 19,921 thousand) and a write-down of uncollectible receivables in the amount of EEK 1,758 thousand was recorded (2009: EEK 13,854 thousand). Management considers it likely that the receivables carried in the financial statements will be paid by customers. As at the balance sheet date, the amount of overdue receivables was EEK 75,695 thousand, including EEK 21,568 thousand held as security by customers, which will be released at the completion of the project upon presentation of a guarantee. By the date of approval of the financial statements, EEK 19,872 thousand of overdue debt had been collected.

A more detailed overview of the Company's credit risk is provided in Note 36.

Note 17. Loans granted

| <i>in thousands of kroons</i> | 2010 | 2009 |
|---|----------------|----------------|
| Loans granted to joint ventures | | |
| Loan balance at beginning of the year | 35,396 | 34,667 |
| Granted | 39,171 | 3,925 |
| Collected | (100) | (3,153) |
| Exchange rate difference | (59) | (43) |
| Loan balance at end of the year (Notes 34, 36) | 74,408 | 35,396 |
| incl. current portion | - | 16,500 |
| non-current portion 1...5 years | 74,408 | 18,896 |
| Average effective interest rate 5.6% (2009: 12.4%) | | |
| Loans granted to entities under common control | | |
| Loan balance at beginning of the year | 45,945 | 7,065 |
| Granted | - | 61,178 |
| Reclassification of receivable as loan granted | - | 19,962 |
| Collected | (14,535) | (42,246) |
| Reclassification of loan as prepayment for the registered immovable | (7,048) | - |
| Exchange rate difference | (3) | (14) |
| Loan balance at end of the year (Notes 34, 36) | 24,359 | 45,945 |
| incl. current portion | 24,359 | 43,056 |
| non-current portion 1...5 years | - | 2,889 |
| Average effective interest rate 6.3% (2009: 3.2%) | | |
| Loans granted to unrelated legal entities | | |
| Loan balance at beginning of the year | 37,318 | 26,885 |
| Granted | 85,775 | 782 |
| Reclassification of receivable as loan granted | 27,017 | 10,045 |
| Collected | (49,975) | (394) |
| Loan balance at end of the year | 100,135 | 37,318 |
| incl. current portion | 77,175 | 37,318 |
| non-current portion 1...5 years | 22,960 | - |
| Average effective interest rate 7.0% (2009: 7.7%) | | |
| Loans granted to unrelated individuals | | |
| Loan balance at beginning of the year | - | - |
| Granted | 1,735 | - |
| Loan balance at end of the year | 1,735 | - |
| incl. current portion | 170 | - |
| non-current portion 1...5 years | 1,565 | - |
| Average effective interest rate 3.5% | | |
| Total loans granted | | |
| Loan balance at beginning of the year | 118,659 | 68,617 |
| Granted | 126,681 | 65,885 |
| Reclassification of receivable as loan granted | 27,017 | 30,007 |
| Collected | (64,610) | (45,793) |
| Reclassification of loan as prepayment for the registered immovable | (7,048) | - |
| Exchange difference | (62) | (57) |
| Loan balance at end of the year | 200,637 | 118,659 |
| incl. current portion (Notes 16, 36) | 101,704 | 96,874 |
| non-current portion 1...5 years (Notes 21, 36) | 98,933 | 21,785 |

All loans granted are fully performing at the balance sheet date.

Note 18. Inventories

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|---|-------------------|-------------------|
| Raw materials and materials | 15,046 | 6,752 |
| Work-in-progress | 497,970 | 470,428 |
| Finished goods | 200,801 | 268,242 |
| Goods for resale | | |
| Registered immovables purchased for resale | 618,241 | 686,543 |
| incl. registered immovables located on nature preserve areas* | 59,653 | 59,653 |
| Other goods purchased for resale | 18,360 | 2,543 |
| Total goods for resale | 636,601 | 689,086 |
| Prepayments for inventories | | |
| Prepayments for real estate properties | 103,907 | 87,192 |
| incl. from related parties (Note 34) | 74,177 | 57,462 |
| Prepayments for other inventories | 1,547 | 14,763 |
| Total prepayments for inventories | 105,454 | 101,955 |
| Total inventories | 1,455,872 | 1,536,463 |

* There are strict building restrictions on immovables located on nature preserve areas and their use for development purposes, either directly or indirectly, is not permitted. According to the Nature Conservation Act of the Republic of Estonia, an immovable which is located within the territory of a protected area, special conservation area or species protection site and the use of which for intended purposes is significantly hindered by the protection procedure, may be transferred to the state by an agreement between the state and the owner of land for a consideration equivalent to the usual value of the immovable (§20 of Nature Conservation Act). Until the entry into force of the new version of the Act, an older version was in force until 01.08.2008 which laid down the exchange of nature preserve areas with the state.

The value of an immovable, other than a forest immovable, is determined using the transaction comparison method. In determining the value of an immovable, the real rights which due to their nature cannot be deleted from the land register are considered (e.g. servitudes, neighbourhood rights) as well as those arising from laws other than the restrictions on an immovable property arising from the protection procedure which forms a basis for the acquisition of an immovable.

Due to the overall economic environment and a tense state budget situation, the transfer of the registered immovables is unlikely in the near term. Management is of opinion that in the long term, the state is required to purchase these registered immovables or annul the restrictions set for them as a result of which they have been treated as land without restrictions for valuation purposes and the value of registered immovables have not been written down.

As at 31.12.2010, inventories have been written down to their net realisable value by EEK 24,895 thousand (2009: EEK 81,752 thousand) and earlier write-downs have been reversed in the amount of EEK 8,951 thousand (Notes 2, 4, 36):

The assets pledged as collateral for loans total EEK 669.8 million.

| | Carrying amount before write-down | Write-down | Reversal of write- down | Carrying amount after write-down |
|-----------------------------|--|-------------------|------------------------------------|---|
| 31.12.2010 | | | | |
| Finished goods | 200,681 | - | 120 | 200,801 |
| Work-in-progress | 501,861 | 12,722 | 8,831 | 497,970 |
| Land purchased for resale | 622,687 | 4,446 | - | 618,241 |
| Prepayments for real estate | 111,634 | 7,727 | - | 103,907 |
| 31.12.2009 | | | | |
| Finished goods | 288,232 | 19,990 | - | 268,242 |
| Work-in-progress | 474,144 | 3,716 | - | 470,428 |
| Land purchased for resale | 726,854 | 40,311 | - | 686,543 |
| Prepayments for real estate | 104,927 | 17,735 | - | 87,192 |

Note 19. Shares in subsidiaries

| <i>in thousands of kroons</i> | Ownership and voting rights % | | Location | Area of operation |
|-----------------------------------|-------------------------------|------------|-------------------------------------|---------------------|
| | 31.12.2010 | 31.12.2009 | | |
| Subsidiaries of AS Merko Ehitus | | | | |
| AS Gustaf | 85 | 75 | Pärnu | construction |
| AS Merko Tartu | 66 | 66 | Tartu | construction |
| Ringtee Tehnopark 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 Woody | 100 | 100 | Tallinn | real estate |
| OÜ Gustaf Tallinn | 80 | 80 | Tallinn | construction |
| OÜ Maryplus | 100 | 100 | Tallinn | real estate |
| OÜ Metsailu | 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 | 75 | Harjumaa, Viimsi rural municipality | construction |
| OÜ Tähelinna Kinnisvara | 100 | 100 | Tallinn | real estate |
| OÜ Mineraal | 100 | 100 | Tallinn | other mining |
| AS Merko Infra | 100 | 100 | Tallinn | construction |
| Merko Ukraine LLC | 100 | - | Republic of Ukraine, Kharkiv | construction |

At 8 December 2010, AS Merko Ehitus established a subsidiary Merko Ukraine LLC, the main activity of which is construction.
At 3 February 2010, the Company purchased 10% of the shares of AS Gustaf from a non-controlling interest.

Acquisition of a 10% additional ownership in the subsidiary AS Gustaf *in thousands of kroons*

| | | |
|--|-------|-------|
| Acquired ownership | 10% | 10% |
| Value of non-controlling interest acquired | 2,148 | 2,148 |
| Cost | 2,148 | 2,148 |

Cash flows from acquisition of a subsidiary

| | |
|---|---------|
| Cost of acquisition of shares of AS Gustaf | 2,148 |
| Amount due from the seller for the acquisition of the shares of AS Gustaf in 2006 | (1,000) |
| Interest calculated on amount due | (38) |
| Cash flows from acquisition of subsidiaries | 1,110 |

Acquisition of subsidiaries in 2009

At 2nd of April 2009, AS Merko Ehitus merged with its wholly-owned subsidiary OÜ Rae Tehnopark that is engaged in real estate development.

At 18th of December 2009, AS Merko Ehitus acquired full ownership of OÜ Tähelinna Kinnisvara, which is the subsidiary of AS Riverito's subsidiary E.L.L. Kinnisvara, the main activity of which is the leasing of the head office building of AS Merko Ehitus.

At 18th of May 2009, AS Merko Ehitus acquired a subsidiary OÜ Mineraal involved in sand and gravel extraction and which had not yet launched its operations, and in November 2009, it set up a subsidiary AS Merko Infra, in which the former department of outdoor utility lines launched its operations.

At 2nd of December 2009, the wholly-owned subsidiary of AS Merko Ehitus, Tallinna Teede AS, acquired 100% ownership in a subsidiary AS Vooremaa Teed, the main activity of which is also road construction.

