

MANAGEMENT REPORT

General information

Merko Ehitus is a leading construction group offering complete solutions, with entities located in Estonia, Latvia and Lithuania. Merko Ehitus was set up in 1990. The Group consists of 26 subsidiaries and 5 associates and joint ventures, the largest of which are SIA Merks (100%), UAB Merko Statyba (100%), Tallinna Teede AS (100%), AS Gustaf (75%), OÜ Gustaf Tallinn (80%), AS Merko Tartu (66%), OÜ Woody (100%), OÜ Fort Ehitus (75%) and AS Tartu Maja Betoontooted (25%).

These financial statements reflect the operating activities and financial information of AS Merko Ehitus for the 12 months of 2008, including those of its legal predecessor (former name: AS Merko Ehitus) for the first 7 months of 2008.

Key changes occurred at the Group in 2008:

- At 7 October 2008, AS Merko Ehitus disposed of its 100% interest in OÜ Põrguvälja Soojus (registry code 10711682) as a business not relevant for carrying amount the strategic objectives of the Group (http://www.baltic.omxnordicexchange.com/market/?pg=news&news_id=227308).
- At 21 May 2008, AS Merko Ehitus disposed of its 50% interest in joint venture OÜ Tornimäe Apartments (registry code 11016607) to co-shareholder AS EKE Invest. The sales price of the company was EEK 58 million (http://www.baltic.omxnordicexchange.com/market/?pg=news&news_id=223709).
- At 2 May 2008, AS Merko Ehitus disposed of its 100% interest in OÜ Karulaugu Kinnisvara (registry code 11034491) to AS E.L.L. Kinnisvara. The sales price of the company was EEK 42 million, of which the balance of the company's liabilities and current assets in the amount of EEK 4.12 million was deducted (http://www.baltic.omxnordicexchange.com/market/?pg=details&instrument=EE3100003559&list=2&tab=news&news_id=223284). The company only held a 51,7 th. m² registered immovable in Viimsi rural municipality.
- Due to the need to simplify the Group's structure, AS Merko Ehitus liquidated its subsidiaries AS Merko Insenerihitus, OÜ Merko Ehitustööd and OÜ Pire Projekt as well as the subsidiaries of SIA Merks: SIA MR Multifunktionälais centrs, SIA Ziemeļzeme, SIA Otrā Skanstes virsotne, SIA Trešā Skanstes virsotne, SIA Ceturtā Skanstes virsotne and Limited partnership MBC in 2008.

At 3 April 2009, a suspicion was elaborated which was earlier submitted against AS Merko Ehitus in relation to the giving of a bribe to Ivo Parbus. While the suspicion submitted at 17 December 2008 stated that the bribe was given for the purpose of accelerating the proceedings with the plans of seven properties, then according to the elaboration of 3 April, the number of properties decreased to three. Concerning the plans for the remaining four properties, a suspicion on the same bribe object was submitted against OÜ Woody, OÜ Metsailu and OÜ Constančia that are subsidiaries of AS Merko Ehitus. In addition to Estravel's gift coupon of EEK 25 thousand, the suspected bribe of AS Merko Ehitus also includes book "Eesti Talurahva Arhitektuur" costing EEK 410. The suspicion submitted against the subsidiaries mentions Estravel's gift coupon of EEK 25 thousand, a book costing EEK 410 and Estravel's gift coupon of EEK 15 thousand as the bribe. The suspects consider the suspicions to be unfounded (http://www.nasdaqomxbaltic.com/market/?pg=news&news_id=232461).

At 17 December 2008, the Security Police Board submitted a suspicion against AS Merko Ehitus concerning the giving of bribe. According to the suspicion, a member of the Management Board of AS Merko Ehitus presented a book and a travel coupon of EEK 25 thousand to a city official for arranging detailed plans for seven properties in the City of Tallinn. AS Merko Ehitus does not agree with the submitted suspicion (http://www.nasdaqomxbaltic.com/market/?pg=details&instrument=EE3100098328&list=2&tab=news&news_id=229083).

At 1 August 2008, the registration department of Harju County Court registered the demerger of AS Merko Ehitus (registry code 10068022, with the new business name of public limited company Järvevana) into public limited companies Merko Ehitus (registry code 11520257) and Järvevana (registry code 10068022) with the Commercial Register.

According to the demerger plan, AS Järvevana transferred to AS Merko Ehitus upon division the complete set of assets related to the economic activities of the construction company, including all concluded construction contracts, subcontracts and supply contracts, facilities, equipment and employees, all professional know-how and cash flows from uninterrupted, continuous economic activities (<http://www.merko.ee/upload/File/Restruktureerimise%20dokumendid/AS%20Merko%20Ehitus%20jaqunemiskava%20ENG.pdf>).

