

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
Telephone	+ 372 6 262 202
Fax	+372 6 262 300
E-mail	tvesi@tvesi.ee
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

TABLE OF CONTENTS

MANAGEMENT REPORT	Pg. 3
CHAIRMAN'S STATEMENT.....	3
RESULTS OF OPERATIONS - FOR THE YEAR 2008.....	5
CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RECOMMENDATIONS REPORT.....	12
 FINANCIAL STATEMENTS	
DECLARATION OF MANAGEMENT	16
BALANCE SHEETS.....	17
INCOME STATEMENTS.....	18
CASH FLOW STATEMENTS.....	19
STATEMENTS OF CHANGES IN EQUITY.....	20
 NOTES TO THE FINANCIAL STATEMENTS	
NOTE 1. GENERAL INFORMATION.....	21
NOTE 2. ACCOUNTING PRINCIPLES.....	22
NOTE 3. FINANCIAL RISK MANAGEMENT.....	34
NOTE 4. CRITICAL ACCOUNTING ESTIMATES	37
NOTE 5. CREDIT CRUNCH.....	38
NOTE 6. CASH AND CASH EQUIVALENTS.....	39
NOTE 7. CUSTOMER RECEIVABLES.....	39
NOTE 8. ACCRUED INCOME AND PREPAID EXPENSES.....	39
NOTE 9. PROPERTY, PLANT AND EQUIPMENT, AND INTANGIBLE ASSETS	40
NOTE 10. SHORT-TERM AND LONG-TERM BORROWINGS.....	41
NOTE 11. TRADE AND OTHER PAYABLES.....	42
NOTE 12. TAXES PAYABLE.....	42
NOTE 13. GOVERNMENT GRANTS.....	42
NOTE 14. CONTINGENT LIABILITIES.....	43
NOTE 15. PREPAYMENTS AND DEFERRED INCOME.....	43
NOTE 16. SHARE CAPITAL	43
NOTE 17. REVENUE.....	44
NOTE 18. STAFF COSTS.....	44
NOTE 19. COST OF GOODS SOLD, MARKETING AND GENERAL ADMINISTRATIONS EXPENSES.....	45
NOTE 20. OTHER INCOME / EXPENSES.....	45
NOTE 21. FINANCIAL INCOME AND EXPENSES.....	46
NOTE 22. DIVIDENDS.....	46
NOTE 23. EARNINGS PER SHARE.....	46
NOTE 24. NOTES TO THE CASH FLOW STATEMENT.....	47
NOTE 25. OPERATING LEASE.....	48
NOTE 26. COLLATERAL OF LOANS AND PLEDGED ASSETS.....	49
NOTE 27. RELATED PARTIES.....	50
 CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS	 51
 INDEPENDENT AUDITORS' REPORT.....	 52

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 18.9 mln EUR 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 19.1 mln EUR in 2008 in our networks, treatment plant 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

MANAGEMENT REPORT

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 EUR	2008	2007	2006*	2005*	2004*
Sales	46,0	41,4	37,7	35,1	30,6
Gross profit	28,6	27,6	23,6	22,2	18,0
Gross profit margin %	62,1	66,6	62,6	63,3	58,8
Operating profit	25,9	24,1	21,6	18,1	16,3
Operating profit margin %	56,3	58,2	48,7	47,7	46,5
Profit before taxes	23,1	21,3	18,9	13,4	12,7
Profit before taxes margin %	50,3	51,4	42,5	35,4	36,3
Net profit	18,9	17,8	15,9	11,1	11,1
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	12,8	12,8	12,8	12,8	12,8

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 46.0 mln EUR. 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 42.1 mln EUR, 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 22.2 mln EUR. Sales to commercial customers increased by 7.4% to 17.3 mln EUR. 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 1.7 mln EUR. Overpollution fees received were 0.88 mln EUR, 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.

MANAGEMENT REPORT

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 3.1 mln EUR 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 17.4 mln EUR in 2008, an increase of 3.6 mln EUR or 25.9% from the equivalent period in 2007.

Pollution tax payable for 2008 was 1.1 mln EUR compared to 0.40 mln EUR positive cost effect in 2007, resulting from release of the 0.85 mln EUR pollution tax provision in the first quarter of 2007. In 2008 the Company did not achieve 0.5 coefficient for pollution tax in 2nd and 4th quarters what meant 0.58 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 1.5 mln EUR, 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 chemical prices.

Electricity costs increased by 0.22 mln EUR 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 0.76 mln EUR 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 0.59 mln EUR 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 0.40 mln EUR, 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.

MANAGEMENT REPORT

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 28.6 mln EUR, which is an increase of 0.99 mln EUR, or 3.6%, compared to the gross profit of 27.6 mln EUR for 2007.

Operating Costs and Operating Margin

Marketing expenses decreased by 0.08 mln EUR to 0.79 mln EUR 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 0.15 mln EUR to 3.5 mln EUR 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 1.8 mln EUR in 2008 compared to a net income of 0.91 mln EUR in 2007. The rest of the other income/expenses totaled an expense of 0.19 mln EUR in 2008 compared to an income of 0.12 mln EUR in 2007.

