AS Merko Ehitus

Group

Consolidated Annual Report

Beginning of financial year: 01.01.2008

End of financial year: 31.12.2008

(translation of the Estonian original)

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Main activity:	general contracting of construction
Auditor:	AS PricewaterhouseCoopers

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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. Real Estate. 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 Insenerehitus, OÜ Merko Ehitustööd and OÜ Pire Projekt as well as well as the subsidiaries of SIA Merks: SIA MR Multifunkcionālais 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 Constancia 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%20jagunemiskava%20ENG.pdf).

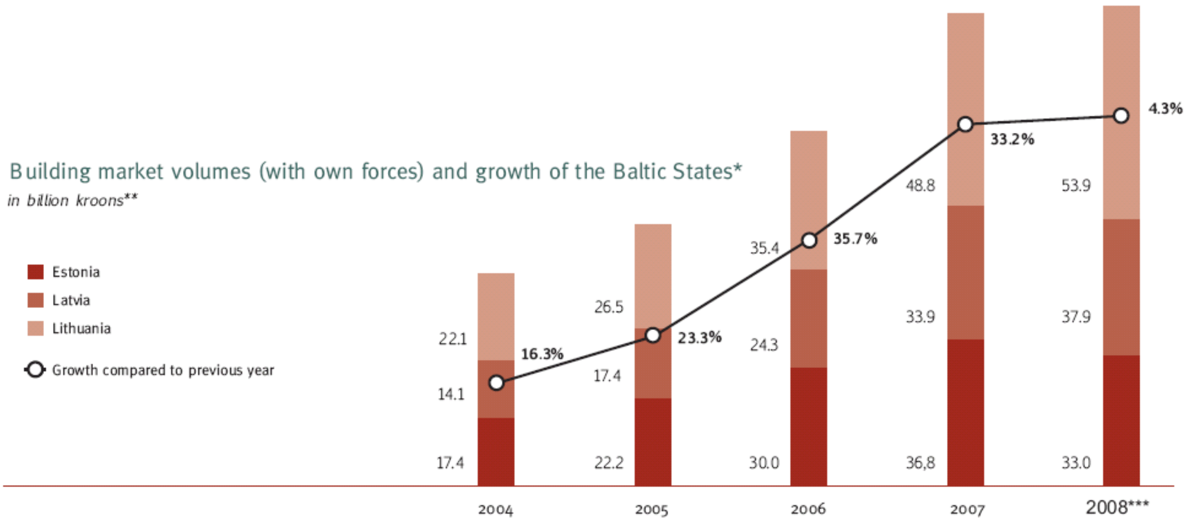
At 3 June 2008, the General Meeting of Shareholders (http://www.nasdaqomxbaltic.com/market/?pg=news&news_id=226094) approved the demerger of the Company into public limited companies the new Merko Ehitus (registry code 11520257) and Järvevana (registry code 10068022).

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%20jagunemiskava%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.



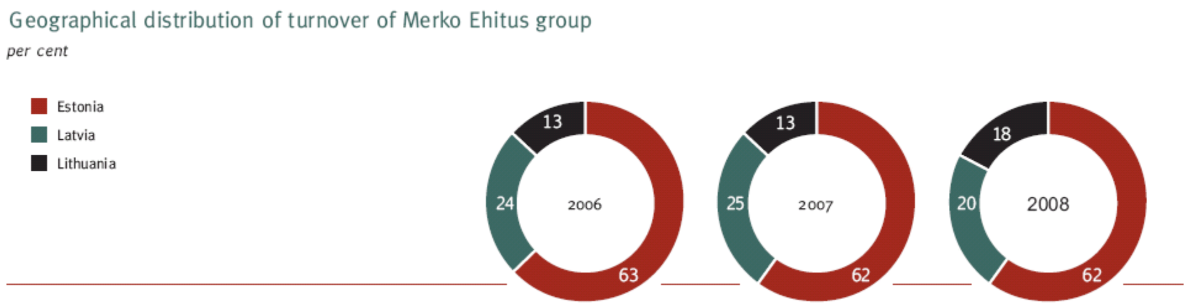
* Based on the data of local statistical offices.
** According to the unofficial central exchange rate of Eesti Pank.
*** Data of 2008 tenative, based on short-term statistics.

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.

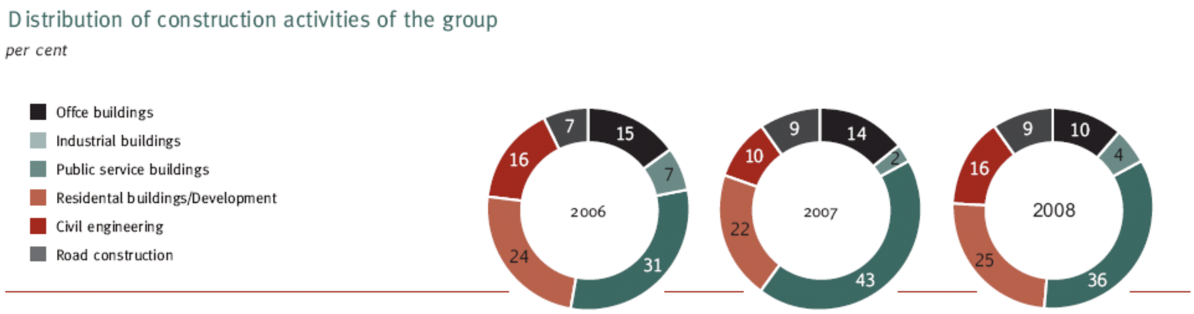


The consolidated sales revenue of the Group's largest entities:

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.

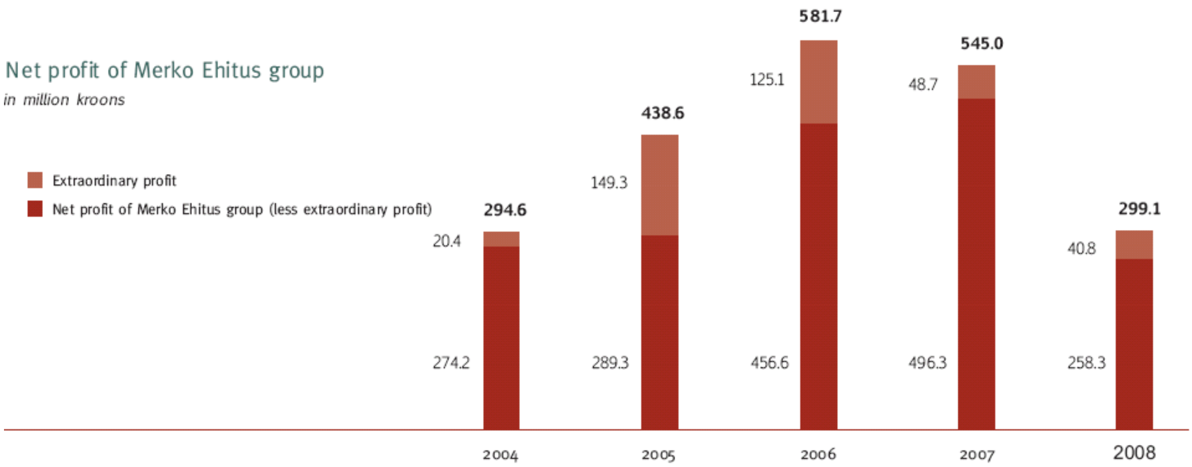


The largest projects completed in 2008

Viru Prison	new facility	Jõhvi, Ida-Virumaa	43 392 m²	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 m²	AS Merko Ehitus
Ülemiste City commercial and office building 2	new facility	Lõõtsa 2, Suur-Sõjamäe 10B, Tallinn	6348 m²	AS Merko Ehitus
Apartment building	new facility	Pärnu Str129c, Tallinn	9019 m²	AS Merko Ehitus
Shopping centre Valleta	new facility	Riia Str 4, Valmiera	16 580 m²	SIA Merks
Hotel	new facility	Kalnciema 90, Riia	7 908 m²	SIA Merks
Panorama shopping centre	new facility	Saltoniškių 9, Vilnius	65 000 m²	UAB Merko Statyba
National road No 6 Valga-Uulu	reconstruct-tion	Valga-Uulu Highway 98.2-106.7 km	85 000 m²	Tallinna Teede AS
Production complex of Hilding Baltic AS	new facility	Loomäe 10, Rae Technology Park, Harjumaa	14 400 m²	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%.



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 financers), 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 1.1 (31.12.2007: 1.3). 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.

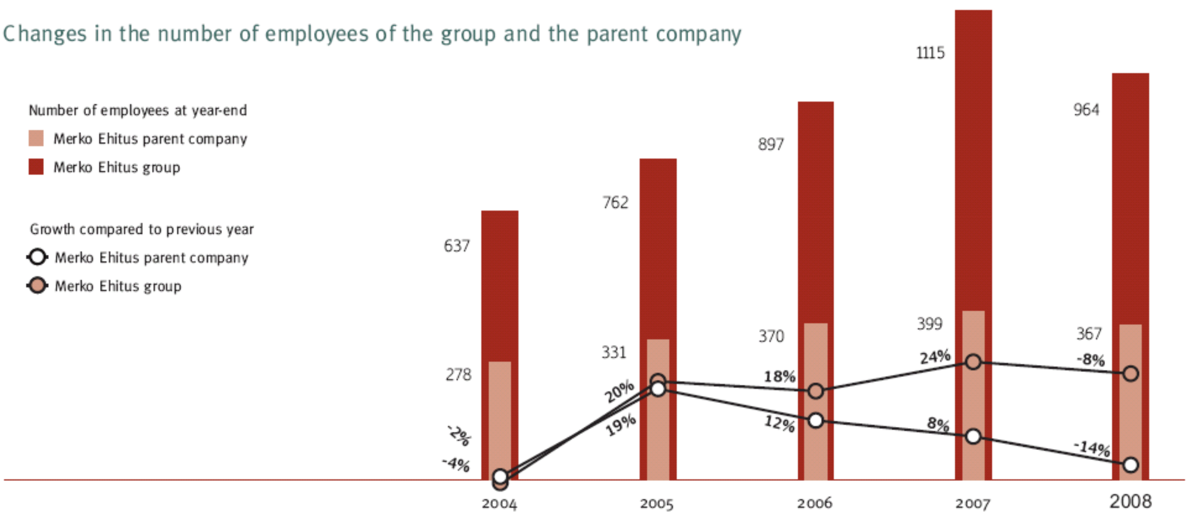
Legal risks. Due to different interpretation of contracts, regulations and laws, there is a risk that some buyers, contractors or supervisory authorities consider the Company's activities to be in conflict with the laws or contracts. As at 31.12.2008, the Company had set up provisions for potential claims 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 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 full-time employees decreased by 151 people in a year and at 31.12.2008, the Group had 964 full-time employees. The gross wages and salaries of the Group's full-time 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 full-time 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%.



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

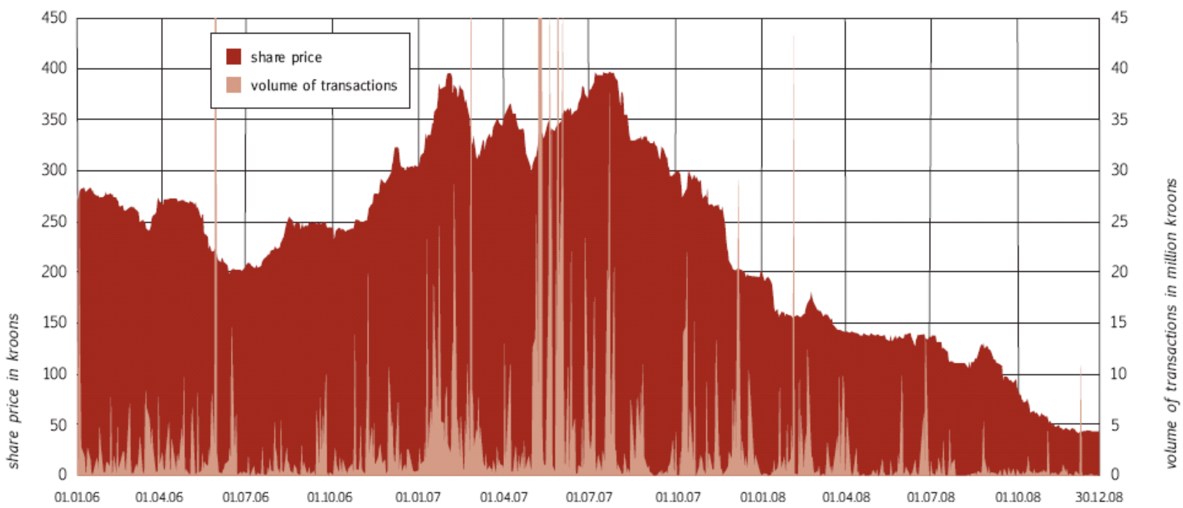
Activity of issuer	Construction
Residency of issuer	Estonia
Nominal value	10.00
Currency	EEK
Number of securities	17 700 000
Number of votes per share	1 vote
Registration at ECSD	08.07.2008
Stock Exchange List	Main List

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 next 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 reliably 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.

FINANCIAL STATEMENTS

MANAGEMENT DECLARATION

The Management Board confirms the correctness and completeness of AS Merko Ehitus consolidated financial statements as presented on pages 18-72.

