

AS Tallinna Vesi

Annual Report | **20
05**



Values

We value our colleagues
are committed to customers
are competent and willing to make things happen
keep our word and promises
are innovative
are team players
take initiative

A glass of water sits on a light-colored wooden table in the foreground. In the background, a person is blurred, holding a large sheet of paper. The scene is brightly lit, likely from a window, creating a clean and professional atmosphere.

Vision

We will be a role model for every service providing company and employer, exceeding the expectations of our customers, employees and owners and setting a benchmark for environmental behaviour in order to improve the quality of life.

Mission

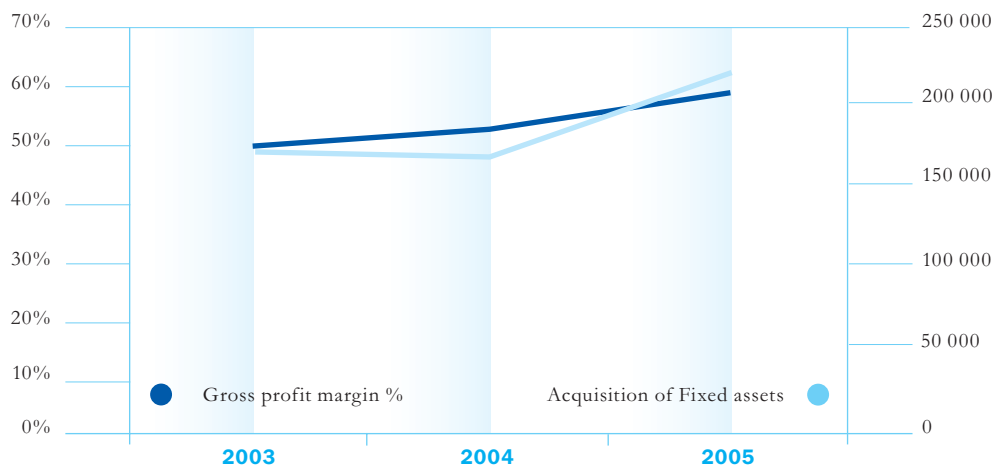
We create a better life with pure water!

Key performance Indicators

	2005	2004	2003
Sales	592 029	548 529	504 017
Main operating activities	549 918	478 814	434 794
Other operating activities	42 111	69 715	69 223
Gross profit	351 636	286 864	249 252
Gross profit margin %	59%	52%	49%
Operating profit	282 560	254 918	169 835
Operating profit margin %	48%	46%	34%
Profit before taxes	209 722	199 238	119 822
Profit before taxes margin	35%	36%	24%
Net profit	174 354	172 961	104 451
ROA %	7%	8%	5%
Debt to total capital employed	55,3%	55,1%	58,4%
Acquisition of Fixed assets	223 145	158 379	173 568

Sales Breakdown	2005
Water supply service	44%
Wastewater disposal service	39%
Stormwater treatment and disposal service	8%
Connection fees to water and sewerage network	7%
Fire hydrants service, other works and services	2%

Graph 1. Profits and Investments in 2003 – 2005 (kroons)



AS Tallinna Vesi in Brief

AS Tallinna Vesi is the largest water utility in Estonia providing drinking water and wastewater disposal services to over 400 000 people in Tallinn and in several neighbouring municipalities of Tallinn. AS Tallinna Vesi has the exclusive right to provide water and sewage services in Tallinn until the year 2015.

The company has two treatment plants Ülemiste Water Treatment Plant (WTP) and Paljassaare Wastewater Treatment Plant (WWTP). The first Ülemiste Plant started working in 1927 and the new plant has been operating since 1970. Ülemiste WTP uses Lake Ülemiste's water to produce drinking water for about 90% of the City of Tallinn. The rest of Tallinn, about 10% uses ground water. Drinking water in Tallinn meets all the required EU quality standards and has been constantly improving over the last 5 years.

Paljassaare WWTP started operating in 1980 and has been developing its treatment processes year by year. As a result, the quality of the effluent discharged into the Baltic Sea has continuously improved.

Both Paljassaare WWTP and Ülemiste WTP have spare production capacity to support the potential extension of the service area to the neighbouring municipalities.

AS Tallinna Vesi also operates over 2000 kilometres of water, wastewater and stormwater network in the City of Tallinn.

The company has obtained ISO certificates for quality (ISO 9001) and environmental management (ISO 14001). The company's laboratories also hold an ISO 17025 certificate. In 2005, AS Tallinna Vesi was the first company in the Baltics to receive the EU EMAS (Eco-Management and Audit Scheme) certificate.

The company has over 19 000 contractual customers and employs on average 340 people.

AS Tallinna Vesi shares have been listed on the main list of the Tallinn Stock Exchange since June 1st 2005.





Address by the Chairman of Board



2005 has been an outstanding year for the Company and all its stakeholders. Significant steps have been taken on all fronts and major improvements delivered across all spheres of our activity.

SUCCESSFUL LISTING IN TALLINN STOCK EXCHANGE

In February 2005 the decision was taken by our shareholders to list the Company on the Tallinn Stock Exchange and to sell down 30% of their shareholding creating a free float of 6 million shares. This was the first new listing on the Tallinn Stock Exchange for 6 years and we were committed to carrying it out in the most professional manner and to ensure its success. The Company, with its key advisers, prepared a prospectus of the highest quality and met our target timetable to the day. Significant interest was shown by both institutional and retail investors and the offering was 6 times oversubscribed.

The IPO share price was finalized at 9.25 euros and trading in our shares on the TSE commenced on 1st

June 2005. The shares have consistently been one of the most traded shares on the TSE and indeed the Baltic Exchange. By the end of the year the share price had risen to 13.50 euro an increase of 46% placing an equity value on the Company of 270 million euro or 4.2 billion kroons. The IPO was a true success both for the Company and its shareholders, but also for the Tallinn Stock Exchange, this is an achievement of which all those involved should be very proud.

OUTPERFORMANCE OF SERVICES AGREEMENT

During 2005 the Company continued to outperform the service levels set within its contract with the City. Drinking water quality reached its highest level yet with 99.9% microbiological compliance and 99.7% chemical compliance. These levels demonstrate that we are already delivering the standards required from 1st January 2007 twelve months ahead of schedule. We are continuing to reduce leakage levels and we are now at a level of leakage below 18.0%, this is 50% lower than five years ago and over 8% below our contractual target. In 2005 a new and challenging level of service was introduced where no unplanned interruptions to supply should last more than

12 hours. Once again by additional investment and using all the skills and expertise available we have been able in 2005 to reduce the number of occurrences by 90% to just 3, and we will continue to look for ways to eliminate those failures completely.

IMPROVED ENVIRONMENT

Our focus on the environment is unwavering and in 2005 we have continued to invest heavily in schemes and methods of operation which protect the world we live in. The first phase of the composting fields at Paljassaare has been completed and 100% of sewage sludge is being converted into fertiliser and recycled. In addition the construction of the upgrade of the nitrogen removal process at Paljassaare WWTP was completed during the year. The commissioning process is ongoing and will not be completed until the middle of 2006. At present we are on target to deliver the 25% reduction in nitrogen discharged into Tallinn Bay. Compliance with these higher wastewater quality requirements will also help to protect the Baltic Sea in line with the HELCOM recommendations.

FIRST EMAS AWARDED COMPANY

The Company is extremely proud to have been recognized by the Ministry of Environment as the first in Estonia and in the Baltics to be considered capable of achieving the EU Eco Management and Audit Scheme (EMAS) certification. Following close co-operation within the project managed by the Ministry and the Dutch Ministry of Economics and a very testing external audit I am delighted that the Company received full EMAS certificate on 14th October 2005. This recognition is a clear sign of our understanding and management of our environmental responsibilities. In addition we were also successful in June 2005, with the renewal of our ISO 14001 based Environmental Management System certificate.

EXCELLENT FINANCIAL PERFORMANCE

The financial results for 2005 have once again shown solid improvement. Our managers and their staff are continuously looking to reduce our cost of delivery and also identifying opportunities for growth in our service. As a result the Profit Before Tax (PBT) earned in 2005, was 209.7 million kroons, an increase of 5% compared with 2004, and this is after absorbing the one off costs incurred during the year.

Following the successful listing of the Company on the Tallinn Stock Exchange the decision was taken to review the long term loan structure of the Company. As a result of this approximately 50% of the EBRD loan facility was prepaid and the terms and conditions of the remaining 37.5 million euro loan renegotiated and significantly improved. In addition the prepaid proportion of the EBRD loan was replaced with a 37.5 million euro loan from Nordea Bank, again with much improved terms and conditions. The Company has now put in place a loan financing structure, which has reduced our interest costs going forward by approximately 25% per annum and also provides enhanced terms and conditions and greater

flexibility in the use of our cash reserves. This provides a strong platform for the future.

LAUNCH OF KEY IT PROJECTS SUPPORTING THE BUSINESS

During 2005 the Company completed the implementation of two major IT system implementations which will deliver improved cost efficiency and customer service in 2006 and beyond. The Maximo asset management and work planning system which went live in early 2005 will enable us to analyse and understand the maintenance costs of our assets and plan the work more effectively. In the latter part of 2005 our new Customer Information and Billing System went live, initially running in parallel with the existing system, and following successful testing the old system was switched off in November. This project was a highly complex project and a huge effort was put in to deliver it on time and to budget. Due to the implementation of this system we will be able to provide a wide range of payment options, including direct debits, and also provide a full web-based access for all our customers.

EMPLOYEES – OUR KEY ASSET

The people who work for us are our most important asset and once again in 2005 they have all responded magnificently to the challenges they have been presented with. I thank them wholeheartedly personally and on behalf of the Management Board as a whole. We have once again carried out an independent staff opinion survey to which over 50% of our staff responded. I am very pleased to be able to report that staff satisfaction increased again in 2005 to the highest level ever. The level of response and the degree of satisfaction indicates that we are on the right track, but we will continue to strive for further improvement and we have already developed the necessary action plans to address the issues which were raised by the staff in the survey.

Our Health and Safety performance continues to be at the highest level. During 2005 there were only 2 work accidents, the same as in 2004, but the number of lost work hours and the severity of the accidents has significantly decreased. Our close co-operation with our contractors has also shown benefits and there were no accidents with contractors' employees on AS Tallinna Vesi sites during 2005.



EXTENSIVE INVESTMENTS

2005 has been a major year for investments in our assets with over 223 million kroon of work being carried out, an increase of 41% over 2004. The major investments were in the network for replacement and rehabilitation, of 53 million kroons; network extensions 74 million kroons; the nitrogen upgrade and extension of the compost fields at Paljassaare Wastewater treatment Plant 30 million kroons; the ongoing improvement of the raw water facilities and biomanipulation project at Ülemiste Water Treatment Plant 12 million kroons; the delivery of the new work management and customer service IT systems 13 million kroons, and the costs of privatising land at Ülemiste and Paljassaare 21 million kroons.

During 2005 major changes and developments have occurred. These have set a firm foundation for future progress in 2006 and looking forward once again the Company is aiming to further improve across a wide range of activities. Our 2006 capital investment programme will be larger at just under 250 million kroons. Once again the key areas of focus will be on network extension and rehabilitation, with particular emphasis on drinking water quality, with forecast investments of around 150 million kroons. A further 15 million kroons will be spent at Ülemiste, again concentrating on raw water quality. At Paljassaare WWTP over 50 million kroons will be invested on improving our sludge handling process and a further extension to the compost fields. These investments clearly indicate our ongoing commitment to meeting and exceeding our levels of service.

FOCUS ON CUSTOMERS

We will launch in 2006 a Guaranteed Standards Scheme for our customers, which we believe is the first of its kind and scope in the Baltics. Through this scheme the Company will declare over 20 levels of service and if we fail to meet the levels of service a monetary compensation will be paid to the customer. By operating a scheme of this kind the Company is demonstrating very powerfully, its commitment to the customer and its belief that we can deliver the service that is required. This scheme will also be supported by the improved customer service capability of the new customer information and billing system implemented in late 2005, the full year benefits of which will be received by all our customers in 2006.

STRENGTHENING OF THE GOVERNANCE OF THE COMPANY

During 2005 there have been a number of changes in the membership of our Supervisory Council and I would like to thank all those Council members for their support during a very challenging year. As a result of the Company's listing on the Tallinn Stock Exchange we have two additional independent directors, Helo Meigas

and Valdur Laid, I very much welcome both of them to the Council and look forward to working with them in the future.

The recruitment of the two new independent Supervisory Council members will only serve to strengthen still further the Corporate Governance of the Company. This is something we have continued to improve throughout 2005 by working closely with the Financial Supervision Authority on the clarity and quality of our reporting. In September 2005 the Tallinn Stock Exchange issued an expanded set of Corporate Governance recommendations. These come into effect from the financial reporting period 1 January 2006 for Tallinna Vesi, it is our intention to comply with these recommendations as required. For this reporting period all information required to be reported by the Tallinn Stock Exchange or by Estonian Accounting law not contained within this text is included in the annual accounts and notes.

Clearly we have come a long way in the year and none of this could have been achieved without all the support and total commitment of our staff who have once again been outstanding. The support and guidance we receive from our partners the City of Tallinn and the Ministry of Environment has been invaluable. During 2005 we achieved outstanding success in our quality of product, service and financial targets and I believe can now be very proud of being a world class water company.

