



2005

TABLE OF CONTENTS

MANAGEMENT REPORT	2
FINANCIAL STATEMENTS	9
MANAGEMENT DECLARATION	9
CONSOLIDATED INCOME STATEMENT	10
CONSOLIDATED BALANCE SHEET	11
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY	12
CONSOLIDATED CASH FLOW STATEMENT	14
NOTES	15
Note 1 Accounting principles	15
Note 2 Business and geographical segments	27
Note 3 Cost of goods sold	28
Note 4 Marketing costs	28
Note 5 General and administrative expenses	28
Note 6 Other operating income	29
Note 7 Other operating expenses	29
Note 8 Financial income	29
Note 9 Finance cost	29
Note 10 Corporate income tax	30
Note 11 Earnings per share	30
Note 12 Dividends per share	30
Note 13 Cash and cash equivalents	30
Note 14 Financial assets at fair value through profit or loss	31
Note 15 Trade receivables	31
Note 16 Loans granted	32
Note 17 Inventories	33
Note 18 Investments in subsidiaries	34
Note 19 Investments in associates and joint ventures	36
Note 20 Other long-term loans and receivables	38
Note 21 Deferred income tax assets	39
Note 22 Investment property	39
Note 23 Property, plant and equipment	40
Note 24 Intangible assets	41
Note 25 Leased assets	41
Note 26 Borrowings	42
Note 27 Trade payables	43
Note 28 Government grants	43
Note 29 Short-term provisions	44
Note 30 Long-term trade payables	44
Note 31 Deferred income tax liability	44
Note 32 Loan collateral and pledged assets	44
Note 33 Share capital	45
Note 34 Construction contracts	46
Note 35 Related party transactions	46
Note 36 Contingent liabilities	48
Note 37 Risks	49
Note 38 Events after the balance sheet date	49
Note 39 Number of shares belonging to the members of the Supervisory and Management Board and their close relatives	49
Note 40 Shareholders with more than 5% ownership	49
Note 41 Separate balance sheet, income statement, statement of changes in equity and cash flow statement of the parent company	50
SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2005 ANNUAL REPORT	53
Attached documents:	
	Auditor's report
	Profit allocation proposal
	Contacts of Merko Ehitus analysts

AS MERKO EHITUS GROUP

CONSOLIDATED ANNUAL REPORT

Beginning of financial year: 01.01.2005

End of financial year: 31.12.2005

Commercial

Registry no: 10068022

Address: Järvevana Rd 9G
11314 Tallinn
Estonia

Phone: +372 680 5105

Fax: +372 680 5106

E-mail: merko@merko.ee

Web site: www.merko.ee

Main activities: general contracting of construction

Auditor: AS PricewaterhouseCoopers

MANAGEMENT REPORT

GENERAL INFORMATION

The Group Merko Ehitus is engaged in construction and related activities in Estonia, Latvia and Lithuania. The Group consists of 32 subsidiaries and 8 associates and joint ventures the largest of which are: SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (100%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%) and AS Tartu Maja Betoontooted (25%).

In 2005, the following important changes took place in the Group's structure.

- The holding of Merko Ehitus in OÜ Constancia and OÜ Pire Projekt increased from 50% to 100%.
- Subsidiary OÜ Merko Kaevandused was sold.
- Baltic Electricity Engineering OÜ was established; the company designs and installs medium and high voltage electrical networks and substations.
- Joint venture AS Insenerivõrgud was liquidated.
- Merko Ehitus decreased its holding of AS Telegrupp from 45% to 31%.
- SIA Merks acquired a 50% holding in a company engaged in real estate development, SIA Zakusala Real Estates.

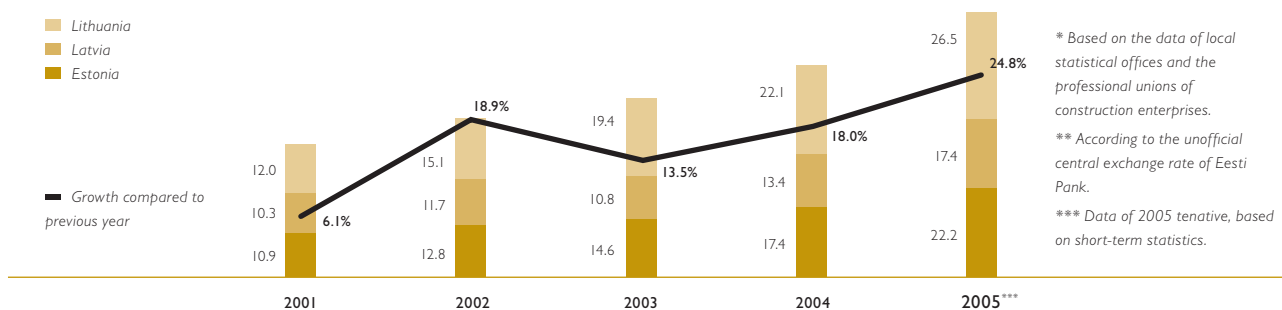
OVERVIEW OF THE CONSTRUCTION MARKET AND ITS DEVELOPMENTS

The Baltic construction market grew by 24.8% in a year under the conditions of a favourable loan environment and fast economic growth. In 2005, construction work in the Baltic region was performed for 66.1 billion kroons which is 13.1 billion kroons higher than in 2004.

The sector's fastest growth occurred in Latvia, where the market grew in current prices by 29.0 per cent in a year and reached 17.5 billion kroons. Despite fast growth, the ratios describing the Latvian construction market were relatively modest: construction work per capita was performed for 485 euros and construction output per one GDP euro was 9 cents. According to the data by the Estonian Statistical Office, Estonian construction companies performed construction work with their own forces in Estonia and foreign countries for 23.2 billion kroons which is 28.3% more than last year. In Estonia, construction work was completed for 22.2 billion kroons and in foreign countries for 1.0 billion kroons. Growth also continued in the Lithuanian construction market which increased by 19.3% in a year and totalled 26.8 billion kroons. Similarly to Estonia and Latvia, construction activities in Lithuania also centred around the largest cities (Vilnius, Klaipeda, Kaunas).

BUILDING MARKET VOLUMES (WITH OWN FORCES) AND GROWTH OF THE BALTIC STATES*

in billion kroons**



Simultaneously with the fast growth of the construction market, the construction prices appreciated uncontrollably. The manufacturers of construction materials could not keep pace with the growth of construction volumes, the delivery periods of

ordered materials increased and there was deficit with regard to shelf goods at the stores. However, the most critical situation occurred in respect of qualified labour, as simultaneously with volume growth, skilled labour left en masse to the EU countries with higher standards of living. The prices of construction services increased by 11.4% in Latvia, 7.6% in Lithuania and 7.3% in Estonia.

Residential housing development has been the main profitability driver in the construction sector over the last several years. In 2005, the sales prices of new housing increased by 40-50 percent which guaranteed continuous good profitability in this area. The prices of registered immovables suitable for development increased by 150-200% in a year and reached a level where the profit to be derived from development activities was discounted into the price of land by land owners, allowing the developers to make a profit on the project only on account of additional price increases of new housing.

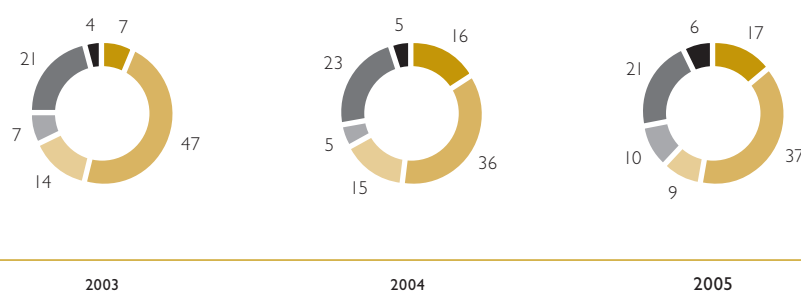
BUSINESS OPERATIONS

The year 2005 was a good one for Merko Ehitus. The Group's net sales increased by 3.9% in a year and totalled 3,232 million kroons. Construction activities contributed 93.8% and other activities 6.2% to the Group's revenue.

DISTRIBUTION OF CONSTRUCTION ACTIVITIES OF THE GROUP

per cent

- Residential buildings
- Public service buildings
- Office buildings
- Industrial buildings
- Civil engineering
- Road construction



Of the Group's construction activities, 86% was new structures and 14% renovation and reconstruction work. In 2005, the largest construction projects worth mentioning were the Estonian Art Museum, the residential building at R vala Blvd, Wendre's production facility, Muuga coal terminal, trade centre Spice and the business and residential building Admiral's House).

THE LARGEST PROJECTS COMPLETED IN 2005

Muuga coal terminal	new facility	Muuga, Harjumaa	573,500 m ²	AS Merko Ehitus
Road construction of S�pruse Blvd (Endla St - Linnu Rd)	reconstruction	S�pruse Blvd, Tallinn	45,000 m ²	Tallinna Teede AS
3 apartment buildings	new facility	R�vala Blvd 19, Tallinn P�rnu Rd 131B, Tallinn Uus-Tatari 23, Tallinn	26,647 m ²	AS Merko Ehitus
Wendre's production facility	new facility	Lina 31, P�rnu	24,957 m ²	AS Merko Ehitus
Stage 2 of shopping centre Spice	new facility	Leilirbes 29a, Riga	24,000 m ²	SIA Merks
Estonian Art Museum	new facility	Weizenbergi 34/Valge 1, Tallinn	23,910 m ²	AS Merko Ehitus
Business and residential building Admiral's House	new facility	Ahtri 6, Tallinn	23,424 m ²	AS Merko Ehitus
Shopping centre Rimi	new facility	On the corner of Ateities and Žadeikos Streets, Vilnius	9,300 m ²	UAB Merko Statyba
Administrative building of the Ministry of Social Affairs	reconstruction	Gonsiori 29, Tallinn	8,560 m ²	AS Merko Tartu
Shopping centre K-Rauta	new facility	Lucasalas 3, Riga	8,528 m ²	SIA Merks
Business centre L3	new facility	Laisv�s 3, Vilnius	6,499 m ²	UAB Merko Statyba

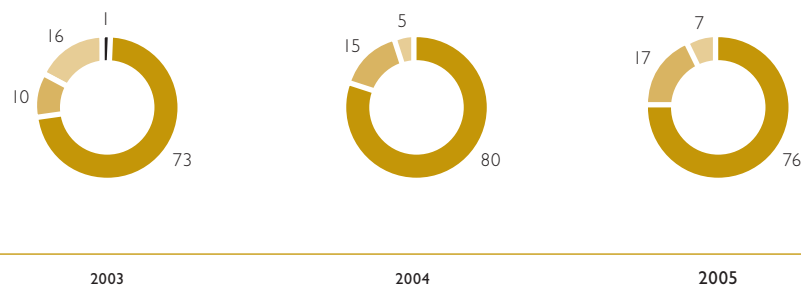
In autumn 2004, the Group accepted its biggest challenge ever - SIA Merks entered into a contract with Riga's City Government committing itself to build a multifunctional hall in Riga accommodating 12,500 visitors by the time of the Ice Hockey World

Championships in 2006. A limited timetable, a complex engineering-technical solution of the structure and the failure of two developers to complete the project presented a real challenge for the Company. Arena Riga was not only a challenge from the construction point of view, but SIA Merks was also the developer, builder and investor of the building. Being aware of the problems of building and operating such complexes in neighbouring countries, it was not easy to find investors and financiers ready to join the project. We are obliged to the fans of culture and sports who acquired personal chairs or boxes in the complex and to Hansapank which believed in us and financed the project with 17.5 million euros. Despite all issues encountered, the building was completed on time, at 31.01.2006 the hall was granted authorisation for use and the inhabitants of Riga gained a complex that the city badly needed.

The home market of AS Merko Ehitus is the Baltic countries. Due to growth of construction volumes in Latvia and Lithuania, the share of exported goods and services provided outside Estonia increased from 20% in 2004 to 24% in 2005.

GEOGRAPHICAL DISTRIBUTION OF TURNOVER OF MERKO EHITUS GROUP

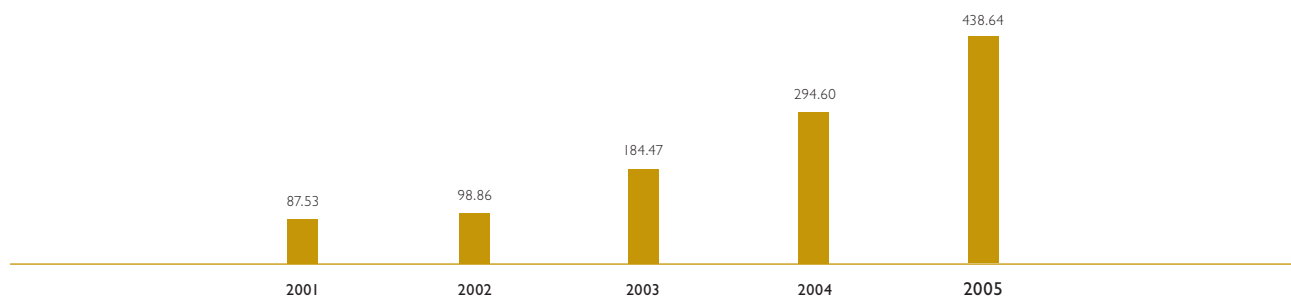
per cent



The net profit of the Group in 2005 totalled 438.6 million kroons, an increase of 48.9% over the net profit of 294.6 million kroons in 2004. Net profit from construction and development activities totalled 289.3 million kroons, one-time transactions contributed 149.3 million kroons to net profit, of which 84.7 million kroons was earned in the transfer of registered immovables, 53.7 million kroons from government grants and 10.9 million from the transfer of ownerships and rights. Decent profitability was ensured by the Company's own residential housing projects, better sales of subsidiaries and the transfer of registered immovables unimportant for the attainment of the Company's strategic goals.

NET PROFIT OF MERKO EHITUS GROUP

in million kroons



In 2005, the Group's total cash flow from operations amounted to +129.7 million kroons, of which cash flow from operating activities was +264.7 million kroons. The cash flow of the accounting period was mostly affected by the operating profit of +435.1 million kroons, a change in inventories -464.9 million kroons, a change in liabilities and prepayments +186.6 million kroons, depreciation and amortisation +109.6 million kroons, adjustment of revenue from construction contracts under the stage of completion method +66.6 million kroons. The Group's cash flow from investing activities was -378.1 million kroons, of which -227.0 million kroons was investments into property -148.5 million kroons investments into subsidiaries and associates, -190.1 million kroons loans granted, +176.3 million kroons loan repayments received and +11.2 million kroons other income from investing activities. Investments were made from own funds as well as borrowed funds in the amount of 293.6 million kroons. The Company's cash flow from financing activities totalled +243.1 million kroons, of which the balance of credit liabilities assumed/repaid in the amount +281.0 million kroons, dividends paid -60.1 million kroons and government grants received +22.2 million kroons.

THE RATIOS AND THE METHODOLOGY FOR CALCULATING THE GROUP'S MAIN ACTIVITIES WERE AS FOLLOWS

	2003	2004	2005
Net profit margin	6.8%	9.5%	13.6%
Net profit margin *	6.8%	8.8%	9.0%
Operating profit margin	7.5%	10.3%	13.5%
Return on equity per annum	48.3%	49.9%	48.2%
Return on assets per annum	19.9%	24.1%	24.9%
Equity ratio	40.4%	55.3%	49.6%
Current ratio	1.5	2.0	2.0
General expenses to net sales	3.3%	3.4%	4.6%
Staff costs to net sales	5.7%	6.3%	7.3%

* Less extraordinary profit.

