AS TALLINNA VESI

Consolidated Annual report
for the financial year ended
31 December 2011
(Translation of the Estonian original)

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

Beginning of the financial year	1 January 2011
End of the financial year	31 December 2011
Name of the Company	AS TALLINNA VESI
Legal form of the Company	Public limited company
Commercial register number	10257326
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Chairman of the Board	Ian John Alexander Plenderleith
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Web-page	www.tallinnavesi.ee
Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditors	AS PricewaterhouseCoopers
Documents attached to the Annual Report	Independent auditor’s report

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MANAGEMENT REPORT

CHAIRMAN'S STATEMENT

In 2011 AS Tallinna Vesi has demonstrated an extremely high level of resilience. Our company's privatisation contract, business model and operational standards have been questioned, and many declared illegal, by the new "price checker" the Competition Authority. Since taking over the "price checking" function from the City of Tallinn the Competition Authority has refused to engage with any aspect of our privatisation contract preferring to ignore the outstanding operational performance of the company, whilst declaring our privatisation contract "illegal".

During 2011 the Competition Authority refused to accept our tariff application for 3.5% tariff increase. We would like to highlight that our tariff application was made solely on the basis of the privatisation contracts that were approved by the City of Tallinn and the Estonian Government in 2001. Furthermore, in order to assist the Competition Authority with this tariff application we asked the international consultancy company Oxera to make an independent review of the company's economic performance and profits since privatisation in 2001. This review revealed that the profits made by the Company were not excessive, and that this could be proved by benchmarking against the profits allowed by the UK and Dutch regulators. A further benefit of obtaining an independent perspective is that it enables the company and the Competition Authority to have a professional and meaningful discussion based on the evidence presented, however in spite of our best efforts, to date we have not been able to engage in such discussions.

Unfortunately the Competition Authority refused to review any aspect of our application preferring to insist on the use of its own unverified internal guidelines. As a consequence in June 2011 we were forced to make a complaint to the courts to try to have the contractual rights upheld. To date, no court date has been set.

In October 2011, preferring to circumvent due legal process the Competition Authority used a ministerial decree in order to issue a prescription to ASTV demanding that we reduce our tariffs by 29%. This is in spite of the fact that these tariffs had been set in accordance with the privatisation contract and had been approved by the previous regulator the City of Tallinn. To prevent this we have issued a further complaint to the courts asking for an injunction to stop the 29% tariff cut at least until the courts have ruled on the legality of the terms and conditions of the privatisation contracts. On 6 February 2012 the courts gave a positive reply to the Company's injunction request. The Competition Authority appealed against this ruling on 17 February2012. The Company is awaiting the Tallinn District Court's ruling on the matter, which should indicate whether the tariffs will be frozen until the court makes its final judgement on the legality of the privatisation agreements.

We do not believe that AS Tallinna Vesi, its owners, its employees, its customers and its business partners should be forced to defend itself in court for following the terms and conditions of the privatisation contract that were set by the Estonian authorities themselves. As a consequence, without the prospect of meaningful dialogue ASTV is faced with no option but to use all available legal means to protect its contractual rights.

In spite of all these political and contractual discussions I am delighted to report that in 2011 our operational and service performance has been the best ever. In August 2011 the biofilter, the new treatment stage at the WWTP (Wastewater treatment plant), came into operation. This improvement to the plant has significantly improved the quality of treated effluent discharged into the Baltic Sea, reducing the amount of nitrogen discharged by over 10%, and makes a significant contribution to Estonia's strategy for a cleaner Baltic Sea. In addition, in late 2010 we made some important changes to our structure and processes, and during this current year the results of these changes can clearly be seen in our performance. This improvement is a testimony to the attitude and commitment of our staff who have worked tirelessly to provide a better service for our clients. For this, on behalf of the Management Board, Supervisory Council and owners of the company, I would like to say thank you.

It is very pleasing to see that the quality of our governance and the transparency of our work has been recognised externally. At the NASDAQ OMX Baltic Stock Exchange awards for 2011 we once again won the award for the company with the best Investor Relations in Estonia and 2nd place in all three Baltic countries. These awards are clear demonstrations of the company's commitment to transparent reporting and high quality corporate governance, both of which are pre-requisites for any responsible utility company.

Operations performance – best ever across all business areas

We have continued to ensure we meet or exceed the services contract we have with the City of Tallinn. This services contract requires us to maintain a high standard of service to our customers across a range of over 90 levels of service, ensuring that we deliver a service to our customers that is second to none.

We invested 16.5 mln euros in 2011, with the main focus being our improvements into the wastewater treatment plants. In 2011, these investments and changes in working practices enabled us to improve our performance across all areas of our value chain, achieving the highest standards ever for water quality, wastewater treatment, and the performance of our networks. The standards of water produced and wastewater treated will stand comparison with the very best in Western Europe, and of this we are rightly very proud!

Good customer service but with room for improvement.

This year our customer satisfaction rating declined from a TRI*M index high of 78 in 2010 to 72 points at the end of 2011. Whilst this rating is well above the European average for utility companies it is disappointing for our company to see that our customers think we have not performed as well as in the previous year. Although our operational results demonstrate the excellent progress we have made across all our main performance indicators in 2011 these improvements have not been recognised by our customers.

In 2012 we will of course carry on focussing on continuous improvement across all business areas. We understand that the provision of a high quality product and service 365 days a year, 24 hours a day is fundamental for all our customers. However, based on our 2011 results we can see that we must do more if we want to give the very best service to our customers. Therefore, during 2012 we will supplement performance improvement with better customer feedback, which will help us to understand what is important to our customers. In addition, we will look externally into the service environment in Estonia and across Europe to see where we can learn from our other utilities and service providing companies.

Developing opportunities for our people and teams

In 2011 the commitment of our workers was once again exemplary. Our staff have met the challenges of higher service standards and a new organisational structure and have delivered a world class service. The recognition of these successes can be seen in the results of our employee opinion survey.

In 2011 employee satisfaction rose from 66 to 74, reflecting the increased motivation our staff feel as a result of working in meaningful and successful jobs.

We strive to give our staff the opportunity to develop within the company, and during the past year we have seen a number of our talented people rise into management and Board positions. In early 2012 we made some changes at Management Board level and as a result two of ASTV's senior managers were promoted to Management Board positions. By promoting from within we are sharing our success with our staff and demonstrating that significant career opportunities exist in AS Tallinna Vesi. We remain committed to the personal and professional development of our staff as we believe it will make the company an attractive employer for the brightest and the best.

Stable Revenues, returns in accordance with other privatised utilities

We are a financially robust and resilient business. Our turnover from our main business activity, sales of water and wastewater increased by 3.0% to 46.5 mln euros and our operating profit from these activities increased by 5.2 % to 25.4 mln euros. The real return (net of inflation) on invested capital in our main business was 6.5% in 2011 and 7.0% over the five year period from 2007 to 2011, which is in accordance with the rates of return made by other privatised water utilities.

Limited growth potential at this point in time

Our excellent operational performance leaves us well placed to expand our service offering across the Baltic's. We already provide a very high quality service and we should be able to utilize this operational strength to increase revenues from activities outside of the City of Tallinn whilst bringing a better quality service to other municipalities at a lower cost. Unfortunately the new regulatory regime implemented in late 2010 lacks transparency which means that growth opportunities within Estonia are extremely limited. We will however continue to work with the various ministries and regulatory authorities to demonstrate the benefits that outsourcing in the water sector can bring for both customers and the environment.

Outlook

In the current political and regulatory environment the outlook for the company is very uncertain. Given that the Estonian authorities are unwilling to enter into any meaningful discussions over the privatisation contracts it appears that the company will be engaged in a long court process, which could last a number of years. It is apparent that the significant improvements in service count for very little within the new system of regulation. I would however like to ensure all our stakeholder groups, as a 100% professional organisation we are committed to delivering the best, and incomparable in Estonia, level of service to all our direct customers and service users.

Finally, I would like to thank my colleagues in Tallinna Vesi and Watercom, and all our suppliers and business partners for all their expertise, energy and support in serving our customers in this difficult time. It is because of all your efforts that we are once again able to report a level of operating and service performance that is second to none.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

RESULTS OF OPERATIONS - FOR THE YEAR 2011

Return on invested capital

The real return on capital invested at the time of privatisation was 6.5% in 2011, which is slightly higher than the 6.2% average real return on capital invested over the contract period starting from 2001, as the privatisation contract designed the returns to be lower in early years of contract.The Company has chosen the average real return on invested capital[1] (ARRIC) calculation in order to prove its returns since 2001, which is the classical formula used for verifying utility profits. ARRIC calculation uses the capital paid for the 50.4% of the shares at privatization to calculate the Regulatory Asset Base (RAB). This calculation is recommended by the World Bank for tariff setting for privatized utilities. For further information on the RAB calculation please see paragraph 3.2 and the tables 4 and 5 of Note 5 of the tariff application[2].

Furthermore, in the interests of an open and professional dialogue to demonstrate that its return on invested capital has not been excessive, the international economic consulting group Oxera has independently verified the calculation of the average real return on capital invested at the time of privatisation and Oxera's report is available on AS Tallinna Vesi's webpage.

Both, the average and the annual return on capital invested are in accordance with the returns allowed by Ofwat, the UK regulator over this same period[3], and the return permitted by the Dutch Energy regulator Energiekamer, which allowed a real rate of return of 6.0% in its regulatory determination of September 2010.

Other main economic indicators

million euros	**2011**	**2010**	**2009**	**2008**	**2007**
Sales	51,2	49,7	49,4	46,0	41,4
Gross profit	30,3	29,0	31,2	28,6	27,6
Operating profit	28,9	27,5	29,5	25,9	24,1
Operating profit - main business	25,4	24,2	26,9	24,1	23,2
Profit before taxes	25,8	24,9	25,6	23,1	21,3
Net profit	21,5	16,4	21,7	18,9	17,8
Gross profit margin %	59,2	58,4	63,2	62,1	66,6
Operating profit margin %	56,4	55,3	59,8	56,3	58,2
Profit before taxes margin %	50,3	50,1	51,9	50,3	51,4
Net profit margin %	42,0	33,0	44,0	41,1	42,9
ROA %	11,2	8,9	12,3	11,6	10,9
Debt to total capital employed	58,9	60,1	49,7	49,9	51,8
ROE%	27,3	22,4	24,4	23,1	22,5
Current ratio	4,9	2,1	4,2	1,8	1,9
Number of full-time equivalent employees	299	305	322	317	303
Share capital	12,0	12,8	12,8	12,8	12,8

[1] ARRIC – EBIT from regulated services/regulatory asset base during the contract period from 2001
[2] http://www.tallinnavesi.ee/static/files/932.AS Tallinna Vesi Tariff Application for 2011-2015.pdf
[3] http://www.ofwat.gov.uk/regulating/reporting/rpt_fpr_2007-08.pdf , page 15

Gross profit margin – Gross profit / Net sales
Operating profit margin – Operating profit / Net sales
Profit before taxes margin – Profit before taxes / Net sales
Net profit margin – Net profit / Net sales
ROA – Net profit /Total assets
Debt to Total capital employed – Total liabilities / Total capital employed
ROE – Net profit / Shareholders' equity
Current ratio – Current assets / Current liabilities

Statement of comprehensive income

Sales

In 2011 the Company's total sales increased, year on year, by 3.1% to 51.2 mln euros. Sales in the main operating activity principally comprise of sales of water and treatment of wastewater to domestic and commercial customers within and outside of the service area, and fees received from the City of Tallinn for operating and maintaining the storm water system. There is no considerable seasonality in the Company's operation.

Sales of water and wastewater services were 46.5 mln euros, a 3.0% increase compared to 2010, resulting from the slight rise in sales volumes as described below.

Within the service area, sales to residential customers decreased by 0.4% to 23.7 mln euros. Sales to commercial customers increased by 6.6% to 18.2 mln euros. Sales to customers outside of the service area increased by 10.9% to 3.8 mln euros compared to 2010. Over pollution fees received were 0.77 mln euros, an 8.7% decrease compared to 2010.

In 2011, the volumes sold to residential customers remained broadly at 2010 level, with 0.1% reduction year on year. Eliminating the minor impact of revenues reclassification from inside area to the outside area the domestic consumption is flat.

The volumes sold to commercial customers inside the service area increased by 7.2% compared to the respective period in 2010. The sales volumes increased mainly due to improvement in leisure sector and related industrial and transportation services as result of pick up in tourism sector. The volume increase exceeds the sales increase due to the proportionally higher increase in wastewater services with the tariffs of the respective service being a bit lower compared to the water tariffs.

Volumes sold to outside service area were 9.9% higher than in 2010. The main factor in this increase was higher storm water volume in 2011 compared to 2010, resulting in sales increase of 10.9% year on year.

The sales from operation and maintenance of storm water and fire-hydrant system increased by 2.7% to 3.6 mln euros in 2011 compared to last year. This is in accordance with the terms and conditions of the contract whereby the storm water and fire-hydrant costs are invoiced based on actual costs and volumes treated.

Cost of Goods Sold and Gross Margin

The cost of goods sold for the main operating activity was 20.9 mln euros in 2011, an increase of 0.24 mln euros or 1.2% from the equivalent period in 2010. The cost increase was mainly the result of increased treatment volumes by 6.3% that affected all variable costs, balancing the savings related to the operational outperformance described below.

To mitigate the nitrogen treatment and tax risks discussed throughout the 2010, we completed the construction and implemented the additional stage in sewage treatment process in the beginning of the 3rd quarter of 2011. In spite of the increase in volumes treated in 2011 and the increase in tax rates year on year by 14.8%, the treatment results were excellent and resulted in reduced pollution tax payment. The pollution tax calculation depends on wastewater treatment results and concentration of different waste components in treated wastewater. In 2011 the Company was successful to remove all pollutants below the level required for the application of the beneficial coefficient in all quarters. Thereby the Company achieved in 2011 the beneficial 0.5 tax coefficient in contrary to 2010 with coefficient 1.0 in three quarters, and thereby the amount of pollution tax payable was 1.4 mln euros compared to 2.3 mln euros in 2010. We still have to note that the Company accounted for a one-off provision for pollution tax in Maardu related to storm water outlet not fully in control of the Company. Eliminating the 0.44 mln euros provision the pollution tax would have been 57.7% lower than in 2010.

