AS TALLINNA VESI

Consolidated Annual report
for the financial year ended
31 December 2012
(Translation of the Estonian original)

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

Beginning of the financial year	1 January 2012
End of the financial year	31 December 2012
Name of the Company	AS TALLINNA VESI
Legal form of the Company	Public limited company
Commercial register number	10257326
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Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditors	AS PricewaterhouseCoopers
Documents attached to the Annual Report	Independent auditor's report

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MANAGEMENT REPORT

CHAIRMAN'S STATEMENT

In 2012, AS Tallinna Vesi has continued to deliver a standard of product and service that is without comparison across the Baltic region. Once again we have managed to improve our performance across all business areas. These successes demonstrate that our sharp focus on operational performance continues to deliver significant benefits for the citizens of Tallinn and the wider environment.

Against this background of continuous improvement in our services it is very disappointing to find that the privatisation contract, which has helped to deliver these improvements, continues to be attacked by the Competition Authority, and as such the company finds itself having its contract broken as the Competition Authority has refused to grant the contractually agreed tariff increases for the past two years. In spite of our best efforts to engage in a professional dialogue with the Competition Authority it refuses to do so, and instead has increased its criticism of the company and its shareholders by alleging that the privatisation contract signed in 2001 is "illegal" and always was "illegal". These statements have been made without any supporting evidence.

Although our dispute with the Competition Authority continues into 2013 there were a number of positive legal developments for the company. The most important of these was the May 2012 decision of the District Court when it ruled that the tariff mechanism that was the key part of our privatisation is a public law contract. This means that unless the Competition Authority is able to prove that the privatisation was manifestly against the public interest then it will have to uphold the contract or, if not, then the state of Estonia will be liable for compensation. Decisions such as this one clearly demonstrate the professionalism and integrity of the Estonian court system.

Operations performance – Continuous improvement and highest ever standards

We have continued to ensure we meet or exceed the services contract we signed with the City of Tallinn. This services contract requires us to maintain a high standard of service to our customers across a range of over 90 levels of service, ensuring that we deliver a service to our customers that is second to none.

During 2012 we have continuously improved our performance across all areas of the water and wastewater value chain, achieving the highest standards ever for wastewater treatment, and the performance of both our water network and wastewater network. After setting new high standards in 2011 we are extremely proud to have surpassed these levels in 2012, a clear demonstration of the success of our strategy of continuous improvement.

Excellent customer service - highest ever service ranking

This year our customer satisfaction rating increased to a TRI*M index all time high of 85. This is a huge improvement from the rating of 72 points at the end of 2011. We are now starting to see the benefits of our improved operational performance in our customer satisfaction results. Over the last few years we have made significant reductions in the number of interruptions to supply and other service related problems, for example since 2010 we have reduced the number of sewer blockages from 1 193 to 749. In addition, we have always tried to ensure our customers know in advance about our work when it would impact their daily lives. During the year over 90% of customers that were being impacted by our activities were notified in advance. In 2012, these proactive improvements were well recognised in the comments made by our customers in the results of our customer satisfaction survey.

Privatisation contract dispute

Throughout 2012 we have been unable to bring our dispute with the Competition Authority to a professional conclusion. As a consequence our tariffs remain at 2010 levels, and we still stand accused of acting illegally in Estonia. However, in spite of the fact that our legal disputes has not ended, the year saw a number of positive developments.

In the first quarter of 2012 the courts ruled that the Competition Authority could not unilaterally impose a 29% tariff cut on the company. The company sought an injunction from the courts to stop the Competition Authority's precept taking effect until all of our court cases have been concluded and the courts granted this injunction.

In May 2012, the Estonian Courts ruled that the tariff agreement from the privatisation contract was a public law contract. This is a landmark decision as it means that unless the Competition Authority is able to prove that the privatisation contract is manifestly against the public interest then the contract must be honoured or if not the state of Estonia will have to pay compensation. The Competition Authority had previously tried to avoid any discussion of the privatisation contract by claiming it was a private arrangement between the City of Tallinn and AS Tallinna Vesi and as such should be treated as a civil law contract.

Our only disappointment was that the courts upheld the Competition Authority's request for closed court proceedings. We find it strange that an organisation that purports to represent the interests of the public should not believe its methods should be subject to public scrutiny. However, as we believe in absolute transparency in all our communications we have applied to the courts to have the court proceedings re-opened.

In addition, we continue with our complaint to the EU Commission. Throughout the year we have engaged in thorough and very professional dialogue with the EU Commission to help it fully understand all aspects of our case.

Our people and teams

The people in ASTV are key to the delivery of the highest levels of service to our customers and we would like to thank them for their dedication and continued hard work during the year. Against the backdrop of continued negative media coverage supplemented by the over-politicisation of our company, our staff have once again, delivered world class performance.

We believe that a committed, capable and motivated workforce is central to delivering our strategy and we remain fully focused on maintaining high levels of employee development and engagement. We strive to give our staff the opportunity to develop within the company, which can be seen in the fact that three of our five Management Board members have been promoted from within AS Tallinna Vesi.

The safety and well-being of our employees is paramount and we believe that everybody in AS Tallinna Vesi, both collectively and individually, has a part to play in maintaining a safe working environment. In 2012, our health and safety performance stood comparison with the performance of the best in class, and we will remain vigilant in our efforts to achieve the same very high standards in 2013.

Responsible company

As a company we are responsible to our shareholders, customers and other stakeholders for the performance and long-term success of our company. We believe that the way in which we operate already reflects the highest standards of corporate governance. In 2012, our approach to doing business was reflected in the following nominations and awards:

- Responsible Company - Gold award of the Responsible Business Forum in Estonia
- Environmentally friendly Office - the Ministry of Environment
- European Union Commission's EMAS 2012 Award - nomination for environmental performance
- BMA awards - Nasdaq OMX - Best IR 2nd in the Baltics

The community in which we operate is of great importance to our business and we have continued our investment in Tallinn through sponsorship and in terms of employee time through volunteering. Our main partners in 2013 were as follows:

- Ristiku Elementary School
- Õunakese Kindergarten
- Estonian Disabled Sports Union
- PÖFF in Tallinn (Dark Nights Film Festival)

Stable Revenues, returns in accordance with other privatised utilities

We are a financially robust and resilient business. Our turnover from our main business activity - sales of water and wastewater - increased by 3.1% to 47.9 million euros and our operating profit from these activities increased by 5.2% to 26.7 million euros. The real return (net of inflation) on invested capital in our main business was 6.6% in 2012 and 6.9% over the five year period from 2007 to 2011, which is in accordance with the rates of return made by other privatised water utilities.

In 2012, we improved the long term financial stability of the company by extending our 37.5m Euro loan facility with Nordea bank, extending the maturity on this loan from November 2013 to 2018. By securing this re-financing early we have removed capital market risk by securing our capital structure for a further two years.

Outlook

In the current political and regulatory environment the outlook for the company is very uncertain. Given that the Estonian authorities are unwilling to enter into any meaningful discussions over the privatisation contracts, it appears that the company will be engaged in a long court process, which could last a number of years. It is apparent that the significant improvements in service count for very little within the new system of regulation. I would, however, like to inform all our stakeholders that we are committed to delivering the highest levels of service to all our direct customers and service users. This ongoing dispute severely limits our growth opportunities and as such, in 2013, our primary focus will be on improving performance and efficiency in our main services area in Tallinn. By continuing our focussed approach to operational improvements and developing a repeatable business model we believe we will be ideally placed to expand across the region, once our current legal dispute is behind us.

Finally, I would like to thank my colleagues in AS Tallinna Vesi and Watercom OÜ, and all our suppliers and business partners for all their expertise, energy and support in serving our customers in this difficult time. It is because of all your efforts that we are, once again, able to report a level of operating and service performance that is second to none.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

RESULTS OF OPERATIONS - FOR THE YEAR 2012

Return on invested capital

The real return on capital invested at the time of privatisation was 6.6% in 2012, which is slightly higher than the 6.2% average real return on capital invested over the contract period starting from 2001, as the privatisation contract designed the returns to be lower in early years of contract. Furthermore, in the interests of an open and professional dialogue to demonstrate that its return on invested capital has not been excessive, the international economic consulting group Oxera has independently verified the calculation of the average real return on capital invested at the time of privatisation and Oxera's report is available on AS Tallinna Vesi's webpage.

Both, the average and the annual return on capital invested are in accordance with the returns allowed by Ofwat, the UK regulator over this same period[1], and the return permitted by the Dutch Energy regulator Energiekamer, which allowed a real rate of return of 6.0% in its regulatory determination of September 2010.

Other main economic indicators

million euros	2012	2011	2010	2009	2008
Sales	52,9	51,2	49,7	49,4	46,0
Gross profit	32,6	30,3	29,0	31,2	28,6
Operating profit	28,8	28,9	27,5	29,5	25,9
Operating profit - main business	26,7	25,4	24,2	26,9	24,1
Profit before taxes	27,1	25,8	24,9	25,6	23,1
Net profit	22,6	21,5	16,4	21,7	18,9
Gross profit margin %	61,6	59,2	58,4	63,2	62,1
Operating profit margin %	54,4	56,4	55,3	59,8	56,3
Profit before taxes margin %	51,1	50,3	50,1	51,9	50,3
Net profit margin %	42,7	42,0	33,0	44,0	41,1
ROA %	11,3	11,2	8,9	12,3	11,6
Debt to total capital employed	57,8	58,9	60,1	49,7	49,9
ROE%	26,7	27,3	22,4	24,4	23,1
Current ratio	4,3	4,1	2,1	4,2	1,8
Number of full-time equivalent employees	301	299	305	322	317
Share capital	12,0	12,0	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

[1] http://www.ofwat.gov.uk/regulating/reporting/rpt_fpr_2007-08.pdf, page 15

Statement of comprehensive income

Sales

In 2012 the Group's total sales increased year on year by 3.3% to 52.9 mln euros. Sales in the main operating activity principally comprise of sales of water and treatment of wastewater to domestic and commercial customers within and outside of the service area, and fees received from the City of Tallinn for operating and maintaining the storm water system. There is no considerable seasonality in the Group's operation.

Sales of water and wastewater services were 47.9 mln euros, a 3.1% increase compared to 2011, resulting from the rise in sales volumes as described below.

Within the service area, sales to residential customers increased by 0.3% to 23.8 mln euros. Sales to commercial customers increased by 2.9% to 18.8 mln euros. Sales to customers outside of the service area increased by 19.4% to 4.5 mln euros compared to 2011. Over pollution fees received were 0.83 mln euros, a 7.6% increase compared to 2011.

As result of same tariffs billable in 2012 compared to 2011 the sales volumes reflect the same variances in main services area as prescribed above.

The volumes sold to residential customers stayed broadly flat year on year. The volumes sold to commercial customers inside the service area increased by 2.7% compared to the respective period in 2011, mainly due to improvement in industrial sector.

Volumes sold to outside service area were 30.2% higher than in 2011. The main factor in this increase was higher storm water and sewage volumes in 2012 compared to 2011, resulting in sales increase of 19.4% year on year.

The sales from operation and maintenance of storm water and fire-hydrant system increased by 9.6% to 3.9 mln euros in 2012 compared to last year. 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 20.3 mln euros in 2012, a decrease of 0.59 mln euros or 2.9% from the equivalent period in 2011. The cost decrease is mainly the result of savings from switching from outsourcing to insourcing balanced by increased costs due to higher staff, electricity and chemicals costs as explained below.

Total variable costs decreased by 0.10 mln euros or 1.5% year on year in combination of increase in regulated prices and tax rates and movements in treatment volumes that affected the variable costs together with the following additional factors:

- Water abstraction charges increased only by 0.04 mln euros or 4.5% to 0.94 mln euros in 2012, despite of 10% increase in tax rates due to positive impact from reduced leakage ratio.
- Total chemical costs increased by 0.20 mln euros or 13.8% to 1.6 mln euros. Chemicals costs increased due to an increase in chemicals price worth 0.13 mln euros (0.07 mln euros coming from methanol price increase by 10%) and due to higher volume impact worth 0.07 mln euros.

- Electricity costs in total increased by 0.72 mln euros or 24.3% in 2012 compared to 2011. Electricity costs were the most impacted by considerable increase in electricity prices, which on average have increased 13.8% with an adverse effect of 0.45 mln euros, in addition the Group was affected by the adverse impact from the increased treated storm water volumes.
- Pollution tax decreased by 1.1 mln euros or 75.4% in 2012. The pollution tax cost was largely impacted by the fact that the Group released a one-off provision related to storm water outlet not fully in control of the Group. Significant improvements in nitrogen removal process also balance the pollution tax increase due to the 15% increase in tax rates and 12.2% increase in volumes.

  The improved nitrogen removal is the result of the environmental project that was implemented to mitigate the nitrogen treatment and tax risks discussed throughout the 2010 and 2011. The project was completed by the Group in second half of 2011 when we finished the construction and implemented the additional stage in sewage treatment process.

To mitigate the external price risk of maintenance services the Group has switched from outsourcing to in-sourcing in various areas in the 3rd quarter of 2012. Total fixed cost of goods sold in the main operating activity decreased by 0.49 mln euros or 3.4% year on year due to said switch.

