

# ***AS TALLINNA VESI***

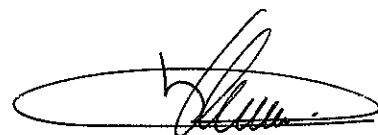
*Annual report  
for the financial year ended  
31 December 2007*

# AS TALLINNA VESI

## ANNUAL REPORT

---

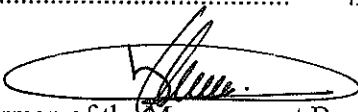
Beginning of the financial year	1 January 2007
End of the financial year	31 December 2007
Name of the Company	AS TALLINNA VESI
Legal form of the Company	Public limited company
Commercial register number	10257326
Address	Ädala St.10, Tallinn, Estonia
Chairman of the Board	Roch Jean Guy Antoine Chéroux
Telephone	+ 372 6 262 202
Fax	+372 6 262 300
E-mail	tvesi@tvesi.ee
Web-page	www.tallinnavesi.ee
Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditors	AS Deloitte Audit Eesti
Documents attached to the Annual Report	Independent auditor's report



Chairman of the Management Board:

**TABLE OF CONTENTS**

	Pg.
<b>MANAGEMENT REPORT</b> .....	3
CHAIRMAN'S STATEMENT.....	3
RESULTS OF OPERATIONS - FOR THE YEAR 2007.....	6
CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RECOMMENDATIONS REPORT.....	12
 <b>ANNUAL ACCOUNTS</b>	
DECLARATION OF MANAGEMENT .....	15
BALANCE SHEETS.....	16
INCOME STATEMENTS.....	17
CASH FLOW STATEMENTS.....	18
STATEMENTS OF CHANGES IN EQUITY.....	19
 <b>NOTES TO THE ANNUAL ACCOUNTS</b>	
NOTE 1. ACCOUNTING PRINCIPLES.....	20
NOTE 2. CASH AND CASH EQUIVALENTS.....	26
NOTE 3. CUSTOMER RECEIVABLES.....	26
NOTE 4. ACCRUED INCOME AND PREPAID EXPENSES.....	26
NOTE 5. INVENTORIES.....	26
NOTE 6. ASSETS FOR SALE.....	26
NOTE 7. TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS.....	27
NOTE 8. SHORT-TERM AND LONG-TERM BORROWINGS.....	28
NOTE 9. TRADE AND OTHER PAYABLES.....	29
NOTE 10. TAXES PAYABLE.....	29
NOTE 11. SHORT-TERM PROVISIONS.....	30
NOTE 12. DEFERRED INCOME.....	30
NOTE 13. SHARE CAPITAL .....	30
NOTE 14. NET SALES.....	31
NOTE 15. PERSONNEL EXPENSES.....	31
NOTE 16. COST OF GOODS SOLD, MARKETING AND GENERAL ADMINISTRATIONS EXPENSES.....	32
NOTE 17. FINANCIAL INCOME AND EXPENSES.....	33
NOTE 18. DIVIDENDS.....	33
NOTE 19. EARNINGS AND DIVIDENDS PER SHARE.....	33
NOTE 20. NOTES TO THE CASH FLOW STATEMENT.....	34
NOTE 21. COMMITMENTS.....	35
NOTE 22. CONTINGENT INCOME TAX ON DIVIDENDS.....	36
NOTE 23. COLLATERAL OF LOANS AND PLEDGED ASSETS.....	36
NOTE 24. RELATED PARTIES.....	37
NOTE 25. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS	38
 <b>CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS</b>	41
<b>INDEPENDENT AUDITORS' REPORT</b> .....	42

  
 Chairman of the Management Board:

**MANAGEMENT REPORT**

---

**CHAIRMAN'S STATEMENT**

In 2007, Tallinna Vesi made steady progress on its route towards its strategic objectives and delivered good results. Customer service has improved as clearly demonstrated by the results of the independent satisfaction survey, operational efficiency has improved with the achievement of our best ever water and treated effluent quality, the Company has launched a new activity demonstrating its will to grow, and finally a solid set of financial results, with growth in turnover and profit.

**Customer Service Excellence**

Providing our Customers with excellent service is a prime objective for the Company. We are pleased that the customer satisfaction survey independently carried out by TNS Emor at the end of 2007 demonstrated a significant improvement regarding customer relationships. The index indicating customer satisfaction has increased from 73 to 79 on a scale of 100, this places the company in the top 10% of world utility companies.

A lot has been done to achieve this improvement. Beside the educational message continuously circulated across the Company about the need for customer focus, we have developed and implemented some additional tools and restructured our organization. Following the new Customer Management System that went live in 2006, we developed in early 2007 a web based interface, giving our clients more possibilities to easily manage their accounts. This interface, along with new billing functionalities (direct debit, e-invoice) has had tremendous success.

The internal organization has also been reviewed. Looking at our activities from a customer point of view, client related processes have been analysed and the customer and network management activities have been reorganized to better support these processes and deliver better customer service.

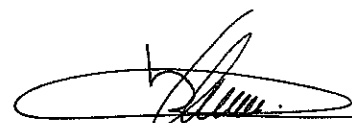
Being an environmental company and dealing with a product that impacts the life of one third of the Estonian population every day, we have a very special responsibility towards our clients, the Community and the Environment. Besides focusing on the quality of product and the quality of service, we have further engaged with the Community, supporting social and educational projects. We have this year completed 'Randur Tilk' a computer based educational game about water. This game will be distributed to all schools in Estonia with the aim to raise the environmental awareness of the younger generation.

**Operational Excellence**

The team greatly improved the quality and efficiency of operation and can be credited with several real successes.

The water quality delivered to our customers was the highest ever achieved. We know that this is one of the most important factors for the satisfaction of our clients. Each day, throughout the process: from catchment area to water network operation via water treatment plant in a joint effort the teams are looking for every possible way to improve the water quality even further.

The quality of the treated effluent was also the highest ever achieved. The large investments carried out during the last years in the wastewater treatment plant (particularly to treat nitrogen pollution and to improve sludge processing) coupled with the highly professional skills of the team enable us to treat the pollution of the Capital city and its surrounding municipalities to a level that is fully compliant with EU standards.



Chairman of the Management Board:

**MANAGEMENT REPORT**

---

Health and Safety of our people is of paramount importance for us. In 2007, international occupational health and safety management system (OHSAS) certificate was awarded to the Company after a successful audit in May. This is great recognition for the work that has been done to improve the working conditions of our staff, but we are even more proud of the fact that in 2007 there were simply no work accidents.

Being able to improve our operation efficiency results from a combination of two factors: the commitment of our people and the large investment programme that we have carried out in 2007 and during the previous years. In 2007 we have continued to invest heavily (285 mln kroons) on water quality, with improvements made in the catchment area, the water treatment plant and continuous renewal of our distribution network. We have also invested in wastewater treatment with the completion of the nitrogen treatment project. This project received the final approval of the Ministry of Environment and together with the completion of the sludge treatment plant we are able to keep under control the quality of the treated effluent.

These investments give us the possibility to improve our operational efficiency and the quality of our product, and in addition they also help us to reduce our environmental impact. This is apparent in the high quality and fully compliant treated effluent discharged to Tallinn Bay, full reuse of sludge as soil conditioner and better use of the water resource with control of the amount of water lost in leakages. Taking care of the environment is something that we have included in our actions and will continue to do in the future.

**Growing the activity of the Company**

One of our ambitions is to grow the activity of the Company by focussing on our core competences and developing our core business: management of water and wastewater assets. In 2007 we have launched the trademark 'Veemees' (Waterman). This activity is very closely linked to our core activity. Veemees is operating on the private side of the connection and proposes to our clients to take care of their plumbing problems, small pipe construction works inside their plots and houses. The volume of activity remained modest in 2007 but we expect it to grow because it corresponds to a real demand from clients.

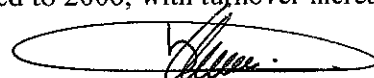
Our work to bring public water and sewerage network to the citizens of Tallinn has continued in 2007, and we have laid down another 14.9 km of pipe. We have also continued to extend the stormwater network by an additional 10.4 km. This construction activity will improve the service to customers, enlarge our area of activity but also improve the protection of the environment.

Our cooperation with the municipalities surrounding Tallinn is an important component of our development activity. With spare capacity at our plants, we can provide the surrounding municipalities with a large quantity of good quality, EU compliant water and we can collect their effluent and treat it to EU standards. Physical connections have been built between our network and the territories of the municipalities, we are already providing water and receiving wastewater and we are ready to accompany the surrounding municipalities in their development during the following years.

**Delivering Shareholder Value**

An important milestone was delivered in 2007 with the signing of the amendment to the Services Agreement which sets the rights and obligation of the Company and the City of Tallinn. The amendments shall significantly accelerate the construction of the sewerage network and ensure its provision for the City by March 2011 (currently 97% of the City is covered with sewerage network). The amendment to the Agreement places the responsibility for the delivery of the programme on the Company. This amendment ensures an excellent visibility for the revenue of the company until 2020, extended term of the agreement, and sustainability of the profitability level as the K-coefficient is fixed until the end of the contract period.

The financial results of 2007 have been good, in steady progress compared to 2006, with turnover increased by 18.4% and profit before tax increased by 12.9%.



Chairman of the Management Board:

**MANAGEMENT REPORT**

---

In terms of revenue, the volumes sold to domestic customers were almost constant and a small decrease was registered from the commercial customers mainly due to one industrial consumer leaving Tallinn. The volumes from the surrounding municipalities have shown a good increase reflecting the intense development of these areas. The connection activity was also very dynamic generating a 65.7% increase in turnover. Overall the total revenue increased to 820.8 mln kroons.

The Company has been successful in managing its cost despite an inflationary environment. Cost of goods sold has decreased by 1.75%. When taking out the exceptional items, the underlying increase of cost of goods sold would have been 4.5%, which is a remarkable performance considering the inflationary situation of some items (especially wages) in Estonia. This was achieved by a strong cost control culture and a constant focus on efficient improvement.

In 2007, the Company increased its dividend payment to shareholder by 25%.

It was great that the Company was recognized by its peers and awarded the title of 'Most Competitive Service Company' in Estonia by the Estonian Chamber of Commerce and Industry and the Estonian Employer's Confederation.

The Company stays committed to achieve high standards of corporate governance. Our aim is to be transparent in our ways of working, corporate disclosures and relation with shareholders and stakeholders. Once again in 2007 this was recognized by the financial community as the Company was nominated by the OMX Baltic Stock Exchange for the quality of its investor relations.

**A Team effort**

All this has only been possible because of the fantastic effort the team has put into the Company and I want to pay tribute to them for their commitment. The employee opinion survey carried out in 2007 has seen the index increasing by 10%. This is a very positive result, and we will continue to work on our human resource strategy to improve further this result.

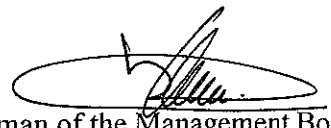
In 2007, we invested significant time and energy on our human resource strategy and policy and have developed a set of values:

Commitment  
Customer Focus  
Teamwork  
Creativity

We do believe that behaving according to these values will strongly support the achievement of our strategic objectives. A new remuneration system, based on performance achievement, will be implemented from the beginning of 2008. It includes an assessment on behaviour and how we live our values.

We have a clear vision for the future of the Company. To achieve this vision we have set clear long term strategic objectives. We set every year Company's annual objectives derived from the strategic objectives, and finally we cascade down these company's objectives into individual objectives. This is the heart of our performance management system and it has proven to be an efficient way to drive the Company towards success. We will continue to use this methodology in 2008.

All in all, in 2007, the Company performed well and delivered good results. This is another step in building a strong foundation for the future. In 2008, with our strategic objectives as a target, we will continue to stay focussed on delivering a high level of performance.



