Consolidated Annual Report of AS Eesti Telekom 2006

In thousands of Estonian kroons

Beginning of the financial year	1 January 2006
End of the financial year	31 December 2006
Name of the company	**AS Eesti Telekom**
Registration number	10234957
Address	Roosikrantsi 2, 10119 Tallinn Estonia
Telephone	+ 372 631 12 12
Facsimile	+ 372 631 12 24
E-mail	mailbox@telekom.ee
Web-page	www.telekom.ee
Field of activity	Primarily, the provision of telecommunications and IT services to private and business clients, as well as other telecommunications operators, in the Estonian domestic market. The operation of a mobile and fixed-line communications network.
Auditor	AS PricewaterhouseCoopers

CONTENTS

MANAGEMENT REPORT

In Estonia, 2006 was a year for rapid economic development. This provided good growth opportunities for the telecommunications sector, but also generated increased competition and new possibilities for development.

Economic environment
The economic growth that gained momentum in 2005 accelerated even further in 2006. The increase in Estonia's GDP reached 11% in the past year. With this result, Estonia together with its neighbors Latvia and Lithuania clearly form the three top economic performers in the European Union.

Domestic demand has been the principal motor for economic growth. Estonia's accession to the European Union has generated an extensive inflow of money through structural funds, which has supported investments into agricultural infrastructure, the social sphere, and much more. Membership in the EU and close ties to Nordic banking have kept interest rates low and enlivened the use of loans by entrepreneurs and private individuals. Tough competition on the job market has generated comprehensive salary increases—compared to 2005, average wages increased by more than 15%.

In 2006, the excellent economic environment also supported the development of the telecommunications sector. Thanks to larger incomes, the consumption of communications services increased. Using beneficial financing opportunities, both private individuals and companies have traded in their telephones, computing technology, and other telecommunications equipment for something newer and more up-to-date. Construction activity, which has been increasing for seven years, has provided abundant orders for equipping new homes, offices, and production facilities with communications solutions.

The majority of economic analysts believe that Estonia achieved the apex of its economic growth in 2006. Stabilization at a more sustainable 7-8% is projected for the Estonian economy.

Telecommunications market
Since telecommunications companies primarily provide services, their activities are largely limited to the domestic market. For Estonian companies, the domestic market means 1.3 million residents and about 40 thousand companies. The deficit of fixed-line telephones that prevailed during the period that Estonia was part of the Soviet Union is ancient history. The number of mobile telephones has exceeded the number of residents. The wish to keep developing and to increase turnover and profits forces telecommunications companies to search for new fields of activity.

In 2006, one of the keywords in Estonian telecommunications was **data communications.** The Estonian population has been quick to adopt new telecommunications innovations—the majority of Estonians prefer Internet banking to visiting the local bank branch; during the past few years, the e-tax office, the e-school, and e-commerce has significantly improved; and the e-government has also garnered a great deal of attention in the world. Thus, the Internet is a natural part of Estonians' well-being. For several years, the number of permanent connections added every year has been measured in the tens of thousands, while the availability of quality permanent connections has primarily been the privilege of residents in cities and larger towns. However, in 2006, several steps were taken by the state, to guarantee access to permanent connections for every home or office. In 2005-2006, within the framework of the *Külatee 3* project, state procurements were organized in order to provide access to permanent connections for 90% of all the counties. The Communications Board organized a competition for creating a communications network based on broadband technology to cover the entire territory of Estonia. As a result, the construction of a network based on numerous technologies was started that should bring permanent Internet connections to every solitary farm in the woods during the next few years.

The e-world is becoming increasingly popular and an ever-increasing number of people wish to be connected, regardless of their location or the time of day. This, in turn, has accelerated the development of mobile data communications. In October 2005, AS EMT was the first in Estonia to put a 3G mobile communications network into commercial operation. In 2006, the possibilities of 3.5G were added to 3G. Third generation mobile communications can currently be used in the larger cities; all the largest settlements are covered by an EDGE network, and mobile data communications are possible throughout Estonia with GPRS.

The multitude of connection possibilities has made operators think about the **new services** they could provide to their customers, to entice them to choose their technology. Mobile operators introduced several new and interesting offers in 2006. Thus, the owners of 3G telephones could follow the Winter

Olympics and the Eurovision Song Competition on their mobile phone screens. In everyday life, it is possible to avoid traffic jams when driving to and from work, by accessing pictures from traffic cameras through your mobile phone.

The second keyword in 2006 was the rapid expansion of **digital TV.** The first offers for digital TV arrived in our market in 2005. In April 2006, Elion Enterprises introduced the DigiTV solution for the broader market. The success of DigiTV also inspired Elion's principal competitors to promote digital TV more actively, and by year's end, about 50,000 Estonian families had decided in favor of a better quality TV picture. By 2010, the service providers expect the majority of Estonia's households to be customers of digital TV.

In 2006, the third important development in the telecommunications market was the **development of the regulatory side**. On 1 January 2005, Estonia's new Electronic Communications Act came into force, and thereby, the common regulatory framework for European Union electronic communications networks and services was adopted. In 2006, the Communications Board issued the first declarations for undertakings with significant market power.

Eesti Telekom Group in 2006
The fact that in 2006 the Eesti Telekom Group kept pace with the advantageous economic environment and developments in the telecommunications sector is reflected in our financial results.

2006 saw record levels for the numbers of call minutes, mobile messages, and data volumes passing through the communications networks. Growth in the number of mobile customers and permanent connections continued. Despite falling rates, the revenues earned from customers remained stable. The growth of revenues from the private and business sector, as well as favorable financing conditions, swelled the group's retail sales results.

Last year, satisfaction can be gained from the following developments in the group's branches of operations:

- For years, a challenge for the Eesti Telekom Group has been to **find new growth opportunities** in the Estonian telecommunications market, with its limited volumes and decreasing rates. At the end of 2005, a powerful entry into the IT service market was made by acquiring AS MicroLink Eesti, Estonia's largest IT company. 2006 saw MicroLink and Elion IT reorganized along with their provision of data communications services. Today, **IT services** have become the third most important branch of operations after mobile and standard communications solutions. At the same time, this is also the Group's great competitive advantage, since, compared to other telecommunications companies, we can provide our customers with a wider range of services.
- In order to strengthen competitiveness among private clients, during the past year, Elion expanded its range of services by adding ones that had to date only been provided by its competitors. Thus, Elion, which entered the television transmission market in 2005, has become the most successful provider of **digital TV.** At the same time, it is possible for Elion customers to use Elion's Estonian-language **VoIP solution.**
- Increased competition in the telecommunications market had made customer segmentation, along with the development of solutions and approaches for each customer group, topical for many years. I consider one of the achievements in this field in 2006 to be EMT's purchase of a majority shareholding in the company that administers Rate.ee, Estonia's most popular social communications portal. Also important is the introduction of products that integrate the potential of the web and mobile communications, thereby enabling rapid growth of market share in the **youth segment.**

Financial results

Profit

In 2006, the **Eesti Telekom Group consolidated sales revenues** reached 5,768 million EEK, increasing by 12% compared to 2005 (2005: 5,159 million EEK).

Almost 40% of the increase in external turnover came from mobile communications. In 2006, the sales revenues for the **EMT Group**, the group active in the mobile communications field, were 3,502 million EEK, increasing 14% compared to 2005. The revenues for the EMT Group principal activities outside the Eesti Telekom Group increased by 10% and the revenues of the Group's companies dealing with trading increased 15%.

During the past year, the increase in the revenues for the principal activity in the mobile field was related primarily to an increase in the number of call minutes. The number of call minutes initiated from the EMT network increased in 2006 by approximately 20% compared to 2005. The larger number of call minutes was caused by an increase in the number of users for call services, as well as more active use of the service on average by each customer.

As of 31 December 2006, AS EMT had 759 thousand active SIM-cards, which is 82 thousand more than at the end of 2005 (31 December 2005: 677 thousand). The company also maintained its 47% market share in 2006.

The number of AS EMT contractual customers remained stable throughout 2006. If the year started with 406 thousand active SIM-cards, then during the year, the number of cards increased by 27 thousand and 2006 ended with 433 thousand contractual SIM-cards.

The pre-paid card market was passive at the beginning of 2006, and the first six months ended with a decrease in the number of active SIM-cards. However, in the second half of the summer, the trend reversed and the number of pre-paid cards started to increase. During 2006 as a whole, the number of pre-paid cards increased by 55 thousand, reaching 326 thousand as of 31 December 2006 (31 December 2005: 271 thousand). The principal portion of the increase in the number of pre-paid cards can be ascribed to the newcomer, Ratemobiil. On 5 April 2006, AS EMT acquired 51% of the shares of Serenda Invest OÜ. The Rate trademark belongs to Serenda Invest OÜ and it administers the popular youth Internet communications environment of the same name—Rate.ee. In the summer of 2006, AS EMT introduced a mobile package, Ratemobiil, especially designed to appeal to Rate.ee user, which by the end of the year had attracted 35,000 users. The rapid growth in the number of pre-paid cards in the second half of the year has increased their proportion in the total number of active EMT cards. If at the end of 2005, pre-paid cards constituted 40% of the total number of cards, then by the end of 2006, their relative importance had increased to 43%.

In addition to the increase in the client base, the number of call minutes used per customer also increased, and in 2006, more than 5% more minutes per customer were initiated from the EMT network than in 2005. The increase of the customer base, along with the greater number of call minutes, also compensated the decline in the minute rates that continued in 2006, and the revenues earned from call services increased by 7% compared to 2005 (including the fees for packages that allow for a certain number of call minutes for a monthly fee).

The number of call minutes terminated in the EMT network increased at approximately the same rate as the call minutes initiated in the AS EMT network. In 2006, the Communications Board declared all the companies operating mobile networks as undertakings with significant power in the voice communications termination market of their mobile phone network, and, among other things, demanded they decrease the termination fees from 2.50 EEK per minute to 2.05 EEK per minute as of 1 July 2006. However, since Elisa Mobiilsideteenused AS and Tele2 Eesti AS have challenged the decision of the Communications Board, the termination fees of all the mobile networks remained unchanged at 2.50 EEK per minute throughout 2006, and the increase in the number of terminated call minutes in the EMT network was accompanied by a similarly paced increase in the revenues earned from connection fees.

In addition to call services, the volume of other mobile services increased rapidly in 2006. The number of SMS messages increased by almost 60%. The number of MMS messages increased by more than 30%. One of the factors fostering the use of these services was definitely Ratemobiil, since young people are the most active users of message services. Since, in 2006, the users of many packages, including Ratemobiil, were able to send free messages within the framework of various campaigns, the increase in revenues earned from messages grew at a slower rate than the number of messages, but still reached 13%.

In 2006, the number of mobile data communications users increased by almost 10%. At the end of December, AS EMT had 110,000 users of mobile data communications (31 December 2005: 103 000). Since mobile data communications activity also increased, the increase in the revenues earned from this field of activity grew significantly faster than the increase in the number of customers.

In 2006, AS EMT earned average revenues of 332 EEK per customer per month, which is 1.4% less than in 2005 (2005: 337 EEK).

The contribution of fixed communications to the turnover of the Telekom Group in 2006 was almost equal to mobile communications. In this connection, both the revenues earned from IT services, a new field of activity, and traditional telecommunications services increased. In 2006, the turnover of the **Elion Group,** the Eesti Telekom Group subsidiary operating in the fixed communications field increased by 13% reaching 2,930 million EEK (2005: 2,585 million EEK). The revenues of the Elion Group outside the Eesti Telekom Group increased by 12% and the revenues earned from retail sales by 25%.

Of the Elion Group's principal fields of activity, the fastest growth was demonstrated by revenues from the monthly fees for integrated solutions. Compared to 2005, the revenues from the given category have increased by almost 70%. The reason for the growth is the great popularity of integrated solution among the customers. While Elion had offered double solutions (Internet and fixed-line telephone connections) to its customers starting in 2004, then in April 2006, a triple solution was introduced, which, in addition to Internet with a downloading speed of up to 12 Mb per second and voice communications, also offers the provision of quality digital TV reception through a permanent connection network. While initially the service was only available in Tallinn and its immediate vicinity, then by the end of the year, the coverage area had expanded to all Estonian cities and about 100 larger settlements. In addition to the basic package offered for the triple solution monthly fee, as of June 2006, customers can order theme packages for an extra fee. At the digiExpo in Tallinn in November, remote video rental, which enables users to order films and programs directly from the TV screen, was first demonstrated to the fair visitors. In February 2007, the first HD TV channel in Estonia and the Baltic States, Voom HD, should reach the viewers of DigiTV. Supported by all these interesting offers, the number of Elion DigiTV customers increased more than 30 times in 2006, reaching 28,400 by the end of the year (31 December 2005: 918).

Regrettably the increase of revenues from integrated solutions has partially been achieved at the expense of separate communications services. Thus, the number of Elion permanent Internet connections also increased at a record pace, reaching 141,700 by the end of the year (31 December 2005: 108 000). The increase in permanent Internet connections has been helped on the one hand by the development of the market as a whole. Elion has actively participated in *Külatee 3,* the government's targeted project for introducing the Internet to rural areas, the goal of which is to improve the availability of permanent Internet connections in sparsely populated rural areas. As a result of the program, the Internet should become as available in rural areas as it is in densely populated areas. Within the framework of the project, Elion has completed the internetization of the first counties. In September 2006, Elion started to offer wireless Internet in Harju and Lääne counties. By the end of the year, the construction of a WiMAX network was completed in Rapla County, Elva, and West-Viru County and work continued in Tartu County. At the same time, the consolidation of Estonia's permanent connections market continued. Thus, in the last quarter of 2006, Elion acquired Norby Telecom's private client service business. Elion's market share of the permanent connection market for private clients increased to almost 56%. Since during the past year, Elion invested primarily in the provision of integrated solutions, then the revenues earned from permanent Internet connection decreased by 15% compared to 2005. In addition to the popularity of integrated solutions, the decrease in revenues is caused by an increase in the proportion of *Kortermaja* Internet customers, who thereby pay a lower monthly fee.

After several years during which the number of Elion call interfaces[1] decreased, the number increased slightly in 2006 reaching 463,900 by the end of the year (31 December 2005: 458,450). The decrease of call interfaces was halted thanks to the active efforts by the company to retain existing customers and find new ones. This included offering various customer segments different solutions that are suitable for their needs. Therefore, in 2006, campaigns for discount packages targeting price-sensitive clients were organized. New voice communications customers have been added along with the increase in the number of customers for integrated solutions, since telephone connections are a component of both the double and triple packages. The number of call interfaces has also been increased by the introduction of Elion's own VoIP service, Hotifon, in the second quarter of 2006. However, in 2006, the monthly fees earned from voice communications connections decreased by 14% compared to 2005, since the relative importance of packages with the lower monthly fees has increased.

Another important field of activity that showed an increase among Elion's principal fields of activity in 2006 was IT, the 2006 revenues for which exceed those for 2005 by almost 200%. The acquisition of the subsidiaries AS MicroLink and AS MicroLink Eesti by Elion Enterprises on 31 October 2005, and the consolidation of their revenues as of November 2005, also played an important role in the increase of IT revenues. If the effect of adding the new companies were deducted, the increase of revenues in 2006 would be 25%. At the beginning of 2006, IT and data communications at MicroLink and Elion were reorganized, in the course of which the provision of all IT services was concentrated in MicroLink Eesti and the field of data communications was concentrated in Elion Enterprises. The synergy that has developed from the cooperation of the two companies has helped the Elion Group strengthen its

[1] The users of VoIP services and active users of call services

position in the provision of telecommunications and IT services, primarily in the business client segment. The sale of permanent IT services to clients has increased over 35% and the sale of business projects, consultations, and projects by 13%.

In 2006, the Elion Group call revenues have decreased by 6% compared to 2005. The basic part of the decrease in revenues came at the expense of local calls, the revenues of which decreased 23% during the year. The decrease in the revenues from local calls is caused predominantly by making free call minutes available to the users of call and integrated solutions, by a decrease in minute volumes, and the more active use of various discounts by customers. The revenues earned from international calls decreased by 13% compared to 2005, and the revenues from calls made from fixed-line telephones to mobile communications networks by 7%. Other voice communications revenues, including connection fees and revenues earned from call transit, increased by 5% during the year.

Elion's market share for call minutes initiated in a fixed network was 83% in December 2006 (December 2005: 85%). The market share of local call minutes was 85% (December 2005: 86%), 65% for international call minutes (December 2005: 66%), 70% for minutes for calls made to mobile phones (December 2005: 72%), and 97% for called-in minutes (December 2005: 97%).