Robert John Gallienne

Chairman of the Management Board



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Operating Overview

In 2005, we have continued to build on the very sound foundations laid during the previous years, and as a result we have been able to deliver a very successful year for our stakeholders.



OUR CUSTOMERS

have benefited from the high level of investments undertaken on water network which enabled us to raise the water quality to a level never previously achieved and to comply with the regulatory consents a year ahead of target. At the same time we have opened new offices in which to welcome our customers. These offices, with extended opening hours, offer the full range of services in a friendlier atmosphere and more effective layout. Furthermore, all the contractual levels of service have been achieved; the Company delivering this year once again a world-class service to the Estonian capital.

OUR SHAREHOLDERS

have been constantly at the heart of our activity: the high level of quality of product and service achieved has not been to the detriment of cost efficiency, and strong cost control provided a good result in operating margin. The

investments in network extensions generated new clients and, as result of the intensive development activity undertaken to provide water and sewerage services to the surrounding municipalities, a substantial growth was recorded among the clients outside Tallinn. The successful listing on Tallinn Stock Exchange was also a major event.

THE ENVIRONMENT

which is a constant preoccupation in our everyday activity: several major projects are ongoing in different fields - water resource management with the biomanipulation of the Lake Ülemiste to improve the quality of its raw water; a monitoring system to regulate the flows and levels of the water extracted from the catchment area and water losses management with a further reduction of leakage levels, now at 50% of what they were 5 years ago. By-product management with the commissioning of the nitrogen treatment in Paljassaare; improving consistently the quality of the treated effluent discharged and the extension of the composting fields to reprocess all our sludge into an environmentally friendly compost.

OUR EMPLOYEES

whose dedication to the Company is just outstanding: this year again the Company has demonstrated that it sees its employees as its key asset - training programmes have continued to be developed and implemented to constantly upgrade the highly qualified skills of the staff; exchange programmes within the United Utilities Group gave the opportunity to share the best practice existing in different countries; health and safety has constantly been in the Company's sight and as a result the record has been excellent. The satisfaction of the employees, registered by an independent survey, has risen once again this year.

THE COMMUNITY

to which the Company has demonstrated its commitment: may it be in the social sphere with assistance to charity organization, or in the education sphere, with open days and visits to our main operational sites supported by the special education programme we have developed for children, or eventually in the professional associations where the Company is taking an active role.

Indeed, 2005 was a successful year and an important milestone: being now a public Company is not only an achievement after four years of successful transformation, but also the beginning of a new era where the Company will be able to build on its strong foundations.



Roch Jean Guy Antoine Chérourx

Chief Operating Officer

Member of the Management Board









Merle Lindma,
Head of Customer Service



Riho Sobi,
Head of Treatment Plants

Market Place

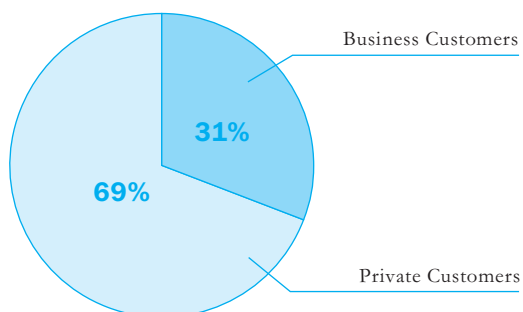
Customers are our business. Our motto is to provide excellent customer service, be open, effective and honest in our business conduct. Our team is committed to take the extra steps to exceed our customers' expectations 24 hours a day.

AS Tallinna Vesi provides water and wastewater services to 19 000 customers in Tallinn and its surrounding areas. Approximately 2/3 of these are private customers. See Graph 2.

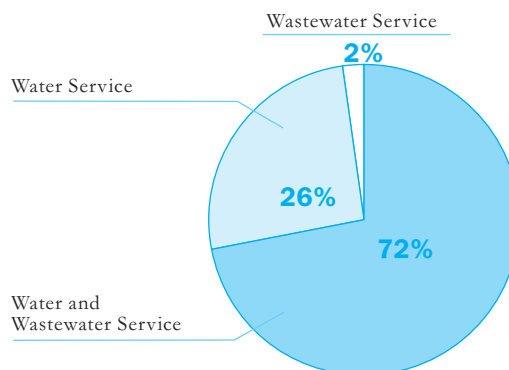
The company provides the majority of its customers with both water and wastewater service, however there is a proportion of customers who just use either water or wastewater service. See Graph 3.



Graph 2. Division of customers in 2005



Graph 3. Services provided to customers in 2005

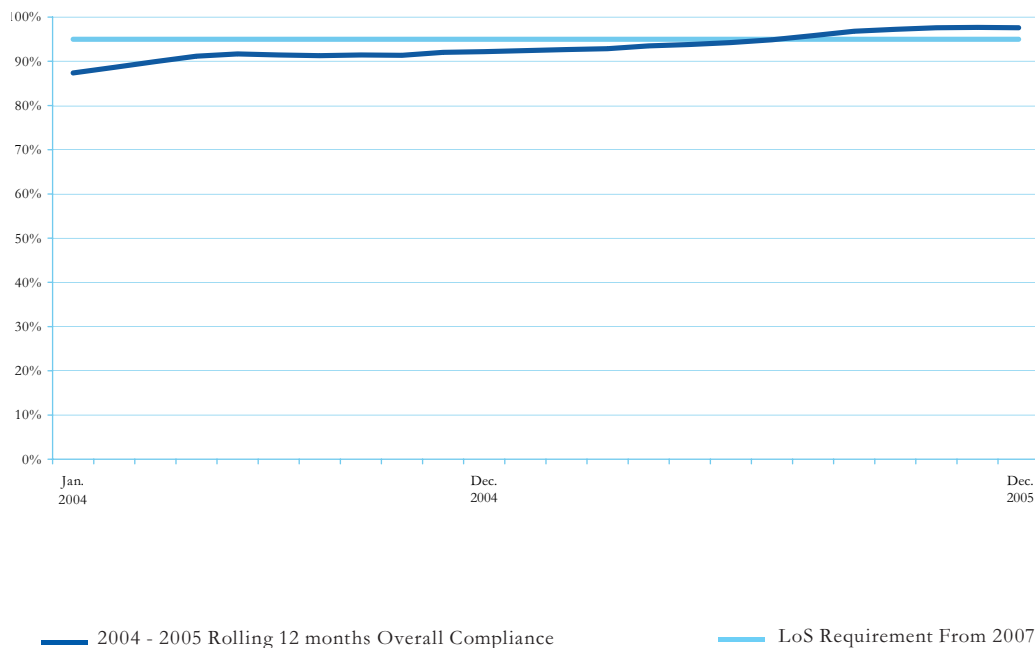


WATER QUALITY OVERVIEW

Our company's most important responsibility is to provide high quality drinking water to our customers. In 2005, we have reached the highest water quality ever with 99.9% microbiological compliance and 99.7%

chemical compliance. We are already today delivering drinking water that meets the quality standards required from 1st January 2007, which is twelve months ahead of schedule. See Graph 4.

Graph 4. Overall Drinking Water Compliance in 2004 - 2005



This excellent result in water quality has been achieved due to the efforts of our different teams. Firstly, to improve drinking water quality pumped from groundwater bore wells, the company has installed iron and manganese filters. Secondly, at the Ülemiste WTP, we use activated charcoal to improve the odour and taste

of drinking water and reduce organics content during the summer period. Thirdly, investments in the replacement of old water pipes and water network extensions have also contributed to the improvement of water quality. See the overview of water network rehabilitation and extension in Table 1.

TABLE 1. WATER NETWORK REHABILITATION AND EXTENSION IN 2005

Water network rehabilitation	15.8 km
Water network extension	0.3 km

Fourthly, the company continues an extensive water network airscouring programme in the course of which approximately 200 km of water network is cleaned a year.

As a result of the water quality improvement works, the number of customer complaints about water quality has steadily decreased year by year. See Table 2.

TABLE 2. CUSTOMER COMPLAINTS ON WATER QUALITY 2002 - 2005

Water quality	2002	2003	2004	2005
Complaints by phone	181	137	40	17
Written Complaint	51	14	16	8
TOTAL COMPLAINTS	232	151	56	25

IMPROVED CUSTOMER SERVICE FACILITY

In 2004, the company initiated a customer service facility improvement project in the company's head office that was fully completed in May 2005. The new modern office brings together employees from different departments – call centre, contact centre, accounting, design department, credit group, archive, etc - that all have direct contact with our customers. This way it enables customers to have all their inquiries solved in one location – one stop shop. The company also extended the customer parking facilities and improved access for disabled, and there is a special corner for children where they can play while their parents visit our customer service. We believe that we have created a customer friendly atmosphere that will create a positive experience for customers whilst they are conducting business with us.

CUSTOMER INFORMATION SYSTEM LAUNCH

The company launched the new customer information and billing system at the end of 2005, however, the final tuning and testing of the project will be completed during the first half of 2006. The new system replaces the four previously used programmes, and enables more efficient and customer friendly service. As a result, a wide range of new options like web-based self-service, direct debit, e-invoices and other services will be available. Moreover, the system is integrated with different national registries and databases, which enables the automatic receipt of information and much faster response to customer inquiries. In addition, different automatic reminder systems via email or SMS will be available. All in all, the new system will significantly improve our customer communication and that benefits both the customer as well as the company.

CUSTOMER SATISFACTION

An independent research company carried out a customer satisfaction survey, which interviewed a total of 900 customers and end users that evaluated the services provided by Tallinna Vesi. The survey concluded that 76% of our end-users are either very satisfied or satisfied with services provided by Tallinna Vesi.

Being a water company, our customers' key expectation from us is the delivery of high quality drinking water. Water quality was also mentioned as the main

influencing factor when grading Tallinna Vesi. Therefore we are proud to report that customer satisfaction with water quality has significantly increased. Both customers as well as end users acknowledge the improvements with water quality in every aspect – better taste, smell and colour.

Another aspect that was highly graded was our customer service people's attitude and helpfulness when dealing with customers. The key challenge for the coming years, however, will be the improvement of problem solving response time.

DEVELOPMENT ACTIVITIES

One of AS Tallinna Vesi's strategic objectives is extending its water and sewer services to the neighbouring areas of Tallinn. Rapid real estate development and demand for new housing surrounding Tallinn support our objective. Moreover, both of our plants, Ülemiste WTP and Paljassaare WWTP, have extra capacity to increase production and provide services to a larger population.

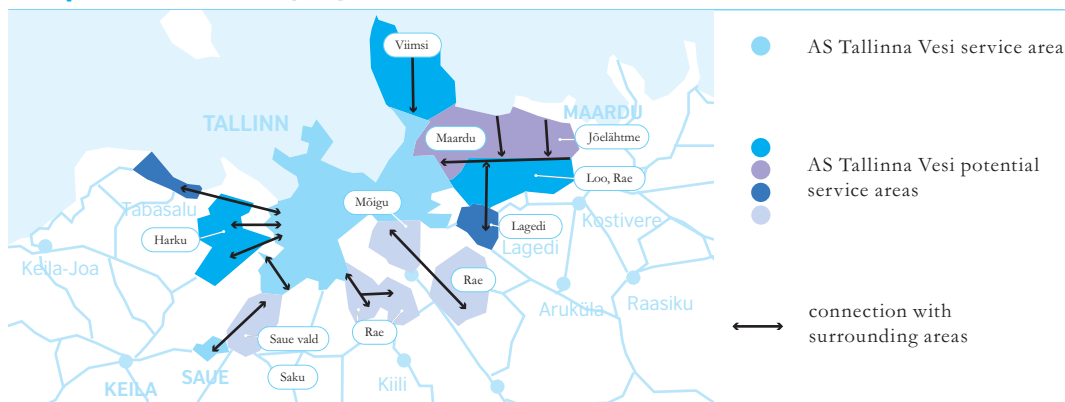
In 2005, AS Tallinna Vesi signed and renewed several service agreements with Kiili, Jõelähtme, Saue and Harku municipality in the areas surrounding Tallinn.

In Kiili, the company set up a wastewater preflow main and a water network that provides the ability to supply the northern part of Kiili Parish and the area behind Lake Ülemiste with a high quality drinking water from Tallinn and cover the same areas with wastewater network. In Jõelähtme Parish, the company started receiving the wastewater from Loo and Iru settlements to Tallinn's public sewer network. In Harku Parish, AS Tallinna Vesi was appointed the water company in Harku settlement and an agreement to provide services in Pillado development area was signed.

In addition, a number of local municipalities have confirmed their interest in receiving drinking water from the Ülemiste Water Treatment Plant operated by Tallinna Vesi. Thus, in a long-term perspective, AS Tallinna Vesi has the opportunity to provide services from the border of Tallinn in Rae Municipality and in Harku Parish in Apametsa and Harku settlements. See the Graph 5.



Graph 5. Developing areas for Tallinna Vesi







Jana Kelus,
Quality Manager

Leho Võrk,
Head of Networks

Environment

In 2005, the company continued the improvement of the quality and environmental management system, and successfully renewed ISO 9001, ISO 14001 and ISO 17025. The quality and environmental management system encompasses all major fields of activity of the company, ranging from customer service, water treatment, drinking water supply, discharge of wastewater and storm water, to wastewater treatment and the related auxiliary activities.