Acquisition of subsidiaries

| <i>in thousands of kroons</i> | AS Vooremaa Teed | | OÜ Tähelelinna Kinnisvara | | OÜ Mineraal | |
|----------------------------------|------------------|------------|---------------------------|------------|-----------------|------------|
| | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value |
| Cash | 6,552 | 6,552 | 30,763 | 30,763 | 40 | 40 |
| Receivables | 6,455 | 6,455 | 32 | 32 | - | - |
| Inventories | 3,120 | 3,120 | - | - | - | - |
| Property, plant and equipment | 21,180 | 35,182 | 31,059 | 56,544 | - | - |
| Current liabilities | (6,151) | (6,151) | (217) | (217) | - | - |
| Non-current liabilities | (10,639) | (10,639) | (36,196) | (36,196) | - | - |
| Net assets | 20,517 | 34,519 | 25,441 | 50,926 | 40 | 40 |
| Acquired ownership interest | 100% | | 100% | | 100% | |
| Value of acquired net assets | 20,517 | 34,519 | 25,441 | 50,926 | | 40 |
| Cost | | 48,458 | | 50,926 | | 40 |
| Goodwill (Note 25) | | 13,939 | | - | | - |
| Sales revenue | | | | | | |
| - from the beginning of the year | 54,179 | | 8,511 | | 873 | |
| - post acquisition | 4,484 | | 180 | | 873 | |
| Net profit (loss) | | | | | | |
| - from beginning of the year | 8,830 | | 4,993 | | 320 | |
| - post acquisition | 541 | | (59) | | 320 | |

As at the balance sheet date, a goodwill test was performed for the cash-generating unit AS Vooremaa Teed which goodwill is attributable to. In the reporting period, goodwill was not written down because the recoverable amount of the cash-generating unit exceeded the carrying amount of the non-current assets and goodwill of the cash-generating unit.

The recoverable amount of the assets is determined as its value in use, using management-approved cash flow projections for the next 5 years. According the development plan, the purpose for the acquisition of the entity was expansion into the road maintenance market and development of a road construction unit in Central Estonia. The acquisition of AS Vooremaa Teed also enables better use of the existing resources and finding of synergies for product development. Post-projection period's cash flows are extrapolated using reasonable growth rates. The long-term growth rate of 2.5% for revenue and expenses is not higher than the estimated long-term GDP growth rate in Estonia.

The weighted average cost of capital is used as the discount rate, taking into consideration the Company's activities and risk level. For determining the gross margin, management uses previous periods' business experience.

Assumptions used for determining value in use:

| | 31.12.2010 | 31.12.2009 |
|--|------------|------------|
| Budget period, years | 5 | 5 |
| Average revenue growth in budget period, % | 24% | 26% |
| Average expense growth in budget period, % | 23% | 26% |
| Discount rate for cash flows, % | 14% | 14% |
| Post-budget period's growth rate, % | 2,5% | 2.5% |
| EBITDA margin of the budget period, % | 12% | 13% |

| Cash flows from acquisition of subsidiaries | AS Vooremaa Teed | OÜ Tähelinna Kinnisvara | OÜ Mineraal | Total |
|--|---------------------|----------------------------|-------------|----------|
| Cost | 48,458 | 50,926 | 40 | 99,424 |
| Paid on acquisition in 2009 | (48,458) | (50,926) | (40) | (99,424) |
| Cash and cash equivalents on acquisition of subsidiaries | 6,552 | 30,763 | 40 | 37,355 |
| Cash flows on acquisition of subsidiaries | (41,906) | (20,163) | - | (62,069) |

Note 20. Investment in associates and joint ventures

| | Ownership and voting rights % | | Location | Area of operation |
|-----------------------------------|-------------------------------|------------|--------------------------|-------------------|
| | 31.12.2010 | 31.12.2009 | | |
| Associate of AS Merko Ehitus | | | | |
| AS Tartu Maja Betoontooted | 25 | 25 | Tartu | concrete elements |
| | | | | |
| Joint ventures of AS Merko Ehitus | | | | |
| OÜ Unigate | 50 | 50 | Tallinn | real estate |
| Poolkoksimäe Sulgemise OÜ | 50 | - | Tallinn | construction |
| | | | | |
| Joint ventures of SIA Merks | | | | |
| PS Merks Terbe Lat | - | 50 | Republic of Latvia, Riga | construction |
| SIA Zakusala Estates | 50 | 50 | Republic of Latvia, Riga | real estate |
| | | | | |
| Joint venture of AS Merko Tartu | | | | |
| OÜ Kortermaja | 50 | 50 | Tartu | real estate |

In July 2010, AS Merko Ehitus liquidated its 50% joint venture SIA Merks Terbe Lat.

| | Invest- ment at 31.12.2009 | Changes in 2010 | | | | Invest- ment at 31.12.2010 |
|--|----------------------------------|---------------------------------------|----------------------------------|--------------|--|----------------------------------|
| | | establish- ment and liquidation | Profit/ loss from entities | Dividends | Currency translation adjustments | |
| <i>in thousands of kroons</i> | | | | | | |
| Associate of AS Merko Ehitus | | | | | | |
| AS Tartu Maja Betoontooted | 40,419 | - | (4,723) | - | - | 35,696 |
| Joint ventures of AS Merko Ehitus | | | | | | |
| OÜ Unigate | 972 | - | (23) | - | - | 949 |
| Poolkoksimäe Sulgemise OÜ | - | 22 | (2) | - | - | 20 |
| Joint ventures of SIA Merks | | | | | | |
| PS Merks Terbe Lat | 24 | (24) | - | - | - | |
| SIA Zakusala Estates | 135,943 | - | (1,090) | - | (40) | 134,813 |
| Joint venture of AS Merko Tartu | | | | | | |
| OÜ Kortermaja | 2,063 | - | (382) | (220) | - | 1,461 |
| Total joint ventures | 139,002 | (2) | (1,497) | (220) | (40) | 137,243 |
| Total associates and joint ventures | 179,421 | (2) | (6,220) | (220) | (40) | 172,939 |

| <i>in thousands of kroons</i> | Investment at 31.12.2008 | Changes in 2009 | | Investment at 31.12.2009 |
|--|-----------------------------|------------------------------|-------------------------------------|-----------------------------|
| | | Profit/loss from entities | Currency translation adjustments | |
| Associate of AS Merko Ehitus | | | | |
| AS Tartu Maja Betoontooted | 53,875 | (13,456) | - | 40,419 |
| Joint venture of AS Merko Ehitus | | | | |
| OÜ Unigate | 984 | (12) | - | 972 |
| Joint ventures of SIA Merks | | | | |
| PS Merks Terbe Lat | 24 | - | - | 24 |
| SIA Zakusala Estates | 149,154 | (12,961) | (250) | 135,943 |
| Joint venture of AS Merko Tartu | | | | |
| OÜ Kortermaja | 2,724 | (661) | - | 2,063 |
| Total joint ventures | 152,886 | (13,634) | (250) | 139,002 |
| Total associates and joint ventures | 206,761 | (27,090) | (250) | 179,421 |

As at 31.12.2010, the difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee totalling EEK 266 thousand (2009: EEK 647 thousand) is due to the effect from the unrealised gains of mutual transactions.

As at 31.12.2010, the difference between the value of the investment in SIA Zakusala Estates and the equity of the investee in the amount of EEK 135,778 thousand is attributable to the difference between the cost and market value of the 126 thousand square meter registered immovable located on Zakusala island in the centre of Riga that was privatised in December 2010 by the joint venture. As at 31.12.2009, this difference was EEK 135,819 thousand attributable to the lease agreement concerning the aforementioned registered immovable entered into with the City of Riga until 2 June 2051, pursuant to which SIA Zakusala Estates had the right to use the land and which was not included in the statement of financial position of the joint venture.

| Associates | Assets 31.12. | Liabilities 31.12. | Revenue | Net profit/loss |
|-------------------------------|----------------------|---------------------------|----------------|------------------------|
| <i>in thousands of kroons</i> | | | | |
| 2010 | | | | |
| AS Tartu Maja Betoontooted | 195,679 | 52,893 | 243,075 | (15,769) |
| 2009 | | | | |
| AS Tartu Maja Betoontooted | 239,191 | 77,513 | 186,523 | (52,699) |

| Joint ventures | Assets 31.12. | | Liabilities 31.12. | | Equity 31.12. | Income | Expenses | Net profit/loss |
|-------------------------------|-----------------------|---------------------------|----------------------------|--------------------------------|----------------------|---------------|-----------------|------------------------|
| | Current assets | Non-current assets | Current liabilities | Non-current liabilities | | | | |
| <i>in thousands of kroons</i> | | | | | | | | |
| 2010 | | | | | | | | |
| OÜ Unigate | 53,225 | - | 627 | 50,701 | 1,897 | 1 | 47 | (46) |
| Poolkoksimaä Sulgemise OÜ | 1,450 | 95 | 1,505 | - | 40 | 12,016 | 12,016 | 0 |
| SIA Zakusala Estates | 63,451 | - | 7,386 | 57,994 | (1,929) | 36 | 2,217 | (2,181) |
| OÜ Kortermaja | 3,770 | - | 316 | - | 3,454 | 4,565 | 6,092 | (1,527) |
| Total | 121,896 | 95 | 9,834 | 108,695 | 3,462 | 16,618 | 20,372 | (3,754) |
| 2009 | | | | | | | | |
| OÜ Unigate | 49,681 | - | 46,504 | 1,234 | 1,943 | 6 | 31 | (25) |
| PS Merks Terbe Lat | 17 | - | - | - | 17 | - | - | - |
| SIA Zakusala Estates | 1,853 | 28,663 | 7,250 | 23,018 | 248 | 48 | 8,235 | (8,187) |
| OÜ Kortermaja | 7,607 | - | 2,187 | - | 5,420 | 10,380 | 14,694 | (4,314) |
| Total | 59,158 | 28,663 | 55,941 | 24,252 | 7,628 | 10,434 | 22,960 | (12,526) |

Note 21. Other long-term loans and receivables

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|---|-------------------|-------------------|
| Long-term loans (Notes 17, 36) | 98,933 | 21,785 |
| incl. from related parties (Note 34) | 74,408 | 21,785 |
| Long-term interest receivables (Note 36) | 4,823 | - |
| incl. from related parties (Note 34) | 4,506 | - |
| Long-term bank deposit (Note 36)* | 4,994 | 2,809 |
| Long-term receivable from buyer of subsidiary (Note 36)** | 1,500 | 1,375 |
| Long-term receivables from customers of construction services (Note 36) | 18,957 | 6,499 |
| Total other long-term loans and receivables | 129,207 | 32,468 |

* The long-term bank deposit in the amount of EEK 2,259 thousand with the maturity of 28 December 2012 and interest rate of 4.63% has been pledged as collateral for the warranty granted to a customer of a construction contract. The interest rate on the deposit in the amount of EEK 2,185 thousand and the due date of 25 June 2012 is 1.6% and that of the deposit in the amount of EEK 550 thousand and the due date of 27 June 2018 is 5.35%.