Due to the start-up of services the Group increased its headcount resulting in 0.36 mln euros or 8.2% increase in salary costs due to overall increase in headcount, which was offset by cost savings for maintenance services and transportation, worth 0.54 mln euros.

As a result of all of the above the Group's gross profit for 2012 was 32.6 mln euros, which is an increase of 2.3 mln euros, or 7.5%, compared to the gross profit of 30.3 mln euros for the 2011.

Other Operating Costs

Marketing expenses increased by 0.02 mln euros or 3.1% to 0.77 mln euros during 2012 compared to the corresponding period in 2011.

In 2012 the General administration expenses increased by 0.45 mln euros or 10.4% year on year to 4.7 mln euros, mainly due to the increase in legal consultancies acquired in the process of tariff dispute.

Other income/expenses

Other net income decreased by 1.9 mln euros or 53.1% to a net income of 1.7 mln euros, compared to 3.6 mln euros net income in 2011. The considerable variances are not related to the main operating performance of the Group.

In previous years the majority of the income in Other net income/expenses has been related to constructions and government grants. As the major programs were almost entirely completed by end of 2011, the income from this activity have considerably dropped. Profits from constructions and government grants recorded in 2012 were 2.0 mln euros compared to a net income of 3.5 mln euros in 2011.

The rest of the other income/expenses totalled an expense of 0.35 mln euros in 2012 compared to an income of 0.14 mln euros in 2011 that was mainly related to an increase in doubtful debts.

As a result the Group's operating profit from main services for 2012 totalled 26.7 mln euros compared to 25.4 mln euros in 2011. In total the Group's operating profit for all activities for 2012 was 28.8 mln euros, a decrease of 0.12 mln euros compared to an operating profit of 28.9 mln euros achieved in 2011. Year on year the operating profit for 2012 has decreased by 0.4%.

Financial expenses

Net Financial expenses were 1.7 mln euros in 2012, which is a decrease of 1.4 mln euros in expenses compared to 3.1 mln euros net expenses in 2011. In 2011 the financial costs were mainly impacted from the non-cash revaluation of the fair value of swap agreements, in 2011 the revaluation impact was negative by 2.2 mln euros and in 2012 the revaluation impact was negative by 0.09 mln euros.

The standalone swap agreements have been signed to mitigate the majority of the long term floating interest risk, the interest swap agreements are signed for 75 mln euros and 20 mln euros is thereby still with floating interest rate. At the of the financial year the estimated fair value of the swap contracts is negative, totalling 4.6 mln euros.

Effective interest rate (incl. swaps interests) in 2012 was 3.32%, amounting in the interest costs of 3.2 mln euros, compared respectively to 2.99% and 2.9 mln euros in 2011. This reflects mainly the adverse impact from swap agreements.

Profit Before and After Tax

The Group's profit before taxes for 2012 was 27.1 mln euros, which is 1.3 mln euros higher than the profit before taxes of 25.8 mln euros for 2011, resulting from the movements in fair value of financial instruments as described above.

The Group's profit after taxes for the 2012 was 22.6 mln euros, which is 1.1 mln euros higher than the profit after taxes of 21.5 mln euros for 2011.

Statement of financial position

In the twelve months of 2012 the Group invested 11.3 mln euros into fixed assets. As of 31 December 2012 non-current assets amounted to 158.1 mln euros.

Current assets increased by 7.7 mln euros to 42.6 mln euros in the year mainly due to increased cash at bank. In the twelve months of 2012, cash at bank increased by 9.2 mln euros.

Current liabilities increased by 1.4 mln euros to 9.9 mln euros in the year due to increased customer prepayments and fair value of financial instruments.

The Group has a Total debt/Total assets level as expected of 57.8%, in range of 55%-65%, reflecting the year-end equity profile. This level is consistent with the same period in 2011 when the total debt/total assets ratio was 58.9%.

Long-term liabilities stood at 106.2 mln euros at the end of December 2012, consisting mainly of the outstanding balance of three long-term bank loans totalling 95 mln euros. The first repayment of loans or refinancing should take place at the end of 2014. The weighted average interest margin for the total loan facility is 0.96%. The rest of long term liabilities reflect mainly the accounting record of deferred income from connection fees.

In the 4th quarter of 2011 the Group disclosed an exceptional contingent liability, which could cause an outflow of economic benefits of up to 36.0 mln euros, as per note 3 to the accounts. Considering that the court proceedings are continuously on-going and no conclusion have been made to-date, the Management has not changed the evaluation of the contingent liability.

Cash flow

During the twelve months of 2012, the Group generated 31.7 mln euros of cash flows from operating activities, a decrease of 1.5 mln euros compared to the corresponding period in 2011. 2012 operating cash flows were below 2011 cash flows mainly due to one-off large payments of overdue debt in 1st half of 2011. Underlying operating profit still continues to be the main contributor to operating cash flows.

In the twelve months of 2012 net cash flows from investing activities resulted in a cash inflow of 2.0 mln euros, an increase of 10.5 mln euros compared to an outflow of 8.4 mln euros in the twelve months of 2011. This is mainly due to lower capex spent on network extensions as this program of investments was largely completed by the end of 2011.

In the twelve months of 2012 the cash outflows related to the fixed asset investments were 10.0 mln euros compared to 18.5 mln euros spent in the same period of 2011, a decrease of 8.5 mln euros. The compensations received for the construction of pipelines were 11.2 mln euros in the twelve months of 2012, a decrease of 0.09 mln euros compared to same period in 2011. In 2012 the Group also gave the 0.77 mln euros loan to AS Maardu Vesi according to the Operating agreement signed in 2008. In 2011 the loan granted to AS Maardu Vesi amounted to 3.2 mln EUR.

In the twelve months of 2012, cash outflow from financing amounted to 24.6 mln euros due to dividends paid to shareholders, dividend tax payment and interest payment which is 1.3 mln euros more than in the same period of 2011.

As a result of all of the above factors, the total cash inflow in the twelve months of 2012 was 9.2 mln euros compared to a cash inflow of 1.5 mln euros in 2011. Cash and cash equivalents stood at 23.9 mln euros as of 31 December 2012, which is 9.2 mln euros higher than in the end of 2011.

Employees

At the end of 2012, the total number of employees was 313 compared to 311 at the end of 2011. The full time equivalent (FTE) was respectively 301 in 2012 compared to the 299 in 2011. The management continues to work actively for the efficiencies in processes to balance the increase in individual salaries and cost pressure from the market with more productive company structure.

The total salary cost was 6.9 mln euros, including 0.37 mln euros paid to the Management and Supervisory Board members. The off balance sheet potential salary liability would be up to 0.03 mln euros if the Supervisory Board would want to replace the Management Board member.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

Corporate structure

At the end of the year, as of 31 December 2012, the Group consisted of 2 companies. The subsidiary Watercom OÜ is wholly owned by Company and consolidated to the results of the Company.

Dividends and share performance

Based on the results of the 2011 financial year, the Company paid 16,800,600 euros of dividends. Of this, 600 euros was paid to the owner of the B-share and 16,800,000 euros, i.e. 0.84 euros per share to the owners of the A-shares. The dividends were paid out on 15 June 2012, based on the list of shareholders, which was fixed on 05 June 2012.

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

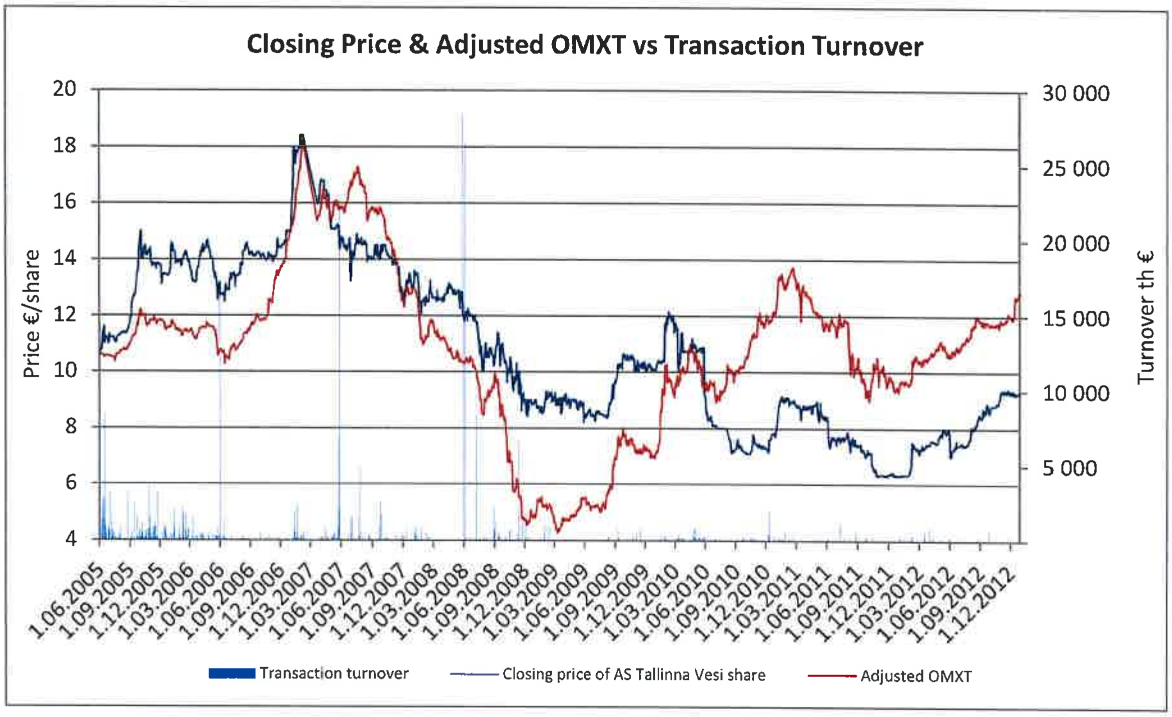
As of 31 December 2012, the shareholders of AS Tallinna Vesi, with a direct holding over 5%, were:

United Utilities (Tallinn) BV	35.3%
City of Tallinn	34.7%

Parvus Asset Management owned in total 2.53% of the shares of the Company as per Company's best information as of 31 December 2012. As Parvus has reduced their holding in the Company pension funds have continued to increase their portfolios during 2012, owning 1.98% of the total shares compared to 0.53% at the end of 2011.

At the end of the year, 31 December 2012, the closing price of the AS Tallinna Vesi share was 9.20 euros, which is a 46.26% increase compared to the closing price of 6.29 euros at the beginning of the year. During the same period the OMX Tallinn index rose by 38.22%. Throughout the year the Company's share price was mainly impacted by the on-going contractual debate and interim court decisions.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)



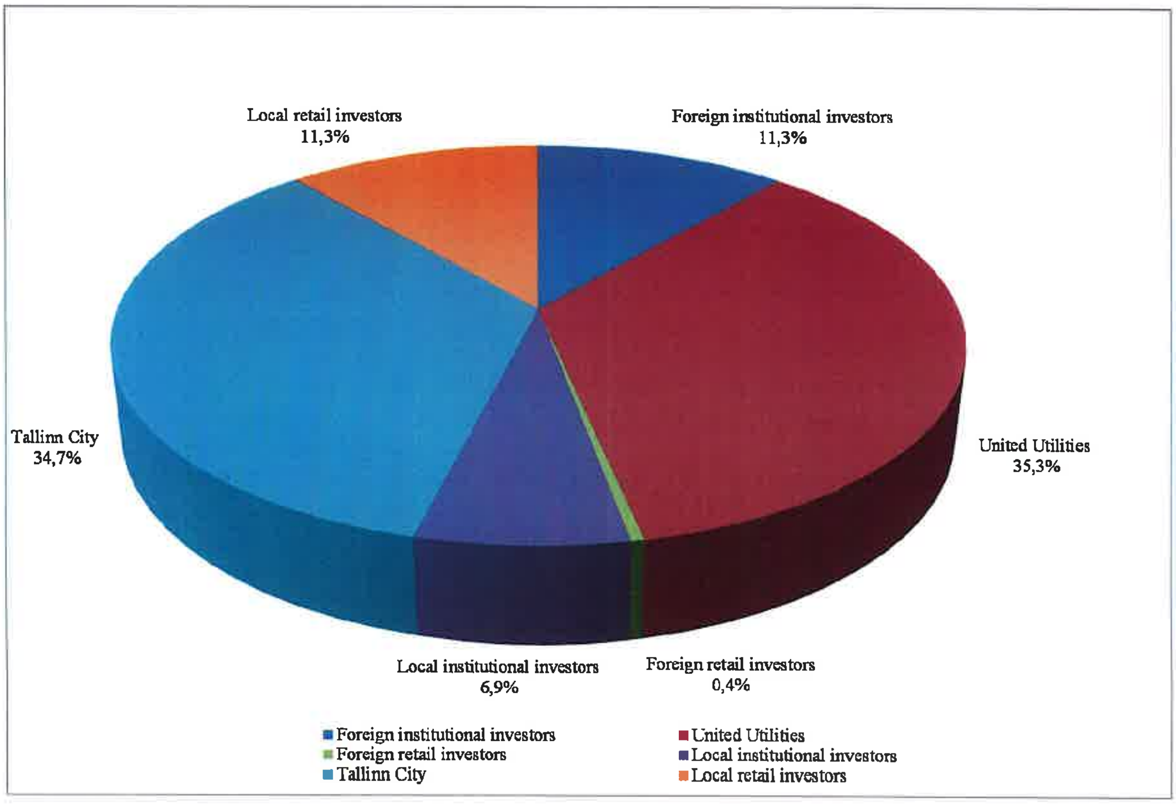
Share price statistics

euros	2012	2011	2010	2009	2008
Share price, open	6,30	7,90	10,18	9,00	13,25
Share price, at the end of the year	9,20	6,29	7,89	10,00	8,99
Share price, low	6,30	6,29	7,00	8,20	8,41
Share price, high	9,40	9,29	12,25	10,69	13,60
Share price, average	7,91	7,76	8,95	9,28	11,38
Traded volume	2 375 967	1 927 386	2 879 132	1 547 108	7 958 820
Turnover, million	18,6	14,9	25,6	14,5	92,9
Capitalisation, million	184,0	125,8	157,8	200,0	179,8
Earnings per share	1,13	1,08	0,82	1,09	0,95
Dividend per share	n/a	0,84	0,80	1,60	0,73
Dividend / net profit	n/a	78%	98%	147%	78%
P/E	8,14	5,82	9,62	9,20	9,50
P/BV	2,2	1,6	2,2	2,2	2,2