In 2006, revenues for the Eesti Telekom Group as a whole from the **retail and wholesale trading** of telecommunications and IT merchandise increased by almost 20% compared to 2005. The increase was caused by an expansion of the assortment being offered, as well as favorabe developments in the Estonian economy and an increase in the purchasing power of residents and companies.

The **operating expenses** of the Eesti Telekom Group have increased in 2006 by 20% reaching 3,621 million EEK (2005: 3,018 million EEK).

In 2006, the EMT Group operating expenses totaled 2,158 million EEK, growing 20% during the year (2005: 1,792 million EEK). The basic part, or almost 200 million EEK, of the additional operating expenses were related to principal activities. Operating expenses increased in connection with larger costs for connection services (resulting from a larger number of call minutes made to the networks of other operators) and increased roaming costs. A strong pressure on salaries in the Estonian economy generally also affected EMT, and the personnel costs increased by 12% compared to 2005. At the same time, the proportion of personnel costs in the total costs of EMT is relatively modest. Since the retail and wholesale trading of telecommunications and IT merchandise is a field of activity that has very low profitability compared to the principal fields of activity, then EMT Group's increase in trading revenues has been accompanies by an increase of comparable size in operating expenses.

In 2006, the operating expenses of the Elion Group were 2,100 million EEK, increasing 23% on the year (2005: 1,716 million EEK). The increase in the expenses for the Elion Group principal activities were influenced primarily by the consolidation of MicroLink and MicroLink Eesti. In 2006, the operating expenses of MicroLink and MicroLink Eesti throughout the year, but only during the last two months of 2005. The amount of MicroLink operating expenses subject to consolidation increased four-fold in 2006. The Elion Group personnel costs increased 12% compared to 2005. The relative importance of personnel costs among total operating expenses is greater for fixed communications than for the mobile field. The increase in the operating expenses of the Elion Group, as well as the EMT Group, has been significantly influenced by the increase in the turnover of the sales of merchandise and the greater costs for purchasing the necessary goods.

The Eesti Telekom Group EBITDA in 2006 was 2,195 million EEK (2005: 2,151 million EEK). The EBITDA of the EMT Group increased 5% compared to 2005, reaching 1,346 million EEK. Elion Group EBITDA decreased a bit, to 875 million EEK (2005: 882 million EEK). At the same time, the 2006 number for the Elion Group (and the Eesti Telekom Group consolidated number) also included a 43-million-kroon profit, which Elion Enterprises earned from the sale of real estate in the second quarter of 2006. The EBITDA margin during the year fell, reaching 38.1% in 2006 (2005: 41.7%). The margins decreased in both the mobile and fixed communication fields. The drop in the margin is primarily caused by the rapid growth of activities with lower margins (commerce, IT) and their relative importance in the Group's turnover.

The Eesti Telekom Group depreciation in 2006 was 548 million EEK (2005: 753 million EEK). The primary factor for the decrease in depreciation is the application of new depreciation rates. At the beginning of 2006, TeliaSonera introduced new uniform useful life spans for the fixed assets of its 100% subsidiaries. As the result of a thorough analysis, the companies in the Eesti Telekom Group also decided to introduce the depreciation periods suggested by TeliaSonera (with some adjustments based on local peculiarities) in Eesti Telekom, starting on 1 May 2006. However, adjustments in connection with the implementation of new periods were not made in the depreciation that has already been calculated. The remaining useful life spans of existing fixed assets will be adjusted. Another important factor influencing the decrease in depreciation is the modest investments made during the last few years.

If depreciation in 2006 has decreased extensively, then the operating profit of the Eesti Telekom Group increased by 18% compared to 2005 reaching 1,646 million EEK (2005: 1,398 million EEK). The (net) financial revenues earned by the Eesti Telekom Group in 2006 increased somewhat compared to 2005 reaching 41 million EEK (2005: 38 million EEK). In 2006, AS Eesti Telekom paid its shareholders a record-setting dividend. Due to the increase in the amount of the dividend, despite the decrease in the tax rate, the income tax due upon the payment of the dividend increased in 2006 to 373 million EEK (2005: 349 million EEK).

In 2006, the Eesti Telekom Group earned a net profit of 1,314 million EEK (2005: 1,088 million EEK). The revenue per share reached 9.49 EEK (2005: 7.88 EEK).

Investments
In 2006, the Eesti Telekom Group invested 771 million EEK into tangible and intangible fixed assets.

The investments of EMT Group reached 274 million EEK in the past year (2005: 191 million EEK). The significant increase of investments compared to 2005 results from relatively low investments in the base period as well as the rapid development of the mobile data communications network in 2006. During the last quarter of 2005, AS EMT was the first operator to put a third-generation mobile communications network into commercial operation in Estonia. In 2006, the coverage area of the 3G and EDGE networks expanded significantly. On 25 April 2006, EMT opened a 3.5G service in Tallinn, being the second operator in the Nordic countries and the first in Estonia that put a HSDPA into operation. By the end of 2006, 3G and 3.5G had also reached Tartu, Pärnu and Viljandi.

The Elion Group invested 496 million EEK in 2006 (2005: 415 million EEK). The increase in investment resulted primarily from increased consumer demand for new permanent connections and the demand presented by DigiTV on Internet connections. Almost a third of the investments in 2006 were related to the establishment and improvement of networks necessary for the provision of broad-based solutions for end consumers. An important field of investment in 2006 was also increasing the power of the basic network, to guarantee quality service to an increased number of customers and to reach the numerous new housing developments.

In order to keep pace with developments in the telecommunications sector, at the beginning of 2006, Elion put an IP-based multimedia service platform into operation, which will enable private and business clients to use new opportunities for IP-based voice communications, and in the future, also for new multimedia services.

In 2006, investments were also made into the expansion of the Eesti Telekom Group. At the beginning of 2006, Elion Enterprises increased its participation in AS MicroLink to 100%. In April, AS EMT acquired a 51% participation in Serenda Invest OÜ. Serenda Invest OÜ owns the trademark Rate and the company administers the Estonian Internet communications portal Rate.ee. Of Serenda Invest OÜ, 49% belongs to Rate Solutions OÜ, which is owned by Andrei Korobeinik, the creator of Rate.ee.

Rate.ee is Estonia's largest social network which unites 360 thousand registered users. AS EMT feels that Rate.ee provides new opportunities for offering telecommunications and multimedia services. The total value of the transaction is less than 40 million EEK (approximately 2.5 million euros).

Balance sheet and cash flows
As of 31 December 2006, the balance sheet total for the Eesti Telekom Group was 4,812 million EEK (31 December 2005: 4659 million EEK). The Group's fixed assets increased by 347 million EEK. The increase in fixed assets is based on greater investments by the Group's companies in the past year. During the year, the current assets decreased by 195 million EEK, while the cash and cash equivalents, as well as short-term investments, have decreased by 283 million EEK. The reason for the reduction in cash and short-term investments is a dividend payment that is 138 million EEK larger than last year, along with a large dividend income tax and growth of investments.

Eesti Telekom Group equity as of 31 December 2006 was 4,113 million EEK (31 December 2005: 4040 million EEK). On the one hand, the equity was reduced by a large dividend payment in 2005. However, on the other hand, equity was increased by a net profit that was 226 million EEK larger than 2005.

As of 31 December 2006, the Eesti Telekom Group had long-term liabilities totaling 8 million EEK (31 December 2005: 6 million EEK) and short-term liabilities totaling 654 million EEK (31 December 2005: 598 million EEK). As of the end of the year, provisions totaling 36 million EEK had been made. The Group's net debt at the end of 2006 was -1,383 million EEK and the ratio of net debt to equity was -34% (31 December 2005: -1,663 million EEK and -41%).

The 2006 Eesti Telekom Group cash flow from operations was 1,899 million EEK (2005: 2,006 million EEK). The Group's cash flow into investments in 2006 was 761 million EEK (2005: 776 million EEK). During the past year, the cash flow into the acquisition of tangible and intangible fixed assets increased to 770 million EEK (2005: 554 million EEK). Cash flow into investment activities in 2006 was 1,243 million EEK (2005: 1,131 million EEK), including the payment of a dividend of 1,242 million EEK (2005: 1,104 million EEK).

Management and personnel
The number of employees at Eesti Telekom Group as of 31 December was 2,312 (31 December 2005: 2186). The average number of employees during 2006 was 2,206.

As of 31 December 2006, the number of employees at EMT Group was 553 (31 December 2005: 507). The number of employees has increased in connection with the growth of the client base and expansion of the service portfolio.

The number of employees at Elion Group as of 31 December 2006 was 1,736 (31 December 2005: 1673). The number of employees has increased in connection with the growth of the client based for new business fields and the consolidation of the Internet market, in the course of which small providers of connection services have been acquired and their personnel has been transferred to Elion.

The total amount of the salaries paid in 2006 for Eesti Telekom Group employees was 484 million EEK (2005: 396 million EEK). The employees at EMT Group were paid 128 million EEK (2005: 114 million EEK). The Elion Group paid its employees 344 million EEK (2005: 274 million EEK).

As of 31 December 2006, there were 54 people in management and upper management in the Eesti Telekom Group (31 December 2005: 61 people). During 2006, the salaries calculated for management and upper management totaled 57.2 million EEK (2005: 40.3 million EEK)

Report on Corporate Governance

As of 1 January 2006, AS Eesti Telekom ("**Eesti Telekom**") follows the instructions of the Estonian Principles of Corporate Governance ("**PCG**"). This report describes the management of Eesti Telekom in 2006 and its conformity with PCG instructions. In 2006, Eesti Telekom believes it adhered to PCG instructions except in the cases noted in this report.

Eesti Telekom
Eesti Telekom is a public limited company registered in the Republic of Estonia, at Roosikrantsi 2, 10119 Tallinn, with the registry code of 10234957. The share capital of Eesti Telekom in 2006 was 1,379,545,280 EEK, which is divided into registered shares of a single type with a nominal value of 10 EEK. Eesti Telekom shares are listed on the main list of the Tallinn Stock Exchange (Baltic Main List), with the abbreviation ETLAT. The Eesti Telekom share register is maintained by the registrar of the Estonian Central Register of Securities. Eesti Telekom has approximately 3,000 shareholders. In addition, the global depositary receipts (GDR) of Eesti Telekom shares are listed on the Main Market of the London Stock Exchange, with the abbreviation EETD. Every Eesti Telekom GDR represents three Eesti Telekom shares.

General Meeting
The highest management body of Eesti Telekom is the shareholders' general meeting. General meetings can be regular or extraordinary. The authority of the general meeting is defined by the Estonian Commercial Code and the Eesti Telekom articles of association (the articles of association are available on the Eesti Telekom website at www.telekom.ee). Among other things, the authority of the general meeting includes amending the Eesti Telekom articles of association, approving the annual report, distributing the profits and electing the members of the Supervisory Board. Each Eesti Telekom share provides one vote at the general meeting and shareholders can participate in general meetings and vote at the meetings personally or through representatives. Usually, the general meeting has the authority to pass resolutions if more than half the votes represented by shares are present. Resolutions of the general meeting are passed if over half the votes represented at the general meeting vote in favor, except in certain cases (i.e. amending the articles of association, recalling members of the

Supervisory Board before the end of their term, increasing and reducing share capital, issuing convertible bonds, and the merger, division, reorganization, and termination of Eesti Telekom), in which case the resolution is passed if at least 2/3 of the votes represented at the general meeting vote in favor.

In 2006, the shareholders' regular general meeting took place on 18 May. The meeting approved the 2005 Annual Report and proposal for the distribution of profits, approved the conditions for the repurchase of Eesti Telekom shares, recalled the members of the Eesti Telekom Supervisory Board and elected new members, approved the procedure for the remuneration of Supervisory Board members, chose the Eesti Telekom auditor for the 2006 financial year, and approved the procedure for paying for auditing services. No extraordinary general meetings took place in 2006.

On 6 February 2007, an extraordinary shareholders' meeting took place based on the application of Eesti Telekom shareholder Baltic Tele AB, which recalled three members of the Eesti Telekom Supervisory Board. The recall of the Supervisory Board members was related to internal structural changes at TeliaSonera AB, the parent company of Baltic Tele AB, which caused changes in the work assignments of some of the TeliaSonera employees who were members of the Eesti Telekom Supervisory Board, thereby making the performance of their assignments as Supervisory Board members more difficult.

The Eesti Telekom Management Board announces the convening of a general meeting at least three weeks in advance in the case of a regular meeting and at least one week in advance in the case of an extraordinary meeting, by publishing the corresponding notice in at least one newspaper with national circulation in the Republic of Estonia. The notice regarding the 2006 regular general meeting was published in the *Postimees* on 20 April 2006 and through the Tallinn Stock Exchange information system on 19 April 2006. No questions were asked regarding the agenda presented in the given notice and no supplementary proposals were made.

Therefore, in respect to the 2006 Eesti Telekom general meeting, the PCG instructions were followed, except for the rule prescribed by PCG clause 1.3.2, which was partially observed. Pursuant to the given clause, the candidates for Supervisory Board member who have not previously been members of the issuer's Supervisory Board will participate in the general meeting. Heido Vitsur, a candidate for Supervisory Board member, did not participate in the 2006 regular general meeting for reasons not related to Eesti Telekom.

Supervisory Board

The Supervisory Board plans the activities of Eesti Telekom, elects the members of the Management Board, and executes supervision over the activities of the Management Board. In conformity with the Eesti Telekom articles of association, the Supervisory Board makes decisions regarding the companies activities in significant fields of activity and questions that are not under the sole authority of the general meeting according to the law or statutes and which are outside the framework of the company's everyday economic activities (i.e. approval of budgets and business plans, resolving organizational questions related to Eesti Telekom and its group, etc.).

Pursuant to the articles of association, the Eesti Telekom Supervisory Board comprises six to ten members who are elected by the general meeting for a maximum of one year. Until 18 May 2006, the Eesti Telekom Supervisory Board included the following people: Bengt Andersson, Erik Hallberg, Alo Kelder, Tarmo Porgand, Tomas Lenke, Mats Salomonsson, and Raivo Vare. As of 18 May 2006, the following people comprised the Eesti Telekom Supervisory Board: Bengt Andersson, Erik Hallberg, Heido Vitsur, Tarmo Porgand, Hans Tuvehjelm, Mats Salomonsson, and Aare Tark. The following people are associated with the Swedish company TeliaSonera AB that controls Eesti Telekom: Bengt Andersson, Erik Hallberg, Tomas Lenke, Mats Salomonsson, and Hans Tuvehjelm. Supervisory Board member Aare Tark has had business connections with Eesti Telekom through a company (provision of legal services) controlled by him. Therefore, it is not precluded that as of 18. May 2006, Eesti Telekom will not observe the practice prescribed by clause 3.2.2, according to which at least three members of a seven-member Supervisory Board must be independent. In this respect, Eesti Telekom refers to the regulations of the Tallinn Stock Exchange, according to which an acceptable minimum standard is the existence of two totally independent members on the Supervisory Board. The members of the Supervisory Board will elect a Chairman from among themselves. In 2006, Erik Hallberg acted as Chairman of the Supervisory Board.

At the extraordinary meeting of Eesti Telekom shareholders on 6 February Bengt Andersson, Erik Hallberg, and Hans Tuvehjelm were recalled and Terje Christoffersen, Jörgen Latte, and Anders Gylder were elected to replace them. At the Supervisory Board meeting held on the same day, the Supervisory Board elected Terje Christoffersen as the new chairman.

Remuneration for the work of the members of the Supervisory Board has be made according to the resolution of the 2006 regular shareholders' meeting. In 2006, the payment for the Chairman of the Supervisory Board was 20,000 EEK per month and 9,000 EEK for the members of the Supervisory Board, and the direct costs incurred by the members of the Supervisory Board related to the performance of their obligations were compensated. No other additional payments are made to the members of the Supervisory Board.

The work of the Eesti Telekom Supervisory Board (location, meetings, resolutions, and minutes of the Supervisory Board) is organized according to the Supervisory Board regulations approved by them. In 2006, the Supervisory Board held eight meetings. The Management Board presented regular reports to the Supervisory Board on the economic activities and financial status of the Eesti Telekom Group. The Supervisory Board was provided a summary of the topics discussed by the Auditing Committee and the Committee on Remuneration and Appointments, including the results of the audits conducted by the internal and external auditors. During 2006, the Supervisory Board approved the 2005 Annual Report, the 2005 results of the motivational system for Eesti Telekom Group top management, the Group's business plan for 2007-2008, as well as the 2007 Eesti Telekom Group and Eesti Telekom budgets and the motivational system for the top management for 2007.

Pursuant to the law and the articles of association, decisions regarding transactions between members of the Supervisory Board and Eesti Telekom are under the authority of the general meeting, and the members of the Supervisory Board may not compete with Eesti Telekom without the permission of the shareholders' general meeting. Until the compilation of this report, the members of the Supervisory Board have not notified the Eesti Telekom Management Board of any cases of conflict of interest in 2006.

