

AS TALLINNA VESI

*Annual report
for the financial year ended
31 December 2008*

(Translation of the Estonian original)

AS TALLINNA VESI

ANNUAL REPORT

Beginning of the financial year	1 January 2008
End of the financial year	31 December 2008
Name of the Company	AS TALLINNA VESI
Legal form of the Company	Public limited company
Commercial register number	10257326
Address	Ädala St.10, Tallinn, Estonia
Chairman of the Board	Ian John Alexander Plenderleith
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Web-page	www.tallinnavesi.ee
Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditors	AS PricewaterhouseCoopers
Documents attached to the Annual Report	Independent auditor's report

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MANAGEMENT REPORT

CHAIRMAN'S STATEMENT

It is a pleasure to write my first statement as CEO of AS Tallinna Vesi. I would like to thank my predecessor Roch Cheroux for all his hard work during his tenure in this role.

In 2007 we started work on our long term plans to deliver our strategic objectives and I am pleased to report that in 2008 we have made good progress towards company wide excellence.

We are pleased to report a good set of operational and financial results for 2008. In a challenging economic environment, high inflationary pressure in the first half of the year and the impact of the credit crunch in the last quarter we have managed to deliver an increase in profit after taxes of 6% to 296 mln EEK and improved all our key performance measures.

The first of our strategic objectives is operational excellence. Operational excellence underpins everything we do. As a company we have always focused on meeting or exceeding the services contract we have with the City of Tallinn and in 2008 we are delighted to report that we achieved this for all levels of service. In almost all indicators we improved our operational performance, the highlights being: Drinking water quality compliance at the customer's tap has improved to over 98%, which is well above the EU standard and close to the highest standards in Western Europe: Leakage level of close to 17%, which is well below our contractual target and reflects our commitment to ensure the water resource is used as sustainably as possible. One standout performance in 2008 has been the achievement of the level of service that no unplanned interruptions to supply should last more than 12 hours. In 2008, through additional investment, using all the skills and expertise of our staff, and of course a little bit of luck we were able to achieve this target with zero failures.

It gives us a great deal of satisfaction to know that our services and environmental performance are being appreciated by the wider community. In October 2008 we were proud to receive the award of "Tallinn's Most Responsible Company" in recognition of our efforts across all aspects of our business. This is the first time this award has been presented and we will be striving to improve our performance in 2009.

To build on these successes and continue to improve we invested over 300 mln EEK in 2008 in our networks, treatment plan and catchment area and will continue to invest to ensure our quality standards remain as high as ever.

On the positive side our customers were pleased with the quality of our products and services. I was disappointed to see that our customer satisfaction rating declined in 2008, and that we were unable to remain ranked in the top 10% for world utilities. We will however need to improve our customer interactions and communications if we wish to return to the top group. To achieve this, in 2009 we will be amending our Guaranteed Service Standards to make it more customer focused and we will change the way we measure and report our service standards to drive further improvement. We recognize that you do not achieve service excellence without investing in your staff and we will ensure all our service personnel have the right skills and knowledge to consistently deliver service excellence. We are committed to make the investments necessary in our people, processes and technologies to achieve the highest service standards.

Working in partnership with the City of Tallinn we are pleased to say that in 2008 a further 1,300 homes have received the opportunity to connect to our water and wastewater networks. This has tremendous benefits for our clients as it reduces the costs of sewage disposal and improves the wider environment. In 2009 a further 1,400 homes will have the opportunity to connect by the end of 2010 almost all households in Tallinn will have access to our services.

In respect of expanding our activities to the areas surrounding Tallinn 2008 was a good year. Within our current portfolio of bulk water supply and wastewater treatment contracts sales volumes to surrounding municipalities grew by over 40%. Furthermore, in August 2008 we signed a landmark 30 year contract with the City of Maardu to provide water, wastewater and operations and maintenance services. This will

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provide the citizens of Maardu with access Tallinna Vesi's EU compliant water and wastewater. This contract is the first of its kind and demonstrates the willingness of other cities and municipalities to partner with Tallinna Vesi for the benefit of their communities.

To continue our progress towards excellence we need to go further to instill our company values - commitment, customer focus, teamwork and creativity. These values are crucial in reinforcing our sense of duty to provide the highest quality to the citizens of Tallinn, whilst sharpening our focus on operational and financial performance. The key to embedding continuous improvement is through our leadership team. In 2009 we will place a far greater emphasis on leadership at every level in the Company. We have expanded our executive team to broaden the thinking and experience, and we will be investing to develop the leadership and management skills across the Company. This will enable our managers to have the necessary skills and knowledge to inspire our people to deliver further improvements.

We have seen good progress this year, but there is still some way to go if we are to reach the standards of the very best. However with quality of our people and teams I am confident of further gains in 2009.

MANAGEMENT REPORT**RESULTS OF OPERATIONS - FOR THE YEAR 2008****Main economic indicators**

million EEK	2008	2007	2006*	2005*	2004*
Sales	719,9	648,3	589,2	549,9	478,8
Gross profit	447,2	431,7	368,6	347,9	281,6
Gross profit margin %	62,1	66,6	62,6	63,3	58,8
Operating profit	405,4	377,4	337,9	282,6	254,9
Operating profit margin %	56,3	58,2	48,7	47,7	46,5
Profit before taxes	362,2	333,1	294,9	209,7	199,2
Profit before taxes margin %	50,3	51,4	42,5	35,4	36,3
Net profit	296,0	277,8	248,0	174,4	173,0
Net profit margin %	41,1	42,9	42,1	31,7	36,1
ROA %	11,6	10,9	10,0	7,3	7,8
Debt to total capital employed	49,9	51,8	53,4	55,3	55,1
ROE%	23,1	22,5	21,5	16,4	17,3
Current ratio	1,8	1,9	2,2	1,9	0,9
Number of employees	327	312	318	334	351
Share capital	200	200	200	200	200

Gross profit margin – Gross profit / Net sales

Operating profit margin – Operating profit / Net sales

Profit before taxes margin – Profit before taxes / Net sales

Net profit margin – Net profit / Net sales

ROA – Net profit / Total assets

Debt to Total capital employed – Total liabilities / Total capital employed

ROE – Net profit / Shareholders' equity

Current ratio – Current assets / Current liabilities

* Sales and Gross profits of 2004, 2005 and 2006 are adjusted retrospectively to fit the reclassification (see Note. 2).

Income Statement**Sales**

In 2008 the Company's total sales increased, year on year, by 11.0% to 719.9 mln EEK. Sales in the main operating activity principally comprise of sales of water and treatment of wastewater to domestic and commercial customers within (Tallinn) and outside of the service area, supplemented mainly by fees received for operating and maintaining the storm water system. There is no considerable seasonality in the Company's operation.

Sales of water and wastewater services were 658.3 mln EEK, a 9.8% increase compared to 2007, resulting from the 11.7% increase in tariffs from 1 January 2008 for the Company's residential and commercial customers combined with the factors described below.

Included within this amount were the following increases by sector: within the service area sales to domestic customers increased by 8.7% to 346.8 mln EEK. Sales to commercial customers increased by 7.4% to 271.2 mln EEK. Sales to customers outside of the service area, primarily bulk volumes of wastewater treatment services provided to the surrounding municipalities, increased by 49.4% reaching 3.8 mln m³ or 26.4 mln EEK. Overpollution fees received were 13.8 mln EEK, 34.1% increase compared to 2007.

In 2008, the volumes sold to residential customers dropped 2.7%. We believe that this is mainly related to the fact that people have moved to the surrounding areas of Tallinn.

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The volumes sold to commercial customers inside the service area decreased by 4.1% compared to the relevant period in 2007 due to several factors combined. Part of the reduction in sales volumes in Tallinn is due to companies moving to the surrounding municipalities, supplemented by companies implementing different efficiency measures or reducing their production.

The real estate market has changed considerably compared to last year. Although the number of new apartments and business buildings being constructed in Tallinn in 2008 remained high, a large share of new buildings still remain vacant as commercial customers as well as people in need of space were moving to surrounding areas due to more affordable real estate prices.

This trend is also reflected in the Company's sales to surrounding areas, which has increased by 49.4% in 2008 compared to the last year. This reflects the success of the Company's strategy to re-capture customers leaving Tallinn. The Company is actively looking for the further expansion opportunities into the neighboring municipalities.

The sales from the operation and maintenance of the storm water and fire-hydrant system increased by 22.8% to 48.8 mln EEK in 2008 compared to 2007. This is in accordance with the terms and conditions of the contract whereby the storm water and fire hydrant costs are invoiced based on actual costs and volumes treated.

Cost of Goods Sold and Gross Margin

The cost of goods sold for the main operating activity was 272.8 mln EEK in 2008, an increase of 56.1 mln EEK or 25.9% from the equivalent period in 2007.

Pollution tax payable for 2008 was 17.0 mln EEK compared to 6.2 mln EEK positive cost effect in 2007, resulting from release of the 13.3 mln EEK pollution tax provision in the first quarter of 2007. In 2008 the Company did not achieve the 0.5 coefficient for pollution tax in 2nd and 4th quarters, that meant 9 million kroons extra costs to the Company. The rest of the increase in pollution tax is due to the increase in tax rates year on year by 20%, supplemented by increased volume and pollution impact. Despite the fact that the pollution level of the incoming waste water varies and the Company does not have a full control over storm water outlets regarding the pollution, we are working hard to use the optimum level of chemicals to achieve the 0.5 coefficient in the following quarters.

The chemical costs were 22.8 mln EEK, representing an 8.9% increase compared to the corresponding period in 2007. This result is the combination of waste water volumes treated, and chemicals dosed, also affected by the increase in chemicals' prices.

Electricity costs increased by 3.4 mln EEK or 12.8% in 2008 compared to 2007 due to higher electricity prices combined with waste water volumes treated.

Salary expenses increased in 2008, year on year, by 11.9 mln EEK or 23.1% due to a number of factors. Firstly, increased headcount from the new services launched. Secondly, a highly competitive labour market has led to a significant salary inflation. Finally in the 1st quarter of 2008 the Company restructured and combined departments to increase the efficiencies and to improve the service processes, which resulted in transferring cost from one line to another.

Depreciation charges increased in 2008 by 9.3 mln EEK or 12.7% year on year due to some constructions commissioned in the end of 2007. Also in the beginning of 2008 the depreciation rates were revised to correspond with the useful life of assets.

Other costs of goods sold in the main operating activity increased by 6.2 mln EEK, or 15.3% year on year. This was due to higher costs on a number of support services and maintenance and repair contracts, reflecting the increase in labour and services costs, but also the tightening of warranty requirements regarding the emergency repair works in Tallinn.

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The cost pressure sets the challenge to the Company to identify further efficiency opportunities through review of processes, procedures and procurements.

As a result of the above the Company's gross profit for 2008 was 447.2 mln EEK, which is an increase of 15.5 mln EEK, or 3.6%, compared to the gross profit of 431.7 mln EEK for 2007.

Operating Costs and Operating Margin

Marketing expenses decreased by 1.2 mln EEK to 12.3 mln EEK during 2008 compared to the corresponding period in 2007. This is partly the result of the structural changes, balanced by an increase in depreciation charges.

Mainly as a consequence of structural changes the General administration expenses decreased by 2.3 mln EEK to 54.5 mln EEK in 2008 year on year.

Other net income/expenses

In order to more appropriately reflect different types of compensations received, the accounting policy for constructions was changed in 2008. In accordance with the new policy, any compensation received from the local governments are treated as government grants in accordance with IAS 20 and are recognized as income over the periods necessary to match them with the related costs which they are intended to compensate. Accordingly, such compensations are deducted from the carrying amount of the pipeline assets constructed; any excess of the compensation receivable compared to the related construction cost that the compensation is intended to compensate is recognized in income once the construction is completed. The net effect of these transactions can be seen from other income/expenses and the change in the accounting policy is accounted retrospectively.

Until 2007 and also during the first 3 quarters of 2008, the Company accounted for any compensations received from customers and local governments for constructing new pipelines as income once the construction was completed and receipt of the compensation was probable. Compensations were presented in the income statement as "Revenues from other operating activities" and the related construction costs were presented as "Costs of goods sold (other operating activities)".

Income/expenses from constructions totaled a net income of 27.9 mln EEK in 2008 compared to a net income of 14.3 mln EEK in 2007. The rest of the other income/expenses totaled an expense of 2.9 mln EEK in 2008 compared to an income of 1.9 mln EEK in 2007.

As a result of all of the above the Company's operating profit for 2008 was 405.4 mln EEK, an increase of 28.0 mln EEK compared to an operating profit of 377.4 mln EEK achieved in 2007. Compared to the operating profit in 2007, the operating profit has increased 7.4%.

Financial expenses

Net Financial expenses were 43.2 mln EEK in 2008, which is a decrease of 1.0 mln EEK or 2.3% compared to 2007. The Company's interest costs have increased by 6.9% compared to 2007. This is due to the fact that some loans of the Company are bound to the 6 month Euribor rate. The increase in interest expenses is partially offset by an increase in financial income earned during 2008, as a result of a more favourable cash position and increasing interest rates.

