Annual Report of Consolidation Group

ARCO VARA AS
Translation of Estonian Original

Beginning of financial year:	1 January 2008
End of financial year:	31 December 2008

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Core activities:	Construction of buildings (EMTAK 41000) Civil engineering (EMTAK 42000) Special engineering(EMTAK 43000) Real estate related services (EMTAK 68000)
Supervisory board:	Richard Tomingas, Hillar-Peeter Luitsalu, Ragnar Meitern, Kalev Tanner, Aare Tark
Management board:	Lembit Tampere, Heigo Metsoja, Veiko Taevere
Auditor	Ernst & Young Baltic AS

Contents

Management Report

Area of activity

Arco Vara AS and other companies of the Group (Arco Group) are engaged in various aspects of the real estate business that can be divided into three business lines: Service Division, Development Division and Construction Division. At the end of 2008, Arco Vara AS Group comprised 29 subsidiaries (2007: 34), 17 joint ventures (2007: 20) and one associate (2007: 1).

The performance of all divisions is subject to seasonal fluctuations. The transaction volumes of the Service Division usually expand in autumn and spring while the turnover of the Construction Division and the investment volumes of the Development Division subside in the winter.

The principal activity of the Service Division is real estate brokerage, valuation, management, consulting and short-term investment in residential real estate.

The principal activity of the Development Division is developing integrated residential environments and commercial real estate. Fully developed housing solutions are sold to end-customers. Commercial properties are developed until they start generating cash flow after which they are sold to a real estate fund or another developer. However, the Group holds some completed commercial properties that are yielding income from rent, but have not been sold yet as they have not been developed to their full potential.

The principal activity of the Construction division is offering general and subcontracting service and carrying out environmental engineering works.

Domestic markets of Arco Group are Estonia, Latvia and Bulgaria.

Mission, vision and common values

The mission of Arco Vara Group is **to be a valued provider of comprehensive real estate solutions**.

The vision of Arco Vara group is **to become a symbol of real estate**.

Core values of Arco Group:

Partnership – our client is our partner
Reliability – we are reliable, open and honest
Professionalism – we deliver high-quality services
Respect – we respect our client's personality
Responsibility – we keep our promises

Comments by the CEO

Our clients have purchased or booked 128 apartments and plots in 2008 – 15 more than the previous year. In the fourth quarter substantial correction in the margins and sales periods of the business resulted in additional write downs of all assets in accounting and in continuing business at a much lower price level. A significant shift in the market took place in October when the interbank lending market froze, whereas the negative long term effect of the situation on liquidity, outlook and price expectations of property market in the Group's home markets became obvious by the end of the year. Considering the situation the Group initiated a fixed cost reduction programme in value of at least 50 million kroons (3.2 million euros). As at the end of March 2009 the Group employed about 250 people. Top management salaries have also been cut by 10% after the balance sheet date.

As at the end of the year the Group has liquid assets in value of 213.0 million kroons (13.6 million euros). Bank loans and bonds amount to 1 046.3 million kroons (66.9 million euros) of which 353.4 million kroons (22.6 euros) are short-term. To decrease liquidity and refinancing risks the Group intends to sell some of the land bank and cash flow generating properties. The goal for 2009 is to decrease the net debt position by 300 million kroons (19.2 million euros). The refinancing risk in 2009 is mainly related to Latvian SEB and Sampo Bank in Estonia.

The restructuring programme in service division is ongoing: the offices in Lithuania and Romania are closed; also some of the offices in smaller locations have been closed or franchised. The Group is no longer subsidising the brokerage offices in Ukraine and Bulgaria. The number of employees in service division has decreased to 73 by March 2009. After the balance sheet date it can be said that the service division does not yet break-even but there has been a substantial decrease in losses. The division concentrates its activities foremost on the Estonian, Latvian and Bulgarian markets.

Development division's performance indicators (planning, construction, vacancies and apartment sales) for the year were positive. Highlights of the period included: adoption of zonings in projects Tivoli, Laeva 2 and MB-2, exiting from the Simferopol project and the apartment sales block deal in Sofia. It is essential to complete the ongoing projects within the year 2009 (Madrid in Sofia, Merivälja and Kodukolde in Tallinn, Bišumuiža-1 and Mazais Baltezers-3 in Riga) to enable us to sell the already booked product and to decrease the leverage. By the beginning of March 2009 an additional more than 27 apartments have already been sold or booked, including 12 in Kodukolde project in Tallinn.

It is a growing challenge for the construction division to turn a profit and to be able to win environmental engineering tenders in both Estonia and Latvia. Many contracts have been signed in the industry as a whole; however, the state financing is pending. Internal sales have almost vanished and future pipeline consists mainly of external orders. After the balance sheet date the number of employees has been decreased substantially due to completion of a major project in Latvia.

Key Financials

- Revenue and other income for the year totalled 690.4 million kroons (44.1 million euros), 20.4% down year-over-year.
- EBIT amounted to -1 049.7 million kroons (-67.1 million euros);
- Net loss was -1 160.1 million kroons (-74.1 million euros), of which fair value adjustments -1 086.6 million kroons (69.4 million euros);
- Equity ratio was 36.1% (2007: 54.1%). ROE -74.5% (2007: 14.3%). ROIC -40.3% (2007: 10.0%);
- Group's order backlog in the construction business stood at 185.0 million kroons (11.8 million euros) against 331.0 million kroons (21.2 million euros) last year.
- During the year 98 apartments and plots in projects of Arco Vara were sold and 30 were booked (2007 were sold and booked: 113).

	EEK					EUR				
	2008	**2007**	**2006**	**2005**	**2004**	**2008**	**2007**	**2006**	**2005**	**2004**
In millions										
Revenue and other income	660	727	484	476	350	42	46	31	30	22
Gross profit/loss	-351	185	135	118	109	-22	12	9	8	7
Operating profit/loss	-1 050	103	260	154	130	-67	7	17	10	8
Profit before tax	-1 151	250	227	121	109	-74	16	15	8	7
Net profit/loss	-1 160	236	217	116	107	-74	15	14	7	7
Net revaluation gains/losses	-1 086	77	375	104	58	-69	5	24	7	4
Net loans	842	517	1 143	578	555	54	33	73	37	35
Loan term, years	2,5	2,2	2,7			2,5	2,2	2,7		
Interest rate of loans	7,0%	6,7%	5,6%			7,0%	6,7%	5,6%		
Gross margin, %	-53%	25%	28%	25%	31%	-53,0%	25,4%	27,8%	24,7%	31,2%
Operating margin, %	-159%	14%	54%	32%	37%	-159,0%	14,2%	53,8%	32,3%	37,0%
Net margin, %	-176%	32%	45%	24%	30%	-176,0%	32,4%	44,9%	24,5%	30,5%
ROE, %	-74,5%	14,2%	31,5%	26,9%		-74,5%	14,2%	31,5%	26,9%	
ROA, %	-38,3%	7,5%	11,7%	8,5%		-38,3%	7,5%	11,7%	8,5%	
ROIC, %	-40,3%	10,0%	15,7%	12,3%		-40,3%	10,0%	15,7%	12,3%	
Quick Ratio	0,9	1,1	0,2	0,5	0,2	0,9	1,1	0,2	0,5	0,2
Current Ratio	2,5	2,2	0,6	0,8	0,8	2,5	2,2	0,6	0,8	0,8
EPS, in kroons and euros	-12,2	2,8	3,1	1,6	1,6	-0,8	0,2	0,2	0,1	0,1
Lowest share price, in kroons and euros	2,4	20,5				0,2	1,3			
Highest share price, in kroons and euros	23,2	38,8				1,5	2,5			
Number of staff	396	664	478	280	220	396	664	478	280	220

Revenue and profit

	EEK		EUR	
	2008	2007	**2008**	2007
In millions				
Revenue and other income				
Service	104,1	139,6	6,7	8,9
Development	246,4	566,3	15,7	36,2
Construction	416,8	425,5	26,6	27,2
Eliminations	-76,8	-264,1	-4,9	-16,9
Total revenue and other income	**690,4**	**867,3**	**44,1**	**55,4**
EBIT				
Service	-47,9	-16,5	-3,1	-1,1
Development	-985,1	162,0	-63,0	10,4
Construction	6,3	16,9	0,4	1,1
Eliminations	-2,6	-16,5	-0,2	-1,1
Unallocated expenses	-20,4	-42,9	-1,3	-2,7
EBIT	**-1 049,7**	**103,1**	**-67,3**	**6,6**
Interest income and expense	5,1	-3,7	0,3	-0,2
Net other financial items	-106,7	150,9	-6,8	9,6
Income tax expense	-8,8	-14,8	-0,6	-0,9
Net profit / loss	**-1 160,1**	**235,5**	**-74,4**	**15,1**

The bulk of the Group's revenue was generated by the construction division, 416,8 million kroons (26,6 million euros). The plunge in sales may be attributed to the performance of the development division. Although 128 apartments and land plots were sold or booked, the majority of revenue and gross profit is recorded at the end of 2009 and in spring 2010, after completion of the projects Madrid, Merivalja, Kolde and BM-1. Around 50% of the spaces of the Madrid project have already been booked.

As for the year, we had to accept net loss of -1 160.1 million kroons (-74.3 million euros). This includes write down of inventory in the amount of 434.3 million kroons (27.8 million euros), 555.6 million kroons (35.5 million euros) write down of the fair value of real estate investments, 45% write down (54.5 million kroons; 3.5 million euros) claim of AS Ühendatud Kapital, write down of other claims totalling 21.1 million kroons (1.4 million euros) and the write down of property, plant and equipment and intangible assets including Goodwill adjustments in the amount of 21.1 million kroons (1.4 million euros).

Financial income was: interest income 53.3 million kroons (3.4 million euros), including cancellation of the claim of interest and principal payment of the Kippsala project in the amount of 27.9 million kroons (1.8 million euros) and the currency rate gains 12.2 million kroons (0.8 million euros).
Financial expenses were: loss due to disposal of shares in AVEC Asset Management AS were 38.0 million kroons (2.4 million euros) and interest expenses in the amount of 48.2 million kroons (3 million euros).

Cash flows

	EEK		EUR	
	2008	2007	**2008**	2007
In millions				
Cash flows from operating activities	-127,6	-547,9	-8,2	-35,0
Cash flows from investing activities	-62,6	136,7	-4	8,7
Cash flows from financing activities	-402,2	1 118,4	-25,7	71,5
Net cash flow	**-592,4**	**707,2**	**-37,9**	**45,2**
Cash and cash equivalents at beginning of period	765,0	58,3	48,9	3,7
Effect of exchange rate fluctuations	0	-0,5	0,5	0,0
Cash and cash equivalents at end of period	**172,6**	**765,0**	**11,0**	**48,9**

The main components of negative operating cash flow were the changes in inventories where investments in Kolde, BM-1, Madrid and Manastirski residential projects are recorded. Although VAT receivable has decreased the balance is still considerable at 46.7 million kroons (3.0 million euros), including the VAT receivable from the Latvian Tax Board – 22.0 million kroons (1.4 million euros).
The main components of negative investment cash flow were: payables for acquired subsidiaries due in the amount of 44.0 million kroons (2.8 million euros), Ukraine investments and loans of 108.4 million kroons (6.9 million euros) and depositing and investing liquid assets to short-term bonds.
The main components of financing cash flow were: 82.3 million kroons (5.2 million euros) of interests cost, 57.7 million kroons (3.7 million euros) of gross dividend payment, 252.0 million kroons (16.1 million euros) change in net debt, the majority of which were extraordinary principal repayments during refinancing transactions or the redemption of bonds.
A major setback for the short term liquidity has been the default of AS Ühendatud Kapital to pay its 11 million USD outstanding debt (136.4 million kroons, 8.7 million euros). By the moment of publishing the report, Arco Vara has filed a relevant action in the Tallinn Arbitration Court. The claim by Arco is already due.

In January 2009 the company made an extraordinary repayment of 40 million kroons related to Tivoli and Laeva loans to SEB Bank to release the obligation to maintain liquid assets worth 150 million kroons (9.6 million euros) in SEB bank accounts. After the payment the level of short term liabilities decreases to 310 million kroons (19.8 million euros) of which commercial papers coming due in the summer amount to 60 million kroons (3.8 million euros), the land acquisition loan for Ahtri project is 97.2 million kroons (6.2 million euros) and the loan for Hills in Vilnius ca 20 million kroons (1.3 million euros). In addition, 90 million kroons (5.6 million euros) of loans are accounted as short term, because the repayment depends on the sales of apartments and the management's estimation of sales period. Unless the apartments are sold, the loan will not have to be repaid in 2009.

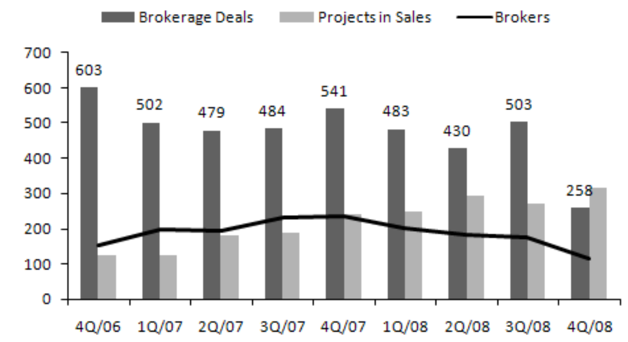
Approximately 650 million kroons (41.5 million euros) of total interest-bearing liabilities are related to Estonian projects of which 240 million kroons (15.3 million euros) are nominated in kroons and the rest in euros. 190 million kroons (12.1 million euros) are related to Bulgarian projects of which the majority is nominated in euros. 190 million kroons (12.1 million euros) are related to Latvian projects of which the majority is nominated in euros.

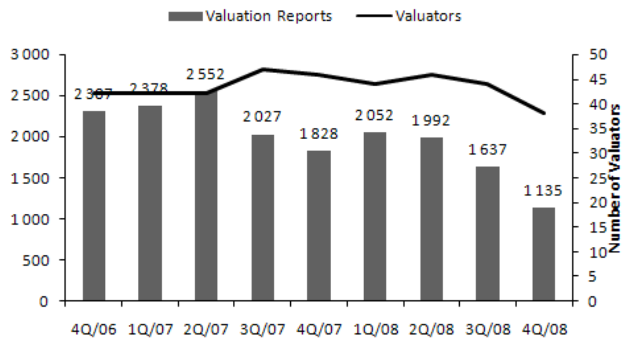
Service division

The number of brokerage transactions in a year has decreased by 17%, the number of valuation reports has decreased by 22%. The fall has been particularly significant in the fourth quarter – the number of transactions diminished by 47% and the number of valuation reports by 44%. Considering the market situation we have closed 10 offices within a year and exited the Lithuanian and Romanian markets. As at the end of December the service division operates in 18 locations.

The Bulgarian and Kiev offices are no longer subsidised and will have to be self-reliant. The number of top and middle management in the division has been cut substantially. The main focus in the service division is on adjusting the business model and the cost structure in line with the 50% fall of the market volumes.
As at the end of the year the division employed 139 people (402 in 2007).

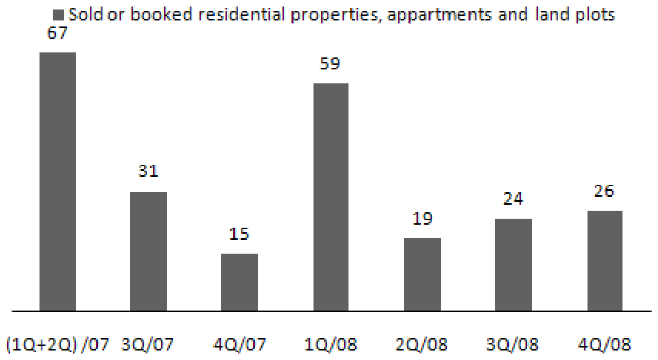
	2008	2007	Changes, %
Number of properties brokered	1 674	2 006	-17%
Number of projects on sale	282	183	54%
Number of valuation reports issued	6 816	8 785	-22%
Number of appraisers	38	46	-17%
Number of real estate brokers	114	237	-52%
Average number of staff	139	402	-65%





Development division

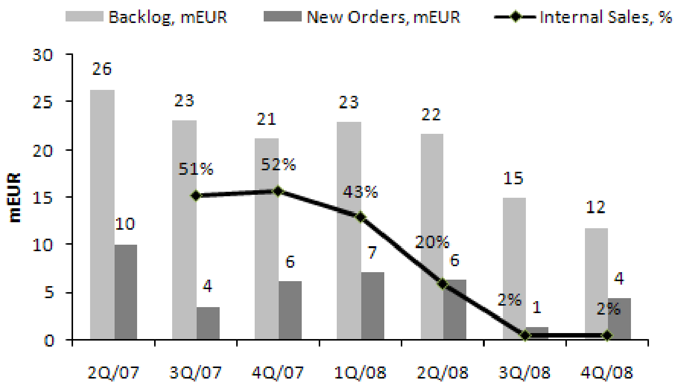
The main risk factor for the development division is the refinancing of loans for the land bank in Estonia. Ongoing projects must be completed and for that the bank funding is secured in Estonia, Latvia and Bulgaria. 27 units of apartments have been already sold or booked during first two months of 2009. In the Madrid project in Sofia 50% of the total volume has already been pre-booked, in the Manastirski project it is 10% respectively. In the Kolde project in Tallinn the construction of a new house will be completed and 62 apartments will be put on market. In order to cope with the liquidity risk, the prices in current projects in the Baltic's as well as in Sofia have been decreased substantially and during the year we aim at selling cash flow generating projects and partially also the land bank. As at the end of the year the division employed 44 people (55 in 2007). Further information on the projects: www.arcorealestate.com/development.



Constructions divsion

The construction division has only won tenders of environmental and infrastructure engineering. The average volume of the tenders has decreased and the contractor is usually the state or local governments. During the year, the following major procurements were won: design and construction contract for drinking water structures in the basin of the Emajõe and Võhandu rivers in Estonia, design and construction contract for the pedestrian tunnel for the Stockmann department store in Riga, and the design and construction contract for the iron separation station for the water purification station in the Ogre village, Latvia.

During the year, construction contracts worth 299 million kroons (19 million euros) were awarded. At the year-end, the Construction division's order backlog stood at 185 million kroons (11.89 million euros). As at the end of the year the division employed 191 persons (2007: 183).



Summary table of major projects

Type	Name	Location	Holding	Building rights according to business plan	Current state	Classification in the balance sheet
Commercial	Ahtri 3	Estonia, Tallinn	50%	ca 44 500m^2	The old plan and building permit are in effect. Municipality is processing a new detail plan. In the new plan, above-ground building rights extend to ca 51,100 m^2. Negotiations with potential tenants ongoing.	Investment property
Commercial	Ilmarine	Estonia, Tallinn	50%	Ca 80 000 m^2	Adoption of the thematic plan "Location of high rise buildings in Tallinn" is under way.	Investment property
Commercial	Laeva 2	Estonia, Tallinn	100%	7 776 m^2	Detail plan approved Construction permit in place. Negotiations with potential tenants.	Investment property
Commercial	Paldiski 80	Estonia, Tallinn	100%	24 000 m^2	No building rights. Municipality is processing the detail plan.	Investment property

Type	Name	Location	Holding	Building rights according to business plan	Current state	Classification in the balance sheet
Cash flow	Enerpoint	Estonia, Kuressaare	100%	3 352 m^2	Construction to extend a new production building is completed. Building rights in place. Generates cash flow.	Investment property
Cash flow	Kaarli 2	Estonia, Tallinn	33%	Plot 4 791 m^2	Café with a total area of 242 m2 and a car park. Generates cash flow.	Investment property
Cash flow	Kerberon	Estonia, Tallinn	100%	15 750 m^2	Building rights in place, building rights.. Generates cash flow.	Investment property
Cash flow	Melon	Estonia, Tallinn	50%	5 728 m^2	Building rights in place. We are applying for additional building rights on the yard ca 11,000m2. Sketches of the approved detail plan are subject to proceedings at the Tallinn City Planning Department.. Generates cash flow.	Investment property
Cash flow	Pärnu turg	Estonia, Pärnu	100%	2 529 m^2	Building rights in place. Generates cash flow.	Investment property
Cash flow	Raekoja 10	Estonia, Kuressare	50%	1 493 m^2	Generates cash flow.	Investment property
Cash flow	Rüütli 16 / 18	Estonia, Tallinn	50%	980 m^2	Building rights in place. Generates cash flow.	Investment property
Cash flow	TOP Äripinnad	Estonia, Tallinn	50%	17 754 m^2	Building rights according to the existing construction. New detail plan is being adopted, the whole volume at least 74.675 m2. Generates cash flow.	Investment property

Type	Name	Location	Holding	Building rights according to business plan	Current state	Classification in the balance sheet
Apartments	Bišumuiža 1	Latvia, Riia	80%	Unsold building rights 18 800 m2	Sales of the apartments in progress.	Inventories
Apartments	Bišumuiža 2	Latvia, Riia	40%	87 770 m^2	Design work is under way.	Inventories
Apartments	Hills	Lithuania, Vilnius	100%	6 500 m^2	Building rights in place. The project is on sale.	Inventories
Apartments	Kolde	Estonia, Tallinn	100%	Unsold building rights 18 580 m2	Leasehold right. Sales of apartments in progress.	Inventories
Apartments	Madrid	Bulgaria, Sofia	100%	Unsold building rights 12 349 m2	Building rights. Construction and sale of apartments are under way.	Inventories
Apartments	Manastirski	Bulgaria, Sofia	100%	Unsold building rights 26 075 m2	Building rights. Construction and sale of apartments are under way.	Inventories

Apartments	Tivoli	Estonia, Tallinn	100%	58 470 m^2	Construction right in place. The zoning is completed.	Inventories
Apartments	TOP Elupinnad	Estonia, Tallinn	50%	33 770 m^2	No building rights. Planning is in the initial stage.	Investment property
Plots	Baltezers-2	Latvia, Riia	80%	1 940 m^2	7 plots on sale.	Investment property
Plots	Baltezers-3	Latvia, Riia	80%	172,380 m2, land total 861 900 m2	Leasehold right. 189 plots. Preparations for first stage (33 plots) infrastructure construction.	Inventories
Plots	Baltezers-5	Latvia, Riia	80%	48 plots unsold	Building rights in place. Construction has been completed. Sale is ongoing.	Inventories
Plots	Merivälja 2	Estonia, Merivälja	100%	Unsold 63 572 m2, 52 plots	Road and communications construction will be started. Sale of plots ongoing.	Inventories
Plots	Pärtli	Estonia, Saue	50%	84 plots, average plot 1 500 m2	No building rights. Adoption of a detail plan suspended until improvement o market situation.	Investment property
Plots	Tooma	Estonia, Saue	50%	107 plots, average plot 1 802 m2	No building rights. Adoption of a detail plan suspended until improvement in market situation.	Inventories
Plots	Vahi	Estonia, Vääna	100%	21 plots, average plot 3 363 m2	Building rights and building design in place, suspended until improvement in market situation.	Inventories

Note: The development and success of the Group's development projects depend largely on external factors, particularly the adoption of plans and the issuance of building permits by the local government and the planning authorities. The information presented in the tables, such as building rights according to business plan, current state, project type and classification of the project in the balance sheet, has been recorded based on management's intentions and best judgment and may change in line with changes in the planning process. Expectations of the projects' realisation may also change over time according to changes in the market and in competition. Management estimates the value of the project portfolio on an ongoing basis and is prepared to sell any project or part of a project at any time, depending on the results of the cost-benefit analysis.

The projects presented in the summary table account for the following portions of the Group's assets:

Balance Sheet Item	EEK		EUR	
	Balance sheet item at 31.12.2008	Book values of projects presented in the summary table at 31.12.2008	**Balance sheet item at 31.12.08**	Book values of projects presented in the summary table at 31.12.2008
In millions				
Total assets	1 970.6	1 294.7	125.9	82.7
Inventories	849.4	753.0	54.3	48.1
Investment property	542.8	541.7	34.7	34.6
Assets under construction	41.8	0.0	2.7	0.0

Significant changes in detail plans in 2008

Tivoli: Tallinn City Council adopted a detail plan for the property. The gross enclosed area of up to five-floor apartment blocks is 51 400 m2 and the area for commercial premises is 7 000 m2. In addition, the plan foresees underground parking spaces on up to 21 150 m2. An apartment owner in the neighbouring community has filed a challenge and initial court protection is requested on his behalf. The case continues.
Ahtri: The property has a detail plan with building rights. We have submitted a draft of a new detail plan to the city government. Until the new plan is adopted, the building rights provided in the previous plan will apply. In the new detail plan we apply for 51 110 m2 of above ground construction right.

Laeva 2: Detail plan approved. According to the plan we are allowed to construct a 6-storey building, total volume of gross space 7 776 m2. There will be an underground car park for 72 cars.
PM80: Detail plan is subject to adoption proceedings in the City Council and to forwarding to public review.
Baltezeres-3: Detail plan adopted by Garkalne municipality. The size of the plot is 86 ha, 60 ha of which can be built up with an intensity of 30% so that maximum building rights extend to 172 380 m2 of gross enclosed area.

Changes in the group's structure

The most significant change in the Group's structure was the divestment of shares in AVEC Asset Management AS. The largest transaction involved exchange of interests in subsidiaries – the Group exchanged its entire holding in Tallinna Linnaehituse AS for full ownership in Kolde AS and Kerberon OÜ. Furthermore, the construction division acquired a 55% holding in a small enterprise Tempera Ehitus OÜ, which has after the reporting period proven to be a bad investment and is being terminated. Holdings were sold in smaller enterprises such as UAB Ikas Projekt and SIA Plavnieku Centrs. The effect of the transactions on the Group's consolidated finances is presented in note 7 to the financial statements.

Staff

By the end of the year 2008 the staff of Arco Vara Group was reduced to 396 employees (2007: 664; 2006: 478) and the total salary paid to the staff, including the associated taxes, amounted to 129.3 million kroons (8.3 million euros). As at 01.12.2008 the distribution of the employees by regions and areas of activity was as follows:

2008	**Estonia**	**Latvia**	**Lithuania**	**Ukraine**	**Bulgaria**	**Romania**	**TOTAL**
Services	58	35	0	29	17	0	**139**
Development	27	7	0	0	10	0	**44**
Construction	63	128	0	0	0	0	**191**
General management	22	0	0	0	0	0	**22**
TOTAL	170	170	0	29	27	0	**396**
2007							
Services	123	101	52	65	34	27	402
Development	36	8	3	0	5	3	55
Construction	84	99	0	0	0	0	183
General management	24	0	0	0	0	0	24
TOTAL	267	208	55	65	39	30	664

In 2008 the members of the management board were paid remuneration including the associated taxes in the aggregate amount of 19 million kroons (1.2 million euros) of which the remuneration of the members of the management board, including the associated taxes amounted to 2.7 million kroons (0.2 million euros) , the bonuses, including the associated taxes – to 12.2 millon kroons (0.78 million euros) and the severance pays, including the associated taxes – to 4.1 million kroons (0.3 million euros).

The remuneration paid to members of the supervisory board, including the associated taxes amounted to 0.6 million kroons (0.04 million euros).

Share information

At the end of the year 2008 the aggregate number of shareholders was 1767; 98% of the shareholders holds less than 100 000 shares, and 67% – less than 1000 shares. The total number of outstanding shares of the company is 95 284 150. At the end of December the closing price of a share was 2.82 kroons (0.18 euros). The company holds 450 000 of its own shares with the average acquisition value of 8.87 kroons (0.57 euros). In a year the share price has dropped 88.3%.
The share price changes (in EUR) of the shares of Arco Vara AS, and changes of transaction volumes in 2008 are illustrated by the following diagram.