As a result of all of the above the Company's operating profit for 2008 was 25.9 mln EUR, an increase of 1.8 mln EUR compared to an operating profit of 24.1 mln EUR achieved in 2007. Compared to the operating profit in 2007, the operating profit has increased 7.4%.

Financial expenses

Net Financial expenses were 2.8 mln EUR in 2008, which is a decrease of 0.06 mln EUR 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 23.1 mln EUR, which is 1.9 mln EUR higher than the profit before taxes of 21.3 mln EUR 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

MANAGEMENT REPORT

resulted in the release of a provision worth 0.85 mln EUR for environmental taxes. Looking at the underlying profit before taxes for the twelve months of 2007, it shows a 2.7 mln EUR or 13.2% increase in 2008 for the same period.

Balance sheet

During the twelve months of 2008 the Company invested 19.6 mln EUR into fixed assets. Non-current assets were 141.4 mln EUR at 31 December 2008. Current assets decreased by 1.7 mln EUR to 22.2 mln EUR in the twelve months of the year, customer receivables increased by 0.24 mln EUR. During the twelve months of 2008 cash at bank increased by 3.3 mln EUR.

Current liabilities decreased by 0.45 mln EUR to 12.3 mln EUR in the twelve months of the year. This was mainly due to increases in Current portion of long-term borrowings by 2.7 mln EUR, 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 69.4 mln EUR 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 25.1 mln EUR of cash flows from operating activities, an increase of 3.8 mln EUR 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 1.7 mln EUR, which is 8.1 mln EUR 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 19.6 mln EUR – 16.9 mln EUR on networks (including 12.1 mln EUR on extension and developments), 1.1 mln EUR at Paljassaare wastewater treatment plant and sludge treatment, 0.63 mln EUR on water quality (Ülemiste water treatment plant and raw water) and 0.88 mln EUR for other investments (IT, capital maintenance, meters, etc).

The cash outflows from financing activities were 20.1 mln EUR during the twelve months of 2008 compared to cash outflow of 16.1 mln EUR 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 3.3 mln EUR compared to a cash outflow of 4.5 mln EUR in the twelve months of 2007. Cash and cash equivalents stood at 14.7 mln EUR as at 31 December 2008.

MANAGEMENT REPORT

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 5.6 mln EUR, including 0.18 mln EUR paid to the Management and Supervisory Council members. The off balance sheet potential salary liability would be up to 0.03 mln EUR 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 15,914,640 EUR of dividends. Of this 639 EUR was paid to the owner of the B-share and 15,914,000 EUR, i.e. 0.80 EUR 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.

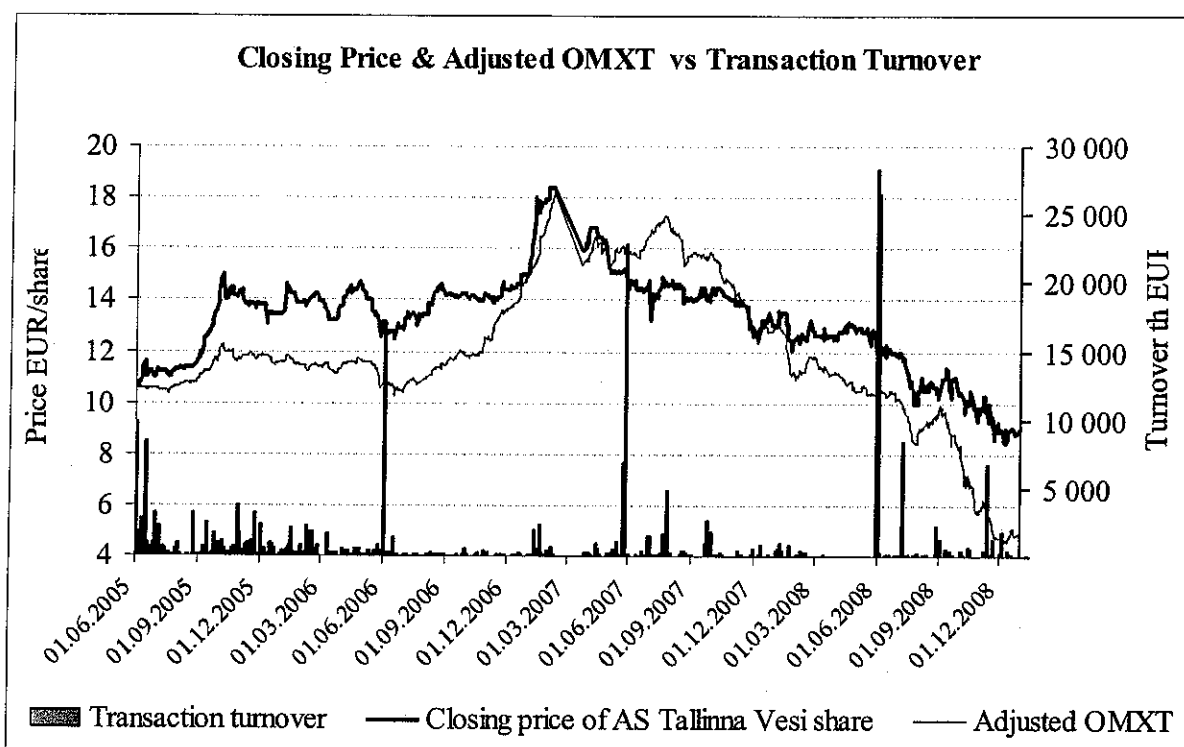
As of 31 December 2008 AS Tallinna Vesi shareholders, with a direct holding over 5%, were:

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 8.99 EUR, which is a 30.6% decrease compared to the closing price of 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.

MANAGEMENT REPORT



Share price statistics after listing

EUR	2008	2007	2006	2005	2004	2003
Share price, open	13,25	15,00	13,50	9,94	n/a	n/a
Share price, at the end of the year	8,99	12,96	15,01	13,48	n/a	n/a
Share price, low	8,41	12,50	12,47	9,94	n/a	n/a
Share price, high	13,60	18,59	15,01	15,05	n/a	n/a
Share price, average	11,38	14,84	13,90	12,62	n/a	n/a
Traded volume	7 958 820	5 462 916	4 274 094	7 993 844	n/a	n/a
Turnover, million	92,9	82,8	58,4	96,5	n/a	n/a
Capitalisation, million	179,8	259,2	300,2	269,6	n/a	n/a
Earnings per share	0,95	0,89	0,79	0,56	0,55	0,33
Dividend per share	n/a	0,80	0,63	0,50	0,36	0,24
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

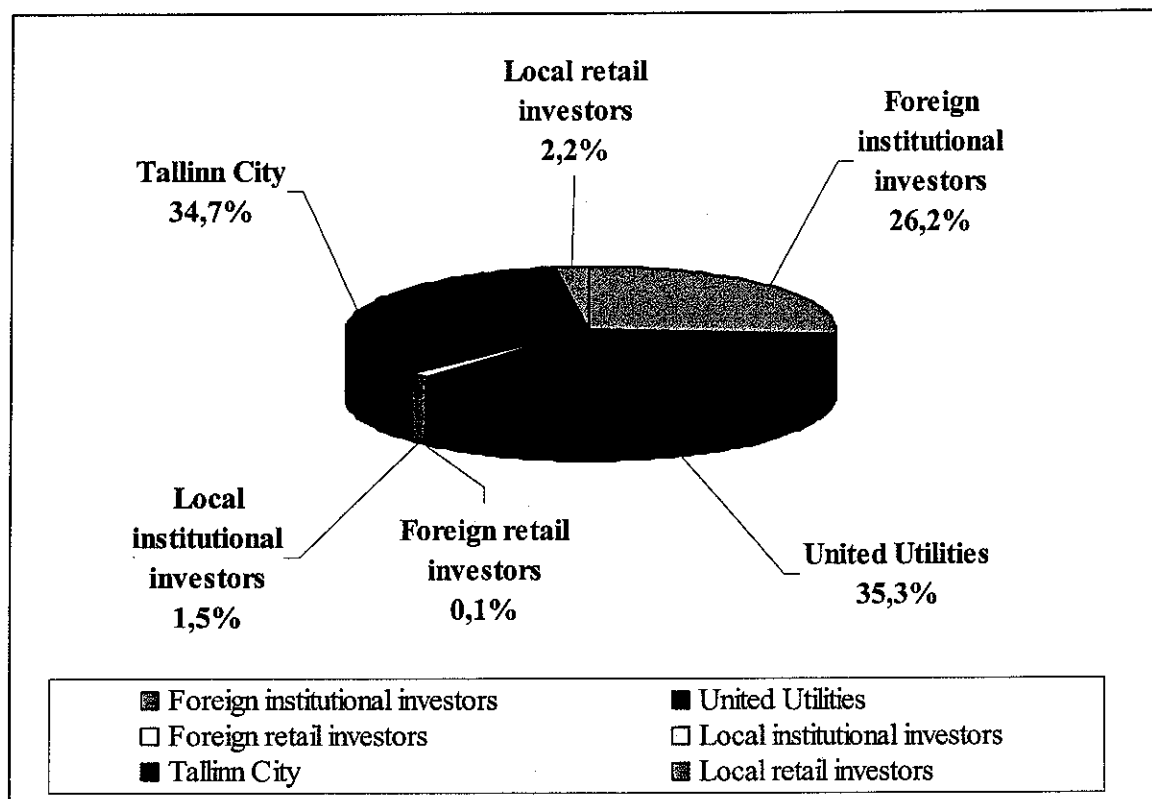
P/E = share price at the end of the year / earnings per share

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

MANAGEMENT REPORT

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.

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 Hyyrynen, 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;

MANAGEMENT REPORT

- 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.