Profit Before Tax

The Company's profit before taxes for 2008 was 362.2 mln EEK, which is 29.1 mln EEK higher than the profit before taxes of 333.1 mln EEK for 2007. The results for the twelve months of 2007 were impacted by the fact that the Ministry of Environment gave final approval to the success of the nitrogen project, which

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resulted in the release of a provision worth 13.3 mln EEK for environmental taxes. Looking at the underlying profit before taxes for the twelve months of 2007, it shows a 42.4 mln EEK or 13.2% increase in 2008 for the same period.

Balance sheet

During the twelve months of 2008 the Company invested 306.3 mln EEK into fixed assets. Non-current assets were 2,212 mln EEK at 31 December 2008. Current assets decreased by 26.2 mln EEK to 347.4 mln EEK in the twelve months of the year, customer receivables increased by 3.7 mln EEK. During the twelve months of 2008 cash at bank increased by 51.4 mln EEK.

Current liabilities decreased by 7.0 mln EEK to 192.2 mln EEK in the twelve months of the year. This was mainly due to increases in Current portion of long-term borrowings by 41.5 mln EEK, as result of the reclassification of the loan based on repayment schedule and decrease in Trade payables.

The Company continues to maintain its leverage level within its target range of 50% with total liabilities to total capital employed of 49.9% as of 31 December 2008. Long-term liabilities stood at 1,085.5 mln EEK at the end of December 2008, consisting almost entirely of the outstanding balance on the two long-term bank loans.

Cash flow

During the twelve months of 2008, the Company generated 393.1 mln EEK of cash flows from operating activities, an increase of 59.5 mln EEK compared to the corresponding period in 2007. Underlying operating profit continues to be the main driver for growth, supplemented by excellent debt collection in twelve months of 2008.

In the twelve months of 2008 net cash outflows from investing activities were 26.8 mln EEK, which is 126.1 mln EEK less than in 2007. This was mainly due to the change in constructions compensation mechanism as result of the 30 November 2007 agreement with the local municipality. In the 1st quarter 2008 the Company received the compensation for 2007 constructions. In 2008 the Company invested 306.3 mln EEK – 265.1 mln EEK on networks (including 189.7 mln EEK on extension and developments), 17.5 mln EEK at Paljassaare wastewater treatment plant and sludge treatment, 9.9 mln EEK on water quality (Ülemiste water treatment plant and raw water) and 13.7 mln EEK for other investments (IT, capital maintenance, meters, etc).

The cash outflows from financing activities were 314.9 mln EEK during the twelve months of 2008 compared to cash outflow of 251.8 mln EEK during the same twelve months of 2007, representing the payouts of the dividend and the income tax on dividends of respective years. The Company made its first scheduled repayment to EBRD. Considering the extensive network extension program and related investment outflows until 2011, the Company does not intend to reduce the loan capital and therefore the repayment amount was replaced with a new loan drawdown from Nordea. The Company signed the new loan agreement with Nordea in November 2008. The total loan facility is 37.5 mln EUR and the interest margin applicable to the 6 month Euribor is 1,15 %.

As a result of all of the above factors, the total cash inflow in the twelve months of 2008 was 51.4 mln EEK compared to a cash outflow of 71.0 mln EEK in the twelve months of 2007. Cash and cash equivalents stood at 229.9 mln EEK as at 31 December 2008.

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Employees and Salaries

At the end of 2008, the number of employees was 327, compared to 312 at the end of 2007. The average full time employment equivalent of 2008 was 317, an increase by 14 positions compared to the 2007 as result of the launch of new services and the increased project supervision need related to extensive network extension program. The total salary cost was 88.4 mln EEK, including 2.8 mln EEK paid to the Management and Supervisory Council members. The off balance sheet potential salary liability would be up to 0.5 mln EEK if the Council would want to replace the Management Board member.

Dividends and share performance

Based on the results of the 2007 financial year, the Company paid 249,010,000 EEK of dividends. Of this 10,000 EEK was paid to the owner of the B-share and 249,000,000 EEK, i.e. 12.45 EEK per share to the owners of the A-shares. The dividends were paid out on 13 June 2008, based on the list of shareholders, which was fixed on 30 May 2008.

AS Tallinna Vesi is listed on OMX Main Baltic Market with trading code TVEAT and ISIN EE3100026436.

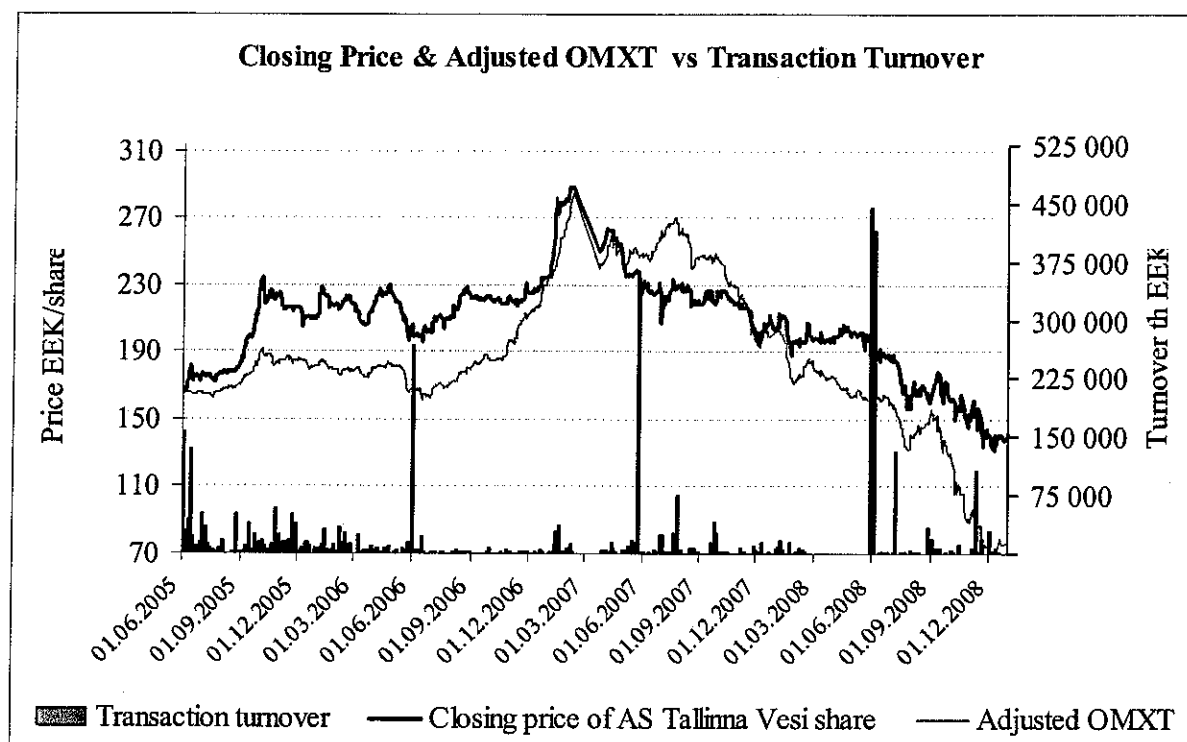
As of 31 December 2008 AS Tallinna Vesi shareholders, with a direct holding over 5%, were:

United Utilities (Tallinn) BV	35.3%
City of Tallinn	34.7%
Credit Suisse Securities (Europe) Ltd Prime Brokerage A/C Prime Brokerage Clients	5.76%
HSBC Bank Plc Re Parvus European Absolute Opportunities Master Fund	5.46%

Parvus AM has declared that their shareholding in the clients' accounts exceeds 10% and AKO Capital has declared their indirect ownership above 5% of the share capital.

At the end of the year, 31 December 2008, the closing price of the AS Tallinna Vesi share was 140.66 EEK (8.99 EUR), which is a 30.6% decrease compared to the closing price of 202.78 EEK (12.96 EUR) at the beginning of the year, this is still outperforming the market as the OMX Tallinn index dropped by 63.0% during the year.

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Share price statistics after listing

EEK	2008	2007	2006	2005	2004	2003
Share price, open	207,32	234,70	211,23	155,53	n/a	n/a
Share price, at the end of the year	140,66	202,78	234,86	210,92	n/a	n/a
Share price, low	131,59	195,58	195,11	155,53	n/a	n/a
Share price, high	212,79	290,87	234,86	235,48	n/a	n/a
Share price, average	178,09	232,20	217,49	197,46	n/a	n/a
Traded volume	7 958 820	5 462 916	4 274 094	7 993 844	n/a	n/a
Turnover, million	1 453,07	1 295,94	913,22	1 509,88	n/a	n/a
Capitalisation, million	2 813	4 056	4 697	4 218	n/a	n/a
Earnings per share	14,80	13,89	12,40	8,72	8,65	5,23
Dividend per share	n/a	12,45	9,80	7,85	5,60	3,75
Dividend / net profit	n/a	90%	79%	90%	65%	72%
P/E	9,50	14,60	18,94	24,19	n/a	n/a
P/BV	2,2	3,3	4,1	4,0	n/a	n/a

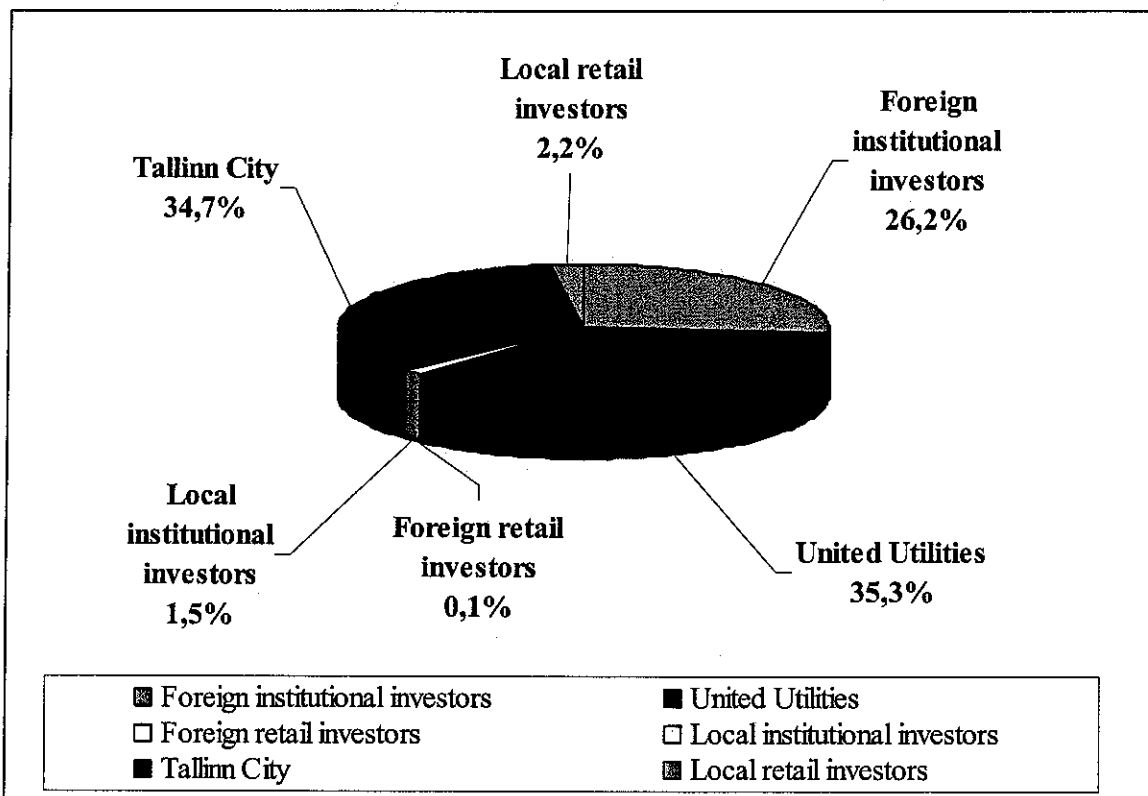
P/E = share price at the end of the year / earnings per share

P/BV = share price at the end of the year / book value per share

In 2005 the listing price was 144.70 EEK, equal to the 9.25 EUR

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Shareholders by type as of 31.12.2008



Distribution of share capital by size of share ownership as of 31.12.2008

	Shareholders	Shareholders %	No. of shares	% of share capital
1-100	522	31,2%	26 598	0,1%
101-200	470	28,1%	70 222	0,4%
201-300	178	10,6%	46 139	0,2%
301-500	169	10,1%	70 279	0,4%
501-1 000	156	9,3%	121 176	0,6%
1 001-5 000	136	8,1%	290 411	1,5%
5 001-10 000	12	0,7%	81 222	0,4%
10 001-50 000	12	0,7%	305 717	1,5%
50 000+	19	1,1%	18 988 236	94,9%
TOTAL	1 674	100,0%	20 000 000	100,0%

More detailed information about the structure of the equity and the preference share, giving the special control rights, is disclosed in note 16.

