





AS MERKO EHITUS

GROUP

CONSOLIDATED ANNUAL REPORT
01.01.2016 – 31.12.2016

Business name:	AS Merko Ehitus
Main activities:	Holding companies General contracting of construction Real estate development
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Auditor:	AS PricewaterhouseCoopers
Supervisory Board:	Toomas Annus, Teet Roopalu, Indrek Neivelt, Olari Taal
Management Board:	Andres Trink, Tõnu Toomik

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MAIN FACTS

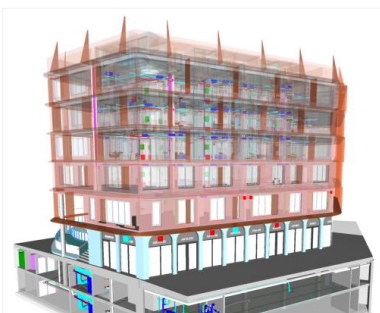


The largest listed construction company in the Baltics

AS MERKO EHITUS CONSISTS OF:

- Estonia's leading construction company AS Merko Ehitus Eesti
- Latvian-market-oriented SIA Merks
- UAB Merko Statyba operating on the Lithuanian market
- From 2016 Norwegian construction company Peritus Entreprenør AS
- The real estate development business unit along with real estate holding companies.

Merko Ehitus group focuses on general contracting of construction and on providing complete solutions in professional construction and real estate development. Long-term experience in various countries, a wide scope of construction services, flexibility, reliability and meeting the deadlines and primarily quality have helped group companies to achieve a strong position in the Baltics.



2016 new contracts signed: EUR 202 mln



2016 revenue: EUR 252 mln

COMPETITIVE ADVANTAGES:

- Broad range of construction services and products, and comprehensive solutions offered to clients
- Strong quality management system
- Experienced project managers and engineers
- Longstanding experience on the subcontractors and suppliers market
- Innovative technological approaches and construction solutions
- Strong financial capability
- Inventory of residential development projects and a strong brand



2016 net profit: EUR 6,1 mln

2016 EBITDA: EUR 11.2 mln



31.12.2016: 797 employees

VALUE OFFERING

AS GENERAL CONTRACTOR, WE OVERSEE THE ENTIRE CONSTRUCTION PROCESS AND ARE RESPONSIBLE FOR THE COMPLETION OF THE CONSTRUCTION PROJECT AS A WHOLE:

- Integrated project management and construction service and provision of strategic consultation to the contracting entity throughout the process;
- As needed, combined use of subcontractors and Merko workforce (concrete works, road construction, electrical constructions both indoor and outdoor);
- Real estate investments and development, managing the entire apartment development process: development, construction and sales;
- Co-investing, risk distribution and participation in PPP (public-private partnership) projects;
- International quality, environmental protection and occupational safety certificates ISO 9001, ISO 14001 and OHSAS 18001.



Work volume nearly 7% of the total volume of the Estonian construction market. Estonia's leading builder of substations.

STATEMENT OF THE CHAIRMAN OF THE MANAGEMENT BOARD

Dear shareholders,

2016 was a complicated year for Baltic construction companies – despite active residential construction the total construction market of Baltic capitals failed to show any growth. Public investments in infrastructure objects have remained low for the seventh year in a row, with the group's civil engineering volumes failing to meet expectations in 2016. Nonetheless, we succeeded in maintaining the group's revenue on par with the previous period at the expense of growth in residential development and private sector construction orders, which has also been in our strategic focus in the last few years. We cannot, however, be satisfied with the profitability of the construction sector – price competition in construction procurements remains extremely tight, slimming down the margins and forcing both main contractors and contracting entities to take huge risks. Careful planning of the construction process and efficient management, as well as implementation of new construction technologies is becoming increasingly important for maintaining a competitive edge.

In 2016, the group's construction companies completed several prominent objects, including the Hilton Tallinn Park Hotel, tower A of the office building "Õpiku Maja", Tallink Tennis Centre, Poordi 1 apartment building in Estonia, as well as the kindergarten and school building complex in Pinki, Latvia. C-block of the North Estonia Medical Centre and the Riga Airport passenger terminal, both reconstructed by Merko, were also opened. In Estonia, Merko has become the leading builder of substations, with the new substations of Paljassaare and Leisi completed in 2016. In the utility networks area, we reconstructed nearly 3 km of water pipes, supplying drinking water to nearly 100,000 residents of Mustamäe and Õismäe. We aim at maintaining our position as the leader of the general contracting market as well as apartment development in Estonia. We will seize any opportunity to enhance profitability, above all by improving internal efficiency.

We continue pursuing our strategy of growth beyond Estonian borders – in the future, we would like to see a half of our business positioned abroad. Despite the decrease in revenue, compared to last year, we have gradually strengthened our capacity and market position in Latvia and Lithuania as general contractors, and have also made new real estate investments. In Latvia, we remain competitive in most private and public sector procurements. In Lithuania, we hold the biggest market share in terms of international orders, and are planning more active participation in public procurements. Last year, we took the first steps on the Norwegian market, with a long-term objective of gaining the trust of contracting entities as a local company, and gradually building the capacity to undertake bigger projects.

Apartment buyers continue to trust and appreciate the Merko brand as a developer, builder and seller of living environments and apartments. We have had the honour of creating a home for thousands of families all over the Baltics, with approximately 500 homes added in 2016. In 2016 we invested a total of nearly EUR 73 million in residential development and made one of the largest real estate investments in recent years in the heart of Tallinn – a site which allows to create 1,500 new homes in the future. The apartment markets of Tallinn and Vilnius continue to excel. Riga has yet to achieve the expected potential, but we remain well-positioned for any growth in demand. Against the backdrop of a stable development of the apartment market, we are planning to launch the construction of nearly 650 new apartments in the Baltic states in 2017, investing a total of EUR 45 million in various development projects.

For the tenth time, we also received recognition as the most competitive construction company in Estonia in 2016. Several Lithuanian projects were recognised as well: The "Kražiu namai" project received the Best Residential Development Project award of the Lithuanian Real Estate Development Association, and the gym of the American International School and the converter substation of NORDBALT HVDC received the gold medal at the Lithuanian Product of the Year competition held by the Lithuanian Confederation of Industrialists. The good results and achievements can be attributed to our professional staff – Merko won the Builder of the Year 2016 award once again. Investing in the employer brand is important for our future and posterity. We are very happy to rank among the most valued Estonian employers every year, and to take first position among construction and real estate development companies.

We continue to make a contribution to society in general. Our greatest sponsorship project is Estonian Health Trails, with 24-hour free-of-charge access to more than a hundred health trails all over Estonia. Regular movement in fresh air is fundamental to human health, supporting an active society and economy.

I would like to thank all of our contracting entities and partners who have helped us to contribute to a better living environment and a modern-day infrastructure. I would also like to thank the 800 staff members of our group companies for contributing to the attainment of our common objectives.

Wishing you all the best in cooperation for the future,

Andres Trink



ANDRES TRINK
AS MERKO EHITUS
CHAIRMAN OF THE
MANAGEMENT BOARD



MAIN EVENTS IN 2016

JANUARY	
Contract for design and construction of the Tallink Tennis Centre in Tallinn, with the contract value amounting to EUR 7 million.	Extension of the powers of the Members of the Management Board of SIA Merks Oskars Ozoliņš and Janis Šperbergs for three more years, until 1 February 2019.
Nasdaq Baltic Stock Exchange recognises the publicly traded companies with the best investor relations. Merko Ehitus ranks third.	
FEBRUARY	
The group publishes the unconsolidated unaudited interim financial statements for 12M and Q4 2015.	
MARCH	
Merko Investments AS acquires a 56% shareholding in the Norwegian construction company Peritus Entreprenør AS (www.peritus-entreprenor.no).	Change in the Supervisory Board of AS Merko Ehitus Eesti: the Supervisory Board continues with three members – Andres Trink (Chairman), Tõnu Toomik and Teet Roopalü.
AS Merko Tartu launches construction of the last apartment building of the Kaupmehe development project in Tartumaa County (merko.ee/kaupmehe).	Contract for design and construction of the BAUHAUS DIY store in Tallinn. The contract value is approximately EUR 7.6 million.
APRIL	
Contract for design and construction of the warehouse complex at Katlakalna 6D in Riga. The contract value is approximately EUR 4.8 million.	The general meeting of the shareholders approves the Annual Report 2015, the net profit for the financial year in the amount of EUR 9,999,830 and the decision to pay dividends from retained earnings in the total amount of EUR 9,027,000, i.e. EUR 0.51 per share. The general meeting also resolves to amend the Articles of Association.
MAY	
Contract for construction of the Juuliku junction and road section of the Tallinn Bypass, with the cost of the contract amounting to approximately EUR 11 million.	The group discloses the economic results for Q1 2016: revenue amounts to EUR 46.8 million, EBITDA to EUR 1.2 million and profit before taxes to EUR 0.3 million.
SIA Merks launches construction of the second stage of the Skanstes Parks apartment development project in Riga (skanstesparks.lv/).	The powers of the Member of the Management Board of AS Merko Ehitus Tõnu Toomik are extended until 6 June 2019. The Management Board of AS Merko Ehitus continues with two members: Andres Trink (Chairman) and Tõnu Toomik.
AS Merko Ehitus Eesti launches construction of the first stage of the Noblessner Home Port in Tallinn (merko.ee/noblessner), consisting of the Staapli 4 apartment building and the underground parking garage connecting the entire residential complex.	The Liepāja Concert Hall wins the People's Choice Award at the prominent Architizer A+ Awards architecture competition in the concert and theatre hall category.
Contract for construction of the buildings and facilities of the Viru Infantry Battalion's technical park. The contract value is approximately EUR 4 million.	
JUNE	
Contract for construction of the extension of the Radisson Blu Hotel Lietuva in Vilnius, with the total value amounting to approximately EUR 15.7 million.	AS Merko Ehitus launches the next stage of the Paepargi apartment development in the Lasnamäe district of Tallinn, covering two four-storey apartment buildings at Paepargi 35 and 37 (merko.ee/perepargi).
The first Hilton Hotel in the Baltic states opens its doors. Merko was responsible for the design, construction and furnishing of the Hilton Tallinn Park Hotel.	SIA Merks completes the international development and architectural concept competition for the Zakusala development area in Riga, Latvia. The jury declares the work of young Latvian architects (RUUME arhitekti) as the winner.
JULY	
Contract for construction of a residential complex consisting of four buildings in Jurmala. The contract value is approximately EUR 4.9 million.	
AUGUST	
Completion of the Jahu 1A apartment building in the Kalamaja district of Tallinn, with additional value provided by the terraces on the first floor and attic, as well as the arbour, children's playground and recreational area in the garden.	The group publishes the economic results for 6M and Q2 2016: revenue for Q2 amounts to EUR 58.7 million, EBITDA to EUR 3.4 million, profit before taxes to EUR 2.4 million and net profit to EUR 1.7 million. Revenue for 6M 2016 amounts to EUR 105.6 million, EBITDA to EUR 4.6 million, profit before taxes to EUR 2.7 million and net profit to EUR 1.8 million.

Contract for design and construction of a commercial building at Pärnu mnt 22 in the city centre of Tallinn. The contract value is approximately EUR 10 million.

SEPTEMBER	
SIA Merks completes construction of the Exupéry International School in Pinki. The new school building can accommodate 200 pupils, with more than 120 kindergarten places.	The preliminary contract of purchase and sale for the transfer of the building and parking lot of the "ibis" hotel after completion of construction. Pursuant to the contract, the sales price of the "ibis" hotel to be constructed in line with the Accor standards and the real estate must not exceed EUR 8.5 million.
Completion of two three-storey apartment buildings at Kivimäe 32 in the Nõmme district of Tallinn, surrounded by a private garden area. The positioning of the buildings within a pine forest, alongside a health trail ensures a healthy living environment.	
OCTOBER	
AS Merko Ehitus is recognised as the Most Competitive Construction Company in Estonia in 2016.	Completion of the restoration of the Rode altarpiece at Niguliste Church, supported by Merko. More than 6 metres in width and 3.5 metres in height when opened, the conservation work on the winged altarpiece lasted three years, from 2014 to 2016.
Contract for construction of the apartment building at Cēsu 9 in Riga, Latvia. The contract value is approximately EUR 5 million.	Contract for construction of the barracks of the Tapa military base in Tapa, Lääne-Virumaa County, with a total value of more than EUR 7 million.
Launch of construction of the third tower of the Paepargi apartment development at Paepargi 53 in the Lasnamäe district of Tallinn. The building nearest to the sea – the 14-storey building with 60 apartments – is scheduled to be completed by the end of 2017.	
NOVEMBER	
Merko continues its cooperation with Team Haanja, uniting eight Estonian skiers, in the 2016/2017 season.	The group publishes the economic results for 9M and Q3 2016: revenue for Q3 amounts to EUR 67.8 million, net profit to EUR 2.9 million, profit before taxes to EUR 3.0 million and operating profit to EUR 3.0 million. Revenue for 9M 2016 amounts to EUR 173.4 million, net profit to EUR 4.7 million, profit before taxes to EUR 5.7 million and operating profit to EUR 6.1 million.
Merko and the Estonian Academy of Arts launch cooperation for the formation of a professorship in the Architecture and Urban Planning Department, with the Austrian architect Bernhard Sommer.	A change is made in the Management Board of AS Merko Ehitus Eesti – from November 14, Keit Paal is appointed Chairman of the Management Board. The Management Board continues with four members: Keit Paal (Chairman), Jaan Mäe, Veljo Viitmann and Alar Lagus.
Completion of the construction of the Riga International Airport passenger terminal in Riga. SIA Merks was responsible for the interior and exterior finishing of the passenger terminal under construction, as well as for various infrastructure connections, equipment purchase and installations within the terminal.	A change is made in the staff of the Supervisory Boards of the company's subsidiaries. The Supervisory Board of AS Merko Infra continues with three members: Keit Paal (Chairman), Veljo Viitmann and Mihkel Mugur, and the Supervisory Board of Tallinna Teede AS with four members: Tõnu Toomik (Chairman), Keit Paal, Alar Lagus and Veljo Viitmann.
DECEMBER	
The annual award of the Estonian Association of Architects, issued in cooperation with Merko Ehitus, goes to the Pärnu Beach Stadium building.	The Estonian Association of Construction Entrepreneurs declares Tarmo Pohlak of AS Merko Ehitus Eesti as the winner of the Builder of the Year 2016 award. The award was given for the construction of the Hilton Tallinn Park Hotel.
Contract for construction of the Ventspils music school and concert hall at a total value of EUR 25.6 million.	AS Merko Ehitus acquires 36 registered immovables bordered by Veerenni, Tehnika and Vana-Lõuna streets in Tallinn. The development area is laid out on 12 hectares and has a valid detailed spatial plan, allowing to build nearly 1,600 apartments, one commercial building and a kindergarten.

* Construction contract figures do not include VAT.

MERKO GROUP

VISION

Our vision is reliable solutions and quality performance for customers' ideas.

VALUES

RESPONSIBILITY

We decide based on business thinking, awareness and ethical beliefs. We offer enduring and environmentally friendly solutions.

KEEPING PROMISES

We give realistic promises to the shareholders, contracting entities, cooperation partners, employees and we keep our promises. Good solutions are born in cooperation, the keeping of one's promises is mutual.

COMPETENCE

We value quality and professionalism. We constantly develop our professional knowledge and skills.

INITIATIVE

We manage processes and we are result-oriented. We accept the challenges which presume more.

CREATIVITY

We are open, innovative and creative in working out and implementing the solutions. We have a will to carry out forward-looking ideas.



IN WORK ON THE HILTON TALLINN PARK HOTEL, OPENED IN 2016, MERKO OFFERED THE CUSTOMER FULL SERVICE, BEING IN CHARGE OF DESIGN, CONSTRUCTION AND INSTALLING FITTINGS IN THE HOTEL. THE FIRST HILTON HOTEL IN THE BALTICS WAS OPENED IN JUNE 2016.

STRATEGY

The business strategy of AS Merko Ehitus subsidiaries is focussed on improving profitability and enhancing the efficiency of the cost base, offering general contracting services in the field of construction of buildings and infrastructure facilities and developing residential real estate in its main home markets Estonia, Latvia, Lithuania and Norway. AS Merko Ehitus aims to be a preferred partner to its clients for construction works.

LONG-TERM FINANCIAL OBJECTIVES UNTIL 2018

The Management Board and Supervisory Board of AS Merko Ehitus have approved the company's strategic development directions and long-term financial objectives for the period 2013 to 2018, which are:

average return on equity of the period 2013-2018 of at least **10%**

dividend rate **50-70%** of annual profit

equity ratio at least **40%**

Considering the weak growth prospects of the Baltic construction and real estate market in the coming few years, the overall low interest rate environment, as well as the company's high equity base, the strategy and financial objectives are focused towards improving return on invested capital and on increasing the efficiency of the balance sheet.

In 2016, the group fulfilled two out of the three set long-term financial objectives:

average return on equity **5.0%**

dividend rate **119%** of annual profit

equity ratio **51,6%**

In 2016, the group's return on equity was 5.0% (2015: 8.0%). Due to the declining volume of orders on the general contractors market and the prevalent ultracompetitive situation – at a time when the contracts for projects funded in the EU's current financial framework have not yet reached the market – our return on equity fell short of the long-term target.

In 2016, the group achieved the other two long-term financial goal: the dividend rate was 119% (2015: 90%) and the equity ratio was 51.6% (2015: 59.5%). The group's management has made the proposal to pay dividends to shareholders above the current dividend policy rate, considering the return on equity posted in 2016, the group's investment capacity and the outlook for growth of the construction market.

FULFILLMENT OF LONG-TERM FINANCIAL OBJECTIVES 2013-2016

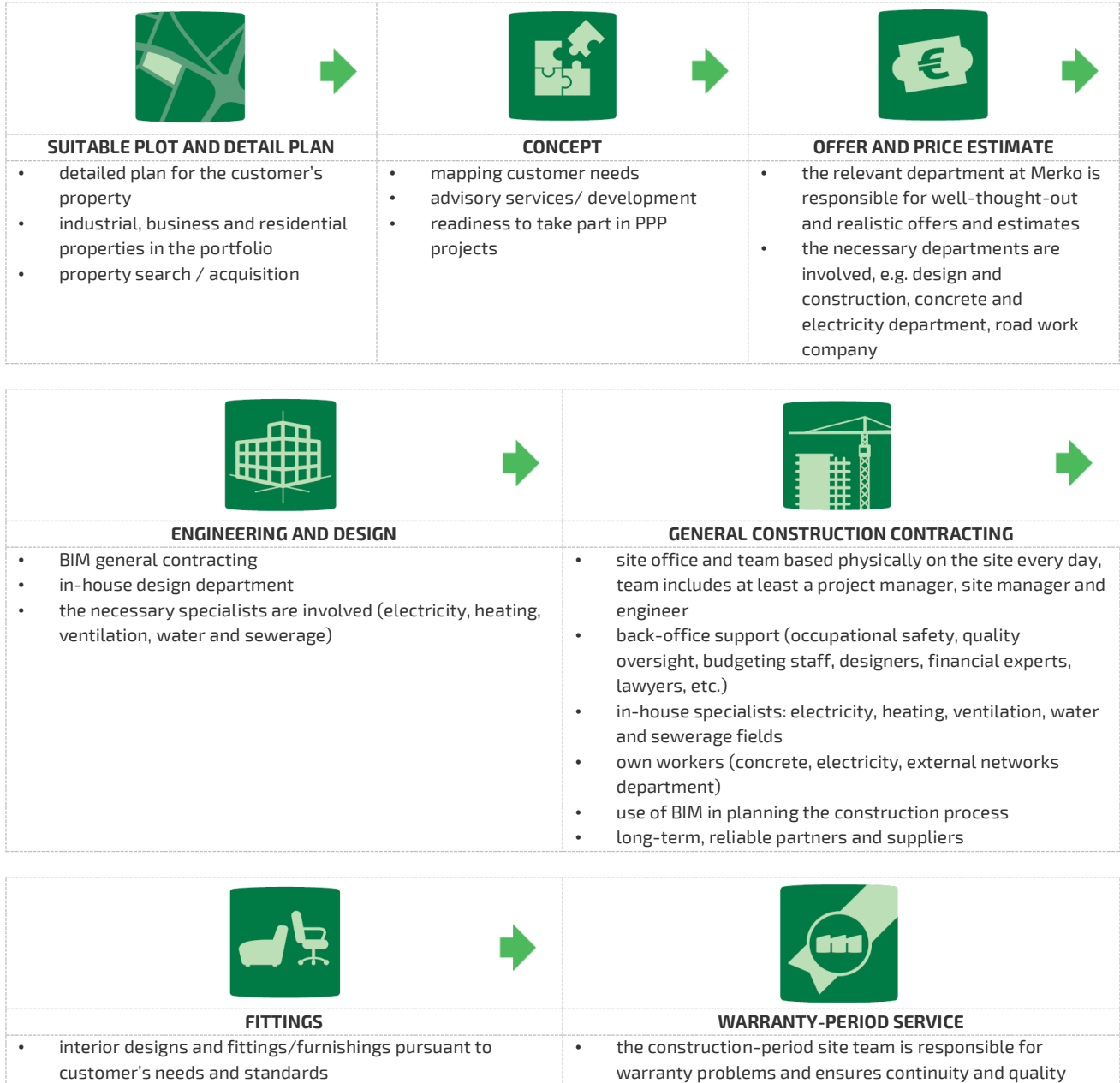
	2016	2015	2014	2013	AVERAGE
Return on equity, ROE (on yearly basis)	5.0%	8.0%	10.1%	8.8%	8.0%
Dividend rate	119%	90%	58%	70%	84%
Equity ratio 31.12	51.6%	59.5%	51.0%	50.9%	53.3%



IN 2016, TWO THREE-STOREY APARTMENT BUILDINGS WERE BUILT IN THE NÕMME DISTRICT OF TALLINN AT KIVIMÄE 32, SURROUNDED BY A PRIVATE GARDEN AREA. THANKS TO THE PINE FOREST AND THE PROXIMITY OF A RECREATIONAL TRAIL, THIS IS A HIGHLY VALUED LIVING ENVIRONMENT.

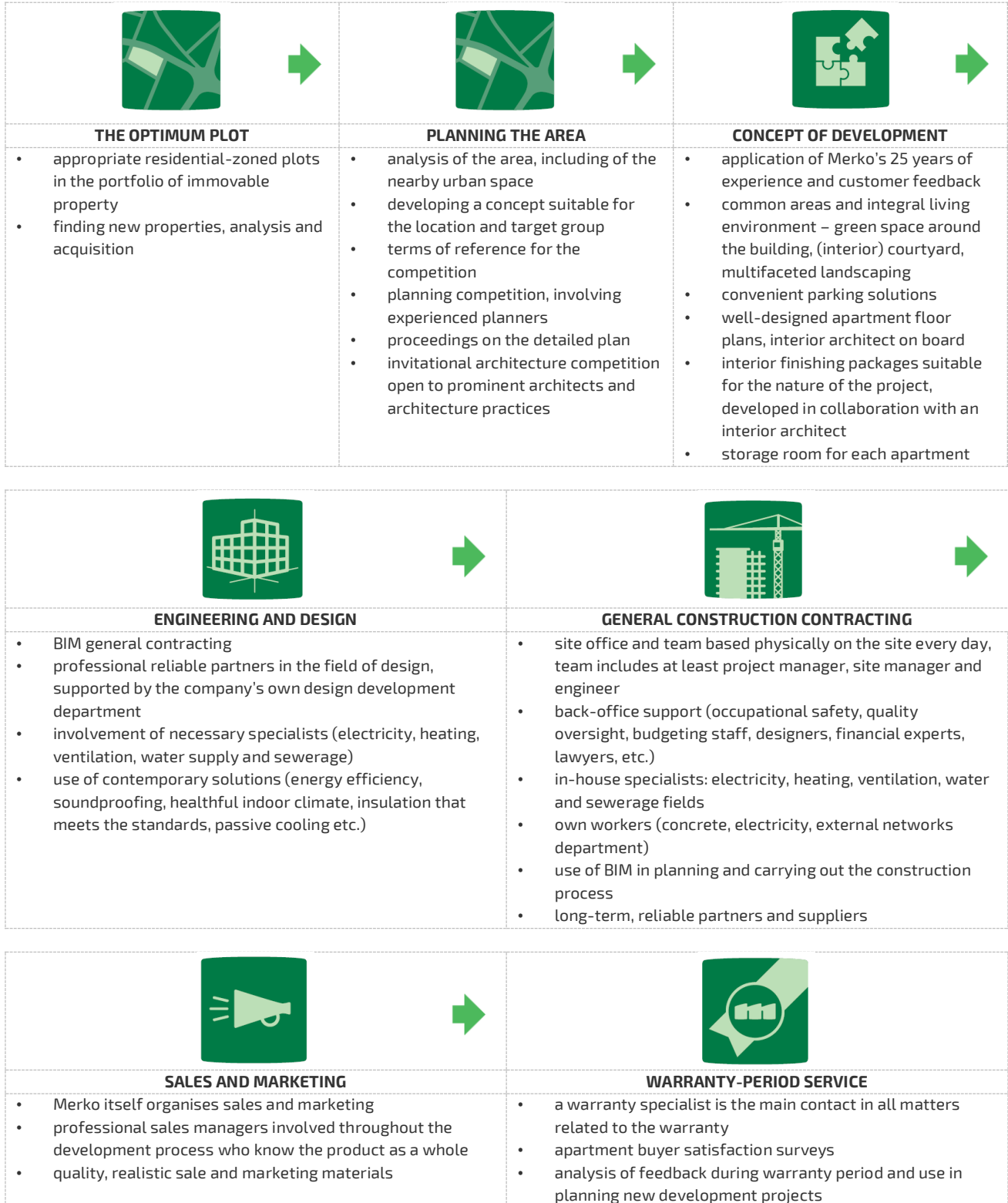
BUSINESS MODEL: CONSTRUCTION SERVICES TO CUSTOMERS

In the framework of general construction contracting Merko offers strategic advisory services and high-quality full-scale solutions throughout the whole process pursuant to the customer's needs: preparation, design, construction, fittings and warranty-period service. If the customer so chooses, we also offer commercial real estate development service, covering preparation for construction along with performance of the construction works. For the best outcome, Merko should be engaged already at the outset of the construction project planning period, and cooperation should take place in the framework of the design and construction agreement.



BUSINESS MODEL: PROPERTY DEVELOPMENTS

Merko has developed homes for thousands of families in Estonia, Latvia and Lithuania and, over the years, the company has become the leading apartment developer in the Baltics. To ensure the best quality, we manage all phases of the development project: planning, design development, construction, sales, and service during the warranty period. The aim is to create apartments that are appropriate for their location, target-group-oriented, architecturally distinguished and attractive as a living environment, with highly functional layouts, quality interior finishing materials, optimum construction cost and high energy performance.

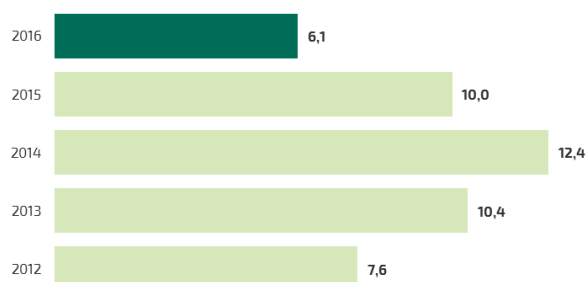


MANAGEMENT REPORT

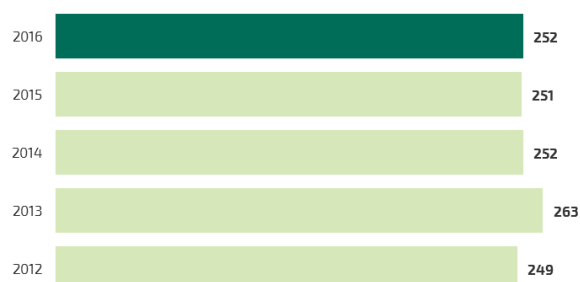
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BRIEF OVERVIEW OF 2016

NET PROFIT
in million euros



REVENUE
in million euros



PROFITABILITY

Net profit in 2016 was EUR 6.1 million (2015: EUR 10.0 million), having decreased by 38.8% compared to the last year. Net profit margin decreased by 39.0% to 2.4% (2015: 4.0%). Profit before tax in 2016 was EUR 7.3 million (2015: EUR 11.7 million), which is equivalent to a profit before tax margin of 2.9% (2015: 4.7%).

REVENUE

Revenue in 2016 was EUR 252.0 million (2015: EUR 251.0 million), which has increased by 0.4% compared to the same period last year. The share of revenue earned outside of Estonia was 32% (2015: 38%) and the share of revenue earned in Estonia was 68% (2015: 62%). The number of apartments sold in 2016 (493 units, incl. 21 apartments in joint ventures) has increased by 22.3% and at the same time revenue from apartment sales (EUR 56.6 million) has decreased by 7.8% (2015: 403 units, revenues of EUR 61.4 million) due to the average apartment price being lower than in 2015.

CASH POSITION

At the end of the reporting period, the group had EUR 33.5 million in cash and cash equivalents and equity EUR 122.8 million (51.6% of total assets). Comparable figures as at 31 December 2015 were accordingly EUR 39.9 million and EUR 125.7 million (59.5% of total assets). As at 31 December 2016 the group had net debt of EUR 12.5 million (31 December 2015: negative EUR 8.7 million).

ORDER BOOK

In 2016, group companies signed new contracts in the amount of EUR 202.4 million (2015: EUR 247.0 million). As at 31 December 2016, the group's secured order book stood at EUR 269.6 million (31 December 2015: EUR 246.9 million).

PROPOSAL FOR DISTRIBUTION OF PROFITS

The Management Board proposes to distribute to shareholders EUR 7.3 million (EUR 0.41 per share) in dividends from retained earnings in 2017. This is equivalent to a 119% dividend rate for 2016.

		2016	2015	VARIANCE
Revenue	million EUR	252.0	251.0	+0.4%
Gross profit	million EUR	11.2	23.0	-27.7%
Gross margin	%	4.4	9.1	-28.0%
EBITDA	million EUR	7.7	15.5	-38.2%
EBITDA margin	%	3.1	6.2	-38.5%
Profit before tax	million EUR	7.3	11.7	-37.7%
PBT margin	%	2.9	4.7	-38.0%
Net profit attributable to equity holders of the parent	million EUR	6.1	10.0	-38.8%
Net margin	%	2.4	4.0	-39.0%
Earnings per share	EUR	0.35	0.56	-38.8%
Dividends per share	EUR	0.41*	0.51	-19.6%

* Pursuant to the Management Board's proposal

		31.12.2016	31.12.2015	VARIANCE
Return on equity (annual)	%	5.0	8.0	-37.7%
Equity ratio	%	51.6	59.5	-13.3%
Order book	million EUR	269.6	246.9	+9.2%
Total assets	million EUR	237.8	211.1	+12.7%
Number of employees	people	797	791	+0.8%

Calculation of ratios is provided on page 133 of the report.

THE MAIN FACTORS INFLUENCING THE CONSTRUCTION MARKET IN 2016

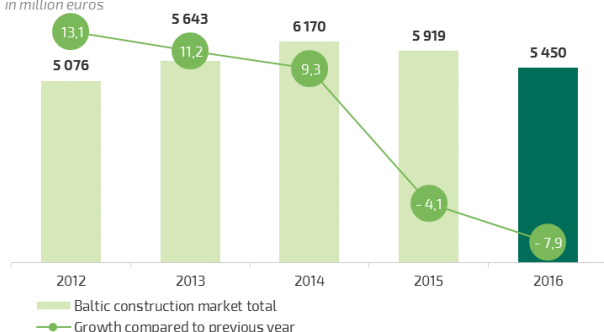
CONSTRUCTION SERVICES

	2016			2015		
	Estonia	Latvia	Lithuania	Estonia	Latvia	Lithuania
GDP annual change in current prices	+1.6%	+2.0%	+2.3%	+1.4%	+2.7%	+1.8%
Construction price index annual change	-0.8%	-0.5%	+1.6%	+0.5%	+0.1%	+1.7%
Labour force	+1.2%	+4.8%	+5.3%	+2.9%	+6.7%	+5.0%
Construction machines	-1.1%	+1.1%	+0.2%	-0.8%	+0.0%	+0.4%
Building materials	-1.8%	-3.2%	-0.5%	-0.7%	-1.9%	-0.2%

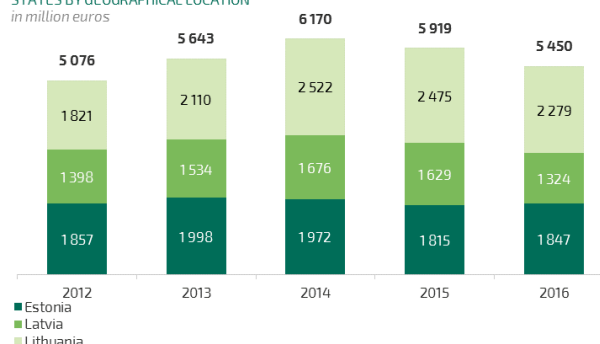
Source: Local national statistical offices.

The Baltic economy continued growing in 2016, but at different rates in different countries – the rate of GDP growth increased in Lithuania and Estonia and slowed in Latvia. Estonia's and Latvia's 2016 GDP growth was among the lowest in the European Union and the lowest since the crisis years. The biggest influence on GDP growth in all three Baltic states was growth in consumer spending backed by increased purchasing power. Reasons for the curtailed growth in GDP vary by countries. Common denominators include sluggish growth in foreign trade and ineffective use of EU funds for supporting investments and the construction sector. On a global scale, the economic growth for 2016 was slower than expected, significantly affected by uncertainty with regard to the outlook – geopolitical tensions are brewing and protectionist views are gaining ground. Government investments continued to decline mainly due to lower external financing, due to a delay in opening of funding in the EU's current budgetary period. Corporate investments increased as a result of an improvement in foreign demand, but also the positive domestic conjuncture. In the construction sector the existing capacities are underused and the general sense of security, particularly in Latvia and Lithuania and to a lesser extent in Estonia, is low, above all due to the external environment. For the construction sector 2016 was a year of continuing adaptation to a new market reality whereby the proportion of new large government contracts was very low and the companies had to actively search for new opportunities to improve efficiency and find new sources of revenue.

CONSTRUCTION MARKET VOLUME (WITH OWN FORCES) AND GROWTH IN THE BALTIC STATES
in million euros



CONSTRUCTION MARKET VOLUMES (WITH OWN FORCES) IN THE BALTIC STATES BY GEOGRAPHICAL LOCATION
in million euros



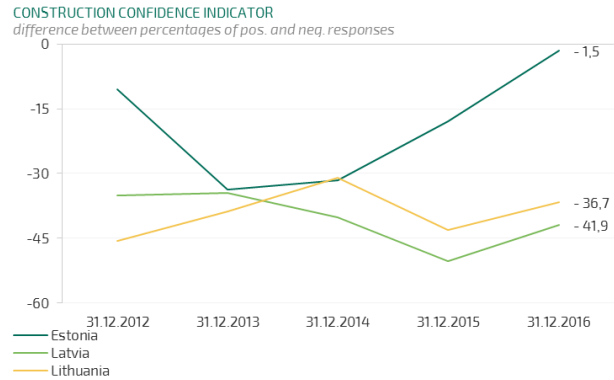
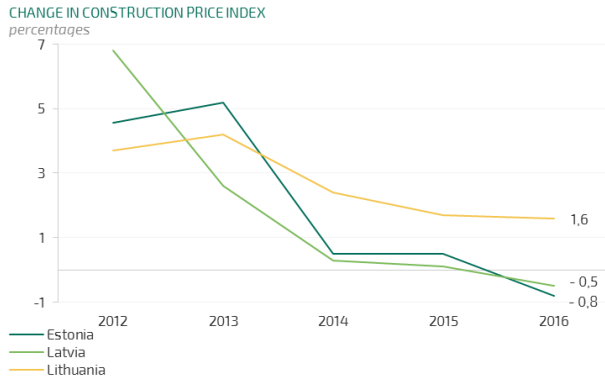
Source: Local statistical services.

In 2016, construction with own resources was performed in the Baltic region for EUR 5,450 million which is EUR 469 million lower than in 2015 (2015: EUR 5,919 million). In 2016, the Baltic construction market decreased by 7.9% in current prices (2015: 4.1%). 2016 was the second year in a row since the continuous post-2010 growth period in which volumes on the construction market declined. The Baltic construction markets still do not reach the boom-era peak levels of 2007-2008 – down by approximately 20% in Estonia and by approximately 30% in Lithuania and by approximately 40% in Latvia. In 2016, the Estonian construction market showed an increase in the Baltics of +1.8% (2015: decrease 7.9%); at the same time the Latvian construction market decreased by 18.7% (2015: decrease 2.8%) and the Lithuanian construction market by 7.9% (2015: decrease 1.9%). In 2016, construction with own resources was performed in Lithuania in current prices for EUR 2,279 million (2015: EUR 2,475 million), in Estonia for EUR 1,847 million (2015: EUR 1,815 million) and in Latvia for EUR 1,324 million (2015: EUR 1,629 million). In 2016, the Lithuanian construction market continued to make up the largest share of the Baltic construction market with 41.8% (2015: 41.8%), followed by Estonia with 33.9% (2015: 30.7%) and the Latvian market still makes up the smallest share of the Baltic construction market with 24.3% (2015: 27.5%).

Similarly, to the national conjuncture, changes took place in the volume of construction work performed by Estonian and Latvian companies in foreign countries at current prices, while the Lithuanian export showed an opposite trend. Lithuania showed the biggest increase in export volumes of 16.1% (2015: 19.1%), followed by Estonia with an export increase of 2.2% (2015: 29.5%); Latvian companies' export decreased by 11.9% (2015: increase by 27.2%) in a year and being thereby the only one in the Baltics to have done so. The construction work performed by Estonian companies in foreign countries amounted to EUR 237 million in 2016 (2015: EUR

232 million) being the highest aggregate result in the Baltics, followed by Lithuanian companies with EUR 233 million (2015: EUR 200 million) and Latvian companies with EUR 102 million (2015: EUR 114 million).

In line with the general change in construction work volumes, changes also took place in the per capita amount of construction work performed. In 2016, construction works per capita were performed for EUR 1,405 in Estonia, EUR 663 in Latvia and EUR 794 in Lithuania (in 2015, in Estonia, Latvia and Lithuania for EUR 1,381, EUR 817 and EUR 852, respectively).



Source: Local statistical services / European Commission Directorate-General for Economic and Financial Affairs.

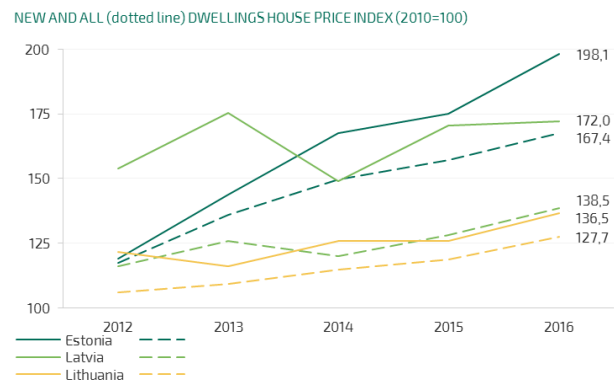
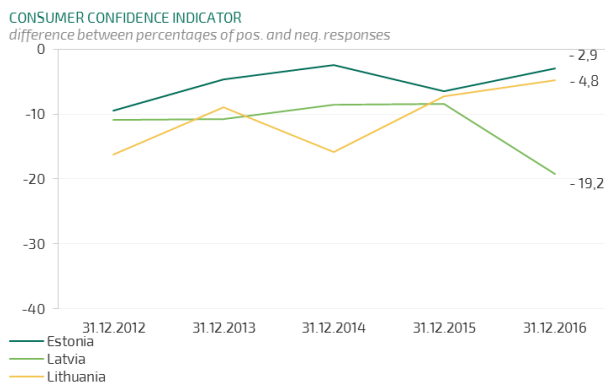
The construction price index decreased in 2016 with respect to the 2015 average both in Estonia (-0.8%) and Latvia (-0.5%), while in Lithuania the construction price index turned to growth (+1.6%). Of the construction price components, the workforce continued rising in all Baltic states, with Lithuanian and Latvian figures being somewhat higher than Estonian. Construction material price components dropped in all Baltic states, while construction machinery price components moved in different directions, decreasing in Estonia, staying the same in Lithuania and rising in Latvia.

The level of indicators of confidence in the construction industry continues to be unfavourable in all three Baltic states. While the situation in Estonia is moderately favourable, the situation in Latvia and Lithuania has essentially stayed on the same level. On a larger scale, confidence is kept negative by the lack of demand, which is largely related to lack of investments in infrastructure. At the same time some positive influence on sector confidence comes from construction of buildings, including the construction of apartment buildings, where presently construction companies have more work ahead. Recent quarters show that the lack of qualified labour in Estonia is slowly starting to chip away confidence, which has yet to play a similar role in Latvia and Lithuania.

Compared to the same period last year, confidence in the construction sector in the Baltic countries in December 2016 improved: in Estonia the most by 16.5 points to -1.5 points (December 2015: -18.0 points), in Latvia 8.4 points from -50.3 points to -41.9 points and in Lithuania 6.4 points from -43.1 points to -36.7 points.

APARTMENT DEVELOPMENT

In 2016, the situation in the apartment market in all three Baltic states has stabilised. We do not forecast a long-term and steep drop in prices; the sale prices of new apartments will likely remain stable, or grow at the same pace with inflation, and the sale periods of not-so-attractive projects will become longer.

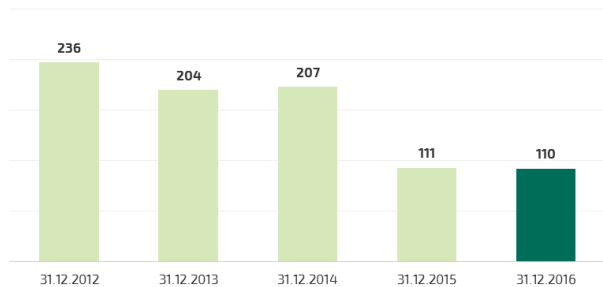


Source: European Commission Directorate-General for Economic and Financial Affairs / Eurostat.

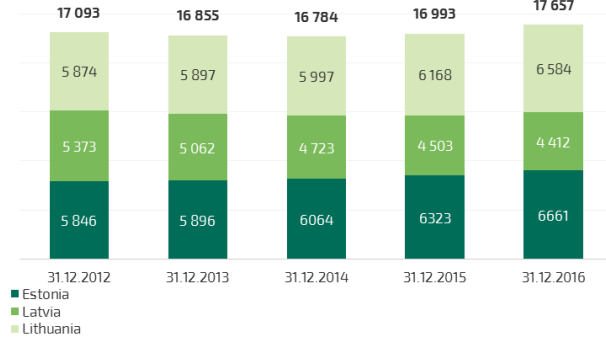
Apartment developers are continually starting new development projects in all three Baltic capitals (though relatively less in Riga), which has increased the supply of new apartments and slightly lengthened the sales periods. Even though the price index curves of new housing (see previous graph) showed a significant growth regarding Estonia and Lithuania in 2016, compared to last year, this should not be extrapolated to the entire market – it is mainly the impact of certain high-end objects in the capitals of these countries,

rather than a general market trend. In the overall picture one could say that the apartment prices of new dwellings, mainly in Estonia but also in Lithuania, have stabilised or grown at a moderate pace, which is reflected by the corresponding price index curves for new dwellings in the respective countries (see dotted lines on the previous graph). It is also important to emphasise that the volatility in prices of new developments in the Baltics has been somewhat greater and often fluctuated in opposite directions than the change in prices on the apartment market in general, as the change in the price of apartments depends directly on the time at which individual development projects were completed and delivered to customers as well as on their price level.

STOCK OF LOANS GRANTED TO HOUSING DEVELOPMENT PROJECTS IN ESTONIA
in million euros



STOCK OF HOUSING LOANS
in million euros



Source: Local central banks.

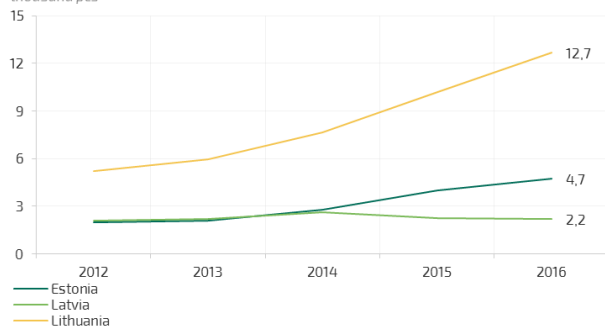
In 2016 the balance of loans granted by banks in Estonia for real estate development showed no significant changes which reflects the market situation, where the larger developers often finance the construction on new projects from their own funds and pre-payments made by customers. As in the current market situation the banks continue to be reluctant to finance residential development projects of smaller developers without a proven track record or require a large number of preliminary sales contracts (up to 50% of total project volume) and a higher own equity contribution, which increases the confidence that there will be no major fluctuations in the market. The trend also gives the Merko Group, being a real estate developer with a long history and extensive references, a competitive edge in launching new development projects to market.

A new trend that has become popular in Estonia and starting from 2016 also in Latvia is raising capital through crowdfunding. This is because there are few alternative investment alternatives and the yields on crowdfunded projects are relatively aggressive. This funding scheme is novel and it is possible that investors who join it do not have enough experience to assess risks related to the development projects, which is also reflected by the fact that to this point the funded projects have been filled up very rapidly. Considering that the market has experienced no major corrections in the last few years, we can estimate the trend to continue in 2017. To sum up, this means of funding has given smaller developers better opportunities for entering the market, and launching such new projects has an impact on the market above all through increasing supply, which in turn impacts the general price level and expectations on the market.

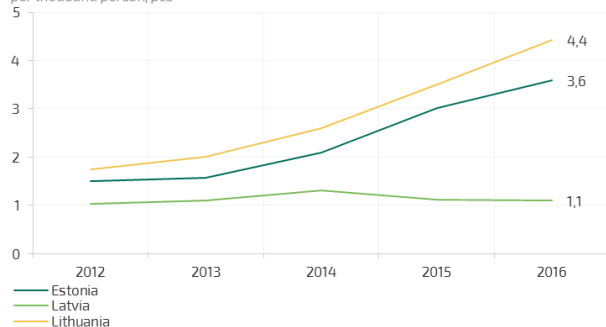
In 2016, the balance of housing loans in the Baltics as a whole increase for the second time after 2008, increasing by EUR 664 million in a year (2015: EUR 209 million) to EUR 17,659 million. The increase is mainly attributable to the housing loan balances in Estonia and Lithuania, which continued the upswing that started in 2013, respectively EUR 416 million in Lithuania (2015: EUR 171 million) and EUR 338 million in Estonia (2015: EUR 259 million). The housing loan balance in Latvia continued its decline, by total of EUR 91 million (2015: EUR 220 million). The growth in the housing loan balance can be largely attributed to the fact that the reference interest rates used for bank loans have fallen well below zero and people are taking loans with increasing confidence because of the low interest rates. People's confidence in the economy in general remains stable. At the same time, it must be noted that although demand for loans has increased, the proportion of loans in buying real estate or construction is substantially lower than in the boom years, which means that more investments are made on equity.

Stable developments on the Baltic real estate markets provided confirmation that the decisions of Merko Ehitus to increase investments in real estate development and launch new apartment developments in all three capitals of the Baltics have been correct.

THE NUMBER OF AUTHORISATIONS FOR USE ISSUED FOR NEW RESIDENTIAL PREMISES
thousand pcs



THE NUMBER OF AUTHORISATIONS FOR USE ISSUED FOR NEW RESIDENTIAL PREMISES
per thousand person, pcs



Source: Local statistical services.