Chairman of the Management Board:

# AS TALLINNA VESI

## MANAGEMENT REPORT

### RESULTS OF OPERATIONS - FOR THE YEAR 2007

#### Main economic indicators

million kroons	2007	2006	2005	2004	2003
Sales	820,8	693,2	592,0	548,5	504,0
Main operating activities	648,3	589,2	549,9	478,8	434,8
Other operating activities	172,4	104,0	42,1	69,7	69,2
Gross profit	445,9	375,6	351,6	286,9	249,3
Gross profit margin %	54,3%	54,2%	59,4%	52,3%	49,5%
Operating profit	377,4	337,9	282,6	254,9	169,8
Operating profit margin %	46,0%	48,7%	47,7%	46,5%	33,7%
Profit before taxes	333,1	294,9	209,7	199,2	119,8
Profit before taxes margin %	40,6%	42,5%	35,4%	36,3%	23,8%
Net profit	277,8	248,0	174,4	173,0	104,5
Net profit margin %	33,8%	35,8%	29,5%	31,5%	20,7%
ROA %	10,9%	10,0%	7,3%	7,8%	4,8%
Debt to total capital employed	51,8%	53,4%	55,3%	55,1%	58,4%
ROE%	22,5%	21,5%	16,4%	17,3%	11,6%
Current ratio	1,9	2,2	1,9	0,9	0,9
Average number of employees	315	322	337	351	348
Share capital	200	200	200	200	200

**Gross profit margin – Gross profit / Net sales**

**Operating profit margin – Operating profit / Net sales**

**Profit before taxes margin – Profit before taxes / Net sales**

**Net profit margin – Net profit / Net sales**

**ROA – Net profit / Total assets**

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

**ROE – Net profit / Shareholders' equity**

**Current ratio – Current assets / Current liabilities**

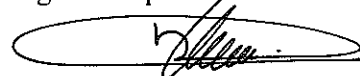
#### Profit and Loss Statement

##### Sales

In 2007 the Company's total sales increased, year on year, by 18.4% to 820.8 mln kroons. Sales from the Company's main operating activities were 648.3 mln kroons. Sales in the main operating activity principally comprise of sales of water and treatment of wastewater to domestic and commercial customers within and outside of the service area, and fees received from the City of Tallinn for operating and maintaining the storm water system.

Sales of water and wastewater treatment including over pollution fees were 599.6 mln kroons, a 9.2% increase compared to 2006. Sales of water and wastewater treatment excluding over pollution fees were 589.3 mln kroons, a 9.7% increase compared to 2006, resulting from the 10.8% increase in tariffs from 1 January 2007 for the Company's residential and commercial customers combined with the factors described below.

Included within this amount were the following increases by the customer groups with different tariffs: Sales to residential customers increased by 10.5% to 319.0 mln kroons. Sales to commercial customers within the service area increased by 7.5% to 252.7 mln kroons. Sales outside of the service area – primarily bulk volumes of wastewater treatment services provided to the surrounding municipalities – increased by



Chairman of the Management Board:

**MANAGEMENT REPORT**

---

32.2% reaching 2.5 mln m<sup>3</sup> or 17.7 mln kroons. Over pollution fees received were 1.5 mln kroons lower than in 2006.

In 2007, the volumes sold to residential customers stayed at a similar level to that in 2006. Volumes sold in 2007 have dropped 0.3% or 90 thousand m<sup>3</sup>, mainly because of the rainy summer in 2007 (compared to 2006) when water used for gardening purposes reduced considerably. This loss of sales is more than recovered (specified below) by the storm water disposal and fire hydrant services line, as due to the rainy year, the treatment volumes of storm water increased.

The volumes sold to commercial customers inside the services area decreased compared to 2006 due to several factors combined. Most of the reduction in sales volumes in Tallinn is due to companies moving to the surrounding municipalities, attracted by cheaper real estate prices. Most of these customers are re-captured through the bulk-supply contracts signed with the surrounding municipalities, but not always. For example in the 2<sup>nd</sup> quarter of 2007, one of the Company's biggest industrial customers moved its facilities out of our area, resulting in a volume loss of 175 thousand m<sup>3</sup>, mainly in the 3<sup>rd</sup> and 4<sup>th</sup> quarter. We have recognized that the overall economic situation and the decline on the real estate market have also had a negative effect on the Company's commercial sales.

Statistics show, that starting from May the tourist flow to Tallinn has slowed down, still exceeding 2005 level, but slightly below 2006. Also the real estate market seems to have reached a point of stagnation. Even though the number of new apartments and business buildings constructed in Tallinn has continued to increase, a large share of new buildings remain vacant as commercial customers as well as people in need of space are moving to surrounding areas due to more affordable real estate prices. This trend is also reflected in the Company's sales to surrounding areas, which has increased by 32.2% compared to 2006.

The sales from the operation and maintenance of the storm water service increased by 24.5% to 37.4 mln kroons in 2007 compared to 2006. This is in accordance with the terms and conditions of the contract whereby the storm water and fire hydrant service costs are invoiced based on actual costs and volumes treated. This is contractually agreed up to 2020.

Sales revenues from other operating activities, mainly connections, network extension and storm water construction, totaled 172.4 mln kroons which is 68.4 mln kroons higher than in 2006. This line depends on construction completion and the revenue is recorded when it is probable that the revenues will flow to the company.

*Cost of Goods Sold and Gross Profit*

The cost of goods sold for the main operating activity was 216.7 mln kroons in 2007, a decrease of 3.9 mln kroons or 1.8% from 2006.

In 2007 the Company recorded zero failures in all pollution measures taken, and as a result the amount of pollution tax payable reduced by 7.1 mln kroons compared to regular tariffs, partly balanced by an increase in tax rates year on year by 20%. In addition, pollution tax was impacted by the fact that the Ministry of Environment gave final approval to the success of the nitrogen project, which resulted in the release of a pollution tax provision (see Note 10). Due to this non-recurring, one-off event the environmental tax decreased by 13.3 million kroons in 2007.

In 2007 tax on special use of water increased by 4.4% compared to 2006. The chemical costs were 21.0 mln kroons, which represents a 1.9% increase compared to 2006. Electricity costs increased by 1.8 mln kroons or 7.3% compared to 2006. All of the above are due to the combination of overall increases in prices and changes in volumes.



Chairman of the Management Board:



**MANAGEMENT REPORT**

---

Salaries cost of goods sold expenses increased by 5.1 mln kroons or 10.9%, as a consequence of growing salaries and the highly competitive labour market. Nevertheless the salaries expense increase is still, in all categories, below the overall increase in average salaries in the Estonian market, which according to the latest statistics has increased by more than 20% year on year.

Other cost of goods sold in the main operating activity increased by 7.2 mln kroons, or 21.5% year on year. In 2007 other costs increased due to increased costs on a number of support services contracts, such as transport, security services, reflecting the significant increase in labour costs in Tallinn.

As a result of all of the above the Company's gross profit in 2007 was 445.9 mln kroons, which represents an increase of 70.3 mln kroons, or 18.7%, compared to the gross profit of 375.6 mln kroons in 2006. Eliminating the non-recurring one off factor, the underlying cost of goods sold from main operating activities increased by 9.4 mln kroons, or 4.3% year on year and the gross profit from recurring activities increased by 57.0 mln kroons to 432.6 mln kroons compared to the gross profit of 2006.

*Operating Costs and Operating Profit*

Marketing expenses increased by 4.0 mln kroons to 13.5 mln kroons in 2007 compared to 2006. This is partly the result of the overall salary increases, but particularly in this group it is impacted by the formation of the new business unit focusing on new business development opportunities. The increase in depreciation charges accounted within marketing expenses is due to the inclusion of the depreciation related to the latest stage of implementation of the Customer Information and Billing system.

General administration expenses increased by 5.5 mln kroons to 56.8 mln kroons in 2007 as a consequence of an increase in salaries and other general administration expenses as described above. The other general administration expenses have been affected by price increases in labor-intensive services, but also non-cash decrease in capitalization to fixed assets. In addition approximately 1.3 mln kroons of the increase is due to rental cost of computers resulting from switching from owning the computers into the lease contracts – a corresponding reduction can be found in the depreciation charge. A switch from old billing related modules to new software, recorded within marketing expenses complements the reduction in this line.

Included within the above cost categories are staff costs. These totaled 76.9 mln kroons in 2007, which is a 9.5 mln kroons or 14.1% increase compared to 2006, which as mentioned earlier was due to exceptional items and the Company wide revision of salaries at end of 2006, in order to maintain competitiveness in the labor market. Salaries expenses are partly compensated by the Company's inner efficiency, which is reflected by the decrease in the number of workers, as described in the financial report.

Other net income/expenses totaled an income of 1.8 mln kroons in 2007 compared to a 23.2 mln kroons income in 2006. Net income in both 2006 and 2007 included non-recurring, one-off income from sale of assets: In 2007 2.0 mln kroons and in 2006 24.1 mln kroons.

As a result of all of the above the Company's operating profit in 2007 was 377.4 mln kroons, an increase of 39.5 mln kroons compared to an operating profit of 337.9 mln kroons achieved in 2006.

*Financial expenses*

Net Financial expenses were 44.2 mln kroons in 2007, which is an increase of 1.2 mln kroons or 2.8% compared to 2006. The Company's interest costs have increased by 10.5% compared to 2006. This is due to the fact that half of the Company's loans are connected to the 6 month Euribor rate, which was 4.707% on 31.12.2007 compared to 3.853% on 31.12.2006. The increase in interest expenses is partially offset by an increase in financial income earned in 2007, as a result of a more favorable cash position and increasing interest rates.



Chairman of the Management Board:

**MANAGEMENT REPORT**

---

*Profit Before Tax*

The Company's profit before taxes in 2007 was 333.1 mln kroons, which is 38.2 mln kroons or 12.9% higher than the profit before taxes of 294.9 mln kroons in 2006. Eliminating non-recurring one off income and expenses mentioned within the above categories, the profit before taxes increased by 47.0 mln kroons or 17.3% from 270.8 mln kroons in 2006 to 317.8 mln kroons in 2007.

**Balance sheet**

During the twelve months of 2007 the Company invested 285.9 mln kroons into fixed assets. Non-current assets were 2 186 mln kroons at 31 December 2007. Current assets increased by 43.1 mln kroons to 373.6 mln kroons in the twelve months of the year, which was largely attributable to an increase in contractual customer receivables payable in 1<sup>st</sup> quarter 2008, mostly payable by the City of Tallinn according to the Services Contract.

Current liabilities increased by 46.6 mln kroons to 198.8 mln kroons in the twelve months of the year. This was mainly due to transfer of current portion of the long-term borrowings from non-current liabilities to current liabilities.

The company continues to maintain its leverage level within a range of 50% with total liabilities to total capital employed of 51.8% as at 31 December 2007. Long-term liabilities stood at 1 126.1 mln kroons at the end of December 2007, consisting almost entirely of the outstanding balance on the two long-term bank loans.

**Cash flow**

During the twelve months of 2007, the Company generated 333.7 mln kroons of cash flows from operating activities, an increase of 13.1 mln kroons compared to the corresponding period in 2006. Operating profit continues to be the main driver for growth.

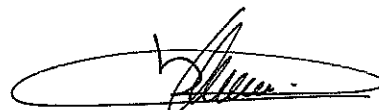
In 2007 net cash flows used for investing activities was 152.9 mln kroons, which is 79.8 mln kroons more than in 2006. Investments to networks extension are paid back to the company and the timing of payments impacts the cash flow. Because of that cash flow was impacted by some big construction revenue invoices that are due in the 1<sup>st</sup> quarter 2008, but also by increased investment levels. In the twelve months of the year, the company invested 285.9 mln kroons – 135.1 mln kroons in networks extension, 50.5 mln kroons in sewerage networks rehabilitation, 46.2 mln kroons in Paljassaare wastewater treatment plant and wastewater treatment, 44.6 mln kroons in water quality (rehabilitation of water network, Ülemiste water treatment plant and raw water) and 9.6 mln kroons in other investments (IT, capital maintenance, meters, etc).

Cash flows used in financing activities were 251.8 mln kroons during 2007 compared to cash outflow of 205.2 mln kroons during 2006, reflecting increased dividend payments and related taxes.

As a result of all of the above factors, the total cash outflow in the twelve months of 2007 was 71.0 mln kroons compared to a cash inflow of 42.3 mln kroons in the twelve months of 2006. Cash and cash equivalents stood at 178.4 mln kroons as at 31 December 2007, which ensured more than sufficient working capital and liquidity needed to manage the Company's cash flows.