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CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RECOMMENDATIONS REPORT

Corporate governance constitutes a system for the management and controls of the company. Generally this system is regulated by law, the Articles of Association and the internal rules of the company. Since 01.01.2006 the companies listed on the Estonian stock exchanges are recommended to follow the "Corporate Governance Recommendations" issued by the Financial Supervision Authority. Throughout 2008 the management of the Company was organized according to these regulations and principles. An Annual General Meeting of Shareholders was convened to approve the annual report, distribution of dividend, appointment of auditors and recalling/election of Supervisory Board members. Changes in the Articles of Association and management of the Company (incl. the election and recall of the members of the management board) are made according to Part VII of the Commercial Code.

AS Tallinna Vesi is committed to high standards of corporate governance for which the Management Board and Supervisory Board are accountable to shareholders. The Company endeavours to be transparent in its ways of working, corporate disclosures and relations with shareholders. The Company has been recognized for this - in 2008 the IR Magazine named the Company the best listed company in the Baltic countries and, the NASDAQ OMX Tallinn Stock Exchange ranked the Company in second place in the field of investor relations in 2008 of companies listed on the Tallinn Stock Exchange.

The Company has regular dialogue with major shareholders with general presentations made at least bi-annually - a list of meetings and the presentations are available on the Company's website. The Company Annual General Meeting keeps the shareholders informed and there is an opportunity for individual shareholders to ask questions of the Management Board and Supervisory Board within the meeting.

The Company is a public limited company, the management bodies of which are the General Meeting of shareholders, the Supervisory Board and the Management Board. The General Meeting of shareholders is the highest directing body.

The Supervisory Board and Audit

The Supervisory Board plans the activities of the Company, organises its management and supervises the activities of the Management Board. Pursuant to the Articles of Association, the Supervisory Council consists of nine members the term of whose authority is two years. In 2008 six Supervisory Board meetings were held. The Supervisory Board approved the 2007 annual report presented at the Annual General Meeting, and approved the 2008 budget.

The members of the Company's Supervisory Board during the composition of this report were as follows: Robert John Gallienne – Chairman of the Supervisory Board, Kevin Starling, Steven Richard Fraser, Matti Hyrynen, Mart Mägi, Valdur Laid, Elmar Sepp, Rein Ratas, Deniss Borodits.

At each meeting, an internal audit report was presented to the Board. The internal auditor of the Company reports directly to Robert John Gallienne, Supervisory Board Member responsible for auditing function. Regular internal audits are conducted in the company in the field of compliance, performance, and finance etc. in order to check that:

- 1.1 the risks have been identified, assessed and managed in the required way;
- 1.2 the relevant financial, managerial and operating information is accurate, reliable and available for prompt usage;
- 1.3 the employees' activities are compliant with the organizational policy, internal regulations, and applicable acts and regulations;
- 1.4 the resources required for operation are acquired cost-effectively, applied efficiently and adequately protected by required means;
- 1.5 the organizational programmes, plans and objectives are achieved;

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1.6 the internal control system within the organization provides the requisite level of protection and supports the continuous improvement of quality;

1.7 reporting is reliable and presented in due time;

1.8 protection and preservation of organizational assets is guaranteed.

In 2008 David Kilgour and Ian Plenderleith held the position of Supervisory Board Member responsible for the audit function.

Pursuant to the Articles of Association of the Company, an external auditor shall be elected by the General Meeting of shareholders for conducting the annual audit. Remuneration of the auditor shall proceed pursuant to the contract, the Management Board has the right of conclusion thereof.

The Management Board

The Management Board is a management body that represents and manages the day-to-day activities of the Company according to law and the Articles of Association. The Management Board is obliged to act in the most economically efficient manner. The Management Board is composed of three members, two of them seconded by United Utilities International Ltd, all of them appointed by the Supervisory Board.

The duties of the Chairman of the Management Board Ian Plenderleith were, amongst other duties, to fulfill the everyday obligations of the Chief Executive Officer of the Company by leading and representing the company, organizing the activities of the Management Board, preparing the strategies and ensuring their implementation.

The duties of the member of the Management Board David Hetherington were, amongst other duties, to fulfill the everyday obligations of the Chief Operating Officer of the Company by managing and being responsible for the operating activities, including the customer service function of the Company.

The duties of the member of the Management Board Siiri Lahe were, amongst other duties, to fulfill the everyday obligations of the Chief Financial Officer of the Company by managing and being responsible for the accounting and financial activities of the Company.

According to the Company's statute the Chairman of the Management Board can represent the Company single-handedly, other Management Board members can represent the company only with the joint approval of the other. In order to make daily decisions the Management Board has validated a framework of principles, according to which certain management team members are authorized to conclude transactions for small amounts.

Conformity to Tallinn Stock Exchange Corporate Governance Recommendations

Starting from January 1, 2006 the companies whose shares have been admitted to trading on the regulated market operating in Estonia shall describe, in accordance with the 'Comply or Explain' principle, their management practices in a Corporate Governance report and confirm their compliance or not with the Corporate Governance recommendations. If the issuer does not comply with the Corporate Governance Recommendations, it shall explain in the report the reasons for its non-compliance.

Declaration of Conformity by AS Tallinna Vesi

AS Tallinna Vesi complies with the vast majority of the non-mandatory Corporate Governance recommendations. However it does not comply with some regulations, which are listed below, together with the reasons for current non-compliance:

'2.2.3. The basis for Management Board remuneration shall be clear and transparent. The Supervisory Board shall discuss and review regularly the basis for Management Board remuneration. Upon determination of the Management Board remuneration, the Supervisory Board shall be guided by evaluation of the work of the Management Board members. Upon evaluation of the work the Management

MANAGEMENT REPORT

Board members, the Supervisory Board shall above all take into consideration the duties of each member of the Management Board, their activities, the activities of the entire Management Board, the economic condition of the Issuer, the actual state and future prediction and direction of the business in comparison with the same indicators of companies in the same economic sector. '

The arrangements concluded in connection with the privatisation of the Company in 2001 provided that, in return for certain fees, United Utilities International Ltd would provide the Company with certain technical and asset management services and would make certain of its personnel available to the Company in connection with its operation and management.

According to the agreement, the working hours, rates of compensation, manner of performance, and all other matters relating to the employment of the individuals appointed by United Utilities International Ltd are to be determined solely by United Utilities International Ltd, the Supervisory Board does not regularly review the principles of those Management Board members remuneration.

'2.2.7. Basic wages, performance pay, severance packages, other payable benefits and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on website of the Issuer and in the Corporate Governance Recommendations Report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the Issuer or the amount of foreseeable expense as of the day of disclosure. The Chairman of the Supervisory Board shall present the essential aspects of the management board remuneration and changes in it to the General Meeting. If the remuneration of some of the Management Board members has occurred on a different base, then the General Meeting shall be presented the differences together with the reasons therefore. '

The Company does disclose the overall management board remuneration in the report appendix 27, but considers that individual remuneration is sensitive and private information and disclosing it would bring no benefit to the shareholders.

'3.2.2. At least half of the members of the Supervisory Board of the Issuer shall be independent. If the Supervisory Board has an odd number of members, then there may be one independent member less than the number of dependent members. '

Pursuant to the Articles of Association, the Supervisory Board consists of nine members. Under the Shareholders' Agreement, United Utilities (Tallinn) B.V. (hereinafter UUTBV) and the City of Tallinn have agreed that the division of seats in the Supervisory Board shall be such that UUTBV shall have four seats, the City of Tallinn shall have three seats and two seats shall be for independent members of the Supervisory Board as described by the Tallinn Stock Exchange.

Information Disclosure

'2.2.2. The member of the Management Board shall not be at the same time a member of more than two management boards of an Issuer and shall not be the Chairman of the Supervisory Board of another Issuer. A member of the Management Board can be the Chairman of the Supervisory Board in company belonging to same group as the Issuer. '

Ian Plenderleith, CEO, is a member of the Supervisory Board of the following companies belonging to United Utilities group: United Utilities Pacific Holdings BV, United Utilities Australia Holdings BV, United Utilities BV, United Utilities (Moray) Limited, United Utilities (Tay) Limited, Birchpoint No 1, Haclyn District Mines Drainage Company Limited, United Utilities International Limited, United Utilities (Overseas Holdings) Limited, United Utilities (Highland) Limited, United Utilities (Europe) Limited, United Utilities International Holdings Limited, United Utilities (Sofia) Limited, United Utilities (Sofia) BV, United Utilities (Tallinn) BV, United Utilities Europe Holdings BV, United Utilities (Poland) BV, Aqua Spolka Akcyjna, United Utilities (Luxembourg) S.A.R.L, United Utilities (Luxembourg) No.2 S.A.R.L, United Utilities Investments BV.

MANAGEMENT REPORT

Siiri Lahe, CFO, and David Hetherington, COO, are not in the Supervisory Boards of other companies.

3.2.5. *The amount of remuneration of a member of the Supervisory Board shall be published in the Corporate Governance Recommendations Report, indicating separately basic and additional payment (incl. compensation for termination of contract and other payable benefits).*

According to the decision of the General Meeting of shareholders the payments for Supervisory Board members is set at 100,000 kroons per year. The fee is subject to deduction and payment of taxes set out by laws and would be payable monthly. The Supervisory Board members are not paid any additional benefits.

3.2.6. *If a member of the Supervisory Board has attended less than half of the meeting of the Supervisory Board, this shall be indicated separately in the Corporate Governance Recommendations Report.*

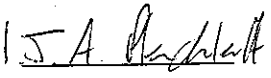

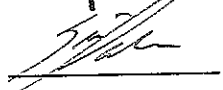
In 2008 six Supervisory Board meetings were held (29 January 2008, 11 March 2008, 22. April 2008, 15 July 2008, 1 September 2008 and 21 October 2008).

Chairman of the Supervisory Board (Robert John Gallienne) and most of the members of the Supervisory Board (Henry Russell, Mart Mägi, Valdur Laid, Elmar Sepp, Rein Ratas, Deniss Boroditš) have attended more than 50% of the meetings during the time held office.

As members of the Supervisory Board have changed during the year the following Supervisory Board members have attended less than half of the meetings held during the year.

- David Leonard Fuller attended all the Supervisory Board meetings (3), until being recalled from Board on 04.07.2008. He attended on 29.01.2008, 11.03.2008 and 22.04.2008 respectively.
- Steven Richard Fraser attended all the Supervisory Board meetings (3) since his nomination on 04.07.2008. He attended on 15.07.2008, 01.09.2008 and 21.10.2008 respectively.
- David John Kilgour attended one Supervisory Board meeting until being recalled from Board on 10.03.2008.
- Kevin Starling did not attend any of the Supervisory Board meetings since his nomination on 11.09.2008.
- Matti Hyrynen did not attend any of the Supervisory Board meetings as no Supervisory Board meetings were held after his nomination on 16.12.2008.

The previous sections, Chairman's statement, Results of operations – for the year 2008, Corporate Governance and Corporate Governance Recommendations Report form the Management Report, which is an integral part of the annual report of AS Tallinna Vesi for the financial year ended 31 December 2008. The Management Report gives a true and fair view of the trends and results of operations, main risks and doubts of the Company.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		25/2/09
David Nigel Hetherington	Member of the Management Board		25-2-09
Siiri Lahe	Member of the Management Board		25.02.09

**DECLARATION OF MANAGEMENT
FOR THE FINANCIAL STATEMENTS**


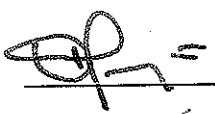
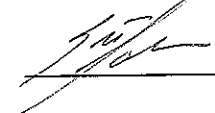
The Management Board of AS Tallinna Vesi hereby declares its responsibility for the preparation of the financial statements for the financial year ended 31 December 2008 on pages 16 to 50.

The financial statements have been prepared according to International Financial Reporting Standards as adopted by the EU, and give a true and fair view of the financial position, results of operations and cash flows of AS Tallinna Vesi.

The preparation of the financial statements according to International Financial Reporting Standards involves estimates made by the Management Board of the Company's assets and liabilities as at 31 December 2008, and of income and expenses during the financial year. These estimates are based on current information about the Company and consider all plans and risks as at 31 December 2008. The actual results of these business transactions recorded may differ from such estimates.

Any subsequent events that materially affect the valuation of assets and liabilities and have occurred up to the completion of the financial statements on 25 February 2009 have been considered in preparing the financial statements.