Therefore, in 2006, PCG instructions were followed in the work of the Eesti Telekom Supervisory Board, except for the rule prescribed by PCG clause 3.2.2, which was not observed starting on 18 May 2006.

Management Board

The Management Board is the Eesti Telekom management body that deals with the management of everyday economic activities and the representation of Eesti Telekom. Each member of the Management Board may represent Eesti Telekom alone in all legal actions (in case of a two-member Management Board). For the achievement of Eesti Telekom's objectives, the Management Board analyzes the risks related to Eesti Telekom's activities and financial objects. With its own resolution, the Eesti Telekom Management Board has established rules regarding the maintenance of internal information, internal rules for accounting, etc. The Management Board must comply with the legitimate regulations of the Supervisory Board. In 2006, a constant exchange of information took place between the Management Board and Supervisory Board of Eesti Telekom, i.e. the Management Board submitted regular reviews on the economic activities and financial status of the Eesti Telekom Group to the Supervisory Board.

According to the Eesti Telekom articles of association, the Supervisory Board may elect two to five members to the Management Board. The members of the Management Board are elected for three years with the option of extending the term. The Supervisory Board appoints one Management Board members as the Chairman, who also acts as the company's Managing Director. In 2006, the members of the Eesti Telekom Management Board were Managing Director Jaan Männik and Financial Director Hille Võrk.

On 5 December 2006, the Supervisory Board of Eesti Telekom decided to appoint Valdo Kalm as the new Chairman of the Management Board. Valdo Kalm will take over the position of Eesti Telekom's Chairman from the current Chairman, Jaan Männik, after the regular Eesti Telekom shareholders' meeting, which is planned for 22 May 2007. The Eesti Telekom Supervisory Board also decided to appoint Valdo Kalm to be a member of the Eesti Telekom Management Board as of 1 January 2007. Until being named Chairman of the Management Board, he will serve as the Deputy Chairman of the Management Board.

The salaries and severance pay of the members of the Management Board, and the payment conditions are determined by the employment contracts concluded with the members of the Management Board. The bonus system for members of the Management Board is approved annually by a resolution of the Supervisory Board. Upon the achievement of the maximum level of the objectives for 2006, the members of the Management Board would receive a bonus equal to six months salary. The retiring Chairman of the Management Board also has a pension agreement with Eesti Telekom. In 2006, Eesti Telekom did not comply with PCG clause 2.2.7, which provides for disclosing the benefits and bonus system of each member of the Management Board on the website and in this report, as well as the presentation of the principles for the remuneration of the members of the Management Board at the general meeting. On 13 December 2005, the Eesti Telekom Supervisory Board decided that, at this time, the disclosure of such information is not in the interests of the Eesti Telekom Group and it would not provide an adequate overview of the motivational system for the Group's top management. Currently, there are no share option programs in the Eesti Telekom Group.

Pursuant to the law and the articles of association, transactions between members of the Management Board and Eesti Telekom must be approved by the Supervisory Board, and members of the Management Board may not compete with Eesti Telekom without the permission of the Supervisory Board. Until the compilation of this report, the members of the Management Board have not notified the Eesti Telekom Management Board of any cases of conflict of interest in 2006.

Therefore, in 2006, PCG instructions were followed in the work of the Eesti Telekom Management Board, except for the rule prescribed by PCG clause 2.2.7.

Control Functions

In addition to a reporting system and procedures for risk management, the Eesti Telekom Supervisory Board and Management Board have established various control functions.

Auditing Committee

The Auditing Committee helps the Supervisory Board to perform its supervisory function. Until 18 May 2006, the Committee members were Mats Salomonsson (Committee Chairman), Tomas Lenke, and Alo Kelder. The secretary was Hille Võrk. On 30 May 2006, Mats Salomonsson (Committee Chairman), Hans Tuvehjelm, and Tarmo Porgand were elected as members of the Committee, and Hille Võrk was appointed as secretary. During 2006, the Committee met five times.

External Auditors

According to the articles of association, the auditor(s) are chosen by the general meeting. In 2006, the Eesti Telekom auditor was Urmas Kaarlep from AS PricewaterhouseCoopers. AS PricewaterhouseCoopers audited all the companies in the Eesti Telekom Group and submitted the auditor's report to the general meeting. The auditors also informed the Auditing Committee and Management Boards of the Group's companies of their observations.

Internal Control

Since April 2002, the internal control service has been purchased from AS Deloitte & Touche Audit. The Audit Committee and Deloitte agree upon the extent of the internal control projects once a year. Deloitte reports on the completed work to the Audit Committee.

Committee on Remuneration and Appointments

The principle function of the Committee on Remuneration and Appointments is to harmonize the remuneration principles for the top management of the Eesti Telekom Group and to make proposals for the appointment of Supervisory Board members and their remuneration. The members of the Committee until 18 May 2006 were Erik Hallberg (Committee Chairman), Bengt Andersson, and Raivo Vare, and the secretary was Jaan Männik. As of 30 May 2006, the members of the Committee are Erik Hallberg (Committee Chairman), Bengt Andersson, and Aare Tark, and the secretary is Jaan Männik. During 2006, the Committee met four times.

Information Disclosure and Financial Reporting

The information required by the PCG instructions are available on the Eesti Telekom website www.telekom.ee, including the financial calendar, articles of association, financial reports, information on presentations and meeting with analysts, information on the members of the Supervisory Board and Management Board, the auditors, and other information. Therefore, in 2006, Eesti Telekom complied with the PCG instructions on information disclosure.

Eesti Telekom prepares its accounting reports in accordance with the international financial reporting standards applied in the European Union. In respect to the disclosure of financial reporting, Eesti Telekom proceeds from the provisions of the law and the regulations of the Tallinn Stock Exchange.

MANAGEMENT BOARD'S CONFIRMATION OF THE FINANCIAL STATEMENTS

The Management Board confirms the correctness and completeness of the consolidated financial statements of AS Eesti Telekom Group for the year 2006 as set out on pages 14 to 62.

The Management Board confirms that:

1 the accounting principles used in preparing the financial statements are in compliance with the International Financial Reporting Standards as adopted by the European Union;

2 the financial statements present a true and fair of the financial position, the results of operations and the cash flows of the Group;

3 Group companies are continuing their operations as a going concern.

Name	*Position*	*Signature*
Jaan Männik	*Chairman of the Board*	....
Valdo Kalm	*Member of the Board*	....
Hille Võrk	*Member of the Board*	....

Tallinn, 26 March 2007

In thousands of Estonian kroons

CONSOLIDATED INCOME STATEMENT

		Year ended 31 December	
	Notes	**2006**	**2005**
Net sales	2 (a, b), 3 (a)	5,767,734	5,159,372
Cost of sales	2 (a), 3 (b)	(3,260,113)	(2,958,335)
Gross profit		**2,507,621**	**2,201,037**
Sales, administrative, and research & development expenses	2 (a), 3 (b)	(908,854)	(811,992)
Other operating income	2 (a), 3 (d)	53,011	23,040
Other operating expenses	2 (a), 3 (d)	(5,405)	(14,234)
Operating profit		**1,646,373**	**1,397,851**
Finance income		42,768	40,820
Finance costs		(1,950)	(3,030)
Finance income, net	2 (a), 3 (f)	40,818	37,790
Share of profit/(loss) from associates	2 (a)	193	452
Profit before tax		**1,687,384**	**1,436,093**
Income tax on dividends	2 (a), 4	(373,377)	(348,515)
Net profit for the period		**1,314,007**	**1,087,578**
Attributable to:			
Equity holders of the Company	2 (a)	1,309,443	1,087,416
Minority interest	2 (a)	4,564	162
		1,314,007	**1,087,578**
Earnings per share for profit attributable to the equity holders of the Company during the year	17 (e)		
Basic earnings per share (in EEK)		9.49	7.88
Diluted earnings per share (in EEK)		9.49	7.88

The notes presented on pages 19 to 62 form an integral part of the consolidated financial statements.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
~~Initsiaalid/initials~~ M. M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

CONSOLIDATED BALANCE SHEET

	Notes	As at 31 December 2006	2005
ASSETS			
Non-current assets			
Property, plant and equipment	5	2,044,595	1,833,916
Intangible assets	7	214,046	166,688
Investments in associates	10	17,247	2,951
Other non-current receivables	11, 12	119,139	44,194
Total non-current assets		**2,395,027**	**2,047,749**
Current assets			
Inventories	13	142,692	86,870
Trade and other receivables	14	884,212	836,945
Short-term investments	15	1,064,859	1,266,638
Cash and cash equivalents	16	324,405	405,548
Total		**2,416,168**	**2,596,001**
Assets classified as held-for-sale	5	771	15,749
Total current assets		**2,416,939**	**2,611,750**
TOTAL ASSETS		**4,811,966**	**4,659,499**
EQUITY AND LIABILITIES			
Capital and reserves attributable to equity holders of the Company	17		
Share capital		1,379,545	1,379,545
Share premium		356,018	356,018
Statutory legal reserve		137,955	137,955
Retained earnings		2,234,831	2,165,819
Total capital and reserves attributable to equity holders of the Company		**4,108,349**	**4,039,337**
Minority interest		5,030	1,160
Total capital and reserves		**4,113,379**	**4,040,497**
Non-current liabilities			
Interest bearing loans and borrowings	18 (a)	3,124	5,773
Retirement benefit obligations	20	7,912	6,926
Provisions	21	22,124	-
Non-interest bearing liabilities	22	5,152	-
Total non-current liabilities		**38,312**	**12,699**
Current liabilities			
Trade and other payables	23	651,365	594,444
Interest bearing loans and borrowings	18 (b)	2,742	3,173
Retirement benefit obligations	20	865	865
Provisions	21	5,303	7,821
Total current liabilities		**660,275**	**606,303**
Total liabilities		**698,587**	**619,002**
TOTAL EQUITY AND LIABILITIES		**4,811,966**	**4,659,499**

The notes presented on pages 19 to 62 form an integral part of the consolidated financial statements.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Notes	Attributable to equity holders of the Company					Minority interest	Total equity
		Share capital	Share premium	Statutory legal reserve	Retained earnings	Total		
1 January 2005		**1,379,545**	**356,018**	**137,645**	**2,182,349**	**4,055,557**	-	**4,055,557**
Amounts transferred to reserves	17 (b)	-	-	310	(310)	-	-	-
Dividends paid	17 (c)	-	-	-	(1,103,636)	(1,103,636)	-	(1,103,636)
Minority interest related to sold subsidiary		-	-	-	-	-	998	998
Total changes		-	-	*310*	*(1,103,946)*	*(1,103,636)*	*998*	*(1,102,638)*
Net profit for the period		-	-	-	1,087,416	1,087,416	162	1,087,578
31 December 2005		**1,379,545**	**356,018**	**137,955**	**2,165,819**	**4,039,337**	**1,160**	**4,040,497**
1 January 2006		**1,379,545**	**356,018**	**137,955**	**2,165,819**	**4,039,337**	**1,160**	**4,040,497**
Dividends paid	17 (c)	-	-	-	(1,241,591)	(1,241,591)	-	(1,241,591)
Minority interest arising on business combinations		-	-	-	1,160	1,160	(694)	466
Total changes		-	-	-	*(1 240,431)*	*(1,240,431)*	*(694)*	*(1,241,125)*
Net profit for the period		-	-	-	1,309,443	1,309,443	4,564	1,314,007
31 December 2006		**1,379,545**	**356,018**	**137,955**	**2,234,831**	**4,108,349**	**5,030**	**4,113,379**

The notes presented on pages 19 to 62 form an integral part of the consolidated financial statements.

In thousands of Estonian kroons

CONSOLIDATED CASH FLOW STATEMENT

	Notes	Year ended 31 December 2006	2005
Net cash from operating activities	27	**1,898,514**	**2,005,936**
Cash flows from investing activities			
Tangible and intangible fixed assets acquired	5, 7	(749,876)	(553,924)
Proceeds from sale of tangible and intangible fixed assets		49,599	17,563
Acquisition of business net of cash acquired and settlements of deferred consideration		(97,591)	(294,052)
Proceeds from sales of subsidiaries		-	217,475
Acquisition of associates	10	(14,100)	-
Proceeds from sales of associates		-	16,305
Net cash changes of short-term investments	15	177,785	(87,660)
Net cash changes of other long-term receivables		(130,548)	(92,162)
Repayments of loans granted to associates		4,100	-
Net cash used in investing activities		**(760,631)**	**(776,455)**
Cash flow before financing activities		**1,137,883**	**1,229,481**
Cash flows from financing activities			
Dividends paid	18 (c)	(1,241,591)	(1,103,816)
Repayments of finance lease liabilities	6	(1,704)	(15,719)
Proceeds from non-convertible debts		-	2,073
Repayments of non-convertible debts		-	(4,602)
Repayments of long-term borrowings		-	(333)
Repayments of short-term borrowings		-	(8,901)
Net cash used in financing activities		**(1,243,295)**	**(1,131,298)**
Net change in cash and cash equivalents		**(105,412)**	**98,183**

Cash and cash equivalents at beginning of year	15, 16	**430,393**	**331,359**
Net change in cash and cash equivalents		(105,412)	98,183
Effect of foreign exchange rate changes		(576)	851
Cash and cash equivalents at end of year	15, 16	**324,405**	**430,393**

The notes presented on pages 19 to 62 form an integral part of the consolidated financial statements.

1. General information and summary of significant accounting policies

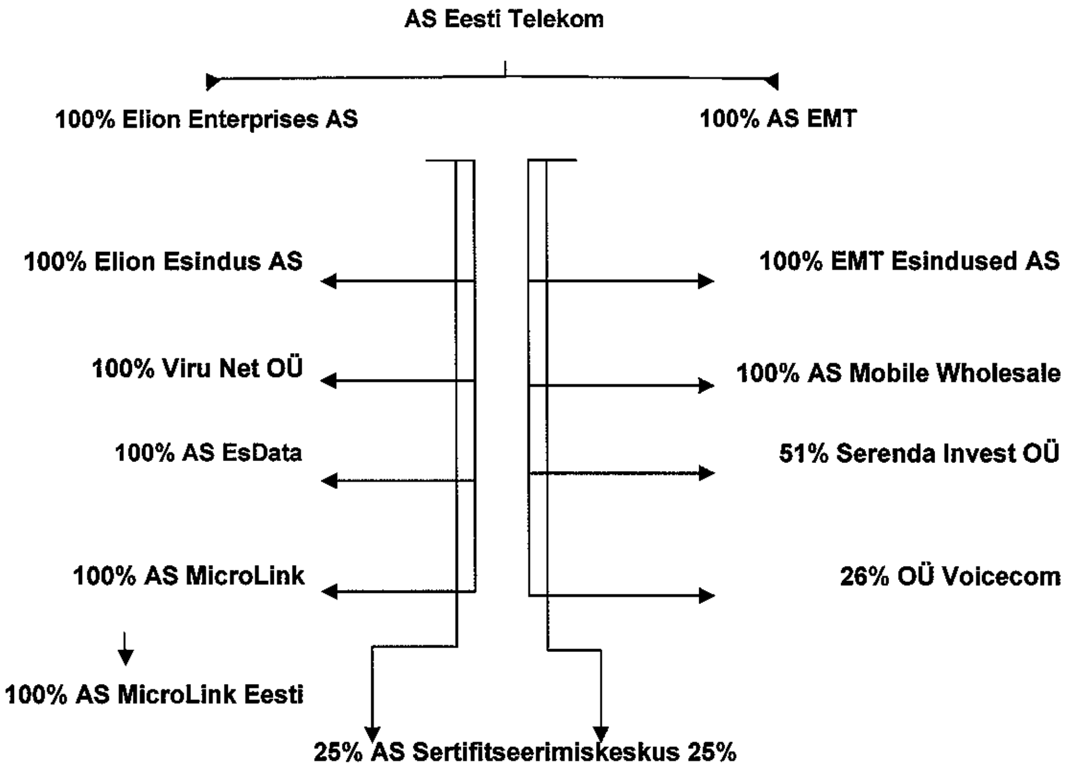
General information

The main activity of AS Eesti Telekom Group is providing services in the field of telecommunications.

AS Eesti Telekom (registration number: 10234957; address: Roosikrantsi 2, 10119 Tallinn, Estonia) is a holding company registered and operating in the Republic of Estonia, with subsidiaries providing services in the field of telecommunications. Starting in 1999, the shares of AS Eesti Telekom are listed on the Tallinn and London Stock Exchanges (OMX: ETLAT / LSE: EETD).

