AS Merko Ehitus

Group

(Translation of the Estonian original)

Consolidated Annual Report
Beginning of financial year: 01.01.2006
End of financial year: 31.12.2006

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Main activities:	general contracting of construction
Auditor:	AS PricewaterhouseCoopers

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MANAGEMENT REPORT

General information

Merko Ehitus is a leading construction group which offers complete solutions and whose companies are located in Estonia, Latvia and Lithuania. Merko Ehitus was set up in 1990. The Group consists of 32 subsidiaries and 7 associates and joint ventures, the largest ones of which are SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (75%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%) and AS Tartu Maja Betoontooted (25%).

In 2006, the following changes took place in the Group's structure:

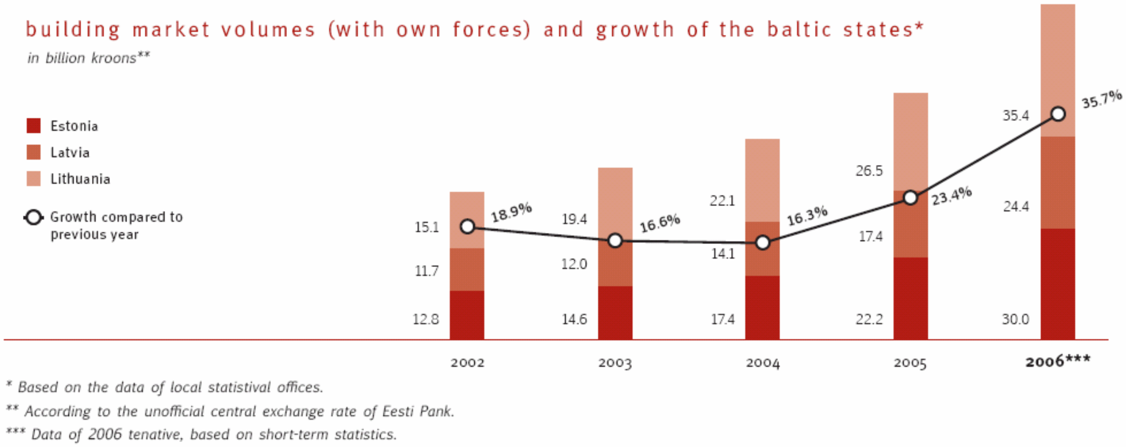
- In February, AS Merko Ehitus sold its 12% holding in the associate AS Telegrupp for 1.85 million kroons and in June, the remaining 19% shares of AS Telegrupp for 3.0 million kroons.
- In June, AS Merko Ehitus sold its 25% holding in the subsidiary AS Gustaf for 5.13 million kroons.
- In December, the Latvian subsidiary of AS Merko Ehitus, SIA Merks sold its 100% holding in the company SIA Arena Riga as a non-core business for 17.61 million euros (275.5 million kroons).
- In December, AS Merko Ehitus sold its 100% holding in OÜ Rannamõisa Kinnisvara for 31.89 million kroons. The sale transaction was recorded as a sale of real estate property in the Group accounting.

Overview of the construction market and its developments

The availability of unlimited funds and strong domestic consumption determined the development of the construction market in 2006. The demand was strong in the sector and the Baltic construction market as a whole grew by 35.7% in a year. In 2006, construction works were performed in the Baltic region for 89.8 billion kroons which is 23.6 billion kroons more than in 2005. Continuing appreciation of construction prices contributed significantly to this growth.

The sector's growth was the fastest in Latvia, where the market grew in current prices by 39.7% in a year and reached 24.5 billion kroons. According to the data by the Estonian Statistical Office, the Estonian construction companies performed construction works with their own workforces in Estonia and foreign countries for 31.4 billion kroons, which is 35.2% more than a year ago. In Estonia, construction works were performed for 30.1 billion kroons and in foreign countries, for 1.3 billion kroons. Fast growth also continued in the Lithuanian construction market which increased by 33.1% and 35.7 billion kroons. Despite fast growth in Latvia and Lithuania, the ratios characterising construction production stayed relatively low as compared with Estonia: construction works per capita were performed for 1493 euros in Estonia, 675 euros in Latvia and 668 euros in Lithuania.

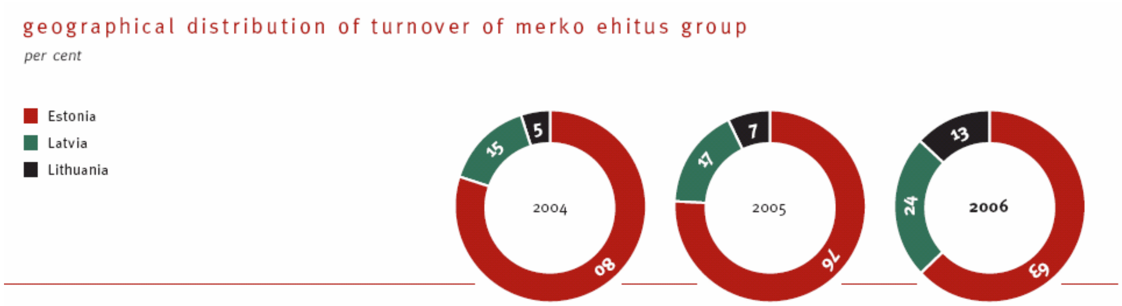
A major part of the growth of the construction market has come from residential construction over the last several years. The year 2006 was characterised by stabilisation of the residential market in Lithuania and Estonia, and as a result, interest towards real estate properties available for development decreased and their prices stabilised. In Latvia, the prices for residential housing continued to climb, appreciating by 30-40% in a year. Other main reason for the price appreciation was inadequate supply due to limited construction capacity and growing demand arising from speculative interest and availability of funds. In 2006, 5068 dwellings were completed in Estonia, 5865 in Latvia and 7292 in Lithuania.



Fast volume growth had an effect on the supply of labour and construction materials and was the driving force behind continuing appreciation of construction prices, which exceeded the growth of the consumer price index several times. The most critical situation occurred in respect of qualified labour, as simultaneously with volume growth, skilled labour left en masse to the EU countries with higher standards of living. The construction services appreciated by 20.9% in Latvia, 10.3% in Estonia and 9.8% in Lithuania, and labour costs appreciated by 44.2% in Latvia, 18.7% in Estonia and 17.5% in Lithuania.

Results of operations

The year 2006 was a challenging one for the Group and ended with the highest ever turnover and net profit. In 2006, the sales revenue of Merko Ehitus totalled 4 414 million kroons, increasing by 36.6% in a year. The volume of construction works performed outside of Estonia increased from 24.5% to 36.7% of the total sales revenue of the Group. In 2006, Estonia contributed 63.3%, Latvia 23.9% and Lithuania 12.8% to sales growth. As compared with 2005, sales revenue increased by 14.5% in Estonia, 88.5% in Latvia and 144.4% in Lithuania.

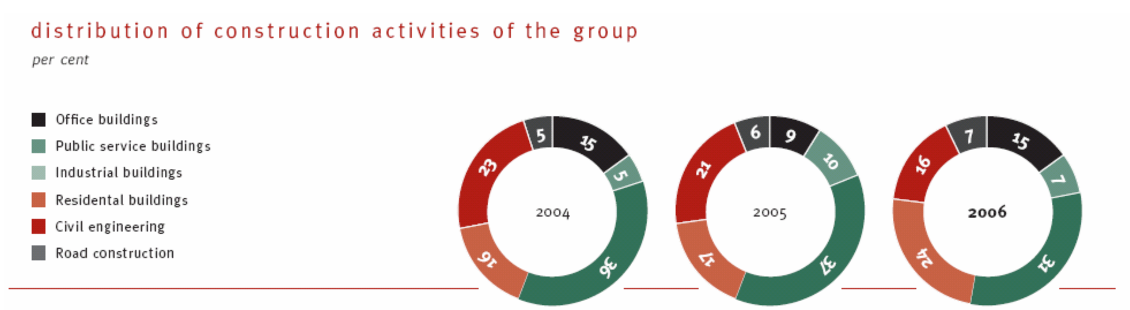


The consolidated sales revenue of the Group's largest companies over the 12 months of 2006 was:

in thousand kroons and euros

	2006		2005	
	EEK	EUR	EEK	EUR
Estonian companies				
Construction:				
AS Merko Ehitus (parent company)	1 864 882	119 188	1 779 827	113 752
AS Gustaf (75% ownership)	97 049	6 203	60 922	3 894
OÜ Gustaf Tallinn (80% ownership)	124 068	7 929	77 555	4 957
AS Merko Tartu (66% ownership)	255 769	16 347	232 972	14 890
Tallinna Teede AS (100% ownership)	317 591	20 298	204 005	13 038
OÜ Woody (100% ownership)	306 354	19 580	106 080	6 780
Latvian companies				
Construction:				
SIA Merks (100% ownership)	973 636	62 227	545 068	34 836
Lithuanian companies				
Construction:				
UAB Merko Statyba (100% ownership)	507 309	32 423	208 850	13 348

Engineering construction contributed 16%, residential construction/development 24%, administrative buildings 31%, office buildings 15%, industrial buildings 7% and road construction 7% to the Group's revenue. Of construction activities, 83% was new structure and 17% was renovation and reconstruction works. In 2006, the Group entered into construction contracts with the total volume of 6 754 million kroons and as at 31.12.06, the Group's contract portfolio totalled 5245 million kroons.



The Group's key events in the year 2006 were related to the Latvian subsidiary SIA Merks which turned 10 last year. At the beginning of the year, a multifunctional recreational centre accommodating 12 thousand people was opened in the district of Skanstes Street which was built by SIA Merks in co-operation with Merko Ehitus. During its first eleven months of operation under the management of SIA Merks, 126 events (including 33 ice-hockey world championships games) were arranged there, 520 000 people visited the complex, the revenue from operating the complex totalled LVL 2 533 000 and operating profit amounted to LVL 425 000. Despite initial success, management considered the risks of operating the complex high and irrelevant for the attainment of the Group's strategic goals; therefore the recreational unit was divested. At 11.12.2006, SIA Merks entered into a sales agreement to divest its holding in the company SIA Arena Riga for 17.61 million euros.

An important acknowledgement of the activities of SIA Merks during the year 2006 was the second prize awarded at the Competition of the Best Building of 2006 by the Latvian Construction Companies Association for the building of Riga Arena built by SIA Merks and the title of the best building of the year for the residential complex of Rūpniecības.

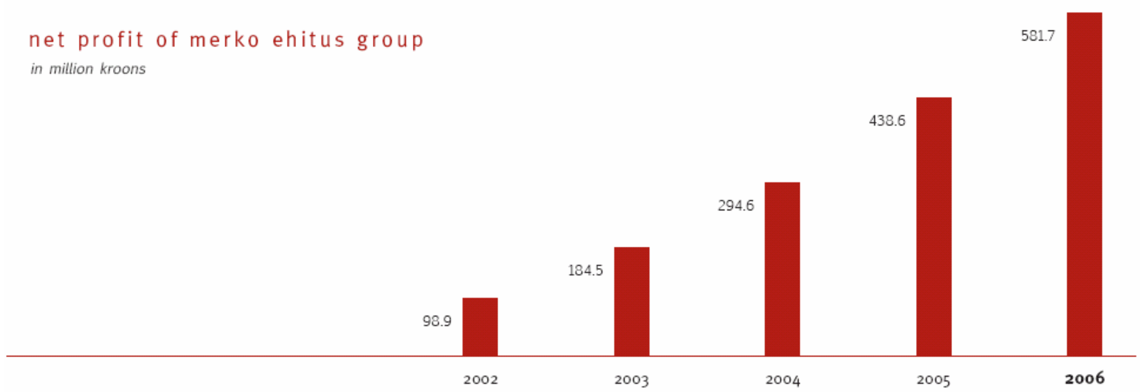
The largest completed projects of 2006 were:

Viimsi schoolhouse	new facility	Randvere tee 8, Viimsi, Harjumaa	18 197 m²	AS Merko Ehitus
Shopping centre	new facility	Mustakivi tee 17, Tallinn	11 279 m²	AS Merko Ehitus
Port of Saaremaa	new facility	Ninase village, Mustjala rural municipality, Saaremaa	11 200 m²	AS Merko Ehitus
Iru social welfare buildings	new facility	Hooldekodu tee 21 and 23, Tallinn	10 387 m²	AS Merko Ehitus
Stage 2 of residential buildings at Tabasalu	new facility	Sarapuu põik, Tabasalu, Harjumaa	9080 m²	AS Merko Ehitus
Apartment buildings and townhouses	new facility	Mooni 89b, Räägu 10c, Räägu 10b, Tallinn Kännu tn. 32/ Lehe tn. 31, Tallinn Räägu tn. 12b/ Kännu tn. 30, Tallinn Räägu tn. 12/ Lehe tn. 29 Tallinn Kolde pst. 67, Tallinn	14 789 m²	OÜ Woody
Stage 3 of shopping centre Spice	new facility	Lielirbes 29a, Riga	27 378 m²	SIA Merks
Apartment building	new facility	Rūpniecības 21, Riga	13 962 m²	SIA Merks
Administrative building of UAB Univesa	new facility	Taikos pst. 88A, Vilnius	4028 m²	UAB Merko Statyba
Section of Jõhvi-Tartu-Valga Highway no. 209, section 209.2-217.4 and Transport Street in Valga	reconstruc-tion	Section of Jõhvi-Tartu-Valga Highway no. 209, section 209.2-217.4 and Transport Street in Valga	100 000 m²	Tallinna Teede AS
Road construction of Mustakivi Road (Tähesaju - Laagna Road)	reconstruct-tion	Mustakivi tee, Tallinn	14 935m²	Tallinna Teede AS
Logistics Centre of A. Le Coq Tartu Beer Factory	new facility	Tähtvere village, Tartumaa	15 692 m²	AS Merko Tartu

Due to the volume growth and appreciation of labour and material costs, the cost of goods sold increased by 36.1% and the distribution and administrative expenses increased by 14.6%, contributing 84.4% and 3.9%, respectively, to sales revenue. Despite fast appreciation of costs related to construction activities and tense situation with regard to labour supply, the Company was able to retain its gross margin at 15.6% and increase its operating margin from 13.5% to 14.3%.

In 2006, the Group's net profit totalled 581.7 million kroons. Extraordinary income from the sale of holdings contributed 125.1 million kroons, development activities 284.7 million kroons, construction activities 164.2 million kroons and financial activities 7.7 million kroons to net profit. The Group's net profit margin before extraordinary income was 10.3% and the profit margin from construction activities was 4.6%.

In a year, the Group's net profit increased by 32.6% and the net profit from other countries increased by 155.4%. For the first time, the net profit earned by the Latvian and Lithuanian business units (252.2 million kroons) exceeded that of the parent company AS Merko Ehitus of 218.1 million kroons.



In 2006, the Group's total cash flows totalled +411.7 million kroons, of which the cash flows from operating activities totalled +155.7 million kroons. The cash flows from operating activities of the reporting period were mostly affected by the operating profit of +632.9 million kroons, a change in inventories –363.6 million kroons, a change in receivables and prepayments related to operating activities -189.2 million kroons, a change in liabilities and prepayments +165.3 million kroons, loss from the sale of non-current assets -122.4 million kroons and prepaid corporate income tax paid 44.0 million kroons. The Group's cash flows from investing activities totalled +234.4 million kroons, of this amount the proceeds from sale of property, plant and equipment totalled +290.8 million kroons, loan repayments received totalled +287.0 million kroons, loans granted in the reporting period -275.4 million kroons, investments into property, plant and equipment -76.3 million kroons and other income from investing activities +8.3 million kroons. The Company's cash flows from financing activities totalled +21.6 million kroons, of which the balance of credit liabilities assumed/repaid totalled +113.5 million kroons and dividends paid –91.9 million kroons.