The Management Board considers AS Tallinna Vesi to be a going concern entity.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		<u>25/2/09</u>
David Nigel Hetherington	Member of the Management Board		<u>25-2-09</u>
Siiri Lahe	Member of the Management Board		<u>25.02.09</u>

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PricewaterhouseCoopers, Tallinn

AS TALLINNA VESI
BALANCE SHEETS
AS AT 31 DECEMBER 2008 AND 2007

(thousand EEK)

ASSETS	Note	2008	2007
CURRENT ASSETS			
Cash and equivalents	6	229 860	178 420
Customer receivables, accrued income and prepaid expenses	7,8	112 638	190 402
Inventories		3 760	3 645
Non-current assets held for sale		1 140	1 120
TOTAL CURRENT ASSETS		347 398	373 587
NON-CURRENT ASSETS			
Property, plant and equipment	9	2 169 121	2 134 583
Intangible assets	9	42 532	51 022
TOTAL NON-CURRENT ASSETS		2 211 653	2 185 605
TOTAL ASSETS		2 559 051	2 559 192
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Current portion of long-term borrowings	10	82 843	41 486
Trade and other payables	11, 12	87 270	113 452
Short-term provisions		2 486	2 231
Prepayments and deferred income	15	19 797	42 099
TOTAL CURRENT LIABILITIES		192 396	199 268
NON-CURRENT LIABILITIES			
Borrowings	10	1 084 642	1 125 491
Other payables	11	735	113
TOTAL NON-CURRENT LIABILITIES		1 085 377	1 125 604
TOTAL LIABILITIES		1 277 773	1 324 872
EQUITY			
Share capital	16	200 001	200 001
Share premium		387 000	387 000
Statutory legal reserve		20 000	20 000
Retained earnings		674 277	627 319
TOTAL EQUITY		1 281 278	1 234 320
TOTAL LIABILITIES AND EQUITY		2 559 051	2 559 192

Notes to the financial statements on pages 21 to 50 form an integral part of the financial statements.

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 PricewaterhouseCoopers, Tallinn

AS TALLINNA VESI

INCOME STATEMENTS

FOR THE YEARS ENDED 31 DECEMBER 2008 AND 2007

(thousand EEK)

reclassified*

	Note	2008	2007
Revenue	2, 17	719 923	648 335
Costs of goods sold	2, 19	-272 752	-216 677
GROSS PROFIT		447 171	431 658
Marketing expenses	19	-12 310	-13 547
General administration expenses	19	-54 546	-56 849
Other income/ expenses (-)	2, 20	25 045	16 100
OPERATING PROFIT		405 360	377 362
Financial income	21	15 606	10 861
Financial expenses	21	-58 805	-55 098
PROFIT BEFORE TAXES		362 161	333 125
Income tax on dividends	22	-66 193	-55 285
NET PROFIT FOR THE PERIOD		295 968	277 840
Attributable to:			
Equity holders of A-shares		295 958	277 830
B-share holder		10	10
Earnings per A share (in kroons)	23	14,80	13,89
Earnings per B share (in kroons)	23	10 000	10 000

*Other revenues and costs related to the main operating activities included in the revenues and costs of goods sold from other operating activities, and other income/ expenses of 2007 have been reclassified, please see the change in the accounting policy, Note 2.

Notes to the financial statements on pages 21 to 50 form an integral part of the financial statements.

AS TALLINNA VESI

CASH FLOW STATEMENTS

FOR THE YEARS ENDED 31 DECEMBER 2008 AND 2007

(thousand EEK)

	Note	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit		405 360	377 362
Adjustment for depreciation/amortisation	9, 19	89 669	79 241
Adjustment for profit from government grants and connection fees	20	-27 921	-14 250
Other finance expenses	21	-1 614	-1 585
Profit from sale of property, plant and equipment, and intangible assets		-455	-2 422
Expensed property, plant and equipment		-19	476
Change in current assets involved in operating activities	24B	22 781	-32 062
Change in liabilities involved in operating activities	24B	906	-327
Interest paid		-57 569	-52 986
Total cash flow from operating activities		431 138	353 447
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of property, plant and equipment, and intangible assets	24C	-332 407	-285 715
Compensations received for construction of pipelines	24A	250 190	101 840
Proceeds from sale of property, plant and equipment, and intangible assets		480	390
Proceeds from sale of non-current assets held for sale	24B	0	242
Interest received		16 906	10 571
Total cash flow used in investing activities		-64 831	-172 672
CASH FLOWS FROM FINANCING ACTIVITIES			
Received long-term loans	10	42 246	0
Repayment of long-term loans	10	-41 910	0
Finance lease payments	10	0	-473
Dividends paid	22	-249 010	-196 010
Income tax on dividends	22	-66 193	-55 285
Total cash flow used in financing activities		-314 867	-251 768
Change in cash and cash equivalents		51 440	-70 993
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD		178 420	249 413
CASH AND EQUIVALENTS AT THE END OF THE PERIOD	6	229 860	178 420

Notes to the financial statements on pages 21 to 50 form an integral part of the financial statements.

AS TALLINNA VESI

STATEMENTS OF CHANGES IN EQUITY FOR THE YEARS ENDED 31 DECEMBER 2008 AND 2007

(thousand EEK)

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
31 December 2006	200 001	387 000	20 000	545 489	1 152 490
Dividends (Note 22)	0	0	0	-196 010	-196 010
Net profit of the financial year (Note 23)	0	0	0	277 840	277 840
31 December 2007	200 001	387 000	20 000	627 319	1 234 320
Dividends (Note 22)	0	0	0	-249 010	-249 010
Net profit of the financial year (Note 23)	0	0	0	295 968	295 968
31 December 2008	200 001	387 000	20 000	674 277	1 281 278

Information about share capital is disclosed in note 16.

Notes to the financial statements on pages 21 to 50 form an integral part of the financial statements.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

NOTE 1. GENERAL INFORMATION

AS Tallinna Vesi (hereinafter referred to as 'the Company') is the largest water utility in Estonia providing drinking water and wastewater disposal services to over 400 000 people in Tallinn and in several neighbouring municipalities of Tallinn. The Company has the exclusive right to provide water and sewerage services in Tallinn's main service area until the year 2020.

The Company's shareholders having a significant influence are, United Utilities Tallinn B.V. with 35.3% and the City of Tallinn with 34.7%, the balance of 30% of shares is free floating on the Tallinn Stock Exchange, in which the Company listed on 1 June 2005.

Company's Contacts:

Commercial register number	10257326
VAT identification number	EE100060979
Address	Ädala 10, 10614 Tallinn
Telephone	62 62 200
Fax	62 62 300
E-mail	tvesi@tvesi.ee

NOTE 2. ACCOUNTING POLICIES

The significant accounting policies applied when preparing the financial statements (hereinafter referred to as 'financial statements') of the Company have been pointed out below. The accounts have been prepared on the basis of the principle of sustainability and comparability; the nature of changes in methodology and their impact have been described in respective annexes. In case the presentation of the entries of the accounts or the method of classification has been amended, then the comparable figures of the previous period have also been adjusted. Accounting principles have been applied consistently for all the periods presented in the accounts.

Principal accounting policies

The Company has prepared the financial statements for year 2008 according to International Financial Reporting Standards (hereinafter IFRS) as adopted by the European Union (EU).

The financial statements have been prepared on a historical cost accounting basis, unless specified otherwise. Initial acquisition cost includes all costs directly related to the acquisition of the asset or liability.

The financial statements do not include the segment reporting as there are no geographical segments and no clearly distinguished business segments related to the activities of the Company.

Preparing the accounts in compliance with IFRS requires the use of certain critical accounting estimates. Also the management board must make decisions in the process of implementing the accounting principles of the Company. The Company provides estimates and makes assumptions regarding the future. Accounting estimates do not often match with the subsequent actual events. Estimates and decisions are constantly reviewed and based on previous experiences and other factors, including expectations regarding future events that are considered justified while taking into consideration the known circumstances.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

Change in accounting policy

Up to 2007 the Company recorded compensations received from customers and local governments for the construction of new pipelines (also connection fees) as revenue as soon as the construction works were completed and receipt of payment was confirmed. These compensations were recorded on the income statement entry "Other revenue related to the main operating activities" and the construction costs related thereto on the entry "Other costs related to the main operating activities". In order to reflect the nature of various received compensations more precisely the accounting principles were amended in 2008.

In compliance with the new principles the compensations received from local governments are treated as government grants pursuant to standard IAS 20 and are recognized as income over the periods necessary to match them with the related costs which they are intended to compensate. Pursuant to the principles of IAS 20 compensations received for the construction of water and wastewater pipelines are deducted from the book value of the constructed pipeline and any amounts exceeding the construction cost of the pipeline shall be recognised as income upon the completion of construction works.

Compensations received from customers are recognised in compliance with standard IAS 18 as income over the period of the duration of customer contract.

The change in the accounting policy is accounted for retrospectively and the comparatives have been changed as follows:

Income Statement 2007

	Opening balance	Reclassification	Revised balance
Revenues from other operating activities	172 437	-172 437	0
Revenue	820 772	-172 437	648 335
Costs of goods sold (other operating activities)	-158 187	158 187	0
GROSS PROFIT	445 908	-14 250	431 658
Other income/ expenses (-)	1 850	14 250	16 100

In addition, the presentation of 2007 *Cashflow Statement* was amended, where the entry of adjusting business profit "Capitalization of operating expenses" was transferred to the entry of investment cashflow "Acquisition of property, plant and equipment and intangible assets" in the amount of 19 764 thousand kroons.

Standards, amendments to published standards and interpretations mandatory for the Group's accounting periods beginning on or after 1 January 2008.

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

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

Reclassification of Financial Assets—Amendments to IAS 39, Financial Instruments: Recognition and Measurement, and IFRS 7, Financial Instruments: Disclosures and a subsequent amendment, Reclassification of Financial Assets: Effective Date and Transition. The amendments allow entities the options (a) to reclassify a financial asset out of the held to trading category if, in rare circumstances, the asset is no longer held for the purpose of selling or repurchasing it in the near term; and (b) to reclassify an available-for-sale asset or an asset held for trading to the loans and receivables category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity (subject to the asset otherwise meeting the definition of loans and receivables). The Company has not elected to make any of the optional reclassifications during the period; as such, this amendment has no impact on the Company's financial statements.

New standards, amendments to standards and interpretations that are mandatory for the Group's accounting periods beginning on or after 1 January 2009 or later periods and which the Group has not early adopted.

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The standard applies to entities whose debt or equity instruments are traded in a public market, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to that used for internal reporting purposes. The Company is currently assessing what impact the standard will have on segment disclosures in the financial statements.

Puttable Financial Instruments and Obligations Arising on Liquidation—IAS 32 and IAS 1 Amendment (effective for annual periods beginning on or after 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of financial liabilities. The Company does not expect the amendment to affect its financial statements.

IAS 23, Borrowing Costs (revised March 2007; effective for annual periods beginning on or after 1 January 2009). The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The Company does not expect the amendment to the standard to have a material effect on its financial statements. Implementing the IAS 23 sooner would have brought along 5 to 10 mln kroons decrease in net financial costs and respective increase in profit.

IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Company expects the revised IAS 1 to affect the presentation of its financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009; the revised standard has not been adopted by the EU). The revised IAS 27 will require an entity to attribute total comprehensive income to the

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Company does not expect the amended standard to affect on its financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Company does not expect the amendment to affect on its financial statements.

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009; the revised standard has not been adopted by the EU). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. IFRS 3 is not relevant to the Company as it does not expect a business combination to occur.

IFRIC 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008; the interpretation has not been adopted by the EU). The interpretation contains guidelines on applying the existing standards by entities being parties to service concessions between the public and the private sector. IFRIC 12 pertains to arrangements where the ordering party controls what services are provided by the operator using the infrastructure, to whom it provides the services and at what price. The Company does not expect the interpretation to affect its financial statements.

IFRIC 13, Customer Loyalty Programmes (effective for annual periods beginning on or after 1 July 2008; according to the EU's adoption the interpretation is effective for annual periods beginning after 31 December 2008, early adoption permitted). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. IFRIC 13 is not relevant to the Company's operations because Company has not any loyalty programmes.

IFRIC 14, IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual periods beginning on or after 1 January 2008; the interpretation as adopted by the EU is effective for annual periods beginning after 31 December

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

2008, early adoption permitted). The Interpretation contains general guidance on how to assess the limit of the surplus of fair value of a defined benefit plan over the present value of its liabilities which can be recognised as an asset, in accordance with IAS 19. In addition, IFRIC 14 explains how the statutory or contractual requirements of the minimum funding may affect the values of assets and liabilities of a defined benefit plan. The Company does not expect the interpretation to affect its financial statements.

IFRIC 15, Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1 January 2009; the interpretation has not been adopted by the EU). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. IFRIC 15 is not relevant to the Company's operations because it does not have any agreements for the construction of real estate.

IFRIC 16, Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008; the interpretation has not been adopted by the EU). The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 does not have any impact on these financial statements as the Company does not apply hedge accounting.

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment (issued in May 2008; effective for annual periods beginning on or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments will not have any impact on the Company's financial statements.

Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009; the amendment has not been adopted by the EU). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have any impact on the Company's financial statements as the Company does not apply hedge accounting.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Company does not expect the amendments to have any material effect on its financial statements.

IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009; the interpretation has not been adopted by the EU). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Company's operations because it does not distribute non-cash assets to owners.

IFRS 1, First-time Adoption of International Financial Reporting Standards (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009; the amended standard has not been adopted by the EU). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Company concluded that the revised standard does not have any effect on its financial statements.

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009; the interpretation has not been adopted by the EU). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not expected to have any impact on the Company's financial statements.

The new standards and interpretations are not expected to significantly affect the Group's financial statements.

Functional currency

The functional currency of the Company is Estonian kroon. Estonian kroon is pegged to the Euro at the fixed exchange rate of 15.6466 kroons per 1 Euro.

Presentation currency

For the convenience of the users, these financial statements have been presented in Estonian kroons, rounded to the nearest thousand, unless stated otherwise.

Foreign currency transactions

Foreign currency transactions are recorded on the basis of the foreign currency exchange rates of the Bank of Estonia at the date of the transaction. Monetary assets and liabilities recorded in foreign

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

currencies in the financial statements have been converted into Estonian kroons based on foreign currency exchange rates valid at the Balance Sheet date. Gains and losses due to exchange rate changes are aggregated and shown in the Income Statement as Other Income (-Expense) on net basis.

Foreign currency transactions are translated into Estonian kroons using the official exchange rates of the Bank of Estonia prevailing at the transaction date. Monetary assets and liabilities, and non-monetary assets and liabilities that are measured at fair value denominated in foreign currencies that are accounted for in fair value are translated using the official exchange rate of the Bank of Estonia prevailing at the balance sheet date. Profits and losses from foreign currency transactions and assets and liabilities denominated in foreign currency are reported in the income statement as gains or losses of that period.

Current and non-current distinction of assets and liabilities

Assets and liabilities are classified in the balance sheet as current or non-current. Assets expected to be disposed of in the next financial year or during the normal operating cycle of the Company are considered as current. Liabilities whose due date is in the next 12 months or that are expected to be settled in the next financial year or during the normal operating cycle of the Company are considered as current. All other assets and liabilities are classified as non-current.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet and the cash flow statement comprise of cash on hand, cash in bank accounts and short-term, risk free, highly liquid bank deposits with original maturities of three months or less.

Financial assets

Financial assets are cash, trade receivables, accrued income, other current and long-term receivables including the derivatives with positive value.

Financial assets are initially recognised at cost that is the fair value of the amount paid for that asset.

Financial assets are recorded in balance sheet at value date (i.e. on a day, the Company becomes the owner of the financial assets and will be removed from the balance sheet when the Company loses the ownership of the sold financial assets).

According to the aim of acquisition and management's plans the financial assets are divided into the following groups:

- Financial assets at fair value through profit or loss
- Receivables and loans
- Investments held-to-maturity
- Financial assets available-for-sale

As at 31 December 2008 and 2007 the Company did not have any investments held-to-maturity and financial assets available-for-sale.

Financial assets held for trading are classified as financial assets at fair value through profit or loss (asset is purchased for resale or for buyback in the near future). Financial assets at fair value through profit or loss are initially recorded at fair value, transaction costs are recorded in the income statement. Financial assets of this category are subsequently carried at fair value and gains/losses due to changes in fair value are recorded in income statement of the period. The quoted market

**NOTES TO THE FINANCIAL STATEMENTS
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price in balance date is their basis for establishing the fair value of financial assets at fair value through profit or loss.

Loans and receivables are initially be recorded at a fair value together with the transaction costs. Loans and receivables will further on be recorded at the corrected acquisition cost, using effective interest rate method (minus possible allowances due to decrease in value).

Receivables

Trade receivables comprise of short term receivables generated in normal operations. Trade receivables are recorded using the amortised cost method (nominal value less repayments and necessary allowances).

Allowance for receivables is recorded if there are objective proofs that all receivable sums are not repaid according to the initial agreement. Impairment of individually material receivables (need for allowance) is evaluated separately for each customer, considering the present value of the sums likely to be received in future. For receivables which are not individually significant and for which we have no direct information that their value has been decreased, the allowance is evaluated as a complex considering the experience of previous years concerning unpaid receivables. Allowance sum of doubtful receivables is the difference between their carrying amount and present value of future cash flows, using effective interest rate method. The carrying amount of receivables is reduced by the impairment loss and impairment loss is recorded in the income statement on the row „Other income/ expenses". Receiving the doubtful receivables is recorded as a decrease of impairment loss.

Receivables, which cannot be collected or the collection is considered economically not justified, are evaluated as uncollectible by the decision of the Management Board based on individual reviews, and are thereby written-off from the balance sheet.

Inventories

Inventories are initially recorded at the cost including purchase costs, non-refundable taxes and transportation and other costs directly connected with the acquisition, less allowances and donations.

The weighted-average cost method has been used in calculating the acquisition cost of inventories. Inventories are evaluated in the balance sheet depending on which is lower, the acquisition cost or net realizable value. Net realizable value is the net selling price less estimated costs necessary to make the sale.

Non-current assets held for sale

Non-current assets held for sale are the property, plant and equipment items that are most probably sold within next 12 months and for which the management has begun sales activity and the assets are offered for sale a realistic price compared to their fair value.

Non-current assets held for sale are recorded in the balance sheet as current assets and depreciation thereof ends at the moment of reclassification. Depending on which is lower, the non-current assets held for sale are recorded in the balance sheet either at book value or at fair value less costs to sell.

**NOTES TO THE FINANCIAL STATEMENTS
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Property, plant and equipment, and intangible assets

Property, plant and equipment are used in operating activities of the Company with an expected useful life of over one year. Property, plant and equipment are presented in the balance sheet at historical cost less any accumulated depreciation and any impairment losses.

Intangible assets are recognised in the balance sheet only if the following conditions are met:

- the asset is controlled by the Company;
- it is probable that the future economic benefits that are attributable to the asset will flow to the Company;
- the cost of the asset can be measured reliably.

Development Costs

Development costs are costs that are made at the implementation of research results for developing, forming or testing new specific products, services, processes or systems. Development costs are capitalized in case there are technical and financial possibilities and positive intention for the implementation of the project available, the Company is able to use or sell the assets to be established and the extent of the development costs and the economic benefit emerging from intangible assets in the future can be measured reliably.

Software

Purchased computer software that is not integral part of the related hardware is recorded as intangible assets. Development costs of computer software are recorded as intangible assets in case these are directly related to the development of such software objects that are distinguishable, controllable by the Company and the use thereof provides future economic benefit during a period of more than one year. Capitalizable development costs of computer software include staff costs and other expenses directly related to the development. Costs related to the day-to-day maintenance of computer software are recognised as expenses in the income statement. Costs of computer software shall be depreciated within an estimated useful lifetime, the duration of which is up to 5 years.

Other intangible assets

Expenses for acquiring patents, trade marks, licences and certificates shall be capitalized in case it is possible to estimate the future economic benefits attributable to these assets. Other intangible assets are amortised on a linear basis over the estimated useful lifetime, the duration of which does not exceed 5 years.

The cost of purchased property, plant and equipment and intangible assets comprises the purchase price, transportation costs, installation, and other direct expenses (incl. internal labour costs) related to the acquisition or implementation.

Labour costs are capitalised with employee's hourly index according to working hours, which are needed for taking the asset to needed working condition and -place determined by Management. Hourly rate is calculated individually for each employee and includes in addition to salary costs also other direct expenses connected with the employee.

If an item of property, plant and equipment consists of components with different useful lives, these components are depreciated as separate items. Interest charges on loans are not capitalised in the cost of property, plant and equipment and intangible assets.

Subsequent expenditures are added to the carrying amount of the item of property, plant and equipment or are recognised as a separate asset only when it is probable that future economic benefits related to the assets will flow to the Company and the cost of the asset can be measured

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

reliably. A replaced component or proportion of the replaced item of property, plant and equipment is derecognised. Cost related to ongoing maintenance and repairs are charged to the income statement.

Land is not depreciated. Depreciation of other property, plant and equipment is calculated on a straight-line basis on cost over the estimated useful life of the asset.

Applicable depreciation/amortization rates:

- buildings 1,25-2,0 % per annum;
- facilities 1,0-8,33 % per annum;
- machinery and equipment 3,33-50 % per annum;
- instruments, facilities etc. 10-20 % per annum;
- intangible assets 10-33 % per annum.

In exceptional circumstances rates may differ from the above rates if it is evident that the estimated useful life of the asset varies materially from the rate assigned to the respective category.

The expected useful lives of items of property, plant and equipment are reviewed during the annual stocktaking, in recognising subsequent expenditures and in case of significant changes in development plans. When the estimated useful life of an asset differs significantly from the previous estimate, it is treated as a change in the accounting estimate, and the remaining useful life of the asset is changed as a result of which the depreciation charge of the following periods also changes. Assets are written down to their recoverable amount when the recoverable amount is less than the carrying amount. To determine profits and losses from the sale of property, plant and equipment, the book value of the sold assets is subtracted from the proceeds. The respective profits and losses are reported in the income statement items "Other income / expenses".

Impairment of assets

Assets that are subject to depreciation/amortisation and property, plant and equipment with unlimited useful lives (land) are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The recoverable value of intangible assets in progress is tested annually, by comparing their recoverable amount with the book value.

Assets are written down to their recoverable amount in case the latter is lower than the carrying amount. The recoverable amount of the assets is the higher of the 2 following:

- fair value less costs to sell;
- value in use.

In case it is not possible to determine the fair value of assets less costs to sell, the asset's value in use is considered to be its recoverable value. The value in use is calculated as the estimated present values to be generated by the assets in the future.

The impairment of assets may be assessed either for a single or a group of assets (cash-generating unit). The smallest separately identified group of assets, the cash flows generated from which are mostly forecasted independently from the cash flows generated by the rest of the assets, is considered as a cash-generating unit. The impairment loss is immediately recognised as a loss in the income statement. Every balance sheet day circumstances indicating the decrease or non-existence of impairment loss accounted for in previous periods are assessed.

If based on the results of the assessment it appears that the recoverable amount of an asset or a group of assets (cash-generating unit) has increased over the book value, the earlier impairment is

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

reversed and the book value of the asset will be increased up to the amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. The reversal of impairment loss is recorded in the income statement of the period as a decrease in impairment loss.

Financial liabilities

Financial liabilities include trade payables, accrued expenses, loans payable and other short term and long term financial liabilities. Financial liabilities are initially registered in their acquisition cost, which is the fair value paid for the financial liability. Subsequently financial liabilities are carried using the amortised cost method.

Amortised cost of short term financial liabilities is usually equal to their nominal value, thus they are carried on balance sheet at the amount payable. For calculating the amortised cost of long-term financial liabilities these are initially recognized at fair value of amount received (less transaction costs), calculating interest expense from the liability using effective interest rate method during next periods.

On the balance sheet the liabilities, the due date of which is later than within 12 months after the balance date, are classified as long-term liabilities. Remaining financial liabilities are classified as short-term.

Taxes

Because in Estonia profit is not object for taxation the principles of deferred income tax are not applicable to the Company.

Income tax on dividends in Estonia

According to the Estonian Income Tax Act the accrued profit of a resident legal entity is not subject to tax, as tax is charged only on dividend distributions. Pursuant to the Income Tax Act Section 50, effective since 1 January 2003, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. Since 1 January 2008 the rate is 21/79 on the amount of the dividends payable (2007: 22/78).

The potential tax liability that may occur if all distributable retained earnings should be paid out as dividends is not reported on the Balance Sheet. The income tax due on dividend distribution is recorded as a liability and as tax cost within the Income Statement during the same period as the dividend is paid regardless of the actual payment date or the period for which dividends are declared. Tax payment liability arises on the 10th date of the month following the dividend payment.

Employee benefits

Employee short-term benefits

Employee short-term benefits include wages and salaries as well as social security taxes, benefits related to the temporary halting of the employment contract (holiday pay or other similar pay) when it is assumed that the temporary halting of the employment contract will occur during 12 months after the end of the period in which the employee worked, and other benefits payable within 12 months after the end of the period during which the employee worked.

Post-employment benefits

Post-employment benefits are benefits which are payable after the Company decides to terminate the employment relationship with the employee before the normal retirement date or when the employee decides to leave voluntarily or when the employee and employer have an agreement, in exchange for the benefits outlined. The Company recognises post-employment benefits as liabilities

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and expenses only when the Company is obliged to offer postemployment benefits in order to encourage voluntary leaving.

Provisions and contingent liabilities

On balance sheet the commitments arising during accounting period or during previous accounting periods that have legal or contractual basis, which requires waiver of the asset in the future and the cost of which can be reliably determined, but the final cost or due date of which is not definitely fixed, but which exist as liability irrespective from the Company's further activities are recorded as provisions.

The sum of servitudes likely payable that henceforth must be paid to the owners of private land resulting from the restrictions related to land use in case the Company's pipes are located on their land, are recorded as provisions. On the balance sheet the liability is classified as short-term, because it can be realized in full extent within 12 months after the balance date. Provisions have been recognised on the basis of the best estimates of the Company's Management Board and the actual costs of these transactions can differ from the provided estimates.