OUTLOOK FOR 2017

CONSTRUCTION SERVICES

In 2017, the economies of the three Baltic countries are forecast to grow 1-2% (average). The Finnish economy is showing the first signs of recovery, fuelled mainly by construction sector investments and household consumption, while foreign trade decreased. The Swedish economy is supported by population growth and the accompanying investments relying on the strong economic growth forecast for 2017, and fuelled by the central bank monetary policy, increase in private sector investments (mainly in housing) and growth in export as well as public sector investments. As a result of the continuing rise in real estate prices, the Swedish economy will remain exposed to risks. As a result of which, in case of negative scenarios, potential risks could be posed to the Baltic credit market as well due to the greater integration between the largest banks in the region with their Swedish parents. The Norwegian economy is still affected by the low price of oil and gas, and the modest foreign demand for Norwegian product, as well as the huge loan burden of households and high real estate prices. The stimulus measures taken by the Norwegian government for stabilising the economic situation via boosting expenditure on infrastructure and public buildings have moderately supported economic recovery, with the economy continuing to adapt to the new normality. The Baltic construction market is expected to post no growth next year; at the same time we are optimistic about the medium-term outlook. Euro base rates remain low, although we continue to believe that there are still inflationary risks in the longer term. The outlook of the Russian economy is mainly related to the oil price, economic sanctions and political uncertainty. Presuming that the oil price will stay on last year's level or recover to some extent in 2017 and the situation in the crisis hotspots with Russian involvement will remain frozen, the economic decline in Russia will slow down or reverse, and the volatility of the rouble will decrease. As the Baltic States all have small and open economies and are largely dependent on our close economic ties and trade with neighbouring countries, the economic developments in both Scandinavia and Russia have a direct effect on us. Besides direct impact, insecurity about the future could curtail economic growth expectations for 2017 in the Baltics, as investment projects may be frozen.

For 2017, we are forecasting a continued stagnation in the volume of Baltic construction contracts. 2016 was a complicated year for the Baltic construction sector. Despite active residential development in the Baltic capitals, the volumes of new construction orders of general contractors remained low, in terms of both infrastructure and commercial and public buildings. The market volume balanced off mainly at the expense of active residential development in Tallinn and Vilnius, but this doesn't mean significantly more work for large general contractors, whose developments often compete in this field with their potential customers. Developments in the construction sector in the near future will be influenced by the activity level of public sector contracts, as it is clear that there is no growth in private sector order volumes. On the other hand, we can detect the first signs suggesting that the sluggish preparation of construction projects funded within the framework of the EU budget period and the announcement of public sector procurements is beginning to pick up pace.

In this market situation, Merko is making a greater contribution to private capital investments in the field of production, logistics and other commercial real estate, although this does not compensate for the shortfall due to the lack of state orders on the construction market as a whole. Based on plans made by public sector contracting entities, we forecast that in early 2017 we will start to see an increase in the number of new public procurements, including projects financed by EU funds, and that these projects will reach the construction phase starting from the second half of 2017 or the beginning of 2018. At the same time, plans to launch procurements have been constantly postponed in recent years. Public sector contracts would help to counterbalance the major fluctuation in construction market order volumes and support investments into the development of the construction sector – both into human resources and technologies. Today the priority of the group in all three Baltic countries is to cooperate more with private clients, to whom we wish to offer comprehensive design and construction services, quality and optimal construction solutions, effective construction process and certainty regarding timely completion of projects.

An overall decrease in construction volumes and a tightening price competition has put pressure on the general contractors' tender pricing and forced to take bigger risks. We have observed that the price competition in the tenders has tightened even more which has led to increased risks for both, the general contractors as the customers. In the market competitors are continuing to submit aggressive offers, anticipating that the input prices will decrease or counting on changes to project design solution, however which may not materialise, especially in light of the expected increase in construction market volumes in the coming years. As a result from the above the direct and indirect risks (incl. risks like receiving a building that doesn't meet the expectations, contractor's financial difficulties and project completion delays deriving from that, disputes between the parties arising from possible changes to the project and compensation of additional works) have increased for the customers that are sometimes not perceived in the light of the favourable prices. As a positive trend we can bring out that more and more private sector clients are increasingly opting to sign design-build contracts instead of mere construction contracts, as the end result of a construction that meets the expectations is more likely with a professional partner who is responsible for the whole process. The continuing expansion of the area of application of building information modelling (BIM) in the construction process is also a positive trend.

Both in 2015 and also in 2016, the average profitability of new contracts signed by general contractor companies remained below previous year's level depending on price competition and the trend is not expected to significantly change in 2017. Competition between general contractors within the Baltic construction market will continue to be tough and bidding for construction tenders will be aggressive. This will provide a competitive edge to construction companies in the market that are efficient and have flexible cost base. Since customers remain focused on the lowest construction cost, often also at the expense of quality, it is still difficult to

stand out in the competition with other general contractors, especially with regard to simpler and smaller construction projects; also the risks related to bids submitted below the actual cost price have increased.

Considering the customers demand with regard to guarantees and lengthy payment terms, the stress on construction companies' working capital continues to be high and capability for cash flow management is required to remain competitive. Merko companies use the group's strong financial position as a competitive advantage in negotiations over payment terms.

Taking into account the relatively weak outlook for growth in the construction market, we do not foresee major changes in the level of construction input prices, despite some wage pressure. Input prices may come under temporary pressure in a situation where multiple major construction sites are in progress simultaneously. This could result in a rise in prices of certain inputs (such as concrete elements). Also the level of Baltic states' construction price indices have remained relatively stable during the last three year. Although one could assume that input prices decline due to the weakness in the construction market, as a result of the general price inflation and trends in the labour market, this is not to be expected. In conditions where there are not a lot of subcontractors with a long history and who are reliable, the subcontractors' prices have not seen a decline similar to the drop in general contractors' prices. This means that general contractors' margins are particularly under pressure – customers are exerting strong pressure for a price decrease in connection with the lower overall volumes on the construction market. Nonetheless, sudden fluctuations in input prices cannot be ruled out against the backdrop of global economic events.

Because the road construction sector suffers from excess capacity of fixed assets, profitability requires continued reduction of machinery and the efficiency of the cost base. In road investments carried out by the Estonian Road Administration, we expect more small-scale construction and repair work and we expect the City of Tallinn to announce the largest procurements of recent years (Reidi road and the Haabersti intersection). Considering that the winter of 2016/2017 has been extraordinarily mild, with temperatures hovering around 0 °C, and that the year 2017 is also the election year for local governments, we expect major investments in street and road repair and maintenance works.

In the field of electrical construction, investments and orders for modernisation and development of main and distribution grids are ongoing in all three Baltic countries, where there is close competition between a limited number of companies.

The Norwegian construction market as a whole continues to be active. In larger cities demand remains strong in the residential real estate market, yet we have to consider the high level of regional disparity and volumes have decreased in Southern and Western Norway. The main construction activity as regards to new residential dwellings is concentrated in the capital Oslo region, where demand remains strong but supply is thwarted by the long period of preparation of new projects. In the field of public building construction, the market is active and for commercial building construction, the market remains moderately stable, but the outlook is negative due to lower employment level and decreased consumption. The share of civil engineering projects with respect to all construction sector projects continues to grow, above all due to large public investments into infrastructure projects which, in turn, has tightened competition in the sector.

As one of the largest general contractors, AS Merko Ehitus Eesti, subsidiary of AS Merko Ehitus, is well positioned in the Estonian construction market and is capable of competing in all activity segments, although there are many general contractors in general construction market segment and there is a tight price competition, often at the expense of quality and contractual risks. In Latvia, SIA Merks, a subsidiary of AS Merko Ehitus, belongs to among the leading general contractors. In Lithuania, UAB Merko Statyba, a subsidiary of AS Merko Ehitus, has focused its construction activities mainly on apartment development and building (general construction) segment, where competition in tenders continues to be tough. The primary focus of the Norway-based Peritus Entreprenør AS lies in the general construction of buildings, where the company is seeking to expand its range of services. One of the key strategic objectives of Merko Group is to enhance revenue and gain market share on foreign markets.

APARTMENT DEVELOPMENT

In Tallinn and Vilnius, the situation in the apartment market has continued to stabilise. In Riga the apartment market continues to be relatively less active, even though some indicators suggest enhanced activity. The increased supply of apartments mainly in Tallinn and Vilnius has been expressed above all in clients' desire for discounts, and a certain amount of lengthening of sales periods in some projects. We do not forecast a long-term and steep change in prices over the next year. Given the Merko brand recognition and reputation in the eyes of apartment buyers, we anticipate that despite the active supply on the apartment housing market, demand will stay strong for the high-quality apartments developed by the Merko Group, in all three capitals of the Baltic states.



IN 2016 MERKO LAUNCHED THE CONSTRUCTION OF THE FIRST APARTMENT BUILDING OF THE NOBLESSNER HOME PORT, PLANNED TO RISE A MERE 7 METRES FROM THE SEA AND SCHEDULED TO BE COMPLETED BY THE END OF 2017. THE MULTI-FUNCTIONAL RESIDENTIAL, COMMERCIAL AND RECREATIONAL ENVIRONMENT OF THE HOME PORT CONSISTS OF A TOTAL OF FOUR APARTMENT BUILDINGS WITH 220 APARTMENTS AND NEARLY 3,700 M² OF COMMERCIAL SPACE.

In the environment of increased supply and greater general awareness apartment buyers are even more focused on reliability (experience and reputation of the developer and contractor), construction quality (energy efficiency, sound insulation) and make their buying decisions based on infrastructure of the area (parking, services, logistics). In addition, the customers are focusing more on the living environment of a neighbourhood as a whole.

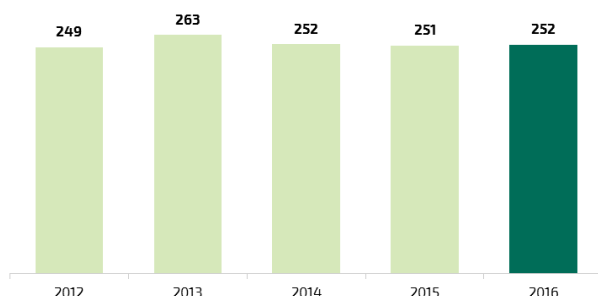
Good availability of bank loans due to the strong capitalisation of banks and loans-to-deposits ratios is also continuously supported by a low reference interest rates level, at the same time customers in Latvia are less inclined to take loans than in Estonia and Lithuania. Apartment market demand is also positively impacted in addition to above by the lack of alternative investment opportunities, an increase in incomes and a stable level of consumer confidence. Although the demand for loans has increased, the proportion of loans in buying real estate or construction is substantially lower than in the boom years, which means that more investments are made on equity.

Merko has established the objective of being represented mainly in the average price category segment of the apartment market and, after careful selection, develop a few select projects in the lower and higher price category.

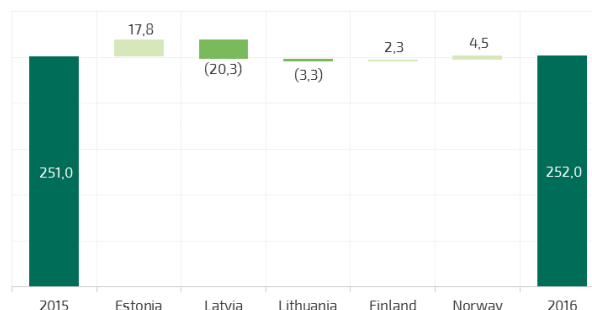
OPERATING RESULT

REVENUE AND PROFIT

GROUP REVENUE
in million euros



GROUP REVENUE
in million euros

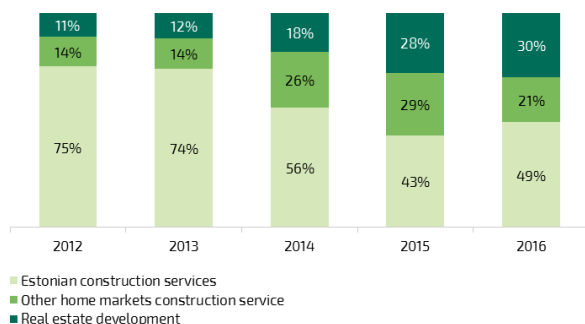


In 2016, the revenue of Merko Ehitus was EUR 252.0 million. (2015: EUR 251.0 million). 68.6% of the period's revenue was generated in Estonia, 17.8% in Latvia, 9.8% in Lithuania, 2.0% in Finland and 1.8% in Norway (2015: 61.6% in Estonia, 26.0% in Latvia and 11.2% in Lithuania and 1.1% in Finland). As compared to 2015, the group's revenue increased by 0.4%, including a 31.1% decline in Latvia and 11.8% in Lithuania and a 11.5% increase in Estonia and 79.7% in Finland and by the initial revenue from Norway.

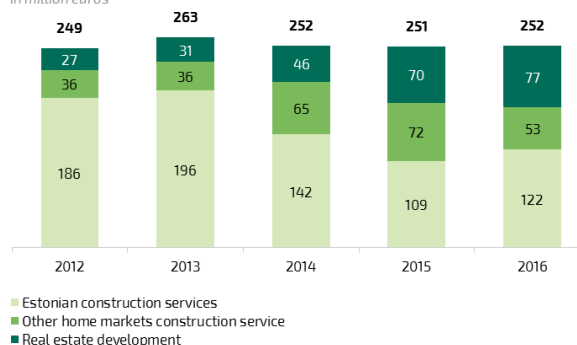
The revenue was below management's expectations mainly due to a somewhat slower than expected launch of several large-scale projects in the first half of the year. This is above all due to circumstances on the customer side as the design work and obtaining related approvals or financing issues have kept construction from being launched at the expected rate in a number of projects across the Baltics. Another factor is the generally lower number of large-scale projects with respect to the comparison period.

The main changes in the revenue structure compared to the same period last year lie in the growth in revenue from Estonian construction services' general construction projects and in the increase in the sales revenue of construction services from joint venture projects and a one-off increase in revenues from immovable properties in the real estate development segment. Revenues are down from Estonian construction services' civil engineering projects and in the other home markets constructions service segment. This trend has been in line with the group's expectations, considering the distribution of the secured order book as at the end of 2015 and the slump in new construction orders in Latvia and Lithuania. The sales revenue earned in Norway is a new component in the group's turnover this year.

DISTRIBUTION OF GROUP REVENUE ACCORDING TO SEGMENTS
percentages



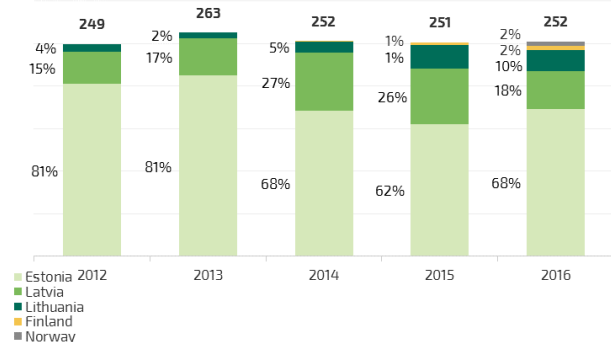
DISTRIBUTION OF GROUP REVENUE ACCORDING TO SEGMENTS
in million euros



Estonian construction service segment contributed 49% (2015: 43%), other home markets construction service segment 21% (2015: 29%) and real estate development segment 30% (2015: 28%) of the group's revenue. 87% of the revenue from construction activities was related to new constructions and 13% to renovation and reconstruction works (2015: 81% and 19% respectively).

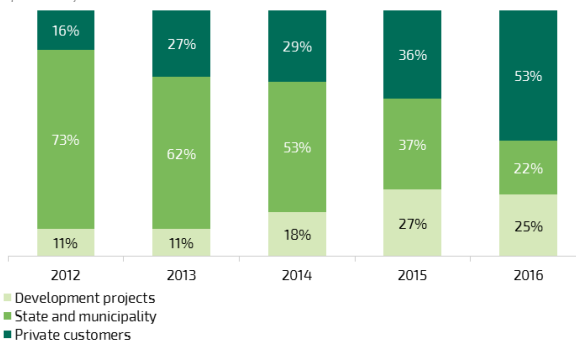
DISTRIBUTION OF GROUP REVENUE BY GEOGRAPHICAL LOCATION

in million euros



DISTRIBUTION OF GROUP REVENUE ACCORDING TO CUSTOMERS

percentages

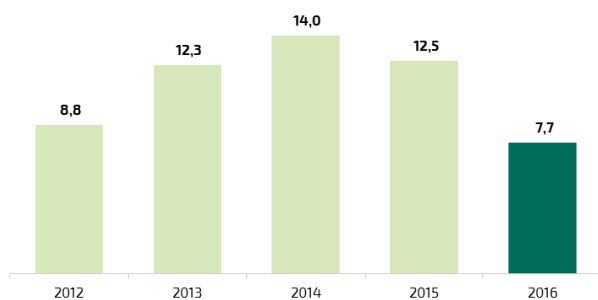


By country, Estonian sales continued to account for the largest share of revenue – 68% (2015: 62%) – as the group's percentage of revenue from outside of Estonia decreased to 32% (2015: 38%). It is one of the group's strategic objectives to increase the proportion of revenue generated from outside of Estonia to approximately 50%, especially in Latvia, Lithuania and Norway.

In 2016, the total number of projects launched by private sector clients has stabilised, but at the same time the number of planned projects has clearly decreased – the trend is clearly visible in both the revenues of Merko Ehitus and in the signed order book. While in the last few years the construction sector was mainly affected by the lack of public sector orders, we expect this trend to be reversed in 2017, especially considering the conservative approach of private-sector contracting entities with regard to new investments. The share of public sector in construction will start increasing again when projects funded in the new EU financial framework come to market, as a result of which we can expect the state to again dominate on the construction market in years ahead, albeit to a lesser extent than in the past.

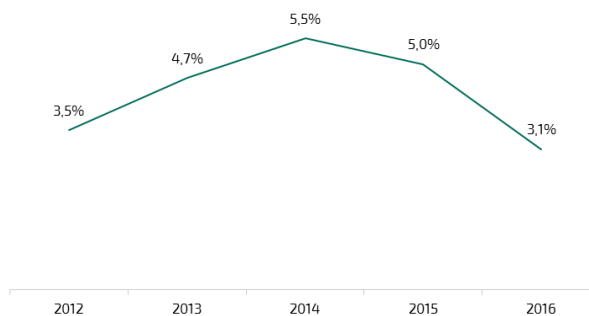
GROUP OPERATING PROFIT

in million euros



GROUP OPERATING PROFIT MARGIN

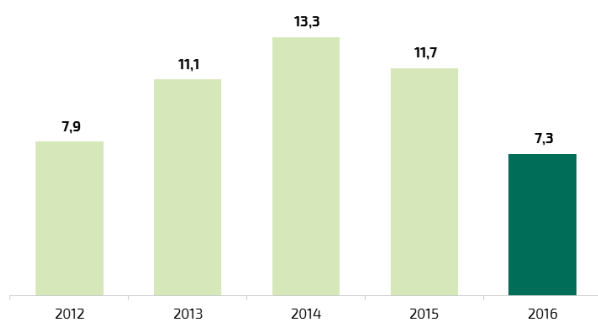
percentages



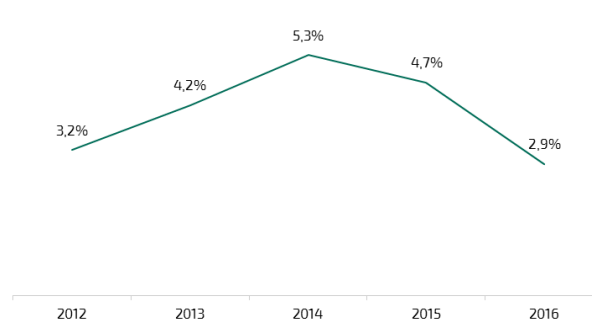
In 2016 the group's operating profit from development and construction activities totalled EUR 7.7 million (2015: EUR 12.5 million). The 2016 operating profit margin (3.1%) has decreased by 1.9 pp compared to last year (2015: 5.0%). The group's aim is to preserve the profitability both in the Estonian but also other home markets construction service domain in spite of the prevailing competition situation on the construction market and the decrease in sales volumes in regard to previously higher-margin civil engineering projects, which was supported by somewhat of a drop in input prices, but which may not continue. The operating profit margin for 2016 has been influenced by the delay of a performance of some contracts due to circumstances attributable, above all, to the contracting entity and the simultaneous launch of several large-scale construction projects and the subcontractors' limited ability to carry out the work or to do that under reasonable circumstances. On the other side operating profit margin has been positively impacted to some extent by the recovery in profitability in the real estate development segment, which depends largely on the price of the land as part of the total specific project expenses and is thus different on a project basis. The level of operating profit compared to that of last year was additionally influenced by higher marketing, general and administrative expenses, mainly due to the additional activity in Norway. The increase in marketing and general administrative expenses in Latvia can be attributed to the costs incurred on maintaining the team against the drop in project volumes, and the corresponding expenses in Lithuania to the change in classification of certain expenditure items.

The scarcity of projects and the ever-tightening competition in the construction sector poses a great challenge in maintaining the current level of operating profits in all segments. The number of companies participating in tenders and the risk of low pricing bids is high in all three Baltic states.

GROUP PROFIT BEFORE TAX
in million euros

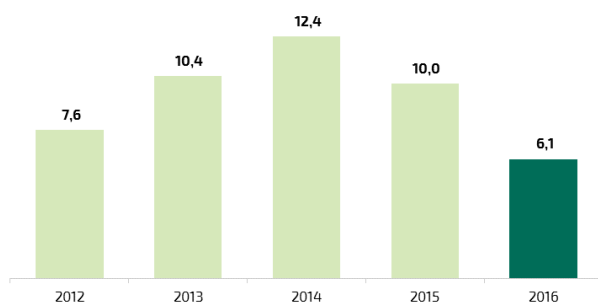


GROUP PROFIT BEFORE TAX MARGIN
percentages

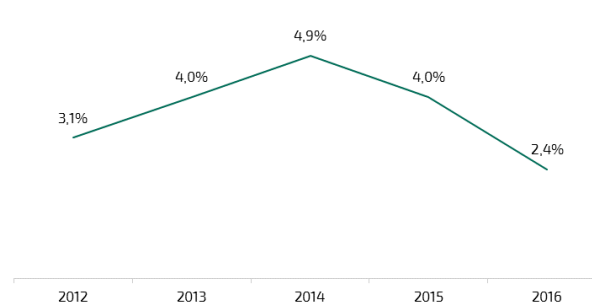


In 2016, the group's pre-tax profit totalled EUR 7.3 million and the net profit attributable to owners of the parent company was EUR 6.1 million as compared to the pre-tax profit of EUR 11.7 million and net profit attributable to owners of the parent company of EUR 10.0 million in 2015. The group's profit before tax margin was 2.9% (2015: 4.7%) and net margin was 2.4% (2015: 4.0%).

GROUP NET PROFIT
in million euros



GROUP NET PROFIT MARGIN
percentages



In the second quarter of 2016, the group paid EUR 9.0 million in dividends, which incurred additional income tax expense in the amount of EUR 0.6 million. The situation in the second quarter of 2015 was alike, when the group paid EUR 7.3 million in dividends, with the exception that then the group incurred additional income tax expense in the amount of EUR 0.9 million.

BUSINESS SEGMENTS

The group operates mainly in Estonian, Latvian and Lithuanian market through its subsidiaries. By purchasing a majority shareholding, the group has formed the basis for entering the Norwegian market starting from Q1 2016. Depending on the country the group offers construction services and real estate development services across the following business segments: Estonian construction service (incl. construction services on project basis in Finland), other home markets construction service (incl. construction services in Norway) and real estate development. See additionally the detailed management structure on page 56.



Pursuant to the international financial reporting standards (IFRS 8), the group discloses in the external financial reporting an aggregate overview of the business segments in countries that constitute a smaller share in operations, in accordance with the requirements established for the disclosure of business segments.

Estonian construction service (incl. construction services on project basis in Finland) and other home markets construction service (incl. construction services in Latvia, Lithuania and Norway) segments include all projects of the respective countries pertaining to construction services:

<p>GENERAL CONSTRUCTION </p> <p>Construction of various buildings starting from commercial and office buildings, shopping and entertainment centres, hotels and spas to public, residential and specific industrial buildings.</p>	<p>CIVIL ENGINEERING </p> <p>Design and construction of infrastructure. The field includes port, waste handling and road infrastructure (bridges, tunnels, overpasses, roads), various environment protection facilities, drinking water and waste water treatment facilities, water and sewerage mains built using both open and no-dig methods, and various other engineering and technical sites.</p>	<p>ELECTRICAL CONSTRUCTION </p> <p>Above all, medium and high voltage substation and cable line engineering configuration and construction. Professional project management team, good cooperation experience with local and international customers. Merko is the Estonian market leader in construction of high-voltage substations.</p>
<p>ROAD CONSTRUCTION </p> <p>Various road maintenance services in Estonia: road construction, maintenance repair of roads and supervision of excavation work and the condition of roads, traffic sign manufacturing and provision of repair services for machinery.</p>	<p>CONCRETE WORKS </p> <p>Solutions for buildings and infrastructure constructed of prefabricated or concrete panels by Merko, its subunits, and out-of-house customers. Merko's concrete works department employs about 100 workers.</p>	<p>REAL ESTATE DEVELOPMENT </p> <p>Development of apartment projects, long-term investments and real estate projects for business purposes.</p>

One of the keys to the success of Merko is the wide scale of its operations – if a certain business segment has more or less work, it is possible to re-assign staff and manage risks. Another competitive advantage is the professional team of project managers and engineers and experience in implementing complex projects using contemporary engineering solutions. The strength of Merko is

also to simultaneously complete various complex and long-term projects and provide quality construction services to customers with different requests.

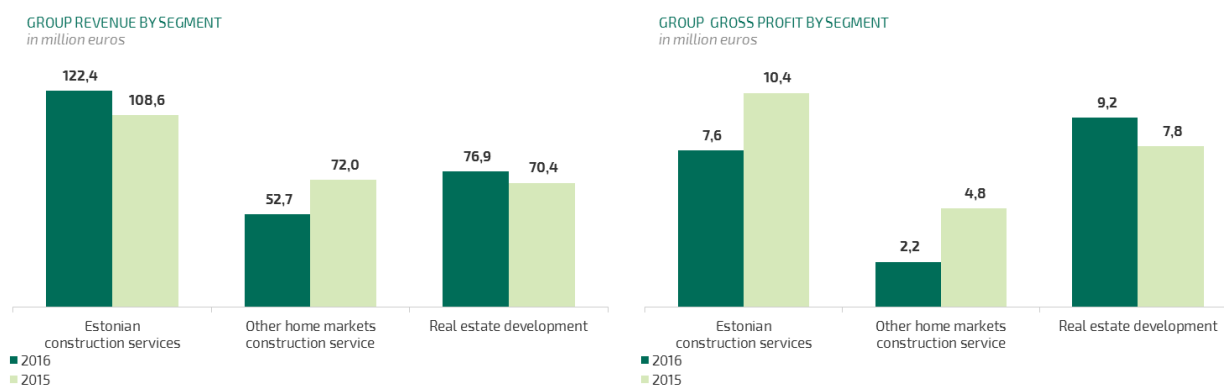
One of the means to our success in the field of civil engineering is the skills and know-how in linking the skills of separate units in carrying out complex engineering projects through skilled and professional project management.

In addition to enhancing our project management capacity, in recent years we have been improving our technical capacity in performance of works. Among others, we have at our disposal several different no-dig technologies for building water and sewerage pipelines in different soils. As the current 2014-2020 EU budget period will see significantly less funding for public water supply and sewerage investments than in the last period, next years will likely see volumes continue to decrease in this segment.

In the electrical construction field, Merko primarily focuses on the design, configuration and construction of mid and high voltage substations and power lines. Merko has a competitive advantage over competitors because the company is not affiliated with any specific manufacturer, enabling to provide the customer with the best possible solution in partnership with various manufacturers. Merko also has an excellent team spanning the entire construction cycle - starting from designers to the final configuration and also professional project managers keeping the process together and managing it.

With the goal of offering customers more integral and higher quality service and bolstering the effectiveness of cooperation between different parties, Merko has adopted BIM – building information modelling. This modern discipline leads to a better understanding of an existing building and its shape and structure, enabling to check for conflicts in project documentation, calculate structural volumes of a project and produce 3D visuals. Within the group, the goal of BIM is currently recognised as simplifying the work of site teams by generating building models that are as detailed as possible. To achieve this, the entirety of the design coordination process on selected projects (architecture, construction and technical systems) follows one master model, to which all parties have access and which contains all of the latest detailed information on the project.

CHANGE IN GROUP REVENUE AND GROSS PROFIT ACROSS BUSINESS SEGMENTS



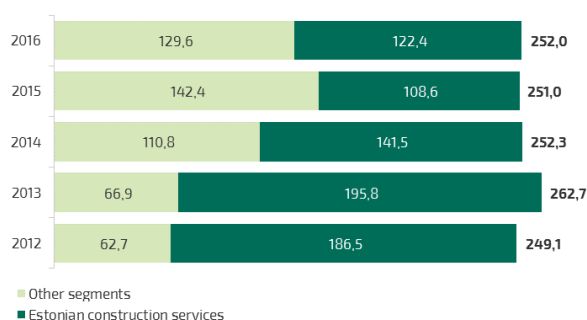
ESTONIAN CONSTRUCTION SERVICE

The Estonian construction services segment consists of various services in the field of general construction, civil engineering (including construction of electrical and external networks) and road construction.

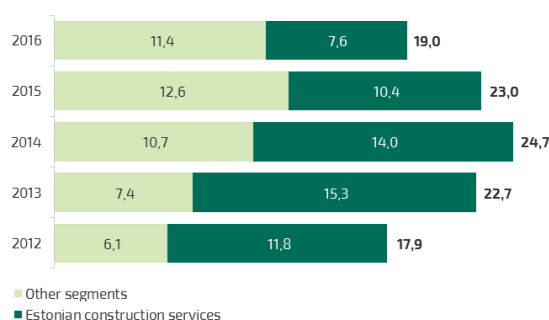
million EUR

	2016	2015	CHANGE
Revenue	122.4	108.6	+12.7%
% of total revenue	48.6%	43.3%	+12.2%
Gross profit	7.6	10.4	-26.6%
Gross profit margin	6.2%	9.6%	-34.8%

REVENUE
in million euros



GROSS PROFIT
in million euros



In 2016, the revenue of the Estonian construction service segment was EUR 122.4 million (2015: EUR 108.6 million), having increased by 12.7% from the same period last year. Estonian construction service revenue includes revenue from Finnish projects in the amount of EUR 0.6 million (2015: EUR 2.8 million). The revenues have clearly decreased in the field of civil engineering and increased in the field of general construction. The increase in revenue in the segment is primarily influenced by the fact that several large-scale general construction projects launched in 2015.

The Estonian construction service segment revenues for 2016 were 48.6% of the group's revenue, forming the largest proportion in the group's revenue, having increased by 12.2% in the yearly comparison.

In 2016, the group earned a gross profit of EUR 7.6 million in this segment (2015: EUR 10.4 million). In 2016, the gross margin of the Estonian construction service segment was 6.2%, which decreased by approximately 1/3 compared to 2015 (9.6%), mainly due to the scarcity of projects in the field of civil engineering but also due to tight competition in the field of general construction. We do not consider this as a satisfactory result, despite the close competition on the Estonian construction services market, in a situation where new contracts have not been concluded in the desired level at new procurements, especially at public procurements, and where the construction market volumes have decreased. We continue critically monitoring any changes in the volume of work-in-progress and also constantly improving the efficiencies of internal project management processes. We have reduced and re-allocated staff within the group and, in order to maintain the efficiency of the cost base, made preparations with the aim for responding to further market changes.

If starting from 2013 we have seen a rise in the proportion of private sector orders, then in 2016 this tendency stabilised. With regard to projects in progress in the Estonian construction service segment as at the end of year, private sector orders constitute approximately 3/4.

Among the substantial projects in process that started in 2016 and earlier and will continue in 2017 are the design and construction works of T1 shopping centre, the design and construction works of Maakri Kvarital business complex, the design and construction works of office building located at Mustamäe road 3, the design and construction works of BAUHAUS DIY store and the design and construction works of Pärnu road 22 office building. Also the construction of the airport tram line infrastructure, the construction works of Viru Infantry Battalion technology park buildings and facilities, Juuliku road junction and road section at Tallinn roundabout and long-term maintenance works done under the service agreement with Tallinn and Viljandi County will continue.

Among the large projects completed and handed over to customers in 2016 in the Estonian construction service segment, the largest ones to highlight are the construction works of Hilton Tallinn Park Hotel and Tallink Tennis Centre, the design and construction works of Poordi st. 1 apartment building and Öpiku Office building A in Tallinn, the construction of water pipeline for the pumping station at Tondi st. 90 in Tallinn, the reconstruction of Kuning, Vana Turg and Viru streets in the Old Town of Tallinn, the repair works of Tapa-Loobu support highway road sections in Lääne-Viru county and the repair works of Kiviõli-Varja support highway road sections, incl. the reconstruction of Lüganuse and Roodu bridges in Ida-Viru county.

CASE STUDY



TALLINN TRAM TRACK LINES CONSTRUCTION WORKS

Since 2014, Merko has contributed to renovation and upgrades of the Tallinn public transport network through various projects. In the course of renovation work on tram line no. 4, completed in 2015, about 30 km of catenary lines were replaced, about 11 km of existing track was renovated, 54 new switches were installed and six traction substations were renovated. Besides the construction of the new tram tracks, the utility lines running under the line were renovated along with the roads and sidewalks and vegetated areas along the tramways, storm drain solutions were provided for the tram tracks and new passenger waiting platforms and pavilions were built at stops. In 2016, Merko performed work on the design and construction of the airport tram line infrastructure, in the course of which 1.3 km of track, one traction substation and a tunnel underneath the railway and Suur-Sõjamäe street were being built.

KEY DATA OF THE LARGEST PROJECTS COMPLETED IN 2016

PROJECT NAME *		LOCATION
Hilton Tallinn Park Hotel	new	Gonsiori st. 20/F.R. Kreutzwaldi st. 23, Tallinn
Tallink Tennis Centre	new	Punane st. 76, Maardu
Poordi 1 apartment building	new	Poordi st. 1, Tallinn
ELKE Auto Narva car center	new	Rebase 7/9, Olgina, Vaivara municipality, Ida-Viru county
Õpiku Office building A	new	Sepise st. 9/Valukoja st. 8, Tallinn
Osula Energia OÜ connection at Sõmerpalu substation	rec	Sõmerpalu, Sõmerpalu municipality, Võru county
AS Graanul Invest 110kV connections at Imavere and Sõmerpalu substations	new	Imavere municipality, Järva county and Sõmerpalu municipality, Võru county
Construction of waste water collector at Vanasadam Port (a total of 647 m of tunnel collectors with a diameter of 600-800 mm and 676 m of pipes laid using conventional means in an open trench; 6 shaft wells and one water metering well; automatic systems)	new	Logi st., Sadama st., Mere avenue, Tallinn
Paljassaare 110kV substation	rec	Paljassaare põik 1A, Tallinn
Leisi 110 kV substation	rec	Kuressaare road 11, Leisi, Saaremaa
Water pipeline laying for the pumping station at Tondi st. 90 (approximately 2,5 km 630 mm water supply pipelines, incl. approximately 1,4 km laid using the no-dig method; 190 m protection sleeves with a diameter of 800 mm; 12 chambers for damper functions)	new	Tondi st. 90, Tallinn
Kuninga, Vana Turg and Viru st. reconstruction (4,025 m ² Old Town parquet paving stone covering, 4,177 m ² granite tiles on pavements; 768 m water supply pipelines, 725 m sewage pipelines, 1,172 m street lighting grid, 375 m medium voltage cable sewage pipelines)	rec	Kuninga st., Vana Turg st. and Viru st., Tallinn
Repair works of Kohtlase bridge on National highway No 13 Jägala-Käreveve km 1,652 (89,600 m ² asphalt concrete pavement)	rec	Jõelähtme municipality, Harju county
Support highway No 24 Tapa Loobu km 11,24-20,201 repair works (9 km renovated roads; 65,000 m ² asphalt concrete pavement)	rec	Lääne-Viru county
National Highway No 34 Kiviõli-Varja km 3,49-4,97 repair works, incl. reconstruction of Lügänuuse and Roodu bridges (1,5 km renovated roads; 14,250 m ² asphalt concrete pavement; approximately 750 m ³ of concrete)	rec	Ida-Viru county
Valukoja temporary parking lot construction	new	Valukoja st. 7, Tallinn

* Indicators characterising the project are provided in brackets.

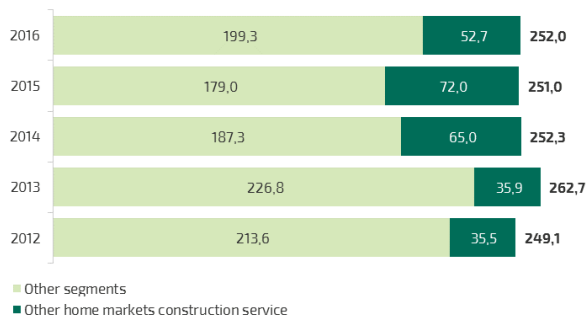
OTHER HOME MARKETS CONSTRUCTION SERVICE

The other home markets construction service segment consists of general construction work in Latvia, Lithuania and starting from the first quarter of 2016 also in Norway and provision of civil engineering services in Latvia.

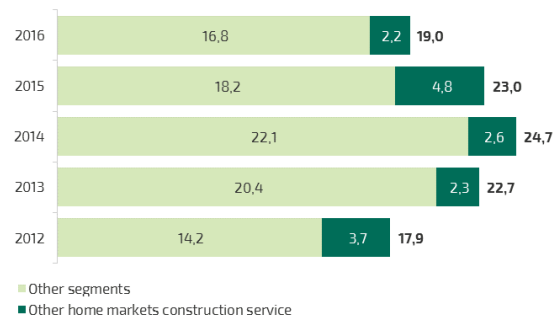
million EUR

	2016	2015	CHANGE
Revenue	52.7	72.0	-26.8%
% of total revenue	20.9%	28.7%	-27.1%
Gross profit	2.2	4.8	-55.0%
Gross profit margin	4.1%	6.7%	-38.5%

REVENUE
in million euros



GROSS PROFIT
in million euros



The revenue of the other home markets construction service segment amounted to EUR 52.7 million in 2016 (2015: EUR 72.0 million), which is 26.8% less than in 2015. If the other home markets construction service segment revenues of 2015 formed 28.7% of the group's revenue, then during 2016 the segments revenues have decreased to 20.9%. The change in this percentage was in line with expectations, considering the lower level of new contracts signed in Latvia and Lithuania during 2015 and the 2015 comparison base, where large-scale projects were finished in Latvia, such as Liepaja Concert Hall and Polipaks NT manufacturing and logistics centre.

In 2016, the gross profit of the other home markets construction service segment amounted to EUR 2.2 million (2015: EUR 4.8 million) and the gross profit margin was 4.1% (2015: 6.7%), which decreased by 38.5% compared to the same period previous year. Merko's strategic position in Latvia is currently strong, as we are now among the leading general contractors there and see opportunities for growing our business volumes. In Lithuania, we are continuing our strategic plan to focus first and foremost on external customers who make up the predominant part of the group's Lithuanian construction contracts portfolio. In Lithuania, we are also cautiously entering the public procurement sphere in the field of general construction. In Norway, the group is performing smaller-scale agreements, but we are actively working on building project management capability and systems to conclude larger general contracting agreements in the years ahead. The group's continued focus is on increasing the revenues outside Estonia.

The largest projects completed in 2016, by SIA Merks, Latvian subsidiary of Merko Ehitus, ones that primarily deserve to be highlighted are the construction works of kindergarten and school buildings complex in Pinki near Riga, the construction works of a meeting house in the city centre of Riga and the construction works of BLRT warehouse and office building in Riga. Among the projects completed in 2016, by UAB Merko Statyba, Lithuanian subsidiary of Merko Ehitus, certainly the most prestigious are the construction works of Šaltinių namai apartment building in Vilnius.

Among the substantial projects in process that started in 2016 and earlier and will continue in 2017 are the construction works of Kauno/Algirdo residential complex with office premises in Vilnius and the construction works of Narbuto 5 office building in Vilnius, the design and construction works of Radisson Blu Hotel Lietuva extension in Vilnius, the reconstruction and extension construction works of Philip Morris plant in Klaipeda, the second phase construction works of the passenger terminal in Riga International Airport, the construction works of apartment building Magdalēnas nami in Riga, the construction works of Cēsu 9 apartment building in Riga, the construction works of Jasmīnu 10 residential complex in Jurmala, the design and construction works of Katlakalna 6D warehouse complex in Riga and the construction works of music school and concert hall located in Ventspils.

CASE STUDY



KINDERGARTEN AND SCHOOL BUILDINGS COMPLEX IN PINKI

In Latvia, in less than a year, the Exupéry International School in Pinki, between Riga and Jurmala, was completed. This is the first purpose-built private school building in Latvia. The Exupéry International School is a unique children's educational centre that combines preschool, elementary school and secondary school education.

The new school has space for 200 schoolchildren and kindergarten places for more than 120 children. The construction encompasses a 2-storey school building and three-storey preschool complex connected to each other by a walkway. The two buildings of the preschool and the private school are connected by an enclosed hallway. One building has a gym and assembly hall; the other, a circular building, has kindergarten rooms on the ground floor with the school on the second floor. In the middle of the circular building is a terrace for the use of the kindergarten. The private school has a total of more than 19,000 m² of floor space.

KEY DATA OF THE LARGEST PROJECTS COMPLETED IN 2016

PROJECT NAME *		LOCATION	COUNTRY
Kindergarten and school buildings complex in Pinki	new	Jaunā st. 8, Piņķi, Babītes, Babītes county	Latvia
Meeting house	new	Lāčplēša st. 71, Rīga	Latvia
BLRT warehouse and office building	new	Katlakalna st. 9D, Rīga	Latvia
Šaltinių namai apartment building	new	Šaltinių st. 24, Vilnius	Lithuania

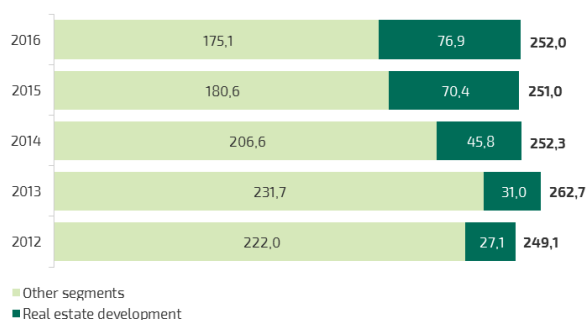
REAL ESTATE DEVELOPMENT

The real estate development segment includes residential construction, the development of apartment projects, long-term real estate investments and commercial real estate projects in all of the different countries where the group operates today (Estonia, Latvia, Lithuania and Finland).

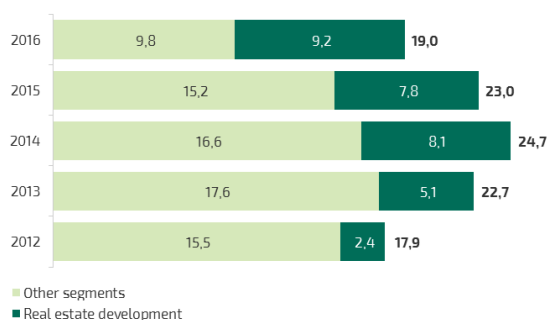
million EUR

	2016	2015	CHANGE
Revenue	76.9	70.4	+9.2%
% of total revenue	30.5%	28.0%	+8.8%
Gross profit	9.2	7.8	+18.8%
Gross profit margin	12.0%	11.0%	+8.8%

REVENUE
in million euros



GROSS PROFIT
in million euros



A total of 493 apartments (incl. 21 apartments in joint ventures) were sold in 2016 at the total value of EUR 56.6 million (excl. VAT), compared to 403 apartments and EUR 61.4 million in 2015. Of the 493 apartments sold 338 were located in Estonia, 66 in Latvia, 79 in Lithuania and 10 in Finland. In 2016, the group has earned EUR 9.2 million of revenue from the sale of properties (2015: EUR 6.6 million). The construction service revenue from projects developed by joint ventures in 2016 was EUR 7.7 million (2015: EUR 0.5 million).

Although in 2016 real estate development segment revenues have increased by 9.2% compared to the same period last year, then despite approximately a 1/5 of more apartments sold, the revenues from apartment sales have decreased by approximately 10%. The decline is primarily influenced by sales of apartments in a more exclusive development in the reference period where the sales price per apartment was higher than the apartments sold during 2016.

In 2016 the share of revenue from the real estate development segment formed as anticipated 30.5% of the group's total revenue (2015: 28.0%), having increased over the year by 8.8%.

In 2016, gross profit of the real estate development segment amounted to EUR 9.2 million (2015: EUR 7.8 million) and the gross profit margin was 12.0% (2015: 11.0%), which increased by 8.8% compared to the same period previous year. The profitability of the apartment development projects varies by project and depends greatly on the cost structure of the specific project, incl. the land acquisition price. If profitability of the apartments sold in 2016 was higher than in the reference period, then on the other hand the segment's gross profit was also significantly influenced by the one-time effect of revenues from the sale of immovable properties that are strategically not needed by the group, the profitability of which is lower than average and not comparable with a situation where the value of land is increased by passing through all phases of the development process. In 2016, the gross profit margin has also been reduced, in comparison with 2015, by the significant growth in the volume of construction service projects developed by joint ventures, where the profit from construction has been generated in the course of construction and the profit from development is realised at a later stage, upon sale of apartments to the final customer, based on the equity method.

The 2016 profitability of the segment was negatively impacted by the impairment of development projects and immovable properties in the amount of EUR 0.04 million (2015: impairments in amount of EUR 1.1 million).

CASE STUDY



TARTU ROAD 52 RESIDENTIAL QUARTER

Merko's real estate development goal is to establish an integral living environment that encompasses high-quality apartments, outdoor areas, parking spaces and storage areas. In the Tartu road 52 project in Tallinn, a secure, lighted interior courtyard with diverse landscaping will be developed in the middle of a group of five buildings. It will help raise the quality of life for families living in the city centre. For adults, the interior courtyard is a good recreational area, children can play safely on the playgrounds here. In 2016, a two-storey heated underground parking garage that connects the entire residential quarter was completed, as were the eight-storey building A along Tartu road and, along the internal street, the 13-storey high-rise building B and five-storey building C.

Managing such a large and valuable portfolio of properties requires careful and detailed planning of the whole process: the development of apartment buildings starts by organising details, detailed planning, designing and construction and ends with the sale of completed production and warranty service. The underlying idea of our development activities is to value land through detailed planning and building development, to find customers for the property and sell the property as developed real estate.

Merko manages all development phases of new housing – planning, designing, building and sales. Homes developed and built by Merko are characterised by integrated living environments, high energy efficiency, good sound insulation from indoor and outdoor noise as well as healthy interior climate.

Our objective is always to create homes that architecturally fit the specific region, have an attractive living environment, functional design solutions, quality interior design materials, optimal construction cost and energy efficiency. A home that is being offered for customers must be of quality and maintain its value in years to come.

In real estate development joint projects, Merko brings its knowledge and experience of real estate development and construction to the partnership and the other party provides the plot and/or investment. The relationships between the parties are regulated by a stakeholders' contract that specifies the liability, rights and responsibility of each partner.

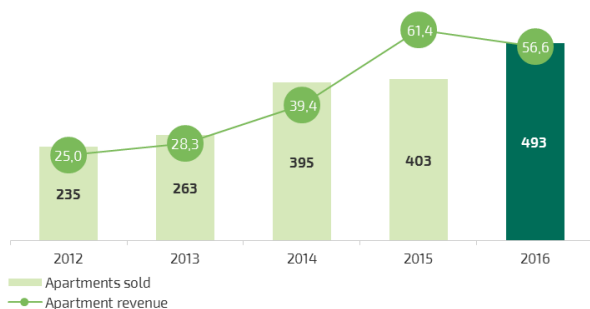
CASE STUDY



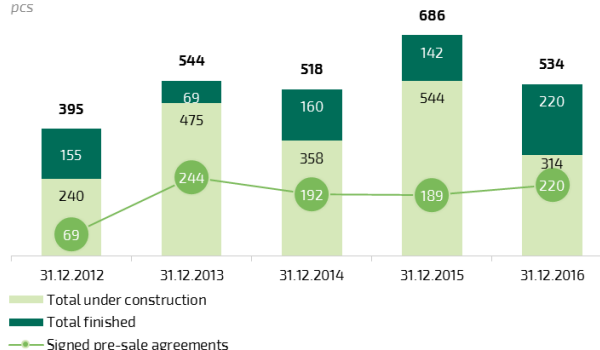
NOBLESSNER HOMEPORT

In cooperation with BLRT Group, Merko is developing the Noblessner area from industrial area to a sophisticated residential, commercial and entertainment environment. The Noblessner Home Port (Kodusadam) development encompasses a total four apartment buildings that will have 200 apartments and close to 3,700 m² of office and retail space. The architecture was designed by Arhitektuuribüroo Pluss, which has put the focus on people's living environment, logistics and activities. Car parking will be on an underground level, private play and recreational areas will be established in the interior courtyards, and the buildings will be surrounded by paths meant for pedestrians. In developing the entire area, BLRT will also build a promenade with a new city plaza, build additional access routes, renovate the yacht club and refurbish the old foundry, which has gained renown as a concert venue.

