ANNUAL REPORT

**for the financial year started on July 1, 2005
and ended on June 30, 2006**

Translation of the Estonian original

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MANAGEMENT REPORT

1. Economic and legal environment

1.1. Effect of the economic environment

In the financial year 2005/2006, AS Kalev was affected by developments on both domestic and foreign markets. In regards to production inputs, favourable changes could be seen in certain raw material prices; however, the price of energy carriers continued to rise. Developments of important export markets for AS Kalev's products ensured an increase in demand, similar to that in domestic demand, which was backed by quick economic development.

The rate of growth in GDP and total demand in Estonia has reached an all-time high, exceeding even that of the second half of the 1990s. Real GDP growth surpasses total production, exceeding an annual 10%. Regardless of quick economic growth in Estonia, the increase in product volumes in different sectors is quite imbalanced—similarly to the processing industry, the food and beverage industry has shown a 9% growth, while pastry production volumes have only increased by 6.5% and dairy product volumes by 3.2%, compared to June 2005. The industrial production index—i.e. change in the cost of sales of industrial products, compared to the base period (in current prices)—only shows a 5.3% increase in food and beverage volumes, suspended growth in pastry product volumes and a small decrease in dairy product volumes.

Having previously shown signs of slowing down, private consumption displayed a 10% real growth in the last 12 months—for instance, domestic sales of food products have increased by an annual 15%. This is backed by wage dynamics, favourable loan market conditions and the real estate market. Consumer prices have shown rapid growth for the second year in a row, exceeding an annual 4%. The overall price increase in Estonia reflects rapid development of a small economy, as well as the growing effect of globalisation.

Economy in general is bound to benefit from a situation where the share of production in the creation of additional value is significantly increasing in Estonia, while savings have not decreased and export is growing. At the same time, real growth in wages has been rapid, while tensions are brewing on the labour market with regard to both skills and availability. The Estonian economy has reached what is in economic theory known as full employment. For the employer, this means limited options in a situation where production capacities need to be increased. Quick growth in personnel expenses, compared to a somewhat slower growth in productivity, however, exerts serious pressure on competitiveness.

Increase in domestic product export is still quicker than nominal economic growth, backed by growing demand for Estonian goods in the foreign sector. Import of cocoa products was minimal in the financial year 2005/2006 (5%), while increase in sugar and sugar confectionery product import volumes was significantly bigger, with an annual growth of 50%. According to the Statistical Office of Estonia, a total of nearly 670 million kroons worth of sugar and sugar confectionery products was imported between July 2005 and June 2006 for domestic consumption, while import exceeded the export of similar products by more than four times. At the same time, 460 million kroons worth of cocoa and cocoa products were imported. Although the export of cocoa products to the foreign sector was five times smaller than import of the same product, export volumes grew by nearly 60%, compared to the previous period. We can consequently draw two important conclusions for AS Kalev: a) competitors have significantly increased their presence on AS Kalev's home market, which, in turn, will have an effect on both product margins and the company's profit forecasts; b) although having significantly increased, the export of cocoa products still falls short of the decrease in the export of sugar confectionery products.

Although the cost of long-term capital is significantly increasing as a result of growing inflation, short-term borrowing remains inexpensive. The near-zero real interest rate and favourable loan conditions push for consumption, although signs of caution are evident among the population in the economy—final consumption is no longer growing as quickly as income. Private consumption—the most important contributor to total demand—makes up ¾ of the final consumption in Estonian economy. Consumer preferences are also changing; surveys on the demand for sweets refer to price-sensitivity among the Estonian population. There has also been a significant shift in consumer awareness of healthier nutrition habits.

No significant changes occurred in global cocoa prices during the financial year, but sudden price fluctuations are frequent on the raw materials markets. Cocoa bean future prices (US$ quoted on the global market) have remained stable. Strengthening of the euro against the US dollar (by nearly 10% in the year) has therefore somewhat lowered the related production input price in AS Kalev. Similar developments were also evident in the global prices for pulse. At the same time, current price trends have made "cost efficiency" the keyword in energy-consuming processes.

1.2. Changes in legal environment

Although the Estonian tax policy has moved towards reducing direct taxation and increasing indirect taxation, local entrepreneurs still incur significant expenses on staff recruitment. Changes in production factors also involve the effect of personnel expenses on the company. In addition to state taxes, personnel expenses are also affected by agreements concluded between employees and trade unions. Nationwide minimum wage agreements concluded in the past three years have raised the minimum wage in Estonia by nearly 40% (incl. in January 1, 2006, minimum wage was raised by 11.5%). This increase has a direct effect on overall wage increase. Under the conditions of a lack of skilled workers, a relatively modest mobility of the labour market, limited growth in production and establishment of additional EU regulations, a material increase in minimum wage may exert ever-increasing pressure on the expenses of companies.

In September 2005, the Government of the Republic approved the euro adoption plan, according to which the euro would be adopted as account currency, in accounting, and contractual relations on January 1, 2007. As Estonia failed to fulfil the economic and legal requirements for countries who wish to join the euro zone, the adoption was postponed. Uncertainty regarding the future of the adoption of the euro has also postponed the related preparations in AS Kalev.

Deeming the current sugar market arrangement unsustainable, the European Commission decided, at the end of 2005, after six months of disputing, to reform the sugar regime of the common EU agricultural policy. As a result of the reforms to be implemented in July 2006, the minimum price of white sugar (which has, so far, been three times higher than the global price) will be lowered by a total of 36% in the following four years (-20% in the first year of the reform, -27.5% in the second year, -35% in the third year and -36% in the fourth year). Standardisation of the EU sugar price with the global sugar price (i.e. price reduction) serves the best interests of AS Kalev, since sugar constitutes an important production input for the company.

2. Overview of AS Kalev Group

AS Kalev pursues three main fields of activity: production and sale of chocolate, sugar and flour confectionery products, production and sale of dairy products, as well as development and management of real estate. The company's production activities are carried out in five production plants located in Põrguvälja near Tallinn, as well as in Paide, Viljandi, Jõhvi and Kiviõli.

AS Kalev owns a pan-Estonian retail chain, consisting of a total of 15 candy stores and cafés. The newest candy store/café was opened in November 2005 in the historic market building in Rakvere. Renovation work is nearing completion also in our candy store/café in Võru.

The parent company of AS Kalev Group is AS Kalev. The group incorporates ten enterprises (see additional information in Note 22). In the financial year 2005/2006, AS Kalev Group employed an average of 787 people, with an average of 806 people being employed in the comparative period. See Note 27.3 and Note 27.2 for information on transactions with the Management Board and related companies.

In July 2004, AS Kalev acquired 60.7% of the shares of AS Vilma. Under the contract, AS Kalev also obliged to acquire the remaining shares of AS Vilma from the shareholders who were willing to sell their stake on the same conditions. Consequently, on December 23, 2005, AS Kalev acquired an additional 39.2% of the shares of its subsidiary AS Vilma, paying a total of 7.3 million kroons for the stake. In addition, on March 31, 2006, AS Kalev purchased 0.1% of the remaining shares of the subsidiary, effectively becoming the full owner of AS Vilma.

In February 2006, AS Kalev's subsidiary AS Kalev Paide Tootmine acquired 31% of the shares of Valmetek Invest AS. With its two co-shareholders, AS Kalev Paide Tootmine is planning to launch cheese production in Valmetek Invest AS. AS Kalev Group's strategy is to become the most efficient food product manufacturer in its operating area. The strategic goal also conditioned the need for expanding production in the subsidiary AS Kalev Paide Tootmine. In order to enhance the efficiency of AS Kalev Paide Tootmine, the company's assets were transferred to Valmetek Invest AS, with any receivables arising from the transfer transactions offset in the amount of 20 million kroons in the course of increasing the share capital of Valmetek Invest AS.

Production of chocolate and sugar confectionery products being its main activity, AS Kalev Chocolate Factory was established in May 2006. AS Kalev, the sole shareholder of AS Kalev Chocolate Factory, resolved to increase the subsidiary's share capital by 90 597 000 kroons. AS Kalev acquired all the new shares. Under the contract, AS Kalev sold its subsidiary technological equipment for producing chocolate and sugar confectionery products, at the cost of 90 597 000 kroons.

In June 2006, AS Kalev's subsidiary AS Kalev Real Estate Company (AS Kalev REC) established a subsidiary in the Republic of Bulgaria. The company was established under the name of Stude REC EOOD, and its main activities include development, management, lease, purchase and sale of real estate in Bulgaria. The share capital of Stude REC EOOD is fully owned by AS Kalev REC.

A new subsidiary—OÜ Sugarstar—was established on the basis of AS Kalev's hitherto event marketing department. The company is involved in rendering both in-house and outhouse event marketing services. OÜ Sugarstar is fully owned by AS Kalev.

3. Economic activities and results

According to the results of the TNS Emor survey published in June 2006 («Recognition and reputation of Estonian companies»), AS Kalev remains the most reputable company in Estonia. With an average score of 8.5 on a ten-point scale, AS Kalev was elected the most reputable company for the fourth year in a row. The survey was conducted for the seventh year in Estonia, covering 47 major Estonian companies this year.

Financial highlights for the twelve months of 2005/2006, compared to the same period last financial year (in thousands of kroons and euros):

	%	EEK	EUR
Increase in revenue	5,6	47 073	3 008
Increase in operating profit	190,6	44 345	2 834
Increase in domestic revenue	7,9	37 023	2 366
Increase in export sales	2,7	10 050	642

The net sales and net profit of AS Kalev Group companies in the twelve months of the financial year 2005/2006 has been brought out in the below tables (in thousands of kroons and euros). The data only covers six companies—the subsidiary AS Kalev Chocolate Factory did not launch its operations until July 1, 2006, while the financial indicators of AS Kalev Merchant Services Ltd are immaterial to the parent company.

	Net sales		Net profit	
EEK	2005/2006 12 months	2004/2005 12 months	2005/2006 12 months	2004/2005 12 months
AS Kalev	423 491	384 561	28 989	-57 677
AS Kalev Paide Tootmine*	413 546	435 996	-44 930	-26 073
AS Kalev REC*	75 363	38 684	127 496	32 453
AS Kalev Jõhvi Tootmine	32 753	53 450	-3 728	-8 170
OÜ Maiasmokk	7 255	6 282	-3 099	-1 198
AS Vilma	36 064	39 989	-1 342	3 444

* consolidated

EUR	2005/2006 12 months	2004/2005 12 months	2005/2006 12 months	2004/2005 12 months
AS Kalev	27 066	24 578	1 853	-3 686
AS Kalev Paide Tootmine*	26 430	27 865	-2 872	-1 666
AS Kalev REC*	4 817	2 472	8 148	2 074
AS Kalev Jõhvi Tootmine	2 093	3 416	-238	-522
OÜ Maiasmokk	464	401	-198	-77
AS Vilma	2 305	2 556	-86	220

* consolidated

In the financial year 2005/2006, the turnover of AS Kalev Group compared to the previous period and the sales revenue amounted to 890 million kroons (56.9 million euros). The consolidated net profit for the period amounted to 1 294 thousand kroons (82.7 thousand euros), with the net profit attributable to the shareholders of the parent company making up 1 153 thousand kroons (73.7 thousand euros). In the comparative period, AS Kalev Group posted a consolidated net loss of nearly 39.9 million kroons (2 552 thousand euros), of which the net loss attributable to the shareholders of the parent company made up 41 million kroons (2 623 thousand kroons). The economic results in general and the net profit growth in particular were influenced by a greater production efficiency, optimisation of the product portfolio, the rapid growth of the sales of confectionery products on the domestic market, the favourable real estate market and successful real estate projects.

Marketing expenses increased 30% compared to the same period of the previous financial year. The reasons for the rapid growth of expenses lie in the changes of the group structure, development of the product portfolio and the general development of the economic environment, with a marked increase in development and advertising expenses. General and administrative expenses of the period decreased by 0.4%, compared to the previous period.

The positive balance of other operating income and expenses increased 4.5 times, amounting to 41.4 million kroons (2.6 million euros). This was mainly due to the appreciation by AS Kalev REC of the immovable at 5 Tervise St, Tallinn, to its fair value, and the reduction of the provision which was made for AS Kalev Paide Tootmine at the end of the financial year 2004/2005. The provision was made to cover the potential losses arising from the unfavourable situation on the dairy products market and from the purchase contracts of crude milk until December 2005. An overview of the risks affecting the financial activities of AS Kalev (incl. both financial risks and non-financial risks) and the company's risk management procedures have been brought out in Note 26.

The main financial ratios of AS Kalev*:

	Group	
	01.07.2005-30.06.2006	01.07.2004-30.06.2005
Current ratio	0.69	0.63
Debt ratio	0.67	0.70
Asset turnover ratio	0.98	1.14
Net profit margin (%)	0.1%	-4.9%
ROA (%)	0.1%	-5.6%

* The ratios are calculated based on the following methods:

Current ratio = current assets / current liabilities
Debt ratio = total liabilities / total assets
Asset turnover ratio = revenue / average total assets
Net profit margin = net profit / revenue * 100%
ROA = net profit / average total assets * 100%

4. Product market and sales

4.1. Confectionery products

AS Kalev retained its strong position as the leader of the Estonian chocolate and sugar confectionery market. According to the retail survey conducted by AC Nielsen Eesti, AS Kalev's market share is 42% in the chocolate confectionery and sugar confectionery sector, and 14% in the biscuit sector. Product development remains a priority for AS Kalev: development and launch of new and innovative products by taking into consideration the expectations of local consumers and export markets.

As a result of active product development, the company has succeeded in launching several new standard assortment products at the market. The popular flavours of Kalev's chocolate series—milk chocolate with hazelnuts, milk chocolate with raisins and milk chocolate with almonds—were also launched in 200-gram tablets. A new product was added to Kalev's 100-gram chocolate series - dark chocolate with cherry. *Kalev* and *Linda* chocolates, which have been a part of Kalev's product assortment since 1970s and 1980s respectively, were wrapped in new packaging, with motifs from the national epic. A new—apple-flavoured—addition was also introduced to the *Draakoni* chewing candy family. The company also started marketing strawberry, bilberry and apple-flavoured *Draakoni* chews in 16.5-gram mini-packages. The *Collection* gift box series was expanded to include *Classic Collection,* a new 220-gram box of handmade candy, as well as a new 340-gram box of soufflé. The company introduced a new praline series by launching four products in the series—praline with marzipan, praline with grilliage, praline with Indian nuts and praline with chocolate. These products are marketed as bulk goods, as well as in 175-gram mini-packages, with marzipan and Indian nut pralines also available in 20-gram bars. The purpose of the new praline series was to strengthen the company's position in the chocolate candy sector.

Kalev has also changed the design of its candy mini-packaging. Five classic candies—marmalade candies *Lily* and *Tiina*, praline candies *Kalev* and *Oravake* and wafer candies *Tallinn*—are now packaged in a more distinctive and more easily recognisable packaging bearing the product trademark. The mini-packaging for other candies was also renewed. The aim of these changes was to improve the display of the trademark on the products, thus better exploiting the trademark strength in the sales process. Kalev's exclusive candy and truffle series packaging was also renewed.