WATER RESOURCE MANAGEMENT

Using nature's raw water resources sparingly is an important goal for Tallinna Vesi. The company collects raw water from a catchment area of 2 000 km². Thus, it is important to monitor and manage the amounts of water extracted from the water bodies in order not to disturb the flora and fauna. The company has set up a special automatic monitoring system that regulates the flows and levels of the water extracted from the catchment area. The main water resource for Tallinn is Lake Ülemiste. In order to improve the raw water quality in the lake, the company has undertaken a biomanipulation process. The objective of which is to balance the natural food chain: predatory fish - carnivorous fish - zooplankton - phytoplankton. Since the population of carnivorous fish in Lake Ülemiste is too large and they eat most of zooplankton allowing phytoplankton to expand, the water quality in the lake will decrease. Thus, the company has taken out 85.6 tons of carnivorous fish by means of mass fishing in 2005.

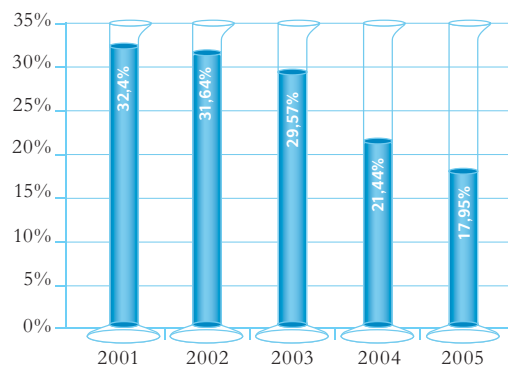
Biomanipulation is a long-term process and therefore the first results will be evident only in a few years. However, there are some initial positive results of the project. The period of "clear water" in spring has extended and the biomass of zooplankton was twice as large in 2005 in comparison with the previous years.



LEAKAGE LEVEL DOWN TO 17.95%

Another important aspect of management is to reduce the water losses in the network. The company has a contractual requirement to reduce water network leakage to 26%, however, the company has outperformed that target and achieved a level of 17.95% by the end of 2005. See Graph 6.

Graph 6. Leakages in 2001 to 2004



Such good results were achieved due to the quick response capability of the Networks Department, supported by the updated water supply networks monitoring system. Even though we have exceeded the contractual requirement, we continue to pursue excellence and maintain the achieved level. Studies elsewhere in the world show that the economic water leakage percentage is between 15-18%. Further investments to lower the rate may be inefficient and exceed the benefits achieved from reduction of water leakages. In 2005, the company has also managed to shorten the average leakage elimination time from 3.7 days to 2.4 days.

CONNECTION TO THE PUBLIC WASTEWATER NETWORK

The company takes its environmental responsibilities very seriously. In order to decrease the risk of pollution and also improve the living conditions of Tallinners, the company has been actively building new public wastewater and stormwater systems. Over the last 6 years, the wastewater network has been extended by more than 11% mainly in Nõmme, Merivälja and new dwellings areas surrounding Tallinn. In 2005, the company built and renovated close to 24 km of wastewater network providing to over 600 households the possibility to connect to the public network in Tallinn. See Table 3.

TABLE 3. WASTEWATER AND STORMWATER NETWORK EXTENSIONS IN 2005

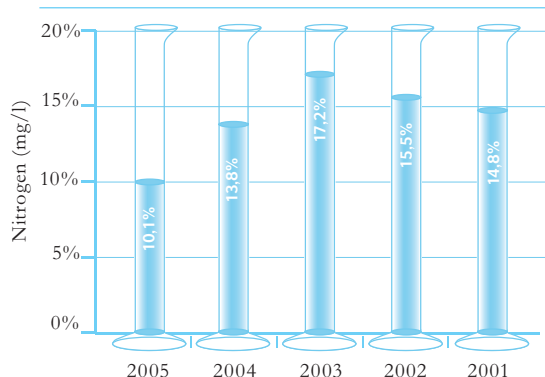
Wastewater network rehabilitation	5.3 km
Wastewater network extension	18.5 km
Storm water network extension	10.8 km

As in the previous years, a large number of people of Tallinn took advantage of the opportunity and connected to the public network. The company concluded 570 new connection contracts, 220 of which received the connection compensation from the City of Tallinn. In addition, the company concluded 2 538 new service contracts.

NITROGEN PROJECT

The key environmental project in Paljassaare WWTP has been the reconstruction of the nitrogen removal system that was fully completed in 2005. However, the testing period of the plant will carry on until the summer of 2006. It is a unique project in the Baltic States during which a new Methanol dosing facility was added enabling an increase in the biological treatment efficiency. As a result of the project, with a total cost of 30 million kroons, the amount of nitrogen in the effluent sent to the Baltic Sea will be reduced by 25%. The initial results of the testing have been successful. See Graph 7.

Graph 7. Nitrogen level in effluent in 2001 - 2004



Reduction of nitrogen in the Baltic Sea is also one of the key objectives of Helcom (Helsinki Commission) that organises the international collaboration between Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Poland, Sweden and Russia in order to protect the Baltic Sea from all potential sources of pollution.

EXTENSION OF COMPOST FIELDS

Paljassaare Wastewater Treatment Plant's treatment process' by-product is sewage sludge. Treated sewage sludge is turned into valuable environmentally friendly compost in compost fields, and can be later used for gardening. In earlier years a significant proportion of sludge was taken to a landfill, however, today 100% is used for composting.

In 2005, a total of 36.400 tons of sludge was produced. 65% of the sludge was recycled and 35% remained in the compost fields to be mixed. The good quality composts is valued among our customers since a significant amount i.e. 19.300 tons of compost was sold in 2005. In order to increase our composting capacity, the company undertook the extension of the composting fields to reprocess all our sludge into environmentally friendly compost. The total area of compost fields completed in 2005 is close to 20 ha.

FIRST TO RECEIVE EMAS

Tallinna Vesi is the first company in Estonia to have received EU EMAS (Eco-Management and Audit Scheme) accreditation. EMAS is the means of environmental management, with the objective to motivate organisations to improve the efficiency of their environmental activity. In addition to meeting the requirements of the standard, the organisation has to compile an Environmental Report which is approved and registered by independent competent bodies and then published.

EMAS implementation is voluntary. The company is pleased that the Ministry of Environment invited us to participate in the pilot project and believed that Tallinna Vesi could be the first company whose activities would meet the requirements. Receiving the certification is of a great importance to the company and further reinforces the message to our customers and to the whole community that we are an environmental company and we take our responsibilities very seriously.





PALJU ONNEI





Ilona Lott,
Head of Human Resources

The average age of permanent staff is 45,3 years and the average length of employment is 12,7 years. See Graph 8 for the division of positions and Graph 9 for employees division by education.

In 2005, there were 2 minor occupational accidents, which resulted in 5 lost working days.

Workplace

OUR PEOPLE

Continuing values based management the main challenge for the year 2005 was to continue in building the supporting systems, and people related processes in a way that would make it easy to enjoy following the values and therefore be motivated. Another objective was to provide development opportunities and new challenges for our staff.

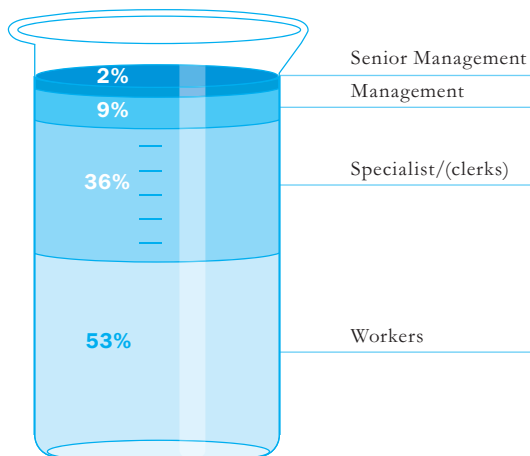
In 2005, the company employed 334 people of whom 327 were permanent staff and 7 fixed-term staff. The split between men and women was respectively 225 and 109.

SUCCESSION PLANNING AND RECRUITMENT

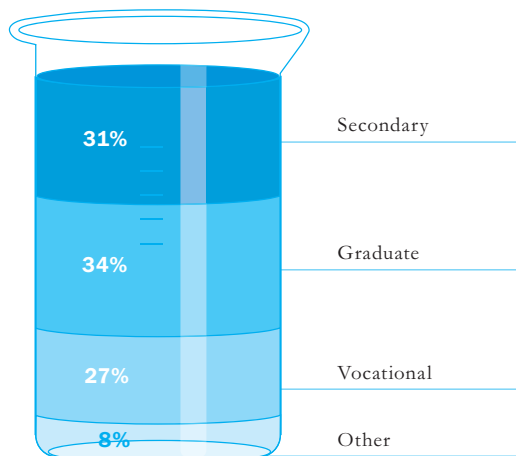
To ensure a constant supply of qualified specialists and future managers to the company we initiated a Young Specialist Programme in spring 2005. The programme creates a system for supervising and instructing young professionals, based on a common competence model for professionals and managers; to establish an environment that encourages and values self-improvement and lifelong learning. As a result mentoring, coaching and supervision has been established as regular parts of the organisational culture.

Our team participated in the student career information days in the Tallinn Technical University and Estonian Agricultural University in order to introduce the development opportunities in the company. We asked students to fill out a questionnaire about the company to see whether they would be interested to be employed by Tallinna Vesi. See Graph 10.

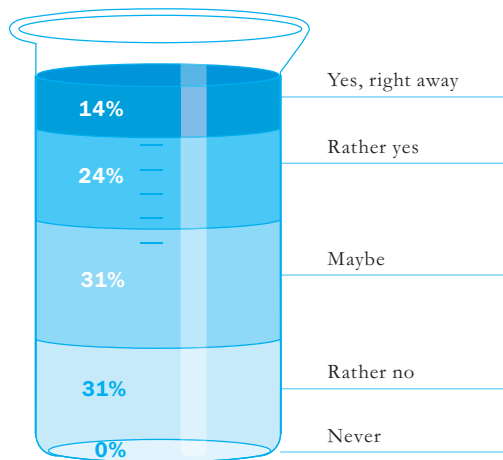
Graph 8. Division by position in 2005



Graph 9. Division by education in 2005



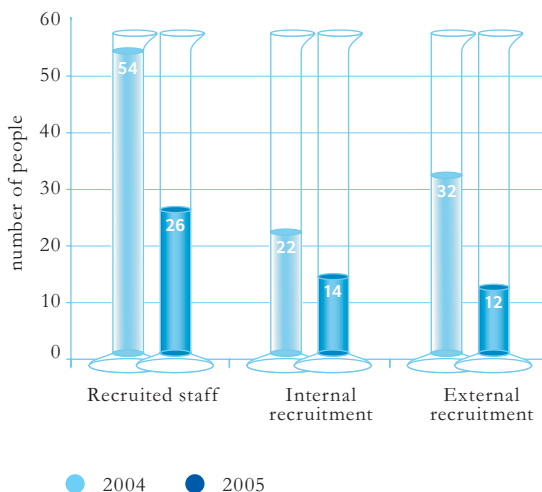
Graph 10. Students' readiness to be employed by Tallinna Vesi



Following the career information days, we recruited four young specialists in water and wastewater management. All four work on a rotational basis for a maximum of 6-months period in our larger operational units, in customer service and the production division. This enables them to acquire all-round knowledge and skills with regard to the main activities, procedures and persons in the company, to try and experience different roles in the organisation and thereby acquire a varied collection of skills and knowledge.

In addition, cooperation with Kopli Trade School continued in 2005. We organised a practice day for 40 students in autumn and participated in putting together the training programme. We believe in building the relationship with the future employee and the employer within the school years.

Graph 11. Recruitment activities in 2005



LIFE-LONG LEARNING AND INTERNAL CAREER BUILDING

Our staff motivation is a key aspect for our business. Since our employees are eager to learn and face new challenges, we put an internal recruitment system in place. In order to make development opportunities available, we offer new opportunities first and foremost to our own qualified employees when a vacancy becomes available in the company. As many as 22 employees were able to change their role within the company to develop and acquire new skills during 2005. This figure is a third higher than in 2005. More details about the recruitment is in Graph 11.

BUILDING VALUES IN OUR BEHAVIOUR

For the first time, we held an Employee Service Conference that concentrated on customer orientated approach and behaviour. The conference, held simultaneously in Estonian, Russian and English, took place on two different days enabling all our staff to participate. The focus of the presentations was on learning how to be CARING towards our customers as well as our colleagues and families.

The presenters were our employees from different divisions as well as positions ranging from top management to workers. In addition, one customer was invited to reflect back on the experience with us. The aim was to share knowledge and experience from which everybody can learn new ways of doing things. Our objective is to create a working environment where both our employees as well as everybody doing business with us would have satisfying experience. As individuals, we strive towards balance and a positive direction in our lives. Creating a positive attitude chain throughout the Company presents a can-do attitude towards customers and this creates open, positive communication and actions. The moral for us is: be positive, provide a resolution to your customers needs as quickly and effectively as possible, give to them the service you would like to receive yourself, because you get back what you give.