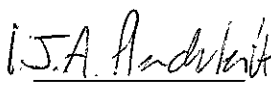

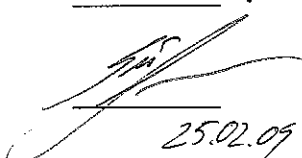
In 2008 six Supervisory Board meetings were held (29 January 2008, 11 March 2008, 22. April 2008, 15 July 2008, 1 September 2008 and 21 October 2008).

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 Borodits) 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**

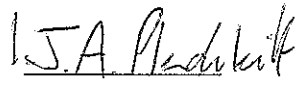
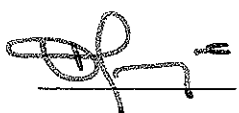

The Management Board of AS Tallinna Vesi hereby declares its responsibility for the preparation of the financial statements for the financial year ended 31 December 2008 on pages 16 to 50.

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		25/2/09
David Nigel Hetherington	Member of the Management Board		25-2-09
Siiri Lahe	Member of the Management Board		25.02.09

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

(thousand EUR)

ASSETS	Note	2008	2007
CURRENT ASSETS			
Cash and cash equivalents	6	14 691	11 403
Customer receivables, accrued income and prepaid expenses	7,8	7 199	12 169
Inventories		240	233
Non-current assets held for sale		73	72
TOTAL CURRENT ASSETS		22 203	23 877
NON-CURRENT ASSETS			
Property, plant and equipment	9	138 632	136 425
Intangible assets	9	2 718	3 261
TOTAL NON-CURRENT ASSETS		141 350	139 686
TOTAL ASSETS		163 553	163 562
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Current portion of long-term borrowings	10	5 295	2 651
Trade and other payables	11, 12	5 578	7 251
Short-term provisions		159	143
Prepayments and deferred income	15	1 265	2 691
TOTAL CURRENT LIABILITIES		12 296	12 736
NON-CURRENT LIABILITIES			
Borrowings	10	69 321	71 932
Other payables	11	47	7
TOTAL NON-CURRENT LIABILITIES		69 368	71 939
TOTAL LIABILITIES		81 665	84 675
EQUITY			
Share capital	16	12 782	12 782
Share premium		24 734	24 734
Statutory legal reserve		1 278	1 278
Retained earnings		43 094	40 093
TOTAL EQUITY		81 889	78 887
TOTAL LIABILITIES AND EQUITY		163 553	163 562

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

Initsialiseeritud ainult identifitseerimiseks Initialed for the purpose of identification only Initsiaalid/initials <u>M. M</u> Kuupäev/date <u>19.03.09</u> PricewaterhouseCoopers, Tallinn
--

AS TALLINNA VESI

INCOME STATEMENTS FOR THE YEARS ENDED 31 DECEMBER 2008 AND 2007

(thousand EUR)

			reclassified*
	Note	2008	2007
Revenue	2, 17	46 011	41 436
Costs of goods sold	2, 19	-17 432	-13 848
GROSS PROFIT		28 579	27 588
Marketing expenses	19	-787	-866
General administration expenses	19	-3 486	-3 633
Other income/ expenses (-)	2, 20	1 601	1 029
OPERATING PROFIT		25 907	24 118
Finance income	21	997	694
Finance expenses	21	-3 758	-3 521
PROFIT BEFORE TAXES		23 146	21 291
Income tax on dividends	22	-4 231	-3 533
NET PROFIT FOR THE PERIOD		18 916	17 757
Attributable to:			
Equity holders of A-shares		18 915	17 757
B-share holder		0,64	0,64
Earnings per A share (in kroons)	23	0,95	0,89
Earnings per B share (in kroons)	23	639	639

*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 presented as 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 EUR)

	Note	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit		25 907	24 118
Adjustment for depreciation/amortisation	9, 19	5 731	5 064
Adjustment for profit from government grants and connection fees	20	-1 784	-911
Other finance expenses	21	-103	-101
Profit from sale of property, plant and equipment, and intangible assets		-29	-155
Expensed property, plant and equipment		-1	30
Change in current assets involved in operating activities	24B	1 456	-2 049
Change in liabilities involved in operating activities	24B	58	-21
Interest paid		-3 679	-3 386
Total cash flow from operating activities		27 555	22 589
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of property, plant and equipment, and intangible assets	24C	-21 245	-18 261
Compensations received for construction of pipelines	24A	15 990	6 509
Proceeds from sale of property, plant and equipment, and intangible assets		31	25
Proceeds from sale of non-current assets held for sale	24B	0	15
Interest received		1 080	676
Total cash flow used in investing activities		-4 143	-11 036
CASH FLOWS FROM FINANCING ACTIVITIES			
Received long-term loans	10	2 700	0
Repayment of long-term loans	10	-2 679	0
Finance lease payments	10	0	-30
Dividends paid	22	-15 915	-12 527
Income tax on dividends	22	-4 231	-3 533
Total cash flow used in financing activities		-20 124	-16 091
Change in cash and cash equivalents		3 288	-4 537
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD		11 403	15 940
CASH AND EQUIVALENTS AT THE END OF THE PERIOD	6	14 691	11 403

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 EUR)

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
31 December 2006	12 782	24 734	1 278	34 863	73 658
Dividends (Note 22)	0	0	0	-12 527	-12 527
Net profit of the financial year (Note 23)	0	0	0	17 757	17 757
31 December 2007	12 782	24 734	1 278	40 093	78 887
Dividends (Note 22)	0	0	0	-15 915	-15 915
Net profit of the financial year (Note 23)	0	0	0	18 916	18 916
31 December 2008	12 782	24 734	1 278	43 094	81 889

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.