The new flour confectionery products launched at the market included *Kookose* and *Meepräänikud* biscuits. The *Nisukliiküpsis* biscuits with fructose and linseed were added to the low-calorie biscuit series with healthy additives. AS Vilma's flour mix series packaging has also been given a new look. The series includes 14 products, with 12 flour mixes for all kinds of cakes, muffins and pizza dough, and 2 products—powdered sugar and cocoa powder—for flavouring and/or decorative purposes. The new packaging bears the classic flecked pattern, as well as a picture of the final product to help consumer locate the product.

4.2. Dairy products

The crude milk stocked by AS Kalev Paide Tootmine is mainly used for producing whole milk and skimmed milk powder, cream and butter. The products are mainly marketed in EU countries. Further to the current situation on the world market—high price of skimmed milk powder and a drop in the price of butter—export subsidies for skimmed milk powder have been cancelled as a result of regulative intervention (the subsidy amounted to 15€/100kg at the beginning of the financial year). At the same time, export subsidies for butter and whole milk powder have dropped to 54€/100kg from the 99.50€/100kg at the beginning of the period. Internal EU prices have shown similar movements, with the wholesale price of German whole milk powder dropping by 4.3% and the price of butter by 9.5%. The average price of skimmed milk powder has, however, remained stable, compared to last year. The prices were only slightly adjusted at the crude milk market in 2006: according to the Statistical Office of Estonia, the average buying-in price of crude milk has dropped by 0.12EEK/kg (i.e. approximately 3%). The market price for finished goods, has, however, shown a bigger decrease in the given period than the price of crude milk. The continual increase in heat energy prices also has a negative effect on the dairy industry.

4.3. Product sales

AS Kalev Group's total confectionery and dairy product sales amounted to 24 300 tons in the financial year 2005/2006, decreasing by 5.5% compared to last financial year. 49% of the total output was sold on the domestic market; 51% was exported.

AS Kalev Group sold a total of over 6 100 tons of confectionery products (incl. chocolate and sugar confectionery products) in the given period—a decrease of 3.2% compared to the previous period. The home market constituted 85% of the total sales of confectionery products; 15% of the sales were exported. 50% of the chocolate and sugar confectionery export went to Russia, 34% to Latvia, 8% to Lithuania, 5% to Finland and 3% to other countries. The total confectionery product export decreased by 3%, compared to last year.

AS Kalev Group's total flour confectionery product (incl. baked goods and biscuits) sales amounted to 4 400 tons in the financial year 2005/2006, decreasing by 13% from last year. 99% of the production was sold on the home market. Approximately 6% of the cookie output was sold in the Baltic States and Russia.

Kalev Group sold 13 800 tons of dairy products (skimmed milk and milk powder, high-temperature pasteurised milk and butter) in the given period—a 3% decrease, compared to the financial year 2004/2005. 83% of the sales volume was exported to various EU countries. Germany was the most important export destination for dairy products, with 68% of the total production volume sold in this country.

4.4. Real estate activities

AS Kalev Real Estate Company (AS Kalev REC), a subsidiary of AS Kalev involved in real estate management and development, continued its activities on the public real estate market in the financial year 2005/2006, both in the housing and commercial space sector. In 2006, Kalev REC launched the development of two apartment buildings—the 19-apartment building on Marat St in Tallinn, and the 25-apartment building on Hommiku St in Pärnu. These buildings are scheduled to be completed before the end of the year.

The biggest real estate project is the development of the registered immovable located at Tervise 5 in Tallinn. The detailed plan which is currently under preparation proposes up to 45 000 m^2 of apartment space to be established in the area. According to initial plans, the detailed plan will be completed by the summer of 2007. No suitable bids were made on the purchase of the above registered immovable at the auction held by BRC Kinnisvara in June 2006 at the starting price of 165 million kroons. Kalev REC will therefore continue developing the land lot. The company has also launched its first development project outside Estonia—the subsidiary Stude REC EOOD is developing a 6 500 m^2 apartment building project in Sofia, the capital of Bulgaria.

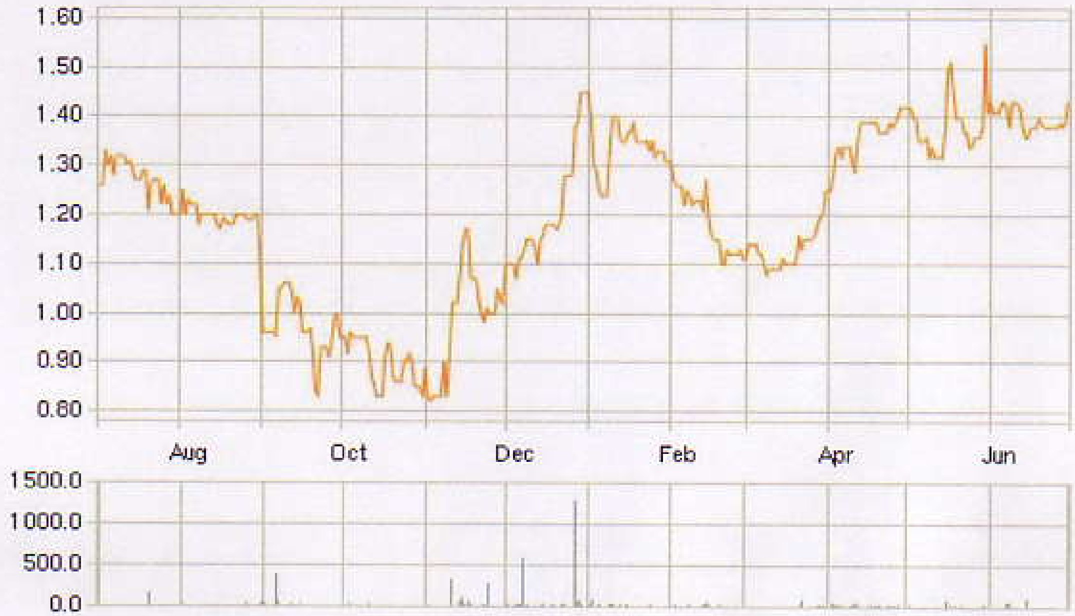
AS Kalev REC transferred several projects and investment properties in the financial year 2005/2006, including sales of the *Tere* building development project, i.e. registered immovable located at Pärnu mnt 139E/2, at the price of 39.4 million kroons (2.5 million euros) and a legal share of the Tartu Külmhoone registered immovables at the price of 24 million euros (1.5 million euros).

5. Securities

The shares of AS Kalev have been listed in the secondary list of the OMX Tallinn Stock Exchange since 1996. With a nominal value of 10 EEK per share, the company has listed 23 632 500 shares on the stock exchange.

Over 5 million shares of AS Kalev were traded in the period between 01.07.2005 and 30.06.2006, generating revenue of nearly 6 million euros. The highest price for the share was 1.55 EUR, and the lowest 0.81 EUR. The closing price of 30 June 2006 was 1.43 EUR. In the given 12-month period, AS Kalev's market capitalisation grew by 13.4%, amounting to 33.8 million euros as of 30 June 2006.

As of the end of the financial year 2005/2006 (June 30), AS Kalev's biggest shareholders included OÜ Linderin Grupp (22% of the shares), customers of SEB AB (16.2%), Tere AS (12.8%), Mailtec OÜ (10.2%).



AS Kalev share price and turnover (in euros) for the period 01.07.2005-30.06.2006 (*source*: OMX Tallinn Stock Exchange)

6. Organisation and personnel

6.1. Organisational management

The company's strategic development is going according to plan and in accordance with the new strategic choices. Consequently, the organisation must focus on new segments, optimise its product portfolio and enhance profitability. In order to enhance efficiency of the implementation of the strategy, AS Kalev has made improvements for better combining strategic and operative planning and enhancing transparency. The new management environment is ready for implementation, with several trainings conducted in sub-units.

Several organisational changes were introduced at the end of the financial year in order to improve the management of AS Kalev and enhance financial transparency. As a result of these changes, the Jüri-based production facility was turned into a separate subsidiary (AS Kalev Chocolate Factory). In addition, AS Kalev established a separate subsidiary (OÜ Sugarstar) on the basis of its event marketing department.

6.2. Human resource management

AS Kalev Group employed an average of 787 people in the financial year 2005/2006—19 people less than in the same period last year. The company conducted 63 recruitment competitions, with the staff flow amounting to 15%. With the growing tension between supply and demand on the Estonian labour market, it is significantly more difficult for the company to recruit new specialists and workers than it was in the previous period. AS Kalev Group's personnel expenses make up nearly 10% of its operating expenses, amounting to 96.4 million kroons in the financial year 2005/2006 (increasing by 12% from the previous period).

In order to better determine the need for labour resources, the company has established the goal of planning positions and competences for a longer period of time. For this purpose, the company has implemented a systematic competence management scheme as well as a long-term labour planning model. Several additional and innovative solutions were applied for recruitment in different regions. In the financial year 2005/2006, AS Kalev also approved its new HR strategy, specifying the main objectives of HR functions.

6.3. Quality management

AS Kalev Group companies pursue quality, thus continually contributing to quality management. AS Kalev and AS Kalev Paide Tootmine passed the ISO 2001:2000 regular audit without any non-compliance (the companies hold the corresponding BVQI-issued quality certificates since 2004 and 2003). All subsidiaries were integrated in the AS Kalev quality management system in the financial year. New developments included establishment of the method for monitoring intra-group quality expenses, and its first results. These activities are planned to be used as an effective tool for managing and optimising quality expenses in the future.

7. Main activity trends for the financial year 2006/2007

Several changes were introduced in the financial year in order to correct the organisational structure of AS Kalev and to bring the structure into line with the activity trends, thus ensuring increase in the efficiency of the company's core processes. AS Kalev Chocolate Factory, which manufactures sugar and chocolate confectionery products since July 1, 2006, also started handling the sales of the pastry and flour confectionery products of AS Vilma and AS Kalev Jõhvi Tootmine in September 2006.

The sales volume of AS Kalev Chocolate Factory is expected to increase in line with the overall economic growth (incl. a 10% increase in net turnover). AS Kalev's main market for sugar and confectionery products is the domestic market. It is important for the company to maintain the current market share (according to AC Nielsen, nearly 37%) as regards cash turnover. At the same time, the company aims at improving the profitability of some products through optimising the assortment and enhancing production efficiency.

We must also take into consideration the factors preventing a material improvement in the profit margin—the continual increase in production expenses, backed by the price increase in inputs (labour market restrictions, incl. lack of labour and the consequent wage increase, increase in energy expenses). As a result of the developments in the supply of production factors, the company is, for instance, pursuing projects which help to decrease the labour requirement for different processes. As the sector is characterised by tight competition between domestic and foreign companies, this sets restrictions on achieving the highest margin.

AS Kalev prioritises product development, focusing on chocolate tablets, chocolate candy and candy box development in the chocolate confectionery sectors, and chewing candy and toffee in the sugar confectionery sector. The overall product development is focused around extending the best before date and creating new flavours.

With the demand for export goods supported by favourable developments on the neighbouring markets, AS Kalev is also optimistic about the foreign sector. As regards export of sugar and chocolate confectionery products, AS Kalev will focus, in the next few years, on strengthening its position in the Baltic States. The chocolate confectionery sector in particular is expected to show an increase in export volumes. On other foreign markets, the company plans to maintain its existing customer base and sales volumes. The Travel Trade will continue to be an important segment for us.

Further activities in the dairy product sector will depend on AS Kalev's strategy in the sector, which has yet to be specified. We expect to focus on product positioning, in order to guarantee sustainable production. In order to achieve the established goals, we plan to review our product portfolio, and bring it into line with the group strategy, by considering the market situation. The price of raw materials and energy are the two factors affecting the cost price in the production process. Since no significant changes have occurred with regard to the first factor, and since the price of energy carriers is increasing, we must take a critical look at our cost structure. We can enhance production efficiency in AS Kalev Paide Tootmine, thus increasing productivity.

AS Kalev's activities in the real estate sector are mediated by AS Kalev REC, and its direct subsidiaries. The real estate sector is among the most quickly growing sectors in the current Estonian economic cycle as well as in the East European context. Real estate development and management therefore forms an important part of the differentiated value creation process in AS Kalev Group. So far, the main attention has focused around residential and commercial space development. In the future, the company plans to develop its activities also in the public real estate sector.

Oliver Kruuda
Manager

Kruuda

CONSOLIDATED FINANCIAL STATEMENTS

STATEMENT OF MANAGEMENT RESPONSIBILITY

Hereby I take responsibility for the correct preparation of the consolidated financial statements of AS Kalev (hereinafter "the Parent") and its subsidiaries (hereinafter together as "the Group") set out on pages 14 to 56 and confirm that:

- accounting policies used in preparing the consolidated financial statements are in compliance with International Financial Reporting Standards (IFRS) as adopted by the European Union;
- the consolidated financial statements give a true and fair view of the financial position of the Group and the results of its operations and cash flows;
- the Group and the Parent are able to continue as a going concern.

Põrguvälja, November 6, 2006

Oliver Kruuda
Manager

CONSOLIDATED INCOME STATEMENT

for the financial years ended June 30

Notes		in thousand EEK		in thousand EUR*	
		2006	2005	2006	2005
	Sales of goods (incl. sold property recognised under inventory)	884 230	836 175	56 513	53 441
	Sales revenue from services	2 244	3 003	143	192
	Rental income	3 149	3 372	201	216
6	**Total net sales**	**889 623**	**842 550**	**56 857**	**53 849**
7	Cost of sales	-745 734	-734 316	-47 789	-46 931
	Gross profit	**143 889**	**108 234**	**9 196**	**6 918**
7	Marketing expenses	-103 153	-79 072	-6 593	-5 054
7	Administrative expenses	-61 012	-61 657	-3 899	-3 941
8	Other operating items	41 360	9 234	2 643	590
	Operating profit (loss)	**21 084**	**-23 261**	**1 347**	**-1 487**
9	Financial income	3 831	731	245	47
9	Financial expenses	-23 621	-17 404	-1 509	-1 112
	Net profit (loss) for the financial year	**1 294**	**-39 934**	**83**	**-2 552**
	incl. net profit (loss) attributable to the shareholders of the Parent	1 153	-41 048	74	-2 623
	minority interests	141	1 114	9	71
10	Basic and diluted earnings per share for net profit (loss) attributable to the shareholders of the Parent (in EEK / in EUR)	0.05	-1.74	0.003	0.11

* In accordance with the rules of Tallinn Stock Exchange, the main financial statements are presented also in euro (EUR), which represents unaudited supplementary information that does not form part of the Group's consolidated financial statements.

Notes to the consolidated financial statements set out on pages 20 to 56 form an integral part of these financial statements.