Electricity costs increased by 0.27 mln euros or 9.9% in 2011 compared to 2010 having adverse impact from higher electricity prices as result of the purchase from the open market, but also from regulated networks fees. Chemical costs were 1.4 mln euros, no change in total cost compared to the corresponding period in 2010.

Salary expenses within costs of goods sold increased in 2011, year on year, by 0.36 mln euros or 8.9% mainly due to higher redundancy payments and performance related pay accrual. CPI (Consumer Price Index) increase in underlying individual salaries was broadly balanced by efficiencies resulted in reduction in headcount.

Other cost of goods sold in the main operating activity increased 0.50 mln euros, or 4.8% year on year, mainly due to the increase in asphalting cost related to the networks emergency works reflecting increase in rates of raw materials but also increased volumes. Other increases in rates were broadly balanced by internal efficiencies.

As a result of all of the above the Company's gross profit for 2011 was 30.3 mln euros, which is an increase of 1.3 mln euros, or 4.5%, compared to the gross profit of 29.0 mln euros for 2010.

Operating Costs and Operating Margin

Marketing expenses decreased by 0.04 mln euros to 0.75 mln euros during 2011 compared to the corresponding period in 2010. This is mainly the result of targeted efficiencies in number of other items.

In 2011 the General administration expenses increased by 0.64 mln euros year on year to 4.3 mln euros, mainly due to the increase in legal consultancies acquired in the process of tariff dispute. Within this group the salary costs increase was partly related to the transfer of management services to the salary line.

Other income/expenses

The majority of the income in Other net income/expenses relates to constructions and government grants. The drivers for this income stream are the networks extension programme and the connections activity in Tallinn. Income and expenses from constructions and government grants totalled a net income of 3.5 mln euros in 2011 compared to a net income of 3.3 mln euros in 2010. Variance in this line depends on construction volumes and estimates to the profit margins on projects completed. The extensive construction programme is expected to be completed in the 1st half of 2012.

The rest of the other income/expenses totalled an income of 0.14 mln euros in 2011 compared to an expense of 0.40 mln euros in 2010. The variance was mainly the result of one-off collection of long term overdue debt in the beginning of 2011.

As a result the Company's operating profit from main services for 2011 totalled 25.4 mln euros compared to 24.2 mln euros in 2010. In total the Company's operating profit for all activities for 2011 was 28.9 mln euros, an increase of 1.4 mln euros compared to an operating profit of 27.5 mln euros achieved in 2010. Year on year the operating profit for 2011 has increased by 5.2%.

Financial expenses

Net Financial income/expenses were 3.1 mln euros in 2011, which is a negative variance of 0.56 mln euros or 21.8% compared to the net expenses in 2010. In both years the financial costs were impacted from the non-cash revaluation of the fair value of swap agreements, in 2010 the impact was negative by 1.2 mln euros and in 2011 the impact was negative by 2.2 mln euros.

The Company has mitigated the majority of the long term floating interest risk with 5 interest swap agreements, each with a principal value of 15 mln euros. At this point in time the estimated fair value of these swap contracts is still negative, totalling 4.5 mln euros, with a negative revaluation in 2011 in the amount of 2.2 mln euros.

The adverse impact from financial costs was partly balanced by increased financial income, mainly related to the interest income calculated on financing of long term construction project.

Profit before Tax

The Company's profit before taxes for 2011 was 25.8 mln euros, which is 0.87 mln euros higher than the profit before taxes of 24.9 mln euros for 2010.

The Company's net profit for 2011 was 21.5 mln euros, which is 5.1 mln euros higher than the net profit of 16.4 mln euros in the equivalent period in 2010 mainly due to the lower dividend payment and related income tax paid on dividends in 2011.

Statement of financial position

During the twelve months of 2011 the Company invested 16.5 mln euros into fixed assets. Non-current assets were 150.7 mln euros as of 31 December 2011.

Current assets increased by 7.7 mln euros to 41.4 mln euros in the twelve months of the year. Customer receivables increased by 6.2 mln euros as result of the increase in accrued income related to long term construction projects and payment schedules, and the cash at bank increased by 1.5 mln euros.

Current liabilities decreased by 7.4 mln euros to 8.5 mln euros in the twelve months of the year. This was mainly due to a 7.6 mln euros reclassification of Current portion of long-term borrowings to Non-current liabilities after renewal of the loan agreement.

The Company has a leverage level as expected of 58.9%, in the target range of 60%, reflecting the increase in Equity of 5.5 mln euros as a result of the higher profit generation compared to the dividend payment in 2011.

Long-term liabilities stood at 104.7 mln euros at the end of December 2011, consisting mainly of the outstanding balance of three long term bank loans. As of 30 April 2011 the total 95 mln euros loan capital was recorded within long term liabilities in accordance with the signed loan agreements. In April 2011 the Company renewed its loan agreement and according to the loan agreements the first repayment of loans or refinancing should take place in 2013. The weighted average interest margin for the total available facility is 0.82%.

It has to be noted that in the 4th quarter of 2011 the Company disclosed an exceptional contingent liability, which could cause an outflow of economic benefits of up to 36.0 mln euros, as per note 3 to the accounts.

Cash flow

During the twelve months of 2011, the Company generated 30.2 mln euros of cash flows from operating activities, an increase of 5.4 mln euros compared to the corresponding period in 2010. 2011 operating cash flows were above 2010 cash flows mainly due to the working capital movement and particularly related to the payments of overdue debts in 2011. Underlying operating profit still continues to be the main contributor to operating cash flows.

In the twelve months of 2011 net cash outflows from investing activities were 8.4 mln euros, which is 1.4 mln euros less than in 2010. In 2011 the cash outflows related to the fixed asset investments were 18.5 mln euros. Within the group the increased compensations received for the construction of pipelines is balancing the increase in capital expenditures. In 2011 the Company has also given a loan of 3.2 mln euros to AS Maardu Vesi according to the Operating agreement signed in 2008.

The cash outflows from financing activities were 20.3 mln euros during the twelve months of 2011 compared to cash outflows of 20.5 mln euros during the same twelve months of 2010, representing the payouts of the dividends and income tax in both years and loans received in 2010.

As a result of all of the above factors, the total cash inflow in the twelve months of 2011 was 1.5 mln euros compared to a cash outflow of 5.5 mln euros in the twelve months of 2010. Cash and cash equivalents stood at 14.8 mln euros as at 31 December 2011 which is 1.5 mln euros higher than in the corresponding period of 2010.

Employees

At the end of 2011, the total number of employees was 311 compared to 319 at the end of 2010. The full time equivalent (FTE) was respectively 299 in 2011 compared to the 305 in 2010. The total salary cost was 6.4 mln euros, including 0.29 mln euros paid to the Management and Supervisory Council members. The off balance sheet potential salary liability would be up to 0.04 mln euros if the Council would want to replace the Management Board member.

Corporate structure

At the end of the year, as of 31 December 2011, the Group consisted of 2 companies. The subsidiary Watercom OÜ is wholly owned by AS Tallinna Vesi and consolidated to the results of the Company.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

Dividends and share performance

Based on the results of the 2010 financial year, the Company paid 16,000,639 euros of dividends. Of this, 639 euros was paid to the owner of the B-share and 16,000,000 euros, i.e. 0.80 euros per share to the owners of the A-shares. The dividends were paid out on 15 June 2011, based on the list of shareholders, which was fixed on 08 June 2011.

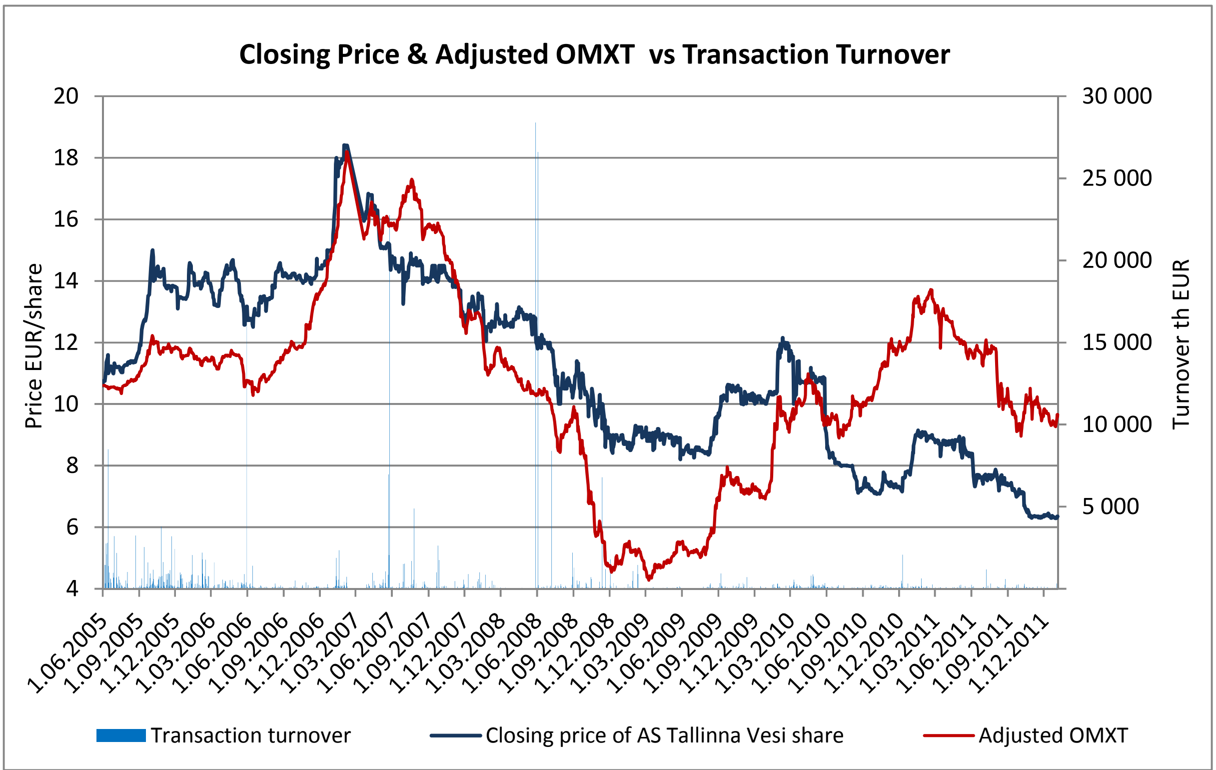
AS Tallinna Vesi is listed on OMX Main Baltic Market with trading code TVEAT and ISIN EE3100026436.

As of 31 December 2011, the shareholders of AS Tallinna Vesi, with a direct holding over 5%, were:

United Utilities (Tallinn) BV	35.3%
City of Tallinn	34.7%

Parvus Asset Management owned in total 7.79% of the shares of the Company as per Company’s best information as of 31 December 2011.

At the end of the year, as of 31 December 2011, the closing price of the share of AS Tallinna Vesi was 6.29 euros, which is a decrease of 20.28% compared to the closing price of 7.89 euros at the beginning of the year. During the same period the OMX Tallinn index decreased by 23.94%.



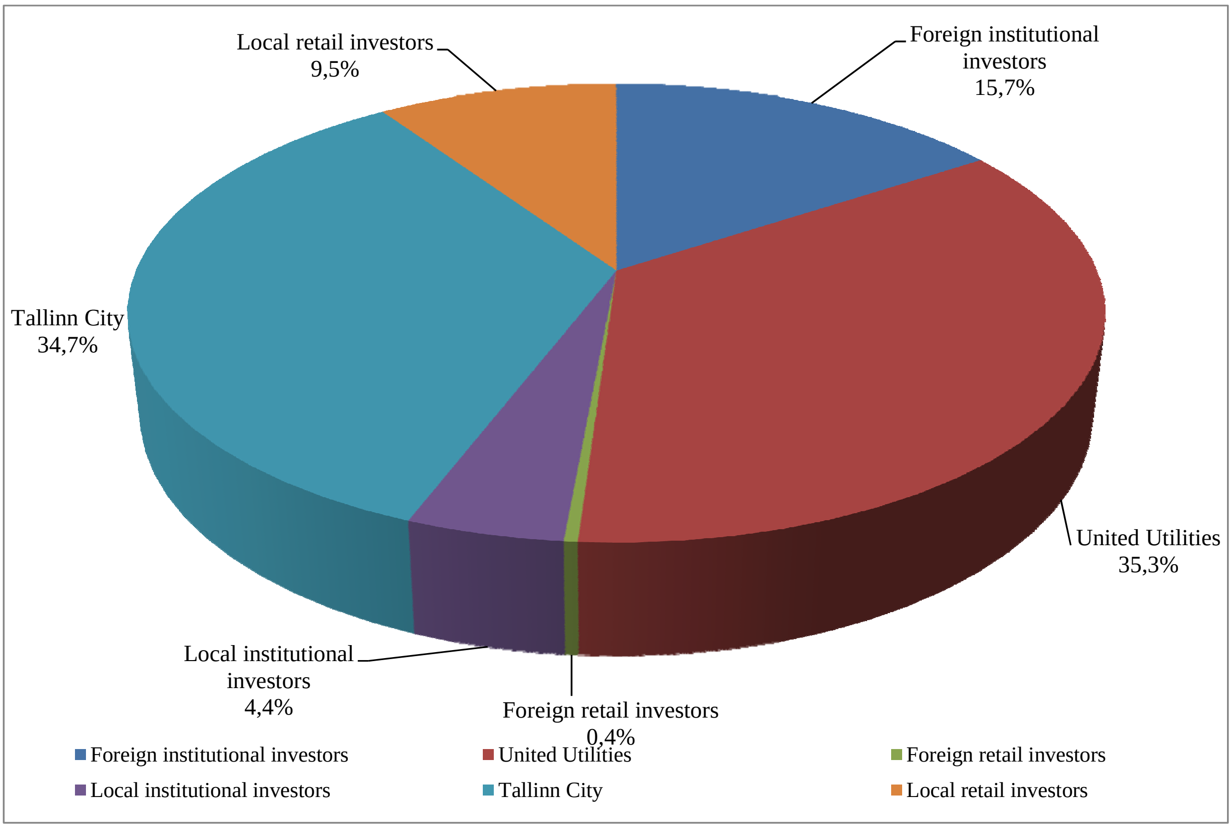
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

Share price statistics

EUR	**2011**	**2010**	**2009**	**2008**	**2007**
Share price, open	7,90	10,18	9,00	13,25	15,00
Share price, at the end of the year	6,29	7,89	10,00	8,99	12,96
Share price, low	6,29	7,00	8,20	8,41	12,50
Share price, high	9,29	12,25	10,69	13,60	18,59
Share price, average	7,76	8,95	9,28	11,38	14,84
Traded volume	1 927 386	2 879 132	1 547 108	7 958 820	5 462 916
Turnover, million	14,9	25,6	14,5	92,9	82,8
Capitalisation, million	125,8	157,8	200,0	179,8	259,2
Earnings per share	1,08	0,82	1,09	0,95	0,89
Dividend per share	n/a	0,80	1,60	0,73	0,80
Dividend / net profit	n/a	98%	147%	78%	90%
P/E	5,82	9,62	9,20	9,50	14,60
P/BV	1,6	2,2	2,2	2,2	3,3

P/E = share price at the end of the year / earnings per share
P/BV = share price at the end of the year / book value per share
In 2005 the listing price was 9.25 euros

Shareholders by type as of 31.12.2011



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Distribution of share capital by size of share ownership as of 31.12.2011

	Shareholders	Shareholders %	No. of shares	% of share capital
1 - 100	764	26,5%	40 059	0,2%
101 - 200	578	20,0%	89 295	0,4%
201 - 300	324	11,2%	85 243	0,4%
301 - 500	336	11,6%	140 507	0,7%
501 - 1 000	362	12,5%	273 448	1,4%
1 001 - 5 000	400	13,9%	845 834	4,2%
5 001 - 10 000	58	2,0%	394 852	2,0%
10 001 - 50 000	40	1,4%	798 487	4,0%
50 000 +	25	0,9%	17 332 275	86,7%
TOTAL	**2887**	**100,0%**	**20 000 000**	**100,0%**

More detailed information about the structure of the equity and the preference share, giving the special control rights, is disclosed in note 16.