** In 2006, AS Merko Ehitus sold 25% of the shares of the subsidiary AS Gustaf. The receivable is discounted at a 5% interest rate and its due date is 1 May 2013.

Note 22. Deferred income tax assets and liabilities

Formation of deferred income tax assets and liabilities at the subsidiaries SIA Merks and UAB Merko Statyba:

| 31.12.2010 | | | |
|--|---------------|------------------|---------------|
| <i>in thousands of kroons</i> | Latvia | Lithuania | Total |
| Deferred income tax liability | - | - | - |
| Deferred income tax assets | 12,567 | 12,020 | 24,587 |
| incl. tax loss carryforwards | - | 7,641 | 7,641 |
| effect of carrying amount of property, plant and equipment | (93) | - | (93) |
| effect of stage of completion method | 657 | 3,751 | 4,408 |
| effect of write-down of receivables | 1,042 | 307 | 1,349 |
| effect of write-down of inventories | 4,794 | - | 4,794 |
| effect of provisions | - | 321 | 321 |
| other effects | 6,167 | - | 6,167 |
| Deferred income tax assets | 12,567 | 12,020 | 24,587 |
| Deferred income tax charge of the financial year (Note 11) | 6,319 | 1,167 | 7,486 |
| 31.12.2009 | | | |
| <i>in thousands of kroons</i> | Latvia | Lithuania | Total |
| Deferred income tax liability | - | - | - |
| Deferred income tax assets | 18,882 | 13,187 | 32,069 |
| incl. tax loss carryforwards | - | 6,002 | 6,002 |
| effect of carrying amount of property, plant and equipment | (565) | - | (565) |
| effect of stage of completion method | 817 | 97 | 914 |
| effect of write-down of receivables | 127 | 531 | 658 |
| effect of write-down of inventories | 10,915 | 6,316 | 17,231 |
| effect of provisions | - | (122) | (122) |
| effect of changes in income tax rate | - | (464) | (464) |
| other effects | 7,588 | 827 | 8,415 |
| Deferred income tax assets | 18,882 | 13,187 | 32,069 |
| Deferred income tax charge of the financial year (Note 11) | 2,257 | (10,133) | (7,876) |

The management considers it likely that the unused tax losses carried forward can be utilised against future profits, although the financial results of the Lithuanian subsidiary were negative in the reporting period.

Note 23. Investment property

| <i>in thousands of kroons</i> | Land | Buildings | Construction in progress | Total |
|--|--------------|---------------|--------------------------|---------------|
| Cost at 31.12.2008 | 2,103 | 10,600 | - | 12,703 |
| Accumulated depreciation at 31.12.2008 | - | (701) | - | (701) |
| Carrying amount at 31.12.2008 | 2,103 | 9,899 | - | 12,002 |
| Exchange rate difference | (5) | (8) | - | (13) |
| Disposals | - | (1,048) | - | (1,048) |
| Reclassification | - | 6,118 | - | 6,118 |
| Depreciation | - | (507) | - | (507) |
| Carrying amount at 31.12.2009 | 2,098 | 14,454 | - | 16,552 |
| Cost at 31.12.2009 | 2,098 | 15,650 | - | 17,748 |
| Accumulated depreciation 31.12.2009 | - | (1,196) | - | (1,196) |
| Carrying amount at 31.12.2009 | 2,098 | 14,454 | - | 16,552 |
| Exchange rate difference | (1) | (1) | - | (2) |
| Acquisition | - | 2,371 | 37,831 | 40,202 |
| Depreciation | - | (666) | - | (666) |
| Carrying amount at 31.12.2010 | 2,097 | 16,158 | 37,831 | 56,086 |
| Cost at 31.12.2010 | 2,097 | 18,020 | 37,831 | 57,948 |
| Accumulated depreciation 31.12.2010 | - | (1,862) | - | (1,862) |
| Carrying amount at 31.12.2010 | 2,097 | 16,158 | 37,831 | 56,086 |

As at 31.12.2010, the carrying amounts of investment properties do not significantly differ from their fair values (31.12.2009: the carrying amounts of investment properties did not significantly differ from their fair values). Fair values have mainly been estimated based on market transactions.

Investment properties have been acquired for the purpose of earning rental income as well as for capital appreciation or development in the future. Buildings located on the plot of land have temporarily been leased out under the operating lease terms. Rental income receivable, maintenance costs incurred and improvement expenses are immaterial.

Note 24. Property, plant and equipment

| <i>in thousands of kroons</i> | Land | Buildings | Right of super- ficies | Machinery and equip- ment | Other fixtures | Construc- tion in progress and pre- payments | Total |
|--|---------------|---------------|------------------------------|---------------------------------|-------------------|--|----------------|
| Cost at 31.12.2008 | 9,697 | 20,008 | 458 | 181,732 | 97,274 | 5,721 | 314,890 |
| Accumulated depreciation and impairment losses at 31.12.2008 | - | (4,909) | (104) | (67,761) | (45,022) | - | (117,796) |
| Carrying amount at 31.12.2008 | 9,697 | 15,099 | 354 | 113,971 | 52,252 | 5,721 | 197,094 |
| Currency translation differences | - | - | - | 24 | (16) | - | 8 |
| Acquisition | - | 837 | - | 9,094 | 1,363 | 1,918 | 13,212 |
| Acquisition in business combinations | 3,208 | 57,462 | - | 31,056 | - | - | 91,726 |
| Disposals | - | - | - | (882) | (25) | - | (907) |
| Reclassification | - | 5,539 | - | 8,937 | (8,090) | (6,773) | (387) |
| Write-offs | - | - | - | (60) | (76) | - | (136) |
| Depreciation | - | (1,018) | (9) | (25,975) | (7,332) | - | (34,334) |
| Carrying amount at 31.12.2009 | 12,905 | 77,919 | 345 | 136,165 | 38,076 | 866 | 266,276 |
| Cost at 31.12.2009 | 12,905 | 89,030 | 458 | 236,939 | 78,588 | 866 | 418,786 |
| Accumulated depreciation and impairment losses at 31.12.2009 | - | (11,111) | (113) | (100,774) | (40,512) | - | (152,510) |
| Carrying amount at 31.12.2009 | 12,905 | 77,919 | 345 | 136,165 | 38,076 | 866 | 266,276 |
| Currency translation differences | - | - | - | 2 | 3 | - | 5 |
| Acquisition | - | 38 | - | 44,705 | 3,633 | 725 | 49,101 |
| Disposals | - | - | - | (1,408) | (963) | - | (2,371) |
| Reclassification | - | - | - | 995 | 596 | (1,591) | - |
| Write-offs | - | - | - | (26) | (37) | - | (63) |
| Depreciation | - | (2,890) | (9) | (27,411) | (4,957) | - | (35,267) |
| Carrying amount at 31.12.2010 | 12,905 | 75,067 | 336 | 153,022 | 36,351 | - | 277,681 |
| Cost at 31.12.2010 | 12,905 | 89,068 | 458 | 275,504 | 78,004 | - | 455,939 |
| Accumulated depreciation and impairment losses at 31.12.2010 | - | (14,001) | (122) | (122,482) | (41,653) | - | (178,258) |
| Carrying amount at 31.12.2010 | 12,905 | 75,067 | 336 | 153,022 | 36,351 | - | 277,681 |

Information on leased assets is provided in Note 26 and on lease payments in Note 27.

No property, plant and equipment are pledged as collateral for borrowings.

Note 25. Intangible assets

| <i>in thousands of kroons</i> | Goodwill (Note 19) | Software | Prepayments | Total |
|--|------------------------------|-----------------|--------------------|---------------|
| Cost at 31.12.2008 | - | 16,377 | 1,362 | 17,739 |
| Accumulated amortisation at 31.12.2008 | - | (5,932) | - | (5,932) |
| Carrying amount at 31.12.2008 | - | 10,445 | 1,362 | 11,807 |
| Currency translation differences | - | 2 | - | 2 |
| Acquisitions | 13,939 | 984 | - | 14,923 |
| Amortisation | - | (2,494) | - | (2,494) |
| Carrying amount at 31.12.2009 | 13,939 | 8,937 | 1,362 | 24,238 |
| Cost at 31.12.2009 | 13,939 | 17,346 | 1,362 | 32,647 |
| Accumulated amortisation at 31.12.2009 | - | (8,409) | - | (8,409) |
| Carrying amount at 31.12.2009 | 13,939 | 8,937 | 1,362 | 24,238 |
| Currency translation differences | - | 1 | - | 1 |
| Acquisitions | - | 1,419 | - | 1,419 |
| Disposals | - | (89) | - | (89) |
| Write-offs | - | (1) | - | (1) |
| Amortisation | - | (1,972) | - | (1,972) |
| Carrying amount at 31.12.2010 | 13,939 | 8,295 | 1,362 | 23,596 |
| Cost at 31.12.2010 | 13,939 | 18,144 | 1,362 | 33,445 |
| Accumulated amortisation at 31.12.2010 | - | (9,849) | - | (9,849) |
| Carrying amount at 31.12.2010 | 13,939 | 8,295 | 1,362 | 23,596 |

Prepayments for intangible assets relate to prospective replacement of the group's accounting software.