For identification purposes only
ERNST & YOUNG
17.11.2006

CONSOLIDATED BALANCE SHEET

as of June 30

Notes		in thousand EEK		in thousand EUR*	
		2006	2005	2006	2005
	ASSETS				
	Current assets				
	Cash and cash equivalents	10 080	5 708	644	365
11	Receivables	134 930	114 860	8 624	7 341
	Prepayments	1 715	1 367	110	87
13	Inventories	240 334	106 541	15 360	6 809
	Total current assets	**387 059**	**228 476**	**24 738**	**14 602**
	Non-current assets				
11	Non-current receivables	7 230	5 116	462	327
15	Investment properties	89 944	200 578	5 748	12 819
16	Property, plant and equipment	545 840	347 316	34 886	22 198
17	Intangible assets	4 560	79	291	5
	Total non-current assets	**647 574**	**553 089**	**41 387**	**35 349**
	TOTAL ASSETS	**1 034 633**	**781 565**	**66 125**	**49 951**
	LIABILITIES AND EQUITY				
	Current liabilities				
18	Borrowings	240 464	119 416	15 368	7 632
19	Customer prepayments	27 821	3 925	1 778	251
19	Trade accounts payable and other payables	286 717	233 426	18 325	14 919
20	Provisions	3 200	5 000	205	319
	Total current liabilities	**558 202**	**361 767**	**35 676**	**23 121**
	Non-current liabilities				
18	Borrowings	132 908	183 035	8 494	11 698
	Total non-current liabilities	**132 908**	**183 035**	**8 494**	**11 698**
	Total liabilities	**691 110**	**544 802**	**44 170**	**34 819**
	Equity				
21	Share capital	236 325	236 325	15 103	15 103
5.15	Mandatory legal reserve	4 020	4 020	257	257
5.8	Revaluation reserve	116 315	8 669	7 434	555
	Retained earnings	-13 225	-20 857	-845	-1 333
	Equity attributable to the shareholders of the Parent	**343 435**	**228 157**	**21 950**	**14 582**
	Minority interests	**88**	**8 606**	**5**	**550**
	Total equity	**343 523**	**236 763**	**21 955**	**15 132**
	TOTAL LIABILITIES AND EQUITY	**1 034 633**	**781 565**	**66 125**	**49 951**

* In accordance with the rules of Tallinn Stock Exchange, the main financial statements are presented also in euro (EUR), which represents unaudited supplementary information that does not form part of the Group's consolidated financial statements.

Notes to the consolidated financial statements set out on pages 20 to 56 form an integral part of these financial statements.

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CONSOLIDATED CASH FLOW STATEMENT

for the financial years ended June 30

Notes		in thousand EEK 2006	in thousand EEK 2005	in thousand EUR* 2006	in thousand EUR* 2005
	Operating activities				
	Operating profit (loss)	21 084	-23 261	1 347	-1 487
	Adjustments to operating profit (loss):				
16,17	Depreciation and amortization of property, plant and equipment and intangible assets	25 410	24 950	1 624	1 595
8	Gain from the revaluation of investment properties	-41 836	-13 063	-2 674	-835
8	Profit (loss) from disposals of non-current assets [1]	-4 398	-5 405	-281	-345
	Changes in assets related to operating activities:				
	Inventories	-44 837	-3 248	-2 865	-207
	Receivables	33 264	81 138	2 126	5 186
	Other	-348	1 477	-22	94
	Changes in liabilities related to operating activities:				
	Trade accounts payable and other payables	-18 985	56 972	-1 213	3 641
	Customer prepayments	23 896	508	1 527	32
	Net cash from operating activities	**-6 750**	**120 692**	**-431**	**7 714**
	Investing activities				
22	Acquisition of subsidiaries, net of cash acquired	-6 314	-37 030	-404	-2 367
22	Proceeds from disposal of subsidiaries, net of cash disposed	1 744	0	111	0
	Proceeds from disposals of non-current assets [1]	56 923	67 955	3 638	4 343
	Purchases of non-current assets [1]	-57 447	-176 956	-3 671	-11 309
	Loans granted	-42 571	-14 876	-2 721	-951
	Repayments of granted loans	2 551	8 530	163	545
	Interests received	325	320	21	20
	Net cash used for investing activities	**-44 790**	**-152 057**	**-2 863**	**-9 719**
	Financing activities				
	Repayments of borrowings	-40 513	-58 332	-2 589	-3 728
	Borrowings received	136 007	151 526	8 692	9 684
	Repayment of finance lease liabilities	-18 081	-11 850	-1 156	-757
	Change in overdraft and inventory financing	-2 704	-32 588	-173	-2 083
	Interests paid	-18 797	-14 463	-1 201	-924
	Net cash from financing activities	**55 912**	**34 293**	**3 573**	**2 192**
	Total net cash flow	**4 372**	**2 928**	**279**	**187**
	Cash and cash equivalents at the beginning of the period	**5 708**	**2 780**	**365**	**178**
	Change in cash and cash equivalents	4 372	2 928	279	187
	Cash and cash equivalents at the end of the period	**10 080**	**5 708**	**644**	**365**

[1] i.e., property, plant and equipment, intangible assets and investment properties.

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the financial years ended June 30

in thousand EEK	Equity attributable to the shareholders of the Parent						
	Share capital	Mandatory legal reserve	Revaluation reserve	Retained earnings	Total	Minority interests	Total equity
As of June 30, 2004	**78 775**	**3 161**	**17 159**	**158 699**	**257 794**	**184**	**257 978**
Transfer from retained earnings to reserves (Note 5.15)	0	859	0	-859	**0**	0	**0**
Increase in share capital (Note 21)	157 550	0	0	-157 550	**0**	0	**0**
Negative goodwill (Note 17)	0	0	0	9 942	**9 942**	0	**9 942**
Reclassification effect (from property, plant and equipment to investment property) (Note 15)	*0*	*0*	*1 469*	*0*	***1 469***	*0*	***1 469***
Transfer from revaluation reserve to retained earnings (Note 5.8)	*0*	*0*	*-9 959*	*9 959*	***0***	*0*	***0***
Net profit (loss) for the financial year	*0*	*0*	*0*	*-41 048*	***-41 048***	*1 114*	***-39 934***
Total income and expenses in 2004/2005	0	0	-8 490	-31 089	**-39 579**	1 114	**-38 465**
Business combination (Note 22)	0	0	0	0	0	7 308	**7 308**
As of June 30, 2005	**236 325**	**4 020**	**8 669**	**-20 857**	**228 157**	**8 606**	**236 763**
Revaluation of property, plant and equipment (Note 16)	*0*	*0*	*112 626*	*0*	***112 626***	*0*	***112 626***
Transfer from revaluation reserve to retained earnings	*0*	*0*	*-4 980*	*4 980*	***0***	*0*	***0***
Net profit (loss) for the financial year	*0*	*0*	*0*	*1 153*	***1 153***	*141*	***1 294***
Total income and expenses in 2005/2006	0	0	107 646	6 133	**113 779**	141	**113 920**
Purchase of minority interests (Note 22)	0	0	0	1 499	**1 499**	-8 659	**-7 160**
As of June 30, 2006	**236 325**	**4 020**	**116 315**	**-13 225**	**343 435**	**88**	**343 523**

Further information on the share capital has been presented in Note 21. Information on the formation and potential uses of the mandatory legal reserve and the revaluation reserve has been presented in Note 5.15.

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in thousand EUR*	Equity attributable to the shareholders of the Parent						
	Share capital	Mandatory legal reserve	Revaluation reserve	Retained earnings	Total	Minority interests	Total equity
As of June 30, 2004	**5 034**	**202**	**1 097**	**10 143**	**16 476**	**12**	**16 488**
Transfer from retained earnings to reserves	0	55	0	-55	**0**	0	**0**
Increase in share capital	10 069	0	0	-10 069	**0**	0	**0**
Negative goodwill	0	0	0	635	**635**	0	**635**
Reclassification effect (from property, plant and equipment to investment property)	*0*	*0*	*94*	*0*	***94***	*0*	***94***
Transfer from revaluation reserve to retained earnings	*0*	*0*	*-636*	*636*	***0***	*0*	***0***
Net profit (loss) for the financial year	*0*	*0*	*0*	*-2 623*	***-2 623***	*71*	***-2 552***
Total income and expenses in 2004/2005	0	0	-542	-1 987	**-2 529**	71	**-2 458**
Business combination	0	0	0	0	0	467	**467**
As of June 30, 2005	**15 103**	**257**	**555**	**-1 333**	**14 582**	**550**	**15 132**
Revaluation of property, plant and equipment	*0*	*0*	*7 198*	*0*	***7 198***	***0***	***7 198***
Transfer from revaluation reserve to retained earnings	*0*	*0*	*-619*	*619*	***0***	***0***	***0***
Net profit (loss) for the financial year	*0*	*0*	*0*	*74*	***74***	***9***	***83***
Total income and expenses in 2005/2006	0	0	6 579	693	**7 272**	**9**	**7 281**
Purchase of minority interests	0	0	0	96	**96**	**-554**	**-458**
As of June 30, 2006	**15 103**	**257**	**7 134**	**-544**	**21 950**	**5**	**21 955**

* In accordance with the rules of Tallinn Stock Exchange, the main financial statements are presented also in euro (EUR), which represents unaudited supplementary information that does not form part of the Group's consolidated financial statements.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 CORPORATE INFORMATION

The consolidated financial statements of AS Kalev and its subsidiaries for the year ended June 30, 2006 were authorised for issue by the Manager on November 6, 2006. According to the Estonian Business Code, the annual report, including the consolidated financial statements, prepared by the Management Board and approved by the Supervisory Board, is authorised by the Shareholders' General Meeting. The shareholders hold the power not to approve the annual report prepared and presented by the Management Board and the right to request a new annual report to be prepared.

AS Kalev is a limited company incorporated and domiciled in Estonia. AS Kalev's shares are listed in the Investors' List of Tallinn Stock Exchange. The principal activities of the Group are the production and sales of different food products and the developing of real estate.

The structure of the Group as of June 30, 2006 has been disclosed in Note 22.

NOTE 2 BASIS OF PREPARATION

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

The Estonian kroon (EEK), which is pegged to euro (EUR) with the exchange rate of 1 EUR = 15.6466 EEK, is the Parent's functional currency and the presentation currency of the consolidated financial statements of the Group. All other currencies are considered to be foreign currencies. The consolidated financial statements are presented in thousands of the Estonian kroons except when otherwise indicated. Pursuant to the requirements of Tallinn Stock Exchange, the main financial statements (i.e., balance sheet, income statement, cash flow statement and statement of changes in equity) are presented also in euros (rounded to the nearest thousand); this represents supplemental information, which does not form a part of the Group's consolidated financial statements. As the Estonian kroon is pegged to euro with the fixed exchange rate, no foreign exchange rate differences arise in the translation of the financial statements.

The consolidated financial statements have been prepared on a historical cost basis unless indicated otherwise below (e.g., investment properties, which are measured at fair value and land and buildings under property, plant and equipment, which are measured at revalued amount).

In order to meet the requirement of the Estonian Accounting Act, the non-consolidated main financial statements of the Parent have been disclosed in the notes to its consolidated financial statements (see Note 29). These statements have been prepared using the same accounting methods and measurement bases that were used for the preparation of the consolidated financial statements, except for investments into subsidiaries (see also Notes 3.1.2 and 5.20).

2.1 Basis of consolidation

The Parent and its subsidiaries (i.e., the entities in which the Parent owns the majority of voting interest or there is other way the Parent is able to control the subsidiary's financial or business activity) compose the consolidation group (hereinafter together also as the Group).

Subsidiaries are consolidated line-by-line from the date of acquisition and continue to be consolidated until the date that such control ceases. For the consolidation purposes, the financial statements of the subsidiaries are prepared for the same reporting period. If a subsidiary uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements

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All inter-group transactions, balances and unrealised profits on transactions between Group's companies have been eliminated in full in the consolidated financial statements. Unrealised losses are eliminated unless costs cannot be recovered.

Minority interests represent the portion of profit or loss and net assets in subsidiaries not held by the Group and are presented separately in the consolidated income statement and consolidated balance sheet (within equity).

New subsidiaries (business combinations) have been included in the consolidated financials statements using the purchase method of accounting. Accordingly, the consolidated income statement and consolidated cash flow statement include the results and cash flows of new subsidiaries for the period starting from their acquisition date. The purchase consideration is allocated to the fair value of the assets acquired and liabilities and contingent liabilities assumed on the date of acquisition. The acquisition cost exceeding fair value of acquired net assets is accounted under goodwill (see accounting principle 5.9). Goodwill represents a payment made in anticipation of future economic benefits from assets of an acquiree that are not capable of being individually identified and separately recognised. If acquisition cost is less than fair value of acquired net assets the difference is recorded as income immediately.

In the case of the acquisition of minority interests, the entire difference between the acquisition cost and the book value of the minority interests (in the consolidated balance sheet) is taken directly to the equity attributable to the shareholders of the Parent.

NOTE 3 CHANGES IN ACCOUNTING POLICIES AND PRESENTATION

The consolidated financial report is composed based on consistency and comparability principles, which means that the Group continually applies same accounting principles and presentation. Changes in accounting policies and presentation take place only if these are required by new or revised IFRS standards and interpretations or if new accounting policy and / or presentation give more objective overview of financial position, financial results and cash flows of the Group.

3.1 Changes with an effect on the financial position and financial results

The accounting policies and presentation adopted in the preparation of the current financial statements are consistent with those of the previous financial year, except that the Group has adopted the following new / revised standards mandatory for the financial year beginning on or after January 1, 2005. The financial position of the Group and the results of its operations are influenced by the following standards:

- IAS 1 Presentation of Financial Statements;
- IAS 27 Consolidated and Separate Financial Statements.

3.1.1 Presentation of minority interests

Previously, minority interests were presented separately from liabilities and equity in the consolidated balance sheet of the Group. According to IAS 1 (revised 2004) and IAS 27 (revised 2004), the minority interests have to be presented under equity in the consolidated financial statements for the annual period starting on or after January 1, 2005 (incl. for comparatives).

As a result of the change in presentation, the Group's equity as of June 30, 2005 increased by 8 606 thousand EEK (the change does not have any effect on the equity attributable to shareholders of the Parent).

3.1.2 Investments into subsidiaries in the non-consolidated financial statements of the Parent

The investments into subsidiaries were accounted for under the equity method of accounting in the previous year separate financial statements of the Parent. IAS 27 (revised 2004) prohibits to use the equity method of accounting for investments into subsidiaries in the separate financial statements of the parent for the annual

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period starting on or after January 1, 2005. Instead, the investments have to be measured at cost or at fair value. In the non-consolidated main financial statements of the Parent presented in the notes to the current consolidated financial statements, the investments into subsidiaries are measured at cost (comparative period has been restated in accordance with the new policy).

As a result of the above change, the retained earnings of the Parent as of July 1, 2004, increase in retained earnings in the year ended June 30, 2005 (negative goodwill) and net profit for the year ended June 30, 2005 decreased by 34 617 thousand EEK, 9 941.5 thousand EEK and 16 629 thousand EEK, respectively. The investments into subsidiaries as of June 30, 2005 decreased by 61 187 thousand EEK.

3.2 Other changes in accounting policies and presentation

The Group has adopted the following revised or new standards during the reporting year and comparative figures have been amended as required. Adoption of revised and new standards does not have any effect on the Group's equity as of July 1, 2004.

- IAS 2 "Inventories";
- IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors";
- IAS 10 "Events after the Balance Sheet Date";
- IAS 16 "Property, Plant and Equipment";
- IAS 17 "Leases";
- IAS 21 "The Effect of Changes in Foreign Exchange Rates";
- IAS 24 "Related Party Disclosures";
- IAS 32 "Financial Instruments: Disclosure and Presentation";
- IAS 33 "Earnings per Share";
- IAS 39 "Financial Instruments: Recognition and Measurement"; and
- IAS 40 "Investment Property";
- IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".

In addition, with purpose to get more objective overview of the Group financial figures, some minor changes are made in presentation in the current consolidated financial statements. The changes which cause amendments in comparatives do not have an influence neither on the Group's equity as of June 30, 2005 nor on the result of the financial year ended then.