Net profit margin : Net profit / Net sales

Operating profit margin : Operating profit / Net sales

Return on equity : Net profit / Average equity of the period

Return on assets : Net profit / Average total assets of the period

Equity ratio : Equity / Total assets

Current ratio : Current assets / Current liabilities

General expenses to net sales : General expenses / Net sales

Staff costs to net sales : Staff costs / Net sales

BUSINESS RISKS

Market risk. One of the peculiarities of construction activities is the fact that carrying out contracts entered into will take months and it ensures relatively long-term revenue stream for the companies which in turn makes the sector immune to changes in the economic environment. Based on the above, the changes having both a negative and positive effect on the demand for construction services will reach construction with a lag of approximately 12 months. This time is long enough to adopt necessary measures and avoid the worst or be prepared for the best.

It is much more difficult to estimate changes in demand in residential housing development where many apartments have been purchased as investments in a hope to make a profit from continuing appreciation of apartment prices and where under strong demand, the prices of new apartments increased by up to 50% in 2005. Will the market be able to absorb the price appreciation? What will happen to apartments purchased as investments if housing prices no longer increase? What will happen to interest rates? How will the bankers in Helsinki and Stockholm view our market if the loan race continues? These and many other issues will make this sector vulnerable and will become a major source of risk for the investor. In order to identify potential issues and manage risk, we closely follow changes in sales numbers, the process of selling apartments is launched before the construction of the building, a preliminary contract is entered into with the buyer at the first opportunity and a deposit is collected to ensure the carrying out of the contract. The largest projects are divided into stages so that they can be frozen quickly and with few expenses. Development activities made up 14.7% of the net sales of the Merko Ehitus Group in 2005.

The accession of the Baltic countries to the European Union opened new markets for construction companies, accompanied by a massive inflow of construction workers into the EU countries. Free movement of labour and growth of construction market volumes led to a deficit of skilled labour in all Baltic countries and fast appreciation of labour costs. Developments in the labour market, convergence of prices for construction services and materials with the prices of the European Union and longer delivery dates of construction materials shall be considered when assessing risks for long-term projects lasting for longer than 12 months. In order to hedge risks we have stepped up international cooperation, in the absence of required competencies, knowledge or work is purchased from other Baltic countries. Frequently, services of Finnish and Swedish colleagues are used.

Operating risk. The Group concludes complete risk insurance contracts with insurance companies in order to hedge unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to 10 million euros. The risks of projects whose cost exceeds 10 million euros or which the annual policy does not cover (water construction, railroad construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding employment contracts for design work, an insurance contract of professional liabi-

lity is required from subcontractors covering the losses arising from designing, erroneous measuring, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2005, applications for compensation in the amount of 0.8 million kroons were submitted to insurance companies and indemnifications in the amount of 0.6 million kroons were received from insurance companies.

The appropriate fulfilment of contractual obligations arising from employment agreements is guaranteed at first demand payable bank guarantees. A reserve for guarantee provisions has been set up at the Company to eliminate the construction errors which become evident during the warranty period. In 2005, warranty provisions were set up in the total amount of 5.6 million kroons and indemnifications amounted to 2.9 million kroons. As at the end of the year, the Company's guarantee reserve amounted to 8.5 million kroons. With regard to work performed by subcontractors, the subcontractor shall eliminate the errors that became evident during the warranty period and the fulfilment of these obligations is guaranteed by bank guarantees.

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

Credit risk is an inevitable part of the Company's activities. In managing credit risk, close attention is paid to the payment behaviour of partners, their financial position is analysed and if necessary, third parties are involved as guarantors. With regard to prepayments to suppliers, a bank guarantee by suppliers is required. In 2005, the customers of Merko demonstrated good payment discipline, despite the average collection period increasing from 30 to 33 days, the amount of invoices exceeding the due date fell from 16.1 million kroons to 2.4 million kroons and the amount of doubtful receivables decreased from 1.2 million kroons to 0.4 million kroons.

Company's free monetary resources are held as short-term deposits in banks with high credit-ratings (Moody's A3/P-2 and higher). In order to guarantee liquidity and better management of cash flows, Group's companies have concluded overdraft contracts with a total value of 112 million kroons.

Interest rate risk. As at 31.12.2005, the Group's interest-bearing liabilities amounted to 307.8 million kroons, of which 105.1 million were short-term loans and the current portion of long-term liabilities in 2006 and 202.7 million were non-current liabilities and finance lease liabilities. The volume of interest-bearing liabilities increased by 285.6 million kroons in a year and as at the end of the year, these liabilities amounted to 13.9% of the balance sheet total of the Company. As the Group intends to transfer most the assets financed through long-term loans within 12-24 months, then the hedging of interest risks of these obligations is not considered appropriate.

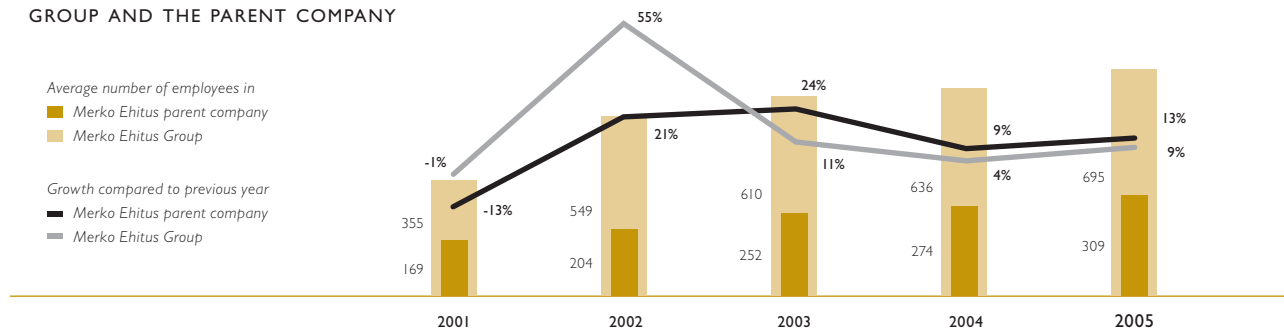
Foreign exchange risk. The Group's construction contracts are mostly concluded in a foreign currency of the country of location and open foreign currency positions in arranging daily activities are tried to be avoided. The most significant foreign contracts are concluded in euros. The Latvian lats, the Lithuanian litas and the Estonian kroons have been pegged to the euro and hence the foreign currency risks of intra-group transactions have been eliminated.

THE COMPANY AND THE PEOPLE

The key to the success of a modern entity is a knowledgeable, motivated team oriented at teamwork. Merko Ehitus appreciates professional behaviour highly and invests into its people.

In 2005, the average number of full-time employees at the parent company was 309, increasing by 35 people in a year. The gross wages and salaries paid to full-time employees amounted to 95.0 million kroons, the annual growth was 7.8%, incl. base salary of 7.4% and bonuses of 8.2%. The average number of full-time employees at the Group was 695 and their gross wages and salaries amounted to 173.9 million kroons, of which base salaries amounted to 70.3% and bonuses 29.7%. As compared to 2004, the number of employees at the Group increased by 9% and the average gross wages and salaries increased by 16.7%.

CHANGES IN THE NUMBER OF EMPLOYEES OF THE GROUP AND THE PARENT COMPANY



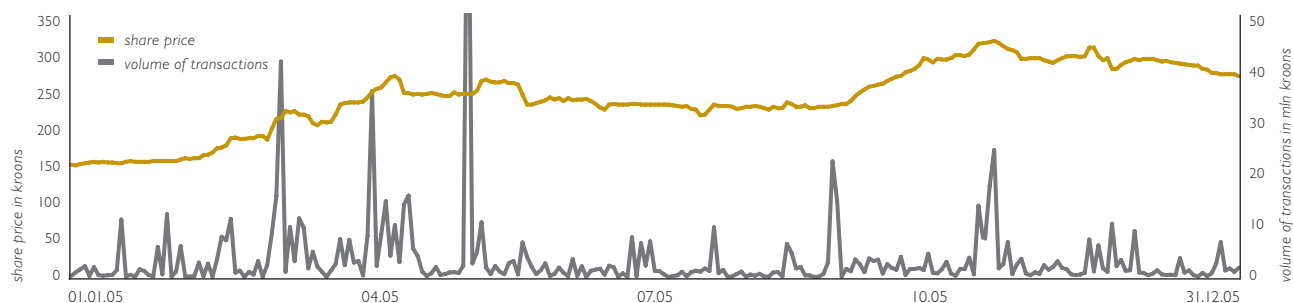
From October 2005, the Management Board of AS Merko Ehitus consists of 5 members. All members of the Management Board work full-time at AS Merko Ehitus and their gross remuneration in 2005 was 7.3 million kroons, incl. base salaries of 1.8 million kroons and bonuses of 5.5 million kroons. The Supervisory Board of AS Merko Ehitus consists of 3 members and their gross remuneration amounted to 5.2 million kroons in 2005, of which base salaries amounted to 1.3 million kroons and bonuses to 3.9 million kroons. All members of the Supervisory and Management Boards currently work on the basis of contracts for services. Members are paid a termination fee upon the early removal of a member of the Supervisory Board and the Management Board or non-extension of the service contract equalling the last 12 month base salary.

One of the largest joys is the joy of giving. At the end of 2004, Hansapank, Eesti Energia and Merko together with the Ministry of Culture signed a cooperation project to build 'Estonian hiking tracks'. The goal of the project was to bring together nature and healthy lifestyles, promote athletic lifestyles and set up a network of hiking tracks in cooperation with private and state structures which would be available to all interested persons regardless of their age or financial position. SA Eesti Terviserajad was set up to implement this project. The private sector assumed the responsibility of investing 30 million kroons into hiking tracks over the following 3 years as well as to maintain them; the responsibility of the public sector was to arrange ongoing management of the facilities. Today, a total of 8 health tracks have been equipped with the necessary technology, established or fixed up and in respect of 4 centres, the design work is still underway. We see success and it encourages us to continue on the path chosen.

SHARES AND SHAREHOLDERS

The shares of Merko Ehitus are listed in the main list of Tallinn Stock Exchange and as at 31.12.2005, the closing price of the share on Tallinn Stock Exchange was 269.90 kroons, increasing by 77.5% in a year.

PERFORMANCE OF MERKO EHITUS SHARE AT TALLINN STOCK EXCHANGE



The earnings per share in 2005 were 24.78 kroons, increasing by 48.9% in a year. Pursuant to the current dividend policy of the Company, a proposal is made at the General Meeting of Shareholders to pay out 20% of the net profit for the year as net dividends, i.e. 5 kroons per share.

STRUCTURE OF MERKO EHITUS AT THE END OF 2005

<i>Shareholders</i>	<i>Shares</i>	<i>Participation</i>
Merko Grupp	12,742,686	72.0%
ING Luxembourg S.A., clients	1,135,900	6.4%
SEB, clients	992,310	5.6%
Nordea Pank, clients	608,683	3.4%
Okobank, clients	262,600	1.5%
Clearstream Banking Luxembourg S.A., clients	245,007	1.4%
J.P. Morgan Bank Luxembourg S.A.	194,200	1.1%
Other shareholders	1,518,614	8.6%
Total	17,700,000	100.0%

OUTLOOK FOR 2006

The overall condition of the construction sector is primarily affected by the country's economic development, general investment climate and availability of funds. We believe that despite slight appreciation of interest rates, the economic growth of 6-7% is sustainable in the Baltic countries in the near term and the construction market will participate in it.

In 2006, the construction of infrastructure and environmental facilities in cooperation with the public sector and the EU Structural Funds will continue. A decent year is expected in general construction, where hotels, trade and office buildings and industrial parks near cities are planned to be built.

Along with general and engineering construction, residential housing development has played an important role over the last several years. The year 2006 will present serious challenges to residential developers. The renewal pace of the housing fund of 1.8-2.9 new housing spaces per 1000 people reached by now is significantly lower than the respective figures in the neighbouring countries: 6.5 in Norway, 5.8 in Finland, 5.0 in Denmark and 3.5 in Sweden and thus to call the volumes of residential housing construction the peak is not justified. On the other hand, how will the market cope with the price increase of 2005, how sustainable are prices in a situation in which the square meter of new residential housing space costs 4-6 average salaries, will the inflow of borrowed funds compensate for the price increase of apartments? We believe that the prices of housing spaces will stabilise and a more distinct regional differentiation will take place. In a stable price environment, demand for housing acquired for the purpose of investment will decrease and a number of families buying new homes will increase. The work of those developers will be difficult, who in anticipation of price increases in 2005 purchased properties, whose disposal in a stable price environment may turn out to be a challenge.

Although the growth of construction activities in Latvia and Lithuania in 2005 was impressive, considering the size of these countries and their populations it can be stated that rapid development is still coming. In 2005, construction projects per capita were completed for 1,001 euros in Estonia, 485 euros in Latvia and 502 euros in Lithuania and construction output was generated for GDP euro of 14 cents in Estonia, 9 cents in Latvia and 8 cents on Lithuania. The modest numbers of Latvia and Lithuania best characterise the hidden potential of construction activities of these countries and allow forecasting faster than average growth in the near term. The Estonian construction market which has experienced fast growth over the last years should reach a stage of stable growth in the upcoming year.

Merko Ehitus will continue to expand its activities in Latvia and Lithuania, where it intends to become one of the largest construction companies through its subsidiaries SIA Merks and UAB Merko Statyba. We maintain our positive stance towards the development of Latvia and Lithuania and believe that in the near term the share of revenue of the subsidiaries located there will reach 50% and Merko will achieve 5% market share in the Baltic construction market.

In 2006, deficit of locally manufactured construction materials and labour will deepen and the price appreciation of construction services will continue. The companies committed to long-term offers will be hit the hardest.

Our experience, knowledge, and people dedicated to their work is value which has brought success for Merko Ehitus and enabled us to continue to be successful in a changing environment. We believe that we will be able to shape the year 2006 so that it will be a successful one for our business partners, customers, the Company's employees and shareholders.




FINANCIAL STATEMENTS

MANAGEMENT DECLARATION

The Management Board confirms the correctness and completeness of AS Merko Ehitus consolidated financial statements as presented on pages 9-52.

