

AS TALLINNA VESI

CONSOLIDATED ANNUAL AND SUSTAINABILITY REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

(Translation of the Estonian original)





(EUR thousand)

AS TALLINNA VESI
CONSOLIDATED ANNUAL AND SUSTAINABILITY REPORT
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

Beginning of the financial year	1 January 2016
End of the financial year	31 December 2016
Name of the Company	AS TALLINNA VESI
Legal form of the Company	Public limited company
Commercial register number	10257326
Address	Ädala St.10, Tallinn, Estonia
Chairman of the Board	Karl Heino Brookes
Telephone	+ 372 6 262 200
Fax	+372 6 262 300
E-mail	tvesi@tvesi.ee
Web-page	www.tallinnavesi.ee
Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditors	AS PricewaterhouseCoopers
Documents attached to the Annual Report	Independent auditor's report



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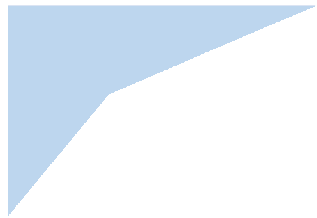
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OUR COMPANY

AS Tallinna Vesi is the largest water utility company in Estonia, providing drinking water and wastewater disposal services to nearly one third of Estonian population. We serve over 22,000 customers and 460,000 end consumers in Tallinn and its surrounding areas. We have a responsibility to bring very high quality drinking water to consumers, ensure service reliability and to collect and treat wastewater and storm water in an environmentally responsible way.

AS Tallinna Vesi was privatised in 2001 and based on the Services Agreement signed with the City of Tallinn at the time of the privatisation, the Company must fulfil 97 levels of services. Current Services Agreement is effective till 2020, still AS Tallinna Vesi has the exclusive right to provide water and wastewater services in Tallinn until 2025.

We have two main treatment plants, Ülemiste Water Treatment Plant and Paljassaare Wastewater treatment plant. In 2016, the Water Treatment Plant produced an average 68,000 m³ of water per day (2015: 67,000). It has been relatively stable over the years. Almost 90% of drinking water is produced from surface water, with Lake Ülemiste as the main source for the residents of Tallinn, leading it to be declared a non-public water body. Approximately 10% of consumers use regional ground water. Average water consumption has been relatively stable over the years, at around 95 litres per day.

In 2016, the Wastewater Treatment Plant treated on average 137,000 m³ of wastewater per day, compared to 124,000 m³ in 2015.

We have an accredited water laboratory and an accredited wastewater laboratory which, in 2016, conducted together approximately 150,000 analysis (2015: 146,000), out of which 100,000 were chemical and microbiological analysis of drinking water (2015: 99,000) and 50,000 chemical analysis of wastewater (2015: 47,000).

The public water supply system comprises almost 1,150 km of water networks, 18 water-pumping stations and 64 ground borehole pumping stations with 93 boreholes. The catchment area in Harju and Järvamaa counties is around 1,800 km². The public sewerage system comprises 1,126 km of wastewater networks, 483 km of storm water networks and 174 sewerage and stormwater pumping stations across the service area. In 2010, AS Tallinna Vesi founded a subsidiary company, Watercom OÜ, aimed at providing services to the Company, but moreover, to diversify the product range on offer and develop a non-regulated business.

AS Tallinna Vesi Group consists of two companies. The subsidiary, Watercom OÜ, is wholly owned by AS Tallinna Vesi and consolidated to the results of the Group (hereinafter referred to as Group). The Group structure has remained unchanged since 2015.

OPERATIONAL SITES

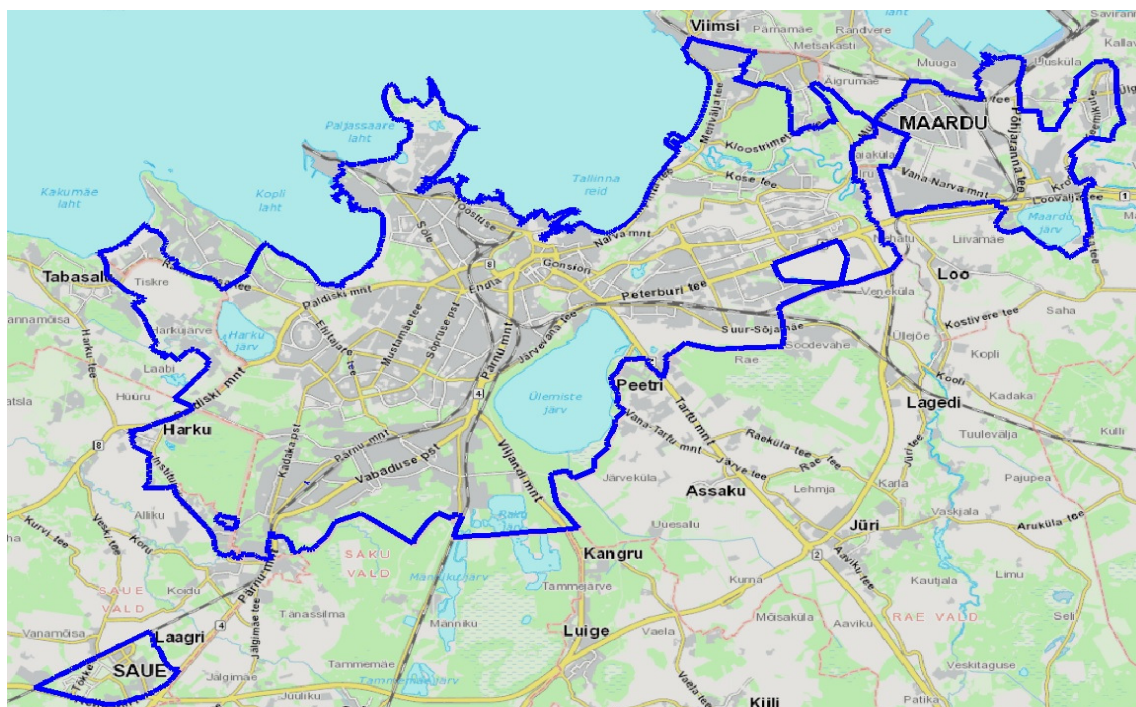
- Head office, customer service, support services and OÜ Watercom at Ädala 10, Tallinn
- Ülemiste Water Treatment Plant, Water and Microbiological Laboratory at Järvevana Road 3, Tallinn
- Paljassaare Wastewater Treatment Plant, Composting Fields and Wastewater Laboratory at Paljassaare Cross 14, Tallinn
- The catchment area of ca 1,800 km² in Harju and Järvamaa counties

OUR MAIN PRODUCTS AND SERVICES

- Water collection, treatment and supply
- Water and wastewater services
- Wastewater and storm water drainage and treatment
- Laboratory services
- Design works
- Pipeline construction works
- Owner supervision and project management
- Transportation services and road construction

COMPANY'S AREA OF OPERATION

- City of Tallinn
- City of Maardu
- City of Saue
- Harku Parish (villages of Tiskre and Harkujärve, and small town of Harku)
- The catchment area in Harju and Järva counties



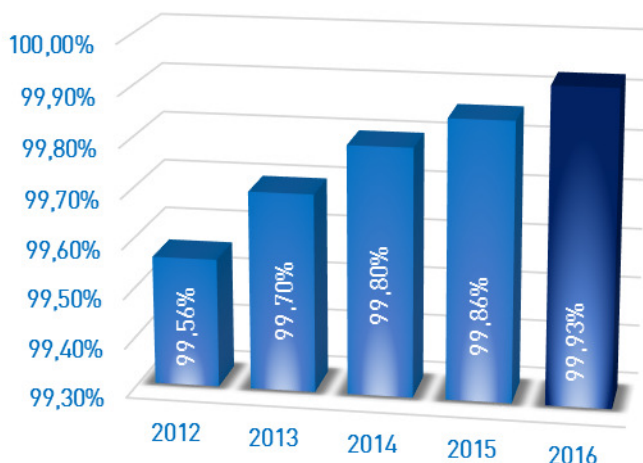
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OUR PERFORMANCE IN 2016

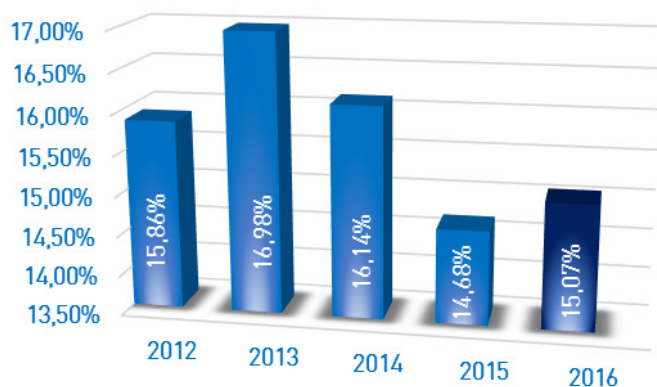
OPERATIONAL HIGHLIGHTS 2016

WATER QUALITY



Water quality was best over the years. Professional operating of the treatment plant and professional and efficient oversight of the processes, supported by continuous monitoring allows us to guarantee consistent and improved water quality.

LEAKAGE LEVEL IN WATER NETWORK

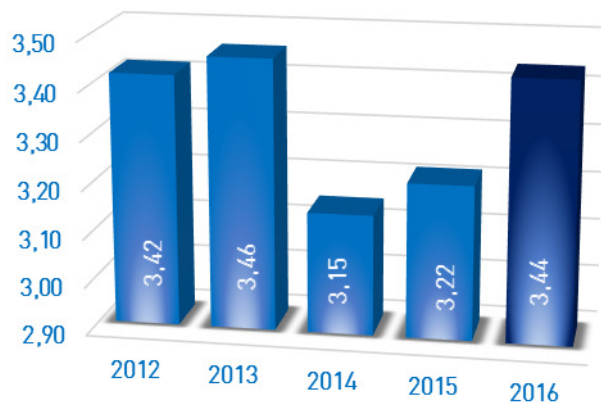


Leakage level has been low for two consecutive years, which is a result of continuous monitoring of the state of our network and good maintenance plan.

(EUR thousand)

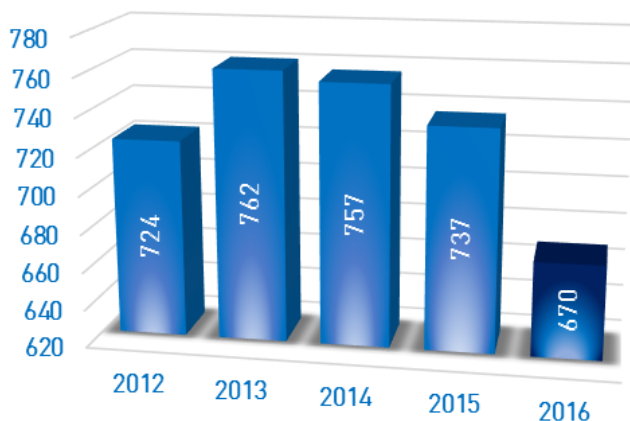
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AVERAGE INTERRUPTION TIME PER PROPERTY IN HOURS



Our aim is to provide high quality drinking water to all our clients and keep the water interruption time as short as possible. Our target is, that water interruptions would not last longer than 3.5 hours on average.

NUMBER OF SEWAGE BLOCKAGES



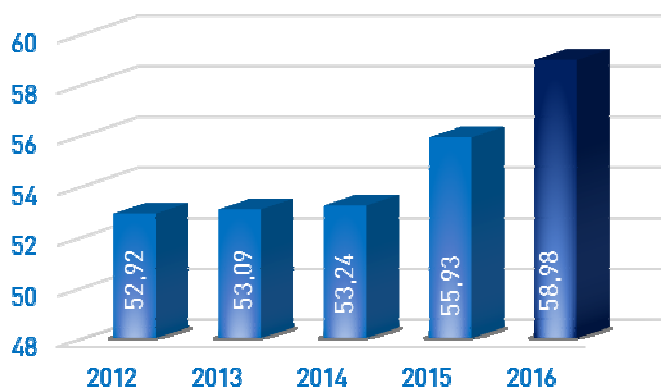
Proactive jet washing has resulted a decrease in blockages.

(EUR thousand)

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FINANCIAL HIGHLIGHTS 2016

SALES



The sales have increased by 5.5% or EUR 3.05 million. 58.5% or EUR 1.79 million of the increase comes from construction and asphaltting services. 41.0% or EUR 1.25 million comes from the increased consumption in the main water and wastewater services area.

GROSS AND OPERATING PROFIT



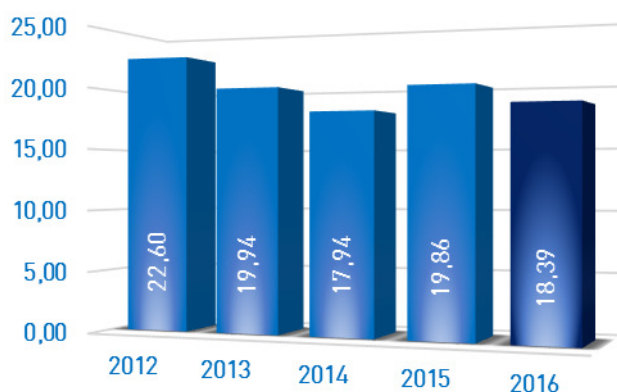
The gross profit increased by 3.1% or EUR 1.01 million to EUR 33.26 million. The increase was related to higher main services revenues and lower chemical costs, accompanied by higher revenues and profit from construction and asphaltting services. It was balanced by lower water, wastewater and storm water revenues from outside the main service area and by higher staff, depreciation and other direct production costs.

The operating profit decreased by 3.7% or EUR 0.95 million to EUR 24.63 million. The decrease was mainly impacted by the described changes in gross profit, accompanied by higher doubtful receivables expenses and tariff dispute related legal costs.

(EUR thousand)

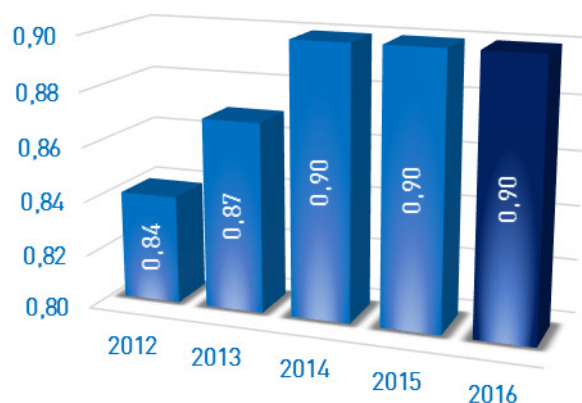
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NET PROFIT



The net profit decreased by 7.4% or EUR 1.47 million to EUR 18.39 million. In addition to discussed changes it was impacted by increased financial expenses mainly in relation to the negative change of the fair value of swap contracts by EUR 1.15 million, balanced by the decrease in interest costs by EUR 0.68 million.

TOTAL DIVIDEND PER SHARE PAY-OUT



Total dividends per share pay-out from 2015 net profit was 90 cents per share. It is in accordance with the Company's dividend policy to maintain dividends to shareholders at the same amount in real terms. Last three years, there has been no change in dividend pay-out per share.

CHAIRMAN'S STATEMENT

Continued Performance

As in previous years, 2016 was another year of exceptional performance for AS Tallinna Vesi. Once again, we managed to achieve further improvements with respect to our operational results and the quality of services that we provide to our customers in Tallinn and surrounding areas. This is further reinforced by the results of the annual customer satisfaction survey, delivery against our contractual obligations and targets set internally. It is also pleasing to see further growth within our wholly owned subsidiary Watercom, which has increased its external revenues 1.6 times.

As a water utility Company, we have a significant interface with the surrounding environment and local communities and we continue to work hard to ensure, that the needs and expectations of our various stakeholders are constantly being met. AS Tallinna Vesi has an internal workforce of more than 300 employees and considerable focus is placed on ensuring their continued safety, commitment and development. Several graduates and apprentices joined the Company during 2016 and they will no doubt generate fresh ideas and innovation throughout their careers within AS Tallinna Vesi. The effectiveness of the management team has also been enhanced, through further training and development. This was rewarded with excellent results in the 2016 employee opinion survey.

The Company has once again excelled in investor relations, which was recognised during the annual Nasdaq Baltic Market Awards, where AS Tallinna Vesi secured 1st place in several awards, including the main category, "Best Investor Relations in the Baltic market" for a fourth consecutive year.

The Company continues to seek a resolution with respect to the ongoing tariff dispute and eagerly awaits the outcome of the International Arbitration, which is expected in the second or third quarter in 2017. In term of the Local Court proceeding, the company received a decision from the Court of the Second instance on the 26th January 2017. The Company's appeal was dismissed by the Circuit Court. The Company submitted the cassation to the Supreme Court on 27 February 2017.

As stated previously and on numerous occasions, the Company remains open to discussions related to a negotiated settlement.

Attractive for shareholders

We firmly believe that our operational and financial performance still makes AS Tallinna Vesi an attractive investment for existing and future shareholders. Last year's total revenues were EUR 58.98 million, showing an increase by 5.5% or EUR 3.05 million year on year. Revenue from water and wastewater services is directly related to increased consumption, as tariffs continue to remain frozen at their 2010 levels. In 2016, we increased external sales of construction, design and asphaltting services by 61.2% or EUR 1.76 million. Operating profit for 2016 was EUR 24.63 million, a decrease of 3.7% or EUR 0.95 million, compared to 2015.

We have been a consistent dividend payer. In June 2016, we made a payment of EUR 0.90 per share. This is in accordance with our current dividend policy, which is to keep the dividends in real terms, therefore providing a return that is consistent with other privatised utilities in Europe.

Operations performance – “High quality water supply with effective wastewater treatment”

The Company’s continued priority is to provide a reliable and high quality drinking water service to our customers, and to ensure that all our activities, from initial water catchment to wastewater treatment, are enacted in accordance with strict environmental legislation.

Together with the legislative requirements, the company adhere to the 97 levels of service, as stipulated within Services Agreement that was signed in conjunction with the City of Tallinn, when the Company was first privatised back in 2001. These levels of service dictate strict customer performance standards and also ensure the company acts as an effective custodian of its asset base, by making timely and informed capital investments from retained earnings and bank loans.

One of the most significant indicators directly impacting public health and wellbeing is the quality of drinking water. This is enforced by strict legislation and is backed up by a rigorous sampling and testing regime. In 2016, we took a total of 2,948 water samples from consumers’ taps in Tallinn and Saue out of which only two samples were non-compliant, indicating 99.93% compliance. Through annual media campaigns, we continue to encourage people to drink tap water and have installed several water fountains throughout the City, including the airport.

A survey, carried out by an independent market research company Kantar Emor, confirmed that on average, 80% of end customers are now drinking tap water, which compares favourably to only 48% in 2011.

AS Tallinna Vesi is also responsible for delivering an effective wastewater treatment and discharge service to almost one third of Estonia’s population. Ensuring the optimal performance of the Company’s wastewater treatment plant at Paljassaare is, therefore, of critical importance in order to guarantee that we meet our environmental obligations, related to the final effluent that is discharged into the Baltic Sea. Throughout 2015 and 2016, treated effluent was 100% compliant with all the stipulated quality requirements, which is a testament to effective operations and maintenance and targeted investments, including the re-construction, without any disruption to service, of the final effluent wet well at a cost of EUR 759 thousand.

Conditional to the previously mentioned Services Agreement, AS Tallinna Vesi replaces 10 km of existing network, each year (5 km water and 5 km wastewater). In addition to this programme, the company also invested in a major water network reinforcement and completed a challenging deep level sewer repair, both of which serve in excess of 100,000 end users.

Excellent customer service – “One of Europe’s best performing utilities”

We are committed to providing the best quality drinking water to our customers. However, we believe this should be reinforced by an equally outstanding service and by effective communications. Each year, an extensive customer satisfaction survey is carried out by an independent research company, Kantar Emor. The results of this survey map the current level of satisfaction for both our contractual clients and our consumers who pay indirectly via housing associations and landlords

The ratings received are not only based on direct customer/consumer experience, but also on the perceptions generated by external coverage in the media and other forms of indirect contact. In 2016, customer satisfaction reached its highest level to date with a 95 index point level being achieved, compared to 94 in the previous year.

Our employees – “Best working environment in Estonia for 2016”

Ensuring the continued health and safety of employees and third parties who interface with the company’s activities is of vital importance. Considerable management focus has been placed on improving the safety culture and enhancing existing policies and procedures.

Critical to AS Tallinna Vesi’s ongoing success is ensuring the continued motivation and commitment of employees, who work extremely hard in all weather conditions, in order to meet the demands set by our customers and external stakeholders. Acting on feedback received from previous employee opinion surveys, additional personal development opportunities have been created and internal communications further enhanced to improve overall staff engagement.

Responsible and sustainable thinking – “Continuous work with stakeholders builds trust”

As a listed company we are accountable to numerous internal and external stakeholders, with whom we interact on a daily basis. Focus remains on creating consistency, transparency and balance between the various elements of our operations and on ensuring the highest standards of corporate governance. Apart from the recognition for excellence in investor relations the Company was also recognised with the award of “Golden” Mark in Corporate Social Responsibility index by Estonian Responsible Business Forum. This is a sign of being responsible in our actions and minds thorough the business.

During the year, we also continued to support the wider community and provided support to a number of good causes and charities, including:

- Years of cooperation with and support to the Estonian Disabled Athlete Sports Association
- Cooperation with the Estonian Basketball Union, Youth basketball
- Many-sided assistance to the nursery “Õunake” for disabled children
- Support to the Elementary School “Ristiku” for children with learning disabilities
- Engaged with fund-raising initiative “Rat Race” and SPIN project to engage youth with sports and healthy lifestyle



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- Provided quality drinking water to several community and sporting events
- Contributed to building ice-skating rinks across the city during the winter period
- Continued our environmental education programmes, in co-operation with educational institutions and nurseries.
- Provided tours of our water and wastewater treatment facilities to more than 3,000 adults and children

Outlook for 2017

AS Tallinna Vesi has been in dispute with the Estonian Competition Authority, with regards to water tariffs, since 2011. Following an unfavourable decision from the Administrative Court, the Company has entered the appeal process and received a verdict of 26th January 2017 from the District Court, where the Company's claim was dismissed. Whilst the appeal process continues, tariffs will remain frozen at 2010 levels.

In parallel, and independent from the Local Court proceedings, International Arbitration Proceedings are being held via the "International Centre for Settlement of Investment Disputes" (ICSID). In 2014, AS Tallinna Vesi and its shareholder United Utilities (Tallinn) B.V. commenced arbitration proceedings against the Republic of Estonia for breach of the "Agreement on the Encouragement and Reciprocal Protection of Investments between the Kingdom of The Netherlands and the Republic of Estonia."

The hearing took place in November 2016 in Paris. Both parties submitted their Post Hearing Briefs to the panel in the beginning of February 2017.

2017 will witness the verdict from the International Arbitration proceedings and potentially a final decision from the protracted Local Court proceedings. Whilst the International Arbitration proceedings will determine potential compensation, it will be the Local Court proceedings that will determine the future fortunes of the company, in terms of tariff revenue. Growth of the regulated business is currently severely curtailed, and focus will therefore remain on delivering an outstanding service and maintaining a positive public perception.

Further growth is expected within the Company's subsidiary Watercom, but this work has to be won within a fiercely competitive environment and with relatively low margins, and it is therefore unlikely to have a significant impact on the future fortunes of AS Tallinna Vesi.

We will continue focussing on delivering an outstanding service to our customers and consumers. Building on the achievements of 2016, we will continue to work with all our stakeholders, including investors, and as a good corporate citizen, will continue to support the wider communities and environment.

Finally, I would like to thank my colleagues in AS Tallinna Vesi, Watercom OÜ and United Utilities, and all our suppliers and business partners for their continued support in helping the company to deliver an exceptional performance during 2016.

Sincerely,
Karl Heino Brookes

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HOW WE CREATE VALUE

We create a better life with pure water, through commitment. We work tirelessly and passionately to achieve the company's goals and objectives.

BY FOCUSING ON PEOPLE	WITH THE AIM OF	DELIVERING VALUE SOCIALLY
<p>We value every employee's contribution</p> <ul style="list-style-type: none">• Everyone's opinion is important.• Health and Safety is paramount in everything we do.• We encourage continuous improvement and share best practice.• We constantly train and develop our workforce.• We are results focused and flexible.• We live by our values.		<p>Customers</p> <p>Our key priority is to provide our customers with a quality service, which they can rely on continuously, 24/7. We are fully aware of our responsibilities and deliver on our promises.</p>
<p>CUSTOMER SERVICE</p> <p>We aim to exceed expectations</p> <ul style="list-style-type: none">• We treat everybody as a valued customer• We anticipate our customers' requirements, before they become problems.• We embrace the latest technology to enhance customer communications• We deliver on our promises	<ul style="list-style-type: none">• Achieving customer service excellence	<p>Employees</p> <p>We value the contribution of our employees and seek to ensure their continued motivation and commitment.</p>
<p>QUALITY</p> <p>We meet and exceed all requirements</p> <ul style="list-style-type: none">• We comply with legislative requirements• We achieve all Levels of Service• We satisfy the needs of our various stakeholders• We deliver a quality service.	<ul style="list-style-type: none">• Delivering shareholder value• Achieving outstanding operational performance• Sustainable and incremental business growth	<p>We create a working environment that encourages everyone to innovate and deliver a high quality service.</p>
<p>SUSTAINABILITY</p> <p>We use resources efficiently and responsibly</p> <ul style="list-style-type: none">• We continuously seek to improve our service, through improved productivity and adopting the latest technology.• We minimise our environmental footprint wherever possible.		<p>Community</p> <p>We play an active part in local communities and seek to minimise our operational and environmental impact wherever possible.</p>
		<p>ENVIRONMENTALLY</p> <p>Quality and environment</p> <p>We value the natural environment we operate in and therefore use natural resources sparingly and continuously seek new ways for more sustainable operations.</p>
		<p>Community</p> <p>We work with local communities to promote environmental thinking and awareness.</p> <p>We donate to non-profit</p>



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- We are good corporate citizens and support local communities.
- We support and cooperate with universities and research institutions

COMPANY'S VALUE

We meet shareholders' expectation

- We spend and invest wisely.
- We seek opportunities for incremental growth.
- We have a sustainable and attractive dividend policy.

organisations and offer continued support worthy causes.