APARTMENTS SOLD / APARTMENT REVENUE
pcs / in million euros



GROUP APARTMENTS INVENTORY
pcs



At the end of the period, Merko Ehitus group's inventory comprised of 220 apartments with preliminary agreement: 62 completed (42 in Estonia, 10 in Latvia and 10 in Lithuania) and 158 apartments under construction (140 in Estonia and 18 in Latvia). The sale of these apartments had not yet been finalised and the apartments had not been delivered to customers, as the development sites are still under construction or the sites were completed at the end of the reporting period and the sales transactions have not all been finalised yet.

As at 31 December 2016, Merko Ehitus group had a total of 314 apartments for active sale (as at 31 December 2015: 497 apartments), for which there are no pre-sale agreements and of which 158 have been completed (95 in Estonia, 30 in Latvia and 33 in Lithuania) and 156 are under construction (88 in Estonia and 68 in Latvia). The number of apartments on sale as at 31 December 2016 has decreased, compared to 31 December 2015, mainly due to the lower volume of projects launched in 2016: launch of construction of 344 new apartments, compared to the 574 new apartments in 2015.

APARTMENT PROJECTS IN PROGRESS AND INDICATIVE DATE OF COMPLETION

PROJECT	MUNICIPALITY/COUNTRY	COMPLETION TIME	NO OF UNSOLD APARTMENTS *	INCL. PRE-SOLD APARTMENTS
Grostonas 17	Riga, Latvia	Completed	1	-
Grostonas 19	Riga, Latvia	Completed	3	2
Grostonas 21	Riga, Latvia	Completed	4	-
Fiziku 8	Vilnius, Lithuania	Completed	7	-
Kraziu 9	Vilnius, Lithuania	Completed	1	-
Tartu road 52 I & II stage	Tallinn, Estonia	Completed	103	25
Jahu 1a	Tallinn, Estonia	Completed	1	-
Kivimäe 32 ***	Tallinn, Estonia	Completed	1	-
Kaupmehe 9 **	Tartu municipality, Estonia	Completed	8	4
Sõpruse avenue 33	Tallinn, Estonia	Completed	24	13
Krokovos 73	Vilnius, Lithuania	Completed	35	10
Grostonas 12 I stage (Skanstes parks)	Riga, Latvia	Completed	32	8
			220	62
Paepargi 51 (Paepargi towers) **	Tallinn, Estonia	Beginning of 2017	60	52
Grostonas 12 II stage (Skanstes parks) **	Riga, Latvia	Summer of 2017	86	18
Staapli 4 (Noblessner Homeport) *** / **	Tallinn, Estonia	End of 2017	66	21
Paepargi 35, 37 (Perepargi) **	Tallinn, Estonia	Spring of 2017	42	38
Paepargi 53 (Paepargi towers) **	Tallinn, Estonia	End of 2017	60	29
			314	158
Total			534	220

* The completed apartments indicate the number of apartments that are unsold and where possession has not been given to consumers.

** Project launched in 2016.

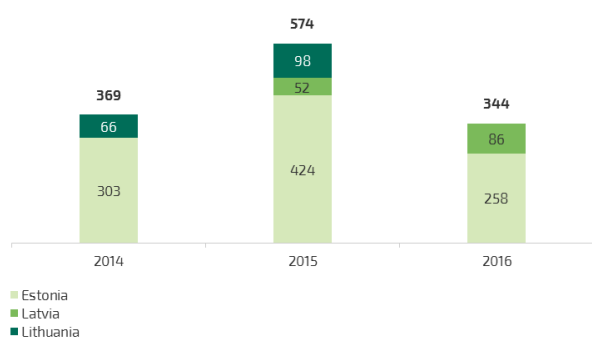
*** A project developed by a joint venture. Group revenue generated through provision of construction services and development activities profit recognised based on the equity method.

In 2016, we launched the construction of a total of 344 new apartments (incl. 66 apartments in a joint venture) in the Baltic states (2015: 574 apartments (incl. 24 apartments in a joint venture)). After the balance sheet date, the group has also launched four apartment development projects:

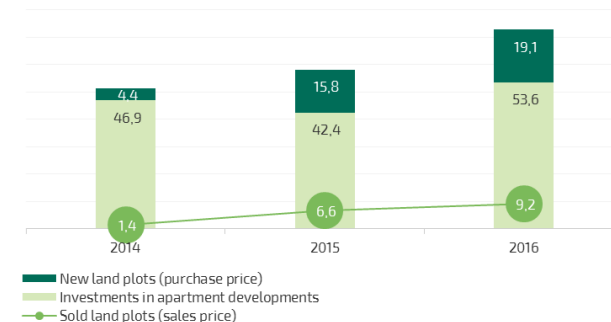
- in Latvia the construction of Gaļezera nami residential development with 96 apartments at Mežciems district in Riga, located between Līduma, Gaļezera and Hipokrāta streets;
- In Lithuania the construction of Rinktinės Urban residential development project with 120 apartments in the city centre of Vilnius, located at the corner of Rinktinės and Ceikiniu streets;
- In Estonia the construction of Staapli 3 apartment building (105 apartments) – the second stage of Tallinn-based Noblessner Home Port development project;
- In Tallinn, Estonia the construction of Paepargi 43 and 47 apartment buildings (66 apartments) in a new stage of Paepargi development area.

In 2016, the group has invested a total of EUR 53.6 million (2015: EUR 42.4 million) in new development projects launched in 2016 as well as projects already in progress from previous year.

APARTMENTS LAUNCHED BY GEOGRAPHICAL LOCATION
pcs



INVESTMENTS IN APARTMENT DEVELOPMENT PROJECTS AND LAND PLOT ACQUISITIONS AND DISPOSALS
in million euros



We will continue to invest in residential real estate projects and depending on the apartment market developments in 2017, the group will launch the construction of approximately 650-700 new apartments (incl. 60-160 apartments in joint ventures) in the Baltic states. In 2016, construction of 344 apartments was started, which is about 150 units less than the level planned in early 2016 (500-550 new apartments) mainly due to the delay in receiving building permits for projects. The investment level in 2017 in both development projects initiated in the previous years and new projects to be launched in 2017 is in the range of EUR 45 million (2016: EUR 53.6 million invested).

One of the group's objectives is to keep a moderate portfolio of land plots to ensure stable inventory of property development projects considering the market conditions. At 31 December 2016, the group's inventories included land plots with development potential, where the construction works have not started, of EUR 63.2 million (31.12.2015: EUR 58.0 million).

GROUP'S INVENTORIES WITH DEVELOPMENT POTENTIAL BY COUNTRY AS AT 31.12

million EUR

	31.12.2016	31.12.2015
Estonia	26.6	14.0
Latvia	28.1	34.8
Lithuania	8.5	9.2
Total	63.2	58.0

In 2016, the group has purchased new land plots at an acquisition cost of EUR 19.1 million purposes, which allocated by country is following: in Estonia EUR 16.8 million and in Lithuania EUR 2.3 million (2015: acquired different new land plots in Tallinn, Estonia at an acquisition cost of EUR 6.6 million and in Vilnius, Lithuania at an acquisition cost of EUR 5.1 million). In 2016, the group acquired the Pakraščio street immovable property in the city centre of Vilnius, Lithuania at an acquisition cost of EUR 2.3 million, where nearly 200 apartments will be developed in the years ahead; in the area located between Veerenni, Tehnika and Vana-Lõuna streets in Tallinn a development area of approximately 12 hectares at an acquisition cost of EUR 16.8 million, which allows the construction of approximately 1,600 apartments. The purchase of the Veerenni land plot constitutes one of the group's largest investments in the last 5 years, and serves to reinforce the group's long-term strategy in Estonia. The construction of the first buildings on the site is scheduled to be launched at the end of 2017. Depending on the apartment market dynamics, the entire development area can be built up within 10-15 years.

The comparison period development activities investments include additionally the signing of a notarised contract of sale of registered immovable in 2015, under which all of the real estate governed by an option agreement in Tallinn were realised for total of EUR 4.0 million. AS Merko Ehitus group 50% joint venture Kodusadam OÜ additionally signed a contract for the acquisition of approximately 1.7 hectares of land in the Noblessner quarter, an historically prestigious industrial area in Tallinn with great potential, for development purpose to build approximately 200 apartments. As of the approval of this report, the first two apartment

buildings in the Noblessner development project at Staapli 4 and 3 are under construction. They are set to be completed by the end of 2017 and the end of 2018, respectively.

Based on its long-term strategy, the group will continue investing in land plots, and is searching for new land plots with development potential, in 2017 above all, in Estonia and Lithuania.

In the second quarter of 2016, the group completed the competition for an international development and architectural concept for the Latvian Zakusala development area (close to 1,500 apartments). A total of eleven entries came in from Estonia, Norway, Poland and Latvia. The competition was organised based on the regulations handed down by the Latvian Architects Union. Six entries from among the works submitted met the qualifications. A five-member jury picked an entry by RUUME arhitekti (ruumearhitekti.wordpress.com), a practice of young Latvian architects, as the winner. The group will continue preparations in order to launch construction in the development area in 3-5 years' time.

In 2016, the group sold off strategically non-essential immovable property at a sale price of EUR 9.2 million (2015: EUR 6.6 million), including for EUR 6.2 million in Estonia, EUR 2.6 million in Latvia and EUR 0.4 million in Lithuania.

After the balance sheet date, the group has acquired a 1.5-hectare development project between Rūpniecības and Pētersalas streets in the heart of Riga at an acquisition cost of EUR 4.1 million, allowing to build nearly 350 apartments in the upcoming years.

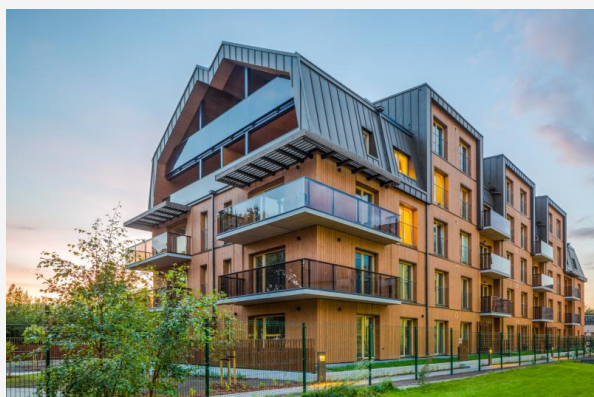
THE SPECIFICATIONS OF PROJECTS COMPLETED IN 2016

PROJECT		LOCATION	SIZE
Paepargi 29, 31, 33	new	Tallinn, Estonia	3,228 m ² , 57 apartments
Tartu road 52 I & II stage	new	Tallinn, Estonia	10,210 m ² , 185 apartments
Jahu 1a	new	Tallinn, Estonia	2,751 m ² , 37 apartments
Sõpruse avenue 33	new	Tallinn, Estonia	3,703 m ² , 51 apartments
Kivimäe 32 *	new	Tallinn, Estonia	1,956 m ² , 22 apartments
Kaupmehe 5	new	Tartu municipality, Estonia	1,760 m ² , 30 apartments
Kaupmehe 9	new	Tartu municipality, Estonia	1,337 m ² , 30 apartments
Grostonas 12 I stage (Skanstes parks)	new	Riga, Latvia	4,593 m ² , 52 apartments
Krokuvos 73	new	Vilnius, Lithuania	5,470 m ² , 98 apartments
Pestikuja 1	new	Helsinki, Finland	1 366 m ² , 10 houses

* A project developed by a joint venture.

Projects completed in 2016 had a total of 572 apartments, of which 204 have not been sold by the year-end and of which 60 apartments had a preliminary agreement signed but where the sale had not yet been finalised and delivered to customers.

CASE STUDY



JAHU 1A SATISFACTION SURVEY

In October 2016, Merko in connection with the service provider Rekommy carried out a satisfaction survey among the buyers of Jahu 1A apartments. The results of the survey confirm that Merko's trademark is highly appreciated among the buyers, and that the buyers are willing to recommend the trademark to their friends and acquaintances.

- The overall recommendation index or the customer loyalty index is +90 (on a scale between -100 and +100)
- the apartment purchase satisfaction index is +56
- satisfaction with the construction quality and solutions is +60
- satisfaction with the living environment is +80

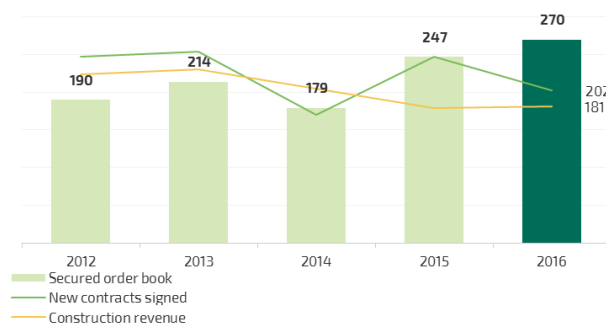
The satisfaction survey gave Merko a much-appreciated feedback and recommendations how to further improve the customers' purchase process, and the products and services offered.

SECURED ORDER BOOK

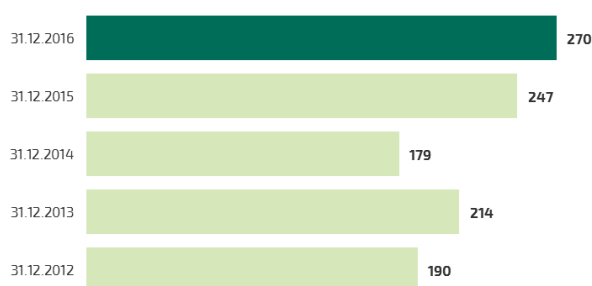
As at 31 December 2016, the group's secured order book (excluding property developments) amounted to EUR 269.6 million as compared to EUR 246.9 million as at 31 December 2015. The secured order book excludes the group's proprietary residential development projects and work related to developing real estate investments.

In 2016, new construction contracts worth EUR 202.4 million were signed (excludes property developments) as compared to EUR 247.0 million in the prior year.

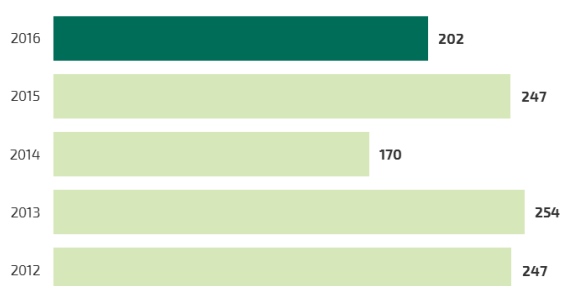
SECURED ORDER BOOK
in million euros



SECURED ORDER BOOK
in million euros



NEW CONTRACTS SIGNED
in million euros



LARGEST CONSTRUCTION CONTRACTS SIGNED IN 2016

BRIEF DESCRIPTION OF CONTRACT	COUNTRY	COMPLETION DATE	COST MILLION EUR
Construction contract to perform Juuliku road junction and road section construction works	Estonia	Autumn of 2017	11.0
Design and construction works of commercial building located in the city centre of Tallinn at Pärnu road 22	Estonia	May of 2018	10.0
Design and construction works of BAUHAUS DIY store in Haabersti district of Tallinn	Estonia	April of 2017	7.6
Design and construction works on Tennis and Sports Complex first stage in Tallinn	Estonia	End of 2016	7.0
Contract to perform construction works of barracks in military campus depot in Tapa, Lääne-Viru county	Estonia	October of 2017	7.0
Construction contract to perform construction works of Viru Infantry Battalion technology park roads and facilities in Jõhvī	Estonia	February of 2017	4.0
			46.6
Contract to perform construction works of music school and concert hall located in Ventšpils	Latvia	December of 2018	25.6
Contract to perform construction works of a residential apartment building in Riga	Latvia	December of 2017	5.0
Construction works of a residential complex consisting of four houses in Jurmala	Latvia	August of 2017	4.9
Design and construction works of warehouse complex consisting of three buildings in Riga	Latvia	June of 2017	4.8
			40.3
Design and construction works of Radisson Blu Hotel Lietuva extension in Vilnius	Lithuania	March of 2018	15.7
Contract to perform the reconstruction and extension construction works of Philip Morris plant in Klaipėda	Lithuania	January of 2018	11.0
			26.7
Total			113.6

After the balance sheet date, the group concluded four large construction contracts:

- On 11 January 2017, AS Merko Ehitus group company UAB Merko Statyba and PK INVEST UAB, part of AS Pro Kapital Grupp group, entered into a contract to perform the design and construction works of the residential complex in Šaltiniu Namai quarter, located at 10 Aguonui street, Vilnius. The contract value is EUR 10.8 million. The works are scheduled for completion by January of 2019.
- On 24 January 2017, AS Merko Ehitus Eesti – a subsidiary of AS Merko Ehitus – signed a contract with AS Mainor Ülemiste, the developer of Ülemiste City, to perform the design and construction works of Õpiku maja second office building, located at Sepise 9/Valukoja 8, Tallinn, Estonia. The value of the contract is approximately EUR 15.5 million. The works are scheduled for completion in the second half of 2018.
- On 15th February 2017, AS Merko Infra, part of AS Merko Ehitus group, and AS Elering entered into a contract to renovate Sindi 110kV switchgear in Pärnu county in Estonia. The value of the contract is EUR 1.9 million. The works are scheduled for completion by November of 2018.
- On 17th February 2017, AS Merko Ehitus Eesti, part of AS Merko Ehitus group, and OÜ Astlanda Ehitus entered into a contract to perform 0-stage concrete works at the construction of Tallinn Courthouse at Lubja 4, Tallinn. The value of the contract is EUR 1.5 million. The works will be performed from February until June 2017.

On 15 September 2016, UAB Merko Bustas, part of AS Merko Ehitus group, entered into a preliminary sales-purchase agreement with UAB Hekon, subsidiary of Orbis S.A., to sell upon completion the "ibis" hotel building and parking premises to be built. UAB Merko Bustas will perform through UAB Merko Statyba the design and construction works of a hotel on the land plot owned by UAB Merko Bustas located at Ceikiniu street 3, Vilnius. According to the contract the total sales price for the hotel building and land shall not exceed EUR 8.5 million euros plus value added tax. As this is Merko's own development project, this contract is not recognised in the group's secured order book. The sales revenue and profit from the contract will become realised in the real estate development segment pursuant to signing of the final sales-purchase agreement, which according to the contract will occur at the latest in summer of 2018.

Of the contracts signed in 2016, private sector orders accounted for the majority proportion, which is also represented in the group's secured order book as at the end of the reporting period, where private sector orders from projects in progress constitute 71.5% and public sector orders make up 28.5% (31.12.2015: 78.9% private sector and 21.1% public sector). Apart from a few large-scale procurements where Merko companies were not as optimistic as our competitors in bidding at a low price, the share of government contracts in 2016 has been very modest. The group continues to focus on comprehensive design and construction contracts. In this regard, five important contracts were signed in 2016.

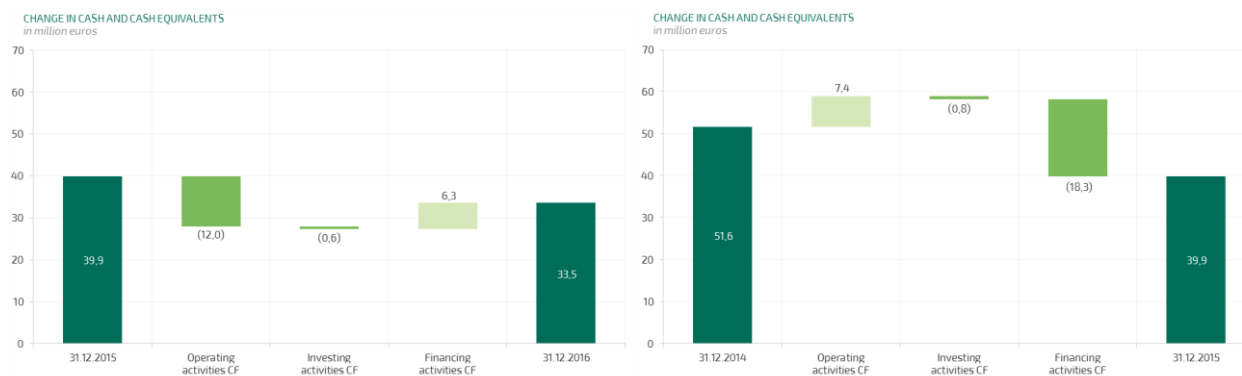
The portfolio of contracts stands relatively strong compared to the same period of the last few years (31.12.2015: EUR 246.9 million; 31.12.2014: EUR 179.1 million). Yet aside from individual larger-scale agreements in Estonia, the secured order book balance is not satisfactory. This is particularly the case in regard to public procurements in Estonia. Considering the beginning phase of the current EU funding period, the volume of 2016 public procurements has stayed at the previous year's level and at the moment we predict that the volume of public procurements in the Baltic states will start to increase again in 2017.

Traditionally the share of Estonian construction activity has been the highest in the group's revenues. Given the weak growth outlook of the Estonian construction market, the group's goal is to increase the volume of construction orders from outside Estonia. Thus, we will continue to identify and strengthen the groups' competitive advantages and are closely monitoring the development and opportunities both in the Baltic states and the Nordic countries. In the last few years, the group has taken part in various individual Finnish and Swedish construction procurements in a selective and project-based manner in order to gain experience and regarding the conditions and requirements set out in these countries for qualifying for construction company procurements, as well as assess the risks so as to evaluate potential competitive advantages for entering these markets. In March 2016, the group concluded a transaction through which it acquired a controlling holding in Peritus Entreprenør AS, a Norwegian construction company that provides general construction services. The long-term objective of the group in Norway is to gradually build the capacity to undertake bigger projects, to operate as a Norwegian company and to gain the trust of local customers, whilst exploiting Merko's experience in quality and project management and the network of partners. The group will continue implementing its chosen strategy with the goal of increasing revenue earned on new markets also in 2017, focusing in the Nordic countries above all on the Norwegian market.

CASH FLOWS

The change in short-term investments and cash equivalents in 2016 of Merko Ehitus group was negative by EUR 6.4 million and as at 31 December 2016 the group had cash equivalents in the amount of EUR 33.5 million (31.12.2015: EUR 39.9 million). The group's cash level is lower compared to the same period last year; still, the financial position is strong, as the group has not utilized its credit lines of existing overdrafts and loan agreements.

The operating cash flows of 2016 were negative by EUR 12.0 million (2015: positive by EUR 7.4 million), the cash flows from investment activities were negative by EUR 0.6 million (2015: negative by EUR 0.8 million) and cash flows from financing activities were positive by EUR 6.3 million (2015: negative by EUR 18.3 million).



The cash flow from operating activity was mostly influenced by the EBITDA (operating profit adjusted with depreciation and amortisation) EUR 11.2 million (2015: EUR 15.5 million), by the positive change in receivables and liabilities related to construction contracts recognised under the stage of completion method EUR 3.7 million (2015: positive change of EUR 2.2 million), by the negative change in provisions EUR 0.5 million (2015: negative change of EUR 1.5 million), by the negative change in trade and other receivables related to operating activities EUR 18.0 million, incl. a net change in financing co-financed projects of EUR 0.0 million and VAT prepayment related to Veerenni development area acquisition in the amount of EUR 3.4 million, which was returned in January of 2017 (2015: positive change of EUR 10.0 million, incl. a negative change in financing co-financed projects of EUR 4.2 million), by the negative change in inventory EUR 14.1 million, incl. negative cash flow from purchase of new land plots in the amount of EUR 19.1 million and positive cash flow from sale of immovable properties in the amount of EUR 8.7 million (2015: negative change of EUR 10.9 million, incl. negative cash flow from purchase of new land plots in the amount of EUR 11.7 million and positive cash flow from sale of immovable properties in the amount of EUR 5.4 million), and by the positive change in trade and other payables related to operating activities EUR 8.9 million (2015: negative change of EUR 27.2 million, incl. significant negative outflow from the realization of an option agreement in the amount of EUR 4.0 million but also from the advances for real estate development projects), interest received EUR 1.5 million (2015: EUR 1.8 million), interest paid EUR 0.7 million (2015: EUR 0.9 million) and by the corporate income tax paid EUR 1.7 million (2015: EUR 1.8 million).

To support cash flows arising from operating activity, the group has been prudent in raising additional external capital, including factoring. At the same time, the debt ratio has remained at a moderate level (19.3% as at 31.12.2016; 14.8% as at 31.12.2015).

Cash flows from investment activities include negative cash flow from the acquisition of non-current asset in the amount of EUR 3.0 million (2015: EUR 0.8 million) and the positive cash flow from the sale of non-current assets in the amount of EUR 1.1 million (2015: EUR 0.3 million). The group mainly invested in non-current assets for the purpose of renewing its fleet of machinery in the road construction segment. Cash flows from investing activities in 2016 was also positively impacted by the acquisition of majority shareholding in subsidiary Peritus Entreprenør AS (related to the offering of construction services on Norwegian market) in the amount of EUR 1.2 million. Cash flows from investing activities in 2015 also included an additional contribution to the share capital of the joint venture OÜ Unigate in the amount of EUR 0.4 million.

The largest single negative item in cash flows from financing was the dividend payment of EUR 9.0 million (2015: EUR 7.3 million). Project specific loans obtained using investment property as collateral were repaid in the amount of EUR 0.6 million (2015: negative cash flow in net amount of EUR 0.6 million, incl. refinancing of an investment loan in the amount of EUR 1.2 million). Net of loans received and loans repaid in connection with development projects amounted to positive cash flow of EUR 3.9 million (2015: negative cash flow of EUR 4.6 million) and finance lease principal repayments of EUR 0.9 million (2015: EUR 2.2 million). In 2016, the group additionally made repayments in the amount of EUR 2.0 million to related party Järvevana OÜ pursuant to the terms and conditions of an overdraft agreement between the parties. The group has not used bank loans to finance all ongoing development projects – and this is the case particularly in Estonia, where many advance sales were agreed in the early phase of construction. If all of the new land plots acquired by the group in 2015 were financed in full from the group's resources without drawing on external funding, then at the end of 2016 EUR 12.5 million was engaged in short-term loan from the parent company AS Riverito to purchase the Veerenni development area. The loan was refinanced at the beginning of 2017 with long-term loans from various credit institutions. Cash flows from financing activities of 2015 was also negatively impacted by a one-time share capital reduction payment to the shareholders in the amount of EUR 4.1 million.

RATIOS

(attributable to equity holders of the parent)

		2016	2015	2014
Income statement summary				
Revenue	million EUR	252.0	251.0	252.3
Gross profit	million EUR	19.0	23.0	24.7
Gross margin	%	7.5	9.1	9.8
Operating profit	million EUR	7.7	12.5	14.0
Operating profit margin	%	3.1	5.0	5.5
Profit before tax	million EUR	7.3	11.7	13.3
EBT margin	%	2.9	4.7	5.3
Net profit	million EUR	6.0	9.8	12.3
attributable to equity holders of the parent	million EUR	6.1	10.0	12.4
attributable to non-controlling interest	million EUR	(0.1)	(0.2)	(0.1)
Net margin	%	2.4	4.0	4.9
Other income statement indicators				
EBITDA	million EUR	11.2	15.5	16.4
EBITDA margin	%	4.4	6.2	6.5
General expense ratio	%	5.3	4.8	4.9
Labour cost ratio	%	11.7	12.2	11.9
Revenue per employee	thousand EUR	325	322	319
Other significant indicators				
		31.12.2016	31.12.2015	31.12.2014
Return on equity	%	5.0	8.0	10.1
Return on assets	%	2.8	4.4	5.0
Return on invested capital	%	5.1	7.9	8.8
Equity ratio	%	51.6	59.5	51.0
Debt ratio	%	19.3	14.8	15.1
Current ratio *	times	2.9	3.2	2.3
Quick ratio *	times	1.1	1.2	1.1
Accounts receivable turnover	days	37	39	56
Accounts payable turnover	days	38	39	39
Average number of employees (total group)	people	776	779	790
Order book	million EUR	269.6	246.9	179.1

Calculation of ratios is provided on page 133 of the report.

* As at 31 December 2016, in the formula for calculating the current ratio and the quick ratio, the amount of current liabilities has been reduced by EUR 12.5 million as a result of refinancing of the short-term loan received from the parent company AS Riverito at the end of 2016 with long-term bank loans at the beginning of 2017. Additional information has been disclosed in Note 33.

RISK MANAGEMENT

Risk management is part of strategic management and is inseparable from daily operations of the company. In managing risks, the main objective of the company is to determine larger and more significant risks and to optimally manage these risks so that the company achieves its strategic and financial objectives. The company considers it important to assess aggregate group's risks, instead of the impact factors of individual risks. Turning constant attention to risk management enables to exclude or minimise a possible financial loss. The following are deemed by the company to be the most significant risks: market risk, operational risk and financial risk, including interest rate risk, foreign currency risk, credit risk, liquidity risk, equity risk and legal risks. Detailed description of financial risks is provided in Note 35 of the financial statements.

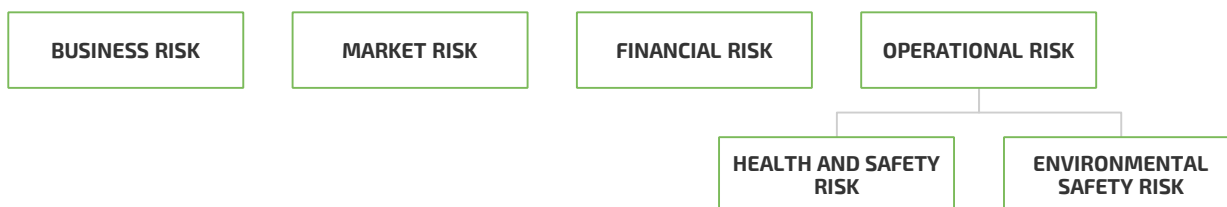
Because of the group's balance sheet structure and the market position, none of these risks has a significant impact as at the date of this report.



The company manages risks so as to achieve its strategic and financial objectives.

Group risk management is coordinated by the management board who develops, implements and maintains processes covering group activities for the management of all material risks impacting the activity and results of Merko Ehitus. Each group company and business unit must ensure that risks are managed on an ongoing basis with reference to the objectives it has been assigned. Risk-taking is a normal part of business but in doing so, one must be convinced that if the risk materializes, purposeful and sustainable activity is maintained with reference to the strategy of the company and business unit. The group assesses ongoing business risks and risks affecting development projects in a calculated manner.

Merko Ehitus divides risks into four main categories:



Business risk

The group takes calculated risks for the purpose of increasing revenue. The biggest business risks relate to the entry of Merko Ehitus to new markets and segments, the management of existing inventories and investments and the execution of awarded construction contracts. One of the peculiarities of construction activities is the fact that the execution of the contracts concluded is a long-term process, making the sector inert to changes in the economic environment. Due to this, both positive and negative changes in the economic environment reach the construction industry with a lag of approximately 12-18 months. This time lag enables the sector to arrange its activities to be prepared for potential setbacks as well as booms.

Operating in several different markets requires orientation in the environments of various countries. The main areas of attention are the different cyclical attributes of different economies and legal, cultural and political differences. The main objective of Merko Ehitus is to expand into new segments in existing markets. When entering new markets, the company thoroughly studies local customs and peculiarities before making final investment decisions and makes sure that the environment is sufficiently stable and a competent team is assembled.

From the investments point of view, the main risks relate to the portfolio of properties and implementation of property development projects. Merko Ehitus carries out real estate development projects as an integrated process, comprising all activities from the acquisition of the property, proceedings related to the detailed plan, handling design and construction and finally sale of finished apartments to the customer and warranty service. The group uses standard policies for implementing real estate development projects in order to ensure the use of best practices that the entire group has accumulated over years. Merko Ehitus continuously analyses its existing inventory of land with development potential to ensure that the portfolio contains a sufficient number of properties to carry out developments suitable to the market. Investments in new properties of up to EUR 3 million are decided on the supervisory board level of subsidiaries and then further approved by the supervisory board of the group.

Market risk

Significantly more attention is being paid to potentially major volatility of input prices in the construction sector that could complicate the budgeting process, completion of projects at planned costs, cause additional risks in carrying out fixed-price construction contracts and weaken projects' profitability. Therefore, the overall economic development is being closely monitored and taking excessive price risks already in the bidding phase is avoided.

The residential development area is one of the main sources of market risk arising from the value of real estate for Merko Ehitus group. The real estate market has become more selective and in pre-launch risk assessment, consideration is given to such important aspects as the project's location, development volume, planning solutions and the target group. Taking into account low interest rates on loans and limited supply on the market of new apartments, in the last three years the demand and transaction activity on the apartment market has grown moderately. Due to the selectiveness of the real estate market, setting the right sale

price for new development projects in the given region have become very important. For hedging the area's price risk, price statistics collected by the group and available from other public sources is being constantly analysed.

Market risk that is partially related to financial risks also includes *currency risk and interest rate risk*. The analysis of these risks is provided in Note 35 of the financial statements.

Financial risk

Financial risks include risks related to adequate capitalisation level and financing, currency, interest rate and credit risk. Financial risks are managed through accounting and finance rules, as well as audit. The group's finance department is ultimately responsible for forecasting the cash flows of Merko Ehitus, continuously monitoring various subsidiaries' cash positions and forecasts. The group has enacted a regular budgeting procedure whereby the group's annual forecasts are updated as a minimum four times per year.

The analysis on *credit, liquidity and legal risks* is provided in Note 35 of the financial statements.

Operational risk

Operational risks are risks caused by inadequate or ineffective processes, people, equipment, systems or external events. The main goal of operational risk management is to reduce the effect of unwanted events. In order to meet the objective, the group is developing internal processes and control systems. In order to ensure the group's high level of project management, project teams are continuously trained, business processes are improved and results are monitored.

Considering the group's field of business, it is essential in operational risk management that the improvement and application of safety standards and regulations continues and that supervision of compliance with environmental requirements is increased. One measure for managing operational risks is the implementation of quality and environmental management systems. Risks related to occupational health and safety in construction are assessed and managed in all units and process stages of the group. The largest construction companies of the group have implemented ISO 9001/14001 management systems and Merko Ehitus Eesti, Merko Infra, Merko Tartu and Latvian and Lithuanian subsidiaries have implemented the occupational health and safety management system OHSAS 18001. The group employs 9 (2015: 9) full-time quality specialists who are responsible for developing quality, safety and management systems and ensuring their functioning.

Insurance is used as additional mitigation of operational risks, especially for risks that cannot otherwise be mitigated. The group concludes total risk insurance contracts with insurance companies in order to hedge the risk of 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 EUR 9.6 million. The risks of the projects which cost exceeds EUR 9.6 million or 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 contracts for services involving design work, an insurance contract for professional liability is required from subcontractors or an insurance contract at own expense is concluded, covering the damage arising from design, erroneous measurement, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2016, indemnity applications submitted to insurance companies totalled EUR 0.12 million (2015: EUR 0.87 million), and insurance benefits were received in the amount of EUR 0.12 million (2015: EUR 0.86 million).

A warranty provision has been provided at the company to cover for the construction errors which have become evident during the warranty period. In 2016, warranty provisions were set up at the group in the total amount of EUR 0.94 million (2015: EUR 1.00 million) and disbursements amounted to EUR 0.80 million (2015: EUR 0.71 million). As at the year-end, the company's warranty provision amounted to EUR 2.48 million (31.12.2015: EUR 2.38 million). With regard to work performed by subcontractors, the subcontractors are responsible for elimination of defects that became evident during the warranty period. With regard to critically significant contracts, the performance of contractual obligations of the contractor arising from contracts of services is guaranteed with bank guarantees to be paid upon first demand.

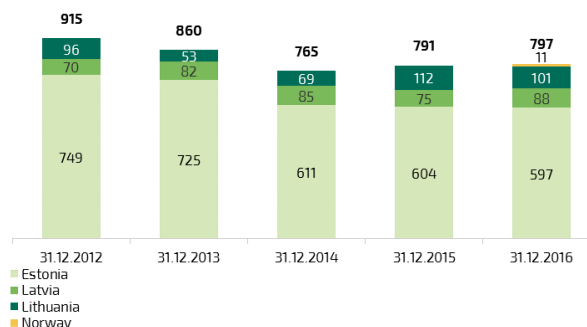
EMPLOYEES

Compared to the same period last year, the number of the group's employees increased by 6 (+0.8%) and as at 31 December 2016, the group had a total of 797 employees (including fixed-term and part-time employees).

176 people joined Merko and 170 people left (2015: 176 people joined and 175 people left) Merko group in the financial year (including both unspecified-term and fixed-term contracts).

In 2016, the number of employees has increased mainly due to the acquisition of a 56% subsidiary Peritus Entreprenør AS in Norway with 11 employees, but also in anticipation of an increase in volumes in Latvia. At the same time the number of employees has decrease in Estonia due to the decrease of civil engineering volumes and at the expense of seasonal workers in Lithuania.

NO OF EMPLOYEES
people



TOTAL NUMBER OF EMPLOYEES BY EMPLOYMENT CONTRACT

	2016		2015	
	Count	%	Count	%
Permanent contract	713	89%	676	85%
Temporary contract	84	11%	115	15%
Total	797	100%	791	100%

TOTAL NUMBER OF EMPLOYEES BY GEOGRAPHICAL LOCATION

	2016		2015	
	Count	%	Count	%
Estonia	597	75%	604	76%
Norway	11	1%	-	-
Latvia	88	11%	75	10%
Lithuania	101	13%	112	14%
Total	797	100%	791	100%

TOTAL NUMBER OF PERMANENT EMPLOYEES BY EMPLOYMENT TYPE

	2016		2015	
	Count	%	Count	%
Full-time	685	96%	636	94%
Part-time	28	4%	40	6%
Total	713	100%	676	100%

TOTAL NUMBER OF EMPLOYEES BY EMPLOYMENT POSITION

	2016		2015	
	Count	%	Count	%
Management	24	3%	23	3%
Middle management, specialists	464	58%	451	57%
Workers	309	39%	317	40%
Total	797	100%	791	100%

TOTAL NUMBER OF EMPLOYEES BY GENDER

	2016		2015	
	Count	%	Count	%
Male	691	87%	686	87%
Female	106	13%	105	13%
Total	797	100%	791	100%

PERSONNEL POLICY

As at 31 December 2016 Merko Ehitus employed a total of 797 people in Estonia, Latvia, Lithuania, Norway and Finland, including office staff, project managers and on-site team members. Experienced professionals are the company's key strength.

The group's personnel policy supports achievement of the company's goals, ensuring sustainability of the organisation and management, staying competitive, maintaining and increasing the value of the organisation and constant development of competence.

We develop responsible management throughout the organisation, guided by company strategy, management system, applicable law, ethical values and good organisation management practice. We treat employees as partners, involving them in the decision-making process and perceiving that the right to make decisions includes responsibility. We support people's achievement of their professional goals and the advancement of their career in the company by encouraging existing employees to apply for vacant or new positions within the company. We ensure an adequate, fair and competitive salary that complies with the contribution of the employee and a motivation package.

We provide employees with conditions for professional development and career opportunities by supporting studies and acquisition of professional knowledge and experience. We support our employees for developing their competence and skills.

In 2016, the number of new grievances about labour practices against Merko group amounted to 0 (2015: 1), the number of grievances (both from current and previous years) addressed was 0 (2015: 1) and the number of grievances (both from current and previous years) resolved was 0 (2015: 1).

THE NUMBER OF EMPLOYEES WHO RECEIVED AN ANNUAL PERFORMANCE REVIEW

	2016		2015	
Estonia	145	24%	159	26%
Norway	2	18%	-	-
Latvia	26	30%	20	27%
Lithuania	101	100%	109	97%
Total	274	34%	288	36%

CASE STUDY



INTERNS

In 2016, 19 students interned at Merko: most were from the Tallinn University of Technology, two were from the Tallinn University of Applied Sciences and one was from the Tallinn School of Construction. Most of the students were studying in fields related to industrial construction and civil engineering, and electrical energy, economics and construction of concrete structures accounted for some of the majors. On the basis of feedback given regarding their internships, students said they had a high regard for Merko's professional and friendly personnel, commitment to on-the-job safety and security, the workplace environment and their display of understanding regarding students. Many of the students who interned at Merko have become Merko employees and made a career for themselves at the company. Merko considers it important to offer students real work experience and over the last three years, a total of 70 interns have worked at the company.

HEALTH AND SAFETY

Creating a safe working environment for well trained, healthy and motivated employees, both in offices and on construction sites, has always been an important aspect in the operations of the group's construction companies. Our goal is to shape and furnish jobs, allocate work equipment and personal protective devices to make it possible to prevent on-the-job accidents and health damage and preserve the work capacity and well-being of workers. Thus, pre-construction risk analysis remains constantly in our focus, aimed at identifying common protection needs of site workers, measures and requirements for use of personal protection equipment. Constant training in the field of occupational health and safety forms part of our personnel policy. Regularly held occupational health and safety trainings provide knowhow and skills that enables to prevent risks, analyse them and find the most suitable technical and economic solutions. All new employees (including office workers) undergo an occupational safety training after they are hired. In addition, we notify our cooperation partners of the fire safety and occupational safety requirements and expect our contractual partners' employees on Merko sites to comply with these requirements. The management system for occupational health and safety that was certified in 2004 and complies with the OHSAS 18001 standard allows to effectively monitor working environment in construction sites and offices. Basic and supplementary training has always been available for inspectors to guarantee their competence.

Periodic health inspection provided by the occupational health partner to assess work-related risk factors helps to prevent employee health problems, plan safer working environments or, with the partial support of the company, to allow employees to use the necessary health rehabilitation measures. Additionally, the company organises for its employees free vaccinations and, naturally, provides its on-site personnel with comfortable compliant work clothes and footwear.

71% of Merko Ehitus group's employees worked in companies with an international health and safety certificate OHSAS 18001 both in 2016 and 2015.

A balanced personal life and a healthy way of living provide a counterbalance to stressful work. In order to promote recreational sports and to maintain working ability we pay our employees sports and health allowance.

In accordance with the GRI guidelines, the rates of injury, occupational diseases, lost days, and absenteeism presented below are related to the number of employees, not the number of hours worked. The factor 200,000 is derived from 50 working weeks at 40 hours per week, per 100 employees.

The total number of injuries/accidents (excluding minor first-aid level injuries/accidents) decreased slightly from 8 cases in 2015 to 6 cases in 2016, leading to a decreased injury rate of 0,9 per 100 employees. As in 2015 the total number of occupational illnesses remained 0 also in 2016, meaning also an occupational diseases rate of 0.0 per 100 employees.

The total number of lost days due to occupational illnesses or injuries/accidents increased by 49% to 510 while the total number of absentee days increased by 8% percent to 6,767, leading to a lost days rate of 72,9 per 100 employees and an absentee rate of 3,9% in a year for all employees.

TOTAL NUMBER AND RATES OF INJURIES, OCCUPATIONAL ILLNESSES, LOST AND ABSENTEE DAYS AND FATALITIES

	2016	2015	2014
Total number of injuries/accidents excluding minor (first-aid level) injuries/accidents	6	8	8
Total number of occupational illnesses	0	0	0
Total number of lost days due to occupational injuries/accidents or illnesses	510	343	304
Total number of absentee days	6,767	6,286	6,177
Total number of fatalities *	0	0	0
Injury rate (per 100 employees)	0.9	1.2	1.1
Occupational diseases rate (per 100 employees)	0.0	0.0	0.0
Lost days rate (per 100 employees)	72.9	50.0	43.1
Absentee rate per year (%)	3.9	3.7	3.5

Calculation of ratios is provided on page 133 of the report.

** In 2016 subcontractors employees working on-site to whom the organisation is liable for the general safety of the working environment had 0 injuries (2015: 1; 2014: 0) and 0 fatal accidents (2015: 0; 2014: 2).*

PERSONNEL DEVELOPMENT AND RECOGNITION

Work at Merko demands great responsibility but also offers variety, new challenges and opportunities for study and development. For Merko as an employer, valuing employees means:

- We offer employees work which they are trained to do and interested in doing and which offers possibilities for development;
- We provide fair remuneration to our employees, taking into account their contribution to achieving the company's objectives;
- We recognise employees who achieve or outperform the agreed objectives.

We value and support employees' personal development, offer various training courses internally and externally both as team training and individual study. Once a year, at an annual employee review, we determine employees' needs for training and career and development desires. A training plan is drawn up on the basis of summaries of annual reviews. Professional, self-development trainings account for the largest share. Quality and environment-themed trainings, language learning and joint team trainings are also highly valued.

To train the young employees of the future, we have been engaged in developing and training students for years, offering them internships and visiting schools to deliver lectures. We have also organised workshops and competitions, excursions to sites. In 2016, we had 19 interns from the Tallinn University of Technology, the Tallinn University of Applied Sciences and the Tallinn School of Construction. We provide multifaceted support and recognition for teaching at school and acquiring a diploma.

We celebrate together with our employees their personal events and company events for employees welcome everybody together with their spouses or guests and family events welcome the whole family. We offer additional benefits in the form of holiday days to our long-time employees and award the company's gold, silver and bronze pins.

We highly value teamwork and a strong sense of team identity. In order to recognise the most prominent employees of the company and the best business partners, employees annually elect AS Merko Ehitus Eesti and Tallinna Teede AS Achievers of the Year. In 2016, the following employees, team and business partner were elected as Achievers of the Year:

AS Merko Ehitus Eesti Achievers of the Year

New Talent of the Year	Silver Tampuu	Site manager, residential construction division
Office Employee of the Year	Toomas Nõmmik	Civil engineering pre-construction project manager
Civil Engineer of the Year	Tarmo Sinisaar	Project director, civil engineering division
Electrical Engineer of the Year	Maksim Melnikov	Foreman, electrical works department

Residential Contractor of the Year	Taavi Kotkas	Site manager, residential construction division
Engineer of the Year	Indrek Tarko	Project manager, general construction division
Construction site manager of the Year	Ahto Luidalepp	Site manager, general construction division
HVAC Specialist of the Year	Heimot Luukas	Expert of electrical works – Electrical system operation specialist, general construction division
General Contractor of the Year	Tarmo Pohlak	Project director, general construction division
Great Feat of the Year in Estonia No 1	Hilton Tallinn Park Hotel construction team	
	Team: Tarmo Pohlak, Indrek Tarto, Ahto Luidalepp, Silver Tamme, Viktor Stepanenko, Madis Ploompuu, Kai Vähi, Heimot Luukas, Hans Anion, Argo Pärn, Andres Lätt, Sven Raja, Rasmus Raamat, Tanel Ojang, Anna Maria Võsu, Riho Leben, Viire Pöder, Tõnis Saarts, Merili Ventsel, Priit Laug and Mati Einama	
Great Feat of the Year in Estonia No 2	North-Estonian Medical Centre construction team	
	Team: Marek Hergauk, Priit Laug, Priit Rauks, Gert Raadel, Taavi Kuusik, Kristo Kökkur, Olev Rõuk, Sten Suurmäe, Taavi Hinnosaar, Margo Mõttus, Alo Adler, Andres Aldoja and Jakov Ivanov	
Business Partner of the Year	AS Merko Ehitus Eesti concrete works department	
	Team: Veikko Sumre, Risto Sappinen, Joel Muzakko, Laivo Pallav, Peeter Puntso, Ago Saluveer, Vello Vares, Mikk Viese, Valdur Kato, Meelis Nukki, Kirill Pekkonen, Risto Ristisaar, Aleksei Stepanov, Rein Tohv	

Tallinna Teede AS Achievers of the Year

Manager of the Year	Rainer Barjabin	Director, road maintenance division
Builder of the Year	Kaupo Raadik	Project manager, construction division
Construction site manager of the Year	Martin Pley	Foreman, construction division
Road maintainer of the Year	Andres Kikkas	Foreman, road maintenance division
Office Employee of the Year	Kristiina Piik	Secretary-personnel specialist
Colleague of the Year	Raiki Reiljan	Project manager, construction division

REMUNERATION

The group's objective is to pay its employees competitive salary. The interests of employees and the company are balanced by performance-based remuneration.

The group defines labour cost as salary (incl. fixed salary, additional pay (night work, overtime and public holidays), holiday pay and bonus), taxes based on salary, fringe benefits and taxes based on fringe benefits. In 2016, the labour cost was EUR 29.6 million (2015: EUR 30.6 million), down 3.3% from the previous year.