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

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

Tõnu Toomik	Chairman of the Management Board		29.03.2006
Alar Lagus	Member of the Management Board		29.03.2006
Veljo Viitmann	Member of the Management Board		29.03.2006
Jaan Mäe	Member of the Management Board		29.03.2006
Andres Agukas	Member of the Management Board		29.03.2006

CONSOLIDATED INCOME STATEMENT

<i>in thousands of</i>		EEK		EUR	
	<i>Note</i>	2005	2004	2005	2004
Sales	2	3,232,392	3,110,399	206,588	198,791
Cost of goods sold	3	(2,738,714)	(2,695,989)	(175,036)	(172,305)
Gross porfit		493,678	414,410	31,552	26,486
Marketing expenses	4	(22,595)	(18,138)	(1,444)	(1,159)
Administrative and general expenses	5	(127,632)	(89,089)	(8,157)	(5,694)
Other operating income	6	185,052	72,063	11,827	4,605
Other operating expenses	7	(93,452)	(59,542)	(5,973)	(3,805)
Operating profit		435,051	319,704	27,805	20,433
Financial income	8	6,253	5,743	400	367
Finance cost	9	(4,710)	(26,919)	(301)	(1,721)
Profit (loss) from sale of subsidiary	18	7,498	(299)	479	(19)
Profit (loss) from associates and joint ventures	19	19,632	9,950	1,255	636
incl. profit (loss) from equity participation		17,065	9,950	1,091	636
Profit before tax		463,724	308,179	29,638	19,696
Corporate income tax expense	10	(18,437)	(9,997)	(1,178)	(639)
Net profit for financial year		445,287	298,182	28,460	19,057
incl. net profit attributable to equity holders of the parent company		438,638	294,600	28,034	18,828
minority interest		6,649	3,582	426	229
Earnings per share for profit attributable to the equity holders of the parent company (basic and diluted, in kroons/euros)	11	24.78	16.64	1.58	1.06

The notes on pages 15-52 are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

<i>in thousands of</i>		EEK		EUR	
	<i>Note</i>	31.12.2005	31.12.2004	31.12.2005	31.12.2004
ASSETS					
Current assets					
Cash and cash equivalents	13	268,446	141,812	17,157	9,063
Financial assets at fair value through profit or loss	14	-	11,775	-	753
Trade receivables	15	542,110	496,943	34,648	31,761
Prepaid corporate income tax		2,471	2,222	158	142
Inventories	17	964,088	449,399	61,617	28,722
Total current assets		1,777,115	1,102,151	113,580	70,441
Non-current assets					
Investments in associates and joint ventures	19	179,609	35,446	11,479	2,265
Other long-term loans and receivables	20	8,524	15,868	545	1,014
Deferred income tax assets	21	8,753	4,124	559	264
Investment property	22	42,506	61,389	2,716	3,924
Property, plant and equipment	23	199,004	78,516	12,718	5,018
Intangible assets	24	4,365	1,110	279	71
Total non-currents assets		442,761	196,453	28,296	12,556
TOTAL ASSETS		2,219,876	1,298,604	141,876	82,997
LIABILITIES					
Current liabilities					
Borrowings	26	114,841	12,578	7,340	804
Trade payables	27	711,236	486,857	45,456	31,116
Corporate income tax liability		950	1,313	61	84
Government grants	28	22,225	44,818	1,420	2,865
Short-term provisions	29	21,741	5,784	1,390	369
Total current liabilities		870,993	551,350	55,667	35,238
Non-current liabilities					
Long-term borrowings	26	202,824	14,046	12,963	898
Other long-term trade payables	30	22,726	8,038	1,452	514
Deferred income tax liability	31	11,385	-	728	-
Total non-current liabilities		236,935	22,084	15,143	1,412
TOTAL LIABILITIES		1,107,928	573,434	70,810	36,650
EQUITY					
Minority interest		10,552	7,200	674	460
Equity attributable to equity holders of the parent company					
Share capital	33	177,000	88,500	11,312	5,656
Share premium		-	2,950	-	189
Statutory reserve capital		8,850	8,850	566	566
Currency translation adjustment		(5,059)	(4,663)	(323)	(298)
Retained earnings		920,605	622,333	58,837	39,774
Total equity attributable to equity holders of the parent company		1,101,396	717,970	70,392	45,887
TOTAL EQUITY		1,111,948	725,170	71,066	46,347
TOTAL LIABILITIES AND EQUITY		2,219,876	1,298,604	141,876	82,997

The notes on pages 15-52 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

in thousands of EEK	Note	Equity attributable to equity holders of the parent company					Total	Minority interest	Total
		Share capital	Share premium	Statutory reserve capital	Currency translation adjustment	Retained earnings			
Balance as at 31.12.2003		88,500	2,950	8,850	(1,380)	364,903	463,823	4,809	468,632
Effect of exchange rate changes		-	-	-	(3,283)	-	(3,283)	-	(3,283)
Net profit for financial year		-	-	-	-	294,600	294,600	3,582	298,182
Business combinations		-	-	-	-	-	-	409	409
Total recognized income for 2004		-	-	-	(3,283)	294,600	291,317	3,991	295,308
Dividends	33	-	-	-	-	(37,170)	(37,170)	(1,600)	(38,770)
Balance as at 31.12.2004		88,500	2,950	8,850	(4,663)	622,333	717,970	7,200	725,170
Effect of changes in accounting policies 01.01.2005	1.3.2	-	-	-	-	2,709	2,709	-	2,709
Effect of exchange rate changes		-	-	-	(396)	-	(396)	-	(396)
Net profit for financial year		-	-	-	-	438,638	438,638	6,649	445,287
Business combinations		-	-	-	-	-	-	(697)	(697)
Total recognized income for 2005		-	-	-	(396)	441,347	440,951	5,952	446,903
Equity capitalization	33	88,500	(2,950)	-	-	(85,550)	-	-	-
Dividends	33	-	-	-	-	(57,525)	(57,525)	(2,600)	(60,125)
Balance as at 31.12.2005		177,000	-	8,850	(5,059)	920,605	1,101,396	10,552	1,111,948

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (CONTINUED)

<i>in thousand of EUR</i>	Equity attributable to equity holders of the parent company						Minority interest	Total
	Share capital	Share premium	Statutory reserve capital	Currency translation adjustment	Retained earnings	Total		
Balance as at 31.12.2003	5,656	189	566	(88)	23,321	29,644	307	29,951
Effect of exchange rate changes	-	-	-	(210)	-	(210)	-	(210)
Net profit for financial year	-	-	-	-	18,828	18,828	229	19,057
Business combinations	-	-	-	-	-	-	26	26
Total recognized income for 2004	-	-	-	(210)	18,828	18,618	255	18,873
Dividends	-	-	-	-	(2,375)	(2,375)	(102)	(2,477)
Balance as at 31.12.2004	5,656	189	566	(298)	39,774	45,887	460	46,347
Effect of changes in accounting policies 01.01.2005	-	-	-	-	173	173	-	173
Effect of exchange rate changes	-	-	-	(25)	-	(25)	-	(25)
Net profit for financial year	-	-	-	-	28,034	28,034	426	28,460
Business combinations	-	-	-	-	-	-	(46)	(46)
Total recognized income for 2005	-	-	-	(25)	28,207	28,182	380	28,562
Equity capitalization	5,656	(189)	-	-	(5,467)	-	-	-
Dividends	-	-	-	-	(3,677)	(3,677)	(166)	(3,843)
Balance as at 31.12.2005	11,312	-	566	(323)	58,837	70,392	674	71,066

The notes on pages 15-52 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

<i>in thousands of</i>		EEK		EUR	
	<i>Note</i>	2005	2004	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES					
Operating profit		435,051	319,704	27,805	20,433
Adjustments:					
depreciation and amortisation	2, 22-24	109,637	70,903	7,007	4,532
(profit) loss from sale of non-current assets	6, 23	(535)	(545)	(34)	(35)
(profit) loss from sale of a unit	6	-	(11,651)	-	(745)
adjustment of revenue from construction contracts under stage of completion method		66,630	(173,460)	4,258	(11,086)
interest income from business activities		(5,590)	(2,591)	(357)	(166)
change in government grants and other provisions		(22,973)	7,650	(1,468)	489
Change in trade receivables related to operating activities		(27,321)	157,969	(1,746)	10,096
Change in inventories		(464,906)	(280,660)	(29,713)	(17,937)
Change in trade payables related to operating activities		186,556	28,092	11,923	1,795
Interest paid		(2,811)	(1,692)	(180)	(108)
Other financial income		3,857	-	247	-
Corporate income tax paid		(12,928)	(15,359)	(826)	(982)
Total cash flows from operating activities		264,667	98,360	16,916	6,286
CASH FLOWS FROM INVESTING ACTIVITIES					
Investments into subsidiaries	18	(23,985)	(5,950)	(1,533)	(380)
Proceeds from sale of subsidiaries	18	3,376	700	216	45
Liquidation proceeds of subsidiary to minority shareholders	18	(694)	-	(44)	-
Investments into associates and joint ventures	19	(136,228)	(2,393)	(8,707)	(153)
Proceeds from sale of associates and joint ventures		8,306	-	531	-
Proceeds from sale of other financial investments		3	141	0	9
Purchase of investment property	22	(63)	(17,018)	(4)	(1,088)
Purchase of property, plant and equipment	23	(226,960)	(79,996)	(14,505)	(5,113)
Proceeds from sale of property, plant and equipment	23	2,143	985	137	63
Purchase of intangible assets		(2,917)	(1,699)	(186)	(108)
Sales of a unit		2,752	(776)	176	(49)
Loans granted	16	(190,123)	(108,961)	(12,151)	(6,964)
Loan repayments received	16	176,311	51,121	11,268	3,267
Interest received		6,641	6,751	424	431
Dividends received		3,323	1,679	212	107
Total cash flows from investing activities		(378,115)	(155,416)	(24,166)	(9,933)
CASH FLOWS FROM FINANCING ACTIVITIES					
Proceeds from borrowings	26	293,567	9,143	18,762	584
Repayments of borrowings	26	(6,724)	(9,063)	(430)	(579)
Finance lease principal payments	26	(5,832)	(3,373)	(373)	(216)
Proceeds from issue of ordinary shares in subsidiary		-	105	-	7
Government grants received	28	22,225	-	1,421	-
Dividends paid		(60,128)	(38,770)	(3,843)	(2,478)
Total cash flows from financing activities		243,108	(41,958)	15,537	(2,682)
Change in cash and cash equivalents		129,660	(99,014)	8,287	(6,329)
Cash and cash equivalents at beginning of year	13	141,812	240,152	9,063	15,349
Effect of exchange rate changes		(3,026)	674	(193)	43
Cash and cash equivalents at end of year	13	268,446	141,812	17,157	9,063

The notes on pages 15-52 are an integral part of these consolidated financial statements.

NOTES

NOTE 1 ACCOUNTING PRINCIPLES

1.1 GENERAL BASES

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

The financial statements have been prepared under the historical cost convention, except for financial assets at fair value through profit or loss.

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

Assets and liabilities have been classified as current and non-current in the balance sheet. Current assets include assets that are expected to be exchanged or used within the next financial year (except deferred tax asset that is classified as non-current asset). Current liabilities include liabilities which due date is within 12 months after the balance sheet date (except deferred tax liability that is classified as non-current liability). The remaining assets and liabilities have been classified as non-current.

Expenses have been classified according to their function in the income statement.

The functional and presentation currency in the consolidated financial statements of Merko Ehitus Group is the Estonian kroon. The financial statements are presented in thousands of kroons. Pursuant to the requirements of Tallinn Stock Exchange, the principal financial statements have also been presented in thousands of euros. As the Estonian kroon is pegged to the euro (EUR 1=EEK 15.6466), then no exchange rate differences arise in the translation of the financial statements.

1.2. NEW IFRS STANDARDS AND INTERPRETATIONS

New IFRS standards and several changes in existing standards were implemented since 1 January 2005. The adoption of these changes became obligatory for the Group from the financial year started on 1 January 2005.

In 2005 the Group adopted all new and revised standards that are effective from or before 1 January 2005. The amended standards, which are applied from 1 January 2005 are the following:

- IAS 2 (revised 2003), Inventories
- IAS 10 (revised 2003), Events After Balance Sheet Date
- IAS 17 (revised 2003), Leases
- IAS 21 (revised 2003), The Effects of Changes in Foreign Exchange Rates
- IAS 27 (revised 2003), Consolidated and Separate Financial Statements
- IAS 32 (revised 2003), Financial Instruments: Disclosure and Presentation
- IAS 33 (revised 2003), Earnings per Share
- IAS 39 (revised 2003), Financial Instruments: Recognition and Measurement
- IAS 40 (revised 2004), Investment Property

The issued new standards and interpretations, which get into force for the period starting from 1 January 2005 and are applied respectively, are the following:

- IFRS 2, Share-based Payments
- IFRS 3, Business Combinations, which get into force for the period starting from 31 March 2004
- IFRS 4, Insurance Contracts
- IFRS 5, Non-current Assets Held for Sale and Discontinued Operations
- IFRIC 1, Changes in Existing Decommissioning, Restoration and Similar Liabilities
- IFRIC 2, Members' Shares in Co-operative Entities and Similar Instruments

The adoption of these amendments and interpretations to standards caused no significant changes to the existing recognition and measurement policies and had no impact to the profit of the Group. However, the adoption of the changed standards has resulted in certain changes in presentation of the financial information and in need to disclose additional information in the financial statements. Previous period's comparative figures have been presented in accordance with the new requirements.

1.3. CHANGE IN ACCOUNTING POLICIES

In preparing the consolidated financial statements for the year 2005, the following accounting policies have been changed:

1.3.1. In 2004, sales revenue from real estate development projects was recognised after the conclusion of a notarial preliminary contract, under the stage of completion method in accordance with International Financial Reporting Standard IAS 11 "Construction Contracts". As a result of the change, revenue from real estate development projects is recognised as sales revenue in accordance with Standard IAS 18 "Revenue", i.e. sales revenue is recognised after transferring the real estate property to the buyer. The effect of the change on comparative information for 2004 is immaterial.

1.3.2. In accordance with International Financial Reporting Standard IFRS 3 "Business Combinations", the carrying amount of negative goodwill which arose in business combinations before 31.03.2004 is taken off the balance sheet as an adjustment of the opening balance of retained earnings. As result, the opening balance of retained earnings and intangible assets as at 01.01.2005 has been adjusted by the carrying amount of negative goodwill which arose in the acquisition of the subsidiary Tallinna Teede AS in 2001 in the amount of 2,709 thousand kroons (Note 24).

1.3.3. In 2005, the subsidiary SIA Merks changed its accounting policy to account for its real estate project Arena Riga. This project has been undertaken in cooperation with Riga's City Government and the Ice Hockey World Championships are planned to be held in this hall in 2006. To cover the incidental expenses related to the short construction period, losses arising from the difference between the market value of this multi-functional hall built by SIA Merks (as the Company's own asset) and the construction and usage costs, plots of land whose fair value exceeded the purchase price were sold to SIA Merks in 2004. In the financial statements for 2004, the construction of the hall as well as the acquired plots of land were reported at acquisition cost. In the financial statements for 2005, these grants are reported under the gross method in accordance with IAS 20 "Government Grants". In conjunction with the change of accounting policies, the comparative information for 2004 has been adjusted, as result of which the acquisition cost of plots was increased to their fair value at the time of acquisition (recognised in inventories) and the liability was increased (deferred income from government grants), both in the amount of 98,067 thousand kroons. Capitalized construction costs of the hall were written down at the end of 2004 to reflect its fair value, according to IAS 36. The impairment loss arising from revaluation in the amount of 55,865 thousand kroons was covered by the income from the government grant. As at 31.12.2004, the amount of the grant was 44,818 thousand kroons, which will be used for covering the costs arising from further write-downs of the hall.

Balance sheet for 2004

<i>in thousands of kroons</i>	reported in 2004	change	adjusted in 2004
Inventories	351,332	98,067	449,399
Total current assets	1,004,084	98,067	1,102,151
Property, plant and equipment	131,765	(53,249)	78,516
Total assets	1,253,786	44,818	1,298,604
Government grants	-	44,818	44,818
Total current liabilities	506,532	44,818	551,350
Total liabilities	528,616	44,818	573,434
Total liabilities and equity	1,253,786	44,818	1,298,604

Income statement for 2004

<i>in thousands of kroons</i>	reported in 2004	change	adjusted in 2004
Other operating income	16,198	55,865	72,063
Other operating expenses	(3,677)	(55,865)	(59,542)

The changes in balance sheet items are translated from Latvian lat to Estonian kroon on the basis of foreign exchange rates of the Bank of Estonia at the balance sheet date, income and expenses on the basis of the weighted average foreign exchange rates for the year.

These adjustments did not affect the net profit, the cash flows and the statement of changes in equity for 2004.

The impact of the changes in the accounting principles to earnings per share (both basic and diluted) is immaterial.

1.4. AMENDMENTS TO THE PRESENTATION FORMAT

The following amendment has been made to the presentation format as compared to the previous year:

- interest income received on loans granted for business purposes has been reported in the income statement line *Other operating income*, last year it was included in *Financial income*.

Comparative information of the previous financial year has been changed in the financial statements to correspond to the new format. The effect of the amendment is immaterial.