The Management Board confirms that:

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

Tiit Roben	Chairman of the Management Board	14.04.2009
Alar Lagus	Member of the Management Board	14.04.2009
Veljo Viitmann	Member of the Management Board	14.04.2009
Andres Agukas	Member of the Management Board	14.04.2009

CONSOLIDATED INCOME STATEMENT

in thousands of		EEK		EUR	
	Note	**2008**	**2007**	**2008**	**2007**
Revenue	3	4 653 933	5 510 760	297 441	352 202
Cost of goods sold	4	(3 893 201)	(4 731 752)	(248 821)	(302 415)
Gross profit		760 732	779 008	48 620	49 787
Marketing expenses	5	(43 921)	(32 472)	(2 807)	(2 075)
Administrative and general expenses	6	(223 698)	(213 806)	(14 297)	(13 665)
Other operating income	7	9 529	6 424	609	411
Other operating expenses	8	(174 560)	(18 109)	(11 156)	(1 157)
Operating profit		328 082	521 045	20 969	33 301
Finance income	9	34 405	11 016	2 199	704
Finance costs	10	(26 631)	(17 762)	(1 702)	(1 135)
Profit from sale of subsidiaries	19	1 418	-	91	-
Profit/loss from associates and joint ventures	20	(4 565)	76 440	(292)	4 885
Profit before tax		332 709	590 739	21 265	37 755
Corporate income tax expense	11	(26 339)	(30 830)	(1 684)	(1 970)
Net profit for financial year		306 370	559 909	19 581	35 785
incl. net profit attributable to equity holders of the parent		299 140	545 049	19 120	34 835
minority interest		7 230	14 860	461	950
Earnings per share for profit attributable to equity holders of the parent (basic and diluted, in kroons/ euros)	12	16.90	30.79	1.08	1.97

The notes set out on pages 24-72 are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

in thousands of		EEK		EUR	
	Note	**31.12.2008**	**31.12.2007**	**31.12.2008**	**31.12.2007**
ASSETS					
Current assets					
Cash and cash equivalents	14	515 191	205 564	32 927	13 138
Short-term deposits	15	262 759	-	16 793	-
Trade and other receivables	16	780 665	1 199 566	49 894	76 666
Prepaid corporate income tax		3 875	2 376	247	152
Inventories	18	1 817 486	2 025 426	116 158	129 448
Assets held for sale		173	-	11	-
		3 380 149	3 432 932	216 030	219 404
Non-current assets					
Investments in associates and joint ventures	20	206 761	272 964	13 214	17 446
Other long-term loans and receivables	21	29 049	14 492	1 857	926
Deferred income tax assets	22	24 226	3 396	1 548	217
Investment property	23	12 002	7 361	767	470
Property, plant and equipment	24	197 094	172 912	12 597	11 051
Intangible assets	25	11 807	12 574	755	804
		480 939	483 699	30 738	30 914
TOTAL ASSETS		3 861 088	3 916 631	246 768	250 318
LIABILITIES					
Current liabilities					
Borrowings	27	206 657	304 879	13 208	19 485
Trade and other payables	28	963 631	1 015 492	61 588	64 902
Corporate income tax liability		8 699	16 718	556	1 068
Government grants	29	-	1 498	-	96
Short-term provisions	30	32 317	73 212	2 065	4 680
		1 211 304	1 411 799	77 417	90 231
Non-current liabilities					
Long-term borrowings	27	531 396	397 713	33 962	25 418
Other long-term trade payables	31	8 824	57 423	564	3 670
		540 220	455 136	34 526	29 088
TOTAL LIABILITIES		1 751 524	1 866 935	111 943	119 319
EQUITY					
Minority interest		34 633	33 939	2 213	2 169
Equity attributable to equity holders of the parent					
Share capital	33	177 000	177 000	11 312	11 312
Statutory reserve capital		17 700	17 700	1 131	1 131
Currency translation differences		(12 550)	(5 085)	(802)	(325)
Retained earnings		1 892 781	1 826 142	120 971	116 712
		2 074 931	2 015 757	132 612	128 830
TOTAL EQUITY		2 109 564	2 049 696	134 825	130 999
TOTAL LIABILITIES AND EQUITY		3 861 088	3 916 631	246 768	250 318

The notes set out on pages 24-72 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

in thousands of ***EEK***	Note	Equity attributable to equity holders of the parent					Minority interest	Total
		Share capital	**Statutory reserve capital**	**Currency translation differences**	**Retained earnings**	**Total**		
Balance as at 31.12.2006		177 000	17 700	(5 751)	1 404 993	1 593 942	18 904	1 612 846
Currency translation differences		-	-	666	-	666	-	666
Net profit for financial year		-	-	-	545 049	545 049	14 860	559 909
Total recognised income for 2007		-	-	666	545 049	545 715	14 860	560 575
Minority interest of acquired subsidiary		-	-	-	-	-	5 240	5 240
Dividends	13	-	-	-	(123 900)	(123 900)	(5 065)	(128 965)
Balance as at 31.12.2007		177 000	17 700	(5 085)	1 826 142	2 015 757	33 939	2 049 696
Currency translation differences		-	-	(7 465)	-	(7 465)	-	(7 465)
Net assets separated in demerger	41	-	-	-	(232 501)	(232 501)	-	(232 501)
Net profit for financial year		-	-	-	299 140	299 140	7 231	306 371
Total recognised income for 2008		-	-	(7 465)	66 639	59 174	7 231	66 405
Minority interest of liquidated subsidiary		-	-	-	-	-	(9)	(9)
Dividends	13	-	-	-	-	-	(6 528)	(6 528)
Balance as at 31.12.2008		177 000	17 700	(12 550)	1 892 781	2 074 931	34 633	2 109 564

*in thousands of **EUR***	**Equity attributable to equity holders of the parent**					**Minority interest**	**Total**
	Share capital	**Statutory reserve capital**	**Currency translation differences**	**Retained earnings**	**Total**		
Balance as at 31.12.2006	11 312	1 131	(368)	89 796	101 871	1 208	103 079
Currency translation differences	-	-	43	-	43	-	43
Net profit for financial year	-	-	-	34 835	34 835	950	35 785
Total recognised income for 2007	-	-	43	34 835	34 878	950	35 828
Minority interest of acquired subsidiary	-	-	-	-	-	335	335
Dividends	-	-	-	(7 919)	(7 919)	(324)	(8 243)
Balance as at 31.12.2007	11 312	1 131	(325)	116 712	128 830	2 169	130 999
Currency translation differences	-	-	(477)	-	(477)	-	(477)
Net assets separated in demerger	-	-	-	(14 860)	(14 860)	-	(14 860)
Net profit for financial year	-	-	-	19 119	19 119	462	19 581
Total recognised income for 2008	-	-	(477)	4 259	3 782	462	4 244
Minority interest of liquidated subsidiary	-	-	-	-	-	(1)	(1)
Dividends	-	-	-	-	-	(417)	(417)
Balance as at 31.12.2008	11 312	1 131	(802)	120 971	132 612	2 213	134 825

The notes set out on pages 24-72 are an integral part of these consolidated financial statements.

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Kuupäev/date 29.04.09
PricewaterhouseCoopers, Tallinn

CONSOLIDATED CASH FLOW STATEMENT

in thousands of		EEK		EUR	
	Note	**2008**	**2007**	**2008**	**2007**
Cash flows from operating activities					
Operating profit		328 082	521 045	20 969	33 301
Adjustments:					
Depreciation and impairment charge	3.23-25	33 437	28 670	2 137	1 832
profit/loss from sale of non-current assets	7,8	(954)	(276)	(61)	(18)
change in receivables and liabilities related to construction contracts recognised under the stage of completion method		146 798	(130 927)	9 382	(8 368)
interest income from business activities		(1 404)	(2 844)	(90)	(182)
change in government grants and other provisions		(48 404)	49 456	(3 094)	3 161
profit on acquisition of subsidiary		-	(720)	-	(46)
Change in trade and other receivables related to		387 471	(108 378)	24 764	(6 927)
Change in inventories		190 082	(665 436)	12 148	(42 529)
Change in trade and other payables related to		(279 853)	(127 742)	(17 886)	(8 164)
Interest paid		(22 381)	(17 144)	(1 430)	(1 096)
Other finance income		(112)	(11)	(7)	(1)
Corporate income tax paid		(51 068)	(34 597)	(3 264)	(2 211)
Total cash flows from operating activities		681 694	(488 904)	43 568	(31 248)
Cash flows from investing activities					
Investment in subsidiaries		-	(14 615)	-	(934)
Proceeds from sale of subsidiaries	19	6 967	500	445	32
Investments in associates and joint ventures	20	(1 000)	(3 352)	(64)	(214)
Proceeds from sale of associates and joint ventures	20	60 231	-	3 850	-
Purchase of financial investment		(265 569)	-	(16 973)	-
Purchase of investment property		(2 063)	-	(132)	-
Purchase of property, plant and equipment		(43 343)	(63 717)	(2 770)	(4 072)
Proceeds from sale of property, plant and equipment		2 895	2 718	185	174
Purchase of intangible assets		(1 837)	(4 413)	(117)	(282)
Proceeds from sale of intangible assets		1	-	0	-
Loans granted	17	(22 307)	(145 692)	(1 426)	(9 311)
Loan repayments received	17	4 190	134 599	268	8 602
Interest received		30 005	16 226	1 918	1 037
Dividends received		-	4 380	-	280
Total cash flows from investing activities		(231 830)	(73 366)	(14 816)	(4 688)
Cash flows from financing activities					
Proceeds from borrowings	27	237 380	582 283	15 171	37 215
Repayments of borrowings	27	(325 946)	(345 739)	(20 832)	(22 097)
Finance lease principal payments	27	(16 909)	(14 260)	(1 080)	(911)
Dividends paid		(6 528)	(128 965)	(417)	(8 242)
Cash flows from financing activities		(112 003)	93 319	(7 158)	5 965
Cash transferred in demerger	41	(25 000)	-	(1 598)	-
Net increase/decrease in cash and cash		312 861	(468 951)	19 996	(29 971)
Cash and cash equivalents at beginning of the period	14	205 564	676 143	13 138	43 213
Exchange losses on cash and cash equivalents		(3 234)	(1 628)	(207)	(104)
Cash and cash equivalents at end of the period	14	515 191	205 564	32 927	13 138

The notes set out on pages 24-72 are an integral part of these consolidated financial statements.

NOTES

Note 1 Summary of significant accounting policies

1.1. General information

The consolidated financial statements of AS Merko Ehitus (hereinafter the parent) and its subsidiaries (hereinafter the Group) for the year ended 31 December 2008 were signed by the Management Board at 14 April 2009.

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

AS Merko Ehitus is an entity registered in the Republic of Estonia (Commercial Register no.: 10068022, address: Järvevana tee 9G, Tallinn) and it operates in Estonia, Latvia and Lithuania. Its main activities are construction and real estate development.

From 22 July 1997, the shares of AS Merko Ehitus are listed on the Tallinn Stock Exchange. As at 31 December 2008, the majority shareholder AS Riverito (previous name: AS Merko Grupp) owned 71.99% of the shares of the Company.

AS Merko Ehitus was established in the demerger of the former AS Merko Ehitus, currently AS Järvevana, as a result of which all operating areas, i.e. all assets and liabilities other than the liabilities related to the criminal proceeding, were transferred to the new entity. Due to the fact that AS Merko Ehitus will largely continue its activities in the newly established entity, the information used as comparative information for 2007 in this annual report is identical to the comparative information for the prior period in the annual report of AS Järvevana. The transactions of the period in 2008 prior to demerger have for the same reason been recorded in both the financial statements of AS Merko Ehitus and AS Järvevana.

1.2. Basis of preparation

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

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

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

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

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

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

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

a) Standards, amendments to standards and interpretations effective for financial year starting 1 January 2008.

IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions*. The interpretation contains guidelines on the following issues: applying IFRS 2 “Share-based Payment” for transactions of payment with shares which are entered into by two or more related entities; and adopting an accounting approach in the following instances: an entity grants its employees rights to its equity instruments that may or must be repurchased from a third party in order to settle obligations towards the employees; or an entity or its owner grants the entity's employees rights to the entity's equity instruments, and the provider of those instruments is the owner of the entity. The amendment will not have an effect on the Group’s financial statements.

Reclassification of Financial Assets* – amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments - Disclosures *and consequential amendment: Reclassification of Financial Assets: Effective Date and Transition.* The amendments allow entities the following options (a) to reclassify a financial asset out of the held-for-trading category if, in rare circumstances, the asset is no longer held for the purpose of selling or repurchasing it in the near term; and (b) to reclassify an available-for-sale or held-for-trading asset to the loans and receivables category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity (subject to the asset otherwise meeting the definition of loans and receivables). The amendments to the standards will not have an effect on the Group’s financial statements.

b) New standards, amendments to standards and interpretations effective for periods beginning at or after 1 January 2009 and which the Group has not adopted early

By the time of preparing these financial statements, new International Financial Reporting Standards and their interpretations have been issued which are effective for the Group’s annual periods beginning at or after 1 January 2009 but that the Group has not adopted early. Below is an estimate of the Group’s management on the potential effect of new standards and interpretation in the period of their first-time adoption:

IFRS 8 *Operating Segments* (effective for annual periods beginning at or after 1 January 2009). The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a securities commission or another regulatory agency for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to that used for internal reporting purposes. The Group will evaluate the effect of the new standard on segment reporting in the consolidated financial statements.

IAS 23 *Borrowing Costs* (revised March 2007; effective for annual periods beginning at or after 1 January 2009). The main change to the standard is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. Entities need to capitalise such borrowing costs within the acquisition cost of the asset. The revised standard is applied prospectively to borrowing costs attributable to specific assets that need to be capitalised from 1 January 2009. The Group estimates that the adoption of the amended standard will not have an effect on the consolidated financial statements.

IAS 1 *Presentation of Financial Statements* (revised September 2007; effective for annual periods beginning at or after 1 January 2009)*.* The main change in IAS 1 is the replacement of the income statement by the statement of comprehensive income which also includes all non-owner changes in equity, such as revaluation of available-for-sale financial assets. Two statements are allowed to be presented as an alternative: a separate income statement and a statement of comprehensive income. The revised standard also requires the disclosure of the financial position (balance sheet) for the opening balances of the comparative period when comparatives have been restated due to reclassifications, changes in accounting policies or correction of errors. The Group estimates that the revised IAS 1 will have an effect on the presentation of financial information but will not be relevant to the recognition and measurement principles used until now in the consolidated financial statements.

IAS 27 *Consolidated and Separate Financial Statements* (revised January 2008; effective for annual periods beginning at or after 1 July 2009; the revised standard has not been adopted by the EU yet). The revised standard requires an entity to attribute total comprehensive income to the owners of the parent and to minority interests even if this results in the non-controlling interests having a deficit balance (in most cases, the current standard requires the excess losses to be allocated to the owners of the parent). The revised standard specifies that changes in the parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group will evaluate the effect of the amended standard on the consolidated financial statements.