3.3 New IFRS standards and interpretations

In the opinion of the management of the Group the new or revised IFRS standards and their interpretations issued by the time of preparing the current consolidated financial statements, but not effective yet, and not applied early by the Group, do not have any effect on the value of the assets and liabilities of the Group as of June 30, 2006. These standards and interpretations will be applied starting from their effective date.

- IFRS 4 *"Insurance Contracts" – Financial Guarantee Contracts (amendments):* related amendment has been also issued to IAS 39;
- IFRS 6 *"Exploration for and Evaluation of Mineral Resources":* related amendment has been also issued to IFRS 1 (effective from the annual periods beginning on or after January 1, 2006)[1]
- IFRS 7 *"Financial Instruments: Disclosures":* the standard requires more disclosures on financial instruments and financial risk management and shall be applied to the annual periods beginning on or after January 1, 2007;
- IAS 1 *"Presentation of Financial Statements":* the amendment requires additional capital disclosures and shall be applied to annual periods beginning on or after January 1, 2007;
- IAS 19 *"Employee Benefits" – Actuarial Gains and Losses, Group Plans and Disclosures (amendments):* applied to annual periods beginning on or after January 1, 2006[1];
- IAS 21 *"The Effect of Changes in Foreign Exchange Rates" (amendments):* specify circumstances, in which a loan shall be considered to be a part of the Group's net investment in a foreign

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operation and currency, which has to be used for such investment. The amendments shall be applied to annual periods beginning on or after January 1, 2006;

- IAS 39 *"Financial Instruments: Recognition and Measurement"*: these amendments are related to hedges of forecast intragroup transactions and the use of the fair value option. The amendments shall be applied to annual periods beginning on or after January 1, 2006;
- IFRIC 4 *"Determining whether an Arrangement Contains a Lease"*: shall be applied to annual periods beginning on or after January 1, 2006;
- IFRIC 5 *"Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds"*: shall be applied to annual periods beginning on or after January 1, 2006[1];
- IFRIC 6 *"Liabilities Arising from Participating in a Specific Market: Waste Electrical and Electronic Equipment"*: shall be applied to annual periods beginning on or after December 1, 2005[1];
- IFRIC 7 *"Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Environments"*: shall be applied to annual periods beginning on or after March 1, 2006[1];
- IFRIC 8 *"Scope of IFRS2"*: shall be applied to annual periods beginning on or after May 1, 2006[1];
- IFRIC 9 *"Reassessment of Embedded Derivatives"*: shall be applied to annual periods beginning on or after June 1, 2006.

[1] changes and amendments do not apply to the current activities of the Group.

NOTE 4 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of consolidated financial statements in conformity with International Financial Reporting Standards as adopted by the European Union requires the management of the Group to make estimates and judgements that affect the reported amounts and accounting policies of assets and liabilities.

Although the estimations and judgements are reviewed by the management consistently and these are based on the previous experiences and the best knowledge on future trends, the actual outcomes may differ from the current estimates.

4.1. Judgements

In the process of applying the Group's accounting policies, the management of the Group has made the following judgements, which have the significant effect on the amounts recognised in the financial statements:

4.1.1 Classification of real estate

The classification of real estate items into classes as inventories, investment property or property, plant and equipment (construction-in-progress) is based on the intention of the management on the future use of the real estate. The accomplishment of the management's plans depends also on the decisions not controlled by the Group (i.e., changing registered intended use of land, approving architectural drawings, licence for construction etc), which may affect the final classification of real estate.

The real estate items with the intention on the future use for development and sale have been classified as inventories. Real estate items purchased for sale have also been recognised as inventories.

The aim of the purchase of an investment property is to earn rental income or income from capital appreciation. The real estate items held for long-term perspective and with several possible intentions on future use are also considered to be investment properties.

The property being constructed or developed or improved for the future use as commercial spaces leased out under operating lease terms (except these items being re-developed for continued future use as investment property) have been recorded as constructions-in-progress under property, plant and equipment and after the completion of work (i.e., after receiving a use permit) have been re-classified to investment property.

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Existing investment property that is being re-developed for continued future use as investment property is not temporarily re-classified to construction-in-progress.

4.1.2 Investments into shares of Valmetek Invest AS

A subsidiary AS Kalev Paide Tootmine owns less than half of the voting rights in Valmetek Invest AS (31.2%). As a result of the agreements of the shareholders' contact of Valmetek Invest AS, in the opinion of the management the Group has the power to govern the financial and operating policies of the entity. Therefore Valmetek Invest AS has been treated as a subsidiary and consolidated line-by-line in the current financial statements.

4.2 Estimation uncertainty

The estimates made by the management of the Group are based on the previous experiences and all information available by the date of the financial statements authorised for issue. There is either lower or higher risk that the estimates reported at the balance sheet date and related to value of assets, liabilities, revenue and expenses will change in the future. The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

4.2.1 Contingent liability related to so-called sugar fine

The Tax and Customs Board has made a decision, which obligates AS Kalev to remove sugar stock in the amount of 15.6 thousand tons from the market (i.e. excess stock as of May 1, 2004). AS Kalev filed a complaint against the aforesaid decision, as in the opinion of the management the Group didn't have such excess sugar stock on May 1, 2004. As the decision of the Tax and Customs Board refers only to the quantity and the judgement of Tallinn Administrative Court stopped the decision of Tax and Customs Board, there is no reliable information on the financial effect of the claim, in case AS Kalev would lose the dispute (in the opinion of the management of the Group, it's not probable that the Group will lose the case). For more detail information on the case, see also Note 25.2.4.

4.2.2 Fair value of land and buildings under property, plant and equipment

Land and buildings under property, plant and equipment are revalued to their revalued amount (i.e., fair value) frequently enough that the fair value of a revalued asset does not differ materially from its carrying amount. The discounted cash flow method has been used as a valuation technique for determining fair value of buildings. Estimating the discounted cash flows requires an appraiser to forecast rental income generated by the real estate and related expenses. In order to calculate the present value of those cash flows an appraiser has to choose a suitable discount rate, which reflects the time value of money and specific risks related to the assets in the best way. The carrying amount of the buildings measured at revalued amount determined using the discounted cash flow method as of June 30, 2006 amounted to 237 865 thousand EEK (2005: 186 902 thousand EEK).

4.2.3 Determining the useful lives of property, plant and equipment

Management has estimated the useful lives of property, plant and equipment and intangible assets, taking into considerations and volumes of business activities, historical experience in this area and future outlook. The further information on the management's estimation regarding the useful lives has been disclosed in Notes 5.8 and 16.

4.2.4 Impairment test of assets of the dairy products segment and determining the value of onerous contracts

As it is disclosed in segment reporting (see Note 6), the dairy product segment has earned losses in the current financial year as well as the previous financial year. Such situation indicates that assets of the segment may be impaired. Therefore the Group performed the impairment test comparing the carrying amounts of the segment's assets with their fair values less cost to sell. As a result of this comparison, the Group verified that the recoverable amount of the dairy product segment's assets is higher than their carrying amount (amounted to 162 581 thousand EEK as of June 30, 2006) and there are no needs for an allowance. If the fair value less cost to sell results in other amount than used by the management, there may arise the risk that the carrying value of the assets has to be decreased. The sale price in aftermarket was used as a fair value for machinery and equipment and fair value determined by an independent real estate expert was used as a fair value for buildings.

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Moreover, the Group analysed the long-term raw milk purchase agreements to assess whether these are onerous agreements or not. For the purpose of the analysis, the Group determined the discounted cash flows of these agreements. This required an estimation of sale prices of finished products (based on the prices in the European dairy market) and related production costs. For the calculation of discounted cash flows, the Group has to also choose a suitable discount rate, which reflects the time value of money and specific risks related to the assets in the best way. The carrying value of the onerous agreements as of June 30, 2006 amounted to 3 200 thousand EEK (2005: 5 000 thousand EEK). For the information on the provision for onerous agreements, see also Note 20.

4.2.5 Impairment test of goodwill

The Group determines whether goodwill arisen from business combinations is impaired at least on an annual basis. This requires an estimation of fair value (less costs to sell) or value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill as of June 30, 2006 was 4 550 thousand EEK (2005: 0 EEK). More details have been laid out in Notes 5.11 and 17.

4.2.6 Carrying value of receivables

The Group has granted several unsecured loans, which recoverable amounts depends mainly on whether the borrower is able to pay its loan back. The book value of unsecured loans as of June 30, 2006 amounts to 63 883 thousand EEK (2005: thousand 10 981 EEK). For further information on loans granted, see Note 11.

Trade accounts receivable include the receivable from Torgovõi Dom Pribaltiiski Kondiiter (in the amount of 4 760 thousand EEK) that due date was already several years ago. As the Group has the payable to the same company, the allowance for this receivable has not been recognised. The court dispute with Torgovõi Dom Pribaltiiski Kondiiter has been started; if the Group loses the dispute, the needs for an allowance may arise. See also Note 25.2.3.

NOTE 5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

5.1 Segment information

The primary segment reporting format is determined to be business segments. A segment has been disclosed as a separate reportable segment, if its products and services distinctly differ from the products and services offered by other segments, and it operates as an independent profit centre. The main segments of the Group are confectionery production and sale, pastries production and sale, production and sale of dairy products, operations with real estate.

Segment revenue is revenue that is directly attributable to a segment and the relevant portion of other revenue that can be allocated on reasonable basis to a segment, whether from sales to external customers or from transactions with other segments of the Group.

Segment expense is an expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to sales to external customers and expenses relating to transactions with other segments of the Group. Segment expense does not include general administrative expenses, interest expenses and other expenses that arise at the Group level and related to the Group as a whole. Expenses incurred at the Group level on behalf of a segment are allocated on a reasonable basis to the segment, if these expenses relate to the segment's operating activities and they can be directly attributed or allocated to the segment.

Segment result is segment revenue less segment expenses.

Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets include current assets, investment property, property, plant and equipment and intangible assets related to the operating activities. If a particular item of deprecation or amortization is included in segment expenses, the

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related asset is also included in segment assets. Segment assets do not include assets used for general Group or head-office purposes or which cannot be allocated directly to the segment. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists.

Segment liabilities are those liabilities that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities include, for example, trade accounts payables and other payables, accrued expenses, customers' prepayments, provisions and other products and services related liabilities. Segment liabilities do not include loans, finance leases, bonds and other liabilities related to financing activities. Income tax liability is not also included in segment liabilities.

The secondary segment reporting format is determined to be geographical segments.

5.2 Revenue recognition

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

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, the revenue and related expenses can be reliably measured and it is probable that the economic benefits will flow to the Group. Sales revenue from services is recorded in the period when the service has been provided or if service is provided for longer period, completion method is used.

Sale of real estate is recorded when all significant risks related to the asset have been transferred to the buyer and seller has no further substantial acts to complete under the contract. In general, revenue is recognised when the real right contract is concluded. If according to the contract under the law of obligations, the buyer was assigned to right of use and had paid the majority of purchase price, the sale is recorded at the signing of contract under the law of obligations. Payments received from clients in advance are recorded under "customers' prepayments" in balance sheet.

Interest income and dividend income is recognised when income is probable and the amount might be reliably assessed. Interest income is recognised based on effective interest rate. Dividend income is recorded when the right for claim has occurred.

5.3 Foreign currency transaction

Transactions in foreign currencies are translated into the Estonian kroons at the exchange rate quoted by the Bank of Estonia ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into the Estonian kroons at the exchange rate quoted by the Bank of Estonia ruling at the balance sheet date. Gains and losses from foreign currency transactions are recorded in the income statement (gains and losses arising from trade accounts receivable and trade accounts payable under operating items and gains and losses arising from other monetary assets and liabilities under financial items).

The functional currencies of the foreign subsidiaries Kalev Merchant Services Ltd and Stude REC EOOD is the currency of their primary economic environment, which differs from the functional currency of the Parent. The following exchange rates are used for translation of financial statements of these subsidiaries into the Estonia kroons:

- the assets (incl. goodwill and fair value adjustments arising from business combinations) and liabilities of these subsidiaries are translated at the rate of exchange quoted by the Bank of Estonia ruling at the balance sheet date;
- income and expenses are translated at the weighted average exchange rates for the year.

The exchange differences arising on the translation are taken directly to the equity (under "Foreign currency translation reserve").

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5.4. Cash and cash equivalents

For the purpose of cash flow statements, cash and cash equivalents are short-term highly liquid investments that are readily convertible to known amount of cash and which are subject to insignificant risk of changes in value, i.e., cash in hand, demand deposits in banks and time deposits with due date up to 3 months.

5.5 Loans and other receivables

Loans and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Other receivables include also trade accounts receivable.

Loans and other receivables are initially recognised at cost, being the fair value of the consideration given, plus directly attributable transaction costs.

After initial measurement, these financial assets are carried at amortised cost using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs.

If there is objective evidence that an impairment loss on loans and other receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Impairment loss on receivables related to operating activities is recognised under "other operating items" and impairment loss on receivables related to investing activities is recognised under financial expenses.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Such reversal is recognised as a reduction of the expense where impairment loss was previously recognised.

The derecognition of loans and other receivables takes place when the money is collected, the receivables are sold or the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement and the Group has transferred substantially all the risks and rewards of the asset.

5.5.1 Factoring

Factoring is the sale of receivables. Depending on the type of the factoring contract, the buyer has the right to resell the transferred receivable within time agreed (factoring with recourse) or there is no right for resale and all the risks and rewards associated with receivable are transferred from the seller to the buyer (factoring without recourse).

Factoring with recourse is recorded as a financing transaction (i.e. the borrowing with collateral): the amount of receivable is recognised in the balance sheet as a receivable until collection or until expiration of the recourse. The related liability is recorded similarly to other borrowings.

Factoring without recourse is recorded as the sale of the receivables. The related expense is recognised as a financial expense or an allowance depending on whether the aim of the transaction was to manage the cash flows or to manage credit risk.

5.6 Inventories

Inventories are valued at the lower of cost and net realisable value. The net realisable value is the estimated selling price in the ordinary course of business, less estimated cost necessary to make the sale. Cost of inventories is assigned by using the weighted average cost method.

Cost of finished goods and work-in-progress consists of cost of the raw materials, direct labour expenses, other direct expenses and production overheads incurred upon bringing the inventories to their present condition and location (based on normal production capacity).

5.7 Investment property

Investment property is property, i.e. land or buildings, held to earn rentals or for capital appreciation, and which is not used for the business activities (production of goods, supply of services and administrative activities) of the Group. Investment properties are measured initially at cost, including directly related transaction costs (i.e. notary fees, state duty, fees paid to advisers, and other expenses in order to complete the transaction). Subsequent to initial recognition, investment properties are stated at fair value. Gains or losses arising from changes in the fair values of investment properties are included in the income statement under "other operating items". For a transfer from property, plant and equipment to investments property, the positive difference between fair value at that date and its previous carrying amount is recognised directly in equity under "revaluation reserve".

5.8 Property, plant and equipment

Property, plant and equipment items are initially recognised at cost, consisting of the purchase price and expenditures directly related to the acquisition.

After initial measurement, land and buildings are stated at revalued amount and other property, plant and equipment items are stated at cost, less accumulated depreciation and any impairment in value.

Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised (e.g. replacements of part of some items) are added to the carrying amount of the assets, if the following criteria are met, i.e. (a) it is probable that future economic benefits associated with the item will flow to the Group, and (b) the cost of the item can be measured reliably. The replaced items are derecognised. All other expenditures are recognised as an expense in the period in which it is incurred.

At the revaluation date, the current cost of land and buildings is replaced by their fair value at the date of revaluation and accumulated depreciation is eliminated. Any revaluation surplus is credited to "revaluation reserve" included in the equity of the balance sheet. However, the increase is recognised in the income statement to the extent that it reverses a revaluation decrease of the same asset previously recognised in the income statement. A revaluation deficit is recognised in the income statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the "revaluation reserve".

Revaluation reserve recorded in equity is transferred to retained earnings during the depreciation period of revalued assets. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

- Buildings 3 %;
- Machinery, equipment and vehicles 10-20%;
- Computer equipment 30-50%;
- Other property, plant and equipment 20-30%.

Land is not depreciated.

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The residual value, method of depreciation and useful lives of items of property, plant and equipment are reviewed at least at each financial year and; if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimation, i.e. prospectively.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable (see also the accounting policy 5.11).

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (i.e., difference between the net disposal proceeds and the book value of the item) is included in the income statement (under "other operating items").

5.9 Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition.

After initial recognition, the goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated (1) represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and (2) is not larger than a segment based on the Group primary reporting format.

For the accounting policy of impairment, see also Note 5.11.

5.10 Other intangible assets

Intangible assets acquired separately from a business are initially recognised at cost. Intangible assets acquired as the part of an acquisition of a business are recorded separately from goodwill if their fair value can be reliably assessed as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either a finite or indefinite life. Intangible assets with finite lives are amortised over the useful economic life (i.e., over 5 years) on a straight-line basis and assessed for impairment whenever there is an indication that the intangible asset may be impaired (see the accounting policy 5.11). The amortisation period and the amortisation method for an intangible asset with finite life are reviewed at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level (see Note 5.11). Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite is made on a prospective basis.

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5.10.1 Research and development expenditures

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is capitalised only when the Group can demonstrate (1) the technical feasibility of completing the intangible asset so that it will be available for use or sale; (2) its intention to complete and its ability to use or sell the asset; (3) how the asset will generate future economic benefits; (4) the ability of resources to complete; and (5) the availability to measure reliably the expenditure during the development.

Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure capitalised is amortised over the period of expected future sales from the related project.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use or more frequently when an indication of impairment arises during the reporting year.

5.11 Impairment of assets

The Group assesses at each balance sheet date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds the estimated recoverable amount, the asset is considered impaired and is written down to its recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and the present value of its estimated future cash flows (i.e., value in use). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If necessary, the external experts are used for determining the fair value. Impairment losses are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

A previously recognised impairment is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. As a result of reversal, the carrying amount of an asset is increased to the extent that increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised as a reduction of the expense where impairment loss was previously recognised. Impairment losses recognised in relation to goodwill are not reversed for subsequent increases in its recoverable amount.

5.12 Financial liabilities

Financial liabilities (trade accounts payables, loans, accrued expenses, bonds and other short- and long-term liabilities) are recognised initially at cost, net of directly attributable transaction costs. In subsequent periods, financial liabilities are stated at amortised cost using the effective interest method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the financial liability. Financial liabilities are derecognised when the obligation under the liability is discharged or cancelled or expired.

Borrowing costs are recognised as an expense when incurred (under "financial expenses").

5.13 Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risk specific to the liability.

Present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources of the Group will be required or whose value can not be reliably measured, are considered to be contingent liabilities. Contingent liabilities are not recognised in the balance sheet, but disclosed in the notes to the consolidated financial statements.

5.14 Income tax

According to Estonian Income Tax Law the company's net profit is not subject to income tax, thus there are no temporary differences between the tax bases and carrying values of assets and liabilities that may cause the deferred income tax. Instead of net profit, all dividends paid by the company are subject to income tax (24/76 of net dividend paid out before December 31, 2005; 23/77 of net dividend paid / payable out during the calendar year 2006 and after that the rate will decrease every year by one point until 20/80 of net dividends paid out after January 1, 2009). Income tax from the payment of dividends is recorded as income tax expense at the moment of declaring the dividends.

In accordance with income tax acts, the company's net profit adjusted by temporary and permanent differences determined in income tax acts is subject to income tax in the USA and Bulgaria (tax rate is 15% in Bulgaria and 22,5% as a minimum in the USA).

In connection with the foreign subsidiaries, deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are recognised only when it is probable that profit will be available against which the deferred tax assets can be utilised.

5.15 Mandatory legal reserve

Mandatory legal reserve is formed according to the Estonian Commercial Code. At least 5% of the net profit must be transferred to the mandatory legal reserve each financial year, until the mandatory legal reserve amounts to at least 10% of the share capital. This reserve can be used for covering the loss, if loss cannot be covered from the distributable shareholder's equity, and for increasing the share capital of the company. The mandatory legal reserve cannot be paid out as dividends.

5.16 Government grants

Government grants are recognised at fair value, where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

The Group applies the "net method" for the assets acquired with government grants. According to this method, the asset is recognised at cost less government grant received and hereafter government grants are recorded as income over the useful life of an asset – as a reduction of depreciation charge.

Government grants received as compensation for expenses are recorded, when related expenses incurred. The Group applies the "gross method" for compensation of expenses. According to this method expenses compensated and compensation received are presented separately in the income statement. Income related to government grants are recorded under "other operating items".

5.17 Employee benefits

The Group makes social insurance contributions under the State's health, retirement benefit and unemployment schemes at the statutory rates in force during the year, based on gross salary payments. The Group pays fixed contributions to a privately administered pension insurance plan. The Group will have no legal or constructive obligations to pay further contributions if the statutory fund or the private pension plan cannot settle their liabilities towards the employees. The cost of these payments is included into the income statement in the same period as the related salary cost.

5.18 Leases

A finance lease is a lease that transfers substantially all the risks and benefits incidental to ownership of the leased item. All other lease transactions are treated as operating lease.

5.18.1 Group as a lessee
Finance leases are capitalized at the inception of the lease at the fair value of the leased assets or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term. Operating lease payments are recognised as operating expenses on a straight-line basis over the lease term.

5.18.2 Group as a lessor
In case of operating lease, the leased assets are recorded in the lessor's balance sheet, like other items of property, plant and equipment and investment property. Lease income from operating leases is recognised in income on a straight-line basis over the lease term.

5.19 Subsequent events

Material circumstances that have an effect on the valuation of assets and liabilities and became evident between the balance sheet date and the date of preparing the financial statements, but are related to transactions that took place in the reporting period or earlier periods, are recorded in the consolidated financial statements.

Subsequent events that have not been taken into consideration when valuating the assets and liabilities but have a material effect on the result of the next financial year, are disclosed in the consolidated financial statements.

5.20 Investments into subsidiaries in the non-consolidated main financial statements of the Parent

Investments in subsidiaries are measured at cost in the non-consolidated main financial statements of the Parent. Accordingly, the investment is initially recognised at cost, being the fair value of the consideration given subsequently adjusted for any impairment losses.

The Group assesses at each balance sheet date whether there is an indication that an asset may be impaired. If such indications exist, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down to its recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and the present value of its estimated future cash flows (i.e., value in use). Impairment loss is recognised in the income statement as a financial expense for the period.

Dividends paid by the subsidiaries are recognised, at the moment when the Group's right to receive the dividends is established, as financial income, excluding the part of the dividends disbursed from the free equity accumulated prior to the acquisition of the investment by the Group. That proportion of the dividends is recorded as a decrease in the carrying value of the investment.

NOTE 6 SEGMENT INFORMATION

for the financial years ended June 30, in thousand EEK

6.1 Primary segment format – business segments

For the purpose of segment information, the confectionery, pastries and dairy products as well as real estate are clearly distinguishable as segments.

2006	Confectionery	Pastries	Dairy products	Real estate	TOTAL
Revenue from external clients:					
- net sales	350 967	86 322	397 847	54 487	889 623
- other operating income	1 298	152	9 685	46 576	57 710
Revenue from other segments	0	0	15 699	20 864	36 563
Total segment revenue	**352 265**	**86 474**	**423 231**	**121 926**	**983 896**
Segment result	**34 842**	**1 668**	**-45 043**	**61 883**	**53 350**
Unallocated expenses					-32 266
Operating profit					**21 084**
Net financial items					-19 790
Net profit for the financial year					**1 294**
Segment assets	193 393	56 282	173 887	511 568	935 130
Unallocated assets					99 503
Total assets					**1 034 633**
Segment liabilities	73 339	14 161	181 066	47 609	316 175
Unallocated liabilities					374 935
Total liabilities					**691 110**
Segment capital expenditures for non-current assets	30 698	7 303	6 562	14 755	59 318
Unallocated capital expenditures for non-current assets					382
Total expenditures for non-current assets (Notes 15 and 16)					**59 700**
Segment depreciation and amortization	12 751	4 116	6 637	143	23 647
Depreciation and amortization of unallocated assets					1 763
Total depreciation and amortization (Notes 16 and 17)					**25 410**
Other non-monetary expenses of segments (allowances, provisions etc.)	522	164	5 147	0	5 833

Transfer prices between business segments are set on arm's length basis in a manner similar to transactions with third parties.

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2005	Confectionery	Pastries	Dairy products	Real estate	TOTAL
Revenue from external clients:					
- net sales	309 291	96 426	418 882	17 951	842 550
- other operating income	8 603	194	3 844	14 534	27 175
Revenue from other segments	0	0	10 903	20 768	31 671
Total segment revenue	**317 894**	**96 620**	**433 629**	**53 253**	**901 396**
Segment result	**22 664**	**4 839**	**-10 704**	**13 117**	**29 916**
Unallocated expenses					-53 177
Operating profit					**-23 261**
Net financial items					-16 673
Net profit for the financial year					**-39 934**
Segment assets	160 211	54 634	93 636	429 866	738 347
Unallocated assets					43 218
Total assets					**781 565**
Segment liabilities	71 573	12 060	126 042	32 676	242 351
Unallocated liabilities					302 451
Total liabilities					**544 802**
Segment capital expenditures for non-current assets	29 790	884	15 785	139 320	185 779
Unallocated capital expenditures for non-current assets					768
Total expenditures for non-current assets					**186 547**
Segment depreciation and amortization	13 759	4 012	6 208	38	24 017
Depreciation and amortization of unallocated assets					933
Total depreciation and amortization					**24 950**
Other non-monetary expenses of segments (allowances, provisions etc.)	3 712	363	5 676	0	9 751

6.2 Secondary segment format – geographical segments

Revenue by location of customers:	2006	2005
Estonia	507 093	470 070
Latvia and Lithuania	23 396	17 965
Scandinavia	9 101	50 312
Other EU countries	314 975	295 132
Others	35 058	9 071
Total	**889 623**	**842 550**

All significant assets of the Group are located in Estonia.

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NOTE 7 COST OF SALES, MARKETING EXPENSES AND ADMINISTRATIVE EXPENSES

for the financial years ended June 30, in thousand EEK

	2006	2005
Cost of materials and goods (incl. sold property recognised under inventory)	-583 096	-594 571
Personnel expenses	-47 896	-44 815
Depreciation (Note 16)	-18 698	-18 105
Expenses related to transport	-12 790	-12 595
Maintenance and rent of buildings and equipment	-21 513	-18 098
Electricity, water, heat	-38 087	-27 937
Other expenses	-23 654	-18 195
Total cost of sales	**-745 734**	**-734 316**
Personnel expenses	-31 017	-26 466
Depreciation (Note 16)	-4 212	-3 662
Expenses related to transport	-18 173	-17 668
Advertising expenses	-22 624	-15 849
Research and development expenses	-4 502	-3 370
Fees for consultations	-5 762	-2 859
Maintenance and rent of premises	-3 058	-546
Other expenses	-13 805	-8 652
Total marketing expenses	**-103 153**	**-79 072**
Personnel expenses	-17 482	-14 981
Depreciation, amortization and impairment loss (Notes 16 and 17)	-2 500	-3 182
Expenses related to transport	-5 370	-4 638
Maintenance and rent of rooms	-6 696	-8 598
Fees for consultations	-12 328	-13 567
Other expenses	-16 636	-16 691
Total administrative expenses	**-61 012**	**-61 657**

Abovementioned personnel expenses are divided as follows:

	2006	2005
Salary and wages	- 72 758	-64 616
Social taxes (see Note 5.17)	-23 637	-21 646
Total personnel expenses	**-96 395**	**-86 262**

In the reporting period, the average number of employees of the Group amounted to 787 (2005: 806). Compensation for lay-offs and employment termination was paid to 62 employees (2005: 47) in the total amount of 1 373 thousand EEK (2005: 1 319 thousand EEK).

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NOTE 8 OTHER OPERATING ITEMS

for the financial years ended June 30, in thousand EEK

	2006	2005
Gain from disposals of property, plant and equipment	75	5 782
Gain from the revaluation of investment properties (Note 15)	41 836	13 063
Gain from sales of investment properties (Note 15)	4 739	1 449
Government grants [1]	10 772	4 054
Other operating income	288	2 827
Total other operating income	**57 710**	**27 175**
Loss from disposals of property, plant and equipment	-416	-1 826
Impairment of inventories (Note 14) [2]	-2 173	-2 921
Impairment of receivables (Note 12)	-460	-3 152
Fines for delay and penalties	-8 281	-3 584
Provisions for onerous agreement (Note 20)	-3 200	-5 000
Net foreign exchange losses	-38	-36
Other operating expenses	-1 782	-1 422
Total other operating expenses	**-16 350**	**-17 941**
Total other operating items	**41 360**	**9 234**

[1] The subsidy was received regarding sales of dairy product and sugar outside of the European Union.

[2] Amount of the impairment also includes inventories in the amount of 146 thousand EEK that were expensed directly (i.e. these inventories were written off from balance sheet without prior allowance recognition).

NOTE 9 FINANCIAL ITEMS

for the financial years ended June 30, in thousand EEK

	2006	2005
Interest income	1 401	731
Gain from disposal of subsidiary (Note 22.4)	2 430	0
Total financial income	**3 831**	**731**
Net foreign exchange losses	-136	-134
Interest expenses	-22 794	-15 240
Other financial expenses	-691	- 2 030
Total financial expenses	**-23 621**	**-17 404**
Total financial items	**-19 790**	**-16 673**

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NOTE 10 EARNINGS PER SHARE

for the financial years ended June 30, in thousand EEK

	2006	2005
Net profit (loss) attributable to the shareholders of the Parent	1 153	-41 048
The weighted average number of shares in the period (in thousands)	23 633	23 633
Earning per share (kroons)	**0.05**	**-1.74**

In the previous financial year, the share capital was increased. Since the increase of share capital was bonus issue (see additional information in Note 21), the new amount of shares was used as an average number of ordinary shares for the full comparative period.

As the Group does not have any potential ordinary shares, then the diluted earnings per share are equal to basic earnings per share.

Further information on the number of shares has been presented in Note 21.

NOTE 11 RECEIVABLES

as of June 30, in thousand EEK

11.1 Short-term receivables

	2006	2005
Trade accounts receivable	61 800	73 938
Short-term loans [1]	56 653	5 865
Other receivables [2]	3 865	7 834
Accrued income	1 881	804
VAT prepayment	12 303	28 745
Allowance for receivables (Note 12)	-1 572	-2 326
Total short-term receivables	**134 930**	**114 860**

[1] The Group has granted short-term loans without guarantee with an average effective interest rate of 6% (2005: 6%).