The ratios and methodology of calculating the financial ratios describing the Company's main operations were as follows:

	2004	2005	2006
Net profit margin	9.5%	13.6%	13.2%
Net profit margin *	8.8%	9.0%	10.3%
Operating profit margin	10.3%	13.5%	14.3%
Return on equity per annum	49.9%	48.2%	43.2%
Return on assets per annum	24.1%	24.9%	21.4%
Equity ratio	55.3%	49.6%	49.6%
Current ratio	2.0	2.0	2.0
General expense ratio	3.4%	4.6%	3.9%
Personnel expense ratio	6.3%	7.3%	8.0%
Debt ratio	3.7%	28.8%	27.8%
Accounts receivable turnover (in days)	30	33	46
Accounts payable turnover (in days)	29	38	45
Sales revenue per employee (in million kroons)	4.891	4.651	5.193

* excluding extraordinary profit

Net profit margin: Net profit / Sales revenue
Operating profit margin: Operating profit / Sales revenue
Return on equity per annum: Net profit / Average equity of the period*
Return on assets per annum: Net profit / Average assets of the period
Current ratio: Owners' equity* / Total assets
Current ratio: Current assets / Current liabilities
General expense ratio: General expenses / Sales revenue
Personnel expense ratio: Personnel expenses / Sales revenue
Debt to equity ratio: Interest-bearing liabilities / Owners' equity*
Accounts receivable turnover: Trade receivables / Sales revenue x 365
Accounts payable turnover: Payables to supplies / Cost of goods sold x 365
Sales revenue per employee: Sales revenue / Average number of full-time employees

* calculated as attributable to the equity holders of the parent company

Business risks

Market risks. One of the peculiarities of construction activities is the fact that the execution of the contracts entered into will take months and it ensures relatively long-term revenue stream for the companies which in turn makes the sector immune to changes in the economic environment. Due to this the changes having both a negative and positive effect on the demand for construction services will reach construction with a lag of approximately 12 months. This time is long enough to take necessary measures and avoid the worst or be prepared for the best.

It is much more difficult to estimate the changes in the demand for housing development. In 2006, the housing development differed among the Baltic countries, the prices stabilised and the sales period of apartments lengthened in Estonia and Lithuania and price appreciation continued in Latvia. How will the market be able to absorb the price appreciation of previous years? What will happen to apartments purchased as investments if housing prices no longer increase? How will the lending market adjust to interest rate hikes? Concurrent interaction between different factors in the dwelling space market is complicated and represents a significant risk for the developer. In order to anticipate potential problems, we closely follow the changes in sales numbers, the process of selling apartments is launched before the construction of the building, a preliminary contract is entered into with the buyer at the first opportunity and a deposit is collected to ensure the execution of the contract. The largest projects are divided into stages so that they can be frozen quickly and with few expenses. Development activities made up 19.2% of the turnover of Merko Ehitus in 2006. As at 31.12.06, 32 completed apartments with the cost price of 18.1 million kroons had not been sold by the Group and 839 apartments with the cost price of 428.1 million kroons were not completed, of which 404 apartments had been sold to buyers under preliminary contracts.

The accession of the Baltic countries to the European Union opened new markets for construction companies, a large gap between the new and old countries led to a massive migration of construction workers into old EU countries. Labour migration and growth of construction market volumes led to shortages of skilled labour in all Baltic countries and fast appreciation of labour costs. Developments in the labour market, convergence of prices of construction services and materials with the prices of the European Union and longer delivery dates of construction materials need to be considered when assessing the risks for long-term projects lasting longer than 12 months. In order to hedge risks we have stepped up international cooperation; in the absence of necessary skills, knowledge or work is purchased from other Baltic countries, Finland and Sweden.

Operating risks. The Group concludes complete risk insurance contracts with insurance companies in order to hedge unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to 10 million euros. The risks of projects whose cost exceeds 10 million euros or which the annual policy does not cover (water construction, railroad construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding employment contracts for design work, an insurance contract of professional liability is required from subcontractors covering the losses arising from design, erroneous measuring, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2006, indemnity applications totalling 2.6 million kroons were submitted to insurance companies and disbursements in the amount of 0.4 million kroons were received from insurance companies and 1.9 million kroons are being processed.

The appropriate fulfilment of contractual obligations arising from employment agreements is guaranteed with bank guarantees payable on first demand. A warranty reserve has been set up at the Company to eliminate the construction errors which became evident during the warranty period. In 2006, warranty provisions were set up in the total amount of 10.7 million kroons and disbursements amounted to 9.5 million kroons. As at the year-end, the Company's warranty reserve amounted to 9.7 million kroons. With regard to work performed by subcontractors, the subcontractor shall eliminate the errors that became evident during the warranty period and the fulfilment of these obligations is guaranteed with bank guarantees.

One important part of managing operating risks is the mapping out of the situation and anticipation of risks. ISO 9001/14001 management systems have been set up at the four largest companies of the Group and the occupational health and safety system OHSAS 18001 has been set up at the parent company. Fifteen full-time quality control specialists work in the Group whose work responsibilities include ensuring the functioning of quality, work safety and management systems.

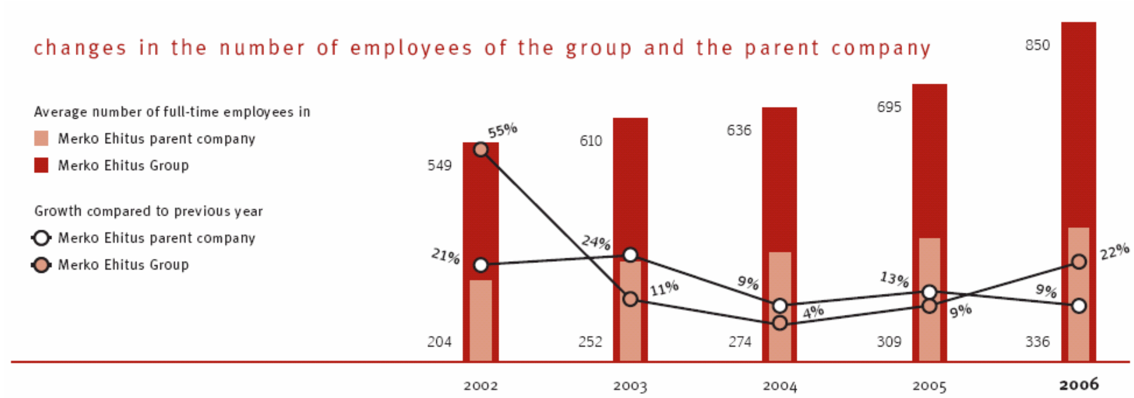
Credit risk is an inevitable part of the Company's activities. In managing credit risk, close attention is paid to the payment behaviour of partners, their financial position is analysed and if necessary, third parties are involved as guarantors. With regard to prepayments to suppliers, a bank guarantee by suppliers is required. In 2006, the payment discipline of customers somewhat deteriorated, the amount of invoices exceeding 30 and more days increased from 2.4 million kroons to 22.4 million kroons and the amount of doubtful receivables increased from 0.4 million kroons to 1.6 million kroons. Due to participation in several large public procurements, the accounts receivable turnover increased from 33 days to 46 days in a year.
The Company's available funds are held in short-term deposits at the banks with high credit ratings (Moody's rating of A3/P-2 and higher). In order to ensure liquidity, the group companies have concluded overdraft contracts with the total value of 148 million kroons.

Interest rate risks. As at 31.12.06, the Group's interest-bearing liabilities totalled 443.1 million kroons, of which short-term loans and the current portion of long-term debt totalled 283.8 million kroons and long-term loans and finance lease liabilities totalled 159.3 million kroons. The volume of interest-bearing liabilities increased by 125.5 million kroons in a year and as at the year-end, these liabilities made up 13.8% of the Company's balance sheet total. Most of the Group's loans relate to short-term development projects the duration of which exceeds 24 months. Due to the short-term nature of loans, the effect of interest rate increases is immaterial on the final results of projects and therefore, the hedging of interest risks of these obligations is not considered appropriate.

Foreign currency risk. The Group's construction contracts are mostly concluded in a foreign currency of the country of location and open foreign currency positions in daily activities are being avoided. The most significant foreign contracts are concluded in euros. The Latvian lats, the Lithuanian litas and the Estonian kroons have been pegged to the Euro and hence the foreign currency risks of intra-group transactions have been eliminated.

The Company and its people

One of the main values of Merko Ehitus is its people. In a year, the number of the Group's employees increased by 155 people and at 31.12.2006, the Group had 850 full-time employees. The gross wages and salaries of the Group's full-time employees totalled 276.5 million kroons, of which the basic wages and salaries made up 68.0% and bonuses made up 32.0%, and that is 59.0% more than in 2005. In 2006, the average number of full-time employees at the parent company AS Merko Ehitus was 336, increasing by 27 employees in a year. Gross wages and salaries paid to full-time employees totalled 125.2 million kroons, the annual growth was 21.2%, incl. the growth of basic wages and salaries of 30.2% and that of bonuses of 8.0%. As compared to 2005, the average number of employees grew by 22.3% at the Group and the average gross wages and salaries grew by 29.8%.



The Management Board of AS Merko Ehitus has 5 members. The members of the Management Board were all full-time employees of AS Merko Ehitus and their gross remuneration totalled 7.1 million kroons in 2006, incl. basic remuneration of 2.8 million kroons and bonuses of 4.3 million kroons. The Supervisory Board of AS Merko Ehitus has three members and their gross remuneration in 2006 totalled 5.5 million kroons, incl. basic remuneration of 1.6 million kroons and bonuses of 3.9 million kroons. All members of the Supervisory and Management Boards work on the basis of service contracts. Upon the premature removal of a member of the Supervisory and Management Boards or non-extension of the service contract, the member is paid severance pay which equals the last 12 months' remuneration.

In 2006, the Group sponsored sports, culture and science with 8.6 million kroons. The Group's largest sponsorship project was the initiative launched in collaboration with Hansabank, Eesti Energia and the Ministry of Culture of the Republic of Estonia as well as the Estonian Ski Association called ' Estonian hiking tracks'. The goal of the project is to help develop the Estonian athletic tracks in order to ensure availability of year-round and free athletic opportunities to all interested people and to promote athletic lifestyles. SA Eesti Terviserajad was set up to implement this project. Over the last two years, the private sector has invested 20 million kroons into the hiking tracks, has cleaned 15 hiking tracks and design works have been launched with regard to 9 centres.

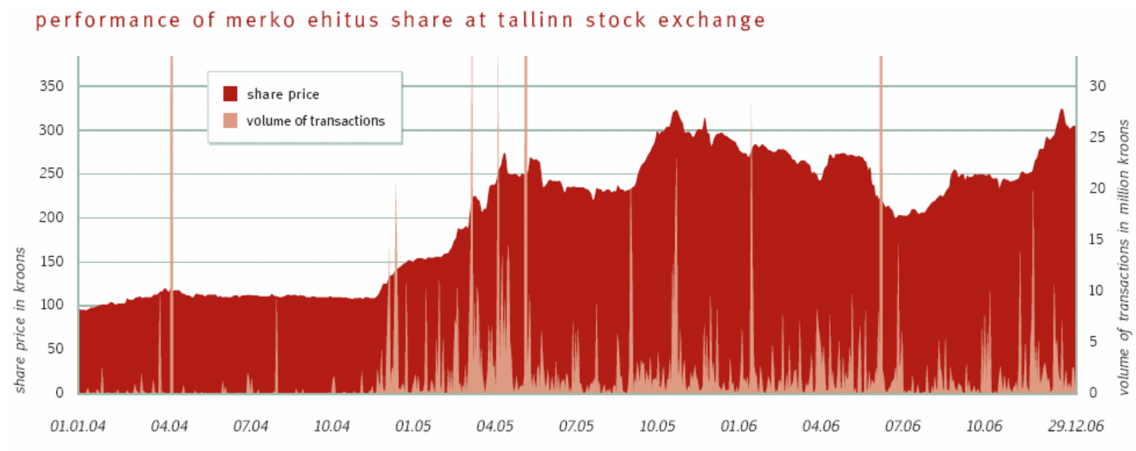
Shares and shareholders

The shares of Merko Ehitus are listed in the main list of Tallinn Stock Exchange.

	31.12.2004	31.12.2005	31.12.2006
Basic earnings per share (EPS), kroons	16.64	24.78	32.87
Owners' equity per share, kroons	40.56	62.23	90.05
P/B (price to book ratio)	3.75	4.34	3.41
P/E (price / earnings ratio)	9.14	10.89	9.35

In 2006, 3589 transactions with the shares of Merko Ehitus were performed in the course of which 3.4 million shares were traded and the total monetary value of transactions was 832.6 million kroons. The lowest share price was 197.46 kroons and the highest price was 326.23 kroons per share. The closing price of the share as at 29.12.2006 was 307.46 kroons.

The share price of Merko Ehitus and trading volume movements on Tallinn Stock Exchange.



The share prices preceding the equity financing have been corrected to the number of shares which resulted from the equity financing carried out in 2005.

Trading history of securities	2004	2005	2006
Highest	152.16	327.01	326.23
Lowest	93.88	150.21	197.46
Closing	152.09	269.90	307.46
Change, %	+61.86	+77.47	+13.92
Traded shares	1 465 632	2 847 923	3 434 847
Turnover, million kroons	355.98	1 052.38	832.59
Market value, in million kroons, as at the year-end	2 691.90	4 777.23	5 442.04

Structure of shareholders as at 31.12.2006

Number of shares	Number of shareholders	% of shareholders	Number of shares	% of shares
1-100	398	39.80%	21 918	0.12%
101-1000	451	45.10%	173 912	0.98%
1001-10 000	116	11.60%	346 672	1.96%
10 001 – 100 000	24	2.40%	889 761	5.03%
100 001 – 1 000 000	9	0.90%	2 310 351	13.05%
1 000 001 - …	2	0.20%	13 957 386	78.86%
Total	1000	100%	17 700 000	100%

The main shareholders of AS Merko Ehitus as at 31.12.2006 were:

	Number of shares	Proportion
AS Merko Grupp	12 742 686	71.99%
ING Luxembourg S.A.	1 214 700	6.86%
Skandinaviska Enskilda Banken Ab, clients	789 365	4.46%
Nordea Bank Finland Plc, clients	503 172	2.84%
OKO Bank Plc, clients	248 594	1.40%
J.P. Morgan Bank Luxembourg S.A.	189 306	1.07%

Outlook for 2007

The overall condition of the construction sector is primarily affected by the country's economic development, general investment climate and availability of funds. Lately, international rating agencies and independent analysts have drawn attention to the current account deficit in the Baltic countries, extremely fast economic growth and accompanying inflation. Analysts think that the economy is showing signs of overheating and requires state intervention. In February 2007, the Government of Latvia announced its programme of measures to balance the economy. The foundation of the programme is the curbing of domestic consumption through reducing the availability of funds and public procurements as well as fiscal policy restrictions. Most of the planned measures would also have a direct effect on the development of the construction sector.

The tightness of the supply of labour and construction materials and fast price acceleration will remain the largest challenges for the sector's further development. The year 2007 may bring some alleviation to the problems of construction materials and labour. The supply of construction materials should improve when the investments made into production in 2005/2006 are launched. Positive changes may also be seen in the supply of the labour market. Fast salary acceleration in the domestic market over the last several years has made the domestic market attractive for construction workers migrating to foreign countries and brought new employees to the market from other sectors of the economy. The above changes are unlikely to solve these problems; therefore the appreciation of the prices of construction services will continue.

The year 2007 will not bring along any structural changes in the construction sector, the construction of infrastructure and environmental facilities financed in collaboration of the public sector and the Structural Funds of the European Union will continue. The private sector will continue to invest in the renovation and construction of hotels, commercial and office buildings and industrial parks.

Besides general and engineering construction, housing construction has played an important role over the last several years. Due to stricter requirements set for the borrowers by banks and lower demand due to higher inflation, the growth of housing loans will slow and as a result, the housing market will stabilise, the sales periods of residential properties will lengthen and the regional differentiation of real estate prices will take place. The renewal pace of the housing fund of 2.1-3.8 new housing spaces per thousand people attained by today is not expected to change significantly over the next several years. The market needs time to get used to the fast price acceleration of the last several years and the purchasing power of people is expected to catch up.

We believe that despite the deterioration of the borrowing environment and the measures taken by the central banks and governments of the Baltic countries to balance the economy, the economic growth rate of the region will maintain its 6-7% growth rate which the construction sector will also benefit from. In the short term, the demand for construction services distinctly exceeds the supply and the growth of volumes and prices is expected to continue. In the medium term, the fast acceleration of the construction services and the forecast deceleration of economic growth will have a negative effect on demand and the growth of the construction sector may slow down.

Although the growth rates of the construction markets of all Baltic countries were similar in 2006, in the future, faster growth is expected to take place in Latvia and Lithuania where the construction volumes do not reflect the size and the number of people in these countries. In 2006, construction works were performed for 1493 euros in Estonia, 675 euros in Latvia and 668 euros in Lithuania. These numbers demonstrate that the growth of construction market is still ahead.