Vesting Conditions and Cancellations - **amendment to IFRS** ***2 Share-based Payment*** (revised in January 2008; effective for annual periods beginning at or after 1 January 2009). The amendment explains that the transfer of ownership may be conditional upon satisfying vesting conditions and performance conditions. Other conditions of share-based payments are not vesting conditions. The amendment explains that all cancellations whether by the Group or other parties shall be accounted for in a similar manner. The Group estimates that the amended standard will not have a material effect on the consolidated financial statements.

Reassessment of Embedded Derivatives **– amendments to IFRIC 9 and IAS 39** (effective for annual periods beginning at or after 30 June 2009; the amendment has not been adopted by the EU yet). The amendment clarifies that upon classification of financial assets out of the category 'at fair value through profit or loss', embedded derivatives shall be assessed and if necessary, recognised separately.

IFRS 3 ***Business Combinations*** (effective for business combinations for which the acquisition date is in the first annual period beginning at or after 1 July 2009; the amended standard has not been adopted by the EU). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to premeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The Group will evaluate the effect of the amended standard on the consolidated financial statements.

Amendment to IAS 32 and IAS 1 – ***Puttable Financial Instruments and Obligations Arising on Liquidation*** (effective for annual periods beginning at or after 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of financial liabilities. The Group estimates that the adoption of the amended standard will not have an effect on the consolidated financial statements.

IFRIC 12 – ***Service Concession Arrangements*** (IFRIC 12, as adopted by the EU is effective for annual periods beginning at or after 30 March 2009, earlier application is permitted). The interpretation contains guidelines on applying the existing standards by entities being parties to service concessions between the public and the private sector. IFRIC 12 pertains to arrangements where the ordering party controls what services are provided by the operator using the infrastructure, to whom it provides the services and at what price. The Group estimates that the adoption of the interpretation will not have an effect on the consolidated financial statements, because none of the group entities provides services to the public sector.

IFRIC 13 – **Customer Loyalty Programmes** (effective for annual periods beginning at or after 1 July 2008; IFRIC 13 as adopted by the EU is effective for annual periods beginning at or after 31 December 2008, earlier application is permitted). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. Due to the Group's business, the amendment has no effect and the Management Board estimates that the interpretation will not have an effect on the consolidated financial statements.

IFRIC 14 IAS 19 – ***The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*** (effective for annual periods beginning at or after 1 January 2008; IFRIC 14 as adopted by the EU is effective for annual periods beginning at or after 31 December 2008, earlier application is permitted). The interpretation contains general guidance on how to assess the limit of the surplus of fair value of a defined

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benefit plan over the present value of its liabilities which can be recognised as an asset, in accordance with IAS 19. In addition, IFRIC 14 explains how the statutory or contractual requirements of the minimum funding may affect the values of assets and liabilities of a defined benefit plan. The Group estimates that the interpretation will not have an effect on the consolidated financial statements because it does not have any such assets.

IFRIC 15 *Agreements for the Construction of Real Estate* (effective for annual periods beginning at or after 1 January 2009, the interpretation has not been adopted by the EU yet). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. IFRIC 15 will not have an effect on the Group's financial statements because the Group's accounting principle is in accordance with it.

IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* (effective for annual periods beginning at or after 1 October 2008; the interpretation has not been adopted by the EU yet). The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The interpretation allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that is being hedged. The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 will not have an effect on the Group's financial statements, because the Group does not use hedge accounting.

***Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* — amendments to IFRS 1 and IAS 27** (issued in May 2008; effective for annual periods beginning at or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying amount as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments will not have an effect on the Group's financial statements.

Eligible Hedged Items* – amendment to IAS 39, *Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning at or after 1 July 2009)*.* The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment will not have an effect on the Group's financial statements because the Group does not use hedge accounting.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method for making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36 clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group's estimates that the amendments will not have a material effect on the financial statements.

IFRIC 17 *Distribution of Non-Cash Assets to Owners* (effective for annual periods beginning at or after 1 July 2009; the interpretation has not been adopted by the EU yet). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed.

A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 will not have an effect on the Group's financial statements, because the Group does not distribute non-cash assets to its owners.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning at or after 1 July 2009; the amended standard has not adopted by the EU yet). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The amendments will not have an effect on the Group's financial statements.

IFRIC 18 *Transfers of Assets from Customers* (effective for annual periods beginning at or after 1 July 2009; the interpretation has not been adopted by the EU yet). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 will not have an effect on the Group's financial statements.

Improving Disclosures about Financial Instruments* - amendment to IFRS 7 *Financial Instruments: Disclosures (effective for annual periods beginning on or after 1 January 2009; the amendment has not been adopted by the EU yet). The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity will be required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee and in the earliest period in which the guarantee can be collected; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable the readers of the financial statements to evaluate the nature and extent of liquidity risk. The Group will assess the impact of the amendment on disclosures in its financial statements.

1.4. Consolidation

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

Upon consolidation, intra-group receivables and liabilities, income and expenses as well as unrealised profits and losses arising from intra-group transactions have been eliminated unless a loss is caused by impairment.
Group entities use uniform accounting policies.

1.5. Business combinations

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

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

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

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

Transactions with minority interest

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

1.6. Associates

Associates are all entities in which the Group has significant influence but not control over their operating and financial policies. Significant influence is presumed to exist when the parent owns between 20% and 50% of the voting rights. Investments in associates are initially recognised at cost and subsequently measured using the equity method of accounting. Investments in associates include goodwill identified on acquisition.

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

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

1.7. Joint ventures

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at cost and subsequently adjusted by the changes that have occurred in the Group's share of the net assets under joint control. The income statement of the Group includes the Group's share in the profits or losses of the entity under joint control. Unrealised gains and losses from transactions between the Group and its joint ventures are eliminated similarly to transactions with associates (Note 1.6).

1.8. Jointly controlled operations

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

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

1.9. Foreign currency

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

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

1.10. Financial assets

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

- financial assets at fair value through profit or loss;
- loans and receivables
- held-to-maturity investments;
- available-for-sale financial assets.

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

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

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

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information on the solvency of the party to transaction. Receivables whose collection is improbable are written down during the reporting period (see also 1.11)

1.11. Impairment of assets

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

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

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

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

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

1.12. Inventories

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

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

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

Expenditure incurred for real estate development is reported in the balance sheet line Inventories either as work-in-progress or finished goods, depending on the stage of completion. When the development of roperty is financed with a loan, the borrowing costs incurred during development are included in the cost of the property. A completed real estate property is sold either in parts (by houses, apartments, office spaces, etc.) or as a whole. Revenue is recognised as income from the sale of goods (Note 1.21). Upon the sale of real estate properties, a notarially certified agreement is entered into between the Group and the acquirer for transferring the property, and a respective entry is made in the land register.

1.13. Investment property

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

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

1.14. Property, plant and equipment

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

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

- buildings 10-33.3 years;
- machinery and equipment 3-5 years:
- other items of property, plant and equipment 2.5-5 years;
- right of superficies 50 years.

Land is not depreciated.

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

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

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

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

1.15. Intangible assets

Intangible assets are recognised in the balance sheet when the asset can be controlled by the Company, the expected future benefits attributable to the asset will flow to the Company and the cost of the asset can be measured reliably. The cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Intangible assets are carried in the balance sheet at cost less any accumulated amortisation and any accumulated impairment losses.

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

1.16. Finance and operating leases

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

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

Finance lease liabilities are reduced by principal payments; interest expenses on lease payments are included within finance costs in the income statement. Finance costs are allocated to rental period so as to achieve a constant periodic rate of interest on the remaining balance of the liability.

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

1.17. Financial liabilities

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

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

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

1.18. Corporate income tax

According to the Income Tax Act of the Republic of Estonia, legal entities are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, costs of entertaining guests, dividends and payments not related to business operations. Thus there are no differences between the tax bases and the carrying amounts of assets which would give rise to a deferred income tax asset or liability. From 01.01.2008, the tax rate on dividends payable is 21/79 (in 2007: 22/78; 2006: 23/77) of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared.

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

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

Legal entities in Latvia and Lithuania that belong to the Group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia and the Republic of Lithuania. The profits of entities located in the Republic of Latvia are taxed at the rate of 15%, the profits of entities located in the Republic of Lithuania are taxed at the rate of 15% in 2008 (2007: 15%+3%).

1.19. Employee benefits

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

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

1.20. Provisions

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

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation which are not included already in the best estimate of the related expenses.

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

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

1.21. Revenue

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

Revenue from the provision of construction services is recognised as revenue by reference to the stage of completion of the contract (see Note 1.22) in accordance with IAS 11 *Construction Contracts*. Revenue from own real estate development projects (private dwelling houses, apartments, office premises, etc. that have been built on the registered immovables owned by entities of Merko Ehitus Group) is recognised as revenue in accordance with IAS 18 *Revenue* when significant risks and rewards of ownership of the goods are transferred to the buyer, the receipt of payment is probable and the costs incurred in respect of the transaction can be measured reliably.

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

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

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

1.22. Construction contracts in progress

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

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

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

1.23. Government grants

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

1.24. Cash and cash equivalents

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

1.25. Contingent liabilities

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

1.26. Statutory reserve capital

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

1.27. Events after the balance sheet date

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

1.28. Dividends

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

1.29. Segment reporting

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

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

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

Note 2 Critical accounting estimates and judgements

The preparation of financial statements in conformity with International Financial Reporting Standards requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are relevant to the consolidated financial statements of Merko Ehitus Group, are disclosed below. Changes in management's estimates are reported in the income statement of the period of the change.

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

Provision for warranty obligations
In determining the provision for warranty obligations, the statistical cost of the Company's warranty works is considered.

Inventory write-down
Inventories are valued separately by individual properties (registered immovable or building). A business plan is prepared for each property based on its nature (intended use and building rights currently effective or being effected) and the project's costs are compared with expected income. If the property's costs exceed the expected revenue or the present value of cash flows to be generated by the property (recoverable amount), the Group shall write down assets in the amount by which the costs exceed income. Due to the volatility of the construction market and low liquidity of the real estate market, the determination of the recoverable amount of the asset depends largely on management assumptions. The sensitivity analysis showed that if the recoverable amount had been overestimated or the real estate prices continued to decrease by 10% (income would be 10% lower upon the disposal of assets), the Company's write-down of inventories would have been 141 023 thousand kroons higher in 2008, and had the inventory value been underestimated or the real estate prices had increased by 10% (income would be 10% higher upon the disposal of assets), the write-down of inventories would have been 83 499 thousand kroons lower.

Revenue under the stage of completion method
Revenue from construction in progress is recognised under the stage of completion method (Note 1.22), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, forecasting and reporting of income and expenses has been introduced for determining the stage of completion. The estimated final result to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the profit estimate is adjusted. As at 31.12.2008, the amount of the provision for onerous contracts was 3525 thousand kroons which was determined after the evaluation of the stage of completion of construction contracts (Note 30). Risk analysis showed that a change in the estimated costs of construction projects in the range of +/- 10% will result in a change in the net profit between an increase of 360 897 thousand kroons and a decrease of 361 475 thousand kroons.

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

Note 3 Business and geographical segments

in thousands of kroons

Business segments

2008	General construction	Road construction	Concrete elements	Group
Consolidated revenue	4 221 660	432 273	-	4 653 933
Inter-segment revenue	10	23 903	-	23 913
Segment revenue	4 221 670	456 176	-	4 677 846
Segment operating profit	322 881	5 201	-	328 082
Finance income/costs				4 627
incl. profit/loss from associates and joint ventures (Note 20)	(1 398)	-	(3 167)	(4 565)
Profit before tax				332 709
Corporate income tax				(26 339)
Net profit of the Group				306 370
incl. attributable to equity owners of the parent				299 140
minority interest				7 230
Segment assets	3 386 340	176 119	-	3 562 459
Associates and joint ventures	152 886	-	53 875	206 761
Unallocated assets				91 868
Total consolidated assets				3 861 088
Segment liabilities	897 711	82 092	-	979 803
Unallocated liabilities				771 721
Total consolidated liabilities				1 751 524
Purchase of investment property (Note 23)	2 063	-	-	2 063
Purchase of property, plant and equipment and intangible assets	40 006	28 283	-	68 289
Depreciation and impairment charge (Notes 23-25)	(21 111)	(12 326)	-	(33 437)

2007	**General construction**	**Road construction**	**Concrete elements**	**Group**
Consolidated revenue	5 004 039	506 721	-	5 510 760
Inter-segment revenue	191	199	-	390
Segment revenue	5 004 230	506 920	-	5 511 150
Segment operating profit	487 697	33 348	-	521 045
Finance income/costs				69 694
incl. profit/loss from associates and joint ventures (Note 20)	55 577	-	20 863	76 440
Profit before tax				590 739
Corporate income tax				(30 830)
Net profit of the Group				559 909
incl. attributable to equity owners of the parent				545 049
minority interest				14 860
Segment assets	3 406 435	178 816	-	3 585 251
Associates and joint ventures	215 922	-	57 042	272 964
Unallocated assets				58 416
Total consolidated assets				3 916 631
Segment liabilities	(1 083 479)	(82 223)	-	(1 165 702)
Unallocated liabilities				(701 233)
Total consolidated liabilities				(1 866 935)
Purchase of property, plant and equipment and intangible assets	52 129	21 822	-	73 951
Depreciation and impairment charge (Notes 23-25)	(18 654)	(10 014)	-	(28 668)

Other long-term receivables and prepaid taxes, other than corporate income tax, are included in the Group's unallocated assets. Borrowings and tax liabilities, other than accrued corporate income tax, are included in the Group's unallocated liabilities. It is not possible or practical to attribute unallocated assets and liabilities to a specific segment.