LABOUR COST
in million euros



Benefits that are standard for full-time employees and not offered to part-time employees are not separately disclosed in Merko Group companies, except with regard to part-time employees employed under a contract for a specified term, who are not entitled to all of the benefits offered to company employees.

ETHICAL BUSINESS PRACTICES

Merko's core values include ethical business practices, which is an important success factor in the long run. By following highly ethical policies, we promote profitable growth, gain the trust of our stakeholders and support fair competition and equal treatment. Unethical business practices carry serious consequences - including hindering the functioning of a fair market and distorting competition.

The AS Merko Ehitus group does not tolerate any form of corruption. We have undertaken the obligation to engage in honest business and to be in compliance with anti-corruption laws in each country where we operate. We are guided by ethical principles in our actions. We make sure that our employees know these principles and adhere to them in their work. In order to facilitate this, the group has enacted a Code of Business Ethics, which all Merko Group employees are obliged to read and adhere to. The code of business ethics includes, among other things, guidelines on the following matters:

- conflicts of interests;
- confidentiality obligation;

- handling of insider information and insider transactions;
- bribery and corruption;
- hospitality and gifts;
- competition rules;
- equal treatment;
- protection and proper use of assets.

The topic of business ethics has been thoroughly covered on the group's website <http://group.merko.ee/en/corporate-governance-2/responsibility/ethical-business-practices/>. All employees, partners and customers can report clear or potential unethical conduct via various anonymous channels, to which the <http://group.merko.ee/en/corporate-governance-2/responsibility/reporting-channels/> website provides an overview. The reporting and information analysis system implemented in AS Merko Ehitus ensures security, confidentiality and, if so desired, anonymity at every stage of the process. Each reported misconduct will be investigated by an independent cooperation partner – AS Merko Ehitus's contractual cooperation partner Ernst & Young – and will lead to appropriate action.

The reports forwarded via the report form, the reporting hotline or e-mail will not be forwarded to Merko – Ernst & Young will only give Merko a summary of the content of reports that need investigation, without any reference to the source of the information. Information will also be kept confidential and used solely for the purposes of solving the relevant incidents by Merko's managers and the audit committee to whom a report has been made. In 2016, the group received no hints which would have led to an internal investigation (2015: 1 hint).



REPORT FORM



E-MAIL



HOTLINE



DIRECT COMMUNICATION

CASE STUDY



BUSINESS ETHICS SURVEY AND SEMINARS

In 2016, Merko conducted a business ethics survey in Latvia and Lithuania, which drew responses from close to 75% of employees. The objective of the survey was to raise employee awareness on business ethics topics and obtain feedback on topics that should be dealt with additionally.

In 2016, Merko dealt with the topic of business ethics at a company-wide seminar in Estonia, highlighting the company's business ethics principles and dealing with specific examples on the basis of cases. The company-wide seminar takes place at least once a year.

In addition, key persons at Merko Ehitus are obliged to file a declaration of personal interests that covers data on holdings in companies, positions held on management bodies of companies and other legal persons, membership of professional organisations, information on valid registrations of economic activities and other data that might indicate a possible conflict of interest. In 2016, no conflict of interest cases were identified by the group.

ENVIRONMENT

Our goal is to offer our customers modern, high-quality buildings with a high consumer value. We are always looking to find the solution that is most suitable to the needs and opportunities of our customer and optimum from a construction technology standpoint.

The environmental management system that complies with ISO 14001 standard continues to focus on waste handling issues of construction sites, highlighting the need to sort waste in the most appropriate location and handing waste over only to such service providers that are licensed to handle such waste. In cooperating with such companies we have often discovered polluted soil and waste containing hazardous substances. For years, the company has been recording the quantities of waste created in construction sites and submitted respective annual reports to the Environmental Authority.

In environmentally sensitive tenders, we have always considered the requirements to the environmental impact assessment of projects, carried out preliminary research if necessary or conducted replacement planting, if it has been inevitable to fell trees when preparing the construction site.

Our environment-related goals are the conservation-minded use of all resources (materials, fuel, energy and water), reducing the amount of waste generated and supporting recovery of materials. To achieve all this, we promote awareness among our employees and partners in cooperation of the environment as a whole.

The European Union is regulating energy consumption requirements, and starting in 2019, public sector buildings must meet near-zero-energy requirements. In 2021, the same requirements come into force for the issuing of building permits to all new buildings and extensive renovations. That will mean that all buildings to be constructed or renovated must have a piece of equipment that generates renewable energy that offsets the building's energy consumption.

In cooperation with a number of customers, Merko has already now, with energy prices increasing, adopted new technologies, materials and technical solutions and used various architectural techniques to achieve buildings with the most economical solutions possible without compromising on other aspects of office or residential environments. Merko's current crop of buildings under construction include ones certified using the LEED system used in the US and evaluated according to the conditions for Britain's BREEAM certificate rating system.

CASE STUDY



NARBUTO 5 OFFICE BUILDING IN VILNIUS

A BREEAM certificate at Very Good rating level is sought for the Narbuto 5 office building being built in Vilnius. Merko complies with BREEAM requirements in all phases of the construction process. A biodiversity manager has been appointed for the construction site; this manager will supervise construction work with the aim of minimizing environmental impact. Measures have been developed on the job site to reduce generation of waste, and use of energy, water and fuel. The volume of waste generated and energy use is measured and compared to the preliminary objective for the project on a monthly basis in the BREEAM SmartWaste programme. The reports for December 2015–December 2016 found that the set objectives have been achieved.

SOCIAL RESPONSIBILITY

The group is responsible for its decisions and activities that have an impact on our employees, customers and partners and, more broadly, on local communities.

In 2016, Merko Ehitus continued its long-term sponsorship projects in the same fields:

- We support sports and recreational sport projects that help create ways for entire communities to participate in sports and recreation.
- We support education in order to develop specialised education and plant the seeds for a new generation of professionals.
- We support keeping art and culture vital and make them available to more people, focusing on sites that are nationally important and have broad appeal.

During the year, the group supported sports, culture and education and made charitable donations total in the amount of EUR 0.26 million (2015: EUR 0.25 million).

SPORTS AND RECREATIONAL SPORTS

The company's largest sponsored project is the Estonian Health Trails (www.terviserajad.ee) project founded in 2005 in collaboration with Swedbank and Eesti Energia. The aim of the project is to adjust and develop the exercise and sports tracks of Estonia to ensure the availability of the year-round and free of charge possibility for active exercise in nature for all interested people and popularise the sporty lifestyle.

CASE STUDY



INDOOR RECREATIONAL TRAILS

The indoor recreational trails concept was established by the Estonian Health Trails Foundation with the objective to emphasize the importance of regular exercise and to promote such activity indoors as well. In cooperation with various organisations, companies and schools, suitable paths have been established inside buildings, making clever use of stairs, corridors and the yard area. As of the end of 2016, the Estonian Health Trails Foundation, had laid out 20 indoor paths that are used by 20,000 people every day.

Institutions and companies that use these paths to encourage their staff to be physically active include the Estonian National Opera, the Tartu Vocational Education Centre, Tallinn University, Tallinn University of Technology, Antsla Upper Secondary School, Estonian Public Broadcasting, the Ministry of Social Affairs, the Tax and Customs Board, Telliskivi Creative City, Swedbank and Eesti Energia.

From 2005 to 2016, SA Eesti Terviserajad (Estonian Health Trails Foundation) invested, with its founders' support, a total of EUR 4.2 million into developing recreational trails. The investments were made into all Estonian counties, with the biggest ones in Harju County, Tartu County and Ida-Viru County. Based on the preferences of the population in the respective locations of the trails and level of active use, the biggest investments were made into the facilities and tracks at Pirita and Nõmme-Harku in Tallinn, and Kõrvemaa and Jõulumäe.

In the period of 2014-2016, the total investment made (includes not only the SA Eesti Terviserajad's investments but state and local government investments and support from the European Union) into the development of the Estonian recreational trails network is nearly EUR 35 million. Of the counties, Harju County, Ida-Viru County, Põlva County and Viljandi County have received the most investments.

As a result of the eleven years of work, Estonia now has 103 health trails all over the country and nearly 1,000 km of paths and exercise tracks, of which soft-surfaced tracks make up 800 km, hard-surfaced paths account for around 200 km and illuminated paths or tracks make up around 200 km. Estonia has an average of 59.8 km of maintained tracks and 15.4 km of illuminated tracks per 100,000 people. They are visited approximately four million times per year.

To simplify navigation for the trail users, 64 large-format maps were installed and 54 trails use markings designed and installed by the foundation. All over Estonia 30 stretching walls have been installed for warm-up and cool-down stretching after exercise. As of the present date, the foundation has also produced about 60 Estonian and Russian language instructional videos.

For many years, Merko has supported Estonian skiing with the goal of contributing to development of top athletes and, on their example, to encourage more people in Estonia to engage in sport and exercise. Merko was the cooperation partner for the Estonian Ski Association for 10 years, supporting the national Nordic skiing team and youth team. Starting from 2015, Merko supports skiing by sponsoring Team Haanja.

CASE STUDY



TEAM HAANJA

From 2015, Merko has been the sponsor of the non-profit Team Haanja, founded at the initiative of eight skiers. The goal of the non-profit is to take new athletes to the top of the international rankings and keep veteran skiers competitive, contributing to fostering conditions for training in line with contemporary requirements.

Team Haanja is made up of eight athletes: national team members Triin Ojaste, Algo Kärp, Raido Ränkel, Aivar Rehema and Karel Tammjärv and the U23/youth team members Marko Kilp, Alvar Johannes Alev and Andreas Veerpalu.

CASE STUDY



ESTONIAN TENNIS ASSOCIATION AND JÜRGEN ZOPP

Estonian tennis is in better shape than it has ever been in its more than century-long history, and that is true on the elite and amateur levels.

From 2015, Merko is again supporting Estonian tennis, having concluded a three-year cooperation agreement with the Estonian Tennis Association (tennis.ee). As a gold sponsor of the Estonian Tennis Association, Merko is focusing on support for organising top tennis and international tournaments, including investing into the development of Jürgen Zopp, and the Merko Estonian Open held in Pärnu in the summertime.

CULTURE AND EDUCATION

As a company that carries out the work of architects on a daily basis, it's an honour for Merko to contribute to recognising their work. Each year the Estonian Union of Architects (arhliit.ee) hands out the annual prize to an architect to recognise one outstanding work of architecture and the architect responsible for it. The EUR 5,000 award is contributed by AS Merko Ehitus. To ensure that the winning work is not just extraordinary in the Estonian cultural context but also strike international audiences as distinctive and innovative, the competition entries are judged by an international jury. This year, the jury included acclaimed Spanish architect Fuensanta Nieto, whose decision meant that out of four nominees, the prize went to the Pärnu Beach Stadium building, designed by Jan Skolimowski and Peeter Loo (KAMP Architects), with Anton Andres as a creative collaborator.

In Lithuania, the group's subsidiary UAB Merko Statyba supported various projects to improve social infrastructure in the city of Vilnius, as part of which construction and maintenance of nursery schools and preschools was supported and public transport was developed. In addition, UAB Merko Statyba also contributed to supporting the field of architecture.

CASE STUDY



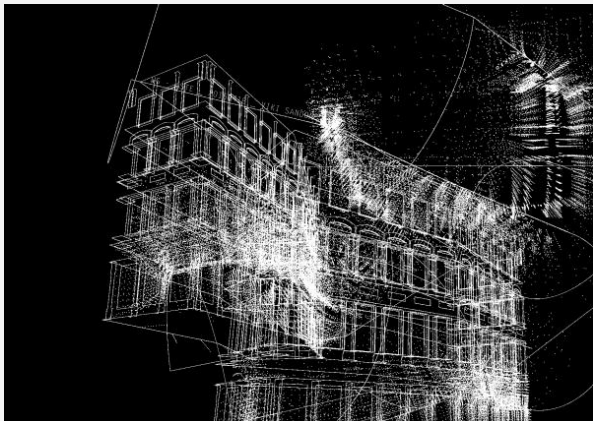
RODE RETABLE RESTORATION

2016 saw the conclusion of the major project at the St. Nicholas Museum, "Rode Altarpiece in Close-up", focusing on the conservation of the grand late medieval retablo of the main altar. This is one of the grandest and best-preserved late medieval northern German panelled altars anywhere in Europe. It came to Tallinn in 1481 and has been in its position for over 500 years. Over 6 metres wide and close to 3.5 metres high when fully open, the conservation work ran from 2014 to 2016. Internationally recognised experts took part in the project and aficionados could visit the St. Nicholas Church Museum to watch the process unfold on the spot. The project won top prize in the Museum Rats Annual Science Prize for 2016 as the project's process was popularized and introduced through educational programmes, workshops and multimedia solutions.

Merko has a successful partnership since 2007 with Tallinn University of Technology for the objective of developing education in the field and train the next generation. In cooperation with the Development Fund of Tallinn University of Technology (ttu.ee/organisatsioonid/arengufond) AS Merko Ehitus Eesti gives out eponymous scholarships. A EUR 3,300 scholarship is awarded in construction specialities to a young lecturer/scientist up to 40 years of age, possessing a Doctoral level degree, in TUT and there is also another scholarship for EUR 2,000 awarded to a successful student of the third, fourth or fifth year in the Faculty of Civil Engineering, in TUT.

In 2016, a three-year cooperation agreement was signed between Merko and Noored Kooli SA (Youth to School Foundation). The mission of the programme is to put value on the role of the teacher and raise the availability of high-quality education, bringing people from different walks of life to school and creating conditions for them to become outstanding teachers and leaders.

CASE STUDY



COOPERATION WITH THE ESTONIAN ACADEMY OF ARTS

Cooperation between Merko and the Estonian Academy of Arts started in 2016, and featured the opening of the energy efficiency professorship in the 2016/2017 academic year in the Department of Architecture and Urban Design. The lectures at the Academy are delivered by energy efficiency professor Bernhard Sommer, whose everyday work is at the architecture practice of Exikon and who teaches energy design at one of the world's most experimental and fascination school of architecture – Universität für angewandte Kunst Wien. Sommer encourages future architects to plan projects from the outset based on energy efficiency and he is committed to the belief that a more intelligent approach to spatial geometry can result in a more energy-efficient future city. Sommer's office Exikon deals with resolving energy performance problems in complex architectural spaces, integrating research with architecture and employing the most modern digital technology.

RECOGNITIONS 2016

In 2016, the activities of AS Merko Ehitus have been recognised in the form of the following prizes:

BALTIC MARKET AWARD 2015

At an award gala held in the first quarter of 2016 – the Baltic Market Awards 2015 - NASDAQ Baltic stock exchanges announced the companies of the year with the best investor relations. The goal of the competition was to raise the general level of investor relations among listed companies by recognising the ones that stood out during the year with first-class investor relations. In 2015, the publicly listed companies received awards in five categories; in addition, the year's best stock exchange member was selected. AS Merko Ehitus received third place in the main category "The Best Investor Relations in the Baltic Countries" for the second year in a row and second place in the category "The Best Annual and Corporate Governance Report".



MERKO EHITUS
Best Annual and Corporate
Governance Report
2ND PLACE
Best Investor Relations
in the Baltic Market
3RD PLACE

CHIEF FINANCIAL OFFICER OF THE YEAR 2016

Each year, under the auspices of Äripäev business daily, Estonia's best financial director is selected at the BIG4 finance conference. From several dozen candidates, the jury selected five nominees. 2016's candidates included also AS Merko Ehitus Group CFO Signe Kukin. The jury consisted of the representatives of four major audit firms – AS PricewaterhouseCoopers, Deloitte Audit Eesti AS, KPMG Baltics OÜ and Ernst & Young Baltic AS, and a representative from Äripäev.

The jury credited Signe Kukin for her key role in making Merko's reporting system more effective, speeding up significantly the availability of financial information both for regulative purposes and management reports. Signe Kukin has also led the introduction of many changes in the group's structure, making it more tax-efficient.

CIVIL ENGINEER OF THE YEAR 2015

Roland Vaikmäe, project manager with AS Merko Ehitus Eesti, was declared the winner of the Civil Engineer of the Year 2015 competition held by the Estonian Association of Civil Engineers in the first quarter of 2016. The victory was an acknowledgement of Roland Vaikmäe's successful management of the reconstruction of the large-scale and complex Water treatment plant of City of Narva as a civil engineer. The competition is aimed at promoting the profession of a civil engineer, and acknowledging the engineers engaged in the field of construction for outstanding professional achievements.

BEST INSTALLER OF ASPHALT PAVEMENT 2015

At the Road Administration annual conference held in Q2 2016, the work of Tallinna Teede AS was recognised with the first awarding of the title "Best Installer of Asphalt Pavements 2015". The winner was elected based on adherence to deadlines, the quality achieved, deductions made, communication with the customer, timely and complete submission of documents and supervision decision.

CASE STUDY



ARCHITIZER A+ AWARDS RECOGNITION

Liepaja Concert Hall, the biggest concert hall in the Baltics, opened in November 2015 and boasting more than 1,000 seats, won in 2016 the Popular Choice award at the prestigious architecture competition Architizer A+ Awards in the hall/theatre category. The building architect is Volker Giencke and the general contractor is SIA Merks, which is part of the Merko Ehitus Group.

A+ Award is one of the most prestigious architecture competitions, with projects submitted from more than 100 countries. Liepaja Concert Hall was one of the nominees in the hall/theatre category and went up against four projects from China, Norway and Poland. More information and photographs of the project and its unique architecture: <http://architizer.com/projects/great-amber-concert-hall-liepajalatvia/>

THE ENTREPRENEURSHIP AWARD 2016

At a gala evening for the Entrepreneurship Awards on 13 October 2016, the AS Merko Ehitus group was awarded the title of The Most Competitive Construction Enterprise. It is the 10th time Merko has claimed the title. The webpage of the entrepreneurship competition at <http://ettevotluskonkurss.ee/2016/> also contains an article introducing AS Merko Ehitus at <http://www.konkurents.ee/merko-ehitus-as-6/> (in Estonian).

The purpose of the competitiveness rankings is to help Estonian companies become more competitive and spur faster economic development. The ranking highlights the most successful companies as an example for others. In 2016, a total of 436 companies took part of the competition.

The rankings date back to 2003, when the Estonian Chamber of Commerce and Industry initiated the tradition. The Estonian Institute for Economic Research runs the technical calculations and assists in compiling the rankings in cooperation with the International Institute for Management Development in Lausanne.

BUILDER OF THE YEAR 2016

The Builder of the Year 2016 award, given by the Estonian Association of Construction Entrepreneurs (EEEL), went to AS Merko Ehitus Eesti's project manager Tarmo Pohlak. This high honour was the result of Tarmo Pohlak's commitment to the management of the Hilton Tallinn Park Hotel construction project. Indeed, it is the second Builder of the Year award for Tarmo Pohlak, who was also recognised in 2009 for the management of the construction of the Tallink office building. The jury deemed the Hilton Tallinn Park Hotel to be a complicated construction project. Nonetheless, Pohlak made no concessions with regard to construction quality, while also successfully managing the team and setting a personal example in terms of work culture.

The winner of the Builder of the Year 2016 award was selected amongst seven candidates from five companies. The purpose of the Builder of the Year award is to honour the best construction manager, whose work has received recognition by the contracting entity, the architect, the designer as well as by the party conducting owner supervision. EEEL held the best builder competition for the seventh year in a row, honouring the profession and recognising the top professionals in the business.

BEST RESIDENTIAL DEVELOPMENT PROJECT 2016

In Q4 2016, the "Kražių namai" project developed and built by UAB Merko Statyba received the Best Residential Development Project 2016 award at the "Sustainable development" competition organised by the Lithuanian Real Estate Development Association (LNTPA).

This year, the winner was elected amongst 16 different projects in Lithuania. The Sustainable Development prize is awarded to a project which is most in line with the requirements established for a sustainable living environment in urban space, is a testament to best practice in architecture, urban planning and construction quality, and results in a perfect combination of functionality and energy efficiency.

Merko has also received recognition within the framework of the same competition on previous occasions: the Balsiai School, developed and built by Merko, won the Best Public Project award in 2012 and the Panorama shopping centre, built by Merko, won the Best Commercial Project award in 2008.

More information about the competition: <http://lntpa.lt/darnios-pletros-akademija/konkursai-uz-darnia-pletra-ir-darni-aplinka/>

LITHUANIAN PRODUCT OF THE YEAR 2016

Two projects built by UAB Merko Statyba received the grand prize - gold medal - in the "Construction and construction material industry" category of the "Lithuanian Product of the Year" award issued by the Lithuanian Confederation of Industrialists (LPK): the gym of American International School and the NORDBALT HVDC converter substation. The popular annual "Lithuanian Product of the Year" competition accepts nominations from any company registered in Lithuania, with regard to any product (including a construction object) which has been manufactured in Lithuania and has been available on the market for a period of at least 6 months. The main purpose of the "Lithuanian Product of the Year" competition is to enhance production quality and strengthen competitiveness by introducing the country's industrial product, goods and services to both local and international consumers, thus endorsing the development of Lithuanian companies.



Merko has also received recognition at the same competition in previous years: gold medal for the Balsiai School developed and built by Merko in 2012 and the Panorama shopping centre built by Merko in 2008, and silver medal for the Šiauliai landfill in 2007 and the private medical centre in Vilnius in 2006.

Additional information about the competition and winners: <http://www.lpk.lt/apdovanojimai/lietuvos-metu-gaminys/>

A HIGH POSITION IN THE COUNTRY'S MOST ATTRACTIVE EMPLOYER RANKINGS 2016

The annual survey conducted by CV Keskus where more than 6,000 people of different age groups in Estonia polled, revealed Estonia's most valuable employers, i.e. companies for which the Estonian people wish to work the most. Eesti Energia, which has ranked first for four years out of the last five, retained its position. AS Merko Ehitus Eesti gained one position – from 17th in 2015 to 16th in 2016.

The survey revealed that the companies considered as the most desirable by Estonian people are those with a competitive wage level, development and career opportunities, and a transparent, honest management style. Management errors and job instability have the greatest negative impact on a company's reputation. The employer's good reputation also helps recruitment – any company with a poor reputation is forced to offer a significantly higher salary to recruit a talent; yet this is still no guarantee that the talent actually wishes to work for such a company.

BALTIC MARKET AWARD 2016

At an award gala held in the first quarter of 2017 – the Baltic Market Awards 2016 - NASDAQ Baltic stock exchanges announced the companies of the year with the best investor relations. The goal of the competition was to raise the general level of investor relations among listed companies by recognising the ones that stood out during the year with first-class investor relations. In 2016, the publicly listed companies received awards in five categories; in addition, the year's best stock exchange member was selected. AS Merko Ehitus received third place in the main category "The Best Investor Relations in the Baltic Countries" for the third year in a row and third place in the category "The Best Annual and Corporate Governance Report".



MERKO EHITUS
Best Reporting Company
3RD PLACE
Best Investor Relations
In Baltics
3RD PLACE

SHARE AND SHAREHOLDERS

The shares of Merko Ehitus are listed in the Main List of NASDAQ Tallinn. As at 31 December 2016, the company has 17,700,000 shares. The number of shares did not change during 2016.

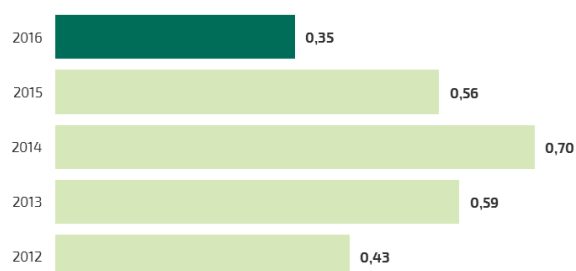
In 2016, 2,312 transactions were conducted with the shares of Merko Ehitus in the course of which 0.63 million shares were traded (3.6% of shares outstanding) and the total monetary value of transactions was EUR 5.35 million (comparative data for 2015: 2,829 transactions, in the course of which 0.90 million shares were traded (5.1% of shares outstanding) and the total monetary value of transactions was EUR 7.71 million). The lowest share price was EUR 7.60 and the highest share price was EUR 9.22 (2015: EUR 7.06 and EUR 10.50 respectively). The closing price of the share as at 31.12.2016 was EUR 9.05 (31.12.2015: EUR 8.48). As at 31.12.2016, the market capitalisation of AS Merko Ehitus was EUR 160.2 million, up 6.7% compared to the end of the equivalent period in the prior year (31.12.2015: EUR 150.1 million).

The number of shares that belong to the members of Supervisory Board and Management Board as at 31 December 2016 was 9,964,734 shares (31 December 2015: 9,964,334 shares) that accounted for 56.3% of the number of shares (31 December 2015: 56.3%). A more detailed presentation of the members of the Supervisory Board and Management Board and the number of shares they own are provided in the Report on Good Corporate Governance.

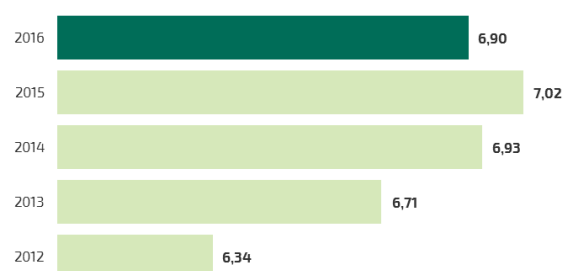
INFORMATION ON SECURITY

Issuer	AS Merko Ehitus
Name of security	Share of Merko Ehitus
Ticker	MRK1T
Residency of issuer	Estonia
Stock Exchange List	NASDAQ Tallinn, Baltic Main List
Industry	Construction
ISIN	EE3100098328
Nominal value	without nominal value
Number of securities	17,700 000
Volume of issue	12,000 000
Currency	EUR
Listing date	11.08.2008

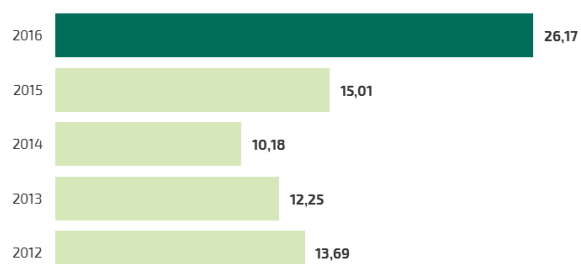
EARNINGS PER SHARE (EPS)
euros



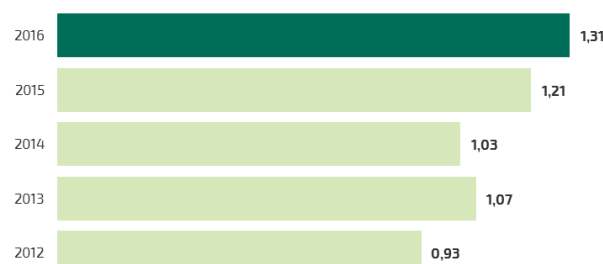
EQUITY PER SHARE
euros

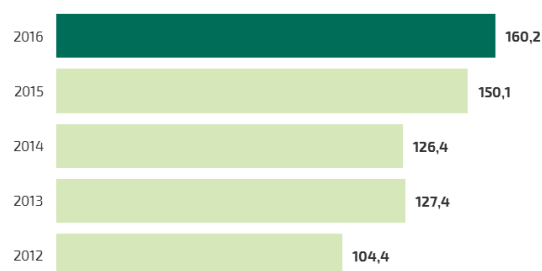


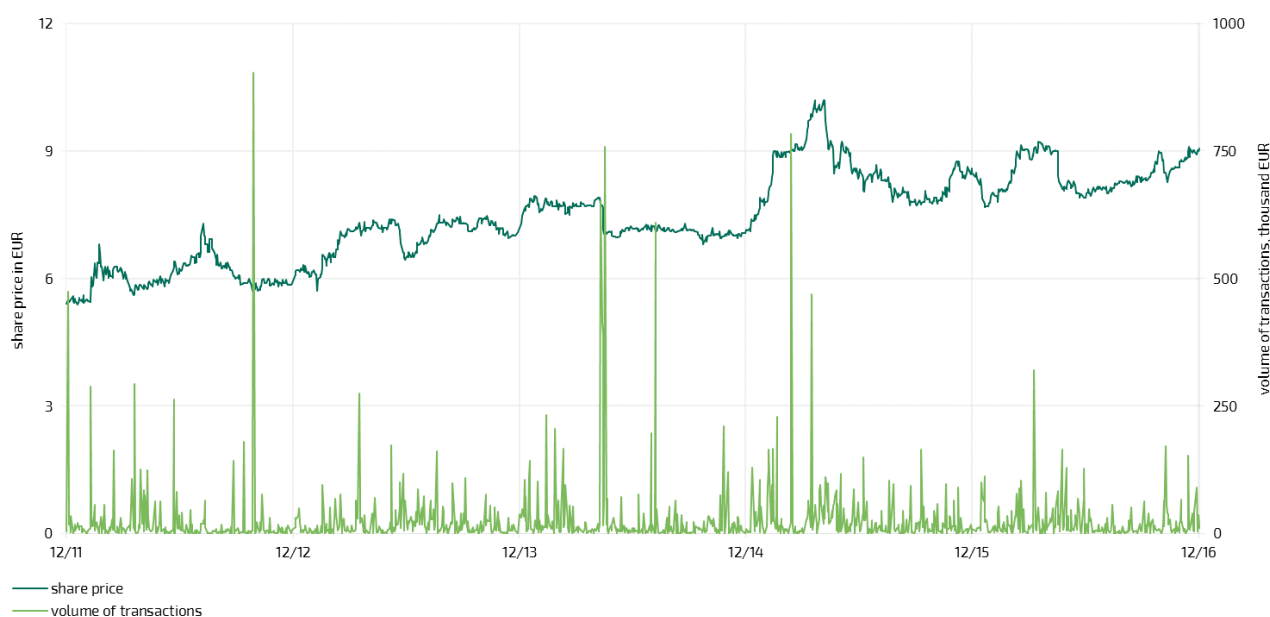
P/E RATIO
times



P/B RATIO
times



MARKET VALUE
in million euros

NUMBER OF SHAREHOLDERS AT YEAR-END
pcs

CHANGE IN THE PRICE AND VOLUME OF AS MERKO EHITUS SHARE AT NASDAQ TALLINN STOCK EXCHANGE

TRADING HISTORY OF SECURITY, IN EUROS

	2016	2015	2014
Highest	9.22	10.50	7.99
Lowest	7.60	7.06	6.70
Closing at 31.12	9.05	8.48	7.14
Average	8.44	8.47	7.33
Change at 31.12, %	+6.72	+18.77	-0.83
Traded shares, pcs	633,185	897,409	1,030,681
Turnover, million EUR	5.35	7.71	7.62
Market value at 31.12, million EUR	160.2	150.1	126.4

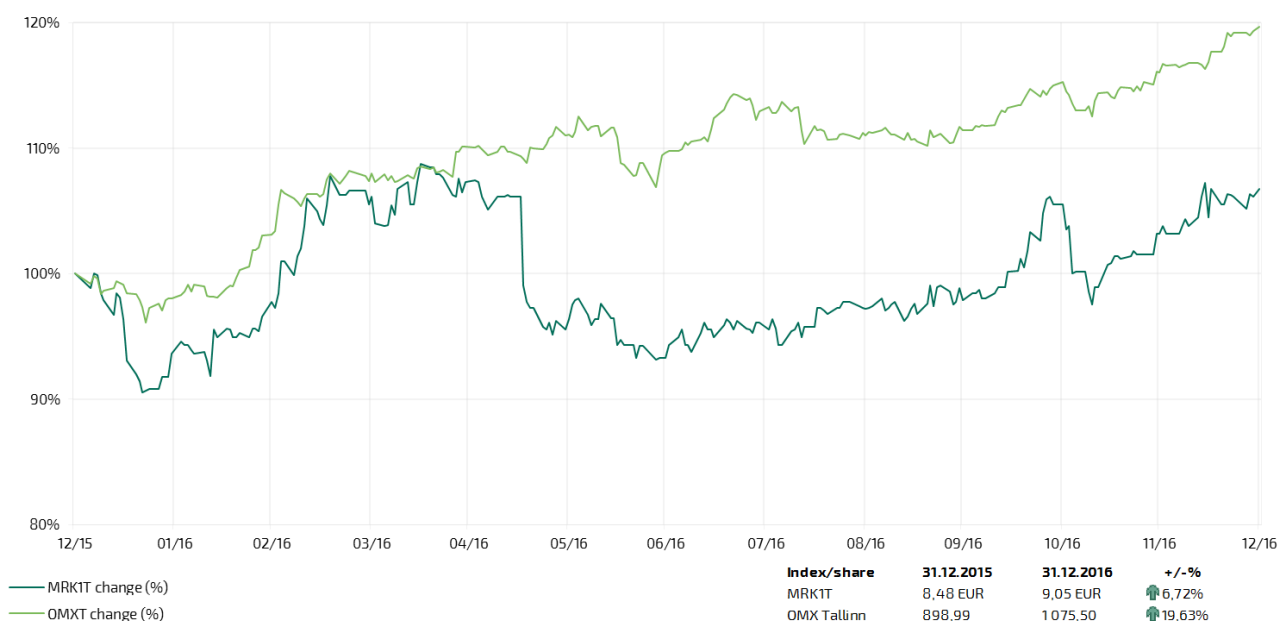
STRUCTURE OF SHAREHOLDERS ACCORDING TO NUMBER OF SHARES AS AT 31.12.2016

NUMBER OF SHARES	NUMBER OF SHAREHOLDERS	% OF SHAREHOLDERS	NUMBER OF SHARES	% OF SHARES
1 000 001 - ...	1	0.06%	12,742,686	71.99%
100 001 - 1 000 000	11	0.61%	2,896,859	16.37%
10 001 - 100 000	33	1.82%	946,350	5.35%
1001-10 000	252	13.90%	721,440	4.08%
101-1000	931	51.35%	362,112	2.04%
1-100	585	32.26%	30,553	0.17%
Total	1,813	100%	17,700,000	100%

STRUCTURE OF SHAREHOLDERS ACCORDING TO HOLDER CATEGORIES AS AT 31.12.2016

CATEGORY	NUMBER OF SHAREHOLDERS	% OF SHAREHOLDERS	NUMBER OF SHARES	% OF SHARES
Non-profit institution serving households	1	0.06%	1,500	0.01%
Insurance corporation	1	0.06%	143,887	0.81%
Other investment fund	4	0.22%	750,201	4.24%
Credit institution	30	1.65%	2,235,204	13.29%
Other financial institution	38	2.10%	373,911	2.11%
Other non-financial corporation	216	11.91%	13,210,515	74.64%
Household	1,523	84.00%	867,782	4.90%
Total	1,813	100%	17,700,000	100%

PERFORMANCE OF THE SHARE OF MERKO EHITUS AND COMPARISON INDEX OMX TALLINN IN 2016



SHAREHOLDERS OF AS MERKO EHITUS AS AT 31.12.2016 AND CHANGE COMPARED TO THE PREVIOUS YEAR

	NUMBER OF SHARES	% OF TOTAL 31.12.2016	% OF TOTAL 31.12.2015	CHANGE
AS Riverito	12,742,686	71.99%	71.99%	-
ING Luxembourg S.A. AIF Account	974,126	5.50%	5.50%	-
Firebird Republics Fund Ltd	389,432	2.20%	2.24%	(6,272)
Skandinaviska Enskilda Banken AB, Swedish customers	260,813	1.47%	1.45%	4,160
SEB S.A. UCITS client assets	232,222	1.31%	1.48%	(29,000)
Firebird Aurora Fund Ltd	220,519	1.25%	1.25%	-
State Street Bank and Trust Omnibus Account A Fund No OM01	153,018	0.86%	0.86%	-
SEB Elu- ja Pensionikindlustus AS	143,887	0.81%	0.82%	(1,133)
Clearstream Banking Luxembourg S.A. customers	143,054	0.81%	0.80%	1,345
OÜ Midas Invest	138,185	0.78%	0.46%	56,500
Total largest shareholders	15,397,942	86.98%	86.85%	25,600
Total other shareholders	2,302,058	13.02%	13.15%	(25,600)
Total	17,700,000	100%	100%	

DIVIDENDS AND DIVIDEND POLICY

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

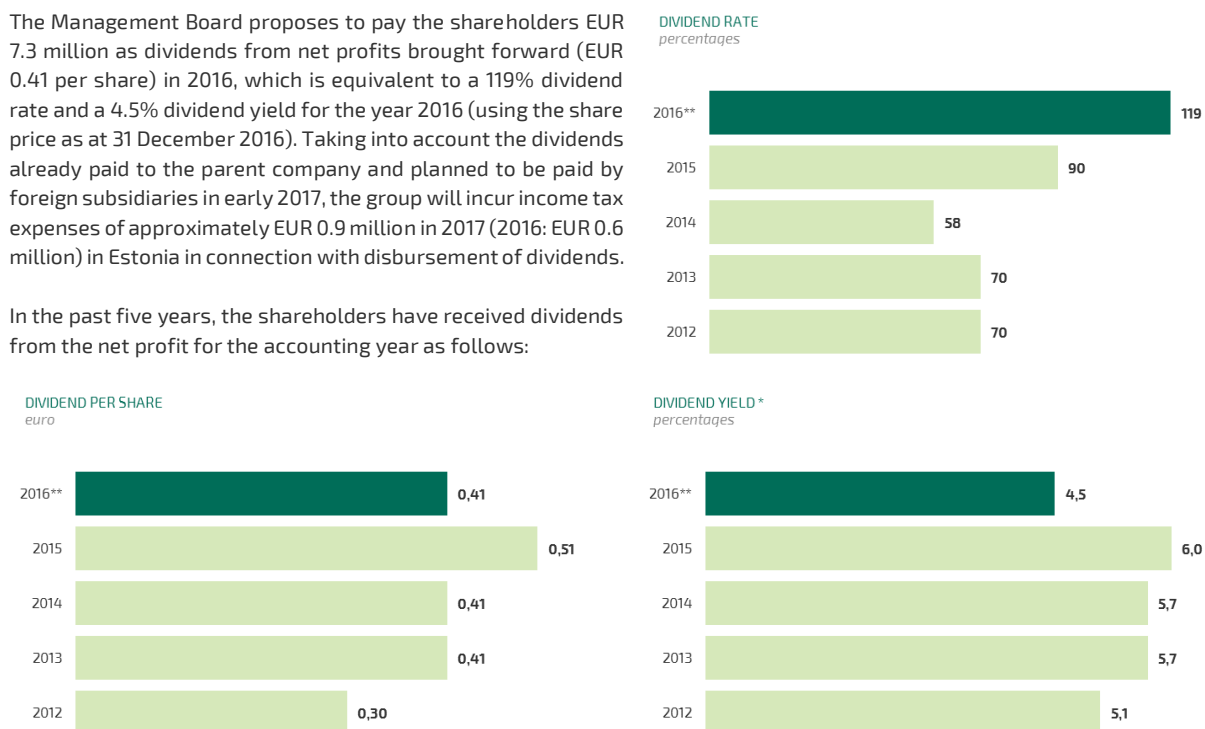
At its meeting held on 8 April 2013, the Management Board and Supervisory Board reviewed the company's strategic direction and confirmed the long-term financial objectives until 2018, as a part of this a new objective was set to pay out 50-70% of the annual profit as dividends to shareholders. The group considers meeting this objective a significant priority.

The annual general meeting of shareholders of AS Merko Ehitus held at 27 April 2016 approved the Supervisory Board's proposal to pay the shareholders the total amount of EUR 9.0 million (EUR 0.51 per share) as dividends from net profit brought forward, which is equivalent to a 90% dividend rate and a 6.0% dividend yield for the year 2015 (using the share price as at 31 December 2015), (comparable figures in 2015 were accordingly: EUR 7.3 million (EUR 0.41 per share) as dividends, which is equivalent to a 58% dividend rate and a 5.7% dividend yield for the year 2014 (using the share price as at 31 December 2014)).

According to the Estonian Income Tax Law §50 section 1¹ AS Merko Ehitus can pay dividends without any additional income tax expense and liabilities occurring due to previously received and taxed distribution of profits from subsidiaries. Taking into account the dividends already paid to the parent company by the subsidiaries, the group incurred additional income tax expense in connection with the disbursement of dividends of EUR 0.6 million (2015: EUR 0.9 million) in Estonia in the second quarter of 2015. The dividend payment to the shareholders took place on 20 May 2016.

The Management Board proposes to pay the shareholders EUR 7.3 million as dividends from net profits brought forward (EUR 0.41 per share) in 2016, which is equivalent to a 119% dividend rate and a 4.5% dividend yield for the year 2016 (using the share price as at 31 December 2016). Taking into account the dividends already paid to the parent company and planned to be paid by foreign subsidiaries in early 2017, the group will incur income tax expenses of approximately EUR 0.9 million in 2017 (2016: EUR 0.6 million) in Estonia in connection with disbursement of dividends.

In the past five years, the shareholders have received dividends from the net profit for the accounting year as follows:



* Using share price as at 31.12

** 2016 figures based on Management Board proposal regarding dividend payment.

Dividend payments are carried out in the next fiscal year in accordance with the decisions of the general meeting of the shareholders, regarding the previous fiscal year.

SHAREHOLDER INFORMATION

GENERAL MEETING OF SHAREHOLDERS

The annual general meeting of shareholders of AS Merko Ehitus will be held on Wednesday, 28 April 2017 at 10.00 a.m. at the Arcturus conference room of Nordic Hotel Forum (Viru väljak 3, Tallinn).

AGENDA

1. Approval of the annual report of the year 2016 and providing an overview of the financial results and the prospects of the year;
2. Proposal on distribution of profits;
3. Deciding on the number of members of the Supervisory Board;
4. Extension of powers of members of the Supervisory Board.

RIGHT OF PARTICIPATION

The shareholders with the right to participate in the general meeting of shareholders will be determined 7 days before the general meeting of shareholders is held, i.e. 21 April 2017 at 11.59 p.m.

REGISTRATION

Registration of participants of the meeting will open on April 28th 2017 at 9.30 a.m.

You are asked to submit the following for the registration of participants of the general meeting:

- Passport or ID document is required to identify shareholders who are natural persons; a suitably prepared Proxy is also required of representatives;
- Representatives of a legal person-shareholders are required to provide an excerpt from an appropriate (business) register where the legal person is registered, which identifies the individual's right to represent the shareholder (legal representation) and passport or identification document of the representative; if the type of representation is other than legal representation, a suitably prepared Proxy must also be provided (authorities granted by transaction) and the representative's passport or identification document. You are kindly asked to legalise the registration documents of a legal person registered in a foreign country (with the exception of unattested proxy) or have them apostilled, if not provided otherwise by an international treaty. AS Merko Ehitus may register shareholders who are legal persons registered in a foreign country as participants of the general meeting when all the required information on the legal person and representative concerned are given in a notarised proxy, issued to the representative in a foreign country, and the proxy is acceptable in Estonia.

A shareholder may notify AS Merko Ehitus of appointing a representative and having withdrawn a proxy before the general meeting, by supplying a digitally signed proxy and other required documents by e-mail to the following address: group@merko.ee or delivering the written and signed documents on paper (proxy and other required documents) to the office of AS Merko Ehitus at Pärnu mnt 141 Delta Plaza 7th floor, Tallinn (on working days from 10.00 a.m. through 4.00 p.m.) by April 27th 2017, at 4.00 p.m., at latest, using the forms published by AS Merko Ehitus on its website at <http://group.merko.ee>. It is not possible to vote electronically or by mail at the general meeting.

DOCUMENTS

The annual report of AS Merko Ehitus for 2016 and the chartered auditor's report are available for inspection on the website of NASDAQ Tallinn Stock Exchange at <http://www.nasdaqomxbaltic.com> or the group's website at <http://group.merko.ee>.

Documents related to the annual general meeting of shareholders of AS Merko Ehitus, including draft resolutions, annual report for the financial year 2016, chartered auditor's report and proposals for distribution of profits along with the articles of association and written report, drawn up for the annual report by the Supervisory Board, are available for inspection as of April 3rd 2017 on the website of AS Merko Ehitus at <http://group.merko.ee> or on working days between 10.00 a.m. and 4.00 p.m. at Pärnu mnt 141 Delta Plaza 7th floor, Tallinn. Questions concerning the agenda of the regular meeting can be asked by sending them to the e-mail address group@merko.ee. Questions and answers will be disclosed at the website of AS Merko Ehitus.

SHAREHOLDER RIGHTS

Shareholders are entitled to information concerning the business of AS Merko Ehitus from the Management Board at the general meeting. The Management Board may refuse to provide the information if there is a good reason to believe that this may cause material damage to the interests of the public limited company. Should the Management Board refuse to provide the information, the shareholder concerned may demand the general meeting to adopt a decision regarding the legitimacy of his/her demand or

within two weeks of the general meeting occurrence file an application for proceedings on application to the court to demand the Management Board to supply the information.

Shareholders, holding shares representing at least 1/20 of the share capital of AS Merko Ehitus may submit a draft resolution of each item on the agenda to the public limited company no later than 3 days prior to the general meeting, that is, until April 25th 2017, submitting it in writing to the following address: AS Merko Ehitus, Pärnu mnt 141 Delta Plaza 7th floor, 11314 Tallinn.

Shareholders, holding shares representing at least 1/20 of the share capital of AS Merko Ehitus, may demand that additional items are added to the agenda of the general meeting, provided that such a request has been submitted in writing at least 15 days prior to the general meeting, that is, until April 13th 2017, to the following address: AS Merko Ehitus, Pärnu mnt 141 Delta Plaza 7th floor, 11314 Tallinn.

IMPORTANT DATES RELATED TO GENERAL SHAREHOLDERS MEETING

EVENT	DATE
The shareholders with the right to participate in the general meeting are determined	21 April 2017 at 11.59 p.m.
Registration of participants in the meeting	28 April 2017 at 9.30 a.m.
General meeting of shareholders	28 April 2017 at 10.00 a.m.
Dividend ex-date	22 May 2017
Dividend record date	24 May 2017 at 11.59 p.m.
Dividend payment date	26 May 2017

REPORT ON GOOD CORPORATE GOVERNANCE

CORPORATE GOVERNANCE AND STRUCTURE

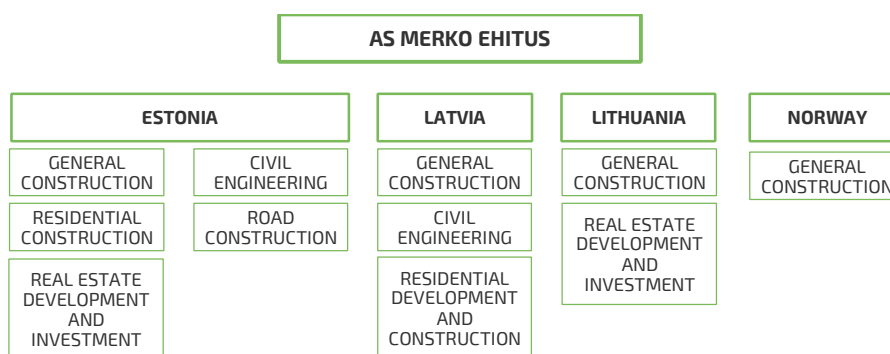
Adherence to the principles of Good Corporate Governance is part of the management of AS Merko Ehitus. Generally, this system is regulated by relevant legislation, the company's articles of association and the company's internal policies. Starting from 1 January 2006, issuers of shares listed on the NASDAX Tallinn Stock Exchange are recommended to adhere to the principles of Good Corporate Governance approved by the Financial Supervisory Authority that covers good practices of enterprise management and treatment of shareholders. AS Merko Ehitus has followed these principles throughout 2016.

AS Merko Ehitus is dedicated to following high standards of corporate governance, for the implementation of which the Management Board and the Supervisory Board are responsible for shareholders. Our objective is to be transparent in our economic activity, in disclosing information and in relations with shareholders.

AS Merko Ehitus operates as a holding company whose companies in Estonia, Latvia, Lithuania and Norway offer complete solutions in the field of construction and real estate development. In the construction sector, the group's largest companies are AS Merko Ehitus Eesti (100%), SIA Merks (100%), UAB Merko Statyba (100%) and the companies belonging to the AS Merko Ehitus Eesti group: Tallinna Teede AS (100%) and AS Merko Infra (100%).

The main activity of the holding company is development and implementation of the strategies of Merko Ehitus group's separate business areas primarily through long-term planning of resources. The holding company AS Merko Ehitus has a two-member Management Board: Andres Trink and Tõnu Toomik.