AS TALLINNA VESI

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	11 021	-11 021	0
Revenue	52 457	-11 021	41 436
Costs of goods sold (other operating activities)	-10 110	10 110	0
GROSS PROFIT	28 499	-911	27 588
Other income/ expenses (-)	118	911	1 029

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 1 263 thousand euros.

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. Implementing the IAS 23 sooner would have brought along 0.3 to 0.6 mln euros 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 owners of the parent and to the non-controlling interests (previously "minority interests") even if

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

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 2008, early adoption permitted). The Interpretation contains general guidance on how to assess the

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

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 in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries

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

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 euros, 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 currencies in the financial statements have been converted into Estonian kroons based on foreign

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

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 held on the Company premises, cash in bank accounts and short-term, risk free, liquid bank deposits convertible into cash within a three month period without penalty.

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 (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^ 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
FOR THE YEAR ENDED 31 DECEMBER 2008**

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
FOR THE YEAR ENDED 31 DECEMBER 2008**

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

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

benefits related to the assets will flow to the Company and the cost of the asset can be measured 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 reversed and the book

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

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

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

exchange for the benefits outlined. The Company recognises post-employment benefits as liabilities 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 arised during accounting period or during previous accounting periods that have legal or contractual basis, which requires waive 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 irrespectively 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 (0.6 euros) each and a single preference share B-Share, with a nominal value of 1 000 kroons (63.9 euros).

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 tranfer 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
FOR THE YEAR ENDED 31 DECEMBER 2008**

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 its 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 its business activities none of before mentioned risks has significant impact to Company.

Financial assets

Receivables (incl cash and cash equivalents)	21 656	23 278
Financial assets at fair value through profit or loss	0	99

Financial liabilities in amortised cost

Financial liabilities at amortised cost	80 240	81 842
---	--------	--------

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 14 691 thousand euros (2007: 11 403 euros) and 14 thousand euros (2007: 0.5 thousand euros) 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.

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

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 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 192 thousand euros (2007: 190 thousand euros). 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 192 thousand euros (2007: 190 thousand euros).

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 1 591 thousand euros (31.12.2007: 6 647 thousand euros).

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

Trade receivable 31.12.2008, in thousand euros

	Balance	Not due	until 3 months	4-6 months	Over due 7-12 months	over 12 months
Commercial entities	3 999	3 664	320	10	5	0
Private persons	2 917	2 780	121	9	7	0
Total	6 916	6 444	441	19	12	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	8 690	7 989	667	25	9	0
Private persons	3 148	3 006	96	42	4	0
Total	11 838	10 995	762	67	13	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	Intrest rate %	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Total
Financial liabilities							
Non-interest bearing	-	5 459	64	54	39	8	5 624
With floating interest rate	6M Euribor + 0,69	-	-	2 085	76 877	7 718	86 680
With fixed interest rate	4,67	-	-	6 920	30 851	2 741	40 512
		5 459	64	9 059	107 767	10 466	132 816

31.12.2007	Intrest rate %	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Total
Financial liabilities							
Non-interest bearing	-	6 552	699	-	-	7	7 258
With floating interest rate	6 months Euribor + 0,24	-	-	1 745	36 337	7 767	45 850
With fixed interest rate	4,67	-	-	4 435	32 104	8 410	44 948
		6 552	699	6 180	68 440	16 184	98 056

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 euros	2008	2007
Equity	81 889	78 887
Total assets	163 553	163 562
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 140.6 mln euros (31.12.2007: 127.8 mln euros) and annual depreciation was 5.7 mln kroons in 2008 (2007: 5.0 mln euros). If the depreciation/amortization rates decreased / increased by 5 %, the depreciation/amortization expense would increase / decrease respectively 0.3 mln euros (2007: 0.3 mln euros).

- The Company has assumed an obligation to construct water and wastewater and stormwater pipelines with an estimated construction cost of up to 41.5 mln euros 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 505 thousand euros (2007: 0.0 thousand euros).

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 63.9 thousand euros (2007: 0.0 thousand euros).