Note 26. Leased assets

| <i>in thousands of kroons</i> | 2010 | 2009 |
|--|-------------|-------------|
| Assets acquired under finance lease terms | | |
| Machinery and equipment | | |
| Cost | 166,494 | 130,007 |
| Accumulated depreciation | (52,426) | (42,391) |
| incl. depreciation charge of the period | (12,247) | (10,205) |
| Carrying amount | 114,068 | 87,616 |
| Assets leased under non-cancellable operating lease terms | | |
| Land lease agreements | | |
| Payments in the reporting period | 1 | - |
| Payments in subsequent periods: | 57 | - |
| Payable next year | 5 | - |
| Payable in 1...5 years | 19 | - |
| Payables after 5 years | 33 | - |

On the basis of cancellable lease agreements, operating lease payments totalling EEK 12,441 thousand (2009: EEK 12,606 thousand) were paid for passenger cars in 2010. The Company does not intend to use a bargain purchase option for the assets leased under the operating lease terms in the reporting period.

Note 27. Borrowings

| <i>in thousands of kroons</i> | 2010 | 2009 |
|--|----------------|----------------|
| Finance lease payables | | |
| Present value of lease payments at beginning of the year | 47,934 | 54,541 |
| Received | 36,489 | 10,869 |
| Paid | (22,647) | (17,476) |
| Exchange rate difference | 2 | - |
| Minimum future lease payments | 61,778 | 47,934 |
| incl. current portion | 16,498 | 16,170 |
| non-current portion 1...4 years | 45,280 | 31,764 |
| Interest expense for the reporting period | 1,713 | 1,800 |
| Minimum future lease payments | 67,136 | 50,619 |
| incl. current portion | 18,459 | 17,303 |
| non-current portion 1...4 years | 48,677 | 33,316 |
| Average effective interest rate 3.1% (2009: 5.3%) | | |
| Base currencies EEK, EUR and LVL | | |
| Bank loans | | |
| Loan balance at beginning of the year | 361,697 | 553,611 |
| Received | 33,088 | 56,841 |
| Borrowing related to acquisition of subsidiary | - | 36,196 |
| Paid | (168,208) | (285,051) |
| Exchange difference | 115 | 100 |
| Loan balance at end of the year | 226,692 | 361,697 |
| incl. current portion | 68,428 | 319,895 |
| non-current portion 1...5 years | 158,264 | 41,802 |
| Interest cost of reporting period | 8,687 | 14,721 |
| incl. capitalised interest cost | 53 | - |
| Average effective interest rate 4.9% (2009: 4.5%) | | |
| Base currencies LVL and EUR | | |
| Loans from entities under common control | | |
| Loan balance at beginning of the year | 109,354 | 125,001 |
| Paid | - | (15,647) |
| Loan balance at end of the year (Note 34) | 109,354 | 109,354 |
| incl. current portion | 109,354 | 109,354 |
| Interest cost of reporting period | 2,640 | 5,589 |
| Average effective interest rate 2.4% (2009: 4.5%) | | |
| Loans from other entities | | |
| Loan balance at beginning of the year | 4,900 | 4,900 |
| Loan balance at end of the year | 4,900 | 4,900 |
| incl. current portion | 2,150 | 2,150 |
| non-current portion 1...5 years | 2,750 | 2,750 |
| Interest cost of reporting period | 276 | 273 |
| Average effective interest rate 5.5% (2009: 5.5%) | | |
| Total loans | | |
| Loan balance at beginning of year | 475,951 | 683,512 |
| Received | 33,088 | 56,841 |
| Borrowing related to acquisition of subsidiary | - | 36,196 |
| Paid | (168,208) | (300,698) |
| Exchange rate difference | 115 | 100 |
| Loan balance at end of year | 340,946 | 475,951 |
| incl. current portion | 179,932 | 431,399 |
| non-current portion 1...5 years | 161,014 | 44,552 |
| Total borrowings | 402,724 | 523,885 |
| incl. current portion (Note 36) | 196,430 | 447,569 |
| non-current portion 1...5 years (Note 36) | 206,294 | 76,316 |

Borrowings with floating interest rates related to Euribor or Rigibor (Riga Interbank Offered Rate - the index of Latvian interbank credit interest rates) are divided by the interest rate changes and the contractual repricing dates as follows:

| <i>in thousands of kroons</i> | 2010 | 2009 |
|---|----------------|----------------|
| Finance lease liabilities | | |
| 6-12 months | 37,683 | 29,597 |
| Bank loans | | |
| up to 6 months | 35,489 | 180,712 |
| 6-12 months | 191,203 | 180,985 |
| Loans from entities under common control | | |
| 6-12 months | 109,354 | 109,354 |
| Total | 373,729 | 500,648 |

Borrowings with the contractual fixed interest rate are divided as follows:

| <i>in thousands of kroons</i> | 2010 | 2009 |
|-------------------------------|---------------|---------------|
| Finance lease liabilities | 24,095 | 18,337 |
| Loans from other entities | 4,900 | 4,900 |
| Total | 28,995 | 23,237 |

The global financial markets returned to stability in 2010. The risk margins of loans continued to increase. As most of the group's loan contracts have been concluded prior to the increase in risk margins, we can assert that the fair value of bank loans is lower than their carrying amount. The carrying amount of loans refinanced in 2010 is equal to their carrying amount. Among the loans from entities under common control, there is a loan from AS Järvevana originating from the demerger, the interest of which after the first 12 months is 12 month Euribor + 1%.

Loan collaterals and pledged assets are presented in Note 31.

Note 28. Trade and other payables

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|--|----------------|----------------|
| Trade payables (Note 36) | 240,357 | 223,149 |
| incl. to related parties (Note 34) | 231 | 94 |
| Payables to employees | 42,262 | 55,364 |
| Tax liabilities, except for corporate income tax | | |
| value added tax | 11,422 | 22,625 |
| personal income tax | 6,913 | 6,783 |
| social security tax | 11,854 | 13,045 |
| land tax | - | 80 |
| unemployment insurance tax | 1,218 | 1,171 |
| contributions to mandatory funded pension | 274 | 107 |
| other taxes | 403 | 604 |
| Total tax liabilities, except for corporate income tax | 32,084 | 44,415 |
| Amounts due to customers for contract works (Notes 33, 36) | 60,649 | 316,095 |
| Other liabilities (Note 36) | | |
| interest liabilities | 1,378 | 1,105 |
| incl. to related parties (Note 34) | 482 | 233 |
| payable for registered immovables from demerger | 100,000 | 100,000 |
| incl. to related parties (Note 34) | 100,000 | 100,000 |
| other liabilities | 4,697 | 4,274 |
| Total other liabilities | 106,075 | 105,379 |
| Prepayments received | 131,182 | 38,068 |
| incl. from related parties (Note 34) | 5 | - |
| Total trade and other payables | 612,609 | 782,470 |

Note 29. Short-term provisions

| <i>in thousands of kroons</i> | 2010 | 2009 |
|---|---------------|---------------|
| Provision for warranty obligation for construction | | |
| Residual value at beginning of the year | 18,518 | 19,916 |
| Set up | 15,109 | 13,620 |
| Used during the year | (16,234) | (15,018) |
| Exchange difference | (1) | - |
| Balance at end of the year | 17,392 | 18,518 |
| Provision for onerous construction contracts | | |
| Residual value at beginning of the year | 4,035 | 3,525 |
| Set up | 33,983 | 2,014 |
| Used during the year | (3,185) | (1,504) |
| Balance at end of the year | 34,833 | 4,035 |
| Provision for legal costs and claims filed | | |
| Residual value at beginning of the year | 14,492 | 7,882 |
| Set up | 1,102 | 7,518 |
| Used during the year | (11,492) | (908) |
| Balance at end of the year (Note 36) | 4,102 | 14,492 |
| Other provisions | | |
| Residual value at beginning of the year | 657 | 994 |
| Set up | 1,415 | 328 |
| Used during the year | (915) | (665) |
| Balance at end of the year | 1,157 | 657 |
| Total short-term provisions | 57,484 | 37,702 |

Note 30. Other long-term trade payables

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|---------------------------------------|---------------|---------------|
| Trade payables (Note 36) | 13,223 | 10,653 |
| Prepayments received | 12 | 5 |
| Total long-term trade payables | 13,235 | 10,658 |

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 Swedbank AS:

A commercial pledge agreement on movable property in the amount of EEK 200 million (registered under the first, second, fifth and seventh 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 EEK 2.3 million has been entered into for guaranteeing the guarantee contract concerning stage I of construction works of Puurmanni traffic network.

Between AS Merko Ehitus and Nordea Bank Finland Plc Estonia branch:

A joint mortgage under the first available order in the amount of EEK 100 million on the registered immovables recognised in the inventories of AS Merko Ehitus. The contractual obligations arising from the overdraft facility are secured by the mortgage.

Between AS Merko Ehitus and AS SEB Pank:

A commercial pledge agreement on movable property in the amount of EEK 60 million (registered under the third, fourth and sixth orders in the register of commercial pledges). The obligations arising from the guarantee contract are secured by the pledge.

Between Tallinna Teede AS, Swedbank AS and AS SEB Pank:

A commercial pledge agreement on movable property in the amount of EEK 25 million (registered under the first order in the register of commercial pledges), whereby Swedbank AS has a 14/25 legal share and AS SEB Pank has a 11/25 legal share.