[2] Group's other receivables as of June 30, 2006 include among others government grants receivable from the Estonian Agricultural Registers and Information Board (PRIA) in the amount of 2 425 thousand EEK (2005: 4 328 thousand EEK).

11.2 Long-term receivables

As of June 30, 2006 long-term receivables include unsecured loans denominated in EEK granted by the Group in the amount of 6 900 thousand EEK (2005: 4 768 thousand EEK) and other receivables in the amount of 330 thousand EEK (2005: 348 thousand EEK). These loans are prepayments for financial assets (i.e. long-term loan receivables and investments into shares). The final allocation between the loans and share investments has not been agreed yet, and therefore the maturity date and interest rate for the loans have not been determined, as well. The maturity date and interest rate of the loans recorded in the balance sheet as of June 30, 2005 were December 31, 2006 and 5-6%, respectively.

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NOTE 12 ALLOWANCE FOR RECEIVABLES

for the financial years ended June 30, in thousand EEK

	2006	2005
Allowance for receivables at the beginning of period	-2 326	-248
Additional allowance	-1 536	-2 078
Derecognition of impaired receivables	490	0
Reversal of allowance recorded previously	1 800	0
Total allowance for receivables	**-1 572**	**-2 326**

During the reporting period the receivables of the Group have been considered as uncollectible receivables in the amount of 724 thousand EEK (2005: 1 074 thousand EEK), i.e. these receivables were written off from balance sheet without prior allowance recognition.

Expenses from allowance for doubtful receivables and write-off of uncollectible receivables and reversal of allowances recorded previously are presented under "other operating items" in income statement.

NOTE 13 INVENTORIES

as of June 30, in thousand EEK

	2006	2005
Raw materials	37 473	43 626
Work-in-progress	7 366	7 389
Finished products	42 455	37 438
Real estate for sale	152 150	13 457
Goods purchased for resale	1 307	3 483
Allowance for inventories	-2 208	-3 357
Prepayments to suppliers	1 791	4 505
Total inventories	**240 334**	**106 541**

As of June 30, 2006, real estate for sale includes real estate projects in the development process in the amount of 152 150 thousand EEK (2005: land purchased for sale in the amount 13 457 thousand EEK).

NOTE 14 ALLOWANCE FOR INVENTORIES

for the financial years ended June 30, in thousand EEK

	2006	2005
Allowance at the beginning of the period	-3 357	-436
Previously recorded allowance used due to sales of respective inventories	3 176	0
Additional allowance	-2 027	-2 921
Allowance at the end of the period	**-2 208**	**-3 357**

As of June 30, 2006 the Group has written down raw materials in the amount of 50 thousand EEK and finished products in the amount of 2 158 thousand EEK, as realisable value of inventories was lower than their cost (2005: 2 681 thousand EEK and 676 thousand EEK respectively). The book value (i.e. net realizable value) of inventories, for which the allowance has been provided for, is 23 469 thousand EEK as of June 30, 2006 (2005: 23 482 thousand EEK).

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The realisable value of inventories was lower than their book value due to a decrease in the sales price of milk products, slow-moving items and lower quality of raw materials.

NOTE 15 INVESTMENT PROPERTY

for the financial years ended June 30, in thousand EEK

	Investment properties, excl. prepayments	Prepayments for investments	Total
Book value June 30, 2004	**43 048**	**15 007**	**58 055**
Acquisitions	104 230	35 858	140 088
Transfer from prepayments to investments	15 007	-15 007	0
Reclassification from property, plant and equipment (Note 16)	34 713	0	34 713
Reclassification to inventories	-17 172	-1 048	-18 220
Disposals	-28 590	0	-28 590
Change in fair value – recorded directly in equity [1]	1 469	0	1 469
Change in fair value – recorded in income statement (Note 8)	13 063	0	13 063
Book value June 30, 2005	**165 768**	**34 810**	**200 578**
Acquisitions	9 149	0	9 149
Transfer from prepayments to investments	21 910	-21 910	0
Transfer from prepayments to receivables	0	-12 900	-12 900
Reclassification from property, plant and equipment (Note 16)	1 876	0	1 876
Reclassification to inventories	-99 224	0	-99 224
Disposals	-51 371	0	-51 371
Change in fair value – recorded in income statement (Note 8)	41 836	0	41 836
Book value June 30, 2006	**89 944**	**0**	**89 944**

[1] a positive difference between fair value and carrying value at a reclassification from property, plant and equipment to investment properties.

In the reporting period, the Group earned rental income from investment properties in the total amount of 3 149 thousand EEK and gain from disposals in the total amount of 4 739 thousand EEK (2005: 3 372 thousand EEK and 1 449 thousand EEK, respectively). All investments are measured in fair value in the balance sheet. Fair value is based on both values determined by independent valuers and intragroup real estate experts (mostly based on the discounted cash flow method based on the market yield). As of June 30, 2006, the carrying amount of investment property that fair value has not been determined by an independent valuer amounts to 79 841 thousand EEK (2005: 123 617 thousand EEK).

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NOTE 16 PROPERTY, PLANT AND EQUIPMENT

for the financial years ended June 30, in thousand EEK

	Land	Buildings	Machinery and equipment	Other items	CIP	Total
Book value as of June 30, 2004	**30 090**	**244 032**	**68 453**	**4 019**	**4 575**	**351 169**
Acquisitions from business combination (Note 22)	114	22 352	2 199	2 790	10	27 465
Other acquisitions	1 693	18 396	19 438	2 876	4 056	46 459
Disposals	-15	-17 659	-132	-494	-660	-18 960
Reclassifications	0	-1 768	2 133	-365	0	0
Reclassifications to investment properties (Note 15)	-20 396	-14 317	0	0	0	-34 713
Depreciation charge	0	-6 594	-15 828	-1 682	0	-24 104
Book value as of June 30, 2005	**11 486**	**244 442**	**76 263**	**7 144**	**7 981**	**347 316**
Acquisitions from business combination (Note 22),	500	11 000	0	0	66 755	78 255
incl. non-monetary contribution made by the Group	-500	-11 000	0	0	-7 606	-19 106
Other acquisitions	1 214	4 392	16 994	4 803	30 754	58 157
Disposals	0	0	-467	-264	-423	-1 154
Reclassifications	0	187	6 345	-1 118	-5 414	0
Reclassifications to investment properties (Note 15)	0	-1 876	0	0	0	-1 876
Reclassifications to inventories	0	-3 037	0	0	0	-3 037
Depreciation charge	0	-7 961	-14 820	-2 560	0	-25 341
Revaluations [1]	411	112 215	0	0	0	112 626
Book value as of June 30, 2006	**13 111**	**348 362**	**84 315**	**8 005**	**92 047**	**545 840**

Cost / revalued amount and accumulated depreciation of property, plant and equipment at the beginning and end of the financial year were:

June 30, 2004						
Cost / revalued amount	30 090	268 294	123 101	13 774	4 810	440 069
Accumulated depreciation	0	-24 262	-54 648	-9 755	-235	-88 900
June 30, 2005						
Cost / revalued amount	11 486	263 196	147 784	18 493	8 216	449 175
Accumulated depreciation	0	-18 754	-71 521	-11 349	-235	-101 859
June 30, 2006						
Cost / revalued amount	13 111	348 362	166 570	18 133	92 282	638 458
Accumulated depreciation	0	0	-82 255	-10 128	-235	-92 618

[1] As there have been significant changes in the real estate market during couple last years, the new revaluation of land and buildings has been carried out as of the end of the reporting financial year. The latest revaluations before that were carried out as of June 30, 2002 and 2003. In order to estimate the fair value of buildings, the discounted cash flow method and amortised replacement cost method were used and prices of comparable transactions were used for determining the fair value of land. Fair value is based on both values determined by independent valuers (in the carrying value of 79 554 thousand EEK) and intragroup real estate experts (in the carrying value of 281 919 thousand EEK).

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The carrying amounts of land and buildings that would have been recognised had the assets been carried under the cost model are 12 700 thousand EEK for land and 227 478 thousand EEK for buildings.

Construction in process (CIP) of the Group includes also uninstalled equipment or equipment currently under installation and prepayments for property, plant and equipment (as of June 30, 2006: 82 818 thousand EEK and 5 270 thousand EEK and 2005: 6 905 thousand EEK and 1 076 thousand EEK, respectively).

Depreciation charge has been recognised as follows: -18 698 (2005: -18 105) thousand EEK as cost of sales, -4 212 (2005: -3 662) thousand EEK as marketing expenses, and -2 431 (2005: -2 336) thousand EEK as administrative expenses.

Cost of fully depreciated property, plant and equipment as of June 30:

	2006	2005
Buildings	243	157
Machinery and equipment	40 350	41 296
Other items	5 389	5 909
Total	**45 982**	**47 362**

NOTE 17 INTANGIBLE ASSETS

for the financial years ended June 30, in thousand EEK

	Positive goodwill	Negative goodwill	Other intangible assets (with finite useful lives)	Total
Book value as of June 30, 2004	**772**	**-9 942**	**153**	**-9 017**
Derecognition of negative goodwill with corresponding entry to retained earnings [1]	0	9 942	0	9 942
Impairment loss [2]	-772	0	0	-772
Amortisation charge	0	0	-74	-74
Book value as of June 30, 2005	**0**	**0**	**79**	**79**
Acquisitions from business combination (Note 22)	4 550	0	0	4 550
Amortisation charge	0	0	-69	-69
Book value as of June 30, 2006	**4 550**	**0**	**10**	**4 560**

Cost and accumulated amortisation of intangible assets at the beginning and end of the financial year were:

June 30, 2004				
Cost	772	-9 942	359	-8 811
Accumulated amortisation	0	0	-206	-206
June 30, 2005				
Cost	0	0	359	359
Accumulated amortisation	0	0	-280	-280
June 30, 2006				
Cost	4 550	0	359	4 909
Accumulated amortisation	0	0	-349	-349

[1] In the financial year 2004/2005 IFRS 3 was applied first for negative goodwill which arose from the business combinations with agreement dates before March 31, 2004. According to the transitional provisions of IFRS 3, the amount of negative goodwill as of June 30, 2004 was directly taken to equity (as increase of retained earnings).

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[2] Impairment loss of positive goodwill in the amount of 772 thousand EEK was recognised. The goodwill resulted from the purchase of shares of OÜ Maiasmokk. It was considered to be impaired, as OÜ Maiasmokk has earned losses during the past two years and according to the Group's management estimates, there are no signs that subsidiary's results may improve so that the present value of net future cash flows could cover the book value of subsidiary's net assets and goodwill.

[3] The impairment test for goodwill was carried out as of the end of the financial year. The goodwill has been fully allocated to the dairy product segment. The value-in-use of the cash generating unit related to the production of cheese and its carrying value were compared. For determining the value-in-use, the Group used the approved budget for one year and 5-years extrapolated projections (based on the prices in the European dairy market) according to which the normal production capacity will be achieved by 2008. 3% of growth rate and 5.1% of gross margin have been used for future cash flows starting from 2008. The gross margin is based on the previous experiences in the dairy industry. 10.2% has been used as the discount rate. As a result of the impairment test, the Group verified that the recoverable amount of the cash generating unit (including goodwill) is higher than its carrying amount and there is no need for an allowance. The time of achieving the normal production capacity may influence significantly the result of the impairment test. If the normal production capacity is achieved one year later, the need to recognize an allowance for goodwill (in part or fully) may arise.

Amortisation charge has been recognised as administrative expenses.

NOTE 18 BORROWINGS

as of June 30, in thousand EEK

2006	Current portion	Non-current portion	Total borrowings	Interest rates	Due dates
Overdraft	46 052	0	46 052	4-6%	2007
Bonds	74 834	0	74 834	6.5%	2007
Other loans	5 000	0	5 000	17.6-20%	2006
Short-term bank loans	12 000	0	12 000	7.5%	2006
Long-term bank loans	93 698	45 127	138 825	4.1-7.5%*	2006-2015
Lease liabilities (Note 23)	8 880	87 781	96 661	5.2-7%**	2006-2013
Total borrowings	**240 464**	**132 908**	**373 372**		

* Certain long-term bank loans have an interest rate related to Euribor (plus 0.85-5.3%) and others have a fixed interest rate (4.5-7.5%).

** Certain leases have an interest rate related to Euribor (plus 2-3%, 2005: 2-3.25%) and others have a fixed interest rate (6-7% in 2006 and 6-10% in 2005).

2005	Current portion	Non-current portion	Total borrowings	Interest rates	Due dates
Overdraft	41 277	0	41 277	4-6%	2006
Bonds	31 004	0	31 004	6.5%	2005
Short-term bank loans	7 800	0	7 800	5.5-7.5%	2005
Long-term bank loans	21 121	88 887	110 008	EURIBOR +0.85-5.3%	2005-2013
Inventory financing	7 479	0	7 479	5.15%	2006
Lease liabilities (Note 23)	10 735	94 148	104 883	4.2-10%**	2005-2013
Total borrowings	**119 416**	**183 035**	**302 451**		

All loans have been denominated in EEK or EUR. See Note 24 for information on pledged assets.

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NOTE 19 TRADE ACCOUNTS PAYABLE AND OTHER PAYABLES AND CUSTOMERS' PREPAYMENTS

as of June 30, in thousand EEK

19.1 Payables

	2006	2005
Trade accounts payable	211 973	215 657
Other payables	51 879	0
Taxes payable	10 119	10 235
Payables to employees	6 535	6 430
Other accrued expenses	6 211	1 104
Total	**286 717**	**233 426**

Other payables are mainly related to the potential purchase of Valmetek Invest AS minority interests. Please refer to Note 22 for more detailed information.

The balance of taxes payable includes the following taxes:

	2006	2005
Social tax	6 026	5 458
Personal income tax	3 084	2 120
VAT	212	1 393
Other taxes	501	656
Tax penalties	296	608
Total	**10 119**	**10 235**

19.2 Customer prepayments

	2006	2005
Prepayments received for real estate	27 505	3 460
Other prepayments	316	465
Total	**27 821**	**3 925**

The balance of prepayments received for real estate has increased, as the Group started with developing new real estate project regarding to which they have already received advances (see also the accounting policy 5.2).

NOTE 20 PROVISIONS

in thousand EEK

	Provision for onerous contracts
Book value as of June 30, 2004	**0**
Recording of provision (Note 8)	5 000
Book value as of June 30, 2005	**5 000**
Provision used	-5 000
Recording of provision (Note 8)	3 200
Book value as of June 30, 2006	**3 200**

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The Group's subsidiary AS Kalev Paide Tootmine has concluded long-term agreements (effective until December 31, 2006) for purchase of crude milk, with fixed price and minimum quantity, which the Group is obligated to buy. As prices of finished products of AS Kalev Paide Tootmine (i.e. milk and skim milk powder and butter) are at low level on the European market (the major market for dairy products of the Group) at the moment, the agreements specified above are considered as onerous agreements, and therefore the provision is recorded. The provision was recorded based on current prices, possible changes in prices, and quantity of products possible to produce from crude milk, which was not yet purchased as of June 30, 2006 and June 30, 2005 based on the agreements.