1.5. CRITICAL ACCOUNTING ESTIMATES, AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES

In accordance with International Financial Reporting Standards, certain decisions and estimates shall be made which may affect the assets and liabilities reported in the financial statements of the next financial year. In addition to estimates, the management will provide their estimates with regard to the application of accounting policies used.

The most significant management estimates are as follows:

1.5.1. Revenue under the stage of completion method

Revenue from construction in progress is recognised under the stage of completion method (Note 1.25), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, and reporting of income and expenses has been introduced to determine the stage of completion. The estimated final revenue to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the revenue estimate is adjusted. In the financial year, revenue was decreased by 103,424 thousand kroons (Note 34) as a result of determining the stage of completion of construction services in progress. Risk analysis showed that a change in the estimate of the stage of completion of construction projects in the range of +/- 10% will result in a change in the net profit in a range between an increase of 97,627 thousand kroons and the decrease of 207,960 thousand kroons.

1.5.2. Determination of the useful life of property, plant and equipment

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

1.5.3. Assessing the recoverable amount of Arena Riga

Considering the experience in neighbouring countries, where the recoverable amount of multifunctional halls established has been lower than the constructions cost, the management has carried out the impairment test of the Arena Riga in order to assess the recoverable amount of the hall. Taking into account the specifics of the hall, lack of active market and absence of a sales offer, determining the fair value of the hall through comparative sales arrangements was not feasible, which is why the recoverable value was determined via value in use.

In order to determine the value in use, the management analysed the indices of similar multifunctional halls in Estonia and Lithuania (number of events per year, average number of visitors per event day, average revenue/expense per event and visitor, expenses per halls usable area and visitor, etc.) and composed a business plan of the hall based on these indices. The cash-flows for the following 10 years and the present value of these cash-flows were generated based on the model. As a result of the impairment test and the recoverable amount determined, the hall was written down by 145,100 thousand kroons. As the Group has no experience in this field, it was not feasible to compare the cash-flow prognosis and assumptions with historical data.

1.6. CONSOLIDATION

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

The parent company and its subsidiaries are treated as one economic entity in the consolidated financial statements. Upon consolidation, intra-group receivables and liabilities, income and expenses as well as unrealised profits and losses arising from intra-group transactions have been eliminated in full. Minority interest is reported separately.

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

1.7. RECOGNITION OF SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES IN THE FINANCIAL STATEMENTS OF THE PARENT COMPANY

In accordance with the Estonian Accounting Act, separate principal financial statements (of the parent company) shall be disclosed in the notes. The principal financial statements of the parent company are disclosed in Note 41. The principal financial statements of the parent company have been prepared using the same accounting methods and measurement bases that were used for the preparation of the consolidated financial statements.

Amendments to accounting policies in separate financial statements.

In conjunction with the amendment to IAS 27 "Consolidated and Separate Financial Statements" and IAS 31 "Joint ventures", the accounting policy for reporting subsidiaries, associates and joint ventures has been changed in the separate financial statements disclosed in the notes to the financial statements (Note 41) – instead of the previous equity method, subsidiaries, associates and joint ventures are accounted for at their acquisition cost in the separate financial statements. The effect of the change in the accounting policy was recorded as at 31 December 2004; the balance of retained earnings was reduced by 46,367 thousand kroons and currency translation adjustment reserve has increased by 4,663 thousand kroons. Accordingly, the cost of investments into subsidiaries has also been reduced.

1.8. BUSINESS COMBINATIONS

Business combinations between independent parties are accounted for under the purchase method. The difference between the cost of an acquisition and the fair value of the acquired net assets is recorded as goodwill. From the date of acquisition, the revenue and expenses of the acquired entity are reported in the income statement of the Group and the resulting goodwill in the balance sheet of the Group.

Goodwill is the difference between cost of acquisition and the fair value of assets, liabilities and contingent liabilities acquired in a business combination, reflecting the portion of the acquisition cost which was paid for such assets of the acquired entity that cannot be separated and recognised separately. Goodwill is recognised at its acquisition cost as an intangible asset at the date of the acquisition.

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

With regard to goodwill which arose in business combinations set up before 31.03.2004, amortisation of goodwill has been terminated as at 01.01.2005, an impairment test has been carried out at the balance sheet date and if necessary, goodwill has been written down.

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement. Such differences that arose before 01.01.2005 has been included in retained earnings as at 01.01.2005 (see also Note 1.3.2).

1.9. ASSOCIATES

Associates are entities over which the Group has significant influence but whose operating and financial policies it does not control. Significant influence is generally presumed to exist when the Group holds between 20 and 50% of the voting power of the investee. Investments into associates are accounted for under the equity method. Under the equity method, the amount of the investment is adjusted to recognise the share of the Group in the profits or losses of the associate and unrealised profits and losses arising from mutual transactions have been eliminated based on the Group's share in the associate.

Investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

1.10. JOINT VENTURES

Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at acquisition cost and subsequently adjusted by the changes that have occurred in the venturer's share of the net assets under common control. The income statement of the venturer includes the share of the venturer in the profits or losses of the entity under common control.

1.11. JOINTLY CONTROLLED OPERATIONS

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

- the assets that it controls and the liabilities it incurs;
- the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

1.12. FOREIGN CURRENCY

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

The functional currency of subsidiaries located abroad is the currency of their business environment; therefore the financial statements of such subsidiaries have been translated into Estonian kroons for consolidation purposes. The asset and liability items have been translated on the basis of foreign exchange rates of the Bank of Estonia, income and expenses on the basis of the weighted average foreign exchange rates for the year and other changes in equity have been translated using the foreign exchange rates at the date on which they arose. Exchange rate differences arising from translation are reported in the equity item *Currency translation adjustment*.

1.13. FINANCIAL ASSETS

The purchases and sales of financial assets are recognised at the transaction date.

Depending on the purpose for which financial assets were acquired, investments are classified in the following categories at the Group:

- financial assets at fair value through profit or loss;
- loans and receivables not held for trading purposes;
- held-to-maturity investments;
- available-for-sale financial assets.

Financial assets at fair value through profit or loss include financial assets held for trading purposes (i.e. assets acquired or created principally for the purpose of selling or repurchasing in the short term; a part of a jointly managed portfolio of financial instruments; or a derivative financial instrument which is not a hedging instrument) and other financial assets that have not been designated by management at their initial recognition as at fair value through profit or loss. Assets in this category are classified as current assets if they are principally held for trading purposes or are expected to be realised within 12 months after the balance sheet date. After initial recognition, financial assets in this category are carried at fair value.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are included in current assets except for maturities greater than 12 months after the balance sheet date. Such assets are classified as non-current assets. Loans and receivables are initially recognised at their fair value less transaction costs. After initial recognition, the Group carries loans and receivables at amortised cost (less any impairment losses), calculating interest income on the receivable in the following periods using the effective interest rate method.

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information on the solvency of the party to transaction. Receivables whose collection is improbable are expensed during the accounting period.

The Company does not have any held-to-maturity and available-for-sale financial assets. The Company does not have any derivative transactions either.

1.14. IMPAIRMENT OF ASSETS

Financial assets at amortised cost

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Company about the following events:

- significant financial difficulty of the issuer or debtor;
- a breach of contract, such as a default or delinquency in payments;

- it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

If there is objective evidence that an impairment loss has been incurred on loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Non-financial asset

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of impairment at each reporting date.

1.15. INVENTORIES

Inventories are recorded in the balance sheet at their acquisition cost, consisting of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition.

In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishably from each other, then the weighted average cost method is used.

Inventories are accounted for in the balance sheet at the lower of acquisition cost and net realisable value. The net realisable value is the sales price less estimated costs to sell.

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

1.16. INVESTMENT PROPERTY

Investment property is real estate property which is primarily held for the purpose of earning rental income or for capital appreciation or for both, but not for the production of goods or services, for administrative purposes or for sale in the ordinary course of business. Investment property is measured under the acquisition cost method, that is at acquisition cost less any accumulated depreciation and any accumulated impairment losses.

Buildings included in investment properties are depreciated on a straight-line basis over the period of 12.5 to 33.3 years. Land is not depreciated.

1.17. PROPERTY, PLANT AND EQUIPMENT

An item of property, plant and equipment is an asset used for production, provision of services or administrative purposes over a period longer than one year. The acquisition cost consists of the purchase price of the asset and other expenditure incurred in bringing the asset to its operating condition and location.

An item of property, plant and equipment is carried in the balance sheet at acquisition cost less any accumulated depreciation. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years;
- machinery and equipment 3-5 years;
- other property, plant and equipment 2.5-5 years;
- right of superficies 50 years;
- land is not depreciated.

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

Non-current assets are written down to their recoverable value if the recoverable value is below the carrying amount. The recoverable value is the higher of the asset's net selling price and its value in use.

1.18. OTHER INTANGIBLE ASSETS

Other intangible assets (development costs, patents, licenses, trademarks, software) are recognised in the balance sheet when the asset is controlled by the Company, it gives rise to future economic benefits and the cost of the asset can be measured reliably. The acquisition cost of an intangible asset consist of its purchase price and other expenditure directly related to the purchase. Other intangible assets are carried in the balance sheet at acquisition cost less any accumulated amortisation. Amortisation is calculated on a straight-line basis over the estimated useful lives of assets, which is 5 years maximum.

1.19. FINANCE AND OPERATING LEASES

Leases of property, plant and equipment where the company has substantially all the risks and rewards of ownership are classified as finance leases. All other leases are recognised as operating leases.

Assets and liabilities leased under the finance lease terms are reported in the balance sheet at the lower of fair value of the leased asset and the present value of minimum rental payments. Items of property, plant and equipment leased under the finance lease terms are depreciated over the shorter of the lease term and the useful life.

Finance lease liabilities are reduced by principal payments; interest expenses on rental payments are included in financial expenses in the income statement.

Operating lease payments are reported in the income statement as expenses on an accrual basis over the lease term.

1.20. CORPORATE INCOME TAX

According to the Income Tax Act of the Republic of Estonia, legal persons are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, reception costs, dividends and payments not related to business operations. Thus there are no differences between the tax bases and the carrying values of assets which would give rise to a deferred income tax liability.

The tax rate on dividends payable is 23/77 (until 31.12.2005: 24/76 and until 31.12.2004: 26/74) of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared.

Corporate income tax on profits earned by subsidiaries located in Latvia and Lithuania and the deferred income tax expenses or income as well as the corporate income tax on dividends of Estonian companies are reported in the consolidated income statement.

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the balance sheet. Deferred tax assets are recognised in the company's balance sheet if their future realisation is probable.

Legal persons in Latvia and Lithuania that belong to the Group calculate taxable income and the corporate income tax in accordance with the legislation of the Republic of Latvia and the Republic of Lithuania. The profits of entities located in the Republic of Latvia and the Republic of Lithuania are taxed at the rate of 15%.

1.21. BORROWINGS

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest rate method.

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

1.22. EMPLOYEE BENEFITS

1.22.1. Termination benefits – Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an other offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

1.22.2. Profit-sharing and bonus plans – The Group recognizes a liability and an expense for bonuses and profit-sharing, based on formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognizes a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

1.23. PROVISIONS

Provisions are constructive or legal obligations which arise as a result of events occurring before the balance sheet date. Setting up of provisions or increasing existing provisions is recognised as expenses in the income statement of the accounting period.

Pursuant to the Building Act, the construction companies of the Group provide 2-year warranties on their buildings. The calculation of warranty provisions is based on the management estimates and actual experience of previous periods with regard to actual warranty expenses.

1.24. REVENUE

Revenue is recognised at the fair value of the consideration received or receivable.

Revenue from the sale of goods (incl. sale of a real-estate development projects) is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer, the amount of revenue and the costs incurred in respect of the transaction can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the enterprise.

Revenue from the provision of services is recognised based on the stage of completion of the service at the balance sheet date.

Revenue arising from interest and dividends is recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of the revenue can be measured reliably.

1.25. CONSTRUCTION CONTRACTS

Income and expenses of unfinished construction services have been matched under the stage of completion method. The stage of completion is determined on the basis of the relationship between the actual costs incurred by the balance sheet date and the estimated costs of the contract. The actual costs of the contract consist of direct and general costs of the construction contract.

If invoices submitted to the customer by the balance sheet date are either higher or lower than the income calculated under the stage of completion method, then the difference is recognised as a liability or as a receivable in the balance sheet.

When it is probable that total contract costs exceed total contract revenue, the expected loss is recognised as an expense immediately.

1.26. GOVERNMENT GRANTS

Government grants are recognised as income over the periods necessary to match them with the related costs, which they are intended to compensate. Government grants received to compensate the operating expenses of the previous period or where there are no additional conditions attached to grants to be addressed in the future, are accounted for as income when the grant is received. Government grants are recognised where there is reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

1.27. CASH AND CASH EQUIVALENTS

In the balance sheet and the cash flow statement, cash and cash equivalents are highly liquid funds with low variation in value, such as cash on hand, cash in bank accounts, highly liquid securities such as money market funds and term deposits of three months or less.

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

1.28. CONTINGENT LIABILITIES

Contingent liabilities are those liabilities whose realisation is less probable than non-realisation and whose amount cannot be determined reliably. Potential liabilities are not recognised in the balance sheet, they are disclosed in the notes to the financial statements.

1.29. STATUTORY RESERVE CAPITAL

Reserve capital is formed to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be entered in reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

1.30. EVENTS AFTER THE BALANCE SHEET DATE

The financial statements of the reporting period include material circumstances affecting the assessment of assets and liabilities which became evident between the balance sheet date and the date of preparing the financial statements but that are related to transactions in the accounting period or previous periods. Material events after the balance sheet date not related to transactions in the accounting period or previous periods are not reported in the balance sheet but they are disclosed in the notes to the financial statements.

1.31. RELATED PARTIES

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

- parent company AS Merko Grupp;
- shareholders of AS Merko Grupp with significant influence through AS Merko Grupp;
- other shareholders with significant influence;
- other subsidiaries of AS Merko Grupp;
- subsidiaries;
- other controllable subsidiaries;
- joint ventures;
- associates;
- close relatives of persons with significant influence;
- key managers and their close relatives;
- entities under control of persons mentioned above;
- companies sharing key managers with AS Merko Ehitus.

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

1.32. DIVIDEND DISTRIBUTION

Dividend distribution to the Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

1.33. SEGMENT REPORTING

A business segment is a part of the Group engaged in making similar products or providing similar services and whose profitability and risks differ from those of other parts of the Group. The business segments at the Group are construction from which road construction has been separated, construction of communication networks and production of concrete elements. Segment expenses are those which are incurred in the segment's main operations and which can be allocated to the segment reliably and objectively. Such expenses, assets and liabilities have not been allocated to segments cannot be or are not suitable to be associated with a specific segment. Business segments have been considered as primary segments when preparing the financial statements.

A geographical segment is a part of the Group whose operating activities occur in an economic environment whose returns and risks differ from the respective figures of other parts of the Group. The main geographical segments at the Group are Estonia, Latvia and Lithuania. When preparing the financial statements, geographical segments have been considered as secondary segments.

The main operating environment of the parent company is Estonia. All business segments of the Group are represented in Estonia. Construction is the main business segment in Latvia and Lithuania. The segment's sales revenue is shown on the basis of geographical segments of markets and segment's assets, based on the geographical location of assets.

1.34. NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS AND INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE (IFRIC) INTERPRETATIONS

By the time of preparing these financial statements, new International Financial Reporting Standards and their interpretations have been issued which shall become mandatory for the Company's financial statements prepared for accounting periods beginning at or after 1 January 2006. Below is the Company's estimate on the potential effect of new standards and interpretations on the financial statements upon their first-time application.