10 major shareholders as at 31.12.2008	Number of shares	Shareholding %
TOLETUM OÜ	20 718 508	21.74%
HM INVESTEERINGUD OÜ	20 675 883	21.70%
FREIER PROJEKT OÜ	19 929 133	20.92%
SEB Ab Clients	11 549 471	12.12%
JPMORGAN CHASE BANK, UK RESIDENTS	6 901 743	7.24%
Central Securities Depository of Lithuania	2 897 556	3.04%
GAMMA HOLDING OÜ	1 429 192	1.50%
SEB PROGRESSIIVNE PF	684 471	0.72%
SEB KASVUFOND	582 250	0.61%
UNICREDIT BANK AUSTRIA AG	491 520	0.52%
Other	9 424 423	9.89%

Share positions of the members of the management board and the supervisory board as at 31.12.2008	Position	Number of shares	Shareholding %
Lembit Tampere	Chair of the management board	0	0.00%
Veiko Taevere	Member of the management board	0	0.00%
Heigo Metsoja	Member of the management board	0	0.00%
Richard Tomingas (Toletum OÜ)	Chair of the supervisory board	20 718 508	21.74%
Hillar-Peeter Luitsalu (HM Investeeringud OÜ, related perosn)	Member of the supervisory board	20 734 558	21.76%
Aare Tark	Member of the supervisory board	0	0.00%
Kalev Tanner	Member of the supervisory board	0	0.00%
Ragnar Meitern	Member of the supervisory board	0	0.00%
Total		41 453 066	43.50%

Dividend Policy

In the years between 2005 and 2008 Arco Vara Group was announcing dividends in the amount of up to 15% of the consolidated net profit, and intends to continue the distribution of dividends pro rata to its net profit. Nevertheless the Group cannot warrant that dividend payments will be continuing at the same rate in the future, because the exact sum of dividends depends on the results of the latest financial year of the Group and the estimated liquidity position in the medium run.

Financial Risks Management

An overview of the financial risks management policy and the risk positions as at 31.12.2008 has been provided in Note No. 33 to the financial statements of the consolidation group.

Corporate Management and Compliance with Recommended Corporate Governance Practices of Tallinn Stock Exchange

The shares of Arco Vara AS were listed in the main list of the Tallinn Stock Exchange on 21 June 2007.
Being a publicly traded company Arco Vara AS is governed in its operations by the legislation effective in the Republic of Estonia, the requirements, rules and guidelines established by the Tallinn Stock Exchange, and the company's core values.

- Partnership – our client is our partner
- Reliability – we are reliable, open and honest
- Professionalism – we deliver quality
- Respect – we respect our client's personality
- Responsibility – we keep our promises

Along with the annual report Arco Vara AS also submits its Corporate Governance Practices (CGP) report, in which the management of the company confirms the adherence to the CGP requirements, and explains the reasons of any failure to do so.

The annual report has been prepared in compliance with the CGP guidelines. This CGP report is a separate chapter of the management report constituting a part of the annual report.

I General Meeting of Shareholders

The highest directing body of a company is the general meeting of shareholders.
The competence of the general meeting, the procedure for calling a meeting and passing of decisions is set forth in the articles of association of the company.

In 2008 the company held one annual and one special general meeting of shareholders.
The annual general meeting took place on 13.05.2008 in Tallinn at Tõnismägi 2. The meeting was called by publishing the relevant notice in *Eesti Päevaleht* and on the company's website on 21.04.2008. The notice contained information on the location where the shareholders were given the possibility to review all the essential data and materials of the general meeting, and where to submit their questions. The following were not disclosed to the shareholders: the contract executed with the auditor, because according to the pre-contractual negotiations the contents of the contract was not subject to disclosure; the information on the candidate to the position of a member of the supervisory board regarding the candidate's participation in supervisory boards, management boards or executive management of other companies. The omission was eliminated on 14.05.2008, when the CV of the new member of the supervisory board was published, along with the resolutions of the general meeting.
The information was provided to the shareholders both in Estonian as well as in English. The company responded to the questions posed by shareholders before the general meeting, and published the questions and answers pertaining to the items on the agenda of the general meeting on the website of the company.
Before the general meeting the supervisory board did not publish its proposals regarding the topics on the agenda of the meeting, because the supervisory board did not have suggestions of any relevance.
The meeting was chaired by Hannes Vallikivi, who is not the chair of the supervisory board of the meeting, nor a member of the management board. The agenda of the meeting included approval of the annual report, division of profit, election of auditors, granting the right to acquire own shares, as well as removal of a member of the supervisory board, and election of a new member of the supervisory board. The distribution of profit was discussed at the meeting as a separate topic, and a separate decision was taken in respect to the same. The general meeting of shareholders was held in the Estonian language and the chair of the meeting ensured smooth running of the meeting. All the members of the management board, the chair of the supervisory board (Richard Tomingas) and two members of the supervisory board (Hillar-Peeter Luitsalu and Arti Arakas) attended the meeting. The rest of the members of the supervisory board (Aare Tark and Kalev Tanner) and the auditor were unable to attend the meeting due to their duties in other companies. The candidate to the supervisory board, Ragnar Meitern, who had not previously been a member of the supervisory board, could not participate in the general meeting, inasmuch as his place of work is outside the Republic of Estonia. The company deemed monitoring of and participation in the general meeting of shareholders via means of communication not possible.

The special general meeting of shareholders was held on 06.11.2008 in Tallinn at Narva mnt. 7c. The notice on calling the meeting was published on 29.10.2008 in the newspaper *Päevaleht* and on the company's website. The notice stated the reason for calling the special meeting, and the person proposing to call the meeting. This information was provided to the shareholders both in Estonian as well as in English. The company responded to the questions posed by shareholders before the special general meeting, and published the questions and answers pertaining to the items on the agenda of the special general meeting on the website of the company.
The meeting was chaired by Hannes Vallikivi, who is not the chair of the supervisory board of the meeting, nor a member of the management board. The issue on the agenda was partial modification of the resolution of the general meeting of shareholders dated 13.05.2008, by which the company was granted authorisation to acquire its own shares, and the minimum price per one share was set as 1/10 of the nominal value of the share. The special general meeting of shareholders was held in the Estonian language and the chair of the meeting ensured smooth running of the meeting. All the members of the management board, the chair of the supervisory board (Richard Tomingas) and one member of the supervisory board (Hillar-Peeter Luitsalu) attended the meeting. The rest of the members of the supervisory board (Aare Tark, Kalev Tanner and Ragnar Meitern) and the auditor were unable to attend the meeting due to their duties in other companies. The company deemed monitoring of and participation in the general meeting of shareholders via means of communication not possible.

Information pertaining to the agendas of the annual and special general meeting of shareholders, as well as the questions posed by shareholders before the meetings, and the responses given are displayed until the notice on calling the next general meeting of shareholders is published.

II Management Board

Since 16.10.2008 as well as on the date of preparing this report the management board of Arco Vara AS includes 3 members:

- Lembit Tampere – chair of the management board, who organises the work of the management board, and the management of the company;
- Heigo Metsoja – member of the management board organising financial management of the company;
- Veiko Taevere – member of the management board responsible for the management of the development division.

From 01.01.2008 till 05.02.2008 the management board included 5 members: Viljar Arakas (chair of the management board), Ahto Altjõe (member of the management board, head of the construction division), Aare Tammemäe (member of the management board, financial manager), Veiko Pedosk (member of the management board, head of the development division) ja Avo Rõõmussaar (member of the management board, head of the service division).

From 06.02.2008 till 18.02.2008 the management board included 4 members: Aare Tammemäe (chair of the management board, financial manager), Ahto Altjõe (member of the management board, head of the construction division), Veiko Pedosk (member of the management board, head of the development division) ja Avo Rõõmussaar (member of the management board, head of the service division).

From 18.02.2008 till 28.08.2008 the management board included 4 members: Aare Tammemäe (chair of the management board, financial manager), Ahto Altjõe (member of the management board, head of the construction division), Veiko Taevere (member of the management board, head of the development division) ja Avo Rõõmussaar (member of the management board, head of the service division).

From 28.08.2008 till 15.10.2008 the management board included 4 members: Lembit Tampere (chair of the management board), Heigo Metsoja (member of the management board, financial manager), Veiko Taevere (member of the management board, head of the development division) ja Avo Rõõmussaar (member of the management board, head of the service division).

Upon assuming the office every member of the management board has executed a service contract with the company governing the service assignments of that member. Contracts with members of the management board have been entered into for the term of three years. None of the members of the management board is concurrently a member of management boards of more than two issuers, a chair of the supervisory board of another issuer, nor a chair of the supervisory board of an issuer of the company's group.

All the members of the management board have executed a contract of a member of the management board with the company, which specifies the rights, obligations and liability of the members of the management board, and lays down the provisions governing payment of principal remuneration. The amount of the remuneration was agreed upon in line with the service assignments and activities entrusted to the relevant member of the management board, the current state of the business, and the future trends.

In the contracts of a member of the management board, which were signed with Viljar Arakas, Aare Tammemäe, Veiko Pedosk and Avo Rõõmussaar, were included bonus system.
The members of the management board are entitled to a bonus, if the consolidated profit and turnover of the company match the agreed benchmarks. If the consolidated turnover or profit was higher or lower than the agreed benchmarks, a separate formula was applied to calculate the bonus. No bonus was paid in the case of negative economic results, and the members of the management board were not charged the respective negative amount. The described system encouraged persons to act in the best interests of the company, and to refrained from acting in one's own interests or in the interest of other persons. In the event that a member of the management board was removed from office without a good reason, the member of the management board was entitled to a bonus payable for the relevant year *pro rata* to the number of days in office, based on the approved economic results of the preceding quarter of the relevant year.

In 2008 the members of the management board were paid remuneration in the aggregate amount of 14 311 872 EEK of which the remuneration of the members of the management board amounted to 2 049 707 EEK, the bonuses – to 9 164 992 EEK and the severance pays – to 3 097 173 EEK.

The members of the management board have informed the company of their participation in other business entities, which are not members of the Arco Vara Group, or management bodies thereof.

- Ahto Altjõe – member of the management board of OÜ Infotrade;
- Veiko Pedosk – member of the management board and sole shareholder of Kvaliteks OÜ;
- Avo Rõõmussaar – member of the management board and shareholder of Strateg Consulting OÜ, the sole shareholder and member of the management board of Energiamets OÜ*;*
- Viljar Arakas – member of the management board of Estonian Property Owners' Association (Eesti Omanike Keskliit) and the sole shareholder and member of the management board of OÜ Miemma Holding;
- Lembit Tampere – member of the management board of CHB Kindlustusmaakler OÜ, OÜ Alasniidu, OÜ Overseas, OÜ ECE Maja and OÜ Harku Projektijuhtimine and the sole shareholder and member of the management board of OÜ Remmelga Aiand;
- Aare Tammemäe – the sole shareholder and member of the management board of OÜ Brandeis Grupp;

Certain interest held by the members in management board, and their participation in managing bodies does not constitute a breach of the prohibition on competition. Moreover the members of the management board have assumed the obligation to refrain from any breach of the non-competition obligation under their respective agreements. Furthermore, the internal work procedure rules of the company stipulate that no member of the management board or any employee shall demand or accept in their own personal interest any moneys or other benefits from any third persons in connection with their job, nor grant any third persons unlawful or unreasonable favours.

The members of the management board have not concluded any transactions with themselves, any persons connected with or related with themselves, nor taken any decisions based on their personal interests.

III Supervisory Board

The task of the supervisory board is to plan the operations of the company, organise the business and carry out supervision over the activities of the management board. The members of the supervision of Arco Vara AS are elected by the general meeting of shareholders.

In line with the CGP one-half of the members of the management board of the issuer are independent. If the supervisory board includes an uneven number of members the number of independent members may be less by 1.

The supervisory board of the company consists of 5 members. From the beginning of the financial year until 16.05.2008 the members of the supervisory board were Richard Tomingas (chair of the supervisory board), Hillar-Peeter Luitsalu, Arti Arakas, Aare Tark and Kalev Tanner. At the annual general meeting of shareholders held on 16.05.2008 Arti Arakas was removed from the office of a member of the supervisory board, and Ragnar Meitern was elected a new member of the supervisory board.

Since 16.05.2008 the independent members of the supervisory board, in line with the definition provided by CGP, are Kalev Tanner and Ragnar Meitern. The members of the supervisory board Hillar-Peeter Luitsalu and Richard Tomingas cannot be deemed independent members, because within the last three years they have been members of the management of a number of business entities of the issuer's group, and have business relationships via the business entities OÜ HM Investeeringud and OÜ Toletum in which they hold interest. According to the CGP definition Aare Tark is also not an independent member, because he provides legal services to Arco Vara AS through the Law Office Tark&Co, controlled by him.
Therefore the supervisory board of the company includes 2 independent and 3 dependent members, which meets the CGP's requirement according to which, in the case that the supervisory board has an uneven number of members, the number of independent members may be one less than the number of dependent members. Such composition of the supervisory board ensures efficient management and is the best option for the company and the shareholders.

The members of the supervisory board elect from among themselves the chair of the supervisory board.
Since 1997 the position of the chair of the supervisory board was held by Arti Arakas; on 12.12.2007 he submitted an application to the meeting of the supervisory board on his resignation from the position of the chair of the supervisory board. The supervisory board granted the application and from 21.01.2008 the position of the chair of the supervisory board is held by Richard Tomingas.

The remuneration of the members of the supervisory board has been approved by the resolution of the general meeting of shareholders dated 31.05.2007; the amount payable to every member of the management board is 7500 EEK/month (without social tax). No additional remuneration is paid to the members of the supervisory board, and no special remuneration is paid to the chair of the supervisory board. No severance pay is paid to resigning members of the supervisory board.
Arti Arakas, Hillar-Peeter Luitsalu and Richard Tomingas who are also active members of supervisory boards of companies controlled by the issuer, have been granted the use of cars, computers and mobile telephone, and according to the resolution of the general meeting the expenses connected with the same are borne by the issuer.

The supervisory board has formed no committees.

Altogether 10 meetings of the supervisory board were held in 2008. In 2008 each member of the supervisory board of the issuer participated in more than one-half of the meetings of the supervisory board held during their term of office.

Before Ragnar Meitern was elected a member of the supervisory board it was ascertained that he has no conflict of interest with the issuer. Furthermore, no conflict of interest has emerged in 2008 with respect to the other members of the supervisory board.

IV Co-operation of Management Board and Supervisory Board

In line with the articles of association of the issuer, and the established routine of work the management board and the supervisory board work in close co-operation.
The members of the supervisory board Hillar-Peeter Luitsalu and Richard Tomingas are actively involved in the supervisory boards of all the parent companies of all the three key areas of activity (Arco Ehitus OÜ, Arco Investeeringute AS and Arco Real Estate AS).
The management board and the supervisory board hold joint meetings when matters concerning the company's strategy are discussed, and the parties continuously exchange information pertaining to the strategic development of the issuer. Furthermore, at such meetings the management board informs the supervisory board of any deviations from the company's plans and targets and the reasons thereof.
When needed meetings of the chair of the supervisory board and the chair of the management board are held to exchange information. With respect to exchange of information the internal rules governing the keeping, disclosure of internal information, as well as transactions with the shares of Arco Vara As are applied.

On 25.08.2008 the supervisory board removed from their respective offices the chair of the management board Aare Tammemäe and a member of the management board Ahto Altjõue. This removal from office of the chair and the member of the management board was deemed necessary for the purpose better organisation of the business of the company, ensuring management efficiency, and restructuration of its activities. Lembit Tampere was appointed the new chair and Heigo Metsoja the new member of the management board. On 18.09.2008 the supervisory board granted the resignation application of the member of the management board Avo Rõõmussaar, and removed him from office at his own request.

V Disclosure of Information

Since listing of the shares Arco Vara AS on the Tallinn Stock Exchange the company has been adhering to the information disclosure requirements laid down by Tallinn Stock Exchange and in compliance with the objective of applying equal treatment to all its shareholders.
The website of Arco Vara AS can be found at the address www.arcorealestate.com and the information targeted at shareholders is available at the easily found section http://www.arcorealestate.com/en/investor-info/general where it is available both in Estonian as well as in English. The issuer has disclosed on its website all the facts and assessment pertaining to the issuer, which have been disclosed to financial analysts or other persons. Moreover, the website of the issuer discloses information about meetings held with analysts, presentations made to analysts or investors, as well as the time and place of presentations and press conferences intended for institutional investors, and general directions of the issuer's strategy. The issuer did not draw up a so-called financial calendar at the beginning of the financial year, inasmuch as the issuer has published all the information subject to disclosure by the deadlines set forth in the relevant legislation.

Company has organised once a meeting with investors, directly before the dates of disclosure of financial reports, but in the meetings were not published inside information or undisclosed financial data.

VI Financial Reporting and Auditing

The consolidated accounts of Arco Vara AS have been prepared in accordance with the International Financial Reporting Standards as adopted by the European Union (IFRS).

The meeting of the supervisory board, which discussed the auditing results, was attended by the auditor. The auditor submitted his report; the members of the management board were not present when the results were reviewed. No minutes were taken at the relevant meeting of the supervisory board.

The notice on calling the annual general meeting of shareholders of the company contained the data pertaining to the candidate to the auditor's position. The auditor has been auditing the financial results of the company for past years, and inasmuch the supervisory board had no negative comments regarding the auditor's activities the supervisory board deemed did not deem necessary to have a separate report on the auditor's activities be presented to the general meeting.

Arco Vara AS does not disclose the amount of the fee paid to the auditor, inasmuch as, in the opinion of the issuer, the non-disclosure thereof does not affect the reliability of the auditor's report prepared following the auditing.

Formulas

Invested capital = current interest-bearing liabilities plus long-term liabilities plus equity
Net loans = current interest-bearing liabilities at the end of period plus long-term liabilities at the end of period less cash and cash equivalents at the end of period less short-term investments in securities
Equity to assets ratio = equity at the end of period / total assets at the end of period
Average equity = the past 4 quarters' closing equity / 4
ROE = net profit for the period/ the period's average equity
Average invested capital = the sum of current interest-bearing liabilities, long-term liabilities and equity for the last four quarters / 4
ROIC = the sum of pre-tax profit and interest expenses for the last 4 quarters / average invested capital
EPS 1 = net profit attributable to equity holders of the parent / weighted average number of ordinary outstanding shares of the period
EPS 2 = net profit attributable to equity holders of the parent / number of shares at the end of period
Quick Ratio = (current assets – inventories & biological assets)/current liabilities at the end of period
Current Ratio = current assets at the end of period / current liabilities at the end of period

Confirmation

The Group's management board confirms that the management report presents fairly the development, performance and financial position of the company and the Group and provides an overview of the main risks and uncertainties.

17.04.09

Lembit Tampere
Chair of the management board

17.04.09

Veiko Taevere
Member of the management board

17.04.09

Heigo Metsoja
Member of the management board

Consolidated financial statements

Statement of management's responsibility

We acknowledge our responsibility for the preparation of the consolidated financial statements on pages 17 to 80 of this report and confirm that:

1. the accounting policies applied on the preparation of the consolidated financial statements of Arco Vara AS (the "Parent") and its subsidiaries and interests in jointly controlled entities (together referred to as the "Group") comply with International Financial Reporting Standards as adopted by the European Union;

2. the consolidated financial statements give a true and fair view of the financial position of the Group and of the results of its operations and its cash flows;

3. the Group and the Parent are going concerns.

17.04.09

Lembit Tampere
Chair of the management board

17.04.09

Heigo Mëtsoja
Member of the management board

Veiko Taevere
Member of the management board

17.04.09

______________ 2009.

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ERNST & YOUNG
17.04.2009

Consolidated income statement

		EEK		EUR	
	Note	**2008**	2007	**2008**	2007
In EEK , thousands					
Rendering of services		487 478	345 856	31 156	22 104
Sale of goods		172 301	381 332	11 012	24 372
Total revenue	5	**659 779**	**727 188**	**42 168**	**46 476**
Cost of sales	8	-1 010 810	-542 135	-64 603	-34 649
Gross profit		**-351 031**	**185 053**	**-22 435**	**11 827**
Other income	11	30 644	140 090	1 959	8 953
Selling and distribution costs	9	-12 344	-22 534	-789	-1 440
Administrative expenses	10	-125 584	-136 053	-8 026	-8 695
Other expenses	11	-591 402	-63 498	-37 797	-4 058
Operating profit		**-1 049 717**	**103 058**	**-67 088**	**6 587**
Finance income	12	76 089	215 005	4 863	13 741
Finance expenses	13	-177 702	-67 744	-11 357	-4 330
Profit / loss before tax		**-1 151 330**	**250 319**	**-73 582**	**15 998**
Income tax expense	14	-8 811	-14 808	-563	-946
Net profit / loss		**-1 160 141**	**235 511**	**-74 145**	**15 052**
Attributable to minority interests		*-5 182*	*7 924*	-331	*507*
Attributable to equity holders of the parent		*-1 154 959*	*227 587*	-73 815	*14 546*
Loss/Earnings per share (in kroons)	16				
- Basic		**-12,12**	2,76	**-0,77**	0,18
- Diluted		**-12,12**	2,76	**-0,77**	0,18

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17-04. 2009

Consolidated balance sheet

		EEK		EUR	
	Lisa	**31.12.2008**	31.12.2007	**31.12.2008**	31.12.2007
In thousands					
Cash and cash equivalents		172 574	765 008	11 029	48 893
Other financial assets	17	40 416	78 595	2 583	5 023
Receivables	18	294 352	297 189	18 813	18 994
Prepayments		6 165	10 450	394	668
Inventories	19	849 440	1 148 433	54 289	73 398
Biological assets	20	3 679	8 360	235	534
Total current assets		**1 366 626**	**2 308 035**	**87 343**	**147 510**
Other financial assets		255	48 515	16	3 101
Receivables	18	6 671	40 124	426	2 564
Investment property	21	542 753	999 999	34 688	63 912
Property, plant and equipment	22	41 812	141 863	2 672	9 067
Intangible assets	23	12 475	25 505	797	1 630
Total non-current assets		**603 966**	**1 256 006**	**38 599**	**80 274**
TOTAL ASSETS		**1 970 592**	**3 564 041**	**125 942**	**227 784**
Loans and borrowings	24	353 417	753 077	22 587	48 130
Other liabilities	26	132 677	223 591	8 480	14 290
Deferred income	27	65 174	47 216	4 165	3 018
Provisions	28	5 917	3 468	378	222
Total current liabilities		**557 185**	**1 027 352**	**35 610**	**65 660**
Loans and borrowings	24	692 919	600 938	44 286	38 407
Other liabilities	26	4 404	4 607	281	294
Deferred income tax liability		20	1 321	1	84
Provisions		4 291	251	274	16
Total non-current liabilities		**701 634**	**607 117**	**44 842**	**38 801**
TOTAL LIABILITIES		**1 258 819**	**1 634 469**	**80 452**	**104 461**
Share capital	30	952 842	952 842	60 898	60 898
Share premium		712 514	712 514	45 538	45 538
Statutory capital reserve		31 463	20 084	2 011	1 284
Other reserves		0	37	0	2
Retained earnings		-984 668	218 830	-62 932	13 986
Treasury shares (minus)		-3 992	0	-255	0
Total equity attributable to equity holders of the parent		**708 159**	**1 904 307**	**45 260**	**121 708**
Minority interests		3 614	25 265	231	1 615
Total equity		**711 773**	**1 929 572**	**45 491**	**123 323**
TOTAL LIABILITIES AND EQUITY		**1 970 592**	**3 564 041**	**125 943**	**227 784**

For identification purposes only
ERNST & YOUNG
17-04.2009

Consolidated cash flow statement

		EEK		EUR	
	Lisa	**2008**	2007	**2008**	2007
In thousands					
Net profit / loss		-1 160 141	235 511	-74 144	15 052
Interest income and expense	12,13	*-5 080*	*3 663*	*-325*	*234*
Gains and losses on disposal of subsidiaries and interests in jointly controlled entities	7,12,13	*41 295*	*-131 083*	*2 639*	*-8 378*
Gains and losses on other long-term financial assets	12,13	*-2 429*	*-47 861*	*-155*	*-3 059*
Impairment losses on financial assets	13	*72 435*	*25 768*	*4 629*	*1 647*
Depreciation, amortisation and impairment losses on property, plant and equipment and intangible assets	22	*7 412*	*-13 645*	*474*	*-872*
Goodwill adjustments and recognition of negative goodwill as revenues	23	*8 720*	*-283*	*557*	*-18*
Gain / loss on the sale of property, plant and equipment and intangible assets	22	*-248*	*-18*	*-16*	*-2*
Gain / loss on the sale of investment property	21	*-1 535*	*1 633*	*-97*	*105*
Change in the fair value of investment property and biological assets	21	*555 629*	*-59 874*	*35 511*	*-3 827*
Loss on decrease of net realisable value of inventories	8,19,20	*434 272*	*0*	*27 755*	*0*
Exchange rate gains and losses	12,13	*-4 608*	*2 252*	*-295*	*144*
Corporate income tax expense	14	*12 744*	*14 591*	*814*	*933*
Operating cash flow before working capital changes		**-41 534**	**30 654**	**-2 653**	**1 959**
Change in receivables and prepayments		-12 481	-80 085	-798	-5 118
Change in inventory and biological assets		-99 831	-424 902	-6 380	-27 156
Change in payables and deferred income		26 273	-73 596	1 679	-4 704
NET CASH USED IN OPERATING ACTIVITIES		**-127 573**	**-547 929**	**-8 152**	**-35 020**
Acquisition of property, plant and equipment and intangible assets		-39 108	-47 204	-2 499	-3 017
Proceeds from sale of property, plant and equipment and intangible assets		729	8 436	47	539
Acquisition of investment property		-4 222	-12 000	-270	-767
Proceeds from sale of investment property		32 218	51 834	2 059	3 313
Acquisition of subsidiaries and interests in jointly controlled entities, net of cash acquired	7.2	-45 875	-20 176	-2 932	-1 289
Proceeds from disposal of subsidiaries and interests in jointly controlled entities, net of cash sold	7.2	-2 912	222 650	-186	14 230
Acquisition of other financial assets		-202 665	-92 529	-12 953	-5 914
Proceeds from sale of other financial assets		294 621	14 639	18 830	936
Loans granted		-130 158	-52 681	-8 319	-3 367
Repayment of loans granted		2 422	40 878	155	2 613
Interest received		32 328	19 684	2 066	1 258
Dividends received		0	3 147	32	201
NET CASH USED IN / FROM INVESTING ACTIVITIES	34	**-62 622**	**136 678**	**-4 002**	**8 736**
Proceeds from loans received		312 739	800 488	19 988	51 161
Repayment of loans and payment of finance lease liabilities		-569 343	-572 650	-36 388	-36 599
Change in overdraft		-14	-18 516	-1	-1 183
Change in group account liability		-1 568	382	-100	24
Interest paid		-82 271	-55 486	-5 258	-3 546
Proceeds from issue of share capital		0	987 514	0	63 114
Repurchase of own shares		-3 992	0	-255	0
Dividends paid		-42 274	-16 006	-2 702	-1 023
Income tax paid on dividends		-15 516	-7 324	-992	-468
NET CASH FROM FINANCING ACTIVITIES		**-402 239**	**1 118 402**	**-25 708**	**71 480**
NET CASH FLOW		**-592 434**	**707 151**	**-37 862**	**45 195**
Cash and cash equivalents at beginning of period	35	765 008	58 345	48 893	3 729
Increase / decrease		-592 434	707 151	-37 863	45 197
Effect of exchange rate fluctuations		0	-488	0	-32
Cash and cash equivalents at end of period		**172 574**	**765 008**	**11 030**	**48 893**