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 9.25 euros

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

Shareholders by type as of 31 December 2012



Distribution of share capital by size of share ownership as of 31 December 2012

	Shareholders	Shareholders %	No. of shares	% of share capital
1 - 100	803	26,1%	41 913	0,2%
101 - 200	585	19,0%	90 364	0,5%
201 - 300	334	10,9%	87 481	0,4%
301 - 500	373	12,1%	155 901	0,8%
501 - 1 000	399	13,0%	302 734	1,5%
1 001 - 5 000	432	14,0%	927 900	4,6%
5 001 - 10 000	73	2,4%	536 970	2,7%
10 001 - 50 000	50	1,6%	1 049 594	5,2%
50 000 +	29	0,9%	16 807 143	84,0%
TOTAL	**3 078**	**100,0%**	**20 000 000**	**100,0%**

Key contractual events

Contractual tariff debate

Tariffs are still frozen on the 2010 level despite of the fact that on 9th November 2010 the Company submitted its tariff application for a 3.5% tariff increase from 1st January 2011, which was contractually agreed in the privatisation contract to the Competition Authority (CA), the new price checker. The tariff application is fully in accordance with the law and the best practice regulation for privatized utilities, such as that favoured by Ofwat in the UK and recommended by the World Bank for privatized utilities.

On 2nd May 2011 the CA informed the Company about the rejection of the tariff application. The CA completely ignored the privatization contract and did not perform any analysis of the contractual and financial performance of the Company during the period after privatization. The CA is arguing that the Company's profitability is too high using their own recommendatory and unverified methodology.

The Company has calculated that the average real return on invested capital from 2001 till 2012 has been 6.2% and the Company has also had these returns independently verified by the international economics consulting company, Oxera. The annual return on capital invested is in accordance with the returns allowed by Ofwat the UK regulator over this same period[2], and the return permitted by the Dutch Energy regulator Energiekamer, which allowed a real rate of return of 6% in its regulatory determination of September 2010.

The Company and its investors cannot accept such a unilateral breach of the privatization terms and contract by Estonian Authorities and the Company submitted an appeal to the court on 2nd June 2011.

Regrettably the CA decided not to wait for the court ruling regarding the legality of the privatization contract and on 10th October 2011 the CA sent a prescription to the Company asking it to reduce its current tariffs by 29%. The Company lodged another claim against the prescription and asked for the temporary injunction from the Estonian court. The court granted the temporary injunction for the period of court proceedings on 6 February 2012 and this decision was confirmed by next level court on 2nd of March. The ruling cannot be appealed any further and due legal process must now take its course.

On 6th of February the Court joined both the current (2010) tariffs case and the case regarding the rejection of AS Tallinna Vesi's 2011 tariff application. Thus, the prescription has been halted until both disputes have been resolved.

On 31st May 2012 District Court issued a ruling, deeming the tariffs part of the Services Agreement signed in 2001 as part of AS Tallinna Vesi's privatization package of agreements to be an administrative (public law) agreement. The District court has thereby ruled in favour of AS Tallinna Vesi, overturning the Competition Authority's claim that the tariff mechanism specified in the Services Agreement is allegedly a civil law agreement that the Company cannot rely on in an administrative court.

On 13th June 2012 the Competition Authority appealed the Tallinn District Court's ruling to the Supreme Court. In their appeal, the Competition Authority has stated that in its opinion AS

[1] http://www.ofwat.gov.uk/regulating/reporting/rpt_fpr_2007-08.pdf ,page 15

Tallinna Vesi's international privatisation, tariff criteria and the supporting contracts agreed at privatisation in 2001 were the private business activity of the City of Tallinn, and therefore do not warrant any protection under Estonian public law.

On 18th September 2012 the Supreme Court rejected the CA's appeal, meaning that the District Court's decision was upheld and the tariff mechanism is now deemed to be a public law contract. It is now for the Administrative Court to determine whether or not this public law contract should be binding on the CA. AS Tallinna Vesi is firmly of the belief that the terms and conditions of the international privatisation contract that has been deemed a public law contract should not be broken simply by transferring the duties of the regulator from one state institution (the City of Tallinn) to a different state institution (the Competition Authority).

AS Tallinna Vesi was privatised in 2001 with the full support and knowledge of the Estonian national government, with written confirmations from the Prime Minister, the Minister of Finance, and the Competition Authority itself regarding the key terms of the agreements, and utilising the expertise and guidance of the European Bank for Reconstruction and Development (EBRD). In addition to approving the framework of the privatisation the State of Estonia directly benefited as the sovereign guarantee it had been required to provide to EBRD to secure the then municipal AS Tallinna Vesi's loans was passed to the Strategic Investor on privatisation.

Complaint to European Commission

In parallel, on 10th December 2010 AS Tallinna Vesi lodged a complaint to the European Commission regarding certain measures adopted by the Estonian authorities. The Company believes these measures unilaterally alter the terms of AS Tallinna Vesi's privatization regime, and without any objective justification, any form of meaningful prior discussion, or willingness to engage in dialogue. Therefore they violate EU rules on the freedom of establishment and the free movement of capital (articles 49 and 63 TFEU). The process is on-going.

Disclosure of relevant papers and perspectives

The Company has published its tariff application and all relevant correspondence with the CA on its website (http://www.tallinnavesi.ee/?op=body&id=728) and to the Tallinn Stock Exchange and will keep its investors informed of all future developments regarding the further key developments regarding the processing of the tariff application.

In opposite to the Company the CA has requested the Court procedures to be closed. Based on misleading information submitted by the CA the Court approved the CA's request. AS Tallinna Vesi has reapplied for open proceedings.

Still, at this point in time the Company is unable to say what is going to happen to the tariffs before Court judgments and what would be the next steps by the European Commission. The outcome and lengths of the Court proceedings is outside the control of the Company.

CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RECOMMENDATIONS REPORT

Corporate governance constitutes a system of principles for the management of a company. Generally those principles are regulated by law, the Articles of Association and the internal rules of a company. Since 1st January 2006, the companies listed on the Tallinn Stock Exchange are recommended to follow the "Corporate Governance Recommendations" issued by the Financial Supervision Authority. Throughout 2012 the management of AS Tallinna Vesi has followed those regulations and principles.

AS Tallinna Vesi is committed to high standards of corporate governance for which the Management Board and Supervisory Board are accountable to the shareholders. AS Tallinna Vesi endeavours to be transparent in its ways of operating, corporate disclosures and relations with its shareholders. AS Tallinna Vesi has been recognized several times for this – in 2009, the NASDAQ OMX Baltic awarded AS Tallinna Vesi for the Best Annual Report in NASDAQ OMX Baltic and for the Best Investor Relations in NASDAQ OMX Tallinn. In 2010 the NASDAQ OMX Baltic awarded AS Tallinna Vesi for the Best Investor Relations in NASDAQ OMX Tallinn and the Baltic Corporate Governance Institute awarded AS Tallinna Vesi for the Best Corporate Governance in Estonia. In 2011 the Company was awarded the Best Investor relations on the Tallinn Stock Exchange and second place on all the Baltic Stock Exchanges by NASDAQ OMX. In addition the Company's investors' web-page was highlighted amongst the equal top five and the Annual Accounts were awarded the second place on all the Baltic Stock Exchanges. In 2012 the Company was recognized for eminent investor relations, being awarded with second place on all the Baltic Stock Exchanges by Nasdaq OMX for the Best Investor relations. In addition the Company was awarded 2nd place for Best Investor Relations Online and Best Annual Report on all the Baltic Stock Exchanges.

Investor Relations and Disclosure of Information

At the beginning of each calendar year, AS Tallinna Vesi discloses the financial calendar, including the disclosure dates of the quarterly and annual financial information and the date of the Annual General Meeting (AGM) of the Shareholders via the Tallinn Stock Exchange. All information disclosed via the Tallinn Stock Exchange is also subsequently disclosed on the AS Tallinna Vesi's website. In addition, AS Tallinna Vesi discloses the following information on its website: AGM notice, useful background information about the agenda and any candidates standing for election, information about identification documents required for attending the general meeting, annual accounts of the previous year, respective auditor's report, any new agenda items and draft resolutions proposed, and questions about existing agenda items, information about corporate governance and information about the Management and Supervisory Board members as well as the total number of voting rights and number of voting rights by share type. In addition, the following procedures are in place: procedure for familiarising oneself with the general meeting documents, procedure for adding items to the agenda and presenting draft resolutions and procedure for inquiring about the company's activities from the Management Board. All respective documents are also available at the headquarters of AS Tallinna Vesi until the day before the date of the General Meeting. Resolutions of the General Meetings are published on the AS Tallinna Vesi's webpage within 7 (seven) days following the date of the General Meeting.

After the general meeting, the following is uploaded to the company's website: resolutions of the general meeting, Management Board presentation, as well as the minutes of the general meeting, which contain questions and answers regarding the topics discussed at the AGM.

No questions were asked regarding the 2012 AGM agenda. One additional agenda item proposal was submitted for the 2012 AGM by a shareholder asking to send a pre-prepared question to the Prime

Minister and Minister of Economic Affairs and Communications of Estonia, asking them how the government is going to safeguard the investments made by local and overseas investors into Tallinna Vesi.

AS Tallinna Vesi has a regular dialogue with its major shareholders and potential investors - presentations are generally made bi-annually and upon request – the timetable of such meetings and the list of presentations are available on the AS Tallinna Vesi's website. To keep AS Tallinna Vesi's shareholders informed, General Meetings of Shareholders are held at least annually to provide the shareholders with the opportunity to ask questions from the Management Board and the Supervisory Board.

The General Meeting of Shareholders

AS Tallinna Vesi 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 AS Tallinna Vesi's highest directing body.

On 22nd May, 2012, AS Tallinna Vesi held an Annual General Meeting (AGM) of its Shareholders to approve the 2011 annual report, distribution of profit via dividends, re-election of Supervisory Board members, as well as to elect auditors and approve sending an enquiry to the Ministry of Economic Affairs and Communications regarding how the ministry plans to ensure investments made by foreign and local investors would be protected given the recent changes in the law significantly changing the conditions of the company's privatisation. The Management Board also made a presentation on the on-going tariffs dispute to update the shareholders.

In accordance with the Commercial Code and the Corporate Governance Recommendations, AS Tallinna Vesi convenes its General Meetings, both AGMs and EGMs by notifying all of its shareholders via the Tallinn Stock Exchange system and by placing an advertisement in one newspaper with Estonian-wide circulation 3 weeks in advance. Changes in the Articles of Association and management of AS Tallinna Vesi and its subsidiary (incl. the election and recalling of the members of the Management Board) are made according to Part VII of the Commercial Code.

The agendas of AGMs and EGMs of AS Tallinna Vesi are pre-approved by the Supervisory Board, who also puts forward proposals for the attention and voting at the General Meeting. The General Meeting agenda items, the Supervisory Board's proposals, with relevant commentaries about the agenda items, procedural instructions for participating at a General Meeting and how and when to propose additional items to the agenda are disclosed within the General Meeting notice.

Specific rights for adding agenda items granted to shareholders whose shareholding represents at least 1/20 of the share capital are explained in the General Meeting notice as well as on AS Tallinna Vesi's website. Voting rights are explained to the shareholders on AS Tallinna Vesi's website as well as at the beginning of each General Meeting.

The chairman of any AGMs and EGMs is an independent person. In 2012, the AGM was chaired by Mr. Raino Paron, who introduced the procedure for conducting the General Meeting, including the procedure for inquiring about the company's activities from the Management Board.

All members of the Management Board, the Chairman of the Supervisory Board and the auditor participated at the AGM in 2012. When Supervisory Board members stand for election at general meetings, the candidates for these positions usually also participate. However, at the 2012 AGM the UU Supervisory Board member candidates as well as independent Supervisory Board member candidates were unable to participate due to prior commitments. One of the shareholders enquired about their absence and the Company would like to reassure that in the future, all Supervisory Board member candidates would use their best endeavours to participate when they stand for election.