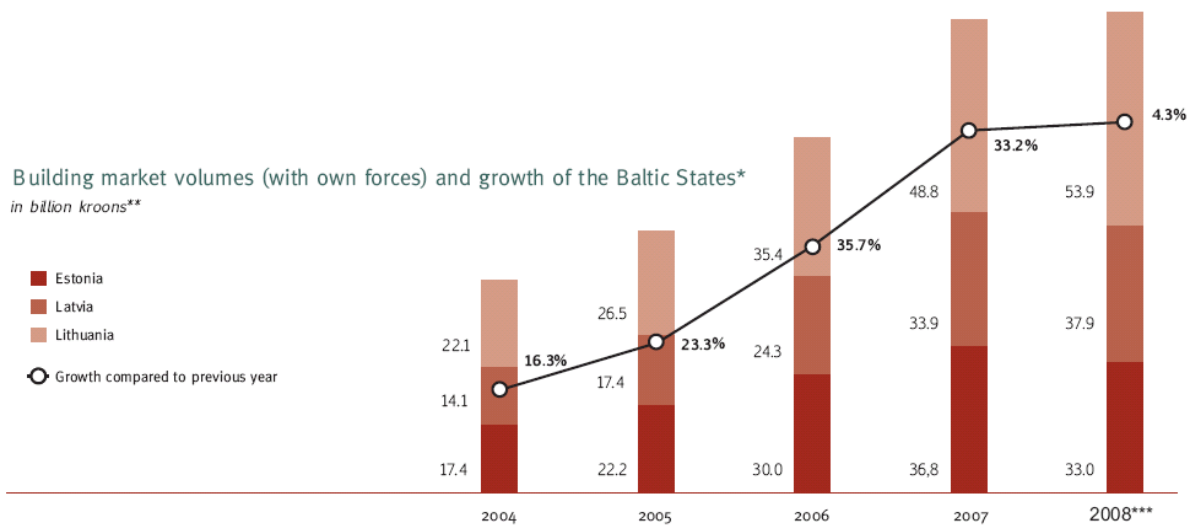
At 3 June 2008, the General Meeting of Shareholders (http://www.nasdaqomxbaltic.com/market/?pg=news&news_id=226094) approved the demerger of the Company into public limited companies the new Merko Ehitus (registry code 11520257) and Järvevana (registry code 10068022).

At 15 April 2008, the management of AS Merko Ehitus presented the Company's restructuring plan (http://www.baltic.omxgroup.com/market/?pg=details&instrument=EE3100003559&list=2&tab=news&news_id=222602), according to which AS Merko Ehitus is divided so that the enterprise of AS Merko Ehitus, i.e. assets (other than liquid assets in the amount of EEK 250 million), liabilities and contracts as well as the business name are separated and transferred to the new company being set up. The demerger plan, which included the detailed specification of assets not to be transferred, was signed at 30 April 2008 and the demerger plan (<http://www.merko.ee/upload/File/Restruktureerimise%20dokumendid/AS%20Merko%20Ehitus%20jaqunemiskava%20ENG.pdf>) was published at 30 April 2008 concurrently with the invitation to the General Meeting of Shareholders <http://www.merko.ee/eng/investor/generalmeeting/2008>.

At a joint meeting held at 14 March 2008, the Management Board and the Supervisory Board of AS Merko Ehitus adopted a resolution to restructure the Company and separate operating activities from the criminal proceedings related to land swap. The Company's management estimates that the restructuring of the Company is the best way to ensure its sustainable development and protect the interests of shareholders and employees in the long-lasting criminal proceedings related to land swap.

Baltic construction market

In 2008, construction works with own resources were performed in the Baltic region for EEK 124.7 billion which is EEK 5.1 billion more than in 2007. Although the Baltic construction market as a whole grew by 4.3% in a year, the results by the countries were very different. The fastest growth occurred in Latvia, where the construction market grew by 11.9% in current prices (2007: 40.2%) and reached EEK 37.9 billion. Lithuania's growth of 10.3% fell short of the respective figure of Latvia similarly to the last year and also significantly decreased as compared to its last year's growth rate of 38.0%, but still reached EEK 53.9 billion. The Estonian market was the only one not to maintain the momentum of previous years. According to the data by Statistics Estonia, construction works with own resources were performed for EEK 33.0 billion in 2008. As compared to 2007, the Estonian construction companies performed construction works for EEK 3.8 billion or 10.4% less. Despite their faster growth rates, Latvia and Lithuania could still not surpass Estonia with regard to construction works per capita. Construction works per capita were performed for EUR 1572 in Estonia, EUR 1072 in Latvia and EUR 1026 in Lithuania.



* Based on the data of local statistical offices.

** According to the unofficial central exchange rate of Eesti Pank.

*** Data of 2008 tentative, based on short-term statistics.

The real estate market crisis that commenced last year deepened in the residential housing market. It manifested itself more acutely in Latvia and Estonia, and a little more modestly in Lithuania. Lower sense of security of consumers and stricter lending terms significantly reduced the demand for residential space. The complexity of the situation was enhanced by completion of new residential space, the construction of which and introduction to the market commenced during the real estate boom. During 2008, a total of 5300 user permits (2007: 7073) were issued in Estonia, 8084 (2007: 9319) in Latvia and 11 829 (2007: 9286) in Lithuania for new dwellings. As a result of the interaction of the above events, the selling periods got significantly longer and the sales prices decreased from the peak in 2007 by 30-40%. For the majority of the projects, the sales prices decreased below the expenses incurred for development of residential housing and so the developer 'pays bonus' to each buyer of an apartment. In many projects, the prices of residential housing decreased to the level of the bank loan taken for its development. Adjustment of sales prices of such projects requires obtaining approval from banks, which significantly reduces flexibility of sellers and generally those apartments are priced above market.

Despite clear indications of an economic downturn, the reports by Statistics Estonia indicated continuous appreciation of construction services in the Baltic States: the year-on-year growth in Latvia was 8.1%, in Lithuania 2.6% and in Estonia 0.5%, including appreciation of labour costs by 10.3% in Latvia and depreciation of labour costs by 1.7% in Estonia. The presented figures rather reflect the time 12 months ago when a majority of the contracts being performed today were concluded.