KEY CONTRACTUAL EVENTS

Contractual tariff application

Tariffs are still frozen on the 2010 level despite the fact that on 9 November 2010 the Company submitted its contract based tariff application to the new regulator. The tariff application is fully in accordance with the law and the best practice regulation for privatised utilities, such as that favoured by Ofwat in the UK and recommended by the World Bank for privatised utilities.

On 2 May 2011 the Competition Authority (CA) informed the Company about the rejection of the tariff application. The CA completely ignored the privatisation contract and did not perform any analysis of the contractual and financial performance of the Company during the period after privatisation. The CA is arguing that the Company’s profitability is too high using their own unverified methodology that is not in accordance with the World Bank guidelines for privatised utilities. The Company has calculated that the average real return on invested capital from 2001 till 2011 has been 6.2% and the Company has also had these returns independently verified by the international economic consulting group, Oxera.

The Company and its investors cannot accept such unilateral breach of the terms and conditions of the privatisation contract by Estonian Authorities and the Company submitted an appeal to the court on 2 June 2011. The outcome and lengths of the Court proceedings is outside the control of the Company.

Complaint to European Commission

In parallel, on 10 December 2010 AS Tallinna Vesi lodged a complaint to the European Commission regarding certain measures adopted by the Estonian authorities. The Company believes these measures unilaterally alter the terms of AS Tallinna Vesi's privatisation regime, and without any objective justification, any form of meaningful prior discussion, or willingness to engage in dialogue. Therefore they violate EU rules on the freedom of establishment and the free movement of capital (articles 49 and 63 TFEU).

As a consequence of this complaint, on 22 February 2011 the European Commission sent a Request For Information to the Estonian authorities regarding the points raised by AS Tallinna Vesi in its complaint. The Estonian authorities were due to respond in early May, however requested and were granted a 30 day extension. The Estonian authorities responded to the Commission by the end of June. In October the Commission sent further questions to the Company for the commentaries. The process is ongoing.

Prescription to reduce the tariffs

On 10 October 2011 the Company received a prescription from the Competition Authority to lower the current tariffs by 29%. In addition and in support of its decision the Competition Authority has taken the extreme action of declaring the privatisation contract signed in 2001 to be illegal. To quote *"the CA, having familiarised itself with ASTV's claim regarding privatisation, is of the opinion that in the part concerning the price of water services, conducting the privatisation with the alleged aim of achieving the lowest possible tariff increase was not in accordance with the law."*

The Company wishes to make it absolutely clear to all its shareholders that it completely disagrees with the position taken by the CA. The Company believes that by declaring the privatisation illegal and using a Ministerial decree to attempt to force down ASTV's tariffs the CA as an agency representing the Estonian state and national government has shown an absolute disregard for legal due process. Furthermore, for the Company to have to defend itself in court for honouring all the terms and conditions of its contract, including most importantly the improved service obligations that were contractually required by the Government of the City of Tallinn in 2001, goes against all the internationally acceptable norms of business conduct and public governance in long term privatisation contracts.

Therefore the Company lodged another claim against the CA regarding the prescription and asked for the temporary injunction from the Estonian Administrative Court. On 06 February the Tallinn Administrative Court informed the Company that it had agreed to the Company's request for an interim injunction and is suspending the fulfilment of the Competition Authority's prescription until the Court delivers a final judgement. The Competition Authority appealed against this ruling on 17 February 2012. The appeal is pending in the Tallinn District Court, which should decide whether the tariffs will be frozen until the court makes its final judgement on the legality of the privatisation agreements. The court also joined both, the current 2010 tariffs and the 2011 tariff application cases, so the prescription is suspended until both complaints are resolved. This means that tariffs for all customer categories will be maintained at current levels until the courts have made their final judgement. The outcome and lengths of the Court proceedings is outside the control of the Company.

Disclosure of relevant papers and perspectives

The Company has published its tariff application and all relevant correspondence with the CA on its website (http://www.tallinnavesi.ee/?op=body&id=728) and to the Tallinn Stock Exchange and will keep its investors informed of all future developments regarding the further key developments regarding the processing of the tariff application. Still, at this point in time the Company is unable to say what is going to happen to the tariffs as it is unclear at the moment how the CA intends to respond to the Court and what would be the next steps by the European Commission.

CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RECOMMENDATIONS REPORT

Overview

Corporate governance constitutes a system of principles for the management of a company. Generally those principles are regulated by law, the Articles of Association and the internal rules of a company. Since 01.01.2006, the companies listed on the Tallinn Stock Exchange are recommended to follow the "Corporate Governance Recommendations" issued by the Financial Supervision Authority. Throughout 2011 the management of AS Tallinna Vesi has followed those regulations and principles.

AS Tallinna Vesi is committed to high standards of corporate governance for which the Management Board and Supervisory Board are accountable to the shareholders. AS Tallinna Vesi endeavours to be transparent in its ways of operating, corporate disclosures and relations with its shareholders. AS Tallinna Vesi has been recognized several times for this – in 2009, the NASDAQ OMX Baltic awarded AS Tallinna Vesi for the Best Annual Report in NASDAQ OMX Baltic and for the Best Investor Relations in NASDAQ OMX Tallinn. In 2010 the NASDAQ OMX Baltic awarded AS Tallinna Vesi for the Best Investor Relations in NASDAQ OMX Tallinn and the Baltic Corporate Governance Institute awarded AS Tallinna Vesi for the Best Corporate Governance in Estonia. In 2011 the Company was awarded the Best Investor relations on the Tallinn Stock Exchange and second place on all the Baltic Stock Exchanges by NASDAQ OMX. In addition the Company's investors' web-page was highlighted amongst the equal top five and the Annual Accounts were awarded the second place on all the Baltic Stock Exchanges.

Investor Relations and Disclosure of Information

At the beginning of each calendar year, AS Tallinna Vesi discloses the financial calendar, including the disclosure dates of the quarterly and annual financial information and the date of the Annual General Meeting (AGM) of the Shareholders via the Tallinn Stock Exchange. All information disclosed via the Tallinn Stock Exchange is also subsequently disclosed on the AS Tallinna Vesi's website. In addition, AS Tallinna Vesi discloses the following information on its website: AGM notice, useful background information about the agenda and any candidates standing for election, information about identification documents required for attending the general meeting, annual accounts of the previous year, respective auditor's report, any new agenda items and draft resolutions proposed, and questions about existing agenda items, information about corporate governance and information about the Management and Supervisory Board members as well as the total number of voting rights and number of voting rights by share type. In addition, the following procedures are in place: procedure for familiarising oneself with the general meeting documents, procedure for adding items to the agenda and presenting draft resolutions and procedure for inquiring about the company's activities from the Management Board. All respective documents are also available at the headquarters of AS Tallinna Vesi until the day before the date of the General Meeting. Resolutions of the General Meetings are published on the AS Tallinna Vesi's webpage within 7 (seven) days following the date of the General Meeting.

After the general meeting, the following is uploaded to the company's website: resolutions of the general meeting, Management Board presentation, as well as the minutes of the general meeting, which contain questions and answers regarding the topics discussed at the AGM, One question was asked regarding the 2011. AGM agenda – a shareholder requested a copy of the presentation of the last item on the agenda before the meeting, but in the interests of safeguarding the requirement of informing all of the shareholders at the same time it was decided not to extend a copy of the presentation, the more so that this agenda item was purely informative (did not entail decisions) and shareholders and their representative were presented the relevant information simultaneously at the general meeting. No additional agenda item proposals were submitted for the 2011 AGM.

AS Tallinna Vesi has a regular dialogue with its major shareholders and potential investors - presentations are generally made bi-annually and upon request – the timetable of such meetings and the list of presentations are available on the AS Tallinna Vesi's website. To keep AS Tallinna Vesi's shareholders informed, General Meetings of Shareholders are held at least annually to provide the shareholders with the opportunity to ask questions from the Management Board and the Supervisory Board.

The General Meeting of Shareholders

AS Tallinna Vesi is a public limited company, the management bodies of which are the General Meeting of Shareholders, the Supervisory Board and the Management Board. The General Meeting of Shareholders is AS Tallinna Vesi's highest directing body.

On 24th May, 2011, AS Tallinna Vesi held an Annual General Meeting (AGM) of its Shareholders to approve the 2010 annual report, distribution of profit via dividends, due to transition to the Euro currency to amend its Articles of Association and decrease the nominal value of shares and the total value of share capital as well as to elect auditors. The Management Board also made a presentation on the change in regulation and its impact on the long term privatisation contract to update the shareholders.

In accordance with the Commercial Code and the Corporate Governance Recommendations, AS Tallinna Vesi convenes its General Meetings, both AGMs and EGMs by notifying all of its shareholders via the Tallinn Stock Exchange system and by placing an advertisement in one newspaper with Estonian-wide circulation 3 weeks in advance. Changes in the Articles of Association and management of AS Tallinna Vesi and its subsidiary (incl. the election and recalling of the members of the Management Board) are made according to Part VII of the Commercial Code.

The agendas of AGMs and EGMs of AS Tallinna Vesi are pre-approved by the Supervisory Board, who also puts forward proposals for the attention and voting at the General Meeting. The General Meeting agenda items, the Supervisory Board's proposals, with relevant commentaries about the agenda items, procedural instructions for participating at a General Meeting and how and when to propose additional items to the agenda are disclosed within the General Meeting notice.

Specific rights for adding agenda items granted to shareholders whose shareholding represents at least 1/20 of the share capital are explained in the General Meeting notice as well as on AS Tallinna Vesi's website. Voting rights are explained to the shareholders on AS Tallinna Vesi's website as well as at the beginning of each General Meeting.

The chairman of any AGMs and EGMs is an independent person. In 2011, the AGM was chaired by Mr. Raino Paron, who introduced the procedure for conducting the General Meeting, including the procedure for inquiring about the company's activities from the Management Board.

All members of the Management Board, the Chairman of the Supervisory Board and the auditor participated at the AGM in 2011. When Supervisory Board members stand for election at general meetings, the candidates for these positions also participate.

AS Tallinna Vesi does not enable the shareholders to participate at the general meetings via electronic communication tools, as it would be too complicated and expensive to establish reliable solutions to identify the shareholders most of whom are overseas' residents.

No shareholder has shares that grant them a right for specific control. AS Tallinna Vesi is not aware that any shareholders have concluded any voting agreements.

As per the Articles of Association of AS Tallinna Vesi amended on 24th May 2011, the company has issued one registered preferred share with the nominal value of 60 euros (B-share). The B-share grants the holder the right to participate at General Meetings as well as in the distribution of profits and of the assets remaining upon dissolution of the company, also other rights provided by law and the Articles of Association of the company. The B-share grants the holder the preferential right to receive a dividend in an agreed sum of 600 euros. The B-share grants the shareholder 1 (one) vote at the General Meeting (restricted right to vote) when deciding on amending the Articles of Association of the company; increasing and reducing the share capital of the company; issuing convertible bonds; acquisition of treasury shares by the company; deciding on the merger, division, transformation and/or dissolution of the company and deciding on issues related to the activities of the company that have not been placed in the sole.

The Supervisory Board

The Supervisory Board plans the activities of AS Tallinna Vesi, organises its management and supervises the activities of the Management Board. Pursuant to the Articles of Association of AS Tallinna Vesi, the Supervisory Board consists of nine members with the term of two years. In 2011, five regular and no extraordinary Supervisory Board meetings were held. The Supervisory Board pre-approved the 2010 annual report presented to the Annual General Meeting for approval, and reviewed AS Tallinna Vesi's preliminary 2012 budget.

At the time of compilation of this report, AS Tallinna Vesi's Supervisory Board consisted of the following members: Messrs Robert John Gallienne (United Utilities), Steven Richard Fraser (United Utilities), Simon Gardiner (United Utilities), Brendan Francis Murphy (United Utilities), Priit Lello (Tallinn City), Rein Ratas (Tallinn City), Toivo Tootsen (Tallinn City), Mart Mägi (independent) and Valdur Laid (independent).

The Supervisory Board has formed three committees to advise the Supervisory Board on audit, remuneration and corporate governance matters as described below.

The Audit Committee and Internal Audit

At each meeting, an internal audit report was presented to the Supervisory Board. The internal auditor of AS Tallinna Vesi reports directly to the Audit Committee, which consists of two members of the Supervisory Board. Mr. Mart Mägi is the Chairman of the Audit Committee and Mr. Robert John Gallienne is the second member of the Audit Committee. The Audit Committee follows the Authorised Public Accountants Act and the guidelines issued by the Financial Supervision Authority regarding the composition and working processes of an Audit Committee.