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17.04.2009

Consolidated statement of changes in equity

	Equity attributable to equity holders of the parent							Minority interests	Total equity
	Share capital	Share premium	Statutory capital reserve	Other reserves	Treasury stocks (minus)	Retained earnings	Total		
In thousands EEK									
At 31 December 2006	**304 530**	**123 083**	**5 486**	**-184**	**0**	**292 002**	**724 917**	**16 964**	**741 881**
Change in unrealised exchange differences	0	0	0	221	0	0	221	0	**221**
Bonus issue	373 312	-123 083	0	0	0	-250 229	0	0	**0**
Issue of share capital	275 000	770 000	0	0	0	0	1 045 000	0	**1 045 000**
Transfer to capital reserve	0	0	14 598	0	0	-14 598	0	0	**0**
Dividend distribution[1]	0	0	0	0	0	-25 430	-25 430	-200	**-25 630**
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	0	577	**577**
Initial recognition of the put options of minority shareholders	0	0	0	0	0	-10 502	-10 502	0	**-10 502**
Total expense for the year recognised directly in equity[2]	0	-57 486	0	0	0	0	-57 486	0	**-57 486**
Profit for the year	0	0	0	0	0	227 587	227 587	7 924	**235 511**
At 31 December 2007	**952 842**	**712 514**	**20 084**	**37**	**0**	**218 830**	**1 904 307**	**25 265**	**1 929 572**
Change in unrealised exchange differences	0	0	0	-37	0	0	**-37**	0	**-37**
Dividend distribution[1]	0	0	0	0	0	-37 160	**-37 160**	-1 252	**-38 412**
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	0	-15 217	**-15 217**
Transfer to capital reserve	0	0	11 379		0	-11 379	0	0	**0**
Purchase of own shares	0	0	0	0	-3 992	0	-3 992	0	**-3 992**
Profit for the year	0	0	0	0		-1 154 959	-1 154 959	-5 182	**-1 160 141**
At 31 December 2008	**952 842**	**712 514**	**31 463**	**0**	**-3 992**	**-984 668**	**708 159**	**3 614**	**711 773**

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ERNST & YOUNG
17.04.2009

	Equity attributable to equity holders of the parent							Minority interests	Total equity
	Share capital	Share premium	Statutory capital reserve	Other reserves	Treasury shares (minus)	Retained earnings	Total		
In thousands EUR									
At 31 December 2006	**19 463**	**7 866**	**351**	**-12**	**0**	**18 662**	**46 330**	**1 084**	**47 414**
Change in unrealised exchange differences	0	0	0	14	0	0	14	0	**14**
Bonus issue	23 859	-7 866	0	0	0	-15 993	0	0	**0**
Issue of share capital	17 576	49 212	0	0	0	0	66 788	0	**66 788**
Transfer to capital reserve	0	0	933	0	0	-933	0	0	**0**
Dividend distribution[1]	0	0	0	0	0	-1 625	-1 625	-13	**-1 638**
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	0	37	**37**
Initial recognition of the put options of minority shareholders	0	0	0	0	0	-671	-671	0	**-671**
Total expense for the year recognised directly in equity[2]	0	-3 674	0	0	0	0	-3 674	0	**-3 674**
Profit for the year	0	0	0	0	0	14 546	14 546	507	**15 053**
At 31 December 2007	**60 898**	**45 538**	**1 284**	**2**	**0**	**13 986**	**121 708**	**1 615**	**123 323**
Change in unrealised exchange differences	0	0	0	-2	0	0	**-2**	0	**-2**
Dividend distribution[1]	0	0	0	0	0	-2 375	**-2 375**	-80	**-2 455**
Change in minority interests (from change in the Group's interests in subsidiaries)	0	0	0	0	0	0	0	-973	**-973**
Transfer to capital reserve	0	0	727		0	-727	0	0	**0**
Purchase of own shares	0	0	0	0	-255	0	-255	0	**-255**
Profit for the year	0	0	0	0		-73 815	-73 815	-331	**-74 145**
At 31 December 2008	**60 898**	**45 538**	**2 011**	**0**	**-255**	**-62 931**	**45 262**	**231**	**45 493**

Further information on share capital and share premium is presented in note 30.

[1] Dividends per share were declared as follows:

	EEK		EUR	
	2008	**2007**	**2008**	**2007**
In thousands				
Dividends declared	**37 160**	**25 430**	**2 375**	**1 625**
Number of shares outstanding on declaration on dividends	**95 284 150**	**67 784 150**	**95 284 150**	**67 784 150**
Dividends per share (in kroons and in euros)	**0,39**	**0,38**	**0,00**	**0,02**

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17-04-2009

Notes to the consolidated financial statements

1 Corporate information

These consolidated financial statements of Arco Vara AS and its subsidiaries and interests in jointly controlled entities as at and for the year ended 31 December 2008 were authorised for issue by the management board on 17 March 2009. Under the Commercial Code of the Republic of Estonia, the final approval of the annual report prepared by the management board and approved by the supervisory board rests with the shareholders' general meeting. The consolidated financial statements are part of the annual report, which is subject to approval by the shareholders, and they serve as a basis for adopting the profit allocation resolution. Shareholders may decide not to approve the annual report, which has been prepared by the management board and approved by the supervisory board, and may demand that a new annual report be prepared.
Arco Vara AS (the "Parent") is a limited company incorporated and domiciled in Estonia. At the end of 2008, Arco Vara AS, its subsidiaries and jointly controlled entities (the "Group") employed 396 people (2007: 664 people). The principal activities of the Group are described in note 5 and 6 "Segment reporting". In addition to Estonia, the Group operates in Latvia, Lithuania, Ukraine and Bulgaria.
The structure of Arco Vara Group as at 31 December 2008 is presented in note 38.

2 Statement of compliance and basis of preparation

The consolidated financial statements of Arco Vara AS and its subsidiaries and interests in jointly controlled entities have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The consolidated financial statements have been presented and submitted for approval in conformity with the requirements of the Estonian Accounting Act and the Commercial Code.
The functional and presentation currency of Arco Vara AS is the Estonian kroon (kroon, EEK). In compliance with the rules of Tallinn Stock Exchange, the financial statements are also presented in euro (EUR). The Estonian kroon is pegged to the euro at the rate of 15.6466 kroons to 1 euro. Therefore, the presentation of the financial statements in euros does not give rise to any exchange differences. All financial information has been rounded to the nearest thousand, except where otherwise indicated.
The consolidated financial statements have been prepared on a historical cost basis, unless otherwise indicated in note 4 "Summary of significant accounting policies" (e.g. certain investments, derivative financial instruments, investment properties and biological assets have been measured at fair value).

Basis of consolidation
The consolidated financial statements comprise the financial statements of Arco Vara AS and its subsidiaries, combined line by line, and the Group's interests in jointly controlled entities (joint ventures), recognised using proportionate consolidation. The financial statements of all Group entities coincide with the calendar year and are prepared using, in all material respects, uniform accounting policies and measurement basis. The accounting policies of foreign Group entities have been adjusted, where necessary, to ensure consistency with the policies adopted by the Group.
A subsidiary is an entity that is controlled by the Parent. Control is the power to govern the financial and operating policies of an entity under a statute or an agreement or by some other means. Control is presumed to exist when the Parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity.
A joint venture is a contractual arrangement whereby two or more parties (including the Parent) undertake an economic activity that is subject to joint control. Joint control exists when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.
The assets, liabilities, income, expenses and cash flows of subsidiaries and interests in joint ventures are consolidated from the date the control or joint control commences until the control or joint control ceases.
The Group's interest in a jointly controlled entity is recognised using proportionate consolidation — the Group's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is combined with similar items in the consolidated financial statements.
In preparing the consolidated financial statements, all receivables, liabilities, income, expenses, cash flows and unrealised gains and losses arising from transactions between the Parent and its subsidiaries are eliminated in full. The effect of transactions with jointly controlled entities is eliminated to the extent of the Group's share. Unrealised losses are eliminated only to the extent that there is no evidence of impairment.
A minority interest, i.e. the portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, is separately presented in the consolidated balance sheet (within equity) and the consolidated income statement.
Acquisitions of subsidiaries and interests in jointly controlled entities are accounted for by applying the purchase method. Under the purchase method, the acquirer's assets, liabilities and contingent liabilities ("net assets") are recognised at their fair values. The excess of the cost of the business combination over the Group's interest in the fair value of the acquirer's net assets is recognised as goodwill. If the Group's interest in the fair value of the acquirer's net assets exceeds the cost of the business combination, the Group reassesses the identification and measurement of the acquirer's assets, liabilities and

contingent liabilities and recognises any excess remaining after that reassessment (negative goodwill) immediately as income in the income statement. For subsequent measurement of goodwill, see policy "Goodwill" in note 4.
Acquisitions of minority interests are accounted for by recognising the difference between the book value of the share of the net assets acquired and the cost of the interest acquired as (positive or negative) goodwill. The net assets acquired are not re-measured to fair value (acquisitions of minority interests are not accounted for by applying the purchase method described in IFRS 3 *Business Combinations*). In case that the Group acquires a group of assets or net assets that does constitute a business, it allocates the cost of the group assets between the individual identifiable assets and liabilities in the group based their relative fair values at the acquisition date.
When an interest in a subsidiary or a jointly controlled entity is disposed of, the difference between the sum of the consideration received and the carrying amount of the Group's share in the subsidiary's or jointly controlled entity's assets, liabilities and goodwill is recognised immediately in the income statement, either as a gain in "Finance income" or a loss in "Finance expenses". If control ceases (e.g. the Group's interest decreases below half of the voting power) but influence does not cease, the remaining interest in the carrying amounts of the subsidiary's assets, liabilities and goodwill is classified either as an investment in an associate, an interest in a jointly controlled entity, or an investment in other financial assets.

3 Changes in accounting policies and presentation practice

Consolidated financial report is compiled on the basis of the principles of consistency and comparability, which means that the Group always applies the same accounting policies and presentation practices. The accounting policies and presentation practice are modified only in the event that this is required by new or amended International Financial Reporting Standards (IFRS) and interpretations thereof, or if the new accounting policy and/or presentation practice provides a more objective overview of the financial standing, financial results and cash flows of the Group.

a) Amended International Financial Reporting Standards, new International Financial Reporting Standards and interpretations provided by the International Financial Reporting Interpretations Committee (IFRIC)

The accounting policies and the presentation practice applied to this financial report are consistent with those applied in the previous year. Additionally the following new and revised standards have been adopted, which did not have any material effect on the financial results of 2008 and the information subject to disclosure.

- IFRIC 11 IFRS 2 "Group and Treasury Share Transactions";
- IFRIC 12 "Service Concession Agreements";
- IFRIC 13 "Customer Loyalty Programmes";
- IFRIC 14 IAS 19 "The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction";
- Amendments to IAS 39 and IFRS 7 "Reclassification of Financial Assets".

b) New International Financial Reporting Standards and interpretations, which have been published, but have not entered into effect yet

According to the opinion of the management the new or amended International Financial Reporting Standards and interpretations thereof, which were adopted but had not entered into effect by the time of preparing this financial report, and that the Group has not been using thus far, do not affect the value of the assets and liabilities as at 31 December 2008. The Group is applying the following standard and interpretations thereof from the date of their entry into effect:

- IAS 1 Revised Presentation of Financial Statements, effective for financial years beginning on or after 1 January 2009. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group is yet to decide whether to present one or two statements;

- IFRS 8 Operating Segments, effective for financial years beginning on or after 1 January 2009. IFRS 8 requires entities to disclose segment information based on the information reviewed by the entity's chief operating decision maker. The Group has determined that the operating segments disclosed in IFRS 8 will be the same as the business segments disclosed under IAS 14. The impact of this standard on other segment disclosures is still to be determined;

- IAS 23 "Borrowing Costs (revised)": shall be applied in respect of the reporting period commencing on 1 January 2009 or thereafter.

- IFRS 1 "First-time Adoption of International Financial Reporting Standards "and IAS 27 "Consolidated and Separate Financial Statements": shall be applied in respect of the reporting period commencing on 1 January 2009 or thereafter.

- IFRS 3R Business Combinations and IAS 27R Consolidated and Separate Financial Statements, effective for financial years beginning on or after 1 July 2009. IFRS 3R introduces a number of changes in the accounting for business combinations occurring after this date that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. IAS 27R requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary;

• IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation, effective for financial years beginning on or after 1 January 2009. The changes do not affect the accounting for put options of minority shareholders;

• IAS 39 "Financial Instruments: Recognition and Measurement – Eligible Hedge Items": shall be applied in respect of the reporting period commencing on 1 July 2009 or thereafter;

• IFRS 2 "Share-based Payment (revised)": shall be applied in respect of the reporting period commencing on 1 January 2009 or thereafter.

• IFRIC 15 "Agreements for the Construction of Real Estate": shall be applied in respect of the reporting period commencing on 1 January 2009 or thereafter;

• IFRIC 16 "Hedges of a Net Investment in a Foreign Operation"; shall be applied in respect of the reporting period commencing on 1 January 2009 or thereafter;

• IFRIC 17 "Distribution of Non-cash Assets to Owners": shall be applied in respect of the reporting period commencing on 1 January 2009 or thereafter;

• IFRIC 18 "Transfer of Assets from Customers": shall be applied in respect of the reporting period commencing on 1 January 2009 or thereafter.

c) Amendments to IFRSs

In May 2008 IASB issued the first collection of amended standards the purpose of which was to eliminate controversies, and clarification of wordings. The collection contains separate transitional provisions applicable to every standard, and most of the amendments shall be applied to reporting periods, which commence on 01 July 2009 or later. According to the opinion of the Group expects that these amendments have no material impact on the financial reports, except as indicated below.

- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Presentation of Financial Statements
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 Events after the Balance Sheet Date.
- IAS 16 Property Plant and Equipment
- IAS 18. Revenue
- IAS 19 Employee Benefits
- IAS 20 Accounting for Government Grants and Disclosure of Government Assistance
- IAS 23 Borrowing Costs
- IAS 27 Consolidated and Separate Financial Statements
- IAS 28 Investments in Associates
- IAS 29 Financial Reporting in Hyperinflationary Economies
- IAS 31 Interests in Joint Ventures
- IAS 34 Interim Financial Reporting
- IAS 36 Impairment of Assets
- IAS 38 Intangible Assets
- IAS 39 Financial Instruments: Recognition and Measurement
- IAS 40 Investment Property
- IAS 41 Agriculture

The amendment to IAS 40 Investment Property is particularly relevant to the Group. It revises the scope of IAS 40 such that property under construction or development for future use as an investment property is not longer classified as property, plant and equipment but as investment property from the beginning of construction or development. If fair value cannot be reliably determined, the investment under construction will be measured at cost until such time as the fair value can be determined or construction is complete.

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17.04.2009

4 Summary of significant accounting policies

Significant accounting judgements, estimates and assumptions

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses, and the disclosure of contingent assets and contingent liabilities.

Although estimates and underlying assumptions are reviewed on an ongoing basis and they are based on historical experience and expectations of future events that are believed to be reasonable under the circumstances, actual results may differ from the estimates.

In applying the Group's accounting policies, management has made the following judgements that have the most significant effect on the financial statements:

Classification of properties

Properties are classified as inventories, investment properties and items of property, plant and equipment (assets under construction) both on initial recognition and on any subsequent reclassification based on management's intentions regarding their further use. Realization of management's plans depends, among other factors, on resolutions adopted by other parties (e.g. changes in the intended purpose of land, approval of detailed plans, issuance of construction permits, etc). This lessens the accuracy of the classification.

Properties which are acquired for the development and subsequent sale of living environments, single residential buildings, or residential plots, and properties which are acquired for resale in the ordinary course of business are classified as inventories.

Properties which are held to earn operating lease rentals or for capital appreciation and properties which are held over an extended period for an undetermined future use are classified as investment property.

Properties which are being developed for future use as commercial or business environments that will be let under operating lease and commercial and business properties which are being extensively renovated are classified as investment properties only after the development or renovation is complete (the permit for use has been obtained). Until the development or renovation is complete, the properties are classified as items of property, plant and equipment (assets under construction).

Investment properties that are being redeveloped for continued use as investment properties are not temporarily transferred to property, plant and equipment (assets under construction).

Company as the lessor

Assets leased out under operating lease are recorded in the balance sheet pursuant to standard procedure, similarly to non-current assets. Leased-out assets are depreciated based on the depreciation principles applied by the company for assets of similar type. Operating lease payments are recorded during the rental period as income based on the straight-line method.

Estimation uncertainty

The estimates made by management are based on historical experience and the information available at the date the financial statements are authorised for issue. There is a risk that the estimates applied at the balance sheet date in respect of assets and liabilities and associated income and expenses need to be revised in the future. The key sources of estimation uncertainty that have a significant risk of causing material adjustments to the consolidated financial statements are discussed below.

Impairment of goodwill

The Group assesses whether goodwill arisen on the acquisition of subsidiaries and interests in jointly controlled entities may be impaired (i.e. whether the carrying amount of the goodwill exceeds its recoverable amount) at least annually. This assumes estimating the fair value (less costs to sell) or value in use of the cash-generating unit to which the goodwill has been allocated. Value in use is determined by estimating the future net cash flows to be derived from the cash-generating unit and by applying an appropriate discount rate to calculate the present value of those cash flows. At 31 December 2008, the carrying amount of goodwill was 11 397 thousand kroons (728 thousand euro). The corresponding figure for 2007 was 23 975 thousand kroons (1 532 thousand euro). Further information on the principles and results of impairment testing is provided in notes 4 and 23.

Carrying value of receivables

The Group's receivables include mostly receivables from construction division and given loans. As at 31.12.2008 total receivables amount to 96 263 thousand kroons (6 151 thousand euro). The corresponding figure for 2007 was 48 236 thousand kroons (3 083 thousand euro). Further details on risks that might affect the carrying values of receivables are disclosed in note 18.

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ERNST & YOUNG
17-04-2009

Estimates of net realisable value of inventories

The Group has several real estate objects classified as inventories. As at 31. December 2008 the management has performed net realisable value tests for all significant inventories and made the necessary write-downs. Further details on inventories are disclosed in note 19.

Fair value of investment property

At each reporting date, investment properties are measured at their fair values. In 2008, the fair values of investment properties were determined based on the valuations performed by qualified independent appraisers. Fair value is determined by reference to two basic techniques - the discounted cash flow method and the sales comparison method. In order to estimate a property's discounted cash flows, an appraiser has to forecast the property's future rental income (including rental per 1 m^2 and the occupancy rate) and operating expenses. In addition, to determine the present value of the future net cash flow, the appraiser has to apply a discount rate, which best reflects the time value of money and the risks specific to the asset. At 31 December 2008, the carrying amount of investment properties whose fair value was determined using the discounted cash flow method was 337 367 thousand kroons (21 562 thousand euro). The corresponding figure for 2007: 468 377 thousand kroons (29 935 thousand euro) . Further information on measuring the fair value of investment property is provided in note 21.

At 31 December 2008, the sensitivity of the carrying amounts of investment properties measured using the discounted cash flow method to the key valuation assumptions applied was as follows:

- a 1 percentage point increase in the discount rate would have caused a 19981 thousand kroon (1 277 thousand euro) decrease in the fair value of investment property (31 December 2007: a 28 828 thousand kroon (1 842 thousand euro) decrease);
- a 1 percentage point decrease in the discount rate would have caused a 21 751 thousand kroon (1 390 thousand euro) increase in the fair value of investment property (31 December 2007: a 31 560 thousand kroon (2 017 thousand euro) increase)
- a 5% decrease in the forecasted net operating cash flows would have caused a 16 843 thousand kroon (1 076 thousand euro) decrease in the fair value of investment property (31 December 2007: a 21 983 thousand kroon (1 405 thousand euro) decrease)
- a 5% increase in the forecasted net operating cash flows would have caused a 16 959 thousand kroon (1 077 thousand euro) increase in the fair value of investment property (31 December 2007: a 21 983 thousand kroon (1 405 thousand euro) increase)

Segment reporting

Segment reporting is based on the grouping of structural units for the Group's internal accounting and reporting purposes (management accounting and budgeting). The Group's primary reporting format is business segments. A business segment is a distinguishable component of the Group that is engaged in providing products or services that are different from those of other business segments, and which operates as an independent profit centre.

The Group's business segments comprise:

- Development. The development of residential and commercial environments and long-term investment in real estate.
- Service. Real estate brokerage, valuation and management and short-term investment in real estate.
- Construction. General and sub-contracting in the field of general construction and environmental engineering, and construction supervision.

Segment revenue is revenue that is directly attributable to a segment and the relevant portion of the Group's revenue that can be allocated to the segment on a reasonable basis, whether from sales to external customers or from transactions with other segments of the Group. Revenue arising from transactions with companies belonging to the same segment is eliminated.

Segment expense is expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of the Group's expense that can be allocated to the segment on a reasonable basis, including expenses relating to sales to external customers and expenses relating to transactions with other segments of the Group. Segment expense does not include finance expenses, the Group's general administrative expenses and other expenses that arise at the Group level. The costs incurred at the Group level are allocated to a segment only if they relate to the segment's operating activities and they can be directly attributed to the segment on a reasonable basis. Expenses arising from transactions with companies belonging to the same segment are eliminated.

Segment result is segment revenue less segment expenses.

Unrealised gains and losses arising from transactions between the Group's segments are not allocated to any segment but are presented in inter-segment eliminations. Unrealised gains and losses arising from transactions between the Parent and a segment which can be allocated to the segment on a reasonable basis are included in the segment result. Such gains and losses may include previously capitalised interest expense which upon the reclassification of assets accounted for under the cost model to assets accounted for under the fair value model is recognised as a fair value adjustment in the period in which the assets are reclassified.

Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on reasonable basis. Segment assets include, for example, current assets, investment properties, property, plant and equipment and intangible assets used in a segment's operating activities. If an asset's depreciation or amortisation expense is included in segment expenses, the asset is included in segment assets. Segment assets do not include assets used for the Group's general needs or which cannot be directly allocated to the segment. Assets shared by two or more segments are allocated to those segments if a reasonable basis for allocation exists.

Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities include, for example, trade and other payables, accrued expenses, advances received from customers, warranty provisions and other liabilities related to the segment's products and services. Segment liabilities do not include loans, finance leases, debt securities and other liabilities related to financing activities. Income tax liabilities are not included in segment liabilities either.

Unallocated items comprise revenue and expenses and assets and liabilities which are not directly related to any segment and therefore cannot be allocated to any segment.

The Group's secondary reporting format is geographical segments. At 31 December 2008, geographical segments comprised Estonia, Latvia, Lithuania, Ukraine and Bulgaria.

Foreign currency

All currencies other than the Estonian kroon (the functional currency of the Parent) are treated as foreign currencies. Transactions in foreign currencies are initially recorded at the foreign exchange rates of the Bank of Estonia ruling at the date of the transaction. Monetary assets (cash, cash equivalents and receivables) and monetary liabilities (loans and borrowings, payables and other liabilities) denominated in foreign currencies at the reporting date are retranslated to Estonian kroons at the Bank of Estonia exchange rates ruling at the balance sheet date. Foreign exchange gains and losses are recognised in the income statement in finance income and finance expenses respectively in the period in which they arise. Non-monetary items denominated in foreign currencies that are measured in terms of historical cost are translated using the Bank of Estonia exchange rates ruling at the dates of the initial transactions. Non-monetary items denominated in foreign currencies that are measured at fair value are translated using the Bank of Estonia exchange rates ruling at the date when the fair value was determined.

When the functional currency of a subsidiary or a jointly controlled entity differs from the Parent's functional currency (e.g. the functional currency of the Latvian entities is the Latvian lats, the functional currency of the Lithuanian subsidiary is the Lithuanian litas and the functional currency of the Ukrainian entities is the US dollar), the financial statements of the subsidiary or jointly controlled entity are translated for consolidation purposes using following exchange rates:

- the assets and liabilities of foreign subsidiaries and jointly controlled entities (including goodwill and fair value adjustments arising on acquisition) are translated at the exchange rates ruling at the balance sheet date
- the income and expenses, other changes in equity, and cash flows of foreign subsidiaries and jointly controlled entities are translated at the weighted average exchange rates for the period.

The exchange differences arising on translation, i.e. the differences between the rates ruling at the balance sheet date and the weighted average exchange rates are taken directly to equity and reported in "Other reserves". On the divestment of a foreign entity, the relevant amounts in "Other reserves" are transferred to profit or loss.

Revenue

Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be measured reliably.

Revenue from the sale of properties (real estate)

Sales of properties are recognised when all significant risks and rewards related to the properties have been transferred to the buyer and the Group has no obligation to perform significant additional work. In general, a sale is deemed to have occurred when the real right contract has been signed. Payments made by customers before the signature of the real right contract are recognised as deferred income.

Revenue from long-term service contracts

The revenue and expenses arising from long-term service contracts (including construction contracts) are recognised by reference to the stage of completion method. The stage of completion of a service is determined as the proportion that the costs incurred until the balance sheet date bear to the estimated total costs of the transaction. If the amount of progress billings as at the balance sheet date differs from the revenue determined by reference to the stage of completion method, the difference is recognised as a payable or a receivable.

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

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17.04.2009

Revenue from other services

Revenue from the rendering of other services arises on the rendering of the service. Revenue from brokerage services is recognised when the transaction has been completed. Rental income from investment properties is recognised on a straight-line basis over the lease term. Revenue and expenses from intermediation of utilities services (electricity, heat, water, etc. charges) are offset against the costs of purchasing those services.

Revenue from the sale of other goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer and the amount of revenue can be measured reliably.

Finance income

Interest income is recognised on an accrual basis using the effective interest rate method. Dividend income is recognised when the Group's right to receive payment is established.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, current accounts, demand deposits and short-term highly liquid investments which are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value, such as term deposits with a maturity of up to three months and shares in money market funds.

Financial assets

When a financial asset is recognised initially, it is measured at cost, which is the fair value of the consideration given for it plus any costs that are directly attributable to the acquisition of the asset, including fees and commissions paid to agents, advisers, brokers and dealers, as well as any non-recoverable levies, taxes and duties. Exceptions include transaction costs directly attributable to the acquisition of a financial asset at fair value through profit or loss which are recognised as an expense when incurred.

A regular way purchase or sale of financial assets is recognised using trade date accounting. The trade date is the date on which the Group commits itself to purchase or sell a financial asset (e.g. the date on which the agreement is signed). A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established by regulation or convention in the marketplace concerned.

Subsequent to initial recognition, financial assets are classified into different categories (see below) and the designation is re-evaluated at each financial year end. Financial assets whose reclassification is not permitted by IFRS are not reclassified. After initial recognition, financial assets are measured as follows:

1) financial assets at fair value through profit or loss – at their fair values;
2) held-to-maturity investments – at their amortised cost;
3) loans and receivables – at their amortised cost; and
4) available-for-sale financial assets – at their fair values or, in the case of equity instruments whose fair value cannot be measured reliably, at cost.

Financial assets measured at fair value

Financial assets that are measured at fair value are re-measured to fair value at each balance sheet date without any deduction for transaction costs that may be incurred on the sale or disposal of the asset. The fair values of listed securities are based on the closing prices of the securities and the official exchange rates of the Bank of Estonia ruling at the balance sheet date. The fair values of unlisted securities are determined based on all available information and by reference to comparison with the fair values of other instruments which are substantially the same and/or the discounted cash flow analysis.