AS Tallinna Vesi does not enable the shareholders to participate at the General Meetings via electronic communication tools, as it would be too complicated and expensive to establish reliable solutions to identify the shareholders most of whom are overseas' residents.

No shareholder has shares that grant them a right for specific control. AS Tallinna Vesi is not aware that any shareholders have concluded any voting agreements.

As per the Articles of Association of AS Tallinna Vesi amended on 24th May 2011, the Company has issued one registered preferred share with the nominal value of 60 euros (B-share). The B-share grants the holder the right to participate at General Meetings as well as in the distribution of profits and of the assets remaining upon dissolution of the Company, also other rights provided by law and the Articles of Association of the Company. The B-share grants the holder the preferential right to receive a dividend in an agreed sum of 600 euros. The B-share grants the shareholder 1 (one) vote at the General Meeting (restricted right to vote) when deciding on amending the Articles of Association of the company; increasing and reducing the share capital of the company; issuing convertible bonds; acquisition of treasury shares by the company; deciding on the merger, division, transformation and/or dissolution of the company and deciding on issues related to the activities of the company that have not been placed in the sole.

The Supervisory Board

The Supervisory Board plans the activities of AS Tallinna Vesi, organises its management and supervises the activities of the Management Board. Pursuant to the Articles of Association of AS Tallinna Vesi, the Supervisory Board consists of nine members with the term of two years. In 2012, five regular and no extraordinary Supervisory Board meetings were held. The Supervisory Board pre-approved the 2011 annual report presented to the Annual General Meeting for approval, and reviewed AS Tallinna Vesi's preliminary 2013 budget.

At the time of compilation of this report, AS Tallinna Vesi's Supervisory Board consisted of the following members: Messrs Robert John Gallienne (United Utilities), Steven Richard Fraser (United Utilities), Simon Gardiner (United Utilities), Brendan Francis Murphy (United Utilities), Priit Lello (Tallinn City), Rein Ratas (Tallinn City), Toivo Tootsen (Tallinn City), Mart Mägi (independent) and Valdur Laid (independent).

The Supervisory Board has formed three committees to advise the Supervisory Board on audit, nomination and remuneration, and corporate governance matters as described below.

The Audit Committee and Internal Audit

At each meeting, an internal audit report was presented to the Supervisory Board. The internal auditor of AS Tallinna Vesi reports directly to the Audit Committee, which consists of two members of the Supervisory Board. Mr. Mart Mägi is the Chairman of the Audit Committee and Mr. Robert John Gallienne is the second member of the Audit Committee. The Audit Committee follows the Authorised Public Accountants Act and the guidelines issued by the Financial Supervision Authority regarding the composition and working processes of an Audit Committee.

The main tasks of the Audit Committee are:

- to monitor and analyse financial information;
- to monitor and analyse the efficiency of risk management and internal controls;
- to monitor and analyse the processes regarding actual accounts and the consolidated audit report;
- to monitor and analyse independence of appointed external auditor and legality of his/her activity regarding ASTV;
- to evaluate the work of external auditors annually and report to the Supervisory Board about the results of such evaluation.

The appointed external auditor and any member of the external audit team cannot provide any service outside the scope of annual audits without prior approval from the Audit Committee. In 2012, the external auditor did not provide any services to AS Tallinna Vesi outside the scope of the annual audit.

Pursuant to the Articles of Association of AS Tallinna Vesi, an external auditor shall be elected by the General Meeting of Shareholders for conducting the annual audit. The remuneration of the external auditor is regulated in the respective contract, signed between the external auditor and the Management Board. AS Tallinna Vesi chooses an external auditor by following internal procurement procedures (which includes approval by the Supervisory Board of AS Tallinna Vesi), ensuring the best match of service quality and the price offered for the services. Offers are taken only from internationally respected, high quality audit companies (the Big 4). AS Tallinna Vesi signs up to 3-year audit contract with a clause that requires the re-appointment of the auditor each year and follows the requirement of the Authorised Public Accountants Act to rotate the auditor after 7 years. Based on the report of the Audit Committee, the Supervisory Board evaluates the quality of the work of the external auditor annually in the course of the approval of the Annual Accounts and discloses the summary of such evaluation in the AGM notice. The external auditor is present at the AGM and participates where necessary.

Nomination and Remuneration Committee

In 2011 the Supervisory Board renamed the Remuneration Committee as Nomination and Remuneration Committee, which in 2012 continued to advise the Supervisory Board on management remuneration issues and on Management Board nominations. Mr. Valdur Laid is the Chairman of the Nomination and Remuneration Committee and Mr. Robert John Gallienne and Mr. Mart Mägi are the members of the Nomination and Remuneration Committee.

Supervisory Board approves the remuneration principles of the issuer's managers and appoints the Remuneration Committee. The Remuneration Committee recommends the remuneration principles of the Company and exercises supervision that the principles approved by the Supervisory Board and the requirements of the Securities Market Act are being followed.

The Nomination and Remuneration Committee ensures that the proposed remuneration principles are based on the long-term and annual objectives of the Company, taking into account the financial performance of the company and legitimate interests of investors and creditors. The Nomination and Remuneration Committee ensures also that the proportion of remuneration for the principal job and performance related pay (PRP) are in accordance with the duties of the Management Board Member and that the remuneration for principal job forms a sufficient part of the total remuneration. The PRP depends on annual performance and can be adjusted upwards or downwards, incl. not paid at all if so warranted, depending on annual performance results.

Corporate Governance Committee

The Corporate Governance Committee has been formed to improve corporate governance of AS Tallinna Vesi for the benefit of its Supervisory Board and shareholders. Mr. Robert John Gallienne is the Chairman of the Corporate Governance Committee and Messrs Laid and Plenderleith are the other members of the Corporate Governance Committee.

The Management Board

The Management Board is a management body that represents and manages the day-to-day activities of a company in accordance with the law and the Articles of Association of the company. The Management Board is obliged to act in the most economically efficient manner. The Management Board can be composed of three to five members according to the Articles of Association. The Management Board always prepares management reports for Supervisory Board meetings and such reports are disseminated to the Supervisory Board members 1 (one) week in advance of the meeting, as required by the Commercial Code. The Management Board also reports *ad hoc* to the Supervisory Board ex-meetings, when it feels this is necessary as and when requested by the Chairman of the Supervisory Board.

Both, the Management Board and Supervisory Board members are deemed to be insiders, have signed respective insider agreements, are aware of AS Tallinna Vesi's insider rules and together with their related persons are listed in AS Tallinna Vesi's insider list. In 2012 the Management Board consisted of five members, and at the time of compilation of this report the person in the position of Chief Financial Officer has changed and the role of the Chief Operating Officer has been split in two. The responsibilities of all Management Board members are specified below. The Chairman of the Management Board is seconded from United Utilities International Ltd, all Management Board members are appointed by the Supervisory Board of AS Tallinna Vesi.

The duties of the Chairman of the Management Board, Mr. Ian John Alexander Plenderleith were, amongst others, to fulfil the everyday obligations of the Chief Executive Officer (CEO) of AS Tallinna Vesi by leading and representing the Company, ensuring the compliance with the contract and the law, organizing the activities of the Management Board, preparing the strategies and ensuring their implementation.

Until October 2012, the duties of the member of the Management Board, Mr. Leho Võrk, were, amongst others, to fulfil the everyday obligations of the Chief Operating Officer (COO) of AS Tallinna Vesi by managing and being responsible for the operating activities of the Company. Mr. Võrk was appointed to the Management Board from 1st February 2012. Throughout 2011 and until 31st January 2012 Mr. Robert Thomas Yuille was appointed to the role of COO. From 29th October 2012 the role of COO was split into two and from then onwards Mr, Võrk fulfils the everyday obligations of the Customer Operations Director, managing everyday operation of the water and sewerage networks and being responsible for customer services as well as for customer relations with external partners.

The duties of the member of the Management Board, Mr. Aleksandr Timofejev, are, amongst others, to fulfil the everyday obligations of the Asset Operations Director of AS Tallinna Vesi by managing and being responsible for the operations of treatment facilities and planning and delivery of long-term investments. Mr. Timofejev was appointed to the Management Board from 29th October 2012.

The duties of the member of the Management Board, Ms. Riina Käi, are, amongst others, to fulfil the everyday obligations of the Chief Financial Officer (CFO) of AS Tallinna Vesi by managing and being responsible for the accounting and financial activities of the Company. Ms. Käi was appointed to the Management Board from 29th October 2012.

The duties of the member of the Management Board, Ms. Ilona Nurmela are, amongst others, to fulfil the role of the AS Tallinna Vesi's General Counsel and act as the head of legal and compliance. Ms. Nurmela was appointed to the Management Board from 1st February 2012.

AS Tallinna Vesi has signed Service contracts with all members of the Management Board. AS Tallinna Vesi has not made any transactions with the members of the Management Board nor their related parties.

According to the Articles of Association of AS Tallinna Vesi, the Chairman of the Management Board has the sole representation right of the company; other Management Board members can represent the company only jointly. 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 in small amounts.

The Management Board of AS Tallinna Vesi also acts on behalf of AS Tallinna Vesi as the sole shareholder of OÜ Watercom.

Conformity with Tallinn Stock Exchange Corporate Governance Recommendations

Starting from 1st January 2006, the companies whose shares have been admitted for 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 non-compliance with the Corporate Governance recommendations. If the issuer does not comply with the Corporate Governance Recommendations, it shall explain the reasons for its non-compliance in the report.

Declaration of Conformity by AS Tallinna Vesi

In 2012, AS Tallinna Vesi has complied with the vast majority of the Corporate Governance principles. However, AS Tallinna Vesi did not comply with certain principles, which are listed below together with the reasons for such 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 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 undertaken in connection with the privatisation of AS Tallinna Vesi in 2001 provided that, in return for certain fees, United Utilities International Ltd. would provide AS Tallinna Vesi with technical and asset management services and make its personnel available to the company in connection with its operation and management. The working hours, rates of compensation, and all other matters relating to the employment of the individual directly employed by United Utilities International Ltd. are to be determined solely by United Utilities International Ltd., the Supervisory Board does not review the principles of remuneration of this Management Board member.

'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.

AS Tallinna Vesi does disclose the overall Management Board remuneration in the report, appendix 25, but considers that individual remuneration is sensitive and private information and the disclosure thereof 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 of AS Tallinna Vesi, 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 reserved for independent members to be elected to the Supervisory Board as permitted by the Tallinn Stock Exchange on listing in June 2005.

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.'

The Management Board Members of AS Tallinna Vesi are not in the Management Boards and Supervisory Boards of other Issuers.

2.3.2. The Supervisory Board shall approve the transactions which are significant to the Issuer and concluded between the Issuer and a member of its Management Board or another person connected/close to them and shall determine the terms of such transactions.

The Supervisory Board approves the remuneration principles of the Management Board. In 2012, there were no other transactions between AS Tallinna Vesi and any member of the Management Board.

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 the remuneration of Supervisory Board members is set at 6 391 euros per year per person. The fee is paid to six members out of nine. The fee is subject to deduction and payment of applicable taxes and is payable monthly. The Supervisory Board members were not paid any additional benefits in 2012.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

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 2012, five Supervisory Board meetings were held (26th January 2012, 22nd March 2012, 26th April 2012, 19th July 2012 and 25th October 2012).

The following members of the Supervisory Board attended more than 50% of the meetings during the time they were appointed or elected in 2012: Mr. Robert John Gallienne, Mr. Steven Richard Fraser, Mr. Simon Gardiner, Mr. Brendan Francis Murphy, Mr. Rein Ratas, Mr. Toivo Tootsen, Mr. Priit Lello and Mr. Mart Mägi.

3.3.2. A Supervisory Board member candidate shall inform other members of the Supervisory Board about the existence of conflict of interests before their election and immediately upon arising of it later. Members of the Supervisory Board shall promptly inform the Chairman of the Supervisory Board and Management Board regarding any business offer related to the business activity of the Issuer made to him, a person close to him or a person connected with him.

All Supervisory Board members are aware of this requirement and at minimum once per annum AS Tallinna Vesi requires all Supervisory Board members to update the record of their business interests. No business transactions took place between AS Tallinna Vesi and either any Supervisory Board member or any persons or companies related to them in 2012.

The previous sections, Chairman's statement, Results of operations – for the year 2012, Corporate Governance and Corporate Governance Recommendations Report from the Management Report are an integral part of the annual report of AS Tallinna Vesi for the financial year ended 31 December 2012. The Management Report gives a true and fair view of the trends and results of operations, main risks and doubts of AS Tallinna Vesi.

Name	**Position**	**Signature**	**Date**
Ian John Alexander Plenderleith	Chairman of the Management Board	I.J.A. [signature]	25.02.2013
Leho Võrk	Member of the Management Board	[signature]	25.02.2013
Aleksandr Timofejev	Member of the Management Board	[signature]	25.02.13
Riina Käi	Member of the Management Board	[signature]	25.02.2013
Ilona Nurmela	Member of the Management Board	[signature]	25.02.2013

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT CONFIRMATION

The Management Board hereby declares its responsibility for the preparation of the consolidated financial statements of AS Tallinna Vesi (Company) and its subsidiary Watercom OÜ (together referred as Group) for the financial year ended 31 December 2012 on pages 24 to 58.