The main tasks of the Audit Committee are*:*

- to monitor and analyse financial information;
- to monitor and analyse the efficiency of risk management and internal controls;
- to monitor and analyse the processes regarding actual accounts and the consolidated audit report;
- to monitor and analyse independence of appointed external auditor and legality of his/her activity regarding ASTV;
- to evaluate the work of external auditors annually and report to the Supervisory Board about the results of such evaluation.

The appointed external auditor and any member of the external audit team cannot provide any service outside the scope of annual audits without prior approval from the Audit Committee. In 2011, the external auditor did not provide any services to AS Tallinna Vesi outside the scope of the annual audit.

Pursuant to the Articles of Association of AS Tallinna Vesi, an external auditor shall be elected by the General Meeting of Shareholders for conducting the annual audit. The remuneration of the external auditor is regulated in the respective contract, signed between the external auditor and the Management Board. AS Tallinna Vesi chooses an external auditor by following internal procurement procedures (which includes approval by the Supervisory Board of AS Tallinna Vesi), ensuring the best match of service quality and the price offered for the services. Offers are taken only from internationally respected, high quality audit companies (the Big 4). AS Tallinna Vesi signs up to 3-year audit contract with a clause that requires the re-appointment of the auditor each year and follows the requirement of the Authorised Public Accountants Act to rotate the auditor after 7 years. Based on the report of the Audit Committee, the Supervisory Board evaluates the quality of the work of the external auditor annually in the course of the approval of the Annual Accounts and discloses the summary of such evaluation in the AGM notice. The external auditor is present at the AGM and participates where necessary.

Nomination and Remuneration Committee

In 2011 the Supervisory Board renamed the Remuneration Committee as Nomination and Remuneration Committee, which continues to advise the Supervisory Board on management remuneration issues and now also advises the Supervisory Board on Management Board nominations. Mr. Valdur Laid is the Chairman of the Nomination and Remuneration Committee and Mr. Robert John Gallienne and Mr. Mart Mägi are the members of the Nomination and Remuneration Committee.

Supervisory Council approves the remuneration principles of the issuer’s managers and appoints the Remuneration Committee. The Remuneration Committee recommends the remuneration principles of the company and exercises supervision that the principles approved by the Supervisory Council and the requirements of the Securities Market Act are being followed.

The Nomination and Remuneration Committee ensures that the proposed remuneration principles are based on the long-term and annual objectives of the company, taking into account the financial performance of the company and legitimate interests of investors and creditors. The Nomination and Remuneration Committee ensures also that the proportion of remuneration for the principal job and performance related pay (PRP) are in accordance with the duties of the Management Board Member and that the remuneration for principal job forms a sufficient part of the total remuneration. The PRP depends on annual performance and can be adjusted upwards or downwards, incl. not paid at all if so warranted, depending on annual performance results.

Corporate Governance Committee

In addition, the Supervisory Board has formed a Corporate Governance Committee to improve corporate governance of AS Tallinna Vesi for the benefit of its Supervisory Council and shareholders. Mr. Robert John Gallienne is the Chairman of the Corporate Governance Committee and Messrs Laid and Plenderleith are the other members of the Corporate Governance Committee.

The Management Board

The Management Board is a management body that represents and manages the day-to-day activities of a company in accordance with the law and the Articles of Association of the company. The Management Board is obliged to act in the most economically efficient manner. The Management Board can be composed of three to five members according to the Articles of Association. The Management Board always prepares management reports for Supervisory Board meetings and such reports are disseminated to the Supervisory Board members 1 (one) week in advance of the meeting, as required by the Commercial Code. The Management Board also reports *ad hoc* to the Supervisory Board ex-meetings, when it feels this is necessary as and when requested by the Chairman of the Supervisory Board.

Both, the Management Board and Supervisory Board members are deemed to be insiders, have signed respective insider agreements, are aware of AS Tallinna Vesi's insider rules and together with their related persons are listed in AS Tallinna Vesi's insider list. In 2011 the Management Board consisted of three members, but at the time of compilation of this report the Management Board consisted of four members, both responsibilities are specified below. The Chairman of the Management Board is seconded from United Utilities International Ltd, all Management Board members are appointed by the Supervisory Board of AS Tallinna Vesi.

The duties of the Chairman of the Management Board, Mr. Ian John Alexander Plenderleith were, amongst others, to fulfil the everyday obligations of the Chief Executive Officer (CEO) of AS Tallinna Vesi by leading and representing the company, ensuring the compliance with the contract and the law, organizing the activities of the Management Board, preparing the strategies and ensuring their implementation.

The duties of the member of the Management Board, Mr. Leho Võrk, are, amongst others, to fulfil the everyday obligations of the Chief Operating Officer (COO) of AS Tallinna Vesi by managing and being responsible for the operating activities of the company. Mr. Võrk was appointed to the Management Board from 1 February 2012. Throughout 2011 and until 31 January 2012 Mr. Robert Thomas Yuille was appointed to the role of COO.

The duties of the member of the Management Board, Ms. Siiri Lahe, were, amongst others, to fulfil the everyday obligations of the Chief Financial Officer (CFO) of AS Tallinna Vesi by managing and being responsible for the accounting and financial activities of the company.

The duties of the member of the Management Board, Ms. Ilona Nurmela are, amongst others, to fulfil the role of the AS Tallinna Vesi's General Counsel and act as the head of legal and compliance. Ms. Nurmela was appointed to the Management Board from 1 February 2012.

AS Tallinna Vesi has signed Service contracts with all members of the Management Board. AS Tallinna Vesi has not made any transactions with the members of the Management Board nor their related parties.

According to the Articles of Association of AS Tallinna Vesi, the Chairman of the Management Board has the sole representation right of the company; other Management Board members can represent the company only jointly. In order to make daily decisions, the Management Board has validated a framework of principles, according to which certain management team members are authorized to conclude transactions in small amounts.

The Management Board of AS Tallinna Vesi also acts on behalf of AS Tallinna Vesi as the sole shareholder of OÜ Watercom.

Conformity with Tallinn Stock Exchange Corporate Governance Recommendations

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

Declaration of Conformity by AS Tallinna Vesi

In 2011, AS Tallinna Vesi has complied with the vast majority of the Corporate Governance principles. However, AS Tallinna Vesi did not comply with certain principles, which are listed below together with the reasons for such non-compliance:

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

The arrangements undertaken in connection with the privatisation of AS Tallinna Vesi in 2001 provided that, in return for certain fees, United Utilities International Ltd. would provide AS Tallinna Vesi with technical and asset management services and make its personnel available to the company in connection with its operation and management. The working hours, rates of compensation, and all other matters relating to the employment of the individual directly employed by United Utilities International Ltd. are to be determined solely by United Utilities International Ltd., the Supervisory Board does not review the principles of remuneration of this Management Board member.

'2.2.7. Basic wages, performance pay, severance packages, other payable benefits and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on website of the Issuer and in the Corporate Governance Recommendations Report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the Issuer or the amount of foreseeable expense as of the day of disclosure.

AS Tallinna Vesi does disclose the overall Management Board remuneration in the report, appendix 25, but considers that individual remuneration is sensitive and private information and the disclosure thereof would bring no benefit to the shareholders.

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

Pursuant to the Articles of Association of AS Tallinna Vesi, the Supervisory Board consists of nine members. Under the Shareholders` Agreement, United Utilities (Tallinn) B.V. (hereinafter UUTBV) and the City of Tallinn have agreed that the division of seats in the Supervisory Board shall be such that UUTBV shall have four seats, the City of Tallinn shall have three seats and two seats shall be reserved for independent members to be elected to the Supervisory Board as permitted by the Tallinn Stock Exchange on listing in June 2005.

Information Disclosure

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

The Management Board Members of AS Tallinna Vesi are not in the Management Boards and Supervisory Boards of other Issuers.

2.3.2. The Supervisory Board shall approve the transactions which are significant to the Issuer and concluded between the Issuer and a member of its Management Board or another person connected/close to them and shall determine the terms of such transactions.

The Supervisory Board approves the remuneration principles of the Management Board. In 2011, there were no other transactions between AS Tallinna Vesi and any member of the Management Board.

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

According to the decision of the General Meeting the remuneration of Supervisory Board members is set at 6 391 euros per year per person. The fee is paid to six members out of nine. The fee is subject to deduction and payment of applicable taxes and is payable monthly. The Supervisory Board members were not paid any additional benefits in 2011.

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

In 2011, five Supervisory Board meetings were held (27th January 2011, 24th March 2011, 28th April 2011, 28th July 2011 and 27th October 2011).

The following members of the Supervisory Board attended more than 50% of the meetings during the time they were appointed or elected in 2011: Messrs Robert John Gallienne, Leslie Anthony Bell, Simon Gardiner, Andrew James Prescott, Rein Ratas, Deniss Boroditš, Ardo Ojasalu, Brendan Francis Murphy, Toivo Tootsen, Mart Mägi and Valdur Laid.
Only Mr. Philip Anthony Aspin did not attend any Supervisory Board meetings during the period when his powers as the Board member were valid. Mr. Priit Lello did not attend any of the

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

Supervisory Board meetings as no Supervisory Board meetings were held after his election on 16.11.2011.

3.3.2. A Supervisory Board member candidate shall inform other members of the Supervisory Board about the existence of conflict of interests before their election and immediately upon arising of it later. Members of the Supervisory Board shall promptly inform the Chairman of the Supervisory Board and Management Board regarding any business offer related to the business activity of the Issuer made to him, a person close to him or a person connected with him.

All Supervisory Board members are aware of this requirement and at minimum once per annum AS Tallinna Vesi requires all Supervisory Board members to update the record of their business interests. No business transactions took place between AS Tallinna Vesi and either any Supervisory Board member or any persons or companies related to them in 2011.

The previous sections, Chairman's statement, Results of operations – for the year 2011, Corporate Governance and Corporate Governance Recommendations Report from the Management Report are an integral part of the annual report of AS Tallinna Vesi for the financial year ended 31 December 2011. The Management Report gives a true and fair view of the trends and results of operations, main risks and doubts of AS Tallinna Vesi.

Name	**Position**	**Signature**	**Date**
Ian John Alexander Plenderleith	Chairman of the Management Board		27/02/12
Leho Võrk	Member of the Management Board		27.02.12
Siiri Lahe	Member of the Management Board		27.02.12
Ilona Nurmela	Member of the Management Board		27.02.12

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT CONFIRMATION

The Management Board hereby declares its responsibility for the preparation of the consolidated financial statements of AS Tallinna Vesi (Parent Company) and its subsidiary (together referred as Group) for the financial year ended 31 December 2011 on pages 23 to 57.

The financial statements 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 the Group.

The preparation of the financial statements according to International Financial Reporting Standards involves estimates made by the Management Board of the Group's assets and liabilities as of 31 December 2011, and of income and expenses during the financial year. These estimates are based on current information about the Group and consider all plans and risks as of 31 December 2011. 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 and have occurred up to the completion of the financial statements on 27 February 2012 have been considered in preparing the financial statements.

The Management Board considers AS Tallinna Vesi and its subsidiary to be going concern entities.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		27/02/12
Leho Võrk	Member of the Management Board		27.02.12
Siiri Lahe	Member of the Management Board		27.02.12
Ilona Nurmela	Member of the Management Board		27.02.12

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

		as of 31 December	
ASSETS	**Note**	**2011**	**2010**
CURRENT ASSETS			
Cash and equivalents	6	14 770	13 235
Trade receivables, accrued income and prepaid expenses	7	19 845	20 088
Inventories		248	306
Non-current assets held for sale		73	76
TOTAL CURRENT ASSETS		**34 936**	**33 705**
NON-CURRENT ASSETS			
Other long-term receivables	8	9 583	0
Property, plant and equipment	9	145 973	148 179
Intangible assets	9	1 577	1 972
TOTAL NON-CURRENT ASSETS		**157 133**	**150 151**
TOTAL ASSETS		**192 069**	**183 856**
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Current portion of long-term borrowings	10	0	7 624
Trade and other payables	11	5 789	6 367
Derivatives	12	1 552	963
Provisions		0	117
Prepayments	15	1 146	810
TOTAL CURRENT LIABILITIES		**8 487**	**15 881**
NON-CURRENT LIABILITIES			
Deferred income from connection fees		6 824	5 765
Borrowings	10	94 938	87 428
Derivatives	12	2 936	1 304
Other payables	11	9	115
TOTAL NON-CURRENT LIABILITIES		**104 707**	**94 612**
TOTAL LIABILITIES		**113 194**	**110 493**
EQUITY			
Share capital	16	12 000	12 782
Share premium		24 734	24 734
Statutory legal reserve		1 278	1 278
Retained earnings		40 863	34 569
TOTAL EQUITY		**78 875**	**73 363**
TOTAL LIABILITIES AND EQUITY		**192 069**	**183 856**

Notes to the financial statements on pages 27 to 57 form an integral part of the financial statements.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

		for the year ended 31 December	
	Note	**2011**	**2010**
Revenue	17	51 240	49 680
Costs of goods sold	19	-20 927	-20 684
GROSS PROFIT		**30 313**	**28 996**
Marketing expenses	19	-748	-787
General administration expenses	19	-4 294	-3 651
Other income(+)/ expenses(-)	20	3 619	2 906
OPERATING PROFIT		**28 890**	**27 464**
Financial income	21	1 947	1 060
Financial expenses	21	-5 071	-3 624
PROFIT BEFORE TAXES		**25 766**	**24 900**
Income tax on dividends	22	-4 253	-8 495
NET PROFIT FOR THE PERIOD		**21 513**	**16 405**
COMPREHENSIVE INCOME FOR THE PERIOD		**21 513**	**16 405**
Attributable profit to:			
Equity holders of A-shares		21 512	16 404
B-share holder		0,60	0,64
Earnings per A share (in euros)	23	1,08	0,82
Earnings per B share (in euros)	23	600	639

Notes to the financial statements on pages 27 to 57 form an integral part of the financial statements.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

CONSOLIDATED STATEMENT OF CASH FLOW

		for the year ended 31 December	
	Note	**2011**	**2010**
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit		28 890	27 464
Adjustment for depreciation/amortisation	9,19	5 729	5 620
Adjustment for income from government grants and connection fees	20	-3 484	-3 312
Other finance income(+)/expenses(-)	21	35	-14
Profit(-)/loss(+) from sale of property, plant and equipment, and intangible assets		55	-3
Expensed property, plant and equipment		10	70
Change in current assets involved in operating activities		720	-8 894
Change in liabilities involved in operating activities		1 306	6 297
Interest paid		-3 051	-2 443
Total cash flow from operating activities		**30 210**	**24 785**
CASH FLOWS FROM INVESTING ACTIVITIES			
Loans granted	8	-3 151	0
Acquisition of property, plant and equipment, and intangible assets		-18 506	-17 055
Compensations received for construction of pipelines		11 284	6 139
Proceeds from sale of property, plant and equipment, and intangible assets		13	16
Interest received		1 939	1 109
Total cash flow used in investing activities		**-8 421**	**-9 791**
CASH FLOWS FROM FINANCING ACTIVITIES			
Received loans	10	0	20 000
Dividends paid	22	-16 001	-31 956
Income tax on dividends	22	-4 253	-8 495
Total cash flow used in financing activities		**-20 254**	**-20 451**
Change in cash and cash equivalents		**1 535**	**-5 457**
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD		**13 235**	**18 692**
CASH AND EQUIVALENTS AT THE END OF THE PERIOD	6	**14 770**	**13 235**

Notes to the financial statements on pages 27 to 57 form an integral part of the financial statements.