- 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 EUR)

NOTE 6. CASH AND CASH EQUIVALENTS

	as of 31 December	
	2008	2007
Cash in hand and in bank	99	2 418
Short-term deposits	14 592	8 985
Total cash and cash equivalents	14 691	11 403

NOTE 7. TRADE RECEIVABLES

	as of 31 December	
	2008	2007
Accounts receivable	7 138	6 900
Deferred income* (Note 27)	0	5 159
Allowance for doubtful receivables	-222	-221
Total trade receivables	6 915	11 838

* 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	-11	-30
Receipt of receivables previously written off as uncollectible	11	10
Change in allowance for doubtful receivables	-1	111

NOTE 8. ACCRUED INCOME AND PREPAID EXPENSES

	as of 31 December	
	2008	2007
Accrued interest	49	132
Prepaid expenses	234	199
Total accrued income and prepaid expenses	283	331

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

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

(thousand EUR)

	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	Prepayment for fixed assets	Unfinished intangible assets	Development costs	Acquired licenses and other intangible assets		
As of 31 December 2006											
Acquisition cost	22 054	128 906	34 169	1 120	5 751	7 488	179	108	1 121	4 073	204 969
Accumulated depreciation	-3 801	-40 970	-20 812	-696	0	0	0	0	-729	-1 104	-68 113
Book value	18 253	87 935	13 356	424	5 751	7 488	179	108	392	2 969	136 856
Transactions in the period 01.01.2007 - 31.12.2007											
Acquisition in book value (Note 24C)	0	0	0	0	9 110	8 634	167	365	0	0	18 276
Write off and sale of property, plant and equipment, and intangible assets in book value	-96	0	-5	0	0	0	0	0	0	0	-101
Compensated by government grants (Note 24A)	0	0	0	0	0	-10 110	0	0	0	0	-10 110
Reclassification	1 320	7 628	3 008	42	-11 912	-256	0	-353	116	237	-170
Depreciation (Note 19)	-253	-2 150	-2 018	-70	0	0	0	0	-123	-451	-5 064
Total transactions in the period 01.01.2007 - 31.12.2007	971	5 478	985	-28	-2 802	-1 732	166	13	-7	-214	2 829
As of 31 December 2007											
Acquisition cost	23 276	136 449	36 200	1 132	2 949	5 756	345	120	1 215	4 270	211 713
Accumulated depreciation	-4 052	-43 036	-21 859	-736	0	0	0	0	-830	-1 515	-72 027
Book value	19 224	93 413	14 341	396	2 949	5 756	345	120	385	2 755	139 686
Transactions in the period 01.01.2008 - 31.12.2008											
Acquisition in book value (Note 24C)	0	0	0	0	7 256	12 121	0	197	0	0	19 573
Write off and sale of property, plant and equipment, and intangible assets in book value	18	1	-1	0	0	0	0	0	0	0	18
Compensated by government grants (Note 24A)	0	0	0	0	0	-11 906	0	0	0	0	-11 906
Reclassification	251	6 416	2 026	73	-8 736	-93	-227	-200	375	-175	-290
Depreciation (Note 19)	-270	-2 430	-2 214	-78	0	0	0	0	-571	-169	-5 731
Total transactions in the period 01.01.2008 - 31.12.2008	-1	3 986	-189	-4	-1 481	123	-227	-4	-195	-344	1 665
As of 31 December 2008											
Acquisition cost	23 522	142 813	37 431	1 174	1 469	5 878	118	117	1 134	3 986	217 643
Accumulated depreciation	-4 299	-45 414	-23 279	-783	0	0	0	0	-944	-1 575	-76 293
Book value	19 223	97 399	14 153	391	1 469	5 878	118	117	190	2 412	141 350

* 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 finance lease.

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

Intalluseeritud ainult identifitseerimiseks
 Initall for the purpose of identification only
 Initsiaalid/initials M. M
 Kuupäev/date 19.03.09
 Põhikontrolli/Control Tallinn

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

(thousand EUR)

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	34 465	4,67	4,95	05.2015
Nordea Bank I	37 487	6 month Euribor + 0,24	6 kuu Euribor + 0,255	11.2015
Nordea Bank II	2 663	6 month Euribor + 1,15	6 kuu Euribor + 1,28	11.2013
Total borrowings incl	74 616			
Short-term portion	5 295			
Long-term portion	69 321			

As of 31 December 2007

Bank loans	Carrying amount 31 December 2007	Contractual interest rate %	Effective interest rate %	Maturity date
EBRD	37 098	4,67	4,93	05.2015
Nordea Bank I	37 485	6 month Euribor + 0,24	6 kuu Euribor + 0,274	11.2015
Total borrowings incl	74 583			
Short-term portion	2 651			
Long-term portion	71 932			

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.

AS TALLINNA VESI

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

(thousand EUR)

NOTE 11. TRADE AND OTHER PAYABLES

as of 31 December

	Balance amount	Balance amount	Short-term	Long-term	
	2008	2007	portion	portion	Maturity date
			2008	2008	
Liabilities					
Trade payables - operating expenditures	893	832	893	0	
Trade payables - capital expenditures	1 713	3 391	1 713	0	
Factoring	7	0	7	0	
Payables to related parties (Note 27)	254	261	254	0	
Payables to employees*	745	734	745	39	12.2011
Interest payable	309	333	309	0	
Other accrued expenses	186	6	186	0	
Long-term guarantee deposit**	8	7	0	8	04.2102
Total trade and other payables	4 114	5 565	4 106	47	

* 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	122	124		21% (2007: 22%)
VAT	492	1 016		18%
Tax on special use of water	175	168	0,02 - 0,05 euros/m ³ (2007: 0,02 - 0,05 euros/m ³)	
Pollution taxes*	451	112	314 - 9 970 euros/t (2007: 261 - 8 321 euros/t)	
Social security tax	249	246		33%
Other	22	27		0,3 -21%
Total	1 510	1 693		

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 10 182 thousand euros (2007: 7 602 thousand euros). (Note 27)

Property, plant and equipment have been reduced by the amount received as government grants of 8 680 thousand euros (2007: 7 206 thousand euros).