A gain or loss arising from a change in the fair value of a financial asset is recognised in profit or loss (in "Finance income" and "Finance expenses" respectively), except for a gain or loss arising from a change in the fair value of an available-for-sale financial asset which is recognised directly in the revaluation reserve in equity. When an available-for-sale financial asset is derecognised or determined to be impaired, the cumulative gain or loss previously recognised in the revaluation reserve is removed from equity and recognised in profit or loss. In the case of impaired items, the amount of the cumulative loss that is removed from equity and recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

A gain and loss arising on the disposal of financial assets measured at fair value as well as the interest and dividends on these assets are recognised in the income statement (in "Finance income" and "Finance expenses").

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ERNST & YOUNG
17-04 2009

Loans and receivables and held-to-maturity investments

Loans and receivables, except those that the Group intends to sell in the near term, and held-to-maturity investments are measured at amortised cost using the effective interest method. The amortised cost is calculated taking into account any discount or premium on acquisition and any directly attributable transaction costs.

If there is objective evidence that an impairment loss on a financial asset carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised in the income statement. Impairment losses on financial assets related to operating activities are charged to administrative expenses and impairment losses on financial assets related to investing activities are charged to finance expenses.

Financial assets that are individually significant are assessed for impairment individually. Receivables overdue for 180 days or more are considered impaired and are expensed in full. If impairment becomes evident sooner, the asset is written down earlier.

If a receivable which has been written down is collected or any other event occurs which reverses an impairment loss which has been recognised, the reversal is recognised by reducing the expense item in which the impairment loss was initially recognised.

Interest income on loans and receivables and held-to-maturity investments is recognised in the income statement in "Finance income".

Financial assets measured at cost

A financial asset measured at cost is written down to its recoverable amount when the latter decreases below the asset's carrying amount. The recoverable amount of a financial asset measured at cost is the present value of its estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are recognised in "Finance expenses" and are not reversed.

A financial asset is derecognised when the Group's contractual rights to the cash flows from the financial asset expire or when the Group assumes the obligation to remit the cash flows from the financial asset without material delay to a third party to whom most of the risks and rewards associated with the financial asset are transferred.

Derivative financial instruments

The Group uses derivative financial instruments such as interest rate swaps to hedge the interest rate risk. Such derivative instruments are initially recognised at fair value at the date the contract is signed. Subsequent to initial recognition, the instrument is restated to fair value at each balance sheet date. Derivatives with a positive fair value are carried as assets and derivatives with a negative fair value are carried as liabilities. The fair value of the Group's existing interest rate swaps is determined by reference to the discounted cash flow method based on Reuters' estimates of 6-month EURIBOR.

Gains and losses arising from changes in the fair value of derivative financial instruments are recognised in "Finance income" and "Finance expenses" respectively except for the gains and losses on derivative instruments that qualify for hedge accounting. In the reporting and prior periods, the Group had no instruments that qualified for hedge accounting.

Treasury shares

Own equity instruments which are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss recognised in the income statement on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration is recognised in the other capital reserves.

Inventories

Finished goods and work in progress are initially recognised at their cost of conversion. The cost of conversion includes all direct and indirect production costs incurred in bringing the inventories to their present location and condition. Production overheads are allocated to the costs of conversion based on the normal capacity of the production facilities. Other inventories are initially recognised at cost. The cost of inventories includes all direct and indirect costs incurred in bringing the inventories to their present location and condition. The cost of properties carried as inventories includes, among other items, the borrowing costs (interest charges, amortisation of contract fees, etc) incurred in financing the construction of the properties. Borrowing costs are capitalised until the construction of the underlying asset is complete. Borrowing costs related to registered immovable properties and apartments treated as movable properties are added to the carrying amounts of the assets until a permit of use has been issued.

The cost of inventories is assigned using the weighted average cost formula except that the cost of registered immovable properties and apartments treated as movable properties is assigned by specific identification of their individual costs.

In the balance sheet, inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Inventory write-downs to net realisable value are recognised in the "Cost of sales" in the income statement.

Investment property

Investment property is property (land or a building or both) held to earn rentals or for capital appreciation, rather than for use in the production or supply of goods or services of for administrative purposes. In addition, investment property includes properties which are held over an extended period for an undetermined future use. Land and buildings acquired for development and resale are carried as inventories. Properties being constructed or developed for future use as investment properties (commercial buildings) and buildings treated as movable properties (commercial buildings under renovation) are carried as items of property, plant and equipment until their construction or development is complete.

An investment property is measured initially at its cost. Transaction costs are included in the initial measurement. Transaction costs that are directly attributable to acquisition include notary's fees, stamp duties, advisors' fees and other transaction costs. After initial recognition, investment properties are measured using the fair value model. The fair value of investment property reflects market conditions at the balance sheet date.

The fair value of investment property is determined based on the valuations performed by qualified independent appraisers. The following valuation methods are applied:

- Discounted cash flow analysis. In order to calculate the present value of a property's future cash flows, the appraiser has to forecast the property's future rental income (including rental per 1 m^2 and the occupancy rate) and operating expenses. Depending on the terms of the lease (whether and how easily the lease can be terminated by the lessee), the appraiser will base the projections on either the property's existing cash flows or the market's current average cash flows for similar properties. The present value of the future net cash flow should be found by applying a discount rate which best reflects the current market assessments of the time value of money and the risks specific to the asset. The discount rate should be selected based on the market's average capital structure, not asset structure. The discounted cash flow method is used to determine the value of properties that generate stable rental income.
- Sales comparison method. Under this method, the market value of a property is determined by reference to the price per square metre agreed in transactions performed with similar properties. This method is used to determine the value of properties which do not generate rental income but are held for development or capital appreciation. As the transactions selected for comparison are practically never identical with the property being valued, their prices are adjusted to reflect differences in time, location, size and detailed plan.

Gains and losses arising from changes in the fair value of investment property are recognised in the income statement in the period in which they arise (in "Other income" and "Other expenses" respectively).

An investment property is derecognised on disposal or when the property is permanently withdrawn from use and no future economic benefits are expected from its disposal. Gains and losses arising from the retirement or disposal of investment property are recognised in the income statement in the period of the retirement or disposal (in "Other income" or "Other expenses" respectively).

Transfers to and from investment property are made when there is a change in use (IAS 40.57). From the date of transfer, an asset is accounted for using the policies applied to the group of assets to which it has been transferred. For a transfer from investment property to inventories or property, plant and equipment, the property's deemed cost for subsequent accounting is its fair value at the date of transfer.

When an item of property, plant and equipment is transferred to investment property, any positive difference between the fair value and carrying amount of the property at the date of transfer is recognised in the revaluation reserve in equity. Any negative difference is recognised in the income statement in depreciation expense. Exceptions include assets under construction. When they are transferred to investment property, any difference (positive or negative) between fair value and carrying amount is recognised in the income statement in "Other income" or "Other expense" as appropriate. When a property is transferred from inventories to investment property, any difference between fair value and carrying amount is recognised in the income statement in "Other income" or "Other expense" as appropriate.

Biological assets

A living animal or plant is recognised as a biological asset when it is held to obtain economic benefits and its fair value or cost can be measured reliably. A biological asset is measured on initial recognition and at each balance sheet date at its fair value less estimated point-of-sale costs. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. If an active market exists for a biological asset, the quoted price in that market is used as a basis for determining the fair value of that asset. If an active market does not exist, the fair value of an asset is determined using the discounted cash flow method.

On measuring the quantity of plant production, the Group uses 15 sample areas of 77 cm x 77 cm (2 times 2 planting boxes) or 0.593 m^2 per each 100 m^2. All living plants on those areas are counted and the average of the sample areas calculated. Based on this information, the number of plants per 1 m^2 is identified and multiplied with the area of all planting boxes.

Biological assets are classified into consumable and bearer biological assets. All biological assets in the consolidated balance sheet are consumable biological assets which have been classified into mature and immature biological assets (see note 20). For the determination of fair value, biological assets are grouped according to significant attributes (age, species, and degree of maturity). For each group, a period of sale, sales revenue (based on the market prices prevailing during the season) and sales costs are estimated. Fair value is determined using the discounted cash flow method.

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ERNST & YOUNG
17.04.2009

A gain or loss arising from a change in the fair value of a biological asset is recognised in the income statement in operating profit in the period in which it arises.

Property, plant and equipment

Assets are recognised as items of property, plant and equipment when their cost exceeds 20 000 kroons and useful life extends beyond one year.

An item of property, plant and equipment is initially recognised at cost. The cost of an item of property, plant and equipment comprises its purchase price and any costs directly attributable to its acquisition. The cost of properties which are carried as items of property, plant and equipment includes borrowing costs (interest charges, amortisation of contract fees, etc) incurred in financing the construction of the properties. Capitalisation of borrowing costs commences at the date the construction of the asset begins and ceases when the asset is complete.

After recognition, an item of property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses.

If an item of property, plant and equipment consists of significant parts that have different useful lives, the parts are accounted for separately and assigned depreciation rates that correspond to their useful lives.

Subsequent expenditure on an item of property, plant and equipment (e.g. the costs of replacing a part of an item) is added to the carrying amount of the item, provided that it meets the following criteria: (a) it is probable that future economic benefits associated with the item will flow to the Group; and (b) the cost of the item can be measured reliably. The carrying amounts of the parts that are replaced are derecognised. All other subsequent expenditures related to property, plant and equipment are recognised as an expense in the period in which they are incurred.

Items of property, plant and equipment are depreciated on a straight-line basis. Each part of an item of property, plant and equipment is assigned a depreciation rate that corresponds to its useful life. The following annual depreciation rates are applied:

- Buildings and structures 2–18%
- Plant and equipment 8–20%
- Vehicles 15–25%
- Other equipment and fixtures 20–40%

Items of property, plant and equipment are depreciated until their residual value exceeds their carrying amount. The residual value is the estimated amount that the Group would currently obtain from the disposal of the asset if the asset were already of the age and in the condition expected at the end of its useful life.

Depreciation methods, depreciation rates and residual values are reviewed at each reporting date. When measurement bases are revised, the revisions are applied prospectively.

The carrying amounts of items of property, plant and equipment are reviewed for impairment when there is evidence that the carrying amount of an asset may exceed its recoverable amount. Impairment testing is described in more detail below (see the policy "Impairment of assets").

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of property, plant and equipment is recognised in the income statement in "Other income" or "Other expenses", as appropriate, in the period in which the item is derecognised.

Items of property, plant and equipment whose sale within the next 12 months is highly probable, are reclassified to non-current assets held for sale. Non-current assets held for sale are presented separately from other assets in the balance sheet and their depreciation is discontinued. A non-current asset held for sale is measured at the lower of its carrying amount and fair value less costs to sell.

Goodwill

Goodwill acquired in a business combination is initially measured at cost. Goodwill is the excess of the cost of the business combination over the Group's interest in the net fair value of the acquirer's identifiable assets, liabilities and contingent liabilities (net assets) recognised at the date of acquisition.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash-generating units or groups of cash-generating units that are expected to benefit from the synergies of the combination. Each cash-generating unit or group of units to which goodwill is allocated is not larger than a segment in the Group's primary reporting format.

Goodwill is assessed for impairment at least annually, at the end of the financial year, or more frequently if events or changes in estimates indicate that the carrying amount of goodwill may be impaired. Impairment is determined by measuring the recoverable amount of the cash-generating unit to which the goodwill has been allocated. An impairment loss is recognised when the recoverable amount of the cash-generating unit to which goodwill has been allocated is less than the carrying amount of the unit. Impairment losses on goodwill are recognised in "Administrative expenses" in the income statement.

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ERNST & YOUNG
17.04.2009

Other intangible assets

Other acquired intangible assets are initially measured at cost. Following initial recognition, intangible assets are measured at cost less any accumulated amortisation and any accumulated impairment losses.

Intangible assets are divided into assets with finite and indefinite useful lives. Intangible assets with finite useful lives are amortised on a straight-line basis over their estimated useful lives (generally three to six years). Amortisation expense is recognised in the income statement in the expense category consistent with the function of the underlying asset. The amortisation periods and amortisation methods of intangible assets with finite useful life are reviewed at each financial year end. Changes in the expected useful life of an asset and the pattern in which the asset's future economic benefits are expected to be consumed are accounted for as changes in accounting estimates and are applied prospectively.

Intangible assets with indefinite useful lives are not amortised. The useful life of an intangible asset with an indefinite useful life is reviewed annually to determine whether events and circumstances continue to support the indefinite life assessment for that asset. If not, the change is accounted for as a change in an accounting estimate on a prospective basis and the asset is subjected to amortisation.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the level of the cash-generating unit. The carrying values of intangible assets with finite useful lives are reviewed for impairment when there is evidence that the carrying value may not be recoverable. If an impairment test indicates that the recoverable amount of an intangible asset is lower than its carrying amount, the asset is written down to its recoverable amount. Impairment losses are recognised in the income statement similarly to amortisation expenses, i.e. they are grouped according to the use of the underlying assets. Impairment testing is described in greater detail in the section "Impairment of assets".

Impairment of assets

The Group assesses at each reporting date whether there is any indication that an asset may be impaired. If such an indication exists or at least once a year (if so required by IFRS), the Group measures the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down, either individually or as part of a cash-generating unit, to its recoverable amount. An asset's recoverable amount is the higher of the present value of its estimated future cash flows (value in use) and its fair value less costs to sell. In measuring value in use, the estimated cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where necessary, the assistance of independent experts is used. Impairment losses, including impairment losses for cash-generating units are recognised in the income statement in depreciation and amortisation expense in the period in which they are incurred.

If there is evidence that an impairment loss recognised in prior years no longer exists or has decreased, the impairment loss is reversed. Impairment losses and prevailing circumstances are reviewed at least annually at each reporting date. The increased carrying amount of an asset attributable to a reversal of an impairment loss may not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised. As an exception, an impairment loss recognised for goodwill is not reversed in a subsequent period.

Minority shareholders' put options

The three minority shareholders of the Group entities have effective put options, which grant the minority shareholders the right to sell, and the Group – the obligation to purchase the shares of stock or membership shares held by the minority shareholders. In the case of one shareholder agreement the option exercise price was the amount equalling the market value of the said shares. In the case of other shareholder agreement, the option exercise price was a pro rata share of the book value of the company's equity.

In compliance with IAS 32 paragraph 23, the Group recognised financial liabilities for the present values of the redemption amounts of the options. The liabilities are measured based on the market value (i.e. adjusted equity) or book value of the entities in which the minority shareholders have an interest at the balance sheet date, as appropriate in accordance with the contractual arrangements. Upon initial recognition, the minority shareholders' interests in the adjusted or book equity are recorded as current liabilities and adjustments to retained earnings. Subsequent gains and losses arising from changes in the carrying amounts of the financial liabilities are recognised in the income statement in "Finance income" and "Finance expenses" respectively.

As at 31.12.2008 the option provided by the shareholder agreement is effective.

Financial liabilities

All financial liabilities (trade and other payables, loans and borrowings, accrued expenses, bonds, and other short and long-term liabilities) are initially recognised at cost. The cost of a financial liability includes all transaction costs that are directly attributable to its acquisition. After initial recognition, financial liabilities are measured at amortised cost (except for financial liabilities held for trading which are measured at their fair value).

As a rule, the amortised cost of a short-term financial liability equals its nominal value. Therefore, short-term financial liabilities are stated in the balance sheet at the amount payable. Long-term financial liabilities are initially recognised at the fair value of the consideration received (less the transaction charges). Thereafter, they are measured at amortised cost using the effective interest rate method. Interest expenses on financial liabilities are recognised in "Finance expenses" in

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ERNST & YOUNG
12.04.2009

the income statement on an accrual basis except that interest expenses on financing the development of assets (properties carried as inventories, investment properties, and items of property, plant and equipment) are capitalised and added to the carrying amount of the asset from the date the development of the asset commences to the date the development is complete.

A financial liability is classified as current when it is due to be settled within 12 months after the balance sheet date or the Group does not have an unconditional right to defer settlement of the liability for more than 12 months after the balance sheet date. Financial liabilities which are due to be settled within 12 months after the balance sheet date are classified as current even if an agreement to refinance on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue. When a contract is breached on or before the balance sheet date with the effect that the liability becomes payable on demand, the liability is classified as current.

Financial liabilities are derecognised when the obligation under the liability is discharged, cancelled or expired.

Government grants

Government grants related to income are recognised as income over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. A government grant that becomes receivable as compensation for expenses or losses already incurred with no future related costs is recognised as income of the period in which it becomes receivable. Government grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attaching to them and the grants will be received. Potential obligations related to government grants are recognised as provisions or disclosed as contingent liabilities.

An asset acquired with a government grant is recognised at cost less the amount of the grant received (the net method). An asset acquired with a government grant is depreciated over the useful life of the asset.

Provisions and contingent liabilities

A provision is recognised only when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Promises, guarantees and other commitments that may transform into obligations under certain circumstances (which have not yet occurred) are disclosed as contingent liabilities in the notes to the financial statements.

Present obligations arising from past events which according to management's judgement will not realise or cannot be measured reliably are also disclosed as contingent liabilities.

Leases

A lease that transfers substantially all the risks and rewards incidental to ownership of the leased asset to the lessee is classified as a finance lease. All other leases are classified as operating leases.

Finance leases related to assets acquired are recognised as assets and liabilities at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Assets acquired with finance lease are depreciated over the shorter of the lease term and the useful life of the asset. Assets leased out under a finance lease are recognised in the balance sheet and presented as a receivable at an amount equal to the net investment in the lease. Lease payments made are apportioned between finance expense and the reduction of the outstanding liability and lease payments received are apportioned between finance income and repayment of the principal. A constant periodic rate of interest is applied throughout the lease term.

Assets subject to operating leases are recognised in the lessor's balance sheet. Operating lease receipts and payments are recognised as income and expense respectively on a straight-line basis over the lease term.

Statutory capital reserve

According to the Commercial Code, the statutory capital reserve has to amount to at least 10% of the Parent's share capital and the Parent has to transfer at least 5% of its net profit for the financial year to the capital reserve until the required level has been achieved. The capital reserve may not be distributed as dividends but it may be used for covering accumulated losses if the latter cannot be covered with unrestricted equity, and for increasing share capital through a bonus issue.

Income tax

Income tax assets and liabilities and income tax expense and income comprise current and deferred items. Current tax is recognised as a short-term asset or liability and deferred tax is recognised as a long-term asset or liability.

<u>Parent company and subsidiaries and jointly controlled entities registered in Estonia</u>

Pursuant to the Estonian Income Tax Act, companies do not have to pay income tax on their earnings (profit for the financial year). Instead, income tax is levied on profit distributions (dividends). From 31 December 2008 the tax rate is

21/79 of the amount distributed as the net dividend. Income tax resulting from payment of dividends is recognised in the income statement as expense upon declaration of dividends (emergence of the payment obligations).

As a result of the specific nature of the taxation system Estonian registered entities will not incur deferred income tax claims or liabilities. The contingent income tax liability, which would arise on the distribution of retained earnings as dividends, is not recognised in the balance sheet. The maximum income tax liability, which would arise if all of the unrestricted equity were distributed as dividends, is disclosed in Note 31.

Latvian, Lithuanian, Ukrainian, Bulgarian and Romanian subsidiaries and jointly controlled entities

In Latvia, Lithuania, Ukraine, Bulgaria and Romania the profit earned by companies is subject to income tax. The tax rate is 15% in Latvia and Lithuania, 25% in Ukraine, 10% in Bulgaria and 16% in Romania. Taxable income is identified by adjusting profit before tax for the temporary and permanent differences permitted by the local tax laws.

In the case of foreign subsidiaries, deferred income tax assets and deferred income tax liabilities are recognised for all temporary differences between the carrying amounts and tax bases of assets and liabilities. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised

Investments in subsidiaries and jointly controlled entities in the Parent's unconsolidated financial statements presented in accordance with the Estonian Accounting Act

The Parent's unconsolidated primary financial statements (note 39) represent supplementary information which is presented in accordance with the Estonian Accounting Act and they do not constitute separate financial statements as defined in IAS 27.

In the Parent's unconsolidated primary financial statements, investments in subsidiaries and jointly controlled entities are measured using the cost model. This means that the investment is initially recognised at cost, which is considered equal to the fair value of the consideration given for it, and thereafter measured at cost less any impairment losses.

Investments are tested for impairment at each financial year end or whenever there is any indication that an investment may be impaired (see policy "Impairment of assets"). Impairment losses are recognised in "Finance expenses" in the income statement.

Dividends received and receivable from subsidiaries and jointly controlled entities are recognised in "Finance income" when the right to receive payment has been established. The dividends distributed from the retained earnings accumulated by a subsidiary or jointly controlled entity before the date of acquisition are not recognised as income. Instead, such dividends are recognised as a reduction of the investment.

5 Segment reporting by business segments

The Group's business segments comprise:

Service - real estate brokerage, valuation and management and short-term investment in real estate

Development - development of residential and commercial environments and long-term investment in real estate

Construction - general and sub-contracting in the field of general construction and environmental engineering, and construction supervision

Inter-segment transactions are performed on an arm's length basis and priced similarly to external transactions. A major portion of inter-segment transactions is performed by the Construction segment and the Service segment who supply the Development segment with construction and brokerage services. On the supply of construction services, the Construction segment adds a 2.5-7.2% profit margin in Estonia and a 12% profit margin in Latvia. The price of brokerage services is 1-3% of the cost of the brokered property in all markets.

	EEK		EUR	
Revenue and other income	**2008**	2007	**2008**	2007
In thousands				
Service	**104 106**	**139 621**	**6 654**	**8 924**
External revenue	93 708	115 184	5 989	7 362
Other external income	1 817	8 588	76	549
Inter-segment revenue and other income	9 211	15 849	589	1 013
Development	**246 375**	**566 260**	**15 746**	**36 191**
External revenue	212 569	418 372	13 586	26 739
Other external income	29 109	133 746	1 860	8 548
Inter-segment revenue and other income	4 697	14 142	300	904
Construction	**416 774**	**425 484**	**26 637**	**27 193**
External revenue	353 504	193 631	22 593	12 375
Other external income	346	44	22	3
Inter-segment revenue and other income	62 914	231 809	4 021	14 815
Eliminations	**-76 822**	**-264 087**	**-4 911**	**-16 879**
Total revenue and other income	**690 423**	**867 278**	**44 125**	**55 429**

For identification purposes only
ERNST & YOUNG
17.04.2009

Operating profit	EEK 2008	EEK 2007	EUR 2008	EUR 2007
In thousands				
Service	**-47 884**	**-16 540**	**-3060**	**-1 057**
Including depreciation and amortisation	- 1 646	-1 575	-105	-101
Including recognition of negative goodwill as income and impairment losses on goodwill	-4 884	0	-312	0
Including change in fair value of investment property	-4 641	7 000	-297	447
Including impairment losses on property, plant and equipment	-402	0	-26	0
Development	**-985 082**	**161 988**	**-62 958**	**10 353**
Including depreciation and amortisation	-695	-948	-44	-61
Including recognition of negative goodwill as income and impairment losses on goodwill	0	283	0	18
Including impairment losses on property, plant and equipment	-1 192	18 778	-76	1 200
Including value decrease of inventories	-434 272	0	-27 755	0
Including change in fair value of investment property	-550 988	52 874	-35 215	3 379
Construction	**6 274**	**16 926**	**401**	**1 082**
Including depreciation and amortisation	-2 239	-1 789	-143	-114
Including recognition of negative goodwill as income and impairment losses on goodwill	-4 008	0	-256	0
Eliminations	**-2 581**	**-16 455**	**-165**	**-1 052**
Unallocated expenses	**-20 444**	**-42 861**	**- 1 307**	**-2 739**
Including depreciation and amortisation	-1 481	-821	-95	-52
Including impairment losses on property, plant and equipment	-6 264	0	-400	0
Total operating profit	**-1 049 717**	**103 058**	**-67 089**	**6 587**
Including depreciation, amortisation and impairment losses (notes 8, 10)	-6 061	-5 133	-387	-328
Including recognition of negative goodwill as income and impairment losses on goodwill (note 10)	-8 892	283	-256	18
Including impairment losses on property, plant and equipment (note 11)	- 7 858	18 778	-76	1 200
Including value decrease of inventories (note 11)	-434 272	0	-27 755	0
Including change in fair value of investment property and biological assets (note 11)	-555 629	59 874	-35 512	3 826

Assets As at 31 December	EEK 2008	EEK 2007	EUR 2008	EUR 2007
In thousands				
Service	**21 195**	63 600	**1 355**	4 065
Development	**1 619 595**	2 395 424	**103 511**	153 095
Construction	**101 633**	126 767	**6 496**	8 102
Eliminations	-146 758	-83 558	-9 380	-5 340
Unallocated assets	374 927	1 061 808	23 962	67 862
Total assets	**1 970 592**	**3 564 041**	**125 944**	**227 784**

Liabilities As at 31 December	EEK 2008	EEK 2007	EUR 2008	EUR 2007
In thousands				
Service	**4 784**	25 260	**306**	1 614
Development	**126 984**	122 195	**8 116**	7 810
Construction	**35 135**	102 153	**2 246**	6 529
Eliminations	-38 238	-63 555	-2 444	-4 062
Unallocated liabilities	1 130 154	1 448 416	72 229	92 573
Total liabilities	**1 258 819**	**1 634 469**	**80 453**	**104 464**

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17.04.2009

6 Segment reporting by geographical segments

Revenue by customer's location and business segments	Service		Development		Construction		Eliminations		Total	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
In thousands EEK										
Estonia	50 019	74 218	147 621	317 422	184 932	364 422	-64 222	-187 651	318 350	568 411
Latvia	21 842	31 097	71 034	73 443	231 486	102 437	-2 533	-67 522	321 829	139 455
Lithuania	5 750	6 374	0	200	0	0		-49	5 750	6 525
Ukraine	8 633	8 182	0	0	0	0		0	8 633	8 182
Bulgaria	7 722	9 160	40	26	0	0	-3 036	-6 636	4 726	2 550
Romania	1 623	2 332	504	0	0	0		0	2 127	2 332
Eliminations	-865	-267	0	0	0	0		0	-865	-267
Total revenue	**94 724**	**131 096**	**219 199**	**391 091**	**416 418**	**466 859**	**-69 791**	**-261 858**	660 550	**727 188**

Revenue by customer's location and business segments	Service		Development		Construction		Eliminations		Total	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
In thousands EUR										
Estonia	3 197	4 743	9 435	20 287	11 819	23 291	-4 105	-11 993	20 346	36 328
Latvia	1 396	1 987	4 540	4 694	14 795	6 547	-162	-4 315	20 569	8 913
Lithuania	367	407	0	13	0	0	0	-3	367	417
Ukraine	552	523	0	0	0	0	0	0	552	523
Bulgaria	494	585	3	2	0	0	-194	-424	302	163
Romania	104	149	32	0	0	0	0	0	136	149
Eliminations	-55	-17	0	0	0	0	0	0	-55	-17
Total revenue	**6 055**	**8 377**	**14 010**	**24 996**	**26 614**	**29 838**	**-4 461**	**-16 735**	42 218	**46 476**

Assets by geographical location AS at 31 December	EEK		EUR	
	2008	2007	2008	2007
In thousands				
Estonia	**999 969**	1 771 908	**63 910**	113 246
Latvia	**278 406**	274 834	**17 793**	17 565
Lithuania	**16 800**	39 705	**1 074**	2 538
Ukraine	**1 213**	727	**78**	46
Bulgaria	**514 438**	413 797	**32 879**	26 446
Romania	**0**	7 188	**0**	459
Eliminations	0	-5 926	0	-379
Unallocated assets	159 766	1 061 808	10 212	67 863
Total assets	**1 970 592**	**3 564 041**	**125 946**	**227 784**

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12.04.2009

7 Changes in structure of Arco Vara Group

7.1 Scope of consolidation

	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	Total
Subsidiaries							
At 31 December 2007	16	8	3	2	3	2	**34**
Acquisitions	1	-	-	-	-	-	**1**
Disposals	-2	-2	-1	-	-	-1	**-6**
At 31 December 2008	**15**	**6**	**2**	**2**	**3**	**1**	**29**
Interests in jointly controlled entities							
At 31 December 2007	17	3	0	0	0	0	**20**
Acquisitions	-	-	-	-	-	-	**-**
Disposals	-2	-1	-	-	-	-	**-3**
At 31 December 2008	**15**	**2**	**0**	**0**	**0**	**0**	**17**
Associates (not consolidated)							
At 31 December 2007	1	-	-	-	-	-	**1**
Acquisitions	-	-	-	-	-	-	**-**
Disposals	-	-	-	-	-	-	**-**
At 31 December 2008	**1**	**-**	**-**	**-**	**-**	**-**	**1**

At 31 December 2008, the Group's consolidated entities broke down between countries as follows: 30 in Estonia (2007: 33), 8 in Latvia (2007: 11), 2 in Lithuania (2007: 3), 2 in Ukraine (2007: 2), 3 in Bulgaria (2007: 3) and 1 in Romania (2007: 2)

In the 12 months of the year 2008 the total number of consolidated entities decreased by nine, incl. one subsidiary was merged with another company of the Group, one subsidiary was acquired (Note 7.3) and three subsidiaries and two jointly controlled entities were sold (Note 7.2).