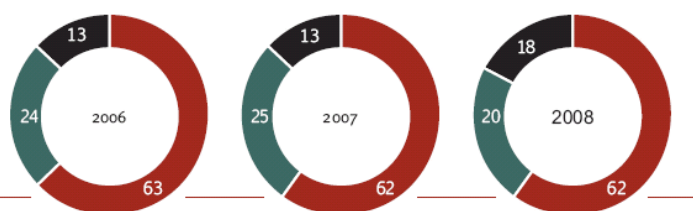
Operating results

Although the performance indicators of the Group in 2008 remained below those in the previous years, the performance may be considered good in the changed economic environment. In 2008, the revenue of Merko Ehitus group was EEK 4653.9 billion, decreasing by 15.5% in a year. In 2008, Estonia contributed 62.2%, Latvia 19.4% and Lithuania 18.4% to Group sales. As compared to 2007, the revenue increased by 15.8% in Lithuania, and decreased by 14.5% in Estonia and 34.7% in Latvia.

Geographical distribution of turnover of Merko Ehitus group

per cent

- Estonia
- Latvia
- Lithuania



The consolidated sales revenue of the Group's largest entities:

in thousands of kroons and euros

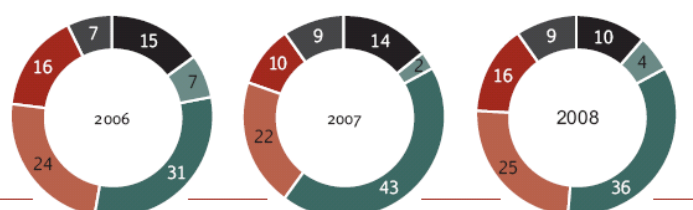
	2008		2007	
	EEK	EUR	EEK	EUR
Estonian entities				
AS Merko Ehitus (parent)	1 861 553	118 975	2 221 823	142 000
AS Gustaf (75% ownership)	142 558	9 111	153 123	9 786
OÜ Gustaf Tallinn (80% ownership)	140 930	9 007	146 568	9 367
AS Merko Tartu (66% ownership)	308 732	19 732	309 282	19 767
Tallinna Teede AS (100% ownership)	432 273	27 627	363 272	23 217
OÜ Woody (100% ownership)	79 803	5 100	218 642	13 974
Latvian entity				
SIA Merks (100% ownership)	878 295	56 133	1 225 816	78 344
Lithuanian entity				
UAB Merko Statyba (100% ownership)	797 902	50 995	696 010	44 483

Engineering construction contributed 16%, residential construction/development 25%, service buildings 36%, office buildings 10%, industrial buildings 4% and road construction 9% to the Group's revenue. Of construction activities, 84% was for new building and 16% was renovation and reconstruction works. In 2008, the Group concluded construction contracts in the total amount of EEK 3504 million and as at 31.12.2008, the Group's contract portfolio totalled EEK 2986 million.

Distribution of construction activities of the group

per cent

- Office buildings
- Industrial buildings
- Public service buildings
- Residential buildings/Development
- Civil engineering
- Road construction



The largest projects completed in 2008

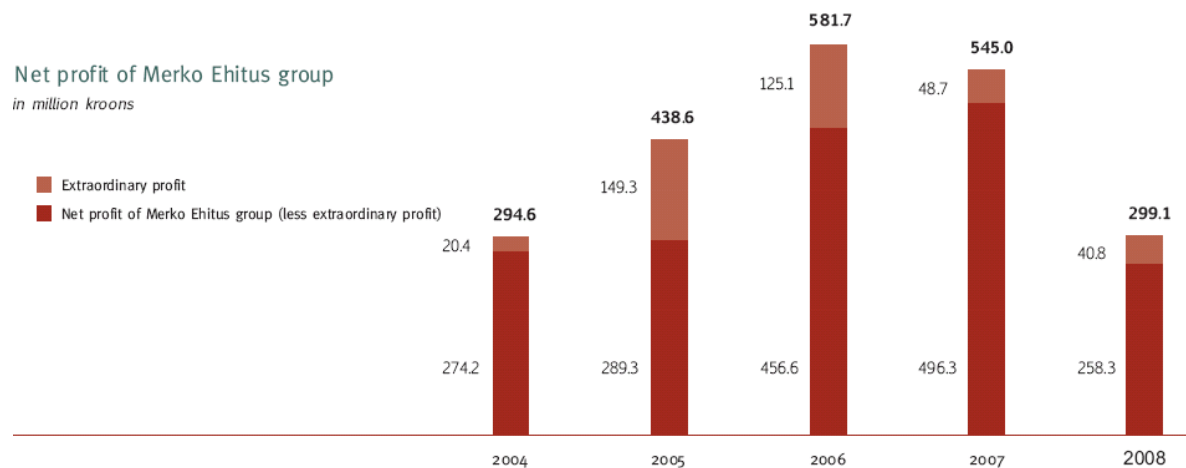
Viru Prison	new facility	Jõhvi, Ida-Virumaa	43 392 m ²	AS Merko Ehitus
Extension of Pärnu water and sewerage network	new facility	Pärnu City	68.3 km	AS Merko Ehitus
Saviliiva apartment buildings and small houses	new facility	Saviliiva Rd 8A and Vabaõhumuuseumi Rd 95B, Harjumaa	19 472 m ²	AS Merko Ehitus
Ülemiste City commercial and office building 2	new facility	Lõõtsa 2, Suur-Sõjamäe 10B, Tallinn	6348 m ²	AS Merko Ehitus
Apartment building	new facility	Pärnu Str 129c, Tallinn	9019 m ²	AS Merko Ehitus
Shopping centre Valleta	new facility	Riia Str 4, Valmiera	16 580 m ²	SIA Merks
Hotel	new facility	Kalneciema 90, Riga	7 908 m ²	SIA Merks
Panorama shopping centre	new facility	Saltoniškių 9, Vilnius	65 000 m ²	UAB Merko Statyba
National road No 6 Valga-Uulu	reconstruction	Valga-Uulu Highway 98.2-106.7 km	85 000 m ²	Tallinna Teede AS
Production complex of Hilding Baltic AS	new facility	Loomäe 10, Rae Technology Park, Harjumaa	14 400 m ²	AS Gustaf

In a year, the cost of goods sold by the Group decreased by 17.7% while marketing, and general and administrative expenses increased by 8.7%, amounting to 83.7% and 5.8%, respectively, of the revenue. Several extraordinary expenses in the period contributed to the growth of marketing and general and administrative expenses, arising from the demerger of AS Merko Ehitus and AS Järvevana, legal expenses arising from the dispute concerning legal succession of Merko Ehitus and existence of experience, severance pay and expenses for labour not engaged in construction charged to overheads.