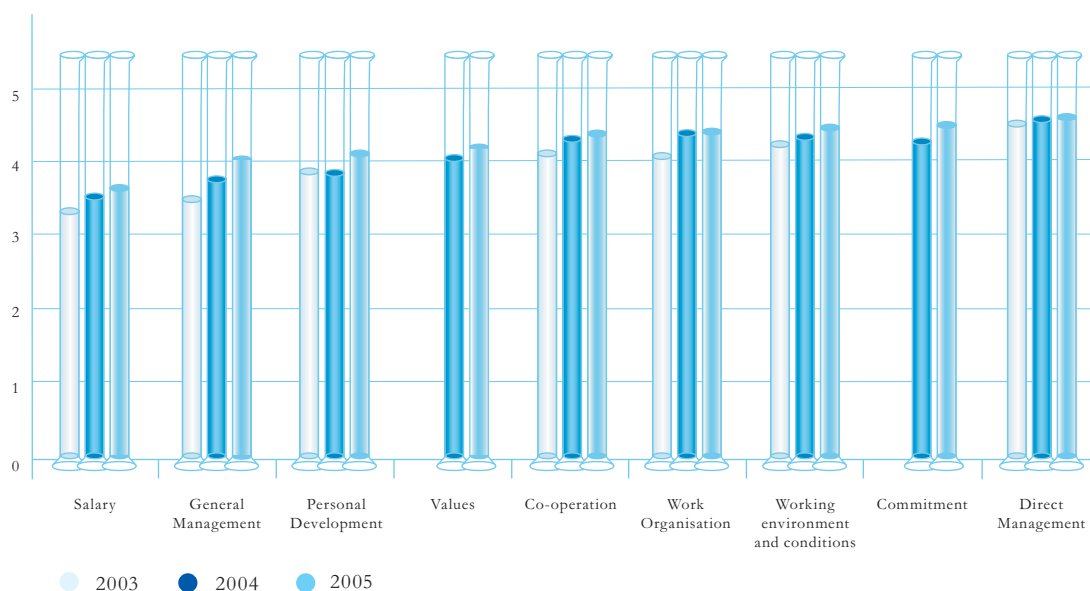
We also continued with our values based internal training Tulemuste Võti (Key to Results) for all the new employees who joined the company in 2005. The aim of the training in to improve our staff's teamwork abilities and also build on personal development.



EMPLOYEE OPINION SURVEY

Our greatest asset is our employees. In order to "measure the temperature" of the organisation an independent specialist company has carried out opinion surveys in the company over the past three years. The satisfactions survey results are then used as a base for our development activities. Survey results demonstrated that in almost all aspects the commitment and satisfaction of employees has continued to improve. See Graph 12. As a part of the employee survey we donated money to kindergarten for children with special needs, "Õunake", for each questionnaire that was filled in. The money was used to help the kindergarten to open a special "cognition room" for the children.

Graph 12. Satisfaction with different business aspects 2003 - 2005



PARTNERSHIP WITH TRADE UNION & RETIREES' ACTIVITIES

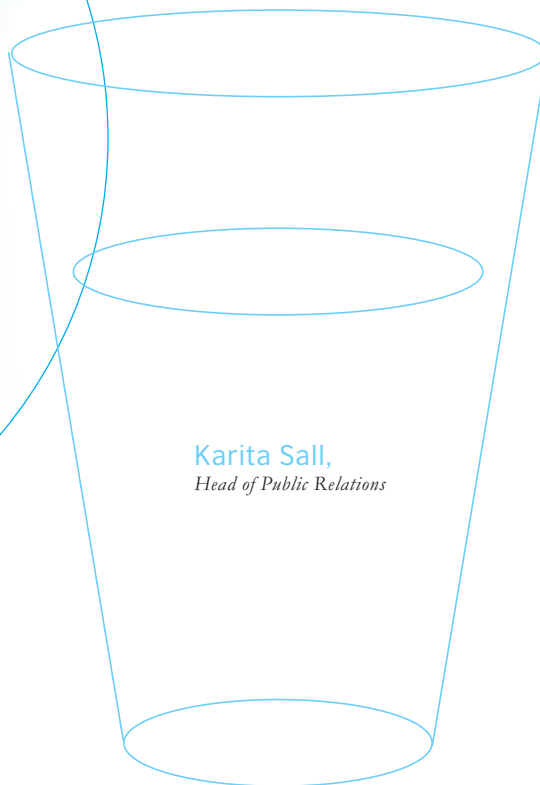
A positive working relationship has been developed with the Union. Besides the Collective Agreement all major employee related issues are discussed between the Union trustees and the employer's representatives. In 2005 the constructive dialogue between the Employer and the Trade Union representatives continued.

The company provides financial support to the retirees' club. The club consists of Tallinna Vesi's former employees who have contributed at least 20 years of their working life to the water service in Tallinn. They organise club events on quarterly basis, spend a SPA weekend together in Pärnu and have a special Christmas event. In addition, they have their own office with an Internet access in our premises. Retired employees also take an active part in helping the company out when the workload is high or there is a lack of resources, for example, during vacations period.

OUTLOOK FOR 2006

Due to the changes in the number of employees within the last five years, the age structure and the changing work organization, the demands for employees are increasing. In order to support our staff in the achievement of the targets we have started to develop mentoring and coaching skills. In 2006 we focus also on self-learning and supporting these activities. In 2006 the focus will be on the further development of skills, succession planning and strengthening of our workforce with new people.





Karita Sall,
Head of Public Relations

Community

Tallinna Vesi is a company that all people of Tallinn have a contact with either as customers or as end users of our water and wastewater services. Our services satisfy the basic physiological needs of every human being. Therefore everything we do has a significant impact on a large group of people i.e. 1/3 of the population of Estonia plus the ever increasing number of tourists who are visiting Tallinn. It is our responsibility to educate people about using water wisely and protecting the environment. Thus, the company has undertaken several educational projects targeted at younger children, schoolchildren as well as students.



EDUCATIONAL PLAY FOR CHILDREN

For children in elementary schools and kindergartens we put together a fun yet educational play. It was prepared jointly with the children's theatre Trumm, and it focused on the protection of the Lake Ülemiste. The play provides knowledge on why water is so important, what should be done for its protection to keep it pure and not waste it. The play has three characters of which Ülemiste Vanake, the legendary old man from the bottom of the lake, is the central one. The play has humorous, however, educative songs and children can participate in the play by answering to the actors' questions. The play has been received very well and has already been performed in over 60 schools and kindergartens in Tallinn and its surrounding areas.

ÖKOKRATT ON WATER PROTECTION

The company also participated in the non-profit organisation Ökokratt's educational water related educational programme "How to save and protect water". The programme included several lectures for schoolteachers that were given by Tallinna Vesi specialists on how to present water-related information in classrooms. We also organised tours to our Ülemiste WTP and Paljassaare WWTP as a part of the environmental weeks in schools.

In addition to schoolchildren, the company hosts a significant number of student groups, environmental specialists and other interested parties in our treatment plants. Year by year the interest has grown, which allows us to believe that people are more aware of the nature around them and care about their protection. It 2005, the company organised ca 200 tours in our treatment plants.

SOCIAL SPHERE PROJECTS

In addition to educational programmes, the company supports different charity events directed to people with special needs or to socially challenged groups. The company has helped the children in Ristiku School both financially but also in kind. For example, our employees put together Christmas presents for each class in school and also collected clothes for school children in need.

We have a similar partnership with Õunake, a kindergarten for children with special needs. The company donated money to repair their physiotherapy swimming pool. Moreover, our employees personally donated money for the completion of a "cognition room" for the blind children.

The company is also participating in the sauna project for the homeless initiated by Oleviste Church. The company has been providing free water for the sauna but also collected clothes and towels for the homeless.

Already for several years, the company has provided funds for the non-profit organisation Victims' Help. We help to carry out the trainings for the coaches that help the victims of crime or persecution.

SUPPORTING HEALTHY LIFESTYLE

Tallinna Vesi promotes healthy life-style among its employees as well as the society in general. We have a long-term tradition of the Race around Lake Ülemiste. Every year there is a 16 km run around the main water reservoir of Tallinn. Since the territory around the lake is closed for public, on the day of the race people can take the opportunity to visit the site and enjoy the beautiful nature of the area surrounding the Lake.


In 2005, we introduced a shorter distance of 5 km for people who find the longer race too challenging. The number of participants has been constantly growing amounting to close to 500 people in 2005.

The company has also been supporting the series of Hansabank park races in Tallinn. Each Wednesday from May until September, Tallinna Vesi provides free tank of water where all people participating the event can have a refreshing sip of our drinking water.

PROFESSIONALS' PRESENTATIONS

Our employees are members of professional associations both for water industry related issues as well as general business areas. Many of our employees are recognised as opinion leaders and therefore often invited to give presentations and share the company's experience. The topics range from water related legal aspects to human resources, water and sewer networks, treatment efficiencies, public relations and investor relations.





AS Tallinna Vesi

Beginning of financial year	1 January 2005
End of financial year	31 December 2005
Name of Company	AS TALLINNA VESI
Legal form of Company	Public limited company
Commercial register number	10257326
Address	Ädala St.10, Tallinn, Estonia
Chairman of the Board	Robert John Gallienne
Telephone	+ 372 6 262 202
Fax	+372 6 262 300
E-mail	tvesi@tvesi.ee
Web-page	www.tallinnavesi.ee
Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditors	AS Deloitte Audit Eesti
Documents attached to the Annual Accounts	Proposal for the profit distribution; Independent auditor's report

A photograph of a laboratory setting. In the foreground, a clear glass tumbler is partially filled with water. In the background, out of focus, are various pieces of laboratory glassware, including a large Erlenmeyer flask and a graduated cylinder. A blue rectangular banner is positioned in the upper right corner of the image.

Financial Report

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Financial structure in place for the foreseeable future

OVERVIEW

During the financial year 2005 a number of significant changes occurred in Tallinna Vesi. In the first half of the year we became the first company to list on the Tallinn Stock Exchange since 1999. This stock exchange listing has changed the environment in which we operate. We now have the challenges of meeting the expectations of a much wider shareholder base, how we meet those expectations through improved corporate governance, and how effectively we communicate that message through the quality of our quarterly financial reporting.

In the fourth quarter of 2005 we re-structured the Company's long-term debt. This restructuring puts in place the financial structure of the Company for the foreseeable future, giving us a solid platform for sustainable business growth. We replaced a proportion of the original EBRD loan with a new loan facility from Nordea Bank and significantly improved the terms and conditions on the outstanding balance of the EBRD loan. These changes have brought significant tangible benefits to the Company, firstly, the weighted average cost of interest has been reduced by approximately 1,3%, considerably reducing interest costs in 2006. Secondly, the extension of the grace periods means that principal repayments will not commence for a further three and five years, enabling the Company to maintain gearing close to current levels.

Operationally we are continuing to meet our financial targets. Sales volumes of water and wastewater began to increase in the second half of 2005, which is encouraging for the Company's future performance. Continued efficient cost management throughout the Company once again enabled us to keep operating cost increases below inflation, after taking account of one-off Initial Public Offering (IPO) costs of 26 million kroons.

The dividend declared from 2005 profits, at 157 million kroons, represents a 40% increase when compared to that generated from 2004 profits.

2006 is anticipated to be a year where we continue to build upon past achievements. With the medium term financial structure now in place we can concentrate on the day-to-day measures that will drive further improvements in results. Growth in sales volumes in the main business activity will be fundamental to this success. We will continue to seek growth opportunities through expansion into the surrounding municipalities and, through the implementation of the new Customer Management system, our revenue protection and revenue accounting will be stronger than in previous years.



ACCOUNTING STANDARDS

The financial statements for 2005 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

COMPANY RESULTS

Total turnover for the year increased by 7.9% to 592 million kroons due entirely to higher sales from main operating activities.

Sales in the main operating activity increased by 14.9% to 549.9 million kroons due primarily to the water and wastewater tariff increase from 1 January 2005, plus year on year volume increases of 0.8% in the residential sector and 1.1% in the commercial sector.

Sales from other operating activities, principally connections income, reduced by 39.6% to 42.1 million kroons reflecting the reduction in reimbursable connections constructed on behalf of the City of Tallinn. There was a corresponding reduction in the cost of goods sold from this activity of 40.5% to 38.3 million kroons in 2005.

Gross profit increased by 22.6% to 351.6 million kroons in 2005 as a result of the increase in sales from the main operating activity offset by an increase of 2.4%, worth 4.8 million kroons, in cost of goods sold in the main operating activity, and a 1.5 million kroons reduction in the gross profit from other operating activities.

Operating profit for the year increased by 10.8% to 282.6 million kroons in the year. This consists of the increase in gross profit, offset by increases in marketing and administrative expenses of 24.1 million kroons and a reduction in other net income of 13 million kroons. The increases in marketing and administrative expenses relate to 26 million kroons of one off IPO costs incurred during the year, whilst the reduction in other net income is mainly due to a lower capitalisation of operating expenses in 2005.

Net financial expenses for the year were 72.8 million kroons compared to 55.7 million kroons in 2004. The increase was entirely due to the 18.2 million kroons of one time costs incurred as a result of the loan refinancing which was completed in quarter four 2005.

As a result of all of the above profit before tax in 2005 increased by 5.3% to 209.7 million kroons.

Taxation paid in 2005 was 35.4 million kroons, an increase of 9.1 million kroons from that paid in 2004. This is entirely due to the dividend paid in 2005 increasing by 37 million kroons to 112 million kroons – corporate income tax in Estonia is only paid on profit distributions or other payments considered as not related to the business of the company.