The structure of Arco Vara Group is presented in note 38.

<u>The effect of interests in jointly controlled entities on the consolidated income statement and balance sheet:</u>

	EEK		EUR	
As at 31 December or for the year	**2008**	2007	**2007**	2007
In thousands				
Revenue and other income	43 662	140 540	2 791	8 982
Expenses	-14 458	-69 278	-924	-4 428
Finance income	19 788	9 149	1 265	585
Finance expenses	-65 814	-45 802	-4 206	-2 927
	0			
Current assets	176 657	228 814	11 290	14 624
Non-current assets	423 662	769 323	27 077	49 169
Current liabilities	12 627	150 908	807	9 645
Non-current liabilities	250 525	337 916	16 011	21 597

The most significant jointly controlled entities include Tallinna Olümpiapurjespordikeskus AS (owns a property at Regati pst 1, Tallinn), Arco HCE OÜ (owns the Ahtri 3 development project in Tallinn) and Floriston Grupp OÜ (owns a number of development projects in Tallinn).

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ERNST & YOUNG
17-04.2009

Companies belonging to Arco Vara Group:

The company	Domicile	Group's ownership interest 31.12.2008	31.12.2007
%			
Service segment			
Subsidiaries			
Arco Real Estate EOOD	Bulgaria	100	100
Arco Real Estate AS	Estonia	100	100
Arco Rumeenia Valdused OÜ	Estonia	merged	100
Arco Ukraina Valdused OÜ	Estonia	75	75
Arco Vara Kinnisvarabüroo	Estonia	100	100
Adepto SIA[1]	Latvia	80	80
Arco Real Estate SIA	Latvia	80	80
Arco Real Estate UAB	Lithuania	sold	80
Arco Real Estate Consulting SRL[1]	Romania	sold	100
Arco Neruhomist TOV[1]	Ukraine	75	75
Interests in jointly controlled entities			
AVEC Asset Management OÜ	Estonia	sold	50
Development segment			
Subsidiaries			
Arco Invest EOOD	Bulgaria	100	100
Arco Project EOOD[1]	Bulgaria	100	100
Arco Bulgaaria OÜ	Estonia	100	100
Arco Investeeringute AS	Estonia	100	100
Arco Vara Kinnistute AS	Estonia	100	100
Arco Vara Puukool OÜ	Estonia	100	100
Arco Vara Riia Valdused OÜ	Estonia	100	100
Kerberon OÜ	Estonia	100	83,4
Kolde AS	Estonia	100	89,3
Pärnu Turg OÜ	Estonia	100	100
Waldrop Investments OÜ	Estonia	100	100
Wilson Kinnisvara OÜ	Estonia	100	100
AD Saulkrasti SIA[1]	Latvia	63	50,4
Arco Development SIA	Latvia	80	80
Rasmussen Invest SIA[1]	Latvia	closing	80
Ulmana Gatves Nami SIA[1]	Latvia	100	80
Vidus Nams SIA (closing)[1]	Latvia	closing	100
Arco Invest UAB	Lithuania	100	100
Arco Capital Real Estate SRL	Romania	100	100
Arco Investments TOV	Ukraine	75	75
Interests in jointly controlled entities			
Arco HCE OÜ	Estonia	50	50
Arco Vara Arenduse OÜ	Estonia	50	50
Arco Vara Saare Kinnistud OÜ	Estonia	50	50
Arco Ärikeskus OÜ	Estonia	50	50
Chalwell OÜ[1]	Estonia	50	50
Floriston Grupp OÜ	Estonia	50	50
Hopson Capital OÜ[1]	Estonia	50	50
Kastner Grupp OÜ[1]	Estonia	50	50
Koduküla OÜ	Estonia	50	50
Noland Grupp OÜ[1]	Estonia	50	50
Pärnu Elumaja OÜ	Estonia	50	50

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ERNST & YOUNG
17.04.2009

The company	Domicile	Group's ownership interest 31.12.2008	31.12.2007
%			
Redman Invest OÜ[1]	Estonia	50	50
Snowden OÜ[1]	Estonia	50	50
Steadman OÜ[1]	Estonia	50	50
Tallinna Olümpiapurjespordikeskus AS	Estonia	50	50
Varamaad Kinnisvara OÜ[1]	Estonia	33,4	33,4
Bišumuižas Nami SIA	Latvia	40	40
Plavnieku Centrs SIA[1]	Latvia	sold	40
Sporting Riga SIA[1]	Latvia	40	40
Associate			
Gilmor Grupp OÜ	Estonia	20	20
Construction segment			
Subsidiaries			
Arco Ehitus OÜ	Estonia	100	100
Tallinna Linnaehituse AS	Estonia	sold	80
Arco Construction SIA	Latvia	55	55

[1] The Group has an interest in the company through a subsidiary or a jointly controlled entity.

7.2 Disposals of interests in subsidiaries and jointly controlled entities

In 2008, the Group disposed of interests in the following companies:

Company	% Interest disposed of by the Group	EEK Sales price	EEK Gain or loss on disposal (notes 12, 13)	EUR Sales price	EUR Gain or loss on disposal (notes 12, 13)
In thousands					
Subsidiaries					
Arco Real Estate UAB[1]	100	1	-3 170	0	-203
Arco Real Estate Consulting SRL[2]	100	1	4 487	0	287
Divestment of shares in Tallinna Linnaehituse AS - acquisition of shares in Kolde AS and Kerberon OÜ[3]	80	12 943	- 1 558	827	-100
Jointly controlled entities					
Plavenieku Centrs SIA[4]	50	11 132	-3 047	711	-194
AVEC Asset Management AS[5]	50	35 708	-38 007	2 282	-2 428
Total		**59 785**	**-41 295**	**3 820**	**-2 638**

[1] On 4 December 2008 the Group disposed of its interest in the company IKAS Projekt UAB (former business name Arco Real Estate UAB)
[2] On 20 December 2008 the Group executed a contract of purchase and sale of 100% of the ordinary shares of S.C.L-Base Project S.R.L (former business name Arco Real Estate Consulting SRL) that was notarised in Romania on 22.01.09. The transaction is recognised in 2008.
[3] Note 7.4
[4] On 5 December 2008 the Group disposed of its interest in the jointly controlled entity Plaveniku Centers SIA. The sales price of the stake was 11 132 thousand kroons (711 thousand euros). The buyer of the shares was Plavenieku Centrs SIA itself.
[5] On 20 June 2008 the Group disposed of its interest in the jointly controlled entity AVEC Asset Management AS. The sales price of the stake consisted of an immediate payment of 35 708 thousand kroons (2 282 thousand euros), and deferred payment equalling 25% of the amount payable upon dissolution of Explorer Property Fund AB. According to the assessment of the management board of the Group the value of the said claim as at 31.12.08 amounts to 0 kroons (0 euros) (Note 12). In accordance with the contract of sale of AVEC Asset Management AS the Group shall retain control over the assets, liabilities and equity of the fund until disbursements of the fund.

In 2007, the Group disposed of interests in the following companies:

Company	% Interest disposed of by the Group	EEK Sales price	EEK Gain or loss on disposal (notes 12, 13)	EUR Sales price	EUR Gain or loss on disposal (notes 12, 13)
In thousands					
Subsidiaries					
Arco HCE OÜ[1]	50	22,711	-2,981	1,451	-191
Arco Capital TOV	75	2,726	4,923	174	315
Bišumuižas Nami SIA and Sportings Riga SIA[2]	40	120,291	118,491	7,688	7,573
Jointly controlled entities					
Kramer Kinnisvara OÜ	50	2,311	2,119	148	136
Cromer Trade OÜ[3]	50	2,400	0	153	0
Barrow Investments OÜ[3]	50	1,214	0	78	0
Castleberry OÜ[3]	50	123	0	8	0
Dreilini-Ulbroka-1 SIA	40	22	0	1	0
Varamaad Kinnisvara OÜ[4]	16.6	8,650	8,531	553	545
Home Service SIA	40	2	0	0	0
Total		**160,450**	**131,083**	**10,254**	**8,378**

[1] At the beginning of 2007, Arco Vara AS disposed of a 50% stake in the subsidiary Arco HCE OÜ. In addition to the sales price, the buyer settled 50% of Arco Vara AS' receivables from the subsidiary, i.e. 106 188 thousand kroons (6 787 thousand euros). After the disposal of the interest, the share capital of Arco HCE OÜ was increased by 20 thousand kroons (one thousand euros). The par value of the share of either shareholder was increased in proportion to their ownership interest. Shareholders paid for the increase with share premium of 73 829 thousand kroons (4 719 thousand euros) in aggregate. The Group's contribution was 72 839 thousand kroons (4 655 thousand euros).

The direct costs of disposing of the 50% interest in Arco HCE OÜ were 2 360 thousand kroons (150.8 thousand euros).

[2] On 18 May 2007, the Group entered into an agreement with SIA Linstow Baltic for the disposal of a 40% stake in Bišumuiža Nami SIA. In compliance with the terms of the transaction, in August 2007 Bišumuiža Nami SIA paid Arco Vara AS and the minority shareholder of Sportings Riga SIA 19 220 thousand euros (300 728 thousand kroons) for the acquisition of the Group's subsidiary Sportings Riga SIA. After the transaction, the Group's subsidiary Arco Investeeringute AS owns 40% of the shares in Bišumuiža Nami SIA and the investments in Bišumuiža Nami SIA and Sportings Riga SIA are classified as interests in jointly controlled entities.

[3] In the first half of 2007, the Group disposed of its interests in jointly controlled entities Cromer Trade OÜ, Barrow Investments OÜ and Castleberry OÜ. The entities were project companies which held properties carried as inventories. Therefore, the disposal of the interests has been recognised in revenue in the income statement and in operating cash flows in the cash flow statement.

[4] The sales price charged for the disposal of a 16.6% interest in Varamaad Kinnisvara OÜ of 8 650 thousand kroons (553 thousand euros) was offset against the Group's liabilities to the acquirer.

The effect of the disposals on the Group's assets, liabilities and equity was as follows:

Effect of the disposal of subsidiaries on the Group's assets and liabilities	EEK 2008	EEK 2007	EUR 2008	EUR 2007
In thousands				
Cash and cash equivalents	-159	120 953	-10	7 730
Other current assets	-1 555	-2 489	-99	-159
Non-current receivables	-112	49 322	-7	3 152
Investment property (note 21)	0	-192 500	0	-12 303
Property, plant and equipment (note 22)	-1 577	-6 801	-101	-435
Intangible assets (note 23)	-110	0	-7	0
Current loans and borrowings	-5 163	-62 509	-330	-3 995
Other current liabilities	-2 878	-46 395	-184	-2 965
Non-current loans and borrowings	-9 231	49 322	-590	3 152

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ERNST & YOUNG
12.04.2009

Effect of the disposal of interests in jointly controlled entities on the Group's assets and liabilities	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Cash and cash equivalents	-19 118	-53	-1 222	-3
Other current assets	-18 394	-487	-1 176	-31
Inventories (note 19)	-13 143	-22 707	-840	-1 451
Property, plant and equipment (note 22)	-340	-96	-22	-6
Intangible assets (note 23)	-4 209	0	-269	0
Current loans and borrowings	0	-2 385	0	-152
Other current liabilities	-9 511	-330	-608	-21
Non-current loans and borrowings	0	-11 213	0	-717

7.3 *Business combinations*

Business combinations in 2008

Acquisition of an interest in the construction company Tempera Ehitus OÜ

On 2 April 2008, the Group acquired a 55% stake in the construction company Tempera Ehitus OÜ. Initial acquisition cost of the shares was 6 300 thousand kroons (403 thousand euros), of which 2 100 thousand kroons (134 thousand euros) was paid at the signing of the purchase agreement. According to the agreement, if Tempera Ehitus OÜ makes losses for three consecutive years after the acquisition, the Group is not under an obligation to pay the rest of the acquisition price as long as accumulated profit brakes even. The final acquisition cost of Tempera Ehitus OÜ was 2 100 thousand kroons (134 thousand euros).

The cost of acquisition has been allocated to the net assets acquired and goodwill as follows:

	EEK	EUR
In thousands		
Cost	**2 100**	134
Fair value of net assets acquired [1]	1 468	94
Goodwill (note 23)	632	40

[1] At the date of acquisition, the fair values of the assets, liabilities and net assets of Tempera Ehitus OÜ were equal to their carrying amounts.

The goodwill acquired in the business combination represents mainly the benefits arising from the customer base of Tempera Ehitus OÜ and the entity's relations with potential customers which allow the Group to enter into a larger number of profitable sales contracts than could have been achieved without the acquisition of Tempera Ehitus OÜ. In 2008 financials the write down of the acquisition cost of Tempera Ehitus OÜ is 2 100 thousand kroons (134 thousand euros).

The acquisition cost is distributed to 55% of assets and liabilities of Tempera Ehitus OÜ as follows:

	EEK	EUR
In thousands		
Cash	326	21
Receivables and prepayments	5 031	322
Inventories	124	8
Property, plant and equipment (note 15)	1 440	92
Goodwill (note 16)	632	40
Liabilities	-5 453	-349
Cost	**2 100**	**134**

For identification purposes only
ERNST & YOUNG
17-04. 2009

Termination of Tempera Ehitus OÜ

Tempera Ehitus OÜ was declared bankrupt on 26 February 2009. The trustee in bankruptcy established that the solvency problems were caused by the mistakes made by the management of Tempera Ehitus OÜ, by taking on disproportionate contracts, excessive optimism in making business plans during the period of rapid economic growth and changed business environment. For these reasons the Group refused making any additional investments to the company. Further information is presented in Note 37.

It was found during auditing that a fair assessment of the assets and liabilities of Tempera Ehitus OÜ is not possible and based on this, the management decided to not consolidate Tempera Ehitus OÜ.

Sale of jointly controlled entities

On 1 April 2008 an entity jointly controlled by the Group disposed of its 100% interest in its subsidiary Hopson Capital OÜ. The sales price of the stake was 700 thousand kroons (45 thousand euros). The said entity was a project entity, holding a registered immovable, recognised as stocks, and therefore the sale of the jointly controlled entity is recognised in the income statement as sales revenue and in the cash flow statement – as operating cash flow.

Business combinations in 2007

On 11 January 2007, the Group acquired a 55% stake in the Latvian construction company Arco Construction SIA for 4 303 thousand kroons (275 thousand euros); 1 945 thousand kroons (124 thousand euros) of the purchase price was settled in 2007 in cash and the rest will be settled within two years by March 2010. The liability does not bear any interest. Therefore the liability and the cost of the acquisition have been discounted to 4 070 thousand kroons (260 thousand euros). At the end of 2008, the balance was 1 442 thousand kroons (92 thousand euros).

The cost of acquisition was allocated to net assets acquired and goodwill as follows:

In thousands	EEK	EUR
Cost of acquisition	**4 070**	260
Fair value of net assets acquired[1]	710	45
Goodwill (note 23)	3 360	215

[1]At the date of acquisition, the fair values of the assets, liabilities and net assets of Arco Construction SIA equalled their carrying amounts.

The goodwill arisen on acquisition is primarily related to the customer base of Arco Construction SIA and the relations between Arco Construction SIA and potential customers which allow performing more profitable sales transactions in subsequent periods than the Group could have performed without the acquisition of Arco Construction SIA. The customer base and customer relations have not been recognised as separate intangible assets because at the date of acquisition long-term sales contracts had not been signed and, accordingly, the fair value of the relations could not have been measured reliably.

The cost of acquisition was allocated to the assets and liabilities of Arco Construction SIA as follows:

In thousands	EEK	EUR
Cash	179	11
Receivables and prepayments	3 239	207
Inventories	559	36
Property, plant and equipment (note 22)	382	24
Goodwill (note 23)	3 360	215
Liabilities	-3 649	-233
Cost of acquisition	**4,070**	**260**

The Group's consolidated financial statements for 2007 comprise Arco Construction SIA's revenue and expenses for twelve months of 2007 and assets and liabilities as at 31 December 2007. Arco Construction SIA's revenue for 2007 accounted for 37 664 thousand kroons (2 407 thousand euros) of the Group's consolidated revenue for 2007 and the entity's impact on the Group's net profit for 2007 was negative to the extent of -873 thousand kroons (-56 thousand euros). The negative effect on net profit resulted mainly from the elimination of the Latvian entity's intra-group profits arisen in connection with the Bishumuizas I project.

For identification purposes only
ERNST & YOUNG
17.04.2009

In October 2007, the Group acquired the remaining 50% of the shares in the jointly controlled entity Arco Rumeenia Valdused OÜ, taking its ownership interest in Arco Rumeenia Valdused OÜ and Arco Real Estate Capital SRL to 100%. The cost of acquisition was allocated to net assets acquired and goodwill as follows:

	EEK	EUR
In thousands		
Cost of acquisition	**20**	1
Fair value of net assets acquired	-2 438	-156
Goodwill (note 23)	2 458	157

As a result of the transaction, the Group reclassified two interests in jointly controlled entities to subsidiaries. The effect of the reclassification on the Group's assets and liabilities was the following:

	EEK	EUR
In thousands		
Cash	399	26
Other current assets	276	18
Property, plant and equipment (note 22)	576	37
Goodwill (note 23)	2 458	157
Loans and borrowings	1 522	97
Current liabilities	843	54

If Arco Rumeenia Valdused OÜ would have acquired on 1 January 2007, the impact on the Group's consolidated revenue would have been increased for 1 039 thousand kroons (66 thousand euros) and consolidated net profit would have been decreased for 2 205 thousand kroons (141 thousand euros).

7.4 *Acquisitions from minority shareholders*

As a result of the share swap transaction that took place in the beginning of April 2008 the Group swapped the interests held in subsidiaries, and as a result of the transaction the Group holds 100% of the membership shares and shares of stock in Kerberon OÜ and Kolde AS. In the said transaction the Group disposed of the shares of Tallinna Linnaehituse AS.

		EEK		EUR	
	Interest divested / acquired	**Cost of transaction**	**Gain / loss on the transaction (note 13)**	**Cost of transaction**	**Gain / loss on the transaction (note 13)**
In thousands					
Divestment of shares in Tallinna Linnaehituse AS	-80%	12 943	-1 094	827	-70
Acquisition of shares in Kerberon OÜ	16.63%	10 199	-657	652	-42
Acquisition of shares in Kolde AS	10.71%	3 101	218	198	14
Total			**-1 533**		**-98**

At the beginning of 2007, the Group acquired from minority shareholders their interests in the Group's subsidiaries Arco Vara Riia Valdused OÜ (a 25% interest), Arco Vara Puukool OÜ (a 25% interest) and Arco Real Estate UAB (a 20% interest), taking its ownership in the subsidiaries to 100%. Acquisition of the shareholdings cost 2 466 thousand kroons (158 thousand euros) and gave rise to positive goodwill of 2 581 thousand kroons (165 thousand euros).

7.5 *Establishment of companies*

The Group established no entities in 2008.

In 2007, the Group established or participated in the establishment of the following companies:

Company	Domicile	Group's interest in the entity, %	Contribution to share capital EEK	Contribution to share capital EUR
In thousands				
Subsidiaries				
AD Saulkrasti SIA	Latvia	50.4	28	2

For identification purposes only
ERNST & YOUNG
17.04.2009

Adepto SIA	Latvia	80	45	3
Arco Invest EOOD	Bulgaria	100	800	51
Arco Capital Real Estate SRL	Romania	100	978	63
Arco Investments TOV	Ukraine	75	71	5
Arco Real Estate AS	Estonia	100	400	26
Jointly controlled entities				
Arco & Koger EOOD	Bulgaria	50	20	1
Plavnieku Centrs SIA	Latvia	40	13 180	842
Total			**15,522**	**993**

Notes to the consolidated income statement

8 *Cost of sales*

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Cost of properties sold	-149 856	-264 966	-9 578	-16 934
Cost of construction services purchased	-309 019	-159 122	-19 750	-10 170
Management and administration costs	-15 336	-11 398	-980	-728
Personnel expenses	-75 146	-84 980	-4 803	-5 431
Vehicle expenses	-4 838	-7 163	-309	-458
Depreciation and amortisation (notes 22, 23)	-2 419	-2 002	-155	-128
Value decrease of inventories[1] (note 19)	-434 272	0	-27 755	0
Other costs	-19 924	-12 504	-1 273	-800
Total cost of sales	**-1 010 810**	**-542 135**	**-64 603**	**-34 649**

[1] As a result of radical change for the worse of the economic condition inventories have been discounted to their net realisable value. In 2008 inventories were discounted by 434 272 thousand kroons (27 755 thousand euros); in 2007 inventories weren't discounted.

9 *Selling and distribution expenses*

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Advertising expenses	-10 337	-17 356	-661	-1 109
Brokerage and intermediation fees	-59	-421	-4	-27
Market research expenses	-192	-444	-12	-28
Personnel expenses	-709	-829	-45	-53
Other selling and distribution expenses	-1 047	-3 484	-67	-223
Total selling and distribution expenses	**-12 344**	**-22 534**	**-789**	**-1 440**

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ERNST & YOUNG
17.04.2009

10 Administrative expenses

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Personnel expenses	-60 729	-85 110	-3 881	-5 440
Office expenses	-29 049	-31 108	-1 857	-1 988
Legal and consulting fees[1]	-1 956	-953	-125	-61
Depreciation, amortisation and impairment losses (notes 22)	-4 246	-3 131	-271	-200
Impairment loss of goodwill (note 23)	-8 895	0	-568	0
Recognition of negative goodwill as income	0	283	0	18
Allowance for doubtful receivables	-3 029	-1 481	-194	-95
Vehicle expenses	-8 847	-9 832	-565	-628
Other expenses	-8 833	-4 721	-565	-301
Total administrative expenses	**-125 584**	**-136 053**	**-8 027**	**-8 695**

[1] Legal and consulting fees for 2008 include the costs arising from a bonus scheme agreed with a member of the board of a jointly controlled entity, which extend to 12.5% of the entity's equity. In 2008, the entity's equity decreased, which reduced the costs arising from the bonus scheme by 10 484 thousand kroons (670 thousand euros). In 2007, the costs arising from the bonus scheme totalled 11 483 thousand kroons (734 thousand euros).

11 Other income and other expenses

Other income

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Gains on fair value adjustments to investment property (note 21)	21 664	133 029	1 385	8 502
Gains on sale of investment property	1 547	2 620	99	167
Gains on fair value adjustments to biological assets (note 20)	1 568	2 756	100	176
Gains on sale of property, plant and equipment (note 22)	90	57	6	4
Miscellaneous income	5 775	1 628	369	104
Total other income	**30 644**	**140 090**	**1 959**	**8 953**

Other expenses

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Losses on fair value adjustments to investment property (note 21)	-577 293	-75 200	-36 896	-4 806
Losses on sale of investment property (note 21)	-12	-4 253	-1	-272
Impairment losses on property, plant and equipment (note 22)	-7 946	18 739	-509	1 198
Interest on arrears and penalty charges[1]	-4 780	-481	-305	-31
Other expenses	-1 371	-2 303	-88	-147
Total other expenses	**-591 402**	**-63 498**	**-37 799**	**-4 058**

[1] Interest on arrears and penalty charges are inclusive of, among other items, 1 250 thousand kroons (80 thousand euros) paid under the compromise contract to Faalanks OÜ, and 2 900 thousand kroons (185 thousand euros) paid to Hexanor OÜ.

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ERNST & YOUNG
17.04.2009

12 Finance income

	EEK		EUR	
	2008	2007	2008	2007
In thousands				
Gains on sale of investments in subsidiaries (note 7)	4 487	123 414	287	7 888
Gains on sale of interests in jointly controlled entities (note 7)	0	10 650	0	681
Interest income	53 264	30 177	3 405	1 929
Foreign exchange gains	12 203	39	780	2
Change in the fair value of minority put option	6 122	0	391	0
Income on other non-current financial assets[1]	13	50 725	1	3 241
Total finance income	**76 089**	**215 005**	**4 863**	**13 741**

[1] Income on other non-current financial assets for 2007 are inclusive of the profit in the amount of 41 238 thousand kroons (2 636 thousand euros) earned as the result of revaluation of Explorer Property Fund –Baltic States AB owned by an entity under joint control of the Group to the fair value, and the profit in the amount of 1 362 thousand kroons (87 thousand euros) resulting from revaluation of the preferred share of Arco Balti Kinnisvaraportfell AS to the fair value.

13 Finance expenses

	EEK		EUR	
	2008	2007	2008	2007
In thousands				
Losses on sale of shares in subsidiaries (note 7)	-4 728	-2 981	-302	-191
Losses on sale of shares in joint ventures (note 7)	-41 054	0	-2 623	0
Interest expense[1]	-48 184	-33 840	-3 080	-2 163
Expenses on other non-current financial assets	-3 706	-2 864	-237	-183
Foreign exchange losses	-7 595	-2 291	-485	-146
Impairment losses on financial assets[2]	-72 435	-25 768	-4 629	-1 647
Total finance expenses	**-177 702**	**-67 744**	**-11 356**	**-4 330**

[1] Interest expense includes mainly the interest expense of loans taken and debt securities issued for the acquisition and construction of properties. Interest expenditures incurred in connection with loans taken to finance development projects in progress are capitalised. In 2008, capitalised interest expenditures totalled 38 387 thousand kroons (2 453 thousand euros). The corresponding figure for 2007 was 21 646 thousand kroons (1 383 thousand euros).

[2] The impairment loss for 2007 related to the Kippsala project in the amount of 25 258 thousand kroons (1 614 thousand euros) was reversed in 2008, because a part of the loan had been credited to the account by the balance sheet date, and subsequent receipt is taking place in accordance with the schedule. Impairment losses on financial assets are inclusive of, among other items, the partial write-off of the claim stemming from the loan claim against Sigma Real Estate Ltd in the amount of 54 463 thousand kroons (3 481 thousand euros). Impairment losses on the investment made in the jointly controlled entity Bišumuiža Nami SIA in the amount of 41 097 thousand kroons (2 627 thousand euros). In 2007 provisions of loans given to the jointly controlled entities weren't made.