In 2008, the Group's net profit totalled EEK 299.1 million, of which EEK 3.1 million was earned from the sale of the group entities, EEK 192 million from the sale of registered immovables, EEK 121.5 million from construction activities and EEK 32.7 million from financing activities. The loss from development activities, including write-down of inventories, was EEK 50.2 million. Similarly to a decline in gross and operating margins, the net profit margin also decreased, to 6.4% from 9.9% in the comparable period. The Group's net profit margin before extraordinary income was 5.6% and the profit margin from construction activities was 3.4%.

Net profit of Merko Ehitus group

in million kroons



In 2008, the Group's total cash flows amounted to EEK +312.9 million, of which the cash flows from operating activities totalled EEK +681.7 million. The cash flows from operating activities of the reporting period were mostly affected by the operating profit EEK +328.1 million, change in receivables and prepayments related to operating activities EEK +387.5 million, change in liabilities and prepayments related to operating activities EEK -279.9 million, change in inventories EEK +190.1 million, stage of completion adjustment of revenue from construction contracts EEK +146.8 and corporate income tax paid EEK -51.1 million. The Group's cash flows from investment activities totalled EEK -231.8 million, of which EEK -265.6 totalled acquisition of financial investments, loan repayments received and interest in the period totalled EEK +34.2 million, loans granted during the period totalled EEK -22.3 million, investments in property, plant and equipment totalled EEK -43.3 million and sale of subsidiaries and associates totalled EEK +67.2 million. The Company's cash flows from financing activities totalled EEK -112.0 million, of which the balance of credit liabilities assumed/repaid was EEK -105.5 million and dividends paid EEK -6.5 million.

The ratios and methodology for calculating the financial ratios describing the Company's main operations:

	2006	2007	2008
Net profit margin	13.2%	9.9%	6.4%
Net profit margin (excluding extraordinary profit)	10.3%	9.0%	5.6%
EBT margin	14.5%	10.7%	7.1%
Operating profit margin	14.3%	9.5%	7.0%
Return on equity per annum	43.2%	30.2%	14.6%
Return on assets per annum	21.4%	15.3%	7.7%
Equity ratio	49.6%	51.5%	53.7%
Current ratio	2.0	2.4	2.8
General expense ratio	3.9%	4.5%	5.8%
Personnel expense ratio	6.3%	7.4%	8.8%
Debt ratio	27.8%	34.9%	35.6%
Accounts receivable turnover (in days)	46	59	42
Accounts payable turnover (in days)	45	41	34
Sales revenue per employee (in million EEK)	5.193	5.376	4.549
Average number of full-time employees at the Group	850	1025	1023

Net profit margin: Net profit / Revenue

EBT margin: Profit before tax / Revenue

Operating profit margin: Operating profit / Revenue

Return on equity per annum: Net profit / Average equity of the period*

Return on assets per annum: Net profit / Average assets of the period

Equity ratio: Owners' equity* / Total assets

Current ratio: Current assets / Current liabilities

General expense ratio: General expenses / Revenue

Personnel expense ratio: Personnel expenses / Revenue

Debt to equity ratio: Interest-bearing liabilities / Owners' equity*

Accounts receivable turnover: Trade receivables / Revenue x 365

Accounts payable turnover: Payables to supplies / Cost of goods sold x 365

Sales revenue per employee: Sales revenue / Average number of full-time employees

* attributable to equity owners of the parent

Business risks

Market risk. One of the peculiarities of construction activities is the fact that the execution of the contracts concluded will take months, making the sector inert to changes in the economic environment. Due to this, the changes in economic environment having both a negative and positive effect will reach construction industry with a lag of approximately 12-18 months. This time lag enables the sector to arrange its activities to be prepared for potential setbacks as well as booms. Given both the local and global economic downturn, the sector will face a general contraction in the next period.

The concurrent occurrence of several unfavourable factors – appreciation of credit, a decline in demand and general uncertainty towards future led to a significant decrease in the investing interest of both private and legal persons. Due to a fast decline in the market prices and demand, the Group has frozen a majority of housing development projects and focused on the sale of existing inventories. In 2008, real estate development made up 23.2% of the revenue of Merko Ehitus, including housing development of 16.9%. In 2008, the Group sold 529 apartments and as at the year-end held in inventories unsold 412 completed apartments and 449 apartments in the construction stage, of which the construction process was frozen for 438 apartments until a recovery in demand.

Operating risk. The Group concludes total risk insurance contracts with insurance companies in order to hedge unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor for up to EUR 10 million. The risks of projects whose cost exceeds EUR 10 million or which the annual policy does not cover (water construction, railroad construction, bridges, etc.) are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its peculiarities. In concluding contracts for design work, an insurance contract for professional liability is required from subcontractors covering the damage arising from design, erroneous measurement, advice and instructions, or such contract is concluded at own expense. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2008, indemnity applications totalling EEK 3.8 million were submitted to insurance companies and insurance benefits were received in the amount of EEK 1.6 million.