Earnings per share increased by 0.8% to 8.72 kroons. The increases in profits at all levels being offset by the non recurring costs of the IPO and loan refinancing, plus the increased tax charge.

From the 2005 profits the Management Board and Supervisory Council are proposing a dividend per share of 7.85 kroons.

FIXED ASSETS

The company continues to make significant investments in fixed assets that are well above the annual levels of depreciation, a clear demonstration of the Company's commitment to meeting or exceeding all levels of service. As at 31 December 2005 the net book value of the non-current tangible and intangible assets was 2,090 million kroons, an increase of 105.7 million kroons compared to 31 December 2004.

CASH FLOWS

Net cash inflows from operating activities increased by 139.3 million kroons to 307.1 million kroons in 2005. This increase is principally due to the release for use in the business of 77.5 million kroons of cash that had to be held on long-term deposit under the terms of the original EBRD loan. During 2004 a payment of 46.1 million kroons was made into this long-term deposit account.

In 2005 cash outflows on fixed assets amounted to 200 million kroons, reflecting the highest annual investment programme carried out since privatisation. The main areas of focus for this investment programme were, higher standards of drinking water through a network rehabilitation programme, environmental projects, of which the major project is to reduce the level of nitrogen in wastewater which will lead to cleaner coastal waters in the Baltic Sea, and the network extensions programme that is carried out on behalf of the City of Tallinn. The company also received 64.1 million kroons from other investing activities, which was almost entirely due to payments and prepayments received for fixed asset and real estate investment sales.

In 2005 the company had a positive cash movement on long-term loans and finance leases of 29.6 million kroons. This reflects the receipts, payments and prepayments made to EBRD during the year plus the new loan facility taken out with Nordea Bank. The company also paid out 112 million kroons of dividends, and 35.4 million kroons of income tax on dividends.

As a result of all of the above movements, cash and cash equivalents had increased by 106.1 million kroons to 207.1 million kroons at 31 December 2005. Gearing, measured as net debt divided by net debt plus equity reduced to 51%, compared to 53% at 31 December 2004.



Ian John Alexander Plenderleith

Chief Financial Officer

Member of the Management Board

Declaration of management for the year ended 31 December 2005

The Management Board of AS Tallinna Vesi (hereinafter the Company) hereby declares its responsibility for the preparation of the annual accounts for the financial year ended 31 December 2005.

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

The preparation of the annual accounts according to International Financial Reporting Standards involves estimates made by the Management Board of the Company's assets and liabilities as at 31 December 2005,

and of income and expenses during the financial year. These estimates are based on current information about AS Tallinna Vesi and consider all plans and risks as at 31 December 2005. The actual results of these business transactions recorded may differ from such estimates.

Any subsequent events that materially affect the valuation of assets and liabilities until the preparation of the annual accounts as at 10 February 2006 have been assessed as part of this review.

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

<i>Name</i>	<i>Position</i>	<i>Signature</i>
Robert John Gallienne	<i>Chairman of the Management Board</i>	
Roch Jean Guy Antoine Chérourx	<i>Member of the Management Board</i>	
Ian John Alexander Plenderleith	<i>Member of the Management Board</i>	

Balance Sheets At 31 December

2005 And 2004 (thousand EEK)

ASSETS	Note	2005	2004
CURRENT ASSETS			
Cash at bank and in hand	2	207 067	101 000
Customer receivables	3	66 737	51 644
Accrued income and prepaid expenses	4	5 286	3 952
Inventories	5	3 156	3 266
Assets for sale	6	1 390	1 621
TOTAL CURRENT ASSETS		283 636	161 483

NON-CURRENT ASSETS			
Long-term investment assets	7	0	78 868
Tangible assets	8	1 838 528	1 779 897
Intangible assets	8	43 981	18 460
Unfinished assets - non connections	8	94 793	102 634
Unfinished pipelines - new connections	8	109 190	79 675
Prepayments for fixed assets	8	3 479	3 648
TOTAL NON-CURRENT ASSETS		2 089 971	2 063 182
TOTAL ASSETS		2 373 607	2 224 665

LIABILITIES	Note	2005	2004
CURRENT LIABILITIES			
Current portion of long-term borrowings	9	1 340	88 863
Trade and other payables, incl. dividends	10	53 507	55 707
Taxes payable	11	22 724	20 534
Short-term provisions	12	289	912
Deferred income	13	68 569	18 582
TOTAL CURRENT LIABILITIES		146 429	184 598

NON-CURRENT LIABILITIES			
Finance lease	9	415	1 685
Bank loans	9	1 165 219	1 039 192
Other payables	10	100	100
TOTAL NON-CURRENT LIABILITIES		1 165 734	1 040 977
TOTAL LIABILITIES		1 312 163	1 225 575

EQUITY CAPITAL			
Share capital	14	200 001	200 001
Share premium		387 000	387 000
Statutory legal reserve	14	20 000	93 394
Accumulated profit		280 089	145 734
Net profit for the period		174 354	172 961
TOTAL EQUITY CAPITAL		1 061 444	999 090
TOTAL LIABILITIES AND EQUITY CAPITAL		2 373 607	2 224 665

Income Statements For The (thousand EEK) Years 2005 And 2004

	Note	2005	2004
Sales from main operating activities	15	549 918	478 814
Revenues from other operating activities	15	42 111	69 715
NET SALES		592 029	548 529
Costs of goods sold (main operating activities)	16,17	-202 055	-197 255
Costs of goods sold (other operating activities)	17	-38 338	-64 410
GROSS PROFIT		351 636	286 864
Marketing expenses	16,17	-6 778	-6 134
General administration expenses	16,17	-64 257	-40 739
Other income/ expenses (-)	17	1 959	14 927
OPERATING PROFIT		282 560	254 918
Financial income / expenses (-)	18	-72 838	-55 680
PROFIT BEFORE TAXES		209 722	199 238
Income tax on dividends	19	-35 368	-26 277
NET PROFIT FOR THE PERIOD		174 354	172 961
Attributable to:			
Equity holders of A-shares		174 344	172 951
B-share holder		10	10
EARNINGS PER SHARE IN KROONS	20	8,72	8,65



Cash Flow Statements For The Years 2005 And 2004 (thousand EEK)

	Note	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit		282 560	254 918
Adjustment for depreciation	17	78 741	79 506
Adjustment for income and expenses from constructions	21A	-3 773	-5 305
Other financial income and expenses		-20 012	-3 835
Profit from sale of fixed assets		-11 870	-2 844
Expensed fixed assets		394	1 900
Capitalization of operating expenses		-23 280	-38 974
Movement in current assets involved in operating activities	21B	57 754	-48 978
Movement in liabilities involved in operating activities	21B	6 414	-11 045
Interest paid		-59 854	-57 513
TOTAL CASH FLOW FROM OPERATING ACTIVITIES		307 074	167 830
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of shares of associated company		0	6 259
Acquisition of fixed assets (incl pipelines construction)	21C	-199 875	-133 705
Proceeds from pipelines financed by construction income	21A	52 494	59 370
Proceeds from sale of and prepayments received for fixed assets		47 345	3 799
Proceeds from sale of investment property		11 700	2 250
Interest received		5 067	2 661
TOTAL CASH FLOW FROM INVESTING ACTIVITIES		-83 269	-59 366
CASH FLOWS FROM FINANCING ACTIVITIES			
Received long-term loans	9	696 318	31 293
Repayment of long-term loans	9	-664 981	-19 001
Finance lease payments	9	-1 707	-2 632
Dividends paid	19	-112 000	-75 000
Income tax on dividends	19	-35 368	-26 277
TOTAL CASH FLOW FROM FINANCING ACTIVITIES		-117 738	-91 617
CHANGE IN CASH AND BANK ACCOUNTS		106 067	16 847
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD		101 000	84 153
CASH AND EQUIVALENTS AT THE END OF THE PERIOD	2	207 067	101 000

Statements Of Changes In Equity For The Years Ended 31 December (thousand EEK) 2005 And 2004

	Share capital	Share premium	Statutory legal reserve	Accumulated profit	Net profit	Total equity
31 DECEMBER 2003	200 001	387 000	93 394	116 193	104 541	901 129
Transfer of financial year profit to the accumulated profit	0	0	0	104 541	-104 541	0
Dividends	0	0	0	-75 000	0	-75 000
Net profit of the financial year	0	0	0	0	172 961	172 961
31 DECEMBER 2004	200 001	387 000	93 394	145 734	172 961	999 090
Transfer of financial year profit to the accumulated profit	0	0	0	172 961	-172 961	0
Transfer of statutory legal reserve to the accumulated profit	0	0	-73 394	73 394	0	0
Dividends	0	0	0	-112 000	0	-112 000
Net profit of the financial year	0	0	0	0	174 354	174 354
31 DECEMBER 2005	200 001	387 000	20 000	280 089	174 354	1 061 444

Notes To The Annual Accounts For The Year Ended 31 December 2005

NOTE 1. ACCOUNTING PRINCIPLES

The annual accounts for the financial year 2005 (hereinafter financial statements) have been prepared according to International Financial Reporting Standards (hereinafter IFRS) as adopted by the European Union. All IFRS standards effective from 1 January 2005, and applicable to the Company have been adopted in the preparation of the statements. The IFRS 7 “Financial Instruments: Disclosures”, which is not effective yet, is not adopted in the preparation of the statements and the Company considers the possible impact from the adaptation of the standard to be immaterial.

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

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

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

FOREIGN CURRENCY TRANSACTIONS

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

FINANCIAL ASSETS AND LIABILITIES

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

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

Company acquires ownership according to the financial asset or liability contract conditions.

Loans are recorded at the value of the proceeds received, net of direct transaction costs, which are accounted for on an accruals basis proportionally to the income statement during the loan agreement validity period. As the transaction costs have been considered immaterial compared to the loans received, no effective interest method is implemented.

CASH AND CASH EQUIVALENTS

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

RECEIVABLES

Receivables are presented using the amortized cost method. Provisions for accounts receivable that are considered to be doubtful are recorded in the Income Statement under “Other expenses” and a respective allowance is recorded on the Balance Sheet line “Customer receivables”. Accounts receivable from previous periods that were recorded as doubtful, but that were received during the year, are recorded on the same expense account as a reverse entry. Receivables which cannot be collected, or the collection is considered to be economically not justified, are evaluated as un-collectible and written-off from the Balance Sheet.

For evaluation of the doubtful debts the individual debts are grouped by age and the following percentages are applied in the doubtful debt calculation:

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

INVENTORIES

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

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

ASSETS FOR SALE

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

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

TANGIBLE AND INTANGIBLE FIXED ASSETS

Assets with useful life more than one year and with a minimum value of 2 000 EEK are capitalised as fixed assets. Fixed assets are recorded at acquisition cost, which comprises of purchase price, non-recoverable taxes and all other direct costs required to take the fixed asset object into operation, including internal labour costs. Capitalisation of internal labour costs is based on hours worked on the acquisition of asset. In addition to salary costs all other employee related costs are capitalized in the same proportion.

The interest cost of Company debt during the acquisition period of any fixed assets is capitalized during the construction process, incl. unfinished pipelines – new connections, which are calculated as the proportion of the amount of construction in progress compared to the balance of the corresponding debt.

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

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

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

Land is not depreciated.

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

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

Improvements to fixed assets are capitalised if the properties of that asset are improved substantially or,

as a result of the improvement, the useful life of the asset will be extended, or it is foreseen that additional future revenues will result. Maintenance and repair works are expensed in the period incurred.

All costs of identifiable and controllable development projects which are likely to earn future revenues, and the acquisition costs of computer software are capitalised as intangible assets on the Balance Sheet and amortised on a straight-line basis for a period of up to 5 years. If the software is necessary to take computer hardware into use, the acquisition cost of such software is capitalised in the acquisition cost of the hardware and depreciated according to the useful life of the hardware. Research costs are expensed.

IMPAIRMENT OF TANGIBLE AND INTANGIBLE ASSETS

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

LIABILITIES

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

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

As profits are not taxable in Estonia no deferred tax liabilities are applicable. Taxation is described more thoroughly in notes 11 and 23.

PROVISIONS

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

Contingent liabilities are excluded from recognition in the balance sheet. The Company had no known contingent liabilities at the time of the preparation of the financial statements.

RESERVES

Statutory legal reserve is recorded based upon the requirements of the Commercial Code and comprises of the allocations made from net profits. The annual allocation must be at least 5% of the approved net profit of the financial year until the statutory legal reserve is equal to 10% of share capital.

ACCOUNTING FOR LEASES

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

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

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

REVENUES

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

Sales income from goods is recorded in the period when all material risks and benefits related to the ownership have been delivered to the purchaser, the proceeds from the sale of goods is probable and the revenue and the costs related to the goods are reliably identified. Sales income from services is recorded in the period when the service has been provided, the proceeds from the provision of the service is probable and the revenue and the costs related to the provision of the service are reliably identified.

Connections revenue is recorded when construction is completed and the connection contract is concluded, ensuring the correct matching of revenues and expenses in the same accounting period. If the construction works of new connections is not compensated by the property owner and takes place in a different accounting period from the connection contract completion date, then the revenue and costs are booked in the accounting period when compensation confirmation is received.