14 Income tax expense

	EEK		EUR	
	2008	2007	2007	2007
In thousands				
Income tax expense on dividends	-12 968	-12 129	-829	-775
Income tax expense on the profit of Latvian subsidiaries[1]	-768	-2 569	-49	-164
Income tax expense on the profit of Bulgarian subsidiaries[2]	4 925	163	315	10
Income tax expense on the profit of Ukrainian subsidiaries	0	-273	0	-17
Total income tax expense	**-8 811**	**-14 808**	**-563**	**-946**

[1] Income tax expense on the profit of Latvian subsidiaries for 2008 includes income tax expense for the current year levied on the profit in the amount of 763 thousand kroons (49 thousand euros), and the change in deferred income tax liability in the amount of 4 thousand kroons. The relevant figures of the year 2007 were, respectively, 1 008 thousand kroons (64 thousand euros), the change in deferred income tax liability – 5 thousand kroons

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ERNST & YOUNG
17.04.2009

[2] Positive result of the income tax expense arises from the prepaid income tax stemming from the impairment loss on Bulgarian inventories.

As at 31.12.2008 the Group has recognised prepaid income tax in the amount of 3 718 thousand kroons (242 thousand euros); the relevant figures as at 31.12.2007 were, respectively, income tax liability 1 321 thousand kroons (84 thousand euros).

15 Operating lease expenses

The Group uses office premises, vehicles and office equipment under operating lease. Related expenses break down as follows:

Lease expense for	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Premises	7 582	10 642	485	680
Vehicles	3 606	4 535	230	290
Office equipment	2 199	2 951	141	189
Total	**13 387**	**18 128**	**856**	**1 159**

16 Earnings per share

Basic earnings per share are calculated by dividing the profit or loss attributable to ordinary equity holders of the Parent by the weighted average number of ordinary shares outstanding during the period. The company does not have any potential ordinary shares. Therefore, diluted earnings per share equal basic earnings per share.

	EEK		EUR	
	2008	2007	**2008**	2007
Weighted average number of ordinary shares outstanding (pc)	**95 284 150**	82 516 293	**95 284 150**	82 516 293
Profit or loss attributable to equity holders of the parent (in thousands)	**-1 154 959**	227 587	**-73 815**	14 545
Earnings per share	**-12,12**	2,76	**-0,77**	0,18

In May 2007, Arco Vara AS increased its share capital by 373 331 thousand kroons (23 860 thousand euros) through a bonus issue. The issue was arranged using the company's equity; no additional contributions were made. The company issued 37 331 113 new shares with a par value of 10 kroons each.

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ERNST & YOUNG
17.04.2009

Notes to the consolidated balance sheet

17 Other financial assets

Short-term financial investments at 31.12.2008 consist of Kesko OY commercial papers. At the end of 2008 the Group held 4 110 pieces of commercial paper of Kesko OY with the total value of 9 834 kroons (629 euros) each, i.e. in the total amount of 40 416 thousand kroons (2 583 thousand euros). The redemption date of the commercial paper is 13.03.2009.

In addition to Kesko OY commercial paper, at 31 December 2007 other current financial assets included a deposit of 4 620 thousand kroons (295 thousand euros) put up as financial security for a loan taken by a subsidiary. The deposit will be recovered in the first half of 2008.

Other non-current financial assets break down as follows:

	EEK		EUR	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Non-current investments in equity instruments – carried at cost	129	128	8	8
Non-current investments in equity instruments – carried at fair value[1]	126	48 387	9	3 093
Prepayments for other financial assets	0	0	0	0
Total other non-current financial assets	**255**	**48 515**	**17**	**3 101**

[1] Non-current investments in equity instruments carried at fair value includes mainly investments in Explorer Property Fund AB and Arco Balti Kinnisvaraportfell AS which at 31 December 2007 totalled 48 281 thousand kroons (3 086 thousand euros).

On 20 June 2008 the Group disposed of its interest in the jointly controlled entity AVEC Asset Management AS. The sales price of the stake consisted of an immediate payment of 35 708 thousand kroons (2 282 thousand euros), and deferred payment equalling 25% of the amount payable upon dissolution of Explorer Property Fund AB. According to the assessment of the management board of the Group the value of the said claim as at 31.12.2008 amounts to 0 kroons (0 euros). In accordance with the contract of sale of AVEC Asset Management AS the Group shall retain control over the assets, liabilities and equity of the fund until disbursements of the fund.

18 Receivables

Current items

	EEK		EUR	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Trade receivables				
Receivables from customers	96 263	48 236	6 151	3 083
Allowance for doubtful receivables	-5 936	-70	-379	-4
Total trade receivables	**90 327**	**48 166**	**5 772**	**3 079**
Other short-term receivables				
Receivables from jointly controlled entities (note 36)	17 090	53 719	1 092	3 433
Loans granted[1]	94 563	12 391	6 044	792
Other short-term receivables[2]	28 765	47 449	1 838	3 033
Total other receivables	**140 418**	**113 559**	**8 974**	**7 258**
Accrued income				
Interest receivable	1 329	5 807	85	371
Due from customers under long-term construction contracts[3]	7 612	21 635	486	1 383
Prepaid and recoverable VAT[4]	53 034	107 406	3 389	6 864
Other accrued income	1 632	616	104	39
Total accrued income	**63 607**	**135 464**	**4 064**	**8 657**
Total current receivables	**294 352**	**297 189**	**18 810**	**18 994**

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ERNST & YOUNG
17.04.2009

[1] The loans given are inclusive of, among other items, the claim stemming from the loan claim against Sigma Real Estate Ltd in the amount of 108 838 thousand kroons (6 956 thousand euros). In the spring of 2008 the Group made a prepayment for the shares of an entity participating in the shopping centre projects in Simferopol, Ukraine, in the aggregate amount of 79 096 thousand kroons (5 055 thousand euros), and in connection with the same project granted the entity a loan in the amount of 20 598 thousand kroons (1 316 thousand euros). All payments were made in US Dollars. As at 31.12.2008 the management of the Group has decided to not participate in the Ukrainian shopping centre project, and recall the funds. The Parties are holding negotiations regarding additional securities and deferral. The claim has been discounted in the balance sheet by 45%. The new book value is 66 657 thousand kroons (4 260 thousand euros).

Unsecured loans given carry interest rates between 5-18% per annum (2007: 4.8% per annum).

These loans are inclusive of receivables from related parties in the aggregate amount of 22 188 thousand kroons 1 418 thousand euros). In 2007, respectively, 12 391 thousand kroons (792 thousand euros). The receivables have arisen in the course of business operation, as a result of dissolution and division of subsidiaries. Further information on related parties is presented in Note 36.

[2] Other short-term receivables as at 31.12.08 include:

- Claim connected with the Kippsala project in the amount of 25 258 thousand kroons (1 614 thousand euros). The respective figure at 31.12.2007 amounted to 33 675 thousand kroons (2 152 thousand euros).

[3] Due from customers under long-term construction contracts comprises receivables under long-term construction contracts measured by reference to the stage of completion method.

[4] At 31 December 2008, prepaid and refundable VAT included mainly VAT prepayments for development projects in progress in Bulgaria, Latvia and Lithuania which will be recovered in 2009. At 31 December 2008, VAT prepayments related to the Madrid and Manastirski (Bulgaria), Hills (Lithuania) and Bišumuiža I (Latvia) projects totalled 34 045 thousand kroons (2 176 thousand euros). In 2007 totalled 94 009 thousand kroons (6 008 thousand euros).

Non-current items

	EEK		EUR	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Receivables from jointly controlled entities (note 36)	5 750	38 538	367	2 463
Long-term loan receivables	254	907	16	58
Other non-current receivables	667	679	43	43
Total non-current receivables	**6 671**	**40 124**	**426**	**2 564**

19 *Inventories*

	EEK		EUR	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Properties purchased and developed for resale[1]	785 906	1 111 527	50 229	71 040
Other goods purchased for resale	4 806	4 498	307	287
Materials and finished goods	62	529	4	34
Prepayments to suppliers	58 666	31 879	3 749	2 037
Total inventories	**849 440**	**1 148 433**	**54 289**	**73 398**

The line "Properties purchased and developed for resale" includes all residential development projects and properties which have been acquired for resale.

Based on the decision of the management the inventories were discounted in connection with the change in the net realisable value by the amount of 434 272 thousand kroons (27 755 thousand euros).

At 31 December 2008, the Group had pledged properties purchased and developed for resale of 602 332 thousand kroons (38 496 thousand euros) as collateral for its loan commitments. At 31 December 2007, the corresponding figure was 810 212 thousand kroons (51 782 thousand euros).

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ERNST & YOUNG
17.04.2009

20 Biological assets

	EEK	EUR
In thousands		
At 31 December 2006	**6 141**	**392**
Increases due to purchases	164	10
Decreases due to sales	-701	-45
Gain or loss from change in fair value (note 11)	2 756	176
At 31 December 2007	**8 360**	**534**
Increases due to purchases	267	17
Decreases due to sales	-4 971	-318
Gain or loss from change in fair value (note 11)	23	1
At 31 December 2008	**3 679**	**235**

Biological assets according to maturity:

	EEK		EUR	
As at 31.12.2008	**31.12.2008**	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Mature, ready for sale plants	0	696	0	44
Immature, not ready for sale plants	1 157	724	74	46
Mature harvestable forest	2 441	0	156	0
Growing forest without a cutting permit	81	6 940	5	445
Total biological assets	**3 679**	**8 360**	**235**	**535**

In 2008, asset management expenses totalled 2 960 thousand kroons (189 thousand euros). The corresponding figure for 2007 was 1 381 thousand kroons (88 thousand euros).

21 Investment property

Investment properties include commercial buildings which are leased out and properties with development potential whose future use has not been determined.

Movements in investment property in 2008 and in 2007:

	EEK	EUR
In thousands		
At 31 December 2006	**1 479 281**	**94 543**
Acquisitions	3 016	193
Sales	-58 949	-3 768
Acquisitions through business combinations (note 7)	-192 500	-12 303
Transfer to inventories (note 19)	-300 000	-19 173
Transfer from property, plant and equipment (note 22)	11 322	724
Gain or loss on change in fair value (note 11)	57 829	3 696
At 31 December 2007	**999 999**	**63 912**
Acquisitions	4 222	270
Sales	-6 040	-387
Transfer from property, plant and equipment (note 22)	100 201	6 404
Gain or loss on change in fair value (note 11)	-555 629	-35 511
At 31 December 2008	**542 753**	**34 688**

In 2008, the fair values of most important investment properties were determined by reference to valuations performed by qualified independent real estate appraisers.

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ERNST & YOUNG
17.04.2009

In determining the fair values of investment properties, cash flow projections were based on the following assumptions:

%	2008	2007
Annual increase in rental income	0.0-3.0	1.5-3.0
Annual increase in operating expenses	2.0-5.0	0.0-5.0
Vacancy rate of the premises	0.0-20.0	0.0-20.0
Discount rate on exit from project	8.5-13.0	7.5-9.5

In 2008, rental income on investment properties amounted to 38 772 thousand kroons (2 279 thousand euros). The corresponding figure for 2007 was 36 027 thousand kroons (2 303 thousand euros). Direct property management expenses totalled 7 266 thousand kroons (464 thousand euros). The corresponding figure for 2007 was 7 906 thousand kroons (505 thousand euros).

Non-cancellable operating lease rentals receivable in subsequent periods break down as follows:

Rental income receivable	EEK		EUR	
	2008	2007	2008	2007
In thousands				
Less than 1 year	21 619	14 400	1 382	920
Between 1 and 5 years	36 043	36 678	2 304	2 344
More than 5 years	14 982	16 103	958	1 029
Total	**72 644**	**67 181**	**4 644**	**4 294**

22 *Property, plant and equipment*

In thousands EEK	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total
Carrying amount at 31 December 2006	**21 329**	**2 261**	**4 324**	**53 799**	**81 713**
Cost at 31 December 2006	*30 052*	*5 553*	*8 256*	*53 799*	*97 660*
Accumulated depreciation at 31 December 2006	*-8 723*	*-3 292*	*-3 932*	*0*	*-15 947*
Additions	7 207	3 115	5 396	37 341	53 059
Capitalised borrowings costs	0	662	0	14 530	15 192
Additions through business combinations (note 7)	0	482	789	0	1 271
Reversal of impairment loss (note 11)	0	0	0	18 778	18 778
Disposals	0	-569	-79	-8 965	-9 613
Disposals through divestment of interests in jointly controlled entities (note 7.2)	-96	0	0	-6 801	-6 897
Transfer	0	0	0	-6 876	-6 876
Transfer to investment properties (note 21)	-63	300	-300	0	-63
Depreciation charge (note 8, 10)	-1 437	-1 117	-2 147	0	-4 701
Carrying amount at 31 December 2007	**26 940**	**5 134**	**7 983**	**101 806**	**141 863**
Cost at 31 December 2007	*37 083*	*9 108*	*13 637*	*101 806*	*161 634*
Accumulated depreciation at 31 December 2007	*-10 143*	*-3 974*	*-5 654*	*0*	*-19 771*
Additions	369	3 115	5 396	10 806	19 686
Capitalised borrowings costs	0	662	0	7 218	7 880
Disposals	-1 701	-5 633	-4 768	-8 965	-21 067
Additions through business combinations (note 7)	0	482	789	0	1 271
Transfer	1 619	0	0	0	1 619
Impairment loss (note 11)	-3 420	0	0	0	-3 420
Transfer of property investments (note 21)	0	0	0	-100 201	-100 201
Depreciation charge (note 8, 10)	-1 692	-1 264	-2 863	0	-5 819
Carrying amount at 31 December 2008	**22 115**	**2 496**	**6 537**	**10 664**	**41 812**
Cost at 31 December 2008	*33 950*	*7 734*	*15 054*	*10 664*	*67 402*
Accumulated depreciation at 31 December 2008	*-11 835*	*-5 238*	*-8 517*	*0*	*-25 590*

In thousands EUR	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total
Carrying amount at 31 December 2006	**1 363**	**145**	**276**	**3 438**	**5 222**
Cost at 31 December 2006	*1 921*	*355*	*528*	*3 438*	*6 242*
Accumulated depreciation at 31 December 2006	*-558*	*-210*	*-251*	*0*	*-1 019*
Additions	461	199	345	2 387	3 392
Capitalised borrowings costs	0	42	0	929	971
Additions through business combinations (note 7)	0	31	50	0	81
Reversal of impairment loss (note 11)	0	0	0	1 200	1 200
Disposals	0	-36	-5	-573	-614
Disposals through divestment of interests in jointly controlled entities (note 7.2)	-6	0	0	-435	-441
Transfer	0	0	0	-439	-439
Transfer to investment properties	-4	19	-19	0	-4
Depreciation charge (note 8, 10)	-92	-71	-138	0	-301
Carrying amount at 31 December 2007	**1 722**	**328**	**510**	**6 507**	**9 067**
Cost at 31 December 2007	*2 370*	*582*	*872*	*6 507*	*10 331*
Accumulated depreciation at 31 December 2007	*-648*	*-254*	*-362*	*0*	*- 1264*
Additions	24	199	345	691	19 686
Capitalised borrowings costs	0	42	0	461	7 880
Disposals	-109	-360	-305	-573	-21 067
Additions through business combinations (note 7)	0	31	50	0	1 271
Transfer	103	0	0	0	1 619
Impairment loss (note 11)	-219	0	0	0	-3 420
Transfer of property investments	0	0	0	-6 404	-100 201
Depreciation charge (note 8, 10)	-108	-81	-183	0	-5 819
Carrying amount at 31 December 2008	**1 413**	**159**	**417**	**682**	**41 812**
Cost at 31 December 2008	*2 169*	*494*	*962*	*682*	*67 402*
Accumulated depreciation at 31 December 2008	*-756*	*-335*	*-545*	*0*	*-25 590*

Other information on property, plant and equipment:

	EEK		EUR	
As at 31 December	**31.12.2008**	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Carrying amount of property, plant and equipment pledged as collateral	29 137	102 541	1 862	6 554
Payable for purchase of property, plant and equipment	124	2 864	8	183
Amounts due under construction contracts for properties carried as assets under construction	0	2 631	0	168

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17.04.2009

23 Intangible assets

In thousands EEK	Goodwill	Software	Total
Carrying amount at 31 December 2006	**15 558**	**1 147**	**16 705**
Cost at 31 December 2006	*15 558*	*1 840*	*17 398*
Accumulated amortisation at 31 December 2006	*0*	*-693*	*-693*
Additions	0	825	825
Additions through business combinations (note 7)	5 818	0	5 818
Additions through acquisition of interests from minority shareholders (note 7)	2 581	11	2 592
Disposals	0	-3	-3
Amortisation charge (note 10)	0	-432	-432
Carrying amount at 31 December 2007	**23 957**	**1 548**	**25 505**
Cost at 31 December 2007	*23 957*	*2 665*	*26 622*
Accumulated amortisation at 31 December 2007	*0*	*-1 117*	*-1 117*
Additions	0	482	482
Disposals	0	-229	-229
Additions through business combinations (note 7)	632	0	632
Disposals through divestment of subsidiaries (note 7)	-4 014	-195	-4 209
Impairment loss (note 11)	-8 720	0	-8 720
Amortisation charge (note 10)	0	-521	-521
Carrying amount at 31 December 2008	**11 855**	**620**	**12 475**
Cost at 31 December 2008	*11 855*	*2 258*	*14 113*
Accumulated amortisation at 31 December 2008	*0*	*-1 638*	*-1 638*

In thousands EUR	Goodwill	Software	Total
Carrying amount at 31 December 2006	**994**	**73**	**1 068**
Cost at 31 December 2006	*994*	*118*	*1 112*
Accumulated amortisation at 31 December 2006	*0*	*-41*	*-41*
Additions	0	53	53
Additions through business combinations (note 7)	372	0	372
Additions through acquisition of interests from minority shareholders (note 7)	164	1	165
Amortisation charge (note 10)	0	-28	-28
Carrying amount at 31 December 2007	**1 531**	**99**	**1 630**
Cost at 31 December 2007	*1 531*	*170*	*1 701*
Accumulated amortisation at 31 December 2007	*0*	*-71*	*-71*
Additions	0	31	31
Disposals	0	-15	-15
Additions through business combinations (note 7)	40	0	40
Disposals through divestment of subsidiaries (note 7)	-257	0	-557
Impairment loss (note 11)	-557	0	0
Amortisation charge (note 10)	0	-33	-33
Carrying amount at 31 December 2008	***758***	***144***	***797***
Cost at 31 December 2008	*0*	*-105*	*-105*

At the end of 2008, a goodwill impairment test was conducted, based on which the goodwill related to two objects in the service segment were written down. For both objects, writing down was caused by the fact that as of the end of year, their

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12.04.2009

equity was negative. In the construction division, the write down of the share of Arco Ehituse OÜ was 4 008 thousand kroons (256 thousand euros).

Goodwill was tested for impairment at the end of 2007. The tests indicated that goodwill was not impaired.

Assumptions applied on estimating the recoverable amount of goodwill allocated to the Service segment

- The recoverable amount was estimated based on value in use.
- Cash flows were projected:
  - based on the Group's prior experience of the growth of service companies in Estonia, Latvia, Bulgaria and Ukraine;
  - assuming that the revenue of the Service segment will increase at the rate of 0% per year (2007:10%) ;
  - by discounting free cash flows at the weighted average cost of capital of 15% per year (2007:14%);
  - based on the budgets approved by management for the next five years.

Assumptions applied on estimating the recoverable amount of goodwill allocated to the Construction segment

- The recoverable amount was estimated based on value in use.
- Cash flows were projected as follows:
  - The forecasted growth of the volume of environmental engineering projects in based on EU requirements, and the possibility of participating in the related public procurements within the next five years in the total amount of 1 550 million kroons (99 million euros). The Group has forecasted a growth in revenues and gross profit related to environmental engineering in the amount of 0.8-10% per year. (2007: 0.8-10%) Estonia.

Assumptions applied on estimating the recoverable amount of goodwill allocated to the Development segment:

- The recoverable amount was estimated based on value in use;
- in 2008, by estimating of goodwill of Group's plant production company the Group's management has based on the cash flow forecast of the expected growth in the plant production volume, which in turn was based on the budgets approved by the management for the next five years as well as the earlier experience of the Group with plant cultivation. For the cash flow discount, the weighted average capital charges of 15% per year has been used.(2007 : same).

24 Loans and borrowings

	31.12.2008		31.12.2007	
In thousands EEK	Total	Including current portion	Total	Including current portion
Debt securities[2]	59 303	59 303	139 284	124 545
Bank loans[3]	911 946	256 095	1 094 580	563 689
Finance lease liabilities (note 25)	5 462	1 708	6 712	2 475
Other loans[4]	69 625	36 311	113 439	62 368
Total (note 35)	**1 046 336**	**353 417**	**1 354 015**	**753 077**

	31.12.2008		31.12.2007	
In thousands EUR	Total	Including current portion	Total	Including current portion
Debt securities[2]	3 790	3 790	8 902	7 960
Bank loans[3]	58 284	16 367	69 956	36 026
Finance lease liabilities (note 25)	349	109	429	158
Other loans[4]	4 450	2 321	7 250	3 986
Total (note 33)	**66 873**	**22 587**	**86 537**	**48 130**

[1] At 31 December 2008, Group companies had access to overdraft facilities whose limits totalled 221 thousand kroons (14 thousand euros). At the end of 2007, the limits of available overdraft facilities totalled 8 723 thousand kroons (556 thousand euros).

[2] In 2008, the Group issued short- and long-term commercial paper with a total par value of 66 498 thousand kroons

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ERNST & YOUNG
17.04.2009

(4 250 thousand euros) and redeemed commercial paper at the total par value of 140 299 thousand kroons (8 967 thousand euros). In 2007, the Group issued commercial paper with a total par value of 119 379 thousand kroons (7 630 thousand euros) and redeemed commercial paper at the total par value of 73 640 thousand kroons (4 706 thousand euros). The average effective interest rate of the issues was 8.47% (2007: 6.85%).

At 31 December 2008 and 31 December 2007, the following debt securities issues were still redeemable:

Settlement date	Redemption date	Commercial paper	Par value EEK	Par value EUR	Interest rate, %	Balance, EEK 31.12.2008	Balance, EEK 31.12.2007	Balance, EUR 31.12.2008	Balance, EUR 31.12.2007
In thousands									
1.12.2005	1.12.2008	Arco Vara AS FRN 1.12.2008	85,000	5,432	6,92	0	85,000	0	5,432
22.06.2006	1.12.2008	Arco Vara AS FRN 1.12.2008 increase	9,560	0,611	6,92	0	94,423	0	6,035
22.01.2007	21.01.2011	Arco Vara AS bond 21012011	27,929	1,785	8,38	0	14,739	0	0,942
21.09.2007	20.06.2008	Arco Vara AS CP 20062008	31,000	1,981	6,25	0	30,121	0	1,925
11.07.2008	10.07.2009	Arco Vara commercial papers 10.07.2009	66,498	4,250	12,00	59,303	0	3,790	0
Total						**59,303**	**139,284**	**3,790**	**8,902**

[3] In 2008, the weighted average interest rate of loans and borrowings was 6.95% (2007: 6.70%). The weighted average interest rate of bank loans was 6.56% (2007: 6.51%).

The interest rates of major bank loans are as follows:
Information on assets pledged as security for bank loans is presented in note 29.
The Group's loan liabilities are denominated in Estonian kroons, Latvian lats, Bulgarian leevs or euros

	Loan balance EEK 31.12.2008	Loan balance EEK 31.12.2007	Loan balance EUR 31.12.2008	Loan balance EUR 31.12.2007	Interests rate, % 2008	Interests rate, % 2007
In thousands						
Long-term bank loan	156 000	94 000	9 970	6 008	6,74	7,80
Short-term bank loan	134 500	145 000	8 596	9 267	8,15	6,90
Short-term bank loan	97 250	97 000	6 215	6 199	6,22	5,99
Long-term bank loan	87 621	88 000	5 600	5 624	4,93	6,16
Short-term bank loan	80 325	122 000	5 134	7 797	4,36	6,29
Long-term bank loan	61 069	104 000	3 903	6 647	6,07	5,53
Short-term bank loan	30 000	83 000	1 917	5 305	8,00	6,25

[4] At 31 December 2008, other loans included loan liabilities to related parties of 36 009 thousand kroons (2 301 thousand euros). At 31 December 2007, the corresponding figure was 100 484 thousand kroons (6 422 thousand euros). For further information on related parties, please refer to note 36.

25 *Finance lease liabilities*

Finance lease liabilities by settlement term	31 December 2008 Minimum lease payments	31 December 2008 Present value of minimum lease payments	31 December 2007 Minimum lease payments	31 December 2007 Present value of minimum lease payments
In thousands EEK				
Less than 1 year	3 537	3 222	2 551	2 272
Between 1 and 5 years	2 232	1 980	4 434	3 896
More than 5 years	268	260	552	544
Lessor's gross investment	**6 037**	**5 462**	**7 537**	**6 712**
Future interest expense	-575		-825	
Lessor's net investment	**5 462**	**5 462**	**6 712**	**6 712**

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ERNST & YOUNG
17-04.2009

Finance lease liabilities by settlement term	31 December 2008 Minimum lease payments	31 December 2008 Present value of minimum lease payments	31 December 2007 Minimum lease payments	31 December 2007 Present value of minimum lease payments
In thousands EUR				
Less than 1 year	226	206	163	145
Between 1 and 5 years	143	127	283	249
More than 5 years	17	17	35	35
Lessor's gross investment	**386**	**350**	**481**	**429**
Future interest expense	-36	0	-53	
Lessor's net investment	**350**	**350**	**428**	**429**

Assets acquired with finance lease	EEK		EUR	
	31 December 2008	31 December 2007	**31 December 2008**	31 December 2007
Investment property	5 145	3 426	329	219
Property, plant and equipment	4 094	6 307	262	403
Total carrying amount	**9 239**	**9 733**	**591**	**622**

26 Payables and other liabilities

Payables
Current items

	EEK		EUR	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Trade payables[1]	75 454	60 612	4 822	3 874
Other payables				
Payables to jointly controlled entities (note 36)	0	6 386	0	408
Payables from securities transactions[2]	1 236	48 616	79	3 107
Miscellaneous payables[3]	16 329	29 496	1 043	1 885
Total other payables	**17 565**	**84 498**	**1 122**	**5 400**
Taxes payable				
Value added tax	3 099	1 761	197	113
Income tax on dividends	0	3 449	0	220
Personal income tax	2 053	2 535	131	162
Social tax	3 569	4 841	228	309
Other taxes	2 228	4 037	141	258
Total taxes payable	**10 949**	**16 623**	**697**	**1 062**
Accrued expenses				
Interest payable[4]	10 054	7 164	643	458
Payables to employees	8 871	27 671	567	1 769
Dividends payable	1 232	8 743	79	559
Other accrued expenses[5]	8 552	18 280	547	1 168
Total accrued expenses	**28 709**	**61 858**	**1 836**	**3 954**
Total payables	**132 677**	**223 591**	**8 477**	**14 290**

[1] At 31 December 2008, trade payables included items of 3 308 thousand kroons (211 thousand euros) payable for the acquisition of property, plant and equipment. At 31 December 2007, the corresponding figure was 2 631 thousand kroons (168 thousand euros).