Initsialiseeritud ainult identifitseerimiseks	
Initialed for the purpose of identification only	
Initsiaalid/initials	M. M
Kuupäev/date	19.03.09
PricewaterhouseCoopers, Tallinn	

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

(thousand EUR)

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 43 094 thousand euros (2007: 40 093 thousand euros). Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 11 455 thousand euros (2007: 10 658 thousand euros).

NOTE 15. PREPAYMENTS AND DEFERRED INCOME

	as of 31 December	
	2008	2007
Prepayments of customer	69	70
Prepayments for pipelines (Note 24A and 24B)	1 197	2 621
Total deferred income	1 265	2 691

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 (12 782 394 euros), composed of 20 000 000 shares with nominal value of 10 kroons (0.6 euros) per share (A-share) and one preferred share with a nominal value of 1 000 kroons (63.9 euros) (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 EUR)

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:	42 073	38 322
<u>Private clients, incl:</u>	<u>22 167</u>	<u>20 385</u>
Water supply service	12 379	11 405
Waste water disposal service	9 788	8 980
<u>Corporate clients, incl:</u>	<u>17 335</u>	<u>16 148</u>
Water supply service	9 630	8 864
Waste water disposal service	7 705	7 284
<u>Outside service area clients, incl:</u>	<u>1 687</u>	<u>1 130</u>
Water supply service	138	98
Waste water disposal service	1 549	1 031
<u>Overpollution fee</u>	<u>884</u>	<u>659</u>
Stormwater treatment and disposal service	2 950	2 392
Fire hydrants service	172	151
Other works and services	816	571
Total revenue	46 011	41 436

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

NOTE 18. STAFF COSTS

for the year ended 31 December

	2008	2007
Salaries and wages	-4 239	-3 686
Social security and unemployment insurance taxation	-1 412	-1 227
Staff costs total (Note 19)	-5 651	-4 913
Number of employees at the end of reporting period	327	312

Initsialiseeritud ainult identifitseerimiseks
 Initialed for the purpose of identification only
 Initsiaalid/initials M. M
 Kuupäev/date 19.03.09
 PricewaterhouseCoopers, Tallinn

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

(thousand EUR)

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	-691	-671
Chemicals	-1 460	-1 341
Electricity	-1 902	-1 686
Pollution tax	-1 087	397
Staff costs (Note 18)	-4 059	-3 299
Development	-2	-6
Depreciation and amortization (Note 9)	-5 246	-4 653
Transport	-1 259	-1 155
Other costs of goods sold	-1 727	-1 434
Total cost of goods sold	-17 432	-13 848
Marketing expenses		
Staff costs (Note 18)	-346	-390
Depreciation and amortization (Note 9)	-324	-227
Other marketing expenses	-117	-248
Total cost of marketing expenses	-787	-866
General administration expenses		
Staff costs (Note 18)	-1 246	-1 224
Depreciation and amortization (Note 9)	-161	-184
Other general administration expenses	-2 079	-2 225
Total cost of general administration expenses	-3 486	-3 633

NOTE 20. OTHER INCOME / EXPENSES

	for the year ended 31 December	
	2008	2007
Profit from connection fees (Note 24A)	283	515
Profit from government grant (Note 24A)	1 501	396
Other income / expenses (-)	-184	118
Total other income / expenses	1 601	1 029

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

AS TALLINNA VESI

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

(thousand EUR)

NOTE 21. FINANCE INCOME AND EXPENSES

	for the year ended 31 December	
	2008	2007
Interest income	997	694
Interest expense	-3 655	-3 420
Other finance expenses	-103	-101
Total finance income / expenses	-2 761	-2 827

NOTE 22. DIVIDENDS

	for the year ended 31 December	
	2008	2007
Dividends declared during the period	15 915	12 527
Dividends paid during the period	15 915	12 527
Income tax on dividends paid	-4 231	-3 533
Income tax accounted for	-4 231	-3 533
<i>Paid-up dividends per shares:</i>		
Dividends per A-share (in kroons)	0,80	0,63
Dividends per B-share (in kroons)	639	639

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)	18 915	17 757
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)	0,95	0,89
Earnings per B share (in kroons)	639	639

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 EUR)

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)	13 690	11 021
Increase in prepayments for pipelines (Note 15 and 24B)	-1 424	589
Change in accounts receivable from pipelines (Note 24B)	3 724	-5 101
Proceeds from connection fees	15 990	6 509
Acquisition cost of pipelines taken into use (Note 9 and 20)	-11 906	-10 110