Merko Ehitus continues to expand its operations in Latvia and Lithuania where it aims at becoming one of the leaders of the Latvian and Lithuanian construction markets with the help and the branch offices of Merko Ehitus and subsidiaries SIA Merks and UAB Merko Statyba. We are optimistic regarding the developments in Latvia and Lithuania and believe that over the next 3 years, the share of their operations will grow to 50% of the Group's revenue.

Our experience, knowledge, and people are a value which has brought success for Merko Ehitus over the years. We believe that we will be able to turn the year 2007 into another successful year for the Company's business partners, clients, employees and shareholders.

Corporate Governance Code

From 2006, the Corporate Governance Code (CGC) which lays down the general principles of managing companies and treating shareholders, applies to the issuers of equity securities which are listed on Tallinn Stock Exchange. The application of the CGC principles is recommended to the listed companies and the companies are free to decide whether to follow the main CGC principles or not. The Corporate Governance Code is based on the principle of *follow or explain* according to which a company shall explain its standpoints and activities with regard to those CGC provisions which it does not follow.

Merko Ehitus places great value on the equal treatment of its shareholders, the transparency of the Company's management processes as well as the reliability of its activities. This report deals with those CGC principles which AS Merko Ehitus does not follow for technical, economic or other reasons.

I General Meeting of Shareholders

The Company's highest governing body is the General Meeting of Shareholders, the authorities of which are regulated by legislation and the articles of association of the Company.

The Company shall announce the time, place, and agenda of the General Meeting as well as the recommendations of the Supervisory Board with regard to the items on the agenda in a national daily newspaper, on the Company's website and through the stock exchange system. The General Meeting shall be conducted at the place shown on the notice, on a working day and between 9 a.m. and 6 p.m. enabling most of the shareholders to participate in the General Meeting of Shareholders. Any shareholder or his authorised representative may participate in the General Meeting. No picture taking or filming is allowed at the General Meeting, because it may disturb the privacy of shareholders. Participation in the General Meeting cannot be accomplished through the means of communication because there are no reliably way to identify shareholders and to ensure the privacy of participating shareholders.

On behalf of the Company, the Chairman of the Management Board and the Chairman of the Supervisory Board shall participate in the General Meeting of AS Marko Ehitus, and if necessary, other members of the

Management and Supervisory Boards shall be involved. The Company does not consider the participation of all members of the Management and Supervisory Boards in the General Meeting relevant.

II Management Board

The Management Board of AS Merko Ehitus represents the Company and manages its daily operations. The Management Board of AS Merko Ehitus has five members and the activities of the members are divided by areas of operation: general management – Tõnu Toomik, construction – Andres Agukas, development – Tõnu Korts, technology – Veljo Viitmann, finance – Alar Lagus. The Chairman of the Management Board, Tõnu Toomik presides over the work of the Management Board.

The members of the Management Board have entered into three-year service contracts with the Company. The Company discloses the total amount of remuneration and bonuses of the members of the Management Board in the annual report, as it believes that the disclosure of personalised remuneration does not create additional value and disturbs the privacy of the members of the Management Board. Upon premature termination or non-extension of the service contract and under the condition that the members of the Management Board shall not compete with the Company, severance pay shall be paid to the members of the Management Board equalling twelve-month basic remuneration of the member of the Management Board.

In paying bonuses to the members of the Management Board, the financial performance of the companies managed by the Group and the Management Board shall be considered. Besides reviewing the quarterly results of operations, the Supervisory Board shall review and approve the bonuses payable to the Management Board. Twenty-five per cent of the bonuses payable on the basis of interim financial statements shall be withheld and paid after the approval of the annual report by the General Meeting of Shareholders. No share options have been used to motivate the members of the Management Board.

III Supervisory Board

The General Meeting of Shareholders shall elect the Supervisory Board. The Supervisory Board shall determine the Company’s operating strategy, endorse the transactions as authorised by the articles of association, elect the members of the Management Board and monitor the performance of the Management Board during the time the General Meetings are not held. The Supervisory Board of AS Merko Ehitus has three members: Teet Roopalu, Jaan Mäe and Chairman of the Supervisory Board, Toomas Annus.

Merko Ehitus does not have any independent members of the Supervisory Board meeting the definition of the CGC, as the members also participate in the work of the companies controlled by the Company and in the Supervisory Boards of the Company’s controlling shareholder. The members of the Supervisory Board shall be elected on the basis of their knowledge and experience in the field of construction and real estate development. The peculiarity of the work procedures of the Supervisory Board of Merko Ehitus is the fact that the members work full-time on the basis of service contracts. Such a work procedure adds responsiveness to the activities of the Group, ensures better informativeness of the Supervisory Board and altogether enables more efficient supervision over the activities of business units which are dispersed geographically and have diverse operations.

The General Meeting of Shareholders shall approve the remuneration of the members of the Supervisory Board. The terms and conditions of the service contracts in force, including the procedures for paying remuneration to the members of the Supervisory Board were approved by the General Meeting of Shareholders in May 2006.

The performance-based pay of the members of the Supervisory Board shall be determined on the basis of the financial performance of the Group. The payment of bonuses occurs on a quarterly basis after the publication of the issuer's interim financial statements. Twenty-five per cent of the bonuses payable on the basis of interim financial statements shall be paid after the approval of the annual report by the General Meeting of Shareholders.

Upon the premature termination or non-extension of the service contract and under the condition that the members of the Supervisory Board shall not compete with the Company, severance pay shall be paid to the members of the Supervisory Board equalling twelve month basic remuneration.

IV Collaboration of the Management and Supervisory Boards

To ensure that the Company's interests are met as best as possible, the Management and Supervisory Boards shall collaborate extensively. At least once a month, a meeting between the members of the Supervisory and Management Boards shall take place, at which the Management Board shall inform the Supervisory Board of significant issues regarding the Company's business operations, the fulfilment of the Company's short and long-term goals and the risks affecting them.

V Disclosure of information

In disclosing information, AS Merko Ehitus shall follow the rules and regulations of Tallinn Stock Exchange and immediately disclose important information regarding the Company's activities to the shareholders after obtaining reasonable assurance as to its correctness and that the disclosure of such information shall not harm the interests of the Company and its partners. Important information shall be disclosed through the stock exchange system and on the Company's website.

During the year, Merko Ehitus shall not publish the dates for disclosing information, the so-called financial calendar, because the disclosure of reliable dates would incorporate additional time factor into the dates and endanger the timeliness of disclosures. Merko Ehitus publishes important information regarding the Company after the end of the trading day and from 2007, informs shareholders about publishing interim financial statements and the annual report at least two days prior to their disclosure.

If possible, the Company shall participate in the presentation and press conferences arranged by analysts and investors. The information made available at the meetings is public, i.e. available in the reports of the Company, on its website or other public sources. We believe that the publication of the schedule for meetings does not provide any additional information for the shareholders and therefore, such information shall not be published.

VI Election of an auditor and auditing the financial statements

The Company's financial statements are prepared in accordance with International Financial Reporting Standards as adopted in the European Union.

In electing the auditor, the Company shall consider his/her independence, competence, reliability and the price of the service offered by him/her. The Company shall not publish the fees paid for the provision of auditing and consulting services, because such activities may significantly impair the Company's ability to obtain the service for a competitive price in the future.

When proposing to elect a new auditor, the Supervisory Board shall also present its rationale for the change. In extending the contract with the auditor who audited the Company in the previous financial year, the Supervisory Board acknowledges with its choice that the auditor has fulfilled the expectations laid on him/her and the Supervisory Board is content with the quality of the service provided.

FINANCIAL STATEMENTS

MANAGEMENT DECLARATION

The Management Board confirms the correctness and completeness of AS Merko Ehitus consolidated financial statements as presented on pages 16-64.

The Management Board confirms that to the best of its knowledge:

- the accounting methods used for preparing the financial statements are in compliance with International Financial Reporting Standards as adopted by the European Union;
- the financial statements give a true and fair view of the financial position, the results of operations and the cash flows of the Group:
- the parent company and all group companies are going concerns.

Tõnu Toomik	Chairman of the Management Board		29.03.2007
Alar Lagus	Member of the Management Board		29.03.2007
Veljo Viitmann	Member of the Management Board		29.03.2007
Andres Agukas	Member of the Management Board		29.03.2007
Tõnu Korts	Member of the Management Board		29.03.2007

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Kuupäev/date 12.04.07
PricewaterhouseCoopers, Tallinn

CONSOLIDATED INCOME STATEMENT

in thousands of		EEK		EUR	
	Note	**2006**	**2005**	**2006**	**2005**
Revenue	2,3	4 414 361	3 232 392	282 129	206 588
Cost of goods sold	4	(3 727 561)	(2 738 714)	(238 234)	(175 036)
Gross profit		686 800	493 678	43 895	31 552
Marketing expenses	5	(23 390)	(22 595)	(1 495)	(1 444)
Administrative and general expenses	6	(148 792)	(127 632)	(9 501)	(8 157)
Other operating income	7	148 205	185 052	9 463	11 827
Other operating expenses	8	(29 952)	(93 452)	(1 914)	(5 973)
Operating profit		632 871	435 051	40 448	27 805
Financial income	9	8 303	6 253	530	400
Financial expenses	10	(20 353)	(4 710)	(1 301)	(301)
Profit from sale of subsidiaries	18	2 326	7 498	149	479
Profit from associates and joint ventures	19	17 461	19 632	1 116	1 255
incl. profit from equity participation		17 038	17 065	1 089	1 091
Profit before tax		640 608	463 724	40 942	29 638
Corporate income tax expense	11	(49 917)	(18 437)	(3 190)	(1 178)
Net profit for financial year		590 691	445 287	37 752	28 460
incl. net profit attributable to equity holders of the parent company		581 738	438 638	37 180	28 034
minority interest		8 953	6 649	572	426
Earnings per share for profit attributable to equity holders of the parent company (basic and diluted, in kroons / euros)	12	32.87	24.78	2.10	1.58

The notes set out on pages 22-64 are an integral part of these consolidated financial statements.

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CONSOLIDATED BALANCE SHEET

in thousands of		EEK		EUR	
	Note	**31.12.2006**	**31.12.2005**	**31.12.2006**	**31.12.2005**
ASSETS					
Current assets					
Cash and cash equivalents	14	676 143	268 446	43 123	17 157
Trade and other receivables	15	854 103	542 110	54 587	34 648
Prepaid corporate income tax		6 428	2 471	411	158
Inventories	17	1 356 734	964 088	86 712	61 617
Assets held for sale		733	-	47	-
		2 894 141	1 777 115	184 970	113 580
Non-current assets					
Investments in associates and joint ventures	19	200 798	179 609	12 833	11 479
Other long-term loans and receivables	20	8 476	8 524	542	545
Deferred income tax assets	21	6 592	8 753	421	559
Investment property	22	3 900	42 506	249	2 716
Property, plant and equipment	23	90 445	199 004	5 781	12 718
Intangible assets	24	10 177	4 365	650	279
		320 388	442 761	20 476	28 296
TOTAL ASSETS		3 214 529	2 219 876	205 446	141 876
LIABILITIES					
Current liabilities					
Borrowings	26	283 792	114 841	18 138	7 340
Trade and other payables	27	1 081 396	711 236	69 114	45 456
Corporate income tax liability		18 868	950	1 206	61
Government grants	28	1 498	22 225	96	1 420
Short-term provisions	29	33 517	21 741	2 142	1 390
		1 419 071	870 993	90 696	55 667
Non-current liabilities					
Long-term borrowings	26	159 335	202 824	10 183	12 963
Other long-term trade payables	30	23 277	22 726	1 488	1 452
Deferred income tax liability	21	-	11 385	-	728
		182 612	236 935	11 671	15 143
TOTAL LIABILITIES		1 601 683	1 107 928	102 367	70 810
EQUITY					
Minority interest		18 904	10 552	1 208	674
Equity attributable to equity holders of the parent company					
Share capital	32	177 000	177 000	11 312	11 312
Statutory reserve capital		17 700	8 850	1 131	566
Currency translation differences		(5 751)	(5 059)	(368)	(323)
Retained earnings		1 404 993	920 605	89 796	58 837
		1 593 942	1 101 396	101 871	70 392
TOTAL EQUITY		1 612 846	1 111 948	103 079	71 066
TOTAL LIABILITIES AND EQUITY		3 214 529	2 219 876	205 446	141 876

The notes set out on pages 22-64 are an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

in thousands of ***EEK***	Note	Equity attributable to equity holders of the parent company							
		Share capital	**Share premium**	**Statutory reserve capital**	**Currency translation differences**	**Retained earnings**	**Total**	**Minority interest**	**Total**
Balance as at 31.12.2004		88 500	2 950	8 850	(4 663)	622 333	717 970	7 200	725 170
Derecognition of negative goodwill	24	-	-	-	-	2 709	2 709	-	2 709
Balance as at 01.01.2005		88 500	2 950	8 850	(4 663)	625 042	720 679	7 200	727 879
Currency translation differences		-	-	-	(396)	-	(396)	-	(396)
Net profit for financial year		-	-	-	-	438 638	438 638	6 649	445 287
Total recognised income for 2005		-	-	-	(396)	438 638	438 242	6 649	444 891
Liquidation proceeds to minority shareholders		-	-	-	-	-	-	(697)	(697)
Fund issue	32	88 500	(2 950)	-	-	(85 550)	-	-	-
Dividends	13	-	-	-	-	(57 525)	(57 525)	(2 600)	(60 125)
Balance as at 31.12.2005		177 000	-	8 850	(5 059)	920 605	1 101 396	10 552	1 111 948
Currency translation differences		-	-	-	(692)	-	(692)	-	(692)
Net profit for financial year		-	-	-	-	581 738	581 738	8 953	590 691
Total recognised income for 2006		-	-	-	(692)	581 738	581 046	8 953	589 999
Minority interest sold	18	-	-	-	-	-	-	2 799	2 799
Dividends	13	-	-	-	-	(88 500)	(88 500)	(3 400)	(91 900)
Transfers to statutory reserve capital		-	-	8 850	-	(8 850)	-	-	-
Balance as at 31.12.2006		177 000	-	17 700	(5 751)	1 404 993	1 593 942	18 904	1 612 846

in thousands of ***EUR***	**Equity attributable to equity holders of the parent company**							
	Share capital	**Share premium**	**Statutory reserve capital**	**Currency translation differences**	**Retained earnings**	**Total**	**Minority interest**	**Total**
Balance as at 31.12.2004	5 656	189	566	(298)	39 774	45 887	460	46 347
Derecognition of negative goodwill	-	-	-	-	173	173	-	173
Balance as at 01.01.2005	5 656	189	566	(298)	39 947	46 060	460	46 520
Currency translation differences	-	-	-	(25)	-	(25)	-	(25)
Net profit for financial year	-	-	-	-	28 034	28 034	426	28 460
Total recognised income for 2005	-	-	-	(25)	28 034	28 009	426	28 435
Liquidation proceeds to minority shareholders	-	-	-	-	-	-	(46)	(46)
Fund issue	5 656	(189)	-	-	(5 467)	-	-	-
Dividends	-	-	-	-	(3 677)	(3 677)	(166)	(3 843)
Balance as at 31.12.2005	11 312	-	566	(323)	58 837	70 392	674	71 066
Currency translation differences	-	-	-	(45)	-	(45)	-	(45)
Net profit for financial year	-	-	-	-	37 180	37 180	572	37 752
Total recognised income for 2006	-	-	-	(45)	37 180	37 135	572	37 707
Minority interest sold	-	-	-	-	-	-	179	179
Dividends	-	-	-	-	(5 656)	(5 656)	(217)	(5 873)
Transfers to statutory reserve capital	-	-	565	-	(565)	-	-	-
Balance as at 31.12.2006	11 312	-	1 131	(368)	89 796	101 871	1 208	103 079