Geographical segments

Revenue

	2008	**2007**
Estonia	2 893 304	3 385 635
Latvia	905 345	1 386 332
Lithuania	855 284	738 793
Total	4 653 933	5 510 760

	Total assets		Purchase of investment property		Purchase of property, plant and equipment	
	31.12.2008	31.12.2007	2008	2007	2008	2007
Estonia	2 111 648	2 022 549	1 059	-	61 467	59 117
Latvia	1 418 020	1 486 220	1 004	-	6 484	14 741
Lithuania	331 420	407 862	-	-	338	93
Total	3 861 088	3 916 631	2 063	-	68 289	73 951

Note 4 Cost of goods sold

in thousands of kroons

	2008	2007
Construction services	2 343 275	3 191 237
Properties purchased for resale	426 138	398 825
Materials	399 557	419 679
Staff costs	356 945	373 901
Construction mechanisms and transport	137 136	106 955
Design	81 547	92 772
Depreciation and impairment charge	24 327	20 596
Other expenses	124 276	127 787
Total cost of goods sold	3 893 201	4 731 752

Note 5 Marketing costs

in thousands of kroons

	2008	2007
Advertising, sponsorship	19 330	12 379
Staff costs	13 118	10 674
Construction tenders	3 643	1 754
Transport	1 887	1 226
Depreciation and impairment charge	417	434
Other expenses	5 526	6 005
Total marketing costs	43 921	32 472

Note 6 General and administrative expenses

in thousands of kroons

	2008	2007
Staff costs	112 222	127 856
Allowance for doubtful receivables	20 878	1 214
Consulting, legal, auditing	18 796	27 916
Office expenses, communication services	18 040	15 494
Depreciation and impairment charge	8 666	7 638
Transport	8 339	8 114
Computer equipment and software	7 292	3 061
Other expenses	29 465	22 513
Total general and administrative expenses	223 698	213 806

Note 7 Other operating income

in thousands of kroons

	2008	2007
Fines and penalties for delay received	3 966	723
Interest income from operating activities	1 404	2 844
Profit from sale of non-current assets	954	488
Other income	3 205	2 369
Total other operating income	9 529	6 424

Note 8 Other operating expenses

in thousands of kroons

	2008	2007
Inventory write-down (Note 18)	152 105	-
Fines, penalties	12 457	13 307
Gifts, donations	5 044	3 851
Foreign exchange loss	-	325
Loss from sale of investment property	-	212
Doubtful interest receivable	1 025	-
Other expenses	3 569	414
Total other operating expenses	174 560	18 109

Note 9 Finance income

in thousands of kroons

	2008	2007
Interest income	34 401	11 016
Other finance income	4	-
Total finance income	34 405	11 016

Note 10 Finance costs

in thousands of kroons

	2008	2007
Interest expenses	18 392	16 948
Foreign exchange loss	6 942	809
Other finance costs	1 297	5
Total finance costs	26 631	17 762

Note 11 Corporate income tax

in thousands of kroons

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

2008	Latvia	Lithuania	Estonia	Total
Profit before tax	72 554	30 210	229 945	332 709
Tax rate applicable to profits	15%	15%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(10 883)	(4 531)	-	(15 414)
Tax calculated on expenses not deductible for tax purposes	(3 269)	(283)	-	(3 552)
Tax calculated on income not subject to tax	2 478	508	-	2 986
Effect of change in income tax rate	-	299	-	299
Tax loss not recognised in the reporting period	-	464	-	464
Corporate income tax on dividends	-	-	(11 122)	(11 122)
Tax charge	(11 674)	(3 543)	(11 122)	(26 339)
incl. current tax	(30 348)	(5 699)	(11 122)	(47 169)
deferred tax charge (Note 22)	18 674	2 156	-	20 830

2007	Latvia	Lithuania	Estonia	Total
Profit before tax	134 848	24 592	431 299	590 739
Tax rate applicable to profits	15%	18%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(20 227)	(4 427)	-	(24 654)
Tax calculated on expenses not deductible for tax purposes	(4 594)	(680)	-	(5 274)
Tax calculated on income not subject to tax	8 672	295	-	8 967
Corporate income tax on dividends	-	-	(9 869)	(9 869)
Tax charge	(16 149)	(4 812)	(9 869)	(30 830)
incl. current tax	(15 978)	(1 787)	(9 869)	(27 634)
deferred tax charge (Note 22)	(171)	(3 025)	-	(3 196)

Income tax on dividends was incurred at the Group due to the distribution of the subsidiaries' profits as dividends.
As at 31.12.2008, it is possible to pay out dividends to shareholders from retained earnings in the amount of 1 485 383 thousand kroons and the corresponding income tax would amount to 394 849 thousand kroons. As at 31.12.2007, it would have been possible to pay out 1 438 635 thousand kroons, and the corresponding income tax would have amounted to 382 422 thousand kroons.

Note 12 Earnings per share

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

	2008	2007
Net profit attributable to shareholders (in thousands of kroons)	299 140	545 049
Weighted average number of ordinary shares (thousand pcs)	17 700	17 700
Earnings per share (in kroons)	16.90	30.79

In 2007 and 2008, the Group did not have any potential ordinary shares to be issued; therefore the diluted earnings per share equal the basic earnings per share.

Note 13 Dividends per share

Dividends payable are recognised after the approval of profit allocation at the General Meeting of Shareholders. According to the profit allocation proposal, EEK 61 950 thousand, i.e. EEK 3.50 per share, will be distributed as net dividends in 2009, incurring a maximum corporate income tax charge of 21/79 of the amount paid i.e. EEK 16 468 thousand. The parent AS Merko Ehitus did not pay dividend in 2008. In 2007, 123 900 thousand kroons, i.e. 7.0 kroons per share were paid out as dividends whereas AS Merko Ehitus did not need to pay corporate income tax due to the dividends received from subsidiaries and which were taxable in prior periods.

Note 14 Cash and cash equivalents

in thousands of kroons

	31.12.2008	31.12.2007
Cash on hand	346	116
Bank accounts	50 691	53 722
Overnight deposits	231 505	149 226
Term deposits with maturities of 3 months and less	232 649	2 500
Total cash and cash equivalents	515 191	205 564

As at 31.12.2008, the weighted average interest on overnight deposits was 5.3% (31.12.2007: 4.63%). The weighted average interest on bank deposits with maturities of 3 months or less was 7.6% (2007: 4.11%) and the average maturity as at 31.12.2008 was 58 days (31.12.2007: 6 days).

Note 15 Short-term deposits

in thousands of kroons

	31.12.2008	31.12.2007
Bank deposits with maturities greater than 3 months	262 759	-

The weighted average interest on bank deposits with maturities greater than 3 months was 6.5% and the average maturity as at 31.12.2008 was 155 days.

Note 16 Trade and other receivables

in thousands of kroons

	31.12.2008	31.12.2007
Trade receivables		
accounts receivable	556 511	886 967
allowance for doubtful receivables	(20 085)	(2 111)
	536 426	884 856
Tax prepayments excluding corporate income tax		
value added tax	37 320	38 139
social security tax	6	12
other taxes	1 268	1
	38 594	38 152
Amounts due from customers for contract works (Note 34)	109 305	151 119
Other short-term receivables		
short-term loans (Note 17)	47 454	41 135
interest receivables	6 940	2 075
receivable from sale of subsidiary	7 000	1 000
other short-term receivables	1 519	2 662
	62 913	46 872
Prepayments for services		
prepayments for construction services	24 127	64 864
prepaid insurance	1 540	2 339
other prepaid expenses	7 760	11 364
	33 427	78 567
Total trade and other receivables	780 665	1 199 566

Trade receivables by due dates

	31.12.2008		31.12.2007	
Not overdue	403 913	75.3%	833 330	87.3%
1-30 days overdue	49 458	9.2%	41 505	8.7%
31-60 days overdue	18 060	3.3%	1 000	0.7%
61-90 days overdue	6 102	1.1%	1 180	2.1%
91-120 days overdue	15 827	3.0%	719	0.2%
121-180 days overdue	16 976	3.2%	3 846	0.9%
More than 180 days overdue	26 090	4.9%	3 276	0.1%
Total trade receivables	536 426	100.0%	884 856	100.0%

Due to the overall deterioration of the financial environment and liquidity, the quality of receivables has also considerably deteriorated. In a year, the share of overdue receivables in total receivables has increased from 12.7% to 24.7%. In 2008, the Group wrote down uncollectible receivables in the amount of 20 085 thousand kroons (2007: 2111 thousand kroons), including a receivable from one customer in the amount of 16 098 thousand kroons. The total amount owed by this customer without considering the write-down was 32 195 thousand kroons, incl. an overdue portion in the amount of 5774 thousand kroons which had not been written down as at 31.12.2008 (included in receivables 31-60 days overdue). After the balance sheet date, this customer has paid off 17 262 thousand kroons. Management considers it likely that the receivables carried in the financial statement will be paid by customers. As at the balance sheet date, the amount of overdue receivables was 132 513 thousand kroons, including 38 514 thousand kroons held as security by customers, which will be released at the completion of project upon presentation of a guarantee. By the date of approval of the financial statements 103 227 thousand kroons of overdue debt had been collected.

A more detailed overview of the Company's credit risk is provided in Note 38.

Note 17 Loans granted

in thousands of kroons

	2008	2007
Loans granted to joint ventures		
Loan balance at beginning of the year	12 725	24 750
Granted	22 307	6 725
Collected	(175)	(18 750)
Exchange difference	(190)	-
Loan balance at end of the year	34 667	12 725
incl. current portion	16 400	7 000
non-current portion 1...5 years	18 267	5 725
Average effective interest rate 5.0% (2007: 6.0%)		
Loans granted to entities under joint control		
Loan balance at beginning of the year	7 178	12 700
Granted	-	110 230
Loan receivable relating to sale of subsidiary	4 015	-
Collected	(4 015)	(115 774)
Exchange difference	(113)	22
Loan balance at end of the year	7 065	7 178
incl. current portion	4 169	4 236
non-current portion 1...5 years	2 896	2 942
Average effective interest rate 8.0% (2007: 4.5%)		
Loans granted to un-related legal entities		
Loan balance at beginning of the year	29 899	1 177
Granted	-	28 737
Collected	-	(15)
Write-down	(3 000)	-
Exchange difference	(14)	-
Loan balance at end of the year	26 885	29 899
incl. current portion	26 885	29 899
Average effective interest rate 6.0% (2007: 6.0%)		
Loans to un-related individuals		
Loan balance at beginning of the year	-	60
Collected	-	(60)
Loan balance at end of the year	-	-
Total loans granted		
Loan balance at beginning of the year	49 802	38 687
Granted	22 307	145 692
Reclassification of loan granted to subsidiary	4 015	-
Collected	(4 190)	(134 599)
Exchange difference	(317)	22

Write-down	(3 000)	-
Loan balance at end of the year	**68 617**	**49 802**
incl. current portion (Note 16)	47 454	41 135
non-current portion 1…5 years (Note 21)	21 163	8 667

All loans granted are fully performing at the balance sheet date. A loan has been written down by 3 million kroons, the carrying amount of which was 25.7 million kroons subsequent to the write-down. A write-down was carried out in the amount which according to the Management Board equated the carrying amount of the loan with the recoverable amount of the property set as collateral.

Note 18 Inventories

in thousands of kroons

	31.12.2008	**31.12.2007**
Raw materials and materials	5 372	3 501
Work-in-progress	541 134	1 209 117
Finished goods	522 205	72 434
Goods for resale		
registered immovables purchased for resale	713 803	704 111
*incl. registered immovables located on nature preserve areas**	*61 098*	*61 098*
other goods purchased for resale	11	13
	713 814	704 124
Prepayments for inventories		
prepayments for real estate properties	33 257	35 653
prepayments for other inventories	1 704	597
	34 961	36 250
Total inventories	1 817 486	2 025 426

* There are strict building restrictions on immovables located on nature preserve areas and their use for development purposes, either directly or indirectly, is not permitted. According to the Nature Conservation Act of the Republic of Estonia, an immovable which is located within the territory of a protected area, special conservation area or species protection site and whose use for intended purposes is significantly hindered by the protection procedure, may be transferred to the state by agreement between the state and the owner of land for a consideration equivalent to the usual value of the immovable (§ 19 and 20 of Nature Conservation Act). Until the entry into force of the new version of the Act, an older version was in force until 01.08.2008 which laid down the exchange of nature preserve areas with the state

The value of an immovable, other than a forest immovable, is determined by applying the transaction comparison method. In determining the value of an immovable, the real rights which due to their nature cannot be deleted from the land register are considered (e.g. servitudes, neighbourhood rights) as well as those arising from laws other than the restrictions on an immovable property arising from the protection procedure which forms basis for the acquisition of an immovable.

Based on the overall economic environment and a tense state budget situation, the transfer of the registered immovables is unlikely in the near term. Management is of opinion that in the long term, the state is required to purchase these registered immovables or annul the restrictions set for them as a result of which they have been treated as land without restrictions and the registered immovables have not been written down.

As at 31.12.2008, inventories have been written down to their net realisable value by write-down of 152 105 thousand kroons (Notes 2, 8):

	Carrying amount before write-down	Write-down	Carrying amount after write-down
Finished goods	656 652	133 447	522 205
Work-in-progress	556 909	15 775	541 134
Land purchased for resale	716 686	2 883	713 803

With regard to finished goods and work-in-progress, apartment buildings have been written down.

Note 19 Shares in subsidiaries

in thousands of kroons

	Participation and voting rights %		Location	Area of operation
	31.12.2008	31.12.2007		
Subsidiaries of AS Merko Ehitus				
AS Gustaf	75	75	Pärnu	construction
AS Merko Tartu	66	66	Tartu	construction
AS Merko Insenerehitus	-	100	Tallinn	construction
OÜ Merko Ehitustööd	-	100	Tallinn	construction
Ringtee Tehnopark OÜ (previous name: Eesti Ehitusekspordi OÜ)	100	100	Tallinn	construction
Tallinna Teede AS	100	100	Tallinn	road construction
SIA Merks	100	100	Republic of Latvia, Riga	construction
UAB Merko Statyba	100	100	Republic of Lithuania, Vilnius	construction
OÜ Merko Elamu	100	100	Tallinn	real estate
OÜ Põrguvälja Soojus	-	100	Tallinn	real estate
OÜ Woody	100	100	Tallinn	real estate
OÜ Gustaf Tallinn	80	80	Tallinn	construction
OÜ Karulaugu Kinnisvara	-	100	Tallinn	real estate
OÜ Rae Tehnopark	100	100	Tallinn	real estate
OÜ Maryplus	100	100	Tallinn	real estate
OÜ Metsailu	100	100	Tallinn	real estate
OÜ Pire Projekt	-	100	Tallinn	real estate
OÜ Constancia	100	100	Tallinn	real estate
OÜ Käibevara	100	100	Tallinn	real estate
OÜ Baltic Electricity Engineering	100	100	Tallinn	electricity systems
OÜ Fort Ehitus	75	75	Harjumaa, Viimsi County	construction

In May 2008, AS Merko Ehitus sold its subsidiary OÜ Karulaugu Kinnisvara to the subsidiary of AS Riverito, E.L.L. Kinnisvara AS which was recognised as a sale of property at the Group (one-asset entity, the only significant asset of which was land included in inventories). The sales price for land was 37 882 thousand kroons which is recognised as revenue in the income statement, and of this amount, the profit amounted to 37 649 thousand kroons. The sales price had been collected by the balance sheet date.