NOTE 2. CASH AND CASH EQUIVALENTS *(thousand EEK)*

	2005	2004
Cash and bank accounts	46 822	85 253
Short-term deposits	160 245	15 747
Total cash and cash equivalents	207 067	101 000

NOTE 3. CUSTOMER RECEIVABLES *(thousand EEK)*

	2005	2004
Accounts receivable	74 133	59 383
Allowance for doubtful debts	-7 396	-7 739
Total customer receivables	66 737	51 644

Impairment costs of receivables:

Write off of uncollectible receivables	-1 074	-1 723
Proceeds from uncollectible receivables	216	190
Change in allowance for doubtful debts	343	4 273

NOTE 4. ACCRUED INCOME AND PREPAID EXPENSES (thousand EEK)

	2005	2004
Accrued interest	173	274
Other accrued income	20	92
Prepaid taxes	1 105	3
Other prepaid expenses	3 988	3 583
Total accrued income and prepaid expenses	5 286	3 952

NOTE 5. INVENTORIES

Inventories consist of raw materials and are shown net of provisions for obsolete assets.

Old raw materials with a nature and value only specific to the Company are considered obsolete, subject to the assumption that management has made all reasonable efforts to sell the unnecessary assets during the year. The most likely outcome for the majority of these assets is treatment as scrap with no material revenue to the Company. These items have been fully provided in the accounts, 222 thousand kroons and 1 508 thousand kroons as of 31 December 2005 and 2004 respectively. Any subsequent revenues received on the sale of these assets have been immaterial in value and have been offset against the value written off.

NOTE 6. ASSETS FOR SALE (thousand EEK)

	2005	2004
Land and buildings for sale	494	693
Prepayments for the land related to the assets for sale	896	928
Total assets for sale	1 390	1 621

NOTE 7. LONG-TERM INVESTMENT ASSETS (thousand EEK)

	2005	2004
Long-term deposit	0	77 538
Investment property (acquisition value)	0	1 786
Accumulated depreciation of investment property (-)	0	-456
Total long-term investment assets	0	78 868

Long-term investment assets included the long-term deposit and the real estate investment at address Järvevana Street 3, Tallinn in years 2004 and 2005. The obligation to hold on long-term deposit an amount of approximately 80 million kroons was a requirement of the terms and conditions of the original European Bank for Reconstruction and Development (hereinafter EBRD) loan concluded in 2002. This obligation was removed when the company refinanced and made amendments to the loan agreement in 2005 (see note 9). The property was sold in the 1st quarter of 2005 with the sales profit of 10.4 million kroons recorded in the row "Other income/expenses" of the income statement.

	2005*	2004
Rental revenue from the investment, excluding VAT	266	1 064
Direct operating expenses that generated rental income	98	456
 The occupation rate of the property (average of the reporting year)	 84%	 93%

* Data recorded for the first quarter only when the asset was sold by the company.

NOTE 8. TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS *(thousand EEK)*

	TANGIBLE ASSETS IN USE				
	Land and buildings	Facilities	Machinery and equipment	Other equipment	
Acquisition cost at					
31.12.03	303 802	1 863 685	472 187	14 905	
Acquisition	0	0	0	0	
Sale of fixed assets	-1 462	0	-2 204	-6	
Write-off of fixed assets	-205	-2 885	-4 504	-412	
Reclassification within balance sheet	331	0	0	0	
Reclassification to expenses	0	0	0	0	
Expensed pipelines	0	0	0	0	
Reclassification from assets in progress	9 004	38 719	19 416	1 848	
31.12.04	311 470	1 899 519	484 895	16 335	
Acquisition	0	0	0	0	
Sale of fixed assets	-83	-126	-2 994	-5	
Write-off of fixed assets	-1 011	-3 212	-15 943	-181	
Reclassification within balance sheet	0	229	0	0	
Reclassification to expenses	0	0	0	0	
Expensed pipelines	0	0	0	0	
Reclassification from assets in progress	39 565	49 711	37 630	2 994	
31.12.05	349 941	1 946 121	503 588	19 143	
Accumulated depreciation					
31.12.03	49 466	561 724	248 581	9 669	
Depreciation	4 141	27 883	40 275	1 102	
Depreciation of fixed assets sold and written-off (-)	-718	-2 857	-6 530	-414	
Reclassification	0	-3	3	0	
31.12.04	52 889	586 747	282 329	10 357	
Depreciation	3 886	29 905	35 934	1 359	
Depreciation of fixed assets sold and written-off (-)	-1 094	-3 334	-18 531	-182	
31.12.05	55 681	613 318	299 732	11 534	
Net book value					
31.12.03	254 336	1 301 961	223 606	5 236	
31.12.04	258 581	1 312 772	202 566	5 978	
31.12.05	294 260	1 332 803	203 856	7 609	

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

Net balance sheet value of finance leases was 4 283 thousand kroons and 9 434 thousand kroons in 2005 and 2004 respectively.

Interest capitalised to fixed assets was 1 075 thousand kroons and 2 689 thousand kroons in 2005 and 2004 respectively.

	ASSETS IN PROGRESS			INTANGIBLE ASSETS		TOTAL TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS
	Unfinished assets - non connections	Unfinished pipelines - new connections	Prepayment for fixed assets	Development costs	Acquired licenses and other intangible assets	
	62 797	93 176	8 565	8 375	25 421	2 852 913
	104 254	54 125	0	0	0	158 379
	0	0	0	0	0	-3 672
	0	0	0	0	0	-8 006
	173	0	-81	0	0	423
	-495	-1	0	0	0	-496
	0	-64 410	0	0	0	-64 410
	-64 095	-3 215	-4 836	1 223	1 936	0
	102 634	79 675	3 648	9 598	27 357	2 935 131
	128 979	74 363	19 803	0	0	223 145
	0	0	0	0	0	-3 208
	0	0	0	0	-184	-20 531
	0	0	0	0	0	229
	-59	-3	-169	0	0	-231
	0	-38 339	0	0	0	-38 339
	-136 761	-6 506	-19 803	4 243	28 927	0
	94 793	109 190	3 479	13 841	56 100	3 096 196
	0	0	0	6 136	6 299	881 875
	0	0	0	905	5 155	79 461
	0	0	0	0	0	-10 519
	0	0	0	0	0	0
	0	0	0	7 041	11 454	950 817
	0	0	0	2 389	5 261	78 734
	0	0	0	0	-185	-23 326
	0	0	0	9 430	16 530	1 006 225
	62 797	93 176	8 565	2 239	19 122	1 971 038
	102 634	79 675	3 648	2 557	15 903	1 984 314
	94 793	109 190	3 479	4 411	39 570	2 089 971

NOTE 9. SHORT-TERM AND LONG-TERM DEBT OBLIGATIONS (thousand EEK)

The Company's short-term and long-term debt obligations as of 31.12.2005 and the changes recorded during 2005 in the respective debts were as follows:

Bank loans	Loan date	Loan received	Residual amount 31.12.2004	Repayments during 2005	Drawdowns in 2005
EBRD	12.2002	1 251 731	1 142 157	-664 983	109 574
incl. A loan		860 565	785 233	-273 817	75 332
incl. B loan		391 166	356 924	-391 166	34 242
EBRD loan costs	12.2002	-17 404	-15 879	0	0
Nordea Bank	11.2005	586 747	0	0	586 747
Nordea Bank loan costs	11.2005	-290	0	0	0
Total bank loans		1 820 784	1 126 278	-664 983	696 321
Finance lease		15 905	3 462	1 707	0
Total debt obligations		1 836 689	1 129 740	-663 276	696 321

In November 2005 the EBRD loan was restructured and amended- the whole amount of B loan and a proportion of the A loan were repaid, and the interest rate of the A loan was reduced from 5,69% to 4,67%.

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

The long-term part of the finance lease and loans are respectively recorded on the Balance sheet lines "Finance lease" and "Bank loans".

The underwriting of the loans are indicated in Note 24.

NAME REPAYMENTS PERIOD

EBRD	Loan repayments start in 2008. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.
Nordea Bank	Loan repayments start in 2011. The repayments will be made twice a year in May and November in accordance with the repayment terms agreed in the loan agreement.
Finance lease	Repayments on a monthly or quarterly basis in accordance with the contracts.

The repayments, by due dates, are as follows:

	Less than 1 year	1-5 years	Over 5 years	Total	Repayment period from
EBRD	0	335 284	251 463	586 747	9 years
Nordea Bank	0	117 349	469 398	586 747	9 years
Finance lease	1 340	415	0	1 755	2 years
Total	1 340	453 048	720 861	1 175 249	

Residual amount 31.12.2005	Short-term portion	Long-term portion	Interest rate %	Maturity date
586 747	0	586 747		05.2015
586 747	0	586 747	4,67	
0	0	0	6 month Euribor + 1,5	
-7 985	0	-7 985		05.2015
586 747	0	586 747	6 month Euribor + 0,24	05.2015
-290	0	-290		05.2015
1 165 219	0	1 165 219		
1 755	1 340	415	3,56-9,28	06.2007
1 166 974	1 340	1 165 634		



NOTE 10. TRADE AND OTHER PAYABLES (thousand EEK)

Liabilities	Balance amount 31.12.2004	Balance amount 31.12.2005	Short-term portion 31.12.2005	Long-term portion 31.12.2005	Maturity date
Accounts payable - operating expenditures	15 025	15 984	15 984	0	until 31.12.2006
Accounts payable - capital expenditures	20 855	19 318	19 318	0	until 31.12.2006
Factoring	282	0	0	0	until 31.12.2006
Payables to parent company	1 523	2 423	2 423	0	until 31.12.2006
Payables to employees	12 865	11 597	11 597	0	until 31.12.2006
Interest payable	5 120	4 131	4 131	0	until 31.12.2006
Other accrued expenses	37	54	54	0	until 31.12.2006
Long-term guarantee deposit*	100	100	0	100	04.2102
Total trade and other payables	55 807	53 607	53 507	100	

* Long-term deposit is presented in acquisition value.

NOTE 11. TAXES PAYABLE (thousand EEK)

	31.12.2005	31.12.2004
Income tax	1 515	1 593
VAT	4 588	4 147
Water usage tax	2 333	2 289
Pollution taxes*	11 259	9 274
Social security tax	2 859	2 815
Other	170	416
Total	22 724	20 534

* Within pollution taxes is an accrual for 10.5 mln kroons. This accrual is recorded in order to cover the full value of the taxes that the Company has been exempted up to 31 December 2005. This relates to tax on Nitrogen waived by the Ministry of the Environment in return for the upgrade of the Waste Water Treatment Works undertaken by the Company. At this moment in time the Company is unable to predict with any degree of certainty the results of measurements to be taken at the end of the second quarter of 2006 that will determine if these taxes have to be re-paid, therefore a liability has been recorded.

NOTE 12. PROVISIONS (thousand EEK)

Provisions include expected losses from the following:

	2005	2004
Contractual obligations	0	912
Servitudes	289	0
Total provisions	289	912

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

NOTE 13. DEFERRED INCOME (thousand EEK)

	2005	2004
Operating revenues incl connection revenues	22 969	18 582
Prepayments for sale of fixed assets*	45 600	0
Total deferred income	68 569	18 582

*The Company received prepayments based on pre-agreements concluded for the sale of fixed assets, including properties. The actual revenue from the sales may vary depending upon the final agreements.

NOTE 14. SHARE CAPITAL AND STATUTORY LEGAL RESERVE

At 31 December 2005 the nominal value of the share capital is 200 001 000 (two hundred million one thousand) kroons, composed of 20 000 000 shares with nominal value of 10 kroons per share and one preferred share with a nominal value of 1 000 kroons.

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

In 2004 United Utilities (Tallinn) B.V. owned 10 086 957 (50,4%) A- shares and the City of Tallinn owned 9 913 043 A-shares (49,6%) and 1 B- share. In May 2005 an initial public offering (hereinafter IPO) took place, with the existing shareholders selling down total 6 000 000 shares in direct proportion to their original shareholding. The shares of the Company were listed on the Tallinn Stock Exchange on 1 June 2005. As result United Utilities (Tallinn) B.V. owns 7 060 870 (35,3%) A- shares, the City of Tallinn owns 6 939 130 (34,7%) A- shares, with 6 000 000 shares in free float. Nordea Bank Finland Plc customers owned 2 312 667 (11,6%) shares as of 31.12.2005. Other shareholders owned less than 5% of the shares as of 31.12.2005.

From Supervisory and Management Board members only Ian John Alexander Plenderleith and Roch Jean Guy Antoine Cheroux owned 110 and 262 shares respectively, both proportion in shareholding was approximately 0 as of 31.12.2005.

The shareholders reduced the statutory legal reserve from 93 394 thousand kroons to 20 000 thousand kroons on 3 February 2005. The share capital was reduced in 2002, but the statutory legal reserve, which has to be 10% of the share capital, was not revised at this time.