The notes set out on pages 22-64 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

in thousands of		EEK		EUR	
	Note	**2006**	**2005**	**2006**	**2005**
Cash flows from operating activities					
Operating profit		632 871	435 051	40 448	27 805
Adjustments:					
depreciation and impairment charge	2,22-24	30 747	109 637	1 965	7 007
profit/loss from sale of non-current assets	7,23	(122 403)	(535)	(7 823)	(34)
adjustment of revenue from construction contracts under stage of completion method		38 109	66 630	2 436	4 258
interest income from business activities		(2 335)	(5 590)	(149)	(357)
change in government grants and other provisions		5 455	(22 973)	349	(1 468)
Change in trade and other receivables related to operating activities		(189 193)	(27 321)	(12 092)	(1 746)
Change in inventories		(363 595)	(464 906)	(23 238)	(29 713)
Change in trade and other payables related to operating activities		186 197	186 556	11 900	11 923
Interest paid		(16 168)	(2 811)	(1 033)	(180)
Other financial income (expense)		(7)	3 857	(1)	247
Corporate income tax paid		(43 991)	(12 928)	(2 812)	(826)
		155 687	264 667	9 950	16 916
Cash flows from investing activities					
Investments into subsidiaries	18	(3 029)	(23 985)	(195)	(1 533)
Proceeds from sale of subsidiaries	18	(2)	3 376	0	216
Subsidiary liquidation proceeds to minority shareholders		(20)	(694)	(1)	(44)
Investments into associates and joint ventures	19	(7 866)	(136 228)	(503)	(8 707)
Proceeds from sale of associates and joint ventures		1 847	8 306	118	531
Proceeds from sale of other financial assets		3 004	3	192	0
Purchase of investment property	22	-	(63)	-	(4)
Purchase of property, plant and equipment	23	(76 264)	(226 960)	(4 874)	(14 505)
Proceeds from sale of property, plant and equipment	23	290 753	2 143	18 583	137
Purchase of intangible assets		(6 739)	(2 917)	(431)	(186)
Sale of a business unit		9 717	2 752	621	176
Loans granted	16	(275 353)	(190 123)	(17 598)	(12 151)
Loan repayments received	16	286 953	176 311	18 340	11 268
Interest received		8 393	6 641	536	424
Dividends received		3 000	3 323	192	212
		234 394	(378 115)	14 980	(24 166)
Cash flows from financing activities					
Proceeds from borrowings	26	268 726	293 567	17 175	18 762
Repayments of borrowings	26	(144 017)	(6 724)	(9 204)	(430)
Finance lease principal payments	26	(11 163)	(5 832)	(714)	(373)
Government grants received	28	-	22 225	-	1 421
Dividends paid		(91 900)	(60 128)	(5 873)	(3 843)
		21 646	243 108	1 384	15 537
Change in cash and cash equivalents		411 727	129 660	26 314	8 287
Cash and cash equivalents at beginning of the period	14	268 446	141 812	17 157	9 063
Exchange gains/(losses) on cash and cash equivalents		(4 030)	(3 026)	(258)	(193)
Cash and cash equivalents at end of the period	14	676 143	268 446	43 213	17 157

The principal non-cash transaction is the exchange of inventories discussed in Note 3.
The notes set out on pages 22-64 are an integral part of these consolidated financial statements.

NOTES

Note 1 Summary of significant accounting policies

1.1. Basis of preparation

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

The consolidated financial statements have been prepared under the historical cost convention.

Several financial figures are based on management's estimates, including for example, assessment of profitability of construction contracts upon the application of the stage of completion method, assessment of useful lives of items of property, plant and equipment, assessment of impairment losses of receivables and inventories, recognising provisions for warranty obligations. Management's estimates have been made to the best of its knowledge, but they may not be accurate. The effect of changes in accounting estimates is reported in the financial statements of the period in which the change occurred.

Assets and liabilities are classified as current and non-current in the balance sheet. Current assets include assets that are expected to be used within the next financial year. Current liabilities include liabilities the due date of which is within 12 months after the balance sheet date. The remaining assets and liabilities are classified as non-current.

Expenses are classified according to their function in the income statement.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency): Estonian kroons, Latvian lats and Lithuanian litas. The consolidated financial statements of Merko Ehitus Group are presented in Estonian kroons, which is the Group's presentation currency. The primary financial statements and notes are presented in thousands of kroons. Pursuant to the requirements of Tallinn Stock Exchange, the primary financial statements are also presented in thousands of euros. As the Estonian kroon is pegged to the Euro (EUR 1=EEK 15.6466), no exchange rate differences arise in the translation of the financial statements.

1.2. New International Financial Reporting Standards, amendments and International Financial Reporting Interpretations Committee (IFRIC) interpretations

Standards, amendments and interpretations effective in 2006
From 1 January 2006, several amendments to the text of existing standards as well as new IFRS standards, which became mandatory for the Group for the financial year beginning at 1 January 2006, became effective.

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but have no material impact on the Group financial statements:

- **IAS 19** (Amendment), Employee Benefits;
- **IAS 21** (Amendment), Net Investment in a Foreign Operation;
- **IAS 39** (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- **IAS 39** (Amendment), The Fair Value Option;
- **IAS 39** and **IFRS 4** (Amendment), Financial Guarantee Contracts;
- **IFRS 6**, Exploration for and Evaluation of Mineral Resources;
- **IFRS 1** (Amendment), First-time Adoption of International Financial Reporting Standards and **IFRS 6** (Amendment), Exploration for and Evaluation of Mineral Resources;
- **IFRIC 4**, Determining whether an Arrangement contains a Lease;
- **IFRIC 5**, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- **IFRIC 6**, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

Amendments in IAS 19, IAS 21, IFRS 1, new standard of IFRS 6 and interpretations in IFRIC 4, IFRIC 5 and IFRIC 6 are not relevant to the Group's operations and therefore have no substantial effect on the Group's accounting policies. Amendments to IAS 39 are relevant to the Group's operating activities, but they did not affect the accounting policies used by the Group that already comply with the requirements established.

New standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group
Certain new International Financial Reporting Standards, amendments to existing standards and the interpretations of the standards have been published by the time of compiling these financial statements which became mandatory for the Group's accounting periods beginning on or after 1 January 2007 and have not been early adopted by the Group. The overview of these standards and the Group management estimate of the potential impact of applying the new standards and interpretations is given below:

- **IAS 1** (amendment) – *Presentation of Financial Statements*: Capital Disclosures. The amendment to IAS 1 is effective for accounting periods beginning at or after 1 January 2007. The standard requires additional disclosures in the financial statements and presents additional requirements for the parent company's capital and capital management.
- **IFRS 7** *Financial instruments*: Disclosures. IFRS 7 is effective for accounting periods beginning at or after 1 January 2007. The standard requires additional disclosures in the financial statements. This standard does not have any impact on the classification and valuation of the Group's financial instruments.
- **IFRS 8** - *Operating Segments* – is effective from 1 January 2009. The management is considering the impact on Group's financial statements.
- **IAS 23** (revised) *Borrowing costs-* is effective from 1 January 2009. Revised standard requires capitalisation of borrowing costs.

The management is of opinion that the following new standards, their amendments and interpretations do not have a significant effect on the financial statements of the Group:
- **IFRIC 7** - *Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Environments* (effective 1 March 2006)
- **IFRIC 8** - *Share-based Compensations as defined in IFRS 2* (effective 1 May 2006)
- **IFRIC 9** - *Reassessment of Embedded Derivative*s (effective 1 June 2006)
- **IFRIC 10** - *Interim Financial Reporting and Impairment* (effective 1 November 2006)
- **IFRIC 11** - *IFRS 2 – Group Treasury Share Transactions* (effective 1 March 2007)
- **IFRIC 12** - *Service Concession Arrangements* (effective 1 January 2008).

Standard IFRS 8, IAS 23 (revised) and interpretations IFRIC 10, IFRIC 11 and IFRIC 12 have not yet been endorsed by European Union.

1.3. Management estimates

The preparation of financial statements in conformity with International Financial Reporting Standards 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. Although these estimates are based on management's best knowledge of current event and actions, actual results ultimately may differ from those estimates. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements of AS Merko Ehitus, are disclosed below. The effect of changes in an accounting estimate is recognised prospectively by including it in profit or loss in the period of the change.

The most significant management estimates are as follows:

Revenue under the stage of completion method
Revenue from construction in progress is recognised under the stage of completion method (Note 1.22), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, and reporting of income and expenses has been introduced to determine the stage of completion. The estimated final result to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the profit estimate is adjusted. In the financial year, after evaluating the stage of completion of construction

in progress, a provision for onerous construction contracts in the amount of 17 848 thousand kroons (Note 29) was recognised. Risk analysis showed that a change in the stage of completion of construction projects in the range of +/-10% will result in a change in the net profit between an increase of 257 594 thousand kroons and a decrease of 291 769 thousand kroons.

Determination of the useful lives of items of property, plant and equipment
Management has estimated the useful lives of items of property, plant and equipment, taking into consideration conditions and volumes of business activities, historical experience in this area and future outlook. Management estimates that the useful lives of buildings and facilities are between 10 and 33.3 years depending on their structure and use. The average useful lives of machinery and equipment are on average between 3 and 5 years and those of other fixtures between 2.5 to 5 years depending on the purpose of use of the asset.

1.4. Consolidation

Subsidiaries or entities that are either directly or indirectly through fellow subsidiaries controlled by the parent company AS Merko Ehitus, have been consolidated on a line-by-line basis. Control exists when the parent company owns more than one half of the voting rights of the subsidiary or otherwise has power to govern the operating and financial policies of the other entity. Subsidiaries are reported in the financial statements of the Group from the date of acquiring control until the date at which the control ceases.

The parent company and its subsidiaries are treated as one economic entity in the consolidated financial statements. Upon consolidation, intra-group receivables and liabilities, income and expenses as well as unrealised profits and losses arising from intra-group transactions have been eliminated in full. Minority interest is reported separately.

Group companies use uniform accounting policies for similar transactions occurred under similar circumstances.

1.5. Business combinations

Business combinations between independent parties are accounted for under the purchase method. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. From the date of acquisition, revenue and expenses of the acquired entity are reported in the income statement of the Group and goodwill is reported in the balance sheet of the Group.

Goodwill is the excess of the cost of acquisition over the fair value of assets acquired, reflecting the portion of the acquisition cost which was paid for such assets of the acquired entity that cannot be separated and recognised separately. Goodwill is recognised at its acquisition cost as an intangible asset at the date of acquisition.

Goodwill is subsequently measured at its acquisition cost less any impairment losses. Goodwill arising in a business combination is not amortised. Instead, an impairment test is carried out once a year. Goodwill is written down to its recoverable amount if the latter is below its carrying amount (Note 1.11).

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement

Transactions with minority interests
The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

1.6. Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

1.7. Joint ventures

Joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at acquisition cost and subsequently adjusted by the changes that have occurred in the Group's share of the net assets under common control. The income statement of the Group includes the Group's share in the profits or losses of the entity under common control.

1.8. Jointly controlled operations

Under IAS 31 "Interests in Joint Ventures", jointly controlled operations are joint operations with third parties, whereby the assets and other resources of venturers are used without the establishment of a new company or another unit or creation of a separate financial structure. Each venturer uses its own property, plant and equipment and carries its own inventories in the balance sheet. The venturer also incurs its own expenses and liabilities and raises its own funds which represent its own obligations. In respect of its interest in jointly controlled operations, a venturer recognises in its financial statements:

- the assets that it controls and the liabilities it incurs;
- the expenses that it incurs and its share of revenue that it earns from the sale of goods or services of the joint venture.

1.9. Foreign currency

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia prevailing at the dates of the transactions. Monetary financial assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing at the balance sheet date. Exchange rate differences from translation are reported in the income statement of the accounting period.

The functional currency of subsidiaries located abroad is the currency of their business environment; therefore the financial statements of such subsidiaries are translated into Estonian kroons for consolidation purposes. The asset and liability items are translated using the foreign exchange rates of the Bank of Estonia, income and expenses using the weighted average foreign exchange rates for the year and other changes in equity using the foreign exchange rates at the date at which they arose. Exchange rate differences arising from translation are reported in the equity item *Currency translation differences*.

1.10. Financial assets

The purchases and sales of financial assets are recognised at the trade date.
Depending on the purpose for which financial assets were acquired, financial assets are classified into the following categories at the Group:

- financial assets at fair value through profit or loss;
- loans and receivables not held for trading purposes;
- held-to-maturity investments;
- available-for-sale financial assets.

Management determines the classification of its financial assets at initial recognition.

Financial assets at fair value through profit or loss include financial assets held for trading purposes (i.e. assets acquired or created principally for the purpose of selling or repurchasing in the short term; a part of a jointly managed portfolio of financial instruments; or a derivative financial instrument which is not a hedging instrument) and other financial assets that have been designated by management at their initial recognition as at fair value through profit or loss. Assets in this category are classified as current assets if they are principally held for trading purposes or are expected to be sold within 12 months after the balance sheet date. After initial recognition, financial assets in this category are carried at fair value.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are included within current assets except for maturities greater than 12 months after the balance sheet date. Such assets are classified as non-current assets. Loans and receivables are initially recognised at their fair value less transaction costs. After initial recognition, the Group carries loans and receivables at amortised cost (less any impairment losses), calculating interest income on the receivable in the following periods using the effective interest rate method.

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information on the solvency of the party to transaction. Receivables whose collection is improbable are written down during the accounting period.

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement as part of other income. Dividends on available-for-sale equity instruments are recognised in the income statement as part of other income when the Group's right to receive payments is established.

The Group does not have any held-to-maturity financial assets. The Group does not have any derivatives.

1.11. Impairment of assets

Financial assets at amortised cost
The Group assesses at each balance sheet date whether there is any indication that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (loss events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that is available to the Group regarding the following events:

- significant financial difficulties of the debtor;
- a breach of contract, such as a default or delinquency in payments;
- it is probable that the debtor will enter bankruptcy;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a financial asset or a group of financial assets, although the decrease cannot yet be measured reliably.

If there is objective evidence that an impairment loss has incurred for loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have already been recognised), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Non-financial assets
Assets that have indefinite useful lives (including goodwill) are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and is compared with the carrying amount. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit). Non-financial assets other than goodwill that suffered an impairment loss are reviewed for possible reversal of impairment at each reporting date and if necessary, the impairment loss is reversed.

1.12. Inventories

Inventories are recorded in the balance sheet at their acquisition cost, which consists of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition.

In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishably from each other, then the weighted average cost method is used.

Inventories are recognised in the balance sheet at the lower of acquisition cost and net realisable value. The net realisable value is the sales price less estimated costs to sell.

Expenditure incurred for real estate development is reported in the balance sheet line *Inventories* either as work-in-progress or finished goods, depending on the stage of completion. A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Sales revenue on real estate development is recognised as income from the sale of goods (Note 1.21). Upon the sale of real estate properties, a notary certified agreement is entered into between the Group and the acquirer for transferring the property and the respective entry is made in the land register.

1.13. Investment property

Investment property is real estate property which is primarily held for the purpose of earning rental income or for capital appreciation or for both, but not for the production of goods or services, for administrative purposes or for sale in the ordinary course of business. Investment property is measured under the acquisition cost method, that is at acquisition cost less any accumulated depreciation and any accumulated impairment losses.

Buildings included in investment properties are depreciated on a straight-line basis over the period of 12.5 to 33.3 years. Land is not depreciated.

1.14. Property, plant and equipment

An item of property, plant and equipment is an asset used for production, provision of services or administrative purposes over a period longer than one year. The acquisition cost consists of the purchase price of the asset and other expenditure incurred in bringing the asset to its operating condition and location.

An item of property, plant and equipment is carried in the balance sheet at its acquisition cost less any accumulated depreciation. Subsequent expenditure incurred for items of property, plant and equipment are recognised as non-current assets when it is probable that future economic benefits associated with the asset will flow to the Group and the cost of the asset can be measured reliably. Other repairs and maintenance costs are recognised as expenses at the time they are incurred.
Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years;
- machinery and equipment 3-5 years:
- other items of property, plant and equipment 2.5-5 years;
- right of superficies 50 years;
- land is not depreciated.

At each balance sheet date, the validity of applied depreciation rates, the depreciation method and the residual values applicable to assets is assessed.

Non-current assets are written down to their recoverable amount if the latter is below its carrying amount. The recoverable amount is the higher of the asset's net selling price and its value in use.

1.15. Other intangible assets

Other intangible assets (development costs, patents, licenses, trademarks, software) are recognised in the balance sheet when the asset is controlled by the Group, it gives rise to future economic benefits and the cost of the asset can be measured reliably. The acquisition cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Other intangible assets are carried in the balance sheet at acquisition cost less any accumulated amortisation. Amortisation is calculated on a straight-line basis over the estimated useful lives of assets, which is a maximum of 5 years.

1.16. Finance and operating leases

Leases of property, plant and equipment which transfer all significant risks and rewards of ownership to the lessee are classified as finance leases. All other leases are recognised as operating leases.