**Employees**

At the end of 2007, the number of employees was 312, compared to 318 at the end of 2006.



Chairman of the Management Board:

**MANAGEMENT REPORT****Dividends and share performance**

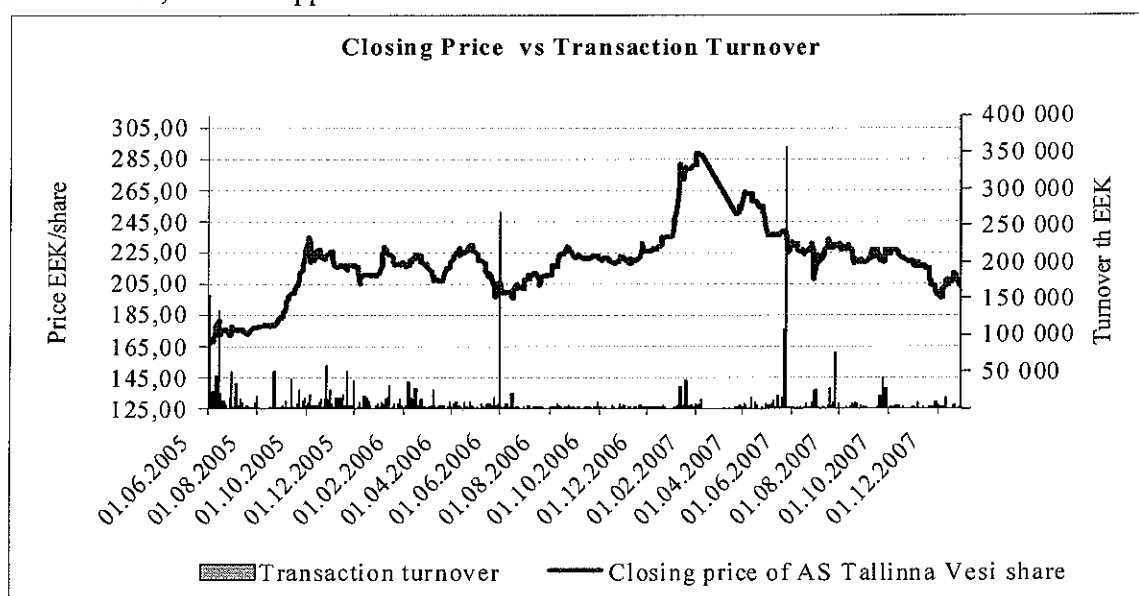
Based on the results of the 2006 financial year, the Annual General Meeting of shareholders of AS Tallinna Vesi voted to pay 196 010 000 kroons of dividends. Of this 10 000 kroons was paid to the owner of the B-share and 196 mln kroons, i.e. 9.8 kroons per share to the owners of the A-shares. Dividends were paid on 15 June 2007.

As of 31 December 2007 AS Tallinna Vesi shareholders, with a direct holding over 5%, were:

United Utilities (Tallinn) BV	35.3%
City of Tallinn	34.7%
Nordea Bank Finland Plc clients account trading	7.71%
Morgan Stanley + Co International Equity client account	6.81%

In course of the preparation of the annual accounts AKO Master Fund Limited had notified the Company that their indirect shareholding in the Company was 5.76%. They own the shares through the client accounts of investment banks.

At the end of the year, 31 December 2007, the closing price of the AS Tallinna Vesi share was 202.78 kroons (12.96 euros), which is a 13.7% decrease compared to the closing price of 234.70 kroons (15.00 euros) in the beginning of 2007. The Company's share price decrease was at the same level as the OMX Tallinn index, which dropped 13.3% in 2007.

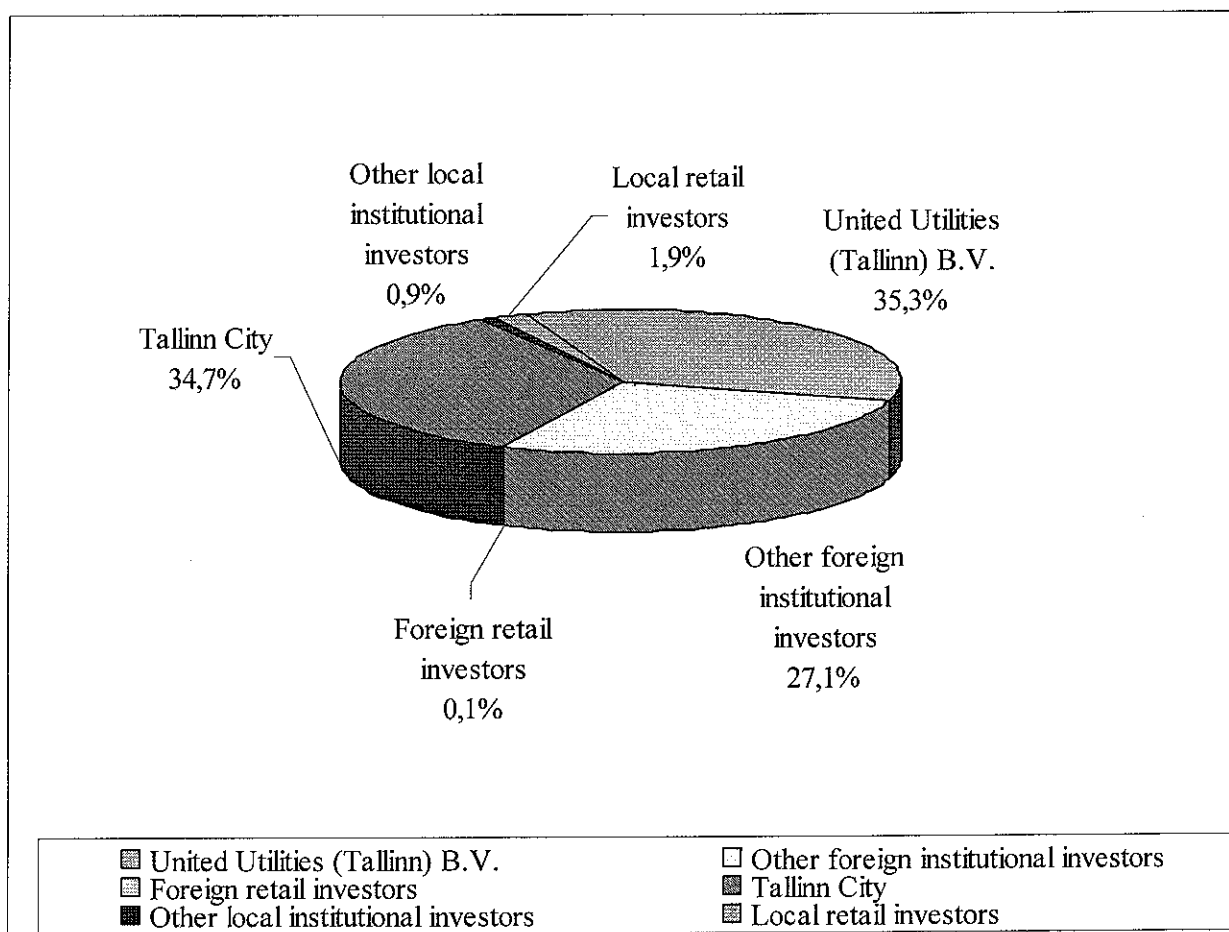
**Share price statistics starting from the listing at Tallinn Stock Exchange**

(kroons/%)	2007	2006	2005	2004	2003
Share price, open	234,70	211,23	155,53	n/a	n/a
Share price, at the end of the year	202,78	234,86	210,92	n/a	n/a
Share price, high	290,87	234,86	235,48	n/a	n/a
Share price, low	195,58	195,11	155,53	n/a	n/a
Share price, average	232,20	217,49	197,46	n/a	n/a
Traded volume	5 462 916	4 274 094	7 993 844	n/a	n/a
Turnover, million	1295,94	913,22	1509,88	n/a	n/a
Capitalisation, million	4 056	4 697	4 218	n/a	n/a
Earnings per share	13,89	12,40	8,72	8,65	5,23
Dividend per share	n/a	9,80	7,85	5,60	3,75
P/E	14,60	18,94	24,19	n/a	n/a

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

Chairman of the Management Board:

## Shareholders by type as of 31.12.2007



## Distribution of share capital by size of share ownership as of 31.12.2007

	Shareholders	Shareholders %	No. of shares	% of share capital
1-100	435	30,5%	22 224	0,1%
101-200	435	30,5%	63 792	0,3%
201-300	146	10,3%	37 753	0,2%
301-500	150	10,5%	60 840	0,3%
501-1 000	112	7,9%	82 182	0,4%
1 001-5 000	109	7,7%	225 779	1,1%
5 001-10 000	11	0,8%	79 746	0,4%
10 001-50 000	14	1,0%	309 784	1,5%
50 000+	12	0,8%	19 117 900	95,6%
<b>TOTAL.</b>	<b>1 424</b>	<b>100,0%</b>	<b>20 000 000</b>	<b>100,0%</b>

More detailed information about the structure of the equity and the preference share, giving the special control rights, is disclosed in note 13.

Chairman of the Management Board:

**MANAGEMENT REPORT**

---

**CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RECOMMENDATIONS REPORT**

AS Tallinna Vesi is committed to high standards of corporate governance for which the Management Board and Supervisory Board are accountable to shareholders. The Company endeavours to be transparent in its ways of working, corporate disclosures and relations with Shareholders and this was recognised in 2006 and 2007 when the Company was nominated by Baltic Stock Exchanges for the quality of its investor relations program.

The Company has regular dialogue with major shareholders with general presentations made at least bi-annually - a list of meetings and the presentations are available on the Company's website. The Company also uses the Annual General Meeting to keep shareholders informed and there is an opportunity for individual shareholders to ask questions of the Management Board and Supervisory Council within the meeting.

Throughout 2007 the management of the Company was organized according to good governance principles, Commercial Code and Articles of Association of the Company. An annual General Meeting of Shareholders was convened to approve the annual report, distribution of dividend, appointment of auditors and recalling/election of Supervisory Board members. Change of the Articles of Association and management of the Company (incl. the election and recall of the members of the management board) is done according to the Part VII of the Commercial Code.

**The Supervisory Board and internal audit**

Five Supervisory Board meetings were held. The Supervisory Board organized the Management of the Company and supervised the activity of the Management Board. The Supervisory Board approved the 2006 annual report presented at the Annual General Meeting, and approved the 2007 budget.

Members of the Company's Supervisory Board during the composition of the report were as follows: Robert John Gallienne – Chairman of the Supervisory Board, David John Kilgour, Henry Emanuel Russell, David Leonard Fuller, Mart Mägi, Rein Ratas, Elmar Sepp, Deniss Boroditš and Valdur Laid.

At each meeting, an internal audit report was presented to the Board. The internal auditor of the Company reports directly to David Kilgour, Supervisory Board Member responsible for auditing function.

**The Management Board**

The Management Board of the Company managed the activity of the Company. The Management Board is composed of three members, two of them seconded by United Utilities International Ltd, all of them appointed by the Supervisory Board.

The duties of the Chairman of the Management Board Roch Chérourx among the other duties were to fulfill the everyday obligations of the Chief Executive Officer of the Company by leading and representing the company, organizing the activities of the management board, preparing the strategies and ensuring their implementation.

The duties of the member of the Management Board David Hetherington among the other duties were to fulfill the everyday obligations of the Chief Operating Officer of the Company by managing and being responsible for the operating activities, including the customer service function of the Company.

The duties of the member of the Management Board Siiri Lahe among the other duties were to fulfill the everyday obligations of the Chief Financial Officer of the Company by managing and being responsible for the accounting and financial activities of the Company. Siiri Lahe was appointed to the position since August 1, 2007. Before that the same position was held by Ian John Alexander Plenderleith.

Chairman of the Management Board:

## MANAGEMENT REPORT

According to the Company's statute the Chairman of the Management Board can represent the Company single-handedly, other members together with another member. In order to make daily decisions the Management Board has validated a framework of principles, according to which certain management team members are authorized to conclude transactions to small amounts.