Between Tallinna Teede AS and Swedbank AS:

A commercial pledge agreement on movable property in the amount of EEK 2 million (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 secured by the pledges.

Between Tallinna Teede AS, OÜ Tevener and Swedbank AS:

A mortgage in the amount of EEK 23.4 million on the registered immovable included within the non-current assets of OÜ Tevener, located in Kirdalu village, Saku rural municipality, Harjumaa up to its carrying amount of EEK 26.7 million, for guaranteeing the obligations arising from the loan contract entered into between Swedbank AS and Tallinna Teede AS.

Between AS Vooremaa Teed and Swedbank AS:

A mortgage on the registered immovable with the carrying amount of EEK 1.1 million located in Jõgeva that is carried within the non-current assets has been set as collateral for the limit agreement of off-balance sheet products with the limit of EEK 1 million.

Between AS Gustaf and Swedbank AS:

A commercial pledge agreement on movable property in the amount of EEK 9.1 million (registered under the first and second orders in the register of commercial pledges). Guarantee contracts entered into are guaranteed by the pledge.

Between OÜ Gustaf Tallinn and Swedbank AS:

A commercial pledge agreement on movable property in the amount of EEK 3.9 million for guaranteeing guarantee contracts.

Between AS Merko Tartu and AS SEB Pank:

A commercial pledge agreement on movable property in the amount of EEK 22.0 million. Guarantee contracts entered into are guaranteed by the pledge.

Between AS Merko Tartu and AS SEB Pank:

A mortgage has been set as collateral for the loan contract in the amount of EEK 5.0 million concerning 9 apartment ownerships in Tartumaa (investment property with the carrying amount of EEK 9.6 million in the statement of financial position), for guaranteeing the obligations arising from the loan contract.

Between AS Merko Tartu and Danske Bank AS Estonia branch:

Joint mortgages on 13 registered immovables in Tartumaa up to their carrying amount of EEK 38.7 have been set as collateral for the loan contract with the limit of EEK 5.0 million and for the loan contract in the amount of EEK 25 million, for guaranteeing the obligations arising from the loan contract.

Between OÜ Raadi Kortermaja and Danske Bank AS:

Mortgages have been set on two registered immovables in Tartumaa (finished goods with the carrying amount of EEK 31.9 million in the statement of financial position) as collateral for the loan contract in the amount of EEK 30.4 million, for guaranteeing the obligations arising from the loan contract. In addition, the same loan contract is guaranteed by the contract of surety of AS Merko Tartu.

Between SIA Merks and AS Swedbank:

A commercial pledge agreement on assets in the amount of LVL 20.2 million (EEK 444.4 million). The obligations arising from overdraft contracts and guarantee contracts are guaranteed by the pledge.

Mortgages on 19 registered immovables in Riga (property purchased for resale in the statement of financial position) have been pledged as collateral for the loan contract in the amount of EUR 6.3 million (EEK 98.1 million) up to their carrying amount of

LVL 11.6 million (EEK 256.6 million). The obligations arising from guarantee contracts have also been guaranteed by the mortgages on 19 registered immovables in Riga in the amount of LVL 5.2 million (EEK 114.6 million).

Between SIA Merks and Nordea Bank Finland Plc branch:

A mortgage on a registered immovable consisting of apartment ownerships and apartments in the stage of construction (construction in progress in the statement of financial position) up to its carrying amount of LVL 11.0 million (EEK 242.6 million) has been set as collateral for the loan contract with the limit of EUR 3.7 million (EEK 57.9 million).

The group's assets have been pledged in the total amount of EEK 1,475.9 million (incl. movable property in the amount of EEK 768.7 million, inventories in the amount of EEK 669.8 million and items of property, plant and equipment in the amount of EEK 37.4 million).

Note 32. Share capital

In 2010 and 2009, no changes occurred in share capital.

As at 31.12.2010, the share capital in the amount of EEK 177,000 thousand 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

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|---|-------------------|-------------------|
| Costs incurred for construction contracts in progress and corresponding profit* | 5,964,456 | 6,277,655 |
| Progress billings submitted | (5,812,983) | (6,491,606) |
| Revenue recorded from construction services during the period | 2,365,782 | 2,772,962 |
| Amounts due from customers for contract works (Notes 16, 36) | 212,122 | 102,144 |
| Amounts due to customers for contract works (Notes 28, 36) | (60,649) | (316,095) |
| Advance payments received for contract works | 131,182 | 38,068 |

Amounts due from customers for contract works are included in the statement of financial position line *Trade and other receivables*. Amounts due to customers for contract work are included in the statement of financial position line *Trade and other payables*.

* Costs incurred for construction contracts in progress and corresponding profit have been presented for contracts in effect, including those entered into in 2009 and 2008.

Note 34. Related party transactions

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

- parent company AS Riverito;
- shareholders of AS Riverito with significant influence over AS Merko Ehitus through AS Riverito;
- other shareholders with significant influence;
- other subsidiaries of AS Riverito, so-called 'entities controlled by the parent';
- associates and joint ventures;
- key members of the management, their close relatives and entities under their control or significant influence;
- entities sharing key personnel with AS Merko Ehitus.

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

The parent of AS Merko Ehitus is AS Riverito. As at 31.12.2010 and 31.12.2009, AS Riverito owned 72% of the shares of AS Merko Ehitus. The ultimate controlling party of the group is Mr Toomas Annus.

Goods and services

| <i>in thousands of kroons</i> | 2010 | 2009 |
|---|---------------|----------------|
| Purchased construction services | | |
| Associates and joint ventures | 1 | 2,435 |
| Entities under common control | 2,232 | 10,972 |
| Total purchased construction services | 2,233 | 13,407 |
| | | |
| Other services purchased | | |
| Parent company | 17,000 | - |
| | | |
| Construction services rendered | | |
| Parent company | 752 | - |
| Associates and joint ventures | 2,007 | 67 |
| Entities under common control | 11,825 | 133,434 |
| Management members | 13,058 | 15,237 |
| Other related parties | 74 | 896 |
| Total construction services rendered | 27,716 | 149,634 |
| | | |
| Construction materials purchased | | |
| Parent company | 1,182 | - |
| Other related parties | 87 | 82 |
| Total construction materials purchased | 1,269 | 82 |
| | | |
| Real estate purchased | | |
| Entities under common control | - | 50,926 |
| | | |

Loans granted to related parties are disclosed in Note 17 *Loans granted*.

Balances with related parties

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|--|-------------------|-------------------|
| Trade and other receivables | | |
| Trade receivables (Note 16) | | |
| Parent company | 85 | 190 |
| Associates and joint ventures | 285 | 74 |
| Entities under common control | 63 | 483 |
| Other related parties | 77 | 2,431 |
| Short-term loans (Note 17) | | |
| Associates and joint ventures | - | 16,500 |
| Entities under common control | 24,359 | 43,056 |
| Interest receivables (Note 16) | | |
| Associates and joint ventures | 5,987 | 9,147 |
| Entities under common control | 2,731 | 1,624 |
| Other short-term receivables (Note 16) | | |
| Associates and joint ventures | - | 1 |
| Entities under common control | 70 | - |
| Prepayments for inventories (Note 18) | | |
| Entities under common control | 74,177 | 57,462 |
| Other long-term loans and receivables | | |
| Long-term loans (Note 17) | | |
| Associates and joint ventures | 74,408 | 18,896 |
| Entities under common control | - | 2,889 |
| Interest receivables (Note 21) | | |
| Associates and joint ventures | 4,506 | - |
| Borrowings | | |
| Short-term loans and bonds (Note 27) | | |
| Entities under common control | 109,354 | 109,354 |
| Trade and other payables | | |
| Trade payables (Note 28) | | |
| Parent company | 180 | 2 |
| Entities under common control | 46 | 90 |
| Other related parties | 5 | 2 |
| Interest liabilities (Note 28) | | |
| Parent company | 254 | - |
| Entities under common control | 228 | 233 |
| Other liabilities (Note 28) | | |
| Entities under common control | 100,000 | 100,000 |
| Prepayments received (Note 28) | | |
| Entities under common control | 5 | - |

In 2010, an allowance for the receivables from entities under common control has been recognised in the amount of EEK 7,727 thousand (2009: EEK 17,735 thousand), the balance written down in 2010 had been included under prepayments for inventory in the consolidated financial statements.

Remuneration of the members of the Supervisory and Management Boards, and senior executives

In 2010, the members of the Supervisory and Management Boards as well as senior executives (directorates) of AS Merko Ehitus were paid remuneration totalling EEK 11,434 thousand (2009: EEK 14,529 thousand). In 2010, the management structure was changed, during the course of which the directorate was liquidated and its functions were returned to the Supervisory Board.

Termination benefits of members of the Supervisory and Management Boards

Authorisation agreements have been entered into with the members of the Supervisory Board according to which no termination benefits are paid to them upon the termination of the contract. 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 EEK 6,348 thousand (2009: EEK 5,556 thousand). In 2010, compensation totalled EEK 780 thousand (2009: EEK 360 thousand).

Contracts of surety

AS Merko Ehitus provides surety for the liabilities arising from the lease agreements of its subsidiaries and consolidation group entities to Swedbank Liising AS in the amount of EEK 679 thousand (31.12.2009: EEK 1,555 thousand).

The fair value of group's surety contracts is immaterial, therefore no liability has been recorded in the balance sheet as at 31.12.2010 as well as at 31.12.2009.

Note 35. Contingent liabilities

The group has purchased the following guarantees from financial institutions to guarantee the group's obligations to third parties. These amounts represent the maximum right of claim by third persons against the group in case the group is unable to meet its contractual obligations. Management estimates that additional expenses related to these guarantees are unlikely.