A warranty reserve has been set up at the Company to cover the construction errors which have become evident during the warranty period. In 2008, warranty provisions were set up in the total amount of EEK 16.1 million and disbursements amounted to EEK 12.8 million. As at the year-end, the Company's warranty provision amounted to EEK 18.9 million. With regard to work performed by subcontractors, the subcontractor is responsible for elimination of errors that became evident during the warranty period. With regard to significant contracts, the performance of contractual obligations of the contractor arising from contracts of services is guaranteed with bank guarantees to be paid upon the first demand.

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

Credit risk. In connection with a substantial deterioration of the economic climate, the share of credit risk in the Group's risk matrix has significantly increased. In managing credit risk, close attention is paid to the payment behaviour of business partners, their financial position is analysed and if necessary, third parties are involved as guarantors in transactions. With regard to prepayments to suppliers, a bank guarantee by suppliers is required.

In 2008, the payment discipline of customers clearly worsened, the amount of invoices past due 30 and more days increased from EEK 10.0 million to EEK 83.1 million in the period and at the same time, the amount of doubtful receivables increased from EEK 2.1 million to EEK 20.1 million. As at 31.12.2008, the Group had receivables past due in the amount of EEK 132.5 million, of which EEK 103.2 million were collected after the balance sheet date. The management carefully monitors the pattern of receivables and is of opinion that receivables as at the year-end do not contain any credit risks significant for sustainability of the Company's operations. The Company's available funds are held in short-term deposits at the banks with a high credit rating (Moody's rating of Baa3/D and higher).

Interest rate risk. As at 31.12.2008, the Group's interest-bearing liabilities totalled EEK 738.1 million, of which short-term loans and the current portion of long-term debt totalled EEK 206.7 million and long-term loans and finance lease liabilities totalled 531.4 million. The volume of interest-bearing liabilities increased by 35.5 million kroons in a year and as at the year-end, these liabilities made up 19.1% of the Company's balance sheet total. Most of the Group's loans relate to short-term development projects and the maturity dates of loans do not necessarily take into account the longer selling period resulting from a change in the demand, therefore the need of extension of their maturity dates is likely. Due to the substantial deterioration of the financing environment (increase of risk margins of the financiers), the refinancing of loans is accompanied by a significant increase of interest expenses. In order to manage interest expenses, management has refinanced long-term loans with a higher base interest taken in local currencies, and monitors especially carefully the sales of inventories and reduction of interest bearing liabilities.

Liquidity risk. Due to a decrease of money supply, lower turnover speed of development projects and potential negative scenarios with regard to the payment discipline, one of the Group's main priorities in the near future will be the ensuring of liquidity. As at 31.12.2008, the Group's current ratio was 2.8 (31.12.2007: 2.4) and quick ratio was 1.3 (31.12.2007: 1.0). To ensure liquidity and better management of the cash flows, the group entities have concluded overdraft contracts with banks in the total amount of EEK 207.1 million. In addition to overdraft credits, the Company has a working capital loan facility with the limit of EEK 50 million from AS Riverito. A majority of the Group's loans were taken for implementation of short-term development projects. Due to a decrease in demand for residential housing, it may be forecast that the selling periods of projects will get longer as compared to the initial plan and the effective period of existing contracts does not cover the longer selling periods. As a result of this, there is a need to extend the existing loans during 12 to 18 months. Management estimates that the Group's capital structure – high equity ratio of 54% of the balance sheet total and a moderate proportion of borrowings of 19% of the balance sheet total – ensures the feasibility of the extension of existing financial liabilities and obtaining additional working capital in the changed economic cycle, as well as the Company's trustworthiness in the eyes of creditors. In 2008, the Group's liquidity was positively impacted by the finalisation of several projects with unusually long accounts receivable turnover and the transfer of residential space included in inventories to buyers. The Company's priority in 2009 will be preservation of liquidity and only then profitability.

Foreign currency risk. The Group's construction contracts are mostly concluded in the currency of the country of location and open foreign currency positions in daily activities are being avoided. The most significant foreign contracts are concluded in euros. The Latvian lats (exchange rate EUR 1 = LVL 0.702804 +/- 1%), the Lithuanian litas and the Estonian kroon are pegged to the Euro and hence the preconditions for short-term hedge of foreign currency risks have been created. Due to the recent frequent speculations about the stability of the currencies of the Baltic states, the Group has adjusted its approach to foreign currency risks and pays more attention than before to the balancing of currencies by assets and liabilities. As at 31.12.2008, 12.2% of the assets and 9.8% of the liabilities of the Group were denominated in foreign currencies.

Legal risks. Due to different interpretation of contracts, regulations and laws, there is a risk that some buyers, contractors or supervisory authorities consider the Company's activities to be in conflict with the laws or contracts. As at 31.12.2008, the Company had set up provisions for potential claims and legal costs in the amount of EEK 7.9 million. In 2008, legal costs in the amount of EEK 1.4 million were covered from the provisions and new reserves were set up in the amount of EEK 4.0 million.