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 the Group.

The preparation of the financial statements according to International Financial Reporting Standards involves estimates made by the Management Board of the Group's assets and liabilities as of 31 December 2012, and of income and expenses during the financial year. These estimates are based on current information about the Group and consider all plans and risks as of 31 December 2012. 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 2013 have been considered in preparing the financial statements.

The Management Board considers AS Tallinna Vesi and its subsidiary to be going concern entities.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		25.02.2013
Leho Võrk	Member of the Management Board		25.02.2013
Aleksandr Timofejev	Member of the Management Board		25.02.13
Riina Käi	Member of the Management Board		25.02.2013
Ilona Nurmela	Member of the Management Board		25.02.2013

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PricewaterhouseCoopers, Tallinn

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

		as of 31 December	
ASSETS	**Note**	**2012**	**2011**
CURRENT ASSETS			
Cash and cash equivalents	6	23 935	14 770
Trade receivables, accrued income and prepaid expenses	7	18 323	19 845
Inventories		356	321
TOTAL CURRENT ASSETS		**42 614**	**34 936**
NON-CURRENT ASSETS			
Other long-term receivables	8	7 560	9 583
Property, plant and equipment	9	149 400	145 973
Intangible assets	9	1 154	1 577
TOTAL NON-CURRENT ASSETS		**158 114**	**157 133**
TOTAL ASSETS		**200 728**	**192 069**
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Current portion of long-term borrowings	10	115	0
Trade and other payables	11	5 482	5 789
Derivatives	12	2 039	1 552
Prepayments	15	2 252	1 146
TOTAL CURRENT LIABILITIES		**9 888**	**8 487**
NON-CURRENT LIABILITIES			
Deferred income from connection fees		7 892	6 824
Borrowings	10	95 717	94 938
Derivatives	12	2 538	2 936
Other payables		20	9
TOTAL NON-CURRENT LIABILITIES		**106 167**	**104 707**
TOTAL LIABILITIES		**116 055**	**113 194**
EQUITY			
Share capital	16	12 000	12 000
Share premium		24 734	24 734
Statutory legal reserve		1 278	1 278
Retained earnings		46 661	40 863
TOTAL EQUITY		**84 673**	**78 875**
TOTAL LIABILITIES AND EQUITY		**200 728**	**192 069**

Notes to the financial statements on pages 28 to 58 form an integral part of the financial statements.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Note	for the year ended 31 December 2012	2011
Revenue	17	52 924	51 240
Costs of goods sold	19	-20 337	-20 927
GROSS PROFIT		**32 587**	**30 313**
Marketing expenses	19	-772	-748
General administration expenses	19	-4 740	-4 294
Other income(+)/ expenses(-)	20	1 696	3 619
OPERATING PROFIT		**28 771**	**28 890**
Financial income	21	1 591	1 947
Financial expenses	21	-3 297	-5 071
PROFIT BEFORE TAXES		**27 065**	**25 766**
Income tax on dividends	22	-4 466	-4 253
NET PROFIT FOR THE PERIOD		**22 599**	**21 513**
COMPREHENSIVE INCOME FOR THE PERIOD		**22 599**	**21 513**
Attributable profit to:			
Equity holders of A-shares		22 598	21 512
B-share holder		0.60	0.60
Earnings per A share (in euros)	23	1.13	1.08
Earnings per B share (in euros)	23	600	600

Notes to the financial statements on pages 28 to 58 form an integral part of the financial statements.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

CONSOLIDATED STATEMENT OF CASH FLOW

	Note	for the year ended 31 December 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit		28 771	28 890
Adjustment for depreciation/amortisation	9,19	5 879	5 729
Adjustment for income from government grants and connection fees	20	-2 043	-3 484
Other finance income(+)/expenses(-)	21	-56	35
Other non-cash adjustments		-97	0
Profit(-)/loss(+) from sale and write off of property, plant and equipment, and intangible assets		-6	65
Change in current assets involved in operating activities		-160	720
Change in liabilities involved in operating activities		-568	1 306
Total cash flow from operating activities		**31 720**	**33 261**
CASH FLOWS FROM INVESTING ACTIVITIES			
Loans granted	8	-765	-3 151
Acquisition of property, plant and equipment, and intangible assets		-10 011	-18 506
Compensations received for construction of pipelines		11 198	11 284
Proceeds from sale of property, plant and equipment, and intangible assets		38	13
Interest received		1 585	1 939
Total cash flow used in investing activities		**2 045**	**-8 421**
CASH FLOWS FROM FINANCING ACTIVITIES			
Interest paid and loan financing costs, incl swap interests	21	-3 272	-3 051
Repayment of finance lease		-61	0
Dividends paid	22	-16 801	-16 001
Income tax on dividends	22	-4 466	-4 253
Total cash flow used in financing activities		**-24 600**	**-23 305**
Change in cash and cash equivalents		**9 165**	**1 535**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		**14 770**	**13 235**
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	6	**23 935**	**14 770**

Notes to the financial statements on pages 28 to 58 form an integral part of the financial statements.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
as of 31 December 2010	**12 782**	**24 734**	**1 278**	**34 569**	**73 363**
Reduction of the share capital	-782	0	0	782	0
Dividends (Note 22)	0	0	0	-16 001	-16 001
Comprehensive income for the period (Note 23)	0	0	0	21 513	21 513
as of 31 December 2011	**12 000**	**24 734**	**1 278**	**40 863**	**78 875**
Dividends (Note 22)	0	0	0	-16 801	-16 801
Comprehensive income for the period (Note 23)	0	0	0	22 599	22 599
as of 31 December 2012	**12 000**	**24 734**	**1 278**	**46 661**	**84 673**

Notes to the financial statements on pages 28 to 58 form an integral part of the financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. GENERAL INFORMATION

AS Tallinna Vesi (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. AS Tallinna Vesi has the exclusive right to provide water and sewerage services in Tallinn's main service area until the year 2020.

Shareholders of AS Tallinna Vesi 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 Nasdaq OMX Baltic Exchange, in which AS Tallinna Vesi was listed on 1 June 2005

Watercom OÜ (Subsidiary) was founded at 2010 by the Company and its main areas of activity are services related to water business and owner supervision, construction and project management services related to water and sewage.

The Company and the Subsidiary together form a group (Group).

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

Contacts:

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NOTE 2. ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements (hereinafter referred to as 'financial statements') are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

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

The financial statements have been prepared under the historical cost convention, as modified by the accounting policy for derivatives, measured at fair value through profit and loss, as disclosed in the accounting policies below.

The Management Board of AS Tallinna Vesi authorised these consolidated financial statements for issue at 25 February 2013. Pursuant to the Commercial Code of the Republic of Estonia, the financial statements are subject to approval by the Supervisory Board of AS Tallinna Vesi and the General Meeting of Shareholders. Shareholders have the right not to approve the annual report prepared and approved by the Management Board, and request preparation of a new annual report.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Changes in presentation of statement of cash flow

In 2012 the Group decided to change the presentation of cash flow statement by reclassifying interest paid and loan financing costs that were previously shown under cash flows from operating activities to cash flows from financing activities. The reason for reclassification is to give better overview of Group's cash flows as the Group considers that interest paid and loan financing costs are more related with financing activities rather than operating activities.

Adoption of New or Revised Standards and Interpretations

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2012 that would be expected to have a material impact to the Group.

Certain new or revised standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2013 or later periods and which the Group has not early adopted:

IFRS 13, Fair Value Measurement, effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU. Aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its financial statements.

There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on the Group.

Principles of consolidation, accounting for business combinations and subsidiaries

A subsidiary is an entity in which the Group, directly or indirectly, has interest of more than one half of the voting rights or otherwise has power to govern the operating and financial policies so as to obtain economic benefits. The subsidiary has been consolidated in the Group's financial statements.

In the consolidated financial statements, the financial statements of the subsidiary are combined on a line-by-line basis. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Group and its subsidiary use uniform accounting policies. Where necessary, the accounting policies of the subsidiary have been changed to ensure consistency with the policies adopted by the Group.

Investment in subsidiary is carried at cost (less any impairment losses) in the separate primary financial statements of the Company.

Foreign currency

Functional and presentation currency

Consolidated financial statements for the year ended 31 December 2012 have been presented in euros.

For the convenience of the users, these financial statements have been presented in thousands of euros, unless stated otherwise.

Foreign currency transactions and balances

All other currencies except for the functional currency (the functional currency of the Parent Company and subsidiary located in Estonia is Euro) constitute foreign currencies. Foreign currency transactions have been translated to functional currencies based on the foreign currency exchange rates of the European Central Bank prevailing on the transaction date. Monetary assets and liabilities denominated in a foreign currency (monetary receivables and loans) have been translated into functional currency based on the foreign currency exchange rates of the European Central Bank prevailing on the balance sheet date. Foreign exchange gains and losses are recognised in the statement of comprehensive income as income or expenses of that period.

Current and non-current distinction of assets and liabilities

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

Cash and cash equivalents

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

Cash flows from operating activities are reported using the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows. Cash flows from investing and financing activities are reported using the direct method.

Financial assets

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

Financial assets are recorded in statement of financial position at value date (i.e. are recognised when the Group becomes the owner of the financial assets and are derecognised when the Group has transferred substantially all risk and rewards incidental to ownership).
According to the purpose of acquisition and management intentions 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 of 31 December 2012 and 2011 the Group 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 acquired for the purpose of selling in the near term). Financial assets at fair value through profit or loss are initially recorded at fair value, transaction costs are recorded in the profit or loss. Financial assets of this category are subsequently carried at fair value and gains/losses from changes in fair value are recorded in profit or loss of the period. The quoted market price on 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 recognised at a fair value plus the transaction costs. Loans and receivables are subsequently carried at amortised cost, using effective interest method (less any impairment allowances).

As of 31 December 2012 and 2011 the Company had given one loan.

Receivables

Trade receivables comprise of short term receivables generated in the ordinary course of business. Trade receivables are recorded using at the amortised cost method.

Allowance for receivables is recorded if there is objective evidence that the Group is not able to collect all amounts due according to the original terms of the agreement. Impairment of individually material receivables is evaluated separately for each customer, considering the present value estimated future cash flows. For receivables which are not individually significant and for which there is no direct information that their value has been decreased, the allowance is evaluated collectively using previous years experience on impairment of receivables. The amount of the allowance for 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 statement of comprehensive income on the row „Other income/ expenses". Subsequent recoveries of doubtful receivables are recorded as a decrease of impairment loss.

Inventories

Inventories are initially recorded at cost including purchase costs, non-refundable taxes and transportation and other costs directly connected with the acquisition, less allowances and discounts. The weighted-average cost method has been used to determine the cost of inventories. Inventories are carried in the statement of financial position at the lower of the cost and 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 for a reasonable price compared to their fair value.

Non-current assets held for sale are classified in the statement of financial position as current assets and depreciation ended at the moment of reclassification. Non-current assets held for sale are carried in the statement of financial position at the lower of at book value and fair value less costs to sell.

Property, plant and equipment, and intangible assets

Property, plant and equipment are tangible assets used in operating activities of the Group with an expected useful life of over one year. Property, plant and equipment are carried in the statement of financial position at historical cost less accumulated depreciation and any impairment losses.

Intangible assets are recognised in the statement of financial position only if the following conditions are met:
- the asset is controlled by the Group;

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

Acquired licenses

Acquired computer software that is not an integral part of the related hardware is recognised as an intangible asset. Development costs of computer software are recognised as intangible assets if these are directly related to the development of such software objects that are identifiable, controllable by the Group and that are expected to generate economic benefits beyond 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 statement of comprehensive income. Costs of computer software shall be depreciated over the estimated useful lifetime, the duration of which is up to 10 years.

Other intangible assets

Expenses for acquiring patents, trademarks, licences and certificates are capitalized if it is possible to estimate the future economic benefits attributable to these assets. Other intangible assets are amortised on a straight line basis over the estimated useful lifetime, the duration of which does not exceed 10 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 applied to working hours which are needed for taking the asset to the location and condition necessary for it to be capable of operating in the manner intended by the management. Hourly rate is calculated individually for each employee and includes other direct expenses connected with the employee in addition to salary expense.

If an item of property, plant and equipment consists of components with different useful lives, these components are depreciated as separate items.

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

Subsequent expenditures are added to the carrying amount of the item of property, plant and equipment or are recognised as a separate asset only when it is probable that future economic benefits related to the assets will flow to the Group 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. Costs related to ongoing maintenance and repairs are charged to the statement of comprehensive income.

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 and other equipment etc. 10-20 % per annum;
- acquired licenses and other intangible assets 10-33 % per annum.

In exceptional circumstances rates may differ from the above ranges if it is evident that the estimated useful life of the asset varies materially from the ranges of rates 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 line "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 carrying amount.

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:
- fair value less costs to sell and
- 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 present value of the estimated future cash flows generated by the assets.