It is important to maintain a simple organisational structure in the group and in management to be guided primarily by the group's objectives and requirements. For the purposes of maximum effectiveness in group management, we in some cases differentiate the management structure and legal structure. The group's management is carried out on a country basis. The groups country and business area detailed management structure as at 31 December 2016 is the following:



GROUP'S LEGAL STRUCTURE

As at 31 December 2016, the group comprises of 46 companies (31.12.2015: 43). The group's legal structure is predominantly based on tax efficiency and there is not in all cases a direct linear relationship with the group's effective management structure. The detailed list of group companies is provided in Notes 18 and 19 of the financial statements.

Changes in the legal structure of the group

The 100% subsidiary in the Kingdom of Norway, Merko Investments AS (registry code 916 750 323) was founded in February 2016 and, on 17 February, entered into the register. Merko Investments AS, registered in Norway, is a 100% subsidiary of AS Merko Ehitus. The first contribution of NOK 30 thousand was made to the new subsidiary's share capital on 3 February; the second contribution, of NOK 4,700 thousand, was made on 3 March (totalling approximately EUR 502 thousand). This is a technical step aimed at creating the legal platform for launching operations in Norway.

On 7 March 2016, Merko Investments AS, part of AS Merko Ehitus Group, signed contracts with Norwegian companies SDV Holding AS and Aucon AS to acquire 56% ownership interest in Norwegian construction company Peritus Entreprenør AS. The total purchase price was NOK 4,000 thousand (EUR 425 thousand). Non-controlling interest in the amount NOK 2,572 thousand (EUR 273 thousand; as at 31.12.2016 EUR 283 thousand) resulted from the business combination. Peritus Entreprenør AS (www.peritus-entreprenor.no) is a Norwegian construction company, offering general construction services, with the sales turnover of approximately 7 million euros in 2015. The former owners will continue to participate in the daily management of the company and they will keep their 44% ownership interest. The objective of the acquisition is to start offering construction services in the Norwegian market.

On 7 March 2016, Merko Ehitus group subsidiary UAB Merko Bustas entered into an agreement with the company Venturecorp Property Holdings Ltd for acquiring a 100% ownership in the Lithuanian real estate developer UAB Rinktinės projektai with a total purchase price of EUR 2 thousand.

On 30 March 2016, AS Merko Ehitus's 100% subsidiary AS Merko Ehitus Eesti made a non-monetary contribution into subsidiary OÜ Fort Ehitus. The object of the non-monetary contribution was the ceding of claims arising from a loan agreement to OÜ Fort Ehitus totalling EUR 1,880 thousand. Among other things, AS Merko Ehitus ceded claims worth EUR 1,429 thousand and the non-controlling interest in the amount of EUR 451 thousand. After executing the transaction, AS Merko Ehitus Eesti's ownership interest in the subsidiary OÜ Fort Ehitus increased by 1% percentage to 76%.

On 8 November 2016, AS Merko Ehitus launched a process for restructuring its 100% subsidiary in Lithuania, UAB Merko Bustas. In accordance with the restructuring plan, UAB Merko Bustas's 100% subsidiary UAB VPSP1 will be merged with parent company UAB Merko Bustas. The restructuring will be completed and the final merger entry in the Commercial Register will be done during the first quarter of 2017.

On 5 December 2016, AS Merko Ehitus' 100% subsidiary SIA Merks and SIA Ostas celtnieks established a general partnership PS Merks-Ostas-celtnieks for the performance of the consortium agreement entered into for the construction of the Ventspils Music School and concert hall. SIA Merks holds a 65% ownership interest and SIA Ostas celtnieks a 35% ownership interest in the consortium.

On 28 December 2016, AS Merko Ehitus's 100% subsidiary AS Merko Ehitus Eesti initiated a process to merge its fully owned subsidiaries AS Merko Tartu, AS Gustaf, OÜ Rannamõisa Kinnisvara and OÜ Heamaja, all engaged in real estate development, in order to have savings in administrative cost related to company management. The acquiring company is AS Merko Tartu. The companies being acquired will be merged into AS Merko Tartu and as a result of the merger the companies being acquired will wind up without liquidation proceedings and AS Merko Tartu will become the legal successor of the companies being acquired. As a result of the merger, AS Merko Ehitus Eesti will remain the sole shareholder in AS Merko Tartu, the acquiring company. The closing date of the merger was 1 January 2017 after which all transactions of the acquirees have been deemed to have been made on account of the acquirer. The final merger entry in the Commercial Register will be made in the first half of 2017.

On 17 March 2017, AS Merko Ehitus and AS Ehitusfirma Rand ja Tuulberg launched a process for liquidating their joint venture Poolkoksimäe Sulgemise OÜ, owned 50% by both. The liquidation will be completed and the final deletion entry in the Commercial Register will be made sometime in the summer of 2017.

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 general meeting of shareholders decides, among others, the appointment and recall of members of the Supervisory Board, appointment of the auditor and approval of the results of the financial year, the payment of dividends. The annual general meeting of shareholders is held at least once a year and shall approve the annual report within six months of the end of the financial year.

The general meeting of the shareholders was held on 27 April 2016. The general meeting resolved to approve the annual report and the profit allocation proposal for 2015. The dividends in the sum of EUR 9.0 million (EUR 0.51 per share) were paid out to shareholders on 20 May 2016.

In addition, it was decided at the general meeting of the shareholders to amend the articles of association. The articles of association were amended to enable electronic voting and web transmission of the general meeting, as well as for better organisation of management of AS Merko Ehitus.

The Management Board made a presentation on the company's financial results and future prospects.

In accordance with the Commercial Code, its Articles of Association and Good Governance Code, AS Merko Ehitus calls the annual and extraordinary general meeting of shareholders by notifying the shareholders through the Tallinn Stock Exchange and by publishing a meeting call in one national daily newspaper at least 3 weeks in advance. The general meeting shall be held at the place shown in 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.

Before their publication, agendas at annual and extraordinary general meetings of the company's shareholders are approved by the Supervisory Board that shall also present to the general meeting subjects for discussion and voting. Agenda items of the general meeting, recommendations of the Supervisory Board with relevant explanations, procedural guidance for participation in the general meeting and how and when new agenda items can be proposed are published together with the notice on calling the general meeting.

General meetings can be attended by any shareholder or his or her authorised representative. AS Merko Ehitus does not allow participation in general meetings by electronic means of communication equipment since the deployment of reliable solutions for the identification of shareholders some of whom live abroad, while ensuring the privacy of participating shareholders, would be too

complicated and costly. No picture taking or filming is allowed at the general meeting, because it may disturb the privacy of shareholders.

Annual and extraordinary general meeting of shareholders shall be chaired by an independent person. In 2016, the general meeting was chaired by attorney-at-law Vesse Võhma who introduced the procedure for conducting the general meeting and the procedure of asking questions from the Management Board and Supervisory Board about the company's activities.

On behalf of the company, usually the Chairman of the Management Board and the Chairman of the Supervisory Board shall participate in the General Meeting of AS Merko Ehitus, and if necessary, other members of the Management and Supervisory Boards shall be involved. If necessary, the company's auditor shall participate.

The annual general meeting of shareholders of AS Merko Ehitus held in 2016 was attended by Andres Trink (Chairman of the Management Board), Tõnu Toomik (Member of the Management Board), Signe Kukin (Group Chief Financial Officer) and Ago Vilu (Auditor).

SUPERVISORY BOARD

The Supervisory Board shall plan the activities of the company, organise the management of the company and supervise the activities of the Management Board. The Supervisory Board shall notify the general meeting of shareholders of the results of a review. The Chairman of the Supervisory Board organises the work of the Supervisory Board. The main duties of the Supervisory Board are to approve the group's material strategic and tactical decisions and to supervise the activities of the group's Management Board. The Supervisory Board's actions are guided by the company's articles of association, guidelines of the general meeting and law.

According to the Articles of Association of Merko Ehitus, the Supervisory Board has 3 to 5 members who shall be elected for the term of three years.

At the annual general meeting of shareholders held at 30 April 2014, it was decided to extend the term of office of Supervisory Board members Toomas Annus, Teet Roopalu, Indrek Neivelt and Olari Taal until 30 April 2017, i.e. for three years from the decision of the extension.

The Supervisory Board of AS Merko Ehitus has four members of whom, in accordance with the requirements of the Good Corporate Governance Code, two - Indrek Neivelt and Olari Taal - are independent members:



Toomas Annus (56) *Chairman of the Supervisory Board*

Positions held:

2011-... AS Merko Ehitus, Chairman of the Supervisory Board
 2014-... E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
 2009-2014 E.L.L. Kinnisvara AS, Member of the Management Board
 2008-... Järvevana OÜ, Member of the Management Board
 1999-2009 E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
 1997-2008 AS Merko Ehitus, Chairman of the Supervisory Board
 1996-... AS Riverito, Chairman of the Management Board
 1991-1996 AS EKE Merko, Chairman of the Management Board
 1989-1991 EKE MRK, director of the company

Education:

Tallinn University of Technology, industrial and civil engineering
 Tallinn Technical School of Building and Mechanics, industrial and civil engineering

Number of shares: 8,322,914 (AS Riverito)



Teet Roopalu (67) *Member of the Supervisory Board*

Positions held:

2004-... AS Merko Ehitus, Member of the Supervisory Board
 2010-... AS Riverito, Member of the Management Board
 2003-... E.L.L. Kinnisvara AS, Member of the Supervisory Board
 2015-... Järvevana OÜ, Member of the Member Board
 2002-2004 AS Merko Ehitus, Adviser to the Management Board
 Has worked for different construction companies, including as a director of finance. Has been in charge of economic activities in the EKE system as a chief economist; worked as a bank director; and has also worked in building design.
 Member of Supervisory Boards of group subsidiaries

Education:

Tallinn University of Technology, construction economics and organisation

Number of shares: -


Indrek Neivelt (49) *Member of the Supervisory Board*
Positions held:

2008-... AS Merko Ehitus, Member of the Supervisory Board
 2015-... AS Pocopay, Member of the Management Board
 2016-... OÜ Poco Holding, Member of the Management Board
 Has held various executive positions in Hansapank (now Swedbank), incl. Director General of the Group, Chairman of the Management Board and also in Bank Saint Petersburg as the Chairman of the Supervisory Board.

Belongs to Supervisory Boards of various companies.

Education:

Tallinn University of Technology, civil engineering economics and management.

Stockholm University, banking and finance, MBA

Number of shares: 31,635 (Trust IN OÜ)


Olari Taal (63) *Member of the Supervisory Board*
Positions held:

2008-... AS Merko Ehitus, Member of the Supervisory Board
 Has been the head of the Tartu Elamuehituskombinaat (Tartu Housing Plant; Tartu Maja) and Eesti Hoiupank (Estonian Savings Bank).

Has served the Republic of Estonia as Minister of Construction, Minister of Economic Affairs, Minister of the Interior and as a Member of the 10th Riigikogu (Parliament of Estonia).

Belongs to Supervisory Boards of various companies.

Education:

Tallinn University of Technology, civil engineering.

Number of shares: 2,500 (Eggera OÜ)

The meetings of the Supervisory Board generally take place once a month, except in summer months. In 2016, the Supervisory Board held 11 regular meetings. No extraordinary Supervisory Board meetings were held. Participation of members of the Supervisory Board at meetings:

NAME	PARTICIPATION IN MEETINGS	PARTICIPATION %
Toomas Annus	11	100%
Teet Roopalu	11	100%
Indrek Neivelt	9	82%
Olari Taal	11	100%

The Supervisory Board fulfilled all its obligations laid down in legal acts. The Supervisory Board has set up an audit committee as its work body. The Supervisory Board has not considered it necessary to set up a remuneration committee or appointment committee. Remuneration of the members of the Supervisory Board is approved by the general meeting of shareholders. The valid procedure for remuneration of Supervisory Board members was approved by the general meeting of shareholders held at 31 October 2008.

No termination benefits are paid to the members of the Supervisory Board upon the termination or non-extension of the contract. In the 2016 and 2015 financial years, the members of the Supervisory Board were remunerated as follows (in euros):

NAME	2016	2015
Toomas Annus	42,182	42,182
Teet Roopalu	38,347	38,347
Indrek Neivelt	38,347	38,347
Olari Taal	38,347	38,347
TOTAL	157,223	157,223

Remuneration, less the statutory taxes, to the members of the Supervisory Board is paid on a monthly basis.

MANAGEMENT BOARD

The Management Board is a governing body which represents and manages AS Merko Ehitus in its daily activities in accordance with the law and the Articles of Association. The Management Board has to act in the most economically purposeful manner, taking into consideration the best interests of all shareholders and ensures the company's sustainable development in accordance with set

objectives and strategy. To ensure that the company's interests are met in the best way possible, the Management and Supervisory Boards shall extensively collaborate. At least once a month, a joint meeting of the members of the Supervisory and Management Boards shall take place, in 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 impacting them. For every meeting of the Supervisory Board, the Management Board shall prepare a management report and submit it well in advance of the meeting so that the Supervisory Board can study it. The Management Board prepares reports for the Supervisory Board also in between the meetings, if it is considered necessary by the Supervisory Board or its Chairman.

Pursuant to the Articles of Association approved at the general meeting of shareholders in 2012, the Management Board may have up to three members. AS Merko Ehitus has a two-member Management Board: Andres Trink (Chairman of the Management Board) and Tõnu Toomik (Member of the Management Board).



Andres Trink (49) *Chairman of the Management Board*
Appointed: 1 January 2012
Term ends: 1 January 2018

Positions held:

2012-... AS Merko Ehitus, Chairman of the Management Board
2016-... Swedbank Investeerimisfondid AS, Member of the Supervisory Board
Chairman of the Supervisory Board of Merko Ehitus Eesti AS, SIA Merks and UAB Merko Statyba
Has held various executive positions in the private and public sector. Before being hired at Merko Ehitus, worked for 15 years in the financial sector, including as a Member of the Management Board of Baltic banking at Hansapank (now Swedbank).

Education:

Tallinn University of Technology, automated management systems specialty (summa cum laude).
Estonian Business School, international business administration.
Graduate of the INSEAD University (France), executive management programme.

Number of shares: 500



Tõnu Toomik (55) *Member of the Management Board*
Appointed: 6 June 2013
Term ends: 6 June 2019

Positions held:

2013-... AS Merko Ehitus, Member of the Management Board
2014-... E.L.L. Kinnisvara AS, Member of the Supervisory Board
2011-2013 AS Merko Ehitus, Member of the Supervisory Board
2009-2014 E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
2008-2011 AS Merko Ehitus, Chairman of the Supervisory Board
1999-2009 E.L.L. Kinnisvara AS, Member of the Supervisory Board
1997-1999 E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
1997-2008 AS Merko Ehitus, Chairman of the Management Board
1996-... AS Riverito, Member of the Management Board
1993-1996 AS EME Merko, Estonian Regional Director
1993-1993 AS EKE Merko, Project Manager
Member of the Supervisory Board of Merko Ehitus Eesti AS, SIA Merks and UAB Merko Statyba

Education:

Tallinn University of Technology, industrial and civil engineering

Number of shares: 1,607,185 (AS Riverito)

The responsibilities of Andres Trink, Chairman of the Management Board, include, among others, fulfilling daily obligations of the CEO of AS Merko Ehitus, managing and representing the company, ensuring compliance with the Articles of Association, legal acts, organising the work of the Management Board and supervisory boards of the more important subsidiaries, coordinating the development of strategies and providing for their implementation, being responsible for business development and finance. Tõnu Toomik is responsible for the management of the portfolio of properties and coordination of construction segment development activities across the whole group.

Members of the Management Board have entered into three-year contracts of service with the company. The procedure and principles of remuneration of Management Board members are approved by the Supervisory Board. The members of the Management Board are paid a fee for fulfilling their official duties. Bonuses payable to the Management Board depend on the fulfilment of the targets of the given financial year by the group and the Management Board. The members of the Management Board are paid bonuses once a year based on the fulfilment of the targets of the previous financial year.

In the 2016 and 2015 financial years, the Management Board members' remuneration incl. service fees and bonuses, accrued for the reporting year were as follows (in euros):

NAME	2016	2015
Andres Trink	226,060	292,979
Tõnu Toomik	211,050	238,342
TOTAL	437,110	531,321

Changes in the management of AS Merko Ehitus

On 3 May 2016, the Supervisory Board of AS Merko Ehitus decided to extend the powers of the Member of the Management Board, Mr. Tõnu Toomik for three years, i.e. from 6 June 2016 until 6 June 2019. The Management Board of AS Merko Ehitus will continue with current two members: Mr. Andres Trink (The Chairman) and Mr. Tõnu Toomik.

SUPERVISORY AND MANAGEMENT BOARDS OF SUBSIDIARIES

Authorisation and responsibility of supervisory boards of subsidiaries of AS Merko Ehitus are based on their Articles of Association and intergroup rules. Generally, Supervisory Boards of subsidiaries consist of members of the Management Board and Supervisory Board of the company that is the main shareholder of the specific subsidiary. Supervisory Board meetings of the most significant subsidiaries are held usually once a month, otherwise according to the group's needs, Articles of Association of subsidiaries and legal provisions. Generally, no separate fee is paid to members of the Supervisory Board of subsidiaries. Members of the Supervisory Board will also receive no termination benefit in case their contract of service is terminated before due date or not extended.

The chairman or member of the Management Board of the subsidiary shall be named by the subsidiary's Supervisory Board. Below are the supervisory boards and management boards of the most significant subsidiaries that are wholly-owned by AS Merko Ehitus as at 31 December 2016:

COMPANY *	SUPERVISORY BOARD	MANAGEMENT BOARD
AS Merko Ehitus Eesti (37 085 730 euros)	Andres Trink (Chairman), Teet Roopalu, Tõnu Toomik	Keit Paal (Chairman), Jaan Mäe, Alar Lagus, Veljo Viitmann
AS Merko Infra (7 614 513 euros)	Keit Paal (Chairman), Veljo Viitmann, Mihkel Mugur	Arno Elias (Chairman), Tarmo Pohlak, Boris Tehnikov
Tallinna Teede AS (12 380 623 euros)	Tõnu Toomik (Chairman), Keit Paal, Alar Lagus, Veljo Viitmann	Jüri Läll (Chairman), Jüri Helila
OÜ Merko Investments (21 580 976 euros)	-	Andres Trink, Signe Kukin
SIA Merks (17 635 933 euros)	Andres Trink (Chairman), Tõnu Toomik, Signe Kukin	Oskars Ozoliņš (Chairman), Jānis Šperbergs
SIA Merko Investments (41 018 973 euros)	-	Andres Trink (Chairman), Oskars Ozoliņš
UAB Merko Statyba (2 187 695 euros)	Andres Trink (Chairman), Tõnu Toomik, Signe Kukin	Saulius Putrimas (Chairman), Jaanus Rāstas
OÜ Metsailu (6 417 804 euros)	-	Tiit Kuusik, Ines Prual

* The figure in brackets indicates the amount of equity held by the parent company's owners in significant subsidiaries as at 31 December 2016.

Changes in the management of group subsidiaries

On 21 January 2016, the Supervisory Board of SIA Merks – part of AS Merko Ehitus group – decided to extend the powers of the Members of the Management Board, Mr. Oskars Ozoliņš and Mr. Janis Šperbergs for three years, i.e. from 2 February 2016 till 1 February 2019. The Management Board of SIA Merks will continue in a former two-member panel: Mr. Oskars Ozoliņš (The Chairman) and Mr. Janis Šperbergs.

On 10 March 2016, the Management Board of AS Merko Ehitus decided to change the composition of the Supervisory Board of AS Merko Ehitus Eesti, part of AS Merko Ehitus group. Mr. Toomas Aak will leave the Supervisory Board of AS Merko Ehitus Eesti and the Supervisory Board will continue with three members: Mr. Andres Trink (the Chairman), Mr. Tõnu Toomik and Mr. Teet Roopalu.

On 14 October 2016, the Management Board of AS Merko Ehitus decided to extend the powers of the group's subsidiary company OÜ Metsailu management board members: Mr. Tiit Kuusik and Ms. Ines Prual for three years, i.e. from 28 October 2016 till 27 October 2019. The Management Board of OÜ Metsailu will continue in a former two-member panel.

On 3 November 2016, the Supervisory Board of AS Merko Ehitus Eesti – part of AS Merko Ehitus group – decided to change the Management Board of AS Merko Ehitus Eesti as of 14 November 2016. Instead of Tiit Roben, Keit Paal will become the Chairman of the Management Board of AS Merko Ehitus Eesti. The Management Board of the AS Merko Ehitus Eesti will continue with four members: Keit Paal (the Chairman), Jaan Mäe, Alar Lagus and Veljo Viitmann.

On 14 November 2016, the Management Board of AS Merko Ehitus Eesti decided to make changes to the composition of the Supervisory Boards of AS Merko Infra and Tallinna Teede AS, both subsidiaries of AS Merko Ehitus Eesti, part of AS Merko Ehitus Group.

Keit Paal will become the Chairman of the Supervisory Board of AS Merko Infra as of 14 November 2016. The Supervisory Board will continue with three members: Keit Paal (the Chairman), Veljo Viitmann and Mihkel Mugur. There was also decided to extend the

powers of the Members of the Supervisory Board of AS Merko Infra, Veljo Viitmann and Mihkel Mugur according to the statutes for the three years' tenure, i.e. until 13 November 2019.

Tõnu Toomik will become the Chairman and Keit Paal will join as an additional member of the Supervisory Board of Tallinna Teede AS as of 14 November 2016. Alar Lagus and Veljo Viitmann will continue as the Members of the Supervisory Board of Tallinna Teede AS.

On 17 January 2017, the Supervisory Board of AS Merko Infra, Estonian subsidiary, part of AS Merko Ehitus group, decided to extend the powers of the Chairman of the Management Board, Mr. Arno Elias and the Member of the Management Board, Mr. Boris Tehnikov for three years, i.e. from 23 January 2017 until 22 January 2020. The Board appointed Mr. Marek Hergauk as a new member of the Management Board from 23 January 2017 until 22 January 2020. Mr. Tarmo Pohlak's mandate as a Member of the Management Board was not renewed and will expire on 22 January 2017. The Management Board of AS Merko Infra will continue with three members: Arno Elias (The Chairman), Boris Tehnikov and Marek Hergauk.

Remuneration paid to the members of the Management Boards of significant subsidiaries is provided in Note 33 of the financial statements.

AUDIT COMMITTEE

The Supervisory Board of AS Merko Ehitus has formed an audit committee as its work body. The responsibility of the audit committee is advising the Supervisory Board in supervision related issues. The Committee executes supervision over the whole group (incl. subsidiaries): a) arrangement of accounting, b) preparation and approval of the financial budget and reports, c) management of financial risks, d) performance of external audit, e) functioning of an internal control system and f) legality of the activities. Subsidiaries have not formed audit committees.

As at 10 January 2011, the company's Supervisory Board set up a 3-member audit committee and appointed Indrek Neivelt and Olari Taal as its members and Teet Roopalu as its Chairman. A member of the committee is elected for a term of three years, but at the decision of the Supervisory Board, a member of the committee may be recalled before the expiration of their term of office.

Members of the auditing committee are not separately remunerated.

REPORTING AND FINANCIAL AUDIT

Availability of adequate and timely information is the basis for obtaining quality management decisions. It is important to ensure that reporting is factual, but also forward-looking. This will enable to manage, to the best of one's knowledge, risks and, in competition with other market operators, turn them into opportunities. The company's reporting can be roughly divided into: a) financial reporting and b) management reporting.

Financial reporting consists of interim reports of consolidated economic indicators and annual reports of companies that belong to the AS Merko Ehitus group, that are made public through the stock exchange system of NASDAQ Tallinn and that are available to all shareholders, potential investors and analysts covering the company.

On the other hand, management reporting is meant for the company's internal use. It is appropriate to separate reporting on various operating indicators that focuses on the performance of business segments and different group companies as well as return on equity. The refinement of reporting is a continuous process during which indicators affecting the achievement of agreed objectives are reviewed. Management reporting includes budgets and forecasts that AS Merko Ehitus does not disclose.

Financial audits are conducted on the basis of International Standards on Auditing. The auditor of AS Merko Ehitus is approved by the general meeting of shareholders. The selection process is managed by the Supervisory Board and its findings are presented to the general meeting for approval. As a result of the tender and with the resolution made by the general meeting in 2015, the financial auditor for annual reports of 2015-2017 is AS PricewaterhouseCoopers (PwC). Auditors authorised to sign the report differ, depending on the country of residence of the group company. Chartered auditor Ago Vilu is responsible for the consolidated audit report.

AS Merko Ehitus considers it important to ensure independence of the financial auditor and to avoid of conflicts of interest. In 2016, PwC did not perform to AS Merko Ehitus services that could have affected the independence of the auditor. We find that the financial audit was conducted in 2016 in compliance with regulative acts, international standards and expectations. PwC presented the results in two stages: a) as part of an interim audit and b) with regard to the final audit before the opinion is issued. Auditor's report is presented on pages 120-126.

In 2016, the fees for financial audit of AS Merko Ehitus Group amounted to EUR 91 thousand (2015: EUR 97 thousand) and for other counselling services (incl. tax advisory and IS consultations) to EUR 43 thousand (2015: EUR 19 thousand).

CONFLICT OF INTEREST AND HANDLING OF INSIDER INFORMATION

It is important to appropriately handle insider information in order to protect shareholders' interest and ensure honest and fair trading of shares. Significant information about AS Merko Ehitus and its subsidiaries must be available in a timely, consistent and equal manner for all shareholders and potential new shareholders. It is inevitable that persons related to AS Merko Ehitus and its subsidiaries have, because of their job, at certain times and in certain cases more information about the group than investors and the public. To prevent the misuse of such information, we have adopted internal rules in the group's companies on maintaining and publication of insider information and on making transactions on the basis of insider information (hereinafter: insider information rules). Insider information rules include a reporting system under which employees who may develop a conflict of interest when fulfilling their job duties are required to disclose their economic interests and confirm their independence by self-assessment.

The members of the Management and Supervisory Board of AS Merko Ehitus are users of insider information (so-called insiders). They have signed a relevant statement, are aware of insider information rules of AS Merko Ehitus and together with people connected with them are registered in the list of the company's insiders. Moreover, the list of insiders includes the financial employees of the parent company who have access to the group's consolidated operating results as well as members of the Management and Supervisory Boards of the more important subsidiaries together with the employees who are responsible for preparing and presenting accounting information.

As at 31 December 2016, the company's insider register lists 62 persons with permanent access (31.12.2015: 60 persons). The group keeps records on insiders in accordance with requirements set forth in the Securities Market Act and NASDAQ Tallinn rules and regulations.

To the best of our knowledge, in the financial year 2016 there were no cases of any misuse of insider information or conflicts of interest. No transactions with related parties were made at other than market terms.

OWNERSHIP INTERESTS OF AS MERKO EHITUS MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARD (OVER 5%) IN OTHER COMPANIES

NAME	RELATED COMPANY
Toomas Annus	AS Riverito, Kardispordi Arendamise OÜ, Kental OÜ, Kental Grupp OÜ, Audrupark OÜ
Teet Roopalu	Teet Konsult OÜ
Indrek Neivelt	Trust IN OÜ
Olari Taal	Eggera OÜ
Andres Trink	None
Tõnu Toomik	AS Riverito

No members of the company's supervisory or management board hold shares in an entity that operates in the core business area of AS Merko Ehitus – construction sector.

An overview of transactions with related parties in 2016 is provided in Note 33 of the financial statements.

DISCLOSURE OF INFORMATION

In disclosing information, AS Merko Ehitus shall follow Estonian law, the rules and regulations of NASDAQ Tallinn Stock Exchange and guidelines of the Financial Supervision Authority of Estonia 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 business partners.

The group has adopted an information disclosure procedure that describes the main policies in communication with investors and the public. The objective of the information disclosure procedure is to ensure access to adequate and yet accurate information about the group and its operations that will form the basis for the price of the securities issued by the company. Information will be disclosed without undue delay and impartially. The main principles of information disclosure of Merko Ehitus are consistency, impartiality, transparency, truthfulness and preventive approach.

The group discloses information about its financial condition and strategy in its financial statements, annual report and interim reports pursuant to the schedule that has been set. The disclosure dates of each next financial year will be announced before the end of the previous financial year.

Merko immediately discloses all decisions, issues and events that in the company's view may significantly change the price of the securities issued by the company and that are to be disclosed pursuant to laws and regulations. Stock exchange releases are published in Estonian and English.

Stock exchange releases are always published regarding the following subjects:

- financial statements, interim reports;
- amendment to previously published strategies and financial objectives;
- profit warnings;
- major projects and construction contracts;
- major investments and financial arrangements;
- significant corporate reorganisations and partnership agreements;
- significant reorganisation, streamlining or discontinuation of functions or operations;
- management board's proposals to the annual general meeting and resolutions adopted in the annual meeting;
- significant legal actions, legal proceedings or actions of the authorities.

Merko discloses information about projects in the form of stock exchange notice if contract value exceeds EUR 3 million excluding VAT and in case of public procurements without the customer's reserve (price limit subjected to construction contracts by Merko). Generally, Merko will only make disclosures about awarded contracts, i.e. information is disclosed after the contract is signed. We emphasize the fact that the said EUR 3 million limit is not absolute but a criterion for making it easier for investors to understand which projects Merko covers in its press releases sent via the stock exchange information system. In certain cases, there may be a need to send out press releases via the stock exchange information system on contracts smaller than that amount, if these exert a significant influence on the price of the company's securities or are relevant to current and prospective investors.

Important information shall be disclosed through the stock exchange system and on the company's website. In 2016, AS Merko Ehitus published 38 stock exchange releases through the stock exchange system.

NUMBER OF RELEASES	CONTENT OF RELEASE
13	New construction contracts
6	New development projects
5	Operating results
1	Acquisition of new properties
7	Changes in structure and management
3	General meeting
3	Other releases

We will publish 2017 consolidated interim reports as follows:

KUUPÄEV	SÜNDMUS
11.05.2017	2017 3 months and I quarter unaudited interim report
10.08.2017	2017 6 months and II quarter unaudited interim report
09.11.2017	2017 9 months and III quarter unaudited interim report
15.02.2018	2017 12 months and IV quarter unaudited interim report

In 2017, reports will be published before the start of the trading day, at 8 am local Estonian time (EET). Annual accounts of subsidiaries are not generally published, but they can be obtained, if necessary, from AS Merko Ehitus or the local Commercial Registries.

Our objective is to support fair pricing of Merko shares through constant and continued distribution of information to all market operators. Moreover, our objective is to maintain the loyalty of existing shareholders towards the company and to create interest in new shareholders and analysts.

It is our responsibility to prepare quarterly and annual reports, stock exchange releases and presentation and to plan and organise investor meetings with shareholders and analysts. We also collect and analyse feedback from investors and analysts in order to increase the value of information to be disclosed.

The company shall not hold meetings with analysts or presentations for investors immediately before the dates of disclosure of financial reporting (interim reports, annual report). AS Merko Ehitus communicates regularly with its larger shareholders and potential investors and, if requested, holds meetings. The information presented in these meetings is public, i.e. available from the company's reports, website or other public sources. We carefully monitor insider information rules during these meetings.

The investor calendar published on the AS Merko Ehitus website group.merko.ee/en/investors/investor-calendar/2017-01 provides an overview of investor meetings both past and upcoming. Current shareholders can request their participation in planned meetings shown on the investor calendar. Requests should be made in a timely fashion. In addition to the investor meeting date, time and

names of participants, Merko's website has a section with the presentations used at the meetings. In 2016, AS Merko Ehitus organised 14 investor meetings (2015: 23) including 1 investor tour (2015: 2).

For informing the company's shareholders an annual general meeting of shareholders is called at least once a year where all shareholders can ask questions from members of the company's Management Board and Supervisory Board.

The main analysts who cover AS Merko Ehitus are:

SWEDBANK AS	AS LHV PANK
Liivalaia 8, 15040 Tallinn, Estonia	Tartu mnt 2, 10145 Tallinn, Estonia
phone +372 631 0310	phone +372 680 0457
e-mail info@swedbank.ee	e-mail research@lhv.ee
www.swedbank.ee	www.lhv.ee

Information on investor relations of AS Merko Ehitus is available from:

ANDRES TRINK	SIGNE KUKIN	AS MERKO EHITUS
Chairman of the Management Board	Group Chief Financial Officer	Delta Plaza, 7th Floor
phone +372 650 1250	phone +372 650 1250	Pärnu mnt 141, 11314 Tallinn, Estonia
fax +372 650 1251	fax +372 650 1251	phone +372 650 1250
e-mail andres.trink@merko.ee	e-mail signe.kukin@merko.ee	group.merko.ee

DECLARATION OF CONFORMITY TO RECOMMENDATIONS OF GOOD CORPORATE GOVERNANCE CODE

The Corporate Governance Code principles are recommended to the publicly traded companies and the entities 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 an entity shall explain its standpoints and activities with regard to those CGC provisions which it does not follow.

We have assessed the structure and functions of the management of AS Merko Ehitus on the basis of Good Governance Code. Above we have described significant components of corporate governance. Having assessed the compliance of the structure and functioning of the company's management system, we find that our organisation and activities are in significant part in compliance with the Good Governance Code. Also, our activities comply with the Estonian legislation that regulates several principles provided in the code in more detail. We hereby declare, that AS Merko Ehitus has followed all the recommendations of CGC, with exception of Section 2.2.7, that is provided below with the explanation why the company is not following it at the present:

CORPORATE GOVERNANCE RECOMMENDATIONS

2.2.7 Basic wages, performance pay, severance packages, other benefits payable and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on the website of the issuer and in the Corporate Governance Recommendations report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the issuer or the amount of foreseeable expense as of the day of disclosure.

EXPLANATIONS BY MANAGEMENT AND SUPERVISORY BOARDS

AS Merko Ehitus publishes in its annual report the total amount of remuneration and bonuses paid to member of the Management Board, as it believes that public disclosure of individual income items does not create value added for shareholders but does violate the privacy of members of the Management Board.

MANAGEMENT DECLARATION

The Management Board declares and confirms that according to their best knowledge, the year 2016 annual accounts, prepared in accordance with International Financial Reporting Standards as adopted by European Union, present a correct and fair view of the assets, liabilities, financial situation and profit or loss of AS Merko Ehitus and the undertakings involved in the consolidation as a whole, and the management report gives a true and fair view of the development and results of the business activities and financial status of AS Merko Ehitus and the undertakings involved in the consolidation as a whole and contains a description of the main risks and doubts.

Andres Trink

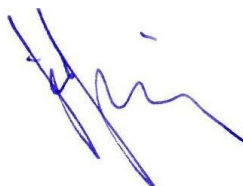
Chairman of the Management Board



28.03.2017

Tõnu Toomik

Member of the Management Board



28.03.2017

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

in thousands of euros

	Note	2016	2015
Revenue	3	251,970	251,012
Cost of goods sold	4	(232,961)	(228,044)
Gross profit		19,009	22,968
Marketing expenses	5	(3,281)	(3,230)
General and administrative expenses	6	(10,076)	(8,907)
Other operating income	7	2,466	1,943
Other operating expenses	8	(399)	(278)
Operating profit		7,719	12,496
Finance income	9	46	120
Finance costs	10	(649)	(786)
Loss from joint ventures	19	163	(138)
Profit before tax		7,279	11,692
Corporate income tax expense	11	(1,275)	(1,857)
Net profit for financial year		6,004	9,835
incl. net profit attributable to equity holders of the parent		6,122	10,000
net profit attributable to non-controlling interest		(118)	(165)
Other comprehensive income, which can subsequently be classified in the income statement			
Currency translation differences of foreign entities		19	2
Comprehensive income for the period		6,023	9,837
incl. attributable to equity holders of the parent		6,140	10,002
attributable to non-controlling interest		(117)	(165)
Earnings per share for profit attributable to equity holders of the parent (basic and diluted, in EUR)	12	0.35	0.56

The notes set out on pages 72-118 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

in thousands of euros

	Note	31.12.2016	31.12.2015
ASSETS			
Current assets			
Cash and cash equivalents	14	33,544	39,905
Trade and other receivables	15	45,566	24,854
Prepaid corporate income tax		617	421
Inventories	17	123,364	109,090
		203,091	174,270
Non-current assets			
Investments in joint ventures	19	434	284
Other long-term loans and receivables	20	15,371	16,419
Deferred income tax assets	21	1,325	1,423
Investment property	22	4,108	4,371
Property, plant and equipment	23	12,838	13,442
Intangible assets	24	673	879
		34,749	36,818
TOTAL ASSETS		237,840	211,088
LIABILITIES			
Current liabilities			
Borrowings	26	21,485	5,525
Payables and prepayments	27	56,259	43,266
Income tax liability		278	711
Short-term provisions	28	5,637	5,013
		83,659	54,515
Non-current liabilities			
Long-term borrowings	26	24,516	25,660
Deferred income tax liability	21	1,122	788
Other long-term payables	29	2,061	1,159
		27,699	27,607
TOTAL LIABILITIES		111,358	82,122
EQUITY			
Non-controlling interests	18	3,692	3,268
Equity attributable to equity holders of the parent			
Share capital	31	7,929	7,929
Statutory reserve capital		793	1,200
Currency translation differences		(645)	(663)
Retained earnings		114,713	117,232
		122,790	125,698
TOTAL EQUITY		126,482	128,966
TOTAL LIABILITIES AND EQUITY		237,840	211,088

The notes set out on pages 72-118 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

in thousands of euros

	Equity attributable to equity holders of the parent					Non-controlling interest	Total
	Share capital	Statutory reserve capital	Currency translation differences	Retained earnings	Total		
Balance as at 31.12.2014	12,000	1,200	(665)	114,492	127,027	4,455	131,482
Profit (loss) for the financial year	-	-	-	10,000	10,000	(165)	9,835
Other comprehensive income	-	-	2	-	2	-	2
Total comprehensive income (loss) for the financial year	-	-	2	10,000	10,002	(165)	9,837
Transactions with owners							
Contribution to subsidiary's share capital (Note 18)	-	-	-	-	-	1	1
Net assets transferred by division (Note 18)	-	-	-	(3)	(3)	(1,023)	(1,026)
Share capital reduction (Note 31)	(4,071)	-	-	-	(4,071)	-	(4,071)
Dividends (Note 13)	-	-	-	(7,257)	(7,257)	-	(7,257)
Total transactions with owners	(4,071)	-	-	(7,260)	(11,331)	(1,022)	(12,353)
Balance as at 31.12.2015	7,929	1,200	(663)	117,232	125,698	3,268	128,966
Balance as at 31.12.2015	7,929	1,200	(663)	117,232	125,698	3,268	128,966
Profit (loss) for the financial year	-	-	-	6,122	6,122	(118)	6,004
Other comprehensive income	-	-	18	-	18	1	19
Total comprehensive income (loss) for the financial year	-	-	18	6,122	6,140	(117)	6,023
Transactions with owners							
Contribution to subsidiary's share capital (Note 18)	-	-	-	-	-	108	108
Increase of share capital by non-monetary contribution and acquisition of non-controlling interest (Note 18)	-	-	-	(21)	(21)	472	451
Non-controlling interest of acquired subsidiary (Note 18)	-	-	-	-	-	283	283
Option over shares relating to non-controlling interests (Note 18)	-	-	-	-	-	(322)	(322)
Reserve capital reduction	-	(407)	-	407	-	-	-
Dividends (Note 13)	-	-	-	(9,027)	(9,027)	-	(9,027)
Total transactions with owners	-	(407)	-	(8,641)	(9,048)	541	(8,507)
Balance as at 31.12.2016	7,929	793	(645)	114,713	122,790	3,692	126,482

The notes set out on pages 72-118 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

in thousands of euros

	Note	2016	2015
Cash flows from (used in) operating activities			
Operating profit		7,719	12,496
Adjustments:			
Depreciation	22-24	3,488	3,004
(Profit)/loss from sale of non-current assets	7	(444)	(114)
Change in receivables and liabilities related to construction contracts recognised under the stage of completion method	32	3,711	2,229
Interest income from operating activities	7	(1,856)	(1,592)
Change in provisions	28	(520)	(1,487)
Change in trade and other receivables related to operating activities		(17,954)	9,985
Change in inventories	17	(14,128.)	10,936
Change in trade and other payables related to operating activities		8,945	(27,234)
Interest received	7, 9, 15	1,515	1,793
Interest paid	10, 27	(732)	(857)
Other finance income and costs	9, 10	(32)	(36)
Corporate income tax (paid)/reclaimed		(1,733)	(1,754)
Total cash flows from (used in) operating activities		(12,021)	7,369
Cash flows from investing activities			
Acquisition of subsidiaries	18	1,276	-
Increase of equity in joint venture	19	-	(355)
Purchase of property, plant and equipment	23, 26	(2,834)	(699)
Proceeds from sale of property, plant and equipment	7, 23	1,098	311
Purchase of intangible assets	24	(191)	(116)
Interest received	9, 15	47	97
Total cash flows from investing activities		(604)	(762)
Cash flows from (used in) financing activities			
Proceeds from borrowings	26	36,839	17,115
Repayments of borrowings	26	(20,807)	(21,846)
Finance lease principal payments	26	(855)	(2,186)
Contributions to the subsidiary's share capital from non-controlling shareholder	18	108	1
Share capital reduction	31	-	(4,071)
Non-controlling interest buyout	18	-	(41)
Dividends paid	13	(9,027)	(7,257)
Total cash flows from (used in) financing activities		6,258	(18,285)
Net increase/decrease in cash and cash equivalents		(6,367)	(11,678)
Cash and cash equivalents at the beginning of the period	14	39,905	51,583
Effect of exchange rate changes		6	-
Total at the end of the period	14	33,544	39,905

The notes set out on pages 72-118 are an integral part of these consolidated financial statements.

NOTES

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.1. GENERAL INFORMATION

The consolidated financial statements of AS Merko Ehitus (hereinafter the parent) and its subsidiaries (hereinafter collectively the group) for the financial year ended 31 December 2016 were signed by the Management Board at 28 March 2017.

Pursuant to the Commercial Code of the Republic of Estonia, the annual report prepared by the Management Board and approved by the Supervisory Board and which also includes the consolidated financial statements shall be approved at the General Meeting of Shareholders. Shareholders have the right not to approve the annual report prepared and presented by the Management Board and require preparation of a new annual report.

AS Merko Ehitus is a corporation registered in the Republic of Estonia (Commercial Register No.: 11520257, address: Järvevana tee 9G, Tallinn) and it operates mainly in Estonia, Latvia, Lithuania and Norway. Its main activities are construction and real estate development.

From 22 July 1997, the shares of AS Merko Ehitus are listed on NASDAQ Tallinn Stock Exchange. As at 31 December 2016, the majority shareholder AS Riverito owned 71.99% of the Company's shares through which the ultimate controlling person is Toomas Annus.

AS Merko Ehitus was established in 2008 in the demerger of the former AS Merko Ehitus, currently AS Järvevana, as a result of which all operating areas, i.e. all assets and liabilities other than the liabilities related to the criminal proceeding, were transferred to the new entity.

From 1 January 2012, the group's construction operations in Estonia were transferred to AS Merko Ehitus Eesti. Thereafter, AS Merko Ehitus operates as a holding entity with no independent production activities. It has 100% ownership interests in construction entities in Estonia, Latvia and Lithuania and a real estate development unit consisting of entities holding real estate properties.

1.2. BASES FOR PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

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 using the stage of completion method, assessment of the useful lives of items of property, plant and equipment, estimation of allowances for receivables and inventories, recognition of 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 statement of financial position. Current assets include assets that are expected to be realized in the course of ordinary operating cycle. 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 Merko Ehitus group entities are measured using the currency of their primary economic environment (the functional currency): the euro and the Norwegian krone. The consolidated financial statements are presented in euros. The primary financial statements and notes are presented in thousands of euros.

1.3. NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS, AMENDMENTS TO PUBLISHED STANDARDS AND INTERPRETATIONS OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE (IFRIC)

ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

The new or revised standards or interpretations, which became effective in the financial year starting 1 January 2016, do not have a material impact on the group.

NEW ACCOUNTING PRONOUNCEMENTS

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2017, and which the Group has not early adopted.

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

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition. The Group is currently assessing the impact of the amendments on its financial statements.

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

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Group is currently assessing the impact of the amendments on its financial statements.

Transfers of Investment Property - Amendments to IAS 40 (effective for annual periods beginning on or after 1 January 2018). The amendment clarified that to transfer to, or from, investment properties there must be a change in use. This change must be supported by evidence; a change in intention, in isolation, is not enough to support a transfer. The Group is currently assessing the impact of the amendments on its financial statements.

The other new or revised standards or interpretations, which are not yet effective, are not expected to have a material impact on the group.

1.4. CONSOLIDATION

Subsidiaries include all entities under the control of the group. The group controls the entity if it receives or is entitled to variable profits arising from its role in the entity and the group can influence the amount of profit by exerting influence over the entity. Subsidiaries are consolidated in the financial statements from the date of acquiring control until the date at which control ceases. The financial figures of the parent company and the subsidiaries have been consolidated on a line-by-line basis in the consolidated annual financial statements. Upon consolidation, intra-group transactions, balances and unrealised profits arising from intra-group transactions have been eliminated. Unrealised losses have also been eliminated, unless a loss is caused by impairment. Group entities use uniform accounting policies.

Investments are recognised in the parent company's unconsolidated financial statements at acquisition cost, less any accumulated impairment losses due to a drop in value of the asset.

1.5. BUSINESS COMBINATIONS

The group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the group makes an election whether to recognise any non-controlling interest in the acquiree at fair value or at the non-

controlling interest's proportionate share of the acquiree's net assets. From the date of acquisition, the revenue and expenses of the acquired entity are reported in the income statement of the group and goodwill is reported in the statement of financial position of the group.

The excess of the consideration transferred, the amount of any non-controlling interests in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the statement of comprehensive income.

Goodwill is subsequently measured at its 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 carrying amount is not recoverable (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 NON-CONTROLLING INTERESTS

The group treats transactions with non-controlling interests as transactions with equity owners of the group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying amount of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

1.6. JOINT VENTURES

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to common control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at cost and subsequently adjusted for the post-acquisition 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. Unrealised gains and losses from transactions between the group and its joint ventures are eliminated.

1.7. JOINTLY CONTROLLED OPERATIONS

Under IFRS 11 Joint Arrangements, 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 entity 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 statement of financial position. 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 that it incurs;
- the expenses that it incurs and its share of revenue that it earns from the sale of goods or services of the jointly controlled operation.

In 2016 and 2015, the group had no jointly controlled operations.

1.8. FOREIGN CURRENCY

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank prevailing at the dates of the transactions. Monetary financial assets and liabilities denominated in foreign currencies at the balance sheet date are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the balance sheet date. Exchange rate differences from translation are reported in the income statement of the reporting 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 euros for consolidation purposes; the asset and liability items are translated using the foreign exchange rates of the European Central Bank prevailing at the balance sheet date, 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 and in the consolidated comprehensive income item Currency translation differences of foreign entities.

1.9. 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;
- held-to-maturity investments;
- available-for-sale financial assets.

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

The Company does not have any held-to-maturity investments, financial assets at fair value through profit or loss and available-for-sale financial assets. The group does not have any derivatives either.

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 about the solvency of the party to the transaction. Receivables whose collection is improbable are written down during the reporting period (see also 1.11).

1.10. 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 a 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 a group of financial assets that can be reliably estimated. Objective evidence that a financial asset or a group of financial 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;
- probability that the debtor will enter bankruptcy;
- disappearance of an active market for that financial asset because of financial difficulties;
- 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 objectively be related to an event occurring after 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 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 compared with the carrying amount. An impairment loss is recognised 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 that suffered an impairment loss are reviewed at each reporting date and if necessary, the impairment loss is reversed except for impairment of goodwill.

1.11. INVENTORIES

Inventories are initially recorded in the statement of financial position at 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 distinguishable from each other, then the weighted average cost method is used.

Inventories are measured in the statement of financial position 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 either as work-in-progress or finished goods, depending on the stage of completion in the line Inventories in the statement of financial position. When the development of property is financed with a loan, the borrowing costs incurred during development are included in the cost of the property. Borrowing costs incurred during the period of construction are capitalised until a permit for use is obtained for the project. Interest expenses associated with maintenance or usage of the property are not capitalised.

A completed real estate property is sold either in units (by houses, apartments, office spaces, etc.) or as a whole. Revenue is recognised as income from the sale of goods (Note 1.20). Upon the sale of real estate properties, the group and the acquirer enter into a notarised agreement for transferring the property, and a respective entry is made in the land register.

1.12. 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, administrative purposes or sale in the ordinary course of business. Investment property is measured using the cost method, i.e. at 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.

1.13. 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.