[2] At 31 December 2008, the amounts payable for securities transactions included the following items:

- Payables from securities transactions consist of the arrears in the amount of 1 196 thousand kroons (76 thousand euros) originating from the acquisition of a Latvian construction company through the business association in 2007. The long-term part of the same arrears have been reflected under the long-term payables. The liability has no interest and has therefore been discounted with a rate of 5%. Discounting cost in 2008 was 94 thousand kroons (6 thousand euros) and was reflected in the income statement under the financial and investment business as item Interest expenses. The book value of liabilities as of 31 December 2008 was 1 196 thousand kroons (76 thousand euros).
- as of end both 2007 and 2008, the arrears of the Group from the acquisition of an associate in 2006 are 40 thousand kroons (3 thousand euros).

At 31 December 2007, the amounts payable for securities transactions included the following items:

- an amount of 41 964 thousand kroons (2 682 thousand euros) due to a minority shareholder for the interests acquired in Group entities in March 2006. The liability is non-interest-bearing. Therefore, it is discounted at the rate of 5%. Discounting expense for 2007 amounted to 1 978 thousand kroons (126 thousand euros) and has been recognised in the income statement in finance expense (as an item of interest expense). At 31 December 2007, the carrying amount of the liability was 41 539 thousand kroons (2 655 thousand euros).
- a liability of 6 121 thousand kroons (391 thousand euros) arising from a put option granted under a shareholder agreement.
- a liability of 914 thousand kroons (58 thousand euros) arisen from the acquisition of a Latvian construction company through a business combination. The non-current portion of the liability is carried in "Other liabilities"

[3] Miscellaneous payables as of 31 December 2008 include:

- payables to related parties in the amount of 21 029 thousand kroons (1 344 thousand euros), at the end of 2007 respectively 28 406 thousand kroons (1 815 thousand euros). Additional information on related parties, see note 36.

[4] Interest payables as of 31 December 2008 include, amongst others, interest payables to related parties in the amount of 3 745 thousand kroons (239 thousand euros), at the end of 2007 respectively 2 474 thousand kroons (158 thousand euros). Additional information on related parties, see note 36.

[5] Other accrued expenses as of 31 December 2008 include the following liabilities:

- accrued expenses from development projects calculated on the basis of the accrual method in the amount of 4 869 thousand kroons (311 thousand euros), at the end of 2007 respectively 12 495 thousand kroons (799 thousand euros).

- payables to related parties in the amount of 2 322 thousand kroons (148 thousand euros), at the end of 2007 there were no payables to related parties.

Other liabilities
Non-current items

	EEK		EUR	
	31.12.2008	31.12.2007	31.12.2008	31.12.2007
In thousands				
Liabilities from securities transactions[1]	248	1 211	16	77
Deposits received[2]	1 402	1 461	90	93
Miscellaneous long-term liabilities[2]	2 754	1 935	175	124
Total other liabilities	**4 404**	**4 607**	**281**	**294**

[1] Liabilities from securities transactions comprise a liability incurred in 2007 in connection with the acquisition of a Latvian construction company. The current portion of the liability is carried in "Other payables".

[2]At 31 December 2008, miscellaneous long-term liabilities included liabilities to related parties of 1 778 thousand kroons (114 thousand euros). At the end of 2007, the corresponding figure was 997 thousand kroons (64 thousand euros).Further information on related parties is presented in note 36.

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ERNST & YOUNG
17.04.2009

27 Deferred income

	EEK		EUR	
	31.12.2008	31.12.2007	31.12.2008	31.12.2007
In thousands				
Advances for sale of real estate	58 845	23 758	3 761	1 518
Deferred income from long-term service contracts[1]	4 419	2 114	282	135
Other deferred income	1 910	21 344	122	1 365
Total deferred income	**65 174**	**47 216**	**4 165**	**3 018**

[1] Adjustment of the revenue of long-term service contracts

	EEK		EUR	
	31.12.2008	31.12.2007	31.12.2008	31.12.2007
In thousands				
Costs incurred and recognised profit under the stage of completion	464 214	94 664	29 669	6 050
Progress billings	-460 117	-75 143	-29 406	-4 804
Total revenue adjustment	**4 097**	**19 521**	**263**	**1 246**
Including due from customers (note 18)	8 517	21 635	486	1 383
Including due to customers	-4 420	-2 114	-282	-135

28 Provisions

In thousands EEK	Warranty provision[1]	Other provisions[2]	Total
Provision at 31 December 2006	433	2 615	3 048
Provisions made during the year	1 268	1 392	2 660
Provisions used during the year	-398	-1 591	-1 989
Provision at 31 December 2007	**1 303**	**2 416**	**3 719**
Including current portion	1 303	2 165	3 468
Provisions made during the year	4 674	3 420	8 094
Provisions used during the year	-712	-894	-1 606
Provision at 31 December 2008	**5 265**	**4 942**	**10 207**
Including current portion	1 146	4 771	5 917

In thousands EUR	Warranty provision[1]	Other provisions[2]	Total
Provision at 31 December 2006	28	167	195
Provisions made during the year	81	89	170
Provisions used during the year	-25	-102	-127
Provision at 31 December 2007	**84**	**154**	**238**
Including current portion	83	138	221
Provisions made during the year	299	219	518
Provisions used during the year	-46	-57	-103
Provision at 31 December 2008	**337**	**316**	**653**
Including current portion	73	304	377

[1] Warranty provisions are recognised based on management's best estimates, i.e. by reference to the terms and conditions of each construction contract (whether the Group acts as a general contractor or uses own labour, who the subcontractors are, how complicated the project is, where the project is performed, etc). A provision amounts to up to 1% of the cost of the contract. Warranty provisions are created for covering the costs which may be incurred during the warranty period. A warranty period lasts for two years from the delivery of work performed.

[2]At 31 December 2008, provisions for additional expenses which could be incurred from transactions performed in prior periods totalled 1 100 thousand kroons (70 thousand euros). At the end of 2007, the corresponding figure was 1 271 thousand kroons (81 thousand euros). According to estimates, the risk of additional expenses will expire within 2 to 4 years.

At 31 December 2008, the Group's Bulgarian development company had created a builder's warranty provision of 458 thousand kroons (29 thousand euros). This is the amount by which at 31 December 2008 the construction company providing services to the Group had reduced the invoices paid to it on a monthly basis. The provision will be used for covering construction defects and deficiencies. The provision will be recognised for 15 years after the delivery of the work performed.

29 Assets pledged as security

The Group has pledged the following assets as security for its loans and borrowings (including finance lease liabilities):

	EEK		EUR	
	31.12.2008	**31.12.2007**	**31.12.2008**	**31.12.2007**
In thousands				
Properties carried as inventories (note 20)	602 332	810 212	38 496	51 782
Investment property (note 23)	501 893	983 568	32 077	62 861
Property, plant and equipment (note 24)	32 414	102 541	2 072	6 554
Total pledged assets	**1 136 639**	**1 896 321**	**72 645**	**121 197**

30 Share capital

	EEK		EUR	
	31.12.2008	**31.12.2007**	**31.12.2008**	**31.12.2007**
Number of issued shares fully paid up	95 284 150	95 284 150	95 284 150	95 284 150
Share capital (in thousands)	952 842	952 842	60 898	60 898
Share premium per share (in kroons and in euros)	7,48	7,48	0,48	0,48
Total share premium (in thousands)	712 514	712 514	45 538	45 538
Treasury shares (minus)[1]	-3 992	0	-255	0

The maximum amount of Arco Vara AS shares to be issued as of 31 December 2008 is 121 812 148.

[1] Own shares: Based on the resolution of the annual general meeting of Arco Vara shareholders on 14 May 2008, Arco Vara AS was entitled to acquire own shares under the following conditions:

a) the public limited company is entitled to acquire own shares within five years after taking the resolution of the general meeting;

b) the total amount of the nominal value of shares acquired by the public limited company shall not exceed 10% of the share capital;

c) the amount to be paid for one share shall not be less than a half of the nominal value of the share nor higher than the price of the last independent transaction made on Tallinn Stock Exchange on the day of acquiring the share or the highest valid independent purchase offer made on Tallinn Stock Exchange on the day of acquiring the share;

d) for the own shares, from the assets shall be paid that exceed the share capital, reserve capital and the issue premium.

On 8 October 2008, Arco Vara AS decided to terminate this repurchase programme.

In May 2007, Arco Vara AS increased the share capital through a bonus issue in the amount of 373 331 thousand kroons (23 860 thousand euros) without making any additional contributions on the account of the equity capital of the public limited company. Within the bonus issue, 37 331 113 new shares with a nominal value of 10 kroons were issued.

In June 2007, the Group additionally issued 27 500 thousand shares with a nominal value of 10 kroons. The shares were subscribed for within the initial public offering on the Tallinn Stock Exchange. The subscription price of shares was 38 kroons (2.43 euros), which resulted in 1 045 00 kroons (66 788 thousand euros) paid to the Group. The costs directly related to the issue of shares are reflected as a decrease in the issue premium in the amount of 57 486 thousand kroons (3 674 thousand euros).

31 Contingent liabilities

Income tax on dividends

	EEK		EUR	
	2008	2007	2008	2007
In thousands				
Retained earnings at 31 December	-984 668	218 830	-62 932	13 986
Contingent income tax liability	0	45 954	0	2 937
Amount	**0**	**172 876**	**0**	**11 049**

The maximum contingent income tax liability has been calculated on the assumption that the net dividend and the associated dividend tax expense may not exceed the distributable profits as of 31 December 2008.

In 2009, no dividends will be paid. In 2008, the Management Board of the Group made a proposal to the Supervisory Board and the shareholders of the Group to distribute 37 210 thousand kroons (2 378 thousand euros) from the net profit of 2007.

Pending lawsuits

Litigation against the subsidiary Arco Investeeringute AS

<u>Action brought by Profitor Group OÜ</u>

In December 2006, Profitor Group OÜ filed a statement of claim against Arco Investeeringute AS for settlement of an invoice of 1 377 thousand kroons (88 thousand euros) and related interest on arrears of 225 thousand kroons (14 thousand euros).

In January 2007, Arco Investeeringute AS filed a counterclaim against Profitor Group OÜ for charging 4 368 thousand kroons (279 thousand euros) for services not delivered.

On 6 October 2008, the Harju County Court issued a decision not to take cognisance of the action by Profitor Group OÜ.
On 12 November 2008, the Harju County Court made a default judgement taking effect on 30 December 2008 and ordering the payment of 4 367 529 thousand kroons to be made to Arco Investeeringute AS.

By the time of preparing the report the legal proceedings have been concluded and the court ruling forwarded to the bailiff to be proceeded.

<u>Adoption of a detail plan for Narva mnt 67</u>
On 19 May 2008 a resident of the Liivaoja residential area brought an action for annulment of Resolution No 72 Adoption of a Detail Plan for Narva mnt 67 in the City Centre passed by Tallinn City Council on 17 April 2008, filing also a request for the application of provisional legal protection According to the complainant, the detail plan adopted for the property known as the Tivoli plot is unlawful and violates the rights of the complainant.
Since the property belongs to Arco Investeeringute AS, the Group is involved in the proceedings as a third party.
On 8 July 2008 Tallinn Administrative Court ruled that the request for provisional legal protection would be satisfied and execution of Tallinn City Council Resolution 72 of 17 April 2008 would be suspended until the completion of litigation and entry into force of a judicial decision.
On 18 July 2008 both the Tallinn City Council and Arco Investeeringute AS filed an appeal with Tallinn Circuit Court in which they requested annulment of the ruling on provisional legal protection.
The Tallinn Circuit Court heard the appeal against the court ruling on 11 August 2008 and dismissed the appeals by Tallinn City Council and Arco Investeeringute AS.

The Group's management finds the implementation of provisional legal protection unjustified as:
The court has been biased in defining the public interest and has not considered the interest of a third party in suspending the validity of the detail plan.

- The complainant does not follow the principles of good faith.
- Traffic arrangement of the detail plan is in compliance with the comprehensive plan, the plans of neighbouring areas and the relevant standard EVS 843:2003 "Town streets", the traffic solution is adequately motivated in the decision.

- The parking development plan is not administrative legislation of general application but a good practice not obligatory to comply with.
- The arguments of environmental impact assessment are adequate.

On 14 October 2008 Arco Investeeringute AS submitted a request for annulment of the ruling on provisional legal protection to Tallinn Circuit Court. Arco Investeeringute AS and Tallinn City Council agreed to make a compromise in regard of adding parking spaces to the area subject to the plan, the opinions on the shortcomings of the detail plan as indicated in the ruling on provisional legal protection were also explained and reasoned by documents as well as factually. Yet, the court did not annul the ruling on provisional legal protection.
Despite the execution of provisional legal protection, the Group's management believes that in the long term the dispute will have an outcome allowing the implementation of the detail plan, particularly as the Group intends to develop the plot in the long term.

At the time of preparing the report the Tallinn Administrative Court is still in the process of making the decision.

Actions brought by the subsidiary Arco Ehitus OÜ

Bankruptcy action against OÜ Kaanon Kinnistud
On 26 June 2008 Arco Ehitus OÜ filed a motion with Harju County Court in which it requested that bankruptcy proceedings be initiated against OÜ Kaanon Kinnistud and that OÜ Kaanon Kinnistud be declared bankrupt. The Group management finds that the request for bankruptcy against OÜ Kaanon Kinnistud is fully justified. Arco Ehitus OÜ and OÜ Kaanon Kinnistud agreed on 1 April 2006 on the construction and designing of sewage system for OÜ Kaanon Kinnistud OÜ. Arco Ehitus OÜ submitted delivery documents concerning all works performed on 31 July 2007 and OÜ Kaanon Kinnistud signed the documents. Arco Ehitus OÜ has invoiced OÜ Kaanon Kinnistud for services rendered and the customer has not disputed the amounts charged. As at 30.05.2008 the Group's receivables from OÜ Kaanon Kinnistud totalled 1,887 thousand kroons (the principal liability of 516 thousand kroons and interest 1 371 thousand kroons), 121 thousand euros respectively (principal liability 33 thousand euros and interest 88 thousand euros).
As at 30 June 2008 the receivable from Kaanon Kinnistud OÜ is classified as fully impaired (irrecoverable).
On 25 August 2008, the Harju County Court decided that in order to proceed with the case Arco Ehitus OÜ must pay a 15 thousand kroons (1 thousand euros) remuneration fee of an interim trustee. As the Group had already started separate negotiations with OÜ Kaanon Kinnistud and one of the conditions set was the withdrawal of the application, on 11 September 2008 Arco Ehitus OÜ submitted an application to the court to terminate the bankruptcy proceeding.
To date the litigation has ended.

32 Government grant

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Greenhouses	843	0	54	0
Watering beam	142	0	9	0
Inventory	33	0	2	0
Total	**1 018**	**0**	**65**	**0**

In 2008, resources for targeted financing in the amount of 1 018 thousand kroons (65 thousand euros) were received from the foundation Environmental Investments Centre. In 2007, the Group received no finances for targeted financing.

33 Financial instruments and financial risk management

The Group's activities expose it to various financial risks: market risk (interest rate risk and currency risk), credit risk and liquidity risk.

The Group's risk management programme is based on the assumption that the financial markets are unpredictable and appropriate measures have to be adopted to minimise potential adverse impacts on the Group's financial activities. The Group can use derivative financial instruments to hedge certain risk exposures.

The Group's risk management process is based on the premise that the Group's success depends on constant monitoring, careful analysis and effective management of the risks faced by the Group. Centralised financial risk management is the responsibility of the Group's financial team. The main objective of financial risk management is to prevent any damage or financial loss that could jeopardise the Group's equity and continuous operation. The Group establishes risk management policies and activities which are aimed at identifying, evaluating, monitoring and managing risks and spreading risks across time, activities and geographical areas. Risk management policies and activities are implemented by the managers of Group entities.

By implementing financial risk management process the critical issue is to monitor the Group's risk exposure in development segment due to the concentration of interest rate and liquidity risk in one business segment –development and geographically in Estonia. The main reason is that the property development is very capital intensive and several large development projects in Estonia are under process at the same time.

Information on financial instruments by category

	EEK		EUR	
In thousands	**31.12.2008**	31.12.2007	**31.12.2008**	31.12.2007
Cash and cash equivalents	172 581	765 008	11 030	48 893
Loans and receivables	*172 581*	*765 008*	*11 030*	*48 893*
Receivables	301 023	337 313	19 239	21 558
Loans and receivables	*301 023*	*335 983*	*19 239*	*21 473*
Derivatives	*0*	*1 330*	*0*	*85*
Other financial assets	40 671	127 110	2 599	8 124
Loans and receivables	*129*	*128*	*8*	*8*
Current investments in equity instruments – carried at fair value	*40 542*	*126 982*	*2 591*	*8 116*
Total financial assets	**511 480**	**1 229 431**	**32 689**	**78 575**
Loans and borrowings	1 046 336	1 354 015	66 873	86 537
Carried at amortized cost	*1 046 336*	*1 354 015*	*66 873*	*86 537*
Payables and other liabilities	137 081	228 198	8 761	14 585
Carried at amortized cost	*137 081*	*228 198*	*8 761*	*14 585*
Total financial liabilities	**1 183 417**	**1 582 213**	**75 634**	**101 122**

Income, expense, gains and losses on financial instruments can be assigned to the following categories:

					2008
In thousands EEK	**Loans and receivables**	**Derivatives**	**Liabilities – carried at fair value**	**Liabilities carried at amortized cost**	**Total**
Interest income (note 12)	48 511	826	3 927	0	**53 264**
Interest expense (note 13)	0	-156	0	-48 028	**-48 184**
Gains and losses from other non-current financial assets (note 12, 13)	0	0	2 429	0	**2 429**
Impairment losses on financial assets (note 13)	-72 435	0	0	0	**-72 435**
Net result	**-23 924**	**670**	**6 356**	**-48 028**	**-64 926**

					2008
In thousands EUR	**Loans and receivables**	**Derivatives**	**Liabiliites– carried at fair value**	**Liabilities carried at amortized cost**	**Total**
Interest income (note 12)	3 100	53	251	0	**3 404**
Interest expense (note 13)	-2 351	-10	0	-719	**-3 080**
Gains and losses from other non-current financial assets (note 12, 13)	-214	0	79	290	**155**
Impairment losses on financial assets (note 13)	-4 629	0	0	0	**-4 629**
Net result	**-4 094**	**43**	**330**	**-429**	**-4 150**

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ERNST & YOUNG
17.04.2009

2007

	Loans and receivables	Derivatives	Liabilities – carried at fair value	Liabilities carried at amortized cost	Total
In thousands EEK					
Interest income (note 12)	29 472	0	705	0	**30 177**
Interest expense (note 13)	0	-156	0	-33 684	**-33 840**
Gains and losses from other non-current financial assets (note 12, 13)	0	0	43 317	4 544	**47 861**
Impairment losses on financial assets (note 13)	-25 768	0	0	0	**-25 768**
Net result	**3 704**	**-156**	**44 022**	**-29 140**	**18 430**

2007

	Loans and receivables	Derivatives	Liabilities – carried at fair value	Liabilities carried at amortized cost	Total
In thousands EUR					
Interest income (note 12)	1 884	0	45	0	**1 929**
Interest expense (note 13)	0	-10	0	-2 153	**-2 163**
Gains and losses from other non-current financial assets (note 12, 13)	0	0	2 768	290	**3 058**
Impairment losses on financial assets (note 13)	-1 647	0	0	0	**-1 647**
Net result	**237**	**-10**	**2 813**	**-1 863**	**1 177**

Financial assets overdue

The Group has some trade receivables which are overdue but for which no impairment allowance has been made. The Group's management has assessed the recoverability of such receivables on an individual basis and has come to the conclusion that the items are not impaired.

The following table provides an overview of overdue receivables:

	EEK		EUR	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007
In thousands				
Until 3 months	54 892	38 340	3 509	2 451
3 - 6 months	18 620	1 150	1 191	73
6 - 12 months	11 695	5 855	747	374
More than 12 months	5 120	2 821	327	180
Total trade receivables (note 18)	**90 327**	**48 166**	**5 774**	**3 079**

The Group's other financial assets do not include overdue items for which an impairment allowance has not been made.

Liquidity risk

Liquidity risk is the risk that a change in financial position will cause the Group to encounter difficulty in meeting the obligations associated with financial liabilities in a due and timely manner, or that the Group will be unable to dispose of property at market price and within the desired timeframe. Above all, the Group's liquidity is affected by the following factors:

- Group entities' ability to generate independent positive net operating cash flows and the volatility of those cash flows
- Mismatch in the maturities of assets and liabilities and flexibility in adjusting it
- Marketability of long-term assets
- Volume and pace of property development
- Volume and pace of geographical expansion
- Financing structure

The Group's financial team manages the Group's liquidity based on a relevant strategy which is aligned with the Group's investment plan.
Short-term liquidity management of Group is first and foremost based on steadily observing of quarterly cash flow forecast. The purpose of short-term liquidity management is to guarantee the availability of sufficient highly liquid funds (i.e. cash and cash equivalents and highly liquid investments). The main tools for short-term liquidity management are the group account, which pools the funds of Group entities, and, in the case of foreign Group entities, loans from the Parent.

Long-term liquidity is primarily influenced by investment decisions. The Group observes the principle that Group entities' net cash inflows from operating and investing activities have to cover the Group's cash outflows from financing activities. Accordingly, the purpose of long-term liquidity management is to ensure sufficient liquidity of the investment (property) portfolio, harmonize the timing of cash flows from investing and financing activities, and determine the optimal financing structure. Long-term projects are monitored to ensure that the timing and amounts of investing cash flows do not differ significantly from the timing and amounts of financing cash flows. The following table illustrates the Group's open position in refinancing loan liabilities:

Maturity structure of financial assets and financial liabilities

					31.12.2008
In thousands EEK	**< 3 months**	**3-12 months**	**1-5 years**	**> 5 years**	**Total**
Cash and cash equivalents	172 574	0	0	0	172 574
Receivables	100 900	193 452	6 671	0	301 023
Investments in financial assets	40 416	0	255	0	40 671
Total assets	**313 890**	**193 452**	**6 926**	**0**	**514 268**
Loans and borrowings	18 958	334 459	576 126	116 793	1 046 336
Payables	92 175	40 502	4 404	0	137 081
Total liabilities	**111 133**	**374 961**	**580 530**	**116 793**	**1 183 417**

					31.12.2007
In thousands EEK	**< 3 months**	**3-12 months**	**1-5 years**	**> 5 years**	**Total**
Cash and cash equivalents	685 008	80 000	0	0	765 008
Receivables	76 224	220 965	40 124	0	337 313
Investments in financial assets	78 595	0	48 515	0	127 110
Total assets	**839 827**	**300 965**	**88 639**	**0**	**1 229 431**
Loans and borrowings	111 888	605 374	500 983	135 770	1 354 015
Payables	139 093	84 498	4 607	0	228 198
Total liabilities	**250 981**	**689 872**	**505 590**	**135 770**	**1 582 213**

					31.12.2008
In thousands EUR	**< 3 months**	**3-12 months**	**1-5 years**	**> 5 years**	**Total**
Cash and cash equivalents	11 029	0	0	0	11 029
Receivables	6 449	12 364	426	0	19 239
Investments in financial assets	2 583	0	16	0	2 599
Total assets	**20 061**	**12 364**	**442**	**0**	**32 867**
Loans and borrowings	1 212	21 376	36 821	7 464	66 873
Payables	5 891	2 589	281	0	8 761
Total liabilities	**7 103**	**23 965**	**37 102**	**7 464**	**75 634**

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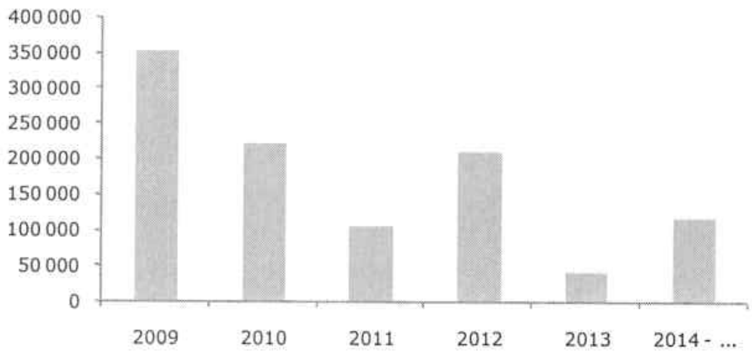
17.04.2009

					31.12.2007
	< 3 months	3-12 months	1-5 years	> 5 years	Total
In thousands EUR					
Cash and cash equivalents	43 780	5 113	0	0	48 893
Receivables	4 872	14 122	2 564	0	21 558
Investments in financial assets	0	0	3 101	0	3 101
Total assets	**48 652**	**19 235**	**5 665**	**0**	**73 552**
Loans and borrowings	7 151	38 690	32 019	8 677	86 537
Payables	8 890	5 400	294	0	14 584
Total liabilities	**16 041**	**44 090**	**32 313**	**8 677**	**101 121**

With regard to the repayment terms of the liabilities within the loan portfolio, the weighted duration of loan liabilities as of 31 December 2008 is 2.5 years, which is somewhat shorter than the weighted duration from 31 December 2007. The division of loan liabilities on the year-over-year basis is displayed on the following chart.

Breakdown of loans and borrowings by maturity (in thousands of kroons)



Refinancing risk is managed by monitoring the liquidity position on a daily basis and analysing different financing options on a consistent and ongoing basis. In addition, partner banks and professionals qualified in analysing developments in capital markets are involved in the process already in the initial stage. For the purpose of mitigation of the refinancing risk the option of a project sale is being considered as an alternative.

Interest rate risk and currency risk

Interest rate risk is the risk that a rise in market interest rates will increase interest expense to an extent that will have a significant impact on the Group's operating efficiency. Exposure to interest rate risk results from:

1. use of loans and borrowings with a floating interest rate, and

2. the need for refinancing in connection with the arrival of the due dates of liabilities or the involvement of new loans in connection with the realisation of the investment plan in a situation where the volatility of financial markets is increasing and the economic environment is changing.

Most of the Group's long-term loans and borrowings are linked to EURIBOR. Therefore, the Group is exposed to developments on the international financial markets. Interest rate risk is managed, among other things, by monitoring movements in the money market interest rate curve, which reflects the market participants' expectations of market interest rates and allows estimating a trend for euro-denominated interest rates.

In response to a 1.7 percentage point decrease in EURIBOR in 2008, the Group analysed the sensitivity of its profit before tax and cash flows to a 1 percentage point change in interest rates.

The sensitivity analysis of generated cash flows to changes in interest rate demonstrated that a 1 percentage point change (rise or decline) in interest rates would affect (increase or reduce) the cash flows generated in 2008 by 9 147 thousand kroons (585 thousand euros) (2007: 8 281 thousand kroons (529 thousand euros)). The sensitivity analysis of profit before tax demonstrated that a 1 percentage point change (rise or decline) in interest rates would affect (increase or reduce) profit before tax for 2008 by 5 628 thousand kroons (360 thousand euros) (2007: 5 050 thousand kroons (328 thousand euros)). In managing its short-term interest rate risks, the Group regularly compares potential losses from changes in interest rates against corresponding risk hedging expenses. To date, no financial instruments have been used to hedge short-term interest rate risks because according to management's assessment hedging expenses would exceed the losses which might be incurred.