The impairment of assets may be assessed either for an individual asset or a group of assets (cash-generating unit). For the purposes of assessing impairment, the Group is considered to be a single cash-generating unit as it is the lowest level for which there are separately identifiable cash flows. The impairment loss is immediately recognised in the statement of comprehensive income. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

If based on the results of the assessment it appears that the recoverable amount of an asset or the cash-generating unit has increased, the earlier impairment is reversed 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 statement of comprehensive income 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 and derivatives. Financial liabilities (except derivatives) are initially recognised at fair value net of transaction cost. Subsequently financial liabilities are carried at the amortised cost.

Amortised cost of short term financial liabilities is usually equal to their nominal value, thus they are carried on statement of financial position 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), interest expense is calculated from the liability using the effective interest method subsequently.

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

Derivatives

With regard to derivatives, the Group uses interest rate swap contracts, in order to mitigate risks related to fluctuations in interest rates. Such derivatives are initially recognised at their fair value at the date of entering into the contract and are subsequently carried at fair value with changes recognised in profit or loss. If fair value is positive, the derivative is recognised as an asset, if negative, as a liability. Derivatives are classified as a current asset or liability if expected to be settled within 12 months; otherwise, they are classified as non-current.

Gains and losses attributable to changes in the fair value of derivatives are recognised in the statement of comprehensive income of the reporting period. Gains and losses from the disposal of derivatives are also recognised in the statement of comprehensive income.

Corporate income tax

According to the Income Tax Act, the annual profit earned by enterprises is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise.

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, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The rate is 21/79 on the amount of the dividends payable (2011: 21/79).

The contingent tax liability that would occur if all distributable retained earnings were paid out as dividends is not recognized in the statement of financial position. The income tax due on dividend distribution is recorded as a liability and as a tax expense in the statement of comprehensive income during the same period as the dividend is declared regardless of the actual payment date or the period for which dividends are declared. Income tax liability is due 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. Social security tax payments include contribution to state pension funds. The Group has no legal or constructive obligation to make pension or similar payments beyond social security tax.

Termination benefits

Termination benefits are benefits which are payable after the Group decides to terminate the employment relationship with the employee before the normal retirement date or when the employee decides to leave voluntarily or when the employee and employer have an agreement, in exchange for the benefits outlined. The Group recognises termination benefits as liabilities and expenses only when the Group is obliged to offer termination benefits in order to encourage voluntary leaving.

Provisions and contingent liabilities

Provisions are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

The amount 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 Group's pipes are located on their land, are recorded as provisions. On the statement of financial position the liability is classified as short-term, because it can be realized to full extent within 12 months from the balance date.

Provisions have been recognised based on of the best estimates of the Group's Management Board and the actual costs of these transactions can differ from the provided estimates.
Commitments and other possible and existing liabilities, the realization of which is unlikely or the amount of accompanying costs cannot be assessed with sufficient reliability but 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 Group's Articles of Association, the Group has two classes of shares: the A-Shares, with a nominal value of 0.60 euros each and a single preference share B-Share, with a nominal value of 60 euros.

Statutory reserve capital

Pursuant to the requirements of the Commercial Code the statutory reserve capital is set up comprising of the allocations from net profits. The annual allocation must be at least 5% of the net profit of the accounting year until the reserve capital is equal to 10% of paid-up share capital. As the Group's reserve capital has reached the required level, the reserve capital is no longer increased from net profit.

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

Leases

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

The Group as the lessee
Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset and the present value of minimum lease payments. Each lease payment is apportioned between 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 statement of comprehensive income. The finance lease liability is recognised either within short or long-term borrowing in the statement of financial position.

Payments made under operating leases are charged to the statement of comprehensive income 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 the period when government grant was received. Government grants are not recognised as income before there exists sufficient confidence that Group complies with the conditions relating to government grants and the grants will be received.
Government grants received as compensations for the construction of water, sewerage and storm 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 delivery of construction works within "Other income/expenses" as income from government grants.

Revenue

Revenue is recognised at the fair value of consideration received or receivable, net of VAT and sales discounts. Revenue comprises sales of services.

Sales of water, wastewater, storm water and fire hydrants services and other sales income is recorded in the period when the service has been provided, the amount of the revenue and cost incurred for the transaction can be measured reliably, it is probable that economic benefits associated with the transaction will flow to the entity.

Connection fees received from customers are recognised as income during the period of the duration of useful life of related assets which is 75 years. The acquisition costs of pipelines taken into use and the connection fees received from customers are recorded respectively on the statement of financial position as “Property, plant and equipment” and “Deferred income from connection fees”. Income/expense from amortization of assets and liabilities is respectively recorded as “Other income/expenses”.

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 effective interest method.

Earnings per share

Earnings per share are calculated by dividing the net profit of the accounting year with the weighted average number of issued shares of the period. The Group has no instruments that would have a diluting effect on the earnings per share.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Management Board, being the chief operating decision-maker. The Management Board, who is responsible for allocating resources and assessing performance of the operating segments, reports to the Supervisory Board which has been identified as the steering committee that makes strategic decisions. The Management Board has determined that the activities of the Group form a single operating segment. The internal reporting reviewed by the Supervisory Board and the Management Board is prepared using the same accounting principles and format of statement of financial position and statement of comprehensive income as provided in these consolidated financial statements.

NOTE 3. CONTINGENT LIABILITY REGARDING THE TARIFF RISK

On 10th October 2011 the Estonian Competition Authority (CA) issued a prescript for the Company to reduce the tariffs of water and sewerage services in Tallinn by 29%. The Company disagrees with the position of the CA and has turned to the Estonian Administrative Court disputing the prescription that seeks to break the privatization contract without any evidence to support its view that privatization contract should not be honoured. Should the Court uphold the CA's position the privatization contract could cease to be the basis for the tariffs of water and sewerage services in Tallinn. The length of the court process and the decision are not within the Company's control.

The management has evaluated the amount of the contingent liability as of 31 December 2012 arising from the potential claims against the Company if the Court ruling would support the CA's position. As result of this, the outflow of economic benefits could be up to 36 mln euros that could be claimed within 10 years of the final judgement of the courts.

NOTE 4. CRITICAL ACCOUNTING ESTIMATES

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of material misstatements to the carrying amounts of assets and liabilities within the next financial year are addressed below.

- Management has estimated the useful lifetime of property, plant and equipment and intangible assets. The results of the estimates are disclosed in the note 2 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 2012 Group owns property, plant and equipment, and intangible assets with a book value of 150.6 mln euros (31 December 2011: 147.6 mln euros) and annual depreciation was 5.9 mln euros (2011: 5.8 mln euros). If the depreciation/amortization rates decreased / increased by 5 %, the depreciation/amortization expense would increase / decrease respectively by 295 thousand euros (2011: 286 thousand euros).

- The Group has assumed an obligation to construct water and wastewater and storm water pipelines in construction costs of 41 mln euros (2011: 41 mln euros) in 2008-2012. The construction of pipelines is compensated by local government with the grants receivable in 2008-2014. Compensations received from local government are recognised as government grants -

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compensations received or receivable 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 statement of financial position as a receivable from local government at its present value. Recognition of the above compensations is dependent on several uncertain circumstances and the estimates of the Management Board, in particular those regarding the total and the fair value of the compensations receivable. In recording income from government grants (Note 20) 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.

As payment of government grant for pipelines will be received until June of 2014 and the exact extent of compensation depends on water consumption, the fair value of compensation receivable is also based on estimates. In the estimates compensation is receivable for 2013-2014 and has been discounted using a rate of 7% (2011: 7%). If the discount rate would be decreased/increased by 50 basis points, the profit of the accounting period would increase/decrease up to 81 thousand euros (2011: up to 198 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%.

Impairment of individually material receivables can differ from the rates above.

NOTE 5. FINANCIAL RISK MANAGEMENT

5.1 Financial risk factors

In its business activities the Group is exposed to different financial risks: market risk (including currency risk, price risk, cash flow interest rate risk and fair value interest rate risk), credit risk and liquidity risk. The Group's financial risk management focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

According to the Group's procedures, approved by the Management Board, the financial risk management is carried out by the financial department. Financial department identifies, evaluates and hedges financial risks in co-operation with the Group's operating units.

Market risk

Foreign exchange risk

Foreign exchange risk arises when future commercial transactions or recognised assets or liabilities are denominated in a currency that is not the entity's functional currency. The Group's foreign exchange risk is related to purchases done and amounts owed in foreign currencies.

Majority of Group's purchases are made in euros. The proportion of purchases in other currencies in 2012 was less than 0.5% (2011: less than 0.5%). Because of the small proportion of transactions in foreign currencies the Group has not taken any special activities to reduce this risk.

On 31 December 2012 the Group's bank accounts balances (including deposits) totalled 23 935 thousand euros (31 December 2011: 14 770 thousand euros) from which no sums were in foreign currencies (31 December 2011: no foreign currencies). There were no other significant exposures to foreign currencies arising from Group's other financial assets and financial liabilities.

Due to the above the Group considers its currency risk level to be low.

Price risk

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

Cash flow interest rate risk and fair value interest rate risk

Fair value interest rate risk is the risk that the fair value of financial instruments will fluctuate in the future due to changes in market interest rates. Cash flows interest rate risk is the risk that financial expenses arising from financial liabilities with floating interest rate will increase when interest rates on the market increase.

The Group's interest rate risk arises mostly from long-term borrowings. Borrowings issued at variable interest rates (Note 10) expose the Group to cash flow interest rate risk. The Group's policy is to maintain approximately 75% of its borrowings at fixed rate. In order to mitigate the cash flow interest rate risk, the Group has concluded 5 (2011: 5) floating-to-fixed interest rate swap contracts (Note 12). As of 31 December 2012 the interest rate swap contracts have the notional amount of 75 mln euros (31 December 2011: 75 mln euros), therefore only borrowings in the amount of 19.9 mln euros (31 December 2011: 19.9 mln euros) remain exposed to the cash flow interest rate risk.

As of 31 December 2012, if the interest rates of the Group's borrowings and interest rate swap contracts had been 50 basis points (31 December 2011: 50 basis points) higher/lower with all other variables held constant, profit for the year would have been EUR 333 thousand (2011: EUR 698 thousand) higher/lower, mainly as a result of higher/lower interest expense on floating rate borrowings and fair value change of interest rate swaps.

Overnight and fixed term deposits and long-term loan to co-partner have fixed interest rate and therefore expose the Group to fair value interest rate risk. As all these instruments are carried at amortised cost, the change in market interest rates would not have an effect on the financial statements of the Group.

Credit risk

Credit risk expresses potential loss that can arise if counterparty fails to fulfil its contractual obligations. Cash in bank accounts and deposits, financial assets at fair value through profit and loss, trade and other receivables are exposed to credit risk.

According to the Group's risk management policies the Group's short term resources can be deposited only in accounts, overnight deposits and fixed term deposits opened in credit institutions. For fixed term depositing counterparties with at least a long term A rating (by Moody's) are used. As of 31 December 2012 100% of Group's fixed term deposits were deposited with counterparty with higher rating than A3 (31 December 2011: 100% higher than A3). Starting from Jan 2012 the Group is also monitoring European Banking Authority's recommendations regarding banks' recapitalization needs and fixed term deposits are opened only in banks with no capitalization shortfall.

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The selling of Group's products and services is done in compliance with internal procedures. To reduce credit risk related to accounts receivable the customers' payment discipline is consistently observed. In the case of overdue debt the clients are contacted by Group's Credit group. At the end of December 2012 only one client's (31 December 2011: one client's) receivables (Note 25) exceeded 5% of total trade receivables constituting 47.0% of it (31 December 2011: 46.2%).

Financial assets

as of 31 December 2012	**Balance**	**Not due**	**Overdue** Not impaired (up to 2 months)	Impaired	Impairment
Cash and cash equivalents (Note 6)	23 935	23 935	0	0	0
Trade receivables (Note 7)	10 470	10 353	83	533	-499
Commercial entities	7 278	7 201	51	480	-454
Private persons	3 192	3 152	32	53	-45
Accrued income (Note 7)	21	21	0	0	0
Loan to co-partner (Note 7, 8)	3 916	3 916	0	0	0
Government grant receivable (Note 7, 8, 25)	10 868	10 868	0	0	0
Total	**49 210**	**49 093**	**83**	**533**	**-499**

Financial assets

as of 31 December 2011	**Balance**	**Not due**	**Overdue** Not impaired (up to 2 months)	Impaired	Impairment
Cash and cash equivalents (Note 6)	14 770	14 770	0	0	0
Trade receivables (Note 7)	10 808	10 625	150	547	-514
Commercial entities	7 460	7 348	92	401	-381
Private persons	3 348	3 277	58	146	-133
Accrued income (Note 7)	16	16	0	0	0
Loan to co-partner (Note 8)	3 151	3 151	0	0	0
Government grant receivable (Note 7, 8, 25)	15 310	15 310	0	0	0
Total	**44 055**	**43 872**	**150**	**547**	**-514**

The Group's maximum credit risk is equal to the carrying amount of the financial assets and is considered to be low.