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|---|-------------------|-------------------|
| Performance period's warranty to the customer | 302,593 | 262,573 |
| Tender warranty | 51,261 | 59,254 |
| Guarantee warranty period | 152,890 | 152,114 |
| Prepayment guarantee | 161,078 | 81,296 |
| Contracts of surety | 829 | 9,705 |
| Payment guarantee | 2,678 | 3,318 |
| Letter of credit | - | 6,404 |
| Total contingent liabilities | 671,329 | 574,664 |

Performance period's warranty to the customer – warranty provider guarantees to the customer that the contractor's obligations arising from construction contract will be adequately completed.

Tender warranty – warranty provider guarantees to the customer arranging the tender process that the tenderer will sign a contract as per tender conditions.

Guarantee for warranty period – warranty provider guarantees to the customer that the construction defects discovered during the warranty period will be repaired.

Prepayment guarantee – warranty provider guarantees to the customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.

Payment guarantee – warranty provider guarantees to the 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.

For legal risks, please refer to the respective paragraph of Note 36.

Note 36. Risk management

Credit risk

Credit risk relates to potential losses 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. Cash is mostly held in overnight deposits or term deposits at Swedbank, SEB, Nordea and Unicredit group. Management estimates that the group is not exposed to significant credit risk.

Financial assets exposed to credit risk

| <i>in thousands of kroons</i> | Allocation by due dates | | Carrying amount | Collateral |
|--|-------------------------|----------------|------------------|---------------|
| | 1-12 months | 2-5 years | | |
| 31.12.2010 | | | | |
| Cash and cash equivalents (Note 14) | 154,211 | - | 154,211 | - |
| Term deposits (Notes 15, 21) | 41,475 | 4,994 | 46,469 | - |
| Trade receivables (Notes 16, 21) | 322,146 | 20,457 | 342,603 | - |
| Amounts due from customers for contract works (Notes 16, 33) | 212,122 | - | 212,122 | - |
| Loans granted (Notes 16, 17) | 101,704 | 98,933 | 200,637 | 25,000 |
| Interest receivables (Notes 16, 21) | 12,642 | 4,823 | 17,465 | - |
| Other short-term receivables (Note 16) | 2,973 | - | 2,973 | - |
| Total | 847,273 | 129,207 | 976,480 | 25,000 |
| 31.12.2008 | | | | |
| Cash and cash equivalents (Note 14) | 135,018 | - | 135,018 | - |
| Term deposits (Notes 14, 15, 21) | 625,630 | 2,809 | 628,439 | - |
| Trade receivables (Notes 16, 21) | 385,109 | 7,874 | 392,983 | - |
| Amounts due from customers for contract works (Notes 16, 33) | 102,144 | - | 102,144 | - |
| Loans granted (Notes 16, 17) | 96,874 | 21,785 | 118,659 | 25,000 |
| Interest receivables (Notes 16, 21) | 13,524 | - | 13,524 | - |
| Other short-term receivables (Note 16) | 9,378 | - | 9,378 | - |
| Total | 1,367,677 | 32,468 | 1,400,145 | 25,000 |

The group's customers are primarily large local companies or public sector entities (as of 31.12.2010 the public sector proportion in accounts receivable amounted to 46,6%) with well-known and sufficient creditworthiness. The group carefully monitors the payment behaviour of its customers and publicly available information on the payment discipline of entities.

Of the financial assets, an allowance has been set up for doubtful receivables. In 2010, the group's doubtful receivables amounted to EEK 18,130 thousand (2009: EEK 19,921 thousand) and a write-down of uncollectible receivables in the amount of EEK 1,758 thousand was recorded (2009: EEK 13,854 thousand). Management estimates that there are sufficient grounds to assume that the amounts carried in the financial statements will be paid by the customers.

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 98,767 thousand (31.12.2009: EEK 81,341 thousand) are loans to entities under common control and associates of whose economic activities the group has a good overview and therefore, no additional collateral is required. The loans granted to unrelated legal entities include two loans in the amount of EEK 71,939 thousand, the borrowers of which have not been able to timely meet the obligations arising from the loan contract but which have been secured by a mortgage or by parent company guarantee. Management estimates that the collateral covers the balance of the loan principal and there is no need for recognising an allowance for these financial assets. The loans granted to other unrelated legal persons do not carry significant credit risk.

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 group'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 entities. As the share of interest-bearing liabilities at the group's capital structure is low (as at 31.12.2010: 13.2% and 31.12.2009: 14.9% 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 finance costs

As at 31.12.2010, the group's interest-bearing liabilities totalled EEK 402,724 thousand. Loan interest depended on the base interest of 3-12 month interbank money market loans of the respective country of incorporation and Euribor.

As at 31.12.2010, the group's maximum need to repay/refinance liabilities in 2011 was EEK 196,430 thousand. The need may decrease, because of the total amount, EEK 27,102 thousand is related to housing development and, depending on the selling success of apartments, the loan is repaid on a continuous basis. Of the liabilities assumed, those with fixed interest rates total EEK 9,447 thousand, including non-current liabilities of EEK 6,405 thousand. Liabilities in the amount of EEK 393,277 thousand have floating base interest rates, of which EEK 390,518 thousand is exposed to changes in Euribor and EEK 2,759 thousand to changes in Rigibor. As at 31.12.2010, 12-month Euribor was 1.507% and management estimates that it may increase by 100 basis points over the next 12 months. A change of +/- 100 basis points in Euribor rate at the current level of liabilities would increase/decrease the group's interest expenses by EEK 3,905 thousand. In addition to Euribor risk, the refinancing of liabilities also carries a risk due changes in risk margins attributable to the changes in the economic environment. Management estimates that it may reduce interest rates by 50-100 basis points in 2011, depending on the time of prior fixing of the interest rate. The change in interest rates of loans taken in local currencies by +/- 100 would increase/decrease the group's interest expenses by EEK +/- 77 thousand. The balance of liabilities exposed to the changes in the risk margin as at 31.12.2010 was EEK 86,184 thousand and a change of +/- 100 basis points in the risk margin would increase/decrease the group's interest expenses by EEK +/- 862 thousand.

Foreign exchange risk

The group's economic activities are conducted mainly in the currencies of the countries of location of the companies: Estonian kroons, Latvian lats and Lithuanian litas. From 1 January 2011, Estonia adopted the euro as its national currency. Latvian lats and Lithuanian litas are pegged to the euro. The exchange rate of the Latvian lats is 1 EUR= LVL 0.702804 +/-1%. In order to eliminate foreign exchange risk, the proportions of assets and liabilities denominated in different currencies are monitored and key foreign contracts and long-term loan contracts are preferentially concluded in euros. As at the balance sheet date, EEK 2,942,420 thousand or 96.2% of the assets were denominated in local currencies, including the assets in EEK which made up 55.1%, assets in LVL 34.7% and assets in LTL 6.4% of the balance sheet total, and EEK 2,643,585 thousand or 86.4% of the liabilities were denominated in local currencies, including liabilities in EEK which made up 67.3%, in LVL 17.1% and in LTL 2.0% of the balance sheet total.

Liquidity risk

The Company's liquidity or solvency represents its ability to settle its liabilities to creditors on time. As at 31.12.2010, the group's current ratio was 2.7 (31.12.2009: 2.3) and the quick ratio was 1.1 (31.12.2009: 1.1). To complement available current assets and to ensure liquidity and better management of cash flows, the group has concluded overdraft agreements with banks. As at end of the year, the group entities had concluded overdraft contracts with banks in the total amount of EEK 93,226 thousand. In addition to the overdraft facility, the Company has a current loan facility with the limit of EEK 78,233 thousand from AS Riverito.

In 2010, the group's liquidity was mostly impacted by the negative cash flows from financing activities in the amount of EEK 352,467 thousand, including dividends paid in the amount of EEK 194,700 thousand and repayment of borrowings in the amount of EEK 190,855 thousand. Also, the extension of payment / acceptance deadlines arising from the structural change of customers (higher share of the state and local governments) had an effect of EEK 238,058 thousand.

Management estimates that the group's capital structure – a high proportion of equity at 63.8% of the balance sheet total and a low proportion of interest bearing liabilities at 13.2% of the balance sheet total – ensures the Company's trustworthiness for creditors in the changing economic climate and significantly improves the feasibility of the extension of existing financial liabilities and raising of additional debt.