NOTE 21 SHARE CAPITAL

As of June 30, 2004 the share capital of the Parent consisted of 7 877 500 shares with nominal value of 10 EEK per share. According to Shareholders' General Meeting of AS Kalev from November 24, 2004, AS Kalev increased the share capital by 157 550 thousand EEK. The increase of share capital was a bonus issue, i.e. new shares were issued on account of retained earnings in the way that the Parent's shareholders received two new shares of 10 EEK for each share owned before issue. After share issue the share capital of AS Kalev consists of 23 632 500 ordinary shares. The increase of share capital was registered in the Business Register on January 27, 2005.

There were no changes in the share capital of the Parent during the reporting period.

According to the Articles of Association of the Parent the maximum number of authorised ordinary shares is 31 510 000.

NOTE 22 SUBSIDIARIES

in thousand EEK

As of June 30, AS Kalev participates in subsidiaries as follows:

Subsidiaries	Country of incorporation	Main activities	Owner-ship % 2006	Owner-ship % 2005
AS Kalev REC [3]	Estonia	real estate development, maintenance, real estate related consultancy	100,0%	100,0%
Stude REC EOOD	Bulgaria	real estate development, maintenance, rent, sale and purchase of real estate	100,0%	-
OÜ Sõbra Korterid [2]	Estonia	real estate development	-	50,0%
Kalev Merchant Services Ltd	USA	sales and introduction of AS Kalev products in USA	100,0%	100,0%
AS Kalev Paide Tootmine	Estonia	production of dairy products	100,0%	100,0%
Valmetek Invest AS [1]	Estonia	production of cheese	31,2%	-
AS Kalev Jõhvi Tootmine	Estonia	manufacturing and sale of flour confectionery and pastry	99,1%	99,1%
OÜ Maiasmokk	Estonia	manufacturing and sale of confectionery and pastry	81,3%	81,3%
AS Vilma	Estonia	manufacturing of confectionery, pastry and flour half-finished products	100,0%	60,7%
AS Kalev Chocolate Factory	Estonia	Production of chocolate and sugar confectionery	100,0%	-

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[1] Valmetek Invest AS is considered to be a subsidiary, as in accordance with the shareholders' agreement the Group can appoint all members of the Supervisory Board of the entity and therefore has a power to govern the financial and operating policies of the entity.

[2] Although the Group's interest in OÜ Sõbra Korterid does not exceed 50% of voting shares, this entity has been treated as a subsidiary, as the Group has practically the power to govern the financial and operating policies of the entity. The investment was sold during the financial year 2005/2006 – see more detail information in Note 22.4.

[3] 39.4% of shares of AS Kalev Real Estate Company has been pledged in favour of AS SEB Ühispank to secure the bonds issued by AS Kalev.

22.1 Business combinations

On February 20, 2006, a subsidiary AS Kalev Paide Tootmine acquired 31.2% of voting rights in Valmetek Invest AS. This acquisition took place through an issue of new shares of the subsidiary. Non-monetary contribution in the amount of 20 million EEK was paid for these shares by the Group. The purpose of the acquisition of the shares of Valmetek Invest AS was to expand the operations of the Group in the field of dairy products (starting with the production of cheese).

According to the shareholders' agreement of Valmetek Invest AS, the subsidiary AS Kalev Paide Tootmine has a put option, according to which the Group has to purchase the rest of shares of Valmetek Invest AS on demand of other shareholders. The purchase price will be determined either as:

- five times of previous financial year EBITDA multiplied by the other shareholders' interests in the share capital of Valmetek Invest AS; or
- investments into the share capital of Valmetek Invest AS made by other shareholders plus cumulative interest (16%).

Other investors can use their right to sell its interest in Valmetek Invest AS with 6-month notification since July 1, 2007.

As the specified option is related to equity instruments (minority interests are presented under equity), the fair value of the amount, which the Group has to pay for the minority interests, if other shareholders decided to use their right to sell, has been recorded as a liability and has been considered as a part of the acquisition cost (i.e., the Group purchased 100% of interests in Valmetek Invest AS). In the opinion of the management, it is more probable that other shareholders will use the sale price based on fixed yield, if they realise their options, and therefore the liability incurred is subsequently measured at amortised cost. As of June 30, 2006, the liability in the amount of 51 191 thousand EEK has been recognised under other payables (see Note 19).

In addition, according to the shareholders' agreement of Valmetek Invest AS, AS Kalev Paide Tootmine also has a call option (the price of which, similarly to the put option, either depends on EBITDA or investments plus cumulative interest of 20%). According to the call option the Group has a right to purchase the rest of shares of Valmetek Invest AS with 6-month notification. As the Group cannot reliably measure the fair value of this option, it has not been recognised as a derivative in the balance sheet.

The fair value of assets, liabilities and contingent liabilities of Valmetek Invest AS at the date of acquisition were:

	Fair value	Carrying value
Cash and cash equivalents	846	846
Other current assets	5 141	5 141
Non-current assets	78 255	78 255
Liabilities	-21 132	-21 132
Net assets	**63 110**	**63 110**

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Acquisition cost:	
Purchase price (non-monetary)	20 000
Liability from the put option	47 660
	67 660
Participation of AS Kalev in acquired net assets	63 110
Goodwill	**4 550**

Goodwill is related to the benefit from synergies, which the dairy product segment obtains through using skim for more profitable dairy products (i.e., for cheese).

In the previous financial year (i.e., on July 1, 2004), AS Kalev acquired 60.67% of voting shares of AS Vilma paying for these shares 11 245 thousand EEK. Additionally, the Group received 50% of ownership in OÜ Sõbra Korter for free of charge. The liability in the amount of 26 000 thousand EEK regarding an acquisition occurred in June 2004 was also settled in the previous financial year.

The fair value of assets, liabilities and contingent liabilities of AS Vilma and OÜ Sõbra Korterid at the date of acquisition were:

	Fair value	Carrying value
Cash and cash equivalents	215	215
Other current assets	4 789	4 789
Non-current assets	27 465	18 251
Borrowings	-10 655	-10 655
Other payables	-3 261	-3 261
Net assets	**18 553**	**9 339**
Acquisition cost (purchase price)	11 245	
Participation of AS Kalev in acquired net assets	11 245	
Cash obtained from acquisition	215	
Cash paid for business combinations	-11 245	
Net cash flow from business combinations	**-11 030**	

The effect of business combinations on the financial results of the Group is:

	2006	2005
Net profit / (loss) of subsidiaries acquired, which is included in the consolidated income statement of the Group	-208	2 848
Net profit / (loss) of the Group for the period as though the acquisition dates had been the beginning of the financial year	174	-39 934
Revenue of the Group for the period as though the acquisition dates had been the beginning of the financial year	889 623	842 550

22.2 Acquisition of minority interests

On December 23, 2005 AS Kalev acquired 39.2% of and on March 31, 2006 0.1% of shares of AS Vilma. The difference between the acquisition cost of minority interests (i.e., 7 160 thousand EEK) and carrying value of minority interests in the amount of 1 499 thousand EEK has been recognised directly in equity. After these acquisitions the Group owns 100% of shares of AS Vilma.

22.3 Establishing new subsidiaries

In the reporting financial year, the Group established two new subsidiaries with 100% of ownership. The establishments took place through monetary contribution into the share capital of subsidiaries: 400 thousand EEK into the share capital of AS Kalev Chocolate Factory and 40 thousand EEK into the share capital of Stude REC EOOD.

22.4 Disposal of subsidiary

On December 6, 2005, the group sold its 50% of interests in OÜ Sõbra Korterid. The effect of the transaction on the financial position of the Group was:

	December 6, 2005
Cash and cash equivalents	56
Inventories	13 305
Other current assets	2 796
Borrowings	-13 647
Other payables	-3 140
Net assets	**-630**
Sale price	1 800
Gain from disposal of subsidiary	**2 430**
Net cash flow from disposal of subsidiary:	**1 744**
Sale price	1 800
Cash of subsidiary at the disposal date	-56

NOTE 23 LEASES

in thousand EEK

23.1 Finance leases – Group as a lessee

The future minimum lease payments under finance lease and the present value (PV) of the net minimum lease payments have been presented below (as of June 30):

	2006		2005	
	Minimum lease payments	PV of lease payments	Minimum lease payments	PV of lease payments
Within one year	13 498	8 880	14 886	10 735
After 1 year, but not more than 5 years	57 094	33 541	45 996	33 242
Over 5 years	49 878	54 240	78 474	60 906
Total minimum lease payments	**120 470**	**96 661**	**139 356**	**104 883**
Future financial charges	-23 809		-34 473	
PV of minimum lease payments	**96 661**	**96 661**	**104 883**	**104 883**

In the financial year, the Group purchased machinery in the total amount of 9 859 thousand EEK (2005: 2 791 thousand EEK) under finance lease terms. Book value of non-current assets purchased under finance lease terms as of June 30:

	2006	2005
Investment properties	8 228	34 023
Land and buildings recorded under property, plant and equipment	249 395	215 021
Machinery and equipment	18 247	18 161
Other items	112	183
Total	**275 982**	**267 388**

23.2 Operating leases – Group as a lessee

The Group has entered into operating lease agreement for renting cars, commercial vehicles and computers. These contracts are cancellable without any additional payments.

In the reporting period the Group paid lease payments in the total amount of 7 391 thousand EEK (2005: 8 933 thousand EEK).

23.3 Operating leases – the Group as a lessor

The Group leases its investment properties out as office and other rooms. As of June 30, 2006, the book value of leased assets amounted to 27 666 thousand EEK (2005: 67 652 thousand EEK). During the reporting period, rental income amounted to 3 149 (2005: 3 372) thousand EEK.

As of June 30 there are no non-cancellable operating lease agreements.

NOTE 24 PLEDGED ASSETS

as of June 30, in thousand EEK

The following assets (in book value) have been pledged to secure the borrowings (except lease liabilities) of the Group:

	2006	2005
Mortgage – real estate under inventories	122 086	13 454
Mortgage – real estate under property, plant and equipment	303 053	21 523
Mortgage – real estate under investment properties	41 788	118 837
Commercial pledge	74 000	69 060

Additionally, the trademark „Kalev" (with zero book value) has been pledged in order to secure the borrowings of the Group received from AS Hansa Liising Eesti and AS Hansapank, in the extent of which the balance of these borrowings exceeds 130 million EEK. As of June 30, 2006, borrowings secured with this pledge amounted to 70 118 thousand EEK.

As of June 30, 2005 the trademark „Kalev" was pledged in order to secure the borrowings of AS Kalev and AS Kalev REC received from AS Hansa Liising Eesti, which exceed 130 million EEK. As of June 30, 2005 there was no such excess.

The lease liabilities have been secured by the assets purchased under finance lease terms (Note 23.1).

NOTE 25 CONTINGENT LIABILITIES AND COMMITMENTS

25.1 Income tax of dividends

Both the Group and the Parent have no distributable equity as of June 30, 2006, therefore the Group has no possible income tax liability. As of June 30, 2006, the Group's subsidiaries registered in Estonia have distributable equity in the total amount of 208 528 thousand EEK (incl. attributable to minority interests). The maximum possible income tax liability, which would become payable if the retained earnings were fully distributed is 47 961 thousand EEK, of which the Parent can use 47 944 thousand EEK for reduction of its income tax liability, when it has earned distributable profits and is paying it out as dividends. The maximum possible tax liability has been calculated based on the assumption that the net dividends and the related income tax together do not exceed the retained earnings and that all distributable equity will be paid out as dividends before January 1, 2007, i.e. tax rate effective for dividends paid out during 2006 was used.

25.2 Court cases

During the financial year 2005/2006, the Group has been a party of the following court cases that can be treated as contingent liabilities:

<u>25.2.1 G. van den Bergh Nijmegen B.V versus AS Paide Piimakombinaat, AS Hansa Liising Eesti and AS Kalev</u>
G. van den Bergh Nijmegen B.V filed a statement of claim against AS Paide Piimakombinaat, AS Hansa Liising Eesti and AS Kalev as joint and several debtors, the claim amounting to 9 268 thousand EEK. With the judgement of May 28, 2004 Järva County Court satisfied the statement of claim. On June 15, 2004 AS Kalev filed an appeal against the judgement of Järva County Court with Tallinn Circuit Court and the judgement of Järva County Court did not take effect.

On June 03, 2005 the parties to the civil matter entered into a judicial agreement. The Tallinn Circuit Court approved the agreement, whereby G van den Bergh Nijmegen B.V waived the claims set out in its statement of claim in the amount of 9 268 thousand EEK against the defendants and confirmed that it and other parties to whom it has waived the receivables in part have neither any claims against AS Kalev, AS Kalev Paide Tootmine nor the members of the management of these two companies. With the judgement, the Circuit Court terminated the judgement of Järva County Court and finished the proceeding of the given civil case.

The Group has not recognised and reversed any provisions regarding this claim before or during the proceeding of the case.

<u>25.2.2 OÜ G-Trading & Ko (bankrupt) versus AS Kalev and AS Hansa Liising Eesti</u>
OÜ G-Trading & Ko (bankrupt) filed a statement of claim against AS Hansa Liising Eesti and AS Kalev, the claim amounting to 10 774 thousand EEK.

With its judgement of March 22, 2006 Harju County Court approved the settlement, whereby OÜ G-Trading & Ko waived all claims against AS Kalev and AS Hansa Liising Eesti set out in its statement of claim. The judgement finished the proceeding of the given civil case; no liabilities arose for the Group from this court case.

The Group has not recognised and reversed any provisions regarding this claim before or during the proceeding of the case.

<u>25.2.3 Torgovõi Dom Pribaltiiski Kondiiter versus AS Kalev</u>
On November 20, 2003 a Russian company Torgovõi Dom Pribaltiiski Kondiiter filed a statement of claim against AS Kalev with Kaliningrad Arbitration Court for the ordering of payment of trade accounts receivable for goods sold in the amount of 1 195 274 RUR. On December 5, 2003 the same plaintiff filed a statement of claim with the same contents with Kaliningrad Arbitration Court in the amount of 11 873 840 RUR.

Should the Arbitration Court decide that AS Kalev shall pay said invoices, it will not have any additional impact on the profit and equity of AS Kalev, as said invoices have already been recorded as liabilities in the accounting

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records of AS Kalev. The court disputes also have no material financial impact on AS Kalev, as AS Kalev has receivables due from the plaintiff in about a similar amount deriving from sale of raw materials to the plaintiff. It means that the parties are arguing who has to pay first or can they offset their receivables and payables.

25.2.4 Tax and Customs Board versus AS Kalev

On October 20, 2004 the Põhja tax centre of the Tax and Customs Board issued an order whereby inspection was commenced with the purpose of determining the stock of sugar on hand in AS Kalev during the period starting on March 1 and ending on May 31, 2004.

On June 17, 2005 the Põhja tax centre of the Tax and Customs Board made a decision on the determination of the carry-over stock on hand and excess stock on hand as a result of its inspection. With its decision the Tax and Customs Board obligated AS Kalev to remove the excess sugar stock in the amount of 15.6 thousand tons that had been in its possession as of May 1, 2004 not later than by November 30, 2005.

AS Kalev filed a complaint against the aforesaid decision of the Tax and Customs Board with Tallinn Administrative Court on July 15, 2005. This case has not been discussed in court, yet and it's quite probable that the case will become a long-time proceeding. The court stopped with its judgement force of decision of Tax and Customs Board until the enforcement of the court conclusion.