ECONOMICALLY

Investors

We aim to be transparent and honest through our business activities, giving timely and accurate information to our shareholders. All stakeholders are treated equally, and we are focused on a path of continuous improvement, whilst ensuring continued sustainability.

Partners

We build and develop strategic relationships with partners and suppliers to create additional efficiency and enhance customer service.

OUR VISION AND STRATEGY

OUR MISSION

Creating a better life through pure water

OUR VISION

Everyone wants to be our customer, employee and partner, because we are the leading water services company in the Baltics.

STRATEGIC OBJECTIVES

We have established strategic objectives, which balance the requirements of our various stakeholders:

- To achieve customer service excellence
- To achieve operational excellence
- To grow the activity of the company
- To deliver shareholder value

By achieving our overall strategic objectives, we hope to be the leading water services company in the Baltics, both for the quality of the product as well as the quality of the service. Fundamental to the successful delivery of our strategic objectives is the need to work closely with all our stakeholders.

TO ACHIEVE CUSTOMER SERVICE EXCELLENCE

We are committed to achieving customer service excellence - delivering a service that matches and even exceeds the expectations of all our stakeholders: customers, employees, community, investors, partners and the public. To achieve this, we need to have systems, processes and people that focus on each of our customers and end users.

Over the years we have already put in place many of the building blocks required for outstanding customer service. Some of the key ones are: high levels of water quality and security of supply, recently updated billing and customer information system, a functional web-based self-service – all of which have been acknowledged in the results of the recent customer satisfaction survey. As customers are becoming more focussed towards e-services and web-based solutions, it is important that we continue to enhance our web-based self-services, particularly in relation to billing and online submission of meter readings.

The overall aim is to provide customers with a seamless and invisible service that simplifies and limits the necessity for interaction, and provides operational information on a proactive basis.

Media communication and growing consumer awareness about the environment and our processes also provide opportunities to strengthen customer relations.

Delivering excellence in customer service requires the commitment of all AS Tallinna Vesi employees, and especially of our front-line staff who interact with customers on a daily basis.

To deliver customer service excellence, we will:

- Meet and exceed the expectations of our customers.
- Further develop proactive and convenient methods of customer communication and interaction.
- Continue to ensure a customer-focussed mind-set throughout the Company.
- Further develop our employees to deliver outstanding customer service
- Continue to develop our IT-solutions, to support the business and make customer communication and interaction as uncomplicated as possible.
- Adjust and simplify our processes, procedures and structure, to make contact and business with us simple
- Constantly measure and act on customer feedback to ensure continued customer service excellence.

TO ACHIEVE OPERATIONAL EXCELLENCE

We are committed to achieving continued operational excellence - delivering the best service and product at a reasonable price and utilising the most efficient processes and technology. This is backed up by our continued compliance and out-performance of our contractual obligations, as detailed in the Services Agreement, with the City of Tallinn.

To ensure these obligations are met, the Company has constantly improved and invested in its operational processes and procedures, an example of which is attaining several internationally recognized quality standards – ISO 17025, ISO 9001, ISO 14001, EMAS (Eco Management and Audit Scheme) and OHSAS 18001 (Occupational Health and Safety Management System).

Sustainability means looking at the long term and ensuring that our actions will not jeopardize the long term future of the company or damage the relationship with its numerous stakeholders. AS Tallinna Vesi has a significant environmental footprint, and taking the utmost care is critical within all of our activities.

Achieving operational excellence means also using the latest tools and equipment to maximise performance and limit the impact we have on customers. The water cycle involves many different techniques in many different fields of activity. Most of these techniques are in a

constant state of evolution and improvement. Some of them, like main treatment processes, are changing slowly, whilst others, like network automation and IT are developing quickly. Being open to change and being innovative is an important driver to constantly ensure the delivery of the best quality product at an efficient cost.

Achieving operational excellence is not possible without the continued commitment of our workforce. We consider our people as our greatest asset and we offer an environment where people with passion and commitment work together not only towards the achievement of corporate goals, but also towards personal career goals, supported with training and the continuous development of staff.

Cooperation and communication with stakeholders is also a key driver to achieve operational excellence. Our everyday actions have a direct impact on our numerous stakeholders, and we must ensure that we are proactive in communicating and explaining our activities.

To deliver operational excellence, we will:

- Continue to comply with all regulatory and contractual obligations.
- Continue to be an effective custodian of our asset base and invest appropriately.
- Maintain awareness of new technology in the sector that could further improve service and efficiency.
- Maintain focus on training and developing both new and existing employees.
- Constantly seek feedback and constructive cooperation with all our stakeholders.
- Constantly seek to simplify our existing processes, procedures and structure
- Constantly measure, monitor and improve performance.

TO GROW THE ACTIVITY OF THE COMPANY

We are committed to seek potential growth of the company's activity – increasing company's turnover whilst keeping a satisfactory rate of return.

Considering the current situation as regards to the tariff dispute, growth within the services area is anticipated to come from two main sources. Firstly, increased household consumption related to increases in GDP per capita, and secondly, macroeconomic growth will drive increase in numbers of commercial customers. There is a correlation between increase in wealth and increase in water consumption. The commercial sector growth is anticipated to be driven by macroeconomic performance increasing customer numbers in the services sector, especially in retail, tourism and leisure.

We are also prepared to grow turnover through areas that immediately surround Tallinn. The real estate market continues to develop in such a way that people are moving from apartments in the city centre to larger apartments and private houses in the suburbs and neighbouring municipalities. We have constructed connections with surrounding areas enabling us to supply water and wastewater services to these neighbouring municipalities.

This way we can make more efficient use of our networks and can use the existing spare capacity of the treatment plants, whilst though the connection into the company's network the surrounding municipalities receive water and wastewater services that are fully compliant with Estonian and EU legislation.

Besides targeting growth in volumes of water and wastewater, we are also actively looking at new opportunities that support the company's core business through our subsidiary Watercom OÜ. Watercom was established in 2010 with two main objectives – to grow the external revenues for the company and to provide certain services to AS Tallinna Vesi with as high quality and efficiency as possible. In recent years Watercom has made significant developments with regard to growing external revenues – focussing even more on securing public procurements and providing services to other companies, carrying out large construction projects in Tallinn and broader in Estonia.

To grow the activity of the company, we will:

- Be prepared to treat more wastewater from and provide services to municipalities surrounding Tallinn.
- Continue to grow and support the activities of Watercom.
- Actively communicate what we can bring to the potential clients.

TO INCREASE SHAREHOLDER VALUE

We are committed to increasing shareholder value – delivering the right rate of return, combining distribution of dividends and improving value of the share on the market.

From the financial perspective, a strong earnings base will be accomplished through increased consumption of water per capita supported by effective cost management. Operationally, service excellence through contract out-performance and compliance with all Estonian and EU regulations. We keep striving for better results both operationally and financially. We focus on high quality customer service, which gives our clients and end-users a product they can trust. Our aim is to have as low impact on the environment as possible. All of this will add to the positioning and image of the company, enabling it to meet the expectations of investors and analysts.

Ensuring its investment programme is kept under control is one of the future challenges faced by the company. The assets are in good condition, but some significant investments are required to refurbish and enhance the existing wastewater treatment process. The prices of contracted construction services for network renovation works are also expected to increase to keep in line with the construction price indexes.

It is also important that we continue to communicate our targets and performance to investors. This is done through holding regular meetings between the key institutional shareholders, potential investors and the company's management and by holding investor webinars following the quarterly financial results. We have worked hard at our investor relations programme since listing on the Tallinn Stock Exchange and will continue to do so in the future.



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One of the key challenges on the Company's future financial results is the possible negative outcome of ongoing tariff dispute both locally and internationally. We are of the belief that the Services Agreement signed at the time of privatisation is an administrative contract and therefore should be honoured. This was also confirmed by the Estonian Courts, back in 2012.

In order to further increase the transparency of our Management Board activities to shareholders, we applied and have reported good corporate governance recommendations on regular bases starting from 2006.

To increase shareholder value, we will:

- Continue to deliver Customer Service Excellence.
- Focus on Operational Excellence.
- Carefully assess each expenditure decision, both capital and operational.
- Retain sufficient control over revenues and receivables.
- Communicate transparently with our stakeholders.

DELIVERY OF OBJECTIVES

DELIVERY OF 2016 OBJECTIVES

PEOPLE

Status

Work accidents frequency rate (AFR) is lower than 0.4	Achieved
At least 90% of satisfactory results from the H&S audits at the Company's construction and repair sites	Achieved

CUSTOMER SERVICE

The number of customer complaints does not exceed 88	Achieved
The monthly client satisfaction surveys' result is higher than 4 (on the scale of 5)	Achieved

OPERATIONAL PERFORMANCE

0 non-compliances with Levels of services (LoS), except LoS WS7 (length of water interruptions must be <12 hours)	Achieved
Level of leakages should not exceed 15%	Not achieved
Drinking water quality is at least 99.5% compliant with all the requirements	Achieved
No pollution incidents	Achieved
The effluent leaving the Wastewater Treatment Plant is 100% compliant with all the requirements	Achieved

FINANCIAL PERFORMANCE

The subsidiary's OÜ Watercom external revenues are equal or higher than EUR 3.33 million	Achieved
The subsidiary's OÜ Watercom external profits are equal or higher than EUR 333 thousand	Not achieved
The subsidiary's OÜ Watercom connection point construction revenues are equal or higher than EUR 614.4 thousand	Achieved
The subsidiary's OÜ Watercom connection point construction profits are equal or higher than EUR 55.1 thousand	Achieved
Saving in fixed and variable costs w/o agreed exceptions EUR 300 thousand	Not achieved

2017 OBJECTIVES

PEOPLE

Metric

Work accidents frequency rate (AFR) is lower than 0.2	<0.2
At least 93% of satisfactory results from the H&S audits at the Company's construction and repair sites	93%

CUSTOMER SERVICE

The number of customer complaints is lower than 70	<70
Number of responses rated „1“ in the monthly customer feedback questionnaire carried out by the company remains below 5.5%.	<5.5%

OPERATIONAL PERFORMANCE

0 non-compliances with LoS	0
Level of leakages lower than 15%	<15%
Drinking water quality is at least 99.6% compliant with all the requirements	99,6%
No pollution incidents	0
Average length of the water interruption less or equal to 3.5 hours	≤3.5

FINANCIAL PERFORMANCE

The subsidiary's OÜ Watercom external revenues are equal or higher than EUR 6.25 million	≤EUR 6.25 million
The subsidiary's OÜ Watercom external profits are equal or higher than EUR 400 thousand	≤EUR 0.40 million
The subsidiary's OÜ Watercom connection point construction revenues are equal or higher than EUR 650 thousand	≤EUR 0.65 million
The subsidiary's OÜ Watercom connection point construction profits are equal or higher than EUR 45 thousand	≤0.045 million
Saving in fixed and variable costs w/o agreed exceptions EUR 300 thousand	≥ 0.3 million

OUR PERFORMANCE

ECONOMIC ENVIRONMENT

As AS Tallinna Vesi operations are only in Estonia, then our activities are mainly dependent on the trends in Estonian economy.

According to the Ministry of Finance forecast, Estonia's Gross Domestic Production (GDP) will grow by 2.5% in 2017 and 3% in 2018. Domestic demand growth in 2016 and 2017 is mainly supported by private consumption, which in itself is related to continuous growth of salaries. Whilst in 2016 the Consumer Price Index (CPI) was mostly negative, then average salaries increase supported consumption. At the end of 2016 CPI started to pick up and it will continue to grow also in 2017. At the end of 2015 the CPI was negative of 0.9%, already at the end of 2016 CPI had increased to 2.2% and is expected to grow further to 2.7% in 2017 and 2018. Last time, when CPI increase was more than 2.2% remains back to August 2013, when the CPI was 2.9%. The biggest impact to CPI came from the increase of fuel prices of 16.1% compared to the end of 2015.

According to the Services Agreement between AS Tallinna Vesi and City of Tallinn Company's tariffs are directly related to CPI. Still due to ongoing tariff dispute the Company's tariffs are frozen at 2010 level. There has been an incremental increase in consumption for last few years in Company's main services areas and also in surrounding areas. It has been impacted by urbanization and population growth in Tallinn and surrounding municipalities.

Changes in CPI and construction price index have direct impact on expenditures both operating and capital. According to the Statistical Board, average construction price index decreased by 0.8% compared to 2015. Although salary increase continued, then the prices of materials and machinery were lower by 1.8% and 1.1% respectively.

AS Tallinna Vesi is also dependent on labour market. Labour market continues to be intensive and pressure for salary growth for skilled employees remains. Employment growth is expected to be on the same level with 2016 Summer Macroeconomic Prognosis of Ministry of Finance of Estonia. Still it is relatively difficult to find skilled staff. The average change in salaries has been quite high over last couple of years. Despite lower real wage growth, impacted by higher expected CPI, the nominal growth in salaries is expected to stay almost the same level in 2017 and 2018, which has an impact to Company's profitability. Changes in the average salaries have an impact on the operating and capital expenditures.

OPERATIONAL RESULTS

Customer Service	2016	2015	Performance		2012
			2014	2013	
Number of written complaints	46	67	76	118	152
Number of customer contacts regarding water quality	166	115	152	252	239
Number of customer contacts regarding water pressure	339	337	380	576	736
Number of customer contacts regarding blockages and discharge of storm water	1,190	1,061	1,060	1,405	1,651
Responding written customer contacts within 2 work days	99.46%	99.20%	99.10%	99.10%	98.46%
Number of failed promises	4	9	54	117	19
Results of the annual customer satisfaction survey (TRI*M index)	94	94	85	79	85
Number of contacts per customer	1.3	1.3	1.5	1.9	n/a
Notification of unplanned water interruptions at least 1 h before the interruption	98.8%	98.7%	95.0%	96.9%	89.0%
Wastewater					
Number of sewer blockages	670	737	757	762	749
Number of sewer collapses	107	127	119	139	134
Compliance of effluent leaving Wastewater Treatment Plant	100%	100%	100%	100%	100%
Water					
Compliance of water quality at the customers' tap	99.93%	99.86%	99.80%	99.70%	99.55%
Water loss in the water distribution network	15.07%	14.68%	16.14%	16.98%	15.86%
Average duration of water interruptions per property in hours	3.44	3.22	3.15	3.46	3.42

- **Drinking Water Quality.** In 2016, tap water remained excellent and comparable to that of any other country in Western Europe. Strict legal requirements apply to the quality of drinking water. Compliance is monitored in accordance to the drinking water monitoring programmes, approved by the Estonian Health Board. In 2016, we took a total of 2,948 samples across the service area (2015: 2,945). The quality of drinking water taken from the customers' tap was 99.93% compliant with the requirements. This is the best result in history.
- **Leakage Level.** As a result of proper maintenance plan of network, 2016 the Company has managed to keep the leakage level in a low level of 15.07% (2015: 14.68%). Leakage



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level was impacted by unfavourable weather conditions in the beginning of the year and therefore the leakage level was slightly higher than in 2015.

- **Water interruptions.** The target for an average water interruption of 3.5 hours in 2016 was met. On average the water interruption lasted 3.44 hours in 2016 (2015: 3.22). In 2016 we finished with the additional valve installation project, which was started already in 2015. This project also helps to minimise the amount of customers affected during network interruptions.
- **Water Treatment Plant.** Although the raw water quality was worse, than in 2015, the quality of water produced at Ülemiste Water Treatment Plant, and ground water pumping stations, complied with all legal requirements.
- **Wastewater Treatment Plant.** Despite of the several severe rainfall events, there were no pollution incidents at the wastewater treatment plant in 2016. A series of investments have been planned over the next 3 years that will provide additional security and minimise the risk of any future pollution incidents.
- **Levels of Service.** Our target is to fulfil all the 97 service levels as set in the Services agreement every year. In 2016 the company had one service level failure, where a customer was without water for 18 hours, against the target of 12 hours.



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FINANCIAL RESULTS

Main financial indicators EUR million, except key ratios and share data	PERFORMANCE				
	2016	2015	2014	2013	2012
Sales	58.98	55.93	53.24	53.09	52.92
Gross profit	33.26	32.25	30.84	30.58	32.59
Operating profit	24.63	25.58	24.83	24.76	28.77
Operating profit - main business	24.44	25.24	24.54	24.50	26.82
Profit before taxes	22.89	24.36	22.73	24.56	27.07
Net profit	18.39	19.86	17.94	19.94	22.60
Gross profit margin %	56.39	57.66	57.93	57.61	61.57
Operating profit margin %	41.75	45.73	46.63	46.63	54.36
Profit before taxes margin %	38.81	43.55	42.69	46.27	51.14
Net profit margin %	31.18	35.51	33.70	37.55	42.70
ROA %	8.61	9.50	8.73	9.83	11.26
Debt to total capital employed %	58.15	57.43	57.61	56.98	57.82
ROE %	20.57	22.31	20.59	22.86	26.69
Current ratio	3.91	5.40	5.35	4.21	4.32
Number of full-time equivalent employees, at the end of the year	301	311	307	292	301
Share price, at the end of the year	13.80	13.80	13.10	11.90	9.20
Share capital	12.00	12.00	12.00	12.00	12.00
Earnings per share	0.92	0.99	0.90	1.00	1.13
Dividend per share	n/a*	0.90	0.90	0.90	0.87
Cash balance, at the end of the year	33.99	37.82	38.56	31.79	23.94
Investments to fixed assets	14.95	11.30	11.07	8.65	11.31

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 / Average Total assets for the period

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

ROE – Net profit / Total equity

Current ratio – Current assets / Current liabilities

Main business – water and wastewater activities, excl. connections profit and government grants, construction and asphalting services, doubtful debt, other income

**Dividends for 2016 have not been declared at the time of issuance of the report.*

STATEMENT OF COMPREHENSIVE INCOME

Sales

As the Company's tariffs are frozen at the 2010 tariff level, the changes in the main activities revenues, i.e. from sales of water and wastewater services, are fully driven by consumption with no considerable seasonality in the main operation. No dramatic increases or decreases in the consumption is expected also in the future. There has been incremental increases in consumption in the past and that is expected to continue.

In 2016 the Group's total sales were EUR 58.98 million, showing an increase by 5.5% or EUR 3.05 million year-on-year. 85.1% of sales comprise of sales of water and wastewater services to domestic and commercial customers within and outside of the service area. 6.2% of sales comprise from the fees received from the City of Tallinn for operating and maintaining the storm water system and fire hydrants, 7.6% from construction and asphaltting services and 1.0% from other works and services. The construction and asphaltting services sales are more seasonal and the Group continues to seek possibilities to keep and to grow these services revenues.

EUR thousand	for the year ended 31 December			Variance 2016/2015	
	2016	2015	2014	EUR	%
Private clients, incl:	24,949	24,408	24,154	541	2.2%
Water supply service	13,720	13,436	13,303	284	2.1%
Wastewater disposal service	11,229	10,972	10,851	257	2.3%
Corporate clients, incl:	20,069	19,358	19,085	711	3.7%
Water supply service	11,075	10,736	10,664	339	3.2%
Wastewater disposal service	8,994	8,622	8,421	372	4.3%
Outside service area clients, incl:	4,400	4,765	4,520	-365	-7.7%
Water supply service	1,306	1,280	1,153	26	2.0%
Wastewater disposal service	2,709	3,011	2,957	-302	-10.0%
Storm water disposal service	385	474	410	-89	-18.8%
Over pollution fee	778	766	839	12	1.6%
Total water supply and waste water disposal service	50,196	49,297	48,598	899	1.8%
Storm water treatment and disposal and fire hydrant service	3,671	3,357	3,073	314	9.4%
Construction service, design and asphaltting	4,511	2,724	943	1,787	65.6%
Other works and services	604	550	627	54	9.8%
Sales revenues total	58,982	55,928	53,241	3,054	5.5%

Sales from water and wastewater services were EUR 50.20 million, showing a 1.8% or EUR 0.90 million increase compared to the twelve months of 2015, resulting from the changes in



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sales volumes as described below:

- There has been an increase in private customers' revenues by 2.2% to EUR 24.95 million. 81% of the total increase in domestic customer consumption volumes comes from apartment blocks, which is also our biggest residential customer group. There has been also a slight increase in other private customer groups.
- Sales to corporate customers within the service area have increased by 3.7% to EUR 20.07 million. Increase is mostly related to industrial segment, accompanied by increase in leisure and other commercial customer segments.
- Sales to customers outside the main service area have shown a decrease by 7.7% to EUR 4.40 million. It is mainly driven by decrease in wastewater revenues by 10.0% to EUR 2.71 million. The decline is related to the sales to Viimsi, as they started to use their new wastewater treatment facilities from the beginning of 2016. While the sales to Viimsi have ceased, the sales to other outside areas in total have increased.
- Over pollution fees received have increased by 1.6% to EUR 0.78 million.

Sales from the operation and maintenance of the main service area storm water and fire-hydrant system were EUR 3.67 million, showing an increase of 9.4% or EUR 0.31 million year-on-year.

Sales of construction, design and asphalting services were EUR 4.51 million, increasing by 65.6% or EUR 1.79 million year-on-year. The increase was mainly related to higher pipe construction revenues resulting from different projects during the year.

Cost of goods/services sold and Gross profit

Cost of goods/services sold amounted to EUR 25.72 million in the twelve months of 2016, showing 8.6% or EUR 2.04 million increase compared to the equivalent period in 2015. The cost increase is mainly influenced by increase in construction and asphalting services related costs and other costs of goods sold costs, apart from decrease in chemicals cost.

EUR thousand	for the year ended 31 December			Variance 2016/2015	
	2016	2015	2014	EUR	%
Water abstraction charges	-1,169	-1,101	-1,057	-68	-6.2%
Chemicals	-1,308	-1,531	-1,737	223	14.6%
Electricity	-3,107	-3,035	-3,032	-72	-2.4%
Pollution tax	-1,091	-1,002	-2,163	-89	-8.9%
Total direct production costs	-6,675	-6,669	-7,989	-6	-0.1%
Staff costs	-5,729	-5,603	-4,880	-126	-2.2%
Depreciation and amortization	-5,862	-5,690	-5,370	-172	-3.0%
Construction service, design and asphalting	-4,006	-2,398	-784	-1,608	-67.1%
Other costs of goods sold	-3,449	-3,319	-3,376	-130	-3.9%
Total other costs of goods/services sold	-19,046	-17,010	-14,410	-2,036	-12.0%
Total cost of goods/services sold	-25,721	-23,679	-22,399	-2,042	-8.6%

Total direct production costs (water abstraction charges, chemicals, electricity and pollution taxes) were EUR 6.68 million, showing a slight increase by 0.1% or EUR 0.01 million year-on-year. Changes in direct production costs came from a combination of changes in prices and in treated volumes that affected the cost of goods sold together with the following additional factors:

- Water abstraction charges increased by 6.2% to EUR 1.17 million, driven mainly by increase in treated volumes.
- Chemicals costs decreased by 14.6% to EUR 1.31 million, driven mainly by on average 30.0% lower methanol price and smaller use of different chemicals to remove pollutants in wastewater treatment process, worth respectively EUR 0.17 million and EUR 0.09 million, balanced by increased water treatment process chemicals costs, driven by increase in usage and treated volumes, worth in total EUR 0.04 million.
- Electricity costs have increased by 2.4% to EUR 3.11 million, driven mainly by increase in treated volumes and in usage, worth EUR 0.18 million, balanced by on average 3.2% lower electricity prices, worth EUR 0.11 million.
- Pollution tax expense increased by 8.9% to EUR 1.09 million, driven mainly by increase in treated sewage volumes, worth EUR 0.11 million, balanced by lower nitrogen pollution load, worth EUR 0.05 million.

Other costs of goods/services sold (staff costs, depreciation, construction and asphaltting services costs and other costs of goods/services sold) amounted to EUR 19.05 million, showing an increase by 12.0% or EUR 2.04 million compared to the same period in 2015.

Main increase came from increase in costs related to higher construction and asphaltting services, accompanied by increase in all other costs of goods/services sold costs groups. Increase in construction and asphaltting services costs by 67.1% to EUR 4.01 million was related to an increase in construction and asphaltting services revenues mentioned earlier.

Staff costs increased by 2.2% to EUR 5.73 million. Higher staff costs were related to the increases in individual salaries in 2016 in order to pay fair and competitive salaries. Staff costs were also affected by the increase in redundancy payments and higher bonus reserve at the end of 2016. Increase in depreciation costs by 3.0% to EUR 5.86 million was mainly related to accelerated depreciation of fixed assets in wastewater treatment process.

As a result of all above the Group's gross profit for 2016 was EUR 33.26 million, showing an increase by 3.1% or EUR 1.01 million compared to the gross profit of EUR 32.25 million in 2015.