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 -1 784 thousand euros (2007: -911 thousand euros) (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	1 674	-2 757
<u>Adjustments:</u>		
Change in cash and cash equivalents	3 288	-4 537
Movements between non-current and current assets	272	141
Sales of non-current assets held for sale	0	-15
Change in accrued interests	-53	19
Change in accounts receivable from pipelines (Note 24A)	-3 724	5 101
Total change in current assets	1 456	-2 049
Current liabilities		
Change in balance sheet	-439	2 951
<u>Adjustments:</u>		
Change in non-current borrowings	-2 599	-2 599
Change in trade payables – capital expenditures (Note 24C)	1 671	-15
Change in prepayments for the sale of property, plant and equipment, and deposits	0	230
Change in prepayments for pipelines (Note 15 and 24A)	1 424	-588
Total change in current liabilities	58	-21

Intellatseeritud ainult identifitseerimiseks
 Initialed for the purpose of identification only
 Initsiaalid/innits: M. M
 Kuupäev/date: 19. 03. 09
 PricewaterhouseCoopers, Tallinn

AS TALLINNA VESI

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

(thousand EUR)

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)	-19 573	-18 276
<i>Adjustments:</i>		
Change in trade payables – capital expenditures (Note 24B)	-1 671	15
Total acquisition of property, plant and equipment and intangible assets	-21 245	-18 261

NOTE 25. OPERATING LEASE

Leased assets

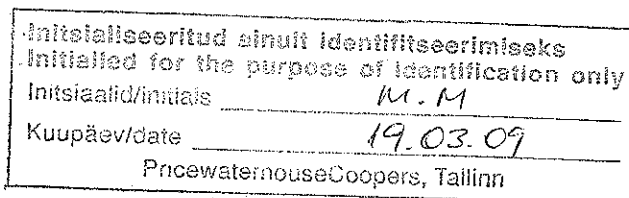
for the year ended 31 December

	2008	2007
Total operating lease expenses for computers and vehicles	509	465

Following period operating lease payments from the non-cancellable contracts are as follows:

	as of 31 December	
Less than 1 year	469	444
1-5 years	512	579
Total minimum lease payments	981	1 023

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



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

(thousand EUR)

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 movable property in favour of EBRD to the value of 120 000 thousand euros; the book value of the current assets pledged is 7 278 thousand euros (31.12. 2007: 12 275 thousand euros) and the residual value of the property, plant and equipment is 35 016 thousand euros (31.12. 2007: 35 564 thousand euros). The total book value of pledged assets is 42 294 thousand euros (31.12.2007: 47 839 thousand euros).
- 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 18 750 thousand euros, total 37 500 thousand euros; the residual value of the property, plant and equipment pledged is 29 961 thousand euros (31.12. 2007: 29 474 thousand euros).
- 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 37 500 thousand euros, the residual value of the property, plant and equipment pledged is 29 961 thousand euros (31.12. 2007: 29 474 thousand euros).
- 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.

Initialiseeritud ainult identifitseerimiseks
Initialed for the purpose of identification only
Initsiaalid/initials M. M
Kuupäev/date 19.03.09
PricewaterhouseCoopers, Tallinn

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

(thousand EUR)

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	1 594	1 912
Accrued income (Note 7)	0	5 159
Accounts payable - short-term trade and other payables (Note 11)	254	261

for the year ended 31 December

Transactions with the related parties	2008	2007
Sales of services	3 122	2 543
Compensations received from the local governments for constructing new pipelines (Note 13)	10 182	7 602
Purchase of administrative and consulting services	1 316	1 431

for the year ended 31 December

	2008	2007
Management Board fees excluding social tax	147	135
Supervisory Board fees excluding social tax	32	37

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.

Initsiaalliseeritud ainult identifitseerimiseks	
Initialed for the purpose of identification only	
Initsiaalid/initials	M. M
Kuupäev/date	19.03.09
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		<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>
Robert John Gallienne	Chairman of the Supervisory Board		<u>26.3.2009</u>
Kevin Starling	Member of the Supervisory Board		<u>26.3.2009</u>
Matti Hyyrynen	Member of the Supervisory Board		<u>26.3.2009</u>
Steven Richard Fraser	Member of the Supervisory Board		<u>26.3.2009</u>
Mart Mägi	Member of the Supervisory Board		<u>26.03.09</u>
Rein Ratas	Member of the Supervisory Board		<u>26.03.09</u>
Elmar Sepp	Member of the Supervisory Board		<u>26.03.09</u>
Deniss Borodits	Member of the Supervisory Board		<u>26.03.09</u>
Valdur Laid	Member of the Supervisory Board		<u>26.03.09</u>

AS PricewaterhouseCoopers
Pärnu mnt. 15
10141 Tallinn
Estonia

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

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS 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.

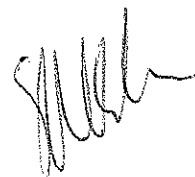
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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.*