Assets and liabilities leased under the finance lease terms are reported in the balance sheet at the lower of fair value of the leased asset and the present value of minimum rental payments. Items of property, plant and equipment leased under the finance lease terms are depreciated over the shorter of the lease term and the useful life.

Finance lease liabilities are reduced by principal payments; interest expenses on lease payments are included within financial expenses in the income statement.

Operating lease payments are reported in the income statement as expenses on an accrual basis over the lease term.

1.17. Corporate income tax

According to the Income Tax Act of the Republic of Estonia, legal entities are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, reception costs, dividends and payments not related to business operations. Thus there are no differences between the tax bases and the carrying values of assets which would give rise to a deferred income tax asset or liability. Starting from 01.01.2007 the tax rate on dividends payable is 22/78 (in 2006: 23/77; 2005: 24/76) of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared.

Corporate income tax on profits and deferred income tax expense or income of the subsidiaries located in Latvia and Lithuania as well as corporate income tax on dividends of Estonian companies are reported in the consolidated income statement.

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the balance sheet. Deferred tax assets are recognised in the Group's balance sheet if their future realisation is probable.

Legal entities in Latvia and Lithuania that belong to the Group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia and the Republic of Lithuania. The profits of entities located in the Republic of Latvia are taxed at the rate of 15%, the profits of entities located in the Republic of Lithuania are taxed at the rate of 15%+4% in 2006 and 15%+3% in 2007.

1.18. Borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost, calculating interest income on the borrowing in subsequent periods using the effective interest rate method.

Borrowings are classified as current when the borrower does not have a right to pay off the loan later than 12 months after the balance sheet date.
Borrowing costs are recognised as an expense in the period in which they are incurred.

1.19. Employee benefits

Termination benefits – Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of another offer made to encourage voluntary redundancy. Benefits due more than 12 months after the balance sheet date are discounted to present value.

Profit-sharing and bonus plans – The Group recognises a liability and an expense for bonuses and profit-sharing, based on formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a provision where contractually obliged or when there is past practice that has created a constructive obligation.

1.20. Provisions

Provisions are constructive or legal obligations which arise as a result of events occurring before the balance sheet date. Setting up of provisions or increasing existing provisions is recognised as expenses in the income statement of the accounting period.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense

Pursuant to respective building acts, the construction companies of the Group provide 2-year warranties on their buildings. The calculation of warranty provisions is based on management estimates and previous periods' experience with regard to actual warranty expenses.

The expected loss arising from construction contracts is immediately recognised as an expense. A provision is recognised for onerous construction contracts which have not been completed yet (Note 1.22).

1.21. Revenue

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

Revenue from construction service is recognised as revenue by reference to the stage of completion of the contract (see Note 1.22) in accordance with IAS 11 "Construction Contracts". Revenue from own real estate development projects (developed on immovables belonging to Merko Ehitus group) is recognised as revenue in accordance with IAS 18 "Revenue" when significant risks and rewards of ownership of the goods are transferred to the buyer, the receipt of payment is probable and the costs incurred in respect of the transaction can be measured reliably and it is probable that future economic benefits associated with the transaction will flow to the entity.

When goods are sold or swapped in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Revenue from the provision of services is recognised based on the stage of completion of the service at the balance sheet date.

Revenue arising from interest and dividends is recognised when it is probable that future economic benefits associated with the transaction will flow to the entity and the amount of the revenue can be measured reliably.

1.22. Construction contracts in progress

Income and expenses of construction contracts in progress have been matched under the stage of completion method. The stage of completion is determined on the basis of the relationship between the actual costs incurred by the balance sheet date and the estimated costs of the contract. The actual costs of the contract consist of direct and certain overhead costs of the construction contact.

If invoices submitted to the customer by the balance sheet date are either higher or lower than the income calculated under the stage of completion method, then the difference is recognised as a liability or as a receivable in the balance sheet.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately and in full.

1.23. Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs, which they are intended to compensate. Government grants received to compensate the operating expenses of the previous period or where there are no additional conditions attached to grants to be addressed in the future, are accounted for as income when the grant is received. Government grants are recognised when there is reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

1.24. Cash and cash equivalents

In the balance sheet and the cash flow statement, cash and cash equivalents comprise highly liquid funds with low variation in value, such as cash on hand, cash in bank accounts, highly liquid securities such as money market funds and term deposits with maturities of three months or less.
The indirect method has been used for the preparation of the cash flow statement.

1.25. Contingent liabilities

Contingent liabilities are those liabilities which realisation is less probable than non-realisation and the amount of which cannot be determined reliably. Contingent liabilities are not recognised in the balance sheet, but they are disclosed in the notes to the financial statements.

1.26. Statutory reserve capital

Reserve capital is formed to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be entered in reserve capital, until reserve capital reaches one-tenth of share capital. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

1.27. Events after the balance sheet date

The financial statements of the reporting period include material circumstances affecting the assessment of assets and liabilities which became evident between the balance sheet date and the date of preparing the financial statements but that are related to transactions in the accounting period or previous periods. Material events after the balance sheet date not related to transactions in the accounting period or previous periods are not reported in the balance sheet but they are disclosed in the notes to the financial statements.

1.28. Dividend distribution

The distribution of dividends to the Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

1.29. Segment reporting

A business segment is a part of the Group engaged in making similar products or providing similar services and whose profitability and risks differ from those of other parts of the Group. The business segments at the Group comprise construction, road construction, construction of communication networks and production of concrete elements. Segment expenses are those which are incurred in the segment's main operations and which can be allocated to the segment reliably and objectively. Such expenses, assets and liabilities have not been allocated to segments that cannot be or are not suitable to be associated with a specific segment. In preparing the financial statements, business segments have been considered as primary segments.

A geographical segment is a part of the Group where operating activities occur in an economic environment in which returns and risks differ from those of other parts of the Group. The main geographical segments at the Group are Estonia, Latvia and Lithuania. In preparing the financial statements, geographical segments have been considered as secondary segments.

The main operating environment of the parent company is Estonia. All business segments of the Group are represented in Estonia. Construction is the main business segment in Latvia and Lithuania. Segment revenue is shown according to geographical segments of markets and segment assets, according to geographical locations of assets.

Note 2 Business and geographical segments

in thousands of kroons

Business segments

2006	General construction	Road construction	Concrete elements	Group
Consolidated revenue	4 097 263	317 098	-	4 414 361
Inter-segmental revenue	377 656	104 117	-	481 773
Segment revenue	4 474 919	421 215	-	4 896 134
Segment operating profit	596 374	36 497	-	632 871
Financial income/expenses				7 733
incl. profit/loss from associates and joint ventures (Note 19)	(416)	-	17 877	17 461
Profit before tax				640 604
Corporate income tax				(49 913)
Net profit of the Group				590 691
incl. attributable to equity owners of the parent company				581 738
minority interest				8 953
Segment assets	2 772 635	187 047	-	2 959 682
Associates and joint ventures	160 619	-	40 179	200 798
Unallocated liabilities				54 049
Total consolidated assets				3 214 529
Segment liabilities	1 033 996	63 825	-	1 097 821
Unallocated liabilities				503 862
Total consolidated liabilities				1 601 683
Purchase of property, plant and equipment and intangible assets	80 654	12 510	-	93 164
Depreciation and impairment (Notes 22-24)	22 377	8 370	-	30 747

2005	General construction	Road construction	Concrete elements	Construction of communi-cation networks	Group
Consolidated revenue	3 028 386	204 006	-	-	3 232 392
Inter-segmental revenue	4 773	34 338	-	-	39 111
Segment revenue	3 033 159	238 344	-	-	3 271 503
Segment operating profit	416 770	18 281	-	-	435 051
Financial income/expenses					28 673
incl. profit/loss from associates and joint ventures (Note 19)	5 839	1 924	10 660	1 209	19 632
Profit before tax					463 724
Corporate income tax					(18 437)
Net profit of the Group					445 287
incl. attributable to equity owners of the parent company					438 638
Minority interest					6 649
Segment assets	1 856 012	121 555	-	-	1 977 567
Associates and joint ventures	150 773	-	25 302	3 534	179 609
Unallocated assets					62 700
Total consolidated assets					2 219 876
Segment liabilities	715 238	37 671	-	-	752 909
Unallocated liabilities					355 019
Total consolidated liabilities					1 107 928
Purchase of investment property	63	-	-	-	63
Property, plant and equipment and intangible assets	227 228	9 015	-	-	236 243
Depreciation and impairment (Notes 22-24)	99 525	10 112	-	-	109 637

Costs, assets and liabilities that cannot be related to a specific asset or it is not practical to do so are considered as unallocated.

Geographical segments

Revenue	Group	
	2006	2005
Estonia	2 794 317	2 441 325
Latvia	1 055 632	560 107
Lithuania	564 412	230 960
Total	4 414 361	3 232 392

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	Total assets		Purchase of investment property		Purchase of property, plant and equipment	
	31.12.2006	31.12.2005	2006	2005	2006	2005
Estonia	1 700 964	1 033 085	-	39	27 018	20 440
Latvia	1 244 312	991 929	-	24	65 699	215 356
Lithuania	269 253	194 862	-	-	447	447
Total	3 214 529	2 219 876	-	63	93 164	236 243

Note 3 Revenue

in thousands of kroons

	Group	
	2006	2005
Rendering of services	3 535 810	2 751 778
Sale of real estate and real estate development projects	831 490	475 748
Rental income	45 272	2 354
Sale of goods	1 789	2 512
Total revenue	4 414 361	3 232 392

In 2005, revenue included 86.3 million kroons generated by non-cash inventory exchange transactions (immovables located on nature preserve areas were exchanged with the Government of the Republic of Estonia for non-restricted immovables owned by the state). In 2006, there were no non-cash transactions with inventories.

Note 4 Cost of goods sold

in thousands of kroons

	Group	
	2006	2005
Materials	369 094	367 736
Construction services	2 592 026	1 934 926
Properties purchased for resale	215 889	78 303
Staff costs	247 902	152 619
Depreciation and impairment charge	25 098	15 253
Design	72 851	72 115
Construction mechanisms and transport	108 629	82 951
Other expenses	96 072	34 811
Total cost of goods sold	3 727 561	2 738 714

Note 5 Marketing costs

in thousands of kroons

	Group	
	2006	**2005**
Staff costs	9 407	11 651
Depreciation and impairment charge	356	253
Advertising, sponsorship	9 015	5 017
Transport	1 268	1 256
Construction tenders	900	918
Other expenses	2 444	3 500
Total marketing costs	23 390	22 595

Note 6 General and administrative expenses

in thousands of kroons

	Group	
	2006	**2005**
Staff costs	95 827	72 967
Depreciation and impairment charge	5 293	4 793
Computer equipment and information services	7 080	10 413
Transport	6 820	5 677
Offices expenses, communications services	16 701	14 638
Other expenses	17 071	19 144
Total general and administrative expenses	148 792	127 632

Note 7 Other operating income

in thousands of kroons

	Group	
	2006	**2005**
Profit from sale of non-current assets	122 403	535
Fines and amounts for delay received	1 223	971
Foreign exchange gains	-	16
Interest income from operating activities	2 335	5 590
Revenue from government grants (Note 28)	20 727	177 333
Other income	1 517	607
Total other operating income	148 205	185 052

Profit from sale of non-current assets in 2006 include the profit from the sale of multifunctional hall Arena Riga by subsidiary SIA Merks in the amount of 122 053 thousand kroons (Note 23).

Note 8 Other operating expenses

in thousands of kroons

	Group	
	2006	**2005**
Fines, penalties	1 339	2 790
Foreign exchange loss	10	-
Gifts, donations	4 674	904
Impairment charge (Note 23)	-	89 338
Expenses of arranging ice-hockey world championship	22 522	-
Other expenses	1 407	420
Total other operating expenses	29 952	93 452

Note 9 Financial income

in thousands of kroons

	Group	
	2006	**2005**
Financial income from other long-term loans and receivables	7	11
Interest income	6 462	1 470
Gains from available-for-sale financial assets	618	3
Other financial income	1 216	4 769
Total financial income	8 303	6 253

Note 10 Financial expenses

in thousands of kroons

	Group	
	2006	**2005**
Interest expenses	14 288	2 418
Foreign exchange loss	6 064	2 277
Other financial expenses	1	15
Total financial expenses	20 353	4 710

Note 11 Corporate income tax

in thousands of kroons

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate applicable to profits of the consolidated entities as follows:

2006	**2006**			
	Latvia	**Lithuania**	**Estonia**	**Total**
Profit before tax	271 450	25 031	344 127	640 608
Tax rate applicable to profits	15%	19%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(40 717)	(4 756)	-	(45 473)
Tax calculated on expenses not deductible for tax purposes	(49)	(91)	-	(140)
Tax calculated on income not subject to tax	1 295	17	-	1 312
Corporate income tax on dividends	-	-	(5 616)	(5 616)
Tax charge	**(39 471)**	**(4 830)**	**(5 616)**	**(49 917)**
Incl current tax	(18 925)	-	(5 616)	(24 541)
deferred tax charged/(credited) to the income statement (Note 21)	(20 546)	(4 830)	-	(25 376)

2005				
	Latvia	**Lithuania**	**Estonia**	**Total**
Profit before tax	91 113	17 252	355 359	463 724
Tax rate applicable to profits	15%	19%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(13 667)	(2 588)	-	(16 255)
Tax calculated on expenses not deductible for tax purposes	(570)	(477)	-	(1 047)
Tax calculated on income not subject to tax	-	1 243	-	1 243
Tax losses for which no deferred income tax asset was recognised	-	6 452	-	6 452
Corporate income tax on dividends	-	-	(8 830)	(8 830)
Tax charge	**(14 237)**	**4 630**	**(8 830)**	**(18 437)**
Incl current tax	(2 852)	-	(8 830)	(11 682)
deferred tax charged/(credited) to the income statement	(11 385)	4 630	-	(6 755)

As at 31.12.2006, it is possible to pay out dividends to shareholders from retained earnings in the amount of 1 091 409 thousand kroons and the corresponding income tax would amount to 307 833 thousand kroons. As at 31 December 2005 (taking into account the statutory requirement to increase the statutory reserve capital), it would have been possible to pay out 698 156 thousand kroons as dividends, and the corresponding income tax would have amounted to 208 540 thousand kroons.

Note 12 Earnings per share

Basic earnings per share for profit attributable to equity holders of the parent company has been derived by dividing the net profit attributable to shareholders by the weighted average number of shares.

	2006	2005
Net profit attributable to shareholders *(in thousands of kroons)*	581 738	438 638
Weighted average number of ordinary shares *(thousand pcs)*	17 700	17 700
Earnings per share (in kroons)	32,87	24,78

In 2005 and 2006, the Group did not have any potential ordinary shares to be issued; therefore the diluted earnings per share equal the basic earnings per share.

Note 13 Dividends per share

Dividends payable are recognised after the approval of profit allocation at the General Meeting of Shareholders. According to the profit allocation proposal 123 900 thousand kroons will be distributed as dividends in 2007, i.e. 7.00 kroons per share and the accompanying maximum income tax expense will amount to 22/78 of the amount payable, i.e. 34 946 thousand kroons.
In 2006, 88 500 thousand kroons, i.e. 5.0 kroons per share were paid, on which AS Merko Ehitus did not need to pay corporate income tax due to the taxable dividends received from subsidiaries. In 2005, dividends paid amounted to 57 525 thousand kroons, i.e. 6.50 kroons per share, on which income tax amounted to 4 446 thousand kroons.

Note 14 Cash and cash equivalents

in thousands of kroons	Group	
	31.12.2006	31.12.2005
Cash on hand	155	97
Bank accounts	437 456	135 577
Short-term deposits	238 532	121 258
Units of Estonian money market funds	-	11 514
Total cash and bank	676 143	268 446

As at 31.12.2006, the interest on short-term overnight bank deposits was 3.37% (31.12.2005: 2.15) and the weighted average interest on term deposits was 3.85% (2005: 2.5%). As at 31.12.2006, the average maturity of bank deposits was 25.6 days (31.12.2005: 7.6 days).