Administrative and marketing expenses, other income and expenses

Administrative and marketing expenses were EUR 8.16 million, showing an increase of 25.2% or EUR 1.64 million. Most of the increase came from higher tariff dispute related legal and consultation fees. Legal fees continue to be at a high level during the time the Company has ongoing local and international disputes.

Other income and expenses were EUR 0.47 million, showing an increase by EUR 0.32 million. The increase was mostly impacted by increase in doubtful receivables.



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Operating profit

As a result of the factors listed above the Group's operating profit for 2016 amounted to EUR 24.63 million, showing a decrease by 3.7% or EUR 0.95 million year-on-year. The Group's operating profit from main business was EUR 24.44 million, showing a decrease by 3.1% or EUR 0.80 million compared to the same period in 2015.

Financial expenses

The Group's net financial income and expenses have resulted a net expense of EUR 1.74 million, compared to net expense of EUR 1.22 million in 2015. The increase was mainly impacted by a EUR 1.15 million negative change in the fair value of the swap contracts, balanced by a decrease in the interest costs by EUR 0.68 million.

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 EUR 75 million and EUR 20 million are still with floating interest rate. At this point in time the estimated fair value of the swap contracts is negative, amounting to EUR 1.32 million. Effective interest rate of loans (incl. swap interests) in 2016 was 1.54%, amounting to interest costs of EUR 1.48 million, compared to the effective interest rate of 2.21% and the interest costs of EUR 2.13 million in 2015.

Profit before taxes and net profit

The Group's profit before taxes for 2016 was EUR 22.89 million, showing a decrease by 6.0% or EUR 1.47 million compared to the relevant period in 2015. The Group's net profit for 2016 was EUR 18.39 million, showing a decrease by 7.4% or EUR 1.47 million year-on-year. Eliminating the effects of the derivatives change in fair value, the profit before taxes and the net profit for 2016 would have been respectively EUR 23.20 million and EUR 18.70 million (as of 31st December 2015 EUR 23.53 million and EUR 19.03 million respectively).

STATEMENT OF FINANCIAL POSITION

In 2016 the Group invested EUR 14.95 million into fixed assets. As of 31st December 2016 non-current tangible assets amounted to EUR 171.18 million and total non-current assets amounted to EUR 172.01 million (31st December 2015: EUR 162.73 million and EUR 163.63 million respectively).

Compared to the year end of 2015 the receivables and prepayments have been relatively stable showing a slight decrease of EUR 0.01 million to EUR 7.17 million. The collection rate of receivables has slightly decreased from 99.74% in 2015 to 99.49% in 2016. Decline is related to couple of bigger receivables which collectability was assessed as doubtful.

Current liabilities have increased by EUR 2.22 million to EUR 10.64 million compared to the year end of 2015. The increase mainly derives from increased prepayments of connections in construction process by EUR 0.75 million and increase in trade and other payables by EUR 1.44 million, which is related to increased construction activities and investments related liabilities.

Deferred income from connection fees has grown compared to the end of 2015 by EUR 2.02 million to 17.05 million.

The Group's loan balance has remained stable at EUR 95 million. The weighted average interest risk margin for the total loan facility is 0.95%.

The Group has a Total debt to assets level as expected of 58.1%, in range of 55%-65%, reflecting the Group's equity profile. This level is consistent with the same period in 2015 when the Total debt to assets ratio was 57.4%.

CONTINGENT LIABILITY REGARDING THE TARIFF RISK

In the 4th quarter of 2011 the Group evaluated and noted an exceptional off-balance sheet contingent liability, which could cause an outflow of economic benefits of up to EUR 36 million. In the 4th quarter of 2016 the Group re-evaluated the liability, which now stands at EUR 43 million, as per note 3 to the accounts. The re-evaluation of the potential liability has been carried out annually at the end of the year. If material circumstances occur, which give indication of the material changes in the amounts or probabilities of the contingent liabilities, then the review is carried out at the time, when those circumstances have occurred.

CASH FLOW

As of 31st December 2016 the cash position of the Group is strong. At the end of December 2016 the cash balance of the Group stood at EUR 33.99 million, which is 15.9% of the total assets (31st December 2015: EUR 37.82 million, forming 18.1% of the total assets).

The biggest contribution to the cash flows comes from main operations. During 2016 the Group generated EUR 31.87 million of cash flows from operating activities, an increase of EUR 0.76 million compared to the corresponding period in 2015. Underlying operating profit continues to be the main contributor to operating cash flows.

In 2016 the result of net cash flows from investing activities was a cash outflow of EUR 11.43 million, an increase of EUR 4.56 million compared to the cash outflow of EUR 6.87 million in 2015. This is made up as follows:

- The cash outflows from investments in fixed assets have increased by EUR 1.03 million compared to 2015, amounting to EUR 14.53 million.
- The compensations received for the construction of pipelines were EUR 3.00 million, showing a decrease of EUR 3.50 million compared to the same period of 2015. It is mostly related to the network extension program in corporation with the City of Tallinn for which last payments were received in the 1st quarter of 2015.

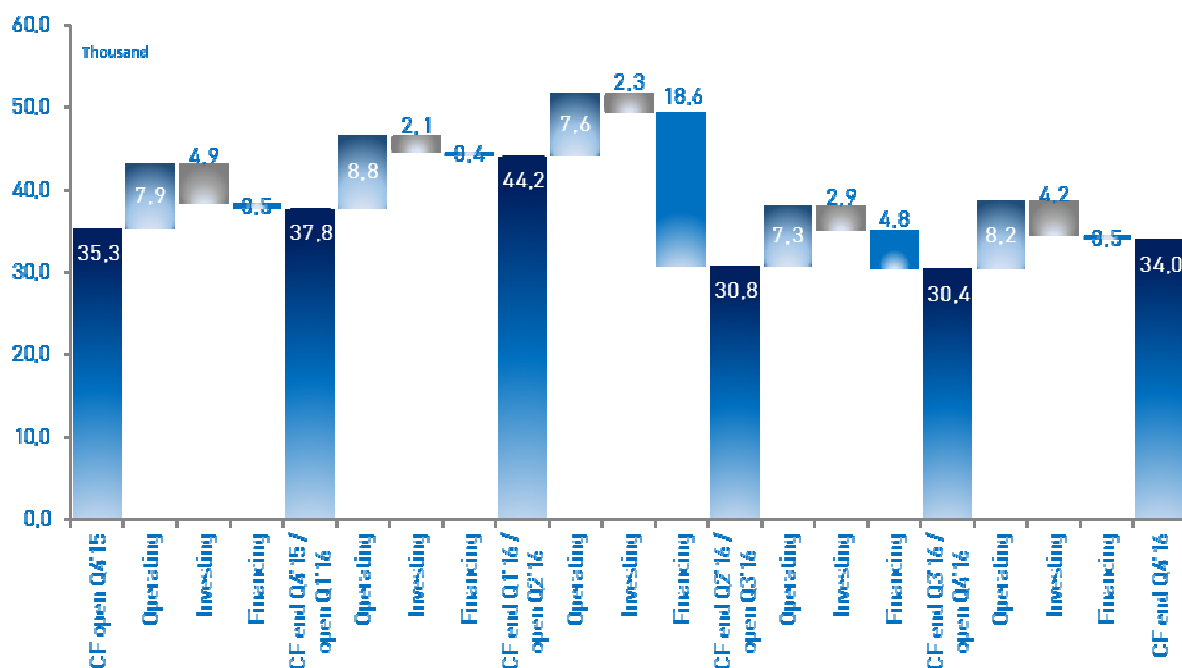
In 2016 cash outflow from financing activities amounted to EUR 24.28 million, decreasing by EUR 0.71 million compared to the same period in 2015. The change was mainly related to reduction in interest payments by EUR 0.67 million related to renewal of swap contracts in the 2nd quarter of 2015. Most of the outflow was comprised of the dividends and income tax on dividends payment, respectively in the amount of EUR 18.00 million and EUR 4.50 million in both years.

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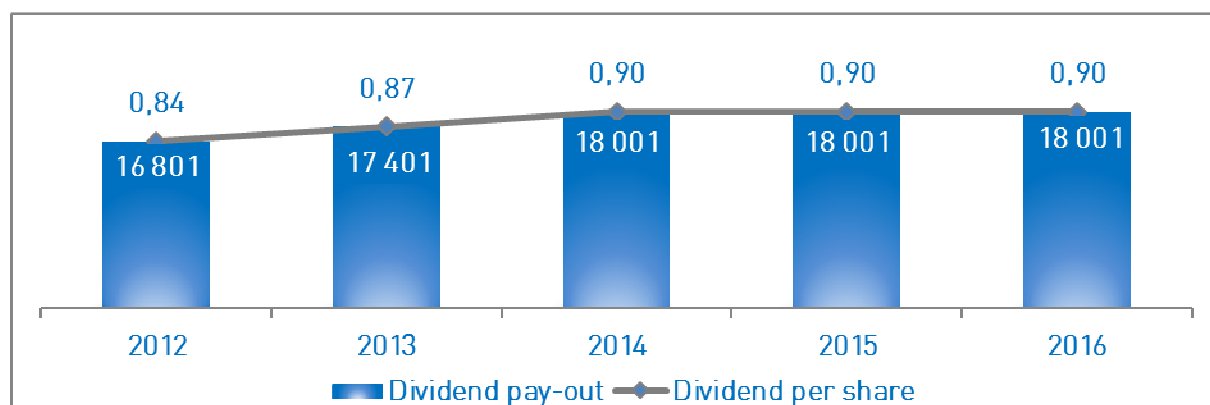
DIVIDENDS

Dividend allocation to the shareholders is recorded as a liability in the financial statement of the Company at the time when the profit allocation and dividend payment is confirmed by the annual general meeting of shareholders.

According to the dividend policy, which is also published on Company's website, the Company has maintained the dividends to shareholders in real terms, i.e. dividends amounts have been increased in line with inflation each year.

In the annual general meeting of shareholders held on 2nd of June 2016, 90 cents dividends per share and the total dividend pay-out from the profit of 2015 net income in the amount of EUR 18.0 million was approved. It is in accordance with the Company's dividend policy. There has been no change compared to 2014 and 2015 in dividends of 90 cents per share.

Dividends were paid out on 27th June 2016. Dividend pay-outs in last five years have been as follows:



SHARE PERFORMANCE

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

As of 31st December 2016 AS Tallinna Vesi shareholders, with a direct holding over 5%, were:

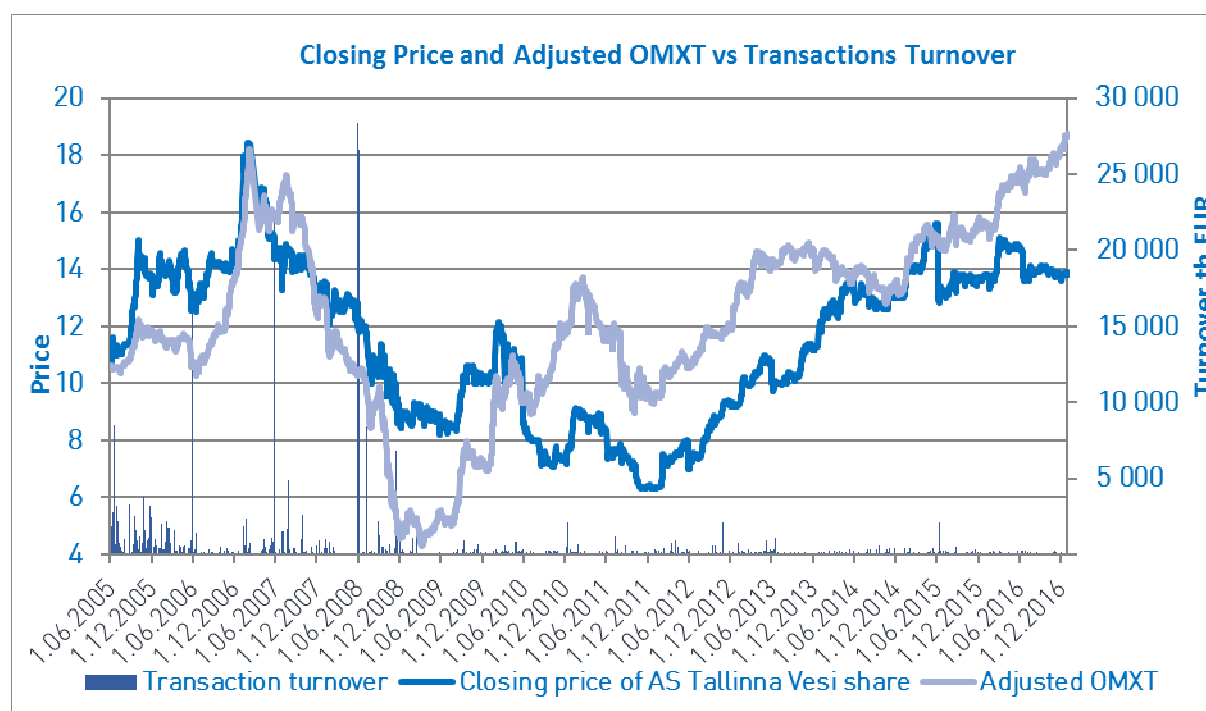
United Utilities (Tallinn) BV	35.3%
City of Tallinn	34.7%

During 2016 the shareholder structure has been relatively stable compared to the end of 2015. At the end of 2016 the pension funds owned 2.11% of the total shares compared to 1.88% at the end of 2015.

As of 31st December 2016, the closing price of the AS Tallinna Vesi share was EUR 13.80, which is the same price as at the beginning of the year EUR 13.80 (in 2015: the price increased by 5.3%). During 2016 the OMX Tallinn index increased by 19.6% (2015: 19.1%).

In 2016 6,502 deals with the Company's shares were concluded (2015: 7,818 deals), during which 1,048 thousand shares or 5.2% of total shares exchanged their owners (2015: 1,581 thousand shares or 7.9%).

The turnover of the transactions was EUR 7.03 million lower than in 2015, amounting to EUR 14.71 million.



(EUR thousand)

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Share price statistics

EUR	2016	2015	2014	2013	2012
Share price, open	13.80	13.10	12.00	9.25	6.30
Share price, at the end of the year	13.80	13.80	13.10	11.90	9.20
Share price, low	13.30	12.80	11.80	9.20	6.30
Share price, high	15.10	15.60	13.60	12.00	9.40
Share price, average	14.12	13.88	12.91	10.42	7.91
Traded volume, thousand	1,048	1,581	1,239	1,852	2,375
Turnover, EUR million	14.71	21.74	15.95	19.14	18.59
Capitalisation, EUR million	276	276	262	238	184
Earnings per share	0.92	0.99	0.90	1.00	1.13
Dividend per share	n/a*	0.90	0.90	0.90	0.87
Dividend / net profit	n/a	91%	100%	90%	77%
P/E	15.00	13.94	14.56	11.90	8.14
P/BV	3.1	3.1	3.0	2.7	2.2

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

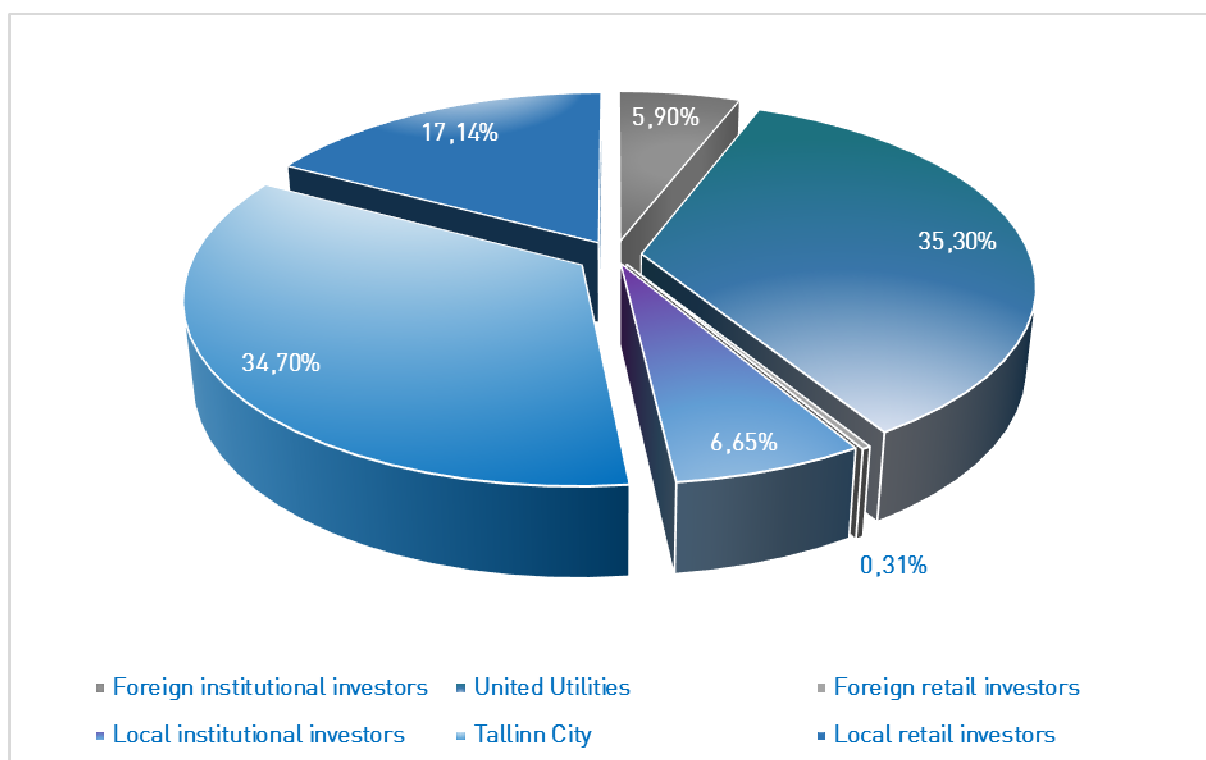
P/BV = share price at the end of the year / book value per share

*Capitalization = share price at the end of the year * No of shares*

In 2005 the listing price was 9.25 euros

**Dividends for 2016 have not been declared at the time of issuance of the report.*

Shareholders by type as of 31st December 2016





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Distribution of share capital by size of share ownership as of 31st December 2016

	Shareholders	Shareholders %	No. of shares	% of share capital
1 - 100	1,840	36.5%	93,302	0.5%
101 - 200	864	17.1%	133,877	0.7%
201 - 300	474	9.4%	122,684	0.6%
301 - 500	523	10.4%	220,022	1.1%
501 - 1,000	585	11.6%	442,505	2.2%
1,001 - 5,000	581	11.5%	1,257,230	6.3%
5,001 - 10,000	91	1.8%	660,128	3.3%
10,001 - 50,000	64	1.3%	1,277,768	6.4%
50,000 +	18	0.4%	15,792,484	79.0%
TOTAL	5,040	100.0%	20,000,000	100.0%

ACTIVITIES OF THE SUBSIDIARY COMPANY OÜ WATERCOM

OÜ Watercom was established by AS Tallinna Vesi in 2010.

Watercom provides the following services:

- Construction and design of pipes;
- Services related to road maintenance;
- Project management and owner's supervision;
- Jet washing and transportation.

Watercom has achieved certification for the following standards: ISO 9001, ISO 14001 and OHSAS 18001.

Construction of pipeline and road construction

In 2016, the construction of water and wastewater networks for developers, companies and individuals was the main activity of Watercom. Construction of pipes is carried out under the trademark of Veemees. Similarly to previous years, the focus was on large construction projects in Tallinn and elsewhere in Estonia.

2016 was a challenging year in the construction sector due to a reduction of financing from the European Union Cohesion Fund and from state funds. Construction market is competitive and therefore the efficient cost management is crucial to achieve sustainable profitability. Watercom has sufficient experience to grow the revenues from pipe construction.

Asphalting and backfilling service was initially launched for the Group's internal needs. By now Watercom has carried out projects for external clients in Tallinn but also in other parts of Estonia. Focus in road construction is on smaller projects as we are not operating in big road construction market.

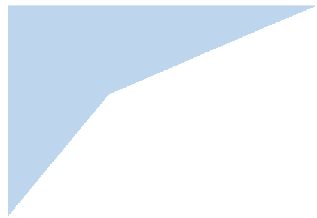
Other services

Owner supervision and project management are the areas which Watercom has high competence. In 2016 supervision services was provided for several bigger sites. In 2017 Watercom continues to seek additional possibilities to retain and increase the sales from supervision through participating on various procurements.

Jet washing services are mostly provided to AS Tallinna Vesi. Through pre-agreed proactive jet washing program, the number of blockages in AS Tallinna Vesi are under much better control. Both jet washing and transportation services are provided both for Group as well as for external clients.

Watercom's main objectives and development trends in the next year

In 2017, Watercom plans to keep all its current business lines, with a focus to grow pipe construction revenues. Watercom's objective is to deliver additional value to its customers by



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providing full service in pipeline construction and maintenance from project management, pipeline construction, back-filling to asphaltting.

SOCIAL RESPONSIBILITY AND SUSTAINABILITY

Sustainability and social responsibility report is based on the guidelines of Global Reporting Initiative (GRI) G4. The GRI Guideline provides for a choice between “core” and “comprehensive” levels depending on the level of details of the report. Considering the Company’s size and scope of operations in global context, the most suitable of these two options is “core”, which includes data about the Company’s profile, management type and key performance indicators. The Company measures the impacts of material aspects through several various indicators, but only the most important key performance indicators for each aspect have been described in the report. For some aspects indicators provided by GRI Guidelines were insufficient to describe the performance of the Company. Thus, additionally to GRI indicators, few Company-specific indicators have been introduced by this report (marking: TV).

Material aspects for the Company were identified and the significance thereof was assessed based on information received from stakeholders, feedback from Company’s employees and customers and direct communication with shareholders and partners. GRI guidelines have been taken as the basis for identifying the content of the report and describing the topics. Additionally, also external impacts stemming from legislation, market situation and natural environment were considered in the assessment. The impacts that make aspects material are present both within the organisation as well as outside the Company, which is why all material aspects impact either directly or indirectly also the organisation and its stakeholders. The impacts and the management approach are described in more detail under each aspect description.

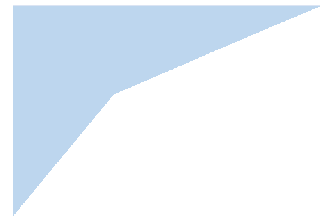
Our identified material aspects are as follows:

- Economic performance;
- Sustainable water use;
- Effluent quality;
- Responsible customer service;
- Ensuring uninterrupted service;
- Development and succession of staff;
- Equal treatment of staff;
- Occupational health and safety;
- Contribution to local communities;
- Anti-corruption.

Social responsibility and sustainability report provides an overview of AS Tallinna Vesi and OÜ Watercom activities and performance in 2016 from the perspective of sustainable development in economic, environmental and social areas.

Our activity affects a large number of people. Our aim is to be a trusted partner to our customers, investors, employees and representatives of the community, therefore our management practices take into account the impact that we have on surrounding living environment and the association with the different stakeholder interests.

We understand the impact of our business on the surrounding natural habitat and therefore deem it important, that our activities engage with the interests of different stakeholders. Having in mind the perspectives of our development, we have mapped our stakeholders, considering those who are the most impacted by our activity and decisions and whose



(EUR thousand)

satisfaction is important for us. The main stakeholders, whom we receive feedback from through surveys, direct communication and involvement, are our employees, customers, cooperation partners, shareholders and investors, but also local governments and community.

We strive to be a reliable partner to our stakeholders, therefore we regularly disclose information on our activity, financial and operational performance and financial position. It is instrumental for us to provide timely, reliable and clear information about our activities both pro-actively and when needed. Due to the strong impact of our activity on both the people and environment, responsible communication is fundamental to our stakeholders and ourselves. Given that our stakeholders have different expectations, it is vital to address all necessary aspects and balance those expectations. Reliable and transparent communication plays an important role in shaping the Company's reputation.

CUSTOMERS

We provide water supply and sewerage services to over 23,300 contractual customers and approximately 460,000 end users in Tallinn and its surrounding areas. We are responsible for serving almost one third of the Estonian population with reliable and high-quality water supply and sewerage services.

Our customers:

2016

Private houses	Apartment associations	Commercial customers
65%	25%	10%

2015

Private houses	Apartment associations	Commercial customers
63%	25%	12%

Great customer service relies on understanding what our customers need, anticipating problems and resolving complaints quickly and courteously. We want our customers to trust us and have confidence in our service.

In 2016, our sharpened focus was on solving complaints, ensuring the stability of water quality in all service areas, and covering environment related topics in the media.

Feedback from our customers

Systematic and regular feedback from our customers and consumers is instrumental for us. Customer satisfaction and feedback from customers allow us to have their honest opinion on our activities, recognise our strengths and also the weaknesses, which we should address more in the future. Addressing customer satisfaction is also important to our partners, investors, community and public sector. High results in customer satisfaction improve the reputation and reliability of the Company. Each year, an independent market research company Kantar Emor carries out a survey among our customers and end users. Satisfaction is measured using TRI*M method developed by the research company to characterise the strength of customer relationships and to allow comparison with other companies. This model focuses on three elements:



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- TRI*M index, which measures the strength of customer relationships and comprises further four elements – general satisfaction, recommendation, repeated use and usefulness/necessity of services/products;
- TRI*M typology of customer relationships, describing the satisfaction and loyalty of customers;
- TRI*M grid analysis to highlight the strengths and weaknesses of a company.