An item of property, plant and equipment is carried in the statement of financial position at its cost less any accumulated depreciation. The cost consists of the purchase price and other costs directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. Subsequent expenditure incurred for items of property, plant and equipment is recognised as non-current assets when it is probable that future economic benefits associated with the asset will flow to the Company and the cost of the asset can be measured reliably. Other repair and maintenance costs are recognised as expenses at the time they are incurred. Items of property, plant and equipment leased under the finance lease terms are accounted for similarly to purchased property, plant and equipment.

Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years;
- machinery and equipment 2-20 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 are assessed.

If an item of property, plant and equipment consists of separately identifiable components with different useful lives, these components are accounted for as separate assets and accordingly, separate depreciation rates are set for them depending on their useful lives.

Items of property, plant and equipment are derecognised on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition of items of property, plant and equipment are included either within other operating income or other operating expenses in the income statement.

Non-current assets are written down to their recoverable amount if the latter is lower than their carrying amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

1.14. INTANGIBLE ASSETS

Intangible assets are recognised in the statement of financial position when the asset can be controlled by the Company, the expected future benefits attributable to the asset will flow to the Company and the cost of the asset can be measured reliably. The cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Intangible assets are carried in the statement of financial position at cost less any accumulated amortisation and any accumulated impairment losses. Goodwill is not amortised.

SOFTWARE AND INFORMATION SYSTEMS

The costs related to the development of information systems and software which are reported as intangible assets, are depreciated under a straight-line method over their estimated useful lives (2-10 years).

1.15. 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 statement of financial position 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 finance costs in the income statement. Finance costs are allocated to the rental period so as to achieve a constant periodic rate of interest on the remaining balance of the liability.

Operating lease payments are reported in the income statement as expenses on a straight-line basis over the lease term.

1.16. FINANCIAL LIABILITIES

All financial liabilities of the group belong to the category "other financial liabilities at amortised cost".

All financial liabilities (trade payables, borrowings, and other short and long-term borrowings) are initially recognised at their fair value and are subsequently carried at amortised cost, using the effective interest rate method. The amortised cost of current financial liabilities normally equals their nominal value; therefore current financial liabilities are stated in the statement of financial position at their redemption value. To calculate the amortised cost of non-current financial liabilities, they are initially recognised at fair value of the proceeds received (net of transaction costs incurred) and an interest cost is calculated on the liability in subsequent periods using the effective interest rate method.

Financial liabilities are classified as current when they are due to be settled within twelve months after the balance sheet date; or the group does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Borrowings that are due within 12 months after the balance sheet date, but which are refinanced after the balance sheet date as non-current, are recognised as current ones. Also, borrowings are classified as current if the lender had a contractual right at the balance sheet date to demand immediate repayment of the borrowing due to the breach of conditions set forth in the agreement.

Borrowing costs directly related to the construction of a real estate property until the property is ready for use or sale, are capitalised. In other cases, borrowing costs are recognised as an expense in the period in which they are incurred.

FACTORING

Recognition of the amounts received for resale of receivables that arose in the ordinary course of business (factoring) depends on whether in case it is not collected, the buyer of the receivable (factor) has the right to transfer it back to the buyer (factoring with recourse) or not (factoring without recourse). For factoring without recourse, the amounts collected are recognised as a reduction of the receivable. The difference between the book value of the receivable and the amount collected is recognised within period expenses. Factoring with recourse is accounted for as a financial liability assumed using receivables as collateral. Until collection of the receivable by the factor, the amounts collected from the sale of receivables are recognised as interest-bearing liabilities. The difference between the book value of the receivable and the proceeds received is recognised within period finance costs.

1.17. 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, costs of entertaining guests, dividends and payments not related to business operations. Thus, in Estonia there are no differences between the tax bases and the carrying amounts of assets which would give rise to a deferred income tax asset or liability. From 1 January 2015, the tax rate on dividends payable is 20/80 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, Lithuania and Norway as well as corporate income tax on dividends and deferred income tax cost on dividends of Estonian entities 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 amounts. Deferred tax assets are recognised in the group's statement of financial position if their future realisation is probable.

Legal entities in Latvia, Lithuania, Ukraine, Finland, Norway and Russia that are part of the group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia, the Republic of Lithuania, the Republic of Finland, the Kingdom of Norway and the Russian Federation. The profits of entities located in the Republic of Latvia are taxed at the rate of 15% (2015: 15%), in the Republic of Lithuania at the rate of 15% (2015: 15%), in the Republic of Finland at the rate of 20% (2015: 20%), in the Kingdom of Norway at the rate of 25% and in Russian Federation at the rate of 20% (2015: 20%).

1.18. 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 a detailed formal plan without a possibility of withdrawal; or providing termination benefits as a result of another offer made to encourage voluntary redundancy. Termination benefits are discounted to their present value.

PROFIT-SHARING AND BONUS PLANS

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

1.19. 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 an expense in the income statement of the reporting period.

Provisions are recognised in the statement of financial position based on the best estimate of the management board at the present value of the expenditure expected to be sufficient to settle the obligation. A pre-tax rate of discount is used, which reflects current market valuations of the time value of money and the risks associated with liabilities that are not already included in the best estimate of the related expenses.

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 must be immediately recognised as an expense. A provision is recognised for onerous construction contracts which have not yet been completed (Note 1.21).

A provision for expenses yet to be incurred and invoices not yet received is formed for sold apartment projects, which is recognised in the income statement as an expense and in the balance sheet as a liability.

1.20. REVENUE

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

Sale of construction services is recognised as revenue under the stage of completion method (see Note 1.21) in accordance with IAS 11 Construction Contracts. Proceeds from the sale of own real estate development projects (private houses, apartments, office premises, etc. that have been built on the registered immovables owned by entities of 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.

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

Sale of services is recognised based on the stage of completion of the service at the balance sheet date.

Income 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 revenue can be measured reliably.

1.21. CONSTRUCTION CONTRACTS IN PROGRESS

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 overhead costs of the construction contract.

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

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.

1.22. CASH AND CASH EQUIVALENTS

In the statement of financial position 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 and term deposits with maturities of three months or less. Management regards deposits with maturities greater than 3 months as investments and hence does not include them in cash and cash equivalents. The indirect method has been used for the preparation of the cash flow statement.

1.23. LOANS GRANTED

Loans granted are recognised in the group based on business principles and the loans are issued to companies with whom contracts are in place for the purpose of co-financing development projects. Real estate developers are granted loans on condition that the group receives an opportunity to provide construction service in the developments being financed. Due to the direct link between the loans and the group's business activity, the said loans and the related interests received are recognised in the cash flow statement under cash flows from operating activities (Note 16).

1.24. CONTINGENT LIABILITIES

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

1.25. 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.

1.26. 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 reporting period or previous periods. Material events after the balance sheet date not related to transactions in the reporting period or previous periods are not reported in the statement of financial position but they are disclosed in the notes to the financial statements.

1.27. DIVIDENDS

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

1.28. SEGMENT REPORTING

According to IFRS 8 Operating Segments, segment reporting is applicable to operating segments whose results are regularly reviewed by the entity's chief operating decision maker to make business-related decisions. Operating segments are components of the entity for which it is possible to obtain discrete financial information to make decisions about resources to be allocated to the segment and assess its performance.

NOTE 2 MANAGEMENT ESTIMATES

The preparation of the 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 events and actions, actual results may ultimately differ from those estimates. However, it can be stated that seasonality and cyclicity do not have a significant effect on the group's activities within a year. The areas involving a higher degree of judgement or complexity where assumptions and estimates have an impact on the consolidated financial statements of Merko Ehitus group, are disclosed below. The effect of changes in management's estimates are reported in the income statement of the period of the change.

REVENUE UNDER THE STAGE OF COMPLETION METHOD

Revenue from construction in progress is recognised under the stage of completion method (Note 1.21), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, forecasting and reporting of income and expenses has been introduced for determining 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. As at 31.12.2016, the amount of the provision for onerous contracts was EUR 79 thousand (2015: EUR 392 thousand), which was determined after the evaluation of the stage of completion of construction contracts (Note 28). The risk analysis showed that a change in the estimated costs of construction projects in the range of +/-5% would result in a change in the net profit between EUR -20,789/+7,386 thousand (2015: EUR -19,364/+5,251 thousand).

INVENTORY WRITE-DOWN

Inventories are valued separately by individual properties (registered immovable or building). A business plan is prepared for each property based on its nature (intended use and building rights currently effective or being effected) and the project's costs are compared with expected income. If the property's costs exceed the expected revenue to be generated from the realisation of the project (net realisable value), the group shall write down assets in the amount by which the costs exceed income. Due to the volatility of the construction market and low liquidity of the real estate market, determination of the net realisable value of the assets depends largely on management estimates. The sensitivity analysis of inventories showed that had the net realisable value been overestimated by 10% (i.e. income would be 10% lower upon the disposal of assets), the company's write-down of inventories (work-in-progress, finished goods, acquisition of real estate properties for sale) would have been EUR 274 thousand higher in 2016 (2015: EUR 1,541 thousand higher), incl. real estate properties for sale in the amount of EUR 0 thousand (2015: EUR 463 thousand), work-in-progress in the amount of EUR 190 thousand (2015: EUR 1,065 thousand) and finished goods in the amount of EUR 84 thousand (2015: EUR 13 thousand). Had the value been underestimated by 10% (income would be 10% higher upon the disposal of assets), the write-down of inventories for the year 2016 would have been EUR 37 thousand lower (2015: EUR 781 thousand), incl. real estate properties for sale in the amount of EUR 0 thousand (2015: EUR 310 thousand), and finished goods in the amount of EUR 37 thousand (2015: EUR 471 thousand).

VALUATION OF RECEIVABLES

For valuation of receivables, each receivable is analysed separately. For determining the need for a complete or partial write-down of receivables, the debtor's financial position, the guarantees provided, the solutions offered to pay off the loan and the previous payment behaviour of the debtor are considered (Note 15).

PROVISION FOR WARRANTY OBLIGATIONS

For determining the provision for warranty obligations, the historical cost of the Company's warranty works is considered (Note 28).

VALUATION OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLES

At each balance sheet date, an impairment test is performed for the intangible assets with indefinite useful lives including goodwill, and the carrying amount is written down to its recoverable amount if it is lower than the carrying amount. An impairment test is also carried out for property, plant and equipment and intangibles when an event or change in circumstances indicates that impairment may have occurred. As at 31.12.2016, the carrying amount of property, plant and equipment was EUR 12,838 thousand euros (31.12.2015: EUR 13,442 thousand) and the carrying amount of intangible assets was EUR 673 thousand (31.12.2015: EUR 879 thousand) (Note 23, 24).

The recoverable amount is the higher of the fair value of an asset less costs to sell and its value in use. Evaluation of fair value is based on reliable information regarding the proceeds from a sale to an informed, interested and independent party, less costs of disposal. The test is used both for single assets and for a cash-generating unit. Assets, intangible assets included, which have no autonomous (independent from other assets) capacity to earn revenue, are treated as cash-generating units and valuation of their recoverable amount is based on their value in use.

For the purpose of the test, in order to assess the value in use, management prepares a realistic forecast for the cash flows to be earned in subsequent periods by the business unit and calculates the present value of these cash flows. For determining the present value, the discount rate is used which according to management objectively reflects the risk level of the respective business unit and its expected rate of return. If the recoverable amount determined in such a way exceeds the carrying amount of non-current assets and goodwill of the business unit subject to testing, these assets are not written down.

VALUATION OF INVESTMENT PROPERTY

Investment properties are recognised at cost, less any accumulated depreciation and any impairment losses. Management estimates that the carrying amount of investment properties as at 31.12.2016 does not significantly differ from their fair value. Management's estimate regarding the fair value of investment properties is based on the existing market value of the assets. The estimated amount for which the asset can be exchanged in a transaction between independent parties at the date of estimation is considered to be its market value. External experts were not involved in the estimation of the fair value of investment properties. Market value estimates are mostly based on market transactions, with the exception of real estate that is estimated using discounted cash flow method. As at 31.12.2016, the carrying amount of investment property was EUR 4,108 thousand (31.12.2015: EUR 4,371 thousand) (Note 22).

NOTE 3 OPERATING SEGMENTS

in thousands of euros

The chief operating decision-maker, i.e. the Management Board of parent AS Merko Ehitus, monitors the business of the group by countries and operating segments. The performance of the business is assessed by the chief operating decision-maker based on segment revenue derived from outside the group and pre-tax profit. Pre-tax profit of segments is made up of income and expenses directly related to them. Other income and expenses not directly related to segments cannot be allocated and they are monitored together at the group level.

Based on internal management information, the group's Management Board monitors activities by the following segments:

- Estonian construction service,
- Other home markets construction service,
- Real estate development.

Estonian construction service and other home markets construction service segments include all projects of the respective countries in general construction, civil engineering and road construction. Other operating areas (management services, supervision service, etc.) are insignificant to the group and they are recognised within the construction service segment. In the 2015 financial statements, other home markets construction service segment was named Latvian and Lithuanian construction service and according to methods of recognition the segment includes construction services in Latvia and also individually insignificant (<10%) Lithuanian and Norwegian construction service segments. The real estate segment primarily consists of the group's own real estate development – construction and sale, to a lesser degree, it also includes real estate maintenance and leasing. The amount of each cost item in segment reporting is a figure presented to management for making decision about allocation of resources to segments and assessing the performance of the segment. Unallocated expenses and income after the profit of reporting segments are accounted in segment reporting using the same principles as in the financial statements and are not used for evaluation of the results of operating segments by the company's management.

In the segment reporting, all intra-segment income and expenses have been eliminated from the pre-tax profit of the segments and all unrealised internal profits have been eliminated from the segment assets.

2016	Estonian construction service	Other home markets construction service	Real estate development	Total segments
Segment revenue	122,566	52,993	108,199	283,758
Inter-segment revenue	(191)	(262)	(31,335)	(31,788)
Revenue from external clients	122,375	52,731	76,864	251,970
Gross profit (-loss)	7,629	2,175	9,205	19,009
Segment pre-tax profit (loss)	7,946	2,168	10,729	20,843
incl. interest income from operating activities (Note 7)	-	-	1,675	1,675
depreciation (Note 4)	(2,629)	(40)	(293)	(2,962)
impairment of inventories (Note 4)	-	-	(37)	(37)
recognition of provisions (Notes 4, 28)	(687)	(527)	(1,860)	(3,074)
reversal of provisions (Note 4, 28)	166	23	-	189
profit from joint ventures (Note 19)	-	-	163	163
other finance income (costs) (Notes 9, 10)	(35)	(3)	(280)	(318)
incl. interest income	-	-	1	1
interest expenses	(35)	(3)	(262)	(300)
Segment assets 31.12.2016	32,636	12,137	158,128	202,901
incl. joint ventures (Note 19)	-	-	434	434

2015	Estonian construction service	Other home markets construction service	Real estate development	Total segments
Segment revenue	117,983	72,155	95,528	285,666
Inter-segment revenue	(9,377)	(134)	(25,143)	(34,654)
Revenue from external clients	108,606	72,021	70,385	251,012
Gross profit (-loss)	10,389	4,831	7,748	22,968
Segment pre-tax profit (loss)	10,381	4,830	8,886	24,097
incl. interest income from operating activities (Note 7)	-	-	1,516	1,516
depreciation (Note 4)	(2,010)	(31)	(302)	(2,343)
impairment of inventories (Note 4)	-	-	(1,058)	(1,058)
recognition of provisions (Notes 4, 28)	(919)	(1,326)	(876)	(3,121)
loss from joint ventures (Note 19)	(19)	-	(119)	(138)
other finance income (costs) (Notes 9, 10)	(63)	-	(253)	(316)
incl. interest income	-	-	3	3
interest expenses	(63)	-	(252)	(315)
Segment assets 31.12.2016	31,971	8,834	133,202	174,007
incl. joint ventures (Note 19)	-	-	284	284

In addition to the segment assets, as at 31.12.2016 the group holds assets in the amount of EUR 34,939 thousand (31.12.2015: EUR 37,081 thousand) that cannot be associated with a specific segment or the allocation of which to segments would be impracticable. The unallocated assets of the group comprise cash and cash equivalents, deposits, loans receivable excluding loans to joint ventures, tax prepayments, other receivables and an unallocated portion of property, plant and equipment.

RECONCILIATION OF THE PRE-TAX PROFIT OF SEGMENTS AND THE GROUP

	2016	2015
Pre-tax profit from reporting segments	20,843	24,097
Unallocated income (expense)		
marketing expenses (Note 5)	(3,281)	(3,230)
general and administrative expenses (Note 6)	(10,076)	(8,907)
incl. recognition of provisions (Notes 6, 28)	(76)	(115)
cancellation of provisions (Notes 6, 28)	-	172
other operating income (expense)	78	82
incl. interest income from operating activities (Note 7)	180	76
finance income (costs) (Notes 9, 10)	(285)	(350)
incl. interest income	44	118
interest expense	(310)	(441)
Total profit before tax	7,279	11,692

Unallocated finance costs and income include income from bank deposits, foreign exchange gains (losses), uncapitalised loan interest expenses and other finance income and costs.

REVENUE BY CLIENT LOCATION

in thousands of euros and percentage

	2016		2015	
Estonia	172,656	68%	154,809	62%
Latvia	44,924	18%	65,226	26%
Lithuania	24,801	10%	28,134	11%
Finland	5,110	2%	2,843	1%
Norway	4,479	2%	-	-
Total	251,970	100%	251,012	100%

NON-CURRENT ASSETS (EXCEPT FOR FINANCIAL ASSETS AND DEFERRED INCOME TAX ASSETS) BY LOCATION OF ASSETS
 in thousands of euros

	31.12.2016	31.12.2015
Estonia	17 054	18 200
Latvia	443	473
Lithuania	10	19
Norway	112	-
Total	17 619	18 692

NOTE 4 COST OF GOODS SOLD

in thousands of euros

	2016	2015
Construction services and properties purchased for resale	145,079	142,961
Materials	40,911	35,382
Staff costs	20,703	22,514
Construction mechanisms and transport	8,161	9,079
Design	2,987	2,158
Real estate management costs	221	227
Depreciation (Note 3)	2,962	2,343
Impairment of inventories (Notes 3, 17)	37	1,058
Provisions (Notes 3, 28)	2,885	3,121
Other expenses	9,015	9,201
Total cost of goods sold	232,961	228,044

NOTE 5 MARKETING EXPENSES

in thousands of euros

	2016	2015
Staff costs	2,375	2,336
Advertising, sponsorship	335	456
Transport	196	183
Depreciation	67	90
Other expenses	308	165
Total marketing expenses	3,281	3,230

NOTE 6 GENERAL AND ADMINISTRATIVE EXPENSES

in thousands of euros

	2016	2015
Staff costs	6,510	5,754
Office expenses, communication services	592	498
Consulting, legal, auditing	623	581
Transport	322	227
Computer equipment and software	466	456
Depreciation	459	559
Provisions (Notes 3, 28)	76	(57)
Other expenses	1,028	889
Total general and administrative expenses	10,076	8,907

NOTE 7 OTHER OPERATING INCOME

in thousands of euros

	2016	2015
Interest income from operating activities	1,856	1,592
Profit from sale of non-current assets	444	114
Fines and penalties for delay received	22	13
Collection of doubtful receivables	3	2
Other income	141	222
Total other operating income	2,466	1,943

NOTE 8 OTHER OPERATING EXPENSES

in thousands of euros

	2016	2015
Fines, penalties	6	9
Gifts, donations	246	207
Doubtful receivables expense (Notes 15, 35)	117	31
Other expenses	30	31
Total other operating expenses	399	278

NOTE 9 FINANCE INCOME

in thousands of euros

	2016	2015
Interest income	46	120
Total finance income	46	120

NOTE 10 FINANCE COSTS

in thousands of euros

	2016	2015
Interest expense	610	756
Foreign exchange losses	6	3
Other finance costs	33	27
Total finance costs	649	786

NOTE 11 CORPORATE INCOME TAX

in thousands of euros

The income tax on the group's profit before tax differs from the theoretical amount that would arise using the statutory tax rates applicable to profits of the consolidated entities for the following reasons:

2016	Latvia	Lithuania	Other foreign countries	Estonia	Total
Profit (loss) before tax	1,033	1,372	93	4,781	7,279
Tax rate applicable to profits	15%	15%	25%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(155)	(206)	(24)	-	(385)
Tax calculated on expenses not deductible for tax purposes	(49)	(129)	-	-	(178)
Tax effect of income not subject to tax	-	(168)	-	-	(168)
Tax losses of previous periods recognised in the reporting period	-	108	-	-	108
Tax losses not recognised in the reporting period	(81)	-	(5)	-	(86)
Income tax withheld on dividends	-	-	-	(566)	(566)
Total income tax expense	(285)	(395)	(29)	(566)	(1,275)
incl. income tax expense	(236)	(11)	(29)	(566)	(842)
deferred income tax expense (Note 21)	(49)	(384)	-	-	(433)
2015	Latvia	Lithuania	Other foreign countries	Estonia	Total
Profit (loss) before tax	3,069	3,592	(11)	5,042	11,692
Tax rate applicable to profits	15%	15%	20%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(460)	(539)	2	-	(999)
Tax calculated on expenses not deductible for tax purposes	(56)	(370)	-	-	(426)
Tax effect of income not subject to tax	-	531	-	-	531
Tax losses of previous periods recognised in the reporting period	-	(41)	-	-	(41)
Income tax withheld on share capital reduction	-	-	-	(18)	(18)
Income tax withheld on dividends	-	-	-	(906)	(906)
Total income tax expense	(516)	(419)	2	(924)	(1,857)
incl. income tax expense	(572)	(199)	-	(924)	(1,695)
deferred income tax expense (Note 21)	56	(220)	2	-	(162)

As at 31 December 2016, the company has no previously taxed dividends and income received from abroad on which income tax has been withheld (31.12.2015: EUR 0 thousand).

As at 31.12.2016, it is possible to pay out dividends to shareholders from retained earnings in the amount of EUR 91,255 thousand (31.12.2015: EUR 93,255 thousand). Considering the taxed dividends received and income tax withheld on foreign income totalling EUR 0 thousand (31.12.2015: EUR 0 thousand), the corresponding income tax on dividends would amount to EUR 22,813 thousand (31.12.2015: EUR 23,314 thousand). For calculating the additional income tax on dividends, the income tax rate in force in 2016 was used, which is 20/80 of the amount paid as net dividends. The income tax related to disbursement of dividends is recognised as a liability and income tax expense upon the announcement of dividends.

NOTE 12 EARNINGS PER SHARE

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

	2016	2015
Net profit(-loss) attributable to shareholders (<i>in thousand EUR</i>)	6,122	10,000
Weighted average number of ordinary shares (<i>thousand pcs</i>)	17,700	17,700
Earnings (loss) per share (<i>in euros</i>)	0.35	0.56

In 2016 and 2015, 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. In accordance with the profit allocation proposal, dividends payable in parent company AS Merko Ehitus in 2017 will total EUR 7,257 thousand, incl. EUR 0.41 per share, and the accompanying maximum income tax liability would amount to 20/80 on the amount paid out, i.e. EUR 1,814.3 thousand, which shall be covered by the income tax withheld on taxed dividends to be received from subsidiaries and by the income tax withheld on foreign income. The additional income tax expenses in connection with disbursement of dividends will be approximately EUR 0.9 million.

In 2016, the parent company AS Merko Ehitus paid EUR 9,027 thousand in dividends, i.e. EUR 0.51 per share, incurring an income tax obligation of 20/80 of the amount disbursed, i.e. EUR 2,256.7 thousand, which was covered in part from income tax withheld on taxed dividends received from subsidiaries in previous periods. In Q2 2016, the group incurred an additional income tax expense of EUR 566 thousand related to disbursement of dividends.

In 2015 the parent company AS Merko Ehitus distributed dividends in the amount of EUR 7,257 thousand, i.e. EUR 0.41 per share. AS Merko Ehitus had to pay an additional income tax expense of EUR 906 thousand in Estonia related to disbursement of dividends.

NOTE 14 CASH AND CASH EQUIVALENTS

in thousands of euros

	31.12.2016	31.12.2015
Cash on hand	2	4
Bank accounts	33,291	32,667
Overnight deposits	251	7,234
Total cash and cash equivalents (Note 35)	33,544	39,905

As at 31.12.2016, the weighted average interest on overnight deposits was 0,5% (31.12.2015: 1%).

NOTE 15 TRADE AND OTHER RECEIVABLES

in thousands of euros

	31.12.2016	31.12.2015
Trade receivables (Note 35)		
Accounts receivable	31,735	15,431
Allowance for doubtful receivables	(265)	(326)
	31,470	15,105
Tax prepayments excluding corporate income tax		
Value added tax	3,318	887
Other taxes	-	35
	3,318	922
Accrued income form construction services (Notes 32, 35)	4,606	3,948
Other short-term receivables		
Short-term loans (Notes 16, 35)	1,560	1,432
Interest receivables (Note 35)	218	200
Other short-term receivables (Note 35)	347	617
	2,125	2,249
Prepayments for services		
Prepayments for construction services	3,155	2,036
Prepaid insurance	348	275
Other prepaid expenses	544	319
	4,047	2,630
Total trade and other receivables	45,566	24,854
incl. short-term loan receivables from related parties (Note 16)	-	1,432
other short-term receivables and prepayments to related parties (Note 33)	4,333	541

In 2016, the payment discipline of customers deteriorated slightly compared to last year. The share of overdue receivables increased from 14.0% to 14.6% of total receivables, and as at the balance sheet date, the amount of overdue receivables was EUR 4,590 thousand (31.12.2015: 2,126 thousand). By 12 March 2017, overdue receivables had been collected in the amount of EUR 2,441 thousand. In 2016, the average collection period of trade receivables was 37 days (2015: 39 days).

	2016	2015
Doubtful receivables at the beginning of the period	(326)	(728)
Reporting period doubtful receivables expenses (Note 8)	(108)	(31)
Reestablishment of receivables written off in previous years	(3)	-
Receivables written off during the year as uncollectible	169	431
Received doubtful receivables	3	2
Doubtful receivables at the end of the period	(265)	(326)

Additionally, in 2016, advance payments to suppliers were wrote down in the amount of EUR 9 thousand (2015: EUR 0 thousand), (Note 8). According to the management estimates, based on historical experience, there are sufficient reasons to conclude that the trade receivables reported in the financial statements will be collected from the buyers.

Accounts receivable in the amount of EUR 1,411 thousand have been secured by a collateral on the registered immovable located at Bokšto 14, Vilnius in the amount of EUR 1,500 thousand.

A more detailed overview of the Company's credit risk is provided in Note 35.

NOTE 16 LOANS GRANTED

in thousands of euros

	Joint ventures (Note 33)	Unrelated legal entities	Unrelated individuals	Total
2016				
Loan balance at beginning of the year	3,888	1,500	-	5,388
Granted	536	10	-	546
Reclassification of interest receivable into loan	88	50	-	138
Collected	(560)	-	-	(560)
Loan balance at end of the year	3,952	1,560	-	5,512
incl. current portion (Notes 15, 35)	-	1,560	-	1,560
non-current portion 1...5 years (Notes 20, 35)	3,952	-	-	3,952
Average effective interest rate	6.7%	8.0%	-	
2015				
Loan balance at beginning of the year	1,775	753	10	2,538
Granted	2,113	1,500	-	3,613
Collected	-	(753)	(10)	(763)
Loan balance at end of the year	3,888	1,500	-	5,388
incl. current portion (Notes 15, 35)	1,432	-	-	1,432
non-current portion 1...5 years (Notes 20, 35)	2,456	1,500	-	3,956
Average effective interest rate	6.7%	8.0%	5.0%	

All issued loans reported as at the balance sheet date had not yet fallen due.

The loan granted to an unrelated legal person both in 2016 and 2015 is secured by a mortgage on the registered immovable property at Tatari st. 6a, Tallinn, amounting to EUR 1,650 thousand.

NOTE 17 INVENTORIES

in thousands of euros

	31.12.2016	31.12.2015
Materials	422	600
Work-in-progress	39,537	28,397
Finished goods	18,918	19,603
Goods for resale		
Registered immovables purchased for resale	63,150	58,029
Other goods purchased for resale	746	790
	63,896	58,819
Prepayments for inventories		
Prepayments for real estate properties	-	1,086
Prepayments for other inventories	591	585
	591	1,671
Total inventories	123,364	109,090

The inventories pledged as collateral as at 31.12.2016 for loans total EUR 44,870 thousand (2015: EUR 42,577 thousand), (Note 30).

In 2016, inventories have been written down to their net realisable value by EUR 37 thousand (2015: EUR 1,058 thousand) and previously made write-downs haven't been reversed (2015: EUR 0 thousand) (Notes 2, 4, 35).

	Carrying amount before write-down	Write-down	Reversal of write- down	Carrying amount after write-down
31.12.2016				
Finished goods	18,955	(37)	-	18,918
Total	18,955	(37)	-	18,918
31.12.2015				
Finished goods	20,173	(570)	-	19,603
Land purchased for resale	58,517	(488)	-	58,029
Total	78,690	(1,058)	-	77,632

NOTE 18 SHARES IN SUBSIDIARIES

	Ownership and voting rights %		Location	Area of operation
	31.12.2016	31.12.2015		
AS Merko Ehitus Eesti	100	100	Estonia, Tallinn	Construction
Tallinna Teede AS	100	100	Estonia, Tallinn	Road construction
AS Vooremaa Teed	100	100	Estonia, Jõgeva	Road construction
AS Merko Infra	100	100	Estonia, Tallinn	Construction
AS Gustaf	100	100	Estonia, Pärnu	Construction
AS Merko Tartu	100	100	Estonia, Tartu	Construction
OÜ Fort Ehitus	76	75	Estonia, Viimsi	Construction
OÜ Mineraal	100	100	Estonia, Tallinn	Mining
OÜ Heamaja	100	100	Estonia, Tallinn	Real estate
OÜ Rannamõisa Kinnisvara	100	100	Estonia, Tallinn	Real estate
UAB Merko Statyba	100	100	Lithuania, Vilnius	Construction
UAB Statinių priežiūra ir administravimas	100	100	Lithuania, Vilnius	Real estate
OÜ Merko Property	100	100	Estonia, Tallinn	Real estate
UAB Balsiu mokyklos SPV	100	100	Lithuania, Vilnius	Real estate
UAB Merko Bustas	100	100	Lithuania, Vilnius	Real estate
UAB MN Projektas	100	100	Lithuania, Vilnius	Real estate
UAB Jurininku aikštele	100	100	Lithuania, Vilnius	Real estate
UAB VPSP1	100	100	Lithuania, Vilnius	Real estate
UAB Timana	100	100	Lithuania, Vilnius	Real estate
UAB Rinktinės projektai	100	-	Lithuania, Vilnius	Real estate
OÜ Jõgeva Haldus	100	100	Estonia, Tallinn	Real estate
OÜ Metsailu	100	100	Estonia, Tallinn	Real estate
OÜ Tähelinna Kinnisvara	100	100	Estonia, Tallinn	Real estate
Väike-Paekalda OÜ	100	100	Estonia, Tallinn	Real estate
Suur-Paekalda OÜ	100	100	Estonia, Tallinn	Real estate
SIA Merko Investments	100	100	Latvia, Riga	Holding
OÜ Merko Investments	100	100	Estonia, Tallinn	Holding
SIA Merks	100	100	Latvia, Riga	Construction
SIA SK Viesturdarzs	100	100	Latvia, Riga	Real estate
SIA Merks Investicijas	100	100	Latvia, Riga	Real estate
SIA Industrialas Parks	100	100	Latvia, Riga	Real estate
SIA Elniko	100	100	Latvia, Riga	Real estate
SIA Ropažu Priedes	100	100	Latvia, Riga	Real estate
PS Merko-Merks	100	100	Latvia, Riga	Construction
SIA Zakusala Estates	75	75	Latvia, Riga	Real estate
PS Merks-Ostas celtnieks	65	-	Latvia, Riga	Construction

	Ownership and voting rights %		Location	Area of operation
	31.12.2016	31.12.2015		
Merko Finland Oy	100	100	Finland, Helsinki	Construction
Hartian Oy	75	75	Finland, Helsinki	Real estate
As.Oy Helsingin Pestikuja 1	-	100	Finland, Helsinki	Real estate
Lenko Stroi LLC	100	100	Russia, Peterburi	Construction
Merko Investments AS	100	-	Norway, Sofiemyr	Holding
Peritus Entreprenør AS	56	-	Norway, Sofiemyr	Construction

2016

The 100% subsidiary in the Kingdom of Norway, Merko Investments AS (registry code 916 750 323) was founded in February 2016 and, on 17 February, entered into the register. Merko Investments AS, registered in Norway, is a 100% subsidiary of AS Merko Ehitus. The first contribution of NOK 30 thousand was made to the new subsidiary's share capital on 3 February; the second contribution, of NOK 4,700 thousand, was made on 3 March (totalling approximately EUR 502 thousand). This is a technical step aimed at creating the legal platform for launching operations in Norway.

On 7 March 2016, Merko Investments AS, part of AS Merko Ehitus Group, signed contracts with Norwegian companies SDV Holding AS and Aucon AS to acquire 56% ownership interest in Norwegian construction company Peritus Entreprenør AS. The total purchase price was NOK 4,000 thousand (EUR 425 thousand). The purchase price was paid in cash. Non-controlling interest in the amount NOK 2,572 thousand (EUR 273 thousand; as at 31.12.2016 EUR 283 thousand) resulted from the business combination, which due to contractual conditions is recognised in the group as an option over shares of non-controlling interests as a liability under other debts to related parties. The liabilities related to the non-controlling interest buyout option also include the profit attributable to the non-controlling interest in the amount of EUR 39 thousand. The due date for the option is 7 March 2021. Peritus Entreprenør AS (www.peritus-entreprenor.no) is a Norwegian construction company, offering general construction services, with the sales turnover of approximately 7 million euros in 2015. The former owners will continue to participate in the daily management of the company and they will keep their 44% ownership interest. The aim of the acquisition is to start offering construction services in the Norwegian market.

On 7 March 2016, Merko Ehitus group subsidiary UAB Merko Bustas entered into an agreement with the company Venturecorp Property Holdings Ltd for acquiring a 100% ownership in the Lithuanian real estate developer UAB Rinktinės projektai with a total purchase price of EUR 2 thousand.

On 30 March 2016, AS Merko Ehitus's 100% subsidiary AS Merko Ehitus Eesti made a non-monetary contribution into subsidiary OÜ Fort Ehitus. The object of the non-monetary contribution was the ceding of claims arising from a loan agreement to OÜ Fort Ehitus totalling EUR 1,880 thousand. Among other things, AS Merko Ehitus ceded claims worth EUR 1,429 thousand and the non-controlling interest in the amount of EUR 451 thousand. After executing the transaction, AS Merko Ehitus Eesti's ownership interest in the subsidiary OÜ Fort Ehitus increased by 1% percentage to 76%.

On 8 November 2016, AS Merko Ehitus launched a process for restructuring its 100% subsidiary in Lithuania, UAB Merko Bustas. In accordance with the restructuring plan, UAB Merko Bustas's 100% subsidiary UAB VPSP1 will be merged with parent company UAB Merko Bustas. The restructuring will be completed and the final merger entry in the Commercial Register will be done during the first quarter of 2017.

On 5 December 2016, AS Merko Ehitus' 100% subsidiary SIA Merks and SIA Ostas celtnieks established a general partnership PS Merks-Ostas-celtnieks for the performance of the consortium agreement entered into for the construction of the Ventspils Music School and concert hall. SIA Merks holds a 65% ownership interest and SIA Ostas celtnieks a 35% ownership interest in the consortium.

On 28 December 2016, AS Merko Ehitus's 100% subsidiary AS Merko Ehitus Eesti initiated a process to merge its fully owned subsidiaries AS Merko Tartu, AS Gustaf, OÜ Rannamõisa Kinnisvara and OÜ Heamaja, all engaged in real estate development, in order to have savings in administrative cost in managing the company. The final merger entry will be made to the Commercial Register in the first half of 2017.

ACQUISITION OF SUBSIDIARIES

in thousands of euros

	Peritus Entreprenør AS Fair value	UAB Rinktinės projektai Fair value
Cash	1,682	2
Short-term receivables	642	-
Inventories	5	-
Property, plant and equipment	47	-
Short-term liabilities	1,730	-
Long-term liabilities	25	-
Net assets	621	2

	Peritus Entreprenør AS	UAB Rinktinės projektai
	Fair value	Fair value
Non-controlling interest	(273)	-
Acquired ownership interest	56%	100%
Net assets acquired	348	2
Acquisition cost	425	2
Goodwill	77	-
Subsidiary's cash and cash equivalent on acquisition	1,368	2
Paid on acquisition	(126)	-
Cash flow from acquisition of subsidiary	1,242	2
Revenue	4,479	-
Net profit for the period	86	-
Comprehensive income for the period	88	-
incl. net profit attributable to equity holders of the parent	49	-
net profit attributable to non-controlling interest	39	-

The fair values of the Peritus Entreprenør AS receivables are in conformity with the book values of the claims.

FINANCIAL INFORMATION REGARDING SIGNIFICANT SUBSIDIARY WITH A NON-CONTROLLING INTEREST

in thousands of euros

	SIA Zakusala Estates	
	31.12.2016	31.12.2015
Statement of financial position		
Cash	441	102
Trade and other receivables	9	2
Inventories	14,988	14,883
Total short-term assets	15,438	14,987
Short-term liabilities	92	0
Net assets	15,346	14,987
Equity	15,346	14,987
Non-controlling interest %	25%	25%
Non-controlling interest	3,836	3,747
Statement of comprehensive income	01.01-31.12.2016	01.01-31.12.2015
Other expenses	(2)	(6)
Land tax	(68)	(45)
Financial expenses	(1)	-
Net loss for the period	(71)	(51)
Comprehensive loss for the period	(71)	(51)
incl. attributable to equity holders of the parent	(53)	(39)
attributable to non-controlling interest	(18)	(12)
Cash flow statement	01.01-31.12.2016	01.01-31.12.2015
Operating profit	(70)	(51)
Change in receivables related to operating activities	(7)	(2)
Change in inventories	(104)	(10)
Change in payables related to operating activities	20	-
Total cash flow from operating activities	(161)	(63)
Proceeds from borrowings	70	-
Issue of share capital	430	-
Total cash flow from financing activities	500	-
Change in cash and cash equivalents	339	(63)
Cash and cash equivalents in the beginning of the period	102	165

SIA Zakusala Estates

Cash and cash equivalents at the end of the period	441	102
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In 2016, a contribution was made to the share capital of SIA Zakusala Estates, as a result of which the non-controlling interest in the company increased by EUR 108 thousand.

As at 31 December 2016, the group's non-controlling interest in equity is EUR 3,692 thousand (31.12.2015: EUR 3,268 thousand), including ZIA Zakusala Estates non-controlling interest in the amount of EUR 3,836 thousand (31.12.2015: EUR 3,747 thousand). The other companies with a non-controlling interest – totalling at EUR (144) thousand (31.12.2015: EUR (479) thousand) – do not separately constitute a significant item for the group.

2015

On 22 December 2014 AS Merko Ehitus initiated a process to merge real estate development companies in which it has a 100% holding – OÜ Metsailu, OÜ Ringtee Tehnopark, OÜ Maryplus and OÜ Constanca – specifically for the purpose of reducing the administrative costs of managing the companies. The final merger entry in the Commercial Register was made on 3 July 2015.

On 6 February 2015, OY Merko Finland, fully owned subsidiary of AS Merko Ehitus, made a monetary contribution in the amount of EUR 2,250 to the share capital of a 75% subsidiary Hartian Oy. The share capital of the subsidiary is EUR 3,000. The company was established with the aim of acquiring a residential quarter, construction rights for 10 private houses, in Pestikuja 1, Helsinki.

On 4 March 2015, AS Merko Ehitus Eesti, fully owned subsidiary of AS Merko Ehitus, initiated a merger of its 66% subsidiary AS Merko Tartu, engaged in construction, and Raadi Kortermaja OÜ, fully owned subsidiary of AS Merko Tartu engaged in real estate development, in order to have savings in administrative cost related to company management. The final merger entry in the Commercial Register was made on 15 April 2015.

On 20 March 2015, Hartian Oy, a 75%-owned subsidiary of Oy Merko Finland, fully owned subsidiary of AS Merko Ehitus, made a monetary contribution in amount of EUR 2,500 into the share capital of a newly formed 100%-owned subsidiary Asunto Oy Helsingin Pestikuja 1, which will develop and maintain the residential quarter in Pestikuja 1.

On 25 March 2015, a 100% subsidiary of AS Merko Ehitus group, AS Merko Ehitus Eesti acquired a 100% holding in OÜ Rannamõisa Kinnisvara from a related party E.L.L. Kinnisvara AS, with a share capital of EUR 2,556 and for a purchase price of EUR 3,261 thousand. The purchase price is to be paid to the seller after the transfer of immovable properties belonging to OÜ Rannamõisa Kinnisvara to third parties but no later than 30 June 2016. In addition, the Parties have entered into an agreement on an option to resell the 100% holding, with an expiration date of 29 June 2016, which will not materialise due to sale of the OÜ Rannamõisa Kinnisvara registered immovable properties after the balance sheet date. Acquisition of the subsidiary is recognised in the group as an acquisition of land and is recorded under inventories from the time of acquisition as registered immovables purchased for resale (Note 17).

On 19 May 2015, the shareholders of the AS Merko Ehitus Eesti, part of AS Merko Ehitus group, subsidiary AS Merko Tartu, decided to approve a notarized division plan signed on 14 May 2015, under which the division of AS Merko Tartu will be accomplished by way of demerge. According to the division plan approved by the shareholders the transfer of EUR 1,026 thousand in net assets of AS Merko Tartu to the acquiring company OÜ Ignatsi (foundation in progress) and decrease of the minority interest of EUR 1,023 thousand were recognised in the II quarter of 2015. As a result of the division of AS Merko Tartu, the transaction will have an estimated EUR 3 thousand loss influence on the consolidated results of AS Merko Ehitus group, a decreasing influence on assets of EUR 987 thousand and an increasing influence on liabilities of EUR 39 thousand. Prior to the division, AS Merko Tartu is owned by AS Merko Ehitus Eesti and by owner of the non-controlling interest Margus Kull respectively 66% and 34%. As a result of the division, the 4,000 no-par-value shares of AS Merko Tartu held by the owner of the non-controlling interest Margus Kull will be cancelled and the share capital of AS Merko Tartu will accordingly be reduced by EUR 27 thousand under simplified procedure to EUR 53 thousand. After the reduction of the share capital of AS Merko Tartu, the share capital of AS Merko Tartu will be EUR 53 thousand and the sole shareholder of AS Merko Tartu will be AS Merko Ehitus Eesti. The final division entry in the Commercial Register was made on 23 July 2015. Post completion a monetary payment in the amount of EUR 41 thousand was processed according to the division plan.

On 4 March 2015, AS Merko Ehitus launched a process for restructuring its 100% subsidiary in Lithuania, UAB Merko Bustas, a process that was partially carried out in Q2 2015. In accordance with the restructuring plan, AS Merko Ehitus founded on 14 May 2015 a 100% subsidiary in Lithuania called UAB Kražiu valdymas with share capital of EUR 2,896, which under an instrument of delivery and receipt of assets signed on 18 May 2015 took control of the assets transferred from UAB Merko Bustas by division, including a 100% holding in UAB Kražiu Projektas. The restructuring was completed on 1 September 2015, when UAB Kražiu valdymas and UAB Kražiu Projektas were merged with AS Merko Ehitus's 100% subsidiary UAB Merko Statyba and the final merger entry in the Commercial Register was done.

On 31 July 2015, AS Merko Ehitus Eesti, fully owned subsidiary of AS Merko Ehitus, initiated a merger of its 100% subsidiary Tallinna Teede AS, engaged in road construction and maintenance, and Tevener OÜ, fully owned subsidiary of Tallinna Teede AS engaged in mining, in order to have savings in administrative cost related to company management. The final merger entry in the Commercial Register was made on 14 September 2015.

ACQUISITION OF SUBSIDIARY

in thousands of euros

	OÜ Rannamõisa Kinnisvara	
	Book value	Fair value
Cash	0	0
Inventories	848	3,261
Short-term liabilities	843	843
Net assets	5	2,418
Acquired ownership interest	100%	
Value of acquired net assets	5	2,418
Acquisition cost		2,418
Subsidiary's cash and cash equivalent on acquisition		0
Paid on acquisition		-
Cash flow from acquisition of subsidiary		-
Net loss from the beginning of the year	(129)	
Net loss after the acquisition	(116)	

NOTE 19 INVESTMENTS IN JOINT VENTURES

	Ownership and voting rights		Location	Area of operation
	%			
	31.12.2016	31.12.2015		
Joint ventures				
OÜ Unigate	50	50	Estonia, Tallinn	Real estate
Poolkoksimäe Sulgemise OÜ	50	50	Estonia, Tallinn	Construction
Kivimäe 32 OÜ	50	50	Estonia, Tallinn	Real estate
Kodusadam OÜ	50	50	Estonia, Tallinn	Real estate

2016

No transactions were concluded with the shares of joint ventures in 2016.

2015

On 11 December 2015, the shareholders of OÜ Unigate, a 50%-owned joint venture of AS Merko Ehitus, resolved to increase the nominal value of the share of the joint venture by EUR 2 to EUR 6 thousand with the aim of bringing the company's share capital into line with the requirements arising from the Commercial Code. A monetary contribution of EUR 355 thousand was made by both shareholders, with the nominal value of the share capital amounting to EUR 1 and the remaining portion as share premium.

On 22 December 2015, AS Merko Tartu, a 100% subsidiary of AS Merko Ehitus Eesti, part of AS Merko Ehitus group, signed an agreement for the transfer of its entire 50% holding in the joint venture Kortermaja OÜ for the sales price of EUR 0,4 thousand and earning a loss of EUR 2 thousand. The holding was transferred with the purpose of re-arranging the structure of the group companies and reducing holdings in non-significant companies.

in thousands of euros

	Investment at 31.12.2015	Changes in 2016		Investment at 31.12.2016
		acquisition (sale)	profit (loss) on entities	
Joint ventures				
OÜ Unigate	279	-	(119)	160
Poolkoksimäe Sulgemise OÜ	0	-	(0)	0
Kivimäe 32 OÜ	0	-	269	269
Kodusadam OÜ	5	-	(0)	5
Total joint ventures	284	-	150	434

in thousands of euros

	Investment at 31.12.2014	Changes in 2015		Investment at 31.12.2015
		acquisition (sale)	profit (loss) on entities	
Joint ventures				
OÜ Unigate	40	355	(116)	279
Poolkoksimäe Sulgemise OÜ	19	-	(19)	0
OÜ Kortermaja	2	0	(2)	-
Kivimäe 32 OÜ	1	-	(1)	0
Kodusadam OÜ	5	-	0	5
Total joint ventures	67	355	(138)	284

Changes in 2016 profit presented in the income statement from joint ventures in the amount of EUR 150 thousand differs from profit recognised in the joint venture in the amount of EUR 13 thousand. The difference stems from the restatement of intragroup retained earnings.

ÜHISETTEVÕTTED

in thousands of euros

	Assets 31.12.		Liabilities 31.12		Equity 31.12.	Income	Expenses	Net profit/ (loss)
	Current assets	Non- current assets	Current liabilities	Non- current liabilities				
2016								
OÜ Unigate	3,747	-	-	3,427	320	-	(237)	(237)
Poolkoksimäe Sulgemise OÜ	0	-	-	-	0	41	(36)	5
Kivimäe 32 OÜ	614	-	80	-	534	3,853	(3,260)	593
Kodusadam OÜ	9,756	-	4,747	5,000	9	-	(1)	(1)
Total	14,117	-	4,827	8,427	863	3,894	(3,534)	360
2015								
OÜ Unigate	3,708	-	3,151	-	557	-	(233)	(233)
Poolkoksimäe Sulgemise OÜ	10	-	15	-	(5)	-	(42)	(42)
Kivimäe 32 OÜ	916	-	195	781	(60)	-	(45)	(45)
Kodusadam OÜ	4,359	-	4,525		(166)	-	(176)	(176)
Total	8,993	-	7,886	781	326	-	(496)	(496)

Interest expenses for the following companies are recognised in the joint venture's expenses: OÜ Unigate EUR 215 thousand (2015: EUR 231 thousand), Kivimäe 32 OÜ EUR 58 thousand (2015: EUR 44 thousand) and Kodusadam OÜ EUR 0 thousand (2015: EUR 176 thousand).