Amendment to **IAS 1 – Presentation of Financial Statements**: Capital disclosures. The amendment to IAS 1 shall be applied to accounting periods beginning at or after 1 January 2007. The Company has decided not to apply the amendments to the standards early. The standard requires additional disclosures in the financial statements.

Amendments to **IAS 39 – Financial Instruments: Recognition and Measurement** (Recognition of cash flow hedges for forecasting intra-group transactions; Fair value option). The amendments to the standards shall be applied to accounting periods beginning at or after 1 January 2006. The Company has decided not to apply the amendments to the standards early. The management estimates that the application of the amendments will not lead to any changes in the recognition of existing assets and liabilities at the time of preparing the financial statements.

Amendment to **IAS 39 Financial Instruments: Recognition and Measurement** and **IFRS 4 Insurance Contracts – Financial guarantee contracts**. The amendments to the standards shall be applied to accounting periods beginning at or after 1 January 2006. The Group has decided not to apply the amendments to the standards early. The management estimates that the application of the amendments will not lead to any changes in the recognition of existing assets and liabilities at the time of preparing the financial statements.

IFRS 7 – Financial instruments: Disclosures. IFRS 7 shall be applied to accounting periods beginning at or after 1 January 2007. The Company has decided not to apply the amendments to the standards early. The standard requires additional disclosures in the financial statements.

IFRIC 4 – Determining Whether an Arrangement Contains a Lease. IFRIC 4 shall be applied to accounting periods beginning at or after 1 January 2006. The Company has decided not to apply IFRIC 4 early. The management estimates that the application of IFRIC 4 will not lead to any changes in the recognition of existing agreements at the time of preparing the financial statements.

Amendment to **IAS 19 – Concerning Reporting Actuarial Gains and Losses and disclosures** (effective from 1 January 2006)

Amendment to **IAS 21 – The Effects of Changes in Foreign Exchange Rates** (effective from 1 January 2006).

Amendment to **IFRS 1 – First-time Application of IFRS** and amendment to **IFRS 6 – Exploration for and Evaluation of Mineral Resource** (effective from 1 January 2006)

IFRIC 5 – Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)

IFRIC 6 – Liabilities Arising from Participating in a Specific Market: Waste Electrical and Electronic Equipment (applicable for periods beginning at or after 1 December 2005 and effective from 1 January 2006)

IFRIC 7 – Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Environments (applicable for periods beginning at or after 1 March 2006 and effective from 1 January 2007)

IFRIC 8 – Scope of IFRS 2 (applicable for periods beginning at or after 1 May 2006 and effective from 1 January 2007)

IFRIC 9 – Reassessment of Embedded Derivatives (effective from 1 June 2006)

IFRS 6 – Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)

IFRS 7, IAS 21, IFRS 6 and IFRS 1 have not yet been endorsed by the European Union. Despite that, the Company's management has decided to refer to these standards above, as the European Union may require their application retrospectively. For example, IFRIC 2 was officially issued at 7 July 2005, but its application is mandatory for periods beginning at or after 1 January 2005. Thus, the standard was entered into force and applied retrospectively before the date of endorsement.

NOTE 2 BUSINESS AND GEOGRAPHICAL SEGMENTS

BUSINESS SEGMENTS

2005 <i>in thousands of kroons</i>	Construc- tion	Road construction	Concrete elements	Construction of communication networks	Group
Sales	3,028,386	204,006	-	-	3,232,392
Sales between segments	4,773	34,338	-	-	(39,111)
Sales of the segment	3,033,159	238,344	-	-	3,271,503
Segment's operating profit	416,770	18,281	-	-	435,051
Financial income (expenses)					28,673
incl. profit (loss) from associates and joint ventures (Note 19)	5,839	1,924	10,660	1,209	19,632
Profit before tax					463,724
Corporate income tax					(18,437)
Net profit of the Group					445,287
incl. attributable to equity owners of the parent company					438,638
minority interest					6,649
Segment's assets	1,856,012	121,555	-	-	1,977,567
Associates and joint ventures	150,773	-	25,302	3,534	179,609
Unallocated assets					62,700
Total consolidated assets					2,219,876
Segment's liabilities	715,238	37,671	-	-	752,909
Unallocated liabilities					355,019
Total consolidated liabilities					1,107,928
Purchase of investment property	63	-	-	-	63
Purchase of property, plant and equipment and intangible assets	227,228	9,015	-	-	236,243
Depreciation and amortisation (Notes 22-24)	99,525	10,112	-	-	109,637
2004 <i>in thousands of kroons</i>	Construc- tion	Road construction	Concrete elements	Construction of communication networks	Group
Sales	2,962,857	147,542	-	-	3,110,399
Sales between segments	483	13,819	-	-	(14,302)
Sales of the segment	2,963,340	161,361	-	-	3,124,701
Segment's operating profit	297,432	22,272	-	-	319,704
Financial income (expenses)					(11,525)
incl. profit (loss) from associates and joint ventures (Note 19)	6,107	531	5,243	(1,931)	9,950
Profit before tax					308,179
Corporate income tax					(9,997)
Net profit of the Group					298,182
incl. attributable to equity owners of the parent company					294,600
minority interest					3,582
Segment's assets	1,138,264	87,043	-	-	1,225,307
Associates and joint ventures	20,284	3,627	5,243	6,292	35,446
Unallocated assets					37,851
Total consolidated assets					1,298,604
Segment's liabilities	520,263	15,119	-	-	535,382
Unallocated liabilities					38,052
Total consolidated liabilities					573,434
Purchase of investment property	6,468	-	-	-	6,468
Purchase of property, plant and equipment and intangible assets	63,579	15,673	-	-	79,252
Depreciation and amortisation (Notes 22-24)	61,934	8,969	-	-	70,903

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

NOTE 2 BUSINESS AND GEOGRAPHICAL SEGMENTS (CONTINUED)

GEOGRAPHICAL SEGMENTS

<i>in thousands of kroons</i>		
Sales	2005	2004
Estonia	2,441,325	2,489,027
Latvia	560,107	460,510
Lithuania	230,960	160,862
Total	3,232,392	3,110,399

<i>in thousands of kroons</i>	Total assets		Purchase of investment property		Purchase of property, plant and equipment	
	31.12.2005	31.12.2004	2005	2004	2005	2004
Estonia	1,033,085	849,690	39	6,468	20,440	21,119
Latvia	991,929	321,926	24	-	215,356	57,861
Lithuania	194,862	126,988	-	-	447	272
Total	2,219,876	1,298,604	63	6,468	236,243	79,252

NOTE 3 COST OF GOODS SOLD

<i>in thousands of kroons</i>	2005	2004
Materials	367,736	369,727
Construction services	1,934,926	1,931,422
Sale of investment property	78,303	68,972
Staff costs	152,619	135,464
Depreciation and amortisation	15,253	12,293
Design	72,115	45,799
Construction mechanisms and transportation	82,951	77,886
Other expenses	34,811	54,426
Total cost of goods sold	2,738,714	2,695,989

NOTE 4 MARKETING COSTS

<i>in thousands of kroons</i>	2005	2004
Staff costs	11,651	7,255
Depreciation and amortisation	253	168
Advertising costs, sponsorship	5,017	4,514
Transportation	1,256	1,060
Construction tenders	918	1,576
Other expenses	3,500	3,565
Total marketing costs	22,595	18,138

NOTE 5 GENERAL AND ADMINISTRATIVE EXPENSES

<i>in thousands of kroons</i>	2005	2004
Staff costs	72,967	54,373
Depreciation and amortisation	4,793	2,577
Computer equipment and information services	10,413	5,446
Transportation	5,677	4,489
Offices expenses, communications services	14,638	10,965
Other expenses	19,144	11,239
Total general and administrative expenses	127,632	89,089

NOTE 6 OTHER OPERATING INCOME

<i>in thousands of kroons</i>	2005	2004
Proceeds from sale of non-current assets	535	545
Fines and amounts for delay received	971	657
Foreign exchange gains	16	-
Proceeds from sales of a unit	-	11,651
Interest income from operating activities	5,590	2,591
Revenue from government grants	177,333	55,865
Other income	607	754
Total other operating income	185,052	72,063

NOTE 7 OTHER OPERATING EXPENSES

<i>in thousands of kroons</i>	2005	2004
Fines, penalties	2,790	1,213
Foreign exchange loss	-	673
Gifts, donations	904	872
Depreciation and impairments	89,338	55,865
Other expenses	420	919
Total other operating expenses	93,452	59,542

NOTE 8 FINANCIAL INCOME

<i>in thousands of kroons</i>	2005	2004
Financial income from other long-term loans and receivables	11	-
Interest income	1,470	5,607
Gains of financial assets at fair value through profit or loss	3	-
Other financial income	4,769	136
Total financial income	6,253	5,743

NOTE 9 FINANCE COST

<i>in thousands of kroons</i>	2005	2004
Interest expenses	2,418	3,395
Foreign exchange losses	2,277	5,254
Losses of financial assets at fair value through profit or loss	-	14,557
Loss from revaluation of financial assets at fair value through profit or loss	-	2,949
Other financial expenses	15	764
Total finance cost	4,710	26,919

NOTE 10 CORPORATE INCOME TAX

<i>in thousands of kroons</i>	2005	2004
Profit before tax	463,724	308,179
Corporate income tax on dividends	8,830	6,672
Corporate income tax	2,851	3,325
Deferred income tax expense	6,756	-
incl. deferred income tax gain (Note 21)	(4,629)	-
deferred income tax expense (Note 31)	11,385	-
Total corporate income tax	18,437	9,997

NOTE 11 EARNINGS PER SHARE

Basic earnings per share for profit attributable to the equity holders of the parent company has been derived by dividing the net profit attributable to the shareholders by the weighted average number of shares, without considering treasury shares (in 2004 and 2005, AS Merko Ehitus did not hold any treasury shares).

	2005	2004
Net profit attributable to shareholders (in thousands of kroons)	438,638	294,600
Weighted average number of ordinary shares (thousand pcs)	17,700	17,700
Earnings per share (in kroons)	24.78	16.64

The figures for 2004 have been calculated taking into consideration the equity capitalization which took place in the accounting period (Note 33).

In 2004 and 2005, the Group did not have any potential ordinary shares to be issued, therefore the diluted earnings per share equal the basic earnings per share.

NOTE 12 DIVIDENDS PER SHARE

Dividends payable are recognised after the approval of profit allocation at the General Meeting of Shareholders. According to the profit allocation proposal, 88,500 thousand kroons will be distributed in 2006, i.e. 5.00 kroons per share and the accompanying income tax expense will amount to 23/77 of the amount payable, i.e. 26,435 thousand kroons.

In 2005, 57,525 thousand kroons i.e. 6.50 kroons per share were paid out, and the accompanying income tax amounted to 4,446 thousand kroons.

NOTE 13 CASH AND CASH EQUIVALENTS

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Cash on hand	97	137
Bank accounts	135,577	36,763
Short-term deposits	121,258	95,206
Units of Estonian money market funds	11,514	9,706
Total cash and cash equivalents	268,446	141,812

As at 31.12.2005, the interest on short-term bank overnight deposits was 2.15% (31.12.2004: 2.0%) and the weighted average interest on term deposits was 2.5% (2004: 2.41%). As at 31.12.2005 the weighted average maturity of the bank deposits is 7.6 days (2004: 10.6 days). The average rate of return on the units of Estonian money market funds over the last 12 months was 1.87% (2004: 2.04%).

NOTE 14 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Financial assets at fair value through profit or loss	-	11,775
Total financial assets at fair value through profit or loss	-	11,775

As at 31.12.2004, shares in the amount 11,755 thousand kroons that belonged to the subsidiary SIA Merks, and that were sold in 2005 have been recognised at the Group. The expense related to the revaluation to fair value amounted to 1,149 thousand kroons.

NOTE 15 TRADE RECEIVABLES

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Trade receivables		
accounts receivable	296,626	257,992
allowance for doubtful receivables	(345)	(1,158)
Total trade receivables	296,281	256,834
Prepaid expenses, except for corporate income tax		
value added tax	34,193	15,637
social security tax	6	-
Total prepaid expenses, except for corporate income tax	34,199	15,637
Receivables from the customers of construction works (Note 34)	82,224	117,180
Other short-term receivables		
short-term loans (Note 16)	49,481	72,637
interest receivable	1,846	2,004
uncollected dividends	-	224
other short-term receivables	6,026	3,252
Total other short-term receivables	57,353	78,117
Prepayments for services		
prepayments for construction services	68,357	25,992
prepaid insurance	1,062	1,727
other receivables and prepaid expenses	2,634	1,456
Total prepayments for services	72,053	29,175
Total trade receivables	542,110	496,943

NOTE 16 LOANS GRANTED

<i>in thousands of kroons</i>	2005	2004
Loans granted to associates		
Loan balance at beginning of year	49,155	5,909
Granted	28,005	45,047
Collected	(37,440)	(1,275)
Reclassification to a loan granted to subsidiary	(18,395)	(526)
Loan balance at end of year	21,325	49,155
incl. current portion	21,325	49,155
<i>Average interest rate 6.2% (2004: 4.5%).</i>		
Loans granted to entities under common control		
Loan balance at beginning of year	5,991	4,265
Granted	83,243	21,726
Reclassification from a loan granted to subsidiary	31,183	-
Collected	(66,183)	(20,000)
Reclassification to a loan granted to subsidiary	(47,669)	-
Loan balance at end of year	6,565	5,991
incl. current portion	6,565	5,991
<i>Average interest rate 4.0% (2004: 4.0%).</i>		
Loans to other related parties		
Loan balance at beginning of year	380	5,740
Granted	1,593	-
Collected	-	-
Reclassification to a loan granted to subsidiary	-	(5,360)
Loan balance at end of year	1,973	380
incl. current portion	500	-
non-current portion 2...5 years	1,473	380
<i>Average interest rate 1.0% (2004: 0.0%).</i>		
Loans granted to non-related legal persons		
Loan balance at beginning of year	17,754	5,791
Granted	76,860	42,188
Collected	(72,678)	(29,846)
Reclassification to a loan granted to subsidiary	-	(379)
Reclassification to a other receivables	(1,006)	-
Loan balance at end of year	20,930	17,754
incl. current portion	20,679	17,491
non-current portion 2...5 years	251	263
<i>Average interest rate 3.5% (2004: 4.0%).</i>		

NOTE 16 LOANS GRANTED (CONTINUED)

<i>in thousands of kroons</i>	2005	2004
Loans granted to non-related physical persons		
Loan balance at beginning of year	-	-
Granted	422	-
Collected	(10)	-
Loan balance at end of year	412	-
incl. current portion	412	-
<i>Average interest rate 3.7%.</i>		
Total loans		
Loan balance at beginning of year	73,280	21,705
Granted	190,123	108,961
Reclassification from a loan granted to subsidiary	31,183	-
Collected	(176,311)	(51,121)
Reclassification to a loan granted to subsidiary	(66,064)	(6,265)
Reclassification to a receivables	(1,006)	-
Loan balance at end of year	51,205	73,280
incl. current portion (Note 15)	49,481	72,637
non-current portion 2...5 years (Note 20)	1,724	643

NOTE 17 INVENTORIES

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Raw materials and materials	1,845	1,506
Work-in-progress	200,482	29,738
Finished goods	4,461	1,209
Goods purchased for resale		
Registered immovables purchased for resale	752,789	377,951
Other goods purchased for resale	11	12
Total goods purchased for resale	752,800	377,963
Prepayments for inventories		
Prepayments for real estate properties	4,500	35,842
Prepayments for other inventories	-	3,141
Total prepayments for inventories	4,500	38,983
Total inventories	964,088	449,399

NOTE 18 INVESTMENTS IN SUBSIDIARIES

	Participation and voting rights %		Location	Area of operation
	31.12.2005	31.12.2004		
Subsidiaries of AS Merko Ehitus				
AS Gustaf	100	100	Pärnu	construction
AS Merko Tartu	66	66	Tartu	construction
AS Merko Insenerihitus	100	100	Tallinn	construction
OÜ Merko Ehitustööd	100	100	Tallinn	construction
OÜ Merko Kaevandused	-	100	Tallinn	construction
Eesti Ehituseksporti OÜ	100	100	Tallinn	construction
Tallinna Teede AS	100	100	Tallinn	road construction
SIA Merks	100	100	Republic of Latvia, Riga	construction
UAB Merko Statyba	100	100	Republic of Lithuania, Vilnius	construction
OÜ Merko Elamu	100	100	Tallinn	real estate
OÜ Merko Maja	100	100	Tallinn	real estate
OÜ Merko Kinnisvara	100	100	Saue	real estate
OÜ Woody	100	100	Tallinn	real estate
OÜ Gustaf Tallinn	80	80	Tallinn	construction
OÜ Rannamõisa Kinnisvara	100	100	Tallinn	real estate
OÜ Maavõlur	100	100	Tallinn	real estate
OÜ Rae Tehnopark (previous name OÜ Teistest Ees)	100	100	Tallinn	real estate
OÜ Maryplus	100	100	Tallinn	real estate
OÜ Metsailu	100	100	Tallinn	real estate
OÜ Pire Projekt	100	50	Tallinn	real estate
OÜ Constancia	100	50	Tallinn	real estate
OÜ Käibevara	100	-	Tallinn	real estate
OÜ Baltic Electricity Engineering	100	-	Tallinn	electricity systems

In December 2005, AS Merko Ehitus acquired a private limited company OÜ Käibevara from AS Merko Grupp's subsidiary E.L.L. Kinnisvara AS for real estate development and set up a private limited company Baltic Electricity Engineering (share capital 40 thousand kroons), whose main activity is the construction of electricity networks. In April 2005, a 50% participation was acquired in OÜ Pire Projekt and OÜ Constancia, as a result of which these joint ventures became subsidiaries. In July 2005, a subsidiary OÜ Merko Kaevandused was sold to the parent company AS Merko Grupp.