AS Kalev is on the opinion that it declared its stock of sugar on hand correctly and the company was not the owner or possessor of 15.6 thousand tons of an excess stock of sugar on hand as established by the Tax and Customs Board as of May 1, 2004. The statements and conclusions set out in the decision of the Põhja tax centre of the Tax and Customs Board dated July 17, 2005 are incorrect and unfounded, provisions of substantive law have been applied incorrectly and procedural provisions have been violated. Therefore, in the opinion of the management of AS Kalev, the aforesaid decision shall be repealed and consequently the provision has not been recorded on the balance sheet.

As the decision of the Tax and Customs Board refers only to the quantity, there is no reliable information on the financial effect of the claim, in case AS Kalev would lose the dispute (in the opinion of the management of the Group, the probability of such result is remote).

25.3 Other contingent liabilities

The Group has not recorded a liability in the amount of 5 million EEK arising from a previous financial year's purchase of goods in its balance sheet, as in the opinion of the management the goods were substandard and the Group does not have to pay for the purchase. By preparing the current financial statements, the Group has not received any positive or negative feedback from the supplier on not paying of this liability. In the opinion of the management, it's not probable that the group has to pay for these goods and therefore no provision has been recognised.

NOTE 26 FINANCIAL RISK MANAGEMENT AND FAIR VALUE OF FINANCIAL INSTRUMENTS

26.1 Credit risk

The Group manages credit risk by offering credit sales to its business partners depending on the length of the cooperation and the background information of the company. The cooperation partners in Russia and the CIS usually receive goods for an advance payment. The credit risks of larger buyers are managed through letters of guarantee of the bank. The maximum credit risk exposure of unsecured receivables of the Group at the balance sheet date is 150 934 thousand EEK (2005: 124 825 thousand EEK).

26.2 Interest rate risk

The long-term borrowings of the Group are mainly related to EURIBOR, therefore these are dependent on changes in international financial markets. On a regular basis, the Group compares the potential loss from interest rate fluctuations to costs from using related risk management instruments. The Group did not use financial instruments to hedge interest rate risks during the reporting period, as based on the Management's assessment, the cost of risk management would have exceeded the potential loss arising from interest rate fluctuations.

Below, a summary of the Group's exposure to interest rate risk is presented (in thousand EEK):

	June 30, 2006			June 30, 2005		
	<1 year	1-5 years	Total	<1 year	1-5 years	Total
Fixed interest rate						
Interest-bearing receivables	56 653	6 900	63 553	4 065	4 786	8 851
Interest-bearing liabilities	-225 388	-11 501	-236 889	-88 548	-1 822	-90 370
Net position	**-168 735**	**-4 601**	**-173 336**	**-84 483**	**2 964**	**-81 519**
Floating interest rate						
Interest-bearing liabilities	-187 674	0	-187 674	-212 040	0	-212 040
Net position	**-187 674**	**0**	**-187 674**	**-212 040**	**0**	**-212 040**

The division of interest-bearing receivables and liabilities between the groups of up to 1 year and 1-5 years is based on maturity date in case of receivables and liabilities with fixed interest rates and repricing date in the case of floating interest rate.

26.3 Currency risk

Most of the Group's contracts are related to EEK and EUR in order to minimize exposure to currency risk. Similarly, the Group has no significant foreign currency liabilities other than euro-based. All material long-term loan agreements are also concluded in EUR, therefore these are considered as risk-free liabilities from currency risk perspective. Considering all this, the Group's exposure to currency risk is assessed to be minimal.

26.4 Liquidity risk

The working capital of the Group is negative: as of June 30, 2006 it amounted to -171 143 thousand EEK and as of June 30, 2005 to -133 291 thousand EEK.

Although during the reporting period current assets increased more than current liabilities (70% and 54% respectively), the amount of negative working capital increased. Such a change occurred mainly due to classifying long-term loans to short-term loans and taking on additional short-term loans for investment activities. Operating profit for the reporting period is positive while during the comparable period it was negative. In the opinion of the management there is no liquidity issue in the Group considering that the economic results have improved (net profit for the period of 2005/2006 was 1 153 thousand EEK) and:

- the Group has several real estate objects, which can be profitably realised, if necessary; these objects have been recorded under investment properties (non-current assets) in the balance sheet;
- in necessary, the Group has an opportunity to receive additional finances from the issue of bonds, i.e., after redemption of current bonds they can issue new bonds. The previous bond issue was subscribed in excess and the same situation is expected also for new issuance, resulted in the better price of bonds for AS Kalev;
- AS Kalev and its subsidiaries have continually reliable support of the financial sector, which helps the Group in its liquidity management and development processes – prior experiences have shown that, if necessary, it is possible to renew or refinance existing borrowings.

Based on due dates the Group's borrowings can be divided as follows:

	<1 year	1-5 years	>5 years	Total
As of June 30, 2006	240 464	55 135	77 773	373 372
As of June 30, 2005	119 416	95 942	87 093	302 451

26.5 Fair values

In the opinion of the Group's management there are no significant differences between the carrying value and the fair value of financial assets and liabilities. Fair value has been determined based of the discounted cash flow method.

NOTE 27 TRANSACTIONS WITH RELATED PARTIES

in thousand EEK

The following parties have been considered to be related parties in the consolidated financial statements:

- shareholders of the Parent that owns a significant influence over the Parent (i.e, with an ownership more than 20%);
- close relatives of these shareholders;
- key personnel of the management and their close relatives;
- entities controlled by the companies and persons specified above.

27.1 Transactions with companies controlled by key personnel of the management

for the financial years ended June 30, in thousand EEK

	2006	2005
Goods and services purchased		
Services purchased	31 128	33 840
Goods purchased	135 489	129 650
Goods and services sold		
Services sold	239	2 716
Goods sold	130 374	156 200
Balances		
Payables at the beginning of the period	26 974	1 662
Payables at the end of the period	**7 028**	**26 974**
Receivables at the beginning of the period (unsecured)	3 168	23 917
Receivables at the end of the period (unsecured)	**1 820**	**3 168**

Sales and purchases of goods are mostly related to Tallinna Piimatööstuse AS – raw milk and dairy products have been sold to and purchased from this company. Services have been mostly purchased from Tööstuse Teenindamise AS – maintenance services for the Group's machinery and equipment.

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The Group has supported non-profit organisations related to the Manager in the amount of 1 193 thousand EEK (2005: 1 123 thousand EEK).

During the reporting period, the Group has granted loans in the amount of 34 964 thousand EEK (2005: 0) to related parties and accrued interest income on these loans in the amount of 288 thousand EEK (2005: 0)., These loans and accrued interests were fully unpaid as of June 30, 2006 (2005: 0).

27.3 Remunerations paid to the management

The key personnel of the management received a remuneration totalling 455 thousand EEK (2005: 868 thousand EEK). The key personnel of the management do not receive pension entitlements from the Group

NOTE 28 EVENTS AFTER BALANCE SHEET DATE

28.1 Kalev starts up bread and white bread manufacturing

AS Kalev Chocolate Factory began the sale of bakery products under the trademark "Kalev" on August 28, 2006. Kalev's bread and white bread are manufactured in Jõhvi and Viljandi and in total, eleven bakery products were launched bearing the trademarks "Kalevipoeg" and "Linda". Launch investment came to the sum of 10,3 million EEK, most of which was spent on purchasing new manufacturing and packaging equipment, and on marketing.

28.2 Renewal of overdraft agreements

The loans of the Group in the total amount of 49 555 thousand EEK (had to be initially paid back in July 2006) have been renewed by 6 months. Moreover, the subsidiary AS Kalev Real Estate Company borrowed additional money in the total amount of 97 350 thousand EEK for the development of real estate projects. The maturity of these loans is in the range of 6 months to 5 years.

28.3 New subsidiary

After the balance sheet date, the Group acquired 100% of voting rights in an inactive company OÜ BCA Center, with share capital of 40 thousand EEK, paying for that 40 thousand EEK. After acquisition this new subsidiary participated in a procurement competition (public-private partnership projects for schools in Tallinn). The winner of the competition has to modernise 5 schools and after that lease out together with real estate management and maintenance services. According to the offer, the investment will amount to 441 000 thousand EEK and the investments have to be done by the second half of the year 2008.

NOTE 29 NON-CONSOLIDATED MAIN FINANCIAL STATEMENTS OF THE PARENT

in thousand EEK

29.1 Balance sheet of the Parent

As of June 30

	2006	2005[1]
ASSETS		
Current assets		
Cash and cash equivalents	2 497	969
Receivables	90 249	98 955
Prepayments	1 438	727
Inventories	60 472	59 923
Total current assets	**154 656**	**160 574**
Non-current assets		
Non-current receivables	330	2 975
Investments into subsidiaries	235 640	140 899
Property, plant and equipment	25 987	59 276
Intangible assets	10	79
Total non-current assets	**261 967**	**203 229**
TOTAL ASSETS	**416 623**	**363 803**
LIABILITIES AND EQUITY		
Liabilities		
Current liabilities		
Borrowings	110 434	84 274
Customer prepayments	179	432
Trade accounts payable and other payables	109 335	105 627
Total current liabilities	***219 948***	***190 333***
Non-current liabilities		
Borrowings	716	6 500
Total non-current liabilities	***716***	***6 500***
Total liabilities	**220 664**	**196 833**
Equity		
Share capital	236 325	236 325
Mandatory legal reserve	4 020	4 020
Revaluation reserve	3 689	8 669
Retained earnings	-48 075	-20 857
Total equity	**195 959**	**228 157**
TOTAL LIABILITIES AND EQUITY	**416 623**	**424 990**

[1] Adjusted – see Note 3.1.2.

29.2 Income statement of the Parent

for the financial years ended June 30, in thousand EEK

	2006	2005[1]
Revenue	423 491	384 561
Cost of sales	-294 978	-294 626
Gross margin	**128 513**	**89 935**
Marketing expenses	-93 355	-72 666
Administrative expenses	-43 739	-43 981
Other operating items	50 502	1 451
Operating profit (loss)	**41 921**	**-25 261**
Financial income	533	641
Financial expenses	-13 465	-33 057
Net profit (loss) for the financial year	**28 989**	**-57 677**

[1] Adjusted – see Note 3.1.2.

29.3 The Parent's statement of changes in equity

for the financial years ended June 30, in thousand EEK

	Share capital	Mandatory legal reserve	Revaluation reserve	Retained earnings	Total equity
As of June 30, 2004 previously reported	**78 775**	**3 161**	**17 159**	**158 700**	**257 795**
Change of accounting policy (Note 3.1.2)	0	0	0	-34 617	-34 617
As of June 30, 2004 restated	**78 775**	**3 161**	**17 159**	**124 083**	**223 178**
Transfer from retained earnings to reserve	0	859	0	-859	**0**
Increase in share capital (Note 20)	157 550	0	0	-157 550	**0**
Annual transfer of revaluation reserve	*0*	*0*	*-9 959*	*9 959*	***0***
Additional revaluation reserve from re-classification of investment property	*0*	*0*	*1 469*	*1 469*	***0***
Net loss for the financial year	*0*	*0*	*0*	*-57 677*	***-57 677***
Total income and expense for 2004/2005	0	0	-8 490	-47 718	**-56 208**
As of June 30, 2005	**236 325**	**4 020**	**8 669**	**-82 044**	**166 970**
Annual transfer of revaluation reserve	*0*	*0*	*-4 980*	*4 980*	***0***
Net loss for the financial year	*0*	*0*	*0*	*28 989*	***28 989***
Total income and expense for 2005/2006	0	0	-4 980	33 969	**28 989**
As of June 30, 2006	**236 325**	**4 020**	**3 689**	**-48 075**	**195 959**

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Adjusted equity of the Parent according to the Estonian Accounting Law (as of June 30):

	2006	2005
Equity in the non-consolidated balance sheet of the Parent	195 959	166 970
Carrying value of subsidiaries in the non-consolidated balance sheet of the Parent	-235 640	-140 899
Value of subsidiaries calculated in accordance with equity method accounting	383 116	202 086
Adjusted equity of the Parent	**343 435**	**228 157**

29.4 Cash flow statement

for the financial years ended June 30, in thousand EEK

	2006	2005
Operating profit (loss)	41 921	-25 261
Adjustments of operating profit (loss):		
Depreciation and amortisation of property, plant and equipment and intangible assets	8 849	8 126
Gain / loss from disposal of property, plant and equipment	-48 968	-5 634
Changes in assets related to operating activities	18 376	100 680
Changes in liabilities related to operating activities	5 170	-22 227
Net cash flows from operating activities	**25 348**	**55 684**
Acquisition of subsidiaries	-99 288	-37 245
Proceeds from disposal of property, plant and equipment	91 274	48 018
Acquisition of property, plant and equipment and intangible assets	-24 215	-14 079
Loans granted	-4 010	-56 817
Repayments of granted loans	289	19 980
Interests received	117	374
Net cash flow from investing activities	**-35 833**	**-39 769**
Repayments of borrowings	-38 988	-25 003
Proceeds from borrowings	83 434	48 494
Capital lease principle payments	-846	-871
Changes in overdraft and inventory financing	-23 224	-33 303
Interests paid	-8 363	-6 226
Net cash flow from financing activities	**12 013**	**-16 909**
Total net cash flow	**1 528**	**-994**
Cash and cash equivalents at the beginning of the year	**939**	**1 963**
Change in cash and cash equivalents	1 528	-994
Cash and cash equivalents at the end of the year	**2 497**	**969**

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Translation of the Estonian Original

AUDITOR'S REPORT TO THE SHAREHOLDERS OF AS KALEV

We have audited the consolidated financial statements of AS Kalev (hereafter "the Company") and its subsidiaries (hereafter "the Group") for the financial year ended June 30, 2006, which are set out on pages 14 through 56 of the Annual Report. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Group as of June 30, 2006, and the results of its operations and its cash flows for the financial year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Without qualifying our opinion we draw attention to the fact that after approving the consolidated financial statements for issue by the manager of AS Kalev, but before the date of our opinion two significant after balance sheet events have occurred. These events are the following:

- the Tax and Customs Board annulled its decision regarding the excess sugar, which has been disclosed in Note 25.2.4;
- the Group signed a new loan contract with the Estonian branch of AS DnB Nord Bank in the amount of 200 million EEK to refinance its existing borrowings with more beneficial terms. The interest rate of the new loan is 6-months Euribor + 1.4% and the final maturity date is the year 2016.

Tallinn, November 17, 2006

Hanno Lindpere
Ernst & Young Baltic AS

Marju Põldniit
Authorised Auditor

STATEMENT OF PROFIT ALLOCATION

The Chairman of AS Kalev proposes to the Shareholders' General Meeting to transfer the net profit for 2005/2006 in the amount of 1 153 thousand kroons to the retained earnings of the previous periods.

Põrguvälja, November 6, 2006

Kruuda

Oliver Kruuda
Juhataja

APPROVAL OF ANNUAL REPORT 2005/2006

Hereby, the members of the Management Board and Supervisory Board of AS Kalev sign the Annual Report 2005/2006, which consists of Management Report, Financial Statements, Profit Allocation Report and Auditors' Report, confirming the correctness of information presented in it:

Manager: Oliver Kruuda

Kruuda

Supervisory Board: Ülo Suurkask Ü. Suurkask

Heino Priimägi

Marko Kaha

Põrguvälja, November 23, 2006