Customer services in 2016

Year 2016 was remarkable for again an exceptionally high customer satisfaction indicator, which, by the survey carried out by Kantar Emor, reached 95-96 TRI*M index points amongst end users, private clients and apartment associations' representatives, which shows also small progress compared to the previous year (2015: 93-95 TRI*M index points). The ratings were slightly lower compared to the previous year only amongst other business clients, still 88 TRI*M index points (2015: 95 TRI*M index points), belongs to the top 10% of European manufacturing industry. The overall result was 94 TRI*M index points, thus the Company repeated last year's excellent result (2015: 94 TRI*M). With these results the Company outperforms the European and Estonian averages for industrial sector, by a considerable margin. 900 customers and end users were surveyed to map changes in our customer relations' strength and the factors influencing it, as well as to receive feedback on our activities' success.

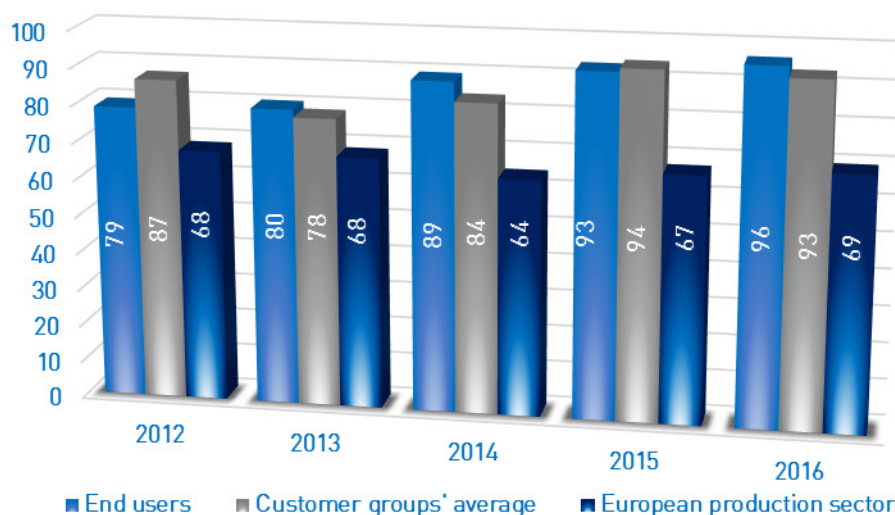
The company has managed to strengthen customer relations step-by-step. Within several years the satisfaction growth is visible and it can be seen in majority of the aspects. Private clients' satisfaction has increased in nearly all aspects, business clients are more satisfied with the quality and supply of water and the billing process. Business clients also deem smooth reporting of meter readings.

Strong customer relations also rely on the positive shift in the company's media image. We are pleased about the number of people, who trust to drink tap water, which continues to be high both among private and commercial customers and has increased considerably among end-users. "Drink tap water" message has been noticed by all segments and over the years this has brought about a change in the daily habits of consumers. More and more people have started to drink tap water. Five years ago only 48% of people drank tap water. According to the customer survey conducted by Kantar Emor by today already around 80% of end users drink tap water.

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Satisfaction of the Company's customers and end users in comparison with European manufacturing industry



Trends in 2017

Even though the clients' feedback to our services continues to be good, we need to continue to keep making efforts in maintaining and increasing the client satisfaction through the improvements in the services provided and in customer service itself.

Problem solving continues to be a focus. Improvements are sought for the solutions offered, promptness of actions and quality of service – keeping promises, keeping clients informed of the course of action. Second development priority are the subjects, which have high importance but currently are with average ratings. For end users and private clients, the attention should be paid to the taste of water and stable water pressure. With business clients we need to focus on quicker and efficient problem solving. In addition the prevention of leakages is of an importance to all our clients and a focus area for us.

Responsible customer service

Besides the high quality of product, responsible customer service is another aspect underpinning customer satisfaction. Our responsible customer service is primarily represented in three activities:

1. Pro-active communication
 - Giving advance notices to customers of interruption to services;
 - Providing alternative water supply during interruptions (temporary connections, water tanks) if possible.
2. Consistent monitoring of complaints and issues. Taking improvement actions, if needed
 - Internal procedures for problem handling.
3. Specific promises related to ensuring the availability of service and providing information.

We have implemented a unique system of promises, which means that if we fail to keep our promises, we automatically pay compensation to our customers. Our promises to customers are the following:

WE PROMISE TO:

- Ensure, that water meter readings are accurate;
- Send an accurate bill;
- Respond timely to phone enquiries;
- Respond timely to written enquiries;
- Keep the agreed appointments;
- Close and open water supply at the time promised;
- Restore water supply as quickly as possible;
- Ensure a consistent water pressure;
- Deliver high quality water;
- Keep the environment.

In 2016, we failed to keep our promises in 4 cases (2015: 9), each of which has been analysed and compensation has been paid to the customers. The number of customer complaints has decreased year-on-year, the total number of complaints being 46 in 2016 (2015: 67).

Providing uninterrupted services

Our role is to ensure the availability of high quality water services to our customers and community 24 hours a day and 365 days a year. Therefore, our focus lies on ensuring the reliability of the service, preventing problems and finding fast resolutions to the problems. Stringent control over drinking water and consistently high quality levels in all segments of our products and services are fundamental to ensure the provision of uninterrupted services. Effective water treatment and functioning of the water network, prevention of problems through regular maintenance and efficient, prompt and smooth discharge of wastewater and treatment thereof in compliance with strict requirements contribute to the availability of uninterrupted service.

Each year we set ourselves targets to our operational performance in order to focus on compliance to the expectations of our stakeholders. Services Agreement signed with the City of Tallinn at the time of privatisation sets us 97 levels of services (LoS), which the Company must comply with. One of those set criteria is the duration of unplanned interruptions. Therefore, we make continuous efforts to provide uninterrupted services to our customers and minimise the duration of an unplanned interruptions. Last year only in one occasion an unplanned interruption lasted longer than 12 hours, while an average duration of an interruption was 3 hours and 26 minutes.

Interruptions entail unexpected discomfort, which is why we have prepared measures to alleviate the situation for our customers. In case of interruption, we employ the measures to mitigate the inconveniences resulting from an interruption to the service. For instance, if an interruption lasts longer than 5 hours, we provide our customers with temporary water tanks. Furthermore, last year we were able to notify the customers in advance of any unplanned interruptions in 98,8% of the events.

(EUR thousand)

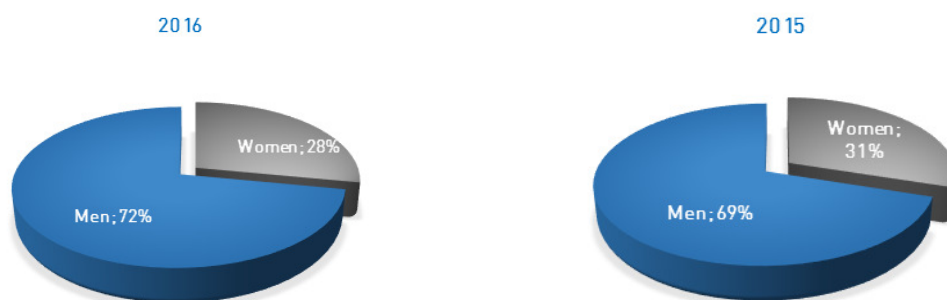
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EMPLOYEES

The most important task of our team is to provide a reliable and high-quality service to the residents, which is what our close-knit and hard-working team stands for. People are the key in maintaining and growing the vitality of a company. Supportive work environment is an essential prerequisite for good performance and the staff to enjoy their work.

The number of our staff has been relatively stable in the last few years. As at the end of last year, a total of 311 people worked in AS Tallinna Vesi and its subsidiary OÜ Watercom (2015: 323) under employment contracts with unspecified term, 98% of them worked full-time and 2% part-time (2015: 98% full-time and 2% part time). As part of the Company's succession related programs 9 seasonal employees were hired at fixed term contract in 2016 (2015: 6). Majority of the employees were placed in Tallinn.

Employees by gender



Equal treatment of staff

We believe it is important to treat our employees equally, involve them in the decision-making process and to inform them regularly. We consider the involvement of our staff in the decision-making process instrumental for them to understand and be able to support the Company in its pursuits. Our staff can vary to a large degree in age, nationality, nature of work and in many other aspects. This requires us to be resourceful and flexible in our communication with the staff in order to involve, engage and listen to them. This is done using several opportunities and channels of communication, such as regular staff meetings with the management, information boards, intranet, informative letters, team events and a quarterly internal newsletter. Estonian is not a communication language for quite a number of our staff. Therefore, we organise Estonian classes at the Company's expense to make the staff, whose mother tongue is not Estonian, also feel as part of our unified team. At the same time, we provide the majority of important information also in Russian.

We have described our human resource policies. We follow equality principles in selecting and managing people, which translates into providing, when feasible, equal opportunities to everyone. Understanding and appreciating the diversity of our staff, we ensure, that everyone is treated fairly and equally and they have access to the same opportunities as is reasonable and practicable. We aim to ensure, that no employees are discriminated against due to, but



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not exclusive to age, gender, religion, cultural or ethnic origin, disability, sexual orientation or marital status.

Groups of staff 2016	Total number	Women	Men	Women/Men
Management Board	3	1	2	33%/66%
Executive Team (incl. Management Board)	8	4	4	50%/50%
Management Team	25	12	13	48%/52%
All staff	311	87	224	28%/72%

Groups of staff 2015	Total number	Women	Men	Women/Men
Management Board	3	1	2	33%/66%
Executive Team (incl. Management Board)	9	6	3	66%/33%
Management Team	20	11	9	55%/45%
All staff	323	99	224	31%/69%

Our employees are loyal to the Company, the person with the longest service has been with the Company for 53.4 years (2015: 53.0 years). The average number of years in the Company is 12.7 years (2015: 12.4 years) and 48 (2015: 53) members of staff have been with the Company for over 25 years. Our voluntary employee turnover is low, 3.1% in 2016 (2015: 3.8%).

The average age of our staff is relatively high, 47 years (2015: 47 years). The age profile within the Group is as follows:

Groups of staff 2016	Age groups		
	<30 years	30-50	>50 years
Management Board	0	3	0
Executive Team (incl. Management Board)	0	8	0
Management Team	0	23	2
All staff	30	157	124

Groups of staff 2015	Age groups		
	<30 years	30-50	>50 years
Management Board	1	2	0
Executive Team (incl. Management Board)	0	8	0
Management Team	1	17	2
All staff	39	142	142

To ensure equal treatment, we have signed a collective agreement with the Trade Union of Water Supply and Sewerage Staff. Less than 10% (2015: less than 10%) of our staff belong to the trade union. Contractual obligations and benefits agreed on in the agreement extend to all our employees.

All members of staff have the opportunity to receive annual performance related pay (PRP), which is based on very clear and transparent principles and the delivery of a balanced combination of personal and company objectives, which are set for each year. Every year the Corporate KPI targets are agreed and 60% of the total PRP is dependant of fulfilment of

(EUR thousand)

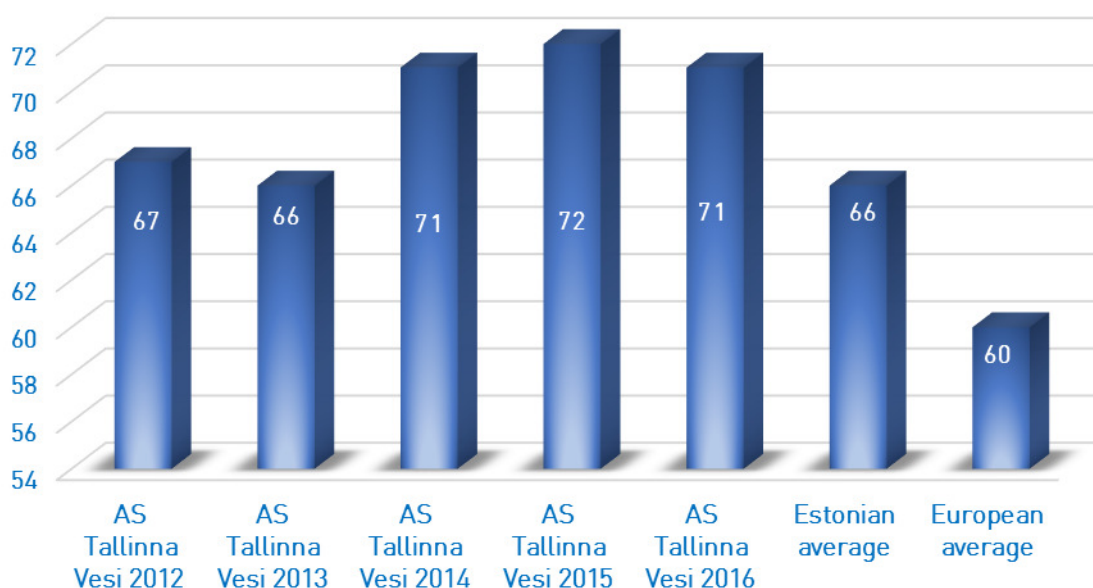
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Corporate objectives (See Delivery of 2016 Objectives). 40% of the PRP is dependent on personal objectives.

Commitment in the team

Two-way interaction is of high importance in the teamwork and therefore, feedback from the employees plays an important role in the company culture. Employee commitment surveys are carried out on an annual basis. We have managed to maintain the high level of commitment of our employees also in 2016. According to the survey, conducted by an independent research company Kantar Emor, our company's employee commitment score is significantly better than the Estonian average. In 2016, a record of 95% (2015: 93%) of our employees participated in the survey. We believe this is a sign of our employees understanding the importance of their feedback. The results of the survey are discussed separately in all teams to develop action plans for further improvements. Last survey identified two most important issues: how to improve internal communication and how to provide internal career opportunities.

Commitment of our staff in 2012–2016 in comparison with Estonian and European average by Kantar Emor (TRI*M index)



Development and succession planning of staff

Considering the age structure in the Company it is of critical importance for us to have a systematic approach and action plan for succession planning. We believe that the teams, containing both recently graduated people with fresh ideas and more experienced people of advanced age, make the strongest teams of all.

We support the development of staff internally and provide career opportunities within the Company. We encourage our employees to continuously learn and develop themselves and we try to find development opportunities, which serve the interests of both the employees and the Company. The majority of trainings concern the following areas: occupational safety, leadership, technical skills trainings, language and computer trainings. In 2016 we had 2.2

[2015: 1.8] training days per employees. In monitoring the training days and providing training opportunities genders are not distinguished, as the training is arranged taken into consideration of the training need of our employees. The discussion of the plans for professional development always constitute a part of the annual performance interviews, which are held in the beginning of each calendar year with all of the employees (100%), who have worked in the company at least nine months.

We provide training and support to our managers to be able to effectively manage their teams. As a basis for leadership development and feedback to managers we created Good Leadership Standard.

Competitions for all vacancies are public; however, we always circulate the job offers also internally. We inspire our staff to develop and rotate between different teams.

In 2016, we continued with the summer trainee programme and launched 3 significant succession-related programs – graduate programme, apprentice programme and internal young specialist program. This enables us to engage young people in the activities of our Company already whilst they are studying and provide them with valuable work experience and development opportunities.

In 2016, Good Retirement Practice was implemented. All retirements are planned ahead, to ensure the transfer of know-how from more experienced staff to the young members of staff and to thank the people, who retire for their commitment. In positions, which require significant company-specific knowledge and skills, the retiring employee and young specialist work in parallel along with each other for 2-6 months. By providing a direct transfer of knowledge and experience to the learning employee, we value the experience of the retiring employee and contribute to the professionalism of the new employee. In case of retirement, the Company also pays the retiring employee a company benefit depending on the duration of employment.

OCCUPATIONAL HEALTH AND SAFETY

Occupational safety is an inseparable part of our business, being central to everything we do. No work assignment is worth getting injured for.

Our Company's work environment performance is compliant with the requirements of national legislation and international occupational health and safety management system standard OHSAS 18001. Work environment management system is based on the assessment of risks and execution of activities aimed at preventing or reducing dangerous situations. Workplaces are under constant internal monitoring. Furthermore, internal and external audits of the management system are carried out regularly.

One of the main indicators for assessing occupational health and safety is the accident frequency rate (AFR), which demonstrates how many work accidents with major injuries or with >3 days lost have there been for 100,000 working hours. AFR is monitored in the Company since 2015 and it was also one of the Company's objectives for 2016 (AFR<0.4). In 2016, the accident frequency rate was 0 (2015: 0). There was one minor work accident, but no working days were lost due to this incident. Additionally, the total number of work accidents has reduced consistently year-on-year.



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	2016	2015	2014	2013	2012
Total number of work accidents	1	1	2	3	4

Together towards occupational safety

We care about our employees. Thus, to reduce any potential risks, we continue contributing to the safety of our company's working environment. Key aspect in creating and maintaining a safe work environment is definitely the awareness of the employees. The involvement of staff in various work environment-related initiatives and activities is fundamental in improving the awareness. We organise informative meetings, providing the staff the opportunity to share information. Through discussions and different printed materials and safety videos we try to increase the awareness of people about the safety issues. We carry out work environment trainings on a regular basis. During these trainings, various topics are addressed, e.g. training and in-service training in first aid, occupational hygiene, hot works training, chlorine safety training at the water treatment plant, various safety trainings whilst working with chemicals, machinery and electricity, and trainings on several other important topics concerning our everyday work. In 2016, one larger training was organised to be prepared for major high risk situations. In April, training exercise was organised at Ülemiste Water Treatment Plant to simulate a major pollution incident in Lake Ülemiste. Additionally, we carried out trainings in first aid to all employees who do not work in the office. Systematic engagement of employees has resulted in considerably increased attention towards one's work environment, which is where the occupational safety starts in the first place.

In 2016 we elected new work environment representatives both for AS Tallinna Vesi as well as OÜ Watercom, altogether 11 representatives and 10 members of Work Environment Council. For the first time 5 members were elected as employees' representatives from among work environment representatives with the aim of increasing the contribution of work environment representatives to improving the work environment. The remaining 5 members were nominated by the Company. We strive towards work environment representatives and members of Work Environment Council having greater role and impact than before.

Continuous improvement of work environment

Occupational health and safety is central to everything we do, and we absolutely do not make any compromises in that regards. We are committed to ensure a safe work environment and guarantee that our employees use equipment, that meets the required standards and needs. Therefore, despite the good results achieved so far, it is important not to rest on our laurels, but to carry on channelling our time and energy into maintaining a safe work environment and making further improvements therein.

In addition to the everyday checks to emergency and construction sites by the Health and Safety team, our management team managers and members of Work Environment Council carried out over 200 (2015: 273) safety audits, during which more than 300 (2015: 329) proposals were presented in order to improve our work environment. Compliance of emergency and construction sites (at least 90% compliant sites) has also been set as the Company's overall objective. In 2016, 93.65% (2015: 95.31%) of the audited sites met the safety

requirements. We also check the compliance to the safety requirement of our cooperation partners and subcontractors on a regular basis. In order to increase awareness on occupational safety we organised an information day for subcontractors and cooperation partners in 2016, during which we introduced our safety requirements at emergency and construction sites. We plan to continue carrying out such events regularly also in the future. In order to ensure the safety of our own employees, it is important to us that our subcontractors and cooperation partners regard occupational safety to be significant. We wish to be an example to them with regard to that.

In 2016, we carried out also other activities to improve safety and work environment. Special attention was paid to improve the safety of excavation and backfilling sites. Safety requirements as well as methods for ensuring safety were reviewed. Additional safety instructions were carried out. We also focused on getting more feedback and observations on occupational safety from our employees. For that purpose, we reviewed the feedback system and analysed incidents more thoroughly. In 2016 employees made more than 80 observations, improvement proposals and notices of near-misses either directly or through working environment representatives, which is nearly twice more than in 2015.

In 2016 we developed new safety videos in Estonian, Russian and English for the visitors of both Ülemiste Water Treatment Plant and Paljassaare Wastewater Treatment Plant. These videos are shown to visitors always before going to the plant.

All of the initiatives above, as well as several other actions help us to make our work environment safer and more comfortable.

COMMUNITY AND PUBLIC

The community we operate in, people whose lives our work impacts – they are vital for us. We therefore consider it very important to take actively part and support the community we operate in. We try to spread the messages that help to increase the environmental awareness, and provide environment-related educational study materials and programs for free. We also strive to spread our knowledge on our activity as we believe we have managed to gather and grow a lot of excellent experts in this field to our Company.

Community-orientated mind-set starts from ourselves

We support and encourage our employees to actively participate in the community activities. It is namely our employees who, in addition to their daily work, have an important responsibility of passing on the environment- and community-orientated mind-set. Our employees enable to carry out the activities that are orientated to community, and create cohesion between these activities – either in maintenance works, organising events, or increasing the awareness. For example, each year, our employees help to organise the open door days at our water and/or wastewater treatment plant so that visitors could learn about water and/or wastewater treatment operations. They also take actively part in carrying and communicating our messages that help to increase environmental awareness.

Improved environmental awareness of consumers and next generation

We value the natural environment we operate in and therefore use natural resources sparingly and continuously seek new ways for a more sustainable consumption. In order to help shaping an environmentally conscious mind-set in the society, we encourage and

support others accordingly. We do that by running various campaigns, providing educational materials for teachers, and engaging children to workshops on sustainable use of water.

- We keep working hard to promote environmental thinking amongst our population. In our messages and activities, we encourage people to drink tap water. With our message “Tap water **IS** drinking water” we draw people’s attention to the excellent quality of tap water. In 2016 we organised a campaign “Drink tap water”, which was aimed to remind people, that drinking tap water on a daily basis is a simple and good way to improve one’s quality of life. With various activities within the campaign we asked people to join the movement of drinking tap water.
- We also continued our co-operation with restaurants. We encourage restaurants to provide tap water to their clients. The campaign “Ask for tap water” also was aimed to encourage customers to ask for tap water when they dine out in restaurants. In May 2016 we launched a tap water restaurant website www.vesikraanist.ee, aimed at promoting restaurants in Tallinn where people can drink tap water for free. Clients can add proposals for restaurants to be added and restaurants can also join themselves. While only few years ago, in 2011, 48% of people trusted to drink tap water, the number of people drinking tap water had grown to 80% by the end of 2016 (2015: 75%).
- The topic of health consciousness is becoming more and more popular in the society. Therefore, water carries a very strong message, serving as a very efficient brand ambassador for the Company, enabling to communicate tap water as a healthy alternative. In 2016, we participated in a joint campaign with Healthy Estonia, Ministry of Social Affairs and Norway Grants aimed at attracting youth with playful message “Tap makes you beautiful. Smoking and drinking make you ugly”.
- We continue contributing to environmental awareness of young people who would value nature and environment. Each year, our employees organise group conversations in nurseries and schools discussing water circulation, how to save water and avoid blockages. 1,553 children participated in these group conversations in 2016 (2015: 1,482).
- Over the years, we have prepared many educational study materials related to water and environment issues for children and teachers. These include, for example, a study material series “Blue Classroom” for the teachers for nature studies supporting the national study program in water-related classes. To introduce the water-related study materials and programs to nursery and school teachers, we participated on an information day, which was organised by the Ministry of the Environment in September 2016.
- Besides our main responsibilities – production of drinking water and treatment of wastewater – our treatment plants also have an important role to play in increasing the population’s awareness. Each year we introduce the plants’ operation to more and more people. In 2016, 2,885 visitors took guided tours in the treatment plants (2015:3076).
- This year we opened the doors of our wastewater treatment plant also during the doors open day. In spring 2016, we had 109 people visiting the wastewater treatment plant.

Cooperation and attention

We support people, who need more help and attention, so that they would also experience the feeling of success.

- High quality drinking water was provided at numerous popular sports and health promotion events. We also provide water for the Flower Festival and building of ice skating rinks in winter.
- In July 2016 a major gymnastics event Estonia's 5th Gymnastics Party "Hingelind" was held with 6,000 dancers gathered across Estonia. The event was broadcasted and covered by Estonian Public Broadcasting (ERR) and across all other media. We provided water during rehearsals and the main festival and we also gave a water bottle to all participants.
- We support the Estonian Disabled People's Sports Union. Our wish is to provide support to the disabled people and encourage them to do the sports and participate in social life, so that those people in the society who need more help and attention would also experience the feeling of success.
- Together with the Estonian Basketball Union, we support the athletic development of young people and through that strengthen the mind-set striving for a healthier life style among the young generation.
- For years now, we have been supporting nursery "Õunake" for disabled children. In 2016, we supported the installation of the machine improving the balance of children with better motor skills. Balancing equipment was installed for kids with better movement abilities. For years now, the Company's printed and electronical Christmas card is decorated with a drawing made by the children from "Õunake". This year our employees also spent a day with those kids baking gingerbreads together.
- In 2016 we started supporting a SPIN programme aimed at children to develop their social skills necessary for life. Within the programme Estonian and Russian children are brought together, so they could learn to communicate with each other through various activities, such as football.

Cooperation with local municipalities and government

We aim at being good partners with national and municipality government institutions. We hold regular meetings with the City of Tallinn to discuss the problems and topics on the agenda to further improve the service provided to our customers and consumers in our main service area, seeking together for the most optimal solutions. Additionally, we want to actively participate in the development of areas related to our activity as well as the preparation of legislation of the respective field. Our specialists, experts in their respective fields, are always willing and prepared to consult and assist with sharing area-specific knowledge.

INVESTORS

We aim to be transparent and honest through our business activities, giving timely and accurate information to our shareholders. We treat all our shareholders equally and are dedicated to efficiency while ensuring the sustainability of the Company.

Investor communication

Continuous and transparent communication is one of the main factors in maintaining excellent investor relations. Therefore, we continue to regularly communicate our targets, strategy and performance to the investors, as well as all other stakeholders. Each quarter, we introduce Company's quarterly financial results to the investors and take part in discussions on the webinars. Additionally, we hold regular meetings with key institutional shareholders and potential investors and company's Management Board. All shareholders are welcomed to ask questions from the members of the Management Board and the Supervisory Board on the Annual General Meeting of Shareholders.