NOTE 15. NET SALES (thousand EEK)

	2005	2004
REVENUES FROM MAIN OPERATING ACTIVITIES		
Water supply service	262 693	220 688
Waste water disposal service	232 852	204 494
Stormwater treatment and disposal service	46 574	44 731
Fire hydrants service	2 040	1 959
Other works and services	5 759	6 942
TOTAL REVENUES FROM MAIN OPERATING ACTIVITIES	549 918	478 814
REVENUES FROM OTHER OPERATING ACTIVITIES		
Water, sewerage and storm water connections construction income	42 111	69 715
TOTAL NET SALES	592 029	548 529

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

NOTE 16. PERSONNEL EXPENSES (thousand EEK)

	2005	2004
Salaries and wages	-52 949	-48 461
Social security taxation	-17 739	-16 235
STAFF COSTS TOTAL	-70 688	-64 696
 Average number of employees during the reporting period	 337	 343

NOTE 17. COSTS AND EXPENSES (thousand EEK)

	2005	2004
COST OF GOODS SOLD (MAIN OPERATING ACTIVITIES)		
Tax on special use of water	-9 049	-9 272
Chemicals	-13 477	-9 387
Electricity	-23 628	-26 151
Pollution tax	-6 905	-8 380
Staff costs	-45 692	-44 643
Research & development	-186	-85
Depreciation and amortization	-73 582	-74 873
Other costs of goods sold	-29 536	-24 464
TOTAL COST OF GOODS SOLD (MAIN OPERATING ACTIVITIES)	-202 055	-197 255
COST OF GOODS SOLD (OTHER OPERATING ACTIVITIES)		
Water, sewerage and storm water connections construction cost	-38 338	-64 410
MARKETING EXPENSES		
Staff costs	-4 777	-4 240
Depreciation and amortization	-192	-113
Other marketing expenses	-1 809	-1 781
TOTAL COST OF MARKETING EXPENSES	-6 778	-6 134
GENERAL ADMINISTRATION EXPENSES		
Staff costs	-14 151	-15 813
IPO bonus to employees	-6 068	0
IPO services	-11 445	0
Depreciation and amortization	-4 967	-4 520
Other general administration expenses	-27 626	-20 406
TOTAL COST OF GENERAL ADMINISTRATION EXPENSES	-64 257	-40 739

Other income/expenses include 8 490 thousand kroons of IPO costs in 2005, in years 2004 and 2005 the profits recognised on the sale of fixed assets during the period, the movement of the bad debt provision during the year and provisions recognised and released throughout the financial period. It also includes income and costs generated from a consultancy project in Republic of Tajikistan.

In total, the costs for the period ended 31 December 2005 include IPO costs of 26 003 thousand kroons, being made up of 19 935 thousand kroons for services and 6 068 thousand kroons for staff bonus costs as referred to above.

NOTE 18. FINANCIAL INCOME AND EXPENSES *(thousand EEK)*

	2005	2004
Interest income	4 966	2 780
Interest expense	-57 791	-54 757
Loans restructuring costs	-19 497	0
Other financial income / expenses (-)	-811	-3 504
Foreign exchange gain/loss (-)	295	-199
TOTAL FINANCIAL INCOME / EXPENSES	-72 838	-55 680

NOTE 19. DIVIDENDS *(thousand EEK)*

	2005	2004
Dividends declared during the period	112 000	75 000
Dividends paid during the period	112 000	75 000
Income tax on dividends declared	-35 368	-26 351
Income tax paid on dividends received	0	74
INCOME TAX ACCOUNTED	-35 368	-26 277

The income tax rates were 26/74 and 24/76 respectively in 2004 and 2005.

NOTE 20. EARNINGS AND DIVIDENDS PER SHARE *(thousand EEK)*

	2005	2004
Earnings per share from continuing operations:		
Earnings for the purposes of basic earnings per share (net profit for the period minus B-share preference rights)	174 344	172 951
Weighted average number of ordinary shares for the purposes of basic earnings per share	20 000 000	20 000 000
Earnings per share in kroons	8,72	8,65
Dividends per A-share in kroons	5,60	3,75
Dividends per B-share in kroons	10 000,00	10 000,00

Diluted earnings per share for the periods ended 31 December 2005 and 31 December 2004 are equal to the earnings per share figures stated above.



NOTE 21. NOTES TO THE CASH FLOW STATEMENT (thousand EEK)

NOTE 21A. PIPELINES FINANCED BY CONNECTION FEES

	2005	2004
REVENUE		
Connection fees from pipelines taken into use	42 111	69 715
Increase/decrease (-) in prepayments for pipelines	7 750	-19 088
Decrease in accounts receivable from pipelines	3 340	8 743
Offset with liabilities	-707	0
CONNECTION FEES RECEIVED	52 494	59 370
Acquisition cost of pipelines taken into use	-38 338	-64 410

The connection fees from and the acquisition costs of pipelines taken into use are eliminated from "Cash flows of operating activities" as these are recorded within "Cash flows from investing activities". The net amounts eliminated were respectively -3 773 thousand and -5 305 thousand kroons in 2005 and in 2004.

NOTE 21B. CHANGE IN CURRENT ASSETS AND LIABILITIES

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

	2005	2004
CURRENT ASSETS		
Change in balance sheet	-122 154	-8 438
Adjustments:		
Change in cash balance	106 067	16 847
Changes between fixed assets and current assets	-229	-423
Assets sold from assets for sale	0	-2 250
Change in deferred interests and long-term loans	-101	119
Offset of debts	-26	0
Change in construction income debt	-3 340	-8 743
Cash from/to long-term deposit	77 537	-46 090
TOTAL CHANGE IN CURRENT ASSETS	57 754	-48 978
LIABILITIES		
Change in balance sheet	-39 048	20 040
Adjustments:		
Change in finance lease and loan costs	96 994	-67 163
Change in payables for capital investments	1 818	16 990
Prepayments for the sale of fixed assets	-45 600	0
Change in construction income prepayments	-7 750	19 088
TOTAL CHANGE IN LIABILITIES	6 414	-11 045

NOTE 21. NOTES TO THE CASH FLOW STATEMENT (continued)

NOTE 21C. PAYMENTS FOR FIXED ASSETS

	2005	2004
Acquisition of fixed assets	-223 145	-158 379
Adjustments:		
Decrease in accounts payable related to investments	-1 818	-16 990
Offsetting of payments for investments	733	0
Interest capitalization	1 075	2 690
Capitalization of operating expenses	23 280	38 974
TOTAL PAYMENTS FOR FIXED ASSETS	-199 875	-133 705

NOTE 22. COMMITMENTS (thousand EEK)

Leased assets

	2005	2004
Total operating lease expense for computers and vehicles	4 804	4 077

Minimum operating lease payments are as follows:

Less than 1 year	5 005
1-5 years	6 103
TOTAL MINIMUM LEASE PAYMENTS	11 108

As of 31.12.2005 the Company had taken commitments for capital investments, i.e. concluded contracts and requested works with purchase orders to the value of 77 355 thousand kroons.

NOTE 23. INCOME TAX ON DIVIDENDS

According to the Estonian Income Tax Act the accrued profit of a resident legal entity is not subject to tax, as tax is charged only on dividend distributions. Pursuant to the Income Tax Act Section 50, effective since 1 January 2003, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The tax rate applicable is 23/77 on the amount of the dividends payable in 2006, in 2005 the rate was 24/76.

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

The Company's distributable retained earnings as at 31 December 2005 amounted to 454 443 thousand kroons. Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 135 743 thousand kroons.

NOTES 24. COLLATERAL OF LOANS AND PLEDGED ASSETS

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

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

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

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

NOTE 25. RELATED PARTIES (thousand EEK)

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

The transactions with related parties in 2004 and 2005 and respective balances as of 31.12.2004 and 31.12.2005 are recorded as follows:

	Tallinn City Government and related boards	The companies belonging to the same group with the United Utilities (Tallinn) B.V.
2004		
Transactions recorded in Working Capital on the Balance Sheet of AS Tallinna Vesi		
Customer receivables	1 551	0
Accounts payable - short-term trade and other payables	0	1 523
Transactions recorded to the Income Statement of AS Tallinna Vesi		
Net sales	99 216	40
General administration expenses	0	7 663
Transactions recorded to other accounts on the Balance Sheet of AS Tallinna Vesi		
Non-current assets incl unfinished assets and new connections	0	14 306
2005		
Transactions recorded in Working Capital on the Balance Sheet of AS Tallinna Vesi		
Deferred income	71	0
Accounts payable - short-term trade and other payables, incl. dividends	0	2 423
Transactions recorded to the Income Statement of AS Tallinna Vesi		
Net sales	77 465	0
General administration expenses	0	12 990
Other income (-)/ expenses	0	504
Transactions recorded to other accounts on the Balance Sheet of AS Tallinna Vesi		
Non-current assets incl unfinished assets and new connections	0	13 480

	2005	2004
Management Board fees excluding social tax	2 121	2 059
Supervisory Board fees excluding social tax	70	18

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

NOTE 26. RECLASSIFICATION *(thousand EEK)*

Due to the reclassification of impairment loss the following reclassifications are recorded in the Income Statement of 2004:

Line of Income Statement	Opening balance	Reclassification	Closing balance
Costs of goods sold (main operating activities)	-195 486	-1 769	-197 255
Other income/ expenses (-)	13 158	1 769	14 927

The net sales and the cost of goods sold, both recorded in one line of the Income Statement of 2004, are both split between main operating and other operating activities as recorded in the Income Statement of the financial reports.

NOTE 27. FINANCIAL RISK MANAGEMENT

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

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

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The Company has no significant interest-bearing assets. The Company has two loans, from which the first is at a fixed interest rate, the second loan is split into two parts: the first part is calculated by reference to the Euribor 6 Months rate with an upper and lower cap to limit exposure, the rest of the balance, which is immaterial, is at market rates.

The Company has no significant concentrations of credit risk. The Company has procedures in place to ensure that sales of products and services and purchases are only made in accordance with the Company's policies. The debt management group participates in the determination of payment terms and schedules to facilitate the collection of debt and controls the payment discipline of customers as part of a daily routine, for example by sending out invoice reminders, making debt follow up phone calls and other debt management tools.

In management of liquidity risk the Company has taken a prudent view, maintaining sufficient cash and marketable securities funding availability through an adequate amount of committed credit facilities. Continuous cash flow forecasting and control are essential tools in the day-to-day liquidity risk management of the Company.

The Company is insured against sudden and unexpected physical loss, damage or destruction, business interruption and extra expenses, third party claims against the Company including sudden and unexpected environment pollution damages, Company crime risks, liability of D&O (management board, supervisory board and members of senior management), accident insurance of personnel, motor vehicle accidents, theft, vandalism etc.

NOTE 28. FINANCIAL INDICATORS

	2005	2004
Operating Margin (1)	47,7%	46,5%
Net profit margin (2)	29,5%	31,5%
Return on equity (3)	16,9%	18,2%
Return on assets (4)	7,6%	8,0%
Debt to equity ratio (5)	1,2	1,2
Current ratio (6)	1,9	0,9

Notes:

(1) Operating profit as a percentage of net sales

(2) Net profit as a percentage of net sales

(3) Net profit as a percentage of average total equity capital

(4) Net profit as a percentage of average total assets

(5) Total liabilities divided by total equity capital

(6) Total current assets divided by total current liabilities



PROFIT DISTRIBUTION PROPOSAL

The distributable equity capital of AS Tallinna Vesi as of 31 December 2005 is as follows:

Accumulated profit	280 089 thousand kroons
Net profit for the period	174 354 thousand kroons
Total	454 443 thousand kroons

The Management Board of AS Tallinna Vesi proposes to distribute 157 000 thousand kroons to shareholders as dividends from the available equity capital accumulated by end of the year 2005.

10 February 2006



Robert John Gallienne

Chairman of the Management Board

INDEPENDENT AUDITORS' REPORT

To the Shareholders of AS Tallinna Vesi:

We have audited the annual accounts of AS Tallinna Vesi ("the Company") for the year ended 31 December 2005. These annual accounts are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on these annual accounts based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the annual accounts. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall presentation of the annual accounts. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the annual accounts present fairly, in all material respects, the financial position of the Company as of 31 December 2005, the results of its operations and its cash flows for the years then ended, in accordance with Estonian Accounting Law and International Financial Reporting Standards as adopted by the EU.



Sander Kallasmaa
Certified Auditor
10 February 2006



AS Deloitte Audit Eesti

CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS TO THE ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2005

The Management Board has prepared the management report and the annual accounts of AS Tallinna Vesi on 10 February 2006.

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

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

<i>Name</i>	<i>Position</i>	<i>Signature</i>	<i>Date</i>
Robert John Gallienne	<i>Chairman of the Management Board</i>		10/2/2006
Roch Jean Guy Antoine Chérourx	<i>Member of the Management Board</i>		10/2/2006
Ian John Alexander Plenderleith	<i>Member of the Management Board</i>		10/2/2006
Michael James Southworth	<i>Chairman of the Supervisory Board</i>		6/4/06
Karl Olof Joakim Forsberg	<i>Member of the Supervisory Board</i>		22/3/06
David John Kilgour	<i>Member of the Supervisory Board</i>		6/4/06
Marion Elaine Price	<i>Member of the Supervisory Board</i>		14/3/06
Toivo Tootsen	<i>Member of the Supervisory Board</i>		14.03.06
Rein Ratas	<i>Member of the Supervisory Board</i>		14.03.06
Elmar Sepp	<i>Member of the Supervisory Board</i>		14.03.2006
Helo Meigas	<i>Member of the Supervisory Board</i>		14.03.06
Valdur Laid	<i>Member of the Supervisory Board</i>		14/3/06





Eteri Harring,
*Head of Treasury and
Investor Relations*

Useful Information for Shareholders



INVESTOR CALENDAR FOR 2006:

2 February 2006	preliminary Annual Report 2005
15 March 2006	audited Annual Report 2005
21 April 2006	1st quarter financial results for 2006
13 May 2006	fixing shareholder list entitled to vote in Annual General Meeting of the Shareholders at 8 am
23 May 2006	Annual General Meeting of Shareholders
31 May 2006	cum-dividends date
1 June 2006	ex-dividends date
6 June 2006	record date of shareholders entitled to dividends at 8 am
15 June 2006	dividend payment date
27 July 2006	2nd quarter financial results for 2006
26 October 2006	3rd quarter financial results for 2006

IMPLEMENTATION OF CORPORATE GOVERNANCE RECOMMENDATIONS

The Financial Inspectorate has approved the advisory guidelines “Corporate Governance Recommendations”, which are valid starting from 1 January 2006. The guidelines are expected to be followed by the companies listed on the Tallinn Stock Exchange and have been also enforced through their regulations.