Note 15 Trade and other receivables

in thousands of kroons

	Group	
	31.12.2006	**31.12.2005**
Trade receivables		
accounts receivable	552 732	296 626
allowance for doubtful receivables	(1 370)	(345)
	551 362	296 281
Corporate income tax paid		
value added tax	32 183	34 193
social security tax	171	6
other taxes	199	-
	32 553	34 199
Amounts due from customers for contract work (Note 33)	135 408	82 224
Other short-term receivables		
short-term loans (Note 16)	34 883	49 481
interest receivables	2 913	1 846
other short-term receivables	1 549	6 026
	39 345	57 353
Prepayments for services		
prepayments for construction services	86 326	68 357
prepaid insurance	2 245	1 062
other prepaid expenses	6 864	2 634
	95 435	72 053
Total trade and other receivables	854 103	542 110

Note 16 Loans granted

in thousands of kroons

	Group	
	2006	**2005**
Loans granted to associates		
Loan balance at beginning of the year	21 325	49 155
Granted	10 950	28 005
Collected	(7 525)	(37 440)
Reclassification to loan granted to subsidiary	-	(18 395)
Loan balance at end of the year	24 750	21 325
incl. current portion	24 750	21 325
Average effective interest rate 6.5% (2005: 6.2%)		
Loans granted to entities controlled by the parent company		
Loan balance at beginning of the year	6 565	5 991
Granted	264 286	83 243
Reclassification of loan granted to subsidiary	2 046	31 183
Reclassification of loan granted to related party	1 473	-
Collected	(261 670)	(66 183)
Loan balance at beginning of the year	-	(47 669)

Loan balance at end of the year	12 700	6 565
incl. current portion	8 896	6 565
non-current portion 2...5 years	3 804	-
Average effective interest rate 4.5% (2005: 4.0%)		
Loans granted to other related parties		
Loan balance at beginning of the year	1 973	380
Granted	-	1 593
Collected	(500)	-
Reclassification to loan granted to entities controlled by the parent company	(1 473)	-
Loan balance at end of the year	-	1 973
incl. current portion	-	500
non-current portion 2...5 years	-	1 473
Average effective interest rate 4.5% (2005: 1.0%)		
Loans granted to non-related legal entities		
Loan balance at beginning of the year	20 930	17 754
Granted	117	76 860
Reclassification from other receivables	1 009	-
Collected	(16 906)	(72 678)
Reclassification to other receivables	(3 973)	(1 006)
Loan balance at end of the year	1 177	20 930
incl. current portion	1 177	20 679
non-current portion 2…5 years	-	251
Average effective interest rate 4.0% (2005: 3.5%)		
Loans to other non-related private individual		
Loan balance at beginning of the year	412	-
Granted	-	422
Collected	(352)	(10)
Loan balance at end of the year	60	412
incl. current portion	60	412
Average effective interest rate 3.7% (2005: 3.7%)		
Total loans granted		
Loan balance at beginning of the year	51 205	73 280
Granted	275 353	190 123
Reclassification of loan granted to subsidiary	2 046	31 183
Reclassification from other receivables	1 009	-
Collected	(286 953)	(176 311)
Reclassification to loan granted to subsidiary	-	(66 064)
Reclassification to other receivables	(3 973)	(1 006)
Loan balance at end of the year	38 687	51 205
incl. current portion (Note 15)	34 883	49 481
non-current portion 2…5 years (Note 20)	3 804	1 724

Note 17 Inventories

in thousands of kroons	Group	
	31.12.2006	**31.12.2005**
Materials	4 579	1 845
Work-in-progress	567 868	200 482
Finished goods	18 121	4 461
Goods for resale		
land purchased for resale	723 334	752 789
*incl. immovables located on nature preserve areas**	*61 098*	*53 625*
other goods purchased for resale	107	11
	723 441	752 800
Prepayments for inventories		
prepayments for real estate properties	34 767	4 500
prepayments for other inventories	7 958	-
	42 725	4 500
Total inventories	1 356 734	964 088

* There are strict building restrictions on immovables located on nature preserve areas. These immovables can be used for real estate development only by exchanging these with the Government of the Republic of Estonia. According to Nature Conservation Act an immovable which is located within the territory of a protected area, special conservation area or species protection site and whose use for its intended purposes is significantly hindered by the protection procedure may be exchanged for an immovable owned by the state based on an agreement between the state and the owner of the immovable, or may be acquired (based on a decision of the Government of the Republic of Estonia) by the state for a charge equivalent to the usual value of the immovable if the owner of the immovable agrees (§ 19 and 20 of Nature Conservation Act).
The management of the Group is on the opinion that Estonian legislation at the date of signing this annual report allows to exchange those immovables for other, unrestricted immovables (with at least similar value) with Estonian state, and consequently the Group has not assumed any significant risks which would trigger the need for impairment of the immovables referred to above.

Note 18 Shares in subsidiaries

in thousands of kroons

	Participation and voting rights % 31.12.2006	31.12.2005	Location	Area of operation
Subsidiaries of AS Merko Ehitus				
AS Gustaf	75	100	Pärnu	construction
AS Merko Tartu	66	66	Tartu	construction
AS Merko Inseneriehitus	100	100	Tallinn	construction
OÜ Merko Ehitustööd	100	100	Tallinn	construction
Eesti Ehitusekspordi OÜ	100	100	Tallinn	construction
Tallinna Teede AS	100	100	Tallinn	road construction
SIA Merks	100	100	Republic of Latvia, Riga	construction
UAB Merko Statyba	100	100	Republic of Lithuania, Vilnius	construction
OÜ Merko Elamu	100	100	Tallinn	real estate
OÜ Merko Maja	100	100	Tallinn	real estate
OÜ Merko Kinnisvara	-	100	Saue	real estate
OÜ Woody	100	100	Tallinn	real estate
OÜ Gustaf Tallinn	80	80	Tallinn	construction
OÜ Rannamõisa Kinnisvara	-	100	Tallinn	real estate
OÜ Maavõlur	100	100	Tallinn	real estate
OÜ Rae Tehnopark	100	100	Tallinn	real estate
OÜ Maryplus	100	100	Tallinn	real estate
OÜ Metsailu	100	100	Tallinn	real estate
OÜ Pire Projekt	100	100	Tallinn	real estate
OÜ Constancia	100	100	Tallinn	real estate
OÜ Käibevara	100	100	Tallinn	real estate
OÜ Baltic Electricity Engineering	100	100	Tallinn	electricity systems

In May 2006, AS Merko Ehitus sold its subsidiary OÜ Merko Kinnisvara which had not started its operating activities yet. In July 2006, AS Merko Ehitus sold 25% of the shares of its subsidiary AS Gustaf.
In December 2006, AS Merko Ehitus sold its subsidiary OÜ Rannamõisa Kinnisvara to a related party (see note 34). In accordance with the substance and economic reality (subsidiary was a one-asset-company; assets comprised of land purchased for resale), the sales transaction was recognised as a sale of land included within inventories at the Group.
In 2006, Merko Ehitus group companies paid 3029 thousand kroons for shares in subsidiaries acquired during previous years.

Proceeds from sales of subsidiaries

	OÜ Merko Kinnisvara	AS Gustaf	Total
Participations sold	100%	25%	
Carrying amount of participations sold	42	2 801	2 843
Sales price	40	5 125	5 165
Profit from sale	2	2 324	2 326
Cash received	40	-	40
Cash and cash equivalents of subsidiary from sale	(42)	-	(42)
Cash flows from sale at the Group	(2)	-	(2)
Sales consideration receivable (Note 20)	-	4 624	4 624

Note 19 Investments into associates and joint ventures

	Participation and voting rights % 31.12.2006	31.12.2005	Location	Area of operation
Associates of AS Merko Ehitus				
AS Tartu Maja Betoontooted	25	25	Tartu	concrete elements
AS Telegrupp	-	31	Tallinn	telecommunications
Joint ventures of AS Merko Ehitus				
Normanni Linnagrupi AS	50	50	Tallinn	construction
OÜ Unigate	50	50	Tallinn	real estate
OÜ Tornimäe Apartments	50	50	Tallinn	real estate
Joint ventures of SIA Merks				
PS Merks Terbe Lat	50	50	Republic of Latvia, Riga	construction
SIA Zakusala Estates	50	50	Republic of Latvia, Riga	real estate
Associate of AS Merko Tartu				
OÜ Kortermaja	50	50	Tartu	real estate

In February 2006, AS Merko Ehitus sold a 12% holding in its associate AS Telegrupp. The remaining 19% holding was recognised as available-for-sale financial assets and the total holding was sold in July of the same year.

in thousands of kroons

	Investment at 31.12. 05	Changes occurred in 2006: acquisition, sale and liquidation	Profit / (loss) from associates and joint ventures	dividends	currency translation adjustment	Investment 31.12. 06	Participation in equity of investee
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	25 302	-	17 877	(3 000)	-	40 179	40 179
AS Telegrupp	3 534	(4 233)	699	-	-	-	-
Total associates	28 836	(4 233)	18 576	(3 000)	-	40 179	40 179
Joint ventures AS Merko Ehitus							
Normanni Linnagrupi AS	422	-	(9)	-	-	413	413
OÜ Unigate	92	-	(70)	-	-	22	22
OÜ Tornimäe Apartments	24	-	98	-	-	122	122
Joint ventures of SIA Merks							
PS Merks Terbe Lat	12	-	396	-	(2)	406	406
SIA Zakusala Estates	148 319	11 238	(1 939)	-	(275)	157 343	10 191
Joint venture of AS Merko Tartu							
OÜ Kortermaja	1 904	-	409	-	-	2 313	4 160
Total joint ventures	150 773	11 238	(1 115)	-	(277)	160 619	15 314
Total associates and joint ventures	179 609	7 005	17 461	(3 000)	(277)	200 798	55 493

in thousands of kroons

	Investment 31.12. 04	Changes in 2005: acquisition, sale and liquidation	Changes in 2005: profit/loss from associates and joint ventures	Changes in 2005: dividends	Changes in 2005: Currency translation adjustment	Investment at 31.12. 05	Participation in equity of investee
Associates of AS Merko Ehitus							
AS Tartu Maja Betoontooted	16 142	-	10 660	(1 500)	-	25 302	25 302
AS Telegrupp	6 292	(2 257)	1 209	(1 710)	-	3 534	3 534
Associate of OÜ Talbit							
AS Bituumen	3 627	(5 550)	1 923	-	-	-	-
Total associates	26 061	(7 807)	13 792	(3 210)	-	28 836	28 836
Joint venture of AS Merko Ehitus							
Normanni Linnagrupi AS	389	-	33	-	-	422	422
AS Insenervõrgud	623	(499)	(124)	-	-	-	-
OÜ Pire Projekt	849	(5 800)	4 951	-	-	-	-
OÜ Constancia	760	(1 384)	624	-	-	-	-
OÜ Unigate	412	-	(320)	-	-	92	92
OÜ Tornimäe Apartments	19	-	5	-	-	24	24
Joint ventures of SIA Merks							
PS Merks Terbe Lat	5 100	-	-	(5 099)	11	12	(4)
SIA Zakusala Estates	-	148 319	-	-	-	148 319	910
Joint venture of AS Merko Tartu							
OÜ Kortermaja	1 233	-	671	-	-	1 904	2 012
Total joint ventures	9 385	140 636	5 840	(5 099)	11	150 773	3 456
Total associates and joint ventures	35 446	132 829	19 632	(8 309)	11	179 609	32 292

As at 31.12.2006, the difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee totalling 1847 thousand kroons (2005: 108 thousand kroons) is due to the effect from the unrealised gains of mutual transactions.

As at 31.12.2006, the investment into the joint venture SIA Zakusala Estates includes intangible assets in the amount of 147 152 thousand kroons (2005: 147 409 thousand kroons). The assets and liabilities of the joint venture are immaterial, but it has a signed a lease agreement with the City of Riga expiring at 2 June 2051 which gives it a right to use the 126 thousand m^2 registered immovable on Zakusala island in the centre of Riga. This intangible asset represents a payment for future economic benefits that arise from the aforementioned right to use the property.

Associates *in thousands of kroons*	**Assets 31.12.**	**Liabilities 31.12.**	**Revenue**	**Net profit**
2006				
AS Tartu Maja Betoontooted	272 892	112 176	442 962	71 508
2005				
AS Tartu Maja Betoontooted	244 556	143 348	249 750	42 629
AS Telegrupp	25 139	13 700	76 923	1 257

Joint ventures *in thousands of kroons*	**Assets 31.12.**		**Liabilities 31.12.**		**Equity 31.12.**	**Income**	**Expenses**	**Net profit/loss**
	Current assets	**Non-current assets**	**current**	**non-current**				
2006								
Normanni Linnagrupi AS	826	-	-	-	826	56	73	(17)
OÜ Unigate	25 488	-	13 260	12 184	44	-	139	(139)
OÜ Tornimäe Apartments	204 795	-	204 568	-	227	195	17	178
PS Merks Terbe Lat	811	-	8	-	802	884	73	811
SIA Zakusala Estates	11 810	8 870	299	-	20 381	187	4 063	3 876
OÜ Kortermaja	54 084	-	14 124	31 638	8 322	27 772	23 474	4 298
2005								
Normanni Linnagrupi AS	1 399	-	-	555	844	11 084	11 018	66
AS Insenervõrgud	-	-	-	-	-	6	252	(246)
OÜ Pire Projekt	-	-	-	-	-	25 367	15 465	9 902
OÜ Constancia	-	-	-	-	-	14 502	13 254	1 248
OÜ Unigate	18 940	-	15 055	3 701	184	6	647	(641)
OÜ Tornimäe Apartments	158 184	-	105 617	52 518	49	21	11	10
PS Merks Terbe Lat	921	-	928	-	(7)	5	34	(29)
SIA Zakusala Estates	1 524	1 122	825	-	1 821	3 151	5 159	(2 008)
OÜ Kortermaja	16 635	-	12 611	-	4 024	17 804	16 543	1 261

Note 20 Other long-term loans and receivables

in thousands of kroons

	Group 31.12.2006	**Group 31.12.2005**
Long-term loans (Note 16)	3 804	1 724
Long-term receivable from buyer of business unit*	-	6 800
Long-term receivable from the acquirer of a subsidiary (Note 18)**	4 624	-
Long-term receivables from customers of construction services	48	-
Total other long-term loans and receivables	8 476	8 524

* In 2004, Tallinna Teede AS sold a project management and supervision unit of related road maintenance works. As at 31.12.2006, the payable had been paid by the buyers.

** In 2006, AS Merko Ehitus sold 25% of the shares of the subsidiary AS Gustaf. The receivable is discounted at a 5% interest rate.

Note 21 Deferred income tax assets and liabilities

in thousands of kroons

Income tax assets and liabilities arisen at the subsidiaries SIA Merks and UAB Merko Statyba:

31.12.2006

	Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	2 669	3 923	6 592
incl tax loss carryforwards	-	3 062	3 062
effect of carrying amount of property, plant and equipment	2 669	-	2 669
effect of stage of completion method	-	443	443
other	-	418	418
Net deferred income tax assets / (liabilities)	**2 669**	**3 923**	**6 592**
Deferred income tax charge of the financial year (Note 11)	20 546	4 830	25 376
Reclassification*	(34 600)	-	(34 600)
Net change in deferred tax balance	(14 054)	4 830	(9 224)

31.12.2005

	Latvia	Lithuania	Total
Deferred income tax liability*	34 600	-	34 600
incl effect of difference between fair value and carrying amount of real estate inventories	34 600	-	34 600
Deferred income tax assets	23 215	8 753	31 968
incl tax loss carryforwards	-	8 351	8 351
effect of carrying amount of property, plant and equipment	20 608	-	20 608
effect of other provisions	1 682	-	1 682
other	925	402	1 327
Net deferred income tax assets / (liabilities)	**(11 385)**	**8 753**	**(2 632)**

* The effect of difference between fair value and carrying amount of real estate inventories (in 2005 in Latvia in the amount of 34 600 thousand kroons) was reclassified from deferred tax liability to actual tax liability in 2006 due to changes in management estimates, and the amount was paid to State Revenue Service in Latvia in 2006.

In Lithuania tax losses can be carried forward for 5 years and the management considers it likely that respective tax losses will be utilized against future profits.