The majority owner of the AS Eesti Telekom is TeliaSonera AB, which is listed on the Stockholm Stock Exchange, through Baltic Tele AB.

The 2006 consolidated statements for the AS Eesti Telekom include the financial results for the following companies:



Summary of significant accounting polices

Significant accounting policies adopted in the preparation of the financial statements of AS Eesti Telekom (the parent company) and its subsidiary companies (together referred as "the Group") are set out below.

These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

The consolidated financial statements of the Eesti Telekom Group are prepared in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union.

The functional currency of AS Eesti Telekom is Estonian kroon (EEK). The financial statements are presented in thousand of Estonian kroons (EEK), unless indicated otherwise.

The financial statements are prepared on the historical cost convention except for certain financial instruments that are stated at their fair value.

These group consolidated financial statements were authorised for issue by the Management Board on 26 March 2007.

Changes in the manner of presenting information in 2006

In 2006, the format of the Group's income statement was changed. In the past, operating expenses were aggregated according to their nature. Starting from 2006, the operating expenses are aggregated based on their function in the company. The comparatives for 2005 were reclassified accordingly. The management believes that the presentation by function will provide reliable and more relevant information to the users of the financial statements on the cost of different functions and how economic benefits are created in the company. Certain reclassifications were also made in the balance sheet and in the cash flow statement.

Critical accounting estimates and judgements

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:.

a) Recognition of intangible assets in business combinations

The group allocates the cost of a business combination to separately identifiable assets, liabilities and contingent liabilities, including any intangible assets of the acquiree. Identification of separable intangible assets and determination of their fair value requires judgement. In the course of its recent acquisitions the group has recognised intangible assets in respect of certain trademarks and contractual customer relationships (see Notes 7 and 9). The fair values of those assets were assessed by external valuation experts.

b) Impairment of property, plant and equipment and intangible assets

The carrying values of the Group's intangible, tangible, and financial fixed assets are reassessed, at least annually and else whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable, by analyzing individual assets or classes of assets that essentially belong together. If an analysis indicates that the value recorded is too high, the asset's recoverable value is set, which is the higher of the fair value less cost to sell of the asset and its value in use. Value in use is measured as expected future discounted cash flows (DCF model). A write-down consists of the difference between carrying value and recoverable value.

A number of significant assumptions and estimates are involved in using DCF models to forecast operating cash flows, for example with respect to factors such as market growth rates, revenue volumes, market prices for telecommunications services, costs to maintain and develop communications networks and working capital requirements. Forecasts of future cash flows are based on the best estimates of future revenues and operating expenses using historical trends, general market conditions, industry trends and forecasts and other available information. These assumptions are subject to review by Management Board. The cash flow forecasts are adjusted by an appropriate discount rate derived from our cost of capital plus a reasonable risk premium at the date of evaluation. If the projections for future cash flows for any of Group have fixed assets change as a result of changes in business model or strategy, competitive pressures, or regulatory environment, The Group may have to recognize impairment charges on the intangible and tangible fixed assets.

c) Useful lives of telecommunication equipment and software

The Company's management determines the estimated useful lives and the related depreciation and amortisation charges for its' telecommunication equipment and software. The estimate is based on the projected technology and related software lifecycles. It could change significantly as a result of technical innovations and competitor actions in response to voice and data transmission. On the contrary, if no significant technological changes will occur, the equipment might be used longer than currently estimated.

Network assets form the largest part of the Group's tangible assets. If useful lives of network assets would be longer by 10%, depreciation costs of the Group would be down by 32.8 million EEK.

d) Provisions and contingent assets and liabilities

In estimating the probability of realisation of contingent assets and liabilities the management is considering the historical experience, general information about the economical and social environment and the assumptions and conditions of the possible events in the future based on the best knowledge of the situation.

Provisions for restructuring costs, environmental restoration, are recognized when: a legal or constructive obligation exists as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

Where there are a number of similar obligations, the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small but it is probable that some outflow of resources will be needed to settle the class of obligations as a whole.

e) Impairment provision for accounts receivable

Impairment provision for accounts receivable was determined based on the management's estimates on recoverability and timing relating to the amounts that will not be collectable according to the original terms of receivables. This determination requires significant judgement. Judgement is exercised based on significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments. Current estimates of the Company could change significantly as a result of change in situation in the market and the economy as a whole. Recoverability rate also highly depends on success rate and actions employed relating to recovery of significantly overdue amounts receivable.

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

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's and Company's operations:

- IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts
- IAS 19 (Amendment), Actuarial Gains and Losses, Group Plans and Disclosures;
- IAS 21 (Amendment), Net Investment in a Foreign Operation;
- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- IAS 39 (Amendment), The Fair Value Option;
- IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources; IFRS 6, Exploration for and Evaluation of Mineral Resources; IFRIC 4, Determining whether an Arrangement contains a Lease;
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

Standards, amendments to standards and interpretations have been issued but are not effective for 2006 and have not been early adopted

The following standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's and the Company's accounting periods beginning on or after 1 January 2007:

- IFRS 7, Financial Instruments: Disclosures, and the complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007). The Management is considering the impact on Group accounts;
- IFRS 8, Operating segments (effective from 1 January 2009). The Management is considering the impact on Group accounts;
- IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). IFRIC 7 is not relevant to the Group's operations;
- IFRIC 8, Scope of IFRS 2 (effective for annual periods beginning on or after 1 May 2006). IFRIC 8 is not relevant to the Group's operations;
- IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006). Management believes that this interpretation is not relevant the Group's operations;
- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). It is not expected that the interpretation will have significant impact to the Group's accounts;
- IFRIC 11, 'IFRS 2 - Company and treasury share transactions' (effective for annual periods beginning on or after 1 March 2007). Management does not expect the interpretation to be relevant for the Group's accounts; and
- IFRIC 12, 'Service Concession Arrangements' (effective for annual periods beginning on or after 1 January 2008). Management do not expect the interpretation to be relevant to the Group.

IFRIC 10, 11, 12 and IFRS 8 have not been yet endorsed by EU.

Principles of consolidation

a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Control is presumed to exist where more than one half of the subsidiary's voting power is controlled by the parent company, or the parent company is able to govern the financial and operation policies of the subsidiary, or control the removal or appointment of a majority of the subsidiary's supervisory council.

The consolidated financial statements include all subsidiaries that are controlled by the parent company. Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. 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.

Group companies use in all material aspects the same accounting principles. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group. In case the accounting principles are changed, the comparative data from previous periods is also changed retrospectively.

The information of the Group's subsidiaries is disclosed in Note 8.

b) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss (see Note 2.6).

In thousands of Estonian kroons

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

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

The information of the Group's associates is disclosed in Note 10.

c) *Transactions and minority interests*

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

Foreign currency

Transactions in foreign currencies are recorded using the rate of exchange quoted by the Bank of Estonia on the transaction date. On the balance sheet date, monetary assets and liabilities denominated in foreign currencies are recorded at the rate of exchange quoted by the Bank of Estonia on that date. Respective exchange differences are recognised in the income statement for the year.

The exchange rates used in the financial statements were the following:

Currency	Exchange rate in 2006		Exchange rate in 2005	
	As of 31 December	**Average**	**As of 31 December**	**Average**
EUR	15.64660	15.64660	15.64660	15.64660
USD	11.88180	12.46499	13.22060	12.58756
SEK	1.72897	1.690088	1.66071	1.68612
LTL	4.53157	4.53157	4.53157	4.53157
LVL	22.43340	22.47352	22.47260	22.47419

Property, plant and equipment

Property, plant and equipment is carried at its cost less any accumulated depreciation and any accumulated impairment loss. Historical cost includes expenditure that is directly attributable to the acquisition of the items (including the custom duties and other non refundable taxes). Cost includes direct and indirect costs related to acquisition of property, plant and equipment necessary to bring them to their present state and condition, as well as estimates of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item. The cost of self-constructed fixed assets includes the cost of materials and direct labour.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

If the fixed asset object consists of components, which have significantly different useful lives, the components will be recorded as independent fixed asset objects, with separate depreciation rates assigned according to their useful life. Groups of fixed assets with similar estimated useful lives will be recorded as aggregates.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the assets are presented at their estimated recoverable value. Recoverable value is equivalent to the higher of a particular asset's fair value less costs to sell, or value in use. The anticipated future discounted cash flows are used as the basis for determining value in use (see also part of accounting polices "Impairment of non-financial assets"). Impairment losses in fixed assets are expressed as an increase in accumulated depreciation and are recognised as an expense in the income statement. A recovery in value in use is recognised as a reversal of impairment loss.

In thousands of Estonian kroons

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Depreciation rates are set separately to each asset depending on its estimated useful life. Depreciation of an asset is started when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that asset is classified as held for sale (or included in a disposal group that is classified as held for sale) and the date the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from the active use unless the asset is fully depreciated.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is higher than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the income statement.

At the beginning of 2006, TeliaSonera introduced new uniform useful life spans for the fixed assets of its 100% subsidiaries. As the result of a thorough analysis, the companies in the Eesti Telekom Group also decided to introduce the depreciation periods suggested by TeliaSonera (with some adjustments based on local peculiarities) in Eesti Telekom, starting on 1 May 2006. Implementation of new periods was applied prospectively. The remaining useful life spans of existing fixed assets will be adjusted.

The following depreciation rates are used by the Group:

	Until 1 May 2006	Since 1 May 2006
• Buildings	3-8% per annum	2-12% per annum
• Telecommunication network equipment	10-20% per annum	10-20% per annum
• Plant and equipment	15-40% per annum	3-20% per annum
• Furniture, fixtures and fittings	10-50% per annum	20-30% per annum
• Intangible assets (excl. goodwill)	20% per annum	Individual

Land is not depreciated.

The impact of the implementation of new depreciation rates on depreciation of the period was decrease of approximately 114 million kroons.

Leases

Leases of plant and equipment under which the Group assumes substantially all risks and rewards of ownership are classified as finance leases.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases.

a) The Group as lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the net investment outstanding in respect of the leases.

Rental income from operating leases is recognised on a straight-line basis over the term of the lease, irrespectively from collection of relevant receivables.

Assets leased under operating lease are recorded on the balance sheet in conventional rules similarly to that for other Group's assets.

b) The Group as lessee

Assets held under finance leases are recognised as assets of the Group at their fair value at the date of acquisition or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recorded in income statement on accrual basis of accounting, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the group's general policy on borrowing costs.

Finance leased assets are depreciated in accordance with the depreciation policy described above, with the depreciation period being the estimated useful life of the asset.

Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Intangible assets

Goodwill represents the excess of the cost of acquisition over the fair value of the identifiable net assets acquired. Goodwill is recognised as an intangible asset in the Group's consolidated financial statements and it shall be not amortised. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed (see "Impairment of non-financial assets"). Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Other intangible assets: Licenses, patents, trademarks and client contracts are stated at the lower of the carrying or recoverable amount, and are amortised on the straight-line method over their estimated useful lives (individual for each asset object). Amortisation expenses are recorded in the income statement. Recoverable value is equivalent to the higher of a particular asset's sale price, from which sales costs have been deducted, or value in use. The anticipated discounted cash flows for the coming year are used as the basis for determining value in use (see also part of accounting polices "Impairment of non-financial assets").
Amortisation of the third generation mobile communications license acquired by AS EMT started in August 2003 and will continue for ten years.

Research and development expenditure

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when the following criteria are fulfilled:

(a) it is technically feasible to complete the intangible asset so that it will be available for use or sale;
(b) management intends to complete the intangible asset and use or sell it;
(c) there is an ability to use or sell the intangible asset;
(d) it can be demonstrated how the intangible asset will generate probable future economic benefits;
(e) adequate technical, financial and other resources to complete the development and to use or sell the intangible asset are available; and
(f) the expenditure attributable to the intangible asset during its development can be reliably measured.

Capitalised development costs are amortised over five years using the straight-line method.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its useful life, not exceeding five years.

Non-current assets held for sale

Non-current assets (or disposal groups) are classified as assets held for sale and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is recovered principally through a sale transaction rather than through a continuing use.

Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment.

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is 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 value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Impairment losses are recognised as period expenses.

Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

Inventories

Inventories for resale are recorded at cost, which comprises purchase price, non-refundable taxes as well as transportation and other costs directly attributable to the acquisition of inventories, less discounts.

Inventories are stated at the lower of acquisition cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale.

Cost is determined by the first-in, first-out method.

Financial assets and liabilities

Cash, shares and other securities, trade receivables, accrued income and other short and long-term receivables are considered to be financial assets. Trade payables, accrued expenses and other short and long-term payables are considered to be financial liabilities.

Financial assets and liabilities are initially measured at cost, which is the fair value of consideration given or received to acquire the financial asset or liability. All costs directly connected with the financial asset or obligations are included in the acquisition price.

Financial assets and liabilities are recognised on the balance sheet when the ownership title is transferred to the Group in accordance with the terms of the contract for the financial asset or liability.

a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

b) Held-to-maturity financial assets

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available for sale. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the balance sheet date, which are classified as current assets.

On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to income for the financial year.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

c) Trade Receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate.

Long-term receivables and long-term loans granted are recognised at their net present value, from which doubtful accounts are deducted. The difference between the nominal value and the net present value of the receivable until the due date is reported in the income statement by applying the internal interest rate upon return of the receivable.

Loans without interest or loans with an interest rate different to market rates are initially recognized at their net present value, applying the market interest rate, and the difference between the nominal value and the net present value of the receivable is amortized during the period remaining until the due date. The initial revaluation to the net present value and the subsequent amortisation of the receivable's nominal value and net present value is reported in the income statement.

d) Factoring of receivables

Factoring is the transfer of receivables. Depending on the terms of the factoring contract the entity either transfers substantially all the risks and rewards of the ownership of the receivable or retains certain risks and rewards.

If the entity retains the control over receivable or other risks associated to the receivable (for example factoring with recourse), the transaction is recorded as a financing transaction (a collateralized borrowing); the amount is retained in the balance sheet as a receivable until collection or until expiration of the recourse. The related liability is recorded similar to other borrowings.

If the entity transfers the control over the asset and substantially all respective risks and rewards at the moment of transferring receivables, the transaction is recorded as the sale of receivable. Related cost is recognized as financial expense or as a cost related to receivables, depending whether the aim of the transaction was to manage the cash flows or to manage the credit risk.

e) Liabilities

All financial liabilities (debts to suppliers, loans taken, accrued expenses, and other short-and long-term debt liabilities) are recorded at their acquisition cost, which includes all the direct expenses related to the acquisition. Subsequent recognition is executed by the adjusted acquisition cost method.

The adjusted acquisition cost of short-term financial liabilities is generally equal to their nominal value, and therefore, short-term financial liabilities are recognized on the balance sheet at the payable amount. In order to calculate the adjusted acquisition cost of long-term financial liabilities, they are initially recorded at the fair value of the received payment (from which transaction costs have been deducted), by calculating the interest cost on the obligations for the period using the internal interest rate method.

Borrowing costs are not capitalised but expensed in the period they occurred.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Liabilities that have arisen during the financial year or prior periods, which have a legal or contractual basis, which are expected to result in the outflow of resources, and which can be reliably measured, but for which the actual payment amount and payment date has not been definitely determined, are recorded as **provisions** on the balance sheet. Provisions are measured according to the Management Board's estimates and previous experience, and when necessary also the assessments of independent experts.

Provisions

Site restoration expense provision has been recognized to the extent a legal or constructive obligation to a third party exists, the acquisition cost includes estimated costs of dismantling and removing the asset and restoring the site. A change in estimated expenditures for dismantling, removal and restoration is added to and/or deducted from the carrying value of the related asset. To the extent that the change would result in a negative carrying amount, this effect is recognized as income. The change in depreciation charge is recognized prospectively.

The **retirement benefit provisions** are recognised based on the entity's obligation to provide the agreed benefits to certain current and former employees for a fixed period of time after their retirement. The company has no retirement benefit obligations except for those arsing from a small number of individual agreements concluded in the past. The retirement benefit provision is measured at the present value of the related obligation.

In thousands of Estonian kroons

Termination (redundancy) compensations are recognised as liabilities and as expenses when, and only when, the company has clearly and unequivocally expressed its intention to terminate the employment relationship in the ordinary manner, in accordance with an accord between employer and employee, or before the employee's legally stipulated retirement date. An enterprise is demonstrably committed to a termination only when the enterprise has a detailed formal plan for the termination, and has no other realistic option for solving the situation.

Contingent liabilities are disclosed in the Notes to the financial statements as contingent liabilities.