The Corporate Governance Recommendations describe the conduct that should be followed by companies in order to contribute to a better and more transparent management and management control of companies. Firstly, through the organisation of management, which should be carried out in such a way as to provide adequate opportunity for investors to supervise the management. Secondly, through the disclosure of information, which should be directed towards equality of treatment of investors and shareholders. Based upon these objectives, the Corporate Governance Recommendations will help structure the work of the management board, supervisory board, general meeting and also the disclosure of information related to the management and management activity. Tallinna Vesi intends to implement the principles of the

Corporate Governance Recommendations in 2006, with all the necessary disclosures reported on the Company's website and the Tallinn Stock Exchange website.

The Corporate Governance Recommendations are available both as the advisory instructions of the Financial Inspectorate as well as the commented publication issued in cooperation with the leadership magazine "Director". The materials are available at:

- the Financial Inspectorate's website:
www.fi.ee
- the Tallinn Stock Exchange website:
www.omxgroup.com/tallinn/heatava.

Printed and commented publications are available at the Financial Inspectorate office (Sakala 4, Tallinn) and the Tallinn Stock Exchange office (Tartu Road 2, Tallinn).

KEEPING YOU IN THE PICTURE

You can find more information about Tallinna Vesi quickly and easily on the Tallinn Vesi website. In addition to the annual report and interim reports, key company announcements, environmental reports and company presentations are also published on the web site. www.tallinnavesi.ee. Investors can also join the regular investor mailing list by contacting the Head of Treasury and Investor Relations (details below).

Additional information to the shareholders:

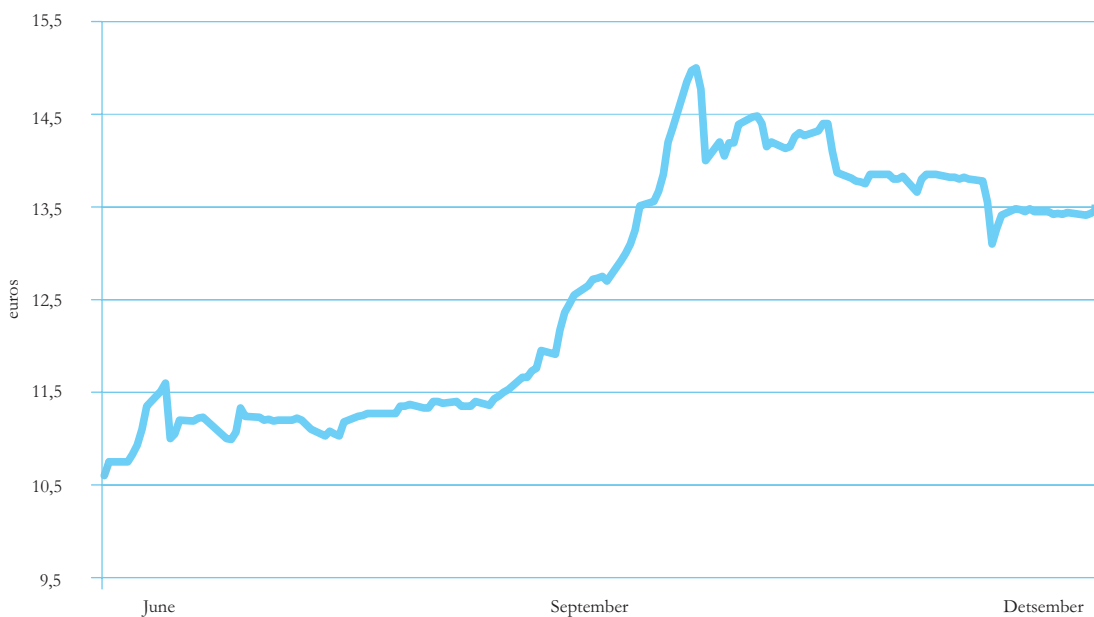
Eteri Harring

Head of Treasury and Investor Relations

Tel (+372) 6262 225

E-mail: eteri.harring@tvesi.ee

Graph 13. Share price performance in TSE in 2005



AS Tallinna Vesi Management Board

The Management Board represents the Company in its relations with third parties and manages the Company's daily activities and organises its accounting. The Management Board reports to and is instructed by the Supervisory Council. According to the Articles of Association the Management Board of AS Tallinna Vesi consists of two (2) to five (5) members who are elected for three (3) years.

The members of AS Tallinna Vesi Management Board are:

Robert John Gallienne

*Chairman of the Management Board,
Chief Executive Officer (CEO)*

Bob Gallienne, British, has served as the CEO and Chairman of the Management Board of the Company since 1st April 2002. Prior to this Mr. Gallienne held the position of Managing Director in Sofyiska Voda and Group Customer Services Director of Manila Water in the Philippines. He has over 25 years experience in senior management positions in the water industry both in England and overseas.

Roch Jean Guy Antoine Chérourx

*Member of the Management Board,
Chief Operating Officer (COO)*

Roch Chérourx, French, Chief Operating Officer and Member of the Board of the Company since 1st April 2002, graduated from one of the French "Grandes Ecoles" in engineering and business management. He has more than 14 years experience in the water and wastewater sector in France. He has held successive management positions in a French water company, first in the design and construction of water and waste water facilities then in operation and finally took the position of Managing Director for the north of France.

Ian John Alexander Plenderleith

*Member of the Management Board
Chief Financial Officer (CFO)*

Ian Plenderleith, British, joined the company in October 2004 as Chief Commercial Officer of the Company. He has over 13 years experience in a variety of financial roles within the utilities sector both in the UK and internationally. Prior to joining the Company he was employed as Financial Controller for United Utilities Networks in the UK. He is a member of the Chartered Institute of Management Accountants.

AS Tallinna Vesi Supervisory Board

The Supervisory Board has the ultimate responsibility for the organisation of work of the Company, plans the activities of the Company and supervises the activities of the Management Board. The Board consists of nine (9) members whose term lasts two (2) years. Board members are elected and appointed in accordance with the following principles:

- Five (5) members of the Board are elected and removed by the shareholders' general meeting, whereas the person who receives the most of votes shall be considered elected. A Board member who is elected by the shareholders' general meeting may be removed before the end of his/her term, provided that at least 2/3 of the votes represented by the shares at the shareholders' general meeting vote in favour of the removal.
- Two (2) members of the Board are appointed and removed by the holder of the B-Share or by a shareholder whose shares represent at least 34% of the votes granted by the A-Shares, provided however that no single shareholder may appoint or remove more than two members of the Board.

The Tallinn Stock Exchange Rules require that if more than 30 per cent of the share capital of a company listed on the Tallinn Stock Exchange is held by a single shareholder, then at least two (2) members of the supervisory council of the relevant company must be independent. Thus, AS Tallinna Vesi held an Extraordinary General Meeting of shareholders on 22 November 2005 where two independent Board members were elected. Members of the Board elect from among themselves the Chairman of the Board who will organise the activities of the Board and chair Board meetings.

The members of AS Tallinna Vesi Supervisory Board are:

Michael James Southworth,

The Chairman of the Supervisory Board

Nominated by United Utilities group, since 12 September 2003. His experience in engineering, operations and management in the water and wastewater sector spans over 28 years. Mr. Southworth's international experience began in 1992 where he has held several roles in both business development and operations in North and South America, as well as in Central and Eastern Europe. Mr. Southworth also holds the following positions: United Utilities International Limited, Strategic Relations Director, Supervisory Board Member of Sofiyska Voda, President of United Utilities Canada and Chairman of the Balkan and Black Sea Branch of the Pipeline Industries Guild. He has an Honours Degree in Civil Engineering and is a Chartered Engineer, Member of the Institution of Civil Engineers and a Member of the Institution of Water and Environmental Management.

David John Kilgour

Nominated by United Utilities group, since 3 September 2002. David Kilgour is the Finance Director of United Utilities PLC's international operations. He qualified as a Chartered Accountant in 1986, while working for PricewaterhouseCoopers. Between 1989 and 1993, he held the position of Group Financial Controller with an international engineering group. Since joining the United Utilities group in 1993, he has held various senior financial posts within the company. He sits on the boards of a number of United Utilities' international operational businesses. Mr. Kilgour graduated from Leeds University with a BSc. in metallurgy.

Karl Olof Joakim Forsberg

Nominated by the European Bank of Reconstruction and Development (EBRD), since 19 November 2004. He has a Master of Science degree in civil engineering and another degree in finance. He has been active in infrastructure and utility financing for more than seven years. Between 1997 and 2000, Mr Forsberg worked for the major international construction company Skanska. Since 2000, he has been working for the EBRD in London, where he is currently responsible for managing municipal and environmental projects in certain Baltic countries.

Marion Elaine Price

Nominated by the EBRD, since 22 March 2005 as an Independent Director. Mrs. Price is a Director of Mobsby Associates Ltd, which she set up in 2000. Mobsby Associates Ltd specialises in project finance, privatisation and PFI/PPP, working for both the public and private sectors. Prior to this, Mrs. Price was a Partner with PricewaterhouseCoopers with responsibility for the project finance for and privatisation of the energy sector. She is a career banker and project financier and has been involved in a wide range of project financing. In addition, in 2002, Mrs. Price formed PPP Solutions Ltd, which provides PFI/PPP advice to the public sector in the United Kingdom and overseas. Mrs. Price is also a non-executive director and a member of the committee of Crown Agents Financial Services Ltd, and in December 2002 was appointed a Gateway Team Leader for the British Government's Office of Government Commerce. Mrs Price studied languages and commerce at Holborn College of Law (now part of Westminster University).

Tallinn City representatives:

Elmar Sepp

Nominated by the City of Tallinn, since 7 December 2005. Elmar Sepp is the Deputy Chairman of the Tallinn City Council, Chairman of the Tallinn City Council's Centre Party Faction since autumn 2005. During the periods of 2003-2005 and 1999-2002 he was a Member

of Tallinn City Council. Mr. Sepp was also employed by AS Tallinna Soojus (Tallinn Heat Generating Company) as the Chairman of the Management Board for 1 year. Prior working in Tallinna Soojus, he was Tallinn City Centre District elder. Elmar Sepp has a law degree from the University of Tartu.

Toivo Tootsen

Nominated by the City of Tallinn, since 6 April 2005 (and previously from 21 December 2001 to 17 November 2004). Mr. Tootsen has been a Member of the Parliament of Estonia since 1999. He has belonged to the Tallinn City Council for 11 years as a member of both the Finance and City Economy Committees. Between 1996 and 1999 Mr. Tootsen held the positions of Chairman and Vice-Chairman of the Estonian Journalists' Association. He has 29 years' experience in journalism having served as a Senior Editor for Estonian National Radio. Mr. Tootsen graduated from the University of Tartu, majoring in Estonian language and literature and also graduated from Tallinn Pedagogical University as a stage manager-producer.

Rein Ratas

Rein Ratas was elected the member of the Supervisory Board in 22 November 2005. Since 1999 Mr. Ratas has been employed by AS Tallmac as the Head of Environmental Department and an environmental expert. Simultaneously Rein Ratas has been teaching at the Estonian Agricultural University in Environmental Protection Institute. Prior to that Mr. Ratas was the Secretary General in the Environmental Ministry for 7 years. Rein Ratas has PhD in the field of biology from the University of Tartu.

Independent Members:

Helo Meigas

Helo Meigas was elected the independent member of the Supervisory Board in 22 November 2005. Since September 2004 Helo Meigas has been working as the Managing Director of the Investment Management Division in Hansabank, the largest bank of Estonia. Prior Hansabank she was employed by McKinsey & Co in Finland as an Engagement Manager for three years and by the Bank of Estonia as the Deputy Governor for two years. She was also the Chief Executive Officer of Tallinn Stock Exchange in 1995 – 1998. Helo Meigas holds an M.A.L.D from Fletcher School, Tufts University, USA.

Valdur Laid

Valdur Laid was elected the independent member of the Supervisory Board in 22 November 2005. Since February 2004 Valdur Laid holds the position of CEO in Elion, the largest telecom company in Estonia. He joined Elion in 2002 as the CFO and Member of the Management Board. Prior Elion, Valdur Laid was employed by the Bank of Estonia holding different managerial positions for 8 years. In 1999 – 2000 he served as an Executive Director and Member of the Management Board of the Bank of Estonia. Valdur Laid has MBA degree from International Institute of Management Development in Lausanne, Switzerland.