Note 22 Investment property

in thousands of kroons

	Land	Buildings	Prepayments	Total
Cost at 31.12.2004	56 919	4 172	1 427	62 518
Accumulated depreciation at 31.12.2004	-	(1 129)	-	(1 129)
Carrying amount at 31.12.2004	56 919	3 043	1 427	61 389
Acquisitions	63	-	-	63
Reclassification	(21 348)	4 254	(1 427)	(18 521)
Depreciation charge	-	(425)	-	(425)
Carrying amount at 31.12.2005	35 634	6 872	-	42 506
Cost at 31.12.2005	35 634	8 959	-	44 593
Accumulated depreciation at 31.12.2005	-	(2 087)	-	(2 087)
Carrying amount at 31.12.2005	35 634	6 872	-	42 506
Write-offs	-	(2 331)	-	(2 331)
Reclassification	(33 500)	(2 432)	-	(35 932)
Depreciation charge	-	(343)	-	(343)
Carrying amount at 31.12.2006	2 134	1 766	-	3 900
Cost at 31.12.2006	2 134	2 589	-	4 723
Accumulated depreciation at 31.12.2006	-	(823)	-	(823)
Carrying amount at 31.12.2006	2 134	1 766	-	3 900

At 31.12.2006, the carrying amount of the investment property does not significantly differ from their fair values (31.12.2005: the fair value was 110 442 thousand kroons).
In 2006, the Group reclassified land in the amount of 33 500 thousand kroons from investment property into inventories, and reclassified buildings to property, plant and equipment in the amount of 2432 thousand kroons. Write-offs in the amount of 2331 thousand kroons relate to the pulling down of useless buildings.

In 2005 the Group reclassified a land in the amount of 21 348 thousand kroons and a prepayment in the amount of 1427 thousand kroons into inventory. Also a part of a building being leased out was reclassified from property, plant and equipment (PPE) to Investment Property, the reclassification amounted to 4254 thousand kroons.

Investment property has not been acquired for the purpose of earning rental income but for capital appreciation or development in the future. Buildings located on the plot of land have been temporarily leased out under the operating lease terms. Rental income receivable, maintenance costs incurred and improvement expenses are immaterial.

Note 23 Property, plant and equipment

in thousands of kroons

	Land	Buildings	Right of super-ficies	Machinery and equipment	Other	Construction in progress	Prepayments	Total
Cost at 31.12.2004	145	7 020	458	81 389	35 090	65 027	872	190 001
Accumulated depreciation at 31.12.2004	-	(2 549)	(67)	(33 503)	(19 501)	(54 993)	(872)	(111 485)
Carrying amount at 31.12.2004	145	4 471	391	47 886	15 589	10 034	-	78 516
Foreign exchange rate changes	-	-	-	-	(2)	(8)	-	(10)
Acquisitions	-	-	-	10 968	10 504	209 350	1 394	232 216
Sales	-	-	-	(1 102)	(506)	-	-	(1 608)
Reclassification	-	8 384	-	-	-	(12 639)	(124)	(4 379)
Write-offs	-	-	-	(76)	(201)	-	-	(277)
Depreciation charge	-	(447)	(9)	(8 794)	(6 866)	-	-	(16 116)
Impairment charge	-	-	-	-	-	(89 338)	-	(89 338)
Carrying amount at 31.12.2005	145	12 408	382	48 882	18 518	117 399	1 270	199 004
Cost at 31.12.2005	145	14 872	458	88 070	42 794	260 100	1 270	407 709
Accumulated depreciation at 31.12.2005	-	(2 464)	(76)	(39 188)	(24 276)	(142 701)	-	(208 705)
Carrying amount at 31.12.2005	145	12 408	382	48 882	18 518	117 399	1 270	199 004
Foreign exchange rate changes	-	-	-	-	20	4	-	24
Acquisitions	-	8 042	-	12 893	34 151	29 841	1 510	86 437
Sales	-	(142 592)	-	(586)	(25 137)	-	-	(168 315)
Reclassification	-	143 670	-	(440)	6 740	(146 691)	(2 780)	499
incl. to non-current assets available for sale	-	-	-	(733)	-	-	-	(733)
Write-offs	-	-	-	(3)	(165)	-	-	(168)
Depreciation charge	-	(6 282)	(10)	(9 476)	(11 268)	-	-	(27 036)
Carrying amount at 31.12.2006	145	15 246	372	51 270	22 859	553	-	90 445
Cost at 31.12.2006	145	18 682	458	92 430	51 257	553	-	163 525
Accumulated depreciation at 31.12.2006	-	(3 436)	(86)	(41 160)	(28 398)	-	-	(73 080)
Carrying amount at 31.12.2006	145	15 246	372	51 270	22 859	553	-	90 445

Impairment charge during 2005 in the amount of 89 338 thousand kroons related to multifunctional hall Arena Riga. Considering the experience in neighbouring countries, where the recoverable amount of multifunctional halls established has been lower than the constructions cost, the management carried out the impairment test of the Arena Riga in order to assess the recoverable amount of the hall as at 31.12.2005. Taking into account the specifics of the hall, lack of active market and absence of a sales offer, determining the fair value of the hall through comparative sales arrangements was not feasible. Therefore the recoverable value was determined via value in use. In order to determine the value in use, the management analysed the indices of similar multifunctional halls in Estonia and Lithuania (number of events per year, average number of visitors per event day, average revenue/expense per event and visitor, expenses per halls usable area and visitor, etc.) and composed a business plan of the hall based on these indices. The cash-flows for the following 10 years and the present value of these cash-flows were generated based on the model. As a result of the impairment test and the recoverable amount determined, the hall was written down by 89 338 thousand kroons. As the Group had no experience in this field, it was not feasible to compare the cash-flow prognosis and assumptions with historical data.
In 2006, the Arena Riga was sold by subsidiary SIA Merks and reported as the sale of buildings in the table above. The profit from the sale amounted to 122 053 thousand kroons.

Information on leased assets is provided in Note 25 and on lease payments in Note 26.

Note 24 Intangible assets

in thousands of kroons

	Goodwill	Negative goodwill	Other	Prepayments	Total
Cost at 31.12.2004	3 163	(6 773)	1 098	1 224	(1 288)
Accumulated amortisation at 31.12.2004	(1 160)	4 064	(506)	-	2 398
Carrying amount at 31.12.2004	2 003	(2 709)	592	1 224	1 110
Derecognition of negative goodwill according to IFRS 3 as at 01.01.2005	-	2 709	-	-	2 709
Acquisitions	1 110	-	1 294	1 623	4 027
Write-offs	(3 113)	-	(21)	-	(3 134)
Amortisation charge	-		(347)	-	(347)
Carrying amount at 31.12.2005	-	-	1 518	2 847	4 365
		-			
Cost at 31.12.2005	-	-	2 371	2 847	5 218
Accumulated amortisation at 31.12.2005	-		(853)	-	(853)
Carrying amount at 31.12.2005	-	-	1 518	2 847	4 365
		-			
Acquisitions	-	-	2 059	4 668	6 727
Sales	-	-	(46)	-	(46)
Amortisation charge	-		(869)	-	(869)
Carrying amount at 31.12.2006	-	-	2 662	7 515	10 177
		-			
Cost at 31.12.2006	-	-	4 368	7 515	11 883
Accumulated amortisation at 31.12.2006	-	-	(1 706)	-	(1 706)
Carrying amount at 31.12.2006	-	-	2 662	7 515	10 177

Prepayments for intangible assets relate to prospective replacement of Group's accounting software. As at 01.01.2005 the carrying amount of negative goodwill was charged to retained earnings.

Note 25 Leased assets

in thousands of kroons	Group	
	2006	**2005**
Assets acquired under finance lease terms		
Machinery and equipment		
Cost	49 324	38 144
Accumulated depreciation	(12 076)	(7 470)
incl. depreciation charge	(4 606)	(3 077)
Carrying amount	37 248	30 674
Assets acquired under operating lease terms		
Right of superficies		
Payments made in financial year	93	93
Future lease payments		
incl. payments in next financial year	93	238
payments in 2…5 years	372	1 188
payments after year 5	3 806	9 720

On the basis of cancellable lease agreements, operating lease payments totalling to 8028 thousand kroons (2005: 5489 thousand kroons) were paid for passenger cars in 2006.

Note 26 Borrowings

in thousands of kroons	Group	
	2006	**2005**
Finance lease payables		
Present value of lease payments at beginning of the year	25 098	16 959
Received	11 916	13 971
Paid	(11 163)	(5 832)
Present value of lease payments at end of the year	25 851	25 098
incl. current portion	8 367	9 697
non-current portion 2...4 years	17 484	15 401
Interest expense of financial year	1 316	955
Minimum future lease payments:	26 000	30 118
Average effective interest rate 5.0% (2005: 5.0%)		
Base currencies EEK, EUR and LVL		

Loans

Bank loans		
Loan balance at beginning of the year	292 567	5 202
Received	268 726	293 567
Paid	(144 017)	(6 202)
Loan balance at end of the year	417 276	292 567
incl. current portion	275 425	105 144
non-current portion 2…5 years	141 851	187 423
Interest expense of financial year	12 474	3 356

Average effective interest rate 4.5% (2005: 4.0%)
Base currency EUR

Loans from associates and joint ventures		
Loan balance at beginning of the year	-	3 941
Paid	-	(3 941)*
Loan balance at end of the year	-	-

Loans from entities controlled by the parent company		
Loan balance at beginning of the year	-	522
Paid	-	(522)
Loan balance at end of the year	-	-

Total loans		
Loan balance at beginning of the year	292 567	9 665
Received	268 726	293 567
Paid	(144 017)	(10 665)*
Loan balance at end of year	417 276	292 567
incl. current portion	275 425	105 144
non-current portion 2…5 years	141 851	187 423
Total borrowings	443 127	317 665
incl. current portion	283 792	114 841
Non-current portion 2...5 years	159 335	202 824

* includes a non-monetary transaction, a net settlement against dividends receivable in amount of 3941 thousand kroons.

Long-term bank loans have floating rates related to EURIBOR or RIGIBOR (Riga Interbank Offered Rate - the index of Latvian interbank credit interest rates). The exposure of the Group's bank borrowings to interest rate changes and the contractual repricing dates at the balance sheet dates are as follows:

	2006	**2005**
6 months or less	271 458	275 712
6-12 months	145 818	16 855
Total bank loans	**417 276**	**292 567**

The fair value of borrowings equals their carrying amount.

Loan collaterals and pledged assets are presented in Note 31.

Note 27 Trade and other payables

in thousands of kroons

	Group	
	31.12.2006	**31.12.2005**
Payables to suppliers	464 199	282 087
Payables to employees	64 218	37 688
Tax liabilities, except for corporate income tax		
value added tax	19 998	11 919
personal income tax	5 884	3 032
social security tax	13 654	9 269
land tax	130	166
unemployment insurance tax	206	201
contributions to mandatory funded pension	307	173
other taxes	1 687	260
	41 866	25 020
Amounts due to customers for contract work (Note 33)	276 940	185 648
Other payables		
interest liabilities	-	65
payables for shares of subsidiaries		14 735
other payables	27 290	4 837
advance payments received	206 883	161 156
	234 173	180 793
Total trade and other payables	1 081 396	711 236

Note 28 Government grants

in thousands of kroons

The Company's Latvian subsidiary SIA Merks was engaged (in 2004) in a project according to which Merko took the responsibility to build a multifunctional hall (known as Arena Riga) at its own expense in the city of Riga, Latvia. It also took the responsibility to complete the hall by 1 February 2006 so that it would be possible to host 2006 World Championship in ice-hockey in Riga. As the due completion of the building involved major risks (see note 35) and the aggregate expected construction costs of (to build) the hall (Arena) were considerably higher than the recoverable amount of the Arena when completed, the project was not feasible on commercial ground. Therefore, to encourage the possible developer (before Merks two developers had rejected the project) the Riga Municipality provided a government grant to the project by selling some land plots (in Riga) at a price below their fair value to Merko in 2004 and 2005. The difference between the purchase price actually paid and the fair value of the land plots on the date of acquisition was accounted for as a government grant. This government grant was accounted as a revenue in the same periods as the impairment losses on unfinished construction of the Arena were recognised. The excess amount of government grant, i.e. the amount by which the government grant finally appeared to be higher than impairment loss (see Note 8 and 23 for impairment losses recognised) on the Arena, was also recognised as a revenue in 2005, as it was reasonably certain that the Group was able to comply with the conditions attaching to the conditions of the grant.

In 2006, the world championships in ice-hockey took place in the multifunctional hall Arena Riga. The City of Riga supported the raising of funds for the arrangement of the world championship and the carrying out of competitions with 22 225 thousand kroons in 2005. The grant was used to arrange the world championships in ice-hockey in 2006. The cost of the ice-cleaning machine included within inventories to be given over to the City of Riga equals to the remaining balance of government grant in the amount of 1498 thousand kroons as at 31.12.2006.

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	Group	
	31.12.2006	31.12.2005
Carrying amount at beginning of the year	22 225	44 818
Received during the year	-	154 740
Recognised in income during the year	(20 727)	(177 333)
Balance at end of the year	1 498	22 225

Note 29 Short-term provisions

in thousands of kroons

	Group	
	2006	2005
Provision for warranty obligation for construction:		
Carrying amount at beginning of the year	8 463	5 784
Accrued during the year	10 692	5 567
Utilized during the year	(9 493)	(2 888)
Balance at end of the year	9 662	8 463
Provision for covering unprofitable construction contracts:		
Residual value at beginning of the year	-	-
Accrued during the year	17 848	-
Utilized during the year	-	-
Balance at end of the year	17 848	-
Provision for potential cancellation of construction project:		
Residual value at beginning of the year	6 664	-
Accrued during the year	-	6 664
Utilized during the year	(6 664)	-
Balance at end of the year	-	6 664
Provision for covering court fees and claims:		
Residual value at beginning of the year	6 090	-
Accrued during the year	1 000	6 090
Utilized during the year	(3 036)	-
Balance at end of the year	4 054	6 090
Other provisions		
Residual value at beginning of the year	524	-
Accrued during the year	1 953	524
Utilized during the year	(524)	-
Balance at end of the year	1 953	524
Total short-term provisions	33 517	21 741

Note 30 Other long-term trade payables

in thousands of kroons	Group	
	31.12.2006	**31.12.2005**
Payables to suppliers	10 352	9 884
Advance payments received	12 925	12 842
Total long-term trade payables	23 277	22 726

In 2005, the subsidiary SIA Merks received advance payments in the amount of 12 842 thousand kroons for renting the space of Arena Riga from 2007 (lease agreements were entered into for 5-7 years). In 2006, Arena Riga was sold.
In 2006, SIA Merks received initial payment and advance payments for apartments in Skanste Street, Riga in the amount of 12 925 thousand kroons. The apartments will be completed in 2009.

Note 31 Loan collaterals and pledged assets

The following agreements have been entered into for guaranteeing loans and other obligations:

Between AS Merko Ehitus and Hansabank:
A commercial pledge agreement on movable property in the amount of 140 million kroons (registered under the first, second and fifth orders in the registry of commercial pledges). The obligations arising from guarantee contracts and overdraft contracts are guaranteed by the pledge.

Between AS Merko Ehitus and SEB Eesti Ühispank:
A commercial pledge agreement on movable property in the amount of 60 million kroons (registered under the third, fourth and sixth orders in the registry of commercial pledges). The obligations arising from guarantee contract are guaranteed by the pledge.

Between Tallinna Teede AS, Hansabank and SEB Eesti Ühispank:
A commercial pledge agreement on movable property in the amount of 25 million kroons (registered under the first order in the registry of commercial pledges), whereby the 14/25 legal share of the commercial pledge belongs to Hansabank and 11/25 to SEB Eesti Ühispank.

Between Tallinna Teede AS and Hansabank:
A commercial pledge agreement on movable property in the amount of 2 million kroons (registered under the second order in the registry of commercial pledges). All claims of the banks arising from contracts under the law of obligations have been guaranteed by the pledges.

Between AS Gustaf and Hansabank:
A commercial pledge agreement on movable property in the amount of 6 million kroons for guaranteeing guarantee contracts.

Between OÜ Gustaf Tallinn and Hansabank:
A commercial pledge agreement on movable property in the amount of 3.9 million kroons for guaranteeing guarantee contracts.

Between AS Merko Tartu and SEB Eesti Ühispank:
A commercial pledge agreement on movable property in the amount of 12.0 million kroons. Guarantee contracts entered into are guaranteed by the pledge.

Between SIA Merks and Hansabanka:
A commercial pledge agreement on assets in the amount of 3.0 million Latvian lats (67,3 million kroons). Obligations arising from the guarantee contracts and the loan agreements are guaranteed by the pledge.
Mortgages in the amount of 17.36 million Latvian lats (389,4 million kroons) for 7 registered immovables in Riga have been set as collateral for a loan contract totalling 17.5 million euros (268,3 million kroons).