Taxation

a) Corporate income tax

According to current legislation, the profits of Estonian companies are not taxed, whereby deferred income tax claims or liabilities do not exist. In Estonia instead of profits, dividends paid from undistributed profits are taxed at a rate of 22/78 (until 31 December 2006, a tax rate of 23/77 was in force and until 31 December 2005, a tax rate of 24/76), on the net dividend paid out. The corporate tax resulting from the payment of dividends is recognized as an income tax expense in the same period as the dividends are declared regardless of for which period the dividends are declared or when they are actually paid out.

b) Other taxes

Other taxes, that are affected the Group's results, and tax rates in 2006 were the following:

• Social tax	- 33% of the paid payroll to the employees and of the fringe benefits;
• Unemployment tax	- 0,3% of the paid payroll to the employees;
• Income tax on fringe benefits	- 23/77 of the fringe benefits to the employees; (2005: 24/76)
• Income tax on expenses not related to business activities	- 23/77 of the expenses not related to business activities (2005: 24/76);
• Land tax	- 0,5-2% of the taxable value of the land per annum.

Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to the income statement on a straight line basis over the expected lives of the related assets.

Government grants for operating expenses are recognised in proportion with the related expenses. The expenses for compensating and the compensations are recorded separately.

Revenue recognition

Net sales are recorded at the sales value, adjusted for discounts granted and sales related taxes. Sales principally consist of traffic charges including interconnect and roaming, subscription fees, connection and installation fees, and service charges.

Revenue is recognized for the period in which the service is performed, base on actual traffic or over the contract term, as applicable, or when the product is delivered. Subscription fees are recognized as revenue over the subscription period.

Sales relating to public phone cards and prepaid mobile cards are deferred and recorded in revenue based on the actual usage of the cards. Rollover of unused minutes are deferred and recognized as revenues when the service is provided.

Connection fees are recognized at completion of connection, if the fees do not include any amount for subsequent servicing but only cover the connection costs.

When invoicing end-customers for third-party content services, revenue is reported on a net basis if the Group acts as an agent without assuming the risks and rewards of ownership of the services.

The services and products may be bundled into one customer offering. Offerings may involve the delivery or performance of multiple products or services (multiple deliverables). In some cases, the arrangements include initial installation, initiation, or activation services and involve consideration in the form of a fixed fee or a fixed fee coupled with a continuing payment stream. Telecom equipment is accounted for separately from service where a market for each deliverable exist and if title to the equipment passes to the end-customer. Costs associated with the equipment are recognized at the time of revenue recognized. Composite contracts are divided into part, if the separate parts correspond to the division criterion. The terms and conditions of the contract are allocated to the separate parts according to the proportion of the fair value with certain restrictions. The revenue is allocated to equipment and services in proportion to the fair value of the individual elements.

Customized equipment that can be used only in connection with services or products provided by the Group is not accounted for separately and revenue is deferred over the total service arrangement period. There are generally no options for the customer to acquire the equipment at the end of the service contract period (e. g. DigiTV). Revenue for such functionality agreements is recognized over the service period but part of the periodic fixed fee is deferred to meet the costs at the end of the contract period (maintenance and up-grades).

Revenue from interconnection is accrued at the end of each accounting period based on the actual traffic of incoming calls from different carriers. Accrued revenue is adjusted to actual after reconciliation with the carrier is performed.

In relation to the rendering of services, revenue is recognised when no significant uncertainties remain concerning the derivation of consideration or associated costs. Revenues from the sale of services are recognized after the service is provided, or if the service is provided for a longer period, then the percentage-of-completion method is used.

In relation to the sale of goods, revenue is recognised when the significant risks and rewards of ownership have been transferred to the buyer, and no significant uncertainties remain regarding the derivation of that consideration, associated costs, or the possible return of goods.

Interest and dividends are recognised when it is probable that the economic benefits associated with the transaction will flow to the Group and the revenue can be measured reliably. Interest income is recognised as it accrues, unless collectibility is in doubt. Dividend income is recognised when the shareholder's right to receive payment is established.

Cash and cash flows

For the purposes of the cash flow statement, cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

Subsequent events

Significant events that occurred during the preparation of the annual accounts and are related to transactions that took place during the financial year, and confirm the conditions that existed at the date of the financial statement, are considered in the valuation of assets and liabilities.

Significant events that occurred during the preparation of the annual accounts and are not considered in the valuation of assets and liabilities, but significantly influence the results of the next financial year, are disclosed in the notes to the annual accounts.

Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and return that are different from those of segments operating in other economic environments.

The report provides information about the Group's segments, and this information is organised by both business segments (the primary format for segment reporting) and geographic segments (the secondary format for segment reporting).

A business segment is a distinguishable component of the Group that is engaged in providing a group of related services or products and that is subject to risks and returns that are different from those of other business segments.

Geographic segment is a part of the Group that provides services in a specific economic environment whereof risks and profitability differ from its other parts that act in other different economic environments. The majority of the Group's revenues are generated in Estonia.

Two major segments, fixed network telecommunications and mobile telecommunications are distinguished as primary segments in the consolidated financial statements.

Segment expense is expense resulting from the operating activities and is directly attributable to the segment.

Segment gross profit is segment revenue less segment expense. Segment gross profit is determined before any adjustments for minority interest.

Segment assets are those operating assets that are operatively employed and that are directly attributable to the segment. Segment liabilities are those directly attributable to the segment.

Capital expenditure represents total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant and equipment, and intangible assets).

Statutory reserve

The statutory reserve in equity is a mandatory reserve, created in accordance with Estonian Commercial Code and it can only be used for covering losses or conversion to the share capital. At each year at least 1/20 of net profit should be recognised as statutory reserve until the statutory reserve comprises 1/10 of share capital. The distribution to shareholders from the statutory reserve is not permitted.

Earnings per share

Basic earning per share is calculated by dividing the profit of the year attributable to equity holders of the parent company by the weighted average number of ordinary shares outstanding during the year.

Diluted earning per share is calculated based on profit or loss attributable to the ordinary equity holders of the parent company, and the weighted average number of shares outstanding, adjusted for the effects of all dilutive potential ordinary shares. As the Group has not issued any potential ordinary shares, the diluted earnings per share equals to the basic earnings per share.

Supplementary disclosure on the parent entity of the Group

According to the Estonian Accounting Law the separate primary reports of parent company should be disclosed. The respective disclosure is in Note 32.

There are included parent company's balance sheet, income statement, statement of changes in equity and cash flows statement, which are presented as annex to the consolidated financial statements. These primary reports do not form a full set of parent company financial statements. The primary reports of parent company are prepared using the same accounting policies as in the preparation of consolidated financial statements.

According to the revised IAS 27 Consolidated and Separate Financial Statements, in the unconsolidated statements of the parent company, which are presented as an annex to the consolidated statement, the investments in subsidiary companies are recognized at the acquisition cost (less the necessary discounts).

2. Segment information

Two major segments, fixed network telecommunications and mobile telecommunications are distinguished in the consolidated financial statements.

Fixed network telecommunications – this segment operates the national telecommunications network, with providing fixed telecommunication services and related value-added services as well as providing production, marketing and sales of other related services. The companies belonging to this business segment are Elion Enterprises AS, AS Elion Esindus, AS EsData, Group Eesti MicroLink and Viru Net OÜ.

Mobile telecommunications – this segment operates mobile networks and systems, and deals with the producing, marketing and selling of services related thereto. The companies belonging to this business segment are AS EMT, EMT Esindused AS, AS Mobile Wholesale and Serenda Invest OÜ.

Segment turnover represent inter-company income and expenses of the three above-mentioned segments. The inter-company turnovers between the companies belonging to the same segment are eliminated in this report.

All assets of AS Eesti Telekom Group are located in Estonia.

NOTES TO THE FINANCIAL STATEMENTS
In thousands of Estonian kroons
(Translation of the Estonian original)

(a) Primary reporting format – business segments

	Fixed network telecommunications		Mobile telecommunications		Unallocated / Eliminations		Consolidated	
	2006	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Total segment revenue	2,929,821	2,585,454	3,502,152	3,080,456	-	-	6,431,973	5,665,910
Inter-segment net sales	(211,881)	(182,415)	(452,358)	(324,123)	-	-	(664,239)	(506,538)
External revenue	**2,717,940**	**2,403,039**	**3,049,794**	**2,756,333**	-	-	**5,767,734**	**5,159,372**
Operating profit/(loss)	571,189	494,960	1,101,698	921,470	(26,514)	(18,579)	1,646,373	1,397,851
Financial income					-	-	42,768	40,820
Financial costs							(1,950)	(3,030)
Finance income – net							40,818	37,790
Share of profit / (loss) of associates	59	1,084	134	(632)	-	-	193	452
Profit before tax							1,687,384	1,436,093
Income tax on dividends							(373,377)	(348,515)
Net profit for the period	-	-	-	-	-	-	**1,314,007**	**1,087,578**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

Other information by business segments

	Fixed network telecommunications		Mobile telecommunications		Unallocated / Eliminations		Consolidated	
	2006	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Assets (except investments in associates and goodwill)	2,532,512	2,228,407	1,939,985	1,858,785	232,540	513,940	4,705,037	4,601,132
Goodwill	50,834	55,416	38,848	-	-	-	89,682	55,416
Investments in associates	8,030	927	9,217	2,024	-	-	17,247	2,951
Total assets	**2,591,376**	**2,284,750**	**1,988,050**	**1,860,809**	**232,540**	**513,940**	**4,811,966**	**4,659,499**
Liabilities	642,825	396,991	423,881	308,044	(368,119)	(86,033)	698,587	619,002
CAPEX	496,457	414,911	274,309	190,657	12	116	770,778	605,684
Depreciation, amortization and write-downs	299,530	386,877	243,984	366,157	48	(293)	543,562	752,741
Impairment of goodwill	4,774	-	-	-	-	-	4,774	-

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M. M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

b) Secondary reporting format – geographic segments

The components of revenues by geographic segments are as follows:

	Fixed network telecommunications				Mobile telecommunications				Consolidated			
	2006		**2005**		**2006**		**2005**		**2006**		**2005**	
		%		%		%		%		%		%
European Economic Area (EEA)	2,676,037	98.46%	2,377,304	98.93%	3,036,191	99.55%	2,744,817	99.58%	5,712,228	99.04%	5,122,121	99.28%
Rest of Europe	26,342	0.97%	4,553	0.19%	10,072	0.33%	8,537	0.31%	36,414	0.63%	13,090	0.25%
North-America	15,561	0.57%	21,182	0.88%	1,814	0.06%	1,692	0.06%	17,375	0.30%	22,874	0.44%
Rest of world	-	-	-	-	1,717	0.06%	1,287	0.05%	1,717	0.03%	1,287	0.02%
Total,	**2,717,940**	**100.00%**	**2,403,039**	**100.00%**	**3,049,794**	**100.00%**	**2,756,333**	**100.00%**	**5,767,734**	**100.00%**	**5,159,372**	**100.00%**
of which												
Estonia	2,466,051	90.73%	2,249,214	93.60%	2,893,800	94.89%	2,601,627	94.39%	5,359,851	92.93%	4,850,841	94.02%
Outside Estonia	251,889	9.27%	153,825	6.40%	155,994	5.11%	154,706	5.61%	407,883	7.07%	308,531	5.98%

In thousands of Estonian kroons

3. Additional information on the income statement

	2006	2005
(a) Net sales		
Mobile communications	2,902,067	2,670,056
Fixed telephony	1,368,363	1,441,897
Service, installation and customer equipment	791,509	387,764
Internet	549,693	418,267
Data communications and network capacity	487,988	339,738
Other	909,003	723,881
Inter-group transactions	(1,240,889)	(822,231)
	5,767,734	**5,159,372**
(b) Operating costs by function		
Cost of sales	**3,260,113**	**2 958 335**
Sales administrative and R&D expenses		
Sales	*496,187*	*566,968*
Administration	*412,546*	*244,903*
Research and development	*121*	*121*
	908,854	**811,992**
	4,168,967	**3,770,327**
(c) Operating costs by nature		
Goods purchased	1,745,293	1,097,896
Network expenses, interconnect traffic	1,740,100	1,538,659
Other goods and services purchased	90,342	202,037
	3,575,735	**2,838,592**
Wages and salaries	483,534	395,984
Social charges	167,902	135,846
Other	38,141	31,208
	689,577	**563,038**
Marketing expenses	184,128	173,816
Information technology	71,700	40,203
Rent and leasing fees	48,377	36,485
Rent cars and equipment	38,142	37,429
Energy expenses	35,310	33,228
Travel expenses	9,268	3,359
Consultants' services	6,206	5,030
Audit fees and costs	3,569	2,171
Change of bad debt expenses	(14,201)	12,812
Other expenses	51,881	56,275
	4,699,692	**3,802,438**
Inter-group transactions	(1,079,061)	(784,852)
Total external OPEX	**3,620,631**	**3,017,586**
Depreciation, amortization and write-downs	548,336	752,741
Total operating expenses	**4,168,967**	**3,770,327**

In thousands of Estonian kroons

3. Additional information on the income statement (continued)

	2006	2005
(d) Other operating revenues and expenses		
Other operating income		
Profit from sales of fixed assets	35,196	9,256
Foreign exchange gain	4,068	3,184
Interest on fines and penalties	3,603	1,908
Other	10,144	8,692
	53,011	**23,040**
Other operating expenses		
Foreign exchange loss	3,872	2,861
Interest on fines and penalties	882	2,996
Loss from sales of fixed assets	651	1,692
Other	-	6,685
	5,405	**14,234**
Net effect on profit	**47,606**	**8,806**
(e) Depreciation and amortisation		
Production	481,321	671,498
Sales	32,185	76,251
Administration	34,830	4,992
	548,336	**752,741**
(f) Other net financing items		
Interest income	42,177	39,748
Foreign exchange gain	591	1,072
	42,768	**40,820**
Foreign exchange loss	1,269	221
Interest expense	681	2,809
	1,950	**3,030**
Net effect on profit	**40,818**	**37,790**

In thousands of Estonian kroons

4. Taxation

According to the Income Tax Act of the Republic of Estonia the net profit earned by enterprises is not taxed. Thus, there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets and liabilities arise. Instead of taxing the net profit, the distribution of retained earnings is subject to income tax: 22/78 of net dividend paid (until 31 December 2006 the tax rate was 23/77 and until 31 December 2005: 26/74). The corporate income tax arising from the payment of dividends is accounted for as an expense in the period which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid for.

In case dividends are paid from the retained earnings for the period 1994-1999, it is possible to deduct the income tax paid earlier on the part of the retained earnings and prepayments of the tax on dividends made before the year 2000 from the amount of income tax to be paid on the respective amount of distribution.

Corporate income tax

	2006	2005
Dividends paid	1,241,591	1,103,816
Income tax 23/77 (29.87%) (2005:24/76 (31.58%))	(370,865)	(348,573)
Part of the income tax paid by Group subsidiaries, which is transferred to the next accounting period	(2,512)	-
Reduction of the income tax on dividends due to tax rate change	-	58
Current tax expense	**(373,377)**	**(348,515)**
Effective income tax rate	30.07%	31.57%

In thousands of Estonian kroons

5. Property, plant and equipment

	Land and buildings	Machinery and equipment	Other equipment and fixtures	Construction in process	Expenditures for non-current assets	Total
At 31 December 2004						
Cost	**690,500**	**6,703,351**	**652,126**	**37,416**	**-**	**8,083,393**
Accumulated depreciation	(409,122)	(5,222,945)	(436,418)	-	-	(6,068,485)
Net book amount	**281,378**	**1,480,406**	**215,708**	**37,416**	**-**	**2,014,908**
Year ended 31 December 2005						
Opening net book amount	281,378	1,480,406	215,708	37,416	-	2,014,908
Additions	-	69,260	48,985	395,444	19,943	533,632
Acquired by finance leases	-	7,240	-	-	-	7,240
Acquired through business combination (Note 9)	-	4,397	11,292	-	-	15,689
Reclassification	15,439	272,430	92,174	(372,612)	(7,431)	-
Reclassification to assets classified as held-for-sale	(4,219)	-	-	-	-	(4,219)
Disposals	(356)	(5,686)	(59)	(497)	-	(6,598)
Depreciation charge (Note 2 (a))	(27,789)	(580,406)	(118,541)	-	-	(726,736)
Closing net book amount	**264,453**	**1,247,641**	**249,559**	**59,751**	**12,512**	**1,833,916**
At 31 December 2005						
Cost	**676,214**	**7,012,031**	**801,147**	**59,751**	**12,512**	**8,561,655**
Accumulated depreciation	(411,761)	(5,764,390)	(551,588)	-	-	(6,727,739)
Net book amount	**264,453**	**1,247,641**	**249,559**	**59,751**	**12,512**	**1,833,916**
Year ended 31 December 2006						
Opening net book amount	264,453	1,247,641	249,559	59,751	12,512	1,833,916
Additions	22,758	208,563	4,234	475,825	-	711,380
Acquired through business combination (Note 9)	-	910	9,039	-	-	9,949
Reclassification	77,146	498,107	(94,599)	(468,142)	(12,512)	-
Reclassification to assets classified as held-for-sale	-	(771)	(972)	-	-	(1,743)
Disposals	-	(132)	(1,259)	(39)	-	(1,430)
Depreciation charge (Note 2 (a))	(36,354)	(416,949)	(54,174)	-	-	(507,477)
Closing net book amount	**328,003**	**1,537,369**	**111,828**	**67,395**	**-**	**2,044,595**
At 31 December 2006						
Cost	**852,189**	**7,531,843**	**407,649**	**67,395**	**-**	**8,859,076**
Accumulated depreciation	(524,186)	(5,994,474)	(295,821)	-	-	(6,814,481)
Net book amount	**328,003**	**1,537,369**	**111,828**	**67,395**	**-**	**2,044,595**

As at 31.12.2005 the real estate located in Tallinn at Särje 22A, 24 and 26 in amount of 4,219 thousand kroons and the data communication network of 11,530 thousand kroons were recorded as 'Assets classified as held for sale". These assets were sold on 2006 with a gain of 44 000 thousand kroons and 1 500 thousand kroons respectively. As at 31.12.2006 for the unused network amount of 771 thousand kroons remained as 'Assets classified as held for sale".