### **Conformity to Tallinn Stock Exchange Corporate Governance Recommendations**

Starting from January 1, 2006 the companies whose shares have been admitted to trading on the regulated market operating in Estonia shall describe, in accordance with the 'Comply or Explain' principle, their management practices in a Corporate Governance report and confirm their compliance or not with the Corporate Governance recommendations. If the issuer does not comply with the Corporate Governance Recommendations, it shall explain in the report the reasons for its non-compliance.

### **Declaration of Conformity by AS Tallinna Vesi**

AS Tallinna Vesi complies with the vast majority of the non-mandatory Corporate Governance recommendations. However it does not comply with some regulations, which are listed below, together with the reasons for current non-compliance:

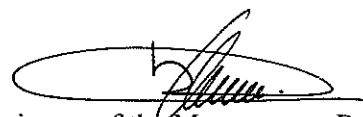
*'2.2.3. The basis for Management Board remuneration shall be clear and transparent. The Supervisory Board shall discuss and review regularly the basis for Management Board remuneration. Upon determination of the Management Board remuneration, the Supervisory Board shall be guided by evaluation of the work of the Management Board members. Upon evaluation of the work the Management Board members, the Supervisory Board shall above all take into consideration the duties of each member of the Management Board, their activities, the activities of the entire Management Board, the economic condition of the Issuer, the actual state and future prediction and direction of the business in comparison with the same indicators of companies in the same economic sector.'*

The arrangements concluded in connection with the privatisation of the Company in 2001 provided that, in return for certain fees, United Utilities International Ltd would provide the Company with certain technical and asset management services and would make certain of its personnel available to the Company in connection with its operation and management.

According to the agreement, the working hours, rates of compensation, manner of performance, and all other matters relating to the employment of the individuals appointed by United Utilities International Ltd are to be determined solely by United Utilities International Ltd, the Supervisory Board does not regularly review the principles of those Management Board members remuneration.

*'2.2.7. Basic wages, performance pay, severance packages, other payable benefits and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on website of the Issuer and in the Corporate Governance Recommendations Report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the Issuer or the amount of foreseeable expense as of the day of disclosure. The Chairman of the Supervisory Board shall present the essential aspects of the management board remuneration and changes in it to the General Meeting. If the remuneration of some of the Management Board members has occurred on a different base, then the General Meeting shall be presented the differences together with the reasons therefore.'*

The Company does disclose the overall management board remuneration in the report appendix 24, but considers that individual remuneration is sensitive and private information and disclosing it would bring no benefit to the shareholders.



Chairman of the Management Board:

**MANAGEMENT REPORT**

*'3.2.2. At least half of the members of the Supervisory Board of the Issuer shall be independent. If the Supervisory Board has an odd number of members, then there may be one independent member less than the number of dependent members.'*

Pursuant to the Articles of Association, the Supervisory Board consists of nine members. Under the Shareholders' Agreement, United Utilities (Tallinn) B.V. (hereinafter UUTBV) and the City of Tallinn have agreed that the division of seats in the Supervisory Board shall be such that UUTBV shall have four seats, the City of Tallinn shall have three seats and two seats shall be for independent members of the Supervisory Board as described by the Tallinn Stock Exchange.

**Information Disclosure**

*'2.2.2. The member of the Management Board shall not be at the same time a member of more than two management boards of an Issuer and shall not be the Chairman of the Supervisory Board of another Issuer. A member of the Management Board can be the Chairman of the Supervisory Board in company belonging to same group as the Issuer.'*

Roch Ch eroux, CEO, is a member of the Supervisory Board of the following companies belonging to United Utilities group: United Utilities BV, United Utilities Investment BV, United Utilities (Tallinn) BV, United Utilities (Luxembourg) sarl, United Utilities (Luxembourg) No. 2 sarl and also in Eesti Vee-ettev tete Liit (Estonian Water Companies Association).

Siiri Lahe, CFO, and David Hetherington, COO, are not in the Supervisory Boards of other companies.

*3.2.5. The amount of remuneration of a member of the Supervisory Board shall be published in the Corporate Governance Recommendations Report, indicating separately basic and additional payment (incl. compensation for termination of contract and other payable benefits).*

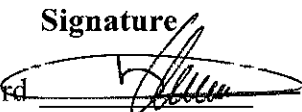
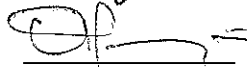

According to the decision of shareholders meeting that the payments for Supervisory Board members is set at 100,000 kroons per year. The fee is subject to deduction and payment of taxes set out by laws and would be payable monthly. The Supervisory Board members are not paid any additional benefits.

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

The members of the Supervisory Board have attended more than 50% of the meetings during the time held office. As members of the Supervisory Board have changed during the year, consequently the following Supervisory Board members have attended less than half of the meetings held during the year.

- David Leonard Fuller and Deniss Borodit  attended all the Supervisory Board meetings since their nomination on 04.10.2007 and 19.09.2007 respectively.
- Toivo Tootsen attended two Supervisory Board meetings, until recalled from Board on 06.04.2007.

The previous sections, Chairman's statement, Results of operations – for the year 2007, Corporate Governance and Corporate Governance Recommendations Report form the Management Report, which is an integral part of the annual report of AS Tallinna Vesi for the financial year ended 31 December 2007. The Management Report gives a true and fair view of the trends and results of operations, main risks and doubts of the Company.

<b>Name</b>	<b>Position</b>	<b>Signature</b>	<b>Date</b>
Roch Jean Guy	Chairman of the Management Board		15 Feb 2008
Antoine Ch�eroux	Member of the Management Board		15 Feb 08
David Nigel Hetherington	Member of the Management Board		15.02.08

## AS TALLINNA VESI

### **DECLARATION OF MANAGEMENT FOR THE ANNUAL ACCOUNTS**

---


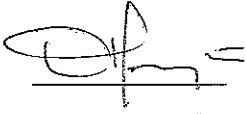

The Management Board of AS Tallinna Vesi (hereinafter the Company) hereby declares its responsibility for the preparation of the Annual Accounts for the financial year ended 31 December 2007.

The annual accounts have been prepared according to International Financial Reporting Standards as adopted by the EU, and give a true and fair view of the financial position, results of operations and cash flows of AS Tallinna Vesi.

The preparation of the Annual Accounts according to International Financial Reporting Standards involves estimates made by the Management Board of the Company's assets and liabilities as at 31 December 2007, and of income and expenses during the financial year. These estimates are based on current information about the Company and consider all plans and risks as at 31 December 2007. The actual results of these business transactions recorded may differ from such estimates.

Any subsequent events that materially affect the valuation of assets and liabilities until the preparation of the annual accounts as at 15 February 2008 have been assessed as part of this review.

The Management Board considers AS Tallinna Vesi to be a going concern entity.

<b>Name</b>	<b>Position</b>	<b>Signature</b>	<b>Date</b>
Roch Jean Guy Antoine Chérourx	Chairman of the Management Board		<u>15 Feb 2008</u>
David Nigel Hetherington	Member of the Management Board		<u>15 Feb 08</u>
Siiri Lahe	Member of the Management Board		<u>15.02.08</u>



## AS TALLINNA VESI

BALANCE SHEETS  
AT 31 DECEMBER 2007 AND 2006

Signed for identification purposes:

AS Deloitte Audit Eesti

(thousand EEK)

ASSETS	Note	2007	2006
<b>CURRENT ASSETS</b>			
Cash and equivalents	2	178 420	249 413
Customer receivables	3	185 223	71 490
Accrued income and prepaid expenses	4	5 179	4 756
Inventories	5	3 645	3 142
Assets for sale	6	1 120	1 648
<b>TOTAL CURRENT ASSETS</b>		<b>373 587</b>	<b>330 449</b>
<b>NON-CURRENT ASSETS</b>			
Tangible assets	7	1 992 978	1 877 105
Intangible assets	7	49 137	52 595
Unfinished assets - non connections	7	48 034	91 676
Unfinished pipelines - new connections	7	90 057	117 162
Prepayments for fixed assets	7	5 399	2 795
<b>TOTAL NON-CURRENT ASSETS</b>		<b>2 185 605</b>	<b>2 141 333</b>
<b>TOTAL ASSETS</b>		<b>2 559 192</b>	<b>2 471 782</b>
<b>LIABILITIES AND EQUITY</b>			
<b>CURRENT LIABILITIES</b>			
Current portion of long-term borrowings	8	41 486	473
Trade and other payables	9	86 966	85 250
Taxes payable	10	26 486	30 508
Short-term provisions	11	2 231	538
Deferred income	12	42 099	36 325
<b>TOTAL CURRENT LIABILITIES</b>		<b>199 268</b>	<b>153 094</b>
<b>NON-CURRENT LIABILITIES</b>			
Borrowings	8	1 125 491	1 166 098
Other payables	9	113	100
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>1 125 604</b>	<b>1 166 198</b>
<b>TOTAL LIABILITIES</b>		<b>1 324 872</b>	<b>1 319 292</b>
<b>EQUITY</b>			
Share capital	13	200 001	200 001
Share premium		387 000	387 000
Statutory legal reserve		20 000	20 000
Accumulated profit		349 479	297 443
Net profit for the period		277 840	248 046
<b>TOTAL EQUITY</b>		<b>1 234 320</b>	<b>1 152 490</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>2 559 192</b>	<b>2 471 782</b>

Chairman of the Management Board:

Signed for identification purposes:



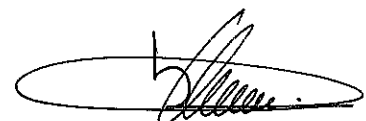
AS Deloitte Audit Eesti

AS TALLINNA VESI

**INCOME STATEMENTS  
FOR THE YEARS ENDED 31 DECEMBER 2007 AND 2006**

(thousand EEK)

	Note	2007	2006
Sales from main operating activities	14	648 335	589 176
Revenues from other operating activities	14	172 437	104 048
<b>Net sales</b>		<b>820 772</b>	<b>693 224</b>
Costs of goods sold (main operating activities)	15,16	-216 677	-220 537
Costs of goods sold (other operating activities)	16	-158 187	-97 096
<b>GROSS PROFIT</b>		<b>445 908</b>	<b>375 591</b>
Marketing expenses	15,16	-13 547	-9 578
General administration expenses	15,16	-56 849	-51 319
Other income/ expenses (-)	16	1 850	23 229
<b>OPERATING PROFIT</b>		<b>377 362</b>	<b>337 923</b>
Financial income / expenses (-)	17	-44 237	-42 981
<b>PROFIT BEFORE TAXES</b>		<b>333 125</b>	<b>294 942</b>
Income tax on dividends	18	-55 285	-46 896
<b>NET PROFIT FOR THE PERIOD</b>		<b>277 840</b>	<b>248 046</b>
Attributable to:			
Equity holders of A-shares		277 830	248 036
B-share holder		10	10
<b>Earnings per share in kroons</b>	19	<b>13,89</b>	<b>12,40</b>





## CASH FLOW STATEMENTS

FOR THE YEARS ENDED 31 DECEMBER 2007 AND 2006

(thousand EEK)

	Note	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Operating profit		377 362	337 923
Adjustment for depreciation	16	79 241	81 047
Adjustment for income and expenses from constructions	20A	-14 250	-6 952
Other financial income and expenses	17	-1 585	-536
Profit from sale of fixed assets		-2 422	-24 917
Expensed fixed assets		476	1 106
Capitalization of operating expenses	20C	-19 764	-20 921
Change in current assets involved in operating activities	20B	-32 062	-4 142
Change in liabilities involved in operating activities	20B	-327	5 994
Interest paid		-52 986	-48 051
<b>Total cash flow from operating activities</b>		<b>333 683</b>	<b>320 551</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Acquisition of fixed assets (incl pipelines construction)	20C	-265 951	-192 048
Proceeds from pipelines financed by construction income	20A	101 840	112 662
Proceeds from sale of and prepayments received/ repaid(-) for fixed assets		390	-1 293
Proceeds from sale of assets for sale and of real estate investments		242	1 107
Interest received		10 571	6 545
<b>Total cash flow used in investing activities</b>		<b>-152 908</b>	<b>-73 027</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Finance lease payments	8	-473	-1 282
Dividends paid	18	-196 010	-157 000
Income tax on dividends	18	-55 285	-46 896
<b>Total cash flow used in financing activities</b>		<b>-251 768</b>	<b>-205 178</b>
<b>Change in cash and bank accounts</b>		<b>-70 993</b>	<b>42 346</b>
<b>CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD</b>		<b>249 413</b>	<b>207 067</b>
<b>CASH AND EQUIVALENTS AT THE END OF THE PERIOD</b>	2	<b>178 420</b>	<b>249 413</b>