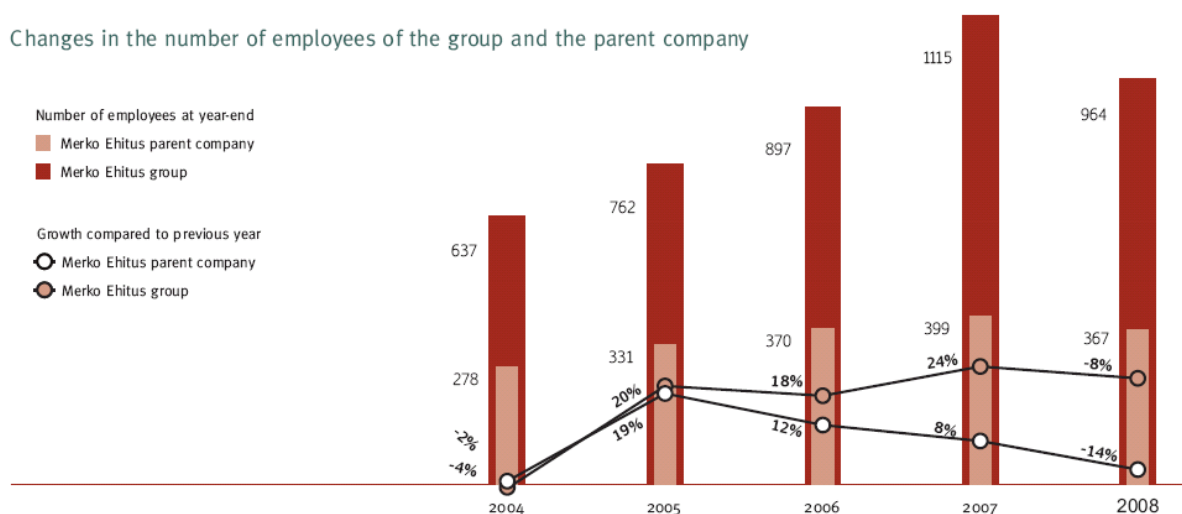
At 17 December 2008, the Prosecutors' Office submitted a suspicion against AS Merko Ehitus for the giving of a bribe to an official. According to the suspicion, the Company gave through the person of a member of the Management Board a gift coupon of EEK 25 thousand and a book to an official for proceedings with 7 detailed plans/building permits. According to the elaboration of 3 April by Prosecutors' Office, the number of properties decreased to three. Concerning the plans for the remaining four properties, a suspicion on the same bribe object was submitted against OÜ Woody, OÜ Metsailu and OÜ Constancia that are subsidiaries of AS Merko Ehitus. Management is on the position that the Company has followed the applicable laws of the Republic of Estonia and good industry practices.

The competitors of Merko Ehitus have disputed the possession of experience and succession of AS Merko Ehitus in participation in several public procurements. The position of AS Merko Ehitus is, that the demerger has not limited the rights and capabilities of the company to participate in public procurement. The position of AS Merko Ehitus has been supported by past judicial practice. The Supreme Court has not yet taken a position in this matter.

The Company and its people

One of the main values of Merko Ehitus is its people. Due to the general deterioration of the economic situation, the number of the Group's employees decreased by 151 people in a year and at 31.12.2008, the Group had 964 employees. The gross wages and salaries of the Group's employees totalled EEK 408.4 million, of which base wages and salaries made up 71.7% and bonuses made up 28.3%, or 0.5% more than in 2007. As compared to 2007, the average number of Group's employees decreased by 13.5% and the average gross wages per employee grew by 0.7%. The number of employees of the parent AS Merko Ehitus was 367 at the year-end 2008, decreasing by 32 people in a year. Gross wages and salaries paid to employees totalled EEK 181.5 million, the annual growth of 2.4%, including the growth of base wages of 1.9% and that of bonuses of 3.2%.

Changes in the number of employees of the group and the parent company



As at 31.12.2008, the Management Board of AS Merko Ehitus had four members. The members of the Management Board are all full-time employees of AS Merko Ehitus and their gross remuneration in 2008 totalled EEK 12.7 million, incl. base remuneration of EEK 3.2 million and bonuses of EEK 9.5 million. Until 11 December 2008, the Management Board of Merko Ehitus had five members and the above gross remuneration contains the remuneration for the five-member Management Board. All members of the Management Board currently work on the basis of service contracts. Upon the premature removal of a member of the Management Board or non-extension of their service contracts, its members are paid severance pay which equals their last 12 months' remuneration.

According to a resolution of the general meeting of shareholders, the management structure of the Group was reformed at 31 October 2008, as a result of which a 3-member Directorate was formed and the Supervisory Board of AS Merko Ehitus has 5 members. Due to the change, a part of the functions of the Supervisory Board were reallocated to the 3-member Directorate and significant changes were made in the remuneration principles concerning the members of the Supervisory Board. In 2008, the members of the Supervisory Board were paid gross remuneration of EEK 9.6 million, incl. basic remuneration of EEK 2.9 million and bonuses of EEK 6.7 million. According to the new principles, 12-month remuneration of the members of the Supervisory Board would have been EEK 3.1 million.

In 2008, the Group sponsored sports, culture and education with EEK 8.3 million.

In sports, Merko Ehitus sponsored the Estonian national cross-country skiing team, youth team Merko Team, the centre of beach volleyball and football of Audentes Volleyball Club, and Riga VEF basketball club in Latvia. The Group's largest sponsorship project continued to be the initiative launched in collaboration with Swedbank, Eesti Energia and the Ministry of Culture of the Republic of Estonia as well as the Estonian Ski Association, called the Estonian Hiking Tracks.

In culture and education, the publication of book "Sillaehitajad ajas ja ruumis" was supported in cooperation with Eesti Kultuurfilm (Estonian Culture Film) and Tallinn University of Technology, and a three-year cooperation agreement was concluded with the Estonian Art Museum. Cooperation continued with the Estonian Drama Theatre under the framework of a three-year sponsorship agreement concluded in 2007. In education, the Group's priority is construction education and research. In 2008, cooperation continued with Tallinn University of Technology in the fields of development, research and studies, and with the Development Fund of Tallinn University of Technology for granting the scholarship bearing the name of professor Heinrich Laul for young lecturers/scientists with a doctoral degree in construction science. Merko Ehitus pays scholarships to 19 Master's degree students at Tallinn University of Technology.