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

6. Property, plant and equipment acquired by finance lease

	Machinery and equipment
At 31 December 2004	
Cost	**22,700**
Accumulated depreciation	(2,270)
Net book amount	**20,430**
Year ended 31 December 2005	
Opening net book amount	20,430
Additions	7,240
Acquired through business combinations	532
Termination of lease	(19,677)
Depreciation charge	(1,392)
Closing net amount	**7,133**
At 31 December 2005	
Cost	**7,772**
Accumulated depreciation	(639)
Net book value amount	**7,133**
Year ended 31 December 2006	
Opening net book amount	7,133
Depreciation charge	(1,894)
Closing net book amount	**5,239**
At 31 December 2006	
Cost	**7,772**
Accumulated depreciation	(2,533)
Net book amount	**5,239**

Finance lease liability

	2006	2005
At 31 December	**4,497**	**6,603**
Principal payments during the financial year	1,704	15,719
Interest expenses during the financial year	302	109
Average annual interest rate	3%	3%

In thousands of Estonian kroons

7. Intangible assets

	Goodwill	Licenses, patents and trademarks and client relations	Total
At 31 December 2004			
Cost	-	**231,298**	**231,298**
Accumulated amortisation	-	(140,108)	(140,108)
Net book amount	-	**91,190**	**91,190**
Year ended 31 December 2005			
Opening net book amount	-	91,190	91,190
Additions	55,416	20,292	75,708
Acquired through business combination (Note 9)	-	28,831	28,831
Disposals	-	(3,036)	(3,036)
Amortisation charge (Note 2 (a))	-	(26,005)	(26,005)
Closing net book amount	**55,416**	**111,272**	**166,688**
At 31 December 2005			
Cost	**55,416**	**277,814**	**333,230**
Accumulated amortisation	-	(166,542)	(166,542)
Net book amount	**55,416**	**111,272**	**166,688**
Year ended 31 December 2006			
Opening net book amount	55,416	111,272	166,688
Additions	39,040	38,496	77,536
Acquired through business combination (Note 9)	-	10,953	10,953
Disposals and write-offs	-	(272)	(272)
Amortisation charge (Note 2 (a))	-	(36,085)	(36,085)
Impairment charge (Note 2 (a))	(4,774)	-	(4,774)
Closing net book amount	**89,682**	**124,364**	**214, 046**
At 31 December 2006			
Cost	**89,682**	**314,292**	**403,974**
Accumulated amortisation	-	(189,928)	(189,928)
Net book amount	**89,682**	**124,364**	**214,046**

Impairment tests for goodwill

Management determined budgeted gross margin based on past performance and its market expectations. The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used reflect specific risks relating to the relevant CGUs.

The carrying value of goodwill was tested as of 31 December 2006. The recoverable amount of a Cash Generating Unit (CGU) is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-seven-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates. Management determined budgeted gross margin based on past performance and its expectations for the market development.

In thousands of Estonian kroons

The key assumptions used for goodwill tests are as follows:

	Fixed network telecommunications CGU's	Mobile telecommunications CGU's
WACC [1]	8,3%	10%
Growth rate [2]	3.0%	3.0%
Discount rate [3]	8.3%	8.0%
Net book amount of goodwill relating to CGU's	50.834	38.848

1) Weighted average cost of capital.
2) Weighted average growth rate used to extrapolate cash flows beyond the budget period.
3) Discount rate applied to the cash flow projections.

As a result of testing the goodwill that was allocated to one fixed network's CGU's an impairment loss in amount of 4,774 thousand EEK was identified.

8. *Investments in subsidiaries*

	Notes	Country of incorporation	Ownership interest 2006	Ownership interest 2005	Principal activity	Owner
Elion Enterprises AS		Estonia	100%	100%	Network services for operators, data communication and Internet products, voice communication solutions and Internet content services for business and residential customers	AS Eesti Telekom
AS Elion Esindus		Estonia	100%	100%	Retail sales of telecommunication products and services	Elion Enterprises AS
AS EsData		Estonia	100%	100%	Operating and development of data communication, Internet and cable networks, and providing related services; sale, installation and maintenance of equipment related with this activities	Elion Enterprises AS
Viru Net OÜ		Estonia	100%	100%	Internet services	Elion Enterprises AS
AS MicroLink	9	Estonia	100%	99,72%	Holding Company	Elion Enterprises AS
AS MicroLink Eesti	9	Estonia	100%	99,72%	IT services: system integration and infrastructure solutions; software development; ERP and business solutions; data communications and networking; central systems and data centre solutions; systems management and maintenance; end-user PC services and support; full IT outsourcing.	AS MicroLink
AS EMT		Estonia	100%	100%	Construction and operating of mobile networks, providing mobile communication services	AS Eesti Telekom
EMT Esindused AS		Estonia	100%	100%	Retail sales of telecommunication products and services	AS EMT
AS Mobile Wholesale		Estonia	100%	100%	Wholesale of mobile phones	AS EMT
Serenda Invest OÜ	9	Estonia	51%	-	Administration of communication portal based in Estonia internet	AS EMT

9. Acquisition of business combinations

In April 2006, AS EMT, a wholly owned subsidiary of AS Eesti Telekom, purchased 51 per cent of the shares of Serenda Invest OÜ. Serenda Invest OÜ owns the brand name Rate and administrates Estonian internet based communication portal Rate.ee.

49% of Serenda Invest OÜ belongs to Rate Solution OÜ, which owner is Andrei Korobeinik, the author and founder of Rate.ee.

Rate.ee is the biggest social network in Estonia, which connects 360,000 registered users. The aim of the acquisition of Serenda Invest OÜ is to provide and expand telecommunication- and multimedia services.

The acquired subsidiary contributed revenue of 12 027 thousand EEK and net profit of 9 315 thousand EEK to the Group for the period from the date of acquisition to 31 December 2006. If the acquisition had occurred on 1 January 2006, the contribution to Group revenue would have been be approximately the same and profit would have been be lower of approximately 1 000 thousand kroons.

The purchase consideration comprises cash and cash equivalents paid of 29 328 thousand EEK, and deferred consideration of 10 078 thousand EEK payable in 2008 and 2009 (see Notes 22 and 23).

The goodwill is primarily attributable to the profitability of the acquired business, the significant synergies and combined costs savings expected to arise.

Fair value of assets and liabilities acquired are based on discounted cash flow models. The valuation of identifiable intangible assets was performed by an independent professional appraiser.

In the last quarter of 2006, Elion acquired Norby Telecom's private client service business. Fair value of assets and liabilities acquired are based on discounted cash flow models. The valuation of identifiable intangible assets was performed by an independent professional appraiser. The purchase consideration of 20 030 thousand kroons was allocated fully to tangible and intangible assets.

On October 31, 2005, the transfer of 96% of the shares of AS MicroLink, the leading IT company in the Baltic States, to Elion Enterprises AS (subsidiary belonging 100% to AS Eesti Telekom) came into force. The purchase price for the shares was 445 million EEK. MicroLink AS offers services for software development, business and financial information systems, infrastructure solutions, computer workplace and information system maintenance, administration of data communications, private networks, and centralized systems, as well as monitoring and client support services. AS MicroLink contributed revenue of 52,409 thousand EEK and net profit of 7,664 thousand EEK to the Group for the period November 1 to 31 December 2005.

If the acquisition had occurred on 1 January 2005, the effect on the revenue would have been 183,746 thousand EEK and the net profit 30,319 thousand EEK. The calculations are based on the group's accounting principles. The results of the subsidiaries have been adjusted as if the depreciation of the acquired assets and other adjustments had been recognized based on their fair values starting from 1 January 2005.

In December 2005, an additional 3.24% and in 2006, an additional 0.28% of minority interest was purchased in AS Mircolink for 14 million EEK and 0.9 mln EEK respectively.

In thousands of Estonian kroons

The effect of the acquisition of subsidiaries on goodwill and cash flows in 2006 and 2005 were as follows:

	Note	2006			
		Serenda Invest OÜ		Norby Telecommunications	
		Fair value	Acquirer's carrying amount	Fair value	Acquirer's carrying amount
Fixed assets (Note 5)		910	910	9,039	3,213
Intangible assets (Note 7)		-	-	10,953	-
Trade receivables		-	-	38	38
Cash and cash equivalents		40	40	-	-
Liabilities		(8)	(8)	-	-
Net identifiable assets and liabilities		**942**	**942**	**20,030**	**3,251**
Interest aquired		51%		100.00%	
Share in net identifiable assets and liabilities aquired		480		20,030	
Goodwill	7	38,848		-	
Total consideration		**39,328**		**20,030**	
Cash and cash equivalents paid		40		-	
Unpaid consideration (Note 22,23)	22,23	(10,078)		-	
Net cash out flow		**(29,210)**		**(20,030)**	

Acquisition of minority interest

In 2006 the Group acquired remaining 0,28% of the share capital of MicroLink AS.

Details of minority interest of MicroLink AS acquired and related goodwill arising on the acquisition are as follows:

Purchase consideration	937
Minority interest acquired	(745)
Goodwill	192

In thousands of Estonian kroons

	Note	2005			
		Group Eesti MicroLink At 31 October		Viru Net OÜ At 1 January	
		Fair value	Acquirer's carrying amount	Fair value	Acquirer's carrying amount
Fixed assets		17 524	16 694	2,976	2,976
Trademark		17 607	-		
Client contracts		9 143	-		
Inventories		1 653	1,653	-	-
Trade receivables		12 916	12,916	123	123
Other receivables		12 901	12,901	-	-
Assets classified as held for sale					
Data communication network		11 530	1,899	-	-
Investments held for sale		238 898	90,759	-	-
Cash and cash equivalents		123 598	123,598	56	56
Liabilities		(36 075)	(36,075)	(2,107)	(2,116)
Net identifiable assets and liabilities		**409,695**	**224,345**	**1,048**	**1,039**
Interest acquired		96.48%		100%	
Share in net identifiable assets and liabilities acquired		395,273		1,048	
Goodwill	7	49,312		5,602	
Total consideration		**(444,585)**		**(6,650)**	
Cash and cash equivalents		123,598		56	
Deferred consideration (Note 22,23)		45,802		1,650	
Net cash out flow		**(275,185)**		**(4,944)**	

The trademark of MicroLink was valued using an income based approach. Contractual customer relationships were valued using multi-period excess earnings method. The expected future revenue streams and EBIDTA margin on a combination of historical trends and future expectations of management have been benchmarked for reasonableness against the forecasts for a group of guideline companies. A remaining useful life of 7 years has been assigned to the customer relationships.

In thousands of Estonian kroons

10. Investments in associates

	Year ended 31 December	
	2006	2005
Cost of investments	32,509	18,409
Share of post-acquisition loss, net of dividends received	(15,262)	(15,458)
	17,247	2,951

During the 2006 year, subsidiaries of the Eesti Telekom Group - Elion Enterprises AS and AS EMT- each invested an additional 7 050 thousand EEK in AS Sertifitseerimiskeskus, thereby increasing the associated company's share capital by the corresponding amount. During the same period, the same amount was invested in the enlargement of the share capital of AS Sertifitseerimiskeskus by the company's co-shareholders, Hansapank AS and SEB Eesti Ühispank AS.

Details of the Group's associates, as of 31 December 2006 and 2005, are as follows:

	Country of incorporation	Ownership interest		Principal activity	Owner
		2006	2005		
AS Sertifitseerimiskeskus	Estonia	50%	50%	Providing certification and related services	Elion Enterprises AS – 25% AS EMT – 25%
OÜ Voicecom	Estonia	26%	26%	Designing and providing software for mobile related services	AS EMT

Financial information of associates

	AS Sertifitseerimis-keskus	OÜ Voicecom	**Total**
2005			
Assets	15,455	6,488	**21,943**
Liabilities	11,748	2,266	**14,014**
Revenues	21,315	8,007	**29,322**
Profit / (loss)	(3,127)	595	**(2,532)**
2006			
Assets	35,352	7,022	**42,374**
Liabilities	3,233	2,490	**5,723**
Revenues	19,249	10,221	**29,470**
Profit / (loss)	212	310	**522**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

11. Long-term receivables

The interest rates and repayment terms of the Group's long-term receivables are as follows:

	Note	Interest rate	Maturity date	Year ended 31 December 2006	2005
(a) Long- term loan receivables					
Loan to Union of Põlva County Municipalities		10.00%	2010	1,055	-
Non-current portion of receivables				1,055	-
(b) Long- term receivables from associated company					
Loan to AS Sertifitseerimiskeskus	28	6.50%	2006	-	4,100
Current portion of receivables (-)				-	(4,100)
Non-current portion of receivables				-	-
(c) Non-current trade receivables					
Factoring receivables				1,369	2,342
Non-current trade receivables				17,603	610
				18,972	2,952
Current portion of receivables (-)				(14,468)	(1,452)
Non-current portion of receivables				4,504	1,500
(d) Other long-term receivables					
Instalment receivables		2% - 16%	2006 - 2010	143,767	88,177
Finance lease receivables	12 (a)	8% - 16%	2006 - 2010	76,283	1,325
				220,050	89,502
Current portion of receivables (-)				(106,470)	(46,808)
Non-current portion of receivables				113,580	42,694
Total other non-current receivables				**119,139**	**44,194**

Expected repayments of the long-term receivables:

	2006	2005
Within one year	120,925	52,360
Later than one year and not later than five years incl.	119,152	44,194
	240,077	**96,554**

12. Finance and operating leases (the Group as lessor)

a) Finance leases

The investments in finance leases and respective receivables are as follows:

	Note	Year ended 31 December 2006	2005
(a) Finance lease - non-current receivables			
Finance lease – gross receivables		51,904	331
Unearned finance income (-)		(5,743)	(22)
Finance lease – net receivables		46,161	309
(b) Finance lease – current receivables			
Finance lease – gross receivables		34,417	1,133
Unearned finance income (-)		(4,295)	(117)
Finance lease – net receivables		30,122	1,016
Total finance lease net receivables	11 (d)	**76,283**	**1,325**

PC, DigiTV equipment (three-year contract) and mobile phones (two-year contract) are leased out at the terms of finance lease.

In thousands of Estonian kroons

Expected repayments of the referred finance lease receivables:

		Year ended 31 December	
	Note	2006	2005
(a) Gross receivables from finance lease			
Within one year		33,998	1,133
Between one and two years		52,323	331
		86,321	**1,464**
Unearned future finance income on finance lease (-)		(10,038)	(139)
Net investment in finance lease	11 (d)	**76,283**	**1,325**
(b) Net investment in finance lease			
Within one year		29,741	1,016
Between one and two years		46,542	309
Net investment in finance lease	11 (d)	**76,283**	**1,325**

b) Operating leases receivables

The Group leases office space and IT equipment and solutions under the terms of operating lease. Income from such leases amounts to 37,851 thousand EEK and 23,327 thousand EEK in 2006 and 2005, respectively.

13. Inventories

	Year ended 31 December	
	2006	2005
Raw materials and consumables	43,987	38,171
Goods for resale	93,133	48,487
Advances to suppliers	5,572	212
	142,692	**86,870**

In 2006, impairment for the inventories were in the total amount of 3,556 thousand EEK (2005: 26,816 thousand EEK) based on the estimated decline of the net realisation value below their acquisition cost.