We have worked hard at our investor relations programme since listing on the Tallinn Stock Exchange and will continue to do so in the following years. In order to further increase the transparency of our Management Board activities to shareholders, we applied and have reported good corporate governance recommendations on regular bases starting from 2006.

Our contribution to maintaining excellent investor relations has been also recognised externally.

ECONOMIC PERFORMANCE

AS Tallinna Vesi is a listed company and its shares have been listed on NASDAQ OMX Main Baltic Market since 1 June 2005. A company's market value is a good indication of the overall value of the company and the investors' perceptions of its business prospects. Market value is affected not only by factors controlled by the company but also by those, which are not. Profitability and cost effectiveness are major influences on market value and can be controlled by the management of the Company. Given the ongoing tariff dispute with the Estonian Competition Authority, a significant rise in revenues from our main activities – water and wastewater treatment – is not feasible. However, better control over revenues, in conjunction with the growing population of Tallinn and its surrounding municipalities, allowed us to unveil a strong, steady and a slightly increasing revenue stream also in 2016. In addition, similarly to 2015, more attention was paid on the growth of non-regulated revenues, i.e. revenues from pipe construction and asphaltting. In 2016, the above-mentioned revenues increased by EUR 1,787 thousand (2015: EUR 1,781 thousand). Considering the high competition in this area each opportunity is carefully considered to ensure no significant risk to the core business.

Profitability is the primary goal of all business ventures as without the business will not in the long run survive. We strive to deliver this goal as environmentally friendly and as socially responsible manner as possible. Measuring current and past profitability is very important. Profitability is measured through income and expenses. Profitability also provides us with the financial capital that allows us to fulfil our commitment to provide a reliable and high quality water service to our customers and ensure that all our activities, from initial water catchment to wastewater treatment, are enacted in accordance with strict environmental legislation. As a listed company, we are also accountable to shareholders, customers and a variety of external stakeholders, with whom we interact daily.

Cost efficiency is one of the main ways for the Company to be profitable and meet its goals due to the current situation in which our tariffs are frozen and the Company is involved in two separate law suits regarding tariffs. As a means of being more cost-effective the Company

has switched from outsourced services to insourced services that are provided by the subsidiary OÜ Watercom.

For us it is also important to have a healthy cash balance, in order to meet our immediate and short-term obligations, which is important to our partners. It also makes us an attractive investment for current and future shareholders. We have been a consistent dividend payer. In June 2016, we made a payment of EUR 0.90 per share. This is in accordance with our current dividend policy, which is to increase dividends by a minimum of CPI each year, therefore providing a return that is consistent with other privatised utilities in Europe.

AS Tallinna Vesi makes a financial contribution to its stakeholders by paying taxes, salaries to its staff, dividends to its shareholders and fair price to its suppliers. AS Tallinna Vesi is a responsible and ethical tax payer acting in accordance with the legal acts of the Republic of Estonia.

For 2016 we paid EUR 17,318 thousand as taxes (2015: EUR 16,564 thousand).

PARTNERS

We strive to do more than we are expected to by legislative and contractual requirements. To serve that purpose, we focus on dialogue and cooperation, both within our team and with various partners. Changes in applicable legislation are constantly monitored and communicated to the relevant managers, whom those changes concern. On the other hand, we also value preventive cooperation and actively participate in the development and amending of legal acts primarily via the Estonian Waterworks Association. We also cooperate with several quality-conscious and environmentally aware companies to promote doing business in an ethical and responsible way.

Cooperation with suppliers

AS Tallinna Vesi is a service provider. Considering the nature of our activity as a water company, our supply chain includes other service providers and partners, who help us to guarantee the performance of our main operations and availability of services to the customers. Unlike many other industries, our supply chain is relatively simple, because the Company produces and sells the service without having any other links in its supply chain. Still, the Company itself is often an integral link in our customers' supply chain and therefore, it is very important that our service meets high quality standards. However, for this short but vital supply chain to work without any interruptions, we need our suppliers to be reliable. For this purpose in several chains of critical importance we have alternative suppliers in place to whom we can turn to in case something should happen with our main contract partner. We find our suppliers mostly through tenders, which gives us an opportunity to set the criteria that we expect our suppliers to meet. We consider the environmental safeness and safety of our suppliers' employees very important.

Our cooperation partners can be divided up into three larger groups:

- suppliers of goods;
- suppliers of services;
- suppliers of construction works.

In a globalising world, the suppliers' market is constantly changing. Our suppliers are mostly Estonian based but we do also have international tenders. We choose high quality products and invest in the renovation of systems in order to ensure an effective and sustainable operational activity. We outsource various support services so that our focus can remain on the main activity. For instance, we are outsourcing our advertising and cleaning services and many other specific services.

Our subsidiary, OÜ Watercom, also ensures that all construction works are completed properly and on time, outsourcing some of the works if needed and economically justified. We sign long-term contracts to retain our suppliers and to ensure good and reliable cooperation. We have, at any time, approximately 1,000 suppliers in our database with whom we have been in cooperation at least once a year.

Looking for new suppliers, as well as monitoring and improving the cooperation with current partners, is equally important to us. We consistently and systematically assess our cooperation with the suppliers, enabling us to have a two-way interaction with our current partners, create a reliable base of suppliers and employ suppliers' competencies in order to create additional value for the company. Besides assessing the activity of suppliers, we also ask for feedback on our own activity in order to develop our relations and cooperation with the suppliers further, while at the same time aiming at being a better partner.

Our Principles and Membership in Organisations

We deem it important to be involved and express our opinion on the issues that are relevant in society and to contribute to the development of areas related to our activity and the preparation of legislation. To these purposes, we have joined and become a founder member of various associations. We are a founder member of the Estonian Association of Environmental Management and the Corporate Social Responsibility Forum in Estonia, a collective member of the Association for Quality, and a member of the Estonian Waterworks Association.

We are responsible for providing consumers with a reliable supply of drinking water and for treating wastewater and storm water, by using safe and environmentally friendly technologies. To us, bearing this fact in mind, while acting consistently and systematically in making our management decisions and while performing our daily business activities, is a key. Therefore, our management practices need to consider the impact we have on our surrounding environment and the expectations of various stakeholders. Our management has approved the following policies and guiding principles that set the overall framework for acting in different areas. All of the following policies are available at least in Estonian and English and can also be found on our website:

- Environmental policy
- Quality policy
- Health and safety policy
- Human resource policy
- Principles of responsible business.

ENVIRONMENT

The natural environment provides what is essential for us – water. We take raw water from Lake Ülemiste, as well as extract groundwater, to supply the citizens of Tallinn with pure drinking water. We rely directly on natural water resources, which we highly appreciate and care for. Thus, we do our best to employ these resources sustainably and contribute to the well-being of the environment.

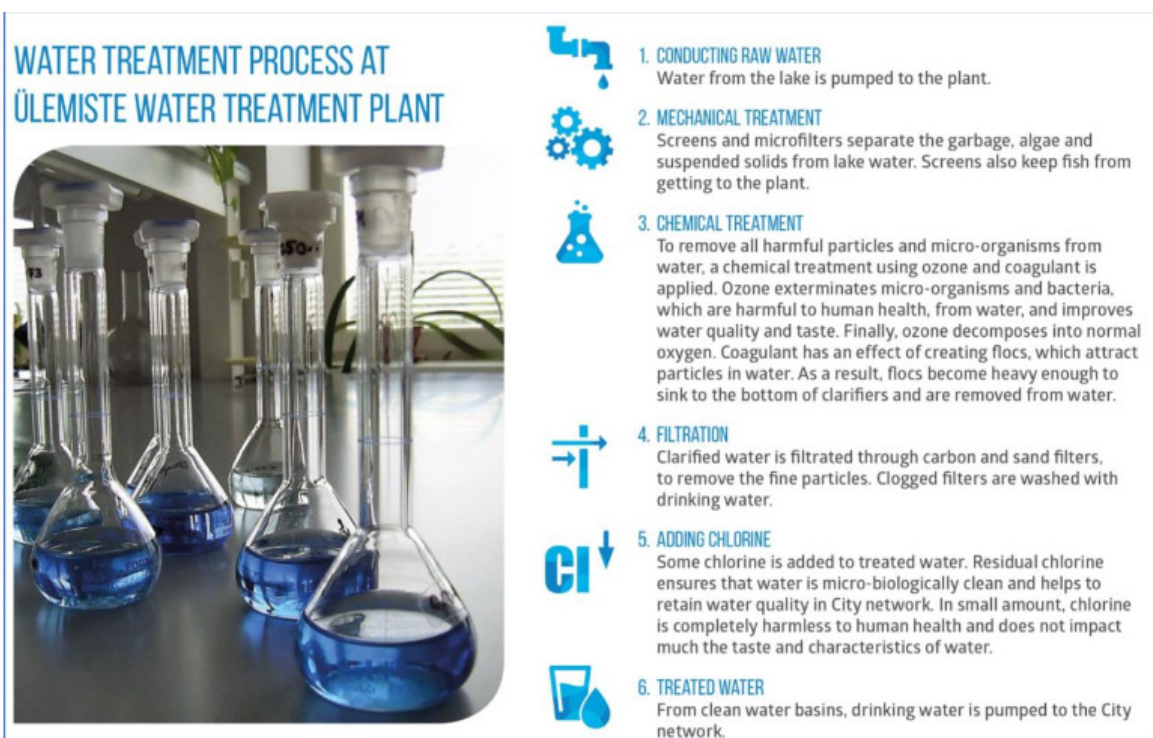
In 2016 we provided about 25.08 million m³ (2015: 24.46 million m³) of pure drinking water to the network and safely collected, treated and recycled 50.22 million m³ (2015: 45.07 million m³) of wastewater back to the environment. Therefore, besides a sustainable use of water, we are also determined to improve the natural and living environment around the Baltic Sea. We are committed to maintaining high standards and achieving results that can outperform the standards that have been set for treated effluent discharged into the Baltic Sea.

Our environmental activity and environmental management system are in compliance with the requirements of the international environmental standard ISO 14001 and EU Eco Management and Audit Scheme (EMAS) Regulation. The Company's environmental activities are, to a large extent, regulated by requirements arising from the EU, from national and local government legislation and from the environmental permits issued by the Environmental Board. Consequently, the environmental impact of our daily activities as a company is rather well mapped and managed.

In order to keep our main activities operational, we must rely on resources that have an environmental impact. The Company's core activity is highly dependent on the use of electricity and this has the strongest impact on the environment. We continue striving for higher efficiency in our electricity consumption by maximizing the use of biogas, a product of the sludge digestion process, in local heat production. This contributes significantly towards improving our energy efficiency. Our duty as a water company is to ensure the availability of high-quality drinking water to our customers. However, the Company itself is also in need of water in order to keep its work processes on-going and to ensure an uninterrupted water supply to the residents of Tallinn. In order to reduce ambient air pollution, the Company is focused on limiting the amount of pollutants emitted from Ülemiste and Paljassaare boiler houses, such as nitrogen dioxide, carbon monoxide, volatile organic compounds and CO₂ greenhouse gas emissions. A more detailed overview of our environmental performance is available in our environmental report. The 2015 environmental report can be viewed on AS Tallinna Vesi's webpage. The 2016 environmental report is due to be published at the end of the 2nd half of 2017 at the latest and will be available on the Company's web page. In 2016, the Company did not identify any non-compliance with environmental laws or regulations.

SUSTAINABLE USE OF WATER

To provide drinking water to the citizens of Tallinn, water must be extracted from its natural environment. AS Tallinna Vesi supplies its customers with drinking water extracted from both surface water and groundwater sources. Approximately 90% of our clients use water from Lake Ülemiste, which has been treated in the Ülemiste Water Treatment Plant. We are determined to use the water sustainably and continuously increase the efficiency of our water usage.



One of our main objectives is to keep leakages i.e., losses of pure water in the water network, at a minimum level because lower levels of leakages also means lower volumes of water extracted from natural water sources. As a consequence of lower level of leakages, the demand for water extraction as well as the risks of soil erosion are also reduced. Besides the increased value the lower levels of leakages provide in terms of environmental sustainability, they also reduce our own costs due to the reduction in treated water losses. This, in turn, directly and indirectly affects our employees, investors and clients as well as the public sector and the community.

About ten years ago the level of leakages exceeded 32% while in 2016, the level of leakages was 15.07% (2015: 14.68%). This means we are currently saving over 14,000 m³ of treated water a day compared to ten years ago. The reduction in the level of leakages has been facilitated by our consistent efforts to use the water resource sustainably and with lower losses. To achieve this result, we have acquired new equipment for faster detection and enhanced remote inspection. Detecting and eliminating leakages as fast as possible and regular preventive action continue to contribute further to the reduction in the level of leakages.

EFFLUENT QUALITY

We treat wastewater collected in Tallinn and its nearest surrounding areas by using environment-friendly and modern technologies at our Paljassaare Wastewater Treatment Plant.

(EUR thousand)

WASTEWATER TREATMENT
PROCESS AT PALJASSAARE
WASTEWATER TREATMENT PLANT**1. MAIN PUMPING STATION**

All wastewater collected via tunnel collectors is pumped into wastewater works, by using three pressure pipes.

**2. MECHANICAL TREATMENT**

With screens and grit traps, garbage and grit is removed from incoming influent. Wastewater is then conducted to pre-sedimentation basins where sedimentation is used to remove suspended solids (raw sludge) from wastewater. Fats and oils floating on surface are also removed here. Raw sludge is passed on to the sludge treatment process.

**3. BIOLOGICAL AND CHEMICAL TREATMENT**

Biological treatment is carried out by various bacteria (activated sludge), who survive on wastewater nutrients. Biological treatment removes most of nitrogen and part of phosphorus from wastewater. For better phosphorus compounds removal, additional chemical treatment is used, by injecting coagulant which settles dissolved phosphorus compounds. In secondary sedimentation basins, all the sediments and activated sludge are removed from wastewater. Some of the sludge is redirected to treatment process and the rest is sent to sludge treatment process.

**4. TREATED EFFLUENT PUMPING STATION**

Thoroughly treated effluent is pumped via deep-sea outlet 3 km away into the Bay of Tallinn.

**5. SLUDGE TREATMENT**

Raw sludge and activated sludge removed throughout treatment process is fermented in methane tanks. Sludge fermentation produces biogas, which is used in technological process and for heating plant facilities. Fermented sludge is dewatered and used to produce a nutritious compost soil that can be used on greening purposes.

The quality of the effluent discharged into the sea has a direct impact on the marine environment, and therefore, directly and/or indirectly constitutes an important aspect for all our stakeholders. Our focus is on maintaining high standards and outperforming all standards established for effluent discharged into the Baltic Sea.

50,22 million m³ of wastewater was treated at the Paljassaare Wastewater Treatment Plant in 2016 (2015: 45.07 million m³). The quality of effluent discharged into the sea is set by legal acts and water extraction permits. The concentration of pollutants in wastewater arriving at the treatment plant and in the effluent leaving the plant are monitored in order to assess the efficiency of the treatment process and the quality of effluent. The wastewater laboratory carries out analyses at different wastewater treatment stages. Such results provide us essential information which allows us to further improve the efficiency of the treatment processes and the quality of the effluent.

Compared to regulatory requirements the treatment efficiency of the Paljassaare Wastewater Treatment Plant was in 2016 higher than all of the parameters:

Biological oxygen demand (BOD)– requirement 80%, our result 97% (2015:98%);

Chemical oxygen demand (COD)– requirement 75%, our result 89% (2015: 92%);

Suspended solids – requirement 90%, our results 97% (2015: 98%);

Total nitrogen (N_{tot})– requirement 80%, our result 83% (2015: 84%);

Total phosphorus (P_{tot})– requirement 80%, our result 92% (2015: 93%);

Oil products – requirement 75%, our results 88% (2015: 93%).

Our work is largely dependent on the weather: for example, it affects the quality and quantity of water entering into the plants, and sewage parameters, and the amount of energy and chemicals required in the treatment processes. Therefore, extreme weather conditions pose a great challenge as they may have significant impact on our business. The strongest impact on the activities of the Company and its stakeholders (including employees, community, clients and the public) result from extreme weather events, such as heavy downpours. Heavy downpour and peaking quantities of storm water may cause flooding and short-term incapacity of the sewage and storm water network to take in such large amounts of water. Moreover, it may result in the incapacity of the Wastewater Treatment Plant to take in and/or fully treat such large amounts of sewage. Under these circumstances and to avoid major damages, we are, from time to time, forced to discharge partially treated sewage into the sea or to open emergency outlets to conduct highly diluted wastewater into the sea.

During 2016, we were forced, during heavy showers, to open the emergency outlets in the Wastewater Treatment Plant eight times (2015: five times), all for a short period of time, in order to avoid major damages. A total of 122,687 m³ of wastewater diluted by storm water (dilution ¼) was conducted to the sea (2015: 45,443 m³).

Due to the shock loads, which exceeded the biological treatment capacity, 584,074 m³ of highly diluted wastewater that had undergone mechanical treatment were in 2016 discharged into the sea through the deep-sea outlet (2015: 317,432 m³). An effective operation and minimalization of the risks are fundamental in keeping such occurrences as rare as possible.

COMPLIANCE

We are the most regulated water company in Estonia. To ensure the fulfilment of minimum environmental requirements set for water companies, we are required to comply with legislative acts issued by the European Union (EU) and the Estonian government, as well as by the local governments. At EU level, this means above all the compliance with Water Framework Directive No 2000/60/EC of the EU Council. At national level, the Company is required to comply with the Water Act, the Public Water Supply and Sewerage Act, the General Part of the Environmental Code Act, the Environmental Monitoring Act, the Environmental Liability Act, the Waste Act, the Chemicals Act, Ambient Air Protection Act and any regulations adopted on the basis thereof. At the local level, the Company has to abide by various guidelines and regulations established by the local government in Tallinn and neighbouring municipalities.

To ensure the best quality of service for our customers, besides legislative requirements, we are contractually required to comply with 97 levels of service. This responsibility stems from the Services Agreement concluded with the City of Tallinn and the investors in 2001. Our performance and the levels of service are reviewed annually by an independent monitoring unit – the Supervisory Foundation for Water Companies in Tallinn – to whom we submit annual Levels of Service reports.

In 2015 and 2016, we complied with and in many cases outperformed all of the contractual levels of service. For example the required leakage level should not exceed 26%, in 2016 leakage level was at 15.07% (2015: 14.68%). Also the water quality was the highest over time, being 99.93% (2015: 99.86%) against the target of 95%.

Besides the 97 levels of service, pursuant to the Services Agreement we are required to comply with the following management systems:

- Since 2001, ISO 17025 Quality Management System of Laboratories;
- Since 2002, ISO 9001 Quality Management System;
- Since 2003, ISO 14001 Environmental Management System.

Doing business in an environmentally safe manner and the safety of our employees is fundamental to us, therefore we have voluntarily implemented the following management systems:

- Since 2005, EMAS-compliant European Eco-Management and Audit Scheme;
- Since 2007, OHSAS 18001 Occupational Health and Safety Management System.

In 2015 and 2016, our activity, the activity of our subsidiary OÜ Watercom and our management systems fully complied with all applicable quality, environmental, occupational safety and work environment standards and systems and legal requirements. Such compliance is regularly monitored via internal audits and confirmed by way of an external audit undertaken by Det Norske Veritas Eesti OÜ on the EMAS-compliant Eco-Management and Audit Scheme, established by the European Union.

Auditors highlighted many positive observations, especially related to increase of environmental awareness in society. In addition auditors drew special attention to our the ability to meet set objectives, our board members' involvement in safety audits and the improvement in client satisfaction.

We act in accordance with the requirements of the environmental permits issued to us and comply with the precepts issued by authorities. The following environmental permits have been issued to AS Tallinna Vesi:

- 4 permits for the special use of water
- 2 waste permits;
- 2 ambient air pollution permits.

Strict drinking water quality control

The quality of drinking water is subject to strict legal requirements. The quality must comply with Regulation No 82 "Quality and control requirements and analysis methods for drinking water", issued by the Minister of Social Affairs, pursuant to the Estonian Water Act and the European Drinking Water Directive 93/83/EC. In addition to legislative requirements, we have also agreed on additional and even tighter quality standards in the Services Agreement concluded with the City of Tallinn. In terms of water quality, we have outperformed those requirements assuring a supply of good quality drinking water to each and every one of our customers. The results of all analyses are public and made available on the Company's website at: www.tallinnavesi.ee -> About Us -> Our Core Business -> Drinking Water Quality.

Water quality is inspected by following the drinking water monitoring programme approved by the Health Board. The programme specifies the sampling points, sampling frequency and the



(EUR thousand)

AS TALLINNA VESI
CONSOLIDATED ANNUAL AND SUSTAINABILITY REPORT
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

parameters to be analysed. Samples are taken from raw water (Lake Ülemiste and its catchment area and from ground water), from the treatment process and from consumers' taps. There are 120 sampling points in Tallinn including nurseries, schools and other institutions, evenly spread out across the entire service area. In case any non-compliant water gets into the network, we have a legal requirement to notify the Health Board and the public if necessary, of such occurrences and take immediate steps to resolve the problem.

We have a separate laboratory unit, which has been accredited by the Estonian Accreditation Centre since 2001. The laboratory unit consists of a water and microbiology laboratory at the Ülemiste Water Treatment Plant and a wastewater laboratory at the Paljassaare Wastewater Treatment Plant. Water analyses are made in our water and microbiology laboratory, which is also one of the largest laboratories in Estonia. The quality of analyses is guaranteed by the attested samplers, accredited quality management system (ISO 17025) and modern equipment, as well as the professional staff who enable us to offer a wide range of services also externally. Water quality is independently monitored by the Northern Services of the Health Board and Supervisory Foundation of Water Enterprises in Tallinn, and our laboratories are supervised by the Estonian Accreditation Centre. In 2016, the Company's water and microbiology laboratories carried out 100,000 analyses in total (2015: 99,000).

CORPORATE GOVERNANCE

CORPORATE GOVERNANCE REPORT

Corporate governance is a system of principles for the control and management of a company. These principles are regulated by law, by the Articles of Association and by the internal rules of a company. As of 1st January 2006, companies listed on the Nasdaq Tallinn Stock Exchange have been encouraged to follow the Corporate Governance Recommendations issued by the Financial Supervision Authority. AS Tallinna Vesi is committed to following those recommendations and acted accordingly throughout 2016. This report covers the principles applicable as of 31st December 2016 and approved by the Financial Supervision Authority.

AS Tallinna Vesi is committed to high standards of corporate governance, for which the Management Board and the Supervisory Board are accountable to the shareholders. The corporate governance model and operational structure are designed to ensure that all employees work towards the common objectives of the Company. Good corporate governance, internal controls and risk management are all key elements to a successful business. Good corporate governance, transparency, sustainability, internal controls and risk management are fundamental components to build and maintain the trust and credibility of all stakeholders of the Company. AS Tallinna Vesi considers it crucial to be transparent in its methods of operation through corporate disclosures and through its relations with its stakeholders. AS Tallinna Vesi has received recognition for best investor relations by Nasdaq Baltic on several occasions:

- In 2009, AS Tallinna Vesi was awarded Best Investor Relations in Nasdaq Tallinn; the Company was also bestowed with an award for Best Annual Report.
- In 2010, AS Tallinna Vesi was awarded Best Investor Relations in Nasdaq Tallinn while the Baltic Corporate Governance Institute awarded AS Tallinna Vesi with Best Corporate Governance in Estonia.
- In 2011, AS Tallinna Vesi was conferred with Best Investor Relations on the Nasdaq Tallinn Stock Exchange and second place in the Nasdaq Baltic Markets.
- In 2012, AS Tallinna Vesi's was recognized as one of the final nominees for the "Best Interactive Investor Relations" and its annual report was awarded second place in the Baltic Markets
- In 2013, as recognition to the work done in the field of corporate governance and investor relations, AS Tallinna Vesi won the main category award for Best Investor Relations in the Baltic Markets thus becoming the first Estonian recipient of the award.
- In 2014, AS Tallinna Vesi received Best Investor Relations in the Baltic Markets for a second year. In addition, AS Tallinna Vesi was also recognized as the most attractive company in the Baltic Markets.
- In 2015, AS Tallinna Vesi won the Nasdaq Market Awards main category "Best Investor Relations in Baltics" for a third consecutive year. Additionally, the Company was

recognized with first places in the following categories: “Best Investor Relations according to market professionals”, “Best Interactive Investor Relations” and the “Most Trustworthy Company within the Baltic Markets”.

- In 2016, AS Tallinna Vesi won the Nasdaq Market Awards main category “Best Investor Relations in Baltics” for the fourth consecutive year. Additionally, the Company got the first places in categories “The Best Interactive Investor Relations” and “Best Reporting Company”. The Company’s investor relations were highly recognised also by market professionals and the Company received the second place in the category of “Best Investor Relations According to Market Professionals”.

Since 2010 AS Tallinna Vesi has been a member of the Baltic Institute of Corporate Governance, which promotes the best practices of corporate governance in the region. All members of the Management Board of AS Tallinna Vesi have successfully completed the Executive Program of Professional Board Members provided by the Baltic Institute of Corporate Governance.

INVESTOR RELATIONS AND DISCLOSURE OF INFORMATION

Corporate Governance Recommendations statements are available on AS Tallinna Vesi’s homepage <https://www.tallinnavesi.ee> under the section “Investor”. The Corporate Governance Recommendations Report is an integral part of the Annual Report of AS Tallinna Vesi, which is prepared at the end of each financial year. Annual reports are made public on the Nasdaq Tallinn Stock Exchange and are also available on the Company’s homepage <https://www.tallinnavesi.ee> → Investor → Reports.