In October 2008, AS Merko Ehitus sold its subsidiary OÜ Põrguvälja Soojus, having previously made an additional contribution to its share capital in the amount of 12 000 thousand kroons in order to restore its equity. Of the sales price, 6 000 thousand kroons had not been collected by the balance sheet date.

In December 2008, AS Merko Ehitus made additional contributions to share capital of its subsidiaries in order to restore their equity: 1200 thousand kroons into the subsidiary OÜ Metsailu and 6500 thousand kroons into the subsidiary OÜ Käibevara .

In June 2008, AS Merko Ehitus liquidated its non-operating wholly-owned subsidiaries AS Merko Insenerehitus, OÜ Merko Ehitustööd and OÜ Pire Projekt; according to allocation plans of assets, liquidation proceeds totalled 1539 thousand kroons, 77 thousand kroons ja 12 395 thousand kroons, respectively.

In 2007, Tallinna Teede AS acquired a 100% interest in the one-asset entity OÜ Tevener (the only significant asset being land for mining of mineral resources), as a result of which the acquisition of the entity was not accounted for as a business combination. The fair value of land included within non-current assets of the subsidiary OÜ Tevener is based on the market value. In 2008, the second instalment payment was made in the amount of 15 000 thousand kroons for OÜ Tevener.

Proceeds from sale of subsidiaries

	OÜ Põrguvälja Soojus
Ownership interest sold	100%
Sales price	12 000
Profit from sale	1 418
Cash received	6 000
Cash and cash equivalents upon the sale of subsidiary	(33)
Cash flows from the sale at the Group	5 967
Collected for the 25% of the shares of the subsidiary AS Gustaf sold in 2006	1 000
Total cash flows from the sale of subsidiaries	6 967

Note 20 Investments in associates and joint ventures

	Participation and voting rights % 31.12.2008	31.12.2007	Location	Area of operation
Associates of AS Merko Ehitus				
AS Tartu Maja Betoontooted	25	25	Tartu	concrete elements
Joint ventures AS Merko Ehitus				
Normanni Linnagrupi AS	-	50	Tallinn	construction
OÜ Unigate	50	50	Tallinn	real estate
OÜ Tornimäe Apartments	-	50	Tallinn	real estate
Joint ventures of SIA Merks				
PS Merks Terbe Lat	50	50	Republic of Latvia, Riga	construction
SIA Zakusala Estates	50	50	Republic of Latvia, Riga	real estate
Joint venture of AS Merko Tartu				
OÜ Kortermaja	50	50	Tartu	real estate

In May 2008, AS Merko Ehitus sold its ownership interest in the joint venture OÜ Tornimäe Apartments at the sales price of 59 856 thousand kroons and in December 2008, its ownership interest in the joint venture Normanni Linnagrupi AS at the sales price of 375 thousand kroons. As at 31.12.08, the cash received from the sale totalled 60 231 thousand kroons.

in thousands of kroons	**Investment at 31.12.2007**	**Changes in 2008**			**Investment 31.12.2008**
		acquisition, sale	**profit/loss from entities**	**currency translation adjust-ments**	
Associates of AS Merko Ehitus					
AS Tartu Maja Betoontooted	57 042	-	(3 167)	-	53 875
Total associates	57 042	-	(3 167)	-	53 875
Joint ventures AS Merko Ehitus					
Normanni Linnagrupi AS	410	(375)	(35)	-	-
OÜ Unigate	16	1 000	(32)	-	984
OÜ Tornimäe Apartments	56 255	(59 856)	3 601	-	-
Joint ventures of SIA Merks					
PS Merks Terbe Lat	25	-	-	(1)	24
SIA Zakusala Estates	154 701	-	(3 141)	(2 406)	149 154
Joint venture of AS Merko Tartu					
OÜ Kortermaja	4 515	-	(1 791)	-	2 724
Total joint ventures	215 922	(59 231)	(1 398)	(2 407)	152 886
Total associates and joint ventures	272 964	(59 231)	(4 565)	(2 407)	206 761

in thousands of kroons	**Investment at 31.12.2006**	**Changes in 2007**			**Investment at 31.12.2007**
		profit/loss from entities	**dividends**	**currency translation adjust-ments**	
Associates of AS Merko Ehitus					
AS Tartu Maja Betoontooted	40 179	20 863	(4 000)	-	57 042
Total associates	40 179	20 863	(4 000)	-	57 042
Joint ventures AS Merko Ehitus					
Normanni Linnagrupi AS	413	(3)	-	-	410
OÜ Unigate	22	(6)	-	-	16
OÜ Tornimäe Apartments	122	56 133	-	-	56 255
Joint ventures of SIA Merks					
PS Merks Terbe Lat	406	-	(382)	1	25
SIA Zakusala Estates	157 343	(2 749)	-	107	154 701
Joint venture of AS Merko Tartu					
OÜ Kortermaja	2 313	2 202	-	-	4 515
Total joint ventures	160 619	55 577	(382)	108	215 922
Total associates and joint ventures	200 798	76 440	(4 382)	108	272 964

As at 31.12.2008, the difference between the carrying amount of the investment of OÜ Kortermaja and the equity of the investee totalling 2143 thousand kroons (2007: 2265 thousand kroons) is due to the effect from the unrealised gains of mutual transactions.

As at 31.12.2008, the investment in the joint venture SIA Zakusala Estates includes intangible assets in the amount of 150 496 thousand kroons (2007: 147 263 thousand kroons) which are not recognised in the balance sheet of the investee. The intangible asset represents the lease agreement with the City of Riga expiring at 2 June 2051 which gives it a right to use the 126 thousand m^2 registered immovable on Zakusala island in the centre of Riga.

In order to restore equity in the joint venture OÜ Unigate, the existing shares were cancelled in January 2008, and an additional contribution was made to the share capital in the amount of 1 million kroons, of which the nominal value of one share was 40 thousand kroons and the share premium was 960 thousand kroons.

Associates *in thousands of kroons*	**Assets 31.12**	**Liabilities 31.12**	**Revenue**	**Net profit/loss**
2008				
AS Tartu Maja Betoontooted	282 694	66 520	253 545	(13 159)
2007				
AS Tartu Maja Betoontooted	308 168	80 000	520 146	83 452

Joint ventures *in thousands of kroons*	**Assets 31.12**		**Liabilities 31.12**		**Equity 31.12**	**Income**	**Expenses**	**Net profit/loss**
	current assets	**non-current assets**	**current liabilities**	**non-current liabilities**				
2008								
OÜ Unigate	46 055	-	42 237	1 851	1 967	3	67	(64)
PS Merks Terbe Lat	35	-	-	-	35	-	-	-
SIA Zakusala Estates	4 715	28 717	2 625	22 398	8 409	71	6 354	(6 283)
OÜ Kortermaja	20 750	-	67	10 948	9 735	4 051	7 876	(3 825)
Total	71 555	28 717	44 929	35 197	20 146	4 125	14 297	(10 172)
2007								
Normanni Linnagrupi AS	819	-	-	-	819	2	9	(7)
OÜ Unigate	45 996	-	43 497	2 468	31	3	15	(12)
OÜ Tornimäe Apartments	114 163	-	1 654	-	112 509	331 711	219 446	112 265
PS Merks Terbe Lat	49		-	-	49	-	-	-
SIA Zakusala Estates	4 978	24 648	7 222	7 528	14 876	-	5 498	(5 498)
OÜ Kortermaja	27 316	-	13 756	-	13 560	39 121	33 883	5 238
Total	193 321	24 648	66 129	9 996	141 844	370 837	258 851	111 986

Note 21 Other long-term loans and receivables

in thousands of kroons

	31.12.2008	31.12.2007
Long-term loans (Note 17)	21 163	8 667
Long-term bank deposit*	2 259	-
Long-term receivable from buyer of subsidiary*	2 625	3 625
Long-term receivables from customers of construction services	3 002	2 200
Total other long-term loans and receivables	29 049	14 492

* The long-term bank deposit with the maturity at 28 December 2012 and interest rate of 4.63% has been pledged as collateral for the warranty granted to a customer of a construction contract.
* In 2006, AS Merko Ehitus sold 25% of the shares of the subsidiary AS Gustaf. The receivable is discounted at a 5% interest rate and its due date is 1 May 2011.

Note 22 Deferred income tax assets and liabilities

in thousands of kroons

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

31.12.2008	Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	21 172	3 054	24 226
effect of carrying amount of property, plant and equipment	(788)	-	(788)
effect of stage of completion method	676	10	686
effect of write-down of receivables	2 519	314	2 833
effect of write-down of inventories	17 236	1 228	18 464
effect of provisions	-	892	892
effect of changes in income tax rate		299	299
Other effects	1 529	311	1 840
Deferred income tax assets	**21 172**	**3 054**	**24 226**
Deferred income tax charge of the financial year (Note 11)	(18 674)	(2 156)	(20 830)

31.12.2007	Latvia	Lithuania	Total
Deferred income tax liability	-	-	-
Deferred income tax assets	2 498	898	3 396
incl. tax loss carryforwards	68	-	68
effect of carrying amount of property, plant and equipment	(613)	-	(613)
effect of stage of completion method	3 043	191	3 234
other effects	-	707	707
Deferred income tax assets	**2 498**	**898**	**3 396**
Deferred income tax charge of the financial year (Note 11)	171	3 025	3 196

In Lithuania, unused tax losses carried forward expire in 4 years and the management considers it likely that the respective tax losses can be utilised against future profits.

Note 23 Investment property

in thousands of kroons

	Land	Buildings	Total
Cost at 31.12.2006	2 134	2 589	4 723
Accumulated depreciation at 31.12.2006	-	(823)	(823)
Carrying amount at 31.12.2006	2 134	1 766	3 900
Exchange difference	2	15	17
Sale	-	(212)	(212)
Reclassification	-	3 733	3 733
depreciation	-	(77)	(77)
Carrying amount at 31.12.2007	2 136	5 225	7 361
Cost at 31.12.2007	2 136	5 600	7 736
Accumulated depreciation at 31.12.2007	-	(375)	(375)
Carrying amount at 31.12.2007	2 136	5 225	7 361
Exchange difference	(33)	(64)	(97)
Cost	-	2 063	2063
Reclassification	-	3 003	3 003
Depreciation	-	(328)	(328)
Carrying amount at 31.12.2008	2 103	9 899	12 002
Cost at 31.12.2008	2 103	10 600	12 703
Accumulated depreciation at 31.12.2008	-	(701)	(701)
Carrying amount at 31.12.2008	2 103	9 899	12 002

As at 31.12.2008, the carrying amounts of investment properties do not significantly differ from their fair values (31.12.2007: the carrying amounts of investment properties did not significantly differ from their fair values).
In 2007, items of property, plant and equipment in the amount of 3733 thousand kroons were reclassified from construction in progress to investment property. In 2008, unsold apartments in the amount of 3003 thousand kroons were reclassified from finished goods of inventories to investment property.

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

Note 24 Property, plant and equipment

in thousands of kroons

	Land	Buil-dings	Right of super-ficies	Machi-nery and equip-ment	Other fixtures	Construc-tion in progress and prepay-ments	Total
Cost at 31.12.2006	145	18 682	458	92 430	51 257	553	163 525
Accumulated depreciation at 31.12.2006	-	(3 436)	(86)	(41 160)	(28 398)	-	(73 080)
Carrying amount at 31.12.2006	145	15 246	372	51 270	22 859	553	90 445
Currency translation differences	-	-	-	-	57	-	57
Cost	15 798	4 695	-	33 766	16 543	13 695	84 497
Acquisition in business combinations	-	1 106	-	28 757	-	1 278	31 141
Sale	-	-	-	(2 181)	(738)	-	(2 919)
Reclassification	-	-	-	1 915	1 114	(6 762)	(3 733)
Write-offs	-	-	-	(250)	(136)	-	(386)
Depreciation	-	(666)	(9)	(14 790)	(10 725)	-	(26 190)
Carrying amount at 31.12.2007	15 943	20 381	363	98 487	28 974	8 764	172 912
Cost at 31.12.2007	15 943	24 627	458	153 587	64 970	8 764	268 349
Accumulated depreciation at 31.12.2007	-	(4 246)	(95)	(55 100)	(35 996)	-	(95 437)
Carrying amount at 31.12.2007	15 943	20 381	363	98 487	28 974	8 764	172 912
Currency translation differences	-	-	-	-	(248)	-	(248)
Acquisition	5 105	-	-	27 258	22 525	11 564	66 452
Acquisition in business combinations	-	-	-	-	15 000	-	15 000
Sale	-	-	-	(1 331)	(595)	-	(1 926)
Non-current assets of sold subsidiary	(901)	(4 457)	-	(3 396)	-	-	(8 754)
Reclassification	(10 450)	(18)	-	9 449	14 917	(14 571)	(673)
Write-offs	-	-	-	(24)	(61)	(36)	(121)
Depreciation	-	(807)	(9)	(16 472)	(13 260)	-	(30 548)
Carrying amount at 31.12.2008	9 697	15 099	354	113 971	52 252	5 721	197 094
Cost at 31.12.2008	9 697	20 008	458	181 732	97 274	5 721	314 890
Accumulated depreciation at 31.12.2008	-	(4 909)	(104)	(67 761)	(45 022)	-	(117 796)
Carrying amount at 31.12.2008	9 697	15 099	354	113 971	52 252	5 721	197 094

Information on leased assets is provided in Note 26 and on lease payments in Note 27.
No property, plant and equipment are pledged as collateral for borrowings.