Liquidity risk

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

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

Financial liabilities in terms of payment (undiscounted amounts):

as of 31 December 2012	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Trade and other payables	2 863	38	0	0	9	2 910
Derivatives	2 039	0	0	2 538	0	4 577
Borrowings (incl finance lease)	78	168	953	55 876	44 038	101 113
Total	**4 980**	**206**	**953**	**58 414**	**44 047**	**108 600**

as of 31 December 2011	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Trade and other payables	2 761	34	0	0	9	2 804
Derivatives	1 552	0	0	2 936	0	4 488
Borrowings	150	301	1 427	84 810	14 628	101 316
Total	**4 463**	**335**	**1 427**	**87 746**	**14 637**	**108 608**

In liquidity risk management the Group has taken a prudent view, maintaining sufficient cash balance and short term deposits to be able to fulfil its financial liabilities at every moment of time. Continuous cash flow forecasting and control are essential tools in the day-to-day liquidity risk management of the Group.

5.2 Capital management

The Group's objectives when managing capital is to safeguard the Group's ability to continue as a going concern, to be in accordance with Business Plan's capital structure approved by Supervisory Board and the long-term borrowing contracts that limit the Company's equity ratio to a minimum of 35% of the total assets.

The Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (Note 10; including 'current and noncurrent borrowings' as shown in the consolidated balance sheet) less cash and cash equivalents (Note 6). Total capital is calculated as 'equity' as shown in the consolidated balance sheet plus net debt.

		as of 31 December
	2012	**2011**
Borrowings	95 832	94 938
Cash	-23 935	-14 770
Net debt	**71 897**	**80 168**
Equity	**84 673**	**78 875**
Total capital	**156 570**	**159 043**
Gearing ratio	45,9%	50,4%
Total assets	200 728	192 069
Proportion of equity to total assets	42,2%	41,1%

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5.3 Fair value estimation

Fair values of cash and cash equivalents, trade receivable, other long-term receivables, short-term borrowings and trade payable do not vary significantly from their carrying amount because their realization will take place within 12 months or these were recognised close to the balance sheet date.

At the end of 2012 all Group's long-term borrowings had floating interest rates. Because Group's contractual long-term borrowings risk margins were smaller, than market's risk margin currently applicable to the Group, the fair value of its long-term borrowings on 31 December 2012 was 1 240 thousand euros smaller than their carrying amount (31 December 2011: 2 167 thousand euros smaller).

Smaller interest risk margins compared to market situation means that if the Group would like to refinance its long-term borrowings on existing market conditions it would bring along higher interest expenses compared to the existing agreements.

The fair value of financial instruments carried at fair value (interest rate swap contracts, Note 12) has been measured using the inputs other than quoted prices, but observable for the asset or liability either directly or indirectly, i.e. level 2.

NOTE 6. CASH AND CASH EQUIVALENTS

	as of 31 December	
	2012	**2011**
Cash in hand and in bank	1 859	1 456
Short-term deposits	22 076	13 314
Total cash and cash equivalents	**23 935**	**14 770**

NOTE 7. TRADE RECEIVABLES, ACCRUED INCOME AND PREPAID EXPENSES

	as of 31 December	
	2012	**2011**
Accounts receivable	10 969	11 322
Allowance for doubtful receivables	-499	-514
Total trade receivables	**10 470**	**10 808**
Allowance for doubtful receivables at the beginning of the period	**-514**	**-1 152**
Proceeds from doubtful receivables during the period	150	894
Allowance for doubtful receivables recognised during the period	-319	-480
Receivables written off balance sheet during the period	184	224
Allowance for doubtful receivables at the end of the period	**-499**	**-514**

Impairment losses recognised during the period are reported in profit or loss as "Other income (+) / expenses (-)". For further information on ageing of receivables (including overdue receivables), please see Note 5.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

	as of 31 December	
	2012	**2011**
Accrued interest	21	16
Government grant receivables	7 123	8 878
Prepaid expenses	709	143
Total accrued income and prepaid expenses	**7 853**	**9 037**
Total trade receivables, accrued income and prepaid expenses	**18 323**	**19 845**

The Group's current assets (incl. trade receivables, accruals and inventory) in the amount of 18 679 thousand euros (31 December 2011: 20 166 thousand euros) have been pledged as a security for the bank loans (Note 10), as a part of commercial pledge.

NOTE 8. OTHER LONG-TERM RECEIVABLES

	as of 31 December	
	2012	**2011**
Government grant receivables	3 746	6 432
Loan to co-partner	3 814	3 151
Total other long-term receivables	**7 560**	**9 583**

The Group's long term receivables in the amount of 3 746 thousand euros (31 December 2011: 6 432 thousand euros) have been pledged as a security to the bank loans (Note 10), as a part of commercial pledge.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

NOTE 9. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

	Property, plant and equipment				Assets in progress			Intangible assets	
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Unfinished pipelines	Unfinished intangible assets	Acquired licenses and other intangible assets	Total property, plant and equipment and intangible assets
as of 31 December 2010									
Acquisition cost	24 067	155 727	39 570	1 157	2 216	7 462	119	5 232	235 550
Accumulated depreciation	-4 838	-50 307	-26 120	-755	0	0	0	-3 379	-85 399
Book value	**19 229**	**105 420**	**13 450**	**402**	**2 216**	**7 462**	**119**	**1 853**	**150 151**
Transactions in the period 01 January 2011 - 31 December 2011									
Acquisition in book value	0	0	0	0	5 178	11 126	234	0	16 538
Write off and sale of property, plant and equipment, and intangible assets in book value	-1	0	-65	0	0	0	0	0	-66
Compensated by government grants (Note 13)	0	0	0	0	0	-13 270	0	0	-13 270
Reclassification	182	6 412	1 553	43	-4 545	-3 641	-131	131	4
Depreciation (Note 19)	-273	-2 646	-2 181	-78	0	0	0	-629	-5 807
as of 31 December 2011									
Acquisition cost	24 247	162 106	40 594	1 175	2 849	1 677	222	5 363	238 233
Accumulated depreciation	-5 110	-52 920	-27 837	-808	0	0	0	-4 008	-90 683
Book value	**19 137**	**109 186**	**12 757**	**367**	**2 849**	**1 677**	**222**	**1 355**	**147 550**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (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	Unfinished pipelines	Unfinished intangible assets	Acquired licenses and other intangible assets	
Transactions in the period 01 January 2012 - 31 December 2012									
Acquisition in book value	0	0	0	0	7 862	3 153	293	0	11 308
Write off and sale of property, plant and equipment, and intangible assets in book value	0	0	-1	0	-32	0	0	0	-33
Compensated by government grants (Note 13)	0	0	0	0	0	-2 392	0	0	-2 392
Reclassification	545	5 361	3 713	153	-8 421	-1 398	-490	537	0
Depreciation (Note 19)	-273	-2 701	-2 062	-80	0	0	0	-763	-5 879
as of 31 December 2012									
Acquisition cost	24 793	167 389	44 018	1 302	2 258	1 040	25	5 899	246 724
Accumulated depreciation	-5 384	-55 543	-29 611	-862	0	0	0	-4 770	-96 170
Book value	**19 409**	**111 846**	**14 407**	**440**	**2 258**	**1 040**	**25**	**1 129**	**150 554**

Property, plant and equipment and intangible assets are written off if the condition of the asset do not enable further usage for production purposes. As of 31 December 2012 the book value of the assets (Machinery and equipment) leased under financial lease is 886 thousand euros (31 December 2011: 0 euros).

The Group's non-current assets in the amount of 14 573 thousand euros (31 December 2011: 13 939 thousand euros) have been pledged as a security for the bank loans (Note 10), as a part of commercial pledge. A mortgage for the Group's non-current assets (land, buildings and facilities) in the book value amount of 32 766 thousand euros (31 December 2011: 32 558 thousand euros) serves as a security to the bank loans (Note 10).

During the year, the Group has capitalised borrowing costs amounting to 57 thousand euros (2011: 86 thousand euros) on qualifying assets. Borrowing costs were capitalised at the weighted average rate of its general borrowings of 1.39% (2011: 2.13%).

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

NOTE 10. BORROWINGS

	as of 31 December	
	2012	**2011**
Current borrowings		
Current portion of long-term finance lease liabilities	115	0
Total current borrowings	**115**	**0**
Non-current borrowings		
Long-term bank loans	94 919	94 938
Long-term finance lease liabilities	798	0
Total non-current borrowings	**95 717**	**94 938**

Bank loans at 31 December 2012		
Currency EUR (euro)	**Balance**	**Effective interest rate**
Borrowings at floating interest rate (based on 1- and 6-month Euribor)	94 919	0.82%-1.55%
Finance lease liabilities	913	2.27%-3.05%

Bank loans at 31 December 2011		
Currency EUR (euro)	**Balance**	**Effective interest rate**
Borrowings at floating interest rate (based on 1- and 6-month Euribor)	94 938	1.64%-2.24%

In November 2012 the Company renewed its loan agreements in a total amount of 75 000 thousand euros. As a result of the renewal one 37 500 thousand euro loan agreement was prolonged to November 2018 (31 December 2011: November 2013). Company's other loan agreements' due dates were not changed being May 2019 (31 December 2011: May 2019) for 20 000 thousand euros loan agreement and November 2015 (31 December 2011: November 2015) for 37 500 thousand euros loan agreement.

Collateral of loans and pledged assets

		Collateral at book value as of 31 December	
Type of collateral	**Specification and location of collateral**	**2012**	**2011**
Commercial pledge	Movables of the Company (Notes 7, 8, 9)	36 998	40 537
Mortgage	Real Estates located at Paljassaare põik 14 and Järvevana tee 3, Tallinn, Estonia (Note 9)	32 766	32 558

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NOTE 11. TRADE AND OTHER PAYABLES

	for the year ended 31 December	
	2012	**2011**
Trade payables - operating expenditures	1 743	1 860
Trade payables - capital expenditures	834	568
Payables to related parties (Note 25)	187	194
Payables to employees	869	849
Interest payable	50	76
Other accrued expenses	135	172
Guarantee deposit	28	0
Taxes payable incl:		
Income tax	142	136
VAT	744	733
Water abstraction charges	236	219
Pollution taxes	181	665
Social security tax	284	273
Other	49	44
Total trade and other payables	**5 482**	**5 789**

NOTE 12. DERIVATIVES

Liabilities	**Balance amount**	**Short-term portion**	**Long-term portion**
as of 31 December 2012			
SWAP contracts	**4 577**	2 039	2 538
as of 31 December 2011			
SWAP contracts	**4 488**	1 552	2 936

		as of 31 December
	2012	**2011**
Contracts start date	May 2010 – November 2011	May 2010 – November 2011
Contracts maturity date	November 2013 – November 2015	November 2013 – November 2015
Contracts notional amount	75 000	75 000

NOTE 13. GOVERNMENT GRANTS

Government grants for assets

Government grants receivable accrued during the financial year for completed constructions of pipelines amounted to 4 429 thousand euros (2011: 16 749 thousand euros). Property, plant and equipment compensated by the government grant amounted to 2 392 thousand euros (2011: 13 270 thousand euros) (Note 9). The remainder of the compensation is recognised in the statement of comprehensive income (Note 20).

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

NOTE 14. OTHER CONTINGENT LIABILITIES

Tax authority is entitled to check the Group'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 Group's Management Board there are no circumstances as a result of which tax authority could impose a significant additional amount of tax to the Group.

The Group's distributable retained earnings as at 31 December 2012 amounted to 46 661 thousand euros (2011: 40 863 thousand euros). Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 12 404 thousand euros (2011: 10 863 thousand euros).

NOTE 15. PREPAYMENTS

	as of 31 December	
	2012	**2011**
Prepayments for water and sewerage services	76	143
Prepayments for connection fee	2 176	1 003
Total prepayments	**2 252**	**1 146**

NOTE 16. SHARE CAPITAL

At 31 December 2012 the nominal value of the share capital was 12 000 060 (twelve million and sixty) euros, composed of 20 000 000 (twenty million) A-shares with the nominal value of 0.60 euros (sixty eurocents) per share and 1 (one) preferred B-share with a nominal value of 60 (sixty) euros.

The one B-share has been issued with the right of veto to the shareholder when voting on the following issues: amending the Articles of Association, increase and decrease of share capital, issuance of convertible bonds, acquisition of own (treasury) shares, deciding on the merger, division, transformation and/or dissolution of AS Tallinna Vesi, and, deciding other issues related to the activities of the AS Tallinna Vesi that have not been placed in the sole competence of the General Meeting by law that either the Management Board or the Supervisory Board have put to the vote of the General Meeting. In 2011 and 2012, the B-share granted the holder the preferential right to receive a dividend in an agreed sum of 600 (six hundred) euros.

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

As of 31 December 2012 and 2011 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 1 (one) B-share, with 6 000 000 shares in free float. Other direct shareholders each owned less than 5% of the shares as of 31 December 2012 and 2011.

As of 31 December 2012 from all Supervisory Board and Management Board members Riina Käi owned 100 and Leho Võrk 179 shares (2011: Siiri Lahe 700 and Leho Võrk 179 shares).
Dividends declared and paid are disclosed in note 22.