AS Tallinna Vesi discloses the following year’s financial calendar on the Nasdaq Tallinn Stock Exchange prior to the end of the calendar year. This information includes the dates of the quarterly and annual financial information and the date of the Annual General Meeting (AGM) of Shareholders. All information disclosed via the Nasdaq Tallinn Stock Exchange is also subsequently made available on AS Tallinna Vesi’s homepage.

Additionally, prior to the AGM, AS Tallinna Vesi discloses the following information on its website:

- AGM notice;
- background information about the agenda, including the Annual Report to be approved, the Supervisory Board’s report and the Auditor’s report;
- information about the Supervisory Board member to be elected and the auditor candidate;
- the total number of voting rights and number of voting rights by share type;
- procedure for adding items to the agenda and presenting draft resolutions;
- procedure for inquiring about the Company’s activities from the Management Board
- the list of identification documents required for attending the general meeting, including the form of power of attorney.

Decisions of the General Meetings and Management Board presentations are being published shortly after the meeting via the Nasdaq Tallinn Stock Exchange. Finalised and certified minutes of the General Meetings are published seven days following the date of the General Meeting. All documents and information published via Nasdaq Tallinn Stock Exchange are available on AS Tallinna Vesi's homepage <https://www.tallinnavesi.ee> -> Investor -> Shareholders meeting.

AS Tallinna Vesi holds regular discussions with its major shareholders and potential investors. To this end, the Company holds General Meetings for shareholders, not less than once per year, to keep shareholders informed and to provide them with an opportunity to question directly the Management Board and the Supervisory Board. The Management Board also meets both existing and potential investors outside of the General Meetings including but not limited to meetings on site, roadshows, by being present in conferences and through investor calls.

AS Tallinna Vesi organises quarterly investor webinars, using the NASDAQ webinar service. Webinar is a virtual conference, in which company representatives provide information about the company and its performance. Webinar allows interactive communication and the possibility to ask questions and receive answers directly from the Management Board members of the Company. The webinar information is announced via the Nasdaq Tallinn Stock Exchange and is open to all interested parties. All webinar recordings and presentations of the webinars are disclosed on the Nasdaq Tallinn Stock Exchange and on AS Tallinna Vesi's homepage.

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 management body.

In accordance with the Commercial Code and with the Corporate Governance Recommendations, AS Tallinna Vesi convenes both Annual General Meetings (AGM's) and Extraordinary General Meetings (EGM's) by notifying all of its shareholders via the Nasdaq Tallinn Stock Exchange and by publishing information on its homepage and in one national daily newspaper at least 3 weeks in advance. Information related to General Meetings is disclosed in Estonian and English on the Company's homepage and in Stock Exchange announcements. The announcement in the daily newspaper is published only in Estonian.

The agendas of AGMs and EGMs of AS Tallinna Vesi are pre-approved by the Supervisory Board, which also puts forward proposals requiring attention and for voting at the General Meeting. The General Meeting's agenda items, the Supervisory Board's proposals along with relevant comments about the agenda items, procedural instructions for participating in a General Meeting and procedure for proposing additional items to the agenda are disclosed within the General Meeting's notice.

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

On 2nd June 2016, AS Tallinna Vesi held the Annual General Meeting (AGM) of its shareholders to approve the 2015 Annual Report, distribution of profit, amendment to Articles of Association and to elect four Supervisory Board members and an auditor. The Management Board made a presentation on the overall performance of the Company, highlighting the improvements in the occupational environment and safety area as well as in the financial and operational performance. No questions regarding the items in the 2016 AGM agenda were asked, nor were any additional agenda item proposals made in 2016.

The Chairman of any AGM is an independent person. In 2016, the AGM was chaired by Mr. Raino Paron, who introduced the procedure for conducting the General Meeting, including the procedure for inquiring about AS Tallinna Vesi's activities from the Management Board.

All members of the Management Board, the Chairman of the Supervisory Board and the lead auditor participated in the AGM in 2016. When a Supervisory Board member or a lead auditor stands for election at the General Meeting, the candidate for the respective position usually participates in the Meeting. Therefore, the Supervisory Board member candidates Mr Mart Mägi, Mr Rein Ratas, Dr Martin Padley and Mr Simon Roger Gardiner participated in the 2016 AGM. The candidate for the position of lead auditor, Mr. Ago Vilu, also participated in the 2016 AGM.

AS Tallinna Vesi does not allow its shareholders to participate at the General Meetings via electronic communication tools, as it has proven too complicated and expensive to establish reliable solutions to identify the shareholders, especially those who are overseas' residents. In the AGM held on 2nd June 2016, the Articles of Association were amended to allow remote voting should a reliable means be identified.

No shareholders have shares granting them a right for specific control. AS Tallinna Vesi is unaware of any shareholders having concluded any voting agreements.

As per the Articles of Association of AS Tallinna Vesi, AS Tallinna Vesi has issued one registered preferred share with a nominal value of 60 euros (B-share). The B-share grants the holder the right to participate in General Meetings, in the distribution of profits and disposal of assets remaining upon dissolution of AS Tallinna Vesi and other rights provided by law and by the Articles of Association of AS Tallinna Vesi. The B-share grants the holder preferential right to receive a dividend to 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 amendments to the Articles of Association of AS Tallinna Vesi, on increasing or reducing the share capital of AS Tallinna Vesi, on issuing convertible bonds, on acquisition of treasury shares by AS Tallinna Vesi, on deciding on a merger, division, transformation and/or dissolution of AS Tallinna Vesi and on deciding issues related to the activities of AS Tallinna Vesi that have not been placed under the exclusive competence of the General Meeting by the law.

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 each with a term of two years. In 2016, five regular and no extraordinary Supervisory Board meetings were held. The Supervisory Board pre-approved the 2015 Annual Report presented to the Annual General

Meeting for approval, reviewed the dividend proposal, which was presented to the Annual General Meeting for approval and reviewed AS Tallinna Vesi's budget for 2017. In addition, in its meetings, the Supervisory Board reviewed major risks that the Company faces, regulatory and legal issues, matters regarding operations, finances and human resources, customer service and satisfaction, market development for non-regulated businesses and other operational and business matters.

The following points are usually brought up at every Supervisory Board meeting:

- minutes of the previous meeting;
- information on issues dealt with by the Supervisory Board's committees as appropriate;
- the Management Board report covering the following areas: operational, legal and regulatory, financial, communication, human resources, health, safety and quality;
- major projects and issues;
- decisions on special cases.

At the time of compilation of this report, AS Tallinna Vesi's Supervisory Board consisted of the following members:

- Mr. Simon Gardiner (United Utilities (Tallinn) B.V.), Supervisory Board member until 2nd June 2018;
- Mr. Steven Richard Fraser (United Utilities (Tallinn) B.V.), Supervisory Board member until 21st January 2018;
- Mr. Brendan Francis Murphy (United Utilities (Tallinn) B.V.), Supervisory Board member until 27th October 2017;
- Mr. Martin Benjamin Padley (United Utilities (Tallinn) B.V.), Supervisory Board member until 1st November 2018;
- Mr. Priit Lello (Tallinn City), Supervisory Board member until 15th November 2017;
- Mr. Rein Ratas (Tallinn City), Supervisory Board member until 2nd June 2018;
- Mr. Toivo Tootsen (Tallinn City), Supervisory Board member until 6th April 2017;
- Mr. Mart Mägi (independent) Supervisory Board member until 2nd June 2018;
- Mr. Allar Jõks (independent) Supervisory Board member until 28th May 2017.

AS Tallinna Vesi has not made any transactions with members of the Supervisory Board nor their related parties.

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

AUDIT COMMITTEE AND INTERNAL AUDIT

The Audit Committee is the subcommittee to the Supervisory Board, which provides an oversight of the financial reporting process, the audit process, the systems of internal controls, review of risk management and assessment and compliance with the laws and regulations. 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 responsibilities of the Audit Committee are:

- to review quarterly and annual financial statements, including reporting to the Supervisory Board on significant issues considered by the Audit Committee in relation to the financial statements and how those issues were addressed;
- to monitor and analyse the effectiveness of risk management systems and internal controls;
- to review the annual report and the scope, processes and results of the annual audit and to report to the Supervisory Board on the effectiveness of the audit process;
- to monitor and analyse the independence and objectivity of external auditors and the legality of their activity regarding AS Tallinna Vesi and how the objectivity has been safeguarded;
- to annually evaluate the work of external auditors and report to the Supervisory Board about the results of such evaluation;
- to make recommendations to the Supervisory Board for the appointment or reappointment of the external auditor and to be responsible for the tender of the external audit and agree on the fees paid to the auditor;
- to monitor the independence of the internal auditor;
- to review the scope effectiveness of the internal audit function, including reviewing and approving the annual audit plan.

At the time of compilation of this report, the Audit Committee consisted of the following members of the Supervisory Board:

- Mr. Brendan Francis Murphy acting as the Chairman of the Audit Committee;
- Mr. Allar Jõks and
- Mr. Simon Gardiner.

At each Supervisory Board meeting, an internal audit report is presented to the Supervisory Board. In 2016, the internal audit service was bought in from Ernst & Young Baltics AS. The internal auditor of AS Tallinna Vesi reports directly to the Audit Committee.

The external financial auditor appointed 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 2016, the external auditor did not provide any services to the Group outside the scope of the annual audit for financial accounts, except external assurance provided on GRI

G4 reporting referred in GRI index for the period ended 31 December 2016. In 2017 also the corporate social responsibility and sustainability report will be externally audited.

Pursuant to the Articles of Association of AS Tallinna Vesi, an external auditor, whose responsibility is to conduct the annual audit, is elected by the General Meeting of Shareholders. The remuneration of the external auditor is regulated in the contract signed between the external auditor and the Management Board. In 2016, the Group paid EUR 27 thousand for the annual financial audits against the relevant invoices issued and EUR 36 thousand for internal audit services against the relevant invoices issued. AS Tallinna Vesi chooses an external auditor by following internal procurement procedures (which include approval by the Audit Committee and the Supervisory Board of AS Tallinna Vesi), thus ensuring the best match of service-quality and price offered for the services. Offers are taken only from internationally respected, high-quality audit companies. In 2015 and 2016, AS Tallinna Vesi signed a 1-year audit contract with a clause that requires re-appointment of the lead auditor every 5 years and follows the Financial Supervision Authority guidelines of 1st November 2013 "Rotation of the auditors of certain subjects of financial supervision by the state" with regard to the requirement to rotate the lead auditor every 5 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 2016, the Nomination and Remuneration Committee continued to advise the Supervisory Board on management remuneration issues and Management Board nominations.

At the time of compilation of this report, the Nomination and Remuneration Committee consisted of the following members of the Supervisory Board:

- Mr. Steven Richard Fraser, acting as the Chairman of the Nomination and Remuneration Committee;
- Mr. Mart Mägi and
- Mr. Simon Gardiner.

The Supervisory Board approves the remuneration principles of the issuer's managers and appoints the Nomination and Remuneration Committee. The Nomination and Remuneration Committee recommends the remuneration principles of AS Tallinna Vesi and exercises due supervision to ensure 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 remuneration principles proposed are based on the short- and long-term objectives of AS Tallinna Vesi, taking into account the financial performance of AS Tallinna Vesi and the legitimate interests of investors. The Nomination and Remuneration Committee also ensures 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 the principal job forms a sufficient part of the total remuneration. According to the existing PRP principles,

members of the Management Board are entitled to a maximum PRP of 25% of their annual gross salary. The PRP depends on the annual financial and operational performance of the company, 60% of the PRP is related to Group objectives and 40% of PRP is related to individual specific objectives. The proportion and objectives are reviewed and confirmed by the remuneration and nomination committee. If the annual results are worse than expected, a decision can be taken not to pay any PRP.

CORPORATE GOVERNANCE COMMITTEE

In 2016, the Corporate Governance Committee continued to advise the Supervisory Board on the improvement of corporate governance of AS Tallinna Vesi for the benefit of its Supervisory Board and shareholders.

At the time of compilation of this report, the Corporate Governance Committee consisted of the following members:

- Mr. Allar Jõks acting as Chairman of the Corporate Governance Committee;
- Mr. Karl Heino Brookes and
- Mr. Simon Gardiner.

MANAGEMENT BOARD

The Management Board is a management body that represents and manages the day-to-day business of AS Tallinna Vesi in accordance with the law and the Articles of Association of AS Tallinna Vesi. The Management Board is obliged to act in the most economically efficient manner. The Management Board can be composed of two to five members, in line with the Articles of Association, and is elected for a term of 3 years. The Management Board always prepares management reports for the Supervisory Board meetings and such reports are distributed 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 outside of meetings, when considered necessary, and if requested to do so by the Chairman of the Supervisory Board.

Both Management Board and Supervisory Board Members are deemed to be insiders who are aware of AS Tallinna Vesi's insider rules and together with their related persons, are listed in the Group's insider list. Since 2nd June 2014 and until compilation of this report, the Management Board of AS Tallinna Vesi has consisted of three members. The Supervisory Board of AS Tallinna Vesi has appointed all Management Board members. The members are as follows:

- Mr. Karl Heino Brookes, with the powers of Management Board member until 21st March 2020;
- Ms. Riina Käi, with the powers of Management Board member until 29th October 2018;
- Mr. Aleksandr Timofeev, with the powers of Management Board member until 29th October 2018.

The responsibilities of all Management Board members are specified below.

The duties of the Chairman of the Management Board, Mr. Karl Heino Brookes, are to, inter alia, fulfil the everyday obligations of the Chief Executive Officer (CEO) of AS Tallinna Vesi by leading and representing AS Tallinna Vesi, by ensuring its compliance with contracts and the law, by organizing the activities of the Management Board and by coordinating the preparation of strategies and ensuring their implementation.

The duties of the member of the Management Board, Mr. Aleksandr Timofejev, are to, inter alia, fulfil the everyday obligations of the Chief Operations Officer (COO) of AS Tallinna Vesi by managing and being responsible for the operations of the treatment facilities, the planning and delivery of long-term investments and the management of AS Tallinna Vesi's water and sewerage networks' everyday operations, as well as being responsible for customer services and for relations established with external partners.

The duties of the member of the Management Board, Ms. Riina Käi, are to, inter alia, 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 AS Tallinna Vesi.

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 with any of their related parties outside of the main services.

According to the Articles of Association of AS Tallinna Vesi, the Chairman of the Management Board has the sole representation right of AS Tallinna Vesi; other Management Board members can represent AS Tallinna Vesi only jointly. In order to make daily decisions, the Management Board has approved 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.

EQUAL OPPORTUNITIES AND DIVERSITY IN SELECTING MANAGEMENT BOARD AND SUPERVISORY BOARD MEMBERS

In selecting members to the Management and Supervisory Boards, AS Tallinna Vesi is committed to the principles of equality being adhered to. Nobody is discriminated against because of their age, gender, religion, ethnic origin or other characteristics. In selecting Management Board Members and Supervisory Board Members, experience in the business or area of expertise, education and background are considered to be the most important, in order to provide an effective and balanced Board. The allocation between men and women in the Management Board is outlined in the Management Report. There are no women sitting in the Supervisory Board.

CONFORMITY WITH NASDAQ TALLINN STOCK EXCHANGE CORPORATE GOVERNANCE RECOMMENDATIONS

As of 1st January 2006, 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 2016, AS Tallinna Vesi complied with the vast majority of the Corporate Governance Recommendations. However, AS Tallinna Vesi did not comply with certain recommendations, which are listed below, along 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 and 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 AS Tallinna Vesi 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 discuss or regularly review the principles of remuneration of the relevant 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 the 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 discloses the overall Management Board remuneration in Note 25 of the annual accounts but considers that individual remuneration is private and sensitive information and that additional disclosure 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 a company belonging to same group as the Issuer.”

The Management Board Members of AS Tallinna Vesi are not in 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 2016, the transactions between AS Tallinna Vesi and any member of the Management Board or any persons or companies related to them were carried out by the arm's length principle and are disclosed in the related parties' appendix of the financial accounts.

“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).”

The Supervisory Board member's fee was determined by the General Meeting in 2005, at the time of the listing of the Company's shares on the Tallinn Stock Exchange. The remuneration of Supervisory Board members was set at EUR 6,391 per year per person and has remained unchanged. The fee has been paid to five members out of nine. The Supervisory Board member's fee is not paid to the members representing UUTBV. The fee is subject to deduction and payment of applicable taxes and is payable on a monthly basis. The Supervisory Board members were not paid any additional benefits in 2016.

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

In 2016, five Supervisory Board meetings were held as follows: 28th January 2016, 24th March 2016, 28th April 2016, 28th July 2016 and 3rd November 2016.

The 28th January 2016 Supervisory Board meeting was attended by Messrs. Simon Gardiner, Martin Padley, Brendan Murphy, Steven Richard Fraser, Mart Mägi, Toivo Tootsen, Allar Jõks, Priit Lello and Rein Ratas.

The 24th March 2016 Supervisory Board meeting was attended by, Messrs. Simon Gardiner, Martin Padley, Brendan Murphy, Mart Mägi, Toivo Tootsen, Allar Jõks, Priit Lello and Rein Ratas.

The 28th April 2016 Supervisory Board meeting was attended by, Messrs. Simon Gardiner, Martin Padley, Brendan Murphy, Steven Richard Fraser, Mart Mägi, Toivo Tootsen, Allar Jõks, Priit Lello and Rein Ratas.



(EUR thousand)

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The 28th July 2016 Supervisory Board meeting was attended by, Messrs. Simon Gardiner, Martin Padley, Brendan Murphy, Steven Richard Fraser, Mart Mägi, Toivo Tootsen and Priit Lello.

The 3rd November 2016 Supervisory Board meeting was attended by, Messrs. Simon Gardiner, Martin Padley, Brendan Murphy, Mart Mägi, Toivo Tootsen, Allar Jõks and Priit Lello.

Considering the above, Messrs. Simon Gardiner, Martin Padley, Brendan Francis Murphy, Mart Mägi, Priit Lello and Toivo Tootsen attended all Supervisory Board meetings. Mr Allar Jõks attended more than 50% of the meetings. Mr. Steven Richard Fraser and Mr Rein Ratas attended three meetings out of five. Mr Steven Richard Fraser did not attend two meetings due to performance of other duties in United Utilities. Mr. Rein Ratas did not attend two meetings out of five due to health reasons. Mr. Allar Jõks attended four meetings out of five. He did not attend one meeting due to the presidential campaign in Estonia as he was one of the candidates. Nevertheless, Messrs. Steven Richard Fraser, Allar Jõks and Rein Ratas familiarised themselves with all papers distributed for each Supervisory Board meeting and have been well informed of matters concerning AS Tallinna Vesi.

“3.3.2. A Supervisory Board member candidate shall inform other members of the Supervisory Board about the existence of a 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 year, AS Tallinna Vesi requests all Supervisory Board members to update the record of their business interests. No business transactions, outside of the main business, took place between AS Tallinna Vesi and either any Supervisory Board member or any persons or companies related to them in 2016. Water and wastewater services were sold to the Supervisory Board members at a price it was sold to all other clients.

The Management Report which consists of the Chairman's statement, the Results of operations – for the year 2016, Corporate Governance and the Corporate Governance Recommendations Report and Social Responsibility and Sustainability Report is an integral part of the annual report of AS Tallinna Vesi for the financial year ended 31 December 2016. The Management Report gives a true and fair view of the trends and results of operations, main risks and doubts of AS Tallinna Vesi.

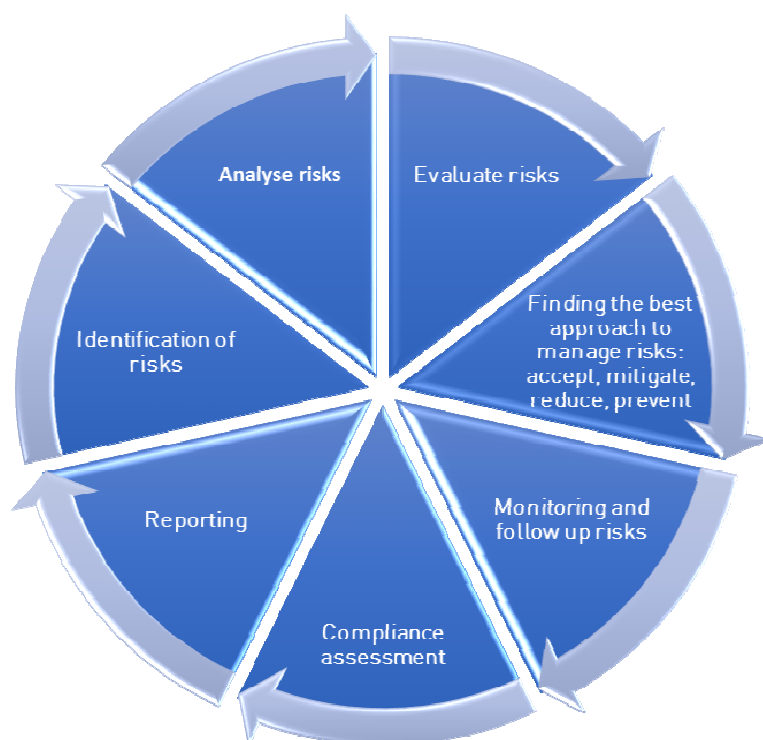
RISKS AND UNCERTAINTIES

In the everyday operations any company is a subject to a variety of risks and uncertainties. AS Tallinna Vesi has defined risk as anything that could have a material adverse effect on the achievement of AS Tallinna Vesi goals and objectives. Risks can be threats, uncertainties or lost opportunities relating to AS Tallinna Vesi current or future operations or activities.

RISK MANAGEMENT PROCESS

Risk management is a central part of any organisation's strategic management. As a precautionary approach, we constantly assess and monitor our operational and financial risks. Although risks cannot be entirely avoided we have worked out an effective system to manage them. The objective of our risk management process is to understand, assess and control the risks and uncertainties, to increase probability of success and minimise the probability of failure and the uncertainty of achieving the Company's overall objectives. AS Tallinna Vesi has defined the roles and responsibilities as well as the components of the risk management process, which is also in line with the Emergency Act.

Risk management process is something that is integrated and embedded in AS Tallinna Vesi organisational culture and processes and supports the implementation of the strategical objectives of the Company. It involves the strategical objectives, processes which need to be efficient to achieve those objectives and structures and recourses which are needed to be involved in order to achieve goals and objectives.



CONTINUOUS MONITORING

The objective of the continuous risk management process is that all major risks, that may harm the achievement of AS Tallinna Vesi objectives, are regularly assessed, treated and monitored. Management ensures, that awareness of risks is established among the employees and those are considered in daily decision making. Risk reporting is integrated into the business planning process and risks are reviewed regularly and escalated through the organisation.

Quarterly the Audit Committee and the Supervisory Board receive and review the overview of the significant risks together with details of the current controls and any further actions that are planned; and potential financial impact when possible.

AS Tallinna Vesi has divided the risks in following categories:

- Financial risks
- Operational risks
- Reputational risks
- Legal and regulatory risks
- Health and safety risks
- Environmental risks
- Personnel risks
- IT risks
- Organisational risks
- Reporting risks
- Going concern risks

Major risk areas, which the Company needs to focus on, are as follows:

Effective laws and regulations and changes in laws and regulations

The Company's operations are subject to extensive regulation (price regulations, environmental, health and safety). Non-compliance with existing laws and regulations might result in additional operational expenditures and extra workload. The Company also continuously monitors the changes in laws and the development of draft laws, in order to plan its activities on time, as in many cases changes in the laws may require intensive capital investments and/ or increase operating costs significantly. Currently the sludge strategy is being reviewed at the state level, also the discussions of changes in the public water and sewerage act are ongoing.

Outcome of material litigations

The Company has two ongoing material litigations in relation to the Services Agreement and tariff regulation. The development of litigation aspects are described in the Chairman statement and in our stock exchange announcements. In adverse outcome of the dispute with Competition Authority the tariff regulation will continue according to Competition Authority's methodology not the tariff regime agreed at the time of privatisation in the Services

Agreement. The possible contingent liability is described and calculated in the Note no 3 to the financial statement.

Financial market conditions and interest rates

Changes in interest rates and EURIBOR might have an adverse impact on the Company's cash flows and results of operations. Information on financial risk management is presented in Note 5 to the consolidated financial statements.

Threat of cybercrime and/or terrorism

Our resources, assets and infrastructure are exposed to various threats (malicious or accidental), cyber attack or terrorism which might cause the disruption to the operations. Regular reviews of the system security is carried out in order to identify our strengths and weaknesses and corrective measures are taken when justified.

Health and safety

Serious risks related to occupational health and safety are generally linked to excavation, construction and maintenance work. Depending on the circumstances the Group could be fined for breaches of statutory obligations, be held liable to third parties and sustain reputational damage. The Group has worked out the full set of procedures and activities, which minimise the possibility of incidents in relation to health and safety.

Inability to treat incoming effluent

In the case of very heavy rainfall there is a risk that the wastewater treatment plant has difficulties to treat all incoming effluent for a short period of time, which might result in pollution incidents. During last years, the risk has been lower, still additional capital investments are planned to minimise the risk further.

Deterioration in raw water quality

The main source of drinking water is Lake Ülemiste and there are periods, when the raw water quality is lower than expected. Worsened raw water quality puts high pressure to the treatment process. In addition to continuous monitoring and adjustment of treatment process accordingly, some improvements are planned to maximize the possible use of alternative resources.