Between SIA Merks and SEB Unibanka:
A commercial pledge agreement on assets in the amount of 1.9 million Latvian lats (42,6 million kroons). Obligations arising from the loan agreement have been guaranteed by the pledge.

Between SIA Merks and Nordea Banka:
Mortgages in the amount of 11.07 million (248,3 million kroons) Latvian lats for registered immovables in Riga have been set as collateral for a loan contract totalling 17.5 million euros (273,8 million kroons).

Between UAB Statyba and Hansabankas:
A commercial pledge agreement on movable property in the amount of 6.0 million Lithuanian litas (27.2 million kroons). The obligations arising from guarantee contracts and overdraft contracts are guaranteed by the pledge.

Note 32 Share capital

In accordance with the resolution of the General Meeting of Shareholders from 28.04.2005, the share capital was increased in May of the same year by transferring the share premium paid during previous share issues (2 950 thousand kroons) and retained earnings (85 550 thousand kroons) by the amount of 88 500 thousand kroons by means of equity capitalisation, by issuing 8850 thousand new ordinary shares with the nominal value of 10 kroons each. As at 31.12.2005, the share capital in the amount of 177 000 thousand kroons consisted of 17 700 thousand registered shares with the nominal value of 10 kroons each.

In 2006, no changes occurred in share capital.

According to the articles of association, the maximum number of ordinary is 18 000 thousand shares. All issued shares have been paid for.

Note 33 Construction contracts in progress

in thousands of kroons

	Group	
	2006	**2005**
Costs incurred for construction contracts in progress and corresponding profit	4 016 033	2 312 322
Progress billings submitted	(4 157 565)	(2 415 746)
	31.12.2006	**31.12.2005**
Amounts due from customers for contract work (Note 15)	135 408	82 224
Amounts due to customers for contract work (Note 27)	(276 940)	(185 648)
Advance payments received for contract work	86 326	68 357

Amounts due from customers for contract work are included in the balance sheet line *Trade and other receivables*. Amounts due to customers for contract work are included in the balance sheet line *Trade and other payables*.

Note 34 Related party transactions

in thousands of kroons

In compiling the Annual Report, the following entities have been considered as related parties:
- parent company AS Merko Grupp;
- shareholders of AS Merko Grupp with significant influence through AS Merko Grupp;

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- other shareholders with significant influence;
- other subsidiaries of AS Merko Grupp, so-called 'entities controlled by the parent company';
- subsidiaries;
- other controllable entities;
- associates;
- close relatives of persons with significant influence;
- key managers and their close relatives;
- entities under control of persons mentioned above;
- entities sharing key management with AS Merko Ehitus.

Significant influence is presumed to exist when the person has more than 20% of the voting power.

As at 31.12.2006 and 21.12.2005, AS Merko Grupp owned 72% of the shares of AS Merko Ehitus. The ultimate controlling party of the Group is Mr Toomas Annus.

Goods and services

	Group	
	2006	**2005**
Purchased construction services		
Associates and joint ventures	91 732	45 202
Entities controlled by the parent company	7 858	5 444
Total purchased construction services	99 590	50 646
Construction services rendered		
Associates and joint ventures	118 667	136 160
Entities controlled by the parent company	986 301	425 568
Management members	5 970	1 526
Total construction services provided	1 110 938	563 254
Construction materials purchased		
Other related parties	208	2 008
Real estate sold		
Entities controlled by the parent company (Note 18)	31 890	-

Loans granted to related parties are disclosed in Note 15 *Loans granted* and **loans received** from related parties are disclosed in note 26 *Borrowings.*

Balances with the related parties:

	Group	
	31.12.2006	**31.12.2005**
Trade receivables		
Trade receivables		
Associates and joint ventures	13 678	39 044
Entities controlled by the parent company	141 050	56 946
Other related parties	18	-
Short-term loans		
Associates and joint ventures	24 750	21 325
Entities controlled by the parent company	8 896	6 565
Other related parties	-	500

Interest receivables		
Associates and joint ventures	2 656	1 541
Entities controlled by the parent company	32	-
Other related parties	-	8
Other short-term receivables		
Entities controlled by the parent company	6 890	-
Other related parties	-	2 917
Prepayments for services		
Associates and joint ventures	1 068	7 698
Entities controlled by the parent company	-	562

Other short and long-term investments

Long-term loans		
Entities controlled by the parent company	3 804	1 473
Other long-term receivables		
Other related parties	-	6 800

Trade payables

Payables to suppliers		
Associates and joint ventures	9 414	19 179
Entities controlled by the parent company	272	223
Other related parties	7	116
Prepayments received		
Entities controlled by the parent company	16 551	16 847
Interest liabilities		
Entities controlled by the parent company	-	21
Management members	-	18
Other payables		
Management members	-	307
Associates and joint ventures	3 365	-
Entities controlled by the parent company	-	2 419

Remuneration of the members of the Supervisory and Management Boards and senior executives

In 2006, the members of the Supervisory and Management Boards as well as senior executives of AS Merko Ehitus were paid remuneration totalling 15 171 thousand kroons (2005: 15 743 thousand kroons).

Termination benefits of members of the Supervisory and Management Boards

Upon premature removal or termination of authority of the members of the Supervisory and Management Boards, the Group has the obligation to pay compensation totalling to 4392 thousand kroons (2005: 3108 thousand kroons).

Contracts of surety

AS Merko Ehitus provides surety for:

- obligations arising from lease agreements of subsidiaries and consolidation group companies to Balti Autoliisingu AS in the amount of 9883 thousand kroons (31.12.2005: 0 kroons),

- obligations arising from loan agreements of the joint venture OÜ Tornimäe Apartments to SEB Eesti Ühispank in the amount of 7500 thousand kroons (31.12.2005: amount was 5000 thousand kroons);
- obligations arising from loan agreements of the joint venture OÜ Unigate to Hansabank in the amount of 1000 thousand kroons (31.12.2005: same amount).

The fair value of Group's surety contracts is immaterial, therefore no liability has been recorded in the balance sheet as at 31.12.2006 as well as at 31.12.2005.

Note 35 Contingent liabilities

The Group has issued guarantees to cover Group's obligations to third parties:

in thousands of kroons	Group	
	31.12.2006	**31.12.2005**
Performance period's warranty to the customer	180 617	108 448
Tender warranty	72 352	15 355
Guarantee for warranty period	73 295	107 042
Prepayment guarantee	105 478	87 215
Sureties (Note 34)*	26 483	13 000
Investment obligation**	-	67 409
Payment guarantee	3 743	-
Total contingent liabilities	461 968	398 469

* In addition to sureties disclosed in Note 34, the Group has issued in the extent of 8100 thousand kroons sureties covering obligations of third parties (31.12.2005: amount was 7000 thousand kroons).

** At 25 May, the Riga City Council and SIA Merks concluded the investment agreement whereby SIA Merks assumed the responsibility to build the multifunctional hall Arena Riga. The contract included the following terms and conditions:

- SIA Merks shall pay penalty fees totalling 67.4 million kroons to Riga City Council if hall fails to obtain a permit for use by February 1, 2006;
- Riga City Council has the right to demand a refund for the grant if the hall fails to obtain a permit for use by 31 December 2006.

At 31 January 2006, the hall obtained the permit for and consequently SIA Merks was released of the contingent investment liability.

Performance period's warranty to the customer – warranty provider grants to customer that contractor's obligations arising from construction contract will be adequately completed.
Tender warranty – warranty provider grants to customer arranging the tender process that tenderer will sign a contract as per tender conditions.
Guarantee for warranty period - warranty provider grants to customer that construction defects discovered during the warranty period will be repaired.
Prepayment guarantee - warranty provider grants to customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.
Payment guarantee – warranty provider grants to customer payment for goods or services.

Tax authorities have the right to review the Group's tax records within 6 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines. The Group's management estimates that there are not any circumstances which might lead the tax authorities to impose additional significant taxes on the Group.

Note 36 Risks

Credit risk
Credit risk relates to potential damage which would occur if the parties to the contract are unable to fulfil their contractual obligations. In order to lower credit risks, the payment discipline of customers is constantly being monitored; construction activities are partly funded by customer prepayments. Available funds are mostly held at Hansabank and SEB Eesti Ühispank. The management estimates that the Group does not have any major credit risks.

Interest risk
Interest risk arises from floating rate borrowings. Interest on bank loans is related to EURIBOR. Changes in EURIBOR and changes in average market interest rates affect the Group's interest expenses. The Group's management estimates that the Group does not have any major interest risks.

Foreign exchange risk
The Group's transactions are carried out in Estonian kroons, Latvian lats and Lithuanian litas. The Estonian kroons as well as the Lithuanian litas are pegged to the Euro. Risks to the Group's income and expenses arise from the exchange rate changes of the Latvian lats.
In order to hedge foreign exchange risk, key foreign contracts are concluded in euros. All long-term loan agreements of the Group have been concluded in euros.

Fair value
The carrying amounts of the Group's financial assets and financial liabilities do not significantly differ from their fair values.

Note 37 Number of shares belonging to the members of the Supervisory and Management Board and their close relatives

	Shares	Ownership %
Member of the Management Board		
Tõnu Toomik	18 000	0,10

Note 38 Shareholders with more than 5% ownership

	Shares	Ownership %
AS Merko Grupp	12 742 686	71.99
ING Luxembourg S.A.	1 214 700	6.86

Note 39 Supplementary disclosures on the parent company

The financial information of the parent company comprises separate primary statements of the Parent Company (income statement, balance sheet, cash flow statement and statement of changes in equity), the disclosure of which is required by the Estonian Accounting Act. The primary financial statements of the parent company have been prepared using the same accounting methods and measurement bases as for the preparation of the consolidated financial statements, except for subsidiaries, associates and joint ventures which are reported at cost in the separate primary financial statements of the parent company.

Income statement

in thousands of kroons

	Parent company	
	2006	**2005**
Revenue	2 111 887	1 860 068
Cost of goods sold	(1 834 444)	(1 575 816)
Gross profit	277 443	284 252
Marketing expenses	(12 591)	(15 743)
Administrative and general expenses	(63 775)	(55 278)
Other operating income	19 323	9 399
Other operating expenses	(4 782)	(3 608)
Operating profit	215 618	219 022
Financial income	2 226	3 876
Financial income from investments into subsidiaries	113 488	43 157
Financial income/expenses from investments into associates and joint ventures	2 499	(3 166)
Profit before tax	333 831	262 889
Corporate income tax	-	(4 446)
Net profit for the financial year	333 831	258 443

Balance sheet

in thousands of kroons

	Parent company	
	31.12.2006	**31.12.2005**
ASSETS		
Current assets		
Cash and cash equivalents	311 059	124 033
Trade receivables	948 507	850 188
Prepaid corporate income tax	1 451	272
Inventories	154 132	79 299
	1 415 149	1 053 792
Non-current assets		
Investments in subsidiaries	229 604	171 333
Investments in associates and joint ventures	3 540	9 824
Long-term financial assets	129 326	82 145
Investment property	-	16 460
Property, plant and equipment	12 653	10 193
Intangible assets	6 197	1 743
	381 320	291 698
TOTAL ASSETS	1 796 469	1 345 490
LIABILITIES		
Current liabilities		
Borrowings	32 463	29 431
Trade payables	617 514	421 136
Short-term provisions	18 727	11 856
	668 704	462 423
Non-current liabilities		
Other long-term payables	5 250	5 883
TOTAL LIABILITIES	673 954	468 306
EQUITY		
Share capital	177 000	177 000
Statutory reserve capital	17 700	8 850
Retained earnings	927 815	691 334
TOTAL EQUITY	1 122 515	877 184
TOTAL LIABILITIES AND EQUITY	1 796 469	1 345 490

Statement of changes in equity

in thousands of kroons

Parent company	**Share capital**	**Share premium**	**Statutory reserve capital**	**Retained earnings**	**Total**
Balance as at 31.12.2004	88 500	2 950	8 850	575 966	676 266
Net profit for the financial year	-	-	-	258 443	258 443
Fund issue	88 500	(2 950)	-	(85 550)	-
Dividends	-	-	-	(57 525)	(57 525)
Balance as at 31.12.2005	177 000	-	8 850	691 334	877 184
Carrying amount of holdings under dominant or significant influence					(181 157)
Carrying amount of holdings under dominant or significant influence under the equity method					405 369
Adjusted unconsolidated equity at 31.12.2005					**1 101 396**
Net profit for the financial year	-	-	-	333 831	333 831
Transfers to statutory reserve capital	-	-	8 850	(8 850)	-
Dividends	-	-	-	(88 500)	(88 500)
Balance as at 31.12.2006	177 000	-	17 700	927 815	1 122 515
Carrying amount of holdings under dominant or significant influence					(233 144)
Carrying amount of holdings under dominant or significant influence under the equity method					704 571
Adjusted unconsolidated equity at 31.12.2006					**1 593 942**

Adjusted unconsolidated retained earnings represent the amount that is available for distribution to the shareholders according to the Estonian Accounting Act.

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Cash flow statement

in thousands of kroons

	Parent company	
	2006	**2005**
Cash flows from operating activities		
Operating profit	215 618	219 022
Adjustments:		
depreciation and impairment	7 648	4 517
gain/loss from sale of non-current assets	(107)	(139)
adjustment of revenue from construction contracts under stage of completion method	(102 843)	38 601
interest income from operating activities	(17 913)	(9 017)
change in provisions	9 697	10 940
Change in trade receivables related to operating activities	(214 673)	(38 516)
Change in inventories	(60 913)	8 773
Change in trade payables related to operating activities	147 513	51 307
Interest paid	(931)	(632)
Other financial income received	0	3 857
Corporate income tax paid	-	(4 446)
	(16 904)	284 267
Cash flows from investing activities		
Investments into subsidiaries	(69 834)	(43 095)
Proceeds from sale of subsidiaries	25 039	4 600
Proceeds from sale of associates	1 847	2 756
Proceeds from sale of other financial assets	3 004	-
Purchase of property, plant and equipment	(7 501)	(7 275)
Proceeds from sale of property, plant and equipment	155	610
Purchase of intangible assets	(4 570)	(1 279)
Loans granted	(303 095)	(411 744)
Loan repayments received	510 324	170 640
Interest received	20 379	8 971
Dividends received	88 579	43 446
	264 327	(232 370)
Cash flows from financing activities		
Borrowings	33 242	28 529
Repayments of borrowings	(5 165)	-
Dividends paid	(88 500)	(57 525)
	(60 423)	(28 996)
Change in cash and cash equivalents	187 000	22 901
Cash and cash equivalents at beginning of the period	124 033	101 143
Currency translation adjustment	26	(11)
Cash and cash equivalents at end of the period	311 059	124 033

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INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)

To the Shareholders of AS Merko Ehitus

We have audited the accompanying consolidated financial statements of AS Merko Ehitus and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Urmas Kaarlep	Tiit Raimla
AS PricewaterhouseCoopers	Authorised Auditor

12 April 2007

PROFIT ALLOCATION PROPOSAL
in kroons

Retained earnings	823 254 549
Net profit for 2006	581 738 087
Total retained earnings as at 31.12.2006	**1 404 992 636**

The Management Board proposes to allocate the net profit as follows:

As dividends (7.00 kroons per share)	123 900 000
Retained earnings after the allocation of net profit	**1 281 092 636**

Tõnu Toomik	Chairman of the Management Board	29.03.2007
Alar Lagus	Member of the Management Board	29.03.2007
Veljo Viitmann	Member of the Management Board	29.03.2007
Andres Agukas	Member of the Management Board	29.03.2007
Tõnu Korts	Member of the Management Board	29.03.2007

SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2006 ANNUAL REPORT

The Management Board of AS Merko Ehitus has prepared the management report, consolidated financial statements and the profit allocation proposal for 2006.

Tõnu Toomik	Chairman of the Management Board	29.03.2007
Alar Lagus	Member of the Management Board	29.03.2007
Veljo Viitmann	Member of the Management Board	29.03.2007
Andres Agukas	Member of the Management Board	29.03.2007
Tõnu Korts	Member of the Management Board	29.03.2007

The Supervisory Board has reviewed the Annual Report which consists of the management report and the financial statements prepared by the Management Board and which also includes the auditor's report and the profit allocation proposal, and approved it for presentation at the General Meeting of Shareholders.

Toomas Annus	Chairman of the Supervisory Board	12.04.2007
Teet Roopalu	Member of the Supervisory Board	12.04.2007
Jaan Mäe	Member of the Supervisory Board	12.04.2007

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