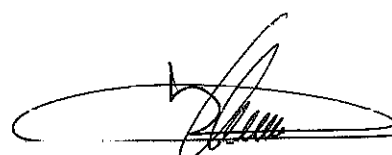


## AS TALLINNA VESI

STATEMENTS OF CHANGES IN EQUITY  
FOR THE YEARS ENDED 31 DECEMBER 2007 AND 2006

(thousand EEK)

	Share capital	Share premium	Statutory legal reserve	Accumulated profit	Net profit	Total equity
<b>31 December 2005</b>	<b>200 001</b>	<b>387 000</b>	<b>20 000</b>	<b>280 089</b>	<b>174 354</b>	<b>1 061 444</b>
Transfer of financial year profit to the accumulated profit	0	0	0	174 354	-174 354	0
Dividends	0	0	0	-157 000	0	-157 000
Net profit of the financial year	0	0	0	0	248 046	248 046
<b>31 December 2006</b>	<b>200 001</b>	<b>387 000</b>	<b>20 000</b>	<b>297 443</b>	<b>248 046</b>	<b>1 152 490</b>
Transfer of financial year profit to the accumulated profit	0	0	0	248 046	-248 046	0
Dividends	0	0	0	-196 010	0	-196 010
Net profit of the financial year	0	0	0	0	277 840	277 840
<b>31 December 2007</b>	<b>200 001</b>	<b>387 000</b>	<b>20 000</b>	<b>349 479</b>	<b>277 840</b>	<b>1 234 320</b>



Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

**NOTE 1. ACCOUNTING PRINCIPLES**

The annual accounts for the financial year 2007 (hereinafter financial statements) have been prepared according to International Financial Reporting Standards (hereinafter IFRS) as adopted by the European Union. IFRS as adopted by the EU do not currently differ from IFRS as issued by the International Accounting Standards Board (IASB), except for certain hedge accounting requirements under IAS 39 which have not been endorsed by the EU. The Company has determined that the unendorsed hedge accounting requirements under IAS 39 would not impact the financial statements had they been endorsed by the EU at the balance sheet date. The new standard or an interpretation of a standard which became effective from 1 January 2007 and applicable to the Company are:

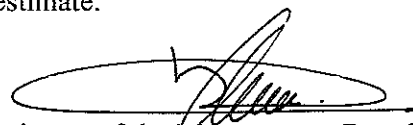
- IFRS 7 'Financial Instruments: Disclosures' – implementation of the standard caused disclosure of additional information about financial instruments in the Company's reports.
- IAS 1 'Presentation of Financial Statement' - implementation of the standard caused disclosure of additional information about capital in the Company's reports.

At the time of preparing the current financial statements, the following new IFRS standards and interpretations have been issued, which shall be mandatory for the Company's financial statements prepared for accounting periods beginning on or after 1 January 2008:

- IFRS 8 'Operating segments' shall be applied to the annual periods beginning on or after 1 January 2009;
- IFRS 3 'Business combinations' (revised) shall be applied to the annual periods beginning on or after 1 July 2009;
- IFRS 2 'Share-based payment' amendments shall be applied to the annual periods beginning on or after 1 July 2008;
- IAS 1 'Presentation of Financial Statement' amendments shall be applied to the annual periods beginning on or after 1 January 2009;
- IAS 23 'Borrowing costs' amendments shall be applied to the annual periods beginning on or after 1 January 2009;
- IAS 27 'Consolidated Financial Statements and Accounting for Investments in Subsidiaries' amendments shall be applied to the annual periods beginning on or after 1 January 2009;
- IFRIC 11 'IFRS 2 on Group and treasury shares transactions' shall be applied to the annual periods beginning on or after 1 March 2007;
- IFRIC 12 'Service concession arrangements' shall be applied to the annual periods beginning on or after 1 January 2008;
- IFRIC 13 'Customer Loyalty Programmes' shall be applied to the annual periods beginning on or after 1 July 2008;
- IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' shall be applied to the annual periods beginning on or after 1 January 2008.

IFRS 3, IFRS 2 amendments, IAS 1 amendments, IAS 23 amendments, IFRS 27 amendments and IFRIC 12, IFRIC 13, IFRIC 14 have not yet been endorsed for use in the EU, however endorsement is expected by the time the standards and interpretations become effective. Based on management's best estimate the implementation of the standards or interpretations mentioned above will not have an impact on the Company's financial statements in the future, except :

- Implementing the IAS 23 sooner would have brought along 5 to 10 mln kroons decrease in net financial costs and respective increase in profit. The Company has not decided yet, whether or not to apply the IAS 23 in 2008, but based on the management estimate the impact of the implementation would be in the same size as the 2007 estimate.

  
Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

Signed for identification purposes:



AS Deloitte Audit Eesti

- Implementing the IFRS 8 sooner would not have brought along any changes to the 2007 financial statements. Hence the management considers the probable impact of IFRS 8 in further years based on the sales volumes from the new activities in extra to the main operating services. During the composition of the report the impact is not predictable.

The functional currency of the Company is Estonian kroon. The financial statements are prepared in Estonian kroons (kroons) rounded to the nearest thousand, unless otherwise indicated. The financial statements have been prepared on a historical cost accounting basis, unless specified otherwise. Initial acquisition cost includes all costs directly related to the acquisition of the asset or liability.

The financial statements do not include the segment reporting as there are no geographical segments and no clearly distinguished business segments related to the activities of the Company.

The main accounting principles applied in the preparation of the financial statements are detailed below.

**Critical accounting estimates**

Management has made an assessment of the key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year. The most important areas of estimates contained in the financial statements are the following:

- Management has estimated the useful lifetime of property, plant and equipment and intangible assets. The results of the estimates are disclosed in the section 'Tangible and intangible fixed assets' below, and the information about the carrying amounts is disclosed in note 7 to the financial statements.

**Foreign currency transactions**

Foreign currency transactions are recorded on the basis of the foreign currency exchange rates of the Bank of Estonia at the date of the transaction. Monetary assets and liabilities recorded in foreign currencies in the financial statements have been converted into Estonian kroons based on foreign currency exchange rates valid at the Balance Sheet date. Profits and losses due to exchange rate changes are aggregated and shown in the Income Statement. Gains and losses from foreign currency transactions are recorded in the Income statement on net basis.

**Financial assets and liabilities**

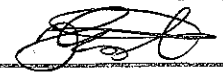
Financial assets are cash, trade receivables, accrued income, other current and long-term receivables including the derivatives with positive value. Financial liabilities are accounts payable, accrued expenses, other current and long term liabilities including the derivatives with negative value.

Financial assets and liabilities are recognized at acquisition cost, which is assumed to be a fair value paid for or gained from that asset or liability. Financial assets and liabilities are recorded in the Balance Sheet when the Company acquires ownership according to the financial asset or liability contract conditions.

Loans are recorded at the value of the proceeds received, net of direct transaction costs, which are accounted for on an accruals basis proportionally to the income statement during the loan



Chairman of the Management Board:



**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

agreement validity period. As the transaction costs have been considered immaterial compared to the loans received, no effective interest method is implemented.

Interest income and expenses are recorded on an accrual basis using the effective interest rate on line 'Financial income/expenses' in the Income Statement.

The interest rate swap is initially recognised at fair value at the date the interest rate swap is entered into and is subsequently remeasured to its fair value at each balance sheet date. The resulting gain or loss is recognised as a profit or loss immediately. The fair value of the swap is recorded either in current assets or in current liabilities depending on the swap's positive or negative value.

**Cash and cash equivalents**

Cash and cash equivalents within the Balance Sheet and the Cash Flow Statement comprise of cash held on the Company premises, cash in bank accounts and short-term, risk free, liquid bank deposits convertible into cash within a three month period without penalty.

**Receivables**

Receivables are presented using the amortized cost method. Provisions for accounts receivable that are considered to be doubtful are recorded in the Income Statement under 'Other income/expenses(-)' and a respective allowance is recorded on the Balance Sheet line 'Customer receivables'. Accounts receivable from previous periods that were recorded as doubtful, but that were received during the year, are recorded on the same expense account as a reverse entry. Receivables which cannot be collected, or the collection is considered to be economically not justified, are evaluated as uncollectible by the decision of the Management Board based on individual reviews, and written-off from the Balance Sheet.

For the evaluation of doubtful debts the individual debts are grouped by age and, based on past experience, the following percentages are applied in the doubtful debt calculation:

61 to 90 days	10%;
91 to 180 days	30%;
181 to 360 days	70%;
over 360 days	100%.

Bigger discount rates could be applied in case of individual receivables if needed.

**Inventories**

Raw materials and spare parts are recorded at acquisition cost, which consists of purchase price, non-recoverable taxes, freight costs and other direct costs, less discounts and subsidies received. Any inventories received at nil cost are recorded at zero value.

Inventories are recorded on the Balance Sheet at the lower of acquisition cost and net realizable value with any impairment recorded in the Income Statement to 'Other income/expenses(-)'. The acquisition cost of inventories is accounted for by using weighted average acquisition cost method.



Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

**Assets for sale**

The land and buildings held for sale in the ordinary course of business are classified as assets for sale, as management has made the sale decision and will endeavour to make every effort to do so during the next financial year.

Assets for sale are measured at cost. For assets for sale the depreciation is stopped after the decision is taken to move the assets to the assets for sale group.

**Tangible and intangible fixed assets**

Fixed assets are the assets used for production, services or administration purposes that have a minimum useful lifetime of 1 year and with an acquisition value exceeding 10 thousand kroons. Assets that have a value less than this are only accounted as fixed assets if the item is an essential part of fixed asset or if the expected useful lifetime is considerably longer than 1 year and the asset has an important role in the provision of key business process (for example the water meters used to measure consumption).

Fixed assets are recorded at acquisition cost, which comprises of purchase price, non-recoverable taxes and all other direct costs required to take the fixed asset object into operation, including directly related internal labour costs. Capitalisation of internal labour costs is based on hours worked on the acquisition of asset. In addition to salary costs all other employee related costs are capitalized in the same proportion.

Unfinished pipelines – new connections include the costs of acquiring water or sewerage pipelines. After completion of construction and the concluding of the connection contracts with customers the costs related to the acquisition of these pipelines are recorded within costs of goods sold to ensure the correct matching of revenues and expenses in the same accounting period. Remaining expenses relating to the construction, that are not directly compensated to the Company, are recorded within the Balance Sheet as 'Tangible assets'.

Depreciation is calculated on a straight-line method. The depreciation rate of each fixed asset is based on the fixed asset's useful life, using the following rates:


- buildings 1,25-2,0 % per annum;
- facilities 1,0-8,33 % per annum;
- machinery and equipment 3,33-50 % per annum;
- instruments, facilities etc. 10-20 % per annum;
- intangible assets 10-33 % per annum.

Land is not depreciated.

In exceptional circumstances rates may differ from the above rates if it is evident that the useful lifetime of the asset varies materially from the rate assigned to the respective category.

Depreciation and amortisation of fixed assets are recorded in the Income Statement according to the business' use of the relevant asset, i.e. in 'Cost of goods sold (main operating activities)' or in 'Marketing expenses' or in 'General administration expenses'.

Prepayments for fixed assets and construction-in-process, including unfinished pipelines – new connections, are recorded as fixed assets and are not depreciated.



Chairman of the Management Board:





**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

Improvements to fixed assets are capitalised if the properties of that asset are improved substantially or, as a result of the improvement, the useful life of the asset will be extended, or it is foreseen that additional future revenues will result. Maintenance and repair works are expensed in the period incurred.