BUSINESS ETHICS

As a listed company, it is one of AS Tallinna Vesi's priorities to ensure that its activities and the course of its directors, officers, employees or any third parties acting on its behalf observe the highest standards of integrity. AS Tallinna Vesi's is committed to be reliable partner to all its stakeholders in its activities and is committed to contributing to reliable business climate. AS Tallinna Vesi does not tolerate corruption in any shape or form. In order to prevent corruption AS Tallinna Vesi has worked out several procedures and rules which require all directors, officers, employees and all who act on behalf of the Company, act with high integrity. It is important that our activities at all levels would be transparent, in accordance with the legal requirements and high business ethics. At least on an annual basis we introduce the principles to our employees and carry out the risk assessment about possible corruption and fraud. During 2016 AS Tallinna Vesi did not identify any proven corruption or fraud incidents.



(EUR thousand)

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FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

**CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016**



MANAGEMENT CONFIRMATION


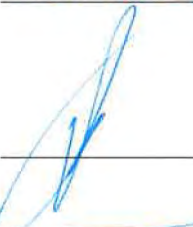

The Management Board hereby declares its responsibility for the preparation of the consolidated financial statements of AS Tallinna Vesi (Company) and its subsidiary Watercom OÜ (together referred as Group) for the financial year ended 31 December 2016 on pages 77 to 116.

The financial statements have been prepared according to International Financial Reporting Standards as adopted by the European Union, and give a fair presentation 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 2016, 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 2016. 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 17 March 2017 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
Karl Heino Brookes	Chairman of the Management Board		17-3-17
Aleksandr Timofejev	Member of the Management Board		17-3-17
Riina Käi	Member of the Management Board		17.3.17

(EUR thousand)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

		as of 31 December	
ASSETS	Note	2016	2015
CURRENT ASSETS			
Cash and cash equivalents	6	33,987	37,819
Trade receivables, accrued income and prepaid expenses	7	7,167	7,174
Inventories		449	447
TOTAL CURRENT ASSETS		41,603	45,440
NON-CURRENT ASSETS			
Derivatives	8	0	142
Property, plant and equipment	9	171,177	162,732
Intangible assets	10	830	758
TOTAL NON-CURRENT ASSETS		172,007	163,632
TOTAL ASSETS		213,610	209,072
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Current portion of long-term borrowings	11	264	328
Trade and other payables	12	7,030	5,586
Derivatives	8	610	523
Prepayments	14	2,735	1,983
TOTAL CURRENT LIABILITIES		10,639	8,420
NON-CURRENT LIABILITIES			
Deferred income from connection fees		17,050	15,030
Borrowings	11	95,795	95,974
Derivatives	8	715	628
Other payables		15	13
TOTAL NON-CURRENT LIABILITIES		113,575	111,645
TOTAL LIABILITIES		124,214	120,065
EQUITY			
Share capital	15	12,000	12,000
Share premium		24,734	24,734
Statutory legal reserve		1,278	1,278
Retained earnings		51,384	50,995
TOTAL EQUITY		89,396	89,007
TOTAL LIABILITIES AND EQUITY		213,610	209,072

Notes to the financial statements on pages 81 to 114 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

		for the year ended 31 December	
	Note	2016	2015
Revenue	16	58,982	55,928
Costs of goods/services sold	18	-25,721	-23,679
GROSS PROFIT		33,261	32,249
Marketing expenses	18	-365	-435
General administration expenses	18	-7,799	-6,086
Other income (+)/ expenses (-)	19	-470	-150
OPERATING PROFIT		24,627	25,578
Financial income	20	41	95
Financial expenses	20	-1,778	-1,315
PROFIT BEFORE TAXES		22,890	24,358
Income tax on dividends	21	-4,500	-4,500
NET PROFIT FOR THE PERIOD		18,390	19,858
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD		18,390	19,858
Attributable profit to:			
Equity holders of A-shares		18,389	19,857
B-share holder		0.60	0.60
Earnings per A-share (in euros)	22	0.92	0.99
Earnings per B-share (in euros)	22	600	600

Notes to the financial statements on pages 81 to 114 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 31 December

	Note	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit		24,627	25,578
Adjustment for depreciation/amortisation	9,10,18,19	6,406	6,184
Adjustment for revenue from connection fees	19	-218	-194
Other non-cash adjustments		-15	-15
Profit (-)/loss (+) from sale of property, plant and equipment, and intangible assets		-42	2
Change in current assets involved in operating activities		41	-897
Change in liabilities involved in operating activities		1,073	453
TOTAL CASH FLOWS FROM OPERATING ACTIVITIES		31,872	31,111
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of property, plant and equipment, and intangible assets	9,10	-14,526	-13,495
Compensations received for construction of pipelines, incl connection fees		3,002	6,499
Proceeds from sale of property, plant and equipment, and intangible assets		50	30
Interest received		45	99
TOTAL CASH FLOWS USED IN INVESTING ACTIVITIES		-11,429	-6,867
CASH FLOWS FROM FINANCING ACTIVITIES			
Interest paid and loan financing costs, incl swap interests		-1,510	-2,178
Finance lease payments		-264	-306
Dividends paid	21	-18,001	-18,001
Income tax on dividends	21	-4,500	-4,500
TOTAL CASH FLOWS USED IN FINANCING ACTIVITIES		-24,275	-24,985
CHANGE IN CASH AND CASH EQUIVALENTS		-3,832	-741
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	6	37,819	38,560
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	6	33,987	37,819

Notes to the financial statements on pages 81 to 114 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
as of 31 December 2014	12,000	24,734	1,278	49,138	87,150
Dividends (Note 21)	0	0	0	-18,001	-18,001
Comprehensive income for the period (Note 22)	0	0	0	19,858	19,858
as of 31 December 2015	12,000	24,734	1,278	50,995	89,007
Dividends (Note 21)	0	0	0	-18,001	-18,001
Comprehensive income for the period (Note 22)	0	0	0	18,390	18,390
as of 31 December 2016	12,000	24,734	1,278	51,384	89,396

Notes to the financial statements on pages 81 to 114 form an integral part of the financial statements.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENT

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 under the services agreement until the year 2020. AS Tallinna Vesi has been also appointed as a water undertaker till 2025.

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, design and asphaltting service, services related to water and sewage.

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

Contacts:

Name	AS Tallinna Vesi	OÜ Watercom
Commercial register number	10257326	11944939
VAT identification number	EE100060979	EE101374619
Address	Ädala 10, 10614 Tallinn	Ädala 10, 10614 Tallinn
Telephone	62 62 200	62 62 620
Fax	62 62 300	62 62 300
E-mail	tvesi@tvesi.ee	watercom@watercom.eu

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 17 March 2017. 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.

Adoption of New or Revised Standards and Interpretations

There are no new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2016 that 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 2017 or later periods and which the Group has not early adopted:

IFRS 9, Financial Instruments: Classification and Measurement, effective for annual periods beginning on or after 1 January 2018. Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).

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- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

IFRS 15, Revenue from Contracts with Customers, [effective for annual periods beginning on or after 1 January 2018. The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

IFRS 16, Leases, [effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU]. The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value;

and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

The Group is currently assessing the impact of the new standards 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 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 Parent Company 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 unconsolidated primary financial statements of the Company.

Foreign currency

Functional and presentation currency

Consolidated financial statements for the year ended 31 December 2016 have been presented in euros.

The 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.

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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 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 2016 and 2015 the Group did not have any investments held-to-maturity and financial assets available-for-sale.

Financial assets at fair value through profit or loss are initially recorded at fair value, transaction costs are recorded in the profit or loss (interest swap). 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 2016 and 2015 the Group had given no loans.

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 or 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 have the following measurement categories: (a) recognised at fair value through profit or loss (derivatives), (b) recognised at amortised cost.

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 reporting 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. In 2016, the rate was 20/80 on the amount of the dividends payable (2015: 20/80).

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 reporting 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.

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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.

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

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses; whose operating results are regularly reviewed by the Management Board of the Group to assess its performance and for which discrete financial information is available. Reportable segments are identified and segment information is reported on the same principle as the Group's structural units are grouped for internal accounting and reporting purposes. As the Group's operating segments other than water supply and waste water disposal service segment, are insignificant, the Management Board of the Group considers the activity of the Group as a single operating segment.

NOTE 3. CONTINGENT LIABILITY REGARDING THE TARIFF RISK

On 10th October 2011 the Estonian Competition Authority (CA) issued a precept 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 precept that seeks to break the privatization contract. 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. On 5th June 2015 Tallinn Administrative Court dismissed AS Tallinna Vesi's complaint in tariff dispute. AS Tallinna Vesi appealed the decision in the Circuit Court. On 26th January 2017, Tallinn Circuit court dismissed the Companies appeal. The Company do not agree with the decision and filed the cassation to the Supreme Court on 27th February 2017. The length of the court process and the decision are not within the Company's control.

No reliable estimate can be made at this stage regarding the ultimate outcome of the legal proceedings or the exact amount of the potential outflow of economic benefits. The management has evaluated the amount of the contingent liability as of 31 December 2016 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 EUR 43 million (31 December 2015: EUR 42.8 million) the part that CA considers to be excessively charged from the clients going back three years, and which 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:

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- 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 notes 9 and 10.
- As of 31 December 2016 Group owns property, plant and equipment, and intangible assets with a net book value of EUR 172 million (31 December 2015: EUR 163.5 million) and annual depreciation was EUR 6.4 million (2015: EUR 6.2 million). If the depreciation/amortization rates decreased/increased by 5%, the depreciation/amortization expense would increase/decrease respectively by EUR 320 thousand (2015: EUR 309 thousand).
- 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.

The Group's financial risks are managed under the control and supervision of the Management Board by the financial department. Financial department identifies, evaluates and manages 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 owned in foreign currencies.

Majority of Group's purchases are made in euros. The proportion of purchases in other currencies in 2016 was 5.9% (2015: 2.7%). 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 2016 the Group's bank accounts balances (including deposits) totalled EUR 33,987 thousand (31 December 2015: EUR 37,819 thousand) from which no sums were in foreign currencies (31 December 2015: 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 change.

Borrowings issued at variable interest rates (Note 11) expose the Group to cash flow interest rate risk. In order to mitigate the cash flow interest rate risk, the Group concludes floating-to-fixed interest rate swap contracts (Note 8). The Group's policy is to maintain approximately 80% of its borrowings at fixed rate. The Group's interest rate risk arises from long-term borrowings and, with Euribor being below zero, from the ineffectiveness of swap contracts as hedging instruments.

At the end of reporting period, the Group had the following variable rate borrowings and interest rate swap contracts outstanding:

	31 December 2016		31 December 2015	
	Effective interest rate	Balance	Effective interest rate	Balance
Long-term borrowings	0.98%	94,939	0.98%	94,923
Interest rate swaps (notional principal amount)	0.545%	75,000	0.545%	75,000
Net exposure to cash flow interest rate risk in case Euribor>0		19,939		19,923
Net exposure to cash flow interest rate risk in case Euribor<0		75,000		75,000

The Group's profit is sensitive to higher/lower borrowings and interest rate swaps interest expenses as a result of changes in interest rates.

	Impact on profit	
	2016	2015
Interest rates- Increase by 50 basis points*	24	-85
Interest rates- Decrease by 50 basis points*	-381	-340

*Holding all other variables constant

Overnight and fixed term deposits 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 cash in banks and short term depositing counterparties with at least a long term Baa1 rating (by Moody's) is used. As of 31 December 2016 100% of Group's cash in banks and short term deposits were deposited with counterparties with higher rating than A3 (31 December 2015: higher than A3).

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.

Sales 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 billing group. As of the end of December 2016 there were 1 client (31 December 2015: no clients) with receivable (Note 24) exceeding 5% of total trade receivables. The receivable has been paid before the date of completion of this financial statements.

Financial assets as of 31 December 2016	Balance	Not due	Overdue		Impairment
			Up to 60 days	More than 60 days	
Cash and cash equivalents (Note 6)	33,987	33,987	0	0	0
Trade receivables (Note 7)	6,755	6,604	220	344	-413
Commercial entities	3,309	3,214	178	314	-397
Private persons	3,446	3,390	42	30	-16
Accrued income	1	1	0	0	0
Total	40,743	40,592	220	344	-413

Financial assets as of 31 December 2015	Balance	Not due	Overdue		Impairment
			Up to 60 days	More than 60 days	
Cash and cash equivalents (Note 6)	37,819	37,819	0	0	0
Trade receivables (Note 7)	6,684	6,524	131	129	-100
Commercial entities	3,353	3,266	75	93	-81
Private persons	3,331	3,258	56	36	-19
Accrued income	7	7	0	0	0
Derivatives (Note 8)	142	142	0	0	0
Total	44,652	44,492	131	129	-100

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 does not have enough funds to serve its loans, to fulfil its working capital needs, to invest and/or to make declared dividend payments.

Financial liabilities in terms of payment* as of 31 December 2016	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Trade and other payables (Note 12)	3,796	283	0	0	0	4,079
Derivatives (Note 8)	609	0	0	715	0	1,324
Borrowings (incl finance lease)	77	153	897	87,029	11,093	99,249
Total	4,482	436	897	87,744	11,093	104,652

Financial liabilities in terms of payment* as of 31 December 2015	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Trade and other payables (Note 12)	2,149	436	0	0	0	2,585
Derivatives (Note 8)	523	0	0	628	0	1,151
Borrowings (incl finance lease)	76	172	996	84,377	14,860	100,481
Total	2,748	608	996	85,005	14,860	104,217

*All amounts above are undiscounted

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 Group'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 11; including 'current and non-current borrowings' as shown in the consolidated Statement of financial position) less cash and cash equivalents (Note 6). Total capital is calculated as 'equity' as shown in the consolidated Statement of financial position plus net debt.

	as of 31 December	
	2016	2015
Borrowings	96,059	96,301
Cash	-33,987	-37,819
Net debt	62,072	58,482
Equity	89,396	89,007
Total capital	151,468	147,489
Net debt to total capital ratio	41.0%	39.7%
Total assets	213,610	209,072
Proportion of equity from total assets	41.9%	42.6%

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.

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To provide an indication about the reliability of the inputs used in determining fair value, the group has classified its financial instruments into the three levels prescribed under the accounting standards.

Level 1: The fair value of financial instruments traded in active markets is based on quoted market prices at the end of the reporting period. The quoted market price used for financial assets held by the group is the current bid price. As of 31 December 2016 and 2015, the Group did not have any financial instruments of level 1.

Level 2: The fair value of financial instruments that are not traded in an active market is determined using valuation techniques which maximise the use of observable market data and rely as little as possible on entity-specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

At the end of 2016 all Group's long-term borrowings had floating interest rates. The fair values of long-term borrowings are based on discounted cash flows using the borrowing rate of 0.95% (2015: 0.95%) and are within level 3 of the fair value hierarchy. As of 31 December 2016, the fair value of the Group's long-term borrowings was EUR 113 thousand higher than their carrying amount (31 December 2015: EUR 150 thousand higher).

The financial instruments carried at fair value (interest rate swap contracts, Note 8) are included in level 2. The fair value of interest rate swap contracts is calculated as the present value of estimated future cash flows based on observable yield curves.

NOTE 6. CASH AND CASH EQUIVALENTS

	as of 31 December	
	2016	2015
Cash and bank accounts	21,900	13,738
Short-term deposits	12,087	24,081
Total cash and cash equivalents	33,987	37,819

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NOTE 7. TRADE RECEIVABLES, ACCRUED INCOME AND PREPAID EXPENSES

	as of 31 December	
	2016	2015
Accounts receivable	7,167	6,784
Allowance for doubtful receivables	-412	-100
Total trade receivables	6,755	6,684
Allowance for doubtful receivables at the beginning of the period	-100	-94
Proceeds from doubtful receivables during the period	7	9
Allowance for doubtful receivables recognised during the period	-328	-22
Receivables written off balance sheet during the period	9	7
Allowance for doubtful receivables at the end of the period	-412	-100

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.

	as of 31 December	
	2016	2015
Accrued interest	1	5
Other accrued income	125	254
Prepaid expenses	286	231
Total accrued income and prepaid expenses	412	490

Total trade receivables, accrued income and prepaid expenses **7,167** **7,174**

The Company's current assets (incl. trade receivables, accruals and inventory) in the amount of EUR 7,142 thousand (31 December 2015: EUR 7,056 thousand) have been pledged as a security for the bank loans (Note 11), as a part of commercial pledge.

NOTE 8. DERIVATIVES

	as of 31 December	
	2016	2015
Non-current assets		
Interest rate swap contracts	0	142
Current liabilities		
Interest rate swap contracts	610	523
Non-current liabilities		
Interest rate swap contracts	715	628

	2016	as of 31 December 2015
Contracts start date	November 2013 – June 2015	November 2013 – June 2015
Contracts maturity date	November 2018 – November 2020	November 2018 – November 2020
Contracts notional amount	75,000	75,000

NOTE 9. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Total property, plant and equipment
as of 31 December 2014						
Acquisition cost	25,689	181,365	47,206	1,359	1,959	257,578
Accumulated depreciation	-5,940	-60,735	-32,446	-976	0	-100,097
Net book value	19,749	120,630	14,760	383	1,959	157,481

Transactions in the period 01 January 2015 - 31 December 2015

Acquisition in book value	0	0	0	0	11 127	11 127
Write off and sale of property, plant and equipment in residual value	0	-12	-19	-1	0	-32
Reclassification	310	6,895	1,752	43	-8,935	65
Depreciation	-327	-2,836	-2,668	-78	0	-5,909

as of 31 December 2015

Acquisition cost	25,950	187,943	47,016	1,277	4,151	266,337
Accumulated depreciation	-6,218	-63,266	-33,191	-930	0	-103,605
Net book value	19,732	124,677	13,825	347	4,151	162,732

Transactions in the period 01 January 2016 - 31 December 2016

Acquisition in book value	0	0	0	0	14,628	14,628
Write off and sale of property, plant and equipment in residual value	0	0	-3	0	0	-3
Reclassification	183	12,724	2,361	39	-15,377	-70
Depreciation	-326	-3,007	-2,702	-75	0	-6,110

as of 31 December 2016

Acquisition cost	26,134	199,921	47,297	1,104	3,402	277,858
Accumulated depreciation	-6,545	-65,527	-33,816	-793	0	-106,681
Net book value	19,589	134,394	13,481	311	3,402	171,177

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Property, plant and equipment are written off if the condition of the asset does not enable further usage for production purposes. As of 31 December 2016 the book value of the assets (Machinery and equipment) leased under financial lease is EUR 1,130 thousand (31 December 2015: EUR 1,422 thousand).

The Group's non-current assets in the amount of EUR 12,555 thousand (31 December 2015: EUR 12,911 thousand) have been pledged as a security for the bank loans (Note 11), 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 EUR 30,556 thousand (31 December 2015: EUR 30,849 thousand) serves as a security to the bank loans (Note 11).

During the year, the Group has capitalised borrowing costs amounting to EUR 63 thousand (2015: EUR 34 thousand) on qualifying assets. Borrowing costs were capitalised at the weighted average rate of its general borrowings of 0.95% (2015: 1.02%).

NOTE 10. INTANGIBLE ASSETS

	Acquired licenses and other intangible assets	Unfinished intangible assets	Total intangible assets
as of 31 December 2014			
Acquisition cost	5,013	75	5,088
Accumulated amortization	-4,226	0	-4,226
Net book value	787	75	862
Transactions in the period 01 January 2015 - 31 December 2015			
Acquisition in book value	0	171	171
Reclassification	184	-184	0
Amortization	-275	0	-275
as of 31 December 2015			
Acquisition cost	5,192	62	5,254
Accumulated amortization	-4,496	0	-4,496
Net book value	696	62	758
Transactions in the period 01 January 2016 - 31 December 2016			
Acquisition in book value	0	324	324
Write off and sale of intangible assets in residual value	-5	0	-5
Reclassification	180	-131	49
Amortization	-296	0	-296
as of 31 December 2016			
Acquisition cost	5,313	255	5,568
Accumulated amortization	-4,738	0	-4,738
Net book value	575	255	830

NOTE 11. BORROWINGS

		as of 31 December
	2016	2015
Current liabilities		
Current portion of long-term finance lease liabilities	264	328
Non-current liabilities		
Long-term bank loans	94,939	94,923
Long-term finance lease liabilities	856	1,051
Bank loans at 31 December 2016 EUR	Balance	Effective interest rate
Borrowings at floating interest rate (based on 1- and 6-month Euribor)	94,939	0.96%-0.99%
Finance lease liabilities	1,120	0.85%-2.07%
Bank loans at 31 December 2015 EUR	Balance	Effective interest rate
Borrowings at floating interest rate (based on 1- and 6-month Euribor)	94,923	0.95%-0.98%
Finance lease liabilities	1,378	1.21%-3.05%

The Group's loan agreements mature in November 2018 (31 December 2015: November 2018) in the amount of EUR 37.5 million and in November 2020 (31 December 2015: November 2020) in the amount of EUR 37.5 million, the third loan agreement in the amount of EUR 20 million will be repaid in eleven equal semi-annual repayments from November 2019 to November 2024 (31 December 2015: November 2019 to May 2024).

Collateral of loans and pledged assets		Collateral at book value as of 31 December	
Type of collateral	Specification and location of collateral	2016	2015
Commercial pledge	Movables of the Company (Note 7, 9)	19,696	19,967
Mortgage	Real Estates located at Paljassaare põik 14 and Järvevana tee 3, Tallinn, Estonia (Note 9)	30,556	30,849

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NOTE 12. TRADE AND OTHER PAYABLES

	for the year ended 31 December	
	2016	2015
Trade payables - operating expenditures	2,555	1,371
Trade payables - capital expenditures	1,286	932
Payables to related parties (Note 24)	190	184
Payables to employees	1,131	1,241
Interest payable	31	30
Other accrued expenses	48	98
Warranty reserve	76	68
Taxes payable incl:		
Income tax	163	161
VAT	621	618
Water abstraction charges	317	282
Pollution taxes	240	236
Social security tax	328	323
Other	44	42
Total trade and other payables	7,030	5,586

NOTE 13. OTHER CONTINGENT LIABILITIES

Tax authority have got the right to review to the Group's tax accounting within 5 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 2016 amounted to EUR 51,384 thousand (2015: EUR 50,995 thousand). Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is EUR 12,846 thousand (2015: EUR 12,749 thousand).

NOTE 14. PREPAYMENTS

	as of 31 December	
	2016	2015
Prepayments for water and sewerage services	76	87
Prepayments for connection fee	2,659	1,896
Total prepayments	2,735	1,983

NOTE 15. SHARE CAPITAL

At 31 December 2016 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 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 2016 and 2015, the B-share granted the holder the preferential right to receive a dividend in an agreed amount 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 2016 and 2015 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 2016 and 2015.

As of 31 December 2016 from all Supervisory Board and Management Board members Riina Käi owned 100 shares (2015: Riina Käi 100 shares). Dividends declared and paid are disclosed in note 21.

Contingent income tax on the dividend payments from retained earnings is described in note 13.

(EUR thousand)

NOTE 16. REVENUE

	for the year ended 31 December	
Revenues from main operating activities	2016	2015
Total water supply and waste water disposal service, incl:	50,196	49,297
Private clients, incl:	24,949	24,408
Water supply service	13,720	13,436
Waste water disposal service	11,229	10,972
Corporate clients, incl:	20,069	19,358
Water supply service	11,075	10,736
Waste water disposal service	8,994	8,622
Outside service area clients, incl:	4,400	4,765
Water supply service	1,306	1,280
Waste water disposal service	2,709	3,011
Storm water disposal service	385	474
Over pollution fee	778	766
Storm water treatment and disposal service (Note 24)	3,671	3,357
Construction service, design and asphalting	4,511	2,724
Other works and services	604	550
Total revenues	58,982	55,928

100% of the Group's revenue was generated within the Estonian Republic.

NOTE 17. STAFF COSTS

	for the year ended 31 December	
	2016	2015
Salaries and wages (Note 18)	-5,999	-5,963
Social security and unemployment insurance taxation (Note 18)	-2,028	-2,017
Total staff costs	-8,027	-7,980
Number of employees at the end of reporting period	311	323

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NOTE 18. COST OF GOODS/SERVICES SOLD, MARKETING AND ADMINISTRATIVE EXPENSES

	for the year ended 31 December	
	2016	2015
Cost of goods/services sold		
Water abstraction charges	-1,169	-1,101
Chemicals	-1,308	-1,531
Electricity	-3,107	-3,035
Pollution tax	-1,091	-1,002
Staff costs (Note 17)	-5,729	-5,603
Depreciation and amortization	-5,863	-5,690
Construction service, design and asphalting	-4,006	-2,398
Other costs of goods/services sold	-3,448	-3,319
Total cost of goods/services sold	-25,721	-23,679
Marketing expenses		
Staff costs (Note 17)	-312	-362
Depreciation and amortization	-1	-11
Other marketing expenses	-52	-62
Total marketing expenses	-365	-435
Administrative expenses		
Staff costs (Note 17)	-1,986	-2,015
Depreciation and amortization	-343	-308
Other general administration expenses	-5,470	-3,763
Total administrative expenses	-7,799	-6,086

NOTE 19. OTHER INCOME/EXPENSES

	for the year ended 31 December	
	2016	2015
Connection fees	218	194
Depreciation of single connections	-199	-175
Doubtful receivables expenses (-)/expense reduction (+)	-322	13
Other income (+)/expenses (-)	-167	-182
Total other income/expenses	-470	-150

NOTE 20. FINANCIAL INCOME AND EXPENSES

	for the year ended 31 December	
	2016	2015
Interest income	41	95
Interest expense, loan	-881	-981
Interest expense, swap	-566	-1,149
Increase (+)/decrease (-) of fair value of swap	-316	830
Other financial income (+)/expenses (-)	-15	-15
Total financial income/expenses	-1,737	-1,220

NOTE 21. DIVIDENDS

	for the year ended 31 December	
	2016	2015
Dividends declared during the period	18,001	18,001
Dividends paid during the period	18,001	18,001
Income tax on dividends paid	-4,500	-4,500
Income tax accounted for	-4,500	-4,500

Income tax rates in 2016 were 20/80 (2015: 20/80).