Financial assets/liabilities

| <i>in thousands of kroons</i> | Allocation by due date | | | Total | Carrying amount |
|--|------------------------|----------------|----------------|------------------|------------------|
| | 1-3 months | 4-12 months | 2-5 years | | |
| 31.12.2010 | | | | | |
| Assets | | | | | |
| Cash and overnight deposits (Note 14) | 154,211 | - | - | 154,211 | 154,211 |
| Term deposits (Notes 15, 21) | - | 41,475 | 4,994 | 46,469 | 46,469 |
| Trade receivables (Notes 16, 21) | 297,764 | 24,382 | 20,457 | 342,603 | 342,603 |
| Receivables recorded based on the stage of completion of construction contracts (Notes 16, 33) | 212,122 | - | - | 212,122 | 212,122 |
| Loans and interest (Notes 16, 17, 21) | - | 114,346 | 103,756 | 218,102 | 218,102 |
| Other short-term receivables (Note 16) | 894 | 2,079 | - | 2,973 | 2,973 |
| Total | 664,991 | 182,282 | 129,207 | 976,480 | 976,480 |
| Liabilities | | | | | |
| Trade payables (Notes 28, 30) | 207,787 | 32,570 | 13,223 | 253,580 | 253,580 |
| Due from customers of construction works (Notes 28, 33) | 60,649 | - | - | 60,649 | 60,649 |
| Loan and finance lease liabilities (Note 27)* | 16,483 | 179,947 | 206,294 | 402,724 | 402,724 |
| Other liabilities (Note 28) | 101,133 | 4,942 | - | 106,075 | 106,075 |
| Total | 386,052 | 217,459 | 219,517 | 823,028 | 823,028 |
| 31.12.2009 | | | | | |
| Assets | | | | | |
| Cash and overnight deposits (Note 14) | 135,018 | - | - | 135,018 | 135,018 |
| Term deposits (Notes 14, 15, 21) | 224,714 | 400,916 | 2,809 | 628,439 | 628,439 |
| Trade receivables (Notes 16, 21) | 358,791 | 26,318 | 7,874 | 392,983 | 392,983 |
| Due from customers of construction works (Notes 16, 33) | 102,144 | - | - | 102,144 | 102,144 |
| Loans and interest (Notes 16, 17, 21) | 523 | 109,875 | 21,785 | 132,183 | 132,183 |
| Other short-term receivables (Note 16) | 198 | 9,180 | - | 9,378 | 9,378 |
| Total | 821,388 | 546,289 | 32,468 | 1,400,145 | 1,400,145 |
| Liabilities | | | | | |
| Trade payables (Notes 28, 30) | 217,408 | 5,741 | 10,653 | 233,802 | 233,802 |
| Due from customers of construction works (Notes 28, 33) | 316,095 | - | - | 316,095 | 316,095 |
| Loan and finance lease liabilities (Note 27)* | 7,932 | 439,637 | 76,316 | 523,885 | 523,885 |
| Other liabilities (Note 28) | 103,947 | 1,432 | - | 105,379 | 105,379 |
| Total | 645,382 | 446,810 | 86,974 | 1,179,161 | 1,179,161 |

* The schedule of expected interest payments cannot be determined with reasonable accuracy. In line with the industry practice of property development, the loan obligations to acquire land plots have been assumed with open-end maturities.

The repayment of these loan obligations depends on the progress of related development projects and on the timing of cash flows generated from those projects after their completion. Consequently, management is of opinion that even its best estimate of the timing of expected interest payments would not be sufficiently accurate for the users of these financial statements and this information has not been disclosed.

Capital management

The Commercial Code of the Republic of Estonia specifies the following requirements for the share capital of the entities registered in Estonia:

- the minimum share capital of a public limited company shall be at least EEK 400 thousand;
- 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 thousand.

The size of share capital or its minimum and maximum limits are set out in the articles of association of a public limited company whereas the minimum share capital shall equal at least $\frac{1}{4}$ 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 85,000 – 340,000 thousand. As at 31.12.2010, the share capital of AS Merko Ehitus was EEK 177,000 thousand and the net assets were EEK 1,951,700 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 an economic cycle and hence it monitors that its equity to assets ratio should be at least 40% (31.12.2010: 63.8%, 31.12.2009: 60.5%) at any given time and interest bearing debt to assets ratio would not exceed 25% (31.12.2010: 13.2%, 31.12.2009: 14.9%). The overdraft contract with Nordea Bank Finland Plc Estonia branch sets a requirement that the share of the Company's consolidated equity of total assets would not fall below 35%.

Legal risk

Due to different interpretations 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 from the perspective of laws or contracts from a different position and dispute the legitimacy of the Company's activities.

As at 31.12.2010, a provision has been set up at the group in the amount of EEK 4,102 thousand for covering potential claims and legal costs (31.12.2009: EEK 14,492 thousand), (Note 29).

An overview of the key legal disputes of group entities as at 31.12.2010 is presented below.

At 8 November 2010, Lithuanian company UAB Olinda filed a claim with the Arbitration Court of Helsinki Chamber of Commerce and Industry against UAB Merko Statyba in the amount of LTL 17,300 thousand (EEK 78,396 thousand). UAB Olinda's losses were allegedly incurred in conjunction with the refusal of UAB Merko Statyba to launch work pursuant to the construction contract. UAB Merko Statyba is of opinion that the project submitted by the customer and the building permit were not in compliance with Lithuanian laws as well as the detailed plan of the registered immovable intended for the purpose of construction, and Merko Statyba was under the obligation to refuse performance of illegal construction activities. The Lithuanian Planning and Construction Inspectorate is also of opinion that the launch of construction activities on the property is illegal until the documentation of the construction project and building permit has been brought into compliance with Lithuanian legislation. At the request of the Inspectorate, Vilnius Administrative Court has also suspended the validity of the building permit. The session at the court of arbitration in the disputed matter will take place at 14-15 June 2011. The group's management is of the opinion that UAB Merko Statyba's refusal to launch construction activities on the grounds of an invalid building permit was justified and the claim will be dismissed.

At 31 December 2010, customer UAB Neringos Vanduo filed a claim against the Lithuanian branch of AS Merko Ehitus in the amount of LTL 2,000 thousand (EEK 9,063 thousand) related to the alleged improper fulfilment of the contract for services concerning Neringa wastewater treatment plant and effected the performance warranty issued by the bank to the customer in the amount of LTL 1,000 thousand (EEK 4,532 thousand). Merko Ehitus is of opinion that the goals laid down in the contract have been attained – the wastewater treatment plant has received authorisation for use, incl. permit by the Lithuanian Health Board in accordance with the contract for services and Lithuanian laws, the customer has no legal grounds to demand payment of contractual penalties and it intends to prove its right in court.

At 9 January 2011, a court case opened at Harju County Court which among other issues deals with the claim filed against AS Merko Ehitus in relation to the giving of bribe to the former Tallinn city official Ivo Parbus. The Prosecutor's Office has charged Merko Ehitus with the giving of the bribe – Estravel's gift coupon of EEK 25,000 and the book with the list price of EEK 410 titled "Eesti Talurahva Arhitektuur" (Estonian Vernacular Architecture) in order to accelerate the proceedings with the plans of three registered immovables located in Tallinn. The group's management is of opinion that the Company has not given a bribe and has conducted its activities in conformity with the laws of the Republic of Estonia. According to section 44 of the Penal Code, a court can, upon conviction, impose a pecuniary punishment from EEK 50 thousand to EEK 250 000 thousand. Pecuniary punishment may be imposed as supplementary punishment in addition to forced liquidation.

AS Solaris Keskus has not paid EEK 33,385 to the general contractors (AS Merko Ehitus ja AS Skanska EMV) for the work performed at Solaris recreational centre. AS Solaris Keskus delays with the payment of invoices, referring to the erroneous overpayment made to the builders in the amount of EEK 5,085 thousand and additional expenses incurred for the opening and subsequent use of the centre due to the alleged low quality of construction work performed. This lawsuit will be settled by the parties in court. The group's management is of opinion that the refusal of Solaris Keskus to pay the invoice is not justified.

Asset valuation

Despite the stabilisation of the economic environment in 2010, the effect of real estate market risk was still significant when evaluating the activities of the Company. In 2010, the group made significantly less write-downs of inventories and assets as due to the stabilisation of the economic environment, their net realisable value exceeded the costs incurred for their acquisition. The group incurred a loss in the amount of EEK 17,702 due to the write-down of the value of assets, including EEK 15,944 thousand due to the write-down of inventories (incl. registered immovables for resale of EEK 4,446 thousand, prepayment for registered immovable of EEK 7,727 thousand, construction in progress of EEK 3,891 thousand (incl. write-down of construction in progress of EEK 12,722 thousand and reversal of the write-down of construction in progress of EEK 8,831 thousand) and reversal of the write-down of finished goods of EEK 120 thousand) and a loss of EEK 1,758 thousand on the write-down of irrecoverable receivables.

In 2010, market risk arose primarily as a result of changes in input prices. Due to strong global demand, the construction sector inputs have appreciated, the prices of all materials and the rent of equipment have increased. Strong demand in the construction sectors of Central Europe and Scandinavia has created a real alternative for local workforce to sell their labour to foreign countries and has led to appreciation of labour costs. Appreciation of inputs and orientation of many subcontracting entities towards foreign markets has led to significant appreciation of construction services over the last 9 months. As compared to the bottom of the construction market in 2009, construction prices have increased by 20-25%. Great volatility of prices will complicate the budgeting of new projects and completion of construction of projects with the budgeted costs and will lead to additional risk when performing construction contracts with fixed prices and put price pressure on profitability of projects. This reason was of significant importance for the formation of weaker than expected results of the group in the 4th quarter.

Note 37. Supplementary disclosures on the parent

The financial information of the parent comprises separate primary statements of the parent (income statement, statement of financial position, 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 have been prepared using the same accounting methods and measurement bases as those used 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.