Commitments, guarantees and other possible and existing liabilities, the realization of which is unlikely or the amount of accompanying costs cannot be assessed with sufficient reliability, however, which can become liabilities on certain terms in the future, are disclosed as contingent liabilities in the notes to the financial statements.

Share capital

Shares are recorded within the equity capital. Pursuant to the Company's Articles of Association, the Company has two classes of shares: the A-Shares, with a nominal value of 10 kroons each and a single preference share B-Share, with a nominal value of 1 000 kroons.

Statutory legal reserve

Pursuant to the requirements of the Commercial Code the statutory legal reserve is recorded in the accounts, which comprises of the allocations made from net profits. The annual allocation must be at least 5% of the approved net profit of the accounting year until the legal reserve is equal to 10% of paid-up share capital. As the Company's legal reserve has reached the required level, the legal reserve is no longer increased from net profit.

At the decision of the General Meeting of the Shareholders the legal reserve can be used for the covering of loss in case it is not possible to cover it from the Company's available shareholders' equity, also for increasing the Company's share capital. The legal reserve cannot be used for making the payments to the shareholders.

Leased assets

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series payments the right to use an asset for an agreed period of time. Leases which transfer all significant risks and rewards incidental to ownership to the lessee are classified as finance leases. Other leases are classified as operating leases.

The Company as the lessee

Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset or the present value of minimum lease payments. Each lease payment is apportioned between

**NOTES TO THE FINANCIAL STATEMENTS
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the finance charge and the reduction of the outstanding liability. Finance charges are allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. The finance lease liability is reduced by principal payments. The finance charge is recognised as an interest expense in the income statement. The finance lease liability is recognised either as a short or long-term borrowing in the balance sheet. Payments made under operating leases are charged to the income statement over the lease term on a linear basis.

Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs which they are intended to compensate. Government grants received for expenses incurred in previous periods or which do not include additional conditions for future compliance, are recognised as income in period when government grant was received. Government grants are not recognised as income before exists sufficient confidence that Company complies with the conditions attaching to government grants and the grants will be received. Government grants received as compensations for the construction of water pipelines shall be deducted from the book value of the pipeline constructed and any amounts exceeding the construction cost of pipeline shall be recognized as income upon completion of construction works as "Other income/expenses".

Revenue

Revenue is recorded on an accrual basis at the fair value received or receivable. Revenue comprises of the income received from goods and services sold net of sales discounts.

Sales of water, services of waste water, stormwater firehydrants and other sales income is recorded in the period when the service has been provided, the proceeds from the provision of the service is probable and the revenue and the costs related to the provision of the service are reliably identified. Revenues received from the sale of assets shall be recognised when all the significant risks and benefits related to the possession of assets have been transferred to the purchaser, the receipt of the revenue receivable from the sale is probable and the cost related to the transaction can be reliably determined.

Compensations received from local governments for the construction of water pipeline shall be recognised as government grants. Compensations shall be deducted from the book value of the constructed pipeline and any amounts exceeding the construction cost of pipeline shall be recognized as income upon the completion of construction works as "Other income/expenses". Connection fees and other compensations received from customers are recognized as income during the period of the duration of customer contract.

Interest income is recognised in case the receipt of income is likely and the amount of income can be determined reliably. Interest income is recognised using the asset's effective interest rate, except when the receipt of interests is uncertain. In this case interest income is calculated on cash basis.

Earnings per share

Earnings per share is calculated by dividing the net profit of the accounting year with the weighted average number of issued shares of the period. When calculating diluted earnings per share, the earnings and the average number of shares are adjusted with potential shares that have a diluting effect on the earnings per share.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

NOTE 3. FINANCIAL RISK MANAGEMENT

In it's everyday business activities Company faces different financial risks: market risk (including currency risk, price risk and cash flow and fair value interest rate risk), credit risk, liquidity risk and equity risk. Because of the Company's position on the market and characteristics of it's business activities none of before mentioned risks has significant impact to Company.

	31.12.2008	31.12.2007
Financial assets		
Receivables (incl cash and cash equivalents)	338 839	364 220
Financial assets at fair value through profit or loss	0	1 550
Financial liabilities in amortised cost		
Financial liabilities at amortised cost	1 255 490	1 280 542

According to the Company's risk administration procedures, and instructions from the Management Board the financial risk management is carried out by the financial department.

Market risk

Currency risk

Currency risk is the potential loss from currency exchange rates unfavourable movements against Estonian kroon. Sums that have received, paid or owned in euros are considered currency risk free because euro's exchange rate to Estonian kroon is fixed.

The Company's currency risk is mainly related to international purchases and sums owned in foreign currencies (excluding euro).

Because most of Company's international purchases are made in euros, the proportion of purchases in other currencies in 2008 was 1.1% (2007: 0.5%), the Company considered it unnecessary to undertake special activities to minimise this currency risk.

On 31.December 2008 the Company's bank account (including deposits) balances totalled 229 860 thousand kroons (2007: 178 420 kroons) and 219 thousand kroons (2007: 7 thousand kroons) in other currencies.

Due to the above, the Management Board considers the Company's currency risk level to be low and to continue to minimise this risk plans to make most of business transactions in Estonian kroons or euros.

Price risk

The Company has no price risk regarding financial instruments because it has no investments into equity instruments.

Cash flow and fair value interest rate risk

Interest rate risk is the risk that the fair value of financial instruments or cash flows will fluctuate in the future due to changes in market interest rates. Interest rate risk of cash flows is the risk that financial expenses or financial liabilities with floating interest rate will increase when interest rates on the market increase. Fair value interest rate risk is the risk that the fair value of financial liabilities with a fixed interest rate will increase when interest rates on the market decrease.

In essence the Company's operating incomes and expenses are independent from interest rate changes on the market. Interest risk related to financial incomes arises from depositing finances to

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

overnight and fixed term deposits. The Company does not use any other possibilities for depositing finances. The Company does not have fair value interest rate risk because it has no interest bearing instruments accounted for at fair value.

The Company's interest rate risk related to financial expenses is related to taken long term loans, which have fixed and floating interest rates. The Company faces cash flows interest rate risks with loans with a floating interest rate from Nordea bank. According to the Management Board's assessment this risk has a low possible impact and therefore no financial instruments have been used to reduce it. The loan with a fixed interest rate from the EBRD (European Bank for Reconstruction and Development) exposes the Company to fair value interest rate risk. According to the Management Board's assessment the fair value of the long term loan with a fixed interest rate does not differ significantly from its carrying amount. The EBRD loan's fixed interest rate is 4,67% (was the same in 2007) and Company's average loans' interest rate in 2008 was 4,88% (2007: 4,34%). More detailed information about the Company's loans can be seen in Note 10.

If the interest rates of the Company's loans with floating interest rates had been 50 basis points higher and all other variables were held constant, then the Company's profit before tax for the year ended 31 December 2008 would have decreased by 3 002 thousand kroons (2007: 2 974 thousand kroons). If these interest rates had been 50 basis points lower and all other variables were held constant, then the Company's profit before tax for the year ended 31 December 2007 would have increased by 3 002 thousand kroons (2007: 2 974 thousand kroons).

Credit risk

Credit risk expresses potential loss that could arise if a counterparty fails to fulfil its contractual obligations. Cash in bank deposits, held-to-maturity financial assets, trade and other receivables are exposed to credit risk.

According to the Company's risk management principles the Company's short term available resources can be deposited only in accounts and fixed term deposits opened in credit institutions. For depositing the counterparty must have at least a Moody's Aa3 rating. In 31.12.2008 60% of Company's cash and deposits was deposited in a counterparty with a Aa2 rating and 40% in a counterparty with a Aa3 Moody's rating (2007: 100% Moody's Aa3).

The Company has established procedures for co-operation with customers, to guarantee that selling of products and services is always in compliance with the Company's guiding principles. To reduce the credit risk related to accounts receivables the customers payment discipline is consistently observed. In the case of clients overdue debts the Company's Credit group sends invoice remainders, makes contact by phone or uses a variety of other measures to collect the overdue debt. Depending on the negotiations with the customer it is possible to agree exceptional payment terms and plans to help customers pay their invoices. The Company has defined policies regarding the commencement of court proceedings to recover overdue debt. On 31.12.2008 no receivable from any customer exceeded 5% of total receivables, except Tallinna Kommunaalamet whose total receivables at the end of the year amounted to 24 893 thousand kroons (31.12.2007: 104 000 thousand kroons).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

Trade receivable 31.12.2008, in thousand kroons

	Balance	Not due	until 3 months	4-6 months	Over due 7-12 months	over 12 months
Commercial entities	62 566	57 322	5 012	155	77	0
Private persons	45 638	43 502	1 886	143	108	0
Total	108 204	100 824	6 898	298	184	0

	Balance	Not due	until 3 months	4-6 months	Over due 7-12 months	over 12 months
Commercial entities	100%	91,62%	8,01%	0,25%	0,12%	0,00%
Private persons	100%	95,32%	4,13%	0,31%	0,24%	0,00%
Total	100%	93,18%	6,37%	0,28%	0,17%	0,00%

Trade receivable 31.12.2007, in thousand kroons

	Balance	Not due	until 3 months	4-6 months	Over due 7-12 months	over 12 months
Commercial entities	135 965	125 004	10 431	390	141	0
Private persons	49 258	47 036	1 499	658	66	0
Total	185 223	172 040	11 929	1 048	207	0

	Balance	Not due	until 3 months	4-6 months	Over due 7-12 months	over 12 months
Commercial entities	100%	91,94%	7,67%	0,29%	0,10%	0,00%
Private persons	100%	95,49%	3,04%	1,33%	0,13%	0,00%
Total	100%	92,88%	6,44%	0,57%	0,11%	0,00%

The Company's maximum credit risk is equal to the carrying amount of the financial assets. Its level according to the assessment of the Management Board is low.

Liquidity risk

Liquidity risk is the risk that the Company is unable to fulfil its financial obligations due to insufficient cash inflows. This risk crystallizes when the Company doesn't have enough funds to serve its loans, to fulfil its working capital needs, to invest and/or to make declared dividend payments.

Maturities of the financial assets and liabilities (undiscounted):

31.12.2008	Interest rate %	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Total
Financial liabilities							
Non-interest bearing	-	85 422	1 006	842	614	121	88 005
With floating interest rate	6M Euribor + 0,69	-	-	32 626	1 202 864	120 753	1 356 243
	4,67	-	-	108 278	482 712	42 881	633 871
With fixed interest rate		85 422	1 006	141 746	1 686 190	163 755	2 078 119

31.12.2007	Interest rate %	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Total
Financial liabilities							
Non-interest bearing	-	102 519	10 933	-	-	113	113 565
With floating interest rate	6M Euribor + 0,24	-	-	27 308	568 549	121 532	717 389
	4,67	-	-	69 387	502 311	131 587	703 285
With fixed interest rate		102 519	10 933	96 695	1 070 860	253 232	1 534 239

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

In liquidity risk management the Company has taken a prudent view, maintaining sufficient cash balance and availability of short-term marketable securities to fulfil its financial liabilities. Continuous cash flow forecasting and control are essential tools in the day-to-day liquidity risk management of the Company.

Equity risk management

The Management Board of the Company ensures the management of the capital structure of the Company according to the Business Plan approved by the Supervisory Board. The Loan agreement with Nordea bank limits the minimum ratio at 35% for the equity capital from the total assets.

Equity ratio, in thousands kroons	31.12.2008	31.12.2007
Equity	1 281 278	1 234 320
Total assets	2 559 051	2 559 192
Equity ratio	50%	48%

Fair value

Fair values of cash and cash equivalents, accounts receivable, short term loans and accounts payable do not vary significantly from their carrying amount because their realisation will take place within 12 months from the date the balance sheet was composed. The fair value of EBRD's long-term loan does not vary significantly from its carrying amount because its fixed interest rate does not vary significantly from the market interest rate. The risk margin, that influences the financing price, has recently significantly increased, however it has been compensated by the decrease in 6 month's EURIBOR. The fair value of Nordea's long-term loans is smaller than their carrying amount. Both Nordea's loans have a floating interest rate however, since signing both agreements the risk margins have significantly increased. This means that if the Company would like to refinance these loans on today's market conditions it would bring higher total loan costs compared to the existing agreements.