In April 2005, AS Merko Ehitus increased share capital in its subsidiary SIA Merks by 1,500 thousand Latvian lats. In order to restore equity at its subsidiaries OÜ Maryplus, OÜ Rannamõisa Kinnisvara, OÜ Merko Ehitustööd, OÜ Maavõlur and OÜ Metsailu, additional contributions of 40 thousand kroons were made into equity during 2005.

In September 2005, UAB Merko Statyba sold its subsidiary UAB Upes Centras to AS Merko Grupp subsidiary E.L.L. Kinnisvara AS.

In October 2005, Tallinna Teede AS liquidated its subsidiary OÜ Talbit. In December, liquidation proceeds were paid from the distribution plan to Tallinna Teede AS in the amount of 4,857 thousand kroons and to minority shareholders in the amount of 694 thousand kroons.

NOTE 18 INVESTMENTS IN SUBSIDIARIES (CONTINUED)

INVESTMENTS INTO SUBSIDIARIES

<i>in thousands of kroons</i>	OÜ Käibevara	OÜ Pire Projekt	OÜ Constancia	Total
Cash and cash equivalents	24	4,932	5	4,961
Trade receivables	-	3,147	18,238	21,385
Inventories	54,185	120	-	54,305
Current liabilities	51,781	2,399	16,859	71,039
Fair value of net assets acquired	2,428	5,800	1,384	9,612
Participation acquired	100%	50%	50%	
Revenues at the time of purchase	-	25,363	14,502	39,865
Profit at the time of purchase	(512)	4,951	624	5,063
Goodwill (Note 24)	-	350	760	1,110
Acquisition cost	2,428	6,150	2,144	10,722
Paid upon acquisition in 2005	-	(6,150)	(2,144)	(8,299)
Cash and cash equivalents of subsidiary upon acquisition	24	9,864	9	9,897
Cash flows from investments into subsidiaries	24	3,714	(2,135)	1,603
Cash flow from investment into subsidiary SIA Merks				(20,227)
Payable of Tallinna Teede AS for subsidiary acquired in 2003				(1,830)
Payable of SIA Merks for subsidiary acquired in 2004				(3,528)
Paid for other expenses related to setting up subsidiaries				(3)
Total cash flows from investments				(23,985)

As the subsidiaries acquired prepared their financial statements (until the acquisition) in accordance with the local GAAP, disclosing the carrying values (determined in accordance with IFRS, immediately before the combination) of the assets acquired during the business combination is considered impracticable.

PROCEEDS FROM SALE OF SUBSIDIARIES

<i>in thousands of kroons</i>	OÜ Merko Kaevandused	Sale of UAB Merko Statyba's subsidiary UAB Upes Centras	Total
Participation sold	100%	100%	
Sales price	4,600	150	4,750
Profit from sale	5,143	2,355	7,498
Cash received	4,600	150	4,750
Cash and cash equivalents of subsidiary upon the sale	(66)	(1,308)	(1,374)
Cash flows at Group from sale	4,534	(1,158)	3,376

NOTE 19 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

	Participation and voting rights %		Location	Area of operation
	31.12.2005	31.12.2004		
Associates of AS Merko Ehitus				
AS Tartu Maja Betoontooted	25	25	Tartu	concrete elements
AS Telegrupp	31	45	Tallinn	telecommunications
Associate of OÜ Talbit				
AS Bituumen	-	24,2	Tallinn	real estate management
Joint ventures of AS Merko Ehitus				
Normanni Linnagrupi AS	50	50	Tallinn	construction
AS Insenerivõrgud	-	50	Tallinn	construction
OÜ Pire Projekt	-	50	Tallinn	real estate
OÜ Constancia	-	50	Tallinn	real estate
OÜ Unigate	50	50	Tallinn	real estate
OÜ Tornimäe Apartments	50	50	Tallinn	real estate
Joint ventures of SIA Merks				
PS Merks-Terbe Lat	50	50	Republic of Latvia, Riga	construction
SIA Zakusala Estates	50	-	Republic of Latvia, Riga	real estate
Joint venture of AS Merko Tartu				
OÜ Kortermaja	50	50	Tartu	real estate

In 2005, the remaining 50% participation was acquired in joint ventures OÜ Pire Projekt and OÜ Constancia, after which they were accounted for as subsidiaries. During the same year a 14% share in AS Telegrupp (associate) was sold and a joint venture AS Insenerivõrgud was liquidated.

Before the liquidation of OÜ Talbit, a subsidiary of Tallinna Teede AS, OÜ Talbit sold its participation in OÜ Bituumen.

In December 2005, SIA Merks acquired a subsidiary SIA Zakusala Estates for real estate development with the acquisition cost of 148,319 thousand kroons, of which 136,228 thousand kroons was paid in 2005.

NOTE 19 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES (CONTINUED)

<i>in thousands of kroons</i>	Investment 31.12. 2004	Changes in 2005				Investment 31.12. 2005	Participation in equity of investee
		Acquisition, sale and liquidation	Profit (loss) on associated	Dividends	Currency translation adjustment		
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	16,142	-	10,660	(1,500)	-	25,302	25,302
AS Telegrupp	6,292	(2,257)	1,209	(1,710)	-	3,534	3,534
Associate of OÜ Talbit							
AS Bituumen	3,627	(5,550)	1,923	-	-	-	-
Total associates	26,061	(7,807)	13,792	(3,210)	-	28,836	28,836
Joint ventures of AS Merko Ehitus							
Normanni Linnagrupi AS	389	-	33	-	-	422	422
AS Insenerivõrgud	623	(499)	(124)	-	-	-	-
OÜ Pire Projekt	849	(5,800)	4,951	-	-	-	-
OÜ Constancia	760	(1,384)	624	-	-	-	-
OÜ Unigate	412	-	(320)	-	-	92	92
OÜ Tornimäe Apartments	19	-	5	-	-	24	24
Joint ventures of SIA Merks							
PS Merks Terbe Lat	5,100	-	-	(5,099)	11	12	(4)
SIA Zakusala Estates	-	148,319	-	-	-	148,319	910
Joint venture of AS Merko Tartu							
OÜ Kortermaja	1,233	-	671	-	-	1,904	2,012
Total joint ventures	9,385	140,636	5,840	(5,099)	11	150,773	3,456
Total associates and joint ventures	35,446	132,829	19,632	(8,309)	11	179,609	32,292
Changes in 2004							
<i>in thousands of kroons</i>	Investment 31.12. 2003	Acquisition, sale and liquidation	Profit (loss) on associated	Dividends	Currency translation adjustment	Investment 31.12. 2004	Participation in equity of investee
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	10,899	-	5,243	-	-	16,142	16,142
AS Telegrupp	9,901	-	(1,930)	(1,679)	-	6,292	6,292
OÜ Maryplus	-	366	(366)	-	-	-	-
Associate of OÜ Talbit							
AS Bituumen	3,096	-	531	-	-	3,627	3,627
Total associates	23,896	366	3,478	(1,679)	-	26,061	26,061
Joint ventures of AS Merko Ehitus							
Normanni Linnagrupi AS	388	-	1	-	-	389	389
AS Insenerivõrgud	736	-	(113)	-	-	623	623
OÜ Pire Projekt	20	-	829	-	-	849	849
OÜ Constancia	-	-	760	-	-	760	760
OÜ Unigate	-	2,000	(1,588)	-	-	412	412
OÜ Tornimäe Apartments	-	20	(1)	-	-	19	19
Joint ventures of SIA Merks							
PS Merks Terbe Lat	-	-	5,351	-	(251)	5,100	5,100
Joint venture of AS Merko Tartu							
OÜ Kortermaja	-	-	1,233	-	-	1,233	1,381
Total joint ventures	1,144	2,020	6,472	-	(251)	9,385	9,533
Total associates and joint ventures	25,040	2,386	9,950	(1,679)	(251)	35,446	35,594

NOTE 19 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES (CONTINUED)

The difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee in the amount of 108 thousand kroons (2004: 148 thousand kroons) is due to the loss from the unrealised gains of the mutual transaction.

As at 31.12.2005, the investment into the joint venture SIA Zakusala Estates includes intangible assets in the amount of 147,409 thousand kroons. The assets and liabilities of the joint venture are immaterial, but the company has a signed agreement with Riga city that gives them a right to use the 126 thousand m² land-plot on Zakusala island in the center of Riga, until 2 June 2051. The intangible assets recognized reflects the future economic benefits that arise from the use of the right described.

Associates <i>in thousands of kroons</i>	Assets 31.12.	Liabilities 31.12.	Sales	Net profit
2005				
AS Tartu Maja Betoontooted	244,556	143,348	249,750	42,629
AS Telegrupp	25,139	13,700	76,923	1,257
2004				
AS Tartu Maja Betoontooted	133,733	69,165	165,829	21,110
AS Telegrupp	22,073	8,092	65,953	2,302
AS Bituumen	14,999	-	-	2,195

Joint ventures <i>in thousands of kroons</i>	Assets 31.12.		Liabilities 31.12.		Equity 31.12.	Revenue	Expenses	Net profit (loss)
	Current assets	Non-current assets	Current	Non-current				
2005								
Normanni Linnagrupi AS	1,399	-	-	555	844	11,084	11,018	66
AS Insenervõrgud	-	-	-	-	-	6	252	(246)
OÜ Pire Projekt	-	-	-	-	-	25,367	15,465	9,902
OÜ Constancia	-	-	-	-	-	14,502	13,254	1,248
OÜ Unigate	18,940	-	15,055	3,701	184	6	647	(641)
OÜ Tornimäe Apartments	158,184	-	105,617	52,518	49	21	11	10
PS Merks Terbe Lat	921	-	928	-	(7)	5	34	(29)
SIA Zakusala Estates	1,524	1,122	825	-	1,821	3,151	5,159	(2,008)
OÜ Kortermaja	16,635	-	12,611	-	4,024	17,804	16,543	1,261
2004								
Normanni Linnagrupi AS	5,505	-	4,105	623	777	128,420	128,418	2
AS Insenervõrgud	481	767	2	-	1,246	8	235	(227)
OÜ Pire Projekt	34,239	-	32,540	-	1,699	30,398	28,739	1,659
OÜ Constancia	24,459	-	22,939	-	1,520	21,975	20,189	1,786
OÜ Unigate	16,812	-	11,712	4,275	825	-	1,037	(1,037)
OÜ Tornimäe Apartments	31,386	-	5,565	25,782	39	2	3	(1)
PS Merks Terbe Lat	12,506	-	1,518	788	10,200	47,821	37,037	10,783
OÜ Kortermaja	13,937	-	11,175	-	2,762	23,555	20,909	2,646

NOTE 20 OTHER LONG-TERM LOANS AND RECEIVABLES

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Long-term loans (Note 16)	1,724	643
Long-term receivable from the buyer of a subsidiary*	6,800	9,717
Long-term receivables from customers of construction services	-	5,508
Total long-term loans and receivables	8,524	15,868

* The long-term receivable from the buyer of subsidiary's business unit has been discounted at an interest rate of 6 per cent.

NOTE 21 DEFERRED INCOME TAX ASSETS

Income tax assets arisen at the subsidiary UAB Merko Statyba:

<i>in thousands of kroons</i>	2005	2004
Effect of stage of completion method	153	984
Warranty provision	20	126
Vacation pay provision	57	131
Provision for allowance for doubtful receivables	172	170
Tax loss carryforwards	8,351	2,713
Deferred income tax assets at end of year	8,753	4,124
Deferred income tax assets at beginning of year	4,124	4,124
Gain on deferred income tax for the financial year (Note 10)	4,629	-

NOTE 22 INVESTMENT PROPERTY

<i>in thousands of kroons</i>	Land	Buildings	Prepayments	Total
Cost at 31.12.2003	26,180	3,496	23,588	53,264
Accumulated depreciation at 31.12.2003	-	(396)	-	(396)
Residual value at 31.12.2003	26,180	3,100	23,588	52,868
Acquisitions	28,629	-	(22,161)	6,468
Reclassification	2,110	249	-	2,359
Depreciation	-	(306)	-	(306)
Residual value at 31.12.2004	56,919	3,043	1,427	61,389
Cost at 31.12.2004	56,919	4,172	1,427	62,518
Accumulated depreciation at 31.12.2004	-	(1,129)	-	(1,129)
Residual value at 31.12.2004	56,919	3,043	1,427	61,389
Acquisitions	63	-	-	63
Reclassification	(21,348)	4,254	(1,427)	(18,521)
Depreciation	-	(425)	-	(425)
Residual value at 31.12.2005	35,634	6,872	-	42,506
Cost at 31.12.2005	35,634	8,959	-	44,593
Accumulated depreciation at 31.12.2005	-	(2,087)	-	(2,087)
Residual value at 31.12.2005	35,634	6,872	-	42,506

At 31.12.2005, the fair value of investment property was 110,442 thousand kroons (31.12.2004: 107,844 thousand kroons).

In 2005 the Group reclassified a land in amount of 21,348 thousand kroons and a prepayment in amount of 1,427 thousand kroons into an Inventory. Also a part of a building being rented out was reclassified from property, plant and equipment (PPE) to Investment property, the reclassification amounted to 4,254 thousand kroons (2004: 2,359 thousand kroons was reclassified from PPE to Investment property).

Investment property have not been acquired for the purpose of earning rental income but for capital appreciation or development in the future. Buildings located on the plot of land have been temporarily leased out under the operating lease terms. Rental income receivable, maintenance costs incurred and improvement expenses are immaterial.