INCOME STATEMENT

| <i>in thousands of kroons</i> | 2010 | 2009 |
|--|----------------|----------------|
| Revenue | 1,468,193 | 1,941,232 |
| Cost of goods sold | (1,376,653) | (1,770,366) |
| Gross profit | 91,540 | 170,866 |
| Marketing expenses | (23,886) | (24,105) |
| General and administrative expenses | (53,044) | (64,997) |
| Other operating income | 45,234 | 34,157 |
| Other operating expenses | (3,897) | (9,117) |
| Operating profit | 55,947 | 106,804 |
| Finance income/costs | 2,961 | 15,911 |
| Finance income/costs from investments in subsidiaries | 281,497 | 176,760 |
| Finance income/costs from investments in associates and joint ventures | (3) | - |
| Net profit for the year | 340,402 | 299,475 |

STATEMENT OF FINANCIAL POSITION

| <i>in thousands of kroons</i> | 31.12.2010 | 31.12.2009 |
|--|-------------------|-------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | 38,754 | 176,152 |
| Short-term deposits | 23,475 | 400,916 |
| Trade and other receivables | 567,300 | 680,160 |
| Prepaid corporate income tax | 6,354 | 3,438 |
| Inventories | 205,093 | 202,844 |
| Non-current assets held for sale | 840 | 1,750 |
| Total current assets | 841,816 | 1,465,260 |
| Non-current assets | | |
| Investments in subsidiaries | 529,955 | 445,301 |
| Investments in associates and joint ventures | 4,040 | 4,020 |
| Other long-term financial assets | 864,409 | 357,391 |
| Property, plant and equipment | 18,096 | 24,620 |
| Intangible assets | 6,563 | 7,605 |
| Total non-current assets | 1,423,063 | 838,937 |
| TOTAL ASSETS | 2,264,879 | 2,304,197 |
| LIABILITIES | | |
| Current liabilities | | |
| Borrowings | 147,348 | 216,763 |
| Trade and other payables | 409,009 | 525,834 |
| Short-term provisions | 24,798 | 24,526 |
| Total current liabilities | 581,155 | 767,123 |
| Non-current liabilities | | |
| Other long-term trade payables | 9,237 | 8,289 |
| TOTAL LIABILITIES | 590,392 | 775,412 |
| EQUITY | | |
| Share capital | 177,000 | 177,000 |
| Statutory reserve capital | 17,700 | 17,700 |
| Retained earnings | 1,479,787 | 1,334,085 |
| TOTAL EQUITY | 1,674,487 | 1,528,785 |
| TOTAL LIABILITIES AND EQUITY | 2,264,879 | 2,304,197 |

STATEMENT OF CHANGES IN EQUITY

| Parent <i>in thousands of kroons</i> | Share capital | Statutory re- serve capital | Retained ear- nings | Total |
|---|---------------|--------------------------------|------------------------|------------------|
| Balance as at 31.12.2008 | 177,000 | 17,700 | 1,096,560 | 1,291,260 |
| Net profit for financial year | - | - | 299,475 | 299,475 |
| Dividends | - | - | (61,950) | (61,950) |
| Balance as at 31.12.2009 | 177,000 | 17,700 | 1,334,085 | 1,528,785 |
| Carrying amount of holdings under dominant or significant influence | | | | (449,321) |
| Value of holdings under dominant or significant influence under the equity method | | | | 1,047,417 |
| Adjusted unconsolidated equity 31.12.2009 | | | | 2,126,881 |
| Net profit for financial year | - | - | 340,402 | 340,402 |
| Dividends | - | - | (194,700) | (194,700) |
| Balance as at 31.12.2010 | 177,000 | 17,700 | 1,479,787 | 1,479,787 |
| Carrying amount of holdings under dominant or significant influence | | | | (533,995) |
| Value of holdings under dominant or significant influence under the equity method | | | | 811,285 |
| Adjusted unconsolidated equity 31.12.2010 | | | | 1,951,777 |

Adjusted unconsolidated retained earnings represent the amount that is available for distribution to the shareholders according to the Estonian Accounting Act.

CASH FLOW STATEMENT

| <i>in thousands of kroons</i> | 2010 | 2009 |
|--|------------------|------------------|
| Cash flows from operating activities | | |
| Operating profit | 55,947 | 106,804 |
| Adjustments: | | |
| depreciation and impairment charge | 8,918 | 7,957 |
| profit/loss from sale of non-current assets | (15) | (26) |
| adjustment of revenue from construction contracts under stage of completion method | (240,366) | 73,172 |
| interest income from business activities | (43,641) | (33,927) |
| change in provisions | (7,757) | 8,426 |
| Change in trade and other receivables related to operating activities | (14,101) | (19,801) |
| Change in inventories | (2,249) | 34,035 |
| Change in trade and other payables related to operating activities | 51,170 | (60,172) |
| Interest paid | (4,324) | (16,659) |
| Corporate income tax reimbursed | 8 | - |
| Total cash flows from operating activities | (196,410) | 99,809 |
| Cash flows from investing activities | | |
| Investments in subsidiaries | (100,615) | (114,008) |
| Proceeds from sale and liquidation of subsidiaries | - | 1,125 |
| Merger with subsidiary | - | 72,950 |
| Acquisition of associates and joint ventures | (22) | - |
| Purchase of/ proceeds from short-term deposits with maturities greater than 3 months | 377,441 | (138,157) |
| Purchase of property, plant and equipment | (2,052) | (10,422) |
| Proceeds from sale of property, plant and equipment | 1,834 | 584 |
| Purchase of intangible assets | (209) | (886) |
| Loans granted | (398,063) | (176,750) |
| Loan repayments received | 102,752 | 87,364 |
| Interest received | 42,910 | 30,061 |
| Dividends received | 298,497 | 60,461 |
| Total cash flows from investing activities | 322,473 | (187,678) |
| Cash flows from financing activities | | |
| Proceeds from borrowings | 6,480 | 62,916 |
| Loan repayments received | (75,928) | (132,142) |
| Finance lease principal payments | (685) | (712) |
| Dividends paid | (194,700) | (61,950) |
| Total cash flows from financing activities | (264,833) | (131,888) |
| Net increase/decrease in cash and cash equivalents | (138,770) | (219,757) |
| Change in deposits with maturities greater than 3 months | (377,441) | 138,157 |
| Total change | (516,211) | (81,600) |
| Cash and cash equivalents in the beginning of period | 176,152 | 394,877 |
| Deposits with maturities greater than 3 months at the beginning of period | 400,916 | 262,759 |
| Total at the beginning of period | 577,068 | 657,636 |
| Effects of changes in foreign exchange rates | 1,372 | 1,032 |
| Cash and cash equivalents at end of the period | 38,754 | 176,152 |
| Deposits with maturities greater than 3 months at the end of period | 23,475 | 400,916 |
| Total at the end of period | 62,229 | 577,068 |

SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2010 ANNUAL REPORT

The Management Board of AS Merko Ehitus has prepared the management report, the consolidated financial statements and the profit allocation proposal for 2010.

| | | | |
|----------------|----------------------------------|--|------------|
| Tiit Roben | Chairman of the Management Board |  | 12.04.2011 |
| Alar Lagus | Member of the Management Board |  | 12.04.2011 |
| Veljo Viitmann | Member of the Management Board |  | 12.04.2011 |
| Andres Agukas | Member of the Management Board |  | 12.04.2011 |
| Jaan Mäe | Member of the Management Board |  | 12.04.2011 |
| Viktor Mõisja | Member of the Management Board |  | 12.04.2011 |

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.

| | | | |
|----------------|-----------------------------------|--|------------|
| Tõnu Toomik | Chairman of the Supervisory Board |  | 18.04.2011 |
| Indrek Neivelt | Member of the Supervisory Board |  | 18.04.2011 |
| Teet Roopalu | Member of the Supervisory Board |  | 18.04.2011 |
| Olari Taal | Member of the Supervisory Board |  | 18.04.2011 |



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, which comprise the consolidated statement of financial position as of 31 December 2010 and the consolidated statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

Management Board is responsible for the preparation, and true and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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 about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 true and fair presentation of the consolidated 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 consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of AS Merko Ehitus and its subsidiaries as of 31 December 2010, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers

Tiit Raimla
Auditor's Certificate No.287

Märten Padu
Auditor's Certificate No.513

15 April 2011

* 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 EUR

| | | |
|---|--------------------|----------------------------|
| Retained earnings | 111,992,184 | (EEK 1,752,296,911) |
| Net profit for 2010 | 1,229,186 | (EEK 19,232,573) |
| Total retained earnings as at 31.12.2010 | 113,221,370 | (EEK 1,771,529,484) |

The Management Board proposes profit allocation as follows:

| | | |
|--|--------------------|----------------------------|
| As dividend (0.10 EUR per share) | 1,770,000 | (EEK 27,694,482) |
| Retained earnings after distribution of dividends | 111,451,370 | (EEK 1,743,835,002) |

Tiit Roben Chairman of the Management Board



12.04.2011

Alar Lagus Member of the Management Board



12.04.2011

Veljo Viitmann Member of the Management Board



12.04.2011

Andres Agukas Member of the Management Board



12.04.2011

Jaan Mäe Member of the Management Board



12.04.2011

Viktor Mõisja Member of the Management Board



12.04.2011

CONTACT DATA OF ANALYSTS FOR MERKO EHITUS GROUP

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REVENUE BREAK-DOWN OF THE PARENT PRESENTED ACCORDING TO THE ESTONIAN CLASSIFICATIONS OF ECONOMIC ACTIVITIES

Revenue break-down of the standalone parent of the group AS Merko Ehitus is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), as required under the Commercial Code § 4 p.6:

| EMTAK code | | <i>in thousands of kroons</i> | |
|---------------|---|-------------------------------|------------------|
| | | 2010 | 2009 |
| | Rendering of construction services | | |
| 4120 | construction of residential and non-residential buildings | 526,549 | 1,022,873 |
| 4110 | development of building projects | 111,623 | 64,173 |
| 4211 | construction of roads and railways | 420,191 | 408,564 |
| 4221 | construction of utility projects for fluids | 220,965 | 221,260 |
| 4222 | construction of utility projects for electricity and telecommunications | 65,513 | 90,734 |
| 4291 | construction of water projects | 47,878 | 32,980 |
| 4213 | construction of bridges and tunnels | 2,717 | 54,472 |
| 4299 | construction of other civil engineering projects n.e.c. | 63,132 | 37,138 |
| | Total rendering of construction services | 1,458,568 | 1,932,194 |
| | | | |
| | Real estate activities | | |
| 6810 | sales of own real estate | 9,400 | 8,500 |
| 6820 | renting and operating of own or leased real estate | 225 | 538 |
| | Total real estate activities | 9,625 | 9,038 |
| | | | |
| | Total revenue | 1,468,193 | 1,941,232 |