All costs of identifiable and controllable development projects which are likely to earn future revenues, and the acquisition costs of computer software are capitalised as intangible assets on the Balance Sheet and amortised on a straight-line basis for a period of up to 10 years. If the software is necessary to take computer hardware into use, the acquisition cost of such software is capitalised in the acquisition cost of the hardware and depreciated according to the useful life of the hardware. Research costs are expensed.

**Impairment of tangible and intangible assets**

At each balance sheet date, the Company reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. Individual assets with no realization value are removed from operations and the net balance sheet value is recorded in the Income Statement to the lines 'Cost of goods sold – main operating activities', 'Marketing expenses' or 'General administration expenses' depending on purpose of asset usage before the impairment.

**Liabilities**

Liabilities with payment terms of more than one year after the balance sheet date are considered to be long-term liabilities. All other liabilities are considered to be short-term liabilities.

No long-term employee benefit schemes are applicable to the Company. The company has made an internal decision to pay bonuses to the employees based on the accounting year results of the company and other individual performance criteria. The expected cost is recorded on the Income Statement as an expense and on the Balance Sheet as a short-term liability.

As profits are not taxable in Estonia no deferred tax liabilities are applicable. Taxation is described more thoroughly in notes 10 and 22.

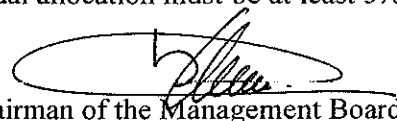
**Provisions**

Legal or contractual liabilities which have arisen during the financial year or previous periods, which are reasonably expected to result in abandoning the asset and result in costs that can be reliably measured at any point in the future, but the final cost or term of payment is not firmly fixed, and the expected loss from the liquidation of financial assets existing independently of the Company's future actions, are accounted for as provisions. Provisions for losses are recorded using the best evaluations made by the management of the Company. The final costs of such transactions may differ from these estimates.

Contingent liabilities are not recognised on the balance sheet. The Company had no known contingent liabilities at the time of the preparation of the financial statements.

**Reserves**

Statutory legal reserve is recorded based upon the requirements of the Commercial Code and comprises of the allocations made from net profits. The annual allocation must be at least 5% of the



Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

Signed for identification purposes:



AS Deloitte Audit Eesti

approved net profit of the financial year until the statutory legal reserve is equal to 10% of share capital.

**Accounting for leases**

Lease contracts are considered as finance leases if all relevant risks and benefits with reference to the ownership of the asset are borne by the lessee, otherwise the lease contract is considered as an operating lease.

Operating lease payments are recorded as an expense during the period incurred i.e. the asset is neither recorded as a fixed asset nor is it depreciated.

Assets acquired under a finance lease and finance lease liabilities are recognised on the balance sheet of the lessee. If ownership is expected to be transferred to the lessee, depreciation is calculated in the usual manner.

**Revenues**

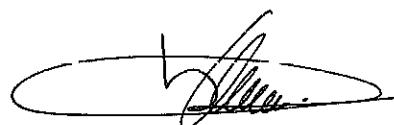
Sales revenue is recorded on an accrual basis at the fair value received or receivable. Sales comprises of the income received from goods and services sold after the deduction of sales discounts.

Periodical sales income from services is recorded in the period when the service has been provided, the proceeds from the provision of the service is probable and the revenue and the costs related to the provision of the service are reliably identified.

Construction cost compensations, incl. connection revenue, related to pipeline construction and network extension is recorded when construction is completed, the cost is reliably identified and inflow of the revenue is guaranteed with contract or with the payer's confirmation about the volumes of the service, ensuring the correct matching of revenues and expenses in the same accounting period.

Revenue from selling goods and assets is recorded when all significant risks and benefits related to owning the goods are devolved to the buyer, inflow from the sale is probable and sales revenue and expense related to the transaction are reliably identified.

Interest revenue is recorded based on accrual concept using the effective interest rate.



Chairman of the Management Board:

## AS TALLINNA VESI

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

(thousand EEK)

**NOTE 2. CASH AND CASH EQUIVALENTS**

	as of 31 December	
	2007	2006
Cash and equivalents	37 838	53 702
Short-term deposits	140 582	195 711
<b>Total cash and cash equivalents</b>	<b>178 420</b>	<b>249 413</b>

**NOTE 3. CUSTOMER RECEIVABLES**

	as of 31 December	
	2007	2006
Accounts receivable	107 957	76 692
Deferred contractual proceeds	80 727	0
Allowance for doubtful debts	-3 461	-5 202
<b>Total customer receivables</b>	<b>185 223</b>	<b>71 490</b>

Impairment costs of receivables:**for the year ended 31 December**

	2007	2006
Write off of uncollectible receivables	-472	-607
Proceeds from uncollectible receivables	157	9
Change in allowance for doubtful debts	1 741	2 194

**NOTE 4. ACCRUED INCOME AND PREPAID EXPENSES**

	as of 31 December	
	2007	2006
Fair value of interest rate swap	1 549	436
Accrued interest	516	226
Other accrued income	2	200
Prepaid taxes	59	263
Other prepaid expenses	3 053	3 631
<b>Total accrued income and prepaid expenses</b>	<b>5 179</b>	<b>4 756</b>

**NOTE 5. INVENTORIES**

Inventories consist of raw materials and are shown net of provisions for obsolete assets. Old raw materials with a nature and value only specific to the Company are considered obsolete, subject to the assumption that management has made all reasonable efforts to sell the unnecessary assets during the year. The most likely outcome for the majority of these assets is treatment as scrap with no material revenue to the Company. In 2006 and 2007 previously discounted materials were used, utilized and sold without profit and therefore there was no need for additional discount.

**NOTE 6. ASSETS FOR SALE**

	as of 31 December	
	2007	2006
Assets for sale	0	0
Prepayments for the land related to the assets for sale	291	750
<b>Total assets for sale</b>	<b>291</b>	<b>750</b>

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007

(thousand EEK)

## NOTE 7. TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS

	Tangible assets in use			Assets in progress			Intangible assets			Total tangible and intangible non-current assets
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Unfinished assets - non connections	Unfinished pipelines - new connections	Prepayment for fixed assets	Development costs	Acquired licenses and other intangible assets	
<b>Acquisition cost at</b>										
<b>31 December 2005</b>	349 941	1 946 121	503 588	19 143	94 793	109 190	3 479	13 841	56 100	3 096 196
Acquisition	0	0	0	0	139 665	106 811	0	0	0	246 476
Sale of fixed assets	-7 876	-8 965	-5 088	-7	0	0	0	0	0	-21 936
Write-off of fixed assets	0	-967	-4 930	-2 483	0	0	0	0	-7 006	-15 386
Reclassification within balance sheet	0	0	0	0	-43	-33	0	0	0	-76
Reclassification to expenses	0	-1	0	0	-614	0	-489	0	0	-1 104
Expensed pipelines	0	0	0	0	0	-97 096	0	0	0	-97 096
Reclassification from assets in progress	3 009	80 746	41 057	879	-142 125	-1 710	-195	3 702	14 637	0
<b>31 December 2006</b>	345 074	2 016 934	534 627	17 532	91 676	117 162	2 795	17 543	63 731	3 207 074
Acquisition	0	0	0	0	148 257	135 085	2 611	0	0	285 953
Sale of fixed assets	-1 506	0	-1 505	0	0	0	0	0	0	-3 011
Write-off of fixed assets	-34	-1 319	-13 772	-482	0	0	0	-346	-623	-16 576
Reclassification within balance sheet	0	0	0	0	-170	-2 029	-7	0	0	-2 206
Reclassification to expenses	0	0	0	0	-460	0	0	0	0	-460
Expensed pipelines	0	0	0	0	0	-158 187	0	0	0	-158 187
Reclassification from assets in progress	20 654	119 355	47 058	658	-191 269	-1 974	0	1 809	3 709	0
<b>31 December 2007</b>	364 188	2 134 970	566 408	17 708	48 034	90 057	5 399	19 006	66 817	3 312 587
<b>Accumulated depreciation at</b>										
<b>31 December 2005</b>	55 681	613 318	299 732	11 534	0	0	0	9 430	16 530	1 006 225
Depreciation	3 864	31 471	34 143	1 844	0	0	0	1 978	7 747	81 047
Depreciation of fixed assets sold and written-off (-)	-70	-3 740	-8 231	-2 484	0	0	0	0	-7 006	-21 531
<b>31 December 2006</b>	59 475	641 049	325 644	10 894	0	0	0	11 408	17 271	1 065 741
Depreciation	3 952	33 642	31 569	1 102	0	0	0	1 918	7 058	79 241
Depreciation of fixed assets sold and written-off (-)	-34	-1 318	-15 197	-482	0	0	0	-346	-623	-18 000
<b>31 December 2007</b>	63 393	673 373	342 016	11 514	0	0	0	12 980	23 706	1 126 982
<b>Net book value at</b>										
<b>31 December 2005</b>	294 260	1 332 803	203 856	7 609	94 793	109 190	3 479	4 411	39 570	2 089 971
<b>31 December 2006</b>	285 599	1 375 885	208 983	6 638	91 676	117 162	2 795	6 135	46 460	2 141 333
<b>31 December 2007</b>	300 795	1 461 597	224 392	6 194	48 034	90 057	5 399	6 026	43 111	2 185 605

Before 2006 the minimum value of a fixed asset was 2 thousand kroons. As a result of the increase in the minimum acquisition value to 10 thousand kroons, additional depreciation of 522 thousand kroons was expensed to the profit and loss account with respect to assets capitalised in prior years. The initial acquisition value of these assets was 1 463 thousand kroons. The additional depreciation for the year is recorded mainly within 'Cost of goods sold (main operating activities)'.

Fixed assets are written off if the condition of the asset does not enable further usage for production purposes.

At 31 December 2005 the net balance sheet value of finance leases was 2 448 thousand kroons.

Signed for identification purposes:

AS Deloitte Audit Eesti

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007

(thousand EEK)

NOTE 8. SHORT-TERM AND LONG-TERM BORROWINGS

The Company's short-term and long-term debt obligations as of 31 December 2007 and the changes recorded during 2007 in the respective debits were as follows:

Bank loans	Loan date	Loan received	Residual amount		Repayments and loan cost amortization 2007	Residual amount 31. December 2007	Short-term portion	Long-term portion	Interest rate %	Maturity date
			31. December 2006	31. December 2007						
EBRD	11.2005	586 747	586 747	0	586 747	41 910	544 837	4,67	05.2015	
EBRD loan costs	11.2005	-17 404	-7 137	848	-6 289	-424	-5 865		05.2015	
Nordea Bank	11.2005	586 747	586 747	0	586 747	0	586 747	6 month Euribor + 0,24	11.2015	
Nordea Bank loan costs	11.2005	-290	-259	31	-228	0	-228		11.2015	
<b>Total bank loans</b>		<b>1 155 800</b>	<b>1 166 098</b>	<b>879</b>	<b>1 166 977</b>	<b>41 486</b>	<b>1 125 491</b>			
<b>Finance lease</b>		<b>15 905</b>	<b>473</b>	<b>-473</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>5,9 - 8,63</b>	<b>06.2007</b>	
<b>Total borrowings</b>		<b>1 171 705</b>	<b>1 166 571</b>	<b>406</b>	<b>1 166 977</b>	<b>41 486</b>	<b>1 125 491</b>			

All short-term debts are recorded on the Balance sheet line 'Current portion of long term borrowings'.

The long-term part of the finance lease and loans are respectively recorded on the Balance sheet lines 'Borrowings'.

The collaterals of the loans are indicated in Note 23. The repayments are indicated in Note 25.


Name                      Repayments period

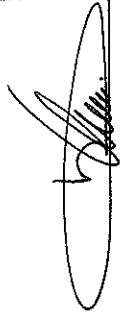
EBRD

Loan repayments start in November 2008. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.

Nordea Bank

Loan repayments start in May 2011. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.