In social field, Merko Ehitus has selected Tilsi Children's Home as its partner, it is a substitute home for 65 children. In August, a trip to Gotland was organised for the best students of Tilsi, in September, the children of Tilsi visited Tallinn during a two-day excursion, they visited exhibitions of KUMU museum of fine arts, enjoyed the artist's meal and prepared a ceramic item or T-shirt in workshops.

Shares and shareholders

Information on securities

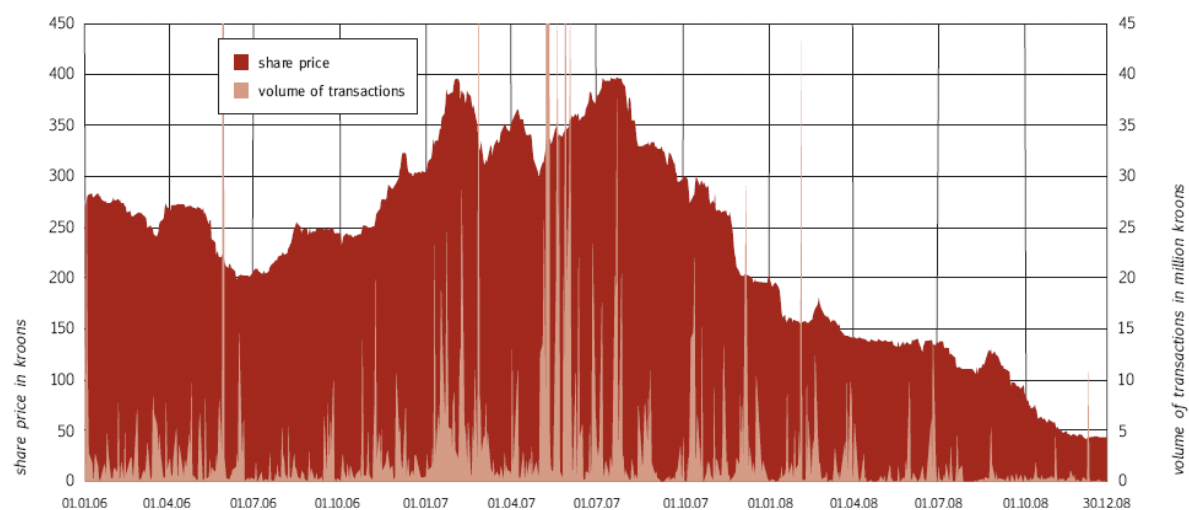
Name of security	Share of Merko Ehitus
ISIN	EE3100098328
Type of security	Freely transferable ordinary shares
Issuer	AS Merko Ehitus
Activity of issuer	Construction
Residency of issuer	Estonia
Nominal value	10.00
Currency	EEK
Number of securities	17 700 000
Number of votes per share	1 vote
Registration at ECSD	08.07.2008
Stock Exchange List	Main List

All information prior to 01.08.2008 includes information on AS Järvevana, a legal predecessor of AS Merko Ehitus.

	31.12.2006	31.12.2007	31.12.2008
Basic earnings per share (EPS), EEK	32.87	30.79	16.90
Earnings per share, EEK	90.05	113.88	117.23
P/B (price to book ratio)	3.41	1.79	0.37
P/E (price / earnings ratio)	9.35	6.61	2.59

In 2008, 2283 transactions with the shares of Merko Ehitus were performed in the course of which 2.4 million shares were traded and the total monetary value of transactions was EEK 285.1 million. The lowest share price was EEK 40.40 and the highest price was EEK 202.62 per share. The closing price of the shares as at 30.12.2008 was EEK 43.81.

Performance of Merko Ehitus share at NASDAQ OMX Tallinn Stock Exchange



Trading history of securities	2006	2007	2008
Highest	326.23	402.12	202.62
Lowest	197.46	191.67	40.40
Closing	307.46	203.41	43.81
Change, %	+13.92	-33.84	-78.46
Traded shares	3 434 847	5 532 018	2 367 089
Turnover, million EEK	832.59	1 830.68	285.14
Market value, in million EEK, as at the year-end	5 442.04	3 600.35	775.44

Structure of shareholders as at 31.12.2008

Number of shares	Number of shareholders	% of shareholders	Number of shares	% of shares
1-100	330	36.55%	17 194	0.10%
101-1000	407	45.07%	170 302	0.96%
1001-10 000	125	13.84%	373 165	2.11%
10 001 - 100 000	31	3.43%	1 120 587	6.33%
100 001 - 1 000 000	8	0.89%	2 046 053	11.56%
1 000 001 - ...	2	0.22%	13 972 699	78.94%
Total	903	100%	17 700 000	100%

The main shareholders of AS Merko Ehitus as at 31.12.2008

	Number of shares	Proportion
AS Riverito	12 742 686	71.99%
Skandinaviska Enskilda Banken Ab, clients	1 230 013	6.95%
ING Luxembourg S.A., clients	963 376	5.44%
Mellon Treaty Omnibus	205 349	1.16%
The Bank of New York/ING Bank Slaksi A/C ING Parasol	189 683	1.07%

Outlook for 2009

Construction market and its developments

The overall global negative background and expectations about the real estate and financial sector, current account and budgetary imbalance in the Baltic States, and increasing unemployment are just a few examples of the negative indicators characterising the economic environment, which determine the development trends of the Baltic States in the near future both at micro and macro level.