In connection with the joint venture, the group has contractual obligations to finance, as needed, the joint ventures' activities with loans totalling EUR 3,972 thousand (31.12.2015: EUR 4,292 thousand), of which the group has paid EUR 3,952 thousand in total (31.12.2015: EUR 3,888 thousand).

TRANSACTIONS INVOLVING JOINT VENTURES AFTER THE BALANCE SHEET DATE

On 17 March 2017, AS Merko Ehitus and AS Ehitusfirma Rand ja Tuulberg launched a process for liquidating their joint venture Poolkoksimäe Sulgemise OÜ, owned 50% by both. The liquidation will be completed and the final deletion entry in the Commercial Register will be made sometime in the summer of 2017.

NOTE 20 OTHER LONG-TERM LOANS AND RECEIVABLES

in thousands of euros

	31.12.2016	31.12.2015
Long-term loans (Notes 16, 35)	3,952	3,956
Long-term bank deposit (Note 35) *	36	37
Long-term interest	261	7
Long-term trade receivables (Note 35) **	11,122	12,419
Total other long-term loans and receivables	15,371	16,419
incl. long-term loan receivables from related parties (Note 16, 33)	3,952	2,456
other long-term receivables and prepayments from related parties (Note 16, 33)	261	7

* incl. a deposit in the amount of EUR 36 thousand with the due date of 27 June 2018 and interest rate of 5.35%.

** incl. long-term receivables from buyer of Balsiu School in amount of EUR 10,580 thousand (31.12.2015: EUR 11,199 thousand), incl. overdue short-term accounts receivable that have been reclassified by the management as long-term, amounting to EUR 0 thousand (31.12.2015: EUR 527 thousand), for which no provisions have been made as the counterparty is a local government and the management considers minimal the risk that these receivables will not be collected.

As at 31.12.2015 long-term accounts receivable of EUR 1,145 thousand was secured by a mortgage of EUR 6,500 thousand on the registered immovable property at Peterburi tee 2, Tallinn.

NOTE 21 DEFERRED INCOME TAX ASSETS AND LIABILITIES

in thousands of euros

Break-down of deferred income tax assets and liabilities in Latvian and Lithuanian subsidiaries:

31.12.2016	Latvia	Lithuania	Norway	Other foreign countries	Total
Deferred income tax liability					
effect of other payables	-	(1,122)	-	-	(1,122)
Deferred income tax assets					
incl. tax loss carryforwards	(49)	-	-	5	(44)
effect of carrying amount of property, plant and equipment	(12)	-	-	-	(12)
effect of stage of completion method	43	47	-	-	90
effect of write-down of receivables	32	17	-	-	49
effect of write-down of inventories	800	-	-	-	800
effect of provisions	-	6	-	-	6
other effects	436	-	-	-	436
Total deferred income tax assets	1,250	70	-	5	1,325
Deferred income tax expense (-charge) of the financial year (Note 11)	(49)	(384)	-	-	(433)

31.12.2015	Latvia	Lithuania	Other foreign countries	Total
Deferred income tax liability				
effect of other payables	-	(788)	-	(788)
Deferred income tax assets				
incl. tax loss carryforwards	-	39	5	44
effect of carrying amount of property, plant and equipment	(12)	-	-	(12)
effect of stage of completion method	43	47	-	90
effect of write-down of receivables	32	17	-	49
effect of write-down of inventories	800	-	-	800
effect of provisions	-	17	-	17
other effects	435	-	-	435
Total deferred income tax assets	1,298	120	5	1,423
Deferred income tax expense (-charge) of the financial year (Note 11)	56	(220)	2	(162)

NOTE 22 INVESTMENT PROPERTY

in thousands of euros

	Land	Right of superficies	Buildings	Total
Cost at 31.12.2014	51	29	5,245	5,325
Accumulated depreciation 31.12.2014	-	(10)	(696)	(706)
Carrying amount at 31.12.2014	51	19	4,549	4,619
Depreciation	-	-	(248)	(248)
Carrying amount at 31.12.2015	51	19	4,301	4,371
Cost at 31.12.2015	51	29	5,245	5,325
Accumulated depreciation 31.12.2015	-	(10)	(944)	(954)
Carrying amount at 31.12.2015	51	19	4,301	4,371
Depreciation	-	(1)	(262)	(263)
Carrying amount at 31.12.2016	51	18	4,039	4,108
Cost at 31.12.2016	51	29	5,245	5,325
Accumulated depreciation 31.12.2016	-	(11)	(1,206)	(1,217)
Carrying amount at 31.12.2016	51	18	4,039	4,108

As at 31.12.2016, the carrying amounts of investment properties do not significantly differ from their fair values (31.12.2015: the carrying amounts of investment properties did not significantly differ from their fair values). Fair values have mainly been estimated based on comparable transactions (Level 2), with the exception of investment property to the extent of EUR 2,031 thousand (31.12.2015: EUR 2,162 thousand) in carrying amount that has been measured using the discounted cash flow method. Fair value measurement was carried out using Level 3 inputs of the fair value hierarchy.

Investment properties have been acquired for the purpose of earning rental income as well as for capital appreciation or development in the future. Buildings located on the plot of land have temporarily been leased out under the operating lease terms. Information about leased investment properties is disclosed in Note 25. Maintenance costs incurred and improvement expenses are immaterial.

Investment properties pledged as collateral as at 31.12.2016 for loans total EUR 3,688 thousand (31.12.2015: EUR 3,899 thousand) (Note 30). The Pärna avenue properties in Tartu and the court and police building in Jõgeva have been pledged as collateral to bank loans.

NOTE 23 PROPERTY, PLANT AND EQUIPMENT

in thousands of euros

	Land	Buildings	Machinery and equipment	Other fixtures	Construction in progress and prepayments	Total
Cost at 31.12.2014	824	5,726	18,888	5,270	25	30,733
Accumulated depreciation at 31.12.2014	-	(1,628)	(10,042)	(4,060)	-	(15,730)
Carrying amount at 31.12.2014	824	4,098	8,846	1,210	25	15,003
Acquisition	-	6	1,040	129	58	1,233
Disposals	-	-	(275)	-	-	(275)
Division by way of demerger	-	-	(10)	-	-	(10)
Reclassification	-	-	21	4	(27)	(2)
Write-offs	-	-	(71)	(2)	-	(73)
Depreciation	-	(185)	(1,955)	(294)	-	(2,434)
Carrying amount at 31.12.2015	824	3,919	7,596	1,047	56	13,442
Cost at 31.12.2015	824	5,725	18,910	5,141	56	30,656
Accumulated depreciation at 31.12.2015	-	(1,806)	(11,314)	(4,094)	-	(17,214)
Carrying amount at 31.12.2015	824	3,919	7,596	1,047	56	13,442
Acquisition	-	47	1,479	170	1,190	2,886
Acquired subsidiary's non-current assets	-	-	2	41	-	43
Disposals	(3)	(80)	(697)	(4)	-	(784)
Reclassification	-	-	144	-	(153)	(9)
Write-offs	-	-	(35)	(1)	-	(36)
Depreciation	-	(184)	(2,028)	(492)	-	(2,704)
Carrying amount at 31.12.2016	821	3,702	6,461	761	1,093	12,838
Cost at 31.12.2016	821	5,650	17,625	5,190	1,093	30,379
Accumulated depreciation at 31.12.2016	-	(1,948)	(11,164)	(4,429)	-	(17,541)
Carrying amount at 31.12.2016	821	3,702	6,461	761	1,093	12,838

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

Property, plant and equipment pledged as collateral as at 31.12.2016 for the loan total EUR 3,777 thousand (31.12.2015: EUR 4,239 thousand) (Note 30). The group's most significant item of property, plant and equipment pledged as collateral to the loans is the Järvevana tee 9G property and the office building thereon.

NOTE 24 INTANGIBLE ASSETS

in thousands of euros

	Goodwill *	Software	Prepayments	Total
Cost at 31.12.2014	891	1,155	-	2,046
Accumulated amortisation and impairment at 31.12.2014	(178)	(857)	-	(1,035)
Carrying amount at 31.12.2014	713	298	-	1,011
Acquisitions	-	17	100	117
Write-offs	-	(69)	-	(69)
Amortisation and impairment	(89)	(91)	-	(180)
Carrying amount at 31.12.2015	624	155	100	879
Cost at 31.12.2015	891	1,075	100	2,066
Accumulated amortisation and impairment at 31.12.2015	(267)	(920)	-	(1,187)
Carrying amount at 31.12.2015	624	155	100	879
Unrealised exchange rate differences	1	-	-	1
Acquisitions	-	17	174	191
Obtained in the course of business combination	78	-	-	78
Reclassification	-	70	(61)	9
Amortisation and impairment	(389)	(96)	-	(485)
Carrying amount at 31.12.2016	314	146	213	673
Cost at 31.12.2016	970	1,137	213	2,320
Accumulated amortisation and impairment at 31.12.2016	(656)	(991)	-	(1,647)
Carrying amount at 31.12.2016	314	146	213	673

* As at the balance sheet date, an impairment test was performed for the cash-generating unit AS Vooremaa Teed which goodwill is attributable to. In the reporting period, a goodwill impairment loss of EUR 389 thousand was recognised (2015: EUR 89 thousand) because the recoverable amount of the cash-generating unit did not exceed the carrying amount of the non-current assets and goodwill of the cash-generating unit. The decrease of goodwill is recognised under the depreciation in the income statement (Note 4). The recoverable amount of the assets is determined as its value in use, using management-approved cash flow before tax projections for the next 5 years. Post-projection period cash flows are extrapolated using reasonable growth rates. The management has re-evaluated the near-term outlook for road construction and therefore, it has used 0,3% (2015: 0%) as the long-term growth rate of income and expenses, 2% (2015: 2%) as the average sales growth and 9% (2015: 10%) as the average EBITDA margin. The average weighted cost of capital of 9.5% (2015: 9.5%) is used as the discount rate, which takes account of the company's area of activity and risk level. For determining the budgeted gross margin, the management used previous periods' business experience and the competitive situation on the market.

NOTE 25 LEASED ASSETS

in thousands of euros

	31.12.2016	31.12.2015
Assets acquired under finance lease terms		
Registered immovables purchased for resale		
Cost	-	929
Machinery and equipment		
Cost	4,511	7,557
Accumulated depreciation	(2,411)	(3,080)
Carrying amount	2,100	4,477
Assets leased under non-cancellable operating lease terms	2016	2015
Land lease agreements		
Payments in the reporting period	2	2
Payments in subsequent periods:	13	14
Payable next year	2	2
Payable in 1...5 years	7	7
Payables after 5 years	4	5

On the basis of cancellable lease agreements, operating lease payments totalling EUR 357 thousand were paid for passenger cars in 2016 (2015: EUR 208 thousand). The Company does not intend to use a bargain purchase option for the assets leased under the operating lease terms in the reporting period.

Lease agreements does not set any limits to groups' dividend or financing policies. Rented assets have not been re-rented.

INVESTMENT PROPERTY LEASED OUT UNDER NON-CANCELLABLE OPERATING LEASE TERMS

	31.12.2016	31.12.2015
Cost	5,297	5,296
Accumulated depreciation	(1,207)	(944)
Carrying amount	4,090	4,352
	2016	2015
Operating lease income received for investment properties (Note 22)	503	503
Future operating lease income:	1,979	2,723
Next year	485	491
In 1...5 years	1,491	1,846
Later than 5 years	3	386

NOTE 26 BORROWINGS

in thousands of euros

	Finance lease liabilities at present value	Loans from					total	Total borrowings (Note 35)
		banks	parent company (Note 33)	entities under common control (Note 33)	related parties (Note 33)	other entities		
2016								
Balance at beginning of the year	2,704	19,403	-	8,000	-	1,078	28,481	31,185
Received	51	24,339	12,500	-	-	-	36,839	36,890
Loan liability related to the acquisition of subsidiary	-	-	-	-	-	25	25	25
Repaid	(855)	(18,039)	-	(2,000)	-	(768)	(20,807)	(21,662)
Sale to lessor	(131)	-	-	-	-	-	-	(131)
Reclassification of loan into other payables	-	-	-	-	-	(306)	(306)	(306)
Loan balance at end of the year	1,769	25,703	12,500	6,000	-	29	44,232	46,001
incl. current portion	1,282	7,696	12,500	-	-	7	20,203	21,485
non-current portion 1...5 years	487	18,007	-	6,000	-	22	24,029	24,516
Accrued interest of reporting period	49	472	25	177	-	27	701	750
incl. capitalised interest cost	-	140	-	-	-	-	140	140
Average effective interest rate	2.3%	2.3%	4.0%	2.5%	-	4.2%		
Base currencies	EUR	EUR	EUR	EUR	-	EUR, NOK		
2015								
Balance at beginning of the year	4,434	24,049	-	8,145	102	916	33,212	37,646
Received	534	8,953	-	8,000	-	162	17,115	17,649
Repaid	(2,186)	(13,599)	-	(8,145)	(102)	-	(21,846)	(24,032)
Sale to lessor	(78)	-	-	-	-	-	-	(78)
Loan balance at end of the year	2,704	19,403	-	8,000	-	1,078	28,481	31,185
incl. current portion	912	2,535	-	1,000	-	1,078	4,613	5,525
non-current portion 1...5 years	1,792	16,868	-	7,000	-	-	23,868	25,660
Accrued interest of reporting period	114	521	-	193	2	18	734	848
incl. capitalised interest cost	29	57	-	6	-	-	63	92
Average effective interest rate	3.7%	2.4%	-	1.9%	4.8%	5.5%		
Base currencies	EUR	EUR	-	EUR	EUR	EUR		
				2016		2015		
Minimum future payments under finance lease					1,807		2,793	
incl. current portion					1,312		964	
non-current portion with the term of 1...4 years					495		1,829	

Borrowings with floating interest rates related to EURIBOR are divided by the interest rate changes and the contractual repricing dates as follows:

	2016	2015
Finance lease liabilities		
1-5 months	401	559
6-12 months	1,090	1,628
Bank loans		
1-5 months	-	3,635
6-12 months	25,703	15,768
Loans from entities under common control		
6-12 months	6,000	8,000
Loans from management members		
6-12 months	-	-
Total	33,194	29,590

Borrowings with the contractual fixed interest rate are divided as follows:

	2016	2015
Finance lease liabilities	278	517
Loan from parent company	12,500	-
Loans from other entities	29	1,078
Total	12,807	1,595

Although different risk factors prevailed in global financial markets throughout the year, it was generally a relatively stable year. The risk margins on loans did not significantly change as compared to last year because EURIBOR was stable and other risk margins have not changed significantly since the loans were taken. Therefore, we can state that the fair value of bank loans to a material extent equals their carrying amount. The fair value of loans is measured using the discounted cash flow method and on the basis of Level 3 inputs of the fair value hierarchy (Note 35).

Among the loans from entities under common control, there is a loan from AS Järvevana, the interest of which is 6-month EURIBOR + 2.65%.

Loan collaterals and pledged assets are presented in Note 30.

NOTE 27 PAYABLES AND PREPAYMENTS

in thousands of euros

	31.12.2016	31.12.2015
Trade payables (Note 35)	25,035	16,325
Payables to employees	7,106	8,122
Tax liabilities, except for corporate income tax		
value added tax	4,122	2,005
personal income tax	513	490
social security tax	993	908
unemployment insurance tax	55	56
contributions to mandatory funded pension	46	45
other taxes	122	96
	5,851	3,600
Prepayments for construction services (Notes 32, 35)	8,943	4,575
Other liabilities (Note 35)		
interest liabilities	21	143
other liabilities	508	3,527
	529	3,670
Prepayments received	8,795	6,974
Total payables and prepayments	56,259	43,266
incl. payables to related parties (Note 33)	38	3,891

NOTE 28 PROVISIONS

in thousands of euros

	Provision for warranty obligation for construction	Provision for onerous construction contracts	Provision for legal costs and claims filed (Note 35) *	Provision for costs of projects sold	Other provisions	Total provisions
2016						
Balance at beginning of the year	2,378	392	100	2,120	23	5,013
Recognised (Notes 3, 4, 6)	936	55	173	1,973	22	3,159
Related to acquired subsidiary's provisions	5	-	-	42	-	47
Used during the year	(787)	(368)	-	(1,205)	(24)	(2,384)
Reversed (Notes 3, 6)	(56)	-	-	(142)	-	(198)
Balance at end of the year	2,476	79	273	2,788	21	5,637
incl. current portion	2,476	79	273	2,788	21	5,637
2015						
Balance at beginning of the year	2,096	2,079	172	1,838	54	6,239
Recognised (Notes 3, 4, 6)	996	164	100	1,949	27	3,236
Used during the year	(714)	(1,851)	-	(1,667)	(58)	(4,290)
Reversed (Notes 3, 6)	-	-	(172)	-	-	(172)
Balance at end of the year	2,378	392	100	2,120	23	5,013
incl. current portion	2,378	392	100	2,120	23	5,013

* Additional information is provided in subsection "Legal risk" in Note 35.

The basic principle for making provisions for warranty obligations are the historical trends in the statistical share of construction contract volumes. Historically the amount of provision used has not varied significantly from the amount of provision recognised. The provisions for costs of projects sold are based on the total costs of projects as defined in business plans, which are constantly updated and realized pursuant to the work performed.

NOTE 29 OTHER LONG-TERM PAYABLES

in thousands of euros

	31.12.2016	31.12.2015
Trade payables (Note 35)	1,317	1,159
Other long-term payables (Note 35)	744	-
Total other long-term payables	2,061	1,159
incl. other long-term payables to related parties (Notes 18, 33)	322	-

NOTE 30 LOAN COLLATERALS AND PLEDGED ASSETS

in thousands of euros

The group has entered into commercial pledge contracts to secure loans and other liabilities, set mortgages on assets and pledged the shares of its subsidiaries:

Commercial pledges	31.12.2016	31.12.2015
Movable property	41,641	40,074
Term deposit	36	37
Financial assets*	12,719	13,500
Total	54,396	53,611

* The financial assets of UAB Balsiu mokyklos SPV which OÜ Merko Property has pledged to secure the investment loan in the amount of EUR 5,665 thousand for the benefit of Nordea Bank AB Lithuania Branch.

Mortgages	31.12.2016	31.12.2015
Inventories (Note 17)	44,870	42,577
Land and buildings (Note 23)	3,401	3,584
Other non-current assets (Note 23)	376	655
Investment properties (Note 22)	3,688	3,899
Total	52,335	50,715

Pledges of shares

In addition to the commercial pledge for financial assets, OÜ Merko Property has pledged the shares of its wholly-owned subsidiary UAB Balsiu mokyklos SPV for the benefit of Nordea Bank AB Lithuania Branch. An investment loan in the amount of EUR 5,665 thousand (31.12.2015: EUR 6,019 thousand) is secured by the pledge.

As at 31.12.2015, UAB Merko Bustas had pledged its shares of the (100%) subsidiary UAB MN Projektas to Swedbank AB. The pledge secured an investment loan with a EUR 1,900 thousand line of credit.

NOTE 31 SHARE CAPITAL

The Commercial Code of the Republic of Estonia specifies the following requirements for the share capital of the entities registered in Estonia:

- the minimum share capital of a public limited company shall be at least EUR 25 thousand;
- the net assets of a public limited company shall be at least one half of the Company's share capital but not less than EUR 25 thousand.

The size of share capital or its minimum and maximum limits are set out in the articles of association of a public limited company whereas the minimum share capital shall equal at least ¼ of maximum share capital.

According to the current articles of association of AS Merko Ehitus, the Company's share capital consists of 17,700 thousand registered ordinary shares without nominal value which have been fully paid for and without amending the articles of association of the public limited company, changes can be made to the Company's share capital within the range of EUR 6,000 – 24,000 thousand.

As at 31.12.2016, the consolidated net assets of AS Merko Ehitus were EUR 122,790 thousand, therefore the Company's equity and share capital were in compliance with the requirements established in the Republic of Estonia.

The general meeting of the shareholders held on 29 April 2015 resolved to approve the Supervisory Boards proposal to reduce the share capital by EUR 4,071 thousand (EUR 0.23 per share).

Pursuant to subsection §50 section 2 of the Income Tax Act in force in Estonia, income tax does not have to be paid on the portion of payments made from the equity upon reduction of the share capital or contributions, upon redemption of shares or contributions or in other cases, and on the portion of the paid liquidation distributions made by way of previous monetary contributions. About EUR 4.0 million in the said monetary contributions have been made in AS Merko Ehitus.

Based on the resolution of the general meeting of the shareholders, share capital was reduced by EUR 4,071 thousand (EUR 0.23 per share), from the amount EUR 12,000 thousand to EUR 7,929 thousand. Share capital was reduced by way of reducing the book value of the shares and as a result of the reduction the book value of one share was reduced from EUR 0.677966 to EUR 0.447966; the number of shares remained the same – 17,700,000 shares.

Considering the perspectives of the Baltic construction market in the coming years and the related need for capital by the group, the share capital was reduced in order to improve the group's capital structure and support return on equity. AS Merko Ehitus lacked the need to possess share capital in the existing amount and the requirements that legislation imposes on share capital are also met in the case of the reduced share capital.

The reduction of share capital in the Commercial Register was made on 14 August 2015 and the monetary payments to the shareholders in the amount of EUR 4,071 thousand (EUR 0.23 per share), related to the reduction of share capital was made on 16 November 2015. Shareholders, that were entered into the share register of AS Merko Ehitus on 22 May 2015, at 23.59, were entitled to the monetary payments from the reduction of share capital.

NOTE 32 CONSTRUCTION CONTRACTS IN PROGRESS

in thousands of euros

	31.12.2016	31.12.2015
Costs incurred for construction contracts in progress and corresponding profit*	335,989	496,969
Progress billings submitted	(340,324)	(497,596)
Revenue recorded from construction services during the period**	173,218	178,523
Accrued income from construction services (Notes 15, 35)	4,606	3,948
Prepayments for construction services (Notes 27, 35)	(8,943)	(4,575)
Advance payments received for construction contract works	3,825	1,455

* Costs incurred for construction contracts in progress and corresponding profit have been presented for contracts in effect, including those entered into in 2016 and 2015.

** The difference in sales revenue from construction service with respect to the amount recognised in Note 3, EUR 1,888 thousand (2015: EUR 2,104 thousand) stems from sales revenue from other segments, including extraction of filler sand for road construction.

Accrued income from construction services are included in the statement of financial position line *Trade and other receivables*. Prepayments for construction services are included in the statement of financial position line *Trade and other payables*.

NOTE 33 RELATED PARTY TRANSACTIONS

in thousands of euros

In compiling the Annual Report, the following entities have been considered as related parties:

- parent company AS Riverito;
- shareholders of AS Riverito with significant influence over AS Merko Ehitus through AS Riverito;
- other shareholders with significant influence;
- other subsidiaries of AS Riverito or so-called sister companies, in this Note "Entities under common control";
- joint ventures;
- key members of the management (supervisory and management board), their close relatives and entities under their control or significant influence.

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

The parent of AS Merko Ehitus is AS Riverito. As at 31.12.2016 and 31.12.2015, AS Riverito owned 71,99% of the shares of AS Merko Ehitus. The ultimate controlling party of the group is Mr Toomas Annus.

GOODS AND SERVICES

in thousands of euros

	2016	2015
Provided services and goods sold		
Parent company	15	12
Joint ventures	7,471	530
Entities under common control	5,641	49
Members of the management	108	1,837
Other related parties	617	-
Total services provided and goods sold	13,852	2,428
Interest income		
Joint ventures	280	171
Purchased services and goods		
Parent company	90	90
Joint ventures	20	-
Entities under common control	126	125
Other related parties	-	6
Total purchased services and goods	236	221
Interest expense		
Parent company	38	-
Entities under common control	177	201
Other related parties	-	2
Total interest expense	215	203

BALANCES WITH RELATED PARTIES

in thousands of euros

	31.12.2016	31.12.2015
Receivables from related parties		
Loans granted (Note 15, 16, 20)		
Joint ventures	3,952	3,888
Receivables and prepayments (Note 15)		
Parent company	4	4
Joint ventures	3,896	536
Entities under common control	433	1
Total receivables and prepayments	4,333	541
Other long-term receivables (Note 20)		

	31.12.2016	31.12.2015
Joint ventures	261	7
Total receivables from related parties	8,546	4,436
Payables to related parties		
Short-term loans received (Note 26)		
Entities under common control	12,500	-
Other related parties	-	1,000
Total short-term loans received	12,500	1,000
Payables and prepayments (Note 27)		
Parent company	9	9
Entities under common control	29	3,264
Other related parties	-	618
Total payables and prepayments	38	3,891
Long-term loans received (Note 26)		
Entities under common control	6,000	7,000
Other long-term payables (Note 15)		-
Other related parties	322	-
Total payables to related parties	18,860	11,891

With regard to receivables from related parties, no impairments were performed in either 2016 or 2015.

TRANSACTIONS INVOLVING RELATED PARTIES (ADDITIONAL INFORMATION)

On 14 December 2016, AS Merko Ehitus signed a short-term (due date 31 of January 2017) loan agreement in the amount of EUR 12,500 thousand with parent company AS Riverito, to partially finance the acquisition of Veerenni land plots (purchase price EUR 16,800 thousand). On 26 January 2017 the loan from AS Riverito has been repaid after the balance sheet date and before the due date and refinanced with long-term loans from different credit institutions.

REMUNERATION OF THE MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARDS

In 2016, the members of the Supervisory and Management Boards of AS Merko Ehitus and Management Boards of its significant subsidiaries were paid gross fees totalling EUR 2,221 thousand (2015: EUR 2,191 thousand).

TERMINATION BENEFITS OF MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARDS

Authorisation agreements have been entered into with the members of the Supervisory Board according to which no termination benefits are paid to them upon the termination of the contract. 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 EUR 716 thousand (2015: EUR 795 thousand). In 2016, compensation was paid to the management board members in the amount of EUR 65 thousand (2015: EUR 18 thousand).

MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARD

Track record and photographs of the members of the Supervisory Board can be found in the management report and on AS Merko Ehitus website at: group.merko.ee.

Shares held by members of the Supervisory Board of AS Merko Ehitus as at 31 December 2016

		NO OF SHARES	% OF SHARES
Toomas Annus (AS Riverito)	Chairman of the Supervisory Board	8,322,914	47.02%
Indrek Neivelt (OÜ Trust IN)	Member of the Supervisory Board	31,635	0.18%
Olari Taal (OÜ Eggera)	Member of the Supervisory Board	2,500	0.01%
Teet Roopalu	Member of the Supervisory Board	-	0.00%
		8,357,049	47.21%

The Management Board of the holding company AS Merko Ehitus has two members: Andres Trink and Tõnu Toomik.

Shares held by members of the Management Board of AS Merko Ehitus as at 31 December 2016

		NO OF SHARES	% OF SHARES
Andres Trink	Chairman of the Management Board	500	0.00%
Tõnu Toomik (AS Riverito)	Member of the Management Board	1,607,185	9.08%
		1,607,685	9.08%

NOTE 34 CONTINGENT LIABILITIES

in thousands of euros

The group has purchased the following guarantees from financial institutions to guarantee the group's obligations to third parties. These amounts represent the maximum right of claim by third persons against the group in case the group is unable to meet its contractual obligations. Management estimates that additional expenses related to these guarantees are unlikely.

	31.12.2016	31.12.2015
Performance period's warranty to the customer	21,036	9,174
Tender warranty	767	745
Guarantee warranty period	20,470	23,988
Prepayment guarantee	4,411	2,336
Payment guarantee	30,500	30,500
Contracts of surety	3,902	654
Letter of credit	-	2,000
Total contingent liabilities	81,086	69,397

The "Payment guarantee" entry as at 31.12.2016 and 31.12.2015 includes a payment guarantee for the benefit of a financial institution, issued within the framework of a contract for construction, in order to secure the customer's contractual payment obligations in the total amount of up to EUR 30,500 thousand. The realisation of the payment guarantee is not considered likely by the group. To secure the customer's contractual obligations, a first-ranking mortgage of EUR 36,600 thousand with the financing institution as the beneficiary has been established on the registered immovable property of the building to be constructed in the framework of the construction agreement. To secure the group's payment guarantee, a second-ranking mortgage of EUR 8,500 thousand with the group as the beneficiary has been established.

Performance period's warranty to the customer – warranty provider guarantees to the customer that the contractor's obligations arising from construction contract will be adequately completed.

Tender warranty – warranty provider guarantees to the customer arranging the tender process that the tenderer will sign a contract as per tender conditions.

Guarantee for warranty period – warranty provider guarantees to the customer that the construction defects discovered during the warranty period will be eliminated.

Prepayment guarantee – warranty provider guarantees to the customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.

Payment guarantee – guarantor guarantees repayments of the customer's/developer's loan.

Letter of credit – A letter of credit is the obligation of the buyer (i.e. the bank opening the letter of credit) to pay the seller (i.e. the receiver of the letter of credit) the amount of the letter of credit if the seller fulfils and presents documentation to the bank regarding the fulfilment of the conditions fixed with the letter of credit.

As at 31 December 2016 the group has recognised a provision (Note 28) with regards to the guarantee for warranty period which is based upon historical experience and contractual volumes.

Tax authorities have the right to review the group's tax records within 5 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines. The group's management estimates that there are no circumstances which might lead the tax authorities to impose additional significant taxes on the group.

For legal risks, please refer to the respective paragraph of Note 35.

NOTE 35 RISK MANAGEMENT

FINANCIAL RISKS MANAGEMENT

In its daily activities, the group needs to consider various financial risks. The key risks include: market risk (incl. interest rate risk and foreign currency risk), credit risk, liquidity risk and equity risk. Based on the group's balance sheet structure and position in the market, none of these risks have a significant impact as at the date of preparation of the financial statements. The group's risk management is based on laws, regulations, requirements and regulations arising from International Financial Reporting Standards, as well as the group's internal regulations and good business practices. The group's finance department is responsible for management of financial risks.

1. CREDIT RISK

Credit risk relates to a potential damage which would occur if the parties to the contract are unable to fulfil their contractual obligations. For mitigating credit risk, the payment behaviour of clients is constantly monitored, their financial position is analysed and if necessary, third persons are engaged as a guarantor in transactions. Construction activities are partially financed by customer prepayments. As a rule, a precondition for receiving a prepayment is a bank guarantee for the prepayment submitted to the customer. Free cash is mostly held in overnight deposits or term deposits at Swedbank, LHV, SEB, Nordea and DnB bank groups. Swedbank AS, AS LHV Pank and SEB Pank AS do not have separate ratings by Moody's. The parent company of Swedbank AS - Swedbank AB, the parent company of SEB Pank AS - Skandinaviska Enskilda Banken AB and Nordea Bank AB all have a long-term rating Aa3 by Moody's. DnB Bank ASA had a long-term credit rating Aa2 by Moody's. The management estimates that the group is not exposed to significant credit risk.

FINANCIAL ASSETS EXPOSED TO CREDIT RISK

in thousands of euros

	Allocation by due dates		Carrying amount	Collateral
	1-12 months	2-5 years		
31.12.2016				
Cash and cash equivalents (Note 14)	33,544	-	33,544	-
Term deposits (Notes 20)	-	36	36	-
Trade receivables (Notes 15, 20)	31,470	11,122	42,592	1,500
Accrued income from construction service (Notes 15, 32)	4,606	-	4,606	-
Loans granted (Notes 15, 16, 20)	1,560	3,952	5,512	1,650
Interest receivables (Notes 15, 20)	218	261	479	-
Other short-term receivables (Note 15)	347	-	347	-
Total	71,745	15,371	87,116	3,150
	,	,	,	,
31.12.2015				
Cash and cash equivalents (Note 14)	39,905	-	39,905	-
Term deposits (Notes 20)	-	37	37	-
Trade receivables (Notes 15, 20)	15,105	12,419	27,524	6,500
Accrued income from construction service (Notes 15, 32)	3,948	-	3,948	-
Loans granted (Notes 15, 16, 20)	1,432	3,956	5,388	1,650
Interest receivables (Notes 15, 20)	200	7	207	-
Other short-term receivables (Note 15)	617	-	617	-
Total	61,207	16,419	77,626	8,150

The group's customers are primarily large local entities or public sector entities (as at 31.12.2016, the public sector proportion in accounts receivable amounted to 20.8% (as at 31.12.2015: 15.5%)) with well-known and sufficient creditworthiness.

Trade receivables by due date (excluding long-term receivables):

	31.12.2016		31.12.2015	
	Amount	Percentage	Amount	Percentage
Not overdue	26,880	85,4%	12,979	86,0%
1-30 days overdue	2,076	6,6%	1,397	9,3%
31-60 days overdue	1,384	4,4%	50	0,3%

	31.12.2016		31.12.2015	
61-90 days overdue	141	0,4%	475	3,1%
91-120 days overdue	152	0,5%	4	0,0%
121-180 days overdue	551	1,8%	94	0,6%
More than 180 days overdue	286	0,9%	106	0,7%
Total trade receivables (Note 15)	31,470	100%	15,105	100%

As at the balance sheet date, the amount of overdue short-term receivables was EUR 4,590 thousand (31.12.2015: EUR 2,126 thousand), of which EUR 2,441 thousand has been collected by 12 March 2017. In a year, the share of overdue short-term receivables in total receivables increased from 14.0% to 14.6%. The group keeps running track of payment history for all customers separately for each receivable. The management estimates that there are sufficient reasons to conclude that the receivables reported in the financial statement will be paid off by the buyers. Trade receivables and receivables from customers of construction works under the stage of completion method have not been guaranteed with additional collateral as is customary in the industry.

As at balance sheet date, the loans granted to joint ventures, the economic activities of which the group has a good overview of, totalled EUR 3,952 thousand (31.12.2015: 3,888 thousand) and therefore, no additional collateral is required. As at 31.12.2016, loans granted to unrelated legal entities amounted to EUR 1,560 thousand (Note 16) (31.12.2015: 1,500 thousand), which in management's opinion is not exposed to material credit risk. As at the year-end, the management expects to collect these loans on time.

2. MARKET RISK

INTEREST RISK

Interest risk arises from interest rate changes in the financial markets as a result of which it may be necessary to revalue the group's financial assets and take into consideration higher financing costs in the future. Most of the group's bank loans have floating interest rates based on either Euribor or the interbank rates of the countries of incorporation of the entities. In 2016, the share of interest-bearing liabilities in the group's capital structure decreased and management considers this share to be moderate (as at 31.12.2016, 19.3% and as at 31.12.2015, 14.8% of the balance sheet total) and effect of changes in the interest rate environment to be insignificant for the group's results over the next 12 months.

EFFECT OF CHANGES IN INTEREST RATE RISK ON FINANCE COSTS AND INCOME

As at 31.12.2016, the group's interest-bearing liabilities totalled EUR 46,001 thousand, of which short-term loans and repayments of long-term liabilities in 2017 totalled EUR 21,485 thousand and long-term loans and finance lease liabilities totalled EUR 24,516 thousand. As at 31.12.2016, the group's loans granted totalled EUR 5,512 thousand, of which EUR 1,560 thousand were classified as short-term loans with repayments in 2017 and EUR 3,952 thousand as the long-term loans. Loan interest depended on interbank 1-12 month loan base interest in the entity's domicile and Euribor. As at 31.12.2016, the break-down of interest-bearing borrowings and loans granted was as follows:

	31.12.2016	31.12.2015
Fixed rate liabilities	12,809	1,595
Liabilities with floating rate interests 1-5 months	401	4,194
Liabilities with floating rate interests 6-12 months	32,791	25,396
Total interest-bearing borrowings	46,001	31,185
Fixed rate receivables	5,512	5,388

The management does not expect big changes in base interest rates, the market is stable and base interest rates remain low. Assuming that average EURIBOR is 10 pp higher over the next 12 months as compared to the beginning of the year and there is no change in the position of liabilities, interest expenses would increase by EUR 33 thousand (31.12.2015: EUR 30 thousand). All the loans granted have fixed interest rate and therefore a change in the reference rates would have no impact on the interest income.

In addition to risk arising from changes in Euribor, there is risk due to changes in the risk margin attributable to the changes in the economic environment related refinancing of liabilities. This is most directly manifested in a possible need to extend overdraft credit contracts. As at the year-end, group entities had entered in overdraft contracts with banks and other unrelated third parties in the total limit amount of EUR 11,198 thousand, of which EUR 3,000 thousand was withdrawn. In 2017, contracts in the total amount of EUR 11,198 thousand will expire, the extension of which is currently under consideration.

FOREIGN EXCHANGE RISK

The group's economic activities are conducted mainly in the currencies of the countries of location of the companies: euros in Estonia, Latvia and Lithuania and kroons in Norway. Transactions within the group are conducted in euros as a rule. To eliminate foreign currency risks, close track is kept of the proportions of the company's assets and liabilities held in different currencies and, when it

comes to entering into long-term construction contracts, the euro is the preferred currency in the Baltics, and, in Norway, the krone. The break-down of financial assets and liabilities in local currencies as at the balance sheet date is as follows:

	In EUR	In NOK
31.12.2016		
Assets	98.3%	1.7%
Liabilities	98.7%	1.3%
31.12.2015		
Assets	100.0%	-
Liabilities	100.0%	-

Considering the fact that the materials and services used in construction are generally from the local market or supplied from within the EU, the currency risk in the group is currently minimal.

3. LIQUIDITY RISK

The group's liquidity or solvency represents its ability to settle its liabilities to creditors on time. As at 31.12.2016, the group's current ratio was 2.9 (31.12.2015: 3.2) and the quick ratio 1.1 (31.12.2015: 1.2). As at 31 December 2016, for calculating the current ratio and the quick ratio, the amount of current liabilities has been reduced by EUR 12.5 million because the short-term loan received from parent company AS Riverito was refinanced with long-term bank loans in January 2017. Additional information has been disclosed in Note 33. In addition to available current assets, and to ensure liquidity and better management of cash flows, the group has concluded overdraft agreements with banks. As at end of the year, the group entities had concluded overdraft contracts with banks and other unrelated third parties in the total amount of EUR 11,198 thousand, of which EUR 8,198 thousand was unused, (31.12.2015: EUR 9,401 thousand, of which EUR 8,636 thousand was unused). In addition to the overdraft facility, the Company has a current loan facility with the limit of EUR 3,500 thousand (31.12.2015: EUR 3,500 thousand) from AS Riverito, which had not been withdrawn in full as at the end of current and previous financial years.

The management estimates that the group's capital structure – equity at 51.6% (31.12.2015: 59.5%) of the balance sheet total and a moderate proportion of interest bearing liabilities at 19.3% (31.12.2015: 14.8%) of the balance sheet total – ensures the group's trustworthiness for creditors in the changing economic climate and significantly improves the feasibility of the extension of existing financial liabilities and raising of additional debt.

FINANCIAL ASSETS/LIABILITIES

in thousands of euros

	Allocation by due date			Total	Carrying amount
	1-3 months	4-12 months	2-5 years		
31.12.2016					
Assets					
Cash and overnight deposits (Note 14)	33,544	-	-	33,544	33,544
Term deposits (Notes 20)	-	-	36	36	36
Trade receivables (Notes 15, 20)	26,828	4,642	11,122	42,592	42,592
Accrued income from construction services (Notes 15, 32)	4,606	-	-	4,606	4,606
Loans and interest (Notes 15, 16, 20)	81	1,697	4,213	5,991	5,991
Other short-term receivables (Note 15)	117	230	-	347	347
Total	65,176	6,569	15,371	87,116	87,116
Liabilities					
Trade payables (Notes 27, 29)	22,332	2,703	1,317	26,352	26,352
Prepayments for construction services (Notes 27, 32)	8,943	-	-	8,943	8,943
Loan and finance lease liabilities (Note 26) *	20,067	1,418	24,516	46,001	46,001
Other liabilities (Note 27, 29)	236	293	744	1,273	1,273
Financial guarantees	-	32,465	-	32,465	-
Total	51,578	36,879	26,577	115,034	82,569
Net assets / liabilities	13,598	(30,310)	(11,206)	(27,918)	4,547

	Allocation by due date			Total	Carrying amount
	1-3 months	4-12 months	2-5 years		
31.12.2015					
Assets					
Cash and overnight deposits (Note 14)	39,905	-	-	39,905	39,905
Term deposits (Notes 20)	-	-	37	37	37
Trade receivables (Notes 15, 20)	14,157	948	12,419	27,524	27,524
Accrued income from construction services (Notes 15, 32)	3,948	-	-	3,948	3,948
Loans and interest (Notes 15, 16, 20)	1,631	1	3,963	5,595	5,595
Other short-term receivables (Note 15)	87	530	-	617	617
Total	59,728	1,479	16,419	77,626	77,626
Liabilities					
Trade payables (Notes 27, 29)	12,793	3,532	1,159	17,484	17,484
Prepayments for construction services (Notes 27, 32)	4,575	-	-	4,575	4,575
Loan and finance lease liabilities (Note 26) *	2,150	3,375	25,660	31,185	31,185
Other liabilities (Note 27, 29)	45	3,625	-	3,670	3,670
Financial guarantees	-	30,902	-	30,902	-
Total	19,563	41,434	26,819	87,816	56,914
Net assets / liabilities	40,165	(39,955)	(10,400)	(10,190)	20,712

* The schedule of expected interest payments cannot be determined with reasonable accuracy. In line with the best practice of property development, the loan obligations to acquire land plots have been assumed with open-end maturities. The repayment of these loan obligations depends on the progress of related development projects and on the timing of cash flows generated from those projects after their completion. Consequently, the management is of opinion that even its best estimate of the timing of expected interest payments would not be sufficiently accurate for the users of these financial statements and this information has not been disclosed.

4. FAIR VALUE ESTIMATION

According to the estimation of the group, the carrying values of financial assets at amortised cost (Notes 14, 15, 16, 20) and financial liabilities at amortised cost (Notes 26, 27, 29) in the consolidated balance sheet as at 31 December 2016 and 31 December 2015 do not vary significantly from their fair value.

The fair values of short-term receivables and loans granted and short-term payables and accounts payable to suppliers do not differ significantly from their value recognised in the statement of financial position, as their realisation takes place within 12 months or recognition took place during an interval proximate to the balance sheet date.

The Management Board estimates that the fair value of long-term receivables does not materially differ from their carrying amount because no material changes have occurred in risk margins of the borrowers. The fair value of receivables is measured using the discounted cash flow method in accordance with IFRS 7 on the basis of Level 3 inputs of the fair value hierarchy.

The fair value of trade receivables (31.12.2016: EUR 10,580 thousand; 31.12.2015: EUR 11,199 thousand) related to Balsiu School – other receivables and amounts receivable from invoices issued (including VAT) – equals their carrying amount, as the impact of discounting is not significant. The fair value of the mentioned receivables is equal to EUR 23,744 thousand using the effective interest rate of 0.31% (31 December 2015: EUR 24,828 thousand using the effective interest rate of 1.49%). As the amount receivable is due from the state institution, the interest rate used for the fair value calculation is a long-term borrowing rate at the end of the period applicable to the Republic of Lithuania (www.ecb.europa.eu/stats/financial_markets_and_interest_rates/long_term_interest_rates). Long-term receivables related to Balsiu School are valued on the basis of Level 2 inputs of the fair value hierarchy.

A significant part of the group's long-term payables have a floating interest rate, which changes according to fluctuations of the market interest rate. In the estimation of the management, the group's risk margins have not materially changed since the loans were obtained and the interest rates on the group's debt meet the market conditions. The fair value of long-term financial obligations is determined based on discounted future contractual cash flows using the market interest rate available to the group for the use of similar financial instruments (Level 3).

To provide an indication of the inputs used to determine fair value, the group has classified its financial instruments into three levels based on the requirements of accounting standards.

Level 1: Financial instruments valued at unadjusted prices on the stock market or other active regulated market. As at 31 December 2016 and 2015, the group did not have any Level 1 financial instruments.

Level 2: Financial instruments whose values are based on valuation methods based on observable inputs. This category includes e.g. financial instruments valued based on prices of identical instruments traded on an active regulated market or financial instruments which are revalued at regulated market price but have low liquidity on the stock market.

Level 3: Financial instruments where the valuation methods used for revaluation are based on non-observable inputs.

CAPITAL MANAGEMENT

The group considers borrowings and total equity as capital. As at 31.12.2016, the total equity attributable to equity owners of the parent was EUR 122,790 thousand (31.12.2015: EUR 125,698 thousand). The group's principle is to maintain a strong equity base for the purpose of retaining its trustworthiness among its shareholders, creditors and the market, and to ensure the group's sustainable development. Over the long term, the group's goal is to increase income for its shareholders and ensure its ability to pay dividends.

The group's equity is currently mainly tied up in the land plots portfolio invested in for the purpose of real estate development, which the group has either increased or decreased according to the changes in the market primarily through its own developments. The group can additionally regulate the equity structure through dividends payable to shareholders or repayments of share capital.

The group considers it important to ensure an optimal capital structure. Therefore, it monitors that the group's equity to assets ratio should be at least 40% (31.12.2016: 51.6%, 31.12.2015: 59.5%) and interest-bearing debt to assets ratio would not exceed 25% (31.12.2016: 19.3%, 31.12.2015: 14.8%). The requirement laid down in the overdraft contract entered into with Nordea Bank AB Estonia branch specifies that the share of the company's consolidated equity from total assets would not fall below 35% and the group has complied with this requirement.

According to the good market practice, the group uses the ratio of net debt to total capital to monitor its capital:

	31.12.2016	31.12.2015
Borrowings	46,001	31,185
Less: cash and cash equivalents and short-term deposits	(33,544)	(39,905)
Net debt	12,457	(8,720)
Total equity attributable to owners of the parent	122,790	125,698
Total net debt and equity attributable to equity owners of the parent	135,247	116,978
Share of net borrowings	9.2%	-7.5%

The group's net debt at 31.12.2016 stood at EUR 12.5 million (31.12.2015: negative EUR 8.7 million).

MANAGEMENT OF OTHER RISKS

LEGAL RISK

Due to different interpretations of contracts, regulations and laws related to group's principal activities, there is a risk that some buyers, contractors or supervisory authorities evaluate the Company's activities from the perspective of laws or contracts from a different position and dispute the legitimacy of the Company's activities.

As at 31 December 2016, a provision has been set up at the group in the amount of EUR 273 thousand for covering potential claims and legal costs (31 December 2015: EUR 100 thousand), (Note 28).

An overview of the key legal disputes of group entities ended during 2016 and ongoing as of 31.12.2016 is presented below.

ESTONIA

Lawsuit against former employee

On 17 December 2014, AS Merko Infra filed a claim in Harju County Court against a former AS Merko Infra employee, Maksim Vihharev, seeking EUR 97 thousand in damages (EUR 84 thousand being the principal claim and EUR 13 thousand late interest) along with a petition to secure the action. The lawsuit relates to intentional damage caused by fictitious transactions concluded by Maksim Vihharev on behalf of AS Merko Infra while serving as electrical work project manager and purchase of items not necessary for contractual work. The potential positive outcome of this suit is not recognised in the group's financial reporting. On 3 October 2016, Harju County Court proclaimed a court decision satisfying AS Merko Infra's action in full with regard to a claim for principal (EUR 84

thousand) and late interest EUR 12 thousand; the defendant was also ordered to pay AS Merko Infra procedural expenses totalling EUR 37 thousand.

By decision of 22 February 2017, the Tallinn Circuit Court partially satisfied Maksim Vihharev's appeal and made changed the decision of Harju County Court. The Tallinn Circuit Court ordered Maksim Vihharev to pay AS Merko Infra damages of EUR 56 thousand and late interest as of 22 February 2017 of EUR 9 thousand. AS Merko Infra plans to appeal the Tallinn Circuit Court decision in the extent to which Vihharev's appeal was affirmed.

On 3 March 2015, Maksim Vihharev filed an action in Harju County Court against AS Merko Infra seeking compensation for alleged damage to his reputation. The plaintiff is seeking EUR 6,658 thousand in reparations plus damages in an undetermined amount due to alleged impairment of his health. The abovementioned legal formulation is legally opaque and unjustified, and as a result AS Merko Infra does not acknowledge Maksim Vihharev's claim, deems the mentioned demand to be without merit, and is petitioning the court to dismiss it. On 22 January 2016, Harju County Court refused to hear the action filed by Maksim Vihharev against AS Merko Infra (civil matter No 2-15-6047), in which Maksim Vihharev accused AS Merko Infra of defamation and of causing damage thereof. On 30 January 2017, Harju County Court dismissed the case filed by Maksim Vihharev against AS Merko Infra (civil matter No 2-15-6047), seeking compensation for health damage.