The Group's interest-bearing assets and liabilities

By maturity In thousands EEK	< 3 months	3-12 months	1-5 years	> 5 years	31.12.2008 Total
Interest-bearing assets	163 678	103 905	254	0	267 837
Interest-bearing liabilities	18 958	334 459	576 126	116 793	1 046 336
Net position	**144 720**	**-230 554**	**-575 872**	**-116 793**	**-778 499**

By maturity In thousands EEK	< 3 months	3-12 months	1-5 years	> 5 years	31.12.2007 Total
Interest-bearing assets	692 865	145 062	38 578	0	876 505
Interest-bearing liabilities	111 888	605 374	500 983	135 770	1 354 015
Net position	**580 977**	**-460 312**	**-462 405**	**-135 770**	**-477 510**

By maturity In thousands EUR	< 3 months	3-12 months	1-5 years	> 5 years	31.12.2008 Total
Interest-bearing assets	10 461	6 641	16	0	17 118
Interest-bearing liabilities	1 212	21 376	36 821	7 464	66 873
Net position	**9 249**	**-14 735**	**-36 805**	**-7 464**	**-49 755**

By maturity In thousands EUR	< 3 months	3-12 months	1-5 years	> 5 years	31.12.2007 Total
Interest-bearing assets	44 282	9 271	2 466	0	56 019
Interest-bearing liabilities	7 151	38 690	32 019	8 677	86 537
Net position	**37 131**	**-29 419**	**-29 553**	**-8 677**	**-30 518**

Currency risks are hedged by performing most transactions and signing most agreements and contracts in euros or currencies pegged to the euro. The main currency risk is the devaluation of the local currency against the euro. In view of the low probability of the devaluation, the risk is not significant.

Breakdown of loans and borrowings by currency

	EEK		EUR		share, %	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007	**31.12.2008**	31.12.2007
In thousands						
EUR	793 877	875 421	50 738	55 950	76	65
EEK	239 597	472 055	15 313	30 170	23	35
Other currencies	12 862	6 539	822	418	1	0
Total	**1 046 336**	**1 354 015**	**66 873**	**86 538**	**100**	**100**

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ERNST & YOUNG
17.04.2009

Breakdown of interest-bearing assets by currency

	EEK		EUR		share, %	
	31.12.2008	31.12.2007	**31.12.2008**	31.12.2007	**31.12.2008**	31.12.2007
In thousands						
EEK	211 248	817 937	13 501	52 276	79	93
EUR	0	58 568	0	3 743	0	7
Other currencies	56 589	0	3 617	0	21	0
Total	**267 837**	**876 505**	**17 118**	**56 019**	**100**	**100**

The Group's liabilities are denominated mainly in the euro or in the Estonian kroon and operating volumes are the largest in countries whose local currency is pegged to the euro. Therefore, the currency risk is insignificant. Currency risks arising from open positions are hedged by euro-denominated transactions between countries and matching the timing of receipts and payments in the country involved.

Credit risk

Credit risk is the risk that the other party to a financial instrument will cause a financial loss to the Group by failing to discharge an obligation.

Credit risk is managed by making sure that there are no major concentrations of credit risk. Group entities prevent and minimize credit risk by monitoring and managing customers' settlement behaviour on a daily basis so that appropriate measures could be applied in due time. In addition, sales and construction activities are partly financed with customer prepayments and in real estate transactions, where the other party is often financed by a credit institution, the Group cooperates with banks. Consequently, the risks arising from customer insolvency are well hedged.

Allowances are made for potential losses. Potential losses are estimated based on historical experience, the other party's ability to meet existing obligations in the short term, and developments in the economic environment.

Group entities perform transactions only with counterparties who are considered creditworthy. As a rule, immediate payment is demanded. Credit is granted against additional collateral only. Accordingly, management believes that the need for additional hedging of credit risk is minimal. The maximum potential credit risk equals the total carrying amount of receivables, cash and cash equivalents and investments in financial assets.

Fair value

The main financial assets and financial liabilities of Group entities are recognised in the balance sheet. The Group does not have any significant off-balance sheet financial assets or liabilities which have not been disclosed in the financial statements. Because of the accounting and reporting principles applied, the carrying amounts of the financial assets and financial liabilities do not differ significantly from their fair values.

The fair values of assets and liabilities with a fixed interest rate are not significantly different from their carrying amounts because the fixed interest rate does not differ significantly from current market interest rates.

Hedging

All derivative financial instruments which are used to hedge risks are recognised as assets or liabilities. Regardless of their purpose, they are initially recognised at their fair values. Changes in the fair values of such derivative instruments are recognised in the income statement in finance income and expenses (in "Interest expense/interest income").

As of 31 December 2008, the Group has no valid risk hedging transactions. As of 31 December 2007, the fair value of risk hedging transactions was 1 330 thousand kroons (85 thousand euros). The final term for the interest change agreement was 1 December 2008. The fair value of the interest change agreement is reflected on the balance sheet as short-term receivable or other short-term liabilities.

Capital management

The objective of capital management is to maintain a capital base which ensures the Group's continuous operation and development and to prevent risks which could jeopardise the Group's equity.

The Group finances its operations with both debt and equity capital. Property development is very capital intensive. Therefore, as a rule, related investment projects are financed on the assumption that equity financing should be at least 30% of the cost of the project.

In designing the optimal financing structure and identifying and measuring risks, the Group monitors the proportion of equity in the consolidated balance sheet. At 31 December 2008, equity accounted for 36.0 % (2007: 54.1 %) of the balance sheet total.

Management makes a proposal for the distribution of dividends based on the Group's results of operation and investment plan, and developments in the economic environments of the markets in which the Group operates.

Notes to the cash flow statement

34 *Note to the cash flow statement*

The main components of negative operating cash flow were the changes in inventories where investments in Kolde, BM-1, Madrid and Manastirski residential projects are recorded.
The main components of negative investment cash flow were: payables for acquired subsidiaries due in the amount of 44 000 thousand kroons (2 812 thousand euros), Ukraine investments and loans of 111 052 thousand kroons (7 097 thousand euros) and depositing and investing liquid assets to short-term bonds.
The main components of financing cash flow were: 82 271 thousand kroons (5 258 thousand euros) of interests cost, 57 790 thousand kroons (3 693 thousand euros) of gross dividend payment, 256 604 thousand kroons (16 400 thousand euros) change in net debt, the majority of which were extraordinary principal repayments during refinancing transactions or the redemption of bonds.
A major setback for the short term liquidity has been the default of AS Ühendatud Kapital to pay its 10 907 thousand USD outstanding debt (121 124 thousand kroons, 7 741 thousand euros). By the moment of publishing the report, Arco Vara has filed a relevant action in the Tallinn Arbitration Court. The claim by Arco is already due.

35 *Cash and cash equivalents*

Cash comprises cash on hand, bank cheques and demand deposits. In accordance with IAS 7 *Cash Flow Statements*, cash and cash equivalents also include term deposits with a maturity of less than three months.

	EEK		EUR	
	31.12.2008	**31.12.2007**	**31.12.2008**	**31.12.2007**
In thousands				
Cash and demand deposits	49 313	70 738	3 152	4 521
Term deposits	123 261	694 270	7 878	44 372
Total cash and cash equivalents	**172 574**	**765 008**	**11 030**	**48 893**

As of 31 December 2008, the time deposits consist of deposits with a length of up to 3 months in the amount of 123 261 thousand kroons (7 878 thousand euros), at the end of 2007 respectively 646 466 thousand kroons (41 317 thousand euros), and overnight deposits in the amount of 30 498 thousand kroons (1 949 thousand euros), at the end of 2007 respectively 58 035 thousand kroons (3 709 thousand euros).

The annual interest rates of time deposits were in 2008 between 1.8% and 7.85% (2007: 2.46% to 7.9%).

The annual interest rates of demand deposits were 0.25% to 0.5% (2007: same).

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17.04.2009

Other information

36 *Transactions with related parties*

For the purposes of these consolidated financial statements related parties comprise:

- jointly controlled entities
- associated companies
- companies and other persons having control, joint control or significant influence over the Group or Group entities (this includes venture partners and shareholders of the Parent);
- key members of the Group's management (this includes members of the Parent's supervisory board and members of the management boards of the Group's subsidiaries and jointly controlled entities)
- other related parties (this includes companies related to members of the Parent's supervisory board)

	EEK		EUR	
As at 31 December or for the year	**2008**	2007	**2008**	2007
In thousands				
Transactions with jointly controlled entities[1]				
Sales revenue	1 690	5 017	108	321
Services purchased	-52	-46	-3	-3
Short-term loan receivables (note 18)	13 855	52 530	885	3 357
Long-term loan receivables (note 18)	5 750	37 688	367	2 409
Trade receivables (note 18)	1 030	963	66	62
Other current receivables (note 18)	2 205	226	141	14
Other non-current receivables (note 18)	0	850	0	54
Payables (note 26)	0	6 386	0	408
Transactions with companies having joint control over Group companies				
Sales revenue	0	135	0	9
Services purchased	-445	-555	-28	-35
Other current receivables (note 18))	13 348	3 490	853	223
Short-term loan liabilities (note 24)	16 377	51 852	1 047	3 314
Dividends payable (note 26)	0	8 743	0	559
Trade payables (note 26)	368	24	24	2
Interest payable (note 26)	968	2 101	62	134
Long-term loan liabilities (note 24)	0	38 898	0	2 486
Other long-term liabilities (note 26)	0	815	0	52
Transactions with key staff of the Group and the Group's management				
Sales revenue	11 747	5 093	751	326
Trade receivables (note 18)	262	1 377	17	88
Short-term loan liabilities (note 24)	85	1 945	5	124
Interest payable (note 26)	0	373	0	24
Transactions with other related parties				
Sales revenue	1 869	14 395	119	920
Service purchased	-33	10 582	-2	676
Short-term loan receivables (note 18)	0	12 391	0	792
Interest receivable (note 18)	0	1 242	0	79
Other current receivables (note 18)	0	2 825	0	181
Long-term loan receivables (note 18)	0	907	0	58
Short-term loan liabilities (note 24)	11 424	298	730	19
Trade payables	0	17	0	1
Other payables (note 26)	0	28 406	0	1 815
Long-term interest liabilities (note 26)	0	997	0	64
Long-term liabilities (note 24)	31 151	7 491	1 991	479

[1] The figures do not include the sales and purchases, and receivables and payables which have been eliminated in the consolidated financial statements based on the Group's interest.

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17.04.2009

Management remuneration

The total remuneration of 2008, including taxes, paid by the Group to the Management Board of the parent undertaking and the managers of divisions amounted to 24 710 thousand kroons (1 579 thousand euros), in 2007 respectively 24 313 thousand kroons (1 554 thousand euros). In termination payment in the amount of 4 100 thousand kroons (262 thousand euros) was paid to two members of the Board, in 2007 respectively 4 267 thousand kroons (273 thousand euros).

37 Events after the balance sheet date

Arco Vara AS and Arco Ehitus OÜ creditors claims towards OÜ Tempera Ehitus.

On 26.02.2009 Harju Country Court proclaimed bankruptcy of OÜ Tempera Ehitus.

On 04.03.2009 Arco Vara AS filed proof of claim. Arco Vara's creditor claim is in amount of 2 343 thousand kroons (150 thousand euros) based on credit agreement signed on 07.08.2008.

On 09.03.2008 Arco Ehitus OÜ filed proof of claim. Arco Ehitus's creditor claim is in amount of 2 371 thousand kroons (152 thousand euros) based on a given loan and object management and construction management agreements.

First general body of creditors was held on 25th March 2009. General body of creditors decided not to approve Maire Arm as trustee in bankruptcy. On 3rd of April 2009 all creditors jointly presented to the Court a list of trustees in bankruptcy they are in favour. On 09.04.2009 Court appointed Katrin Prükk as a new trustee in bankruptcy.

Bankruptcy report states that debtor has debt obligations in around 13 588 thousand kroons (868 thousand euros) but there is lack of any kind of tangible assets. According to prior mention the Board believes that it will be unlikely that debtor will manage to acquit a debt to Arco Vara or Arco Ehitus.

Currently the bankruptcy proceedings are pending.

Arco Investeeringute AS action towards AS Ühendatud Kapital

On 26.02.2008 Arco Investeeringute AS, Sigma Real Estate Ltd. and AS Ühendatud Kapital signed a Letter of Intent ("LOI") in order to set the main principles and conditions for the acquisition of 50% stake in Cypros holding company that should manage and develop shopping centre projects in Ukraine. According to LOI Arco Investeeringud made capital payments in value of 10 000 thousand USD (111 052 thousand kroons; 7 098 thousand euros) that Arco has the right to get back. The proceeds were guaranteed by AS Ühendatud Kapital, an Estonian entity. Taking into account that AS Ühendatud Kapital doesn't agree to Arco Investeeringud compromise to sign additional collateral and longer payment schedule, Arco's management has decided to execute AS Ühendatud Kapital guarantee.

On 19.02.2009 Arco Investeeringute AS filed and action to The Arbitration Court Of The Estonian Chamber Of Commerce And Industry to collect arrears from AS Ühendatud Kapital in value 10 907 thousand USD (121 124 thousand kroons; 7 741 thousandeuros) and an application to secure an action. The Board of The Arbitration Court Of The Estonian Chamber Of Commerce And Industry forwarded the Arco's application to secure an action with its decision to Harju Country Court and the Court with its ruling has fully satisfied an action.

To secure an Arcos action the Harju Country Court made notation concerning prohibition of any shares and stocks of AS Ühendatud Kapital subsidiary companies, seized debtors all pecuniary means in all banks of Estonia and put judicial mortgage on registered immovable property of debtor.

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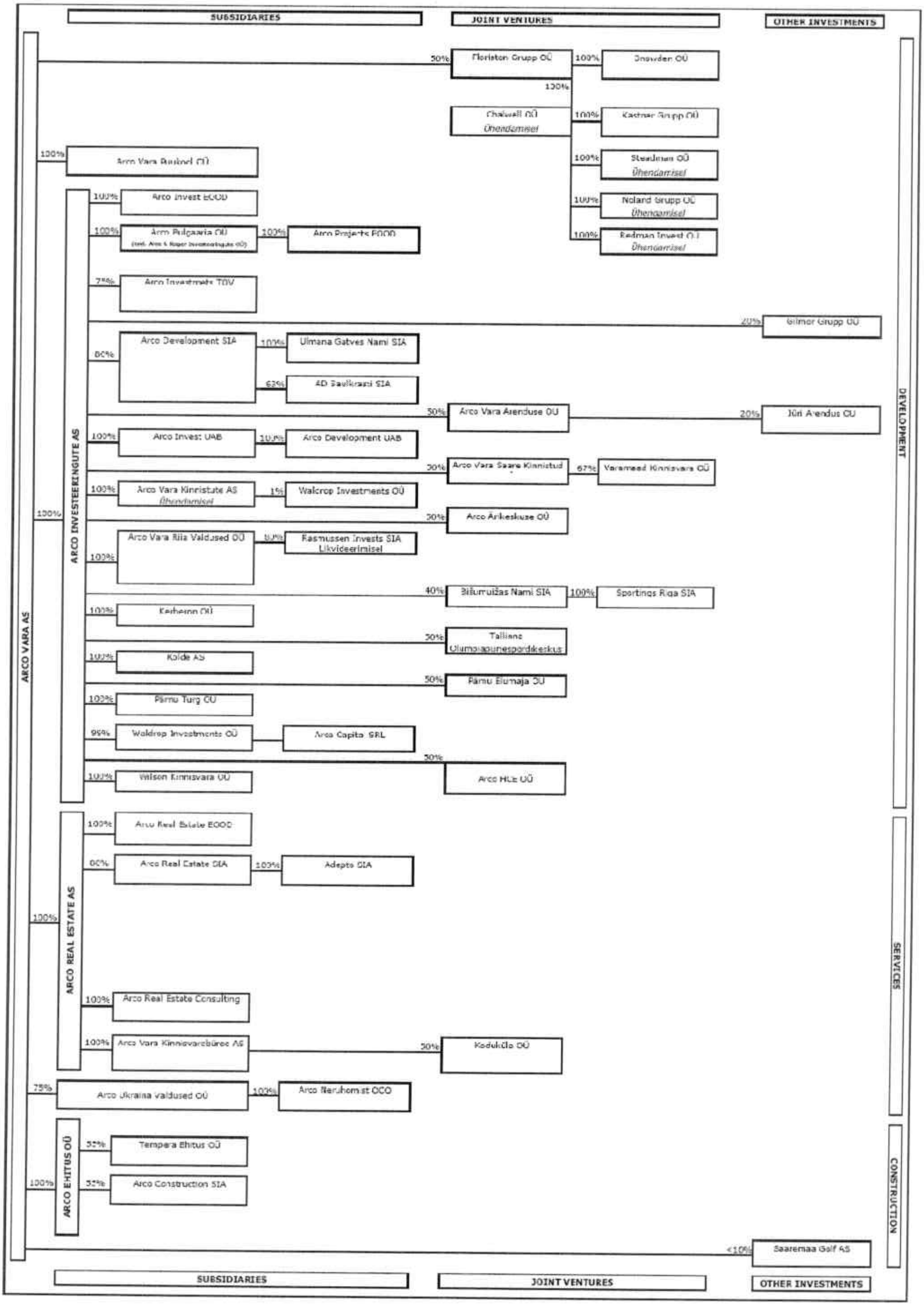
17.04.2009

38 Structure of Arco Vara Group



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17.04.2009

39 The Parent's unconsolidated financial statements presented in accordance with the Estonian Accounting Act

The Parent's unconsolidated primary financial statements have been prepared and presented in accordance with the Estonian Accounting Act and they do not constitute the Parent's separate financial statements as defined in IAS 27 *Consolidated and Separate Financial Statements*.

UNCONSOLIDATED INCOME STATEMENT

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Revenue from rendering of services	18 742	10 250	1 198	655
Cost of sales	-3 936	-9 068	-252	-580
Gross profit	**14 806**	**1 182**	**946**	**75**
Other income	0	8 404	0	537
Selling and distribution expenses	-2 555	-4 717	-163	-301
Administrative expenses	-28 478	-38 431	-1 820	-2 456
Other expenses	-16 773	-355	-1 072	-23
Operating profit	**-33 000**	**-33 917**	**-2 109**	**-2 168**
Gain / loss on shares in subsidiaries and jointly controlled entities	9 343	479 204	597	30 627
Finance income	160 414	26 997	10 252	1 725
Finance expenses	-17 323	-14 093	-1 107	-901
Profit before tax	**119 434**	**458 191**	**7 633**	**29 283**
Income tax expense	-12 682	-9 230	-811	-590
Profit for the year	**106 752**	**448 961**	**6 822**	**28 693**

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17.04.2009

UNCONSOLIDATED BALANCE SHEET

As at 31 December	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Cash and cash equivalents	117 861	687 926	7 533	43 966
Financial investments	40 416	78 595	2 583	5 023
Receivables	1 099 074	638 185	70 244	40 787
Prepayments	130	690	8	44
Inventories	0	0	0	0
Total current assets	**1 257 481**	**1 405 396**	**80 368**	**89 820**
Financial investments	555 555	489 709	35 506	31 298
Investment property	7 075	16 540	453	1 058
Property, plant and equipment	4 293	12 221	275	781
Intangible assets	650	610	43	39
Total non-current assets	**567 573**	**519 080**	**36 277**	**33 176**
TOTAL ASSETS	**1 825 054**	**1 924 476**	**116 645**	**122 996**
Loans and borrowings	99 346	124 558	6 349	7 961
Payables	6 729	131 883	430	8 429
Total current liabilities	**106 075**	**256 441**	**6 779**	**16 390**
Loans and borrowings	84	14 739	5	942
Total non-current liabilities	**84**	**14 739**	**5**	**943**
TOTAL LIABILITIES	**106 159**	**271 180**	**6 784**	**17 333**
Share capital	952 842	952 842	60 898	60 898
Share premium	712 514	712 514	45 538	45 538
Statutory capital reserve	31 463	20 084	2 011	1 284
Retained earnings	26 068	-32 144	1 666	-2 054
Treasury stocks (minus)	-3 992	0	-255	0
Total equity	**1 718 895**	**1 653 296**	**109 858**	**105 666**
TOTAL LIABILITIES AND EQUITY	**1 825 054**	**1 924 476**	**116 642**	**122 999**

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17.04.2009

UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY

In thousands EEK	Share capital	Share premium	Statutory capital reserve	Retained earnings	Total
At 31 December 2006	**304 530**	**123 083**	**5 486**	**-189 200**	**243 899**
Bonus issue	373 312	-123,083	0	-250 229	0
Issue of share capital	275 000	712 514	0	0	987 514
Transfer to capital reserve	0	0	14 598	-14 598	0
Change in retained earnings from merger with a subsidiary	0	0	0	-1 648	-1,648
Dividend distribution	0	0	0	-25 430	-25,430
Profit for the period	0	0	0	448 961	448,961
At 31 December 2007	**952 842**	**712 514**	**20 084**	**-32 144**	**1 653 296**
Transfer to capital reserve	0	0	11 379	-11 379	0
Dividend distribution	0	0	0	-37 161	-37 161
Profit for the period	0	0	0	106 752	106 752
Treasury stocks (minus)	0	0	0	-3 992	-3 992
At 31 December 2008	**952 842**	**31 463**	**31 463**	**22 076**	**1 718 895**

In thousands EUR	Share capital	Share premium	Statutory capital reserve	Retained earnings	Total
At 31 December 2006	**19 463**	**7 866**	**351**	**-12 092**	**15 588**
Bonus issue	23 859	-7 866	0	-15 993	0
Issue of share capital	17 576	45 538	0	0	63 114
Transfer to capital reserve	0	0	933	-933	0
Change in retained earnings from merger with a subsidiary	0	0	0	-105	-105
Dividend distribution	0	0	0	-1 625	1 625
Profit for the period	0	0	0	28 694	28 694
At 31 December 2007	**60 898**	**45 538**	**1 284**	**-2 054**	**105 666**
Transfer to capital reserve	0	0	727	-727	0
Dividend distribution	0	0	0	-2 375	-2 375
Profit for the period	0	0	0	6 823	6 823
Treasury shares (minus)	0	0	0	-255	-255
At 31 December 2008	**60,898**	**45,538**	**2 011**	**1 412**	**109 859**

ADJUSTED UNCONSOLIDATED EQUITY (for calculating compliance with the requirements of the Commercial Code)

As at 31 December	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
The Parent's unconsolidated equity	1 718 895	1 653 296	109 857	105 665
Carrying amount of interests in subsidiaries and jointly controlled entities in the Parent' unconsolidated balance sheet	-199 613	-120 442	12 767	-7 698
Carrying amount of interests in subsidiaries and jointly controlled entities under the equity method	- 811 123	601 460	122 624	38 440
The Parent's adjusted equity	**708 159**	**2 134 314**	**245 248**	**136 407**

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CASH FLOW STATEMENT

	EEK		EUR	
	2008	2007	**2008**	2007
In thousands				
Operating profit	-33 000	-33 917	-2 109	-2 168
Adjustments for:	7 745	-7 940	495	-507
Depreciation and amortisation	*1 481*	*464*	95	30
Gain / loss on sale of investment property	*6 264*	*0*	400	0
Change in fair value of investment property	*0*	*-8 404*	0	-537
Operating profit after adjustments	**-25 255**	**-41 857**	**-1 614**	**-2 675**
Change in receivables and prepayments	-9 796	144	-626	9
Change in payables	-2 460	12 348	-157	789
NET CASH USED IN OPERATING ACTIVITIES	**-37 511**	**-29 365**	**-2 397**	**-1 877**
Acquisition of property, plant and equipment and intangible assets	-631	-486	-40	-31
Acquisition of subsidiaries and interests in jointly controlled entities	-41 964	-10 355	-2 682	-662
Proceeds from disposal of subsidiaries and interests in jointly controlled entities	0	262 994	0	16 808
acquisition of other financial investments	-202 665	-78 595	-12 953	-5 023
Proceeds from disposal of other financial investments	243 871	0	15 586	0
Loans granted	-207 964	-661 560	-13 291	-42 281
Repayment of loans granted	93 139	220 428	5 953	14 088
Change in group account receivables	-296 229	104 906	-18 932	6 705
Interest received	44 296	28 062	2 831	1 793
Dividends received	0	800	0	51
NET CASH USED IN INVESTING ACTIVITIES	**-368 147**	**-133 806**	**-23 528**	**-8 552**
Proceeds from loans received	60 709	155 029	3 880	9 908
Repayment of loans	-144 839	-215 915	-9 257	-13 799
Change in overdraft	-14	-15 895	-1	-1 016
Change in group account liability	-18 515	-5 934	-1 183	-379
Interest paid	-8 310	-7 592	-531	-485
Proceeds from issue of share capital	0	987 514	0	63 114
Repurchase of won shares	-3 992	0	-255	0
Dividends paid	-42 274	-15 807	-2 703	-1 010
Income tax paid on dividends	-15 300	-4 388	-979	-279
NET CASH FROM FINANCING ACTIVITIES	**-172 535**	**877 012**	**-11 029**	**56 054**
NET CASH FLOW	**-578 193**	**713 841**	**-36 954**	**45 625**
Cash and cash equivalents at beginning of period	687 926	14 142	43 966	904
Increase / decrease	-578 193	673 841	-36 954	45 625
Effect of exchange rate fluctuations	8 128,00	-57	519,00	-4
Cash and cash equivalents at end of period	**117 861**	**687 926**	**7 531**	**46 525**

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ERNST & YOUNG
12.04.2009

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VAT payer code EE 100770654

Translation of the Estonian Original

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Arco Vara AS

Report on the Financial Statements

We have audited the consolidated financial statements of Arco Vara AS and its subsidiaries (hereafter "the Group"), which comprise the balance sheet as of 31 December 2008, the statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes. The audited financial statements, which we have identified on the accompanying pages, are enclosed with the current report.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements present fairly, in all material respects, the financial position of Arco Vara AS as of 31 December 2008, and 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.

Report on Other Legal and Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The financial information of Arco Vara AS as a parent company in Note 39 is presented because it is required by the Estonian Accounting Law and is not a required part of the consolidated financial statements prepared under International Financial Reporting Standards as adopted by the European Union. Such financial information has been subject to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is prepared in all material respects in accordance with the requirements of the Estonian generally accepted accounting principles and in relation to the consolidated financial statements taken as whole.

Tallinn, 17 April 2009

Hanno Lindpere
Ernst & Young Baltic AS

Urmo Kallakas
Authorised Auditor

Loss allocation proposal

The Management Board proposes that the General Meeting of the shareholders of Arco Vara AS allocate loss as follows (in thousands of kroons):

Retained earnings at 31 December 2008	-984 668
Share premium	-712 514

The rest of loss in amount of 272 154 will be covered by future profits.

17.04.09

Lembit Tampere
Chairman of the Management Board

17.04.09

Heigo Metsoja
Member of the Management Board

17.04.09

Veiko Taevere
Member of the Management Board

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Signatures

We hereby confirm that the information presented in the consolidated financial statements of Arco Vara AS for 2008 is true and fair.

21.04.2009
Richard Tomingas
Chairman of the Supervisory Board

Hillar-Peeter Luitsalu
Member of the Supervisory Board
21.04.09

Ragnar Meitern 21.04.09
Member of the Supervisory Board

21.04.09
Kalev Tanner
Member of the Supervisory Board

21.04.2009
Aare Tark
Member of the Supervisory Board

21.04.09
Lembit Tampere
Chairman of the Management Board

Veiko Taevere 21.04.09
Member of the Management Board

21.04.09
Heigo Metsoja
Member of the Management Board

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