Paid-up dividends per shares:

Dividends per A-share (in euros)	0.90	0.90
Dividends per B-share (in euros)	600	600

NOTE 22. EARNINGS PER SHARE

	for the year ended 31 December	
	2016	2015
Net profit minus B-share preferred dividend rights	18,389	19,857
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)	0.92	0.99
Earnings per B-share (in euros)	600	600

Diluted earnings per share for the periods ended 31 December 2016 and 2015 are equal to earnings per share figures stated above.

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NOTE 23. OPERATING LEASE

Leased assets	for the year ended 31 December	
	2016	2015
Total operating lease expenses for vehicles	325	216
Operating lease (compensated by customers)	905	881
Following periods operating lease payments from the non-cancellable contracts are as follows:	as of 31 December	
	2016	2015
Less than 1 year	80	54
1-5 years	214	124
Total minimum lease payments	294	178

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

NOTE 24. RELATED PARTIES

Transactions with related parties are considered to be transactions with members of the Group's 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 on the statement of financial position of the Group	2016	2015
Accounts receivable	420	271
Trade and other payables (Note 12)	190	184
	for the year ended 31 December	
Transactions	2016	2015
Revenue (Note 16)	3,671	3,357
Purchase of administrative and consulting services	1,031	1,050
Financial income	0	14
Short-term employee benefits to the Group's Management Board (excluding social tax)	191	151
The Group's Supervisory Board fees (excluding social tax)	32	32

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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 received direct compensations from the companies belonging to the group of United Utilities (Tallinn) B.V. as overseas secondees. Such compensations are recorded as purchase of administrative and consulting services.

Throughout the years ending on 31 December 2016 and 2015, management board members were not paid any termination payment. The potential salary liability would be up to 82 thousand euros (excluding social tax) if the Supervisory Board would want to replace all Management Board members.

The Group's Management Board or Supervisory Board members do not have more than 5% shareholding in any of the companies having important business or cooperation relations with the Group.

The information about AS Tallinna Vesi shares belonging to the related parties is disclosed in note 15.

Paid-up dividends are described in note 21.

NOTE 25. SUBSIDIARIES

Subsidiary	Location	Activity	Holding (%) as of 31 December	
			2016	2015
Watercom OÜ	Tallinn, Estonia	Provision of construction and other services related to water business	100	100

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

NOTE 26. 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.

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STATEMENT OF FINANCIAL POSITION

	as of 31 December	
	2016	2015
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	33,458	37,384
Trade receivables, accrued income and prepaid expenses	6,659	6,600
Receivables from subsidiary	40	43
Inventories	442	413
TOTAL CURRENT ASSETS	40,599	44,440
NON-CURRENT ASSETS		
Derivatives	0	142
Investment in subsidiary	527	527
Property, plant and equipment	174,660	165,484
Intangible assets	823	742
TOTAL NON-CURRENT ASSETS	176,010	166,895
TOTAL ASSETS	216,609	211,335
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Current portion of long-term borrowings	118	170
Trade and other payables	6,277	4,786
Derivatives	609	523
Payables to subsidiary	342	605
Prepayments and deferred income	2,733	1,980
TOTAL CURRENT LIABILITIES	10,079	8,064
NON-CURRENT LIABILITIES		
Deferred income from connection fees	17,050	15,031
Borrowings	95,032	95,062
Derivatives	715	628
TOTAL NON-CURRENT LIABILITIES	112,797	110,721
TOTAL LIABILITIES	122,876	118,785
EQUITY		
Share capital	12,000	12,000
Share premium	24,734	24,734
Statutory legal reserve	1,278	1,278
Retained earnings	55,721	54,538
TOTAL EQUITY	93,733	92,550
TOTAL LIABILITIES AND EQUITY	216,609	211,335

STATEMENT OF COMPREHENSIVE INCOME

	for the year ended 31 December	
	2016	2015
Revenue	54,439	53,164
Costs of goods/services sold	-21,515	-21,081
GROSS PROFIT	32,924	32,083
Marketing expenses	-365	-435
General administration expenses	-7,563	-5,665
Other income (+)/expenses (-)	-138	-131
OPERATING PROFIT	24,858	25,852
Financial income	458	836
Financial expenses	-1,740	-1,287
PROFIT BEFORE TAXES	23,576	25,401
Income tax on dividends	-4,393	-4,314
NET PROFIT FOR THE PERIOD	19,183	21,087
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	19,183	21,087
Attributable profit to:		
Equity holders of A-shares	19,182	21,086
B-share holder	0.60	0.60
Earnings per A-share (in euros)	0.96	1.05
Earnings per B-share (in euros)	600	600

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(EUR thousand)

AS TALLINNA VESI

CONSOLIDATED ANNUAL AND SUSTAINABILITY REPORT

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

STATEMENT OF CASH FLOWS

	for the year ended 31 December	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating profit	24,858	25,852
Adjustment for depreciation/amortisation	6,184	5,992
Adjustment for revenue from connection fees	-218	-194
Other non-cash adjustments	-15	-23
Profit (-)/loss (+) from sale and write off of property, plant and equipment, and intangible assets	-14	2
Change in current assets involved in operating activities	-75	-559
Change in liabilities involved in operating activities	862	-12
TOTAL CASH FLOW FROM OPERATING ACTIVITIES	31,582	31,058
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property, plant and equipment, and intangible assets	-15,042	-14,409
Compensations received for construction of pipelines	3,002	6,499
Proceeds from sale of property, plant and equipment, and intangible assets	44	30
Interest received	44	95
TOTAL CASH USED IN INVESTING ACTIVITIES	-11,952	-7,785
CASH FLOWS FROM FINANCING ACTIVITIES		
Interest paid and loan financing costs	-1,487	-2,150
Finance lease payments	-105	-133
Dividends received	430	745
Dividends paid	-18,001	-18,001
Income tax on dividends	-4,393	-4,314
TOTAL CASH USED IN FINANCING ACTIVITIES	-23,556	-23,853
CHANGE IN CASH AND CASH EQUIVALENTS	-3,926	-580
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD	37,384	37,964
CASH AND EQUIVALENTS AT THE END OF THE PERIOD	33,458	37,384

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STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
as of 31 December 2014	12,000	24,734	1,278	51,453	89,465
Dividends	0	0	0	-18,001	-18,001
Comprehensive income for the period	0	0	0	21,087	21,087
as of 31 December 2015	12,000	24,734	1,278	54,539	92,551
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	0
Adjusted unconsolidated equity as of 31 December 2015	12,000	24,734	1,278	54,539	92,024
as of 31 December 2015	12,000	24,734	1,278	54,539	92,551
Dividends	0	0	0	-18,001	-18,001
Comprehensive income for the period	0	0	0	19,183	19,183
as of 31 December 2016	12,000	24,734	1,278	55,721	93,733
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	0
Adjusted unconsolidated equity as of 31 December 2016	12,000	24,734	1,278	55,721	93,206

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CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS

The Management Board has prepared the management report and the financial statements of AS Tallinna Vesi on 17 March 2017. The Supervisory Board of AS Tallinna Vesi has reviewed the annual report, prepared by the Management Board, consisting of Management Report, the financial statements 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
Karl Heino Brookes	Chairman of the Management Board		<u>30-3-2017</u>
Aleksandr Timofejev	Member of the Management Board		<u>17.03.2017</u>
Riina Käi	Member of the Management Board		<u>14.03.17</u>
Simon Roger Gardiner	Chairman of the Supervisory Board		<u>30.3.2017</u>
Steven Richard Fraser	Member of the Supervisory Board		<u>30.3.2017</u>
Martin Padley	Member of the Supervisory Board		<u>30/3/17</u>
Brendan Francis Murphy	Member of the Supervisory Board		<u>30/3/17</u>
Mart Mägi	Member of the Supervisory Board		<u>30/3/2017</u>



Rein Ratas	Member of the Supervisory Board	_____	_____
Toivo Tootsen	Member of the Supervisory Board		<u>30.03.17</u>
Allar Jõks	Member of the Supervisory Board		<u>30.03.17</u>
Priit Lello	Member of the Supervisory Board		<u>30.03.2017</u>

GRI INDEX

General standard disclosures

STRATEGY AND ANALYSIS

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ORGANISATIONAL PROFILE

G4-3	Name of the organisation AS Tallinna Vesi	
G4-4	Primary brands, products, and services See section OUR COMPANY	p. 4-5
G4-5	Location of the organisation's headquarters See section OUR COMPANY	p. 5
G4-6	Countries where the organisation operates Estonia	
G4-7	Nature of ownership and legal form See section OUR COMPANY	p. 4
G4-8	Markets served See section OUR COMPANY	p. 4
G4-9	Scale of the organisation See section OUR COMPANY, FINANCIAL HIGHLIGHTS 2016, OPERATIONAL HIGHLIGHTS 2016 and EMPLOYEES	p. 4, 6-9, 43
G4-10	Total workforce by employment type and contract See section EMPLOYEES	p. 43-44
G4-11	Percentage of employees covered by collective bargaining agreement See section EQUAL TREATMENT OF STAFF	p. 43
G4-12	Description of supply chain See section COOPERATION WITH SUPPLIERS	p. 52-53
G4-13	Significant changes during the reporting period regarding size, structure, ownership or supply chain Compared with the previous reporting period, there has not been any significant changes in the company's size, structure, ownership, or the supply chain.	
G4-14	Precautionary principle See section RISKS AND UNCERTAINTIES	p. 72-74
G4-15	Externally developed characters or principles to which the organisation subscribes or endorses See section OUR PRINCIPLES AND MEMBERSHIP IN ORGANISATIONS	p. 53
G4-16	Memberships of associations See section OUR PRINCIPLES AND MEMBERSHIP IN ORGANISATIONS	p. 53

MATERIAL ASPECTS AND BOUNDARIES

- G4-17 Entities
See section **SOCIAL RESPONSIBILITY AND SUSTAINABILITY** and **MANAGEMENT CONFIRMATION**
p. 38, 76
- G4-18 Process for defining report content and aspect boundaries, and how the reporting principles have been implemented
See section **SOCIAL RESPONSIBILITY AND SUSTAINABILITY**
p. 38
- G4-19 List of material aspects
See section **SOCIAL RESPONSIBILITY AND SUSTAINABILITY**
p. 38
- G4-20 Aspect boundary within the organisation
See section **SOCIAL RESPONSIBILITY AND SUSTAINABILITY**
p. 38
- G4-21 Aspect boundary outside the organisation
See section **SOCIAL RESPONSIBILITY AND SUSTAINABILITY**
p. 38
- More information on the impacts can be found under each aspects DMA**
- G4-22 Effect of any restatements of information provided in previous reports
Compared to the previous report there have not been any significant changes in the restatements.
- G4-23 Significant changes from previous reporting periods in the scope and aspect boundaries
Compared to the previous report there have not been any changes in the scope and aspect boundaries. However, compared to the previous report, the aspects have been rephrased and rearranged.

STAKEHOLDER ENGAGEMENT

- G4-24 ... G4-27
- List of stakeholder groups, basis for identification of stakeholders, and approach to stakeholder engagement.
- No separate stakeholder engagement was undertaken specifically as part of the report preparation process, however the interests of different stakeholders were gathered throughout the year from different meetings and surveys.**
- See section **SOCIAL RESPONSIBILITY AND SUSTAINABILITY, CUSTOMERS, EMPLOYEES, COMMUNITY AND PUBLIC, INVESTORS, and PARTNERS**
p. 38-53

REPORT PROFILE

- G4-28 Reporting period
Calendar year 2016
- G4-29 Date of the most recent previous report
Previous report was an independent CSR report published on 12/07/2016
Starting from 2016 CSR will be part of an integrated annual report.
- G4-30 Reporting cycle
Annual reporting. We issue the report according to the GRI- guidelines annually since 2012.
All reports are available on the website of AS Tallinna Vesi.
- G4-31 Contact point for questions regarding the report or its contents
tvesi@tvesi.ee
- G4-32 GRI content index and external assurance



(EUR thousand)

AS TALLINNA VESI
CONSOLIDATED ANNUAL AND SUSTAINABILITY REPORT
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

This report follows the guidelines of the international Global Reporting Initiative (GRI) G4 and is reported according to standard's *in accordance – core* option.

For the external assurance report please see INDEPENDENT AUDITORS' LIMITED ASSURANCE REPORT ON THE SUSTAINABILITY p. 128

- G4-33 Policy and current practice with regard to seeking external assurance to the report
External assurance to the report has been provided by AS PricewaterhouseCoopers in accordance with International Standard on Assurance Engagement ISAE 3000 "Assurance Engagements Other than Audits or Reviews of Historical Financial Information". The Auditing Company has performed a limited assurance engagement.

GOVERNANCE

- G4-34 Governance structure of the organisation with regards to the decision making on economic, social and environmental impacts
See section CORPORATE GOVERNANCE p. 60-67

ETHICS AND INTEGRITY

- G4-56 Values, principles, standards and norms of behaviour such as code of conduct and code of ethics
See sections HOW WE CREATE VALUE, OUR PRINCIPLES AND MEMBERSHIP IN ORGANISATIONS and BUSINESS ETHICS p. 13-14, 53, 74



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SPECIFIC STANDARD DISCLOSURES

ECONOMIC ASPECTS		
Economic performance [GRI: Economic performance]		
DMA	Disclosures on management approach	P. 51-52
G4-EC1	Direct economic value generated and distributed	Table on p. 26 See more on. 26-32, 51-52 Water loss in the water distribution network
ENVIRONMENTAL ASPECTS		
Sustainable water use [GRI: Water]		
DMA	Disclosures on management approach	P. 22, 55-59
TV-01	Water loss in the water networks (leakages)	15.07% See more on pages: 6, 24, 55, 57
Effluent quality [GRI: Effluents and waste]		
DMA	Disclosures on management approach	P. 25, 54-58
G4-EN22	Total water discharge by quality and destination (treatment efficiency parameters)	BOD – 97%; COD – 89% Suspended solids – 97%; N _{tot} – 83%; P _{tot} – 92% Oil products – 88% See more on pages: 56

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FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

SOCIAL ASPECTS		
Labor practices and decent work		
Occupational health and safety [GRI: Occupational health and safety]		
DMA	Disclosures on management approach	P. 22, 46-48
TV-02	Accident frequency rate	AFR: 0 See more on pages: 21, 46
TV-03	Percentage of satisfactory results at the Company's inspected construction and repair sites	93.65% See more on pages: 21, 47
Development and succession of staff [GRI: Training and education]		
DMA	Disclosures on management approach	P. 43, 45-46
G4-LA9	Days of training per employee	2.2 days See more on pages: 45
G4-LA10	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings	Narrative introduction of our programs are described in chapter Development and succession planning of staff See on pages: 45-46
G4-LA11	Regular performance and career development reviews	100% See more on page 46
Equal treatment of staff [GRI: Diversity and equal opportunity]		
DMA	Disclosures on management approach	P. 43-45
G4-LA12	Composition of governance bodies and breakdown of employees per employee category	Tables on p. 44 See more on pages: 43-45
Society		
Contribution to local communities [GRI: Local communities]		
DMA	Disclosures on management approach	P. 48-50
TV-04	Consumers' trust against tap water	80% See more on pages: 11, 40, 49
Anti-corruption [GRI: Anti-corruption]		
DMA	Disclosures on management approach	P. 74
G4-S05	Confirmed incidents of corruption and actions taken	0 See more on page 74 [chapter Business ethics]
Product responsibility		
Responsible customer service [GRI: Product and service labelling]		
DMA	Disclosures on management approach	P. 16-17, 39-42
G4-PR5	Results of surveys measuring customer satisfaction	94 TRI*M index points See more on pages: 12, 24, 40
Ensuring uninterrupted service [GRI: Compliance]		
DMA	Disclosures on management approach	P. 7, 42
TV-05	Interruptions to service lasting longer than 12 hours	1 interruption See more on pages: 25, 42



Independent auditor's report

To the Shareholders of AS Tallinna Vesi

(Translation of the Estonian original)*

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS Tallinna Vesi (the Company) and its subsidiary (together the Group) as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS).

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2016;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

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 the Company and the Estonian Competition Authority. Our opinion is not qualified in respect of this matter.

Our audit approach

Overview



Materiality

Overall group materiality is EUR 1,144 thousand which represents approximately 5% of profit before tax.

Audit scope

The Group comprises of two units: the Company and its subsidiary. Both units are located in Estonia. The audit team performed full scope audit procedures for the Company and for its subsidiary.

Key audit matters

- Contingent liability relating to the legal dispute with the Estonian Competition Authority
 - Estimates involved in capitalisation of capital expenditures and determining their useful lives
-

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the Management Board made subjective judgments; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgment, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall group materiality	EUR 1,144 thousand
How we determined it	5% of profit before tax
Rationale for the materiality benchmark applied	We have applied this benchmark, as profit before tax is the key measure used both internally by management and, we believe, externally by shareholders in evaluating the performance of the Group.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters

How our audit addressed the key audit matters

Contingent liability relating to the legal dispute with the Estonian Competition Authority (refer to Note 3 'Contingent liability regarding the tariff risk' for further details).

The Company is involved in the lawsuit with the Estonian Competition Authority over the tariffs of water and sewage services.

The assessment of the possible outcome of the lawsuit, including the probability of losing the case and the amount of any resulting potential obligation, involves significant judgment by the management.

According to the management, no reliable estimate can be made at this stage the ultimate outcome of the legal proceedings or the amount of the potential outflow of economic benefits. However, based on the management's judgment, in case the Estonian Competition Authority's position were upheld by the courts, the outflow of economic benefits of the Group could reach up to EUR 43 million.

We have considered the ongoing litigation between the Company and the Competition Authority to be a key audit matter given the potential magnitude and uncertainty in the possible outcomes of the dispute.

We discussed the status and potential outcome of the litigation with the Group management and the Audit Committee. We read the minutes of meetings of the Management and Supervisory Board where developments in the legal proceedings were discussed. We also obtained confirmations from the Group's internal and external legal counsels in order to compare their expert opinions to management's position on the contingency.

We discussed with the management the inputs and assumptions used to estimate the amount of potential outflows of economic benefits in case the dispute would be lost. We found the management's estimations supportable in the context of information available.

We read the disclosures regarding the dispute and resulting contingent liability and concluded that they met the disclosure requirements of IFRS standards and appropriately reflected the nature of the dispute and uncertainties related to the outcome.

We have included an emphasis of matter paragraph in our auditor's report to highlight the importance of this contingency to the users of the financial statements.

Estimates involved in capitalisation of capital expenditures, and determining their useful lives (refer to Note 2 'Accounting policies', Note 4 'Critical accounting estimates' and Note 9 'Property,

We assessed whether the Group's accounting policies in relation to the capitalisation of expenditures are in compliance with IFRS and found them to be consistent.

plant and equipment' for further details).

In 2016, the Group capitalised additions to property, plant and equipment (PPE), mainly related to the construction of water and wastewater network and new customer pipeline connections, in the amount of EUR 14.6 million.

Expenditures are capitalised, if they create new or enhance the existing assets, and expensed, if they relate to repair or maintenance of the assets. Classification of the expenditures involves judgment.

The useful lives of PPE items are based on management's estimates regarding the period during which the asset or its significant components will be used. The estimates are based on historical experience and market practice and take into consideration the physical condition of the assets.

Capital expenditure is not considered to be an area of significant risk for our audit but as it requires considerable time and resource to audit due to its magnitude, it is considered to be a key audit matter.

We obtained a listing of capital expenditures incurred during the year and, on a sample basis, checked whether the projects were undertaken based on internal purchase order that had been properly approved by the responsible individuals with such authority with no material exceptions noted.

We inspected a sample of contracts and underlying invoices to determine whether the classification between capital and operating expenditure was appropriate. We noted no material exceptions.

We evaluated whether the useful lives determined and applied by the management were in line with historical experience and the market practice.

We checked whether the depreciation of PPE items was commenced timely, by comparing the date of the reclassification from construction in progress to finished projects, with the date of the act of completion of the work. We noted no material exceptions.

How we tailored our audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group comprises of two entities: the Company and its subsidiary, both located in Estonia. The group audit team performed full scope audit procedures on the financial statements of the Company and its subsidiary. We also audited the consolidation process to obtain evidence that there were no material misstatements of the consolidated financial information.

Other information

The Management Board is responsible for the other information contained in the Consolidated Annual and Sustainability Report in addition to the consolidated financial statements, our auditor's report thereon and our auditor's report on the sustainability information.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Management Board and those charged with governance for the consolidated financial statements

The Management Board is responsible for the preparation and fair presentation of the 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.

In preparing the consolidated financial statements, the Management Board is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management Board either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.



- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

AS PricewaterhouseCoopers

Ago Vilu
Certified auditor in charge, auditor's certificate no.325

Doris Egel
Auditor's certificate no.587

17 March 2017

** 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.*



Independent Limited Assurance Report on the Sustainability Information To the Shareholders of AS Tallinna Vesi

(Translation of the Estonian original)*

Introduction

We have been engaged by the Management Board of AS Tallinna Vesi to provide limited assurance on the selected Sustainability Information described below and included on pages 4-74 and 117-121 in the Consolidated Annual and Sustainability Report of AS Tallinna Vesi and its subsidiary (together the "Group") for the year ended 31 December 2016).

Selected Sustainability Information

We assessed the quantitative and qualitative information disclosed in the GRI Index on pages 117-121 and the information on pages 4-74 as referred from the GRI Index (hereinafter the "Sustainability Information"), in the Consolidated Annual and Sustainability Report of the Group for the year ended 31 December 2016. The Sustainability Information has been prepared using the Global Reporting Initiative Sustainability Reporting Framework, including version G4 of the Sustainability Reporting Guidelines (hereinafter "GRI G4") as described on page 38 in the Consolidated Annual and Sustainability Report of the Group.

Our limited assurance engagement was performed with respect to the information of the year ended 31 December 2016 only and we have not performed any procedures with respect to earlier periods or any other elements included in the pages 4-74 and 117-121 of the Consolidated Annual and Sustainability Report and, therefore, do not express any conclusion thereon.

Reporting Criteria

We assessed the Sustainability Information using the GRI G4. We believe that these reporting criteria are appropriate given the purpose of our limited assurance engagement.

Responsibilities of the Management Board

The Management Board of the Group is responsible for:

- designing, implementing and maintaining internal systems, processes and controls over information relevant to the preparation of the Sustainability Information that is free from material misstatement, whether due to fraud or error;
 - establishing objective reporting criteria for preparing the Sustainability Information;
 - measuring the Group's performance based on the reporting criteria; and
 - the accuracy and completeness of the information presented within the Sustainability Information.
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Our Responsibilities

Our responsibility is to form an independent conclusion, based on our limited assurance procedures, on whether anything has come to our attention to indicate that the Sustainability Information is not stated, in all material respects, in accordance with the reporting criteria.

We conducted our engagement in accordance with the International Standard on Assurance Engagements (ISAE) 3000 "Assurance engagements other than audits or reviews of historical financial information". This standard requires that we comply with ethical requirements to plan and perform the assurance engagement to obtain limited assurance on the Sustainability Information.

This report, including our conclusions, has been prepared solely for management of the Group to assist management in reporting on the Group's sustainability performance and activities. Our limited assurance report has been prepared in accordance with the terms of our engagement. We permit this report to be disclosed in the Consolidated Annual and Sustainability Report of the Group for the year ended 31 December 2016, to enable management to show that as part of their governance responsibilities they have obtained an independent limited assurance report in connection with the Sustainability Information. We do not accept or assume responsibility to anyone other than management of the Group for our work or this report.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

Our firm applies International Standard on Quality Control ISQC 1 and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Work Done

Our procedures included:

- enquiries of the Group's management;
- interviews of personnel responsible for sustainability reporting and data collection;
- analysis of the relevant policies and basic reporting principles and gaining an understanding of the design of the key structures, systems, processes and controls for managing, recording and reporting the Sustainability Information;
- limited substantive testing of the Sustainability Information on a selective basis to verify that data had been appropriately measured, recorded, collated and reported; and
- reviewing the Sustainability Information for compliance of the disclosures with the requirements of GRI G4.

Limited assurance gives less in confidence than reasonable assurance, as a limited assurance engagement is substantially less in scope in relation to both the assessment of risks of material misstatement and the procedures performed in response to the assessed risks..

Reporting and Measurement Methodologies

There are no globally recognised and established practices for evaluating and measuring the Sustainability Information. The range of different, but acceptable, techniques can result in materially different reporting outcomes that may affect comparability with other organisations. The reporting criteria used as a basis of the Group's sustainability reporting should therefore be read in conjunction with the Sustainability Information.

Limited Assurance Conclusion

Based on our work described in this report nothing has come to our attention that causes us to believe that the Sustainability Information for the year ended 31 December 2016 has not been prepared, in all material respects, in accordance with the Core requirements of GRI G4.

AS PricewaterhouseCoopers



Ago Vilu
Certified auditor in charge, auditor's certificate no.325



Doris Egel
Auditor's certificate no.587

17 March 2017

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