Signed for identification purposes:  
  
AS Deloitte Audit Eesti

  
Chairman of the Management Board:

NOTES TO THE ANNUAL ACCOUNTS  
 FOR THE YEAR ENDED 31 DECEMBER 2007

(thousand EEK)

## NOTE 9. TRADE AND OTHER PAYABLES

as of 31 December

Liabilities	Balance amount	Balance amount	Short-term	Long-term	Maturity date
	2006	2007	portion	portion	
Accounts payable - operating expenditures	15 476	13 019	13 019	0	until 31.12.2008
Accounts payable - capital expenditures	52 555	53 063	53 063	0	until 31.12.2008
Factoring	270	0	0	0	until 31.12.2008
Payables to related parties	2 176	4 091	4 091	0	until 31.12.2008
Payables to employees	10 034	11 492	11 492	0	until 31.12.2008
Interest payable	4 681	5 207	5 207	0	until 31.12.2008
Other accrued expenses	58	94	94	0	until 31.12.2008
Long-term guarantee deposit*	100	113	0	113	04.2102
<b>Total trade and other payables</b>	<b>85 350</b>	<b>87 079</b>	<b>86 966</b>	<b>113</b>	


\* Long-term deposit is presented in acquisition value.

## NOTE 10. TAXES PAYABLE

as of 31 December

	2007	2006	Most common tax rates
	Income tax	1 948	
VAT	15 891	5 877	18%
Water usage tax	2 627	2 523	0,36 - 0,80 kr/m <sup>3</sup> (2006: 0,35 - 0,72 kr/m <sup>3</sup> )
Pollution taxes*	1 752	16 558	4 091 - 130 200 kr/t (2006: 3 409 - 108 540 kr/t)
Social security tax	3 853	3 399	33%
Other	415	432	0,3 -22%
<b>Total</b>	<b>26 486</b>	<b>30 508</b>	

\* Within pollution taxes was an accrual for 13.3 mln kroons at 31 December 2006. This accrual is recorded was order to cover the full value of the taxes that the Company had been exempted up to 31 December 2006. This relates to tax on Nitrogen waived by the Ministry of the Environment in return for the upgrade of the Waste Water Treatment Works. At this moment in time the Company had not received a reply to the final report of Nitrogen removal improvement project from the Ministry of the Enviroment, therefore a liability had been recorded. In February 2007 a liability was removed in accordance with the resolution of Ministry of the Enviroment.



AS Deloitte Audit Eesti

(thousand EEK)

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007****NOTE 11. SHORT-TERM PROVISIONS**

as of 31 December

Provisions include an estimate of the value of servitudes

	2007	2006
<b>Servitudes</b>	<b>2 231</b>	<b>538</b>

The provision recorded for servitudes is the management estimate of the expected cost of potential future payments to private land owners whose use of land has been restricted as a result of the Company's pipelines laid on their land. According to the management estimate there are no ongoing courtcases which will cause any extra cost that would need to be recorded as a provision or off-balance sheet liability.

**NOTE 12. DEFERRED INCOME**

as of 31 December

	2007	2006
Operating revenues incl connection revenues	42 099	32 724
Prepayments for sale of fixed assets	0	3 601
<b>Total deferred income</b>	<b>42 099</b>	<b>36 325</b>

**NOTE 13. SHARE CAPITAL**

At 31 December 2007 the nominal value of the share capital is 200 001 000 (two hundred million one thousand) kroons, composed of 20 000 000 shares with nominal value of 10 kroons per share (A-share) and one preferred share with a nominal value of 1 000 kroons (B-share).

One B-share has been issued giving the right of veto to the shareholder when voting on the following issues: change in statute, increase and decrease of share capital, issuance of replacement bonds, termination of Company activities, joining, sharing and rearrangements, acquisition of own shares and, on demand of management or supervisory board, deciding other issues related to the activities of the Company that have not been placed in the sole competence of the General Meeting by law. The B-share grants the holder the preferential right to receive a dividend in an agreed sum of 10 thousand kroons.

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

Restrictions on transfer of shares are disclosed in chapter 'Description of capital stock and corporate governance' of the IPO offering circular of AS Tallinna Vesi shares. The circular is available from the Company's website ([www.tallinnavesi.ee](http://www.tallinnavesi.ee)).


As of 31 December 2006 and 31 December 2007 United Utilities (Tallinn) B.V. owns 7 060 870 (35,3%) A- shares, the City of Tallinn owns 6 939 130 (34,7%) A- shares and one B-share, with 6 000 000 shares in free float.

Nordea Bank Finland PLC customers 1 542 491 (7,71%) and Morgan Stanley + Co International PLC customers owned 1 361 459 (6,81%) shares. Other direct shareholders owned less than 5% of the shares as of 31 December 2007.

From Supervisory and Management Board members only Siiri Lahe and Roch Jean Guy Antoine Chérourx owned 180 and 1 000 shares respectively, both proportion in shareholding was approximately 0 as of 31 December 2007.

Chairman of the Management Board

AS TALLINNA VESI

Signed for identification purposes:  
  
 AS Deloitte Audit Eesti

NOTES TO THE ANNUAL ACCOUNTS  
 FOR THE YEAR ENDED 31 DECEMBER 2007

(thousand EEK)

NOTE 14. NET SALES

for the year ended 31 December

	2007	2006
<b>Revenues from main operating activities</b>		
Total water supply and waste water disposal service, incl:	599 612	548 977
<u>Domestic clients, incl:</u>	<u>318 963</u>	<u>288 712</u>
Water supply service	178 452	161 931
Waste water disposal service	140 511	126 781
<u>Corporate clients, incl:</u>	<u>252 658</u>	<u>235 029</u>
Water supply service	138 693	126 617
Waste water disposal service	113 965	108 412
<u>Outside service area clients, incl:</u>	<u>17 676</u>	<u>13 372</u>
Water supply service	1 541	703
Waste water disposal service	16 135	12 669
<u>Overpollution</u>	<u>10 315</u>	<u>11 864</u>
Stormwater treatment and disposal service	37 426	30 052
Fire hydrants service	2 361	3 007
Other works and services	8 936	7 140
<b>Total revenues from main operating activities</b>	<b>648 335</b>	<b>589 176</b>
<b>Revenues from other operating activities</b>		
Water, sewerage and storm water connections construction income	172 437	104 048
<b>TOTAL NET SALES</b>	<b>820 772</b>	<b>693 224</b>

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

Code of Estonian Classification of Economic Activities (EMTAK) is 36001.

NOTE 15. PERSONNEL EXPENSES

for the year ended 31 December

	2007	2006
Salaries and wages	-57 666	-50 532
Social security taxation	-19 203	-16 832
<b>Staff costs total</b>	<b>-76 869</b>	<b>-67 364</b>
<b>Number of employees at the end of reporting period</b>	<b>312</b>	<b>318</b>

  
 Chairman of the Management Board:



**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

(thousand EEK)

**NOTE 16. COST OF GOODS SOLD, MARKETING AND GENERAL ADMINISTRATIONS EXPENSES**

	for the year ended 31 December	
	2007	2006
<b>Cost of goods sold (main operating activities)</b>		
Tax on special use of water	-10 493	-10 050
Chemicals	-20 979	-20 638
Electricity	-26 382	-24 594
Pollution tax	6 207	-11 988
Staff costs	-51 611	-46 521
Research & development	-99	-129
Depreciation and amortization	-72 806	-73 278
Other costs of goods sold	-40 514	-33 339
<b>Total cost of goods sold (main operating activities)</b>	<b>-216 677</b>	<b>-220 537</b>
<b>Cost of goods sold (other operating activities)</b>		
Water, sewerage and storm water connections construction cost	-158 187	-97 096
<b>Marketing Expenses</b>		
Staff costs	-6 107	-4 710
Depreciation and amortization	-3 553	-2 453
Other marketing expenses	-3 887	-2 415
<b>Total cost of marketing expenses</b>	<b>-13 547</b>	<b>-9 578</b>
<b>General Administration Expenses</b>		
Staff costs	-19 151	-16 133
Depreciation and amortization	-2 882	-5 316
Other general administration expenses	-34 816	-29 870
<b>Total cost of general administration expenses</b>	<b>-56 849</b>	<b>-51 319</b>

**Other income/expenses** - in both 2006 and 2007 other income/expenses includes the profits recognised on the sale of fixed assets during the period, the movement of the bad debt provision during the year and provisions recognised and released throughout the financial period. It also includes income and costs generated from a consultancy project in the Republic of Tajikistan.

Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

(thousand EEK)

**NOTE 17. FINANCIAL INCOME AND EXPENSES**

	for the year ended 31 December	
	2007	2006
Interest income	10 861	7 034
Interest expense	-53 513	-48 445
Other financial expenses	-1 585	-1 571
<b>Total financial income / expenses</b>	<b>-44 237</b>	<b>-42 981</b>

**NOTE 18. DIVIDENDS**

	as of 31 December	
	2007	2006
Dividends declared during the period	196 010	157 000
Dividends paid during the period	196 010	157 000
Income tax on dividends declared	-55 285	-46 896
<b>Income tax accounted</b>	<b>-55 285</b>	<b>-46 896</b>

The income tax rates were 22/78 and 23/77 respectively in 2007 and 2006.

**NOTE 19. EARNINGS AND DIVIDENDS PER SHARE**

	as of 31 December	
	2007	2006
Earnings per share from continuing operations:		
Earnings for the purposes of basic earnings per share (net profit for the period minus B-share preference rights)	277 830	248 036
Weighed average number of ordinary shares for the purposes of basic earnings per share	20 000 000	20 000 000
Earnings per share in kroons	13,89	12,40
Dividends per A-share in kroons	9,80	7,85
Dividends per B-share in kroons	10 000	10 000

Diluted earnings per share for the periods ended 31 December 2007 and 31 December 2006 are equal to the earnings per share figures stated above.



**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

(thousand EEK)

**NOTE 20. NOTES TO THE CASH FLOW STATEMENT**

for the year ended 31 December

NOTE 20A. PIPELINES FINANCED BY CONNECTION FEES

	2007	2006
<b>Revenue</b>		
Connection fees from pipelines taken into use	172 437	104 048
Increase in prepayments for pipelines	9 218	9 481
Change in accounts receivable from pipelines	-79 815	-867
<b>Connection fees received</b>	<u>101 840</u>	<u>112 662</u>
Acquisition cost of pipelines taken into use	-158 187	-97 096

The connection fees from and the acquisition costs of pipelines taken into use are eliminated from "Cash flows of operating activities" as these are recorded within "Cash flows from investing activities". The net amounts eliminated were respectively -14 250 thousand and -6 952 thousand kroons in 2007 and in 2006.

NOTE 20B. CHANGE IN CURRENT ASSETS AND LIABILITIES

In addition to changes in the balance sheet, current assets and liabilities are changed as follows:

	2007	2006
<b>Current assets</b>		
Change in balance sheet	-43 138	-46 813
<u>Adjustments:</u>	0	0
Change in money balance	-70 993	42 346
Changes between fixed assets and current assets	2 206	76
Assets sold from assets for sale	-242	-1 107
Change in deferred interests	290	489
Change in construction income debt	79 815	867
<b>Total change in current assets</b>	<u>-32 062</u>	<u>-4 142</u>
<b>Current liabilities</b>		
Change in balance sheet	46 174	6 666
<u>Adjustments:</u>		
Change in finance lease and loan costs	-40 659	317
Change in payables for capital investments	-238	-33 507
Prepayments for the sale of fixed assets	3 600	42 000
Change in construction income prepayments	-9 204	-9 482
<b>Total change in current liabilities</b>	<u>-327</u>	<u>5 994</u>

Signed for identification purposes:



AS Deloitte Audit Eesti

AS TALLINNA VESI

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

(thousand EEK)

**NOTE 20. NOTES TO THE CASH FLOW STATEMENT (continued)**

for the year ended 31 December

NOTE 20C. PAYMENTS FOR FIXED ASSETS

	2007	2006
Acquisition of fixed assets	-285 953	-246 476
<u>Adjustments:</u>		
Change in accounts payable related to investments	238	33 507
Capitalization of operating expenses	19 764	20 921
<b>Total payments for fixed assets</b>	<b>-265 951</b>	<b>-192 048</b>

**NOTE 21. COMMITMENTS**

as of 31 December

**Leased assets**

	2007	2006
Total operating lease expense for computers and vehicles	7 281	5 355

Minimum operating lease payments are as follows:

Less than 1 year	6 946
1-5 years	9 053
<b>Total minimum lease payments</b>	<b>15 999</b>

As of 31 December 2007 the Company had taken commitments for capital investments, i.e. concluded contracts and requested works with purchase orders to the value of 39 528 thousand kroons.