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
as of 31 December 2009	**12 782**	**24 734**	**1 278**	**50 120**	**88 914**
Dividends (Note 22)	0	0	0	-31 956	-31 956
Comprehensive income for the period (Note 23)	0	0	0	16 405	16 405
as of 31 December 2010	**12 782**	**24 734**	**1 278**	**34 569**	**73 363**
Reduction of the share capital (Note 16)	-782	0	0	782	0
Dividends (Note 22)	0	0	0	-16 001	-16 001
Comprehensive income for the period (Note 23)	0	0	0	21 513	21 513
as of 31 December 2011	**12 000**	**24 734**	**1 278**	**40 863**	**78 875**

Notes to the financial statements on pages 27 to 57 form an integral part of the financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. GENERAL INFORMATION

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 sewerage services in Tallinn's main service area until the year 2020.

Shareholders of AS Tallinna Vesi having a significant influence are, United Utilities Tallinn B.V. with 35.3% and the City of Tallinn with 34.7%, the balance of 30% of shares is free floating on the Tallinn Stock Exchange, in which AS Tallinna Vesi listed on 1 June 2005.

Contacts of AS Tallinna Vesi:

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NOTE 2. ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements (hereinafter referred to as 'financial statements') are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU) (hereinafter IFRS).

The financial statements have been prepared under the historical cost convention, as modified by the accounting policy for derivatives, measured at fair value through profit and loss, as disclosed in the accounting policies below.

The Management Board of AS Tallinna Vesi authorised these consolidated financial statements for issue at 27 February 2012. Pursuant to the Commercial Code of the Republic of Estonia, the financial statements are subject to approval by the Supervisory Board of AS Tallinna Vesi and the General Meeting of Shareholders. Shareholders have the right not to approve the annual report prepared and approved by the Management Board, and request preparation of a new annual report.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Management Board, being the chief operating decision-maker. The Management Board, who is responsible for allocating resources and assessing performance of the operating segments, reports to the Supervisory Board which has been identified as the steering committee that makes strategic decisions. The Management Board has determined that the activities of the Group form a single operating segment. The internal reporting reviewed by the Supervisory Board and the Management Board is prepared using the same accounting principles and format of statement of financial position and statement of comprehensive income as provided in these consolidated financial statements.

Adoption of New or Revised Standards and Interpretations

The following new or revised standards and interpretations became effective for the Group from 1 January 2011:

Amendment to IAS 24, Related Party Disclosures. The amended standard simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. As a result of the revised standard, the Group provided disclosures of only individually significant transactions with government-related entities.

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2011 that would be expected to have a material impact to the Group.

Certain new or revised standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2012 or later periods and which the Group has not early adopted:

IFRS 13, Fair Value Measurement, effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU. Aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its financial statements.

There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on the Group.

Principles of consolidation, accounting for business combinations and subsidiaries

A subsidiary is an entity in which the Group, directly or indirectly, has interest of more than one half of the voting rights or otherwise has power to govern the operating and financial policies so as to obtain economic benefits. The subsidiary has been consolidated in the Group's financial statements.

In the consolidated financial statements, the financial statements of the subsidiary are combined on a line-by-line basis. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Group and its subsidiary use uniform accounting policies. Where necessary, the accounting policies of the subsidiary have been changed to ensure consistency with the policies adopted by the Group.

Investment in subsidiary is carried at cost (less any impairment losses) in the separate primary financial statements of the Parent company.

Foreign currency

Functional and presentation currency

On 1 January 2011, the Republic of Estonia joined the Euro area and adopted the Euro as its national currency, replacing the Estonian kroon. Consequently, the functional currency of the Parent company and the subsidiary since 1 January 2011 is Euro. Change in the functional currency has been accounted for prospectively. The parent company and its subsidiary have translated the balances on their accounts as of 1 January 2011 by applying the currency rate of 15,6466 kroon/euro.

2011 consolidated financial statements have been presented in euros. Comparative figures presented in the financial statements have been translated from Estonian kroons to euros using the conversion rate of 15.6466 kroon/euro. As the exchange rate has been the same during previous periods, no differences in currency arose in translation.

For the convenience of the users, these financial statements have been presented in thousands of euros, unless stated otherwise.

Foreign currency transactions and balances

All other currencies except for the functional currency (the functional currency of the parent company and subsidiary located in Estonia is Euro (Estonian kroon until 31 December 2010)) constitute foreign currencies. Foreign currency transactions have been translated to functional currencies based on the foreign currency exchange rates of the European Central Bank prevailing on the transaction date (until 31 December 2010 the currency exchange rates of the Bank of Estonia). Monetary assets and liabilities denominated in a foreign currency (monetary receivables and loans) have been translated into functional currency based on the foreign currency exchange rates of the European Central Bank (until 31 December 2010 the currency exchange rates of the Bank of Estonia) prevailing on the balance sheet date. Foreign exchange gains and losses are recognised in the statement of comprehensive income as income or expenses of that period.

Current and non-current distinction of assets and liabilities

Assets and liabilities are classified in the statement of financial position as current or non-current. Assets expected to be recovered of in the next financial year or during the normal operating cycle of the Group are considered as current. Liabilities whose due date is in the next 12 months or that is expected to be settled in the next financial year or during the normal operating cycle of the Group are considered as current. All other assets and liabilities are classified as non-current.

Cash and cash equivalents

Cash and cash equivalents in the statement of financial position and the cash flow statement comprise of cash on hand, cash in bank accounts and short-term, risk free, highly liquid bank deposits with original maturities of three months or less.

Cash flows from operating activities are reported using the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows. Cash flows from investing and financing activities are reported using the direct method.

Financial assets

Financial assets are cash, trade receivables, accrued income, others current and long-term receivables including the derivatives with positive value.

Financial assets are recorded in statement of financial position at value date (i.e. are recognised when the Group becomes the owner of the financial assets and are derecognised when the Group has transferred substantially all risk and rewards incidental to ownership).
According to the purpose of acquisition and management intentions the financial assets are divided into the following groups:

- Financial assets at fair value through profit or loss
- Receivables and loans
- Investments held-to-maturity
- Financial assets available-for-sale

As of 31 December 2011 and 2010 the Group did not have any investments held-to-maturity and financial assets available-for-sale.

Financial assets held for trading are classified as financial assets at fair value through profit or loss (asset is acquired for the purpose of selling in the near term). Financial assets at fair value through profit or loss are initially recorded at fair value, transaction costs are recorded in the profit or loss. Financial assets of this category are subsequently carried at fair value and gains/losses from changes in fair value are recorded in profit or loss of the period. The quoted market price on balance date is their basis for establishing the fair value of financial assets at fair value through profit or loss.

Loans and receivables are initially recognised at a fair value plus the transaction costs. Loans and receivables are subsequently carried at amortised cost, using effective interest method (less any impairment allowances).

As of 31 December 2011 and 2010 the parent company had given one loan.

Receivables

Trade receivables comprise of short term receivables generated in the ordinary course of business. Trade receivables are recorded using at the amortised cost method.

Allowance for receivables is recorded if there is objective evidence that the Group is not able to collect all amounts due according to the original terms of the agreement. Impairment of individually material receivables is evaluated separately for each customer, considering the present value estimated future cash flows. For receivables which are not individually significant and for which there is no direct information that their value has been decreased, the allowance is evaluated collectively using previous years experience on impairment of receivables. The amount of the allowance for doubtful receivables is the difference between their carrying amount and present value of future cash flows, using effective interest rate method. The carrying amount of receivables is reduced by the impairment loss and impairment loss is recorded in the statement of comprehensive income on the row „Other income/ expenses". Subsequent recoveries of doubtful receivables are recorded as a decrease of impairment loss.

Inventories

Inventories are initially recorded at cost including purchase costs, non-refundable taxes and transportation and other costs directly connected with the acquisition, less allowances and discounts.

The weighted-average cost method has been used to determine the cost of inventories. Inventories are carried in the statement of financial position at the lower of the cost and net realizable value. Net realizable value is the net selling price less estimated costs necessary to make the sale.

Non-current assets held for sale

Non-current assets held for sale are the property, plant and equipment items that are most probably sold within next 12 months and for which the management has begun sales activity and the assets are offered for sale for a reasonable price compared to their fair value.

Non-current assets held for sale are classified in the statement of financial position as current assets and depreciation ended at the moment of reclassification. Non-current assets held for sale are carried in the statement of financial position at the lower of at book value and fair value less costs to sell.

Property, plant and equipment, and intangible assets

Property, plant and equipment are tangible assets used in operating activities of the Group with an expected useful life of over one year. Property, plant and equipment are carried in the statement of financial position at historical cost less accumulated depreciation and any impairment losses.

Intangible assets are recognised in the statement of financial position only if the following conditions are met:
- the asset is controlled by the Group;
- it is probable that the future economic benefits that are attributable to the asset will flow to the Group;
- the cost of the asset can be measured reliably.

Acquired licenses

Acquired computer software that is not an integral part of the related hardware is recognised as an intangible asset. Development costs of computer software are recognised as intangible assets if these are directly related to the development of such software objects that are identifiable, controllable by the Group and that are expected to generate economic benefits beyond one year. Capitalizable development costs of computer software include staff costs and other expenses directly related to the development. Costs related to the day-to-day maintenance of computer software are recognised as expenses in the statement of comprehensive income. Costs of computer software shall be depreciated over the estimated useful lifetime, the duration of which is up to 10 years.

Other intangible assets

Expenses for acquiring patents, trademarks, licences and certificates are capitalized if it is possible to estimate the future economic benefits attributable to these assets. Other intangible assets are amortised on a straight line basis over the estimated useful lifetime, the duration of which does not exceed 10 years.

The cost of purchased property, plant and equipment and intangible assets comprises the purchase price, transportation costs, installation, and other direct expenses (incl. internal labour costs) related to the acquisition or implementation. Labour costs are capitalised with employee's hourly index applied to working hours which are needed for taking the asset to the location and condition necessary for it to be capable of operating in the manner intended by the management. Hourly rate is calculated individually for each employee and includes other direct expenses connected with the employee in addition to salary expense.

If an item of property, plant and equipment consists of components with different useful lives, these components are depreciated as separate items.

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

Subsequent expenditures are added to the carrying amount of the item of property, plant and equipment or are recognised as a separate asset only when it is probable that future economic benefits related to the assets will flow to the Group and the cost of the asset can be measured reliably. A replaced component or proportion of the replaced item of property, plant and equipment is derecognised. Costs related to ongoing maintenance and repairs are charged to the statement of comprehensive income.

Land is not depreciated. Depreciation of other property, plant and equipment is calculated on a straight-line basis on cost over the estimated useful life of the asset.

Applicable depreciation/amortization rates:
- buildings 1,25-2,0 % per annum;
- facilities 1,0-8,33 % per annum;
- machinery and equipment 3,33-50 % per annum;
- instruments and other equipment etc. 10-20 % per annum;
- acquired licenses and other intangible assets 10-33 % per annum.

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

The expected useful lives of items of property, plant and equipment are reviewed during the annual stocktaking, in recognising subsequent expenditures and in case of significant changes in development plans. When the estimated useful life of an asset differs significantly from the previous estimate it is treated as a change in the accounting estimate and the remaining useful life of the asset is changed as a result of which the depreciation charge of the following periods also changes. Assets are written down to their recoverable amount when the recoverable amount is less than the carrying amount. To determine profits and losses from the sale of property, plant and equipment the book value of the sold assets is subtracted from the proceeds. The respective profits and losses are reported in the line "Other income / expenses".

Impairment of assets

Assets that are subject to depreciation/amortisation and property, plant and equipment with unlimited useful lives (land) are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The recoverable value of intangible assets in progress is tested annually, by comparing their recoverable amount with the carrying amount.

Assets are written down to their recoverable amount in case the latter is lower than the carrying amount. The recoverable amount of the assets is the higher of the:
- fair value less costs to sell and
- value in use.

In case it is not possible to determine the fair value of assets less costs to sell, the asset's value in use is considered to be its recoverable value. The value in use is calculated as the present value of the estimated future cash flows generated by the assets.

The impairment of assets may be assessed either for an individual asset or a group of assets (cash-generating unit). For the purposes of assessing impairment, the Group is considered to be a single cash-generating unit as it is the lowest level for which there are separately identifiable cash flows. The impairment loss is immediately recognised in the statement of comprehensive income. Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

If based on the results of the assessment it appears that the recoverable amount of an asset or the cash-generating unit has increased, the earlier impairment is reversed up to the amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. The reversal of impairment loss is recorded in the statement of comprehensive income of the period as a decrease in impairment loss.

Financial liabilities

Financial liabilities include trade payables, accrued expenses, loans payable and other short term and long term financial liabilities and derivatives. Financial liabilities (except derivatives) are initially recognised at fair value net of transaction cost. Subsequently financial liabilities are carried at the amortised cost.

Amortised cost of short term financial liabilities is usually equal to their nominal value, thus they are carried on statement of financial position at the amount payable. For calculating the amortised cost of long-term financial liabilities these are initially recognized at fair value of amount received (less transaction costs), interest expense is calculated from the liability using the effective interest method subsequently.