14. Trade and other receivables

		Year ended 31 December	
	Note	2006	2005
Trade receivables			
Accounts receivable		666,772	623,488
Provision for impairment of receivables		(11,231)	(17,856)
		655,541	**605,632**
Other receivables			
Receivables from associates	28	200	4,259
International settlements		43,278	63,990
Accrued interest		14,917	15,001
Other accrued income		1,038	49
Prepaid expenses		42,804	60,865
Prepaid value-added tax		3,612	3,146
Prepaid other taxes		60	25
Current portion of other long-term receivables	11 (d)	106,470	46,808
Other receivables		16,292	37,170
		228,671	**231,313**
		884,212	**836,945**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

15. Short-term investments

	Year ended 31 December	
	2006	**2005**
(a) Short-term investments with maturities up to three months		
Current securities held-to-maturity	-	24,845
(b) Short-term investments with maturities over three months		
Current securities held-to-maturity	83,931	52,520
Deposits	980,928	1,189,273
	1,064,859	**1,241,793**
Total short-term investments	**1,064,859**	**1,266,638**

The effective interest rates on short-term investments in 2006 were:

- investments in EEK - 3.12% (2005: 2.53%)
- investments in EUR – 2.87% (2005: 2.33%).

		2006	2005
Short-term investments in EEK		**935,198**	**1,145,345**
	Deposits	859,085	1,092,350
	Current securities held-to-maturity	76,113	52,995
Short-term investments in EUR		**129,661**	**121,293**
	Deposits	121,843	96,923
	Current securities held-to-maturity	7,818	24,370
Short-term investments total		**1,064,859**	**1,266,638**
Deposits total		980,928	1,189,273
Current securities held-to-maturity		83,931	77,365

There were no assets for trading or available-for-sale in 2006 or 2005.

16. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and shares of money-market funds:

	Year ended 31 December	
	2006	**2005**
Bank accounts and cash on hand	234,924	173,912
Deposits with maturities up to three months	89,481	231,636
	324,405	**405,548**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

17. Capital and reserves

a) Issued capital

	Year ended 31 December	
	2006	**2005**
Shares issued		
Ordinary shares, par value 10 EEK per share, fully paid	137,954,528	137,954,528

The holders of ordinary shares are entitled to receive dividends as declared by the general meeting, and are entitled to one vote per share at general meetings of the shareholders of the parent company.

The following charts list the largest owners of ordinary AS Eesti Telekom shares at the year ended:

	2006	
	Number of shares	Ownership interest %
TeliaSonera AB (immediate parent company Baltic Tele AB)	74,110,079	53.72
Republic of Estonia	37,485,100	27.17
Deutsche Bank Trust Company Americas	12,505,821	9.07
Skandinaviska Enskilda Banken AB Clients	2,238,107	1.62
ING Luxembourg S. A.	1,491,330	1.08
Morgan Stanley + Co International Equity Client Account	1,191,442	0.86
Danske Bank Clients Holdings	1,017,063	0.74
Trigon New Europe Small (Little) Associates Found	645,240	0.47
Bank Austria Creditanstalt AG Clients	579,526	0.42
The Northen Trust Company	470,000	0.34
Other public investors	6,220,820	4.51
	137,954,528	**100.00**

	2005	
	Number of shares	Ownership interest %
TeliaSonera AB (immediate parent company Baltic Tele AB)	69,330,171	50.26
Republic of Estonia	37,485,100	27.17
Deutsche Bank Trust Company Americas	13,700,667	9.93
Skandinaviska Enskilda Banken AB Clients	6,588,858	4.78
Ing Luxembourg S. A.	1,663,000	1.21
Danske Bank Clients Holdings	787,464	0.57
Clearstream Banking Luxembourg S. A. Clients	590,209	0.43
Morgan Stanley + Co International Equity Client Account	562,400	0.41
Skandinaviska Enskilda Banken Finnish Clients	527,899	0.38
Trigon Centre and East Europe Found	488,658	0.35
Other public investors	6,230,102	4.52
	137,954,528	**100.00**

In thousands of Estonian kroons

b) Reserves

Reserves include:

- Statutory legal reserve required by the Commercial Code. Subject to the approval of the general meeting, the reserve may be used for covering cumulated losses, if the latter cannot be covered with other unrestricted equity, and for increasing share capital.

- Share premium – the positive difference between the issue price and nominal value of issued shares (issue premium).

c) Dividends

Dividends in the total amount of 1,241,591 thousand EEK (2005: 1,103,636 thousand EEK) or 9.00 EEK per ordinary share were declared and disbursed in the reporting period 2005 (2005: 8.00 EEK).

d) Treasury shares

The Annual General Meeting of Shareholders, on 18 May 2006, authorized AS Eesti Telekom Management Board to acquire within one year from the adoption of this resolution, i.e. until 18 May 2007 (the same authority, which was obtained from last Annual General Meeting on 18 May 2005, terminated on 18 May 2006) AS Eesti Telekom shares of A-series so that the total of nominal values of treasury shares held by AS Eesti Telekom would not exceed the limit set by statutory regulations, and that the price payable per share would not exceed the highest price paid for the ordinary shares of AS Eesti Telekom on the Tallinn Stock Exchange on the day of acquiring the shares. AS Eesti Telekom has to pay for the shares from the Group's assets in excess of its share capital, legal reserve and share premium. The amount of shares to be acquired each time shall be determined on each occasion separately by a resolution of AS Eesti Telekom's Supervisory Council.

AS Eesti Telekom has not acquired treasury shares during 2006 and 2005.

e) Earnings per share

Basic earnings per share have been calculated as follows:

	2006	2005
Profit for the year from continuing operations for the period attributable to equity holders of the Company (EEK)	1,309,443,000	1,087,416,000
The average number of ordinary shares	137,954,528	137,954,528
EPS	9.49 EEK	7.88 EEK

As the Group has no instruments with a dilutive effect on earnings per share neither in 2006 or 2005, **diluted earnings per share** equals basic earnings per share.

f) Share price

AS Eesti Telekom shares are quoted in the main list of the OMX Tallinn Stock Exchange and in the main list of GDR-s on the London Stock Exchange. Each GDR (Global Depositary Receipts) represents three ordinary shares.

The highest price of an AS Eesti Telekom share on the OMX Tallinn Stock Exchange during 2006 was 131.43 EEK; the lowest price was 108.74 EEK (2005: 134.56 EEK and 111.09 EEK respectively), and the average price was 120.38 EEK per share (2005: 122.43 EEK per share).

In thousands of Estonian kroons

18. Interest-bearing liabilities

	Notes	Year ended 31 December 2006	2005
(a) Non-current			
Non-convertible long-term debts	19	423	1,117
Finance lease liability	6, 24 (a)	2,701	4,656
		3,124	**5,773**
(b) Current			
Non-convertible debts	19	946	1,226
Finance lease liability	6, 24 (b)	1,796	1,947
		2,742	**3,173**

19. Interest-bearing liabilities information

The Group does not have any contingencies from outstanding bank loans as of 31 December 2006.

On 18 January 2001, AS Eesti Telekom entered into a loan facility agreement with a syndicate of international banks for the purpose of raising a 40 million EURO (625.9 million EEK) debt. The maturity date of the loan was 5 years (until 18 January 2006) and the annual interest rate wass EURIBOR of relevant interest period + 0.775%. The syndicate consisted of Bankgesellschaft Berlin AG, the Dai-Ichi Kangio Bank Ltd, Landesbank Schleswig Holstein Girozentrale, Sampo Bank Plc, AB Swedbank and AS Hansapank.

As of 31 December 2006 and 2005, the loan has not been used.

The details of the Group's non-convertible long-term debts are as follows:

	Notes	Year ended 31 December 2006	2005
Factoring		**1,369**	**2,343**
Current portion of non-convertible long-term debts (-)	18 (b)	(946)	(1,226)
Non-convertible long-term debts	18 (a)	423	1,117

Expected repayments of the referred long-term debt:

	2006	2005
Within one year	946	1,226
Later than one year and not later than three years incl.	423	1,117
	1,369	**2,343**

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M. M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

20. Retirement benefit obligations

	Year ended 31 December	
	2006	**2005**
Current portion of retirement benefit obligations	865	865
Non-current portion of retirement benefit obligations	7,912	6,926
Total retirement benefit obligations	**8,777**	**7,791**
Balance at the beginning of the year	**7,791**	**8,657**
Benefits paid	(865)	(866)
Additional provisions	1,505	-
Interest accrued	224	80
Exchange differences	122	(80)
Balance at the end of the year	**8,777**	**7,791**

The calculation of **retirement benefit provisions** are based on agreements concluded with certain individuals for a fixed period and amount. These provisions are recorded in the balance sheet at their present value. The interest rates of high-quality corporate bonds are used as the average discount rate of 4,5 %.

21. Provisions

	Site restoration expense provision	Termination benefits provision	Disputed penalties provision	Compensation of the tolerance of technical infrastructure provision	Guarantee provision	**Total**
Current portion of provisions	-	3,171	2,132	-	-	5,303
Non-current portion of provisions	19,183	-	-	1,980	961	22,124
	19,183	**3,171**	**2,132**	**1,980**	**961**	**27,427**
At 31 December 2005	**-**	**3,709**	**2,132**	**1,980**	**-**	**7,821**
Additional provisions	19,183	3,171	-	-	961	23,315
Used provisions during year	-	(3,709)	-	-	-	(3,709)
At 31 December 2006	**19,183**	**3,171**	**2,132**	**1,980**	**961**	**27,427**

- **Site Restoration** expense provision. In 2006, AS EMT recognized site restoration expense provision to the extent a legal or constructive obligation to a third party exists. The company has concluded two types of contracts for the use of the land under masts and modular buildings: "Contracts constituting rights of superficies" and "Contracts encumbering a registered immovable with the personal right of use". The majority of the contracts have been concluded for periods of 25 and 50 years. Upon the expiration of the contracts, AS EMT is obligated to compensate all the costs that are related to the restoration of the land under the masts and modular buildings to its usual economically good condition, primarily to free the contract objects from unusable structures and buildings and to restore the property into the condition that existed before the contract was signed.

- **Termination benefits provision.** The provision has been created and it will be used in connection with the termination employment contracts when, and only when, the company has a detailed written plan for the termination of the work relationship and there are no realistic possibilities for not implementing this plan.

- **Provision for disputed penalties.** Elisa Mobiilsideteenused AS has submitted a statement of claim against Elion Enterprises AS, in which they demand the performance of contractual obligations, and that interconnection fees not paid on time in the amount of 9,652 thousand EEK and a penalty of 2,132 thousand EEK thereon be ordered to be paid by Elion Enterprises AS. Elion Enterprises AS has contested the propriety of the interconnection fee claim. The amount for interconnection fees is recognized in the Group's 2005 operating cots, but has not been transferred to Elisa Mobiilsideteenused AS. Based on the statement of claim, an appropriation has been made for penalty in case the court action in not resolved in favor of Elion Enterprises AS.

- **Provision for the compensation of the tolerance of technical infrastructure.** According to the Riigikogu resolution of April 30, 2004, owners of technical infrastructure and networks are obligated to pay landowners compensation for the tolerance of technical infrastructure and networks built on their land starting on October 1, 2004. The implementation act regarding the size and payment of the compensation has not yet been passed. Upon the passage of the implementation act, Elion Enterprises AS will have to compensate possible claims started from October 1, 2004. Considering this, an appropriation has been made totaling the possible compensation amount for the period October 1, 2004 – December 31, 2006. The calculation of the amounts is based on the law and the draft regulation of the Government of the Republic.

In thousands of Estonian kroons

- **Guarantee provision.** Provision for long-term additional guarantee of services.

22. Non-current non-interest bearing liabilities

	Note	Year ended 31 December 2006	2005
Non-current liability for purchase of shares in subsidiaries	9	5,144	-
Other		8	-
		5,152	-

23. Trade and other payables

	Note	Year ended 31 December 2006	2005
Trade payables		365,381	319,745
Payable to employees		122,205	82,333
International settlements		54,285	46,265
Current liability related to acquisition of shares	9	4,934	47,452
Other accrued expenses		13,295	25,439
Value-added tax payable		18,319	23,621
Social insurance tax payable		14,749	15,134
Employee withholding tax payable		8,234	8,802
Income tax fringe benefits payable		1,654	2,441
Unemployment contribution payable		358	588
Other taxes payable		586	575
Customer advances		3,427	6,829
Deferred income from government grants	25	1,804	928
Other prepaid revenue		41,822	14,180
Payables to associates	28	312	112
		651,365	**594,444**

24. Operating and finance leases (the Group as lessee)

a) Operating lease payments

	Year ended 31 December 2006	2005
Minimum lease payments under non-cancellable operating leases:		
Within one year	26,220	22,122
Later than one year and not later than five years incl.	48,666	43,462
After five years	-	29
	74,886	**65,613**

The operating lease expenses for 2006 and 2005 were 28,246 thousand EEK and 24,268 thousand EEK, respectively.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

In thousands of Estonian kroons

b) Finance lease payments

	Note	Year ended 31 December 2006	2005
Finance lease payments, both principal and interest charge, are payable as follows:			
Within one year		1,951	2,026
Later than one year and not later than five years incl.		2,816	4,749
		4,767	**6,775**
Interest charge (-)		(270)	(172)
Current portion of finance lease liability	18 (b)	(1,796)	(1,947)
Long-term liability	**18 (a)**	**2,701**	**4,656**

25. Government grants

The following table contains information about the usage of government grants occurred from the state budget and used by EMT for financing hardware and software. The government grants have been accepted by the Estonian Ministry of Economic Affairs and Communications.

	Notes	2006	2005
Government grants for operating expenses			
Balance of unappropriated government grant at the beginning of the period		-	-
Received from the Government of the Republic		-	854
Recognized as government grant revenue		-	854
Balance of unappropriated government grant at the end of the period		-	-
Government grants of assets			
Undepreciated balance at the beginning of the period		928	-
Received from the Government of the Republic		5,020	1,656
Depreciated into revenue		4,144	728
Undepreciated balance at the end of the period	23	1,804	928
Total government grants recognized as revenue		**4,144**	**1,582**

26. Financial risk management

The Group's activities expose it to a variety of financial risks: interest rate risk, credit risk, liquidity risk, currency risk and fair value risk. The Group's risk management is focused on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

Funding the Group as well as managing Group's excess liquidity and financial risks are the responsibilities of the Treasury Department that fulfils its obligations in accordance with the rules approved by the Supervisory Board of AS Eesti Telekom.

To manage the Group's liquid assets more efficiently the Group has cash pooling agreements in Hansapank, SEB Eesti Ühispank, Sampo Pank and in Estonian branch of Nordea Bank Finland. The cash pool is also used for funding the subsidiaries.

a) Interest rate risk

Interest rate risk bearing financial assets and liabilities have long term maturities which are sensitive to movements in interest rates. The Group does not have long-term interest rate sensitive financial assets.

Interest rate risk for financial liabilities represents the volatility of interest rates, which may result the difficulties in forecasting exact amounts of debt repayments. In worst case scenario, if the company has large amounts of debt on its balance sheet and the interest rates rise sharply, the solvency of the company becomes under threat.

Impact of 1% parallel change (rise) in the interest rate curve to net interest revenue would be 1,564 thousand EEK.

The interest rates and repayment terms of the Group's loans are disclosed in note 19 in the financial statements.

b) Credit risk

Credit risk represents the accounting loss that would be recognised at the reporting date if counter parties failed to perform as contracted. The Group does not have significant exposure to credit risk to any individual customer or counter party. To reduce exposure to credit risk, the Group performs ongoing customer performance evaluations. The management does not expect the failure of customers in meeting their obligations.

The Group has policies that limit the amount of credit exposure to any financial institution or other counterparty. The Group manages its excess liquidity and financial risks only with and through Estonian banks, which have at least a Baa3 Moody's credit rating, and foreign banks, which have at least an A2 Moody's credit rating.

c) Foreign exchange risk

Currency risk is the potential loss of unfavourable movements in currency exchange rates against Estonian kroons. To hedge the currency risk arising from liabilities denominated in foreign currencies, the Group may conclude currency forward, option and swap transactions; also the Group's group accounts include foreign currency assets.

Group Treasury manages currency risk so that in any time the movement of currency exchange rates more than 5% has not bigger effect to open currency positions than 3 million EEK.

Main operating currencies for the Group, other than Estonian kroon, are EUR and USD. In 2006 approximately 10% of settlements were in EUR and less than 5% of settlements in USD. Other foreign currencies contributed less than 1% of the total settlements.

As of 31 December 2006 the Group did not have any outstanding derivative contracts related to hedge currency risks.

d) Liquidity risk

Liquidity risk relates to the availability of sufficient funds for debt service, dividend payment, and capital expenditure and/or working capital requirement.