There is a myriad of opinions in the market on the further behaviour of construction prices. According to some estimates, the construction prices have reached their bottom, but there are also opinions that the real bottom will be reached only in 2010. However, it is sure that the myriad of opinions, despair and instability prevailing in the sector are reflected in the construction tenders in 2009 where the prices of construction work may vary 40-50% based on the position and future visions of tenderers. We believe that further decline of prices is not sustainable and their stabilisation will occur already in the first half of 2009. Under the circumstances of intensifying competition, efficiency and quality will become more important, as a result of which entities that are financially weaker and provide unprofessional services will be impacted the most. The number of entities that will go bankrupt or undergo reorganisation will significantly increase this year. Clients should pay more attention than before to the financial position and general reliability of a contractor.

Appreciation of interest rates, stricter control over lending and negative expectations have significantly undermined the sense of security of consumers and investment activities of investors. Most of the private sector is engaged in cost saving and reanimation of cash flows, any kind of expansion plans are postponed for an indefinite period. Since the properties whose construction commenced in 2008 are completed and no new contracts can be expected, the construction sector will face a decline of 40-50% in 2009. While the private sector experienced a clear decrease in orders already in 2008, the freezing of public sector investments will be a new trend in 2009. The general slowdown of consumption has significantly lowered the revenue base of the public sector and budgetary deficit of the state or local governments is in a more or less acute form on the agenda of all Baltic States. Similarly to the private sector, the public sector has started to curb investments, because the freezing of investments provides a positive saving effect and generates the least social tensions. The only exception here is the projects on infrastructure and environmental facilities that are financed by the Structural Funds of the European Union and by the public sector, and the implementation of which is set as a priority in all the three states.

In 2008/2009, the developers will be engaged in launching completed rental projects and sale of residential space and therefore, their interest in new projects will be low. Serious interest in new projects may arise only in the second half of 2009, when the market will have absorbed the existing supply and the sense of security of consumers will have been restored. Until then, the biggest challenge facing the sector will be coping with expenses, scarcer funding opportunities and skilful management of liquidity risks.

Corporate Governance Code (CGC)

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

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

I General Meeting of Shareholders

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

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

means of communication because there are no reliable ways to identify shareholders and to ensure the privacy of participating shareholders.

On behalf of the Company, the Chairman of the Management Board and the Chairman of the Supervisory Board shall participate in the General Meeting of AS Merko Ehitus, and if necessary, other members of the Management and Supervisory Boards shall be involved. The Company does not consider the participation of all members of the Management and Supervisory Boards in the General Meeting relevant.

II Management Board

The Management Board of AS Merko Ehitus has five members but from 11 December 2008, the Management Board of AS Merko Ehitus has four members after AS Merko Ehitus terminated the contract with the member of the Management Board Tõnu Korts (http://www.nasdaqomxbaltic.com/market/?pg=news&news_id=228966). The Management Board of AS Merko Ehitus represents the Company and manages its daily operations. The activities of the members of the Management Board are divided by areas of operation: general management and development – Tiit Roben, construction – Andres Agukas, technology – Veljo Viitmann, finance – Alar Lagus. The Chairman of the Management Board, Tiit Roben, leads the work of the Management Board.

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

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

III Supervisory Board

The General Meeting of Shareholders shall elect the Supervisory Board. The Supervisory Board shall determine the Company's operating strategy, endorse the transactions as authorised by the articles of association, elect the members of the Management Board and monitor the performance of the Management Board during the time the General Meetings are not held. From 31 October 2008, the Supervisory Board of AS Merko Ehitus has five members: Teet Roopalu, Jaan Mäe, Indrek Neivelt, Olari Taal and Chairman of the Supervisory Board, Tõnu Toomik.

The General Meeting of Shareholders shall approve the remuneration of the members of the Supervisory Board. The procedure for paying remuneration to the current Supervisory Board was approved by the General Meeting of Shareholders held at 31 October 2008.

Upon premature termination or non-extension of the powers, no severance pay is paid to the members of the Supervisory Board.

Simultaneously with the election of the new Supervisory Board at 31 October 2008, the Directorate of AS Merko Ehitus was set up, the main function of which is the development of the positions in respect of the Group's strategy and activities for expansion to the markets located outside the Republic of Estonia and for subsidiaries and associates set up in foreign countries as well as group entities involved in lines of business requiring specific knowledge. The Directorate shall grant the Management Board its consent to complete the transactions concerning the Directorate's functions or shall refuse to grant it. The Supervisory Board shall oversee the Directorate's activities. The Group's Directorate has 3 members who are also members of the Supervisory Board.

IV Collaboration of the Management and Supervisory Boards

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

V Disclosure of information

In disclosing information, AS Merko Ehitus shall follow the rules and regulations of NASDAQ OMX Tallinn Stock Exchange and immediately disclose important information regarding the Company's activities to the shareholders after obtaining reasonable assurance as to its correctness and that the disclosure of such information shall not harm the interests of the Company and its business partners. In respect of construction contracts entered into, contracts with the volume of 150 million kroons and higher shall be disclosed separately in the stock exchange release. Important information shall be disclosed through the stock exchange system and on the Company's website.

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

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

VI Election of an auditor and auditing the financial statements

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

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

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

The Board of AS Merko Ehitus declares and confirms that to the best knowledge of the Management, the Management Report of the 2008 Annual Report gives a true and fair view of the business development and performance and financial state of the company and consolidated entrepreneurs as a whole and includes a description of risks and suspicions.

Tiit Roben	Chairman of the Management Board		03.08.2009
Alar Lagus	Member of the Management Board		03.08.2009
Veljo Viitmann	Member of the Management Board		03.08.2009
Andres Agukas	Member of the Management Board		03.08.2009