Liabilities are classified as current liabilities, unless the Group has an unconditional right to defer the settlement of the liability for at least 12 months after the balance sheet date.

Derivatives

With regard to derivatives, the Group uses interest rate swap contracts, in order to mitigate risks related to fluctuations in interest rates. Such derivatives are initially recognised at their fair value at the date of entering into the contract and are subsequently carried at fair value with changes recognised in profit or loss. If fair value is positive, the derivative is recognised as an asset, if negative, as a liability. Derivatives are classified as a current asset or liability if expected to be settled within 12 months; otherwise, they are classified as non-current.

Gains and losses attributable to changes in the fair value of derivatives are recognised in the statement of comprehensive income of the reporting period. Gains and losses from the disposal of derivatives are also recognised in the statement of comprehensive income.

Corporate income tax

According to the Income Tax Act, the annual profit earned by enterprises is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise.

Income tax on dividends in Estonia
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, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The rate is 21/79 on the amount of the dividends payable (2010: 21/79).

The contingent tax liability that would occur if all distributable retained earnings were paid out as dividends is not recognized in the statement of financial position. The income tax due on dividend distribution is recorded as a liability and as a tax expense in the statement of comprehensive income during the same period as the dividend is declared regardless of the actual payment date or the period for which dividends are declared. Income tax liability is due on the 10th date of the month following the dividend payment.

Employee benefits

Employee short-term benefits
Employee short-term benefits include wages and salaries as well as social security taxes, benefits related to the temporary halting of the employment contract (holiday pay or other similar pay) when it is assumed that the temporary halting of the employment contract will occur during 12 months after the end of the period in which the employee worked, and other benefits payable within 12 months after the end of the period during which the employee worked. Social security tax payments include contribution to state pension funds. The Group has no legal or constructive obligation to make pension or similar payments beyond social security tax.

Termination benefits
Termination benefits are benefits which are payable after the Group decides to terminate the employment relationship with the employee before the normal retirement date or when the employee decides to leave voluntarily or when the employee and employer have an agreement, in exchange for the benefits outlined. The Group recognises termination benefits as liabilities and expenses only when the Group is obliged to offer termination benefits in order to encourage voluntary leaving.

Provisions and contingent liabilities

Provisions are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

The amount of servitudes likely payable that henceforth must be paid to the owners of private land resulting from the restrictions related to land use in case the Group's pipes are located on their land, are recorded as provisions. On the statement of financial position the liability is classified as short-term, because it can be realized to full extent within 12 months from the balance date.

Provisions have been recognised based on of the best estimates of the Group's Management Board and the actual costs of these transactions can differ from the provided estimates.

Commitments and other possible and existing liabilities, the realization of which is unlikely or the amount of accompanying costs cannot be assessed with sufficient reliability but which can become liabilities on certain terms in the future, are disclosed as contingent liabilities in the notes to the financial statements.

Share capital

Shares are recorded within the equity capital. Pursuant to the Group's Articles of Association, the Group has two classes of shares: the A-Shares, with a nominal value of 0,60 euros each and a single preference share B-Share, with a nominal value of 60 euros.

Statutory reserve capital

Pursuant to the requirements of the Commercial Code the statutory reserve capital is set up comprising of the allocations from net profits. The annual allocation must be at least 5% of the net profit of the accounting year until the reserve capital is equal to 10% of paid-up share capital. As the Group’s reserve capital has reached the required level, the reserve capital is no longer increased from net profit.

At the decision of the General Meeting of the Shareholders the reserve capital can be used for the covering of loss in case it is not possible to cover it from the Group's available shareholders' equity, also for increasing the Group's share capital. The reserve capital cannot be distributed to the shareholders.

Leases

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series payments the right to use an asset for an agreed period of time. Leases which transfer all significant risks and rewards incidental to ownership to the lessee are classified as finance leases. Other leases are classified as operating leases.

The Group as the lessee
Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset and the present value of minimum lease payments. Each lease payment is apportioned between the finance charge and the reduction of the outstanding liability. Finance charges are allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. The finance lease liability is reduced by principal payments. The finance charge is recognised as an interest expense in the statement of comprehensive income. The finance lease liability is recognised either within short or long-term borrowing in the statement of financial position.

Payments made under operating leases are charged to the statement of comprehensive income over the lease term on a linear basis.

Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs which they are intended to compensate. Government grants received for expenses incurred in previous periods or which do not include additional conditions for future compliance are recognised as income in the period when government grant was received. Government grants are not recognised as income before there exists sufficient confidence that Group complies with the conditions relating to government grants and the grants will be received.

Government grants received as compensations for the construction of water, sewerage and storm water pipelines shall be deducted from the book value of the pipeline constructed and any amounts exceeding the construction cost of pipeline shall be recognized as income upon completion of construction works within "Other income/expenses" as income from government grants.

Revenue

Revenue is recognised at the fair value of consideration received or receivable, net of VAT and sales discounts. Revenue comprises sales of services.

Sales of water, wastewater, storm water and fire hydrants services and other sales income is recorded in the period when the service has been provided, the amount of the revenue and cost incurred for the transaction can be measured reliably, it is probable that economic benefits associated with the transaction will flow to the entity.

Connection fees received from customers are recognised as income during the period of the duration of useful life of related assets. Such income/expense is recorded as "other income/expenses". The acquisition costs of pipelines taken into use and the connection fees received from customers are recorded on the statement of financial position as “Property, plant and equipment” and “Deferred income from connection fees”.

Interest income is recognised in case the receipt of income is likely and the amount of income can be determined reliably. Interest income is recognised using the effective interest method.

Earnings per share

Earnings per share are calculated by dividing the net profit of the accounting year with the weighted average number of issued shares of the period. The Group has no instruments that would have a diluting effect on the earnings per share.

NOTE 3. CONTINGENT LIABILITY REGARDING THE TARIFF RISK

On 10th October 2011 the Estonian Competition Authority (CA) issued a prescript for the Company to reduce the tariffs of water and sewerage services in Tallinn by 29%. The Company disagrees with the position of the CA and has turned to the Estonian Administrative Court disputing the prescription that seeks to break the privatization contract without any evidence to support its view that privatization contract should not be honoured. Should the Court uphold the CA's position the privatization contract could cease to be the basis for the tariffs of water and sewerage services in Tallinn. The length of the court process and the decision are not within the Company’s control.

The management has evaluated the amount of the contingent liability as of 31.12.2011 arising from the potential claims against the Company if the Court ruling would support the CA’s position. As result of this, the outflow of economic benefits could be up to 36 mln euros that could be claimed within 10 years of the final judgement of the courts.

NOTE 4. CRITICAL ACCOUNTING ESTIMATES

The group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

- Management has estimated the useful lifetime of property, plant and equipment and intangible assets. The results of the estimates are disclosed in the note 2 in section 'Property, plant and equipment, and intangible assets' and the information about the carrying amounts is disclosed in note 9.
  As of 31 December 2011 Group owns property, plant and equipment, and intangible assets with a book value of 147.6 mln euros (31.12.2010: 150.1 mln euros) and annual depreciation was 5.8 mln euros in 2011 (2010: 5.7 mln euros). If the depreciation/amortization rates decreased / increased by 5 %, the depreciation/amortization expense would increase / decrease respectively by 286 thousand euros (2010: 288 thousand euros).

- The Group has assumed an obligation to construct water and wastewater and storm water pipelines with an estimated construction cost of up to 41 mln euros (2010: 41 mln euros) in 2008-2012. The construction of pipelines is compensated by local government with the grants receivable in 2008-2014. Compensations received from local government are recognised as government grants - compensations received or receivable are deducted from the book value of the constructed pipeline. Any amount exceeding the construction cost of the pipeline is recognized as income upon the completion of construction works. The part of the compensation that is received after the completion of the construction works is recognized in the statement of financial position as a receivable from local government at its present value. Recognition of the above compensations is dependent on several uncertain circumstances and the estimates of the Management Board, in particular those regarding the total cost of the project and the fair value of the compensations receivable. In recording income from government grants (Note 20) in these financial statements the best knowledge and estimates of the Management Board of the profit rates of the project have served as the basis for calculation. If the actual construction costs increased compared to these estimates by 5%, the profit of 2011 would decreased by 60 thousand euros (2010: 297 thousand euros).

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As payment of government grant for pipelines will be received until June of 2014 and the exact extent of compensation depends on water consumption, the fair value of compensation receivable is also based on estimates. In the estimates compensation is receivable for 2008-2014 and has been discounted using a rate of 7% (2010: 9.4%). If the discount rate would be decreased/increased by 50 basis points, the profit of the accounting period would increase/decrease up to 198 thousand euros (2010: up to 64 thousand euros).

- Accounts receivable - for the evaluation of doubtful debts the individual debts are grouped by age and, based on past experience, the following percentages are applied in the doubtful debt calculation:
  61 to 90 days over due date 10%;
  91 to 180 days over due date 30%;
  181 to 360 days over due date 70%;
  over 360 days over due date 100%.

  Impairment of individually material receivables can differ from the rates above.

NOTE 5. FINANCIAL RISK MANAGEMENT

In its everyday business activities the Group has to take into account different financial risks: market risk (including currency risk, price risk and cash flow and fair value interest rate risk), credit risk, liquidity risk and equity risk. Because of the Group's position on the market and characteristics of its business activities none of before mentioned risks has significant impact to the Group.

Financial assets	**as of 31 December**	
	2011	**2010**
Loans and receivables (including cash and cash equivalents)	44 060	33 173
Total	**44 060**	**33 173**

Financial liabilities	**as of 31 December**	
	2011	**2010**
Financial liabilities at amortised cost	97 818	99 083
Financial liabilities at fair value through profit and loss	4 488	2 267
Total	**102 307**	**101 350**

The risk management of the Group is based on the requirements established by the Tallinn Stock Exchange, the Financial Supervision Authority and other regulatory bodies, generally accepted accounting standards and good practice, and the internal regulations and policies of the Group. According to the Group's risk administration procedures the financial risk management is carried out by the financial department.

Market risk

Currency risk

Currency risk is the potential loss due to unfavourable movements in currency exchange rates against euro. The Group's currency risk is related to purchases done and amounts owed in foreign currencies.

Majority of Group's purchases are made in euros. The proportion of purchases in other currencies in 2011 was less than 0.5% (2010: less than 0.5%). Because of the small proportion of transactions in other currencies the Group has not taken any special activities to reduce this risk.

On 31 December 2011 the Group's bank accounts balances (including deposits) totalled 14 770 thousand euros (2010: 13 235 thousand euros) from which no sums were in other currencies than euros (2010: less than 0.06 thousand euros in other currencies than Estonian kroon or euros). There were no other significant exposures to foreign currencies arising from other financial assets and financial liabilities.

Due to the above the Group considers its currency risk level to be low.

Price risk

The Group has no price risk regarding financial instruments because it has no investments into equity instruments.

Cash flow and fair value interest rate risk

Fair value interest rate risk is the risk that the fair value of financial instruments will fluctuate in the future due to changes in market interest rates. Cash flows interest rate risk is the risk that financial expenses arising from financial liabilities with floating interest rate will increase when interest rates on the market increase.

The Group's interest rate risk arises mostly from long-term borrowings. Borrowings issued at variable interest rates (Note 10) expose the Group to cash flow interest rate risk. The Group's policy is to maintain approximately 75% of its borrowings at fixed rate. In order to mitigate the interest rate risk, the Group has concluded 5 (2010: 5) floating-to-fixed interest rate swap contracts (Note 12). As of 31.12.2011 the interest rate swap contracts have the notional amount of 75 mln euros (2010: 75 mln euros), therefore only borrowings in the amount of 19.9 mln euros (2010: 19.9 mln euros) remain exposed to the cash flow interest rate risk.

As at 31.12.2011, if the interest rates of the Group's borrowings and interest rate swap contracts had been 50 basis points (2010: 50 basis points) higher/lower with all other variables held constant, profit for the year would have been EUR 698 thousand (2010: EUR 1 017 thousand) higher/lower, mainly as a result of higher/lower interest expense on floating rate borrowings and fair value change of interest rate swaps.

Overnight and fixed term deposits and long-term loan to co-partner have fixed interest rate and therefore expose the Group to fair value interest rate risk. As all these instruments are carried at amortised cost, the change in market interest rates would not have an effect on the financial statements of the Group.

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Credit risk

Credit risk expresses potential loss that can arise if counterparty fails to fulfil its contractual obligations. Cash in bank accounts and deposits, financial assets at fair value through profit and loss, trade and other receivables are exposed to credit risk.

According to the Group's risk management policies the Group's short term resources can be deposited only in accounts, overnight deposits and fixed term deposits opened in credit institutions. For depositing counterparties with at least a long term A rating (by Moody's) are used. As of 31.12.2011 100% of Group's cash and deposits were deposited with counterparty with higher rating than A3 (2010: 100% higher than A3). Starting from Jan 2012 the Group is also monitoring European Banking Authority's recommendations regarding banks' recapitalization needs and depositing is done only in banks with no capitalization shortfall.

The selling of Group's products and services is done in compliance with internal procedures. To reduce credit risk related to accounts receivable the customers' payment discipline is consistently observed. In the case of overdue debt the clients are contacted by Group's Credit group. At the end of December 2011 only one client's (2010: one client's) receivables (Note 25) exceeded 5% of total trade receivables constituting 46.2% of it (2010: 57.1%).

Financial assets as of 31 December 2011	**Balance**	Not due	**Overdue** Not impaired (up to 2 months)	Impaired	Impairment
Trade receivables (Note 7)	10 808	10 625	150	548	-514
Commercial entities	7 460	7 348	92	401	-381
Private persons	3 348	3 277	58	147	-133
Accrued income (Note 7)	16	16	0	0	0
Loan to co-partner (Note 8)	3 151	3 151	0	0	0
Government grant (Note 7, 8, 25)	15 310	15 310	0	0	0
Total	**29 285**	**29 102**	**150**	**548**	**-514**

Financial assets as of 31 December 2010	**Balance**	Not due	**Overdue** Not impaired (up to 2 months)	Impaired	Impairment
Trade receivables (Note 7)	12 672	7 179	3 449	3 196	-1 152
Commercial entities	9 453	4 049	3 376	2 489	-461
Private persons	3 219	3 130	73	707	-691
Accrued income (Note 7)	9	9	0	0	0
Loan to co-partner (Note 8)	0	0	0	0	0
Government grant (Note 7, 8, 25)	7 256	7 256	0	0	0
Total	**19 937**	**14 444**	**3 449**	**3 196**	**-1 152**

The Group's maximum credit risk is equal to the carrying amount of the financial assets and is considered to be low.