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

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NOTE 17. REVENUE

Revenues from main operating activities	for the year ended 31 December 2012	2011
Total water supply and waste water disposal service, incl:	47 912	46 492
Private clients, incl:	23 789	23 711
Water supply service	13 096	13 072
Waste water disposal service	10 693	10 639
Corporate clients, incl:	18 767	18 234
Water supply service	10 248	9 881
Waste water disposal service	8 519	8 353
Outside service area clients, incl:	4 524	3 789
Water supply service	1 028	901
Waste water disposal service	3 496	2 888
Over pollution fee	832	758
Storm water treatment and disposal service	3 713	3 351
Fire hydrants service	202	221
Other works and services	1 097	1 176
Total revenues	**52 924**	**51 240**

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

NOTE 18. STAFF COSTS

	for the year ended 31 December 2012	2011
Salaries and wages	-5 150	-4 801
Social security and unemployment insurance taxation	-1 718	-1 602
Total staff costs	**-6 868**	**-6 403**
Number of employees at the end of reporting period	**313**	**311**

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NOTE 19. COST OF GOODS SOLD, MARKETING AND ADMINISTRATIVE EXPENSES

	for the year ended 31 December	
	2012	**2011**
Cost of goods sold		
Water abstraction charges	-937	-897
Chemicals	-1 631	-1 433
Electricity	-3 695	-2 972
Pollution tax	-347	-1 409
Staff costs (Note 18)	-4 750	-4 390
Depreciation and amortization	-5 167	-5 182
Other costs of goods sold	-3 810	-4 644
Total cost of goods sold	**-20 337**	**-20 927**
Marketing expenses		
Staff costs (Note 18)	-373	-349
Depreciation and amortization	-326	-325
Other marketing expenses	-73	-74
Total marketing expenses	**-772**	**-748**
Administrative expenses		
Staff costs (Note 18)	-1 745	-1 664
Depreciation and amortization	-295	-222
Other general administration expenses	-2 700	-2 408
Total administrative expenses	**-4 740**	**-4 294**

NOTE 20. OTHER INCOME / EXPENSES

	for the year ended 31 December	
	2012	**2011**
Income from government grant	2 037	3 479
Doubtful receivables expenses (-) / expense reduction (+)	-169	414
Other income(+)/expenses(-)	-172	-274
Total other income / expenses	**1 696**	**3 619**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

NOTE 21. FINANCIAL INCOME AND EXPENSES

	for the year ended 31 December	
	2012	**2011**
Interest income	1 591	1 947
Interest expense, loan	-1 358	-2 058
Interest expense, swap	-1 851	-827
Decrease of fair value of swap	-89	-2 221
Other financial income(+)/expenses(-)	1	35
Total financial income / expenses	**-1 706**	**-3 124**

NOTE 22. DIVIDENDS

	for the year ended 31 December	
	2012	**2011**
Dividends declared during the period	16 801	16 001
Dividends paid during the period	16 801	16 001
Income tax on dividends paid	-4 466	-4 253
Income tax accounted for	**-4 466**	**-4 253**

Income tax rates in 2012 and 2011 were 21/79.

Paid-up dividends per shares:		
Dividends per A-share (in euros)	0.84	0.80
Dividends per B-share (in euros)	600	600

NOTE 23. EARNINGS PER SHARE

	for the year ended 31 December	
	2012	**2011**
Net profit minus B-share preferred dividend rights	22 598	21 512
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 euros)	1.13	1.08
Earnings per B share (in euros)	600	600

Diluted earnings per share for the periods ended 31 December 2012 and 2011 are equal to earnings per share figures stated above.

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NOTE 24. OPERATING LEASE

Leased assets

	for the year ended 31 December	
	2012	**2011**
Total operating lease expenses for computers and vehicles	319	339
Operating lease (compensated by customers)	770	667

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

		as of 31 December	
		2012	**2011**
	Less than 1 year	255	230
	1-5 years	296	239
Total minimum lease payments		**551**	**469**

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

NOTE 25. 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 have control or significant influence 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 statement of financial position of the Group	**2012**	**2011**
Accounts receivable	4 919	4 977
Accrued income	7 123	8 878
Other long-term receivables	3 746	6 432
Trade and other payables	187	194

	for the year ended 31 December	
	2012	**2011**
Transactions		
Revenue	3 877	3 535
Government grant receivable for constructing new pipelines	4 429	16 750
Purchase of administrative and consulting services	998	1 001
Financial income	1 226	1 624

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

Short-term employee benefits to Management Board (excluding social tax)	326	246
Supervisory Board fees (excluding social tax)	40	39

The Group's Management Board and Supervisory Board members are considered as key management personnel who have received only the contractual salary payments as disclosed above. In addition to this some Board Members have also received direct compensations from the companies belonging to the group of United Utilities (Tallinn) B.V. as overseas secondees. Such compensations are recorded on line "Purchase of administrative and consulting services".

In 2012 45 thousand euros was paid to Management Board members as termination fees (2011: 0 euros). The off balance sheet potential salary liability would be up to 90 thousand euros (excluding social tax) if the Supervisory Board would want to replace all Management Board members.

Market prices were checked and used in the 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.

NOTE 26. SUBSIDIARIES

			Holding (%) as of 31 December	
			2012	**2011**
Subsidiary	**Location**	**Activity**		
Watercom OÜ	Tallinn, Estonia	Provision of non-core services related to water business	100	100

AS Tallinna Vesi registered its subsidiary Watercom OÜ on 25th May 2010.

NOTE 27. SUPPLEMENTARY DISCLOSURES ON THE PARENT COMPANY OF THE GROUP

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (Parent Company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the Parent Company the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for reporting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the Annual Report in conjunction with IAS 27, Consolidated and Separate Financial Statements.

In the parent separate primary financial statements, disclosed to these consolidated financial statements (Supplementary disclosures), investments into the shares of subsidiaries are accounted for at cost less any impairment recognised.

The separate reports on the Parent Company

According to the Estonian Accounting Law, the amount which can be distributed to the shareholders is calculated as follows: adjusted unconsolidated equity less share capital, share premium and reserves.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

STATEMENT OF FINANCIAL POSITION

	as of 31 December	
ASSETS	**2012**	**2011**
CURRENT ASSETS		
Cash and cash equivalents	23 354	14 442
Trade receivables, accrued income and prepaid expenses	18 246	19 702
Receivables from subsidiary	35	98
Inventories	353	321
TOTAL CURRENT ASSETS	**41 988**	**34 563**
NON-CURRENT ASSETS		
Other long-term receivables	7 559	9 583
Investment in subsidiary	527	527
Property, plant and equipment	149 133	146 255
Intangible assets	1 087	1 577
TOTAL NON-CURRENT ASSETS	**158 306**	**157 942**
TOTAL ASSETS	**200 294**	**192 505**
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Current portion of long-term borrowings	19	0
Trade and other payables	4 486	5 238
Derivatives	2 039	1 552
Payables to subsidiary	1 369	622
Prepayments and deferred income	2 221	1 082
TOTAL CURRENT LIABILITIES	**10 134**	**8 494**
NON-CURRENT LIABILITIES		
Deferred income from connection fees	7 892	6 824
Borrowings	94 953	94 939
Derivatives	2 538	2 936
Other payables	9	9
TOTAL NON-CURRENT LIABILITIES	**105 392**	**104 708**
TOTAL LIABILITIES	**115 526**	**113 202**
EQUITY		
Share capital	12 000	12 000
Share premium	24 734	24 734
Statutory legal reserve	1 278	1 278
Retained earnings	46 756	41 291
TOTAL EQUITY	**84 768**	**79 303**
TOTAL LIABILITIES AND EQUITY	**200 294**	**192 505**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

STATEMENT OF COMPREHENSIVE INCOME

	for the year ended 31 December	
	2012	**2011**
Revenue	52 437	50 669
Costs of goods sold	-20 014	-20 196
GROSS PROFIT	**32 423**	**30 473**
Marketing expenses	-731	-673
General administration expenses	-4 553	-4 186
Other income(+)/ expenses (-)	1 291	3 593
OPERATING PROFIT	**28 430**	**29 207**
Financial income	1 587	1 986
Net financial expenses	-3 285	-5 106
PROFIT BEFORE TAXES	**26 732**	**26 087**
Income tax on dividends	-4 466	-4 253
NET PROFIT FOR THE PERIOD	**22 266**	**21 834**
COMPREHENSIVE INCOME FOR THE PERIOD	**22 266**	**21 834**
Attributable profit to:		
Equity holders of A-shares	22 265	21 833
B-share holder	0.60	0.60
Earnings per A share (in euros)	1.11	1.09
Earnings per B share (in euros)	600	600

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

CASH FLOW STATEMENT

	for the year ended 31 December 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating profit	28 431	29 207
Adjustment for depreciation/amortisation	5 786	5 675
Adjustment for income from government grants and connection fees	-2 043	-3 432
Other finance income(+)/expenses(-)	0	35
Other non-cash adjustments	7	0
Profit (-)/loss(+) from sale and write off of property, plant and equipment, and intangible assets	30	66
Change in current assets involved in operating activities	-262	671
Change in liabilities involved in operating activities	-10	1 354
Total cash flow from operating activities	**31 939**	**33 576**
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans granted	-765	-3 151
Acquisition of property, plant and equipment, and intangible assets	-10 530	-19 010
Compensations received for construction of pipelines	11 198	11 284
Proceeds from sale of property, plant and equipment, and intangible assets	2	12
Interest received	1 581	1 943
Total cash flow used in investing activities	**1 486**	**-8 922**
CASH FLOWS FROM FINANCING ACTIVITIES		
Interest paid and loan financing costs	-3 242	-3 051
Repayment of finance lease	-4	0
Dividends paid	-16 801	-16 001
Income tax on dividends	-4 466	-4 253
Total cash flow used in financing activities	**-24 513**	**-23 305**
Change in cash and cash equivalents	**8 912**	**1 349**
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD	**14 442**	**13 093**
CASH AND EQUIVALENTS AT THE END OF THE PERIOD	**23 354**	**14 442**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
as of 31 December 2010	**12 782**	**24 734**	**1 278**	**34 676**	**73 470**
Reduction of the share capital	-782	0	0	782	0
Dividends	0	0	0	-16 001	-16 001
Comprehensive income for the period	0	0	0	21 834	21 834
as of 31 December 2011	**12 000**	**24 734**	**1 278**	**41 291**	**79 303**
Carrying amount of investments under control and significant influence	0	0	0	0	-527
Value of investments under control and significant influence using the equity method	0	0	0	0	99
Adjusted unconsolidated equity as of 31 December 2011	**12 000**	**24 734**	**1 278**	**41 291**	**78 875**
as of 31 December 2011	**12 000**	**24 734**	**1 278**	**41 291**	**79 303**
Dividends	0	0	0	-16 801	-16 801
Comprehensive income for the period	0	0	0	22 266	22 266
as of 31 December 2012	**12 000**	**24 734**	**1 278**	**46 756**	**84 768**
Carrying amount of investments under control and significant influence	0	0	0	0	-527
Value of investments under control and significant influence using the equity method	0	0	0	0	432
Adjusted unconsolidated equity as of 31 December 2012	**12 000**	**24 734**	**1 278**	**46 756**	**84 673**

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Kuupäev/date 25.02.2013
PricewaterhouseCoopers, Tallinn

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012 (thousand EUR)

CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS

The Management Board has prepared the management report and the financial statements of AS Tallinna Vesi on 25 February 2013. The Supervisory Board of AS Tallinna Vesi has reviewed the annual report, prepared by the Management Board, consisting of Management Report and the financial statements, the Management Board's proposal for profit distribution and the independent auditors' report, and has approved the annual report for presentation on the Shareholders' General Meeting.
The annual report has signed by all the members of the Management Board and Supervisory Board.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		25.02.2013
Leho Võrk	Member of the Management Board		25.02.2013
Aleksandr Timofejev	Member of the Management Board		25.02.2013
Riina Käi	Member of the Management Board		25.02.2013
Ilona Nurmela	Member of the Management Board		25.02.2013
Robert John Gallienne	Chairman of the Supervisory Board		21.03.2013
Steven Richard Fraser	Member of the Supervisory Board		
Simon Gardiner	Member of the Supervisory Board		21.03.2013
Brendan Francis Murphy	Member of the Supervisory Board		21.03.2013
Mart Mägi	Member of the Supervisory Board		
Rein Ratas	Member of the Supervisory Board		21.03.2013
Toivo Tootsen	Member of the Supervisory Board		21.03.2013
Valdur Laid	Member of the Supervisory Board		21.03.2013
Priit Lello	Member of the Supervisory Board		21.03.2013

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS Tallinna Vesi

We have audited the accompanying consolidated financial statements of AS Tallinna Vesi and its subsidiary, which comprise the consolidated statement of financial position as of 31 December 2012 and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of AS Tallinna Vesi and its subsidiary as of 31 December 2012, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Emphasis of Matter

We draw attention to Note 3 to these consolidated financial statements, which describes the uncertainty related to the outcome of the lawsuit between AS Tallinna Vesi and Estonian Competition Authority. Our opinion is not qualified in respect of this matter.

AS PricewaterhouseCoopers

Tiit Raimla
Auditor's Certificate No.287

Stan Nahkor
Auditor's Certificate No.508

25 February 2013

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* *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.*