Note 25 Intangible assets

in thousands of kroons

	Software	Prepayments	Total
Cost at 31.12.2006	4 368	7 515	11 883
Accumulated amortisation at 31.12.2006	(1 706)	-	(1 706)
Carrying amount at 31.12.2006	2 662	7 515	10 177
Cost	2 004	2 410	4 414
Reclassification	8 112	(8 112)	-
Amortisation	(2 017)	-	(2 017)
Carrying amount at 31.12.2007	10 761	1 813	12 574
Cost at 31.12.2007	14 443	1 813	16 256
Accumulated amortisation at 31.12.2007	(3 682)	-	(3 682)
Carrying amount at 31.12.2007	10 761	1 813	12 574
Currency translation differences	(27)	(3)	(30)
Cost	1 837	-	1 837
Reclassification	314	(448)	(134)
Amortisation	(2 440)	-	(2 440)
Carrying amount at 31.12.2008	10 445	1 362	11 807
Cost at 31.12.2008	16 377	1 362	17 739
Accumulated amortisation at 31.12.2008	(5 932)	-	(5 932)
Carrying amount at 31.12.2008	10 445	1 362	11 807

Prepayments for intangible assets relate to prospective replacement of the Group's accounting software.

Note 26 Leased assets

in thousands of kroons

	2008	2007
Assets acquired under finance lease terms		
Machinery and equipment		
Cost	117 012	90 195
Accumulated depreciation	(31 400)	(20 871)
incl. depreciation charge	(11 019)	(8 291)
Carrying amount	85 612	69 324
Assets leased under non-cancellable operating lease terms		
Right of superficies		
Payments made in financial year	173	-
Future lease payments		
payments in next financial year	-	475
payments in 1...5 years	-	950
payments after year 5	-	9 482

On the basis of cancellable lease agreements, operating lease payments totalling 11 254 thousand kroons (2007: 11 675 thousand kroons) were paid for passenger cars in 2008. The Company does not intend to use a bargain purchase option for the assets leased under the operating lease terms in the reporting period.

Note 27 Borrowings

in thousands of kroons

	2008	2007
Finance lease payables		
Present value of lease payments at beginning of the year	48 114	25 851
Received	23 336	36 523
Paid	(16 909)	(14 260)
Present value of lease payments at end of the year	54 541	48 114
incl. current portion	17 198	11 879
non-current portion 1...4 years	37 343	36 235
Interest cost of reporting period	3 434	3 272
Minimum future lease payments	65 777	51 404
incl. current portion	22 472	13 441
non-current portion 1...4 years	43 305	37 963
Average effective interest rate 6.9% (2007: 5.7%)		
Base currencies EEK, EUR and LVL		
Bank loans		
Loan balance at beginning of the year	630 543	417 276
Received	237 380	558 348
Paid	(306 911)	(345 739)
Exchange difference	(7 401)	658
Loan balance at end of the year	553 611	630 543
incl. current portion	62 308	273 965
non-current portion 1...5 years	491 303	356 578
Interest cost of reporting period	35 969	28 714
incl. capitalised interest cost	25 071	20 975
Average effective interest rate 5.2% (2007: 7.0%)		
Base currencies LVL and EUR		
Loans from the parent		
Loan balance at beginning of the year	19 035	-
Received	-	19 035
Paid	(19 035)	-
Loan balance at end of the year	-	19 035
incl. current portion	-	19 035
Average effective interest rate 4.9% (2007: 4.9%)		
Loans granted to entities under common control		
Loan balance at beginning of the year	-	-
Received in demerger (Note 41)	125 001	-

Loan balance at end of the year	125 001	-
incl. current portion	125 001	-
Interest cost of reporting period	3 188	-
Average effective interest rate 6.0%		
Loans from associates and joint ventures		
Loan balance at beginning of the year	4 900	-
Received	-	4 900
Loan balance at end of the year	4 900	4 900
incl. current portion	2 150	-
non-current portion 2...5 years	2 750	4 900
Interest cost of reporting period	273	140
Average effective interest rate 5.5% (2007: 6.0%)		
Total loans		
Loan balance at beginning of year	654 478	417 276
Received	237 380	582 283
Received in demerger	125 001	-
Paid	(325 946)	(345 739)
Exchange difference	(7 401)	658
Loan balance at end of year	683 512	654 478
incl. current portion	189 459	293 000
non-current portion 1...5 years	494 053	361 478
Total borrowings	738 053	702 592
incl. current portion	206 657	304 879
non-current portion 1...5 years	531 396	397 713

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

	2008	**2007**
6 months or less	352 809	354 423
6-12 months	200 802	276 120
Total bank loans	553 611	630 543

In the second half of 2008, significant changes occurred in the global financial markets and the risk margins of loans increased. As most of the Group's loan contracts had been entered into before the increase of loan margins, it can be stated that the fair value of bank loans assumed is lower than their carrying amount.
Among the loans from entities controlled by the parent, there is a loan from AS Järvevana, the interest of which in the first 12 months is fixed at 6% per annum. In the event of a long-term use of the loan, a floating interest rate of 12 month EURIBOR + 1% per annum will be applied.
According to loan contracts, the loans from other entities have fixed interest rates.
Loan collaterals and pledged assets are presented in Note 31

Note 28 Trade and other payables

in thousands of kroons

	31.12.2008	31.12.2007
Trade payables	366 551	528 857
Payables to employees	63 077	74 892
Tax liabilities, except for corporate income tax		
value added tax	28 211	26 979
personal income tax	8 402	10 720
social security tax	17 841	17 654
land tax	19	46
unemployment insurance tax	297	319
contributions to mandatory funded pension	546	527
other taxes	1 103	570
	56 419	56 815
Amounts due to customers for contract works (Note 34)	266 708	161 725
Other liabilities		
interest liabilities	1 176	465
payable for registered immovables from demerger (Note 41)	100 000	-
Other liabilities	3 811	21 503
	104 987	21 968
Prepayments received	105 889	171 235
Total trade and other payables	963 631	1 015 492

Note 29 Government grants

in thousands of kroons

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

	31.12.2008	31.12.2007
Residual value at beginning of the year	1 498	1 498
Accrued during the year	(1 498)	-
Balance at end of the year	-	1 498

Note 30 Short-term provisions

in thousands of kroons

	2008	2007
Provision for warranty obligation for construction		
Residual value at beginning of the year	15 625	9 662
Set up	17 114	13 325
Used during the year	(12 823)	(7 362)
Balance at end of the year	19 916	15 625
Provision for onerous construction contracts		
Residual value at beginning of the year	32 512	17 848
Set up	1 378	20 541
Accrued during the year	(30 365)	(5 877)
Balance at end of the year	3 525	32 512
Provision for completion of construction		
Residual value at beginning of the year	-	-
Set up	375	-
Balance at end of the year	375	-
Provision for legal costs and claims filed		
Residual value at beginning of the year	22 786	4 054
Set up	4 010	21 878
Accrued during the year	(1 414)	(3 146)
Separated in demerger (Note 41)	(17 500)	-
Balance at end of the year	7 882	22 786
Other provisions		
Residual value at beginning of the year	2 289	1 953
Set up	619	2 480
Accrued during the year	(2 289)	(2 144)
Balance at end of the year	619	2 289
Total short-term provisions	32 317	73 212

Note 31 Other long-term trade payables

in thousands of kroons

	31.12.2008	31.12.2007
Trade payables	8 824	11 091
Prepayments received	-	46 332
Total long-term trade payables	8 824	57 423

Note 32 Loan collaterals and pledged assets

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

Between AS Merko Ehitus and Swedbank AS:
A commercial pledge agreement on movable property in the amount of 200 million kroons (registered under the first, second, fifth and seventh orders in the register of commercial pledges). The obligations arising from guarantee contracts and overdraft contracts are guaranteed by the pledge. In addition, a deposit pledge contract in the amount of 2.3 million kroons has been entered into for guaranteeing the guarantee contract concerning stage I of construction works of Puurmanni traffic network.

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

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

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

Between Tallinna Teede AS and Swedbank AS:
A pledge agreement on the right to demand release of the term deposit in the amount of 3 million kroons, guaranteeing the receivables of Danske Bank AS from Tallinna Teede AS which arise from the guarantee contracts entered into between Danske Bank AS and Tallinna Teede AS and any amendments and improvements to be made to them in the future.

Between Tallinna Teede AS, OÜ Tevener and Swedbank AS:
A mortgage in the amount of 23.4 million kroons on the registered immovable included within the non-current assets of OÜ Tevener, located in Kirdalu village, Saku rural municipality, Harjumaa to the extent of its carrying amount of 29.9 million kroons, guaranteeing the obligations arising from the loan contract entered into between Swedbank AS and Tallinna Teede AS.

Between AS Gustaf and Swedbank AS:
A commercial pledge agreement on movable property in the amount of 9.1 million kroons (registered under the first and second orders in the register of commercial pledges). Guarantee contracts entered into are guaranteed by the pledge.

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

Between AS Merko Tartu and AS SEB Pank:
A commercial pledge agreement on movable property in the amount of 20.0 million kroons. Guarantee contracts entered into are guaranteed by the pledge.

Between AS Merko Tartu and Danske Bank AS:
Mortgages with the carrying amount of 38.7 million kroons on 6 registered immovables in Tartumaa have been set as collateral for the loan contract with the limit of 40.0 million kroons.

Between OÜ Raadi Kortermaja and Danske Bank AS:
Mortgages have been set on two registered immovables in Tartumaa (finished goods and investment property with the carrying amount of 47.0 and 3.0 million kroons, respectively, in the balance sheet) as collateral for the loan contract in the amount of 42.0 million kroons, for guaranteeing the obligations arising from the loan contract. In addition, the same loan contract is guaranteed by the contract of surety of AS Merko Tartu.

Between SIA Merks and AS Swedbank:
A commercial pledge agreement on assets in the amount of 24.2 million Latvian lats (533.7 million kroons). The obligations arising from overdraft contracts and guarantee contracts are guaranteed by the pledge.
Mortgages on 14 registered immovables in Riga (in the balance sheet, property purchased for resale) have been pledged as collateral for the loan contract totalling 6.95 million euros (108.7 million kroons) up to their carrying amount of 17.2 million Latvian lati (379.0 million kroons). The obligations arising from guarantee contracts have also been guaranteed by the mortgages on 14 registered immovables in Riga in the amount of 14.7 million Latvian lati (324.8 million kroons).

Between SIA Merks and Nordea Bank Finland Plc branch:
A mortgage on a registered immovable consisting of apartment ownerships and unfinished apartments (work in progress in the balance sheet) with the carrying amount of 21.0 million Latvia lati (329.1 million kroons) has been set as collateral for the loan with the limit of 31.1 million Latvia lati (687.2 million kroons).

Between UAB Statyba and "Swedbank", AB:
A commercial pledge agreement on assets in the amount of 6.0 million Lithuanian litai (27.2 million kroons). The obligations arising from overdraft contracts and guarantee contracts are guaranteed by the pledge.
A mortgage on registered immovables including buildings (construction in progress in the balance sheet), with the carrying amount of 28.7 million Lithuanian litai (129.9 million kroons) has been set as collateral for the loan contract with the outstanding balance of 3.3 million euros (51.0 million kroons) and 15.2 million Lithuanian litai (69.0 million kroons) .

The Group's assets have been pledged in the total amount of 2 220.9 million kroons.

Note 33 Share capital

In 2006 and 2007, no changes occurred in share capital.

As at 31.12.2008, the share capital in the amount of 177 000 thousand kroons consisted of 17 700 thousand registered shares with the nominal value of 10 kroons each.

Additional information is disclosed in Note 38 under *Capital management*.

Note 34 Construction contracts in progress

in thousands of kroons

	31.12.2008	31.12.2007
Costs incurred for construction contracts in progress and corresponding profit*	8 855 973	5 570 285
Progress billings submitted	(9 013 376)	(5 580 891)
Revenue recorded from construction services during the period	3 561 963	4 584 409
Amounts due from customers for contract works (Note 16)	109 305	151 119
Amounts due to customers for contract works (Note 28)	(266 708)	(161 725)
Advance payments received for contract works	105 889	171 235

Amounts due from customers for contract works are included in the balance sheet line *Trade and other receivables*. Amounts due to customers for contract work are included in the balance sheet line *Trade and other payables*.
* Costs incurred for construction contracts in progress and corresponding profit have been presented for contracts in effect, including those entered into in 2007and 2006.

Note 35 Related party transactions

in thousands of kroons

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

- parent AS Riverito;
- shareholders of AS Riverito with significant influence over AS Merko Ehitus through AS Riverito;
- other shareholders with significant influence;
- other subsidiaries of AS Riverito, so-called 'entities controlled by the parent';
- associates and joint ventures;
- key managers and their close relatives;
- entities sharing key personnel with AS Merko Ehitus.

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

The parent of AS Merko Ehitus is AS Riverito. As at 31.12.2008 and 31.12.2007, AS Riverito owned 72% of the shares of AS Merko Ehitus. The ultimate controlling party of the Group is Mr Toomas Annus.

Goods and services

	2008	2007
Purchased construction services		
Associates and joint ventures	31 098	86 123
Entities under common control	11 870	8 425
Total purchased construction services	42 968	94 548
Construction services rendered		
Associates and joint ventures	1 944	33 642
Entities under joint control	934 790	1 576 911
Management members	6 412	10 027
Other related parties	1 865	-
Total construction services provided	945 011	1 620 580
Construction materials purchased		
Other related parties	151	211
Real estate sold		
Entities under joint control	142 480	81 583
Other related parties	1 212	-
Total real estate sold	143 692	81 583

Loans granted to related parties are disclosed in Note 16 *Loans granted*.

Balances with the related parties

	31.12.2008	31.12.2007
Trade and other receivables		
Trade receivables		
Associates and joint ventures	81	16 046
Entities under joint control	117 065	182 802
Other related parties	66	-
Short-term loans		
Associates and joint ventures	16 400	7 000
Entities under joint control	4 169	4 236
Interest receivables		
Associates and joint ventures	3 873	649
Entities under joint control	2 505	-
Other short-term receivables		
Entities under joint control	74	-
Other related parties	-	2
Other long-term loans and receivables		
Long-term loans		
Associates and joint ventures	18 266	5 725
Entities under joint control	2 896	2 942
Other long-term loans and receivables		
Entities under joint control	1 831	-
Borrowings		
Short-term loans and bonds		
Parent	-	19 035
Entities under joint control	125 001	-
Trade and other payables		
Trade payables		
Associates and joint ventures	1 045	11 098
Entities under joint control	478	326
Other related parties	1	6
Prepayments received		
Entities under joint control	-	16 094
Interest liabilities		
Parent	-	272
Entities under joint control	645	-
Other liabilities		
Entities under joint control	100 000	-

No allowances for impairment losses have been set up for receivables from related parties in 2008.