AS TALLINNA VESI

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

(thousand EEK)

**NOTE 22. CONTINGENT INCOME TAX ON DIVIDENDS**

According to the Estonian Income Tax Act the accrued profit of a resident legal entity is not subject to tax, as tax is charged only on dividend distributions. Pursuant to the Income Tax Act Section 50, effective since 1 January 2003, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The tax rate applicable is 22/78 on the amount of the dividends payable in 2007, in 2006 the rate was 23/77. Since 1 January 2008 the rate is 21/79.

The potential tax liability that may occur if all distributable retained earnings should be paid out as dividends is not reported on the Balance Sheet. The income tax due on dividend distribution is recorded as a tax cost within the Income Statement during the same period as the dividend is paid.

The Company's distributable retained earnings as at 31 December 2007 amounted to 627 319 thousand kroons. Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 166 756 thousand kroons.

**NOTES 23. COLLATERAL OF LOANS AND PLEDGED ASSETS**

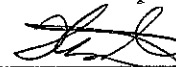
In connection with the loan agreements concluded between the EBRD and the Company and between the Estonian affiliate of Nordea Bank Plc (hereinafter Nordea Bank) and the Company, the following guarantee contracts were concluded, which concern the assets of the Company :

- a) Commercial Pledge Agreement in favour of EBRD to the value of 1 877 592 thousand kroons;
- b) Separate Mortgage Agreements in favour of EBRD regarding the properties of Ülemiste water treatment plant and Paljassaare waste water treatment plant whereby both pledges are to the value of 293 374 thousand kroons;
- c) Combined Mortgage Agreement in favour of Nordea Bank regarding the properties of Ülemiste water treatment plant and Paljassaare waste water treatment plant to the value of 586 748 thousand kroons.

The mortgages in favour of Nordea Bank and EBRD have the same ranking.

- d) A Security Sharing Agreement is concluded between EBRD and Nordea Bank.



NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007

(thousand EEK)

## NOTE 24. RELATED PARTIES

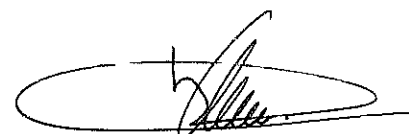
Transactions with related parties are considered to be transactions with members of the Supervisory Board and Management Board, their relatives and the companies in which they hold majority interest and transactions with shareholder having the significant influence. Dividend payments are indicated in the Statement of Changes in Equity.

The transactions with related parties in 2007 and 2006 and respective balances as of 31 December 2007 and 31 December 2006 are recorded as follows:

	Tallinn City Government and related boards	The companies belonging to the same group with the United Utilities (Tallinn) B.V.
<b>2007</b>		
<b>Transactions recorded in Working Capital on the Balance Sheet of AS Tallinna Vesi</b>		
Accounts receivable	110 639	0
Accounts payable - short-term trade and other payables	0	4 091
<b>Transactions recorded to other accounts on the Balance Sheet of AS Tallinna Vesi</b>		
Non-current assets incl unfinished assets and new connections	0	5 836
<b>Transactions recorded to the Income Statement of AS Tallinna Vesi</b>		
Net sales	158 733	0
General administration expenses	0	17 612
<b>2006</b>		
<b>Transactions recorded in Working Capital on the Balance Sheet of AS Tallinna Vesi</b>		
Accounts payable - short-term trade and other payables	0	2 176
<b>Transactions recorded to other accounts on the Balance Sheet of AS Tallinna Vesi</b>		
Non-current assets incl unfinished assets and new connections	0	11 593
<b>Transactions recorded to the Income Statement of AS Tallinna Vesi</b>		
Net sales	84 686	0
General administration expenses	0	14 729
Other expenses	0	10
	<b>for the year ended 31 December</b>	
	<b>2007</b>	<b>2006</b>
<b>Management Board fees excluding social tax</b>	2 118	2 097
<b>Supervisory Board fees excluding social tax</b>	578	500

The fees disclosed above are contractual payments made by the Company to the management board members. In addition to this the board members have also received direct compensations from the companies belonging to the group of United Utilities (Tallinn) B.V. as overseas secondees.

The information about AS Tallinna Vesi shares belonging to the related parties is disclosed in note 13.



Chairman of the Management Board:

**NOTE 25. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS**

The Company operates only in Estonia and the number of international transactions is limited to specific purchases and loan transactions. The Company still seeks to minimise potential adverse effects on the financial performance of the Company. A Financial Department under instructions given by the Management Board carries out risk management.

	2007	2006
<b>Financial assets</b>		
Receivables (incl cash and cash equivalents)	364 220	321 592
Swap contract	1 549	436
<b>Financial liabilities</b>		
Financial liabilities by amortised cost	1 280 542	1 282 429

The fair value of financial instruments is equal to the carrying amount.

**Foreign exchange risk**

The Company's international transactions are mainly in euros, which rate is fixed against Estonian kroons, all transactions in other currencies may be considered immaterial. Therefore, the likelihood of being exposed to foreign exchange risk arising from currency exposures is low and as such no specific activities for foreign exchange management are needed at this moment in time.

**Interest rate risk**

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The Company has no significant interest-bearing assets. Interest bearing financial liabilities are loans and swap contract.

AS Tallinna Vesi is exposed to interest rate risk as it borrows funds at both fixed and floating interest rates. The risk is managed by the Company by maintaining an appropriate mix between fixed interest rate borrowings (4,19% + 48 basis points) from EBRD, and floating rate borrowings (6 month EURIBOR + 24 basis points) from Nordea by the use of interest rate swap contract, the aim of which is fixing the floating interest rate at certain dates depending on the respective spot rate of the 6 month EURIBOR.

**Interest rate swap contract:**

Maturity date: 28.05.2009

Notional amount: 347 144 thousand kroons

The fair value of the interest rate swap contract is 1 549 thousand kroons as at 31.12.2007.

If interest rates had been 50 basis points higher and all other variables were held constant, ASTV's profit before tax for the year ended 31 December 2007 would decrease by 4 578 thousand kroons. If interest rates had been 50 basis points lower and all other variables were held constant, ASTV's profit before tax for the year ended 31 December 2007 would increase by 1 774 thousand kroons.

**Credit risk**

The Company has no significant concentrations of credit risk. The Company has procedures in

Chairman of the Management Board:

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

(thousand EEK)

place to ensure that sales of products and services and purchases are only made in accordance with the Company's policies. The debt management team participates in the determination of payment terms and schedules to facilitate the collection of debt and controls the payment discipline of customers as part of a daily routine, for example by sending out invoice reminders, making debt follow up phone calls and other debt management tools.

The Company's maximum credit risk equals the carrying amount of financial assets. Non of the receivables from one customer exceeds 5 % of the total receivables, except City of Tallinn, which is 111 mln kroons.

**Liquidity risk**

In liquidity risk management the Company has taken a prudent view, maintaining sufficient cash balance and availability of short-term marketable securities to fulfil its financial liabilities. Continuous cash flow forecasting and control are essential tools in the day-to-day liquidity risk management of the Company.

Maturities of the non-derivative financial assets and liabilities:

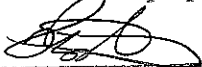
2007	Intrest rate %	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Total
<b>Financial assets</b>							
Non-interest bearing	–	98 048	87 236	–	–	–	185 284
Fixed interest rate instruments	3,72	179 219	–	–	–	–	179 219
		<b>277 267</b>	<b>87 236</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>364 503</b>
<b>Financial liabilities</b>							
Non-interest bearing	–	102 519	10 933	–	–	113	113 565
Variable interest rate instruments	6 months Euribor + 0,24	–	–	27 308	568 549	121 532	717 389
Fixed interest rate instruments	4,67	–	–	69 387	502 311	131 587	703 285
		<b>102 519</b>	<b>10 933</b>	<b>96 695</b>	<b>1 070 860</b>	<b>253 232</b>	<b>1 534 239</b>
<b>2006</b>							
	Intrest rate %	Less than 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	Over 5 years	Total
<b>Financial assets</b>							
Non-interest bearing	–	70 485	1 468	–	–	–	71 953
Fixed interest rate instruments	6,94	249 729	–	–	–	–	249 729
		<b>320 214</b>	<b>1 468</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>321 682</b>
<b>Financial liabilities</b>							
Non-interest bearing	–	84 562	31 196	–	–	100	115 858
Financial lease liability	4,5 - 8,63	–	–	473	–	–	473
Variable interest rate instruments	6 months Euribor + 0,24	–	–	26 308	468 766	248 623	743 697
Fixed interest rate instruments	4,67	–	–	27 401	336 582	366 703	730 686
		<b>84 562</b>	<b>31 196</b>	<b>54 182</b>	<b>805 348</b>	<b>615 426</b>	<b>1 590 714</b>

Chairman of the Management Board:



AS TALLINNA VESI

**NOTES TO THE ANNUAL ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

Signed for identification purposes:  
  
AS Deloitte Audit Eesti

(thousand EEK)

**Requirements to the capital**

The management board of the Company ensures the management of the capital structure of the Company according to the Business Plan approved by the Supervisory Council. The Business plan foresees a ratio of the total liabilities to the total asset at least on 50% level. The company's leverage ratios were respectively 51.8% and 53.4% as of 31.12.07 and 31.12.06. The loan agreement with Nordea does limit the minimum ratio 35% for the equity capital from the total assets.



Chairman of the Management Board:


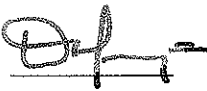


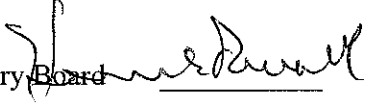
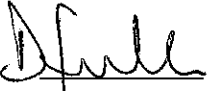



**AS TALLINNA VESI**

**CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS TO THE ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2007**

The Management Board has prepared the management report and the annual accounts of AS Tallinna Vesi on 15 February 2008.

The Supervisory Board of AS Tallinna Vesi has reviewed the annual report, prepared by the Management Board, consisting of Management Report and the annual accounts, the Management Board's proposal for profit distribution and the independent auditors' report, and has approved the annual report for presentation on the Shareholders' General Meeting.

The annual report has signed by all the members of the Management Board and Supervisory Board.

<b>Name</b>	<b>Position</b>	<b>Signature</b>	<b>Date</b>
Roch Jean Guy Antoine Chérourx	Chairman of the Management Board		<u>10.03.08</u>
David Nigel Hetherington	Member of the Management Board		<u>12.02.08</u>
Siiri Lahe	Member of the Management Board		<u>10.03.08</u>
Robert John Gallienne	Chairman of the Supervisory Board	_____	_____
Ian John Alexander Plenderleith	Member of the Supervisory Board		<u>11/3/08</u>
Henry Emanuel Russell	Member of the Supervisory Board		<u>15/3/08</u>
David Leonard Fuller	Member of the Supervisory Board		<u>10-03-08</u>
Mart Mägi	Member of the Supervisory Board		<u>11.03.08</u>
Rein Ratas	Member of the Supervisory Board	_____	_____
Elmar Sepp	Member of the Supervisory Board	_____	_____
Deniss Boroditš	Member of the Supervisory Board		<u>11.03.08</u>
Valdur Laid	Member of the Supervisory Board		<u>11.03.08</u>

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of AS Tallinna Vesi:

We have audited the accompanying annual accounts (page 15 to 40) of AS Tallinna Vesi, which comprise the balance sheet as at 31 December 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### *Management Board's Responsibility for the Annual Accounts*

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

### *Auditor's Responsibility*

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

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

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

### *Opinion*

In our opinion, the annual accounts present fairly, in all material respects, the financial position of AS Tallinna Vesi as of 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.



Sander Kallasmaa  
Certified Auditor  
15 February 2008



AS Deloitte Audit Eesti