NOTE 23 PROPERTY, PLANT AND EQUIPMENT

<i>in thousands of kroons</i>	Land	Buildings	Right of superficies	Machinery and equipment	Other	Construction in progress	Pre-payments	Total
Acquisition cost at 31.12.2003	2,189	7,720	458	84,038	25,180	95	145	119,825
Accumulated depreciation at 31.12.2003	-	(2,735)	(58)	(30,046)	(13,935)	-	-	(46,774)
Residual value at 31.12.2003	2,189	4,985	400	53,992	11,245	95	145	73,051
Foreign exchange rate changes	(79)	(32)	-	-	(85)	2,575	41	2,420
Acquisitions	-	-	-	6,684	7,705	62,357	831	77,577
Sales	-	-	-	(460)	(113)	-	-	(573)
Reclassification	(1,965)	(225)	-	(1,999)	1,999	-	(145)	(2,335)
Write-offs	-	-	-	(581)	(262)	-	-	(843)
Depreciation/impairment	-	(257)	(9)	(9,750)	(4,900)	(54,993)*	(872)	(70,781)
Residual value at 31.12.2004	145	4,471	391	47,886	15,589	10,034	-	78,516
Acquisition cost at 31.12.2004	145	7,020	458	81,389	35,090	65,027	872	190,001
Accumulated depreciation at 31.12.2004	-	(2,549)	(67)	(33,503)	(19,501)	(54,993)	(872)	(111,485)
Residual value at 31.12.2004	145	4,471	391	47,886	15,589	10,034	-	78,516
Foreign exchange rate changes	-	-	-	-	(2)	(8)	-	(10)
Acquisitions	-	-	-	10,968	10,504	209,350	1,394	232,216
Sales	-	-	-	(1,102)	(506)	-	-	(1,608)
Reclassification	-	8,384	-	-	-	(12,639)	(124)	(4,379)
Write-offs	-	-	-	(76)	(201)	-	-	(277)
Depreciation/impairment	-	(447)	(9)	(8,794)	(6,866)	(89,338)	-	(105,454)
Residual value at 31.12.2005	145	12,408	382	48,882	18,518	117,399	1,270	199,004
Acquisition cost at 31.12.2005	145	14,872	458	88,070	42,794	260,100	1,270	407,709
Accumulated depreciation at 31.12.2005	-	(2,464)	(76)	(39,188)	(24,276)	(142,701)	-	(208,705)
Residual value at 31.12.2005	145	12,408	382	48,882	18,518	117,399	1,270	199,004

* Refer to note 1.3.3 and note 28.

Information on leased assets is provided in Note 25 and on lease payments in Note 26.

Acquisition of non-current assets differs from acquisition of non-current assets in the cash flow statement due to the periodical payments of non-current assets under the finance lease.

The sale of non-current assets is stated at the residual value. Sales are stated at the sales price and net sales as an adjustment of operating profit in the cash flow statement.

NOTE 24 INTANGIBLE ASSETS

<i>in thousands of kroons</i>	Goodwill	Other	Prepayments	Total
Acquisition cost at 31.12.2003	(4,144)	652	-	(3,492)
Accumulated amortisation at 31.12.2003	2,221	(321)	-	1,900
Residual value at 31.12.2003	(1,923)	331	-	(1,592)
Additions	5	446	1,224	1,675
Write-offs	529	-	-	529
Amortisation	683	(185)	-	498
Residual value at 31.12.2004	(706)	592	1,224	1,110
Acquisition cost at 31.12.2004	(3,610)	1,098	1,224	(1,288)
Accumulated amortisation at 31.12.2004	2,904	(506)	-	2,398
Residual value at 31.12.2004	(706)	592	1,224	1,110
Effect of change in accounting policies (Note 1.3.2)	2,709	-	-	2,709
Additions	1,110	1,294	1,623	4,027
Write-offs	(3,113)	(21)	-	(3,134)
Amortisation	-	(347)	-	(347)
Residual value at 31.12.2005	-	1,518	2,847	4,365
Acquisition cost at 31.12.2005	-	2,371	2,847	5,218
Accumulated depreciation at 31.12.2005	-	(853)	-	(853)
Residual value at 31.12.2005	-	1,518	2,847	4,365

NOTE 25 LEASED ASSETS

<i>in thousands of kroons</i>	2005	2004
Assets acquired under finance lease terms		
Machinery and equipment		
Acquisition cost	38,144	28,714
Accumulated depreciation	(26,827)	(4,342)
depreciation charge of the accounting period	(3,077)	(2,762)
Residual value	11,317	24,372
Assets acquired under operating lease terms		
Right of superficies		
Payments made in financial year	93	93
Future lease payments		
incl. payments in next financial year	238	93
payments in 2...5 years	1,188	1,188
payments after year 5	9,720	9,957

On the basis of cancellable lease agreements, operating lease payments totalling 5,489 thousand kroons (2004: 4,005 thousand kroons) were paid for passenger cars in 2005.

NOTE 26 BORROWINGS

<i>in thousands of kroons</i>	2005	2004
FINANCE LEASE PAYABLES		
Present value of lease payments at beginning of year	16,959	19,783
Received	13,971	549
Paid	(5,832)	(3,373)
Present value of lease payments at end of year	25,098	16,959
incl. payments in next financial year	9,697	3,560
payments in 2...4 years	15,401	13,399
Interest expense of financial year	955	882
Minimum future lease payments	30,118	19,040
<i>Average interest rate 5.0% (2004: 5.0%). Underlying currencies EEK, EUR and LVL.</i>		
LOANS		
Bank loans		
Loan balance at beginning of year	5,202	9,063
Received	293,567	5,202
Paid	(6,202)	(9,063)
Loan balance at end of year	292,567	5,202
incl. payments in next financial year	105,144	4,555
payments in 2...5 years	187,423	647
Interest expense of financial year	3,356	152
<i>Average interest rate 4.0% (2004: 2.3%). Underlying currency EUR.</i>		
Loans from associates and joint ventures		
Loan balance at beginning of year	3,941	-
Received	-	3,941
Paid	(3,941)*	-
Loan balance at the end of year	-	3,941
incl. payments in next financial year	-	3,941
Loans from entities under common control		
Loan balance at beginning of year	522	-
Reclassification to loans from subsidiaries	-	522
Paid	(522)	-
Loan balance at end of year	-	522
incl. payments in next financial year	-	522
Total loans		
Loan balance at beginning of year	9,665	9,063
Received	293,567	9,143
Reclassification to loans from subsidiaries	-	522
Paid	(10,665)*	(9,063)
Loan balance at end of year	292,567	9,665
incl. payments in next financial year	105,144	9,018
payments in 2...5 years	187,423	647
TOTAL BORROWINGS	317,665	26,624
incl. payments in next financial year	114,841	12,578
payments in 2...5 years	202,824	14,046

* Includes a non-monetary transaction, a net settlement against dividends receivable in amount 3,941 thousand kroons.

Loan collaterals and pledged assets have been provided in Note 32.

NOTE 27 TRADE PAYABLES

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Payables to suppliers	282,087	211,034
Payables to employees	37,688	30,630
Tax liabilities, except for corporate income tax		
value added tax	11,919	281
personal income tax	3,032	2,230
social security tax	9,269	7,296
land tax	166	34
unemployment insurance tax	201	111
contributions to mandatory funded pension	173	121
other taxes	260	43
Total tax liabilities, except for corporate income tax	25,020	10,116
Receivables from customers of construction works (Note 34)	185,648	153,974
Other payables		
interest liabilities	65	112
dividends payable	-	3
payables for shares of subsidiaries	14,735	10,844
other payables	4,837	3,339
prepayments received	161,156	66,805
Total other payables	180,793	81,103
Total trade liabilities	711,236	486,857

NOTE 28 GOVERNMENT GRANTS

The Company's Latvian subsidiary SIA Merks was engaged (in 2004) in a project according to which Merko took the responsibility to build a multifunctional hall (known as Arena Riga) at its own expense in the city of Riga, Latvia. It also took the responsibility to complete the hall by 1 February 2006 so that it would be possible to host 2006 Ice Hockey World Championships in Riga, the competition being due in spring 2006. As the due completion of the building involved major risks (see note 36) and the aggregate expected construction costs of (to build) the hall (Arena) were considerably higher than the recoverable amount of the Arena when completed, the project was not feasible on commercial ground. Therefore, to encourage the possible developer (before Merks two developers had rejected the project) the Riga Municipality provided a government grant to the project by selling some land plots (in Riga) at a price below their fair value to Merks in 2004 and 2005. The difference between the purchase price actually paid and the fair value of the land plots on the date of acquisition was accounted for as a government grant. This government grant has been accounted as a revenue in the same periods as the impairment losses on unfinished construction of the Arena were recognised. The excess amount of government grant, i.e. the amount by which the government grant finally appeared to be higher than impairment loss (see Note 7 and 23 for impairment losses recognised) on the Arena, was also recognised as a revenue in 2005, as it was reasonably certain that the Company was able to comply with the conditions attaching to the conditions of the grant.

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Residual value at beginning of year	44,818	-
Received	154,740*	98,067
Used	177,333	53,249
Balance at the end of year	22,225	44,818

* Includes an additional government grant received in 2005 in cash in the amount of 22,225 thousand kroons for the purpose of acquiring specific equipment for hosting 2006 Ice Hockey World Championships.

NOTE 29 SHORT-TERM PROVISIONS

<i>in thousands of kroons</i>	2005	2004
Provision for warranty obligation for construction		
Residual value at beginning of year	5,784	5,191
Set up	5,567	3,965
Used	(2,888)	(3,372)
Balance at end of year	8,463	5,784
In addition, the following short-term provisions were set up:		
provision for the potential losses regarding discontinuing of a construction project	6,664	-
provision for covering court fees	6,090	-
other provisions	524	-
Total short-term provisions	21,741	5,784

NOTE 30 LONG-TERM TRADE PAYABLES

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Supplier payables	9,884	7,421
Prepayments received	12,842	-
Other long-term payables	-	617
Total long-term trade payables	22,726	8,038

The subsidiary SIA Merks has received prepayments in the amount of 12,842 thousand kroons for renting the space of Arena Riga beginning in 2007 (lease agreements entered into for 5-7 years).

NOTE 31 DEFERRED INCOME TAX LIABILITY

A deferred income tax liability was incurred at the subsidiary SIA Merks:

<i>in thousands of kroons</i>	2005	2004
Effect of difference between fair value and carrying amount of real estate inventories	34,600	-
Effect of tax amortisation of non-current assets	(20,608)	-
Unrealised profit upon consolidation	(925)	-
Effect of provisions	(1,682)	-
Deferred income tax expense of the financial year (Note 10)	11,385	-

NOTE 32 LOAN COLLATERAL AND PLEDGED ASSETS

The following agreements have been entered into for guaranteeing loans and other obligations:

Between AS Merko Ehitus and Hansapank:

A commercial pledge agreement on movable property in the amount of 140 million kroons (registered under the first, second and fifth orders in the registry of commercial pledges). The obligations arising from guarantee contracts and overdraft contract are guaranteed by the pledge.

NOTE 32 LOAN COLLATERAL AND PLEDGED ASSETS (CONTINUED)

Between AS Merko Ehitus and SEB Eesti Ühispank:

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

Between Tallinna Teede AS, Hansapank and SEB Eesti Ühispank:

A commercial pledge agreement on movable property in the amount of 25 million kroons (registered under the first order in the registry of commercial pledges), whereby the 14/25 legal share of the commercial pledge belongs to Hansapank and 11/25 to SEB Eesti Ühispank.

Between Tallinna Teede AS and Hansapank:

A commercial pledge agreement on movable property in the amount of 2 million kroons (registered under the second order in the registry of commercial pledges). All claims of the banks arising from contracts under the law of obligations have been guaranteed by the pledges.

Between AS Gustaf and Hansapank:

A commercial pledge agreement on movable property in the amount of 6 million kroons for guaranteeing guarantee contracts.

Between OÜ Gustaf Tallinn and Hansapank:

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

Between AS Merko Tartu and SEB Eesti Ühispank:

A commercial pledge agreement on movable property in the amount of 8.5 million kroons (registered under the first order in the registry of commercial pledges). Guarantee contracts entered have been guaranteed by the pledge.

Between SIA Merks and Hansabanka:

A commercial pledge agreement on assets in the amount of 3.0 million Latvian lats. Obligations arising from the guarantee contracts and the loan agreements have been guaranteed by the pledge.

Mortgage in the amount of 17.15 million Latvian lats (7 real properties in Riga, Latvia) to guarantee the loan commitments in amount of 17.5 million euros.

Mortgage in the amount of 8.4 million Latvian lats (a real property in Riga, Latvia) to guarantee the loan commitments in amount of 8.52 million euros.

Between SIA Merks and SEB Unibanka:

A commercial pledge agreement on assets in the amount of 3.9 million Latvian lats. Obligations arising from the loan agreement have been guaranteed by the pledge.

NOTE 33 SHARE CAPITAL

There were no changes in share capital in 2004. As at 31.12.2004, the share capital in the amount of 88,500 thousand kroons consisted of 8,850 thousand registered shares with the nominal value of 10 kroons each.

In accordance with the resolution of the General Meeting of Shareholders from 28.04.2005, share capital was increased in May by transferring the share premium paid during previous share issues (2,950 thousand kroons) and retained earnings (85,550 thousand kroons) by the amount of 88,500 thousand kroons by means of a equity capitalization, via issuing 8,850 new ordinary shares with the nominal value of 10 kroons. Share capital after the equity capitalization consists of 17,700 thousand ordinary shares with the nominal value of 10 kroons each.

According to the articles of association, the maximum number of shares is 18,000 thousand. All issued shares have been paid for.

In 2005, dividends in the amount of 57,525 thousand kroons have been declared and distributed to the shareholders (in 2004, dividends in the amount of 37,170 thousand kroons were declared and distributed).

NOTE 34 CONSTRUCTION CONTRACTS

<i>in thousands of kroons</i>	2005	2004
Costs incurred for construction in progress and corresponding revenue	2,312,322	2,433,813
Progress billings submitted	(2,415,746)	(2,470,607)
Total adjustment of revenue	(103,424)	(36,794)

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Receivables from customers for construction works (Note 15)	82,224	117,180
Payables to customers of construction works (Note 27)	(185,648)	(153,974)
Total adjustment of revenue	(103,424)	(36,794)

Revenue increase is shown for all those contracts in progress for which revenue corresponding to the costs incurred exceeds than the progress billing submitted to the customers. The increase of revenue is included in the balance sheet line *Receivables and prepayments*.

A decrease of revenue is shown for all those unfinished contracts for which the revenue corresponding to the costs incurred are lower than the progress billings submitted to the customers. The decrease of revenue is included in the balance sheet line *Liabilities and prepayments*.

NOTE 35 RELATED PARTY TRANSACTIONS

The parent company of AS Merko Ehitus is AS Merko Grupp, as at 31.12.2005 and 31.12.2004, AS Merko Grupp (who is also the ultimate controlling party) owned 72% of the shares of AS Merko Ehitus.

Goods and services

<i>in thousands of kroons</i>	2005	2004
Purchased construction services		
Associates and joint ventures	45,202	136,641
Affiliates	5,444	5,155
Total purchased construction services	50,646	141,796
Construction services rendered		
Associates and joint ventures	136,160	39,233
Affiliates	425,568	86,915
Management members	1,526	1,804
Total construction services provided	563,254	127,952
Construction materials purchased		
Other related parties	2,008	1,864

Loans granted to related parties are provided in Note 16 *Loans granted* and **loans received** from related parties are provided in Note 26 *Borrowings*.