NOTE 4. CRITICAL ACCOUNTING ESTIMATES

Management has made an assessment of the key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that may have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year. The most important areas of estimates contained in the financial statements are the following:

- Management has estimated the useful lifetime of property, plant and equipment and intangible assets. The results of the estimates are disclosed in note 2 the in section 'Property, plant and equipment, and intangible assets' and the information about the carrying amounts is disclosed in note 9.
As of 31 December 2008 Company owns property, plant and equipment, and intangible assets in book value 2.2 bn kroons (31.12.2007: 2.0 bn kroons) and annual depreciation was 89 mln kroons in 2008 (2007: 79 mln kroons). If the depreciation/amortization rates decreased / increased by 5 %, the depreciation/amortization expense would increase / decrease respectively 4.5 mln kroons (2007: 4.0 mln kroons).
- The Company has assumed an obligation to construct water and wastewater and stormwater pipelines with an estimated construction cost of up to 650 mln kroons in 2009-2011. The construction of water and wastewater pipelines is compensated by local governments with the grants receivable in 2008-2017. Compensations received from local governments are

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

recognised as government grants - compensations received or receivable and are deducted from the book value of the constructed pipeline. Any amount exceeding the construction cost of the pipeline is recognized as income upon the completion of construction works. The part of the compensation that is received after the completion of the construction works is recognized in the balance sheet as a receivable from local government at its present value. Recognition of the above compensations is dependant on several uncertain circumstances and the estimates of the Management Board, in particular those regarding the total cost of the project and the fair value of the compensations receivable. As construction works continue until 2011 and the exact extent thereof can change, there is no certainty regarding the total cost of the construction of the pipelines and the profitability of the project. In recording income from government grants in these financial statements the best knowledge and estimates of the Management Board of the profit rates of the project have served as the basis for calculation. If the actual construction costs differed from these estimates, a change of 5% in the profit rates of the project would have an impact to the profit of 2008 by 7.9 mln kroons (2007: 0,0 mln kroons).

As compensations for water pipelines will be received until 2017 and the exact extent thereof depends on water consumption, the fair value of compensations receivable is also based on estimates. The estimated compensations receivable in 2008-2017 that have been discounted using a rate of 7%. If the discount rate decreased/increased by 0.5%, the profit of the accounting period would increase/decrease up to 1 mln kroons (2007: 0.0 mln kroons).

- Accounts receivable - for the evaluation of doubtful debts the individual debts are grouped by age and, based on past experience, the following percentages are applied in the doubtful debt calculation:

61 to 90 days over due date	10%;
91 to 180 days over due date	30%;
181 to 360 days over due date	70%;
over 360 days over due date	100%.

Bigger discount rates could be applied in case of individual receivables if needed.

NOTE 5. IMPACTS OF ECONOMIC CRISIS

Recent volatility in global (and Estonian) financial markets.

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. The uncertainties in the global financial markets have also led to bank failures and bank rescues in the United States of America, Western Europe, Russia and elsewhere. Indeed the full extent of the impact of the ongoing financial crisis is proving to be impossible to anticipate or completely guard against.

The volume of wholesale financing has significantly reduced since August 2007. This may affect the Company's results regarding securing its long term financing.

Debtors of the Company may be affected by the lower liquidity situation which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for debtors may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has properly reflected revised estimates of expected future cash flows in its impairment assessments. Management is unable to reliably estimate the effects on the Company's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Company's business in the current circumstances.

AS TALLINNA VESI

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 6. CASH AND CASH EQUIVALENTS

	as of 31 December	
	2008	2007
Cash in hand and in bank	1 551	37 838
Short-term deposits	228 309	140 582
Total cash and cash equivalents	229 860	178 420

NOTE 7. CUSTOMER RECEIVABLES

	as of 31 December	
	2008	2007
Accounts receivable	111 681	107 957
Deferred income* (Note 27)	0	80 727
Allowance for doubtful receivables	-3 477	-3 461
Total trade receivables	108 204	185 223

* Government grant receivable that is based on construction cost, the invoice was issued in the next financial year.

Impairment loss of receivables:

for the year ended 31 December

	2008	2007
Write off of uncollectible receivables	-169	-472
Receipt of receivables previously written off as uncollectible	172	157
Change in allowance for doubtful receivables	-16	1 741

NOTE 8. ACCRUED INCOME AND PREPAID EXPENSES

	as of 31 December	
	2008	2007
Accrued interest	765	2 065
Prepaid expenses	3 669	3 114
Total accrued income and prepaid expenses	4 434	5 179

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008

NOTE 9. PROPERTY, PLANT AND EQUIPMENT, AND INTANGIBLE ASSETS

(thousand EEK)

	Property, plant and equipment				Assets in progress			Intangible assets			Total property, plant and equipment and intangible assets
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Construction in progress - unfinished pipelines*	Prepayment for fixed assets	Unfinished intangible assets	Development costs	Acquired licenses and other intangible assets	
As of 31 December 2006											
Acquisition cost	345 074	2 016 934	534 627	17 532	89 989	117 162	2 795	1 687	17 543	63 731	3 207 074
Accumulated depreciation	-59 475	-641 049	-325 644	-10 894	0	0	0	0	-11 408	-17 271	-1 065 741
Book value	285 599	1 375 885	208 983	6 638	89 989	117 162	2 795	1 687	6 135	46 460	2 141 333
Transactions in the period 01.01.2007 - 31.12.2007											
Acquisition in book value (Note 24C)	0	0	0	0	142 541	135 085	2 611	5 716	0	0	285 953
Write off and sale of property, plant and equipment, and intangible assets in book value	-1 507	0	-80	0	0	0	0	0	0	0	-1 587
Compensated by government: grants (Note 24A)	0	0	0	0	0	-158 187	0	0	0	0	-158 187
Reclassification	20 654	119 355	47 058	658	-186 381	-4 003	-7	-5 518	1 809	3 709	-2 666
Depreciation (Note 19)	-3 952	-33 642	-31 569	-1 102	0	0	0	0	-1 918	-7 058	-79 241
Total transactions in the period 01.01.2007 - 31.12.2007	15 195	85 713	15 409	-444	-43 840	-27 105	2 604	198	-109	-3 349	44 272
As of 31 December 2007											
Acquisition cost	364 188	2 134 970	566 408	17 708	46 149	90 057	5 399	1 885	19 006	66 817	3 312 587
Accumulated depreciation	-63 393	-673 373	-342 016	-11 514	0	0	0	0	-12 980	-23 706	-1 126 982
Book value	300 795	1 461 597	224 392	6 194	46 149	90 057	5 399	1 885	6 026	43 111	2 185 605
Transactions in the period 01.01.2008 - 31.12.2008											
Acquisition in book value (Note 24C)	0	0	0	0	113 524	189 651	0	3 082	0	0	306 257
Write off and sale of property, plant and equipment, and intangible assets in book value	283	12	-19	0	0	0	0	0	0	0	276
Compensated by government: grants (Note 24A)	0	0	0	0	0	-186 282	0	0	0	0	-186 282
Reclassification	3 925	100 384	31 701	1 149	-136 695	-1 452	-3 546	-3 137	5 873	-2 736	-4 534
Depreciation (Note 19)	-4 221	-38 023	-34 635	-1 218	0	0	0	0	-8 931	-2 641	-89 669
Total transactions in the period 01.01.2008 - 31.12.2008	-13	62 373	-2 953	-69	-23 171	1 917	-3 546	-55	-3 058	-5 377	26 048
As of 31 December 2008											
Acquisition cost	368 045	2 234 538	585 674	18 373	22 978	91 974	1 853	1 830	17 742	62 372	3 405 379
Accumulated depreciation	-67 263	-710 568	-364 236	-12 247	0	0	0	0	-14 774	-24 638	-1 193 726
Book value	300 782	1 523 970	221 439	6 125	22 978	91 974	1 853	1 830	2 968	37 734	2 211 653

* Please vide Note 4.

Property, plant and equipment and intangible assets are written off if the conditions of the asset do not enable further usage for production purposes.

As of 31 December 2008 and 2007 there were no contracts for financial lease.

Collateral of loans and pledged assets is described in note 26.

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 10. SHORT-TERM AND LONG-TERM BORROWINGS

As of 31 December 2008

Bank loans	Carrying amount 31 December 2008	Contractual interest rate %	Effective interest rate %	Maturity date
EBRD	539 266	4,67	4,95	05.2015
Nordea Bank I	586 550	6 month Euribor + 0,24	6 kuu Euribor + 0,255	11.2015
Nordea Bank II	41 669	6 month Euribor + 1,15	6 kuu Euribor + 1,28	11.2013
Total borrowings incl	1 167 485			
Short-term portion	82 843			
Long-term portion	1 084 642			

As of 31 December 2007

Bank loans	Carrying amount 31 December 2007	Contractual interest rate %	Effective interest rate %	Maturity date
EBRD	580 458	4,67	4,93	05.2015
Nordea Bank I	586 519	6 month Euribor + 0,24	6 kuu Euribor + 0,274	11.2015
Total borrowings incl	1 166 977			
Short-term portion	41 486			
Long-term portion	1 125 491			

The collaterals of the loans are indicated in Note 26.

Name	Repayments period
EBRD	Loan repayments started in November 2008. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.
Nordea Bank I	Loan repayments start in May 2011. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.
Nordea Bank II	The repayment will be made once in November 2013.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 11. TRADE AND OTHER PAYABLES

as of 31 December

Liabilities	Balance amount 2008	Balance amount 2007	Short-term	Long-term	Maturity date
			portion 2008	portion 2008	
Trade payables - operating expenditures	13 966	13 019	13 966	0	
Trade payables - capital expenditures	26 805	53 063	26 805	0	
Factoring	107	0	107	0	
Payables to related parties (Note 27)	3 972	4 091	3 972	0	
Payables to employees*	11 658	11 492	11 658	614	12.2011
Interest payable	4 829	5 207	4 829	0	
Other accrued expenses	2 913	94	2 913	0	
Long-term guarantee deposit**	121	113	0	121	04.2102
Total trade and other payables	64 371	87 079	64 250	735	

* Long-term payable includes the performance related pay that will realise in 2011 in case of the successful delivery of the project.

** Long-term deposit is presented at cost.

NOTE 12. TAXES PAYABLE

as of 31 December

	2008	2007	Tax rates
Income tax	1 916	1 948	21% (2007: 22%)
VAT	7 699	15 891	18%
Tax on special use of water	2 732	2 627	0,38 - 0,88 kr/m ³ (2007: 0,36 - 0,80 kr/m ³)
Pollution taxes*	7 052	1 752	4 909 - 156 000 kr/t (2007: 4 091 - 130 200 kr/t)
Social security tax	3 890	3 853	33%
Other	345	415	0,3 - 21%
Total	23 634	26 486	

NOTE 13. GOVERNMENT GRANTS**Government grants for assets**

Government grants received as compensations for constructing pipelines taken into use in the financial year amounted to 159 310 thousand kroons (2007: 118 947 thousand kroons) (Note 27).

Property, plant and equipment have been reduced by the amount received as government grants of 135 820 thousand kroons (2007: 112 750 thousand kroons).

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 14. CONTINGENT LIABILITIES

Tax authority is entitled to check the Company's tax accounting within 6 years after the term for the submission of tax declaration and when mistakes are detected to impose an additional amount of tax, interests and fines. According to the Company's management board there are no circumstances as a result of which tax authority could impose a significant additional amount of tax to the Company.

According to the management board none of the current litigations involve any expenses that should be included in the balance sheet or referred to as an off-balance-sheet contingent commitment.

The Company's distributable retained earnings as at 31 December 2008 amounted to 674 276 thousand kroons (2007: 627 319 thousand kroons). Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 179 238 thousand kroons (2007: 166 756 thousand kroons).

NOTE 15. PREPAYMENTS AND DEFERRED INCOME

	as of 31 December	
	2008	2007
Prepayments of customer	1 073	1 095
Prepayments for pipelines (Note 24A and 24B)	18 724	41 004
Total deferred income	19 797	42 099

NOTE 16. SHARE CAPITAL

At 31 December 2008 and 2007 the nominal value of the share capital was 200 001 000 (two hundred million one thousand) kroons, composed of 20 000 000 shares with nominal value of 10 kroons per share (A-share) and one preferred share with a nominal value of 1 000 kroons (B-share).

One B-share has been issued giving the right of veto to the shareholder when voting on the following issues: change in the Articles of Association, increase and decrease of share capital, issuance of replacement bonds, termination of the Company's activities, merging, sharing and rearrangements, acquisition of own shares and, on demand of the management or supervisory board, deciding other issues related to the activities of the Company that have not been placed in the sole competence of the General Meeting by law. The B-share grants the holder the preferential right to receive a dividend in an agreed sum of 10 thousand kroons.

General Meeting of Shareholders has the authority to decide the emission and buyback of the shares, following the principles established in the Articles of Association. Management board does not have any respective authorities.

Restrictions on the transfer of shares are disclosed in chapter 'Description of capital stock and corporate governance' of the IPO offering circular of AS Tallinna Vesi shares. The circular is available on the Company's website (www.tallinnavesi.ee).

As of 31 December 2008 and 2007 United Utilities (Tallinn) B.V. owned 7 060 870 (35,3%) A- shares, the City of Tallinn owned 6 939 130 (34,7%) A- shares and one B-share, with 6 000 000 shares in free float.