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

In 2008, the members of the Supervisory and Management Boards as well as senior executives of AS Merko Ehitus were paid remuneration totalling 24 531 thousand kroons (2007: 25 355 thousand kroons).

Termination benefits of members of the Supervisory and Management Boards

Authorisation agreements have been entered into with the members of the Supervisory Board according to which no termination benefits are paid to them upon the termination of the contract. Upon premature removal or termination of authority of the members of the Supervisory and Management Boards, the Group has the obligation to pay compensation totalling 5556 thousand kroons (2007: 4410 thousand kroons).

Contracts of surety

AS Merko Ehitus provides surety for:

- obligations arising from lease agreements of subsidiaries and consolidation group entities to Balti Autoliisingu AS in the amount of 6212 thousand kroons (31.12.2007: 4158 kroons);

The fair value of Group's surety contracts is immaterial, therefore no liability has been recorded in the balance sheet as at 31.12.2008 as well as at 31.12.2007.

Note 36 Contingent liabilities

in thousands of kroons

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

	31.12.2008	**31.12.2007**
Performance period's warranty to the customer	300 657	309 904
Tender warranty	61 258	23 761
Guarantee warranty period	107 491	55 500
Prepayment guarantee	100 110	68 756
Contracts of surety	6 362	9 999
Payment guarantee	-	5 176
Letter of credit	-	11 218
Total contingent liabilities	575 878	484 314

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

At 29 February 2008, a claim of fine was filed against the Latvian branch of Merko Ehitus in the amount of 7.5 million kroons. In 2008, a court of first instance decided that the claim of fine submitted to AS Merko Ehitus is not justified. The plaintiff has contested the court ruling in a circuit court. The session of the circuit court has been set for September 2009. In the opinion of the Group's management, this claim is unfounded as a result of which no provision has been recognised.

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

Note 37 Effects of the economic crisis

The greatest challenge for the construction sector in the short-term is the ability to cope with the effects of the global liquidity crisis and the related general economic crisis. In management's opinion, the Group's economic activities are primarily affected by the following factors:

- increase in credit risk. The potential solvency issues of debtors may lead to cancellation of contracts already entered into, impairment of the Group's receivables and additional impairment losses;
- the Group may not be able to find capital to fund its investment plans at reasonable prices. Refinancing of current loans will become more complicated and finance costs will increase;
- in a more complicated economic environment, the Group may have difficulties in meeting the terms laid down in the loan contract, as a result of which the lender may be entitled to recall the loan prematurely;
- lower demand will affect the liquidity and value of assets especially that of residential housing built for sale and registered immovables purchased for development. The net realisable value of assets purchased and built during the economic boom may fall below the cost of assets and the Group may incur additional impairment losses;
- the Group's activities depend on suppliers who may experience difficulties and this may cause problems in meeting the deadlines laid down in construction contracts;
- due to lower demand, the sector's income base will decrease significantly. In order to ensure the sustainability of the Group's operations, unpopular decisions need to be made – reduction of operating expenses and postponement of investments.

Although the economic crisis has also positive side-effects, such as improvement in the quality of work and services, a decline in the prices of inputs – it may be claimed that in the short term, there are no winners in the construction sector during the recession. In the long term, the crisis may lead to reallocation and consolidation in the market, and entities with a solid capital structure and high liquidity will be more successful.

Management does not consider it possible to reliably assess the effects of the economic crisis, and to a great extent, the scope of the realisation of the aforementioned factors will depend largely on the duration of the crisis. Management believes that it has adopted all measures to ensure the sustainability of the Group's development in the conditions of the economic crisis.

Note 38 Risks

Credit risk

Credit risk relates to a potential damage which would occur if the parties to the contract are unable to fulfil their contractual obligations. In order to lower credit risks, the payment discipline of customers is constantly monitored; construction activities are partly funded by customer prepayments. Cash is mostly held in overnight deposits or term deposits at Swedbank, SEB and the banks in Den Danske Bank Group with a high credit rating (Moody's rating Baa3/D and higher). Management estimates that the Group is not exposed to significant credit risk.

Financial assets exposed to credit risk *in thousands of kroons*	Allocation by due dates 1-12 months	2-5 years	Carrying amount	Collateral
31.12.2008				
Cash and overnight deposits	282 543	-	282 543	-
Term deposits	495 408	2 259	497 667	-
Trade receivables	536 426	5 626	542 052	-
Amounts due from customers for contract works	109 305	-	109 305	-
Loans granted	47 454	21 163	68 617	25 000
Interest receivables	6 940	-	6 940	-
Other short-term receivables	8 519	-	8 519	-
Total	**1 486 595**	**29 048**	**1 515 643**	**25 000**
31.12.2007				
Cash and overnight deposits	53 838	-	53 838	-
Term deposits	151 726	-	151 726	-
Trade receivables	884 856	5 825	890 681	-
Amounts due from customers for contract works	151 119	-	151 119	-
Loans granted	41 135	8 667	49 802	30 000
Interest receivables	2 075	-	2 075	-
Other short-term receivables	3 662	-	3 662	-
Total	**1 288 411**	**14 492**	**1 302 903**	**30 000**

The Group's customers are primarily large local entities or public sector entities with well-known and sufficient creditworthiness. The Group carefully monitors the payment behaviour of its customers and publicly available information on the payment discipline of entities.
Of the financial assets, an allowance has been set up for doubtful receivables. Receivables in the amount of 20 085 thousand kroons (2007: 2111 thousand kroons) have been written down in full.
According to the industry practice, trade receivables and receivables recorded based on the stage of completion of construction contracts have no collateral.
Of the loans granted, 41 732 thousand kroons (31.12.2007: 19 903 thousand kroons) are loans to entities under joint control and associates of whose economic activities the Company has a good overview and therefore, no additional collateral is required. Due to the failure to meet the terms of a loan contract, the Company wrote down loan to unrelated legal entity in the amount of 3 000 thousand kroons and interest on the same loan in the amount of 1025 thousand kroons in 2008.

Interest risk

Interest risk arises from interest rate changes in the financial markets as a result of which it may be necessary to revalue the Company's financial assets and take into consideration higher financing costs in the future. Most of the Group's bank loans have floating interest rates based on either EURIBOR or the interbank rates of the countries of incorporation of the entities. As the share of interest-bearing liabilities in the Group's capital structure is low (as at 31.12.2008: 19% of the balance sheet total), management considers the effect of changes in the interest rate environment insignificant for the operating results of the Group.

Effect of changes in interest risks on finance costs

As at 31.12.2008, the Group's interest-bearing liabilities totalled 738 052 thousand kroons. Loan interest depended on the base interest of 3-12 month interbank money market loans of the respective country of incorporation and EURIBOR.
Management expects the European Central Bank to lower the euro base rates over the following 12 months as a result of which EURIBOR will fall by approximately 50 basis points. However, we expect the base rates on loans denominated in national currencies of the Baltic States to increase by approximately 200 basis points. A change in risk margins due to the changes in the financial environment is more important than an increase in base interest rates in the short term which according to management's estimate is 250 basis points higher than the margins used until now. The effect of the change in risk margins will become evident in refinancing current loan

contracts. If all current loans were refinanced at a level which is +250 basis point higher than the current level , the Group would incur additional finance costs in the amount of 18 451 thousand kroons.
Assuming that the volume and structure of borrowings does not change during the year, the following will occur: 1) a decrease/increase of EURIBOR by -50/+50 basis points will change the Company's interest costs by +/-1857 thousand kroons; 2) an increase/decrease of the base rate on loans denominated in national currencies by +200/-200 basis points will increase/decrease financing costs by +/- 7 334 thousand kroons. If all liabilities need to be refinanced, the effect of the change in the risk margin on the total portfolio would be 27 642 thousand kroons. As the loan maturities are different and a loan in Latvian lati has been refinanced after the balance sheet date, the possible increase of finance costs would be significantly lower.

Intrest rate risk in 2007
Management believes that in the following 12 months, the European Central Bank will lower the euro base rate as a result of which EURIBOR will fall by ca. 50 basis points. At the same time, we expect the base rates on loans granted in national currencies to increase by 75 basis points.
Assuming that the volume and structure of borrowings does not change during the year, the following will occur: 1) a decrease/increase of EURIBOR by -50/+50 basis points will change the Company's interest costs by -/+1195.6 thousand kroons; 2) an increase/decrease of the base rate on loans assumed in national currencies by +75/-75 basis points will increased/decrease financing costs by +/-3476.1 thousand kroons.

Foreign exchange risk
As at 31.12.2008, the Group had interest bearing borrowings in the amount of 738 052 thousand kroons, of which the balance of liabilities was 30 663 thousand kroons in Estonian kroons, 335 780 thousand kroons in Latvian lats, 261 thousand kroons in Lithuanian litas and 371 348 thousand kroons in euros.
The Group's transactions are carried out in Estonian kroons, Latvian lati and Lithuanian litai. The Estonian kroon, as well as the Latvian lats and Lithuanian litas are pegged to the Euro. The exchange rate of the Latvian lats is 1 EUR=0.702804 LVL +/-1%. In order to eliminate foreign exchange risk, key foreign contracts and long-term loan agreements are concluded in euros. Speculations regarding devaluation of the national currencies of the Baltic States have recently abounded. As at the balance sheet date, 87.8% or 3 388 108 thousand kroons of the Group's assets were denominated in local currencies and 472 980 thousand kroons were denominated in euros, with regard to liabilities, 90.2% or 3 482 488 thousand kroons were denominated in local currencies and 378 586 thousand kroons were denominated in euros. If all national currencies are simultaneously devalued by 25%, the Group will incur additional finance income in the amount of 23 593 thousand kroons. After the balance sheet date, SIA Merks refinanced a loan assumed in Latvian lati in the amount of 325 507 thousand kroons as a euro-based loans. Assuming that the remaining balance sheet structure does not change by the time of refinancing, the Group will incur finance costs in the amount of 57 784 thousand kroons during simultaneous devaluation of national currencies.

Liquidity risk
The Company's solvency represents its ability to settle its liabilities to creditors on time. As at 31.12.2008, the Group's current ratio was 2.8 (31.12.2007: 2.4) and the quick ratio was 1.3 (31.12.2007: 1.0). To complement available current assets and to ensure liquidity and better management of cash flows, the Group has concluded overdraft agreements with banks. As at the end of the year, the group entities had concluded overdraft contracts with banks in the total amount of 207 097 thousand kroons. In addition to the overdraft facility, the Company has a current loan facility with the limit of 215 000 thousand kroons from AS Riverito. Management estimates that the Group's capital structure – a high proportion of equity at 54% of the balance sheet total and a low proportion of interest bearing liabilities at 19% of the balance sheet total – ensures the Company's trustworthiness for creditors in the changing economic climate and significantly improves the feasibility of the extension of existing financial liabilities and raising of additional debt. One of the priorities of the Group in 2009 will be the improvement of the Company's financial position and ensuring of its liquidity.

Financial assets / liabilities *in thousands of kroons*	Allocation by due dates			Total	Carrying amount
	1-3 months	4-12	2-5 years		
31.12.2008					
Assets					
Cash and overnight deposits	282 543	-	-	282 543	282 543
Term deposits	207 649	287 759	2 259	497 667	497 667
Trade receivables	536 426	-	5 626	542 052	542 052
Prepaid taxes *	38 594	-	-	38 594	38 594

Receivables recorded based on the stage of completion of construction contracts	109 305	-	-	109 305	109 305
Loans and interest	2	54 392	21 163	75 557	75 557
Other short-term receivables	569	7 950	-	8 519	8 519
Total	**1 175 088**	**350 101**	**29 048**	**1 554 237**	**1 554 237**
Liabilities					
Trade payables	286 700	79 851	8 824	375 375	375 375
Payables to employees	63 078	-	-	63 078	63 078
Tax liabilities	65 118	-	-	65 118	65 118
Loan and finance lease liabilities **	12 355	194 301	531 396	738 052	738 052
Other liabilities	105 642	206	-	105 848	105 848
Total	**524 194**	**274 358**	**540 220**	**1 347 471**	**1 347 471**
31.12.2007					
Assets					
Cash and overnight deposits	53 838	-	-	53 838	53 838
Term deposits	151 726	-	-	151 726	151 726
Trade receivables	884 856	-	5 825	890 681	890 681
Prepaid taxes *	40 528	-	-	40 528	40 528
Receivables recorded based on the stage of completion of construction contracts	151 119	-	-	151 119	151 119
Loans and interest	779	42 431	8 667	51 877	51 877
Other short-term receivables	3 662	-	-	3 662	3 662
Total	**1 286 508**	**42 431**	**14 492**	**1 343 431**	**1 343 431**
Liabilities					
Trade payables	528 856	-	11 091	539 947	539 947
Payables to employees	74 892	-	-	74 892	74 892
Tax liabilities	73 533	-	-	73 533	73 533
Loan and finance lease liabilities **	91 535	213 344	397 713	702 592	702 592
Other liabilities	7 991	13 977	-	21 968	21 968
Total	**776 807**	**227 321**	**408 804**	**1 412 932**	**1 412 932**

* Although prepaid taxes do not meet the definition of financial assets, they will offset the amount of negative cash flows from tax liabilities.
** The schedule of expected interest payments cannot be determined with reasonable certainty. In line with property development best practice, the loan obligations to acquire land plots have been assumed with open-end maturities.
The repayment of these loan obligations is dependent on the progress of related development projects and on the timing of cash flows generated from those projects upon completion. Consequently, management is of opinion that even their best estimate on the timing of expected interest payments would not be sufficiently accurate for the users of these financial statements and this information has not been disclosed.

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

- the minimum share capital of a public limited company shall be at least EEK 400 thousand;
- the net assets of a public limited company shall be at least one half of the Company's share capital but not less than EEK 400 thousand.