Appeal for the revocation of the order of the Minister of the Environment

On 7 April 2015, Suur-Paekalda OÜ and Väike-Paekalda OÜ, which are the subsidiaries of AS Merko Ehitus, filed an appeal to the Tallinn Administrative Court for the revocation of the Order of the Minister of the Environment No. 22 of 27 March 2015, by which the boundaries of the permanent habitat of protected plants, which were established by the Minister of the Environment Order No. 9 of 3 February 2006, were amended so that the disputed registered immovable properties at Paekalda St were excluded from protected area. The primary objective of the appeal is to prevent the release of the immovable properties from nature conservation restrictions, which would justify the refusal to acquire the immovable properties by the state. By decision of 16 September 2016, Tallinn Administrative Court turned down the appeal. The appellants did not appeal the said decision.

On 2 February 2016, AS Merko Ehitus subsidiaries Suur-Paekalda OÜ and Väike-Paekalda OÜ filed a complaint in Tallinn Administrative Court for compensation of damage. The plaintiffs are seeking a ruling ordering that the state pay damages of approximately EUR 3.2 million to Suur-Paekalda OÜ (amount to be determined) and approximately EUR 1.6 million to Väike-Paekalda (amount to be determined) as well as late interest at the rate specified in subsection 113 (1) of the Law of Obligations Act starting from 2 February 2016 until due compliance with the demand for compensation. The claims consist of direct patrimonial damage (reduction in the value of immovable property and expenditures made on development activity) and claims for revenue foregone (failed development activity in 2005-2007). The possible positive impact of the claim submitted has not been recognised by the group in its financial statements.

LATVIA

Lawsuit against former employee

On 5 May 2015, SIA Merks filed suit in Riga District Court against former SIA Merks employee Rolands Mēnesis in a claim for the compensation of damage amounting to EUR 337 thousand. Previously, on 2 March 2015, SIA Merks had filed a petition to secure the action in the same amount, which was duly granted by the court. The object of the statement of claim is damage deliberately caused by project manager Rolands Mēnesis by entering into fictitious transactions on behalf of SIA Merks and purchase of items not necessary for contractual work. The possible effect of the potential positive outcome of this suit has not been taken into account in the group's financial reporting. On 6 April 2016 the case was transferred to Ogre District Court in order to expedite the reviewing of the case. The following court hearing is scheduled for 11 April 2017.

On 18 June 2015, SIA Merks filed an action against Rolands Mēnesis for termination of the employment contract due to entry into transactions and conduct of operations causing damage to SIA Merks as described above in accordance with the Latvian law, which provides for the corresponding procedure in cases where the trade union objects to the dismissal of an employee. The statement of claim has been accepted. On 12 January 2016, Rolands Mēnesis filed a counterclaim against SIA Merks, asking the court to declare unlawful the removal from work and order SIA Merks to pay damages in the amount of average remuneration, starting from the initial suspension of the employment contract (7 January 2015), as well as non-patrimonial damage in the amount of 12-month average remuneration. At a court hearing held on 23 August 2016, the court decided to satisfy the action brought by SIA Merks against Rolands Mēnesis to terminate the employment contract, reject the counter-action filed by Rolands Mēnesis against SIA Merks to have his removal from work declared unlawful and for compensating him for average remuneration, and to order Rolands Mēnesis to pay procedural expenses totalling EUR 1 thousand. To the knowledge of SIA Merks, Rolands Mēnesis has appealed the decision made. Furthermore, Rolands Mēnesis has submitted an application for extra-judicial adjudication, and had until 3 February 2017 to present his own proposal for a compromise solution. SIA Merks did not received any noteworthy proposals from Rolands Mēnesis. Since the possibility of a compromise is unlikely, the next hearing is scheduled to take place on 12 April 2017.

Maschinenbau

On 29 February 2016, SIA Merks filed a claim in Ogre Circuit Court against MS-Maschinenbau und Vertriebs GmbH (hereinafter "Maschinenbau") seeking EUR 228 thousand to compensate the value of defective equipment supplied by Maschinenbau and direct expenses incurred by Merks. The potential positive outcome of this court case is not recognised in the group's financial reporting. On 27 January 2017, the parties reached a mutual settlement, according to which Maschinenbau will buy back the previously delivered device by making a payment of EUR 75 thousand by 30 May 2017 at the latest. Upon receipt of the payment, SIA Merks will be obliged, on its behalf, to waive any future claims against Maschinenbau and withdraw the action.

LITHUANIA

Vakaru

At 25 May 2012, BUAB Vakaru inžineriniai tinklai (hereinafter "Vakaru") filed a claim against the Lithuanian branch of AS Merko Ehitus in the amount of EUR 197 thousand, related to the repeal of the joint venture contract concerning the sewerage and wastewater pipeline project (project "Construction of Sewerage and Wastewater Pipelines in Seda, Plinkšiai and Bugeniai"). Although it was the view of AS Merko Ehitus that the joint venture agreement was terminated for cause due to breaches of the partner, not illegally the court ruled in the matter in favour of Vakaru on its decision from 29 April 2015. The said decision took effect on 7 February 2016 when the Lithuanian Supreme Court decided not to admit to proceedings the cassation appeal filed by AS Merko Ehitus.

In the end of 2012, bankruptcy proceedings were initiated against Vakaru. In relation to that, AS Merko Ehitus has filed creditor's claims (incl. claims for damages) in the bankruptcy proceedings totalling EUR 1,220 thousand. Said claim (incl. claim for damages) is not included on the group's balance sheet and claims that arose earlier were already provisioned in full in 2012.

On 4 April 2014, District Court of Plungė, made the judgement in the litigation with regard to declaring invoices partially unjustified, which fully satisfied the claim of AS Merko Ehitus. On 5 May 2014, Vakaru appealed the court decision to Klaipėda District Court, which decided to return the case back to District Court of Plungė. On 22 of April 2015 the court took the decision to commission expert analysis to establish whether the disputed work had been performed or not. The judicial proceedings on the action are suspended until completion of the expert analysis. The court hearing regarding the litigation to declaring invoices partially unjustified took place on 10 November 2015, where the court decided to appoint another expert to analyse the new matters raised.

After rigorous negotiations between the parties, the Lithuanian branch of AS Merko Ehitus and BUAB Vakaru inžineriniai tinklai signed a settlement agreement, finalising all ongoing court cases and outstanding balances between the companies, on 17 June 2016. The court decision approving the conditions of the settlement agreement came into force on 12 July 2016. Due to AS Merko Ehitus having more unpaid invoices and other request to the counterparty than BUAB Vakaru inžineriniai tinklai, the parties agreed in the final payment by AS Merko Ehitus in the amount of EUR 49 thousand.

Vilniaus vandenys

On 18 May 2016, AS Merko Ehitus and UAB Merko Statyba, acting pursuant to the joint venture agreement, filed an action against UAB Vilniaus vandenys (hereinafter "Vilniaus vandenys") in the total amount of EUR 183 thousand, encompassing the acceptance of additional works and the compensation of direct expenses incurred, interest on unpaid sums and the extension of the contract term of the sewerage and wastewater pipeline project carried out in Avižieniai region (project "Extension of water supply and waste water networks in Avižieniai Subdistrict"). The plaintiffs maintain that due to the actions of Vilniaus vandenys, both the construction period became longer and also additional works were carried out – works that the customer later refused to pay for. The potential positive outcome of this claim is not recognised in the group's financial reporting. In the hearing on 2 February 2017 the plaintiffs asked the court to appoint a court expertise. The courts decision regarding appointment of the court expertise is to be expected latest by the end of March 2017.

Krokuvos

On 9 March 2016 State territorial planning and construction inspectorate under the Ministry of environment (hereinafter „the Inspectorate“) based on the complaint of the owners of the neighbouring land plot filed an action against UAB VPSP 1 and Administration of Vilnius city municipality regarding inadequate distance of the building (Krokuvos 73 apartment building under construction) from the neighbouring land plot (from 1 m to 3 m). The validity of the construction permit and the construction works have not been stopped. On 30 August 2016 the Inspectorate, Administration of Vilnius city municipality and UAB VPSP 1 signed a peace agreement according to which the Inspectorate recognised that there is no breach and all construction works are performed according to the valid legal acts. On 28 October 2016 the court took decision to approve the signed peace agreement. On 4 November 2016, owners of the neighbouring immovable filed an appeal against the verdict, to which UAB VPSP 1 submitted its explanations on 23 November 2016. The owners of the neighbouring immovable consequently withdrew their complaint. On 7 December 2016, the court approved the settlement and the case was dismissed.

VALUE OF ASSETS

Although the economic environment has attained certain stability, the effect of the real estate market risk was material for assessing the company's activities. In 2016, the group recognised EUR 543 thousand (2015: EUR 1,178 thousand) in impairment losses on assets and inventories, incl. impairment loss of EUR 37 thousand (2015: EUR 570 thousand) on finished goods and EUR 0 thousand (2015: EUR 488 thousand) on developments under properties acquired for sale, EUR 389 thousand (2015: EUR 89 thousand) on goodwill impairment under intangible assets, EUR 108 thousand (2015: EUR 31 thousand) on the write-off of doubtful and irrecoverable receivables and EUR 9 thousand loss from write-off of prepayments to suppliers (2015: EUR 0 thousand). In 2016 and 2015, no prior period impairment losses on inventories were reversed. In 2016, receivables expensed in prior periods of EUR 3 thousand were collected (2015: EUR 2 thousand). Notes 15, 17 and 24.

NOTE 36 SUPPLEMENTARY DISCLOSURES ON THE PARENT COMPANY

The financial information of the parent comprises separate primary statements of the parent (income statement, statement of financial position, 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 have been prepared using the same accounting methods and measurement bases as those used 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.

INCOME STATEMENT

in thousands of euros

	2016	2015
Revenue	14,262	13,691
Cost of goods sold	(12,505)	(12,986)
Gross profit	1,757	705
Marketing expenses	(86)	(236)
General and administrative expenses	(1,609)	(1,705)
Other operating income	506	640
Other operating expenses	(673)	(141)
Operating profit (loss)	(105)	(737)
Finance costs	(215)	(113)
Finance income from investments in subsidiaries	9,027	5,076
Profit before tax	8,707	4,226
Deferred income tax expense	-	(18)
Net profit for the year	8,707	4,208

STATEMENT OF FINANCIAL POSITION

in thousands of euros

	31.12.2016	31.12.2015
ASSETS		
Current assets		
Cash and cash equivalents	1,434	9,742
Receivables and prepayments	3,719	7,747
Inventories	36,080	16,379
	41,233	33,868
Non-current assets		
Investments in subsidiaries	131,382	123,375
Investments in joint ventures	764	764
Other long-term financial assets	6,149	2,096
Investment property	18	18
Property, plant and equipment	80	155
Intangible assets	88	38
	138,481	126,446
TOTAL ASSETS	179,714	160,314
LIABILITIES		
Current liabilities		
Borrowings	16,652	1,332
Trade and other payables	13,781	8,560
Short-term provisions	1,176	513
	31,609	10,405
Non-current liabilities		
Long-term borrowings	6,024	7,071
Other long-term trade payables	-	437
	6,024	7,508
TOTAL LIABILITIES	37,633	17,913
EQUITY		
Share capital	7,929	7,929
Statutory reserve capital	793	1,200
Retained earnings	133,359	133,272
TOTAL EQUITY	142,081	142,401
TOTAL LIABILITIES AND EQUITY	179,714	160,314

STATEMENT OF CHANGES IN EQUITY

in thousands of euros

Parent	Share capital	Statutory reserve capital	Retained earnings	Total
Balance as at 31.12.2014	12,000	1,200	136,321	149,521
Net profit for financial year	-	-	4,208	4,208
Share capital reduction	(4,071)	-	-	(4,071)
Dividends	-	-	(7,257)	(7,257)
Balance as at 31.12.2015	7,929	1,200	133,272	142,401
Carrying amount of holdings under control or significant influence				(124,139)
Value of holdings under control or significant influence under the equity method				107,436
Adjusted unconsolidated equity 31.12.2015				125,698
Net profit for financial year	-	-	8,707	8,707
Reserve capital reduction	-	(407)	407	-
Dividends	-	-	(9,027)	(9,027)
Balance as at 31.12.2016	7,929	793	133,359	142,081
Carrying amount of holdings under control or significant influence				(132,146)
Value of holdings under control or significant influence under the equity method				112,855
Adjusted unconsolidated equity 31.12.2016				122,790

Adjusted unconsolidated equity is used as the basis for verifying compliance with equity requirements set forth in the Commercial Code.


CASH FLOW STATEMENT

in thousands of euros

	2016	2015
Cash flows from operating activities		
Operating profit (loss)	(105)	(737)
Adjustments:		
Depreciation and impairment charge	53	65
Profit/(loss) from sale of non-current assets	(1)	(4)
Adjustment of revenue from construction contracts under stage of completion method	2	(716)
Interest income from business activities	(497)	(636)
Change in provisions	625	345
Change in trade and other receivables related to operating activities	296	3,088
Change in inventories	(19,683)	(6,251)
Change in trade and other payables related to operating activities	4,971	(1,662)
Interest received	175	767
Interest paid	(416)	(216)
Corporate income tax (paid)/reclaimed	-	(18)
Total cash flows from operating activities	(14,580)	(5,975)
Cash flows from investing activities		
Acquisition of subsidiaries	(502)	-
Investments in subsidiaries	(9,110)	(5,688)
Reduction of equity in subsidiary	1,605	14,208
Increase of equity in joint venture	-	(355)
Purchase of property, plant and equipment	(3)	(2)
Proceeds from sale of property, plant and equipment	6	4
Purchase of intangible assets	(51)	(38)
Interest received	43	90
Dividends received	9,027	5,076
Total cash flows from investing activities	1,015	13,295
Cash flows from financing activities		
Proceeds from borrowings	22,035	8,007
Loan repayments received	(7,712)	(8,152)
Finance lease principal payments	(30)	(28)
Share capital reduction	-	(4,071)
Dividends paid	(9,027)	(7,257)
Total cash flows from financing activities	5,266	(11,501)
Net increase/decrease in cash and cash equivalents	(8,299)	(4,181)
Cash and cash equivalents in the beginning of period	9,742	13,923
Effect of exchange rate changes	(9)	-
Cash and cash equivalents at end of the period	1,434	9,742


SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2016 ANNUAL REPORT

The Management Board of AS Merko Ehitus has prepared the management report, the consolidated financial statements and the profit allocation proposal for 2016.

Andres Trink	Chairman of the Management board		28.03.2017
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Tõnu Toomik	Member of the Management Board		28.03.2017
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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		31.03.2017
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Teet Roopalu	Member of the Supervisory Board		31.03.2017
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Indrek Neivelt	Member of the Supervisory Board		31.03.2017
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Olari Taal	Member of the Supervisory Board		31.03.2017
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Independent auditor's report

To the Shareholders of AS Merko Ehitus

(Translation of the Estonian original) *

Our opinion

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

What we have audited

The Group's consolidated financial statements comprise:

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

Basis for opinion

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

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

Independence

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

Our audit approach

Overview



Materiality

Overall group materiality is EUR 2.5 million, which represents approximately 1% of total revenue.

Audit scope

A full scope audit was performed by us or, under our instructions, by PwC network firms or other auditors for Group entities covering 95% of the Group's revenues and 98% of the Group's assets. Selected audit procedures were performed on remaining balances to ensure we obtained sufficient appropriate audit evidence to express an opinion on the Group's financial statements as a whole.

Key audit matters

- Revenue recognition on construction contracts
- Valuation of inventory relating to property developments

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

Materiality

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

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

Overall group materiality	EUR 2.5 million
How we determined it	1% of total revenues
Rationale for the materiality benchmark applied	We have used revenue rather than profit as a basis of our materiality calculation, because revenue is a more stable benchmark that is used both internally by management as well as, we believe, externally by shareholders in evaluating the performance of the Group. The profit of the Group has fluctuated significantly in recent years, depending on the cycle of the construction and real estate market and on the timing of sales of large development projects.



Key audit matters

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

Key audit matters	How our audit addressed the key audit matters
<p>Revenue recognition on construction contracts (refer to Note 1 ‘Summary of significant accounting policies – subsections 1.20 ‘Revenue’ and 1.21 ‘Unfinished construction contracts’, and Note 3 ‘Operating Segments’ for further details).</p> <p>In 2016 the Group has recognised revenue of EUR 252.0 million, EUR 173.2 million of which is related to construction services.</p> <p>The Group’s revenues from construction services are generated from a large portfolio of contracts with different terms regarding service fee, use of subcontractors or partners and profit sharing. Revenue from construction contracts is recorded by reference to the stage of completion of contract. The stage of completion method requires the management to estimate the cost to complete the contract, as well as any possible adjustments to the contractual fee, at each measurement date.</p> <p>Accounting estimates have subjective nature and rely on many sources of information, both within the Group and external, about the expected outcome of a contract. The complexity resulting from both the large number of varying contractual terms and estimation uncertainties regarding the expected outcome of construction contracts could lead to errors that may become material, when aggregated.</p> <p>As such, revenue recognition on construction contracts requires significant time and resource to audit due to both its magnitude and complexity, and is therefore considered to be a key audit matter.</p>	<p>We audited revenue recognition on construction contracts through a combination of controls testing and substantive testing.</p> <p>We performed testing of the design, implementation and operating effectiveness of manual controls supporting identification of contractual terms, selection of suitable accounting policies and assessment of the stage of completion. We did not identify any exceptions that impacted our audit approach.</p> <p>The controls testing was supported by substantive audit procedures. We selected a sample of contracts and performed substantive procedures that included, but were not limited to:</p> <ul style="list-style-type: none">• reconciling the contract fee used in calculating the revenue based on the stage of completion to the contract;• reconciling incurred contract costs included in revenue calculation to accounting records and testing the proper allocation of costs to individual contracts;• testing correct periodisation of contract costs;• checking the formula used for calculation of revenue based on stage of completion;• investigating the estimates of margins during current and comparative periods applied for revenue calculation of the same contracts to identify potential management bias. <p>We evaluated the correctness of disclosures in relation to the construction contracts.</p> <p>As a result of our work, we found no material exceptions.</p>

Valuation of inventory relating to property developments (refer to Note 1 'Summary of significant accounting policies – subsection 1.11 'Inventories', Note 17 'Inventories' and Note 35 'Risk management' subsection 'value of assets' for further details).

As at 31 December 2016 the Group's balance sheet includes inventory in the amount of EUR 123.4 million, of which EUR 18.9 million were finished apartments, EUR 39.5 million unfinished apartments and EUR 63.2 million land purchased for development and resale (mostly with the aim of being developed as residential property).

Inventories are carried at the lower of cost and net realisable value.

With property prices, especially those of residential property, following the economic cycle and exhibiting substantial fluctuation over time, net realisable value of the inventory of finished and unfinished apartments and property for resale needs to be carefully monitored against the carrying amount. Should the net realisable value of a property fall below its carrying amount, a write-down to net realisable value is necessary. Determining the net realisable value of property requires estimates of the expected selling price and may require estimates of the cost to complete the development of the property.

Due to the magnitude and related estimation uncertainty, valuation of inventory of finished and unfinished apartments and land to be developed for sale is considered a key audit matter.

We assessed the management's expertise to perform valuation of property. The management is experienced in property valuation and the outcomes of completed development projects have usually met the profitability estimates.

We evaluated the model prepared by the management for determining the net realisable value and identifying any necessary write-down. We validated that the valuation model is in accordance with IFRS requirements.

We performed testing of the inputs used in the valuation model. Our work targeted individual properties on our assessment of the risk, based on the location, carrying amount and any specific conditions related to a property. For inputs based on estimates, which include unit costs applicable for completing the construction and sales price, we assessed the reasonableness of the inputs by comparing them with historical data from completed projects and available market information such as construction price indexes. Where available, we compared the estimated sales prices with comparable market transactions.

It was evident from our work that sufficient attention had been paid to each property's individual characteristics including their construction quality, geographic location and relevant legal or contractual obligations.

We also read the disclosures provided in respect of net realisable value of inventory, including sensitivity analysis, and found them to comply with IFRS requirements.

We concluded that the assumptions used in the management's valuations were supportable in light of available property-specific and market evidence. As a result of our work, we noted no material exceptions.

How we tailored our audit scope

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

The Group comprises a number of subsidiaries that are further disclosed in Note 18. A full scope audit was performed by PwC Estonia or, under our instructions, by other PwC network firms for entities covering 94% of the Group's assets and 92% of the Group's revenues, and by an external independent audit firm covering 4% of the Group's assets and 3% of the Group's revenues. The remaining entities of the Group were immaterial, therefore we only performed selected audit procedures on these components relating to specified account balances or disclosures.



Where work was performed by component auditors from another PwC network firm or from an external independent audit firm, we determined the level of involvement we needed to have to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole. The nature, timing and extent of the work impacting the Group audit opinion is set and monitored in Estonia, with input from the teams outside Estonia at the risk assessment stage.

At the Group level we also audited the consolidation process. We also evaluated whether significant risk of material misstatement existed, using analytical procedures in relation to the aggregated financial information of the remaining entities not subject to audit or audit of specified account balances, including comparing their account balances to those present at the time of deciding the audit scope.

Other information

The Management Board is responsible for the other information contained in the Group's 2016 Consolidated Annual Report in addition to the consolidated financial statements and our auditor's report thereon.

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

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

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

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

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

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



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

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation



precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Ago Vilu', is written over a faint, light blue circular watermark or stamp.

Ago Vilu
Certified auditor in charge, Auditor's Certificate No 325

28 March 2017

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

PROFIT ALLOCATION PROPOSAL

In euros

Total retained earnings as at 31.12.2016	114,712,805
incl. net profit for 2016	6,121,804

The Management Board proposes profit allocation as follows:

Dividends (EUR 0.41 per share)	7,257,000
Retained earnings after profit allocation	107,455,805

Andres Trink

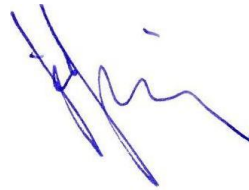
Chairman of the Management Board



28.03.2017

Tõnu Toomik

Member of the Management Board



28.03.2017

OTHER NOTES TO THE ANNUAL REPORT

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KEY FINANCIAL INDICATORS IN 2012-2016

CONSOLIDATED INCOME STATEMENT

in thousands of euros

	2016	2015	2014	2013	2012
Revenue	251,970	251,012	252,323	262,719	249,131
Cost of goods sold	(232,961)	(228,044)	(227,591)	(239,996)	(231,220)
Gross profit (loss)	19,009	22,968	24,732	22,723	17,911
<i>% of revenue</i>	7.5%	9.2%	9.8%	8.6%	7.2%
Marketing expenses	(3,281)	(3,230)	(3,190)	(3,041)	(2,107)
General and administrative expenses	(10,076)	(8,907)	(9,128)	(9,260)	(9,173)
Other operating income	2,466	1,943	1,901	2,264	2,961
Other operating expenses	(399)	(278)	(340)	(425)	(834)
Operating profit (loss)	7,719	12,496	13,975	12,261	8,758
<i>% of revenue</i>	3.1%	5.0%	5.5%	4.7%	3.5%
Finance income	46	120	143	84	184
Finance costs	(649)	(786)	(680)	(1,062)	(1,203)
Profit (loss) from associates and joint ventures	163	(138)	(130)	(138)	163
Profit (loss) before tax	7,279	11,692	13,308	11,145	7,902
<i>% of revenue</i>	2.9%	4.7%	5.3%	4.2%	3.2%
Corporate income tax expense	(1,275)	(1,857)	(1,055)	(791)	(289)
Net profit (loss) for the financial year	6,004	9,835	12,253	10,354	7,613
incl. attributable to equity holders of the parent	6,122	10,000	12,417	10,399	7,627
<i>% of revenue</i>	2.4%	4.0%	4.9%	4.0%	3.1%
Attributable to non-controlling interests	(118)	(165)	(164)	(45)	(14)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

in thousands of euros

	31.12.2016	31.12.2015	31.12.2014	31.12.2013	31.12.2012
ASSETS					
Current assets					
Cash and cash equivalents	33,544	39,905	51,583	46,633	35,316
Short-term deposits	-	-	-	-	-
Trade and other receivable	45,566	24,854	46,382	57,172	60,343
Prepaid corporate income tax	617	421	3	19	478
Inventories	123,364	109,090	117,638	87,451	82,830
	203,091	174,270	215,606	191,275	178,967
Non-current assets					
Investments in joint ventures	434	284	67	7,349	7,190
Other long-term loans and receivables	15,371	16,419	11,409	20,066	17,188
Deferred income tax assets	1,325	1,423	1,535	1,592	1,919
Investment property	4,108	4,371	4,619	4,672	3,566
Property, plant and equipment	12,838	13,442	15,003	13,117	14,853
Intangible assets	673	879	1,011	1,167	1,365
	34,749	36,818	33,644	47,963	46,081
TOTAL ASSETS	237,840	211,088	249,250	239,238	225,048
LIABILITIES					
Current liabilities					
Borrowings	21,485	5,525	14,287	18,916	16,299
Payables and prepayments	56,259	43,266	71,122	72,162	63,209
Corporate income tax liability	278	711	352	62	-
Short-term provisions	5,637	5,013	6,239	5,906	6,165
	83,659	54,515	92,000	97,046	85,673
Non-current liabilities					
Long-term borrowings	24,516	25,660	23,359	16,469	19,205
Deferred income tax liability	1,122	788	738	505	327
Other long-term payables	2,061	1,159	1,671	2,162	1,576
	27,699	27,607	25,768	19,136	21,108
TOTAL LIABILITIES	111,358	82,122	117,768	116,182	106,781
EQUITY					
Non-controlling interests	3,692	3,268	4,455	1,193	1,342
Equity attributable to equity holders of the parent					
Share capital	7,929	7,929	12,000	12,000	12,000
Statutory reserve capital	793	1,200	1,200	1,200	1,200
Currency translation differences	(645)	(663)	(665)	(669)	(512)
Retained earnings	114,713	117,232	114,492	109,332	104,237
	122,790	125,698	127,027	121,863	116,925
TOTAL EQUITY	126,482	128,966	131,482	123,056	118,267
TOTAL LIABILITIES AND EQUITY	237,840	211,088	249,250	239,238	225,048

OTHER KEY FIGURES

attributable to equity holders of the parent

		2016	2015	2014	2013	2012
EBITDA	million EUR	11.2	15.5	16.4	15.1	11.4
EBITDA margin	%	4.4	6.2	6.5	5.7	4.6
General expense ratio	%	5.3	4.8	4.9	4.7	4.5
Staff costs ratio	%	11.7	12.2	11.9	11.8	11.2
Revenue per employee	thousand EUR	325	322	319	308	278
ROE	%	5.0	8.0	10.1	8.8	6.8
ROA	%	2.8	4.4	5.0	4.4	3.4
ROIC	%	5.1	7.9	8.8	8.0	6.0
Equity ratio	%	51.6	59.5	51.0	50.9	52.0
Debt ratio	%	19.3	14.8	15.1	14.8	15.8
Current ratio	times	2.9	3.2	2.3	2.0	2.1
Quick ratio	times	1.1	1.2	1.1	1.1	1.1
Accounts receivable turnover	days	37	39	56	58	58
Accounts payable turnover	days	38	39	39	43	47
Number of employees 31.12	people	797	791	765	860	915
Average number of employees	people	776	779	790	853	895
Secured order book	million EUR	270	247	179	214	190
New contracts signed	million EUR	202	247	170	254	247

* As at 31 December 2016, in the formula for calculating the current ratio and the quick ratio, the amount of current liabilities has been reduced by EUR 12.5 million as a result of refinancing of the short-term loan received from the parent company AS Riverito at the end of 2016 with long-term bank loans at the beginning of 2017. Additional information has been disclosed in Note 33.

SHARE-RELATED KEY FIGURES

attributable to equity holders of the parent

		2016	2015	2014	2013	2012
Earnings per share (EPS)	EUR	0.35	0.56	0.70	0.59	0.43
Equity per share	EUR	6.90	7.02	6.93	6.71	6.34
Dividend per share	EUR	0.41*	0.51	0.41	0.41	0.30
Dividend rate	%	119*	90	58	70	70
Dividend yield	%	4.5*	6.0	5.7	5.7	5.1
P/E ratio	times	26.17	15.01	10.18	12.25	13.69
P/B ratio	times	1.31	1.21	1.03	1.07	0.93
Share price trend						
Average	EUR	8.44	8.47	7.33	6.96	6.04
Highest	EUR	9.22	10.50	7.99	7.70	7.30
Lowest	EUR	7.60	7.06	6.70	5.71	5.37
Share price 31.12	EUR	9.05	8.48	7.14	7.20	5.90
Market value 31.12	million EUR	160.2	150.1	126.4	127.4	104.40
Share turnover trend						
Share turnover	million EUR	5.35	7.71	7.62	5.08	5.47
Share turnover of shares outstanding	%	30.2	43.5	43.0	28.7	30.9
Transactions	pcs	2 312	2,829	1,699	2,183	1,662
Shares traded	million pcs	0.63	0.90	1.03	0.73	0.94
Number of shares	million EUR	17.70	17.70	17.70	17.70	17.70
Number of shareholders 31.12	pcs	1,813	1,624	1,423	1,425	1,406

* Pursuant to the Management Board's proposal regarding dividend payment.

DEFINITIONS OF RATIOS

Gross profit margin (%)	=	$\frac{\text{Gross profit}}{\text{Revenue}}$
Operating profit margin (%)	=	$\frac{\text{Operating profit}}{\text{Revenue}}$
EBT margin (%)	=	$\frac{\text{Earnings before tax}}{\text{Revenue}}$
Net profit margin (%)	=	$\frac{\text{Net profit (attributable to equity holders of the parent)}}{\text{Revenue}}$
Return on equity, ROE (%)	=	$\frac{\text{Net profit (attributable to equity holders of the parent) of the current 4 quarters}}{\text{Shareholders equity (average of the current 4 quarters)}}$
Return on assets, ROA (%)	=	$\frac{\text{Net profit (attributable to equity holders of the parent) of the current 4 quarters}}{\text{Total assets (average of the current 4 quarters)}}$
Return on invested capital, ROIC (%)	=	$\frac{\text{(Profit before tax + interest expense - foreign exchange gain (loss) + other financial income) of the current 4 quarters}}{\text{(Shareholders equity (average) + interest-bearing liabilities (average)) of the current 4 quarters}}$
Equity ratio (%)	=	$\frac{\text{Shareholders equity}}{\text{Total assets}}$
Debt ratio (%)	=	$\frac{\text{Interest-bearing liabilities}}{\text{Total assets}}$
Current ratio	=	$\frac{\text{Current assets}}{\text{Current liabilities}}$
Quick ratio	=	$\frac{\text{Current assets - inventories}}{\text{Current liabilities}}$
Accounts receivable turnover (days)	=	$\frac{\text{Trade receivables of the current 4 quarters (average)} \times 365}{\text{Revenue of the current 4 quarters}}$
Accounts payable turnover (days)	=	$\frac{\text{Payables to suppliers of the current 4 quarters (average)} \times 365}{\text{Cost of goods sold of the current 4 quarters}}$
EBITDA (million EUR)	=	Operating profit + depreciation
EBITDA margin (%)	=	$\frac{\text{Operating profit + depreciation}}{\text{Revenue}}$
General expense ratio (%)	=	$\frac{\text{Marketing expenses + General and administrative expenses}}{\text{Revenue}}$
Labour cost ratio (%)	=	$\frac{\text{Labour costs}}{\text{Revenue}}$
Revenue per employee (EUR)	=	$\frac{\text{Revenue}}{\text{Number of employees (average)}}$
Earnings per share, EPS (EUR)	=	$\frac{\text{Net profit (attributable to equity holders of the parent)}}{\text{Number of shares}}$
Equity/share (EUR)	=	$\frac{\text{Shareholders equity (average of the current 4 quarters)}}{\text{Number of shares}}$
Dividend per share (EUR)	=	$\frac{\text{Payable dividends}}{\text{Number of shares}}$
Dividend rate (%)	=	$\frac{\text{Payable dividends} \times 100}{\text{Net profit (attributable to equity holders of the parent)}}$
Dividend yield (%)	=	$\frac{\text{Dividends payable per share}}{\text{Share price 31.12}}$
P/E	=	$\frac{\text{Share price 31.12}}{\text{Earnings per share of the current 4 quarters}}$
P/B	=	$\frac{\text{Share price 31.12}}{\text{Equity per share (average of the current 4 quarters)}}$
Market capitalisation	=	Share price 31.12 x Number of shares
Injury rate	=	$\frac{\text{Total number of injuries/accidents excluding minor (first-aid level) injuries/accidents} \times 200\,000}{\text{Total number of working hours per year}}$
Occupational diseases rate	=	$\frac{\text{Total number of occupational illnesses} \times 200\,000}{\text{Total number of working hours per year}}$
Lost days rate	=	$\frac{\text{Total number of lost days due to occupational illnesses/injuries/accidents} \times 200\,000}{\text{Total number of working hours per year}}$
Absentee rate	=	$\frac{\text{Total number of absentee days}}{\text{Calculated number of total working days per year}}$

REVENUE BREAK-DOWN OF THE PARENT PRESENTED ACCORDING TO THE ESTONIAN CLASSIFICATIONS OF ECONOMIC ACTIVITIES

Revenue break-down of the parent of AS Merko Ehitus for the year 2016 is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), as required under the Commercial Code § 4 p.6:

in thousands of euros

EMTAK code		2016	2015
	Rendering of construction services		
4221	construction of utility projects for fluids	-	5,997
	Real estate activities		
6810	sales of own real estate	14,187	7,609
6820	renting and operating of own or leased real estate	75	85
		14,262	7,694
	Total revenue	14,262	13,691

SUSTAINABLE DEVELOPMENT REPORT

SUSTAINABILITY REPORTING PRINCIPLES

From 2017, the Annual Report of Merko Ehitus group is prepared based on the international integrated reporting framework and the Global Reporting Initiative (GRI) "G4 Sustainability Reporting Guidelines". The purpose of the Annual Report is to provide a clear overview and description of how Merko Ehitus creates additional value to its customers, shareholders and other stakeholders, while highlighting the key factors of the value chain process. The Annual Report no longer focuses on past events but is more focused, through integrated reporting, on the horizon. We aim at giving the reader a better overview of the strategy, long-term objectives and sustainability of AS Merko Ehitus group as a whole.

Key economic, social responsibility and environmental aspects have been presented by using the integrated reporting principle, in the different sections and notes to the annual report.

For the above reasons, Merko Ehitus no longer prepared a separate sustainability or social responsibility report. The last report on the above subjects was prepared for 2015. This section of the Annual Report provides a more detailed overview of the sustainability and social responsibility principles of Merko Ehitus group in accordance with the GRI G4 instructions. In preparing the report, Merko Ehitus has focused on the key subjects of the group companies, depending on the specifics of their business.

Further information on the internationally integrated reporting framework and GRI G4:

integratedreporting.org
www.globalreporting.org



STAKEHOLDERS

The Merko Ehitus Group has mapped its primary stakeholder groups: Merko Group employees, shareholders and investors, customers for construction service and apartment buyers, local government units and public organisations, cooperation partners, subcontractors and suppliers and the public. Stakeholders are mapped and selected based on the standpoint of both the company and the stakeholder, taking into account cooperation between the parties and the impact of the company on the stakeholder.

The primary principles for disclosure of information at Merko are continuity, neutrality, transparency, integrity and fairness and preventive approach. Various channels have taken shape for communicating with different stakeholders:

Employees	Everyday cooperation and communication with the company's colleagues and managers at various levels, annual performance reviews, company's website, Intranet and newsletter, company information days and other events, in-house trainings and social media.
Shareholders and investors	Stock market system and press releases, website section aimed at investors, investor meetings, materials and events.
Customers and apartment buyers	Everyday cooperation and communication in the course of the construction process, feedback from customers, company's website, public communication. Additional communication channels for apartment buyers: apartment development project website and sales materials, sales director and, in the case of some projects, sales office, customer days, model apartment, social media, satisfaction survey.
Partners in cooperation, subcontractors and suppliers	Everyday cooperation and communication in the course of the construction process, meetings and events, public communication.
Local governments and public organisations	Meetings, public communication.
Broader public	Social responsibility and support and cooperation projects, cooperation with different organisations, public communication, social media.

GRI CONTENT INDEX

General disclosures		Page
STRATEGY AND ANALYSIS		
G4-1	CEO's statement	p. 5
ORGANISATIONAL PROFILE		
G4-3	Name of the organisation	p. 2
G4-4	Products, services and trademarks	p. 4
G4-5	Location of organisation's headquarters	p. 2
G4-6	Number of countries and location of operations	p. 4, 81-83, 89-93
G4-7	Nature of ownership and legal form	p. 4, 56-65
G4-8	Markets served	p. 4, 13, 20-23, 50-52, 81-83
G4-9	Scale of reporting organisation	p. 4, 39-42, 50-52, 81-82
G4-10	Basic information on employees	p. 39
G4-11	Percentage of employees covered by collective bargaining agreements	Merko Ehitus group doesn't have the general collective bargaining agreements, it complies with company-specific agreements in line with local legislation.
G4-12	Supply chain description	Merko Ehitus group companies use suppliers and subcontractors extensively in its operations in all of the countries it operates in. The materials used in construction come from an extensive network of suppliers located mainly in Europe, particularly in the group's current operating countries. Merko Ehitus group companies mainly act as general contractors hence the large extent of the workforce used in construction, with the exception of project management, comes from the subcontractor network. Subcontractors and their workforce are largely from the group's operating countries.
G4-13	Significant changes during the reporting period	p. 14-16, 50-52, 56-57, 89-94
G4-14	Addressing the precautionary approach in environmental issues	p. 37-38, 43-44
G4-15	Voluntary charters and other initiatives	No significant commitments to voluntary charters and other initiatives.
G4-16	Memberships in associations	Merko Ehitus group companies are members in the following associations and organisations: Estonian Chamber of Commerce and Industry Estonian Association of Construction Entrepreneurs Estonian Waterworks Association Estonia Concrete Association Estonian Association of Electrical Enterprises Estonian Society for Electrical Power Engineering Estonian Asphalt Pavement Association Latvian Chamber of Commerce and Industry Latvian Partnership of Building Contractors Latvian National Real Estate Developers Alliance Skanste Development Agency Lithuanian Builders Association

MATERIAL ASPECTS AND BOUNDARIES																																						
G4-17	Coverage of the report		The report covers all of the Merko Ehitus group's functions, unless otherwise mentioned.																																			
STAKEHOLDER ENGAGEMENT																																						
G4-24	List of stakeholders	p. 135																																				
G4-25	Identification and selection of stakeholders	p. 135																																				
G4-26	Approach to stakeholder engagement	p. 135																																				
REPORT PROFILE																																						
G4-28	Reporting period	p. 2	The reporting period is the calendar year, January 1, 2016 – December 31, 2016																																			
G4-29	Date of most recent previous report		The most recent previous annual report was published on April 05, 2016 and social responsibility report in May 2016.																																			
G4-30	Reporting cycle		The report is published annually.																																			
G4-31	Contact point	p. 2	Signe Kukin, Group CFO																																			
G4-32	GRI Content Index	p. 136-139																																				
G4-33	External assurance		The GRI report has not been assured by a third party.																																			
GOVERNANCE																																						
G4-34	Governance structure	p. 56-62																																				
ETHICS AND INTEGRITY																																						
G4-56	Organisation's values, principles, standards, norms of behaviour and codes of ethics	p. 8, 42-43	In addition to Merko Ehitus values, mission and vision, our operations are guided by management and business principles. These are included in the orientation of new personnel and also highlighted in various events and materials for personnel.																																			
ECONOMIC RESPONSIBILITY																																						
Economic Performance																																						
G4-DMA	Management approach		Merko Ehitus group operations have an important economic impact on the surrounding society and the company's key stakeholders. Group employs a significant number of personnel and creates business for suppliers and subcontractors. Merko Ehitus business operations are long-term in nature, which is also reflected in the group's co-operation with stakeholders where possible, and stakeholders' economic stability.																																			
G4-EC1	Direct economic value generated and distributed		<p>Direct economic value generated and distributed for stakeholders 2016 (2015)</p> <table border="1"> <thead> <tr> <th></th> <th>Suppliers</th> <th>Employees</th> </tr> </thead> <tbody> <tr> <td rowspan="2">Customers Revenue EUR 252 million (251.0)</td> <td>Materials and goods, EUR 49.1 million (44.5)</td> <td>797 employees (791)</td> </tr> <tr> <td>External services EUR 145.1 million (143.0)</td> <td>Labour costs EUR 29.6 million (30.6)</td> </tr> <tr> <td></td> <th>Investors</th> <th>Public sector</th> </tr> <tr> <td></td> <td>Dividends EUR 9.0 million (7.3)</td> <td>Corporate income tax expense EUR 1.3 million (1.9)</td> </tr> <tr> <td></td> <td>Share capital reduction EUR 4.0 million in 2015</td> <td></td> </tr> </tbody> </table> <p>Merko Ehitus group approach to taxes Group is committed to being a responsible taxpayer in all of its operating countries. It complies with local and international tax regulations, practices and interpretations, as well as requirements concerning tax returns and other documentation. Merko Ehitus group applies the market price principle pursuant to the OECD Transfer Pricing Guidelines and local transfer pricing regulations in the Group's internal business transactions.</p> <p>PAID* TAXES BY COUNTRIES in thousands of euros</p> <table border="1"> <thead> <tr> <th></th> <th>2016</th> <th>2015</th> </tr> </thead> <tbody> <tr> <td>Estonia</td> <td>18,936</td> <td>17,766</td> </tr> <tr> <td>Norway</td> <td>632</td> <td>-</td> </tr> <tr> <td>Latvia</td> <td>2,976</td> <td>5,436</td> </tr> <tr> <td>Lithuania</td> <td>1,138</td> <td>166</td> </tr> <tr> <td>Total</td> <td>23,682</td> <td>23,368</td> </tr> </tbody> </table> <p>* Actually paid and not calculated tax mounts.</p>		Suppliers	Employees	Customers Revenue EUR 252 million (251.0)	Materials and goods, EUR 49.1 million (44.5)	797 employees (791)	External services EUR 145.1 million (143.0)	Labour costs EUR 29.6 million (30.6)		Investors	Public sector		Dividends EUR 9.0 million (7.3)	Corporate income tax expense EUR 1.3 million (1.9)		Share capital reduction EUR 4.0 million in 2015			2016	2015	Estonia	18,936	17,766	Norway	632	-	Latvia	2,976	5,436	Lithuania	1,138	166	Total	23,682	23,368
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PAID* TAXES BY TAX TYPES

in thousands of euros

	2016	2015
Corporate income tax	1,428	1,483
Value added tax	8,463	7,760
Taxes on employee wages and fringe benefits	12,893	13,141
Other taxes	898	984
Total	23,682	23,368

* Actually paid and not calculated tax mounts.

Market presence			
G4-EC6	Proportion of management hired from the local community at significant locations of operation	p. 58-62	
Indirect economic impacts			
G4-EC7	Infrastructure investments and services	p. 25, 45	
G4-EC8	Significant indirect economic impacts	p. 25, 27, 45	
Procurement practices			
G4-EC9	Proportion of spending on local suppliers at significant locations of operation	p. 4, 83	The materials and services used in construction are generally from the local market or supplied from within the EU.
ENVIRONMENTAL RESPONSIBILITY			
Materials			
G4-DMA	Management approach		Operations in the construction business involve substantial use of construction materials. As such, the efficiency of the use of construction materials is also a significant cost issue that is given a lot of attention from that perspective in particular. Every construction project is unique, which makes it difficult to develop an unambiguous measure of material efficiency that would accurately reflect its true level. For this reason, material efficiency is monitored and managed on a project-specific basis. In addition to project-specific analysis, Merko Ehitus engages in more general development of design management and technical calculation practices from the perspective of material efficiency, focusing on aspects such as the optimisation of building structures and the selection of materials.
Energy			
G4-DMA	Management approach		Construction industry is not particularly energy-intensive. Due to the project-intensive nature of Merko Ehitus group business, energy consumption can vary significantly from one period to the next. The company focuses on the energy-efficiency of its own operations particularly at the project and unit level by developing various energy-efficient working methods and replacing its vehicles and equipment as energy efficiency improves.
G4-EN3	Energy consumption within the organisation	p. 38, 43-44	AS Merko Ehitus Group companies have been awarded environmental management system certificate ISO 14001. In addition, pursuant to EED 2012/27/EU, large companies have the obligation to regularly conduct an energy audit. In the Republic of Estonia, this obligation is governed by the Energy Sector Organisation Act, which entered into force in 2016.
G4-EN4	Energy consumption outside of the organisation	p. 44	
Waste			
G4-DMA	Management approach		Significant amounts of waste are generated in the construction business. A particularly large volume of waste is generated when a construction site has existing buildings that are demolished to make way for new construction. Like materials and energy, the reutilisation of waste, reducing waste volume and recycling waste are cost-efficiency issues for Merko Ehitus group, and as such

they are managed and developed on a project-specific and unit-specific basis. As a rule, Merko Ehitus group's construction sites sort the construction waste they generate and focus is placed on reducing the volume of waste. Waste that can be reutilised as material is reused depending on the local availability of reuse methods.

Compliance		
G4-DMA	Management approach	The risk of significant environmental damage is quite small in group's business operations, although local damage may be significant in cases such as fuel leaks. Merko's construction sites have established practices for avoiding and managing such risks. In addition to the prevention of actual environmental damage, Merko Ehitus group companies take also special protection measures in its construction projects to avoid negative impacts from construction on endangered species, for example. The assessment is very project-specific in these situations.
G4-EN29	Significant fines and sanctions for non-compliance with environmental regulations	No significant fines and sanctions for non-compliance with environmental regulations during the period.
SOCIAL RESPONSIBILITY		
LABOUR PRACTICES AND DECENT WORK		
Employment		
G4-LA1	Total number and rates new employee hires and employee turnover	p. 39
G4-LA2	Benefits provided to full time employees	p. 42
Occupational Health and Safety		
G4-DMA	Management approach	Occupational health and safety is one of the key responsibility aspects related to Merko Ehitus group's personnel, and it also creates the foundation for an employment relationship that is good in other respects as well. As the risk of occupational accidents is always present in construction business, the group places significant focus on the development of occupational safety. Over a period of several years, the company has created a very systematic approach to ensure occupational safety in particular, including personnel training, the development of operating methods, management engagement, as well as continuous reporting and monitoring.
G4-LA6	Rates of injury, fatalities and absenteeism	p. 40-41
G4-CRE6	Coverage of internationally recognised health and safety management system	p. 38, 40-41
		The international health and safety certificate OHSAS 18001 covered 71% of Merko Ehitus group's employees both in 2016 and 2015.
Training and Education		
G4-DMA	Management approach	One of the material factors in the value creation in Merko Ehitus business operations is personnel competence and its development. Regular and high-quality performance and development discussions create a strong foundation for competence development at the group. They are used to monitor the development of personnel and provide encouragement at the individual level. The response to competence development needs includes coaching programmes aimed at all personnel groups, training, seminars and other development methods.
G4-LA10	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings	p. 41-42
G4-LA11	Employees receiving regular performance and	p. 40

career
development
reviews

Labour practices		
Grievance Mechanisms		
G4-LA16	Number of grievances about labour practices filed, addressed, and resolved through	p. 39-40
SOCIETY		
Local Communities		
G4-S01	Percentage of operations with implemented local community engagement, impact assessments, and development programs	p. 10-11, 44-47, 135
G4-S02	Operations with significant actual and potential negative impacts on local communities	p. 44-47, 135
Anti-corruption		
G4-DMA	Management approach	Due to construction industry the group must pay attention to the prevention of corruption in its business operations. Merko Code of Ethics is complied with throughout the group companies, and there is a general communication channel for anonymously reporting suspicions of illegal activity in the various languages spoken in group's operating countries. Group does not tolerate any form of corruption. Group's core values include ethical business practices, which is an important success factor in the long run.
G4-S04	Communication and training on anti-corruption policies and procedures	p. 42-43 Merko continuously provides training and orientation to its personnel on the prevention of corruption and other illegal operating practices. The content and scope of the training depends partly on the role of the persons concerned.
G4-S05	Confirmed incidents of corruption and actions taken	There were no confirmed incidents of corruption in 2016. In addition to the prevention of corruption, Merko Ehitus group has a principle of investigating all suspected cases of misconduct and deciding on further action based on the results of the investigation.
Political contributions		
G4-S06	Contributions to political parties and related institutions	Merko Ehitus group does not support any politicians, political parties or other political institutions.
PRODUCT RESPONSIBILITY		
Customer satisfaction		
G4-PR5	Results of surveys measuring customer satisfaction	p. 32