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Liquidity risk

Liquidity risk is the risk that the Group is unable to fulfil its financial obligations due to insufficient cash funds or inflows. This risk realizes when the Group doesn't have enough funds to serve its loans, to fulfil its working capital needs, to invest and/or to make declared dividend payments.

Financial liabilities in terms of payment (undiscounted amounts):

as of 31 December 2011	**Up to 1 month**	**1 - 3 months**	**3 - 12 months**	**1 - 5 years**	**Over 5 years**	**Total**
Trade and other payables	2 761	34	0	0	9	2 804
Derivatives	1 552	0	0	2 936	0	4 488
Borrowings	150	301	1 427	84 810	14 628	101 316
Total	**4 464**	**335**	**1 427**	**87 746**	**14 637**	**108 608**

as of 31 December 2010	**Up to 1 month**	**1 - 3 months**	**3 - 12 months**	**1 - 5 years**	**Over 5 years**	**Total**
Trade and other payables	3 661	30	192	106	9	3 998
Derivatives	963	0	0	1 304	0	2 267
Borrowings	29	67	8 966	77 516	14 529	101 107
Total	**4 653**	**97**	**9 158**	**78 926**	**14 538**	**107 372**

In liquidity risk management the Group has taken a prudent view, maintaining sufficient cash balance and short term deposits to be able to fulfil its financial liabilities at every moment of time. Continuous cash flow forecasting and control are essential tools in the day-to-day liquidity risk management of the Group.

Capital management

The Group's objectives when managing capital is to be in accordance with Business Plan's capital structure approved by Supervisory Council and the long-term borrowing contracts that limit the Parent Company's equity ratio to a minimum of 35% of the total assets.

	as of 31 December	
	2011	**2010**
Equity	78 874	73 363
Total assets	192 069	183 856
Equity ratio	**41,1%**	**39,9%**

Fair value

Fair values of cash and cash equivalents, trade receivable, other long-term receivables, short-term borrowings and trade payable do not vary significantly from their carrying amount because their realization will take place within 12 months or these were recognised close to the balance sheet date.

At the end of 2011 all Group's long-term borrowings had floating interest rates. Because Group's contractual long-term borrowings risk margins were smaller, than market's risk margin currently applicable to the Group, the fair value of its long-term borrowings on 31.12.2011 was 2 167 thousand euros smaller than their carrying amount (2010: 2 856 thousand euros smaller).

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Smaller interest risk margins compared to market situation means that if the Group would like to refinance its long-term borrowings on existing market conditions it would bring along higher interest expenses compared to the existing agreements.

The fair value of financial instruments carried at fair value (interest rate swap contracts, Note 12) has been measured using the inputs other than quoted prices, but observable for the asset or liability either directly or indirectly, i.e. level 2.

NOTE 6. CASH AND CASH EQUIVALENTS

	as of 31 December	
	2011	**2010**
Cash in hand and in bank	1 456	651
Short-term deposits	13 314	12 584
Total cash and cash equivalents	**14 770**	**13 235**

NOTE 7. TRADE RECEIVABLES, ACCRUED INCOME AND PREPAID EXPENSES

	as of 31 December	
	2011	**2010**
Accounts receivable	11 322	13 825
Allowance for doubtful receivables	-514	-1 152
Total trade receivables	**10 808**	**12 673**

Impairment loss of receivables:	for the year ended 31 December	
	2011	**2010**
Write off of uncollectible receivables	-224	-12
Increase of allowance for doubtful receivables	-648	-290

	as of 31 December	
	2011	**2010**
Accrued interest	16	9
Government grant receivables	8 878	7 255
Prepaid expenses	143	151
Total accrued income and prepaid expenses	**9 037**	**7 415**
Total trade receivables, accrued income and prepaid expenses	**19 845**	**20 088**

The Group's current assets (incl. trade receivables, accruals and inventory) in the amount of 20 166 thousand euros (2010: 20 470 thousand euros) have been pledged as a security for the bank loans (Note 10), as a part of commercial pledge.

NOTE 8. OTHER LONG-TERM RECEIVABLES

	as of 31 December	
	2011	**2010**
Government grant receivables	6 432	0
Loan to co-partner	3 151	0
Total other long-term receivables	**9 583**	**0**

The Group's long term receivables in the amount of 6 432 thousand euros (2010: 0 euros) have been pledged as a security to the bank loans (Note 10), as a part of commercial pledge.

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NOTE 9. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

	Property, plant and equipment				Assets in progress			Intangible assets	
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Unfinished pipelines	Unfinished intangible assets	Acquired licenses and other intangible assets	Total property, plant and equipment and intangible assets
as of 31 December 2009									
Acquisition cost	23 913	150 807	38 419	1 179	2 561	3 885	95	5 641	226 500
Accumulated depreciation	-4 566	-47 723	-24 774	-737	0	0	0	-3 159	-80 959
Book value	**19 347**	**103 084**	**13 645**	**442**	**2 561**	**3 885**	**95**	**2 482**	**145 541**
Transactions in the period 01.01.2010 - 31.12.2010									
Acquisition in book value	0	0	0	0	6 738	10 734	62	0	17 534
Write off and sale of property, plant and equipment, and intangible assets in book value	-2	0	-4	-9	0	0	0	0	-15
Compensated by government grants (Note 13)	0	0	0	0	0	-7 080	0	0	-7 080
Reclassification	156	4 929	1 890	51	-7 083	-77	-38	37	-135
Depreciation (Note 19)	-272	-2 593	-2 081	-82	0	0	0	-666	-5 694
as of 31 December 2010									
Acquisition cost	24 067	155 727	39 570	1 157	2 216	7 462	119	5 232	235 550
Accumulated depreciation	-4 838	-50 307	-26 120	-755	0	0	0	-3 379	-85 399
Book value	**19 229**	**105 420**	**13 450**	**402**	**2 216**	**7 462**	**119**	**1 853**	**150 151**

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	Property, plant and equipment				Assets in progress			Intangible assets	
	Land and buildings	**Facilities**	**Machinery and equipment**	**Other equipment**	**Construction in progress**	**Unfinished pipelines**	**Unfinished intangible assets**	**Acquired licenses and other intangible assets**	**Total property, plant and equipment and intangible assets**
Transactions in the period 01.01.2011 - 31.12.2011									
Acquisition in book value	0	0	0	0	5 178	11 126	234	0	16 538
Write off and sale of property, plant and equipment, and intangible assets in book value	-1	0	-65	0	0	0	0	0	-66
Compensated by government grants (Note 13)	0	0	0	0	0	-13 270	0	0	-13 270
Reclassification	182	6 412	1 553	43	-4 545	-3 641	-131	131	4
Depreciation (Note 19)	-273	-2 646	-2 181	-78	0	0	0	-629	-5 807
as of 31 December 2011									
Acquisition cost	24 247	162 106	40 594	1 175	2 849	1 677	222	5 363	238 233
Accumulated depreciation	-5 110	-52 920	-27 837	-808	0	0	0	-4 008	-90 683
Book value	**19 137**	**109 186**	**12 757**	**367**	**2 849**	**1 677**	**222**	**1 355**	**147 550**

Property, plant and equipment and intangible assets are written off if the condition of the asset do not enable further usage for production purposes. As of 31 December 2011 there were no finance lease contracts. As of 31 December 2010 the book value of the assets leased under financial lease 257 thousand euros.

The Group's non-current assets in the amount of 13 939 thousand euros (2010: 35 246 thousand euros) have been pledged as a security for the bank loans (Note 10), as a part of commercial pledge. A mortgage for the Group's non-current assets (land, buildings and facilities) in the book value amount of 32 558 thousand euros (2010: 33 221 thousand euros) serves as a security to the bank loans (Note 10).

During the year, the Group has capitalised borrowing costs amounting to 86 thousand euros (2010: 59 thousand euros) on qualifying assets. Borrowing costs were capitalised at the weighted average rate of its general borrowings of 2.13% (2010: 1.58%).

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

NOTE 10. BORROWINGS

	as of 31 December	
	2011	**2010**
Current borrowings		
Current portion of long-term bank loans*	0	7 482
Current portion of long-term finance lease liabilities	0	124
Total current borrowings	**0**	**7 606**
Non-current borrowings		
Long-term bank loans	94 938	87 446
Total non-current borrowings	**94 938**	**87 446**

* - in 2011 one loan agreement was amended and therefore short-term loan payment is reclassified as long term.

Bank loans at 31 December 2011		
Currency EUR (euro)	**Balance**	**Effective interest rate**
Borrowings at floating interest rate (based on 1- and 6-month Euribor)	94 938	1.64%-2.24%

Bank loans at 31 December 2010		
Currency EUR (euro)	**Balance**	**Effective interest rate**
Borrowings at floating interest rate (based on 1- and 6-month Euribor)	94 928	1.03% - 2.20%

Collateral of loans and pledged assets		**Collateral at book value as of 31 December**	
Type of collateral	**Specification and location of collateral**	**2011**	**2010**
Commercial pledge	Movables of the Company (Notes 7, 8, 9)	40 537	55 716
Mortgage	Real Estates located at Paljassaare põik 14 and Järvevana tee 3, Tallinn, Estonia (Note 9)	32 558	33 221

NOTE 11. TRADE AND OTHER PAYABLES

	Balance amount	**Short-term portion**	**Long-term portion**
as of 31 December 2011			
Trade payables - operating expenditures	1 860	1 860	0
Trade payables - capital expenditures	568	568	0
Payables to related parties (Note 25)	194	194	0
Payables to employees	849	849	0
Interest payable	76	76	0
Other accrued expenses	172	172	0
Long-term guarantee deposit	9	0	9

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Taxes payable incl:				Tax rates
Income tax	136	136	0	21%
VAT	733	733	0	20%
Tax on special use of water	219	219	0	0,0309 - 0,0743 euros/m³
Pollution taxes	665	665	0	453 - 14 447 euros/t
Social security tax	273	273	0	33%
Other	44	44	0	0,3 - 21%
Total trade and other payables	**5 798**	**5 789**	**9**	
as of 31 December 2010				
Trade payables - operating expenditures	1 120	1 120	0	
Trade payables - capital expenditures	2 276	2 276	0	
Payables to related parties (Note 25)	200	200	0	
Payables to employees	773	667	106	
Interest payable	157	157	0	
Other accrued expenses	163	163	0	
Long-term guarantee deposit	9	0	9	
Taxes payable incl:				Tax rates
Income tax	125	125	0	21%
VAT	408	408	0	20%
Tax on special use of water	208	208	0	0,0281 - 0,0675 euros/m³
Pollution taxes	748	748	0	414 - 13 759 euros/t
Social security tax	230	230	0	33%
Other	65	65	0	0,3 - 21%
Total trade and other payables	**6 482**	**6 367**	**115**	

NOTE 12. DERIVATIVES

Liabilities	**Balance amount**	**Short-term portion**	**Long-term portion**
as of 31 December 2011			
SWAP contracts	4 488	1 552	2 936
as of 31 December 2010			
SWAP contracts	2 267	963	1 304

	as of 31 December	
	2011	**2010**
Contracts start date	2010.05 - 2011.11	2009.11 - 2011.05
Contracts maturity date	2013.11 - 2015.11	2013.11 - 2015.11
Contracts notional amount	75 000	75 000

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NOTE 13. GOVERNMENT GRANTS

Government grants for assets
Government grants receivable accrued during the financial year for completed constructions of pipelines amounted to 16 749 thousand euros (2010: 10 390 thousand euros). Property, plant and equipment compensated by the government grant amounted to 13 270 thousand euros (2010: 7 080 thousand euros) (Note 9). The remainder of the compensation is recognised in the statement of comprehensive income (Note 20).

NOTE 14. OTHER CONTINGENT LIABILITIES

Tax authority is entitled to check the Group's tax accounting within 6 years after the term for the submission of tax declaration and when mistakes are detected to impose an additional amount of tax, interests and fines. According to the Group's Management Board there are no circumstances as a result of which tax authority could impose a significant additional amount of tax to the Group.

The Company's distributable retained earnings as at 31 December 2011 amounted to 40 863 thousand euros (2010: 34 569 thousand euros). Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 10 863 thousand euros (2010: 9 189 thousand euros).

NOTE 15. PREPAYMENTS

	as of 31 December	
	2011	**2010**
Prepayments for water and sewerage services	143	53
Prepayments for pipelines	1 003	757
Total prepayments	**1 146**	**810**

NOTE 16. SHARE CAPITAL

At 31 December 2010 the nominal value of the share capital was 200 001 000 (two hundred million and one thousand) kroons (12 782 394 euros), composed of 20 000 000 (twenty million) A-shares with the nominal value of 10 (ten) kroons (0.6 euros) per share and 1 (one) preferred B-share with a nominal value of 1 000 (one thousand) kroons (63.9 euros).

At 31 December 2011 the nominal value of the share capital was 12 000 060 (twelve million and sixty) euros, composed of 20 000 000 (twenty million) A-shares with the nominal value of 0.60 euros (sixty eurocents) per share and 1 (one) preferred B-share with a nominal value of 60 (sixty) euros. The share capital was reduced with the decision of the 24.05.2011 ordinary meeting of shareholders of AS Tallinna Vesi in connection with the requirement to convert share capital from kroons to euros - the share capital of the Company was reduced by 782 333,62 euros (seven hundred and eighty two thousand three hundred and thirty three euros and sixty two euro cents) by way of reducing the nominal value of the A-share to 0.60 euros (sixty euro cents) and by way of reducing the nominal value of B-share to 60 (sixty) euros, whereas the value of the share capital was reduced without making any disbursements, with the new value of share capital being 12 000 060 (twelve million and sixty) euros. The rounding of the result of the conversion of the nominal value of shares has no legal consequences.