As of 31 December 2008 Credit Suisse Securities (Europe) Ltd Prime Brokerage A/C customers 1 151 948 (5,76%) and HSBC Bank PLC RE ParvusEuropean Absolute Opportunities Master Fond customers owned 1 091 109 (5,46%) shares.

As of 31 December 2007 Nordea Bank Finland PLC customers 1 542 491 (7,71%) and Morgan Stanley + Co International PLC customers owned 1 361 459 (6,81%) shares. Other direct shareholders owned less than 5% of the shares as of 31 December 2008 and 2007.

As of 31 December 2008 from Supervisory and Management Board members only Siiri Lahe owned 700 shares (2007: 180).

Dividends declared and paid are disclosed in note 22.

Contingent income tax on the dividend payments from retained earnings is described in note 14.

AS TALLINNA VESI

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

(thousand EEK)

NOTE 17. REVENUE

for the year ended 31 December

	2008	2007
Revenues from main operating activities		
Total water supply and waste water disposal service, incl:	658 305	599 612
<u>Private clients, incl:</u>	<u>346 836</u>	<u>318 963</u>
Water supply service	193 688	178 452
Waste water disposal service	153 148	140 511
<u>Corporate clients, incl:</u>	<u>271 231</u>	<u>252 658</u>
Water supply service	150 669	138 693
Waste water disposal service	120 562	113 965
<u>Outside service area clients, incl:</u>	<u>26 401</u>	<u>17 676</u>
Water supply service	2 160	1 541
Waste water disposal service	24 241	16 135
<u>Overpollution fee</u>	<u>13 837</u>	<u>10 315</u>
Stormwater treatment and disposal service	46 158	37 426
Fire hydrants service	2 687	2 361
Other works and services	12 773	8 936
Total revenue	719 923	648 335

100 % of AS Tallinna Vesi revenue was generated within the Estonian Republic.

NOTE 18. STAFF COSTS

for the year ended 31 December

	2008	2007
Salaries and wages	-66 330	-57 666
Social security and unemployment insurance taxation	-22 093	-19 203
Staff costs total (Note 19)	-88 423	-76 869
Number of employees at the end of reporting period	327	312

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 19. COST OF GOODS SOLD, MARKETING AND GENERAL ADMINISTRATIONS EXPENSES

	for the year ended 31 December	
	2008	2007
Cost of goods sold		
Tax on special use of water	-10 804	-10 493
Chemicals	-22 841	-20 979
Electricity	-29 759	-26 382
Pollution tax	-17 010	6 207
Staff costs (Note 18)	-63 516	-51 611
Development	-26	-99
Depreciation and amortization (Note 9)	-82 079	-72 806
Transport	-19 693	-18 070
Other costs of goods sold	-27 024	-22 444
Total cost of goods sold	-272 752	-216 677
Marketing expenses		
Staff costs (Note 18)	-5 417	-6 107
Depreciation and amortization (Note 9)	-5 065	-3 553
Other marketing expenses	-1 828	-3 887
Total cost of marketing expenses	-12 310	-13 547
General administration expenses		
Staff costs (Note 18)	-19 490	-19 151
Depreciation and amortization (Note 9)	-2 525	-2 882
Other general administration expenses	-32 531	-34 816
Total cost of general administration expenses	-54 546	-56 849

NOTE 20. OTHER INCOME / EXPENSES

	for the year ended 31 December	
	2008	2007
Profit from connection fees (Note 24A)	4 430	8 053
Profit from government grant (Note 24A)	23 491	6 197
Other income / expenses (-)	-2 876	1 850
Total other income / expenses	25 045	16 100

Please see the changes in the accounting policy from Note 2.

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 21. FINANCE INCOME AND EXPENSES

	for the year ended 31 December	
	2008	2007
Interest income	15 606	10 861
Interest expense	-57 191	-53 513
Other financial expenses	-1 614	-1 585
Total finance income / expenses	-43 199	-44 237

NOTE 22. DIVIDENDS

	for the year ended 31 December	
	2008	2007
Dividends declared during the period	249 010	196 010
Dividends paid during the period	249 010	196 010
Income tax on dividends paid	-66 193	-55 285
Income tax accounted for	-66 193	-55 285
<i>Paid-up dividends per shares:</i>		
Dividends per A-share (in kroons)	12,45	9,80
Dividends per B-share (in kroons)	10 000	10 000

The income tax rates were 21/79 and 22/78 respectively in 2008 and 2007.

NOTE 23. EARNINGS PER SHARE

	for the year ended 31 December	
	2008	2007
Earnings per share:		
Net profit for the period ended 31.12 minus B-share preference rights (in kroons)	295 958	277 830
Weighted average number of ordinary shares for the purposes of basic earnings per share (in pieces)	20 000 000	20 000 000
Earnings per A share (in kroons)	14,80	13,89
Earnings per B share (in kroons)	10 000	10 000

Diluted earnings per share for the periods ended 31 December 2008 and 2007 do not vary significantly from the earnings per share figures stated above.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 24. NOTES TO THE CASH FLOW STATEMENT

for the year ended 31 December

NOTE 24A. COMPENSATIONS RECEIVED FOR CONSTRUCTION OF PIPELINES

	2008	2007
Income		
Connection fees and government grants received for pipelines taken into use (Note 20)	214 203	172 437
Increase in prepayments for pipelines (Note 15 and 24B)	-22 280	9 218
Change in accounts receivable from pipelines (Note 24B)	58 267	-79 815
Proceeds from connection fees	250 190	101 840
Acquisition cost of pipelines taken into use (Note 9 and 20)	-186 282	-158 187

The connection fees from and the acquisition costs of pipelines taken into use are eliminated from "Cash flows of operating activities" as these are recorded within "Cash flows from investing activities". In 2008 the net amount eliminated was -27 921 thousand kroons (2007: -14 250 thousand kroons) (Note 20).

NOTE 24B. CHANGE IN CURRENT ASSETS AND LIABILITIES

In addition to the changes in the balance sheet, current assets and liabilities have been adjusted as follows:

	2008	2007
Current assets		
Change in balance sheet	26 189	-43 138
Adjustments:		
Change in cash and cash equivalents	51 440	-70 993
Movements between non-current and current assets	4 252	2 206
Sales of non-current assets held for sale	0	-242
Change in accrued interests	-833	290
Change in accounts receivable from pipelines (Note 24A)	-58 267	79 815
Total change in current assets	22 781	-32 062
Current liabilities		
Change in balance sheet	-6 872	46 174
Adjustments:		
Change in non-current borrowings	-40 659	-40 659
Change in trade payables – capital expenditures (Note 24C)	26 150	-238
Change in prepayments for the sale of property, plant and equipment, and deposits	7	3 600
Change in prepayments for pipelines (Note 15 and 24A)	22 280	-9 204
Total change in current liabilities	906	-327

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 24. NOTES TO THE CASH FLOW STATEMENT (continued)

for the year ended 31 December

NOTE 24C. ACQUISITION OF PROPERTY, PLANT AND EQUIPMENT, AND INTANGIBLE ASSETS

	2008	2007
Acquisition of property, plant and equipment, and intangible assets (Note 9)	-306 257	-285 953
<i>Adjustments:</i>		
Change in trade payables – capital expenditures (Note 24B)	-26 150	238
Total acquisition of property, plant and equipment and intangible assets	-332 407	-285 715

NOTE 25. OPERATING LEASE

Leased assets

for the year ended 31 December
2008 2007

Total operating lease expenses for computers and vehicles	7 970	7 281
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Following period operating lease payments from the non-cancellable contracts are as follows:

	as of 31 December	
Less than 1 year	7 342	6 946
1-5 years	8 010	9 053
Total minimum lease payments	15 352	15 999

The underlying currency of all lease contracts is Estonian kroon. Leased assets have not been subleased.

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTES 26. COLLATERAL OF LOANS AND PLEDGED ASSETS

In connection with the loan agreements concluded between the EBRD and the Company and between the Estonian affiliate of Nordea Bank Plc (hereinafter Nordea Bank) and the Company, the following guarantee contracts were concluded, concerning the assets of the Company :

- a) Commercial Pledge Agreement on the Company's tangible fixed assets in favour of EBRD to the value of 1 877 592 thousand kroons; the book value of the current assets pledged is 113 878 thousand kroons (31.12. 2007: 192 055 thousand kroons) and the book value of the property, plant and equipment is 547 887 thousand kroons (31.12. 2007: 556 462 thousand kroons). The total book value of pledged assets is 661 765 thousand kroons (31.12.2007: 748 517 thousand kroons).
- b) Separate Mortgage Agreements in favour of EBRD regarding the properties of Ülemiste water treatment plant and Paljassaare waste water treatment plant, whereby both pledges are to the value of 293 374 thousand kroons, total 586 748 thousand kroons; the book value of the property, plant and equipment pledged is 468 790 thousand kroons (31.12. 2007: 461 174 thousand kroons).
- c) Combined Mortgage Agreement in favour of Nordea Bank regarding the properties of Ülemiste water treatment plant and Paljassaare waste water treatment plant to the value of 586 748 thousand kroons the book value of the property, plant and equipment pledged is 468 790 thousand kroons (31.12. 2007: 461 174 thousand kroons).
- d) The mortgages in favour of Nordea Bank and EBRD have the same ranking and were valid on the same basis as of 31.12.2007.
- e) A Security Sharing Agreement is concluded between EBRD and Nordea Bank.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

(thousand EEK)

NOTE 27. RELATED PARTIES

Transactions with related parties are considered to be transactions with members of the Supervisory Board and Management Board, their relatives and the companies in which they hold majority interest and transactions with shareholder having the significant influence. Dividend payments are indicated in the Statement of Changes in Equity.

Shareholders having the significant influence

as of 31 December

Balances recorded in working capital on the balance sheet of the Company	2008	2007
Accounts receivable	24 935	29 912
Accrued income (Note 7)	0	80 727
Accounts payable - short-term trade and other payables (Note 11)	3 972	4 091

for the year ended 31 December

Transactions with the related parties	2008	2007
Sales services	48 845	39 787
Compensations received from the local governments for constructing new pipelines (Note 13)	159 310	118 947
Purchase of administrative and consulting services	20 585	22 387

for the year ended 31 December

	2008	2007
Management Board fees excluding social tax	2 295	2 118
Supervisory Board fees excluding social tax	500	578

The fees disclosed above are contractual payments made by the Company to the management board members. In addition to this the board members have also received direct compensations from the companies belonging to the group of United Utilities (Tallinn) B.V. as overseas secondees.

The market prices were implemented in transactions with related parties.

The information about AS Tallinna Vesi shares belonging to the related parties is disclosed in note 16.

Paid-up dividends are described in note 22.

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PricewaterhouseCoopers, Tallinn	

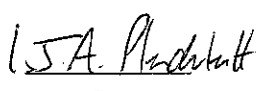
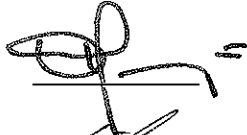



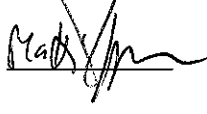


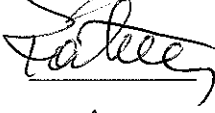
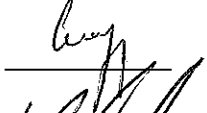
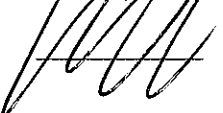
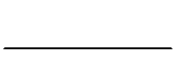
AS TALLINNA VESI

THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

The Management Board has prepared the management report and the financial statements of AS Tallinna Vesi on 25 February 2009.

The Supervisory Board of AS Tallinna Vesi has reviewed the annual report, prepared by the Management Board, consisting of Management Report and the financial statements, the Management Board's proposal for profit distribution and the independent auditors' report, and has approved the annual report for presentation on the Shareholders' General Meeting.

The annual report has signed by all the members of the Management Board and Supervisory Board.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		25/2/09
David Nigel Hetherington	Member of the Management Board		25-2-09
Siiri Lahe	Member of the Management Board		25.02.09
Robert John Gallienne	Chairman of the Supervisory Board		26.3.2009.
Kevin Starling	Member of the Supervisory Board		26.3.2009
Matti Hyyrynen	Member of the Supervisory Board		26.3.2009
Steven Richard Fraser	Member of the Supervisory Board		
Mart Mägi	Member of the Supervisory Board		26.03.09
Rein Ratas	Member of the Supervisory Board		26.03.09
Elmar Sepp	Member of the Supervisory Board		26.03.09
Deniss Boroditš	Member of the Supervisory Board		26.03.09
Valdur Laid	Member of the Supervisory Board		

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS Tallinna Vesi

We have audited the accompanying financial statements of AS Tallinna Vesi (the Company) which comprise the balance sheet as of 31 December 2008 and the income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

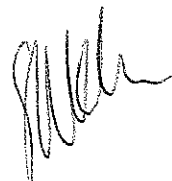
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.



Tiit Raimla
AS PricewaterhouseCoopers



Stan Nahkor
Authorised Auditor

19 March 2009

** This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*