NOTE 35 RELATED PARTY TRANSACTIONS (CONTINUED)

Balances with the related parties

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Trade receivables		
Trade receivables		
Associates and joint ventures	39,044	3,972
Affiliates	56,946	17,955
Short-term loans		
Associates and joint ventures	21,325	49,155
Affiliates	6,565	5,991
Other related parties	500	-
Interest receivables		
Associates and joint ventures	1,541	900
Other related parties	8	-
Dividends receivable		
Associates and joint ventures	-	224
Other short-term receivables		
Other related parties	2,917	-
Prepayments for services		
Associates and joint ventures	7,698	-
Affiliates	562	-
Long-term financial investments		
Long-term loans		
Other related parties	1,473	380
Non-current receivables		
Other related parties	6,800	-
Borrowings		
Short-term loans		
Affiliates	-	522
Trade payables		
Payables to suppliers		
Associates and joint ventures	19,179	2,577
Affiliates	223	212
Other related parties	116	-
Prepayments received		
Affiliates	16,847	10,850
Interest liabilities		
Affiliates	21	-
Management members	18	74
Other payables		
Management members	307	915
Affiliates	2,419	2,242
Non-current liabilities		
Other long-term payables		
Management members	-	305

NOTE 35 RELATED PARTY TRANSACTIONS (CONTINUED)

REMUNERATION OF THE MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARDS AND SENIOR EXECUTIVES

In 2005, the members of the Supervisory and Management Boards as well as senior executives of AS Merko Ehitus were paid remuneration in the amount of 15,743.1 thousand kroons (2004: 11,989.6 thousand kroons).

BENEFITS OF THE MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARDS

Upon premature removal or expiry of duties of the members of the Supervisory and Management Board, compensation totaling 3,108 thousand kroons (2004: 2,748 thousand kroons) has to be paid in case the contract for services is not extended.

CONTRACTS OF SURETYSHIP

AS Merko Ehitus provides surety for:

- obligations arising from limits of loan-, construction- and guarantee contracts of the subsidiary SIA Merks to Hansabanka in the amount of 344,892 thousand kroons;
- obligations arising from guarantee contracts of the subsidiary UAB Statyba to UAB Lindra in the amount of 1,262 thousand kroons and obligations arising from construction contracts to Hansabankas in the amount of 10,738 thousand kroons;
- obligations arising from guarantee contracts of the subsidiary AS Merko Tartu to Sampo Pank in the amount of 5,000 thousand kroons;
- obligations arising from loan agreements of the joint venture OÜ Tornimäe Apartments to SEB Eesti Ühispank in the amount of 5,000 thousand kroons;
- obligations arising from loan agreements of the joint venture OÜ Unigate to Hansapank in the amount of 1,000 thousand kroons;
- obligations arising from loan agreements of the joint venture AS Uus Sakala to Hansapank in the amount of 7,000 thousand kroons.

NOTE 36 CONTINGENT LIABILITIES

<i>in thousands of kroons</i>	31.12.2005	31.12.2004
Performance period's warranty to the customer	108,448	72,604
Bid warranty	15,355	15,158
Guarantee for warranty period	107,042	75,005
Prepayment guarantee	87,215	23,352
Suretyships	376,892	43,433
Investment obligation*	67,409	67,409
Payment guarantee	-	15,150
Credits established	-	6,723
Total contingent liabilities	762,361	318,834

* On 25 May 2004 the Riga City Council and SIA Merks concluded the investment agreement whereby SIA Merks obliged to build in the Skanstes street the multifunctional hall Arena Riga (including necessary investment). The contracts included the following conditions:

- Penalties in the amount of 67.4 million kroons in favour of the Riga City Council, if hall construction will not be completed due to Company's fault latest at 1 February 2006;
- The Riga City Council has rights to request the return of government grant if the hall will be not put into operation by 31 December 2006.

On 31.12.2006 the hall was officially commissioned by city authorities and consequently SIA Merks was released of the contingent investment liability.

As at 31.12.2005 (taking into account the statutory requirement to increase the statutory reserve capital), it would be possible to pay out dividends to shareholders from retained earnings in the amount of 698,156 thousand kroons and the corresponding income tax would amount to 208,540 thousand kroons. As at 31 December 2004, it would have been possible to pay out 471,671 thousand kroons as dividends, and the corresponding income tax would have amounted to 148,949 thousand kroons.

Tax authorities have the right to review the Company's tax records within 6 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines.

The Company's management estimates that there are not any circumstances which might lead the tax authorities to impose additional significant taxes to the Company.

NOTE 37 RISKS

CREDIT RISK

Credit risk relates to potential damage which would occur if the parties to the contract cannot fulfill their contractual obligations. In order to lower credit risks, the payment discipline of customers is constantly being monitored; construction activities are partly funded by customer prepayments. Available funds are mostly held at Hansapank and SEB Eesti Ühispank. The management estimates that the Group does not have any major credit risks.

INTEREST RISK

Interest risk arises from floating rate borrowings. Interest on bank loans is related to EURIBOR. Changes in EURIBOR and changes in average market interest rates affect the Group's interest expenses. The Company's management estimates that the Group does not have any major interest risks.

FOREIGN EXCHANGE RISK

The Company's transactions are carried out in Estonian kroons, Latvian lats and Lithuanian litas. The Lithuanian litas was pegged to the euro at the beginning of 2002. Risks to the Group's income and expenses were related to the exchange rate changes of the Latvian lats. From 01.01.2005, the Latvian lats is tied to the euro.

In order to hedge foreign exchange risk, key foreign contracts are concluded in euros. All long-term loan agreements of the Group have been concluded in euros.

FAIR VALUE

The carrying amounts of the company's financial assets and financial liabilities does not significantly differ from their fair values.

NOTE 38 EVENTS AFTER THE BALANCE SHEET DATE

As at 31.12.2005, AS Merko Ehitus had a 31% participation in AS Telegrupp. In February 2006, shares in the total amount of 1,847 thousand kroons were sold, after which AS Merko Ehitus owns 19% of the shares of AS Telegrupp.

NOTE 39 NUMBER OF SHARES BELONGING TO THE MEMBERS OF THE SUPERVISOR AND MANAGEMENT BOARD AND THEIR CLOSE RELATIVES

	Shares	Ownership %
Member of the Management Board		
Tõnu Toomik	9,000	0.10

NOTE 40 SHAREHOLDERS WITH MORE THAN 5% OWNERSHIP

	Shares	Ownership %
AS Merko Grupp	12,742,686	71.99
Clients of ING Luxembourg S.A.	1,135,900	6.42
Clients of Skandinaviska Enskilda Banken	992,310	5.61

NOTE 41 SEPARATE BALANCE SHEET, INCOME STATEMENT, STATEMENT OF CHANGES IN EQUITY AND CASH FLOW STATEMENT OF THE PARENT COMPANY

Balance sheet		
<i>in thousands of kroons</i>	31.12.2005	31.12.2004
ASSETS		
Current assets		
Cash and cash equivalents	124,033	101,143
Trade receivables	850,188	602,774
Prepaid corporate income tax	272	18
Inventories	79,299	76,908
Total current assets	1,053,792	780,843
Non-current assets		
Investments in subsidiaries	171,333	127,706
Investments in associates and joint ventures	9,824	19,000
Other long-term loans and receivables	82,145	43,029
Investment property	16,460	27,903
Property, plant and equipment	10,193	7,587
Intangible assets	1,743	504
Total non-current assets	291,698	225,729
Total assets	1,345,490	1,006,572
LIABILITIES		
Current liabilities		
Borrowings	29,431	902
Trade payables	421,136	320,820
Short-term provisions	11,856	3,235
Total current liabilities	462,423	324,957
Non-current liabilities		
Other long-term liabilities	5,883	5,349
Total liabilities	468,306	330,306
EQUITY		
Share capital	177,000	88,500
Share premium	-	2,950
Statutory reserve capital	8,850	8,850
Retained earnings	691,334	575,966
Total equity	877,184	676,266
Total liabilities and equity	1,345,490	1,006,572

NOTE 41 SEPARATE BALANCE SHEET, INCOME STATEMENT, STATEMENT OF CHANGES IN EQUITY AND CASH FLOW STATEMENT OF THE PARENT COMPANY (CONTINUED)

Income statement		
<i>in thousands of kroons</i>	2005	2004
Sales	1,860,068	2,110,292
Cost of goods sold	(1,575,816)	(1,819,097)
Gross profit	284,252	291,195
Marketing expenses	(15,743)	(13,136)
Administrative and general expenses	(55,278)	(47,503)
Other operating income	9,399	2,418
Other operating expenses	(3,608)	(2,056)
Operating profit	219,022	230,918
Financial income (expenses)	3,876	572
Financial income (expenses) from investments into subsidiaries	43,157	18,975
Financial income (expenses) from investments into associates and joint ventures	(3,166)	1,679
Profit before tax	262,889	252,144
Corporate income tax	(4,446)	(3,588)
Net profit for financial year	258,443	248,556

Statement of changes in equity						
<i>in thousands of kroons</i>	Share capital	Share premium	Statutory reserve capital	Currency translation adjustment	Retained earnings	Total
Balance as at 31.12.2003	88,500	2,950	8,850	(1,380)	364,903	463,823
Currency translation adjustment	-	-	-	(3,283)	-	(3,283)
Net profit for financial year	-	-	-	-	294,600	294,600
Dividends	-	-	-	-	(37,170)	(37,170)
Balance as at 31.12.2004	88,500	2,950	8,850	(4,663)	622,333	717,970
Effect of recognising subsidiaries and associates at cost	-	-	-	4,663	(46,367)	(41,704)
incl. for previous periods	-	-	-	1,380	(323)	1,057
for accounting period	-	-	-	3,283	(46,044)	(42,761)
Balance at 31.12.2004 adjusted	88,500	2,950	8,850	-	575,966	676,266
The book value of shareholdings under dominant or significant influence						(146,706)
The value of shareholdings under dominant or significant influence accounted by the equity method						188,410
Adjusted unconsolidated equity 31.12.2004						717,970
Net profit for financial year	-	-	-	-	258,443	258,443
Equity capitalization	88,500	(2,950)	-	-	(85,550)	-
Dividends	-	-	-	-	(57,525)	(57,525)
Balance as at 31.12.2005	177,000	-	8,850	-	691,334	877,184
The book value of shareholdings under dominant or significant influence						(181,157)
The value of shareholdings under dominant or significant influence accounted by the equity method						405,369
Adjusted unconsolidated equity 31.12.2005						1,101,396

NOTE 41 SEPARATE BALANCE SHEET, INCOME STATEMENT, STATEMENT OF CHANGES IN EQUITY AND CASH FLOW STATEMENT OF THE PARENT COMPANY (CONTINUED)

Cash flow statement		
<i>in thousands of kroons</i>	2005	2004
Cash flows from operating activities		
Operating profit	219,022	230,918
Adjustments		
depreciation and amortisation	4,517	4,314
(profit) loss from sale of non-current assets	(139)	(10)
adjustment of revenue from construction contracts under stage of completion method	38,601	(151,427)
interest income from operating activities	(9,017)	(2,242)
change in provisions	10,940	6,045
Change in trade receivables related to operating activities	(38,516)	159,757
Change in inventories	8,773	20,785
Change in trade payables related to operating activities	51,307	(37,921)
Interest paid	(632)	(184)
Other financial income received	3,857	-
Corporate income tax paid	(4,446)	(2,992)
Total cash flows from operating activities	284,267	227,043
Cash flow from investing activities		
Investments into subsidiaries	(43,095)	(4,489)
Proceeds from sale of subsidiaries	4,600	700
Investments into associates and joint ventures	-	(2,393)
Proceeds from sale of associates and joint ventures	2,756	-
Purchase of property, plant and equipment	(7,275)	(2,725)
Proceeds from sale of property, plant and equipment	610	50
Purchase of intangible assets	(1,279)	(504)
Loans granted	(411,744)	(372,103)
Loan repayments received	170,640	55,463
Interest received	8,971	5,934
Dividends received	43,446	20,222
Total cash flow from investing activities	(232,370)	(299,845)
Cash flows from financing activities		
Interest received	28,529	-
Dividends paid	(57,525)	(37,170)
Total cash flows from financing activities	(28,996)	(37,170)
Change in cash and cash equivalents	22,901	(109,972)
Cash and cash equivalents at the beginning of the period	101,143	211,116
Currency translation adjustment	(11)	(1)
Cash and cash equivalents at end of period	124,033	101,143

SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2005 ANNUAL REPORT

The Management Board of AS Merko Ehitus has prepared the management report, consolidated financial statements and the profit allocation proposal for 2005.

Tõnu Toomik	Chairman of the Management Board		29.03.2006
Alar Lagus	Member of the Management Board		29.03.2006
Veljo Viitmann	Member of the Management Board		29.03.2006
Jaan Mäe	Member of the Management Board		29.03.2006
Andres Agukas	Member of the Management Board		29.03.2006

The Supervisory Board has reviewed the Annual Report which consists of the management report and the financial statements prepared by the Management Board and which also includes the auditor's report and the profit allocation proposal, and approved it for presentation at the General Meeting of Shareholders.

Toomas Annus	Chairman of the Supervisory Board		6.04.2006
Ott Kikkas	Member of the Supervisory Board		6.04.2006
Teet Roopalu	Member of the Supervisory Board		6.04.2006

AS PricewaterhouseCoopers

Pärnu mnt. 15

10141 Tallinn

Estonia

www.pwc.ee

Phone 6 141 800

Fax 6 141 900

AUDITOR'S REPORT

To the shareholders of AS Merko Ehitus

We have audited the accompanying consolidated balance sheet of AS Merko Ehitus and its subsidiaries (the Group) as of 31 December 2005 and the related consolidated statements of income, cash flows and changes in shareholders' equity for the year then ended. These financial statements as set out on pages 9 to 52 are the responsibility of the Management Board of AS Merko Ehitus. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2005 and of the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.



Urmas Kaarlep
AS PricewaterhouseCoopers



Tiit Raimla
Authorised Auditor

5 April 2006

PROFIT ALLOCATION PROPOSAL

in kroons

Retained earnings	481,967,065
Net profit for 2005	438,637,484
Total retained earnings as at 31.12.2005	920,604,549

The Management Board proposes to allocate the net profit as follows:

As dividends (5.00 kroons per share)	88,500,000
Transfers to statutory reserve capital	8,850,000
Retained earnings after the allocation of net profit	823,254,549

Tõnu Toomik	Chairman of the Management Board		29.03.2006
Alar Lagus	Member of the Management Board		29.03.2006
Veljo Viitmann	Member of the Management Board		29.03.2006
Jaan Mäe	Member of the Management Board		29.03.2006
Andres Agukas	Member of the Management Board		29.03.2006

CONTACTS OF MERKO EHITUS ANALYSTS

AS Hansapank

Liivalaia 8 Tallinn, 15040 Estonia

Phone: +372 631 0310

Fakx +372 631 0410

e-mail: hansa@hansa.ee

www.hansa.ee

AS Suprema Securities

Tartu Rd 2 Tallinn, 10145 Estonia

Phone: +372 640 5700

Fax: +372 640 5701

e-mail: suprema@suprema.ee

www.suprema.com

AS Lõhmus, Haavel & Viisemann

Tartu Rd 2 Tallinn, 10145 Estonia

Phone: +372 680 0401

Fax: +372 680 0410

e-mail: lhv@lhv.ee

www.lhv.ee

Orion Securities ASA

Laisves pr. 88 Vilnius, LT-06125 Lithuania

Phone: +370 5 247 8339

Fax: +370 5 278 4487

E-mail: orion@securities.no

www.securities.no

Impivaara Securities Ltd.

30, Countess Road, Kentish Town, London NW5 2XJ, United Kingdom

Phone: +44 (0)20 7284 3937

Fax: +44 (0)20 7284 3938

E-mail: impivaara@pomor.com

www.impivaara.com