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The one B-share has been issued with the right of veto to the shareholder when voting on the following issues: amending the Articles of Association, increase and decrease of share capital, issuance of convertible bonds, acquisition of own (treasury) shares, deciding on the merger, division, transformation and/or dissolution of AS Tallinna Vesi, and, deciding other issues related to the activities of the AS Tallinna Vesi that have not been placed in the sole competence of the General Meeting by law that either the Management Board or the Supervisory Council have put to the vote of the General Meeting. In 2010, the B-share granted the holder the preferential right to receive a dividend in an agreed sum of 10 000 (ten thousand) kroons (639 euros). As a result of the amendment of AS Tallinna Vesi’s Articles of Association at the 2011 General Meeting , the B-share now grants its holder the preferential right is to a dividend in an agreed sum of 600 (six hundred) euros.

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

As of 31 December 2011 and 2010 United Utilities (Tallinn) B.V. owned 7 060 870 (35.3%) A-shares, the City of Tallinn owned 6 939 130 (34.7%) A-shares and 1 (one) B-share, with 6 000 000 shares in free float. Other direct shareholders owned less than 5% of the shares as of 31 December 2011 and 2010.

As of 31 December 2011 and 2010 from Supervisory Council and Management Board members Siiri Lahe owned 700 and Leho Võrk 179 shares.
Dividends declared and paid are disclosed in note 22.
Contingent income tax on the dividend payments from retained earnings is described in note 14.

NOTE 17. REVENUE

	for the year ended 31 December	
Revenues from main operating activities	**2011**	**2010**
Total water supply and waste water disposal service, incl:	46 492	45 167
Private clients, incl:	23 711	23 797
Water supply service	13 072	13 232
Waste water disposal service	10 639	10 565
Corporate clients, incl:	18 234	17 108
Water supply service	9 881	9 441
Waste water disposal service	8 353	7 667
Outside service area clients, incl:	3 789	3 415
Water supply service	901	840
Waste water disposal service	2 888	2 575
Overpollution fee	758	847
Stormwater treatment and disposal service	3 351	3 286
Fire hydrants service	221	193
Other works and services	1 176	1 034
Total revenue	**51 240**	**49 680**

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

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NOTE 18. STAFF COSTS

	for the year ended 31 December	
	2011	**2010**
Salaries and wages	-4 801	-4 340
Social security and unemployment insurance taxation	-1 602	-1 445
Total staff costs	**-6 403**	**-5 785**
Number of employees at the end of reporting period	**311**	**319**

NOTE 19. COST OF GOODS SOLD, MARKETING AND GENERAL ADMINISTRATION EXPENSES

	for the year ended 31 December	
	2011	**2010**
Cost of goods sold		
Tax on special use of water	-897	-847
Chemicals	-1 433	-1 433
Electricity	-2 972	-2 704
Pollution tax	-1 409	-2 290
Staff costs	-4 390	-4 030
Depreciation and amortization	-5 182	-5 092
Other costs of goods sold	-4 644	-4 288
Total cost of goods sold	**-20 927**	**-20 684**
Marketing expenses		
Staff costs	-349	-320
Depreciation and amortization	-325	-334
Other marketing expenses	-74	-133
Total marketing expenses	**-748**	**-787**
General administration expenses		
Staff costs	-1 664	-1 435
Depreciation and amortization	-222	-194
Other general administration expenses	-2 408	-2 022
Total general administration expenses	**-4 294**	**-3 651**

NOTE 20. OTHER INCOME / EXPENSES

	for the year ended 31 December	
	2011	**2010**
Income from government grant	3 479	3 310
Other income / expenses (-)	140	-404
Total other income / expenses	**3 619**	**2 906**

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NOTE 21. FINANCIAL INCOME AND EXPENSES

	for the year ended 31 December	
	2011	**2010**
Interest income	1 947	1 060
Interest expense	-2 885	-2 372
Decrease of fair value of swap	-2 221	-1 238
Other financial income(+)/expenses(-)	35	-14
Total financial income / expenses	**-3 124**	**-2 564**

NOTE 22. DIVIDENDS

	for the year ended 31 December	
	2011	**2010**
Dividends declared during the period	16 001	31 956
Dividends paid during the period	16 001	31 956
Income tax on dividends paid	-4 253	-8 495
Income tax accounted for	**-4 253**	**-8 495**

The income tax rates were 21/79 in 2011 and 2010.

Paid-up dividends per shares:		
Dividends per A-share (in euros)	0,80	1,60
Dividends per B-share (in euros)	600	639

NOTE 23. EARNINGS PER SHARE

	for the year ended 31 December	
	2011	**2010**
Net profit minus B-share preference rights	21 512	16 404
Weighted average number of ordinary shares for the purposes of basic earnings per share (in pieces)	20 000 000	20 000 000
Earnings per A share (in euros)	1,08	0,82
Earnings per B share (in euros)	600	639

Diluted earnings per share for the periods ended 31 December 2011 and 2010 are equal to earnings per share figures stated above.

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NOTE 24. OPERATING LEASE

Leased assets	**for the year ended 31 December**	
	2011	**2010**
Total operating lease expenses for computers and vehicles	339	393
Operating lease (compensated by customers)	667	631

Following period operating lease payments from the non-cancellable contracts are as follows:		**as of 31 December**	
		2011	**2010**
	Less than 1 year	230	236
	1-5 years	239	261
Total minimum lease payments		**469**	**497**

The underlying currency of all lease contracts is euro. Leased assets have not been subleased.

NOTE 25. RELATED PARTIES

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

Shareholders having the significant influence

	as of 31 December	
Balances recorded in working capital on the statement of financial position of the Group	**2011**	**2010**
Accounts receivable	4 977	7 194
Accrued income	15 310	7 256
Accounts payable - short-term trade and other payables	194	200

	for the year ended 31 December	
	2011	**2010**
Transactions with the related parties		
Revenue	3 535	3 440
Compensation receivable from the local governments for constructing new pipelines	16 750	10 390
Purchase of administrative and consulting services	1 001	1 032
Financial income	1 624	732

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Management Board short-term employee benefits (excluding social tax)	246	199
Supervisory Board fees (excluding social tax)	39	38

The Group's Management Board and Supervisory Board members are considered as key management personnel who have received only the contractual salary payments as disclosed above. In addition to this some Board Members have also received direct compensations from the companies belonging to the group of United Utilities (Tallinn) B.V. as overseas secondees. Such compensations are recorded on line "Purchase of administrative and consulting services".

Market prices were checked and used in the transactions with related parties.
The information about AS Tallinna Vesi shares belonging to the related parties is disclosed in note 16.
Paid-up dividends are described in note 22.

NOTE 26. SUBSIDIARIES AND BUSINESS COMBINATIONS

Subsidiary	Location	Activity	Holding (%) at 31.12.2011	Holding (%) at 31.12.2010
Watercom OÜ	Tallinn, Estonia	Provision of non-core services related to water business	100	100

AS Tallinna Vesi registered its subsidiary Watercom OÜ on 25.05.2010.

NOTE 27. SUPPLEMENTARY DISCLOSURES ON THE PARENT COMPANY OF THE GROUP

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for reporting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the Annual Report in conjunction with IAS 27, Consolidated and Separate Financial Statements.

In the parent separate primary financial statements, disclosed to these consolidated financial statements (Supplementary disclosures), investments into the shares of subsidiaries are accounted for at cost less any impairment recognised.

The separate reports on the parent company

According to the Estonian Accounting Law, the amount which can be distributed to the shareholders is calculated as follows: adjusted unconsolidated equity less share capital, share premium and reserves.

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STATEMENT OF FINANCIAL POSITION

	as of 31 December	
ASSETS	**2011**	**2010**
CURRENT ASSETS		
Cash and equivalents	14 442	13 093
Trade receivables, accrued income and prepaid expenses	19 702	20 029
Receivables from subsidiary	98	18
Inventories	248	305
Non-current assets held for sale	73	77
TOTAL CURRENT ASSETS	**34 563**	**33 522**
NON-CURRENT ASSETS		
Long-term investment assets	9 583	524
Investment in subsidiary	527	3
Property, plant and equipment	146 255	147 892
Intangible assets	1 577	1 972
TOTAL NON-CURRENT ASSETS	**157 942**	**150 391**
TOTAL ASSETS	**192 505**	**183 913**
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Current portion of long-term borrowings	0	7 624
Trade and other payables	5 238	6 310
Derivatives	1 552	963
Payables to subsidiary	622	8
Short-term provisions	0	117
Prepayments and deferred income	1 082	810
TOTAL CURRENT LIABILITIES	**8 494**	**15 832**
NON-CURRENT LIABILITIES		
Deferred income from connection fees	6 824	5 765
Borrowings	94 939	87 428
Derivatives	2 936	1 304
Other payables	9	115
TOTAL NON-CURRENT LIABILITIES	**104 708**	**94 612**
TOTAL LIABILITIES	**113 202**	**110 444**
EQUITY		
Share capital	12 000	12 782
Share premium	24 734	24 734
Statutory legal reserve	1 278	1 278
Retained earnings	41 291	34 675
TOTAL EQUITY	**79 303**	**73 469**
TOTAL LIABILITIES AND EQUITY	**192 505**	**183 913**

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STATEMENT OF COMPREHENSIVE INCOME

	for the year ended 31 December	
	2011	**2010**
Revenue	50 669	49 434
Costs of goods sold	-20 196	-20 404
GROSS PROFIT	**30 473**	**29 030**
Marketing expenses	-673	-729
General administration expenses	-4 186	-3 646
Other income(+)/ expenses (-)	3 593	2 917
OPERATING PROFIT	**29 207**	**27 572**
Financial income	1 986	1 059
Net financial expenses	-5 106	-3 624
PROFIT BEFORE TAXES	**26 087**	**25 007**
Income tax on dividends	-4 253	-8 495
NET PROFIT FOR THE PERIOD	**21 834**	**16 512**
COMPREHENSIVE INCOME FOR THE PERIOD	**21 834**	**16 512**
Attributable profit to:		
Equity holders of A-shares	21 833	16 512
B-share holder	0,60	0,64
Earnings per A share (in euros)	1,09	0,82
Earnings per B share (in euros)	600	639

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CASH FLOW STATEMENT

	for the year ended 31 December	
	2011	**2010**
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating profit	29 207	27 571
Adjustment for depreciation/amortisation	5 675	5 599
Adjustment for income from government grants and connection fees	-3 432	-3 312
Other finance income/expenses(-)	35	-14
Profit/loss(+) from sale of property, plant and equipment, and intangible assets	56	-3
Expensed property, plant and equipment	10	86
Change in current assets involved in operating activities	671	-8 809
Change in liabilities involved in operating activities	1 354	6 201
Interest paid	-3 051	-2 443
Total cash flow from operating activities	**30 525**	**24 876**
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans granted	-3 151	-524
Acquisition of property, plant and equipment, and intangible assets	-19 010	-17 174
Compensations received for construction of pipelines	11 284	6 139
Proceeds from sale of property, plant and equipment, and intangible assets	12	425
Interest received	1 943	1 109
Total cash flow used in investing activities	**-8 922**	**-10 025**
CASH FLOWS FROM FINANCING ACTIVITIES		
Received loans	0	20 000
Dividends paid	-16 001	-31 956
Income tax on dividends	-4 253	-8 495
Total cash flow used in financing activities	**-20 254**	**-20 451**
Change in cash and cash equivalents	**1 349**	**-5 600**
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD	**13 093**	**18 693**
CASH AND EQUIVALENTS AT THE END OF THE PERIOD	**14 442**	**13 093**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
as of 31 December 2009	**12 782**	**24 734**	**1 278**	**50 120**	**88 914**
Dividends	0	0	0	-31 956	-31 956
Comprehensive income for the period	0	0	0	16 512	16 512
as of 31 December 2010	**12 782**	**24 734**	**1 278**	**34 676**	**73 470**
Carrying amount of investments under control and significant influence	0	0	0	0	-3
Value of investments under control and significant influence using the equity method	0	0	0	0	-104
Adjusted unconsolidated equity at 31.12.2010	**12 782**	**24 734**	**1 278**	**34 676**	**73 363**
Reduction of the share capital	-782	0	0	782	0
Dividends	0	0	0	-16 001	-16 001
Comprehensive income for the period	0	0	0	21 834	21 834
as of 31 December 2011	**12 000**	**24 734**	**1 278**	**41 291**	**79 303**
Carrying amount of investments under control and significant influence	0	0	0	0	-527
Value of investments under control and significant influence using the equity method	0	0	0	0	99
Adjusted unconsolidated equity at 31.12.2011	**12 000**	**24 734**	**1 278**	**41 291**	**78 875**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2011 (thousand EUR)

CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS

The Management Board has prepared the management report and the financial statements of AS Tallinna Vesi on 22 February 2012. The Supervisory Board of AS Tallinna Vesi has reviewed the annual report, prepared by the Management Board, consisting of Management Report and the financial statements, the Management Board's proposal for profit distribution and the independent auditors' report, and has approved the annual report for presentation on the Shareholders' General Meeting. The annual report has signed by all the members of the Management Board and Supervisory Board.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		27/02/12
Leho Võrk	Member of the Management Board		27.02.12
Siiri Lahe	Member of the Management Board		27-02-12
Ilona Nurmela	Member of the Management Board		27.02.12
Robert John Gallienne	Chairman of the Supervisory Board		22/3/12
Steven Richard Fraser	Member of the Supervisory Board		23/3/12
Simon Gardiner	Member of the Supervisory Board		22/3/12
Brendan Francis Murphy	Member of the Supervisory Board		22/3/12
Mart Mägi	Member of the Supervisory Board		22.03.12
Rein Ratas	Member of the Supervisory Board		22.03.12
Toivo Tootsen	Member of the Supervisory Board		22.03.12
Valdur Laid	Member of the Supervisory Board		
Priit Lello	Member of the Supervisory Board		21.03.2012

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS Tallinna Vesi

We have audited the accompanying consolidated financial statements of AS Tallinna Vesi and its subsidiary, which comprise the consolidated statement of financial position as of 31 December 2011 and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

Management Board is responsible for the preparation, and true and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of AS Tallinna Vesi and its subsidiary as of 31 December 2011, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Emphasis of Matter

We draw attention to Note 3 to these consolidated financial statements, which describes the uncertainty related to the outcome of the lawsuit between AS Tallinna Vesi and Estonian Competition Authority. Our opinion is not qualified in respect of this matter.

AS PricewaterhouseCoopers

Tiit Raimla	Stan Nahkor
Auditor's Certificate No.287	Auditor's Certificate No.508

27 February 2012

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