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

According to the current articles of association of AS Merko Ehitus, the Company's share capital consists of 17 700 thousand ordinary shares with the nominal value of 10 kroons each and without amending the articles of association of the public limited company, changes can be made to the Company's share capital within the range of 85 – 340 000 thousand kroons. As at 31.12.2008, the share capital of AS Merko Ehitus was 177 000 thousand kroons and the net assets were 2 109 703 thousand, so the Company's equity and share capital were in compliance with the requirements established in the Republic of Estonia.

In capital management, the Company follows the principle of maintaining its trustworthiness, sustainable development and the assets of shareholders through economic cycle pursuant to which it monitors that its equity to assets ratio at any given time would be at least 45% (31.12.2008: 54%, 31.12.2007: 52%) and interest bearing debt to assets ratio would not exceed 25% (31.12.2008: 19%, 31.12.2007: 18%). The overdraft contract with Nordea Bank sets a requirement for the consolidated equity to be 35%.

Legal risk
Due to different interpretations of contracts, regulations and laws related to Group's principal activities, there is a risk that some buyers, contractors or supervisory authorities evaluate the Company's activities in abiding by a law or a contract on different grounds and dispute the legitimacy of the Company's activities.

As at 31.12.2008, a provision has been set up in the Group in the amount of 7882 thousand kroons for covering potential claims and legal costs (31.12.2007: 22 786 thousand kroons), (Note 30).

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. Management is on the position that the Company has followed the applicable laws of the Republic of Estonia and good industry practices. At 3 April 2009, 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 Constancia that are subsidiaries of AS Merko Ehitus.

According to section 44 of Penal Code, a court can, upon conviction, impose a pecuniary punishment from EEK 50 thousand to EEK 250 000 thousand. Pecuniary punishment may be imposed as supplementary punishment in addition to forced liquidation.

Fair value
Due to the significant deterioration of the economic environment in 2008, the market risk had a major effect on the Company's activities. In 2008, the Group wrote down inventories in significant amounts because due to the changes in the economic environment, their net realisable value exceeded the costs incurred for the purchasing of assets. In conjunction with the poor outlook for the economic environment, the effect of the market risk on the Company's financial indicators is high in the short term.

Note 39 Number of shares owned by the members of the Supervisory and Management Board and their close relatives

As at 31.12.2008, neither members of the Supervisory Board and Management Board of AS Merko Ehitus nor their close relatives owned any shares of Merko Ehitus, except for Toomas Annus and Tõnu Toomik through AS Riverito.

Note 40 Shareholders with more than 5% ownership

	Shares	Ownership %
AS Riverito	12 742 686	71.99
Customers of Skandinaviska Enskilda Banken Ab	1 099 653	6.21
Customers of ING Luxembourg S.A.	963 376	5.44

Note 41 Demerger of the Company

The delay in the criminal proceedings related to land swap launched in 2005, the accompanying uncertainties and speculations in the media started to inhibit the Company's economic activities and harm the Company's and its shareholders' interests. In 2008, a resolution was adopted to restructure the Company and separate the economic activities from the criminal proceedings related to land swap. The objective of restructuring is to ensure the Company's sustainable development in the best way possible and to protect the interests of shareholders and employees in the long-lasting proceedings related to land swap.

At 15 April 2008, the management of AS Merko Ehitus prepared the Company's restructuring plan which was approved at the General Meeting of Shareholders at 3 June 2008. At 1 August 2008, the demerger entries were registered in the Commercial Register. AS Merko Ehitus was demerged in such a way that the core business of AS Merko Ehitus (i.e. assets, liabilities, contracts and the business name), except for the net assets in the amount of 232.5 million kroons were separated and transferred to the new entity. As a result of the demerger, each shareholder of the public limited company received one share of the newly founded AS Merko Ehitus which is listed from 1 August 2008 on the Tallinn Stock Exchange for each share of the previous AS Merko Ehitus. The new business name of the demerged AS Merko Ehitus is AS Järvevana and its shares continue to be listed on the Tallinn Stock Exchange; the sole member of its Management Board is Toomas Annus.

Demerger balance sheet of Merko Ehitus group as at 31.07.2008 (in thousands of kroons):

	Merko Ehitus before demerger	**Separated in demerger**	**AS Merko Ehitus**
Assets			
Current assets			
Cash and cash equivalents	691 689	(25 000)	666 689
Trade and other receivables	1 025 425		1 025 425
Inventories	2 016 384		2 016 384
	3 733 498	(25 000)	3 708 498
Non-current assets			
Long-term financial assets	251 404		251 404
Investment property	12 811		12 811
Property, plant and equipment	209 040		209 040
Intangible assets	12 275		12 275
	485 530		485 530
TOTAL ASSETS	4 219 028	(25 000)	4 194 028
Liabilities			
Current liabilities			
Borrowings (Note 27)	414 870	125 001	539 871
Trade and other payables	1 139 264	100 000	1 239 264
Government grants	1 483		1 483
Short-term provisions (Note 30)	69 616	(17 500)	52 116
	1 625 233	207 501	1 832 734
Non-current liabilities			
Long-term borrowings	210 386		210 386
Other long-term trade payables	8 358		8 358
	218 744		218 744
TOTAL LIABILITIES	1 843 977	207 501	2 051 478
EQUITY			
Minority interest	31 617		31 617
Equity attributable to equity holders of the parent			
Share capital	177 000		177 000

Statutory reserve capital	17 700		17 700
Currency translation differences	(10 984)		(10 984)
Retained earnings	2 159 718	(232 501)	1 927 217
	2 343 434	(232 501)	2 110 933
TOTAL EQUITY	2 375 051	(232 501)	2 142 550
TOTAL LIABILITIES AND EQUITY	4 219 028	(25 000)	4 194 028

In the demerger, AS Järvevana retained the net assets in the amount of 232 501 thousand kroons, which consist of the following assets and liabilities:

- cash in the amount of 25 000 thousand kroons in the bank account;
- registered immovables covered by a contract which grants a right to AS Merko Ehitus to purchase these registered immovables at any time and a right to AS Järvevana to resell these registered immovables to AS Merko Ehitus at any time. The contractual transaction price is at least 100 000 thousand kroons. For accounting purposes, AS Merko Ehitus recognises the registered immovables at the initial cost of 36 721 thousand kroons and a payable to AS Järvevana related to the purchase of these registered immovables in the amount of 100 000 thousand kroons;
- receivable for loan issued in the amount of 125 001 thousand kroons, which is carried in the balance sheet of AS Merko Ehitus under *Borrowings*;
- liabilities related to the criminal proceedings, incl. a provision for legal costs in the amount of 17 500 thousand kroons and an off-balance sheet contingent liability in the amount of a maximum fine of 250 000 thousand kroons.

Note 42 Supplementary disclosures on the parent

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

Income statement

in thousands of kroons

	2008	**2007**
Revenue	2 059 123	2 466 908
Cost of goods sold	(1 837 333)	(2 194 892)
Gross profit	221 790	272 016
Marketing expenses	(20 097)	(16 439)
Administrative and general expenses	(88 922)	(121 424)
Other operating income	29 064	24 683
Other operating expenses	(37 908)	(14 413)
Operating profit	103 927	144 423
Finance income/costs	10 693	(861)
Finance income/costs from investments in subsidiaries	79 174	124 079
Finance income/costs from investments in associates and joint ventures	59 711	4 000
Net profit for the year	253 505	271 641

Balance sheet

in thousands of kroons

	31.12.2008	31.12.2007
ASSETS		
Current assets		
Cash and cash equivalents	394 877	107 000
Financial assets at fair value through profit or loss	262 759	-
Trade and other receivables	702 420	964 874
Prepaid corporate income tax	3 438	1 433
Inventories	192 619	373 734
	1 556 113	1 447 041
Non-current assets		
Investments in subsidiaries	317 742	318 069
Investments in associates and joint ventures	4 020	3 540
Other long-term financial assets	338 781	338 763
Property, plant and equipment	25 048	15 681
Intangible assets	7 957	8 801
	693 548	684 854
TOTAL ASSETS	2 249 661	2 131 895
Liabilities		
Current liabilities		
Borrowings	322 870	262 391
Trade and other payables	612 950	534 169
Corporate income tax liability	-	9
Short-term provisions	15 905	59 380
	951 725	855 949
Non-current liabilities		
Other long-term trade payables	6 676	5 690
TOTAL LIABILITIES	958 401	861 639
EQUITY		
Share capital	177 000	177 000
Statutory reserve capital	17 700	17 700
Retained earnings	1 096 560	1 075 556
TOTAL EQUITY	1 291 260	1 270 256
TOTAL LIABILITIES AND EQUITY	2 249 661	2 131 895

Statement of changes in equity

in thousands of kroons

Parent	Share capital	Statutory reserve capital	Retained earnings	Total
Balance as at 31.12.2006	177 000	17 700	927 815	1 122 515
Net profit for financial year	-	-	271 641	271 641
Dividends	-	-	(123 900)	(123 900)
Balance as at 31.12.2007	177 000	17 700	1 075 556	1 270 256
Carrying amount of holdings under dominant or significant influence				(321 609)
Value of holdings under dominant or significant influence under the equity method				1 067 110
Adjusted unconsolidated equity 31.12.2007				**2 015 757**
Net assets separated in demerger	-	-	(232 501)	(232 501)
Net profit for financial year	-	-	253 505	253 505
Balance as at 31.12.2008	177 000	17 700	1 096 560	1 291 260
Carrying amount of holdings under dominant or significant influence				(321 762)
Value of holdings under dominant or significant influence under the equity method				1 105 433
Adjusted unconsolidated equity 31.12.2008				**2 074 931**

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

Cash flow statement
in thousands of kroons

	2008	2007
Cash flows from operating activities		
Operating profit	103 927	144 423
Adjustments:		
depreciation and impairment charge	7 049	6 462
profit/loss from sale of non-current assets	(111)	57
adjustment of revenue from construction contracts under stage of completion method	115 547	19 786
interest income from business activities	(27 696)	(24 585)
change in provisions	(33 743)	49 203
Change in trade and other receivables related to operating activities	323 111	(220 877)
Change in inventories	181 115	(219 603)
Change in trade and other payables related to operating activities	(106 496)	(6 242)
Interest paid	(13 181)	(7 513)
Corporate income tax paid	(17)	-
	549 505	(258 889)
Cash flows from investing activities		
Investments in subsidiaries	(19 700)	(65 807)
Proceeds from sale and liquidation of subsidiaries	45 388	500
Investments in associates and joint ventures	(1 000)	-
Proceeds from sale of associates and joint ventures	60 231	-
Purchase of other financial assets	(265 019)	-
Purchase of property, plant and equipment	(15 302)	(5 459)
Proceeds from sale of property, plant and equipment	126	151
Purchase of intangible assets	(285)	(3 332)
Loans granted	(80 310)	(283 278)
Loan repayments received	15 115	161 502
Interest received	39 555	18 223
Dividends received	35 313	128 079
	(185 888)	(49 421)
Cash flows from financing activities		
Proceeds from borrowings	41 297	259 651
Loan repayments received	(91 128)	(30 436)
Finance lease principal payments	(714)	(1 063)
Dividends paid	-	(123 900)
	(50 545)	104 252
Cash transferred in demerger	(25 000)	-
Net increase/decrease in cash and cash equivalents	288 072	(204 058)
Cash and cash equivalents at beginning of the period	107 000	311 059
Exchange losses on cash and cash equivalents	(195)	(1)
Cash and cash equivalents at end of the period	394 877	107 000

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INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS Merko Ehitus

We have audited the accompanying consolidated financial statements of AS Merko Ehitus and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2008, 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.

Tiit Raimla
AS PricewaterhouseCoopers

Märten Padu
Authorised Auditor

29 April 2009

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** This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

PROFIT ALLOCATION PROPOSAL
in kroons

Retained earnings	1 826 141 952
Net assets separated in demerger	(232 500 687)
Net profit for 2008	299 139 513
Total retained earnings as at 31.12.2008	**1 892 780 778**

The Management Board proposes profit allocation as follows:

As dividend (3,50 kroons per share)	61 950 000
Retained earnings after distribution of dividend	**1 830 830 778**

Tiit Roben	Chairman of the Management Board	14.04.2009
Alar Lagus	Member of the Management Board	14.04.2009
Veljo Viitmann	Member of the Management Board	14.04.2009
Andres Agukas	Member of the Management Board	14.04.2009

SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2008 ANNUAL REPORT

The Management Board of AS Merko Ehitus has prepared the management report, consolidated financial statements and the profit allocation proposal for 2008.

Tiit Roben	Chairman of the Management Board	14.04.2009
Alar Lagus	Member of the Management Board	14.04.2009
Veljo Viitmann	Member of the Management Board	14.04.2009
Andres Agukas	Member of the Management Board	14.04.2009

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

Tõnu Toomik	Chairman of the Supervisory Board	30.04.2009
Jaan Mäe	Member of the Supervisory Board	30.04.2009
Indrek Neivelt	Member of the Supervisory Board	30.04.2009
Teet Roopalu	Member of the Supervisory Board	30.04.2009
Olari Taal	Member of the Supervisory Board	30.04.2009

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REVENUE BREAK-DOWN OF THE PARENT COMPANY PRESENTED ACCORDING TO ESTONIAN CLASSIFICATIONS OF ECONOMIC ACTIVITIES (EMTAK 2008)

Revenue break-down of the standalone parent company of the group AS Merko Ehitus is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), information which is required under Business Code § 4 p.6.

EEK, thousand

EMTAK code		2008	2007
	Rendering of construction services		
4120	construction of residential and non-residential buildings	1 017 558	1 577 180
4110	development of building projects	341 052	205 982
4211	construction of roads and railways	21 965	107 501
4221	construction of utility projects for fluids	398 042	388 160
4222	construction of utility projects for electricity and telecommunications	155 985	53 113
4291	construction of water projects	36 590	29 845
4213	construction of bridges and tunnels	61 517	28 787
4299	Construction of other civil engineering projects n.e.c.	25 600	16 994
		2 058 309	2 407 562
	Real estate activities		
6810	sales of own real estate	-	58 500
6820	Renting and operating of own or leased real estate	814	846
		814	59 346
	Total revenue	2 059 123	2 466 908