Minimum required liquidity position (MRLP) should at any time exceed the level of 5% of planned annual turnover. MRLP is calculated as follows:

MRLP = current assets + unused committed credit facilities – debt repayable within 12 months.

e) Fair value

The fair values of cash, receivables, trade payables, loans and borrowings are not materially different from their carrying amounts.

In thousands of Estonian kroons

27. Cash flows from operating activities

	Notes	Year ended 31 December 2006	2005
Cash flows from operating activities			
Net profit for the period		1,314,007	1,087,578
Adjustments for:			
Depreciation, amortization and impairment of fixed and intangible assets	3 (e), 5, 7	548,336	752,741
Profit from sales and write-off of fixed assets	3 (d)	(34,545)	(7,564)
Share of profit/(loss) from associates		(193)	(452)
Provisions		20,150	4,015
Other net financing items		(42,244)	8,917
Income tax on dividends		4	(53)
Miscellaneous non-cash items		(6,728)	(18,971)
Operating cash flows before changes in working capital		**1,798,787**	**1,826,211**
Change in current receivables		43,537	(22,384)
Change in inventories		(55,782)	39,166
Change in current liabilities		52,232	104,428
Change in working capital		**39,987**	**121,210**
Cash generated from operations		**1,838,774**	**1,947,421**
Interest received		68,126	65,220
Interest paid		(8,386)	(6,705)
Net cash from operating activities		**1,898,514**	**2,005,936**

28. Related party transactions

Transactions with related parties are transactions with ultimate parent company, associates, shareholders, key management, supervisory council, their relatives and the companies in which they hold majority interest.

a) Name and relationship of related party

Name	Relationship with AS Eesti Telekom Group
Key management, supervisory council and their relatives	
List of associates is shown in Note 10	
Enterprises of TeliaSonera AB Group	Parent company, shareholder
State Government (State Chancellery and ministries)	Shareholder
Companies where supervisory council members of the Group have significant influence	

b) Key managements' and supervisory councils' remuneration

The remunerations of key management of the members of management board of Group Companies and supervisory council during the year were as follows:

	2006	2005
Salaries and other short-term employee benefits	53,872	39,596
Termination benefits	2,608	98
Other	698	596
	57,178	**40,290**

In thousands of Estonian kroons

c) Trading transactions

No impairment has been made in 2006 and 2005 for the receivables to related parties.

During the year, Group companies entered into the following transactions with related parties:

	2006	2005
Telecommunication services provided		
Associated companies	1,890	1,053
Shareholders	212,352	206,884
Companies where supervisory council members of the Group have significant influence	240	-
	214,482	**207,937**
Other sales		
Associated companies	110	36
Shareholders	11,021	1,790
Companies where supervisory council members of the Group have significant influence	14	-
	11,145	**1,826**
Telecommunication services purchased		
Associated companies	477	2,141
Shareholders	180,894	154,960
	181,371	**157,101**
Other services purchased		
Associated companies	689	63
Shareholders	4,824	2,535
Companies where supervisory council members of the Group have significant influence	211	-
	5,724	**2,598**
Financial income		
Associated companies	**264**	**267**
Financial expenses		
Shareholders	-	**78**
Amounts owed by related parties		
Associated companies	200	4,259
Shareholders	25,053	36,172
Companies where supervisory council members of the Group have significant influence	38	-
	25,291	**40,431**
Amounts owed to related parties		
Associated companies	312	112
Shareholders	23,976	22,407
Key management and supervisory council	22,818	9,768
	47,106	**32,287**

In thousands of Estonian kroons

29. Contingencies

a) Contingent income tax liability

The consolidated retained earnings of AS Eesti Telekom as at 31 December 2006 amounted to 2,234,831 (31 December 2005: 2,165,819) thousand EEK. As from 1 January 2007 income tax of 22/78 of net dividend paid (up to 31 December 2006: 23/77) is imposed on the profit distributed as dividends. Thus, the retained earnings as at 31 December 2006 that can be paid out as dividends to the shareholders, amount to 1,743,168 thousand EEK and the corresponding income tax would amount to 491,663 thousand EEK. As at 31 December 2005 it would have been possible to pay out dividends to the shareholders in the amount of 1,667,681 thousand EEK and the corresponding income tax would have amounted to 498,138 thousand EEK.

b) Other contingent liabilities

	2006	2005
Key management termination benefits	17,736	21,936

The key management termination benefits above are obligations only in case of termination of contracts originated by Group.

During the last few years, the Group's companies have not been controlled by the Customs and Tax Board.

The tax authority has the right to control a company's accounting for tax purposes within 6 years of the tax return being submitted, and upon establishing mistakes to assess an additional tax amount, interest, or fines. In addition, in certain cases, upon the discovery of possible tax offences, fines may be assigned.

According to the assessment of the management, there are no circumstances, whereby the tax authority could assess the company with any significant supplemental tax.

c) Court Actions

- **Making operator pre-selection possible**
  On 22 April 2004, the National Communications Board issued a precept to Elion which obligated Elion Enterprises AS to guarantee the possibility of pre-selecting the use of the telephone services of other companies, incl. the transmission of accounting data for free, to the users of its telephone network analogue exchange.
  On 20 May 2004, Elion Enterprises filed an action in the Tallinn Administrative Court to suspend the fulfilment of the order. On 17 April 2006, the court satisfied the company's complaint and annulled the order of the Communications Board. The court found that the obligation imposed by the order would require Elion Enterprises to make an approximately 200-million-kroon investment in connection with the exchange of analog exchanges for digital exchanges.
  The Communications Board, in turn, filed an appeal on 15 May 2006, in which it asked for the nullification of the court judgment.
  On 10 January 2007, the Tallinn District Court partially satisfied the appeal by the Communications Board, by changing the motive of the Tallinn Administrative Court. The Tallinn District Court considered the judgment of the Tallinn Administrative Court to be correct and justified.
  It is important to note that today the legal situation has changed—the Electronic Communications Act that came into force on 1 January 2005 obligates undertakings with significant market power to enable pre-selection. Therefore, Elion must count on the corresponding investments in the future.

- **Dispute over the fees for Kodulahenduse and Kõneaja boonus**
  On 8 May 2005, the Communications Board issued a precept to Elion Enterprises, according to which undertakings with significant market power do not have the right to include discounts in the fees for services. Also an execution proceeding was initiated in respect to Elion for the collection of the penalty payment.
  On 22 August 2005, Elion filed a complaint with the Tallinn Administrative Court to have the execution proceeding of the Communications Board nullified and to have the illegality of the coercive measure ascertained. With a judgment on 12 December 2005, the Tallinn Administrative Court dismissed the complaint by Elion Enterprises. Elion Enterprises filed an appeal with the Tallinn District Court, which also dismissed it.
  On 28 December 2006, the Elion filed an appeal in cassation with the District Court. The District Court has not made a judgment regarding accepting the appeal in cassation.
  The court dispute has a practical meaning for Elion Enterprises – this is a question of pricing strategy.

d) Relations with the regulator

- **AS EMT was declared an undertaking with significant market power**
  On 23 March 2006, the Estonian National Communications Board notified AS EMT of its decision to declare it an undertaking with significant power in the market of voice call termination on mobile networks. The Communications Board also declared the remaining two communications companies operating mobile communications networks—Elisa Mobiilsideteenused AS and Tele2 Eesti AS—as undertakings with significant power in the market of voice call termination on mobile networks. In addition, the Communications Board established a transparency obligation, non-discrimination obligation, accessibility obligation, and an obligation for price controls and cost accounting.
  According to the decision, the companies that have been declared undertakings with significant market power were to perform these obligations starting on July 1, 2006.
  On April 21, both Tele2 and Elisa filed a complaint in the Tallinn Administrative Court, in which they applied to have the aforementioned decision related to undertaking with significant market power partially (Tele2) or entirely (Elisa) annulled, along with a preliminary application for legal protection. On May 8, the Tallinn Administrative Court suspended the validity of the decision in the part relevant to Elisa and the part relevant to the obligations established for Tele2.
  Pursuant to EMT's application, the Communications Board also suspended the validity of the obligation for price controls and cost accounting for EMT, because the enforcement of the Communications Board decision only on the part of EMT would cause discriminatory treatment and the distortion of competition. In connection with the partial suspension of the Communications Board decision, the obligation to reduce termination fees to a maximum of 2.05 kroons by July 1 does not apply to any mobile operator.
  The partial and temporary suspension of the Communications Board's declaration of EMT as undertaking with significant market power will continue while the validity of the Communications Board decision is suspended by the application of preliminary legal protection for Elisa and/or Tele2. AS of 26 March 2007, the Communications Board's declaration of all three operators as undertaking with significant market power continued to be suspended.

30. Employees

The average number of employees during 2006 was 2,206 and during 2005, 2,175.

31. Parent of the Group

The parent company of the Group is AS Eesti Telekom, situated at Roosikrantsi St. 2, 10119 Tallinn, Estonia.

The immediate parent company of AS Eesti Telekom Group is Baltic Tele AB, a 100%-owned subsidiary of TeliaSonera AB. Address: Box 7754, SE-103 96, Stockholm, Sweden.

AS Eesti Telekom Group consolidated financial statements are consolidated into TeliaSonera AB, the ultimate parent company, situated at Sturegatan 1, SE-106 63 Stockholm, Sweden.

In thousands of Estonian kroons

32. Supplementary disclosures on the parent entity of the Group

INCOME STATEMENT OF THE PARENT ENTITY

	2006	2005
Administrative expenses	(26,511)	(18,996)
Other operating revenues and expenses	(3)	(5)
Gross loss	**(26,514)**	**(19,001)**
Net income from subsidiaries	1,250,000	1,100,000
Other net financing items	18,789	13,356
Profit before tax	**1,242,275**	**1,094,355**
Income tax on dividends	-	(1,148)
Net profit for the period	**1,242,275**	**1,093,207**

BALANCE SHEET OF THE PARENT ENTITY

	Year ended 31 December	
	2006	2005 Restated
ASSETS		
Non-current assets		
Fixed assets	219	243
Intangible assets	35	53
Investments in subsidiaries	1,317,383	1,317,383
Total non-current assets	**1,317,637**	**1,317,679**
Current assets		
Trade and other receivables	337,179	66,909
Short-term investments	277,206	541,030
Total current assets	**614,385**	**607,939**
TOTAL ASSETS	**1,932,022**	**1,925,618**
EQUITY AND LIABILITIES		
Capital and reserves		
Share capital	1,379,545	1,379,545
Share premium	356,018	356,018
Statutory legal reserve	137,955	137,955
Retained earnings	44,522	43,838
Total capital and reserves	**1,918,040**	**1,917,356**
Non-current liabilities		
Retirement benefit obligations	**3,707**	**1,856**
Current liabilities		
Trade and other payables	7,104	6,406
Provisions	3,171	-
Total current liabilities	**10,275**	**6,406**
Total liabilities	**13,982**	**8,262**
TOTAL EQUITY AND LIABILITIES	**1,932,022**	**1,925,618**

In thousands of Estonian kroons

Reclassification of balances

In 2006, the following comparative balances of 2005 were reclassified:

	Initial 31.12.2005	Reclassification	Restated 1.01. 2006
Current assets			
Short-term investments	1 266 638	(725 608)	541 030
Current liabilities			
Interest-bearing liabilities	725 608	(725 608)	-

Until 2006, the entry "Short-term financial investments" on the parent company's balance sheet included all monetary allocations related to the consolidated account. As of 2006, they have been proportionally distributed among the Group's members according to their participation in the consolidated account.

STATEMENT OF CHANGES IN EQUITY OF THE PARENT ENTITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	**Total**
1 January 2005	**1,379,545**	**356,018**	**137,645**	**54,577**	**1,927,785**
Increase in statutory legal reserve	-	-	310	(310)	-
Dividends paid	-	-	-	(1,103,636)	(1,103,636)
Total changes	-	-	*310*	*(1,103,946)*	*(1,103,636)*
Net profit for the period	-	-	-	1,093,207	1,093,207
31 December 2005	**1,379,545**	**356,018**	**137,955**	**43,838**	**1,917,356**
The book value of shareholdings under dominant or significant influence	-	-	-	(1,317,383)	(1,317,383)
The value of shareholdings under dominant or significant influence accounted by the equity method	-	-	-	3,439,364	3,439,364
Adjusted equity as at 31 December 2005	**1,379,545**	**356,018**	**137,955**	**2,165,819**	**4,039,337**
1 January 2006	**1,379,545**	**356,018**	**137,955**	**43,838**	**1,917,356**
Dividends paid	-	-	-	(1,241,591)	(1,241,591)
Total changes	-	-	-	*(1,241,591)*	*(1,241, 591)*
Net profit for the period	-	-	-	1,242,275	1,242,275
31 December 2006	**1,379,545**	**356,018**	**137,955**	**44,522**	**1,918,040**
The book value of shareholdings under dominant or significant influence	-	-	-	(1,317,383)	(1,317,383)
The value of shareholdings under dominant or significant influence accounted by the equity method	-	-	-	3,507,692	3,507,692
Adjusted equity as at 31 December 2006	**1,379,545**	**356,018**	**137,955**	**2,234,831**	**4,108,349**

The adjusted equity is the basis for the determination of distributable equity according to the Estonian Accounting Law.

In thousands of Estonian kroons

CASH FLOW STATEMENT OF THE PARENT ENTITY

	2006	2005
Operating activities		
Net profit for the period	1,242,275	1,093,207
Adjustments for:		
Depreciation and amortization	48	130
Provisions	4,676	-
Other net financing items	(537)	(1,036)
Operating cash flows before changes in working capital	**1,246,462**	**1,092,301**
Change in current receivables	(273)	1,048
Change in current liabilities	(6)	(117)
Change in working capital	**(279)**	**931**
Net cash from operating activities	**1,246,183**	**1,093,232**
Investing activities		
Tangible and intangible fixed assets acquired	(12)	(116)
Proceeds from sale of tangible and intangible fixed assets	6	-
Net cash changes of short-term investments	239,707	(37,474)
Net cash changes of interest-bearing receivables	(273,301)	72,712
Repayments of long-term loans granted	4,100	-
Net cash used in / from investing activities	**(29,500)**	**35,122**
Cash flow before financing activities	**1,216,683**	**1,128,354**
Financing activities		
Dividends paid	(1,241,591)	(1,103,636)
Net cash used in financing activities	**(1,241,591)**	**(1,103,636)**
Net change in cash and cash equivalents	**(24,908)**	**24,718**

Cash and cash equivalents at beginning of year [1)]	**24,845**	-
Net change in cash and cash equivalents	(24,908)	24,718
Effect of foreign exchange rate changes	63	127
Cash and cash equivalents at end of year [1)]	-	**24,845**

1) The account "Cash and cash equivalents" also includes short-term investments with maturity up to three months.

Initsialiseeritud ainult identifitseerimiseks
Initialled for the purpose of identification only
Initsiaalid/initials M.M
Kuupäev/date 26.03.07
PricewaterhouseCoopers, Tallinn

MANAGEMENT BOARD'S AND SUPERVISORY COUNCIL'S SIGNATURES TO THE ANNUAL REPORT

The Management Board has prepared the management report and the consolidated financial statements of AS Eesti Telekom for the financial year ended 31 December 2006 on 26 March 2007.

The Supervisory Council of AS Eesti Telekom has reviewed the annual report, prepared by the Management Board, consisting of the management report, the consolidated annual accounts and the notes to the annual accounts, the Board's proposal for profit distribution and the independent auditor's report, and has approved the annual report for presentation on the General Meeting of Shareholders.

All the members of the Management Board and Supervisory Council have signed the annual report.

Name	*Position*	*Signature*	*Date*
Jaan Männik	*Chairman of the Board*		
Valdo Kalm	*Member of the Board*		
Hille Võrk	*Member of the Board*		
Terje Christoffersen	*Chairman of the Council*		
Andres Gylder	*Member of the Council*		
Jörgen Latte	*Member of the Council*		
Tarmo Porgand	*Member of the Council*		
Mats Salomonsson	*Member of the Council*		
Aare Tark	*Member of the Council*		26.03.2007
Heido Vitsur	*Member of the Council*		

PRICEWATERHOUSECOOPERS

AS PricewaterhouseCoopers
Pärnu mnt. 15
10141 Tallinn
Estonia

Telephone +372 614 1800
Facsimile +372 614 1900
www.pwc.ee

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)

To the Shareholders of AS Eesti Telekom

We have audited the accompanying consolidated financial statements of AS Eesti Telekom and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

PRICEWATERHOUSECOOPERS

Opinion

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Urmas Kaarlep
AS PricewaterhouseCoopers

Heidi Seeland
Authorised Auditor

26 March 2007